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The Economic Implications of the Dual Crisis in the Gulf Cooperation Council

A kettős válság gazdasági következményei a Perzsa-öböl Menti Együttműködési Tanács országaiban

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Abstract: The aim of the analysis is to interpret the economic effects of the dual crisis of 2020, namely the spread of the new coronavirus and the latest collapse of the oil price, on the states of the Gulf Cooperation Council. While the economies of the six monarchies are far from collapsing, the developments of the last few months have exacerbated the already existing structural challenges and placed enormous fiscal pressure on state budgetary policies. The most important effects of the dual crisis will be visible in the recalibration of national reform programmes, the acceleration of nationalisation tendencies in the labour market and weakening economic cooperation; nevertheless the strategy of the Gulf States, built on participation in economic globalisation and connectivity, will likely remain unchanged.

Keyword: Gulf Cooperation Council, GCC, economic integration, coronavirus, oil market

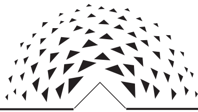
Összefoglaló: *Az elemzés célja a 2020. tavaszi kettős válságnak – az új koronavírus-járványnak és az olajár ismételt összeomlásának – a Perzsa-öböl Menti Együttműködési Tanács országaiban tapasztalható hatásainak az ismertetése. Bár a hat monarchia gazdasága távol van az összeomlástól, az elmúlt hónapok eseményei felerősítették a meglévő strukturális kihívásokat, és nagy fiskális nyomást helyeztek az állami költségvetési politikára. A tanulmány fő következtetése szerint a kettős válság legfontosabb hatásai a nemzeti reformprogramok rekalibrálásában, a munkapiacon megkezdett nacionalizációs tendenciák felgyorsulásában és a regionális gazdasági együttműködés gyengülésében mutatkoznak meg, mindazonáltal az öbölállamok valószínűleg nem változtatnak a gazdasági globalizációban való részvételre és konnektivitásra épülő stratégiájukon.*

Kulcsszavak: *Öböl Menti Együttműködési Tanács, GCC, gazdasági integráció, koronavírus, olajpiac*

Introduction

Before the new coronavirus crisis, economic projections regarding the Middle East and North Africa region (MENA) had been modestly fair for 2020. After almost complete regional stagnation in 2019, the IMF predicted a 2.6% nominal growth rate, while the World Bank foresaw 2.4%, fuelled by more investments and a stronger business climate. 2020 should have been the year of take-off for the troubled Iranian economy as well as the members of the Gulf Cooperation Council (GCC), which showed almost no economic growth in 2019 (except for the United Arab Emirates (UAE) and Bahrain, with 1.8% and 2%, respectively) and were expected to expand by 1–3.7% this year.

A few months later, there is no sign of optimism: the economy of the whole region is expected to shrink by 3.3%, with GCC countries suffering greatly. Beyond



the direct effect of the novel coronavirus and the measures against it, two additional characteristics of the region have enhanced the negative trends. First, the current crisis arrived in the region earlier than the virus itself due to its close economic connections with China, the first victim of COVID–19, as the most important individual trading partner of the MENA region. (Collectively, the European Union accounts for almost three times the share of China, but given the slow economic recovery foreseen in the EU, this is hardly a silver lining.) Second, the fall of the oil price in March hit producing countries to a great extent, especially in the Gulf, even if it had practically been initiated by Saudi Arabia.

