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The Oil-Producing Gulf States, the IMF and the International Financial Crisis*

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Throughout 2006 and 2007, the good fortunes of the emerging market economies, once chronic users of the International Monetary Fund (IMF) but soured by years of ill-advised IMF policies, allowed them to amass foreign exchange reserves as a form of insurance against the need to resort to the IMF in future crises. The IMF's consequent loss of clientele and dwindling resources led some officials to pronounce the Fund "irrelevant." Indeed, the IMF's crisis of legitimacy reflects a discernable shift in global economic power from the Western industrialized countries to the emerging market economies.

Within the IMF itself, this shift in global economic power highlighted the increasingly obsolescent nature of the Fund's governance structure. While managing directors and executive board members had worked for years to reconfigure the IMF's quotas and shares to earn the emerging market economies' support for Fund reform, by mid-2008, with few of the ambitious reform proposals having been implemented, that effort had hit an impasse.

Then, in a twist of irony, the 2008 international financial crisis caused all eyes to turn once again to the IMF to watch it go to the rescue of one country after another, among them Iceland, Hungary, Ukraine, Pakistan, Serbia, Latvia, Turkey, and Belarus. The Fund was expected to help coordinate and play a catalytic funding role to mitigate these countries' credit problems, to provide ideas to failed regulatory regimes, and to predict the course of the tumultuous international financial road ahead.

As part of this process, and in an attempt to respond to the international financial crisis, leaders of the world's largest economic powers — now expanded from the Group of 8 to the Group of 20 — met in Washington, DC, in November 2008, where it was hoped they would help rewrite the rules of the global financial system and shore up the dwindling resources and legitimacy of the IMF and other international financial institutions as they attempted to address the crisis. Hope rested, in particular, on countries such as China, Japan, and the oil-producing Gulf states that were holding large foreign reserves. The failure to come up with an ambitious redesign of Bretton Woods was predictable, but the unwillingness of a number of states with large capital surpluses to reinvest in the IMF was unexpected.¹ Some analysts have suggested that this reflects continuing concerns in the international community about the IMF's legitimacy. I argue, however, that, at least in the case of the oil-producing Gulf states — that is, Bahrain, Kuwait, Oman, Qatar, the United Arab Emirates (UAE), and Saudi Arabia, collectively known as the Gulf Cooperation Council (GCC) — the failure to support the IMF is more reflective of the crisis of their own domestic legitimacy.

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CIGI was founded in 2002 by Jim Balsillie, co-CEO of RIM (Research In Motion), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario. CIGI gratefully acknowledges the contribution of the Government of Canada to its endowment Fund.

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ISSN 1915-822X (Online)

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As a result of the steep rise in oil prices, from a 20-year low of US\$20 per barrel in 2001 to a high of US\$140 per barrel in mid-2008, the Gulf states had been reaping huge economic benefits. Between 1997 and 2002, for example, GCC oil earnings averaged US\$146 billion per year; in contrast, between 2002 and 2006, earnings averaged US\$327 billion per year (IIF, 2007). These greatly increased oil revenues led to impressive economic growth in the GCC, comparable to rates in the leading emerging market economies: between 2003 and 2007, growth in real gross domestic product (GDP) in the GCC averaged 7.1 percent per year (IMF, 2008: 44). The growth in savings within the GCC was similarly impressive, with gross official reserves climbing from US\$388.4 billion in 2007 to US\$625.2 billion by October 2008. Meanwhile, the Gulf states' current account surpluses declined from US\$200 billion in 2006 to US\$143 billion in 2008 (IIF, 2007; IMF, 2008: 61). Given the relative small population of the six GCC states – 40 million in 2008, 28 million of them in Saudi Arabia – and their abundance of petrodollar wealth, where and how should these oil earnings be recycled?

