THE ARAB SPRING & THE GULF STATES

TIME TO EMBRACE CHANGE

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1970–2011: FOUR DECADES OF TRANSFORMATION IN THE GULF

OVER THE PAST 40 YEARS, the Gulf states have transformed themselves from sleepy, obscure sheikhdoms into modern states with global influence. The transformation has been swift, and the Gulf Co-operation Council (GCC) states have experienced some of the most rapid spurts of development and economic growth in recent global history. In this relatively short period, they have made huge progress in terms of public health, standards of living, education, the creation of institutions and state building.

Before the 1970s, standards of living in the Gulf states were poor. There is no shortage of indicators to prove this: in Saudi Arabia in 1970 the literacy rate was 15 per cent for men and 2 per cent for women;[1] and in 1960 in the UAE the infant mortality rate was 145 per 1,000.[2]

Politically, the Gulf states were fragile. The older countries in the region, such as Kuwait and Saudi Arabia, were slowly building state institutions and enforcing state control in all their territories. The younger ones, such as Bahrain, Qatar and the UAE, only achieved independence from British rule in 1971 and were just beginning the process of state building. In most Arabian states the lack of institutions

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meant that the ruler and his immediate circle controlled all decision-making, even in unimportant matters.

Arabian society was largely untouched by modernisation before the 1970s, relying on traditional forms of social organisation. Tribal structures were important. Since the crash of the pearl market in the 1930s, the economies of the region had been sluggish. Many inhabitants had a semi-subsistence lifestyle, with income from farms and livestock and any work they could find.

The Gulf oil industry started in the 1940s, but it was not until the 1970s that it began to generate revenues that could be distributed among the states' inhabitants. This income allowed the Gulf states to take the first steps towards the transformation of their economies. In 1972 the Arab oil embargo meant that the price of oil quadrupled to almost $12 a barrel. As a result, oil revenues in Saudi Arabia rose from $4.3bn in 1973 to $101.8bn in 1980.[3] Similar increases occurred in the other Gulf states.

With the rise in oil revenues, government spending increased rapidly. There was investment in infrastructure projects such as roads, hospitals and schools, which encouraged many of the region's inhabitants to become more loyal to their state. Merchants set up companies to take advantage of government spending on infrastructure. These companies, many of which are still in business today, formed the basis of the modern private sector in the region. The huge increase in demand for food, vehicles, consumer goods and other products meant that many of these merchant families and their royal patrons became very wealthy in a short period of time.

The second Gulf oil boom

Since 2000, the Gulf states have experienced a second oil boom. At its peak, prices hit $140 a barrel. This boom had similar effects to that of the 1970s. GDP per head rose further and in some cases became among the highest in the world. Massive

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government spending pushed economies into double-digit growth.

The region attracted publicity as some of its more ambitious leaders sought to develop their countries into world centres. Building projects such as the Burj Khalifa tower and Palm islands in Dubai captured the world's imagination and hastened the development of the Gulf tourism industry. Other countries in the region devised aggressive investment plans and acquired assets throughout the world.

By the middle of the 2000s, optimism throughout the Gulf was high. Government investment drove growth and GCC citizens, as well as many foreign residents, experienced unprecedented affluence. Banks embarked on aggressive campaigns to expand their loan portfolios and businesses and individuals became increasingly comfortable with highly leveraged positions.

These developments were accompanied by keenly optimistic predictions about the region's future. These were often built on the premise that the Gulf's strategic position at the crossroads between Asia, Europe and Africa could make it a global hub for services and trade. In July 2008, Nasser al-Saidi, chief economist of the Dubai International Finance Centre, predicted that the GCC would become the world's fifth biggest economy by 2020.[4]

Even when the global economic crisis intensified after the collapse of Lehman Brothers in September 2008, many felt that the GCC would remain immune. However, the effects of the recession were quickly felt across the region. Oil prices fell from highs of $147 a barrel to less than $38 in January 2009, and the region's exposure to Western stock markets and other assets left both individuals and institutions nursing serious losses. As some countries entered recession, loan portfolios started to perform poorly and some banks needed government support to survive.

Businesses that had enjoyed years of strong growth suddenly had to learn to operate in a downturn, and governments had to adapt to managing recession. Dubai, which had developed the

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most high-profile image in the region, mainly as a result of huge real estate projects, soon encountered significant problems. Real estate prices fell rapidly and the economy started to contract. The emirate still looks fragile, with its flagship company, Dubai World, seeking to restructure billions of dollars of debt.

The recession demonstrated that although much had been accomplished in the previous ten years, the Gulf states remain vulnerable to shocks in the global economy, making the need to diversify away from a reliance on oil income more pressing than ever.

