

# Wealth Effects in the GCC from Energy Commodity Prices

Oil-exporting countries, including the GCC economies, have experienced a windfall as a result of high oil prices since 2003. Hydro-carbon revenues in the Middle East which has the world's largest share of oil and natural gas reserves have filtered into their domestic economies through increased government spending and large scale investment projects. However, given the exhaustible nature of energy resources, long term planning is necessary in order to ensure that the revenues are not spent unwisely.

Friedman's Permanent Income Hypothesis (PIH) helps to connect economic theory to the practical/empirical approach of estimating the effect of higher energy prices on the stock of wealth represented by fossil fuel underground reserves. The PIH states that individuals base their consumption (and savings) decisions not on their current income which may be subject to transitory, short term fluctuations, but on their permanent income, their longer-term income prospects, and an estimate of their future wealth. The same reasoning, *mutatis mutandis*, can be applied to countries. In the DIFC Economic Note 6 titled "[Wealth Effects in the GCC from Energy Commodity Prices](#)", we calculate the permanent income effect on the GCC countries deriving from the fluctuations of energy commodity prices and the implications for the future development of this region. Several scenarios are considered – based on assumptions over oil and gas prices and discount rates of income streams.

The central result shows that the present value of the hydrocarbon wealth for the GCC countries can be estimated at USD 11.2 trillion, assuming a 3% rate of return (and discount rate) and a price of \$50 per barrel (at 2009 constant prices). The analogous value for natural gas reserves assuming a discount rate of 3% and a price \$9 per mn Btu stands at USD

7.1 trillion. Hence, the permanent wealth from oil and natural gas reserves under rather conservative assumptions stands at a whopping USD 18.3 trillion, giving GCC the potential to swap their fossil fuel reserves for half of the world's current (August 2009) stock market capitalization!

There are a number of important lessons and consequences of the increased wealth of the GCC.

- Their higher current and prospective wealth enables the GCC countries and other energy exporters to use their wealth to invest in economic diversification to reduce their vulnerability to oil and gas price fluctuations.
- The increased financial wealth of the GCC calls for increased investment and resources to be devoted to wealth and asset management and control.
- The fiscal situation and debt capacity of the GCC countries should be analysed taking into consideration the vast current and prospective wealth of the GCC countries.
- The recent financial crisis has demonstrated the importance of the financial cushion provided by the international financial assets that the GCC built up over 2003-2008 in helping them weather the global economic and financial crisis.