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**ECONOMIC DIVERSIFICATION IN THE  
OIL-PRODUCING COUNTRIES**  
**THE CASE OF THE GULF COOPERATION  
COUNCIL ECONOMIES**



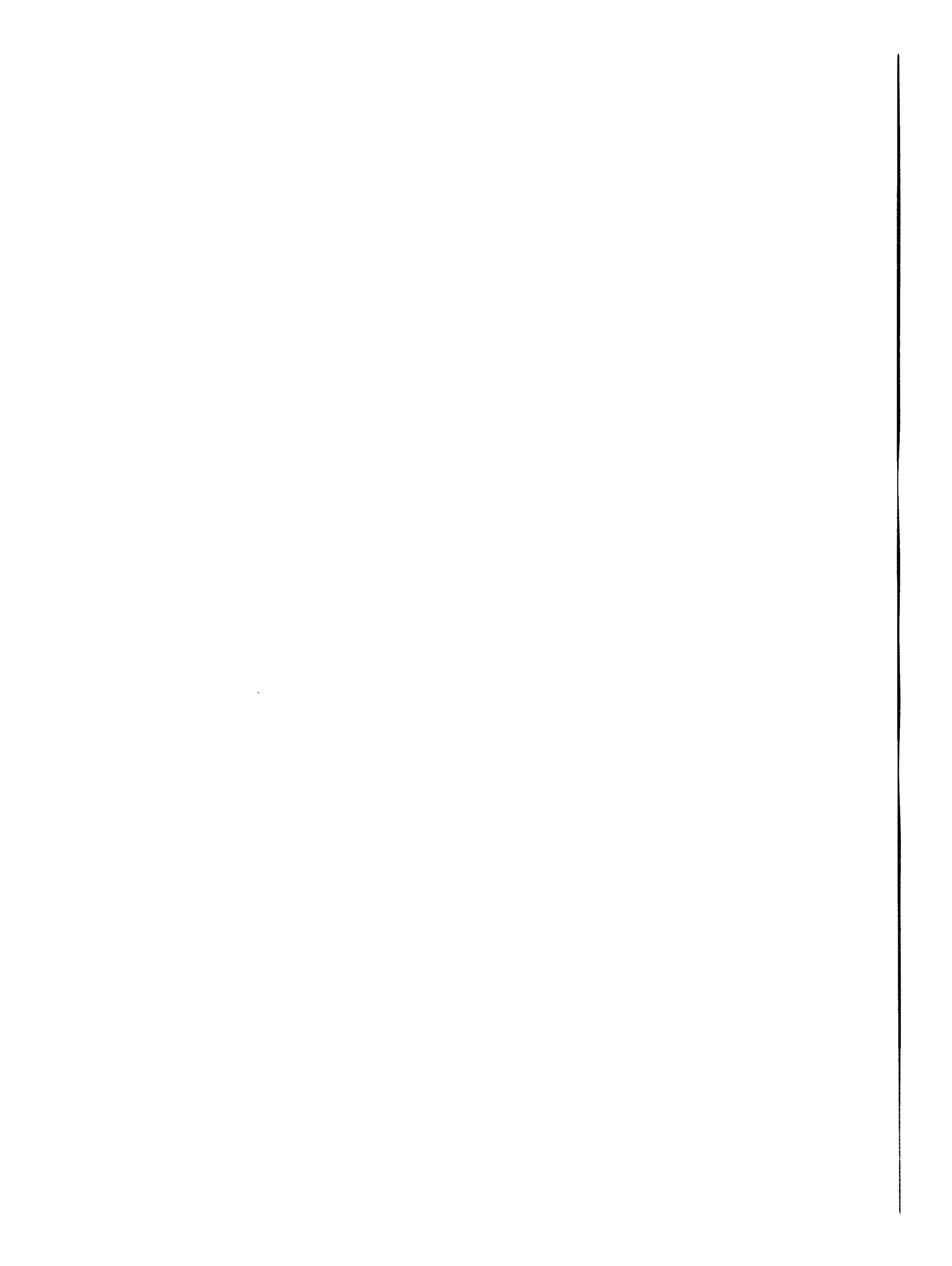
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## **Preface**

This study is part of the biennium work programme of the Economic Development Issues and Policies Division of the United Nations Economic and Social Commission for Western Asia (ESCWA) in implementation of activity No.3R22fD7O4, entitled “Economic diversification in the oil-producing countries: the case of the Gulf Cooperation Council economies”.



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## Executive summary

The purpose of this study is to assess the economic diversification efforts, plans and policies, in the Gulf Cooperation Council (GCC) countries. The assessment covers the targets, objective and overall achievements of this effort. The study also endeavours to present some policy options and recommendations for the future.

Within the context of the GCC countries, economic diversification means reducing heavy dependence on the oil sector by developing a non-oil economy, non-oil exports and non-oil revenue sources. By implication, it also means reducing the leading role of the public sector in the GCC economies by promoting the growth of the private sector.

At the time of the first oil boom in the early 1970s, the GCC countries shared a number of basic characteristics that hindered balanced economic growth. These included heavy dependence on oil production and exports, a scarcity of natural resources other than hydrocarbons, a limited domestic labour force and the initial lack of a tradition of enterprise. The oil sector accounted for more than 70 per cent of the gross domestic product (GDP) of all the GCC countries, except Bahrain, and an average of 90 per cent of exports and Government revenues.

Initially, the economic diversification process was driven by a sense of uncertainty about the duration of the first oil boom. This was accompanied by a rush to develop the physical and social infrastructure in order to provide a basis for the development of the economy outside the oil sector. Subsequent sharp fluctuations in oil prices during the 1980s and 1990s generated considerable instability in all the GCC economies and made economic diversification one of the basic priorities of economic policy. In addition to the continued expansion of the physical and social infrastructure, economic diversification in the GCC countries has come to encompass the development of heavy industry, particularly petrochemicals, and basic metals industries, as well as other manufacturing industries, agriculture and services, including financial services and, more recently, tourism. Increasing emphasis has also been placed on education and training to reduce the very large increase in the size of the expatriate labour force, which has been essential for the growth of the non-oil economy. Privatization of public utilities and other Government-owned enterprises, the reduction of domestic subsidies and the development of non-oil revenue sources have also been among major stated objectives of economic diversification plans.

During the last two decades, the GCC countries have pursued the above objectives with varying degrees of seriousness and success. There have been many impediments, however, among them the scarcity of agricultural land and water resources, the limited human resource base, the underdeveloped state of the region's capital markets and the political instability in the region, especially highlighted by the first and the second Gulf wars. The momentum of the process of economic diversification has also varied over time. Periods of rising oil prices and revenues have generally distracted GCC Governments from pursuing economic diversification, although the diversification priority sprang back in force as a prime objective during periods of falling oil prices and rising budgetary deficits.

Some of the main results and achievements of the economic diversification efforts have included the establishment of successful petrochemical, chemical fertilizer and basic metal industries; the creation of a wide base of manufacturing industries; the development of agricultural resources (albeit at heavy cost in terms of agricultural subsidies); the growth of the services sector, including financial services and offshore banks, as well as tourism. Some progress also has been made in the privatization of public sector enterprises and utilities. In recent years, there has also been an increasing trend to relax and remove restrictions on foreign investment in a bid to encourage such investments in diversification projects and to expand local financial markets.

Notwithstanding the achievements of the last three decades, there is still more to be done if the GCC countries are to break away from their heavy dependence on oil and limit the impact of future oil price fluctuations on their economies.

The immediate challenge is to maintain the momentum of economic diversification policies and programmes, in spite of the sharp rise in oil prices since 1999. Policy priorities for the future include:

(a) Speeding up privatization programmes, including the full or partial privatization of public utilities and some large Government-owned industrial and other enterprises;

(b) Developing financial markets in all the GCC countries on the basis of a legal and regulatory framework that opens up those markets to foreign investors and ensures transparency and adequate legal safeguards;

(c) Continuing the reduction of domestic subsidies on the basis of a timetable, taking into account social and political opposition to the removal of some of these subsidies;

(d) Reassessing the industrialization policies to ensure the growth of fully viable and competitive industries to meet the challenges of globalization and free trade. This process should be aligned with a serious pursuit of coordination of industrialization policies and projects among the GCC countries;

(e) Concentration on market-oriented education and training programmes to speed up the process of replacing expatriate labour with GCC nationals and create national labour capabilities adaptable to the requirements of the GCC labour markets.

Despite various shortcomings, the economic diversification policies since the 1970s produced a significant impact on the structure of the GCC economies. The direct relative contribution of the oil sector to GDP has declined, non-oil exports have grown significantly and the proportion of Government revenues from non-oil sources has generally increased.

The main challenges for the future are to maintain the momentum of the economic diversification policies in spite of the rise in non-oil revenues (since 1999), to speed up the privatization programmes and to open up the GCC economies to foreign investment. This is the way to reduce and eventually eliminate domestic subsidies, especially those enjoyed by business, to foster the growth of more competitive economies and continue to develop non-oil revenue sources.



## INTRODUCTION

“Economic diversification” has been the by-word and catch phrase of economic policy in the Gulf countries ever since the first oil boom in the 1970s. It was initially dictated by worries about the limited life of the oil and gas reserves that had brought the Gulf countries sudden wealth and by the awakened need to develop and diversify the traditional economies that lay beyond the rapidly growing hydrocarbon sector. In the last two decades, this policy has been pursued as a strategic objective to overcome the economic instability inherent in the heavy dependence on oil exports and to cater to the rapid growth of the native Gulf populations and labour force.

Within the context of the Gulf economies, therefore, economic diversification basically means development of the non-oil sectors and the reduction of the proportion of Government revenues and export proceeds from oil and gas. By implication, however, it also means reducing the role of the public sector in the Gulf economies, an objective which is central to the ongoing efforts to restructure and liberalize those economies.

The question arises as to whether and to what extent the Gulf countries have succeeded so far in achieving economic diversification. Some sceptics describe economic diversification in the Gulf as a myth, as illustrated by the recent impact of the sharp drop in oil prices during 1997-1998 on the economies of the region. By other measures, however, it can be argued that the process has made significant strides. This is indicated by the growth of the non-oil economy, the decreasing size of the public sector, the gradual reduction of domestic subsidies and the equally gradual development of non-oil revenue sources.

The purpose of this study is to assess the process of economic diversification in the Gulf countries in terms of its targeted objectives, its overall achievements and the prospects and challenges for the future.

The first part of the study will take a close look at the meaning and significance of economic diversification in the Gulf economies in terms of the following:

- (a) The basic characteristics of the Gulf economies, mainly the sectoral distribution of production and employment, the public revenue and budgetary situation and the external accounts;
- (b) The historical impact of oil price fluctuations on the above economic aggregates and the resultant economic instability.

The second part reviews the evolution of economic diversification policies and the success of those policies in terms of their microeconomic and macroeconomic impact on the Gulf economies to date.

The third and final part of the study will attempt to draw lessons from the experience of the Gulf countries in economic diversification, the policies followed and their results, and will also address future challenges and policy options in this regard.

## I. THE MEANING AND MEASUREMENT OF ECONOMIC DIVERSIFICATION IN THE GULF COOPERATION COUNCIL COUNTRIES

### A. IMPORTANCE OF ECONOMIC DIVERSIFICATION IN THE CONTEXT OF THE GCC ECONOMIES

In 1981, six countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates—formed the Cooperation Council for the Arab States of the Gulf, better known as the Gulf Cooperation Council (GCC), on the basis of a perceived identity of shared interests and common social, cultural, political and economic characteristics.

Historically, the common economic characteristics of the region have been considered as limiting to balanced long-term economic growth. They include:

(a) Heavy dependence on the exports of crude oil and other hydrocarbon products for export receipts and Government revenue;

(b) A relatively small private sector and a tradition of strong public sector ownership of the means of production and as a main driving force in the domestic economy. This situation arose directly from the dependence of the Gulf countries on oil revenues, coupled with Government ownership of all hydrocarbon resources;

(c) The limited availability of natural resources other than hydrocarbons. Agricultural resources are very minimal, or virtually non-existent in commercial terms in Kuwait, Qatar and the United Arab Emirates. Mineral resources are also limited and the natural water supply is scarce;

(d) A very low degree of self-sufficiency in most requirements except hydrocarbons;

(e) A limited domestic labour force in most countries and its low involvement in most basic production activities because of cultural and social mores and constraints. Initially, illiteracy rates in the region were high and the domestic labour force was poorly trained, although substantial investment in education and training during the last two decades has helped alleviate this problem to varying degrees in the different countries involved;

(f) The initial lack of a tradition of enterprise and strong work ethic in what were primarily bedouin or subsistence societies.

In the mid-1970s, the oil sector accounted for an estimated average of 65 to 70 per cent of the gross domestic product (GDP) of the GCC countries (except Bahrain, whose oil resources are very limited). This ratio had not changed significantly by 1980, when it averaged nearly 61 per cent. The ratio of oil exports to GDP at that time averaged around 75 per cent, while oil exports accounted for an average of more than 100 per cent of total exports, with the ratio rising to 95 per cent in Qatar and nearly 99 per cent in Saudi Arabia. Oil revenues in 1980 also accounted for the bulk of Government revenues, with the proportion averaging nearly 90 per cent for all six GCC countries and ranging between a low of 77 per cent in Bahrain and a high of 96 per cent in the United Arab Emirates (see table 1).

At the time of the first oil boom in 1973-1974, the traditional economy outside the hydrocarbon sector was severely constrained in all the GCC countries by the scarcity of productive resources, the near absence of qualified manpower, high illiteracy rates and small market size. Accordingly, the high rates of growth in GDP during this early period and the sharp rise in GDP per capita misrepresented the actual situation of the majority of the native population. This is particularly so, given that the limitations on the domestic labour supply had to be overcome by the importation of large numbers of expatriate workers to undertake skilled and semi-skilled jobs in both the public and private sectors, to staff the Government bureaucracy and to assume most managerial jobs.

TABLE I. CONTRIBUTION OF OIL TO GDP, EXPORTS AND GOVERNMENT REVENUES  
IN THE GCC COUNTRIES IN 1980  
(Percentage)

Country	Contribution of the oil sector to GDP	Ratio of oil exports to total exports	Ratio of oil exports to GDP	Ratio of oil revenues to total Government revenues
Bahrain	28.0	33.6	85.0	77.0
Kuwait	59.7	90.0	74.7	82.0
Oman	59.3	92.4	57.7	86.0
Qatar	64.0	95.0	77.4	94.0
Saudi Arabia	65.8	99.9	87.8	91.2
United Arab Emirates	57.9	94.0	65.7	96.0

Sources: International Monetary Fund (IMF), *International Financial Statistics Yearbook*, 1999; ESCWA, *Statistical Abstract of the ESCWA Region*, various issues and country sources.

Because of these initial conditions, savings generated in the non-oil domestic economies of the region played a minor role in generating funds for investment. Such savings that did occur were mainly transferred from oil revenues through the Gulf Governments and accrued in such amounts that the capital available for investment exceeded physical and economic possibilities for investment, at least in the early years. This created a problem of absorptive capacity being limited by non-financial factors.

The sudden wealth that was generated by the first oil boom was in itself the first incentive for economic diversification, as Gulf Governments became increasingly aware of the finite nature of their oil resources and worried about a possible reversal of fortunes if and when the oil boom ended.

A World Bank working paper in 1981 considered a hypothetical case where oil reserves would be everlasting and argued that economic diversification would be pointless in that case and that the objective of Governments in such a situation would simply be to institute mechanisms for "an effective and continuous 'trickle down' of oil revenues to the totality of their populations."<sup>1</sup> Alternatively, and given that oil resources were not everlasting, economic diversification was defined to mean "the creation of a viable modern economy outside of oil that will sustain a relatively high income level after the end of the oil era."<sup>2</sup>

But even from the beginning, and especially starting in the mid-1980s when sharp oil price fluctuations became a relatively frequent occurrence, economic diversification had acquired an important purpose: namely, to reduce the dependence on oil long before oil resources run out, in order to limit the effect of oil price fluctuations on export proceeds, current accounts, Government revenues and ultimately on total income and employment.

Total crude oil production by the GCC countries rose from 7.9 million barrels per day (b/d) in 1970 to 14.07 million b/d in 1980, or by more than 77 per cent. Saudi production in 1980 reached an all-time average annual peak of 9.9 million b/d, while the United Arab Emirates oil output grew 150 per cent between 1970 and 1980, or nearly twice the rate of increase of the total production of other GCC countries. In parallel with this increase in crude production, the average crude basket price of the Organization of Petroleum Exporting Countries (OPEC) rose from an annual average of US\$ 2.04 per barrel (/b) in 1971 to US\$ 28.67/b in 1980, or by more than fourteen times, and then climbed further to an average of US\$ 32.5/b in 1981 under the impact of the Iran-Iraq war, which began in the second half of 1980 and resulted in a sharp drop in oil production in those two countries. The combined result of these developments was a massive growth in the total exports of the GCC countries from US\$5.2 billion in 1970 to US\$ 157.8 billion in 1980. As the bulk of these exports consisted of crude oil, the GCC countries during the 1970s found themselves enjoying an increasing and unprecedented windfall from their oil resources. A good part of this windfall was

<sup>1</sup> Rudolf Hablutzel, *Development Prospects of the Capita-Surplus Oil-exporting Countries*, World Bank Staff Working Paper, No. 483 (August 1981).

<sup>2</sup> Ibid.

in the nature of economic rent, given the strong role played by OPEC in controlling the market during this period (see tables 2, 3 and 4).

TABLE 2. CRUDE OIL PRODUCTION IN THE GCC COUNTRIES, 1970-1999  
(Thousand b/d)

Year	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates	GCC total
1970	77	2 737	250	356	3 800	682	7 902
1971	74	3 197	285	430	4 770	934	9 690
1972	70	3 040	290	466	6 033	1 000	10 899
1973	68	3 020	293	570	7 596	1 548	13 095
1974	67	2 546	291	518	8 480	1 678	13 580
1975	61	2 084	340	438	7 075	1 695	11 693
1976	58	2 145	366	497	8 577	1 942	13 585
1977	58	1 969	342	445	9 200	2 014	14 028
1978	55	2 131	314	487	8 301	1 831	13 119
1979	51	2 500	295	508	9 532	1 831	14 717
1980	48	1 664	283	471	9 900	1 704	14 070
1981	46	1 130	318	415	9 808	1 503	13 220
1982	44	824	325	332	6 483	1 249	9 257
1983	42	1 054	389	269	4 999	1 149	7 902
1984	42	1 163	417	375	4 576	1 069	7 642
1985	42	1 017	419	300	3 385	1 203	6 366
1986	44	1 416	558	323	5 042	1 370	8 753
1987	42	1 315	572	298	4 205	1 485	7 917
1988	42	1 410	598	327	5 180	1 565	9 122
1989	43	1 815	639	396	5 158	1 936	9 987
1990	42	1 161	660	396	6 410	2 120	10 789
1991	42	65	700	390	8 227	2 410	11 834
1992	41	1 048	741	400	8 405	2 290	12 925
1993	40	1 868	775	420	8 140	2 170	13 413
1994	40	2 035	812	405	8 185	2 200	13 677
1995	50	2 052	864	449	8 150	2 190	13 810
1996	50	2 050	890	490	8 150	2 230	13 860
1997	50	2 105	910	620	8 345	2 250	14 280
1998	50	2 080	900	670	8 370	2 290	14 360
1999	50	1 830	890	630	7 790	2 060	13 250

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, various issues.

