



Gulf Research Center
Knowledge for All

Food Inflation in the GCC Countries

GRC Report
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INTRODUCTION	3
1. INFLATION IN THE GCC	4
2. GLOBAL FOOD INFLATION	5
3. REASONS FOR GLOBAL FOOD INFLATION	6
SUPPLY DEMAND EQUATION	6
POPULATION GROWTH	7
CHANGE OF DIETS, ESPECIALLY IN EMERGING MARKETS	8
ALTERNATIVE USAGES FOR BIOFUELS	8
INFLATION OF INPUT FACTORS (E.G. DIESEL, FERTILIZER)	8
DOLLAR DEVALUATION	8
DROUGHTS, SOIL EROSION, GLOBAL WARMING AND OTHER CHALLENGES	9
4. IMPACT OF GLOBAL FOOD INFLATION ON THE GCC COUNTRIES	10
GCC POPULATION GROWTH	10
THE (FUTURE) DECLINE OF GCC'S AGRICULTURE	11
GROWING IMPORT REQUIREMENTS	13
DECLINE OF EXPORTABLE AGRICULTURAL SURPLUS WORLDWIDE	13
EFFECT ON DIFFERENT SOCIAL STRATA: FOOD INFLATION AS A SOCIAL PROBLEM	16
5. COUNTER MEASURES AGAINST FOOD INFLATION IN THE GCC	18
SAUDI ARABIA	18
UAE	19
KUWAIT	19
BAHRAIN, QATAR AND OMAN	19
6. CONCLUSION AND POLICY RECOMMENDATIONS	20



Introduction

The GCC countries and the UAE and Qatar in particular have witnessed accelerated inflation rates for three years now. Besides the dominant rent inflation, food inflation has been put in the spotlight recently in the wake of food price hikes on a global scale. There should be no doubt that high food prices are very dangerous for political stability in all directions. That is because food security is a key element of human psychology. When such security is not guaranteed, it tends to exacerbate all sorts of cleavages and contrasts. There are also direct implications for the GCC countries where the demographic situation consists of a large expatriate population and a smaller national population base. In such situations, individuals who are normally tolerant of income or rights differences could begin to revolt and even question the political order. Moreover, it is the rulers who ultimately will be made responsible for the situation, and suspicion and animosity may erupt rapidly and unexpectedly. The issue thus deserves the utmost attention and decisive action.

Within the local context, there are several scenarios that must be considered as a result of higher food prices:

- Dissatisfaction, particular among the large low-skilled work force could lead to strikes and demonstrations with the possibility of violence
- there could be an increase in tensions between foreigners and locals due to the increase of disparity among them
- even among the national population, higher prices could lead to a greater demand for a say in politics if the government should fail to mitigate the impact of food price inflation
- there could also be an increase in tensions between rich and poor nationals. In particular, the business community could be seen as political scapegoats by the rulers and the people;
- Finally, there could be an increase in tensions between the food producers and food consumers, thus having direct implications and repercussions at the international relations level.

The bottom line is that although the causes of higher food prices are global, and not under the direct control of the UAE or other GCC governments, the people will expect a solution from the local authorities.

This briefing paper analyzes the impact of rising global food prices on the GCC countries and suggests measures which could be taken to mitigate this impact.

This GRC report is structured into six parts:

- 1) Food price inflation as part of the overall GCC inflation
- 2) An empirical overview of recent global food price rises
- 3) Reasons for global food price hikes like population growth, change of diets and inflation of input factors (e.g. diesel, fertilizer)
- 4) The impact of this global food inflation on the GCC countries and the UAE specifically is analyzed. An overview of food production, consumption and imports in the GCC is given with an assessment of the effect of food price hikes on different social strata
- 5) Measures to counter rising food inflation in the GCC are outlined like increase of subsidies (Saudi Arabia) or price controls (UAE)
- 6) Finally, a set of policy recommendations is given based on the analysis above

1. Inflation in the GCC

After two decades of low inflation rates, inflation has returned as a global phenomenon. Most notably food inflation affects lower income brackets disproportionately as they have to spend a relatively high share of their disposable income on food. The GCC countries have felt the impact as well; inflation, which was mostly below 1 percent and virtually non-existent until 2002, has developed into a serious problem in the Gulf nowadays. The last two years especially have seen a marked rise in inflation. The UAE and Qatar were particularly affected with official inflation figures in double digit territory. But other countries like Saudi Arabia and Kuwait have also witnessed a pronounced pick up in inflation in 2007, reaching more than 6 percent.

Inflation in GCC Countries 2002-2007 (%)

	2002	2003	2004	2005	2006	2007
Bahrain	-0.5	1.7	2.3	2.6	2.1	8.4
Kuwait	0.5	1.2	1.3	4.3	3.3	6.6
Oman	-0.7	-0.3	0.9	1.9	3.1	5.3
Qatar	0.2	2.2	6.8	8.8	11.8	12.8
Saudi Arabia	0.2	0.6	0.3	0.7	2.2	6.5
UAE	2.9	3.1	5.1	7.1	11.3	11.6

Note: Inflation figures have been calculated from changes in CPI data as reported by Central Banks of GCC countries. For Saudi Arabia, it is based on the cost of living index, as reported by SAMA. 2007 data is based on second quarter of the year

Compared to other regions in the world, the Gulf and the Middle East countries as a whole thus witnessed comparatively high inflation rates.

Inflation Rates World (%)

	2000	2001	2002	2003	2004	2005	2006	2007
Africa	13.3	9	8.3	6.8	5.3	6.1	7.2	6.5
ASEAN-4	2.9	6.7	5.8	4.1	4.6	7.3	8.2	4
Central and Eastern Europe	18.5	21.1	10.3	8	6.1	4.4	5.1	4.7
Developing Asia	2.4	2.6	1.8	3	4.2	4	4.1	5.7
European Union	3.2	2.6	2.3	2.2	2.4	2.3	2.2	2.4
Major Advanced Economies (G7)	2.3	1.1	1.9	1.5	2.4	2.3	1.9	2.3
Middle East	3.3	4.3	6.3	6.9	8.9	5.7	9.4	9.9
Newly Industrialized Asian Economies	1.8	0.7	2	1.6	2.2	2.3	1.6	2.7
World	4.2	4	3.7	3.2	3.9	3.6	3.5	4.2

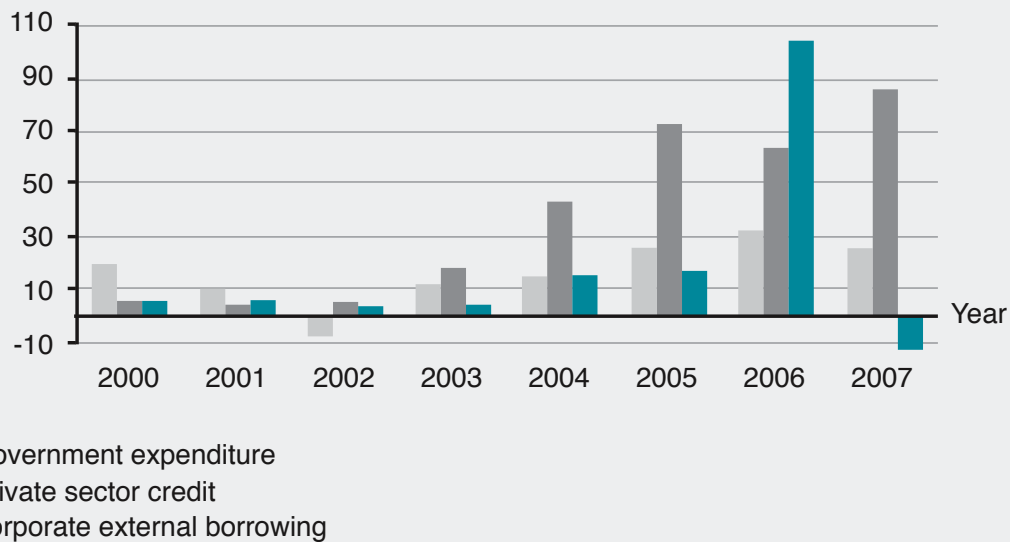
Source: International Monetary Fund (IMF), World Economic Outlook Database, April 2008

About two thirds of this inflation is homemade and can be attributed to abundant liquidity and a domestic investment boom that faces increasing capacity constraints, most notably in real estate and construction. Money supply and private sector credit growth both run well above 30 percent in the UAE for example.