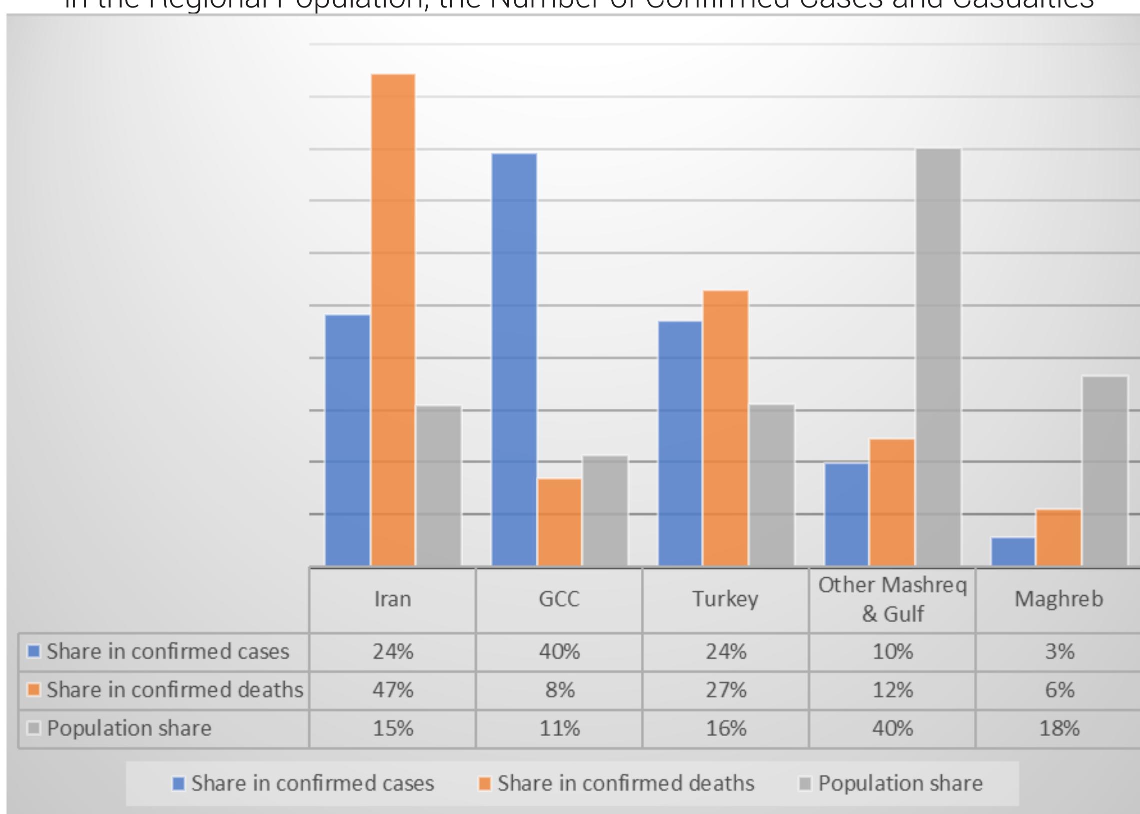
The aim of this analysis is to give an assessment of the economic implications of the dual crisis of the new coronavirus and the so-called oil price war in the Gulf Cooperation Council from a regional perspective. First, I will briefly describe the exposure of the GCC and the MENA region to both developments, then I will turn to the assessment of the implications in terms of national reform programmes, the labour market and regional cooperation. The scope of the analysis will be limited to economic tendencies, without taking into account unrelated domestic or international political dynamics.

Asymmetric Exposure to COVID–19 and Various Government Responses

The novel coronavirus has affected Middle Eastern and North African countries differently, as the national figures for both confirmed cases and deaths have varied to a great extent. According to the data provided by John Hopkins University, 88% of all cases and 82% of casualties by 10 June were reported in three areas – Iran, Turkey and the members of the Gulf Cooperation Council. The rest of the Mashreq and Gulf region provided only 10 and 12% of the infected and the deceased, while the same ratios for the Maghreb are 3% and 6%, respectively (see Chart 1). This asymmetric exposure is especially dramatic if we compare it to the share of the population of the above-mentioned regions – in terms of both confirmed cases and deaths, Turkey and Iran have far exceed their population share, while in the GCC the discrepancy is only visible in the case of the infected (which can be a sign of better health services).