TABLE 3. DEVELOPMENT OF THE AVERAGE PRICE OF THE OPEC CRUDE OIL BASKET, 1970-1999

Year	Price (US\$/barrel)	Year	Price (US\$/barrel)	Year	Price (US\$/barrel)
1971	2.04	1981	32.50	1991	18.62
1972	2.30	1982	32.38	1992	18.44
1973	3.07	1983	29.04	1993	16.33
1974	10.77	1984	28.20	1994	15.53
1975	10.73	1985	27.01	1995	16.86
1976	11.51	1986	13.53	1996	20.29
1977	12.40	1987	17.73	1997	18.68
1978	12.70	1988	14.24	1998	12.28
1979	17.28	1989	17.31	1999	17.47
1980	28.67	1990	22.26	..	..

Source: ESCWA, *Survey of Economic and Social Developments in the ESCWA Region, 1997-1998 and 1999-2000* (E/ESCWA/ED/1998/5 and E/ESCWA/ED/2000/2, respectively).

Note: Two dots (..) indicate that data are not available.

TABLE 4. TOTAL EXPORTS OF GCC COUNTRIES, 1970-1999  
(Millions of US dollars)

Year	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates	GCC total
1970	218	1 654	143	240	2 371	523	5 149
1971	269	2 219	154	315	3 849	871	7 677
1972	347	2 531	167	397	4 772	1 157	9 391
1973	479	3 816	239	628	7 802	1 807	14 771
1974	1 272	10 962	1 134	2 015	35 554	6 414	57 351
1975	1 107	9 184	1 044	1 805	29 682	7 262	50 084
1976	1 320	9 846	1 134	2 211	38 286	9 535	62 332
1977	1 845	9 754	1 140	1 999	43 463	9 636	67 837
1978	1 893	10 427	1 096	2 391	40 664	9 126	65 597
1979	2 488	18 404	1 570	3 789	63 431	13 652	103 334
1980	3 606	19 663	2 386	5 672	109 084	20 676	157 841
1981	4 347	16 044	3 203	5 691	119 876	21 238	170 398
1982	3 789	10 864	2 555	4 343	79 077	16 837	117 465
1983	3 119	11 504	4 222	3 345	45 861	14 672	82 723
1984	3 204	11 623	3 926	4 285	37 545	14 192	74 775
1985	2 897	10 487	4 705	4 203	27 481	14 043	63 816
1986	2 199	4 383	2 321	2 719	20 185	12 387	44 194
1987	2 430	8 264	3 198	3 670	23 199	14 165	54 926
1988	2 411	7 661	2 625	2 210	24 377	13 934	53 218
1989	2 831	11 476	4 068	2 738	28 382	17 596	67 091
1990	3 761	7 042	5 508	3 890	44 417	23 544	88 162
1991	3 511	1 088	4 874	3 209	47 797	24 436	84 915
1992	3 464	6 660	5 553	3 841	50 286	24 756	94 560
1993	3 723	10 248	5 370	3 245	42 395	26 666	91 647
1994	3 617	11 614	5 545	2 981	42 614	27 385	93 756
1995	4 113	12 931	5 962	3 557	50 040	29 335	105 938
1996	4 700	14 858	7 339	3 832	60 729	33 184	124 642
1997	4 384	13 946	7 630	3 856	62 382	34 012	126 210
1998	3 269	9 529	..	5 030	..	..	..
1999	4 088	3 711	..	..	..	..	..

Sources: ESCWA, *Statistical Abstract of the ESCWA Region*, various issues; IMF, *International Financial Statistics Yearbook, 1999*.

Note: Two dots (..) indicate that data are not available.

Beginning in 1982, however, the production cutbacks agreed upon by OPEC member countries to counter increased crude production by non-OPEC countries and maintain the upward momentum on oil prices reduced the total value of GCC exports by 31 per cent, to US\$ 117.5 billion. By 1986, the OPEC crude basket price was 58 per cent lower than the 1981 average, with the result that total exports of the GCC countries dropped to about US\$ 44 billion, or about only 26 per cent of their peak level five years earlier.

Total oil revenues of GCC members rose rapidly, from around US\$ 51 billion in 1974, to US\$ 150 billion in 1980 and to a peak of nearly US\$ 158 billion in 1981, thus averaging US\$ 85.5 billion a year during this eight-year period. Between 1982 and 1986, however, total oil revenues dropped again and by a massive 75 per cent to return in 1986 to a level lower than that of 1974, by 25 per cent in nominal terms and even less than that in real terms (see table 5).

The effects of these developments on fiscal and monetary policies in the region were far reaching indeed. The rise in oil revenues during the 1970s was accompanied by an equally large increase in Government spending. This, together with severe economic bottlenecks, resulted in sharp increases in domestic liquidity in all the GCC countries and fuelled inflationary pressures. During the period 1975-1979, the inflation rates in those countries (excluding Oman, for which data are not available) averaged about 10

per cent annually and reached an average annual rate of 15.6 per cent in Saudi Arabia and 15 per cent in Bahrain. Monetary policy instruments were still rudimentary and the effective pegging of GCC currencies to the United States dollar limited the possible scope and effectiveness of these policies even further. But to the extent that inflationary pressures were fuelled by Government spending, they were also indirectly a function of oil prices. The downturn in those prices in the 1980s worked also to reduce the average annual rate of inflation to 3.7 per cent during the period 1980-1984 and to less than 1 per cent during the period 1985-1989.

TABLE 5. OIL REVENUES IN THE GCC COUNTRIES, 1974-1998  
(Billions of US dollars)

Year	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates	GCC total
1974	0.99	10.03	0.82	1.98	31.06	6.33	51.21
1975	0.90	8.06	1.04	1.75	27.62	6.81	46.18
1976	1.17	8.95	1.13	2.14	36.08	8.38	57.85
1977	1.45	8.82	1.13	2.05	41.11	9.26	63.82
1978	1.51	9.42	1.09	2.31	37.75	8.66	60.74
1979	2.03	16.67	1.56	3.55	57.15	12.86	93.82
1980	3.20	18.40	2.37	5.40	101.40	19.50	150.27
1981	3.90	14.20	4.40	5.50	111.50	18.30	157.80
1982	3.10	9.10	4.10	4.20	73.30	14.50	108.30
1983	2.60	10.10	4.20	3.00	44.80	11.40	76.10
1984	2.70	11.00	3.90	4.20	36.30	12.40	70.50
1985	2.40	9.70	4.70	3.20	27.50	12.50	60.00
1986	1.80	6.00	2.50	1.00	20.00	7.00	38.30
1987	1.80	6.90	3.50	1.90	22.70	8.80	45.60
1988	1.50	6.20	3.10	1.60	21.10	7.10	40.60
1989	0.27	9.31	3.66	1.95	24.09	11.50	50.77
1990	0.80	5.56	3.99	2.80	40.13	15.69	68.97
1991	0.79	0.43	3.16	2.38	43.31	14.67	64.74
1992	0.90	6.22	3.30	3.20	47.56	14.49	75.67
1993	0.80	9.99	4.50	2.59	41.35	12.09	71.32
1994	0.76	9.24	4.23	2.16	39.20	11.79	67.38
1995	1.10	11.80	4.75	2.60	42.70	13.35	76.30
1996	1.32	14.13	5.88	3.80	50.05	14.98	90.16
1997	1.20	13.47	5.78	4.66	48.22	15.27	88.60
1998	0.80	8.39	3.71	3.11	31.98	10.26	58.25
1999 <sup>a/</sup>	1.16	10.50	5.22	4.16	42.34	13.13	76.51

Source: ESCWA, *Survey of Economic and Social Developments in the ESCWA Region*, various issues.

<sup>a/</sup> Estimates.

Government budgets followed the same pattern. The boom conditions of the 1970s and early 1980s allowed GCC Governments to increase spending to unprecedented levels while at the same time achieve budget surpluses in most cases and accumulate foreign financial reserves. But as oil prices dropped after 1981, budgetary commitments and the absence of other major sources of revenue led to rising deficits and a gradual depletion of those surpluses.

Overall, the instability of oil revenues had a substantial impact on the growth rates of the GCC countries, especially through its effect on Government spending. Available real GDP data going back to 1976 show that the GCC countries recorded fairly high growth rates during the period 1976-1980. After that, during the period 1981-1986, average real GDP actually contracted and steady meaningful growth was not achieved again until 1988 (see table 6).

TABLE 6. REAL GDP GROWTH RATES IN THE GCC COUNTRIES, 1970-1999  
(Percentage)

Year	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
1970	..	..	3.3	..	15.3	..
1971	..	18.9	1.0	..	32.0	..
1972	..	3.9	9.2	..	19.7	..
1973	..	(6.5)	(14.0)	..	15.1	..
1974	..	(12.8)	28.2	..	0.3	14.5
1975	..	(12.1)	28.6	..	8.6	6.2
1976	23.73	6.60	15.97	22.58	15.11	15.56
1977	14.70	(2.45)	17.64	(6.63)	5.95	17.40
1978	8.12	7.24	17.65	8.77	6.96	(2.32)
1979	(1.12)	13.72	4.60	7.05	10.11	24.80
1980	6.57	(20.37)	5.72	(6.79)	7.92	26.53
1981	(6.65)	(18.92)	17.04	(5.32)	1.65	2.84
1982	(7.51)	(11.75)	11.55	(9.35)	(10.75)	(8.29)
1983	8.48	7.92	15.96	(5.48)	(0.12)	(2.66)
1984	3.81	5.25	16.74	5.81	(2.21)	4.46
1985	(2.76)	(4.26)	13.76	(3.76)	(4.05)	(2.44)
1986	1.18	8.57	2.14	2.30	5.56	(21.25)
1987	1.91	8.14	(3.99)	1.23	(1.38)	3.63
1988	9.02	(10.05)	5.25	3.97	7.56	(0.22)
1989	2.43	25.90	2.98	3.81	0.18	15.24
1990	4.63	(35.07)	8.38	2.11	10.66	17.51
1991	10.40	(38.88)	6.04	(1.06)	8.39	0.81
1992	7.79	87.27	8.50	10.33	2.79	2.73
1993	8.60	34.23	6.14	0.60	0.60	(0.90)
1994	1.40	8.41	3.85	1.00	0.51	2.20
1995	3.40	1.03	4.83	0.80	0.47	6.10
1996	2.90	2.80	3.53	4.60	1.39	9.50
1997	3.10	2.20	3.60	15.50	1.91	3.00
1998	2.21	1.00	2.50	4.40	(0.60)	(1.00)
1999	1.00	0.70	3.00	6.00	1.5	1.3

Sources: 1970-1975: IMF, *International Financial Statistics Yearbook*, various issues; 1976-1999: ESCWA, *Survey of Economic and Social Developments in the ESCWA Region*, various issues.

Notes: Two dots (..) indicate that data are not available; ( ) indicates negative growth.

During the first oil boom years, the GCC countries allocated a large proportion of Government expenditures to the development of the physical and social infrastructure which had been until then primitive or rudimentary, at best. The programmes and projects that were undertaken in this respect were quite ambitious, by any measure, and included the development of the transportation network, housing facilities, water, electricity, schools and hospitals. A smaller proportion of investment went to projects in the main productive sectors and to the heavy industries that were launched at that time.

This initial effort was driven to a large degree by a sense of uncertainty and anxiety about the duration of the oil bonanza, and it is to the credit of the Gulf Governments that they moved quickly to take advantage of this bonanza to try to establish the basis of a modern economy. What happened has been described, in fact, as “an experiment in national economic management that is unique in modern history” in that it consisted of “pushing the investment/GDP ratio in the non-oil economy beyond all historical records and precedents, and of testing the achievable speed at which economically backward traditional societies—with a predominant pastoralist and/or agricultural sector, very low literacy rates, and little or no manufacturing

other than handicrafts—could be modernized by implanting the basis for a fully operational and economically viable economy in the style of the advanced countries of the world.”<sup>3</sup>

By the late 1970s, with the then prevailing oil prices, Government expenditures in the region had reached levels that created the prospect of the emergence of budgetary deficits. This prospect was pushed to the background by the sharp rise in oil prices during the period 1980-1982, but even before that and especially by the mid-1980s, the rationale and urgency of economic diversification had become more clear to GCC Governments and policy makers.

The working paper on Gulf economic cooperation presented at the first summit of GCC heads of State in May 1981 stressed, among other objectives, the need for comprehensive development that depends, on the one hand, on building the basic infrastructure and a stable productive base, and on the other hand, on human development and training. Subsequently, the GCC Unified Economic Agreement called for the coordination of economic policies, especially those related to industry, in order to achieve a diversification of productive bases on an integrated scale. Saudi development plans, even from the mid-1970s, gave strategic emphasis to measures to accelerate the process of economic diversification towards a developed economy. The Kingdom's industrial development policy stressed the need to encourage and expand manufacturing industries, including agricultural industries, which can contribute to an increase in national income, raise standards of living and employment and diversify the economy. In Kuwait also, the development of the manufacturing industry was emphasized in various policy statements as the basis for balanced sustainable growth that would reduce the impact of oil revenue fluctuations on the Kuwait economy and allow the transfer of technology and the development of human resources. In the other GCC countries, economic policy pronouncements gave increasing emphasis to economic diversification or balanced growth or reducing dependence on oil as strategic and primary objectives.

In summary, it can be said that within the limitations that characterize the GCC countries, economic diversification has been proclaimed and pursued as an objective that broadly implies the modernization and development of the non-oil sectors in those countries, in order to reduce the proportional contribution of oil to GDP and the impact of fluctuations in oil revenues on total Government revenues and budgets, exports and the external position. From this, and in the light of policy pronouncements and action since 1970, the scope of economic diversification has come to encompass the following:

- (a) The development of the physical and social infrastructure as an essential base for the growth of the non-oil economy;
- (b) The development of capital-intensive industries that utilize the region's comparative advantage in hydrocarbon resources;
- (c) The development of other manufacturing industries;
- (d) The development of other productive sectors and services, including agriculture, trade, banking and, lately, tourism;
- (e) Reducing the direct role of the public sector as an agent of economic growth by privatizing public-owned companies and utilities and reducing domestic subsidies. Public ownership of hydrocarbon resources, however, remains sacrosanct.

Closely related to the above objectives was the emphasis given to the education, training and development of the domestic labour force, particularly in view of the fast rate of growth of the expatriate population and the fears that arose about the negative implications of this heavy dependence on foreign labour. In recent years, increasing emphasis has also been placed on encouraging foreign direct investment (FDI) and developing capital markets in the region as a means of expanding private investment.

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<sup>3</sup> Ibid.



As will be discussed in greater detail below, the GCC countries have pursued the above objectives with varying degrees of seriousness and success during the last two decades. The experience of this period has shown that there are, in fact, many limitations to economic diversification in the region. Some have to do with the natural resource base, while others are the outcome of the socio-political structure of the GCC countries and the nature of policy-making in those countries. Generally, it must be said that these limitations have restricted the success of the GCC member countries so far in adjusting to swings in real incomes resulting from oil price volatility by modifying Government consumption and investment spending to reflect oil price fluctuations.

Concern about the lifetime of oil resources may have provided the early impetus for economic diversification plans, but the repeated upgrading of the size of the region's hydrocarbon reserves since then and the very abundance of those reserves have proven a mixed blessing for economic diversification. Oil and gas exports provided the investment funds necessary for the development of the infrastructure and the various productive sectors of the economy, but the instability of oil revenues also limited the speed of the diversification process and the seriousness with which it has been pursued so far. During periods of weak oil prices, concern about budgetary deficits and the fact that current expenditures were inflexible downwards (mainly because of the public sector wage bill and domestic subsidies) meant that development expenditures took the brunt of budgetary cutbacks, even as the drop in oil revenues made economic diversification a more vital goal. Alternatively, periods of rising oil prices and revenues in many instances distracted Gulf Governments and policy makers from the urgency of reducing dependence on oil. According to a number of observers, therefore, the desire for reform has been inversely proportional to the price of oil.

Other basic limitations to the speed and success of economic diversification in the GCC countries so far include the following:

(a) The scarcity of agricultural and natural water resources. Poor soil, harsh climatic conditions and the high cost of desalinated water have severely constrained the scope of agricultural development in most GCC countries;

(b) The lack of an indigenous technological base and of technical and managerial cadres. This has necessitated dependence on foreign technical know-how and personnel at great cost to industrial ventures in some cases;

(c) The comparative advantage, mainly in hydrocarbon-related heavy industries (such as petrochemicals and fertilizers) and the energy-intensive industries that are subject to price cycles;

(d) Limited coordination among the different GCC countries in development planning, notwithstanding the ideals expressed in the Unified Economic Agreement. This has led to unnecessary competition in diversification ventures, especially those relating to industrialization and the development of services (banking and financial services, free zones, and others), restricting the size of potential markets for those ventures and limiting their overall benefits;

(e) The general scarcity of national human resources and the social, political and economic limitations on the import of expatriate labour;

(f) The underdeveloped state of the region's capital markets, which restricted their role and potential in funding private and public sector diversification projects;

(g) Restrictions on foreign investment and the lack of legal safeguards for such investment;

(h) The political instability of the Gulf region during the last two decades or more, which was in itself a major factor that held back the process of economic diversification in the region. The Iran/Iraq war of 1980-1988 and the Gulf war in 1990 forced Gulf Governments to divert a huge amount of funds to war efforts. Real or perceived threats to the security of the region have also necessitated large defence budgets that could have otherwise been allocated to economic development projects.

Since 1999, nearly three decades after the first oil boom, oil prices have been on a major up-trend and in September 2000 reached their highest level since the Gulf War. The GCC countries, in common with other oil producers, have enjoyed a new windfall from this most recent rise in prices, which only a few years ago seemed inconceivable to most oil market analysts. Yet, while the recent situation in the oil market has helped boost the GCC economies, there is a real risk that it will encourage policy makers in the region to give less attention to economic diversification priorities, which should continue to be the basic long-term objective.

