Public Finance and Tax Equity in the Arabian Gulf Monarchies

Timothy Mathews
Kennesaw State University, tmathew7@kennesaw.edu

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Public Finance and Tax Equity in the Arabian Gulf Monarchies

Timothy Mathews

Abstract

This study examines notions of public finance equity in the six Arabian Gulf monarchies of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Because of unique characteristics of government expenditures and revenues in these monarchies, many of the standard concepts of public finance (such as the Benefits Principle, Ability-to-Pay Principle, Vertical Equity, and Horizontal Equity) do not provide relevant insights. Consequently, four innovative notions of equity are reviewed and discussed: Within Group Horizontal Equity; Within Group Vertical Equity; Favored Group Horizontal Equity; and Favored Group Vertical Equity. Finally, these four conceptions of equity are applied to a discussion of potential future changes to the existing public financing systems within the countries in this region.

Introduction

This study focuses on notions of fairness (or equity) in regards to public finance with the six Arabian Gulf monarchies of the Gulf Cooperation Council (GCC) as the backdrop. Historically, each of these six countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—has operated with what some observers have classified as a “Ruling Bargain.” Under such an arrangement, Kamrava (2013) writes, “citizens surrender their political and social rights to participatory government, are expected to accept the legitimacy of the ruling regime . . . and in return are rewarded with a variety of goods and services . . . as well as socio-economic benefits” (p. 1). While all governments to some degree or another create “a ruling bargain” with their constituents, promising to provide rule of law and valuable social services, with monarchies the difference is that their legitimacy rests primarily on hereditary factors rather than democratic ones. Therefore, the author has chosen to use the term “agreement” rather than the more derogatory term “bargain” to emphasize that a similar process exists in other political systems while still

1 Dept. of Economics, Finance, and Quantitative Analysis, Coles College of Business, Kennesaw State University, 560 Parliament Garden Way, Kennesaw, GA 30144-5591; (470) 578-2072; tmmathews@gmail.com. I would like to thank Dan Paracka and four anonymous referees for making thoughtful suggestions which greatly improved this paper.
addressing the specific circumstances and substantive need to address concerns of public finance and tax equity in these countries.

A quintessential example of such a Ruling Agreement is the arrangement in place between the ruling Al Maktoum family (which has ruled Dubai continually since 1833) and the native Emiratis of Dubai. In exchange for conceding that the present ruler of the Al Maktoum family holds absolute authority, native Emiratis expect to be given a comfortable standard of living. Writes Krane (2009), “Emiratis get free land, cheap electricity, and free water. Health care is free. Food and gasoline are subsidized. Education is free, often including graduate degrees in Europe and America. When they marry, Emirati men are eligible for no-interest loans to build houses. The state gives them $19,000 toward their wedding costs…and there is no income or property tax” (p. 267). Foreigners (no matter how long they live in Dubai) are not eligible for these benefits. As is evident from this description, under this arrangement the government is providing benefits that are far more lavish than those provided in any western country with even the most generous welfare state.

Furthermore, not only do the benefits (i.e., expenditures, from the perspective of the government) within the public finance equation differ markedly from most other countries, the revenues (i.e., funding sources for the government) differ as well. For example, in the United States, 81.6% of federal government revenue comes from individual income taxes and individual payroll taxes. In stark contrast, none of the six GCC countries imposes an individual income tax on its citizens.

Because of these significant differences in the fundamental characteristics of the types and levels of government expenditures and the sources of government revenues, many of the standard tools of public finance do not provide relevant, meaningful insights. For example, when attempting to assess the equity (or fairness) of taxation, the concepts of the “Benefits Principle” and the “Ability-to-Pay Principle”—along with the consequent notions of “Vertical Equity” and “Horizontal Equity”—are widely accepted and applied by scholars and practitioners alike. However, for a government that has a Ruling Agreement where citizens and non-citizens are treated differently, these notions will not adequately capture the unique but essential features of social preferences underlying the society’s accepted normative notions of fairness. New yardsticks are needed.

The remainder of the paper is structured as follows. An overview of several of the important common characteristics of the GCC economies is provided in Section Two. The viability of the Ruling Agreements as currently structured is discussed within Section Three, wherein it is argued that because of the potential for citizens to demand increased political freedom in the future, coupled with declining oil reserves in the region, these agreements as presently structured are very likely to change. Section Four begins with a brief overview of accepted notions of public finance fairness/equity, followed by an identification of their shortcomings for assessing outcomes under the Ruling Agreements of the Gulf Monarchies. Subsequently, four new concepts of fairness/equity are defined and discussed within the context of a Ruling Agreement. Potential changes to the existing Ruling Agreements—and, more broadly, public finance and the political relation between rulers and citizens—in the region are discussed within Section Five. Section Six concludes.

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3 In 1988, Saudi Arabia reintroduced an income tax on foreign workers (see Almutairi, 2014, p. 770).
Overview of Common Characteristics of GCC Economies

As noted within the introduction, each of the six GCC monarchies has a Ruling Agreement of some form in place. Under such an arrangement the citizens of the country concede that the ruling family has legitimate power and in return are provided with an extensive array of social and economic benefits. As noted by Davidson (2013), the accepted view is that in these countries “political acquiescence” has essentially been “bought” with citizens being “satisfied as long as they benefited from a mode of production caught somewhere between feudalism and capitalism, in which traditional familial or tribal ties to a ruling family guaranteed access to wealth and economic opportunity” (p. 7). The rulers of the GCC monarchies base their legitimacy on three sources: tradition, religion, and oil revenues. Weiffen (2008) observes, “traditional authority is closely interwoven with the social and political influence of tribalism” with the monarchs portraying “themselves as the embodiment of tribal values and heritage” this traditional validity is coupled with “religious legitimation” (p. 2,588). In recent decades (as will be discussed in further detail below), this governing structure has been strengthened immensely by the realization of significant oil revenues.

Because of the high levels of income and wealth presently realized by each of these countries, the benefits provided to the “favored group” (i.e., the citizens who are eligible recipients) within each such agreement are able to be very generous by global standards. Present levels of GDP Per Capita on a Purchasing Power Parity basis are stated in Table 1 for these six countries, plus (for the sake of comparison) the United States and European Union. All six of these countries have a level of GDP Per Capita which exceeds that of the European Union as a whole; four of the six countries have a level of GDP Per Capita above that of the United States. Qatar actually has the highest GDP Per Capita of any country in the world, while Kuwait and the United Arab Emirates also rank in the top 10 (of the 188 countries for which a figure was available in 2012).

It is important to recognize that for government provided goods and services to truly be benefits as part of an agreement, their financing cannot fall upon their recipients. Thus, it is necessary for the government to have significant revenue sources distinct from the favored group who receive the benefits of the agreement. In recent decades, the GCC monarchies have relied upon the profits earned by state/ruling-family owned enterprises and resources, particularly crude oil production, for this purpose.

