ECONOMIC DIVERSIFICATION IN GULF COOPERATION COUNCIL (GCC) STATES

Kristian Coates Ulrichsen, Ph.D.
Fellow for the Middle East, Center for the Middle East

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“Economic Diversification in Gulf Cooperation Council (GCC) States”
Abstract

This paper maps out the existing landscape in GCC states in terms of economic diversification initiatives and seeks to construct a series of ideas about potential ways forward. The major takeaway is that there is a window of opportunity to redesign aspects of Gulf economic and political structures that many observers and analysts had deemed sacrosanct, but this window is not open-ended. The sustained drop in oil prices that started in June 2014 has brought forward the urgency of economic diversification in GCC states both as a strategic imperative and as a tool to make economies more resilient and less vulnerable to external sources of volatility. Policymakers and publics across the Gulf states acknowledge and understand that far-reaching measures need to be taken, and that the status quo simply is not sustainable.

The opening section examines how previous economic diversification initiatives have largely been nested within grandiose multidecade “visions” that, in most cases, have promised far more than they have delivered in practice. The launch in April 2016 of “Saudi Vision 2030” and the unveiling in June of the first in a series of national transformation programs for the kingdom have focused attention on the use of multiyear state-led plans as the drivers of economic diversification and development in GCC states. Far from representing a new policy response to the prolonged slump in oil prices and government revenue since mid-2014, such visions have, in fact, featured prominently in regional policymaking for more than two decades. What is missing from many of the visions is an appreciation of the sensitivity of the (frequently unofficial) political and economic trade-offs that may be needed to accompany and underpin the more intangible aspects of reform that cannot easily be obtained by technocratic measures alone.

This is followed by a middle section that analyzes the growth of strategic niches as integral components of the broader programs of national development and economic diversification unveiled since the 2000s, with an emphasis on renewable and alternative energy in the United Arab Emirates (UAE) and Saudi Arabia, higher education and research in Qatar and Oman, and refined products and petrochemicals (primarily) in Saudi Arabia. A combination of significant resource availability in the late 2000s and relatively few domestic political constraints on how to deploy the windfall from high oil prices enabled a series of large-scale initiatives that also aimed to generate reserves of soft power and international repute. These, in turn, have strengthened local cycles of innovation and enterprise and stimulated the growth of the non-oil sector that will one day be needed to cushion the eventual transition to post-oil economies.

The paper ends with 10 policy suggestions for the next phase of efforts to transition further down the road toward a post-oil political economy and to expand the processes of economic transformation far beyond their current “enclaves of excellence.” Numerous uncertainties abound as ruling circles in Gulf states adjust to the era of lower oil prices and seek to make economies more resilient, diversified, and better able to withstand volatile externalities. The capital accumulation during the long years of budget surplus prior to 2014 and the size of Gulf-based sovereign wealth funds mean that policymakers are not
short of resources as they begin their task, but they do need to begin to show results if the capital advantage is not to dissipate over time, as has already started in Saudi Arabia. Whether governments and public sectors have the political will to loosen their sociopolitical and economic grip may determine the eventual fate of economic reforms.

Officials in GCC states therefore will need to carefully balance the need for far-reaching economic change against any sudden or disruptive change to the political economy that has underpinned the “social contract” in GCC states since the onset of the oil era in the 1960s. The top-down and state-controlled nature of reform processes in Gulf states means that sustained support of ruling circles is likely to be significant in determining whether initial reforms expand into a substantive commitment to long-term change, or whether they follow the pattern of a previous era of (political) reform in the early 2000s that resulted in a stalled “halfway house,” whereby initial bursts of activity stagnated and did not expand into substantive changes to policies or patterns of behavior. However, it remains far from clear that economic transformation can be stripped of its political aspects and eliminate the need for debate on how the relationship between a state and its citizenry might evolve in a context where the state is no longer primarily the distributor of wealth and the employer of first resort.

Introduction

Although they vary greatly in size and scale of resource endowment, the economies of all six GCC states remain heavily reliant on hydrocarbon revenues, despite multiple initiatives to diversify and develop non-oil sectors over more than three decades. Overdependence on oil—and, in Qatar’s case, natural gas—means that GDP, government revenues, and export earnings in GCC states are linked closely to a commodity that is subject to cyclical swings and that, additionally, is now the object of global efforts to reduce its use over the longer term at the same time resource development outside of the GCC—especially shale development in the US—provides competition for GCC production. Such external volatility exposes Gulf economies to vulnerabilities they can do little to control in practice. The symbiotic link between government and oil revenues was evidenced as Kuwait recorded a 45.2% year-on-year fall in government revenues for the first eight months of the 2015–2016 fiscal year and a near-identical 46.1% drop in oil revenues over the same period. This is not a new phenomenon; during the oil price slump of the 1980s, Saudi oil and government revenues declined precipitously from SR 329 billion and SR 368 billion respectively in 1981 to SR 42 billion and SR 76 billion respectively by 1986, and Saudi Arabia and other GCC states ran budget deficits nearly every year between 1983 and 2000.

