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

Bessma Momani

A finance-strapped IMF at the centre of an unfolding international financial crisis

Throughout 2006 and 2007, the good fortunes of the emerging market economies, which were once chronic users of the IMF, had led some officials to pronounce the International Monetary Fund (IMF) as 'irrelevant'. Emerging market economies had been soured by years of ill-advised policies and amassed foreign exchange reserves; for past users of the IMF it served as a form of self-insurance, to avoid resorting to the IMF in future crises. The Fund was, in the words of *The Economist*, 'a fire engine with no cat to rescue'. In the background of the Fund's loss of clientele, its dwindling of resources and its legitimacy crisis, there has been a discernible shift in global economic power from the western industrialised countries to the emerging market economies. These global imbalances have polarised states, generating wealth and production from states dependent on consumption.

The shift in global economic power meant that the IMF's governance structure was reflective of a global economic system that no longer existed. For a number of years, several IMF managing directors and executive board members worked to reconfigure the Fund's quotas and shares to earn the emerging market economies' support in reinvigorating the IMF. By mid-2008, the debate on IMF reform had hit an impasse as few of the ambitious IMF reform issues were implemented. Then, in a twist of irony,

Bessma Momani is Assistant Professor, University of Waterloo and Senior Fellow, Centre for International Governance and Innovation ???

the 2008 international financial crisis returned all eyes to the IMF as it went to the rescue of Iceland, Hungary, Ukraine, Pakistan, Serbia, Latvia, Turkey and Belarus. The Fund was to help coordinate and provide a catalytic funding role for many countries' credit problems, to provide ideas to failed regulatory regimes and to predict the tumultuous international financial road ahead.

In an attempt to respond to the international financial crisis, leaders of the Group of 20 (G20) were invited to Washington, DC, in November 2008, to both help rewrite the rules of the global financial system and to help shore up the dwindling resources of the international financial institutions now embarking on addressing the global economic crises. By expanding the Group of 8 (G8) to include the emerging market economies, the latter were asked to help restore the Fund's dwindling resources and return a general loss of faith in the Fund's advice and loss of legitimacy in Fund governance. Eyes turned in particular to those holding large foreign reserves, like China, Japan and the oil-producing Gulf states. The failure to come up with an ambitious redesign of Bretton Woods was predictable, but the unwillingness of a number of capital surplus states to reinvest in the IMF was surprising and unexpected.[1] Some have reflected that this may have been the result of deep fissures in the international financial institutions' legitimacy; fissures that seemed to continue and be nowhere near healing. This article argues that, for the oil-producing Gulf states, led by Saudi Arabia, the legitimacy crisis at home would prove to be more pressure than the international political leaders' ire.

The economic situation in the oil-producing Gulf states collectively known as the Gulf Cooperation Council (GCC), which includes Bahrain, Kuwait, Oman, Qatar, the United Arab Emirates and Saudi Arabia, had been a positive one since the record high oil prices started their climb after 2003. The steep rise in oil prices – from a 20-year low of $20/barrel in 2001 to a record high of $140/barrel in mid-2008 – meant that the Gulf states had been reaping the economic benefits of rising oil prices with burgeoning oil earnings. Specifically, from 1997 to 2002, GCC oil earnings averaged $146 billion per annum; in contrast, from 2002 to 2006, GCC oil earning averaged $327 billion per annum (International Institute for Finance, 2007). For many years, this has led to impressive economic growth in the GCC,

[1] Japan did, however, commit $100 million to the IMF at the G20.

comparable to economic growth rates in the world's leading emerging market economies. Specifically, from 2003 to 2007, the GCC's real GDP growth rates increased on average by 7.1%/year (IMF, 2008). The GCC's savings were similarly impressive. The GCC's gross official reserves stood at $388.4 billion in 2007 and reached $625.2 billion by October 2008 (IMF, 2008); moreover, the GCC states' current account surpluses reached $200 billion in 2006 and dropped to $143 billion in 2008 (International Institute for Finance, 2007). The six GCC states have relatively small populations: 40 million people in total by 2008, of which 28 million live in Saudi Arabia. With an abundance of petrodollar wealth generated by states with a relatively small number of people, the questions often posed have been where and how to recycle these oil earnings.

