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Redesigning the distributional bargain in the GCC

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Introduction

In the face of revolutions in the wider Arab world, the GCC countries have shown that they truly are "oil monarchies" (Gause 1994): Although political systems in the GCC differ quite substantially, when faced with oppositional stirrings, all of them have instinctively reacted to the crisis with stepped-up patronage spending, financed through greatly augmented oil revenues. Together with more or less measured security crackdowns, rentier largesse seems to have done the trick: For the time being, the regimes are stable and the opposition, where it exists, is subdued.

At the same time, however, increased levels of spending raise questions of long-term sustainability – not only in political but also in purely economic terms. The oil prices needed to sustain current systems of patronage in the GCC are several times higher than they were just a decade ago. And even if the richer of the GCC countries won't run out of money any time soon, the way in which patronage is organized arguably reinforces problematic socio-economic cleavages within society.

As this paper will argue, stepped-up distribution ironically means more economic exclusion for the majority of GCC citizens, as it tends to drive them out of the private labour market, and a deepening cleavage between the citizenry at large and the local private sector. As long as distribution of rents in the GCC is not fundamentally re-engineered, it will entrench structures of entitlement that are both costly and exclusionary, and that give the vast majority of nationals a rational interest in policies that are deleterious to long-term economic development. This is true under both authoritarian and semi-democratic conditions, although it is a more acute problem in the latter case.

This paper will both analyse the socio-economic incentives and interests created by the current distributional regimes and outline a number of potential alternatives that would serve to integrate the citizenry into the local economy. It will start with an empirical overview of existing distributional systems in the GCC and of the efficiency, equity and fiscal sustainability issues they create. It will then discuss a number of potential scenarios for redesigning distribution regimes in a more incentive-neutral and sustainable way, with particular focus on the idea of a general "citizens' income". The final section will then discuss how such re-engineered distribution would have to combine with targeted labour market reforms in order to integrate citizens in the private labour market and generate common interests between business and citizenry.

The paper's theoretical ambition is the revision and refinement of the classical fiscal sociology of rentier states (Beblawi and Luciani 1987, Delacroix 1980, Mahdavy 1970, Moore 2004, Shambayati 1994). Similar to work recently done by Michael Herb (2009), I aim to disaggregate the political effects of rentier distribution on different groups in society, moving beyond the (often implicit) assumption that state and society in rentier states are, for political purposes, coherent aggregates. As in previous, more state-centric work (Hertog 2010b), I aim to trace more closely what rentier states actually do when they distribute resources – a process that has too often been dealt with in pure macro-terms.

An overview of GCC distributional systems and the incentives they create

The GCC reaction to the Arab spring has uniformly deepened existing structures of rentier patronage. Measures announced include more than 120,000 new public jobs in Saudi Arabia, 35,000 new public sector positions in Oman and 20,000 new positions in Bahrain.[1] All of the latter are to be created in the country's Ministry of Interior; the number is equivalent to more than half of the existing (official) public sector labour force of 35,000.[2]

Increased public sector wages, new food subsidies, reduced fees for a variety of public services as well as a plethora of new welfare payments and public housing initiatives have also been announced. The total spending package announced in Saudi Arabia in February and March amounts to an estimated 130 billion USD – equivalent to twice the size of the total national budget as recently as 2003.[3]

None of the measures is revolutionary or even original; for the most part, they deepen existing structures of patronage. They do this at a time, however, when the GCC countries are striving to develop a modern, or even "post-oil", economy and when they are trying to increasingly integrate their growing national populations into the productive workforce. All of these objectives have become harder to obtain after the recent bonanza of giveaways. Some of the generosity is fairly incentive-neutral – e.g. the one-off payments to families of nationals in Kuwait and Bahrain – and the "damage" done is limited to the immediate fiscal cost. Other forms of patronage however distort economic behaviour in ways that either undermine fiscal sustainability through over-consumption of precious goods and services with valuable alternative uses, or push nationals out of private employment. The following section will analyse the latter types of distribution, focusing on the provision of cheap domestic energy and public job creation.[4]

Free or subsidized public services and goods[5]

The provision of cheap energy in the shape of free or low-tariff electricity and water as well as very cheap transport fuels has a long tradition in the GCC. Low prices lead to high levels of consumption per capita and, very likely, even higher levels of consumption per citizen.

The GCC is the world region with the lowest gasoline prices; the UAE is the only GCC country that provides gasoline at a price that is close to the production cost based on international oil prices. Consumption levels are accordingly high: Per capita gasoline consumption in the GCC has risen by a third since 1986, and total consumption has risen by 158 percent (Hodson 2011).

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[1] Gulf News, 6 March 2011; Emirates 24/7 Business, 31 May 2011; Reuters, 18 March 2011; Arab News, 5 June 2011.

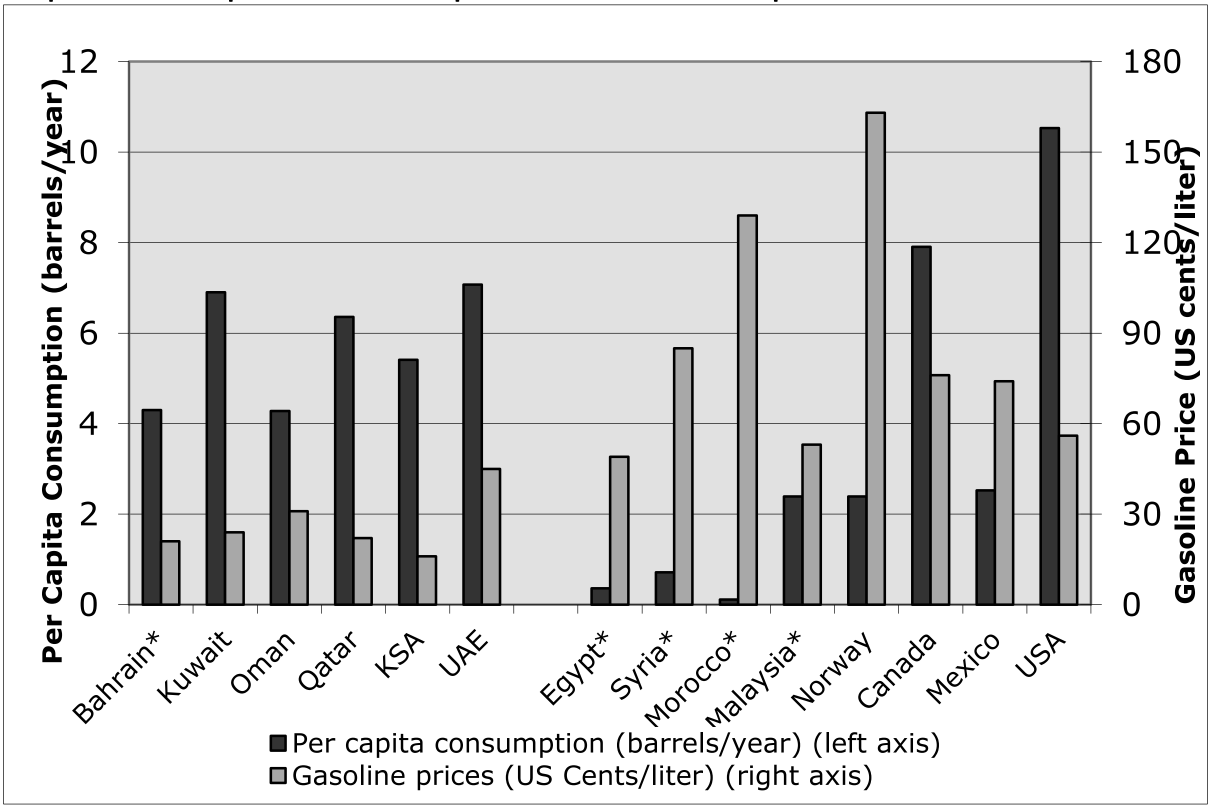
[2] Central Bank of Bahrain, Economic Indicators, September 2009.

[3] For details cf. John Sfakianakis et al., *Strategy shift: Saudi spending swells, oil price jump evens out fiscal balance*, Banque Saudi Fransi report, April 2011.

[4] Other significant forms of distribution that are relatively less distortionary include government provision of housing and land, subsidized public services that are not energy-based, food subsidies, as well as pensions and other welfare payments.

[5] In significant parts, the following section draws on a working paper by Nathan Hodson on distributional systems in the Gulf published by the Kuwait Program at Sciences Po/Paris (Hodson 2011).

Graph 1: Gasoline prices and consumption in international comparison



Taken from Hodson (2011); sources cited there: GTZ International Fuel Prices (2009); OPEC Statistical Bulletin (2009); U.S. Department of Energy's Energy Information Administration (EIA)
*Figures from 2006

The provision of very cheap gas and oil products to utility companies, most of whom are still publicly owned, allows the provision of cheap or free electricity and desalinated water for national consumers.[6] Low prices lead to very high energy consumption: Kuwaiti, Emirati and and Qatari electricity consumption e.g. is about twice as high per capita as in the EU, despite the presence of a large and for the most part poor expatriate population whose consumption needs are modest. Annual growth rates are between 6 and 10%, i.e. significantly above population growth. A disproportionate share of electricity is used in the residential sector: 42.5% of the 2007 total in the whole GCC, compared to an OECD average of 26.8% and a non-OECD average of 17.5% (for details see Hodson 2011).

When populations were small, the international market for oil saturated and associated gas from local oil production available in relative abundance, provision of cheap fuels and energy was a fairly rational thing to do in the GCC. Nowadays however populations are much larger, oil can be sold internationally at much higher prices, spare capacity is scarce and the region is short of gas for either electricity generation or industrial use. Low-tariff policies hence impose a much larger opportunity cost, forcing states to build and maintain expensive spare production capacity and forego significant export revenue (Luciani, Giacomo 2011). The below tables show the rapid pace at which gas and oil consumption have grown in the GCC.

[6] Natural gas in the GCC is made available to electricity producers at prices below 1 USD per million btu, compared to Henry Hub prices of 4-5 USD in the in United States in 2011.