The diversification struggle

Economic diversification away from oil revenues has been a mantra repeated by Gulf policymakers for several decades. In many respects the region has made real progress. Between 2002 and 2008, the GCC's non-oil sector is believed to have grown at an annual rate of about 7.5 per cent.[5]

Increasingly, the Gulf's private sector is becoming more powerful and confident. GCC companies now have footholds across the Middle East and are gaining access to Western and emerging markets. Firms are strengthening their corporate structure and some have listed on stock markets. Management standards have improved and a number of GCC citizens are obtaining MBAs as well as experience in multinational companies. Many of these firms are able to operate in Middle Eastern markets where cultural and political restrictions make things difficult for Western companies. As the private sector has grown, there has also been growth in trade within the GCC. Between 2000 and 2005, inter-Arab trade tripled, although around half of this consisted of oil.

However, despite growth in the private sector, government investment still plays a huge role in the economy. Over the next five years it is estimated that the total value of public and private investment in the GCC will be $1.9 trillion, and 65 per cent of

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this will be spent on infrastructure.[6] These large projects are aimed at diversifying the economy away from oil, and billions are being invested in tourism, airlines, industry and transport infrastructure.

There are many impediments to growth in the private sector. Although GCC states have taken steps towards cutting red tape and bureaucracy, their efforts have sometimes been in vain. Excessive bureaucracy is believed to be the reason foreign direct investment in Kuwait is lower than it is in Yemen.

Companies complain that it is hard to do business because of governmental failure to streamline procedures for obtaining work visas and import licences and the lack of action taken to ease the movement of goods across borders.[7] According to the World Bank, the highest-ranking Middle Eastern country in its most recent 'Ease of Doing Business Survey' was Saudi Arabia, with a global ranking of 13.[8] This is lower than Asian countries such as Singapore, China and Thailand, all of which have experienced strong economic growth over the past decade.

Despite some improvements, governments in the region have been unable to shape their policies to suit the needs of the private sector. Decision-making processes have been clouded by political and security factors that restrict new measures on issues such as open borders. For example, friction between Saudi Arabia and Qatar has at times prevented a lifting of restrictions that would make it easier for commercial businesses to cross their shared border.[9]

Another effect of the lack of democratic structures and procedure in the region has been a lack of transparency in decision-making. Government bodies and those who run them are not always accountable; in some cases in the GCC, ministers have been in their ministries for years. In many states, a handful of individuals from the ruling elite dominate certain sectors and protect monopolies at the expense of other businesspeople who want to enter markets and offer new products and services that would compete with the established order.

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A rentier class

Since the discovery of oil, a 'rentier class' has developed which generates an income through the collection of 'rents'. These include providing agencies for foreign companies that wish to operate in GCC states, sponsoring foreign workers' permits in return for fees, and real estate ownership and speculation. Other forms of rent gathering include taking commissions from foreign companies seeking contracts with the government. The GCC region also has a large number of financiers who invest in projects but do not take an active role in their development.

The rentier class limits economic development as it undermines productivity and provides minimal incentives for risk-taking. Its existence has prevented the development of a large entrepreneur class with the ambition to accomplish more than the collection of rents. There are many examples of GCC citizens who are successful entrepreneurs, but these are few considering the resources and education available to them.

Another hurdle for the private sector has been the workforce nationalisation policies in all GCC countries, brought in to reduce dependence on expatriate workers. These policies are a necessity and in some cases have been implemented successfully. However, the system of imposing hiring quotas on private-sector companies has its flaws. It has caused a malaise among some citizens, who feel they are entitled to jobs in the private sector. It has been difficult for these nationals to be sacked, and therefore many have had little incentive to perform to the best of their ability.

For decades there have been anecdotal stories about nationals arriving at work late and having much of their work done by expatriates, who are cheaper and more efficient to employ. This phenomenon has been bad for the private sector. It has also had a negative effect on the development of GCC nationals, who have not been forced to give of their best because they have been subject to lower benchmarks than those set for expatriate workers.

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Another aspect of this problem is the patronage networks within the public and private sectors, which mean that people are hired not necessarily on the basis of competence or skills but because of their connections. This creates a malaise among the local workforce, who feel that they are either guaranteed a job because of their standing in society or disenfranchised because of their lower standing and therefore have no incentive to work hard or gain new skills.

Planning for a post-oil future

One of the realities in the Gulf is that oil is a finite resource that will eventually be depleted. Furthermore, as oil becomes more expensive there is a greater economic incentive to develop alternative energy sources that would reduce its value. As a result, governments in the region have established sovereign wealth funds (SWFs) designed to protect them against fluctuations in oil and gas prices and safeguard the future of their economies when hydrocarbon reserves run out. Over the years, these SWFs have been allotted a percentage of oil revenues and have grown to a significant size. Accordingly, their activities have generated considerable attention around the world.

SWFs operate in various ways. Some have low profiles and low-risk strategies that avoid majority stakes in companies and focus on assets perceived to be secure, such as US Treasury bonds. Abu Dhabi, Saudi Arabia and Kuwait have traditionally preferred this strategy. Others have sought controlling stakes in high-profile Western companies and have adopted a type of private-equity strategy involving high degrees of leverage. Dubai and Qatar have generally followed this strategy.

