Oil prices fell again the week of November 9 to a more than a six and a half year low.

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Oil prices fell again the week of November 9 to a more than a six and a half year low. Brent, the global benchmark for oil, traded at $43.61 a barrel on November 13. Global stockpiles are at a record three billion barrels of crude and oil products in tanks worldwide, according to the International Energy Agency. This is now the budget reality of oil-producing states. According to researchers at HSBC, Middle East hydrocarbon earnings are likely to be down $320 billion this year. Energy exporters are experiencing the most dramatic shift in their terms of trade in perhaps 30 years.

Budget deficits will be the new normal for oil-exporting Arab Gulf states. All of the GCC states are projecting deficits for next year and all are considering how to issue debt. Kuwait is perhaps the only outlier, in that its prudent choice in 2012 to increase the percentage of its public revenues (mostly from oil exports) from 10 to 25 percent transferred to its Future Generations Fund, along with its reserve fund, have accumulated assets of more than half a trillion U.S. dollars. These funds can now be tapped to continue existing plans in infrastructure development, including a new airport and refinery. Other GCC states, also with significant reserve assets, will have to decide how they will adjust state spending.

The question has become what fiscal and monetary policy changes might these states take to counteract the decline in revenues. So far, there has been little effort to adjust currency pegs, with most of the region's monetary policies tied to the U.S. dollar. In fiscal policy, there have been few changes to increase taxes or fees, to reduce subsidies or to reduce government spending. The United Arab Emirates (UAE) continues to consider a VAT, and has begun to reduce (though not remove) fuel subsidies. Absent major fiscal cuts, the Arab Gulf states have begun to approach local debt markets and to raise capital through asset sales.

In terms of defense spending, there is no clear evidence that Arab Gulf states are reducing military expenditure. It is difficult to estimate the cost of the UAE and Saudi Arabia's operations in Yemen, as well as the amount of aid and military support extended to Syria. We do know that the spending patterns in weapons and equipment sales over the last decade have clearly enabled the current military operations. The question will be if this pattern in military expenditure will continue in the new economic climate, and what the cost of using this equipment will entail, including substantial servicing, replacement, and resupply.

Saudi Arabia spent more than $80 billion on weaponry last year, making it the world's fourth largest defense market. The UAE spent nearly $23 billion last year in defense contracts. According to the Stockholm International Peace Research Institute (SIPRI), the Arab Gulf states have used the last decade of high oil prices to rapidly increase defense spending. Defense expenditure in the UAE increased 135 percent since 2005, as well in Bahrain (126 percent) and Saudi Arabia (112 percent). Figures for Qatar are available only from 2010, when defense spending stood at $1.9 billion, but orders for weapons worth $23.9 billion were announced in 2014.

While it is difficult to estimate the cost of the war in Yemen for Saudi Arabia and the UAE, we do have comparable estimates for United Nations peacekeeping missions around the world at $8.5 billion a year, averaging $68,000 per soldier. The United States spent more than $500,000 per soldier per year to maintain troops in Afghanistan and Iraq. One estimate of the invasion and security operation in Yemen with 30,000 troops, projects costs in the range of $15 billion per year. We do not have exact figures of the number of Saudi, Emirati, and Arab coalition troops operating in Yemen.

Of course, the United States stands as an example of deficit spending and military spending in the face of economic downturn. The difference for the Arab Gulf states is that perhaps a war economy has little domestic benefit. The private contractor business and defense market of the United States at least produced some jobs and investment over the course of the decade long Iraq war. The bulk of the Arab Gulf states' military procurement is with U.S. and European-based firms. Moreover, the major part of this spending has been focused on increasing a defense posture toward Iran, though there has been little coordination or sharing of systems within the GCC. Lockheed Martin sold the same anti-ballistic missile system to the UAE, Qatar, and Saudi Arabia. The inefficiency due to the continued absence of a shared defense strategy is a major weakness in the defense posture of the Arab Gulf states. Still, the Arab Gulf states, namely Saudi Arabia, see some of their key interests at stake and seem willing to spare no expense for their operation in Yemen.

Deficit spending, debt issuance and tapping foreign reserves are the new fiscal policy mechanisms for the Arab Gulf states for the foreseeable future. Military expenditure, driven by political and security concerns, is likely to continue to be a priority even in this new restricted budget environment.

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