Encouraging Private Sector Growth in the GCC

by Tim Callen [1]

It's time to wean the Gulf economies off oil

The growth model followed by Gulf Cooperation Council (GCC) countries has delivered strong economic outcomes over several decades. The model is based on the extraction and exportation of oil (with oil sales making up the vast majority of both export and fiscal revenues), and the oil sector accounting for a high share of national GDP. Historically, growth in the non-oil sector has also been closely linked to oil. The government's spending of oil revenues on public sector wages on the one hand and goods and services provided by companies on the other has long been the main driver of non-oil economic growth. Yet the sharp drop in oil prices since mid-2014 has underscored the weaknesses of this economic model. Over the past two years, growth in the Gulf states has slowed noticeably as governments have reduced spending amid lower oil revenues.

Change is now needed more than ever to move away from oil-led growth and toward a sustainable employment-generating private sector. Achieving this will reduce the exposure of the GCC economies to the volatility of the global oil market, help create private sector jobs and increase productivity.

The benefits of diversification

Gulf states have long-recognized the importance of encouraging sustained private sector growth and diversification. They all have development plans that aim to move their economies in this direction. Perhaps the one that gets most attention because of the scale of its ambition is Saudi Arabia's Vision 2030 released in April 2016.

On the face of it, Gulf states already have in place many features that are favorable to private sector development. Infrastructure is generally very good, taxes are low and the populations are both young and growing. Yet the incentives facing workers and businesses have been skewed by the distribution of oil money in the economy.

To this day, nationals still largely prefer public over private sector employment or entrepreneurship. That's because significant wage and benefit gaps skew the supply of national labor toward the public sector, with the demand for private sector labor filled by expatriates. For example, in Saudi Arabia around 70 percent of nationals work in the public sector whereas expatriates hold 80 percent of private sector jobs. These preferences are amplified by working conditions including a shorter work week for government employees, as well as the perceived stability of public sector employment.

Education and skills also play a key role. Nationals are often perceived as not having the skills needed by the private sector, and the desire for public sector work in turn skews the educational choices of nationals. As for businesses, it has been

[1] The views expressed in this article are those of the author and do not necessarily represent the views of the IMF, its executive board or its management.

less risky and more profitable to use the ready supply of low-skilled and low-wage foreign labor to produce non-tradables in industries like construction.

Steps toward a robust private sector

These skewed incentives will need to be realigned before sustained and diversified private sector growth can take hold. To do so, what policies can governments pursue?

First, it is important that governments are clear about future fiscal policy. Policymakers should explicitly set out their plans in medium-term fiscal frameworks that would allow workers and businesses to make informed decisions about future employment and investment opportunities. The reality of the new oil price environment is that government spending will be lower than in the past, public employment will begin to slow and government contracts will be less easily available. All of this needs to be transparently communicated so that behavior is adjusted accordingly.

Second, labor market reforms are essential. The competitiveness of national workers in the private sector will need to increase. This will require better education and training to equip workers with the skills that are in demand by the private sector. As well, allowing more mobility for expatriate workers to move between jobs will begin to erode some of the advantages businesses see in employing expats over nationals. Companies themselves will need to do more to offer attractive working conditions—on-the-job training and a greater focus on career development will help. In addition, female participation in the workforce remains far too low in most GCC countries. Women in the region are as well educated as men and bringing more females into the workforce will help boost productivity and growth.

Finally, governments can do more to support the private sector and the tradables sector in particular. Growth payoffs are likely to come from market reforms that focus on business competition, regulations and property rights. In this context, improving the business environment and reducing trade barriers (including in the service sector) is likely to help boost competition. Ensuring that exporters have adequate access to finance, are supported with market information and are not hamstrung by too many restrictions will encourage businesses to look for markets overseas rather than just focusing at home.

Change is now needed more than ever to move away from oil-led growth and toward a sustainable employment-generating private sector.

The experience of oil-exporting countries shows that it is much easier to talk about diversification and private sector growth than to actually achieve it. Nevertheless, this should not stop Gulf states from identifying the policies that can begin to move their economies toward a new growth model that provides the jobs and incomes sought by their young and growing populations.

Tim Callen is an Assistant Director of the International Monetary Fund's Middle East and Central Asia Department.