Indicators of Investment and Liquidity

(annual change, billions of dollars)



Source: Institute of International Finance (IIF)

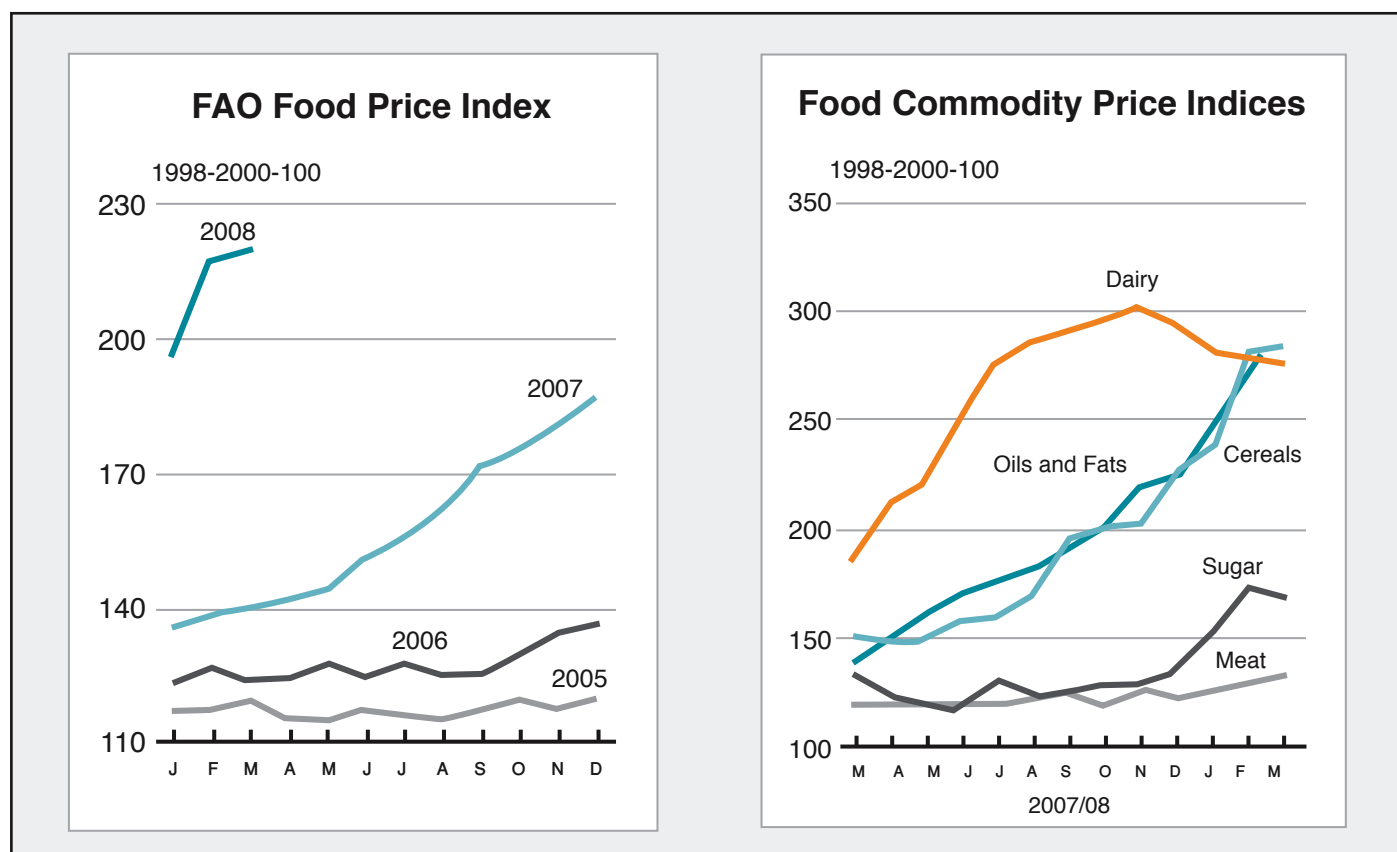
About one third of GCC inflation, however, is imported. Food and commodity prices have risen globally, especially in dollar terms. Such price hikes are not mitigated by an exchange rate mechanism in the GCC (with the partial exception of Kuwait), as the GCC economies have tied their currencies to the US dollar, which has devalued considerably against other major currencies.

For Saudi Arabia, Saudi British Bank estimates a 35 percent share of imported inflation in overall inflation.¹ For Kuwait, estimates of 25 percent have been given using food imports as a proxy for imported inflation. Still, even in these countries the domestic part of inflation (non-tradables like rents, services and fees) is dominant. This is all the more true for the UAE and Qatar. Official UAE sources recently stated that 50 percent of the inflation can be attributed to rent and 33 percent to imported inflation. In Qatar, the index of tradables increased by almost 15 percent from the year 2005 to 2006. This is why Qatar experienced the highest rate of inflation in the GCC. In Kuwait, the general level of wholesale prices of imported goods (whose relative weight in the General Wholesale Price Index is 76.9 percent) also increased in the year 2007. The inflation rate of food prices in the UAE was between 27 and 30 percent in 2007, according to a survey conducted by the Emirates Consumer Protection Society (ECPS).²

Food thus constitutes a considerable part of imported inflation as import dependency will reach 60 percent in the arid GCC countries by 2010, according to the FAO (see map).³ In Saudi Arabia, for example, about 15 percent of all imports are food items.⁴ With growing population, growing food imports and rising food prices, this ratio is likely to remain on an elevated level. The GCC countries are a price taker for agricultural imports and heavily exposed to the global price hikes in food items.

2. Global Food Inflation

In the last decade, real world output and world trade increased at an annual rate of 5 percent and 8 percent respectively with a low inflation rate of 2 percent. But the last two years witnessed dramatic changes. While primary commodity prices have been increasing gradually from 2002 to 2005, they virtually soared since around the middle of 2006.



Source: Food and Agriculture Organisation (FAO)

By March 2008, the Food Price Index of the Food and Agriculture Organization of the United Nations (FAO) increased by 57 percent compared to its level in March 2007. Prices of nearly all food commodities have risen since the beginning of 2008 supported by a persistent tight supply and demand situation. In 2007, the index averaged 157, which was an increase of 23 percent from 2006. The largest price increases were seen in cereals and oils and fats, while dairy products corrected slightly from the elevated levels they had reached in 2007. The price increases for meat and sugar were less pronounced, with the latter also correcting in the spring of 2008.

Rice, which lagged the price increases in other cereals like wheat thus far, has picked up and shown the largest price increases in recent months. Maize has gained as well, while wheat prices corrected in April as larger crops were anticipated for 2008. However, as stocks continue to be low, wheat prices remain high and well above their levels of last year. Dairy items also corrected slightly after tight supplies from traditional exporters, strong import demand, and the exhaustion of public stocks had caused a steep price hike in late 2006 which has lasted through 2007.

3. Reasons for Global Food Inflation

Supply Demand Equation

On average, cereal production has risen less than cereal utilization since 1999, which has led to a fall in cereal stockpiles to historic lows. Growing population, changing diet habits and additional demand for the production of biofuels caused a rise in demand, while input factors like fuel, freight and fertilizer showed marked cost increases. Tight food markets have thus led to higher prices. Besides the physical supply and demand equation, part of the inflation was purely financial; the devaluation of the dollar made food inflation in this currency particularly pronounced.



World Cereal Production and Utilization (1997-2007)

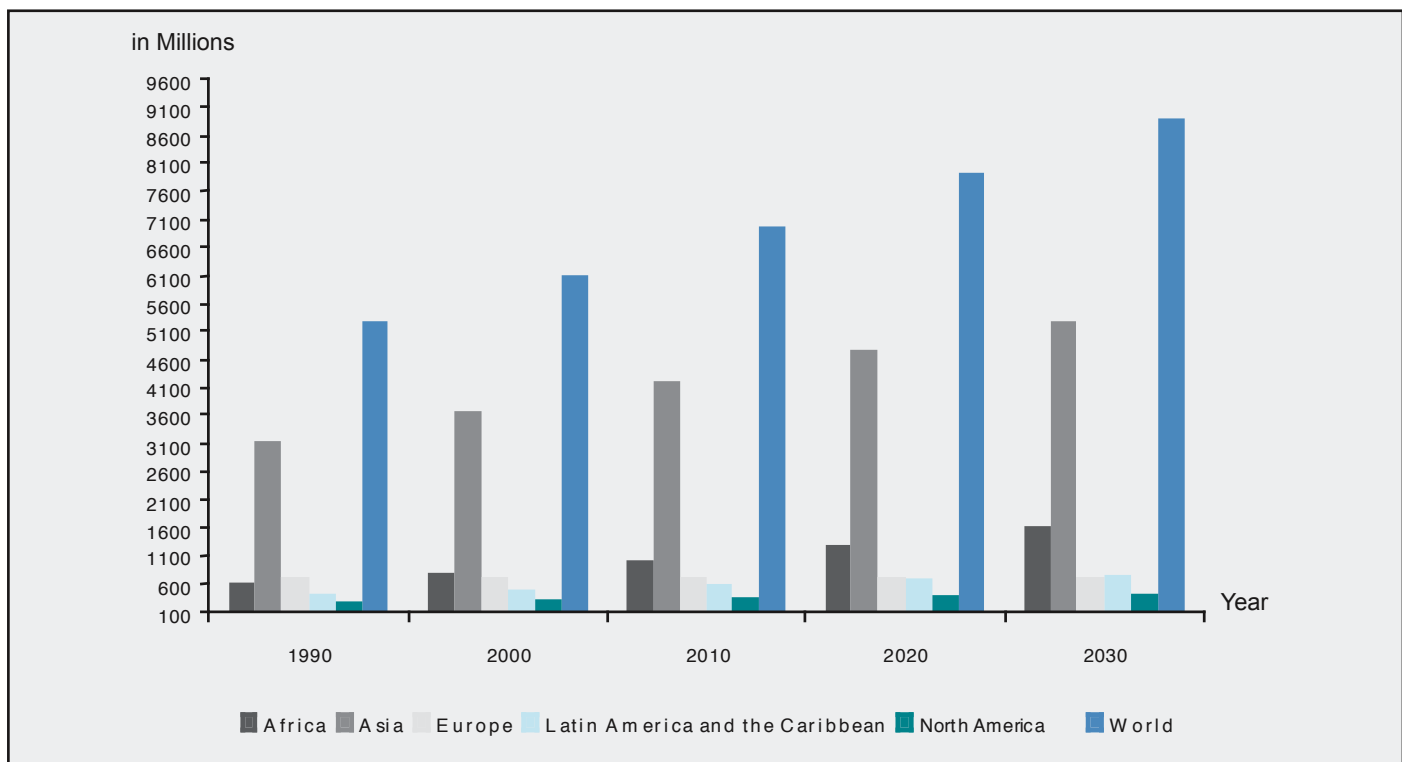


Source: FAO

Population Growth

Although the world population growth has been slowing from 1.26 percent (1996-2005) to 1.10 percent (projected 2006-2015) there will be a strong increase in absolute numbers. Annually 50 to 70 million people will be added to world population between now and 2030, most of them in Africa and Asia.⁵

World Population



Source: United Nations (UN) World Population Prospects 2006. Database available at: <http://esa.un.org/unpp/p2k0data.asp>.

