Assessing The Impact Of The Global Financial Crisis On GCC Countries

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ABSTRACT

No doubt, the international financial crisis that started in the United States of America will cast its effects on all countries of the world, developed and developing. Yet these effects vary from one country to another for several reasons. The GCC countries would not escape these negative effects of this severe crisis. The negative effects of the crisis on gulf countries come from many aspects: first, decrease in price of oil on whose revenues the development programs in these countries depend; second, decrease in the value of US$ and the subsequent decrease in the assets owned by these countries in US$; third, a case of economic stagnation will prevail in the world with effects starting to appear. It is obvious that this would be reflected on the real sector in the economies causing a series of negative effects through decrease of the world demand for exports of GCC countries of oil, petrochemicals and aluminum. Lastly, increased inflation rates with decreased interest rates will result in a decrease in real interest with an accompanying decrease in incentives for saving and consequently investment and economic development. The main aim of the research is to assess the economic effects of the global financial crisis on GCC countries. The paper results are that the big reserves of foreign currencies achieved by the GCC countries in the past few years have helped increase their ability to bear the effects of the financial effects on one hand and their ability to adopt expansionary policies through pumping liquidity to absorb the regressive effects of the crisis on the other. The paper recommends the necessity of taking precautionary procedures for the effects which will result from the expansionary policies effective in GCC countries.

Keywords: Financial Crisis, GCC countries, financial sector, real sector

1. INTRODUCTION

In the Group of 20 summit (London Summit Communiqué, 2009), several key decisions were derived. There was also the support to IMF and World Bank by more than US$1 trillion, liquidating a part of the gold reserve with the IMF to help the poor, monitoring the financial system through establishing a financial system stability council and working toward fighting tax evasion. The summit assigned the OECD to declare a list of tax havens or paradises. Earlier in the century, OECD published a list with only three countries; namely, Monaco, Andorra and Lichtenstein. In subsequent years, several countries were withdrawn from the list after they pledged to stick to transparency. Belgium, Austria, Luxemburg, Switzerland, as well as Lichtenstein and Andorra, one right after another, declared the amendment of some of their national legislations regarding banking secrecy, for fear of enlisting on the new list to be declared. Luxemburg and Austria agreed to cooperate with other countries through exchanging bank information in case of suspected tax evasion. As for Monaco, it agreed to negotiate an agreement on exchanging taxation information with the EU, while Switzerland, on its own, declared it would abide by OECD criteria. Oxfam-France shows that only four countries are blacklisted, while the grey list is surprisingly long. It points out that the minimum guarantees given in recent weeks were apparently enough to convince the leaders of ‘The Twenty’. Also, one of the most important decisions of the summit was funding US$ 5 trillion until 2010 (Abdelbaki, H., 2009; London summit, 2009).

Despite referring to the current crisis storming the world as "financial", the effects of such a crisis are not limited to the financial sector; but extended to all sectors as a result of the established strong relations between the financial and real estate sectors of the economy. Such referral came about due to the fact that the crisis began in the financial sector, especially in the U.S. real estate sector, before including all U.S. sectors and then going to the rest of the world.

The international financial crisis, which began in the USA, has undoubtedly affected all developed and developing countries, yet the effects vary from one country to another for several reasons. GCC countries would not escape the negative effects of this severe crisis. With regard to Arab countries being affected by the crisis, analysts divided them into three groups: 1) Arab countries with high economic and financial liberalization, including GCC countries; 2) Arab countries with moderate-to-above moderate liberalization, including Egypt, Jordan and Tunisia; and 3) Arab countries with low liberalization, including Sudan and Libya.

The effect of the financial crisis on the economies of GCC countries is multifaceted and include: 1) decreased oil prices and its effect on the status of the public budgets of these countries, and consequently on investment and development programs; 2) decreased international demand for GCC exports as a result of the economic recession whose effects began to appear; and 3) increased unemployment as a result of productive institutions decreasing the size of their work force and a decreased demand affecting gulf financial markets. These effects are further proliferated with the maximization role of the financial sector in the economy, on the one hand, and the degree of economic openness to the world on the other hand. This research, therefore, aims to analyze the effect of the financial sector in GCC countries and the extent of these effects on the national economy.

In this study, we also seek to analyze the degree of openness in these countries and the extent of their being affected by international economic variables and events. In the next section, we present the concept and evolvement of the current global financial crisis. Then we measure the extent of the effect of the financial crisis on GCC countries by analyzing the role of the financial sector in GCC countries' economies and the degree of openness of GCC countries. In section four, we present an explanation of the policies followed by GCC countries to delimit the effects of the international financial crisis on these economies. Section five is devoted to analyze the effects of the international financial crisis on GCC countries. Lastly, conclusions and results are discussed.