The socioeconomic/political paradigm that exists between the rulers and citizens, initially based upon tradition and religion, has now evolved to become a rentier state. As noted by Mitchell (2010), “The Gulf governments’ access to enormous wealth—without the need to depend on its citizens, through taxation, to obtain it—is the most distinctive aspect of the GCC economies, and carries huge political consequences” (p. 279).

Table 1: GDP Per Capita, Purchasing Power Parity (2012)

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4 The values are for 2012 (the most recent year for which data is available for all six countries) measured in “current international dollars,” which (as described on the preceding webpages) have “the same purchasing power over GDP as the U.S. dollar has in the United States.”
<table>
<thead>
<tr>
<th>Country/Region</th>
<th>GDP Per Capita, Purchasing Power Parity</th>
<th>Ordinal Rank (out of 188 countries)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qatar</td>
<td>$134,290</td>
<td>1st</td>
</tr>
<tr>
<td>Kuwait</td>
<td>$83,840</td>
<td>4th</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>$59,845</td>
<td>8th</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>$52,043</td>
<td>11th</td>
</tr>
<tr>
<td>Oman</td>
<td>$45,334</td>
<td>15th</td>
</tr>
<tr>
<td>Bahrain</td>
<td>$41,465</td>
<td>23rd</td>
</tr>
<tr>
<td>United States</td>
<td>$51,496</td>
<td>12th</td>
</tr>
<tr>
<td>European Union</td>
<td>$34,638</td>
<td>n/a</td>
</tr>
</tbody>
</table>


**Table 2: Crude Oil Production**

<table>
<thead>
<tr>
<th>Country</th>
<th>Barrels Per Day</th>
<th>% of Global Total</th>
<th>Ordinal Rank (out of 131 countries)</th>
<th>Barrels Per Day Per Square Mile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>11,730,000</td>
<td>13.17%</td>
<td>1st</td>
<td>14.13</td>
</tr>
<tr>
<td>United States</td>
<td>11,110,000</td>
<td>12.48%</td>
<td>2nd</td>
<td>2.92</td>
</tr>
<tr>
<td>Russia</td>
<td>10,440,000</td>
<td>11.73%</td>
<td>3rd</td>
<td>1.58</td>
</tr>
<tr>
<td>China</td>
<td>4,155,000</td>
<td>4.67%</td>
<td>4th</td>
<td>1.12</td>
</tr>
<tr>
<td>Canada</td>
<td>3,856,000</td>
<td>4.33%</td>
<td>5th</td>
<td>1.00</td>
</tr>
<tr>
<td>Iran</td>
<td>3,594,000</td>
<td>4.04%</td>
<td>6th</td>
<td>5.65</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>3,213,000</td>
<td>3.61%</td>
<td>7th</td>
<td>99.54</td>
</tr>
<tr>
<td>Iraq</td>
<td>2,987,000</td>
<td>3.35%</td>
<td>8th</td>
<td>17.65</td>
</tr>
<tr>
<td>Mexico</td>
<td>2,936,000</td>
<td>3.30%</td>
<td>9th</td>
<td>3.87</td>
</tr>
<tr>
<td>Kuwait</td>
<td>2,797,000</td>
<td>3.14%</td>
<td>10th</td>
<td>406.57</td>
</tr>
<tr>
<td>Qatar</td>
<td>1,579,000</td>
<td>1.77%</td>
<td>18th</td>
<td>352.98</td>
</tr>
<tr>
<td>Oman</td>
<td>923,800</td>
<td>1.04%</td>
<td>25th</td>
<td>7.73</td>
</tr>
<tr>
<td>Bahrain</td>
<td>49,160</td>
<td>0.06%</td>
<td>62nd</td>
<td>167.53</td>
</tr>
</tbody>
</table>


Moreover, Haimerl (2013) writes, “since the state receives external income in the form of oil rents and distributes it to society in the form of welfare benefits, it is relieved of having to impose taxation, meaning that it does not have to offer concessions to society such as a democratic bargain” (p.8). Admittedly, it is difficult (if not impossible) to assess the degree to which citizens in the GCC monarchies actually “consent” to such arrangements. However, in practice “the effectiveness [of such an arrangement] in a mainly economic sense” serves as the “basis for the functioning of [a] ‘contract’ between the rulers...
and the ruled” (Haimerl, 2013, p. 8). Thus, the foundation of the rentier state model employed by GCC monarchies in recent decades is crude oil.

Crude oil is a vitally important economic resource for all six of these countries. The significance of each country’s crude oil production for the global economy can be gauged by observing output per day. The number of barrels of crude oil produced per day is reported in Table 2 for each of the 10 leading oil producers in the world, plus the three GCC which are outside of the top 10.\(^5\) Saudi Arabia is the world’s leading producer of crude oil, accounting for 13.17% of total global production. The United Arab Emirates and Kuwait also rank in the top 10 countries globally, respectively accounting for 3.61% and 3.14% of global output. Bahrain is the only GCC country with crude oil production accounting for less than 1% of the global total.

While it could be easily argued that the crude oil output of Bahrain (and even Qatar and Oman) is not important to the global economy, the converse is not true—that is, crude oil production is critically important to the economy of Bahrain (and each of the other five GCC countries). This point is evident by observing levels of Oil Rents as a Percentage of GDP for each GCC country, as reported in Table 3.\(^6\) This value measures the percentage of each country’s economic output generated by crude oil production. Kuwait’s realized value of 53.8% was surpassed only by the Republic of the Congo (which realized a value of 71.0%, but with a much lower Per Capita GDP of only $5,733). Three of the six GCC countries (Kuwait, Saudi Arabia, and Oman) have values of Oil Rents as a Percentage of GDP above 37%, placing them in the top 10 of all countries worldwide. All six countries have realized values of 12.1% or higher and place in the top 25 globally. For comparison, Oil Rents as a Percentage of GDP are 3.1% for the world as a whole and are only 0.9% for the United States (which, as reported in Table 2, ranks second globally in crude oil production). Similarly, observing barrels of crude oil produced per day per square mile in each country (as reported in the last column of Table 2) also places production in a proper context relative to the size of each country. For the six GCC countries, this figure ranges from a low of 7.73 (Oman) to a high of 406.57 (Kuwait). Thus, all six of these countries are producing more oil per area of territory than other leading oil producers such as the Mexico (3.87), United States (2.92), Russia (1.58), China (1.12), and Canada (1.00). Clearly, crude oil production is vitally important to the economy of each GCC country.

\(^5\) In the former list there are 131 countries with a positive level of crude oil production.

