The six states of the Gulf Cooperation Council (GCC) – Saudi Arabia, Qatar, Kuwait, Bahrain, United Arab Emirates and Oman – are in a period of profound change, both economic and social.

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The six states of the Gulf Cooperation Council (GCC) – Saudi Arabia, Qatar, Kuwait, Bahrain, United Arab Emirates and Oman – are in a period of profound change, both economic and social. The economic changes are a long overdue reaction to natural resource revenue dependency in their fiscal policies, while the social changes are a reaction to compounded migration and demographic shifts. The resilience of Gulf political economies will be defined by the ability to change both fiscal governance and policies of inclusion.

The Reform (R)evolution

The resilience of the economic reform agenda, which includes the reduction or termination of subsidies of public goods like water, electricity, and fuel, along with public sector hiring freezes, salary and benefit reductions, depends on societal acceptance of a renegotiation of Gulf citizenship, but also of labour. State-led capitalism in the GCC has left little room for private enterprise, except as service providers like contractors to state infrastructure projects and in the retail and hospitality sectors. Real estate markets and financial sectors are often linked to state interests, as is most industrial production of petrochemicals or metallurgy. Labour markets are dominated by low-wage foreign workers, often men, making women less visible across the spectrum of service sector and professional services employment.

The reform agenda is both a natural evolution away from carbon resource dependency, but also an ideological revolution in rejecting the patriarchal tenet that the state should be the primary source of employment and of social welfare. The shifts in domestic politics are, however, not a revolution in political institutions or to the structure of leadership in the Gulf states. Youthful citizen populations and large migrant labour communities now compete for limited private sector employment and stressed state provisions of services. To reform the economies of the GCC, there will have to be a careful rebalancing of the workforce, and the creation of new workplaces – companies and entities which do not depend on the state. This reform will displace some migrants and discomfort some citizens, who will have to come to terms with a lifestyle with fewer guarantees of state financial support and social safety nets.

Economic resilience is threatened by institutional weaknesses of the GCC political economies. Formal institutional weaknesses include bank sectors that are prone to cyclical risk, connected lending and state pressure for favourable lending to government initiatives. For example, in periods of high oil and gas prices, domestic banks are flooded with government deposits, which then fund construction and real estate booms. When oil and gas prices decline, lending decreases and banks deposits are low, as non-performing loans mount on their balance sheets. Adding to these cyclical pressures are bank ownership structures that are often closely connected to ruling families, further exposing banks to the non-performing loans of owners and their related business interests. In leaner times, governments have encouraged banks to extend loan repayment options for construction and infrastructure firms (many that are in arrears because they have not been paid for government contract work).

In informal institutions, there are weaknesses in civil society and associational life, or what scholars define as social capital. Because labour cannot organise or form unions in most of the GCC states, and business associations or policy advocacy groups are largely repressed, there are limited entry points to policymaking for the concerns of private sector workers and investors. Furthermore, there is an absence of a policy feedback loop, in which advocacy groups might petition the state for changes to regulatory regimes on a host of issues, from environmental protection to identity-based discrimination.

Economic resilience, in terms of fiscal policy of the Gulf states, will entail difficult choices about prioritising social spending over military expenditure. For the moment, even in the most fiscally constrained states like Oman and Bahrain, military expenditure continues to represent a significant chunk in 2016 and 2017 budgets. Saudi Arabia, however, has recently increased its budget allocation to education above its official military expenditure. The authoritarian state's ability to coerce and repress is directly linked to its fiscal health. Prolonged fiscal crises that hollow out military capacity and the security state often lead to the failure of these regimes, hence governments tend to protect the 'coercive apparatus' even in times of austerity.

Sovereign debt is increasingly a source of weakness, for some Gulf states more than others. While the GCC states have amassed debt issues in the last two years since the decline of oil prices in late 2014, repayment will depend on the ability to generate government revenue apart from oil and gas expected revenues. For a state like Saudi Arabia, non-oil government revenue accounts for less than 20% of expenditure, meaning that most of the money the state spends comes from the export of oil.

Strengths and Potential

Sources of strength for the Gulf states are many, including a young and well-educated citizen population, especially among young women. Citizen populations also tend to have a strong sense of nationalism, which Gulf states strive to increase especially through new conscription programmes for military service. Gulf states, with some variation, have good infrastructure with recent investments in airports, ports and roads over the last decade. The linking of the Gulf through its competing financial centres and free zones has increased the availability of financial services and access to international capital. Internet service and social media are widely used by Gulf populations. In effect, Gulf states have created a strong architecture for growth, investing in higher education, general welfare provisions, and infrastructure for their citizens. Creating the space to let citizens and residents set the pace of economic growth will be the challenge.

Despite the spike in debt issuance, Gulf governments are still in fairly liquid financial positions, in comparison to the recent debt crisis in southern Europe, most are (with the exception of Bahrain) investment grade debt issuers. Access to international capital is plentiful and recent loan and bond issues have found eager investors. For governments like Kuwait, Qatar, the UAE and Saudi Arabia, sovereign wealth funds also provide an important reserve asset.

The European Union is faced with a changing Middle East, in which the Gulf states play an increasingly important part, as they are more interventionist in their foreign policies and military engagements in the region. Since 2011 the Gulf states have played an important role in providing in-kind aid in oil and gas, as well as cash injections to struggling central banks (e.g., Egypt) and favourable investment and loan commitments. With their own financial crises, these aid and loan commitments may be less forthcoming. The role of post-conflict reconstruction in Yemen and Syria will depend on Gulf state involvement and finance. Directing policy choices and the implementation of reconstruction efforts will require multilateral coordination. Furthermore, the impact of low-growth Gulf economies will have important implications for migrant communities and remittances in the wider Middle East and South Asia regions. Aid policies from the EU to communities as far as Pakistan, Egypt, Bangladesh and Afghanistan will need to adjust to changed labour markets and growth trajectories in the Gulf.

The European Union policy coordination and collaboration to support economic resilience in the Gulf could include sharing knowledge and practices on financial governance, particularly on how best to implement austerity measures while maintaining systems in place for society's most vulnerable communities. It could also impart lessons learned on maintaining customs unions and systems of economic integration when domestic pressures for fiscal reform compete with trade agreements. Finally, the Union could offer support to civil society organisations and business associations, particularly on issue areas related to renewable energy, small and medium-sized businesses, and efforts to increase women's inclusion in the workplace.

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