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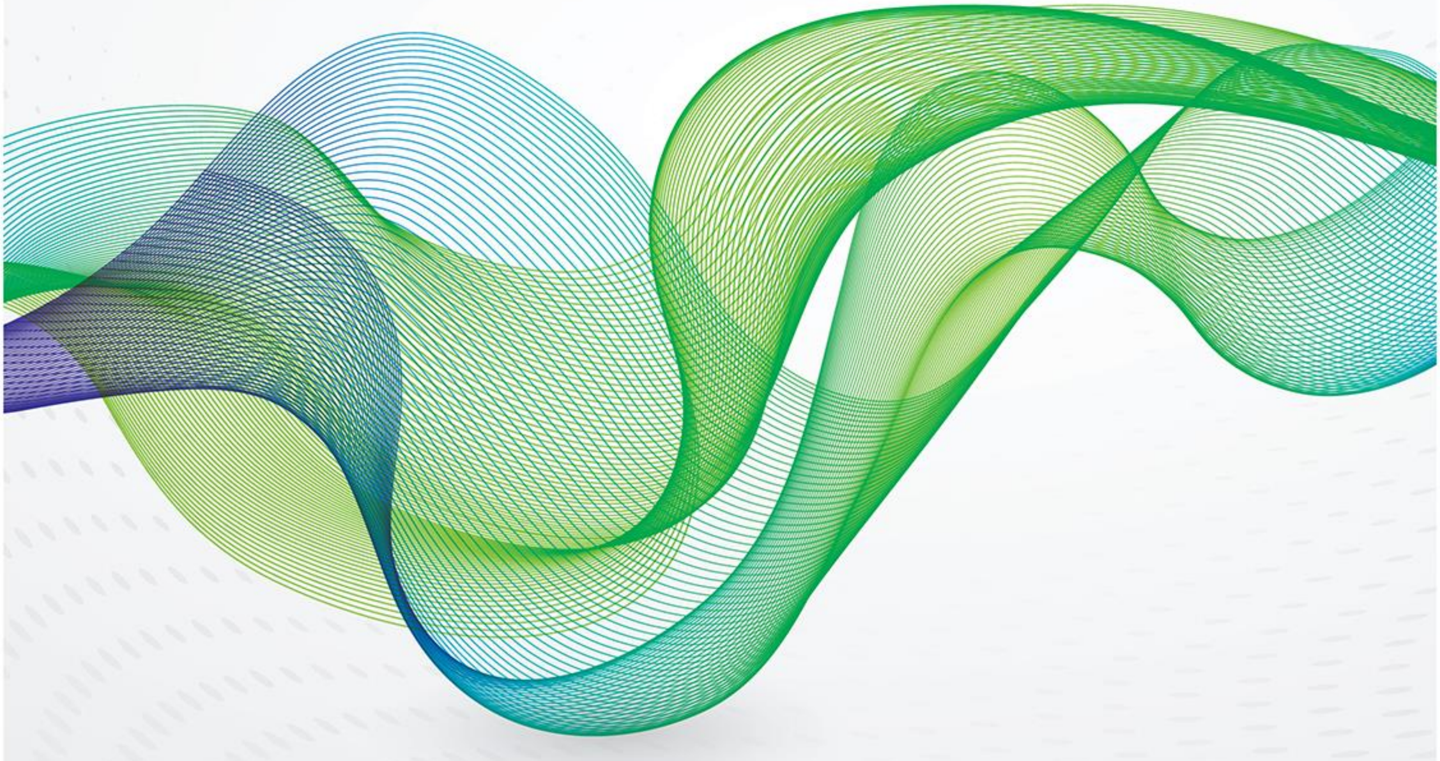
Harnessing Social Safety in a Context of Changing Social Interactions:
Compensation Schemes and Subsidy Reforms in the GCC



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Abstract

Due to the sustained low oil price in international markets and the resulting fiscal stress, GCC countries have begun reforming their energy prices. Some of these reforms are structural, and intended to last beyond the low-oil-price period. However, so far, most GCC countries have not used compensation measures to mitigate the negative impacts on households from the reforms. While the social contract proved sufficiently resilient to allow for the initial price increases from a very low base, new pricing reforms should be accompanied by the introduction of new distributive welfare methods to compensate for the adverse impact of higher energy prices on households. In their absence, growing income inequalities and public discontent could very well lead to the reversal of reforms. This paper analyses the complex nature of the development and implementation of new social safety mechanisms. It argues that while cash transfers seem the best option to compensate for loss of household welfare as a result of energy pricing reforms, they are not a panacea to resolve the structural deficiencies of these states. The success of cash transfers will depend on their design and implementation, as well as on the introduction of complementary short-term mitigation measures. The paper concludes with key considerations for the development of more targeted and cost-effective social safety nets in the medium term. The conclusion emphasizes that a combination of subsidy reforms and cash transfers are a good start, but are still insufficient to move rentier states to productive states. This would require policy reforms in the areas of, inter alia, labour market, migration, education, and social insurance.

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Introduction

During the last three years, GCC countries have increased energy prices and announced a longer-term reform of their energy subsidy systems. The main driver behind these price increases has been the fiscal stress caused by lower government revenues due to the decline in the international oil price. There is also a realization that universal subsidies had become increasingly unsustainable, particularly in the wake of falling international oil prices and higher uncertainty about oil market dynamics. The fiscal stress is lower in some countries (such as Kuwait, Qatar, the UAE) than in others (like Bahrain, Oman, Saudi Arabia), but all GCC countries are now taking measures to structurally reform their energy pricing systems – an important step in the wider process towards shifting to a more sustainable development model and diversifying their economies.

While low domestic energy prices have historically been a cornerstone of the social contract and development model in GCC countries, the recent increases in energy prices were implemented with relatively little public opposition and without the governments having introduced compensation schemes to offset the impact of higher energy prices on households and firms (Fattouh et al., 2016). Political economy conditions (for example: larger acceptability of subsidy reforms across the MENA region, an openness to discuss long-term fiscal sustainability, and geopolitical trends increasing the legitimacy of domestic leadership) were favourable for the implementation of such reforms. Also, prices were so low to begin with that the social contract was sufficiently elastic to accommodate such initial price increases (Fattouh et al., 2016).

That said, further energy pricing reforms will have bigger impacts on households and industry and thus will exert serious pressures on the social contract and the GCC development model, if not accompanied by well-designed compensation mechanisms. In exchange for public acquiescence to its authoritarian rule and power over the country's resources, GCC governments (like other governments in the MENA region) have implemented a generous welfare system, distributing rents through various mechanisms – for instance by offering public employment and low-cost or free-of-charge goods and services. As GCC governments currently deepen their reforms of the energy pricing systems, it may be necessary to abide by the logic of the rentier social contract and provide direct welfare support to their citizens to ease the impact of these reforms.

The key question then is: what distribution channels and compensation mechanisms can be used to cushion the impact of reforms on households and, ideally, garner support for further structural reform measures? Public employment is not a sustainable option as the public sector is already bloated and its growth is expected to slow. About half of Bahraini and Omani citizens, 70 per cent of Saudi citizens, and 90 per cent of Qatari and Kuwaiti citizens work in the governmental sector (GCC-STAT, 2017). The average public sector wage bill in the GCC grew from 7.4 per cent of GDP in 2009 to 9.4 per cent in 2013 (IMF, 2014). As GCC countries are also addressing labour market distortions, the region is in need of a new distribution mechanism.