Recycling the Gulf States' Oil Earnings

Their small population has meant that, historically, many Gulf states have had limited “absorption channels” through which to reinvest their oil earnings domestically. Instead, they have used the “capital account channel” by augmenting their central bank reserves, purchasing foreign assets – through vehicles such as sovereign wealth funds (used by the UAE) and official liabilities such as US government treasury bills – and investing in international financial institutions such as the IMF (see Nsouli, 2006). Indeed, in 1974 and 1975, Saudi Arabia and Kuwait were principal backers of IMF facilities designed to help oil-importing member countries facing balance-of-payment problems to borrow money with minimal conditions from the IMF. In 1977, Saudi Arabia also assisted in the creation of the Supplementary Financing Facility (SFF) – also known as the Witteveen Facility. In 1981, the IMF borrowed 8 billion special drawing rights (SDRs) from the Saudi Arabian Monetary Agency to finance the SFF and the Fund's new policy of expanded access for countries with chronic balance-of-payments problems.

These past Gulf efforts to recycle petrodollar wealth through the IMF were in response to the global imbalances created by a decade of increased inflation, steep rises in commodity prices, including that of oil, and the overall global recession. Not surprisingly, the current international financial crisis raises analogies with that of the 1970s and early 1980s, and attention has turned once again to the Gulf's oil-producing states in the search for another infusion of funds that the IMF could use to meet the needs of countries in deficit.

Prior to the November 2008 G20 meetings, the United Kingdom's prime minister, Gordon Brown, called on both China and the Gulf states to contribute to the IMF's liquidity to prevent the international financial crisis from spreading to vulnerable countries. Brown stated: “I think it is the countries that have got substantial reserves, the oil-rich countries and others who are going to be the biggest contributors to this fund. Obviously I am going to the Gulf at the weekend and it is one of the items that will be on the discussion with all the international leaders” (quoted in Watt and Chrisafis, 2008).² While it could be argued that Brown's Gulf tour was meant primarily to shore up domestic support for his ailing party, it is clear that he believed he would be able to get the Saudis, at least, to commit to some contribution to the IMF's liquidity.

Accordingly, in early November 2008, Brown visited a number of oil-rich Gulf states. On his first stop, in Saudi Arabia, Brown sounded optimistic, stating that “The Saudis will, I think, contribute like other countries, so that we can have a bigger fund world-wide to avoid the contagion, to avoid this spreading to different parts of the

world” (quoted in Norman, 2008). Without detailing how much the Saudis planned to contribute, Brown hinted that their pledge would be revealed at the G20 summit in mid-November (Coates, 2008). In Abu Dhabi, at the end of his Gulf trip, Brown reiterated: “To stop the spread of contagion to neighbouring countries, we must build agreement for a new facility for the International Monetary Fund, and I very much hope the Gulf states will be able to contribute to these efforts....It’s in all our interests to stop the contagion that is happening and to rebuild confidence in the world financial system” (quoted in Stanton, 2008a). Newly appointed Secretary of State for Business and former European Union Trade Commissioner Peter Mendelson, who was a member of the UK delegation, went further, noting, “We are seeking buy-in from Saudi Arabia and other Gulf states to the necessary response that we all need to make to the turmoil of the international financial system. If we don’t get that money, we will fail” (quoted in Stanton, 2008b).

As it turned out, Brown had indeed failed: the Saudis came to the G20 meetings a few weeks later with empty hands and balked at international pressure to contribute funds to the IMF’s liquidity. In his statement to the G20, the Saudi king, Abdullah, blamed “undisciplined globalization and the inadequate control for the financial sector” for the international financial crisis and called on the IMF to enhance its monitoring of the industrial countries’ financial sectors. The king also highlighted Saudi Arabia’s commitment to take care of its own region and play a lead role in ensuring a balance between the needs of oil-consuming and oil-producing states, and he pointed out the need to better institutionalize the role of the G20 in the governance of the global financial system. The king made no references to a Saudi contribution to IMF liquidity; instead, he pointed out the Saudi government’s intention to spend US\$400 billion over five years to promote infrastructure projects and services, focusing on using his country’s petrodollar wealth to enhance domestic absorptive capacity (Abdullah, 2008). According to a Saudi government official, this was not a commitment of new money; rather, it was a means of “reassuring global markets” that Saudi Arabia would continue with its industrial development and economic diversification policy (Karam, 2008).

Other Gulf countries also announced they would introduce domestic stimulus packages rather than aid the IMF. For example, Kuwait’s sovereign wealth fund said it would invest its money in the country to spur growth in the local economy, while the UAE minister of economy, Sultan bin Saeed Al Mansouri, announced a domestic stimulus package that followed his government’s injection of Dh120 billion (about US\$32.7 billion) into the central bank to shore up domestic banks and a blanket guarantee on domestic deposits (Reilly, 2008).