Other imbalances also persist across GCC economies irrespective of their size, and they include stark splits between the public and private sectors as well as distorted and largely


2 Steffen Hertog, Princes, Brokers, and Bureaucrats: Oil and the State in Saudi Arabia (Ithaca, New York: Cornell University Press, 2010), 118.
parallel labor markets for citizens and expatriates. The intertwined nature of these dynamics has seen citizens of GCC states work almost exclusively in public sectors—including government-owned oil and gas companies—and the private sector become the preserve of largely foreign (and cheaper) workers. In Kuwait, by the early 2000s expatriates constituted 83% of the overall workforce, and 92% of working Kuwaitis were in public sector employment. The situation in the UAE was more pronounced, as non-nationals made up 91% of the workforce across the federation by 2006, while in Dubai a year earlier, only 2% of jobs were held by Emiratis (and 54% held by Indian nationals). Meanwhile, in Qatar, the expansion of the public sector and government-related enterprises as the development of the country’s gas reserves accelerated resulted in the proportion of Qatars employed in the private sector being more than halved, from 10% in 1986 to 4% in 2007.

A related challenge to past government attempts to overhaul the structure of Gulf economies and address the labor market disparities noted above has been the lack of substantial business or income tax to offset the overreliance on hydrocarbon revenues. Saudi Arabia taxed the incomes of expatriates working in the kingdom for decades until the tax was suspended in the mid-1970s, and an attempt in 1988 to reimpose the income tax during the prolonged oil price slump of the mid-1980s failed when it triggered large-scale expatriate protests at the proposed 30% rate. GCC states additionally engaged in cutting taxes on profits and capital gains of foreign-owned firms in the late 2000s and early 2010s in a competitive bid to attract greater levels of foreign direct investment, but at the cost of further drawing down the already small streams of tax revenue. Post-2014 fiscal pressures belatedly forced a reassessment of this approach and ushered in a series of actual and proposed tax “increases”—such as a rise in corporate tax from 12% to 15% in Oman and the imposition of a 5% value-added tax across the GCC by 2018—but budget deficits are far more likely to be plugged through a rise in oil prices and revenues rather than taxation. But the GCC does not unilaterally control when a significant and sustained rise in oil prices will occur.

The sustained drop in oil prices that started in June 2014 has brought forward the urgency of economic diversification in GCC states, both as a strategic imperative and as a tool to make economies more resilient and less vulnerable to external sources of volatility. Measures enacted since early 2015 in all six GCC states are but the first steps in a much longer and rockier road toward putting Gulf economies onto firmer footing. Any effective transition toward a genuinely post-oil future will require deeper reforms that amount to reformulating the very pillars of welfare spending and wealth redistribution that have underpinned the political economies of GCC states since at least the 1970s. The policy

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4 Kasim Randeree, “Workforce Nationalization in the Gulf Cooperation Council States” (Occasional Paper no. 9, Center for International and Regional Studies, Georgetown University School of Foreign Service in Qatar, Doha, Qatar, 2012), 8.
5 Ibid., 19.
dilemma that has long confronted policymakers in the Gulf, but which has now become acute, is how to ensure that the pathway of inherently “radical” reform is consensual rather than contested and politically as well as economically robust.

In moving toward a more targeted form of what this paper labels “strategic diversification,” policymakers in GCC states will need to carefully balance the need for far-reaching economic change against any sudden or disruptive change to the political economy that has underpinned the “social contract” in GCC states since the onset of the oil era in the 1960s. The top-down and state-controlled nature of reform processes in Gulf states means that sustained support of ruling circles is likely to go a long way toward determining whether initial reforms expand into a substantive commitment to long-term change, or whether they follow the pattern of a previous era of (political) reform in the early 2000s that resulted in a stalled “halfway house,” whereby initial bursts of activity stagnated and did not expand into substantive changes to policies or patterns of behavior. Critically, officials must find ways of altering the risk-averse culture that has proven stubbornly difficult to dislodge, and of changing the dependency on low-risk government employment that, as survey data indicates, continues to resonate among Gulf nationals.

This paper maps out the existing landscape in GCC states in terms of economic diversification initiatives and seeks to construct a series of ideas about potential ways forward. The opening section examines how previous economic diversification initiatives have largely been nested within grandiose multi-decade “visions” that, in most cases, have promised far more than they have delivered in practice. This is followed by a middle section that analyzes the growth of strategic niches as integral components of the broader programs of national development and economic diversification unveiled since the 2000s, with emphasis on renewable and alternative energy in the UAE and Saudi Arabia, higher education and research in Qatar and Oman, and refined products and petrochemicals (primarily) in Saudi Arabia. The paper ends with 10 policy suggestions for the next phase of efforts to transition further down the road toward a post-oil political economy and to expand the processes of economic transformation far beyond their current “enclaves of excellence.”

The major takeaway from what follows is that there is a window of opportunity to redesign aspects of Gulf economic and political structures that many observers and analysts had deemed sacrosanct. But this window is not open ended, and “success” will be hard to measure and “outcomes” often more intangible than tangible; like trying to turn around a supertanker, the transition away from oil and gas will take considerable time. It is certainly the case that policymakers and publics across the Gulf states acknowledge and understand that far-reaching measures need to be taken and that the status quo is simply not sustainable. It is also the case that the prolonged fall in oil prices and government revenues has prompted a generation of leaders such as Prince Mohammed bin Salman Al Saud in Saudi Arabia and the sheikhs of Abu Dhabi and Dubai to think big and outside the box. Furthermore, the policies of capital accumulation and debt repayment during the decade of healthy budget surpluses prior to 2014 could not be more different from the earlier oil price boom of the 1970s, when surging revenues entered societies that had comparatively
low absorptive and human capacity to manage the sudden wealth and were ruled by elites prone to commissioning extravagant and wasteful “white elephant” prestige projects.