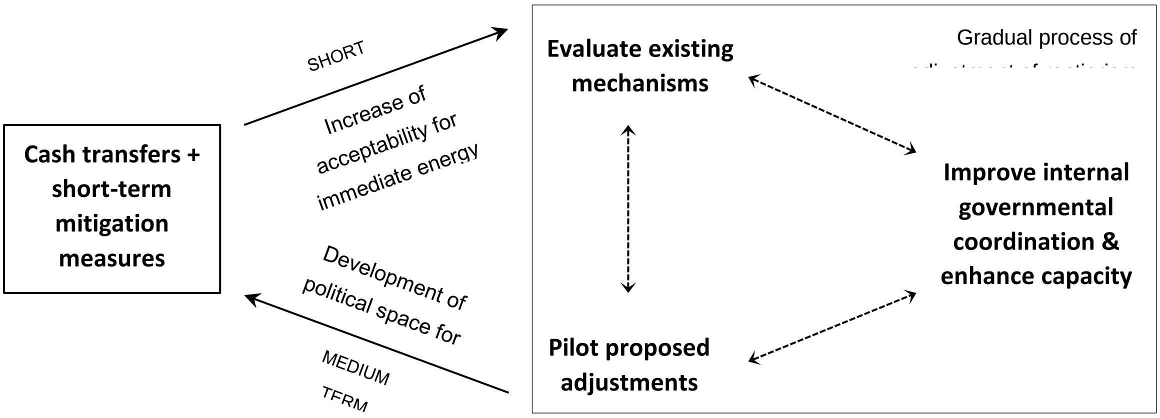
Many have suggested that cash transfers (CT) can be this new mechanism (Hertog, 2017; Moss et al., 2015). This paper will set forth the benefits and drawbacks, opportunities and threats of using cash transfer schemes in the GCC context. However, cash transfers are complex and are by no means a panacea to the many structural problems facing the GCC. They can, however, increase the acceptance of reform measures if they are well designed and implemented. This is a crucial point: cash transfers are a heterogeneous type of social assistance, and their success depends on the appropriateness of their design and their implementation in light of the local context of each GCC country.

Finally, this paper assesses the longer-term strategy aimed at achieving a targeted social safety net. It is argued that moving immediately to targeted social safety nets is very difficult in the GCC context. Like other MENA countries, this is both because of a lack of institutional capacity and the presence of rentier social contract dynamics. 'Rentierism' is self-reinforcing and new initiatives will be used to reinforce existing structures of power and patronage. The introduction and development of social

safety nets should be primarily concerned with the following rentier reform conundrum: how could cash transfer schemes be used to allow greater acceptance of reforms, while at the same time act as a catalyst for a reduction of existing rentier mechanisms in the medium to the long term to achieve more inclusive and sustainable development?

It is evident that a temporal consideration is required to tackle the rentier conundrum. As shown in Figure 1, in the short term, cash transfers with complementary mitigation measures can increase the acceptability of reforms. If implemented well, these open up possibilities for further reforms that can result in a more inclusive and sustainable development model, underpinned by a targeted social safety net. In the medium term, successful reforms that gradually transform existing rentier state dynamics can then make way for structural reforms of social security, including plausible policies that target cash transfer recipients better. In the following sections of this paper we explore these lines of argument in detail.

Figure 1: Social safety net development & rentierism



Source: Author

I. Cash transfers as a short-term catalyst for social contract change

(A) Why cash transfers? Commonalities across GCC countries

At first glance, cash transfer schemes appear to be the best available answer to compensate GCC citizens for the adverse welfare impacts of domestic economic reforms. There is ample empirical evidence suggesting that cash transfers can be successful policy interventions to garner support for subsidy reforms in the short term (Vagliasindi, 2015). They can pose as a politically feasible and popular policy response that takes into account the constraints facing GCC governments:

- Compared to more advanced social protection mechanisms (such as means-tested support), cash transfers are relatively easier to administer and therefore do not require time consuming and costly innovations in institutional and bureaucratic capacity;
- Compared to direct (energy) subsidies and public employment schemes, cash transfers are more equitable, less distortive of consumption decisions, and are, overall, more transparent (Hertog, 2017);
- Cash transfers provide direct income support and can therefore cushion the impact of energy pricing reforms

Thus cash transfers have significant advantages vis-à-vis other social protection mechanisms. If GCC countries are seeking to implement energy-pricing reforms in the short term, then compensation mechanisms should take into account the GCC's intrinsic political economy constraints. The development of targeted social safety nets requires large administrative capacity, inter-ministerial coordination, as well as coordination between national and regional/local parts of government. This type of intra-governmental coordination is currently absent in the GCC (Hvidt, 2013).

In contrast, cash transfers require less administrative and institutional capacity to initiate, but subsequently necessitate learning-by-doing to improve their efficiency. The fact that they are new programmes also means that they can be administered more transparently. As such, a cash transfer mechanism can be a first step towards setting up structures that are more efficient than current fragmented bureaucracies. This development ultimately paves the way for achieving well-targeted social safety nets in the medium term.

Cash transfers are also useful because they are very popular and therefore fit within existing social contract dynamics. In the MENA region there is overwhelming support for mechanisms that clearly benefit the poor (as opposed to singling out widows, orphans, or the disabled) and that involve a cash transfer (as opposed to in-kind benefits) (Silva, J. et al., 2012). The fact that cash transfers provide real income support is important. The main reason for citizens disapproving of energy-pricing reforms is the impact that these reforms have on household budgets, with the reduction of their purchasing power via the inflationary shocks that commonly follow pricing reforms.

(B) The design of cash transfers? Differences across GCC countries

While there are a number of political economy commonalities between GCC countries, there are also notable differences that affect the type of cash transfers that should be considered. These differences operate at various levels, and ultimately influence the potential ambition and function of cash transfer programmes:

- A political function to cushion the impacts of pricing reforms;
- A redistributive function to redistribute welfare – aiming at reducing poverty and reducing inequality;
- An economic function to serve longer-term development needs and structural reforms in the labour market

For example, in Kuwait, the Parliament and unions are much stronger than in other GCC countries and will therefore need to be incorporated into the planning and execution of compensation schemes. The fact that Kuwait has significant foreign reserves and a relatively small population means that it can run a more conventional rentier model for much longer. As a result, resistance to subsidy reforms has been particularly strong and therefore the country may have less interest in reform and in setting up a cash transfer system that serves a long-term economic function. Nevertheless, given its stronger fiscal position, the country would be in a better position than its GCC neighbours to implement such an ambitious scheme.

On the other hand, GCC countries like Bahrain (through Vision 2030), Oman (through Vision 2020), and Saudi Arabia (through Vision 2030) all foresee a much stronger role for private sector-led development. The goal is to encourage the employment of nationals in the private sector and relieve the public sector from the role of job creation; this means that they could have an interest in using CT for a potential economic function. At the same time, however, they have lower fiscal capacity to implement CT schemes. Rather, they may want to focus on using CTs as a redistributive tool. The GDP per capita ratios of Saudi Arabia, Oman, and Bahrain are low compared to other GCC countries, and there are increasing concerns about income inequality and rising poverty.

The capacity of cash transfers to achieve the government's stated objectives ultimately depends on their design. Different designs of CTs should be considered as different compensatory mechanisms. The most notable design features that can differentiate one CT from another are:

- Conditional or unconditional cash grants;
- Level and duration of the benefit;
- Registration and delivery method;
- Financing of cash transfers;
- Institutional design.