2. CONCEPT AND EVOLVEMENT OF THE CURRENT GLOBAL FINANCIAL CRISIS

The term "financial crisis" points to the sudden decrease in the prices of an asset which might be a material, such as machinery and equipment, or financial, such as shares and bonds. The sudden decrease may take place as a result of the price bubble, which may mean a big and sudden increase in prices ending in their sudden collapse (Bashir, F., and A., Al Ameen, 2007). Experts, politicians and decision-makers all over the world confirm that the current economic crisis is dangerous and deep and that it is going to continue for a period of two to three years. Statistical reports point to the fact that the number of unemployed all over the world will increase by 51 million during the coming two years. The international economic growth will decrease from 3 to 4% (to about half percent). It also denotes that the depth of the crisis is the decrease of financial indicators in international and regional money markets and the volume of consequent losses therein. Also, the bankruptcy of giant international institutions, such as Lehman Brothers, which is considered one of the most eminent banks in the world in different financial services, and American Insurance Group (AIG), the guarantor of revenues for several American real estate funds and 18th place in the list of the biggest joint stock companies, is considered another result of the crisis and its deep effect. Then comes General Motors. If we look at the status of developing and poor countries, we find that the turmoil seems to be deeper and worse, especially with the presence of an international food crisis overwhelming the status of these poor people. With the waves of inflation suffered by the world in the last two years, the crisis intensifies and gains momentum (Abdelbaki, H., 2008_1, Abdelbaki, H., forthcoming).

The crisis started with irresponsible behavior by those responsible for the real estate market in the USA as they expanded granting housing loans in an unprecedented manner, consequently resulting in the value of loans exceeding the value of assets. The officials granted these loans without taking the simplest guarantees reflecting the trustworthiness of borrowers. The result was that many borrowers could not pay back their loans, which was reflected in the financial status of these institutions, consequently their inability to pay their obligations, thus collapse. This resulted in bonding or papering; i.e., turning housing loans into bonds supported by these loans. With the meshing of economic sectors in the national economy, this negatively affected other sectors in the American economy. With the beginning of stumbling and bankruptcy of giant institutions, fear and distrust spread among depositors, which is an important factor in dealing with the financial system because the main preoccupation of clients or depositors is to achieve a satisfactory income with no losses in their money or deposits. Distrust resulted in many depositors withdrawing their deposits, which made new institutions – which were still enjoying a good financial status – exposed to problems and bankruptcy. The crisis spread in the USA and financial and political officials in the USA tried to conceal these facts from the world. Yet, due to the meshing international relations, the crisis spread to the rest of the world because of the big effect of the American economy on the world economy and also as a result of the economic globalization, especially after the establishment of WTO in 1995 (Cooper, G., 2008). The crisis resulted in decreased expectations of economic development, an increase in unemployment in all countries, and an expectation of long-term international economic stagnation (IMF, 2009). The crisis affected liquidity in an unprecedented manner, and central banks, together with governments in all countries, urgently took all necessary measures to work toward increasing the monetary supply with expansive financial and monetary policies, which no doubt would wear the budget of many countries and cause more inflation pressures with negative effects, especially in poor and developing countries.

3. MEASURING THE EXTENT OF THE EFFECT OF THE FINANCIAL CRISIS ON GCC COUNTRIES

The negative effects of the financial crisis on a certain country depend on two major factors: 1) The extent of the role of the financial sector in the national economy; the greater this role, the greater is the effect of the crisis on the sector and the transfer of these effects to the real sector in the economy, and 2) The degree of openness of the national economy; the more the degree of openness, the more the economy is affected by the crisis through its relations with world countries.

3.1. The Role of the Financial Sector in the National Economy of GCC Countries

Analysts use three indicators to measure the extent of the financial sector's contribution to the national economy:

1. M2 ratio to the gross national product, usually called cash rate, reflects the size of financial market in the national economy. The rise of this ratio indicates the expansion of the financial sector compared to the rest of the national economy sectors (Levine, R., 1997).
2. The ratio of demand deposits to money supply, in its narrow definition, reflects the extent of development of the financial sector, especially banks. The rise in this ratio points to an increased diversity degree in financial institutions and rise in the use of deposit money in transactions.
3. Credit issued by financial institutions to the non-financial private sector as a ratio to the gross national product. This indicator is considered the most important of the three as it reflects the main activity of the financial sector (Aly, H., 2007; Abdelbaki, H., 2008_2).

Tables 1A, B & C show the value of the three indicators of the financial sector in GCC countries for the period 1994-2004.

Table 1A: Performance Indicators of the Financial Sector in GCC Countries in the Period 1994-2004

Year	First Indicator					
	Kuwait	Qatar	Oman	Saudi	Bahrain	Emirates
1994	0.906	0.686	0.283	0.518	0.644	0.525
1995	0.908	0.629	0.285	0.450	0.658	0.518
1996	0.776	0.596	0.278	0.438	0.651	0.493
1997	0.823	0.525	0.334	0.440	0.674	0.504
1998	0.966	0.625	0.394	0.516	0.807	0.555
1999	0.838	0.576	0.375	0.499	0.786	0.628
2000	0.722	0.445	0.315	0.445	0.720	0.547
2001	0.880	0.445	0.342	0.481	0.790	0.613
2002	0.915	0.448	0.354	0.538	0.818	0.625
2003	0.764	0.431	0.339	0.512	0.765	0.616
2004	0.700	0.433	0.308	0.513	0.692	0.651

Source: calculated by the author by using liquidity data in Arab countries available on Arab Monetary Fund website

According to the first indicator, the financial sector in the State of Kuwait was the largest in the national economy, as the value of the indicator in Kuwait was the highest of the GCC countries during the same period, except for the year 2003 when the indicator was highest in the Kingdom of Bahrain. Also, by observing the data of the second indicator, we find that Kuwait ranks first in the years 1995-1997, then from 2002 – 2004. Bahrain occupied first place in the years 1994 and from 1998–2001. This reflects the degree of competition between both states in competing for most developed regional financial center.

