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Chapter 3

How the GCC did it: formal and informal governance of successful public enterprise in the Gulf Co-operation Council countries

by

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Like state apparatuses in the rest of the Middle East and North Africa, Gulf bureaucracies are not known as paragons of lean administration. This chapter explores the emergence of important "pockets of efficiency" in Gulf Co-operation Council countries' public sectors, namely in state-owned enterprises such as Saudi Aramco, Etisalat and others. In so doing, this analysis seeks to demonstrate that the success of Gulf-based state-owned enterprises can, to an extent, be explained by their adherence to some good corporate governance practices, but also to highlight that the way these principles have been implemented is often quite different than in other jurisdictions. Finally, this chapter seeks to isolate the elements that have contributed to the success of the state-owned enterprises and explore how these lessons can be extrapolated to other MENA jurisdictions.

Introduction

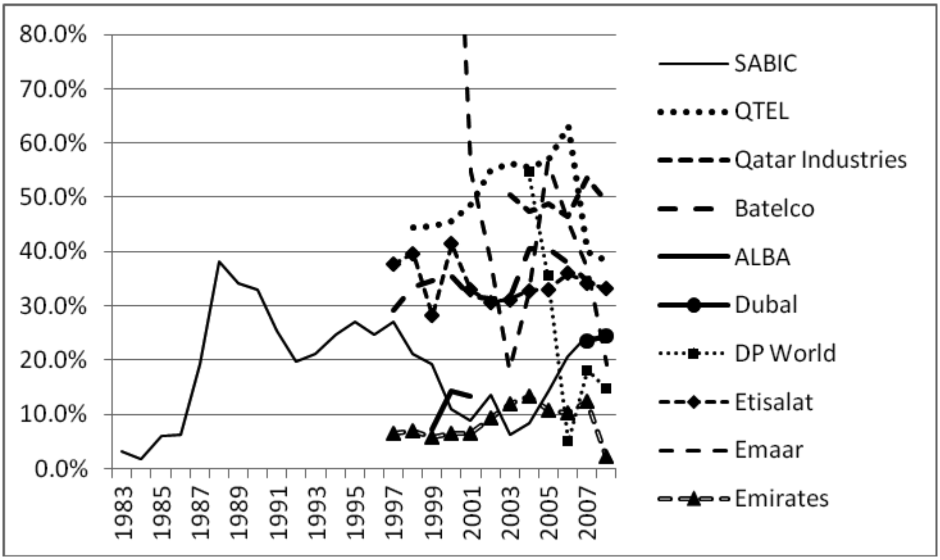
In the first chapter in this volume, Alissa Amico points out that 32 of the top 100 listed companies in the Middle East and North Africa (MENA) region are state-owned enterprises (SOEs). A full 29 of these are based in the Gulf Co-operation Council (GCC). To the extent that successful listings represent a vote of confidence in majority state-owned companies, GCC companies appear far ahead of the game in the region.

The size and prominence of Gulf SOEs can be explained by the availability of large capital surpluses that have made it easier to establish and maintain public enterprise. But there is also a genuinely different perception of public industries in the Gulf, many of which are seen as the best run national companies and the most attractive employers. In a poll that Ernst & Young conducted in 24 countries in 2010, 86% of Saudis agreed that big industry should remain in government hands – more than in any other country. Saudis also topped the list in agreeing that SOEs deliver better services and that SOE managers were better than their counterparts in the private sector (Ernst &Young, 2010).

Although the Gulf has seen its share of white elephants and failed investments, in comparison with the wider region and the developing world in general, the region stands out in having produced a number of profitable and, by most accounts, well-run public enterprises in a number of strategic industries. Players like the Saudi Basic Industries Corporation (SABIC), Emirates Airlines, Dubal and Etisalat have managed to make their mark not only domestically, but also in international product and service markets.

Figure 3.1 below provides a historical overview of the profit margins of some large Gulf-based SOEs.

Figure 3.1. Profit margins of successful Gulf SOEs



Notes:
1. Figure demonstrates operating margins as opposed to return on equity.
2. Series start in early 1980s to demonstrate SABIC's long-term track record.
3. In early 2000, Emaar was endowed with land grants, so the company had large initial profits on small operating expenditures in early years.
Source: Company reports, Markaz Financial Center, Kuwait.

Like state apparatuses in the rest of the MENA region, Gulf bureaucracies at large are not known as paragons of lean administration. What, then, explains the emergence of important "pockets of efficiency" (Evans, 1989; Geddes, 1996) in the GCC public sectors that seem to contrast with the struggling SOEs in many other Arab countries?

This chapter will show that the success of Gulf SOEs is explained by an adherence to some of the good practices of SOE governance as laid out by the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (OECD, 2005). The way these principles have been implemented is, however, often quite different from the specific governance mechanisms recommended by the OECD.

