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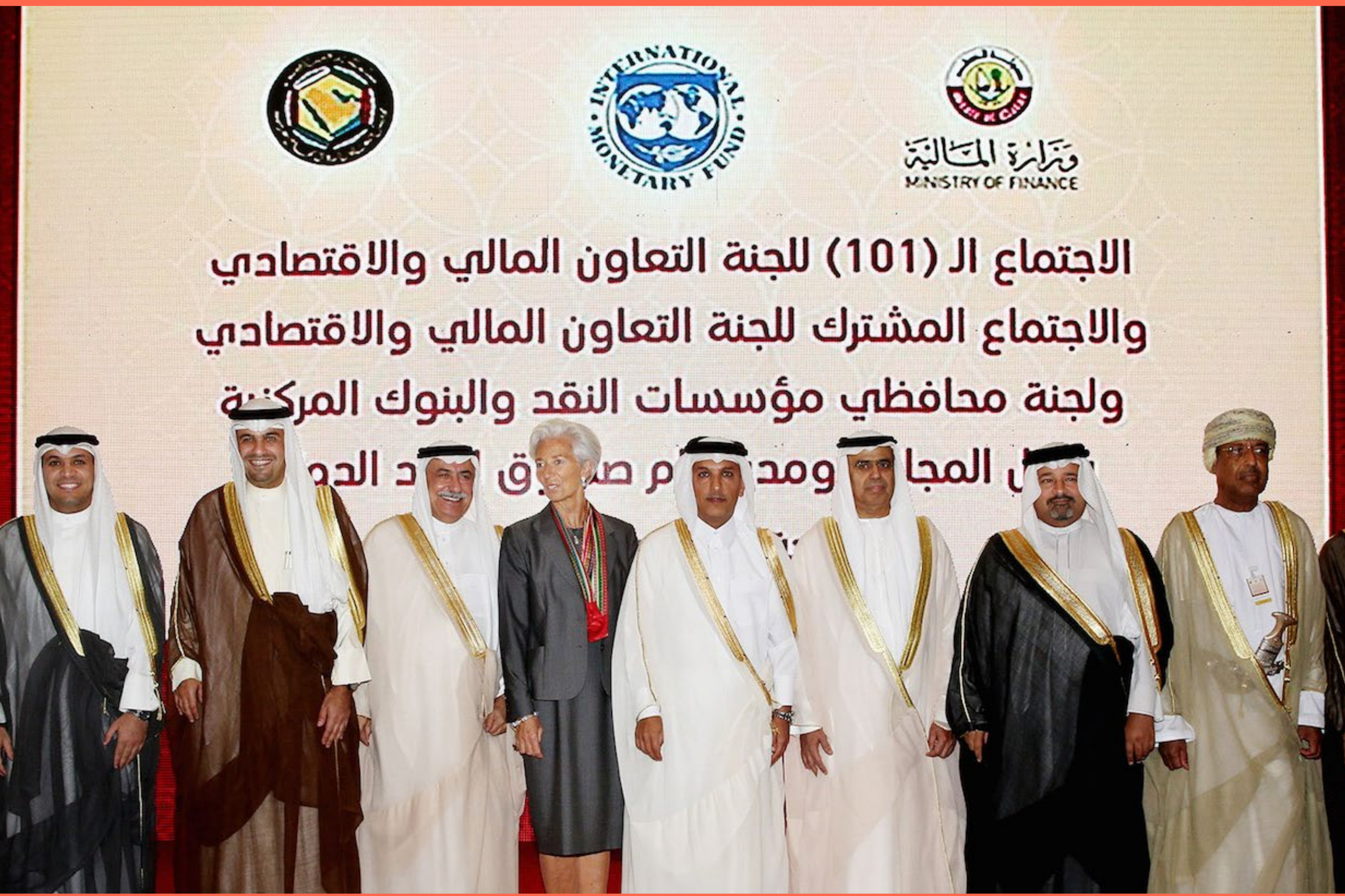


The AGSIW *Visions of Change* Series

# Economic Diversification Plans: Challenges and Prospects for Gulf Policymakers

Kristian Coates Ulrichsen

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September 26, 2016

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Policy Paper

#2

2016

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As Gulf Arab governments adjust to fiscal deficits driven by lower oil prices, the state, traditionally the leader in economic development, is under pressure to utilize available finance from the private sector. In labor markets, the state will need to reassess its role in providing the bulk of job creation for Gulf citizens, as well as question its reliance on low-wage foreign labor. These recalibrations of the Gulf economic development model have been under discussion in the "visions" of national development plans for some time. But the necessity of expeditious structural reforms is now far more pressing. Diversification away from resource-dependent state spending will require changes across the economies, and the societies, of the Gulf Arab countries.

