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Small Gulf States in World Markets

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Twenty-five years ago, Ian Lustick blamed the absence of great regional powers for the Middle East's mounting developmental challenges (Lustick 1997). Colonialism and foreign intervention prevented large states like Egypt, Iraq and Syria from evolving into regional powers like Germany or the United Kingdom (UK). This robbed the region of the large-scale state-building wars that catalyzed European nation building and industrialization. Instead, the region's large states remained weak and subdued. Defeat in the Six Day War and Iraq's routing in the 1990 Gulf War epitomized their 20th century fragility.

If the failure of large states cast a pall over the Arab world a quarter century ago, then small Gulf states – Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates (UAE) – crowd the narrowing spotlight of economic development in the region today. And while large European states' historical development bears little resemblance to their Arab peers, some of the institutional underpinnings of the prosperity experienced by small European states exist in the Gulf. As in Europe, open markets and large public sectors have embedded small Gulf states into the global economy, pairing economic integration with political stability. This has helped Gulf regimes capitalize on their vast resource abundance, powering unprecedented prosperity over the past half century.

The Rise of Small Gulf States

The 2022 FIFA World Cup in Qatar is one of many markers of small Gulf states' economic ascendance. Almost two hundred Fortune 500 companies have regional headquarters in Dubai, making it the city with by far the largest corporate presence in the Middle East and Africa (Arabian Business 2017). Small Gulf states host two of the world's ten busiest airports (Airports Council International 2022), over fifty branches of international university campuses (Kinser and Lane 2022), and the only Louvre outside of France. Small Gulf states' developmental success extends beyond glitzy stadiums and college campuses. They lead the region in the United Nations Development Programs (UNDP) Human Development Index, an index that measures development in terms of educational, health and economic outcomes. All of the Gulf's small states obtained the index's "high levels of human development" in 2020 (United Nations Development Programs (UNDP) 2020, 369-370).

This is not to deny the developmental challenges confronting small Gulf states (Kabbani 2020). Their private sectors remain state-dependent (Hertog 2013). Female labour force participation is low. Migrant workers – who constitute the bulk of small Gulf states' labour force – toil under poorly regulated and precarious conditions (Human Rights Watch 2018). Nevertheless, over the past decade rulers of small Gulf states have weathered popular uprisings, low oil prices, a global pandemic and for Qatar, an economic blockade, to provide levels of public service and political stability that are the envy of the region. Resource wealth is clearly key to small Gulf states' economic success. Small Gulf states sit on fourteen percent of the world's oil and seventeen percent of the world's natural gas reserves (Fattouh and El-Katiri 2012, 10). Despite efforts to diversify, small Gulf states' economies remain largely tethered to their oil and gas industries (Kabbani and Ben Mimoune, 2021).

But resource wealth is only part of the story. Not all oil abundant small states are prosperous. Equatorial Guinea has the tenth highest oil production per capita in the world (BP Statistical Review of World Energy 2022). But three-quarters of its population live in poverty (World Bank 2022). Azerbaijan's oil rents (oil revenue minus oil production costs) as a percentage of GDP were more than twice as high as Bahrain's in 2020 (World Bank 2020), yet its citizens' average life expectancy was four years lower (World Bank 2022).

Larger states' protection also explains some of the small Gulf states' economic success. The United States sheltered small Gulf states from Saddam Hussein's Iraq and now Iran. Saudi Arabia's intervention stopped mass uprisings in Bahrain from potentially toppling the ruling Al Khalifa family. But foreign patrons are only part of the story as well. Foreign support, like oil, can be a curse. US protection and aid has not turned Egypt and Jordan into developmental states (Zimmermann 2017).

The Institutional Underpinnings of Small Gulf States' Prosperity

In his classic book *Small States in World Markets: Industrial Policy in Europe*, Peter Katzenstein argues that low populations and scarce territory make small European states highly dependent on international trade (Katzenstein 1985). Consumers in small states need imports because their state lacks the domestic labour force and diversity of resources to produce many goods locally. Meanwhile, small state producers need to export because their domestic market is too small for major expansion. This dependency on international trade render small European states' welfare highly vulnerable to fluctuations in the global economy. These vulnerabilities pushed leaders of small European states to open their markets and provide generous welfare programs. The twinning of economic integration and social protection "embedded" small European states into world economy (Ruggie 1982), allowing their economies to profit from open markets while mitigating the political and social costs of international competition.