Change of Diets, Especially in Emerging Markets

It is not only the increasing number of people that has caused a surge in demand; the dramatic change in global diet patterns during the last four decades has also had an impact. The relative share of staple foods like cereals, roots and pulses has declined, while livestock products, fruit and vegetables with their higher needs of water and fertilizer have acquired increasing popularity because of rising living standards, urbanization and changes in relative prices. In recent years, this trend has been particularly pronounced in emerging markets like China and India, which in turn could lead to more imports and lesser exports by these countries in the future.⁶

Alternative Usages for Biofuels

Both high oil prices and government policies in the US, Europe, Brazil and elsewhere have promoted bio-fuels as an alternative to petroleum. This has led to significant shifts in acreage as well as use of certain grains. For example, in 2006, the US diverted more than 20 per cent of its maize production to the production of ethanol; Brazil used half of its sugarcane production to make bio-fuel, and the European Union used the greater part of its vegetable oil production as well as imported vegetable oils, for the same purpose.⁷ Since early 2004 ethanol and bio-diesel production in OECD countries has risen sharply, and this has naturally reduced the land available for producing food. On the other hand, land use for biofuels currently constitutes only 1 percent of total acreage worldwide (14 million hectares), a figure that the IEA sees increasing to 35 million hectares by 2030. Thus, biofuels' influence in pushing up prices may have been more modest than is often assumed.

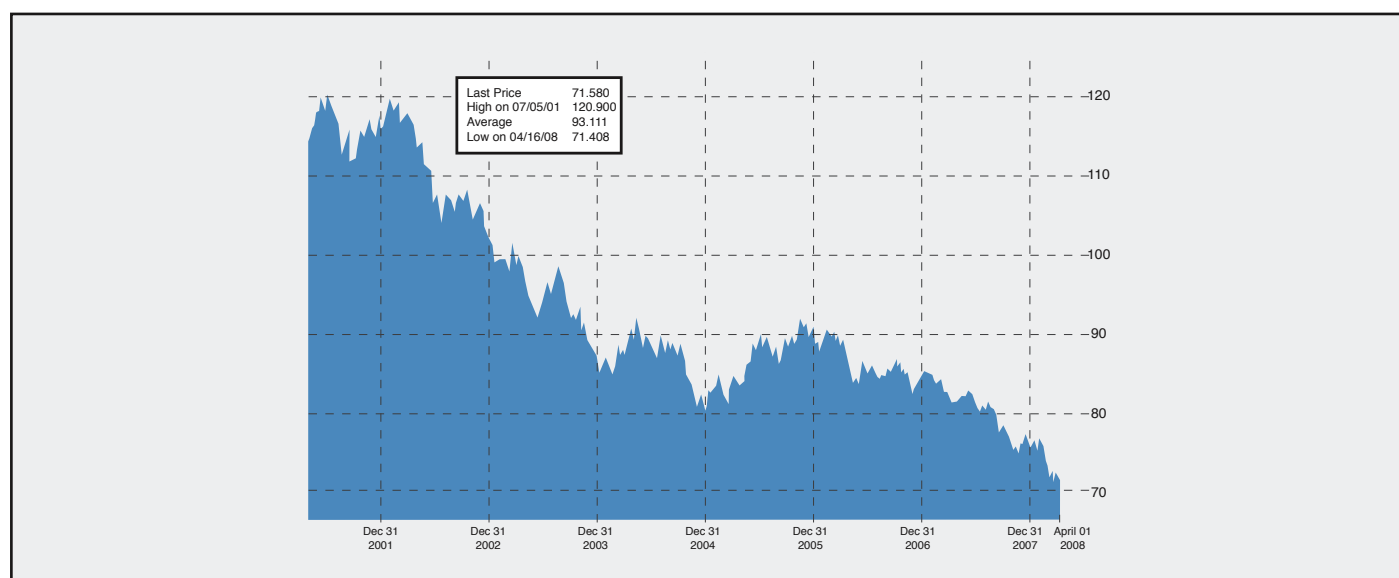
Inflation of Input Factors (e.g. diesel, fertilizer)

There is the impact of high oil prices, which affect agricultural costs directly because of the significance of energy as an input in the cultivation process itself (through fertilizer and irrigation costs) as well as in transporting food. Across the world, governments have reduced protection and subsidies on agriculture, which means that high costs of energy directly translate into higher costs of cultivation, and, therefore, higher prices of output.

Dollar Devaluation

The dollar has shown a marked devaluation since 2001. The US Dollar Index (DXY) which measures its value against a basket of major currencies (EUR, JPY, GBP, CAD, CHF and SEK) decreased from 120 in 2001 to nearly 70 in April 2008. Price rises in dollar terms have thus been particularly pronounced.

US Dollar Index 2001-2008



Source: Bloomberg



Droughts, Soil Erosion, Global Warming and Other Challenges

It is remarkable that the increased cereal production during the last decade has been achieved on a stable or even declining amount of land by increased input of fertilizer and technology. In the short-term, there could be additional land for cultivation in the EU and the US. The decision of the European Union to suspend its 10 percent obligatory set aside requirement for the 2007/2008 season could provide an estimated 3 million hectares of land for cultivation. In the longer run, new land could be cultivated in Latin America, Sub-Saharan Africa, South-East Asia and Eastern Europe, but this would require large-scale investments in infrastructure and transport facilities.

Food Inventories and Cultivated Land/ World

	Wheat		Coarse Grains		Rice Milled		Total Grains	
	Area (million hectares)	Ending Stocks (million metric Tons)	Area (million hectares)	Ending Stocks (million metric Tons)	Area (million hectares)	Ending Stocks (million metric Tons)	Area (million hectares)	Ending Stocks (million metric Tons)
1998-99	225.1	207.9	308.6	237.5	152.6	134.4	686.3	579.7
1999-00	215.4	208.5	299.7	232.2	156.3	143.5	670.4	584.3
2000-01	217.6	205.8	296.8	210.5	151.7	147.3	666.0	563.6
2001-02	214.7	201.6	301.5	197.7	150.6	133.6	666.8	532.9
2002-03	214.6	166.3	293.2	170.0	145.9	103.9	653.8	440.2
2003-04	209.6	132.4	306.4	140.3	148.2	82.4	664.2	355.0
2004-05	217.7	150.6	299.7	177.8	150.5	74.7	667.9	403.1
2005-06	218.4	147.8	300.8	163.7	152.6	76.8	671.8	388.4
2006-07	211.9	124.3	303.6	135.1	152.9	75.6	668.4	335.0
2007-08	216.7	110.1	314.4	133.0	153.6	72.2	684.7	315.2

Source: United States Department of Agriculture (USDA), 2008

It remains to be seen whether the intensification of agriculture could lead to adverse effects in the medium term. The shifts in acreage from food crops to cash crops relying on purchased inputs; the excessive use of ground water and inadequate attention to preserving or regenerating land and soil quality; the lack of attention to relevant agricultural research and extension; the over-use of chemical inputs that have long run implications for both safety and productivity; the ecological implications of both pollution and climate change, including desertification and loss of cultivable land: all these are issues that have been highlighted by analysts but largely ignored by policy makers in most countries. Global warming and an increased occurrence of droughts (e.g. in Australia) are also risk factors that have to be taken into consideration.

There is also the impact of changes in market structure, which allow for greater international speculation in commodities. It is often assumed that rising food prices automatically benefit farmers, but this is far from the case, especially as the global food trade has become more concentrated and vertically integrated. A small number of agribusiness companies worldwide increasingly control all aspects of cultivation and distribution, from supplying inputs to farmers to buying crops and even, in some cases, retail food distribution. This means that marketing margins are large and increasing, so that direct producers do not get the benefits of increases except with a time lag and even then not to the full extent. This concentration also enables greater speculation in food, with more centralized storage.

4. Impact of Global Food Inflation on the GCC Countries

The GCC countries have low levels of self-sufficiency in food production and are not very well suited for agriculture given the arid climate and paucity of arable land, which only constitutes a small portion of their large land mass. Nevertheless, the larger countries like Saudi Arabia and the UAE have developed subsidized agricultural schemes that are economically doubtful and ecologically unsustainable because of an increasing water shortage. Together with a rapidly growing population, this will lead to increased reliance on food imports in the future.

