Life after Oil: Economic Alternatives for the Arab Gulf States

J. E. Peterson

There have been three economic transformations of the Arab Gulf. Yet the obstacles today remain eerily similar to those of forty years ago. The first transformation occurred after the discovery of oil, variously between the 1930s and the 1960s. For the first time, what had been one of the world's poorest regions had the means to build elements of basic infrastructure and to improve standards of living. Urban centers appeared and rulers had the means both to transform their countries' economies and to exert greater control over their citizens.

The second transformation was the result of the oil price revolution of 1973–4. The tripling of income set off a gold-rush atmosphere. More spending was directed at socioeconomic development and infrastructural projects than the country's absorptive capacity could handle. Standards of living improved dramatically and new generations of educated citizens emerged. The decline in oil prices during the 1980s, though, hammered home a key lesson, namely, that prosperity and continued growth could not remain unhealthily dependent on oil income, reinforced by the fact that oil was a depletable resource—and was being depleted rapidly in some states.

The third transformation was prompted by the recent spiraling of oil prices in the first decade of the twenty-first century. While the gulf states

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have experienced the euphoria of a second "gold rush," memories remain of the wake-up call of the mid-1980s, and the fundamental question that these states must answer is what to do when oil runs out. With oil prices and national incomes at record levels, now is the time to devise and implement successful strategies, while the money is still there. In this respect, the third transformation is the last opportunity. This realization has been hammered home by the drop of oil prices in early 2009 to forty dollars a barrel and less. All of the Gulf Cooperation Council (GCC) states recognize the problem, but the future is closer and more somber for some than others.

Simply stated, the problem is that oil reserves are finite. While additional reserves are constantly being discovered and exploited, new fields tend to be of smaller quantities and less quality, more expensive to produce and more difficult to get at. The big oilfields sustaining the biggest production have been deemed mature for years or decades, and in recent years there has been considerable concern that as much as half of the proven reserves in these fields may never be recovered.

The second aspect of the problem is that nonoil resources — minerals, arable land, skilled populations, and even capital for some countries — are scarce. Thus the path to economic diversification is especially difficult in the gulf. In conjunction, since oil revenue flows to the state, the state has assumed the responsibility for distribution and development. Almost inevitably, this has meant that state-managed diversification efforts and development activities are slow, inefficient, and biased in one way or another.

Apart from Saudi Arabia, all the GCC populations are small (see table 1). There are considerable expatriate communities in all six states, and expatriates form the majority of the population in half of them. Nearly all the states are growing rapidly in citizen population, and at least three face tremendous problems in unemployment. While three countries export natural gas, the income from this source is far smaller than crude oil exports and, like oil, it is a capital-intensive industry and so does little for employment. Two-thirds or more of state revenues are produced by hydrocarbon revenues, and that cannot be sustained indefinitely.

While all the GCC members possess similar economies in general, they can be split evenly into two groups: those that enjoy considerable surplus income at present (Kuwait, Qatar, and the United Arab Emirates) and those

Table 1

Comparative GCC Statistics

	Bahrain	*Kuwait*	*Oman*	*Qatar*	*Saudi Arabia*	*UAE*
Population (millions)	0.7	2.5	3.2	0.9	27.6	4.4
Nationals (%)	67.0	48.0	72.0	15–20.0*	80.0	15–20.0*
Population growth rate (%)	1.4	3.6	3.2	2.4	2.1	4.0
Population 0–14 years (%)	27.0	27.0	42.7	23.1	38.2	20.6
Literacy (%)	86.5	93.3	81.4	89.0	78.8	88.9
GDP (US$ billions)	16.9	103.4	40.5	65.8	374.5	189.6
GDP per capita (US$ thousands)	35.0	55.0	19.0	76.0	21.0	55.0
Labor force in industry (%)	79.0				25.0	15.0
Labor force in services (%)	20.0				63.0	78.0
Labor force in agriculture (%)	1.0				12.0	7.0
Unemployment rate (%)	15.0	2.2	15.0	0.7	13.0#	2.4
Oil production (thousand bbl)	184.0	2,669.0	740.0	1,111.0	11,000.0	2,540
Oil exports (thousand bbl)	235.0	2,200.0	733.0	961.0	8,900.0	2,540
Natural gas production (billion cu m)	10.0	11.8	19.0	44.0	68.3	45.1
Natural gas exports (billion cu m)	0.0	0.0	10.2	26.0	0.0	6.8
Budget revenues (US$ billions)	6.0	66.9	13.8	23.5	193.7	58.2
Budget expenditures (US$ billions)	5.0	36.4	13.7	19.6	122.2	38.1
Oil and natural gas revenues as part of total state revenues* (%)	74.0	77.2	77.0	66.5	46.2–89.7	76.1
Public debt (% of GDP)	28.0	7.8	2.8	23.2	22.6	14.8
External debt (US$ billions)	7.7	33.6	3.5	31.1	52.9	41.5