National Visions

The launch in April 2016 of Saudi Vision 2030 and the unveiling in June of the first in a series of national transformation programs for the kingdom have focused attention on the use of multiyear state-led plans as the drivers of economic diversification and development in GCC states. Far from representing a new policy response to the prolonged slump in oil prices and government revenue since mid-2014, such visions have, in fact, featured prominently in regional policymaking for more than two decades. They set out ambitious targets and objectives for diversifying economies and expanding the productive base to ease the eventual transition toward a post-oil political economy. As such, the visions have typically been multidecade in length and contained key buzzwords about the development of social and human capital designed to appeal to a global audience of potential investors and business partners. The major initiatives launched during this period were the following:

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<th>Year</th>
<th>Country</th>
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<tr>
<td>1995</td>
<td>Oman</td>
<td>Oman 2020: Visions for Oman’s Economy</td>
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<td>2008</td>
<td>Bahrain</td>
<td>Economic Vision 2030</td>
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<td>2008</td>
<td>Qatar</td>
<td>Qatar National Vision 2030</td>
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<td>2010</td>
<td>Kuwait</td>
<td>Kuwait Vision 2035</td>
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<td>2010</td>
<td>UAE</td>
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<td>2016</td>
<td>Saudi Arabia</td>
<td>Saudi Vision 2030</td>
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<td>2017</td>
<td>Kuwait</td>
<td>New Vision 2035</td>
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Different motivations lay behind each of the national visions. Oman and Bahrain possess the smallest oil reserves among the Gulf states and thus had the most pressing need to diversify their economies. Decision-makers in the UAE and Qatar lacked such urgency but launched their own strategic visions in order to underpin the growth of Dubai, Abu Dhabi, and Doha into aspirant global cities. Iran’s plan was approved by Supreme Leader Ayatollah Ali Khamenei in 2005 as part of a strategy to overhaul and strengthen the Iranian economy and make it more resilient to external pressure and international sanctions.

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8 The drawing up of such plans was not limited exclusively to Gulf states; the Egyptian government under President Abdel Fattah el-Sisi published “Sustainable Development Strategy: Egypt Vision 2030” in March 2015 ahead of a major international investor conference that was, in part, organized by Egypt’s close post-2013 GCC partners.


first Kuwaiti vision was prepared at considerable public expense by a team of consultants working in the name of former British Prime Minister Tony Blair, and it caused a political stir in Kuwait when the cost of the plan was leaked to the media. Blair’s plan was shelved after Sheikh Nasser Mohammed Al-Sabah, the prime minister who commissioned it, left office in November 2011, and more than five years elapsed before a local group of policymakers put together a ‘new’ Vision 2035. Finally, the Saudi plan was put together as the kingdom’s assertive new leadership responded to the fall in world oil prices and the significant budgetary shortfalls it inherited from the government of the late King Abdullah bin Abdulaziz.

Although no two plans were the same, they all included a number of common features. One was the clear intent to create knowledge-based economies in which growth is driven by research, development, and innovation and the creation of internationally competitive, high value-added economic sectors. To this end, there was invariably a heavy emphasis on strengthening and expanding the private sector and creating new jobs capable of absorbing the fast-growing and increasingly well-qualified pool of entrants into local labor markets. A further characteristic of many of the plans of the Arab Gulf states drawn up since the 2000s is that, like Kuwait’s, they were devised primarily by international consultants such as McKinsey & Company, which played a key role in Saudi Vision 2030. In 2004, McKinsey was commissioned by Bahrain’s Crown Prince Salman bin Hamad Al Khalifa to turn Bahrain, through its own Vision 2030, into a “productive, globally competitive economy, shaped by the government and driven by a pioneering private sector.”

What is missing from many of the visions is an appreciation of the sensitivity of the (frequently unofficial) political and economic tradeoffs that may be needed to accompany and underpin the more intangible aspects of reform that cannot easily be obtained by technocratic measures alone. This would require policymakers to address deep-rooted expectations and entitlements within the context of the redistributive mechanisms of governance and the durability of the imbalances between the public and private sector and the citizen and expatriate labor markets. Social insurance data from Saudi Arabia, for example, has shown that fewer than 400,000 private sector jobs in the kingdom paid more than SR 3,000 (c. $800) per month, a figure usually considered to be the minimum level for Saudi high school leavers to consider taking a job. The fact that Saudi Arabia created

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417,000 new jobs in 2015 but that 88% (368,000) of them went to nonnationals testifies to the continuing resilience of such obstacles to successful reform. So, too, does an April 2016 survey in Kuwait that illustrated the strength of attachment to the notion of the government as provider of both welfare and employment for its citizenry, as it found that 58% of unemployed Kuwaitis preferred to remain jobless and wait for a government position to open up rather than take a job in the private sector. Several months later, a study of the Riyadh workforce reported even more pronounced results, as 80% of unemployed respondents indicated a preference for a job in the public sector over the private sector due primarily to greater perceived levels of job security, fewer working hours, and longer periods of annual leave.