\(^6\) As stated on these pages, “Oil rents are the difference between the value of crude oil production at world prices and total costs of production.” In 2012, there were 134 countries for which the reported value of this figure was positive.
Table 3: Oil Rents as a Percentage of GDP (2012)

<table>
<thead>
<tr>
<th>Country/Region</th>
<th>Oil Rents as Percentage of GDP</th>
<th>Ordinal Rank (out of 134 countries)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kuwait</td>
<td>53.8%</td>
<td>2nd</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>45.8%</td>
<td>5th</td>
</tr>
<tr>
<td>Oman</td>
<td>37.2%</td>
<td>9th</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>21.9%</td>
<td>16th</td>
</tr>
<tr>
<td>Bahrain</td>
<td>19.4%</td>
<td>18th</td>
</tr>
<tr>
<td>Qatar</td>
<td>12.1%</td>
<td>24th</td>
</tr>
<tr>
<td>United States</td>
<td>0.9%</td>
<td>55th</td>
</tr>
<tr>
<td>World</td>
<td>3.1%</td>
<td>n/a</td>
</tr>
</tbody>
</table>


In all of these countries the leading (and in some cases only) oil producing firms are government owned enterprises (either directly, or indirectly through a sovereign wealth fund), namely: Bahrain Petroleum Company, Kuwait Petroleum Company, Petroleum Development Oman, Qatar Petroleum, Saudi Aramco, and Emirates National Oil Company. In several of these countries, profits of oil companies are subject to high rates of taxation well above tax rates imposed in other sectors (e.g., tax rates of 46% in Bahrain, 55% in Oman, and 35% in Qatar). Consequently, the bulk of the profits from this sector ultimately flow back to the government in each country, providing a significant amount of funds to bankroll the Ruling Agreement.

Harrison (2010) provides a detailed historical overview of implemented and proposed taxes in the Arabian Gulf region. By global standards, these countries have overall levels of taxation which are low. None of the six countries imposes an income tax on citizens. Corporate income taxes are also low or non-existent, with the exception (as noted above) of taxes on oil and gas companies.

7 As described by Bremmer (2010), “sovereign wealth funds . . . are state managed pools of excess cash that can be invested strategically. Governments can use the profits they generate for political purposes” (p. 69). As of March 2009, the two most valuable sovereign wealth funds in the world were the Abu Dhabi Investment Authority, with a value as high as $650 billion, and the Saudi Arabian Monetary Agency, with a value as high as $500 billion. At this time, Kuwait and Qatar also had sovereign wealth funds with values in excess of $65 billion. See Bremmer 2010, p. 76.

8 Various country reports available on “The Heritage Foundation” website—such as http://www.heritage.org/index/country/bahrain for Bahrain—provide concise summaries of public finance, including sources of government revenues, for each country in the region.

9 Ibid.

Finally, it is important to stress that the Ruling Agreement exists between the monarch in power and the citizens of the country, not the residents of the country (and in these countries it is virtually impossible for a non-citizen to become a naturalized citizen). Furthermore, due to labor migration into the region, all six of the GCC countries have resident populations which consist of large portions of non-citizens. Table 4 summarizes the breakdown of the resident population between citizens and non-citizens in each country.\(^\text{11}\) The resident population of Qatar consists of only 14.30% citizens. The United Arab Emirates and Kuwait also have citizen populations below one-third of their total population. In contrast, the population of Saudi Arabia is comprised of 67.58% citizens and therefore 32.42% non-citizens, but even this is a relatively high concentration of non-citizens. For perspective, only 7.30% of the resident population of the United States is non-citizens.\(^\text{12}\) All of the countries in this region have relatively large non-citizen populations.

In multiple respects, as currently structured these societies depend heavily upon voluntary participation by non-citizens. Laborers from low income countries such as India and Pakistan are willing to migrate to the region for work because the wages paid (while very low by First World standards) are well in excess of what could be earned at home. At the other end of the spectrum (in regards to levels of human capital), educated professionals from high income countries are attracted to the region to provide financial, healthcare, educational, and engineering services in part because of low taxes and extensive government services (e.g., infrastructure), which are part of the current ruling agreement. As will be noted within the discussion in Section 5, any alterations to the existing ruling agreements should consider these demographic realities.

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\(^{11}\) For each country, populations are stated for the most recent date available between 2010 and 2013.  
The Fragile State of the Ruling Agreements in the GCC Monarchies

The future of the Ruling Agreements in these six countries is uncertain for two primary reasons. First, as citizens around the world demand a greater political voice, an absolute monarch would have to either increase political participation in decision making and/or ensure the maintenance of, if not increases in, the benefits provided to the citizenry. Second, the natural resources which have been used to fund each agreement will not last indefinitely. Each of these changes will make the future financing of such a Ruling Agreement difficult. Consequently, for each Ruling Agreement, at the very least the fundamental characteristics will have to be altered or, more dramatically, the agreement will either collapse or have to be abandoned. Indeed, Davidson (2013) argues that “most of these regimes—at least in their present form—will be gone within the next two to five years” (p. ix).

In recent decades there has been a global shift toward increased political rights and civil liberties. In 2014 there were 125 electoral democracies in the world, up from only 69 in 1989 (Puddington, 2015, p. 6). Similarly, between 1984 and 2014, the percentage of countries categorized as “free” increased from 32% up to 46%, while the percentage of countries categorized as “not free” declined from 33% down to 26% (Puddington, 2015, p. 8). While the long-term trend has been toward greater freedom, during the most recent decade levels of freedom globally have actually remained constant or slightly declined—”one notable exception was Tunisia, which (following the Arab Spring) became the first Arab country to achieve the status of Free since Lebanon . . . 40 years ago” (Puddington, 2015, p. 1).

This increased freedom has not yet spread to the GCC monarchies. Freedom House’s “Freedom in the World 2015” ranking (as partially summarized in Table 5) measures both Political Rights and Civil Liberties. Each of the 195 countries included in this study is first assigned a score in seven different sub-dimensions of political rights and liberties. From these scores an overall rating—ranging between 1 (most free) and 7 (least free)—is determined in the two separate broad dimensions of Political Rights and Civil Liberties. Finally, based upon an average of these two values, each country is categorized as “free,” “partly free,” or “not free” (Puddington, 2015, p. 2).

Table 5 provides a summary of the results of the Freedom House study for each of the GCC Monarchies (plus the United States, as a point of reference). With respect to Political Rights: Bahrain and Saudi Arabia were assigned scores of 7 (least free); Oman, Qatar, and the United Arab Emirates were assigned scores of 6; and Kuwait was assigned a score of 5. As for Civil Liberties: Saudi Arabia was assigned a score of 7 (least free); Bahrain and the United Arab Emirates were assigned scores of 6; and Kuwait, Oman, and Qatar were assigned scores of 5. Consequently, of the six GCC monarchies, only Kuwait was ultimately classified as “partly free,” while all five other countries were assessed to be “not free” (Puddington, 2015, pp. 21-26).

The Overall Political Rights Rating is determined by scores on the sub-categories of “Electoral Process,” “Political Pluralism and Participation,” and “Functioning of Government.” For these sub-categories a higher value reveals greater rights, with

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13 Table 5 was compiled from various reports accessible at https://freedomhouse.org/report/freedom-world/freedom-world-2015#.VdHx-_lViWa
maximum possible values of 12, 16, and 12 in these three dimensions respectively. Similarly, the Overall Civil Liberties Rating is determined by scores on the sub-categories of “Freedom of Expression and Belief,” “Association and Organizational Rights,” “Rule of Law,” and “Personal Autonomy and Individual Rights.” Again, for these sub-categories a higher value reveals greater rights, with maximum possible values of 16, 12, 16, and 16 in these four dimensions respectively. Examining the assigned scores in these sub-categories provides valuable insights on the similarities and differences in rights and liberties in these countries.

