



Gulf Research Centre Cambridge
Knowledge for All

Workshop 9

Economic Diversification: Challenges and Opportunities in the GCC

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Abstract

The Gulf Cooperation Council (GCC) countries share specific structural economic features. They depend heavily on the hydrocarbon sector, which was reflected in key macroeconomic indicators in 2014, as accounts for high budget receipts at 84 percent and approximately 69 percent of total GCC exports. Despite the huge accumulated financial surplus and the GCC governments' investment in their economies, outcomes have fallen short of targets set out in their national visions, while the challenges of economic diversification persist. This workshop will explore the current economic policies of the GCC countries and their efforts to shift their economies away from heavy dependence on hydrocarbons towards a more diversified economic system, where the private sector becomes the engine of growth. The overarching focus will be on the challenges of diversification in terms of strategic planning, policy-making, implementation, and global best practices. This workshop is expected to critically evaluate the current diversification strategies and underline some key assumptions that could lead, at a later stage, to the development of a new mode of diversification in the GCC context.

Background and Literature Survey

A significant volume of literature has dealt with GCC economic diversification from different perspectives (Luciani 2012, 2013). The shift from oil dependence to economic diversification in the GCC countries underscores the economic risks associated with rentier state theory (Beblawi 1987) and the Dutch Disease theory, which argues that natural resource windfalls often result in weakening other sectors due to currency appreciation and the attractive high profits in the resource sector (Cordon & Neary 1982). The economic risk of Dutch Disease supports such analysis as oil revenues tend to quickly crowd out any other economic activity; hence diversification is a means of controlling risks in GCC countries (Hvidt 2013).

For GCC countries, the aim of economic diversification is not only to minimize the negative impact of oil price fluctuations; it is also a necessity as a diversified economy tends to be more stable and has the capacity to create jobs while being less susceptible to the boom and bust cycle of oil and gas prices. Such necessity has put diversification at the very core of economic development strategies and planning since the mid-1990s (Fasano & Iqbal 2002). This is clearly evident in the national visions, where each GCC country stresses the importance of promoting entrepreneurship and supporting and increasing the role of the private sector in the economic development process.

Evidence of diversification may be seen in the decline in the share of oil and gas in GDP from 41 percent in 2000 to 33 percent in 2013 (IIF 2014) and increased spending on industrial infrastructure across the region, with UAE's spending increasing by over 400 percent, particularly in aviation, aerospace and defense, in the past three years (Davidson 2011). This is also evident in the rising share in GDP of the services and financial sectors, as well as the huge investments in education, healthcare, water, communications, transportation, tourism, and other non-hydrocarbon sectors. In the energy sector, diversification is facilitated by investment in renewable and alternative energy sources such as solar, carbon capture and storage, and clean technology. In food security, the GCC countries have strengthened their agro-security by the acquisition of large areas of farmland outside their own national borders and investing heavily in major agricultural projects in Sudan, Ethiopia, Egypt, Turkey, Ukraine, Kazakhstan, Philippines, and Brazil (Woertz 2013; Al Obaid 2010; Deninger et al. 2011).

However, economic diversification is facing significant challenges across the region. Most GCC countries suffer from weak institutions, lack of coordination between policy-making and policy implementation, small and ineffective private sectors, lack of innovation and limited investment in R&D, poorly skilled national workforces incapable of meeting the demands of the private sector, inefficient legal and regulatory systems,

and lack of accountability and transparency. Analysis also shows that severe implementation issues in the education, labor and trade sectors, as well as fundamental weaknesses in the GCC economic structure, negatively affect economic diversification (Coury & Dave 2010). What remains important here is not whether diversification will succeed or fail, but how GCC countries will address the main challenges of diversification.

