Globalisation, Countertrade and Privatisation in the Arabian Gulf

By

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A thesis submitted in conformity with the requirements for the degree of Doctor of Philosophy
Graduate Department of Political Science
University of Toronto

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Abstract

This thesis asks two central questions: How are the states of Kuwait and Saudi Arabia pursuing economic development and why have they chosen countertrade policies to achieve this. By analysing the application of Offset ventures and Build, Operate and Transfer (BOT) schemes, the thesis argues that countertrade marks an important phase in the state-society development of Kuwait and Saudi Arabia. We are now witnessing the first stages of a move from the traditional 'allocation state' towards a 'production state.' Countertrade has become an elite-led political strategy to promote a gradual restructuring of rentier state-societal relations. It is a strategy that has developed over time. To observe and explain the shifting motivations of countertrade over the last two decades, the thesis employed three inter-linked hypotheses.

- **Hypothesis I** asked if countertrade was predominantly used to buttress the institutions of the rentier state under conditions of fiscal austerity. As the Gulf elite derives legitimacy from a welfare state created by the reallocation of oil revenues, countertrade was initially perceived as a tool to supplement redistribution and resist significant socio-economic change. This approach explains early moves toward countertrade, especially in Saudi Arabia.
• Hypothesis II investigated whether rentierism was being challenged from below. It shows the private sector to be politically active, seeking countertrade benefits that the rentier state can no longer adequately provide, (access to global markets/partners, technology transfers, education and training etc.). Such demands on the government can no longer be explained, or satisfied, in terms of a simple redistribution of rent.

• Hypothesis III provides the strongest explanation. It argues that countertrade must now been seen within the context of a wider “state-building” effort by the Gulf elite to restructure the relationship between state, society and the economy. Rentierism is challenged from above, with Offset and BOT ventures facilitating moves towards the eventual privatisation of the rentier state and a long-term future beyond oil.

By exploring these questions and synthesising the findings of the hypotheses the thesis provides a critique of the rentier state model and offers a more accurate explanation of the political economy of the Arabian Gulf.
Acknowledgements

Although the actual writing of a doctoral thesis is an individual effort, its successful completion is entirely dependent upon the support, guidance and encouragement of a large number of peers, associates and friends. Among those whose support and friendship I relied upon most was my supervisor Professor Paul Kingston. His advice, insight, and encouragement when the going got tough enabled me to successfully complete my research. I owe him an immense debt of gratitude. I would also like to thank my committee members at the Department of Political Science, University of Toronto - Professor Louis Pauly and Professor John Kirton who helped shape the direction of the research in its early stages. Professor Walid Hejazi from the Rotman Business School and Professor Richard Sandbrook also helped structure my research questions. Professor Judith Teichman suggested valuable revisions during the final stages of the research for which I am extremely grateful. My external examiner, Professor Gregory Gause of the University of Vermont, cast a welcome critical eye over the conclusions contained within. Professor Richard Blackburn from the Department of Near East Studies demonstrated great patience and skill in successfully guiding me through "Intensive Arabic." I would also like to express my gratitude to two other academics. Dr. Andrew Rathmell at King's College London was responsible for introducing me to the Gulf region both as a teacher and through employment at Gulf States Newsletter. Dr. Michael Dumper from the University of Exeter was the first academic to realise my potential, to channel it and to successfully guide me through the early stages of my academic career. The result of his efforts and of those listed above is what you see before you.
This research took me to four countries on three continents. Along the way I met many interesting people and witnessed many acts of extraordinary kindness. I would like to thank all those who granted me interviews as well as those individuals who provided excellent contacts and who pre-arranged interviews. In Kuwait Al’a’ a Al Omran, Jackie Barlow, Roger Cluney and Jasem Al Sadoun arranged for me to meet and interview many interesting individuals. In Washington, Jessica Grentner facilitated my research, as did the staff of the U.S.-Saudi Business Council. Alec Geddes kindly provided a place to stay in the American capital. Bob and Ruth from the Documentation Unit at the Centre for Arab Gulf Studies at Exeter University were welcome faces during my summer there.

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To my family,
especially my Mother, Valerie Joan Curtis
and the memory of my late Father, Bertram Richard Curtis
Globalisation, Countertrade and Privatisation in the Arabian Gulf

Table of Contents

CHAPTER ONE: THE SIGNIFICANCE OF THE RENTIER STATE MODEL IN KUWAIT AND SAUDI ARABIA

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>The Rentier State: A Definition</td>
<td>3</td>
</tr>
<tr>
<td>II</td>
<td>Internal Challenges to Rentier State Autonomy</td>
<td>8</td>
</tr>
<tr>
<td>i</td>
<td>Rethinking Rent: The Declining Profitability of Oil</td>
<td>11</td>
</tr>
<tr>
<td>ii</td>
<td>Socio-Economic Pressures: Population Growth, Urbanisation and Unemployment</td>
<td>16</td>
</tr>
<tr>
<td>iii</td>
<td>Reckless Spending: Government Debts and Deficits</td>
<td>20</td>
</tr>
<tr>
<td>iv</td>
<td>Geo-Strategic Vulnerability: War and Defence Expenditure</td>
<td>24</td>
</tr>
<tr>
<td>III</td>
<td>Global Challenges to Rentier State Autonomy</td>
<td>27</td>
</tr>
<tr>
<td>IV</td>
<td>Methods of Incorporation and the Reactivation of Politics</td>
<td>35</td>
</tr>
<tr>
<td>V</td>
<td>Institutional Malaise and the Rentier State: A Countertrade Solution?</td>
<td>48</td>
</tr>
<tr>
<td>VI</td>
<td>The Rentier Mentality</td>
<td>51</td>
</tr>
<tr>
<td>VII</td>
<td>Countertrade and the Rentier State Model</td>
<td>54</td>
</tr>
<tr>
<td></td>
<td>Hypothesis I: The Regime Maintenance Model</td>
<td>55</td>
</tr>
<tr>
<td></td>
<td>Hypothesis II: Rentierism Challenged From Below</td>
<td>57</td>
</tr>
<tr>
<td></td>
<td>Hypothesis III: Rentierism Challenged From Above</td>
<td>58</td>
</tr>
<tr>
<td>VIII</td>
<td>Concluding Remarks</td>
<td>63</td>
</tr>
</tbody>
</table>

CHAPTER TWO: THE APPLICATION OF COUNTERTRADE IN THE ARABIAN GULF

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Countertrade and Development: A Definition</td>
<td>65</td>
</tr>
<tr>
<td>II</td>
<td>If Countertrade is Ineffective, Why are Gulf States Applying it Today?</td>
<td>68</td>
</tr>
<tr>
<td>i</td>
<td>Technology Transfers</td>
<td>69</td>
</tr>
<tr>
<td>ii</td>
<td>Opportunity Costs</td>
<td>73</td>
</tr>
<tr>
<td>iii</td>
<td>Competitive v Comparative Advantage</td>
<td>75</td>
</tr>
<tr>
<td>III</td>
<td>Why Has the Study of Countertrade Been Neglected?</td>
<td>77</td>
</tr>
<tr>
<td>i</td>
<td>First World: Rolling Back the State</td>
<td>78</td>
</tr>
<tr>
<td>ii</td>
<td>Second World: Rejection of the State</td>
<td>83</td>
</tr>
<tr>
<td>iii</td>
<td>Third World: Failing States</td>
<td>84</td>
</tr>
<tr>
<td>iv</td>
<td>Quantitative Difficulties</td>
<td>87</td>
</tr>
<tr>
<td>IV</td>
<td>Why Study Countertrade Now?</td>
<td>89</td>
</tr>
<tr>
<td></td>
<td>Build, Operate and Transfer (BOT)</td>
<td>93</td>
</tr>
<tr>
<td></td>
<td>Offset</td>
<td>98</td>
</tr>
<tr>
<td>V</td>
<td>Concluding Remarks</td>
<td>105</td>
</tr>
<tr>
<td>VI</td>
<td>Appendix</td>
<td>106</td>
</tr>
</tbody>
</table>
**CHAPTER THREE: HYPOTHESIS I: THE REGIME MAINTENANCE MODEL**

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Hypothesis I</td>
<td>118</td>
</tr>
<tr>
<td>II</td>
<td>The Pace of Reform: A Crisis-Driven Approach?</td>
<td>121</td>
</tr>
<tr>
<td>III</td>
<td>Why is the Incidence of Countertrade Greater than Privatisation?</td>
<td>125</td>
</tr>
<tr>
<td>IV</td>
<td>Is Countertrade a Mechanism to Pacify the Needs of the Immediate Support Base?</td>
<td>133</td>
</tr>
<tr>
<td>V</td>
<td>The Incorporation of the Merchants into BOT and Offset</td>
<td>137</td>
</tr>
<tr>
<td>VI</td>
<td>Why Build, Operate then Transfer?</td>
<td>140</td>
</tr>
<tr>
<td>VII</td>
<td>Countertrade in Action:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>i  BOT and the Provision of Electricity</td>
<td>143</td>
</tr>
<tr>
<td></td>
<td>ii BOT and Kuwait's Construction Sector</td>
<td>151</td>
</tr>
<tr>
<td></td>
<td>iii The Al-Yamamah Offset Project</td>
<td>154</td>
</tr>
<tr>
<td>VIII</td>
<td>Concluding Remarks</td>
<td>157</td>
</tr>
</tbody>
</table>

**CHAPTER FOUR: HYPOTHESIS II: RENTIERISM CHALLENGED FROM BELOW?**

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Hypothesis II</td>
<td>162</td>
</tr>
<tr>
<td>II</td>
<td>The Private Sector and the Rentier State</td>
<td>165</td>
</tr>
<tr>
<td>III</td>
<td>The Influence of the Merchant Class</td>
<td>169</td>
</tr>
<tr>
<td>IV</td>
<td>The Private Sector in Saudi Arabia</td>
<td>176</td>
</tr>
<tr>
<td>V</td>
<td>The Private Sector in Kuwait</td>
<td>179</td>
</tr>
<tr>
<td>VI</td>
<td>How Private Sector Influence is Channeled</td>
<td>181</td>
</tr>
<tr>
<td>VII</td>
<td>Kuwait: The Private Sector Push for Offset</td>
<td>190</td>
</tr>
<tr>
<td>VIII</td>
<td>Reluctant Partners: Offset and the Saudi Private Sector</td>
<td>193</td>
</tr>
<tr>
<td>IX</td>
<td>Private Sector Encouragement for BOT</td>
<td>200</td>
</tr>
<tr>
<td>X</td>
<td>The Realities of Countertrade for the Business Elite</td>
<td>202</td>
</tr>
<tr>
<td></td>
<td>i  Education and Training: The Private Sector Pursuit of Offset</td>
<td>203</td>
</tr>
<tr>
<td></td>
<td>ii The Health Sector and the Failure of Offset</td>
<td>207</td>
</tr>
<tr>
<td></td>
<td>iii BOT, Nepotism and Private Sector Disappointment</td>
<td>211</td>
</tr>
<tr>
<td>XI</td>
<td>Concluding Remarks</td>
<td>213</td>
</tr>
</tbody>
</table>
CHAPTER FIVE: HYPOTHESIS III: RENTIERISM CHALLENGED FROM ABOVE?

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Hypothesis III</td>
<td>219</td>
</tr>
<tr>
<td>II</td>
<td>What Does State Building Mean?</td>
<td>221</td>
</tr>
<tr>
<td>III</td>
<td>Interests</td>
<td>226</td>
</tr>
<tr>
<td></td>
<td>i A New Elite</td>
<td>226</td>
</tr>
<tr>
<td></td>
<td>ii The New Elite Conception of State Building</td>
<td>230</td>
</tr>
<tr>
<td></td>
<td>iii State Building: An Additional Method of Political Support</td>
<td>233</td>
</tr>
<tr>
<td>IV</td>
<td>Receptivity</td>
<td>237</td>
</tr>
<tr>
<td></td>
<td>i Rentier Citizenship: “A Matter of Rights and Duties”</td>
<td>237</td>
</tr>
<tr>
<td></td>
<td>ii Tackling the Rentier Mentality</td>
<td>240</td>
</tr>
<tr>
<td>V</td>
<td>Capacity</td>
<td>247</td>
</tr>
<tr>
<td></td>
<td>i Bypassing the Rentier Bureaucracy</td>
<td>248</td>
</tr>
<tr>
<td></td>
<td>ii Offset: A Trigger for Institutional Reform?</td>
<td>256</td>
</tr>
<tr>
<td></td>
<td>iii State Building by Stealth</td>
<td>258</td>
</tr>
<tr>
<td>VI</td>
<td>Countertrade: Learning or Foresight?</td>
<td>261</td>
</tr>
<tr>
<td>VII</td>
<td>Countertrade in Action</td>
<td>265</td>
</tr>
<tr>
<td></td>
<td>i Offset and the Privatisation of the Saudi Telecommunications Sector</td>
<td>265</td>
</tr>
<tr>
<td></td>
<td>ii AEC: The Exemplar of Saudi State Building?</td>
<td>268</td>
</tr>
<tr>
<td>VIII</td>
<td>Countertrade: Failure or Facilitator?</td>
<td>271</td>
</tr>
<tr>
<td>IX</td>
<td>Concluding Remarks</td>
<td>279</td>
</tr>
<tr>
<td>X</td>
<td>Appendix</td>
<td>283</td>
</tr>
</tbody>
</table>

CHAPTER SIX: CONCLUSION: COUNTERTRADE AND ITS IMPLICATIONS FOR THE RENTIER STATE MODEL

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>The Reactivation of Politics</td>
<td>287</td>
</tr>
<tr>
<td>II</td>
<td>Rentier Incorporation</td>
<td>289</td>
</tr>
<tr>
<td>III</td>
<td>Rentier Autonomy</td>
<td>294</td>
</tr>
<tr>
<td>IV</td>
<td>Rentier Bureaucracy</td>
<td>297</td>
</tr>
<tr>
<td>V</td>
<td>Rentier Mentality</td>
<td>301</td>
</tr>
<tr>
<td>VI</td>
<td>The Transition From Allocation to Production State</td>
<td>304</td>
</tr>
</tbody>
</table>

BIBLIOGRAPHY                                                                                         308
Globalisation, Countertrade and Privatisation in the Arabian Gulf

List of Tables

CHAPTER ONE

1. World Crude Oil Exports: 1977-1997 12
2. World Consumption of Refined Produced by Region: 1977-1997 13
3. Oil Reserves in GCC States (at Year End) 14
7. Kuwait’s Total Loss: Direct, Indirect and Intangibles 25
9. Typology for Assessing the Rentier State Model 61

CHAPTER TWO

10. Countertrade, the Three Worlds and the State 78
11. Developing Countries Engaged in Countertrade in 1985 86
12. The Macro Multipliers 103
13. The Micro Multipliers 103
14. Countries Currently Engaged in Countertrade 106
15. Kuwaiti Offset Program: Participating Foreign Contractors 110
16. Saudi Arabia: Peace Shield I Offset Program 111
17. Saudi Arabia: Peace Shield II Offset Program 111
18. Saudi Arabia: Al Yamamah Offset Program 112
19. Saudi Arabia: Sawari Offset Program 113
20. Saudi Arabia: Contracts Awarded to Offset Companies 113
22. Variations of Build, Operate and Transfer (BOT) 115
23. Phases of a BOT Project 116

CHAPTER THREE

24. GCC Projected Power Requirements 145
25. Saudi Arabia: Power Generation Demand Forecast 146
Chapter One

The Significance of the Rentier State Model in Kuwait and Saudi Arabia

Introduction

This chapter considers the significance of the rentier state model when applied to the states of the Arabian Gulf as we enter the 21st century. Since the rentier model was first advanced some thirty years ago it has developed into the primary analytical tool to investigate politics and economics inside the Gulf states. However, in recent years, these states have undergone significant changes that have important consequences for the theory of rentierism. By focusing attention upon specific economic development policies pursued by Kuwait and Saudi Arabia we are able to make a contribution to the rentier debate - an important sub-field of Middle Eastern and comparative politics. Although rentierism remains central to any political and economic analysis of Kuwait and Saudi Arabia, we must continually assess the significance of the concept in the light of new evidence. I argue that an investigation into the application of countertrade allows us to craft a nuanced critique of the rentier state model. Without seeking to destroy the conjectural clarity of the model, this thesis re-considers a number of its assumptions with a view to increasing its accuracy.
To achieve this task, the following chapter is divided into seven basic sections. The first of these outlines the central propositions of the rentier state model. Sections two to six develop a ‘thematic approach’ to the inherent assumptions of renterism. Section two considers the proposition that rentier states are highly autonomous decision-making units, pointing out recent circumstances that might force us to question this concept. Section three discusses the problems associated with the “internationalisation” of the rentier state, - a fact largely neglected by theorists. Rentier states are subject to the forces of globalisation, which have an important bearing on the redistributive policies pursued by the Gulf elite. Section four evaluates the diverse range of “political incorporation” strategies employed by the rentier elite. It also questions the assumption that the rentier state is a “de-politicised” entity. In fact, the rentier state continually reacts to political demands by instigating additional incorporative strategies – of which the application of countertrade is a good illustration. Section five considers the institutional malaise that appears to afflict the rentier state, while section six takes a new look at a central proposition of rentierism – the “rentier mentality.” The final section introduces three inter-related hypotheses to question and assess the nature of global and internal political and economic dynamics upon the rentier state model. The evidence and issues discussed are developed and examined fully in chapters three, four and five, with a view to synthesising the findings in chapter six.
I. The Rentier State: A Definition

Rentier states possess a number of characteristics that differentiate them from other states. Although every economy contains elements of rent, rentier economies are those in which rents predominate over any other source of income. Rentier states rely upon substantial and steady flows of foreign exchange generated by the sale of a particular commodity. The origin of government revenue is predominantly based abroad. In non-rentier economies, government income is derived internally from taxation. Giacomo Luciani labels these states “esoteric states.” Yet if rents are both external and substantial, governments can bypass the extractive process – they are “exoteric states.” It is also important to note that very few individuals are engaged in the generation of the rent although society benefits from the distribution and utilisation of it. Rentier states are “allocation” states and differ from conventional “production” states. The government is the principal recipient of rent, enabling it to “buy-off” potential political dissent via distributive payments. As a result, rentier states are said to possess considerable political and economic autonomy from a politically passive society and rent-dependent private sector. Yet this autonomy does not translate into good governance. Corruption and nepotism flourish within the redistribution policies pursued by the state. Attempts at reforming this system are stymied by a bloated and inefficient rentier bureaucracy and

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1 Rent is income generated from a non-productive activity which does not represent surplus value derived from a combination of capital and wage labour. Rent is defined in terms of the nature of accumulation rather than on a sectoral designation of economic activity. See: Booth, C. ‘The Making of a Rentier Class: Wealth Accumulation and Political Control in Senegal’ The Journal of Development Studies Vol. 26, No. 3 April 1990 pp. 425-449


resisted by a indolent populace afflicted with the 'rentier mentality.' These central propositions form the basis of the rentier state model that dominates the analysis of state-societal relations and economic development in the Gulf peninsula. As Gerd Nonneman points out:

This concept forms a major part of the debate on the nature of state and economy in the Middle East. Its implications are particularly important for an understanding of the region's political economy and development, and, more significantly, for an understanding of the characteristics, dynamics and purposes of development policy.

Rentierism is an extension of the patrimonial nature of politics found inside developing countries. Patrimonialism, - the maintenance of what Max Weber calls 'traditional authority' - uses kinship linkages, the state bureaucracy and a military apparatus to preserve the established avenues of elite power 'that have always existed.' The patrimonial state limits political power, influence and privilege to an elite group of individuals who share similar aspirations. The elite is prepared to admit new members into the patrimonial regime but only through conformity. This allows individuals of diverse backgrounds to become members of the patrimonial elite without involving major shifts in the redistribution of power. Through favours and persuasion, to coercion and

---

4 The rentier state was first coined in 1970 by Hossein Mahdavy when oil revenues were first transforming underdeveloped nations. See: Mahdavy, H. 'The Patterns and Problems of Economic Development in Rentier States: The Case of Iran' in: Cook, M. A. (ed.) Studies in the Economic History of the Middle East (Oxford: Oxford University Press, 1970), pp. 428-467

5 Nonneman, G. Development and Stability in the Middle East: An Exploration of the Dynamics of and Linkages Between, Development Policy and Stability, with Special Reference to the Yemens Ph.D. Thesis submitted to the Department of Politics, Faculty of Social Studies, University of Exeter, UK January 1993, p. 155

force, the ruling elite is able to concentrate authority and limit popular participation through the establishment of a ‘political order.’ The state influences society, not the other way around. As Roett’s investigation into the politics of Brazil shows, the patrimonial state ‘relies on corporatist forms of organisation to ensure the dominant position of the state over society.’

To what extent does a rentier state differ from a patrimonial state? As this chapter will show more fully, the rentier elite uses a number of incorporation strategies to ensure that political order is maintained. In this regard, the rentier state is a patrimonial state. However, it is a particularly interesting variant of the patrimonial state. Saudi Arabia and Kuwait are archetypal rentier states. Few states in the world are so heavily dependent upon one external source of revenue while no other state has absorbed vast levels of wealth among relatively small populations so rapidly. Writing twenty years ago Rodney Wilson asserted that Saudi Arabia ‘presents an almost perfect example of a rentier economy, a state with high consumption but little production, large incomes but no necessity to work for these earnings.’ Writing at the same time as Wilson, Yusif Sayigh argued that rentierism in Kuwait had led to vested interests, excessive unchecked dependence on government and permissiveness in pricing, all of which ‘are gaining

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7 Roth, G. ‘Personal Rulehip, Patrimonialism and Empire Building in the New States’ World Politics Vol. XX, No. 2 January 1968 pp. 194-206
momentum in what looks like an irreversible course." Rentierism produces unique and highly deleterious consequences for political and economic development.

Rentierism appears to facilitate patrimonialism. In many non-rentier developing states, the ability of the patrimonial elite to maintain political order under conditions of rapid economic growth has eroded. Modernisation theorists predict a correlation between socio-economic development and demands for democratisation. If the patrimonial elite cannot incorporate these demands, political instability will occur and "traditional authority" is diminished. Yet in rentier states economic growth is overwhelmingly derived from unproductive activity. Crucially, the patrimonial elite is in a position to generate economic growth through the redistribution of oil wealth. This should allow the Saudi and Kuwaiti leadership to purchase political compliance. Rentierism broadens elite options for political incorporation. "In no other area of the world is the division between industrialisation and political development so pronounced as in the case of the Persian Gulf." If rentierism is an extension of patrimonialism, then Saudi Arabia and Kuwait represent its furthest extension. Using kinship ties supported by the establishment of post-oil state institutions, the Gulf elite should be in a position to strengthen the political order. However, as the rentier state expands, the nature of patrimonialism begins to change. Whereas the patrimonial state specialises in the granting of favours to those within and around the ruling elite, rentierism grants favours, and raises expectations, to a

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much greater and wider degree. The extensive provision of public goods, from welfare to education; from infrastructure to subsidies, extends the nature of patrimonialism both quantitatively and qualitatively. Whereas patrimonialism is based on exclusivity, rentierism is based on inclusivity. Patrimonialism in Kuwait and Saudi Arabia is no longer an extended form of personalism. Political order is also built on welfarism. Unfortunately it is extremely expensive to administer. This should not be a concern when oil rents are plentiful. However, in situations where oil rents begin to diminish, the political order and popular legitimacy built by welfarism is threatened. As this chapter highlights, the rentier elite cannot simply return to its reliance on pre-oil patrimonial linkages. Rentierism has the potential to destroy many of the traditional channels through which the pre-oil patrimonial elite once operated. Rentierism brings new opportunities and challenges to the elite of Saudi Arabia and Kuwait.

This thesis re-considers aspects of rentierism in light of the application of two specific countertrade analogues – Offset and Build, Operate and Transfer (BOT) – which are introduced and explained more fully in chapter two. Rentierism still remains central to any political and economic analysis of Kuwait and Saudi Arabia. However, can the existing rentier state model explain the application of countertrade, which I argue is partly the result of sophisticated bargaining between the state and interest groups under conditions of fiscal austerity? Can the rentier state model, largely developed during the

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12 Many pre-rentier institutions withered during the oil boom. The extractive capacity of the Kuwaiti and Saudi state bureaucracies wasted away while rents were used to undermine the productive capacity of the merchants and therefore their political power.
oil-boom decades of the 1970s and early 1980s, still accurately describe the political and 
economic situation of Kuwait and Saudi Arabia in the year 2000? Both states are seeking 
to move away from their dependence on oil. Yet how diversification is to proceed is an 
intensely political question and the methods chosen will tell us much about the autonomy 
of the rentier state. If countertrade is the result of political bargaining, what does this tell 
us about the alleged “depoliticisation” of the rentier state? What does countertrade tell us 
about the changing nature of political incorporation inside the rentier state? The answers 
to these questions will be addressed throughout the subsequent chapters. First, we must 
undertake a thorough investigation of the assumptions implicit in the rentier state model.

II. Internal Challenges to Rentier State Autonomy

State “autonomy” is an elusive concept. When applied to the rentier states of the 
Arabian Gulf, the concept is particularly obscure. The states of the region, affluent with 
oil revenues and benefiting from the apparent absence of democratic traditions, are 
presumed to be highly autonomous. The rentier model asserts that dissent towards the 
framing and application of state policy can be “bought off” with oil receipts. For 
example, Lisa Anderson cites Kuwait as a country where the elite is ‘virtually completely 
autonomous from its society.’14 Unfortunately, most of the rentier literature is guilty of 
‘presenting a snapshot of oil producing states in the period immediately after the arrival 
of oil revenues.’15 Autonomy is presented as a static occurrence regardless of long-term

1 1987 pp. 1-18
15 Crystal, J. Oil and Politics in the Gulf: Rulers and Merchants in Kuwait and Qatar (Cambridge: 
Cambridge University Press, 1995) 2nd ed.
changes in the domestic and global environment of the rentier state. In fact, autonomy is a constantly changing phenomenon. States that were once strong can become weak and vice versa. This section will show that long-term changes in the profitability of rent, demographic shifts, rising deficit levels and responses to the geo-strategic vulnerability of the Gulf states force us to reconsider conventional notions of rentier state autonomy. Before doing so, it is necessary to define autonomy as precisely as possible and point out the difficulties in framing a definition.

Political scientists argue it is possible to categorise states as being either “strong” or “weak.”\(^\text{16}\) Classification is predicated on the degree of autonomy each state possesses. Autonomy is generally defined as the capacity of a state to formulate and implement its preferences, while the state itself can be defined as, and limited to, ‘those individuals who are endowed with society-wide decision-making powers.’\(^\text{17}\) Steven Krasner argues that autonomy is the ability of state officials to translate their weighted preferences into authoritative actions.\(^\text{18}\) Similarly, Theda Skocpol defines state autonomy as a situation where the state can ‘pursue goals that are not simply reflective of the demands or interests of social groups, classes or society.’\(^\text{19}\) States that are able to resist demands from interest groups within society by defusing opposition are considered to be “strong states.”


states" do not have the power to achieve this and policies must reflect the interests of powerful groups within society.\textsuperscript{20} In recent years this rather crude classification has come under attack.\textsuperscript{21} Ikenberry calls for a more nuanced understanding of autonomy, arguing that the ‘characterisation of weak and strong does not capture the elements of state capacity.’\textsuperscript{22} Ikenberry argues that although the American state is “weak” in terms of the decentralisation of decision making, state actors had considerable leeway to formulate decisive policies during the oil crisis of the early 1970s. The state possessed the necessary policy instruments to implement its desired policy under crisis conditions. Therefore, it is not the formal institutional design of the state that renders it autonomously “strong” or “weak” but rather the ‘nature of the socio-economic crisis at hand and on the possibilities of finding an effective fit between the available instruments and the particular problems.’\textsuperscript{23} After all, oil rents gave the Shah of Iran “autonomy” yet he was unable to craft policies to prevent the Islamic revolution of 1979.\textsuperscript{24}

\textsuperscript{19} Skocpol, T. ‘Bringing the State Back In: Strategies of Analysis in Current Research’ p. 9 in: Evans, P. B., Rueschemeyer, D., Skocpol, T. (eds.) \textit{Bringing the State Back In} (Cambridge: Cambridge University Press, 1985), Chpt. 1, pp. 3-37
\textsuperscript{23} Ikenberry, G. J. \textit{ibid.}, p. 204
\textsuperscript{24} Skocpol, T. ‘Rentier State and Shi'a Islam in the Iranian Revolution’ \textit{Theory and Society} Vol. 11, No. 3 May 1992 p. 265-292
Given the premise that the rentier state is a "strong" state, it is time to question whether Kuwait and Saudi Arabia are able to follow through with their policy preferences considering the impact of long-term "internal" challenges to power and stability. To paraphrase Ikenbury, it is the ability of the rentier elite to manage domestic (and global) pressures that will give us a true reflection of Kuwaiti and Saudi autonomy and, importantly, provide an antidote to the simplistic rendering of "rentier state autonomy." In this context, an investigation into the application of countertrade is warranted. If countertrade represents a means for the states of Kuwait and Saudi Arabia to mitigate some, or all, of the pressures listed below, we will have to reconsider both how rentier autonomy is defined as well as how autonomous each state actually is.

How is Autonomy Challenged?

i) Rethinking Rent: The Declining Profitability of Oil

Rentier states are said to be unique because one substantial income source surpasses all other receipts. However, this scenario describes the Gulf of the 1970s rather than the Gulf of the 1990s. The oil boom is over, with Saudi Arabia accruing debts currently estimated to be 120% of GDP. The profitability of oil has declined dramatically. The possession of what was once termed "black gold" does not produce the same amount of wealth as it did in the past. Despite the recent rise in crude oil, prices over the last ten years have fluctuated between $10 and $30 a barrel – levels lower than relative prices in the 1970s. This is due to increased competition in world oil markets from non-OPEC
members. There are simply more players in the rentier game chasing too few rents.  

Traditional Gulf export markets such as North America are becoming increasingly competitive with Latin American countries eager to obtain market shares. Oil is still a wealthy asset to possess but no where near as wealthy as it once was. Despite the attempts of OPEC nations (whose members include Kuwait, Qatar, Saudi Arabia and the UAE) to restrict supplies, the cartel has not succeeded in creating a supply shortage.

Table 1: World Crude Oil Exports: 1977-1997
(thousand barrels per day)

<table>
<thead>
<tr>
<th></th>
<th>1977</th>
<th>1987</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total World</td>
<td>32,990.0</td>
<td>23,001.4</td>
<td>34,605.9</td>
</tr>
<tr>
<td>OPEC</td>
<td>27,322.7</td>
<td>12,594.0</td>
<td>19,182.7</td>
</tr>
<tr>
<td>OPEC %age</td>
<td>82.8</td>
<td>54.8</td>
<td>55.4</td>
</tr>
</tbody>
</table>


Despite the desire of OPEC states to fix prices at a rate considered conducive to their economic and political needs, the influence of the cartel has waned. In the 1970s over four-fifths of the world’s supply of oil came from the nations of the cartel. During the 1990s this figure had fallen to just over half. In 1998 the price of oil fell to only 38%

26 GCC States hold 45% of the world’s proven oil reserves but control only 18% of global crude production. ‘Gulf Oil Ministers to Meet in Abu Dhabi’ Agence France-Presse March 18, 1999 http://www.arabia.com/content/business/3_99/gulf18.shtml
27 In recent years the Venezuelan national oil company (PDVSA) has implemented an aggressive market share expansion strategy in the United States. It has purchased loss-making refineries and gas stations inside the market to reinforce its foothold. With its geographical proximity to the American market and its large supply of heavy oils, Gulf states face stiff export competition.
of its level in 1980 in current dollars and to less than 20% in real terms. UN/US embargoes have artificially boosted prices. As Odell argues, 'it is, as usual, politics rather than economics which have generally continued to generate an oil price which remains significantly above its competitive level, even if not a level high enough to satisfy the exporters.' Allied to this is the fall in demand from traditional export markets. Both Europe and North America consume less refined oil than during the troubled 1970s. As the table below demonstrates, despite record economic growth the North American market imported less oil in 1997 than it did twenty years earlier.

Table 2: World Consumption of Refined Products by Region: 1977-1997
(thousand barrels per day)

<table>
<thead>
<tr>
<th>Region</th>
<th>1977</th>
<th>1987</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>19,037.3</td>
<td>17,548.7</td>
<td>18,944.6</td>
</tr>
<tr>
<td>Latin America</td>
<td>4,009.1</td>
<td>4,701</td>
<td>6,014.6</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>9,520.9</td>
<td>10,550.1</td>
<td>5,350.4</td>
</tr>
<tr>
<td>Western Europe</td>
<td>13,212.9</td>
<td>11,889.9</td>
<td>12,202.3</td>
</tr>
<tr>
<td>Middle East</td>
<td>1,183.8</td>
<td>2,379.3</td>
<td>3,395.3</td>
</tr>
<tr>
<td>Africa</td>
<td>1,097.0</td>
<td>1,633.5</td>
<td>1,954.2</td>
</tr>
<tr>
<td>Asia &amp; Far East</td>
<td>9,419.5</td>
<td>9,880.9</td>
<td>17,383.1</td>
</tr>
<tr>
<td>Oceania</td>
<td>731.1</td>
<td>776.7</td>
<td>797.2</td>
</tr>
<tr>
<td>Total World</td>
<td>58,211.6</td>
<td>59,360.8</td>
<td>67,041.8</td>
</tr>
</tbody>
</table>


This can be explained in terms of moderate increases in domestic supply sources and government initiatives to reduce dependency upon oil imports. For example, North American and European governments have encouraged the efficient use of oil in many economic sectors from the motorcar industry to power generation. Gas-fired and nuclear

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28 Figures from Odell, P. *International Oil Market Prospects: Middle East Domination or Regionalisation?* Paper presented at Conference on Gulf Studies Centre for Arab Gulf Studies, University of Exeter, UK 6-8 July, 1999
power stations have reduced the use of oil as a source of fuel. Although petroleum will continue to play an important role in the economic and political arrangements of the Gulf States, it is important to highlight the fact that these reserves have a finite life-span. Indeed, the rate of discovery for new reserves has declined in recent years despite large-scale investment and the utilisation of the latest technology.

Table 3: Oil Reserves in GCC States (at Year End)
(billion barrels)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Kuwait</td>
<td>96.5</td>
<td>96.5</td>
<td>96.5</td>
<td>96.5</td>
<td>97.0</td>
<td>92.5</td>
<td>67.9</td>
</tr>
<tr>
<td>Oman</td>
<td>5.2</td>
<td>5.3</td>
<td>5.2</td>
<td>5.2</td>
<td>4.4</td>
<td>4.0</td>
<td>2.3</td>
</tr>
<tr>
<td>Qatar</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
<td>3.0</td>
<td>4.5</td>
<td>3.6</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>261.5</td>
<td>261.6</td>
<td>261.5</td>
<td>261.4</td>
<td>260.3</td>
<td>169.0</td>
<td>181.2</td>
</tr>
<tr>
<td>UAE</td>
<td>98.1</td>
<td>98.1</td>
<td>98.1</td>
<td>98.1</td>
<td>98.1</td>
<td>33.0</td>
<td>30.4</td>
</tr>
</tbody>
</table>


Although the debate regarding future oil reserves is heated, Kuwait and Saudi Arabia have witnessed little discernible growth in oil capacity in the 1990s. Although Kuwait and the United Arab Emirates found new reserves in the early 1980s, this has reached a plateau in recent years. The stabilisation of oil reserves over the last 15 years in comparison to earlier rates of growth suggests that the Gulf has reached its reserve boundary. Future production will begin to reduce reserves. Although Gulf oil production has a longer life-span due to the amount of reserves held this advantage will only be

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29 Odell, P. *ibid.*, p. 2
30 For more information see Farid, A. M. & Sirriyeh, H. (eds.) *The Decline of Arab Oil Revenues* (London: Croom Helm, 1986)
31 For evidence of this debate see 'The Oil Riddle' *Gulf States Newsletter* November 1999 Vol. 25, No. 625 p. 13
short-lived. Experts predict that a twenty-year privilege exists before production levels inevitably fall.\textsuperscript{32} As Fleay points out, oil production in the major producing regions of the world have peaked or are about to peak:

A fifty-year transition period began in the USA in 1970. The former Soviet Union’s oil production peaked in 1989 and has suffered rapid decline ever since. The remainder of the producing region’s outside of the Arabian Gulf are expected to peak by the year 2005....(The Arabian Gulf region) is likely to peak in about 2020. Production of oil in the world as a whole is likely to peak some ten years earlier.\textsuperscript{33}

This trend should in theory give the Gulf states an oil windfall in the next century. However, as prices rise, so efforts to find alternative, cheaper sources of fuel will intensify. As Don Huberts, Head of Shell Hydrogen, pointed out in an article in the Economist, “the stone age did not end because the world ran out of stones, and the oil age will not end because we run out of oil.”\textsuperscript{34} It is highly conceivable that technology may render oil obsolete before the oil runs dry.\textsuperscript{35} Even if new reserves are found the cost of exploiting them will rise considerably in the next decades. A large proportion of reserves is located in inaccessible wells. Excessive drilling and over production has weakened underground water reservoirs. As one oil executive remarks, “the quality of the Burgan reservoir is a great blessing if you are just producing oil, but if you are also producing

\textsuperscript{32} As reserves fall increasing levels of investment are required to reach new sources of oil. The law of diminishing returns comes in to play: the amount invested gradually increases while the amount extracted gradually decreases.

\textsuperscript{33} Fleay, B. J. \textit{The Decline of the Age of Oil} (Annandale, NSW: Pluto Press Australia, 1995), p. 1

\textsuperscript{34} \textit{The Economist} July 24, 1999

\textsuperscript{35} According to Medhi Varzi, oil analyst at Dresdner Klienwort Benson, “we are on the verge of a post-oil era. Within this decade a lot of existing technological developments will contribute to the long-term demise of oil.” Mortished, C. ‘Sheikhs Rattled by Role of a UK Gas Generator Company’ \textit{The Times} London, July 6, 2000
water you have a great problem." Exploiting oil reserves without creating environmental problems will prove to be technically challenging and therefore extremely expensive.

ii) Socio-Economic Pressures: Population Growth, Urbanisation and Unemployment

The Gulf States are experiencing a population explosion which threatens to undermine many of the advances in economic development that have taken place in recent decades. In less than twenty years all states, with the exception of Kuwait, have witnessed their populations more than double in this period. The Saudi population of 9,370,000 in 1980 had grown to 19,258,000 by 1997. As the following table demonstrates, the Saudi population is expected to reach 47,000,000 by the year 2030. Such figures demonstrate the need for additional development policies that can absorb this increase without causing social instability.

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36 Oil executive (unattributed) quoted by Kielmas, M. ‘Diminishing Returns for Kuwaiti Oil’ Middle East Economic Digest 1 May, 1992 pp. 4-5

37 Kuwait’s population growth mirrored that of its neighbours until the Iraqi invasion.

Table 4: Gulf Population Figures 1990-1995 and Projected Population in the year 2030

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>508,037</td>
<td>3.1</td>
<td>1990</td>
<td>12.4</td>
<td>87.6</td>
<td>1,004,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1995</td>
<td>9.7</td>
<td>90.3</td>
<td></td>
</tr>
<tr>
<td>Kuwait</td>
<td>1,575,983</td>
<td>-4.7</td>
<td>1990</td>
<td>4.2</td>
<td>95.8</td>
<td>2,910,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1995</td>
<td>3.0</td>
<td>97.0</td>
<td></td>
</tr>
<tr>
<td>Oman</td>
<td>2,018,074</td>
<td>1.6</td>
<td>1990</td>
<td>37.9</td>
<td>62.1</td>
<td>5,803,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1995</td>
<td>24.4</td>
<td>75.6</td>
<td></td>
</tr>
<tr>
<td>Qatar</td>
<td>369,079</td>
<td>2.5</td>
<td>1990</td>
<td>10.1</td>
<td>89.9</td>
<td>815,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1995</td>
<td>8.6</td>
<td>91.4</td>
<td></td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>16,929,294</td>
<td>3.7</td>
<td>1990</td>
<td>21.5</td>
<td>78.5</td>
<td>47,074,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1995</td>
<td>17.2</td>
<td>82.8</td>
<td></td>
</tr>
<tr>
<td>U.A.E.</td>
<td>1,043,225</td>
<td>6.5</td>
<td>1990</td>
<td>19.1</td>
<td>80.9</td>
<td>2,829,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1995</td>
<td>16.2</td>
<td>83.8</td>
<td></td>
</tr>
</tbody>
</table>


Existing oil rents are insufficient to support this demographic trend. This population will require access to education and health provision. Demand for basic services such as fresh water and electricity supplies will put existing subsidised supplies under tremendous strain. Between 1977 and 1997 the population of the Saudi Arabia grew by 141% in the 20 year period. The government admits that ‘shortages have begun to occur in the provision of services such as electricity, telecommunications, water, education and health services.’ Furthermore, the expanding population will expect to gain access to its share of redistributed rents. Unfortunately, with oil rents diminishing,
the utility of redistribution policies implemented by the Gulf elite will have little practical benefit. Unless tackled, the potential for unrest will intensify.\textsuperscript{41}

Allied to the overall trend in population growth is the rise in urbanisation. As the table above illustrates there has been a marked shift towards urbanisation as rural populations are pulled into the city in the belief that greater economic opportunities exist. This trend is most apparent in Saudi Arabia rather than Kuwait, - the latter having had very high levels of urbanisation for some time. Nevertheless, the urban infrastructure of both states is under immense strain. ‘Demographic growth will require an annual average of $10 billion of capital expenditure alone within the GCC on public utilities and infrastructure.’\textsuperscript{42} Furthermore, urban lifestyles themselves exacerbate demand as the population becomes accustomed to luxury items such as air conditioning units. These devices are largely to blame for the electricity blackouts that occur in the summer months in many Gulf cities. Urbanisation has created a much more sophisticated and demanding population base.

The rapid increase in population exacerbates the region’s unemployment problem. Oil rents alone will not guarantee individuals the “jobs for life” that earlier generations could have expected. Already the public sector is over manned, highly inefficient and extremely costly. Unemployment among the Saudi working age population has risen to

\textsuperscript{41} Khalaf, R. ‘Explosive Mix of Youthful Anger Stalks Saudi Arabia’ Financial Times June 27 1996 p. 5
\textsuperscript{42} ‘A Tough Future’ Gulf States Newsletter 9 August, 1999 Vol. 24, No. 617 p. 5
27%, and women, particularly in Saudi Arabia, are not encouraged to engage in productive employment. Part of the problem lies in the large expatriate community that resides in the Gulf. Low wages are paid to nationals from poor developing countries for services that most Gulf nationals will not contemplate. Young Saudis and Kuwaitis want jobs that offer both prestige and high wages. Unfortunately, these job opportunities are limited, creating a large, disenchanted and idle young population. 41% of the population is under 15 years of age while the percentage of those above the age of 60 is just 4%. A report prepared by one Saudi bank in the mid-1990s warned of the burdens this placed on the economy. ‘Such a population structure leads to a high dependency ratio in the sense that the economically active population has to bear the burden of inactive persons which is twice as heavy as in most developed countries.’ Participation rates in the economies of the region by Gulf nationals are low: 32% for Bahrain, 30% for Saudi Arabia, 24% for Kuwait and 20% for the UAE. Male employment is also low. At the start of the decade 85% of non-national adult males were commercially active in Gulf economies compared to an average of 50% of national males.

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43 “Unemployment Soars in Saudi Arabia” Reuters, 11 April, 1999
45 The Saudi news agency now claims half the population is under 15 years old. See: SPA News Agency, Riyadh, in Arabic 0913 GMT 14 January, 1997 SWB 21 January, 1997
47 National Commercial Bank ibid., p. 4
The growth in population, urbanisation and unemployment poses significant challenges for development policy inside the rentier states of the Arabian Gulf. Oil revenues are insufficient to benefit everyone as they have in the past. In 1981 Saudi Arabia’s per capita income was $18,800. By 1998 this figure had fallen to $6,133.\textsuperscript{48} In Kuwait, the situation is less serious. In 1995, the UN estimated Kuwait’s real GDP per capita on a PPP basis to be $23,848.\textsuperscript{49} Nevertheless, by defining the rentier state as a country ‘that receives on a regular basis substantial amounts of external economic rent,’\textsuperscript{50} the rentier model assumes demography to be a constant. Yet unless rent increases proportionately to population growth the existing model can no longer anticipate the economic and political dynamics inside rentier states. For the governments themselves, new development policies must be found beyond simple rent redistribution if social instability is to be annulled.

iii) Reckless Spending: Government Debts and Deficits

Conventional analyses of Gulf states usually describe them as “super-affluent”\textsuperscript{51} yet in reality the region suffers from what one commentator calls a “myth of wealth.” The combined GDP of the Gulf is comparable to Switzerland, a country of fewer than 7 million people.\textsuperscript{52} Yet during the 1970s, the rentier states were extraordinarily complacent

\textsuperscript{48} MEED Databank  \textit{Middle East Economic Digest} 9 June, 2000 Vol. 44, No. 23 p. 32
\textsuperscript{49} United Nations \textit{Human Development Index 1998} http://undp.org/hdri/98hdi.htm
\textsuperscript{51} See Ismael, J. S. \textit{Kuwait: Social Change in Historical Perspective} (Syracuse, NY: Syracuse University Press, 1982), p. 1
with regard to their expenditures. In Saudi Arabia, the oil shock of 1973-74 led to a fiscal surplus of $18.8 billion, equal to 47.4% of GDP. Within 3 years however, Saudi Arabia was spending more than it earned. Between 1971-72 and 1981-82, Kuwait’s expenditures rose twelve times while Saudi Arabia’s were thirty times higher. Although there was much talk of conserving stocks and plans to diversify the economy, serious attempts were not instigated until the late 1980s. As one Saudi development plan from the mid-1970s pointed out, ‘the Kingdom’s oil revenues are ample to sustain any foreseeable level of production required, either for revenues to finance the Plan, or to meet the needs of the extensive hydrocarbon based industrial complexes planned for the next decade.’ Such thinking led to large-scale budget deficits once oil prices collapsed in the 1980s.

The Kuwaiti government now admits that the deficit challenge has grown from a “surface problem” covered by the state’s general reserve to a “structural concern” where ‘its continuity threatens to become a mechanism for consuming the national wealth.’ The following table clearly illustrates that the state has been living beyond its means.

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54 Kingdom of Saudi Arabia, Ministry of Information *Outline of Second Five Year Development Plan 1973-1980*
Table 5: Summary of Public Revenues and Expenditure in Kuwait: 1992-1999
(KD million)

<table>
<thead>
<tr>
<th>Period</th>
<th>Revenue</th>
<th>Expenditure</th>
<th>Surplus/Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992/93</td>
<td>2,363.7</td>
<td>3,953.3</td>
<td>-1,589.6 Deficit</td>
</tr>
<tr>
<td>1993/94</td>
<td>2,775.1</td>
<td>4,240.8</td>
<td>-1,465.7 Deficit</td>
</tr>
<tr>
<td>1994/95</td>
<td>3,100.7</td>
<td>4,193.2</td>
<td>-1,092.5 Deficit</td>
</tr>
<tr>
<td>1995/96</td>
<td>3,473.1</td>
<td>4,126.5</td>
<td>-653.4 Deficit</td>
</tr>
<tr>
<td>1996/97</td>
<td>4,391.0</td>
<td>3,888.6</td>
<td>+502.4 Surplus</td>
</tr>
<tr>
<td>1997/98</td>
<td>3,607.8</td>
<td>3,977.8</td>
<td>-370.0 Deficit</td>
</tr>
<tr>
<td>1998/99*</td>
<td>2,443.5</td>
<td>4,362.0</td>
<td>-1,918.5 Deficit</td>
</tr>
</tbody>
</table>

Source: Adapted from Central Bank of Kuwait Quarterly Statistical Bulletin October-December 1998, Vol. 24, No. 4, p. 56

* Approved Budget $1=0.30 dinar

The deficit trend has worsened in recent years. In 1998 the Kuwaiti authorities introduced a series of emergency laws to draw money from the Future Generations Fund, leading to the Oil Minister, Sheikh Sa’id Nair Al Sabah, to describe the economic condition as “critical.” Despite efforts to reduce the deficit, the government’s future expenditures will still exceed its income. Government ministers have described the deficit as a security issue as well as an economic concern. According to Planning Minister, Dr. Ali Fahd Al Zumay, the state will no longer possess the reserves to quell discontent among future generations. Industrial unrest has already increased in Kuwait with workers in the electricity and water industries demanding recompense of back payments and pay rises.

55 State of Kuwait, Ministry of Planning and Center for Research and Studies on Kuwait Kuwait and Social Development: Leadership, Planning, Popular Participation and Humanitarian Orientation (Kuwait: Ministry of Planning, 1995), p. 189
56 Kuwaiti News Agency, Kuwait, in Arabic 1144 GMT 3 November, 1998 SWB 5 November, 1998 The Kuwaiti government is believed to have withdrawn $80 billion from the fund since 1990. See “Kuwait Withdrew Over $80 Billion From Reserve Fund’ Reuters Kuwait City June 11, 2000
57 Kuna News Agency, Kuwait City, in Arabic 2135 GMT 28 December, 1998 SWB 5 January, 1999
58 Al Watan, web-site, Kuwait City, in Arabic 12 April, 1999 SWB 20 April, 1999
59 Kuwait Satellite Channel TV, in Arabic 1856 GMT 8 January, 1997 SWB 14 January, 1997
A similar deficit crisis exists in Saudi Arabia. In the twenty-two years ending 1997 only five were in surplus. The government has had to borrow heavily to offset these deficits although it has denied asking for a $5 billion loan from the UAE to achieve this.61

(Billion riyals)

<table>
<thead>
<tr>
<th>Period</th>
<th>Revenue (Bn riyals)</th>
<th>Expenditure (Bn riyals)</th>
<th>Surplus/Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>136.0</td>
<td>128.3</td>
<td>+7.7 Surplus</td>
</tr>
<tr>
<td>1980</td>
<td>348.1</td>
<td>236.6</td>
<td>+111.5 Surplus</td>
</tr>
<tr>
<td>1985</td>
<td>133.6</td>
<td>184.0</td>
<td>-50.4 Deficit</td>
</tr>
<tr>
<td>1990-91*</td>
<td>316.6</td>
<td>476.8</td>
<td>-160.2 Deficit</td>
</tr>
<tr>
<td>1992</td>
<td>165.4</td>
<td>232.5</td>
<td>-67.1 Deficit</td>
</tr>
<tr>
<td>1993</td>
<td>141.4</td>
<td>205.5</td>
<td>-64.1 Deficit</td>
</tr>
<tr>
<td>1994</td>
<td>129.0</td>
<td>163.8</td>
<td>-34.8 Deficit</td>
</tr>
<tr>
<td>1995</td>
<td>146.5</td>
<td>173.9</td>
<td>-27.4 Deficit</td>
</tr>
<tr>
<td>1996</td>
<td>179.1</td>
<td>198.1</td>
<td>-19.0 Deficit</td>
</tr>
<tr>
<td>1997</td>
<td>205.5</td>
<td>221.3</td>
<td>-15.8 Deficit</td>
</tr>
<tr>
<td>1998 #</td>
<td>143.0</td>
<td>189.0</td>
<td>-46.0 Deficit</td>
</tr>
</tbody>
</table>

Source: Adapted from Kingdom of Saudi Arabia, Saudi Arabian Monetary Agency (SAMA) 34th Annual Report (1998) p. 21
* Two-Year Financial Period $1=3.75 rials

Despite Saudi efforts to reduce expenditures in the light of the collapse of the international oil prices, deficits have grown larger than ever. Gulf states are caught between a rock and a hard place. Reducing expenditure levels makes good economic sense but inside an allocation state such cutbacks are politically sensitive. Raising the level of non-oil income implies greater taxation inside states that have no tradition of direct excise collection and a population unwilling to pay tax unless granted greater political representation. Inside the rentier state, rational economic solutions are nullified by political considerations.

iv) Geo-Strategic Vulnerability: War and Defence Expenditure

Gulf states are situated in an region that suffers from recurrent geo-strategic vulnerabilities as witnessed by the Iran-Iraq war between 1980 and 1988 and the Iraqi invasion of Kuwait in 1990 and subsequent liberation in 1991. Reliance upon one major source of income exacerbates this vulnerability. For Kuwait, the cost of physical reconstruction and subsequent deterrent expenditures on defence was enormous. It intensified efforts to obtain new methods of development financing across the region. Early estimates of the total cost of the war put the figure at $177 billion. However, subsequent research undertaken by the State of Kuwait suggests this figure is extremely conservative with Kuwait’s losses alone totalling $168 billion. The total cost of the war for all those involved may well be double initial estimates.

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Table 7: Kuwait's Total Loss: Direct, Indirect and Intangibles

<table>
<thead>
<tr>
<th>Category of Loss</th>
<th>Loss in US $ Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Direct Loss</td>
<td></td>
</tr>
<tr>
<td>A. Static</td>
<td></td>
</tr>
<tr>
<td>1. Forced Departure</td>
<td>285.6</td>
</tr>
<tr>
<td>2. Tangible Assets</td>
<td>26,271.0</td>
</tr>
<tr>
<td>3. Under-Reporting of Damages</td>
<td>4,051.9</td>
</tr>
<tr>
<td>4. Support to Kuwaitis Abroad</td>
<td>1,259.7</td>
</tr>
<tr>
<td>5. Desert Shield and Desert Storm</td>
<td>22,918.0</td>
</tr>
<tr>
<td>6. Oil Sector Loss</td>
<td>41,722.9</td>
</tr>
<tr>
<td>Total of Static Direct Loss</td>
<td>96,509.1</td>
</tr>
<tr>
<td>A. Dynamic</td>
<td></td>
</tr>
<tr>
<td>1. Civilian Injuries</td>
<td>232.1</td>
</tr>
<tr>
<td>2. Veteran Costs</td>
<td>58.0</td>
</tr>
<tr>
<td>Forgone Income of Civilian Deaths</td>
<td>130.3</td>
</tr>
<tr>
<td>Interest Payments</td>
<td>28,578.1</td>
</tr>
<tr>
<td>Total of Dynamic Direct Loss</td>
<td>28,998.5</td>
</tr>
<tr>
<td>II Indirect Loss</td>
<td></td>
</tr>
<tr>
<td>A. Static</td>
<td></td>
</tr>
<tr>
<td>1. Assistance to Allied Nations</td>
<td>6,811.0</td>
</tr>
<tr>
<td>B. Dynamic</td>
<td></td>
</tr>
<tr>
<td>1. Labour Productivity Loss</td>
<td>5,560.0</td>
</tr>
<tr>
<td>2. Cost of Bailing Out Banking System</td>
<td>7,310.5</td>
</tr>
<tr>
<td>3. Interest on Government Loans</td>
<td>684.6</td>
</tr>
<tr>
<td>4. Cost of Claim Preparation</td>
<td>296.1</td>
</tr>
<tr>
<td>5. GDP Loss</td>
<td>10,205.7</td>
</tr>
<tr>
<td>Total of Dynamic Indirect Loss</td>
<td>24,256.9</td>
</tr>
<tr>
<td>Total Indirect Loss</td>
<td>31,082.8</td>
</tr>
<tr>
<td>III Intangibles</td>
<td></td>
</tr>
<tr>
<td>1. Cost of Delayed Graduation</td>
<td>781.5</td>
</tr>
<tr>
<td>2. Forgone Interest on Non-Claimable Losses</td>
<td>10,981.7</td>
</tr>
<tr>
<td>Total Intangible Loss</td>
<td>11,763.2</td>
</tr>
<tr>
<td>Grand Total Loss</td>
<td>168,352.6</td>
</tr>
</tbody>
</table>

Source: Public Authority for Assessment of Compensation from the Iraqi Aggression Damage Assessment Study (Kuwait: Arab Dar Consultants, December 1993), p. 176

Like Kuwait, the Gulf War impacted heavily upon Saudi decision-making with regard to economic development. Already suffering from the affects of the oil price collapse in the 1980s the Saudis were forced to sell their foreign reserves and borrow heavily to pay for the war, - initially estimated to be $25 billion.63 There were few

63 Figure from Middle East Economic Digest 18 January, 1991
benefits derived from the war other than giving the Gulf elite an opportunity to reform areas of the economy that had been politically unacceptable in the past. Kuwaiti Minister of Trade and Industry in the early 1990s, Abdullah Al Jarallah, admitted that the war enabled the government to give “a bullet of mercy” to the country’s most inefficient enterprises. Yet for every inefficient enterprise that was killed off, many more efficient industries would not recover. Although the private sector was forced to adapt to lower government spending, the state faced serious economic difficulties in the 1990s.

Kuwait has also been forced to set aside future income for defence procurement. This has made Kuwait the world’s largest spender on defence in per capita terms. $12 billion has been set aside for arms purchases between 1992 and 2004 and following the Gulf War, 29.28% of its budget was allocated to defence spending in 1993. The table below illustrates how much of each state’s GDP is consumed by defence expenditure.

**Table 8: International Comparisons of Defence Expenditure as a Percentage of GDP: 1985-1997**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>3.5</td>
<td>5.4</td>
<td>6.5</td>
</tr>
<tr>
<td>Kuwait</td>
<td>9.1</td>
<td>12.5</td>
<td>11.4</td>
</tr>
<tr>
<td>Oman</td>
<td>20.8</td>
<td>12.5</td>
<td>10.9</td>
</tr>
<tr>
<td>Qatar</td>
<td>6.0</td>
<td>8.9</td>
<td>13.7</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>19.6</td>
<td>12.7</td>
<td>12.4</td>
</tr>
<tr>
<td>UAE</td>
<td>7.6</td>
<td>5.2</td>
<td>5.5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>5.2</td>
<td>3.0</td>
<td>2.8</td>
</tr>
<tr>
<td>United States</td>
<td>6.5</td>
<td>3.6</td>
<td>3.4</td>
</tr>
<tr>
<td>Total NATO</td>
<td>3.3</td>
<td>2.4</td>
<td>2.2</td>
</tr>
</tbody>
</table>


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64 *Kuna News Agency*, Kuwait City, in Arabic 0955 GMT 2 September, 1991 *SWB* 10 September, 1991

65 Kuwait Information Centre ‘Kuwait is Biggest Spender on Arms’ *Kuwait: Monthly Bulletin* Published by the Kuwait Information Centre, London Issue 11, March 1995 p. 6
Although expenditure on procurement has fallen since the end of the Cold War, each Gulf state invests significant amounts of money into defence. "The region remains the largest market in the world, in value terms, for direct sales of advanced weaponry. Regional arms deliveries in 1997 were estimated at $17 billion compared to $15 billion in 1996." As a proportion of GDP, the Gulf states continue to spend more than major arms-exporting countries such as the United Kingdom and the United States. In comparison to the average spent by all NATO countries this gap widens further. Furthermore, both Saudi Arabia and Kuwait pay for continued UN and US/UK operations against Iraq. The combination of rising defence expenditure and mounting deficits at a time when oil profitability is low poses significant problems for the rentier states. Hard policy choices have to be made. The state largesse that has existed in the past cannot continue into the future.

