Foreword
by Alia Moubayed

The private sector is a major stakeholder and partner in economic development—it plays a key role in creating jobs, supporting inclusive growth and providing critical services. Yet in most Gulf states, the private sector's contribution to growth and employment (despite some recent improvements) remains limited and its role in service provision almost marginal. The sharp fall in oil prices toward the end of 2014 has highlighted the private sector's over-reliance on oil windfalls. Ever since then, its growth has been severely hit by cuts to spending and the tightening of banks' liquidity. This has underscored the need to rethink the Gulf region's existing growth model and ensure private sector development is put at the center of ongoing economic diversification efforts.

Accelerating private sector development is a macroeconomic imperative for Gulf states. Unemployment remains relatively high and averages 25 percent, while youth unemployment exceeds 30 percent in some countries. The public sector employs more than 80 percent of nationals, and the rising wage bill is a major drag on public finances and increasingly a burden to sovereign balance sheets. Providing an enabling environment for private sector growth and devising policies to encourage job creation in the private sector is therefore necessary to preserve socio-economic stability and improve living conditions. Moreover, by expanding the role of the private sector in public services provisions, private investment levels should rise and the ensuing fiscal savings should then be reallocated toward growth-enhancing spending as well as strengthening safety nets. This would improve the quality of fiscal adjustments and consolidate macroeconomic stability.

To date, Gulf states have made significant progress in advancing reforms aimed at improving the business environment for private sector growth—yet these efforts remain insufficient. The Gulf states have improved their World Bank's Doing Business rankings following important institutional and regulatory reforms, including changes to contract enforcement and company insolvency frameworks. Large investments in infrastructure, as well as the continued modernization of their financial sector, has also helped to make the Gulf economies more competitive. The Gulf states are now in the upper echelons of the 2016-2017 World Economic Forum's Global Competitiveness Report, with the UAE ranked as the 16th most competitive economy out of 144 countries, followed by Qatar at 18th and Saudi Arabia at 29th. Nevertheless, businesses operating in Gulf states are still challenged by restrictive labor regulations, an inadequately educated workforce, inefficient government bureaucracy, a lack of capacity to innovate and, to some extent, a lack of access to finance.

The new wave of the Gulf region's national development strategies puts renewed emphasis on expanding the role of the private sector. These call for tackling the remaining obstacles to private sector development listed above, promoting entrepreneurship and small to medium-sized enterprises (SMEs) and transferring ownership of key public sector enterprises to the private sector. In that respect, Gulf policymakers are keen to resort to public-private partnerships (PPPs) in order to enhance the provision of services through synergies between public authorities and private companies. While the UAE has been at the forefront of these initiatives, other Gulf states are determined to catch up.

As the reform momentum gains speed, accessible finance and efficient regulation are essential to capture the opportunities offered by the region's national transformation plans. According to the World Bank, no more than three percent of bank lending in the Gulf states goes to SMEs, compared to eight percent in the wider MENA region and 18 and 22 percent respectively in middle- and high-income countries. Although support to SMEs has rapidly increased over time, this has occurred at a different pace across the region: the SME sector accounts for more than 50 percent of economic activity in the UAE and 35 percent in Saudi Arabia, but is under-represented elsewhere (28% in Bahrain and 14% in Oman). Recent initiatives—like Enterprise Qatar, Kuwait's National Fund for Small and Medium Enterprises and Saudi Arabia's Kafalah program—are helping to provide training, advisory and financial services to SMEs. Moreover, several countries have adopted national policies requiring that 10 percent of all future government tenders be awarded to SMEs—Saudi Arabia's newly-launched "local content" program goes in that direction.

On the regulatory front, the plan to expand the use of PPPs to finance large infrastructure projects will require robust, legal, governance and supervisory frameworks. This is critical because PPPs can be complex, multigenerational endeavors requiring substantial private sector commitment and close government supervision. PPP laws already exist in Dubai and Kuwait and are being modernized, but other countries like Saudi Arabia and Oman are still in the process of developing theirs.

Ultimately, however, a thriving Gulf private sector requires building local talents and skills. The Gulf states have made significant investments in the educational sector, as is evident by the increased enrollment and improvement in educational attainment over time. Nevertheless, most Gulf students (except for recent progress in the UAE and Bahrain) still lag behind international standards in mathematics, science and reading. The transition toward a knowledge-based economy and the desire to expand the manufacturing base into high value-added industries still requires major adjustments to the region's educational systems. The experiences of Malaysia and Mexico in using targeted investments to address skills shortages may be a useful case study in this regard. But until the supply of skilled national labor becomes sufficient, Gulf states will need to attract the best international talent and maintain their flexible labor and migration policies to avoid hampering the much-needed expansion of the region's private sector.

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