Table 1: Dry natural gas consumption (billion cf, EIA)

	2000	2009	growth
Bahrain	303	444	47%
Algeria	726	1016	40%
Kuwait	339	437	29%
Oman	221	520	135%
Qatar	532	745	40%
Saudi Arabia	1759	2770	57%
UAE	1110	2086	88%

Table 2: Petroleum consumption ('000 bpd, EIA)

	2000	2009	growth
Bahrain	23	45	93%
Egypt	553	716	30%
Kuwait	264	372	41%
Libya	210	264	26%
Oman	53	115	119%
Qatar	48	147	205%
Saudi Arabia	1537	2438	59%
UAE	330	492	49%

The volumes of consumption have become very significant in macro-economic and fiscal terms. Electricity subsidies in the GCC as measured by the difference between de facto production costs (based on international input prices) and retail revenue are estimated between 0.6% (Bahrain) and 3% (Saudi Arabia) of GDP (Hodson 2011: table 6).

The implicit costs of cheap gasoline and diesel can be even higher: In Saudi Arabia, the GCC country with the lowest fuel prices, the subsidy for premium gasoline was 10.4 billion USD in 2008, representing 2.2% of GDP, while the subsidy for diesel fuel was 22.6 billion USD (4.8 percent of GDP). The total subsidy hence amounted to 7% of GDP, corresponding to 23.8% of total government spending (Hodson 2011). In Kuwait and Qatar, the total subsidy is estimated at 1.5 and 1.2% of GDP respectively.

Saudi Arabia's total energy demand in 2010 amounted to 3.4 million barrels of oil equivalent per day.[7] If current trends continue, national oil company Saudi Aramco expects this to reach 8.3 million by 2028, leaving little energy for export.[8] In 2009, the country produced an average of 9.8 million bpd of oil, but only exported 7.3 million. It hence consumed as much oil domestically as Germany, a much richer country with 3 times the population.[9]

It is doubtful that the utility that consumers derive from cheap energy is anywhere near its implicit cost. A good deal of the near-costless consumption of energy in the GCC is frivolous. Some Qataris, who as citizens receive electricity for free, are reported to run air conditioners in their homes for

[7] Saudi Gazette, 25 January 2011.
[8] Arab News, 23 March 2010.
[9] According to data from the US Energy Information Administration.

weeks during summer vacation just to have a cool house on return from their holiday. There are no incentives for buying more fuel-efficient cars and appliances, insulating houses or turning off the lights – all of which would only modestly inconvenience most consumers, but could drastically improve the long-term fiscal position of the government and liberate funds for more productive uses.

The benefits of cheap electricity, water and fuel accrue disproportionately to wealthy households and are hence equivalent to a regressive tax. This becomes an issue especially when there are insufficient funds for rival fiscal purposes – not currently an issue, but a big problem in the 1990s when GCC governments were running out of money and curtailed infrastructure and other public service investment while in several cases being politically unable to increase utility prices.

Public employment

While implicit energy and fuel subsidies are huge, the largest mechanism of patronage in the GCC arguably is that of public employment. Although for different reasons, it is as inequitable as the provision of cheap energy, and creates its own set of perverse incentives. In the less wealthy GCC countries – Bahrain, Oman and Saudi Arabia – an unusually large share of budgets is used for public salaries (Hodson 2011). The officially allocated share in Saudi Arabia in 2008 was about 45% (Kingdom of Saudi Arabia 2009: chapter 11), far above OECD levels, which lie between 20 and 30%.

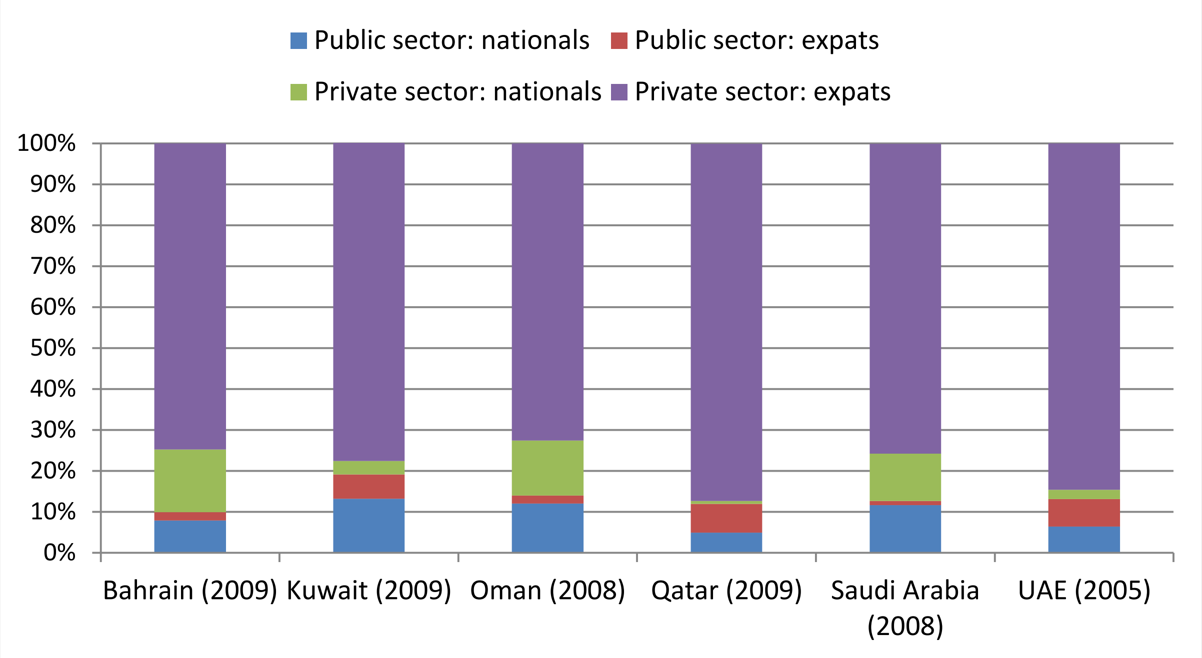
GCC public sectors are notoriously overstaffed and are dominated by nationals enjoying high wages, short working hours, and generous fringe benefits (Forstenlechner and Rutledge 2010). The wage gap to the private sector, which is predominantly staffed by expatriates, is huge: The average salary of Saudi civil servants is about 9000 Saudi Riyals, while the average wage for Saudis in the private sector is just slightly above 3000 SR.[10] The average wage of the private sector in general is closer to 1000 SR, reflecting the large presence of low-wage foreign labour[11] – itself a large source of rents for the local private sector, although a rent not directly derived from government resource allocation.

The segmentation of wages and work conditions between public and private sectors is similar or worse in other GCC countries and pushes nationals into unproductive public employment, even if that means that they have to sometimes spend years waiting for a job. It also deters nationals from acquiring skills that would be relevant in private employment; they instead enrol for low-effort higher education programs that put them into the pipeline for higher-level civil service jobs. Private sector representatives frequently complain about the irrelevance of nationals' education.[12]

Recent bureaucratic wage increases and promises of additional public employment have further deterred nationals from orienting themselves towards the private economy and have increased their reservation wages. The agenda of "nationalizing" private job markets that GCC government have been pursuing since at least the 1990s, has been dealt a heavy blow. If unreported employment in the security sector is counted in, even the poorer GCC countries very likely have more nationals working for the state than in the private sector. This contrasts with public employment shares in the rest of the world that are closer to 20% (Hammouya 1999). The total volume of public salaries dwarves of course that of (lower) private salaries.

[10] Ministry of Labor data; John Sfakianakis et al., *Quota counting: new Saudi employment rules to shake up private sector*; Banque Saudi Fransi report, June 2011.
[11] Saudi Gazette, 11 October 2010.
[12] Various research interviews in Saudi Arabia, Bahrain, Saudi Arabia and Kuwait, 2003 to 2011.

Graph 3: Employment patterns in the GCC



Source: based on Hodson 2011

Overstaffing of bureaucracies tends to be bad for quality and responsiveness of the administration, especially if jobs are seen as entitlements and there is no competitive entry. Public employment as a distributional tool is also deeply unfair at least in the states where not every national can be supplied with a low-effort bureaucratic job due to insufficient rents per capita, namely Saudi Arabia, Bahrain and Oman.

Most GCC nationals are effectively excluded from productive economic activities in their own countries. Even those who are themselves active in business often do so as access brokers rather than as real entrepreneurs: The stipulation of part or full national ownership of businesses in many sectors has led to the emergence of "cover-up" businesses across the GCC that are formally owned by nationals but in fact financed and operated by expatriates who pay an informal "rent" to the official owner. Privilege again serves to keep nationals out of their national economy (Hertog 2010a).

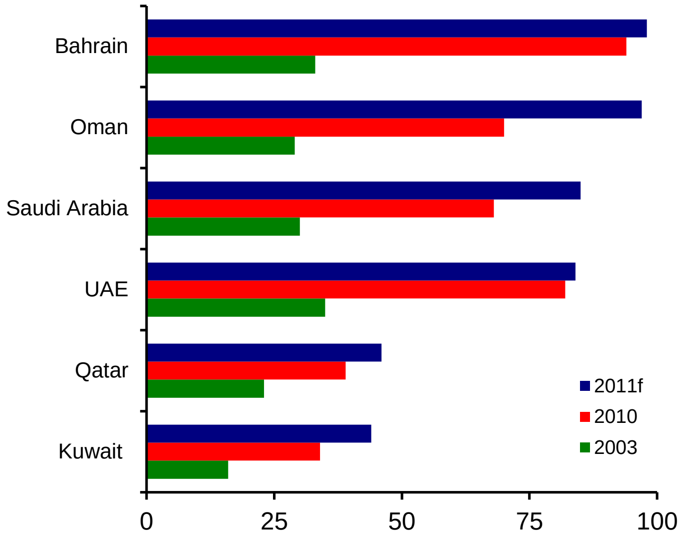
Sustainability issues

We have seen that energy consumption grows faster than the population. The structural need for public employment grows somewhat less quickly, but still at a significant pace: Cohorts of nationals entering the labour market age now were born 20 years ago, when demographic growth was still considerably above 2% in most GCC countries. With private job creation for nationals stagnant, all other things equal the need for public jobs will increase. The recent kneejerk patronage decrees stepping up job creation and increasing civil service benefits have added considerably to public employment costs in the lower-rent countries, although how much exactly is not yet clear.

Expenditure trends over the last decade paint an alarming dramatic picture: In Saudi Arabia, the official budgetary allocation for wages and benefits has increased from 116 billion to 181 billion SR between 2003 and 2008 (Kingdom of Saudi Arabia 2009). For 2010, it has been preliminarily estimated at 240 billion SR (Sfakianakis 2010). It has nominally doubled in just seven years – before the issuance of recent patronage decrees, which will significantly inflate the 2011 wage bill.

