DECLINING OIL PRICE: OPPORTUNITIES FOR CHANGE IN GCC COUNTRIES

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Esteemed Participants, Distinguished Guests

It is my honor and pleasure to speak to you.

At the outset, I would like to welcome and thank Society for Research Development Members in organizing International Conference on Science, Technology, Humanities and Business Management (ICSTHBM-16). In this conference, we will be analyzing declining oil price: opportunities for change.

This is an important topic that has aroused renewed interest in recent years, particularly in light of the 2008 global financial crisis. The primary economic challenges facing the Gulf States are an overreliance on commodity exports and a lack of diversification. In spite of, relatively high levels of state spending, meant to ensure social stability while overcoming geographic constraints to development, Gulf Cooperation Council (GCC) members countries have struggled to expand their economies beyond the realm of oil and gas. The underlying geography of the region and demographic limitations have stood in the way of diversification efforts, along with a general lack of resources to support manufacturing and other value-added exports unrelated to the hydrocarbons industry.

These problems have been endemic to regional economies for decades, but the recent Arab uprisings have brought them back into the spotlight. From late 2013 onward, Gulf Cooperation Council meetings have become more earnestly engaged with the idea of coordinated reforms in areas such as taxation. This has led to the creation of working groups and research teams to prepare assessments and recommendations. Individual members, including Kuwait and the United Arab Emirates have pursued a variety of independent measures, including the slow scaling back of government payments and some social development spending. Whereas, the economies and domestic strategies vary by country, the key issues and potential reform solutions broadly fall into very similar categories.

The Oil prices plunged from over USD 130 barrel a few years ago to below US 30 in 2016. The decline in oil price is good for consumers and major oil importing countries faced problem and signals to deflationary pressure on the country's economy. Some of the emerging economies have projected to grow above 6.5 per cent in 2016 but many fear the global impact of a slowdown. Meanwhile, the recent interest rate hike by the US Federal Reserve has been taken a sign of global economic recovery through many investors' remains nervous about the end of the Fed's quantitative easing policy. Sinking oil prices are expected to continue through to 2017 with some predicting a fall to below USD 30 per barrel. The oversupply of oil is expected to persist and have a major impact on the global economy. First, low oil prices are an indicator of deflationary pressure and a potential deflationary trap. Second, low oil prices set a low benchmark at which renewable energy and lean technology become economically viable. Fossil fuel consumption may increase in the short term, but nationality mandated energy diversification and political leadership will ensure the sustained investments and uptake of alternative sources.

Opportunities for Change

Tax Reform

The Gulf States have some of the most lenient tax structures in the world, both for domestic individuals and businesses and for foreigners. Individual tax codes vary, but none of the GCC states impose a domestic income tax on their citizens though Saudi Arabia does collect a 2.5 percent religious tax or zakat. Foreigners also pay no local taxes while working in the GCC and locally owned businesses pay only a minimal tax in Kuwait, Qatar and Oman.

Moreover, the foreign businesses are also largely exempt. In particular, the countries like Saudi Arabia and Dubai levy a 20 percent tax on foreign corporate entities, a much lower tax rate than in other parts of the world.The GCC members need to tread lightly in any attempt to pursue reforms, not only to avoid raising the risk of domestic dissent but also to not discourage foreign companies and workers from operating in the Gulf.

None of the GCC members are likely to impose new tax schemes till 2015, but Oman could make the biggest strides toward one. Oman has been one of the most outspoken Gulf monarchies about the possibility of raising royalties on mineral exports and potentially imposing a tax on remittances sent by foreign workers. Oman has the smallest body of foreign workers as a percentage of the population, which gives it more leeway than its neighbors. It also suffers from dwindling energy reserves and a more pressing economic situation. Bahrain and Dubai will be less likely to impose higher taxes given their positions as financial and banking centers, but Kuwait and Qatar may well follow Oman's lead in the coming years.

