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Determinants of Economic Diversification in the Gulf Countries

The Sultanate of Oman as an Example

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Introduction

The Omani economy has, like other Gulf economies, grown at an accelerating rate during the past five decades, fueled by oil revenues, the wise management of available resources and the use of those resources to build the constituents of a modern state. Changes to domestic and international indicators, such as GDP in current and fixed prices, per capita GDP and per capita standards of living, the growth of investment at rates that have created additional job opportunities for citizens and attention to developing and educating Omani people are all signs of the positive developments witnessed by the Omani economy. Statistics indicate that the Sultanate's real GDP has increased by 5.1% from 1981 to 2019.

The development model adopted during the past period has had several positive results in terms of completing infrastructure projects that have included airports, roads, and the basic construction relating to ports in Sohar, Salalah and Duqum. Moreover, that model has entailed the establishment of several petrochemicals projects and industrial and free zones, and several integrated touristic ventures. In addition, there have been several positive developments with regard to deepening the framework of economic diversification, the increase in the participation of women in the workforce, a rise in the rates of higher education, and growth in the non-oil sectors. Moreover, progress has been achieved in stabilising the overall economy, particularly in relation to sustainable growth, raising living standards and preserving fiscal stability and exchange rates. The World Bank's Growth and Development Committee has included the Sultanate in a list of 13 countries worldwide that have achieved the highest levels of continuous growth since the Second World War.

Nevertheless, the growth that has been achieved through direct reliance on oil revenues has resulted in several challenges. The Omani economy suffers from a narrow production base and from its focus on oil and gas and industries linked to them, as is clearly illustrated by the data of the National Centre for Statistics and Information. Oil exports comprised 56.3% of overall export revenues, 65% of government revenues and 30% of GDP in 2019. The government continues to play the main role in production, and the economy is bedeviled by a missing link between the economic growth achieved during the previous phase and an effective private sector role. The Omani economy is weak and has a low production base because of a heavy reliance on the importation of goods, services and labour. Domestic industry is still heavily dependent on government initiatives, and the absence of a dynamic private sector, the low level growth of small and medium enterprises and of non-oil sectors have created limited job opportunities. Efforts to make private sector jobs more attractive have met with limited success to date.

In general, there are three determinants of the limited success of overall economic diversification in the Gulf countries, including Oman. The first pertains to the role of domestic commercial activities and restructuring the Omani economy, which is still noticeably dependent on government spending that is based on oil and gas export revenues. Moreover, domestic demand for goods and services is met by imports and foreign labour. The second pertains to a reconfiguration of the roles of the parties working to achieve development – namely the government and its bodies, the private sector with its companies and establishments, Omani society at the individual and family levels and those involved in the process outside Oman. The third determinant is the need to maximise the benefits of various economic and social public policies to rebalance the economic cycle. Such a rebalancing in times of economic stagnation, recession and lower oil prices requires policies that differ from those that were in place during the years of economic prosperity and higher oil prices in order to deal with fiscal, economic and production challenges and the creation of job opportunities. In addition, there is a need to strengthen the use of public policies aimed at tackling the four well-known factors and elements of production, without which no formula for development can succeed.

The first determinant: management of the cycle of domestic commercial activities

The cycle of domestic commercial activities is markedly dependent on imports to meet domestic demand for goods and services. According to the balance of payments shown in the table below, outflows from the country for that purpose came to 20 billion Omani Riyals in 2018, limiting the benefits derived by productive sectors from public spending, because of low forward and backward linkages, leading to a limited multiplier effect.

Aspects of the deformed overall economic structure include the private sector's limited role, and its overwhelming dependence on imports, expatriate labour and government support, in addition to the prevalence of a black economy amongst the expatriate labour force. There is also a major discrepancy between the growth of the contribution of the oil sector and the non-oil sector in the GDP, as the diagram below shows. It is necessary to identify the major roles played by some sectors that affect the cycle of domestic commercial activity in order to influence it so that it flows in the desired direction.

The defects in the framework of the overall economy represent the cumulative defects in all sectors of the national economy. Hence, the government must work to tackle those defects in a manner that strengthens all aspects of productivity, such as strengthening various kinds of exports and boosting investments, including government, private, domestic and inward investment.