III. Global Challenges to Rentier State Autonomy

This thesis argues earlier theorists are guilty of "over-stating the rentier state" because the rentier state was never fully considered in a global context. Events from outside of the borders of the state appear to undermine rentier state authority. Just as global demand for oil gave the Kuwaiti and Saudi elite increasing levels of autonomy between 1940 to 1980, the market place has since taken this autonomy away. Only

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67 Saudi Arabia pays a third ($300m) a year for the cost of Southern Watch no-fly zone in Southern Iraq enforced by the UK and US while Kuwait pays an annual fee of $50 million towards the cost of the UN Iraq-Kuwait Observer Force (UNIKOM). Figures from IISS ibid.
recently, the Kuwaiti Oil Minister, Sheikh Sa'ud Nasir Al Sabah, warned that “an economic catastrophe will face Kuwait” if oil prices were to drop further. Changes in the global market impinge on the ability of the state to act autonomously in its domestic environment. Yet my argument goes further than the fluctuation of oil prices. I argue that fiscal difficulties hide a much deeper malaise. By the 1980s, the rentier state could no longer purchase everything required by its domestic constituents. As chapters four and five will illustrate more fully, oil rents could not pay for the successful utilisation of technology transfers and the establishment of R & D facilities. Oil rents couldn’t purchase a motivated and skilled indigenous workforce to compete in the global market place. Moreover, the rentier state couldn’t act as a surrogate for global markets and the need to form strategic partnerships with overseas partners. The rapid pace of global change prevents the rentier state from buying its way out of problems caused by globalisation.

Many academics have neglected the impact of globalisation on the rentier state. Since oil enables the Gulf region to obtain vast sums of foreign exchange earnings, it is perhaps understandable that its impact has been overlooked. Unlike other developing states, liquidity derived from the sale of natural resources should mitigate the need for Gulf states to obtain income and expertise from foreign sources. Yet the Gulf does not

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69 I borrow this term from Nazih Ayubi’s book Over-stating the Arab State: Politics and Society in the Middle East (London: I. B. Tauris, 1993)
60 Kuna News Agency, Kuwait City, in Arabic 0910 GMT 26 April, 1998 SWB 5 May, 1998
70 For criticism of this see: Al Shayeji, A. Country-Specific Socio-Political Research: Kuwait and its Wider Impact Paper presented at the Conference on Gulf Studies, Centre for Arab Gulf Studies, University of Exeter, UK 6-8 July, 1999
enjoy splendid isolation. Increasingly, Gulf states have to negotiate with agents outside of their borders to obtain these benefits. As Susan Strange puts it, 'governments must now bargain not only with other governments but also with firms and enterprises, while firms now bargain with governments and with one another.'

Conventional wisdom tells us that if Gulf states wish to access these benefits they must be prepared to lose some degree of autonomy in their economic and political decision-making. This tension between liberalisation (to finance diversification) and political control (to direct the manner and extent of diversification) defines new parameters of decision-making inside rentier states and the desire for economic strategies to overcome these constraints.

Economists tend to define globalisation in terms of 'the increased tendency for production and other economic activities to be carried out on a world-wide basis.' Increased flows of international trade, foreign direct investment (FDI) and the diffusion of technology continually alter modes of production. Political Scientists, on the other hand, view it in terms of the distribution of power and on where the preponderance of power lies in the world - with markets, states or societies? The dominant view of globalisation asserts that the trend will fundamentally alter the distribution of power and influence between states and markets. The former will lose influence, the latter will gain it. Staunch proponents of globalisation assert we are living in a “borderless world” where

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maps formally demarcating authority and sovereignty are a "cartographic illusion" and where corporations exceed most governments in size and power. Barnet and Cavanagh assert that leaders of nation-states 'must conform to the demands of the outside world because the outsiders are already inside the gates.' Martin and Schumann argue globalisation threatens to 'systematically nullify the sovereignty of nations,' while Strange maintains that the state is in retreat and power is being diffused throughout the world economy. However, a more benign perspective of globalisation exists. These experts argue we need to temper our analyses with a sense of caution.

Hirst and Thompson are strongly critical of the dominant approach arguing that globalisation is largely a myth. What if the very notion of globalisation is naive and a highly inaccurate picture of the international economy? The result is sub-optimal state policies. We must avoid talking ourselves into believing there is a "global trap" within which there is no

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77 Barnet, R. J. & Cavanagh, J. Global Dreams: Imperial Corporations and the New World Order (New York: Simon & Schuster, 1994), p. 19 The authors point out that Ford's economy is larger than Saudi Arabia's and Norway's while the annual sales for Philip Morris exceed New Zealand's Gross Domestic Product (GDP).
81 Hirst, P. & Thompson, G. Globalization in Question: The International Political Economy and the Possibilities of Governance (Cambridge: Polity Press, 1996), p. 2 They argue that a closer inspection of the "facts" reveals the world economy to be less open and integrated today than from 1870-1914. There are few genuine transnational corporations in the world and most trade, investment and financial flows occur within a "Triad" of North America, Europe and Japan. This Triad possesses significant power to exert powerful governance pressures over international markets.
room for distinctive national macroeconomic policies and political approaches. In fact, state-led development remains a firm reality.\textsuperscript{83}

When applying the globalisation debate to the Gulf region it becomes immediately apparent that exogenous shocks experienced by Gulf economies have far reaching domestic consequences. In short, rentier states cannot successfully weather booms and busts, or sharp and sustained fluctuations in the international price of oil, as one might have anticipated when most of the theoretical advances on rentierism took place. The loyalty of a society created in economic booms, (i.e. the institutional and political relationships that develop between state and society), is likely to dissipate in times of bust and will not necessarily return when oil rents are again plentiful. Chaudhry’s \textit{The Price of Wealth} provides evidence to support this reasoning. During the oil boom of the 1970s, the Saudi Kingdom was freed from domestic economic pressures and was able to conduct highly autonomous economic policies. The private sector was pacified and dependent upon state handouts. This conforms to the predictions of the rentier model. However, Chaudhry points out that this situation did not last and paradoxically the financially autonomous and affluent Saudi state could craft but not implement austerity measures when required.\textsuperscript{84} Without access to revenue, the Saudi state was faced with the difficult task of disassembling the distributive agencies and the economic links largesse had

\textsuperscript{82} Hirst, P. ‘The Global Economy: Myths and Realities’ \textit{International Affairs} 73 (3) 1997, p. 410
created between bureaucracies, princes and entrepreneurs. A host of ties – financial, familial and tribal - between the business class and the government restricted the latter’s room for manoeuvre. It had become entangled in its own institutional web. Through recruitment patterns and mechanisms to redistribute wealth, oil generated strong connections between the bureaucracy and the private sector – both dominated by Najdis. Whereas the boom pacified opposition to government policy, the bust witnessed the private sector exploiting these linkages to resist changes that might alter their positions of privilege. Through a combination of public criticism and private lobbying the business elite forced the government to back down on its proposed austerity measures. This leads Chaudhry to conclude that alliances struck in prosperity do not persist in crisis. The Saudi experience has important consequences for the rentier model. The concept of rentier state autonomy should not be taken as a given. Exogenous economic shocks determine the accuracy of the model. Capital in-flows significantly alter the institutions of the rentier state. When these flows dry up there is no possible return to the situation that existed prior to the oil boom. Pre-boom institutions, such as an extractive bureaucracy, no longer exist. ‘The analytical tasks of explaining...institutional change in periods of isolation and of immersion in the international economy are not identical.’ The rentier model can explain politics based on “isolation” - achievable when rents are plentiful, but not the oscillating impact of capital flows from the global economy.

85 Chaudhry, K. A. *ibid.*, pp. 36-37
86 Chaudhry, K. A. *ibid.*, p. 286
Globalisation has also undermined the ability of the rentier state to remain both isolated and competitive. Rent redistribution while politically efficient is economically inefficient. Heavy subsidisation and relative closure from international competition has resulted in a reduction in competitiveness between the private sector of the Gulf and their international competitors. This is illustrated most comprehensively in the development and application of technology to boost productivity and innovation. Neither Saudi Arabia nor Kuwait was able to develop its own technology base, having instead to import technology from abroad. Simply subsidising the private sector with revenues from oil exports was no longer adequate - the region's private sectors were increasingly being out-priced and out-competed in product development, resulting in ever-larger current account deficits. Two issues required consideration. First, what strategies would boost levels of private sector innovation and productivity, which in turn would reduce costs to benefit the wider rentier economy? Second, in the competitive arena of FDI flows, what policies would attract investment to a part of the world which investors have historically neglected? As the Cold War ended, the global competition for foreign direct investment intensified as East European and former Soviet states also tried to capture shares. Allied to the structural reforms undertaken in many Latin American countries in the 1980s, the global economy became much more competitive. The Gulf States were forced to rethink their development strategies. The Saudi government now acknowledges that, ‘both

domestic and external factors have influenced the preparation of the Sixth Development Plan.\textsuperscript{88} As Crown Prince Abdullah has warned:

\begin{quote}
The Gulf economy cannot remain immune from the effects of the world economy....We cannot live in isolation from the world which is facing an overwhelming trend – namely globalisation – which is calling for the deregulation and removal of obstacles against the free movement of peoples, ideas, capital and goods.\textsuperscript{89}
\end{quote}

Economic policy for the rentier state increasingly resembles a two-level game with the government negotiating its development strategy on two separate tables.\textsuperscript{90} The apparent isolation offered by oil rents no longer exists. Rather than states being highly autonomous units as the model suggests, the freedom to implement redistributive policies has declined as global forces influence institutions located within. These forces, previously treated as exogenous variables, now require us to treat them as endogenous to the model. As one prominent Kuwait economist puts it, "we are a country at the heart of globalisation whether we like it or not."\textsuperscript{91} The traditional rentier model as it currently stands is too static to account for the internationalisation of the Gulf states.

\begin{footnotes}
\textsuperscript{88} Kingdom of Saudi Arabia, Ministry of Planning \textit{Sixth Development Plan 1995-2000 AD} p.91
\textsuperscript{89} \textit{Kingdom of Saudi Arabia Radio}. Riyadh, in Arabic 2230 GMT 7 December, 1998 \textit{SWB} 9 December, 1998
\textsuperscript{90} Putnam, R. D. ‘Diplomacy and Domestic Politics: The Logic of Two-Level Games’ \textit{International Organization} 42, 3, Summer 1988 pp. 427-460
\textsuperscript{91} Interview with Jasem Al Sadoun, President, Al Shall Economic Consultants, Kuwait City, 8 November, 1999
\end{footnotes}
IV. Methods of Incorporation and the Reactivation of Politics

Like other patrimonial states, political incorporation inside the rentier state takes many forms. The rentier elite recurrently uses a host of imaginative strategies to undermine potential political dissent. The maintenance of regime power and stability is derived from what Byman and Green label the application of “sticks” and “carrots.” Confirmation of the “stick” approach is evidenced by the development of an extensive domestic security apparatus paid for by oil receipts. Harassment and imprisonment, together with the threat of force, is often enough to inform potential dissidents that nonconformist actions will not be tolerated. With such a powerful military apparatus, the rentier elite is careful to solidify the support of the military. Historically, the Gulf states have recruited heavily from the Bedouin believing them to be apolitical in nature. In Saudi Arabia, the rank-and-file of the military are drawn from the broad section of Saudi society, representing tribes and villages from across the peninsula. Generous expenditure on the military is designed to incorporate young Saudis from all areas of the Kingdom into an organisation that will shelter them from radical ideas. Loyalty to the Al Saud is carefully cultivated. Indeed, more than other social and political groups, the military leadership is chosen and groomed on the basis of loyalty to the system, and the senior officers represent groups traditionally loyal to the Al Saud, while ruling family members

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93 During the 1950s and 1960s when Arab nationalism was at its peak, Gulf rulers believed the Bedouin would be the group least likely to identify themselves with the urban intellectual rhetoric of pan-Arabism.
In Saudi Arabia it is estimated that many hundreds of princes are officers in the army. In Kuwait, the figure is substantially less, although the Al Sabah is well represented throughout the ranks. In particular, the royal guard is staffed overwhelmingly by the extended family of the ruling elite. The prime duty of officers who belong to the Al Saud and Al Sabah is to identify unusual activity and arrange the administration of the forces so that a coup attempt cannot find peer support. Given than none have succeeded, this arrangement works well.

However, it is the "carrot" that is implemented by the rentier elite on a more frequent and effectual basis. Using the oil wealth at their disposal, ruling families are able to co-opt dissenters through a variety of imaginative strategies. To counter the potential for dissent based on tribal or regional grounds, the rentier elite carefully divides these sources of allegiance to either weaken them or create an opposing balance of power. The tribal heritage of Kuwait and Saudi Arabia has historically threatened the power-base of the rentier elite. Unlike Kuwait, Saudi Arabia's tribal regions are defined by strong geographical cleavages - the strongest being the religiously conservative Najd (the central region and the home of Wahhabism) and the heavily populated and merchant-oriented Hijaz (western region). The Najdis and Hijazi tribes possess a long history of competition, and at times animosity, between each other. The power and stability of the Saudi Kingdom was built by striking a balance of power between the two - a process that

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has been assisted by the redistribution of oil rent.\textsuperscript{96} Chaudhry's research shows how the Saudi government fostered the development of a new business class in the Najdi province via transfer payments to balance the power of the merchant classes in the Hijaz.\textsuperscript{97} In the small emirate of Kuwait, tribal groups are not geographically dispersed. Many of the powerful tribal families engaged in merchant activities, and subsequent merchant cultural practices (such as inter-marriage) cut across tribal linkages. Nevertheless, the Al Sabah regime has taken steps to fix electoral boundaries that straddle tribal affiliations to weaken potential poles of power. Both states have chosen to integrate the tribal elite into the bureaucracy and higher levels of government. In Saudi Arabia, the Nadji-Hijazi tension made this imperative. Under the leadership of King Faisal, the government sought out qualified Najdis to fill important bureaucratic and even ministerial posts (e.g. Aba’l-Khyal who became Finance Minister in 1975) despite the fact that educated Hijazi were more numerous and better qualified. Since 1962, over one-fifth of ministerial posts in the Kuwait government have been awarded to the Asil - the eight most powerful Kuwaiti families that have wield considerable power in the commercial world. Tribal incorporation into the formal institutions of the state is strong. As Gregory Gause argues, oil wealth 'undermined the 'economic' base of Arabian tribalism, and allowed the governments to turn the sheikhs into salaried employees of the state.'\textsuperscript{98} One only has to contrast the situation in Kuwait and Saudi Arabia to that of Yemen. Here the government

\textsuperscript{96} Summer Scott Huyette claims that the results are clearly visible – the people of the Kingdom 'increasingly see themselves as Saudis first and members of other sub-groups second.' Moreover, animosity has given way to pragmatism. 'The Hijazi would lose financially if it was cut off from the oil wealth and the Najd would lack prestige without the stewardship of the Holy Places, so the symbiosis remains a healthy competition of diverse peoples and provinces.' Huyette, S. S. \textit{op cit.}, p. 44

\textsuperscript{97} Chaudhry, K. A. \textit{op cit.}
does not possess the financial means to entice Yemeni tribes into a subordinate position in the political system. These tribes remain economically and militarily independent from the state.

In addition to incorporating individuals, tribal and religious institutions have also been integrated into the apparatus of the state. Control of schools, mosques, courts, *awqaf* (religious endowments) the *ulama* (the religious elite) etc., has enabled the state to gain power at the expense of both tribe and religion. This leads Long to argue that the days when the tribes were an independent political force have long gone. The potential “threat” of tribal or religious affiliation is often exaggerated. Tribes and religious groups face competing interests. Robins points out that religious groups, (e.g. the Shi’a) are themselves fragmented which disrupts the emergence of a common consciousness. In Kuwait, Shi’a merchants have differing material interests than the Shi’a in the non-business class. Saudi Arabia’s economic difficulties have resulted in an upturn of organised Islamic violence. However, those responsible do not draw allegiance based on “traditional” identities. As Chaudhry argues, in the post-oil boom

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99 Gause, F. G. *ibid.*, p. 21
there are no “traditional” groups to return to, no “traditional” identities. Oil wealth has weakened or dispersed groups with a history of antigovernment activism. Rather, violence in Saudi Arabia has been confined to the Nadj region – the region that benefited the most from transfer payments and suffered the worst affects of the subsequent recession. Potential threats to the Al Saud do not result from the re-emergence of old tribal or religious entities, but rather the emergence of new groups whose members, as individuals, are dissatisfied with the austerity measures imposed upon them. To suppress the rise of Islamic opposition, reliance on the “stick” is not enough. More “carrots” need to be offered.

However, Michael Herb casts a critical eye over tribal and religious incorporation through oil wealth. In All in the Family, Herb argues that power and stability are derived primarily from a traditional form of patrimonialism – the family domination of the state. The “dynastic monarchies” of the Gulf have survived precisely because the family has refused to relinquish control over the key ministries of the state (interior, foreign affairs, defence). Even where outsiders hold cabinet portfolios, family members are distributed through out the lower levels of all ministries. This division of responsibilities does not necessarily take place in a harmonious fashion. As Herb points out, blood ties are themselves unable to mitigate the desire for power. Rather, these families have developed mechanisms to distribute and redistribute power among their sheikhs and

103 Chaudhry, K. A. op cit., p. 307
104 For a discussion of current ‘threats’ to the Al Saud see Fandy, M. Saudi Arabia and the Politics of Dissent (New York: St Martin’s Press, 1999)
princes, without drawing insiders into family disputes. In Gulf states, and especially in Saudi Arabia, patronage extends to the family through government contracts and sponsorships in government procurement programmes. In return, the family acts as a vast information network allowing the monarch to keep in touch with his subjects. This leads Herb to argue that 'it is dynastic monarchies more than oil, or the role of the tribes...that explains how the oil monarchs have avoided revolution.' Although the diffusion of the family throughout the state is important, it is still only one of many factors that work towards the maintenance of power and stability. In contrast to Herb, I would argue the role of oil in sustaining the rule of the dynastic monarchies of the Gulf should not be underestimated. This is clearly demonstrated in the careful cultivation of a "national ideology."

Oil wealth is used to show that not only did the "nation state" exist prior to the discovery of oil, but crucially, oil has benefited all citizens within the nation. Early rentier theorists such as Luciani dismissed the notion of a "national myth" as irrelevant for a redistributive state. In addition, a number of Middle East commentators argue that in the Gulf, 'the history of state revenue production is the history of the state.' Yet as Davis argues, 'regimes realised the need to use oil wealth to create a national ideology to which the bulk of the populace could feel some affinity.' Because of this, 'the state

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105 Herb, M. *All in the Family: Absolutism, Revolution & Democracy in the Middle Eastern Monarchies* (New York: State University of New York Press, 1999), p. 4
106 Herb, M. *ibid.*. p. 50
has been able to institutionalise a degree of stable rule.  

In the first instance, oil wealth has been used to fund state “symbolism” in the form of publishing houses, state news agencies, museums, festivals, popular journals, folkloric research centres etc. This enables rentier elites to claim historical links to the pre-oil “state.” Secondly, and importantly, the state portrays life before oil as particularly harsh. Recipients of the modern welfare state are continually reminded of an era where poor housing, illiteracy, disease and superstition were the norm. The rentier elite portrays itself as the liberator from these adverse conditions through the redistribution of rent. The manipulation of history has occurred in all of the rentier states of the Gulf. How to maintain this historical engineering in the face of decline amounts of redistribution is a pressing problem.

Rentier governments possess few qualms about using oil wealth to “buy off” potential dissent. Individual trouble-makers have often been “rewarded” by financial inducements and/or a position in government. Mary Ann Tetreault shows how the Kuwaiti government uses oil wealth to deepen the traditional channels through which the ruling family penetrates society. ‘Oil wealth allows Kuwaiti rulers to manipulate elections by buying candidates and votes, and constrains the actions of voluntary

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110 See: Kechichian, J. A. ‘Saudi Arabia’s Will to Power’ Middle East Policy February 2000 Vol. 7, No. 2 pp. 47-60

associations by requiring them to obtain licences and then funding their activities. Tetreault's earlier research shows that during the early twentieth century, Kuwaiti rulers were willing to cede external sovereignty to the British in order to create a degree of domestic autonomy. This form of "clieny" - British payments to the Al Sabah combined with military protection - enabled the ruling family to gain domestic autonomy from the merchant classes. The discovery of oil made this task much easier. Research conducted by Jill Crystal shows how the powerful merchant families were incorporated by a tacit arrangement whereby they renounced their historical claim to decision-making in return for a large share of redistributed oil revenues. Through the early policy of land acquisition, this incorporation mechanism has developed into an increasingly sophisticated web of government-sanctioned business practices. As the merchant families have expanded, the government has allowed a wide range of formal and informal business customs to develop. Agency commissions, monopoly privileges and gentlemen's agreements are a common feature of Kuwaiti economic life. In addition, Kuwaiti-based businesses must be majority-owned by Kuwaitis, while foreign investors and workers must have Kuwaiti sponsors. This has allowed a secondary-level of

115 Crystal, J. *Oil and Politics in the Gulf: Rulers and Merchants in Kuwait and Qatar* 2nd ed. (Cambridge: Cambridge University Press, 1995)
businessmen to flourish — those who obtain substantial wealth from sponsorship laws — the Kafil. Saudi Arabia also used an array of sponsorship laws such as the 30% Rule\textsuperscript{117} and the Service Agency Regulations,\textsuperscript{118} — both designed to guarantee money was allocated to those who provided political support for the regime. However, the Kingdom differs from Kuwait in that there is little formal demarcation between the royal family and the merchants. Whereas the ruling family in Kuwait has largely disengaged itself from market activity, the extended royal family of Saudi Arabia plays a considerable role in the economy. As chapter four illustrates, Saudi merchant families are increasingly bitter about royal family encroachment into the economic arena, especially when younger royals win contracts solely on the basis of family patronage. This infringement, combined with declining levels of government-awarded contracts to the private sector, threatens to unravel the tacit arrangement that has served both the interests of the rentier elite and the business elite for so long.

Finally, welfarism is the dominant element of political incorporation. It forms the central constituent of the "social contract" between the rentier elite and rentier citizens, upon which all other methods of political incorporation listed above are built upon and adapted. Rentierism holds that subsidies and tax holidays form part of the unwritten

\textsuperscript{116} See Al Najjar, G. H. \textit{Decision Making Process in Kuwait: The Land Acquisition Policy as a Case Study} Ph.D. Dissertation Submitted to Department of Politics, University of Exeter, UK 1984

\textsuperscript{117} Introduced in 1977, the law required foreign contractors who were awarded state contracts to subcontract 30% of the project to Saudi companies.

\textsuperscript{118} This 1978 law necessitated the use of a Saudi agent should foreign firms wish to apply for government contracts.
social contract between royal families and the people. Rentier citizens will forgo representative government in return for high living standards derived from the redistribution and allocation of oil receipts. Although citizens gain "wealth" the real winner in such an arrangement is the rentier elite. The "social contract" preserves the preponderance of political power in the hands of the rentier elite. For most of the post-oil discovery period, this incorporative arrangement has worked well. By providing the individual with generous welfare benefits, greater than those once supplied by the tribe, the state has managed to accrue significant levels of legitimacy to maintain power. However, its efficacy has deteriorated as the wealth of the state has diminished. Declining revenues are straining the social contract. As Andrew Rathmell points out, 'as the state's role in caring for its citizens declines and as Saudis become more exposed to the global market place of ideas, new political bargains have to be struck.' If the welfare state cannot afford to provide welfare, what is its reason for existence? This is a serious concern. 'If the state loses its ability to dispense economic largesse, the social contract may be renegotiated under conditions where buying out is no longer possible – a condition that renders the previous exchange of wealth for power inoperable.' If there is no wealth to redistribute, legitimacy is harder to attain. This suggests the need for additional methods of political incorporation to bolster the validity of the social contract.

119 Economist Intelligence Unit  

120 Rathmell, A. "Saudi Arabia – the Crown Prince Asserts Himself"  
Middle East International  11 December, 1998 No. 589 pp. 20-21

121 Vandewalle, D.  
As a result of the "political incorporation" detailed above, it is often assumed that politics has "shut down" inside the rentier state. The unfortunate corollary of this has been the development of the rentier state model that disregards "societal" influence on decision-making as an irrelevance. In sum, the rentier state model is too statist in nature. Statist approaches vary but all have in common the idea that state cannot be understood as a reflection of societal characteristics or preferences.\textsuperscript{122} The state exists as a conceptual variable.\textsuperscript{123} This perspective contrasts sharply with the pluralist tradition that emphasises societal forces and their ability to constrain leaders. Here, the policies of the state are a consequence of competitive struggles between interest groups within society. The rentier state model is essentially a statist model. Yet can a statist approach fully understand the power of the state and why it undertakes certain policy preferences?\textsuperscript{124} A criticism of the rentier state model is that societal pressures are either neglected or considered so weak that they are not important. For example, Hootan Shambayati asserts that 'rentierism enhances state autonomy by eliminating economically motivated pressure groups and by making a segment of the bourgeoisie dependent on the state.'\textsuperscript{125} This statist approach is also evident in the work of Andrew Hess who argues that 'in states heavily influenced either by the rentier effect or by an authoritarian political culture, the agent of change is still the state.'\textsuperscript{126} However, this thesis will provide evidence to suggest societal forces do

\textsuperscript{122} Krasner, S. D. (1984) \textit{op cit.}, p. 225
\textsuperscript{123} Nettl, J. P. 'The State as a Conceptual Variable' \textit{World Politics} Vol. XX, No. 4 July 1968 pp. 559-592
\textsuperscript{124} See: Colburn, F. D. 'Review Article: Statism, Rationality and State Centrism' \textit{Comparative Politics} July 1998 Vol. 20, No. 4 pp. 485-492
\textsuperscript{125} Shambayati, H. p. 307 'The Rentier State, Interest Groups and the Paradox of Autonomy: State and Business in Turkey and Iran' \textit{Comparative Politics} Vol. 26, No. 3 April 1994 pp. 307-331
\textsuperscript{126} Hess, A. C. 'Peace and Political Reform in the Gulf: The Private Sector' \textit{Journal of International Affairs} Vol. 49, No. 1 Summer 1995 pp. 121-122
play an important role in shaping economic policy. The application of countertrade cannot be explained from a purely statist perspective. Without understanding the demands of the private sectors of Kuwait and Saudi Arabia, we would not get an accurate picture of how and why these policies are pursued. This suggests a greater degree of politicisation inside the rentier state than is usually presumed by rentier theorists. The rentier state crafts additional and complementary policies in response to societal pressures so that it can increase or maintain its level of political support.

In recent years, Middle Eastern specialists have taken a closer look at "depoliticisation." Work published during the late 1980s and 1990s began to assert that the rentier state had merely tamed political demands rather than extinguished them. Farah argued that in a region where populations are still relatively small and where waasta (intermediacy) and the diwaniya (debating arenas) are present, politics takes on a personal rather than institutional flavour. The importance of size is often the neglected variable in analyses of Gulf politics.\(^\text{127}\) Gregory Gause's research into the oil monarchies of the Gulf asserted that "although usually hidden from foreign observers, "politics" – discussion of government performance and social goals, organisation to affect decision making – are going on in these states."\(^\text{128}\) Gause makes a lucid argument, pointing out that as the state has entered into the sphere of everyday life, Gulf citizens become increasingly interested in influencing those decisions that will affect their "rights of


\(^{128}\) Gause, F. G. *op cit.* p. 4
citizenship" – the redistribution of rent. The growth of the rentier state, from flour subsidies to free telephone calls and education, has stimulated “political” activity. This activity intensifies in times of fiscal crisis because austerity measures are going to directly impinge on the lifestyle of all citizens. Like individuals in production states, rentier citizens are interested in shaping policies that may negatively or positively affect them. This political activity has intensified since the Gulf War. As one Director of a British company who visited Kuwait after its liberation observed, ‘society had opened up. Before the Iraqi Invasion people had not seemed comfortable about discussing politics...After the invasion it seemed as if people almost wanted to talk about having more democracy, having more say in who does what and how money should be spent.’

Far from being “depoliticised” what we now witness is a “re-politicisation” of the Gulf state.

In sum, politics is alive and well inside the rentier state. Although numerous and diverse, methods of political incorporation are only effective for short periods of time before potential power shifts to another group within society. Changes in “incorporative methods” are a reflection of the politicisation of the rentier state. In order to force through new economic strategies under conditions of fiscal austerity, the governments of Saudi Arabia and Kuwait increasingly rely upon the private sector to implement their goals. The potential power of the private sector has risen. As chapter four will illustrate, the old assertion that the business community is prepared to cede decision-making

129 Gause, F. G. op cit., pp. 81-84
influence in return for the provision of wealth is not entirely accurate. Old methods of political incorporation are under threat. To maintain its base of support, the rentier elite requires additional economic strategies to complement the methods of incorporation listed above. As subsequent research will show, the application of countertrade was a specific attempt to incorporate and maintain the support of the private sector for the rentier elite. It was a useful addition to complement the range of incorporative strategies already employed.

V. Institutional Malaise and the Rentier State: A Countertrade Solution?

Despite the presumption of significant autonomy, the rentier state has large yet relatively weak institutions. Institutions can be defined as "the formal and informal rules, compliance procedures and standard operating practices that structure the relationship between individuals in the polity and economy."^{130} The rentier state is a "distributive" state. Bureaucratic institutions develop not to extract wealth, but to allocate it. Often over-staffed and inefficient, the bureaucracy of the state has the relatively simple task of spending the oil wealth. Production states, on the other hand, require a bureaucracy to extract wealth from the population. Extracting wealth is a much more difficult task than allocating wealth. An extractive bureaucracy requires a necessary "knowledge base" of information about those whose wealth they are extracting. It must be cost effective, so that the wealth extracted is not absorbed by the cost of extraction. The bureaucracy must possess secondary institutions to offer rebates and exemptions. Moreover, it must have

legitimacy in the eyes of those who are paying. The ability to persuade and coerce redistribution is a fundamental feature of state strength in production states. The rentier government does not possess these skills. Production states that became rentier states after the discovery of oil found little reason to maintain the skills of an extractive bureaucracy. As Chaudry illustrates, the extractive capabilities of the Saudi state withered during the boom times. Unfortunately, when the boom ended the government no longer possessed the bureaucracy to obtain information on earnings or possessed the necessary extractive apparatus. As a result, the rentier bureaucracy works well when oil rents are plentiful. Yet the weakness of the rentier state is all too apparent when oil rents are scarce.

Rentier states therefore suffer from what can be termed institutional malaise. Bureaucracies in the region are characterised by ‘administrative paralysis’ – even the most authoritarian of leaders cannot force through change in either the direction or speed that they require. Gulf bureaucracies are not adaptable to implement new solutions under conditions of fiscal austerity. However, this thesis will show that the application of countertrade is particularly attractive for rentier governments because specific schemes allow them to bypass the constraints imposed by the institutional malaise. Two issues will be highlighted. First, the Saudi government essentially “contracted out” the bureaucracy of the various Offset schemes to Western management teams, investment

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131 Vandewalle, D. *op cit.*, p. 8
banks and overseas companies. In turn, these parties established management and research offices inside the Kingdom, by-passing several levels of the state bureaucracy. Interestingly, the Kuwaiti government neglected to contract out its scheme and as a result the Offset Program has been mired in accusations of bureaucratic mismanagement. Second, and importantly, the thesis contains evidence that the institutional design of the Offset schemes became an informal template for the re-organisation of additional bureaucratic arms. It is no coincidence that the recent establishment of the Supreme Economic Council (SEC) in Saudi Arabia, - the body responsible for Saudi Arabia’s foray into privatisation - closely mirrors the design of the monitoring and implementation capabilities of the Saudi Offset Program. Whether this important institutional development will be replicated still further, and at a wider level, is open to debate. It is certainly an interesting development given the assumption that bureaucracies in the Arab world do not tend to replicate isolated reforms on a parallel basis. As Palmer et al show, low skill-levels, poor pay and overstaffing preclude general reforms at lower levels of the bureaucracy. Conservatism also plays a part. In the Saudi bureaucracy, 92% of all respondents were predisposed against implementing a development policy that might engender social conflict or value change. These insights are valid. Nevertheless, the application of countertrade highlights a potential avenue for reform. Although Saudi Arabia retains a significant rentier bureaucracy, it also possesses smaller and more

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dynamic bureaucratic arms. Broad accusations of "institutional malaise" over-look these small yet potentially significant gains.

VI. The Rentier Mentality

Rentier states are characterised by the damaging affects of the rentier mentality. This is a situation distinct from conventional economic behaviour because it embodies a break in the work-reward causation. In production economies individuals engage in work and risk-bearing activities for reward. However, for individuals in allocation economies rewards are derived by chance or situation. The result is severe "attitudinal problems" among Gulf citizens. 'Reluctance to do productive work is a widespread attitude among dominant groups.' "Reward becomes a windfall gain, an isolated fact, situational or accidental as against the conventional outlook where reward is integrated in a process as the end result of a long, systematic and organised production circuit." Consequently, the rentier model holds that citizens are likely to resist any moves to undermine their share of redistributed rents. 'Expectations, individual behaviour and political beliefs will continue to be shaped by the extraordinary experience of the decade 1974-1985, even if oil prices stay at a very low level for a long time.' The rentier mentality is presumed to be a permanent feature of the rentier state.

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135 Beblawi, H. in: Beblawi, H. & Luciani, G. (eds.) op cit., p.52
Since oil was first discovered in the peninsula, the relationship between state and society has been formatted in such a way that socio-economic interest groups are loosely organised to capture the benefits of rent distribution. Citizenship therefore becomes a source of economic benefit.\textsuperscript{140} The concept of class is considered largely irrelevant in the Gulf because citizens belong to a single rentier group and are entitled to, and are given, a distribution of the wealth derived from rents accrued to the government. The rentier model holds that individuals will not organise themselves politically to advance their individual economic interests. For example, Barnett Rubin argues that ‘in rentier states, social and economic integration is generally low, and class is not a prominent form of identification.’\textsuperscript{141} Even if the benefits of rent are distributed unequally, this is insufficient to force groups of individuals to further their economic interests along class cleavages. ‘To the individual who feels his benefits are not enough, the solution of manoeuvring for personal advantage within the existing set up is always superior to seeking an alliance with others in similar conditions.’\textsuperscript{142} The rentier model therefore asserts that the state possesses considerable autonomy in framing its economic policy. Indeed, unlike production states, this isolation means that allocation governments are not obliged to establish an economic policy - only an expenditure policy.\textsuperscript{143} As Han points out, an economy that feeds on income from rent has little incentive to invest in productive

\textsuperscript{138} Beblawi, H. in: Beblawi, H. & Luciani, G. (eds.) \textit{op cit.}, p.52
\textsuperscript{139} Beblawi, H. and Luciani, G. in: Beblawi, H. & Luciani, G. (eds.), \textit{op cit.}, p. 20
\textsuperscript{140} Beblawi, H. in: Beblawi, H. & Luciani, G. (eds.) \textit{op cit.}, p.53
\textsuperscript{142} Luciani, G. in: Beblawi, H. & Luciani, G. (eds.) \textit{op cit.}, p.74
\textsuperscript{143} Luciani, G. in: Beblawi, H. & Luciani, G. (eds.) \textit{op cit.}, pp. 73-74
activities. Instead it pursues expenditure policies that are detrimental to economic growth and which cannot be sustained in the long run. Consequently, the rentier state is an economically inefficient and wasteful entity lacking policy discipline.\textsuperscript{145} The rentier mentality affects both the government and the citizen.

This thesis argues against taking the rentier mentality as a given. While there is such a phenomenon, the application of countertrade suggests the government is moving toward the implementation of “productive” policies beyond the exclusive reliance upon “allocation” policies. Economic efficiency appears to be an important rationale behind the movement away from state largesse. Political considerations may render this process slow and laborious. Nevertheless, there is movement. The rentier mentality is not necessarily permanent. As one economist argues, although some Kuwaitis are reluctant to work, “this was not the case before 1946. It is not a built-in mechanism, but the result of the system created.”\textsuperscript{146} Chapter five will assert that steps are being taken to reform the system. Only recently Saudi Crown Prince Abdullah issued a stern warning to Gulf leaders at the 1998 GCC summit. “The age of abundance is over and will not return...We must all get used to a new lifestyle that does not rely entirely on the state... (This

\textsuperscript{144} Han, V. X. \textit{Oil, the Persian Gulf States and the United States} (Westport, CT & London: Praeger, 1994)
\textsuperscript{145} For a general analysis on why rentier economies are characterised by ‘severe economic problems...internal political ferment, social tension, identity crises and an overall malaise’ see Amuzegar, J. ‘Oil Wealth: A Very Mixed Blessing’ in: Peterson, J. E. (ed.), \textit{The Politics of Middle Eastern Oil} (Washington DC: Middle East Institute, 1983) pp. 167-186
\textsuperscript{146} Jasem Al Sadoun, quoted in Hindley, A. ‘Kuwait: MEED Special Report’ \textit{Middle East Economic Digest} 15 January, 1993 Vol. 37, No. 2 pp. 7-17
requires) the private sector to assume part of the burden." Furthermore, the thesis will tackle the claim that there is little incentive by interest groups to pursue their goals. Indeed, as subsequent chapters will make clear, the application of countertrade was, in part, a consequence of the business community acting to pursue their own goals. We must ask if the existing rentier model is too inflexible to allow for these subtle transitional phases.

VII. Countertrade and the Rentier State Model

The theoretical advances in explaining and understanding the economic and political modes of organisation inside rentier states have given generalists and Middle Eastern specialists valid insights into these states. However, given the rapid changes underway inside and outside of these states we must critically evaluate the continued utility of this model. Do the theoretical underpinnings of the model still correlate to events on the ground? If they do, do we still need to refine our approach to gain greater accuracy? If they do not, do we need to reconsider much of what we have previously taken for granted? In order to uncover these issues we will need to apply a much more nuanced approach. This section introduces three separate, although ultimately inter-related, hypotheses to help extract the answers. No one hypothesis can ‘stand alone’ in describing the application of countertrade in relation to economic development. However, by proceeding with separate hypotheses in the initial stages we have the advantage of addressing the central question ‘why countertrade’ from differing angles.

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147 'GCC Tackles Economic Fallout' Agence France-Presse 8 December, 1998
This inevitably produces a degree of overlap in the issues involved and in the evidence produced but this is to be welcomed. Countertrade is an attempt by rentier governments to deal with the economic and political difficulties of lower oil revenues and citizen demands. These demands subsequently develop constituencies of their own which push the application of countertrade forward in a manner not originally anticipated. These dynamics may occur simultaneously, and at times, the process of one dynamic may influence another. It is for the purpose of clarity that these dynamics are investigated and explained in detail by employing separate hypotheses. Each hypothesis is not an explanation but an investigation. A full explanation cannot take place until the various elements of each hypothesis are proved or disproved by evidence. Therefore, the concluding chapter will synthesise the findings to show how the dynamics and processes of countertrade fit together. Chapter six will assess the results of each hypothesis with regard to the issues outlined in this introductory chapter.

**Hypothesis I: The Regime Maintenance Model**

This hypothesis looks at the pace and direction of economic development from the political considerations of the rentier elite. It argues that, with a degree of refinement, the rentier state model retains its accuracy. Recent economic changes in Saudi Arabia and Kuwait are in fact cosmetic rather than dramatic as the elite employs countertrade in a reactionary manner to bolster its political support base. The regime maintenance model suggests a determination on the part of the Saudi and Kuwaiti states to retain existing organisational structures of the rentier state and avoid the fundamental socio-political changes that alternative economic strategies (large-scale privatisation and liberalisation)
would bring. Once a government loses direct control over the sources of income into a state it simultaneously begins to see a reduction in its ability to direct economic development and policy generally (particularly if it has to extract surpluses from the population via taxation). As the Gulf elite derives legitimacy from a welfare state created by the reallocation of oil receipts, countertrade is a useful tool to supplement the redistribution networks and resist significant socio-economic change. In doing so it maintains the power-base that facilitates elite rule. Economic decision-making in rentier states has historically been determined by the need to shore up support for the government – to purchase the acquiescence of potential trouble-makers. The response to an IMF recommendation that redistributive arrangements within Saudi Arabia should be changed brought a swift and direct response from the government: “political and social considerations preclude a reduction in subsidies or increases in fees and charges.”148 The changing circumstances outlined earlier in this chapter are forcing governments into a reactionary “crisis-led” position on development. From this perspective the application of countertrade (i.e. how to develop) represents the desire of the government to buttress the institutions of the rentier state under pressure from regional and global dynamics for its own political purposes. Thus, Hypothesis I suggests governments are implementing “survival” strategies rather than far reaching reforms. Countertrade is not a window towards a fundamental economic and political transformation of the state but a rather a potential end-game. A means to limit this process.149

149 In this model oil rents would still have a significant role to play in offsetting the tax burden on private companies and pay for the incentives to attract them in. The operations of subsequent countertrade
Hypothesis II: Rentierism Challenged from Below

Hypothesis II suggests the rentier state model is slowly evolving away from what we would initially expect. Changes in the regional and global environments have triggered new domestic realignments, which the redistributive state now finds increasingly hard to control. In particular, the private sector in both Saudi Arabia and Kuwait is demanding access to economic decision-making. Hypothesis II argues economic development does not merely 'happen' but is determined and conditioned by agents who seek to gain from the development process. It is the relationship between the state and domestic actors that conditions the manner in which development strategies are advanced. As Martinussen points out, 'planning is not exclusively a rational economic activity but also has important political functions.'\(^1\) The development process, '...does not automatically distribute benefits according to need, merit or effort. The distribution is determined rather by economic and political power.'\(^2\) To gain access to the benefits of development political and economic groups must offer some form of economic resources or political support required by the ruling elite. Fiscal austerity is forcing the government to rely heavily upon the private sector to obtain its development objectives. In return for this support, the private sector is demanding greater access to goods and services that the rentier elite can no longer provide by simple rent redistribution. Only greater liberalisation can provide access to global business partnerships, finance and technology. These private sector demands are not sufficiently accounted for by the rentier model. It

assumes the business lobby will be loosely organised and pacified as it is created by, and dependent upon, the allocation state. Hypothesis II asserts that far from being pacified and weak, the private sector is re-emerging to become a powerful force in policy decision-making. Indeed, some scholars in the 1980s predicted that 'subsequent diversification is more likely to be largely the result of private initiative, perhaps with governmental assistance.' If we are able to identify evidence of these pressures, and the relationships that subsequent develop, we will be better placed to understand why and how development is occurring more accurately than the existing rentier model. If countertrade schemes are implemented on the basis of private sector interests, BOT and Offset are a means to some greater end - the end being increasingly identified by the business community. These political issues remain largely neglected in the field of Middle East development.\textsuperscript{153}

\textbf{Hypothesis III: Rentierism Challenged from Above}

Hypothesis III deviates away from the assumptions of the original model. It suggests that the existing rentier model is obsolete. Not only are Gulf states increasingly diversifying their economies away from oil, there also appears to be a fundamental change in philosophy within governments themselves. It short, the rentier elite is seeking to redefine their countries away from the allocation state towards an production state. This implies the implementation of new state-building ethic to move away from the

\textsuperscript{151} Martinussen, J. \textit{ibid.}, p. 236
existing rentier set up that has previously benefited the Gulf elite in the past. Evidence of this “normative shift” is already apparent. According to one senior Qatari official:

Gone are the days when the state took the bills for free college education, housing and foreign holidays and granted every wish of its citizens. Times are hard for the moment and our people have to get used to the fact that money is scarce and cannot be doled out forever.\(^{154}\)

In December 1998, the Kuwaiti government released details of its strategy to reduce public expenditure. There was a distinct emphasis on extraction rather than redistribution. Cuts in fuel subsidies, the taxation of consumer goods, a gradual removal of subsidies on electricity and water, new labour, housing and airport taxes and the introduction of individual contributions to pay for the country’s generous social security budget were announced. This will not prove easy to implement and the government has yet to give a timetable for executing these changes.\(^{155}\) Yet the proposed legislation is enlightening in that it shows the government looking seriously at fundamental change. We now need to investigate whether this change is significant. How does the government perceive the structure of the state and society’s role within it?\(^{156}\) Is the new generation of

\(^{153}\) See for instance Kubursi, A. *Oil, Industrialisation and Development in the Arab Gulf States* (London: Croom Helm, 1984), which focuses predominantly upon the economic issues involved.

\(^{154}\) Confidential source quoted in: ‘Qatars: Learning to Face Economic Realities’ Reuters 4 August, 1999

http://www.arabia.com/content/business/8-99/qatar4.shtml

\(^{155}\) Ash, T. ‘Cautious Road to Reform’ *Middle East Economic Digest* 26 February, 1999, Vol. 43, No. 8 pp. 9-10

\(^{156}\) There is evidence that certain sectors of society are aware of this. According to a Western-educated Qatari businessman quoted by Reuters, “nations are not built by doles and handouts, but by hard work and sacrifices. We don’t mind foregoing state largesse in the interest of the nation.” Reuters 4 August, 1999 *op cit.*
Gulf leaders "learning" from the experience of others? How does the educational background of technocrats influence decision-making? Are these technocrats influenced by their contacts with epistemic communities? Informed advisors, be they individual academics, representatives from international institutions such as the IMF and World Bank, business lobby groups and economic development think-tanks, appear to have an increasingly influential role in the Gulf decision-making environment. As one commentary points out, 'educationally and socially the emerging generation are different. (They are) surrounded by youngish advisors who have had Western educations and have a fair understanding of the implications of global economic and cultural pressures for their societies.'

If a normative switch is occurring the existing rentier model would be inadequate in explaining this shift. Viewed from this perspective, countertrade becomes a window toward a broader restructuring effort, which will ultimately lead to a reduction of the state (via the increasing incidence of privatisation) and greater openness to the forces of globalisation. Countertrade is a facilitator. The rentier mentality implicit in the rentier model is being tackled. The crucial question now facing Gulf leaders, is how to ensure the smooth development of the societies in the rapidly changing global environment.

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157 Jack Levy defines learning as '...a change of beliefs (or the degree of confidence in one's beliefs) or the development of new beliefs, skills or procedures as a result of the observation and interpretation of experience.' p. 283 Levy, J. S. 'Learning and Foreign Policy: Sweeping a Conceptual Minefield' International Organization 48, 2, Spring 1994, pp. 279-312
159 'The Changing of the Guard' ibid., p. 9
As Hypotheses I and III show, there are potentially reactive and active means respectively, to deal with this.

Table 10: Typology for Assessing the Rentier State Model

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<th>Hypothesis</th>
<th>Elite Reasoning</th>
<th>Application of Countertrade</th>
<th>Utility/Obsolescence of Rentier Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Maintenance (No Challenge)</td>
<td>Crisis-Driven</td>
<td>Potential End-Game</td>
<td>Utility</td>
</tr>
<tr>
<td>II Challenged from Below</td>
<td>Reaction</td>
<td>Potential Facilitator</td>
<td>Partial Utility</td>
</tr>
<tr>
<td>III Challenged from Above</td>
<td>Action</td>
<td>Potential Facilitator</td>
<td>Possible Obsolescence</td>
</tr>
</tbody>
</table>

The above table summarises the main points set out in each hypothesis. The regime hypothesis argues that the Gulf elite perceives of economic development in reactionary terms - a necessary process to maintain their existing positions of power. The application of countertrade to achieve this marks a potential end-game - a measured movement away from the traditional allocation state but not a full move to the production state. If confirmed, these assertions conform to what the rentier state model anticipates. Hypothesis II takes this reasoning one stage further. The private sector is the main driving force behind the development and diversification of the state. Rather than being a passive entity relying upon government handouts we see the private sector responding in a manner not anticipated in the rentier model. Government policy towards private sector-led development is therefore reactionary, although it is far from hostile. Domestic agents are increasingly identifying new development opportunities and pushing the countertrade agenda forward. As this generates momentum, countertrade becomes a potential facilitator for wider reforms. As Butter and Kemp point out, the success of BOT schemes
has encouraged the Egyptian government to forge ahead with full privatisation of the power sector.\textsuperscript{160} This same snowballing affect may yet occur in the Gulf. Finally, Hypothesis III questions many of the assumptions of the rentier model. Countertrade represents the start of a much larger project - the possible deconstruction of the allocation (rentier) state and the construction of a production state. Countertrade is a potential facilitator for the eventual privatisation of the rentier state and liberalisation with the global economy.

The Gulf states are still in the process of developing their countertrade options. We have yet to reach the end of the countertrade route. There is still potential for the Kuwaiti or Saudi elite to use countertrade as an end-game or facilitator, or over a sufficient period of time, both. However, by taking the hypothesis approach we are able to survey existing evidence from the different perspectives of the different actors and countries involved. Over the twenty-year period since Offset schemes were first introduced this becomes enlightening. The dynamics and processes inherent in original decisions have the potential to develop beyond what was originally intended. For example, the original calculations of Saudi Offset schemes may indeed mirror Hypothesis I. However, the Saudi Offset scheme sparked interest and lobbying from the Kuwaiti private sector as explained by Hypothesis II. Countertrade in the Gulf requires a sophisticated explanation that can be found within the three hypotheses when taken together. It is not the ‘separateness’ of the hypotheses that is important. While there is merit in pursuing

\textsuperscript{160} Butter, D. & Kemp, P. \textit{op cit.} p. 3
separate hypotheses to view evidence in a new light, all three hypotheses must be reviewed together within the changing political and economic environment of the last twenty years. These changes may increase or decrease the explanatory power of a particular hypothesis over the period of implementation.

VIII. Concluding Remarks

This chapter has set out the assumptions of the rentier state model and some general criticisms of the central propositions as they currently stand. These comments suggest that changing domestic and international circumstances pose a number of complicated issues that the rentier model might have difficulty explaining. The themes elucidated above will be developed further as subsequent chapters seek to clarify the continued utility or possible obsolescence of this model. By probing the institutions of the Gulf states at a deeper level, and by addressing both why and how economic development takes place from a number of angles, we should be in a position to make a better informed judgement. Chapters three, four and five will provide the necessary primary evidence to prove or disprove the assumptions elucidated in each hypothesis. Chapter six will recombine these findings with the aim of casting new light on the central propositions of rentierism. Given the issues considered above, conditions inside the rentier states have changed since the model established to describe them was first developed. What we now have to measure is the degree of change that has occurred.
Chapter Two

The Application of Countertrade in the Arabian Gulf

Introduction

This chapter seeks to clarify why the study and application of countertrade is relevant for those interested in the politics of economic development. It focuses on the experience of the Gulf states in their attempts to diversify their economies and in so doing this chapter is the how section to complement the why question of chapter one. The paper is divided into four sections. The first section briefly defines what countertrade actually is. From this, a second section considers the hypothetical advantages of pursuing countertrade as an economic development strategy. Three reasons are given to show that far from being obsolete, countertrade makes good economic sense in the region. Given these advantages, section three asks why the study of countertrade has been neglected in recent years. Using an analysis of the “Three Worlds” the chapter will show how changes in the international system have rendered the application of countertrade far more difficult in the 1990s than in any previous decade. As a result we have witnessed a decline in the study of the topic. However, the fourth and final section makes a strong case for a re-evaluation of countertrade given the widespread use and apparent success of specific countertrade analogues in the Arabian Gulf. The research will argue that far from judging the success of countertrade in its generic form we should evaluate specific analogues, namely Offset and BOT, that show signs of success. Far from abandoning research into countertrade, we should intensify our efforts to understand and evaluate it in the context of the global economy.
I. Countertrade and Development: A Definition

The generic term ‘countertrade’ can be commonly defined as the trade of goods and services that are exchanged without the sole, or total, use of money. The purpose of countertrade, ‘is not to avoid the use of cash as an exchange of goods or services, rather, it is to have some added impact or effect beyond the exchange of goods *per se*.’ It stimulates some form of economic activity that would not have occurred if a traditional monetary transaction had taken place. The variants of countertrade are many, from simple barter agreements, to lucrative Offset contracts. Compensatory agreements, buy-back, tolling and counterpurchase schemes form a diverse array of potential trade, finance and development mechanisms on offer to all countries. As a technical strategy, it has been analysed in a wide variety of means and potential uses, from trade finance mechanisms, tariff avoidance or the fulfillment political ambitions.¹

This thesis views countertrade as a long-term development strategy that allows the Gulf states of Saudi Arabia and Kuwait to harness foreign direct investment for their development priorities, - an aspect of countertrade that has been under-researched. As an economic policy it straddles the boundary between state planning and the free market offering substantial economic benefits. Contrary to the prevailing neo-liberal paradigm, there is evidence to suggest that government interventionism (what free-market advocates call “market distortions”) has an important role to play in economic development. As a recent UNIDO report argues:

Successful interventionist policies have usually enhanced growth and prosperity and have not produced a negative or harmful impact on development....The private sector can commit itself to long-term economic development if the government has the capacity to formulate and implement credible policies and, if necessary, to take on an entrepreneurial role to expand normal production capacity.²

Yet countertrade is at odds with neo-liberalism - the dominant paradigm in economic development. This neo-classical approach places emphasis upon the market as the most efficient provider of wealth, - its “invisible hand” requires little government interference other than to uphold the rule of law to facilitate the maintenance of contracts and the accumulation of capital.³ State interference in the economy creates inefficiencies and waste, reduces competition and slows the level of economic growth. As the law of diminishing returns takes effect in developing nations, neo-liberal scholars predict the convergence of under-developed economies with their developed counterparts.⁴ However, recent research has shown that advanced nations can prevent the onset of diminishing returns. “New growth” economists argue investments in technology and human capital promotes efficiency and innovations that enable individual firms to accumulate greater amounts of capital. The constant returns to scale anticipated by neo-classical scholars may not actually be realised.

⁴ With the proposition of the law of diminishing returns, the classical approach shows how economic growth can be achieved by adding larger inputs of capital and labour into the domestic economy. However, *ceteris parabis*, each additional unit of capital yields a lower return making it difficult for developed nations to sustain high levels of growth indefinitely.
Robert Barrow’s empirical research from within the New Growth school has resulted in a thesis termed “conditional convergence.” By holding constant such factors as a country’s fertility, human capital (education etc.) and government intervention in the economy, poorer countries do indeed grow faster than richer ones, confirming the neoclassical premise of economic growth. However, as Barrow correctly points out, in the real world these factors do not hold constant and so the convergence of economic growth predicted by classical scholars does not transpire. This suggests that government policies have an important role in facilitating growth in the developing world. By using the correct interventionist policies to obtain technology, attract foreign direct investment and promote education and training, the government itself is an endogenous variable in the drive towards economic development. This line of thinking has proved increasingly influential as witnessed in a recent World Bank study that argues:

An effective state is vital for the provision of the goods and services - and the rules and institutions - that allow markets to flourish and people to lead healthier, happier lives... (T)he state is central to economic and social development, not as a direct provider of growth but as a partner, catalyst and facilitator.  

This chapter will demonstrate that countertrade policies are a tangible example of the state acting as a “partner, catalyst and facilitator” of economic development. The application of countertrade suggests a new variant of the ‘developmental state’ that does

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7 For an analysis of what constitutes a ‘developmental state’ see Chalmers Johnson’s article ‘Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea
not seek protectionism, widespread public expenditure and subsidization but cleverly harnesses market forces in a manner that offers private international capital attractive incentives, yet still retains sufficient control over policy autonomy. Chapter one introduced the political motivations why governments wish to pursue development policies that straddle government planning with market liberalisation. Governments rarely view economic development in terms of economic efficiency. The reasons for this may be varied but as Peter Hall points out, governments are political creatures. ‘Unless economic-policy making is peculiarly immune from the sort of influences found in other policy areas, we can expect political variables to have a decisive impact on the outcome.’

These political considerations will be developed further in subsequent chapters. However, there are also identifiable economic motives for the introduction of countertrade. It is to this that we must now turn.

II. If Countertrade Is Ineffective, Why are Gulf States Applying it Today?

There are clear economic motivations why the Gulf states perceive it is necessary to pursue countertrade. Gulf states believe benefits exist by pursuing policies that allegedly “distort” the market mechanism. Given the neo-liberal premise that free markets lead to greater prosperity, why do the Gulf states of Saudi Arabia and Kuwait on one hand engage the global market yet simultaneously seek the means to control it? This research provides three reasons why countertrade is implemented: i) the ability to obtain


modern, large-scale technology transfers, ii) to offset the opportunity costs of other government expenditures and iii) the ability to move the economy from a comparative advantage to a competitive advantage. Gulf states view countertrade as a means to develop more sophisticated economies. Writing in 1949, Mikesell and Chenery argued that ‘economically, Saudi Arabia is one of the most primitive countries in the world.’ Oil enabled the Gulf states to “modernise” their economies in a relatively short period of time. Yet as Han correctly points out, ‘the GCC states have had more success with modernisation than with diversification.’ The Gulf states view countertrade as a feasible development strategy that can lead them away from oil dependency.

i) Technology Transfers: Technology embraces a wide range of skills and equipment. Ari Kokko separates technology into ‘hardware’ which incorporates machines, tools and other physical objects, and ‘software’ that is captured in manuals, people or organisation, and is necessary to operate plants and machinery. The essence of modern economic growth is the increase in the stock of useful knowledge and the extension of its application. States that fail to obtain access to both the software and

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10 Han, V. X. *op cit.* p. 71
12 Teece, D. J. ‘Technology Transfer by Multinational Firms: The Resource Cost of Transferring Technological Know-How’ *The Economic Journal* No. 87, June 1977, pp. 242-261 New Growth theorists argue that the engine of development lies in “human capital.” Unlike Classical economists, factors such as technology and education are seen as “endogenous” variables to growth. By treating human capital as a direct input requiring constant investment the productive capacity of a state will increase greatly. What determines disparities in the level of growth between a developed and underdeveloped state is the level of investment into human capital. Developed countries have larger resources and stable environments to keep investing in human capital which perpetuates their advantage over states who do not, or cannot, invest in this aspect of the economy.
hardware components of technology are likely to slip further behind in the quest for economic development. The Gulf states are aware of this. The Saudi government asserts that the transfer of technology is necessary 'in order to have the same rate of progress as developed countries.' Similarly, the Kuwaiti government states that 'the transfer of commercially viable technology is a key to Kuwait's long-term economic development.' It believes that the assimilation of suitable technologies will promote investment 'in training, product and process development, R&D, quality control, production planning and other areas.' Trade, migration, cooperation, and overseas education can all facilitate the process of technology transfers. However, the dominant channel of technology diffusion is through outward foreign direct investment (FDI) from the OECD. In the Gulf, countertrade is used to capture this investment.

Research by Blomstrom and Kokko demonstrates that host country characteristics influence both the size and quality of technology to be transferred into a market by private companies. However, as Mansfield and Romeo point out, developing states rarely have access to the most modern sources of technology and management techniques. Their research shows that technology transfers from 31 US-based firms took

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14 State of Kuwait, Ministry of Finance, Countertrade Offset Program Executive Office Guidelines for the Countertrade Offset Program Article 7.2
15 Hejazi, W. & Safarian, A. E. ‘Trade, Foreign Direct Investment and R&D Spillovers’ Journal of International Business Studies Third Quarter 1999 pp. 491-511 Hejazi and Safarian show 6 countries account for 87% of the OECD stock of R&D, which in turn accounts for 96% of the measured world stock of R&D in 1990.
17 Kokko, A. op cit.,
an average of nearly 10 years to reach developing states. By this time much of the technology is obsolete.  

This argument counters Gerschenkron's statement that backward countries accrue advantages in not having to develop (and therefore pay for) technology themselves but can merely import the finished product at a later date. The countertrade strategies of both Offset and BOT require foreign companies to compete for lucrative contracts under the express condition that modern technology and skills are efficiently utilised in the host market. Gulf countertrade also seeks the establishment of indigenous sources of technology in the form of research and development (R&D) cooperatives that foreign direct investment alone would otherwise likely eschew. This creates intra-industry and inter-industry 'spillover' effects, which diffuse the benefits of technology through the economy.

