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Covid-19 in the Gulf
Special Coverage

Navigating Troubled Waters:
Experts’ Views on GCC Challenges for Socio-Economic Recovery in the Post-Covid-19 Period

Nikolay Kozhanov and Luciano Zaccara (eds.)

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Navigating Troubled Waters: Experts' Views on GCC Challenges for Socio-Economic Recovery in the Post-Covid-19 Period

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The Gulf Studies Center is proud to begin publishing a series of interviews with international experts on the Gulf discussing various regional issues. The subject of this publication is the main challenges to be faced by the GCC economies and societies during the period of recovery from the negative impact of low oil prices and COVID-19 pandemic.

Introduction

The GCC economies are being seriously hit by the negative impact of low oil prices and spread of Covid-19 pandemic. The restrained inflow of oil incomes deepens the budget deficit of the countries and makes government spending cuts inevitable in 2020 and, most probably, 2021. As in the past, the first areas to suffer from these cuts are likely to be social programs, the private sector and jobs for expats. Subsequently, the fall in remittances from the Gulf region will cause an additional stress for the social security of the Middle Eastern countries that traditionally provide the GCC states with the bulk of its work force. At the same time, the non-oil sectors suffering from the Coronavirus pandemic are looking for additional support. Subsequently, the budgets of the GCC countries are overloaded with emergency spending allocated to fight the negative economic consequences of the Covid-19 outbreak to support their economies. The steps taken by the states are ranging from acute budget cuts, partial curfew and freezing of spending on ambitious projects to the provision of additional financial support to the banking sector and business. In financial terms, the extra burden of the GCC budgets is measured in, at least, $32bln for Saudi Arabia, $70bln for the UAE, $11.38bln for Bahrain, $16bln for Kuwait, $20.8bln for Oman, and $23.4bln for Qatar. And this bill keeps growing. The oil production cuts under the OPEC+ agreement signed in April, inevitable slowdown of the implementation of new oil projects as well as the decrease in other economic activities will definitely lead to the contraction of the Gulf monarchies' GDPs. According to the IMF estimates, Saudi Arabia's economy is expected to shrink by 2.3 percent, Qatar's by 2.3 percent, Kuwait's by 1.1 percent, Oman's by 2.8 percent and Bahrain's by 3.6%.

In the mid-term, the oil market is likely to regain its balance. Some experts even predict the beginning of supply deficit by 2024-25 inevitably pushing oil prices up. By that moment, the Covid-19 pandemic might be over and the global economy will start its recovery. This period, however, might still be full of problems as well as opportunities for the GCC. In line with its main task to promote knowledge and awareness on the main socio-economic and political trends in the region, the GSC conducted the series of interviews with a selection of leading experts on the Gulf countries asking them *how they see the main challenges for the GCC economies and societies during the process of recovery from the negative impact of the Covid-19 pandemic and low oil prices?* Their responses paint a very complex picture on what is to be done by the GCC in the coming years.

Labor Market and Demography as the Main Source of Concerns

Dr. Hassan Hakimian, Professor of Economics, Director of the Middle Eastern Studies Department of the College of Humanities and Social Sciences (CHSS) at Hamad Bin Khalifa University (HBKU), Doha.

The GCC States' recent experience of shouldering two major crises simultaneously – one a public health crisis, another a huge collapse in oil prices – has raised questions over the popular belief that 'lightning does not strike the same place twice'!

Just as the region was coming to terms with the Covid-19 global pandemic and its far-reaching economic repercussions, calamity in the oil markets struck, pushing down oil prices to levels not seen for more than three decades. Unlike the pandemic, however, the oil shock originated in the region itself with the Saudis flushing the market with large supplies of extra crude at a time when demand was heading south. Arguably, a hugely miscalculated step to secure market share, the immediate impact of this is already clear for the oil-exporting economies. Despite its initial healthy conditions, the GCC region is now potentially deprived of the vast resources it could draw from to deal with the headwinds it faces from the pandemic.

The choice of appropriate policies in the GCC context reveals both similarities and contrasts with other countries. At the broad macro level, boosting aggregate demand and defending jobs is already reliant on a range of fiscal stimuli and monetary instruments, which these states have started to adopt to maintain both purchasing power and banking liquidity. Though their sizeable Sovereign Wealth Funds can assist the likely negative fiscal impacts of these measures, they cannot ignore the potential strains some of them might face if their pegged exchange rate to the US dollar comes under strain (more likely for smaller, less cash-rich countries like Oman and Bahrain).

