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THE CONVERSATION



How Gulf states are coping with the new normal of low oil prices

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Not what they were: oil fields. zhengzaishuru/shutterstock

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The falling price of oil is beginning to have a real impact on the energy-fuelled economies of the Gulf. In 2014, after almost a decade of record highs, the price of a barrel of Brent crude began to collapse from a peak of US\$140 to less than US\$30.

Saudi Arabia is lining up a US\$2 trillion sovereign wealth fund to see it through the twilight years of the oil era. But not all the countries of the Gulf Co-operation Council, or GCC, have this kind of cash. Indeed, even for Saudi Arabia, the new era of low oil prices spells increasing budget deficits, reductions in state subsidies and a slowdown of the energy and construction sectors, which the region's economies have been built on.

Both private and state-owned firms are starting to restructure to reduce costs and increase efficiency now that the boom is over. They are merging divisions or outsourcing certain functions, introducing performance-related earnings, offering redundancies or smaller pay increases to staff. Qatar ought to be able to continue awarding annual salary increases given the continued investment in areas such as construction thanks to the 2022 football World Cup. But others, such as Saudi Arabia – most exposed to oil price fluctuations and subject to wide-ranging public sector cuts – will likely see redundancies at a time when the rate of inflation is high and subsidies are declining.



Construction in Qatar may help it ride out the initial storm.

Philip Lange/Shutterstock

Neighbouring Bahrain, is still coming to terms with the after effects of recent political tensions. As subsidies fall and inflation rises, people living and working in the region are starting to experience a reduction in the purchasing power of their incomes and a subsequent increase in the cost of living.

Governments, meanwhile, look to their relatively stable currencies and large holdings of foreign currency reserves to see out the decline. If the price of a barrel continues to fall, however, these may prove insufficient. This is where Saudi Arabia's huge fund would come into play.

Reserves running low

Oil is the main GCC export, accounting for almost 90% of government revenues across the region. The current price of a barrel of crude means that it's difficult for Gulf economies to balance their budgets as expenditures remain in excess of revenues.

Some of the options available include borrowing more, reducing household fuel subsidies and postponing investment projects. The latter is a reason for firms to restructure, because it reduces the amount of funds they are able to secure for large infrastructure projects. Most of the Gulf region has already seen, for instance, the introduction of higher energy bills for households.

Most analysts expect oil prices to remain depressed for the remainder of 2016 and for GCC economic growth to therefore remain subdued. For the moment, they can count on reserves to tide them over. If the price remains low, these will start to run out in two or three years and further cuts to government spending and the private sector must be expected.

Having said that, it is not all doom and gloom just yet. During an economic downturn, the decline in some sectors could be offset by growth in others. For instance, the population is growing quite quickly in the GCC region and firms are legally required to provide employee health insurance. The frequent shortage of qualified medical staff in the region means that physicians ought to be in high demand at the moment and the health sector should be looking to ride out the direct effects of an oil price decline.



Cracking under pressure?
Joakim Lloyd
Raboff/shutterstock

Across the GCC economy as a whole, however, the growing, young population cannot be accommodated entirely by the public sector. Government programmes to increase the share of Gulf nationals in the labour market may well spill over into the private sector – this is where the Saudi sovereign wealth fund is designed to kick in.

Sovereign wealth funds are large pots of government-controlled money usually earned from commodities such as oil or gas. The Saudi pot will be the largest in the world and is a bold attempt to wean its economy off of oil.

The plan is to sell shares in a small part of the state oil firm Aramco's parent company. Around 3-4% of it will be sold through an initial public offering and the shares transferred into the fund. The proceeds, will then be invested into the Saudi economy as well as overseas markets, generating non-oil returns. Over the years, the fund will diversify and increase investments into different markets and sectors around the world.

It is going far above and beyond existing sovereign wealth funds in the region, thought to be in

the region of around US\$200 billion for Saudi Arabia, US\$600 billion for the UAE's Abu Dhabi Investment Authority and US\$600 billion for Kuwait. But the best opportunity for investment may have been missed when crude oil was fetching over a US\$100 per barrel. Even with sovereign wealth funds to draw upon, the necessary process of restructuring their economies away from oil dependence will be a painful one.



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Saudi Arabia

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