Unless states actively require the transfer of technology via joint ventures or Offsets, the operation of free market forces alone may be insufficient for transferors to commit their resources. This is particularly true where states seek to attract cutting-edge technologies in their research and development (R&D) phase. To cultivate an indigenous source of technology in the future, expertise is required to establish the necessary

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20 Spillovers occur where the transferor of resources does not extract the full value of the gains from his investment. These indirect affects of technology transfer can be broadly classified into two camps: intra-industry and inter-industry spillovers. *Intra-industry spillovers* occur most frequently when transferors of technology enter host markets and stimulate competition by raising levels of efficiency and production. *Inter-industry spillovers* occur when the transferors of technology undertake training of both labour and management. This level of expertise will gradually diffuse through out the economy as individuals move from one economic sector to another.
resources of technological competence. As the Saudi government points out, imports alone 'will not enable the Kingdom to keep abreast of scientific and technological development elsewhere in the world.' However, the research and development phase of technological advancement is a risky business. Private companies gamble large amounts of finance to develop their product lines. Uncertainty already exists without having to concern themselves with the additional risk of developing technologies in plants located in foreign markets. Kuemmerle argues an increasing number of firms are establishing global R&D networks in order to access knowledge located away from home base. This increases the speed of products from the design stage to the market. Yet Kuemmerle does not emphasize the fact that many companies still perceive overseas R&D to be a risky venture. R&D is an expensive venture that may not always retrieve its losses. This is because, 'R&D is an investment process under uncertainty, which leads ex post to innovation rents if the innovation is successful. If unsuccessful, the firm fails to recoup its sunk costs in R&D.' Furthermore, both large and small firms do not always act as profit maximizers seeking entry into every available market. The ability of a decision-maker to act rationally may be constrained by a lack of information of both market conditions and market opportunities. Even if the decision-maker is aware, a company

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22 Kingdom of Saudi Arabia, Ministry of Planning (1995) op cit., p. 97
23 Most large MNCs will delegate the manufacture of their products overseas where labour is cheap. The research and design phase, however, if often kept close to home to obtain educated workers, to guarantee secrecy and to minimize risk with a "hands on" approach.
24 Kuemmerle points out that Canon has established R&D facilities in 8 countries, Motorola in 5 states and Bristol-Myers-Squibb in 12 facilities in 6 countries suggesting a trend towards global R&D networks. See Kuemmerle, W. 'Building Effective R&D Capabilities Abroad' Harvard Business Review March-April 1997 pp. 61-70
may still feel more comfortable operating in the "home environment." Overseas R&D transfers may be perceived as a "leap into the dark." Although public-private sector co-operation and incentive mechanisms play a crucial role in facilitating R&D technology transfer, they cannot guarantee it.

Governments must create the necessary support and incentive mechanisms to reduce the cost of transferring R&D abroad while simultaneously demanding cutting edge technology be transferred into particular economic sectors. A closer inspection of Offset deals is interesting in that in addition to providing extensive support and incentive schemes, they often bind the contractor to the establishment of R&D facilities - a "carrot and stick" approach. The state here plays a much more assertive role in determining the future extent of economic development than is often realised. Countertrade strategies seek modern technology and, crucially, the means to utilise it effectively.

ii) Opportunity Costs: All states, but particularly developing states, are constrained by the large opportunity costs of state expenditure. Expenditure is a choice of one good or service over another. The geo-political landscape of the Gulf peninsula requires states to spend large amounts of money on the provision of military hardware. These expenditures reduce the level of finance available for economic development initiatives. Offset schemes, however, enable states to literally "offset" these costs by requiring contractors to reinvest part of the value of the contract into economic development schemes thereby reducing the effect of opportunity costs. According to
Amin Badr Al Din, Head of the UAE Offsets Group, the Emirates’ scheme was originally mandated to solve this dilemma:

In the later half of the 1980s, the government was having to face increased demands for expenditures in the welfare and military sectors at a time when the price of oil was low. For the UAE to have entered into an invigorated procurement purchasing programme would have meant taking capital away from areas such as education. With the government unwilling to see standards drop, Offset was considered the solution.26

Offset measures have resulted in large-scale technology transfers to the Gulf and the building of modern plant and infrastructure to accommodate enterprises. BOT schemes enable the government to possess sophisticated development infrastructure in the long-term whilst freeing up financial resources in the short-term. According to the UNIDO, sponsors and contractors make technology available in order to maximise the economic advantages of the project. BOT also ensures that technology and training is upgraded through the concessionary period to maximise revenues.27 Opportunity costs are lessened by the introduction of technology as it provides for a more efficient use of development resources. Not only does it enable new approaches to be undertaken to solve old problems, but existing resources can be utilised in a more cost-effective manner. This is important since development projects are often constrained by a lack of financial resources involving large opportunity costs. Technology allows for very efficient planning prior to the implementation of development project. For instance,

26 Amin Badr Al Din, quoted in Hindley, A. ‘The Offset Onset’ Middle East Economic Digest 13 December, 1991 Vol. 35, No. 49 p. 8
major infrastructure projects always have to build into their calculations the costs of waste, inefficiencies and imprecise estimations that occur when the project is transferred from the drawing board to the site itself. In developing countries where the opportunity costs of development are real, a “saving” of ten percent in development costs could easily pay for a new hospital wing or desalinisation plant in a relatively short period of time.

iii) Competitive v Comparative Advantage: The majority of economists argue the most efficient means to achieve economic growth is for the economy to concentrate production into areas in which it has a comparative advantage with other trading nations. This view of factor proportions, first identified by David Ricardo, indicates that where countries possess productive factors in abundance, market forces will allocate the most intensive use of that good/service to industries located inside the state. This will obtain the country in question a trading advantage in relation to its international competitors. In the Gulf, this factor is obviously the production of oil and gas.

However, recent work by Michael Porter suggests that development strategies in today's global markets must move from traditional conceptions of comparative advantage towards what he terms the “competitive advantage.” Porter argues that for countries to achieve high and sustained standards of living, production inside states must be in high-

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28 A good example of this is Computer Aided Design (CAD). CAD enables those in charge of individual development projects to accurately predict the costs involved. As one construction manager in the Middle East puts it; “you don’t have to order an extra five or ten percent of materials in reserve in case it is needed. CAD enables you to order precisely.” Egyptian Construction Manager (unidentified) quoted in Smith, R. ‘CAD Comes of Age in the Gulf’ p. 7 Middle East Economic Digest 9 October 1992, Vol. 36, No.40 pp. 7-10

value added industries, - that is industries based on advanced (created) factors of production and not inherited factors. ‘An abundance of basic inherited factors may, in Porter’s world, work to undermine rather than enhance a nation’s competitive advantage because their existence undermines the incentive to upgrade to more sophisticated and improved products and process.’ The Gulf states therefore need access to finance, technology and skills possessed by foreign investors to move from their comparative advantage (which offers its existing short term benefits) towards a competitive advantage (where medium to long-term benefits accrue). Unless Gulf states move away from their dependence on oil they may become “trapped” by it, unable to catch up and compete with nations that have previously invested in advanced economic processes. Countertrade, with its ability to attract technology and skills training goes some way towards meeting the increasingly sophisticated nature of (global) economic development.

Without a significant level of technology diffused throughout various economic sectors, developing nations are unlikely to become self generating producers of value-added goods and services for their own markets. Developing countries must avoid the trap whereby MNCs, the main harbingers of technology, seek market entry into emerging markets by establishing secondary production inside a country (e.g. assembly of components by an low-wage indigenous work-force) but keep the sophisticated design and technological aspects of their operations outside. This will result in a local workforce

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that is well trained but in no position to harness the knowledge of technological innovation towards the ultimate goal of an indigenous capacity.

III. Why Has the Study of Countertrade Been Neglected?

Given the advantages listed above, why is it that so little attention has been devoted to the study of countertrade? Although the 1970s and 1980s saw a number of publications released on the subject, few academics in the 1990s have continued to research this area. This is somewhat strange considering that, until recently, international institutions and individual academics agreed that countertrade was 'assuming increasing importance'\(^{31}\) as a world trading mechanism, the growth of which 'continues unabated.'\(^{32}\) Agarwala argued that 'the countertrade phenomenon will not subside - at least not in the current decade and beyond'\(^{33}\) and Welt similarly asserted that the 'importance of countertrade is likely to grow.'\(^{34}\) A decade later few academics continue to pursue this line of reasoning and research into the subject has declined despite its continuance in diverse areas of the world. This leads us to ask two important questions: i) why has the study of countertrade been neglected in recent years; and ii) why is it pertinent to study countertrade now?

\(^{32}\) Samonis, V. *Countertrade: A Strategy of Second Best* (Toronto: University of Toronto, 1990) p. 19
The first question can be answered by looking at the reconstruction of the international system in recent years which has affected academic study. It is possible to articulate this by explaining the political and economic changes that have occurred within the "three worlds." Historically, international countertrade has involved considerable state involvement in the global trading market. However, as the table below demonstrates, state-interventionism in the economy has declined for a diverse set of reasons. Events in the international system rendered the application of countertrade far more difficult.

Table 10: Countertrade, the Three Worlds and the State

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<tr>
<th>Three Worlds</th>
<th>The State</th>
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<tr>
<td>First World</td>
<td>Rolling Back the State</td>
</tr>
<tr>
<td>Second World</td>
<td>Rejection of the State</td>
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<tr>
<td>Third World</td>
<td>Failing States</td>
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i) First World: Rolling Back the State

In the first instance, the acceptance of a reduced role of the state in the First World has severely constrained the use of countertrade in industrialised domestic markets and in international trade involving these states. Countertrade, particularly the analogues discussed in this thesis, involve state intervention to obtain objectives that market forces alone would not deliver. In this regard countertrade is at odds with the dominant neoliberal philosophy pursued by industrialised nations. The monetarist doctrines
implemented by Margaret Thatcher and Ronald Reagan in the late 1970s/early 1980s to "roll back the state" have diffused out to other developed nations, curtailing the spread of countertrade transactions occurring within their domestic markets. Moreover, First World nations have been the prime movers in seeking to constrain the growth of countertrade internationally. According to the British Government, countertrade, 'reduces the pressures of competition and market forces by introducing closed good-based transactions, reciprocity, protection and price setting. Therefore, countertrade is not something which the government encourages for its own sake.' The OECD nations have never fully embraced countertrade as an international trade mechanism yet it is only recently that serious efforts have been undertaken to outlaw "market distortions."

Although the General Agreement of Trade and Tariffs (GATT) sought to prohibit discriminatory bilateral trade practices, countertrade was able to flourish despite its recommendations. Verzariu points out that during the 1970s bilateral arrangements covering textiles, steel, automobiles, ships and consumer electronics began to proliferate, '...even gaining a measure of legitimacy through their unchallenged acceptance.' Part of the problem was that GATT never explicitly addressed countertrade. The vagueness of its articles proved to be a problem. It was merely a matter of interpretation whether, in the absence of a GATT waiver, government countertrade requirements on foreign exports contravened Article XI which prohibited import restrictions other than tariff duties.

Similarly restrictions imposed on exports in outlet markets for countertrade goods and services may, or may not, contravene Article XI as a quantitative trade restriction.\textsuperscript{37} The GATT was essentially an \textit{ad hoc} arrangement between nations without proper legal foundation - it was not recognised as an organisation under international law.

However, during the 1980s and 1990s sustained efforts were undertaken to rectify these flaws during what became known as the Uruguay round of the GATT. The conclusions reached after nearly a decade of negotiations resulted in the formation of the World Trade Organization (WTO) in 1994. This not only clarified the position on bilateral trade distortions (the Agreement on Subsidies and Countervailing Measures) but was recognised in law and contained measures to survey and make recommendations on countertrade (The Working Group on Transparency and Government Procurement).

These steps are a major step forward over GATT both in the regulation of the international trade and adherence of member states to it.\textsuperscript{18} Verzariu's assertion that countertrade agreements could exploit the ambiguity of the regulatory environment, thus having 'the potential to make full use of the international financial system and trade interdependence...'\textsuperscript{19} did not anticipate the legislative changes that occurred a decade later.

\textsuperscript{37} Writing in 1983, Gadbaw argued countertrade was a quantitative restriction and a flagrant violation of GATT. Gadbaw, R. M. ‘The Implication of Countertrade Under the General Agreement on Tariffs and Trade’ \textit{Journal of Comparative Business and Capital Market Law} Vol. 5 1983 pp. 355-365


\textsuperscript{19} Verzaiu, P. \textit{op cit.}, p. 152
On 1 January 1996 the WTO's Government Procurement Agreement became effective, covering the states of the European Union, USA, Aruba, Canada, Hong Kong, Japan, Israel, the Republic of Korea, Norway, Singapore and Switzerland. The Agreement binds the governments of the above countries to refuse Offsets when purchasing civil goods and services abroad. ‘However, if the procurer is from a developing country, they can ask for Offset proposals to be submitted with the tenders – although the resulting Offset proposals should not be used as a criterion for awarding the subsequent contracts.’\textsuperscript{40} Countertrade has been constrained but not completely emasculated.

The transformation of the GATT into the WTO is not the only development to proscribe "market distortions." Despite recent reports of its demise, we continue to see moves toward the Multilateral Agreement on Investment (MAI) which seeks to regulate ‘all forms of investment coming from MAI investors, including the cross-border establishment of enterprises, the activities of established foreign-owned or controlled enterprises, portfolio investment and intangible assets.'\textsuperscript{41} The IMF continues to hold Article IV meetings with member states to influence the degree of state interference in trade and investment. In recent years it has sought to project its influence further by the introduction of second-generation reforms. Its aim is ‘to assist members in redefining the role of the state in the economy as a positive force for private sector activity, including through the restructuring and privatisation of state-owned enterprises and by generally

\textsuperscript{40} Department of Trade and Industry (UK) \textit{op cit.}, p. 9
reducing government intervention in areas where market forces provide greater efficiency.\textsuperscript{42} This advocacy of "state-building" measures calls for subsidy cuts and new revenue raising measures including a restructuring of company taxes, the introduction of a consumption tax and increases in fees and charges on public sector services.\textsuperscript{43} Hammond's confident assertion that the use of countertrade by Third World states will help them "...avoid political and financial regulations imposed by international organisations such as the World Bank or IMF"\textsuperscript{44} now appears somewhat naive. Developments in the last decade alone show that concerted efforts are being made to undermine such strategies.

Nevertheless, when I questioned a senior IMF official on the application of specific countertrade measures in the Gulf, he welcomed these developments. Dr Karim Nashashibi, a senior advisor on Middle Eastern affairs at the IMF, pointed out that schemes such as Offset and BOT were crucial for fostering closer links between the region and international business.\textsuperscript{45} Moves toward immediate liberalisation and privatisation are unrealistic without the necessary degree of confidence on both sides. In this regard, a number of IMF officials view countertrade as an important measure in facilitating greater liberalisation in the longer term.

\textsuperscript{44} Hammond, G. T. op. cit., p. 13
ii) Second World: Rejection of the State

Arguably the biggest challenge to countertrade has been the collapse of the centrally planned economies of the Second World since 1989 and the gradual acceptance of freer market principles. The largest countertrade market in the world was that of Eastern Europe and the former Soviet Union. By 1980 up to 35% of Eastern exports to the West were accounted for by countertrade arrangements.\(^4^6\) Countertrade was favoured by the centrally planned economies as it enabled them to guarantee resource allocation into the medium term and reduce their dependence upon Western economic cycles. By the late 1980s a number of academics were applauding the apparent success of these mechanisms. Hammond optimistically asserted that as countertrade 'is already a widespread practice in the communist bloc and among OECD countries as well as in the Third World, it is not likely that it will cease as economic conditions improve or that it can be legislated out of existence by GATT or some other international body....countertrade will continue to grow and ultimately transform the international political economy.'\(^4^7\)

However, the rejection of the centrally planned economy in the 1990s has reduced the level of countertrade in this area of the world. In order to re-enter the world trading system fundamental economic reforms were (and still are) needed. Ahmad and Yang point out that 'credible liberalisation of trade and payments regimes in Eastern Europe, as

\(^4^5\) Interview with Dr Karim Nashashibi, Senior Advisor on Middle Eastern Affairs, International Monetary Fund Exeter, 8 July 1999
\(^4^6\) OECD (1979) op cit., p. 3 Leo Welt puts this figure closer to 50% Welt, L. G. B. op cit., p. 12
\(^4^7\) Hammond, G. T. op cit., p. 134
part of overall economic reforms, is a precondition for their fuller participation in trade with the rest of the world. Access to IMF aid packages are conditional upon structurally adjusting the economy to rid them of their trade distortions. Moreover, the East's trading partners in the West have shown no interest to continue established countertrade relations that existed in the decades before. Even at the height of countertrade practices in the 1970s and 1980s, the majority of private companies in the West viewed them as a necessary burden to obtain market access in the East. There was subsequently little enthusiasm to continue with the practice when market forces were introduced inside Eastern Europe during the 1990s. From this perspective there has been little eagerness to pursue further study into countertrade. The majority of political scientists and economists specialising on Eastern Europe now focus their attention upon the transition to the free market. Countertrade does not appear to figure in these analyses.

iii) Third World: Failing States

The developing world has long been considered to have the potential to fully exploit countertrade. In the 1980s Griffin and Rowse argued that countertrade 'has evolved into a strategy by which Third World nations can create a de facto new international economic order.' Although volumes of trade have often been smaller than East-West exchanges, as a proportion of trade, countertrade between developing countries has been significant. According to one UN study which looked at Third World

countertrade on a regional basis in the late 1980s, countertrade represented 45% of trade in North Africa, 50% for the rest of Africa, 54% for the Middle East, 45% for Asia and 43% for Latin America. The initial growth of countertrade in the Third World can be attributed to linkages developed with the Second World. A study conducted by the OECD found that since the 1960s parallel developments in countertrade occurred between a number of Second and Third World states. For example, the regulatory framework developed by Indonesia in 1981 closely mirrored that of Romania with whom it had conducted countertrade transactions. By the 1980s the Third World experienced an explosion of countertrade deals. Even the OECD, which has always down-played the significance of the trend, pointed out that although most studies over-inflated countertrade figures, 'the absolute amounts involved have apparently tended to increase fairly rapidly in the last few years.' By 1985 the OECD was able to identify 50 developing countries engaged in countertrade schemes.

With the collapse of the Second World however, the Third World’s main source of countertrade transactions ceased with it. Just as the developing world had been influenced by the policies pursued by the Second World, the Third World was forced to rethink a number of its trading and development strategies as a result. For practical reasons, alternatives to countertrade were sought as the market for barter and counterpurchase schemes contracted. Third World states were forced to reconsider their long-term economic development strategies.

Allied to this, several countertrade schemes in the developing world were undermined because of political and economic uncertainties occurring within various regions. The rising incidence of failing states put paid to a number of countertrade schemes in countries as diverse as Yemen, Liberia and Algeria. Successful long-term countertrade schemes are dependent upon stable political and economic environments. The risks and difficulties associated with countertrade are high and it is estimated that

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52 OECD (1985) *ibid.*, p. 9
90% of all proposals discussed fall through before the final agreement is reached. As the UNIDO points out 'even the most practical and financially viable BOT project may not be attractive to sponsors and lenders if the country risks are perceived to be too great.... Insurance against political risks and government guarantees is not an adequate substitute for a stable and supportive political environment.' Indigenous political and economic difficulties have undermined the potential for countertrade in many areas of the developing world. Business eschews instability.

iv) Quantitative Difficulties

The decline in academic study into countertrade is partly attributable to the difficulty in estimating the extent of the phenomenon. Samonis argues the controversial character of countertrade, the confidentiality of transactions and the lack of institutional infrastructure render the circumstances difficult to estimate. The problem of calculating countertrade makes it a complex issue to study, but not impossible. Estimates of countertrade range from as little as 5% of world trade while others argue it is as much as 40%. The GATT conservatively estimated countertrade to account for 8% of total world trade in 1984 while Business International and the Institute of International Economics suggested a figure closer to 12%-15%. Roy Bracher's article 'If Countertrade is Inevitable, Make the Most of it' suggests 20% while Asayhn Desta

53 Welt, L. G. B. op cit., p. 24
54 UNIDO (1996) op cit., pp. 281-282
55 Samonis, V. op cit., p. 12
56 See Hammond, G. T. op cit., p. 10
57 Figures quoted in Samonis, V. op cit., p. 12
58 Bracher, R. 'If Countertrade is Inevitable, Make the Most of it' The Banker, May 1984, p. 69
asserts the figure is closer to 30%.

The OECD cautions against making inflated assumptions. By the mid-1980s it estimated countertrade to be only 4.8% of world exports ($130 billion). This conservative figure is based on the proposition that if the figures had been higher we would also have witnessed an increase in the turnover of trading agencies or companies acting as intermediaries to find outlets for countertrade. Moreover, there would have been considerable development of commercial law dealing with the drafting and litigation aspects of countertrade. Recent research by the British government reveals that countertrade accounts for between 10% and 15% of world trade.

Although this thesis focuses on the qualitative benefits of countertrade - namely the actual and perceived political advantages of Offset and BOT – it is possible to supply accurate quantitative data for our case studies. Countertrade in Kuwait and Saudi Arabia is substantial. The total amount of Kuwaiti Offset obligations (as opposed to the larger contract total) exceeds $1,600 million (see Table 15 in Appendix). The Saudi Offset scheme is particularly secretive, but one investment banker estimates that American companies have obligated $5,000 million into various joint ventures in the Kingdom (see Tables 16-19 in Appendix). This figure looks particularly impressive considering Saudi Arabia in last 25 years has only received $5 billion in non-countertrade FDI, the

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60 Department of Trade and Industry (UK) op cit., p. 5
61 Interview with David Burney, Senior Offset Advisor, Carlyle Arabia, The Carlyle Group Washington, D.C. 26 April, 2000
majority of which is concentrated in petrochemicals.62 Furthermore, the process is intensifying. For example, from the one Offset deal signed in the first year of operation, Kuwait signed fourteen contracts in 1998. Given the quantitative difficulties experienced by previous research, the changes in the international system proscribing the use of countertrade, and the neglect of recent academic study into the area, one would be forgiven for thinking that the outlook for countertrade is not particularly bright. However, appearances are misleading. As the following section will show, there is a strong case for a reevaluation of countertrade both in terms of academic study and as a development strategy.

IV. Why Study Countertrade Now? The Application of BOT and Offset in the Gulf

Why is it necessary to study countertrade now? The answer is straightforward. As Middle Eastern specialists have known for some time, the Arabian Gulf has not only continued with countertrade as an economy strategy, it has also been at the forefront of instigating new uses for specific analogues of countertrade. Welt and Wilson are among a small group of commentators aware of this trend. As they point out, ‘despite the objections of economists and the official U.S. policy discouraging them, Offsets show no sign of disappearing or even of shrinking in importance....Offset requirements will become more, not less, characteristic of sales to Middle Eastern countries.’63 If this is the case, why has it largely been neglected in recent academic study? For the reasons listed above there is a misplaced perception among academics that countertrade “has had its

62 Figures from Middle East Economic Digest 19 May, 2000 Vol. 44, No. 20 p. 4
day.” This is understandable, but I would argue, wrong. There still remains a tendency to think of countertrade as a uniform, amorphous process, which is no longer relevant and a failure as a development strategy. This thesis argues against such an assessment. Indeed, it is not a perception shared by many prominent businessmen. As Philip Condit, President and CEO of the Boeing Company, points out:

Left to its own devices, I suspect Offset would not occur. Contractors do not like it, Congress does not like it, and there are many reasons it would not happen. But, particularly in situations in a developing country where the incentive to think about how you go forward, how you start new enterprises, and then how you keep them going is an issue worth spending time on, and the results can be very positive.64

This argument is shared by Harry Stonecipher, President and CEO of the McDonnell Douglas Corporation, who suggests that countertrade is a strategy worth pursuing further:

Rather than looking at it as something one has to do, we at McDonnell Douglas are treating our Offset programs as a strategic advantage....If you want to think as a global company, then you will quickly come to the point that Offset is the way the world is going and it is particularly to the advantage of an industry like the aerospace industry.65

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63 Welt, L. G. B. & Wilson, D. B. ‘Offsets in the Middle East’ *Middle East Policy* V1, October 1998 (2) p. 9
Although foreign contractors would rather enter into contracts without obligations, most major companies are not dissuaded by countertrade, although there are concerns regarding too much government interference. As Paul Bizas, Director of the International Department for the Middle East in Hughes Corporation, points out, flexibility is the most important factor 'for any international company pursuing foreign investment because the existence of any obstacles makes the company avoid such investments.' So long as interference is limited in its scope, MNCs have few qualms about engaging in Offset. Indeed, one official at the Ministry of Finance in Kuwait argues that, "multinational companies see Offset as a marketing tool, they are often the first to mention Offset and view it as a means to win contracts on offer." Peter Griffith, Regional Director of GEC Marconi, supports this assertion. Obligators take a positive view of Offset schemes, so long as the requirements are not punitive in nature. "It is a way for the nation and the market to work together. The nation can obtain benefits such as technology and skill transfers while the company can earn good profits." A company like GEC is well placed to meet its obligations. It already possesses substantial corporate resources that can be easily employed inside countries with Offset requirements. For instance, GEC has a director of education at its board level to ensure skill training for employees. Consequently, the training of local nationals (which carries the largest multiplier) is very much in tune with the corporate ethos of GEC. As a result, GEC has

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66 Kuna News Agency, Kuwait City, in Arabic 0857 GMT 5 April, 1995 SWB 11 April, 1995
67 Interview with John Barordi, Project Manager, International Computer Consultancy and Researches, Offset Program Department, Ministry of Finance Kuwait City 13 November, 1999
68 Interview with Peter Griffith, Regional Director, GEC Marconi Kuwait City 10 November, 1999
established two technical colleges inside Kuwait to train 400 students a year for Higher National Diplomas (HND) recognised by British Universities.69

In addition to individual company initiatives, the global financial industry is increasingly interested in exploiting these opportunities. For example, the UAE is working with Chase Manhattan to establish an offshore investment fund to provide international contractors doing business in the country the opportunity to satisfy part of their Offset obligations.70 According to John Burge, an investment banker with Dresdner, Klienzwort and Benson in London, countertrade is flourishing. "Almost all public infrastructure projects in Europe that involve the private sector are BOT schemes."71 When one takes a closer look at what countertrade entails one finds that some analogues work better than others. This important distinction has not been sufficiently understood by academics and this is where this research makes an important contribution to the countertrade debate. Rather than think of countertrade in its generic form we must look at specific schemes that give us a far more accurate perspective of the utility and practice of countertrade. Therefore, this research concedes that some countertrade schemes are irrelevant but equally there are some analogues that continue to be practiced for a very

69 Interview with Peter Griffith, Regional Director, GEC Marconi Kuwait City 10 November, 1999
70 Finasa Emirates is a joint venture between Swiss brokerage firm Finasa and Abu Dhabi-based Emirates Investments. In 1994 it signed an agreement with Chase Manhattan Bank to establish a new company in the UAE aimed at facilitating the investments required by Offset partners. This company allows foreign contractors to satisfy their obligations without having to identify and manage new ventures themselves. Instead, companies can purchase shares in the company who will invest funds on their behalf. This partly reflects the difficulties investors have encountered in obtaining reliable information on local market conditions and in identifying potential partners. Middle East Executive Report September 1994 Vol. 17, No. 9 pp. 4-5
71 Interview with John Burge, Global Export Finance Department, Dresdner, Klienzwort, Benson London, 11 January, 2000
good reason. As a result, we should expect to see a reduction in overall countertrade but the increasing use of specific countertrade measures that states believe worthwhile to pursue. As one Saudi businessmen heavily involved in countertrade puts it, 'despite WTO and other constraints, countries have their own sovereignties and ways of addressing issues relating to their populations.' Consequently, the countertrade schemes of BOT and Offset will be investigated more fully.

**Build, Operate and Transfer (BOT)**

Relatively little has been written about Build, Operate and Transfer (BOT), yet it has been used with increasing success in the Arabian Gulf to finance public investment works. The philosophy is deceivingly simple. Once a government decides the provision of a public good is necessary, the authorities offer the contract out to tender to the private sector. In theory, individual firms compete to offer their services at the best value. Once chosen, an individual firm is allowed to build the facility in question and allowed to operate it for a fixed period of time. The company chosen to operate the project will usually possess the majority share in a BOT consortium and smaller shares are designated for consultants and financiers of the project. Governments may decide to operate as a minority shareholder depending on the size of the equity base required although this is not always needed. Operations allow the individual firm to make a profit, large enough to attract investment in the first place, but regulated so consumers do not necessarily pay full market value. This is particularly important in the provision of essential goods such

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72 Abdulaziz Al Sugair, President and CEO, Advanced Electronics Company, Saudi Arabia *Address given to the Third Plenary Meeting US-Saudi Arabian Business Council* The Offset Program: A Launchpad for
as water or electricity, the supply of which forms the basis of other more sophisticated
development projects. Thereupon, after a period stipulated in the original contract, the
countertrade component is invoked. Although BOT is often perceived as a simple
divestiture mechanism, the countertrade element is important. The facility is transferred
back to the government, which reserves the right to place it into public authority or leased
back into private operations (see Table 23 in Appendix). The government is able to
demonstrate to its citizens that it has harnessed private capital to attain a public good. In
an area such as the Gulf, where populations tend to be wary about “the privatisation of
the state,” BOT performs an important political function. For minimum investment itself,
the government has achieved a development ambition by providing a good previously
under-supplied by the market, obtaining the facilities of that enterprise over the long term
and will have used private capital and expertise to employ, train and develop a local
work-force.

BOT employs the advantages offered by more conventional countertrade
schemes: skill and technology transfers, reduction of opportunity costs and a controlling
stake in private sector profit seeking. There are other advantages however. BOT
schemes place the commercial risk of a project onto the private sector. The government
is not bound to pay for the cost of initial start up loses. Moreover, it is the private sector
that has to raise the necessary capital to finance the works. Interest on subsequent loans
is not financed by public debt but by the private sector. Because of these risks it is more
likely that the private sector will only undertake such projects if they are going to be

commercially viable. Public sector developments often result in a number of “white elephant” projects, which cannot attain profits, and debts are merely written off against the government’s revenues. The private sector does not have this luxury. According to Marc Fornacciari of France’s Lyonnaise de Eaux, which has extensive BOT experience in the region, “the private operator brings higher efficiency and better management and technology. The enhanced management approach is much better than building white elephants in the desert.” As a result, the government can expect to inherit BOT projects that are profitable.

The first use of Build, Operate and Transfer can be traced to the financing mechanisms used to build the Suez Canal in 1868. More recently, the Channel Tunnel linking the United Kingdom with France was conducted using a $16 billion BOT finance mechanism. The incidence of BOT schemes has risen rapidly in the 1990s in both the developed and underdeveloped regions of the world. For example, the United Kingdom has used BOT schemes to upgrade and build new motorways, awarding contractors a 30-year concession before transferring the projects back to the public authority. In the Far East, the Philippine government passed a law in 1993 so that it could accept “unsolicited proposals” for BOT schemes that involves new technology and doesn’t require government guarantees, subsidies or equities. As of May 1998 there were 92 active BOT

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72 Quoted in Butter, D. p. 5 “Infrastructure Thirsts for Private Finance” Middle East Economic Digest 1 November, 1996 Vol. 40, No. 44 pp. 4-5
74 The first two British BOT schemes in this sector were awarded to the consortium Road Management Group.
schemes in the Philippines.\textsuperscript{75} The states of the former Eastern bloc are also finding BOT schemes useful in helping to build and finance major infrastructure works with Hungary being the leading advocate. It is in the developing world that BOT schemes are proliferating - Chile, Colombia, Costa Rica, India, Jordan, Korea, Mexico and Sri Lanka are among many developing nations using BOT schemes to finance their expansion priorities. The Middle Eastern region, particularly the Maghreb, has witnessed extensive development of the idea. BOT investments are also the preferred procurement/finance method of the Turkish government.\textsuperscript{76} In June 1994 the government expanded its existing BOT law to clarify and augment the regulatory framework of this countertrade scheme. BOT schemes can now be used in the construction of bridges, tunnels, dams, irrigation, potable water, treatment plants, sewage systems, telecommunications, power generation, transmission, distribution, mining, environmental prevention investments, ports and airports.\textsuperscript{77} In Jordan, the government is relying on a series of BOT projects over the next 14 years to solve water shortages.\textsuperscript{78}

Gulf states have similarly followed suit with Kuwait in particular pursuing BOT on ambitious tertiary projects such as the Kuwait City harbour-front redevelopment and 

\textit{Al Sharq} commercial complex. As the rentier states of the Gulf have responded to budgetary constraints, they have looked toward countertrade schemes to compensate

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{77}] US State Department (Turkey) \textit{ibid.}
\end{itemize}
\end{footnotesize}
reductions in public expenditure. According to a report recently issued by the National Bank of Kuwait, BOT schemes have a significant role to play in moving from public to private provision of utility services.

It is likely that future necessary infrastructure spending will be financed by the private sector under the build–operate–transfer (BOT) schemes....Such projects could increasingly be relied upon to provide investment capital for much needed infrastructure development.79

The Gulf states are pursuing BOT in both primary and tertiary sectors of their economies. In Oman, BOT schemes have been used in the service sector to great effect including, sewage and water treatment, desalination of sea water, electric power generation and the production and overseas marketing of natural gas. In Saudi Arabia, BOT schemes have been utilised in a number of diverse economic sectors including industrial, power, water, health, residential and commercial building and telecommunication sectors.80

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78 *Jordan Times* web-site, Amman, in English 9 September, 1998  *SWB* 15 September, 1998
79 National Bank of Kuwait *Economic and Financial Quarterly* (Safat, Kuwait: NBK, 1998)
**Offset**

According to one American businessman, 'as pressure grows on budgets around the world, you will see more and more Offset arrangements. It is a fact of life, and you will need to do it to do business.' Offset works along the same principle of BOT in that it harnesses private capital to supplant public expenditure. It is commonly used by countries making foreign procurements to ensure that a percentage of funds spent are re-invested back in the economy to achieve development goals. Governments offer public good contracts out to the private sector for competition. Once tendered, the contractor agrees to offset a proportion of profits back into a sector of the economy to train and employ local people in highly skilled industries.

Offset ventures have been employed in a wide variety of countries, most frequently in the purchase of military equipment. For several decades the arms market has been excessively over-supplied creating a "buyer's-market." Governments have increasingly sought to exploit this situation and attachments to the purchase and supply of military equipment has risen fast. During the last decade Gulf states have pioneered the most innovative uses for such schemes in a variety of economic sectors, including electronics, aerospace, computer systems engineering, pharmaceuticals, automotive

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82 The Carlyle Group *Saudi Arabia's Economic Offset Program: A Gateway to the Kingdom*, http://www.thecarlylegroup.com/offset.htm p. 2
products and metals processing. Whereas developed countries tend to use Offset schemes as a means to generate long-term strategic relationships in the defence industry, ‘countries such as Kuwait and the United Arab Emirates are seeking Offset activities that will help create businesses, increase local investment, or diversify the economy.'

Indeed, early ventures have been so successful in Saudi Arabia that the Kingdom is expanding the policy into new sectors including health and medical technology, telecommunications, environment, mining and minerals, energy, agriculture and food processing and downstream petrochemicals. According to one Saudi Minister, ‘the Saudi Offset Program has become an engine for private sector growth, providing crucial, high-value employment and technology transfer to the region.'

Depending upon the extent of the individual agreements, Offset requires that such contracts benefit commercial sectors of the economy. Strict criteria are laid out for each joint venture to fulfill. Usually, each venture must show that the activity diversifies the local industrial base, that it reduces reliance on imports, technology must be transferred, local nationals are employed and local raw materials are utilised. As a result, it is possible for expenditure on public goods to facilitate other types of financing and the opportunity cost of development spending is lessened. In recent years Offset activities have been extended to commercial companies. For example in 1994, AT&T’s $4 billion

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83 The Carlyle Group op cit., p. 1
84 See US General Accounting Office Military Exports: Offset Demands Continue to Grow GAO/NSIAD-96-65 Military Exports, April 12, 1996 pp. 4-5
85 The Carlyle Group op cit., p. 2 Major international companies participating in the Kingdom’s EOP at present include AT&T, Boeing, British Aerospace, General Dynamics, General Electric, Glaxo Wellcome, Hughes, McDonnell Douglas, Rolls Royce, Tate & Lyle, Thomson CSF and United Technologies. p. 2
telephone extension project in Saudi Arabia contained an Offset obligation. In the same year, the Kuwaiti government signed a non-defence Offset agreement with the Japanese consortium of Mitsubishi Heavy Industries, Mitsui and Company and Sasakwa to build a $212 million water project in Al Zour. In 1999 it was announced that the UAE Offsets group was coordinating a $10 billion project to build a regional gas network from Qatar to the UAE and Oman without the use of any defence contractor.

Offset programmes continue to develop in the Middle East both in terms of demand and in regulations. Kuwait now requires Offsets on all defence purchases over $3 million in 1992 and has since extended this policy to civil contracts. The Kuwait Offset Program is used as a means 'to identify feasible projects in the local economy, thus utilising the foreign know-how to establish new industries.' The stated aims are laid out in the Official Guidelines. The government wants to use Offset ventures to diversify the economy, facilitate the transfer of state-of-the-art technology, the creation of educational and training opportunities for Kuwaiti nationals and substitute the use of foreign produced goods with domestically produced goods. Increasingly emphasis is placed on

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50 Mubarak Al Khafrah, Deputy Minister of Industry and Electricity Remarks given to Third Plenary Meeting of the US-Saudi Business Council 2-4 October, 1996 Washington DC
57 O'Sullivan, E. 'GCC Banks on the Offset Factor' Middle East Economic Digest 7 April, 1995 Vol. 39, No. 14 pp. 4-6
58 'Offsets Programme in UAE Taking New Direction' Emirates Daily Bulletin No 04999, 22 March, 1999 Ministry of Information and Culture, UAE via e-mail
59 Ali Abdulsahman Al Rashid Al Bader Managing Director of the KIA 'Kuwait Investment Authority's Dual Role in the Domestic Economy: Promotions and Divestments' p. 26 in Kuwait Investment Authority op cit., pp. 20-27
60 State of Kuwait, Ministry of Finance, Countertrade Offset Program Executive Office Guidelines for the Countertrade Offset Program April 1 1995 Article 2.2 Kuwait implemented its first Offset deal in 1992 when US Hughes Corporation signed a $92 million deal to provide an early warning system for cover the whole state. Hughes reinvested $27.6 million to fulfil its contractual obligations.
"indirect" Offsets to benefit the entire economy. Defence contractors are expected to enter into profitable and sustainable joint ventures with the local workforce.

This preference for indirect Offsets has led to major European and U.S. defence contractor involvement in diverse industries. Thompson-CSF in the garment manufacturing business; Giat Industries in air conditioning, a horse racetrack, a stainless steel service centre, vegetable production and the winding and overhaul of industrial electric motors; Raytheon in aluminium smelting; and McDonnell-Douglas Helicopter Company (now a part of Boeing) in oil-spill clean-ups.91

The eagerness of defence contractors to obtain the lucrative contracts on offer has witnessed the extraordinary phenomenon whereby the companies themselves have voluntarily established diversification joint ventures in anticipation of a procurement sale, commonly known as "pre-performance." Hoping to persuade Gulf governments of their willingness and competence to undertake Offset requirements, major American and European defense contractors are involved in intense competition between themselves in order to secure a small advantage before the contract bidding begins. This has proved to be expensive for the contractors and highly lucrative for the Gulf states.92 Further, Offset agreements have become so sophisticated in some countries that they can be sold or traded to other contractors who require Offset credits to fulfill their own Offset obligations. The UAE has raised the idea of offering Offset credit futures, 'in which joint venture businesses that have a high probability of generating a certain level of

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91 Welt, L. G. B. & Wilson, D. B. op cit.,
92 For example France’s Dassault Aviation, Thomson-CSF and Snecma formed an Offset office in Abu Dhabi known as the French Fighter Investment and Cooperation Program. Soon after it formed a joint venture with Al Hamed Enterprises known as Franserres UAE to build greenhouses for the production of flowers to be exported to Europe and Japan. McDonnell Douglas has similarly invested $18 million in pre-
profitability in the future could sell the rights to the Offset credits that future profitability would generate. Should these schemes be extended in such a way it is highly probable that Offset obligations could be transferred among countries using an Offset exchange rate. These developments suggest that far from being redundant, countertrade is flourishing in the Gulf region.

In Offset schemes throughout the Gulf, governments offer "credits" to reduce the amount of obligations set out in the original contract. These are incentive mechanisms to prioritise the government's development strategy. Offset credit is granted with the use of macro and micro multipliers. Macro multipliers refer to credits that can be earned by establishing ventures in specific economic sectors that the government deems essential to the overall development plan. The following table produced by the Kuwaiti government shows which areas the government wishes to promote:

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performance agreements in the U.A.E., British Aerospace $20 million, as well as Construcciones Aeronauticas SA (CASA) of Spain and others. Welt, L. G. B. & Wilson, D. B. *op cit.*.
Table 12: The Macro Multipliers

<table>
<thead>
<tr>
<th>Category Number</th>
<th>Macro-Multiplier Category</th>
<th>Macro-Multiplier Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Manufacturing</td>
<td>2.5</td>
</tr>
<tr>
<td></td>
<td>Financial Intermediation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Business Activities</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Transport, Storage &amp;</td>
<td>2.25</td>
</tr>
<tr>
<td></td>
<td>Communication</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Education</td>
<td></td>
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<tr>
<td></td>
<td>Health Services</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Fishing</td>
<td>1.75</td>
</tr>
<tr>
<td></td>
<td>Electricity, Gas and Water</td>
<td></td>
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<tr>
<td></td>
<td>Supply</td>
<td></td>
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<tr>
<td></td>
<td>Mining &amp; Quarrying</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Agriculture, Hunting &amp; Forestry</td>
<td>1.5</td>
</tr>
<tr>
<td>5</td>
<td>Construction</td>
<td>1.15</td>
</tr>
<tr>
<td></td>
<td>Public Administration &amp; Defence</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Wholesale and Retail Trade</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Community, Social &amp; Personal Services</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Extra-Territorial Organisations and Bodies</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Real Estate &amp; Renting</td>
<td></td>
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<tr>
<td></td>
<td>Social Work</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Hotel &amp; Restaurant</td>
<td></td>
</tr>
</tbody>
</table>

Source: State of Kuwait, Ministry of Finance, Countertrade Offset Program Executive Office Guidelines for the Countertrade Offset Program April 1st 1995

Within each economic sector there are further credits to be gained at a micro level.

Private investors are expected to invest in specific activities particularly research and development and the training of Kuwaiti nationals as the table below illustrates.

Table 13: The Micro Multipliers

<table>
<thead>
<tr>
<th>Micro-Categories</th>
<th>Micro-Multipliers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education and Training of Kuwaiti Nationals</td>
<td>3.5</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>3.5</td>
</tr>
<tr>
<td>Research and Development Expenditures</td>
<td>3.5</td>
</tr>
<tr>
<td>Purchase of Locally Produced Goods and Services</td>
<td>3.5</td>
</tr>
<tr>
<td>Marketing and Product Development Expenditures</td>
<td>2.3</td>
</tr>
<tr>
<td>Pre-established Expenditures</td>
<td>2.3</td>
</tr>
<tr>
<td>Intangibles</td>
<td>1.1</td>
</tr>
<tr>
<td>Taxes Paid to the State of Kuwait</td>
<td>1.1</td>
</tr>
<tr>
<td>Other Expenses</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Source: State of Kuwait, Ministry of Finance, Countertrade Offset Program Executive Office Guidelines for the Countertrade Offset Program April 1st 1995

Each year credit is calculated by multiplying the Offset company's actual expenses in each micro-category with the appropriate micro-multiplier and then by the approved macro-multiplier. Credits earned are then used to reduce the degree of obligation originally conferred on the venture. For example, using the macro and micro-multipliers on offer, a company that invests in significant technology transfers to establish R&D facilities in the manufacturing sector can discharge its contractual obligations at a faster rate than ventures in the real estate sector that accrue intangible expenses. In this regard, Kuwaiti authorities have prioritised their development needs by assigning greater credits that will appeal to the private sector. It therefore wants “quality” contractual discharges than “quantity.”

Offset deals have become increasingly sophisticated in recent years. In the UAE, for example, the emphasis has shifted away from “inputs” towards “outputs.” What drives the UAE program is “profitability.” Originally the UAE offered credits on investment alone. The Initial Guidelines published in 1990 offered credits on the degree of inputs such as technology transfers, training and investment to discharge commitments within 7 years. However, this was later upgraded to calculate credit on the basis of outputs – namely how profitable the inputs have become. This move was prompted by fears that Offset partners might not work hard to guarantee the success of the schemes they were obligated in. To counter this the UAE punishes companies that create losses in Offset ventures. Not only do contractors suffer the losses but they are also penalised under a liquidated damages provision for failing its Offset obligation. The UAE’s Offset
group describes this as “doubling the ante and doubling the reward.” Offset contractors are expected to play an assertive role in the country’s development strategy.

V. Concluding Remarks

This chapter has argued the case for a re-evaluation of countertrade. The general perception that countertrade has somehow “failed” does not stand up to scrutiny. Rather, we need to be more accurate in our assessment and continue research into the subject. Some countertrade schemes work better than others. While traditional countertrade analogues such as barter and counterpurchase are declining in their usage, the analogues of BOT and Offset show no sign of abating. Indeed, in the Gulf region they are growing ever more sophisticated. This chapter has demonstrated the economic rationale behind countertrade in the Gulf. The rentier states of the region believe it necessary to intervene against the free market in order to obtain sophisticated and applicable transfers of technology. They require mechanisms to offset the large opportunity costs they accrue. There is a widely held perception that unless government intervenes directly, the Gulf has no future beyond oil. Gulf states want to move away from their comparative advantage in oil to a competitive advantage in value-added industries. Market forces alone cannot achieve this. The continued redistribution of oil wealth cannot achieve this. The Gulf region requires a new form of public/private partnership to fulfill its aims. Yet to fully understand why this is the case we must now return to political considerations inside the rentier states that drive the need for economic development.

94 See Eversman, S. & El Sayed ‘UAE’s Unique Program: Only Profitable Projects Earn Credit Toward Offset Obligation of Contractor’ Middle East Executive Reports September 1995 Vol. 18, No. 9 pp. 9-12
Table 14: Countries Currently Engaged in Countertrade

<table>
<thead>
<tr>
<th>Country</th>
<th>Extent of Countertrade Practiced</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>North America</strong></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>Offset used to promote industrial growth in regions. In principle, all major procurements by government (over C$5m+) require Offset.</td>
</tr>
<tr>
<td>USA</td>
<td>US Government does not encourage countertrade however it is thought to account for 20% of US overseas trade</td>
</tr>
<tr>
<td><strong>Latin America</strong></td>
<td></td>
</tr>
<tr>
<td>Argentina</td>
<td>Countertrade laws remain in force but are no longer widely practiced.</td>
</tr>
<tr>
<td>Brazil</td>
<td>Offset required for defence imports</td>
</tr>
<tr>
<td>Columbia</td>
<td>Countertrade regulations remain in force but operations were suspended in 1986</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>Barter laws of 1965 still in force though not widely used</td>
</tr>
<tr>
<td>Cuba</td>
<td>Barter widely used in exports of sugar, nickel, tobacco and coffee</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>Countertrade regulated by the Monetary Board of the Central Bank</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Countertrade used for export of oil, bananas, coffee, sugar, shrimp, fruit and flowers</td>
</tr>
<tr>
<td>El Salvador</td>
<td>Barter and Countertrade regulations in force but are infrequently used</td>
</tr>
<tr>
<td>Guatemala</td>
<td>Government encourages countertrade in private sector but no longer conducts countertrade itself</td>
</tr>
<tr>
<td>Jamaica</td>
<td>No government policy on countertrade but a number of state-run enterprises have engaged in the practice</td>
</tr>
<tr>
<td>Mexico</td>
<td>Positive attitude towards countertrade involving Ministry for Trade and the Foreign Trade Bank</td>
</tr>
<tr>
<td>Peru</td>
<td>Countertrade laws repealed although private companies can choose to engage in it if they wish</td>
</tr>
<tr>
<td>Uruguay</td>
<td>Countertrade law established in 1990. Countertrade is an option not an obligation for government procurement</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Countertrade in force, has become more attractive as oil prices have fallen</td>
</tr>
<tr>
<td><strong>Western Europe</strong></td>
<td>Most countries operate Offset in the defence sector. Offset not required for civil purchases</td>
</tr>
<tr>
<td><strong>Central and Eastern Europe</strong></td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Countertrade widely practiced although there are no formal regulations</td>
</tr>
<tr>
<td>Croatia</td>
<td>Countertrade law introduced 1997. Deals authorised by Ministry of Economy. Offset deals</td>
</tr>
<tr>
<td>Country</td>
<td>Details</td>
</tr>
<tr>
<td>--------------------</td>
<td>---------</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Offset protocol introduced in 1998. Offset requirements for government procurements over Kc 300 million.</td>
</tr>
<tr>
<td>Estonia</td>
<td>Government takes a positive attitude towards countertrade</td>
</tr>
<tr>
<td>FYR Macedonia</td>
<td>Government takes a positive attitude towards countertrade</td>
</tr>
<tr>
<td>Hungary</td>
<td>Offset required for defence procurement</td>
</tr>
<tr>
<td>Latvia</td>
<td>Government takes a neutral position on countertrade</td>
</tr>
<tr>
<td>Lithuania</td>
<td>Government takes a positive attitude towards countertrade</td>
</tr>
<tr>
<td>Poland</td>
<td>Offset requirements for defence contracts, discharged by civil investments</td>
</tr>
<tr>
<td>Romania</td>
<td>Government decree in 1995 requires transactions in excess of US$41 million require Ministry of Finance approval based on proposals submitted by relevant Ministries</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Government takes a positive attitude on countertrade</td>
</tr>
<tr>
<td>Slovenia</td>
<td>No formal rules but companies are encouraged to provide countertrade proposals when bidding for government contracts</td>
</tr>
<tr>
<td>Yugoslavia</td>
<td>Government cooperates on all types of countertrade</td>
</tr>
</tbody>
</table>

**Former Soviet Union**

<table>
<thead>
<tr>
<th>Country</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Azerbaijan</td>
<td>Government positive on all types of countertrade except barter. Regulations introduced 1997</td>
</tr>
<tr>
<td>Belarus</td>
<td>Countertrade regulations introduced in 1995</td>
</tr>
<tr>
<td>Georgia</td>
<td>Countertrade regulated by the Ministry of Trade</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>Countertrade welcomed but barter banned 1995</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>Countertrade policy is early development phase</td>
</tr>
<tr>
<td>Moldova</td>
<td>Countertrade widespread in external and internal trade</td>
</tr>
<tr>
<td>Russia</td>
<td>Countertrade widespread in external and internal trade</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>Countertrade welcomed by Government, barter is prohibited</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>Countertrade policy currently being developed</td>
</tr>
<tr>
<td>Ukraine</td>
<td>Countertrade and offset widespread but government is trying to outlaw barter</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>Countertrade is welcomed but government has banned all barter transactions</td>
</tr>
</tbody>
</table>

**Middle East and North Africa**

<table>
<thead>
<tr>
<th>Country</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>New countertrade law introduced in 1991</td>
</tr>
<tr>
<td>Iran</td>
<td>Barter and buyback arrangements are common practice</td>
</tr>
<tr>
<td>Israel</td>
<td>All foreign suppliers of goods valued at US$50,000 or more are required to offset 35% of contract value into industrial cooperation</td>
</tr>
<tr>
<td>Jordan</td>
<td>No regulations but barter and switch trading are common</td>
</tr>
<tr>
<td>Kuwait</td>
<td>Well developed Offset program</td>
</tr>
<tr>
<td>Country</td>
<td>Description</td>
</tr>
<tr>
<td>------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Lebanon</td>
<td>Countertrade practiced</td>
</tr>
<tr>
<td>Oman</td>
<td>Operates Offset Program with the UK</td>
</tr>
<tr>
<td>Qatar</td>
<td>Government currently developing Offset program</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>Well developed Offset program</td>
</tr>
<tr>
<td>Sudan</td>
<td>Barter commonplace</td>
</tr>
<tr>
<td>Tunisia</td>
<td>Countertrade widely used to finance imports and engineering work for large industrial projects</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>Well developed Offset program</td>
</tr>
<tr>
<td><strong>Sub-Saharan Africa</strong></td>
<td></td>
</tr>
<tr>
<td>Angola</td>
<td>Bilateral countertrade agreements are common</td>
</tr>
<tr>
<td>Botswana</td>
<td>Unofficial Offset practices in operation</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>Government coordinates countertrade deals with private sector and foreign companies</td>
</tr>
<tr>
<td>Ghana</td>
<td>Long history of countertrade, still practiced</td>
</tr>
<tr>
<td>Kenya</td>
<td>Countertrade applied on ad hoc basis</td>
</tr>
<tr>
<td>Malawi</td>
<td>Countertrade formally adopted as an alternative method of conducting trade in 1988</td>
</tr>
<tr>
<td>Mozambique</td>
<td>No legal framework but countertrade is pursued by the Ministry of Industry, Commerce and Tourism</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Oil bartered for goods on a frequent basis</td>
</tr>
<tr>
<td>Senegal</td>
<td>Countertrade is discouraged unless given prior authorisation from Minister of Finance</td>
</tr>
<tr>
<td>South Africa</td>
<td>Civil Offset introduced in Sept 1996</td>
</tr>
<tr>
<td>Tanzania</td>
<td>Countertrade is not a formal policy but government does consider proposals</td>
</tr>
<tr>
<td>Zambia</td>
<td>Countertrade still used but declining in importance</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>Countertrade is not encouraged but government keeps open mind on proposals</td>
</tr>
<tr>
<td><strong>Asia</strong></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>Countertrade is actively promoted by the government</td>
</tr>
<tr>
<td>Burma</td>
<td>Barter and counterpurchase used in times of foreign exchange shortages</td>
</tr>
<tr>
<td>China</td>
<td>Government is encouraging use of countertrade</td>
</tr>
<tr>
<td>India</td>
<td>Offset program currently being developed. Counterpurchase covers a wide range of goods from iron ore to computer software</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Countertrade is widely used in the public sector and government is expanding counterpurchase and offset programs</td>
</tr>
<tr>
<td>Laos</td>
<td>Barter common in the trade of timber, coffee and tin</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Ministry of Finance has established its Offset Program and Countertrade Unit. The recent Asian crisis has led to an expansion of the program</td>
</tr>
<tr>
<td>Mongolia</td>
<td>Barter is common with surrounding states</td>
</tr>
<tr>
<td>Nepal</td>
<td>Government has a positive attitude towards countertrade even though no formal rules exist</td>
</tr>
<tr>
<td>Pakistan</td>
<td>Countertrade used frequently in transactions with Central Asia</td>
</tr>
<tr>
<td>Philippines</td>
<td>Executive Order from 1993 directs government and state sector to adopt countertrade for all imports costing US$1 million and over</td>
</tr>
<tr>
<td>Country</td>
<td>Countertrade activities</td>
</tr>
<tr>
<td>---------------------</td>
<td>-------------------------</td>
</tr>
<tr>
<td>Singapore</td>
<td>Countertrade well established. The Countertrade Pioneer Status Scheme was launched by the government in 1986 to promote Singapore as a base for countertrade activities</td>
</tr>
<tr>
<td>South Korea</td>
<td>Full range of countertrade activities are currently in operation</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>Barter is still a common practice</td>
</tr>
<tr>
<td>Thailand</td>
<td>Countertrade established as a formal policy in 1995</td>
</tr>
<tr>
<td>Vietnam</td>
<td>Barter, counterpurchase and buyback and generally practiced depending on local conditions</td>
</tr>
<tr>
<td><strong>Australasia</strong></td>
<td>Countertrade implemented to boost Australian industrial development</td>
</tr>
<tr>
<td>Australia</td>
<td>Countertrade implemented to boost Australian industrial development</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Government welcomes countertrade proposals where they serve to boost the competitiveness of business</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>Countertrade policy currently under formation</td>
</tr>
</tbody>
</table>

Table 15

Kuwait Offset Program: Participating Foreign Contractors

<table>
<thead>
<tr>
<th>Company</th>
<th>Country</th>
<th>Obligation Amount (US$)</th>
<th>Date Offset Agreement Signed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raytheon/Hughes</td>
<td>United States</td>
<td>27,500,000</td>
<td>29 November 1992</td>
</tr>
<tr>
<td>Aerospatiale</td>
<td>France</td>
<td>5,500,000</td>
<td>20 December 1993</td>
</tr>
<tr>
<td>Raytheon</td>
<td>United States</td>
<td>98,200,000</td>
<td>23 January 1994</td>
</tr>
<tr>
<td>GKN</td>
<td>United Kingdom</td>
<td>288,500,000</td>
<td>4 July 1994</td>
</tr>
<tr>
<td>T-Com</td>
<td>United States</td>
<td>11,900,000</td>
<td>8 April 1995</td>
</tr>
<tr>
<td>TecQuipment</td>
<td>United States</td>
<td>6,500,000</td>
<td>15 May 1995</td>
</tr>
<tr>
<td>Rosvoorouzhenie1</td>
<td>Russia</td>
<td>126,000,000</td>
<td>15 August 1995</td>
</tr>
<tr>
<td>Rosvoorouzhenie2</td>
<td>Russia</td>
<td>102,000,000</td>
<td>15 August 1995</td>
</tr>
<tr>
<td>Short Missile Systems</td>
<td>United Kingdom</td>
<td>22,000,000</td>
<td>16 April 1996</td>
</tr>
<tr>
<td>Thompson CSF</td>
<td>France</td>
<td>15,000,000</td>
<td>21 July 1996</td>
</tr>
<tr>
<td>Mitsubishi, Mitsui &amp; Sasakura</td>
<td>Japan</td>
<td>67,000,000</td>
<td>23 October 1996</td>
</tr>
<tr>
<td>Panhard &amp; Levassor</td>
<td>France</td>
<td>3,800,000</td>
<td>1 December 1996</td>
</tr>
<tr>
<td>Norconsult International</td>
<td>Norway</td>
<td>2,500,000</td>
<td>2 December 1996</td>
</tr>
<tr>
<td>CMN International</td>
<td>France</td>
<td>143,800,000</td>
<td>10 December 1996</td>
</tr>
<tr>
<td>Raytheon/Hughes (2)</td>
<td>United States</td>
<td>8,500,000</td>
<td>10 December 1996</td>
</tr>
<tr>
<td>AV Technology</td>
<td>United States</td>
<td>52,100,000</td>
<td>11 December 1996</td>
</tr>
<tr>
<td>British Aerospace</td>
<td>Australia</td>
<td>4,500,000</td>
<td>4 June 1997</td>
</tr>
<tr>
<td>2 Australia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oerlikon Contraves</td>
<td>Italy</td>
<td>2,000,000</td>
<td>23 June 1997</td>
</tr>
<tr>
<td>ENOSA</td>
<td>Spain</td>
<td>1,100,000</td>
<td>9 November 1997</td>
</tr>
<tr>
<td>GEC Marconi</td>
<td>United States</td>
<td>TBD</td>
<td>24 February 1998</td>
</tr>
<tr>
<td>Boeing</td>
<td>United States</td>
<td>TBD</td>
<td>18 March 1998</td>
</tr>
<tr>
<td>Noreco</td>
<td>China</td>
<td>55,900,000</td>
<td>21 March 1998</td>
</tr>
<tr>
<td>Raytheon/Hughes (3)</td>
<td>United States</td>
<td>1,200,000</td>
<td>31 March 1998</td>
</tr>
<tr>
<td>Matra BAe Dynamics</td>
<td>United Kingdom</td>
<td>45,400,000</td>
<td>26 April 1998</td>
</tr>
<tr>
<td>Gulfstream Aerospace Corp</td>
<td>United States</td>
<td>34,500,000</td>
<td>18 May 1998</td>
</tr>
<tr>
<td>Airwork Advanced Group</td>
<td>United Kingdom</td>
<td>3,922,000</td>
<td>31 May 1998</td>
</tr>
<tr>
<td>United Defence L.P.</td>
<td>United States</td>
<td>135,400,000</td>
<td>3 April 1998</td>
</tr>
<tr>
<td>Racal</td>
<td>United Kingdom</td>
<td>2,500,000</td>
<td>18 May 1998</td>
</tr>
<tr>
<td>Flagship Trading Ltd.</td>
<td>United Kingdom</td>
<td>5,500,000</td>
<td>8 July 1998</td>
</tr>
<tr>
<td>Styer Nutzfahzeuge AG.</td>
<td>Austria</td>
<td>1,600,000</td>
<td>14 August 1998</td>
</tr>
<tr>
<td>Eurocopter</td>
<td>France</td>
<td>2,000,000</td>
<td>28 August 1998</td>
</tr>
<tr>
<td>Cofras</td>
<td>France</td>
<td>13,200,000</td>
<td>4 October 1998</td>
</tr>
<tr>
<td>Kipal</td>
<td>Yugoslavia</td>
<td>8,200,000</td>
<td>28 October 1998</td>
</tr>
<tr>
<td>AstroConsult</td>
<td>Austria</td>
<td>1,500,000</td>
<td>12 May 1999</td>
</tr>
<tr>
<td>General Dynamics</td>
<td>United States</td>
<td>300,000,000</td>
<td>Pending</td>
</tr>
<tr>
<td>British Aerospace Military</td>
<td>United Kingdom</td>
<td>-</td>
<td>Pending</td>
</tr>
<tr>
<td>Aircraft &amp; Aerostucture</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1,599,322,000</td>
<td></td>
</tr>
</tbody>
</table>