This paper is a part of AGSIW's *Visions of Change* series, examining how the Gulf Arab countries are addressing reduced hydrocarbon revenue and responding to pressures to liberalize their economies. This series engages how these efforts are unfolding across the region, by sector and country, to underline the challenges, opportunities, and risks of innovation and economic change.

## About the Author

Kristian Coates Ulrichsen is a Baker Institute fellow for the Middle East at Rice University. His current research examines political, economic, and security trends in the Middle East and, in particular, the GCC states' changing position within the global order. He is the author of numerous works including *The Gulf States in International Political Economy, Qatar and the Arab Spring*, and *Insecure Gulf: The End of Certainty and the Transition to the Post-Oil Era*. Coates Ulrichsen obtained his PhD in history from the University of Cambridge.

# Executive Summary

This paper puts the attempts by Gulf Arab states and Iran to launch large-scale development programs into historical and comparative context. Strategic "visions" have been a hallmark of regional policymaking for more than two decades but persistent difficulties in implementation have meant that the plans have fallen far short of intended outcomes. By focusing on the practical and political challenges of technocratic and economic reforms, using specific examples to illustrate broader thematic points, this paper analyzes what the current generation of officials need to do differently to secure more favorable and sustainable results. Although the prolonged fall in oil prices has provided officials with a window of opportunity to introduce politically and economically sensitive reforms, the urgency of the fiscal pressures on budgets on both sides of the Gulf means there is little margin for error, and it is vital that decision makers absorb the lessons from the flawed earlier attempts at reform.

# Policy Recommendations: Gulf States

- The most invaluable takeaway for current decision makers to absorb from the experience of previous visions in the region is the need to engage and work with as wide a range of policy stakeholders as possible in as much a bottom-up as a top-down approach.
- 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.
- Governments must view reforms 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.
- The economic and political aspects of reform will likely need to be more closely linked as the introduction of taxes and fees, however incremental, inevitably will change the relationship between citizen and state.
- 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 Gulf Cooperation Council states.

# Introduction

The launch in April 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 the Gulf Cooperation Council states and Iran. 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. And yet, the challenge that officials in Riyadh must overcome is that all the earlier plans proved far harder to translate from vision into practice and failed to effect genuinely transformative economic change.

This paper begins by noting briefly each of the plans in the six GCC states and Iran since the 1990s and then examines the challenges of aligning political and economic interests and the resulting impact on policy outcomes. These competing interests have made sustained transformation difficult to achieve in practice, and raising each of them can help to illustrate what policymakers behind current initiatives such as Saudi Vision 2030 must do to ensure a different outcome this time around. Points of analysis include the limited collaboration among key domestic stakeholders, the lack of substantial local buy-in to plans often devised externally, the challenges in aligning technocratic visions with political realities, and the practical obstacles posed by the unique fiscal situation in the GCC states and the impact of overlapping layers of international sanctions in Iran. The paper ends with a series of recommendations for policymakers that can increase the likelihood of current and future plans succeeding where virtually all previous visions failed.