In the “Electoral Process” sub-category the GCC monarchies were assigned scores ranging between 0 and 2 on the 12-point scale (in contrast, the assigned score for the United States was 11). Freedom House, looking at Qatar as an example, notes, “The head of state is the emir, whose family holds a monopoly on political power . . . The constitution stipulates that 30 of the 45 seats of the parliament, the Advisory Council . . . be filled through elections . . . However, elections for the Advisory Council have yet to take place, so all members are currently appointed.”

Table 5: Political Rights and Civil Liberties in the GCC Monarchies

<table>
<thead>
<tr>
<th>Country</th>
<th>Overall Political Rights Rating</th>
<th>Overall Civil Liberties Rating</th>
<th>Summary Status</th>
<th>Electoral Process</th>
<th>Political Pluralism and Participation</th>
<th>Functioning of Government</th>
<th>Freedom of Expression and Belief</th>
<th>Association and Organizational Rights</th>
<th>Rule of Law</th>
<th>Personal Autonomy and Individual Rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>7</td>
<td>6</td>
<td>Not Free</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Kuwait</td>
<td>5</td>
<td>5</td>
<td>Partly Free</td>
<td>2</td>
<td>7</td>
<td>5</td>
<td>6</td>
<td>4</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Oman</td>
<td>6</td>
<td>5</td>
<td>Not Free</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>5</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Qatar</td>
<td>6</td>
<td>5</td>
<td>Not Free</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>8</td>
<td>2</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>7</td>
<td>7</td>
<td>Not Free</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>3</td>
<td>0</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>6</td>
<td>6</td>
<td>Not Free</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>United States</td>
<td>1</td>
<td>1</td>
<td>Free</td>
<td>11</td>
<td>16</td>
<td>10</td>
<td>15</td>
<td>11</td>
<td>14</td>
<td>15</td>
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<tr>
<td>Maximum</td>
<td>12</td>
<td>16</td>
<td>12</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>15</td>
<td>16</td>
</tr>
</tbody>
</table>

There is slightly greater variation across the GCC states in regards to Political Pluralism and Participation. Saudi Arabia is assigned a score of 0 (out of 16), while Kuwait was assigned a score of 7. According to Freedom House, in Saudi Arabia, “Political parties are forbidden . . . Political dissent is criminalized.”

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14 See https://freedomhouse.org/report/freedom-world/2015/qatar#.VdIB7vlViWY
15 See https://freedomhouse.org/report/freedom-world/2015/saudi-arabia#.VdIETfIViWY
degree of Political Pluralism and Participation is Kuwait, where “parliament has substantial legislative powers and more influence still in setting the public agenda” (Herb, 2002, p. 41). However, even in Kuwait, “Formal political parties are banned . . . The royal family frequently interferes in the political process, including through the harassment of political and media figures.”

Moving on to a couple of the sub-categories for Civil Liberties, there is a good amount of variation across the GCC countries with respect to both “Freedom of Expression and Belief” and “Rule of Law.” In regards to “Freedom of Expression and Belief,” the assigned scores range from a low of 2 in Bahrain to a high of 8 in Qatar (on a 16-point scale). In Bahrain, “The government owns all broadcast media outlets” and the state has the power to “imprison journalists for criticizing the king or Islam or for threatening national security.” Even in Qatar, “both print and broadcast media are influenced by leading families” and journalists “practice a high degree of self-censorship and face possible jail sentences for slander.” As for “Rule of Law,” the assigned scores range from a low of 1 in Bahrain to a high of 7 in Kuwait (again on a 16-point scale). Again, according to Freedom House, in Bahrain, the “king appoints all judges” and the “judicial system is seen as corrupt and biased in favor of the ruling family and its backers.” Even in Kuwait, “authorities may detain suspects for four days without charge” and detainees “have been subjected to torture.”

In summary, while the results of the Freedom House’s “Freedom in the World 2015” study reveal differences across the six GCC monarchies with respect to sub-dimensions of Political Rights and Civil Liberties, the similarities which emerge are equally apparent. Five of these six countries (with Kuwait being the one exception) are broadly categorizes as “not free” (a designation given to only 26% of countries globally).

The Arab Spring, which spread to this region in 2011, revealed the delicate nature of these Ruling Agreements. While the experience of each country was unique, in broad terms the Arabian Gulf monarchies were able to suppress any protests by a combination of sticks and carrots. As observed by Lucas (2014): “Economic stimulus packages were used to quell the initial wave of protests in all of the Gulf monarchies . . . political concessions have also been granted that provide for a limited degree of political liberalization . . . [but there has also been an] increased use of repression . . . Censorship, imprisonment, and even torture have become more commonplace in the GCC during the Arab spring” (p. 314). For example, in early 2011 rulers in Saudi Arabia announced that they would spend an additional $130 billion over the coming years to provide increased government housing, unemployment benefits, one-time bonuses (equal to two months’ salary) to government workers, a higher minimum wage for government workers, and the creation of over 60,000 additional public sector jobs (Gause, 2011, p. 6). In the majority of these countries it was possible to have the Ruling Agreement evolve in the short term (by offering more generous

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16 See https://freedomhouse.org/report/freedom-world/2015/kuwait#.VdlEu_lViWY
17 See https://freedomhouse.org/report/freedom-world/2015/bahrain#.VdlIGU_lViWY
18 See https://freedomhouse.org/report/freedom-world/2015/qatar#.VdlGvP1lViWY
19 See https://freedomhouse.org/report/freedom-world/2015/bahrain#.VdlIGU_lViWY
20 See https://freedomhouse.org/report/freedom-world/2015/kuwait#.VdlEu_lViWY
21 Bahrain is the only GCC country in which popular protests to bring down the current monarchy have persisted.
subsidies and social welfare programs) in order to stave off serious protests precisely because of the sizeable endowments of natural resources such as oil and gas. But, if pressures mount for greater political freedoms in the long term future, the citizenry could also demand even higher levels of economic and social benefits within a Ruling Agreement, a scenario that could quickly become prohibitively expensive for these countries.

Furthermore, crude oil deposits will not last indefinitely. For example, in Dubai “oil production has been in decline since hitting a peak of 400,000 barrels per day in 1990 and now could be less than 200,000 barrels per day . . . This is a rate that will exhaust proven reserves in about 20 years” (O’Sullivan, 2008, pp. 288-289). As this revenue source dries up it can no longer serve as the primary source of financing a Ruling Agreement, especially one in which higher levels of benefits are expected. As noted by Gause (2011): “By 2030, the break-even price of oil for the Saudis to meet their obligations will be over $300 per barrel” (p. 12). The price of crude oil is not presently and has never been close to this level. The price of a barrel of crude oil peaked at just over $145 in July, 2008. As recently as July 2014 the price per barrel still stood at just over $100, but by early March, 2015 the price plummeted to under $45 per barrel.22 This current price is well below the level necessary to fund the existing Ruling Agreements: “. . . now that oil . . . has dropped to below $50 a barrel, budgets crafted in the days of $100-plus barrels no longer add up” (“Filling a hole,” 2015).