An Inward-Looking Gulf

What explains this inward-looking approach by the Gulf states to recycling oil earnings in this latest era of global imbalances and international financial credit crisis? The reasons for Saudi and, more generally, Gulf reluctance to infuse funds into the IMF are multifold and multilayered, yet much of the reasoning is domestic. By the early 2000s, the region’s economic liberalization policies had taken off. One by one, Gulf countries acceded to the World Trade Organization and broke down years of statist policies. To the resentment of Saudi Arabia, a number of Gulf countries also negotiated bilateral free trade agreements with the United States as part of the US-Middle East Free Trade Agreement (see Momani, 2007). The GCC also accelerated trade negotiations with the European Union (see Antkiewicz and Momani, forthcoming). In response to these agreements, the GCC has made great strides toward further economic integration in the region by completing a customs union, initiating a common market (albeit a dysfunctional one in many ways), and making plans for a monetary union (Momani, 2008).



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But this rapid pace of economic liberalization also has had unintended sociopolitical consequences. In the past, Gulf states operated under an implicit social contract whereby they would dole out state benefits in exchange for political passivity on the part of their citizens. Under the pressures of globalization, however, this social contract is quickly eroding. Over the past decade, Gulf governments have witnessed, with trepidation, the rising pressure of a new economic class that is more insistent on scrutinizing government spending, particularly abroad, more demanding of government services, and increasingly impatient for the political liberalization that was expected to accompany rapid economic liberalization. While the state-owned sector remains the dominant engine of growth in Gulf economies, in many ways this new economic class can attribute its rise to the successes of the region's private sector, which has flourished with economic liberalization. In many ways, Dubai, in the UAE, is emblematic of the region's innovative ability to create economic growth. The Gulf's dynamic and bold private sector is ambitious to promote both the region's power in the greater Middle East and economic diversification at home (Hertog, 2007). While these ambitions will require more than significant rebranding to take hold, the desires and frustrations of the new class are gaining the attention of wary Gulf leaders (see Cooper and Momani, 2008; Harders and Legrenzi, 2008; Legrenzi, 2008). Though far from revolutionary, this class is often young, foreign educated, frustrated with the region's corruption, and yearns for meritocracy.

Moreover, this new class is highly skeptical of the wasteful ways of Gulf state governments, which are often seen as bailing out Western economies in exchange for the comforts of the US security umbrella. Leading up to the 2008 international financial crisis, for example, Gulf economies witnessed drastic inflation and soaring property prices that many local analysts attribute to the longstanding dollar-peg policy in the region. The declining value of the US dollar from 2006 to mid-2008 led to criticism of the policy and calls for de-pegging or, at a minimum, currency revaluation.³ Despite government assurances to the contrary, it was widely perceived that sound economic policies were being ignored for geopolitical reasons. Indeed, historically, the pegging of Gulf currencies to the US dollar had less to do with economic rationales than with geopolitical concerns, whereby Gulf governments chose to forgo an optimal currency choice out of a sense of regional and domestic insecurity and the need for US military protection (Momani, 2008b).

The reaction to press reports that Gulf states were asked for an infusion of money into the IMF was generally negative in the region. In one regional poll, for example, 65 percent of respondents disagreed with injecting funds into the IMF and the World Bank, 18 percent were supportive, and the remaining 17 percent did not know (YouGovSiraj, 2008). Similar negative reactions could be found in regional editorials, which often pointed out the need for more domestic spending and enhanced Gulf power in international financial and political institutions. Even in one of the more positive editorials, these points of frustration were clearly articulated:

Arabs should provide the much-needed financial assistance. But they must also demand a bigger role and say in international institutions like the IMF, World Bank and the United Nations...Despite being home to the world's most precious energy source and sitting on an area that is triple the size of America stretching from Africa to Asia, the Arabs have little or no say in international affairs. If the world wants Arab money, this state of affairs has to change....The Arabs must use this opportunity to assert themselves. They have to cleverly invest their funds and use their new financial clout to protect their interests and those of their people. This is the time to take charge of their destiny. (Khaleej Times, 2008)

