Jury still out on Gulf’s diversification trial
Efforts pursuing non-oil agenda are cyclically-driven or structurally in doubt

08.02.2014/Andrew Shouler/ GulfNews/ United Arab Emirates/ FRIDE

For those following international markets and economies at present, two critical pressure points have presented themselves.

One is that financial markets are not sure how far ahead they are of the economic recovery they have assumed. Has that elastic relationship been stretched too much; if not in bonds then in equities?

The other is the confusion surrounding the rate of that recovery right now, particularly regarding the data out of the US and China, which have been distinctly mixed.

It is therefore an especially nervous time for traders. Yet, for the Gulf economies also, testing times may lie ahead.

Not only are the speed and scale of the global rebound doubtful, with implications for trade volumes, but the key variable of oil prices is a matter for concern, not only with regard to global demand prospects, but also as to the US’s competing source of supply (in the form of shale), and Iran’s potential re-acceptance into the fold of exporting nations.

The GCC states must therefore be concerned again for the longer-term issue of pursuing more sustainable paths to growth — based on restructuring rather than purely the extension of a short-term cyclical momentum — particularly if a supposed super-cycle in commodities is indeed over.

As a paper this month by Deloitte University Press says, “resource-centric economies are finding their economic growth and fiscal health vulnerable to the vagaries of global markets”, and may have become complacent again. Russia and Venezuela are cited as examples of a failure to undertake reforms, promote the private sector and diversify public finances, but the argument is evidently universal, and relevant to the GCC

“Diversification is tough to attain,” the article affirms, “but it is the only real safeguard.”

It has been suggested, further, that non-oil activity has actually suffered relatively through the oil price boom of recent years. Research by BBVA bank notes that non-oil’s share has actually fallen in the immediate aftermath of the global financial crisis, even though oil-based trade
surpluses have fed money creation and driven multipliers in the construction, real estate and financial sectors accordingly.

“Diversification in the Gulf seems to be facing difficulties,” it ventured, requiring renewed policy attempts so that the obvious comparative advantage in the energy resource is actually reinforced.

Supporting the same view, a research note also this month by Alkhabeer Capital observed that while the non-oil sectors would continue to grow in 2014, they would do so at a slower pace, and be “supported by a continued increase in government spending”. That, of course, traces non-oil growth back to the springboard of the hydrocarbon sector itself, and to the state as the prime economic driver, perhaps inevitably so.

Looking at the record of diversification efforts, at Saudi Arabia in particular but indeed across the Gulf states, recent analysis by Al Masah Capital did not doubt that “aggressive” policy reforms had been taken to develop the industrial base, infrastructure, transport & communications, and human resources, health and social development.

It cited the growth of the “energy-intensive industries of petrochemicals, cement, and metals (including aluminium, steel, and copper), mostly through manufacturing free zones or specialised industrial zones,” with SABIC, Dubai Aluminium, and Aluminium Bahrain being “some of the live examples of the implementation of this strategy”.

Yet, these are not new names, and an old problem persists. Government expenditures on salaries and subsidies, on consumption not investment, have “undermined” those programmes. As a matter of recent political history, “the stimulus measures announced during the Arab Spring showcase the same”, Al Masah’s report contends.

Thus, while the GCC “is learning to manage its oil wealth better”, insofar as petrodollars are now being well spent on creating the “knowledge economy”, still some “best practices” as found elsewhere, might be adopted and, if necessary, adapted. The essence of those models is to ensure that schemes that are not over-ambitious or generate minimally productive returns.

Some sources would seem to imply that this perennial challenge may be virtually insurmountable. Working papers in the past year from the London School of Economics, for example, have described genuine economic development along these lines as some kind of “mission impossible”.

“Global oil demand manipulates real GDP, CPI, the budget balance and the current account,” and hence overwhelms the necessary processes of empowerment. The asymmetry of wage growth in response to rising and falling oil prices (i.e. fast increments, slow declines) exemplifies the point. Even the respective national plans have trouble overcoming those tendencies, and a degree of regional coordination may be necessary to inspire what would be a self-protective, integrated approach to true prosperity, the studies suggest.

That’s arguably the pessimistic case. An optimist might, meanwhile, point to the Gulf’s increasing participation in the globalised world economy. While recognising the “personalisation and predominantly ad hoc nature of much GCC decision-making”, research
by European think tank Fride perceives the Gulf as having weathered the crisis “in relatively better condition” than many counterparts, having built relations with the relatively dynamic Asian region and broadened economic interdependency there (including beyond hydrocarbons), and retaining the advantage of a share in global energy production rising from 28 per cent in 2000 to 33 per cent by 2020.

In that sense, time may still be on the Gulf’s side, provided that sufficient motivation for reform is in attendance.