Managing Gulf Sovereign Wealth: Transition to the 'Modernised Economic Era'

by Sara Bazoobandi

Since the term sovereign wealth fund (SWF) was coined in 2005, it has been used for various state-owned funds that are created from different sources of wealth, such as commodity exports revenue, which are prevalent in the Gulf. These funds have macroeconomic purposes including intergeneration saving, macro stabilisation and domestic development. Some of the most globally well-known and largest SWFs, such as Kuwait Investment Authority (KIA) and Abu Dhabi Investment Authority (ADIA) are owned by the Gulf oil exporting countries. With oil revenues having fallen and domestic spending needs rising in recent years, the role of these investment funds is changing, with sponsor governments investing more heavily at home in some cases and some funds being drawn down rather than receiving new capital. Saudi Arabia is a critical test case, as its economic development plans involve the sales of local assets via privatization and greater reliance on external debt.

SWF varied functions

In addition to macroeconomic goals, the Gulf countries' sovereign wealth, in its broader definition that captures wealth beyond the institutional investors like ADIA, KIA and other comparable government-owned institutional investors, has been used for various political and social purposes:

- State building: establishment of the Gulf states in the twentieth century was followed by the introduction of a new social contract across the region. The ruling families created mechanisms through which they provide security, justice and economic support for the local tribes in return for loyalty. As populations have grown, the expectations in this implicit and in some cases explicit social contract have grown, with demands for public wage bills and subsidies increasing.

- Longevity of the ruling families: distribution of oil wealth throughout the society, as a condition for political compliance, has allowed the Gulf ruling elite to maintain their political power for decades.

- Creation of national identity: new citizenship identities that are built upon the close link between citizenship and economic benefits have been facilitated by the sovereign wealth. These explicitly differentiated nationals from migrants and also between the Gulf and their poorer neighbors. There has been a conscious effort by the ruling families to associate the economic benefits with national identity in order to boost popular support. The privileges that accompany holding GCC passports are reflected in employment benefits, judicial protections, and government grants and payments.

- International recognition: sovereign wealth has been used by the governments across the Gulf to increase their financial status globally. Particularly in the post 2008 global financial system, various investment vehicles from the Gulf have been used for this purpose, investing in high profile global assets ranging from banks to retail institutions to sports and entertainment vehicles. These in turn were viewed as a form of soft power and in some cases a source of competition between GCC countries.

- Weathering the storm of change: more recently, sovereign wealth has been used by the Gulf governments to attempt to buy regional power and quiet social anxiety. The Gulf economies enjoyed a period of sharp increases in oil prices during the initial phase of the Arab Uprisings beginning in 2011. For that reason, the ruling elite reacted to the challenges of the Arab Uprisings mainly by channeling financial expenditures in two distinct ways: 1) by introducing new financial packages domestically, and 2) by providing financial assistance to countries going through political transitions.

New challenges to reshape SWF mandates

While sovereign wealth has served many of the national purposes in the Gulf, it has not contributed much in addressing economic diversification, one of the biggest challenges for all the oil-exporting countries of the region. The Gulf economies have been affected to differing extents by past oil price falls—the impact tends to reflect the size of the population, the availability of savings and associated economic needs. For example, smaller, richer nations like Qatar and the UAE have been more resilient to oil price swings and have been more able to use their wealth to seed new industries. Vulnerability of the existing growth model across the region, and especially the need to increase employment, has underlined the need to make substantive changes towards a more diversified economic growth model.
Decreases in hydrocarbon export income may profoundly affect the growth prospects in the Gulf and it has prompted some of the Gulf economies to introduce new fiscal measures, such as: value-added tax (in Saudi Arabia and the UAE), in order to generate more non-oil revenues. Moreover, the policy makers have begun to address some of the challenges imposed due to unsustainable public spending through policies such as: public sector hiring freezes, pay cuts and subsidy reforms. However, these measures are not sufficient to address structural problems, as the

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main source of government finance has largely remained dependent on oil – and spending cuts/new revenue have not increased sufficiently. Moreover, some of these measures may have to be abandoned to avoid social discontent. Therefore, while economic diversification has affected public policy in the region, there has been very little done to implement necessary measures in a timely manner. Instead, there is a lot of effort amongst the regional ruling elite for rebranding the old economic structures by launching widely publicized modernization initiatives.

Saudi Arabia sets the tone

Saudi Arabia's new economic reform program, Vision 2030, is the best example of such modernisation initiatives and how SWF management is shifting. Saudi Crown Prince, Mohammad bin Salman, has associated himself closely with economic reforms that promised to reduce oil dependence and create more jobs by the private sector. In the case of Saudi Arabia, a new pattern for using sovereign wealth has been emerging. After years of saving the bulk of revenues and investing in a range of more liquid assets abroad, Saudi Arabia's local spending needs have increased sharply since 2011. Since 2014, there has been a recognition that past economic policy is unsustainable. Under the leadership of Mohammad bin Salman, the government has promised to develop the country as a global hub for business, trade and tourism. There is a major difference between the traditional source of sovereign wealth (i.e. commodity export income) and what the Saudi Crown Prince calculated (i.e. through privatization and attracting private investment). Generating sovereign wealth from selling government's assets seems necessary, as the oil price trends make it clear that states can no longer afford to keep spending open-endedly, especially as new spending demands proliferate. However, attracting private investment as a diversification method is challenging for oil exporting economies of the Gulf since investors judge the growth prospects on the basis of the oil price. Moreover, there remain questions about the terms of the mega projects which have kept investors at bay.

All in all, the new economic strategies in the region, in particular in Saudi Arabia, are capturing a lot of attention both at the domestic and international level. However, efforts to reduce the level or at least the pace of growth of government spending combined with privatizing government assets would have serious social consequences. The current economic trends prove that 1) ultimately, the traditional use of sovereign wealth to maintaining longevity of the ruling elite via distribution wealth in exchange for political loyalty, and 2) the transition from the current structures to the 'modernized economic era' will be inevitably associated with risks of growing inequality and social exclusion.

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