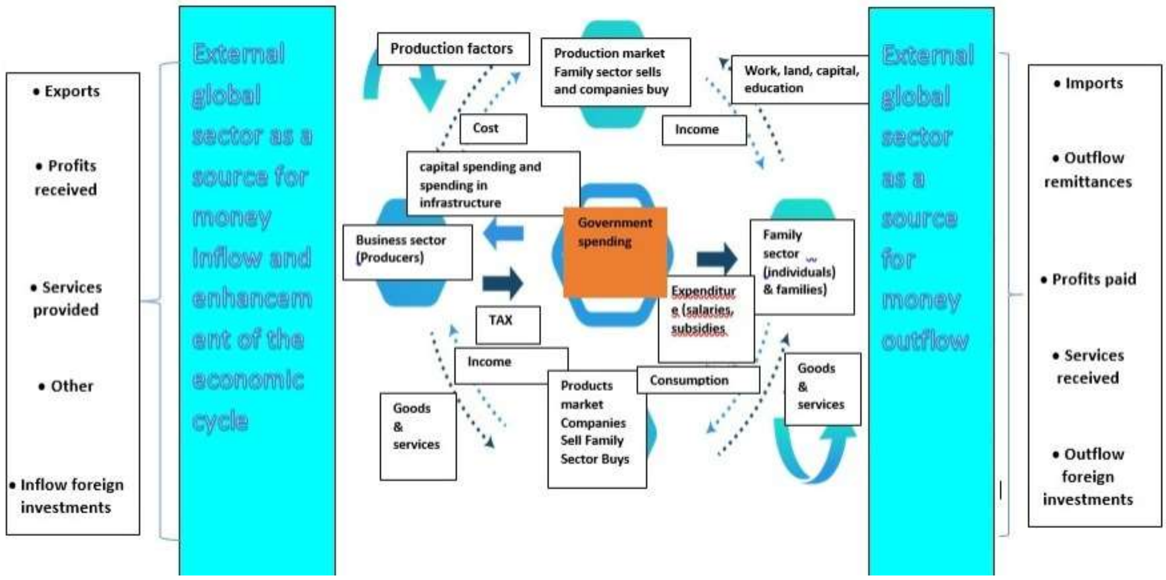
Outward flows in the balance of payments

Outward flows	2012	2013	2014	2015	2016	2017	2018
Imports (FOB)	-9,854	-12,321	-10,723	-10,214	-8,185	-9,275	-9,092
Services (debit)	-3,378	-3,767	-3,850	-3,927	-3,815	-4,168	-4,510
Income (debit)	-2,008	-1,981	-2,103	-1,122	-1,166	-1,603	-2,478
Current transfers (debit)	-3,109-	-3,501	-3,961	-4,226	-3.965	-3,774	-3,829
Total flows	-18,349	-21,570	-20,637	-19,489	-17,132	-18,819	-19,908

SOURCE: Central Bank of Oman Annual Report (2012-2018)

At the same time, the government must limit the external haemorrhage caused by the importation of goods and services and cash transfers in the shape of foreign labour transfers or profits by companies operating in the country.

Cycle of Domestic Commercial Activity

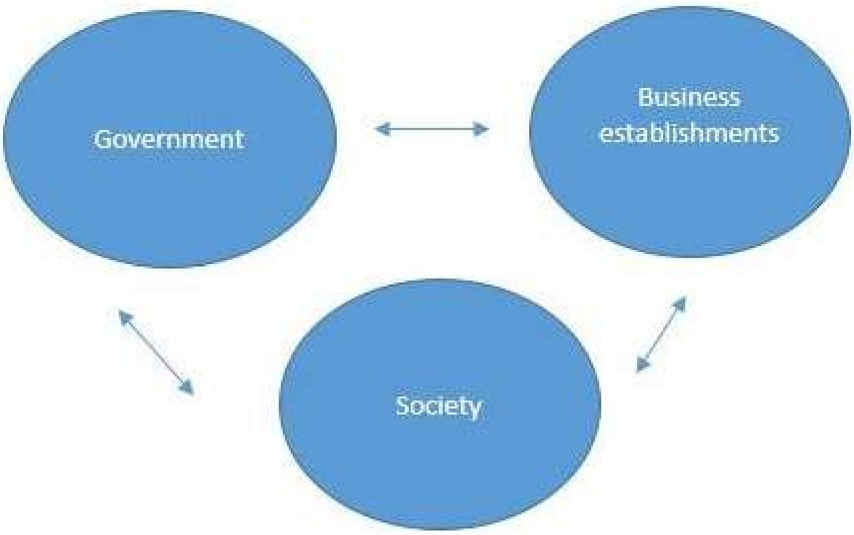


The second determinant: A balanced relationship amongst the government, society and private sector companies

The important factors that have contributed to shaping the current structure and configuration of the Omani economy include relations between the government, the business community and society, and the extent to which balance has been achieved amongst their intersecting objectives. The evidence indicates that the government continues to play all necessary roles in production, financing and investment. Although this is necessary in the initial stages of the development process, the current stages and the capacity attained by the Sultanate require a sharing of roles and costs amongst all relevant parties.