Gulf states recycle oil earnings

The GCC's small population has meant that, historically, many Gulf states have had limited 'absorption channels' to reinvest oil earnings domestically; instead, they have historically 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 through official liabilities such as US government treasury bills – and by investing in international financial institutions such as the IMF (Nsouli, 2006). Indeed, in 1974 and 1975 the Gulf states, namely Saudi Arabia and Kuwait, were principal backers of IMF oil facilities that were designed to help oil-importing member countries facing balance of payment problems to borrow money with minimal conditions from the IMF. Yet again, the Saudis assisted with the 1977 Supplementary Financing Facility (SFF), better known as the Witteveen Facility, which was put to use after 1981 with the help of the Saudi government. In 1981, the IMF borrowed 8 billion SDR from the Saudi Arabian Monetary Agency to finance the IMF's new SFF and the IMF's new policy of enlarged 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 from a decade of increased inflation, steep rises in commodity prices including oil, and the overall global recession. Not surprisingly, the international financial crisis of today has brought historical analogies with the 1970s and early 1980s. The international financial crisis and the ensuing global imbalances in capital have turned attention, yet again, to the Gulf's oil-producing states for another infusion into IMF liquidity that could be used to meet the needs of countries in deficit.

Prior to the November 2008 G20 meeting in Washington, DC, the United Kingdom's Prime Minister Gordon Brown called on both China and the Gulf states to contribute to the IMF's liquidity in order 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' (Watt and Chrisafis, 2008). Brown did not, however, visit China, and instead relied on a phone conversation with Chinese Prime Minister Wen Jiabao. While it could be argued that PM Brown initiated a tour in Europe and then the Gulf to shore up domestic support for his ailing party's popularity, it is clear that he believed he would be able to get some commitment of Saudi contribution to Fund liquidity.

In early November 2008, Brown visited a number of oil-rich Gulf states, starting with Saudi Arabia, Qatar and the United Arab Emirates (both Abu Dhabi and Dubai). He went searching for an infusion of money into IMF liquidity. On his first Gulf 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 worldwide to avoid the contagion, to avoid this spreading to different parts of the world' (Norman, 2008). Without detailing how much the Saudis planned to contribute, Brown hinted that the Saudi pledge would be revealed at the G20 summit in mid-November (Coates, 2008). At the end of his Gulf trip, Brown stated in Abu Dhabi: '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 interest to stop the contagion that is happening and to rebuild confidence in the world financial system' (Stanton, 2008). As part of the same British delegation, newly appointed Secretary of State for Business and former EU Trade Commission Peter Mandelson went further and noted, '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' (Stanton, 2008). Brown had failed indeed, as the Saudis came to Washington a few weeks later with empty hands.

Saudi Arabia attended the G20 meetings in Washington, DC, and in many ways played a representative role for the Gulf Cooperation Council. It came to Washington, DC, empty-handed and baulked at international pressure to contribute funds to IMF liquidity. In his statement to the G20, King Abdullah blamed 'undisciplined globalisation 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 (King Abdullah, 2008). The King also highlighted Saudi commitment to taking care of its own region and playing a lead role in ensuring a balance between the needs of oil consumer and producer states. He finished by pointing out the need to better institutionalise 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 of spending $400 billion in five years to promote infrastructure projects and services, focusing on using his country's' petrodollar wealth for enhancing domestic absorptive capacity (King Abdullah, 2008). This was not a commitment of new money, according to a Saudi government official; instead, it was a means of 'reassuring global markets' that the Kingdom would continue with its industrial development and economic diversification policy (Karam, 2008).

Similar to the Saudis, other Gulf countries announced domestic stimulus packages. Kuwait's sovereign wealth fund announced that it would turn to invest its money in the country to spur growth in the local economy (Reilly, 2008). On the heels of the G20 meeting, the UAE Minister of Economy, Sultan bin Saeed Al Mansouri, announced a domestic stimulus package. This followed both the government's injection of Dh120 billion into the Central Bank to shore up domestic banks and the government's blanket guarantee on domestic deposits (Reilly, 2008). What explains this inward-looking approach to recycling petrodollar wealth, and not choosing the IMF as a safe means of recycling oil earnings in another era of global imbalances and international financial credit crisis?

An inward-looking Gulf

The reasons for Saudi and, more generally, Gulf reluctance to infusing funds into the IMF is multifold and multilayered, yet much of the reasoning is domestic and to a lesser extent international. By the early 2000s, the region's economic liberalisation 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's Middle East Free Trade Agreement (Momani, 2007). The GCC also accelerated trade negotiations with the European Union (Antkiewicz and Momani, 2009). In response to the pressures of these agreements, the GCC made great strides to further economic integration in the region by completing a customs union, initiating a common market (albeit still dysfunctional in many ways) and making plans for a monetary union (Momani, 2008b). This rapid pace of economic liberalisation had unintended sociopolitical consequences as well. The past social contract throughout the Gulf of doling out state benefits in exchange for political passivity was then quickly eroding under the pressures of globalisation.

