A NEW ECONOMIC MODEL FOR THE LOW OIL PRICE ERA

The region is on a transformation path, but GCC governments need to undertake further economic and structural reforms to adjust to the new oil normal, says economist Nasser Saidi

For a region highly dependent on hydrocarbon exports for national income, the 'new oil normal' has been a massive macroeconomic shock.

GCC government budgets have swung into the red, with a deficit of 7.2 per cent of GDP this year, compared with a surplus of 10.8 per cent in 2013. Fiscal austerity programmes have been initiated amid sharp declines in current account balances (estimated at a deficit of 0.3 per cent of GDP this year, compared with a 2013 surplus of 21.4 per cent) and reduced liquidity.

The six GCC countries are able to finance the large twin deficits by drawing on accumulated fiscal buffers and substantial international reserves and by issuing domestic and foreign debt. GCC bond sales in the first quarter of 2017 surged 359 per cent to $24.2bn, and included an $8bn debut issue from the Kuwait government and a $5bn offering from Oman. This follows the $17.5bn debut issue from Saudi Arabia last year, which was the largest issuance by an emerging market country.

But the dip in net foreign asset accumulation is a worrisome trend, as is lower government spending and its impact on the non-oil sector. Tighter financial conditions and a real exchange rate appreciation also challenge economic activity in the non-oil sector.

All this has meant lower growth prospects alongside slower growth in both investment and consumption. The GCC economy is expected to expand by 1.3 per cent this year, compared with an annual average of about 3.8 per cent in 2000-14. Fiscal austerity has exacerbated the impact of the oil price crash.

Policy changes

In the short term, GCC policy adjustments have focused on cuts in fuel, water and electricity subsidies and capital expenditure, in addition to revenue generation through higher or new fees and charges. More significant policy adjustments will include the introduction of a value-added tax at 5 per cent in 2018, which will bring in a potential revenue of 0.8-1.7 per cent of GDP, depending on the country.

Privatisation has been on the agenda of most GCC governments since the oil price drop, but the most anticipated is Saudi Aramco's initial public offering, with the potential to become the world's most valuable company.

All GCC countries have issued vision statements over the past few years, which set out their development plans. Among the more recent ones, Saudi Arabia's Vision 2030 and National Transformation Programme (NTP) is the most ambitious.

GCC REFORMS SINCE 2014

	Revenue	
	Fees	Taxation
Bahrain	✔	
Kuwait		✔
Oman	✔	✔
Qatar		
Saudi Arabia	✔	✔
UAE	✔	

	Subsidy reform		
	Fuel	Water	Power
Bahrain	✔	✔	
Kuwait	✔	✔	✔
Oman	✔	✔	
Qatar	✔	✔	✔
Saudi Arabia	✔	✔	
UAE	✔	✔	✔

Source: Nasser Saidi & Associates, on the basis of country authorities

The NTP lays out 178 strategic objectives with more than 500 reform measures and benchmarks for 24 ministries and government entities to be achieved by 2020. The next step is to implement these plans through policy measures and actions. To be successful, the shock therapy needs clear prioritisation, sequencing of reforms and strong private sector engagement.

The economic and social imperative for GCC governments is to diversify their economies away from oil and boost the role of the private sector to become the main engine of job creation.

A new economic development model for the GCC has several building blocks:

- Greater trade, economic and government revenue diversification. Size matters: more regional integration to achieve a GCC Common Market and economic bloc is key to diversification.

> *"Private sector mobilisation is the lynchpin of diversification and flexibility"*

- Private sector mobilisation is the lynchpin of economic diversification and flexibility. The GCC needs to introduce targeted reforms to legislation, regulation and business procedures with the goal of enhancing competitiveness and attracting foreign direct investment. Removing barriers to foreign ownership would increase investment and lead to an influx of new technology and knowledge. In the World Bank's 2017 Doing Business index, only the UAE ranks within the top 30 globally for ease of doing business. For the GCC, areas of reform include facilitating trading across borders, resolving insolvency and protecting minority investors.

- Education and labour market reforms. State education systems continue to focus on preparing students for public sector jobs, with a persistent skill mismatch compared to market requirements. It is time to invest in education for employment, vocational and on-the-job training. The emphasis should be on promoting STEM (Science, Technology, Engineering and Mathematics), especially given the focus on innovation and shift to e-services in the region. The other major reform is breaking down the barriers to the economic participation and empowerment of women.
- Reforms for a level playing field between private sector and state-owned enterprises (SoEs). GCC market structures and the role of SOEs need to be transformed to allow competition and contestable markets. A case in point is to allow multiple broadband operators to use existing telecom infrastructure to enable a shift to digital economies.
- Public-private partnerships (PPP) and privatisation to draw in private sector investment in infrastructure, logistics, health, education and other sectors. The PPPs should be supported by robust regulatory frameworks that ensure regulator independence, cost-effectiveness and limited fiscal risks.
- Shifting sovereign wealth fund strategy to invest domestically to support greater economic diversification; and co-investing with foreign partners in new technologies and innovative sectors, including clean energy and robotics.

The new oil normal is a blessing in disguise for the GCC: it offers an unprecedented opportunity to implement economic diversification strategies and reform policies that will underpin more sustainable economies. The impact on the region of such reform would be significant, through higher productivity growth, investment rates and trade linkages, not to mention the dynamic effect of greater private sector engagement on job creation and innovation.

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