Absence of conventional governance mechanisms

In line with OECD principles, successful Gulf SOEs are insulated from politics and operate with clear mandates. Lines of command are clear, and most of the successful public enterprises are protected from the kinds of bureaucratic interventions into operational management that have brought public sectors to their knees in other MENA countries.

The way that political insulation and performance orientation are guaranteed often has little to do with specific OECD recommendations such as the formal centralisation of ownership, an explicit ownership policy, the creation of independent boards or comprehensive disclosure requirements. Instead, insulation and performance incentives are generated on the basis of informal political patronage by senior regime players and the creation of regulatory enclaves and privileges that exist in parallel to the rest of the state apparatus.

The Gulf SOE model based on privileged "pockets of efficiency" has in some cases run its course, as the once underdeveloped private sector has caught up with public industry, and as separate regulatory regimes, as well as legal and financial privileges, have lost their developmental justification. In these cases, the GCC faces the challenge of transitioning to a more inclusive (and conventional) regulatory model in which all players, no matter their ownership structure, operate under the same rules. In several important cases, however, SOEs still act as trailblazers, developing infrastructure and business models that would never come into being without state intervention.

Parts of the Gulf SOE model are not readily exportable to other MENA countries, as the political conditions for the emergence of "pockets of efficiency" cannot be readily created through regulatory fiat. Nonetheless, the GCC holds some general lessons about the conditions under which effective public enterprise in MENA can thrive – conditions that are in large part analogous, but not necessarily identical, to the OECD's recommendations.

The GCC SOE story shows that the absence of conventional corporate governance mechanisms does not preclude good SOE performance or political accountability while, conversely, the formal presence of such mechanisms does not guarantee good performance. Sometimes informal politics and ingenuous incentive setting are as important as formal governance structures. It is generally accepted that in the long run, all SOEs should be centrally owned, publicly listed, independently regulated and supervised by independent boards. In the short- to medium term, however, much of this might not be politically feasible or, perhaps worse, could be implemented in a perfunctory way.

Every SOE's circumstances are unique, and the politically feasible solutions to achieve insulation and performance orientation will not be the same in all instances. In many cases, a pragmatic mixture will need to be found between ideal principles derived from SOE governance in highly developed markets, and rules of thumb that take account of the informal nature and institutional imperfections of emerging markets in MENA.

A level playing field – but who wants to play?

The one area in which successful GCC SOEs deviate from the OECD rulebook even on the level of principle is that of the level playing field. Players like SABIC, Industries Qatar, Emirates or Emaar have benefitted from not only large initial capital injections, but also continued concessionary loans from the government, the provision of dedicated infrastructure and -- in the case of heavy industry -- privileged access to cheap feedstock.

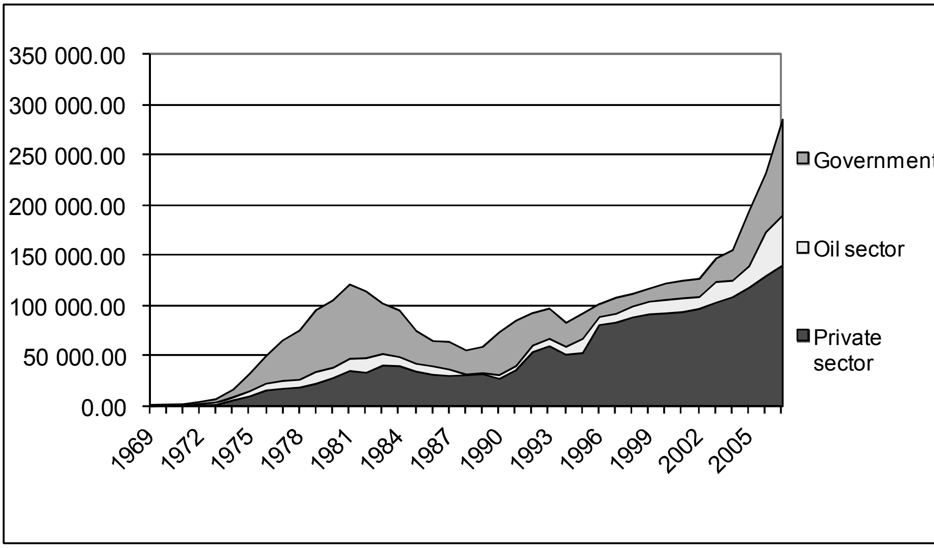
While this has become problematic in some cases, it was arguably a historical necessity to get new industries off the ground in the GCC. There would quite likely be no private aviation in the GCC had Emirates not shown that in principle this sector can be profitable, and no chemicals sector in Saudi Arabia had SABIC not shown the viability of heavy industry in the Arabian desert. Most breakthroughs into new sectors were led by public players, be it in heavy industry, aviation, international real estate, logistics or telecoms.

In contrast to most other countries in the world, GCC states are endowed with surplus capital, both financial and natural, that they need to put to productive use. Figure 3.2. below shows how capital formation in Saudi Arabia was almost by necessity dominated by government until the mid-1980s. Developing new sectors through privileged public enterprises has been a useful strategy for strategically injecting surplus public capital into a growing and diversifying local economy.

