[Steffen Hertog](#)

The evolution of rent recycling during two booms in the Gulf: business dynamism and societal stagnation

Book section

Original citation:
Originally published in Hertog, Steffen (2011) *The evolution of rent recycling during two booms in the Gulf: business dynamism and societal stagnation.* In: Legrenzi, Matteo and Momani, Bessma, (eds.) Shifting geo-economic power of the Gulf: oil, finance and institutions. The international political economy of new regionalisms series . Ashgate, Farnham, UK, pp. 55-74. ISBN 9781409426707

The evolution of rent recycling during two booms in the Gulf: business dynamism and societal stagnation[1]

Introduction

Rentier states are not static systems. Even in a hypothetical ceteris paribus scenario in which levels of rent accruing to government remained unchanged over time, agents who receive the redistributed rents would have the option to accumulate them over time, resulting in progressively higher levels of resources relative to current income and hence a relatively higher level of independence from the state's current allocative decisions. This fact has gone largely unrecognized in the rentier state literature, which treats rentier states as static entities.[2]

The objective of the present chapter is to demonstrate the implications of this near-deterministic process for the political economy of the GCC monarchies, cases with a long and fairly uninterrupted tradition of rent recycling. It is elaborated against the background of important changes in the rent recycling process itself which serve to reinforce the autonomy of rent accumulators.

The chapter will focus mostly on the GCC private sector, as this includes the social agents which have benefited from rent recycling the most. It will compare its role during the boom-bust cycle of the 1970s and 1980s with that of the 2000s, analyzing shifting mechanisms of autonomy from and dependence on the state. A shorter section will contrast the experience of business with that of the general national populations in the GCC, which different from the rent-accumulating capitalist class have mostly acted as rent consumers, explaining their stagnant position in the GCC political economies.

Based on this comparison of accumulation vis-à-vis consumption, the chapter will expound how the evolving linkages of business in the international political economy, and the absence thereof for the population at large, impact their respective negotiating position vis-à-vis the GCC rentier regimes. I will conclude with some speculation on how these strategic positions might affect the conflict over the main socio-economic issue that will have to be negotiated between regimes, capitalists and the national population in the coming years: the integration of nationals on private labour markets.

Saudi Arabia will serve as the main empirical example, but departing from (quite) different baselines, the same causal story expounded here also applies to other GCC states, which will be discussed more briefly.

The private sector during two booms

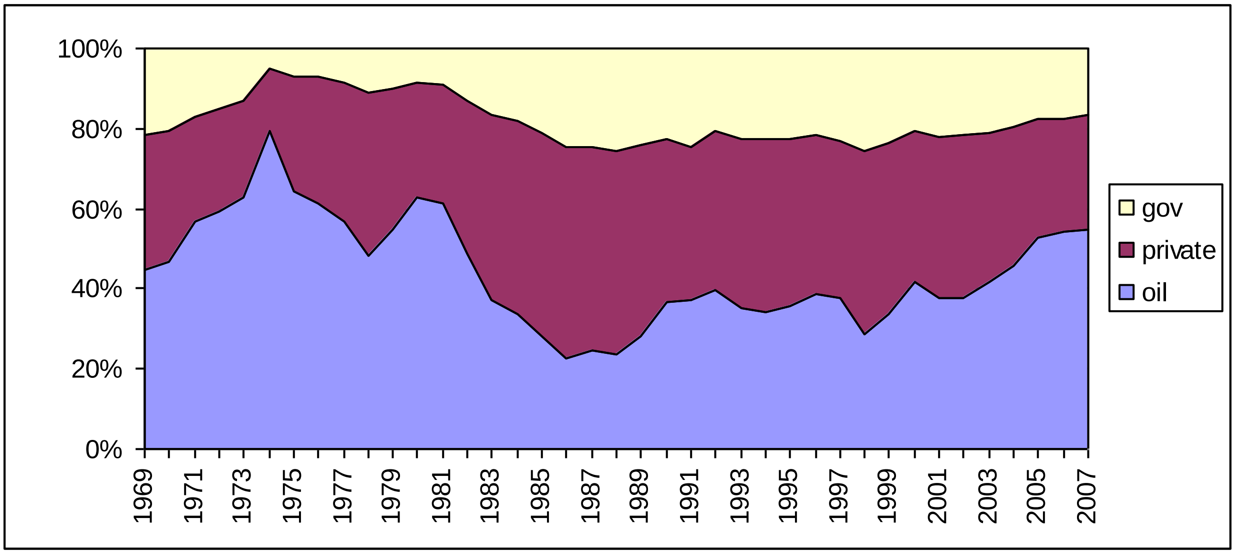
During the recent boom, oil prices in real terms reached peaks comparable to those of the 1970s/1980s boom period. With GCC production levels during both periods roughly comparable, rents accruing to GCC governments returned to the heights of the first boom. But while during the 1970s the oil sector crowded out most of the rest of the economy in relative terms, during the recent boom both government and private sector have kept larger shares of GDP (see figures 1 and 2 below for Saudi and Kuwaiti data). On the face of it, even in boom times, the non-oil economy remains more important. Much of the rest of the chapter will demonstrate that economic activity by government as well as business has undergone important changes also in qualitative terms.

---

[1] I would like to thank the participants of the CIGI workshop on the geo-economic of the Gulf for their comments on a first version of this paper and Nathan Hodson for his help with data.

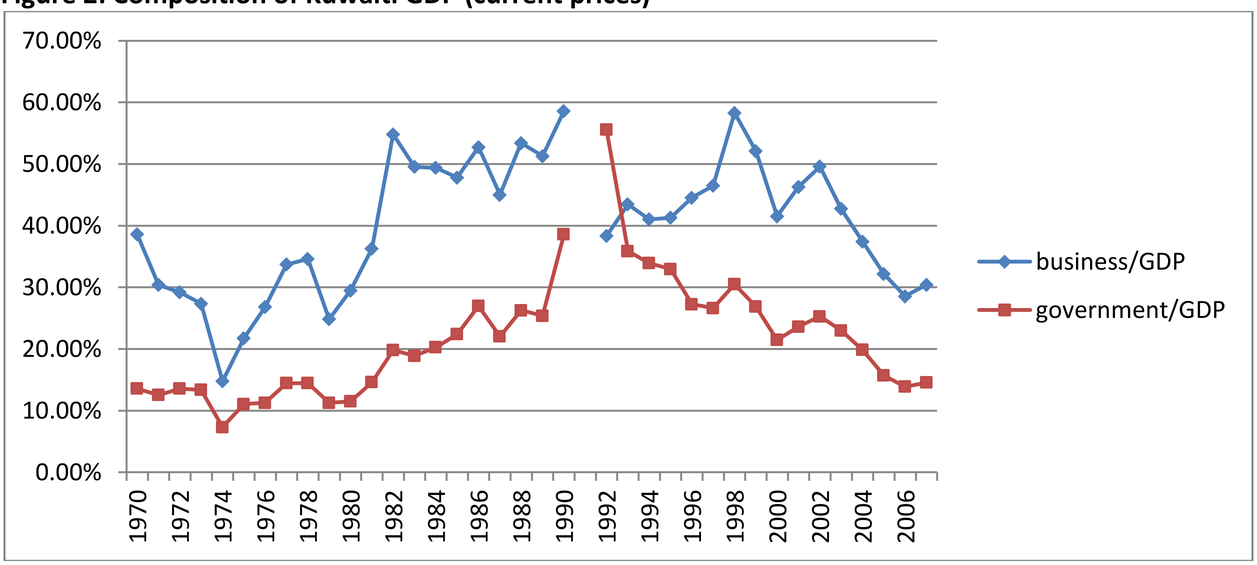
[2] For one important exception discussing rent accumulation and professionalization in the Saudi private sector, see Luciani (2005).

