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A Critical Examination of Oil Wealth Management Strategies and Their Effects on Economic Growth in the Gulf Cooperation Council Countries

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Abstract

Despite their natural resources, the countries of the Gulf Cooperation Council (Kuwait, the United Arab Emirates, Saudi Arabia, Bahrain, Qatar, and Oman) have failed to live up to their economic potential, primarily due to their dependence on a revenue source with volatile prices and political significance in an unstable region. This thesis argues that the best way to convert oil wealth into consistent long term growth is through diversification, both by investing in foreign assets and by growing domestic sectors that are independent from oil and gas prices. The research further investigates the primary tool these countries have used to do so – sovereign wealth funds – and how their implementation and structures have impacted their effectiveness in achieving economic diversification and growth.

Acknowledgements

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Introduction

In the early 1970s, most countries in the Gulf region experienced exceptional economic growth due to their newly discovered oil and gas resources and a spike in oil prices. This caused many to see the oil-exporters of the Gulf as full of economic and geopolitical potential. During this peak, infant mortality in the Gulf was halved, life expectancy rose, and adult literacy increased dramatically.[1] Forty years later, most of those countries have struggled with domestic instability and the economic growth that was once so promising has stagnated and declined.[2] The Gulf countries' failure to rise has meant a significant loss of economic potential, increased global instability, and ultimately the loss of thousands of lives.[3] Many theories have attempted to explain the MENA countries' stagnation and decline, blaming poor leadership, the "resource curse," corruption, religious sectarianism, colonial history, population growth, etc. Though these theories may each explain some aspects of individual countries' decline, they have fallen short of generating feasible policy recommendations.

One of the most indisputable characteristics of the Gulf Cooperation Council countries (Kuwait, the United Arab Emirates, Saudi Arabia, Bahrain, Qatar, and Oman) is that a large portion of their gross domestic product (GDP) comes from oil and gas revenues. These revenues are in turn highly dependent on oil and gas prices, which are extremely volatile and responsive to international instability. Dependency on such a

[1] Wheeling Jesuit University 2016.
Commins 2012, 211.
[2] Abed 2003.
[3] Hertog 2009.

volatile source of income makes it extremely difficult for these countries to plan for the future and manage their wealth efficiently; they have historically over-spent during times of oil windfalls, leaving themselves vulnerable to oil price shocks like that of the early 1980s or to regional turmoil, as in the Gulf War. This uncertainty in turn leads to a volatile domestic market, reduced long term investment both from domestic and foreign sources, and more economic and political instability. This thesis will examine one of the most common tools used to promote for stabilization and growth – sovereign wealth funds – how they have been implemented in different countries, and how their characteristics have led to their success or failure, particularly as regards their compliance with the Santiago Principles.

Introduction to Sovereign Wealth Funds

Since the oil price boom of the 1970s, oil and natural gas exporting countries in the Gulf region have faced a number of challenges when dealing with their natural resource wealth. These challenges are, to a certain extent, unavoidable, but the policies put in place by individual governments can have an immense impact on their effects. An increasingly popular approach to stabilizing government revenue in the face of price instability is the "sovereign wealth fund," which generally takes a certain percentage of domestic commodity revenue, invests it in a diversified portfolio, and therefore mitigates the overall risk inherent in having a large amount of wealth focused in one type of investment.

In 1953, the first sovereign wealth fund was formed in Kuwait as a way to invest oil wealth in a diversified portfolio and thereby reduce the Kuwaiti economy's dependence on oil revenues.[4] In total, the KIA currently manages about US$592 billion which is either invested in long-term, low risk international portfolios or in the domestic economy.[5] In 1986 government income from investments started to exceed oil revenue and it has continued to display strong returns, with the Kuwait Investment Office acting as the country's central bank. Despite a few incidents of mismanagement, it has reduced volatility, released cash for domestic projects, and acted as a back-up source of government funds when assets are frozen, as in the 1990 invasion by Iraq.[6]

Since 1952, hundreds of other sovereign wealth funds have been formed, both to manage oil revenues and other revenue windfalls in a variety of countries around the world.[7] Over 40 of these funds were formed since 2005, showing a renewed interest in this method of managing government wealth, particularly in the Gulf Region. As defined by the Sovereign Wealth Fund Institute, a sovereign wealth fund is:

> "is a state-owned investment fund or entity that is commonly established from balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, governmental transfer payments, fiscal surpluses, and/or receipts resulting from resource exports. The definition of sovereign wealth fund excludes, among other things, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises in the

[4] Kuwait Investment Authority 2015a.
[5] The Sovereign Wealth Fund Initiative 2011.
[6] Reuters 2008.
[7] KPMG 2014, 103

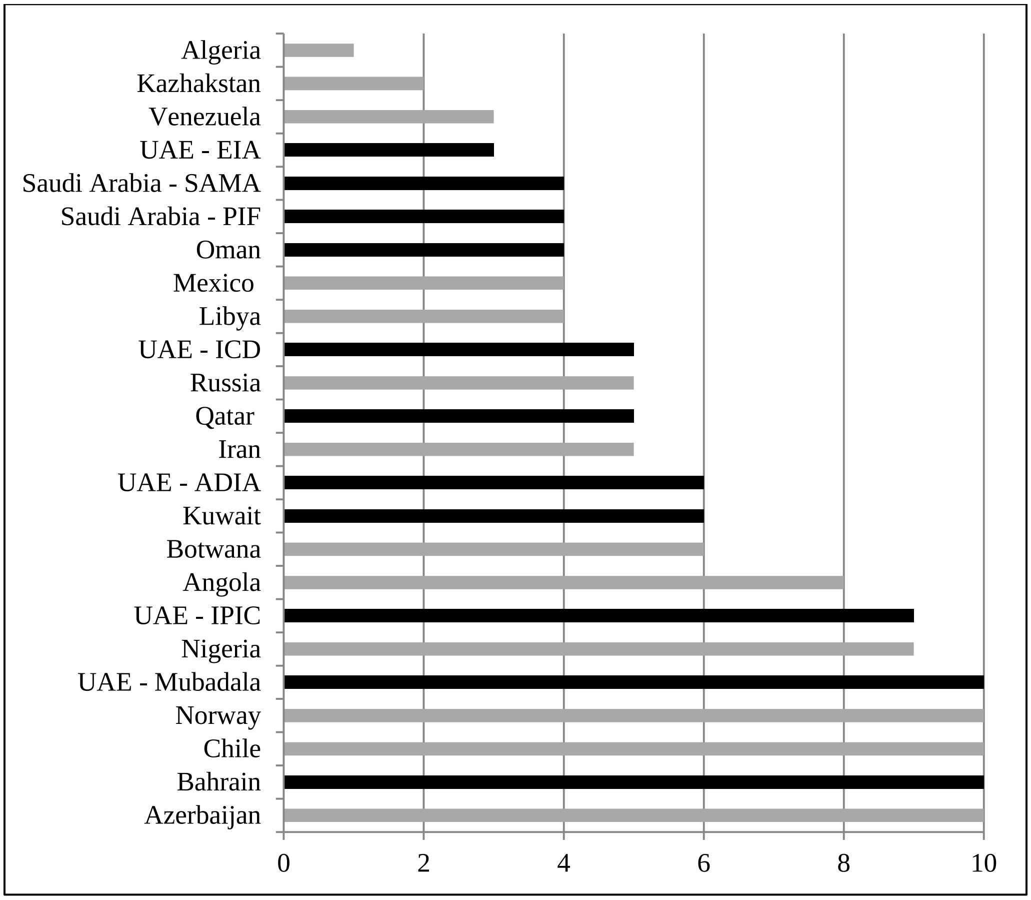
traditional sense, government-employee pension funds, or assets managed for the benefit of individuals."[8]

This definition can include stabilization funds, savings/future generations funds, pension reserve funds, reserve investment funds, and strategic development sovereign wealth funds; each of which can be funded either through revenue from commodity exports or through government budget surpluses. This thesis will primarily examine savings and strategic development funds in the oil-exporting countries of the Gulf, their legal framework, how they have been managed since their formation, where their funds are spent domestically and internationally, and their abilities to promote stable economic growth through diversification away from dependence on oil wealth.

One of the biggest challenges in studying these funds is the lack of transparency regarding their sizes, asset allocations, and spending patterns. The Sovereign Wealth Fund Institute uses the Linaburg-Maduell Transparency Index to rank sovereign wealth funds on a scale from 1-10, with 1 being the least transparent and 10 being the most transparent (see Figure 1). Based on their rankings, only two of the oil-exporting gulf countries (Bahrain and the UAE) have funds that exceed the 8-point minimum needed to qualify as "adequately transparent," and even then, only half of the UAE's funds pass the test.[9]

[8] Sovereign Wealth Fund Institute 2016a.
[9] Sovereign Wealth Fund Institute 2016b.

Figure 1: Sovereign Wealth Fund Transparency Rankings (as of April 2015)[10]



Source: The Sovereign Wealth Fund Institute Linaburg-Maduell Index

Since these commodity-based sovereign wealth funds are so secretive about their assets under management and where the assets are invested, nearly all information about them is speculative. In 2007, Morgan Stanley published an article titled "How Big Could Sovereign Wealth Funds Be by 2015?" and concluded that they could reach US$12 trillion by 2015, about 50 percent of which will come from oil-exporting countries, although that includes Russia, Norway, and other oil-exporters outside the Gulf with sovereign wealth funds.[11] In 2009, Deutsche Bank estimated that the total assets under

[10] The sovereign wealth funds discussed in this paper are highlighted in black
[11] Morgan Stanley 2007.

management of commodity-based sovereign wealth funds amounted to about US$1.65 trillion, making up an estimated 1.5 percent of the total assets in the global banking sector, 2.5 percent of world GDP, and 115 percent of total hedge fund assets when the study was published.[12] The report further stated that the total commodity sovereign wealth fund estimate of US$1.65 trillion would likely increase to US$7 trillion by 2019.[13] US$1.2 trillion of the originally estimated US$1.65 trillion in assets under management was attributed to Saudi Arabia, Abu Dhabi, and Kuwait. To put this in perspective, the combined GDPs of these three countries in 2009 was US$2.542 trillion. It should be noted that these estimates were made while oil prices were much higher than they currently are, so the researchers assumed oil-producing countries would have higher revenues to add to the sovereign wealth funds than they currently do.

This report shows that the investments of sovereign wealth funds can not only have a massive impact on the world economy, but they control a significant portion of the wealth in these countries, and how they are managed is crucial to the countries' success. In order to clarify what exactly good management is, the Santiago Principles were laid out in 2008 by the International Monetary Fund and the International Working Group of Sovereign Wealth Funds. These principles are as follows:

1. The legal framework for the sovereign wealth fund should be sound and support its effective operation and the achievement of its stated objective(s).

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[12] Kern 2009, 5.
[13] Kern 2009, 7-8.

2. The policy purpose of the sovereign wealth fund should be clearly defined and publicly disclosed.
3. Where the sovereign wealth fund's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.
4. There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the sovereign wealth fund's general approach to funding, withdrawal, and spending operations.
5. The relevant statistical data pertaining to the sovereign wealth fund should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.
6. The governance framework for the sovereign wealth fund should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the sovereign wealth fund to pursue its objectives.
7. The owner should set the objectives of the sovereign wealth fund, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the sovereign wealth fund's operations.
8. The governing boy(ies) should act in the best interest of the sovereign wealth fund, and have a clear mandate and adequate authority and competency to carry out its functions.

9. The operational management of the sovereign wealth fund should implement the sovereign wealth fund’s strategies in an independent manner and in accordance with clearly defined responsibilities.
10. The accountability framework for the sovereign wealth fund’s operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.
11. An annual report and accompanying financial statements on the sovereign wealth fund’s operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.
12. The sovereign wealth fund’s operations and financial statements should be audited annually in accordance with recognized international or national accounting standards in a consistent manner.
13. Professional and ethical standards should be clearly defined and made known to the members of the sovereign wealth fund’s governing body(ies), management, and staff.
14. Dealing with third parties for the purpose of the sovereign wealth fund’s operational management should be based on economic and financial grounds, and follow clear rules and procedures.
15. Sovereign wealth fund operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

16. The governance framework and objectives, as well as the manner in which the sovereign wealth fund’s management is operationally independent from the owner, should be publically disclosed.
17. Relevant financial information regarding the sovereign wealth fund should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.
18. The sovereign wealth fund’s investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.
19. The sovereign wealth fund’s investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.
20. The sovereign wealth fund should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.
21. Sovereign wealth funds view shareholder ownership rights as a fundamental element of their equity investments’ value. If a sovereign wealth fund chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The sovereign wealth fund should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding

22. The sovereign wealth fund should have a framework that identifies, assesses, and manages the risks of its operations.
23. The assets and investment performance (absolute and relative to benchmarks, if any) of the sovereign wealth fund should be measured and reported to the owner according to clearly defined principles or standards.
24. A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the sovereign wealth fund.[14]

The purpose of the Santiago Principles is to encourage not only transparency, but the type of institutional framework that will promote sound investment practices and a focus on long-term economic growth. As such, it encourages strict legal guidelines on withdrawals from sovereign wealth funds, specific requirements regarding contributions to the fund by the government, and accountability through external audits and public disclosures. According to the International Working Group of Sovereign Wealth Funds, abiding by these guidelines will not only increase stability, but will also gain these sovereign wealth funds respect in the international financial community, in turn encouraging "an open and stable investment climate" with minimal protectionism.[15]

In addition to analyzing the unique economic challenges that face the Gulf Cooperation Council countries, the following chapters will examine their sovereign wealth funds with respect to their transparency, compliance with the Santiago Principles,

[14] International Working Group of Sovereign Wealth Funds 2008, 7-9.
[15] International Working Group of Sovereign Wealth Funds 2008, 4.

and how their investments have impacted both government revenues and domestic growth.

Chapter 1: Kuwait

Founded in 1953, eight years before Kuwait's independence, the Kuwait Investment Authority is the world's oldest sovereign wealth fund. At the time of its founding, Kuwait was severely underdeveloped, but the Sheikh Abdullah Al-Salem had the forethought to establish a fund with a mission to "achieve long term investment returns on financial reserves… providing an alternative to oil reserves, which would enable Kuwait's future generations to face the uncertainties ahead with greater confidence."[16] As of 1976, the fund has been separated into two parts: the General Reserve Fund and the Future Generations Fund.[17] The General Reserve Fund serves as the treasurer and stabilization fund of the country as well as the primary repository of the state's oil revenues. It also is mandated to invest solely within Kuwait, other MENA countries, and hard currency assets rather than more risky international investments. In order for the Kuwaiti government to withdraw funds from the General Reserve Fund, the withdrawal must be approved in an annual budget passed by Parliament, making this fund a secure savings fund with a focus on long-term domestic stability and growth.[18]

The Future Generations Fund, on the other hand, is invested solely outside of Kuwait, in a variety of investment vehicles including typical stocks and bonds and alternative investments, including private equity, real estate and infrastructure. This allows the Future Generations Fund to focus less on internal development and more on creating steady revenues that will benefit Kuwait over a long-term investment horizon.

[16] Kuwait Investment Authority 2016b.
[17] Kuwait Investment Authority 2016c.
[18] Kuwait Investment Authority 2016d.