Saudi Arabia is now spending 4 times as much as in the late 1990s.[13] The Institute of International Finance estimates that its 2011 breakeven oil price is 85 USD per barrel and will increase to 110 USD by 2015. Bahrain's and Oman's breakeven oil prices are already now around 100 USD. Among the higher-rent GCC countries, the UAE has also reached a breakeven oil price of around 85 USD. Kuwait's and Qatar's breakeven prices are still estimated to lie below 50 USD, but here too, the figures have at least doubled since 2003.[14]

Graph 4: GCC breakeven oil prices (USD per barrel)



Source: IIF

Spending is unlikely to continue growing as rapidly as it has during the last decade. Yet unless there is a fundamental reform to GCC distributional systems, it will have to grow at least somewhat due to the above structural factors that will both demand increased domestic outlays and put a squeeze on oil exports. In the past, it has proven impossible to shrink public sectors and most attempts at tariff reform have faltered (Hertog 2010b: chapter 4). In the long run, however, current systems of distribution are not sustainable.

When the situation will get critical depends most of all on oil price developments. The below graphs show three different scenarios for Saudi fiscal policy under 3 different oil prices. Based on past experience, they assume that current spending – which includes wages – will see minimum growth of 4% even if the government runs a deficit. Capital spending, by contrast, is likely to be the first victim of austerity, as it has been in the 1980s and 1990s. For all oil prices below 80 USD/barrel, Saudi Arabia is likely to run down its overseas capital reserves by the end of the decade, and capital spending will be squeezed before then. Once reserves are used up, the government still has the option to incur domestic debt as it did in the 1990s, but this would likely postpone the reckoning only by a few further years.

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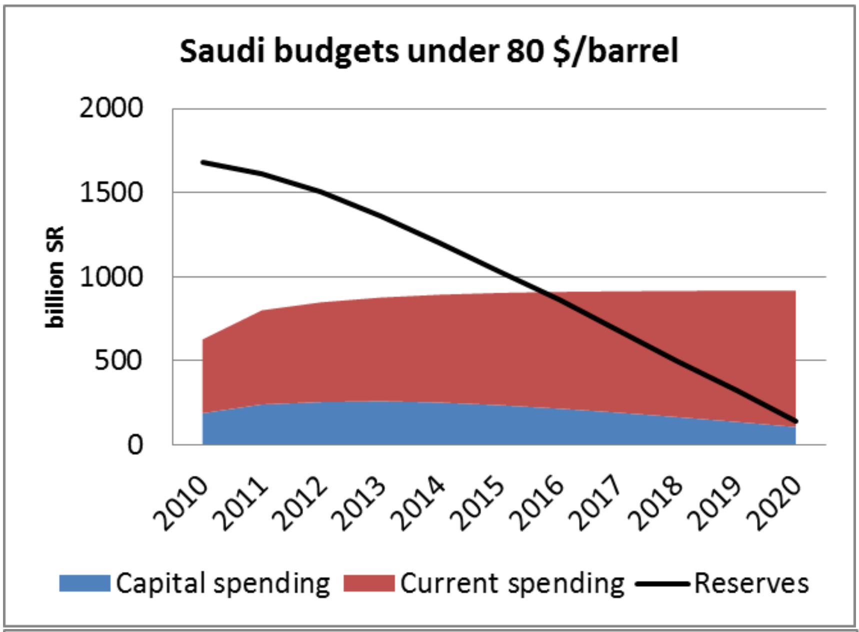
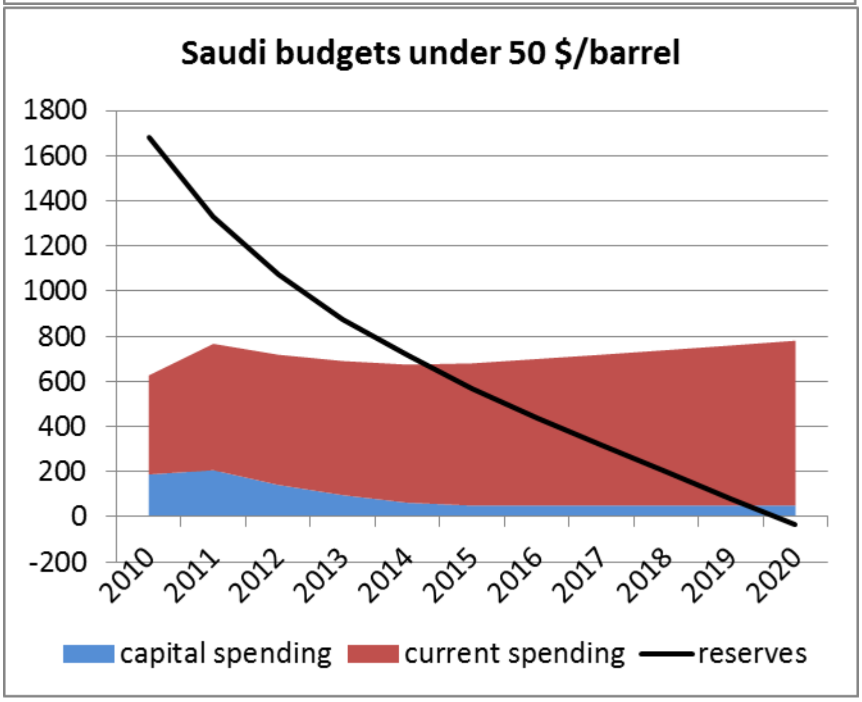
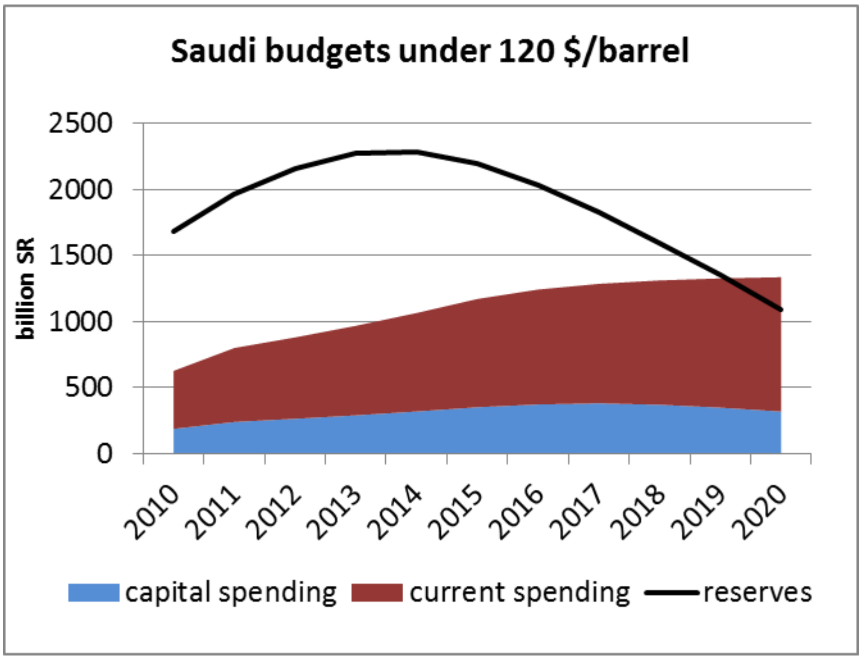
[13] SAMA annual reports, various issues

[14] Institute of International Finance, *The Arab World in Transition: Assessing the Economic Impact,* IIF regional overview, May 2011.

Graphs 5-7: fiscal scenarios for Saudi Arabia until 2020







The situation in Oman and Bahrain is more dramatic, as fiscal needs measured in terms of oil prices are larger and overseas reserves much smaller, as the savings the two countries made during the recent oil boom are negligible. In 2009, both already incurred fiscal deficits. Both have pledged extensive patronage spending during the recent unrest, putting them on an unsustainable fiscal path. It remains to be seen how long the budgetary support pledged by their richer GCC neighbours can stave off a fiscal crisis.

Potential policies

Although time horizons differ significantly from one country to the next, current regimes of distribution in the GCC all appear fiscally unsustainable in the long run. Their socio-economic sustainability is also in question, as they exclude nationals from their own economies, all regime efforts of forcible integration notwithstanding. Economic exclusion in turn feeds into fiscal unsustainability, as the absence of private incomes for nationals heightens pressure for public employment and other direct or indirect transfer schemes.

Distribution in the GCC is a political fact; even the most authoritarian Gulf ruler would find it difficult to rescind his obligation of care towards his subjects. In the fiscal crisis of the 1990s, public employment and cheap public services were the very last budget items that regimes dared to touch. Most of the modest price increases that have happened across the region were subsequently reversed. Entitlements, once created, are very hard to rescind.

Large-scale distribution cannot and arguably should not be abandoned. But if abolition is not an option, are there ways of making it less destructive and unsustainable? There is a growing, if still inchoate debate about this issue among GCC technocrats. Dramatic steps are unlikely in the coming years, but a growing understanding of the challenges could lead to more creative thinking than the region has witnessed to date. Even if ideal solutions might never be implemented in practice, it is important to develop them as a theoretical benchmark, if only to deepen our understanding of the fiscal sociology of GCC rentier states. The following pages will try to do exactly this.

How would distribution be reorganized in an ideal world? Three basic criteria appear to be relevant:

- The fiscal basis of the state should be protected.
- The citizenry should be integrated into the national economy.
- Local private sector and citizenry should develop a shared interest in growth-oriented economic policy.

The importance of the last point will emerge later on in the paper. For now, let us note that the challenge of re-engineering distribution is the same in authoritarian and semi-democratic GCC rentier states, even if the political conditions for re-engineering differ between them. Even a fully democratic GCC regime would face the same problem set.

<u>Over-consumption of energy</u>
A more equitable and incentive-neutral distribution system would avoid over-consumption of costly state-provided services and goods, direct nationals towards private rather than state employment. Addressing the over-consumption issue is the relatively easier bit. The challenge is, in essence, to create marginal consumption costs for electricity and fuel that are in line with the value of these goods, while maintaining the income gains inherent in the lower prices.