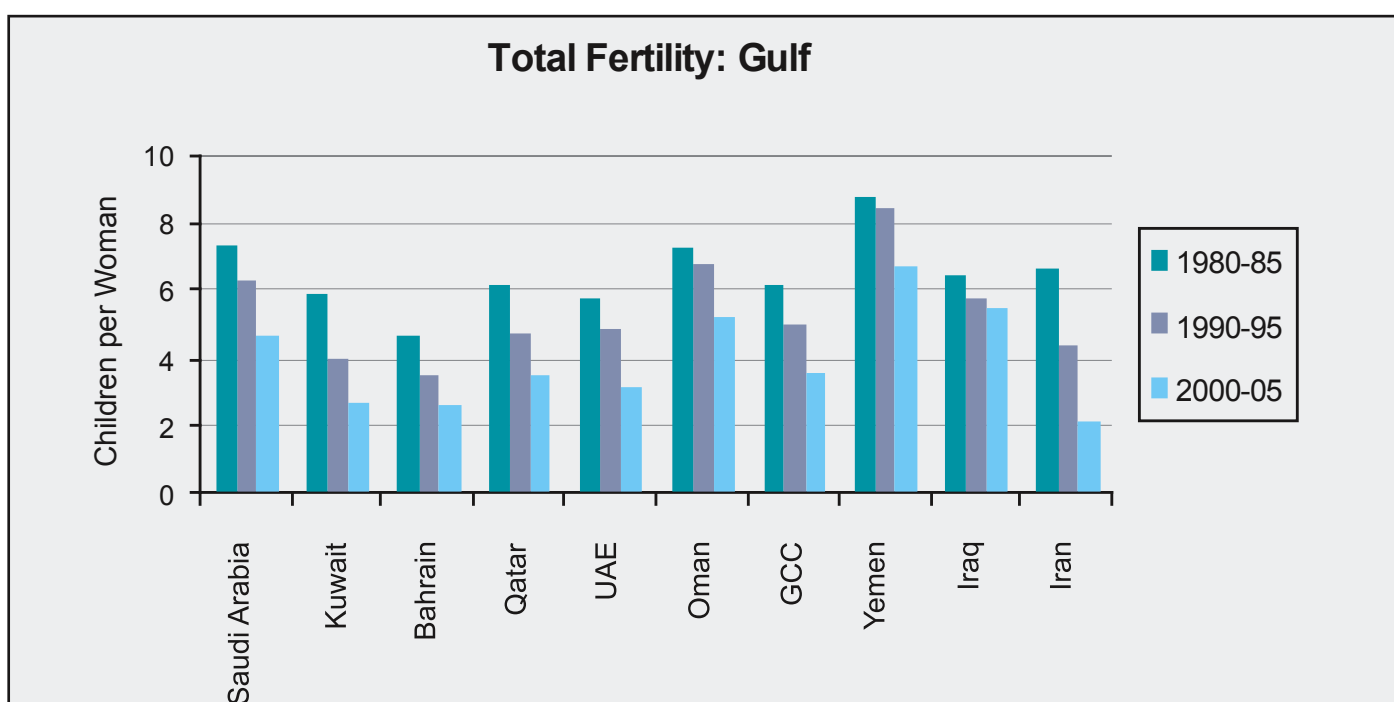
GCC Population Growth

Population growth in the GCC countries is about 2.4 percent annually (simple average), well above the global average of 1.1 percent. Birth rates have come down considerably during the last two decades and there is some beginning of a demographic transformation, but it will take another two or three decades for associated youth bulges to level out; population growth will remain high during this period, also because some Gulf States attract large numbers of expatriate workers. By 2030, the GCC population will have doubled from its level in 2000 reaching nearly 60 million people.

GCC Population (in thousands)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE	GCC
1990	493	2143	1843	467	16256	1867	23069
2000	650	2228	2402	617	20807	3247	29951
2010	799	3080	2791	891	26643	4770	38974
2020	951	3832	3473	1072	33332	5963	48623
2030	1095	4555	4137	1225	39950	7125	58087

Source: United Nations World Population Prospects 2006



Source: United Nations World Population Prospects 2006.



The (Future) Decline of GCC's Agriculture

Conventional water sources – currently the feedstock of irrigated agriculture – are predicted to last for 30 years at most. These calculations are based on the annual water withdrawal taking into consideration the low groundwater recharging ratios in this arid part of the world. The agricultural sector currently demands around 80 percent of the total water supply. The fast growing population and the expected developments on the industrial side will lead to competition for allocation of scarce water resources. By 2025, domestic water demand is expected to double, and the industrial sector will ask for threefold the current water amount. Adding to the widening gap between competing demand and the challenge of maintaining supply, an increase in water costs is conceivable, as substitutes from non-conventional resources (e.g. desalination) are energy-intensive and costly.⁸

Available Arable Land

	% of total land
Poland	40
United Kingdom	24
USA	19
Philippines	19
Indonesia	13
China	11
Argentina	10
Australia	6
Saudi Arabia	2
UAE	1
Iraq	13
Iran	10
Yemen	3

Source: World Bank

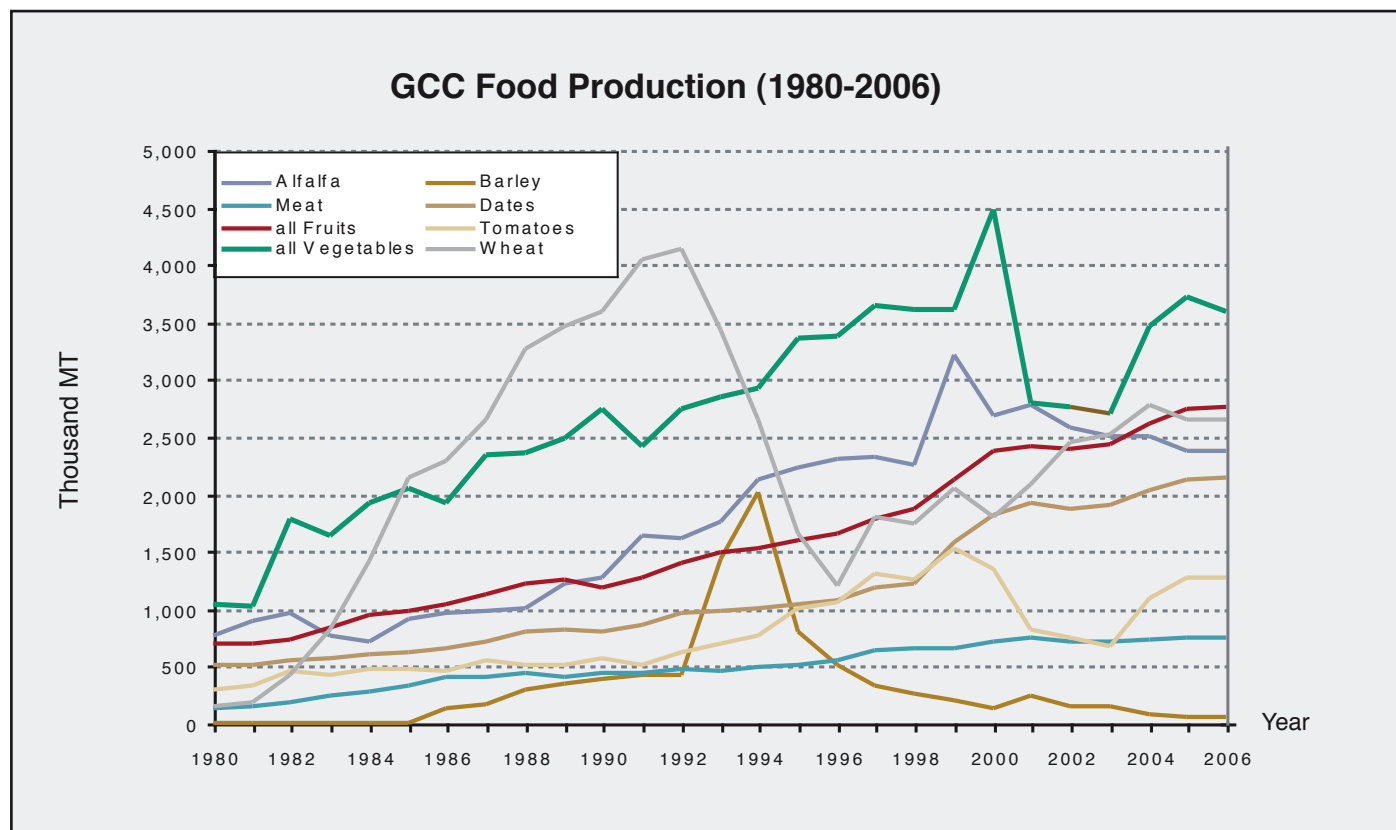
After the uneconomical Saudi wheat bonanza of the 1980s that made the country a wheat net exporter, there is a clear trend away from such crops that consume a relatively high amount of water per unit of value added. With the decline of wheat production came a short rise of barley, which substituted the wheat on the farms. However, after two years, Saudi Arabia decided to decrease barley production as well and rather import the demanded quantities. Albeit Saudi Arabia is nowadays producing less wheat than 15 years ago, wheat is still accounting for 30 per cent of the total agricultural production volume. In Saudi Arabia it has been calculated that it requires roughly 1212 cubic meter of water to produce one ton of barley. In order to provide its huge livestock with fodder, the Kingdom is importing up to 7.5 million tons of feed barley annually. By importing such water intensive crops, Saudi Arabia is thus saving 9.1 billion cubic meter of “virtual water,”⁹ which is half of the current agricultural water demand.¹⁰

The significant increase of fruit production after 1998 is mainly related to the doubling of date production in the United Arab Emirates. The United Arab Emirates