Another short-term challenge for countries so heavily dependent on imported material and day-to-day necessities is the management of the global supply chain at a time most countries are turning inwards and the obstacles to international trade are on the rise. But here too the GCC's sizeable foreign currency reserves and stable currencies can provide a useful cushion.

The real challenge, however, is likely to be at the micro level given the demographic and labour market structures of the GCC states, which are heavily reliant on imported labour. This is where the pandemic has made a disproportionate impact and is hardest to contain. In Qatar, for instance, official data indicate that 32% of all those who tested positive by late April were Indian, followed by 20% Nepalese and 18% Bangladeshis. According to the Economist magazine (23 April 2020), four-fifth of recently confirmed cases in Saudi Arabia were likely to be foreigners.

Although some decisive steps have been taken to contain the pandemic's further spread, it is ultimately the migrants' living and working conditions that will determine healthy and reliable labour supplies for these economies in the future. A new and radical approach to the health and well-being of these workers is a laudable goal in its own right. Although it might raise the short-term costs and slow down the economic growth tempo in the GCC states, it also makes business sense for long-term sustainability of a model of development that relies heavily on large numbers of foreign workers.

The global lockdown might after all be remembered not only for its large-scale shutdowns but hopefully for the new doors it might help to open for a more inclusive and sustainable model of development in the GCC region.

Painful Economic Decisions Needed

Dr. Ahmed Mehdi, Research Associate at the Oxford Institute for Energy Studies, Oxford, the UK.

Almost all GCC economies are weaker since the last oil crisis of 2014: public debt is higher, deficits are wider (driven by increased spending), and growth is slower (due to lower non-oil growth).

While social distancing measures are likely to ease over the next several months (helping slowly restore oil demand), the path of global economic recovery remains highly uncertain. Similarly, despite OPEC+ cuts and a series of shut-ins, global inventories remain highly elevated – dynamics likely to anchor short-run prices in a range of $35-40/bbl. For the GCC, the realities of a sub-$40/bbl world in the short-term is driving painful economic decisions. In Saudi Arabia, spending cuts of $13.4bn (2% of GDP) have been announced; liquidity injections have been unveiled and salaries in the private sector subsidised. While Saudi has been drawing on its liquid reserves, I do not see any major threat to the credibility of the exchange rate peg as the threshold level of reserves is around $300bn. This would require oil prices trading at around $30/bbl throughout next year – unlikely, in my view.

In comparison, Qatar compares better with the GCC average (particularly debt-burdened Bahrain). Over the past few years, Qatar has moved beyond the peak of large capital outlays. Qatar has also accumulated significant savings at QIA of around $350bn – sufficient to weather the current crisis. Longer-term, Qatar's economic fortunes will depend on medium-long term gas fundamentals. Covid-19 has now led to significant project deferrals on LNG projects. Despite the current weakness in gas prices, the crisis has left Qatar undeterred to push ahead with its massive North Field expansion, set to increase hydrocarbon revenues and expand Doha's geopolitical relevance, particularly as gas expands its role in the global energy system out to 2040.

Despite this, the current crisis has highlighted the fiscal sustainability challenge of the GCC. With the IMF having recently estimated that the Gulf's financial assets will be depleted by 2034, the crisis is likely to accelerate domestic reform attention (labour law reform and the sclerotic pace of non-oil growth) and wider issues within the oil and gas sector (rising cost of capital, investor uncertainty, and peak oil demand concerns).

Growing Role of the State is Inevitable

Dr. Karen Young, Resident Scholar at the American Enterprise Institute, Washington DC, the US

Covid-19, combined with a very unsteady oil market, is creating an unprecedented disruption to the economic model of the GCC states. This disruption, however, will likely reinforce state-led recovery rather than shift towards more open economies or societies. Lower oil and gas revenues are putting pressure on governments to reduce spending. Meanwhile, local demand destruction from lockdown and canceled government projects (everything from sports to Expo2020 to large gigaproject development) will disrupt the business cycle. As these are economies that depend on foreign workers to also be local consumers, the effects are severe. There will be job losses, expatriate exits and pressure on local banks to extend credit to firms and the public sector. Whatever momentum there was towards economic diversification will be difficult to resume, as state directed bailouts will favor first nationals and state-related entities. Capital flight, losses from government external holdings in global equity markets, unattractive environments for foreign investment, and mounting expenses in social welfare will all reinforce government dominance in Gulf economies. Right now, it will be survival strategies, rather than growth or innovation that will define Gulf societies and economies.

