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Middle East and North Africa Programme: Future Trends in the GCC Workshop Summary

Political and Economic Scenarios for the GCC

May 2012

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Introduction

This is a summary of discussions that took place at a workshop held at Chatham House in May 2012. Part of Chatham House's 'Future Trends in the GCC' project, the event brought together a group of political activists from different movements, government and NGO representatives, economists, business people and academics¹.

Key points that emerged included:

- Longstanding efforts to diversify the GCC economies away from oil are being undermined by current trends in public spending. These require an ever-increasing oil price in order to balance the budget, and are mainly funding higher salaries and subsidies rather than productive activities.
- Ultimately the GCC states need to become less dependent on oil and on foreign labour. The urgency of such reforms varies from country to country, but each will ultimately face the same challenges. Economic integration efforts should focus on finding common solutions.
- Over the next decade, government spending patterns and the structure of the labour market will need to alter, although the urgency of reform varies between the GCC countries. Economic changes might eventually be the main drivers of political changes.
- In most of the GCC countries, the majority of citizens aspire to evolutionary reform; a variety of participants expressed a desire to contribute ideas for their country's development and felt governments were sometimes too quick to see criticism as a threat without appreciating its constructive potential.

This meeting was held under the Chatham House Rule and the views expressed are those of the participants. This document is intended to serve

¹ The workshop was split into two days. This paper focuses on the topics addressed on the second day. The first day's discussions, on Islamisms and identity politics in the GCC, are summarized at:
http://www.chathamhouse.org/sites/default/files/public/Research/Middle%20East/0512gcc_summary.pdf

as an *aide-mémoire* to those who took part and to provide a general summary of discussions for those who did not.

The Chatham House Rule

‘When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.’

Citizenship and the economy

Much of the debate around citizenship and national identity in the GCC countries focuses on political, social and cultural issues. Yet the nature of citizenship in the GCC is also shaped by the political economy of the GCC countries, as citizenship is closely connected to economic benefits. Future relations between states and their citizens are likely to be shaped by the degree to which these benefits are sustainable, the ways in which they are distributed among different regional, tribal, ethnic or religious groups, the ability of states to manage the economic expectations of citizens, and the extent to which citizens may increasingly see economic benefits as rights rather than privileges.

Participants in this discussion focused on the economic trends that shape relations between citizens and the governments of the GCC and on the economic policy reactions of the GCC governments to the wave of protests across the Arab world in 2011-12. Emphasis was placed on the importance of labour market policies and on the progress of attempts to increase the number of Gulf nationals employed in the private sector. The latter is of critical importance if the GCC is to enjoy sustainable growth; most of the states cannot afford to keep absorbing the ever-growing number of young labour-market entrants into the public sector.

During 2011, economic growth slowed sharply in most of the Middle East and North Africa region². The clear exceptions were the GCC countries, most of which (apart from Bahrain) experienced high growth in 2011 and were broadly

² MENA regional growth slowed from 5% in 2010 to 2.5% in 2011, according to the IMF's World Economic Outlook in mid-2012. International Monetary Fund, World Economic Outlook Update, July 2012; <http://www.imf.org/external/pubs/ft/weo/2012/update/02/index.htm> [accessed July 2012]

expected to repeat this strong performance in 2012. However, this growth was almost exclusively driven by dramatic increases in state spending, which have been a continuous feature of GCC economic policy since the current oil boom began in 2003. Since 2008, fiscal stimulus packages have helped to offset the impact of the global economic crisis, tight local credit markets and private-sector caution. More recently, further increases in spending have been announced, largely focused on wages and subsidies, in response to the Arab Spring. Overall, there has been a vast increase in the ratio of GCC government consumption to private consumption in the last ten years.

The repeated public spending increases that have underpinned strong GCC growth cannot be sustained indefinitely, unless oil prices are to rise continually. Projections by Saudi investment bank Jadwa Investment showed that, if public spending continued to rise at current growth rates, by 2030 Saudi Arabia would need an oil price of US\$320/barrel (/b) in order to balance its books³. Bahrain now needs oil of US\$112/b – or increased handouts from other GCC states – to break even, while Oman based its 2012 budget on an assumed oil price of US\$88/b. Importantly, most of the recent increases in spending have gone into salaries and subsidies, which are essentially a form of rent distribution, rather than being directly linked to productive economic activities. These areas of spending are also notoriously difficult to cut given the likelihood of political opposition from the beneficiaries. Salaries were hiked across the GCC in 2011 and there are ongoing calls for pay rises in Kuwait, illustrating the inflation of wage expectations.