Policymaking in GCC states additionally takes place against the backdrop of a set of highly distinctive drivers of fiscal and budgetary frameworks that make it difficult to replicate or adapt successful models of economic transition from other settings. The role of governments in GCC states as the (re)distributor of wealth, in large part through the provision of jobs and welfare to their citizens, constitutes a policy dilemma for officials, as it complicates the task of aligning the economic and political rationale for reform and contributes to the watered-down policy outcomes that result. One example from Oman exemplifies the impact of one of the most visible political responses to the Arab Spring on the longstanding policy of encouraging more Omanis into the private sector, a key element of the “Oman 2020” vision unveiled in 1995. While the number of Omani employees in private sector jobs had indeed risen by 138% between 2003 and 2010, much of that progress was reversed by the announcement of 35,000 new public sector jobs in spring 2011, which led 30,000 Omanis to resign from private sector employment that year.

Examples abound of the delicate politico-economic equilibrium that, in practice, limits the room for maneuvering around critical issues that are identified as prime targets for reform in the strategic visions. These illustrate not only the entrenched durability of vested interests, but also a pattern whereby officials prioritize the watering down of policy changes over active confrontation with key supporters. Attempts in Bahrain and Saudi Arabia to nationalize the workforce and encourage more citizens to enter the private sector both ran into concerted opposition from business elites, whose control of a cheap, imported labor force came under threat. These highlight the difficulty of making meaningful and sustained policy changes that are able to confront powerful layers of vested interests and can survive any resulting pushback by these influential actors. Furthermore, they illustrate how the private sector can instead position itself against government attempts to reform what many business leaders see as their access to large reserves of cheap labor. This makes it considerably harder to mobilize and engage all key

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stakeholders—encompassing government bodies, private sector organizations, and civil society groups—in support of common objectives.  

Rather than addressing the issue of competing (and often vested) interests head on, a flaw common to regional visions has been that their dry technocratic language appears to presuppose the existence of a tabula rasa that strips away the political aspects of economic reform. While it is the case that the Arab Gulf monarchies—with the partial exception of Kuwait—lack meaningfully pluralized polities, this does not mean that vested political or economic interests are insignificant. Indeed, the frequently opaque nature of politico-economic networks may actually be harder to successfully dislodge than open or formal political structures, precisely because of the intangible role they play in upholding the vaunted “social contract” between regimes and their citizenry. Such networks blur the distinction between the “public” and the “private” sectors, as members of the same extended families often serve both as public officials and business leaders.

Strategic Niches

High levels of state resources have gone into identifying and carving out strategic niches that have positioned the Gulf states as regional hubs and even global leaders in sector-specific areas. A combination of significant resource availability in the late 2000s and relatively few domestic political constraints on how to deploy the windfall from high oil prices enabled a series of large-scale initiatives that also aimed to generate reserves of soft power and international repute. This section illustrates several examples and demonstrates how the process of developing strategic niches has played out in the fields of renewable and alternative energy, higher education, and petrochemicals production. In each of these three examples, the injection of substantial amounts of capital by Gulf governments and state-owned enterprises has resulted in the establishment of enclaves of genuine cutting-edge expertise and excellence. These, in turn, have strengthened local cycles of innovation and enterprise and stimulated the growth of the non-oil sector that will one day be needed to cushion the eventual transition to post-oil economies.

The UAE (Abu Dhabi) and Saudi Arabia unveiled grandiose plans in the late 2000s to become world-leading centers of research and development in renewable and alternative energies. Officials in Abu Dhabi and Saudi Arabia invested considerable time, effort, and capital to become world leaders in renewable and alternative energy. Investment in the UAE rose substantially after 2004, building upon the strong environmental legacy of the nation’s founding father, Sheikh Zayed bin Sultan Al Nahyan, who died the same year. In

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22 Prominent examples of the intermixing of political and economic leadership include the careers of Nasser and Jassim al-Kharafi in Kuwait and, in Oman, the many hats worn by Maqbool al-Sultan, whose long tenure as minister for commerce and industry (prior to his removal from office in 2011) coincided at various times with his chairmanship of the Oman Oil Company, the Capital Market Authority, the Omani Center for Investment Promotion and Export Development, the Sohar Industrial Port Company, Knowledge Oasis Muscat, and the Al Mazunah Free Zone, among others.
April 2006, the Masdar Initiative was launched under the auspices of the Abu Dhabi Future Energy Company, itself a subsidiary of Mubadala, a sovereign wealth fund established in 2002 by current Crown Prince Sheikh Mohammed bin Zayed Al Nahyan. The initiative encompassed not only the expansive “Masdar City” project of creating a zero-carbon city in the desert next to Abu Dhabi’s international airport, but also a wider hub for research into renewable and future energies. This included the Masdar Institute for Science and Technology, which opened in September 2009, and the World Future Energy Summit, which has taken place every year since 2008. Moreover, Abu Dhabi campaigned vigorously to host the International Renewable Energy Agency (IRENA) at Masdar City, successfully beating out Germany and South Korea in the process. Together, these developments enabled the emirate to brand itself as a global leader in the renewable energy field.\(^{23}\)