When it was founded in 1976, 50 percent of the General Reserve Fund's assets were transferred to the Future Generations Fund, and every year since then at least 10 percent of the General Reserve Fund's net profits have been added to the Future Generations Fund as well as 10 percent of state revenues, much of which comes from oil revenues. In order to withdraw any of these funds, special legislation must be passed.[19] Both of these funds have strict regulations on contributions to and withdrawals from the funds by the government, fulfilling the International Working Group of Sovereign Wealth Funds' recommended policy-making guidelines as specified in the Santiago Principles, though these funds fall short of full compliance in other ways, including their transparency standards.[20]

A large part of the Kuwait Investment Fund's sustained success is its relative independence from domestic politics, which is also highly recommended in the Santiago Principles. To reduce the likelihood of major conflicts of interest between the Kuwait Investment Authority and officials with alternative agendas, the board consists of the Minister of Finance, the Minister of Oil, the Governor of the Central Bank of Kuwait, the Under Secretary of the Ministry of Finance, and five other Kuwaiti nationals from the private sector, three of whom may not hold any other public office. From this board, a Managing Director and deputies are selected, and the people holding these positions are not allowed to hold any other government positions or work for any other employers while serving. The presence of officials from the Ministry of Finance and the Central Bank is intended to insure that management of the fund prioritizes long term growth

[19] Kuwait Investment Authority 2016d.
[20] International Working Group of Sovereign Wealth Funds 2008.

rather than rash spending, though the latter choice would be beneficial to other government officials trying to gain domestic support through unnecessary subsidies, ostentatious government projects, etc. Though there will be times when people on the board do want try to withdraw funds for projects, the goal in choosing this type of board is that it will only do so when the Kuwaiti economy truly needs to be propped up in order to reduce domestic volatility.

The Kuwait Investment Authority has not always been successful in its mission to separate bank and state, leading to scandals involving risky deals, fraudulent behavior, and large losses. For example, in the late 1980's, Spain's economy experienced a boom, and the KIO (the London-based office of the Kuwait Investment Authority) invested heavily in various Spanish industries, including Torras Hostench, a paper maker which subsequently acquired multiple other companies, becoming the conglomerate known as Grupo Torras.[21] The KIO's total investment in Grupo Torras was estimated to be over US$5 billion, making it one of the Kuwait Investment Authority's largest and most risky investments. Through Grupo Torras, the Kuwait Investment Authority invested heavily in multiple large and ostentatious projects based in Spain, including the Gate of Europe towers in Madrid.[22]

In 1993, the KIO filed a lawsuit claiming that "through the use of various shell companies, fictitious loans, fraud and embezzlement, the former Torras management conspired to steal at least US$500 million between May 1988 and May 1992."[23] The

[21] Al Husaini 2000.
[22] Al Husaini 2000.
Tremlett 1994.
[23] Cohen 1993.

targets of this suit were the Sheik Fahad Mohammed al-Sabah, the former chairman of the KIO and the cousin to the then-Emir of Kuwait; Fouad Khaled Jarrar, the former vice president of the KIO; and Javier de la Rosa, the Spanish financier who managed Grupo Torras during the scandal and had previously been known to be unscrupulous with his investments.[24] This fraud and embezzlement went unnoticed for years due to a convergence of events: the Spanish boom and bust, negligent monitoring of risky investments, and attention being focused on the Iraqi occupation of Kuwait during the Gulf War.

The Kuwait Investment Authority and the KIO blamed the incident almost entirely on Mr. De la Rosa and the Spanish managers of the Kuwaiti investments, but Sheik Fahad Mohammed al-Sabah and Fouad Khaled Jaffar were also found guilty of fraud, with Fouad Khaled Jaffar earning two years in prison.[25] Mr. De la Rosa, who was also sentenced to fifteen years in prison, did claim, however, that the implication of these two members of the royal family was magnified as a way for figures in Kuwait to harass the ruling al Sabah family. This incident demonstrated the potential for fraudulent activity and serious embezzlement of funds, particularly when members of the royal family are involved in managing the funds rather than overseeing their hired investment managers. It also showed the need for a consistent, long-term investment strategy rather than investments in risky, short-lived booms, and the need for careful auditing of the fund's activities.

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[24] Cohen 1993.
[25] Jannesen 2004.
Martinez 2016.

Currently the fund is audited regularly by the Board Audit Committee, the State Audit Bureau, an internal audit, and jointly by two of the “Big Four” auditing firms, as a way to hedge against the type of fraud seen in the KIO scandal. The leadership of the Kuwait Investment Authority has also become more insulated from the Kuwaiti government, with the primary investing office located in London, making the Kuwait Investment Authority resemble a typical investment management bank much more than a government agency. This separation is meant to ensure that investments are made based purely on potential for returns rather than on domestic politics, particularly within the Future Generations Fund. If this effort to maintain separation is not consistently made, sovereign wealth funds can easily become a tool for governments and members of royal families to support their allies, flaunt their wealth, or benefit individuals in power rather than stabilizing domestic wealth in a way that will benefit their country and its future. These were clearly concerns when the most recent Kuwait Investment Authority guidelines were being laid out, and when describing its investment strategy, the Kuwait Investment Authority reaffirms that it “has based its investment decisions exclusively on commercial considerations, not on the political or foreign policy interests of the state of Kuwait.”

Not only does the Kuwait Investment Authority have to monitor its investments to ensure it achieves its goal of stable domestic growth, but it must also monitor withdrawals from the fund. As mentioned, removing assets from the General Reserve Fund requires the passage of an annual budget by the Kuwait National Assembly, which is meant to ensure some level of liquidity while requiring forethought and due legal process. The regulations on transferring funds from the Future Generations Fund are even stricter, requiring specific legislation. This type of legislation has only been passed once, during the Persian Gulf War in 1990. Before the Iraqi invasion, the Future Generations Fund's assets were estimated to be about US$100 billion, but by the 1994 it had shrunk to about US$35 billion.[26] During this conflict, holding assets overseas proved to have another benefit when then President Bush froze all U.S. held Kuwaiti and Iraqi assets to ensure that Saddam Hussein would not have access to the billions in Kuwaiti assets held abroad.[27] This ability to control the foreign reserves even when the Kuwaiti government was in exile was not only useful to the Kuwaiti government during the conflict, but it showed foreign investors that Kuwaiti wealth was a reasonably safe investment; even when under foreign attack, the wealth was kept safe through foreign holdings and diversification.[28] The regulations of withdrawals of funds are intended to make the General Reserve Fund and Future Generations Fund more stable government funds than can be found in most natural resource-rich countries, but this effort would be futile if the Kuwait National Assembly's authority were dependent on the support of the ruling al-Sabah family. Thankfully, Kuwait has "perhaps the most independent parliament in the Arab World," and members of the royal family are not allowed to serve in the parliament, which helps to check the royal family's control of the funds and keep the fund management somewhat separated.[29]

Unfortunately, restricting the budget is one of the only real powers that the parliament has; most of its strength comes from being able to curb the al-Sabah family's

[26] Marshall 1997.
[27] Farnsworth 1990.
[28] Habibi 2008, 39.
[29] Brown 2001, 16-17.

power, but it is limited in its ability to create new legislation. This leads to a stalemate in which the Emir only proposes limited actions that are beneficial to the royal family and the parliament displays its power by shutting down those proposals. In return, the Emir is able to dissolve the parliament, which has become a fairly common action (it has happened nearly every year in recent years) and requires new elections before the government can go back to functioning normally.[30]

Clearly, there are some serious problems with this system, including incentivizing parliamentarians to pass extravagant public spending legislation in order to gain support for the next election, but it is still much more democratic than the authoritarian rule of some of the other Gulf States.[31] It has some influence in limiting the funds that will be withdrawn from the Future Generations Fund and General Reserve Fund, but whether it will be able to function successfully when Kuwait’s economy needs the funds to manage future volatility is uncertain. Hopefully when the country truly needs to withdraw assets from these funds to maintain stable economic growth, the royal family and the elected parliament will be able to unite and make the best decision for Kuwait.

After the 2009 economic crisis, most Gulf States, including the UAE and Qatar, were quick to withdraw funds from their sovereign wealth funds in order to support the domestic economy, but withdrawals from the Kuwait Investment Authority were delayed due to prolonged negotiations, demonstrating the potential problems that overregulation of the withdrawal of funds can cause. In early 2010, the parliament finally approved a

[30] Kinninmont 2012, 2.
[31] Kinninmont 2012, 8.

four-year, US$105 billion spending plan to mitigate the negative effects of the global economic downturn, but this delay was inefficient and costly.[32]

The Kuwaiti government is currently considering passing legislation to once again withdraw assets from the Future Generations Fund, this time to cover the budget deficit due to low oil prices. If successful, this legislation would liquidate the lowest performing assets, amounting to US$30 billion of the fund's current US$600 billion, and this money would be used to maintain a healthy annual budget and continue large infrastructure projects being planned.[33]

The Kuwaiti government does have to be careful with this type of legislation, however, and only pass it when necessary. There will certainly be times when injecting funds into the domestic economy will be beneficial, but if done too often, it could become a tool to gain support for the Kuwaiti leadership by essentially buying off their constituents. One domestic spending tool that is extremely common in the oil-exporting countries of the Middle East is the use of oil subsidies, and Kuwait is no exception. Many citizens feel that they are entitled to the oil produced by their countries, and subsidizing the price of energy is one way in which these governments help satisfy this expectation. These subsidies are a fairly simple way of gaining domestic support, but cutting them back is not nearly as easy. Nigeria faced weeks of paralyzing protests when President Goodluck Jonathan tried to cut subsidies in January 2012, and countries in the Middle East have faced protests when officials have simply hinted at the possibility of trimming subsidies, despite facing budget deficits which will harm the domestic economy in the

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[32] Baghat, 2011, 24.
Institute of International Finance 2014, 17.
[33] Reuters 2015.

long term.[34] [35] The intractability of subsidies make them a suboptimal spending option, though their tangibility makes them popular. If government officials were given the freedom to withdraw funds from the Kuwait Investment Authority whenever they wanted, it is likely that they would increase subsidies even more in order to gain support and quell public dissatisfaction, despite negative long term effects.

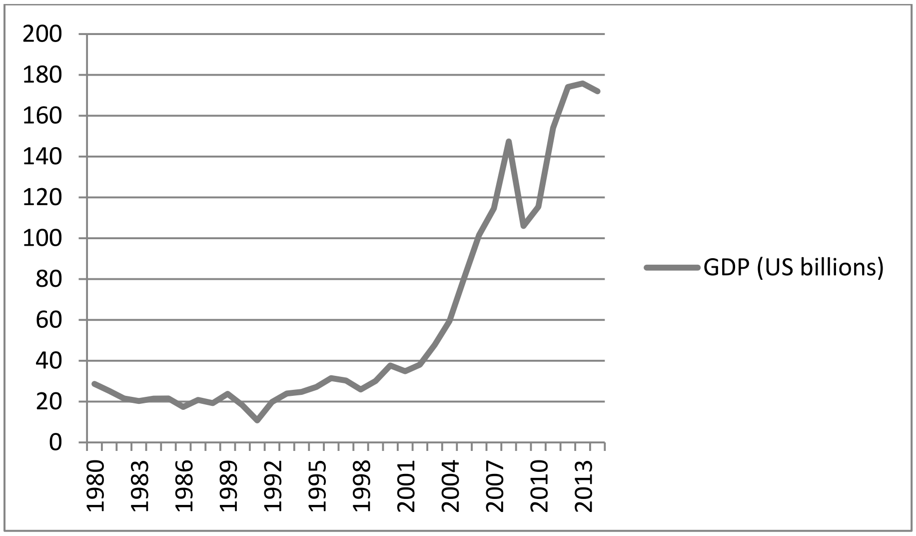
Though Kuwait is one of the richest of the Gulf states and is in no serious economic danger, having the ability to pull funds from the Future Generations Fund in times of severe need will mitigate the type of volatility that could lead to instability or a need to shut down parts of the Kuwaiti economy that are underperforming in today's economy but may rebound in the near future. Whether the current legislation is passed remains to be seen, but if it is, it could further demonstrate to other natural resource-rich countries the benefit of long-term financial planning in a "rainy day fund," and the necessity of having a balanced system that will moderate withdrawals from the state while being willing to inject funds into the economy when necessary.

Managing Volatility In Crises

Due in large part to the way that the Kuwait Investment Authority was established, Kuwait has been largely successful in mitigating volatility through various shocks, including the Iraqi Invasion in the 1990s and oil price fluctuations. It has historically maintained substantial stores of fairly liquid capital which has been relatively accessible when the State of Kuwait has most desperately needed it.

[34] International Institute for Sustainable Development 2012, 34.
[35] The Guardian 2012.

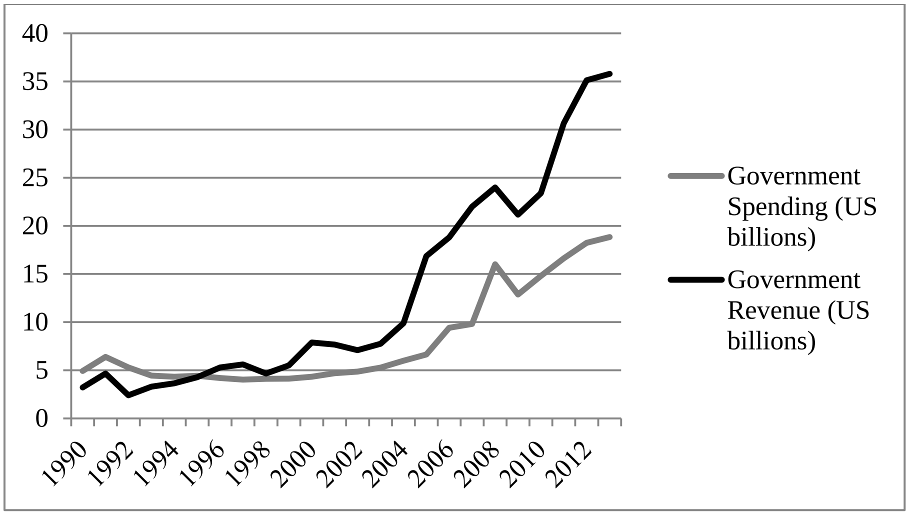
Figure 2: Kuwait GDP per capita (1980-2014)



Source: World Bank National Accounts Data. 2015.

This graph demonstrates that there was a dip from 1990 to 1991 during the Gulf War, with GDP going from US$18.2 billion to US$10.8 billion GNI per capita, but GDP moved back up to US$19.9 billion the next year and maintained steady growth. This rebound was due in large part to the fact that funds from the Kuwait Investment Authority were withdrawn and injected into the domestic economy, stabilizing government spending despite domestic turmoil and decreased government revenues.

