Private Sector Development in the Gulf States Overview

by Mark Neal, Theme Editor

For years, governments of hydrocarbon-rich Gulf states have proclaimed their commitment to diversifying away from oil and gas through expanding their private sectors and encouraging entrepreneurship and small-to-medium enterprises (SMEs). Some governments, like those in Bahrain and Dubai, have achieved much progress toward that end. Yet most Gulf states have struggled to create vibrant and mixed private sectors—the region's economies are still largely dominated by petrochemicals, public sector institutions and family-owned conglomerates.

This situation is frustrating for those who wish to see the Gulf economies placed on a more sustainable footing. Reliance on mineral extraction along with fluctuating energy markets has ensured that the Gulf states have been prone to budget volatility, stop-start development and a recent dramatic tightening of fiscal conditions. It has also led governments to view their citizens as an expense rather than as a beneficial tax base.

Nonetheless, governments and elite networks depend on citizens to be acquiescent for their survival. That's why a social contract ensuring that oil revenues are used to look after the needs of the people has been sustained for decades in the Gulf states. Public sector employment has been offered on a massive scale and through increasingly aggressive workforce localization policies. Yet in the past few years, budgetary pressures have meant that the vast state-financed "job-factories" have become too expensive to maintain. The public sector job market is now "full," and the private sectors in most Gulf states (barring perhaps the UAE and Qatar) are not large or dynamic enough to employ the ever-growing numbers of high school and university graduates demanding jobs.

The region's governments are acutely aware of the ever-growing economic problems—they have been for decades, and they know the solutions to these problems. But even with the low oil price environment, Gulf policymakers are still loath to take the necessary steps to tackle them. Some observers have explained this apprehension as a result of governmental incompetence or lack of vision; others have said it reflects the region's culture of incrementalism, which encourages a wait-and-see approach to governance and economic management. In reality, the Gulf states' reluctance to rebalance their economies boils down to a more basic fear of wider political reform.

Each of the Gulf economies is dominated by a handful of extended families who constitute the political and economic elite. Typically, these are merchant families who have historically provided financial support to the royal family and expected favors in return. Executive political power in each Gulf state is thus a balancing act of keeping citizens acquiescent while catering to the economic demands of powerful families whose continued support is critical to regime survival. For the elite families, their local markets are secure and their involvement in lucrative mega-projects is practically guaranteed.

The families thereby benefit from the unsustainable status quo. A true rebalancing of the region's economies would mean relinquishing the elite's market fiefdoms. It would mean opening them up to competition from small, innovative local start-ups and major foreign players. Family-owned conglomerates in many sectors would quickly find this multivalent competition to be a significant threat. Understandably, they strike deals with political elites to prevent such an outcome. What becomes left of reform are politically-backed glamour projects and cosmetic initiatives that are passed off as sweeping changes.

For this reason, there is a gap between rhetoric and reality in the Gulf region. Economic, fiscal and social policy decision-making is ultimately made through a process of satisficing. Meanwhile, for all their widely-broadcast privatization initiatives, Gulf states experience little real creative-destructive entrepreneurship and innovation. The residual private sectors remain wrapped up in red tape, with SMEs unable to challenge the pre-existing economic domination of the old merchant families.

But there is still a path forward for the Gulf states. This would require policymakers to pursue a number of reforms, including: 1) the dismantling of subsidies; 2) the introduction not just of a value-added tax (VAT), but also income, inheritance and corporate taxes; 3) a new wave of meaningful privatization efforts that loosens both the ownership and control of elite families; 4) a breaking down of the state-sustained barriers to market entry for particular sectors; 5) the end to formal and informal barriers against foreign ownership and entry into domestic markets; 6) a trimming down of the public sector and 7) an end to the social contract that keeps citizens disengaged from the decision-making that affects their lives. Broadly, these efforts demand moving toward a more sustainable future where decisions are made first-and-foremost in the interests of ordinary citizens. For this to happen, meaningful representation should be instituted and a free press allowed to uncover the corruption and hidden deal-making that lies at the heart of some governmental and corporate decision-making.

Gulf policymakers know that such moves would help readjust their economies, expand the private sector, encourage entrepreneurialism and ensure a more dynamic economic and civic future. Gulf leaders know the problems and the solutions—they always have. It's just a matter of how willing they are to enact the necessary changes.

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