Table 1B: Performance Indicators of the Financial Sector in GCC Countries in the Period 1994-2004

Year	Second Indicator					
	Kuwait	**Qatar**	**Oman**	**Saudi**	**Bahrain**	**Emirates**
1994	0.688	0.655	0.478	0.642	0.694	0.686
1995	0.737	0.622	0.497	0.654	0.689	0.692
1996	0.718	0.639	0.540	0.676	0.693	0.696
1997	0.723	0.624	0.551	0.676	0.699	0.710
1998	0.695	0.644	0.514	0.679	0.745	0.705
1999	0.677	0.590	0.463	0.648	0.735	0.660
2000	0.716	0.624	0.482	0.692	0.729	0.706
2001	0.756	0.667	0.603	0.726	0.777	0.733
2002	0.786	0.695	0.623	0.741	0.781	0.746
2003	0.811	0.810	0.622	0.752	0.810	0.763
2004	0.823	0.822	0.637	0.772	0.798	0.805

Source: calculated by the author by using liquidity data in Arab countries available on Arab Monetary Fund website

The third indicator, which is the most important of the three, reflects the principal activity of the financial sector in the national economy. According to this indicator, the UAE ranks first among GCC countries in the beginning of the period 1994-1996. Then Kuwait occupied first place during the rest of that same period. From the three economic indicators, Kuwait, Bahrain and UAE are the three states expected to suffer most from the contagious effects of the financial crisis in their economies compared to the other GCC states.

Table 1C: Performance Indicators of the Financial Sector in GCC Countries in the Period 1994-2004

Year	Third Indicator					
	Kuwait	**Qatar**	**Oman**	**Saudi**	**Bahrain**	**Emirates**
1994	0.262	0.363	0.247	0.252	0.437	0.473
1995	0.345	0.354	0.256	0.227	0.431	0.473
1996	0.371	0.318	0.266	0.209	0.416	0.461
1997	0.513	0.320	0.356	0.216	0.450	0.493
1998	0.678	0.396	0.473	0.294	0.499	0.594
1999	0.606	0.355	0.461	0.269	0.523	0.560
2000	0.517	0.273	0.368	0.244	0.461	0.476
2001	0.645	0.281	0.391	0.273	0.473	0.525
2002	0.733	0.282	0.386	0.291	0.506	0.537
2003	0.689	0.298	0.367	0.284	0.486	0.521
2004	0.659	0.324	0.342	0.334	0.522	0.554

Source: calculated by the author by using liquidity data in Arab countries available on Arab Monetary Fund website

3.2. The Degree of Openness of GCC Countries

Economists use the degree of openness to determine the extent of relations between the national economy and the rest of the world and, consequently, the extent of the said economy being affected by world economic changes.

Economic literature contains several models used to measure the degree of openness. Most famous of these is the one calculated by the sum of exports and imports as a percentage of the gross national product, which is the formula used in the current research. Table 2 shows that the Kuwaiti economy was the most open of GCC countries during the years 1994 & 1995 and also in 1997. Meanwhile, the Qatari economy was the most open in the period 1998–2004. The Saudi economy ranked second in the years 1995 and 1998. The first and second places were taken by Qatar and Kuwait in the years 1994 and 1996, respectively.

Table 2: The Degree of Economic Openness of GCC Countries

Year	Degree of Openness					
	Kuwait	**Qatar**	**Oman**	**Saudi**	**Bahrain**	**Emirates**
1994	0.19	0.18	0.15	0.18	0.02	0.18
1995	0.21	0.07	0.15	0.17	0.11	0.11
1996	0.22	0.14	0.21	0.22	0.11	0.14
1997	0.22	0.08	0.19	0.21	0.10	0.12
1998	0.07	0.19	0.02	0.08	0.00	0.03
1999	0.18	0.40	0.19	0.15	0.14	0.16
2000	0.35	0.49	0.34	0.26	0.23	0.27
2001	0.27	0.42	0.29	0.21	0.20	0.23
2002	0.21	0.37	0.27	0.23	0.14	0.19
2003	0.26	0.38	0.26	0.28	0.15	0.24
2004	0.35	0.46	0.22	0.34	0.13	0.27

Source: calculated by the author by using liquidity data in Arab countries available on Arab Monetary Fund website