Figure 1: Composition of Saudi GDP (current prices)



Source: SAMA

Figure 2: Composition of Kuwaiti GDP (current prices)



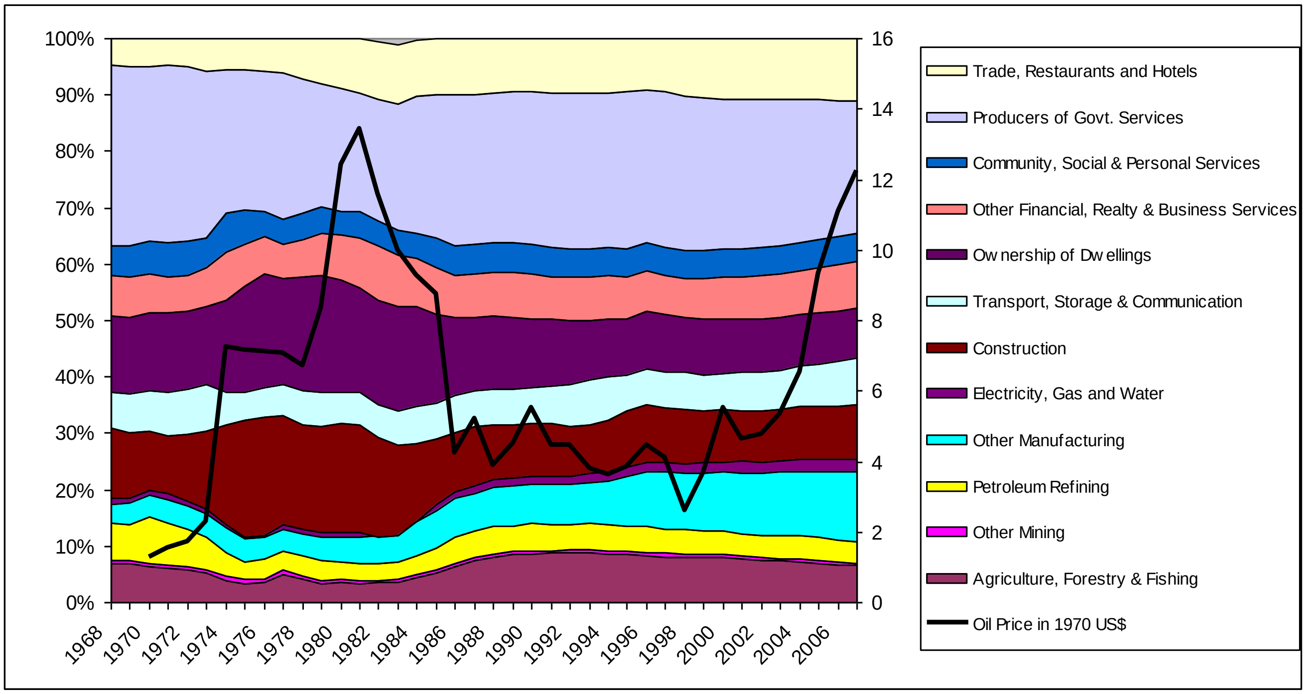
Source: Central Statistical Office

Even if the private sector is relatively larger, it could still rely mostly on rent-driven government spending. Could it be that the larger share of business in GDP simply is driven by larger government activities? Figure 3 below provides for a first eyeball test of this hypothesis on the Saudi case. We see that in the 1970s and 1980s, the higher oil price was correlated with a relative expansion of typical "boom-time" sectors like construction and ownership of dwellings. The immediate transmission mechanism probably was that oil prices allowed for higher levels of current and capital government spending as evidenced in figure 4.[3]

[3] Current spending is used mostly for salaries, transfers, subsidies, operations and maintenance, while capital spending goes into physical assets such as roads, building, machinery etc.

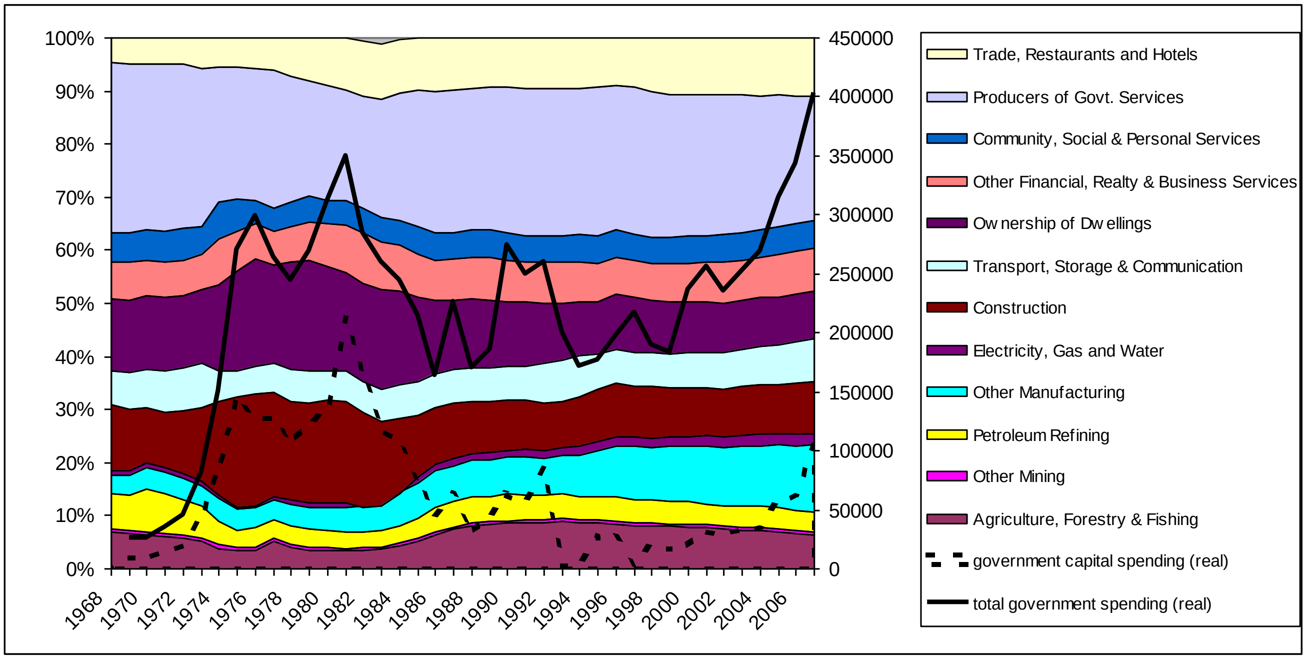
During the second boom period in the 2000s, however, the composition of GDP has changed much less drastically. This seems to indicate that higher oil prices and greater government spending do not lead to the kinds of sectoral distortions witnessed three decades before (and sometimes associated with the Dutch Disease in terms of an unsustainable boom in non-tradables). The impressionistic reading is that the structure of the economy is more robust to short-term demand shocks and on a steadier growth path. On the same grounds, the recent boom, even if it should be followed by a period of reduce spending, is unlikely be followed by a collapse of real estate-related sectors as has happened in the second half of the 1980s in the wake of rapidly decreasing government project spending.

Figure 3: Oil price vs. composition of non-oil GDP in Saudi Arabia



Source: SAMA

Figure 4: GDP composition vs. government spending in Saudi Arabia

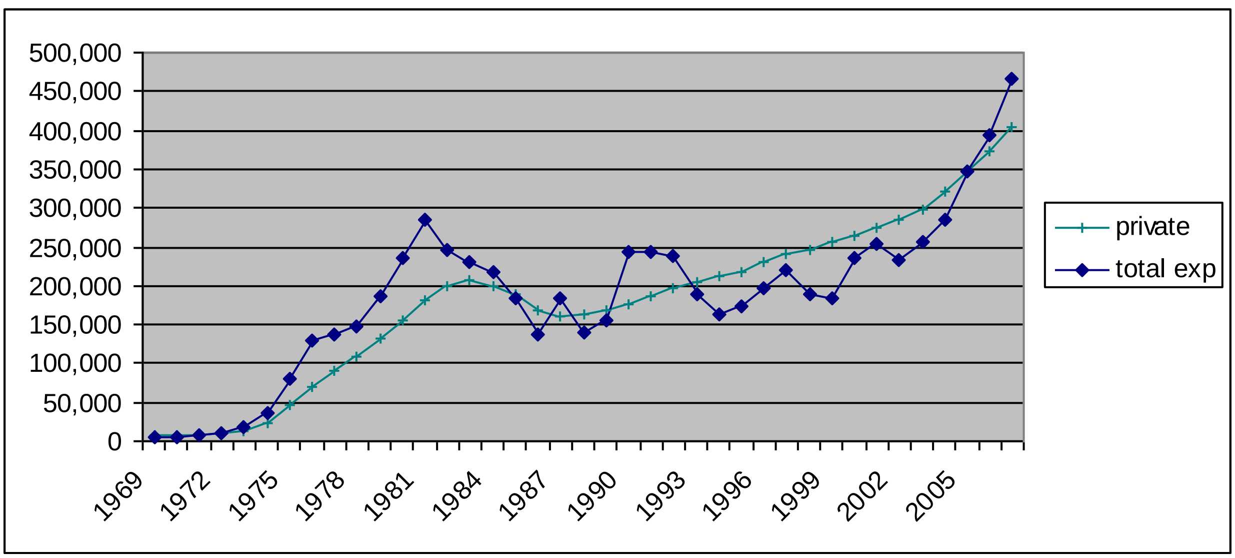


Source: SAMA

The evidence is graphical, not statistical. Moreover, while the relative composition of economic activity might be less affected by state spending, perhaps the absolute level of business activity still is? Has the impact of state spending on business growth changed from the previous boom to the recent one?