With oil prices remaining over US\$100/b in the opening months of 2012, the current levels of spending were affordable for most GCC countries except Bahrain. However, in the next five years, fiscal pressures will mount in other states. Changes to fiscal policy will eventually be needed unless oil prices continued to rise indefinitely; the latter scenario would place further pressure on the global economy and could lead to political tensions between oil producers and importers.

Some participants felt that changes to economic structures would be the main long-term driver of political change in the GCC states. The impact of any eventual introduction of income tax was flagged as one potential game-changer.

³ Jadwa Investment, 'Saudi Arabia's coming oil and fiscal challenge', Saudi-US Relations Information Service, July 2011. <http://www.susris.com/documents/2011/110725-jadwa-challenge.pdf> [accessed July 2012]

Yet participants noted that the relationship between economic and political reform is complex and not necessarily predictable. It was said that in the 1990s, many observers assumed that economic reform in the Gulf would inevitably precipitate political change. It was believed that liberalizing the economy would increase transparency and empower new political actors in the form of private-sector businesspeople. Yet in practice, the last decade's economic reforms in the GCC have not fundamentally altered the role of political elites or state-society relations. Reform has remained selective and the private sector, while larger than in the past, remains highly dependent on the goodwill of Gulf governments (for instance, to obtain contracts, import licences and land).

Public employment policies in the GCC

Public employment policies are key channels of wealth distribution in the GCC. In addition to the recent increase in state employment in Saudi Arabia, public-sector workers enjoy a high degree of protection and are usually hard to fire. Private-sector employers struggle to compete with the public-sector in terms of the wages, hours and lifestyle on offer. As a result the private sector is dominated by an expatriate labour force, which is better trained and often more experienced, but is generally less well-protected and less well-paid.

It was noted that in the UAE, nationals in the public sector earn \$US5,500 per month on average, whereas the average salary of private-sector expatriates is merely \$US700⁴. Nationals working in the private sector earn an average of \$3,700 per month. A participant said that in UAE nationals were almost always paid more than expatriates, though the multiple could vary from 7 to 1.5 times the wage that an expatriate would earn for the same job. Only a tiny handful of expatriates were paid more than nationals, but there was often a perception among nationals that highly skilled expatriates were earning more than they actually were.

There is also a vast difference between the lifestyle of public and private sector employees. Private sector employment entails longer working days and less time spent with the family. It was noted that for a young Saudi national it makes more sense to obtain a degree in a subject such as philosophy and join the waiting list for a public-sector job rather than to be employed in the private sector. This was not so much a 'cultural' issue as an

⁴ Thanks are due to Steffen Hertog, Senior Lecturer in Comparative Politics at the London School of Economics for supplying this data.

economically rational choice given the system of incentives. Similar issues apply across all the GCC states, though the gap between nationals and expatriates varies from country to country. Wage structures may need to be modified to create more incentives for productive work and study.

There are ongoing attempts to 'nationalise' the workforce by integrating more nationals into the private sector, but these policies have generally been failing to meet their targets for some years, and most private-sector jobs created over the past decade have gone to expatriates. Companies have also found ways of getting around the system, for instance by creating 'ghost workers' – who are formally registered on the payroll but do no actual work – in order to comply with nationalisation quotas (quotas for Kuwaiti nationals to be employed in various private-sector fields). Participants generally agreed that these failures would be repeated unless new approaches were adopted.

Long-term ambitions to integrate nationals in the private sector face further setbacks as a result of the ever-rising public-sector salary levels. However, simple arithmetic shows that it is not economically viable to maintain this level of income in the long term, it was said. It was emphasized that nationals must be integrated into the economy at a higher level of productivity, with living wages that were both acceptable to the employees and economically feasible. This is particularly salient since GCC labour productivity has generally been declining in recent years. Where increases in productivity have taken place, these have instead tended to come from more productive use of capital.

Participants noted that employment was not just an issue between nationals and the expatriate community. Perceptions of sectarian discrimination in the Bahraini and Saudi labour markets are longstanding. Participants suggested this trend may also be creeping into other GCC countries. Applicants might also be favoured or rejected because of the region or the family they were from.

Alternative mechanisms of wealth distribution

Participants discussed alternative wealth distribution models that might be useful for the GCC to consider.

1. **Subsidizing the private employment of nationals.** Nationals would be paid a fairly low net wage which could be topped up with a state contribution that made the total wage acceptable to nationals. This method is already being used in Kuwait, but there are concerns that

the system is being manipulated by the employment of large numbers of 'ghost workers'. Better monitoring is needed here.

