Research Global

Make the Gulf great again – how the UAE-KSA rivalry is reshaping our neighbourhood

- **Recent years are marked by an intensifying rivalry between the United Arab Emirates (UAE) and Saudi Arabia (KSA). The two Gulf heavy-weights race to diversify their economies away from fossil fuels, and to attract tourists and investments. In this regard, the KSA continues to catch up the UAE.**
- **Both countries also seek to expand their regional influence. 'Dollar diplomacy' is an old foreign policy instrument for the Gulf states, but lately, their toolbox has expanded from old-school bailouts to mega investments made by their sovereign wealth funds (SWFs). This gives them unforeseen leverage.**
- **As long as oil prices remain high, the Gulf states' growing ambitions and ample financial resources is a '*perfect match'* for ailing economies in the neighbourhood. Enter rivalry and their regional footprint – alongside their global influence – will continue to grow.**

In many ways, as the world is in transition, so is Middle East. The Gulf states acknowledge their crucial role in the global energy market, and they still collaborate in that regard, but they also race to diversify their economies and grow their regional footprint. For two decades already, the United Arab Emirates has been attracting foreign investors, while actively investing in the region itself. Since launching its *Vision 2030* eight years ago, the KSA has grown to become a real challenger for the UAE.

For the Emirates and the Saudis who have a long history of collaboration, the last few years are marked by an intensifying rivalry. It may be bold to say the two have drifted apart for good, but if they have (and *some say* they have), the economic and political implications could be significant. The stability of the oil market often relies on OPEC where an outright conflict already emerged in 2021. Also, Middle East's neighbourhood is our backyard, and any problems there tend to spill over to Europe. Finally, what the Gulf powers are doing across the region is a perfect showcase of the world becoming multipolar.

Flexing muscles, buying influence

The UAE and the KSA are flexing their muscles as they compete, but also, as they see the new world (dis)order giving them a great opportunity to expand their influence. In many cases, the absence of the US or the EU in Middle East and North Africa (MENA) have left a vacuum to fill, or governments there prefer partners outside the West. Meanwhile, China's enthusiasm to invest in the EM space is being dampened by its own economic woes. For example, in 2020s, *China's annual new lending to Africa* has been on average 10% of what it was a decade earlier.

For long, a key motivation for both the UAE and the KSA to engage with neighbours has been to contain any pro-democratic Islamist movements. For both, their security agenda is linked to economic performance. Securing access to the Red Sea waterway that connects Middle East and Asia to Europe is crucial (similarly as is smooth sailing on the Persian Gulf), but that is not all. The ongoing attacks by Houthi rebels also *jeopardise KSA's giga projects* along the Red Sea coast, most of which have a tourism dimension.

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UAE and KSA collaborate on a number of fora

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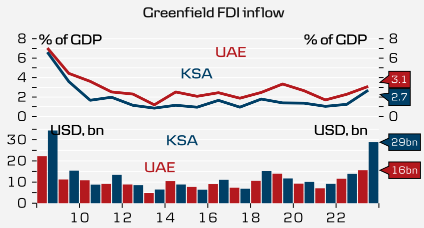
Race for becoming the regional FDI hub

Opening their economies and attracting foreign direct investment (FDI) stand as top priorities for the Gulf states. For long, Emirates' more developed investment legislation combined with perceived political stability, developed infrastructure and high living standards has made the country the region's FDI hub. In the past 10 years, inward FDI skyrocketed for the UAE, surging 149%. Meanwhile, it only increased slightly for the KSA (4%).

However, in greenfield FDI inflows, the Saudis are approaching the scale of Emirates. In 2023, the country attracted USD 29bn in inflows (2.7% of GDP) compared to USD 16bn (3.1% of GDP) in the UAE. In terms of project announcements, the UAE still has a clear lead, though. Last year, with 1323 projects, it ranked second globally after the US. In the KSA, only 389 new projects were announced. As the Saudis trail the UAE much more in terms of the number of projects than in sheer volume, average ticket size must be larger in the KSA. That may be related to the fact that China is the main sponsor of greenfield investments in the KSA, while most of the UAE inflows come from the US.