Source: Central Intelligence Agency, *World Factbook 2008*, www.cia.gov/library/publications/the-world-factbook/.

*Derived from statistical yearbooks and similar government publications of the countries concerned and personal estimates.

Males only.

Blank cells indicate that no information is available.

that face immediate requirements for replacing oil income. One of these, Bahrain, can be said to be a postoil economy already. A second, Oman, may well be facing the same prospect in the next few years. Paradoxically, the third, Saudi Arabia, holds the world's largest oil reserves, yet the size of its growing population means that its gross domestic product (GDP) per capita is among the lowest in the GCC.

Consequently, the strategies chosen by individual states to prepare for a viable future are reflected partially by the group in which they fall: flush with surplus oil income or facing immediate need to replace oil income. In some ways, this bifurcation oversimplifies comparison. Specific strategies must also include

variances in the amount of oil income within each group,

the size of the population of nationals relative to that income,

the physical size and topography of the country,

the availability of other resources,

the individual time frame before depletion of hydrocarbon production,

the political dynamism present within the country, and

the capabilities and responsiveness of a country's leadership and elites to these challenges.

Introduced and Prospective Alternative Strategies

Most of the numerous alternative strategies that the GCC states have adopted or at least considered are in the early or prospective stages. The first involves the creation of a knowledge-based economy. This conception dates from the 1970s, when high hopes of an Arab-world synergy were expressed. The gulf states would provide the capital and knowledge while Egypt and the Levant would provide the labor and Sudan would be the breadbasket. These hopes have not been borne out, and the Iraqi invasion of Kuwait in 1990 reinforced the sharp divisions among these groups of Arab countries. Still, some aspects of this approach continue to resonate in the region, as can be seen in the recent establishment of numerous private educational institutions.

A second, far more realizable strategy has been investment. In part, investment has been a short-term strategy to park budget surpluses temporarily or to provide backing for budgetary stabilization purposes. More important, all the GCC states have created funds for future use after oil. These are most prominently sovereign wealth funds (SWF), although other state instruments carry out investments in their fields, such as the Kuwait Petroleum Corporation and the Saudi Arabia Basic Industries Corporation. Altogether, the GCC SWFs may hold $1 trillion in investments or more (see table 2). Estimates put the total at $1.7 trillion at the end of 2007 and $2 trillion at the end of 2008. More recent estimates note the negative impact of the falling value of global equities, particularly on the smaller asset-rich states.

As part of their fiduciary responsibility, SWFs seek dependable, secure returns. This leads to the majority of the investments being made outside the country and outside the Arab world. While financially rewarding, this imposes a political price on the SWF and its government. Members of Kuwait's National Assembly in the 1980s were volubly opposed to the government's emphasis on foreign rather than domestic investment. On the other hand, the value of the strategy was proven in 1990 when Iraq invaded Kuwait: the presence of huge investments outside the country meant that the country did not lose all its capital and could finance its liberation. Due to incremental growth in absorptive capacity and ever-expanding horizons, all the gulf states are also pursuing investment in huge domestic projects.

Much private capital from the gulf has been invested abroad, for both financial and political reasons, and there has been considerable difficulty in attracting these funds back home. In part, this may be the result of a sound strategy of pursuing a diversified portfolio, as the example of Prince al-Walid bin Talal in Saudi Arabia demonstrates. His station gives his Kingdom Holdings certain advantages as regards domestic investments as well. This does not hold true for non-ruling-family investors. They often face a double whammy. In the first place, they run the risk of interference by ruling-family members, who may simply take over assets without contest, demand participation in enterprises without putting up capital, or compete unfairly in the awarding of government contracts and subsidies. In the second place, local investment opportunities are limited, one explanation for the explosion of demand for shares in local initial public offerings.