Because of the potential for citizens to demand greater political freedom in the future, coupled with declining oil reserves in the region, the Ruling Agreements as presently structured do not appear sustainable in the long term. Consequently, if a Ruling Agreement is going to continue into the future, one of two things (or a combination of the two) must be altered: (1) the revenue sources for financing the benefits that constitute the agreement and/or (2) the level/scope of benefits that constitute the agreement.23 To the latter point, changes in the level/scope of benefits in either direction have advantages and disadvantages in terms of making the agreement more sustainable. Increases in the level/scope of benefits make the agreement itself more appealing to the citizenry, thereby making the agreement more sustainable politically. Decreases in the level/scope of benefits make financing the agreement easier, thereby making the agreement more sustainable and fiscally sound. Thus, adjusting the level/scope of benefits is a delicate balance.

**Notions of Public Finance Equity in the Face of a Ruling-Agreement**

When assessing the fairness or equity of public finance policy, the two most widely applied principles are the “Benefits Principle” and the “Ability-to-Pay Principle.”24 The Benefits Principle specifies that the amount a person pays in taxes should be positively related to

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23 Specific policy recommendations are discussed in Section 5. These include: the imposition of new taxes, user fees for government services, privatization of government owned resources, diversification of the economy (e.g., into sectors such as finance and tourism), and changes in the benefits of the ruling agreements themselves.
24 A detailed overview of the established and accepted standard principles of taxation, including the concepts discussed here, is provided by Hyman (2013) within Chapter 10 (titled “Introduction to Government Finance”).
the benefits received from the government goods/services funded by the taxes. For example, suppose a municipality is going to construct a new opera house. If Adam enjoys going to the opera (and will likely attend several events per year) but Brenda does not (and will likely never use the facility), in many respects it would seem fair if Brenda did not have to make any financial contribution toward the construction of the facility. This position is based upon an application of the Benefits Principle.

While the Benefits Principle often appears to have substantial merit, in some contexts it does not make any sense whatsoever. For example, consider a government program designed to provide free (or subsidized) food to low income households. If Cathy is the head of a low income household that is eligible to receive assistance, she is a recipient of the benefits of the program. But since the whole point of the program is to provide her household with easier access to food, it would be contradictory to the objectives of the program to insist that households such as Cathy’s should be the ones who need to pay the taxes to fund the program.

In a similar vein, for a society that has chosen to implement a Ruling Agreement, the Benefits Principle does not have broad applicability. For government goods/services to truly be benefits for members of the favored group as part of a Ruling Agreement, their financing cannot fall upon the members of the favored group. Rather, the government must have a significant source of revenue separate from the favored group which can fund the benefits of the Agreement, such as income from resources owned by the government (e.g., oil reserves or vast holdings in a sovereign wealth fund) or taxes and fees imposed on members of the “un-favored” group (i.e., people who are not members of the favored group, such as non-citizen residents).

The Ability-to-Pay Principle states that the amount a person pays in taxes should be related to the ease with which the person can bear the burden of paying taxes. In practice, application of this principle often relies upon two more precisely defined notions of fairness—Horizontal Equity and Vertical Equity—each of which makes observations on the relation between economic capacity and tax burden between pairs of different taxpayers. Horizontal Equity states that two individuals of equal economic capacity should have equal tax burdens; Vertical Equity states that individuals of greater economic capacity should not have smaller tax burdens. Both of these well-established notions of fairness derive from principles of justice espoused by Aristotle (1975)—in order for outcomes to be equitable, equals should be treated equally while un-equals should be treated unequally.

In many ways, both of these notions of equity seem palatable and acceptable—the difficulty comes in specifying precisely what is meant by “economic capacity” and “tax burden.” A common approach is to measure economic capacity by income and to measure tax burden by percentage of income paid in taxes. Vertical Equity would then require that an individual with higher income should pay a greater percentage of his income in taxes. For example, suppose David earns $50,000 and Emma earns $100,000. If David has to pay 25

25 If instead tax burden were measured by dollars paid in taxes, then in order for a tax to satisfy the principle of Vertical Equity an individual with higher income would merely have to pay a greater amount of taxes (but not necessarily a greater percentage of income in taxes). In order to simplify the present discussion, it will be assumed throughout that economic capacity is measured by income and tax burden is measured by percentage of income paid in taxes (but recognize that all concepts and discussions could be easily modified to instead allow for tax burden to be measured by dollars paid in taxes).
$5,000 of taxes (10% of his income), the principle of Vertical Equity would be violated if Emma paid anything less than $10,000 of taxes (10% of her income).

A final principle of tax equity which is worth noting is the concept of “no taxation without representation” (hereafter, the taxation-representation principle), which dates at least as far back as 18th century Ireland (McCullough, 2001, p. 61). This idea—with a history in political thought, as opposed to public finance or economics—advocates that people who are taxed should have a voice (at least collectively) in formulating policy. The Ruling Agreements in the GCC monarchies, which entail citizens relinquishing the bulk of their rights to political participation, are clearly at odds with this principle.

Switching attention to public finance fairness/equity in the face of a Ruling Agreement, if a significantly large segment of a society’s population is non-citizens (which is the case for all of the GCC countries; see Table 4) and if social norms dictate that it might be appropriate to have government economic/social policies treat citizens and non-citizens differently (which, due to cultural history, is also the case for the GCC countries), then the standard normative notions of equity developed and applied within public finance are inadequate. Unique principles and notions of equity are needed for a normative assessment of policy outcomes in line with the underlying values and priorities of a society that has chosen to implement a Ruling Agreement.

Continuing with the previous example, again consider David who earns $50,000 and Emma who earns $100,000. Further suppose that these two individuals live in a society with a Ruling Agreement for its citizens, and suppose that Emma is a citizen while David is not. If David has to pay $5,000 of taxes (10% of his income), while Emma pays only $2,000 of taxes (2% of her income), the standard notion of Vertical Equity would be violated. But, from the perspective of this society (given its norms and notions of fairness), this burden of financing government might very well be completely fair and equitable.

With such issues in mind, four innovative concepts of equity are explicitly defined and discussed: (i) “Within Group Horizontal Equity”; (ii) “Within Group Vertical Equity”; (iii) “Favored Group Horizontal Equity”; and (iv) “Favored Group Vertical Equity.” The primary purpose of defining these four concepts is to begin to formalize how a society might feel that it is fair to treat one set of people differently than another with respect to taxation outcomes (something which has not been done by previous researchers). This is admittedly a difficult task—as observed by Moulin (2003), “Unequal treatment of unequals . . . is a vague principle open to many interpretations” (p. 1).