The Saudis are catching up in terms of inward greenfield FDI



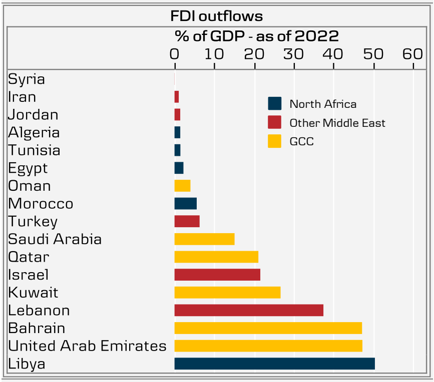
Sources: UNCTAD, IMF, Macrobond Financial, Danske Bank

To encourage more investments, the KSA has introduced a string of new rules. In 2021, the Kingdom imposed *restrictions on imports* from GCC countries, removing tariff-free status for goods manufactured in economic free zones by firms with more than 75% foreign workers and less than 40% added value. Additionally, starting this year, international companies that wish to receive government contracts, *are required* to have their regional headquarter (RHQ) in KSA. Firms that move their RHQ to Saudi Arabia get a *30-year tax exemption* for corporate income tax. The plan seems to work. During Q1, *some 127 multinationals* corporates moved their RHQ to KSA.

Switching on investment gear

If attracting investments is at the core of the rivalry, so is investing abroad. The Gulf nations have a long history of promoting economic stability in their neighbourhood. Since 1963, the Gulf states *have disbursed* more bailout aid to the MENA region than most bilateral or multilateral donors, such as the IMF. Historically, the KSA *has led bailouts* (aid) in the region and it continues to do so, but since the 1980s, the UAE's share has grown significantly. Simultaneously, for the KSA, the past decade marks a transition *from aid into outright investments*. In this regard, compared to the UAE, it has some catching up to do.

Much like FDI inflows, the UAE leads in outbound investments as well



Sources: UNCTAD, Macrobond Financial

The key tool the Gulf nations use to expand their economic influence, is their SWFs. During the past two decades, SWFs have grown massively, positioning their host countries as prominent foreign investors. The UAE and the KSA have been key players in this development, with the UAE's Abu Dhabi Investment Authority and the KSA's Public Investment Fund leading the way. With close to USD 1 trillion in assets, they both rank in the *top 5 largest SWFs globally*, just behind the Norwegians and the Chinese.

Thanks to the growth in SWFs, both the KSA's and the UAE's outward FDIs have propelled over the last ten years, by c. 444% and 298%, respectively. On global scale, the two still trail behind most advanced economies, but lead most similar EM economies, see appendix 1. Their efforts, measured by outward FDI as a share of GDP, remain somewhat mixed. The Emirati figure stands at 47% in 2022 and is comparable in scale to e.g. the Nordic economies, while the number for the Saudis is 15% (appendix Y). The difference in standings also reflects that the UAE launched its own Vision 2030 (economic diversification strategy) eight years earlier.

No escaping oil dependence in short term

Rivalry aside, the Gulf countries cannot afford to ignore a factor that remains critical for their economic success – the oil price. The KSA is the second largest oil producer in the world after the US, constituting just below 34% of OPEC's oil production. The UAE also possesses substantial oil facilities, ranking as the eighth largest oil producer in the world, with 55% of government revenue stemming from oil.

In many ways, however, the two have different incentives when it comes to the oil market. The UAE's lesser oil resources and their earlier adoption of diversification initiatives have made the nation less dependent on oil compared to KSA. For the KSA, oil still accounts for nearly 70% of government revenues. Their breakeven oil price is estimated at USD96/bbl, compared to that of USD57/bbl for the UAE. The UAE runs a sustained budget surplus while the Saudis have used debt for their economic expansion. For example, during the first half of this year, the KSA *issued USD 37bn in debt*, standing as the top issuer in the GCC debt space. Understandably, the KSA has been reluctant to increase oil production and prefers extending production cuts to keep prices high, as low oil prices could hinder its ability to finance its economic diversification plan. Also, ramping up debt to meet its funding needs could make the country less attractive as an FDI destination. Eventually, this could spark a negative feedback loop amid declining FDI inflows, weaker growth and a higher debt-to-GDP ratio.

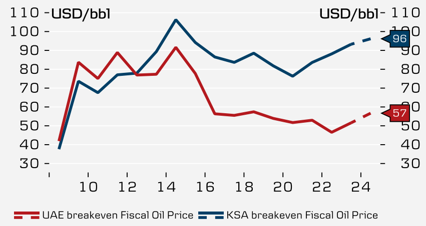
Oil price is also the factor that determines whether and how much the Gulf states have resources to invest abroad and expand their influence. From a current account balance perspective (simplified as it is), in recent years, the UAE and KSA have been able to well meet the external financing needs of the largest countries in their neighbourhood. And as long as oil prices remain high, they are likely to have that capacity going forward. In fact, the recipient countries would not necessarily need support from other partners, if the Gulf states threw all their money at them. Of course, in reality the picture is more complex. Still, it also illustrates that where recipient is poor (and other borrowers are few or inexistent), influence is particularly cheap. Indeed, recently, cash-strapped economies of Egypt, Turkey, Ethiopia and Sudan have welcomed Gulf lenders with open arms.