Table 2

Sovereign Wealth Fund and Other Government Assets as of Late 2008
(with dates of establishment and holdings in US$ billions)

Country	*Asset Entity*	*2007 to mid-2008*	*End 2008*[13]
Bahrain	Mumtalakat Holding Company (2006)[1]	14	
Kuwait	Kuwait Investment Authority (1953)[1,2,6]	225–265	228
Oman	State General Reserve Fund (1980)[1,6]	2–8	
Qatar	Qatar Investment Authority (2000-2003)[1,4,6,9]	40–60	58
Saudi Arabia	Saudi Arabian Monetary Authority (nonreserve assets) and other funds[1,5,6]	250–370	501
UAE	Emirates Investment Authority (established 2007 to invest funds of federal government)[1]	Unknown	
	Abu Dhabi Investment Authority (1976)[1,5,6,9,12]	250–900	}
	Abu Dhabi Investment Council (2007)	Unknown	} 328
	Abu Dhabi Investment Company (1977)[10]	10	}
	Mubadala Corporation (2002)[1]	10	
	International Petroleum Investment Company	13	
	(1984)[10]	0	
	Dubai Holding: Dubai International Capital (2004; international investment arm of Dubai Holding)[7]; Istithmar World (2003; owned by Dubai World)[8]	21	
	RAK Investment Authority (2004) to invest funds of federal government[1]	1	
Total GCC SWF Assets			
		813–1,649	
		Estimate of 1,000[6]	
		Estimate of 1,700[11]	1,200

Sources: 1. Sovereign Wealth Fund Institute, http://swfinstitute.org/, accessed October 2008.
2. Reuters, 6 March 2008.
3. MENAFN.com, 3 February 2008.
4. Reuters, 12 March 2007; *Daily Telegraph*, 3 October 2007.
5. US Treasury Department, *Semiannual Report on International Economic and Exchange Rate Policies*, "Appendix II: Sovereign Wealth Funds," www.treas.gov/offices/international-affairs/economic-exchange-rates/pdf/Dec-2007Appendix2.pdf.
6. Deutsche Bank Research, "Sovereign Wealth Funds—State Investments on the Rise," 10 September 2007, www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000215270.pdf.
7. Dubai International Capital, www.zawya.com/cm/profile.cfm?companyid=1002984.
8. Istithmar World Capital, www.zawya.com/cm/profile.cfm/cid1002333.
9. *Financial Times*, 25 March 2008.
10. *The National* (Abu Dhabi), 13 July 2008.
11. Emirates Industrial Bank bulletin, quoted by Emirates Business 24/7, 11 October 2008, www.business24-7.ae.
12. *Newsweek*, 5 January 2009.
13. Brad Setser and Rachel Ziemba, *GCC Sovereign Funds: Reversal of Fortune* (working paper, Council on Foreign Relations, Center for Geoeconomic Studies, New York, January 2009), 2.

For the richer gulf states, investment—and particularly foreign investment—is a strategy for the relatively distant future, when the oil is gone and the country and its people will live off their investments. This has been seen most clearly in the Kuwait Fund for Future Generations. By law, 10 percent of total state income must be deposited with the Kuwait Investment Authority for this fund and cannot be touched until well into the future.

A third strategy for diversification has been to expand vertical integration within the oil industry. Kuwait has been the major player in this context. In the 1980s, the emirate made a concerted effort to expand downstream in two ways. First, Kuwait bought into major international oil companies, most notably BP. Second, Kuwait sought to purchase and operate its own refineries, distribution networks, and marketing outlets, most prominently through the Q8 brand in the UK and Europe. Saudi Arabia imitated the Kuwaiti strategy in 1988 by purchasing a major share in Texaco refineries and its marketing system in the United States.

Kuwait also moved into upstream activities through the Kuwait Foreign Petroleum Exploration Company, which is active in the Middle East, Asia, and Australia. In some ways, Project Kuwait, the $8.5 billion plan to boost oil production in the northern oilfields by some 400,000 barrels per day (b/d), part of a planned 1.5 million b/d overall expansion, might fall into this category because of its controversial intention to involve foreign oil firms, much to the dismay of the National Assembly.