One option of achieving this would be a system of free minimal consumption allotments, where every citizen is entitled to a certain level of reasonable consumption for free, above which tariffs apply that reflect the actual opportunity costs of energy. Overall consumption levels would be considerably lower, conservation efforts would be encouraged, and the implicit subsidy to the larger, wealthier consumers would be removed. Reimbursing citizens for consumption below their allotted level could be considered, a measure that could have both an additional conservation and a stronger poverty alleviation effect.

A stacked tariff system in which marginal prices rise with rising consumption would be a second-best option that has already been implemented to some (quite modest) extent in the GCC. The introduction of steeper stacked tariff regimes by itself however would simply mean taking away existing entitlements, which would be politically difficult. It would also incentivize savings only above a certain level.

Both consumption allotment and stacked tariff schemes would be harder to organize for transport fuels than for water and electricity. A more easily administered alternative would be a direct cash grant to every adult citizen that would buy a reasonable amount of fuel at market rates. Such cash grants could potentially be subsumed under a broader citizens' income scheme, and idea that will be discussed in the following section.

An issue that is politically and socially much more complex than over-consumption of energy is large-scale over-employment in the public sector. While cheap energy is merely a nice perk of GCC citizenship, the livelihood of the majority of GCC nationals depends directly or indirectly on public sector employment. The volume of salaries accruing to Saudis through the public sector is four times as large as that derived from the private sector. The ratio in Bahrain and Oman probably is comparable, while it is much higher in Kuwait, Qatar and the UAE.

<u>Public employment reform and citizens' income</u>
I have argued above that over-employment in the public sector is an inequitable form of distribution that tends to undermine the quality of bureaucracies and, more important, undermines incentives for nationals to seek gainful private employment and the skills required for it. To alleviate these problems, GCC rentier states should move from public sector over-employment to a modern welfare

system in which distributional entitlements are based on citizenship rather than holding a public sector job.

A substantial trimming down of the civil service would free resources for policies like the introduction of general unemployment insurance and an unemployment assistance scheme for first-time job-seekers. Such measures would be politically insufficient as a quid pro quo for reduced public employment, however. Given the low salary levels prevalent on the private GCC labor market, they would also disincentivize private job-seeking unless set on an unacceptably low level.

There is a politically more palatable and less economically distortionary, if unconventional alternative: a general citizens' income that is not means-tested but is simply paid to all passport holders. Such a distribution mechanism could meet broader political support particularly among those excluded from public employment, and could make the gradual slimming down of the civil service less of a zero-sum game.

Basic income schemes have originally been proposed by economists in OECD countries, but they appear uniquely apposite in the GCC rentier context.[15] They entail unconditional cash grants for all citizens above a certain age, usually paid on a regular basis but potentially also paid out as one-off lump sum transfer (Corneo 2011). The one GCC-specific modification to the standard model should be that public servants – who already are de facto rent recipients – should be excluded from the scheme.

Rent recycling through a GCC citizens' income would make distribution broader, less exclusive, less discretionary and much less distortionary in term of labour market incentives. The level of a citizens' income would have to lie considerably below current civil service salaries, but could be set above the average wage in the private sector at large. It might be difficult to convince significant numbers of incumbent civil servants to leave their jobs for a citizens' income, but it should be easier to persuade future labor market entrants to exchange the more or less vague hope of future public employment for a concrete, life-long entitlement. In the richer countries where public employment is a more certain prospect for young nationals, the citizens' income would have to be set at a relatively higher level – luckily, these are the countries where this would be less fiscally burdensome.

The delinking of public employment and rent distribution would orient nationals towards private employment. Prospects of an easy public job would be more remote, requiring them to seek other sources of work income. In this context, the citizens' income would function somewhat analogous to a wage subsidy:[16] Nationals could achieve acceptable total income levels even if holding less well paying jobs than currently, as their citizens' income would top up their private sector wages without penalty. This might by itself be insufficient to integrate the majority of young GCC job-seekers into the private labor market, but it would be an important step in that direction.

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[15] Alaska is the only oil-producing entity that has a de facto citizens' income, although it is only starting to be analysed in these terms now. A citizens' income is under discussion in Iraq and about to be introduced in Iran; Karl Widerquist, A Day-Long Discussion of "the Alaska Model" at the University of Alaska-Anchorage, May 2011 (http://works.bepress.com/cgi/viewcontent.cgi?article=1024&context=widerquist).
For a general argument in favour of a "resource dividend" especially for poorer rentier states, cf. (Segal 2011). On Iran cf. (Tabatabai, Hamid 2010).

[16] Not strictly analogous, as wage subsidies are only paid when an individual is in paid employment. Such a policy in the GCC context would appear less equitable, however, and be more prone to abuse through fake employment – as has e.g. happened in the case of Kuwait already, where many women hold "paper jobs" in collusion with employers only to collect wage subsidies.

The graphs in the following section schematically illustrate the comparative effect of a citizens' income on nationals' behaviour on the private labor market. In the citizens' income scenario, public employment is scarce and competitive. It is compared with three other theoretically relevant scenarios:

- I – Stylized status quo: (more or less) easy availability of well-paying and low-effort public jobs, no citizens' income and no other income maintenance policies for regular job-seekers[17]
- II – Conventional welfare state: scarce and competitive public employment combined with means-tested income maintenance schemes
- III – Brutal austerity scenario: scarce and competitive public employment, no citizens' income available

The analysis is based on a standard (and highly simplified) micro-economic labor market model in which an individual's choice is determined by the intersection of two curves. The first is a budget constraint (b.c.) that reflects an individual's possible choices between earning money and leisure time. The slope of the budget constraint line represents the wage per time unit; higher wages mean a steeper downward slope and a higher intersection on the Y axis, which is the maximum an individual can earn if she uses all her available time for work. The intersection on the X axis (marked as T in the first graph) is the point at which the individual uses none of her time for work and all of it for leisure.

The second curve is an indifference curve, which represents all combinations of income earned and leisure time at which an individual derives a specific level of utility. Indifference curves usually are convex, meaning that the marginal utility from either income or leisure time diminishes with extreme values if the other is held constant. The result is that people under most – but not all – circumstances will prefer some mixture of income and leisure time instead of having only a lot of one but none of the other. Every individual has a potentially infinite number of (non-intersecting) indifference curves; the further out from the origin a curve lies, the higher the utility associated with it.

The only relevant indifferent curves in our cases are the ones that lie above the budget constraint and just about touch it. The point where the indifference curve is tangent to the constraint curve denotes the combination of income and leisure time that an individual will choose, as it reflects the highest available utility. The following exposition is highly stylized, but captures the basic labor market constraints that typical national job-seekers face.

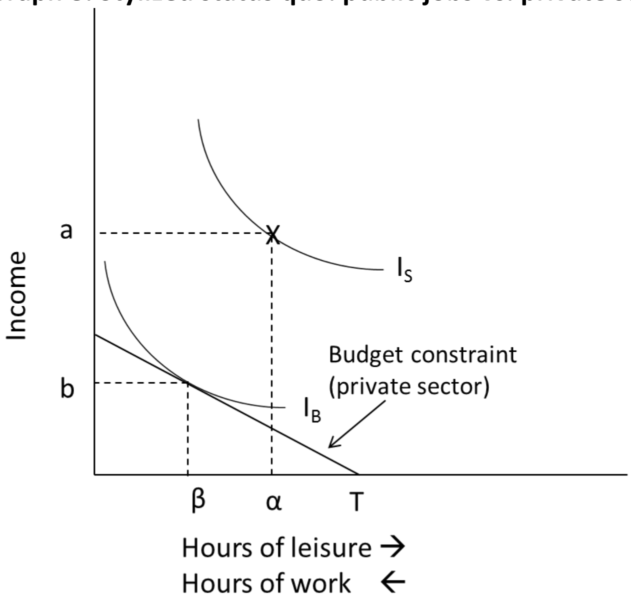
Graph 8 below shows the status quo of a segmented labor market in which a typical[18] national job-seeker faces the choice between a well-paid public sector job with a limited workload and a private labour market where salaries are lower but there is more flexibility in choosing one's work hours.

The combination of leisure time and income offered by public sector jobs is represented by the X in the graph, resulting in leisure time α and income a. The combinations of leisure time and income available in the private sector are represented by the budget constraint line below. The indifference curve I_S that intersects the point representing public sector work is far higher than the indifference curve I_B that is tangent to the private sector budget constraint. Even under the best possible

[17] A variety of new unemployment assistance and insurance schemes have been or about to be introduced in Bahrain, Kuwait, Oman and Saudi Arabia, moving them closer to scenario II, the classical welfare state.
[18] In empirical reality, all individuals different in terms of their preferences and the income they can achieve, but the stylized scenario here is representative of a large part of the population. The model also abstracts from labor market frictions, non-monetary considerations influencing work preferences etc.

combination with the highest utility, a national working in the private sector will put in more hours (β) and earn less (b) than in the public sector.[19]

Graph 8: Stylized status quo: public jobs vs. private sector jobs without income support



Current government employment policies in the GCC result in very high reservation wages among nationals relative to available jobs in the private sector. The recently created minimum salary in the Saudi public sector of 3000 SR per month for example[20] has quite likely put a floor below wage expectations of Saudi citizens, making private sector jobs paying less than 3000 SR unattractive.[21] In 2007, however, only 437,000 out of 6.47 million private sector positions paid more than 3000 SR (Feess 2011).[22]

The next graph leaves the public sector job option remains unchanged, but shows what happens to private sector employment if it is supplemented by a citizens' income. The latter simply shifts the private sector budget constraint upwards, without changing its slope. With no work at all (at point T on the X axis), a citizen would still receive a guaranteed income of CI on the Y axis. It is more likely, however, that a concave indifference curve will be tangent to the constraint curve somewhere between its two extreme points, resulting in a choice of γ hours of leisure and a total income of c.

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[19] In principle, governments can set working hours and income anywhere. As long as the combinations offered lie above the indifference curve that is tangent to the private sector budget constraint, public sector work will be preferred. In principle, public employment could also have been modelled as a steeper budget constraint curve, with the same result that a higher indifference curve is touched and hence public jobs are preferred. This is less realistic and representative however, as in practice working hours for most nationals in the bureaucracy are fixed. A steeper budget constraint curve is used below to illustrate what might happen if private sector salaries rise.

[20] Reuters, 18 March 2011.