Source: State of Kuwait, Kuwait Offset Program http://www2.kema.net/users/offset/participating.htm
### Table 16

**Saudi Arabia: Peace Shield I Offset Program**

<table>
<thead>
<tr>
<th>Project</th>
<th>Joint Venture Partners</th>
<th>Activity</th>
<th>Location</th>
<th>Project Cost</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advanced Electronics Co. (AEC)</td>
<td>Boeing Industrial Technology Group (10%); Gulf Investment Corp. (10%); National Commercial Bank (10%); National Industrialization Co. (10%); Saudi Arabian Airlines (10%)</td>
<td>Manufacture &amp; repair of advanced electronics equipment</td>
<td>Riyadh</td>
<td>$230 million</td>
<td>Operational</td>
</tr>
<tr>
<td>Alsalam Aircraft Co.</td>
<td>BITG (50%); Saudia (25%); GIC (10%); NIC (10%); Saudi Advanced Industries (5%)</td>
<td>Manufacture &amp; repair of military, commercial &amp; civil rotary &amp; fixed hydraulics</td>
<td>Riyadh</td>
<td>$159 million</td>
<td>Operational</td>
</tr>
<tr>
<td>Aircraft Accessories &amp; Components Co. (AACC)</td>
<td>BITG &amp; BAe (50%); Arabasco (30%); Saudia (10%); SAIC (10%)</td>
<td>Repair &amp; Overhaul of critical aircraft systems</td>
<td>Riyadh</td>
<td>SR 46.6 million</td>
<td>Operational</td>
</tr>
<tr>
<td>International Systems Engineering (ISE)</td>
<td>BITG &amp; Hughes Aircraft Co. (50%); United Systems Engineering consortium (50%);</td>
<td>Computing system projects in the military, government &amp; commercial sectors</td>
<td>Riyadh</td>
<td>$20 million</td>
<td>Operational</td>
</tr>
<tr>
<td>Middle East Propulsion Co. (MEPC)</td>
<td>General Electric; Pratt &amp; Whitney &amp; Rolls Royce; GIC; NIC; SAIC, Saudia</td>
<td>Maintenance, repair and overhaul of gas turbine engines</td>
<td>Riyadh</td>
<td>SR 195 million</td>
<td>Operational</td>
</tr>
</tbody>
</table>

### Table 17: Saudi Arabia: Peace Shield II Offset Program

| Middle East Battery Co. | General Motors (49%) and six Saudi companies holding the remaining 51% | Automotive battery manufacturing | Dammam | SR 225 million | Operational |
Table 18: Saudi Arabia: Al Yamamah Offset Program

<table>
<thead>
<tr>
<th>Company/Project Name</th>
<th>Partner/Parties</th>
<th>Description</th>
<th>Location</th>
<th>Cost</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Sugar Co. (USC)</td>
<td>Tate &amp; Lyle (15%), Savola Co. (51%); and a consortium of 15 Saudi companies - SIC</td>
<td>500,000 tpy sugar refinery</td>
<td>Jeddah</td>
<td>SR 600 million</td>
<td>Operational</td>
</tr>
<tr>
<td>Glaxo Saudi Arabia Ltd.</td>
<td>Glaxo Welcome &amp; SIC</td>
<td>Manufacture of pharmaceutical products (e.g. Zantac, Ventolin)</td>
<td>Jeddah</td>
<td>SR 98 million</td>
<td>Operational</td>
</tr>
<tr>
<td>Cyclar Project</td>
<td>Licensing agreement between SABIC and technology suppliers UOP &amp; BP</td>
<td>Supply of technology for the Cyclar Plant &amp; training packages</td>
<td>Yanbu</td>
<td>N/A</td>
<td>Under Construction</td>
</tr>
<tr>
<td>Cumene Manufacturing Project</td>
<td>Universal Petrochemical Co. Ltd. (Unichem), Phenochemie (Germany) &amp; Herdilla (India)</td>
<td>Cumene manufacturing facility</td>
<td>Yanbu</td>
<td>$60 million</td>
<td>Negotiation Stage</td>
</tr>
<tr>
<td>Dhahran Harco Chemical Inds. Ltd</td>
<td>Harlow Chemical Co. Ltd. (Harcow) &amp; Dhahran Chemical Industries (DCI)</td>
<td>Manufacture of a range of dispersion products used in the paint &amp; adhesive industries</td>
<td>Dammam</td>
<td></td>
<td>Under Implementation</td>
</tr>
<tr>
<td>Rezayet Flover Co. Ltd.</td>
<td>Flover Ltd. &amp; Rezayat Trading Co.</td>
<td>Repair or remanufacture of instrumentation equipment across Saudi industry</td>
<td>Eastern Province</td>
<td>N/A</td>
<td>Under Implementation</td>
</tr>
<tr>
<td>Saudi Development &amp; Training Company (SDT)</td>
<td>50:50 split between BAe &amp; YBA Kanoo</td>
<td>Training &amp; development of Saudi workforce</td>
<td>Dammam</td>
<td>N/A</td>
<td>Operational</td>
</tr>
</tbody>
</table>

NB The General Dynamics Economic Balance Program, McDonnell Douglas Offset Program and the AT&T Offset Program all have obligations under consideration.
### Table 19: Saudi Arabia: Sawari Offset Program

<table>
<thead>
<tr>
<th>Company</th>
<th>Offset Program Description</th>
<th>Location</th>
<th>Value</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dhabab Co. Ltd.</td>
<td>Thomson CSF (49%) &amp; Saudi Investors (51%) 110 tpy gold refinery</td>
<td>Jeddah</td>
<td>SR 43 million</td>
<td>Operational</td>
</tr>
<tr>
<td>Al Bilad Catalysts Co. Ltd.</td>
<td>European Catalyst (Eurocat) (35%), Al Bilad Trading (20%), National Contracting Co. (20%) Regeneration of hydro-treating catalysts used in oil refineries and petrochemical units</td>
<td>Jubail</td>
<td>N/A</td>
<td>Operational</td>
</tr>
<tr>
<td>Arabian Meter Co.</td>
<td>Market Trading Co. Manufacture of Electric Meters (90,000 units/year)</td>
<td>Dammam</td>
<td>N/A</td>
<td>Operational</td>
</tr>
</tbody>
</table>

### Table 20: Saudi Arabia: Contracts Awarded to Offset Companies

<table>
<thead>
<tr>
<th>Program</th>
<th>Company</th>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peace Shield</td>
<td>Hughes Aircraft Co.</td>
<td>Manufacture of low voltage power supply for aircraft radar</td>
<td>SR 24 million</td>
</tr>
<tr>
<td>General Dynamics Offset Program</td>
<td>General Dynamics/AEC, Smiths Industries/AEC</td>
<td>Manufacture of circuit boards for the military Production of navigation system for Tanks</td>
<td>SR 163.6 million SR 31.9 million</td>
</tr>
<tr>
<td>McDonnell Douglas Offset Program</td>
<td>McDonnell Douglas/AEC, Smiths Industries/AEC, Northrup Grumman Corp./AEC, Hughes Aircraft Co. AEC, McDonnell Douglas /Alsalem Aircraft Co.</td>
<td>Production of avionics modules for F-15 aircraft Surface Mount Technology (SMT) transfer Manufacture of data flight recorders for F-15 aircraft Production of Pre-Amplifier sub-assembly for F-15 aircraft Power supply modules for F-15s Assignment of 72% of the technical support services for the F-15 aircraft for 3 years</td>
<td>SR 3.2 million SR 204.4 million SR 31.9 million SR 25.5 million SR 24.4 million SR 400 million</td>
</tr>
<tr>
<td>AT&amp;T Offset Program</td>
<td>AT&amp;T/AEC</td>
<td>Manufacture of switch &amp; transmission systems for the TEP-6 project</td>
<td>$252 million</td>
</tr>
</tbody>
</table>

## Table 21

United Arab Emirates: Offset Projects Announced as of January 31, 1997

<table>
<thead>
<tr>
<th>Name</th>
<th>Activity</th>
<th>Contractor</th>
<th>Local Partner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abu Dhabi Shipbuilding</td>
<td>Construction of shipyard for building, maintenance and repair of ships</td>
<td>Newport News</td>
<td>Abu Dhabi Government &amp; Public Offering</td>
</tr>
<tr>
<td>Middle East Equipment</td>
<td>Leasing/sale of industrial equipment</td>
<td>McDonnell Douglas</td>
<td>Al-Jaber</td>
</tr>
<tr>
<td>Laser Re-nu</td>
<td>Recycling Plant</td>
<td>McDonnell Douglas</td>
<td>Emirates Printing Forms</td>
</tr>
<tr>
<td>Abu Dhabi Garment Factory</td>
<td>Building of garment factory in Abu Dhabi</td>
<td>Thomson-CSF</td>
<td>Bin Jabr Group</td>
</tr>
<tr>
<td>GAMAERO</td>
<td>Aircraft maintenance services</td>
<td>Aerospatiale</td>
<td>GAMCO</td>
</tr>
<tr>
<td>Giralda Emirates</td>
<td>Brick and tile manufacturing plant</td>
<td>CASA</td>
<td>Al Ain International Group</td>
</tr>
<tr>
<td>Westinghouse Gulf</td>
<td>Power, media, education, healthcare</td>
<td>Westinghouse</td>
<td>Western Group</td>
</tr>
<tr>
<td>CERT</td>
<td>Centre of Excellence for Research and Training</td>
<td>Westinghouse</td>
<td>Western Group</td>
</tr>
<tr>
<td>Gulf Solar Power</td>
<td>Manufacture of mobile solar energy generators</td>
<td>GEC-Marconi</td>
<td>Awlad Nasser</td>
</tr>
<tr>
<td>Gulf Diagnostic Centre</td>
<td>Out-patient healthcare and telemedicine</td>
<td>Lockheed Martin</td>
<td>Ibn Khaldoun</td>
</tr>
<tr>
<td>Edible Oil &amp; Fine Chemicals</td>
<td>Manufacturing plant in Abu Dhabi</td>
<td>McDonnell Douglas</td>
<td>Nama Development Enterprises</td>
</tr>
<tr>
<td>Access Conference &amp; Seminars Organisers</td>
<td>Company dealing with conferences</td>
<td>McDonnel Douglas, Hughes &amp; ITT</td>
<td>Local Private Investor</td>
</tr>
<tr>
<td>Advanced Technology Development Centre</td>
<td>Technology centre, business incubator</td>
<td>Pratt &amp; Whitney</td>
<td>10-N (National Investor)</td>
</tr>
<tr>
<td>Stainless Steel Plant</td>
<td>Construction of stainless steel plant in Abu Dhabi</td>
<td>Giat Industries</td>
<td>East West, Bin Banduq Group</td>
</tr>
<tr>
<td>Combined Cargo UAE</td>
<td>Own and operate vessels and broker cargo and vessels</td>
<td>Giat Industries</td>
<td>ADIC, Oman and Emirates Investing Holding Company, United Technical Services</td>
</tr>
</tbody>
</table>

Source: *Gulf Business 'Offset Dilemma'* p. 43 (n.d.)
Table 22

Variations of Build, Operate and Transfer (BOT)

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOO</td>
<td>Build, Own, Operate (without any obligation to transfer ownership).</td>
</tr>
<tr>
<td>BTO</td>
<td>Build, Transfer, Operate (A method of relieving the consortium of high cost insurance required by the project during the operation of the facility).</td>
</tr>
<tr>
<td>BRT</td>
<td>Build, Rent, Transfer</td>
</tr>
<tr>
<td>BOOST</td>
<td>Build, Own, Operate, Subsidize, Transfer</td>
</tr>
<tr>
<td>DBFO</td>
<td>Design, Build, Finance, Operate (similar to BTO, the government will retain title and lease it to the private sector over the life of the concessionary agreement).</td>
</tr>
<tr>
<td>BLT</td>
<td>Build, Lease, Transfer</td>
</tr>
<tr>
<td>ROO</td>
<td>Rehabilitate, Own, Operate</td>
</tr>
<tr>
<td>ROT</td>
<td>Rehabilitate, Own, Operate</td>
</tr>
<tr>
<td>DOT</td>
<td>Develop, Operate, Transfer</td>
</tr>
<tr>
<td>CAO</td>
<td>Contract, Add, Operate</td>
</tr>
</tbody>
</table>

Table 23

Phases of a BOT Project

| 1) Identification | Identify project  
Define form of leasing  
Preliminary feasibility study  
Assign project manager and team  
Government decision |
|-------------------|-------------------------------------------------|
| 2) Government Preparation for Tendering | Procurement procedure  
Pre-qualification  
Project agreement  
Tender documents  
Bid evaluation costs |
| 3) Sponsor’s Preparation to Bid | Form consortium/possibly project company  
Feasibility study  
Identification of potential partnership  
Submit bid package |
| 4) Selection | Evaluate bids  
Classifications/adjustments  
Project award |
| 5) Development | Form project company  
Equity contributions  
Loan agreements  
Construction contract  
Supply contract  
Off-take contract  
Insurance contract  
Operation and maintenance agreements |
| 6) Implementation | Construct facility and install equipment  
Testing  
Acceptance  
Technology transfer and capability building  
Evaluation |
| 7) Operation | O & M during the concession period  
Inspection  
Training  
Technology transfer and capability building |
| 8) Transfer | Transfer procedure |

Source: United Nations Industrial Development Organisation  
Chapter Three

Hypothesis I: The Regime Maintenance Model

Introduction

Chapter three introduces the first of the three hypotheses used to uncover the politics behind the countertrade strategies of Offset and Build, Operate and Transfer (BOT). Hypothesis I asserts that decisions are essentially taken in a reactionary manner to bolster the political support of the rentier state under conditions of fiscal austerity. After introducing the main presumptions of Hypothesis I, the chapter will focus on the reactionary nature of economic reform by analysing the “crisis-driven” environment within which the rentier elite operates. Section three asks why the incidence of countertrade is greater than the incidence of privatisation, given that non-rentier economies around the world have used privatisation to solve their development problems. Attention is then devoted to the incorporation capacity of the rentier state. Is the rentier elite primarily interested in countertrade because it offers an additional means to incorporate the extended royal family and the private sector into the support base of the regime? The political considerations in countertrade are investigated more fully by asking why it is necessary to add a “transfer” countertrade component to BOT schemes. A final section will undertake some case studies to evaluate the effectiveness of countertrade as a development strategy.
Hypothesis I

Hypothesis I asks if the application of countertrade is a means to maintain the political status quo of the rentier state. In the fiscally austere environment of the post oil-boom era, the state is employing countertrade as a way to supplement rent redistribution networks. First, as the Gulf elite derives legitimacy from a welfare state created by the reallocation of oil revenues, Hypothesis I asserts that countertrade is a useful tool to augment welfarism – the “social contract” that binds the ruling family to the citizen. The rentier state is under significant fiscal pressure. Yet with the application of BOT and Offset projects, the government has the potential to use private sector finance to maintain its status as “the state of social care.” The need for additional revenue streams is of paramount importance and countertrade is being employed in a reactionary “crisis-driven” manner. However, if the execution of Offset and BOT represents a means for the government to uphold welfarism, Hypothesis I would show that the rentier state has the capability and autonomy to weather periods of economic uncertainty. The rentier state model would still have much utility.

Countertrade has a second important reinforcement feature. According to Dirk Vandewalle, the rulers of rentier states are continually engaged in a process of alliance formation and the strengthening of existing coalitions. Politics is never actually suspended in a rentier state. Instead, the rentier elite is constantly looking for redistribution policies to placate interest groups within the context of rapidly changing circumstances. The bargaining process that is clearly evident in production states, and is
presumed to be missing in allocation states, is in fact a frequent and sophisticated occurrence.

The ruler’s fortunes are closely tied to distributive ability and to effectiveness in managing support coalitions. Changes in the international economy to which the country is highly vulnerable and in citizens’ perception of the ruler’s ability to provide continued distribution and to manipulate informal politics must constantly be attended to. In this peculiar form of political management, the objective is not to engage upon institution-building or to expand the country’s capacity to settle political issues through (depoliticized) institutions but rather to expend political energy on keeping the ruler and supporting coalitions in power.²

In Hypothesis I, the rentier elite is primarily concerned with the maintenance of its existing support coalition. In addition to the preservation of welfarism the ruling elite has to maintain the tacit agreement between itself and the business community. As chapter one pointed out, the business community in both states has forgone political representation in return for access to redistributed oil revenues. Yet the amount of redistributed rent has declined significantly. Additional revenue must be found to maintain this political relationship. Countertrade enables the government to implement strategies to channel foreign direct investment (FDI) while pacifying domestic constituents who want greater access to FDI. The government has the power to stimulate the economy via investment flows while redirecting that investment in a manner akin to redistribution.

Hypothesis I is therefore concerned with the management of crisis-conditions. The key variable dictating the management process is political “survival.” As Richards and Waterbury point out, ‘the current conventional wisdom in the Middle East is that economic reform programs are the result of leaders’ survival strategies.’ For Hypothesis I, the application of Offset and BOT represents a reactionary, yet controlled, process of economic liberalisation. Although the Kuwaiti government asserts that Offset is designed ‘to contribute to the State’s plan towards privatisation,’ Hypothesis I asks if Offset and BOT facilitate a type of privatisation that can be used to preserve the political status quo. Countertrade and privatisation are not incompatible. Countertrade can be seen as a stage along the road to privatisation. (For example, in 1998 the Saudi government awarded 10-year BOT contracts to modernise a number of its port facilities, creating 3,000 new jobs. According to Imad Abdul Jaurnel, General Manager of Globe Marine Services, which runs the roll-on-roll-off passenger ship facilities at Jeddah, BOT “is not what one would call complete privatisation nor is it a subcontract. It is a flexible, semi-privatisation programme.”) Rather, in the rentier state, countertrade is an attempt to limit the political consequences of privatisation. A large-scale privatisation of state assets would result in an active, independent and more assertive private sector. It would inevitably demand political representation commensurate with its role in the economy. As the Secretary General of the Kuwait Democratic Forum argues, ‘privatisation brings new forces that

2 Vandewalle, D. op cit., p. 28
4 Article 36, No. 4 The Kuwaiti Offset Fund: Articles of Association, Industrial Investments Company, State of Kuwait
5 Quoted in Trevelyan, R. ‘Much Reform Talk, Action is Pending’ Middle East Economic Digest 19 September, 1997 Vol. 41, No. 38 pp. 28-31 Future transport plans include the construction of a 1,200 km railway from Jubail to Jalamid in the north under a BOT basis. For more information see Middle East Economic Digest 29 November, 1996 Vol. 40, No. 48 p. 29
eventually acquire political power." So how can the government utilise private sector resources without having to cede decision making to the private sector? Somehow, private sector finance must be employed in a similar manner to rent redistribution to have the same political consequences. As this chapter will show, countertrade is an attempt to buttress the traditional rentier method of redistribution and incorporation.

II. The Pace of Reform: A Crisis-Driven Approach?

Hypothesis I argues that the application of countertrade is "crisis-driven" rather than "elite-led." Policy implementation is reactionary rather than pre-emptive. As chapter one illustrated, declining oil revenues, demographic changes, and rising deficits are forcing the pace of economic reform. These economic pressures cause immense political difficulties for the rentier government. The Saudi Arabian elite is dependent upon oil resources to implement its allocation policies to gain popular acquiescence and political legitimacy. Yamani points out that welfare and development have been the central tenets of ruling Saudi ideology. This has cushioned the royal family from social and political problems that have afflicted other Middle Eastern states. As the Economist puts it, "the spending habits of Saudi rulers are driven by politics, not just economics. Since the days of King Faisal in the 1960s, they have assumed that people will accept

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6 Dr. Ahmed Bishara, Secretary General of the opposition party, the Kuwait Democratic Forum ‘Kuwait Opposition Leaders Meet with Washington Journalists’ The Washington Report of Middle East Affairs April 2000 Vol. XIX, No. 3 p. 101


economic development as a substitute for democracy.  

However, the past two decades has witnessed a "law of diminishing political returns." Allocation policies were much more effective during the 1960s and 1970s than in the subsequent two decades. The Saudi elite no longer possesses significant amounts of rent to satisfy an increasingly large and sophisticated domestic constituency. This has become more apparent in recent years. Popular dissatisfaction with the Saudi government has grown as living standards have fallen. Subsidies have been cut and public services trimmed as the government has implemented austerity measures to offset the decline in oil revenues and the rise in population growth. Past attempts to finance these deficits by borrowing has led to serious economic consequences. Since 1988 the government has issued development bonds in the domestic market to obtain finance with potentially devastating results. The US State Department forecasts domestic debt to exceed 120% of GDP in 2000. Even the government has admitted circumstances since 1990 'caused government expenditures to exceed resources by a considerable margin.'

In addition, administrative reforms and reductions in subsidies and expenditures have all been implemented as strategies to counter the deficit. Saudi Arabia is caught in a vicious cycle where government revenues determine the level of growth in the economy. As revenues have fallen, the government has been unwilling to address the politically charged issue of welfare reform. This means spending cuts must come out of the capital

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9 'Saudi Arabia's Future: The Cracks in the Kingdom' The Economist, March 18, 1995 p. 25
10 U.S. Embassy Riyadh op cit., This figure ties in with that of the Economist Intelligence Unit which forecasted debt to exceed 100% of GDP for 1999. Economist Intelligence Unit Country Report: Saudi Arabia 1st Quarter 1999 (London: EIU, 1999) p. 8
11 Kingdom of Saudi Arabia, Ministry of Planning Sixth Development Plan 1995-2000 AD p. 89
budget. However, less public money invested into infrastructure has an enormous impact on the growth of the economy. The government has therefore delayed most of the painful reforms of its allocation policies. Despite a large deficit in its 1999-2000 budget the government promised that spending on social security, health, education and wealth would remain at the same level as the previous year. This was deemed to be the 'manifestation of the desire of the King, his Crown Prince and the Second Deputy Prime Minister.' This has led to accusations of the government "dragging its feet" over the pace of reform. The National Commercial Bank (NCB) accused the government's reforms as "piecemeal and reactive" hoping that its current problems will be transitory. The authorities were blamed for 'taking remedial action while trying to maintain as much of the old order intact as possible.'

Kuwait is a classic example of an allocation state. Oil was discovered in Kuwait in 1938 and production and exports began in 1946. Although it accounts for less than half of the country's GDP, it constitutes 80% of government revenue. The redistribution of oil rent is enshrined in the state's constitution. Article 16 affirms the individual's rights to redistributed wealth in the form of property, capital and work, while Article 21 declares that 'natural resources and all revenues therefrom are the property of the state. It shall ensure their preservation and proper exploitation, due regard being given to the requirements of state security and the national economy.' The Al Sabah family use oil wealth to redistribute material benefits, which in the past has successfully bought them

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13 *Ukaz, Jeddah, in Arabic 31 December, 1998 SWB 12 January 1999*
14 National Commercial Bank 'Policy Reform and Challenges in the GCC Countries' p. 1 *The NCB Economist May-June 1996 Vol. 6, No. 3 pp. 1-10*
political compliance and acceptance. Through expenditure on education, public employment, housing, health services, the private sector and social welfare, Al Dekhayel shows how these rent redistribution play an important role 'in the process of political legitimation.'\textsuperscript{16} However, like Saudi Arabia, the allocation policies identified by Al Dekhayel are losing their effectiveness as the amount of money available to support rentier regimes declines. The days when Kuwait proudly proclaimed that 'the government has two major factors in its favour – time and money'\textsuperscript{17} are long gone.

The transition from oil-boom to oil-bust has forced an acceptance of economic reform. According to one cabinet minister, the fiscal crisis has obliged the government to address economic reform in a serious manner. Kuwait oil minister, Saud Nasir Al Sabah, argues that Kuwait must 'look earnestly for alternative sources of revenue, stimulate industry, diversify investment and rationalise expenditure.'\textsuperscript{18} The government, eager to avoid blame for the current predicament, called upon the Kuwait public 'to understand that the conditions through which the country is passing are imposed on it and are not of its own doing.'\textsuperscript{19} It was this reluctance to accept blame for the crisis that led the National Assembly's Financial and Economic Affairs Committee to reject the government's draft budget for the fiscal year 1995-96. It accused the government of failing to provide a clear plan to tackle the country’s budget deficit. The Chairman of the Committee, Dr

\begin{flushleft}
\textsuperscript{15} State of Kuwait \textit{The Constitution of the State of Kuwait} (Kuwait: Kuwait Government Printing Press, 1962)

\textsuperscript{16} Al Dekhayel, A. K. H. \textit{The State and Political Legitimation in an Oil Rentier Economy: Kuwait as a Case Study} Unpublished Ph.D. Thesis Submitted to Department of Politics, University of Exeter, UK November 1990 p. 66

\textsuperscript{17} State of Kuwait Ministry of Guidance and Information \textit{Kuwait Today: A Welfare State} (Nairobi: Quality Publications Ltd., no date given = c. 1960s) p. 65

\textsuperscript{18} \textit{Kuna News Agency}, Kuwait City, in Arabic 0836 GMT 7 April, 1999 \textit{SWB} 13 April, 1999

\textsuperscript{19} \textit{Kuna News Agency}, Kuwait City, in Arabic 2135 GMT 28 December, 1998 \textit{SWB} 5 January, 1999
\end{flushleft}
Ismail Al Shatti, argued that the move was necessary "to make the executive authority face up to its responsibilities." Although the end of the oil-boom era has proved to be extremely painful, it created an environment in which the application of alternative economic development strategies was given greater urgency.

III. Why is the Incidence of Countertrade Greater than Privatisation?

If we assume economic development is "crisis-driven" why is there little evidence of Kuwait and Saudi Arabia pursuing conventional "crisis-solutions" followed by most other countries in the world? The majority of developed and underdeveloped states have chosen to tackle unsustainable economic strategies by "rolling back the state." Privatisation of state assets is at the core of structural adjustment policies. A closer examination of the development plans of Kuwait and Saudi Arabia reveals instances of both countertrade and privatisation. However, in both states, the incidence of countertrade is greater than that of privatisation. A recent World Bank study concluded that in the Middle East and North Africa region, progress on privatisation has been slow. The proceeds from major privatisation transactions averaged about 3% of the total worldwide over the period 1991-1998. Privatisation is often mooted as a solution to the problems encountered by the Gulf states, although it means many things to many people. The term "has been worn out and applied in so many different ways that it doesn't seem to mean much anymore." For the purpose of this research a broad conception is used. Privatisation is taken to mean the withdrawal of public expenditures in the provision of

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20 Kuna News Agency, Kuwait City, in Arabic 1633 GMT 21 May, 1995 SWB 30 May, 1995
goods and services and their replacement by private companies. While there are undoubted benefits to privatisation there are also large costs that manifest themselves in particular ways inside rentier states. As a result, privatisation as a “solution” to boost economic development is not taken lightly.

In terms of benefits, privatisation would enable rentier governments to reduce the costs of subsidising industry and service sectors owned by the government and a reduction in their debts. It would also help repatriate money held by Gulf citizens back to the region. According to the Bank of International Settlements deposits of the Gulf countries with international banks abroad reached $130 billion in 1993 while non-monetary assets were estimated to be $400 million.23 As Hasan Al Hu'man, chairman of the Federation of the UAE Chambers of Commerce, argues privatisation offers indigenous investment opportunities where money can, “contribute to the domestic economy instead of being transferred abroad.”24 Yet the rentier states at the turn of the century are in an awkward position – they are the guarantors of living standards yet they must also strive to encourage greater efficiency by introducing the private sector investment to fund government expenditure.25 In theory, privatisation would create new investment opportunities in the region. These apparent benefits have led some scholars to argue that the solution to the rentier malaise is fundamental structural reform. For example, Anthony Cordesman argues that:

23 Taecker, K. ‘Economic Imperatives in the Kingdom and the Role of the Private Sector: Exploiting Comparative Advantages’ p. 9 Middle East Executive Reports October 1997, pp. 9-28
Saudi Arabia must redefine its "social contract." It must begin to tax directly at least its wealthier citizens, eliminate most subsidies and convert to most market prices, diversify its economy (and) make a full commitment to privatisation...\textsuperscript{26}

While this appears to make good sense on paper, in reality a number of political and practical considerations appear to prevent fundamental reform. 'As is frequently the case with matters of public policy, the prescription is easier written than taken.'\textsuperscript{27} Larry Snider is correct to warn about that if historical experience is any guide, 'initial government attempts to expand the tax base would be met with some resistance and hostility while simultaneously increasing a sense of nationalism by those who are suddenly asked to start paying some of the bills.'\textsuperscript{28} There are five basic reasons why privatisation does not appear to be the panacea that Cordesman believes.

Firstly, the patrimonial elite has used oil revenues to carefully construct the idea of the nation state with the ruling families at its centre. Welfarism legitimises the government – undermining welfare provision undermines elite legitimacy. Tetreault is correct to argue that 'achieving structural adjustment in Kuwait conflicts with building support for the regime.'\textsuperscript{29} How to construct economic solutions that simultaneously tackle the political concerns of the rentier elite is an extremely challenging task. How to redefine the social contract between the elite and the citizenry while maintaining the

\textsuperscript{24} AFP News Agency, Paris, in English 1141 GMT 24 March, 1994 SWB 29 March, 1994
\textsuperscript{25} Smith, A. J. Privatized Infrastructure: The Role of Government (London: Thomas Telford, 1999)
\textsuperscript{26} Cordesman, A. H. Saudi Arabia: Guarding the Desert Kingdom (Boulder, CO: and Oxford: Westview Press, 1997), pp. 73-74
\textsuperscript{27} Sick, G. G. in: Sick, G. G. & Potter, L. G. (eds.) op cit., p. 21
\textsuperscript{28} Snider, L. W. 'Comparing the Strength of Nations: The Arab Gulf States and Political Change' Comparative Politics Vol. 20, No. 4 July 1988 pp. 461-484
\textsuperscript{29} Tetreault, M. A. (2000) op cit., p. 156
status quo of political power is problem that has no obvious answer. Second, and allied to the above, the social contract has eliminated the old tradition of taxation. Two immediate problems come to light. First, by selling off assets to the private sector to improve efficiency means the government loses existing sources of income. Unlike most other countries where the profits of privatised companies and the shares of individuals are taxed, this does not occur in any significant manner in the Gulf. This leads to the second issue – for privatisation to work companies and their customers will have to get used to taxation. Unfortunately, demands for taxation usually result in demands for representation.

Third, in a region where services have been kept artificially low for so long, privatisation would invariably mean unpopular price rises for the cost of many basic items. Whereas privatisation in the industrialised world promises price reductions via competition, the Gulf region will inevitably experience price rises. There would also be significant job-losses. Public sector employment in the Gulf engages in the provision of social goods via the “jobs for all” guarantee. Guarantees of employment opportunities and subsidisation of goods and services underpin the power of the rentier state. Private companies, which exist solely to make profits, would be under no compunction to maintain this social good. Despite recent research by Boubakri and Cosset, which shows that two-thirds of all privatisation transactions in the developing world resulted in

significant increases in employment levels, this is unlikely to occur in the Gulf.\textsuperscript{32} The region's public utilities are over-saturated with Gulf nationals. Privatisation does not take into consideration the political consequences of the downsizing of the state. In Kuwait, salaries and wages constitute about 50% of the total public expenditure from the state's general budget.\textsuperscript{33} This makes fundamental economic reforms politically dangerous. It is little wonder that the rentier states of the Gulf have looked towards alternative strategies to pursue their development policies. Previous attempts to reduce public expenditure have often been postponed. In 1979, the Amir of Kuwait admitted that the planned redundancies of 64,000 civil servants were not socially feasible and so the policy was set aside.

Fourthly, Gulf states do not possess a regulatory framework to allow competitive forces to work efficiently. Research by Jan Kalicki of the US Department of Commerce reveals US business leaders eschew investment in the Gulf for a variety of reasons including; an excessive government role in business, an inadequate legal structure, inadequate infrastructure and a lack of contract transparency.\textsuperscript{34} A significant problem is the inability of the bureaucracy to overcome these issues of concern. Regulatory reform is a long and complex process. As Chaudhry points out, 'to create competitive markets, it is not enough to smash the state bureaucracy that owns, controls or regulates goods and services; rather, the instruments of the state must be redeployed to perform the much

\textsuperscript{32} Boubakri & Cosset looked at 79 transactions in 21 developing countries. See Boubakri, N. & Cosset, J. 'The Financial and Operating Performance of New Privatized Firms: Evidence from Developing Countries' \textit{Journal of Finance} 53 (3), pp. 1081-1110
\textsuperscript{33} \textit{Kuna News Agency}, Kuwait City, in Arabic 1510 GMT 18 January, 1994 \textit{SWB} 25 January, 1994
\textsuperscript{34} Kalicki, J. H. 'The US and the Gulf: Commercial Challenges and Opportunities' \textit{Middle East Policy} Vol. 7, No. 1 October 1999 pp. 72-77
more difficult task of indirect regulation and administration.\textsuperscript{35} Even if the bureaucracy was reformed to be an effective market regulator (e.g. codes of conduct, enforcement of anti-competitive practices, the withdrawal of subsidies etc.) this would force the rentier government to treat individuals and companies equally. Yet the rentier state is built upon privileging certain interests groups above others because of the political support they offer. Without the use of favouritism, the power of the rentier elite is ceded to the market with potentially destabilising consequences.\textsuperscript{36}

Fifth and finally, successful privatisation is dependent upon high levels of senior and middle management skills. Kuwait lacks such skills – the result of the expulsion of 400,000 Palestinians in response to PLO support for Saddam Hussein. The Palestinians played an important role in the Kuwaiti economy. Many Palestinians could be classified as middle class managers – they held influential positions in the economy and possessed a strong work ethic. Despite the level of remittances sent home, the Palestinians spent significant amounts of their income in Kuwait. However, in the aftermath of the Iraqi invasion, the Palestinian population dropped to only 30,000. This did relieve some politically sensitive demographic pressures inside Kuwait (400,000 Palestinians compared to just 700,000 Kuwaitis). Nevertheless, the Kuwaiti economy had lost a large proportion of its skilled workforce. Most Palestinians had experience in the private sector and had proved themselves as successful businessmen. Although Egyptian managers replaced the Palestinians, many observers noted that skill levels had fallen. Most

\textsuperscript{35} Chaudhry, K. A. p. 249 'The Myths of the Market and the Common History of Late Developers’ Politics and Society Vol. 21, No. 3, September 1993, pp. 245-274
Kuwaitis did not have the same skills or work ethic to replace "middle management."

These five concerns manifest themselves in Saudi Arabia with extraordinary clarity. The Kingdom is much more circumspect as to the consequences of stimulating development away from oil reserves. Early on in the Kingdom's Sixth Development Plan (1995-2000) the government warns that:

Rapid economic growth and modernisation have led to social instability in many countries, particularly when the benefits of development have been unevenly distributed and traditional values have been abandoned. The Kingdom has been keen to avoid such adverse impacts, however.

Nowhere is this attitude more apparent than in the government's official position on privatisation. Pursuing privatisation upon consideration 'of all social and economic conditions', four themes are identifiable in the purpose of the policy: financing, management, divestment and deregulation. Private capital will be utilised to help finance and manage public sector projects under budgetary constraints. The government also intends to gradually sell off its shares in joint stock companies to the private sector and introduce the market mechanism to various sectors of the economy. However, the Sixth Development Plan warns that, 'in general, privatisation is not considered to be an objective in itself, but rather an instrument for realising economic efficiency.' The Saudi government does not share a particular affinity with the policy, which will be

38 Kingdom of Saudi Arabia, Ministry of Planning *Sixth Development Plan 1995-2000AD* p. 40
39 Kingdom of Saudi Arabia, Ministry of Planning *ibid.* pp. 161-162
40 Kingdom of Saudi Arabia, Ministry of Planning *ibid.* p. 161
implemented in only 'some of the government’s commercial activities.'\textsuperscript{41}

When interviewed in 1994, King Fahd stated that "I am one of the people who are convinced that the management of business by citizens is best."\textsuperscript{42} Such grand statements are typical of the Saudi elite. Yet a more accurate reflection of the political calculations precluding the implementation of this philosophy is given by the Information Minister, Dr. Fu’ad Bin Abd Al Salim Al Farsi. Although the government is committed to a policy of liberalisation to stimulate economic growth, Dr. Al Farsi points out that, "the government will not introduce privatisation if the effects on economic growth, the state budget, national employment and people with limited income are adversely disturbed. Moreover, the state will maintain its role in providing essential services and social welfare to citizens."\textsuperscript{43} This reflects a reticence on behalf of the Saudis to implement the painful measures that are needed. "Although Saudi leaders have in recent years talked the talk of privatisation, they have not yet walked the walk."\textsuperscript{44}

The same degree of reticence appears to be evident in Kuwait. In 1994, Hital Al Mutairi, director general of the Kuwait Chambers of Commerce, complained that "we hear a lot about privatisation but still we do not see any results."\textsuperscript{45} Five years later the same complaint is heard. According to Kuwaiti economist Jasem Al Sadoun, one of the government’s harshest critics, "nothing has changed. There has been no change in attitude. Economic planning is only influenced by the price of oil. When the price of oil

\textsuperscript{41} Kingdom of Saudi Arabia, Ministry of Planning \textit{ibid.}, p. 49
\textsuperscript{42} \textit{Kingdom of Saudi Arabia TVI}, Riyadh, in Arabic 1830 GMT 3 June, 1994 \textit{SWB} 14 June, 1994
\textsuperscript{43} Quoted in \textit{Al-Hawadith}, London, in Arabic 1434 GMT 27 August, 1997 \textit{SWB} 2 September, 1997
\textsuperscript{44} Gause, G. ‘Saudi Arabia: Over a Barrel’ \textit{Foreign Affairs} May/June 2000 Vol. 79, No. 3 pp. 80-94
falls there is talk of reform. When the oil price rises there is still talk, but no action. It is not a question of attitude but oil pressure. This has proved to be a significant handicap towards privatisation. As of December 1998, the total proceeds from privatisation were just KD 872 million ($2.9 billion).

In summary, liberalisation of the economy through the large-scale privatisation of state assets possesses a number of long-term benefits. However, in the short-term, the policy is potentially destabilising to the rentier elite. In countries where the provision of social goods is a perceived right, a rapid withdrawal these goods will stimulate and intensify political activity inside states that possess few formal mechanisms for expression. If privatisation is to proceed it must be introduced in a gradual and controlled process. A mechanism such as BOT provides a potential method for phasing in the liberalisation of economic sectors after years of state largesse. However, as the case study of the Saudi electricity sector will show, whether this potential can be successfully utilised in the manner intended is another question altogether.

V. Is Countertrade a Mechanism to Pacify the Needs of the Immediate Support Base?

The issue as to whether countertrade serves to “buy-off” dissent is an important one. It is also a highly contentious assertion. Because this is essentially a question of corruption, finding documentary evidence to support such an argument is impossible to

45 Quoted in Hindley, A. ‘Kuwait: Learning to Live with a Little Less’ Middle East Economic Digest 25 February, 1994 Vol. 38, No. 8 pp. 7-21
46 Interview with Jasem Al Sadoun, President, Al Shall Economic Consultants Kuwait City, 8 November, 1999
find. However, there is considerable anecdotal evidence that countertrade serves a function beyond that of economic development. Given that the support base of the ruling families is dependent upon close family cohesion, what Ibrahim calls its *esprit de corps*, patronage assists an important purpose in mitigating discontent from within the family, although some commentators argue the Al Saud is still characterised by 'deep divisive schisms.' However, in post oil-boom era, existing avenues of patronage have come under strain. This leads Hess to argue that the only area left open for the royal family is the private sector. Princes and favoured allies of the ruling families (especially in Saudi Arabia) receive substantial royalty fees from sponsorship clauses inserted into contracts with foreign companies. Countertrade is no exception. When interviewed, a number of Kuwaiti businessmen and politicians levelled accusations against individuals for using countertrade, especially Offset, for personal gain. Because of the nature of these allegations, and to protect interviewee confidentiality, specific accusations are not detailed in this thesis. However, where general criticisms have been made, these have been included. It is important to show that complaints regarding countertrade in the Gulf were numerous. There is a definite perception that corruption is widespread. The allegation that members of the ruling families and their supporters benefited from countertrade contracts was frequently asserted.

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47 Figures from Industrial Investments Co. *op cit.* p. 20
49 Ellis, H. F. in: Chelkowski, P. J. & Prayer, R. J. (eds.) *op cit.* p. 57
50 Hess, A. C. *op cit.* p. 119
51 Amin, S. H. *Political and Strategic Issues in the Persian-Arabian Gulf* (Glasgow: Royston Ltd., 1984), p. 196 Hess provides the example of Prince Miteb, the son of the Saudi Crown Prince. In 1989 the Ford Motor Company was taken off the Arab boycott list. Most Saudis thought that this business would revert back to its previous owners - the Ohyan and Alireza families. However, using his personal connections at the highest level, Prince Miteb became Ford's Saudi sponsor. See Hess, A. C. *op cit.* p. 119 Chaudhry cites the interesting example of King Fahd's ownership of the Makkah Construction and Development
If we take these allegations seriously, we have to undertake a closer look at the support base of the ruling families. The Saudi royal family has personal vested interests in diversification beyond that of the state's needs. Bill and Stookey point out that, 'Saudi Arabia is the realm of the House of Saud and its potential stability is ultimately linked with the solidarity of the royal family.'\(^{52}\) The House of Saud is a family fiefdom. The country's wealth is divided among a rapidly expanding royal family numbering several thousand princes. As the extended family increases in size by some 40 additional males per month\(^{53}\) the ability of the Al Saud to fund this increase has diminished in recent years. These 5000 princes, 2000 of which play an active role in the economy, perform an important role in supporting the regime. Oil wealth has made members of the royal family very rich, and accustomed to a certain life-style, through the allocation policies of the government. This leads Munro to argue that 'the ruling elite resists reform because they neither want to share power nor the massive benefits that, in the oil rich Gulf, flow therefrom.'\(^{54}\) If oil cannot continue to fulfil this patrimonial requirement then lucrative contracts can be sought via channels into private companies. The large Saudi defence expenditure is a means for the royal family to obtain wealth reinvested back into joint ventures. Offset contracts therefore fulfil a useful means to supplement and bolster sources of income. From a government perspective, countertrade is an endgame to maintain the informal institutions of the state. The extended royal family is pacified by

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\(^{53}\) Aburish, S. K. *The Rise, Corruption and Coming Fall of the House of Saud* (London: Bloomsbury, 1994), p. 4

\(^{54}\) Munro, M. *op cit.*, pp. 188-189
access to other sources of wealth.\textsuperscript{55}

Similarly, in Kuwait, critics of countertrade have accused the government of implementing schemes to pacify interest groups within ministries and within the wider economy. A number of government departments are accused of using the strategy as a emergency measure until the economic situation improves. One resident accused the ministries of "lining up at the trough." Instead of tackling important reforms necessitated by budget cuts they are put off and countertrade becomes a convenient mechanism for maintaining the existing set up.\textsuperscript{56} According to Dr. Donald Morrow, senior economist at the National Bank of Kuwait, "political arrangements are implicit in all countertrade arrangements inside Kuwait."\textsuperscript{57} Offset and BOT schemes benefit two major constituents: the ruling family and the merchant families. "Everyone wants a piece of the pie and commercial interests have to fight for what is left over." For example, an Offset scheme to provide tele-medicine\textsuperscript{58} to remote desert areas, which would have benefited the Bedouin community, was frustrated by Ministry of Health regulations. As soon as the project was shelved, the Minister of Health resigned and started his own tele-medicine business.\textsuperscript{59} As one of the government's best known critics argues, "the government is interested in Offset because of corruption. It is like adding butter to contracts."\textsuperscript{60}

\textsuperscript{55} This point of view is supported by Saudi opposition groups based abroad. One group claims that the Kingdom's Offset scheme is 'rife with corruption.' \textit{Movement for Islamic Reform in Arabia,} web-site, in Arabic 0230 GMT 26 February 1999 \textit{SWB} 1 May, 1999
\textsuperscript{56} See Executive Briefing \textit{Middle East Executive Reports} June 1995, Vol. 18, No. 6 p. 4
\textsuperscript{57} Interview with Dr. Donald Morrow, Senior Economist, National Bank of Kuwait Kuwait City, 14 November, 1999
\textsuperscript{58} Tele-medicine allows diagnosis and treatment of medical conditions in remote areas by experts located in cities or abroad by the use of satellite technology.
\textsuperscript{59} Interview with anon. Businessman Kuwait City, November 1999
There is little doubt that Offset and BOT are useful political tools in addition to their stated economic goals. The very nature of the rentier state makes this inevitable, and can be observed in similar states beyond the Gulf. In his analysis of Nigeria, Peter Lewis shows that in circumstances of austerity, state and private elites will implement policies ‘to sustain their entitlements and to adapt the outlets for rentier activities….The waxing and waning of economic statism have revealed a continuous quest to build and the preserve, a politicised crony capitalism.’\textsuperscript{61} Yet for countertrade strategies to fulfil their political function they have been institutionally designed to distribute benefits to specific constituencies beyond the immediate family.

VI. The Incorporation of the Merchants into BOT and Offset

Considerable anecdotal evidence suggests the Kuwaiti and Saudi governments use countertrade projects to pacify influential merchants within the private sector. In doing so, countertrade reinforces a long established method of political incorporation whereby the government has allowed merchant families to obtain riches through the use of patronage.\textsuperscript{62} In particular, businessmen involved in the construction and engineering sector have benefited enormously from BOT awards. In Saudi Arabia, BOT schemes have been utilised in a number of diverse economic sectors including industrial, power, water, health, residential and commercial building and telecommunication sectors.\textsuperscript{63} According to one businessman in Kuwait, “the government sees BOT as another source

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\textsuperscript{60} Interview with Jasem Al Sadoun, Al Shall Economic Consultants, Kuwait City, 8 November, 1999
of public sector money.” It is used to buy off potential dissent. Rentier governments frequently use government contracts with an eye to building a political clientele. A classic example of this is the way in which the Saudi and the Kuwaiti governments built conditions into the Offset legislation that would pacify merchant families. Offset agreements cannot proceed unless local businessmen are involved. According to a former advisor to the Kuwaiti Offset Program:

Merchant families get involved in Offset out of institutional design. Foreign investors must have a sponsor to pursue their obligations. Some minor royals are involved in Offset schemes, but not in any significant degree. The merchants are the main benefactors. The bargain between the merchants and the ruling family is still kept.

The political appeal of an Offset or BOT scheme is that solutions to declining rent revenues does not need to translate into difficulties for the business sector. If the government cannot directly provide patronage through the award of a contract, then the government can supply it indirectly. Yet as always, the political gains are often not enough. It should be pointed out that the private sector does not gain uniformly in the awarding of BOT contracts, nor in the share of potential rewards. A number of private sector businessmen complained bitterly about families with close connections to policy makers in the ministries, who are awarded joint venture projects merely on the basis of patronage. Those individuals in the private sector that speak out against the practice are

65 Interview with Dr Donald Morrow, Senior Economist, National Bank of Kuwait Kuwait City, 14 November, 1999
66 Interviews with anon. Businessmen in Kuwait City, November 1999
ostracised from government contracts. Dr Abdul Aziz Sultan, CEO of a large Kuwaiti engineering firm pointed out that his criticisms resulted in his company being blacklisted. His company has earned just one contract since liberation, forcing the firm to engage in overseas contracts. Both foreign and local contractors complain about the politics of BOT incorporation. The major criticism is that private sector companies do most of the project development work only to be forced to enter into a joint venture with an approved Kuwaiti businessman at a later date. One businessman complained that “we do all the work while the client merely signs his name.” For instance, to fulfil an Offset obligation, the foreign contractor must establish an Offset Business Venture with a Kuwait partner, which must conform with Kuwaiti commercial law. The venture cannot proceed until the Kuwaiti partner gives the go ahead. The perceived uncertainty and unfairness of BOT by some businessmen has resulted in a general unwillingness to enter into the expensive tendering phase of the contract. According to Stuart Bosel, a construction economist with a Kuwaiti company that won a $30 million BOT contract to build and refurbish a terminal at Kuwait International Airport, a number of businesses “cannot afford to lose and therefore cannot afford to compete.” This has meant that one of the official reasons for introducing BOT – to stimulate efficiency – has been weakened by the general perception of cronyism.

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67 Interview with Dr. Abdul Aziz Sultan, President, Kuwait Engineering Office, Kuwait City, 13 November, 1999
68 Interview with anon. Businessman, Kuwait City, November 1999
69 Industrial Investments Co. op cit., p. 25
VI. Why Build, Operate then Transfer?

Chapter one pointed out the importance of the rentier state acting as the guarantor of living standards. The ruling families gain a tremendous degree of legitimacy in the eyes of the people via the subsidised provision of goods and services. Indeed, the ruling families frequently reinforce the myth of benevolence. Government propaganda points out living standards have risen because of the foresight and generosity of the rentier elite. Citizens are continually reminded of the harsh conditions before rent redistribution. For many citizens the rentier state is the welfare state. This welfare extends far beyond the welfarism found in the industrialised world. For the rentier citizen, welfare is more than free education and health care. It extends also to free electricity, telephone calls, water supplies and much more. This puts the rentier government in an extremely awkward position. How can it guarantee these services in the face of declining oil revenues? The economic solution appears simple – a gradual restoration of the full market price to be paid by the consumer. The political solution is much more difficult. The rentier state cannot appear to be abandoning its commitment to the welfare state. It must demonstrate to the people that the state will still be there to provide goods and services, even if the citizen will be forced to pay more in the future. If the rentier citizen begins to question the welfare state, the citizen might also question the purpose of the rentier elite. What is needed is the utilisation of private finance for government needs. BOT appears to provide the necessary economic and political solutions.

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76 Interview with Stuart Bosel, Construction Economist, Salem Marzouk & Sabah Abi Hanna. Kuwait City, 10 November, 1999
Build, Operate and Transfer is a form of divestiture – a process of transferring ownership from the public to private sector, which the World Bank describes as a subset of privatisation. Commentaries on countertrade usually describe its application as a technical strategy. For example, the United Nations Economic and Social Commission for Western Africa argues BOT schemes are simply 'techniques for implementing privatisation.' However, if we were to look from only this narrow perspective we would miss the political considerations that are inherent in economic decision-making.

The statement by the Saudi Arabian government that development must ‘ensure that the operations of the free market system do not conflict with the wider interests of society’ is inherently political. If economic efficiency in the provision of services was the goal of the government, surely it would more efficient to leave this to the private sector entirely. Why not simply ask the private sector to build a power station and then allow a private business to own it? Why is it necessary to add a countertrade component – namely the transfer of the facility back to government control after a specified time? The answer lies at the heart of this thesis – politics. The ownership of “public goods” such as electricity and especially water is a contentious issue in the rentier state. In the case of Kuwait, the constitution places ownership of water in the hands of the people. Unlike for example, the United Kingdom, where the sale of public utilities were broadly welcomed by a public used to holding shares, Gulf societies do not possess a “stakeholder” mentality. Citizens of the Gulf do not possess an affinity with the privatisation of public assets.

Gulf governments are understandably reticent about proceeding with "market" solutions for public purposes. According to one prominent Kuwaiti economist, "the government is concerned about safeguards. It lacks the confidence to transfer resources to the private sector, particularly if the company is foreign." Similarly, a project manager with the Municipality of Public Works, who has extensive experience with BOT contracts, argues that "the government is reticent to allow foreigners to own any land within Kuwait." "The government is not in the business of selling the land. It wants to keep it for the people....In any case, the constitution prevents land being given to the private sector." This is understandable since, in most countries of the Middle East, colonial or semi-colonial rule is still a memory. Suspicions over "foreign control" remain. Gulf governments are trapped between a rock and a hard place. There is the desire to increase efficiency, reduce costs and wean the population off the mentality of free public goods. Yet it is concerned with the political consequences of such a transition. As one businessman points out, 'privatisation will not succeed if the public regards it as "selling the family silver" or "cashing in the country's wealth to the foreign investor."' BOT is a very political solution to a political problem. It is favoured by governments because, unlike privatisation, it appears to be a measure that can be more easily revoked if it proves unsatisfactory. Rather than being a leap into the dark, the government possesses three options in the future: a) to continue the contract under

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73 Kingdom of Saudi Arabia, Ministry of Planning Third Development Plan 1980-1985 AD p. 482
74 Interview with Jasem Al Sadoun, President, Al Shall Economic Consultants Kuwait City, 8 November, 1999
75 Interview with Sadoon Al Esia, Project Manager, Ministry of Public Works Kuwait City, 9 November, 1999
76 Interview with Dr. Adnan Al Hamoud, Deputy Director General, Kuwait Institute for Scientific Research Kuwait City, 10 November, 1999
77 Marks, J., Butter, D., O'Sullivan, E., Hindley, A. 'Privatisation Plans Get a Mixed Reception' p. 2 Middle East Economic Digest 22 July, 1994 Vol. 38, No. 29 pp. 2-4
different terms, b) tender the contract to others, c) run the enterprise itself. In this context, the transfer element of BOT is politically appealing. Both Saudi Arabia and Kuwait tell their citizens that option “c” will be implemented. Whether or not this will be the case in 30 years is not a concern for the present government. Indeed, as Hypothesis III will show, it is quite unlikely that BOT schemes will revert to public ownership. Nevertheless, the government of today can still portray itself as the “state of social care” – only the tools to provide this care have changed.

VII. Countertrade in Action

i) BOT and the Provision of Electricity

Under the stewardship of King Fahd the Saudi government perceived of countertrade as a means to supplement existing allocation policies and to maintain the “social contract” that the redistribution of rent had created. Gulf citizens have become used to subsidised electricity paid for by the government’s oil revenues. Electricity supplies discounted below the market rate are not considered a privilege but a right. This puts the Saudi government in an awkward position when prioritising funds, which are gradually diminishing. Similarly, in Kuwait, the cost of current electricity consumption does not make economic sense. Each unit of electricity is sold to the public at 2 fils yet the cost if provision is 15 fils, representing a subsidy of 13 fils for each unit consumed. Consequently, the public does not worry about conservation and uses the resource as a free gift. In Kuwait, electricity supplies have a 90% subsidy and the people owe KD70 million in unpaid bills. “The people are spoiled. They must be hit in the pocket to

78 Edmondes, N. *op cit.*, p. 11
conserve electricity, yet they do not even pay the bills. The government should at least be seen to collect its money but it has no courage."\textsuperscript{79}

A further problem lies with the private sector. The business community in the Gulf region is reliant upon cheap electricity. It is not subject to the same efficiency savings as companies in non-rentier states. Profit margins primarily exist because of government subsidies. Indeed, most companies do not bother to pay the nominal rates charged to them. In such a situation, a conventional privatisation of the electricity industry would ultimately damage the private sector. Privatised utilities would expect to make a profitable return from their investments by charging a rate beyond the cost of production. For the Saudi or Kuwaiti businessman, this would result in a huge increase in operating expenses. The inevitable consequence would be a contraction in the private sector as firms downsized their employees. This would be both politically and economically unacceptable. Failure to undertake these painful decisions has resulted in large outstanding debts that the government has financed via deficit spending. Until recently, the Saudi and Kuwaiti governments have possessed neither the technical capacity nor the political will to retrieve these debts. During the 1990s, however, both governments looked for alternative solutions to two basic problems; i) how to obtain greater value for money in the construction and operation of new and existing power generators, ii) how maintain the supply of electricity while reflecting the actual cost of generation. In both Saudi Arabia and Kuwait, BOT solutions have been used.

\textsuperscript{79} Interview with Dr Adnan A. Al'Hamoud, Deputy Director General, Kuwait Institute for Scientific Research, Kuwait City, 10 November, 1999
Modern development requires the widespread use of electricity. This source of energy provides the building blocks for more sophisticated forms of development and diversification. Unfortunately, providing for large supplies of power does not come cheaply. The start up costs of large power stations, from consultation through to the design and building phases involve considerable amounts of money and technology. As populations in the Gulf states begin to increase and demands for power become ever larger from individuals and industry alike, so rentier states are under increasing pressure to find new ways of supplying this resource without seeking recourse to public borrowing. As the table below illustrates, in order to satisfy current and future levels of demand into the year 2005, GCC states will have to spend over $72,536,000,000 - a staggering figure. In an era of expenditure cutbacks and reduced oil revenues, Gulf states must utilise private finance to pay for this most basic of development resources.

Table 24: GCC Projected Power Requirements

<table>
<thead>
<tr>
<th>Country</th>
<th>Installed Generating Capacity (MW) in 1997</th>
<th>Additional Capacity Required by 2005</th>
<th>Demand Growth Rate</th>
<th>Projected Cost ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>1,200</td>
<td>700</td>
<td>10.0</td>
<td>1,000</td>
</tr>
<tr>
<td>Kuwait</td>
<td>6,680</td>
<td>1,582</td>
<td>7.0</td>
<td>2,000</td>
</tr>
<tr>
<td>Oman</td>
<td>1,662</td>
<td>975</td>
<td>6.0</td>
<td>530</td>
</tr>
<tr>
<td>Qatar</td>
<td>1,900</td>
<td>1,300</td>
<td>7.0</td>
<td>6,200</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>20,300</td>
<td>15,900</td>
<td>7.5</td>
<td>58,100</td>
</tr>
<tr>
<td>UAE</td>
<td>6,400</td>
<td>4,500</td>
<td>8.0-10.0</td>
<td>4,700</td>
</tr>
<tr>
<td>GCC Total</td>
<td>38,142</td>
<td>23,957</td>
<td>-</td>
<td>72,536</td>
</tr>
<tr>
<td>ME Total*</td>
<td>138,780</td>
<td>77,217</td>
<td>-</td>
<td>144,200</td>
</tr>
</tbody>
</table>

Source: Adapted from *Middle East Economic Digest* Vol. 42, No. 5 p. 8
*Total requirements of all Middle Eastern States
Saudi Arabia's consumption of electricity per capita is among the highest in the world. Between 1975 to 1996, the generation capacity of electricity companies increased 16 times from 1,173 to 18,780 megawatts (MW). Yet this figure is still insufficient. The Kingdom's 25-Year Electricity Plan calls for capital investment of $117 billion to increase its generating capacity to 70,000 MW, the overwhelming majority of which will come from foreign direct investment. In order to facilitate this investment the government issued a ministerial ruling in August 1997 defining power generation as an industrial activity. This distinction enabled all subsequent investment into the power sector to accrue the benefits of the foreign investment code, including 10-year tax holidays, exemption from customs duties, and concessionary finance from the Saudi Industrial Development Fund.