# Overview of Earlier Visions

Centralized policy planning and the utilization of Western consultancies have a long history in the region that date to the initial blueprints and "master plans" in the first years of oil-fueled economic and urban development in the 1950s and 1960s. The development of planning in Saudi Arabia illustrates the role of external organizations as a planning agency was established in 1958 on the advice of the International Monetary Fund and later expanded into the Central Planning Organization in 1965. In the 1960s, both the Arabian American Oil Company (Aramco) and the Ford Foundation in the United States helped the Saudi government establish a civil service. By the end of the decade, the collection of statistics on non-oil related activities was becoming more urgent as the information was required by the growing number of international companies that sought to invest in Saudi Arabia. In 1970, the head of the Central Planning Organization (now the Ministry of Economy and Planning), Hisham Nazer, inaugurated the cycle of five-year development plans and contracted the Stanford Research Institute (today, SRI), a private U.S. consulting firm, to draw up both the first (1970-75) and second (1975-80) five-year plans.[1]

1 Sarah Yizraeli, *Politics and Society in Saudi Arabia: The Crucial Years of Development, 1960-1982* (New York: Columbia University Press, 2012), 62, 124, 142.

The national development visions of the 21st century went far beyond the urban master plans and planning agencies of the earlier years. These 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 typically were 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.[2] The major initiatives[3] launched during this period were the following:

| Year | Country | Vision |
|---|---|---|
| 1995 | Oman | Oman 2020: Visions for Oman's Economy |
| 2005 | Iran | Vision 2025 |
| 2008 | Bahrain | Economic Vision 2030 |
| 2008 | Qatar | Qatar National Vision 2030 |
| 2010 | Kuwait | Kuwait Vision 2035 |
| 2010 | UAE | Vision 2021 |
| 2016 | Saudi Arabia | Saudi Vision 2030 |

Different motivations lay behind each of the national visions. Oman and Bahrain possess the smallest oil reserves among the Gulf states and had thus the most pressing need to diversify their economies. Decision makers in the United Arab Emirates 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.[4] 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.[5] The 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 caused a political stir in Kuwait when the cost of the plan was leaked to the media.[6] 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.[7]

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

3 Martin Hvidt, "Economic Diversification in GCC Countries: Past Record and Future Trends," *LSE Kuwait Programme Working Paper No. 27*, January 2013.

4 Kristian Coates Ulrichsen, *The Gulf States in International Political Economy* (New York: Palgrave Macmillan, 2015), 73.

5 Bijan Khajehpour, "Decoding Iran's 'resistance economy,'" *Al Monitor*, February 24, 2014.

6 Joanne Bladd, "Tony Blair's firm set to earn $42.6m in fees from Kuwait," *ArabianBusiness.com*, December 14, 2010.

7 Peter Waldman, "The $2 Trillion Project to Get Saudi Arabia's Economy Off Oil," *Bloomberg Businessweek*, April 21, 2016.

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 the new jobs capable of absorbing the fast-growing and increasingly well-qualified entrants into local labor markets. A further characteristic of many of the plans of the Gulf Arab states drawn up since the 2000s is that, like Kuwait's, they were devised primarily by international consultants, such as McKinsey, which played a key role in Saudi Vision 2030.[8] McKinsey had, in 2004, been 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."[9]

## From Vision to Reality: Challenges of Policy Implementation

For the plethora of national development plans in the Gulf to be worth more than the paper they are written on, the clear signal of policymaking intent contained within them has to be matched by robust implementation capability. Expansive statements mean little if they are not complemented by specific targets and measurable objectives on such issues as the budgetary process, legal and regulatory changes, and policy initiatives that form the building blocks of the broader vision. Given the scale, complexity, and long time frame of the various visions, the failure to provide such detail frequently has undermined their utility and hindered their implementation. In the most recent example, it was striking how many of the "baselines" and "benchmarks" for the key performance indicators in the Saudi National Transformation Program unveiled in June were listed upon publication as "Calculation in Progress" or "Under Study."[10]

The difficulty of compiling precise targets in the Saudi (and other) visions reflects, in part, one of the obstacles to the planning and formulation of public policy in the region, namely the uncertain quality and reliability of statistical and data sources, many of which are fragmentary and scattered across multiple, overlapping, and sometimes incompatible platforms.[11] This magnifies the challenge of aligning policy objectives and performance indicators among the dozens of government bodies that constitute the participating stakeholders in each plan. In the Saudi case, the establishment of an overarching Council of Economic and Development Affairs, reporting directly to Deputy Crown Prince Mohammed bin Salman, represents an

8 Salem Saif, "When Consultants Rein," *Jacobin*, May 9, 2016.

9 Marc Valeri, "Oligarchy vs. Oligarchy: Business and Politics of Reform in Bahrain and Oman," in *Business Politics in the Middle East*, eds. Steffen Hertog, Giacomo Luciani, and Marc Valeri (London: Hurst & Co, 2013), 26.