It is noteworthy that a close, but highly sensitive relationship exists between society and the private sectors (business establishments), and it is necessary to achieve a balance between their respective tasks if each of them is to perform its task in the optimum manner desired by society. The nature of the relationship amongst those three parties provides support and a strong foundation for the success of several programmes and initiatives. Moreover, those three parties have intersecting areas of interest: society seeks a secure environment and an appropriate standard of living, high-quality available public services, a willingness to ensure accountability regarding the use of public funds and the achievement of development aspirations. For their part, members of society are required to take initiatives and to be productive. The government must work to achieve political and economic stability, to ensure security and provide sufficient revenues to fund its activities. This in turn requires the government to adopt increased transparency regarding the achievements it has to which it has committed, and to allow additional monitoring by business establishments and society so that it is accountable to them. On the other hand, the business sector aspires to higher demand for the goods and services it produces, the achievement of high rates of return on investments, increased certainty and the ability to plan for the future, limiting the economic hegemony of the public sector, expanding the role of the private sector (commercial institutions) in the economy and an improvement in the business environment and competitive indicators. For its part, the business sector is required to provide job opportunities for members of society and to fund government operations through taxes. A successful relationship between those three parties depends on the following three basic factors: mutual trust, transparency and a willingness to be subject to accountability. Within that context, the oil-rich countries face a big challenge when it comes to introducing balance and integration to this relationship, particularly given that some members of society assume mixed roles that bring together decision making and business activities, thus giving preferential treatment to a limited number of individuals at the expense of other members of society. The growth and development model that is dependent on oil has produced a model in which the government has become the strongest party, allowing it to determine development priorities as it sees fit, and in a manner that may not necessarily be endorsed by the other parties.

The relationship amongst the government, society and private sector companies



Understanding the nature of the balance between the above three parties is necessary, because it explains many results, determines development priorities and constitutes a major support and foundation for the success of several of the programmes and initiatives that are needed to bring about the required transformation. Within that context, it is necessary to emphasise that oil-rich countries, such as the Sultanate, face challenges stemming from the fact that the decision-maker, in some cases, is also a company owner, and since the government is the strongest party, that entails devoting most of the government's attention to political stability at the expense of economic stability.

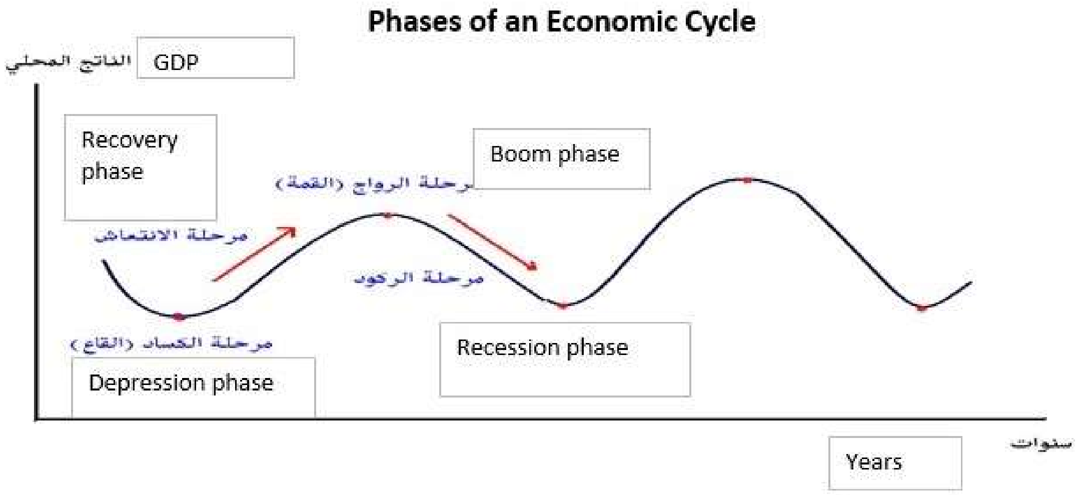
The third determinant: management of the economic cycle

The economic cycle is a periodic change in economic indicators, such as the average number of job seekers and inflation. Hence, the economic cycle is governed by factors that fluctuate between surges, booms and prosperity on the one hand, and stagnation or recession on the other hand. It is obvious that success in tackling the challenges of development is largely linked to proper management of the economic cycle and the balanced policies adopted during periods of prosperity and recession. Constant change in economic cycles is considered a divine decree as mentioned in The Koranic Sura of Yousef. The manifestations of economic cycles vary according to different growth phases and the policies that are in force, and periodically affect overall areas of economic activity, such as such as levels of production, labour and prices. They mainly appear in capitalist countries that espouse economic freedom and no intervention by the state in economic activity.

