The Arab Gulf States Institute in Washington

Building bridges of understanding

Is This Time Different? The Gulf's Early Economic Policy Response to the Crises of 2020

Robert Mogielnicki

The Arab Gulf States Institute in Washington
Building bridges of understanding

Is This Time Different? The Gulf's Early Economic Policy Response to the Crises of 2020

Robert Mogielnicki

August 19, 2020

Issue Paper
#5
2020

The Arab Gulf States Institute in Washington (AGSIW), launched in 2015, is an independent, nonprofit institution dedicated to providing expert research and analysis of the social, economic, and political dimensions of the Gulf Arab states and key neighboring countries and how they affect domestic and foreign policy. AGSIW focuses on issues ranging from politics and security to economics, trade, and business; from social dynamics to civil society and culture. Through programs, publications, and scholarly exchanges the institute seeks to encourage thoughtful debate and inform the U.S. foreign-policy, business, and academic communities regarding this critical geostrategic region.

Cover Photo Credit: AP Photo/Jon Gambrell

About the Author

Robert Mogielnicki is a resident scholar at the Arab Gulf States Institute in Washington. An expert in the political economy of the Middle East and North Africa, he previously served as a senior analyst with the Siwa Group and head of public relations and marketing for Oxford Strategic Consulting, a United Kingdom/Gulf Cooperation Council-focused research consultancy. Prior to his consulting career, he worked as a journalist covering political and economic developments in post-revolutionary Egypt and Tunisia. His work and commentary on the region have appeared in Axios, Forbes Middle East, Al Jazeera's Inside Story, MEED, Al Bawaba, The National (UAE), Gulf Daily News, Tunisia Live, Egypt Oil and Gas Magazine, and Egypt Daily News.

Mogielnicki received his PhD from the University of Oxford's Magdalen College, where he conducted research in conjunction with the Oriental Institute and Middle East Centre. Drawing on extensive fieldwork in the United Arab Emirates, Oman, Qatar, Bahrain, and Kuwait, his dissertation examines the political economy of free zones in Gulf Arab countries. He earned his MA in modern Middle Eastern studies from St Antony's College, University of Oxford, and completed a master's thesis on labor policy formulation and implementation in the emirates of Abu Dhabi and Dubai. He received his BA from Georgetown University as a double major in Arabic and government, graduating magna cum laude and Phi Beta Kappa.

Sima Aldardari, research associate at the Arab Gulf States Institute in Washington, provided research support for this paper.

Executive Summary

The interrelated crises of the coronavirus outbreak and oil price rout of early 2020 have placed severe economic pressure on Gulf Arab governments and private sectors across the region. These extraordinary and acute shocks to Gulf economies drove regional governments to implement wide-ranging policy responses. The resulting – and indeed ongoing – measures fall into five broad categories: expansive economic support packages, reassessing social safety nets and state benefits, budget cuts and spending reallocation, raising new revenue domestically, and tapping debt markets.

Gulf Arab states have managed a handful of economic shocks, including political crises with economic repercussions, over the past two decades. There are strong parallels with these periods, and Gulf Arab states have leveraged many familiar policy mechanisms while confronting the crises of 2020. The oil price collapse of 2014-15 led to year-on-year budget deficits and soaring government debt across the region. In 2011, Gulf governments addressed labor market pressures through unsustainable or short-term measures, such as public sector employment schemes and entrepreneurship promotion. The global financial crisis revealed the risks of heavily indebted commercial entities as well as the importance of Asian economies in the ability of Gulf states to recover from downturns.

The global and regional developments of early 2020 have highlighted prevailing dynamics and exacerbated existing trends in Gulf economies. Three areas stand out. First, economic diversification in Gulf Arab states continues to progress slowly: Gulf government revenue relies predominantly on the oil and gas sector, and the traditional sectors earmarked for diversification efforts face uphill battles over the coming years. Second, there is renewed political momentum behind workforce nationalization initiatives and other labor market interventions to reduce the supply of expatriate workers. Third, governments are imposing new taxes and fees according to national priorities rather than regional cooperation.

The historical parallels and familiar trends offer no panacea for this economic downturn. In fact, the confluence of substantial sovereign debt levels, unprecedented disruptions to the transnational flow of people and goods, and increased likelihood of significant demand destruction in global oil markets distinguishes the economic turbulence of early 2020 from previous crises. However, the initial economic policy response of the region's governments has included more familiar measures than radical experimentation. If a fundamentally different political economy of the Gulf region is on the way, then it has not yet arrived.

Introduction

Economic indicators paint a bleak picture for Gulf economies. The International Monetary Fund expects the economy of Gulf Cooperation Council states to shrink by 7.6% in 2020, an upward revision from the IMF's April forecast of a 2.7% contraction.[1] Forecasts and polls suggest that the gross domestic product of Saudi Arabia – the region's largest economy – may

1 Dania Saadi, "IMF Raises Its Forecast of Gulf Economies Contraction to 7.6% for 2020," *S&P Global Platts*, June 20, 2020.

contract between 5.2% and 6.8% over the year.[2] Many analysts expect a return to regional growth in 2021, but a pervasive sense of uncertainty surrounds the region's economic future. An economic recovery depends on a number of coronavirus-related variables in the region and beyond.