In spite of the fact that Iran made the headlines, especially in February, regarding the huge impact of the SARS-COV-2 virus, the number of confirmed cases per 1000 inhabitants is actually higher in the case of the GCC (5.1) than in the Islamic Republic (2.15) and Turkey (2.09). All these numbers are much more worrisome than those of the rest of the Middle East (0.34) and North Africa (0.21). On the other hand, Iran does produce a higher ratio in terms of casualties with 10 deaths per 100 thousand people, which is almost double of that of Turkey (6) and approx. three times as much as that of the GCC (3) and ten times as much as the rest of the MENA region (1).

Chart 1
The Share of Middle Eastern and North African Countries and Regions
in the Regional Population, the Number of Confirmed Cases and Casualties



Data Source: World Bank, John Hopkins University

The exact reasons behind the different level of exposure to the virus are yet to be confirmed in the academic community, although a few interpretations have been put forward. First, all these numbers should be used with extreme caution, as they only reflect the official number of cases. One obvious issue with the data is the statistics gathered in the three war-torn countries, namely Yemen (128 cases and 20 deaths), Libya (65 cases and 3 deaths) and Syria (58 cases and 3 deaths), which are producing the lowest numbers in the region amid collapsing health care systems. Second, the case can be made that some countries have reacted more quickly and more harshly to the infection, while others (like Iran or Turkey) delayed taking measures due to economic or other reasons. While this interpretation seems plausible, empirically it is difficult to verify. Monitoring government responses to the crisis, the Blavatnik School of Government at the University of Oxford has developed the stringency index, which quantifies the severity of such measures on the basis of 17 indicators on a scale between 0 and 100 (a higher score indicating more and stricter measures). The data shows that on the day of the first recorded death, Iran had practically no measures implemented, while both the GCC and Turkey had taken more severe actions than the rest of the Middle East and North Africa (see Table 1), which does not explain their similar level of exposure to the virus.

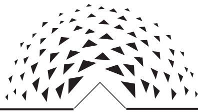


Table 1
Date of the First Reported COVID–19-Related Death and Stringency Index[1]

	Date of first reported death	Stringency index on the date of the first reported death	Latest stringency index
Iran	20 February	5.0	53.0
GCC	17 March	75.7	77.0
Turkey	19 March	72.0	79.0
Other Mashreq & Gulf	6 March	65.9	74.3
Maghreb	9 March	57.7	86.5

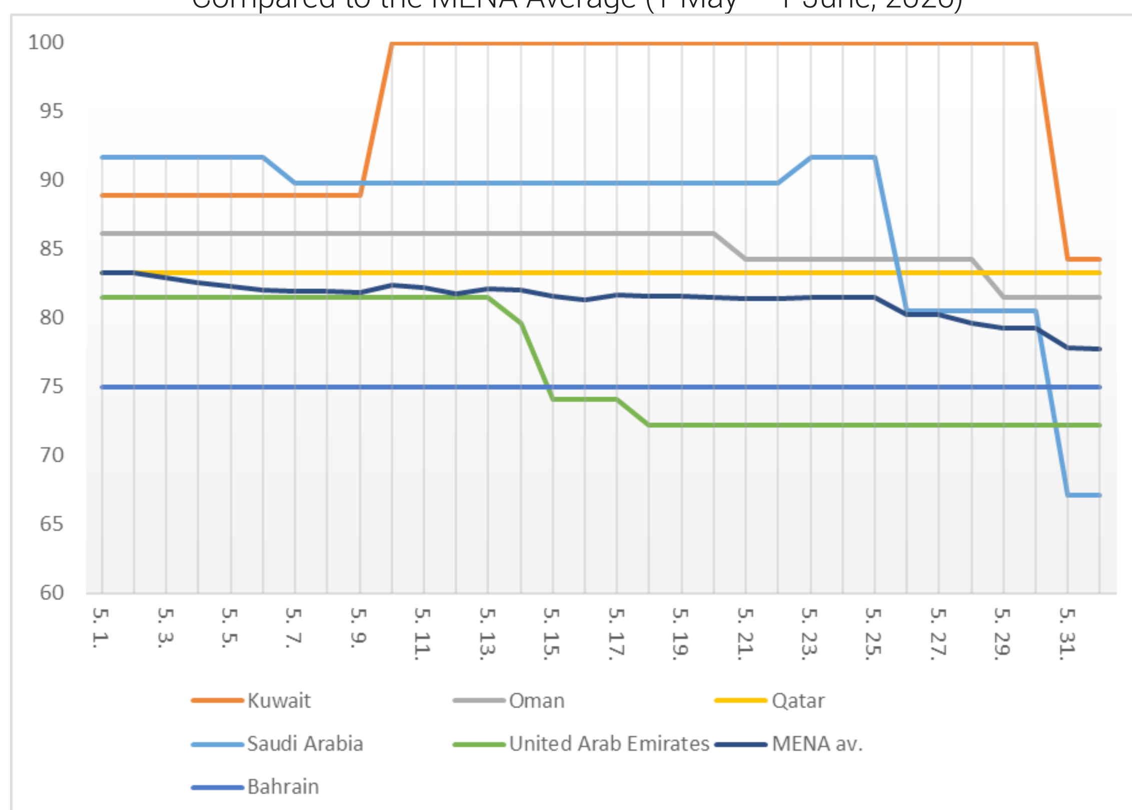
Data Source: the Blavatnik School of Government