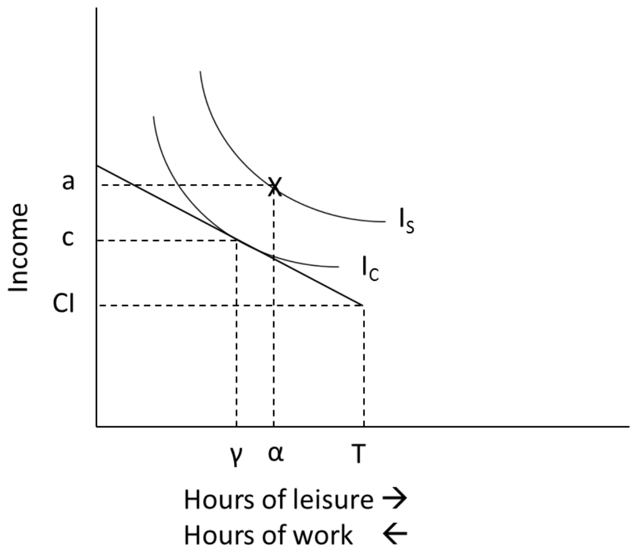
[21] Technically speaking, the reservation wage is the slope of the indifference curve at any given point, i.e. the marginal "price" a worker demands for giving up one unit of leisure. But as in practice most employment is full-time, "reservation wage" denotes the minimum income at which an individual is ready to accept a full-time job.

[22] The discussion here refers to typical job-seekers with average qualifications. Some nationals in the GCC are able to draw much higher salaries in the private sector thanks to either their connections or their qualifications. This small "cream of the crop" faces a much steeper budget constraint, resulting in the choice of better-paid private over public employment. They are a small minority in all GCC countries, however.

In the illustration chosen here, private employment is relatively less attractive, as I_S still lies above I_C. But the two curves are much closer. This means that it would take less of a salary increase in the private sector – less of an increase in the steepness of the budget constraint – to make an individual choose private over public employment. As in reality the private sector wages available to nationals can differ strongly from one individual to the next, and are not necessarily correlated with the public sector wages they can attain, this means that more individuals would choose private over public employment even if public employment continues to be widely available.

Given that most private jobs available pay bad salaries, however, this employment effect would probably still be modest, unless the citizens' income is set quite close to the public sector wages. The latter policy however would be costly and could result in individuals choosing to work in neither the public nor the private sector, instead just collecting their guaranteed income (how frequent the latter reaction is would depend on the steepness of individual indifference curves). It is unlikely that simply adding a citizens' income to existing public employment policies, even if it was fiscally feasible, would solve GCC countries' labor market problems.

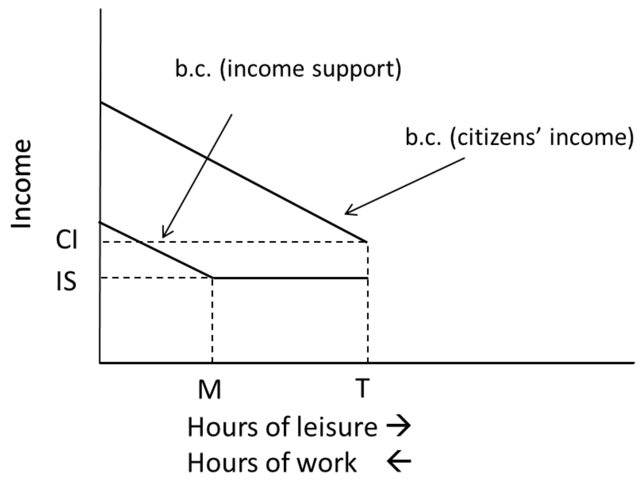
Graph 9: Publics jobs vs. private sector jobs with citizens' income



The implication is that as a quid pro quo for the creation of a citizens' income, surplus state employment would need to be made less easily available through the introduction of competitive and strictly limited recruitment (for options on how to engineer this transition see below).

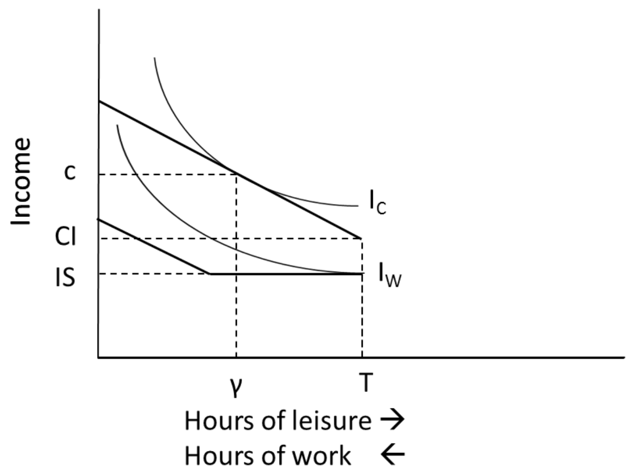
Considering an extreme scenario in which public employment is unavailable, how does citizens' income fare in terms of its labor market impact compared to other forms of social security? The below graph illustrates the budget constraints created by a citizens' income compared to a more conventional income support mechanism where a minimum level of support (IS) is guaranteed to all job-seekers, but gets phased out with increasing work income. It is only at point M that individuals start earning more in the private sector than they can receive through the IS mechanism, meaning that in financial terms, work below that level of effort is not worth it.

Graph 10: Budget constraints under citizens' income vs. means-tested income support



If we add indifference curves to the graph, we observe the following: Under a conventional income support mechanism, such as a simple unemployment assistance scheme, there is a distinct likelihood that the highest indifference curve I_W will touch the budget constraint at the very right end, resulting in a choice of no work and all leisure time. While in principle this can also happen with the citizens' income budget constraint – as will be discussed below in more detail – it is less likely to occur, as indifference curves would have to be considerably steeper.

Graph 11: Private sector jobs – citizens' income vs. means-tested income support



In many cases, therefore, a citizens' income will provide much better incentives for employment than conventional social security.[23] This is entirely intuitive, as increasing work effort under the social security scenario is "taxed" at a rate of 100% up to point M, while under a citizens' income scheme, individuals can keep both wage income and unearned income.

Not all GCC countries have unemployment assistance schemes; but even in those without, support from one's family often plays a similar role – which helps to understand why Saudi Arabia e.g. has

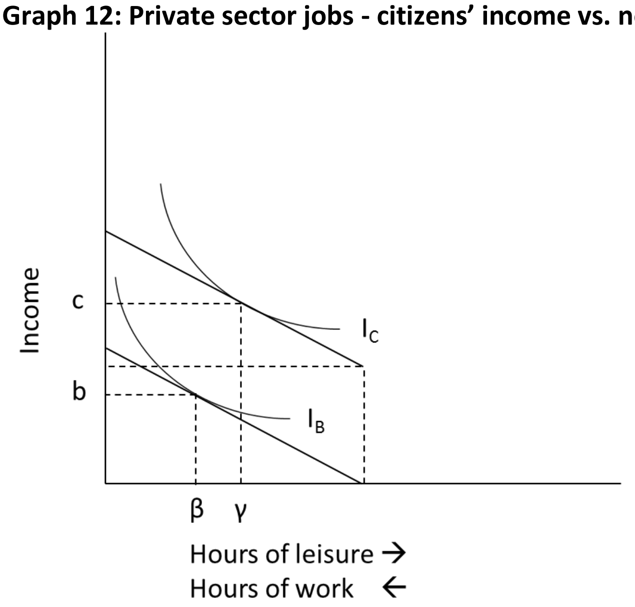
[23] In the case of "pointy" indifference curves, work incentives derived from citizens' income would still be at least as good as those based on conventional welfare, unless the citizens' income is set higher than the welfare payment.

not yet seen any large-scale unrest despite an official youth unemployment rate at almost 40%. If we assume that many families will reduce their support once a young member has found a private sector job, the impact of such intra-family welfare is equivalent to the social security scenario here, i.e. resulting in strong labor market disincentives. A citizens' income could alleviate both fiscal pressures on lower middle class families and the disincentive problem.

It should be noted that there are many different design options for unemployment assistance and other social security mechanisms. They can e.g. include a more generous "earnings disregard" mechanism under which one unit of work income results in a loss of less than one unit of benefit payments – in other words, the "marginal tax" on work income is less than 100%. The more generous such a mechanism is, the closer it would be to a citizens' income limited to job seekers, and the less pronounced the labor market disincentives would be.

We have seen that a citizens' income provides stronger incentives to join the private labor market than either the stylized status quo or conventional welfare mechanisms. How does it compare to a drastic – and highly hypothetical – scenario in which public sector employment is made scarce and no compensation mechanism is provided, leaving private sector work income as an individual's only income option? The below graph compares the two scenarios.

Graph 12: Private sector jobs - citizens' income vs. no unearned income



The result is that employment incentives are likely stronger under the brutal austerity scenario, with more hours being worked (at β) than under the citizens' income scenario (at γ).[24] It is no surprise that individuals will work harder when no forms of supplementary income are available.

The scenario however is mostly of theoretical significance, as it appears both politically unfeasible and morally unjustifiable in the context of states that control huge amounts of rent. The state is always likely to – and should – step in to distribute income to its citizens, and in individual cases where it does not, intra-family welfare often provides for minimum income support.

[24] The shift of indifference curves from the brutal austerity scenario to the citizens' income scenario represents a pure "income effect", which under conventional (Cobb-Douglas) indifference curves implies a reduction of work effort.

The main question therefore is how distribution by the state should be organized. We have seen that a citizens' income appears to be not only easiest to administer, least damaging to bureaucratic efficiency, and most equitable, but also providing the best possible labor market incentives for citizens. In combination with more restrictive public sector hiring, it would strongly reduce nationals' reservation wages, allowing them to compete more effectively with expatriate labor than to date – but without exposing them to net income levels that are socially and politically unacceptable.

Economist James Meade has made the argument that a citizens' income in Western economies would allow full employment without exposing low earners to unacceptably low total incomes (Meade 1996). It is noteworthy that he argued for such a policy in a context in which implementation would be fiscally vastly more complex – and a context in which the need for income supplement policies for private employees is much less urgent, as most of private sector wages in the West are much higher than in the GCC, despite similar levels of overall wealth.

