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Political economy of energy policy reforms in the gulf cooperation council: Implications of paradigm change in the rentier social contract

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ABSTRACT

Member states of the Cooperation Council for the Arab States of the Gulf (the Gulf Cooperation Council (GCC)) are undertaking a number of energy policy reforms to cope with challenges from low oil prices, intensifying regional conflicts, increasing domestic energy consumption and inefficient power generation. This article offers a perspective on energy policy reform and its implications for energy infrastructure in the GCC. It outlines an observed paradigm change in the rentier social contract where energy subsidies – as the key instruments of rent transfer – are been gradually replaced by a premium associated with state-provided jobs. The new paradigm allows efficient and effective distribution of rent to the growing higher-income national population while mitigating the substantial opportunity cost associated with energy subsidies. The paradigm change is being facilitated by the extension of state control from the oil sector to the non-oil energy sector. The article discusses the theoretical implications of the paradigm change and the near-term institutional setting of energy infrastructure development in the GCC.

1. Introduction

The oil rich rentier states, such as countries of the Gulf Cooperation Council (GCC), are facing a dilemma in shaping their future energy policy: shall they leverage cheap energy to develop economy, or decarbonize energy consumption to save fossil fuel for export? Shall they privatize the energy sector or continue with a more "centralized" approach to incorporate new energy sources? Answers to these questions are not only affected by economic factors such as international oil price, renewable energy deployment cost, and the required energy mix to support a more diversified economy; they are also influenced by socio-political factors such as job creation as well as the cost of revising the rentier social contracts. Existing studies of GCC energy policy tend to view the political economic institutions of the GCC as relatively static, and to focus on subsidy as the primary means of rent for transfer [1–6]. However, low oil prices as well as intensifying regional conflicts have introduced significant pressure on the existing political economic institutions of the GCC. Understanding the socio-political rationale of energy policy reform in the GCC is crucial, as it informs the likely path of energy infrastructure development in these countries, which influences international political and energy economy substantially.

The GCC states, including Bahrain, Kuwait Oman, Saudi Arabia, and the United Arab Emirates (UAE), are six Arabic countries located in the Gulf region of the Arabic Peninsula. These countries account for 0.73% of world population, 1.80% of world GDP, 33.3% of global proved oil reserves, 23.8% of global oil production, 20.7% of global proved natural gas reserves, and 11.2% of global natural gas production [7]. Table 1 summarizes the profile of the GCC states. Demographically, all GGC states are labor-importing states, with expatriates accounting for a substantial proportion of the population. All GCC states lie below the UN water scarcity threshold. However, water consumption per capita in GCC is amongst the highest globally. GCC has the lowest oil production cost in the world, making it strategically important for the global energy economy [8].

The member states of the GCC have long been inhabited by nomadic Bedouins whose social norms, customs and governance rules resemble those of tribal systems [10]. Since the discovery of fossil fuel resources in the region, the GCC states have relied heavily on hydrocarbon revenue as the major source of national income. For such states, a rentier social contract has been established in which the population has broadly relinquished political rights in exchange for the distribution of rents [11–14]. While expropriation of wealth or property through taxation or compulsory confiscation, as commonly found with extractive institutions, is minimal in a rentier economy, policy accountability is insignificant in public governance since political power is sustained with rent distribution [15,16]. Meanwhile, tribalism remains an important social construct in contemporary GCC [17,10]. Tribal identity and association are important, as the centuries-old relationships between the rulers and the tribes remain to guide the distribution of land, licenses as well as other economic benefits [18]. In essence,

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Table 1
Basic Profile of GCC States.
Sources: [9,8], [50], [3].

	Total Population[a]	% of total Population as nationals[a]	Proven Oil Reserve (Global ranking)[b]	Proven Gas Reserve (Global Ranking)[b]	Fossil Fuels % of GDP[c]	Fossil Fuels % of Export[c]	Fossil Fuels % of Government Revenue[c]	Total renewable water resources per capita[d]	Total water withdrawal per capita[d]
Bahrain	1,314,562	48.0%	125 (66)	92 (57)	26.2	73.1	85	113	348
Kuwait	4,161,404	30.8%	101,500 (6)	1798 (20)	49.7	66.1	87	9.7	447.2
Oman	4,149,917	56.0%	5373 (22)	849 (28)	62.6	94.3	80	539.7	509.3
Qatar	2,269,672	12.2%	25,244 (14)	24,700 (3)	54.4	91.7	80	49.19	376.6
Saudi Arabia	30,770,375	67.3%	266,455 (2)	8600 (6)	45.1	85.7	78	92.01	907.5
UAE	9,387,004	11.3%	97,800 (7)	2250 (17)	38.9	31.1	65	24.96	665.2

[a] Gulf Labor Markets and Migration (GLMM) [9].
[b] US EIA [8], International Energy Statistics; unit is MMbl for oil and billion m^3 for gas.
[c] Ei-Katiri L. [2].
[d] FAO AQUSTA database, 2002 data for Kuwait, 2007 data for rest of the countries; unit: m^3/person/year.

tribal networks form the foundation of social economic hierarchy [17].