10 "National Transformation Program 2020: A Program by Vision 2030," *Kingdom of Saudi Arabia*, 2016.

11 In an extreme example, the two datasets that provide the main sources for population statistics in Kuwait – census records from the Central Statistical Bureau and the civil registration database held by the Public Authority for Civil Information – differed by 566,159 in 2011, a discrepancy that exceeded 15 percent of a total population estimated to be about 3.6 million people. See Nasra Shah, "Data Discrepancies between the Census and Civil Registration Systems in Kuwait: Reasons, Implications, and Solutions," *Gulf Labor Markets and Migration Explanatory Note 2/2014* (2014): 5-7.

attempt to overcome the limited capabilities of the existing institutional infrastructure, as does the creation of specialized delivery units in each of the 24 government entities involved in Vision 2030.[12]

Officials will be anxious to avoid the pitfalls experienced by Qatar Vision 2030 which, like its Saudi counterpart, was accompanied by a more immediate Qatar National Development Strategy 2011-2016 to align the reforms at macroeconomic and institutional levels with specific short-term projects. However, progress on both the short- and the longer-term plans was complicated by the sheer speed of Qatari population and economic growth, which meant that the goals and objectives rapidly became outdated.[13]

A further obstacle to ensuring collaborative stakeholder coordination and effective policy coordination has, in the past, been the task of securing domestic support and local buy-in for reforms associated with plans drawn up by external consultants and imposed in a largely top-down manner. Relying too heavily on teams of external consultants to lay out the "visions" can instead undermine the process of organically creating 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 that actively undermines the subsequent implementation phase. Lack of local political support was a significant factor that ensured that the Kuwait Vision 2030 prepared by Tony Blair Associates failed to gain any meaningful traction after 2010 and was shelved after its primary Kuwaiti backer – Prime Minister Sheikh Nasser Mohammed al-Sabah – left office in December 2011.[14]

*Failure to involve local stakeholders in the consultation and planning stage of the policymaking process risks generating a culture of apathy that actively undermines the subsequent implementation phase.*

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 Gulf Arab monarchies and, to a lesser extent, Iran 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 private sectors as members of the same extended families often serve both as public officials and business

12 "National Transformation Program 2020: A Program by Vision 2030," *Kingdom of Saudi Arabia*, 2016, 12.

13 Martin Hvidt, "Economic Diversification in GCC Countries: Past Record and Future Trends," *LSE Kuwait Programme Working Paper No. 27*, January 2013, 26.

14 Kristian Coates Ulrichsen, "The Politics of Economic Reform in Arab Gulf States," *Rice University's Baker Institute for Public Policy Research Paper*, June 2016, 15.

leaders.[15] In Iran, many of the privatizations of the late-2000s that followed the launch of Vision 2025 were linked to elite vested interests such as the Armed Forces Pension Fund and the International Revolutionary Guard Corps Cooperative Fund as well as the large parastatal charitable organizations (*bonyads*) that figure so prominently across virtually all sectors of the Iranian economy.[16]

Examples abound of the delicate political-economic equilibrium that in practice limits the room for maneuver 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 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 actually 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 stakeholders – government bodies, private sector organizations, and civil society groups – in support of common objectives.[17]

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 citizen and expatriate labor markets. The fact that Saudi Arabia created 417,000 new jobs in 2015 but that 88 percent (368,000) went to non-nationals testifies to the continuing resilience of such obstacles to successful reform.[18] So, too, does an April 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. The survey found that 58 percent of unemployed Kuwaitis preferred to remain jobless and wait for a government position to open up rather than take a

*...the private sector can actually position itself against government attempts to reform what many business leaders see as their access to large reserves of cheap labor.*

15 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.

16 Kevan Harris, "Vectors of Iranian Capitalism: Privatization Politics in the Islamic Republic," in B*usiness Politics in the Middle East*, eds. Steffen Hertog, Giacomo Luciani, and Marc Valeri (London: Hurst & Co, 2013), 212.

