Petrostates have a cheap oil malady

Countries with oil-focused economies face uncertainty and unrest

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While consumers in the United States and Europe are cheering low prices at the pump, a variety of states that depend on oil revenue are expecting a period of uncertain income and budget shortfalls. Unfortunately, rather than encourage reform in these typically corrupt and authoritarian countries, the pressure of low oil prices is likely to result in increased instability.

Oil has halved in price in the last six months, dropping to just under $50 per barrel. This plunge is driven by contracting global demand as well as efforts by Saudi Arabia to curtail growing oil production by the United States, Russia and other nonmembers of OPEC. The death of Saudi Arabia's King Abdullah is unlikely to alter this situation, as newly crowned King Salman has been careful to emphasize continuity with his predecessor's policies. As a result, oil prices should remain low for a while. Though oil was less than $20 per barrel for much of the 1980s and 1990s, today's prices mark a break from the more recent past, when prices had soared as high as $147 per barrel.

In recent years, oil wealth has had a massive effect on petrostates. Oil revenue contributed to continued authoritarianism in some states and encouraged corruption and poor governance. Leaders had little reason to pursue economic development and diversification, resulting in weak economies reliant on oil income and leading many political scientists to describe oil as a curse.

Given the often odious regimes at the helm of the world's largest oil-producing countries — Saudi Arabia, Iran, Venezuela, Russia — we may be inclined to welcome falling oil prices in hopes that price pressure may finally encourage reform. Unfortunately, these maladies cannot be easily fixed. An oil-focused economy cannot be turned overnight into a diversified economy that appeals to international investors. Rampant, institutionalized corruption cannot be stamped out quickly once it has taken root. And leaders who rely on oil wealth to prop up their authoritarian regimes are unlikely to seek democratic reforms.

Instead, falling oil prices are more likely to breed instability, though not all petrostates will be affected equally. Saudi leaders, for example, can fall back on massive cash stockpiles to see them through the lean times. Instability among OPEC's Gulf members is unlikely unless oil prices remain low for several years. But other OPEC members and non-OPEC states are less fortunate.

Venezuela is the most likely to see problems, with a state budget based on oil prices of $117 per barrel. Moody's recently cut Venezuela's debt rating, giving it a negative outlook. The Venezuelan economy was already rocky, largely because of extremely poor economic management and overreliance on oil-funded social programs. But falling oil prices have made this crisis acute, so much so that President Nicolás Maduro recently traveled to China and Saudi Arabia seeking aid. Venezuela may even default on its debt in 2015. The effects of the crisis will be felt increasingly by average Venezuelans and could trigger further violent protests such as those that rocked Caracas last year.

Iran and Russia face similar though less acute budgetary pressures, amplified by Western sanctions. Tehran recently revised its budget to account for the fall in oil prices, with the majority of cuts coming from infrastructure funds. As in Venezuela, the worsening economy will make popular unrest a possibility.

While sanctions have done some damage to the Russian economy, low oil prices are far more problematic for the Kremlin, which announced spending cuts of 10 percent across the board for this year (with the exception of the military). Although the concomitant collapse of the ruble has, ironically, helped reduce the effect of falling oil prices, the government expects to see inflation of 15 to 17 percent in 2015. This is not likely to lead to popular unrest, as Russians are accustomed to tightening their belts. Instead, dissatisfaction among elites could lead to tensions with President Vladimir Putin's regime or to further domestic repression.

In Nigeria the government depends on crude oil exports for 70 percent of its revenue. Thanks to falling oil prices, inflation has risen to 8 percent, and Nigerian bonds continue to perform poorly. The state suffers from bureaucratic and military corruption even as it faces armed insurgency from Boko Haram. Elections on Feb. 14 may see President Goodluck Jonathan's government out of power. Yet a new government would probably be unable to address these problems, and the low price of oil will only make it harder for Nigeria's corrupt army to succeed in its battle against Boko Haram.

While it's extremely difficult to accurately predict political instability, falling oil prices raise the potential for such instability in petrostates by worsening their existing economic and political problems. So rather than celebrate low prices at the pump, we should be wary: Petrostates are already in bad shape, but cheap oil may throw them into deeper disarray.

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