Table 25: Saudi Arabia: Power Generation Demand Forecast (MW)

<table>
<thead>
<tr>
<th>Year</th>
<th>East</th>
<th>Central</th>
<th>West</th>
<th>South</th>
<th>North</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>6,248</td>
<td>5,272</td>
<td>6,120</td>
<td>1,444</td>
<td>788</td>
<td>19,753</td>
</tr>
<tr>
<td>2000</td>
<td>8,916</td>
<td>7,272</td>
<td>8,398</td>
<td>1,967</td>
<td>1,380</td>
<td>27,933</td>
</tr>
<tr>
<td>2005</td>
<td>10,474</td>
<td>9,008</td>
<td>10,554</td>
<td>2,702</td>
<td>1,967</td>
<td>34,704</td>
</tr>
<tr>
<td>2010</td>
<td>12,637</td>
<td>10,944</td>
<td>12,922</td>
<td>3,487</td>
<td>2,654</td>
<td>42,643</td>
</tr>
<tr>
<td>2015</td>
<td>14,856</td>
<td>12,989</td>
<td>15,507</td>
<td>4,454</td>
<td>3,454</td>
<td>51,260</td>
</tr>
<tr>
<td>2020</td>
<td>16,310</td>
<td>15,156</td>
<td>17,956</td>
<td>5,463</td>
<td>4,382</td>
<td>59,267</td>
</tr>
<tr>
<td>Average Growth Rate, %</td>
<td>3.9</td>
<td>4.3</td>
<td>4.4</td>
<td>6.5</td>
<td>7.1</td>
<td>4.5</td>
</tr>
</tbody>
</table>


Financing the need for increased power in the Kingdom has forced local power authorities to consider radical means of raising capital. The Sixth Development Plan pointed out that the private sector would be expected to increase its participation in

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80 United States-Saudi Arabian Business Council The Saudi Arabian Economy http://us-saudi-
financing, building and operating the electricity facilities. In the early 1990s the Saudi government contracted a number of consultancy firms to conduct research into the viability of alternative financing for public sector projects. Reports submitted by the Canadian consultancy Group INC Strategy and Development and White & Case and EMT Associates, both of the United States, advocated the benefits of a BOT approach. As early as 1993, plans were mooted for a new power station to be built utilising private sector finance. Three years later, in June 1996, the Saudi Consolidated Electric Company for the Western Region (Sceco-West) opened bidding for a 1,750 MW grassroots power station in Shuaiba. The desalination unit attached to the facility planned to produce 120 million gallons per day of water. Located 120 kilometres from Jeddah, the Shuaiba scheme was the first time in which foreign investors were allowed to invest directly in BOT projects. The Saudi government believed private investors would pay for the scheme with little or no cost and inconvenience to itself. However, events did not go as planned.

Following the 1996 request for tenders, five international consortia submitted bids. However, one-by-one, these bids were withdrawn as each consortium expressed doubts over existing tariff structures and whether the necessary legal and operating environment was in place. Over a three-year period, between 1996-1999, the Saudi government was forced to admit that, despite its political appeal, BOT was not a viable economic option. The failure of the Shuaiba scheme was to have important consequences.

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82 For a list of original bidders see: Butter, D. ‘How the Bidders Line Up’ Middle East Economic Digest 11 July, 1997 Vol. 41, No. 28 p. 3
for the way in which the government perceived the future of its loss-making electricity sector. It led to a radical rethink. Under the existing institutional framework, BOT was unlikely to succeed. If BOT was to work at all in the future, the electricity industry had to be “corporatised.”

In February 1999, the government announced a major overhaul of the electricity sector. Creating a central body – the Saudi Electricity Company – the 4 Scecos, together with 6 smaller regional operators, were combined to form the new company. The Saudi authorities aimed to cut costs, improve management and boost profits. The new company would be able to enter into agreements with private companies to provide it with private electricity under BOT contracts. The company also had $6,667 million of inherited liabilities subordinated with a long-term loan and a 25-year grace period. A new tariff structure was introduced which aimed to reflect the true cost of electricity provision. Heavy users of electricity (above 10,000 kWh a month), saw prices almost double, from 20 halalas/kWh to 38 halalas/kWh. Furthermore, the government sought to clarify existing investment laws. As James Gavin points out, the failure of Shuaiba encouraged ‘the government to amend its foreign capital investment regulations to make such proposals more attractive.’83 The government was wary of labelling the process “privatisation” and decided to maintain 85% of the company’s stock. Industry and Electricity Minister Hashem Yamani deliberately avoided the term privatisation in his announcement of the reforms, preferring instead to highlight the aims of ‘development,

83 Gavin, J. ‘The Giant Stirs’ p. 16 Middle East Economic Digest 3 December, 1999 Vol. 43, No. 48 pp. 7-20
diversification and job opportunities. The government continues to provide financial assistance, albeit on a smaller scale, to prevent immediate large-scale redundancies and to allow a gradual rise in electricity prices. However, the government has let it be known its intention to reduce its stock in the company in the future.

The creation of the Saudi Electricity Company had an immediate impact on investment attitudes towards the Kingdom’s power industry. As one Saudi analyst explained, “no financial organisation was prepared to even talk to the Scecos. Now, with the tariffs, they are viable.” Consolidation of the Scecos boosted the creditworthiness of the industry. By early 1999, the Al Rajhi Banking and Investment Corporation had arranged a Build, Transfer, Operate (BTO) agreement with Zurich-based ABB Asea Brown Boveri to build the $835 million Shuaiba power plant. The Saudi Electricity Company will take ownership of the plant when it is built and pay for it over 13 years in quarterly instalments. In addition, Japan’s Hitachi Nichimen Corporation won a $55 million contract to build a 380 km substation at the site. Since this announcement new BOT schemes have been added including a new 1,000 MW power plant for Shuqaiq in the southern region. An expansion project for the 1,800 MW PP-9 power station in Riyadh will be tendered under a BOT arrangement, as will the Saudi Petrochemical Company’s (Sadaf) implementation of a 200 MW generation unit at one of its Jubail plants. As Kemp concludes, ‘the creation of the Saudi Electricity Company seems set to bring several years of uncertainty to a close, heartening political investors in the Saudi

84 ‘Saudis to Privatise Electricity Sector’ Reuters Dubai 1 December, 1998
85 ‘Saudi Still Supports Power Firms’ Reuters Manama 2 December, 1998
86 Anon. Saudi analyst quoted in Kemp, P. ‘The Shape of Things to Come’ Middle East Economic Digest 19 March, 1999 Vol. 43, No. 11 pp. 2-3
power market... If the government is serious about attracting foreign capital, it will have to put the false start made with Shuaiba behind it and prove with its own actions, through the Saudi Electricity Company, that power can be made to pay.\textsuperscript{87}

Privatisation will likely occur in the future, once the new company is established, via a gradual sell-off of government-held shares. However, there are two observations that can be made. First, BOT was originally perceived by the Saudis as an alternative to a "conventional" privatisation of the power industry. However, despite the apparent political benefits on offer to the elite, there was no simple economic solution to an industry that had grown used to government largesse, debt and inefficiency. BOT was not, and is not, an economic or political panacea. Countertrade could not work within the existing system. Therefore, the government was forced to consider an overhaul of this important area of the rentier state. If the government wanted to take the benefits of BOT, it had to provide structural reform in return. This situation corresponds with the assumptions of Hypothesis I. Change was necessary but essentially reactionary. Second, there is still a role for BOT schemes in the future. Although corporatisation marks an important step on the road to possible privatisation, the government still intends to proceed with BOT as method of guiding the private sector in the direction of its development priorities. For the foreseeable future, BOT still has a political role to fulfil.

\textsuperscript{87} Kemp, P. 'Toughing It Out' p. 17 \textit{Middle East Economic Digest} 26 March, 1999 Vol. 43, No. 12 pp. 11-19
ii) BOT and Kuwait’s Construction Sector

Government largesse plays an important role in stimulating the rentier economy, creating a private sector that relies upon government contracts to maintain operations. The most obvious example of this is the construction industry. However, this reliance upon the state creates significant private sector problems when cut-backs are considered. If the government attempts to reduce its deficit by cutting back on public expenditure it risks sending the private sector into recession. Rentier governments require a solution to the following problem: how can the government continue to award construction contracts to the private sector for the provision of public goods without incurring additional expenditures? The answer appears to lie with Build, Operate and Transfer.

The rehabilitation of Kuwait City harbour-front under a BOT scheme represents what can be termed a “tertiary development.” It highlights that BOT can be applied to not only diverse schemes but financially large developments too. This scheme is possibly the most advanced of all the BOT projects, and shows that BOT programme are not only to be used for primary development purposes, but also modern service sector development. Divided into five separate phases, three of which are already complete, the Kuwait municipality has courted private investors to spend money in areas carefully prioritised by the authority. In September 1994, the National Real Estate Company (NREC) was awarded the contract for phase three of the project, known as Al Sharq. Under the arrangement NREC agreed to invest KD35 million over 25 years in the creation of restaurants, shops, cinemas, a marina and a market. The entire 28,800 sq. m site will then be handed back to the Kuwait Municipality after the lease expires. The
influx of private capital has an immediate impact on the local economy. The local construction industry benefits from project requirements in terms of the provision of equipment, construction materials, labour and expertise. For example, the NREC subcontracted out the building of the marina to the Local Consolidate Construction Company (Lonco) for KD5.4 million. In addition, the Local Ahmadia Contracting Trading Company was awarded three separate contracts totalling KD13.3 million. These projects show how private investment can be rapidly diffused throughout the economy. Al Sharq is currently implementing phases four and five of the project. Phase four, awarded to a consortium led by Kuwait’s sole commercial Islamic Bank, Kuwait Finance House, will extend the project down a 2.5 km stretch of the City coastline. Stage five, awarded to the local United Real Estate Company (UREC), will invest KD 50 million over a 24 year period (including a 4-year construction period) by the project is handed back to the Municipality. UREC will build a new mosque complex, government offices, commercial space and parking and recreational facilities.

The success of Al Sharq has led to the expansion of BOT to other large construction projects that, in the past, would have been funded entirely by the government. One such project is the multi-million dollar BOT scheme to redevelop Abdullah Al Ahmed Street in old downtown Kuwait City. This 100 hectare project will be carried out on three phases, the first involving the construction of a heritage village, refurbishment of old buildings, houses and commercial space. The second phase plans the construction of new public housing, thereby buttressing the Kuwait claim to be the “state of social care,” at a cost of $258.1 million. With over 50,000 applications for
housing pending, the government is keen to share this burden with the private sector.\(^8\) A third and final phase will create retail space and recreational facilities. In addition to maintenance of the social contract, the tacit agreement between business and government is also evident. The prime benefactors include four local businesses: the Kuwait Engineering Office (KEO); Salem Al Marzouk and Sabah Abi-Hanna; Jassim Qabazzard Engineering Consultants and Pan Arab Consulting Engineers (PACE). In a similar scheme to Al Sharq, a group of six local consortia are bidding to a 20-year concession to redevelop a 1 km stretch of coastline at Fahaheel.

BOT's application to the construction sector has been immense and reaches into diverse areas of the economy. The airline industry is currently benefiting from new infrastructure work at Kuwait International Airport. Local Kuwaiti consortium United Project Management has signed a $35.5 million, 20 year contract for the construction, maintenance and transfer of new facilities for the arrivals terminal. The largest construction project of all has yet to be implemented but has attracted enormous interest from overseas investors. Following a plan drawn up the Kuwait Institute for Scientific Research (KISR), the Ministry of Public Works (MPW) announced in 1998 plans to build a $350 million wastewater treatment plant at Sulaibiya under a BOT basis. The plant will have a capacity of at least 250,000 cubic metres a day and a reverse osmosis unit to produce non-drinkable water. The winning consortium will operate the plant for 30 years, charging the government 5 fils a kWh with a 3% compounded price increase.

\(^8\) Ash, T. 'Slow Progress on the Road to Reform' *Middle East Economic Digest* 23 February, 1996 Vol. 40, No. 8 pp. 7-18
iii) The Al Yamamah Offset Program

Hypothesis I has suggested that the implementation of countertrade is based on calculations of the elite to create and maintain support. Support from the people can be maintained by the welfare state. However, as some citizens are potentially more powerful than others, special mechanisms of support must be crafted, most notably for the business community. Whereas the Al Shuaiba BOT project demonstrates a means to support welfarism, the Al Yamamah Offset Program illustrates benefits that are exclusive to the business community. In September 1985, the United Kingdom and the Kingdom of Saudi Arabia signed an agreement to provide the Royal Saudi Air Force (RSAF) with British Aerospace-built Tornado, Hawk and PC-9 aircraft, together with associated weapons, equipment and support. Initially the agreement did not include an Offset obligation but this was subsequently renegotiated in late 1987 with a memorandum of understanding that provided for a loosely framed Offset agreement. In July 1988 the Al Yamamah project was expanded. Britain would also supply Saudi Arabia with additional aircraft, an air base construction program and naval vessels. 25% of the value of the contract was to be reinvested back into the Kingdom to form new joint ventures with the business community. In turn, the Saudi government wanted Offset to expand commercial activity in the economy away from oil through these ventures. Aided by technology transfers, licensing and training, the private sector would become less reliant upon government subsidies. The Al Yamamah program stipulated that obligations could only be discharged by the addition of new industrial or commercial enterprises or the addition to existing facilities, involve private sector companies and meet one or more of the following criteria:
• Involved a transfer of technology through research, development, manufacture or production
• Make good use of Saudi natural resources
• Development of Saudi technical, professional and managerial staff
• Fit in well with exiting or planned industrial ventures
• Manufacture products that will substitute for Saudi imports
• Manufacture goods for export potential
• Establishment of service industries to develop Saudi economic infrastructure
• Maintain and enhance the UK's contribution of the development of Saudi industry

So far just 8% of the Al Yamamah Offset Program obligation has been fully discharged. Nevertheless, the Program has produced some impressive examples of economic diversification (see Tables 16-19, Appendix to Chapter Two). For example, BAe was able to persuade Glaxo Welcome to enter into a joint venture with Saudi merchants under an umbrella company called Saudi Import Co. Investing SR 98 million ($26.5 million), Glaxo Welcome built an advanced pharmaceutical plant in Jeddah to produce a wide range of products including Zantac, Servant (asthma) and Zofran (prevents nausea). This plant has subsequently produced a number of benefits to the Saudi economy. Not only does it reduce the importation of medicines into the country, the plant exports its products to other Gulf states. Similarly, the establishment of the United Sugar Company is an exemplar of the effectiveness of Offset when the conditions are right. The British Offset Office was able to bring together a group of powerful

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89 The Economic Bureau (November 1998) *op cit.* p. 16
merchant families involved in sugar trading. It advised them to form a consortium and enter into a partnership with Tate and Lyle of the UK and a local company, Savola Co. The merchants were given a 34% stake the refinery, which cost SR 600 million to build. With a capacity of 500,000 tons of white sugar, one fifth of the sugar produced is earmarked for export markets. In November 1998, BAe's eighth Offset project, Rezayat-Flover, was formed in Al-Khobar between the merchant trading house Rezayat Trading Company (a member of the Alireza Group) and the UK's Flover. The company specialises in the repair and calibration of instruments used in pharmaceutical, oil, petrochemical and energy industries – a local market worth $3,000 million a year. Similar projects to incorporate local businesses into Offset ventures have resulted in diverse, profit making ventures in aromatic, chemical and cumene production and in the remanufacture of technology. For the powerful merchant families in Saudi Arabia and Kuwait, Offset is a potentially lucrative means of diversifying the economy.
VIII. Concluding Remarks

The Gulf elite has entertained countertrade because of the adverse economic conditions it has faced since the mid-1980s. Chapter three has provided evidence that countertrade was instituted as a mechanism to shore up the support base of the rentier elite, both generally (through the welfare state) and specifically (the business community). This was necessary due to prevailing fiscal crisis of the 1980s and 1990s. The ability of the Saudi and Kuwaiti governments to maintain patrimonial redistribution networks in the light of adverse fluctuations in the global price of oil had been undermined. There was no longer enough rent to successfully “buy off” an ever larger group of domestic constituents. Had the oil boom continued there would have been little incentive to continually develop and apply Offset and BOT analogues. This suggests the application of both schemes had a ‘reactionary’ streak about them. Governments did not pre-empt the adverse conditions but reacted to them.

Hypothesis I clearly illustrates the difficult political questions that must be considered during periods of economic austerity. It shows that economic policies must be crafted to suit specific political circumstances. Any attempt to fit the circumstances into the framework of an imported economic philosophy would inevitably fail. For example, more rapid and extensive divestiture of state-held assets would appear to bring substantial economic opportunities – greater investment flows, expansion of the private sector, new employment opportunities etc. This has certainly been the case in the United Kingdom – the country which first implemented a large-scale privatisation of state assets. Yet the experience of the United Kingdom is not necessarily replicated elsewhere. In a
rentier state, there is no guarantee that the current elite would have survived to see these long-term benefits. In the short-term, the “costs” of a rapid movement from rentierism towards the unencumbered operations of the market would probably cause widespread political unrest. The political acquiescence purchased through rent redistribution would not hold if the reallocation of funds dried up. Unlike “production” states, the rentier state does not possess the means to allow significant political unrest to dissipate within the existing system. The response of the elite to unrest would either be abdication of power through a process of democratisation or subjugation of political means by coercion. For the rentier elite, neither “solution” is welcome. It wants to maintain the political status quo. Therefore, it is the perceived probability of structural adjustment unrest that has rendered the privatisation process a long and laborious process.

What of the differences between the Saudi and Kuwaiti experience of countertrade? At the time of the Saudi implementation of Offset, countertrade appeared to offer the elite more political benefits than the sale of government assets through a conventional privatisation process. As the CEO of one Gulf company argues, “countertrade may not be economically efficient but it is politically efficient.”90 The application of Offset has been a long and difficult process, particularly as those merchants who were initially singled out to participate resisted government attempts to impose countertrade on them (see Hypothesis II, Chapter Four). Activity within the Saudi Offset Program intensified as the oil bust period continued. Aware of the political difficulties in pursuing structural adjustment, the government has sought to use Offset as

90 Interview with John Wakefield, Chief Executive Officer, Gulf Insurance Company Kuwait City, 12 November, 1999
a means to channel private money for its own political purposes. Yet Countertrade is not
a simple alternative to privatisation. As the example of the Saudi electricity sector
demonstrated, the application of BOT ventures could not proceed until far-reaching
reforms were implemented. These reforms took the Saudi electricity sector further down
the road to privatisation than was originally intended when BOT solutions were initially
conceived. For countertrade to work, reforms in the nature of redistribution had to take
place. The provision of free electricity as part of the welfare state had to end. The
electricity industry itself could no longer rely on rent handouts. As evidence later in this
thesis shows, although Hypothesis I correctly explains the initial implementation of
countertrade, it was the experience of countertrade, particularly Offset, that gave both
governments the confidence to experiment with privatisation.

The situation differed slightly in Kuwait, where the Offset Program was instituted
some 10 years later. With the benefit of observing the Saudi experience, the Kuwaitis
tailored their Offset program to counter the prevailing economic circumstances and
towards longer-term economic objectives. As Hypothesis III will show, privatisation and
the Kuwaiti Offset Program are particularly complementary to each other. Because of the
Kuwaiti experience, it is harder to make the argument that the Gulf elite perceives
countertrade as a potential end-game – a political tool to preclude the advance of greater
economic liberalisation and the retreat of the state. Since countertrade has been
introduced, the incidence of privatisation has also increased, albeit at a slow pace.
Despite evidence that the Saudi and Kuwaiti governments sought to incorporate the private sector into its countertrade schemes, individual projects have not been implemented fast enough nor on a large enough basis to act as an effective incorporative mechanism. The Al Yamamah Offset project has produced some notable successes in the incorporation of merchant groups. However, from a quantitative perspective, countertrade has been a disappointment. Not enough projects are up and running. This does not negate countertrade as a deliberate political incorporative mechanism. It merely illustrates its relative failure as one. Both the Kuwaiti and Saudi governments "institutionally designed" their BOT and Offset projects so that significant business opportunities could be created for local businessmen. Unfortunately, despite some success stories, countertrade projects remain few on the ground.
Chapter Four

Hypothesis II: Rentierism Challenged from Below?

Introduction

This chapter investigates the plurality of economic decision making inside the rentier state. It focuses on the private sectors of Kuwait and Saudi Arabia and the extent to which they identify and obtain economic concessions from the rentier state. By implementing Hypothesis II, this chapter will investigate the assertion that rentierism is being challenged from below - a force for change not accounted for by the original rentier state model. This is done by first introducing the assumptions of Hypothesis II and by scrutinising the conventionally held relationship between the private sector and the rentier state. Additional analysis is devoted to explaining the importance of the merchant business class in both countries and how commercial influence is channelled. Hypothesis II will then explain why the Kuwaiti private sector was the main instigator in its country’s Offset plan, while the Saudi private sector was initially reluctant to engage in the Kingdom’s program. With regard to BOT, the chapter shows that in both countries the private sector promoted the implementation of these schemes. However, a final section casts a critical eye over the private sector’s advocacy of countertrade – it has not proved to be a panacea. Although some sectors of the economy have benefited from countertrade (e.g. the application of Offset to advance education and training), other sectors have been disappointed with the results. The reality of countertrade does not appear to match initial private sector optimism.
I. Hypothesis II

Hypothesis II asks whether rentierism is being challenged from below. This chapter will focus upon the private sector - a collection of vested business interests inside Kuwait and Saudi Arabia – as an assertive economic group, eager to move beyond the conventional clientalist alliance, which has traditionally characterised state-business relationships inside the rentier state. Rentier theorists assume that the private sector is a passive entity, reliant upon the sponsorship of the state. The private sector is therefore disengaged from politics. However, Hypothesis II questions this assertion. For example, in Kuwait it appears that the private sector is demanding greater access to the decision-making apparatus that directly affects its interests. Crucially, it is demanding access to resources that the conventional rentier state is no longer able to provide. If the private sector is demanding significant change to the redistributive relationship between business and state, this would have important implications for the rentier model. It would suggest a coalescing of economic interests by the business elite within the rentier state and would also imply the rentier state model is developing in a manner not accounted for by earlier research.

Hypothesis II argues economic development does not merely ‘happen’ but is determined and conditioned by agents who seek to gain from the development process. This assertion differs from what is anticipated by the rentier model, which ultimately assumes that domestic groups are passive agents and loosely organised. Since they are dependent upon the allocation state they will remain a weak political force. As Al Hegelan and Palmer illustrate, the rentier state eliminates the influence of the private
sector when decisions are made about the allocation of funds. Similarly, Andrew Hess argues that 'the private sector in the Gulf has neither the power nor the inclination to force major changes in the non-democratic political regimes and state dominated economic systems.' The power of the rentier state impedes pluralistic politics. "Influence" can only be transmitted through quiescence. Hootan Shambayati asserts that 'under rentier conditions, loyalty to the system is the most rational course of action for entrepreneurs.' The phenomenon is not restricted to the rentier states of the Gulf. Peter Lewis's analysis of Nigeria shows how the dispensation of largesse has secured private sector compliance and consolidated the authority of the ruling elite. Most commentators therefore argue that change in the direction of economic policy is best explained by fiscal crises as demonstrated by Hypothesis I. Initiative from domestic constituents is extremely rare. For example, Ayubi argues that 'if the private sector is gaining it is not because of its initiative, drive and organisation, nor is it because the ruling elites have decided sincerely to hand the economy over to it. Rather, it is mainly because the state can no longer, given its chronic "fiscal crisis," continue with its etatiste and its welfarist policies at the same time.'

However, Hypothesis II suggests that far from being a weak and placated group, there is evidence, especially in Kuwait, that the private sector has taken the initiative to influence economic decision-making. These demands are subtle in nature and take place through "back door channels" in the rentier bureaucracy. To suggest that the Saudi and

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2 Hess, A. C. *op cit.* p. 107
3 Shambayati, H. *op cit.* p. 309
Kuwaiti private sectors are demanding a policy such as "privatisation" would be too crude a statement. However, private sector demands for the application of countertrade highlights shrewd changes to the traditional corporatist arrangement. Crucial to explaining this change is the notion of the "new middle class" – an assorted group of individuals broadly defined by income level. Generally, the term refers to the growth of the business and bureaucratic elite, as well as the development of the educated professional classes (teachers, doctors etc.). Yet as Mary Ann Tetreault points out, when we talk about the "middle class" in the Gulf region, we are in fact referring to the "modern" individual not a Marxist definition based on relationships derived from modes of production. She instead prefers to concentrate on the "new man." "Modern persons are individualistic, inner-directed, competitive and oriented toward personal achievement." Using such a definition conveys modernity 'without requiring resolution of definitional conflicts and categorical exclusions associated with the term class." Such a clarification is crucial inside the Gulf state. As Tetreault argues:

The new man in Kuwait sees himself as constructing personal and professional identities from his own efforts rather than receiving them as a consequence of family membership. In this sense, a merchant or a tribe member also may be a new man (another reason why "middle class" is such a confusing designation), although others may have difficulty seeing such persons as individuals independent of their family backgrounds.

Modernisation theory predicts the rise of the modern individual. Crucially, it asserts that once this class (i.e. a collection of motivated individuals) grows in

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4 Lewis, P. *op cit.*, p. 441
membership, it tends to press for continued advancement beyond the point intended by rulers who initially encouraged the modernisation process. This does not necessarily lead to political instability as some modernisation theorists argue. A strong security apparatus and continued oil redistribution preclude this in both rentier case studies. Yet it does appear to be the case that a new business elite has demands above and beyond those anticipated by the rentier elite. In Kuwait, demands for changes to economic decision-making do appear to be ‘interest based’ from within an affluent and increasingly confident business class. As moves are made to reduce reliance upon public expenditure, thereby boosting the role of the private sector within the economy, the business elite has become more assertive in its demands. A businessman inside Kuwait and Saudi Arabia can still retain strong tribal, familial or religious memberships. Yet it is his perceived affiliation to the modern “middle class” that is important. It is the extent to which lobby efforts reflect self interested business concerns above other affiliations that is important. If we are able to uncover evidence of this, we will be better placed to understand why and how economic development is occurring than the existing rentier model.

II. The Private Sector and the Rentier State

The private sector inside the rentier state is dependent upon government expenditure. Very few sectors of the economy can be classified as “independent” from the state. Most private companies (e.g. construction firms) are reliant upon government contracts to sustain operations. Even advanced sectors of the economy, such as banking

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10 Huntington, S. P. *Political Order in Changing Societies* (New Haven: Yale University Press, 1968)
and finance, are indirectly dependent upon the government to maintain "social subsidies." Their profitability is dependent on Gulf citizens retaining sufficient disposable income to spend and invest in the economy. Rentier states promote the extent of GDP that is accounted for by the private sector as a measure of diversification and "sophisticated" development, (petroleum accounts for 50% of GDP in Kuwait and less than 40% in Saudi Arabia\(^\text{11}\)). In fact the strength of the private sector reflects the extent of oil rent redistributed by the state. This puts the government in a strong position with regard to business interests. Rentier theorists point out that by exercising such influence in the economy, the government can reward or discipline the private sector in return for the support, or opposition, that it receives. "The ruling elite can privilege certain sectors, and certain companies within sectors, through letting of state contracts, control over access to capital, policies on the import of labour, and the writing of government regulations...It is impossible to succeed in business without the tacit, if not active, approval of the political elite."\(^\text{12}\) Whereas production states represent business interests via the institutions of government, in allocation states, it is business that often reflects the interests of government.

With the government wielding so much power, we should not expect to find evidence of private sector assertiveness inside Kuwait or Saudi Arabia. Wealth alone

\(^{11}\) Figures from Central Intelligence Agency *The World Factbook 1996* According to one Saudi newspaper, the percentage of oil contribution to GDP has fallen from 55\% to 34\% over the past 20 years. "Editorial: Diversifying Sources of Income" *Al Dammam Al Yawm* in Arabic 12 May, 1998, p. 7 *FBIS-NES-98-137*

\(^{12}\) Gause, F. G. *op cit.*, pp. 54-58
should be enough to depoliticise the business sector.\textsuperscript{13} According to Noreng, 'the parasitic private sector, with its general inability to produce a value added without government assistance and protection, discourages political opportunities and even criticism.'\textsuperscript{14} Alain Gresh argues that 'the local bourgeoisie, weak and dependent on the rentier state and the royal family, has total freedom when it comes to commerce and banking but does not constitute a class which can demand any substantial change.'\textsuperscript{15} However, as the following chapter shows, the private sector has become more assertive. There are two major reasons for this. First, declining levels of rent has undermined the ability of the rentier state to pacify the business community. In recent years, the level of contracts awarded by the state has declined as it no longer has sufficient reserves to implement its development objectives. This fact is still consistent with the rentier state model. If state largesse depoliticises the private sector, state austerity will surely result in re-politicisation. Early rentier theorists never commented upon the potential for "re-politicisation." The implicit assumption was that politics was "shut down" for good. Yet we are witnessing re-politicisation \textit{within} a rentier context. Although Kuwait and Saudi Arabia are still rentier states, fiscal crises increase government reliance on the private sector to attain its development goals. According to Crown Prince Abdullah of Saudi Arabia:

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\textsuperscript{13} For analysis of this in Abu Dhabi and Dubai, see: Van Der Meulen, H. \textit{The Role of Tribal and Kinship Ties in the Politics of the United Arab Emirates} Ph.D. Thesis submitted to the Fletcher School of Law and Diplomacy May 1997 (Ann Arbor: UMI, 1998), Chpts. 3 & 4 \\
\textsuperscript{14} Noreng, O. \textit{Oil and Islam: Social and Economic Issues} (Chichester, West Sussex: John Wiley & Sons Ltd., 1997) \\
\textsuperscript{15} Gresh, A. 'The Most Obscure Dictatorship' p. 4 \textit{Middle East Report} November-December 1995 No. 197 Vol. 25, No. 6 pp. 2-4 & p. 32
\end{flushleft}
The growth of our economy requires the creation of a suitable environment for the private sector so as to enable it to positively contribute to the process of economic development, investment and the management of the investment projects.\textsuperscript{16}

Change is afoot in the rentier relationship between state and business. As Henry Azzam, Chief Economist at the National Commercial Bank (NCB) in Riyadh argues, “as the private sector becomes more mature, it is no longer looking to the government to hold its hand.”\textsuperscript{17} This fact does not completely invalidate early rentier research but it does show government autonomy changes in periods of boom and bust. However, there is a second issue that is important to consider. Quite simply, wealth could not purchase everything that the business community of Kuwait, and to a lesser extent, Saudi Arabia required. If spending alone was enough, Saudi Arabia should have solved its development problems. According to the Ministry of Planning, the Kingdom spent 4,200 billion riyals (700 billion pounds) between 1970 and 1997 to implement its economic and social development plans.\textsuperscript{18} Yet what is needed is quality rather than quantity. In Kuwait, the private sector demanded change. A combination of an inadequately trained local workforce, the need to obtain the latest technology from abroad and the desire to establish joint ventures with overseas companies to exploit global investment flows and potential markets, could not be supplied by the traditional rentier state. Hence, one of the fundamental features of the renter state model, that state largesse nullifies the demands of the business elite, requires clarification. There is a “bottom up” challenge to the rentier state. This suggests a greater degree of complexity to the traditional conception of

\textsuperscript{16} 'Abdullah Urges SEC to Help Speed Up Economic Reforms' \textit{Saudi Gazette} 1 November, 1999
\textsuperscript{17} Quoted in Cooper, J. p. 38 'Special Report: Saudi Arabia' \textit{Middle East Economic Digest} 5 April, 1996 Vol. 40, No. 14 pp. 27-65
\textsuperscript{18} \textit{SPA News Agency}, Riyadh, in Arabic 0642 GMT 21 September, 1997 \textit{SWB} 30 September, 1997
rentierism. The private sector is not demanding greater autonomy from the state (if it did, this would represent a fundamental break with rentierism), but rather it is demanding a different type of redistribution. The problem for the rentier governments is that traditional redistribution policies are the cause of the new demands. State largesse has created specific problems (e.g. the rentier mentality, limited foreign direct investment, the absence of an indigenous technological base etc.), that the private sector wants the state to remedy. This shift is important to the way we think about the private sector in rentier states. Although the bottom-up challenge does not render the rentierism obsolete, it does have important implications for the simplistic statement that political demands can be "bought off." As the experience of Kuwait shows, simple rent redistribution is not enough. The rentier elite must find and use additional economic strategies that can compensate for the deleterious effects of traditional rent redistribution. Only by doing this can the ruling families continue to pacify the interests of the business community, whose support is vital to the maintenance of power.

III. The Influence of the Merchant Class

The merchant classes have always enjoyed wealth and influence in the Arabian peninsula. Prior to the discovery of oil, the rulers of Saudi Arabia and Kuwait primarily relied upon a combination of resources extracted from local trading houses and merchant guilds. Unlike Kuwait, the origins of the merchant elite in Saudi Arabia derived from a specific geographical area – the Hijaz. Between the 1920s and the early 1950s, Hijzai merchants provided the fledgling Saudi state with its financial resources and its administrative capabilities. This gave Hijazi merchant families an influential role in
economic affairs, especially after the Al Saud co-opted them into the first *Majlis Al Shura* or consultative council. The merchants were able to protect their monopoly rights and resist greater efforts by Ibn Saud to tax them further. However, a combination of indirect taxation, greater levels of oil rent and a process of state centralisation undermined Hijazi independence. The Hijazi elite encouraged the gradual process of institutional expansion and centralisation, willingly eliminating the regional merchant guilds (monopolies) in return for access to national decision-making influence. As oil revenues were transforming and unifying the Saudi state, mutual opportunities between merchants and the government began to develop. ‘The expanding national economy, government infrastructure and increasingly stable and legal environment, and the state’s summary treatment of both labour and Pan Arab republicans had created an ideal environment for investors.’19 Merchants grew increasingly wealthy. Yet it was the unified state that was providing the opportunities. A new form of corporatism had developed. Aspiring commercial and industrial elites profited from the redistribution of oil receipts, sponsorship laws with foreign contractors and even ambassadorships. Government-funded Chambers of Commerce were established. The merchant elite, increasingly reliant on the awarding of government contracts, forced the government to require all potential contractors to join the Chambers of Commerce. Unwittingly, the Hijazi merchants were successfully incorporated into the state. ‘Previously independent business communities were utterly transformed into a dependent corporate group with strong institutional ties to the economic ministries.’20 The oil boom of the 1970s was to deepen and extend this corporatism further.

The oil boom fundamentally altered the relationship between business interests and the state. Within a decade, the Hijazi commercial elite was undermined and subsumed by the ascent of a government-created Najdi merchant elite. By investing heavily in infrastructure and construction projects in the Najd region, Najdi businessmen seized the opportunity to expand into the boom sectors of the economy. By contrast, the Hijazi merchants who historically specialised in trade, hesitated and did not diversify their interests in sufficient numbers. As the oil boom intensified, many Hijazi merchants preferred the easy earnings in the retail sector while others concentrated on foreign investments. By a variety of allocation methods (subsidies, loans, grants as well as exclusive agencies, sponsorship clauses, contracts and the establishment of more regional-based chambers of commerce) the Saudi government presided over a decline in the traditional commercial elite and the ascendance of a new corporatist business class. With a preponderance of Najdis in the Kingdom’s bureaucracy, strong kinship-based relationships developed between the state and private sector and a ‘new middle class’ developed.

Although the Al Saud continue to derive support from the Najdi business/bureaucracy relationship, the end of the oil boom has created resentment among the merchant class. This largely derives from the fact that, unlike Kuwait, there is little demarcation between the ruling family, the state and the economy. As the ruling family has grown, so their business interests have eaten into the commercial sector of the state, at the expense of the merchants. Whereas oil rents in the past were sufficient to keep the Al Saud out of the business sector, diminishing amounts of redistributed rent has forced

members of the ruling family to compete against the merchants for contracts. As members of the ruling family have greater access to the informal decision making institutions of the state (i.e. the immediate family of King Fahd) so resentment as risen among the excluded merchants. As King Abdulaziz used to tell his children, "There are two things that do not mix. Running a government and making money. Do not compete with the merchants and they will not compete with you."\textsuperscript{22} Unfortunately, this advice has not been heeded. For example, King Fahd's son, Mohammed, has frequently benefited from the award of government contracts, one of which – the Philips-Ericsson telecommunications award – paid him $500 million in fees.\textsuperscript{23} The merchant classes want access to decision making to counteract the monopoly of trade, and perceived corruption, enjoyed by members of the Al Saud. With fewer government contracts on offer, the fiscally austere environment has 'increased the businessmen's awareness of their collective interests in relation to other actors such as labour, foreign companies, consumers and the government.'\textsuperscript{24}

The situation in Kuwait is somewhat different. Informal rules developed between the ruling Al Sabah family and the merchant classes after the discovery of oil. In return for renouncing their participation in politics, the merchants were able to negotiate \textit{de facto} control over the commercial sector of the economy. The \textit{Asil}, an elite group of merchant families, was able to dominate business within the Kuwaiti economy. 'They were able to do this because of the nuisance value they provided. Simply, it was cheaper

\textsuperscript{23} Wilson, P. W. \& Graham, D. F. \textit{op cit.}, p. 61
\textsuperscript{24} Chaudhry, K. A. (1997) \textit{op cit.}, p. 290
for the government to buy them out than to drive them out.\textsuperscript{25} Historically, the merchants held a powerful position in Kuwaiti society. According to one Kuwaiti academic 'they were the basis of civil society,'\textsuperscript{26} establishing schools, libraries, the press, and overseas trading links. Although the ruling family did possess a degree of autonomy from this class (from revenues provided by the British after the treaty of 1899), revenues from "cliency" were not sufficient to resist merchant demands for the establishment of the first consultative council in the 1930s. As the government relied upon the tax revenues derived from this class, it had little alternative but to cede to merchant demands. The discovery of oil radically altered this arrangement. 'Old alliances, forged in scarcity, did not hold up in an environment of abundance.'\textsuperscript{27} The government was no longer reliant upon British disbursements or merchant taxation. However, during the early days of oil, the merchants were the one group in Kuwaiti society that had the potential to successfully organise political opposition to the ruling family. In response, the Al Sabah instituted a policy of rent redistribution, which was to force the merchants into a position of reliance. During the second half of the twentieth century businesses expanded via the reallocation of revenues. For example, in the 1950s and 1960s the government instigated a policy of land acquisition. Land in downtown Kuwait City was purchased by the state from the merchants at inflated prices for "development purposes." Most of the land was then resold to the merchants at a lower price. In addition, new commercial laws were crafted which guaranteed merchants access to wealth.\textsuperscript{28} Despite the inefficiencies of such a system, it served the Al Sabah well. As Crystal argues, '...the merchants renounced their

\textsuperscript{25} Crystal, J. \textit{Kuwait: The Transformation of an Oil State} (Boulder, CO: Westview Press, 1992), p. 74
\textsuperscript{26} Ghabra, S. 'Kuwait and the Dynamics of Socio-Economic Change' \textit{Middle East Journal} Vol. 51, No. 3 Summer 1997 pp. 358-372
\textsuperscript{27} Crystal, J. (1995) \textit{op cit.}. p. 7
historical claim to participate in decision-making. In exchange, the rulers guaranteed them a large share of the oil revenues. It is worth noting, however, that the Al Sabah family has occasionally drawn individuals from merchant families to fill cabinet positions on an *ad hoc* basis. The pacified nature of the merchants was aptly demonstrated during the height of the oil boom when they failed to raise any protest at the suspension of the Kuwaiti parliament on 16 August, 1976. In fact, during the oil boom the merchants regarded parliament as a potential threat to the privileged position the rentier state had afforded them. Proposed legislation on regulating banking and investments proved particularly unpopular among Kuwaiti businessmen.

Unlike Saudi Arabia, where members of the royal family have a significant presence in the economy, in Kuwait the ruling family is notable by its absence. For example, few Al Sabahs belong to the Chamber of Commerce or on corporate boards. Most family members prefer to invest abroad although there is recent evidence that the family now co-opts younger merchant allies to front domestic investment companies for the Al Sabah. For much of Kuwait's post-oil discovery period the merchants have cultivated a strong presence in the economy but developed fewer political links than could have otherwise have been expected. The merchant class has retained a sense of cohesion by cultural practices such as intermarriage and informal business and social debates (the *diwaniyyah*). They have also been boosted by the growth of a new

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28 For example the Commercial Companies Law of 1960 required 51% company ownership by Kuwaitis.
30 Research conducted by Assiri and Al Mosoufi in the 1980s showed that since 1962, just over one-fifth of the cabinet posts had been awarded to members of the eight families that are collectively known as the Asil. These families wield considerable power in the commercial world (the Al Sager, Al Nisf, Al Ghanim, Al Hamal, Al Mordhaf, Al Khalid, Al Khorafi and Al Mazork). See Assiri, A. & Al Mosoufi, K. 'Kuwaiti's Political Elite: The Cabinet' *Middle East Journal* Vol. 42, No. 1 Winter 1988 pp. 48-58
commercial elite that benefited from rent redistribution and the rise in domestic demand since the 1960s. For most of its recent history, Kuwait has possessed a potentially powerful and cohesive “political class” which has chosen not to engage in politics. However, since the end of the oil boom and particularly since the Gulf War, the ability of the ruling family to uphold the tacit agreement with the merchants has declined. Despite efforts by the Amir to placate his traditional supporters in the post-war era, the government no longer possessed the necessary revenue to appease everyone. More recently, the ruling family has begun to forge links into the commercial sector. As Jill Crystal observes, tension is emerging as the ruling families and their allies renege on the original agreement with the merchants. This has resulted in a gradual return to political life, with merchants standing or supporting candidates in the reconstituted National Assembly – a stark reversal of the situation twenty years earlier. Modernisers, particularly those of the younger commercial elite, have become increasingly critical of the traditional political and social systems. There is a “generational shift” among the merchant classes as the young feel little allegiance to the original bargain. It is therefore increasingly important for the ruling family to look for additional ways in which to redistribute wealth. As Hypothesis I demonstrated, countertrade, particularly Offset, was institutionally designed to buttress the original bargain between the interests of the expanding business community and those of the ruling family. Hypothesis II suggests they had little alternative. The application of countertrade was the result of private sector demands for access to specific business opportunities. Using well-established kinship

31 Despite the country’s budgetary restraints, the post-war government spent heavily to pay off consumer loans, boost salaries and increase subsidies to assure its traditional supporters. This led to a $80 billion withdrawal from the country’s portfolio of investments abroad. Figure from Reuters ‘Kuwait Foreign Investment Body Revives’ Kuwait City, September 15, 1999
ties to the bureaucracy, the private sector in Kuwait demanded, and won, an additional development policy that took in their concerns regarding training, technology and finance.

IV. The Private Sector in Saudi Arabia

The private sector inside Saudi Arabia can be categorised into three major components. Firstly, as the table below demonstrates, there are commercial establishments registered in the Commercial Registrar totalling some 391,000 companies. Secondly, there are retail outlets and small service facilities licensed by various municipalities numbering 134,000 units by the end of 1993. Finally, agricultural holdings and related production units employ an estimated 377,000 farmers and agricultural workers.34

Table 26: Saudi Registered Private Companies and Establishments: 1979-1994

<table>
<thead>
<tr>
<th>Regions</th>
<th>1979</th>
<th>1985</th>
<th>1990</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central</td>
<td>34,963</td>
<td>56,471</td>
<td>76,989</td>
<td>130,761</td>
</tr>
<tr>
<td>Eastern</td>
<td>10,182</td>
<td>27,430</td>
<td>38,952</td>
<td>58,595</td>
</tr>
<tr>
<td>Northern</td>
<td>9,492</td>
<td>18,541</td>
<td>25,101</td>
<td>36,935</td>
</tr>
<tr>
<td>Western</td>
<td>20,271</td>
<td>62,417</td>
<td>88,600</td>
<td>135,972</td>
</tr>
<tr>
<td>Southern</td>
<td>3,862</td>
<td>12,620</td>
<td>18,995</td>
<td>29,304</td>
</tr>
<tr>
<td>Total</td>
<td>78,770</td>
<td>177,479</td>
<td>248,637</td>
<td>391,567</td>
</tr>
</tbody>
</table>

Source: Kingdom of Saudi Arabia, Ministry of Planning *Sixth Development Plan 1995-2000 AD* p. 148

The Saudi private sector has grown considerably. As the table below shows, its contribution to GDP in 1970 was just 21%. Twenty-five years later this figure has risen

33 Ghabra, S. *op cit.* p. 362
34 Figures from Kingdom of Saudi Arabia, Ministry of Planning (1995) *op cit.* p. 147
to 45% of total income generated and 46.7% by 1997. Capital investments have risen significantly and the number of Saudis employed by private companies has grown accordingly.

Table 27: Major Indicators of Saudi Private Sector Development: 1970-1995

<table>
<thead>
<tr>
<th></th>
<th>1970</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution to GDP (%)</td>
<td>21.0</td>
<td>45.0</td>
</tr>
<tr>
<td>Invested Capital (SR bn)</td>
<td>7.0</td>
<td>108.7</td>
</tr>
<tr>
<td>Contribution to Fixed Capital Formation (%)</td>
<td>34.0</td>
<td>67.0</td>
</tr>
<tr>
<td>Employment in the Private Sector (million)</td>
<td>1.7</td>
<td>6.0</td>
</tr>
</tbody>
</table>


The Saudi Association of Chambers of Commerce formally represents the private sector. Saudi Arabia possesses 22 regional chambers of commerce co-ordinated by a central body – the Saudi Council of the Chamber of Commerce and Industry. The oldest in Jeddah was established in 1944 to protect Hijazi merchant interests. During the oil boom the Al Saud used the Chambers to formally integrate the interests of the rising Najdi business elite with those of the ruling family. Subsidies were increased to all regions with the Riyadh Chambers of Commerce as the primary benefactor. New Najd-based Chambers were opened in Mazam’a and Qasim. Although sometimes critical of policies in specific economic sectors, the Chambers of Commerce, dominated by the rent-seeking Nadjis became staunch allies of the Al Saud. Although the growth of the Chambers increased merchant influence, this influence was institutionalised within, and not independent from, the state.

35 *Kingdom of Saudi Arabia Radio*, Riyadh, in Arabic 1630 GMT 22 November, 1998 *SWB* 1 December,
The end of the oil boom placed strain on this relationship. In 1988, the government attempted to implement a series of austerity measures to counter the devastating effects of the oil collapse. To put this collapse in perspective, Saudi Arabia generated $110 billion of rent in 1981. In 1986, this figure had fallen to just $17 billion. In response, the government proposed a series of subsidy cuts, labour market regulations and the imposition of income taxes. However, within three days, the government was forced to rescind these measures. The reason, as Chaudhry illustrates, was a combination of organisational weakness and political resistance. The Saudi state's extractive capacities had withered during the oil boom – it had no effective bureaucracy to return to. More importantly, the Najdi business class and the bureaucratic elite were linked by kinship and economic ties. The Saudi private sector used these patronage relationships to block implementation of the proposed measures. The government, subject to intense lobbying, was persuaded against its proposed course of action.

More recently, the relationship between the private sector and the government has changed still further. Instead of taking responsibility for absorbing the Kingdom's wealth, the private sector is now expected to generate it. King Fahd has encouraged the private sector to engage more fully in the development process in order to 'underpin the policy that stresses a speedy privatisation process.' This is slowly, but surely, pulling apart the clientalist bond that has characterised government-business relations since the oil boom. Two broad commentaries can be made. First, as the amount of redistributed

1997
Rent has declined, the Al Saud fund an ever smaller number of business elites. Many businesses were bankrupted by the depth of the post-1986 recessions and bitterness has been directed toward the royal family. Second, as the private sector slowly, but surely, begins to engage in business activities that are free from rent redistribution, the ability of the royal family to co-opt it becomes more difficult. The merchant elite is beginning to look seriously at prospects with the international business community. For an increasing number of entrepreneurs, the opportunities of the global market place look more appealing than the redistribution of ever-smaller amounts of rent.

V. The Private Sector in Kuwait

The structure of the business sector in Kuwait can be broadly classified into three main sectors; public, private and joint companies. In 1993 there were 31,739 establishments in Kuwait, the majority being privately owned. Yet, with access to the redistribution of oil rents and subsidised goods and services, the private sector has underperformed for many decades. By 1989 only 27% of total gross value was generated by private companies. Once again it was the public sector that generated the majority of GDP. In 1982 a significant event occurred that was to devastate the private sector, forcing the government to come to aid of the business community. The Kuwait Stock Market crash, the result of an unsustainable speculative bubble, saw many businesses go bust. As the business community was the ruling family’s main supporter, the government was forced to bail out many companies by purchasing their share equity. This led to a programme of nationalisation by default. The effect of this was to blur the distinction

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39 Abir, M. op cit., p. 205
between the private sector and the government. By the late 1980s and early 1990s the
government sought to re-sell its equity back to the private sector, via a much-trumpeted
policy of "privatisation". Yet it was a difficult return to the pre-1982 status quo as the
private sector was forced to adjust to market forces. "The government buy-out of the
private sector expanded the bureaucracy and led to a lack of dynamism within the
economy."41 By the mid-1990s the government was still the predominant producer in
many economic sectors. In the medical health sector it accounted for 96%; education
96%; communications 90%; transport and storage 67%; even in the food industry the
government accounted for 18% of total food GDP.42 According to the Ministry of
Planning, the private sector is anticipated to grow strongly in the next few years. It
expects 450,000 jobs to be created in the private sector in the next five years bringing the
workforce towards 50% privately employed and 50% state employed.43 However, this
forecast is woefully optimistic. Research conducted by the National Bank of Kuwait
shows that during the first six months of 1999 (1H1999), of more than 6,000 new
Kuwaiti entrants in the labour market, less than 500 Kuwaitis were hired in the private
sector.

Table 28: Additions to the Kuwaiti Labour Force

<table>
<thead>
<tr>
<th></th>
<th>Labour force at end-1H1999</th>
<th>Net change in labour force 1H1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kuwaitis</td>
<td>218,000</td>
<td>6,017</td>
</tr>
<tr>
<td>Public Sector</td>
<td>203,000</td>
<td>5,543</td>
</tr>
<tr>
<td>Private Sector</td>
<td>15,000</td>
<td>474</td>
</tr>
</tbody>
</table>

Source: National Bank of Kuwait Economic and Financial Quarterly ii/1999 p. 17

40 Figures from Public Authority for Assessment of Compensation for Damages Resulting from Iraqi
Aggression Business Environment and Practice in Kuwait: Final Report op cit.,
41 Interview with John Wakefield, Chief Executive Office, Gulf Insurance Company Kuwait City, 11
November, 1999
42 Figures from Public Authority for Assessment of Compensation for Damages Resulting from Iraqi
Aggression Business Environment and Practice in Kuwait: Final Report op cit., p. x
The Kuwait Chambers of Commerce and Industry was established in November 1959 with a membership of 4,181. The organisation has expanded rapidly in recent years, - by 1991 it possessed 26,700 members. Like the Al Saud, the Al Sabah has used the Chamber of Commerce to bind the merchants into a strong corporatist relationship with the ruling family. The government sponsors most of its operations and has given the Chamber the power to regulate business permits, thereby excluding most foreign competitors from their arena. Despite the rent-seeking nature of the Chamber, the organisation has stepped up its level of criticism against specific government policies. As far back as the 1970s certain members of the Kuwait Chamber of Trade and Commerce criticised the government for its ‘unclarity (sic) of industrialisation policies and their prospective aims’ and called for a ‘clear strategy for the industrialisation of the country, with definite aims and priorities.’ Through its publications, press briefings and informal links, the Chamber of Commerce continues to lobby the government for a greater appreciation of private sector interests.

VI. How Private Sector Influence in Channelled

Through out the 1990s there has been a gradual acceptance among the Saudi elite that adjustments in the system of governance are necessary to reflect the changing economic realities of the Kingdom. The first step in this transition came in 1993 with the

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43 Al Watan, web-site, Kuwait, in Arabic 15 February, 1999 SWB 16 February, 1999
reestablishment of the *Majlis Al Shura*. This established a Consultative Council consisting of a chairman and sixty appointees who serve for a four-year period. In an important step, the Saudi elite chose to use the *Majlis* as an exclusive means to incorporate the "new middle class" of the rentier state. The sixty members had extensive track records in their respective fields – businessmen, academics, retired servicemen, technocrats and civil servants. More than fifty percent of the members held doctorate degrees. In 1997, the Council was expanded to ninety members to broaden the consultative process further. Council members are drafted into eight separate committees dealing with diverse portfolios such as security, health and social affairs. Crucially, a portfolio was created for economic and financial issues. Because of the secretive nature of Saudi decision-making, academics have found it 'difficult to assess its effectiveness as a consultative mechanism and its impact on legislation and policy making.' Dekmejian’s study, nevertheless, was able to show that the Council is busy. Between 1993-1997 it took decisions on 133 issues. Many of these decisions were economic in nature and the private sector was widely consulted. ‘A large number of officials from the public and private sectors were asked to attend the meetings; and significantly these included some cabinet ministers.’ It is therefore important to note that the Saudi rentier state of the 1990s expanded the range of its consultative deliberations to include the private sector at the national level.

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46 At the same time the Council of Ministers was revamped to act as the Kingdom's cabinet. The King presides over the Council as Prime Minister. Other appointees include the First Deputy Prime Minister, the Second Deputy Prime Minister, twenty-one Ministers with Portfolios and six Ministers of State. The Council is responsible for all drafting and implementation of the affairs of the state.
47 O’Sullivan, E. ‘A Promise Fulfilled’ *Middle East Economic Digest* September 3, 1993 Vol. 37, No. 35 p. 7
49 Dekmejian, R. H. *ibid.*, p. 207
Reforms also took place in local government. Announcing a policy of decentralisation to the Kingdom’s thirteen provinces, the Saudi government was quick to emphasis the benefits of “local democracy.” However, as Kechichian correctly points out, the reforms were undertaken in such as way so as not to threaten or weaken the rule of the Al Saud.50 The system of Provincial Councils, announced in March 1992, promised to bring decision making closer to those individuals with a vested interest in the Kingdom’s development programme. Royal Decree A-19 stipulated Council members “should be men of science, experience and specialisation.” A number of tribal figures, notably absent in the membership of the Majlis Al Shura were also included.51 In addition, the stated aim of the reform was to promote greater transparency and equality between provinces and the central government. Historically, high-ranking governors with more power and connections to central government departments could lobby more effectively for development funds than lower ranking governors.52 The government reformed this system. Provincial governors (all members of the royal family) were given significant autonomy to formulate development priorities locally. Each Provincial Council contains at least 10 Saudi citizens from the private sector who have demonstrated the necessary skill and experience in their respective fields. Technically, this system enables local businessmen and entrepreneurs to enter the chain, giving the Saudi system a “bottom up” approach to development planning not anticipated by the rentier model.

50 Kechichian, J. A. Political Dynamics and Security in the Arabian Peninsula Through the 1990s (Santa Monica, CA: RAND, 1993), pp. 48-49
51 O’Sullivan, E. ‘Provincial System Announced’ Middle East Economic Digest 1 October, 1993 Vol. 37, No. 39 p. 20
However, despite the potential for council members to devise provincial budgets and development plans (which are then submitted to the Interior Minister for approval) there is little evidence that the business elite has chosen to work through this administrative system to obtain policy goals. Nor has it been comprehensively illustrated that local initiatives find their way up the chain to be replicated at the national level.

A more direct channel is the link between business and bureaucracy. The Saudi merchant class created during the oil boom was predominantly Najdi – largely the result of huge transfer payments made to region by the government at the expense of the historic merchant centre – the Hijaz. Reforms undertaken in the Kingdom's bureaucracy during the 1950s and 1960s also saw a predominance of Najdis in the various ministries of state that proliferated during the period. Throughout the oil boom of the 1970s, where the merchant elite relied heavily on government contracts for infrastructure and construction work, the Najdis merchant elite and Najdi bureaucratic elite formed close ties. ‘Family, tribal and kinship connections with bureaucrats were utilised by aspiring Najdi businessmen not only to get permits, register agencies, and so on, but also to gather and peddle supposedly confidential information about up-coming government tenders and projects.’ With the 1975 revocation of a 1956 Act that prevented civil servants from entering into business deals, the Saudi private sector developed close institutional linkages between itself and important ministries of state. Bribery, nepotism and corruption characterised the relationship between state and business during the 1970s and

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53 For example, in 1961 the central government moved from the city of Jeddah in the Hijaz to the current capital Riyadh in the Najd, forcing the redundancies of many Hijazi civil servants and their replacement by Nadjis.

still influences the awarding of government contracts today. Indeed, as the private sector begins to take greater responsibility in the economic development of the Kingdom, and as former bureaucrats join expanding private sector enterprises, the informal links between the two will deepen still further.

In Kuwait, the channelling of business interests follows two basic routes – the National Assembly and the bureaucracy. Kuwait is a constitutional monarchy with power residing with the Amir, Sheikh Jaber Al Ahmed Al Jaber Al Sabah. He is advised by the Council of Ministers, which acts as the Kuwaiti cabinet. Key portfolios are held by members of the ruling family. Although Kuwait's democratic experience is rather limited in comparison with the West, in relation to its regional neighbours, advances have been made in recent years. The National Assembly (parliament) was reinstated in 1992 with 50 elected and 25 appointed members. Although the Assembly's powers are constitutionally limited, (political parties - although not pacts - are officially banned), the parliament has become increasingly assertive. All government legislation requires parliament's consent and on a number of occasions it has proved to be more than a mechanism established to merely rubber stamp cabinet decrees. Despite procrastination by the parliament, the government plans to extend the electoral franchise to women, who from 2003 might be allowed to vote and run for the legislature.\(^{56}\)

\(^{55}\) Kuwait has a long history of parliamentarianism since the 1930s. More recently, the National Assembly was suspended in 1976, and restored in 1981 for two parliaments. In 1986 it was suspended for a second time.

\(^{56}\) *Kuwait Times* November 10, 1999 p. 1
However, the business community has witnessed many of its demands frustrated within the parliament. It is not particularly well represented inside the Assembly, where 50% of the parliament is elected based on tribal affiliation. The 50% elected on "political" grounds can be grouped into Islamic and secular factions. The business community cannot rely upon the secular groups alone to push through legislation and it has tried to cultivate cross-sectional links inside parliament. However, according to one pro-business Member of Parliament, these links are not formally established nor well recognised between lobbies. Instead, the private sector is more active in the general environment, especially in the national press, by highlighting the failure of the public sector to generate economic growth and diversification. Only by stimulating debate within the wider community is the private sector "able to undermine vested interests vis-à-vis weak institutions." The private sector is frustrated by what it sees as parliamentary incompetence. In short, "parliamentarians do not know their role." Few parliamentarians are motivated by principle while too much business is done behind the scenes, rather than subject to public scrutiny. The concern for getting re-elected takes priority over reform. Hence, the Kuwaiti parliament is characterised by a lack of long-term planning. This is particularly apparent with regard to privatisation. According to one of Kuwait’s senior parliamentarians, and a staunch advocate of economic reform, Abdullah Al Nebari, "decisions are not made within a framework of a long-term but piece by piece.....There is much talk about privatisation but we don't have any vision beyond the slogan." Similarly, Morrow argues that economic reform in Kuwait is

57 Interview with Abdullah Al Nebari MP, Kuwait City, 10 November, 1999
58 Interview with Dr. Adnan A. Al Hamoud, Deputy Director General, Kuwait Institute for Scientific Research, Kuwait City, 10 November, 1999
59 Interview with Abdullah Al Nebari MP, Kuwait City, 10 November, 1999
characterised by “too much talk and not enough action. Everything that is promised is just round the corner.”

The private sector faces considerable obstacles within parliament. The advancement of a “business-friendly” agenda is no longer a question of negotiating with the ruling family. Abdullah Al Nebari argues that when it comes to the issue of economic reform (and privatisation in particular) it is possible to categorise his colleagues into four main groups. The first, and one of the largest groups, are those MPs who are elected from the tribal communities. These individuals are largely opposed to significant economic reform since tribal communities often perceive that the younger merchants of the business community would be the only benefactors in such a move. Traditionally there has been some overlap between the tribal and business elite. However, tribal elders have grown increasingly suspicious about the rise of a new merchant elite. The business community in Kuwait is increasingly divided between the older merchant class and “the individualistic strategies and goals of ambitious new men.”