(C) Beneficiaries

In terms of beneficiaries, governments can theoretically choose between conditional and unconditional cash transfers. The CT literature does not indicate any clear preference, as the choice between conditional and unconditional cash transfers ultimately depends on the context and objectives of various countries (Pellerano and Barca, 2014). It should, however, be noted that conditioning cash transfers often requires higher administrative capacity. It is undisputed from historical experiences that learning-by-doing through public evaluations is key to better targeting over time (Coady et al., 2004).

i. Choosing between conditional or unconditional cash transfers

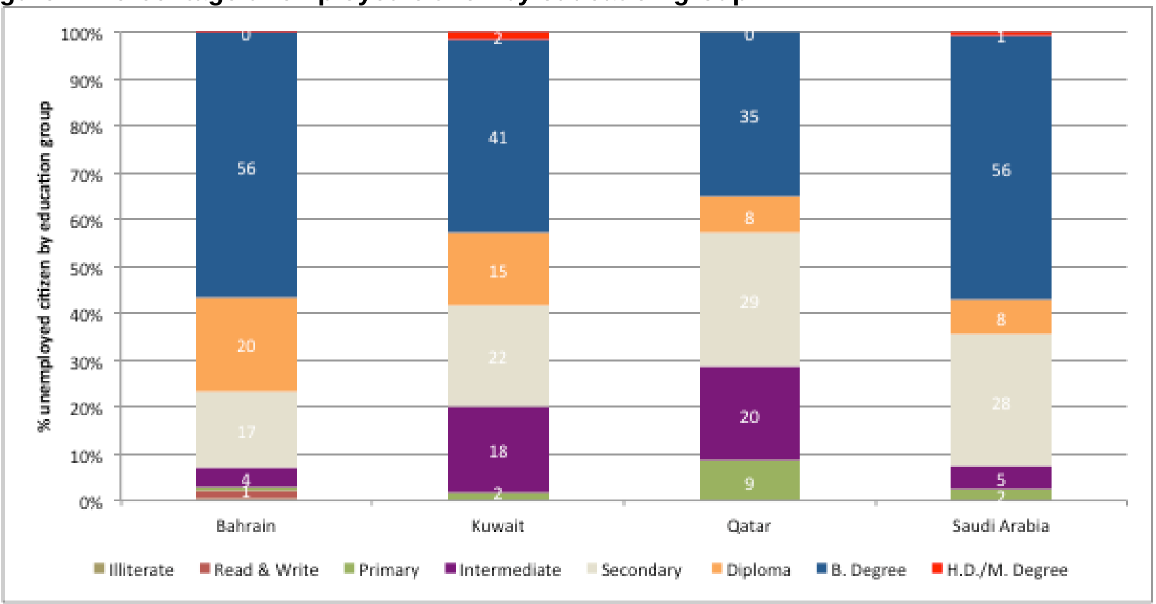
Whether or not cash transfers are conditional or unconditional ultimately depends on the objective of the Government. Cash transfers that primarily aim at satisfying a redistributive function will be different from those that target a gradual shake up of the political economic foundations and the social contract in Gulf countries. Different GCC countries could be looking at different types of cash transfers. Kuwait, Qatar, and the UAE have a higher GDP and rent per capita, and could therefore be in a privileged position to use cash transfers to alter their political economic foundations early on. Saudi Arabia, Oman, and Bahrain, however, have a lower GDP per capita and need to keep the redistributive function more explicitly on their radar.

Many countries around the world have made cash transfers conditional on school attendance, maternal health care, or overall health care participation.[1] This type of conditionality is unnecessary in

[1] For example Nicaragua's cash transfer was conditional upon attending health education workshops every two months.

the GCC. Regarding healthcare, maternal and perinatal diseases continue to decrease. The key challenges are rather an aging population and record high obesity rates. This makes cardiovascular diseases and diabetes the two largest priorities (Mourshed et al., 2006). Such challenges are better addressed through education and health insurance reform, rather than via cash transfers. That said, it is possible to use cash transfers to help improve the situation. Regarding education, school attendance is not a problem in the GCC. In contrast to developing countries, GCC countries have a higher unemployment rate among more highly educated young people. This is predominantly because the region's education system is not adjusted to the needs of higher-skilled jobs in the private sector (see Figure 2 below). This points to a need for an overhaul of the education system and the introduction of labour activation programmes (discussed below).

Figure 2: Percentage unemployed citizen by education group



Source: GCC-STAT, 2017

An unconditional cash transfer seems attractive and is currently a popular topic in both developing and developed economies. The idea of a universal basic income holds many promises. Hertog (2017; 2016) supports the idea of such a scheme to encourage private investment, entrepreneurship, and the development of local markets. If a deep cash transfer with wide coverage were to be combined with a slowdown in public sector employment, then it could incentivize citizens to pursue private sector jobs. As far as state dependency goes, Hertog rightly points out that this is already the case in the GCC, given the system of public employment and in-kind subsidies to distribute welfare. A universal basic income, however, would be less regressive. In comparison to more means-tested social security measures, recipients of universal basic income also have the advantage of not losing income support when they gain additional employment or income. This should, theoretically, reduce state-dependency gaming. For example, experience with cash transfers in Indonesia showed a negligible and statistically insignificant decline in labour supply among adults (Bazzi et al., 2013). Universal basic income also fits within the rentier social contract and requires low administrative capabilities to verify eligibility (Hertog, 2016; Moss et al., 2015; Luciani, 2017).

These advantages of universal basic income, however, should be treated with caution. Experience indeed shows that universal basic income has positive net impacts on reducing poverty and narrowing income inequality (Moss et al., 2015), but that does not mean it maintains the public support that proponents of universal basic income hope for. Iran is the best example in this regard. At first, Iran was planning for a conditional transfer, but since there was no method to identify eligible households, the country finally opted for a universal basic income scheme (GSI, 2016). Initially, the universal cash transfer was widely popular, particularly during the period before the combined effects of international

sanctions, domestic subsidy reforms, and an influx of cash into the economy induced inflationary pressures. Those impacts inevitably manifested themselves after a few months, with a spike in inflation and a resulting reduction in the real value of the cash transfer. This also occurred during a time of currency crisis. Despite the proven long-term benefits in terms of poverty and income inequality reduction, the public blamed the subsidy reforms and cash transfer mechanism for the higher inflation. This destroyed much of the initial support for future economic reforms (Salehi-Isfahani et al., 2015).

Whereas in the Iranian experience there were several factors outside the cash transfer mechanism that influenced inflation, the risk for inflation from unconditional cash grants in the GCC should not be underestimated, particularly if the goal is to implement a universal basic income alongside potential inflation-increasing measures such as energy subsidy reforms, the introduction of VAT, or the risk of de-pegging national currencies from the dollar.

ii. The possibility to combine conditional and unconditional cash transfers

Given the already high benefits associated with public sector employment, conditional transfers should, at least, be under consideration. It is, for example, possible to have both a wide (unconditional) cash transfer to mitigate the price shocks from subsidy reforms, together with another (conditional) cash transfer to encourage the employment of nationals in the private sector. Indonesia used such a multiple cash transfer system. In 2005–06, and 2008–09, broadly targeted cash transfers were used to mitigate the immediate shock of energy subsidy reform. Within these few years, Indonesia developed further targeted cash transfers. One CT (PKH) allocated a transfer of roughly 12 per cent of household income and reached about 7 to 10 per cent of the population. This transfer targeted younger households, often with a female head of household and in rural/agricultural communities. In addition, a second conditional cash transfer (BSM) provided educational assistance to poor students (World Bank, 2012a).

Such a system of dual cash transfers could be considered in the GCC:

1) A first cash transfer would be used to mitigate the shock of reforms and could be dependent on income. For example, Jordan used income conditionality but set the income level quite high. Ultimately 70 per cent of Jordanians received cash transfers (World Bank, 2013a). Another notable example is the Chinese cash transfer that accompanied a reform of state-owned enterprises and a marketization of industries. Essentially intended to reduce the impact on urban unemployment, the scheme played a crucial role in complementing other large reforms. It now also serves as one of the key rural poverty eradication programmes (Zhang and Xu, 2010).