## B. MEASURES OF ECONOMIC DIVERSIFICATION

The following indicators and measures may be used to assess the success and progress of the diversification policies. Owing to the limited data availability, only some of these indicators (as shown in chapter III) can be applied in the case of the GCC member countries:

(a) The rate and degree of structural change, as indicated by the per cent contribution of the oil versus non-oil sectors to GDP and the growth and/or decline of the contribution of those sectors over time. The change is assessed on the basis of initial conditions and thus varies between the different GCC countries. Where data availability permits, it is also useful to measure real rates of growth of GDP by sector;

(b) The degree of instability of GDP and its relation to oil price instability. It is understood that diversification should reduce this instability over time;

(c) The evolution of oil and gas revenues as a proportion of total Government revenues, since one of the objectives of diversification in the GCC countries is to reduce dependence on oil revenues. Another useful indicator here is the rate at which the non-oil revenue base widens over time, as this indicates success in the development of new non-oil revenue sources;

(d) The proportion of non-oil exports to total exports and the composition of non-oil exports. Generally, a steady rise in non-oil exports is indicative of increasing economic diversification. Short-term changes in this measure may be misleading, however, as they could be due to fluctuations in oil prices and exports;

(e) The change of total employment by sector. Obviously this measure should reflect and reinforce changes in the sector composition of GDP;

(f) The change in the relative contribution of the public and private sectors to GDP. This is an important indicator in the GCC countries, since economic diversification in those countries implies or presupposes a growth in the contribution of the private sector to aggregate economic activity;

(g) Pursuant to the above, it is also important to look at the relative contribution of the public and private sectors to gross fixed capital accumulation and rates of change in this by sector;

(h) Distribution of ownership of assets between the public and private sectors. Where data availability allows, this indicator can be used to assess the degree of success of privatization programmes and to test and reinforce the validity of other measures that show changes in the contribution of the public and private sectors to GDP, employment and gross fixed capital formation;

(i) Productivity measures. These measures can be applied especially to various activities in the private sector to assess its rate of development and modernization, but they are difficult to use in the GCC member countries because of data limitations.

## II. ECONOMIC DIVERSIFICATION POLICIES IN THE GCC COUNTRIES SINCE 1970

### A. DEVELOPMENT OF AGRICULTURE

The limited area of arable land, the scarce natural water supply and the harsh climatic conditions in the GCC countries have severely constrained agricultural development options and potential.

With the exception of Oman, surface water supplies in the GCC countries are very limited relative to demand. To supplement these supplies, all countries in the region have resorted to the mining of underground water aquifers and the desalination of sea and brackish water.

Underground water resources have been used increasingly to meet irrigation requirements, as well as to fill domestic needs. A 1999 study on water resources in the ESCWA region, using 1997 data, showed that underground water reserves had been exploited in "great excess of their renewability", so much so that the ratio of underground water recharging to its use for the GCC region as a whole averaged around 29 per cent only.<sup>4</sup> Desalinated water provided a mere 9 per cent of total GCC water consumption at that time, even though desalination capacity in the GCC countries accounted for 56 per cent of total world capacity in 1997 and 72 per cent of capacity in the Arab world. Groundwater resources, on the other hand, made up nearly 84 per cent of total water consumption. With desalinated water accounting for nearly 70 per cent of domestic water requirements, this meant that the bulk of water supplies for agriculture was being met in 1997 from unsustainable groundwater resources (see table 7).

TABLE 7. STATUS OF WATER RESOURCES IN THE GCC COUNTRIES, 1997  
(Million cubic metres)

Country	Surface water	Groundwater use	Groundwater recharging	Desalination	Treated waste-water	Total water use
Bahrain	0.2	218	100	75.0	17.5	310.0
Kuwait	0.1	405	160	388.0	30.0	701.0
Oman	918.0	645	550	47.3	21.5	1 235.0
Qatar	1.4	190	50	98.6	25.0	298.0
Saudi Arabia	2 230.0	14 430	3 850	795.0	131.0	16 300
United Arab Emirates	185.0	900	130	405.0	108.0	1 223.0
GCC Total	3 334.7	16 788	4 840	1 808.9	333.0	20 067.0

Source: Mohamad Abdurazzak, "Status of water use development and management in the ESCWA region", from *Proceedings of the Expert Group Meeting on Assessment of Economic and Social Developments in the ESCWA Region during the Last 25 Years and Priorities for the Next Decade, 2000-2009* (E/ESCWA/ED/1999/22).

The ratio of water utilization to surface water and the rate of groundwater recharge are known as the Water Use Sustainability Indicator. This ratio is used as a measure of water sufficiency. As Abdurazzak points out, when the ratio exceeds 40 per cent, it is understood to indicate water scarcity requiring the immediate implementation of intensive water management strategies. In the GCC countries, this ratio was an average of 245 per cent in 1997 and reached 388 per cent in the United Arab Emirates, 439 per cent in Kuwait and 580 per cent in Qatar.<sup>5</sup>

Projections of the ratio for the year 2000 and then 2025, which take into account population growth and the impact of economic development, paint a grim picture of increasing water scarcity in the GCC region, as shown in table 8. The increasing scarcity projected in other water resources means that desalination will provide a rising proportion of total water consumption in the region in the future, keeping in

<sup>4</sup> Mohammad Abdurazzak, "Status of water resources development and management in the ESCWA region", p. 147 (see source to table 7).

<sup>5</sup> Ibid.

mind that already in 1997 desalinated water covered 55 per cent of total water consumption in Kuwait and 33 per cent in Qatar and the United Arab Emirates. Treated waste-water has been used mainly for urban landscaping so far, but its use for agricultural and industrial purposes is expected to rise in the future.

TABLE 8. THE WATER USE SUSTAINABILITY INDICATOR IN THE GCC COUNTRIES IN 1997 AND PROJECTIONS FOR 2000 AND 2025  
(Percentage)

Country	1997	2000	2025
Bahrain	309	349	608
Kuwait	439	500	874
Oman	84	103	169
Qatar	580	580	943
Saudi Arabia	268	292	398
United Arab Emirates	388	692	1 015

Source: Same as table 7.

Note: Sustainability indicator: water use/renewable water resources.

With the bulk of the water supply in the GCC countries coming from underground sources, desalination and treated waste-water, it is to be expected that the per unit cost of water in the region is much higher than in countries like Egypt, Lebanon and the Syrian Arab Republic, where surface water is the predominant water source. Comparative data in this respect is sketchy, but the available figures give ample indication of this.

In 1994, for example, the cost of desalinated municipal water in Kuwait, at US\$ 1.63 per cubic metre, was 5.5 times higher than municipal water in Egypt and 131 per cent higher than the cost of groundwater in Jordan. In Saudi Arabia in 1987, the cost of desalinated water was more than 9 times higher than the average cost per cubic metre of surface and groundwater in the Syrian Arab Republic. The inevitable conclusion to be drawn from this and other data is that the cost of water in the GCC countries is much higher than in countries with more ample water supplies, especially surface water, and that this difference is increasing over time as groundwater resources in the GCC region are depleted, resulting in heavier dependence on water desalination.<sup>6</sup>

The implications of the water supply situation, as described above, for agricultural development in the GCC region are clear enough. Essentially, the need for year round irrigation, the high cost of water and the increasing competition for the use of scarce water resources have been and will continue to be major obstacles in the development of the region's agricultural potential, albeit limited.

In 1990, use of water for agricultural purposes accounted for an average of nearly 63 per cent of total water use in the GCC countries, ranging between a high of nearly 90 per cent in Saudi Arabia and a low of 21 per cent in Kuwait (see table 9). The average proportion of water use in agriculture has dropped steadily since then, however, while industrial and domestic water usage has increased. Projections for 2000 show that whereas total GCC water consumption is expected to be 14 per cent higher than in 1990, the proportion of total water consumption for agricultural purposes will drop to about 60 per cent on average. Compared with 1990, this proportion has increased in only two countries, Qatar and the United Arab Emirates; but in Oman and Saudi Arabia, the main agricultural producers in the GCC region, it has dropped significantly.

The other equally important barrier to agricultural development in the GCC region is the limited availability of agricultural land. As shown in table 10, the proportion of the cultivable area to the total land area of the GCC countries is very small and has remained so, despite some land reclamation and development projects undertaken during the past three decades.

<sup>6</sup> Ibid., pp. 149-151.

TABLE 9. WATER USE IN THE GCC COUNTRIES BY SECTOR, 1990 AND PROJECTIONS FOR 2000  
(Percentage)

Country	1990			2000		
	Domestic	Agriculture	Industry	Domestic	Agriculture	Industry
Bahrain	38.6	53.8	7.6	43.8	46.4	9.7
Kuwait	77.0	20.9	2.1	63.6	18.6	17.8
Oman	6.1	93.5	0.4	10.0	84.3	5.6
Qatar	39.2	56.2	4.6	31.0	63.8	5.2
Saudi Arabia	9.3	89.6	1.2	13.2	84.4	2.3
United Arab Emirates	34.4	63.8	1.8	34.4	64.2	1.4

Source: Same as table 7.

TABLE 10. THE ARABLE AND IRRIGATED AREAS IN THE GCC COUNTRIES, 1975-1998  
(Percentage)

Country	Arable area to total land area			Irrigated area to total arable area		
	1975	1985	1998	1975	1985	1998
Bahrain	3.2	5.9	7.2	50.0	25.0	100.0
Kuwait	0.1	0.1	0.4	..	50.0	71.4
Oman	0.2	0.2	0.3	..	87.2	100.0
Qatar	0.2	0.6	1.5	..	55.6	76.4
Saudi Arabia	0.4	1.2	1.8	23.6	30.5	42.3
United Arab Emirates	0.2	0.4	1.0	38.5	..	88.9

Source: ESCWA, *Statistical Abstract of the ESCWA Member Countries*, various issues.

Note: Two dots (..) indicate that data are not available.

Within these constraints, and including the fact that agricultural labour had to be imported in many cases, the GCC countries have made some efforts since the 1970s to exploit their limited agricultural potential. What was achieved in this respect, however, was at the cost of sometimes heavy subsidies of the factors of production.

Because of the difficult climatic conditions in the region, the proportion of the arable area under irrigation was increased significantly in all the GCC member countries, except Kuwait, during the period 1975-1998. This led to a more intensive use of the land that became available for farming. The cultivation of grains, pulses, industrial crops, vegetables and some types of fruits were introduced and now grown in limited quantities in the GCC countries. Animal production has grown substantially and a high rate of self-sufficiency in poultry and dairy products has been achieved.

The outcome of agricultural development policies in the GCC region is reflected in agricultural and food production indices that are available in a consistent series for all GCC countries for the period of 1990-1998. These index numbers, given in table 11, show a rise in agricultural and food production in Kuwait, Oman, Qatar and the United Arab Emirates, but a drop in Bahrain and Saudi Arabia. The drop observed in Saudi Arabia is quite important, since the Kingdom has the largest agricultural potential in the GCC region and, during the last two decades, has been heavily subsidizing its agricultural sector. The index shows a significant reduction in agricultural production in Saudi Arabia starting in 1995, with stagnation at this lower level continuing through 1998. In Oman, the second most important country in terms of agricultural potential, the rise in both the agricultural and food production indices was small relative to the other GCC countries.

Perhaps the more meaningful index is that of food production per capita. Here, the figures show that in Saudi Arabia and Oman, the two countries with the largest populations in the region, food production did not keep up with population growth. In fact, the index of food production per capita in those two countries dropped substantially between 1990 and 1998. The same is true for Bahrain, which has the smallest population among the GCC countries. In the other three countries, food production per capita was marked by an upward during the same period.

TABLE 11. INDEX NUMBERS OF AGRICULTURAL AND FOOD PRODUCTION IN THE GCC COUNTRIES,  
1990-1998  
(1989-1991 = 100)

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998
<b>Bahrain</b>									
Total agricultural Production	96.9	88.4	89.4	89.4	94.3	111.5	116.2	118.0	82.7
Agricultural production per capita	96.5	85.6	84.2	82.2	84.6	97.7	99.5	99.0	67.9
Food production	96.9	88.4	89.4	89.4	94.3	111.5	116.2	118.0	82.7
Food production per capita	96.5	85.6	84.2	82.2	84.6	97.7	99.5	99.0	67.9
<b>Kuwait</b>									
Total agricultural Production	119.5	19.0	34.0	88.0	112.0	136.4	162.5	169.5	157.6
Agricultural production per capita	118.8	19.3	36.4	100.6	136.1	171.9	205.2	208.6	185.6
Food production	120.0	19.3	34.3	88.7	112.6	136.7	163.1	169.4	156.8
Food production per capita	119.3	19.6	36.7	101.4	136.8	172.3	205.9	208.5	184.6
<b>Oman</b>									
Total agricultural production	99.7	98.5	101.9	110.1	108.5	98.4	109.2	114.7	111.9
Agricultural production per capita	99.5	94.2	93.4	96.7	91.4	79.5	84.6	85.1	79.7
Food production	99.1	97.8	101.2	109.4	107.7	97.4	108.4	113.9	111.1
Food production per capita	99.0	93.5	92.7	96.1	90.7	78.6	83.9	84.5	79.1
<b>Qatar</b>									
Total agricultural production	95.4	120.6	123.1	127.8	128.7	149.0	156.3	156.3	156.4
Agricultural production per capita	95.6	116.5	115.9	117.6	116.2	132.1	136.1	133.4	131.3
Food production	95.4	120.6	123.1	127.8	128.7	149.0	156.3	156.3	156.4
Food production per capita	95.6	116.5	115.9	117.6	116.2	132.1	133.4	133.4	131.3
<b>Saudi Arabia</b>									
Total agricultural production	104.6	98.1	107.7	103.0	105.7	87.1	80.8	86.4	86.4
Agricultural production per capita	104.2	94.9	101.6	95.0	95.2	76.3	68.7	70.9	68.4
Food production	104.5	98.0	107.7	102.8	105.6	86.5	80.2	85.8	85.8
Food production per capita	104.2	94.8	101.6	94.9	95.1	75.9	68.1	70.4	68.0
<b>United Arab Emirates</b>									
Total agricultural production	102.5	114.4	125.8	138.2	140.4	174.1	197.0	209.3	212.4
Agricultural production per capita	102.7	111.1	118.5	126.5	125.3	151.7	167.8	174.6	173.8
Food production	102.4	114.5	126.2	138.8	140.9	175.0	198.0	210.4	213.6
Food production per capita	102.7	111.2	118.9	127.0	125.8	152.4	168.7	175.5	174.7

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, 19<sup>th</sup> issue (E/ESCWA/STAT/1999/9).

Taking a longer overall view of the period between 1975 and 1998, one finds that the contribution of the agricultural sector (including fishery and forestry) to GDP remained insignificant in Qatar and Kuwait during those years and decreased in Oman and Bahrain. In Saudi Arabia, meanwhile, it grew from 1 per cent in 1975 to nearly 6 per cent in 1998; and in the United Arab Emirates, from 0.8 per cent to 3.17 per cent. Given that from 1975 to 1998, nominal GDP grew at an average annual rate of 7.6 per cent in Saudi Arabia and 16 per cent in the United Arab Emirates, the rise in agricultural production in these two countries during that period becomes much more meaningful. Even in those countries where the contribution of agriculture to GDP remained minimal or declined, it may be said that there was still a substantial growth of the agricultural sector in nominal terms, given the high average annual rates of GDP growth that were recorded (see table 12).

TABLE 12. CONTRIBUTION OF AGRICULTURE TO NOMINAL GDP IN THE GCC COUNTRIES, 1975-1998  
(Percentage)

Country	1975	1980	1985	1990	1995	1998	Average annual growth of nominal GDP, 1975-1998
Bahrain	1.55	1.11	1.29	0.80	0.86	0.88	20.6
Kuwait	0.25	0.19	0.61	0.89	0.43	0.42	4.8
Oman	2.78	2.55	2.71	2.59	2.78	2.67	25.0
Qatar	0.72	0.52	0.95	0.78	0.98	0.82	12.3
Saudi Arabia	0.96	1.19	4.39	6.41	6.71	5.97	7.6
United Arab Emirates	0.83	0.75	1.29	1.55	2.87	3.17	15.9

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, various issues.

In comparison, however, the proportion of the total labour force employed in agriculture has declined steeply in all the GCC member countries since the early 1970s, because of the rapid rural-urban migration to work in the oil sector. According to available labour force data for the years 1965 and 1995, the average proportion of the labour force engaged in agricultural activities in the GCC countries as a group dropped from nearly 32 per cent in 1965 to 11 per cent in 1995. In most of the countries, the average drop was more steep—from 14 per cent to 1.6 per cent in Bahrain and from 68 per cent to 14 per cent in Saudi Arabia, for example.

#### B. DEVELOPMENT OF MANUFACTURING INDUSTRY

As an avenue of economic diversification, industrial development in the GCC member countries has followed two main paths: the first, involving the development of capital- and energy-intensive heavy industries; and the second, involving medium- and small-scale manufacturing industries that produce for their respective domestic markets, as well as for the regional export market.

Excluding the 50 per cent expansion in oil-refining capacity in the region during the past twenty years and the growth of natural gas processing industries, which are considered oil sector industries per se, the development of heavy industry in the GCC countries has concentrated on petrochemicals, chemical fertilizers, steel and aluminium.

Petrochemicals and chemical fertilizers were the first and obvious choice for the establishment of a heavy industry base, in view of the capital-intensive nature of these industries and their use of the abundant supplies of natural gas and/or other hydrocarbon by-products in the region, such as fuel and feedstock. Indeed, when these industries were first set up in the GCC countries in the 1970s and early 1980s, a large proportion of the associated natural gas produced was being flared and thus had a zero opportunity cost. Steel and aluminium were also good choices, because of their capital- and energy-intensive nature.

In the 1970s, Qatar became an early pioneer in the establishment of petrochemical, fertilizer and steel industries in the GCC region. It also set a pattern later followed by all other GCC member countries of bringing in foreign partners into those industrial schemes to provide technical and marketing expertise, as well as to share in financing costs. In 1976, Saudi Arabia set up the Saudi Basic Industries Corporation

(SABIC) to build and manage basic heavy industries and supporting industries in the Kingdom. Within a decade of its establishment, SABIC had 15 heavy industries under its wing, many with foreign joint-venture partners, producing petrochemicals, fertilizers and steel. By the mid-1990s, Saudi Arabia's petrochemical capacity was 14 million tons a year, or 73 per cent of total capacity in the Arab world. Production of chemical fertilizers started in Abu Dhabi in 1985, whereas Dubai and Bahrain opted for aluminium smelters and related aluminium rolling industries. Other heavy industry projects that were in production in the region by the mid-1980s included an iron ore pelletizing plant in Bahrain and a Gulf joint-venture petrochemical plant, also in Bahrain, producing ammonia and methanol.