4. THE PROCEDURES TAKEN TO FACE THE CRISIS IN GCC COUNTRIES

Similar to the rest of the world, all GCC countries have, to a certain extent, been affected and will continue to be affected by the financial crisis. All these economies generally employ the suitable expansionary policies to mitigate the negative effects of both the financial and real sectors' crises. In Kuwait, the government adopted a law to support the financial stability of the economy which was declared in February, 2009. In the Sultanate of Oman, the government prefers to leave the market forces to work without intervention; but at the start of the crisis, the government pumped the equivalent of $392 million through the Investment Equilibrium Fund, which is a joint fund between both the public sector, with a percentage of 60%, and the private sector with the remaining percentage. Its activity is restricted to investment in the shares of companies enlisted in the public market, which consists of 30 companies. The Fund is not profit-making and it began in January 2009. The financial crisis resulted in a decrease in the volume of transactions in the Muscat market, from $26 million prior to the crisis to about $4 million. The size of the Muscat market is estimated at about $14 billion, yet 80% is owned by the government and the funds are not in circulation. Therefore, the size of real transactions in the market is equivalent to 20% of its size, amounting to $2.8 billion. Accordingly, the Investment Equilibrium Fund represents about 14% of the transaction size (Arabia Forbes, No., 57, 2009).

In the UAE, the Central Bank and the Ministry of Finance adopted a set of precautionary policies, including pumping liquidity estimated at $14 billion. The Central Bank of Bahrain was first to abruptly take precautionary procedures in order to stand against any rigging on the Bahraini Dinar. This means that the Kingdom of Bahrain was not affected when these speculators decided to leave the Gulf's financial markets, as the Central Bank of Bahrain did not allow any financial speculation on the value of the Bahraini Dinar. This means that these procedures avoided the Kingdom of Bahrain avoid any lack in liquidity. In the Kingdom of Saudi Arabia, the Saudi foreign currency reserves collected in recent years - which amounted to $444 billion by the end of 2008 - enabled the Kingdom to adopt a series of measures and policies to minimize the effects of the crisis on the Saudi economy, especially through the Kingdom's participation in the Group of Twenty (G – 20) meeting recently held in London where the attending parties adopted a plan to refresh the world economy amounting to $5 trillion. Through this, the KSA adopted a program of investment and development in both government and financial sectors. It is considered one of the largest programs regarding the size of the economy through which Saudi Arabia adopted one of the largest investment and development programs in the financial and government sectors, with funding of $300 billion over the coming five years. The Kingdom joined the Financial Stability Council (formerly the Financial Stability Forum) – entitled IMF - to follow the developments of the bodies supervising the financial sectors all over the world, especially in countries that affect the status of the international money markets. The Saudi incentive plan was distinguished from other incentive plans in the Group of Twenty as these are directed to projects and not to rectify bank situations, recapitalizing them and extinguishing their poisonous assets. Besides working to push international trade, the Kingdom has several channels to finance trade, most important of which is the channel of the Saudi Development Fund, to finance trade, to which was dedicated SR 15 billion. This is an ever-growing program. Moreover, there are other funds pouring into this field, such as: The Arab Financial Fund, Islamic Bank, Islamic Establishment to finance Trade and the Arab Establishment to guarantee investment and finance exports. Reports point to the fact that the State of Qatar is the least affected by the financial crisis for several reasons, the most important being: 1) the great reserves formed during the period 2004-2008, when Qatar achieved development rates reaching 6.97% and 2) the increased production of liquefied natural gas, where production reached 77 million tons per annum (Economist Intelligence, 2008).

5. ANALYSIS OF THE EFFECTS OF THE FINANCIAL CRISIS ON GCC COUNTRIES' ECONOMIES

We would like to stress two important points: 1) The effects of the international financial crisis on GCC countries' economies are the result of the effects of the crisis, measures and policies which these countries began to work with to avoid or alleviate the severity of the crisis and 2) There is non-transparency from the side of governments concerning the volume of losses resulting from the financial crisis. This makes it difficult to make objective analyses on the effects of the crisis. Most of the available data and information were taken from statements of state officials trying to alleviate the effects of losses on individuals and companies in these countries. It is better to divide the effects of the financial crisis on the economies into two major parts: effects on the financial and banking sector and effects on the real sector.

5.1. Effects on the financial and banking sectors

The total capital of Gulf joint stock companies reached $59,088 million in 2003 and it increased to $93,419 million in 2004. Their market values reached $1,059 billion in 2007. The number of companies enlisted in Gulf share markets increased to 579 in 2006 and 642 in 2007.

The repetitions of Saudi share market profitability reached 11 times by the end of 2008, which did not happen for more than 15 years. It was expected to have the share circulation indicator stable at levels between 9,000 and 11,000 points. Yet the decrease, which began in the last two quarters of 2007, made it reach 4,500 points in November 2008. The retreats in 2007 and 2008 may be due to the deflation financial policy that was always adopted by the Kingdom to withdraw a portion of the liquidity. The Kingdom raised the rate of regular deposits as follows: on demand from 7% to 13% and saving and term deposits from 2% to 4%. Of course, as a result of starting effects of the financial crisis in October 2008, the Kingdom followed a reversed policy to treat the crisis of acute liquidity decrease in the Saudi banking sector. Money markets in GCC countries suffered huge deterioration. For example, the Saudi Stock Exchange indicator lost 22% of its value in September 2008 and again to lose another 14% in October of the same year (Table 3).