The GCC – like the wider MENA region – also remains in a different phase of economic development than leading Western economies, with a private sector that is less capable of leading diversification. Which tool(s) should be used to stimulate diversification depends on a country’s specific circumstances and the sector at hand, but in the GCC public enterprise has repeatedly proved to be a powerful instrument in the process.

In terms of scale, planning capacity, time horizon, infrastructure investment and bargaining power with international counterparts, the public sector has often had a strategic advantage over private players. Arguably no private Saudi group could have negotiated the world-scale petrochemical joint ventures that SABIC set up with international partners in the late 1970s and early 1980s.

Figure 3.2. Saudi gross fixed capital formation since 1969 (SAR mil)



Source: Data from the Saudi Arabian Monetary Agency.

Private investors have shown that they are good followers, and despite inevitable tensions, the liberal economic environment in the GCC has generally allowed them to move into new sectors in the wake of SOEs. But private companies often wait for public industry to demonstrate what is feasible.

Conditions differ strongly from sector to sector, of course. In some, scale and long-term planning are more important than in others, notably in heavy industry, logistics and network-based industries. In network-based industries in particular, it has proved advisable to maintain public rather than private monopolies. Especially in emerging markets, SOEs tend to be easier to regulate and control in terms of their developmental and social mandates than the private sector at large.

In other sectors like hospitality and real estate, commerce and distribution, finance, light manufacturing or road transport, there is less of a justification for large-scale state investment. With some exceptions (notably in finance, hospitality, real estate and road transport), GCC governments have largely abstained from creating SOEs in these areas, leaving ample opportunities for local merchant families. These sectors were never subject to the waves of nationalisations that other Arab states witnessed in the 1950s and 1960s and that created public holdings in sectors that had seen vibrant private development in the pre-revolutionary era (Springborg, 1993).

In the GCC, by contrast, "level playing field" was an irrelevant concept in areas that simply did not exist before states started investing there. Treating public enterprises and private investors the same in Gulf heavy industry or aviation in the early phase would arguably have stunted strategic development, leading to either misallocation or non-allocation of capital.

The legacy of state-led diversification is a set of impressive, but often privileged, SOEs whose relationship to a maturing private sector can be tense. Yet this outcome appears preferable to a counterfactual one in which new sectors would likely not have been developed at all. SABIC is in conflict with large local industrialists over feedstock access and local sales of bulk petrochemicals – but there probably would not be any private heavy industry players of note without SABIC's historical role as the sector's handmaiden.

In some new industries such as aerospace or energy technology, and in certain fields of infrastructure and transport, state leadership still appears justified. The challenge in more mature sectors, however, is to move to a next stage of development where SOE capacities are preserved, but where private investors have the same access to inputs and infrastructure, and have the same regulatory status. This stage has probably been reached in Saudi heavy industry as well as in the regional banking and telecoms sectors.

It is in such mature sectors with substantial private capacity that some of the *SOE Guidelines* become relevant, in particular the recommendations on independent sectoral regulators, on clear competition policy and a transparent ownership policy for state assets. Much of this has been achieved in the Gulf telecoms sector, whereas the track record in banking is mixed. In the Saudi heavy industry sector – the only one where there is world-scale investment by private local investors – the situation remains complicated. SABIC seems to resist pressure for further privatisation or equal feedstock access for private investors through joint ventures with local investors: an imperfect situation perhaps, but still vastly preferable to the state of heavy industry in many other OPEC countries, which is both monopolistic and loss-making.

The institutional context of GCC SOEs: governed well without good governance?

The fact that only government entities have the resources and will to invest in specific activities does not mean that the investments will be made well. SOEs can easily get trapped in a perennial "infant industries" circuit of protection, operate at a loss due to "soft budget constraints" (Kornai, 1979), or become tools of patronage or be immobilised by conflicts among their political principals. The broader political context of GCC regimes, as well as the specific institutional framework chosen for new SOEs, explains why in a number of large and important cases this did not happen:

- SOEs have an arm's length relationship to the administration at large. Companies like SABIC, Saudi Aramco, Abu Dhabi's Mubadala or Emirates Airlines are not under the regulatory purview of sectoral ministries, or they enjoy high de facto autonomy from these ministries.
- Executives are usually handpicked by the political leadership, to whom they have direct and privileged access. While chairs of boards are often ruling family members, executives usually are highly skilled "commoner" technocrats.
- The highest level principals accord SOEs political protection against interference by other political players.
- Levels of corruption are generally lower than in the rest of the state apparatus. Corruption is more harshly prosecuted by political principals and incentives for it are weaker thanks to competitive hiring and remuneration.
- SOEs are autonomous in their recruitment and have separate salary and staffing systems that enable them to attract top national talent. These structures are often deliberately set up in contrast to more rigid, less meritocratic (and usually less remunerative) public service employment.
- SOE budgets and capital resources are protected through generous initial capital endowments and through financial autonomy (i.e. SOEs are taxed only on their net revenue and can expand through both retained profits and conventional corporate finance, both in theory and practice).