A fourth diversification strategy has centered on substituting or enhancing oil income with income from natural gas. This can be seen most prominently in Qatar, which contains one-third of the world's natural gas reserves. Most of this gas comes from the huge North Field, which lies offshore north of the Qatar Peninsula and is shared with Iran. This field alone contains 20 percent of world reserves.

Far more than oil, the exploitation of natural gas has required extensive planning, immense capital, long-term contracts with recipients, and lots of patience. The North Field was discovered in about 1971, but Qatar did not begin exporting its first liquefied natural gas (LNG) until 1997. A decade later, however, Qatar became the largest LNG producer in the world, and it is continuing to grow. While 31 million tons were produced in 2007, the figure is expected to double in 2009 and to reach 77 million tons by 2010. Qatar is now recouping its huge investment, but gas exploitation is a principal reason why Qatar's public debt (table 1) is the second highest in the GCC. It should be noted that not all of Qatar's gas is liquefied. The Dolphin Project supplies gas by undersea pipeline to the United Arab Emirates (as well as Oman) and there has been prolonged discussion of the possibility of laying a pipeline to Kuwait.

A fifth diversification strategy has been to create feedstock or fuel-based industries that depend on hydrocarbon reserves. Here, Saudi Arabia has been the leader. The Saudi Arabia Basic Industries Corporation was created in 1976 to manage petrochemical, fertilizer, plastics, and iron/steel plants. These not only utilize a cheap feedstock but also operate on gas as a cheap fuel. To house these industries, two new industrial cities were created, at al-Jubayl on the gulf coast and Yanbu on the Red Sea coast, each with an expected one hundred thousand inhabitants. The Royal Commission for al-Jubayl and Yanbu also announced Yanbu 2 in 2005 as a $50 billion twin to Yanbu 1 for basic, secondary, and light industries.

The Jubayl-Yanbu approach seemed to be so successful that Saudi Arabia designed even bigger investments. The Saudi Arabia General Investment Authority, created in 2000 to encourage and manage domestic and foreign investment in the kingdom, announced plans for a new series of economic cities in 2005–6. Prince Abd al-Aziz b. Musaid Economic City at Hail is meant to be the largest transportation and logistics hub in the Middle East. It is planned to receive $8 billion in investment and to hold a population of three hundred thousand. The Knowledge Economic City at al-Madinah, with $7 billion in investment and a planned population of fifty thousand, will comprise a technology complex, theme parks, medical and biological studies centers, and an Islamic civilization studies center. The King Abdullah Economic City at Rabigh north of Jiddah, with $27 billion in investment and an eventual population of 2 million, will have its own major port, industrial and light manufacturing, resorts, and an education complex. The Jizan Economic City in the south will entail $27 billion in investment and reach a population of 250,000. Its primary anchors will be a port; power and desalination facilities; oil refining; aluminum, steel, and copper production; pharmaceuticals; food processing; and agritech products. Two other cities are expected to be developed at sites yet to be chosen near Tabuk in the north and in the

Eastern Province. Admittedly, these plans may be affected or delayed by the global economic crisis.

A sixth strategy for diversification began with the establishment of entrepôts based on immediate regional trade, but the concept of such economic centers has moved far beyond the entrepôt classification. It may be more accurate to speak of them as a branding or even super-branding strategy. In essence, this is the Dubai model, with emulation by Abu Dhabi and Qatar.

During the first half of the twentieth century, Dubai was an extremely poor settlement without resources astride a small creek. Its ruler, Shaykh Rashid, encouraged the immigration of Persian merchants from the opposite coast, which, along with pearling activities, marked the genesis of Dubai as an entrepôt. Rashid's son, Muhammad, dramatically boosted Dubai's growth, particularly as a result of the 1973–4 oil price explosion. Although Dubai had a modest oil production by this time (later declining to nothing), Shaykh Rashid had a vision of a modern state and economy centered on Dubai being the gulf region's premier entrepôt and more. He built Port Rashid, a modest port with six berths sufficient to cater to Dubai's needs at the time and similar to other new ports along the Arabian littoral.

He also announced his intention to build the world's largest manmade port, a 119-berth monster at nearby Jabal Ali. Critics derided Jabal Ali as a white elephant, but it didn't take long after its completion for the new port to achieve full utilization. Success was helped in large part by the establishment of a free economic zone in association with the port, together with a liberal policy that permitted foreign firms to import unrestricted capital, raw and finished materials, and labor for the re-export or assembly of goods—with no tax or subsidized utilities and the free expatriation of profits. Rashid's intention to build a massive aluminum smelter, Dubal, also produced catcalls, particularly as the only existing smelter was in Bahrain and was considered more than sufficient for the entire gulf. But Dubal was another success story.