Closer examination of Abu Dhabi’s approach toward the Masdar Initiative illustrates some of the comparative advantages—and also the pitfalls—of Gulf attempts to create strategic niches in sector-specific areas. The plans for Masdar City unveiled with great fanfare in 2006 had to be scaled back significantly following the financial slowdown in 2009 and a slew of other difficulties in translating initial intent into capability. Luomi has characterized the challenges that faced the developers as including “over-optimistic assumptions, hasty marketing, colossal promises, rushed implementation, and, most likely, bad recruitment choices.” As a result, in 2010, the operating budget for the city was cut by a quarter, the timeline for its development extended, and a number of technical features cancelled. These had the effect of transforming the original intent of creating a “zero-carbon” city first to a “carbon-neutral” city, and subsequently merely to a “low-carbon” city.\(^{24}\)

Likewise, Abu Dhabi’s first drive into renewable energy proved disappointing. After announcing in 2009 that renewable sources would account for at least 7% of its power generation capacity by 2020, Abu Dhabi promised to build a low-carbon, high-technology energy sector that would not only help it diversify its natural gas-dominated electricity production, but its oil export-dominated economy as well. The emirate invested a huge amount—$700 million—in a 100 megawatt-concentrating solar power plant that, upon startup in 2013, began producing just 0.5% of Abu Dhabi’s power needs. The Shams 1 plant’s capacity, which is based on more than 250,000 mirrors, cost roughly seven times that of a gas-fired plant that is able to generate power a much greater percentage of the time.\(^{25}\) The Shams 1 plant proved so expensive that other plans related to renewables were delayed. Meanwhile, the emirate’s plans to incubate “green economy” businesses also failed, with

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the centerpiece—a thin-film solar panel factory—moved from the UAE to Germany, only to close in 2014.\(^{26}\)

Saudi Arabia joined Abu Dhabi in unveiling an ambitious and multi-pronged bid to become a regional leader in renewable and alternative energy. In April 2010, King Abdullah issued a royal decree establishing the King Abdullah City for Atomic and Renewable Energy (KA-CARE) to oversee the development and implementation of a national energy sustainability program in the kingdom. The city’s launch signaled the acknowledgement, at the highest level of policymaking, of the need to diversify the sources of energy production to offset the soaring domestic levels of energy consumption and demand for electricity. Particular attention focused on projections that—absent concerted measures to conserve energy and develop alternative energies—the overall demand for fossil fuels for power, desalination, and transportation would reach 8.3 million barrels of oil equivalent by 2028. This was broadly consistent with a separate study conducted by the national oil company, Saudi Aramco, which warned that the country’s crude export capacity risked falling by 3 million barrels of oil per day by the same year.\(^{27}\)

The launch of KA-CARE was concurrent with a series of other initiatives designed to place Saudi Arabia at the forefront of the development of renewable and alternative energy. These included the 2009 establishment of the King Abdullah University of Science and Technology (KAUST) near Jeddah and the 2012 creation of a dedicated renewables investment fund by Saudi Aramco. KAUST began operating in September 2009 with a $10 billion endowment and research tracks dedicated to examining natural resources, energy, and the environment. Notably, the university placed special emphasis on clean combustion technologies and the science of solar and alternative energy, and it possessed the funding and the capability to attract world-leading faculty and equipment. Equally significant was the role of Saudi Aramco, rather than the Ministry of Higher Education, in assuming the lead role in financing and operating KAUST, thereby bypassing cumbersome bureaucratic processes.\(^{28}\) Saudi Aramco also was pivotal in setting up the Saudi Aramco Energy Ventures fund (SAEV) in 2012 with a mandate “to invest globally into start-up and high-growth companies with technologies of strategic importance” to the kingdom.\(^{29}\)

Together, the Emirati and Saudi initiatives demonstrate the importance of top-level leadership and “buying in” among the most senior decision-makers. This has led to skepticism and the belief that the initiatives represent little more than “vanity” projects whose existence may not outlive the passing of their patrons, or the decline of oil prices and the reassessment of spending priorities. Yet this notwithstanding, the scale of the resources being deployed to renewable and alternative energies is indicative of the growing urgency of local and regional debates on energy sustainability and long-term prospects.

\(^{26}\) Mark Osborne, “Masdar PV a-Si Thin-Film Plant in Germany to Close,” _PV Tech_, May 26, 2014.


Moreover, the strategy of creating “enclaves” is itself an acknowledgement of the obstacles presented by the resilience of layers of vested interests with a stake in the maintenance of the political and economic status quo. As Saudi Aramco has done with KAUST, a measure of the success (or otherwise) of the projects will be their ability to generate durable new linkages not only with each other, but also organically with local economic and sociopolitical patterns of activity.

Beginning in the 2000s, all six Gulf states embraced the concept of “knowledge economies” as integral to their ambitious programs of economic diversification and development. These, in turn, also represented a crucial element of the adaptation of Gulf economies to the broader processes of structural changes in the global economy, based on accelerating flows of information, capital, and people across national boundaries. Policymakers in the Gulf states directed a large share of the capital accumulation during the 2002–2008 oil price boom to investment in high-profile initiatives in higher education and scientific research and development. Underlying such moves was an awareness of the necessity of producing a well-educated and highly skilled workforce of qualified nationals capable of competing in global labor markets and alleviating systemic problems of domestic unemployment and underemployment. Some of the results have been eye-catching, as hubs of agglomeration for knowledge-intensive goods and services have already emerged, adding a new dimension to the national visions described above.