Some of these structures and practices are informal and difficult to re-create through formal legal instruments. They can come into being thanks to a leadership that is fairly autonomous in its allocation decisions and to the absence of the populist economic ideology that has made public industry a tool of social engineering and patronage in some other developing countries (Hertog, 2010a). Neither of these two background factors can be influenced easily by policy decisions.

Some of the aforementioned privileges now undermine a level playing field with private players, but they were necessary initial conditions for building insulated, efficient structures in an otherwise often mediocre administrative environment. Dag Detter (2009) points out that "political insulation" is one pre-condition of SOE efficiency. While in the OECD context, this is achieved through separate regulators, the concentration of ownership in a central agency and other formal accountability mechanisms, in the GCC countries institutional insulation is a result of a top-down decision to establish structures separate from the rest of the civil service and its administrative culture.

Accountability, however, is almost exclusively to the top, not to a broader public or an independent regulator, and formal ownership is often fragmented among different government entities. Vertical accountability is particularly easy to orchestrate in political systems where other, horizontally organised interests in state and society are weak, as is the case in most GCC countries.

Such centralisation (and often personalisation) meets its limits when regulatory tasks become more complex, but it can be an important substitute for formal regulation and accountability mechanisms when the state apparatus at large is not sufficiently equipped for such tasks. Top-down control can also lend itself to abuse, but this is remarkably limited in the Gulf SOE sector compared with public sectors in many other centralised states. Rent seeking, for example, happens mostly in other fields.

Legal status and regulation: measured privilege

That being said, the formal and legal structures of Gulf SOEs do evince some characteristics of Western corporate practices, mixed with local institutional traditions to produce a fairly distinctive hybrid. For instance, successful Gulf SOEs are all incorporated as companies. None of them is a public agency, as many of the traditional SOEs in Arab countries have been (and still are) in Iraq or Yemen. Their senior management is structured very similarly to those of major Western companies, their accounts are usually audited by international auditing firms (though not always published), and their financial management and corporate finance practices broadly follow international standards.

At the same time, they are not just large and autonomously managed companies that happen to be state-owned. Many of them are statutory corporations established through presidential decrees or other special statutes that give them a particular mandate and/or privileges, including that of not being regulated by line agencies like local ministries of commerce, industry, labour, or electricity and water. Saudi Aramco had the particular extraterritorial privilege of being incorporated in Delaware until 1988, eight years after it had been fully nationalised by the Saudi government (Hertog, 2008). Publicly listed SOEs in the UAE are exempt from the country's corporate governance code for listed companies, to some extent moving them beyond the purview of the country's capital markets regulator, the Emirates Commodities and Securities Authority (see Chapter 1 in this volume).

SOEs often have access to separate infrastructure and public service providers, and to the extent that they are subject to dedicated regulators, these often function as specialised support agencies rather than enforcers of competition or transparency. For instance, in the mid-1970s, the Royal Commission for the Industrial Cities of Jubail and Yanbu in Saudi Arabia was given a dedicated mandate to bypass the rest of the Saudi bureaucracy in regulating SABIC's operations and creating enabling utility and other infrastructure. Similarly, the Dubai Civil Aviation Authority is at least as much a support agency for Emirates as a classical regulator. Industries Qatar is not subject to supervision by a sectoral regulator, but instead functions under the umbrella of its majority owner, Qatar Petroleum, which is a large institutional and infrastructural enclave of its own.[1]

Where sectoral regulators exist, they tend to be stronger than general competition authorities that often lack the official mandate or the practical powers to address SOE-related matters. Sectoral bodies often have a clearer, focused mandate and a more established relationship with the entities under their purview. Only in the telecoms and finance do they attend to issues of competition and market access in a systematic way. In all other sectors, they tend to be midwives of and service providers for SOEs as much as anything else. If there is a dedicated regulatory mandate, however, it is usually not held by the agency that exercises the ownership in a given SOE.

Generally speaking, entities with separate ownership functions are passive shareholders. For example, the Saudi Public Investment Fund (PIF), which controls most of the kingdom's large SOEs outside of aviation and the oil upstream sectors, is de facto a unit of the Ministry of Finance with no strategic mandate and circumscribed autonomy. It has a limited number of lower level representatives on the boards of the various entities it formally owns. It appears to be the default receptacle for SOEs of very different provenances and purposes; their actual political principals are arguably located on more senior levels than the PIF.

The situation of some of the funds formally holding UAE SOEs such as Emirates Airlines or Etisalat is similar. The Qatar Investment Authority (QIA), which holds stakes in Qatar Airways, Qtel and the large real estate SOE - Diar, is one of more active ownership, with direct involvement of the ruling family. That said, Industries Qatar, a heavy industry giant and a centrepiece of the country's diversification strategy, is not among QIA's assets.