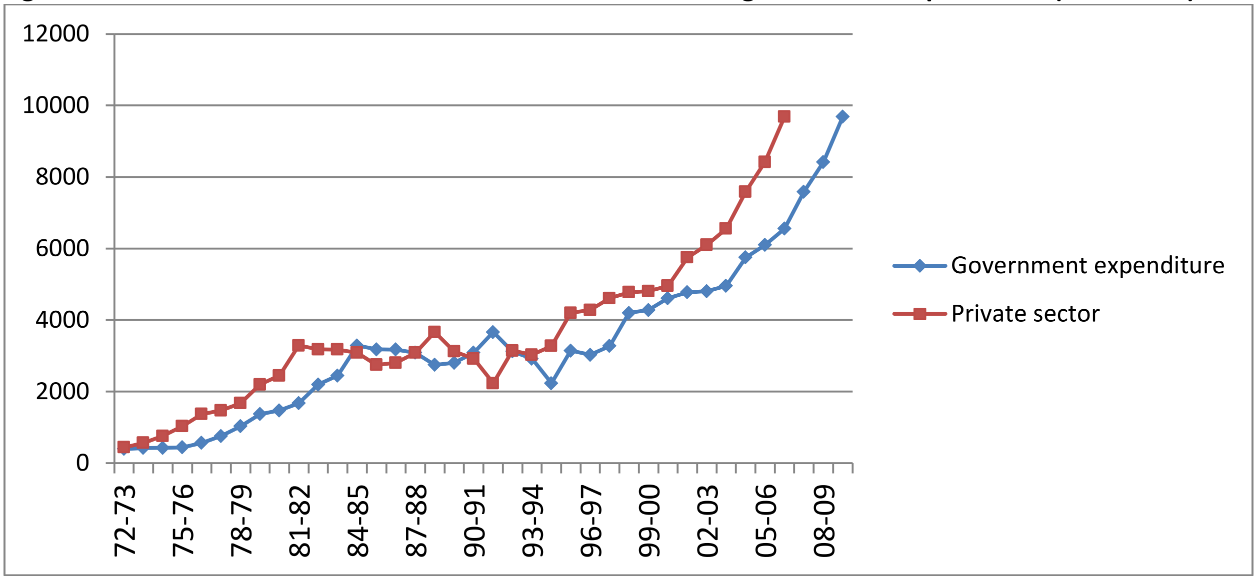
Impressionistically, the absolute size of the private sector seems to closely follow state spending in both Saudi Arabia and Kuwait:

Figure 5: Private sector contribution to Saudi GDP vs. total government expenditure (million SR)



Source: based on SAMA data

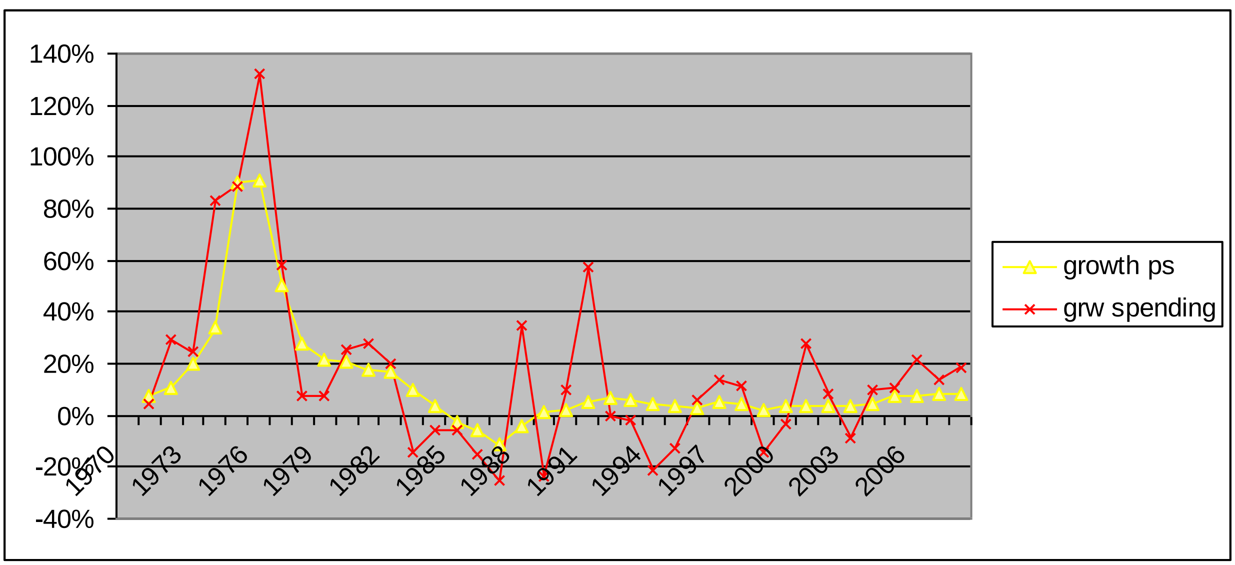
Figure 6: Private sector contribution to Kuwaiti GDP vs. total government expenditure (million KD)



Source: based on Central Statistical Office data

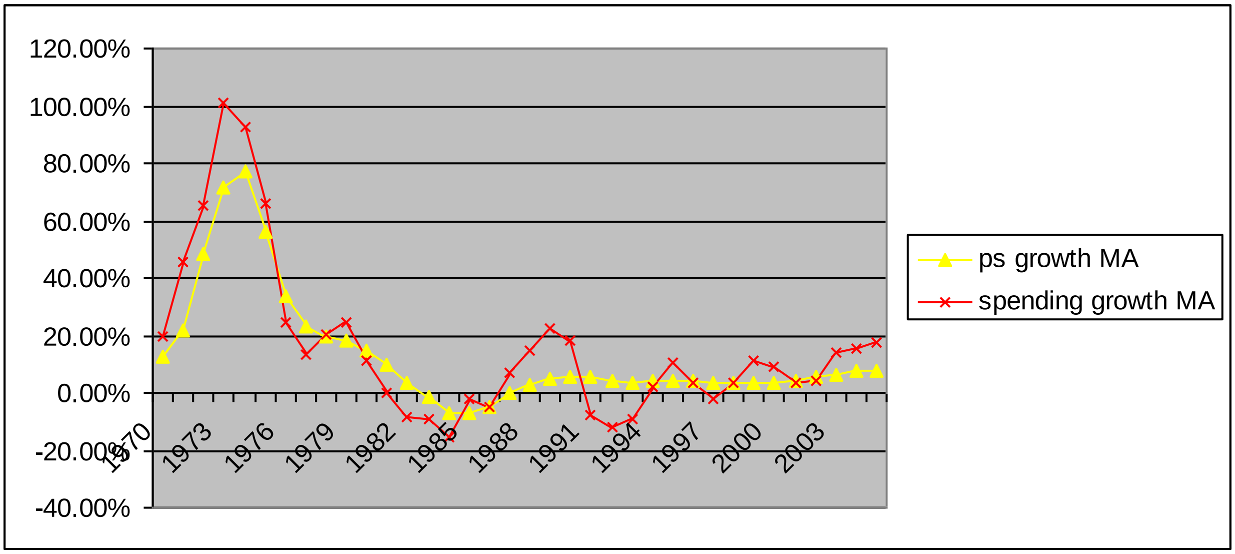
To gauge the causal impact of state spending – at least in the short run – we rather have to look at growth rates, however. Figure 7 seems to indicate that Saudi business growth tracked the growth of state spending only up to the mid-1980s, with subsequent fluctuations in state spending affecting business growth rates much less.