It is also the case that the “new merchant elite” front ruling family investments and they are subsequently rewarded with lucrative contracts and agencies. Tribal representatives are keen to curb the growing influence of these men, who are best placed to politically and economic benefit from economic liberalisation. A second large grouping are MPs who view change with trepidation. Although claiming to be advocates for the “small people” in society, these MPs are concerned with the destabilising effects

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60 Interview with Dr. Donald Morrow, Senior Economist, National Bank of Kuwait, Kuwait City, 14 November, 1999
of moving from the perceived certainties of the public sector to the insecurity of the private sector. They argue that the consequence of radical reform would be unemployment, leading to less, rather than more, opportunity. For example, privatisation would primarily benefit expatriate labour rather than greater opportunities for Kuwaitis. Thirdly, there is a smaller group of “pragmatists.” These individuals want to see privatisation phased in so that the state can counter the negative impact that the policy might entail. Finally, there are a smaller group of members who are “pro-liberalism” and advocate radical reform as a matter of urgency. These MPs are critical at the speed of economic reform. For example, Abdullah Al Nebari has called for the government to impose income taxes as soon as possible.63 It is within these four groupings that business interests have to be entertained. Unfortunately, for the Kuwaiti business community, allies inside the assembly are few and far between.64

Historically, the Kuwaiti business community has found that the deliberative institutions of the rentier state tend to frustrate change rather than facilitate it. Between 1986 and 1992 there was no deliberative mechanism at all. The National Assembly had been suspended by Amiri decree. Change had to be introduced by other avenues. Using its informal channels of influence, powerful private sector companies were able to directly alert the government of their grievances and suggest solutions. Like the Najdi business community in Saudi Arabia, members of the Kuwaiti merchant families hold powerful positions in the state bureaucracy, giving the private sector what one academic

62 Tetreault cites younger members of the Behbehani and Marzouk merchant families as examples of the growing influence of the new merchant elite. Tetreault, M. A. (2000) op cit., p. 130
64 Interview with Abdullah Al Nebari MP, Kuwait City, 10 November, 1999
calls, "back door political clout."65 Merchant clans have not been integrated wholesale into the state apparatus. Instead, they have their greatest presence in specific bureaucracies that relate directly to their interests – commerce, finance, industry and electricity.66 This leads Crystal to assert that the bureaucracy is now the new arena for Kuwaiti politics, - 'a place for merchants and others to undermine the original pact.'67 High and middle ranking bureaucrats constitute an important element of the new middle class found in Saudi Arabia and Kuwait. Although broadly supportive of the ruling families (their jobs depend on the maintenance of state largesse), they are not without a political agenda of their own. The professional bureaucratic class is wary of tribal patronage, believing instead that 'the realm of politics should be reduced in favour of technical-professional decisions.'68 Business leaders in Kuwait were able to persuade a number of well-placed bureaucrats of the merits of an alternative development strategy. It was through this back-door channel that the private sector approached the government about instituting a Kuwaiti Offset programme. Jill Crystal's proposition that 'an unintended consequence of bureaucratic expansion is that merchants, taken out of decision making at one end, may be gradually re-entering through the back door of the bureaucracy'69 is confirmed.

66 Herb, M. A. op cit., p. 58
VII. Kuwait: The Private-Sector Push for Offset

The Kuwaiti private sector was the main instigator of the country’s Offset programme. The government was alerted to the possibility of countertrade by two private sector companies in 1991. The Kuwait Investment (Contracting) Company and the Kuwait International Investment Company, approached the Ministry of Finance to ask whether an Offset scheme could be used to boost the private sector after the ravages of the war.70 High-ranking civil servants persuaded finance ministers to undertake a feasibility study on behalf of the private sector. The business community was subsequently well represented in a committee established by the government, which undertook an assessment of the viability of an Offset scheme for Kuwait. Headed by Dr. Mohammad Al Sabah (who became the Kuwaiti Ambassador to Washington) this informal committee visited Saudi Arabia to assess how the scheme was progressing there and to make any future Kuwaiti program more attractive than their neighbours.71 Utilising the advice of two investment banks - Lehman Brothers and the Bank of America, the Committee reported back to the Council of Ministers in early 1992 and formulated the “general principles” that were approved by the Council of Ministers on 26 July, 1992. In order to facilitate these principles into a coherent program the Council of Ministers approved a new committee to formulate the Official Offset Guidelines. The Advisory Committee was formed to take into consideration both the government’s and the private sector’s concerns. The Deputy Governor of the Central Bank, the Chairman of the National Petroleum Company, the General Manager of the Kuwait Investment

70 Crystal, J. (1995) op cit., p. 179
71 Interview with Mazan Madooh, Head of Offset Department, Ministry of Finance, Kuwait City 13 November, 1999
Authority, a Professor from Kuwait University and a number of government under-secretaries formulated the details of the schemes that were finally agreed by the government in March 1995. Representatives of the private sector continue to act in an advisory role to the Offset Office along with quasi-government entities such as the Kuwait Investment Authority, Kuwait Institute of Scientific Research, Industrial Bank of Kuwait and Gulf Investment Finance Company.

The private sector saw the application of Offset as important for a number of reasons. It wanted the government to be more assertive in attracting foreign investment into the economy. The (declining) redistribution of oil revenues was no longer sufficient for private sector needs. Greater investment opportunities were available only by accessing capital flows in the global economy. However, the private sector identified a lack of confidence on behalf of foreign investors in their perception of Kuwait. Something had to be done to attract international capital and to commit it to long-term investments. According to one senior Ministry of Finance official, the private sector saw countertrade as an initial step to build confidence between itself and foreign investors so that more investment would flow at a later date. This point of view is confirmed by a CEO of a large Kuwaiti private sector company. According to John Wakefield of the Gulf Insurance Company, the implementation of Offset is both desirable and necessary to link the private sector with world class defence, and ultimately commercial, enterprises.

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71 The working committee consisted of delegates from the Ministry of Finance, the Central Bank of Kuwait, Kuwait Investment Authority, Kuwait Trading Construction and Investment Company and the Kuwait International Investment Company.
72 Interview with Mazan Madooh, Head of Offset Department, Ministry of Finance Kuwait City 13 November, 1999
73 Interview with John Wakefield, Chief Executive Officer, Gulf Insurance Company Kuwait City 11 November, 1999
Furthermore, Offset represents good commercial sense as capital can be freely obtained to invest in profit making adventures and crucially, by investing in sectors of the economy preferred by the government, the private sector can generate an enormous amount of goodwill with the government.\textsuperscript{74} “It’s a win-win situation, it helps the government in its development plans and it helps our goals.”\textsuperscript{75}

In addition to the lobby efforts of the private sector and the influence of the Saudi experience, and the invasion of Iraq also forced the government’s hand. Private sector demands coincided with a government desperate for new methods of development finance. Kuwait’s first five-year plan (1990/1-1995/6) was to be published in 1990 but never saw the light as Iraqi troops overran the territory. The invasion led to a rethink of the manner in which development was to be pursued. Kuwait no longer possessed sufficient resources to rebuild existing infrastructure nor could it afford to fund new projects planned in the 1990 development plan. It therefore began to look for alternative strategies employed by its neighbours. Although the first Offset agreements were with defence contractors (e.g. Hughes Aircraft Company, Aerospatiale, Raytheon, General Dynamics and others), Kuwait was soon extending its program with commercial companies. Even before the formal guidelines were published in 1995, Kuwait had already signed an Offset agreement with Mitsubishi Heavy Industries Ltd., to build a new power station.

\textsuperscript{74} Interview with John Wakefield, Chief Executive Officer, Gulf Insurance Company Kuwait City 11 November, 1999
\textsuperscript{75} Interview with John Wakefield, Chief Executive Officer, Gulf Insurance Company Kuwait City 11 November, 1999
VIII. Reluctant Partners: Offset and the Saudi Private Sector

The Kuwaiti private sector experience contrasts with that in the Kingdom. In Saudi Arabia, the implementation of the Offset program was not enthusiastically greeted by the Kingdom’s private sector. On the whole, Offset was welcomed by large Saudi companies and resisted by the smaller firms. Large Saudi companies had called for greater business opportunities with global partners as early as the mid-1970s. By the late 1970s/early 1980s, Saudi businessmen began to express displeasure to the government over levels of defence expenditure. Defence procurement accounted for one third of the Kingdom’s budget yet there was little “trickle down” benefits for the business community. The government was pressured to make sure the vast sums involved were re-invested into the Kingdom. However, an additional problem was how to absorb the redistribution of rent. The indigenous workforce lacked the skills to sustain the boom. According to Graham Flack, Manager of the Saudi Development and Training Company, a Saudi Offset scheme established by British Aerospace, the business community became concerned at this trend:

...thinking Saudis and the government became uneasily aware that as projects were completed, the technological expertise deployed in their implementation was leaving the country along with the enriched foreign contractors and their workers. An attempt had to be made to ‘transfer’ the technology involved and, indeed, to bring in others that would make good and sustained use of the new infrastructure and facilities.76

Bolstered by criticism over its procurement policy and concerned with the sustainability of its development programme, the Kingdom began to look for solutions to

the problem. The result was a tentative move towards the establishment of its Offset programme. In 1979 the Foreign Capital Investment Regulation provided incentives for overseas investors to form joint ventures with Saudi partners. During this period, a series of conversations took place between two individuals who were to have profound impact upon the development of the scheme. In 1979 Prince Fahad bin Abdullah, director of operations at the Saudi Air Force began to discuss ways to enhance private sector cooperation in the defence industry with Mr. David Burney, an investment banker with Lehman Brothers. Lehman Brothers had been advising on Offset deals in the 1970s from countries as diverse as Israel and South Korea. The Prince and Burney had met early on in their military careers and had kept in touch over subsequent years. Prince Fahad bin Abdullah expressed concerns that although Saudi Arabia’s wealth had enabled it to purchase the region’s most advanced military equipment, Saudi Arabia’s real weakness was its lack of self-sufficiency in what the Prince perceived to be “strategic industries.” The Saudi private sector did not possess the technology or training to help the Kingdom in its goal. Although Saudi Arabia had access to the latest military hardware, this could only be operated by reliance upon outsiders. Wealth could not purchase self-sufficient technical industries to maintain the military equipment from overseas. Fahad bin Abdullah wanted Saudi Arabia to have the necessary management skills and technology based on Saudi soil so that young Saudis could be trained in hi-tech, knowledge-based industries. It was then that Burney suggested a Saudi Offset scheme, similar to those employed in other countries. The cost of defence procurement was to be offset by obligations laid down by the Saudi military.
Six months after this meeting, Fahad was appointed a deputy minister in the Saudi government. Using his position in the defence department, Fahad formed a working party to study the issue by drafting in deputy ministers from finance, planning, commerce, industries and electricity. Also included was the CEO of the Saudi Arabian Basic Industries Corporation (SABIC) who had developed links to interested parties in the Saudi private sector. Developing rules on an ad hoc basis, the deputy ministers were able to obligate Saudi Arabia's next major defence procurement under an Offset scheme. The result was the $5.6 billion "Peace Shield" contract in 1983. Peace Shield became the Gulf region's first Offset contract. Money from this military communications and command project was to be invested back into the Saudi economy by establishing joint ventures with Saudi merchants. New ventures had to utilise the latest technology, have at least 50% Saudi ownership and the obligators (Boeing, GE, ITT and Westinghouse) were contracted to participate in the projects for at least 10 years. Peace Shield I envisaged 11 projects with a combined value of $700 million – 35% of the contract. The General Investment Offset Program Guidelines, issued on November 11 1983, listed its primary objectives:

- To assist the government in the drive towards economic growth and diversification
- To facilitate the transfer of technology to the Kingdom
- To establish appropriate joint ventures involving:
  - high technology projects and services
  - meaningful contributions to management and technology training
- be capital and/or energy intensive

- Other desirable characteristics:
  - geographically diversified ventures and new and inter-related ventures

However, smaller Saudi companies, which make up the bulk of the Kingdom’s private sector, were not so enthusiastic about the ‘opportunities’ on offer. “On the whole, the Saudi private sector fought Offset. The government was forced to fight the private sector, although it moved against them with great caution. Only recently, when budget cuts were inevitable, did the private sector accept Offset.” The private sector became worried that competition from Offset companies might alter market shares. If Offset companies were successful, their range of expertise and their ability to undercut domestic competitors would result in the loss of government contracts. Furthermore, many Saudi companies thought the government was trying to introduce “Saudi-ization” through the back door. Like the Kuwaiti government, Saudi authorities encouraged Offset ventures to employ as many Saudis as possible through the weighting mechanism in the micro-multipliers. Saudi business has often resented the implementation of Saudi-ization – a long held government strategy to boost levels of Saudi nationals working in the private sector.

According to one Saudi academic, such is the dislike of this policy that when the government tries to impose reform on the labour force it undermines the consensus

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78 Interview with Mr. David Burney, Senior Advisor, Carlyle Arabia, The Carlyle Group Washington, D.C. 26 April, 2000
between business and the ruling family upon which the Saudis have relied.\textsuperscript{80} Government regulations which require all Saudi companies with 20 or more employees to increase their number of Saudi employees per annum, or forfeit government loans and contracts, has created much resentment. Rather than comply, Saudi firms often split into smaller units to by-pass the law, resulting in a weak and fragmented private sector. Saudi businessmen have little faith in the quality of the Saudi workforce. As one Saudi Businessmen recently asked:

Why would I want to hire a Saudi? By law, I must pay them more, I must give them an expensive package of benefits, and if they turn out to be poor workers, I can’t fire them. I can hire an energetic and well-trained Pakistani or Indian for less money and no risk.\textsuperscript{81}

A combination of an unmotivated individuals, tradition that precludes manual work for males and worthwhile employment for females, and the inflexibility of the national workforce (e.g. Najdis prefer to work in the Najd, Hijazis in the Hijaz) leads to a preference of expatriate workers. This is particularly true of the most dynamic Saudi companies, -- those that operate in global markets. The private sector equated Offset with greater burden. They were extremely wary about participating.

Furthermore, Saudi businessmen are generally risk-averse and distrust any movement away from state patronage. Saad Eddin Ibrahim argues that 'Saudis are not fruitfully productive; nor are they completely parasitic. But they could be anything in between. Unlike the typical Western counterpart, the Saudi entrepreneur does not take

\textsuperscript{80} Yamani, M. in Hollis, R. (ed.) \textit{op cit.}, p. 146
\textsuperscript{81} Saudi businessmen quoted by Sick, G. G. p. 18, in Sick, G. G. & Potter, L. G. \textit{op cit.}.
any risk and loses hardly any of his capital. In fact he may undertake his role without much or any capital to start with. Nevertheless he is always assured of a making a profit.\textsuperscript{82} Saudi businessmen prefer to act as middlemen or as a sponsor (\textit{Kafil}) between the government and foreign businessmen. Although not every Saudi is a \textit{Kafil}, there are enough individuals throughout the Gulf to make them a distinct social formation.\textsuperscript{83} As a subcontractor, the Saudi businessman can make substantial profits by utilising personal contacts and guaranteeing political support for the project concerned. However, by making Offset companies deal direct with foreign contractors, the government is forcing Saudi businessmen to enter into agreements with businesses that have more exacting standards than the government. There is more work to do for the same (often less) money than the past.

In comparing the Kuwait and Saudi experience of Offset we find the former willing to engage in the scheme and the latter wary of it. The most significant variable explaining these divergent positions is time. The Saudi Offset scheme was undertaken in the early 1980s. The Kuwaiti Offset Program was instituted during the early 1990s. This period of time is important. At the start of the decade both countries were still experiencing the revenue benefits of the oil boom. By the end of the decade, both states were forced to deal with the recessionary consequences of the oil bust. These events not only altered government views as to the nature and direction of economic development policy, it also forced the private sector to reconsider how the oil bust would impact on its ability to generate wealth. When the Saudi government first implemented Offset the

\textsuperscript{82} Ibrahim, S. E. \textit{op cit.}, p. 8
\textsuperscript{83} Ibrahim, S. E. \textit{op cit.}, p. 13
Saudi private sector was disinclined to move away from the corporatist framework established a decade earlier. Although complacent, the belief that the oil boom would continue was widespread. There simply was no incentive for the Saudi private sector to engage Offset with any degree of vigour when fortunes could be easily made via government largesse. As the oil bust took effect, a small number of Saudi merchants were prepared to engage in preliminary discussions with Offset obligators. Though painfully slow at first, the Saudi private sector has slowly warmed to the opportunities on offer. As the bust has intensified the business community has realised that no amount of lobbying through the state bureaucracy can result in more contracts if the government no longer has the money. Hence, the Saudi private sector’s acceptance of Offset has been reluctant in nature.

In Kuwait, the situation was markedly different. The oil bust of the mid-1980s had galvanised efforts to look for alternative development methods. The apparent success of privatisation and liberalisation efforts in the West became increasingly evident by the late 1980s and coincided with the need to find new sources of revenue. This climate of change was reinforced with the Iraqi invasion of Kuwait in 1990. The private sector was encouraged to play a more robust role in generating wealth. Yet what is particularly interesting about the Kuwaiti case is the fact that Tetreault’s “new businessmen” were interested in Offset because it offered them the means to exploit their individualistic and competitive work ethics. The state was asked to indirectly provide a range of non-traditional rentier goods through the awarding of government contracts to foreign companies. For the younger merchant elite eager to build businesses
by means other than family membership, access to technology, management techniques and strategic joint ventures were required. Although the Kuwaiti government had created a range of sponsorship laws in the past, Kuwaiti businessmen lobbied hard to obtain the specific advantages that Offset could bring.

IX Private Sector Encouragement for BOT

While the motivations behind Saudi and Kuwaiti private sector acceptance of Offset differed, the business communities in both states welcomed the application of BOT. After witnessing its application in neighbouring states, both groups saw the potential to make money out of its application in the post-oil boom era. According to World Bank figures, private participation in infrastructure has rapidly gained ground through out the world. Between 1984 and 1995, 90 countries privatised 550 infrastructure companies. More than 80 countries instituted nearly 600 new private infrastructure projects. During this same period, private investment flows to infrastructure projects averaged $60 billion a year. Yet barely 1% of this investment flowed into the Middle East and North Africa.\(^85\) Much of the Arab world has been slow to grasp the opportunities on offer. However, the apparent success of private sector application in industrialised areas of the world has led to a new appreciation of the benefits on offer. International businesses are seeking out BOT contracts in the Middle East. As Frank Tabury of German company Dyckerhoff & Widman asserts, “BOT is the sector of the future. We will certainly be part of it.”\(^86\) Gulf states have introduced, albeit


\(^{86}\) *Middle East Economic Digest* 15 November, 1996 Vol. 40, No. 6 p. 41
slowly, private sector solutions to their public sector difficulties. For the private sector, this change in philosophy was broadly welcomed.

BOT schemes arrived in the Gulf region in the mid-1990s – the result of three major processes – of which the business community played an important role. The first of these was a “spillover” effect from the states of North Africa. Morocco, Algeria and Tunisia were at the forefront of BOT adoption at the start of the decade. These states undertook BOT schemes in road building, water desalination and power provision schemes. Private sector construction companies in the Maghreb were awarded large contracts by servicing, or joining, international consortia. The apparent success of these programs saw similar schemes implemented eastwards to Turkey and the Levant (e.g. Lebanon, Jordan and the West Bank) and eventually onto the Gulf. Secondly, the Middle East business community became aware of the successful implementation of BOT schemes in the United States and the United Kingdom. Most European states followed suit through the decade – including heavily statist nations such as France. North African countries watched these French developments with interest. Businessmen venturing overseas learned that there were profitable private sector opportunities to be had in the provision of public services. By learning from their experiences abroad, and with their interaction with businessmen from the Maghreb and Levant regions of the Middle East, Gulf businessmen promulgated the benefits of BOT through Chamber of Commerce publications and through their contacts in various ministries of state. Cognisant that the roads, bridges, hospitals, electricity and telecommunications networks built with the

87 See Bodgener, J. ‘Birecik Dam Opens BOT Floodgates’ *Middle East Economic Digest* 1 December, 1995 Vol. 39, No. 48 p. 6
absorption of petro dollars in the 1970s now required substantial repairs, the private sector was willing to join BOT schemes during the fiscal austerity of the 1990s. The Gulf private sector found Gulf governments eager to experiment with BOT, having transmitted vague “private sector solutions” in their five-year development plans. Oman was the first country in the Gulf to identify BOT as a development mechanism. Its Manah power project was originally conceived in 1989 although the project was not tendered until 1992. The final route was through the epistemic communities represented by international organisations like the World Bank. The World Bank in particular was at the forefront in persuading and advising Middle Eastern countries to consider BOT solutions to their public sector expenditure difficulties.88 For example, the Omani government commissioned a World Bank report into its proposed BOT project at Manah. The Bank’s recommendation to proceed was extremely influential in getting the project off the ground. Although the World Bank does not actually advise the richer oil nations of the Gulf, the World Bank legitimised this form of government/business partnership in way that Offset has never attained. BOT’s legitimacy boosted its profile and its desirability. Yet as the next section shows, the promises on offer failed to match the reality of the situation.

X. The Realities of Countertrade for the Business Elite

The application of countertrade has produced mixed results across each country and within specific sectors of the economy. As this section shows, the application of Offset in to promote advancement in education appears to have produced real private

88 Interview with Jean Claude Villiard, Director, Infrastructure Development Group, Middle East & North Africa Region The World Bank Washington, D. C. 28 April, 2000
sector benefits, especially in Kuwait. Here, Offset schemes will have positive long-term spillover effects through out the economy. However, business elites in the Kuwaiti health sector, whose sector was awarded a high macro-multiplier value, have not witnessed the implementation of Offset on the scale that was originally envisaged. The application of BOT produces similar private sector winners and losers. The business communities of Saudi Arabia and Kuwait, especially those involved in the construction sector, encouraged the introduction of the schemes to guarantee the continued financing of public sector projects. Yet the reality of the situation is that there are more losers than winners. BOT only benefits a small group of merchants with links to the bureaucracy and the ruling family. Thus, while there is much evidence of a “re-politicised” rentier state, the actual gains for the private sector are highly ambiguous.

i) Education and Training: The Private Sector Pursuit of Offset

A major reason for the Kuwaiti private sector’s willingness to engage in countertrade is the realisation that the desire for expansion, liberalisation and privatisation is limited by the existence of the damaging effects of the rentier mentality. “Privatisation cannot succeed without developing the labour force. More firms would be willing to come to Kuwait if there were more trained Kuwaitis.” Research recently conducted by the National Bank of Kuwait confirms this point of view. Very few Kuwaitis and non-Kuwaitis have experienced a University education. Many others,
especially women, have no education at all.

The bulk of the Kuwaiti labour force (70%) has an educational level below high school or no education at all. This includes non-Kuwaitis with no formal schooling (40% of the total labour force), non-Kuwaitis with below high school education (22%) and Kuwaitis with below high school education......The remaining 30% of the labour force have either a high school diploma or a university or professional degree. The largest group within this segment are non-Kuwaitis with a high school education (11% of the total labour force), while Kuwaitis with above high school level education make up some 10% of the labour force as a whole.

Yet the need to boost the level of Kuwaiti education is not merely a quantitative argument. As in Saudi Arabia, Kuwaiti businessmen are critical of the quality of education provided. One head of a large Kuwait engineering firm argues that “we cannot absorb much more money as Kuwaitis because we do not have enough training. Kuwait University is just another government ministry. It is not good enough for the private sector.” Realising this, in 1999, one of Kuwait’s largest private sector companies, the Kuwait Investment Projects Company (KIPC), identified a profit making opportunity in the education sector, and simultaneously used Offset money to train individuals in financial services, thereby creating a talented pool of potential future employees. A subsidiary of the KIPC, the Gulf Insurance Company (GIC), had invested a significant amount of resources into an in-house training scheme to bring graduates of Kuwaiti University up to a level required by the private sector. However, the GIC found

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91 National Bank of Kuwait, Economic and Financial Quarterly, i/1999 p. 21
92 For analysis into the quantitative aspect of Gulf education see: Gilbar, G. G. The Middle East Oil Decade and Beyond: Essays in Political Economy (London: Frank Cass, 1997), pp. 74-102
93 For analysis of the situation in the Kingdom see: Yamani, M. in Hollis, R. (ed.) op cit., pp. 145-146
that the pool of qualified candidates was extremely small. Most graduates of Kuwait University were simply turned off by the rigours of the private sector and preferred the easier life in the public sector. This left an extremely small amount of willing, though not necessarily able, graduates wishing to enter the private sector. As the head of the GIC put it, "so many people in Kuwait are unemployable." Realising that it could exploit the country's Offset scheme to its own advantage, proposals were submitted, and excepted, to build a private technical college to train 1,000 Kuwaiti nationals a year in a number of professional subjects. For example, MBA courses regulated by the Northern Group of British Universities (Durham, Leeds etc.) provide recognised certification of professional qualifications. Similarly, the Institute of Insurance (UK) certification is offered. As a result, the GIC hopes institutions like these will undermine the rentier mentality that limits the expansion of the private sector in Kuwait. "This college will turn out individuals that are employable." Furthermore, by offering distance learning by satellite from the M.I.T in Boston this will alleviate concerns by the Kuwaiti authorities of sending graduates, particularly female graduates, overseas for study.

Funding to build the school came from Offset obligations incurred by British Aerospace, which donated $6 million to the project ($40 million in total obligation, which has been reduced by the multiplier). However, this is not simply a charitable project. The school is 100% owned by the private sector, - the GIC and BAe are joint

94 Interview with Dr Abdul Aziz Sultan, President, Kuwait Engineering Office, Kuwait City, 13 November, 1999
95 Interview with John Wakefield, Chief Executive Officer, Gulf Insurance Company Kuwait City, 11 November, 1999. One of the most successful Offset schemes has been undertaken by Raytheon to build an Aluminium smelter. To build and maintain the plant, Raytheon had to train 250 local Kuwaitis as engineers.
partners charging market rates for the courses offered. This project is a significant private sector initiative to improve the quality of education through the Offset scheme. Yet as Richard Bullen, Economic Advisor to the Central Bank of Kuwait, pointed out, "the greatest potential benefit of the Offset scheme – the training of Kuwaiti nationals – is resisted in certain quarters by vested interests. The most powerful of these is Kuwait University." 97 The idea that the state should cede duties to the private sector is not warmly welcomed by an institution that has a monopoly of post secondary education for fear that its financial resources be slashed.

As with Kuwait, the Saudi private sector also suffered from the Kingdom's educational policies. The government did not base the country's educational development on the needs of the private sector. Instead, seeking to pacify supporters in the religious establishment, 'the conservative cultural requirements of the state dictated an educational policy that reflected non-modern values.' Hess cites this as an example of the state's defence of its political position, at the expense of a dynamic national private sector. 98 Such developments have frustrated the private sector. In order to manoeuvre around the religious establishment and placate the business community, the government has encouraged the contracting out of technical and vocational education under the Offset scheme. The Saudi experience has understandably been slower than Kuwait's. Nevertheless, movement is underway and the future will be represented by companies

96 Interview with John Wakefield, Chief Executive Officer, Gulf Insurance Company  Kuwait City  11 November, 1999
97 Interview with John Bullen, Advisor, Central Bank of Kuwait  Kuwait City, 8 November, 1999
98 Hess, A. C. *op cit.*  p. 114
such as the Saudi Development and Training Company (SDT) based in Dammam.\textsuperscript{99} Similarly, BAe has established a school in Riyadh to train Saudis in engineering trades associated with aircraft maintenance. These schools provide education and training to young Saudis, which are relevant to the private sectors needs. Similar institutions will be built by Hughes Aircraft Co. and Thomson CSF – both companies having announced recent commitments to formally train and develop Saudi nationals employed in their respective Offset programs. Though small, these developments represent a qualitative leap in the provision of education geared towards private sector interests. Although the push for education through Offset schemes has been government-led, Saudi businesses have begun to recognise the value these developments as trained individuals trickle out through the economy.

ii) The Health Sector and the Failure of Offset

The redistribution of oil rent in the 1960s and 1970s led to huge advances in the provision of health care for Gulf nationals. Life expectancy rates rose rapidly as citizens were given access to state-of-the-art facilities. However, during the 1980s, these improvements were undermined by two factors; i) the huge rise in health costs as the region experienced a population explosion and ii) the rising cost of specialist labour and equipment. Despite increasing levels of money set aside for health care, the sector failed

\textsuperscript{99} SDT was formed under the Al-Yammah economic Offset program as a joint venture with the Kanoo group of merchants. Co-ordinated by British Aerospace, the government asked BAe officials to help overcome the skills shortages in the Kingdom. Using state of the art training packages, SDT has worked in the Saudi oil, defence and banking sectors, to equip Saudi nationals with the skills needed to compete in “knowledge-based” industries.
to achieve the desired rates of expansion. These concerns were compounded following the Iraqi invasion. The Kuwaiti health sector lost over $2 billion worth of equipment through looting by Iraqi soldiers. Through out the 1990s, the Kuwait government forced greater numbers of expatriate workers to take out private medical insurance.

There was a recognition that the private sector should shoulder some of the burden. The Saudi government sought solutions by proposing to take the 'necessary measures to increase the utilisation of private hospitals and centres, thus stimulating private investment in the construction of such facilities.' In this environment, the health sector is one area that should be flourishing within Offset schemes. Using the resources and technology of large multinational companies to provide health care for Gulf nationals appeals to all governments in the region. As one private health sector manager in Kuwait argues, “the government uses Offset as a political tool, it wants the Kuwaitis to see that it is still a beneficent state. Consequently, multipliers are weighed heavily towards social concerns that help legitimise the government. They are social multipliers.” In this context one would anticipate the private health sector flourishing via joint partnerships with large MNCs. Yet, the private sector has not found countertrade to be a panacea to the problems it faces. For example, a private sector proposal to provide a 100-bed acute care general hospital was submitted to the Kuwait Offset Program in 1995. International Health Services, a Kuwaiti-based private hospital saw the Offset program as a useful

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102 ‘Kuwait Health Insurance Scheme Worries Expatriates’ Agence France-Presse Kuwait City April 12, 2000
103 Kingdom of Saudi Arabia, Ministry of Planning (1995) op cit., p. 95
means to attract investment into new equipment and to train Kuwaiti nationals in health technology and management skills. The proposal called for an expansion of the hospital premises on a vacant plot of land adjacent to the existing hospital. Hoping to obtain the co-operation of Offset obligators in the defence industry, the hospital was confident of success. In theory, this was a classic example of the sort of “win-win” situation that the government hoped Offset schemes would provide. Yet five years on from the original project, the plot of land remains empty. The individual who came up with the Offset idea and charged with the task to submit the proposal is frank about its failure. According to John Morley, Financial Controller of the International Clinic, the problems with the Offset scheme does not lie with the Kuwaiti private sector but with the administration of the scheme and a general lack of enthusiasm among Offset obligators to pursue their responsibilities with vigour.¹⁰⁵

In the first instance, the government and the management of the Offset scheme is characterised by the avoidance of making important decisions. Unlike the Saudi Offset Program, which contracted out its bureaucracy (detailed in Hypothesis III), the Kuwaiti Offset Program was kept “in house.” The result was bureaucratic inertia. One Kuwaiti businessman describes leadership in the schemes as a “a boat without a sail and a captain.”¹⁰⁶ Although Offset is designed to train Kuwaiti nationals, ironically, the Kuwaiti Offset program is run by a large number of bureaucrats who have little knowledge of management and the demands of the private sector. As one economist put

¹⁰⁴ Interview with John Morley, Financial Controller, The International Clinic Kuwait City 9 November, 1999
¹⁰⁵ Interview with John Morley, Financial Controller, The International Clinic Kuwait City 9 November, 1999
it, "Offset is a classic example of Kuwait management – it looks good from the top but it neglects bottom-level detail." Similarly, Dr. Abdul Aziz Sultan, argues that, "the problem with any scheme in Kuwait is capability. Government bureaucracies cannot implement programs effectively. Most individuals are appointed not because they are competent but because of patronage." Government officials within the Ministry of Finance confirm this. Abdul Rahman Al Ebrahim, Head of the Economic Studies and Research Division at the Ministry of Finance, admits that, "Offset could be made better if the regulations were reformed. Many Offset projects have been stymied by bureaucracy." Endless meetings and the avoidance of decision making frustrated Morley's efforts. The project did not end by any government decision. Rather, the project was allowed to die a slow death within the bureaucracy of government.

The second significant problem was that of the Offset obligators. The International Clinic approached a large British Offset defence obligator that had in-house expertise in the application of appropriate technological and logistical techniques (e.g. waste disposal experience). However, Morley found that the organisation in question showed little enthusiasm for the scheme. This is largely explained by the nature of international business in the 10 years since Offset was first discussed inside Kuwait. Within this period, the world's major defence contractors have significantly altered the nature of their businesses. A series of mergers and acquisitions in the global defence

106 Interview with Dr. Abdul Aziz Sultan, President, Kuwait Engineering Office, Kuwait City 13 November, 1999
107 Interview with Donald Morrow, Senior Economist, National Bank of Kuwait, Kuwait City 14 November, 1999
108 Interview with Dr. Abdul Aziz Sultan, President, Kuwait Engineering Office, Kuwait City 13 November, 1999
industry has resulted in a consolidation of core activities and the shedding of peripheral industries. This contrasts sharply with the 1980s where companies talked frequently of corporate diversification. In this earlier context, Offset appeared viable. Therefore, while Saudi Arabia launched its Offset scheme during a period of corporate diversification, Kuwait launched its program during a period of rationalisation and consolidation. The environment for the application of Offset is therefore more difficult today than in earlier periods. These factors lead Morley to assert that from his perspective, "countertrade should work, but it hasn't yet."  

iii) BOT, Nepotism and Private Sector Disappointment

Like Offset, the application of BOT has met with mixed results. While a number of merchant families in the construction sector have benefited from awards, private sector enthusiasm for BOT waned. Not every firm in the private sector was to benefit from this new method of government contracting. According to Levy, BOT projects require four components to be successful. The project must be viable, there must be a receptive host government, a group of experienced professionals and it should utilise expertise of local partners. Local partnerships boost indigenous construction industries and the use of local suppliers creates valuable sub-contracting opportunities. BOT sponsors usually welcome local partnerships, for they can utilise local contacts in both industry and government. Yet according to one UK businessman employed in a firm of Kuwait.

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109 Interview with Abdul Rahman Al Ebrahim, Head of Economic Studies and Research Division, Ministry of Finance Kuwait City, 13 November, 1999
110 Interview with John Morley, Financial Controller, The International Clinic Kuwait City 9 November, 1999
111 Interview with John Morley, Financial Controller, The International Clinic Kuwait City 9 November, 1999
architects, the local private sector has little incentive to make BOT work. There are a number of reasons for this. Firstly, corruption is inherent in the system. This undermines business confidence as the UNIDO points out. ‘Private companies cannot be expected to invest time and resources in the developing of bids if the process for awarding a BOT project is not reasonably orderly, fair and transparent so that the chances for success are predictable.’\textsuperscript{113} Yet these concerns are most apparent in the Gulf. According to Stuart Bosel, “BOT is not healthy, for businesses there are easier ways to make money.”\textsuperscript{114} Because the BOT process is essentially a top-down scheme, the private sector complains of a lack of transparency in contract dealings. As another businessmen put it, “why pay $350,000 for project development costs when you can pay a back-hander.”\textsuperscript{115} Furthermore, foreign investors are wary of engaging in projects when the ground rules are not clearly laid out. “It’s all wast$ and diwaniyyah politics which is a turn-off to foreign direct investment. Furthermore, the legal framework in which to work is a nightmare.”\textsuperscript{116} This point of view was supported by NBK Economist, Dr. Donald Morrow, who argues that “a Kuwaiti contract is simply a basis for future negotiation.”\textsuperscript{117} The lack of transparency in the BOT process has two detrimental consequences. First, perceived corruption undermines the efficiency of the BOT process and limits the number of schemes that are successfully tendered. Second, the current process of BOT tendering in Saudi Arabia and Kuwait is deeply frustrating to those companies who are

\begin{itemize}
  \item \textsuperscript{112} Levy, S. M. \textit{Build, Operate, Transfer: Paving the Way for Tomorrow’s Infrastructure} (New York: John Wiley & Sons, Inc., 1996), pp. 22-23
  \item \textsuperscript{113} UNIDO (1996) \textit{op cit.}, p. 283
  \item \textsuperscript{114} Interview with Stuart Bosel, Construction Economist, Salem Marzouk & Sabah Abi Hanna, Kuwait City 10 November, 1999
  \item \textsuperscript{115} Interview with anon. Businessman, Kuwait City
  \item \textsuperscript{116} Interview with Stuart Bosel, Construction Economist, Salem Marzouk & Sabah Abi Hanna, Kuwait City 10 November, 1999
\end{itemize}
unsuccessful in the bidding process. They are frustrated because they believe contracts are awarded based on patronage alone. Patronage is nothing new in the awarding of Saudi and Kuwaiti government contracts. When oil receipts were plentiful both governments used patronage frequently. Unfortunately, BOT schemes are not as abundant as redistributed oil rents. Private sector companies that once saw BOT as a solution to the diminishing level of traditional state largesse are now disillusioned with the process. In this regard, the BOT experience parallels recent research by Gregory Gause who argues that the major reason why the Saudi private sector is advocating WTO membership is to make the government’s commercial decision-making more transparent and regular. Under WTO membership rules, the Saudi elite would be unable to preserve local monopolies, thereby boosting the privatisation process. BOT’s ability to successfully incorporate business demands appears limited in nature.

XI. Concluding Remarks

Hypothesis II set out to uncover whether the application of countertrade is the result of the private sector demanding changes to the manner of redistribution inside the rentier state. The answer to this question is complex, and at times ambiguous, but conclusions can be drawn. First, we can categorically state that private sector demands for the application of countertrade do not represent a fundamental break with rentierism. Demands for change are most evident in Kuwait, but these demands take place within the context of rentierism. In Kuwait, the business elite is in fact asking for changes in the type of redistribution offered. It is not asking for an end to redistribution itself. While

117 Interview with Dr. Donald Morrow, Senior Economist, National Bank of Kuwait, Kuwait City, 14 November, 1999
the private sector complains bitterly about the standard of education in Kuwait and the excess of "free goods" that undermine work ethics, *the private sector still seeks state solutions to these problems*. The initiative of the Kuwaiti private sector was limited to utilising its links in the state bureaucracy where merchant sympathies are strongest (i.e. the Ministry of Finance). Evidence of the private sector seeking access to institutions that impinge on specific business interests is important to the way in which we think about the rentier state. The Kuwaiti businessmen who brought the idea of an Offset program to the government forces us to reconsider the extent of de-politicisation in the rentier state. Self-interest does exist and it is strong enough to galvanise businessmen to demand changes to prevailing economic policies. Nevertheless, the private sector still turns to the state for solutions to its problems. The benefits of Offset are derived indirectly from continued state largesse (primarily through defence spending but also through civilian contracts). The benefits of BOT are similarly derived through an extension of state benevolence. The government still rewards BOT contracts to local businessmen (often in partnership with a foreign contractor) in a manner akin to traditional patronage.

A second significant conclusion is the difference in attitudes towards Offset in both countries. In Saudi Arabia, the program was essentially "imposed" on the private sector by the government. In Kuwait, it was the private sector that asked the government to instigate the scheme. This marked difference in motivations is primarily explained by the time-frame in which each program was considered and ultimately implemented. The Saudi scheme was considered during the early 1980s while the Kuwait program was

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planned during the early 1990s. This ten-year period witnessed a stark reversal of fortunes for the Gulf states. The oil-boom was replaced by the oil-bust. When the Saudi government considered Offset as a viable development strategy, the private sector had no incentive to engage in the venture. Oil rent was plentiful. Despite signing a number of potentially lucrative Offset deals during the 1980s, the private sector remained cool about the idea. Only after the oil bust in 1986 did Saudi merchants reconsider the potential opportunities. Even then it was grudgingly accepted. During the 1990s the Saudi Offset scheme eventually took off. As the number of successful joint ventures increases, the number of Saudi businessmen interested in taking part has grown. Undoubtedly, the success or failure of Offset is tied to the price of oil. Kuwaiti businessmen, by contrast, were influenced by the twin impact of the oil collapse and the Iraqi invasion. During the 1990s, it was increasingly apparent to Kuwaiti merchants that there could be no return to the oil-boom. Nor did the younger commercial elite want a return to traditional rent redistribution. For those Kuwaiti businessmen who wanted to forge new businesses a new form of state largesse was required. Access to strategic partnerships with local firms, education and management techniques and the application of modern yet relevant technology were important goals for the private sector. Utilising its links in the Finance Ministry, the Kuwaiti private sector demanded and won support for state largesse to purchase the required goods and services.

A third important aspect uncovered in this chapter is the growing disillusionment with countertrade as an effective development strategy that satisfies private sector requirements. Again, the complexity of the Offset experience requires clarification. As
the chapter has demonstrated, both Saudi and Kuwaiti businessmen are benefiting from the application of skills training from Offset obligators. The general consensus among those involved with Offset is that education offers the Saudi and Kuwaiti business communities significant long-term benefits. Other sectors have not flourished in a manner that was initially anticipated. The Kuwaiti health sector provides a good example. Although French company Aerospatiale recently completed a $5.5 million Offset obligation to provide a public Kuwaiti hospital with a Human Patient Simulator, small private clinics have found obligators unwilling to invest time or tailor resources into specific programs. The BOT process has likewise proved a disappointment to the private sector.

Finally, it should be noted that if there is a threat to rentierism from the private sector, it is likely to arise because the government is unable to supply redistribution in the manner demanded by businessmen. Evidence contained in this paper confirms the suspicion that the rentier state's Achilles' heal is its inability to adequately deal with changing revenue situations. In Kuwait, the rentier state has difficulty providing the goods and services demanded of it by the private sector. Offset, and to a lesser extent BOT, represent an attempt by the state to "purchase" specific goods and services for the private sector. However, obtaining these goods in sufficient numbers is a difficult task. We can make the argument that the traditional utility of oil revenues might not be sustained over the longer term. Kuwait and Saudi Arabia cannot "buy-off" the private sector in the same way as they did in the past. Indeed, oil revenues are part of the problem rather than the solution. Few could have foreseen the deleterious effects that oil
would have upon the education and motivational outlooks of the indigenous workforce. As the following chapter will detail, the rentier mentality could not be solved by spending more rent. This was, and still is, a qualitative issue rather than a quantitative issue. Motivation and self-improvement, the key to innovation and professionalism, could not be bought. Oil redistribution is still fundamental to the private sector. But so is technology, strategic joint ventures and an adequately trained workforce.
Chapter Five

Hypothesis III: Rentierism Challenged from Above?

Introduction

Chapter five seeks to address the application of countertrade from a unique perspective. It asks whether countertrade marks the start of a fundamental break with rentierism. To achieve this, Hypothesis III asks if the rentier elite are engaged in a process of “state-building” – the movement away from the allocation state towards the building of a production state. The basic premise of Hypothesis III is that countertrade is a facilitator of privatisation and liberalisation with the global economy. The state is to be reigned in, by tackling the prevailing rentier mentality, by establishing a “critical mass” of private sector knowledge and skills and by creating the institutions to allow privatisation to go ahead. At the core of the chapter are three sections – “Interests,” “Receptivity” and “Capacity.” “Interests” refers to the rise of a new rentier elite. The governments and bureaucracies of Saudi Arabia and Kuwait are now staffed with a new breed of western-educated technocrats. This new elite has an alternative conception as to the nature of rentier state development. “Receptivity” looks at the manner in which the elite is conditioning the population to accept a future beyond state largesse. “Capacity” refers to the ability of the rentier elite to implement this objective. Using two case studies, the chapter will show how countertrade facilitates state building while a final section casts a critical eye over the results of the policy.
I. Hypothesis III

Hypothesis III marks a sharp deviation away from the assumptions of the original rentier model by arguing that it is increasingly outdated. Not only are Gulf states set on diversifying their economies away from oil but, crucially, there appears to be a fundamental change in philosophy within governments themselves. Hypothesis III asks if the elites are redefining their countries away from the allocation state towards a productive state. If so, this implies the implementation of new state-building ethic to move away from the institutions of the rentier state that had, until recently, benefited the Gulf elite. The use of the term “state-building” refers to the move from allocation to production through a privatisation of state assets. For the state to survive after the exhaustion of oil rents the economy must be restructured away from its reliance upon government subsidies towards what can be termed a “stakeholder” economy. The government is not the creator of socio-economic relationships, but a reflection of them.

In May 1994, during a graduation ceremony at King Saud University, King Fahd said that the Saudi state intended to “relinquish” its role in the economy.1 Similarly, in December 1998, the Kuwaiti government released details of its strategy to reduce public expenditure. Cuts in fuel subsidies, the taxation of consumer goods, a gradual removal of subsidies on electricity and water, new labour, housing and airport taxes and the introduction of individual contributions to pay for the country’s generous social security budget were announced.2 Privatisation is on the agenda. As one recent report noted, ‘privatisation in Kuwait has actively started in the last two years to take a new form.

From a mere disposal of government-held shares into the assignment of major

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1 *Kingdom of Saudi Arabia Radio*, Riyadh, in Arabic 1130 GMT 9 May, 1994 *SWB* 17 May, 1994
development and infrastructure projects to the private sector such as the Sulaibiya Waste Water Treatment project, which will be executed under a BOT structure. Is the application of countertrade measures therefore a prelude to a broader restructuring of the socio-economic environment in the Gulf? A number of Saudi economists think so. The Economic bureau, an economic think-tank based in Riyadh, recently asserted that ‘Saudi Arabia’s implementation of its economic Offset programs has without doubt heralded a new phase of development in the country’s economy.’

Hypothesis III suggests the move towards expanding and diversifying the productive capacity of the Gulf states cannot be entirely explained by the “crisis-driven” pressures outlined in Hypothesis I nor the pressures from domestic constituents as described in Hypothesis II. Instead, there is a “normative switch” occurring within governments that implies a new state-building ethic is underway. Although conservative-minded ministers and bureaucrats still hold positions of influence, they are outnumbered by western-educated technocrats. We need to investigate whether there a significant change occurring in the way in which Gulf governments are perceiving the structure of the state and society’s role within it. To do this we must understand the statecraft of the Saudi and Kuwait elite – ‘the skills whereby the political elites or ruling classes promote state formation.’

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2 Ash, T. ‘Cautious Road to Reform’ *Middle East Economic Digest* February 26, 1999, Vol. 43, No. 8 pp. 9-10
II. What Does State Building Mean?

A variety of factors are responsible for the building of a state. Theorists have posited a number of variables, ranging from economic growth and modernisation, the use of coercion and war or the threat of war. While most Gulf states can trace their history to the period before the oil era, oil itself transformed weak entities into modern ‘states.’ Yet while Kuwait and Saudi Arabia possess many of the characteristics of other states around the world, very few of the institutions they possess are strong. Although both states have widespread social provision and possess an extensive security apparatus, Gulf states are institutionally “weak” states. Both Kuwait and Saudi Arabia acquired the trappings of modern statehood in a short period of time. Prior to the oil boom, the evolution of statehood was both protracted and contested. Within ruling elites, tensions rose over how to spend limited resources. However, the oil boom ameliorated these strains. New bureaucracies were established overnight to implement a variety of redistribution policies. The rulers of the Gulf believed that modern statehood could be “bought” by oil wealth, essentially bypassing the difficult and destabilising process of

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11 Samuel Huntington illustrates the example of the struggle between King Saud and Prince Faisal during the 1960s. Faisal wanted expenditure on the royal family cut and savings assigned to education and social welfare. The victorious Faisal cut family expenditure from 15% of the national budget to 6%. However, the transfer of power split the royal family. See Huntington, S. P. *op cit.*, p.157
modernisation that they had earlier experienced. Rulers could be autonomous and powerful, the ruled could be wealthy and pacified. However, the fiscal crises experienced by Gulf states since the 1980s has exposed the flaws in this philosophy. A state that is built upon oil wealth may not survive when that wealth disappears. This poses an interesting question; how can the rentier state survive beyond the oil-age? Hypothesis III asserts that this question is now the guiding principle in the application of economic policy. State-building is defined as the movement away from the rentier state towards the productive state. In sum, state-building that cannot be bought.

A major consequence of this process would be the restructuring of the relationship between state and society. The governments of the Arabian Gulf are concerned about the manner in which oil has adversely affected the outlook of individuals. This rentier mentality is economically unsustainable. Instead of viewing the state as an endless source of free goods, governments want their citizens to take greater responsibility of their own welfare and economic well-being. This is an important aspect of state building. As one Kuwaiti commentator puts it, 'it is not natural resources that build a nation, but its people and their determination.'\textsuperscript{12} The overly generous provision of public goods and the heavy subsidisation of other services cannot last indefinitely. By acting now, governments have a sufficient (and necessary) period of time in which to alter the perception of the state held by many Gulf citizens. There is a gradual movement away from welfarism towards increasing self-reliance. As Sayigh argues, 'the discrepancy between the substantial benefits received and the absence of a tax burden remains a

\textsuperscript{12} Al Sabah, Y. S. F. \textit{The Oil Economy of Kuwait} (London & Boston: Kegan Paul International Ltd., 1980)
serious social flaw in the system, and the longer the flaw stands uncorrected, the more
difficult it will be in the future to train the population to bear its tax responsibility. 13
Reform will be a long and painful process because the rentier state has created a "gap"
between societal expectations and state capabilities. 'Because perceptions and attitudes
change very slowly, the effects of the oil-boom years last longer than the oil boom
itself.'14 If efforts to remedy this flaw are significant, countertrade would have to be seen
as an intermediate measure adopted by Gulf states to ease in this transition. According to
Ala’a Omran, a research co-ordinator at the Offset Projects Unit at the Arab Research
Centre based in Kuwait, "countertrade is an intermediate phase in Kuwait’s economic
development...It is not an alternative to privatisation but a facilitator."15

In addition, bureaucratic institutions must be reformed to enable the state to
function in a form other than as an organisation of rent redistribution. The rentier state is
described by strong, although highly inefficient, redistribution bureaucracies. It has
no extractive apparatus to obtain tax revenues from the population. Establishing an
effective administrative apparatus to accomplish this is not easily achievable. Al Omar’s
analysis of bureaucracies in the GCC demonstrates how 'low administrative capacity and
weak planning have impeded economic development, even though the required financial
resources were available.'16 Gulf bureaucracies are unable to formulate clear economic
strategies. In productive states, institutional development has proceeded in a gradual and

13 Sayigh, Y. *The Economies of the Arab World: Development since 1945* (London: Croom Helm, 1978),
p. 122
14 Krimly, R. *op cit.,* p. 260
15 Interview with Ala’a Omran, Research Co-ordinator, Offset Projects Unit, Arab Research Centre,
Kuwait City 3 November, 1999
16 Al Omar, F. A. *Bureaucracy, State and Development in Kuwait and the Arab Gulf States* (Islamabad:
Institute of Policy Studies, 1997), p. 164
increasingly sophisticated manner. These institutions reflect the broad range of social, economic and political ambitions of successive governments. Furthermore, secondary institutions develop to ‘solve problems generated by the intrusive nature of extraction and to forge bureaucratic compromises among those arguing for alternatives.’ None of this exists within rentier states. Hence economic reform is potentially constrained by this administrative vacuum. Dirk Vandewalle’s incisive analysis into state-building in Libya shows that the policy of economic liberalisation (infitah) was abandoned, not because of a lack of political will, but because of the lack of an effective administrative capacity. Chaudhry’s comparative analysis of “late developers” warns that ‘liberalisation will not work without effective national legal and regulatory systems.’ In the Gulf, the weakness of the state prevents a rapid move towards privatisation and liberalisation. World Bank economist, Pierre Guislain, points out that the establishment of a successful privatisation policy requires efficient and independent regulatory mechanisms. Weak institutional capabilities only preclude efforts to implement radical solutions. As this chapter will show, countertrade is interesting in this regard because, in limited instances, the manner of its implementation bypassed many of these problems.

Finally, it should be pointed out that there is nothing paradoxical about “state building” occurring via a strategic “retreat” of the state. State building does not have to occur with the simultaneous expansion of the institutions of the state. Indeed, if elites are consciously employing policies to reduce the permissiveness of the rentier state, this is in

17 Vandewalle, D. op cit., p. 19
18 Vandewalle, D. op cit.,
fact evidence of state durability. As Ikenbury asserts:

The capacity of the state should not be measured solely in terms of the expansions of state controls or activities. The withdrawal of state control or abstentions from interventions in the first place may also be evidence of state capacity.  

A policy of proactive state withdrawal and the implementation of privatisation suggests considerable autonomy and capacity of the rentier state elite. If countertrade is a deliberate attempt by the leaders of Kuwait and Saudi Arabia to relinquish state control and interventionism this would force us to re-evaluate what rentier state autonomy actually means. State strength must be measured by means other than the analysis of redistribution mechanisms that characterise the strong state/weak state debate among rentier theorists.

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21 Ikenbury, G. J. *op cit.*, p. 204
III. Interests

This section concentrates on the growth of a western-educated cadre of decision-makers in the governments of Kuwait and Saudi Arabia. The size of this group within government and the bureaucracy helps explain the apparent “normative shift” in the direction of economic development. This elite is behind the push by the government to persuade citizens of the rentier state to assume greater self-reliance in society. Yet this enlightened view is also designed to shore up support for the regime. Greater private sector investment from overseas is now perceived by the government as a means to strengthen the long-term security of the regime.

i) A New Elite

Central to the concept of state-building in Hypothesis III is the argument that economic decision-making has passed into the hands of a “new elite” of politicians and technocrats who are prepared to look for new solutions to old problems. According to academics that have conducted research into the educational background of the Gulf elite, the findings revealed ‘important clues to their sense of priorities, the direction of socio-economic changes they initiate as well as the political system itself.’\(^2\) The redistribution of oil wealth into education has altered traditional attitudes to socio-economic issues – a process that was noticeable to researchers by the early 1970s.\(^3\) For the last three decades there has been a marked increase in the number of Saudis studying in American universities to obtain familiarity with technology and management techniques. In July


1995, over 100 of 250 senior bureaucrats were replaced by a younger elite. One month later, on August 2 1995, King Fahd announced sweeping changes to the cabinet. Many of the old guard were replaced by a significant number of western-educated technocrats, most in their forties and fifties – relatively young by Saudi standards. Of the 22 non-royal ministers, 15 were new to the cabinet. 16 of the 22 received graduate education (14 Ph.D.s and two Masters) and studied at a diverse range of American universities; Stanford, Arizona, Harvard, Berkeley, Duke, Florida, John Hopkins, Michigan, USC, Oklahoma, North Carolina (see Table 36 - Appendix). Few Western nations boast cabinets and sub-cabinets that are as formally educated as Saudi Arabia’s. Many of these individuals were rapidly promoted to positions of considerable influence, bringing about a change of emphasis toward development strategies. For example, Finance and National Economy Minister, Ibrahim Al Assaf, was appointed to the post in January 1996. A graduate in politics and economics from King Saud University, he holds a doctorate in economics from Colorado State University. Prior to entering the cabinet, Al Assaf represented Saudi Arabia as an executive director at the IMF and the World Bank from 1986-95. Similarly, Osama Bin Jafar Ibrahim Faqih, the Minister of Commerce holds an MBA from the University of Arizona. These two ministers have been instrumental in moves to privatise government companies and in the examination of new methods of taxation. Al Assaf’s tenure at the World Bank straddled a period of time in which BOT divestiture mechanisms were promoted by the organisation through out the developing world. It is no coincidence that the minister charged with overseeing the private financing of infrastructure schemes advocated BOT as an effective development strategy.

Both men are also responsible for preparing Saudi Arabia for WTO membership. During the reshuffle of June 1999 those ministers considered to be reformers kept their portfolios, a move widely interpreted by Saudi observers as confirming the reform process will be intensified.26

Reformers are also well represented in the Kingdom’s Consultative Council and bureaucracy. Research conducted into the latest Majlis Al Shura shows it to be relatively youthful, while the occupational breakdown of the membership in over a dozen categories reflects considerable diversity.27 Although the Majlis is primarily made up of bureaucrats and academics, many have links to various interest groups in society. Big businessmen account for 7.8% of the 1997 Majlis, while another 7% of the bureaucrats have day-to-day dealings with the business community. The Majlis is also extremely well educated. 64% of the members hold doctoral degrees, mainly from American and British universities.28

In Kuwait, a large number of current policy makers were educated abroad. Research conducted by Abdul-Reda Assiri and Kamel Al Mosoufi shows that since independence in 1962, the number of western-educated graduates entering positions of power in the Kuwaiti cabinet has risen sharply. By the late 1970s, most cabinet members were university-educated. The most popular choice of degree subject is economic and

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25 See ‘Executive Briefing’ Middle East Executive Report August 1995, Vol. 18, No.2 p. 4
26 See Trevelyan, R. ‘Keeping Faith’ Middle East Economic Review 2 July, 1999 Vol. 43, No. 26 pp. 2-3
27 Dekmejian, R. H. op cit., p. 210
28 Figures from Dekmejian, R. H. op cit., p. 210
business. As a result, "many under-secretaries now talk the language of economists."

Following the liberation of Kuwait a new cabinet was announced on April 20, 1991. Despite opposition claims of nepotism, the new cabinet was significant in that a number of veterans were replaced by a new, younger breed of technocrats and academics who took over key economic portfolios. This perception of a new class of technocrat is recognised by individuals engaged in Offset negotiations. According to head of the Offset division in the British Ministry of Defence, there is a change afoot. "Personalities are changing. Many have been educated abroad and they have a different view of procurement. There is a maturity of procurement." An example of this can be found within the powerful Industrial Investment Company of Kuwait (IIC). Established in April 1983, this quasi-governmental organisation is responsible the investing, financing, managing and trading in funds and assets related to industrial projects inside the country. The IIC provides expertise and policy initiatives to the Offset Program via its Investment Committee. This Committee is made up of government officials as well as private sector individuals. It is interesting that 6 out of the 7 members hold post-graduate degrees from overseas universities, including Ph.D.s and M.B.A.s. For example, the Chairman and Managing Director of the IIC, Dr. Taleb Ali, has Master and Doctorate degrees in economics from the University of Colorado and was a consultant for the Industrial Bank of Kuwait.

29 Assiri, A. & Al Mosoufi, K. op cit., p. 52
30 Interview with Jasem Al Sadoun, President, Al Shall Economic Consultants Kuwait City, 8 November, 1999
31 Key reformers included Hamoud Abdullah Al Rquba as Oil Minister; Nasser Abdullah Al Rodhan appointed Finance Minister and Badr Jassim Al Yaqoub as the new Information Minister. For more information see: O'Sullivan, E. 'Hard Choices for Kuwait's New Men' Middle East Economic Digest May 3, 1991 Vol. 35, No. 17
Despite these advances, which are significant, the "old guard" still retains leverage in policy formation. Recent advances in the liberalisation of the rentier economies have been opposed by a number of conservative-minded ministers. For example, the Saudi Interior Minister, Prince Nayef bin Abdel-Aziz Al Saud is a senior cabinet minister and member of the ruling family, and has been extremely critical of the speed and direction of economic reforms. In Kuwait, conservative Islamists continue to hold positions of influence. In the first cabinet of the 1999 parliament three portfolios were held by Islamists, – including Electricity and Water and Housing Affairs. Although the power of the conservatives has waned as they are replaced by members of the new elite, the glacial speed of reform illustrates the power they still wield. The application of countertrade and moves toward privatisation has been greatly facilitated by the rise of a new elite. Nevertheless, while public statements profess commitments to economic reform, private battles still rage behind the scenes.

ii) The New Elite Conception of State Building

In recent years it has been possible to detect a change of emphasis in the manner in which development is perceived and implemented in Kuwait and Saudi Arabia. As members of the new elite have taken up positions of responsibility, both governments have looked at change seriously. With the declining health of King Fahd, his half-brother Crown Prince Abdullah Ibn Abdul Aziz has gradually taken over the running of the Kingdom. Responding to the policy of deficit reduction that the government was forcing through in 1996, Abdullah appealed to the average Saudi to "respond positively" to the
changes that were being introduced. At a recent GCC summit held in the UAE, the Crown Prince argued that drastic changes were required inside Gulf States:

It is important to remind ourselves that the boom period is gone for good, and that we have to get used to a different lifestyle in which every individual should perform their effective role and not totally rely on the state. The next phase, therefore, requires the private sector to shoulder some of the burden, which the state has hitherto shouldered.