Newfound fiscal constraints are the result of a steep reduction in government revenue. Oil exporters in the Middle East, North Africa, Afghanistan, and Pakistan confront the prospect of $270 billion in lost oil revenue in 2020, according to IMF estimates.[3] Gulf fiscal deficits – a common feature of the previous decade – are set to widen to an average 18% of GDP, up from 5% in 2019, according to S&P Global Ratings.[4] High-end estimates for central government deficit-to-GDP ratios in 2020 range from 39% in Kuwait to 10% in Qatar.

The Gulf region's population is also set to contract. A projected 13% decline in regional employment may reduce the Gulf's expatriate population by as much as 10% in the United Arab Emirates and Qatar and 4% in Saudi Arabia and Oman.[5]

2020: Overview of the Gulf Response

As Gulf Arab governments raced to mitigate the economic impact of the global coronavirus outbreak and oil price rout in early 2020, officials responded in five economic policy strokes:

- Implementing broad economic support packages to address the economic impact of the coronavirus.
- Reassessing existing social safety nets and state benefits.
- Enacting budget cuts to help offset fiscal deficits and reallocating spending to other priority areas.
- Raising revenue domestically through selective taxes, fees, and privatizations alongside tax exemptions and fee waivers in other areas.
- Balancing new debt issuances against drawdowns in government assets to shore up state finances.

In many respects, these broad policy responses reflect decisions made by governments in other regions across the globe. Yet the Gulf's political economy plays an important role in how these policies have unfolded within individual countries.

2 Dania Saadi, "IMF Raises Its Forecast of Gulf Economies Contraction to 7.6% for 2020," *S&P Global Platts*, June 20, 2020.; Yousef Saba, "POLL-Gulf Economies Seen Shrinking Sharply in 2020, To Pick Up in 2021," *Nasdaq*, July 21, 2020.

3 "Transcript of the Press Conference on the Regional Economic Outlook Update for the Middle East and Central Asia," International Monetary Fund, July 13, 2020.

4 Trevor Cullinan, "Credit FAQ: GCC Government Funding Needs Increase Sharply on Low Oil Prices and COVID-19," *S&P Global Ratings*, July 20, 2020.

5 For more details on expatriate labor dynamics, see: Narayanappa Janardhan, "Expatriate Outflow Adds to Economic Woes in Gulf Arab States," *Arab Gulf States Institute in Washington*, July 14, 2020.

Economic Support Packages

Gulf governments announced economic support packages with large headline figures to boost confidence in the health and resilience of local economies. However, much of this assistance assumed the form of liquidity to domestic banks. Central banks rolled out these early monetary measures: $70 billion in the UAE, $20.8 billion in Oman, $13 billion in Saudi Arabia, and $10 billion in Bahrain.[6] Other types of support included loan repayment deferrals and preferential financing options. In March, Qatar's emir unveiled a $20.6 billion economic support package, and the Qatari government directed $2.5 billion in funds to support the country's stock market.[7]

The fiscal policies enacted to manage the economic downturn have tended to be much smaller than their monetary equivalents. The UAE's fiscal policy response accounted for one-tenth of the value of the country's monetary policy measures.[8] Kuwait allocated $1.6 billion in additional funding to ministries and governmental departments for combating the coronavirus outbreak.[9] Fiscal policy action has likewise relied heavily upon fee reductions or waivers, subsidies, and rebates. These incentives may enable Gulf-based businesses to delay redundancies, bankruptcies, and closures for a time – but not indefinitely.

The initial economic support package announcements have been followed by a steady flow of subsequent economic support measures. For example, Dubai announced its third "stimulus package" of business incentives worth $410 million on July 11, which was preceded by two packages worth $1.31 billion.[10] Many of these commercial incentives expired and then were subsequently renewed in 3-month periods – reflecting the hope that the outbreak would subside and normal business operations would slowly resume.

The emirate of Abu Dhabi's government earmarked 15% of procurement spending and annual contracts for micro, small, and medium-sized enterprises, in addition to other measures to support entrepreneurs and smaller firms.[11] Yet these measures are part of the Ghadan 21 initiative – a 3-year, multibillion dollar program launched in 2019 by the crown prince of Abu Dhabi to promote technology-led development and innovation in the UAE. It does not appear to reflect entirely new spending commitments.

State-owned and government-related entities likewise launched separate versions of economic support packages. This has especially been the case in the UAE, where varied regulatory environments often insulate certain commercial entities – such as free zones – from federal

6 "Policy Responses to COVID-19," International Monetary Fund, accessed July 28, 2020.

7 "Qatar Announces QR75bn Stimulus for Private Sector," *The Peninsula*, March 16, 2020.

8 "Policy Responses to COVID-19," International Monetary Fund, accessed July 28, 2020.

9 "Kuwait Increases Ministries Budget by 500 Mln Dinar – KUNA," *Reuters*, March 16, 2020.

10 "Dubai Announces New Economic Stimulus Package Worth AED1.5 Billion," *Emirates News Agency*, July 11, 2020.