Like their European peers, small Gulf states are highly dependent on international trade. This dependency predates the oil era. With little arable land and sparse populations, small Gulf states' economies have historically flourished and withered with the changing tides of the global economy. In the early 20th century, their economies boomed and quickly crashed with the rise and fall of pearl prices – their primary export (Carter 2019). Strong mercantile interests formed in these highly trade-dependent economies. And while the political and economic influence of the Gulf's merchant groups have waned in the oil era (Crystal 1995; Moore 2004), small Gulf states remain open to international trade and investment.

Indeed, small Gulf states boast the region's most open markets. They belong to the Arab world's only customs union. Two out of the US' four free trade agreements (FTAs) in the region are with small Gulf states. Small Gulf states are also all members of World Trade Organization (WTO), a non-negligible feat considering that more than a third of Arab League states are still outside of the world's largest international trading organization. Open markets have bolstered small Gulf states' economic development. International trade lowers prices, diversifies goods and promotes competition. International trade agreements attract foreign direct investment (FDI) (Buthe and Milner 2014) and incentivize adopting global standards. This pushes small Gulf states to protect property rights, enforce contracts and follow international regulations. Small Gulf states frequently led the region in the World Bank's Ease of Doing Business global rankings (World Bank 2019). Like small European states, small Gulf states also offer their citizens generous safety nets. This welfare is chiefly in the form of public sector employment. Small Gulf states have some of the highest rates of public sector employment of in the world, as measured as a share of the national labour force. Though fed by oil and gas revenues, this high rate of public sector employment stems from small Gulf states' small domestic population size. States with small populations have relatively larger public sectors (Randma-Liiv 2002; Spolaore and Alesina 2003, 172). This is because the minimum labour needed to police, protect and regulate a modern state occupies a relatively higher share of small states' national labour force.

Large public sectors helped embed small Gulf states into the global economy. This is because they minimize domestic opposition to international trade. Cheaper imports do not threaten the livelihoods of bureaucrats and soldiers. For this reason, states with larger public sectors tend to have more open economies, all else being equal (Nooruddin and Rudra 2014).

Furthermore, as in many European states, small Gulf states have exclusionary welfare regimes. Strict citizenship laws prevent immigrants from diluting small Gulf states' welfare provision. This produces "exclusionary openness" (Goodman and Pepinsky 2021): open trade and open labour migration. Small Gulf states have some of the highest rates of foreign labour in the world. Almost two-thirds of the residents of the Gulf's small states were born outside of the Gulf in 2010 (World Bank 2022). Migrants make up 88% of the UAE's population (International Organization for Migration 2019, 70). As a result, unlike many small states, small Gulf states do not suffer from labour shortages. Open labour migration policies coupled with strict citizenship and welfare policies powered Germany's post-war recovery. A similar pairing may propel small Gulf states' diversification from oil as Gulf leaders and business funnel high and low skilled foreign labour into new industries.

In addition to market openness, small Gulf states' large public sectors entrench political stability. Public sector employment has made the state the chief provider of welfare for a majority of Gulf citizens. This helped displace competing non-state distributors of patronage (Valeri 2009). Ruling regimes' monopolization of patronage reinforces their rule. All of the small Gulf states' ruling families have remained in power since independence, far outlasting their peers in the rest of the region. While foreign patrons and oil rents propped up their rule amidst Arab Spring protests (Yom and Gause 2014), the combined benefits of open markets and protected employment no doubt muffled calls for revolution to many Gulf citizens.

Small and Big Powers in the Middle East

What are the developmental and political ramifications of small Gulf states' economic ascendance for the rest of the region? For one, small Gulf states' economic rise has deepened large Arab states' dependence on their smaller neighbors for aid, investment and remittances (Kerr 1981). Foreign capital can strengthen authoritarian rule (Ahmed 2019). It remains to be seen whether large Arab states can use Gulf capital for productive purposes. Second, ruptures between small Gulf states will have greater aftershocks for the rest of the region. Oman and the UAE's territorial disputes in the 1950s and Qatar and Bahrain's island feuds in 1971 were barely noticed in Baghdad, Cairo, and Damascus. This was not the case in the 2017 Qatar blockade. Small Gulf states' rivalries have surfaced and exacerbated conflicts in Syria (Wehrey 2014) and Libya, and infiltrated Egyptian and Tunisian politics (Al-Anani 2022; Mezran and Henneberg 2022). Now more than ever large states in and outside of the region have strong incentives for regional organizations like the Gulf Cooperation Council (GCC) to foster Gulf harmony. Larger Arab states' prosperity will increasingly depend on their smaller Gulf neighbors. ◆

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