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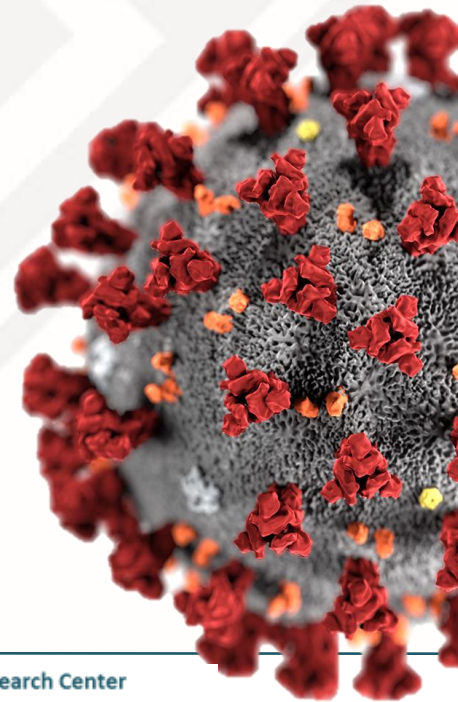
Digital Roundtable on

The Gulf Economy post COVID-19

organized by
Gulf Research Center

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Summary of Discussions



Gulf Research Center Foundation

Avenue de France 23
1202 Geneva
Switzerland
Tel: +41227162730
Fax: +41227162739
Email: Info@grc.net

Gulf Research Centre Cambridge

University of Cambridge
Sidgwick Avenue,
Cambridge CB3 9DA, UK
Tel: +44-1223-760758
Fax: +44-1223-335110
Email: Info@grc.net

Gulf Research Center Jeddah

19 Rayat Al-Itihad St.
P.O. Box 2134 Jeddah 21451
Kingdom of Saudi Arabia
Phone: +966-12-6511999
Fax: +966-2-653-0953
Email: Info@grc.net

For more information:
www.grc.net



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Part 1: Fiscal and budgetary challenges: What fiscal and monetary means do Gulf economies have at their disposal? How much do they need to do and for how long can they sustain low oil revenues from a fiscal and budgetary standpoint? Is this a déjà vu of the 1990s fiscal constraints or is this different?

The discussion established that struggles are faced worldwide due to the current pandemic, including:

- **A supply shock** different from other economic crises in that it is governments themselves that have deliberately stopped economic activity, purposefully intervening to slow down multiple sectors. Other economic crises are typically demand driven.
- **A secondary demand shock** from the crisis-related collapse in consumer demand due to lost income and unemployment. This will affect the GCC differently as most GCC citizens are employed in the public sector, and therefore are afforded a cushion that is absent in many other economies. Saudi Arabia was used as an example where approximately 50% of budgetary spending goes into salaries and public sector transfers. This will protect citizen welfare in the short-term and help to maintain consumer demand. However, the expat labor force remains unprotected against private sector crises, which also highlights humanitarian challenges. They are at risk of decrease of salary payments, and there has been a decrease in incentives to give direct cash transfers to workers who are non-citizens due to the demographic imbalances across the Gulf region. This **growing shift in demographics** could result in an expat exodus, which would subsequently affect consumer demand in smaller Gulf states with larger expatriate populations. Overall, discussions indicated that the downfall of economic demand across the Gulf region will be less in comparison to the economic situation in the West, due to the decreased levels of unemployment rates in Gulf states.
- **Oil price shock and the rapid collapse of oil demand** preventing GCC governments from engaging in expanded fiscal stimulus like



those of Western governments. It was argued that lost fiscal income will not return to the GCC due to the lack of government income from taxes in the Gulf, other than 5% of VAT and corporation taxes. Therefore, rebuilding capacity post lockdown in the Gulf will be difficult. Only a few of the richest Gulf countries hold limited amounts of fiscal reserves, which will result in lower post crisis growth in the region overall, and potentially permanent damage for some countries.