Figure 3: Kuwait Government Spending and Revenue (1990-2013)

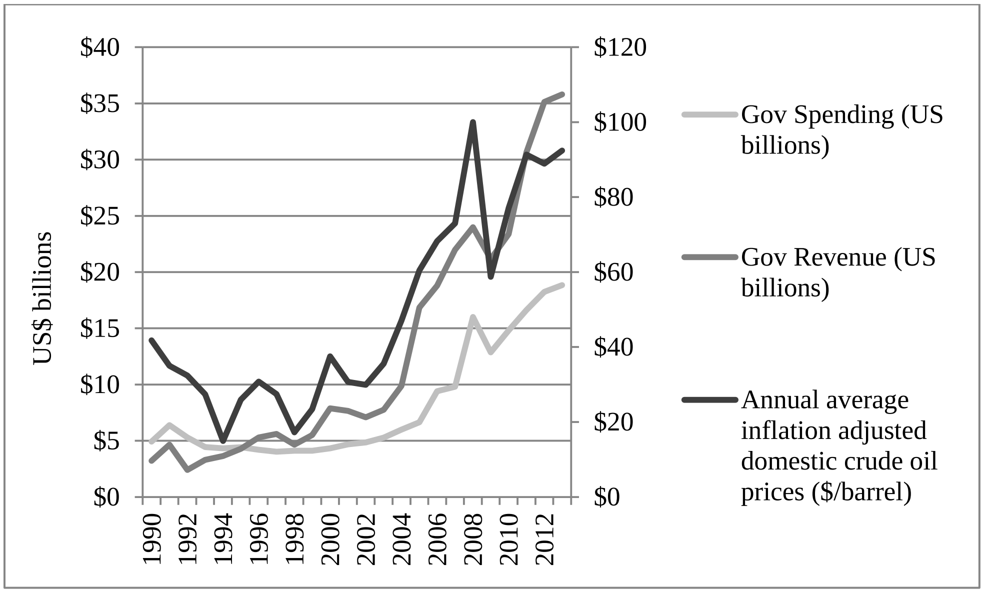


Source: IMF Cross Country Macroeconomic Statistics

Figure 3 displays government spending alongside government revenues starting in 1990. It is clear that the Kuwaiti government was running a deficit during the early 1990s to pay for defense spending and to maintain some stability during the Iraqi Invasion. By 1996, revenue outpaced expenditure and Kuwait has maintained a growing surplus since. From 2007 to 2008, there was a slight increase in revenue (US$21.98 billion to US$23.994 billion), while government spending almost doubled (US$9.8 billion to US$16 billion).

After the global economy was affected in 2008 by the Great Recession and oil exporting countries were faced with plummeting oil prices, however, government revenue dipped more than government spending did (a 24.4 percent drop versus a 13.4 percent drop). This increased spending and subsequent dip shows that, although the Kuwaiti government may have overextended its spending during the worldwide economic growth period leading up to 2008, it was able to keep that spending level relatively steady even while revenues decreased, primarily due to its consistent government surpluses and savings mechanisms in the Kuwait Investment Authority.

Figure 4: Kuwait Government Spending and Revenue overlaid with Oil Prices (1990-2013)



Source: IMF Cross Country Macroeconomic Statistics, U.S. Energy Information Administration

Figure 4 also shows government revenue and expenditure, but overlaid with the inflation adjusted price of oil. This graph emphasizes the volatility of oil prices over time and how government revenue follows this pattern fairly closely, though the volatility is somewhat lessened. Government spending, on the other hand, has maintained a relatively constant level of growth, with the exception of the 2008 spike. Spending has also grown at a much lower rate than revenue, showing that the Kuwaiti government has been wary of over-spending even during periods of economic success.

Conclusion

Overall, the Kuwaiti government has managed its oil wealth wisely over the years, from being the first to establish a sovereign wealth fund to maintaining high levels of contributions to this fund over time. Though this conservative strategy has worked well for the country thus far, Kuwait should use its Future Generations Fund to diversify its domestic economy as well rather than relying on the consistent returns of the General Reserve Fund to propel the nation through economic downturns. As will be examined, most other Gulf countries have made concentrated efforts in recent years to grow their education, banking, trade, and tourism sectors in order to diversify their sources of GDP away from oil.[36]

The International Monetary Fund predicted that Kuwait's GDP would grow by 1.8 percent in 2015, far below its average of 4.8 percent growth per year from 2000 to 2010 and the Gulf's average predicted growth of 4.5 percent in 2015.[37] Its significant capital reserves will prevent the State of Kuwait from any serious deficits in the medium-term, but avoiding risky investments in its own economy will also prevent the state from any remarkable growth. In 2010, it announced a five-year development plan that included US$107 billion of investments in the domestic economy, but nearly every aspect of the plan was delayed due to disagreements between the government and the parliament.[38] The 2015 World Bank Doing Business Survey ranked Kuwait in the lowest half of all countries in the categories of "Ease of Doing Business," "Starting a Business," and "Enforcing Contracts."[39] Unless Kuwait streamlines its business sector and encourages investment away from the oil and gas sector with the funds in the Future Generations Fund, it is likely to stagnate and fall behind the progress of the other Gulf States. There is a fine line between saving to the point that the domestic economy begins to shrink and

[36] Al Asoomi 2012.
[37] IMF 2015, 11.
[38] Townsend 2015.
[39] World Bank 2015.

spending too much on domestic investment, but it appears that Kuwait's wealth management strategy falls under the first category. Its self-control and consistency is commendable, but it should focus on encouraging the domestic economy if it is to achieve long-term economic growth.

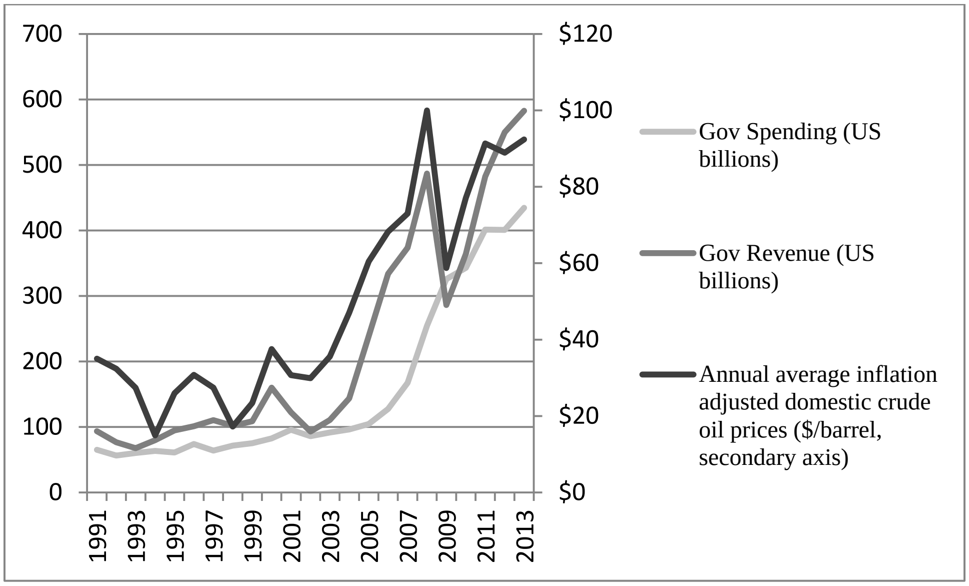
Chapter 2: United Arab Emirates

To fully understand the goals of the Emirate of Abu Dhabi and Dubai's sovereign wealth funds with respect to the United Arab Emirates (UAE), one must first understand the way that the UAE is organized both financially and politically. The UAE is composed of seven different monarchical emirates, united in 1971 under a constitution that established the Federal Supreme Council, comprised of the rulers of the seven emirates. The Federal Supreme Council is given jurisdiction over foreign affairs, citizenship issues, education, public health, and other public services, but many other powers, including management of natural resources and wealth of the emirate, are left under the jurisdiction of the individual emirates.[40] Within the Federal Supreme Council, Abu Dhabi and Dubai have veto power over any new jurisdiction, and the leader of Abu Dhabi has traditionally served as leader of the Council though elections are held every five years.[41] Although institutions have been established to manage the legislative, executive, and judicial activities of the government, Abu Dhabi controls much of the Council's activity, due to its size, control over the oil wealth, and management of the majority of the sovereign wealth funds. Despite being only one of seven emirates, Abu Dhabi controls the majority of government operations and over 90 percent of the oil revenue, while the other emirates, namely Dubai, have more diversified sources of income based on tourism,

[40] "UAE Government: Political System." UAEinteract.
[41] Sara Bazoobandi. "The Political Economy of the Gulf Sovereign Wealth Funds: A case study of Iran, Kuwait, Saudi Arabia, and the United Arab Emirates." Routledge Studies in Middle Eastern Economics. 2013. Page 74.

trade, and service industries.[42] For this reason, this chapter will focus primarily on Abu Dhabi's strategies to manage oil wealth.[43]

Figure 5: UAE Government Spending and Revenue on Oil Prices



Source: IMF Cross Country Macroeconomic Statistics

As seen in Figure 5, the UAE's government revenues have been highly correlated with oil prices historically, falling and rising at the same time from 1990-2010. They both fell dramatically in 2009 as a result of the global economic crisis, but after this point, the two lines intersect and revenue growth begins to outpace oil price growth. Though this turning point is rather recent, it does represent the significant strides that the UAE has

[42] Oxford Business Group 2016.
Bazzoobandi 2012, 75.
[43] Abu Dhabi's other sovereign wealth funds include the Abu Dhabi National Energy Company, the Abu Dhabi Investment Company, and the International Petroleum Investment Company, but these organizations are focused almost exclusively in reinvesting their oil wealth into further development of the oil and gas industry, so their activities are not relevant to oil wealth diversification. Similarly, the Emirates Investment Authority and the Investment Corporation of Dubai serve as active managers of their governments' investments rather than diversification funds, so they are also excluded from this analysis.

made towards becoming more oil revenue independent in recent years, particularly after the formation of the Mubadala sovereign wealth fund.

The Abu Dhabi Investment Authority

As previously mentioned, a key component of a sovereign wealth fund's success in managing oil wealth in a way that best serves the long-term growth of the nation is its transparency. Following the Santiago Principles by publishing frequent reports that show the fund is following a sound legal system not only serves to reduce corruption, but it encourages other foreign investors' trust in the country's stability and trustworthiness, which in turn leads to higher foreign investment and overall growth.[44] Unfortunately, Abu Dhabi is not very transparent in its wealth management activities. The Abu Dhabi Investment Authority (ADIA) has never published an annual report, and very little information regarding its investments, inflows, or outflows is available. Even its size is unknown, and estimates vary from US$600 billion to US$900 billion.[45] The Abu Dhabi Investment Council also owns a number of other sovereign wealth funds: Mubadala (estimated US$60 billion in assets), the Abu Dhabi National Energy Company (US 9 billion), the Abu Dhabi Investment Company (US$7 billion), and the International Petroleum Investment Company (US$6.5 billion), most of which have separate subsidiaries or foreign investment branches.[46] Combined, this makes Abu Dhabi's oil wealth extremely difficult to track, and the idea that significant funds are slipping through the cracks and into particular individuals' private bank accounts is not a far-fetched one.

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[44] International Working Group of Sovereign Wealth Funds 2008, 4.
[45] Seznec 2008, 97.
Sovereign Wealth Fund Institute 2016c.
[46] Seznec 2008, 101.

Some attempts have been made, at least domestically, to give the appearance of transparency. In 1985, the Abu Dhabi Accountability Authority was formed "as an independent body reporting to His Highness the Crown Prince of Abu Dhabi" to oversee public spending and ensure that the Emirate's funds are managed legitimately. Along with auditing government sectors and investigating corruption, it claims to ensure that "public resources and funds are managed, collected, and expended efficiently, effectively, and economically," which includes auditing the activities of Abu Dhabi's sovereign wealth funds.[47] A key flaw in this accountability system is that most of the reports produced by the Abu Dhabi Accountability Authority go directly to the Crown Prince, and are not released to the public, with the exception of selected excerpts. As a result, the organizations being audited are not held to worldwide best-practice standards or are accountable to the citizens of Abu Dhabi. As a result, any corruption that would hurt the Emirate from the perspective of the Crown Prince will likely be minimized, but if the Crown Prince does not see an issue as being particularly important, the world may never know about serious scandals or misconduct. Not only does this reduce the accountability of the royal family to its citizens, but it makes it extremely difficult to measure how well Abu Dhabi's sovereign wealth funds' money is spent and whether it is effective

With between US$ 600 and US$ 900 billion in estimated assets under management, the Abu Dhabi Investment Authority (ADIA) is the world's second largest sovereign wealth fund, after Norway's Government Pension Fund, and whether its funds are invested properly and with good intentions is important to both the UAE and the

[47] Abu Dhabi Accountability Authority 2015.

global economy.[48] The ADIA was founded in 1976, soon after the UAE gained independence, with a mission to "sustain the long-term prosperity of Abu Dhabi by prudently growing capital through a disciplined investment process and committed people who reflect ADIA's cultural values."[49] According to its website, the Abu Dhabi Investment Authority "has no visibility on either the spending requirements of the Government of Abu Dhabi or the activities of other Abu Dhabi entities established by the Government to make investments."[50] This does not seem realistic since the Chairman of the Board of Directors is Sheikh Khalifa bin Zayed Al-Nahyan, the ruler of the emirate of Abu Dhabi and the president of the UAE.[51] The Vice Chairman, Managing Director, and three other members of the ten member board are also members of the Al-Nahyan family and close relatives of Sheikh Khalifa bin Zayed Al-Nahyan.[52]

There is no set percentage of the government revenue that is to be set aside in the Abu Dhabi Investment Authority, as is specified for the Kuwait Investment Authority, but the UAE Constitution does specify that the Emirate's government is to provide the ADIA with funds that are surplus to its budgetary requirements and other funding commitments. If the government is not required to allot a certain amount to the fund each year, there is no incentive for it to give to the fund; if the allotment is based solely on a government surplus, the government may have a perverse incentive to spend on unnecessary or frivolous projects rather than putting the money away. On the other side, the ADIA "is required to make available to the Government of the Emirate of Abu Dhabi,

[48] Sovereign Wealth Fund Institute 2016c.
[49] Sovereign Wealth Fund Institute 2016c.
[50] Abu Dhabi Investment Authority 2016.
[51] Bazoobandi 2012, 82.
[52] Bazoobandi 2012, 82.

as needed, the financial resources to secure and maintain the future welfare of the Emirate.” Both of these are vague regulations, which leave the fund vulnerable to manipulation by the state. When the government holds this power to take from the fund whenever necessary, the fund can lose its effectiveness as a stabilization tool.

Mubadala

Formed in 2002 with the mandate to “strengthen Abu Dhabi’s growth potential, and to help the government meet its socioeconomic targets”, Mubadala is Abu Dhabi’s second largest sovereign wealth fund.[53] Rather than taking a hands-off investment approach by avoiding owning significant parts of any specific company, as most other sovereign wealth funds tend to do, Mubadala takes an active investment approach and attempts to guide the management of the companies with which it partners. While Mubadala does invest its US$60 billion in assets under management globally, it is largely focused on investing within the UAE, supporting infant industries and promoting growth within the country. For example, in 2013 Mubadala worked with Dubai Aluminum and Emirates Aluminum to create Emirates Global Aluminum, which was the largest industrial merger in the history of the UAE. Rather than serving as a savings fund, collecting steady returns for use by future generations, Mubadala is much more focused on delivering “strong social returns to Abu Dhabi and the United Arab Emirates.”[54]

One of Mubadala’s biggest investment projects to date is Masdar City, a planned city eleven miles east of the city of Abu Dhabi designed in collaboration with a British architecture firm and the Massachusetts Institute of Technology and meant to rely

[53] Mubadala 2016a.
[54] Mubadala 2016b.

entirely on solar energy and renewable energy sources. This project is estimated to cost between $18 and $22 billion.[55] Two years after its initiation in 2006, the global financial crisis postponed the project's completion by up to ten years, and the current low oil prices are threatening to further affect the project. The first operational organization in the new city was the Masdar Institute of Science and Technology, and the city is planned to be a hub of scientific advancement, focused primarily on renewable energy and sustainability, with current projects researching desalination techniques, waste management, and sustainable agriculture.[56] While this project does have potential for extremely high returns, both financially and scientifically, it is quite risky. Masdar City could provide critical solutions to climate change, but it could also turn into an unremarkable experiment which essentially wastes US$ 20 billion of the UAE's wealth.

Though Masdar City is Mubadala's biggest project to date, it is not the only extravagant project started in the UAE in recent years. While the country can afford these demonstrations of wealth right now, and they may bring in significant tourism and foreign investment income, they are not the types of investments that have a high probability of creating steady returns through future economic downturns.

