

# ISSUE BRIEF **08.30.18**

## **Can State-led Entrepreneurship lead to Sustainable Economic Diversification and Development in GCC States?**

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Gulf Cooperation Council (GCC) states are currently seeking alternative trajectories of economic development that can maintain the political status quo but simultaneously enhance their global economic competitiveness. Yet GCC economies have reported a sharp slowdown since 2016. Their average growth rate fell from 3.1% in 2015 to 2.2% in 2016 and 2.1% in 2017 (World Bank 2017a). This trend suggests that, despite cuts in public sector spending and other austerity measures, GCC economies remain heavily influenced by oil price trends.

Despite a modest recovery in 2017, especially in the United Arab Emirates (UAE), Kuwait, and Qatar, but less so in Oman and Bahrain,<sup>1</sup> GCC countries are still paying the price of economic overdependence on hydrocarbons, with all the long-term risks that this set of policy choices implies. GCC states have, however, engaged heavily in diversification efforts, albeit with differing levels of success.

By promoting entrepreneurship and raising homegrown entrepreneurs, policies supporting sustainable growth aim to deliver concurrent and long-term positive impacts on human development, sustainable prosperity, and development of the public and private sectors to ensure that GCC economies can weather external and internal economic shocks. Despite divergent views in academic literature, there is a strong link between entrepreneurship and economic development (Toma et al. 2014). The various stakeholders involved must find the right balance between the traditional role of

state-led enterprises and the development of small- and medium-sized enterprises (SMEs). It is especially fundamental to set in place appropriate and robust legal, financial, and regulatory frameworks to allow this process to produce the benefits expected.

### **THE PRIVATE SECTOR AND STATE-LED ENTREPRENEURSHIP IN THE GCC**

Within the GCC member states, the line between the public and private sectors is blurry, in part due to overlapping ownership structures that involve public sector officials and members of ruling families supposedly acting “in a private capacity.” Likewise, a sizable portion of private-sector demand is driven by the state, and by the public sector more generally; hence, when there are state-driven austerity cutbacks (as in Saudi Arabia since 2014), the private sector also contracts. Thus, while the private sector plays a critical role in the Gulf, it is heavily regulated by the state.

Nevertheless, more recently a “new” state capitalism has emerged in the Gulf “in which the state has been an activist and ambitious actor keen to engage economically with the outside world. [...] Most of these states set strategic goals and visions rather than seek to centrally plan or manage the economy; favor tertiary economic sectors and late-late-development concepts above heavy industrialization; and set in place the mechanisms for investment attraction



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and export-led economic growth, rather than pursue import-substitution policies” (Gray 2011, 32). This trend in the Gulf is in line with contemporary economic policies pursued in the African continent: green industrialization, trade facilitation, internal resource mobilization, and investment facilitation.

Contemporary Gulf state capitalism is nevertheless made possible by the fact that major private firms are state-initiated enterprises (e.g., in the UAE and Qatar), meaning that the private sector’s relative autonomy is limited, economically and politically. State-led entrepreneurship, therefore, historically created a comfort zone for the private sector, particularly in strategic sectors. This certainly serves political goals but also guarantees state support to private-sector development, ensuring that needed policies and capacities are provided by the state: “Public leaders (representing governmental bodies) including the elected representatives, professional and private sector work cohesively and on several interrelated principles to form an ecosystem for entrepreneurship growth” (Khan 2013, 30).

This is the case in Saudi Arabia, where the government has actively assisted private-sector actors with financing and other support services (Khan 2013). The government has already established financial institutions and mechanisms dedicated to entrepreneurs, providing them with financial research and consultancy services. Governmental initiatives include research institutions supporting the policy domain, such as the King Abdulaziz City for Science and Technology (KACST) and the King Abdullah University of Science and Technology (KAUST). Although the Saudi Arabian government is currently focusing on SME creation, state-owned companies are still important in Saudi Arabia, and their ongoing privatization strategy entails tough political choices (Onour 2012).