The linking of higher education to the creation of a strategic niche was most evident in the foundation and expansion of Education City and related initiatives in Qatar. Although initial plans to have up to 15 prestigious university branches and a minimum quota of 75% for Qatari students proved unfeasible, by 2010, Qatari students formed about 45% of the total student population of about 10,000 (although a worrying factor for Qatari educational leaders was that as overall enrollment numbers increased, the proportion of Qatari students consistently declined). Officials in Oman also sought to expand rapidly into higher education in the 2000s. Until that point, the public Sultan Qaboos University (SQU) was the only such entity permitted to operate in the country, but the number of private colleges proliferated following their legalization in 1995. By 2008, no fewer than 24 private institutions were operating in the sultanate, including several in partnership with prestigious international collaborators, among them the German University of Technology (“GuTech”). This was a joint venture with the reputable educational provider, RWTH Aachen, well-known in Germany for its expertise in engineering and technology.

The sustained investment in downstream refined products and petrochemicals represents arguably the most successful niche where the Gulf states have emerged as genuine world leaders. Although refineries were first established in the Gulf at the dawn of the oil era in the 1930s (in Bahrain) and 1940s (in Kuwait and Saudi Arabia), these were geared primarily toward domestic markets, and after a brief upsurge in investment in refineries during the

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31 Author interviews with policymakers in Berlin and the Gulf, August–September 2014.
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oil price boom in the 1970s, total capacity remained effectively stagnant until the early 2000s. During this period, much of the investment in refined and retail products took place beyond the Gulf, as with Kuwait Petroleum International’s network of Q8-branded service stations across Europe and ownership of a refinery in the Europort in Rotterdam. Saudi Arabia also launched refining joint ventures with international partners in the United States, Greece, South Korea, and the Philippines. In Abu Dhabi, the ruling family set up the International Petroleum Investment Company (IPIC) in 1984 to invest globally in energy and energy-related industries.32

As international oil prices rose rapidly in the mid-2000s, a qualitative shift occurred, as officials in GCC states began to integrate downstream and move beyond the simple extraction of crude oil toward the creation of sophisticated value-added petroleum products. The rush of new refining and petrochemical ventures was a pragmatic form of economic diversification “not away from oil but leveraging the availability of oil and gas” in sectors where the GCC states possessed a comparative advantage.33 Moreover, the scale of the industrialization projects unveiled in the middle of the decade signified an attempt both to lessen overreliance on the volatility of international oil markets (and revenues) and to broaden the Gulf states’ integration into the global economy. The role of petrochemicals in diversifying economic and commercial relations has been particularly evident in the strengthening of Gulf-Asia ties based on the rapid growth of non-oil trade flows in petrochemicals, plastics, and aluminum. Notably, this impacted Gulf relations with emerging economies such as China just as much (and in different ways) as it did ties with advanced economies such as Japan, as the former provided a large market for export opportunities while the latter benefited GCC partners through technology transfers and inward investment.34

In the 2000s, the Gulf states become global leaders in a variety of industries that ranged from petrochemicals and aluminum to cement and construction products. By 2008, the GCC as a region accounted for 12% of global petrochemical production, and a series of new ventures were launched that represented the biggest such initiatives in the world. These included three in Saudi Arabia alone: the $27 billion Ras Tanura Integrated Project joint venture between Saudi Aramco and Dow Chemical that aims to establish the kingdom as the leading producer of a vast range of petrochemical products, including ethylene, propylene, aromatics, chlorine, chlorine derivatives, polyethylene, ethylene oxide, and glycol; construction of the world's largest petrochemicals facility in the already vast Jubail Industrial City in the Eastern Province; and the upgrading of the Petro Rabigh refinery into one of the most sophisticated integrated oil-refining and petrochemical facilities of its kind.35 Simultaneously, a 2006 partnership between SABIC and the Saudi Kayan

33 Ibid., 167.
Petrochemicals Company illustrated the type of “backward linkages” that officials intend to form the cornerstone of the kingdom’s economic transition into value-added products. In January 2011, Saudi Kayan commenced the first exports originating in the Middle East of acetone (a part of the value chain used to manufacture polycarbonates, solvents, adhesives, and paints) to the substantial Indian market.\footnote{“Saudi Kayan Ships First Acetone Export,” \textit{Saudi Gazette}, January 18, 2011, http://64.65.60.109/index.cfm?method=home.regcon&contentid=2011011891536.}

Similar developments occurred elsewhere in the GCC, most notably in petrochemicals in Qatar and Abu Dhabi and (earlier in the 1970s and 1980s) in aluminum in Bahrain and Dubai. Qatar Petroleum and the Qatar Petrochemical Company (QAPCO) unveiled several high-profile projects in the mid-2000s, including Q-Chem II, a joint venture with the Chevron Phillips Chemical Company to produce high-density polyethylene, and Qatofin, a joint venture between QAPCO and Total Petrochemicals for the creation of a world-scale polyethylene plant in Mesaieed Industrial City. Both joint ventures utilized feedstock from ethylene provided by a third venture, an ethane cracker at Ras Laffan Industrial City established by a partnership between Qatar Petroleum, Qatofin, and QAPCO.\footnote{Luciani, \textit{Refining and Petrochemical Sectors}, 181.}

