THE COSTS OF COUNTER-REVOLUTION IN THE GCC

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The reaction in the GCC monarchies to the uprisings coursing through the Arab world has leaned heavily toward the politics of patronage. Saudi Arabia, Oman, and even Bahrain have met political challenges in part with lavish financial inducements to key sectors of society. Such soft counter-revolutionary strategies seem astute in the short run, as they buy allegiance instead of breeding resentment, and allow regimes to avoid the international opprobrium which comes with undue violence. In the long run, however, they threaten to undermine not only the fiscal sustainability of GCC regimes, but also their strategies to integrate their national populations into a diversifying economy.

Saudi Arabia has a history of throwing money at its most severe domestic problems. The Kingdom has seen two severe political crises in the last four decades: the occupation of the Grand Mosque in 1979 by the Juhayman group, and the domestic backlash to the presence of 500,000 U.S. troops in the wake of Saddam Hussein's invasion of Kuwait in 1990. In both cases, the al-Saud reacted to political instability with increased subsidies, reductions in government fees and other patronage measures. But those past giveaways, although substantial, pale in comparison with the welfare decrees issued in February and March 2011.

With a total estimated volume of $130 billion, the new spending measures are larger than the total annual government budget was as recently as 2007. They include the building of 500,000 houses, the setting of a minimum wage of 3,000 Saudi Riyals (560 Euros) in the public sector, one-time bonus payments for incumbent civil servants, the creation of a general unemployment assistance scheme, budget increases for various public credit agencies, supplementary funds for a number of religious organizations as well as the creation of more than 100,000 new jobs, among them 60,000 new jobs in the Ministry of Interior, an agency that is already said to employ almost as many nationals as the whole Saudi private sector. Some of the spending is immediate, while other components will be rolled out during the coming years.

Many Saudis see the extra cash for religious institutions, including the religious police, as a reward for their vocal public stance against potential anti-regime demonstrations. Amendments to the Saudi media law announced in late April made it a crime to publish any material that insults the kingdom's grand mufti, members of the Council of Senior Ulama and government officials. Dissidents feel that the regime is circling the wagons, and is underwriting its strategy with targeted patronage measures.

The plan to build new houses is arguably the most economically rational component of the spending packages: Although it could cause short-term inflation due to bottlenecks in the construction sector, the shortage of housing for middle and lower class Saudis is a pressing social issue. Home ownership is out of the financial reach of most young nationals, many of whom live with their parents into their late twenties. The inability to pay for their own abode, and the concomitant inability to start a family, has fueled much of the frustration of young protesters all across the Arab world.

In the face of high youth unemployment, the envisaged unemployment assistance scheme also appears a timely move, although the monthly benefit level of 2000 SR announced in March struck local observers as high: The private sector, which remains dominated by foreign employees, provides some 8 million jobs in total, but only about half a million of those pay more than 3000 SR per month. The average wage is closer to 1000 SR.

The provision of more public jobs is a more problematic trend: already now, an estimated 45 percent of the government's total outlays are for salaries, an exceptionally high share in global comparison. The kingdom has stepped up the creation of public jobs since 2008. But if the aim is to soak up all or most of the young Saudis who will enter the job market in the coming years, the government faces a losing battle: Some 400,000 men and women enter working age every year, a volume that even the most generous bureaucracy cannot absorb. Together with the new minimum wage of 3000 SR in the public sector, however, the renewed drive to create state jobs is likely to drive young Saudis out of the private labor market and into the waiting loop for a government position.

Saudi Arabia is calm for the time being: Its opposition is ideologically polarized and badly organized, King Abdullah is popular among important parts of the population, and the regime continues to command wide-ranging patronage networks. It can also afford to be more honest about what it is -- a conservative, kin-based monarchy without democratic pretensions -- than the hypocritical and corrupt republican dynasties that have fallen or are trembling now. In the long run, however, the patronage formula that the regime relies on could come under increasing stress. Already now, the oil price at which the Saudi budget breaks even lies above $80 per barrel. It was closer to $20 just a decade ago. The kingdom's current overseas reserves are large, but so are its budgetary needs.

Bahrain and Oman are the two GCC countries that have witnessed serious oppositional mobilization in recent months, and their fiscal reaction to the crisis closely resembles the Saudi one. In addition to a massive housing program, the Bahraini government has promised 20,000 new jobs in its own Ministry of Interior, a huge number relative to a national population of less than 600,000. In August, Bahraini civil servants received the biggest pay rises in Bahrain's history as part of a 200 million Bahraini Dinar package issued as a supplement to 2011-12 biannual budget that is already 44% larger than the 2009-2010 budget.

In Oman, the government has announced increases in subsidies for commodities, higher welfare and pensions payments as well as the creation of 50,000 new jobs, of which 35,000 are to be provided by the public sector. Between February and August, over 30,000 new civil service jobs had already been created.

In the wake of demonstrations and strikes in Bahrain and Oman, their richer GCC neighbors have recently promised 20 billion dollars to support development in the two countries -- a good share of which will have to be coughed up by Saudi Arabia. In the mid-term, relatively resource-poor Oman and Bahrain run the danger of becoming a fiscal ward of their better endowed neighbors. Bahrain's sovereign ratings have already been downgraded in March, while Oman was under review for potential downgrades until July, with its outlook still rated as negative by Standard and Poor’s.

The revolutionary wave has largely spared the high-rent GCC monarchies with small national populations: Qatar, Kuwait and UAE. Pressures to throw around money have hence been less acute. The UAE government has nonetheless committed to spending $1.6 billion on infrastructure in the poorer and potentially restless northern emirates, raised military pensions by 70 percent and started subsidizing bread and rice. In June, Abu Dhabi announced the creation of 6000 new jobs in the civil service and pledged to allocate 7 billion

Dirhams for housing programs. In the same month, Kuwait doubled the grants for its national student population.

The politics of patronage do not only put rising pressure on national budgets, but also undermine strategies to increase national participation in private labor markets -- a sine qua non of long-term economic sustainability. Easy and well-paid public sector jobs lift nationals' wage expectations and thereby price them out of the private market, weaken incentives to acquire education that is relevant in the private economy, and reinforces an entitlement mentality that can be politically explosive when the going gets tough. Expectations are easy to raise but difficult to curb, creating a ratchet effect that demands ever larger outlays during every political crisis. Almost all past attempts to reduce entitlements of GCC populations -- public jobs, subsidies, cheap utilities etc. -- have come to nought.

It is a lot nicer to be thrown money at than to be shot at and tortured, but neither strategy of containing political challenges appears sustainable. The demography of the GCC's national populations is similar to that of the rest of the region: the ranks of the young are swelling and their aspirations rising. Expectations of lucrative and low-effort public jobs are bound to be disappointed one day. By shifting precious resources toward a bloated bureaucracy, the regimes are kicking the employment problem down the road -- and making it worse, as incipient private job creation for nationals is undermined.

The chances that the GCC's long-term socio-economic challenges of demographic growth and youth unemployment will be solved now look a good deal worse than just a few months ago. For the high-rent countries, the issue will remain largely academic for decades to come. But depending on oil price developments, it could become an existential worry for Bahrain, Oman and Saudi Arabia before the end of the decade, as continued population growth will increase spending pressures.

The breakeven oil prices for GCC budgets have increased significantly in the past few months. Bahrain probably already needs a per barrel price above $100, while the Institute of International Finance predicts a Saudi breakeven price of $110 for 2015. These should be sobering numbers for those who believe that the GCC can always buy its way out of trouble.

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