On the heels of the G20 meetings in Washington, DC, a Kuwaiti newspaper reported that the US government had also approached the Gulf states for US\$300 billion — US\$120 billion from Saudi Arabia, US\$70 billion from the UAE, US\$60 billion from

Qatar, and US\$40 billion from Kuwait — to bail out the US auto sector. This report was similarly met with vocal opposition in editorial columns in the region. In a Saudi paper, one writer highlighted the view that more domestic investment and less spending for the sake of geopolitical positioning were needed:

Saudi Arabia and the Gulf states do not need the protection of other nations. They should depend on themselves and should not trust anybody but themselves for their protection. How could Saudi Arabia help the US auto industry and not help its own stock market that dropped over 80 percent from its value in the last 2 years? Saudi Arabia should help its citizens. Over 50 percent of Saudi families do not own homes. They rent homes. The monthly income of most Saudi families is below \$1,500. To sum up, if there [are] good business opportunities in the US, let us invest in them but the decision must be based on business calculations rather than other considerations. (Al-Rasheed, 2009)

In an unusual move, King Abdullah responded to reports that the United States was seeking money from the Gulf by stating unequivocally that Saudi Arabia would not accede to such a request (Shaheen, 2008).

A number of editorials also noted that, if the IMF wanted more funds from Gulf states, the quid pro quo should be more decision-making power for them in the organization (Hokayem, 2008). Since the late 1970s, as a result of its earlier injection into IMF liquidity, Saudi Arabia has held one of the few seats at the IMF that does not have a constituency. Since 1992, however, its relative quota share has declined and its seat on the IMF board has had less technical weight to justify its presence. In recent quota revisions, Saudi Arabia has voted against reallocating quota shares to emerging market economies because this would mean a relative loss of its own share (Momani et al., 2008). It appears the Saudis also expressed concern about this subject to Prime Minister Brown during his trip to the Gulf. In response, Brown noted that “I very much accept the argument that countries that contribute in this way should have a greater say in the governance of the IMF” (quoted in Stanton, 2008a). During the G20 meetings, Saudi Finance Minister Ebrahim Al Assaf reiterated that his country wants an “appropriate” IMF quota and to preserve its relative decision-making weight in the organization (Reuters, 2008a). In reality, however, after trying for some years to find ways to decrease the size of the IMF’s board and to reallocate quotas and votes from developed countries to underrepresented emerging market economies, IMF member countries are not in the mood to augment Saudi Arabia’s quota (Truman, 2006).

Conclusion

At the time of the November 2008 G20 meetings, few analysts would have predicted that oil prices could plummet below US\$40 a barrel and, consequently, few would have seen the unravelling of some of the economic gains the region has made. Leading up to the G20 meetings, Saudi central bank Vice-Governor Mohammad Al Jasser noted: “We are receiving the winds flowing with contagion but we do not have the crisis that is swirling in Wall Street” (Reuters, 2008b). While this turned out to be a premature assessment, the reasons the Gulf states came to the G20 meetings empty-handed had little to do with their current budget and financial woes.⁴ Then still optimistic, Saudi leaders chose not to shore up the IMF’s finances at the G20 meetings because of the pressure brewing at home to focus on inward spending and because it was clear that any Gulf funding of the IMF would not be reciprocated with increased quotas and a louder voice in the IMF executive board. Where the role of Gulf states is concerned, although a number of analogies have been made between the global recession of the 1970s and the 2008 international financial crisis, the reality is that the Gulf is changing.

Endnotes

* A longer version of this paper will be published in *World Economics* Vol. 10, No. 1

1. Japan did, however, commit US\$100 million to the IMF at the G20.
2. Brown did not, however, visit China, but instead relied on a phone conversation with Chinese premier Wen Jiabao.
3. It should be noted that, of the six GCC states, only Kuwait heeded these domestic pressures, reverting in December 2007 to using a basket of currencies in determining the value of its currency.
4. Squeezed credit markets and the jitteriness of international investors had already had negative effects on sectors that previously had been growing — namely construction, real estate, and financial services — and real GDP growth in the region had been forecast to slow from 5.7 percent in 2008 to 3.6 percent in 2009 (IIF, 2008).

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