Production capacities of these early industries have been expanded steadily since they first came on stream and a series of new heavy industries, mainly petrochemical, have been built since then or are currently planned. In Saudi Arabia, successive and large expansions of production capacities at the various petrochemical plants have made it one of the largest producers of petrochemicals in the world. Kuwait joined the league of Gulf petrochemical producers at the end of 1997, when its first petrochemical complex producing ethylene, polyethylene and ethylene glycol went on stream. Similarly, Abu Dhabi's first petrochemical project to produce ethylene and polyethylene is scheduled to come on stream in 2001. In Bahrain, the petrochemical complex producing ammonia and methanol was expanded by the addition of a urea plant. In Qatar, a new methanol and methyl tertiary butyl ether (MTBE) plant started production in mid-1999 and two other petrochemical complexes are scheduled to be completed in 2001 and 2002. Three other projects are under study, as well as a further expansion of fertilizer production capacity. Two projects are under study in Oman to produce ethylene/polyethylene and fertilizers. Capacities of the steel and aluminium industries in the region have also been expanded in a number of stages during the last decade or so.

The development of heavy industry provided a major boost to the total value of output and exports of the GCC countries outside the oil sector. This effect was most pronounced in Saudi Arabia, where exports of chemical products grew from around 2 per cent of total exports (including oil) in 1985 to 6.5 per cent in 1998. Such exports in 1998 also made up 13.6 per cent of the total exports of Qatar, the other main GCC producer of petrochemicals and fertilizers during that period.

In addition to the heavy industries, a fairly well diversified base of medium- and small-scale manufacturing industries has been developed in the GCC countries during the last two decades or so. These industries are geared mainly for import substitution and/or production for domestic markets, as well as for the GCC and other Arab export markets. They include industries producing cement and building materials and equipment, heavy and light metal products, electrical products, textiles, clothing and accessories, food products, furniture, household items and utensils, and a wide variety of other consumer items. Most industrial establishments in this category are relatively small and labour intensive, and their record of success has been mixed at best.

Recent data show that the number of industrial establishments in the GCC countries increased in total from 4,386 establishments of different sizes in 1989 to around 7,300 establishments in 1999. Total capital invested in the industrial sector in all the GCC member countries also grew by 150 per cent during this period, to reach an estimated US\$ 83 billion in 1999.<sup>7</sup>

From 1980 to 1998, value-added at current prices in the manufacturing industry increased 382 per cent in the United Arab Emirates, 91 per cent in Saudi Arabia, 87 per cent in Kuwait, 75 per cent in Qatar and 41 per cent in Bahrain. In Oman, value-added rose from only US\$ 45 million in 1980 to US\$ 669 million in 1998. A comparison of the period 1990-1998 with that of 1980-1990 (made possible by the fact that average rates of inflation during those two periods were similar) shows that in Bahrain, Kuwait and Saudi Arabia the rate of increase in nominal value-added in the manufacturing sector was significantly more rapid during the period from 1990 to 1998 than from 1980 to 1990. The situation was different in Oman and the United Arab Emirates, where the manufacturing base was very small to begin with and where there was, therefore, a significant jump in total value-added in the sector during the 1980s. Qatar was also in a similar situation, especially since its heavy industries were in full production by the early 1980s (see table 13).

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<sup>7</sup> Gulf Organization for Industrial Consulting. Data does not include small artisan establishments.



TABLE 13. VALUE-ADDED IN MANUFACTURING INDUSTRY IN THE GCC COUNTRIES, 1980-1998  
(Millions of US dollars, current prices)

Country	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998
Value-added in manufacturing industry											
Bahrain	558	369	793	517	516	640	808	1 026	896	932	788
Kuwait	1 609	1 273	2 121	536	1 784	2 109	2 638	2 982	3 683	4 033	3 009
Oman	45	241	342	390	456	525	560	643	616	634	669
Qatar	410	486	874	852	814	717	694	683	687	688	718
Saudi Arabia	6 555	6 764	8 511	9 559	10 481	10 090	10 540	11 434	12 546	13 509	12 542
United Arab Emirates	1 142	1 521	2 643	2 661	2 861	3 035	3 907	4 452	4 883	5 511	5 500
Per cent contribution of manufacturing industry to GDP											
Bahrain	18.0	10.1	10.9	11.2	10.9	12.3	14.5	17.5	14.7	14.7	12.7
Kuwait	5.9	5.9	11.6	5.0	9.0	8.8	10.6	11.2	12.0	13.3	11.9
Oman	0.8	2.4	2.9	3.4	3.7	4.2	4.3	4.7	4.0	4.0	4.7
Qatar	5.2	7.9	11.9	12.4	10.7	10.0	9.4	8.4	7.6	7.5	7.4
Saudi Arabia	4.2	7.8	8.1	8.1	8.5	8.5	8.8	8.9	8.9	9.2	9.7
United Arab Emirates	3.8	1.9	7.9	7.8	8.1	8.5	10.2	10.4	10.2	11.2	11.8

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, 19<sup>th</sup> issue (E/ESCWA/STAT/1999/9).

It is to be noted that, from the mid-1980s on, the rise in the value-added in the manufacturing sector was accompanied by an increasing diversification of the industrial base—in Saudi Arabia and the United Arab Emirates, in particular, and to a lesser extent in the other GCC member countries. In Saudi Arabia, the chemical industries accounted for nearly 50 per cent of the total value of manufacturing output in 1990, with the basic metals industries contributing another 4.4 per cent of this value. By 1998, the value of production in these two industries dropped to around 42 per cent of the total, as against a rise in the contribution of the fabricated metal products industries (from 18 per cent to 22 per cent) and that of industries producing non-metallic mineral products (from 6.2 per cent to 14 per cent). The share of the lighter industries, including food products, remained unchanged at nearly 12 per cent of the total value of output during this period. In the United Arab Emirates, the value of production in the chemicals industries dropped from 61 per cent of the total value of manufacturing output in 1990 to 38 per cent in 1998, as against a rise in the relative value of production in the basic metals and fabricated metal products industries, the food products industry and all other industry categories (see table 14).

As a result, the contribution of the manufacturing sector to GDP in the GCC member countries as a group grew from an average of 6.3 per cent in 1980 to nearly 9 per cent in 1990 and then to 9.7 per cent in 1998. In individual countries, however, the change was more dramatic: this contribution practically doubled in Kuwait and Saudi Arabia between 1980 and 1998, and more than tripled in the United Arab Emirates (see table 13). Data on employment in the manufacturing sector also show that between 1980 and 1998, it grew by 77 per cent in Bahrain, 21 per cent in Kuwait, 32 per cent in Oman, 52 per cent in Qatar, 31 per cent in Saudi Arabia and 345 per cent in the United Arab Emirates.<sup>8</sup>

Despite the growth achieved in the manufacturing sector in all the GCC member countries since 1970, its development faced shortcomings and problems. In some cases, questions were even raised about the long-term viability of certain industries in the region.

<sup>8</sup> Source: *Statistical Abstract of the ESCWA Region*, 19<sup>th</sup> issue. Data for 1998 are ESCWA estimates for all countries. Data for Saudi Arabia include only employment in industrial establishments licensed and in operation under laws protecting national industries and encouraging foreign investment. Data for the United Arab Emirates cover only establishments with a labour force of 10 employees or more.

TABLE 14. VALUE OF PRODUCTION OF MANUFACTURING INDUSTRIES IN THE GCC COUNTRIES BY MAJOR INDUSTRY CATEGORY  
(Millions of US dollars)

Country and years	Food, beverages and tobacco	Textiles, wearing apparel and leather	Wood and wood products including furniture	Paper and paper products, printing and publishing	Chemicals and chemical products	Non-metallic mineral products except coal and petroleum	Basic metal industries	Fabricated metal products	Other manufacturing industries	Total
<b>Bahrain</b>										
1980	34.2	..	114.9	19.4	2 901.8	74.8	345.1	..	..	3 379.3
1985	72.3	..	79.8	28.2	2 220.2	174.5	364.4	..	..	2 877.7
1990	136.7	81.6	57.7	58.5	288.3	97.3	637.8	200.5	86.2	1 669.7
1991	143.6	85.6	33.5	61.2	302.4	102.1	669.2	210.4	90.4	1 751.6
1992	143.4	85.6	103.2	61.2	301.9	101.9	668.1	210.1	90.4	1 749.0
1993	177.4	106.1	127.1	75.8	373.9	126.3	827.7	260.4	112.0	2 167.0
1994	224.2	134.0	95.7	95.7	472.3	159.3	1 045.2	328.7	141.2	2 736.5
1995	284.8	170.2	119.7	121.5	600.3	202.4	1 328.2	417.8	179.5	3 477.2
1996	248.7	148.7	105.1	106.1	523.7	176.9	1 159.3	364.6	156.7	3 034.9
1997	258.8	154.8	156.4	110.4	545.2	184.0	1 206.7	379.5	163.0	3 159.1
1998	218.6	130.6	132.2	93.4	460.4	155.3	1 019.2	320.5	..	2 668.1
<b>Kuwait</b>										
1980	266.3	121.3	160.2	89.5	4 868.6	306.3	26.6	346.3	12.6	6 197.8
1985	337.3	124.1	99.8	88.8	6 041.5	299.0	27.6	348.2	17.0	7 383.3
1990	232.5	136.0	73.9	111.8	4 436.8	289.0	28.6	179.3	40.6	5 528.5
1991	137.7	84.9	42.9	69.2	670.8	146.0	7.2	215.4	27.9	1 402.6
1992	305.1	176.6	132.3	156.1	2 823.4	205.5	25.9	419.6	34.8	4 279.6
1993	364.0	215.5	158.4	170.4	3 400.6	304.0	41.8	492.6	66.6	5 213.4
1994	392.8	201.3	121.0	145.5	4 690.9	383.4	50.1	479.1	29.9	6 493.5
1995	438.3	201.1	150.8	215.8	5 496.5	410.2	48.9	494.3	108.6	7 564.7
1996	486.3	202.1	131.9	217.1	7 418.3	413.8	37.1	552.4	108.9	9 567.8
1997	..	..	..	..	..	..	..	..	..	9 706.2
1998	..	..	..	..	..	..	..	..	..	7 273.5

TABLE 14 (continued)

Country and years	Food, beverages and tobacco	Textiles, wearing apparel and leather	Wood and wood products including furniture	Paper and paper products, printing and publishing	Chemicals and chemical products	Non-metallic mineral products except coal and petroleum	Basic metal industries	Fabricated metal products	Other manufacturing industries	Total
Oman										
1980	..	..	..	..	..	..	..	..	..	..
1985	..	..	..	..	..	..	..	..	..	..
1990	..	..	..	..	..	..	..	..	..	962.0
1991	..	..	..	..	..	..	..	..	..	1 097.8
1992	..	..	..	..	..	..	..	..	..	1 283.5
1993	..	..	..	..	..	..	..	..	..	1 475.4
1994	271.3	91.8	19.2	38.8	694.1	223.1	67.4	148.2	20.8	1 574.8
1995	..	..	..	..	..	..	..	..	..	1 807.0
1996	..	..	..	..	..	..	..	..	..	1 733.4
1997	..	..	..	..	..	..	..	..	..	1 783.1
1998	..	..	..	..	..	..	..	..	..	1 882.4
Qatar										
1980	66.8	..	75.3	12.7	214.2	68.1	150.2	23.0	..	610.4
1985	62.0	21.1	42.6	48.0	385.9	131.5	121.4	35.1	2.0	849.6
1990	72.7	45.8	31.7	33.2	829.0	59.2	195.9	26.9	1.6	1 296.0
1991	70.9	41.3	27.9	24.3	893.1	60.5	173.3	39.9	1.5	1 332.6
1992	74.9	65.4	47.8	54.6	875.1	98.8	190.0	39.1	1.6	1 447.2
1993	75.6	78.7	44.9	34.5	741.4	148.7	219.7	37.4	2.2	1 383.7
1994	97.5	83.1	50.3	39.1	784.0	185.1	207.8	48.1	2.4	1 497.3
1995	90.9	77.2	35.7	37.5	656.8	218.8	203.9	42.4	2.2	1 365.3
1996	88.8	104.6	49.0	34.0	654.3	169.0	202.3	54.3	2.4	1 358.7
1997	..	..	..	..	..	..	..	..	..	1 361.6
1998	..	..	..	..	..	..	..	..	..	1 419.8

TABLE 14 (continued)

Country and years	Food, beverages and tobacco	Textiles, wearing apparel and leather	Wood and wood products including furniture	Paper and paper products, printing and publishing	Chemicals and chemical products	Non-metallic mineral products except coal and petroleum	Basic metal industries	Fabricated metal products	Other manufacturing industries	Total
Saudi Arabia										
1980	..	..	..	..	..	..	..	..	..	..
1985	..	..	..	..	..	..	..	..	..	..
1990	1 551.3	179.3	98.2	382.2	6 087.0	747.1	537.5	2 235.5	301.0	12 119.2
1991	1 647.2	196.2	117.9	418.2	6 457.6	..	573.7	2 398.1	298.2	13 143.6
1992	1 895.5	239.9	172.4	495.5	7 279.2	1 236.4	584.6	2 985.0	383.5	15 272.1
1993	1 757.4	231.5	182.1	473.4	6 694.4	1 342.4	519.3	2 860.4	353.0	14 413.9
1994	1 806.6	248.7	214.2	501.4	6 800.1	1 547.7	496.7	3 070.8	370.8	15 057.0
1995	1 928.0	277.2	258.3	551.3	7 167.4	1 836.7	489.3	3 421.0	404.5	16 333.8
1996	2 080.7	312.4	312.0	613.1	7 634.9	2 188.4	482.4	3 852.3	446.4	17 922.6
1997	2 203.0	345.2	366.6	668.9	7 973.9	2 542.8	460.9	4 254.2	483.3	19 298.9
1998	2 010.4	328.7	368.8	629.2	7 173.3	2 533.7	373.5	4 048.1	451.2	17 916.8
United Arab Emirates										
1980	..	..	..	..	..	..	..	..	..	..
1985	274.0	11.0	49.7	94.3	244.6	394.2	304.0	349.8	28.1	1 749.8
1990	392.3	183.1	109.2	112.8	3 309.2	439.1	411.3	409.2	56.7	5 422.8
1991	412.7	207.0	115.5	116.9	3 323.9	457.9	415.4	448.1	877.1	5 557.3
1992	539.4	277.9	175.7	173.0	3 616.5	525.7	517.6	582.9	84.4	6 493.1
1993	578.0	309.2	185.2	188.0	3 564.7	551.6	542.6	608.6	92.6	6 620.5
1994	806.9	441.0	277.0	278.9	4 306.5	709.3	733.9	842.3	134.8	8 530.4
1995	964.9	538.3	344.0	347.3	4 531.7	797.6	855.1	995.9	165.9	9 540.7
1996	1 175.4	667.7	433.1	437.5	4 860.5	918.0	1 018.0	1 201.3	207.6	10 918.9
1997	1 236.7	713.4	468.5	474.0	4 498.8	915.8	1 049.0	1 252.8	223.1	10 832.7
1998	1 342.4	785.1	521.1	527.6	4 287.7	945.5	1 117.1	1 349.2	247.1	11 123.2

Source: Statistical Abstract of the ESCWA Region, 17<sup>th</sup> issue (E/ESCWA/STAT/1997/8).

Note: Two dots (..) indicate that data are not available.

While concentration on the development of petrochemical and other hydrocarbon and energy-intensive basic industries was a natural and perhaps inevitable choice in the overall economic diversification drive in the Gulf, these industries in themselves have been a source of economic instability, since the prices of their products are affected by movements in oil prices or are subject to cyclical swings, depending on economic conditions in the main export markets.

The period from 1974 to 1979 was characterized by world excess capacity in petrochemical products and low prices. Qatar was an early GCC victim of this situation, as its first fertilizer plant started production in 1973, while its first petrochemical industry was built in the late 1970s and came on stream in 1980. The period since then has seen many upswings and downswings in world demand and prices. More recently, prices of the bulk chemicals that dominate the regional market slate were depressed by weak demand and over-capacity in the developed countries during 1990-1991, and then went through a period of volatility during 1994-1996, after a relative improvement in market conditions during 1992-1993. In 1997, prices started to improve again, but then dropped once more in the latter part of the year because of a collapse in demand in Asia and slower growth in Europe. Since early 1999, there has been a renewed steady improvement in prices, mainly under the impact of higher oil prices, but the effect of the previous two-year slump on GCC producers was quite hard. This is perhaps best exemplified by the drop in SABIC's profits from US\$ 1.68 billion in 1995 to US\$ 539 million in 1998, or by nearly two thirds. As petrochemical production capacity increases in the region, the impact of future price volatility on the GCC economies could be more significant and Gulf producers may face more restrictions in European export markets than they have so far.

Closely related to the issue of increasing capacity in the production of petrochemicals is the fact that the industrialization drive in the GCC countries has been characterized by a multiplicity of similar industries. While this was perhaps inevitable, especially in the case of heavy industry, because of the similarity in resource endowment among the different countries involved, it can be argued that this duplication of projects has been counterproductive, in the sense that it has led to competition among the GCC countries in export markets, including the inter-Gulf market itself. One example of this is the cement industry, where total GCC capacity grew 31 per cent between 1992 and 1999 to 29 million tons a year. Capacity utilization in the industry, however, averaged 72 per cent only in 1999, and the GCC cement companies have suffered considerably from intra-Gulf cut-price competition. This problem is perhaps more pronounced in the case of the medium- and small-scale industries, many of which were built with an eye to the regional export market, where competition has been growing. Needless to say, this pattern of competitive industrial development runs against the ideals of the GCC Unified Economic Agreement, which calls for coordinated and integrated industrial development among the member countries.

The development of medium- and small-scale manufacturing industries in the GCC countries in itself raises a number of interrelated and, at times, complex issues. While the development of heavy industry was based on the comparative advantage the GCC countries had in low-cost fuel and feedstock, the question that arises is whether this comparative advantage should be used to subsidize the entire manufacturing sector by means of low-cost energy or intermediate products produced by the basic industries. Given also that the manufacturing sector has benefited from other subsidies, such as low-cost industrial sites and utilities, tax exemptions and low interest loans, the issue boils down to whether economic diversification should be pursued at the risk of the growth of heavily subsidized industries that may not be competitive in a free trade environment.

This issue has been complicated by two additional considerations. On the one hand, medium- and small-scale industries have the advantage of engaging domestic entrepreneurship in the private sector, particularly since they generally do not require sophisticated technology—which, in the case of the GCC countries, has required long-term technical management and marketing contracts with multinational corporations. To that extent, these smaller industries counteract what may be termed the growth of “foreign enclaves” that has been associated with the heavy industries. Smaller industries also give more meaning to economic diversification, in that they have encouraged the development of indigenous entrepreneurship and skills.

On the other hand, however, it is clear that if diversification means the creation of a viable economy without dependence on oil, then this implies (in so far as industrialization is concerned) the development of industries that can stand on their own without subsidies. In addition, the development of medium- and small-scale manufacturing industries in the GCC countries has entailed, as in the case of the heavy industries, importing large numbers of expatriates to build, operate and manage industrial enterprises. The question that then arises is: to what extent has the social cost of this foreign labour (subsidized housing, education, health services, electricity, consumer subsidies, and so on) reduced or maybe even exceeded the value-added of this labour in manufacturing production, thus nullifying the objectives of diversification.

