Toward a Post-Oil Economy

by Oliver Cornock

Plotting a new course for private sector development in the Gulf states

The recent (and increasingly prolonged) downturn in oil prices has seen several perennial policy chickens return home to roost in the Gulf states. While the most pressing is undoubtedly the region's continuing dependence on oil-related income to fund current spending, the deeper issue is the longer-term failure of most Gulf states to diversify their economies and build a thriving private sector.

The figures speak for themselves. In Saudi Arabia, the Middle East's largest economy, the non-oil private sector currently accounts for about 45 percent of GDP. Yet in terms of employment, almost 80 percent of private sector jobs are taken up by non-nationals. Similarly, in Qatar only 13 percent of the national labor force works in the private sector (the remainder are all employed by the state). Only in relatively oil-poor Bahrain does the share of nationals working in the private sector exceed 50 percent.

As you might expect, these numbers are indicative of a somewhat skewed economy. Many Gulf states are still to some extent "command" economies—though capitalist, they employ top-down development plans to guide the future shape of the nation and its economic growth. These plans typically entail the state's petrodollars being funnelled into large-scale capital projects meant to diversify the economy beyond hydrocarbons. Such projects are usually labor intensive and require large numbers of workers on both a short- and long-term basis.

This constant demand for manpower to convert oil dollars into fixed capital investments means that a majority of these workers—both low- and high-skilled—are imported. As a result, the number of non-national workers in many Gulf states now far exceeds the number of nationals. Even in Saudi Arabia, around one-third of the population is foreign, with this figure rising to roughly 50 percent within the labor force.

The region's nascent private sector

This petrodollar model of development tends to produce knock-on effects throughout the economy. In particular, it leads to two distinct kinds of private sector development. On the one hand, it produces a large and fairly undynamic non-tradable sector that typically focuses on construction, an industry whose growth is heavily reliant on public sector commissioning and low-skilled foreign labor. On the other hand, it also creates a tradable sector largely run by non-nationals that is focused on servicing their needs. For these reasons, the more dynamic parts of the private sector are geared toward what are, in theory, the most transient elements of the economy.

Over time, this state of affairs has led to a degree of path dependency. A significant wage differential is already embedded between the public and private sector, with the latter effectively becoming a closed book to young nationals. Such is the outcome demonstrated in the recent Arab Youth Survey, where 70 percent of young Gulf citizens said they would prefer to work in the public sector, with 51 percent citing higher wages as the main factor needed to entice them to reconsider. Thus, despite all the money governments are investing in economic diversification, few nationals have joined the private sector.

A new kind of private sector?

Breaking down such an entrenched setup is a major challenge for the region's governments. Even policies designed to mitigate poor national workforce participation (such as *Nitaqat*, a Saudi labor nationalization scheme for the private sector) have tended to reinforce the underlying structure: private sector companies are encouraged to employ a handful of "token" nationals to meet the criterion. Yet this raises costs and lowers productivity for all companies involved. Neither does it address the underlying wage differential issue nor the skewed private sector growth model.

What is needed then is not greater private sector participation, but rather an entirely different kind of private sector based on providing jobs geared toward the needs (and the skillsets) of the emerging national workforce. For example, in Saudi Arabia there are 185,000 young people graduating from university each year, which suggests that in the long term about 45 percent of the national labor force will be university graduates. Continuing with a private sector growth model that is essentially based on converting petrodollars into cash disbursements will offer little to these young Saudis. Already, we see that 56 percent of unemployed Saudis are university graduates.

At the same time, there are some encouraging signs that attitudes are beginning to shift and a new course is being plotted. A number of Gulf states are starting to invest in incubator programs that allow young, would-be entrepreneurs to develop their own business ideas. Many of these often follow a similar pattern (mobile apps are ubiquitous), but they do at least mark an opportunity for genuine organic growth in the private sector. Both the Qatar Science and Technology Park and Flat6Labs (which has branches in Jeddah and Abu Dhabi) are examples of this trend. As are a number of business incubator programs that have emerged in Saudi Arabia in recent years.

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No one is pretending that a thriving ecosystem of small-to-medium enterprises is going to emerge in the Gulf region overnight. But such an ecosystem is a prerequisite for sustainable growth. It will also be the glue that eventually holds together the often-disparate strands of heavy capital investments that are currently being made across the region—including the billions being poured into new industrial parks, free zones, logistics hubs and financial centers. If these projects are to meet their promise of creating a diversified and sustainable post-oil economy for the region, then they will require a dynamic private sector alongside them to do so.

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