17 Kristian Coates Ulrichsen, "The Politics of Economic Reform in Arab Gulf States," *Rice University's Baker Institute for Public Policy Research Paper*, June 2016, 16.

18 "Saudis shy away from the jobs market," *Gulf States News* 40, no. 1,011 (March 3, 2016): 8.

job in the private sector.[19] Several months later, a study of the Riyadh workforce reported even more pronounced results as 80 percent 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.[20]

Policymaking in GCC states and Iran 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 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 rose by 138 percent 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.[21]

*...58 percent 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.*

In Iran, a shakeup of fuel subsidies was announced in 2010 as part of the Five-Year Development Plan for 2010-2015, itself an element of the broader Vision 2025 initiative. Although the plan initially was hailed for its boldness in tackling subsidy reform head-on, subsequent implementation was hampered by poor data availability, lack of widespread political backing, and a tripling in the price of gasoline and basic food items, which perversely increased (rather than decreased) low income families' dependence on government handouts, in the form of the direct cash payments that had been introduced in 2010 to offset the impact of the lifting of fuel subsidies.[22] As a result, the government of President Hassan Rouhani has struggled to move to the second phase of the reforms that would invest the surplus generated by the lifting of fuel subsidies into job creation schemes, the health care sector, and public transportation, and, as Iran approaches a presidential elections in 2017, has found little political support for scaling back the cash payments introduced by former President Mahmoud Ahmadinejad in 2010 even in the face of rapidly rising fiscal pressures.[23]

19 Ahmad Jabr, "58 percent unemployed Kuwaitis unwilling to work in private sector – Efforts to Kuwaitize private sector largely failed," *Kuwait Times*, April 18, 2016.

20 "80% Saudis prefer govt jobs," *Arab News*, May 31, 2016.

21 Steffen Hertog, "Arab Gulf States: An Assessment of Nationalisation Policies," *Research Paper, No.1, Gulf Labour Markets and Migration* 2014, 8-9.

22 Marketa Hulpachova, "Iranians brace for price hikes as government rolls back on subsidies," *The Guardian*, April 28, 2014.

23 "Gov Says Cannot Cut Cash Subsidies to 24 Million Homes," *Tehran Times*, April 19, 2016.

# Building Blocks for Meaningful Reform

For reforms that touch on sensitive political and economic issues to have a chance of taking root, it is essential that they be organic rather than imposed. Too many of these development plans failed to gain momentum precisely because they did not mobilize the domestic coalitions of political and economic interests whose support would have been 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.

Officials have long recognized that the welfare state that was constructed during the 1970s, at a time of seemingly plentiful 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 mid-2014. The subsequent pressures on public finances has given governments the 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 increases.[24]

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 already has led to the watering down of measures such as a government bill in Kuwait to raise utility prices, which gained parliamentary approval in April only after members of the National Assembly gutted the initial bill to exempt Kuwaiti citizens from the increased rates.[25] However, recent survey research by Justin Gengler has suggested that the long drawn-out violence of the post Arab Spring conflicts across the Middle East has led citizens in GCC states increasingly to value the provision of stability by their governments over economic handouts and financial benefits.[26]

*...debates about government spending and subsidy reform largely fell on deaf ears during the long years of the oil-price boom that ended in mid-2014.*

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. 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.

24 Jim Krane and Shih Yu Hung, "Energy Subsidy Reform in the Persian Gulf: The End of the Big Oil Giveaway," *Rice University's Baker Institute for Public Policy Issue Brief*, April 28, 2016, 1-2.

25 B. Izzak, "Nod to higher power tariffs for expatriates, businesses – Lawmakers exempt citizens from proposed raises," *Kuwait Times*, April 13, 2016.

26 Justin Gengler, "The Political Economy of Sectarianism in the Gulf," *Carnegie Endowment for International Peace*, August 29, 2016.

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 Vision 2030, indicate 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.

# Conclusion

Sustained and transformative outcomes of reform processes will have to unfold in 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 East politics, defying periodic forecasts of their seemingly inevitable demise and pursuing pragmatic strategies not only of regime survival but also of renewal. Officials in Iran (and also potentially in GCC capitals) will nevertheless be mindful of 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.