Contemporary GCC institutions are thus characterized by a mixture of tribalism and a rentier social contract [19]. Monarchy, as the cornerstone of the traditional tribal system for centuries, remains the central pillar of political and economic institutions in GCC [18]. Accession of ruling title by the ruling family is constitutionalized in five of the six GCC countries[1]; and is an explicit socio-political norm in each emirate of the UAE. Parliament, as a model institution oriented from the West, has been incorporated as part of the political institutions in Bahrain, Kuwait, and Qatar. The intertwined tribal-rentier institutions preserve some though limited levels of inclusiveness. Up to the present time, the "Majlis", the Arabic term that refers to a traditional tented meeting place where hospitality is presented before negotiations occur, remains an informal platform for exchanging and collecting opinions on public affairs. Formalized institutions of inclusiveness, such as laws on private property protection, can be found in areas where the welfare of the national population is protected. These legislations tend to be rightfully enforced [20]. Despite limited preservation of inclusiveness, opacity prevails in the formal policy-making process. Key decisions are typical made by top-level stakeholders in the absence of formalized (i.e. legislated) procedure and public engagement, except partially for Kuwait, which has a functioning parliament with two-thirds of elected members. This institutional setting facilitates speedy adjustment of national strategy and policy in response to volatile oil revenue and geopolitical conflicts. However, the opaque policy-making process may contribute to social tension when policy reforms are perceived to derail the inherited social rentier contract [21].

Under the tribal-rentier institutions, the economic development model of the GCC features strong sate involvement and welfare protection for the nationals. Throughout the GCC, governments control the oil and gas revenue, and utilize the funds to develop the domestic economy via state-owned enterprises (SOEs) [22]. Social welfare is sustained with state-provided jobs, free education and health programs, as well as subsided energy, water and food. In general, state-provided jobs tend to have higher pay, shorter work hours, better job security and non-wage benefits than private jobs [23,3,4]. Fig. 1 shows that the majority of nationals in the GCC work in the public sector; and that public sector tends to hire much more nationals than expatriates. Meanwhile, all GCC states implement "nationalization" policies to further ensure employment of the growing national population.[2] Moreover, foreign investments are subject to sponsorship programs which normally demand a majority share of local partnership (e.g. at least 51%) for businesses to be established in the GCC [24]. The "Kafala" system across the GCC requires that migrant workers be sponsored by either a citizen or a local firm [25]. These sponsorship programs were first introduced to benefit the nationals from foreign investment and labor immigration when local households had limited financial resource and labor skill was low [23]. These initiatives, however, may have decreased foreign investment attractiveness and increased labor market rigidity [26].

2. Energy subsidy in GCC rentier social contract

Energy subsidy has been one of the key components of the rent distributed from the state to the population. Subsidy can take a variety of forms with different impacts on the government, producers and consumers. Explicit subsidy involves direct transfer of budgeted funds from the government to the intended beneficiary; whereas implicit subsidy primarily involves price regulation that does not involve direct transfer of funds from the government to the intended beneficiary. Governments in the GCC, excluding Saudi Arabia, report an on-budget fiscal cost of $16.2 billion for energy subsidy in 2015 budgets (2.1% of GDP), of which Kuwait and UAE account for $11.6 billion [27].

Before 2000's, power and water in GCC was supplied primarily with a highly vertically integrated system owned and operated by the states [28]. The energy subsidy was primarily implicit and implemented via very low consumer prices for energy (e.g. electricity and gasoline). After 2000, rapid increases in the capital needed to expand electricity generating capacity have led to private investment in the form of Independent Power Producers (IPP) or Independent Water and Power Producers (IWPP) (for those operating power-water cogeneration facilities).[3] The IPPs/IWPPs sell their outputs to a state-owned water and power company, as the single buyer (SB), through long-term (typically 20 years) Power Purchase Agreements (PPA) or Power and Water Purchase Agreements (PWPAs). The price to be paid by the single buyer to the IPP is typically based on marginal economic cost, indexed to inflation and the foreign exchange rate. The cost of fuel used by the IPPs to produce power and water is typically paid by the single buyer to the NOC at a pre-determined fixed price [28]. Energy subsidy delivered through the IPP-SB-PPA model is therefore a hybrid of implicit subsidy through consumer price regulation and explicit subsidy via contracted payment from the government to the IWPP. Under this institutional setting, an increase of energy price will certainly decrease the consumer surplus but will not necessarily change the producer surplus without revision of the PPAs.

[1] Law of accession can be found in Article 1 section b of Bahrain's constitution, Article 4 of Kuwait's constitution, Article 5 of Oman's constitution, Article 5 section b of Saudi Arabia's constitution, and Article 8 of Qatar's constitution.

[2] In Saudi Arabia, for example, the "Nitaqat" policy, introduced in 2011, places companies into four different levels of compliance depending on their Saudization ratios (with thresholds varying by company size and sector) and penalize companies in lower bands with a variety of administrative sanctions [26].

[3] The IPPs/IWPPs are consider "private" as they can be either fully foreign and privately owned such as in Oman, or contains a certain level of state-ownership, such as 10% in Saudi Arabia and 60% in Abu Dhabi [28].