Description and Rationale

Since 2011, GCC macroeconomic performance has been robust, characterized by strong GDP growth, significant creation of job opportunities, and large surpluses in the fiscal and balance of payment positions. This has drawn much attention to the GCC economies, not only because of the rise in international oil prices but also the nature of economic growth that has taken more of a vertical route. Global investors and key trade partners such as the EU, the US, and China have vested interests in the GCC economies, particularly in the energy sector; hence, they are keen to develop free trade and investment agreements with the GCC to maintain their access to such important markets. The capacity of the GCC countries to take advantage of such extensive foreign interest in their economies and the huge capital surplus from oil and gas revenues (estimated at \$1.5 trillion in 2013) to achieve economic diversification is still a matter of debate. This workshop aims to provide a forum for participants from both inside and outside the GCC to discuss and exchange views on a variety of issues considered to be important for sustainable economic growth in the GCC, with a particular focus on economic diversification challenges.

The plan is to have a two-day workshop, which will include three themes, each addressed by four papers. The following are the proposed themes for the workshop:

1. The Role of the Private Sector in Economic Diversification

The private sector plays a minimal role in the GCC economies and, for the most part, continues to be dependent on the performance of the hydrocarbon sector (Hertog 2010 and 2013). Though it is the engine of growth in most advanced economies, in the GCC countries the private sector has remained relatively small and heavily financed by oil revenues (Hertog 2014). If the private sector is to play a greater role in the development process of the GCC countries, structural changes should aim at creating conditions favorable for the private sector vis-à-vis the public sector in terms of limiting the role of the government to strategic guidance and diverting production activities away from the public sector to the private sector, which is often characterized by efficient allocation of resources and high productivity. Such changes should also produce an appropriate system that liberalizes the regulatory framework, supports the development of the banking sector

to enable SMEs access to finance, and encourages private investment in the non-hydrocarbon sectors. A balance should also be struck between the nationalization of the labor markets and the requirements of the private sector in the context of high unemployment and low labor productivity among the national workforce (Al Qudsi 2005). Such a balance could reduce the risk of low competitiveness in the GCC markets due to low levels of productivity and efficiency. This underscores the close link between the quality of the education system and entrepreneurship and the performance of workers and the ability of entrepreneurs and SMEs executives to competently utilize the financial and technical support provided by organizations such as Al Khalifa Fund in UAE and Sanad in Oman. Although the performance and share of the private sector in GDP has improved, and the sector is no longer entirely overshadowed by the dominant public sector, the GCC private sector continues to be hampered by the patronage system in privatizing state-owned enterprises, lack of education and training that impacts on productivity, high cost of borrowing and its fragmented nature which prevents SMEs from achieving economies of scale as well as limiting its role in economic diversification.

2. Policy Challenges and Conditions for Successful Economic Diversification

This theme will focus on the importance of designing a specific strategy for economic diversification, to be translated into an action plan with proper indicators and a monitoring and evaluation system. It will also tackle the issue of the establishment of an institutional structure for the implementation of the strategy and elaborate on some of the main conditions for a successful economic diversification strategy. Of course, there is no uniform policy advice that would suit all GCC countries, but a common approach can be developed to enable these countries to realize their economic diversification aims. Among the key policy areas to be examined are completing the process of trade liberalization, simplifying the tax and regulatory system, ensuring that the financial system delivers adequate funding for investments, and improving the infrastructure. These policies could result in creating an enabling business environment, developing well-functioning and quality government institutions, and integrating skills development into sectoral policies, particularly in priority sectors that have the potential to contribute to economic diversification.

This theme is also expected to explore ways through which new policy measures can break the vicious circle and interplay between low productivity and competitiveness and poor economic diversity in the GCC countries. Analysis will focus on the capacity of public institutions and government policies to create the appropriate environment and conditions conducive to economic diversification. This will be examined broadly in the context of the regulatory and institutional environment in the GCC (Sun 2002) and what needs to change to divert capital and human resources from the hydrocarbon sector to other sectors such as manufacturing, finance, services, and tourism.

3. Global Best Practices and the Need for a New Mode of Diversification in the GCC

This theme focuses on how the global forces and best practices facilitate economic diversification in the GCC countries. Recent data indicates that the GCC has become more integrated with the global economy than ever before, contributing 5.9 per cent of total global trade and importing 80-90 per cent of its food and goods from international markets (IIF 2014). It is also estimated that GCC global assets managed by sovereign wealth funds are approaching \$1.5 trillion in 2014, with Saudi Arabia, UAE, and Qatar now major destinations of capital inflows and outflows (UNCTAD 2013). However, the potential gains from such integration have not yet been realized since the region has failed to reap tangible benefits from globalization and multilateral trade arrangements, particularly in attracting FDI and enhancing non-oil exports.