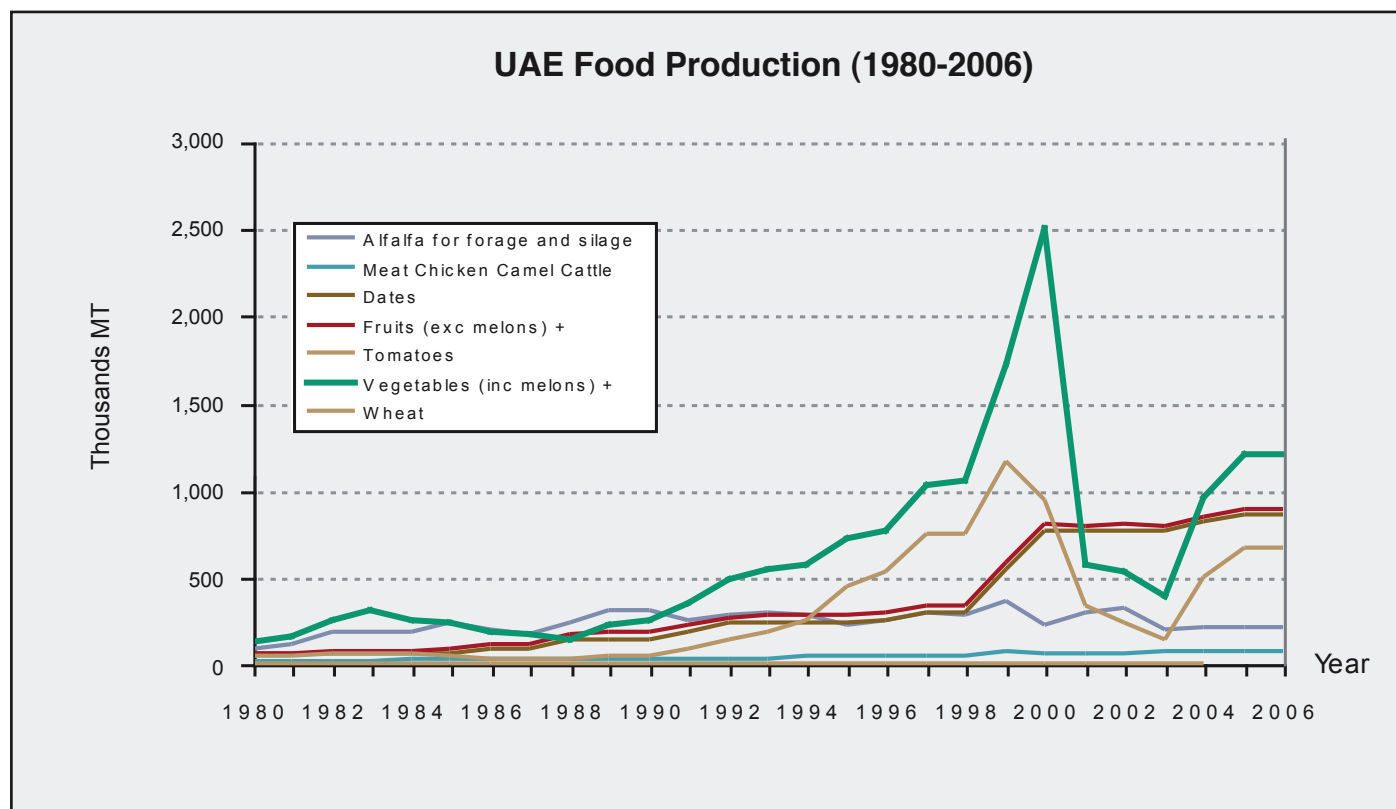
achieved the self-set goal of self-sufficiency in dates in 2002 and began exporting the surplus. At the GCC level the production of meat – mostly chicken – has increased steadily with growing local demand.

Signs of a reorientation of GCC's agriculture are obvious. Most of the GCC countries have entered a process of market-orientated agricultural economic reforms. In compliance with WTO requirements, large-scale procurement of cereals from producers at high guaranteed prices has gradually reduced. Saudi Arabia became a WTO member only in December 2005, as the last country within the GCC group, after 12 years of negotiation. The Kingdom will reduce its domestic support to agriculture by 13.3 percent over a period of 10 years. While direct subsidies of exports have been prohibited in compliance with WTO standards, certain indirect subsidies remain permissible. Among them are programs for developing agricultural infrastructure (e.g. dams) as well as for research and development. Saudi Arabian negotiators have successfully achieved the classification of 165 agricultural commodities as “sensitive,” which allow higher tariff ceilings against the respective imports. These commodities include dates, poultry, vegetables, some fruits and wheat – albeit Saudi Arabia reduced its subsidies for water-intensive products like the latter before the conclusion of the WTO talks. Absolute dependency on the vagaries of the commodity world prices for “strategic”

commodities like wheat let some governments make their provisions. Therefore Saudi Arabia still uses 3.2 billion cubic meter of water to grow 2.4 million tons of wheat in order to meet national demand.



Source: FAOSTAT 2007; World Bank 2007



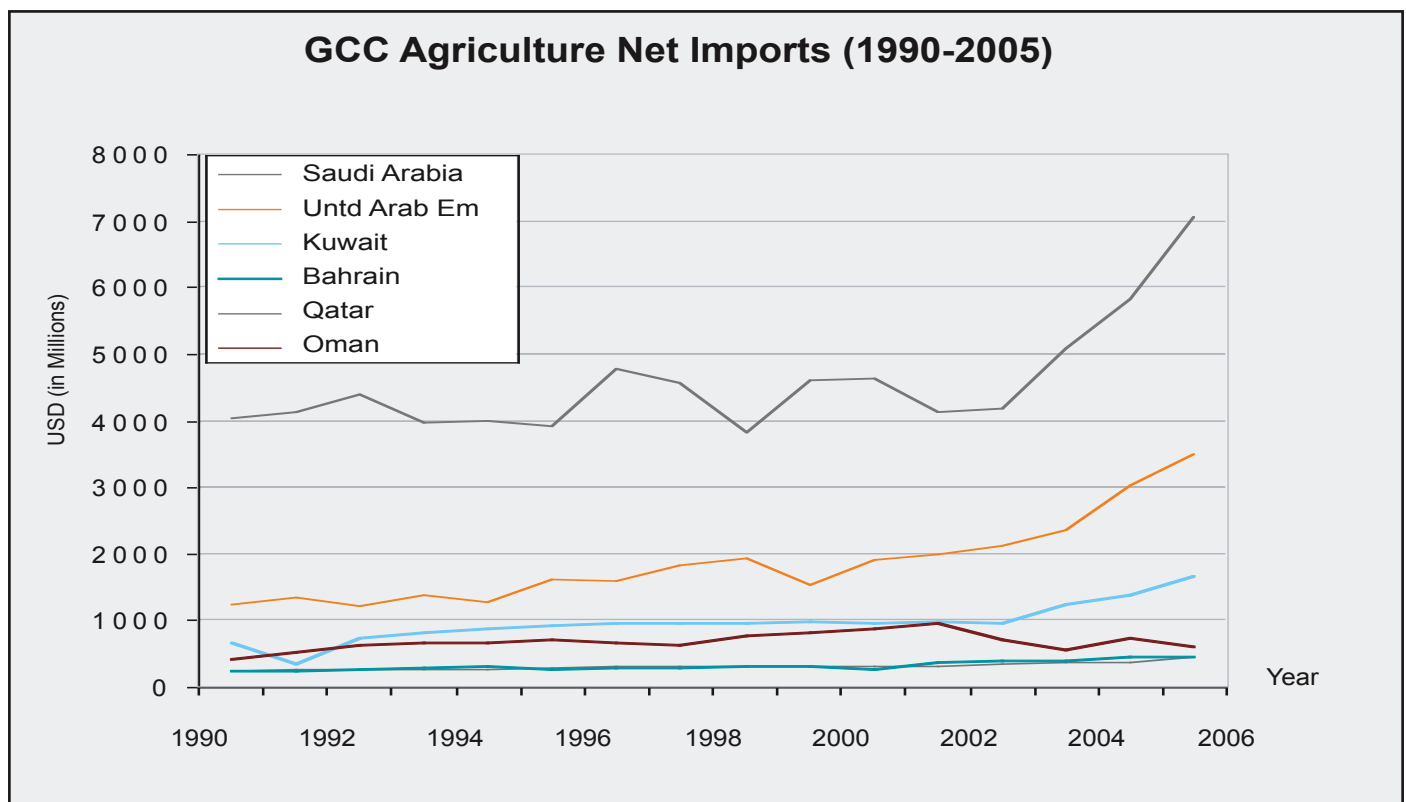
Source: FAOSTAT 2007; World Bank 2007



Recently, the Government of Saudi Arabia announced its plan to reduce the purchasing price of wheat by 12.5 percent per year from 2008. Following Saudi Arabia's new policy approach, the country is likely to become an importer of at least 3 million tons of wheat within the next 10 years. Earlier, the government had announced plans to raise the price of wheat sold on local markets by 20 to 30 percent from April 2008.¹¹

Growing Import Requirements

Growing population, declining agriculture and scarce water resources will cause import requirements of the GCC countries to rise further in the future. The diminishing water resources have to be carefully and wisely utilized in a most economical way. Water-conserving irrigation technologies and a shift of water applications towards more water-efficient and higher value-added crops are essential strategies to deal with these constraints.¹² Water-intensive commodities like wheat and rice – even though they rank high from the strategic viewpoint of food security – will be increasingly imported. Crops with a high salinity tolerance, however, will have a place in local agricultural production.