Third, as we have already suggested in our previous research, the level of integration in the global economic and social sphere could be used as a fairly precise indicator of the countries and regions that are hit more quickly and more profoundly by the COVID–19 pandemic than others. Given the high level of social and economic integration of the Gulf countries, Turkey and Israel, the MENA region supports this hypothesis; nevertheless, it does not seem to explain some cases at first glance, especially that of Iran – only if we take into account the close connections between Iran and China, which manifests itself in, among others, the considerable number of Chinese workers and students in Qom, one of the centres of the infection. This narrative is strengthened by the fact that most confirmed cases have been reported among the migrant worker population (which constitutes approx. 46% of all the inhabitants of the six states), who have no citizenship.

Most measures in the MENA region and the GCC have been in accordance with the usual playbook implemented by national governments, with the closure of educational institutions, prohibiting public gatherings, workplace restrictions and curfews. In general, Bahrain and the UAE have taken the least harsh steps, while Saudi Arabia has taken the strictest ones, especially in terms of domestic travel and stay-at-home requirements (although not in the case of testing). A slow and careful suspension of measures has been implemented since the last days of April, especially in the United Arab Emirates, Oman and Saudi Arabia; the course of Qatar and Bahrain has remained unchanged, while Kuwait (and to some extent Oman) introduced new measures during the second week in May, fighting a new wave of infections, followed by Saudi Arabia and Qatar in the final days of Ramadan. That being said, on the 1st of June, all six states still have a higher stringency index than the global average (67) (or in the case of Saudi Arabia, equal to it) and, except for the UAE, Saudi Arabia, and Bahrain, the regional average (see Chart 2). Unless a new, unforeseen development takes place in the region, one can expect the governments to continue the easing process led by the Emirates and Saudi Arabia.

1 In the case of the GCC, Other Mahsreq & Gulf and the Maghreb, I used the date of the first reported death in the region but the average of the national stringency index on the date of the first reported death.

Chart 2
Patterns of Easing – Changes in the Stringency Index in the Six GCC Countries Compared to the MENA Average (1 May – 1 June, 2020)



Data Source: the Blavatnik School of Government

The coronavirus crisis in itself represents a dual shock for the Gulf economies. On the one hand, due to the reduction of labour (exacerbated by the reliance of the six countries on foreign workers) and a lack of the imported materials much needed to fulfil ambitious construction projects, one can observe a negative supply shock. On the other hand, demand for goods and services exported by the GCC countries has also shrunk as a result of the disruption of global supply chains and energy consumption. A dampened global growth outlook, together with a possible rise in protectionist tendencies in a post-COVID environment, could further cloud the prospects of the region's economies. Such trends alone would have been difficult to manage for the GCC states; nevertheless, a new challenge arose in March.