The main function of most ownership bodies in the GCC does not seem to be active and coherent portfolio management or even consolidated analysis of SOE finances. Instead, their relationship to the assets formally owned tends to be passive and arm's length. Conversely from the supervision recommended by the *SOE Guidelines*, the main function of holding entities seems to be *negative*: that is, preventing other bodies, especially line agencies, from interfering with or claiming ownership of SOE assets, which has led to target conflicts and collusion in other countries.

The only holding that is fairly close to the model of active and consolidated financial and portfolio management is Bahrain's Mumtalakat Holding Company, established in 2006 with a view to create a more active and co-ordinated management of the country's non-oil assets.[2] Its board has senior political players, but also Bahraini nationals who appear to have been chosen because of their financial management experience – in contrast to many other boards, which simply often have a cross-section of senior technocrats and political players with no specialised expertise. Four out of five members of Mumtalakat's executive committee, moreover, are expatriates with specialised financial backgrounds.

Mumtalakat is trying to actively rebalance Bahrain's public enterprise portfolio through partial divestitures as well as the restructuring of less well-performing SOEs, pursuing a much more active and centralised strategy than its counterparts. Bahrain's small size and the increased fiscal pressure it has been under probably explain why it has consolidated governance structures at a time when SOEs in other GCC countries are often well-functioning, but operate in largely separate administrative pockets.

Do GCC boards matter?

As elsewhere in the region (see Chapter 1 in this book), SOE boards in the Gulf remain dominated by government representatives, although the role of line agencies is probably less pronounced. There are nuances between different SOEs, but few have independent directors with specialised expertise, and by and large they appear more passive than boards in OECD jurisdictions.

Saudi Arabia's SABIC is a representative example. The chairman is a member of the ruling family and is also chairman of the Royal Commission for the Industrial Cities of Jubail and Yanbu, while the other members of the board include SABIC's CEO, one current and one former deputy minister as well as three local private sector representatives (two industrialists with a variety of interests and board positions in the Saudi industrial and service sectors, and a financial services manager with tax and accounting expertise).[3] The board members, especially on the government side, appear to have been chosen to a large extent ex officio and on the basis of seniority.

The board of Saudi Telecom (STC) looks similar. It includes a number of local private sector representatives, several senior ministerial representatives and the governor of the Saudi central bank (SAMA), as its chairman. SAMA is historically affiliated with the powerful Ministry of Finance, which controls the PIF that formally holds a majority of STC's shares.[4] The Ministry of Finance hence appears to exert indirect control through a chairman with no background in the telecommunications sector and with extensive other obligations. As with SABIC, the PIF as a formal majority owner is not represented on the board.

Saudi Aramco is the one Saudi SOE that most closely approaches an ideal board with independent directors. Its 12 member board includes 5 executives of the company and a number of very senior Saudi technocrats (including the Minister of Finance), but also one former World Bank managing director and two former international oil executives chosen for their experience and networks in the sector. Aramco is the only major Saudi SOE whose operations are supervised by foreign board members.[5]

The composition of other GCC SOE boards is comparable to the patterns at SABIC and Saudi Telecom. Bahrain's large aluminium smelter Alba, one of the crown jewels in Mumtalakat's portfolio, has the deputy CEO of Mumtalakat as its chairman (with a background in both engineering and public finance); other directors include an under-secretary of the Ministry of Finance who is also a ruling family member, a number of senior representatives of the local private sector and three SABIC executives (SABIC holds a minority share in Alba).[6] One of the private sector representatives hails from a very prominent family, while the other is present on several dozens of company boards in Bahrain. Again, some members of the board seem to be chosen ex officio and on the basis of seniority, people with numerous other obligations and limited sectoral knowledge.

The board of Industries Qatar involves an even closer circle of players. Until 2010, it included a number of senior ministers and advisors around the

Emir of Qatar who have since retired, as well as executives of several units of Industry Qatar's main shareholder, Qatar Petroleum. Since January 2011, the board consists exclusively of the Minister of Petroleum, who is also managing director of Qatar Petroleum, and other senior executives of various Qatar Petroleum and Industries Qatar units. There are no outside or independent directors. Industries Qatar is managed as an enclave within Qatar's energy technocracy by individuals with numerous other obligations and with no industry specific knowledge (barring one board member).[7]

The board of Abu Dhabi's public holding company Mubadala, which has invested in diverse areas like real estate, aerospace and renewable energy, also involves a fairly closed group. The chairman is the emirate's crown prince, while other directors represent a cross section of Abu Dhabi's senior technocracy, several of whom are also members of the emirate's Executive Council and most of whom are also involved with other SOEs across a variety of sectors.[8] No one can be clearly identified as an outside or an independent director, and all members combine numerous other senior functions with their directorship. As in Qatar, some of this can be explained by the thin layer of qualified managers in a small national population. Nonetheless, the extent to which recruitment of directors is limited to a small slice of the official technocracy is striking.