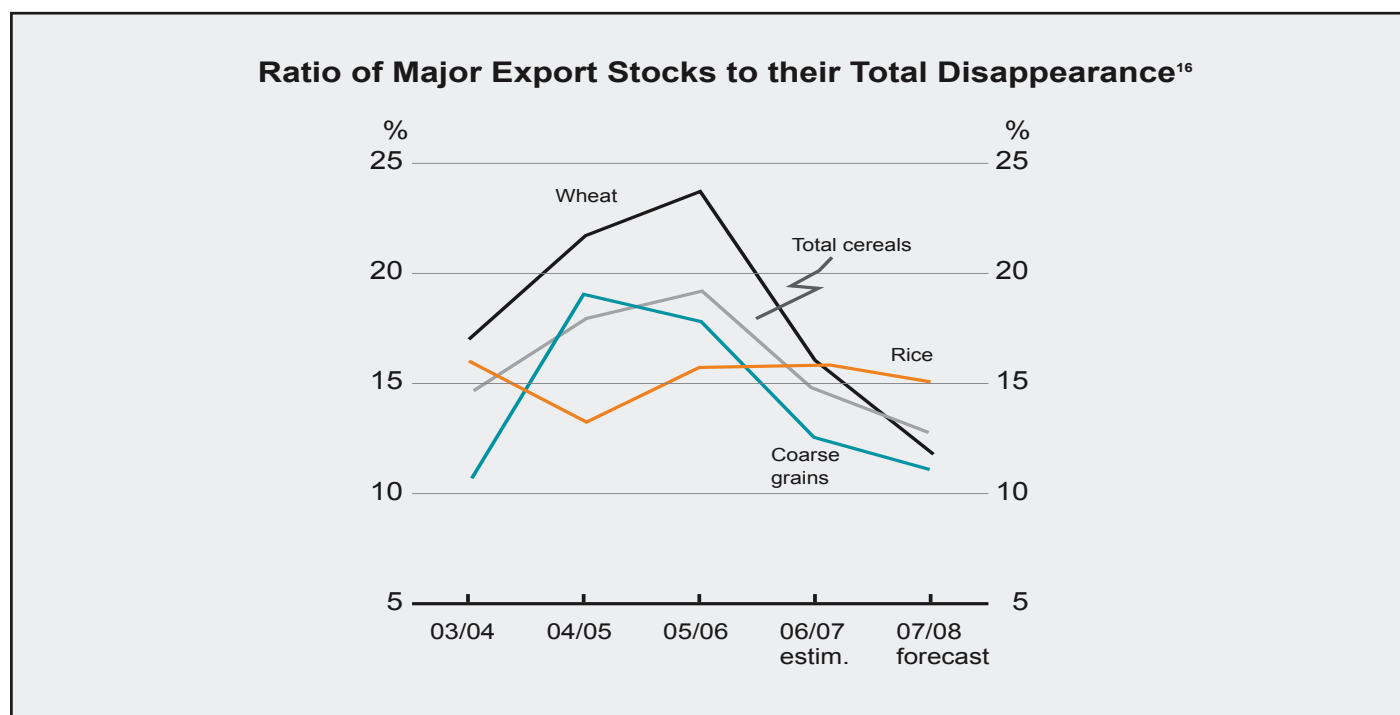
Source: FAO, Agricultural Trade refers to imports and exports pertaining to agricultural products in the narrow sense (i.e. excluding fishery and forestry products)

In absolute numbers Saudi Arabia is the largest Arab food importer in the GCC followed by the United Arab Emirates and Kuwait. In 2007, total GCC food imports hit \$10 billion, \$3 billion of which accrued to the UAE.¹³

Decline of Exportable Agricultural Surplus Worldwide

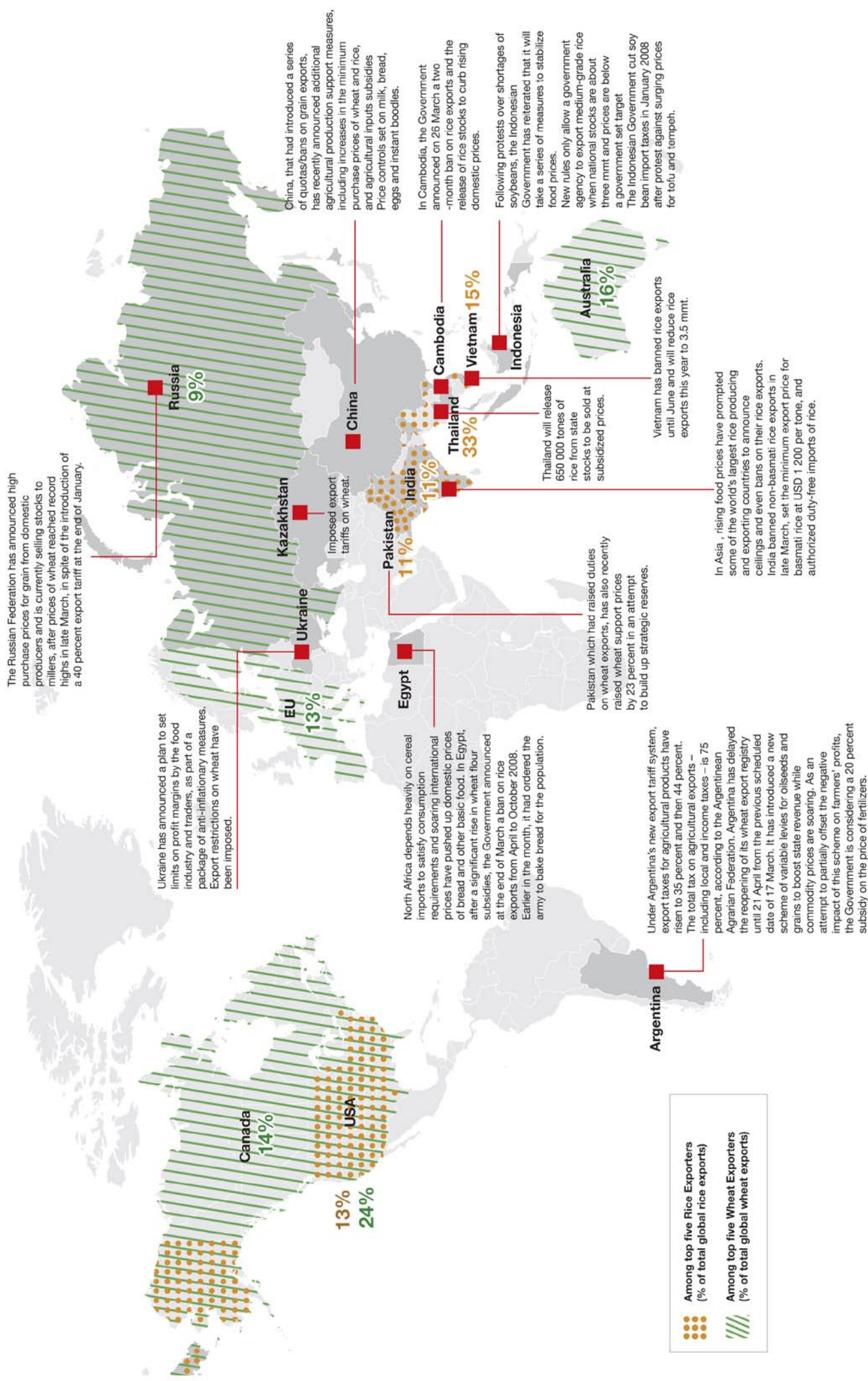
The rising need for food imports in the GCC comes at a time when the exportable agricultural surplus worldwide has declined, as food markets are tight and stockpiles declining. Many exporter countries like India and Vietnam have also implemented export restrictions in order to supply food to their domestic markets and avoid bread riots that have already occurred in some countries like Mexico, Haiti, Egypt and Indonesia (see map). For GCC countries this means that they will need to deal with their dependence on food imports and geo-economic vulnerability more proactively.¹⁴

To attain import security one could think, for example, about agricultural investments in Africa, South East Asia and Eastern Europe and the decision of the UAE government to build up a strategic food reserve has to be commended.¹⁵



Source: FAO

International Agricultural Export Restrictions and Policy Measures

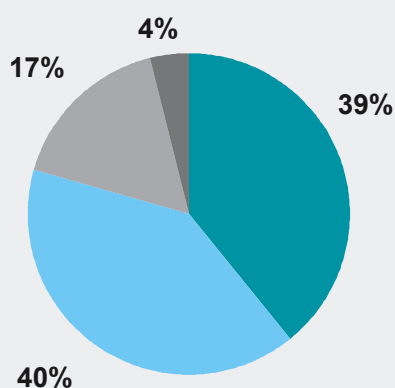


Effect on Different Social Strata: Food Inflation as a Social Problem

Food inflation hits lower income groups especially hard as they have to spend a relatively high share of their disposable income on food. There are no detailed statistics in the GCC about the distribution of income groups and consumer price statistics are insufficient. In the UAE, for example, the existing Consumer Price Index (CPI) of the Central Bank is widely regarded as outdated and is under review. A comprehensive price monitoring system also does not exist. Other GCC countries are more transparent in their CPI and apply more updated and convincing weightings. Still, detailed breakdowns of the CPI data are not always obtainable and methodologies are not uniform. It is assumed that official inflation rates are underestimated and not always reflective of living conditions most notably of lower income expatriates.