Conclusion

In recent years, the UAE's inflation adjusted GDP has grown at an estimated rate of 3.6 percent, while non-oil sector growth has been growing at a rate closer to 5 percent.[57] Figure 6 displays total GDP from 1980-2013 as a function of its different

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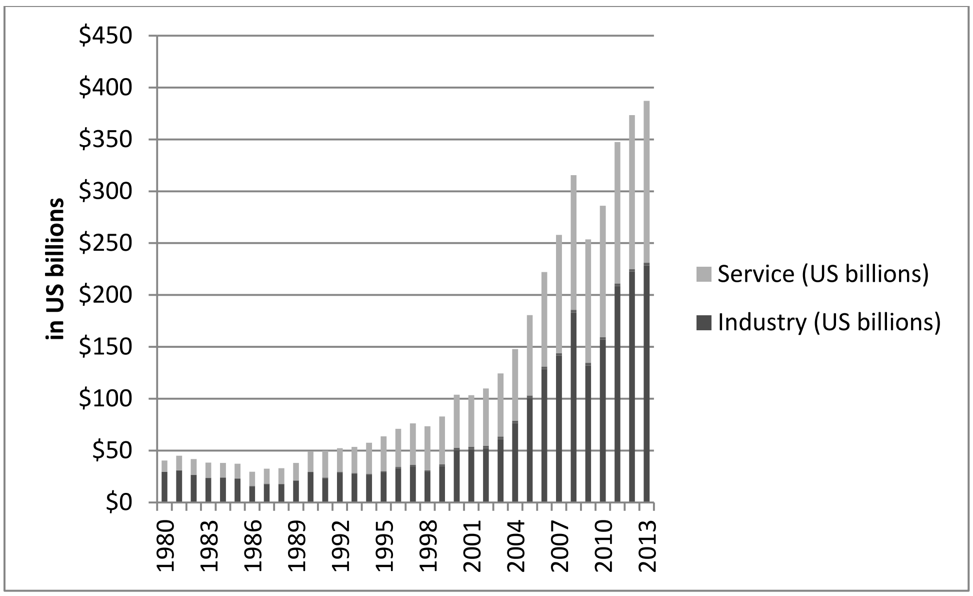
[55] Anderson 2013.
[56] Locke 2008.
[57] Barakat 2015.

industries, with value added from the oil and gas industry included in "Industry" and retail, transport, professional services, personal services, trade, etc. categorized as "Service." While "Industry" has grown over the years at a compounded annual growth rate of 6.4 percent over the 33 years displayed, "Service" has outpaced it at 8.4 percent.

Figure 6: UAE Total GDP by Sector[58]



Source: World Bank 2016a, World Bank 2016b, World Bank 2016c.

Abu Dhabi's sovereign wealth fund strategy is much more focused on diversification through domestic development than other Gulf countries which tend to prioritize long term diversification away from oil dependency through investment in foreign assets. To diversify within the UAE's economy, Abu Dhabi has focused on expanding its healthcare, biotechnology, financial services, telecommunication services, and tourism sectors to make itself more attractive to foreign investment and the

[58] The Agricultural Sector's contribution to GDP is negligible and therefore excluded in this figure.

international business community.[59] As oil reserves are depleted and oil prices become more volatile due to high market supply or instability in the Middle East, this diversification of income within UAE may serve to take the UAE away from oil dependency. However, these extravagant investments do represent high levels of risk and if the funds are not adequately managed, they may do more harm than good.

The UAE has a very small population and the 21st highest GDP per capita in the world as of 2014, so it has significantly more tolerance for wealth mismanagement by the government than a poorer country, but it should be cautious with how funds are transferred to and from the government and the sovereign wealth funds (ideally structuring these regulations in accordance with the Santiago Principles) if it is to maximize its future growth.

The United Arab Emirates has also never had to withstand the direct impact of a significant regional conflict, as Kuwait and Saudi Arabia have, which means that emergency withdrawals have never been needed. To some extent, the UAE will be able to grow and withstand oil price and supply shocks based on its domestic diversification, but investing in the domestic economy diminishes the diversification purpose of sovereign wealth funds to some extent. On the one hand, this strategy does diversify income sources away from dependency on oil revenues, but it does not reduce dependency on a strong domestic economic position. One can only hope that in difficult times such as the current oil plunge that the sectors the UAE has invested in over the recent years will continue to show strong growth.

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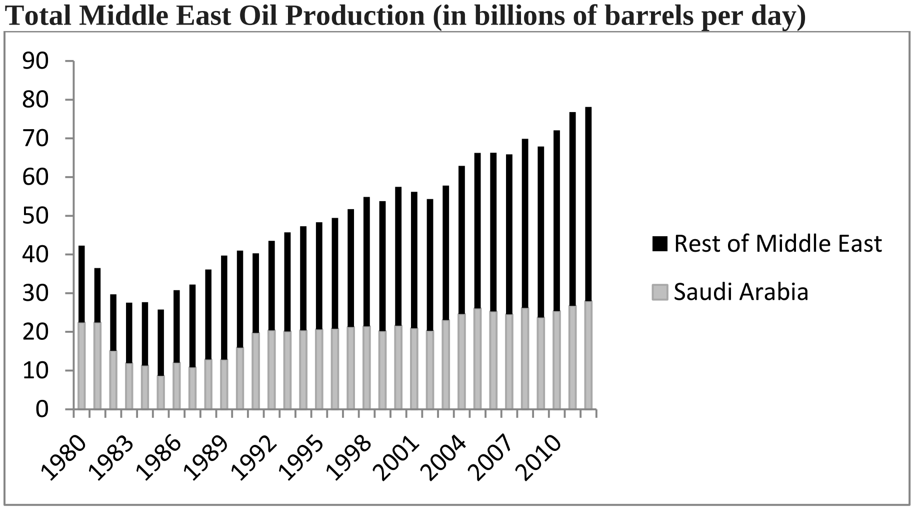
[59] Government of Abu Dhabi 2008.

Chapter 3: Saudi Arabia

Saudi Arabia produces an estimated 9,735,000 barrels of oil per day, making it the second largest oil producer in the world and the leader in total exports.[60] Historically, it has accounted for nearly 40 percent of total Middle East oil production (see Figure 7), and nearly 60 percent of its own GDP comes from oil revenues.[61] Saudi Arabia's oil reserves were first discovered in 1938, and the state-owned Arabian American Oil Company (ARAMCO, now Saudi Aramco) was formed soon after.[62] In 1952, the central bank now known as the Saudi Arabian Monetary Agency (SAMA) was formed in a joint effort by Saudi Arabia and the United States as a way to manage the Kingdom's oil revenues and to introduce some stability to the Kingdom's economic system.[63]

Figure 7: Total Middle East Oil Production (in billions of barrels per day)

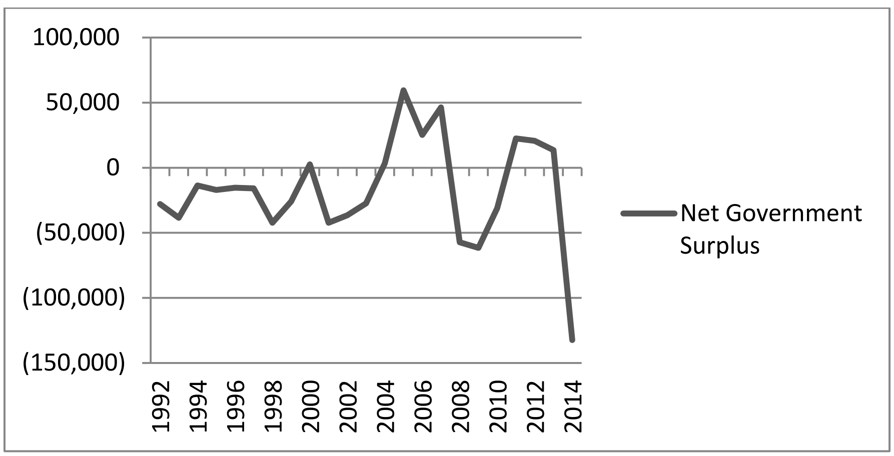


Source: The U.S. Energy Information Administration

[60] The World Factbook 2016a.
The World Factbook 2016b.
[61] The World Bank 2016 a.
U.S. Energy Information Administration 2016a.
[62] Saudi Aramco 2016.
[63] SAMA 2016.

Though the formation of this agency was difficult, as banks and other interest-charging institutions are forbidden by Saudi Arabia's strict Islamic code, SAMA now has an estimated US$632 billion in assets under management and is in charge of issuing currency, developing the banking system, and managing the country's assets both within Saudi Arabia and through foreign investments.[64] Unlike other major oil exporters, Saudi Arabia does not have a separate sovereign wealth fund to manage its oil wealth; instead SAMA acts as both the central bank and the oil wealth manager, investing in foreign assets through SAMA Foreign Holdings.

Figure 8: Saudi Arabia's Net Government Surplus 1992-2014 (in US Billions)



Source: World Bank 2016d

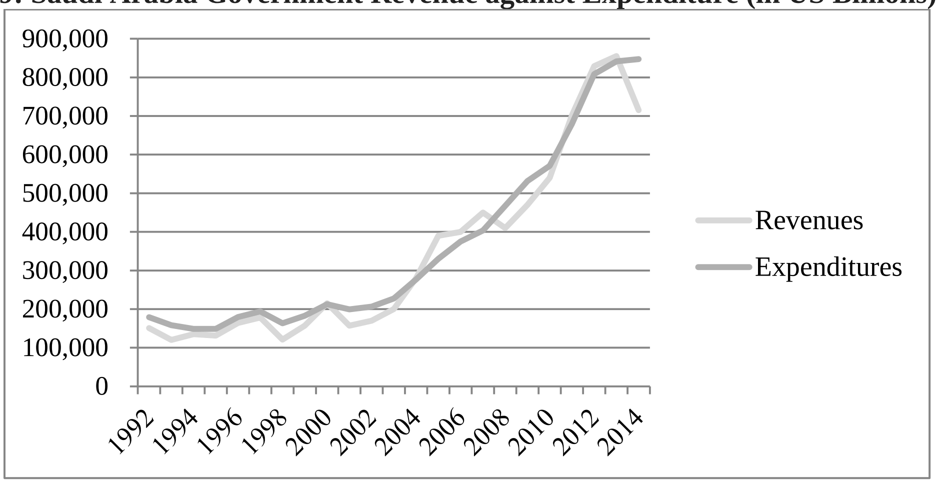
Although the Sovereign Wealth Fund Institute includes SAMA in its list of sovereign wealth funds, it is not officially declared to be one, and it has not received the contributions from the government in the way that sovereign wealth funds typically do.

[64] Bazoobandi 2012, 58.
Dickson 2015, 337.

Domestic Development

Saudi Arabia has managed to consistently run spending deficits, and therefore has not had the same level of government surplus as most other oil producing Gulf countries (see Figure 8), meaning that the country is able to contribute significantly less to the fund than most other oil producers in the Gulf.

Figure 9: Saudi Arabia Government Revenue against Expenditure (in US Billions)



Source: World Bank 2016d.

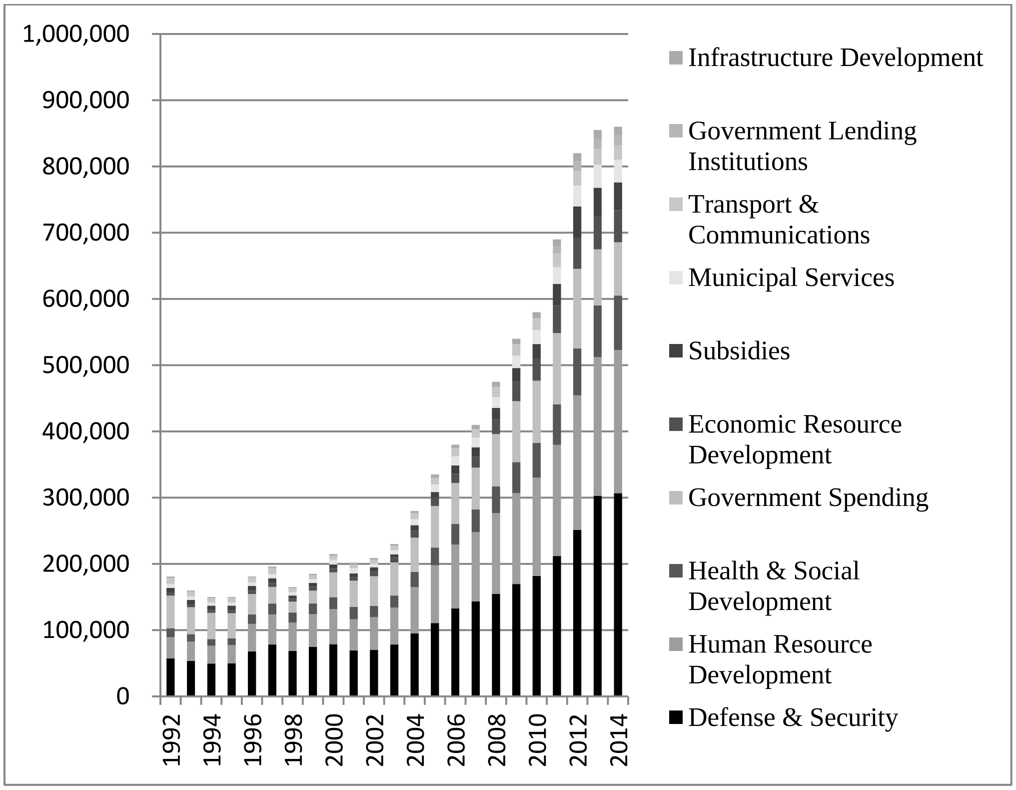
These deficits have generally not been due to low government revenues, but rather to Saudi Arabia's extremely high levels of government spending, as seen in Figure 9. Most of this high level of spending has gone towards the categories of "Defense & Security," and "Human Resource Development."

Defense and Security spending has consistently accounted for between 30 and 40 percent of government expenditure, placing Saudi Arabia third in total military spending worldwide, behind the United States and China, and surpassing many larger countries with much higher levels of gross national product.[65] This spending is important for Saudi Arabia to maintain its position as a military power in an extremely unstable area,

[65] The International Institute for Strategic Studies 2016.

surrounded by the Islamic State of Iraq and Syria, Iran, and other threats to national security; but spending at this level is also a primary reason for the consistent deficits that Saudi Arabia has faced, as displayed in Figure 3.

Figure 10: Government Spending by Category 1992-2014 (in US Billions)



Source: Saudi Arabia 2013 Budget Report

The "Human Resource Development" category also makes up a large portion of the budget, with most of these funds going into the Human Resource Development Fund. The mandate of this fund is to generally increase employment within Saudi Arabia by offering grants, investing in education and training opportunities, providing financial assistance to students, and conduct research in order to better prepare the Saudi workforce and thereby increase Saudi Arabia's human capital.[66] The growth in this

[66] Human Resource Development Fund. 2016.

section of the budget allocation demonstrates a strong commitment by Saudi Arabia to developing its workforce and is the largest attempt at diversifying its human capital value away from the oil and gas sector, but the lack of clear policy objectives or tangible measurements of success makes it difficult to gauge whether these efforts have in fact been successful.

