KONRAD ADENAUER STIFTUNG

Policy Report No. 11 – July 2020

The Evolution of State Capacity in the Gulf Region

Dr. Omar Al-Ubaydli

Background

Building a powerful government bureaucracy that is capable of running the state and delivering services is one of the most important tasks of every government. During the last decade, the Gulf states have been increasing their state capacity considerably, defined as the ability of the state to penetrate society and to mobilize it in the way it wants. The pandemic of Covid-19 has given the Gulf states an unwelcome opportunity to showcase these improvements.

Historically, states in the Arabian Peninsula have been either weak or completely absent, primarily due to the climate: deserts mean that nomadic life predominates, and so entities can seldom gather the resources needed to operate an effective bureaucracy. Moreover, and in contrast to Egypt, in areas such as the Eastern Province of Saudi Arabia and the UAE, colonial powers had only limited interests in building the state's capacity.

As a result, the primary functions of the central governments of the Gulf countries were maintaining law and order and operating foreign policy. In the case of the Kingdom of Bahrain, which is home to the oldest education system in the Gulf region, the first school, Al Hidaya Al-Khalifiyya, was a private philanthropic venture that was established only in 1919.

After the discovery of oil in the 1930s, Anglo-American interest in the region was renewed. Extracting oil is a complex process that requires more sophisticated bureaucracies than was previously necessary. It also generated significant revenues that the Gulf governments could use to build their capacity.

However, since these revenues were external resource rents rather than being acquired through traditional taxation, the Gulf countries skipped a traditionally pivotal step in the state formation process. Building a bureaucracy that is able to manage the process of levying and collecting taxes is a major undertaking, and as the history of Europe and Asia has shown, once a government successfully undertakes this task, its ability to exert its influence throughout society expands massively. But in the case of the Gulf States, the number of people required to manage oil revenues is small, and the penetration of this bureaucracy to society is extremely limited. Consequently, the state capacity in the Gulf States advanced slowly.

State capacity in a changing political and economic environment

The provision of a security guarantee by the Americans and the British reinforced this tendency for limited state capacity. Political scientist Charles Tilly famously argued that war was a major factor in states' formation: it created a need for potent bureaucracies to mobilize the resources required for war, and it also made the process easier by giving rulers extra legitimacy (the need to defend borders from hostile invaders) in their quest for tax revenues. But with the powerful armies of the Americans and British neutralizing any external security threats, the Gulf countries again did not need to go through the same state-building process that countries such as Germany or Japan experienced during the 19th century.[1]

[1] Fukuyama, F., 2011. The origins of political order: From prehuman times to the French Revolution. Farrar, Straus and Giroux.

This security guarantee was not an empty bluff: in addition to the numerous western military installations present in the Gulf region, such as the US Fifth Fleet, the willingness of these foreign powers to protect the Gulf states was demonstrated spectacularly during the liberation of Kuwait in 1990. However, after this high water mark, the calculus began to change in the 1990s and into the new millennium, due to a series of developments.

First, the defeat of the Soviet Union in the cold war signalled a decrease in the US' appetite for foreign military intervention on a large scale. The build-up of troops in the Gulf region was part of the U.S. campaign to prevent communism from taking root in the region, but this threat had now subsided.

Second, the US invasion of Iraq and Afghanistan spawned a new range of threats to the security of the Gulf countries: Iran was able to expand its reach considerably, and the ungoverned areas of Iraq and Afghanistan contributed to the rise of terrorist groups targeting the Gulf states. These threats were amplified in the wake of the Arab spring, when several previously stable states, most notably Syria, experienced prolonged civil wars with adverse consequences for the security of neighbouring countries.

Third, the slow but consistent development of shale oil in the US during the period 2005-2014 led to a diminished US dependence on oil imports from the region, and a much lower exposure of the US economy to oil price shocks. Consequently, the strategic importance it attached to the Gulf region particularly and the Middle East in general decreased, as reflected in the US' reluctance to deploy ground troops in the Syrian civil war.

These developments convinced the Gulf States to build their own defensive capabilities. The unprecedented increase in oil prices that occurred in the period 2003-2014 granted the Gulf States sufficient financial resources to increase expenditure on developing and modernizing their military and security apparatuses, as well as of creating new jobs and maintain the social subsidies to the Gulf countries' indigenous populations, whose numbers had grown substantially since the 1970s.

