Workers lay paving stones on a constructions site in Dubai, UAE on 7 May 2014.

The Private Sector's Role in the GCC Growth Model
by Khalid Alkhater

Production in the Gulf states is concentrated in two main areas: hydrocarbons (public sector) and non-tradables (private sector). The public sector extracts oil, redistributes rents, provides public services and employs citizens. Practically speaking, the private sector does not participate in production, but instead receives rent and recycles it through concentrating on three main activities: construction, services and trade imports.[1] This economic model is characterized by exploiting oil booms through maximizing short-term rent extraction from fiscal expenditures. A major drawback of this model is that the abundant supply of low-skill, low-cost foreign labor available to the private sector has obviated the need to invest in technological improvement and productivity enhancement.

Decades of declining productivity

Over the past four decades, much of the Gulf region's GDP growth has been driven by factor inputs expansion (mainly capital and labor). Indeed, total factor productivity (a measure of technological improvement) has actually been negative for most of the previous decade in four Gulf states. In comparison, developed economies like Singapore, Norway and the United States have all seen positive total factor productivity between 2000 and 2007 (see Table 1).

Table 1: The contribution of factor inputs to GDP growth (2000-2007)

Country	GDP Growth	Capital	Labor	Human Capital	Total Factor Productivity
Oman	4.4	3.3	1.8	0.4	– 1.1
Qatar	9.2	7.2	2.8	0.5	– 1.3
Saudi Arabia	3.5	2.0	1.9	0.7	– 1.0
Singapore	6.0	1.1	1.6	0.5	2.8
Norway	2.6	0.9	0.5	0.7	0.6
U.S.A	2.4	1.2	0.7	– 0.3	0.7

Source: Qatar 2010 IMF Article IV Consultation Staff Report.
Note: Data is listed in average growth percentage rates.

Moreover, the large influx of foreign labor to the Gulf states has profoundly altered the demographic and social structure of the region. Nationals are already becoming minorities in their homelands and make up only 9 percent of the total population in Qatar, 11 percent in the UAE, 30 percent in Kuwait and 47 percent in Bahrain.[2] In Qatar alone, the population has more than doubled from 800,000 to 1.6 million in the oil boom period between 2005 and 2009. Since then population growth has slowed somewhat, with the population reaching 2.6 million in February 2017. (For the sake of perspective, Qatar's population was 109,000 in 1970.) The region's population boom has strained housing, social services and general infrastructure in several Gulf states.

The rapid expansion of real estate and construction has drawn skilled national labor and capital to the assets sector. This further reinforces the concentration of the private sector in non-tradables, and in the meantime crowds out the export tradable sector and fuels asset price inflation. As is often the case, the asset boom bubble eventually bursts and a prolonged recession ensues until oil prices begin rising again. This was the case in both the 1980s and the 2000s.

With the completion of the oil boom cycle in 2014, the role of the private sector in diversification appears to have weakened, as is evident by the fall in productivity and the private sector's further concentration in non-tradables.[3] As such, the Gulf's economies seem to be trapped (between boom and bust cycles) in a low-technology, low-productivity equilibrium. As a result, the private sector provides little investment and employment opportunities for citizens. It neither participates actively in economic diversification nor provides a tax base for the state.

The rent-seeking private sector

The reality of the Gulf economies today appears to be at odds with the claims of national development plans that seek to build human capital and diversified knowledge-based economies with robust private sectors that generate employment opportunities for citizens. Rather, the private sector has performed worse over time and has lost its pre-oil historical role in development—it was more independent and had greater influence on the economic and political decision-making process when it used to provide a tax base.[4]

Today, the Gulf private sector has become a client of the rentier state. It is highly subjected to political patronage and closely connected to the political elites. Decades of accumulating capital, benefiting from gen-

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erous state spending and enjoying protective regulations has enabled the private sector to establish business empires and form barriers to entry to many business activities. As the private sector capitalizes on cheap energy and factor inputs, the rentier states deplete their non-renewable resources in the long run.[5] At the same time, the Gulf region's private sector has not utilized the advantages of cheap factor inputs in upgrading technology or industrial development.

Is reform possible?

For the Gulf region's private sector to play an active role in sustainable development, policymakers need to address a few issues. First, reforms should aim to dismantle monopolistic structures in the economies. This would support creating a dynamic and competitive private sector that can actively participate in technological development, diversification and generating employment for citizens.[6] In part, doing so would require reforming the outdated commercial agency system that appears to create monopoly power within narrow groups of individuals and families. Such concentrations of market power and wealth can potentially preempt the development of local infant industry through unfair competition. Some analysts have suggested that conditioning government support to the private sector on clearly-defined programs can help achieve progress in technological improvement, diversification, penetrating world export markets and generating employment.[7]

Second, reforms are needed to make it worthwhile for private investors to take on riskier ventures in the competitive world export market. This requires a shift from growth that is driven by factor inputs toward growth that is more reliant on human capital, innovation and technological development. To support these objectives, capital expenditures need to be directed more toward developing these areas.

Admittedly, these tasks are easier said than done. Such reforms require revamping the entire Gulf rentier-growth model of extracting resources and redistributing rent. The rent distribution mechanism, the most essential element of preserving the autocratic rentier state, underpins the region's political status quo. Structural reforms therefore face many obstacles—but change remains more important today than ever.

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[5] Hertog, "The private sector and reform in the Gulf Cooperation Council."

[6] Alkhater, "The Challenges of Oil Prices Collapse and Economic Diversification in the GCC Countries."

[7] Hertog, "The private sector and reform in the Gulf Cooperation Council."