2) A second, more limited cash transfer could focus on increasing the employment of nationals in the private sector. One possible way of doing this is to exclude well-paid public sector employees, which would effectively make the CT into a private employment wage subsidy. This would have the benefit of a relative reduction in the cash influx into the domestic economy and a consequent mitigation of certain inflation risks. It can be argued that public sector employees already receive high government-sponsored benefits and are unlikely to risk a move to private sector employment. ‘Loss aversion’ is a basic principle in behavioural economics, which explains that people are averse to losing what they already have, even if the alternative is as good or potentially even better (Kahneman et al., 1991). Keeping this in mind, there may be a case for not handing out cash transfers to higher earning public sector employees, as mentioned above.

From the limited amount of public opinion data in MENA, there seems to be support for such an approach and MENA surveys show that there is an overwhelming support for cash transfers that provide income support. While citizens generally favour unconditional transfers – and these would undoubtedly lead to the highest form of buy-in – respondents did support conditionality related to schooling and job searching (Levin et al., 2012).

It is unlikely that merely having a universal basic income will be sufficient to encourage national private sector employment. In Mexico, for example, the cash transfer and capacity building programme ‘Prospera’ improved access to education but did not clearly result in an uptake of Mexican

employees in productive sectors (Lee, 2015). In China, on the other hand, cash transfers were complementary to large labour market reforms and were, as such, an important catalyst in achieving more private sector employment.

In the GCC, cash transfers that are not accompanied by labour sector and education reforms might be useful, but insufficient to incentivize nationals to take employment in the private sector. A private employment wage subsidy, combined with a reduction of civil service hires, would likely be more effective. For example, Kuwait has taken remarkable steps in supporting the employment of nationals in the private sector by using wage subsidies. In 2000, the Kuwaiti Government decided to collect a 2.5 per cent tax on profits of all listed companies to finance wage subsidies that were aimed at reducing the wage discrepancy between similar public and private sector jobs (IMF, 2015b). Effectively, the wage subsidy extended social and child support to nationals in the private sector. Over time, the programme has come to cover more private sector employees (Hertog, 2014), even though its success is still hampered by high public wages and benefits and a continuing skills mismatch (IMF, 2011).

(D) Financing cash transfers

A key challenge for many countries implementing cash transfers is to secure the appropriate level of funding for such schemes. Savings from the reform of energy (and other) subsidies have already been substantial in the GCC, and these could be even greater. In 2015 (before a number of very important reforms took place and during years of high oil prices), energy subsidies accounted for a large part of GCC GDP. In the UAE and Qatar, they amounted to about 6.5 per cent of GDP; in Kuwait and Oman this was respectively almost 8 per cent and 9 per cent of GDP; Bahrain and Saudi Arabia climb into double digits with 11 per cent and 13 per cent of GDP, respectively (IMF, 2015a). Further reforms to subsidies would thus open up a considerable stream of government revenues.[2]

Reforms so far have helped to finance the current account deficit, even if countries like Saudi Arabia, Bahrain, and Oman have a long way to go. For Oman, it is estimated that the fiscal gains from the increase in gasoline prices amounted to around 1.1 per cent of GDP. In Saudi Arabia, revenues from higher energy prices have been used to finance a deficit that was larger than expected (El-Katiri, 2016; IMF, 2016b). Partly because of the implemented adjustment measures, the Saudi deficit has gone down from SR366 bn in 2015 to SR297 bn in 2016, and to a projected figure of SR198 bn in 2017 (FT, 2016). The 2016 energy subsidy reforms saved Saudi Arabia SR28 bn (or US$7.5 bn), which will increase to SR30 bn annually until 2021. In comparison, the Saudi Citizen's Account Program (for which registrations opened on 1 February 2017 and aiming to distribute cash to low and middle income families via an electronic system) is projected to cost less than this in the first year, but the costs are expected to rise. It is therefore clear that further reforms will be needed to cover the costs of the cash transfer. Saudi Arabia's Fiscal Balance Program aims at achieving SR171 bn of additional annual savings from energy and water pricing reform (Saudi Arabia, 2016).

If energy and water prices continue to be adjusted, the IMF estimates that Saudi Arabia could gain additional revenue of SR314 bn over five years (IMF, 2016a). It should be the intention that savings from reforms are used to finance a CT programme. However, if CT financing is linked to the international oil price, the cost of the CT programme would be unpredictable and could spiral alongside volatile international prices (especially if the cash transfer benefit is high). In theory, GCC governments could tap into other financial resources to finance CTs. One could think of borrowing from central banks, tapping into the various GCC sovereign wealth funds, or relying on large revenue-raising measures such as Aramco's IPO. In practice, such measures could lead to inflation and a lower credit rating.

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[2] These subsidy figures are estimated using a price-gap approach based on the opportunity cost of selling underpriced energy domestically versus at a higher price on the international market. This means subsidy estimates vary alongside the international energy price. The numbers should be considered with caution. Since the drop in international prices in 2014, the energy subsidy estimates for GCC countries have also fallen (as the price gap decreased due to both a lower international price and domestic energy subsidy reforms).

Financing is closely linked to the level of benefit and coverage, and requires careful planning:

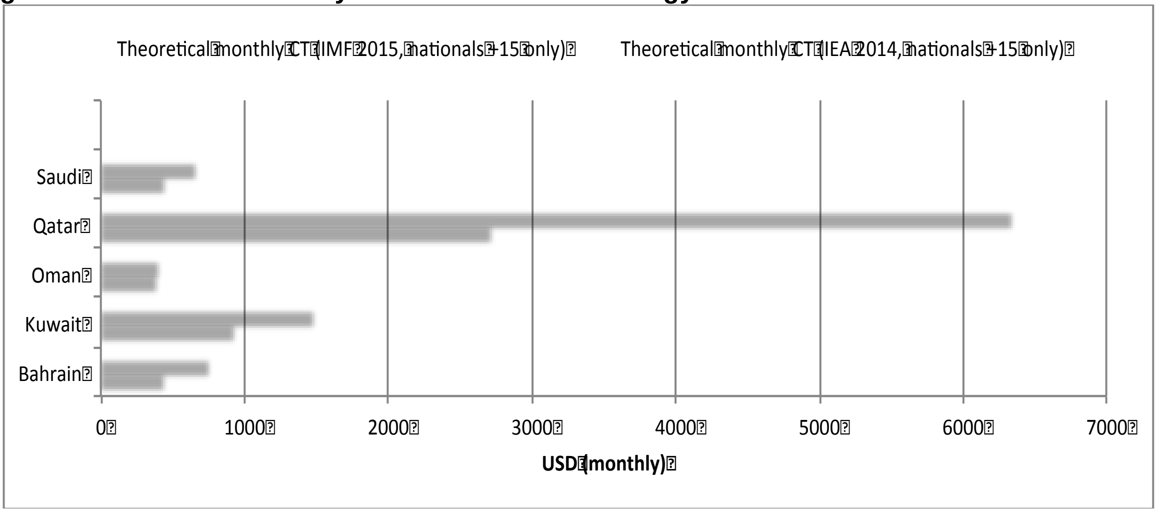
- Iran intended to finance its cash transfer system using 50 per cent of the fiscal savings from its subsidy reforms. However, the actual annual cost of the programme ran to around IRR45 bn whereas savings from reforms were only IRR30 bn. This necessitated government borrowing from the Central Bank and, consequentially, worsened inflation (Salehi-Isfahani et al., 2015). Eventually the Rouhani Government had to slash the number of beneficiaries by a third.
- Other countries have shown a more realistic approach to government finance. In Indonesia, the first (2005–06) CT cost about 2.9 per cent of government spending and the second (2008–09) CT only cost around 1.3 per cent of government spending (World Bank, 2012b).
- In China, the subsistence allowance system cost around 1.09 per cent of fiscal expenditure (Government of China, 2015). Ultimately, Chinese cash transfers continue to depend on the available fiscal capacity, which has been a problem in rural areas given the volatile nature of government revenue there (Guan, 2016).
- In Jordan, cash transfers cost 7 per cent of GDP, but were limited in duration (Fattouh and El-Katiri, 2012).