The Gulf SOE with perhaps the most surprising governance structure is Emirates. Emirates is owned through the Investment Corporation of Dubai, one of the three core holding structures in the emirate, which appears to be a hands-off owner. It is not subject to regulations of the Ministry of Labour and reports directly to the ruler's court. It is an enclave in almost every sense, with few conventional accountability mechanisms. Although the company is rated as one of the world's most successful airlines and publishes its audited accounts, the political leadership in Dubai did not create a board for the company and it is still governed by its executive leadership.[9] Its chairman and CEO is an uncle of the ruler of Dubai, flanked by a president and executive vice-chairman who are both expatriates.

We have seen that most Gulf SOEs have boards that are recruited on the basis of seniority from a fairly small circle of elites, and are staffed with directors who often have little spare time and, despite wide general experience, limited specialised expertise. The one board that has a significant presence of independent and competent directors – Saudi Aramco – is arguably a legacy of Aramco's history as international joint venture. Apart from Aramco, Gulf boards are by and large known to be fairly passive; most successful Gulf SOEs are run by their senior management quite autonomously.

The success of public enterprise in the Gulf hence does not appear to be attributable to high performing boards. Similarly to the passive ownership structures of Gulf SOEs, the main function of boards might be not to exercise close supervision, but rather to act as a buffer against other government institutions and actors interfering with SOE operations. Against a background of meddlesome ministerial technocrats in some other MENA countries, perhaps the very passivity of Gulf SOE boards is their strength.

The actors who do in fact hold the management of SOEs accountable for their performance are by and large not their technocratic directors, but senior members of the ruling family under whose formal or informal patronage they operate and from whom they receive a clear and often delimited mandate to generate profit and, in many cases, compete internationally. In this context, a corporate culture and recruitment structures have come into being that separate SOEs from the rest of the bureaucracy and that seem more important in guaranteeing their performance orientation than conventional corporate governance mechanisms.

Evolution of SOE governance in the Gulf

We have argued that successful Gulf SOEs are politically insulated and held accountable for their results through clear performance metrics monitored by a limited number of powerful principals. While on this level of abstraction the set up sounds very similar to the type of arrangements advocated by the *SOE Guidelines*, the concrete mechanisms through which a clear mandate and performance orientation are achieved are in parts quite different from the canon of Western corporate governance.

Two closely related questions present themselves. First, to what extent are the peculiarities of SOE governance in the GCC a passing phenomenon? In other words, even if the original institutional design is decidedly coloured by local institutional traditions, do they converge on international governance standards as they mature and compete internationally? Secondly, is it a problem if there are aspects in which they don't converge?

Some elements of convergence are undeniable: since the late 1990s, partial stock market listings of Gulf SOEs, including Saudi Telecom, Qtel, Industries Qatar, Emaar, DP World, Etisalat and Alba, have forced them into more extensive (though often still limited) disclosure and have exposed them to some scrutiny by outsiders.[10] This has bolstered disclosure practices and has forced management to publicly justify major strategic decisions. Owing to a fairly weak and short-term oriented shareholder culture and a feeble presence or complete absence of institutional investors, however, listings have not been a game-changer for SOEs. Some of the best performing SOEs, including Saudi Aramco, Dubal and Emirates, remain unlisted.

SOEs have also deepened their international integration through overseas investment and, where applicable, export of their services into overseas markets. Prominent examples include SABIC through its USD 11.6 billion acquisition of GE Plastics in 2007, DP World's acquisition of port assets and operating licenses all around the world, Etisalat's expansion into telecoms markets in the wider Middle East and sub-Saharan Africa, and Emaar's real-estate investments in the Arab world and South Asia.

The more such expansion occurs, the less central the issue of a level domestic playing field becomes, as SOEs abroad have to compete with, and often behave like, private multinational enterprises. Although governments might still illicitly support their SOEs overseas, channels for such support will be more limited. Perhaps more important, there is less of a rationale for such support if the objective of SOEs is simply to generate profits – which is usually the case with outward-oriented ones in the GCC. Expansion abroad also exposes at least parts of such SOEs to the disclosure and governance requirements of overseas jurisdictions.

Finally, Gulf SOEs also increasingly seek corporate finance in international markets, not only through bank loans but also through the issuance of corporate bonds, which requires at least one-off disclosures even from unlisted companies. In fact, during the crisis of 2008-2009, SOEs were practically the only entities active on regional bond markets. Dubai SOEs in particular, which since 2008 have had less generous financial backing from their government, have had to divulge important bits of previously unavailable corporate information to international investors, forcing SOEs to overcome their penchant for secrecy.