Muhammad pushed the envelope further, envisioning an economic center that would rival Singapore and Hong Kong. The projects became ever more breathtaking and grandiose and eventually stretched to the superlative level: "the world's biggest," "the world's best." Thus, Burj Dubai has become the world's tallest building, and there are plans for a second, even taller building. Burj al-Arab was declared the world's most luxurious and only sevenstar hotel. The creation of island resorts and residential communities began in earnest with the Dubai Marina but escalated with the Palm Islands and the World — both of which were said to be visible from space. Dubai is also building the world's largest shopping mall and the world's largest theme park. These endeavors are complemented by an indoor snow-skiing slope, a media city, an Internet city, the Dubai International Financial Center, and many other enterprises. When Dubai's rulers became dissatisfied with Gulf Air's poor service at Dubai airport, they created their own airline, Emirates.

In just a couple of decades, Dubai has moved beyond placement as a tourist and shopping destination — buoyed by "sun and sea," bargains in the shops and during the Dubai Shopping Festival, and the slogan "Fly, Buy, Dubai" — to a financial and knowledge-based hub. Dubai's goal seemingly has been to place itself on the world map, not just the regional map, and in this it has largely succeeded.

Dubai has also inspired competition by neighboring states, particularly Abu Dhabi and Qatar. The imitators benefit from deep pockets but also bear several handicaps. One of these is timing. A fundamental factor in achieving success in branding is being first to establish the brand. Pursuers stand little chance of capturing the brand or replicating the opportunity; instead, they are doomed to not much more than modest success through imitation.

Abu Dhabi's emulation is perhaps driven most strongly by the spirit of competition and an attempt to "keep up with the Joneses." The construction of Emirates Palace Hotel in Abu Dhabi was a direct riposte to Dubai's Burj al-Arab. While Abu Dhabi does have a legitimate justification to develop and diversify, its most successful and natural strategy is similar to that of Kuwait: to make wise investments now that will maintain prosperity in the postoil era. Thus, the Abu Dhabi Investment Authority is said to have controlled assets worth as much as $900 billion in mid-2008, although the value has shrunk considerably since then. Dubai's expansion has also been adversely affected by global economic conditions, with a significant collapse in property values.

Qatar has pursued the Dubai strategy aggressively. In part, this has also involved attempts to keep up with the Joneses, with a parade of new luxury hotels, shopping centers, and the Doha Corniche. It hosts a series of high-profile sporting events, including golf and tennis. It has also sought to achieve global branding through a maverick foreign policy (irritating fellow Arab regimes and especially Saudi Arabia through the controversial Al Jazeera satellite television channel and by inviting the United States to locate its forward base for the Central Command on Qatari territory).

Qatar has sought divergence or uniqueness on two levels. One has been to tweak the branding—and to enhance tourism—by creating an impressive series of world-class museums. It has also plowed efforts into a knowledge-based economy with the creation of the Qatar Foundation, which hosts local campuses of a half-dozen well-known American universities.

Economic Constraints and Variables

All of these strategies are directly subject to a variety of economic constraints, which vary in significance by the characteristics of individual countries. In the first place, all the gulf states possess small indigenous labor forces. Therefore, economic expansion of almost any sort is bound to involve a continued if not increased dependence on expatriates. The indigenous labor force by and large exhibits low standards in terms of quality of education and work discipline and thus entails higher costs to employers.

Economic planning is further complicated by inequalities in the income and standard of living among nationals in each country. Certain sectors have benefited more than others from the oil age, and the lack of any attempt at income redistribution has steadily increased the gap between haves and have-nots.

All six GCC countries possess similar economies, and they display the same comparative advantage in oil, gas, and capital. But they share the same comparative disadvantage of small populations and the absence of other natural resources. Opportunities for intra-GCC or intragulf trade are limited by the small size of markets and by national interests; each state fears that companies from neighboring countries will poach from local industries. There is a tendency to copy each other's success (for example, Saudi Arabia and petrochemicals, Dubai and shopping festivals, and lately Qatar and world-appeal museums and cultural institutions).