Most of the conventional arguments against basic income regarding effects on tax rates, labor market incentives and redistribution do indeed not apply in the GCC (see Van Parijs (2000) for an overview):

A basic income in the West would require significantly higher tax rates on middle to high earners, which could lead to battles over redistribution. In the GCC, by contrast, the basic challenge is not how to raise revenue and from whom, but rather how to distribute the existing rent that accrues from outside of the local economy – an embarrassment of riches that conventional tax states do not know. GCC fiscal policy by definition is a voluntarist regime that is forced to make decisions on allocation; there is no need to build up and justify the extraction of resources from richer parts of society. Closely related, the moral argument that a citizens' income creates a system of free-riders hanging on the coattail of taxpayers does not apply in the rentier state scenario.

A citizens' income in the West would also potentially decrease work incentives for mid- and high earners, who would have to shoulder higher marginal taxes to finance the system (Van Parijs 2000: 15).[25] This again does not apply in the rentier context – as we have argued above, by contrast, a well-designed citizens' income would substantially increase work incentives for GCC nationals. This is probably the biggest selling point of such a scheme for rentier states.

Critics of basic income schemes in the West paint a gloomy picture of an army of idle or near idle citizens living off state-provided payments. In the GCC, however, the idle armies already exist – including significant parts of the public sector – and are supported in very inequitable ways. Relative to the status quo, a citizens' income would lead to significant labor market activation of nationals.

Although a few – previously unsupported – nationals might reduce their private sector work effort, many others will join the labour market in the first place, being able to make a living through combining a citizens' income with salaries that by themselves would have been insufficient. The less available easy public sector jobs and other public and private benefits are, the stronger this effect will be.

Some experimental studies in the West have shown that income maintenance schemes have a modest negative effect on the working hours of beneficiaries. This was in the context of rising

[25] Note that a higher marginal tax on earnings does not necessarily mean less net income, as every citizen receives an untaxed basic income in addition to her private income. Low- to mid-earners might hence be better off materially although potentially working less due a combination of income effect and tax rate effect.

marginal taxes, which would not apply in the GCC.[26] Still, any unearned grant not available otherwise is likely to have a negative impact on work hours thanks to an "income effect", as indicated in graph 12 above. Yet, this point about work disincentives – while of some practical significance in the West – is quite theoretical in the GCC, where alternative sources of income, including easy public sector employment, are widely available and are designed to create much stronger disincentives.[27]
One could also debate whether maximizing individuals' hours of work is really a socially desirable goal, especially in the GCC: As we have seen above, there is currently a shortage of reasonably paid private sector work for GCC nationals, so spreading the available jobs over a broader population with relatively shorter working hours might be a good idea. While in tax-based production states, more work effort tends to beget a growing economy and more work opportunities, this link is less strong in the GCC, where much growth will remain driven by exogenous rents for a long time.

A final GCC-specific argument in favour of a citizens' income is that it will be much easier to implement relative to alternative means-tested income support schemes (see Segal 2011 on the administrative advantages of a "resource dividend" in resource-rich countries in general). Means testing can be difficult even in Western economies, but is particularly dicey in the absence of a conventional taxation system. Means-tested income support requires a huge and complex bureaucracy and creates incentives for various ways of cheating and misreporting.

Different from means-tested unemployment benefits or wage subsidies, a citizens' income is not tied to attempts to find a job, which would eliminate incentives to feign job search attempts or to seek "fake" employment (as is occurring in Kuwait e.g.). Corruption and dissimulation undermining the regulatory capacity of the labor administration will be prevented, and true job seekers more easily identified. Needless to say, a citizens' income would also be less stigmatizing than any form of means-tested distribution.

None of the above is to say that a citizens' income combined with stricter public sector recruitment will solve all GCC labor market problems; I will argue below that by themselves the measures are likely insufficient. It should be clear by now, however, that the outlined policy options are far superior to the status quo and to conventional "welfare state" alternatives.

Feasibility

The present paper focuses on the conceptual aspects of a citizens' income in the GCC rather than on a detailed implementation plan. Nonetheless, a few remarks on how the transition to a citizens' income scenario could be engineered are in order.

First, given the historical stickiness of distributional entitlements in the GCC, no public servants should be fired. This way, popular buy-in will be maximized. Governments should nonetheless aim at downsizing parts of the existing civil service through early pension deals, as has already happened to some extent in Abu Dhabi in recent years. At least some of the incumbent civil servants would also

[26] To be precise, the experiment involved not a basic income, but a negative income tax. If we presume that in a tax economy, a basic income needs to be financed through higher marginal tax rates, the impact is broadly analogous, however (cf. Widerquist 2006). For a discussion of the experiments cf. (Federal Reserve Bank of Boston 1987).
More recent pilot projects in developing countries – in admittedly quite different socio-economic contexts – have shown no effect on or increases in economic activity among recipients of a basic income(Basic Income Grant Coalition 2009, Segal 2011)

[27] For the limited number of nationals active on the private labour market and previously excluded from all distribution, one could moreover put the argument on its head: Marginal work disincentives in these cases could have positive social effects, as a (very) basic livelihood guarantee would mean less pressure to take on dead-end jobs, giving them a better negotiating position and more agency on the labor market (Van Parijs 2000: 10).

find it less hard to leave their sinecures if they knew that potential private sector incomes are supplemented by a guaranteed basic income. Early pensioners should be allowed to pursue employment without loss to their pensions entitlements.

A long-term streamlining of state employment could happen through natural attrition, to be combined with limited and more competitive recruitment in order to avoid excessive over-aging of the bureaucracy. Such streamlining would liberate additional resources for the citizens' income scheme. The fiscally most difficult period would be the transition phase during which the civil service would remain at roughly its current size, while the citizens' income would impose additional costs. Luckily at present most of the GCC countries have the short- to mid-term resources to shoulder this temporary burden.

In a rentier state context, the costs of citizens' income schemes are very easy to calculate. Let us take Saudi Arabia as example. We have seen that the country spent some 240 billion SR on public sector salaries in 2010, a number that is set to increase strongly in 2011 and probably beyond.

There are about 9.5 million Saudis aged 20 years and over (SAMA 2010): 218). Of these, probably about 3 million enjoy some form of public sector employment. Excluding the latter from the citizens' income scheme would leave 6.5 million recipients. If the income is set at 1200 SR/month – just above the average private sector wage, but considerably below the public sector minimum wage of 3000 SR – the scheme would cost 93.6 billion SR/year plus modest implementation costs. This is perhaps a third of current salary expenditure and about 11% of the total government spending expected for 2011 (Sfakianakis et al. 2011).

We noted above that cheap domestic energy in Saudi Arabia imposes an estimated cost of about 10% of **GDP**, which on the basis of preliminary numbers for 2011 corresponds to about 23.4% of the government budget. So eliminating only half of the implicit gasoline, diesel and electricity subsidies could potentially pay for a full-fledged citizens' income scheme.[28] The potential for a large quid pro quo with many winners and few losers seems obvious; it seems the most elegant way of addressing energy over-consumption and labor market disincentives at the same time.

Cheap energy imposes less dramatic costs in the rest of the GCC, but savings potential is nonetheless substantial. And even if a citizens' income should impose short-term cost, it offers long-term saving through a leaner, and quite likely more efficient, civil service. Creating a citizens' income would be easier in the smaller, richer GCC countries than in Saudi Arabia and not much harder in Bahrain and Oman.

Including the private sector in the distributional bargain

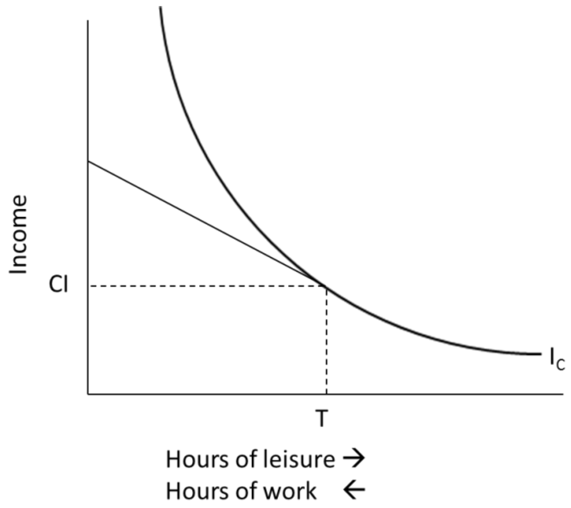
We have outlined steps that could solve over-consumption problems and increase incentives to seek more productive private sector employment. While the various tariff reform options mentioned above would be sufficient to address energy over-consumption issues, it is not clear whether the combination of citizens' income and civil service reform would suffice to integrate the majority of the national population in working age into the private labor market – an aim that GCC governments have long pursued under the banner of "Kuwaitization", "Saudization", Bahrainization" etc. and that has become increasingly pressing with growing populations.

[28] This is a simplified statement: As outlined above, higher domestic prices would lead to reduced consumption, resulting in potentially larger exports of oil and oil products (though not of gas, which Saudi Arabia does not export and which could instead be put to more productive industrial uses). Not all of the additional oil will necessarily find a market, however, and increased exports could put pressure on international prices. The effect is likely to be modest, however, given that consumption patterns will not change drastically overnight, and only concern international sales, not local sales at higher prices.

The impact of the policies outlined above would no doubt increase participation in the private labor market, but given the current structure of wages and competition in GCC labor markets it is far from clear that the effect would be sufficient to involve the majority of adult nationals in the private economy – an outcome that, as we will see, is desirable not only in its own right, but would also serve to defuse socio-economic tensions that threaten to undermine rational economic policy-making in the GCC.

For many GCC nationals, a citizens' income could result in a similar "no-effort" result as in the conventional social security scenario in graph 11 above. If the slope of the budget constraint is too flat, and the indifference curve too steep, an individual will prefer to not work at all and simply live off the citizens' income, see graph 13 below. The risk of this happening is smaller than under conventional welfare mechanisms, but given the very low private salaries and hence flat budget constraint lines in the GCC is still considerable.