11 Sarmad Khan, "Abu Dhabi Earmarks 15% of Procurement Spending to SMEs and Micro Businesses," *The National*, April 29, 2020.

and emirate-level measures. Jebel Ali Free Zone in Dubai slashed business-related fees by as much as 70% for free zone firms, while the Khalifa Industrial Zone Abu Dhabi announced that its businesses would be eligible for savings of up to 36%.[12]

Commercial and Social Safety Nets

The economic crises served as an opportunity to review various forms of commercial and social safety nets and state benefits. Regional governments both introduced temporary support measures and implemented longer-lasting reforms. Protecting the wages of citizens holding private sector jobs remained a top priority, given long-standing government efforts to encourage more Gulf citizens to work in the private sector. Saudi Arabia and Bahrain offered temporary support schemes of 60% and 50%, respectively, of salaries of citizens in the private sector. Qatar permitted private companies to apply for three months of salary support for local and expatriate workers.[13]

Policymakers also reduced several commercial fees. On March 25, the UAE Cabinet approved a temporary 20% reduction in water and electricity bills for shopping malls, commercial shops, hotel buildings, and industrial plants.[14] The ruler of Sharjah concurrently ordered a 10% reduction of water and electricity bills for three months in the emirate.[15] Dubai slashed the market fee paid by business owners for instant licenses by 90%, while commercial tenants of Dubai Developments Group properties received rent-free extensions for three to six months beginning in July.[16] Edamah, the real estate division of Bahrain's sovereign wealth fund, announced rental fee waivers for its tenants operating in retail and food and beverage.[17] In July, Bahrain's Cabinet approved a 50% reduction in Labour Market Regulatory Authority fees for three months.[18] Saudi Arabia's Ministry of Finance exempted private sector companies from certain government fees, while additional layers of Saudi government support targeted strategic sectors, such as mining and industrial activities.[19]

Protecting the wages of citizens holding private sector jobs remained a top priority, given long-standing government efforts to encourage more Gulf citizens to work in the private sector.

12 "DP World Slashes Dubai's Jebel Ali Free Zone License Fees," *Zawya*, March 10, 2020; "KIZAD Announced Covid-19 Relief Package," *Arabian Business*, May 7, 2020.

13 "Bahrain Extends Stimulus for Private Sector, Citizens," *Zawya*, June 30, 2020; "Royal Order Approves Exceptions for Unemployment Insurance (SANED) To Mitigate COVID-19 Effects, on Saudis, Working in the Private Sector," *Saudi Press Agency*, April 3, 2020; Simone Foxman, "Qatar To Pay Private Sector Salaries as Virus Cripples Business," *Bloomberg*, April 12, 2020.

14 "UAE Cabinet Approves Decisions on Reducing Water and Electricity Bills of Businesses," *Emirates News Agency*, March 25, 2020.

15 "Sharjah Ruler Orders 10% Reduction in SEWA Bills for 3 Months," *Emirates News Agency*, March 24, 2020.

16 "Combating Coronavirus: Dubai Reduces Market Fee for Instant Licence from Dh3,000 to Dh250," *Khaleej Times*, April 27, 2020; Cleofe Maceda, "COVID-19 Relief: Dubai Extends Rent-Free Period for Over 1,000 Commercial Tenants," *Zawya*, July 7, 2020.

17 Ranju Warrier, "Edamah Offers Extension on Rents Payment to Businesses," *Construction Week*, March 26, 2020.

18 "Bahrain Cabinet Approves 50% Reduction in Work Permit Fees," *Zawya*, July 7, 2020.

19 "Saudi Arabia Unveils New Measures To Support Mining, Industry," *Arab News*, May 6, 2020; Dana Khraiche, "Saudi Arabia Says Virus Steps To Save Companies $32 Billion," *Bloomberg*, March 20, 2020.

Regional governments simultaneously enacted longer-term measures to reduce expenditures and cut waste. Beginning in June, Saudi Arabia suspended the monthly $267 cost of living allowance for civil employees and military personnel. Oman's royal court issued a circular directing civil and government agencies to reduce expatriate contracts upon their expiration by at least 70% as well as to retire at least 70% of civil servants with more than 30 years of public sector employment.[20] In July, Bahrain's king issued a decree that established the Retirement and Social Insurance Fund, stopped annual pension increases, and stipulated new rules on receiving more than one pension.[21]

Spending Cuts and Reallocation

Policymakers enacted deep budget cuts in nonessential areas. Bahrain's Cabinet slashed spending by government entities by 30% and delayed other projects in preparation for urgent spending needs.[22] Kuwait cut the budgets of government entities by 20%,[23] whereas Dubai ordered a 20% cut to administrative spending in addition to a 50% reduction in capital spending.[24] Oman's government announced plans to reduce spending in the 2020 budget by 10%, and the government directed ministries not to exceed these revised spending limits as they prepare their 2021 budgets.[25] Saudi Arabia introduced $13.3 billion of spending cuts in nonpriority areas – the equivalent of about 2% of the country's GDP.[26] Saudi officials stressed that the country was not in the midst of an "age of austerity" but rather is engaged in the reallocation of funds to address urgent needs.[27]

Large, year-on-year fiscal deficits mean that regional governments must impose drastic cuts to balance their budgets, in the best case, or simply limit the growth of deficits, in the worst case.

Spending cuts pose a challenge for Gulf governments because of their proclivity to spend beyond their means. Large, year-on-year fiscal deficits mean that regional governments must impose drastic cuts to balance their budgets, in the best case, or simply limit the growth of deficits, in the worst case. High-profile events set to take place over the next couple of years in the region – Expo 2020, the G-20 summit, and the 2022 FIFA World Cup – require substantial expenditures. Dubai had, for example, planned to increase government spending by 17% in

20 "Diwan of Royal Court Issues Circular," *Times of Oman*, May 28, 2020.

21 "HM King Issues Decree-Law on Pension Funds in Insurance, Retirement Regulations," *Bahrain News Agency*, July 13, 2020.

22 "UPDATE 1-Bahrain To Cut Government Agencies' Spending by 30% Amid Coronavirus," *Reuters*, April 20, 2020.