Fuel and Power Subsidies

The Gulf monarchies also provide their citizens with some of the cheapest gasoline and diesel in the world. Saudi Arabia subsidizes the crude oil and gas that is produced for refiners, domestic fertilizer use and power generation a practice mirrored throughout the Gulf. In recent years prior to falling oil prices, Saudi Arabia had the highest fuel subsidy bill in the world, spending more than $50 billion annually to provide cheap petroleum and byproducts to its residents. Fuel subsidies have historically been very difficult to reform, for countries such as Venezuela, Jordan, Iran and India. Lower oil prices may give Gulf countries like Saudi Arabia an advantage, though, which could help ease the transition from subsidized fuel costs to market rates. India's government deregulated the price of diesel in 2014 and prices actually fell because of lower global oil prices. The same year, Jordan, Egypt and Iran all reduced fuel subsidies and were largely able to manage the resulting outcry, despite facing more precarious social conditions than the GCC. All of the Gulf States have been careful to show neither institutional weakness nor the financial impact of falling oil prices. But, even if oil prices remain low through 2015 and into 2016, the Gulf monarchies likely will be able to implement some sort of subsidy reduction with limited direct impact to consumers. A decline in the growth of domestic demand for oil could also help Gulf countries allocate more of their production toward exports.

Saudi Arabia has the highest per capita consumption of oil in the world, and rising domestic demand has meant that upticks in Saudi output are increasingly being directed to the domestic market rather than to foreign consumers. By disincentivizing excess consumption, exporters like Saudi Arabia could help secure more future barrels for the export market for a longer period of time, thereby reducing subsidy burdens on the state budget. The subsidies also extend to input energy costs for power generators another challenge for the Gulf monarchies, considering that they have some of the highest concentrations of petroleum-based power generation facilities in the world. With the exception of Qatar and sometimes Oman, the GCC runs natural gas deficits most years. Subsidizing the oil for power plants as well as the cost of electricity has double the impact on state budgets; a similar subsidization scheme in Iran ultimately proved unsustainable. Since fuel, water and electricity subsidies are almost uniformly the largest segment of state subsidy bills in the Gulf, even a modest reduction would help lower state spending in the future.

Employment and Labor Reform

The Gulf States are dependent on foreign labor. The extent of their dependence ranges from a relatively low 28 percent of the population in Oman to a whopping 85 percent in Qatar and the United Arab Emirates. Though conditions are often difficult, the lack of income tax and remittance restrictions as well as relatively high salaries have made the GCC one of the largest sources of remittances in the world. The IMF figures estimate that GCC states accounted for some $93.4 billion in remittances in 2013, equal to 5.7 percent of their collective GDP. The foreign workers make up 47 percent of the GCC's total population, creating unique challenges for countries such as Qatar and the United Arab Emirates. The abundant inexpensive labor has largely fueled the construction booms in the Gulf, especially in Doha and Dubai, but for decades imported labor has also dominated the service, technical, energy, medical and manufacturing sectors of Gulf economies. Gulf States have created a system in which locals are heavily employed by the state in inefficient, bloated bureaucracies while expat workers send tens of billions of dollars outside the host economies. Additionally, Gulf governments are obligated to spend billions on developing transportation infrastructure, housing, water and electricity systems to support populations of foreign workers several times the size of their native populations. Saudi Arabia's large and growing native population, which rose from a little over 3 million in 1950 to over 28 million in 2015, also creates its own logistical complications, since not all Saudis can be employed through state and government organs.