2. **Cash grants for citizens.** Steffen Hertog of the London School of Economics has proposed a system whereby GCC nationals would receive direct cash grants in lieu of public-sector employment. This would be guaranteed and unconditional. The cash grant would be high enough to meet basic needs, yet low enough to incentivize citizens to seek employment in order to have a better standard of living.

In either case, the authorities would no longer need to bulk up public-sector employment with unnecessary jobs – described by one participant as 'masqueraded unemployment' – allowing the bureaucracy to become more efficient. In addition, knowing they had to seek meaningful private employment would give young nationals a greater incentive to seek better education. It would also mean a much smaller loss of national labour resources. At present, large numbers of employees in the civil service achieve little to no productivity; in the private sector these individuals could contribute to national economic development.

Current methods of rent distribution have not been revised as until now the models have worked satisfactorily, at least in political terms. At the moment the system leaves a lot of leeway for political discretion and manipulation; it has allowed governments to favour one group or individual over another. Giving each citizen a lump sum would mean the system was very transparent.

This is the direction in which Iran moved with its subsidy reforms, which were supported by the International Monetary Fund. However, it was argued that in the case of Iran the subsidy reforms occurred much too late and the action was only taken as there was no other option available. Similarly, it was said that distributional reforms would happen in the GCC at some point but, like many other reforms in the region, they would probably happen much too late.

Another option being considered in the UAE is reform of commercial agency laws to create a more level playing field. Currently, nationals can obtain exclusive contracts to act as local agents for large international brands, from car marques to fast-food chains. The government is considering a new system whereby it would sign franchise agreements with brands, allowing any national to apply to open a branch of the franchise in the UAE. This would help them to gain experience in operating small and medium enterprises,

encouraging the culture of entrepreneurship that is developing in the UAE, especially among Emirati women.

However, agency laws have helped the government to secure loyalty from the merchants who benefitted, and changing them would likewise risk alienating the same groups, as large merchant families would object to newfound competition biting into their profits. Several GCC countries had talked about reforming the sponsorship (*kafala*) system, which ties expatriate workers closely to one specific employer, as this would reduce the gap between expatriates and nationals. A participant noted that allowing expatriates to form trade unions could also help by providing expatriates with greater bargaining power. However, vested interests would act as obstacles here as well. It was noted that Bahrain's innovative labour-market reforms had largely been suspended since 2011 in the face of pressure from the business community (especially the construction sector) and power shifts within the ruling Al Khalifa family (see below). More recently, however, Qatar had promised to bring an end to the *kafala* system in time for the FIFA World Cup in 2022.

Public spending priorities

Poor quality education was cited as one of the biggest issues facing the Gulf today. One participant argued that the GCC should be spending less on defence – especially imports of equipment that is largely unused – and more on education. Expenditure on the latter has risen in recent years, but there are still quality issues and a general assumption that education is better overseas.

However, if the labour market does not demand the type of skills that pupils and students are being taught, then there will be no real incentive to pursue an education. It was further noted that a number of intelligent young people are underemployed and overqualified.

Energy consumption and subsidy reform

It was noted that the GCC states consume significant levels of energy: indeed, Qatar and the United Arab Emirates can lay claim to the highest per capita energy consumptions in the world. It was suggested that demand management programmes were implemented to encourage energy saving. However, where these are already in place, the effects have not yet been satisfactory. In Kuwait, for example, there is a promotional programme programme to encourage its population to save electricity and water, and there were several green movements teaching people how to conserve

energy. Yet the impact of this has been limited, leading some participants to the conclusion that the only way to tackle high energy consumption is to raise prices. Energy subsidies are most beneficial to the wealthy; for example, those who can afford three cars would benefit more from energy subsidies than those who could not. The Iranian example of subsidy reforms was seen as flawed yet still worth studying; it uses a system of cash grants which allow the state to distribute money in a manner that is more equitable than a system of subsidies that disproportionately benefit the rich⁵.

Socio-economic cleavages in Bahrain

Socio-economic cleavages and perceptions of unfair wealth distribution were highlighted as key drivers of the protests in Bahrain and Oman, although these also involved a clear political component (participants expressed very different views on the relative role of economic versus political grievances, as they perceived them).

The emergence of sectarian tensions in Bahrain had shocked and surprised many in the Gulf. Yet there were longstanding economic issues that had helped to create divisions between Sunni and Shia citizens. One participant commented that a report issued in 1954 had described a series of clashes between Sunni and Shia Bahrainis over the results of the 1952 municipal elections. According to the report, Sunnis felt that their representation in the municipal council did not adequately reflect the disproportionate share of the wealth that they enjoyed. It was argued that there was still much more that could be done to address socio-economic inequalities. A report issued by the Bahrain Economic Development Board⁶ in the third quarter of 2011 showed that between 1995 and 2006 the poorest 40% of the Bahraini population had become relatively poorer, with their share of annual income dropping from 19.6% to 18.1%.