There is a critical role to be played by the private sector. But the private sector has had difficulty in proving itself up to the task. It needs to move from living off the sale of imports and import substitution activities and feeding off government contracts to taking the initiative in diversification efforts. As most private companies in the gulf are family firms, there is a notable reluctance to raise capital for expansion by joint ventures or by offering shares.

The Future Is Now

Two of the gulf states face an oilless future far more quickly than the others, but neither has been able to surmount the challenge of diversification away from oil completely. Bahrain was the location of the earliest crude oil production in the gulf states, starting in 1932, but its production now is virtually nil at only 38,000 b/d. It also receives the output of Saudi Arabia's Abu Safah field (producing between 150,000 and 300,000 b/d) plus a Saudi donation of 50,000 b/d of crude.

Bahrain faces an expanding population with few natural resources. Available capital is lacking, and most of the government budget is eaten up by current expenditures. For social and political reasons, the emphasis is necessarily on maintaining and expanding social services, particularly in housing and education. Even with the recent rise in oil prices, the government finds it difficult to keep from dropping into deficit.

Bahrain has attempted a variety of strategies to compensate for the loss of oil income. The most sustained of these consist of regional industrial and service concerns. The Arab Shipbuilding and Repair Yard was established in the 1970s under the sponsorship of the Organization of Arab Petroleum Exporting Countries, which chose Bahrain because its economy would benefit the most. At roughly the same time, Bahrain also created Aluminium Bahrain, which has become the Middle East's largest producer and enabled aluminum to be Bahrain's largest export after oil.

For decades, Bahrain has also relied upon the Bahrain International Airport for income and employment, placing it as an international and regional transfer center. However, as transcontinental flights achieved the capacity to overfly the gulf (for example, from London to Singapore nonstop) and regional airlines multiplied, Bahrain's airport has lost much of its luster. Similarly, Bahrain's reliance on Gulf Air (originally created as a private airline and then owned by the governments of Bahrain, Qatar, Abu Dhabi, and Oman) for employment and economic stimulation through the awarding of contracts to Bahraini firms has also diminished. One by one the other owners established their own airlines until the government of Bahrain remained the sole owner.

The turmoil of the Lebanese civil war of the 1970s and 1980s gave impetus to Bahrain as an emerging regional financial and commercial center. A good deal of Bahrain's advantage in this respect has eroded as the infrastructure and regulatory atmosphere improved in neighboring countries and Dubai became a formidable rival. Bahrain does, however, compete with Malaysia as one of the two principal centers of Islamic banking.

Bahrain also invested in tourism. Partly this was aimed at international tourists, particularly Europeans, but Bahrain also positioned itself as a weekend getaway for visitors from neighboring states, especially Saudi Arabia. A dramatic increase in Saudi visitors, including families, was one of the prime effects of the King Fahd Causeway, built to connect Bahrain with Saudi Arabia's Eastern Province. Similarly, the settlement of territorial disputes with Qatar has permitted the two countries to plan a similar causeway between them. This would not only encourage more Qataris to visit Bahrain but would also make it easier for Emiratis and perhaps Omanis to get to Bahrain without having to go through often-unpleasant Saudi border checkpoints. It would also allow Bahrainis to commute to Qatar for work. The downside of tourism is that Bahrain finds itself directly under a Saudi Arabian spotlight and thus influence. It also adds to domestic tensions since active Islamist groups, both Sunni and Shiite, have objected publicly to the free sale of alcohol and concerts by well-known Lebanese female singers. Bahrain has also pursued foreign investment in the country in a relatively minor way. Most of this is aimed at GCC investment and particularly in real estate and banking.

Bahrain's success has been hampered by a number of serious obstacles. Perhaps most important, the country displays a growing inequality in the distribution of wealth. Visitors are struck by the vibrant skyline and luxurious atmosphere present in the many hotels and growing number of big malls. But a short distance away lie the Shiite villages, where poverty and dissatisfaction are evident in the basic residences, pot-holed streets, and frequent graffiti. The real problem of economic diversification in Bahrain is political as much as economic.

Bahrain's Al Khalifah ruling family is proportionately large compared to other gulf states, and the family still remains largely above the law and dominant in the economy and the country's wealth. The prime minister is often held to be one of the richest men in the gulf. Unemployment is a serious threat and constituted one of the principal factors behind the Shiite unrest of the 1990s.