23 Hesham Abdul Khalek, "Kuwait To Cut Government Entities' Budget for Fiscal Year 2020-2021 by At Least 20%," *Reuters*, June 4, 2020.

24 Zainab Fattah, "Dubai Freezes Hiring, New Projects as Pandemic Hurts Revenue," *Bloomberg*, April 9, 2020.

25 "Oman To Cut 2020 Spending by Further 5%," *Gulf News*, May 13, 2020; Turki Al Balushi and Zainab Fattah, "Oman Asks Ministries To Rethink 2021 Spending To Reduce Deficit," *Bloomberg*, July 28, 2020.

26 "Policy Responses to COVID-19," International Monetary Fund, accessed July 28, 2020.

27 Frank Kane, "Saudi Arabia Rules Out 'Age of Austerity' To Fight Virus," *Arab News*, July 23, 2020.

2020.[28] The Kuwaiti Parliament's finance and economic panel approved a proposal to stop the annual 10% transfer of state revenue to the country's Future Generations Fund during years when the government runs a deficit.[29]

The composition of Gulf budgets is also problematic, as it leaves little maneuverability to cut spending without encroaching on wages and subsidies. This domain of expenditures remains difficult to reform in much of the region, where many citizens hold public sector jobs and the citizenry is accustomed to generous benefits from the state. Wages and subsidies constituted more than 70% of Kuwait's budget in 2018 and 2019. In Saudi Arabia, employee compensation accounted for approximately 57% of current expenditures and nearly 48% of total expenditures in 2019.[30] To partially circumvent these budgetary sensitivities, Oman's government cut entry level pay grades for new civil servants by as much as 23%, thereby avoiding broader cuts to the salaries of existing employees.[31]

Policymakers have also consolidated government agencies and merged government-related entities as part of further streamlining and cost-saving measures. A public sector restructuring in July to create a more "swift and agile government" in the UAE included plans to convert half of the country's government service centers into digital platforms and merge half of all federal agencies.[32] Sultan Haitham bin Tariq al-Said oversaw the completion of a merger of Oman's sovereign wealth funds and consolidated all state investments under the newly established Oman Investment Authority. The new sultan then tasked the authority to review the effectiveness of state assets. In June, it merged three state companies – Blue Water, Al Wusta Fishery Industries, and Oceanic Shrimp Aquaculture – into the Oman Fisheries Development group.[33]

Raising New Revenue Locally

Governments have looked inward for domestic sources of non-oil revenue through rate hikes on existing taxes and the imposition of new fees. Saudi Arabia tripled the standard rate of its value-added tax from 5% to 15% in July. Saudi authorities, however, are considering a VAT exemption on Saudi citizens' first residences, as home ownership is an important economic initiative under Crown Prince Mohammed bin Salman.[34] On June 10, the Saudi government also raised customs fees on a range of imported items to help boost non-oil revenue.[35]

28 Simeon Kerr, "Dubai Increases Public Spending To Ward Off Economic Slowdown," *Financial Times*, December 9, 2020.

29 Fiona MacDonald, "Kuwait's $65 Billion Debt Plan in Peril After Draft Law Rejected," *Bloomberg*, August 16, 2020.

30 "Saudi Arabia's 2020 Budget Review," *U.S.-Saudi Business Council*, January 3, 2020.

31 Turki Al Balushi, "Oman Cuts Pay 23% for New Civil Servants," *Bloomberg*, May 18, 2020.

32 Maher Chmeytelli, Lisa Barrington, Rania El Gamal, and Ghaida Ghantous, "UAE Restructures Government Seeking More Agility as It Deals With Coronavirus Impact," *Reuters*, July 5, 2020.

33 "Oman Investment Authority Unveils Merger in Fisheries Sector," *Oman Observer*, June 23, 2020.

34 Eman Al-Khattaf, "Saudi Arabia Considers Full VAT Exemption on First Residence," *Asharq Al-Awsat*, July 22, 2020.

35 Vivian Nereim, "Saudi Arabia Redraws Customs Policy With Consumers To Bear Costs," *Bloomberg*, June 4, 2020.

In July, Oman's Shura Council, the lower house of the Omani Parliament, referred a VAT draft law and an income tax law to the state council.[36] Oman initially agreed to implement a VAT in 2018 as part of a unified VAT agreement among the member states of the GCC. Given the rapid adoption of new policies under Haitham,[37] the new sultan appears more intent than his predecessor on pushing through sensitive tax reforms. Saudi officials have not ruled out the possibility of an income tax in the future. Most Gulf Arab states levy excise taxes, but these taxes account for a relatively small portion of non-oil government revenue.

Other Gulf Arab states with smaller local populations have not moved as aggressively to leverage taxes as part of their economic policy response. Prominent businesspeople in Dubai instead asked their emirate-level government to decrease the VAT rate from 5% to 2% in a letter from the Dubai Chamber of Commerce and Industry.[38] The Federal Tax Authority in the UAE extended payment deadlines for VAT and excise taxes; however, the authority did not change the official tax rates.[39] In late January, before the economic crisis fully emerged, Bahrain waived the 5% VAT on electricity and water bills for all citizens and expatriates.[40]

The privatization of state assets is another method of raising new government revenue. In July, Saudi Arabia's finance minister announced that the country hopes to expand the scope of state assets considered for privatization as part of efforts to generate around $13 billion over the next four to five years.[41] Water utilities, flour mills, health care, logistics, and education have been focus areas for Saudi Arabia's Privatization Vision Realization Program under Vision 2030. The program not only aims to free up state-owned assets for private sector involvement but also to privatize selected government services.[42] Saudi Arabia's National Water Company has invited broad private sector participation in developing and operating wastewater treatment plants in the country.[43] Omani officials have also suggested that the privatization of state-owned assets is an important component of their strategy for plugging the country's deficit. However, privatization initiatives offer no panacea. These processes are time consuming, involve political sensitivities, and currently must contend with unfavorable market conditions.