Table 3: Performance of Gulf Stock Exchange in April 2004 and 2009

Market	2004 / 4 /18	2009 /4 /25	**Percentage change**
Abu Dhabi	2.679	2.565	%7.32
Bahrain	1.674	1.581	%12.36 -
Kuwait	7.417	7.419	%4.68 -
Masqat	5.209	5.262	%3.29 -
Doha	5.379	5.333	%22.55 -
Dubai	1.721	1.653	%1.04
Saudi	5.377	5.055	%5.25

Source: Riyadh Bank, weekly report, 26 April, 2009

The foreign assets owned by GCC countries were estimated at about $1.8-2.0 trillion before the end of 2008, of which 60% were in US$. The financial crisis and its effect on the US$ will, no doubt, affect these assets negatively. In a report issued by Fitch Rating Company for credit categorization during November 2008, the volume of government debts in the State of Dubai with bonds and debts in foreign currencies reached US$ 70 billion.

As for the Islamic financial sector, more than 300 Islamic financial institutions spread all over the world represent banking and financial products in accordance to Islamic Sharia. The value of this sector is estimated at about $1 trillion. The size of Islamic financing in the world is expected to increase about $1 trillion by 2011. Bankers and experts confirmed that the strict rules of loaning helped avoid the effects of the financial crisis on this sector with growing demand on financial investments and services in accordance with the principles of Islamic Sharia. With the financial crisis, demand may rise for Islamic financing to avoid the risks of non-Islamic financing. It is expected that the Middle East, Brunei Kazakhstan and Indonesia head the market of Islamic financing in Asia, amounting to $20 billion. Saudi Arabia represents about 70% of the Islamic investment market in Asia. Islamic banks were affected by the financial crisis because of the risks in the Islamic financial sector, such as the rising ratio of disproportionate dues in Islamic banks with that in traditional banks. Again, as a result of several Islamic major institutions dealing in real estate sector, the crisis effect was less on Islamic banks compared to traditional banks. This is because Islamic banks depend on deposits rather than debts. The competitiveness report (McKenzie) for 2008/2009 in the 15th Annual Conference of Islamic Banks, recently held in Bahrain, showed that retail banks in GCC countries fall in a stage between the two stages of evolvement and development and that the financial crisis will hinder the growth of these banks, which were expected to share by about 50% of the banks’ gross income. Bankers and economists have confirmed that Islamic banks must take advantage of their being not affected by the current financial crisis by presenting a new vision to managing assets, investing wealth and manufacturing products based on Islamic Sharia (Ayaash, H., No., 55, 2009).

5.2. Effects on the Real Sector

The crisis effect will be transmitted to the real sector in the economies causing economic recession. Yet, the reserves of foreign currency, which accumulated with GCC countries in recent years as a result of rises in oil prices, will minimize the effects on this sector. The effect will come through the decrease in world demand for oil and heavy industry products of these countries, especially petrochemical industries and aluminum.

5.3. The Deflationary Effect of the Crisis on GCC Countries

Economic recession will dominate the world countries as a result of the financial crisis. Consequently, countries, including gulf, will suffer negative effects of the recession through the decrease in demand for goods and services, both domestic and foreign, and less employment, i.e. rising unemployment and decreased personal savings. In this section, these effects on GCC countries will be shown.

5.3.1. Decrease in Demand for Products

Analyzing the foreign demand for GCC countries’ products is crucial because of its importance as well as being out of control.

A. Petroleum

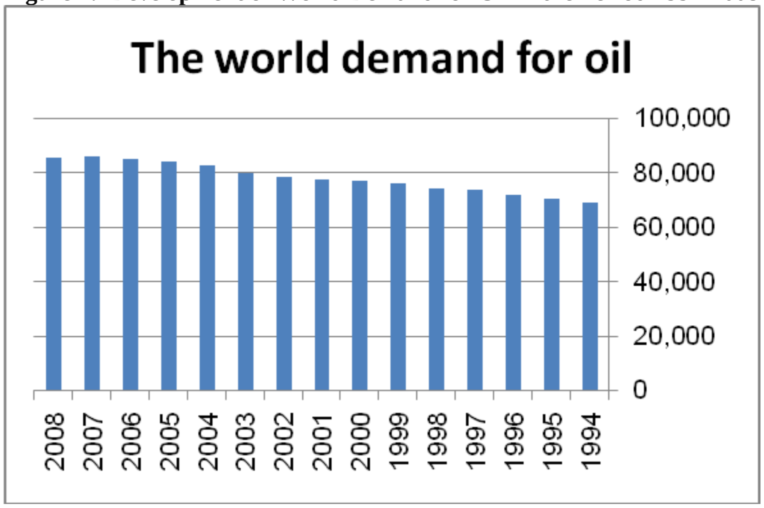
The negative effect resulting from petroleum is represented in decreasing world demand for oil as a result of the financial crisis.