Over the past decade the Gulf governments have with trepidation witnessed the rising pressure of a new class that is more scrutinising of their governments' spending, particularly abroad. These individuals are more demanding of their governments and patiently awaiting the political liberalisation that has yet to accompany rapid economic liberalisation. While the state-owned sector remains the dominant engine of growth in Gulf economies, in many ways this new political and economic class can attribute its rise to the successes of the region's private sector, which has flourished with the region's economic liberalisation. In many ways, Dubai was emblematic of the region's innovation in creating economic growth. The dynamic and bold private sector of the Gulf has ambitions to both promote Gulf power in the greater Middle East and to promote economic diversification at home (Hertog, 2007). While the ambitions of the new Gulf will require more than significant rebranding to take hold, the desires and frustrations of a new class are gaining the attention of wary Gulf leaders (Cooper and Momani, 2008; Legrenzi, 2008). While far from being revolutionary, this class is often young, foreign-educated, frustrated with the region's corruption, yearning for meritocracy, and, what is most relevant to the subject of this paper, highly sceptical of its governments' wasteful ways, which are often seen as a bailing-out of western economies that has been exchanged for the comforts of the American security umbrella.

Leading up to the 2008 international financial crisis, for example, Gulf economies have been witnessing drastic inflation and soaring property prices that many local analysts attributed to the long-standing dollar-peg policy in the region. As the value of the dollar dropped from 2006 to mid-2008, this led to cries against the policy and calls for de-pegging or, at the minimum, currency revaluation.[2] Despite government assurances to the contrary, it was widely perceived that sound economic policies were ignored for geopolitical reasons. Historically, the Gulf governments' peg to the dollar had less to do with economic rationales than with geopolitical concerns: forgoing an optimal currency choice because of a sense of regional and domestic insecurity in need of US military protection (Momani, 2008a).

The reaction to press reports that the Gulf was asked for an infusion of money into the IMF was generally negative in the region. In one regional poll, for example, 65% of Gulf respondents disagreed with injecting funds in the IMF and World Bank, 18% were supportive and the remaining 17% did not know.[3] Similar negative reactions could be found in regional editorials. Editorials often pointed out the need for more domestic spending and for enhanced Gulf power in the international financial and political institutions. In one more positive Gulf editorial, 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)

[2] It should be noted that, of the six GCC states, Kuwait heeded these domestic pressures and, in December 2007, reverted to using a basket of currencies in determining its currency value.

[3] Between 18 and 24 November 2008, YouGovSiraj conducted the poll for the *Doha Debate* television programme aired on the BBC. It was completed by 1119 respondents throughout the Gulf and the Middle East. See http://www.thedohadebates.com/debates/debate.asp?d=45&s=5&mode=opinions.

On the heels of the G20 meeting in Washington, DC, a Kuwaiti newspaper had reported that the US government also approached the Gulf for $300 billion to bail out the US auto sector. Specifically, it was reported that the US sought $120 billion from Saudi Arabia, $70 billion from the Emirates, $60 billion from Qatar and $40 billion from Kuwait (*Middle East Online*, 2008). This report was similarly met with vocal opposition in editorial columns in the region. In a Saudi paper, one writer highlighted again the sentiment of needing more domestic investment and less spending for the sake of geopolitical positioning:

> 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 is 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, the Saudi King responded to reports that the United States sought money from the Gulf and stated unequivocally that the Saudis would not give money to the United States (Rahman Shaheen, 2009).

A number of editorials also noted that, if the IMF wanted more funds from the Gulf, then this should be matched with more decision-making power in the organisation (Hokayem, 2008). Saudi Arabia holds one of the few seats at the IMF that does not have a constituency. It has held the seat since the late 1970s as a result of its earlier injection into IMF liquidity. Since 1992, however, its relative quota share has declined and its seat at the 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 to its quota share (Momani *et al.*, 2008). The Saudis have expressed concern on the subject in the past and it appears that they had repeated this to PM Brown on his trip to the Gulf. Speaking about the Gulf and the IMF, 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' (Stanton, 2008). During the G20 meetings, Finance Minister Ebrahim Al Assaf reiterated that Saudi Arabia wants an 'appropriate' IMF quota and to preserve its relative decision-making weight in the organisation (Reuters, 2008a). In reality, however, the IMF member countries would not have been in the mood to augment Saudi Arabia's quota. After a number of years of trying to find ways of decreasing both the size of the board, and of reallocating quotas and votes from developed countries to under-represented emerging market economies, there would have been little international support to increase Saudi decision-making power in the organisation (see Truman, 2006).