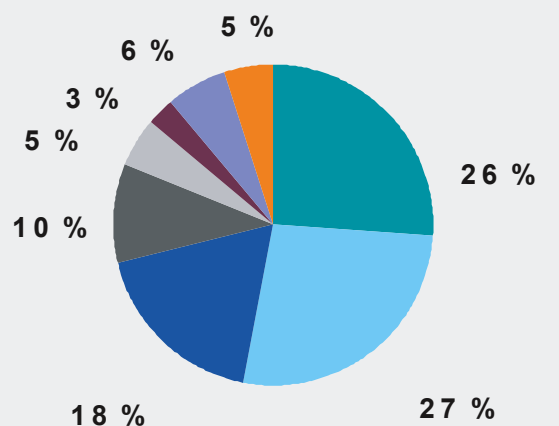
Surveys by recruitment agency Bayt.com and market research company YouGov Siraj provide some approximation and have revealed for example that 50 percent to two thirds of the population in the UAE have faced a decline in purchasing power and living standards in recent years.¹⁷ It seems that only the upper tier of qualified white collar workers has been able to keep pace with inflation. The surveys are sufficiently large with more than 5,000 respondents and also broad-based as one sample below indicates. Still, there could be some sample bias as such surveys are done online and many lower income people presumably lack regular Internet access. The amount spent on food is mostly between 10 and 20 percent of disposable income, according to the Bayt/YouGov survey. Food price rises in the GCC thus contribute significantly to overall inflation as does the important rent component, which ranged between 21 and 50 percent in the UAE in the same survey.

Sample of Bayt.Com/ You Gov Siraj Survey: Rents, Transport and Costs, October 2007



Age

- 20 to 29
- 30 to 39
- 40 to 49
- 50 and above



Income

- Below \$1001
- \$1001-2000
- \$2001-3000
- \$3001-4000
- \$4001-5000
- \$5001-6000
- \$6001 and above
- No income/don't want to say

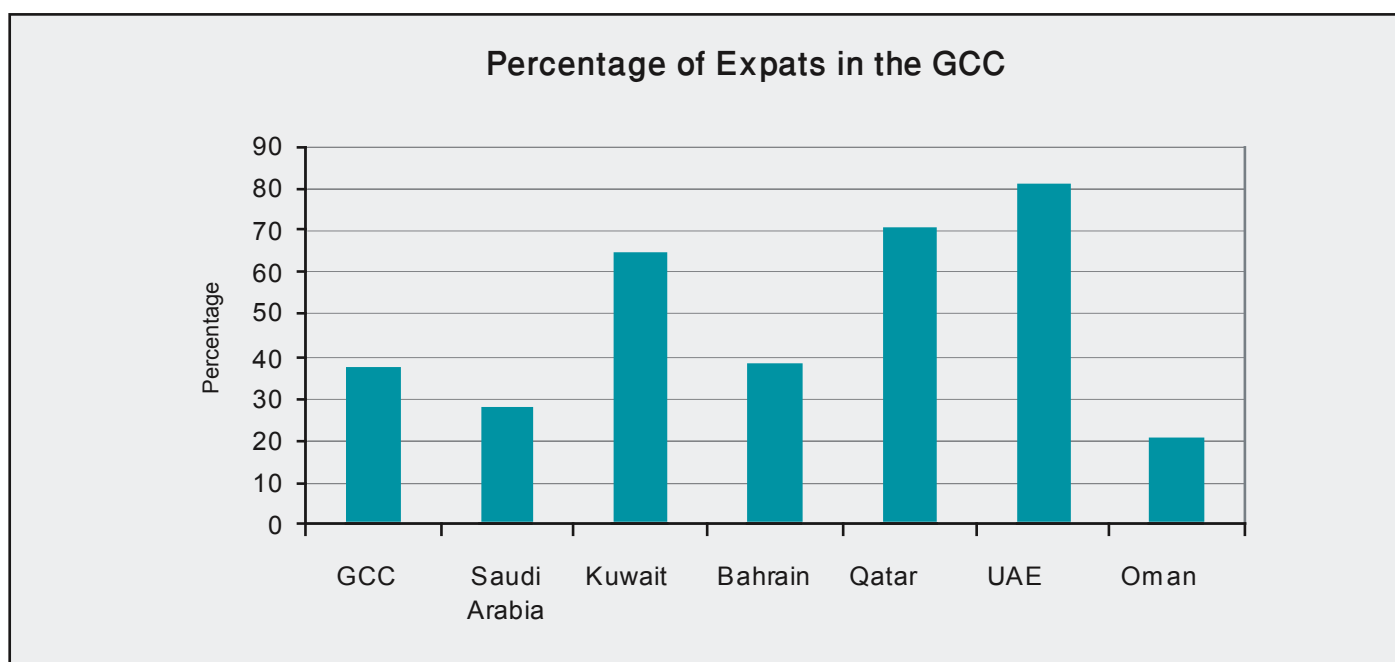


Percentage of Disposable Income Spent on Food

	Bahrain	Egypt	Jordan	Kuwait	Lebanon	Oman	Qatar	Saudi Arabia	Syria	UAE
Sample Size	151	105	948	903	207	135	422	2081	145	3129
Less than 5%	7	5	6	2	5	3	7	7	5	6
Between 5% and 10%	15	6	12	12	10	10	17	15	10	18
Between 11% and 15%	14	12	16	23	13	21	23	20	14	24
Between 16% and 20%	25	9	14	23	27	19	20	18	16	20
Between 21% and 30%	14	14	16	18	13	13	11	15	16	12
Between 31% and 40%	3	7	12	7	9	15	5	6	4	4
Between 41% and 50%	3	4	7	2	3	4	2	4	6	2
Between 51% and 60%	0	10	3	2	0	1	0	1	8	1
Between 61% and 70%	3	6	0	0	1	1	0	0	3	0
More than 70%	0	5	1	0	2	1	0	0	1	1
Don't know/ can't say/NA	16	24	13	11	17	10	15	13	17	13

Sources: Bayt.com/ YouGov Siraj

Another way to gauge the impact of food price rises on lower income brackets is to take the ratio of expatriates as a kind of proxy, as they largely consist of lower to lower middle income groups, most notably from India and Pakistan. The UAE, Qatar and Kuwait have particularly high shares of expatriates, but even in Oman and Saudi Arabia they make up about 20 percent and 30 percent of the total population respectively. According to a study by Tanmia, the Agency for Developing Human Resources and Recruiting UAE Nationals, 75 percent of the UAE labor force is from Asia. Indian workers constitute 42.5 per cent of the population and Arabic-speaking Middle Easterners 13.8 per cent, while expatriates from other countries form 18.2 per cent.¹⁸ Local Emiratis only constitute 15.4 percent of the population, according to the Tanmia study as it assumed a total population of 5.6 million by the end of 2006 – considerably higher than official figures of 4.2 million. According to estimates of the Indian embassy in the UAE, 50 percent of the 1.8 million Indian expatriates in the UAE are unskilled workers, 25 percent, semi-skilled and 25 percent skilled professionals. Besides that large segments of the local population are from the salaried middle classes, namely in Saudi Arabia and Oman, which have also been considerably affected by rising inflation. As they often own houses and thus have not felt the brunt of the dominant rent inflation, food inflation presumably ranks highly in their perception and could be regarded as a problem.



Source: GRC

5. Counter Measures against Food Inflation in the GCC

In the absence of independent monetary policies, all the GCC countries – except Kuwait – have relied upon non-market measures to control price rises such as higher subsidies, allowances, public sector wage increases, and caps on rents.

Saudi Arabia

On January 28 in 2008, the Saudi Cabinet approved a 17-point plan (see text box) to alleviate the impact of rising prices. It is estimated that the package of measures will cost the government SR13.5 billion in additional spending and foregone revenue in 2008 and SR67 billion over the next three-year target period. The measures will not eliminate inflation as a major concern, but will trim some specific price rises.

Key Components of the Saudi Anti-inflation Plan

- Five percent will be added to the salaries of public sector workers in each of the next three years.
- Social insurance benefits will be raised by 10 percent.
- The government will absorb 50 percent of the cost of port fees, issuing passports, traffic licenses and transferring ownership and renewing the residency permits of domestic workers.
- Government will continue to control the prices of basic commodities; these controls will be reviewed after three years.
- A National Housing Agency will be established and the construction of public housing that has already received budgetary approval will be expedited.
- The supply policy, which aims to diversify sources of supply of goods to ensure that local demand can be satisfied at reasonable prices, will be approved.
- Steps will be taken to encourage greater competition, eliminate efforts by the private sector to control prices and monopolistic practices (the agencies system is to be reviewed) and increase consumer awareness.
- The approval of the mortgage law will be expedited.

Source: Brad Bourland, "The Inflation Alleviation Plan" March 6, 2008 at: <http://www.saudi-us-relations.org/articles/2008/loi/080306-bourland-inflation.html>



Additionally, the pricing of medicines will be reviewed and the health insurance system examined. The Saudi Arabian Monetary Agency (SAMA) has also enacted two increases in the commercial banks' reserve requirement. The initial rise in November 2007 was the first time the requirement had been changed in 27 years.

UAE

In the UAE, the governments of Abu Dhabi, Dubai and Sharjah announced caps on annual rent increases of 5 percent (the caps were 7 percent in 2007 and 15 percent in 2006). Anecdotal evidence suggests, however, that the enforcement of the rent caps could be more vigorous. The UAE government also announced in its 2008 budget that it was giving a 70 percent pay hike (of the basic wage) to all public sector workers. A cap on cement prices was also implemented to ease out the rising construction costs. The government also announced penalties on retailers who overcharge. Further, the government announced duty waivers on imports of construction materials like iron pits. The government also instructed the Union Cooperatives to maintain prices of essential consumer goods at the 2006 level for the nationals and advised that goods be imported collectively. As part of this effort the UAE government also signed MoUs with the Lulu retail chain and Carrefour not to increase prices of essential commodities in 2008. Thus, these private sector outlets will need to accept losses on the sale of such items and cross subsidize them by profits made from the sale of other goods, as nothing has been announced about subsidy payments from the government.