(E) Level and duration of benefit

It is clear that the combination of financing, and of the level and duration of benefit, are key considerations in setting up a sustainable cash transfer programme. Theoretically, the level of benefit and its duration are linked to the objective of the CT. The hope that a cash transfer could provide an economic function in addition to a redistributive function relies on the assumption that the benefit would be substantially higher than just covering the impact of subsidy reforms. This is not straightforward, particularly if a universal transfer is envisioned. If the benefit is too generous, it can discourage labour activation and increase the unemployed dependence on government in the long term, and cause additional inflation in the short term. To achieve the necessary buy-in to slowly change the role of subsidies and public employment in the rentier social contract, cash transfers ideally need to have a high coverage, even if this initially leads to leakage (Jawad, 2015). It is therefore advised, particularly for countries with more poverty and lower fiscal capabilities, to progressively decrease cash handouts and limit the number of income groups covered.

If we compare the level of energy subsidies to a country's population size (read: 'GCC nationals, excluding expatriates'), it is clear that energy subsidy reform would open up significant financial capacity to allocate substantial cash transfers to all GCC nationals (see Figure 3). The UAE, Kuwait, and Qatar in particular could address future problems by implementing cash transfers early on. Saudi Arabia, Bahrain, and Oman, however, have less capacity to allocate universal cash transfers, even if they were to reform domestic subsidies. This speaks in favour of conditional transfers. There is a large limitation to these subsidy estimates as their calculation is based on an opportunity cost approach (namely how much more revenue could the government make by reducing domestic consumption and selling resources abroad instead). If oil revenues are higher, then monthly cash transfers could be significantly higher as well.

Figure 3: Theoretical monthly cash transfers if all energy subsidies are rationalized



Source: IEA, 2014; IMF, 2015a, World Bank, Author calculations

Many countries have considered different types of benefits:

- Indonesia made cash transfers during two periods (in 2005–06 and 2008–09) that were limited in duration (12 months and 9 months respectively); these were primarily intended to cushion the immediate shocks of energy price increases. The benefit offered was about US$10 per month and represented about 15 per cent of the average consumption budgets of targeted households. The results were positive and demonstrated that the CT was mainly used to buy necessities (World Bank, 2012b).
- Jordan also limited the duration of its cash transfer. From the beginning, it linked the cash transfer policy to the international oil price (transfers were to stop if the price fell below US$100 per barrel). This added a crucial element of predictability (Atamanov et al., 2015).
- China's subsistence allowance system is based on transfers of variable size. In 2014 the transfer was US$45 per month in urban areas and US$21 in rural areas, with the monthly low-income line respectively at US$64 and US$45 (Government of China Official Figures). Cash transfers thus constitute an importance source of income for low-income groups, and are adjusted according to consumer price inflation (CPI) and Food CPI.
- Iran experienced significant problems with its CT as the benefit was arguably far too high. The transfer was 28 per cent of median per capita income – a figure that was greater than the monthly expenditures of 2.8 million citizens. As the benefit was the same for everybody, the level of importance varied. For the first three income deciles, the benefit constituted 26 per cent, 16 per cent, and 13 per cent of household income. For the richest five deciles, this was within single digits (Salehi-Isfahani et al., 2015). Those in the lowest decile received 13 times the amount they spent on subsidized products, whereas those in the richest decile received 1.8 times that amount. By all measures, this was a universal basic income package. It is logical that the resulting reduction in poverty was mainly in rural areas (a reduction from 44 per cent to 23 per cent) (Enami et al., 2016). Because of financial difficulties, however, Iran ultimately had to cut a third of beneficiaries and introduce goods baskets instead.

If a decision is made to implement cash transfers, GCC countries should be very careful about the level of benefit. Cash transfers that are intended to cushion the impact of subsidy reforms should be designed so that their cost stays below the fiscal savings due to the reform. The Iranian experience demonstrates that the key lesson is to have certainty that the CT programme can indeed be financed. While Jordan's approach was to limit the duration of the cash transfer to the international oil price, such a system is of less relevance to GCC states.

For the GCC, a system of predictability about the level and duration of transfer is essential, even if that means a more limited benefit for a wider part of the population in the short run. Various cash transfer experiences have shown states setting a relatively low benefit level that can be sustained over a number of years, even if more financing is available due to fiscal reforms. On the other hand, linking cash transfers to international oil prices – a measure often suggested – would lead to a less predictable benefit given international oil price volatility.[3] It seems plausible that such a scheme could create public dissatisfaction. But it may be wishful thinking that individuals would save for a rainy day, especially in countries with rising income inequalities.

(F) Registration and delivery of cash transfers

The delivery of cash transfers is not a particular problem in the GCC. There is a high level of financial inclusion since most social security transfers, as well as public employment salaries, are delivered via bank accounts (Held and Ulrichsen, 2011). International experience indicates that there is a drastic reduction in corruption (and therefore in leakage) if direct account transfers are used to deliver social assistance. Given the interests that naturally arise out of social assistance delivery, it is easy to understand the difficulties of switching to bank accounts at a later stage. If there are problems with rural inclusion, it is best to follow Iran's example and set up ATMs while closely monitoring rural registration. This strategy was both cost effective and very successful in reaching rural households (Salehi-Isfahani et al., 2015).

Registration is more difficult. Even if there is a decision on setting theoretical conditions (such as income) for cash transfers, beneficiaries still need to be registered in the system. There are four methods of registration to connect to beneficiaries (Hanna and Karlan, 2017):

1) *Self-targeting*: Households make their own applications, after which Government (based on certain conditions) either enters them into the CT system or not. The benefit of this system is its flexibility, allowing regular updates from the target population.

2) *Proxy means-testing (PMT):* Government collects demographic and other data and uses that information to approximate the level of income. It is important to choose variables that can be easily collected and verified as PMT needs periodical updating. This system requires an autonomous and well-trained statistical team.

3) *Geographic targeting*: Useful if poverty is concentrated in particular regions. Leakage can be smaller as wealthier households are unlikely to be located in particularly poor neighbourhoods.

4) *Community-based methods*: Community members choose who is eligible for the CT programme (based on standards set out by the government) and then communicate the results to higher authorities.

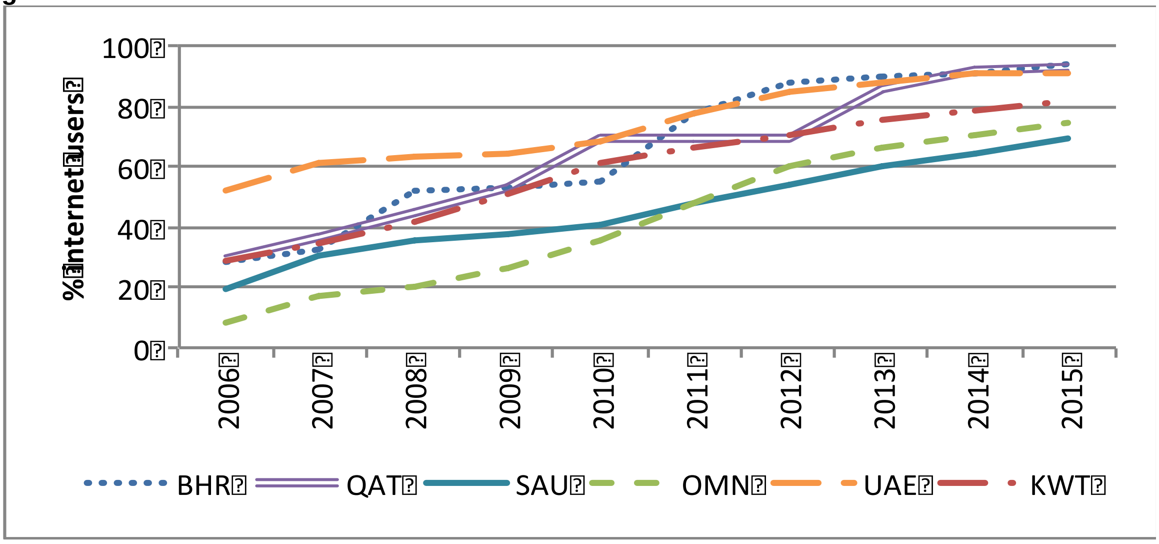
The two latter options do not seem adapted to a GCC context. Geographic targeting requires a certain level of information about the geography of poverty. In addition, as cash transfers are meant to widen the acceptability of subsidy reforms, they would not need to be targeted geographically. Experience with community-based methods shows a high level of leakage and potential exclusion. Adding intermediaries often leads to an increase in corruption. Also, the size of most GCC countries – Saudi Arabia aside – does not justify the construction of a complex vertical system to implemented geographic and community-based targeting.