A semi-consensus exists amongst economists that each cycle consists of four phases (crisis, recovery, peak and recession), followed by another cycle and so on. Differences exist in the names of each phase. Some refer to an economic boom or peak, which is characterised by a progressive rise in prices, and a rapid increase in production, higher income levels and employment, and a low number of job-seekers. During a recession period, prices, production and income levels fall, the number of job seekers rises and goods inventories increase.[1] A depression phase is characterised by low prices, an exacerbation of unemployment and a fall in commerce and economic activity in general. During a recovery phase, also known as expansion, prices rise in general, economic activity gradually increases; GDP returns to growth; the number of job seekers and the level of goods inventory levels both fall, and demand for output rises.

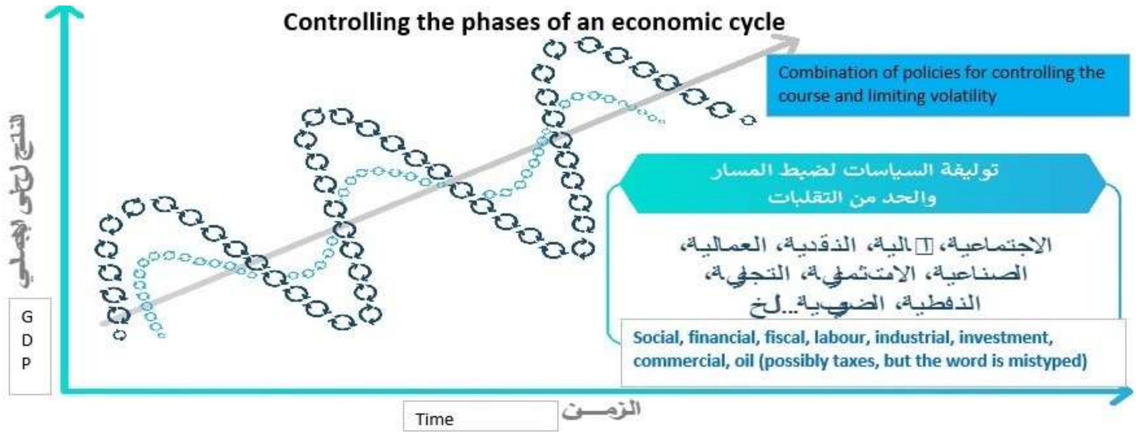
[1] A simple definition of depression is that it is a prolonged period of recession that entails a steeper fall in economic activity.

Phases of an Economic Cycle



Notably, a study of economic cycles shows that they are periodic and occur at regular intervals, although the duration of each phase cannot be accurately defined. However, their degree of regularity is sufficient to show their periodic nature. There is near consensus that such cycles last between seven and ten years, and that they are of a general and comprehensive nature, since the constituent elements of the business world are intimately linked in a manner similar to the state of a living organism. If one business establishment fails or experiences recession, that means that other establishments that deal with it cannot remain unaffected, and they in turn will affect the other commercial establishments with which they deal. In that way, recession will pass from one industry to another, and the time will come when all industries in all areas and all establishments in a country will be deluged by recession, and only a limited number of establishments will survive.

Controlling the Phases of an Economic Cycle



In conclusion and in terms of the future, dealing with the above challenges is critically important to the success of the Gulf countries in the achievement of sustainability and ensuring the desired transition within their development models. This is also a main pillar required for the success of several programmes and initiatives that are part of Gulf visions. Several programmes and important transformations should not be neglected. They include a transformation in the commercial activities cycle, in terms of what we produce and what we export (the cycle of domestic commercial activities remains dependent on oil and gas revenues as generators of domestic income and demand.) Secondly, a transformation in the management of the economic cycle, the formulation of modern, integrated and comprehensive public policies to effect the desired changes during the years of prosperity and the years of economic recession (the development process in the Sultanate is managed spontaneously, and there is no one currently in charge of firmly managing and integrating various public policies, which are the remit of various bodies, and are subject to various unplanned influences that have clear effects on the path of development.) Thirdly, a transformation in the relations amongst members of society, business institutions and government institutions and their respective roles, given that the government continues to play all roles in production, financing and investment. Although this is required during the initial stages of the development process, the current phases and capacity attained by the Sultanate require a division of roles and costs amongst all relevant parties.

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