TABLE 15. MAIN PETROCHEMICAL AND FERTILIZER PROJECTS IN THE GCC COUNTRIES AND CURRENT EXPANSION PLANS

Country and company	Product	Start-up	Design capacity ('000 tons/year)	
<b>Kuwait</b>				
Equate	Ethylene	1997	650	
	Polyethylene	1997	450	
	Ethylene glycol	1997	350	
Petrochemical Industries Company (PIC)	Benzene, Xylene, Paraxylene, Methanol	Awaiting approval	1250	
	Urea	Under bidding	240	
	Urea (expansion)		400	
	Ammonia		300	
	Methanol(expansion)	End 1999	730	
	Ammonia (expansion)	End 1999	320	
<b>Oman</b>				
Government of Oman	Ethylene	Awaiting approval	450	
	Polyethylene		450	
Oman-India Fertilizer Company	Ammonia	Documentation phase	330	
	Urea		1400	
<b>Qatar</b>				
Qatar Fertilizer Company (Qafco)	Qafco I	Ammonia	1969	
		Urea	1969	
	Qafco II	Ammonia	1979	
		Urea	1979	
	Qafco III	Ammonia	1997	
		Urea	1997	
	Qafco IV	Ammonia	Project go-ahead	
		Urea	Approved in September 2000	
	Qatar Petrochemical Company (Qapco)			
	Qatar Fuel Additives Company (Qafac)	MTBE	1999	610
Methanol		1999	825	
Qatar Vinyl Company (QVC)	EDC	Mid-2001	175	
	VCM	Mid-2001	230	

TABLE 15 (continued)

Country and company	Product	Start-up	Design capacity ( '000 tons/year)
Qatar Chemical Company (Q-Chem)	Ethylene	Mid-2002	500
	HDPE/LDPE	Mid-2002	450
	Hexene-1	Mid-2002	47
Qatar Petroleum Corporation (QPC), Enichem	TDI	Awaiting approval	100
QPC, Elf Aquitaine	Propane, Polypropylene	Under study	250
<b>Saudi Arabia</b>			
Saudi Arabian Fertilizer Co. (SAFCO), Dammam	Urea	1970	330
	Ammonia		200
	Sulfuric Acid		100
	Melamine	1985	20
Jubail	Ammonia	1993	500
	Granular urea	1993	600
	Ammonia (expansion)	1999	500
	Urea	1999	600
Saudi Methanol Co. (AR-RAZI), Jubail	Chemical grade Methanol	1983/1992 1993	2 050
	Methanol	1999	850
Al-Jubail Fertilizer Co. (SAMAD), Jubail	Urea	1983	
	Ammonia		
	2-EH	1995	
	DOP	1996	
Saudi Yanbu Petrochemical Co. (YANPET), Yanbu	Ethylene	1985	500
	Ethylene glycol		220
	Polyethylene		296
	Ethylene (expansion)	1999	800
	Polypropylene	1999	260
	Polyethylene (expansion)	1999	535
	Ethylene glycol (expansion)	2000	410
	Pyrolysis gasoline	1999	125
Al-Jubail Petrochemical Co. (KEMYA), Jubail	Polyethylene	1986	270
	Ethylene		700
	Ethylene (expansion)	2000	700
	LLDPE	2000	200
	(expansion)		250
Saudi Petrochemical Co. (SADAF), Jubail	Ethylene	1984/1997	970
	Ethyl. Dichloride	1984/1997	840
	Styrene	1984/1995/1997	960
	Ethanol	1985	300
	Caustic soda	1984/1997	680
	MTBE/ETBE	1997	700
	Styrene (expansion)	2000	500
	Benzene	2000	520

TABLE 15 (continued)

Country and company	Product	Start-up	Design capacity ( '000 tons/year)
National Methanol Co. (IBN SINA), Jubail	Methanol	1984	650
	MTBE	1994	700
Arabian Petrochemical Co. (PETROKEMYA), Jubail	Ethylene 1&2	1985/1994	2x500
	Butene-1	1987/1995	2x500
	Polystyrene	1988/1993	135
	Propylene	1994	300
	Butadiene	1994	100
	Benzene	1994	70
	Ethylene	2000	800
	Propylene (expansion)	2000	275
Eastern Petrochemical Co. (SHARQ), Jubail	LLDPE	1985/1994	2x140
		1985/1993	2x330
	Ethylene glycol	2000	497
	LLDPE (expansion)	2000	300
National Industrial Gas Co. (GAS), Jubail	Nitrogen	1984/1993	490
	Oxygene	1985/1993	876
National Plastic Co. (IBN HAYYAN), Jubail	VCM	1986	300
	PVC 1X2	1986/1996	390
	PVC emulsion	1995	24
Saudi European Petrochemical Co. (IBN ZAHR), Jubail	MTBE	1988	500
	MTBE	1993	700
	MTBE	1995	100
	Polypropylene (1)	1993	200*
	Polypropylene (1) (expansion)	2000	40
	Polypropylene (2)	2000	320
National Chemical Fertilizer Co. (IBN AL-BAYTAR), Jubail	Liquid ammonia	1987	500
	Urea	1987	500
	Granular urea	1991	500
	NPK	1991	500
	TSP	1991	200
	DAP	1991	100
	Liquid fertilizer	1991	10
	Sulfuric acid	2000	887
	Phosphoric acid	2000	265
	Aluminium fluoride	2000	16
	Ammonia/Urea	2000	16
	(expansion)	2000	500



TABLE 15 (continued)

Country and company	Product	Start-up	Design capacity ( '000 tons/year)
Arabian Industrial Fiber Co. (IBN RUSHD), Yanbu	Polyester Fibers	1995	140
	Aromatics	1998	730
	PTA	1998	350
Zenel/Montell	Propylene Propane	2000	250
Saudi Aramco	Xylenes extraction and processing	Awaiting approval	..
Saudi Chevron Petrochemical Company	Benzene	1999	480
	Cyclohexane	1999	220
National Polypropylene Company (Teldene)	Propylene/ Polypropylene	Initiated	250
National Industrialisation Company	Propane dehydrogenation Polypropylene	Under bidding	450
			450
Tashseen	MTBE	2000	900
Arabian Industrial Development Company (Nama)	Epichlorohydrin	Under construction	30
	Chlorine		60
	Caustic soda		65
Gulf Stabilisers	Atioxydant additives	Under bidding	5.7
Saudi International Petrochemical Company	Methanol	Under organization	850
	Acetic acid		200
Gulf Advanced Chemical Industries Company	Butanediol	2002	50
	Maleic anhydride		10
Alujain	MTBE	2000	850
United Arab Emirates			
Abu Dhabi Polymers Company (Borouge)	Ethylene HDPE, LDPE	2001	600
		2001	450
Abu Dhabi National Oil Company (ADNOC)	Ruwais paraxylene	Phase one of 440 t/y under study	880

Sources: Arab Oil & Gas Directory 1998 and Middle East Economic Digest, various issues.

Notes: Two dots (..) indicate that data are not available.

\* Being expanded to 320,000 tons/year.

### C. DEVELOPMENT OF THE SERVICES SECTOR

The development of the services sector followed different patterns and occurred at a varying pace in the GCC countries. Bahrain and Dubai in the United Arab Emirates were forerunners in this respect, as their limited hydrocarbon resources early on pushed them to adopt more open systems and thence to promote themselves as regional banking and services centres. In recent years, however, even Qatar and Saudi Arabia—considered the more conservative regimes in the region—have gradually opened up to the potential of developing their services sector, including the tourism industry.

Within the context of the GCC member countries, the development of the services sector can be broadly defined to include hotels and tourism; various recreational, amusement and retail activities that are geared to promote tourism; international or intra-regional cultural and sports events; financial and insurance services; the advertising industry; various business and corporate services that aim at the creation of regional business centres; the development of free zones; and other similar or related activities and projects.

Significant advances have been made in the development of these various activities across the GCC region during the last two decades at least, and there have been notable success stories. Dubai has come to be described as the most important commercial, business and transport hub between the Far East and Europe. An increasing number of multinational companies view it as a distribution and management centre for the entire Middle East and the Indian subcontinent. Tourism in the United Arab Emirates has grown at an estimated compound annual rate of 15 per cent in the last five years. After the opening of the causeway to Saudi Arabia's Eastern Province in 1986, Bahrain also boomed as a tourism and recreation destination for other Gulf nationals. Although the unstable security situation during the mid-1990s put a dent in this role, it was a temporary one. The tourism boom spawned, among other things, a parallel boom in the construction of new hotels and residential buildings. Bahrain was also a pioneer in establishing an offshore banking industry in the GCC region, as will be discussed in Section D below.

The other GCC member countries are also moving rapidly to exploit their tourism potential. Most notable in this respect was the decision by the Saudi Arabian Government in April 2000 to start issuing tourist visas to non-GCC nationals and to introduce new regulations for the omra visa, which are granted for visits by Muslims to the holy sites in the country outside the hajj season. This decision was followed by the setting up of the Higher Commission for Tourism. It has been estimated that if visa regulations for the *Omra* are eased, the number of foreign visitors to Saudi Arabia for this purpose could reach 10 million a year—and if each visitor spends US\$ 1,000 on average during a visit, the total revenue from this source would be equivalent to around 33 per cent of the 1999 Saudi budget. It is also estimated that if the number of *Hajj* pilgrims were allowed to reach 3 million a year, total expenditure by these pilgrims would be in the order of 4 to 4.5 billion U.S. dollars. There are also projections that the development of the Saudi tourist industry could ultimately generate 500 thousand new jobs in the Kingdom.

The building of hotels, amusement parks, museums and other tourist attractions is continuing to move at a fairly rapid pace across the Gulf. International golf and tennis tournaments and shopping festivals have become well-established major events. In Dubai, the 1999 shopping festival attracted 1.2 million outside visitors, 92 per cent of whom came from other GCC countries and the remaining 8 per cent or 96 thousand visitors from outside the Gulf.

These figures illustrate the importance of intra-Gulf tourism that continues to grow at what is believed, in the absence of comprehensive data, to be a rapid rate. In Saudi Arabia, internal tourism, by itself, is providing a major impetus for the growth of the tourism sector. An estimated 7 million visitors took part in the various summer festivals that were held in different Saudi cities in 2000, the largest proportion of whom were Saudis. The economic relevance of these events is highlighted by available estimates indicating that the festival held in the city of Jeddah generated more than US\$ 500 million in consumer expenditures.

Indicators of tourist activity in the GCC countries are provided by the figures on the number of hotels, the number of tourists and the number of nights spent. A significant factor in this respect, however, is that a sizeable but varying proportion of hotel occupants in the different GCC countries are business visitors.

As would be expected, the largest increase in hotel facilities and the number of tourists/foreign visitors during the period from 1988 to 1997/1998 occurred in the United Arab Emirates and Bahrain. In the United Arab Emirates, the number of hotels grew from 88 in 1988 to 323 in 1997, while the number of beds increased by 150 per cent. The number of hotel residents, including businessmen, tourists and other visitors, reached 2.47 million in 1997, or nearly 150 per cent more than in 1988. In Bahrain, the number of hotels grew from 26 to 71 during this same period, while the number of hotel residents reached 759 thousand in 1997, placing Bahrain in third position among the GCC countries, after Saudi Arabia and the United Arab Emirates, in this respect. The latest available data show that the number of foreign visitors to Saudi Arabia reached 7.2 million in 1996, compared with nearly 5 million in 1988. Saudi Arabia is a special case, however, since most visitors during this period came for the hajj or the omra, or were otherwise business visitors. Similarly, most foreign visitors to Kuwait are businessmen. In Qatar, the number of hotels remains small relative to other GCC countries, but various luxury hotel projects are planned as the country gears itself towards a more open tourism policy (see table 16).

TABLE 16. DEVELOPMENT OF HOTEL CAPACITY IN THE GCC COUNTRIES AND THE NUMBER OF FOREIGN VISITORS, 1988-1998

Country	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
<b>Bahrain</b>											
No. of hotels <sup>a/</sup>	26	26	30	34	34	42	44	..	85	71	..
No. of beds	4 276	4 226	4 778	4 975	4 975	5 175	5 175	..	6 601	6 511	..
No. of tourists <sup>b/</sup>	508	491	679	930	670	464	452	..	529	759	..
Nights spent	..	..	692	828	713	954	1 106	..	1 123	1 563	..
<b>Kuwait</b>											
No. of hotels	27	27	..	..	21	21	21	21	21	20	21
No. of beds	5 338	5 338	..	..	..	..	3 482	3 473	3 473	3 331	3 287
No. of tourists	80 484	89 476	..	..	65	127	55	72	76	79	77
Nights spent	319	334	..	..	221	259	191	239	252	266	267
<b>Oman</b>											
No. of hotels	..	..	..	32	32	35	37	39	49	52	..
No. of beds	..	..	..	3 237	3 129	3 430	3 515	3 600	4 356	5 000	..
No. of tourists <sup>b/</sup>	..	..	..	214	261	344	358	352	436	463	..
Nights spent	..	..	..	..	..	..	..	..	..	..	..
<b>Qatar</b>											
No. of hotels	16	14	14	14	13	12	12	13	13	12	..
No. of beds	2 575	2 406	2 328	2 384	2 310	2 366	2 421	2 667	2 600	2 521	..
No. of tourists <sup>b/</sup>	113	110	136	143	141	160	241	309	327	333	..
Nights spent	226	238	795	255	292	340	367	427	376	394	..
<b>Saudi Arabia</b>											
No. of hotels	249	259	262	268	268	287	287	296	308	..	..
No. of beds	..	..	..	..	..	..	..	..	..	..	..
No. of tourists	4 990	4 847	5 292	5 770	5 944	6 414	7 078	7 193	7 221	..	..
Nights spent	..	..	..	..	..	..	..	..	..	..	..
<b>United Arab Emirates</b>											
No. of hotels	88	109	122	189	215	229	254	291	304	323	..
No. of beds	15 718	17 287	18 146	20 180	25 355	27 526	30 105	34 844	36 639	39 052	..
No. of tourists	1 045	1 071	1 098	1 166	..	..	1 918	2 315	2 572	2 475	..
Nights spent	2 645	3 037	3 412	3 426	4 045	4 823	5 674	6 364	7 004	7 009	..

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, 19<sup>th</sup> issue (E/ESCWA/STAT/1999/9).

a/ Excluding popular hotels.

b/ Number of hotel residents.

Note: Two dots (..) indicate that data are not available.

Apart from tourism and the services related to it, a number of major and successful economic diversification projects have combined services with industrial and/or trading activities. The most obvious example of this is the Jebel Ali Free Zone in Dubai, which has grown to become the largest and most modern port and cargo transit centre in the Middle East. By 1995, in fact, the port facilities in this zone made Dubai the 14th most active port in the world. By this time also, the free zone had attracted an estimated US\$ 600 million in industrial investment and boosted Dubai's re-exports from an insignificant level to US\$ 3 billion a year. It is on the basis of the success of the Jebel Ali Free Zone that Dubai decided to set up the Dubai Internet City, which opened at the end of October 2000 and is considered the first free zone for electronic trade in the world. More than 160 multinational corporations and other companies in the field of information technology have already been licensed to locate in the zone, where Dubai has invested US\$ 600 million in basic infrastructure.

Another example of such projects is the Arab Shipbuilding and Repair Yard in Bahrain which, in spite of early difficulties after launching its operations in 1977, has been able to compete with similar facilities in Asia. Between 1977 and the end of 1999, this shipyard completed repair work on 208 million dead weight tonnage (dwt.) of various types and sizes of vessels. As a result, it is now expanding its capacity and scope of operations to include tanker conversions and the building of tugs, patrol boats and other vessels. A third example is provided by the Emirate of Fujairah in the United Arab Emirates, which is taking advantage of its strategic location outside the Straits of Hormuz to establish itself as a ship refueling and repair centre, as well as a free zone area.

Overall, the lack of detailed data makes it difficult to measure the growth of the services sector in the GCC economies. However, all indicators point to a substantial rise in its relative contribution to output and employment in all the GCC member countries since the 1970s. Nevertheless, as in the case of the development of other sectors and perhaps more so, the main problem with the growth of the services sector has been its heavy reliance on expatriate labour.

#### D. DEVELOPMENT OF OFFSHORE BANKING

In October 1975, and for the first time in the Gulf, the Bahrain Monetary Agency announced a new form of limited banking license which would permit the establishment of offshore banking units. This decision was partly dictated by the need to deflect license applications from international banks to set up branches in the domestic Bahraini market, which the Agency considered to be already over-banked. The principal condition on offshore banks was that they were forbidden from engaging in any individual or corporate business with Bahrain residents without the specific permission of the Bahrain Monetary Agency. But the more important reason was that Bahrain wanted to diversify its traditional role as a service centre in the GCC region and to take advantage of the enormously increased flow of oil revenues that needed fast access to banks in the main financial markets. Diversification in Bahrain benefited from the country's central location in the Gulf, the lack of banking sophistication in Saudi Arabia at that time and the fact that the previous role of Beirut as a regional financial centre was marginalized after the outbreak of the war in Lebanon in 1975.

The offshore banking industry grew rapidly at first, with the number of units rising to 57 by 1980. Total assets of offshore banks also climbed from US\$ 1.69 billion in 1975 to US\$ 37.5 billion by the end of 1980. In 1976, another step was taken in the development of the offshore market by a decision to admit a limited number of foreign exchange brokers. This provided an important boost to international awareness of the Bahrain market and offered the possibility of market prices rather than individual bank quotations, which added to the competitive climate. An additional step that was taken to accelerate the activity of offshore banks was the creation of a forward market in Gulf currencies, especially the Saudi riyal, to meet the needs of contractors who were suffering losses from changes in the exchange rate of the riyal against European currencies and the yen, since it was effectively pegged to the dollar.

During this early period, the offshore banks played a major role in loan syndication in the GCC region. They provided bid and performance bonds and advance payment guarantees for contractors and were involved in trade finance and in financial activities such as selling bonds, promissory notes and certificates of deposit, as well as in private banking. The offshore banking industry in Bahrain reached a peak in 1984,

when the number of units rose to 76 and total assets exceeded US\$ 73 billion, but then started on a slow decline. In the years since then, it has become clear that, as an experiment in economic diversification, the development of offshore banking has not been as successful as originally envisaged.

One major reason for this has been that the development of offshore banking tended to follow the economic fortunes of the GCC region and thus exhibited a similar and parallel degree of instability. The initial success of offshore banks was essentially based on the fast growth of the Saudi economy in the second half of the 1970s. Given the inexperience of Saudi banks, the offshore banks in Bahrain were able to provide financing for most of the projects that were undertaken at the time and provided much needed financial expertise as well. They were also able during this period to assume the targeted role of a main conduit for the recycling of the growing oil wealth of Saudi Arabia, as well as that of the other Gulf countries, to financial institutions in the West.