Given the current conditions of the oil markets and global economic turmoil, the discussion focused on **cost emergency measures** to mitigate against the economic impact of the coronavirus pandemic. Two key questions were considered:

1. Where are the sensitive points in the Gulf government budgets?
2. What measures can GCC governments utilize to generate new revenue through non-controversial approaches?

It was highlighted that the following potential economic measures could result in political consequences:

- **Cutting wages/subsidies**
- **Reducing spending on national development projects**
- **Borrowing and selling government assets**

Finally, the following conclusions were drawn throughout the first part of the discussion:

- Reform agendas to diversify Gulf economies now have a new immediacy.
- No return to normal in Gulf labor markets, or a very difficult return to normal. The Gulf could experience an “expat exodus” greater than that of 2017. This will be devastating to smaller Gulf countries such as the UAE and Qatar.
- Choices will be completely different in the future of Gulf fiscal policy.
- Non-oil revenue sectors such as trade, logistics and tourism will undergo a slow recovery relying on government aid. In this context,



Gulf state support to citizens will remain. However a decrease in the income per capita in countries such as Oman, Bahrain and Saudi Arabia, could consequentially result in them becoming poorer countries.

- Banking sector not in the position to rescue the economy due to a large state presence. A strong blow to the private sector makes banks vulnerable as they are under pressure to be more lenient in loan standards while governments are simultaneously pressuring banks to give them loans as well. Non-performing loans will therefore be a big issue going forward.
- In terms of the healthcare sector, a number of providers are currently reliant on social security spending from government and there will be more pressure on these entities who rely on government as paying customer.
- Non-oil revenue will also decrease, and trade, logistics and tourism sectors will be especially hit hard.

Part 2: Labor and unemployment risks: How will labor markets react? Will the private sector be able to cope with job creation challenges? Will unemployment rise over the short to medium term? What can policy makers do?

In introducing the topic of the labor market, the need to examine the structures of labor markets in the GCC prior to the coronavirus pandemic was emphasized, and it was mentioned that the new normal will not necessarily be much different than the old one, but with increased debt, depleted social services, labor markets deregulated and increased inequality. It is unlikely that the distribution of public spending will change by much as significant reductions could lead to social unrest, and therefore it is difficult to predict that something dramatic will happen in the short-term. It will remain an uphill battle for governments regarding how to manage the macro economy. What will happen in terms of potential unemployment will depend primarily on the private sector.



Two sectors that could potentially face the most impact globally:

1. **Industrial sector-** While affected globally, it will be impacted less so in the GCC compared to other sectors. The industrial and agricultural sectors operating in the region employ a small amount of the workforce.
2. **Service sector-** It will take the biggest hit in the Gulf, with the private services sector dominated by expats (in comparison to the public sector dominated by nationals). Middle wage white collar expats will be most affected by this.

Part 3: Debt and currency constraints: Debt will inevitably rise for all Gulf economies. What is the impact of rising debt on Gulf sovereign ratings and corporations? Do debt sustainability thresholds matter? Will this impinge on their ability to borrow more in the future? How will their currencies be affected in a low oil price environment? Is the question of devaluation back?

Discussions emphasized the difficulty (and arguably impossibility) in predicting oil prices. Therefore it is important to examine non-oil revenues and foreign exchange reserves instead. Studies were cited that indicate nearly all government spending in excess of local tax flows as a loss of foreign exchange reserves. This is balanced by oil demands coming in as oil revenues, however without oil revenue, foreign exchange reserves will face a depletion.

Major challenges (and choices) currently faced by Gulf countries, and in particular by Saudi Arabia:

1. **Choosing aggressive fiscal squeeze on spending towards wages:** Very difficult to implement politically as it could lead to social unrest.
2. **Choosing to deplete foreign exchange reserves:** These reserves will decrease to the extent where a credible fixed peg could be destabilized. With regards to external growth rates, this could have a positive effect by elevating growth rates, however the use of



external borrowing to add to foreign exchange reserves will result in increasing government spending, and foreign exchange reserves will become increasingly leveraged.