Socio-economic differences in Bahrain have manifested themselves in voting tendencies. Research by one participant on the 2002 elections had found clear disparities between constituencies that had voted mainly for Shia Islamists and those who had voted for Sunni Islamists or independents. The disparities to which he referred were particularly marked in family size,

⁵ This system, among other options, is explored in a recent Chatham House Programme Paper, *Burning Oil To Stay Cool: The Hidden Energy Crisis In Saudi Arabia*, Chatham House http://www.chathamhouse.org/sites/default/files/public/Research/Energy,%20Environment%20and%20Development/1211pr_lahn_stevens.pdf

⁶ Bahrain Economic Development Board, *Bahrain Economic Quarterly, Third Quarter 2011*, pp. 14-18. <http://www.bahrainedb.com/uploadedFiles/Bahraincom/BahrainForBusiness/BEQ%20Q3%202011%20%2820%2012%202011%29.pdf> [accessed June 2012]

different levels of urbanization, and the relative development of the areas' sewerage networks.

These cleavages were also evident in 2006 when a number of political groups adopted different positions towards the crown prince's labour market reform project. Aiming to tackle unemployment, the project charged businesses a fee for every foreign worker employed. It was supported by the main Shia opposition group, Al-Wefaq National Islamic Society, as well as the General Federation of Trade Unions, both of whom deemed it conducive for the employment of more Bahraini workers. However, opposition came from sections of the business community traditionally allied with the prime minister, largely because the project would add to the existing costs they faced in running their companies.

Socio-economic cleavages in Oman

It was said that most of the protests in Oman had taken place not in the capital, Muscat, but in the more peripheral areas of Sohar and Salalah. Although Sohar has seen significant economic development, there remains a lingering perception that expatriates and Omanis from elsewhere have benefitted more than locals. Omanisation policies have been difficult to implement, and a participant questioned the commitment of a number of senior ministers (also business owners) to implementing policies that would ultimately add to their labour costs. The sultan had responded to protests by replacing a number of ministers, announcing a series of political and economic reforms, and creating 50,000 new public-sector jobs.

However, another participant reminded the group that protests had started in Muscat in January 2011. The protest movement, they argued, cannot be reduced to its socio-economic drivers. It is led not only by those who are seeking employment but also by those seeking real political reform; they are demanding a number of their human rights, including freedom of expression and political participation. It was noted that Oman had managed to avoid any sectarian component to the protests.

One participant said that Sultan Qaboos is no longer entirely immune from direct criticism by some of the protestors. Nevertheless, this is still a minority phenomenon and criticizing the sultan directly remains taboo for the vast majority of Omanis. The question, the group wondered, is how long this taboo will last.

The GCC in 2020: Future Scenarios

In the final session of the workshop participants split into three groups. Each discussed a different aspect of the future of the GCC.

1. *What will today's 10-year-olds expect from their governments, their families, their peers when they become the 18-year-olds of 2020?*

The ongoing political changes have stimulated greater political awareness among young people. Participants felt that by 2020, the new generation would have come to expect more from politics, and would themselves be increasingly engaged with the political scene. But expectations and political ambitions would undoubtedly vary between people with different positions in society and different conceptions of their own interests. (For instance, Bahraini participants in the discussion differed as to whether they wanted the country to go "back to normal", in the hope their children would enjoy essentially the same way of life that Bahrain had in recent years before the uprising, or whether they wanted the country to change fundamentally, in the hope their children would have a better life.)

In terms of economic developments, participants questioned the sustainability of the consumerist lifestyle to which many in the GCC have become accustomed. It was suggested that expectations were becoming increasingly untenable and may become a future source of conflict, both between governments and young people and between parents and their children. Parents who had enjoyed quite privileged lifestyles would find it very difficult to ask a relatively less privileged lifestyle of their children, it was said.

On a cultural level it was suggested that globalization would lead to the challenging of the traditional patriarchal system. Young people would start to expect more respect for their individuality from their parents.

2. *Will the Gulf states see evolutionary reform, or more confrontational, conflictual paths to change?*

Most participants agreed that by 2020 there will have been some kind of genuine political reform in the GCC, probably through the strengthening of parliaments. Substantial differences are expected between countries, as those experiencing the most severe economic pressures will face greater pressures to reform, although its achievement will also depend on the political will of key ruling family members ('even economic reforms may be hostage to family politics', said one participant). It was predicted that economic trends will be the key drivers of political change as governments simply will not have the money to continue spending in the current manner. But the extent to

which nationals will call for more representative government will depend on the perceived results of political transitions elsewhere in the region. In most countries change was expected to be evolutionary rather than revolutionary, but this would require governments to possess the political will to implement reforms in order to stave off demands for more radical change.