Given the nature of the economic system in the GCC and comparing it with other countries of comparable size and experiences, the premise of this theme is to underscore the need for a new model of diversification that enables the GCC countries to benefit from global trade and FDI in their economic diversification and reform. Comparative analysis and lessons from best practices in economic diversification will be drawn from other emerging economies. Particular attention will be given to the experiences of South Korea and Taiwan, which represent a model of industrial economy, and Singapore and Hong Kong that represent a model of service economy. Indeed, there are huge differences between these models, but they simultaneously share some general features such as government intervention in directing the path of the national economy, clarity and stability of investment policies, and support for export-based activities. The lessons learned from such practices could help the GCC countries in increasing the flexibility and attractiveness of their policies and laws relating to foreign trade and investments; developing attractive incentive packages; and enhancing advantages to the investment environment (Sun 2002). All of these contribute positively to economic diversification.

Anticipated Participants

The workshop aims to bring together resources and knowledge from different fields related to diversification and sustainable development in the GCC and beyond. Therefore, it is expected that contributors will include those involved in policy making and practice but also those from different fields such as sciences, engineering, politics, economics, social sciences and management. However, in order to ensure that a wide range of participants from several disciplines can engage fully and participate in the workshops, contributors are asked to avoid submitting highly technical papers. Papers in the workshop may take various forms, including case studies, surveys, reflective studies,

conceptual papers, and, policy and practice statements. The workshop aims to attract papers which are closely targeted toward one of the three themes of the workshop:

1. The role of the private sector in economic diversification in the GCC
2. Policy challenges and conditions for successful economic diversification in the GCC
3. Global best practices and the need for a new mode of diversification in the GCC

The proposed papers are expected to cover any of the following points:

- Institutions and policies implemented to promote diversification
- Economic diversification for sustainable and inclusive growth
- Absence of diversification has become the source of social and political pressures
- Relationship between economic diversification and sustained growth
- The role of SMEs and governments in generating growth and diversification
- Can economic diversification be the answer to restore business confidence?
- Specific-sector diversification strategies and programs
- Stories about successful diversification, such as corporate or industry case studies.

The workshop also seeks to attract papers from people coming from different backgrounds, including representatives from any of the following organizations:

- Government and public agencies responsible for diversification challenges, related policy and regulation
- Regional institutions promoting diversification challenges
- International accreditation bodies
- Academics and research institutions

Workshop Director Profiles

Dr Ashraf Mishrif is Senior Lecturer in Political Economy in the Institute of Middle Eastern Studies, King's College London. He was Senior Lecturer in International Business and Finance at Ashcroft International Business School, Anglia Ruskin University, Cambridge, and a Lecturer at the University of Greenwich. He has held a range of executive and advisory positions, including ten years as Cultural Advisor for the Egyptian Embassy's Cultural Bureau in London, and has been a member of the Academic Board of Directors at the Boston Business Management School, Singapore. He also provides advisory services to a range of international companies, government departments, and international organizations, including the United Nations Conference on Trade and Development. Dr. Mishrif's area of specialization is foreign direct investment

and international trade policies, with particular focus on economic reforms, diversification, and sustainable development in the Middle East. He is the author of *Investing in the Middle East: the Political Economy of European Direct Investment in Egypt* (I B Tauris, 2010) and is currently working on another book to be published by Cambridge University Press.

Yousuf Hamad Al Balushi is an experienced and qualified economist with more than 18 years' professional experience at the Central Bank of Oman and the Supreme Council for Development and Planning of Oman. Mr. Al Balushi was appointed as seconded FDI Statistics Advisor to the Ministry of Investment in Cairo, Egypt, under the Technical Assistance Program of the International Monetary Fund. He is in the final stages of his Ph.D. at Kings College London, focusing on the impact of FDI on the efficiency of the private sector and economic development in the Gulf region.

Selected Readings

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