It should be noted that previous studies have observed differences in realized taxation outcomes across different segments of society. For example, Ghazanfar (1978) reveals that different age groups of taxpayers ultimately pay significantly different tax rates from state sales taxes in the United States (across all different income levels). Kakwani and Lambert (1999) analytically show that when different socioeconomic groups face different tax schedules, total social welfare is decreased. However, previous researchers essentially

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27 Recognize that such considerations are not contradictory to, but are rather extensions of, the established notion of Horizontal Equity. As noted within the AICPA’s (2007) report titled “Guiding Principles for Tax Equity and Fairness” (when discussing Aristotle’s notions of fairness): “The differential treatment of un-equals is not to be arbitrary, but is to be based on some relevant factor(s)” (p. 2).
assume that such differences across different segments of society are inherently unfair. In contrast, the present study aims to offer an explanation for why realized differences across different segments of society might be perfectly acceptable (even desirable), given the normative values of a society. Ultimately, the four original concepts developed in the present study can be used to assess public finance outcomes in the presence of a Ruling Agreement (as in the case of the Arabian Gulf monarchies) or, for that matter, in any society in which norms and values dictate that one category of people should be treated differently than another in regards to government finance or government benefits.

First, consider the following refinements of the two accepted notions of Horizontal Equity and Vertical Equity:

**Within Group Horizontal Equity**
In a society with different groups of residents, any two individuals within the same group who have equal economic capacity should have equal tax burdens.

**Within Group Vertical Equity**
In a society with different groups of residents, for any two individuals within the same group an individual with greater economic capacity should not have a smaller tax burden.

Returning to the previous example with David (a non-citizen) who earns $50,000 and pays 10% of his income in taxes and Emma (a citizen) who earns $100,000 and pays 2% of her income in taxes, this pair of outcomes does not violate the concept of Within Group Vertical Equity, since the two taxpayers are not within the same group. Now introduce two additional taxpayers into our example: Fred is a non-citizen who earns $100,000 and Greta is a citizen who earns $50,000. The concept of Within Group Vertical Equity is satisfied so long as Fred pays at least $10,000 (i.e., at least 10% of his income) in taxes and so long as Greta pays no more than $1,000 (i.e., no more than 2% of her income) in taxes. Suppose that Fred pays $15,000 (i.e., 15% of his income) in taxes. This outcome does not give rise to a violation of either Within Group Horizontal Equity or Within Group Vertical Equity. It does however violate the standard notion of Horizontal Equity when comparing the taxation outcomes between Emma and Fred: both individuals earn $100,000 of income, but Fred pays more ($15,000 or 15%) in taxes than Emma ($2,000 or 2%). This again illustrates the potential shortcomings of the standard notions of public finance equity when assessing outcomes in a country in which culture, history, and norms dictate that different categories of residents should be treated differently in regards to government policies (e.g., in an Arabian Gulf monarchy with a Ruling Agreement).

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28 Within the AICPA’s (2007) “Guiding Principles for Tax Equity and Fairness” report a concept of “Inter-Group Equity and Fairness” is stated as follows: “No group of taxpayers is favored to the detriment of another without good cause” (p. 3). This is the closest previous statement of a formal principle similar to those developed here. However, the AICPA’s discussion of this principle subsequently focuses on realized differences across different segments of society implicitly assuming that they reveal inequities, without addressing instances in which a society might feel that there is in fact “good cause” to favor one segment of society over another.

29 In the interest of brevity, examples are not provided to illustrate the more basic—and less applicable—concept of Within Class Horizontal Equity.
By definition (and as suggested by the chosen names), the concepts of Within Group Horizontal Equity and Within Group Vertical Equity do not allow for any comparisons across different groups of residents. In order to make such comparisons, consider the following two additional notions of equity:

**Favored Group Horizontal Equity**
In a society with different groups of residents, consider two individuals from different groups who have equal economic capacity; the individual from the favored group should have a lower tax burden.

**Favored Group Vertical Equity**
In a society with different groups of residents, consider two individuals from different groups such that the individual from the favored group has lower economic capacity than the individual from the un-favored group; the individual from the favored group should have a lower tax burden.

Again returning to the previous example, focus on Emma (a citizen) who earns $100,000 and pays 2% of her income in taxes and Fred (a non-citizen) who earns $100,000 and pays 15% of his income in taxes. The pair of outcomes would violate the standard notion of Horizontal Equity, but satisfies the newly defined concept of Favored Group Horizontal Equity (again illustrating how the standard notions of equity are not ideal for assessing outcomes in a society that has chosen to adopt a Ruling Agreement).

To illustrate the concept of Favored Group Vertical Equity, again consider Fred (a non-citizen) who earns $100,000 and pays $15,000 (15% of his income) in taxes and Greta (a citizen) who earns $50,000. The concept of Favored Group Vertical Equity is violated if Greta pays more than $7,500 (i.e., more than 15% of her income) in taxes. Thus, for this example, if Favored Group Vertical Equity is violated then Within Group Vertical Equity is also violated (between Greta and Emma, since as noted above Within Group Vertical Equity required that Greta pays no more than $1,000 in taxes).³⁰

As illustrated by the preceding examples, for a society with culture, history, and norms for which it is deemed appropriate to treat different categories of residents differently, the standard, simple notions of Horizontal Equity and Vertical Equity may identify outcomes as inequitable which the society deems to be fair. Similarly, in order for outcomes to adhere to the standard notions of Horizontal Equity and Vertical Equity, they may very well have to violate society’s notions of fairness. In contrast, the four newly defined concepts of equity allow for more appropriate normative assessments of public finance outcomes for a society with a Ruling Agreement.

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³⁰ Recognize the relation between Favored Group Vertical Equity and the three other newly developed notions of equity. So long as there are sufficiently many people in society (within each group and with different levels of income), then any violation of Favored Group Vertical Equity would also likely require some violation of Within Group Horizontal Equity, Within Group Vertical Equity, and/or Favored Group Horizontal Equity as well.
Moving Forward

As argued within Section 3, because of the declining oil reserves in the region, along with the likelihood for citizens to demand greater political freedom in the future, the Ruling Agreements as presently structured within each Arabian Gulf country will likely have to be altered in the long-term. As noted by Davidson (2013), up to this point in time the GCC monarchs have enjoyed substantial support and legitimacy from their populations, due to a combination of tribal loyalties coupled with the provision of political stability, religious values, and high standards of living. But, as natural resource reserves are depleted, it will become impossible (under current economic arrangements) for these states to continue to provide substantial income and wealth under the existing rentier state model. Changes to the existing Ruling Agreements are inevitable.