In a GCC context, as countries are seeking to implement energy-pricing reforms, self-targeting seems logical and online registration systems for self-registration seem the obvious way to proceed. The GCC can count on high Internet connectivity, with most countries having populations where more than 80 per cent are Internet users (see Figure 4). Oman and Saudi Arabia run slightly behind, but data shows there is a trend towards 80 per cent there as well. Not being Internet-connected could lead to a

[3] This is however dependent on exchange rate policy. If currencies were allowed to devalue alongside declining oil prices, then a cash transfer would also reflect the change in the price of oil while remaining constant in terms of national currency amount.

certain level of exclusion. This could be monitored fairly easily, and complementary policies can be used to reach these households if necessary.

Figure 4: % Internet users in GCC



Source: World Bank, 2017

That said, PMT methods can also be quickly developed and implemented. The choice ultimately depends on the goal of government. If the objective is to target a wide beneficiary scheme (such as a universal basic income scheme), then self-targeting could suffice. If, however, the goal is to move to targeted social assistance over the longer term, then Government will have to develop data collection capacity to satisfy a proxy means test. This is particularly relevant as there is no reliable income data in the absence of a progressive taxation system.

(G) Institutional design

International experience in setting up cash transfers indicates three key lessons. First, cash transfers need high-level leadership and their development needs to stay close to the centre of power. With fiscally tight budgets, leadership from the top levels of government is needed to instruct the CT setup and ensure availability of finance.

- In Egypt, it was the Office of the Prime Minister that issued a decree and established a ministerial-level committee to oversee the preparation and introduction of the CT. A technical working unit to support the committee was also established under the Office of the PM (World Bank, 2013b). To avoid a traditional overlap of terms of reference and an absence of accountability, collaboration protocols were developed and signed by all relevant ministries.
- In Jordan, the Ministry of Finance played the key role in developing the cash transfer mechanism.
- In India, the Ministry of Finance also played a leadership role in transitioning from in-kind subsidies to direct benefit transfers.

Second, financial flows need to be transparent and ideally without intermediaries. Most countries allocate the key function to the Ministry of Finance. To reduce corruption and allegations of corruption, cash transfers should be visibly linked to the savings of energy subsidy reforms. Ideally, such savings are collected in a separate fund (Hertog, 2017; Moss et al., 2015), which could create an island of efficiency as far as accounting goes. The distribution of cash transfers should then rely on a direct link between this body and citizens. GCC countries have the benefit of being able to immediately transfer to citizens' bank accounts.

- In Iran, the Government set up a new account to manage subsidy savings (Al-Monitor, 2014).
- n India and China, corruption was rampant due to local and regional intermediaries. Cutting out regional intermediaries made cash transfers more effective.

Third, cash transfers can be a lever to achieve greater institutional communication, but should not rely on horizontal coordination between institutions at the onset. Horizontal coordination processes should be developed over time, but when immediately implemented, they are often ineffective due to rentier state politics. This is particularly due to the leverage of vertical patronage networks that control financial flows. In other words, actors remain vested in and accountable toward their vertical coordination partners, as they hold the financial capacity to reward or punish them. In this context, resource sharing in horizontal processes is more of a theoretical ideal than being practically possible. The best strategy is to create islands of efficiency and gradually increase their contact with other parts of the administration. Setting up coordinating bodies does not offer an easy fix. Rather, there needs to be coordination closer to the centre of power.

- In Brazil, the Bolsa Família CT programme was designed to avoid patronage. The institutional set up for management and implementation tried to ensure that there was no contact between the CT programme's managers and beneficiaries. This included clear transparency rules, as well as the *ex ante* development of objective criteria for CT adjustment. Politicians themselves thus had a less significant role once the CT programme was up and running (Linder, 2011). The Ministry of Social Development manages Bolsa Família and is well staffed to both manage the programme and lead impact evaluations. Municipalities carry out many aspects of the programme's implementation. There are three control agencies that are responsible for oversight, and the Ministry of Social Development also has its own municipal implementation monitoring and evaluation index. A wide range of additional management tools was used to increase implementation quality (Lindert et al., 2007)
- Alongside its cash transfer policies and as preparation for a maturing of its social protection system, Indonesia set up a National Team for Accelerating Poverty Reduction (TN2PK). Its goal was to conduct research, develop poverty reduction programmes, and coordinate programmes and their implementation across various ministries. It was chaired by the vice-President and co-chaired by coordinating ministers for people's welfare and the economy. Eventually, it mainly developed research, rather than taking up a coordinating role (GSI, 2016).

II. GCC Case example: Saudi Arabia's Citizen's Account

Over the coming years, Saudi Arabia is planning further subsidy reforms, together with the introduction of VAT, and the government has committed itself to set up a cash transfer programme before such reforms take place. The cash handouts, called Citizen's Account, will vary over income groups and complement existing social security mechanisms. The mechanism is redistributive in nature: the two lowest income quintiles will have net gains, the two subsequent quintiles will only have a partial coverage of the negative effects of subsidy reform, and the richest quintile will carry the burden with the highest net loss (and zero cash transfer) (see Table 1).

Table 1: Citizen's Account 2017 Cash transfer projection (SAR/month)

	0–8,699	8,700–11,999	12,000–15,299	15,300–20,159	20,160 +
Expected loss of income	(1000)	(1,100)	(1,300)	(1,500)	(2,000)
Anticipated cash transfer	1,200	1,200	1,000	600	0
Net gain/loss	200	100	(300)	(900)	(2,000)

Source: Saudi Arabia, 2016

The cash transfer is intended to cover the welfare losses from subsidy reforms but is ultimately fairly modest in benefit; in other words, only the lowest two income quintiles have some net welfare gains. This is reflective of the fiscal constraints on the Saudi government. In itself, however, it can be useful to first expand coverage and then subsequently address redistributive strength. It seems that Saudi Arabia is planning to do that. Since registrations opened in February, over 3 million families and 11 million Saudi citizens have registered. From its projections, the government plans to increase the net benefit for lower income quintiles toward 2020 (Table 2).

Table 2: Citizen's Account 2020 Cash transfer projection (SAR/month)

	0 – 8,699	8,700 – 11,999	12,000 – 15,299	15,300 – 20,159	20,160 +
Expected loss of income	(1300)	(1,600)	(1,900)	(2,200)	(3,100)
Anticipated cash transfer	2,000	2,000	1,500	1000	0
Net gain/loss	700	400	(400)	(1200)	(3,100)

Source: Saudi Arabia, 2016

Whereas beneficiaries are fairly clear (receipt of cash transfer is conditional upon income), many questions remain with regards to financing the cash transfers. Table 3 clearly shows that the CT programme is projected to cost more than the savings from current subsidy reforms. As mentioned, in 2016, the energy subsidy reforms saved Saudi Arabia SR28 bn (or US$7.5 bn), which will increase to SR30 bn annually until 2021. Further financing of the cash transfer programme will come from the savings generated by further energy subsidy reforms.