Given the rapid adoption of new policies under Haitham, the new sultan appears more intent than his predecessor on pushing through sensitive tax reforms.

36 "Majlis Refers VAT Draft and Income Tax Law to State Council," *Times of Oman*, July 21, 2020.

37 Turki bin Ali al-Balushi, "100 Days In, Sultan Haitham Charts a New Course for Oman," *Arab Gulf States Institute in Washington*, July 14, 2020.

38 "Dubai Family Businesses Ask for VAT Cut, Faster State Payments," *Bloomberg*, May 12, 2020.

39 Alexander Cornwell, "UAE Extends VAT Payment Period – Statement," *Zawya*, April 21, 2020.

40 "Bahrain's VAT Waiver on Utility Bills Will Include All Customers," *Zaywa*, January 29, 2020.

41 David Barbuscia and Marwa Rashad, "Saudi Arabia To Widen Privatization Scope, Finance Minister Says," *Reuters*, July 22, 2020.

42 Saudi Vision 2030, "Privatization Program," Kingdom of Saudi Arabia, accessed July 23, 2020.

43 Jennifer Gnana, "Saudi Arabia Targets Wastewater Sector for Further Privatisation," *The National*, July 27, 2020.

Tapping International Debt Markets

Gulf governments must strike the right balance between debt issuances and depleting financial buffers. S&P Global Ratings expects that the GCC states' aggregate central government deficit will reach $180 billion in 2020, with $100 billion financed in debt and the remainder from a drawdown in government assets.[44] The scope of completed debt issuances in 2020 and the likelihood of additional issuances suggest that Gulf policymakers believe that returns on their assets and investments will exceed the costs of borrowing. Gulf borrowers do not enjoy equal access to international debt markets. Saudi Arabia, Qatar, Abu Dhabi, Sharjah, and Bahrain have borrowed tens of billions of dollars since the beginning of 2020. Saudi Arabia had to increase its debt ceiling from 30% to 50% to sell more bonds,[45] and the country raised $12 billion from international bonds between January and July.

Kuwait's Parliament must pass a debt law for the country's officials to legally tap international debt markets. On August 16, the Kuwaiti Parliament's finance and economic panel rejected a proposed law that would have permitted the country to borrow $65 billion over 30 years.[46] Officials hope to issue between $13 billion and $16 billion in government debt before the end of Kuwait's fiscal year on March 31, 2021.[47] Facing high borrowing costs, Oman had not tapped international debt markets as of July, but the sultanate is expected to issue debt in the second half of 2020 or early 2021. In late July, Oman's government selected First Abu Dhabi Bank and Bank Muscat to coordinate a $2 billion, 1-year bridge loan from regional and international banks.[48]

> *Gulf governments must strike the right balance between debt issuances and depleting financial buffers.*

Despite these grim economic indicators, regional governments are pushing ahead with ambitious investments and national development projects. This is especially the case in Saudi Arabia. In March and April, the Saudi government transferred $40 billion of the country's foreign reserves to the Public Investment Fund for its overseas investments. Saudi megaprojects under the ownership of the fund – Amaala, Qiddiya, the Red Sea project, and Neom – are also moving forward. Though surprising to many analysts advocating for a steep reduction in Saudi Arabia's investment expenditures, this decision resonates with the country's development strategy under Vision 2030. These high-profile, highly personalized projects emerged in the aftermath of the 2014-15 economic crisis and are likely to play a prominent role in economic development plans over the coming years. That the megaproject at Duqm remains a priority for the new Omani government is further evidence of this trend.

---

44 Davide Barbuscia, "UPDATE2-GCC Government Debt To Surge by Record-High $100 Bln This Year – S&P," *Reuters*, July 20, 2020.

45 Davide Barbuscia and Yousef Saba, "Saudi Arabia May Tap Debt Market as Oil Output Cuts Hit Revenues: Sources," *Reuters*, April 13, 2020.

46 Fiona MacDonald, "Kuwait's $65 Billion Debt Plan in Peril After Draft Law Rejected," *Bloomberg*, August 16, 2020.

47 Ahmed Hagagy, "Exclusive: Kuwait Scrambles To Boost Coffers With Up To $16 Billion Debt Plan," *Reuters*, July 19, 2020.

48 Davide Barbuscia and Yousef Saba, "Muscat To Arrange $2 Billion Loan – Sources," *Reuters*, July 27, 2020.

Lessons From the Past

Examining previous economic and political shocks not only reveals historical parallels but also provides insight into the economic policy mechanisms that Gulf Arab states will deploy in 2020. This section examines two periods of economic crisis and one period of political tension with economic repercussions: 2014-15, 2011, and 2007-09.[49] The economic impact of these periods on the Gulf region was deep and complex. Rather than a comprehensive overview of developments, this section instead highlights the roles of deficits and debt, employment initiatives, and the growing significance of economic cooperation with Asian partners.