The government is trying to persuade Saudis to act as responsible citizens. It attempts to do this by presenting cut backs as beneficial to the average Saudi. Recent broadcasts made by the Saudi news agency argue that increases in petrol prices will support developments in 'the level of various government services, such as education, health and others.' The last decade has seen the government argue the case for increased self-reliance ever more vigorously. Government-sponsored media now requests policies 'to come to grips with the economic slump and retrenchment our country has been experiencing.'

Saudi citizens are chastised for their lack of civic responsibility and national obligation. Fundamental economic reform is necessary, 'even if involves some belt-tightening and the ordinary citizen having to experience a measure of hardship in the interest of a redefinition of the developmental state.' Another Saudi newspaper recently warned its reader that the country is passing through a 'necessary transitional phase from the public welfare state to the state of minimum necessity.....(It is

34 Kingdom of Saudi Arabia Radio, Riyadh, in Arabic 2230 GMT 7 December, 1998 SWB 9 December, 1998
35 Kingdom of Saudi Arabia Radio, Riyadh, in Arabic 2000 GMT 23 May, 1999 SWB 1 June, 1999
36 Text of article by Hasan Bin Sa'd Bin Abd Al Aziz 'Fair or Unfair Distribution' published in Al Jazira, Riyadh, in Arabic 25 December, 1996 SWB 7 January, 1997
37 Al Aziz in Al Jazira ibid.
important) to forge ahead, for the policies of the past are no longer possible.\footnote{Qarmali, A. K. ‘From the Public Welfare State to the State of Necessities’ Jeddah ‘Ukaz in Arabic 20 February 1998, p. 2 FBIS-NES-98-055}{38}

In Kuwait, the language of reform is even louder. According to Jill Crystal, ‘oil has been of such benefit to Kuwait that it is hard to imagine that it might also have serious costs. But it does, and these costs are very real. Economic development has led to overspending, corruption, inefficiencies, inflation, shortages and bottlenecks.'\footnote{Crystal, J. (1992) op cit., p. 62}{39} The Kuwaitis have identified the source of these problems and have proposed solutions. In December 1995, Education Minister Ahmed Al Rubei, told Kuwaitis to readjust their extravagant lifestyles, pointing out that “no society can live without taxes.”\footnote{Quoted in Ash, T. ‘Slow Progress on the Road to Reform’ Middle East Economic Digest 23 February, 1996 Vol. 40, No. 8 pp. 7-18}{40} Crucially, the Kuwaiti government has re-defined development away from board assertions on the advancement of society generally, towards the notion of individual responsibility. As the government puts it, ‘the strategy is to concentrate on shaping the Kuwaiti individual.’\footnote{State of Kuwait For History (1995) op cit., p. 85}{41}

Recognising that oil rents bring negative as well as positive effects, the government believes that ‘society will be able to move swiftly towards development and progress the more that members of society appreciate their responsibility to work hard and to acquire as much knowledge and skills as possible.’\footnote{State of Kuwait For History (1995) op cit., p. 85}{42} In short, the government is engaged in a state building project in which there is now ‘a change in the prevailing idea of government employment from that of a social objective to attain productive and development objectives.’\footnote{State of Kuwait For History (1995) op cit., p. 85}{43} The Kuwaiti authorities realise that the allocation state is not sustainable into the long term. “The government wants to shift the burden of provision...
towards the people themselves." Deputy Prime Minister, Nasir Abdullah Al Rawdan, clearly emphasised this when he stated that 'governments have become unable to provide all of society's requirements at nominal prices or free." Efforts must now be made to reorient the state towards its productive base, which dominated the economy before the discovery of oil.

iii) State Building: An Additional Method of Political Support?

The movement from allocation to production makes good economic sense. Yet changes in the orientation of economic development are usually the result of political calculations. Sceptics would be correct to highlight unease about a change in the direction of development based on enlightenment alone. What about elite self-interest? In fact, self-interest is behind the desire to state build. State building is a means for the rentier elite to maintain power by creating external allies to shore up its support base. Chapter one pointed out that the rentier state has acted in imaginative ways to maintain its incorporation capacity. This has primarily involved the use of rents derived from the sale of oil. Hypothesis II demonstrated that the utilisation of Offset and BOT serves an important political function for the elite by incorporating business classes into the schemes - an extension of rentier patronage. Hypothesis III goes further. Politics inside the rentier state is a never ending process of incorporation. Far from being a threat to the rentier elite, the transformation of the rentier economy from allocation to production is viewed as a means to buttress its support.

43 State of Kuwait For History (1995) op cit., p. 86
44 Interview with Dr. Abdel Raouf Tawfik, Director, Advanced Industrial Consultants, Kuwait City, 6 November, 1999
45 Kuna News Agency, Kuwait City, in Arabic 0725 GMT 12 May, 1997 SWB 20 May, 1997
There is a pressing need to find new methods of political incorporation inside Kuwait and Saudi Arabia. In an age of increasing global awareness and declining levels of oil wealth, rentierism is starting to be perceived as outmoded by citizens who have benefited from free education and welfarism. As one recent commentary on Saudi Arabia explained:

As it grapples with modernity, the distinctions between members of the Al Saud ruling family and the rest of the population is beginning to seem distinctly anachronistic. Previous domestic deference towards the privileged Al Saud is turning into increasingly common, if as yet still mainly private, criticism of their lifestyles. Characteristically such criticisms tend to come from those very youths that have benefited from the country's growth in education and travel abroad. They are also finding that despite the economic and educational boom, their not unreasonable expectations about careers and jobs in their own country are simply not there for the taking. This is a serious and growing disillusionment which, if not properly addressed, will create increasing discontent.46

Additional strategies must be considered to legitimise the rentier elite in the eyes of an increasingly sophisticated "global-oriented" section of the population. This aspect of globalisation threatens to undermine the traditional autonomy of the rentier state. Nevertheless, globalisation appears to offer alternative support strategies – a means not only to pacify changing domestic allegiances but also to obtain support from parties outside of the rentier state. This is not traditional "incorporation." The rentier elite cannot craft a mechanism of control over foreign investors. However, what it can do is create conditions whereby foreign investors view the stability of the ruling family as the best method of safeguarding their investments. Liberalisation of the rentier state might yet buttress the declining support of the rentier elite.

46 'The Democratic Deficit' *Gulf States Newsletter* 29 May, 2000 Vol. 25, No. 637 pp. 8-9
In Kuwait, privatisation was never simply an economic decision, - "there is a political aspect to privatisation that should not be ignored." The central element of this political consideration was the future security of Kuwait. The ruling family calculated that the autonomy of the rentier state from the global economy had actually weakened its security. By restricting the level of foreign direct investment, foreign companies had not generated enough vested interests inside the state. Other than oil, foreign governments had no reason to protect the territorial integrity of the state. However, by boosting the level of foreign investment in the economy, the long-term stability of the state (and therefore the ruling family) would be guaranteed by vested interests of foreign companies, and in turn, foreign governments. By changing the nature of the economy, the Kuwaiti elite had concluded that greater integration into the global economy would actually strengthen the security of the regime. Reliance upon the traditional method of rent redistribution within a closed economy would only weaken security. Therefore, the rentier elite of Kuwait had to extend its support base beyond the rentier state. Yet a combination of political sensitivities, combined with structural impediments, precluded rapid liberalisation as a viable strategy. Countertrade, however, could be a useful facilitator. By the mid-1990s the Kuwaiti government was arguing that BOT schemes were not to be seen as an end in itself but rather as 'a graded method toward increasing the direction for privatisation.'

47 Interview with Dr. Adnan A. Al Hamoud, Deputy Director General, Kuwait Institute for Scientific Research Kuwait City, 10 November, 1999

48 Tetreault offers a counterpoint to this by suggesting that Kuwait's overseas investments, especially in Europe, was a major reason why so many states were willing to enter the UN coalition against Iraq. They did not want inward investment owned and controlled by Saddam Hussein. See Tetreault, M. A. (2000) op cit., p. 57
By obtaining external allies outside the rentier state, the rentier elite has buttressed its declining support amongst important elements of the business community. There is a symmetry of interests at work. If foreign companies, backed by their governments, are interested in protecting their investments by maintaining the stability of the rentier elite, be it the Al Saud or Al Sabah, the domestic private sector also has a vested interest in maintaining the status quo. As Fareed Mohamedi argues, the Gulf bourgeoisie are now willing to reinvest money back into the region because there is ‘a perception that there is little to fear from external or internal threats to political stability – if the US protected Saudis once, the argument goes, it will do so again.’50 This ‘internationalisation’ of the support base is particularly important. One consequence of the BOT tendering process has been the increased demand for avenues of patronage from foreign contractors. Saudi Arabia in particular, has benefited from foreign companies purchasing the sponsorship of extended members of the royal family to win government contracts. Many contractors view this as a form of “political insurance” to protect their business interests.51 As linkages between the government and foreign investors intensify, so it is necessary for the private sector to maintain linkages of support to the rentier government. By advancing a global, business friendly agenda, the rentier elite is in tune with influential merchants who are able to exploit global opportunities. In this regard, there is more commonality between the rentier elite and the merchant elite than at any time since the oil boom ended in the mid 1980s. It is, however, a fine line to tread.

Globalisation is an opportunity to some businesses and a threat to others. Rentier

49 State of Kuwait, Ministry of Planning and Center for Research and Studies on Kuwait (1995) op cit., p. 199
governments will still have to maintain levels of largesse for some time to come to prevent alienation among the smaller businesses.

IV. Receptivity

The use of the term 'receptivity' refers to the efforts taken by the rentier elite to condition the population to take a greater role in the economy and society. In this section, it is argued that the rentier elite is attempting to foster a new type of rentier citizenship. Particular attention is paid to the detrimental consequences of the rentier mentality and why the government demands economic strategies to solve the problem.


Government attitudes towards citizenship and its benefits are changing. State largesse has played an important role in both government’s ‘desire to achieve justice of distribution,’ while also enabling the ruling elite to pacify its potential troublemakers. However, in the post-Gulf War period governments have questioned the impact and utility of redistribution. Largesse has caused as many problems as it has solved. In 1995 the Kuwaiti Council of Ministers announced a 30% ceiling on all state subsidies, ‘so that citizens will make a greater contribution towards easing the state’s financial burden.’ The negative impact of subsidies was also laid out in a forthright manner by a government publication issued in 1995. Not only had the private sector become reliant upon subsidised products, society itself had become inefficient and lazy. The Ministry of

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51 Gause, F. G. *op cit.*, p. 57
52 State of Kuwait, Ministry of Planning and Center for Research and Studies on Kuwait (1995) *op cit.*, p. 57
53 *Kuna News Agency*, Kuwait City, in Arabic 1505 GMT *SWB* 27 June, 1995
Planning called for reform.

(The) traditional pattern of providing subsidies is linked to a degree of interference that affects market mechanisms and the optimal allocation of resources, a matter that requires change in the social view of subsidy and the financial policies responsible for its allocation.\(^5^4\)

This statement was a significant break with previous statements on the purpose and utility of subsidies. It called for both a financial and psychological reorientation of the policy. The population had to prepare itself for a change in allocation policies pursued by the state, and break the rentier mentality that had pervaded it. State policies were to be subsequently pursued on the basis of 'promoting the efficiency of utilising public utilities and services through the re-pricing of them according to criteria that relate their cost to citizens to the cost of wages, production and preparation.'\(^5^5\) Government officials have begun to make forthright statements of the need to move from allocation to production. According to the Second Deputy Prime Minister:

The government has adopted privatisation as a major priority in its general economic policies....The government is steadfastly and carefully drawing a general framework for privatising public services according to a technically sound programme...it will generate and equality in sharing the burdens and benefiting from opportunities.\(^5^6\)

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\(^5^4\) State of Kuwait, Ministry of Planning and Center for Research and Studies on Kuwait (1995) *op cit.* p. 190

\(^5^5\) State of Kuwait, Ministry of Planning and Center for Research and Studies on Kuwait (1995) *op cit.* p. 199
As the Kuwaiti heir apparent, Sheikh Sa’d, now argues; ‘true citizenship is a matter of give and take, rights and duties.’ Unlike the Saudis who have consistently delayed painful reforms, the Kuwaiti state budget for 1999-2000 was actually delayed by the Finance Ministry, which asked all ministries, state directorates and affiliated quarters to reduce expenditure by 25%. In 1999, Finance Minister Sheikh Ali Al Salem, stressed the need to impose charges on fuel, natural gas, medical centres, electricity and communications. The state plans to reduce its contribution to social security by deducting greater contributions from employee’s salaries.

In Saudi Arabia, the government is more cautious but it has become increasingly more strident in its calls for an end to state largesse. According to the Ministry of Planning, which recently published Saudi Arabia’s Seventh Five Year Plan (2000-2005), new economic strategies have to be implemented to solve this problem. ‘Privatisation is a strategic choice for the Kingdom, which wants to create a new economic reality where society’s needs will be satisfied by the private sector’s vitality and initiative.’ In the mid 1990s, the Planning Ministry gave notice that ‘the prices of public services should not be less than their production cost except in rare cases, and that they should be periodically reviewed.’ Five years later, the same Ministry planned to take these reforms a step further. The seventh plan intends to develop what it calls “voluntary

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56 ‘The Speech of His Excellency the Second Deputy Prime Minister, Minister of Finance and Kuwait Investment Authority’s Board Chairman’ pp. 11-12 in: Kuwait Investment Authority Investment Opportunities in Kuwait: Progress and Outlook 18 March, 1995 pp. 10-12
58 Al Watan, web-site, Kuwait, in Arabic 12 April, 1999 SWB 20 April, 1999
59 ‘New Five Year Plan to Focus on Saudization and Privatization.’ Arab News 14 August, 1999
60 Kingdom of Saudi Arabia, Ministry of Planning (1995) op cit., p. 93
services” and to ‘reinforce this concept in society and improve its means and methods.’

Yet many of the Saudi reforms have been piecemeal. Reliance on subsidies to achieve the government’s political and economic aims is a difficult habit to break. Subsidy reductions have led to price rises for electricity, water, petrol, domestic airfares and telephone usage, but most reductions merely reversed recent subsidy increases. The state is still the largest employer with 88% of the workforce employed in the public sector. Only 12% of Saudi men are employed in the service sector, 7% in the private sector and a mere 4% in industry. Yamani argues that the problem is getting worse. “The younger generation of Saudis has inherited the preference for secure government positions over the difficulties and uncertainties of a career in the private sector.” Although it is proving to be extremely difficult, tackling the rentier mentality is a prime objective.

ii) Tackling The Rentier Mentality

By the early 1980s academics in the Gulf region and the West began to write about the deleterious social effects oil revenue was producing. Muhammad Rumaihi’s research, originally published in Kuwait in 1983, criticised his countrymen and neighbours for a lack of work ethic. Work and production was no longer of any great importance for Gulf citizens. Competition and initiative had been stifled because of a

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61 Arab News (14 August, 1999) op cit.
65 Expatriate workers from the Indian subcontinent are highly motivated in comparison to Gulf citizens. See Woodward, P. Oil and Labor in the Middle East: Saudi Arabia and the Oil Boom (New York: Praeger, 1988) Chpt. 12 pp. 135-152 However, for arguments that the rentier state may also undermine ethics in expatriate works see Beblawi, H. ‘The Rentier State in the Arab World’ in: Luciani, G. op cit.
deprivation of incentives.\textsuperscript{66} Observers noticed that ‘there is a negative attitude towards work in a rentier society.’\textsuperscript{67} Chatelus and Schemeil argue the work-reward linkage that is observed in production economies is non-existent in allocation states. Instead, the major preoccupation is gaining access to the rent circuit.\textsuperscript{68} Why work hard or take risks when state largesse guarantees the individual a high standard of living? Individuals in the Gulf are said to suffer from static expectations about their current and future income.\textsuperscript{69} This rentier mentality is particularly acute in Kuwait. It has served to erode the sense of “work ethic” that Kuwaitis possessed prior to the discovery of oil. According to one senior policy maker, “Kuwait is a welfare government. Guaranteeing a job for every Kuwaiti is, in my opinion, a disaster.”\textsuperscript{70} Similarly, Ahmed Bishara, a parliamentarian with the opposition party, the Kuwait Democratic Forum, complains that his country is “the last bastion of socialism. Everything is free and Kuwaitis get paid for doing nothing in government jobs.”\textsuperscript{71} During an interview series with engineers working for Municipality of Public Works (MPW) it was apparent that many of Kuwait’s brightest individuals had no ambition or incentive to join the private sector. The public sector was preferable for a number of reasons. In the first instance, almost all Kuwaitis interviewed had become accustomed to the “job for life” mentality. The state guarantees all Kuwaitis a job even if there is no need for their particular skill. Consequently, “the rentier society

\begin{itemize}
  \item \textsuperscript{66} Rumaihi, M. trans. Dickens, J. \textit{Beyond Oil: Unity and Development in the Gulf} (London: Al Saqi Books, 1986)
  \item \textsuperscript{68} Chatelus, M. & Schemeil, Y. ‘Towards a New Political Economy of State Industrialisation in the Arab Middle East’ \textit{International Journal of Middle East Studies} Vol. 16, No. 2 May 1984 pp. 251-265
  \item \textsuperscript{69} Koppers, S. \textit{Economic Analysis and Evaluation of the Gulf Cooperation Council (GCC)} (Frankfurt: Peter Lang, 1995)
  \item \textsuperscript{70} Interview with Dr Adnan A. Al Hamoud, Deputy Director General, Kuwait Institute for Scientific Research, Kuwait City, 10 November, 1999
\end{itemize}
is not based on merit or achievement.”^72 This mentality develops at an early age. Those interviewed pointed out that there was little incentive to do well at school or university as family contacts would guarantee a position within the desired government department.^73 Allied to the attractiveness of a job guarantee are the wages. The state is extraordinarily generous with its wage provision, leading to warnings of its sustainability.74 Many private sector companies cannot offer wages to better, or even equal, those paid by the government. A final perceived “advantage” of public sector employment is an apparent lack of any responsibility. Whereas the private sector demands accountability and performance targets, these are absent within many departments. The public sector is notoriously relaxed. “Kuwaitis avoid the private sector because performance and insecurity are perceived as a threat.”^75 Only those individuals exposed to “western” management are prepared to entertain the idea of private sector work. According to Ibrahim Ashkanani, an engineer with private sector experience, “the main difference between Kuwaiti workers are those who have worked abroad and those that have not. Those that have are frustrated with the public sector and seek meaningful and productive work. However, most people just sit around drinking tea and reading newspapers.”^76 Unfortunately, motivated individuals are few in number and still prefer to “freelance” with the private sector. A state job is perceived as a “right” and as it is guaranteed, this

^71 Dr. Ahmed Bishara quoted in The Washington Report on Middle East Affairs op cit., p. 101
^72 Interview with Abdullah Al Nebari MP, Kuwait City, 10 November, 1999
^73 Group Interviews with employees of the Municipality of Public Works, Amiri Diwan Kuwait City 9 November, 1999
^74 Dr Adnan Al Hamoud, Deputy Director General of the Kuwait Institute for Scientific Research, warned the government in 1997 that its public sector wage policy was unsustainable over the next five years. Interview with Dr Adnan Al Hamoud, Kuwait City, 10 November, 1999
^75 Dr Adnan Al Hamoud, Deputy Director General, Kuwait Institute for Scientific Research, Kuwait City, 10 November, 1999
^76 Interview with Ibrahim Ashkanani, Engineer, Municipality of Public Works, Kuwait City, 9 November, 1999
forms the "base" salary. As the state only requires the employee to work from 7am to 2pm, talented individuals will begin their "real work" in the afternoon for a few hours. Although all Kuwaitis interviewed expected this situation to end in the future, no one felt any sense of urgency to alter the situation immediately.

The situation is equally acute in Saudi Arabia. The Saudi Chambers of Commerce has characterised Saudi workers as lacking vocationally relevant knowledge and skills; being more concerned with job status than intrinsic value; and possessing unrealistically high salary requirements.77 A survey of 1,500 private sector businesses conducted in Riyadh in 1989 illustrated the motivational differences between the indigenous workforce and foreign contractors.

Table 29: Results of Riyadh Private Sector Employment Survey 1989

<table>
<thead>
<tr>
<th>Criterion</th>
<th>National Workers (%)</th>
<th>Foreign Workers (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular attendance at work/not prone to absence without reason</td>
<td>34.0</td>
<td>66.0</td>
</tr>
<tr>
<td>Suitability in service</td>
<td>12.0</td>
<td>88.0</td>
</tr>
<tr>
<td>Observance of work regulations</td>
<td>15.0</td>
<td>85.0</td>
</tr>
<tr>
<td>Job experience</td>
<td>3.3</td>
<td>96.7</td>
</tr>
<tr>
<td>Amenability to transfer within country</td>
<td>17.4</td>
<td>82.6</td>
</tr>
<tr>
<td>Capability to increase productivity</td>
<td>23.0</td>
<td>77.0</td>
</tr>
</tbody>
</table>


Saudis are taught from an early age that manual labour is 'aib, or shameful. Prestige is an important factor in the choice of job taken. However, prestige does not guarantee a willingness to work hard. Wide gaps between performance, ability and

specialisation still exist between foreign labourers and Saudi nationals.\textsuperscript{78} By working in government bureaucracies, where job performance is not measured, Saudi’s are said to be “psychologically aloof” when they are asked to consider private sector employment.\textsuperscript{79}

Offset appeared to offer a solution. The Official Guidelines of the Kuwait Offset Program calls for the creation of educational and training opportunities for Kuwaiti nationals, the transfer of state-of-the-art technology, diversification of the economy and substitution of the use of foreign produced goods with domestically produced goods.\textsuperscript{80} According to the head of the Offset program in Kuwait, “Offset is a facilitator. Offset is implemented to diversify the economy, to employ Kuwaitis, generate export-oriented industries and to help the government to implement privatisation.”\textsuperscript{81} Through the use of multipliers, the Offset scheme planned to encourage large multinational companies to train nationals in professional and hi-tech areas. Obligators were willing to oblige. According to one Offset manager, “there is a culture change required here. Countertrade is a stepping stone. I think it is a bridge. It is necessary to get people to take the initial step of risk-taking.”\textsuperscript{82} This view is supported by the CEO of a Kuwaiti company engaged in an Offset scheme to train Kuwaiti nationals. “Offset is an important intermediate step to boost private sector participation inside the Kuwaiti economy.”\textsuperscript{83}

\textsuperscript{78} ‘Saudization is a Right and a Necessity’ \textit{Al Dammam Al Yawm} in Arabic 30 August, 1998 p. 2 FBIS-NES-98-246
\textsuperscript{80} State of Kuwait, Ministry of Finance, Countertrade Offset Program Executive Office \textit{Guidelines for the Countertrade Offset Program} April 1, 1995 Article 2.2
\textsuperscript{81} Interview with Mazan Madooh, Manager, Offset Program Department, Ministry of Finance, Kuwait City, 13 November, 1999
\textsuperscript{82} Interview with Peter Griffith, Regional Director, GEC Marconi, Kuwait City, 10 November, 1999
\textsuperscript{83} Interview with John Wakefield, Chief Executive Officer, Gulf Insurance Company Kuwait City, 12 November, 1999
Of course, Offset alone could not be expected to solve the difficulties associated with the rentier mentality. However, its application is interesting because it ties in with evidence of a broader recognition of the problem at government level. It is worth comparing and contrasting the following two statements. During the 1960s the Kuwaiti government was confident that oil would solve its development problems and predicted that the country would 'continue to rely on her “black gold” for some time.'

(There is) money to spare for vast and imaginative development plans in every field. At the same time the government can afford to provide free health facilities, free schooling and many other free services which in other countries must be paid for through various rates and taxes.

At the height of the oil boom in the mid-1970s, academics were asserting similar points of view. ‘Roads, schools, hospitals, whatever is taken as the criterion, Kuwait has everything it requires and all that remains is to add the odd touch of luxury.’ Now compare the statement above with the following announcement by the State of Kuwait in 1995. It argued that the role of oil as the principal generator of income:

...has negatively affected the lifestyle that Kuwait lived before which was based on respect for productive work and considered it (whatever its kind) the mainstay of a man’s status. The case by which a living may be gained has made Kuwaitis disinclined to acquire the necessary skills to hold down many professions without a need to a make an effort.

84 State of Kuwait Ministry of Guidance and Information op cit., p. 180
85 State of Kuwait Ministry of Guidance and Information op cit., p. 66
Similarly the Kuwait Information Centre argues ‘there is now a growing concern within Kuwait that the country has become too dependent upon the single economic resource of oil and that thought must be given to diversification into other areas.’ How to implement a politically viable diversification strategy that could also tackle the rentier mentality became a pressing concern during the oil bust of the 1980s. Without adequate training, Kuwaitis would not fare well in a liberalised economy. After 30 years of well-paid public sector employment, skill shortages would render the typical Kuwaiti unable to engage in anything other than low paid, low skill work. As in Saudi Arabia, the average Kuwaiti views “manual” work as degrading, which is reserved for the country’s immigrant population. Any development strategy therefore had to focus heavily on medium-term, transformation issues such as training, education and technology application, before longer-term liberalisation could take place.

The level of debate on this issue in Kuwait is extraordinary frank. In Saudi Arabia the level of debate is ambiguous. Saudi commentators prefer to “talk up” the success of government policies, even if there is little evidence to support the claims. For example, the Director of King Abdul Aziz University, Ghazi Obeid Madani, argues it is possible to detect changes in the outlook of the Kingdom’s youth. “What has been said about the Saudi youth as lazy and undisciplined during the oil boom could have been true, but this is not the case now.” We are told that Saudis now see subsidy cut backs as

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88 Kuwait Information Centre ‘Kuwait Celebrates Half a Century of Oil’ Kuwait: Monthly Bulletin Published by the Kuwait Information Centre, London Issue 26, June 1996 pp. 4-5
both necessary and beneficial. One recent Saudi commentary suggests that significant changes in the rentier mentality are taking place. An increasing number of Saudis are engaging in ‘blue-collar’ employment such as electricians and mechanics. As a result, ‘we are now seeing unfamiliar scenes’ in which Saudis are apparently rejecting previous behavioural patterns. Although Saudi Arabia is witnessing a change in the right direction, these changes are painfully slow in nature. The movement itself suggests that the rentier mentality is not necessarily a permanent feature of Gulf citizenship. However, Offset schemes that can set in place the “critical mass” of skills and applied technology are few on the ground. Although the government is cognisant of the problem, the rentier mentality, while not inevitably permanent, is likely to afflict Saudi Arabia for some time to come.

V. Capacity

The process of state building is not simply confined to the willingness of a new elite to convince the population of its benefits. The ability or “capacity” to implement change is extremely important. With the rentier state suffering from “institutional malaise,” there would appear to be little opportunity to force through substantial and rapid changes in the direction of economic policy. The Saudi Offset program suggests otherwise.

'Editorial: Expect to Join WTO, Face Challenges' Al Dammam Al Yawn in Arabic 26 February, 1999 p. 5 FBIS-NES-1999-0304
'Al Jazirah, Riyadh, in Arabic 5 September, 1998 SWB 15 September, 1998
i) Bypassing the Rentier Bureaucracy

As chapter one demonstrated, rentier states possess exceptionally large yet extremely ineffective bureaucracies. Overstaffed and under-worked, the bureaucracy extends into large areas of everyday life. If Hypothesis III is accurate, we would expect the rentier elite to utilise the bureaucracy to push through "state-building" measures. Yet would this institution possess the capacity to implement such policies? Given the past performance of the rentier bureaucracy, evidence would presume not. Effective implementation of policies not only requires strong political support, but also 'dedication from the lower administrative echelons, co-operation from the clientele or the public, and co-ordination at all levels.' Kuwait and Saudi Arabia have chosen two very different routes to facilitate countertrade. The most significant bureaucratic change is to be found in the Saudi Offset Program.

There are four basic constituents that identify Offset projects and influence their regulatory frameworks. The first of these is the government itself. In Saudi Arabia, a Ministerial Committee oversees the Economic Offset Committee (EOC), which is responsible for co-ordinating investment plans. In Kuwait, the Ministry of Finance is responsible to the administration and approval of Offset projects. Second, there are a number of organisations such as the Arab Research Centre (ARC) in Kuwait or the Carlyle Group in Saudi Arabia. These are private companies who act as professional advisors to the government on specific issues such as multipliers, project identification etc. Thirdly, the private sector is involved, primarily as individual companies but also
occasionally through the Chamber of Commerce. Finally, multi-national corporations with Offset obligations will offer their own ideas to reduce their commitments, such as BAe’s proposal to build high-technology training centres in both Kuwait and Saudi Arabia.

The Saudi and Kuwaiti Offset schemes vary in one important regard. Although each scheme has a formal Offset bureaucracy, Saudi Arabia has chosen to "sub-contract" out large sections of the day-to-day running of its program. Saudi Arabia has seven separate Offset programs, which are unified by an administrative unit known as the Saudi Economic Offset Program. At the head of this organisation is the Ministerial Committee – a government appointed body headed by the Second Deputy Premier, which consists of four permanent Ministers – the Minister of Finance and National Economy; the Minister of Industry and Electricity; the Minister of Planning and the Minister of Commerce. Other Ministers are drafted in on an ad hoc basis. This committee is the "political brain" of the Offset Program. Decisions pertaining to the political requirements of the government are deliberated within this forum. Under the supervision of the Ministerial Committee, the Economic Offset Committee (EOC) is employed to implement the Minister’s decisions. Formed in 1989, this is a co-ordination forum for the various ministries of state, each represented by a deputy minister. Chaired by the Assistant Minister of Defence and Aviation, the EOC consists of the Deputy Minister of Commerce; the Deputy Minister for Industry; the Deputy Minister of Finance and

National Economy and the Director General of the Public Investment Fund; the Assistant Deputy Minister of Finance; the Deputy Chairman and Managing Director of Saudi Basic Industries Corporation (SABIC) and the Director General of the Saudi Industrial Development Fund (SIDF). The EOC is responsible for the formulation and development of Offset guidelines, the approval and monitoring of projects and for determining the requirements of specific projects. To assist them in their task, the Economic Offset Secretariat (EOS) implements their recommendations. Importantly, the EOS has established institutional linkages to the private sector. It is responsible for publicising the opportunities on offer and to assist companies and individuals to undertake and implement specific Offset ventures.

This conventional bureaucratic set up is broken via a fourth administrative unit that is autonomous from, but has links to, the rentier bureaucracy. Each Offset Program is responsible for the identification and implementation of their own Offset obligations. This is done by sub-contracting out the management of individual Offset projects to the major contractor responsible for the Offset obligation. This unique bureaucratic arrangement developed informally but has now become an important element of Offset management. For example, under the Peace Shield II Offset agreement signed in 1991, Hughes Aircraft Co., of the United States obtained approval from the EOC to manage the identification, evaluation and development of individual projects. The catalyst for this wave of subcontracting was the Al Yamamah Offset Program — signed between the British government and the Kingdom in 1985. Under an *ad hoc* arrangement, British

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94 For example, one small Kuwaiti business had the idea to produce steel from scrap metal. After approaching the ARC, an Offset deal was arranged with the Japanese company, Matsui, to provide the
Aerospace (BAe) agreed to manage its large commitments independently of the Kingdom. BAe convinced the EOC that it could utilise its own inter and intra-industry links far more effectively than the bureaucracy of the Kingdom. The success of this experiment led to its formal adoption in 1997, when BAe and the Ministry of Defence created the British Offset Office. The Office is responsible for identifying specific development projects and matching them to specific companies. This is done through its headquarters in the UK and an office in the Kingdom, and through its merchant bank advisors based in London – Robert Fleming and Company Ltd., and Schroder Asseily and Company Ltd. Al Yamamah investments are not limited to Al Yamamah contractors. BAe was able to approach a fellow British company, Glaxo Welcome, and provide a business plan to build a pharmaceutical factory in Jeddah. Further evidence of BAe’s international links was illustrated when it facilitated negotiations for a technology licensing agreement between SABIC and UOP of the US and BP of the UK which established the SABIC aromatics plan in Yanbu. In addition to these links, the British Offset Office holds regular round table meetings with Saudi businessmen in the Kingdom’s regional capitals (Riyadh, Dammam and Jeddah). This enables the Offset scheme to evaluate local merchant enterprises that have the “best fit” with a multinational partner.
Table 30: Institutional Arrangement of the Saudi Arabia Economic Offset Program

Not only does this arrangement increase efficiency, it also brings with it a level of expertise and skills that is lacking inside the rentier bureaucracy. A clear example of this is the venture capital fund provided by the British Offset Office. With its merchant bank partners, BAe developed a “soft” financing facility designed to lower the investment risks
of companies willing to enter into an Offset agreement and transfer relevant technology. It has established a SR 65 million financing facility fund. Under this financing mechanism, BAe will provide technology transferors with non-recourse loans for up to 50% of the value of their equity stake in an Offset joint venture. Furthermore, BAe can arrange financing for a large portion of the "parent company" guarantee that is required to support the venture's commercial debt financing. This will also take place on a non-recourse basis. A similar financing scheme is operated by US company Raytheon. It was given approval by the EOC for a partnership with DevCorp International to identify, evaluate and implement Offset projects using its own venture capital fund. Raytheon and BAe are therefore providing services that no bureaucracy in the Kingdom could ever supply – sharing the risk of investment with the technology holder while granting management autonomy and an enhanced return potential.95 Saudi Arabia has learned that Offset provides significant political benefits. By subcontracting out the implementation of political decrees formulated by the Ministerial Committee, the institutional malaise of the rentier bureaucracy can be bypassed. The capacity of the Saudi elite to implement effective decisions therefore appears to be strengthened.

Unfortunately, this far-sightedness is not apparent in the administration of the Kuwaiti Offset Program. Although alerted to the possibility of an Offset program by the private sector, the Ministry of Finance has perceived of the scheme as its own. This is hardly surprising – individual bureaucracies are known to jealously guard their areas of administration. Indeed, the Saudi decision to contract out its bureaucratic arms was a

95 The Economic Bureau 'Saudi Arabia's Economic Offset Program: Achievements, Emerging Trends and Recent Developments, Part II' *Middle East Executive Reports* November 1998 p. 17
leap of faith. However, the risks brought rewards. This can not be said for the Kuwait experience where the administration of Offset imitates the deficiencies often found in the rentier bureaucracy. Surprisingly, Kuwait officials responsible for the administration of the Program are willing to admit this. As chapter four illustrated, private sector initiative in the Kuwaiti Offset Program has been marred by the avoidance of decision-making.

In contrast to Offset, BOT schemes are not subject to formal rules and regulations. In fact, they are usually pursued on an ad hoc basis rather than in the formal regulatory framework of Offset. Evidence collected by the World Bank shows that most states in the Middle East prefer to introduce the private sector in infrastructure projects on an individual transaction basis (via BOT) rather than a sector wide approach. The World Bank identified three major reasons why the transaction-by-transaction approach is favoured.

First, policy reform takes time, while transactions can be undertaken expeditiously. As a result, expansion of badly needed services is possible. Second, the transactions are likely to trigger policy and institutional reforms down the road, as new investors demand a better regulatory framework. Finally, the transactions often embody new technology, know-how and finance, all of which improve productivity.

In Kuwait and Saudi Arabia, ministries have separate BOT departments to cater for the unique circumstances of the industries involved and the particular needs of private

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97 This assertion was confirmed to me by Abdul Rahman Al Ebrahim, Head of the Economic Studies and Research Division at the Ministry of Finance Kuwait City, 13 November, 1999
companies entering into BOT contracts. It is important to recognise that unlike Offset obligators, potential BOT investors are under no obligation to invest in the Gulf. They must want to invest. Governments must transmit to the private sector that investor concerns in the post-investment phase will be pacified. Each economic sector requires unique incentive mechanisms to encourage private investors to sign up for BOT schemes. The "private sector" is not some amorphous mass that acts in a uniform manner. Firstly, at a broader level, the private sector in the power industry may face more numerous investment constraints than the water industry or health care sector. Profit margins, set-up costs and time constraints vary from industry to industry and so BOT schemes need to be tailored to specific sectors. Secondly, at a more local level, it is also important to realise that within economic sectors, private firms differ from each other in the manner in which they conduct business. The strategies of risk, investment and regional experience may lend some companies towards a more welcoming philosophy with regard to BOT and other joint venture schemes than their competitors. Government departments must therefore refine their incentive parameters in order to catch potential investors. For instance, BOT investors in the power industry will require guarantees from government that, once constructed, supplies of fuel to individual generating stations will be secured. Specific industry-related questions must be answered. Will the power generated be purchased by the government (who then sells it on to its citizens) or directly to the consumer? The concerns of international businesses and financiers must therefore be taken on board. Therefore, BOT regulatory systems are 'primarily governed by the contractual terms of the project agreements. This approach provides the greatest

flexibility and allows for fine-tuning.\textsuperscript{99} It is harder to dictate to a potential BOT client than an obligated Offset company. Attempts to do so will result in failure. Rigid bureaucratic rules will frustrate the implementation of schemes. As the UNIDO warns, ‘complicated bureaucratic procedures are often cited as a serious obstacle to BOT projects.’\textsuperscript{100} Whereas Offset works well within a formal framework, BOT works better in a decentralised system.

ii) Offset: A Trigger for Institutional Reform?

In August 1999, Saudi Arabia’s privatisation and diversification efforts gained momentum with the creation of the Supreme Economic Council (SEC). The aim of the SEC is to speed up liberalisation reforms, which had previously taken place on a piecemeal basis. According to the Minister of Planning, Dr. Khalid bin Muhammud Al Qusaibi, the SEC is major step in ‘building institutional structures and systems to create an appropriate investment climate in the Kingdom.’\textsuperscript{101} To achieve this, the SEC supervises the formulation and management of the budget and co-ordinates the implementation of policies between government departments and agencies. Council members are responsible for conducting studies on investment and trade into the Kingdom. By creating an institution that can cut through the bureaucracy of the Saudi state, the SEC aims to formulate economic policies and build institutional structures to make foreign investment easier and more attractive in the Kingdom.\textsuperscript{102} Significantly, the institutional design of the SEC closely mirrors that established by Prince Fahad Abdullah

\textsuperscript{99} Edmondes, N. ‘Regulatory Issues Affecting Privatisation in the Gulf’ \textit{Middle East Executive Reports} September 1996, p. 12
\textsuperscript{100} UNIDO (1996) \textit{op cit.}, p. 283
\textsuperscript{101} ‘SEC Will Improve Investment Climate in Kingdom: Qusaib’ \textit{Saudi Gazette} 2 September, 1999
following his discussions with David Burney. The similarity between the Offset arrangements and the SEC was deliberate. "The SEC is modelled on the Offset framework. The Secretariat and Committees are exactly the same as Offset." Offset demonstrated to the Saudis the need for an institution that could co-ordinate effectively between ministries and between government and the private sector. The success of this framework was therefore replicated when the SEC was formulated. The effectiveness of the SEC was demonstrated in April 2000 when it passed the new foreign investment (FDI) law, a significant milestone in the Kingdom’s gradual movement away from allocation towards production. As James Gavin asserts, "the SEC was instrumental in pushing the FDI law through the cabinet and Majlis Al Shura in what was, by Saudi standards, record time."

Table 31: Changes to Saudi Arabia's Foreign Investment Laws

<table>
<thead>
<tr>
<th>Old Law</th>
<th>New Law</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sponsorship</strong></td>
<td></td>
</tr>
<tr>
<td>Saudi partner needed for foreign investor in joint venture</td>
<td>No local sponsor needed</td>
</tr>
<tr>
<td><strong>Ownership of Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Saudi partner required to own land</td>
<td>Licensed companies gain full ownership of project including land</td>
</tr>
<tr>
<td><strong>Tax</strong></td>
<td></td>
</tr>
<tr>
<td>Maximum corporate rate of 45%; tax holdings for 10 years for industrial projects.</td>
<td>Maximum rate of 30% over SR100,000; Tax holiday to be abolished</td>
</tr>
</tbody>
</table>

Source: Gavin, J. "The Walls Come Down" Middle East Economic Digest 19 May, 2000 Vol. 44, No. 20 p. 4

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103 Interview with David Burney, Senior Offset Advisor, Carlyle Arabia, The Carlyle Group, Washington, D.C. 26 April, 2000 The SEC, headed by Crown Prince Abdullah, and Prince Sultan, Minister of Defence and Aviation, includes the ministers of Petroleum and Mineral Resources, Industry and Electricity, Finance and National Economy, Labour and Social Affairs, Commerce and Planning. In addition, the governor of the Saudi Arabian Monetary Agency (SAMA) is included as well as senior bureaucrats such as Dr. Abdulrahman Al Tuwaijri, former Executive Director for Saudi Arabia at the IMF
As with all Saudi investment laws the devil is often in the detail. Already there are signs of hesitation – anticipated liberalisation in the wholesale and retail commercial sectors, the banking and finance industry and the energy sector has been withdrawn. Yet despite these set-backs the new investment law will increase non-oil investment flows (the majority of which are currently accounted for by Offset investments) as well as speed up Saudi Arabia’s application to join the WTO. Significantly, representatives from the Saudi private sector have welcomed the deal. The Supreme Economic Council is already changing the economic landscape of the Kingdom. Offset played a small, yet significant, role in the institutional design of the SEC. Although “spillover” reforms from one branch of the bureaucracy to another are rare, the link between the Saudi Offset experience and the establishment of the SEC suggests some degree of institutional learning took place.

iii) State Building by Stealth

Capacity to implement economic reform does not rest with institutional ability alone. The state must be in a position to persuade the public of the merits of its policy. Failing this, it must deceive the public as to the extent of painful side-effects. I have defined state building in a rentier state is the move away from allocation towards production through a privatisation of state assets. However, privatisation is often perceived by the public as unfair, even when it proves to be ultimately beneficial. State building is politically difficult. Any attempt to implement a rapid privatisation

105 'Abdullah Sets Out Stall in FDI' Middle East Economic Digest 30 June, 2000 Vol. 44, No. 26 p. 16
106 'Saudi Investment Law Wins Qualified Praise' Reuters Dubai April 12, 2000
programme would be dangerous for the rentier elite. 'An across-the-board strategy would be difficult from the government's point of view because it would mobilise multiple constituencies against what each would interpret as its social contract with the regime.'¹⁰⁸ Nor would it be economically beneficial. As Nemet Shafik of the World Bank points out, 'to get the full benefits of privatisation you have to gradually phase out the subsidies.'¹⁰⁹ In the Gulf, suspicions over privatisation are deeply entrenched, in part because 'the intelligentsia and press in much of the region tend to be statist in their orientation and (are) critical of the social impact of privatisation.'¹¹⁰ As John Nellis argues, 'the lesson is that privatisation is always and everywhere an intensely political process; the management of public perception is as important as the financial and technical arrangements.'¹¹¹ What information the public receives, how it receives it, how it matches the reality on the ground are important questions that governments must address.¹¹² Therefore, we can expect the state to engage in a gradual introduction of market forces to reduce the potential political difficulties that might lay ahead.

As Hypothesis I illustrated, there are good short-term reasons for wanting to the private sector to build, operate and transfer back the possession of utilities to the state. Gulf governments must find alternative solutions to finance public expenditure to cope with the pressures created by budgetary constraints and a growing population. However, from a state building perspective BOT offers long-term political benefits. According to

Jean Claude Villiard, Director of the Infrastructure Development Group, Middle East and North Africa Department at the World Bank, BOT is a useful political tool to force through significant and permanent economic change. “BOT is a political smokescreen. Thirty years from now, the ‘transfer’ element will be forgotten. The situation will change, there will no need to transfer, it will never occur. The need to transfer will become increasingly irrelevant.”113 The private sector is clearly aware of this. Nicholas Edmondes, Resident Partner of the Muscat Office of Trowers and Hamlins, led a team responsible for advising the private developers of the BOT Manah Power Project in Oman.

My firm spent a very large amount of time negotiating the transfer element on the Manah power project, but now, with the benefit of hindsight, I wonder whether it was necessary. It was costly to our clients, and I doubt that the government will wish to take the project back when the time comes. I suspect that the policy of privatisation will have moved so far ahead by then that there will be no one to take the project back.114

This long-term capacity to implement significant and permanent change is important. Whereas Offset sets in place the “critical mass” needed for liberalisation to function, BOT schemes enable privatisation to proceed once the conditions are in place. According to Jim Wilson of British Trade International, governments are “buying into the whole BOT idea (because) it allows them to delay government expenditure and have people gain experience of how to develop and manage processes.”115 The ability of the rentier elite to proceed with state-building measures by stealth suggests a greater degree

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112 Nellis, J. in: Fawzy, S. & Galal, A. (eds.) op cit., p. 91
113 Interview with Jean Claude Villiard, Director, Infrastructure Development Group, Middle East and North Africa Region, The World Bank Washington, D. C. 28 April, 2000
114 Edmondes, N. op cit., p. 10
of autonomy in framing and applying policy under adverse conditions.

VI Countertrade: Learning or Foresight?

During the early 1980s when Offset policies were first formulated, no reference was made to privatisation. Indeed, until recently there was little reference to privatisation at all in Saudi Arabia. Yet by the time the Kuwaitis introduced their Offset scheme a decade later, privatisation was very much on the agenda. A closer inspection of the Articles of Association reveals that the aim of the Kuwaiti Offset scheme is ‘to contribute to the State’s plan toward privatisation.’ This was never discussed in the Saudi Articles of Association. It is interesting that in Saudi Arabia, the original Offset programme has been incorporated into the ethos of privatisation, almost as an afterthought. The Kingdom originally saw countertrade as a development strategy separate from privatisation. Indeed, during the early 1980s, very few states were engaged in such wide-scale market reforms. Offset appeared to offer substantial rewards on its own. Yet results did not meet expectations. Privatisation could not be avoided. By the mid-1990s, countertrade started to be incorporated into a wider “business friendly” initiative undertaken by the Saudi government. The objectives of the Sixth Development Plan called for the continued encouragement of private sector participation in socio-economic development. The last significant reference to countertrade as an alternative development strategy can be found in the Sixth Development Plan. It was emphasised as a key structural factor that would influence Saudi development into the future.

116 Article 36, No. 4 Industrial Investments Co *The Kuwaiti Offset Fund: Articles of Association* (n.d)
117 Kingdom of Saudi Arabia, Ministry of Planning *Sixth Development Plan 1995-2000 AD* p. 87
The scope of the existing Offset Programs can be extended to cover more civilian contracts...the successful operation and expansion of the Offset Program will enhance optimism about the future potential of the long-run economic development process in the Kingdom.\footnote{\textit{Kingdom of Saudi Arabia, Ministry of Planning} (1995) \textit{op cit.}, p. 48}

In 1997 Crown Prince Abdullah outlined his government’s policies to encourage greater foreign investment. Countertrade was again at the heart of the proposals. However, by this time the Offset scheme had been broadened into a wider strategy that saw the Kingdom contemplate privatisation seriously. The three-point initiative unveiled included new laws to guarantee the protection of foreign investment from industrialised countries, simplifying the administrative and legal barriers to entry and to extend the Offset programs to include major civilian projects.\footnote{\textit{Kingdom of Saudi Arabia TV1}, Riyadh, in Arabic 1830 GMT 10 March, 1997 \textit{SWB} 18 March, 1997} The Offset program developed over a period of nearly 20 years to become a facilitator of privatisation.\footnote{\textit{Kingdom of Saudi Arabia TV1}, Riyadh, in Arabic 1830 GMT 10 March, 1997 \textit{SWB} 18 March, 1997} This afterthought is contrary to the situation in Kuwait, where countertrade was seen as a facilitator early on in its formulation. Indeed, the formulation of the Kuwaiti scheme took place when privatisation was gaining ground as a major policy initiative in the developed world.

In Kuwait, privatisation was first seriously considered in 1986. A jointly authored study by the Kuwait Institute for Scientific Research (KISR) and Harvard University called for the sell-off of a number of government controlled enterprises. A leading proponent of the reforms was Dr Mohammad Al Sabah, the Minister of Finance and future Ambassador to the USA. However, the study was not implemented because of the
relative buoyancy of the Kuwaiti economy in the late 1980s. As Hypothesis I demonstrated, it was only after the Iraqi invasion that radical solutions for economic development were considered. In this context the original report was re-evaluated. The cost of rebuilding the country and the liquidation of assets forced the issue to the forefront. The government subsequently established the Kuwait Privatisation Consortium, pooling the expertise of the Kuwait Consulting and Investment Company (KCIC), the Industrial Investment Company (IIC), the London-based Adam Smith Institute (ASI) and the London-based Strategic Investment Forum (SIF). At the same time, the Ministry of Finance also established its own privatisation committee to investigate the costs and benefits while a World Bank team arrived for a six-month visit to advise the government on methods of disbursement. Therefore, by the time Kuwait implemented its own Offset scheme, the government was seriously considering privatisation. The country’s first tentative moves toward privatisation coincided with the formulation of the Offset Program. Offset was to be used to buttress privatisation. As Taleb Ali of the Industrial Investments Company, a member of the Kuwait Privatisation Consortium and an architect of the Offset guidelines, argued in early 1993, Offset investments are a facilitator of privatisation. “If the government is embarking on a scheme of privatisation, they will be using funds like this.” In January 1993 the Kuwait Investment Authority (KIA) sold off a 30% stake in the Kuwait Food Company which marked the beginning of a move towards greater liberalisation.

120 According to sources inside BAe, plans for the Al Yamamah III contract are known within the company as the “Saudi privatisation contract,” ‘Al Yamamah plc’ Gulf States Newsletter Vol. 24, No. 642 14 August, 2000 p. 7
121 See Kielmas, M. ‘Kuwait: Radical Plans for Root and Branch Reform’ Middle East Economic Digest 26 February, 1993 Vol. 37, No. 8 pp. 7-8
However, although privatisation would allow a rapid influx of FDI, the issue has proved to be a politically sensitive topic, especially in parliament. For example, a KISR study into the privatisation of the communications sector highlighted the need for substantial job-losses to improve efficiency. Yet, “parliament does not like this element of privatisation.”123 The parliament is largely reactionary and concerned about the effects of unemployment. With the private sector being too small to absorb the shedding of public sector jobs, social discontent would increase. “At the present time, privatisation would be destructive.”124 Undoubtedly the parliamentarians would be blamed. “There is a widely held perception in Kuwait that the parliament should exist to protect the interests of the people from the government.”125 The right to employment is considered sacrosanct to many Kuwaitis. As in Saudi Arabia, movement towards the new elite conception of state building is far from contested. Yet the ability of the elite to proceed with development strategies that pacify opposition concerns without deviating too far from the chosen route leads us to conclude that claims of institutional malaise are inaccurate. This chapter has demonstrated the surprising capacity of the rentier state to bypass problems associated with the rentier bureaucracy and to implement the policies it has crafted on a largely sceptical public.

123 Interview with Dr. Adnan A. Al Hamoud, Deputy Director General, Kuwait Institute for Scientific Research Kuwait City, 10 November, 1999
124 Interview with Ala’a Omran, Research Co-ordinator, Offset Projects Unit, Arab Research Centre Kuwait City, 3 November, 1999
125 Interview with Dr. Adnan A. Al Hamoud, Deputy Director General, Kuwait Institute for Scientific Research, Kuwait City, 10 November, 1999
VII. Countertrade in Action

i) Offset and the Privatisation of the Saudi Telecommunications Sector

By early 1993 American officials were predicting an expansion of Offset away from defence contracts to include civil contracts as well. One internal memorandum from the American Embassy in Riyadh quoted sources close to the EOC that civil Offset contracts were "the wave of the future." In 1994, Saudi Arabia signed its first major civil Offset contract with the American telecommunications giant, AT&T.

A reliable and sophisticated telecommunication service is crucial to the development of the modern state. However, such a service is extremely expensive to introduce. In the early 1990s, Saudi Arabia sought to upgrade its telecommunications system but could no longer afford the billions of dollars needed to introduce a system to a public who expect to pay less than market rates. This precluded a full privatisation of the telecommunications industry. Private companies expect to earn profits. Under the existing system, profits could not be earned. Moreover, few Saudi private sector companies possessed the expertise to engage in the privatisation and upgrade of the Saudi telecommunications industry. What was needed was a "critical mass" of knowledge among Saudi companies before market forces could proceed. This point of view is supported by King Fahd who argues that, "there is no way in which we could give away an establishment that lacks equipment like new aircraft, for example, or repair workshops and so on. Any state enterprise which is to be transferred to the private sector must be

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126 American Embassy Riyadh Telegraphic Report dated 29 September, 1993
equipped and then all citizens would be allowed to participate in it."\textsuperscript{128} Academics share a similar view. Nellis asserts that, 'the weight of experience argues in favour of privatising rapidly any firm that operates in competitive markets but not of privatising infrastructure enterprises possessing a “natural monopoly” component until the essential market structure enhancing competitive forces and regulating elements are in place.'\textsuperscript{129} Government largesse in the telecommunications industry had undermined competition and innovation. In an attempt to counter this, the Saudi government entered into negotiations with the American telecommunications firm AT&T. Under a civilian Offset contract, AT&T agreed to supply 1.5 million new digital lines for ordinary telephones and 200,000 mobile phones over 7 years.\textsuperscript{130} In addition, over $1 billion of the $4 billion contract was to be reinvested in the Kingdom to establish research and manufacturing facilities, technology transfers and the training of Saudi nationals. AT&T would enter into joint ventures with Saudi partners to develop specialised telecommunications companies, able to supply hardware and software components to the Saudi government and eventually the privatised utility. AT&T immediately established three projects. Two of these included joint ventures with other Offset companies – an electronic circuit plant with the Advanced Electronics Company; an operations and systems expertise centre with International Systems Engineering and a new copper and fibre optic apparatus plant. As important was the training of hundreds of Saudi nationals in the engineering and management of a modern telecommunications industry. Lucent technologies employs 3,520 people, of whom 740 are Saudi nationals, which as Peter Kemp points out,
contributes ‘to the creation of a cadre of local telecom experts.’ In addition, 15,000 subcontractors were employed by contracts awarded by Lucent to local contractors.

By the late 1990s, developments were in place to enable a gradual privatisation, or “corporatisation,” of the Saudi telecommunications sector. The decision to corporatise the industry was primarily an economic choice, although security concerns played a part. The government enlisted the help of investment bankers JP Morgan who, in turn, brought in Booz Allen, Price Waterhouse, Baker and Mackenzie and other professionals to oversee the restructuring process. In 1998 the government began this process by establishing a joint stock company, the Saudi Telecommunications Company, (STC) to offer shares to the public at some future date. STC management was given a 24-month period to boost profits, after which the STC’s assets would be valued and shares offered. This final stage has yet to fully proceed, being held up by regulatory difficulties and the need to find a foreign strategic partner. However, initial results from the early stages of the privatisation process are extremely encouraging. The STC has cut costs significantly and boosted sales by introducing new services and features provided to it by Lucent Technologies under the AT&T Offset Program. Lucent’s provision of a digital network has stimulated the demand for telecommunication services across the Kingdom. Monthly revenue prior to privatisation stood at SR700 million. After privatisation, this had reached SR1.2 billion – an increase of 70% during 18 months as a private company. According to Minister of Post, Telegraphs and Telephones, Dr. Al Johani, ‘as a result of

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131 Kemp, P. ‘Telecoms: The Race is on to Boost Capacity’ *Middle East Economic Digest* 11 June, 2000 Vol. 43, No. 23 pp. 5-10
privatising the telecommunications sector, the sector has experienced a real boom.133 During the 1999-2000 fiscal year, STC's revenue exceeded SR 15 billion and is set to continue to grow at an average rate of 20% over the next five years. State revenue from the telecommunication industry had never crossed the SR 30 billion mark in the ten years prior to privatisation, or SR 3 billion annually. However, privatisation is set to boost state revenues by an average of SR 10 billion annually. For the Saudi telecommunications industry, the critical mass of skills and applied technology provided by Lucent and AT&T helped facilitate the privatisation process.

ii) AEC: The Exemplar of Saudi State Building?

The Advanced Electronics Company (AEC) is an exemplar of the type of business the Saudi government is eager to develop under the Offset program. Established in 1988 through the Peace Shield I Offset Program, AEC has become one of the region's largest defence companies, able to provide the Kingdom with its own self-sufficient electronics capability. Since its inception 12 years ago the company has diversified its operations. The research and development of telecommunications technology (including e-commerce) now accounts for two-thirds of the entire business. AEC's paid up capital of SR 100.5 million is distributed between Boeing Industrial Technology Group (BITG) – 50%; National Industrialization Company (NIC) - 15%; Gulf Investment Corp. (GIC) – 15%; National Commercial Bank (NCB) – 10% and Saudi Arabian Airlines (Saudia) – 10%. From its 19,000 square metre manufacturing facility at the KKIA Aerospace

132 According to David Butter, the privatisation of the telecommunications sectors on the Gulf is a sensitive issue as 'state control of communications helps realise the goal of state control of society at large.' Butter, D. 'Choosing the Path to Privatisation' Middle East Economic Digest 30 June, 1995 Vol. 39, No. 26 p. 5
133 'STC's Revenue Up 70% Since Privatisation' Arab News 11 November, 1999
Industrial Park in Riyadh, AEC specialises in three core activities; i) the design, manufacture and assembly of advanced electronics equipment, systems and components; ii) systems implementation and iii) support services (repair, technical support, training and field services). The AEC is the only company in the Gulf region able to manufacture military and civil electronic systems to international commercial and military standards. This level of expertise has allowed it to become a generator of export capital for the Kingdom.

Chapter two described the importance of the Gulf moving from a comparative advantage in oil to a competitive advantage in value added goods. Unless there is a move away from oil towards the development of well paid value-added industries (to provide the incentives for Gulf citizens to seek worthwhile employment) then Gulf states will merely become economic satellites of the West. The economies of Gulf states will be “trapped” by society’s reliance on an exhaustible resource. The AEC is a good example of the direction which Gulf governments want to develop their private sectors. AEC is now exporting its manufactured goods and via its nascent R&D facilities, is starting to tailor its goods to specific export markets. Examples of export-oriented contracts received by AEC include the following:

- Avionics equipment for F-16 export sales under a license manufacturing contract with Lockheed Martin Tactical Aircraft Systems (LMTAS) of the US; F-16 components manufactured at the company are being exported to Scandinavian countries and

Taiwan.

- Smart (coin and card-operated intelligent) pay phones for export to South America under contract with Elcotel of the US.
- Supply of ALE-47 RR-170 and RR-180 chaff and MJU-10 and M-206 flare countermeasures dispensers used on aircraft and helicopters, for regional customers under contract with Tracor Aerospace of the US.
- Supply of upgraded ALQ-135 band 1.5 jammer components (complex power supplies) to the US Air Force under contract with Northrop Grumman ESID of the US.
- Supply of CDU-800 control display unit hardware for use on US Navy aircraft under contract with Col Avionics and Communication Division of Rockwell International of the US.\(^{135}\)

In addition to this, AEC is one of the Kingdom's few private sector enterprises that is willing to embrace the government's employment policy. Tackling the rentier mentality so that young Saudis are willing to enter the private sector instead of a career in the Kingdom's bureaucracy is proving to be a difficult task. Government appeals for the private sector to increase Saudi-isation continue to be resisted. However, the AEC has been particularly successful in achieving the Kingdom's aim to hire Saudis and is able to train them to a high level of professional and technical competence through training schemes provided by BITG. Saudi nationals now make up 63% of the company's workforce. This figure is broken down into technicians (43%), engineers (22.6%),

\(^{135}\) The Economic Bureau (January 1999) *ibid.*, p. 18
professionals (21.7%) and administrative support personnel (12.8%). According to Abdulaziz Al Sugair, President and CEO of AEC, the company has broken the stereotype of the Saudi worker. In 1995 the company averaged just 2.3 days of absenteeism per year, per worker.