However, as rates of growth slowed in the region, the offshore market also declined as well. At the same time, Saudi banks were becoming more sophisticated and could handle more of the Kingdom's financing requirements. Bahrain's role as a foreign exchange centre dealing between the European and Far Eastern time zones never really took off, as it was not able to generate a sufficient volume of business to discourage traders from passing their book directly from Europe to the Far East.

Faced with these changing conditions, many of the banks that were marginal players discontinued their presence in Bahrain, starting in 1985 when the Saudi economy and the rest of the Gulf economies went into a fairly severe slowdown. The situation began to improve in the latter part of the decade, but the second Gulf war in 1990 dealt the offshore banking industry another major blow. By the end of 1991, the number of offshore units was down to 49 and total assets, which had climbed again to nearly US\$ 73 billion at the end of 1989, fell sharply once more to around US\$ 53.4 billion. Since then, the industry has remained subject to fluctuations in the economic situation of the GCC countries. The number of Bahrain offshore units still remained at 48 by the end of 1999, especially owing to the fact that Dubai had gradually established itself as a competitive financial centre since the early 1990s. Total assets rose gradually to reach US\$ 90 billion in 1999, but compared with the level of 1984, this represented an increase of only 21 per cent over a 15-year period.

The offshore banking business was affected negatively once again by the drop in oil prices during 1997-1998 and its impact on the GCC economies. This effect was manifested by a drop in the profits of offshore banks by an average of 45 per cent in 1998. But the situation improved starting 1999. The two largest offshore banks, Arab Banking Corporation and Gulf International Bank, which together account for 50 per cent of the total assets of offshore units in Bahrain, reversed the 1998 situation and showed significantly higher profits in 1999 and the first half of 2000. However, this recovery has not included all the offshore banks. A few recorded a further drop in profits and one a loss, and there is speculation today about serious problems with the fundamentals of some of the weaker banks in the group.

A number of conclusions may be drawn in light of the above concerning the offshore banking industry as a vehicle of economic diversification in Bahrain, namely:

(a) The industry undoubtedly established Bahrain as the leading financial centre of the GCC region, notwithstanding concerted efforts by Dubai and Abu Dhabi in the United Arab Emirates to create rival financial centres. Abu Dhabi recently launched a project to develop an international financial centre on Sa'diyat Island that will host offshore banks, as well as an 'international stock exchange' that will 'bridge the time zone gap between capital markets in the East and West'. The centre will impose no restrictions on foreign ownership, allow full repatriation of capital and profits and offer tax exemptions. For now, however, international bankers and financial institutions remain sceptical about this project, especially since it took Abu Dhabi until the year 2000 to issue a law establishing an autonomous stock market. There are also questions about the regulatory side of the project, such as levels of transparency and accounting standards, and the ability of Abu Dhabi to institutionalize international norms.<sup>9</sup> In contrast, the Bahrain Monetary Agency has required a reputation as one of the most solid supervisory bodies in the GCC countries;

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<sup>9</sup> *Middle East Economic Survey* (4 September 2000).

(b) The industry has also played a major role in diversifying the base of economic activity in Bahrain and has developed significant linkages with a range of other activities such as real estate, the retail trade, business services and other activities by virtue of the employment opportunities that it created and the professional cadres that it attracted to Bahrain. It is significant to note in this respect that a breakdown of GDP by main sector of economic activity shows that the financial institutions and insurance sector accounted for nearly 23 per cent of Bahrain's GDP in 1998, compared with 5.4 per cent in Kuwait, 5.3 per cent in Oman and 6.5 per cent in the United Arab Emirates;

(c) The industry, however, has suffered from one main drawback: it has, as an entire entity, been subject (as noted above) to the unstable economic conditions in the GCC countries since the 1970s. Moreover, while it was built on the premise that Bahrain would continue to be the financial centre of the GCC region, the industry's growth potential was reduced significantly by increasing competition from domestic banks in the region and by the greater ease with which international banks have been able to access the GCC markets from their head offices without having to establish an important presence in the region. These competitive pressures can only grow in the future, which means that the industry will be hard-pressed to maintain its market share and thus its economic contribution.

#### E. PRIVATIZATION AND THE PROMOTION OF FOREIGN INVESTMENT

Within the context of the GCC economies, privatization and the promotion of foreign investment have been important elements in economic diversification policies. They expand the role of the private sector and private capital accumulation, help reorient the economies concerned from dependence on the public sector as the main engine of growth to growth led by the private sector, and reduce the financial burden on the public sector.

Privatization has been a declared policy on the agenda of the GCC countries for a number of years now and its actual implementation dates to the mid-1990s. The process, however, has generally been gradual and, in many cases, quite hesitant. Meanwhile, the last two years have seen noteworthy moves towards liberalization of the GCC economies and opening them up to foreign investment. These moves, some of which reflect significant shifts in economic strategy, were partly dictated by the requirements of accession to the World Trade Organization (WTO), but they also highlight an increasing awareness of the need for foreign capital and the role that it can play in providing efficient project financing and promoting the growth of domestic capital markets.

The transformation of policy proclamations into reality has not been smooth so far. Governments in the GCC countries have been worried that the privatization of profitable public sector enterprises would deprive them of important sources of revenue. There have also been concerns, which have found expression in social and political opposition to privatization, that the sale of public enterprises to the private sector would reduce employment in such enterprises, since they would have to be operated on a commercial basis. It was further argued that the operation of former public enterprises on a commercial basis would, in many cases, necessitate higher prices for the goods and services produced, or in other words, result in a reduction of subsidized social goods and services.

In the same vein, a number of GCC member countries placed various limitations on foreign investment because of concerns about foreign control of enterprises and ownership of resources and, in the case of the region's stock markets, the speculative pressures that could arise from the entry of foreign investors into those markets. This attitude towards foreign capital has its roots perhaps in the control that multinational companies had established on the region's hydrocarbon resources before they were taken over by the young GCC Governments.

Eventually, however, it became clear that serious privatization was an essential prerequisite for the structural change that is vital to economic diversification and that economic liberalization was inescapable if the GCC countries wanted to assume their proper role in the growing global economy. In addition, it was increasingly recognized that the sale of public assets to the private sector would:

- (a) Provide GCC Governments with a substantial windfall that would help correct the large budget deficits that faced these Governments before the latest sharp rise in oil prices;
- (b) Reduce public expenditures by allowing cuts in subsidies, capital grants and loans to public enterprises;
- (c) Help repatriate at least part of the large amount of private GCC capital invested in foreign assets;
- (d) Allow the more efficient and productive use of private capital within the GCC region;
- (e) Expand the ownership base of enterprises in the region and promote private saving and investment;
- (f) Promote the growth of stock markets in the region and/or increase the depth of those markets in terms of listed companies, volume of trading and overall liquidity.

In 1991, Kuwait set up a government committee to formulate a privatization programme and, in 1994, it started the privatization process in the Gulf when it initiated the sale of government shareholdings, through the Kuwait Investment Authority, in 62 local companies. These shareholdings were largely acquired by the Government in 1976, when it stepped in to avert a collapse of the unofficial stock exchange at the time and then in 1982, when this collapse actually happened and the Government had to step in again to try to limit the damage. By the early 1990s, therefore, the Kuwait Investment Authority had substantial shareholdings in 36 of the 48 companies listed on the Kuwait stock exchange.

In August 1993, the World Bank recommended to the Kuwait Government the privatization of 74 companies and industries in which the Kuwait Investment Authority had shareholdings, including 25 per cent of the Kuwait Petroleum Corporation and the Kuwait National Petroleum Company, that together handled all oil production and refining operations. The principle of wide-scale privatization was accepted by the Government, although it was made clear that this would not encompass those two strategically important petroleum companies.

When the sale of Government shareholdings in local companies started in 1994, the initial intention was to complete the sale within a period of three years, but as these shareholdings were sold mainly to Kuwaitis only, the market's absorptive capacity necessitated a gradualist approach. Nonetheless, by the end of the first quarter of 1999, the Kuwait Investment Authority had sold the bulk of its shareholdings in 28 companies that are listed on the Kuwait Stock Exchange, as well as 2 unlisted companies, realizing a total revenue of nearly US\$ 2.92 billion.<sup>10</sup>

The sale of government assets in local companies was considered the first and simple stage of privatization, to be followed by a second and more complex stage encompassing the privatization of major government enterprises, such as utilities and communications. Kuwait's progress in this regard has not been tangible so far. An early attempt in 1992 to privatize the Ministry of Communications was blocked by Parliament for many years and was finally rejected in 1997 on the grounds that it would lead to rival monopolies and result in significant job losses among Kuwaiti employees. The issue of the impact of privatization on job opportunities for nationals is a delicate one in Kuwait, as indeed it is in the other GCC countries, since around 93 per cent of Kuwaiti nationals are employed by the public sector. Other plans include the privatization of the Petrochemical Industries Company, the Kuwait Oil Tankers Company, which owns and runs a fleet of oil tankers operating worldwide, and the national airline, Kuwait Airways.

There are, as yet, no concrete developments regarding privatization prospects for the first two companies. As for the third, a law to reorganize Kuwait Airways into a shareholding company as a first step in its privatization was still awaiting parliamentary approval by mid-2000. The company's recent financial status, in any case, does not make it very attractive to investors in its current state. Plans to privatize petrol

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<sup>10</sup> National Bank of Kuwait, *Economic and Financial Quarterly*, 1999.

stations have been postponed since 1998, though the decision taken in the third quarter of 1999 to increase domestic gasoline prices could make this privatization project less problematic, since it has effectively reduced the domestic gasoline subsidy.

Two recent developments could give further impetus to Kuwait's privatization programme, the achievements of which, in light of the above, can only be described as mixed so far. The first and more important of these developments was the approval by the Government in September 2000 of a project to build, with substantial private sector participation, two power stations with a combined capacity of 3,600 megawatts (MW). The two stations, which will sell power to the Government's power network, and will mark the first entry of private investment into this sector.

The second development was the decision in August 2000 to open up the Kuwait Stock Exchange to non-GCC investors, who are now allowed for the first time to directly own shares in Kuwaiti shareholding companies. At the same time, a new foreign investment law has lifted restrictions on foreign ownership of domestic firms and on FDI by allowing 100 per cent foreign ownership of domestic firms instead of the previous limit of 49 per cent. These decisions, once they are fully implemented should help improve the market's capacity to absorb future privatizations.

Bahrain has made little progress so far in privatizing its main public utilities, in spite of its traditional reputation as having the most liberal economic system among the GCC countries. Various options to privatize the power sector have been 'under consideration' since 1996, even though the power sector has been described as being in a precarious state because of ageing installations and the urgent need to expand generating capacity, which has been delayed by a shortage of funding. Three privatizations options for the power sector have been considered. The first involves the transfer of power facilities to a shareholding company in which the Government will still have a majority shareholding of 51 per cent. The second is the setting up of a commercial company that would run electric power facilities under government supervision. The third and most radical option is the full privatization of all facilities, whereby the Government would buy all power and water requirements from the private sector. No decision has been on these options, though the third looks least likely to be accepted. In the meantime, a project to build a new power complex on a build-own-operate-transfer (BOOT) basis was shelved early in 1998 in favour of State financing through a mixture of syndicated loans and export credit guarantees.<sup>11</sup>

Bahrain's telecommunications sector is controlled by Bahrain Telecommunications Company, in which the Government has shared ownership since 1981 with a 20 per cent foreign shareholder. There are no plans to expand private shareholdings in this company. As against that, the Government since late 1999 has indicated that there are projects under consideration to privatize some operations at Bahrain's main port, Mina Salman, as well as some municipal services.

In Oman, a privatization law passed in 1996 included a programme and guidelines for privatization and provided for the establishment of a ministerial committee to oversee its implementation. In that same year, Oman inaugurated the first independent power project in the GCC region. Strictly speaking, however, this was a BOOT scheme, in that it was built by private sector companies that were given the right to operate it and sell power to the public electricity utility for 20 years before relinquishing ownership to the Government. Since then, the Omani Government has expressed its intention to privatize the entire power sector and to encourage more independent power schemes to boost generating capacity. However, little progress has been achieved on these plans so far.<sup>12</sup>

In the telecommunications sector, Oman has followed the pattern of other GCC countries. It converted the General Telecommunications Authority, the State communications monopoly, into a shareholding company with the intention of selling at least 35 per cent of it to private shareholders. There are also reports

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<sup>11</sup> *Middle East Economic Digest* and *Middle East Economic Survey*, various issues; ESCWA, "Privatization in the Gulf countries" (E/ESCWA/ED/1995/8).

<sup>12</sup> *Middle East Economic Digest* (14 November 1997, 20 November 1998 and 7 May 1999); *Middle East Monitor*, various issues.



that a strategic foreign partner will be brought in to take a substantial stake in the company, while the remaining shares will be sold to the private sector on the local stock exchange.

There is also a plan to privatize Oman's international airport, although the Government will retain control of strategic services, such as traffic control.

Since 1996, Oman has also been taking steps to encourage foreign investment by allowing 100 per cent foreign ownership of some manufacturing projects and reducing income tax rates on shareholding companies with foreign shareholders. Oman, however, faces tough competition from the Jebel Ali Free Zone in Dubai, which offers considerable tax and other incentives to foreign investors and enjoys the most modern infrastructure and most efficient port facilities in the region.

Privatization in Qatar<sup>13</sup> began mainly with the telecommunications sector in 1998, when the Government sold 45 per cent of the Qatar Public Telecommunications Corporation, the government-owned telephone monopoly, to local and foreign private investors. Further sales were planned, but the poor performance of the Doha Stock Market, on which the shares are traded, forced a postponement of further divestments.

The other basic, though still preliminary, privatization move has been in the power and water sector. Qatar began by establishing the Qatar Electricity and Water Corporation in 1999 to take over the functions of the Ministry of Electricity and Water and to operate the national power grid and plan its future development. While still fully owned by the public sector, formation of this corporation prepares the sector for the option of full or partial privatization in the future, as the Government has indicated.

Most important perhaps is that the Government is now planning to meet additional power demand, which is rising by 10 per cent a year, through a so-called 'independent power project' to be built at Ras Laffan. Current plans are to set up a new utility company in which a foreign partner/developer will be given a 60 per cent shareholding, with the remaining 40 per cent held by the Government and the Qatar Electricity and Water Company. In other words, the majority of the project will be owned and operated by the private sector. Capacity is planned at 150 MW initially, rising to 1000 MW by the year 2005.

The scheme is still under negotiation and a number of foreign companies have been invited to bid for the role of foreign partner. Its success hangs on the price of natural gas that will be charged to the project, as well as electric power tariffs in Qatar. The latter issue is also under study, with a view to imposing a tariff for the first time on Qatari nationals and possibly increasing the current tariff on foreigners.

On another level, Qatar has been a leader in the Gulf since the 1970s in bringing in foreign partners as minority shareholders in its main industrial ventures. In 1999, the Government announced a plan to sell 45 per cent of its shareholding in the Qatar Steel Company, as well as shareholdings in a number of other local companies. It was expected at the time that this would bring in revenues of about US\$ 1.4 billion, but the plan has since been postponed because of unfavourable market conditions. Reports in mid-2000 were that Qatar would open up its stock market to non-GCC foreign investors by the end of the year. This move is aimed at increasing liquidity on the market and hence possibly improving its price performance.

Saudi Arabia began privatization rather late. It has, however, been more aggressive in pursuing it, in the sense that, contrary to earlier expectations of selling government shareholdings in traded companies, it has instead, concentrated on the main public utilities. A 1996 study estimated that the privatization of State assets in Saudi Arabia—including telecommunications, electricity, the railway network, education, the national airline and government shares in 37 traded companies—would raise around US\$ 27 billion over three to eight years.<sup>14</sup>

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<sup>13</sup> *Middle East Economic Digest* and *Middle East Economic Survey*, various issues.

<sup>14</sup> Study on Saudi Arabia privatization prepared at King Fahd University and quoted in *Economist Intelligence Unit*, 10 June 2000.

At the end of 1997, the Saudi Government established the Saudi Telecommunications Company to take over the operation of the entire telephone system, with the intention that it would be completely privatized within a period of 18 months. Since then, efforts have concentrated on corporatizing the telephone system, and a number of international investment banks and management consultants have been brought in to prepare for the privatization of the company. According to the Government, the intention is to issue shares on both the local and international markets. There is also talk of bringing in a 'strategic foreign partner' with a shareholding of 20 to 40 per cent, meaning an international telecommunications company with the expertise to help operate and manage the service.

Postal services are also being partly privatized by granting private sector operators licenses to open postal agencies that will sell stamps and offer a full range of other services, including post office boxes and direct delivery.

Electric power and water utilities present a greater challenge for privatization because of large debts and subsidies in this sector. In an approach similar to that adopted in the telecommunications sector, the Saudi Government established in November 1999 a joint stock company, the Saudi Electricity Company, that groups the ten existing regional power generation, transmission and distribution companies in the country. The plan, again, is to corporatize this new company and then to privatize it fully or partly. This will not be an easy task, as the ten regional power companies had estimated combined losses of more than US\$ 900 million and total outstanding debts of US\$ 25.7 billion at the end of April 1998.<sup>15</sup>

The Government's electric power subsidy is estimated to have reached an average of US\$ 180 million during 1998-1999. A step to correct this situation was made at the beginning of 2000 when electricity tariffs were increased for the first time since 1995, by an average of 77.6 per cent.

Another major candidate for privatization is the national airline, Saudia. Early in October 2000, an agreement was signed with a consortium of seven international banks and management consulting and legal firms to prepare a programme for the privatization of the airline, including studies, restructuring and the preparation of subscription procedures. The entire job is expected to take 30 months, which means that the company will be ready for privatization by mid-2003.

Various other privatization opportunities are being studied among the many that exist in Saudi Arabia. The Government does not seem to be in a hurry to sell any part of its 70 per cent share in the Saudi Basic Industries Corporation (SABIC), as this enterprise is profitable and efficiently managed. At the end of 1999, however, the Government approved the privatization of some activities of the Royal Commission for Jubail and Yunbu, the two main industrial sites where most of SABIC's plants are located, but it is not yet clear which activities are to be privatized. A planned development of a railway system in the Kingdom is expected to be partly funded by the private sector.

In its latest Five Year Development Plan for the period 2000-2004, which was issued in October 2000, the Saudi Government reaffirmed its intention to push ahead with the privatization programme, expecting that foreign and domestic private capital would fill the gap left by a reduction in government investment. This falls in line with the major reforms that were introduced into the foreign investment law in April 2000, which for the first time allowed 100 per cent ownership by foreigners of companies and real estate for business purposes in Saudi Arabia, made foreign investors on par with local investors in terms of benefits and incentives, and eliminated the need for a local sponsor. At the same time, the progressive corporate income tax has been revised downwards, effectively allowing a tax rebate of 15 per cent on existing brackets for foreign corporations. A General Investment Authority was set up at that time to oversee implementation of new foreign investment regulations and facilitate procedures for foreign investors.