The crisis is not as immediate in Oman, but nevertheless it is approaching rapidly. Demands on the country's oil income began almost from the beginning of production in 1968 and accelerated dramatically after the 1970 coup d'état put a modernizing ruler on the throne. Faced also with an expensive insurgency in the southern province, Oman found the 1973–4 oil price explosion extremely providential. Nevertheless, the pressure for government expenditure continued to keep budgets in debt.

The sultanate's response to the oil shock of the 1980s was to increase production, which eventually ramped up to 900,000 b/d. But Omani oil was always more expensive to produce than its competitors in the gulf, and oil from newer fields is generally heavy and sulphurous. Of all the gulf producers, Oman faces the greatest problem of declining mature fields and Royal Dutch Shell, the minority shareholder in Petroleum Development Oman and holder of the company's management contract, has been experimenting with enhanced recovery techniques. This is a problem that will soon face other gulf producers, notably Saudi Arabia in its al-Ghawar field, the largest in the world. The consequence has been a year-by-year decline in production, falling to about 700,000 b/d. In a reversal of the 1980s situation, shortfalls in production counteract recent price increases.

Oman continues to face daunting problems in socioeconomic development. It too has a rapidly expanding population, with nearly half under the age of fourteen. The traditional economic sectors that sustained the country for millennia—largely subsistence agriculture and fishing punctuated by cyclical outbursts of maritime trade—have been reduced to a paltry minimum in government income and GDP and it would be impossible for them to sustain the country's present population.

Oman started from a very low base of development. It has continually struggled with limited capital to apply to the problem, and, frankly, not all available income was used properly. Compared to the other gulf states (except Saudi Arabia), Oman is a large and rugged country, and it has the second-largest population of nationals in the GCC. Thus, basic development costs are higher. Cyclone Gonu struck the country hard in June 2007 and caused an estimated $4 billion in damage, which had to be met from funds allocated to the current five-year development plan.

Oman has embarked on an even wider variety of diversification strategies than has Bahrain. Some of these were simply inappropriate, such as the announcement in the 1980s that Oman would permit its use as a flag of convenience for global shipping. The government-owned Oman Oil Company not only carried out its mandate to invest in downstream operations abroad but became caught up in the politics surrounding the Kazakhstan pipeline in the 1990s, an involvement completely contrived by the machinations of several Omani and foreign individuals.

Strategies involving minerals have been of relatively minor significance. Although discoveries have been made of chromium, coal, and small amounts of gold and silver, only one mineral venture was carried through to completion. Ancient copper mines near Suhar were brought back into production and fed a nearby smelter. However, the supply of copper ore was exploited in ten years and the smelter managed to limp on only by importing copper ingots, especially from Iran. Apart from a limited amount of government income, the copper industry at its height provided only minimal employment for Omanis.

There has been more success with natural gas. Exploitation of gas requires enormous investment and a long lead time. Oman's plans have been ambitious, occasionally too much so. Planning for a gas pipeline from Oman to India reached an advanced stage, even though its underwater route through the Gulf of Oman was at the edge of technological feasibility. In the end, Oman dropped the idea out of difficulties of financing its share and concern that India would not be able to achieve the necessary financing for its part.

LNG proved to be more achievable, and Oman has been aggressive in exploiting, supplying, and marketing this resource. A third train recently came onstream, raising Oman's exports to 10 million tons a year, the second highest in the GCC and not an inconsiderable amount. However, this is destined to be the maximum capacity due to both a finite supply of gas and increasing demands of domestic requirements. Oman's modest gas exports by pipeline to Abu Dhabi have been reversed, and Qatari gas is now being shipped to Oman. In the end, gas will never be a replacement for oil but simply a complement. Like crude oil, gas is a capital-intensive industry requiring very little labor.

Another direction was the Salalah container port, conceived and put into operation with the participation of the Maersk and Sea-Land companies. The intention was to capture some of the traffic that could offload cargos bound for destinations in the western Indian Ocean without having to go into the gulf at Dubai. Nevertheless, it has not been a big success, even with a free trade zone established in conjunction with it, although it has provided local employment in Oman's southern Dhufar region.

More recent—and ambitious—emphasis has been placed on an industrial node at Suhar. An entirely new seaport was dredged out of the shallow, sandy beach, intended in part to handle overflow from the country's one major port in Muscat but mainly to service Suhar's planned industrial expansion. Activities are to include petrochemical production, aluminum smelting, and product refinement from a new oil refinery, the country's second.