In several arguably more important ways, GCC SOEs continue to stand apart. First, and most problematically, most of them are not subject to effective competition regulation. In some sectors – for example, aerospace or renewable energy – this is not yet an issue, as SOEs stand alone as large scale investors, while private sector interest in new ventures is muted at best. In other sectors, like large scale tourism projects, heavy industry or aviation, SOEs started out as the only players in town but have now been joined by an active stratum of private investors inspired by the successes of public industry.

While their trailblazer status made dedicated state support and infrastructural privileges for SOEs justifiable or even necessary at an early stage, such treatment now arguably hampers further diversification and maturation of GCC markets. For instance, given that SABIC has been joined by a mature local class of industrialists in the petrochemicals market, it is not so clear anymore why it should get privileged feedstock access. Unfortunately, there is no independent industrial regulator that could effectively arbitrate such questions. The increasing number of joint ventures SABIC has initiated with local capitalists mitigates but does not resolve the issue.

The building of independent sectoral regulators – as regulators in a true sense, not as service providers for SOEs – is the next big challenge in the governance of public industry in the GCC. Telecoms and to an extent the financial sector regulators are ahead in this regard, and their experience should be studied closely. It will be important to build regulators on a sectoral rather than a cross-cutting basis, as attempts to set up transversal institutions like generic competition authorities have never gotten off the ground in the fragmented institutional landscape of GCC states (Hertog, 2010b).

These regulators will require the same kind of high-level backing and institutional privileges that SOE leaders currently enjoy, since the latter are unlikely to cede their exclusive entitlements without a fight. Given local human-resource constraints, it will be initially difficult to staff new regulators with personnel that have no links to the existing SOEs. The case of telecoms has shown, however, that a progressive social and institutional decoupling between the enterprise and its regulator over time is possible.

Access to state finance is a particularly complex issue in this regard. While in principle SOEs should compete for funds, the implicit sovereign backing they enjoy is difficult to abolish. First, it is worth noting that it was SOE investment that kept GCC economies going during the 2008-09 financial crisis when private investment collapsed. Second, thanks to sovereign backing, SOEs are capable of engaging in long-term strategic investments for which the private sector often still lacks the time horizon. Dedicated state support must be limited to exactly these kinds of projects however; anything that can be undertaken by private players should be financed privately or through state funds made available on a competitive basis.

Privileged finance for strategic investment is easier to justify for profitable Gulf SOEs than for public enterprise elsewhere, as leading SOEs in the region are generally not used for patronage purposes, and the "soft budget constraints" they are subject to have not led to the chronic losses generated by Syrian or

Algerian SOEs. Social patronage in the GCC does of course exist, but is rather channelled through bureaucratic over-employment, rules of national economic privilege and variety of subsidy and handout schemes. Important (though not all) segments of public industry have been insulated from it (Hertog, 2010a).

There are further ways in which Gulf SOEs remain different from the generally accepted view of a well governed SOE. Ownership is often still fragmented, and even where there is formal consolidation, the holding entities tend to be administratively weak. Against the background of clear de facto mandates and high bureaucratic insulation, however, this appears to be less of a pressing concern than the issue of the level playing field. As long as SOEs are well-protected and know what their task is, the challenge seems to be independent regulation rather than consolidated ownership.

Despite partial listings and bond issues, Gulf SOEs also remain fairly opaque by Western corporate standards. More often than not, disclosure is kept to the statutory minimum, and performance information is shared with political principals rather than with the broader public (or even other government institutions). While transparency is a value in its own right, its impact on SOE performance and accountability in the GCC for the most part is likely to be muted. As already alluded to above, the audience that could make use of greater disclosure is limited, especially in Oman, Qatar and the UAE, small countries whose civil society is not very active. In other cases, increased transparency might augment populist calls for employment generation, provision of subsidised goods to local business or consumers, or other demands that could dilute SOEs' mandate.

To some extent, the relative opacity of players like Saudi Aramco or SABIC has arguably helped them defend themselves against bureaucratic as well as other encroachments. Such defence should in the long run derive from formal legal guarantees rather than institutionalised secrecy. In the short run, however, if the primary aim is to guarantee SOE performance and market contestability, it will be more important that independent regulators rather than the public have full access to company information, both to maximise impact and guarantee political feasibility.

Similarly, stronger boards with more specialised and independent members along Western lines might on the margin help SOE performance. But they will do little to address the issues of market contestability which are probably the main challenge that Gulf public sectors are facing now. Given the relationship-based nature of doing business in the Gulf, truly independent boards will in any case take a long time to establish.

Lessons for non-GCC countries?

In the long run, as the local private sector matures, Gulf public enterprise could and should converge on best practices that have emerged in more advanced economies. In the meantime, there is much left to analyse and potentially learn from GCC SOEs, pockets of efficiency which have been set up according to their own rulebook and in response to a very different social and economic context.

Not everything that has worked in the GCC will travel easily to other countries. GCC lessons could be difficult to apply in nations with lower levels of rent and hence less spare funding to build institutional enclaves in parallel to the official bureaucracy, and in countries where levels of political mobilisation and societal demands are higher, thereby making informal strategies of institutional insulation harder.