Crisis as an Opportunity for Structural Transformations

Dr. Naji Abi Aad, COO to Petroleb, Beirut, Lebanon

Until very recently, to the average Gulf citizen, his/her nation's economy seemed to be structured around exchanging oil and gas for cars and smart phones. The trouble now is that, as a result of the steep decline in demand mainly due to the Covid-19 aftermath, and of the resulting glut in supply, those fossil fuel products buy ever fewer imports and build fewer infrastructures as prices of oil and gas have plunged and their exports from the region is to further decrease. And the real problem is that oil and gas resources in the Gulf started to lose their strategic importance.

One could well argue that petroleum revenues, as with proceeds from most commodities, are cyclical and sudden price drops, similar to the recent one, are not unusual. However, it would be a mistake for the Gulf nations to assume that prices are to rise again to previous high levels. The recent drop in prices is indeed indicative of an unprecedented structural change in the energy sector — one that is to have significant economic and political implications for the petroleum producing nations.

This is why policymakers in the Gulf are recommended to take advantage of the current window of opportunity presented by low oil prices and budgets that have slipped into deficit in order to push through radical measures that would have been politically far more difficult during periods of plenty.

Gulf governments are recommended to recognise that they do not longer have the luxury of the slow pace of incremental change that has characterised previous episodes of reform in the region, due to the urgency of the fiscal pressures that face their states. Such reforms are to be viewed as merely one step in a journey rather than in relation to any fixed start or endpoint and to have the confidence to persevere with sensitive measures and not be deterred by pushback from vested interests.

Needless to say that Gulf governments are recommended to have the economic and political aspects of reform more closely linked as introducing of taxes and fees and cutting subsidies, however incremental, will inevitably change the relationship between the citizen and the state.

Balancing between East and West

Dr. Sanam Vakil, Deputy Director and Senior Research Fellow at the Middle East and North Africa Programme of Chatham House, London, the UK.

GCC economies are facing an unprecedented double shock from Covid-19 and the dramatic decline in oil prices. While GCC governments have in general implemented timely and effective Covid-19 responses by enforcing quarantine measures alongside offering fiscal stimuli to protect the private sector and implementing spending cuts, the economic and fiscal challenges ahead will be further muddled by an increase in geopolitical tensions. Increasing friction between China and the United States demonstrated by the tit-for-tat barbs over Covid will also play out in the Middle East. US President Donald Trump is already stoking jingoism in what looks like another US-led "you're with us or against us" moment.

Eager for China to resume its recovery and fearful that China might recalibrate its Belt and Road investments (BRI), GCC states have demonstrated solidarity with Beijing. At the same time, China has used Covid diplomacy to improve its image by sending medical supplies to countries around the world. Despite Arab Gulf efforts at engaging China in regional tensions with Iran, Beijing has continued its policy of non-intervention. Here, as friction with Iran continues alongside the Qatar crisis, conflict in Yemen, Libya and Syria, US security ties remain an important buffer for the Arab Gulf. Caught between its Western oriented security relationship and its Eastern focused commercial one, avoiding such a choice and maintaining relations with both poles is essential for the GCC's economic recovery and for sustaining security interests.

Diversification Plans to be Reconsidered

Dr. Kristian Coates Ulrichsen, Fellow for the Middle East at the Rice University's Baker Institute for Public Policy, Houston, the US.

A major challenge for GCC economies as they begin the process of recovery from Covid-19 will be the impact of the dislocation on the sectors that Gulf governments have prioritized as part of their efforts to diversify economies beyond oil and gas. The virtual standstill in international travel and the likelihood that recovery may take years will hit the investments made by Abu Dhabi, Dubai, and Qatar in positioning themselves as regional hubs for air travel and for meetings and events. Dubai will be hit further by the falloff in tourist numbers and the delay to Expo 2020. In Saudi Arabia, the economic impact of Covid-19 and its aftermath will drive a stake through Crown Prince Mohammed bin Salman's already-faltering Vision 2030 program of economic reform and his high-profile initiatives to boost domestic tourism and entertainment and construct the NEOM future city. With oil prices and revenues likely to remain suppressed – and well below budget breakeven prices (which themselves vary widely across the Gulf) – for some time to come, Covid-19 provides an opportunity for governments in GCC states to call a halt to some of the more grandiose mega-projects and to reimagine diversification strategies to better fit the post-pandemic needs of the region.