Graph 13: Citizens' income scenario with steeper indifference curve

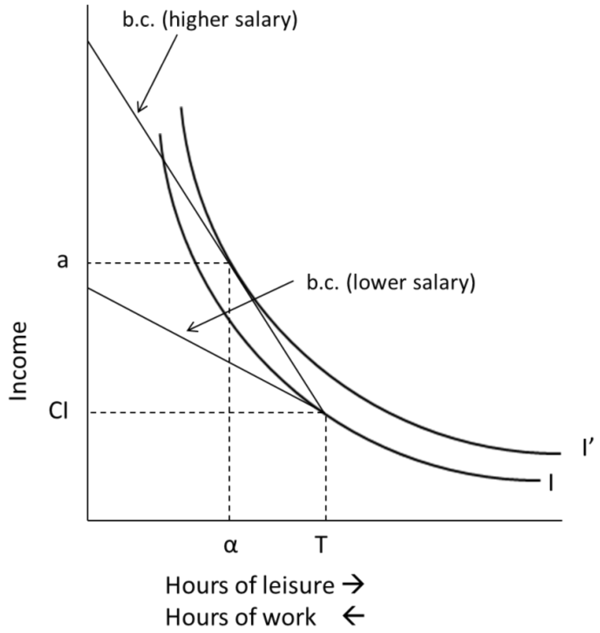


In many segments of GCC labour markets, available wages are a small fraction of the household expenditure of average national families. One could imagine that many young Saudis would refuse a job paying 1000 or 1500 SR/month, preferring to live off their citizens' income combined with parental or other private support – and possibly waiting for a government job after all, despite the longer odds of getting one, as the citizens' income reduces their acute need for a job.

The situation is even more problematic in the richer GCC countries, where private sector salaries are not substantially higher than in Saudi Arabia, but living standards for national households much higher. Against the background of expatriate-dominated labor markets with low salaries, governments could find themselves exposed to residual pressure to provide surplus public jobs despite the availability of a citizens' income. In many ways, a combination of citizens' income and continuing surplus recruitment in the public sector would still be better than the status quo, but it would be less than ideal. How could pressures leading to this scenario be reduced?

There seems to be one simple answer: Wages in the private sector need to increase to reach a level that makes full-time employment, in combination with the citizens' income, attractive for the bulk of nationals. As explained above, higher salaries mean a steeper budget constraint curve. The graph below shows how a higher salary under a citizens' income scenario would move the agent from the above illustration into the workforce, resulting in T-α work hours and a total income of a.

Graph 14: Citizens' income vs. better private wages



The easiest way to increase wages in the GCC private sectors is by making expatriate labor more expensive, either by reducing its inflow, hence making it scarcer, or by taxing it. In either case, the opportunity costs of employing nationals at higher wages would be reduced. Both approaches would obviously impose at least a short-term burden on the local private sector.[29]

As mentioned above, the private sector's privileges in GCC distributional systems are a crucial factor in the segmentation of labor markets. The almost unrestricted imports of low-wage labor allow local business to extract considerable surpluses, but at the same time contribute to the exclusion of nationals from private employment, in turn increasing the pressure to create surplus public sector jobs that further cement segmentation.

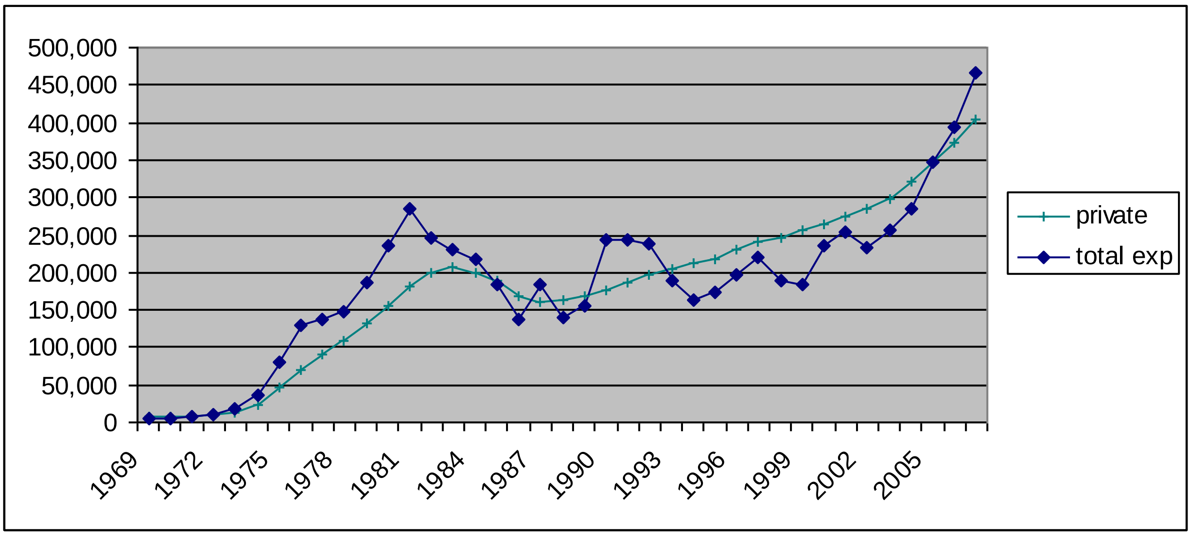
How could the local private sector be integrated in a new distributional bargain that would allow a gradual increase in the price of foreign labour? To answer this question, we need to understand how existing structures of rent recycling shape the fiscal sociology of state-business relations in the GCC.

It is generally known that business profits strongly from state spending in the GCC, be it directly through contracts or indirectly through consumption generated through state salaries. Econometric tests show that the short-term link of state spending growth and business growth is less tight than in the 1970s and 1980s, but that in the long run, the size of business activity is still closely correlated with the size of state spending, as the below graphs illustrate for the Saudi and Kuwaiti cases.[30]

[29] Blanket taxes and total quantitative caps will probably not do the trick, as they would remove many (very) low-cost expatriates from the market who could be replaced by nationals in the short run. For details on more targeted taxation and supply mechanisms aiming at sectors and jobs where the wage gap is relatively narrower, cf. (Hertog 2011).

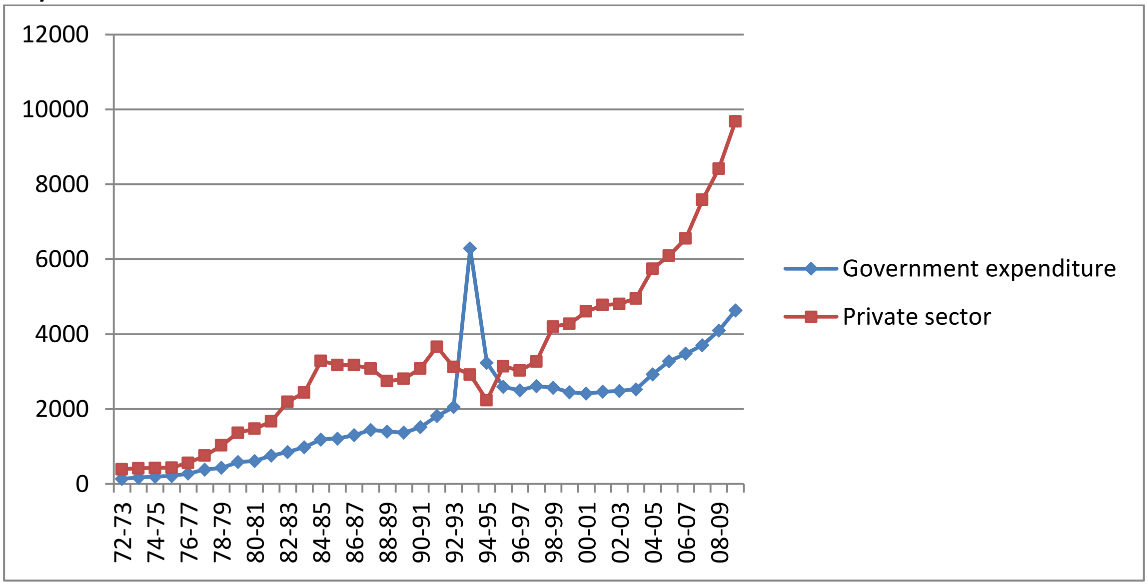
[30] While in tax economies, the causal link can run in both directions – more business activity leading to higher tax revenue and hence higher spending – the linkage in the GCC can almost by definition only be one way.

Graph 15: Private sector contribution to Saudi GDP vs. government expenditure (million SR)



Source: SAMA

Graph 16: Private sector contribution to Kuwaiti GDP vs. total government expenditure (million KD)



Source: Central Statistical Office

What is less well understood is that the rentier nature of GCC economies leads to an unusually direct opposition between the fiscal interests of the citizenry at large and those of the business class: As business growth leads neither to a larger tax base nor to significant employment of nationals, the latter have little rational interest in pro-business spending or indeed any pro-business economic policy. To the extent that voters have a say on economic policy, which is the case notably in Kuwait, they vote for populist distributional policies that are deleterious to private sector development but in their own rational interest – including excess employment in the public sector and a variety of other subsidization schemes. (cf. Herb 2009 for the general argument as well as two case studies).

In the absence of national employment and taxation effects, state spending on business and other pro-business policies only benefit a relatively small group of private investors. Different from conventional tax economies, expansionary fiscal policy is only beneficial to the bulk of the citizenry if it puts money directly into their pockets. If money is spent on, say, public works, in income terms this benefits only the contractors and sub-contractors involved and their predominantly foreign employees, who remit a large share of their salaries to their home countries.

There is a certain asymmetry of interests here, as business still benefits somewhat from spending on public sector salaries which subsequently get spent in the local economy, while pro-business spending bypasses most citizens and leads to a seepage of resources abroad. Business benefits at least from citizens' role as consumers, while business conversely does nothing to generate income for most of the citizenry.[31]

The comparative fiscal sociology of tax states, authoritarian rentier states and (semi-)democratic rentier states is schematically mapped out in the following graphs. In conventional tax states, linkages of taxation, employment and demand generation create interdependence and a potential for class compromise between citizenry and business (Przeworski 1986). Citizens in private sector employment should have some interest in pro-growth spending and regulatory policies; democratic participation allows them to articulate these balanced interests.