Developments in Abu Dhabi focused on the expansion of the range of products and global partnerships of Borouge, a joint venture launched in 1998 by the Abu Dhabi National Oil Company and Borealis, itself co-owned by Abu Dhabi’s IPIC and Austrian oil and gas group OMV. The “Borouge 2” project tripled the polyolefin manufacturing capacity of the petrochemical facility at Ruwais and installed the largest ethane cracker in the world, while “Borouge 3” launched a further phase of expansion into high value-added products in partnership with South Korea’s Hyundai Engineering and Construction and Samsung Engineering.\footnote{Ibid., 191.}

**Strategic Diversification: 10 Ideas**

The final section of this paper presents 10 overarching recommendations should policymakers aim for a more strategic form of diversification that successfully cushions the blow of low oil and gas revenues and guides Gulf economies toward a more sustainable transition. It remains an open question whether a top-down, government-led program of economic reform can generate the creation of new ventures and jobs quickly enough to meet local demands. Moves to shrink state spending and strengthen the private sector as the “engine” of long-term growth are complicated by the fact that the existing private sector in GCC economies is heavily dependent on the state for contracts and services; economic diversification projects have, moreover, been concentrated largely in hydrocarbon-derivative sectors such as refining and petrochemicals, and thus are neither genuinely new areas of economic activity nor necessarily based on a competitive advantage in human capital, rather than a comparative advantage in cheap feedstock. While moves to embed an entrepreneurial spirit as a bedrock of a “knowledge economy” have accelerated across all Gulf states, initiatives have lacked a comprehensive approach to all the interlocking
components of an innovation ecosystem, as well as an appreciation that successful transitions elsewhere have been intergenerational in nature and unfolded over decades.

Numerous uncertainties therefore abound as ruling circles in Gulf states adjust to the era of lower oil prices and seek to make economies more resilient, diversified, and better able to withstand volatile externalities. The capital accumulation during the long years of budget surplus prior to 2014 and the size of Gulf-based sovereign wealth funds means that policymakers are not short of resources as they begin their task, but they do need to begin to show results if the capital advantage is not to dissipate over time, as has already started in Saudi Arabia. Creating an “entrepreneurial class” of women as well as men who can support and drive economic transition will be vitally important to eventual success, but it risks being held back by issues such as local bankruptcy laws and the social stigma of failure. These considerably raise the “risks of risk-taking,” as does the domination of private sector activity by large, politically connected merchant conglomerates, which currently squeeze out small-scale, privately owned companies in terms of access to government contracts and funding from local financial institutions.

Finding ways to integrate an entrepreneurial spirit—which has enormous potential given the overwhelmingly youthful profile of extremely tech-savvy GCC populations—with an innovation structure capable of nurturing and protecting genuine economic diversification will therefore be of paramount importance in the years ahead. Commercializing and incentivizing research, aligning education at all levels with job creation by equipping people with the skill sets needed to compete globally, and encouraging creative thinking and innovative solutions to problem-solving will also feature heavily in any economic transformation. Whether governments and public sectors have the political will to loosen their sociopolitical and economic grip may determine the eventual fate of economic reforms; the early evidence from “Saudi Vision 2030” indicates a desire to strip economic transformation of its political aspects and avoid any examination of how the relationship between a state and its citizenry might evolve in a context where the state is no longer primarily the distributor of wealth and the employer of first resort.

The most invaluable takeaway for current decision-makers is the need to engage and work with a wide range of policy stakeholders as possible to ensure that economic diversification measures are as much a bottom-up as a top-down approach. For reforms that have touched on sensitive political and economic issues to have a chance of taking root, it is essential that they be organic rather than imposed and mobilize the domestic coalitions of political and economic interests, whose support will be crucial to any successful rollout. Failure to involve local stakeholders in the consultation and planning stage of the policymaking process risks generating a culture of apathy in the bureaucratic machinery that lacks a sense of ownership over, or vested interest in, the outcome of the subsequent implementation phase.

Policymakers must take advantage of the current window of opportunity presented by low oil prices and budgets that have slipped into deficit to push through measures that would have been politically far more difficult during periods of plenty. Officials have
long recognized that the welfare state that was constructed during the 1970s—a time of seemingly endless resources and relatively low national populations—is no longer sustainable, but debates about government spending and subsidy reform largely fell on deaf ears during the long years of the oil price boom that ended in 2014. The subsequent pressures on public finances have given governments political capital that has allowed them to begin raising prices for items such as gasoline in a carefully controlled process of incremental change. Most price increases have been relatively small in absolute (if not in relative) terms, but they can reduce the political risks of “tampering” with the social contract by sensitizing populations to the principle of further such increases in the future.39

Recent survey research by Justin Gengler suggests that the violence of the post-Arab Spring conflicts across the region has led citizens in GCC states to increasingly value the provision of stability by their governments over economic handouts and financial benefits.40 If plans such as “Saudi Vision 2030” are to come close to reaching their stated objectives, it is vital that policymakers maintain their nerve and do not permit the occasional manifestation of public disquiet to derail key measures vital to putting Gulf economies on a more sustainable footing. A silver lining of the current budgetary pressures afflicting GCC states is that the longer they go on, the more amenable citizens may become to “extraordinary” measures to stave off political collapse.

