Sohar Power Company's desalination plant in Oman. The company is 65% privately-owned. The power sector leads privatization efforts in the country.

Privatization in the Gulf States
by Paul Stevens[1]

In response to lower oil prices since the summer of 2014, the Gulf states have been devising wide-ranging economic reform plans. In most cases, central to these plans are options to privatize state-owned enterprises (SOEs). Many experts suggest that such privatizations could solve some of the region's underlying economic problems.

Extensive economics literature says that privatization is supposed to do many things to contribute to the greater economic good.[1] It is supposed to: 1) create more effective incentives to improve performance; 2) force greater accountability on senior management; 3) reduce government interference in business operations that gives management clear commercial targets unfettered by social policy requirements and 4) reduce the financial constraints on enterprises that have hitherto been dependent on increasingly cash-strapped governments. Yet much of this current discussion in the Gulf states disregards the negative consequences of privatization experiences elsewhere—particularly those in the UK—during the 1980s and 1990s.

Today, the lessons of privatization raise serious doubts about the effectiveness of possible similar programs

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in the Gulf states. The ideological arguments in favor of privatization were derived from concepts such as the economic theory of politics, theories of public choice and principal-agent analysis. By the early 1980s, these arguments had concluded that government intervention in the allocation of economic resources (this had been the norm in post-WWII Western economies) actually led to "government failure." This was regarded as more damaging to an economy's performance than "market failure," which was said to arise because of imperfect competition, information asymmetries and the presence of externalities and public goods. These views gave rise to what became known (disparagingly) as the Washington Consensus. This simplistic view of how an economy works has now thankfully been discredited. That being said, there can be little doubt that economic development in any economy still requires an active and vibrant private sector.

The UK case study

Privatization programs in the UK in the 1980s under then-prime minister Margaret Thatcher shows that simply switching from public to private ownership is not in itself sufficient to improve economic performance. Other necessary conditions are also required, including: 1) increased competition; 2) improved signals that force management to be responsive, flexible and inventive; 3) reduced government interference to allow management to maximize shareholder value and 4) effective and efficient capital markets to impose the necessary discipline on managers.

Economic liberalization without political liberalization and reform to release the enormous talent, ability and imagination present in the Gulf states is unlikely to realize the region's economic goals.

However, these conditions did not exist in the UK during the 1980s. That's why when the Thatcher government took a state-owned, vertically-integrated gas company that was a monopoly (single supplier) and a monopsonist (single buyer) and sold it off it was actually converted it into a privately-owned, vertically-integrated gas company that was also a de facto monopoly and monopsony. Unsurprisingly, the only effect was to allow the management of the new private company to increase their remunerations. When the UK government later privatized electricity, it took a different approach and managed to split off the transmission network from the generators, with the latter divided into two companies in the failed hope they would not collude. It took over a decade, largely thanks to aggressive independent regulation, to resolve the subsequent mess and create more competitive industries.

It's all about competition

The problem for the Gulf states is that their socio-political contexts are not conducive to creating these necessary conditions. Competition is the key to a successful economy, and this may prove elusive because the region's economy is based upon family and other elite patronage networks.[2] Property rights are dubious, the rule of law may be debatable and the prospects for independent regulation of privatized enterprises are at best uncertain. Most SOEs are vertically-integrated monopolies and are likely to be sold intact to increase the revenue from their sale. These private buyers are likely to retain advantages associated with lack of competition, subsidized input prices and access to relevant infrastructure. Moreover, capital markets in the Gulf states are far from efficient. They are small and volatile, and it is doubtful that they would be able to exert the necessary discipline on enterprises to improve performance.

For these reasons, privatization alone will not be the cure-all that many experts believe it will be for the Gulf states. For the private sector to flourish in the region, a better process is required that would allow easier entry for new competitors to level the playing field. This is especially relevant given the increasingly urgent need to diversify the region's economies away from dependence on oil.

Crucially, it is worth remembering that oil revenue is not income. It simply represents a re-shuffling of a country's portfolio of assets—in effect, exchanging oil below ground for money above ground. Given that oil assets are in decline—either because of natural depletion, transition to a low carbon economy or because of lower prices—it is essential that governments use these above ground assets to create alternative and real income generating sources.

The benefits and risks of economic competition

Increased competition is a more realistic way forward for Gulf states than simply encouraging privatization. Yet this raises the basic question of whether ruling elites and families in the Gulf states will be content to see the rise of a robust private sector and its concomitant potential political power. In the 1950s and 1960s, for example, the new military-based governments in the Middle East and North Africa arose from what became known as the "colonel syndrome." These new rulers deliberately destroyed the private economic power of the old elites to undermine the basis of their political power.[3]

However, economic liberalization without political liberalization and reform to release the enormous talent, ability and imagination present in the Gulf states is unlikely to realize the region's economic goals. If the current privatization programs simply deliver a set of windfalls for the state and its ruling elites while simultaneously reinforcing traditional patronage networks, this is likely to aggravate the same perceptions of corruption and helplessness that triggered the Arab uprisings at the start of 2011.

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[1] Stevens, Paul. "Energy Privatization: Sensitivities and Realties." *The Journal of Energy and Development* 23, no. 1 (1997): 1-14.

[2] Crystal, Jill. *Oil and politics in the Gulf: Rulers and merchants in Kuwait and Qatar.* Cambridge: Cambridge University Press, 1995; Kamrava, Nonneman, Nosova, and Marc Valeri. "Ruling Families and Business Elites in the Gulf Monarchies: Ever Closer?" Chatham House, London, 2016.

[3] Owen, Roger. *State, Power and Politics in the Making of the Modern Middle East*. London: Routledge, 1992.