Figure 7: Growth rates of Saudi private sector contribution to GDP & total government expenditure



To make sure annual fluctuations don't obscure mid-term effects, we can look at a 3-year moving averages of spending and business growth (figure 8):

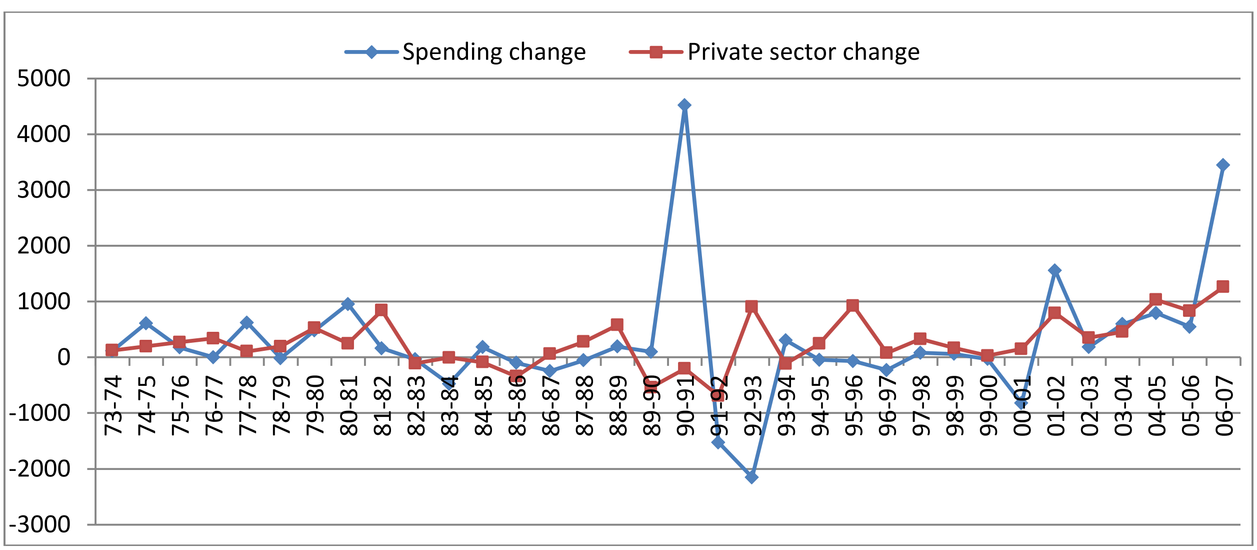
Figure 8: Three-year moving averages of growth rates, Saudi private sector contribution to GDP vs. total government expenditures



The same pattern seems to obtain: a tight correlation during the first boom period and a much steadier, more autonomous private sector growth path after the mid-1980s.

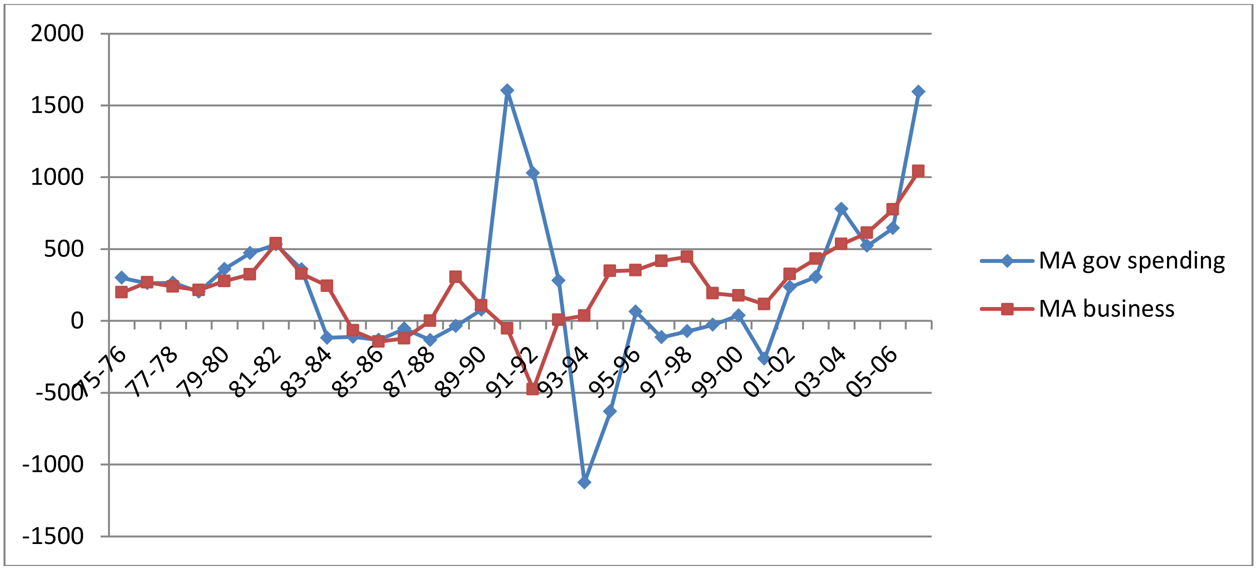
The graphical evidence for Kuwait is less clear when it comes to year-on-year changes:

Figure 9: Annual changes of Kuwaiti private sector contribution to GDP & total government expenditure



The pattern for three-year moving averages is somewhat clearer: An obvious correlation seems to emerge in the pre-Gulf war period, while the correlation afterwards is less straightforward.

Figure 10: Three-year moving averages of growth rates, Kuwaiti private sector contribution to GDP vs. total government expenditures



The argument has, again, been impressionistic. Ordinary least squares time series tests on the Saudi data show, however, that the short-term per unit impact of change in government spending on business activity is indeed much lower in the post-1985 period than in the 1971-1985 boom era. This is true for both current and capital spending, and for the impact of the two on both total business activity as well as on individual sub-sectors such as the ones illustrated in figures 3 and 4. Interestingly, the impact of the "lagged" change in business growth is much larger in the post-1986 period, i.e. in any given year, business growth is strongly influenced by where it was in the preceding year. There hence seems to be a much stronger, continuous momentum of business growth that is less affected by short-term fluctuations of state spending.

In the Kuwaiti case, the statistical evidence is somewhat weaker, but again in line with the results of the "eyeball" tests on the above graphs: Year-on-year changes in government spending seems to have no statistically measurable effect on business growth either before 1989 or after 1993,[4] possibly because the Kuwaiti budget year is out of sync with the calendar year in which GDP figures are reported. By contrast, the three-year moving averages however are strongly correlated, but more so before 1989 than after 1993. The general conclusion seems to be that the immediate impact of state spending on business growth has attenuated since the 1980s. Existing statistical research on (somewhat older) Saudi and Omani data reaches similar conclusions (Kireyev 1998, Treichel 1999).

<u>The private sector and the demand structure of the GCC economies</u>

Although it is likely that long-term business growth still is driven by government spending to a significant extent, business is less sensitive to short- to mid-term fiscal policy decisions. As most politics – notably of the fiscal variety – is negotiated in the short term, this appears an important finding. Business is no more all-dependent on government spending decisions and seems to cater to a more significant private demand at least in the short run.

[4] Due to the Iraqi invasion in 1990 and the idiosyncrasies of post-war rebuilding (high state expenditure accompanied by business caution), the years 1990-92 have been left out of the tests.

Private demand in the GCC rent economies is a curious beast, however, as much of it is in fact indirectly fed by the state: In most cases, the majority of national employees – who tend to be the best earners among the total population – are on the public payroll, and public sector salaries on average are better than private sector salaries on all levels of education.

The statistical results on Saudi Arabia cited above indicate that even current spending – which consists to a significant extent of wage spending – has a much reduced impact on business growth in the post-1986 period. This could be for two reasons:

a) As current spending in the last three decades has grown fairly gradually, without much variation in its growth rate, its potential impact is not picked up well by statistical tests, which would require more variation on the current spending as independent variable.

