

NTS: Stability versus Sustainability Energy Policy in the Gulf Monarchies

*Jim Krane*¹

Motivations underlying the research

Rising populations and growing wealth have coupled with low domestic prices to propel huge increases in energy consumption within the six Gulf Cooperation Council countries, Saudi Arabia, the United Arab Emirates, Kuwait, Qatar, Oman and Bahrain. The trend of large and continuing increases in demand threatens assumptions about the sustainability of the region's oil exports.

At current rates of consumption growth, oil and gas exports from these monarchies could be reduced by the end of the decade, much sooner than expected. This is significant for the countries concerned, because their economies and political systems are based on distributing revenues and in-kind energy from these resources. If exports are reduced, the longevity of these mainly stable and long-serving family-based regimes may be threatened. At the same time, global energy markets also depend on continued supply from the Persian Gulf monarchies. A loss of export capacity, or even spare production capacity, could significantly affect global prices.

With the exception of gas-rich Qatar, these monarchies face an increasingly acute conflict between sustaining exports and maintaining government subsidies on electricity, desalinated water and fuels. Recently, opportunity for reforming these subsidies has been constrained by pan-Arab uprisings.

Account of research performed

I use descriptive statistics and hard data to show evidence of a transformation in the energy balances of these Middle Eastern exporters that reveals them as increasing consumers of their chief export commodities. I show that Kuwait and the United Arab Emirates have, since 2008, become net importers of natural gas, and that Saudi Arabia has surpassed Germany and Brazil to become the world's No. 6 consumer of oil. In most of these monarchies energy demand is rising alongside energy intensity. In effect, these countries are moving in the opposite direction from most of the rest of the world, growing ever less economically productive in energy terms. Regimes have failed to expose consumers to price signals that might reduce consumption in line with rising government costs. In turn, their energy subsidies have become the world's largest, on a per capita basis.

¹ Wallace S. Wilson Fellow for Energy Studies, James A. Baker III Institute for Public Policy, Rice University, 6100 Main Street, Houston, Texas 77005; +1 (713) 348-3567; jkrane@rice.edu

I use a calculation of price elasticity of energy demand to estimate that the region's very low subsidized prices account for about a third of the demand for energy. By removing subsidies, these countries would experience long-run reductions in energy demand ranging from 12% in the UAE to 43% in Saudi Arabia.

Policy implications

I argue that simply imposing the huge price increases required to rationalize prices does not represent a realistic policy choice for regimes which derive their legitimacy not from citizen political participation but through distribution of welfare benefits. Reform policies must account for these political realities if they are to succeed while preserving political systems.

A more measured policy might opt for targeted subsidies designed to protect low-income and vulnerable groups, while allowing prices to rise for those deemed more able to pay. Lost subsidies on energy might be replaced by a new benefit so that overall consumer welfare is not lost. Regimes could consider a cash transfer or an alternate benefit holding an approximately equal value, minus the deadweight loss that accrues from inefficient allocation.

There is some precedent for such a policy. In 2010, Iran became the first country in the world to replace energy subsidies with a universal cash transfer program. Direct payment is a more efficient and equitable redistribution mechanism because increased energy prices encourage consumers to reduce consumption, which, as in the Iranian case, allows households to use part of their compensation to buy preferred goods and services. Iran's reform achieved a positive assessment from the IMF and a large segment of the Iranian public.

Main conclusions

The paper argues that maintaining in-kind resource distribution entails rising *direct costs* in the form of subsidies, rising *opportunity cost* in the form of lost export earnings, premature *displacement* of exports, and premature resource *depletion*, due to uneconomic demand. Reforms can therefore extend the monarchies' status as exporters, bring them higher value from natural resources, and assist with maintenance of prudent fiscal balances. Distributional politics has long been understood as a key element in the Gulf's vaunted political stability. But this practice, however effective over the past 40 years, now comprises a structural encumbrance that threatens the region's economic and political models. The political-stability-versus-economic-sustainability puzzle suggests that Gulf ruling families will be forced to protect their oil revenues, their key stability resource, before preserving energy subsidies, which are a legacy of surplus production.