Egypt: UAE investment helps secure financing from IMF

Historically, Egypt has been *a major recipient* of Gulf money. After the 2013 military coup, the UAE and KSA were quick to support President Sisi's regime. This financial backing has continued in recent years, allowing the Gulf states to advance their own agendas and accelerate their diversification plans.

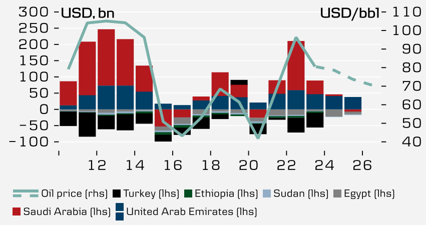
In February 2024, the UAE and Egypt signed a historical deal bringing in USD 35bn of Emirati investments. The Ras El Hekma project aims to build a "next generation city" on the Mediterranean coast. The massive deal, equivalent to 7 % of the Emirati GDP, has been *referred to* as the UAE buying a piece of Egypt. It has allowed Egypt to devaluate its currency and hike rates. It also helped the cash-strapped country secure additional financing from the IMF. The signatories say the project could eventually attract as much as $150bn in investments. The scale *can be questioned,* and real estate projects are often not the ones raising a country's growth potential longer term. Yet, one cannot overstate the importance for Egypt in short term as Emirati transfers already top the size of the country's ongoing IMF program worth USD 8bn.

Different breakeven oil prices and thus diverging interests in the oil market



Sources: IMF, ICE, Macrobond Financial

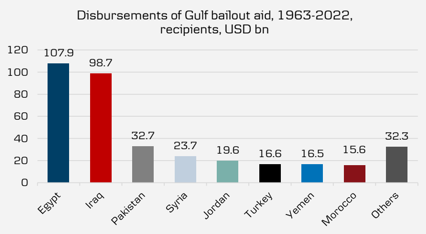
Oil price weighs on the Gulf states' financial capabilities*



Sources: IMF, Macrobond Financial

*lhs represents current account balance

Egypt has been the main recipient of Gulf financial aid

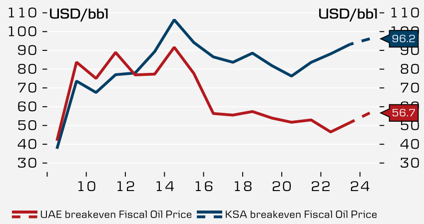


Sources: The International Institute for Strategic Studies, Danske Bank

Turkey: Gulf states provide lifeline at a critical time

Similar to Egypt, in the last two years, Turkey's economy has been suffering from high inflation, capital outflows and foreign currency shortages. Here again, the Emirates and the Saudis provided the necessary economic lifeline. Last year, the KSA deposited USD 5bn at the Turkish Central Bank (CBRT), which was only returned recently. Furthermore, both the UAE and the KSA have recently signed trade agreements with Turkey. As a complement to such agreement, in July 2023, Turkey *signed* a USD 50bn deal with the UAE to fund energy and natural resources projects, as well as reconstruction related to the 2023 earthquake. The Gulf states have also purchased Turkish military drones, bolstering Ankara's exports. The deal with the KSA was the biggest defence contract in Turkey's history. It is an excellent showcase of a win-win: Turkey gets the money while the Gulf nations strengthen their defence and military capabilities[1].

High inflation and low rates were a toxic cocktail for Turkish economy, leading to massive capital outflows

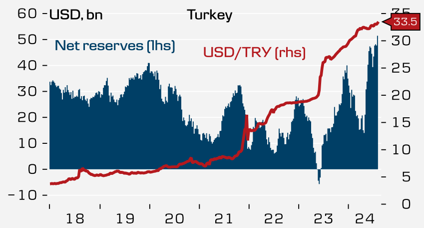


Sources: TurkStat, TCMB, Macrobond Financial

Horn of Africa: much more than a charity case

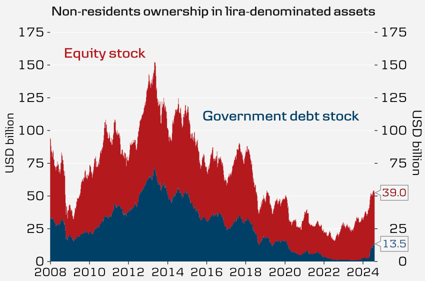
The Gulf powers also have their eyes on Africa, and here again, the UAE took a head start. Over the past decade, it has been the *fourth largest foreign direct investor* in Africa after China, the US and the EU. Since 2021, *it has pledged* more investments in Africa than any other country. Driven by its "string of ports" strategy, the UAE has been particularly active in maritime logistics. The Emirates is nowadays China's main rival in ports in Africa and runs ports in nine African countries, *most of them located* on the Red Sea coast. The UAE *bailed out* Ethiopia in 2018, while the two Gulf states together bailed out Sudan one year later. Sudan is in many ways important. It is the Gulf's breadbasket, and it has been a key provider of troops for their military operations against in Yemen. The civil war in Sudan is also a showcase of where a rift has emerged between the UAE and KSA. The Saudis have continued supporting the internationally recognized Sudani government, while the UAE *has provided weapons* for the rebel group RSF. Again, economic and political interests converge: the UAE has been a large buyer of Sudanese gold, and the RSF controls the country's gold mines.