3. In terms of currency constraints, discussions indicated that one of the main concerns in the Gulf is the **stability of the peg**.

It was highlighted that another factor to consider when examining the general market stability of the Gulf region is the support of foreign assets. The levels of foreign assets still remain in equate reserves. Kuwait was given as an example, whose assets abroad equating to approximately 500% of its GDP. With this in mind, if Kuwait does not generate additional revenues, the country could continue to operate for over 10 years at the current level of spending. This can only be sustained in Gulf countries/regions with large foreign assets such as Qatar, Kuwait and Abu Dhabi (and maybe Saudi Arabia). However, it was argued that these countries will not voluntarily change the peg; if they do, it will be forced upon them due to the running out of reserves, and this is relatively far in the future.

Part 4: Private sector growth and entrepreneurship: How will the private sector fare in this new economic environment? Is the private sector locked in a dependency cycle with government spending or is there deleveraging? Will the private sector be able to grow independent of the government? Will rent-seeking behaviour change and evolve into more competitive practices? What is the future of the Gulf private sector? Are the much talked-about SMEs taking off in the Gulf?

Discussions pointed out that the existing private sector model in the Gulf region operates on two primary flaws that will be exacerbated due to the current crisis:

1. The use of cheap labor
2. Importing and distributing of goods in order to generate value at the expense of innovating productivity. This is due to a heavy reliance on government contracts.



These two flaws have led to the underdevelopment of human capital within the Gulf countries among citizens, with Gulf nationals having minimal incentive to obtain high qualifications and develop adequate skills. Qualifications that workers develop are motivated by 'credentialism,' especially within the public sector. This makes it difficult to measure productivity within the public sector workforce. In this context, higher education credentials are used to generate higher salaries. This is one of the critical reasons why innovation levels in the Gulf region remain low.

According to points made during the discussion, the COVID-19 pandemic disrupted the economic visions in the Gulf in two primary forms:

1. It will affect the economic transitions as it will become more difficult for the private sector to operate without sufficient capital.
2. It will destabilize the relationship between the private sector and the government. This will result negatively in a cycle of poor economic governance with low trust in the government under bureaucratic leaderships.

In conclusion, it was noted that GCC governments should capitalize on the potential entrepreneurial goals of their citizens, especially regarding the abundance of well-educated youth. Governments must experiment with a new model or they could face a more risky situation. Also, it was optimistically noted that Gulf governments have historically depended on long-term thinking, and with young leaders in power, this could positively influence long-term stability.



Part 5: The future of industry: The impact on industry will be vast in an era of trade retrenchment and de-globalization and localization. What will Gulf industries do and how do they adapt in this new environment? Will some have more of a head start than others? What is the comparative advantage in industry for Gulf economies? Is this a good time to rethink individual country-industrial strategies?

Discussions highlighted the continuous industrial competitiveness through trade in the GCC today. In terms of ranking in competitiveness, Saudi Arabia remains ranked 36th globally, and the majority of the GCC countries also increasing their ranks. These measures improve manufacturing export capacities in addition to industrial intensity. There have been ongoing discussions on the comparative advantage of non-oil exports. Nevertheless, participants also discussed the challenges regarding export sophistication measures in terms of knowledge intensity and how this has a tendency to be low. With non-oil exports there are relatively high export concentrations compared to various emerging markets.

Two major trends related to the current COVID-19 crisis were highlighted:

1. Global value chain production is already declining
2. Job intensity of exports has been declining, and the easy employment benefits of exports are currently not what they previously were pre COVID-19 pandemic.

In terms of the future outlook towards recovery, the push and incline towards digitalization was highlighted, i.e. industrial sectors will be more data driven, which will inevitably change production structures and processes. It was argued that the best opportunity is to aim at specialization based on oil but not be confined to it, as this is where the Gulf comparative advantage lies.