2014-15

The proclivity of regional governments to spend beyond their means is not new. The oil price collapse of 2014-15 reflected an important turning point in the fiscal trajectories of Gulf Arab states over the past decade. From 2010 to 2015, Gulf Arab governments largely posted budget surpluses. This trend reversed from 2015 to 2020, although Qatar managed to post surpluses in 2018 and 2019.[50] Since Kuwait's fiscal year runs from April to March, the country posted a sizeable surplus during its 2014-15 fiscal year, but an even larger deficit followed in the 2015-16 fiscal year.[51]

High oil prices at the outset of the decade and lower, volatile oil prices later in the decade help explain this trend. Yet Gulf economic policymakers bear some responsibility for how budgets adapted to changing economic conditions. Following historic lows in oil prices in January 2016, prices generally rebounded through October 2018 before largely stabilizing in 2019.[52] The budget trajectories of Gulf Arab states, though, moved in a number of disparate directions. Saudi Arabia made slow, steady progress on reducing its high deficits, but then Saudi policymakers planned for a budget shortfall of nearly $50 billion in 2020, prior to the coronavirus and oil rout crises.[53] Oman and Bahrain consistently overspent for much of the past decade. Oman's deficit not only spiked in 2016 but also exceeded government estimates by around 60%, while Bahrain managed to reduce its budget in 2019.[54] Kuwait ended its 2019-20 fiscal year with a $18.44 billion deficit, a 69% increase in the year-on-year deficit.[55]

Saudi Arabia made slow, steady progress on reducing its high deficits, but then Saudi policymakers planned for a budget shortfall of nearly $50 billion in 2020, prior to the coronavirus and oil rout crises.

49 For example, the boycott of Qatar that began in 2017 could also be considered a regional economic shock; however, the impact of this crisis was distributed broadly across the region.

50 "Statistics," Qatar Ministry of Finance, accessed August 17, 2020.

51 "KD 3.5 Bln Surplus in Kuwait's 2014-2015 Budget – NBK," *Kuwait News Agency*, August 9, 2015; "Kuwait Budget Deficit at KD 4.6 Billion – Report," *Kuwait News Agency*, July 9, 2016.

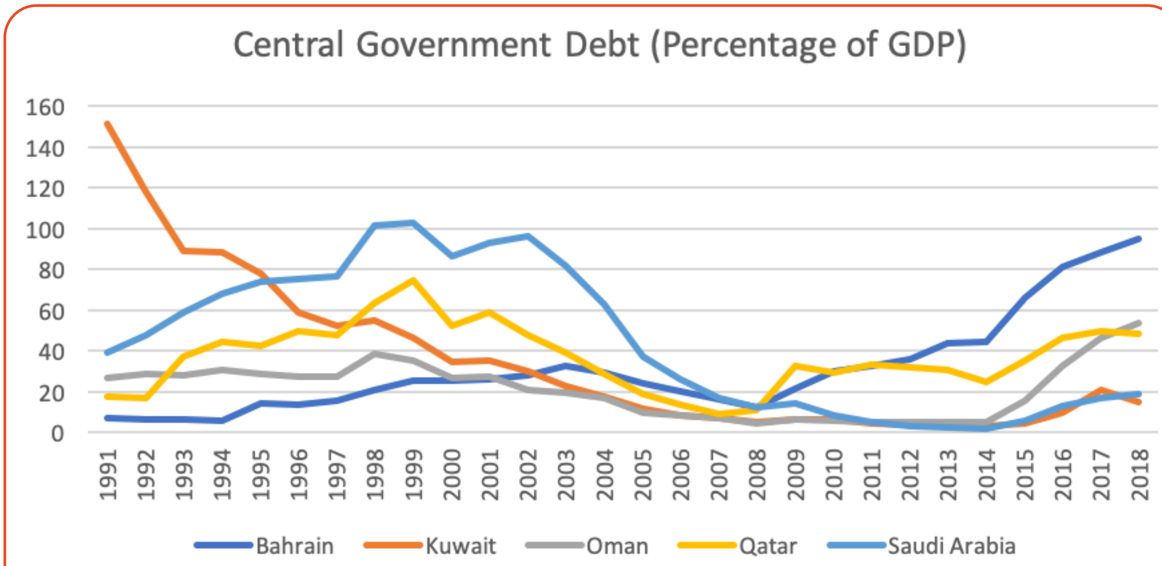
52 "Crude Oil Prices – 70 Year Historical Chart," *Macrotrends*, accessed July 15, 2020.

53 "Saudi Arabia's 2020 Budget Review," *U.S.-Saudi Business Council*, January 3, 2020.

54 A E James, "Oman's Outstanding Debt at OMR7.4b Reasonable: Experts," *Times of Oman*, January 2, 2017; Bahrain Ministry of Finance and National Economy; author's calculations.

55 "UPDATE 1-Kuwait Closes 2019-2020 Fiscal Year With $18 Bln Deficit -Finance Ministry," *Reuters*, August 13, 2020.

The tendency to run deficits has drastically increased sovereign debt levels over a short time. The 2014-15 fall in oil prices played a central role in accelerating debt issuances across the region. In 2016 and 2017, Gulf Arab governments issued more than $90 billion of debt in local and foreign currencies.[56] Oman's gross general government debt jumped from below 5% of GDP in 2014 to nearly 50% in 2018.[57] The central government debt to GDP ratio in Bahrain reached nearly 95% in 2018.[58]



Source: International Monetary Fund

2011

The employment-related reforms from 2014 to 2015 built upon those that emerged following the political unrest of 2011 and its aftermath. During this period, regional governments launched employment initiatives with shorter-term timeframes. Following short-lived – but violent – protests in Oman, the late Sultan Qaboos bin Said announced plans to create 50,000 jobs in the public sector, increased the wages of civil servants and government pensioners, raised the minimum wage, and introduced unemployment allocations.[59] These steps may have eased immediate tensions but did not contribute to a sustainable economic strategy for the sultanate.