- World Demand for Oil

As an international commodity, oil is characterized by special features not found in other commodities, consequently affecting the value of US$ in the world markets; thus the factors affecting international oil price are represented by the rate of growth domestic product of some countries, the international exchange rates on the US$, the American reserve of crude oil and policies taken by OPEC (Pirog, R., 2005).

Based on these characteristics and factors, it is obvious that the global financial crisis will affect demand for oil and, consequently its prices, by affecting the value of the US$ and its relation to other currencies and through the decreased growth rates as a result of the recession effects accompanying the crisis. The available data point to the up-going fluctuation of international demand on oil for the period 1994–2007 and then its decrease in the beginning of 2008 with the start of the financial crisis effects (Figure No.1).

Figure 1: Development of World Demand for Oil in the Period 1994-2008



Source: **:**http://www.eia.doe.gov

- World Oil Price

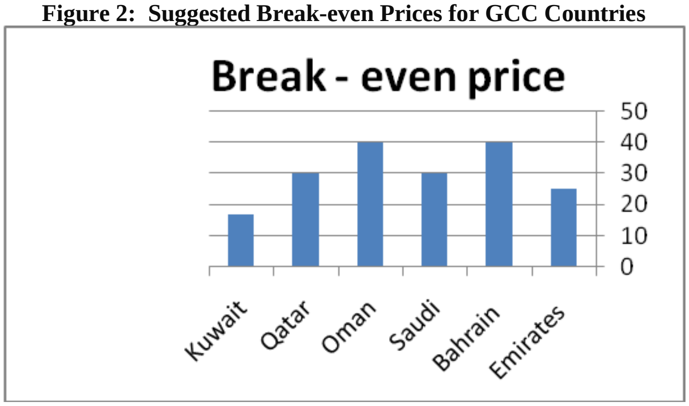
The price of oil reached its highest level in July 2008 at $147.3/barrel. Then it started to decline due to a number of factors, including production reduction decisions by OPEC member countries, fluctuations in US$ prices in international markets, and inconsistent analyses made on the nature of the financial crisis, its period, and the measures to be taken.

The profitability for GCC countries can be calculated by the following equation:

Profitability = (Oil price – Break–even price for the concerned Country) / Break–even Price

The break-even rate reflects the price which achieves the break-even point where the revenues are equal to expenses. For example, the price that makes a profit equal to zero (total revenues = total expenses) for Kuwait is US$17/barrel. Figure 2 and Table 4 show the equation prices and profitability for GCC countries, respectively.

Figure 2: Suggested Break-even Prices for GCC Countries



Source: http://www.eia.doe.gov

Table 4: Estimated Oil Profitability for GCC Countries

Month and year	Average price Dollar/ barrel	Kuwait	Qatar	Oman	Saudi	Bahrain	Emirates
Jan. 2008	89.87	428.6176	199.55	124.6625	199.55	124.6625	259.46
Feb. 2008	90.816	434.2118	202.72	127.04	202.72	127.04	263.264
March 2008	100.48	491.0588	234.9333	151.2	234.9333	151.2	301.92
April 2008	104.98	517.5294	249.9333	162.45	249.9333	162.45	319.92
May 2008	118.93	599.5765	296.4267	197.32	296.4267	197.32	375.712
June2008	128.06	653.3088	326.875	220.1563	326.875	220.1563	412.25
July2008	147.3	766.4706	391	268.25	391	268.25	489.2
August2008	113.97	570.4235	279.9067	184.93	279.9067	184.93	355.888
Sep.2008	98.515	479.5	228.3833	146.2875	228.3833	146.2875	294.06
Oct.2008	73.952	335.0118	146.5067	84.88	146.5067	84.88	195.808
Nov.2008	50.903	199.4265	69.675	27.25625	69.675	27.25625	103.61
Dec.2008	39.708	133.5735	32.35833	-0.73125	32.35833	-0.73125	58.83
Jan. 2009	40.358	137.4	34.52667	0.895	34.52667	0.895	61.432
Feb.2009	41.225	142.5	37.41667	3.0625	37.41667	3.0625	64.9
March2009	45.19	165.8235	50.633	12.975	50.633	12.975	80.76
April2009	49.68	192.2353	65.6	24.2	65.6	24.2	98.72

Source: The first column from http://www.eia.doe.gov and others are calculated by the author.

- Collective Effect of Reduction in Price and Demand for Oil on the Public Budgets of GCC Countries

Oil revenues represent a remarkable proportion of the total revenues of GCC countries. Table 5 shows the sources of public revenues and expenditures of GCC countries for the period 2001-2005. Oil revenues represent about 70% of the total revenues of UAE in 2001 and it fluctuated in 2002, 2003 and 2004 from 65 to 74 to 75%, respectively, to return once more to the 2001 level. For the Saudi economy, for example, oil revenues represented 81% of the total revenues of the Kingdom in 2001. Then it decreased to 78 and 79% in the following two years, increased to 84% in 2004, and to 89% in 2005. So, no wonder the changes in oil prices or demand, or both, will greatly affect the status of the public budgets of the concerned countries.