According to a 2013 International Monetary Fund report, the total unemployment rate has remained around 5.8 percent among all residents in recent years, but unemployment among Saudis alone has risen to 12.1 percent, with unemployment for women and youths at even higher rates.[67] This is attributed to the fact that the sectors that have grown the most in recent years are generally dependent on low-skilled foreign workers, and that, while more women are entering the labor force due to decreasing fertility rates, there is still very poor gender equality in Saudi Arabia, particularly in the labor force. In order for the Human Resource Development Fund to truly grow domestic employment, it should focus on ensuring that women, who make up fifty percent of the country's population, are not left unemployed and underutilized while unskilled foreign workers find ready employment.

While there have clearly been some efforts at domestic development through growing Saudi Arabia's skilled labor force, the capital used for these investments have either come directly from the government budget or through Saudi Aramco itself rather than through a domestic development fund like Kuwait's General Reserve Fund, Abu Dhabi's Mubadala, or Oman's Investment Fund. This lack of an external savings fund

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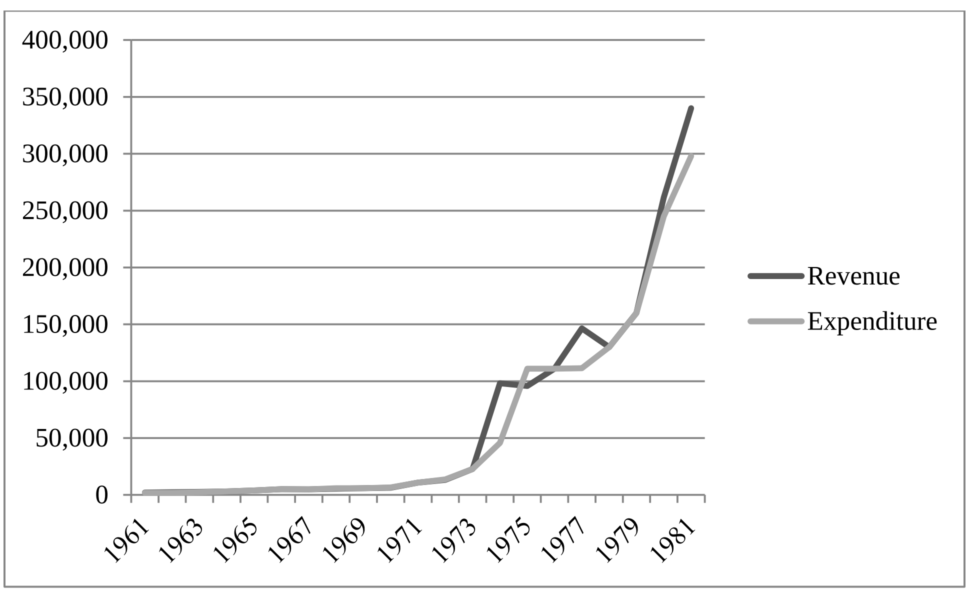
Linkedin 2016.

[67] IMF 2013a, 14-23.

has reduced stability in the kingdom throughout its history. During the 1970s, when oil prices skyrocketed and Saudi Arabia's yearly government revenue increased from US$1.7 billion in 1970 to US$70 billion in 1980, spending rose at almost exactly the same pace, demonstrating a lack of fiscal responsibility (see Figure 11). During this windfall of oil revenues, most other Gulf nations' Kuwait and the UAE's government revenue increased much more than their expenditure, and this excess was placed in savings funds which then either gained interest or were used to fund defense spending during the Persian Gulf War in the early 1990s. Saudi Arabia, on the other hand, experienced a deficit during the Gulf War and was forced to sell most of its foreign assets.[68] Despite this period of financial difficulty, Saudi Arabia has continued either to spend its oil wealth on its domestic energy sector or to retain much of its wealth in Saudi Aramco which invests it further in Saudi Arabia's oil and gas sector.

Figure 11: Saudi Arabia Budget Data 1961-1981 (in million riyals)



Source: SAMA 1960, SAMA 1964, SAMA 1968, SAMA 1972, SAMA 1976, SAMA 1982

[68] Bazoobandi 2012, 59.

Attracting Foreign Investment

In 2015, Saudi Arabia issued its first bonds in the country's history, amounting to 15 billion riyals (about US$ 4 billion), and opened the Saudi Arabian Stock Exchange, hopeful that these two developments would encourage foreign investment.[69] Previously, individuals or firms that were not citizens of a Gulf country had to register with the Saudi Arabian General Investment Authority in order to invest within Saudi Arabia, which deterred significant investments from non-Gulf countries.[70] Furthermore, companies in Saudi Arabia are subject to Sharia law, which restricts their business practices and the types of investments they can accept, particularly regarding interest collection.[71] Encouraging companies to list themselves in this new market also encourages them to publish official annual reports and submit themselves to audits, which would increase the transparency that is often lacking in the Saudi Arabian business sector. In fact, Saudi Arabia earned a score of 52/100 in public sector transparency from Transparency International and GAN Integrity Solutions claims that "Companies operating or planning to invest in Saudi Arabia face a high risk of corruption. Abuse of power, nepotism, and the use of middlemen to do business are particularly common."[72]

Additionally, much of the oil wealth goes to the royal family and their supporters; in 1988, "Prince al-Waleed bin Tala bin Abdelaziz said in an interview that princes on average were getting US$150,000 per year. At the time, and assuming a Saudi royal family of about 15,000, this amounted to about 7 percent of the gross oil revenues after

[69] Dickson 2015, 376.
[70] Dickson 2015, 378.
[71] Mideast Law 2016. .
[72] Transparency International 2016.
Business Anti-Corruption Portal 2016.

production cost."[73] These rankings and excerpts do not encourage foreign investment in the Saudi Arabian economy.

Saudi Aramco is itself one of the world's largest companies, if not the largest, valued at well over a trillion US dollars.[74] For comparison, Apple Inc. is valued at an estimated US$600 billion.[75] In order to further attract foreign investment in the current oil price downturn, Deputy Crown Prince Mohammed bin Salman said in an interview on April 1, 2016 that the Public Investment Fund, an offshoot of Sanabil Investments, would grow exponentially in the near future, eventually managing US$2 trillion dollars.[76] Previously, the Public Investment Fund's sole mandate was to hold equity positions in domestic companies, essentially offering loans to prop up Saudi Arabian industries.[77] The Deputy Crown Prince also revealed that the Public Investment Fund would grow from its current value of almost US$5 US billion to US$2 trillion by selling shares in Saudi Aramco.[78] This will "technically make investments the source of Saudi government revenue, not oil… What is left now is to diversify investments so within 20 years, we will be an economy or state that doesn't depend mainly on oil."

While this does sound like a decent plan initially and it may encourage foreign investment, it does not actually diversify the economy away from oil. It just gives a tiny percentage of the ownership of the oil firm to foreign investors, but the funds are still coming from the value that oil exports bring to the economy. The second part of the

[73] Seznec 2008, 100.
[74] Blas 2016.
[75] Nasdaq 2016.
[76] Micklethwait et al 2016.
[77] Sovereign Wealth Fund Institute 2016d.
[78] Micklethwait et al 2016.

quote seems like a more promising way to diversify the economy away from oil, but whether this stock sale will actually earn enough revenue that Saudi Arabia will be able to make significant returns from further investing abroad is up for debate.[79] Where Saudi Arabia's significant foreign investments would go is another crucial question that must be answered. In response to investments by the Abu Dhabi Investment Authority in Citigroup, Merrill Lynch, and Dubai Ports World in 2006 and 2007, the U.S. enacted the Foreign Investment and National Security Act, requiring the U.S. government to seriously evaluate investments and mergers with and by foreign firms, particularly sovereign wealth funds, and other countries have also become more wary of large investments by sovereign wealth funds.[80] Investments by a US$2 trillion Saudi-based investment fund are bound to attract scrutiny under this Act. This fear of takeover by Gulf States is not specific to the United States, and may also cause problems if Saudi Arabia's Public Investment Fund tries to invest massive amounts of capital in other western firms, particularly if it tries to buy controlling shares in large companies.

The Deputy Crown Prince's plan may also be flawed in his estimates of how much investment Saudi Aramco's Initial Public Offering will attract. It is estimated that Saudi Arabia's fiscal breakeven oil price (the oil price required for the country to balance its current budget) is around US$100 per barrel of crude oil.[81] The price per barrel of oil was at just over US$35 on April 1, 2016, so the probability that Saudi Aramco is going to see significant financial success in this fiscal year is impossibly small. Most companies

[79] Satani 2016.
Faucon 2016.
[80] Masters 2013.
[81] Knoema 2015.

wait until they are experiencing high levels of success before filing an initial public offering because investors are much more likely to invest in a company that is doing well, so the timing of this announcement shows that Saudi Arabia is desperate for an influx of foreign capital, not that it is considering making Aramco public because it is the best financial move.

Another concerning problem that this initial public offering will face is that that the company is "still a quasi-ministry," and that listing even a small amount of the company publicly will dilute the government's ownership in its most valuable asset.[82] Whether it will be willing to give up this power and whether foreign investors will be willing to invest in a company so heavily controlled by the Saudi Arabian government are both very important questions that could seriously alter the outcome of the Deputy Crown Prince's plan.

Conclusion

While some efforts to promote a more diversified economy are being made, particularly by the Human Resource Development Fund, Saudi Arabia is still severely dependent on oil revenues, leaving it extremely vulnerable to oil price downturns like the current one, which is receding slowly, if at all.[83] As mentioned, 60 percent of its GDP comes from oil revenues, which leaves the country vulnerable to price fluctuations, especially when it raises its expenditure on defense and domestic spending whenever revenues rise and leaves very little savings for future downturns. As *Bloomberg*'s Liam

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[82] Liam Denning 2016.
[83] Puko 2016.
Smith 2016.

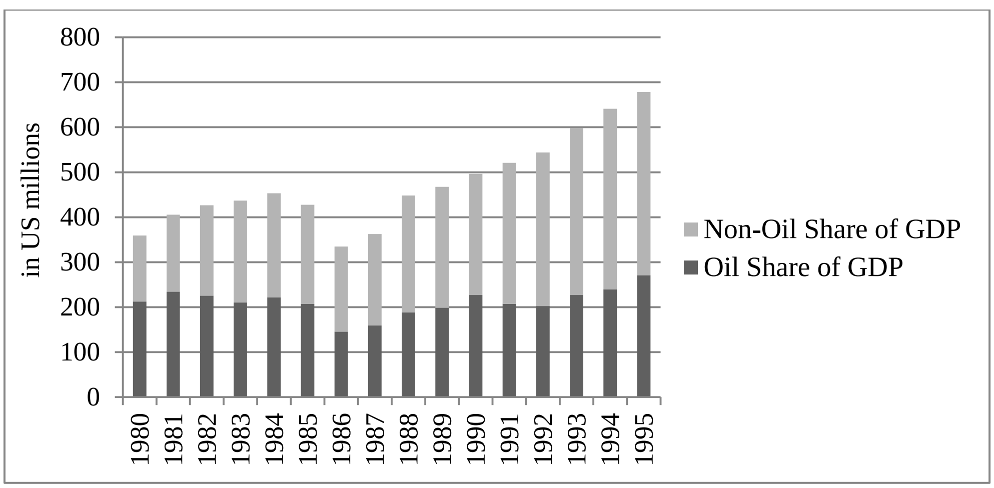
Denning put it, “A good rule of thumb when it comes to public announcements of reform from opaque autocracies is that opaque autocracies generally only do this when they really have to. Saudi Arabia has more money stashed away from the oil boom than many of its peers; but, since peaking in August 2014, its foreign-exchange reserves have dropped by more than a fifth.”[84] Saudi Arabia’s plan to put shares of Saudi Aramco on a public market, even when oil prices are as low as they have been in the past year, is a bold one, and it shows that the government is desperate for diversification and a more steady stream of income. While this strategy may provide an influx of foreign capital in the near future, Saudi Arabia needs a more permanent evolution of its economy from being completely oil dependent and spending beyond its means to one seeking stability and long term growth for future generations. In order to move towards that more sustainable model, the Kingdom of Saudi Arabia should commit to lowering spending wherever possible and committing a significant and consistent portion of its revenues to SAMA or a new sovereign wealth fund which will then invest in low-risk foreign investments and diversification of the domestic Saudi Arabian economy.

[84] Liam Denning 2016.

Chapter 4: Bahrain

Although the Kingdom of Bahrain accounts for less than 1 percent of total oil produced in the Middle East, it was the first country in the region to discover oil, and its economy has always been based on revenues from this natural resource.[85] Despite its initial oil dependence, it has become the least oil dependent country in the Gulf region, with oil revenues making up only 19 percent of GDP in 2012. This diversification away from oil has happened fairly recently; in 2000, the oil and gas sector was responsible for 44 percent of real GDP. Unfortunately, the government budget has not moved away from oil dependency at the same rate, as oil and gas earnings still make up around 90 percent of annual government revenue.[86] Moving away from oil dependence is crucial to the country's sustained success, both economically and politically.

Figure 12: Oil and Non-Oil Revenues as a share of Bahraini GDP (1980-1995)



Source: World Bank 2016a

[85] U.S. Energy Information Administration 2013.
Bahrain Economic Development Board 2013.
[86] Bahrain Economic Development Board 2013.

Geopolitical Aspects of Oil Revenues

Bahrain currently collects revenues from oil originating in two oil fields: the onshore Bahrain Field and the much larger offshore Abu Sa'afa Field, between Bahrain and Saudi Arabia and shared by the two countries. The Bahrain Field has produced about 70,000 barrels per day in recent years, but the majority of production comes from the Abu Sa'afa Field, which has produced about 120,000 barrels per day for Bahrain and about 150,000 barrels per day for Saudi Arabia in recent years. This is supposed to be more equally split, but Bahrain's share of the field has been under maintenance in recent years and has therefore been producing less. This arrangement has been in place since 1996, though before 1958 the field belonged entirely to Bahrain.[87] At that time, Bahrain was ruled by Britain and could only manage its oil fields through the resident British representative, which made it difficult for Bahrain to effectively produce and refine the oil, so Bahrain relinquished control of the field to Saudi but retains half of the oil revenue.[88]

Since then, Saudi Arabia's Aramco has fully managed production and has controlled the amount of revenue Bahrain receives, with this amount fluctuating depending on the success of Saudi's own oil fields and oil prices. This makes Bahrain's largest single source of income vulnerable to the whims of its much larger neighbor. Saudi Arabia has been fairly generous in sharing these profits, not purely out of benevolence but also as a way to support the Sunni leadership in Bahrain while maintaining the bilateral alliance between the countries. While this relationship has

[87] Albawaba 2002.
[88] Mills 2012.

historically remained positive and keeping it so is strategically advantageous to both countries at the moment, it does leave Bahrain vulnerable to Saudi Arabia.

The proprietary right to the revenues of the Abu Sa'afa Fields is not the only way that Bahrain's oil and gas wealth is vulnerable to the region's political conflicts, and diversifying revenues away from dependence on this field has also proven extremely difficult because of this geopolitical instability in the Gulf. Bahrain has tried to expand its oil and gas sectors away from the Abu Sa'afa fields through exploring its own natural gas resources (which would require considerable infrastructure investments), considering purchasing Qatari gas (an idea which was discouraged by Saudi Arabia and subsequently dropped), and even by entering import negotiations with Iran.[89] Though Bahrain's refining capabilities far exceed its production capacity, Iran has the opposite problem, making this seem like a perfect economic match, this option has been put on hold multiple times due to diplomatic conflicts.[90]

Bahrain's population is about 70 percent Shia, but the ruling al Khalifa family is Sunni, corresponding to economic disparity between the ruling Sunni elite and the much less wealthy Shia population.[91] Saudi Arabia is also a Sunni power and supports the continued rule of the al Khalifa family, but Iran, a the major Shia power in the region, does not support the Sunni elite and has been accused of "stoking political protests," and even being involved in the Bahraini uprisings of 2011 in the midst of the Arab Spring.[92]

[89] Mills 2012.
[90] U.S. Energy Information Administration 2016b.
[91] Lulu 2011.
[92] Mabon. 2012.