Offering foreign companies lucrative tax codes is meant to encourage them to hire more local employees, an effort that has had mixed results. Saudi Arabia and many of its neighbors, including Qatar and Oman, essentially impose quotas on foreign companies that specify the number of locals they must hire or necessitate partnerships with local companies. The goal behind such measures is to reduce the domestic population's economic reliance on the state, but practices have become corrupt, inefficient and concentrated among a small number of locals. Saudi Arabia has been slowly pulling back from its Saudization policies and implementing other reforms in the labor market, such as allowing limited expansions of the roles of female employees in the kingdom, but the process has been slow. Other Gulf States, such as Kuwait and Oman, have begun more stringently enforcing labor laws and restrictions on the number of illegal immigrants. The stated motive behind these moves has been security, which may very well be legitimate, but the new level of enforcement has also helped reduce the growth of the countries' expat populations and set plans in place to shrink those expat communities in the coming decades. Saudi Arabia has followed suit, working directly with governments in India, Pakistan, the Philippines and Bangladesh to set more enforceable quotas to help wean the Gulf off its dependence on foreign labor. This will require a slow, managed process to reverse a deeply ingrained cultural aspect of the Middle East, and it will be much easier to implement in some parts of the GCC such as in Oman than in others, such as Qatar and the United Arab Emirates. Still, immigration reform has been one of the GCC's more successful policy initiatives in recent years, and relationships between the Gulf and the countries that receive the bulk of remittance outflows have helped facilitate the process with limited pushback from workers.

Infrastructure, Education and Defense

State spending on infrastructure, education and defense is also high. These will be the last areas to which governments make cuts; much of the GCC budget deficits anticipated in 2015 will be caused by continued spending in infrastructure and development projects. The Gulf States also interpret several geopolitical conditions in the region such as instability in Yemen and the ongoing U.S.-Iranian nuclear negotiations as security threats; therefore, state spending will be maintained, though it may slow in the future as the buildup of equipment slows. Saudi Arabia replaced India as the top purchaser of foreign military equipment and technology in 2014, while Qatar and the United Arab Emirates also significantly increased their purchases of military systems. These changes in defense spending reflect the shifting attitudes of Gulf member states toward their region. The Gulf monarchies will also maintain spending on education, which they see as critical to managing their growing youth populations and keeping them occupied and away from potentially radicalizing influences. States justify spending on education and training as an investment that will create future labor pools and shift their economies toward the services sector, though this approach has had mixed results.

Fiscal pressure caused by falling oil prices may ultimately prove to be temporary; for the short to medium term, the Gulf has ample financial resources and opportunities to borrow abroad to help manage budget deficits. But there is a growing consensus among Gulf leaders, who are themselves experiencing a generational shift, that the state largesse that defined life in the Gulf for much of the 1990s and 2000s is no longer sustainable. The GCC is likely to embark on reforms. However, it will be on its own terms and in its own time. Social stability is of paramount concern, and given the interconnectivity of many of members' concerns, large changes over a short time could negatively impact growth and economic activity.

The GCC is likely to begin the process while it is in a relatively strong financial position, just as it recently decided to maintain high production for long-term gain even though global oil prices were low. Fuel subsidies and tax reforms will likely be among the first issues tackled by some within the GCC, as early as 2016 if oil prices remain low. Iran may very well prove to be a model of some of these changes, implementing a fixed cash payment system to help manage society's frustration with shrinking subsidies. Ultimately, the Gulf States are unlikely to try and institute long-term changes to state subsidization schemes soon, especially as they deal with unrest in Syria and Yemen and manage the emerging relationship between the United States and Iran.

Future Global Growth Drivers

Over the next 15 years will be good years for the global economy as the growth of emerging markets will likely be driven by China, India and Southeast Asia. This is due to three growth drivers: a positive demographic dividend where more people join the workforce; huge catch up opportunity in productivity for emerging markets compared to the US; and surplus of capital, high saving rates and low debts.

Distinguished Guests,

The structural changes and regulatory reforms on various issued on Science, Technology, Humanities and Business Management will be discussed in length over the next two days by academicians and policymakers in sessions. I believe that this conference will produce fruitful and beneficial outcomes for Science, Technology, Humanities and Business Management.

I would like to thank our participants and distinguished guests for their contributions and for being here with us.