Many questions have been raised about these new foreign investment regulations, especially the role of the Investment Authority in vetting investment applications, the required minimum size of investment and the areas barred to foreign investors. But in August 2000, some of these early concerns were relieved when

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<sup>15</sup> National Commercial Bank, 15 December 1999.

licences were issued to four foreign investment projects that involve a combined investment of US\$ 533 million.

The minimum investment required for foreign-owned projects to be approved has been set as follows: the equivalent of US\$ 6.7 million for agricultural projects, US\$ 1.33 million for industrial projects and US\$ 535 thousand for other projects. These requirements are seen as low enough to attract small- and medium-sized foreign enterprises, which means that the expected capital inflow could permeate a broader cross section of economic activity than originally anticipated and thus have a more significant effect on overall private sector activity.

In the United Arab Emirates, the issue of privatization has not been as pressing as in the other GCC countries. Abu Dhabi has enjoyed a better financial situation than the rest of the Gulf and thus has been less willing to accept some of the perceived negative implications of privatization, including job losses for the native workforce and a diminution of the State's role in spreading the oil wealth. In Dubai, on the other hand, the importance of privatization has been pushed into the background by its increasingly liberal business climate and the leading role that the private sector has played in the development of Dubai's services economy. In addition, many government bodies in Dubai, including the police force, have become self-financing bodies, while some main public enterprises, including electricity and water utilities, are run on a commercial basis.

In 1996, Abu Dhabi sold shareholdings worth around US\$ 82 million in two food production enterprises, a move that was considered at the time as the start of privatization. Subsequently, the federal government set up a privatization committee to study ways of transferring public sector shareholdings to the private sector; and the General Industries Corporation, which controls Abu Dhabi's main non-oil industries, announced the intention to sell 80 per cent of its shares in five key factories, worth around US\$ 200 million, to the private sector. These plans have not been realized so far, though a number of important privatization moves have been completed in the last two years or are now ready for completion. These include management contracts for a number of hospitals and medical centres and the management and operation of sewerage networks.

Abu Dhabi also set up in 1996 a committee to "oversee the privatization of water and electricity services". This was superseded in 1997 by a high-level permanent committee that appointed a number of international consultants as advisers. The first result of this committee's work was a decision in 1998 to set up the Abu Dhabi Water and Electricity Authority to replace the Water and Electricity Department. The entire sector was reorganized into twelve new entities under this Authority. However, even though the Government indicated that some of these entities would eventually be partly privatized, with the State retaining full control on electricity and water transmission for strategic reasons, there was still no progress on this by late 2000.

Nonetheless, the public sector's monopoly of the power sector in Abu Dhabi finally ended in October 1998, with the conclusion of a deal for the first semi-independent power project. The foreign company chosen will have a 40 per cent share in the new utility company, which will build, own and operate a new power generation and water desalination plant with a capacity of 580 MW and sell its output to government-owned transmission companies. This project was the second of its kind in the GCC countries, following the one in Oman, as will be indicated later. Planning for a second and larger independent power project is under way and selection of a foreign partner for this project was expected before the end of 2000.<sup>16</sup>

In Dubai, the Government has persisted in maintaining control over the Dubai Water and Electricity Authority, arguing that the Authority is already efficiently run and that no benefits to the Government or the consumers would arise from its privatization. Against that, however, a joint-stock company formed in Dubai, Emirates Basic Industries, is the first company of its kind in the United Arab Emirates to offer individual investors the chance to invest in downstream oil and gas-related projects, including

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<sup>16</sup> *Middle East Economic Digest* (22 August 1997, 25 December 1998 and 19 February 1999) and *Middle East Economic Survey*, various issues.

petrochemicals, through a 55 per cent shareholding offered to the public. In contrast to Abu Dhabi, which has been reluctant so far to liberalize its economy and remove restrictions on foreign investment, Dubai has made significant steps in this direction in the last two years. For the first time, foreign ownership of real estate has been allowed in the new Dubai Internet City and some form of regulated 100 per cent foreign ownership of enterprises is in the cards, especially since the restriction on foreign majority ownership was lifted for nationals of other GCC countries at the beginning of 2000.<sup>17</sup>

The following main conclusions may be drawn from the above survey of privatization and economic liberalization developments in the GCC countries to date:

(a) With the exception of Kuwait, progress in the sale of GCC government shareholdings in local companies has been limited, although the various Governments have declared their intention to move along this path in the future. In particular, the large industrial enterprises remain firmly in the hands of the public sector;

(b) A promising start has been made in the privatization of the main public utilities, especially in Saudi Arabia and Qatar. The trend to establish public corporations to handle power and water utilities as a first step towards the privatization of those utilities has become fully established in the region. The start made on independent power projects and various plans to introduce strategic foreign partners into this sector are also important developments;

(c) Economic liberalization moves in the field of foreign investment regulations have been significant in the GCC region in the last few years. In particular, the new foreign investment regulations in Saudi Arabia set a standard that could well be followed by all other GCC countries in coming years.

#### F. DEVELOPMENT OF NON-OIL PUBLIC REVENUE SOURCES

Efforts to develop non-oil revenue sources in the GCC countries date back to at least the mid-1980s, when the sharp drop in oil revenues forced an urgent search for means to supplement budget revenues. However, the options have been limited by a general reluctance on the part of GCC Governments to impose income taxes on their citizens, to raise customs tariffs from their relatively minimal levels, to end tax exemptions and other tax holidays on local companies, or to increase tariffs on public utilities and other government services. Suggestions by the International Monetary Fund (IMF) for the introduction of a sales tax have also been rejected. Nevertheless, the period since the mid-1990s has seen a gradual change in government attitudes in this respect. Some examples of this are:

(a) A sharp increase in tobacco duties, which has raised total revenue of the GCC countries from tobacco duties from an estimated US\$ 171 million in 1994 to US\$ 581 million in 1999, or nearly 240 per cent;

(b) An increase in electricity tariffs in Saudi Arabia in 1995 and again at the end of 1999, and a doubling of such tariffs in the United Arab Emirates at the end of 1994. In Qatar, the Government is expected to introduce soon a new tariff structure for electricity and water that will impose a monthly ceiling on supplies to Qatari citizens, which have been free of charge so far. If this ceiling is exceeded, the additional consumption has to be paid for;

(c) Fees and charges on various government services, including residence permits, health care charges and municipal duties, for example, have been increased by varying degrees. Kuwait has introduced mandatory health insurance for expatriates to reduce health care costs and Saudi Arabia is moving in the same direction;

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<sup>17</sup> Ibid.

(d) The development of the services sector has helped generate additional government revenues from various duties and charges, though it is difficult to gauge the size of this additional revenue from available data;

(e) Oman took a number of significant steps in 1998 and 1999 to boost non-oil revenues by increasing customs duties on luxury items and raising the corporate income tax. These measures increased non-oil revenue to US\$ 1,428 million in 1998 from US\$ 1,100 million in 1995, or nearly 30 per cent.<sup>18</sup>

Generally, there has been an upward trend in non-oil revenues in all the GCC countries since 1995. Available data for four of these countries show a rise of 17.6 per cent in non-oil revenues in Saudi Arabia from 1995 to 1999, and an increase of 31 per cent in Kuwait, 37 per cent in the United Arab Emirates and 44 per cent in Oman. Nonetheless, as will be shown in chapter III below, non-oil revenues remain a small proportion of total revenues in all the GCC countries.

#### G. REDUCTION OF STATE SUBSIDIES

The issue of State subsidies to the private sector is double-edged, in terms of its relevance to economic diversification in the GCC countries. On the one hand, it can be argued that such subsidies were an essential element of the policy of spreading the oil wealth and using it to promote the growth of the private sector, at least in the initial stages of the development of the GCC economies. On the other hand, it has become increasingly clear that a reduction and eventual elimination of subsidies is a necessary part of the creation of a viable, internationally competitive private sector. The pricing of water, electricity and other public utilities and government services is equally essential for the on-going corporatization of public sector enterprises in preparation for privatization. Additionally, the reduction or removal of domestic subsidies, including the substantial subsidies to individuals, would reduce government expenditures and improve government finances.

But while these conclusions seem obvious, they are also complicated by considerations of comparative advantage. It could be argued that if the GCC economies are not provided with low-priced energy (and hydrocarbon feed stock, in the case of the chemical industries), they would not be exploiting their comparative advantage in energy resources. This principle remains correct so long as the GCC countries supply energy in the international market at the same low prices. This is what is happening.

The GCC countries have taken different directions on domestic subsidies, although generally very little has so far been achieved in terms of significantly reducing those subsidies. Political and social constraints and considerations have been the main reasons. The public sector in most of the GCC countries remains generally large and inefficient; it provides excessively generous social transfers and continues to subsidize public utilities and other public services.

A full review of the status and size of public subsidies is made difficult by limited data and the fact that domestic subsidies are not always spelled out clearly in the national accounts. However, some recent developments and examples highlight the current state of affairs.

In Bahrain, the Government subsidized electricity and water consumption by around US\$ 69 million during 1998, or around 6 per cent of total public expenditures. The electric power tariff was 23.6 per cent lower than production cost, while water was sold at only 18.5 per cent of the cost of production.

In Kuwait, a reduction in fuel subsidies that was proposed in a fiscal correction plan at the end of 1998 would have raised domestic fuel prices by 40 per cent. Family allowances that are paid to all Kuwaiti families cost the State around US\$ 270 million, or around 2.2 per cent of total public expenditures in 1998. The State also pays the entire social security contribution of Kuwaitis working in the public and private sectors. Kuwaitis are also provided with free housing or free land plots and interest-free house building loans. Government land purchases from the private sector were also an important form of subsidy, although

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<sup>18</sup> Omani Minister of Finance quoted in *Middle East Economic Survey*, Vol. 43, No. 13 (27 March 2000).

the size of such purchases has dropped to a minimal level in recent years. Overall, the item of transfers to households in Kuwait's budget accounting system was about 1 per cent of total expenditures and 1.5 per cent of current expenditures in 1987 and remained at nearly the same proportion in 1998.

In Saudi Arabia, the budget for the year 2000 provided for a rise in basic subsidies by 15 per cent above the 1999 appropriation. While budget appropriations are not always a good indicator of actual expenditure in the GCC countries, this budgeted increase nonetheless goes counter to any expectation of a change in policy on subsidies in general. The local subsidies item in Saudi Arabia's budget accounting system amounted to US\$ 1.9 billion in 1997, or 3.9 per cent of total expenditures. The same proportion in 1989 was 3.5 per cent. One notable exception to the general stagnation in the subsidy policy of Saudi Arabia, however, has been the sharp cutback in farming subsidies since the late 1980s, which was responsible for the equally substantial drop in agricultural production, especially wheat production, since then.

A survey of the other GCC countries shows that there has been little interest in significant and meaningful reductions in domestic subsidies. The rise in oil prices since 1999 has pushed this issue further down among the priorities of the GCC Governments. Even those countries that have frozen public sector appointments because of budget constraints prior to 1999 have since removed them. Public sector employment of GCC nationals can be thought of increasingly as a domestic subsidy, since marginal productivity in the public sector is very low and a large proportion of additions to the labour force in this sector are simply made to absorb new entrants into the job market.

### III. MEASURING THE SUCCESS OF ECONOMIC DIVERSIFICATION IN THE GCC COUNTRIES

#### A. QUANTITATIVE MEASURES OF ECONOMIC DIVERSIFICATION

While there are a number of simple quantitative macroeconomic and microeconomic indicators that can be applied to measure the degree of economic diversification achieved in the GCC countries, application of many of these indicators, as outlined in chapter I, is limited by data availability. The analysis below will therefore be limited to the following indicators:

##### 1. *Change in the sector composition of the GDP*

A breakdown of GDP by main sector of economic activity shows a gradual decline in the direct contribution of the oil sector to GDP in all the GCC countries from the 1970s to 1998, the latest year for which detailed GDP data are available. As shown in table 17, the oil sector accounted for an average of 61 per cent of the GDP of Kuwait, Oman, Saudi Arabia and the United Arab Emirates in 1977; but this contribution dropped gradually to 53 per cent on average during the period from 1981 to 1985, 37.4 per cent during the period from 1991 to 1995 and then to an estimated average of 35 per cent during the period from 1996 to 1998. In Qatar, the contribution of the oil sector to GDP dropped from an average of 64 per cent during the period from 1981 to 1985 to 37.7 per cent during the period from 1996 to 1998. Even in Bahrain, where the small oil sector contributed around 27 per cent of GDP in 1997, the contribution dropped to an estimated average of 16.8 per cent during the period from 1996 to 1998.<sup>19</sup>

TABLE 17. CONTRIBUTION OF THE OIL SECTOR TO GDP, 1977-1998  
(Percentage)

Country	1977	1981-1985	1986-1990	1991-1995	1996-1998
Bahrain	27	23.3	12.8	15.7	16.8
Kuwait <sup>a/</sup>	61	61.4	37.2	37.5	38.7
Oman	61	60.3	47.2	39.1	37.7 <sup>b/</sup>
Qatar	..	64	34.7 <sup>c/</sup>	33.9	38 <sup>d/</sup>
Saudi Arabia	63	42.8	28.9	35.2	34.4 <sup>e/</sup>
United Arab Emirates	59	48.9	38.1	37.6	28.2

Sources: ESCWA and the League of Arab States, *Statistical Indicators of the Arab World for the Period 1970-1979*; ESCWA, *Statistical Abstract of the ESCWA Region*, 17<sup>th</sup> and 19<sup>th</sup> issues.

a/ 1991-1995 average excludes 1991 data, which were affected by the invasion of Kuwait.

b/ 1997 and 1998 figures are preliminary estimates.

c/ 1987-1990 average only.

d/ 1998 figures estimates.

e/ 1997-1998 GDP data for Saudi Arabia are preliminary estimates.

Note: Two dots (..) indicate that data are not available.

This pattern of decline is undoubtedly indicative of the increasing diversification of the production base in all GCC countries, particularly the growth of the industrial and services sectors. At least two important qualifications to this conclusion, however, are in order.

First, account should be taken of the indirect contribution of the oil sector to GDP, which is difficult to measure, but is probably quite substantial. This primarily includes the below market cost of power and feedstock supplies to the industrial sector, as well as fuel for power generation and desalination plants. In addition, oil revenues basically finance all other types of domestic subsidies and generally fund the large

<sup>19</sup> See sources to table 17.

public sector. When these factors are taken into consideration, the total contribution of the oil sector to the GCC economies would still be much larger than the proportions given above.

Second, while a trend of gradual decline in the relative size of the oil sector in the GCC economies is obvious, short-term fluctuations in this relative size are clearly a function of oil prices. Thus, for instance, the average contribution of this sector to GDP during the period from 1996 to 1998 was reduced by the sharp drop in oil prices during 1998. Taking the case of Saudi Arabia as an example, if estimated GDP figures for 1998 are excluded, the average contribution of the oil sector to GDP during the period from 1996 to 1997 turns out to be 37.3 per cent, which is higher than the average ratio of 35.2 per cent recorded for the period from 1991 to 1995. By the same token, the sharp rise in oil prices during 2000 is expected to boost the average contribution of the oil sector to GDP in all GCC countries, so that it will probably exceed 40 per cent on average in Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

## *2. Instability of GDP and its relation to oil price fluctuations*

The relationship between oil price fluctuations and the instability of the GDP of the GCC countries is complicated by a third variable; namely, oil production levels. During the period from 1970 to 1986, the total nominal GDP of these countries fluctuated between a peak of US\$ 232.7 billion in 1981 and a trough of US\$ 128.1 billion in 1986, or within a very wide range of nearly US\$ 105 billion and a peak to trough drop of 55 per cent. During this same period, the average price of the OPEC crude basket dropped 41.6 per cent, while total crude oil production declined by 34 per cent. Looking at these consecutive six-year periods for comparative purposes, it is observed that during 1987-1992 total nominal GDP increased by 31 per cent, even though the average oil price rose 4 per cent. The bulk of the rise in GDP during this period is explained by a 63 per cent growth in oil production.

Comparing the two periods 1987-1992 and 1993-1998, it is clear that the impact of the oil price on nominal GDP was less pronounced in the latter period, since a 4 per cent rise in the oil price between 1987 and 1992, coupled with a 63 per cent rise in production, resulted in a 31 per cent increase in GDP during this period, whereas GDP rose 28 per cent between 1993 and 1998 in spite of a 24.5 per cent drop in the average oil price, which was only partly offset by a limited 7 per cent rise in production. However, this conclusion can only be preliminary since the period of analysis is too short, while the variables involved are complex.

## *3. Evolution of oil revenue as a proportion of total Government revenues*

A consistent, though incomplete, data series showing a breakdown of actual Government revenues between those of oil and non-oil is available for only four of the GCC countries; namely, Kuwait, Oman, Saudi Arabia and the United Arab Emirates. As shown in table 15, these figures reflect mixed progress in the diversification of revenue sources away from oil. While a trend of gradual decline in the relative importance of oil revenue is observed in all of these countries except Kuwait during the period from 1980 to 1997-1998, the rise in oil prices since the first quarter of 1999 is expected to have partly reversed this trend.

In Saudi Arabia, the proportion of oil revenue to total Government revenues dropped from more than 91 per cent in 1980 to less than 78 per cent in 1997. Low oil prices during 1989, 1994 and 1995 pushed this proportion significantly below this level, and in 1998 it reached an estimated 56.5 per cent. However, estimated oil revenues were 34 per cent higher in 1999 than in 1998 and a further significant rise is expected in 2000. Accordingly, oil revenues were estimated to have risen again to 70 per cent of total revenues in 1999 and a further rise towards 77-80 per cent was projected for 2000 (see table 18).

## *4. Evolution of non-oil exports and their composition*

A steady rise in the proportion of non-oil exports to total exports is indicative of increasing economic diversification in terms of the growth of other production activities. Table 19 shows the evolution of the non-oil exports of GCC countries as a proportion of total exports for the period from 1990 to 1997/1998 compared with 1985. These ratios were calculated using available trade data grouped by SITC sections, where oil exports are included under the heading of mineral fuels.



TABLE 18. OIL AND GAS REVENUE AS PERCENTAGE OF TOTAL ACTUAL BUDGET REVENUES, 1980-1998

Country	1980	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Bahrain	77.0	..	..	..	..	..	..	..	..	..	..	..	..
Kuwait <sup>a/</sup>	82.0	88.4	85.9	90.8	89.8	76.7	88.2	83.7	89.9	89.6	89.6	88.9	80.6
Oman	86.0	81.6	83.2	82.4	84.6	81.3	79.7	78.9	77.6	77.4	76.8	70.6	..
Qatar	94.0	..	..	..	..	..	..	..	..	..	..	..	..
Saudi Arabia	91.2	..	..	66.2	76.4	..	..	..	74	72.1	76.1	77.8	56.5
United Arab Emirates <sup>b/</sup>	96.0	..	..	..	..	83.4	80.2	80.1	76.6	75.3	72.2	72.6 <sup>c/</sup>	..