Meanwhile, entrepreneurship initiatives became important economic policy mechanisms for Gulf governments following the 2011 uprisings. According to Crystal A. Ennis, "entrepreneurship promotion, although cast in the language of private sector development, has thus far become

56 Trevor Cullinan, "Credit FAQ: GCC Government Funding Needs Increase Sharply on Low Oil Prices and COVID-19," *S&P Global Ratings*, July 20, 2020.

57 Zainab Fattah, "Once A-Rated at S&P, Oman Now Risks Descending Deeper Into Junk," *Bloomberg*, April 21, 2019.

58 "Central Government Debt," International Monetary Fund, accessed July 31, 2020.

59 Sara Hamdan, "Oman Offers Some Lessons to a Region Embroiled in Protest," *The New York Times*, April 6, 2011.

another vehicle for state patronage."[60] State-led support for entrepreneurism partially shifted distributive responsibilities from the government to the private sector. Although government entities and state-run investment vehicles often provided funding and support, entrepreneurs or small business owners assumed ultimate responsibility for the success of their ventures.

Entrepreneurship promotion likewise targets the younger segments of Gulf labor markets: This demographic faced persistently high unemployment rates even prior to the outbreak of the coronavirus and oil price rout. The youth bulge, or the percentage of the population in Gulf Arab states under the age of 25, ranges from 25% in Qatar to 50% in Oman.[61] State-led entrepreneurship initiatives feature prominently in the latest Gulf country visions and strategies and will play a key role in government efforts to generate employment efforts for citizens over the coming months and years.

2007-09

The global financial crisis and its aftermath offered additional lessons in risk and reward for Gulf Arab states. The downside risks of economic development models sustained by heavy debt burdens were readily apparent in this period. Highly leveraged firms were forced to restructure unsustainable debt as they confronted an economic downturn. Dubai World, for example, restructured $23.5 billion of debt in what became a broader reputational blow to flagship conglomerates and firms in the emirate.[62] The painful episode has not been forgotten. In June, Dubai World repaid $8.2 billion more than two years ahead of schedule.

As Gulf countries sought to accelerate an economic recovery, Asian countries – especially China – played a crucial role in driving economic growth across the region.

As Gulf countries sought to accelerate an economic recovery, Asian countries – especially China – played a crucial role in driving economic growth across the region. Kristian Coates Ulrichsen describes this hastening of the Gulf's internationalization as "deepening interdependencies with a multiplicity of external actors."[63] In 2009, China imported more Saudi crude oil than the United States, owing to the deeper slowdown in the United States. "Demographic and economic trends are making it clear – the writing is on the wall. China is the growth market for petroleum," said Khalid al-Falih in 2010, then president and chief executive of Saudi Aramco.[64]

Over the following decade, China steadily increased its relative share of the Gulf's total crude oil exports. Indeed, China imported nearly 90% of Omani crude oil exports in April and May, and China National Petroleum Corp. is reportedly in talks to acquire part of British Petroleum's

60 Crystal A. Ennis, "Between Trend and Necessity: Top-Down Entrepreneurship Promotion in Oman and Qatar," *The Muslim World* 105, no. 1 (December 19, 2014).

61 "Dubai Seeking To Meet Needs of GCC Youth Population," *Oxford Business Group*, accessed July 30, 2020.

62 Nicolas Parasie, "Dubai World Pays $8.2 Billion Early To Complete Debt Revamp," *Bloomberg*, June 30, 2020.

63 Kristian Coates Ulrichsen, "Repositioning the GCC States in the Changing Global Order," *Journal of Arabian Studies* 1, no. 2 (2011).

64 Jad Mouawad, "China's Growth Shifts the Geopolitics of Oil," *The New York Times*, March 19, 2010.

$1.5 billion stake in Oman's Khazzan natural gas field.[65] China also strengthened trade and financial linkages to the region, and increasing flows of Chinese tourists into Gulf countries supported non-oil sectors of Gulf economies earmarked for economic diversification.

A Future of Accelerated Trends

Viewing the economic crises of 2020 from a historical perspective sheds light on prevailing economic trends within the Gulf states. As institutional change tends to occur slowly,[66] the evolution of existing trends is more likely than the establishment of radically new rules of the game. The oil price rout in particular has revealed that, despite ambitious rhetoric, diversifying Gulf government revenue away from the oil and gas sector remains a painfully slow process. The sector alone accounts for more than 70% of government revenue in most Gulf Arab states. Moreover, a large portion of the Gulf's inward foreign direct investment continues to focus on the region's hydrocarbon-related industries.

The coronavirus outbreak has imperiled the traditional sectors earmarked as pillars of economic diversification efforts: aviation, tourism and hospitality, real estate, and logistics. This has renewed interest in ongoing digital transformation agendas and technology-focused development initiatives – both as a means to tap into fast-growing segments of the global economy and also to strengthen the competitiveness of domestic industries.[67] Governments and government-related entities are therefore rolling out new digital platforms and applications to improve resilience and increase profitability. In April, Dubai-based DP World announced a host of new online tools and services to further digitize the management of logistics and better facilitate trade amid crises.[68] Gulf governments are likely to allocate a larger share of potentially smaller investment expenditures in the future toward digital and technology-related development initiatives.