The Oil Price War and the GCC

The second economic crisis the members of the GCC have to handle is that of the second oil price shock in the last seven years. The current one was started by Saudi Arabia and Russia by intensifying their oil export volume in spite of weakening demand on global markets. The so-called "oil price war" has taken place

despite the two states cooperating with each other and many other producers since 2016 in the so-called OPEC+ format. In the talks following the coronavirus crisis, Riyadh and Moscow did not manage to agree on a new arrangement regulating the level and distribution of additional production cuts. As a result, the price of oil fell by almost a quarter, pushing the WTI and Brent price to 31 and 34 USD per barrel (pb), respectively, the biggest drop since 1991.

The affair is a quintessential cooperative conflict: on the one hand, the two governments engaged in a chicken game by pressuring the other to concede to their own proposal, while, on the other hand, they both presumably wanted to hurt the American oil industry and regain control of the price. This medium-term aim overshadowed short-term fiscal concerns in both countries: they let the oil price drop below their breakeven price (the value which theoretically balances state budgets), which is currently 40 USD pb for Russia and 84 USD pb for Saudi Arabia. Moreover, both presumed that they would withstand the pressure by using their financial reserves until the settlement of the dispute.

Eventually, a new OPEC+ deal was reached on 12 April. With the intervention of the United States (and President Donald Trump personally), oil producers agreed to a production cut of 23% compared to their production level of October 2018. The decision was a breath of fresh air for markets, as storage capacities were feared to become full shortly; however, it did not completely calm the markets. The main price indices are still below 40 USD pb, with severe fluctuation, e.g. just one week after the new deal was announced, the American WTI price fell below zero. The IMF predicts the oil price to recover only slightly in 2021, with only a moderate rise of 6.3%. Some analysts suggest the recent oil price collapse could accelerate the ongoing decarbonisation of the global economy; however, oil prices are more likely to bounce back in the coming years, albeit rather slowly.

As rentier economies heavily dependent on the export of petroleum, the GCC countries have been heavily affected by the oil price war. According to IMF estimates, the breakeven price for the six countries was 64 USD pb collectively in 2019, varying at the national level from 45.7 USD (Qatar) to 95.14 USD (Bahrain) this year. Accompanied by the fiscal pressure of the coronavirus crisis, budget deficit predictions took off in the six countries (see Table 2), reaching double digits in five out of six (the only exception being Qatar, whose economy is more dependent on the export of natural gas).

Table 2

Fiscal Balance in the GCC Countries in 2019 and 2020

	2019	2020 estimate made in December, 2019	2020 estimate made in March, 2020
Bahrain	-7.6	-3.2	-13.5
Kuwait	-4.1	1.2	-14.7
Qatar	3.6	0.6	-5.1
United Arab Emirates	1.1	-1.0	-11.4
Saudi Arabia	-4.5	-7.7	-10.0
Oman	-7.9	-9.4	-13.0

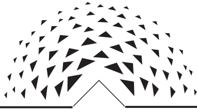
Economic Implications for Reform Programmes, the Labour Market and Regional Cooperation

The GCC was highly exposed to both crises taking place in the first half of 2020 even in regional comparison. The IMF predicts that in the Middle East and Central Asia, oil exporters will suffer more deeply, with the volume of the recession being almost five-fold (3.9) compared to oil importers (0.8). Naturally, the crisis is not only due to the fiscal consequences of the fall of oil prices and the COVID–19 lockdown but also due to monetary troubles. The pressure on Gulf currencies is not critical in itself, especially since the GCC states have traditionally tied the value of their currency to the dollar (or a basket containing the dollar); nevertheless, maintaining the pegs used in this process is getting more and more expensive. That is why several financial analysts question the sustainability of this policy, especially in the case of the Omani and Saudi riyal. If managed sub-optimally, the de-pegging process could pose a serious risk for maintaining confidence in the markets.