Overall in the Arab world, large enterprises (100 or more employees) account for 10–20% on average of all firms and provide 60–80% of private-sector

employment (Nasr & Pearce 2012). Despite a growing policy focus on SMEs in GCC countries, Saudi Arabia and Qatar being the most important cases, government policies still primarily cater to large companies. Therefore, entrepreneurs who may benefit from policies that facilitate SME creation may face difficulties expanding and scaling up their ventures. Entrepreneurs contend with capacity issues and a lack of business training and acumen, as well as challenges in marketing their products and finding partners to expand their activities. Additionally, the lack of robust legal and regulatory frameworks, the need to revise bankruptcy laws (which began in the UAE and later in Saudi Arabia) to reduce the cost of taking risks, and a need to level a playing field that is presently stacked in favor of large enterprises by reserving a proportion of state contracts for SMEs are among other issues new entrepreneurs face in the Gulf.

State-led entrepreneurship refers to the active role of a developmental state (Abdullah and Muhammad 2008) in supporting entrepreneurship creation, especially but not only through policymaking. Policy gaps in other sectors such as regional markets, land ownership, property registrations, and construction permitting also constitute supplementary difficulties for entrepreneurs (Momani 2017). Improving the ecosystem for entrepreneurs is necessary because homegrown entrepreneurship is critical in GCC states; it carries major implications for human and social development and for sustainable prosperity through employment creation and inclusive economic growth.

In states like Qatar and the UAE, where expatriates form the bulk of the population, homegrown entrepreneurship cannot be limited to nationals. However, such efforts focus on residents more generally, emphasizing that solutions and choices must be local while giving priority to national needs and preferences.

## CONCLUSIONS AND POLICY RECOMMENDATIONS: LIMITS AND CHALLENGES

Proactive government efforts to sustain and encourage entrepreneurship in the GCC currently focus on economic diversification and joint initiatives between the public and private sectors in the Gulf region. This creates a peculiar entrepreneurship ecosystem in GCC countries. Public and private-sector stakeholders work together to develop entrepreneurship as a key tool and strategy to diversify economies away from an overreliance on extractive resources and instead transform them toward knowledge-driven economies.

While state-led entrepreneurship policies have worked to achieve many positive outcomes, they have also revealed some major shortcomings. The principal limitation of this strategy is that because the state remains the core actor in all entrepreneurship strategies, such policies also happen to ensure regime security. This perpetrates the current political status quo and prevents the possibility of a genuine political change toward democratization in these countries.

In some cases, there is stark contrast between the discourse used by public officials in the international arena and the actions undertaken at home. This particularly has been the case in Saudi Arabia, where initial measures to cut back waste and inefficiencies have been reversed by the state.

Although the reality is far from ideal and the challenges to achieving economic goals are still sizable, GCC states have to aim at a balance between sustainable economic diversification through entrepreneurship development (especially innovative and green entrepreneurship) and political stability. Despite the limitations of rentier political systems, a rapid and radical political change would be negative and possibly dramatic in the Gulf region. Hence, the political milieu and the business environment have to engage in a gradual process of mutual transformation. Real change may be slow and thus frustrating at the societal level, yet a gradual approach could at least ensure better and longer term results.

The following are policy recommendations to facilitate a path forward in Gulf regimes' efforts to navigate their sometimes divergent economic and political constraints:

- Governments need to develop policies to ensure that the state-led entrepreneurship model remains relevant in a changing economic context and encourages innovation. State-led entrepreneurship is rooted in the mechanisms and history of Gulf states. Adapting this model to the contemporary and changing needs of the region is imperative in order to sustain stability within a framework of reform.
- Meaningful and sizable economic change in the Gulf will be driven on the backs of SMEs, especially green and social enterprises and startups, as it has elsewhere in the world. The recent emphasis on SME development via new policies and measures is a step in the right direction, but this has to be complemented by building the required capacities for entrepreneurs, especially but not only through ad hoc entrepreneurship education curricula.
- Of particular policy significance is the intersection of the state-led entrepreneurship model and the focus on SMEs. These enterprises need a larger and more complex entrepreneurial ecosystem in order to develop. These two policy areas are complementary and can drive economic transformation, yield sizable social effects, and improve employment, which remains a critical problem in Gulf countries. For this to happen, SMEs must be encouraged and supported, notably by reserving specific domains or contracts to such enterprises.
- Gulf countries should develop mechanisms to share their experiences and successful policy implementations (e.g., bankruptcy laws). Such sharing could facilitate adoption of best practices in the MENA region, ultimately leading to improved economic performance.

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## ENDNOTE

1. Babu Das Augustine, "GCC economies expected to post modest recovery in 2017," *Gulf News*, February 5, 2017, <https://gulfnews.com/business/economy/gcc-economies-expected-to-post-modest-recovery-in-2017-1.1973397>.

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