Tourism has also played a major role in Oman's plans. The number of high-quality international hotels in Muscat has mushroomed as the sultanate has liberalized tourist visa policies and captured a growing share of tourists from Europe and Asia. Nearby resorts have been opened or planned and Muscat is now a regular stop for cruise ships. The countryside is attractive to adventure tourists and the government has taken necessary steps to promote Oman as an add-on to Dubai tourist packages. Oman also has welcomed regional visitors from the other gulf states.

In imitation of similar projects in Dubai, Qatar, and Bahrain, Oman has promoted the development of superprojects involving hotels, parks, and residences created on land reclaimed from the sea. But while tourism has provided a definite benefit to the economy, it too is just a supplement to oil income. The real advantage is in employment of nationals. Still, Oman remains far from large population centers and is relatively expensive, thus ensuring tourism will have definite limits.

The Political Dimension

In addition to economic factors, political factors also play a part in determining the success or failure of diversification. Development strategies devised and carried out by authoritarian regimes pose problems. At worst, projects and directions may be biased to benefit ruling families and allied elites. At best, state planning is inefficient. It does not reach the nadir of the Soviet model, but central planning can never capture the efficiency of spontaneous development. All the gulf states display a strong recent emphasis on privatization, but development and diversification remain heavily state-directed. The privatization of utilities and the offerings of shares in public-private enterprises may make these concerns technically private. Nevertheless, their conception, planning, construction, and shepherding into operation remain supervised by the state.

Diversification also depends on popular participation. This may be easier said than done. One impact of the oil era has been to create an extreme dependency on the state as the source of income, welfare, and economic security. The result is often a public attitude of apathy rather than dynamism and a weakness of the private-sector. There is also an unsettled question of how expatriates fit into small and tightly bound societies. Expatriates are not only present in overpowering numbers but they have put their cultural stamp on capitals and daily life and their economic stamp on private enterprise. In many states, significant numbers of expatriates of Arab or Indian origin were born in their country of residence to parents who were also born there. Yet only a handful have been granted citizenship or permanent rights, and the gulf between national and expatriate, so nakedly visible in terms of dress, continues to widen even as it seems clear that expatriate labor and culture is a permanent facet of life in the gulf.

Another obstacle is the effect of discrimination within gulf societies. This can be described as a sociopolitical factor leading to economic inequality. It is perhaps inevitable that rural populations — and especially Bedouin — fare less well in the modernizing societies of the gulf than urban populations, but redistribution of income has never been a GCC goal. Another problem alongside geographical dispersion and occupations is discrimination against minorities in some of the states. This is seen principally in the Shiite populations of Bahrain and Saudi Arabia's Eastern Province and perhaps more generally toward the Baluch.

The Slow Pace of Change

What have the GCC states and the Arabian Peninsula accomplished in the half-century or so of the oil age? In 1969, the respected Arab economist Yusif A. Sayigh examined development in the Arabian Peninsula.[1] In particular, he outlined sixteen problems that these countries faced. Some of these — limited access to education, low levels of acceptance of change and new technology, poor sanitary and health conditions — have disappeared over time.

But many of his points are as problematic today as they were nearly forty years ago. As Sayigh pointed out, there has been vast economic change, but the social impact remains limited. The middle class is still small and restricted economically and politically. National populations remain small, leading to costly social and economic overhead capital. All the states remain dependent on narrowly based oil economies while resources apart from oil and a narrow agricultural base are meager. A large industrial sector is still absent, compounded by a continuing weakness in service sectors and inadequate infrastructure. The emergence of a welfare state provides benefits to nationals but also creates increasing emphasis on distribution to the point that the link between production and distribution is only dimly seen by the work force. Dependence on expatriates increases. Finally, the peninsula remains politically fragmented, thus presenting diseconomies of scale and the duplication of structures and services.

It is dismaying to review Sayigh's list of problems and obstacles and realize that far too many of the sixteen points remain as relevant today as they were in 1969. Time is running out.

1. Yusif A. Sayigh, "Problems and Prospects of Development in the Arabian Peninsula," in *The Arabian Peninsula: Society and Politics*, ed. Derek Hopwood (London: George Allen and Unwin, 1972), 286–309.