Facing the dual challenge, all six members of the GCC have introduced stimulus packages, ranging from 30% of the GDP (in the case of Bahrain and Oman) to 4% (Saudi Arabia). These mostly consist of measures aiming at maintaining temporal liquidity in different sectors (especially in financial institutions), such as suspension of taxes or loan repayment delays. As governments intend to reduce their expenditures simultaneously, this policy directly results in either issuing debt, utilising reserve funds, or raising tax revenues. With a surprise move, Saudi Arabia has already increased the rate of its value added tax (VAT) from 5% to 15% from July 2020, and it is possible that other Gulf states will follow (either by raising their VAT rate or introducing the tax itself). Social reactions will be key to observe in the Kingdom (Qatari portals already assume a negative perception), especially since it is questionable how the Gulf societies would interpret austerity measures.

Beside fiscal stability, most difficulties will probably be observable among small and medium-enterprises (SMEs), in the real estate sector, tourism, industry & energy, transport and logistics, as well as the healthcare and IT sectors, all of which hold key value in the diversification attempts of the six monarchies. This brings us to three inter-related areas that have been heavily affected by the dual crisis: national reform programmes, the labour market, and the question of regional cooperation.

All GCC states had started to implement a multi-annual diversification and reform programme before 2020, aiming at lowering the dependence of national economies on the oil and gas sector and enhancing the efficiency of state institutions. The most ambitious and famous national plan is the Saudi Vision 2030 framework put forward by Crown Prince Mohamed bin Salman. Although in the past couple of years the implementation of the project has had its ups and downs, it had proved successful especially in terms of improving the business environment in the



Kingdom. While it is too early to draw long-term conclusions, the current dual crisis will probably have a highly negative impact on the reform agenda. The success of the programme depends on attracting foreign direct investment, which, in the current situation, will be difficult to achieve. Stock markets in the Gulf lost 25% of their value in the first quarter of 2020, with the flagship company of Saudi Arabia, Saudi Aramco, suffering a huge blow. After the relatively successful initial public offering (IPO) of 1.5% of company shares last year, the price of shares fell below their IPO value for the first time in March.

Moreover, a direct effect of the dual crisis concerns sovereign wealth funds (SWFs). These financial tools were used by the governments of the Gulf States to create a pool from oil incomes to make strategic investments in the global market, to assist diversification and create fiscal reserves for future recessions. Instead of that, the amount controlled by the SWFs is currently used to cover up holes in the national budgets and to support crisis management (e.g. in Kuwait). In the case of Kuwait, Abu Dhabi and Qatar, this policy could mean a 100 billion USD drop in the overall asset of state-run wealth funds, which seriously limits their leverage.

A second sector which will be affected extensively by the dual crisis is the labour market. Migrant workers, who constitute 32–88% of the national populations of the GCC countries, are the first to lose their job during the national lockdowns. Moreover, their precarious situation is not just of an economic nature, as most infections have been registered in their community, without any access to local health services.

This situation will probably have a dual effect on the labour market. First, as the governmental programmes usually focus on sectors, companies and nationals, migrant residents will be excluded from direct financial and other assistance, which will exacerbate the existing social and economic division between nationals and residents. Governments are not keen on supporting foreign nationals as unemployment is likely to rise among citizens. Second, current developments will likely speed up the already started governmental programmes to "nationalise" the labour market by pushing foreigners out of key sectors or at least lowering their participation. The probable outcome of the process is an exodus of foreign workers from the region, comparable or even bigger than in the aftermath of the global economic crisis of 2008 and the oil price crisis of 2014.

While weakening dependence on migrant workers can be seen as a healthy development from many respects, current trends can have dangerous consequences. First, if it is coupled by stigmatisation, the exodus will strengthen social tensions rather than heal them. Second, sending workers home will directly affect the countries of origin through the decrease of remittances, which, in many cases, plays an important economic role not just for the families but for whole societies, especially in India, Pakistan, Bangladesh, the Philippines or Egypt. This may cause tensions in bilateral relations. Third, the process of labour market nationalisation takes time, as it affects several sectors and structural weaknesses of the economies of the GCC (such as the asymmetries between the private and the public sector); therefore, an unplanned rush in the process could cause some troubles (e.g. structural unemployment), as citizens are unlikely to take the jobs left by the migrants.