This period of instability was primarily due to institutionalized discrimination towards the Shia population in Bahrain, particularly in the political realm, though hostility regarding the sectarian differences between Shia and Sunni populations had generally been muffled by the country's economic success in the past. As uprisings spread through the Middle East in 2011, Bahrain's problems surfaced as well, and the fire was stoked by Saudi Arabia and Iran's competition for power that has fueled instability for decades.[93] On March 14, 2011, one month after protests began, the Kingdom of Bahrain sought the help of Saudi Arabian forces through a Gulf Cooperation Council security clause signed into the 1982 GCC Internal Security Agreement.

Since the height of the uprisings, Bahrain has regained some stability, though no real changes were made in the way that the country is governed, and there are still periodic incidents of violence.[94] This pent up dissatisfaction has the potential to cause serious damage to Bahrain in the future, and being caught between Saudi Arabia and Iran in a proxy battle for power is only going to aggravate the problem.[95] In 2011, just before the protests broke out, talks between Bahrain and Iran regarding a pipeline were making progress, but "The project to import Iranian gas (was) halted because of the blatant Iranian interference," and this project is unlikely to make any progress due to the geopolitical complexity of the region.[96] This problem, along with the complications that come with dependency on Saudi Arabia for revenues from Abu Sa'afa, emphasize Bahrain's need for diversification away from oil dependency.

[93] Mabon. 2012.
[94] Mabon. 2012.
[95] Kaplan 2016.
[96] Carlisle 2011.

Economic Diversification

In the 1970s, Bahrain established its reputation as a major offshore banking center for the oil rich Gulf nations, and the tiny island is now home to more than 400 financial institutions.[97] Though its prominence as the banking center of the Middle East is being threatened by growth of the banking industries in Abu Dhabi, Dubai, Doha, and Riyadh, the sector is still widely respected, particularly in the fields of Islamic finance, asset management, and insurance.[98] To “satisfy the training and development needs of the local banking sector,” the Bahrain Institute of Banking and Finance was formed in 1981 and it now educates over 16,000 students a year.[99]

With its central location and with the absence of corporation taxes, personal income taxes, wealth taxes on capital gains, and no restrictions on repatriation of capital, profits, or dividends, Bahrain has made itself extremely appealing to foreign firms and individuals looking for a tax haven.[100] While these lenient tax policies have helped attract businesses to the island state and grow total GDP, they have hurt government revenues, which are still highly dependent on oil revenues (see Figure 13), and fall far short of covering the government’s expenditures. Bahrain’s current level of debt is estimated to be around 6 billion Bahraini dinars (US$15.9 billion), and expenditure on “government debt interest” is set to reach 390 million Bahraini dinars (US$1 billion) in 2016.

[97] Bahrain Economic Development Board 2013, 83.
[98] Bahrain Economic Development Board 2013, 83.
Oxford Business Group 2015, 47.
[99] Bahrain Institute of Banking and Finance 2016.
[100] Deloitte 2015, 6-11.

Figure 13: 2015 Bahrain Government Revenue and Expenditure

	2015
Net Oil & Gas Revenue	4,507,085,550
Non-Oil Revenue	976,106,300
Grants	74,730,000
Total Revenue	5,557,921,850
Total Expenditure	9,544,202,900
Surplus/(Deficit)	**(3,986,281,050)**

Source: Bahrain Institute of Banking and Finance 2016.

This debt needs to be restrained, and the way for Bahrain to do so, according to an IMF report, is to "adopt a gradual retargeting of subsidies, contain public-sector wage increases, increase non-oil revenues, rationalize capital expenditures, and place the pension fund on a sustainable path."[101] In 2015, subsidies for food, housing, retirement programs, the Social Welfare Fund, and the National Social Fund accounted for over US$ 400 million, over ten percent of total government expenditure. Reducing these subsidies will prove challenging, especially with a population that already feels as if the elite has systematically oppressed them by collecting all the oil wealth without letting the masses benefit. Bahrain is moving forward with subsidy cuts though, particularly its subsidies on red meat and energy.[102] To minimize backlash for the meat subsidy cuts, it has established compensation funds, for which over 116,000 families have already signed

[101] IMF 2013b.
El Baltaji 2013.
[102] Naar 2015.

up.[103] Though this compensation program will lower the positive effect of cutting subsidies, only permanent residents of Bahrain will be eligible for compensation.[104] Cutting energy subsidies have further caused a 60 percent rise in Bahraini gas prices, angering residents and several members of Parliament who declared "the decision will make the poor poorer. We demand an improvement to people's standard of living, and what the government did yesterday will not achieve that."[105] Further subsidy cuts on water and electricity are scheduled to take place within the next year, though further protests could postpone those cuts.[106]

Mumtalakat Holding Company

Institutionally, the Bahrain Mumtalakat Holding Company and the Bahrain Future Generations Reserve Fund were founded in 2006 to manage Bahraini funds.[107] Mumtalakat currently manages an estimated US $11.1 billion which is invested in non-oil and gas sector assets within Bahrain.[108] This fund is ranked a ten out of ten in transparency by the Sovereign Wealth Fund Institute' Linaburg-Maduell Index and is independently audited yearly, but it was ranked 28 out of 100 on "Compliance with the Santiago Principles" in a 2011 Report published by the Peterson Institute for International Economics and 24 out of 100 on the same metric by a 2013 report published by

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[103] DT News 2015.
[104] Naar 2015.
[105] Albawaba 2016.
[106] Al Jazeera America 2016.
[107] Sovereign Wealth Fund Institute 2016e
Sovereign Wealth Center 2016a.
[108] Sovereign Wealth Fund Institute 2016e

GeoEconomica.[109] These rankings place Bahrain in the bottom two of twenty funds studied, but offer no explanation for these rankings. The metrics used to measure the Sovereign Wealth Fund Institute's Linaburg-Maduell Transparency Index are similar to those used to rank Santiago Compliance, with some differences that may explain this discrepancy. The Linaburg-Maduell Index focuses on the availability of independently audited annual reports, investment strategies, openness regarding the structure of the firm, and general strategy information.[110] Mumtalakat does publish annual reports with details about the types and geographical locations of its investments as well as the structure of the firm, so it does fulfill these qualifications fairly well.

The Santiago Principles, on the other hand, focus on the firm's internal structure and how it will be able to maintain the type of investment behavior needed to act as a proper savings fund.[111] These principles include having a stated long-term objective, clarifying the terms of adding and withdrawing funds, independence from the governing body of the state, and a focus on generating high long-term returns on investments, alongside the transparency criterion in the Linaburg-Maduell Index. The discrepancies between these ratings can then be at least partially explained by the differences in metrics – Mumtalakat is extremely transparent in some respects, but its internal organization as a savings fund with separation from the state, a focus on steady returns, and a consistent structure by which it manages funding and withdrawals is lacking. There is also a small

[109] Sovereign Wealth Fund Institute 2016b.
Bagnall and Truman 2011, 2.
GeoEconomica 2014, 2.
Mumtalakat 2014 .
[110] Sovereign Wealth Fund Institute 2016b.
[111] International Working Group of Sovereign Wealth Funds 2008, 7-9.

chance that the rankings from 2011 and 2013 are simply outdated and that Mumtalakat has made enormous strides toward becoming more transparent and Santiago Compliant in the meantime, but such a large jump in rankings based on time alone is unlikely. More probable is the idea that Mumtalakat has become slightly more transparent and Santiago compliant in recent years, but it is still seriously lacking a framework that would make it close to fully Santiago compliant.

Future Generations Reserve Fund

The Future Generations Reserve Fund was founded with a more clearly outlined framework for funding and withdrawals. It receives a portion of the state-owned Bahrain Petroleum Company's oil revenues through monthly payments and is tasked with preserving this wealth by investing in liquid securities abroad while dispersing some capital to the government on an annual basis as needed.[112] Unfortunately, oil and gas sector revenues have been relatively low since the Future Generations Reserve Fund's founding in 2006, and the firm only manages an estimated US $400 million.[113] In 2015, just over US $50 million was added to the fund, about 1 percent of total oil revenues, but in 2014 about the same amount was withdrawn to help minimize the government's deficit, so the fund has not had a chance to grow in a significant way since its founding.[114] This fund is meant to imitate Kuwait's Future Generations Fund, which also invests internationally in low risk investment vehicles and receives a percentage of oil and gas sector revenues surpluses yearly, the Kuwait's fund manages closer to US $600

[112] Sovereign Wealth Center 2016a.
[113] Sovereign Wealth Center 2016a.
[114] Bahrain Ministry of Finance 2015.
[114] Sovereign Wealth Center 2016a.

billion in assets. Bahrain’s Future Generations Reserve Fund has the potential to stabilize long term growth in Bahrain based on its strong structure and mission statement, but it is still young and needs significantly more funds if it is to be successful.[115]

Conclusion

Further developing these investment funds both to build domestic business sectors and ensure long-term financial stability will be critical to Bahrain’s future economic success. The Kingdom of Bahrain is currently threatened by domestic instability, regional turmoil, overwhelming government debt, and a serious slump in the oil and gas sector. It has a difficult road ahead, but reducing government spending deficits and managing surpluses in a more stable, interest-earning way will help it achieve growth and stability. The Future Generations Fund may be too small of an effort made too late to make a true impact, but it shows that the Bahraini government is learning from its neighbors that it needs to save and diversify its wealth wherever possible. The Kingdom of Bahrain must capitalize on these lessons to create an economy that is less susceptible to geopolitical turmoil and fluctuating oil prices if it is to create the type of economic growth it needs to quell domestic dissatisfaction.

[115] Sovereign Wealth Fund Institute 2016f.

Chapter 5: Qatar

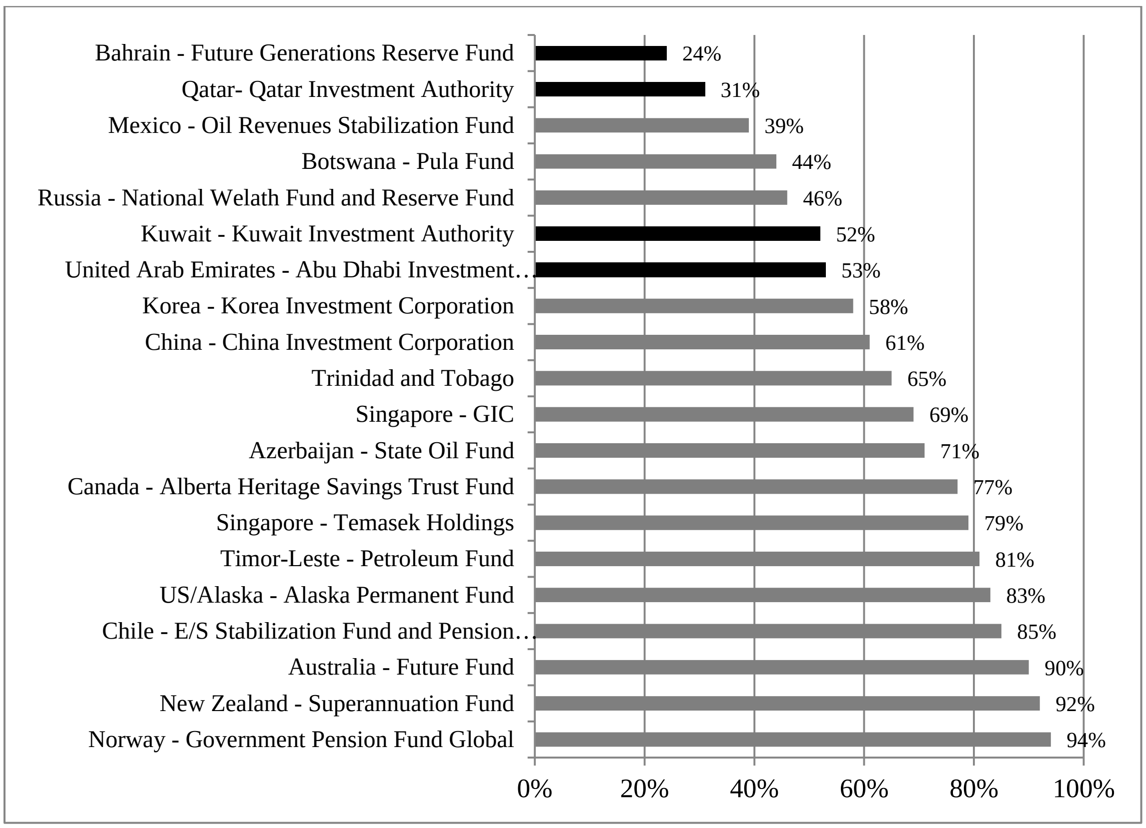
As of 2005, Qatar has been the world's top exporter of liquefied natural gas (LNG).[116] While the rest of its Gulf neighbors were exploiting their oil resources during the oil price boom of the 1970s, Qatar had just begun to discover its natural resource endowment, and it was not until 1997 that it first exported LNG.[117] To help manage the sudden influx of LNG wealth, the Qatar Investment Authority was formed in 2005 (though it was unofficially operating as early as 2002) with a mission "to invest, manage, and grow Qatar's reserves to create long-term value for the State and future generations" and "to support the development of a competitive Qatari economy, facilitating economic diversification and developing local talent."[118] This sovereign wealth fund is now managing over US $256 billion making it the fastest growing sovereign wealth fund in the region.[119] Part of this endowment is also made up of domestic, non-natural resource related assets which were "assigned to Qatar Investment Authority with the objective of improving the oversight and coordination."[120] In this sense, the Qatar Investment Authority is not only a typical sovereign wealth fund, but also an active manager of some domestic resources.

Its initial commitment to transparency, or at least the appearance of it, was demonstrated in 2008 when it played crucial roles in establishing the International Forum

[116] Persian Gulf Fund 2016.
[117] Ibrahim and Harrigan 2012, 2.
[118] Qatar Investment Authority 2016.
Sovereign Wealth Fund Institute 2016g.
[119] Sovereign Wealth Fund Institute 2016h.
[120] International Forum of Sovereign Wealth Funds 2016a.

of Sovereign Wealth Funds and defining the Santiago Principles.[121] However, in a study of Santiago Principle compliance published by GeoEconomica in 2013, the Qatar Investment Authority ranked second to last, ahead of Bahrain, in compliance (see Figure 14).[122] Sven Behrendt, GeoEconomica's managing director, explained this phenomenon by saying, "Many of the sovereign wealth funds thought that by simply signing the principles, the international community would believe they would implement them. This implementation needs to be disclosed so that it can be verified by third parties."[123]

Figure 14: Santiago Compliance Index 2013



Source: GeoEconomica 2014

121 International Forum of Sovereign Wealth Funds 2016a.
122 GeoEconomica 2014, 2.
123 Chasany 2014.

GeoEconomica attributed the lack of compliance to the fact that the Qatar Investment Authority is relatively new and is one of the most activist firms on the list, but some of the much older sovereign wealth funds in the area, including the Abu Dhabi Investment Authority and the Kuwait Investment Authority, are also only rated “partly compliant,” showing that the funds are not guaranteed to become more transparent or Santiago Compliant with time.[124] The report closed its discussion on the Qatar Investment Authority by saying it “could substantially enhance its position as an established financial market participant if it made a bold move towards embracing and implementing substantial parts of the Principles.”[125]

The Qatar Investment Authority does report to the Supreme Council for Economic Affairs and Investments, which must approve its strategy and approve the budget, among other tasks. The Council is made up of the Emir, the Prime Minister, the Minister of Energy and Industry, the Minister of Finance, the Minister of Economy and Trade, the Governor of the Central Bank, the Economic Adviser to the Emiri Diwan, the CEO of the Qatar Investment Authority, and a Representative of the Development Bank. Though this does not fulfill the Santiago Principle definitions of accountability, nor give Qatari citizens access to information regarding where Qatar’s funds are being invested, it may minimize corruption from the Supreme Council’s view in the same way that Abu Dhabi’s Accountability Authority may be able to check the Abu Dhabi Investment Authority’s actions internally.