The oil price rout in particular has revealed that, despite ambitious rhetoric, diversifying Gulf government revenue away from the oil and gas sector remains a painfully slow process.

Gulf officials regularly couch economic diversification efforts in terms of generating new employment opportunities for citizens. Yet, with progress on economic diversification proceeding slowly, governments have turned to shorter-term measures to replace expatriate workers with citizens. Over the past couple of years, Saudi Arabia and Oman have instituted strict sectoral workforce quotas and fees intended to either reduce the number of expatriate residents in the country or force expatriates and their employers to directly contribute to government coffers.

65 "Chinese Oil Giant CNPC Eyes BP's $1.5 Billion Stake in Oman Gas Field," *Bloomberg*, July 30, 2020.

66 Using Douglass C. North's definition of institutions here as "rules of the game" that shape human interaction by structuring incentives in political, economic, and social exchange

67 Robert Mogielnicki, "Oil Outlook, Coronavirus Challenge Gulf's Economic Diversification," *Arab Gulf States Institute in Washington*, March 19, 2020.

68 "DP World Launches Worldwide Digital Platforms Throughout the Supply Chain To Move Global Trade Online," DP World, April 21, 2020.

Workforce nationalization initiatives and other measures intended to reduce the supply of expatriate residents have intensified throughout 2020. Countries with larger shares of local citizens as a proportion of total residents – namely Saudi Arabia, Oman, and Bahrain – are confronting greater labor market pressures. In June, Bahrain's Parliament launched an inquiry into an online portal created by the country's Labour Market Regulatory Authority to connect employers and jobseekers in the private sector. One of the members of parliament leading the inquiry said, "Jobs are for Bahrainis and not expats and advertising jobs for expats is against the law."[69]

Even Gulf countries with smaller ratios of local citizens to expatriates must contend with local demands to address demographic imbalances. Kuwaiti members of parliament are calling for drastic reductions in the expatriate population of Kuwait. With very small local populations, Qatar and the UAE have largely resisted instituting direct labor market interventions of this type. However, Qatar's Ministry of Finance reportedly ordered government-related entities to cut monthly costs for expatriate employees by 30% beginning in June.[70] Outflows of expatriates owing to market forces may help reduce the supply of expatriates in a given country, but these developments alone are unlikely to substantially increase demand for local jobseekers.

Despite beginning as regional policies, new taxes in the Gulf states had become increasingly country specific prior to the coronavirus outbreak and steep drop in oil prices.

There is a healthy degree of economic competition between Gulf Arab states and, indeed, among various emirates within the UAE. Yet, the region's states and polities have managed to cooperate on specific economic policies in the past, often under the umbrella of the – now significantly constrained – GCC. Following the 2014-15 oil price crisis, GCC states signed unified tax agreements in 2016. However, Gulf governments largely levied VAT and excise taxes or chose to avoid them according to national priorities. Despite beginning as regional policies, new taxes in the Gulf states had become increasingly country specific prior to the coronavirus outbreak and steep drop in oil prices.

A similar trend is at work in this moment of crisis: Broad regional movement on the tax front makes it easy to overlook diverging trends within tax regimes. Divergence in tax policies exists not only on the levels of timing implementation and standard rates but also in the finer details: exemptions and other carveouts, zero rating, and varying definitions of taxable economic activities.[71] These forms of preferential tax treatment can reduce VAT revenue by as much as 50%, according to the IMF. Various forms of preferential tax treatment existed prior to 2020, while crisis response measures introduced new exemptions and other carveouts. Harmonizing these disparate elements of tax regimes – especially with relation to cross-border trade and refunds – will pose challenges to regional economic integration over the coming months and years.

69 "Jobs For Expatriates Plan in Bahrain To Be Probed," *Zawya*, June 10, 2020.

70 Simone Foxman, "Qatar Cuts Pay for Foreign Employees Working for Government," *Bloomberg*, June 10, 2020.

71 For more information on the value-added tax in Gulf Arab states, see: Robert Mogielnicki, "Value Added Tax in Gulf Arab States: Balancing Domestic Regional, and International Interests," *Arab Gulf States Institute in Washington*, August 26, 2019.

Conclusion: Emerging Concerns, Renewed Urgency

Certain economic pressures emerging in 2020 present greater concerns than similar developments in previous crises. Most Gulf Arab states remain in relatively strong positions to manage their debt over the short term. Indeed, regional governments successfully managed high levels of government debt throughout the 1990s.[72] However, it appears increasingly unlikely that energy demand will return to the levels witnessed throughout the early 2000s. Looming external debt maturities pose additional challenges. Oman's external debt maturities in 2021 and 2022 are $4.3 billion and $6.4 billion, respectively.

The unprecedented scale of disruption to international flows of people and goods in 2020 contrasts with previous economic crises. Acute shocks in energy and financial markets did not necessarily grind other sectors to a halt. A better picture of the economic distress taking place in the Gulf states will emerge at the end of the fiscal year, when companies weigh the costs and benefits of remaining open in 2021.

There are parallels between the Gulf's various economic crises over the past two decades as well as continuity in many of the economic trends across the region. This does not mean that any political or economic trajectories are entirely determined: The march of history involves a series of switch points that can alter the course of economic development. As Gulf Arab policymakers continue to confront an ambiguous future, they will rely heavily on familiar economic policy measures and avoid straying from the status quo as long as possible.

72 "Central Government Debt," International Monetary Fund, accessed July 31, 2020.