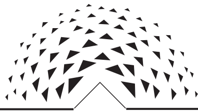
When it comes to regional cooperation inside the GCC, different speculations have been made regarding the effects of COVID–19. The Council has become seemingly inactive due to differing security perceptions and competition among its member states, which became evident in 2017, with three member states cutting ties with Qatar. Some analysts have argued that the emergence of the new coronavirus as a joint threat poses an opportunity for the GCC states to re-establish cooperation. There have been a few optimistic signs as well – on 24 March, the Council convened an emergency virtual summit of financial ministers in which all governments represented themselves, while late in April, they also agreed to establish a food supply safety network.

Nevertheless, in practice, tensions have remained visible during the crisis. The governments of Bahrain and Qatar engaged in a diplomatic rift regarding Shia Bahraini citizens stuck in Iran and later in Qatar. In May, fake news regarding a possible coup attempt in Doha spread on social media and was probably amplified by Saudi, Emirati accounts and diplomats. Beside the Qatari crisis, another obvious sign of lacking enthusiasm for deeper cooperation was Saudi Arabia's already mentioned decision to increase its VAT rate. According to the existing GCC agreement concerning value added taxes, members should indicate their will in case of changing the VAT rate at least six months before implementation, and they should seek an agreement among the six member states. Riyadh did not follow either of these guidelines, which weakens the Council's function as a coordination mechanism. On the other hand, the Saudi government could easily argue that the aforementioned agreement is practically invalid, as the introduction of the tax itself did not take place in a coordinated manner, with three out of the six member states failing to introduce it ever since.

Conclusion

While the outbreak of the COVID–19 epidemic has resulted in unexpected economic uncertainty in almost all countries, the GCC is in a unique position for two reasons. First, the health crisis has magnified the already existing structural problems in the Gulf region, especially in terms of economic and social inequalities, the dependence of national economies on foreign labour and the fiscal vulnerability of their budgetary policy. Second, the oil price war and the subsequent turbulences in the petroleum market have deprived the governments of huge revenues much needed in crisis management. Bahrain and Oman seem to be the weakest links economically in the GCC, even if the international attention is likely to be focused more on the UAE and Saudi Arabia.

The long-term consequences of the current situation are still difficult to predict. A recalibration process is likely to take place in the near future regarding the national reform and diversification strategies of the six states in terms of measures and their implementation timetable. The fear of indebtedness is likely to strengthen, which



could result in speeding up fiscal reforms in the medium term. That being said, strategic change is not on the horizon – the only viable way forward for the GCC economies remains to compete for connectivity and being embedded in the world economy, even if the current crisis draws the attention to the risks associated with globalisation.

The competition between global actors in the Gulf is likely to intensify, as weakening American influence can increase leverage for a growing Russian and Chinese influence, and the fact that the European Union is still lagging behind will remain unchanged in the post-COVID environment. Nevertheless, the crisis holds opportunities for the EU as well. The Gulf economies will be eager to speed up international re-engagement and foster trade and investment ties. A renewed European effort to revive interregional talks might give momentum to the long-awaited EU–GCC free trade agreement (FTA) or other enhanced institutional frameworks for enhanced cooperation.

From the Hungarian perspective, energising FTA negotiations would be beneficial. Although the primary winners of removing tariffs and other barriers in the way of trade and investments would not be European small states, it could lower the high price associated with economic cooperation with the Gulf States. Beside economic opportunities in the GCC (primarily in Saudi Arabia and the UAE), Budapest is also interested in the fiscal stability of Oman and its oil sector, as the Sultanate is the second largest state shareholder in Mol, the Hungarian flagship oil and gas company, which also has a branch office in the country.