Table 3: Cost of Citizen's Account and (potential) savings from subsidy reforms

	2017	2018	2019	2020
Cost of cash transfer (bn SR)	20–25	35–45	50–60	60–70
Savings from previous subsidy reform (bn SR)	29	30	30	30
Potential savings from cost-recovery reform (bn SR)	35	78	125	168

Source: IMF, 2016a; Saudi Arabia, 2016

These numbers resulted from preliminary analysis and government is now re-evaluating them prior to the introduction of the scheme. Nonetheless, as the Table 4 shows, financing cash transfers with savings from subsidy reforms is, *per se*, a logical solution. Saudi Arabia's proposed cash transfer programme becomes far less attractive when considering the duration of the benefit. The cash transfer was set to start in June but remains delayed. In any case, the transfer will always be distributed one month prior to reforms. Before every economic reform, Government will announce the transfer. The government has tried to deal with this uncertainty by adding a virtual calculator online to show the rate of allowances for individual citizens. Yet it remains entirely unclear when reforms and cash transfers will actually happen, and what the level of benefit will be. This shows the ultimate objective of the cash transfer: to cushion impacts of reforms. Even the redistributive nature is limited, as cash transfers will only be given when reforms take place.

In terms of registration, Saudi Arabia has used self-targeting. So far, the process has been remarkably user friendly. Saudi nationals were able to log into a dedicated website to register and pose questions on their eligibility via text. Online registration was the only means of registration, and it is unclear whether government has taken into account potential non-coverage due to a lack of internet-connectivity. The government did release a guide explaining the programme, and dedicated call centres were available for 18 hours a day to respond to queries (Al Arabiya, 2017; Taha 2017). It should be noted that to date nothing is known about how government will check the truthfulness of registered income data. The Ministry of Labor and Social Development is supposed to verify self-reported income against other databases held by itself and other ministries.

The institutional design demonstrates a lack of governmental experience. The Saudi Ministry of Labor and Social Development effectively runs Citizen's Account. To check that allowances reach the right beneficiaries, the CT programme is linked to the Housing Ministry's Ejar Program, an electronic portal to regulate the real estate rental market (Taha, 2017). This could be a valuable proxy for income, to ensure accurate identification in the short term (even though this is far from certain), but it is far from sufficient to develop more mature cash transfers and other social policies in the future. In May 2017, a review of the registration process was supposed to take place, but little is known about its results. It was planned that recommendations from a pre-implementation review would be submitted to the higher ministerial committee. When they are approved, cash transfers are set to start (Saudi Gazette, 2017). While originally planned for June, cash transfers have not yet been implemented at the time of publication with reports indicating that it may happen later in 2017.

III. Non-CT short-term mitigation measures

Many countries rely on a portfolio approach of complementary methods when it comes to compensating citizens for energy subsidy reforms. This effectively means that various policy measures (see below) are used to mitigate negative impacts and widen support for reform. There are three key advantages in using a portfolio approach.

1) *Targeting risk*: Governments reduce the risk of missing particular stakeholders. New instruments like cash transfers often have high leakage in the beginning, reaching those who are not eligible while often also missing households that should be beneficiaries. Complementary mitigation measures can help deal with these concerns in the short term, while the CT mechanism becomes more effective over time because of 'learning-by-doing'.

2) *Maximizing support:* Complementary mitigation measures can be used to target specific stakeholders that may vocally oppose subsidy reforms. For example, measures can be used to target agricultural producers, rural consumers, taxi operators, or unemployed young people. Individually, many of such dedicated programmes have often proven to be insufficient. In combination with cash transfers, however, they could be a catalyst to boost trust in government.

3) *Gaining useful experience for medium-term social safety development:* If the development and implementation of complementary mitigation measures is closely monitored and evaluated, the information gained can be of value to medium-term, more targeted, social safety development. This includes experience within institutions managing compensation measures, as well as a better understanding of various stakeholder groups (and their needs).

In GCC countries, short-term compensation mechanisms will, in the first place, rely on existing mechanisms of welfare distribution such as subsidies and public employment. Many countries in the world have attempted to implement a portfolio of mitigation measures, both relying on new programmes and on an extension of existing benefits. Often, the setup of new, decentralized mitigation measures is difficult from an institutional and bureaucratic point of view. In the short term, countries have therefore mainly relied on measures in which they have administrative experience. Using more targeted subsidies as compensation measures, GCC countries could rely on the following measures:

- *Food subsidies:* Whereas food subsidies are still regressive, and dual pricing leads to corruption, they are less regressive than energy subsidies and are generally popular with households. They were used in Namibia and Egypt, among other countries. In the latter, the government increased the amount of subsidized food groups prior to reforms (James, 2015; GSI, 2016).
- *Transport subsidies:* Some countries have used urban transport vouchers (Mozambique), mass transit schemes (Nigeria), or free transport in government (military) buses (Egypt). Public transport is, however, fairly unpopular in the GCC.
- *Free fuel allowances:* More attractive than public transport vouchers could be the allocation of free fuel allowances. In Kuwait, every national with a driving licence receives 75 litres of 91-octane petrol for free every month (estimated to represent about 30 per cent of consumption demand) (Anderson, 2016). When this was still insufficient for some members of Parliament, the Emir called for new elections, in which anti-austerity parties showed considerable strength (Anderson, 2017; Martin, 2017). The downside of free fuel allowances is that they incentivize consumption up to the level at which prices increase.
- *Electricity block tariffs:* A popular measure is to provide poor citizens with access to free electricity and to introduce blocked tariff design. In the GCC, there are a considerable number of plans to have non-nationals pay more for utility costs and cross-subsidize the savings to citizen-consumers. Many countries are already using blocked tariff designs. The scheme to have

expatriates pay more has been criticized as it is believed that they will factor such added costs into their wage bill.

Besides subsidies, GCC countries can also use employment policies to mitigate impacts. However, international experience suggests that subsidy reforms in combination with limited activation policies are insufficient to restructure the labour market. A restructuring of the labour market requires an overhaul of education, immigration policy, and government employment policy. Compensation measures that target employment can be used to gain experience in these fields and widen the acceptance for subsidy reform, but have fairly unconvincing track records:

- *Extension of public employment*: Richer countries with fewer people can still rely to some extent on the public employment system. While Kuwait increased salaries for lower-earning government employees, it also allowed an increase of already high salaries in the oil sector (Stratfor, 2016). Similarly, Qatar announced that citizens would be compensated for subsidy reforms through a hike in public sector salaries (The National, 2016). An extension of public employment, however, will only increase existing deficiencies and add to an already excessive public wage bill.
- *Employment activation measures*: Few countries in the world have had successful one-off programmes. In India, the MGNREGA programme guaranteed temporary employment at the agricultural minimum wage for 100 days per year. In 2011–12, 25 per cent of all rural households did some MGNREGA work for an average of 48 days. The programme had few benefits in terms of skills development and private sector uptake. In Mexico, Oportunidades (later Prospera) led to better educational performance, but also failed at private sector labour market activation. In Algeria, a smaller youth unemployment alleviation programme was linked to a microcredit mechanism. It, however, struggled to survive as most credit was allocated to low-value sectors (Achy, 2013).
- *Targeted support for farmers:* Whereas the agricultural sector is relatively unimportant in the GCC, it is still a large source of employment in Oman and, to a lesser extent, Saudi Arabia. Agricultural support schemes could therefore mitigate the impacts of reforms for this particular sector (NCB Capital, 2010). Both India and Nigeria have shown that it is possible to make quick and noteworthy advances in direct benefit transfers for fertilizer. If linked to cash transfer schemes, targeted support for fertilizers can increase the overall popularity of the CT mechanism.