Table 5: The Importance of Oil Revenues in Public Budgets of GCC Countries (2001-2005)

Country	Item	2001	2002	2003	2004	2005
Emirates	Total Revenue	20426	17175	20984	25818	43744
	Oil Revenue	14063	11198	15460	19979	30348
	Total Spending	26619	24129	24914	26233	33322
Bahrain	Total Revenue	2608.8	2730.85	3046.54	3458.5	4445.21
	Oil Revenue	1787.7	1838.83	2223.67	2510.11	3365.16
	Total Spending	2214.89	2742.02	2873.14	2937.77	3429.73
Saudi	Total Revenue	60842.4	56800	78133	104610.9	150489.3
	Oil Revenue	49044	44293.3	61600	88000	134544
	Total Spending	68037.3	62266.7	68533	76053.3	92393.1
Oman	Total Revenue	6605.5	7827.05	8596.36	10565.41	11851.5
	Oil Revenue	5067.9	5922.24	6250.71	8265.28	9367.75
	Total Spending	7438.7	7644.99	8293.63	9908.71	10943.04
Qatar	Total Revenue	7582.42	8465.66	12506.19	13479.42	15086.03
	Oil Revenue	5610.37	5628.67	9580.71	8828.98	9950.41
	Total Spending	5617.53	6246.57	7207.94	9208.83	9890.96
Kuwait	Total Revenue	21683.6	22350.6	27384.3	34869.1	51326.7
	Oil Revenue	16001.4	17292.5	20090.3	26015.1	40272.5
	Total Spending	13333.7	14166.8	28243.1	32776.7	20501.8

Sources: 1- Statistical Report, GCC council, No. 14, 2005 and No. 16, 2007
2- The World Bank, World Development Indicators, 2008

It is estimated that keeping the budget balanced in the KSA budget requires oil prices not going under $55/barrel. It is expected to show a deficit of 700 million Bahraini Dinars in Bahrain's budget if the general revenues are estimated at an oil price of $40/barrel in the next two years (Gulf newspaper, 2008).

After approving the budget in the Kingdom of Bahrain, the government agreed to take loans from domestic and foreign markets to cover the deficit, estimated at 450 million Dinars in the public budget for the fiscal year 2009. The loan period would be five years as of the date of their issue (Al-Ayam, 2009).

As the Saudi economy depends basically on government spending, the Kingdom increased government spending in the 2009-2010 budget, compared to that of the previous year, in order to continue carrying out the decided investment programs. Yet, it is expected that the Saudi budget suffers a deficit of $17.3 billion based on revenues of $109 billion and spending of $127 billion.

B. Petrochemicals

GCC countries contribute about 10% of the total world production of petrochemicals. This figure continuously increases due to the current investments in this field. These industries are of special importance to GCC countries because they give an added value to crude oil products and are considered efforts to diversify gulf economies. As a result of the financial crisis, international demand on petrochemical products decreased; consequently, their prices decreased by an unprecedented 60% in three months. Yet, things may become better in the coming two years as a result of making use of the decrease in oil prices, in general, as well as prices of raw materials entering into the production of petrochemical products, such as natural gas - particularly ethane gas being the principal material in the production of these products. In the KSA, in particular, the government owns 70% of the SABIC (Saudi Arabia Basic Industries Company) working in the industries of petrochemicals, fertilizer's basic hydrocarbons innovative plastic industries, metals, etc. Therefore, the company does not suffer liquidity problems or debts as a result of decreased demand and prices (Arabia Forbes, No., 55, 2009).

The net profit decreased by 19% in 2008 compared to 2007 as a result of decreased demand on petrochemicals and metals, especially specialized plastic products, due to decreased demand (Arabia Forbes, No., 55, 2009).

C. Aluminum

The aluminum industry runs second in importance -after the petrochemical industry - in Gulf countries. GCC countries are working to increase their share of the world production in 2012, from 7 to 13%. Most exports of GCC countries go to Asian countries, so it is expected that these industries are much affected by the world's recession. Aluminum inter-trade among gulf countries is about 29%, exporting 10% to Europe, 5% to USA, and the same ratio to African countries. The financial crisis resulted in a decrease in both world demand and prices. This resulted in the closure of many aluminum factories in the USA, Europe and China. The closure of these factories may result in increasing the chances of production and profitability of the aluminum industry in Gulf countries (Eckart, W., 2008).

5.3.2. Losses in Sovereignty Funds

The financial crisis resulted in big losses in Gulf sovereignty funds. For example, the Kuwaiti General Authority for Investment declared it lost $30.7 billion during the period March-December 2008. In March 2009, the Qatari investment authority declared that it also took losses despite the decrease of these losses by 20% of the value of their funds in 2009. The Authority stopped its purchase operation, declaring review of its investment strategy. Analysts requested, from the Saudi General Investment Fund Demand, to increase the loan rate and increase the company loans through giving longer grace periods (Financial Times, 2009). As a whole, the foreign portfolio of the Gulf countries decreased from about $1.3 trillion in 2007 to $1.2 trillion in 2008 (Setser, B., & R., Ziemba, 2009).