There are nonetheless a number of general principles that would seem to apply also outside of the oil monarchies of the Gulf in other MENA or emerging market jurisdictions – even if they might be harder to act on and represent necessary rather than sufficient conditions for guaranteeing performance:

- In countries where informal relations are paramount, successful SOEs require senior figures to give them political support, protection from rival interests and a guarantee of operational autonomy. Senior management needs good access to the leadership and stable, though not guaranteed, tenure. This is a caveat about political preconditions for SOE success rather than an easily actionable technical recommendation – which makes it no less important.

- Successful SOE need to be separate from the rest of bureaucracy, not only in formal and legal terms, but also in their management and human-resource practices. Recruitment needs to be autonomous, and salary and promotion schemes must be based on private-, not public sector, standards. Corporatisation is a necessary but not sufficient step towards this.[11]

- Line ministries should have a minimal role in managing SOEs, even if no independent regulators are in place and technical expertise in the rest of the state apparatus is limited. Indirect control through holding structures or financial agencies seems preferable, as it tends to be more hands-off. Line ministers should not chair holding companies.

- Partial listings of SOE equity or debt can help to advance corporate governance by improving their disclosure practices and subjecting SOEs to external auditing. However, there should be strong supplementary mechanisms of accountability within the government, especially if the local shareholder culture is weak.

- Clear time horizons and sunset clauses should be established for SOEs' administrative, financial and infrastructural privileges, with a defined timeline by which first profits need to be generated and with a clear exit/bankruptcy option for failing SOEs.

- SOE privileges need to be limited to strategic areas where the private sector is not capable of investing. A clear strategy and public commitment is needed for rescinding such privileges, and for guaranteeing market contestability through independent regulation as soon as private investors are ready to follow SOEs into new sectors.

- There should be no SOEs in areas where private business is capable of doing the job in a competitive framework. The state should gradually divest such companies.

- Joint ventures with foreign and local capital should be encouraged in the SOE start-up phase to assure technology and skills transfer, diffusion of a performance-oriented corporate culture and local multiplier effects.

- Where feasible, SOEs should be exposed to foreign competition through a mandate to export their goods and services, and by being subject to domestic competition from foreign exporters. Measured expansion of operations into international markets can have a disciplining impact and generate performance signals that become valuable especially if the domestic playing field is not level.

- If it is politically not feasible to build powerful independent boards, it is better to staff boards with a cross-section of weak figures than with influential but meddlesome bureaucrats, especially if the latter are from the line agencies in charge of the sector at hand.

Broader political conditions for building successful SOEs have been uniquely apposite in the GCC, where political leaders have enjoyed autonomy in their use of incremental oil rents, where a generally pro-market economic ideology is dominant and where organised groups in bureaucracy and society that could interfere with SOEs' strategies and operations tend to be weak.

Nowhere else in the MENA region do all of these conditions appear to apply together, meaning that SOE-driven diversification is a more risky prospect in those countries. For them, the primary challenge remains reform of the existing SOEs.

Even under such less auspicious circumstances, many of the above-mentioned points are relevant, if only as a benchmark to understand local constraints. While the GCC experience of state-driven diversification cannot be easily reproduced wholesale, it provides valuable insights about institutional conditions of SOE success that go beyond formal corporate governance precepts. The latter are important, but they often need to be supplemented with design principles and "tweaks" that take into account the local political context and institutional limitations.

Notes

1. *www.industriesqatar.com.qa/IQ/IQ.nsf/en_Pages/en_AboutUs_GroupStructure*, accessed 30 August 2011.
2. For details, see the company's website at *www.bmhc.bh*.
3. *www.sabic.com/corporate/en/ourcompany/boardofdirectors/default.aspx*, accessed 24 August 2011.
4. *https://www.stc.com.sa/cws/portal/en/stc/stc-landing/stc-lnd-abtsaudtelc/stc-lnd-abtst-bodir* 24 August 2011.
5. The most recent board reshuffle occurred in August 2010 (Arab News, 22 August 2010).
6. *www.aluminiumbahrain.com/en/default.asp?action=article&id=33*, accessed 24 August 2011.
7. Industries Qatar, Annual Report 2010.
8. See *www.mubadala.ae/about/board_of_directors/*, accessed 24 August 2011.
9. As evident from May 2011 contract approval for Emirates' use of airport facilities in San Francisco: *www.sfethics.org/files/yyyymmdd_20100603_126_mayor_emirates_redacted.pdf*, accessed 23 August 2011.
10. SABIC already sold 30% of its shares in 1984, at the time an anomaly among public enterprises – and a practical impossibility in most of the other GCC states,

which did not have stock exchanges (Saudi Arabian Basic Industries Americas 2001: 76).

11. Algerian SOEs that have been formally corporatised have continued to follow public sector salary and promotion procedures (World Bank, 1994).

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