GCC SWFs have invested significant amounts in Western economies and their role is treated with a mixture of suspicion and appreciation. Before the recession, their presence was thought to be threatening: many Western governments were concerned that

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they might use investments in strategic assets for political gain. Following the recession, Western policymakers were keen to encourage their investment in the badly damaged banking sector.

Generally, GCC governments have seen Western assets as stable, reliable investments. The accusation that they have a hidden political agenda is unfounded and, with the exception of the 1970s oil embargo, which is now widely considered to have been a mistake, all GCC states have proven to be reliable energy exporters to Western countries. Their reliability in this regard should be considered a sign of their SWFs' intentions.

However, these institutions are characterised by a damaging lack of transparency. The value, performance and specific details of SWF investments are not made public. Assessments of their size vary wildly and in the case of the Abu Dhabi Investment Authority estimates range from $650bn to $875bn.[10]

Outside the GCC, the management of SWFs is subject to public scrutiny. For example, the Government Pension Fund in Norway is one of the largest equity owners in Europe, with a total value of $455bn as at the end of 2008. Governed by an ethics committee, which ensures its investments remain within established guidelines, the fund is the subject of regular debate in Norway and is wholly transparent.

The lack of transparency in Gulf SWFs is a serious problem for GCC countries, as the primary function of these funds is to safeguard each state's future. That they are not run in a manner that allows public scrutiny clearly threatens this aim. In the worst case, this lack of transparency could lead to money being siphoned off. Ideally, SWFs should be transparently managed and non-political. Moreover, although the recession has lessened objections to Gulf investment in the West, concerns over investor intentions could be eased if these SWFs had more effective public relations policies – a development that would go hand in hand with improved transparency.

Absence of transparency has played a major role in moulding

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the way Gulf economies are managed, and all the GCC countries have suffered as a result. Most of them are relatively young, and there has been little opportunity to develop the checks and balances seen in more mature societies. Breakneck development in recent years has catapulted the Gulf states into the modern era, but in terms of governance, practice has developed little and many decisions are made informally, often in a traditional fashion in which only the necessary stakeholders are consulted. As a result, there is a lack of clarity as to whether SWFs and other investment bodies are acting in the interests of the state or of individuals within the state. Several recent test cases have revealed that officials have invested their own money and that of the state in the same assets.

A tale of two Arab worlds

The rest of the Arab world has experienced a different type of governance. With the exception of Morocco and Jordan, most of the non-Gulf Arab states have been governed by republican systems with a president as head of state. There are several reasons why these states developed differently from the Gulf Arab countries.

Many of the republican systems are the consequence of the rise of nationalist post-colonial politics. After the end of colonial rule by European powers in the 1940s and 1950s, Arab nationalism became an important ideology and leaders such as Egypt's Gamal Abdel Nasser came to power. Arab nationalism was defined by the principles of Arab unity, cultural pride and resistance to Israel.

In the 1950s and 1960s these principles were popular and defined Arab politics. Nasser's power extended across the region and his message even penetrated the Gulf societies, where the conservative monarchies were on the defensive. There was tension between the Gulf monarchies and the nationalist republics, which some historians refer to as the 'Arab cold war'.

Following the defeat of the Arab forces in 1967, however, Arab nationalism began to find itself on the back foot. During the Cold War the US supported conservative monarchies against the republics, which it believed might back Soviet ambitions in the region. Later, the US also engaged with Islamism as it believed it too acted as a bulwark against communism.

After the 1970s, the republics began to decline. Although many of them claimed to be creating more progressive societies, they nonetheless became some of the worst regimes in the region. Baathist states such as Syria and Iraq have abused human rights on a massive scale. Many republics have become notorious for widespread corruption and poor governance. Countries such as Algeria, Lebanon, Yemen and Iraq have been devastated by conflicts. Others such as Egypt, Jordan and Tunisia have remained peaceful but with little achievement in terms of economic development or political improvements.

Aside from human rights and politics, all the non-Gulf Arab states face a serious economic crisis. More than one in four Arabs are out of work and it is estimated that more than 55 million new jobs will have to be created by 2020 to keep this number from growing. Often the talented and educated middle class leave to find jobs in the US and Europe, resulting in a brain drain estimated to cost Arab economies $1.6bn a year.[11]

In the face of this, there has been a lack of innovative ideas or policies. Many governments have not had the vision or the accountability to address unemployment and foster sustainable economic growth. A lack of democracy has resulted in public administrations that are not well audited and whose performance is measured by their ability to maintain stability rather than to introduce progressive policies.

The performance of governments has been poor and the years of damage will have to be undone. The region's inhabitants have had to deal with unemployment, corruption, nepotism and the absence of vision and competitive spirit. Upward mobility

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