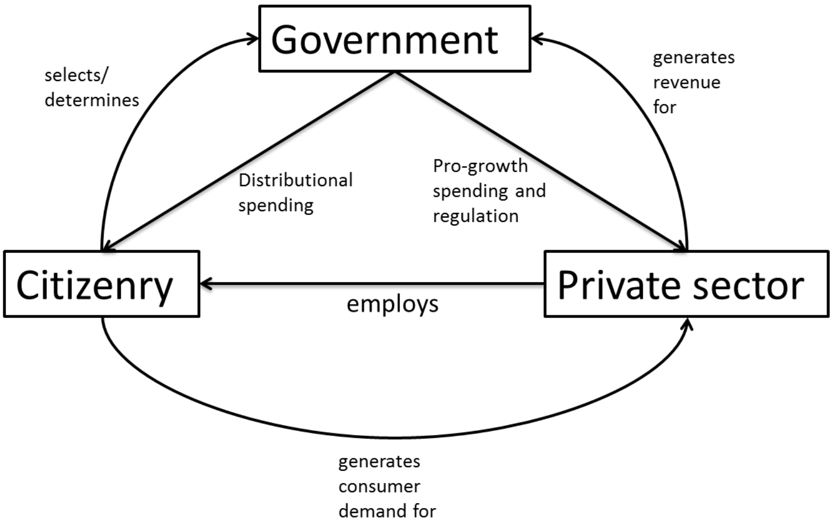
In rentier states, by contrast, there is a near zero-sum conflict between most citizens and the private sector; the two simply want to maximize patronage policies and pro-growth policies respectively. The citizenry is particularly disinterested in pro-growth measures and does not get to feel the negative economic externalities of patronage spending that act as deterrent to populist policies in tax states.

There is a difference between authoritarian and more participatory rentier states: In the (stylized) authoritarian case, links between citizenry and business as well as between citizenry and government are weakened. Government as the source of distribution therefore can play arbiter between rival interests. If the participatory link between citizens and government is NOT broken, however, government is under more pressure to side with citizens, and subordinate pro-growth policies to the distributional demands of the citizenry. Michael Herb has usefully elucidated this contrast in a paired comparison of the UAE and Kuwait, describing exactly the kinds of policy outcomes hypothesized here and in his own theoretical work. While the UAE has been able to pursue a wide range of pro-growth and diversification policies, most economic reform projects in Kuwait have been shot down by an elected parliament primarily concerned with pork barrel politics in the interest of wider sections of the citizenry (Herb 2009).[32]

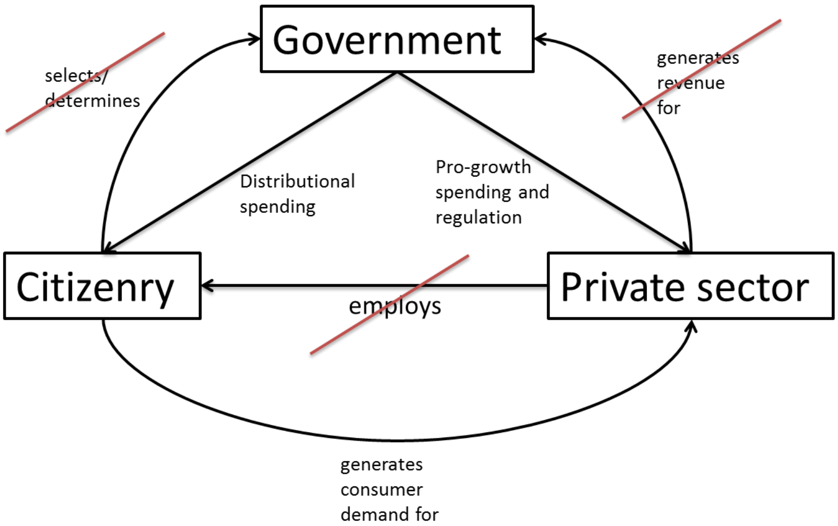
[31] This is perhaps a subsidiary reason why broad salary spending has always been privileged over project spending in times of economic crisis.

[32] This is not to say that non-democratic rentier regimes are fully autonomous from their citizenry – far from it, there are many formal and informal ways in which patronage obligations constrain regimes' policy leeway (Hertog 2010b). Yet, constraints on economic policy-making in democratic cases are more encompassing, as the Kuwaiti case vividly illustrates, especially when the use of incremental funds and the design of new institutions is concerned.

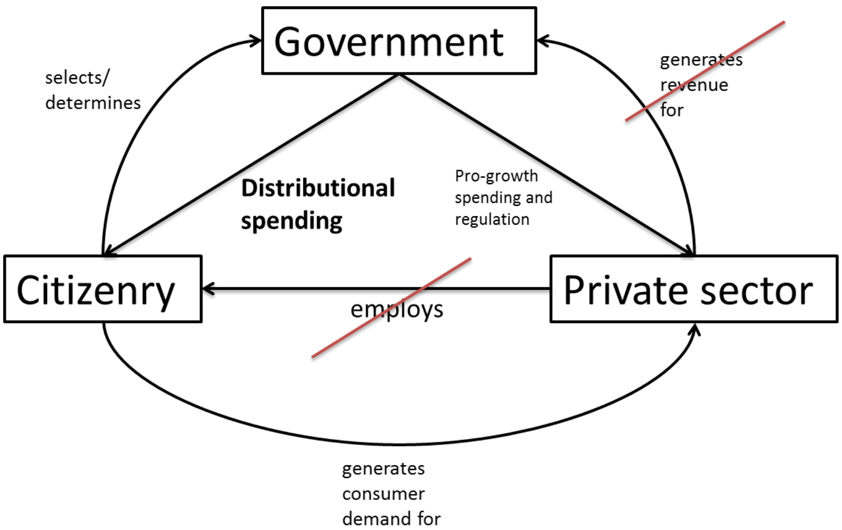
Graph 17: Fiscal sociology of a tax state – interdependence



Graph 18: Fiscal sociology of an authoritarian rentier state – government as arbiter



Graph 19: Fiscal sociology of a participatory rentier state – one-sided pressure



There are numerous fields in which policy interests of citizens and business can be at odds:

- distributional spending (public jobs and subsidized services) vs. spending on industrial and trade infrastructure, technology acquisition
- privatization vs. cheap (if potentially low quality) services
- government streamlining, building of specialized agencies and regulatory capacity vs. bureaucracy as distributional tool
- consumer loans and subsidies vs. industrial loans and subsidies

The conflicts involve the question of what the state should spend money on, but also a more fundamental struggle over whether a government should primarily be an efficient regulator and enabler or a tool of distribution. Even policy issues that most voters don't care about much, such as the creation of a capital markets authority or the planning of new ports infrastructure in Kuwait, can become bargaining chips in distributional haggling. Many fiscally neutral initiatives of diversification and regulatory modernization in Kuwait have become collateral damage in parliamentary fights that were primarily concerned with distributional conflicts, as they were the least costly to give up on.

Elected bodies in the GCC appear to be systematically more populist and oriented towards the politics of distribution, while appointed bodies have a more technocratic and development-oriented bent broadly in line with business interests. Populist inclinations are visible even in very tame (semi-)elected institutions like the Federal National Council in the UAE or the Majlis Al-Shura in Oman. Even the unelected Majlis Al-Shura in Saudi Arabia seems to have become more populist after the ruling family started to choose its membership along regional and tribal rather than purely technocratic criteria.[33]

Both citizenry and business remain highly dependent on state spending in a way that is fundamentally different from tax states. This heightens the long-term conflict potential. Different from tax states, an expansionary fiscal policy does not lead to a larger tax base (as happens in tax states according to the Keynesian "balanced budget multiplier theorem"). This means that state-driven economic expansion in the GCC has inherent fiscal limits, as additional growth tends to require ever larger and less sustainable budgets drawing on rent from finite, non-replenishing resources. Similarly, with demographic growth, the fiscal burden on the state becomes progressively heavier, as a larger population does not contribute to the fisc and, more broadly speaking, to the national economy, instead imposing ever larger costs. Long-term tensions are set to grow, with citizens and business vying for larger shares of a basically constant distributional pie.

It is against this background that labor market reforms aiming at increased private wage levels become relevant. An increase in the cost of foreign labour could indirectly reduce the tension between the fiscal interests of citizenry and business at the same time that it would relieve the distributional pressures on the state fisc.

As outlined above, higher wages would imply a shift towards national employment, as nationals would become more competitive on the private labour market – ideally while at the same time having less easy access to guaranteed state employment and drawing on a citizens' income as a least distortionary rent entitlement. Jobs for nationals in turn would help to link the fiscal interests of business and citizenry, as pro-business policies and the resulting private sector growth would benefit a growing class of national employees.

[33] Discussion with Majlis Al-Shura members, May 2011.

In the case of semi-representative rentier systems like Kuwait – whose development has been falling behind that of its neighbours for decades precisely because the citizenry has a voice in economic policy – this prospect might reduce business resistance against policies to narrow the local-expatriate wage gap. Based on a proper understanding of these linkages, Kuwait could once again become the spearhead of policy reform, as it is the only GCC country where all actors have at least some incentives for a grand distributional bargain. In the long run, higher labour costs would be likely to force stronger investment in national labour skills and productivity, as has historically happened in successful exporters like Germany or Singapore.

At least in the short run, higher private sector salaries – even if induced by quantitative restrictions on foreign labor rather than fees - would be the political and in many ways fiscal equivalent of a tax on local business, or a transfer from business to government: While business expenses on labour would increase, government expenditure on state employment would be allowed to shrink, liberating funds for pro-growth investment. This shift of the cost burden would bring the GCC more in line with conventional tax states, even in the absence of formal taxes.

Business has benefited from state spending and open migration for decades, without paying back to society through either taxes or employment. A more mature local business class should arguably step up to the plate and start contributing to the local economy in a way that includes nationals, and relieves some of the excessive burden on governments that have been expected to be the singular providers of full employment. While this might impose short-term costs for business, it reduces the long-term threat of severe distributional conflicts and anti-growth populist policies. It would allow for the gradual downscaling of the very distributional policies that have led to skewed labor markets in the first place.

In practical terms, it is unlikely that business can be “sold” on such a class compromise easily, even in a state like Kuwait where populist pressures are severe, as the potential benefits are long-term and not certain. There is therefore a potential need for a wider pro-employment coalition in society, mobilizing popular support for migration reform and against a business class that is structurally parasitic. This particular type of populism would be developmental in the long run – although it would require substantial efforts to educate national job-seekers about their own rational interest in more expensive expatriate labor. In an ideal world, authoritarian leader’s fiscal and developmental interest in labor reform would lead them to increase political participation in order to be able to pressure business more effectively.

In addition to pressure tactics, in all of the GCC systems, regimes would likely have to offer additional political concessions to business to involve it in a grand bargain, such as a stronger participation in certain areas of economic policy-making, long-term commitments to investment in national infrastructure, skills and research, and a clearer accountability of the regulatory bureaucracy. As it happens, all of these would be easier to implement by a government that does not need to act as employer of last resort.

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