Prior to the end of 2008, the foreign assets owned by four GCC countries (Saudi Arabia, Kuwait, UAE and Qatar) were estimated at $1.8 trillion dollars with 60% of those assets in US$. As a result of the financial crisis and the decreased value of the US$, the assets owned by these countries decreased accordingly. Estimation indicates that the losses that came upon such funds are estimated to be around 400 Billion US Dollars. No doubt this has its negative effects, especially since these countries did not make use of the profits of these funds for the previous years.

5.3.3. Postponement of some Planned Projects

The countries may be obliged to postpone, cancel, or review some of the planned projects under execution as a result of the recession effect. Information indicates that 60% of the total planned projects of GCC countries were frozen, postponed, or cancelled. Finishing the Dubai Airport was declared postponed from 2010 to 2015 and will consist of only five runways instead of six. This will result in a series of effects, including getting rid of some employees. The effect of this depends on whether this labor is national or expatriates. For example, it was declared in Kuwait to get rid of 2,000 Kuwaiti workers since the start of the crisis. Also, the postponement or cancellation of projects will result in decreased supply of products - either commodities or services - and consequently an increase in prices.

5.3.4. The Effect on the Size of Employment and Unemployment

GCC countries' population is estimated at about 37 million. Foreigners represent 40% (about 15 million) of the total according to the last estimation. Manpower in GCC countries reached 14 million in 2007. The fifth development plan supposes that by the end of 2009, manpower in Saudi Arabia will reach nine million, among which more than three million are foreign workers. More than 80% of the citizens in three gulf countries (Qatar, UAE and Kuwait) work in official circles. The percentage of participation of national manpower is less than 55% in the other three countries, so no wonder that Saudi Arabia, Bahrain, and Oman suffer unemployment among the national labor, and of these three countries, they suffer evident unemployment among females. Females form 85% of the total unemployed in Bahrain. In Saudi Arabia, unemployment in the first half of 2007 reached 27%, while among males, it was within 8% in the same period. Yet, there are 15 million expatriates working in GCC countries and transferring $60 billion abroad every year.

With the negative effects of economic recession, the companies are obliged to lower production and consequently reduce the employment size to minimize costs. Labor markets in the GCC countries are characterized by special features, foremost among them is a great proportion of expatriate workers. So, decreasing the size of employment or exchanging these would have costs exceeding those of getting rid of the national labor or exchanging them. These costs vary from one country to another. The cost of job change for a worker in UAE is estimated at more than $4,000/year. The change includes charges of employment agencies, advertising costs, expenses of health insurance and residence, in addition to other administrative costs (Arabia Forbes, No., 55, 2009).

On the level of the national economy, a reduction in production and employment would lead to a series of negative effects. Income decreases; consequently, the demand for products is decreased. Prices go down and producers' incentives decrease. Again, this would lead to a reduction in production and employment, adding more negative effects to the economy.

5.3.5. Effect on Inflation Rates

This aspect may be considered the bright side of the financial crisis. The expected reduction in development, together with reducing or cancelling investments, will result in decreasing inflation rates. Inflation had reached record highs of 10% in Saudi Arabia and 15% in Qatar. Estimates point to the possibility of its reduction to 8 and 10% in these two countries, respectively, by the end of 2010. It was a must to take precautionary measures with the use of expansionary policies – their financial and economic aspects to increase the financial supply – to treat economic recession. This will contribute to raising inflation rates as a result of increased demand on the products leading to a decrease in the real value and, consequently, negative effects on investment, product and growth in the national economy.

6. CONCLUSION AND RESULTS

The global financial crisis had a negative effect on the economies of GCC countries, either directly or indirectly, through recession effects resulting from it, yet differing from one state to the other for internal economic and non-economic factors. These effects were represented in the deterioration of Gulf stock markets and decreased prices and demand of oil, in addition to decreased international demand for petrochemical products and aluminum. This negatively affected the execution of investment projects and increased the unemployment rate, especially for foreign workers. Again, due to the decrease in the dollar value, the value of assets owned by GCC countries decreased in dollar. The big reserves of foreign currencies achieved by GCC countries during the past few years helped increase their ability to tolerate the effects of the financial crisis and their ability to take expansionary policies through pumping liquidity to absorb the recession effects of the crisis. The precautionary procedures taken by GCC countries resulted in alleviating the severity of the financial crisis effects on their economy. With the expansionary policies applied in GCC countries, precautionary procedures must be taken for the effects that will result from these policies currently applied in GCC countries. These will result in increasing inflation rates and reducing interest levels, leading to a decrease in real interest rates with an accompanying decrease in savings incentive. Moreover, most of the balances used in speculations with GCC currencies were withdrawn with improved dollar status. Lastly, there is non-transparency from the side of the governments concerning the size of losses resulting from the financial crisis.

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Dr. Hisham Handal Abdelbaki is an associate professor of Economics. He has got his BSc in Economics and Master Degree in Economics from university of Mansoura, Egypt and has got his PhD in Economics from Bradford University, UK. His interested areas are macroeconomic analysis, Social accounting Matrix, Income distribution, public policy, economic reform in developing and transition countries. At the present, Dr. Abdelbaki works at University of Bahrain, Bahrain.

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