VIII. Countertrade: Failure or Facilitator?

Critics of countertrade are correct to point out that neither BOT nor Offset has lived up to initial expectations. There has been far too much talk and not enough action. “Offset is a good idea in principle but in practice we don’t see anything. There are few tangible examples.” If we accept these criticisms and argue that countertrade is generally a policy failure, why do Gulf governments continue to pursue these policies? In part, Gulf governments are too proud to admit policy failures. According to economist, Jasem Al Sadoun, “something created by government in this part of the world cannot be allowed to die.” As the table below shows, to date, only two major Kuwaiti Offset contracts have been completely discharged.

Table 32: Completed Kuwaiti Offset Obligations

<table>
<thead>
<tr>
<th>Company</th>
<th>Amount of Obligations</th>
<th>Country</th>
<th>Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aerospatiale</td>
<td>$5,563,193</td>
<td>France</td>
<td>Human Patient Simulator</td>
</tr>
<tr>
<td>T-Com</td>
<td>$11,910,060</td>
<td>United States</td>
<td>Mid-East LTA</td>
</tr>
</tbody>
</table>

Source: Supervisory & Follow Up Division, Offset Program Department, Ministry of Finance, State of Kuwait, 24/10/1999

136 Figures from The Economic Bureau ‘Saudi Arabia’s Economic Offset Program: Achievements, Emerging Trends and Recent Developments: Part III’ Middle East Executive Reports January 1999, p. 8
137 Al Sugair, A. op cit.
138 Interview with Dr. Fahad Al Mkhad, Higher Planning Committee, Arab Research Centre, Kuwait City, 10 November, 1999
However, there is a considerable amount of work-in-progress. Ministry of Finance officials in Kuwait assert that the scheme is "taking off" and that more contracts will come on-stream over the next few years. It is worth pointing out that these schemes are extremely diverse in nature, which is one of the Offset scheme's primary objectives. As the following table demonstrates, medicine, defence, civil aviation, education, industry and others have all benefited from the emphasis of diversification demanded by the system of multipliers.

Table 33: Kuwaiti Offset Foreign Contractors Ongoing Projects

<table>
<thead>
<tr>
<th>Company</th>
<th>Amount Obligation</th>
<th>Country</th>
<th>Project Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raytheon/Hughes Aircraft Systems (1)</td>
<td>$27,600,000</td>
<td>United States</td>
<td>Gulf Industrial Technology</td>
</tr>
<tr>
<td>Raytheon Engineers and Constructors</td>
<td>$98,160,000</td>
<td>United States</td>
<td>Aluminium Smelter Plant</td>
</tr>
<tr>
<td>GKN</td>
<td>$288,569,454</td>
<td>United Kingdom</td>
<td>Waterproof Membranes</td>
</tr>
<tr>
<td>TecQuipment (1)</td>
<td>$6,978,128</td>
<td>United Kingdom</td>
<td>IPETQ Education</td>
</tr>
<tr>
<td>TecQuipment (2)</td>
<td>$2,844,000</td>
<td>United Kingdom</td>
<td>IPETQ Education</td>
</tr>
<tr>
<td>Raytheon/Hughes Aircraft Systems (2)</td>
<td>$8,478,660</td>
<td>United States</td>
<td>Tele-medicine</td>
</tr>
<tr>
<td>CMN International</td>
<td>$143,864,792</td>
<td>France</td>
<td>Airborne Geophysical Survey</td>
</tr>
<tr>
<td>Thomson</td>
<td>$15,074,688</td>
<td>France</td>
<td>Purnice Project</td>
</tr>
<tr>
<td>SCM Panhard &amp; Levassor</td>
<td>$3,800,245</td>
<td>France</td>
<td>Firing Ranges</td>
</tr>
<tr>
<td>Oerlikon Contraves</td>
<td>$2,015,307</td>
<td>Italy</td>
<td>Firing Ranges</td>
</tr>
<tr>
<td>COFRAS</td>
<td>$13,008,999</td>
<td>France</td>
<td>Firing Ranges</td>
</tr>
<tr>
<td>Rosvorouzhenie (1)</td>
<td>$126,000,000</td>
<td>Russia</td>
<td>Deep Oil Technology</td>
</tr>
<tr>
<td>Rosvorouzhenie (2)</td>
<td>$102,900,000</td>
<td>Russia</td>
<td>Deep Oil Technology</td>
</tr>
<tr>
<td>Shorts Missile System</td>
<td>$22,032,043</td>
<td>United Kingdom</td>
<td>Human Patient Simulator</td>
</tr>
<tr>
<td>Gulf Stream Aerospace</td>
<td>$34,442,100</td>
<td>United States</td>
<td>Kuwait International Aircraft Leasing</td>
</tr>
</tbody>
</table>

Source: Supervisory & Follow Up Division, Offset Program Department, Ministry of Finance, State of Kuwait, 24/10/1999

139 Interview with Jasem Al Sadoun, President, al-Shall Economic Consultants Kuwait City, 8 November, 1999
140 Interview with Abdul Rahman Al Ebrahim, Head of Economic Studies and Research Division, Ministry of Finance, Kuwait City 13 November, 1999
Nevertheless, this apparent qualitative success is marred by the lack of quantity. Records from the Supervisory and Follow Up Division at the Ministry of Finance show that many obligators have yet to discharge their obligations. For example, there are three contracts worth well over $100,000,000 in obligation amounts that have not been acted upon since they were signed back in 1996.

Table 34: Companies Yet to Meet Kuwaiti Offset Obligations

<table>
<thead>
<tr>
<th>Company</th>
<th>Amount of Obligation</th>
<th>Country</th>
<th>MOA Signed Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mitsui, Mitsubishi, Sasakura</td>
<td>$67,015,678</td>
<td>Japan</td>
<td>23/10/1996</td>
</tr>
<tr>
<td>Norconsult Telematics</td>
<td>$3,246,330</td>
<td>Norway</td>
<td>2/12/1996</td>
</tr>
<tr>
<td>AV Technology</td>
<td>$52,126,086</td>
<td>United States</td>
<td>11/12/1996</td>
</tr>
<tr>
<td>British Aerospace, Australia</td>
<td>$4,498,651</td>
<td>Australia</td>
<td>4/6/1997</td>
</tr>
<tr>
<td>ENOSA</td>
<td>$1,140,000</td>
<td>Spain</td>
<td>9/11/1997</td>
</tr>
<tr>
<td>GEC-Marconi</td>
<td>TBD</td>
<td>United Kingdom</td>
<td>24/2/1998</td>
</tr>
<tr>
<td>Boeing</td>
<td>TBD</td>
<td>United States</td>
<td>18/3/1998</td>
</tr>
<tr>
<td>Norinco</td>
<td>$55,963,481</td>
<td>China</td>
<td>21/3/1998</td>
</tr>
<tr>
<td>Raytheon/Hughes Aircraft Systems</td>
<td>$1,206,000</td>
<td>United States</td>
<td>31/3/1998</td>
</tr>
<tr>
<td>Airwork Advanced Group</td>
<td>$3,922,064</td>
<td>United Kingdom</td>
<td>31/5/1998</td>
</tr>
<tr>
<td>Flagship Trading</td>
<td>$5,574,579</td>
<td>United Kingdom</td>
<td>8/7/1998</td>
</tr>
<tr>
<td>Steyr Nutzfahrzeuge</td>
<td>$1,652,526</td>
<td>Austria</td>
<td>14/7/1998</td>
</tr>
<tr>
<td>Eurocopter</td>
<td>$2,095,784</td>
<td>France</td>
<td>25/8/1998</td>
</tr>
<tr>
<td>Kipal</td>
<td>$8,236,825</td>
<td>Yugoslavia</td>
<td>28/10/1998</td>
</tr>
<tr>
<td>AstroConsult</td>
<td>$1,564,917</td>
<td>Australia</td>
<td>12/5/1999</td>
</tr>
<tr>
<td>British Aerospace</td>
<td>$9,117,521</td>
<td>United Kingdom</td>
<td>3/5/1999</td>
</tr>
<tr>
<td>British Aerospace</td>
<td>$5,766,930</td>
<td>United Kingdom</td>
<td>3/5/1999</td>
</tr>
</tbody>
</table>

Source: Supervisory & Follow Up Division, Offset Program Department, Ministry of Finance, State of Kuwait, 24/10/1999

Part of the problem lies in the “absorption capacity” of states pursuing Offset.⁴¹

According to Barry Teideman, an Offset Advisor to the Omani government, Gulf states

⁴¹ "The notion of absorption refers to those limits that restrict the ability of an economy to absorb capital funds in an efficient manner." Al Eyd, K. A. Oil Revenues & Accelerated Growth: Absorptive Capacity in Iraq (New York: Praeger, 1979), p. 80
are simply too small to absorb the amount of money generated by Offset. Despite the recent population explosion, the demography of the Gulf cannot support extensive diversification of the region’s economies. “Gulf states cannot absorb the amounts of money we are talking about. If they wanted to absorb this investment then there would have to be a massive influx of immigrants to utilise it. However, this is demographically dangerous.”  

Moreover, it defeats the primary objective of Offset – to provide sustainable employment opportunities for Gulf nationals. In a country such as Kuwait, where Kuwaitis are outnumbered by immigrants by 4:1, further immigration is not an appealing prospect. Indeed, only recently, the UAE engaged in a policy of forced repatriation of many immigrants in an attempt to create job opportunities for its citizens.

The absorption capacity is not a problem unique to Kuwait. In the much larger economy of Saudi Arabia many Offset programs have been frustrated by supply side difficulties. The inability to recruit Saudi citizens with the necessary skills, especially technicians, engineers and managers, has caused numerous delays. Local construction firms are not always able to satisfy specialised construction requirements, while legal delays in securing necessary contracts impedes early implementation. Peace Shield I, Saudi Arabia’s first Offset program encountered numerous difficulties. Major obstacles included lining up financially capable Saudi partners who could engage in joint ventures; difficulties in obtaining commercial licensing agreements and reservations about the

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142 Interview with Barry Teideman, Offset Advisor, Defence Export Services Organisation, Ministry of Defence (UK), London, 11 January, 2000

drafting of long-term technology transfer agreements.\textsuperscript{144} Like Kuwait, Saudi Arabia has very few completed projects and a huge amount of obligations waiting to come on stream in the future. One recent study places the total amount of discharged obligations as low as 10%.

\textbf{Table 35: Saudi Economic Offset Program: Obligations and Rates of Compliance}

<table>
<thead>
<tr>
<th>Nationality</th>
<th>Offset Obligation ($)</th>
<th>Rate of Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>1,700,000,000</td>
<td>16%</td>
</tr>
<tr>
<td>British</td>
<td>2,000,000,000</td>
<td>8%</td>
</tr>
<tr>
<td>French</td>
<td>700,000,000</td>
<td>6%</td>
</tr>
<tr>
<td>\textbf{Total}</td>
<td>\textbf{4,400,000,000}</td>
<td>\textbf{10%}</td>
</tr>
</tbody>
</table>


Despite these disappointments, if Offset is observed in comparison to the total level of foreign direct investment (FDI) in Saudi Arabia over recent years, the scheme is a considerable success. Between 1984 and 1997, the Kingdom attracted net inward investment FDI of just $4.3 billion – or just 3\% of current GDP.\textsuperscript{145} The main disappointment remains the backlog of work in progress, leading Crown Prince Fahad bin Abdullah, Chairman of the EOC, to issue a warning in 1997 for Offset contractors to fulfil their existing obligations or be excluded from future contracts. The EOC promised to implement a “get tough” policy on those obligators who are not proceeding quickly enough, along the lines of the punitive measures implemented in the UAE Offset

\textsuperscript{144} The Economic Bureau (November 1998) \textit{op cit.}, p. 16

\textsuperscript{145} Figures from \textit{Business Middle East} 1-31 December, 1999, p. 3 The lack of FDI causes severe current account difficulties for Saudi Arabia as expatriate workers remit some $15 billion a year back to their countries of origin.
Program. Similarly, Kuwaiti officials warn that they too intend to speed up the Offset process by fining obligators for non-compliance.\footnote{146}{Interview with Mazen Madooh, Manager, Offset Program Department, Ministry of Finance, Kuwait City, 13 November, 1999}

With regard to BOT, it is too early to tell if results will match expectations. Oil revenues appear to prevent a faster pace of application in comparison to Turkey or the Philippines.\footnote{147}{Between 1995-97, the Filipino government announced BOT projects worth $4,733 million.} Yet as Levy points out, it will take many years before it is known whether BOT projects will meet their owners expectations, whether they will be outmoded by technology and at what level citizens bulk at paying for services they once received for free.\footnote{148}{Levy, S. M. \textit{op cit.}, pp. 399-401} Because there is no central body organising BOT projects, figures relating to the number of projects and size of investments precludes conclusions based on quantity alone. Undoubtedly, with BOT being a relatively new finance mechanism in the Gulf, projects have taken a long time to get off the ground. Yet despite these disappointments, ‘the formula continues to command attention.’\footnote{149}{Levy, S. M. \textit{op cit.}, pp. 399-401} BOT will be ‘increasingly relied upon to provide investment capital for much needed infrastructure development.’\footnote{150}{Levy, S. M. \textit{op cit.}, pp. 399-401} Gulf states cannot afford to spend their way out of problems as in the past. As Hypothesis I illustrated, most infrastructure projects in the Gulf region are now implemented under a BOT mechanism. For the governments of Kuwait and Saudi Arabia, BOT has proved to be an extremely useful mechanism to alter long-term perceptions about the utility of private sector finance for development purposes.
The difficulties encountered with Offset and BOT schemes should not come as a surprise. The political uncertainties outlined in Hypothesis 1 combined with the evolutionary nature of the schemes are bound to cause delays and difficulties. However, both Saudi Arabia and Kuwait have derived important economic benefits from the implementation of countertrade. There is now evidence of "cross fertilisation" among separate Offset programs, among themselves and with local non-Offset companies. For example, the Advanced Electronics Company (AEC) which was established under the Peace Shield I Offset Program is Saudi Arabia's first defence company that provides an entirely self-sufficient advanced electronic capability. Evidence of this was recently demonstrated when it was awarded a major manufacturing contract for advanced telecommunication switches by Lucent Technologies, to fulfil part of a separate Offset obligation for AT&T. Cross investment is also in evidence elsewhere, as in BAe's stake in the Aircraft Accessories and Components Company (AACC) – originally established under the Peace Shield I Offset Program; Roll's Royce's and Hughes Aircraft Company's investments in the Middle East Propulsion Company (MEPC), and Hughes' investment into International Systems Engineering (ISE). Furthermore, a number of joint ventures have been established between separate Offset programs – such as the co-operation between the Al Yamamah and Sawari programs to build a refractory plant and ISE and Thompson CSF's plan to run the King Fahd International Airport air traffic control system.

149 Middle East Economic Digest 17 October, 1997 Vol. 41, No. 42 p. 25
150 National Bank of Kuwait Economic and Financial Quarterly (Safat, Kuwait: NBK, 1998)
Countertrade's primary benefit cannot be solely measured by the quantity of schemes undertaken. The application of countertrade has had important and unintended consequences from what the various schemes set out to achieve. Although its original objective of Offset was to diversify the economy, it proved to be a catalyst for privatisation. The Saudi government was willing to experiment with Offset as a strategy for economic development and diversification. It grew into something more than this. As Saudi Arabia's senior Offset advisor points out, "Offset demonstrated to the Saudi government that they could get foreign investment and technology and foreign markets and it gave the government a level of confidence to move onto other things." Although the Saudi Offset scheme has not lived up to quantitative expectations, the long run impact of Offset has proved to be extremely important. "Offset was the engine for other things. This was the proof, this was the test, a very inexpensive test for the government of Saudi Arabia." According to David Burney, Saudi Arabia no longer saw foreign direct investment as a threat to the Kingdom's traditions and customs. Irrational fears of a "take over" by foreign corporations led to a 49% limit on the amount of foreign ownership on any Offset joint venture. These fears proved to be unfounded as the benefits of FDI far outweighed the costs. Offset was a clear demonstration to the Saudis of the benefits of greater liberalisation. In recent years the Kingdom has announced proposals for enhanced liberalisation. New investment laws announced in 1999 by Industry and Electricity Minister, Hashim bin Abdullah Yamani, extended

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151 For example, in the UAE, the Abu Dhabi government has now made the privatisation of its Water and Electricity Department (WED) part of an Offset project. The French company Giat is to help privatise the WED and discharge 20% of its own obligations in doing so. Giat will then charge the Abu Dhabi government for the cost of water and electricity provision.

152 Interview with David Burney, Senior Offset Advisor, Carlyle Arabia, The Carlyle Group, Washington, D.C. 26 April, 2000
foreign ownership of joint ventures to 75% of the project, while tax rates for foreigners fell to 25%. These moves are significant for a country that has not experienced significant cross border investment flows.

IX. Concluding Remarks

Hypothesis III provides a strong case to view the application of Offset and BOT as part of a larger state building project to move from the allocation state to a production state through a process of privatisation. As one businessmen commented, “the application of countertrade is temporary. It is simply the best way for the government to introduce privatisation through the back door. It enables the government to bypass the constitution and to obtain resources, technology and expertise.” Offset provides the “critical mass” necessary for industries to develop and function efficiently via technology transfers, education and training, employment opportunities, finance mechanisms and the provision of strategic partnerships. BOT enables existing welfare goods and infrastructure to be brought under the control of the private sector, without concerning or alienating citizens of the rentier state.

Countertrade is a facilitator of privatisation. However, this should not be construed as inspired foresight on the part of governments before the schemes were implemented. As the Saudi case shows, Offset never mentioned privatisation when it

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153 Interview with David Burney, Senior Offset Advisor, Carlyle Arabia, The Carlyle Group, Washington, D.C. 26 April, 2000
154 Interview with Dr. Abdel Raouf Tawfik, Director, Advanced Industrial Consultants, Kuwait City, 6 November, 1999
was first implemented. What occurred was a gradual learning process among the Saudi elite, buttressed by the infusion of a new western-educated technocratic elite, that saw Offset not as an end-game but as a facilitator for a gradual restructuring of the rentier economy. In Kuwait, authorities had the benefit of learning from the Saudi experience. Hence the forthright claim in the Kuwaiti Offset Program that Offset is designed to facilitate movement toward the country's experiment with privatisation. The application of BOT schemes took place a decade later when both Saudi Arabia and Kuwait were more amenable to private sector solutions for public sector problems. Advocated by the World Bank, those ministers and bureaucrats with links to the organisation were quick to draft and implement BOT projects in diverse areas of their economies.

According to Ayubi, Gulf governments lack the political will and political capacity to reform the bureaucracy. Evidence uncovered by Hypothesis III suggests otherwise. Hypothesis III has forced us to reconsider the notion of institutional malaise. Firstly, the sub-contracting out of the day-to-day running of the Saudi Offset scheme provided the Saudi elite with a means to bypass the inefficiencies of the existing redistribution bureaucracy. The Saudi Offset scheme introduced a greater degree of middle-management professionalism into the rentier bureaucracy, working to the political requirements set by the Ministerial Committee. BAe's expertise in management was utilised to provide a wide range of tools (venture capital funds, commercial debt financing and links with large MNCs) that could not have been provided by keeping the scheme in-house. Unfortunately, Hypothesis III confirmed the assertions of Hypothesis II that the Kuwaiti Offset program is mired in bureaucratic mismanagement. Whereas
Saudi Arabia has demonstrated the ability to extend the capacity of the rentier state through an innovative process of sub-contracting, Kuwait does not exhibit the same ability. However, Kuwait has used BOT on a manner similar to Saudi Arabia to state build by stealth. Capacity to implement reform does not rest with changes to the administrative structure. The state must also have the tools to have the means to implement long-terms goals without mobilising multiple constituencies against the direction of economic policy. As this chapter has shown, the transfer element of BOT provides the benefit of a "political smokescreen."

Undoubtedly, the fiscal crises identified in Hypothesis I played a role in the implementation and adaptation of countertrade strategies. However, Hypothesis III has produced sufficient evidence to show that the politics of decision-making was not entirely "crisis driven." If anything, the fiscal crisis proved to be useful to a new elite wishing to push through economic reform. The crises laid out in chapter one and developed in Hypothesis I enabled Western-educated technocrats to push through their agenda under the guise of a "crisis response." This suggests the need to re-consider the traditional conception of rentier state autonomy. Although the movement away from allocation to production is slow (Saudi Arabia and Kuwait are still rentier states), there is a movement. Because this movement appears deliberate, the gradual reduction in the permissiveness of the state leads us to assert that the Saudi and Kuwaiti elite possesses the political tools to enforce their policy preferences. Dismantling the traditional rentier state under conditions of fiscal austerity should not necessarily be construed as evidence of a strong state becoming a weak state. For the new elite, dismantling the perceived negative

aspects of rentierism has the potential to strengthen the long-term viability of the state and the support base of the regime.

In order to fully assess the information gleaned by the application of Hypothesis III, it must be compared and contrasted with the evidenced provided by Hypotheses I and II. The following concluding chapter will assess the relative strengths and weaknesses of all three hypotheses by returning to the themes first identified in chapter one. From this, we will be able to better assess the political and economic environment of the rentier state and determine what each hypothesis tells us about the significance of the rentier state model.
### XIV. Appendix

**Table 36: University Degrees of Ministers of the 1995 Saudi Cabinet**

<table>
<thead>
<tr>
<th>Post</th>
<th>Degree</th>
<th>University</th>
</tr>
</thead>
<tbody>
<tr>
<td>Princes of the Al Saud</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prime Minister</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Deputy Prime Minister</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Defence &amp; Aviation</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Housing &amp; Public Works</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Interior</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Foreign Affairs</td>
<td>BA</td>
<td>Princeton</td>
</tr>
<tr>
<td>Non Princes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture &amp; Water</td>
<td>Ph.D.</td>
<td>UC Irvine</td>
</tr>
<tr>
<td>Commerce</td>
<td>MBA</td>
<td>Arizona</td>
</tr>
<tr>
<td>Communications</td>
<td>Ph.D.</td>
<td>Arizona</td>
</tr>
<tr>
<td>Education</td>
<td>Ph.D.</td>
<td>Oklahoma</td>
</tr>
<tr>
<td>Finance &amp; National Economy</td>
<td>Ph.D.</td>
<td>Colorado State</td>
</tr>
<tr>
<td>Health</td>
<td>Ph.D.</td>
<td>(German Inst.)</td>
</tr>
<tr>
<td>Higher Education</td>
<td>Ph.D.</td>
<td>Florida</td>
</tr>
<tr>
<td>Industry &amp; Electricity</td>
<td>Ph.D.</td>
<td>Harvard</td>
</tr>
<tr>
<td>Information</td>
<td>Ph.D.</td>
<td>Duke</td>
</tr>
<tr>
<td>Islamic Affairs</td>
<td>Ph.D.</td>
<td>Al Azhar (Cairo)</td>
</tr>
<tr>
<td>Labour and Social Affairs</td>
<td>MBA</td>
<td>Arizona</td>
</tr>
<tr>
<td>Municipal &amp; Rural Affairs</td>
<td>Ph.D.</td>
<td>Michigan State</td>
</tr>
<tr>
<td>Petroleum</td>
<td>MSc</td>
<td>Stanford</td>
</tr>
<tr>
<td>Justice</td>
<td>Ph.D.</td>
<td>Imam U. (Saudi)</td>
</tr>
<tr>
<td>Pilgrimage</td>
<td>Ph.D.</td>
<td>North Carolina</td>
</tr>
<tr>
<td>Planning</td>
<td>Ph.D.</td>
<td>USC</td>
</tr>
<tr>
<td>Post, Telegraphs and Telephones</td>
<td>Ph.D.</td>
<td>UC Berkeley</td>
</tr>
</tbody>
</table>

Source: Herb, M. *All in the Family: Absolutism, Revolution and Democracy in the Middle Eastern Monarchies* (New York: State University of New York Press, 1999), p. 60
Table 37: GDP of Kuwait at Current Prices by Division of Economic Activity

(KD Million)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Livestock, Hunting and Fishing</td>
<td>46.8</td>
<td>31.0</td>
<td>34.0</td>
<td>37.2</td>
<td>38.5</td>
</tr>
<tr>
<td>Mining &amp; Quarrying</td>
<td>2,782.5</td>
<td>2,830.6</td>
<td>3,137.4</td>
<td>4,128.0</td>
<td>3,684.4</td>
</tr>
<tr>
<td>Manufacturing Industries, of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Refined Petroleum Products</td>
<td>998.0</td>
<td>783.5</td>
<td>888.6</td>
<td>1,102.9</td>
<td>1,229.0</td>
</tr>
<tr>
<td>Manufacturing Industries, of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Refined Petroleum Products</td>
<td>763.0</td>
<td>493.7</td>
<td>580.6</td>
<td>798.1</td>
<td>906.8</td>
</tr>
<tr>
<td>Electricity, Gas &amp; Water</td>
<td>-27.1</td>
<td>-44.4</td>
<td>-31.7</td>
<td>-6.9</td>
<td>9.8</td>
</tr>
<tr>
<td>Construction</td>
<td>134.2</td>
<td>237.7</td>
<td>243.5</td>
<td>245.9</td>
<td>246.5</td>
</tr>
<tr>
<td>Wholesale and Retail Trade, Hotels &amp; Restaurants</td>
<td>651.9</td>
<td>586.8</td>
<td>618.9</td>
<td>632.8</td>
<td>651.3</td>
</tr>
<tr>
<td>Transport, Storage &amp; Communications</td>
<td>296.0</td>
<td>364.0</td>
<td>362.3</td>
<td>390.8</td>
<td>425.2</td>
</tr>
<tr>
<td>Finance, Insurance, Real Estate and Business Services</td>
<td>885.2</td>
<td>871.2</td>
<td>900.9</td>
<td>957.0</td>
<td>1,057.8</td>
</tr>
<tr>
<td>Financial</td>
<td>183.4</td>
<td>220.9</td>
<td>229.3</td>
<td>279.6</td>
<td>370.1</td>
</tr>
<tr>
<td>Insurance</td>
<td>11.6</td>
<td>16.8</td>
<td>16.5</td>
<td>18.5</td>
<td>18.5</td>
</tr>
<tr>
<td>Real Estate</td>
<td>655.1</td>
<td>596.3</td>
<td>616.3</td>
<td>618.7</td>
<td>625.5</td>
</tr>
<tr>
<td>Business Services</td>
<td>35.1</td>
<td>37.2</td>
<td>38.8</td>
<td>40.2</td>
<td>43.7</td>
</tr>
<tr>
<td>Community, Social &amp; Personal Services of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Admin. &amp; Defence</td>
<td>1,429.2</td>
<td>1,797.0</td>
<td>1,868.2</td>
<td>1,933.0</td>
<td>2,039.7</td>
</tr>
<tr>
<td>Education</td>
<td>595.6</td>
<td>851.3</td>
<td>876.2</td>
<td>888.7</td>
<td>923.5</td>
</tr>
<tr>
<td>Health Care</td>
<td>376.7</td>
<td>406.0</td>
<td>425.4</td>
<td>457.0</td>
<td>490.3</td>
</tr>
<tr>
<td>Personal &amp; Household Services</td>
<td>171.7</td>
<td>182.8</td>
<td>190.2</td>
<td>189.9</td>
<td>209.2</td>
</tr>
<tr>
<td>Bank Services &amp; Charges</td>
<td>144.2</td>
<td>175.5</td>
<td>194.5</td>
<td>194.2</td>
<td>217.3</td>
</tr>
<tr>
<td>Import Bank Services &amp; Charges</td>
<td>-117.7</td>
<td>-143.9</td>
<td>-165.0</td>
<td>-190.9</td>
<td>-291.7</td>
</tr>
<tr>
<td>Import Duties</td>
<td>63.6</td>
<td>66.2</td>
<td>68.2</td>
<td>77.3</td>
<td>101.5</td>
</tr>
<tr>
<td>GDP @ Purchaser's Value</td>
<td>7,142.7</td>
<td>7,379.7</td>
<td>7,925.3</td>
<td>9,307.1</td>
<td>9,212.0</td>
</tr>
</tbody>
</table>

*Provisional Data
Table 38: Changes in the Structure of Saudi GDP Over the Period 1970-1997
(at 1970 constant prices)

<table>
<thead>
<tr>
<th>GDP by Activity</th>
<th>Million Riyals</th>
<th>Share (%)</th>
<th>Million Riyals</th>
<th>Share %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total GDP</td>
<td>19,582</td>
<td>100.0</td>
<td>64,104</td>
<td>100.0</td>
</tr>
<tr>
<td>Oil Sector GDP</td>
<td>11,542</td>
<td>58.9</td>
<td>22,309</td>
<td>34.8</td>
</tr>
<tr>
<td>Non Oil GDP</td>
<td>8,040</td>
<td>41.1</td>
<td>41,795</td>
<td>65.2</td>
</tr>
<tr>
<td>Government</td>
<td>2,293</td>
<td>11.7</td>
<td>11,436</td>
<td>17.8</td>
</tr>
<tr>
<td>Private</td>
<td>3,747</td>
<td>28.3</td>
<td>30,359</td>
<td>47.4</td>
</tr>
<tr>
<td>GDP by Activity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture, Forestry, Fishing</td>
<td>1,018</td>
<td>5.2</td>
<td>5,618</td>
<td>8.8</td>
</tr>
<tr>
<td>Mining &amp; Quarrying of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude Petroleum and Natural Gas Other</td>
<td>9,971</td>
<td>50.9</td>
<td>19,418</td>
<td>30.3</td>
</tr>
<tr>
<td>Manufacturing of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Petroleum Refining</td>
<td>9,922</td>
<td>50.7</td>
<td>19,226</td>
<td>30.0</td>
</tr>
<tr>
<td>Other</td>
<td>49</td>
<td>0.3</td>
<td>192</td>
<td>0.3</td>
</tr>
<tr>
<td>Electricity, Gas and Water</td>
<td>298</td>
<td>1.5</td>
<td>1,568</td>
<td>2.4</td>
</tr>
<tr>
<td>Construction</td>
<td>957</td>
<td>4.9</td>
<td>3,797</td>
<td>5.9</td>
</tr>
<tr>
<td>Wholesale and Retail Trade, Restaurants</td>
<td>1,051</td>
<td>5.4</td>
<td>8,374</td>
<td>13.1</td>
</tr>
<tr>
<td>and Hotels</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport, Storage and Communications</td>
<td>1,468</td>
<td>7.5</td>
<td>4,767</td>
<td>7.4</td>
</tr>
<tr>
<td>Finance, Insurance, Real Estate and</td>
<td>1,053</td>
<td>5.4</td>
<td>4,429</td>
<td>6.9</td>
</tr>
<tr>
<td>Business Services</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Community, Social and Personal Services</td>
<td>253</td>
<td>1.3</td>
<td>936</td>
<td>1.5</td>
</tr>
<tr>
<td>Memorandum</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP @ Current Prices</td>
<td>22,921</td>
<td>547,413</td>
<td>19.9</td>
<td></td>
</tr>
<tr>
<td>GDP per capita</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Saudi Riyals</td>
<td>3,697</td>
<td>3.697</td>
<td>27,508</td>
<td>7.345</td>
</tr>
<tr>
<td>US$</td>
<td>822</td>
<td>822</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Excluding Import Duties
Chapter Six

Conclusion: Countertrade and its Implications for the Rentier State

Model

Introduction

Chapters three, four and five have illustrated the complex and difficult political decisions that have to be made in a rentier state experiencing fiscal difficulties. Each hypothesis has presented plausible arguments to understand the reasons for the application of countertrade. This concluding chapter looks at how these hypotheses, when taken as an inter-linked process, offer plausible and convincing explanations. By returning to the rentier themes first outlined in chapter one, we will be able to evaluate the impact of countertrade on Kuwait and Saudi Arabia, and in doing so, will contribute to the theory of rentierism. Five basic rentier themes are reconsidered; the repoliticisation of the state; rentier incorporation; rentier autonomy; rentier bureaucracy and the rentier mentality. A final section makes the argument that countertrade represents an important element in an overall strategy by the elite to move state-societal relations away from ‘allocation’ towards ‘production.’
I. The Reactivation of Politics

As chapter one pointed out, rentierism contends that significant levels of oil rent redistribution will depoliticise the state. Oil appears to give the Gulf rulers the ability to "buy off" political dissent. For most of the post-discovery period this has been the case. Yet rent redistribution has proved to be less effective since the mid-1980s as the declining profitability of oil and the population explosion began to take effect. We are witnessing a re-politicisation of the state. This re-politicisation itself does not invalidate the rentier state model. Although early rentier theorists rarely commented on a swing back to the re-politicisation of the state, it is logical to deduce that as high levels of redistribution depoliticises the state, low levels of redistribution repoliticises the state. Therefore, despite the fiscal crises listed in the thesis, the rentier state model retains theoretical coherence. However, the application of the three hypotheses has identified two important issues that rentier theorists of the future must address. First, the re-politicisation of the state means we must extend the rentier state model to account for greater political activity. We can no longer rely upon the limited rentier state model of old if we want to understand the economic decision-making environment of today. Second, the type of demands made by interest groups has potentially serious consequences for the rentier state model.

In the first instance, we must apply a broader approach to rentierism to explain the reactivation of politics inside the state. Hypothesis II demonstrated that the application of countertrade was heavily influenced by private sector concerns. This was more apparent in Kuwait than in Saudi Arabia. Influential corporations within the Kuwaiti private
sector utilised their linkages to the rentier bureaucracy and were granted Offset concessions. These concessions were awarded because the government was increasingly reliant upon the private sector to take greater responsibility in generating economic growth. The initial application of the Saudi Offset Program differed. As the Kingdom was the first state to introduce Offset, the private sector had to be convinced of the benefits of the scheme. However, in the twenty years since the program was first discussed, the private sector has become more amenable to its application. The Kuwaiti experience infers that a broader approach to understanding economic development must be applied if we are to accurately explain decision-making inside Gulf states. The statist approach of the old rentier state model fails to appreciate both the subtle “bottom up” demands for change and the consequences of these changes. State-led “top down” rent redistribution can only pacify so many for so long. In an era of rapid globalisation, private sector concerns extend beyond the boundaries of the state – and that includes the rentier state.

This leads to the second concern. It is the type of demands being made, which I argue has potentially serious consequences for the rentier state model. If private sector demands were exclusively based around greater amounts of rent redistribution, then traditional rentier theorists could still demonstrate the theoretical coherence of the model in today’s environment. However, these are not the sole demands of the private sector. We do not simply find quantitative demands but rather qualitative demands. This poses an interesting political problem – what if the traditional benefits of rentierism are rejected by the private sector? What if the potential benefits of liberalisation (training and
education, technology transfers, strategic business partnerships etc.) appear more attractive to the private sector than the continuance of traditional rentierism (subsidies, protectionism etc.)? This "bottom up" challenge to the rentier state, neglected by the statist rentier model, is important. The private sector is not demanding greater autonomy from the state (if it did, this would represent a fundamental break with rentierism), but rather it is demanding a different type of redistribution. Although the bottom-up challenge does not render the rentierism obsolete, it does have important implications for the simplistic statement that political demands can be "bought off." Although the private sector still looks to the state to provide solutions to its problems, simple rent redistribution is not enough. It is therefore the ability of the rentier state to provide a new array of rentier goods that will determine the extent of politicisation in the future. How can the state purchase the requirements of this increasingly influential business constituency? Countertrade offered a potential solution. However, as this thesis has demonstrated, both BOT and Offset have not been implemented at a fast enough rate. Therefore, it is not the declining level of oil rents that has the potential to invalidate the rentier state model. Instead, it is the inability of the rentier elite to maintain a revised form of the "tacit agreement" between itself and the new business class by oil rents alone.

II. Rentier Incorporation

Evidence of repoliticisation inside Kuwait and Saudi Arabia forces us to reconsider traditional methods of rentier incorporation. If the private sector is demanding greater access to economic decision-making, this is a threat to the traditional means of political co-option. Redistributed rent alone is not enough to pacify the business elite and
shore up support for the ruling families. What does the application of countertrade tell us about incorporation? Hypothesis I and Hypothesis III offer valid, inter-related explanations. Hypothesis I correctly identifies the incorporation concerns of both the Saudi and Kuwaiti governments. Countertrade rules and regulations are institutionally designed to benefit each country’s business elite. For instance, both Offset and BOT schemes would have proceeded more rapidly if overseas investors could by-pass the obligation to form joint ventures with local merchants. Obligators such as BAe would prefer to develop projects themselves, bringing in local partners if and when they are required. Instead, under Offset arrangements, they cannot even obtain a majority shareholding. This is not an economically efficient means of doing business. But in the rentier state economic efficiency is rarely a guiding principle. Instead, political considerations shape the development of Offset and BOT schemes. Hypothesis I correctly identifies the initial application of countertrade as a regime maintenance mechanism.

However, an appraisal of countertrade results shows it not to be a very effective incorporation mechanism. Neither Offset nor BOT have been instigated to an extent where all business elites are pacified by the contracts awarded. There has, of course, been some significant success stories, particularly with the application of BOT schemes. Contracts awarded to government allies and partnerships with foreign contractors proved to be popular with the merchant elite. Similarly, Offset schemes have resulted in over $5 billion worth of foreign direct investment in Saudi Arabia alone. This is a truly impressive figure considering that the Kingdom’s entire stock of inward non-countertrade
FDI for the last 25 years is also $5 billion. Yet $5 billion of Offset deals does not result in a significant number of Offset projects. With the growth of the Saudi business class, there are not enough Offset schemes to satisfy merchant demand. This was not an immediate problem for the Saudi elite given the initial reticence of the private sector to engage in Offset. However, with the private sector progressively more appreciative of the benefits on offer, the Saudi elite is becoming increasingly frustrated with the slow progress of Offset. This is less a problem in Kuwait, where the business elite is smaller than the Kingdom. In fact, the Kuwaiti Offset Program has difficulty absorbing the huge amounts of obligations in progress. Evidence found in Hypothesis III shows that BOT schemes create both winners and losers in the tendering process. Although winners are pacified with the awards, losers in the competitive environment become frustrated, especially when they do not possess informal linkages to decision makers. Accusations of corruption and nepotism are leveled against the BOT process. Like Offset, BOT’s political gains to the ruling elite are often not enough. Therefore, taken together, Hypothesis I & III tells us much about the rentier state and the rentier state model. Rentier governments are using countertrade methods, if unsuccessfully, to buttress, but not replace, the redistribution of rent and hence the incorporative capacity of the rentier state. As Nazih Ayubi argues, once fiscal pressures take hold, one can expect governments to ‘hide behind a deeper and more complex web of institutional arrangements that would keep direct opposition and resistance at bay.’

Countertrade appears to support this assertion.

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1 Figures from *Middle East Economic Digest* 19 May, 2000 Vol. 44, No. 20 p. 4
It should be noted, however, that as the application of countertrade has developed over a twenty-year period, so the political goals of the rentier elite have also changed. Hypothesis III provides an additional ‘transitional’ explanation to incorporation, which is central to this thesis. It does not invalidate the conclusions drawn by Hypothesis I. Instead, it suggests that the earlier aims of political incorporation detailed above, are gradually being replaced by new incorporative calculations. There is now a pressing need to find additional methods of political support for the rentier elite. Previously, the elite has always looked inside the state to buttress its support base. Hypothesis III looks beyond the domestic environment. It accurately suggests that the analogues of BOT and Offset have come to represent a method of facilitating greater economic liberalisation. Privatisation is now on the agenda. However, from the perspective of the traditional rentier state model, privatisation does not make sense. Why would the rentier elite deconstruct the allocation state since its support is derived from allocation? Hypothesis III concludes that the rentier elite is extending its coalition of allies beyond the boundaries of the rentier state. Incorporation is too strong a word. The rentier elite is unable to control foreign businessmen in the same way as domestic businessmen. But what it can do is create allies abroad that have long-term vested interests in regime stability. The scope of support has become internationalised. It is this internationalisation that the traditional rentier state model fails to appreciate. As levels of rent redistribution have less impact than before and as individuals and businesses begin to create linkages to their international counterparts, so the rentier elite has the opportunity to extend its support base. This is most clearly seen in Kuwait. The Kuwaiti elite has calculated that its future is dependent upon securing the prosperity of private sector
interests via means other than oil. At the heart of this calculation is the physical security of the state. If the Kuwaiti elite can boost the level of foreign direct investment into the country, international businesses (and their respective governments) are going to have a vested interest in the stability of the state into the future. To ensure the stability of the state, international constituents must ensure the stability of the regime. International businessmen continually cultivate personal links to the rentier elite to boost their business interests. By extension, if international business views this as the best means of protecting their investments, the Kuwaiti private sector is also keen to maintain the status quo. As Hypothesis II demonstrated, the private sector now possesses much more sophisticated demands than in the past. Liberalisation acquires a symmetry of interests similar to that negotiated when oil was first discovered.

In summary, the application of countertrade has shown us that the rentier state model must readjust its conception of political incorporation. Although the oil-based tacit agreements identified by Crystal\(^1\) and others form the basis of incorporation, oil rents are no longer sufficient to maintain this agreement into the longer term. Oil rents not as profitable as they once were and cannot be used exclusively to "buy off" an expanding business class. In addition, oil rents cannot purchase the types of demands impressed upon the government by the private sector. Finally, rentier theorists must take into account the internationalisation of the rentier support base. The rentier state is not immune from globalisation. As privatisation and liberalisation gather pace, the rentier elite has the ability to expand support from beyond the boundaries of the rentier state.

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\(^1\) Crystal, J. (1992) *op cit.*
The rentier state model must be able to describe how the elite can shore up its domestic support base by utilising resources based outside of the state.

III. Rentier Autonomy

Chapter one introduced the concept of state autonomy generally and rentier autonomy specifically. Autonomy is the ability of the state officials to formulate and implement their goals and objectives. Rentier states are presumed to possess considerable autonomy to pursue elite ambitions because of the absence of political dissent. Hypothesis I highlighted the interesting case study of the Saudi electricity industry. Here, the rentier elite initially thought its development problems could be easily solved by introducing BOT schemes. This would take place without having to make radical changes to the industry. The rentier elite’s main obligation to the social contract, the provision of welfarism, (of which free electricity provision was a major component), could be upheld by asking the private sector to shoulder the cost of rentierism. Had BOT worked under such conditions, this would have been evidence of the oft-mentioned renter state autonomy. Yet as Hypothesis I correctly pointed out, these political calculations did not match economic realities. In fact, the autonomy of the rentier elite was constrained by industry inefficiencies created by years of rentierism. For BOT to be successfully introduced, the rentier elite was forced to rethink the concept of rentierism. For consumers, electricity could no longer be perceived of as free good, while those employed within the industry could no longer look to the state for an endless supply of subsidies to counter is loss-making activities. In short, the ability of the Saudi elite to obtain the benefits of countertrade in the electricity industry (savings in the cost
of infrastructure) only came after a corporatisation of its assets. Without it, the private sector would have eschewed the programme. Although BOT played an important role in the movement towards the privatisation of the electricity sector, this movement was not a deliberate act. It was a reaction to the failed attempt by the Saudi government to use BOT as a stop-gap measure to counter the prevailing fiscal crisis and shore up traditional redistribution networks. It was not enough. The elite did not possess the ability to resist corporatisation. Its autonomy to direct development along political lines alone was weakened. The concerns of the market place had to be addressed.

Evidence produced by Hypothesis III shows Saudi attitudes to the less contentious sector of telecommunications to be rather different from the electricity sector. The application of Offset to solve the damaging effects of rentierism, particularly the under-funding of new technologies, shows a more subtle view of rentier autonomy. If the application of the Offset agreement with AT&T was a deliberate attempt to foster the eventual corporatisation and privatisation of the telecommunications industry, it forces us to reconsider what is presumed to be rentier autonomy. As was mentioned in Hypothesis III, the retreat of the state may be evidence of state capacity. The determining factor is whether the retreat is forced or voluntary. In the electricity industry, with the application of BOT, it was forced. In the telecommunications industry the application of Offset was voluntary. This begs the question, why did the Saudi elite perceive of the two industries differently? The answer is that it did not. When Offset was first discussed for the Saudi telecommunications industry in the early 1990s, the Saudi elite did not envisage a strategic withdrawal of the state along a predetermined timetable. Offset was initially
used to buttress the telecommunications industry via technology transfers, training and new R&D joint ventures. AT&T was not expected to take over the running of the telecommunications industry. Its profits were already determined within the Offset contract. This contrasts sharply with the BOT electricity experience. Here, private sector companies could only earn profits in the future if the industry had a viable future. Within its Offset commitment, AT&T did not pressure the Saudi government towards corporatisation – instead its investments made corporatisation the next logical step. This contrasts with the attitudes of private sector companies involved in the BOT tendering process. Real pressure was asserted on the Saudi government as each company withdrew its tender to build the Shuaiba power plant. Therefore, while the application of BOT in the electricity sector shows traditional rentier state autonomy to be diminishing, the application of Offset in the telecommunications industry is more ambiguous. Although the traditional allocation state was weakened, the rentier elite was able to use the technology transfers and skills of a large MNC to implement its evolving policy preferences.

The traditional assertion of rentier state autonomy must therefore be reassessed. Saudi decision makers could not instigate BOT solutions to the problems facing the electricity industry. The autonomy of the rentier elite was constrained by the demands of potential international investors. If the Saudis wanted a BOT program they had to pacify the investors via a series of reforms. The rentier state could not dictate policy to the private sector. Although BOT was originally conceived as a policy that would ultimately extend the autonomy of the rentier elite, it merely serves to highlight the lack of
autonomy rentier decision makers face under conditions of fiscal austerity. Offset, with its formalised obligations, gives the Saudis greater power to dictate its preferences to overseas investors. However, the success of the AT&T Offset Program was only apparent after the government decided to corporatise the industry with a view to privatisation. This decision was evolutionary in nature. There is little evidence that Offset was to be used to facilitate privatisation when the contract was drawn up in the 1980s. Instead, Offset demonstrated to the Saudis that major investments into the telecommunications industry would never again come from public expenditures. Future policy options were limited. Reluctantly, the Saudi elite understood the reduced level of policy autonomy that it now possesses. The long, slow process of “rolling back” the rentier state has already started.

IV. Rentier Bureaucracy

Chapter one asserted the claim that despite the presumption of significant state autonomy, the ability of the rentier elite to follow through with their policy preferences is often limited by what can be termed “institutional malaise.” The bureaucracy of the state, its largest institution, is over-staffed, highly inefficient and lacks the necessary skills and resources to craft and execute relevant policies under conditions of fiscal stress. Non-rentier states, with significantly less levels of bureaucracy, are often able to implement policies much more effectively. Therefore, state strength is not measured by the extent of bureaucratic institutions but rather their effectiveness. Although oil rents give the impression of significant elite autonomy to craft their desired economic strategies, if the desired preferences are too ambitious the rentier bureaucracy cannot cope. It is therefore
only within specific policy circles involving the reallocation of oil rents that the Gulf elite possesses real autonomy. Policies that do not rely upon allocation are often rendered ineffective by administrative paralysis.

The application of countertrade allows important conclusions to be drawn with regard to the rentier state bureaucracy, and by extension, the rentier state model. First, Hypothesis III showed that the Saudi government, through a process of trial and error, sub-contracted out the day-to-day running of its Offset scheme to those companies which were contracted to discharge their obligations. The government retained overall control of policy direction at the higher level of the Offset administrative structure. However, the management of specific Offset project identification and application was left to large multi-national companies (e.g. McDonnell Douglas, Giat, BAe etc.). This subcontracting out of the bureaucracy extended the state capacity for the rentier elite. It was better able to follow through its political ambitions (set by the government through the Offset multipliers) by creating a new lower level tier of professional management. In the Saudi case, the institutional malaise of the rentier state was effectively bypassed. Although Offset has not proceeded as fast as was originally envisaged, overall, delays have not been blamed on the specific administration of the scheme – a first for the rentier state.

The Saudi experience contrasts with that of the Kuwaiti encounter. The Kuwaiti Offset Program is much smaller than the Saudi program because the size of the purchases is lower. Kuwait decided against sub-contracting out its program, preferring instead to administer it through the Ministry of Finance. Consultants were brought in to advise on
the direction of the overall program, and specific projects as and when required. Hence, the Kuwaiti program is structured within the existing rentier bureaucracy. Although a number of talented individuals are employed in the Ministry’s Offset Department, many Kuwaiti businessmen complain about the direction of the program and the time it takes to process applications. Hypothesis II highlighted the frustrations of one Kuwaiti-based businessman who proposed to expand the activities of a private hospital through an Offset scheme. His attempts were thwarted by red tape and the avoidance of firm decision making. The Kuwaiti experience appears to support the contention of an “institutional malaise” within rentier states.

The application of BOT schemes also takes place within the context of the existing rentier bureaucracy. However, unlike Offset, BOT schemes are relatively similar to redistribution policies, which the rentier bureaucracy already excels. Each department is able to identify specific projects and, following government approval, is allowed to tender contracts to the private sector. This does not mean BOT is best administered by the rentier bureaucracy. It merely demonstrates that despite its limitations, the rentier bureaucracy can dispense a program that is an extension of the allocation state. As Hypothesis III pointed out, the ad hoc nature of BOT enables individual departments to tailor specific schemes to specific industries. Nevertheless, the time it takes to successfully conclude a BOT scheme suggests the political demands of the elite are likely to be frustrated when it comes to implementation.
The second important conclusion that the relative success of the Offset bureaucracy had subtle yet important institutional consequences. According to one senior advisor to the Saudi government, the bureaucratic arrangement of the Offset program was replicated in future reforms. Specific elements of the establishment of the Supreme Economic Council (SEC) closely mirrored the institutional design of the Offset framework established some years earlier. The Saudi elite arrived at this institutional template through a process of trial and error. The Offset Program demonstrated to the Saudis the degree of government interference that could be tolerated by international investors. In the evolutionary process that is state-building, Offset played an important role. Although the rentier state bureaucracy in Saudi Arabia remains large and generally ineffectual, an analysis of Offset shows in limited cases the rentier state is capable of evolutionary, institutional reform. Not only did the Offset program create the means to bypass the worse excesses of the rentier bureaucracy, it also facilitated future reforms. These changes were initially small, but ultimately significant. While Offset has not reaped the rewards it promised at the outset, the establishment of the SEC is arguably the most important bureaucratic reform in the recent history of Saudi Arabia. The SEC is likely to strengthen the capacity of the rentier elite to force through their preferences. It is only by casting a "micro-level" analysis on the changes within the rentier bureaucracy that these variations become apparent. Therefore, the assumption of "institutional malaise" must be treated with caution. The rentier state model is correct to illustrate the redundancy of great swathes of the rentier bureaucracy. However, it is also important to recognise that change within the institutions can, and does, take place. It is highly likely
that as the SEC gains in importance in the future, the assumption of the "institutional malaise" will be questioned by a growing number of rentier academics.

Finally countertrade enabled the rentier elite to employ a stealth approach to state building. Capacity to implement economic reform does not rest with institutional ability alone. The state must be in a position to persuade the public of the merits of its policy. The management of public perception is as important as the financial and technical arrangements. What information the public receives, how it receives it, how it matches the reality on the ground are important questions that governments must address. BOT is a useful political tool to force through significant and permanent economic change, - a political smokescreen. The transfer element can be conveniently forgotten after several decades, during which time the public gets used to private sector solutions to public sector problems. This ability to proceed with state-building measures by stealth suggests a degree of rentier elite autonomy in framing and applying policy under adverse conditions.

V. Rentier Mentality

Evidence of the rentier mentality still exists in the Gulf and the early rentier theorists were correct to highlight its damaging impact. However, should we view the rentier mentality as a permanent consequence of rentierism? I would argue no. While evidence of the mentality can still be observed, so confirmation of new attitudes is apparent. Both the Kuwaiti and Saudi governments now take the issue seriously. In this
context, we must reevaluate this phenomenon. The "severe attitudinal problems" described by rentier theorists are not necessarily permanent.

One problematic issue is that the rentier mentality suggests passivity. Passivity in turn suggests relative contentment with the prevailing situation and a lack of urgency to change the state of affairs. Yet Hypothesis II showed how the private sector became increasingly concerned with the impact of rentierism upon the indigenous workforce. The very fact that the private sector itself identified the rentier mentality as a problem forces us to question this broad "political culture" assumption. If private companies are collections of Gulf citizens, why are they immune from the rentier mentality themselves? In Kuwait, representatives from the private sector acted in a manner quite distinct from the rentier mentality. They approached the Ministry of Finance to persuade the government to adopt an Offset scheme so that they could derive similar benefits to non-rentier states. This is not evidence of a passive private sector lacking entrepreneurship and the ability to demand policy changes based on self-interest alone. Instead, it demonstrates active lobbying to derive specific self-seeking goals. The rentier mentality is a broad sweeping concept that, if not applied with sensitivity, is likely to create a caricature of a Gulf citizen.

Hypothesis III was important because it showed that the rentier mentality does not have to extend to decision-makers. The assumption that oil rents create "policy vacuums" as a consequence of not having to make difficult choices under conditions of fiscal austerity is not necessarily true. In the first instance, fiscal austerity is a very real
problem, as chapter one and Hypothesis I each demonstrated. But the argument is beyond rent fluctuations. Hypothesis III correctly identified the fact that in Kuwait and Saudi Arabia, a new elite is pursuing policies that one would not expect if the rentier mentality is as comprehensive as it is presumed. Oil rents do not isolate policy makers from considering new ideas. First, as Hypothesis II argued, the World Bank has played an extremely important role persuading and advising Middle Eastern states on the benefits of BOT schemes. Having witnessed BOT projects working in neighbouring countries, Kuwaiti and Saudi decision-makers learned how to apply countertrade for their own benefit. Second, many decision-makers lived and studied abroad, in environments that forced them to reconsider what the true benefits of oil rent really were. As Hypothesis III illustrated, significant areas of economic decision-making have passed into the hands of a “new elite.” In both the Saudi and Kuwaiti governments, the majority of ministerial posts are held by individuals with graduate degrees from Western universities. For example, the Saudi Arabian finance minister holds a doctorate from Colorado State University and was an executive director at both the IMF and World Bank. At lower levels of government, a cadre of western-educated technocrats is also apparent. The stereotypical view of Gulf decision-making deserves reconsideration.

So if the rentier mentality has a limited affect upon the new elite and among business leaders, who are those suffering from it? The allocation state appears to have had its most deleterious impact upon the several generations of ordinary Saudis and Kuwaitis who grew up in post-oil discovery boom. Opportunities that earlier generations could only have dreamed of are now considered “rights.” Even among the younger
generation, work ethics have been eroded by "the state of social care." Guarantees of "jobs for life" and generous welfare provision threatens the establishment of a true meritocracy in each state. However, it has become apparent to an ever-larger number of young Kuwaitis and Saudis that this way of thinking can not prevail forever. The young Kuwaiti nationals whose opinions were detailed in Hypothesis III illustrates that although the rentier mentality prevails, all were aware that radical changes would ultimately impact upon their work and lifestyles. This recognition is an important development. Years of government warnings reinforced by (painfully slow) cuts to rentier subsidies are gradually changing attitudes. This suggests that reformulating a future "social contract" between the rentier government and the population might not be as painful as rentier theorists suggest. The rentier mentality will take some considerable political will to break, but the rentier mentality can be broken.

VI. The Transition From Allocation to Production State

The application of each hypothesis has enabled us to obtain unique conclusions by looking at the available evidence from different perspectives. As this concluding chapter has demonstrated, the evidence uncovered offers new ways of thinking about the assumptions implicit in the rentier state model. Over the twenty-year implementation period the three hypotheses help to explain the changing motivations of government policy. It is clear that the dynamics and processes inherent in original decisions have the potential to develop beyond what was originally intended. As countertrade developed an early history of its own, we see certain hypotheses explaining certain historical time periods across borders with greater plausibility than others. While Hypothesis I was
particularly accurate in explaining the initial application of Saudi Offset in the pre-
privatisation era, Hypothesis II shows how the private sector push for Offset in Kuwait a
decade later was influenced by this Saudi experience. In turn the application of
Hypothesis III explains how an increasingly western-educated Kuwaiti government
responded positively to these overtures in the fiscally austere 1990s. Had only one all-
encompassing hypothesis been employed it would have missed these subtle differences
by being too unwieldy to apply. By covering all bases we would have risked creating a
hypothesis that could not have been disconfirmed. Above all, we would have been guilty
of failing to ask interesting questions. Taken together, each individual hypothesis makes
an important contribution to the overall explanation by detailing the changing nature of
elite motivation.

As chapter one argued, the Gulf states are still in the process of developing their
countertrade options. We have yet to reach the end of the countertrade route. However,
we do have the experience and observation of the last twenty years to offer some
indication as to the direction and purpose of countertrade. When compared and
contrasted together all three hypotheses lead us to the argument that the rentier state
model must reflect a gradual and incremental movement away from the allocation state to
the establishment of a production state. The application of countertrade analogues shows
measured progress away from the traditional conception of the rentier state. Countertrade
now represents an important approach in an elite-led strategy to redevelop the
relationship between state and society in the rentier state. It was not always perceived in
this way. Indeed, Hypothesis I provided documentary evidence to suggest the Saudi elite
viewed Offset in the 1980s as “modernisation without change.” Even during the early 1990s the initial application of BOT in the Saudi electricity sector reflected this view. However, as such outlooks became unworkable and as the oil bust continued, so we witness the Saudi and Kuwaiti governments impressing upon rentier citizens the concept of rights and duties. Rentier governments cannot be expected to provide the extensive array of goods and services that existed during the oil boom. The private sector is expected to play its part in the development of the rentier state and few areas of the state are immune from this line of thinking. Free telephone calls, cheap electricity, free educational loans etc. are no longer to be taken for granted. To relieve the burden of the state, the private sector is being asked by the rentier elite to engage in these areas through BOT and Offset schemes. In addition, private companies are now being asked to run areas of the rentier bureaucracy as in the Al Yamamah Offset Program. Consequently, private international firms with their domestic partners are now occupied in profit-making activities in new areas throughout the state – a situation that would have seemed inconceivable only twenty years ago. While countertrade is an on-going process and elite motivations may change, there is little evidence at present to suggest that this direction will alter in the near future.

Oil will continue to play an important role in the economic and political development of Kuwait and Saudi Arabia. Both countries are still rentier states. However, the application of countertrade shows that the impact of oil, and its utility for the rentier elite, appears to be diminishing. Whether it will continue to diminish in the future cannot be determined with absolute certainty. The price of oil may rise (as it did in
2000) as well as fall, while capital flows across borders may decrease as well as increase. The impact of market forces will fluctuate so that the passage from allocation to production takes on an "ebb and flow" movement. In periods of austerity the pressure to move away from rent dependency takes on an added incentive. In periods of relative wealth the incentive is lessened. However, demographic pressures will surely mitigate such complacency. Oil wealth is unlikely to rise as fast as population growth. For the rentier elite, oil rent represents a law of diminishing political returns. The start of the new century is an extremely interesting period in which to study the repoliticised rentier state. We are in the midst of a slow yet significant economic transformation, which will undoubtedly have tremendous political consequences. What these consequences are, how this transition will develop, and how specific political and social actors will be affected cannot be comprehensively predicted at the current time. Yet as the application of countertrade has shown us, the transition period is not some distant date, it is occurring now. The twenty-year application of countertrade marks a significant stage in the economic and political development of the Gulf region.
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