IV. Development of medium-term targeted social safety

There are no easy recipes to build targeted social safety nets from scratch. Neither subsidy reform, nor cash transfers, nor a combination of both is sufficient to immediately transition to cost-effective social safety provision. Rather, the development of medium-term targeted social safety nets depends on a 'learning-by-doing' process that combines the gradual improvement of administrative capacity with a consistent evaluation of existing distribution mechanisms such as cash transfers.

International experience clearly confirms that only with an integrated approach can countries respond to the multi-facetted nature of current challenges such as poverty and labour market activation. Having a coordinated set of programmes that target particular population groups is often called a 'Graduation Approach'; this refers to the goal of graduating individuals from social safety nets by an uptake in the labour market. If a graduation policy is absent, cash transfers can lead to long-term rent seeking behaviour, and will therefore continue to distort labour markets. For example in Saudi Arabia, remarkable economic growth since 2004 was accompanied by a steep increase of social security recipients, indicating the absence of graduation programmes. Moving a country's social safety net policies to effectively implement policies that assist in graduating recipients requires three continuous and inter-dependent efforts that guide the planning and implementation of new measures:

1) Clarify internal governmental responsibility.

2) Evaluate existing programmes and pilot the next ones.

3) Enhance statistical capacity for beneficiary identification.

First, internal governmental coordination needs to improve. Many social security and safety mechanisms (such as those in South Africa and Morocco) have problems in terms of leakage, exclusion, and financial sustainability because of corruption and fraud that finds its way through a myriad of overlapping processes and functions in various ministries and agencies. Morocco, which has been a leader in gradual subsidy reform, has attempted a similar gradual adjustment of existing social safety nets. Despite various partnership and coordination efforts, this has proven difficult, due to institutional path dependency (Angel-Urdinola et al., 2015).

The future development of more mature and targeted social safety nets is thus reliant on a clarification of internal governmental responsibility, authority, and accountability. This starts with measures as simple as the development of terms of reference and a clarification of organizational flow charts. At the same time, effective implementation needs to be leveraged on the creation of new islands of efficiency that are gradually granted more authority to coordinate horizontally. This is a structural process that should be started by the central leadership. It is advised that to be effective, short-term mitigation measures like cash transfers remain isolated from this bargaining process.

Second, governments need to continuously evaluate existing programmes and pilot new ones. This is the stage at which the two objectives of improving internal coordination and the better targeting of beneficiaries affect each other. Pilot projects can be used to assess how ministries cooperate and reach the targeted income group, and would undertake an impact evaluation of the measures. Experience with graduation programmes also shows that such an approach is able to cut costs significantly before a wider-scale implementation (Hanna and Karlan, 2017).

After initial cash transfers to a wider part of the population in exchange for support of subsidy reforms, GCC states would need to choose what model to opt for: a larger, unconditional scheme that resembles universal basic income or more targeted social safety nets. Both would require testing different adjustments of cash transfers, including control groups that do not receive adjusted cash transfers (Hanna and Karlan, 2017). An investigation of household decision patterns would then be required to make sure that the chosen form of cash transfers reaches its intended goals (whether poverty alleviation or labour market activation).

Third, governments need to enhance their statistical capacity to evaluate and plan social safety reforms. Conditioning cash transfers, as well as the longer-term development of more targeted social safety nets, requires strong statistical capacity to collect social data and measure income. To date, income data is fairly unreliable in the GCC and that remains a problem (Luciani, 2017, Moss et al., 2015). A first step in the development of personalized social data is a reliable ID. More advanced cash transfer schemes then link this ID to a bank account directly, in order to avoid fraud and exclusion, while opening up more statistical capacity. As the Saudi example demonstrates, such a unified ID is not yet available across the GCC. There are two particular challenges related to the development of a transparent ID and associated social data:

- *ID choice and information gathering:* Biometric concepts are an increasingly popular way of delivering social services. In India, Aadhaar numbers are essentially biometric IDs for citizens that can be used to access several government services. Linking Aadhaar numbers to bank accounts allowed direct benefit transfers and cut out the middleman. As such, it was also possible to monitor and analyse expenditure, which is useful for the evaluation of social programmes. The development of such a biometric ID can be quick. In 2010, the Indian Government established the Unique Identification Authority of India (UIDAI). In six years' time, UIDAI was able to compile the biometric and demographic data of 1.04 billion citizens (and allocate as many Aadhaar numbers).
- *Information sharing:* Experience in other countries (such as Egypt) with setting up unified national registries illustrates the difficulties of sharing and updating data from various ministries. The main message here is to have an institution with a clear mandate close to the centre of power, which then has the authority to demand social data from various ministries or agencies. The terms of reference of each of these agencies should be clarified to represent their individual data collection responsibilities.

Ultimately, the successful development of a medium-term targeted social safety net also relies on the ability of government to have a holistic vision of reform, one that includes labour market, migration, education, and social security reforms.

Conclusion

The decline in oil prices since 2014 and resulting fiscal stress has pushed GCC countries to increase domestic energy prices. These initial increases, however, have not been accompanied by compensation mechanisms to help offset the adverse impact of higher energy prices on households. Most GCC countries are planning further, deeper, structural reforms, but if they do so without harnessing social safety nets, the process could result in loss of support for reforms and wide popular discontent, with important consequences for political and social stability. Current welfare distribution mechanisms – such as in-kind subsidies and public employment – are unsustainable, and do not offer a cost-effective way of protecting household welfare. Instead, GCC countries should invest in developing the administrative capacity to implement new welfare distribution mechanisms. This paper has recognized a temporal dimension in such a development. In the short term, GCC countries are able to implement cash transfers in combination with other, smaller, compensation measures. Only in the medium term can GCC countries develop the administrative capacity to deliver more targeted social safety. However it is important to stress that:

- Cash transfers can cushion the impact of subsidy reforms, but they are not a panacea to resolve historical deficiencies in labour markets. Cash transfers are popular across the GCC and, relative to more-targeted social safety mechanisms, require less administrative capacity. They can be effective in protecting household welfare affected by price increases, and can be used to redistribute welfare to lower income groups fairly easily. They are, however, insufficient to disentangle GCC rentier state deficiencies. Addressing these deficiencies would require policy adjustments in labour markets, education, migration, and social security. International experience outside rentier states is able to give useful insights into the challenges associated with the design and implementation of cash transfer programmes. These should, however, not be replicated without taking into account the particular political economy characteristics of the GCC.
- Cash transfers are a heterogeneous group of social safety mechanisms. Their design depends on the local context and ambition of the implementing government. The critical design element is the reliability of CT financing. In the GCC, cash transfers do not need to be conditional upon health or education. Countries with a larger poverty problem – such as Oman, Bahrain, and Saudi Arabia – could consider linking different benefits to income levels, even though income level data remains fairly unreliable. Certainty relating to the level of transfer is essential for both households and government. It is therefore advisable to maintain a certain benefit level over time, rather than linking it explicitly with a volatile international oil price.
- The success of cash transfers and of medium-term, more targeted, social safety development depends on the quality of implementation and the ability to develop administrative capacity from earlier experiences. Cash transfer schemes need to be developed close to the centre of power to be successful. Their development and adjustment over time will require a clarification of internal governmental roles and responsibilities that will include the area of data collection, together with the necessary financing to increase governmental capacity. In the short term, it is advised to shield cash transfer mechanisms from fragmented bureaucracies. Top-level leadership is needed to guide this process.

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