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The Uphill Economic Recovery from Covid-19 in the Gulf Cooperation Council:

GCC governments should spend in areas where it can make a long-term impact on productivity growth

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The future of economic growth in the GCC is looking better than some analysts expected in the depths of the downturn in 2020. The Covid-19 pandemic was a twin crisis in the Gulf, as it simultaneously sent a shock to oil prices due to declining demand first from Asia and then globally and hit domestic economic activity through lockdowns and an exit of foreign workers. For oil exporters across the Middle East, the IMF estimates fiscal deficits widened to 10.1 per cent of GDP in 2020 (from 3.8 per cent of GDP in 2019) but are expected to improve significantly in the medium term, reflecting expected higher oil revenue in 2021. Forecasts now see a rebound in 2021 to strengthen to around 3 percent GDP growth after contracting by 5 percent in 2020. The most surprising recovery has been in non-oil economic growth, which in Saudi Arabia is recovering to 3.9% GDP in 2021, according to the Saudi Central Bank.

What may be different in this recovery compared to previous economic crises is a more limited fiscal policy space. In the Global Financial Crisis (GFC) of 2008-09, oil prices quickly rebounded, and governments had comfortable reserve assets, as well as fiscal surpluses and very little external debt. In over a decade since the GFC, a lot has changed. Governments in the Gulf continued spending trajectories, took advantage of international debt capital markets, and only recently began the difficult process of reining in energy subsidies and cutting the public sector wage bill. The buffers or resevoirs of support to that existed within national reserves and even the availability of regional support from neighbors is not the same.

Going into the pandemic, oil producers in the Gulf were already under pressure from weak external demand and lower oil prices since the impact of the shale oil revolution in late 2014. Since December 2016, "OPEC plus" cooperation has been in effect, in which Russia and OPEC members led by Saudi Arabia have tried to limit output to buoy oil prices into a more comfortable range around $60 per barrel, but still below many countries' break even fiscal prices. The Covid pandemic impact, along with a battle for market share early in the pandemic in March 2020, nearly derailed that "OPEC plus" cooperation. Moreover, the ability of governments to respond to the Covid crisis has come after five years of more precarious current account balances, with stubborn fiscal deficits that have been financed with rising public debt levels. According to the IMF, the GCC's average public debt-to-GDP ratio rose from 16.2% in 2006 to 41.4% in 2020. In cases like Oman, debt-to-GDP is closer to 80% and even higher in Bahrain.

The temptation to increase spending will be strong through 2021 and 2022, as oil prices are rebounding to a level approaching or exceeding $70 per barrel in summer of 2021. In some cases, like in Oman, public protests over lack of employment opportunity will pressure the government to scale back some austerity measures and create programs to support public employment. There is simply more expected of governments in the Covid recovery, but the resources to extend support are more limited, or require difficult choices that jeopardize future spending. The external debt burden in Oman, for example, becomes a more constant feature of budget planning.

Rising oil prices and recovering demand first from the US and Europe and then from Asia will be the key signal for Gulf economic policymaking in late 2021 and 2022, again underscoring the procyclical nature of the regional political economy. However, there are headwinds in this recovery. First, recovery in India and across Asia has been slower than in western economies, which is essential to key export markets for the Gulf. Second, the assumption of Iran's re-entry to global oil markets near the end of 2021 and into 2022 continues to affect Gulf Arab states' production restraint plans, calibrating carefully with expected demand recovery. The Iranian re-entry to markets is expected, but not necessarily welcomed, which is also creating some political reconfigurations within the region, as Iran's adversaries seek to diminish differences between each other. And last, the recovery in demand will not benefit all exporters equally. A short-term price hike will not change the longer-term trajectory of oil demand, which is expected to plateau in the next two decades. Taking advantage of this interim period of the global energy transition will mean accelerating government spending in areas where it can make a long-term impact on productivity growth and increased labor force participation among citizens in the private sector, especially women. Some governments will be able to accelerate productivity, including using highly skilled foreign labor and favorable long-term residency regimes, and others will be simply treading water to satisfy immediate demands of their populations.

During the pandemic, the general policy response in terms of stimulus measures across the Middle East was muted compared to other regions, especially OECD economies. In a series of studies by the UNESCWA, the Covid pandemic has exacerbated existing vulnerabilities in youth economic inclusion and labor force participation, lack of efficient tax policy and direct support to workers in the informal sector, and exposed non-oil sectors like tourism and logistics to deep losses. The linkages of the GCC economies to the broader region are essential, with ripple effects on remittances and foreign direct investment flows.

Moreover, within the GCC, wage support to private sector workers was limited, given that Gulf citizens are more likely to be public sector workers and foreigners dominate much of the private sector. The Saudi program SANED, an unemployment insurance stipend, was one exception. But, SANED was rolled out at the same time as a general pairing back of the existing Citizens Account program, meant to provide monthly assistance to low-income families. Instead, governments tended to direct support towards utility subsidies or reduced fees, edging back on some hard-earned subsidy reform. This form of pandemic economic relief also tended to be distributed towards state-related entities as much as small and medium sized enterprises, which may have needed the support more. The same distribution of support occurred in the bank sector, as central banks eased lending requirements to the private bank sector and encouraged looser debt repayment terms, to the benefit of large and state-related entities. Across the Gulf, government mandated lockdowns were strict, and while Dubai opened partially to capture tourism revenue over the New Year holiday, most of the GCC remained under travel restrictions through June 2021, including restrictions on religious tourism in Saudi Arabia. One positive effect of lockdowns has been a demonstration of government competence in curtailing the spread of the Covid-19 disease and rolling out vaccination programs effectively.

In some cases, the Covid pandemic accelerated efforts to generate new sources of revenue through taxes and fees. The effect was jarring for some, especially in Saudi Arabia, as the recently introduced value added tax was hiked from 5% to 15% in July 2020. The introduction of the VAT in Oman (April 2021), Bahrain, the UAE and Saudi Arabia has also contributed to some inflationary pressures. In Saudi Arabia, prices in April 2021 rose 5.3% year-on-year from 2020, with food and beverages rising 8.4% year-on-year, according to Jadwa Investment research.

Going forward, the possibility of more subdued oil demand and prices suggests that it will be more difficult for GCC countries to rely on oil exports revenues for their future growth. The global energy transition is an opportunity for Gulf national oil companies to become renewable energy giants, and to focus on the downstream products of their natural resource wealth, including petrochemicals and new products like blue and green hydrogen. The challenge for GCC governments will be to accelerate productivity growth among a national labor force. The generation of economic growth over the last three decades has been incredible in many ways: the size of the GCC economies has grown from $0.15 trillion in nominal GDP in 1986 to nearly $1.7 trillion in 2019. Supporting that economic expansion has been growth in infrastructure, education, social services and public sector employment opportunity. Lower cost imported labor has been a boost to growth, but not necessarily productivity gains over time. That growth curve is now flattening.

The future of the GCC will be more competitive between national economies, where regulatory policy will determine the ability to attract foreign investment, highly-skilled talent, and to encourage entrepreneurship. Population growth and the demographic trends also weigh heavily on future growth.

As the Gulf citizen youth bulge begins to reach retirement, we will see burdens on social spending and health care increase across the GCC. The road ahead will certainly be bumpy, but the Covid pandemic has shown that the GCC states are capable of difficult policy reforms, particularly in the ability to implement tax reform and to hold steady to some of the lessons learned after the 2014 oil price decline. These states will now compete more for foreign investment and work harder to boost productivity and human capital within national labor markets. A short respite with rising oil prices now could be an important opportunity to set in policies for growth for the long term.

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