[124] Chasany 2014.
[125] GeoEconomica 2014, 4.

Though the procedures have not been made public, apparently clearly defined steps are required for the funding, investment, and withdrawal strategy of the Qatar Investment Authority.[126] As mentioned when discussing the Kuwait Authority's rigorous withdrawal policies, the regulations surrounding fund withdrawals must strike a balance between being strict enough to maintain a strong portfolio, and lenient enough so that the government can withdraw funds when necessary to prop up growth in the domestic economy, particularly when oil and gas prices fall.

Qatar Investment Authority Activities

Investments are also not publicly disclosed, but the Qatar Investment Authority states that its approach is "based on prudent risk management," not subject to conventional short-term performance measures, with the objective to "achieve a superior and sustainable rate of return within levels of risk defined by the Supreme Council for Economic Affairs and Investments." Exactly what these levels of risk are or what can be defined as "prudent" is unknown, but these seem to be wise guidelines if they are actually followed. Some information about the Qatar Investment Authority's investments have been made public by the firms in which it is invested, including Volkswagen, Glencore, the Agricultural Bank of China, Royal Dutch Shell, Siemens, Vinci, and Iberdrola.[127] In 2015, all of these companies had significant losses, and the *Financial Times* estimated that the Qatar Investment Authority had lost US$12 billion, US$8.4 billion of which could have been due to Volkswagen's downturn after their emissions scandal.[128] This

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[126] International Forum of Sovereign Wealth Funds 2016a.
[127] Wright 2015.
[128] McLannahan 2015.

demonstrated the risk of investing significant amounts in private equity rather than more stable fixed income strategies. However, these firms are not usually regarded to be as risky as they were in 2015. Forbes criticized the Financial Times' large loss assumption by saying that it was impossible to know exactly how much Qatar had invested in these firms and therefore how much they had lost, but more importantly, funds like the Qatar Investment Authority are focused on long-term returns, not reacting to each dip and movement in the market. In the long term, investments in companies like Volkswagen are predicted to give steady returns, and they should not be overly concerned about downturns on a quarterly basis.

The Qatar Investment Authority also owns Qatari Diar, a property investment company that owns the Shard in London and the Olympic Village in London, among other high profile properties. One of its first projects was Lusail City, a "smart" city very similar to the Masdar City project in the Abu Dhabi.[129] Again, this project has the potential to create a new type of sustainable living environment that could reduce climate change and have tremendous positive effects, but it is also a massive investment with little guaranteed returns. These investments do not indicate the type of risk-adverse behavior that would be expected of a savings fund meant to create steady returns for future generations, but the Qatar Investment Authority may have such a large surplus of funds that it is not overly concerned with ensuring its investments are safe, making it more of a state investment fund than a savings fund.

Qatar had also made significant investments in diversifying its domestic economy before the formation of the Qatar Investment Authority. In 1994, it started the Qatar

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[129] Real Times 2015.

Foundation for Education, Science and Community Development as a way to "lead human, social, and economic development of Qatar."[130] Since then, the Qatar Foundation created Education City, located just outside of Doha, which is now home to multiple partnerships between Qatar and other institutes and universities, including the RAND-Qatar Policy Institute, Virginia Commonwealth University, Weill Cornell Medicine-Qatar, Texas A&M University at Qatar, Carnegie Mellon University Qatar, Georgetown University of Foreign Service in Qatar, Northwestern University in Qatar, HEC Paris, and the University College London. These universities have attracted students from around the world and have brought Qatar closer to achieve the goal set in its "2030 Vision" to "use the vast revenues from its substantial hydrocarbon resources to transform itself into a modern knowledge-based economy."[131] Education City is not just an educational oasis meant to bring international students to Qatar, but it has also benefitted Qatari students immensely. According to the universities in Education City that have spoken about the admissions processes, priority is given to qualified Qatari citizens and about forty percent of students in Education City are Qatari.[132]

This project is, however a huge risk, both financially and culturally. To attract these universities, the Qatari government gives each of them more than US$320 million each year, showing their dedication to establishing the state's reputation as a center of learning and innovation, even when the price tag is extremely high.[133] Qatar is also known for its strict interpretation of Islam and is the only state, aside from Saudi Arabia,

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[130] GeoEconomica 2014, 3.
Qatar Foundation 2016.
[131] General Secretariat for Development Planning 2008.
[132] Asrar 2015.
[133] Anderson, 2015.

that declares Wahhabism as its official religion.[134] Inviting western universities to educate its people seems like a contradiction to these beliefs, and could threaten the strict rule that the Emir has on free speech, democracy, and other western values.[135] However, Education City does have considerable benefits beyond the education of Qatari citizens and attracting foreign human capital. Both Barak and Michelle Obama have visited Education City as well as the strategic United States Al Udeid air base, and these symbols of alliance with the world's largest military power have helped solidify Qatar's soft power in an unstable region, indirectly protecting Qatar's natural gas resources as well.

Qatar has also gained significant soft power through its ownership of various media sources, including the Al Jazeera Media Network, based in Doha and partially funded by the ruling House of Thani. Al Jazeera was founded in 1996 after BBC Arabic was shut down after Saudi Arabia attempted to censor BBC coverage of executions in Saudi Arabia.[136] As a way to sustain influence in the media, the Emir of Qatar provided a loan to Al Jazeera and promoted its growth. The network has now expanded to include Al Jazeera English, Al Jazeera Balkans, Al Jazeera Sports, AJ+, and other stations which can be accessed in over 100 countries.[137] Though there have been accusations of the Qatari-owned news source as a propaganda machine used by the House of Thani to manipulate Middle Eastern affairs and Western views of issues in the Arab World, even these criticisms say that Al Jazeera is "a pernicious, if effective, tool of foreign policy."[138] The

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[134] American Foreign Policy Council Almanac 2010.
[135] Anderson, 2015.
[136] Al Bab 2016.
[137] Al Jazeera 2016.
Hashmi 2011.
[138] Fahmy 2015

network has been the center of a significant amount of controversy, from supporting the contentious Muslim Brotherhood in Egypt during the overthrow of President Morsi, to being accused of being overly sympathetic to Hamas, to being sued a former Al Jazeera journalist for US$83 million, but it has successfully nonetheless brought western attention to the tiny state of Qatar, associating it with successful media outreach and more free speech than other Gulf states.[139] This visibility and connectivity to the rest of the world is critical to Qatar's defense strategy, as it allows an area with a population of just over two million to maintain control over its offshore LNG resources and defend itself from manipulation from larger and more militarily powerful nations in the Gulf.

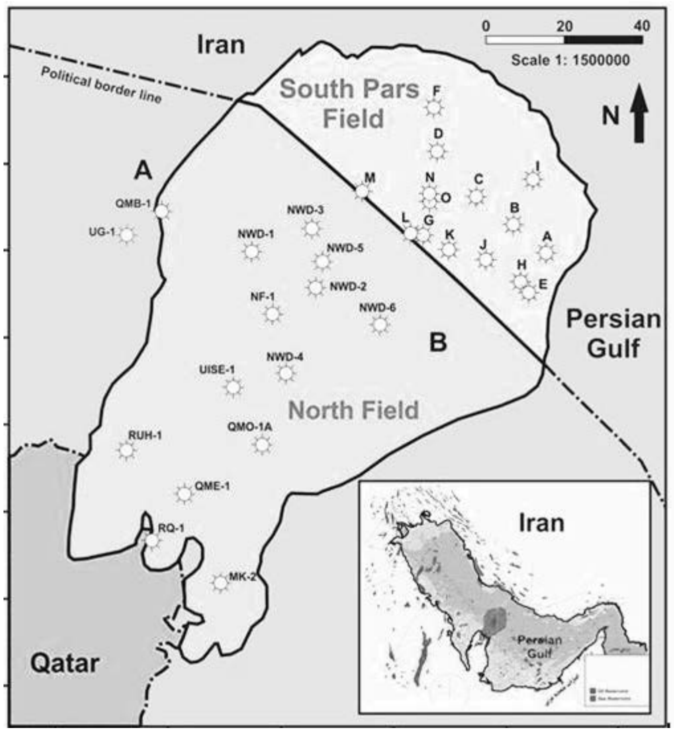
Geopolitical Aspects of Oil Revenues

The majority of Qatar's natural gas resources come from a single offshore area in the Persian Gulf that is split between Qatar's North Field and Iran's South Pars Field (see Figure 15).[140] The Iranian side has been severely underutilized and, as mentioned in the previous chapter, Iran would need to make a deal to use Bahrain's refining facilities if it were to fully tap its resources in South Pars.[141] This does not seem probable, so South Pars will likely remain underdeveloped in the near future. If, however, Iran does decide to further tap the South Pars Field, it may also try to gain access to the North Field, or the

[139] Kessler 2015.
Henderson 2000.
Slade 2014.
[140] Natural Gas Europe 2015.
[141] Khatinoglu 2015.

two countries may engage in a race to extract as much as possible for themselves, flooding the market and causing LNG prices to fall.[142]

Figure 15: South Pars and North Field oil field in the Persian Gulf



Source: Finding Petroleum 2013

Qatar's military is far too weak to successfully defend the North Field from Iran, but a strong relationship with the United States may be a strong enough deterrent to stop Iran from encroaching on Qatari territory. Qatar's strategy of bringing in western investment and influence, housing an American Air Base, hosting the 2022 World Cup, and gaining influence around the world through its media outreach has given the small state tremendous soft power, which may be a better defense than any military system it could ever develop.

[142] Critchlow 2015.

Management of Oil Wealth

Since discovering its significant LNG resources, Qatar's gross national product has expanded exponentially, and it has managed this influx of wealth wisely for the most part, though many of its projects have been more focused on image than productivity. Perhaps because of this delay in natural resource windfalls, Qatar has been much more prudent with its wealth than its Gulf neighbors. In the past twenty years, GDP has growth exponentially, with a compounded annual growth rate of 19 percent from 1994 to 2014. As the Qatar National Vision 2030 put it, "The country's abundant wealth creates previously undreamt of opportunities and formidable challenges."[143] That document stresses the idea of not only having growth in GDP and economic well-being but also "modernization and preservation of traditions, the needs of this generation and the needs of future generations, managed growth and uncontrolled expansion… and economic growth, social development, and environmental management."[144]

As shown in Figure 16, government revenue growth has remained smooth over time regardless of oil prices, with the exception of the dip in revenue in 2009 which was caused primarily by the global economic crisis rather than low oil prices. Government spending has also grown smoothly over the time period displayed and, though it has grown, it has maintained a lower growth rate than revenues, demonstrating the government's dedication to consistent growth rather than over-spending, even when it has the means to do so.

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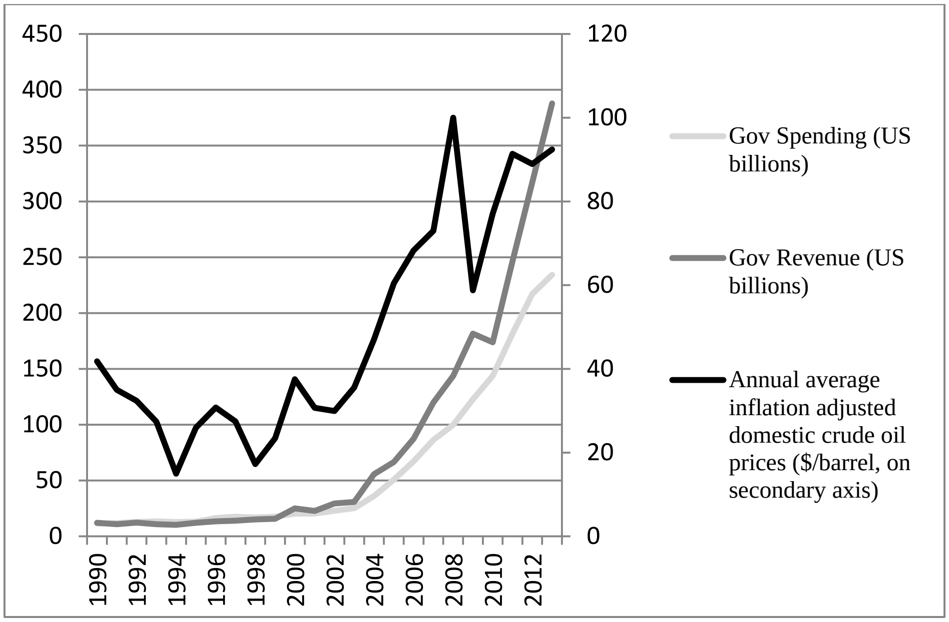
[143] General Secretariat for Development Planning 2008.
[144] General Secretariat for Development Planning 2008.

Figure 16: Qatari Government Spending and Expenditure as compared with Oil Prices



Source: U.S. International Energy Information Administration, IMF Macroeconomic Statistics

If these trends continue, Qatar looks well prepared to handle fluctuations in oil prices while maintaining a strong government surplus and placing its excess surplus into its sovereign wealth funds, creating even higher diversification and government revenues in the long-term.

Conclusion

In the past twenty years, the State of Qatar has evolved from a tiny state in the middle of the Persian Gulf with little significance on the global geopolitical scale to one of the most visible and internationally significant countries in the Middle East. This transition has been full of contradictions, as evidenced by its strict Muslim values functioning alongside strong relationship with Western governments and universities as well as its wealth management strategy – a combination of pioneering western standards and leaving control to a secretive Emir. Qatar's government surpluses and third highest

GDP per capita in the world (at US$96,732 as of 2015) give it the liberty to continue spending on extravagant projects like the World Cup, Education City, and worldwide media outlets, but it should be sure to save its revenues wisely while continuing to grow the Qatar Investment Authority in a way that is conducive to long term growth and savings, as outlined in the Santiago Principles.

Chapter 6: Oman

Oil was first discovered in substantial quantities in the Sultanate of Oman in 1964. Petroleum Development Oman, now 60 percent state-owned, was formed soon after to manage the extraction and refining of this newly discovered resource. Since then, oil revenues have made up a significant percentage of total GDP, with 47.2 percent of total GDP and 85 percent of government revenues coming from the oil and gas sector in 2014.[145] The Sultanate is attempting to diversify away from oil dependency, however, especially after the steep oil price decline in 2009. Every five years, the Omani government publishes a Five Year Development Plan that is meant to outline the current state of the economy, what developments will be made in the next five years both in the oil sector and in non-oil sectors, and set goals for economic growth. The Eighth Five Year Development Plan, published in 2010 and meant to serve as a guide for the years 2011-2015, emphasized the need for diversification away from the oil sector and towards the tourism, industry, agriculture, and fisheries sectors.[146] Its plan to do so involved strengthening small and medium sized business enterprises, developing the financial sector, financing the private sector, improving investment climate, and developing infrastructure.[147] Under this plan, GDP grew at a 3.3 percent annual growth rate, oil activities grew at a 2.3 percent rate, and non-oil activities grew by 5.8 percent annually.