In broadest terms, the Ruling Agreements can be altered by changing: (1) the revenue sources for financing the benefits that constitute the agreement and/or (2) the level/scope of benefits that constitute the agreement. When adjusting the terms of the Ruling Agreement, policymakers should consider the newly developed concepts of Within Group Horizontal Equity, Within Group Vertical Equity, Favored Group Horizontal Equity, and Favored Group Vertical Equity to identify any resulting outcomes which contradict the normative values and objectives that the society wishes to preserve. This section provides an overview of five different types of policies which could prolong the sustainability of the Ruling Agreements in this region, noting how the new developed notions of equity are applicable. These five categories of policies are: (i) new taxes; (ii) user fees; (iii) privatization; (iv) diversification of the economy; and (v) fundamental changes to the Ruling Agreement.

Recall (see Table 4) that in most of these countries the majority of the resident population consists of non-citizens. Consequently, when considering any proposed changes to the ruling agreements, it is important to recognize how alterations to policy would impact voluntary labor migration (noting that the impact could be different for high-skilled workers than for low-skilled laborers).

New Taxes

As noted within the Introduction, none of the six GCC countries impose an income tax on citizens. Corporate income taxes (with the exception of taxes within the oil/gas sectors) are also low or non-existent. Introducing taxes of this nature could provide new revenue sources for the government (to partially fund benefits of a Ruling Agreement) while still allowing the countries to remain globally competitive when trying to attract businesses and workers (since any such taxes could be set well below the levels in other countries).

Such recommendations have been put forth in the past. In the early to mid-1990s, representatives of the GCC states examined the possibility of imposing Value Added Taxes or corporate taxes.31 and “in 2001, an IMF report argued that GCC states could no longer rely on oil sales and recommended them to cut spending and implement income tax, corporate tax, consumption tax, and value added tax” (Almutairi, 2014, p. 770). Any future taxes that are implemented could be designed by policymakers with an eye toward the four

31 As noted by Almutairi (2014, p. 770), a corporate tax was introduced in Oman in 1994.
notions of equity developed in the preceding section. So long as such new taxes are not disproportionately imposed on citizens (i.e., as long as they do not favor non-citizens), then the new notions of tax equity could easily be satisfied.

For a specific example, consider the recent proposal in Oman to impose a 2% tax on remittances by expatriate workers within the country. Since non-citizens account for 43.66% of the resident population of Oman (see Table 4), even in Oman (recall, this figure is actually low relative to most other GCC countries) a tax of this nature with such a relatively low marginal rate could provide a significant amount of revenue—such remittances totaled 3.502 billion Omani Rials ($9.1 billion USD) in 2013.\textsuperscript{32} Imposing this tax on non-citizen foreign workers would clearly not create any violation of either concept of Favored Group Equity. Further, such a proportional tax on non-citizens would satisfy the notions of Within Group Horizontal Equity and Within Group Vertical Equity for the non-citizens.\textsuperscript{33}

However, when considering such a policy it is important to recognize that it will make emigrating for work less appealing to laborers (which may be part of the intention)—this is counter to the aim of generating revenue. But, even after accounting for changes in behavior to avoid paying such a tax, it is estimated that that this proposed measure would generate annual revenue of 60 million Omani Rials ($155.84 million USD).\textsuperscript{34}

Any new taxes on citizens would most certainly be less appealing, since they would run directly counter to and essentially undermine the implicit norms of the Ruling Agreement. If a person is paying to finance a benefit, then it cannot be viewed as compensation in exchange for relinquishing the right to have input on setting policy. As noted by Harrison (2010), “Direct taxation such as personal income tax seems less likely in the short-term because income tax payers would become a party to the taxation-representation argument, whereby their own incomes contribute to state funds and thus they have a stake in its policy-making” (p. 16).

As previously discussed, the taxation-representation principle advocates that people who are taxed should have a voice in formulating policy. Ross (2004) notes that previous scholars have conjectured that when increasing taxes becomes necessary, authoritarian governments are forced to become more democratic. He empirically tests two hypotheses related to this conjecture and finds that: (i) there is no correlation between an increase in taxes relative to income and a subsequent shift to greater democratization, but (ii) there is a positive correlation between an increase in taxes relative to government services and a subsequent shift to greater democratization. To this latter point, Ross finds evidence that regimes tend to become more democratic after either raising taxes (with the level of government services fixed) or cutting services (with the level of taxes fixed). He summarizes this finding by noting that, “When the price of government services goes up, authoritarian regimes tend to become—or, perhaps, are forced to become—more accountable to their citizens” (Ross, 2004, p. 247). More recently, Martin (2014) finds experimental evidence to support a claim that increases in taxes lead to increased demands by citizens for government accountability.

\textsuperscript{32} See Rejimon (2014).
\textsuperscript{33} Recognize that such a tax would violate the standard notions of equity if fairness was assessed collectively over non-citizens and citizens, illustrating the previous noted shortcomings of these concepts in this context.
\textsuperscript{34} See Rejimon (2014).
**User Fees**

Another potential way for governments to raise revenues to fund the Ruling Agreements in their present forms is through the imposition of “user fees” for some government goods/services. In July 2007 Dubai introduced road tolls at several key points on thoroughfares such as Sheikh Zayed Road. In many societies the imposition of such user fees is often justified by the Benefits Principle.

Within the context of a Ruling Agreement, such user fees could be designed in a way so as to require lower payments from the favored group of residents. For example, automobiles registered to citizens for private, personal use could be exempt from a certain number of tolls per month or assessed tolls at a lower rate. Such a rate structure would essentially preserve the spirit of the Ruling Agreement, thereby not violating the notions of Favored Group Equity.

Any increased reliance on user fees will place additional burdens on non-citizens. Thus, it is important to recognize that such policies would diminish (on the margin) the desirability for workers to emigrate to these countries for employment.

**Privatization**

Privatization refers to the transfer of ownership of a government enterprise/resource to the private sector. This took place on a large scale in Great Britain in the 1980s and the former Soviet Union in the 1990s. As long as the government does not simply “give away” the enterprises/resources which it initially owns, then privatization will raise some revenue for the government. This one-time revenue can ease fiscal burdens in the short term, allowing a country with a Ruling Agreement to more easily maintain current levels of benefits (again, at least in the short term). Privatization has already begun in Oman, where the sale of a minority stake in Omantel (a state-owned telecommunications firm) raised $570 million for the government in 2014. The government of Oman—which still owns over 60 enterprises across multiple sectors of the economy—plans to gradually continue such privatization in the coming years, with the Electrical Holding Company slated for sale in the near future. Because of their tremendous value, government owned oil and natural gas resources/enterprises could provide a significant source of revenue if privatized. Since privatization would not impose any new fiscal burdens on citizens, there would be no violations of the newly developed notions of public finance equity from such a policy.

**Diversification of the Economy**

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35 See http://www.salik.gov.ae/en/home. The reaction to the road tolls has been mixed. See Young (2013), as some residents place more weight on the benefits of decreased congestion, while others focus on the expense and administrative difficulties. Nonetheless, there is presently a push by some groups in Oman for the imposition of similar tolls. See Al Shaibany (2015).

