Regional Programme Gulf States

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# German companies recognize GCC-wide opportunities

## Faster regional economic integration would be a strong accelerator for economic diversification

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## Diversification as a Driver for Growth

GCC countries have been pursuing economic diversification with a new sense of urgency since the pandemic's slowdown. The subsequent decrease in the oil price put additional pressure on the Gulf Arab Countries. While its members have been launching various strategies to reduce their oil dependency throughout the last decade, the pace of reform and diversification varies from one state to another.

Despite good intentions, reflected in their national visions and strategic plans, GCC countries at large remain largely dependent on their natural resources, even when for instance the UAE have made considerable progress. However, lower oil revenues and the expected future decrease in global demand for this commodity is expected to push further economic diversification, often under high pressure. New sectors will emerge outside the oil and gas industry, nascent ones will be triggered further. All this will contribute to the attractiveness of the region in the eyes of international firms: next to the European Union market, the GCC market is already now the fifth most important export market worldwide for German companies. Hence, the GCC 'matters' to German industry, and so does its economic prosperity.

## Economic Transformation Unleashes Multiple Opportunities

The United Arab Emirates has recently sped up its strategy to diversify its economy, above all, the industrial sector. In June 2016, His Highness Sheikh Mohammed bin Rashid Al Maktoum, Vice-President and Prime Minister of the UAE and Ruler of Dubai, launched the "Dubai Industrial 2030" approach to establish the Emirate as a global hub for sustainable and innovation-driven companies, focussing on the subsectors like aerospace & maritime, pharmaceuticals and medical equipment, food and beverages. The measures were intended to generate additional AED 160 billion by 2030.

In March 2021, Dubai launched "Operation 300bn", an ambitious plan to turn various industrial sectors into national flagships, increasing its contribution to GDP from AED 133 billion to 300 billion by 2031. On a federal level, the powerful Abu Dhabi investment fund "Mubadala" published a strategy in early 2021 that targets stronger domestic investments in the manufacturing industry. The fund streamlines its assets across the Emirates to establish "National Champions" and to nurture – more than in the past - industrial and commercial clusters.

The UAE are not alone in their ambitious endeavours. Saudi Arabia has launched the "National Industrial Development and Logistics Program" (NIDLP). As part of the "Saudi Vision 2030", the program aims to transform the largest GCC member state into an industrial powerhouse of global importance. These initiatives offer attractive investment and business opportunities for German companies. "Made in Germany" is still a synonym for world-class products and services, especially in machinery and engineering, which are considered prestigious throughout the GCC region.

## Energy Partnerships Supporting Future Beyond Oil

The ongoing exchange and cooperation between the UAE and Germany on energy has proven to be positive and productive. The two countries have maintained an active energy partnership over several years. Their aspiring targets for transforming their energy sectors towards renewable sources (will) unlock various business opportunities for German companies around "Green Energy". The Emirates set an ambitious goal in their "UAE Energy Strategy 2050" plan to increase the share of renewables to 44 percent by 2050, hence reducing further its dependency on fossil energy.

As part of the German-Emirati energy partnership, the two countries are in close negotiations to continue their cooperation, especially on the generation, use and transport of sustainable hydrogen. Siemens Energy is currently (May 2021) launching the first solar-powered hydrogen electrolysis plant at the Mohammed bin Rashid Al Maktoum Solar Park, a joint project with the Dubai Electricity and Water Authority (DEWA) and EXPO 2020. The facility will be providing hydrogen energy for the world expo, which will start on October 1, 2021.

## National Regulations vs. Regional Economic Integration?

The outlined economic opportunities coincide with different national policies and initiatives that may have the potential to slow down the desired process of economic change. Federal regulations occasionally do not align, and mutual integration proves challenging. Companies, especially small and midsize entities (SMEs), need a common framework for their operations, considering the size of the market of the individual Gulf states. The GCC states started various efforts to align and streamline standards and regulations to simplify business activities in the region. The GCC Standardization Organization (GSO) was founded to facilitate the trade exchange among the member states. In January 2003, the GSO established a Customs Union and implemented a common customs tariff of 5 percent on all imports. By April 2021, four out of six member states also integrated their commitment for a standard VAT tax of 5 percent in their national legislation. These are important steps towards creating a single economic area, easing intraregional business operations, especially for SMEs.

However, the perception of a truly integrated regional market cannot be fully developed until institutional and regulatory issues are addressed. Political tensions of past years were imposing an additional burden on firms operating in the region. Closed borders and distorted trade links have been challenging for local and international businesses alike. Companies operating in the region welcomed the end of a three- and half-year economic blockade at the beginning of 2021. Also, the recent COVID-driven travel restrictions and interrupted value chains troubled – not only - many German companies running their businesses for instance from the UAE or serving the region from their manufacturing hub in Saudi Arabia. Like in the case of the EU, formerly 'virtual' borders turned into 'real' ones again, making business operations across those borders difficult.

## Ambitious National Employment Programs

Strong demographics and tight government funds pressure decision-makers from both the public and private sector. The historically fragmented labour market, where local citizens dominate the public sector, while expatriates prevail in the private one, is a 'sunset model'. High unemployment rates, particularly among young local citizens, are economically not sustainable. Therefore, national employment programs like Omanization, Kuwaitization and Saudization, are perceived as tough but much needed remedies. Nevertheless, the operational impact on business cannot be underestimated. Aligning with these regulations, particularly when implemented at short notice, challenges private entities. Finding qualified employees on the local labour market proves difficult, especially for companies that rely on a particularly skilled workforce. Local educational systems often aim at an academic career path, thus companies have to invest in training and education of future talent covering manual and technical skills (see the German technical and vocational education (T-VET) schemes as best-practice-example).

## SME's Struggling with Localization Programs

Besides the mentioned challenges to find and employ the 'right' talent, companies have to work with numerous localization programs, for instance – but not only- Saudi Aramco's *IKTVA* (In Kingdom Total Value Added) and ADNOC's *ICV* (In-Country Value). The programs aim to drive localization and job creation and are pillars of the mentioned company's procurement process. Companies wishing to sell their products or services will need to comply with the program scoring requirements. In principle, high scores are required to be awarded with contracts. The score depends on various criteria, like the company's location, the number of local employees and the investment made by local investors. Engaging in business with these companies requires extensive reporting and poses a range of challenges, especially SMEs.

This paper does not question or challenge the economic rationale or the legitimacy of the various national policies. The aim to develop local value chains and foster local employment in the private sector is understandable und undisputed. However, any investor will need to assess and weigh the various regulations throughout the relatively small individual markets in the GCC. Therefore, mutual recognition between the individual programs and member states would be desirable to further attract foreign investment provided also by small and medium-sized companies – supporting the successful path of economic diversification of the GCC member states.

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