[145] Central Bank of Oman 2015, 17.
[146] Times of Oman 2015.
[147] Central Bank of Oman 2015, 19.

The Ninth Five Year Development Plan was recently released and emphasizes further investment in diversification away from oil, this time led by the manufacturing and transportation sectors alongside continued growth in the tourism, fisheries, and mining sectors. It has also stated a goal of "reducing the contribution of oil in GDP at current prices from 44 percent in the Eighth Plan to 26 percent."[148] The primary driver of the planned growth in the manufacturing sector from 9.3 percent to 15 percent of GDP is the Liwa Plastics Industries Complex, which will "double (Orpic's) profit, support the development of a downstream plastics industry in Oman…, create new business opportunities and employment, and firmly reinforce Orpic as a significant player in the international petrochemicals marketplace."[149] Orpic is also known as the "Oman Oil Refineries & Petroleum Industries Co.," which is the state-owned oil extraction and refining business operating in Oman.[150] While the Liwa Complex is projected to benefit Orpic and therefore government revenues substantially, it is still not entirely oil independent, as oil is a large component of plastics and particularly polyethylene, which will make up a large part of the Liwa's production. Demand for plastic is, however, not perfectly correlated with worldwide demand for oil and gas products, so this project should serve to use Oman's most abundant resource – oil – in a way that is not completely dependent on oil prices.

The second aspect of the Ninth Development Plan is to invest in transportation and logistics.[151] Oman's location in the Gulf, bordered by the Strait of Hormuz and the

[148] Central Bank of Oman 2015, 2.
[149] Orpic 2016a.
[150] Orpic 2016b.
[151] Oman Arab Bank 2016.

Gulf of Oman, gives it the potential to become a shipping hub for the Middle East and east and central Africa, but it needs to invest heavily in infrastructure to improve this sector as much as the Ninth Development Plan claims it will. One of its biggest projects is to develop Duqm, a small fishing and oil refining town on the coast that had only 5,100 residents in 2008. Since then, the population has tripled and it is planned to increase to 100,000 by 2020 due to the addition of an airport, multiple luxury hotels, a railroad, and a Special Economic Zone. A four kilometer dry dock has already been built with a US$1.5 billion investment, and, if this “sleeping giant” were to become as successful as the planners hope, it could “challenge Dubai’s dominance as the region’s trading hub.”[152] According to The Economist, ships travelling from Asia to Europe already stay close to Oman’s coast on their way to the Suez canal and the availability of a reliable port at Duqm would be in great demand.[153]

There are also plans to build roads, pipelines, and railroads to and from Saudi Arabia and the United Arab Emirates with the intention of creating a streamlined oil and gas shipment system that could bypass the Strait of Hormuz, which Iran periodically threatens to close. [154] The Oman Rail Project will also connect Duqm with the capital of Muscat, the port city of Salalah, Sohar near the UAE border, and major mining and oil fields. This US$13-15 billion project is already underway, with Omani natives comprising a large portion of the contracted engineers and workers. At least ten percent of the value for each contract is required to go towards Omani companies, and the project is expected to grow the Omani economy significantly both by directly employing

[152] The Economist 2013.
[153] The Economist 2013.
[154] The Economist 2013.

thousands of Omanis and by streamlining supply chain dynamics, making production and consumption less expensive and more efficient for producers and consumers.[155] Despite the recent downturn in oil prices, there are no signs that the Oman Rail Project will be postponed.[156]

The third leg of Oman's Ninth Development Plan is based on building tourism from two percent of GDP in 2015 to five percent of GDP in 2020.[157] According to the Plan, there are currently almost 40 tourism-based projects in some stage of development, and these projects are expected to generate an estimated 100,000 jobs by 2024. These projects are generally at least partially funded by Oman's pension investment funds, which include its sovereign wealth funds. The other sectors planned to expand under the life of this Plan are the fishing and mining sectors, but there are expected to maintain only moderate growth, with much less government investment that the first three sectors.[158]

Sovereign Wealth Funds

The Sultanate of Oman currently manages two sovereign wealth funds; the Oman State General Reserve Fund was founded in 1980 to "achieve long term sustainable returns on the revenues generated from oil and gas," and the Oman Investment Fund was founded in 2006 as an investment vehicle for the Government of Oman with the goal of

[155] Smith 2015.
Ministry of Transport & Communications 2016.
[156] Railways Africa 2016.
[157] Oman Arab Bank 2016.
[158] Oman Arab Bank 2016.

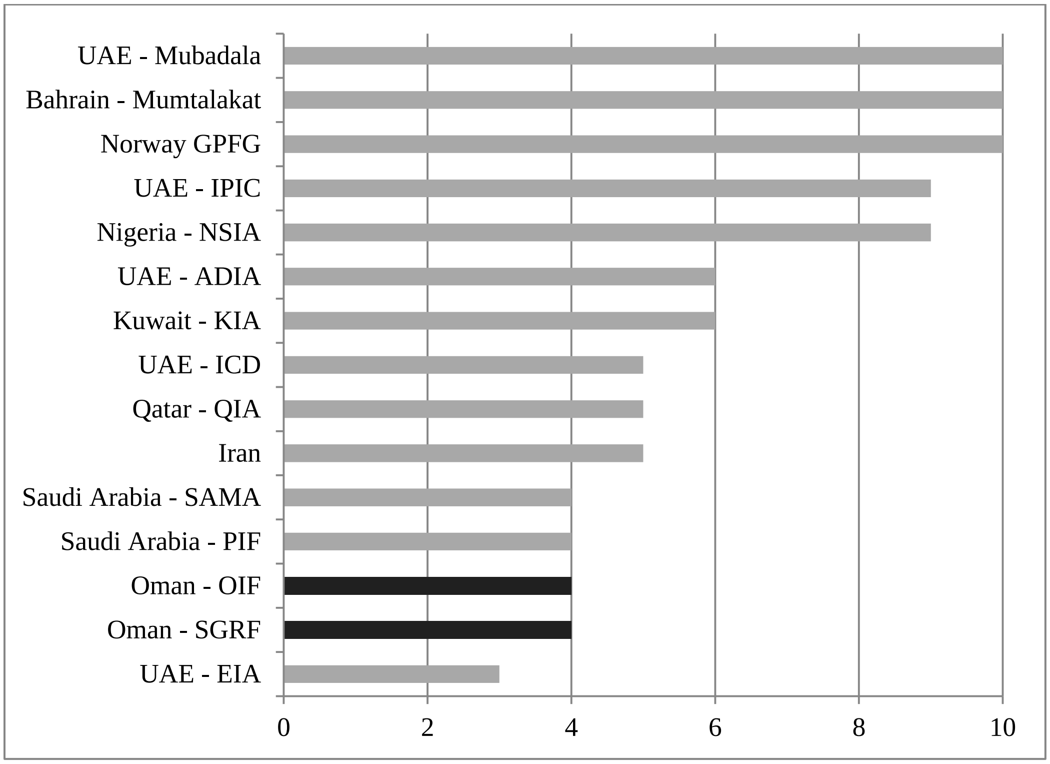
diversifying the Omani economy.[159] The State General Reserve Fund currently manages an estimated US$34 billion and has acted as a savings fund for future generations, with steady, low-risk investments supplying consistent revenues. When the fund was formed, the government of Oman committed 15 per cent of total oil revenues to the fund annually, but in 1998, due to weak oil prices and low economic growth, this contribution requirement was changed to be more lenient, with government revenues in excess of planned budget allocations being set aside in the fund since then.[160] This fund is overseen and regulated by the Financial Affairs and Energy Resources Council which also sets Oman's fiscal policy and manages the state budget.[161] Additionally, the State General Reserve Fund claims to have a "robust governance framework with clearly defined policies, process, and procedures," though this framework is not publicly available.

As with the other oldest sovereign wealth funds in the Gulf (the Kuwait Investment Authority and the Abu Dhabi Investment Authority), the State General Reserve Fund has historically been discreet with its investments, publishing very little and maintaining minimal transparency, though the Kuwait Investment Authority and the Abu Dhabi Investment Authority have made progress towards becoming more transparent since joining the International Forum of Sovereign Wealth Funds and committing to working towards Santiago Principle Compliance (see Figure 1).[162] On March 9, 2015, The International Forum of Sovereign Wealth Funds announced that it had approved the membership applications of the State General Reserve Fund, which

[159] State General Reserve Fund 2016.
[160] Baghat 2011, 271.
[161] Oman Info 2016.
[162] Baghat 2011, 5.

requires a commitment to voluntary endorsement of the Santiago Principles and increased transparency, indicating that Oman's State General Reserve Fund may become more open with its information in the near future.[163]

Figure 17: Selected SWF Transparency Rankings



Source: Sovereign Wealth Fund Institute 2016b.

The Oman Investment Fund was formed much more recently with an objective to grow Oman's economy through diversification away from oil and gas and by investing in private equity, real estate, infrastructure, and equities both within Oman and abroad.[164] Previously, it was known as the Oman Oil Fund This fund is the vehicle through which the Government of Oman is funding its infrastructure and tourism as described in the Ninth Development Plan, but other than these projects very little is known about the size

[163] International Forum of Sovereign Wealth Funds 2016b.
[164] Baghat 2011, 28.

or activity of the Oman Investment Fund. Estimates of the fund's size range from US$6 to 18.2 billion.[165] While this secrecy makes assessing the fund's effectiveness difficult, there are actions that could be taken by the fund that could greatly improve the Omani economy.

Foreign Investment

According to a Capital Markets report on Oman, the country has great difficulty attracting foreign investment, primarily because so few companies have been made themselves public by filing initial public offerings in Oman's stock exchange, the Muscat Securities Market.[166] This market, formed in 1988, currently only has 116 companies listed, less than the total number of listings for the Abu Dhabi and Dubai securities exchanges which were formed in 2000. Capital Markets blames this low public market participation on Omani CEOs potentially being "loathe to share company financial data, reticent to pay dividends, or short on the expertise needed," but no matter what the reason, Omani companies are not likely to attract the type of investment that could propel the economy forward while remaining private and closed off to foreign assistance. Another factor that may prevent foreign investors from investing in Omani companies, even if they are public, is the Oman Investment Stability Fund, which was formed in 2009 by the Government of Oman as a way to stabilize the price of stocks that may swing too far up or down.[167] While this may create a semblance of stability within the markets,

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[165] Sovereign Wealth Fund Institute 2016i
Sovereign Wealth Center 2016b.
[166] Muscat Securities Market 2016.
Oxford Business Group 2010, 65.
[167] Investment Stabilization Fund 2016.

this interference makes the securities even more unpredictable and discourages investments from outsiders that may be looking for more reliable and calculable investments.[168]

Conclusion

Though its markets need significant improvement before individual companies can take advantage of foreign investments, Oman has made progress towards becoming more open to the world economy through trade. In 2009, Oman signed a free trade agreement with the United States that eliminated most tariff barriers; allowed investors to fully own businesses in the other country without a local partner; and provided duty-free access to industrial, agricultural, and consumer products.[169] Though Oman is not currently in negotiations to form any new bilateral free trade agreements, it is expected that the Gulf Cooperation Council countries will have free trade agreements with Singapore, the European Union, India, China, South Kora, Australia, and New Zealand in the near future, and some of these have already been passed.[170] Oman's location already makes it the Gulf's perfect trading hub, letting shipments bypass both the Strait of Hormuz and the Gulf of Aden, and the Sultanate has the potential to follow Singapore and the UAE in using trade as its means to growth, particularly once the Oman Rail Project and the development of Duqm are completed.

[168] Oxford Business Group 2010, 80.
[169] Office of the United States Trade Representative 2016.
Embassy of the United States in Muscat Oman 2016.
[170] Tipitino 2011, 5.
Bilaterals 2012.

Though Oman has historically been somewhat dependent on oil revenues, its oil and gas resources are considered the least accessible in the Gulf, which has forced the Sultanate to diversify its economy. In recent years, it has made significant progress towards growing its mining and trade sectors, moving away from oil dependency and towards being a center of global economic activity. While it is next to impossible to determine what role Oman’s sovereign wealth funds are having in this transition, it is clear that the management of the State General Reserve Fund has been focused on long-term growth and saving for the future, while the Oman Investment Fund will promote domestic growth through more risky, but smaller, investments. As long as these patterns continue and Oman’s development plans continue as outlined in the Ninth Development Plan, the Sultanate’s prospects for economic growth despite oil price volatility look promising.

Conclusion

An analysis of the growth patterns of countries endowed with rich natural resources often shows a gloomy picture of mismanagement and foolish spending, leading to stagnation and lost opportunities for economic development. This has led many prominent scholars to conclude that there is some type of "natural resource curse" that prevents nations from capitalizing on these resources, and often even causes them to "grow more slowly than resource-poor countries."[171] A deeper look at this so-called curse shows that it is not a universal phenomenon, and that low or inconsistent growth is actually related to the very simple problem of placing all of ones eggs in one basket.

This analysis of oil wealth management in the Gulf Cooperation Council countries has revealed that there are two primary ways by which the nations studied have attempted to diversify their oil wealth: by investing abroad through savings funds and by diversifying their domestic economies through strategic development funds. The longer the savings funds have existed, the larger they are likely to be, and the more revenue they are likely to accumulate from investments, eventually creating a situation like that of Kuwait's wherein returns from its sovereign wealth fund's investments have contributed significantly to the government's revenues and propped up its economy when oil revenues have been low. When oil prices plummeted in the 1980s, Kuwait earned more from its foreign investments than from the direct sale of oil, and the Kuwait Investment Authority's reserves were critical to maintaining stability during and after the Gulf War.

[171] Sachs and Warner 2001, 827-838.

On the other side of the spectrum, Qatar and the United Arab Emirates have used their sovereign wealth funds to diversify their domestic economies, creating internal sources of revenues that are independent from oil exports. This strategy, while slightly more risky, has created more sustainable and intrinsic growth by building industries within these countries that are minimally reliant on the success of foreign investments or oil prices. When Oman discovered its natural gas resources, it was quick to follow their lead, forming sovereign wealth funds immediately and focusing on building revenue streams that were not dependent on oil prices. Bahrain, on the other hand, was the first to discover its oil resources and failed to form sovereign wealth funds until 2006. Saudi Arabia was also late to form savings and development funds, instead relying on oil revenues to fund subsidies and its extremely high levels of military spending.

Figure 18 shows the compounded annual growth rates of each of these countries over the past ten and twenty years, and it is clear that the countries with stable funds have experienced the most growth, especially if they were focused on domestic development away from the oil and gas sector.

Figure 18: Compound Annual Growth Rate of GDP

	10 Year CAGR (2004-2014)	**20 Year CAGR (1994-2014)**
Qatar	23.37%	19.28%
Oman	13.99%	10.15%
Kuwait	12.53%	10.73%
UAE	11.68%	10.75%
Saudi Arabia	12.62%	9.47%
Bahrain	11.08%	9.15%

Source: IMF Cross Country Macroeconomic Statistics

One of the fundamental rules of investing is that diversification lowers risk, maximizing the likelihood of earning higher long-term returns on investments.[172] As seen in this analysis, diversifying sources of government revenue and GDP is also crucial to creating steady, long-term growth, particularly when a nation is endowed with a resource whose price is as volatile as oil. Dependency on inconsistent oil revenues creates economic instability, which in turn discourages investments in the future economy of a nation and lowers total growth over time, but moving away from that dependency to a certain extent is attainable. In order to promote sustainable economic growth, countries with large natural resource endowments should follow Qatar, Oman, and Kuwait in forming reliable funds with which they can set aside their resource revenues in stable foreign investments and develop their own domestic economies.

[172] Investopedia 2016.

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