3. *Will the GCC countries be more politically diverse than 2020? Or less so? How might plans for GCC integration affect political development?*

Participants in this breakout group felt every country would see significant political changes by 2020, but to different degrees. Any political changes in Saudi Arabia would have a knock-on effect in the whole GCC, whereas smaller GCC states could carry out reforms without having such a large impact on their neighbours. Participants expressed an interest in more concrete and open discussions about the options and models for GCC integration. There is widespread sympathy with the principles of Gulf integration, especially in ways that increase economic opportunities for nationals (for instance greater freedom of movement for labour). At the same time there is a lack of clarity about the nature of a possible union and there are concerns that it could reinforce authoritarianism.

Game-changers?

As a thought experiment, rather than an exercise in predictions, the groups also discussed possible “wild cards” that could fundamentally alter the development path of the GCC countries.

1. *The US has found a way to become entirely self-sufficient in energy and announces that it is withdrawing all its military bases from the Gulf region. What would this mean for the GCC states? How should they respond?*

Participants suggested the GCC states could pursue two approaches: seeking to bring in another international superpower as a military protector, such as China; or focusing on developing their indigenous security capabilities. It was noted that the British from parts of the Gulf in 1971 had acted as a catalyst for political reform, allowing the newly independent states to introduce constitutions for the first time. Participants suggested that greater independence from the US could similarly lead to a re-evaluation of the social contract.

2. *Scientists in Taiwan announce a new technological breakthrough, creating an innovative form of alternative energy that costs less than oil or gas. It will be released onto world markets one year from now.*

Under such a scenario, the GCC would need to accelerate the existing policies they have to diversify away from oil. Taxation would also have to be introduced. Participants thought that GCC countries could introduce corporation tax and still remain economically competitive as long as it was kept at a low level, but introducing income tax for citizens would change the political model.

3. *A dramatic change in international law compels all the GCC states to give full citizenship to all their residents.*

Participants felt this was the most unlikely of all the 'wild cards', suggesting that GCC states would find ways to reclassify citizens or to create two or three tiers of citizenship. It was believed that mass naturalization would radically destabilize the entire political and economic models of the states. It was also noted that the distinction between nationals and non-nationals is a relatively recent phenomenon and that it had been less than a century years since passports were introduced to the Gulf countries. Looking at more plausible scenarios, GCC states might be able to offer migrants some sort of permanent residency with no other rights attached. One participant suggested the adoption of a Swiss-style model in which migrants were naturalized via a points-based system taking into account their language skills and contribution to society. However, most remained unconvinced that such a system would be adopted.

Conclusions and recommendations

- Reform is seen as inevitable, but participants voiced concerns that this only will take place once it is too late. Recent fiscal responses to the Arab awakenings were largely short-termist reactive policies, focusing on public-sector wage hikes, job creation and subsidies. Such steps had gone against some of the positive longer-term work that governments were doing to make the economies more sustainable.
- Ultimately the GCC states will need to become less dependent on oil and on foreign labour. The urgency of such reforms varies but each country will ultimately face the same challenges. Economic integration efforts should focus on finding common

solutions, rather than simply providing states that were running out of oil with stopgap grants.

- Aspirations for political participation also vary from country to country because of differences in economic structures, political culture and history. In most of the GCC states, the majority of citizens aspire to evolutionary reform; a variety of participants expressed a desire to contribute their ideas for their country's development and felt governments were sometimes too quick to see criticism as a threat without appreciating its constructive potential.
- The GCC remains in a politically risky neighbourhood, with the potential for 'wild cards' to emerge from Iran, Iraq and Yemen. The wider region will continue to be a source of surprises over the coming decade and the GCC countries will need to adapt to maintain their security and prosperity.

FUTURE TRENDS IN THE GCC

The workshops formed part of the MENA Programme's ongoing project looking at 'Future Trends in the GCC'. The project aims to research, analyse and anticipate future scenarios for the political and economic development of the GCC states. The research has two main tracks: political and economic development, looking at the prospects for the GCC countries to adapt and develop their systems to meet the aspirations of their citizens; and identity politics, assessing the politics of sectarianism and prospects for developing more inclusive national identities. These themes will be explored in the context of relevant changes in the wider Middle East region.

www.chathamhouse.org/gulfstates

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