Or

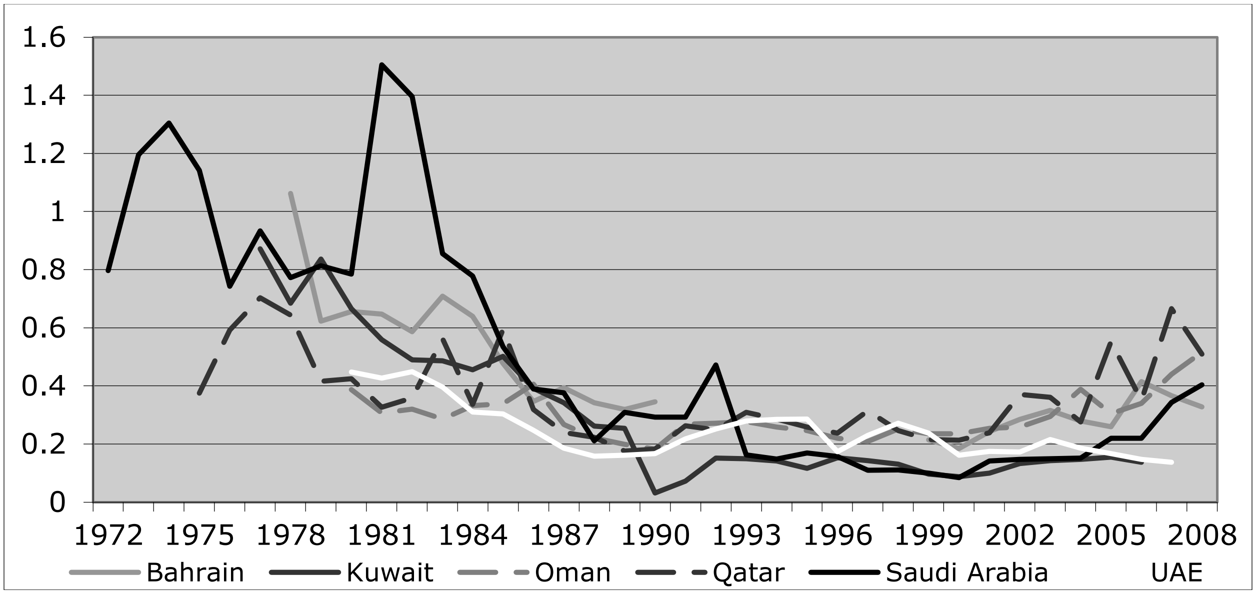
b) Current spending feeds to business activity mostly through the (re-)spending of salaries, which is not instant and does not track current spending closely in the short-run, but rather smoothens it over time.

Both reasons are quite plausible but cannot be established with certainty. What more certain, and arguably more important, is that the ratio of GCC governments' current to capital spending these days is considerably larger than during the 1970s boom, when payrolls were smaller and public sector maintenance costs lower, meaning that most available money could be spent on projects.

Much of business growth during the 1970s was indeed driven by government capital spending, which is usually translated into business activity through direct procurement of capital goods and various types of contracting arrangements. While GCC capital spending has increased again with the recent boom, it is in most cases still much smaller relative to current spending than in the 1970s, the lion's share of which in turn consists of civil servants' salaries.[5]

[5] The one case with the highest ratio, Qatar, is incidentally the one with the least developed private sector and an economy that is mostly driven by state activities.

Figure 11: Ratio of government capital to current expenditures in the GCC[6]



Sources: ESCWA, national sources, IMF

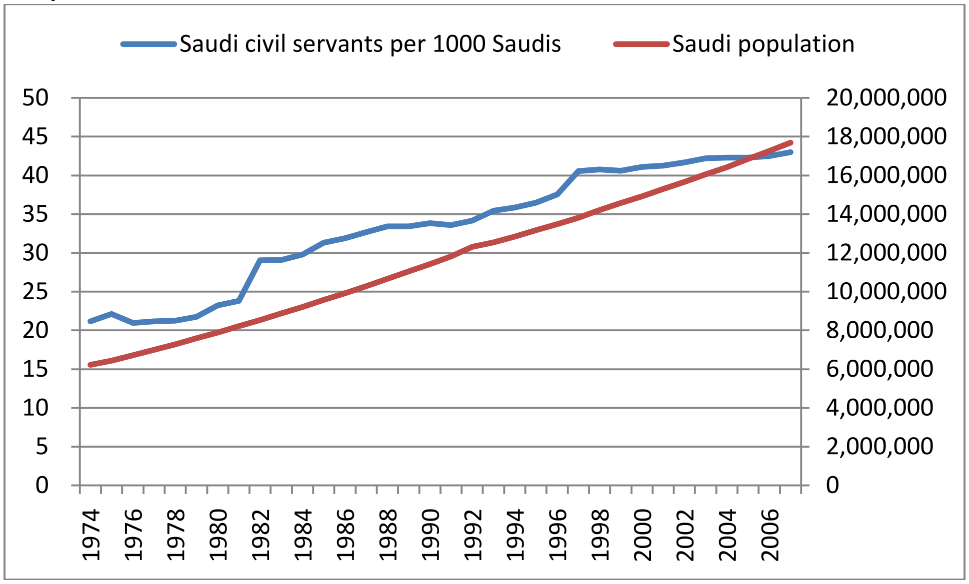
The extent to which the Saudi government in particular is willing to distribute resources through bureaucratic salaries becomes salient when we look at the share of Saudi civil servants in the total population (figure 12), which has continuously increased since the 1970s, despite the rapid growth of the population from about 6 million in 1974 to 18 million in 2008 – and despite uninterrupted fiscal deficits from the 1983 to the year 2000. Even in 2009, when government capital spending had picked up massively, a full 43% of total government spending were estimated to go to salaries.[7] The international average is closer to one fifth of total spending.[8]

[6] The graph is based on Hodson (2010).

[7] In the pre-boom era, the figure was above 50% (Sfakianakis 2009, p. 7).

[8] [and even less for mid-income countries, the category in which KSA has traditionally been placed (IMF 1995).

Figure 12: Density of Saudi civil service employment (left hand side) vs. total population (right hand side)



The majority of Saudis still works in the public sector; given higher salaries there, consumer demand in the kingdom hence is still predominantly fed through state salaries. The official figure of about 900,000 public sector employees is slightly larger than the official figure of registered Saudi workers in the private sector. The former only includes individuals registered with the Ministry of Civil Service however; the actual number of state employees, including security services and the religious sector, has been estimated as twice as large, at 1.8 million individuals.[9]

This means that even if government spending decisions have a much attenuated short-term impact on business growth patterns, indirectly most of the demand on the Saudi private market still is fed through state spending. The economic character and political implications of this spending have changed significantly, however: First, current spending tends to fluctuate much less dramatically, as most of it is on de facto non-discretionary items.[10] While the Saudi government managed to reduce capital spending radically in the 1980s (see figure 11 above), thereby wreaking havoc with the Saudi contracting sector, it did not manage to do the same with politically touchier current spending – which directly affects the livelihood of the Saudi populace through salaries, subsidies and public services.

So even if we ignore the statistical results cited above and assume that reduced current spending could theoretically have a strong negative impact on business growth, in the absence of an existential fiscal crisis, actual current spending is likely to remain on a high plateau. Capital spending will probably remain subject to stronger fluctuations, but is less important for business than in the 1980s. A repeat of a business crisis of 1980s proportions therefore remains unlikely for many years.

[9] Sfakianakis 2008. Expatriates in Saudi Arabia, which constitute about a third of the total population, are mostly employed in the private sector. This means that their consumer spending is mostly derived from private salaries. Average salaries of expatriates however are much lower than those of Saudis – less than a third on average according to Ministry of Labour data – and they tend to save and remit abroad a large share thereof, making them less important for consumer demand on the Saudi market. The situation in other GCC countries is comparable.

[10] On the "stickiness" of entitlement spending in Saudi Arabia over the decades see chapter 4 of Hertog (2010).

The second important implication of the different state spending mix is that although the GCC economies might fundamentally remain driven by rent-fuelled state spending, the state tends to have less control over how the rents are recycled: While capital spending almost by definition requires discriminatory decisions of which private contractors to choose, and which ones not to, at the point when public salaries get recycled into the private economy through diffuse, private consumer decisions, the regime has much less control over which private actors benefit. So while significant segments of the general population remain directly dependent on the state through its (sometimes discretionary) employment decisions and salary payments, much of business is one step removed from direct distributional decisions by the state, instead catering to private if ultimately state-caused demand.

The GCC monarchies hence still are rentier economies; but politically speaking, there is less of a direct rentier relationship between government and business. This is a distinction of degrees and the extent to which direct state dependence has been attenuated differs strongly between the six countries, arguably most in Saudi Arabia and least in Abu Dhabi and Qatar. The trend since the 1970s has been the same everywhere, however. To the extent that consumer spending is more important for business than direct contracting with the state, markets are likely to be more competitive and contestable due to the diffuse and less political nature of consumer decisions.