However, in the period 2014-2016, oil prices collapsed from $120/barrel to $30/barrel, immediately rendering existing budgetary plans as unfeasible. To rebalance their budgets, the Gulf countries needed to increase their non-oil revenues, which in turn necessitated significant upgrades to the state's capacity.

Taxation in the Gulf States

Prior to 2014, taxation in the Gulf countries was virtually absent, with all six countries occupying the highest positions on the "fiscal freedom" dimension of the Heritage Economic Freedom of the World index. There were no income taxes, no VAT, no corporation tax, no sales taxes, no payroll tax, no inheritance taxes, and no property taxes; a small customs duty was the most that residents of the Gulf could expect to pay, and many basic commodities, such as fuel, flour, and meat, were subsidized at high rates by the government.

The Gulf countries began by heavily rolling back many of these subsidies to basic commodities. Fees on the employment of migrant workers were imposed and/or raised, as were the fees on a wide range of commercial activity, in an explicit attempt to generate non-oil fiscal revenues. In 2018, Saudi Arabia and the UAE launched VAT, and in 2019, Bahrain followed suit. Also in 2018, Saudi Arabia consolidated all subsidies under a new system, the "citizen's account", and replaced them with means-tested transfers at the household level. Bahrain also replaced its meat subsidies with direct household-level transfers.

Generating these new revenues and modifying the subsidy systems required significant investment in the state's bureaucratic capabilities. New state organs were established, such as the National Bureau for Revenue in Bahrain, to perform these functions. Crucially, these new activities gave the Gulf governments unprecedented access to information on the financial activities of both households and commercial entities – information that is easily available in Western economies due to the extensive presence of taxation.

At the same time, the imposition of such taxes, while politically unpopular, was rendered much more digestible among the general public by the visible nature of the growing security threats and the U.S. disengagement from the region. Moreover, the complete chaos unfolding in the countries surrounding the Gulf region, most notably Syria, Iraq, and Yemen, also helped create acceptance for the governments' need of taxation.

Covid-19 and Gulf States Capacity

Fast-forwarding to 2020, the Covid-19 pandemic has been a global health and economic disaster, and the Gulf countries have been heavily affected. However, their recently developed state capacity has facilitated some of the response measures.

For example, in Bahrain, the government has paid the wages of nationals working in the private sector, while in UAE, authorities have been disbursing considerable financial support for small businesses. In Saudi Arabia, military personnel have aided in the enforcement of strict lockdowns, while in all of the Gulf countries, governments have been very active in determining and enforcing which types of activities are permissible, and in ensuring the smooth operation of supply chains for critical commodities, including protective equipment for frontline medical personnel.

The UAE has long been an active donor in the global arena, but during the current pandemic, rather than merely supplying financial contributions—which requires limited state capacity—they have been sending in-kind donations using their own aircrafts and their personnel has been active on the ground in recipient countries. Such actions require competent and effective bureaucracies.

Conclusion

There is little doubt that in the 1970s, had they been confronted with a comparable crisis, the Gulf countries would not have been able to manage their affairs as adroitly, whether in health or economic domains. The organic process of building state capacity in response to growing external threats, and as a result of building effective tax-collecting bureaucracies, has been underway in the Gulf countries over the course of the last 20 years, accelerated by the recent sharp declines in oil prices. If the US continues to be wooed by its isolationist past, and the oil-price outlook remains pessimistic, then the Gulf bureaucracies may well continue to develop their capacities; or, as American playwright Kurt Vonnegut once quipped: "We have to continually be jumping off cliffs and developing our wings on the way down."

Omar Al-Ubaydli (@omareconomics) is a researcher at Derasat, Bahrain.

Contact Konrad-Adenauer-Stiftung e.V.

Regional Programme Gulf States

Fabian Blumberg
Representative to the Gulf States
Email: fabian.blumberg@kas.de

Dr. Mohammad Yaghi
Research Fellow and Programme Manager
Email: mohammad.yaghi@kas.de

https://www.kas.de/rpg