36 Yergin and Stanislaw (1998) discuss the historical experiences of both of these countries (Great Britain in Chapter 4 and the former Soviet Union in Chapter 10).

37 See “Oman plans to privatize one more company,” 2014.

38 See “Oman’s EHC picks advisors,” 2015.
Additional funding sources for these Ruling Agreements (other than oil/gas revenues) could be realized by further diversifying these economies into other sectors. This process is well underway in several GCC countries, with Dubai providing the best example.\footnote{Keep in mind that Dubai is only one of the seven emirates which make up the United Arab Emirates. Consequently, while policies enacted in Dubai are impactful, they are not necessarily representative of the GCC monarchies as a whole or even the entire United Arab Emirates. To this latter point, in comparison to Dubai, Abu Dhabi is not only the capital of the United Arab Emirates but is also considerably larger in terms of population, geographic area, and GDP.}

Correctly recognizing that the emirate’s oil and gas reserves were a gift that would not last forever, Sheikh Rashid bin Saeed Al Maktoum (ruler of Dubai from 1958 up until his death on October 7, 1990) had the awareness to use the oil and gas income in thoughtful ways. He made deliberate investments starting in the 1970s which would ultimately have Dubai emerge as a transportation and shipping hub, center of business, and tourist destination.

In the late 1970s, Sheikh Rashid commissioned the construction of Jebel Ali Port (the largest man made harbor in the world), making Dubai a convenient and viable point of large-scale transit between the west and the emerging economies of India and China in the east. In 1985, with $10 million of start-up capital from the Dubai government, Sheikh Rashid established Emirates Airline with Dubai International Airport as its main base of operations. Emirates is by far the largest airline in the Middle East (by any measure) and is the fifth largest airline in the world based upon annual passenger miles flown. Having a world class airline providing service to Dubai has lowered transportation costs in and out of the emirate and region, facilitating its rise as a destination for both tourists and business travelers.

These investments in infrastructure drastically lowered costs for foreign firms of having a base of operations in Dubai. Foreign investors were further enticed by the establishment of “Special Economic Zones” within Dubai. A Special Economic Zone (SEZ) is simply a geographic region in which the behavior of decision makers is subject to fewer restrictions. The first SEZ in Dubai was the Jebel Ali Free Economic Zone, created by Sheikh Rashid in 1985. Businesses operating within this zone were exempt from numerous government regulations, including both federal government import duties plus a federal government restriction requiring all businesses to have majority domestic ownership (outside of the Jebel Ali Free Economic Zone, any foreigner wanting to conduct business within the United Arab Emirates had to find a local partner who would establish a majority ownership stake in the venture, whereas within the Jebel Ali Free Economic Zone foreigners could do business without adhering to this restriction).

Such SEZs were so successful in helping to attract foreign investment to Dubai that the model has been replicated frequently under the leadership of Sheikh Mohammed bin Rashid Al Maktoum (the current ruler of Dubai) with the creation of Dubai Media City and Dubai International Finance Centre, as well as “Studio City, Silicon Oasis, Investment Park . . . Sports City . . . DuBiotech . . . Motor City, Golf City, Maritime City, Logistics City, Academic City, Humanitarian City, and many more” (Krane, 2009, p. 128). In each instance, basically the same approach was followed:

- encourage, coax, or beg a host of global brands to set up shop . . . Offer incentives to draw in the big brands; the herd will pile in afterwards and the rest of the units should fill
themselves... The first 10 percent of the units they almost give away... when the big names are set up, all the other companies decide they have to be there too, especially the Arab companies... They make most of their money by selling the other 90 percent at really high prices. (Barrett, 2010, pp. 85-86)

Such new economic activity provides a country with a significant potential tax base, ultimately allowing a government to continue to provide benefits of a Ruling Agreement without oil and gas revenues. Further, if the newly established enterprises are primarily foreign owned, then taxes can be imposed which ultimately result in government revenue being raised from non-citizens. This will allow the two notions of Favored Group Equity to be satisfied.

**Fundamental Changes to the Ruling Agreement**

Up to this point the discussion has focused on ways to create new revenue streams for financing the existing Ruling Agreements in their present forms. Alternatively, the benefits of such agreements could be changed in order to make them more fiscally sustainable long term. For example, the United Arab Emirates recently removed government subsidies for gasoline. Before removal of this subsidy, the price of gasoline in the United Arab Emirates was roughly 60% of the price in the United States: 50¢ per liter versus 84¢ per liter (Carpenter and Khan, 2015). The removal of this subsidy can be viewed as the elimination of a benefit within the context of the Ruling Agreement.

Expenses associated with a Ruling Agreement could be reduced by the elimination of other specific benefits/programs (in addition to gasoline subsidies). Similarly, countries could keep programs in place, but enact across the board reductions in benefit levels. Finally, some benefits could be means-tested (i.e., eligibility based upon income being below a certain level) or phased-out for high income citizens.

As stated, the newly developed notions of equity focus on government revenues (i.e., taxes) and not government benefits. But, analogous notions of fairness could be satisfied by ensuring that within the favored class the benefits received as part of the Ruling Agreement are not greater for individuals with higher incomes.

It is important to recognize that any such changes would signify a drastic and fundamental change in the understanding of the Ruling Agreement itself. Recall, such agreements entail the citizens of the country conceding that the ruling family have considerable power, in return for an extensive array of social and economic benefits. If the benefits are going to be reduced (or if financing the benefits is borne by recipients, as in some of the previously discussed policy alternatives), then the entire political arrangement may be called into question. As noted above (within the discussion of “new taxes”), if a ruler decides to drastically alter the fundamental characteristics of a Ruling Agreement, then he better be prepared to grant greater political voice to the citizenry.
Conclusion

This study examined notions of public finance equity in the face of a Ruling Agreement. The six Arabian Gulf monarchies of the GCC (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—each of which has historically operated with a Ruling Agreement in place) served as a backdrop for the analysis. After discussing important common characteristics of the GCC economies and arguing that the Ruling Agreements as presently structured are unsustainable in the long term, standard notions of public finance equity were examined. Because of significant differences in the fundamental characteristics of government expenditures and revenues for a country with a Ruling Agreement, many of the customary tools of public finance do not provide adequate insights. For a government that has a Ruling Agreement with a favored group of people within society, the typical concepts of “Benefits Principle,” “Ability-to-Pay Principle,” “Vertical Equity,” and “Horizontal Equity” do not adequately capture the society’s core notions of fairness. Subsequently, four new conceptions of equity (applicable within the context of a Ruling Agreement) were defined: Within Group Horizontal Equity, Within Group Vertical Equity, Favored Group Horizontal Equity, and Favored Group Vertical Equity. Potential changes to the existing Ruling Agreements in this region were considered and analyzed, applying these novel notions of comparative equity. These concepts of equity, along with this initial discussion of policy alternatives, can begin to provide policymakers with thoughtful ways to devise and assess changes to the socio-economic arrangements in the GCC countries moving forward.

References