Since mid-2023 recovery in reserves has led to a stabilisation in FX market



Sources: TCMB, Macrobond Financial

Support from Gulf states helped Turkey stabilise its economy and reverse the trend in portfolio flows



Sources: Bloomberg, Macrobond Financial

[1] The deepening economic ties between Turkey and the Gulf states marks a turnaround in a relationship traditionally strained by ideological differences. We wrote about Turkey's longstanding support to Muslim Brotherhood in *Research Global: The Middle East unveiled - How a regional storm could ignite global flames*, 28 November 2023.

Why should we care?

There are several reasons to monitor the Gulf powers' rivalry. It may undermine the role that the Gulf countries have historically had in stabilising both the oil market and the region's political landscape. The more the two disagree on how to intervene in the region's conflicts and who to side with, the more trouble we can expect. If the two fail to agree on how to run the oil market, prices could turn very volatile, disrupting the world economy.

Secondly, as we have seen with China's lending to EM, significant aid or investment often comes with strings attached. Going forward, as the creditor base for EM economies becomes even more fragmented, we can expect less transparency in debt deals, and more complexity when things get difficult. Multilateral lenders must understand that from the borrower's perspective, they might not be the primary creditor to please. Considering the 'perfect match' of oil-rich lenders and their chronically cash-strapped neighbours, this development may be particularly pronounced in MENA region.

Lastly, the rivalry is a perfect showcase of cool-headed opportunism in the time we live in. It illustrates how the Gulf powers leverage their soft power to form new geostrategic alliances. As for the West, these alliances are usually driven by converging economic and political interests, but they are also more dynamic. A shared ideology is not a strict rule. This approach underlines how neither the US or the EU – nor China, for that matter – should take for granted that rising middle powers will follow their lead on anything. The rising middle powers of Middle East are in no one's sphere of interest but their own.

Friends or foes?

A long-standing aim for both the UAE and the KSA has been to counterbalance Iran's influence in the region, and object the rise of pro-democratic Islamist movements in the region. This is why the two countries quickly found common ground in the aftermath of Arab Spring in 2010s. They took the same side when the crisis in Yemen erupted in 2015, and they both severed ties to Qatar in 2017 due to country's alleged support to Muslim Brotherhood.

An early sign of the UAE-KSA rivalry was in 2009 when the UAE withdrew from the Saudi-led GCC plan to introduce a common currency as the plan entailed establishing the central bank in Riyadh. The Gulf states' interests have also started to diverge in foreign policy. The UAE re-established diplomatic ties with Israel in 2020 while the Saudis are still in process. And for as long as the war in Gaza drags on, any progress on that front is unlikely. The UAE-Israel normalisation has led to increased trade between the two countries, which the Saudis have not always been pleased about. On the other hand, in 2023, the Saudis re-established relations with Iran, something the UAE has not done. This deal was *brokered by* China.

The ending of the Qatar blockade in 2021 was spearheaded by the KSA, the UAE *reluctantly followed*. In Yemen, the KSA has been consistent in its support for the Yemeni government even if it has links to Muslim Brotherhood. The UAE, in turn, has increasingly supported proxy militant groups with conflicting objectives. This illustrates how Emirates' approach to political Islam is often more ideological, while the Saudis prefer a more pragmatic approach. Further, in yet another sign of a deepening rift in foreign policies, the civil war that started in Sudan in 2023 has actually turned into *a proxy war* between the UAE and the KSA.

In recent years, the UAE and KSA have also disagreed on oil production quotas within OPEC. In 2021, KSA presented a plan within OPEC+ to extend production cuts to compensate for the pandemic-induced drop in oil prices. The UAE objected, and although the conflict was resolved in a few weeks' time and the UAE was allowed to raise their production limit, scars remained. In March 2023, the UAE had to *deny rumours* that it was considering leaving OPEC.

Appendix 1 – Overview of outward FDI as per 2022 in G20 space*

Sources: UNCTAD, Macrobond Financial

**African Union not included, while the UAE has been included*

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