This is arguably one of the main processes that has led to the managerial maturation of the main Saudi business groups that survived the 1980s bust, and which has prepared the leaders among them to compete in neighboring markets and, sometimes, overseas. None of this is to say that a large business group could thrive in the GCC if it drew the ire of regime leaders; there remain many non-fiscal, bureaucratic and regulatory instruments with which regimes can influence a company's fortune. Nonetheless, today it is a lot easier to compete when the ruling elite is *indifferent* to a business group, as the state contracts traditionally used to mete out favours have ceased to be the sine qua non of success.

Capital accumulation and the private sector's returns to public services

We have shown that structures of rent distribution by GCC regimes have changed significantly since the 1970s oil boom. Business at least in the short run seems to be less vulnerable to fiscal policy decisions than it used to be, for at least three reasons: reduced government spending elasticity of business growth, more stable government spending patterns, and the predominance of current spending, which feeds into business growth diffusely and indirectly rather than through direct, discretionary regime decisions. Business has significantly improved its relative autonomy.

There is a further, more general and less contingent mechanism through which business has improved its autonomy over time: its gradual accumulation of capital by virtue of its position in the rent recycling circuits. Due to its generality, this mechanism is probably the most relevant for the broader rentier state debate.

Even if we presumed that rent-seeking and distribution structures remained fixed, the distribution of resources in a rentier system is bound to change over time: While the distributional state is forced to continuously disburse its largesse, the recipients of state-provided rents can in principle accumulate resources to the extent that they receive rents above their mundane consumption needs. In the absence of major social unrest and existential economic crises, privileged rent recipients should hence become progressively richer, while the state's fiscal situation is subject to the vagaries of the oil price and of past, politically locked-in spending decisions.

Note that while in "production states"[11] state income will tend to grow with the riches of society thanks to a system of taxation, this is not the case in rentier systems, where in principle, and paradoxically, societal riches can outgrow the resources of the state. Conspicuous consumption and disastrous investment decisions mean that this process of private rent accumulation is not automatic for every individual rent recipient, but given basic political and socio-economic stability, it is hard to see how it should not obtain in aggregate and in the long run. It has important political ramifications.

Let us imagine a business partaking in the rent recycling process over several decades and, for the sake of simplicity, let us assume that the government-provided rents accruing to it on an annual basis are stable over time.[12] Let us also assume that the annual profit of the business is re-invested, either locally or internationally, but the annual returns on these reinvested profits are used for consumption purposes by the business owner; the two hence cancel each other out.[13] In such a scenario, after a few decades of rent-seeking, the immediate access to rents would be much less important than in the first year. The returns on the total accumulated assets after three decades – equivalent to 30 years of profits – are very likely higher than the annual, rent-based returns of the business.

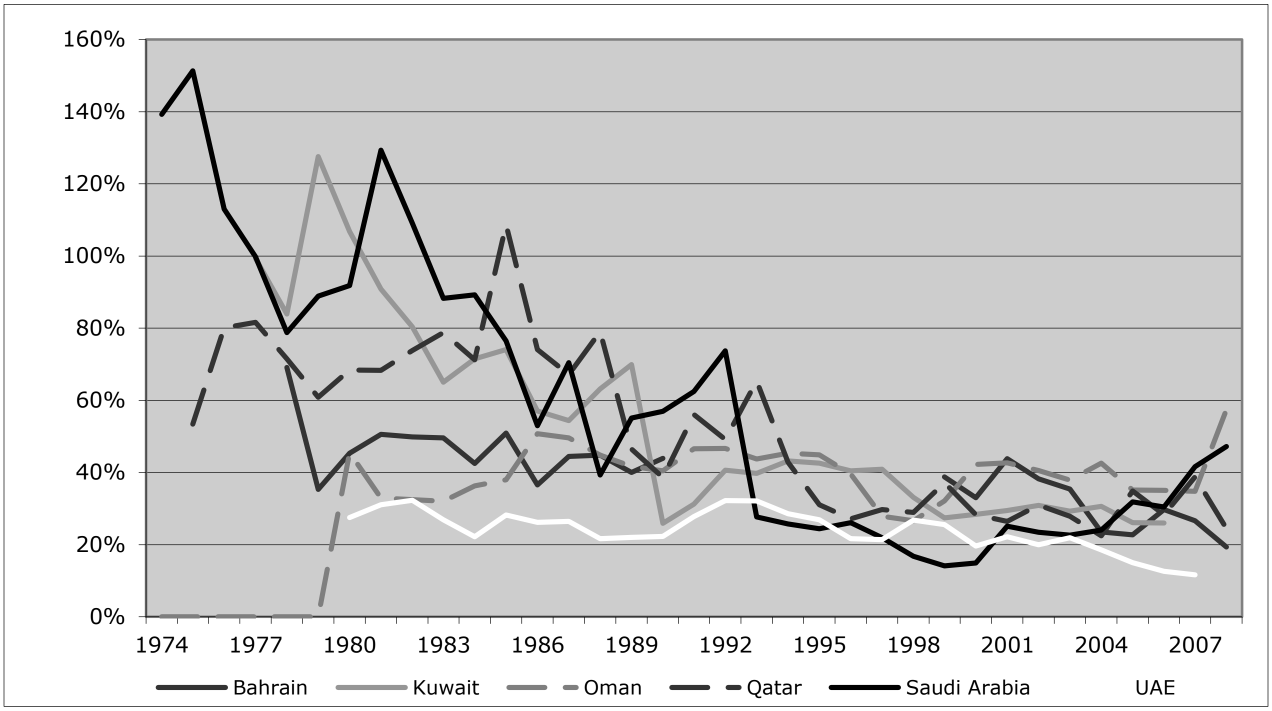
This is of course a highly stylized example, but it illustrates the basic process at work: The longer one accumulates, the less important access to the government-supported rent recycling process becomes, especially if one lives frugally, which many GCC business families do. It also illustrates the main variables determining how quickly this process unfolds in practice: levels of private consumption, rates of return, as well as changes over time in rent flows (decreasing rent flows – as after 1983 – accelerate it, while increasing rent flows – after 2000 – slow it down or reverse it).

Above we have argued that accumulation, though still rooted in rent recycling processes, has increasingly been happening thanks to businesses' catering to private consumer decisions. This augments the autonomy of businesses from government to the extent that they operate on private, generally more competitive markets. The accumulation argument presented here is more general in the sense that it applies no matter whether the rent circuit is tapped thanks to competitive activities or through pure, government-oriented rent-seeking. Even for pure rent-seekers, rents can become less important over time if they incrementally stash away their returns, preferably in overseas accounts.

In fact, many Gulf business families have kept much of their money in the local economies and have reinvested it actively.[14] This corporate reinvestment process, together with the increasing orientation to private markets, has led to a gradual professionalization of many business groups. The increasing contribution of the private sector to national gross fixed capital formation (see figure 12) is a natural result of this process. Much of this investment goes into fairly straightforward real estate projects that require limited expertise, but an increasing share has gone into more demanding projects that used to be almost the sole domain of the public sector.

[11] For the distinction of allocation and production states see Luciani (1990).
[12] This is less unreasonable an assumption than it might seem given the instant riches created in many cases by the 1970s boom and the long-term privileges and stability that many businesses have enjoyed subsequently.
[13] This would of course mean passing from a very frugal initial existence to a lavish life further down the road; in a more realistic scenario, the business owner would first consume more than the returns on reinvested capital, but as his reinvested capital grows, sometime reach the point where consumption would be less than returns on reinvested capital. Such nuances are irrelevant for the basic argument.
[14] On the relative patriotism of the Gulf business classes Luciani 2005.

Figure 12: Share of government capital spending in national gross fixed capital formation[15]



Source: ESCWA, national sources, IMF

Outside of the trade sector, the rentier state had steamrolled over traditional business activities soon after the onset of oil production, marginalizing or putting an end to the private provision of education, health, infrastructure, water and electricity services that had started to unfold in the pre-oil age.

Since the 1980s, and more so the 1990s and 2000s, Gulf business has been gradually returning to such public service and infrastructure provision, having acquired capital resources as well as managerial capacity to once again rival the state apparatus. The independent water and power projects, private schools, universities and hospitals that have been mushrooming all over the region are testimony to this gradual rebalancing of capacities. In several service sectors, veritable multinational enterprises have emerged in the Gulf, including Zain in telecoms or Agility and Aramex in logistics.