Governments must view measures as merely one step in a journey rather than in relation to any fixed start or endpoint and must have the confidence to persevere with sensitive measures and not be deterred by pushback from vested interests. Reforms to issues hitherto considered “sacrosanct” will inherently be highly contentious and are likely to attract opposition from societal actors anxious to preserve various privileges and perks. This has already led to the watering down of measures such as a government bill in Kuwait to raise utility prices, which gained parliamentary approval in April 2016 only after members of the National Assembly gutted the initial bill to exempt Kuwaiti citizens from the increased rates, and the subsequent dissolution of the Kuwaiti parliament in October 2016 in response to mounting political opposition to a government initiative to raise fuel prices that was announced the previous month.41

A successful transformation into a knowledge economy as a key component of economic diversification envisaged in the national visions will involve an ongoing process of structural, and also intangible, change and will be intergenerational in nature. In the East Asian cases of Japan, Taiwan, and South Korea, the overhaul of economic structures that began in the early 1960s only reached fruition in the 1980s. Within the GCC, the UAE—

and, to a lesser extent, Qatar and Saudi Arabia—has made progress in creating enclaves of concentrated expertise in which research and development and sector-specific, university-industry collaboration can flourish. Embedding and expanding the share of these enclaves and free zones will be central to the long-term task of moving from a political economy based on a comparative advantage in hydrocarbons to a knowledge-intensive economy based on a competitive advantage in a globalized setting.42

Policymakers will need to consider whether and how genuine economic diversification might be compatible with the political economy that has underpinned the “social contract” in GCC states since the onset of the oil era in the 1960s. If successfully carried out, the reform of economic processes inherent in any fundamental transition likely would reformulate models of governance and social and political relations in GCC states. The rise of a productive and knowledge-intensive economy would involve systemic changes to the structure and composition of labor markets and the incremental stripping away of the redistributive mechanisms that have underpinned the concept of the “ruling bargain” for the past five decades. Moreover, a highly educated and skilled populace may yet emerge as agents of disruptive change if they perceive limitations to their freedom to access information and utilize knowledge autonomously from government oversight and control.

Genuine diversification requires measures that raise the proportion of government revenues from taxation, grant the private sector the space to develop and grow, and overcome the public/private and citizen/expatriate imbalances in labor markets. The interdependent nature of comprehensive reform means that efforts to support one area risk being compromised if others do not function adequately or if measures are incomplete in scope, are left unfinished, or are partially reversed under pressure from public or political backlash. A political or economic environment characterized by opacity and/or unpredictability in decision-making, poor transparency and regulatory compliance, diluted policy implementation, and pervasive aspects of informality will not likely ever develop into a truly transformative agent of change.

To have a real chance of succeeding, a complex enabling environment must emerge that features greater and sustained engagement on multiple fronts simultaneously and does not neglect to address intangible notions of “entitlement.” This enabling environment will need to interlink reforms to institutional and capacity-building infrastructure, market development and appropriate legal frameworks (particularly over intellectual property rights), a financial system capable of mobilizing and channeling investment to firms whose innovatory outputs may encompass a lengthy startup phase, and reformulating bankruptcy regulations to reduce the cost of failure and stimulate entrepreneurial risk-taking activity, all underpinned by the intangible values inherent in nurturing a meritocratic business culture of productive entrepreneurship.

The economic and political aspects of reform will likely need to be more closely linked, as the introduction of taxes and fees, however incremental, will inevitably change the relationship between citizen and state. The moves toward “e” (electronic) and “m” (mobile) governments in GCC states, especially Saudi Arabia and the UAE, represent in this regard a partial attempt to open up government services and make them more interactive and responsive to citizen demands. While the heavy emphasis on “entrepreneurship” and “innovation” as the accelerator pedals of economic transition—particularly in Dubai and Abu Dhabi, but also in Saudi Arabia—indicates an assumption by governments that citizens take on a more proactive and dynamic role in economic affairs, it remains unclear how ruling elites might react to more assertive demands for a greater say in decision-making structures as well.

The urgency of the fiscal pressures that face Middle Eastern oil-producing states means that policymakers no longer have the luxury of the slow pace of incremental change that has characterized previous episodes of reform in GCC states. Sustained and transformative outcomes of economic diversification will have to unfold during a period of accelerated change and heightened regional uncertainty, but they are necessary if economies are to become less vulnerable to external sources of volatility. If successful, they would be consistent with Gulf leaders’ long record as the great “survivors” of Middle Eastern politics, defying periodic forecasts of their seemingly inevitable demise and pursuing pragmatic strategies not only of regime survival, but also of renewal. Officials will nevertheless be mindful of the Iranian example that resulted from the shah’s missteps in the 1970s, when he set in motion a process of economic and social transformation that quickly moved beyond his control and contributed to his downfall in 1979.