Kuwait

Kuwait announced a 15 per cent hike in government employee salaries and also put in place a strict law allowing the imprisonment of retailers for up to three years if they increased prices without justification (whatever that means) of any of 367 identified food products. Apart from that Kuwait moved to a more flexible foreign exchange regime in May 2007 when it dropped the dollar peg to gain more flexibility in tackling domestic inflation. Barring a cataclysm, Kuwait is plotting a wise course between monetary flexibility, rebuffing currency speculators, and minimizing the devaluation of future oil exports by a significant revaluation of the dinar. The authorities have allowed the dinar to appreciate substantially by around 9 percent since it was de-pegged from the dollar on May 19, 2007. Importantly, with the decision to move to a currency basket, Kuwait split interest rates between a discount rate (the rate charged on borrowing) and the repo rate (the rate charged on deposits) which has enabled the central bank to temper borrowing, without affecting interbank liquidity, simultaneously not discouraging investment-oriented credit flow.

Bahrain, Qatar and Oman

In January 2008, the Bahraini cabinet told parliament to release a BD40 million (\$106 million) fund in the 2008 state budget to give a BD50 inflation allowance to those entitled to the payment.

Qatar imposed price controls on wheat-based products, and also introduced a new law for house rents to address rise in housing costs.

Oman raised wages for government employees by as much as 43 per cent. The CBO has raised the bank reserve requirements to five percent, in order to limit money supply available for credit.

6. Conclusion and Policy Recommendations

Inflation has risen globally, and the GCC countries can hardly decouple from that trend, especially at a time when their economies are experiencing abundant liquidity and a diversification boom powered by high oil prices. With a dollar peg and in the absence of a free floating currency, the GCC countries cannot follow an independent monetary policy. They have to follow the interest rate moves of the Fed in Washington. The falling interest rates at present thus mean rising inflation and a real effective appreciation of the local currencies. They cannot raise rates in order to curb inflation. Kuwait depegged from the dollar and switched to an undisclosed currency basket in May 2007. Since then the Kuwaiti Dinar has appreciated around 9 percent against the dollar; still Kuwait has witnessed accelerated inflation in the second half of 2007. Revaluation and possible re-pegging to a currency basket can provide some relief with regard to imported inflation but it is hardly a panacea, as about two thirds of inflation are homemade and gradual appreciations cannot make up for larger price rises in the global arena. Inflation in Euro terms might be less, but it is still palpable.

In the absence of monetary policy means, the GCC countries have chosen administrative measures to dampen inflation, like continued subsidy schemes, price controls and wage increases, mainly in the public sector. All these measures are piecemeal efforts and may have a limited impact on inflation or may limit supplies. In case of rent caps in the UAE, landlords are more than capable of circumventing these constraints. Pay rises as witnessed in all GCC countries are neither driven by adjustments for the current rate of inflation on the basis of standard of living parameters nor do they take into account worker productivity. Thus raising salaries beyond this level could actually stimulate further inflation. This is because much of the pay rise will be spent and this increase in demand will feed into higher prices if productivity has not increased concomitantly. In the case of food, however, this will be admittedly unlikely, as demand is not likely to be very elastic – one can only eat so much rice and will not start to eat double because of a pay hike. Inflationary impact from such administrative measures has been reported to have happened in the case of Saudi Arabia. The 15 percent government pay rise in August 2005 probably contributed to the current period of rising inflation (the inflation rate has risen in 25 of the subsequent 29 months).

The appropriate policy response should be a combination of monetary policy tightening, revaluation of the dirham and slowing down the pace of retail sector construction to deal with inflation. Revaluation of currency or appreciation of dirham would cut the cost of food imports. That will be the most equitable way to handle equity/distributional problems. Since stronger exchange rate in the event of appreciation takes time to affect the exports, the GCC countries in general and UAE in particular could manage this short-term cost to contain inflation. Instead of subsidies one should better funnel direct aid to needy segments of the population and build up the administrative capacities to engineer such policies.

Food prices might correct after the recent run-ups but are likely to remain on elevated levels. Influences like population growth, factor input inflation and dollar weakness are structural in nature and do not show signs of abating in the near future. The GCC countries are highly dependent on food imports and particularly exposed to global food inflation. As their agriculture is on the decline while their population is growing, this exposure will increase in the future – self-sufficiency is not an option for the arid and increasingly populous GCC countries. Therefore, close dialogue with exporter countries and investments in agricultural projects in Africa, South East Asia and Eastern Europe could add to the GCC countries' food security. Buffer stocks of basic food items could be contemplated as well, in order to reduce exposure to market volatility.



To sum up one can identify the following major policy recommendations:

Monetary measures:

- Revaluation and pegging to a trade weighted currency basket
- Improved financial instruments of central banks (e.g. money market instruments, bond issuance) to mop up excess liquidity
- In the future: Free floating unified GCC currency with the option of setting interest rates independently

Fiscal and administrative measures:

- Keep wage rises and government expenditures in check (could limit growth and could further hardships for working population)
- Enforce rent controls more strictly (could limit supply), tax empty real estate and put low priority construction projects on the backburner to alleviate capacity constraints
- Develop direct aid to needy population segments instead of subsidies

Development strategies:

- Build buffer stocks and a strategic food reserve to reduce exposure to market volatility
- Modernization and downsizing of GCC agriculture, improved irrigation techniques and phasing out of water intensive low value added crops
- Dialogue with food exporter nations and large-scale infrastructure investments for cultivation of new land in Africa, South East Asia and Eastern Europe

Endnotes

- 1 Saudi British Bank, "Giving a Boost: Helping Cope with the Rising Cost of Living in Saudi Arabia," SABB Economic Reports, February 2008.
- 2 *Gulf News*, March 6, 2008.
- 3 Twenty Seventh FAO Regional Conference for the Near East, Doha, March 13-17, 2004, 6, available at: <ftp://ftp.fao.org/unfao/bodies/nerc/27nerc/J1655e.doc>.
- 4 Government of Canada, *Agri-Food. Past, Present & Future Report, Saudi Arabia*, December 2006, 3, available at: http://atn-riae.agr.ca/africa/4290_e.pdf.
- 5 FAO, *Current World Fertilizer Trends and Outlook to 2011/12*, Rome 2008, 4.
- 6 Royal Bank of Scotland, "Global Food Inflation: China is a Minor Player, For Now," Research Note, April 2, 2008.
- 7 World Bank, "Biofuels: the Promise and the Risks," 2008 available on line at http://www.siteresources.worldbank.org/INTWDR2008/Resources/2795087-192112387976/WDR08_05_Focus_B.pdf.
- 8 World Bank (2007): *Making the Most of Scarcity. Accountability for Better Water Management Results in the Middle East and North Africa*, UN FAO Statistics available at: <http://www.fao.org> and <http://faostat.fao.org/>, UN FAO Aquastat Statistic available at: <http://www.fao.org/nr/water/aquastat/main/index.stm>, UN ESCWA Compendium of Environment Statistics in the ESCWA Region (2007) available at: <http://www.escwa.un.org/information/publications/edit/upload/scu-2007-2.pdf>. Further see Nermina Biberovic, "Water and Agriculture Issues in the Gulf," *Gulf Monitor*, January 2008, Vol. 2, No.1 and Mohamed A. Dawoud, *Water Scarcity in the GCC Countries: Challenges and Opportunities* (Dubai: Gulf Research Center, 2007).
- 9 "Virtual water is considered to be water embedded in commodities" (World Water Council) and gives an indication of how much water is needed to produce a (agricultural) product. This might vary from country to country, as there are different climatic conditions or cultivation methods (rain-fed versus irrigated crops).
- 10 Government of Saudi Arabia, Ministry of Economy and Planning: *The Eighth Development Plan 2005-2009*, available at: <http://www.planning.gov.sa/home/Home/English/8Plan/ch26.htm>.
- 11 Food and Agriculture Organization (FAO), "Crop Prospects and Food Situation," No. 1, February 2008, available at: <http://www.fao.org/docrep/010/ah881e/ah881e05.htm>.
- 12 For further policy recommendations see FAO UN, Committee on Agriculture COAG/2007/7 (2007): *Agriculture and Water Scarcity: a Programmatic Approach to Water Use Efficiently and Agricultural Productivity*, Rome, April 25-28, 2007.
- 13 *Gulf News*, March 21, 2008.
- 14 This vulnerability could be exacerbated in times of political crisis. During the Arab oil boycott of 1973 the US, for example, indicated that there could be a boycott of food deliveries to the region as a retaliatory measure. Besides attempts to increase domestic food production, this threat prompted plans to develop Sudan as a bread basket for the Gulf that were later on abandoned. David E. Spiro, *The Hidden Hand of American Hegemony. Petrodollar Recycling and International Markets* (Ithaca/ London: Cornell University Press, 1999), 26.
- 15 *Gulf News*, April 24, 2008.
- 16 This figure shows the exportable surplus of major cereal exporters (i.e. domestic consumption plus exports of the major wheat and coarse grain exporters like Argentina, Australia, Canada, the EU and the United States and major rice exporters like India, Pakistan, Thailand, the United States, and Vietnam).
- 17 Bayt.com conducts Consumer Confidence Index (CCI) surveys across the GCC, Levant and North Africa on a quarterly basis in conjunction with YouGovSiraj, a market research and polling company. For reports see www.bayt.com.
- 18 *Khaleej Times*, February 25, 2008. For a good overview of the topic, see Andrzej Kapiszewski, *Nationals and Expatriates. Population and Labour Dilemmas of the Gulf Cooperation Council States* (Reading: Ithaca, 2001).