Conclusion

At the time of the November 2008 G20 meetings, few analysts would have predicted that oil prices could reach lows of $42 a barrel and, consequently, few would have seen some of the unravelling of economic gains made in the region. Leading up to the G20 meetings, Saudi Central Bank Vice-Governor, Mohammad Al Jasser, similarly 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 for why the Gulf came to the G20 meeting empty-handed had little to do with its current budget and financial woes.[44] Then still optimistic Saudi leaders chose not to shore up the finances of the IMF 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 quota and voice at the IMF Executive Board. While a number of analogies have been drawn between the 2008 international financial crisis and the 1970s global recession, the reality often overlooked is that the Gulf is changing.

[4] Squeezed credit markets and the jitteriness of international investors had negative impacts on previous growth sectors: construction, real estate and financial services. The Institute of International Finance had forecast that real GDP growth would slow in the region from 5.7% in 2008 to 3.6% in 2009 (see International Institute for Finance, 2008).

References

Antkiewicz, A. & Momani, B. (2009) Pursuing geopolitical stability through interregional trade: the EU's motives for negotiating with the Gulf Cooperation Council. *Journal of European Integration* (March).

Al-Rasheed, T.F. (2009) Why should we bail out US automobile industry? *Arab News*, 1 January.

Coates, S. (2008) Gordon Brown extracts IMF pledge from Saudis. *The Australian*, 4 November.

Cooper, A. & Momani, B. (2008) The challenge of re-branding countries in the Middle East: opportunities through new networked engagements versus constraints of embedded negative images. Paper presented to the International Studies Association Annual Conference, San Francisco, March.

Hertog, S. (2007) The GCC and Arab economic integration: a new paradigm. *Middle East Policy*, **14**, 1 (Spring).

Hokayem, E. (2008) If the Gulf wants its voice to be heard, it must be more assertive. *The National*, 12 November.

IMF (2008) *Regional Economic Outlook: Middle East and Central Asia*. Washington, DC: International Monetary Fund, p. 44. Available at: http://www.imf.org/external/pubs/ft/reo/2008/MCD/eng/mreo0508.pdf.

International Institute for Finance (2007) Regional briefing Gulf Cooperation Council, 31 May. Available at: http://iif.com/emr/emr-af.

International Institute for Finance (2008) *Update: Gulf Cooperation Council Countries*, 4 December. Available at: http://iif.com/emr/emr-af.

Karam, S. (2008) Saudi $400 billion plan seen providing no new money. *Forbes*, 17 November.

Khaleej Times (2008) Editorial: An opportunity for Arabs in global financial crisis. *Khaleej Times*, 5 November.

King Abdullah (2008) Statement at the G20 Summit, 15 November. Available at: http://www.saudiembassy.net/2008News/Statements/StateDetail.asp?cIndex=734.

Legrenzi, M. (2008) Did the GCC make a difference? Institutional realities and (un)intended consequences. In: Harders, C. & and Legrenzi, M. (eds) *Beyond Regionalism? Regional Cooperation, Regionalism and Regionalization in the Middle East*. Hampshire: Ashgate.

Middle East Online (2008) US seeks 300 billion dollars from Gulf states. *Middle East Online*, 20 November. Available at: http://www.middle-east-online.com/english/?id=28839.

Momani, B. (2007) A Middle East free trade area: economic interdependence and peace considered. *The World Economy*, November.

Momani, B. (2008a) GCC oil exporters and the future of the dollar. *New Political Economy*, **13**, 3 (September).

Momani, B. (2008b) Shielding against globalization: economic and political integration of the Gulf Cooperation Council. *Journal of the Gulf and Arabian Peninsula Studies*, January.

Momani, B. *et al*. (2008) IMF and monetary reports: Middle Eastern perspectives. *CIGI Conference Report*, 10 March.

Norman, L. (2008) Brown expects support for a global crisis. *Wall Street Journal*, 3 November.

Nsouli, S.M. (2006) Petrodollar recycling and global imbalances. Presentation at the CESifo's International Spring Conference, Berlin, 23–24 March. Available at: http://www.imf.org/external/np/speeches/2006/032306a.htm.

Rahman Shaheen, A. (2008) Saudi king denies US seeking funds. *Gulf News*, 29 November.

Reilly, D. (2008) Is today the day to save the world? *Arabian Business.com*, 8 November.

Reuters (2008a) Saudi Arabia won't offer cash to IMF, 16 November.

Reuters (2008b) Saudis have ample funds for investment, 16 November.

Stanton, C. (2008) Brown waves IMF carrot for GCC cure. *The National*, 4 November.

Truman, E. (2006) A strategy for IMF reform. *Policy Analyses in International Economics*, **77**. Washington, DC: Institute for International Economics, February.

Watt, N. & Chrisafis, A. (2008) Brown looks to China to strengthen IMF's hand. *Guardian*, 29 October.