The recent crash has put many private projects on ice for the time being, as businesses have become risk-averse and local banks even more so, but it has not reversed the fundamental trend. Governments remain committed to the increasing delegation of public service functions to the local capitalist class. Full state funding for recent utility projects has been explicitly framed as a stopgap measure to give way again to public-private partnerships once the storm has been weathered.

The competition for utility partnerships and public service licenses has generally become stronger and even if the playing field is not fully level, no local business groups can hope to obtain a major deal unless it brings significant expertise to the table. While short-term direct dependence of business on

[15] The graph is based on Hodson (2010). The ratios above 100% for some cases in the 1970s are probably due to inconsistencies in national fiscal and national accounts statistics; unless the inconsistencies have changed massively and consistently over time, this should not affect the general trend we observe.

government spending has decreased, government in turn has developed a greater need for the cooperation of the private sector, reflecting a gradual but discernible shift of the respective political bargaining positions.

The exit option

In a world of international capital mobility, capitalist accumulation in the GCC has a further political dimension that works out in favour of business: The "exit option" for private capital in the GCC has become much more important since the 1980s:[16] Private players can threaten to withdraw their resources from local markets if they are unhappy with local policy, and the more important these resources are relative to the current income created by the quotidian rent circuit, the more credible this threat is. It can be "instrumental" in the sense that businesses and private sector associations explain to governments the impact that undesirable regulations have on their willingness to invest, as has happened repeatedly through policy statements emerging from business meetings such as the Riyadh Economic Forum. It can also simply be "structural" in the sense of businesses silently voting with their feet by withdrawing or not reinvesting capital, even if this is not intended as a political statement.

In the recent decade or so, GCC governments have explicitly recognized this threat and bargaining chip: Capital flight to neighbouring countries and the risks of falling behind in terms of regulatory reform are often referred to in public reform statements as well as internal policy reports.[17] In this context, Dubai – despite all its excesses – is often mentioned as benchmark and has indeed become a haven for GCC business players seeking refuge from heavy regulation in their home markets. Probably the highest-profile case of a (mostly) private company voting with its feet however was the relocation of telecoms giant Zain's headquarters from Kuwait to Bahrain in 2007: a slap in the face of the Kuwaiti government which had been struggling to update its business regulations at the same pace as its neighbours. A similar move by an enterprise of this scale would have been unconceivable two decades earlier.

As Gulf business families' ratio of overseas resources relative to local current income has grown over time, some of the large families have taken to actively managing their overseas resources and are increasingly engaged in foreign direct investment. The more this internationalization proceeds, the less potent threats and demands from local governments are. There are no good estimates of the total volume of the Gulf's private overseas assets, but they are clearly much more significant this time around than during the first boom and are increasingly rivalling public overseas assets.

Behind closed doors, some major players have been heard saying that they are ready to abandon their local operations altogether if the business environment turns too inhospitable. This is effectively what some business actors in more hostile (semi-) rentier environments such as Libya and Syria have already done, where parts of the bourgeoisie keep and manage their resources almost completely overseas. The rate of capital repatriation is effectively a vote of confidence in the local political system.

Private GCC capital has also become a factor of soft power in the wide Middle East region: It has played an important role in the economic revival in Jordan and Egypt, and some of the more venturesome Gulf groups are committing increasing resources to the capital-starved Syrian real estate, industrial and banking markets.[18] Investment agencies of poorer MENA states have taken to organizing roadshows in the Gulf to attract Gulf capital to their liberalizing markets.

---

[16] On the concept of "exit" see Hirschman 1970.
[17] See for example SAGIA 2003.
[18] [See the contribution of Bessma Momani in this volume; see also Steffen Hertog [MEP]]

This process of regional integration has again been put on hold by the current bust, but is likely to resume in the coming years: Demographic growth and infrastructural deficits, combined with an immature local capitalist class, make neighbouring countries a natural destination for Gulf capital. The channels for intra-MENA capital movements are far more variegated than twenty or only ten years ago: Most currencies have become convertible, most service and manufacturing sectors have been opened for foreign investment, banks and utilities are slated for privatization, stock markets have been created or re-opened, and a regional private equity industry as well as a new class of regionally oriented investment funds have come into being.

Business in politics

All these factors have given business a stronger role in economic policy-making; consultative structures between government and business have become increasingly formalized through the integration of chambers of commerce and individual business representatives in the debate of drafts laws. This does not mean that business is ready to play a political role in a strict sense, however: It appears to have no interest in political change whatsoever and largely abstains from electoral politics in the cases where meaningful elections take place. Even in economic policy matters, it remains a policy-taker on most issues, usually acting as veto player rather than through the development of its own policy proposals. It tends to leave the development of new sectors to less risk-averse state-owned enterprises. Despite its general managerial maturation, its own governance structures – just as those of GCC ruling elites – have changed little at the core, which remains family-dominated and informal in most cases.

Perhaps the absence of major state-business fault lines and the generally pro-capitalist policies of GCC regimes explain this relative passivity. In the case of a major conflict, however, a professionalized capitalist class with large overseas capital resources would have a very different bargaining position from three decades ago.

The one policy area in which serious state-business conflict appears to be brewing is that of labour nationalization: With bureaucracies overstaffed and current spending on wages already locked in on a very high level, regimes demand that businesses share more of the burden of employing nationals. With higher reservation wages, much better de facto labour rights and little by way of practical education, the employment of nationals threatens to impose a significant burden on a business class used to an almost unlimited influx of cheap and pliable foreign workers. Due to continuing demographic growth and pervasive underemployment of nationals, the battle over labour nationalization is likely to be the main socio-economic issue for decades to come.

As the problem is only going to become more pressing, it could prod GCC businesses into serious collective policy bargaining. Structurally, forcing the employment of nationals on private business is equivalent to taxation: It increases business costs, while alleviating pressure on the public purse, which needs to spend less on over-employment of idle citizens.[19] This logic, independent of whether business players are fully aware of it or not, makes labour nationalization a fundamental challenge to existing rentier state structures and will make it a highly political issue. Although no formal imposition of taxes would have to take place, successful nationalization of labour markets could to some extent make

[19] This is the case independent of whether nationalization is enforced by sectoral or national quotas, by limiting certain jobs to nationals, through quantitative limits on foreign labour, or through fees on imported workers (while only the latter amounts to formal taxation).

“production states”[20] out of the GCC allocative states, through a) a de facto shift of the fiscal burden from government to business and b) through the growth of “real” private demand, i.e. a demand fed by wages that are paid to increasing numbers of nationals in the private sector. This would in turn attenuate even the indirect and long-run dependence of local business on government spending.

It is not clear what, if anything, business could demand in return for a larger contribution to national employment. A deeper integration into policy-making structures with a more formalized veto role, and the delegation of certain regulatory functions to business associations are conceivable demands. Gulf business would however have to get its own organizational act together before any such steps could be undertaken. In any case, if nationalization is imposed in a ham-fisted and top-down way – as it has been thus far – it is more likely to lead to capital flight than to any new political dispensation between state and business. In this sense, the exit option of Gulf capital could have important economic consequences, but a limited impact on political outcomes.

<u>The populace during two booms: the political economy of current expenditure</u>

We have seen that Gulf business today has a position in the local and international political economy that is fundamentally different from the one it occupied in the 1970s. This has much to do with its opportunity to accumulate rents over a prolonged period. The following section will show that the position of most other rent recipients in the GCC countries has remained static by comparison: As the general population have acted mostly as rent consumers, their position in the Gulf political economy is essentially the same as three decades ago.

The bulk of the population remains directly dependent on the state through public employment and its consumption of various subsidized goods and services. Table 1 shows that in most cases, the majority of employed nationals in 2005 were still on the public payroll, while expatriates dominated private labour markets. Low-quality education and uncompetitive wage expectations keep most GCC nationals out of the private labour market: GCC results in international education benchmarking exercises such as PISA and TIMSS have placed them considerably below the global average and far below other countries with comparable per capita GDP. At the same time, they have to compete on a de facto internationalized labour market where low-skilled expatriate workers earn as little as 150 $ per month. While international capital market liberalization has by and large benefited the local business class, the integration of the GCC into the international labour market has had disastrous consequences for national labour.

Table 1: Employed individuals in the GCC in 2005 (‘000)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
Nationals	**106**	**319**	**208**	**64**	**1336**	**262**
% of total labour force	31%	18%	32%	8%	22%	9%
private sector	72	43	99	9	623	70
public sector	34	276	109	55	713	192
Expatriates	**231**	**1495**	**446**	**768**	**4809**	**2738**
% of total labour force	69%	82%	68%	92%	78%	91%
private sector	227	1401	423	601	4739	2538
public sector	3	94	23	167	70	200

[20] [GL]

Total labour force	***337***	***1814***	***654***	***832***	***6145***	***3000***
% of total population	47%	61%	26%	71%	27%	63%

Against this background, the paternal state still feels compelled to care of its citizens through public jobs and other types of handouts. However, at least in Saudi Arabia, Bahrain, Oman and the poorer UAE emirates, resources today are insufficient to provide a job to every male national of working age. Dependency ratios – the number of individuals depending on one salary – remain high, as relying on relatives' salaries is often preferred to entering the private labour market. As real wages in the civil service have often eroded in the course of the 1980s and 1990s, most families have limited savings, increasing their day-to-day dependence on government munificence.

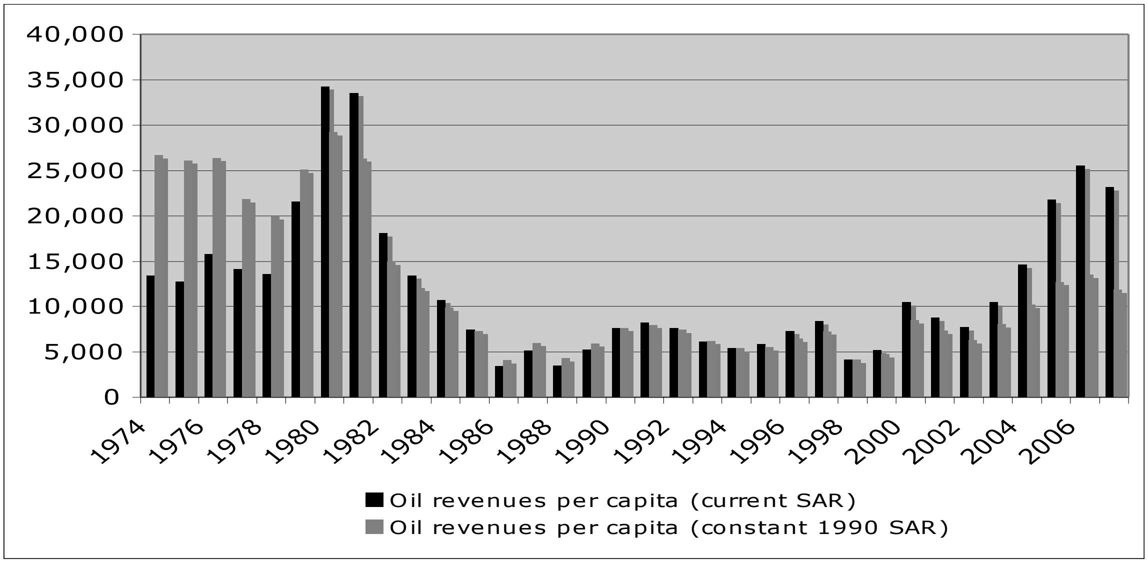
Attempts in the 1980s and 1990s to increase utility and public service prices have met stiff resistance, meaning that most services are still provided free or below cost. In contrast to GCC business, the rentier bargain between GCC regimes and their populations at large remains unchanged, in terms of both the mechanisms of distribution and the level of dependence. Paradoxically, the continuing dependence of a growing population on government spending increases the short-term autonomy of the private sector, as it implies distribution of rents through salaries rather than through capital spending.

International economic integration of the GCC has not worked out to the general citizenry's advantage: While suffering from international labour competition, it has no credible exit option. This is the case with labour in most other parts of the world too – but different from non-rentier countries, national labour inputs are not needed for most production processes in the Gulf. National labour's economic negotiating power vis-à-vis the GCC regimes therefore is restricted.

The recent boom has tempted most GCC regimes to increase distribution to national consumers: Wages, pensions and welfare payments have been increased; in 2006, Saudi Arabia further decreased its petrol prices. This would not be a worry if populations were still as small as during the 1970s boom. Population growth has been rapid however, putting distributional arrangements under strain at least in the lower-rent economies. GCC governments have generally been more cautious with their fiscal expansion during the 2000s boom, expanding government employment only modestly. But in fact, they have also had much less rents available *per national* than during the first boom. Figure 13 compares per capita oil rents in Saudi Arabia in current and real terms, showing that the annual resources available per capita in the 2000s have been about half of what they were in the 1970s and early 1980s.

Figure 13: Oil income per Saudi citizen, nominal and real[21]

[21] The graph is based on Hodson (2010).



Source: SAMA

Lower rents per capita will in turn increase the pressure on the relatively poorer GCC regimes to nationalize their private labour markets. It is here that the continuing dependence of national populations on current rent disbursals will come to haunt the private sector. For the time being, the reserves prudently accumulated during the 2000s have allowed GCC regimes to completely shield national populations from the international financial crisis – different from the business class, which due to its greater autonomy from the state and its larger and more internationally integrated resources was dealt a heavy blow.

In the mid-term, however, the rentier bargain for national populations in Saudi Arabia, Oman and Bahrain is likely to come under strain. The high levels of current spending that have been locked in over the years could put budgets under strain within a decade or so. If Saudi Arabia continues to expand its spending by 3% a year and oil prices remain on 2006 levels, it will have eaten up all of its official reserves by 2026. If it continues to expand spending by 15% a year, as it has been doing during much of the 2000s, its reserves would be gone by 2015 already.

It is this long-term fiscal logic that could involve regime, population and business class in a renegotiation of the rentier bargain in which the state would provide a lesser share of national employment, the population would enter the private labour market in larger numbers, and business would content itself with a costlier and, in the short run, less qualified workforce. The GCC economies would move further away from the pure rentier model. In the ensuing give and take, the state would lose some political control, and population and business some of their privileges. For a long list of reasons elaborated above, business likely would have the strongest bargaining position.

Hertog, Steffen. (2010) *Princes, Brokers and Bureaucrats: Oil and the State in Saudi Arabia*, Cornell University Press, Ithaca.

Hirschman, Albert. (1970) *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Harvard University Press, Cambridge (MA).

Hodson, Nathan. (2010) *Private Sector Dependence on Governments in Arab Gulf Economies*, working paper, ARI/GRC project on the role of the private sector in reform, Princeton/Paris.

International Monetary Fund (Fiscal Affairs Department). (1995) *Unproductive Public Expenditures: A Pragmatic Approach to Policy Analysis*, IMF Pamphlet no. 48, Washington, DC.

Kireyev, A. (1998) “Key issues Concerning Non-Oil Sector Growth.” In International Monetary Fund (Ed.), *Saudi Arabia’s Recent Economic Developments and Selected Issues*, Washington, DC, pp. 29-33.

Luciani, Giacomo. (1990) "Allocative vs. Production States: A Theoretical Framework." In Luciani, Giacomo (Ed.), *The Arab State*, University of California Press, Berkeley, pp. 65-84.

Luciani, Giacomo. (2005) "Saudi Arabian business: From private sector to national bourgeoisie." In Aarts, Paul and Gerd Nonneman (Eds.), *Saudi Arabia in the Balance*, Hurst, London, pp. 144-181.

SAGIA (Saudi Arabian General Investment Authority). (2003) *Izalat mu’wiqat al-bi’a al-istithmariyya fi l-mamlaka al-’arabiyya as-sa’udiyya* [Removing obstacles in the investment environment in the Kingdom of Saudi Arabia], Riyadh, May 2003.

Sfakianiakis, John. (2008) *Giving a Boost*, Saudi-British Bank (SABB) Notes, Riyadh, 7 February 2008.

Sfakianakis, John (2010) *Saudi Arabia's 2010 Budget: "Open for business"* , Banque Saudi Fransi report, Riyadh, 21 Dec ember 2010.

Treichel, V. (1999) “Stance of Fiscal Policy and Non-Oil Economic Growth.” In Mansur, A. and V. Treichel (Eds.), *Oman Beyond the Oil Horizon*, IMF Occasional Paper No. 185, Washington, DC.