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, 17<sup>th</sup> and 19<sup>th</sup> issues; *Middle East Economic Survey*, Vol. 43, No. 6, 7 February 2000 and Vol. 43, No. 37, 11 September 2000.

a/ Fiscal year starting July of each year.

b/ Consolidated government finance account issued by Ministry of Finance and local finance departments.

c/ Preliminary.

Note: Two dots (..) indicate that data are not available.

TABLE 19. NON-OIL EXPORTS AS A PROPORTION OF TOTAL EXPORTS, 1985-1998  
(Percentage)

Year	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
1985	12	11	7	16	6	12
1990	21	22	9	15	10	15
1991	22	20	13	14	9	19
1992	24	5	16	17	10	5
1993	34	3	21	19	9	7
1994	36	3	24	18	11	5
1995	37	4	21	15	13	..
1996	32	3	20	20	11	..
1997	37	3	24	19.9	..	..
1998	..	9	..	..	..	..
Percentage change in the value of oil exports since 1985	11.3	(9.1)	23.1	18.7	209.2	59.9

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, 19<sup>th</sup> issue.

Notes: Two dots (..) indicate that data are not available; ( ) indicates negative.

Bahrain, Oman, Qatar and Saudi Arabia show a fairly convincing rise in the relative importance of non-oil exports during the period in question. In Saudi Arabia, non-oil exports were around 11 per cent of total exports in 1996, compared with 6 per cent in 1985. During this same period, exports of mineral fuels increased 209 per cent in nominal terms, which makes the rise in the proportion of non-oil exports much more significant.

In Bahrain and Oman, the rise in the proportion of non-oil exports between 1985 and 1997 was much more substantial than in Saudi Arabia, although it took place against a relatively limited increase in the value of mineral fuel exports. Qatar's non-oil exports rose to nearly 20 per cent of total exports in 1997, while the value of its oil exports increased 18.7 per cent between 1985 and 1997.

The data for Kuwait are distorted by the impact of the second Gulf war in 1990-91 on the oil sector and other productive sectors. There is, nevertheless, a clear pattern of decline in the relative size of the non-oil exports, which was reversed in 1998 only because of the sharp drop in the value of oil exports. Comparing 1998 with 1985, it is observed that the proportion of non-oil exports to total exports dropped from 11 per cent to 9 per cent, even though the nominal value of oil exports declined by 9 per cent between those two years.

Conclusions in the case of the United Arab Emirates are limited by the fact that detailed trade data are available up to 1994 only. It can be noted, however, that the proportion of non-oil exports dropped from 12 per cent in 1985 to 5 per cent in 1994. This decline occurred against the backdrop of a 60 per cent rise in the nominal value of mineral fuel exports.

In absolute terms, the value of the non-oil exports of Bahrain, Oman and Saudi Arabia has risen considerably since 1985. As shown in table 20, Bahrain's non-oil exports more than quadrupled between 1985 and 1997, while those of Oman grew from only US\$ 348 million in 1985 to more than US\$ 5.5 billion in 1998. Similarly, Saudi Arabia's non-oil exports rose from around US\$ 1.5 billion in 1985 to nearly US\$ 6.5 billion in 1996, or by more than four times. Against that, however, the non-oil exports of both Kuwait and the United Arab Emirates have trended downwards since 1985.

TABLE 20. VALUE OF NON-OIL EXPORTS, 1985-1998  
(Millions of US dollars)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
1985	343.1	1 128.1	348.1		1 543.5	1 519.3
1990	783.2	1 825.6	455.8	562.9	4 288.1	3 613.1
1991	787.5	213.9	613.3	458.7	4 091.2	4 703.5
1992	812.0	360.2	886.2	536.8	5 250.6	1 305.1
1993	1 249.6	261.2	1 124.5	583.4	3 782.8	1 457.7
1994	1 229.2	338.2	1 274.0	640.7	4 481.7	1 033.7
1995	1 548.5	459.1	1 266.8	679.6	6 498.8	..
1996	1 453.6	462.4	1 413.5	616.5	6 465.9	..
1997	1 577.0	417.5	1 801.5	816.4	..	..
1998	..	868.3	5 518.9	..	..	..

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, 19<sup>th</sup> issue, 1999.

Note: Two dots (..) indicate that data are not available.

When viewed under main product category, a high degree of concentration is observed in the composition of non-oil exports. In Saudi Arabia, Kuwait and Qatar, exports of chemical products, mainly petrochemicals, made up 60.5 per cent, 74.6 per cent and 68.7 per cent of total non-oil exports, respectively. In Qatar and Bahrain, which have steel and aluminium industries, exports of those products explain the fact that the category of manufactured goods made up 20 per cent and 24 per cent, respectively, of the total. Exports of food and live animals were significant only in Oman and Bahrain (see table 21).

TABLE 21. COMPOSITION OF NON-OIL EXPORTS OF THE GCC COUNTRIES  
(Percentage)

	Bahrain 1997	Kuwait 1998	Oman 1997	Qatar 1997	Saudi Arabia 1996	United Arab Emirates 1994
Food and live animals	14.0	3.5	11.5	0.4	5.5	5.3
Beverages and tobacco	2.5	0.7	6.5	0.1	0.2	4.1
Crude minerals (except fuel)	2.2	4.6	1.9	1.0	2.7	8.7
Animal and vegetable fats and oils	0.8	0.5	0.8		0.3	0.4
Chemicals	15.7	74.6	2.7	68.7	60.5	5.7
Manufactured goods	24.1	9.6	9.8	20.3	17.8	50.6
Machinery and transport equipment	28.9	4.3	50.9	0.1	11.0	4.5
Miscellaneous manufactures	11.8	2.3	12.8	11.6	2.0	20.7

Source: ESCWA, *Statistical Abstract of the ESCWA Region*, 19<sup>th</sup> issue.

### 5. Sectoral distribution of the labour force

Comparative data on the sectoral distribution of the labour force in the GCC countries are given in table 22 for the years 1965, 1985 and 1995.

TABLE 22. SECTORAL DISTRIBUTION OF THE LABOUR FORCE IN THE GCC COUNTRIES, 1965, 1985 AND 1995 (Percentage)

Country	Agriculture			Industry			Services		
	1965	1985	1995	1965	1985	1995	1965	1985	1995
Bahrain	14	2.2	1.6	45	37.6	31.3	42	60.1	67.1
Kuwait	2		1.2	34	25.9	30.2	64	74.1	68.6
Oman	62	45	42.1	15	9.6	13.5	23	45.5	44.4
Qatar	17		2.6	24	13.5	7.6	59	85.6	89.8
Saudi Arabia	68	43.9	13.9	11	12.3	11.4	21	43.8	74.7
United Arab Emirates	21	3.3	7.5	32	21.6	29.6	47	75.1	62.9

Source: ESCWA, *Proceedings of the Expert Group Meeting on Assessment of Economic and Social Developments in the ESCWA Region During the Last 25 Years and Priorities for the Next Decade 2000-2009* (E/ESCWA/ED/1999/22).

As would be expected, the period since 1965 saw a major shift from the traditional nomadic/pastoral and fishing economy to the oil economy, which was accompanied by a massive increase in the expatriate labour force throughout the GCC region. Accordingly, the proportion of the labour force in the agricultural sector dropped sharply between 1965 and 1995. Interestingly enough, however, the proportion of the total force employed in industry also declined during this period, because of a much faster increase in employment in the services sector. By 1995, this sector employed an average of around 70 per cent of the total labour force in the GCC countries. While in countries like Bahrain and the Emirate of Dubai private sector services activities generated substantial employment opportunities, in other GCC countries the bulk of employment has been in Government services, meaning the public administration and other public sector enterprises.

### 6. Other indicators

While other basic indicators, such as the relative contribution of the private and public sectors to GDP or to gross fixed capital accumulation, the distribution of ownership of assets between those two sectors, and various productivity measures, can provide additional insight into the degree of economic diversification achieved in the GCC countries, the application of these indicators or measures is made difficult if not impossible by the lack of data.

#### B. THE SUCCESS AND/OR FAILURE OF ECONOMIC DIVERSIFICATION AT THE MICROECONOMIC LEVEL

We have in the earlier chapters used global measures as primary indicators of the pace of economic diversification and the extent to which the GCC countries have reduced their dependence on oil and the leading role of the public sector in their economies. The degree of success of economic diversification can, however, also be assessed at the microeconomic level by looking, *inter alia*, at the results of sector development projects and the performance of enterprises that emerged as part of the economic diversification strategy. This analysis can be broad and complex, but it is restricted for the purposes of this study to the few indicative and brief case studies given below.

##### 1. Agricultural subsidies and food self-sufficiency in Saudi Arabia

Since the 1970s, the Saudi Government has given attention to self-sufficiency in food production as an important strategic goal of economic development. With more than 90 per cent of the country's food requirements imported, the Government aimed specifically at self-sufficiency in core agricultural

commodities, especially wheat, and began disbursing large subsidies with a view to encouraging the rural population, which was mostly bedouin, to become settled farmers.

In 1980, the Government announced a guaranteed purchase price for wheat of 3,500 Saudi riyals (US\$ 1,051) a ton, which was much higher than the prevailing world market price. In addition, it announced that designated land areas would be granted to farmers after three years if they developed irrigated fields to grow wheat. The best seed was also provided free by the Ministry of Agriculture and Water. These generous subsidies encouraged the establishment of private agricultural companies that depended on foreign expertise and imported labour to grow wheat on large tracts. The total area under wheat cultivation subsequently expanded rapidly from only 67,000 hectares in 1980 to 907,000 hectares by 1992. High yields of 4.7 tons a hectare were being achieved by 1988.<sup>20</sup>

A decision in 1984 to cut the purchase price by half did not slow the process and Saudi Arabia's total output of grains grew from 258,000 tons in 1980 to a peak of 5.3 million tons in 1993. The Government announced the achievement of self-sufficiency in wheat production in 1984; and, in 1986, the country generated an exportable surplus of 600,000 tons which rose to 2.4 million tons in 1992. The creation of an exportable surplus was not really part of the original plan, however, especially that these quantities were being exported at an estimated loss of US\$ 300 per ton, once subsidies are added to the cost of production. Instructions by the Government to reduce wheat production were not heeded, given the substantial profits that were being realized.

The drop in oil revenues during the second half of the 1980s, in addition to the excessive use of water resources, prompted the Government to start rethinking its agricultural subsidies programme, especially since it was estimated that around US\$ 2 billion of the 1989 budget deficit of around US\$ 13 billion in 1989 was due to agricultural subsidies. In 1993, a decision was finally taken to reduce the cost of the wheat subsidy by allocating production quotas to each farmer, by which the Government would not purchase any quantities in excess of those quotas. The impact of this new policy was a dramatic 70 per cent drop in the area under wheat cultivation between 1992 and 1996 and an equally sharp decline in total production to 1.2 million tons by 1996. The Government then increased production quotas for the 1996/97-crop year in order to maintain self-sufficiency in flour, which was estimated to require 1.8 million tons of wheat. Actual production came in at an estimated 1.5 million tons.<sup>21</sup>

For a few years, land under wheat production was turned over to barley production, which resulted in a four-fold rise in barley output between 1992 and 1994. This move was encouraged by a support price of US\$ 267 a ton, which meant that the Government incurred a loss over the cost of cheaper barley imports, which was estimated at US\$ 537 million in 1994. However, fears about the depletion of underground water resources prompted the Government to apply a quota system to barley production as well, which cut total output back to the 1992 level by 1996/97.<sup>22</sup>

Today, it is clear that the policy of agricultural self-efficiency in Saudi Arabia, at a substantial cost to the treasury, has largely failed. At the same time, a near balance has been achieved between production and domestic requirements of wheat, while imports of barley, as well as corn and soybean meal for the rapidly growing poultry industry, have been rising. Agricultural subsidies continue at a much-reduced level; but even so, budgetary constraints in recent years have often forced the Government to delay payment of those subsidies.

Agricultural production has gradually become more diversified, with greater concentration on vegetables and animal production. Nonetheless—as was shown in table 11, chapter III above—the indices of food production and food production per capita have declined sharply since 1992.

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<sup>20</sup> *Middle East Economic Digest*, 27 November 1998, pp. 30-31.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Ibid.*

## 2. Heavy industry: the case of Dubai Aluminium

Dubai Aluminium (DUBAL), which started production in 1980, was one of the early heavy industries to be set up in the GCC countries. Today, it is one of the largest single site aluminium smelters in the world and is regarded as setting many of the standards in the global aluminium industry.<sup>23</sup>

DUBAL is fully owned by the Dubai Government. During the last four years, the smelter's capacity has doubled to 536 thousand tons a year, at a reported investment of US\$ 1.2 billion. In 1999, a US\$ 600 million syndicated loan was concluded with ten local and foreign banks to finance a further expansion in capacity to 1 million tons a year. The final aim is to reach a capacity of 2 million tons a year by 2010.

DUBAL's export revenues amounted to an estimated US\$ 700 million in 1999 and thus accounted for around 50 per cent of Dubai's non-oil export revenues. After the expansion, exports were expected to reach US\$ 900 million in 2000.<sup>24</sup> The company currently supplies 200 users of aluminium around the world and provides an estimated 25 per cent of the world aluminium supplies used in car wheels, as well as the billets used in aluminium windows and high quality aluminium for the Japanese market. It achieves a purity of 99.92 in its aluminium billet, which exceeds the 99.7 standard set by the London Metal Exchange.

The company's expansion plans are based on its growing importance as a global producer, as well as its profitability. These successes have been achieved on the strength of low costs and good management. Given its high-energy intensity, aluminium was an ideal industry to exploit Dubai's large offshore natural gas reserves. The company thus benefits considerably from a very low energy cost, compared with other world producers. It also benefits from the relatively low cost of its mostly expatriate labour force and is exempt from corporate taxes. For these reasons, the company has been operating at nearly double the average margin of the world's 162 aluminium smelters. This in turn allows it to price its product at a significant discount below the average world price. At the end of 1999, for example, its product was priced at US\$ 1,000 per ton, compared with the European price of US\$ 1,200 per ton.

These prices, in any case, reflect a significant downturn in the aluminium market in 1999. But DUBAL was reportedly able to minimize the impact of this downturn through its ability to hedge its full additional production from its latest capacity expansion for three years, from 2000 to 2003.

The world aluminium market has been growing by around 3 to 4 per cent annually, and DUBAL's aim is to consolidate and increase its market share in coming years. The one obstacle it faces in realizing this goal is the 6 per cent duty imposed by the European Union on selected aluminium producers. Europe is an important export market for aluminium producers, since it produced around 2 million tons in 1999, but consumed around 17 million tons, or nearly one-third of world output.

## 3. Services based on regional positioning: the Jebel Ali Free Zone

The Jebel Ali Free Zone is one of the important success stories of economic diversification in the GCC countries. Its significance stems not only from the fact that it has grown to become one of the world's major free zone areas, but also because its success was not based, like many other projects, on comparative advantage in hydrocarbons, nor on heavy government support, but rather on the proper exploitation of a regional position and advantage.

The Jebel Ali Free Zone was established by the Dubai Government in 1985. Its mission was to become a leading international free zone by providing a first-class infrastructure for manufacturing and distribution, supported by quality value-added services which would attract reputable businesses and thus contribute to the diversification and growth of the economy of Dubai.<sup>25</sup>

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<sup>23</sup> "United Arab Emirates", *Financial Times*, 21 December 1999.

<sup>24</sup> Ibid.

<sup>25</sup> Jebel Ali Free Zone Authority.

The Zone is built around the largest man-made port in the world. It covers over one hundred square kilometres, which include pre-built offices and warehouses, storage facilities and ultra-modern cargo handling equipment. The Zone offers companies the possibilities of setting up a regional distribution base, a trading office, an assembly operation or a logistics centre. The infrastructure offers modern efficient communications and low-cost energy supplies.

Companies in the Zone may be 100 per cent foreign-owned, enjoy exemption from corporate taxes for 15 years (renewable for an additional 15 years), are allowed 100 per cent repatriation of capital and are not restricted in terms of staff recruitment requirements.

Administrative procedures for the granting of licenses to operate in the Zone have been streamlined. Procedures for leasing facilities and the provision of administrative engineering and utility services are also smooth and efficient.

On the strength of all these facilities and services, the Zone has grown to include more than 1,600 companies from more than 85 countries, including a large number of multinationals. The business of these companies spans a wide range of activities. In broad terms, 74 per cent of the companies are involved in trading activities (imports and re-exports from the Zone as a regional distribution centre), 22 per cent carry out industrial activities and the remaining 4 per cent are engaged in services.<sup>26</sup>

The distribution of the companies by nationality is equally broad, a fact which highlights the important role the Free Zone has acquired in the regional context and as a halfway link between the Far East, the Middle East, Europe and the United States. Presently, around 33 per cent of the companies are from the GCC countries, the Middle East and Africa; 23 per cent are from Europe; 25 per cent from the Asia Pacific region; and nearly 13 per cent from America.

Through its rapid growth and the increasing diversification of its activities, the Jebel Ali Free Zone has created considerable linkages with other economic activities in Dubai and has played a major role in helping the Emirate achieve its desired role as the leading commercial and business centre in the GCC region.

### C. CONCLUSIONS

During the period since the 1970s, the GCC countries have reduced the relative size of the oil sector in their economies through the development of industry, services and other sectors. Non-oil exports have also grown on average as a proportion of total exports, while the contribution of oil revenue to total Government revenues has generally been reduced as well.

All these developments are indicative of varying degrees of success in diversification away from dependence on oil. Nonetheless, nearly three decades after the oil boom of the early 1970s, the contribution of the oil sector to the GCC economies in all its aspects remains quite high.

This was perhaps best illustrated by the impact of the decline in oil prices during 1998 and the first part of 1999 on these economies. Real rates of growth dropped, export receipts declined significantly and budget deficits soared. Conversely, the sharp rise in oil prices since 1999 again helped reduce budget deficits in the GCC countries, which reached an estimated total of US\$ 21 billion in 1998. Preliminary projections for the 2000 budget in Saudi Arabia and the 1999/2000 budget in Qatar indicate that the two countries will realize budget surpluses for the first time in 17 years and 12 years, respectively. Non-oil revenue is also expected to drop again as a proportion of total revenues in all the GCC countries, and the same is true for non-oil exports.

On the microeconomic level, many economic diversification projects have been major success stories, to the extent that they were properly conceived, planned and managed to take advantage of the resource endowment and special characteristics of the GCC countries. But a comprehensive review of the overall record in this respect undoubtedly points out many projects that have been expensive failures for the opposite reasons.

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<sup>26</sup> Ibid.

#### IV. POLICY OPTIONS AND RECOMMENDATIONS

1. During the period since the early 1970s, the GCC countries have made significant advances in modernizing their economies and developing their non-oil sectors in order to reduce dependence on oil export revenues and ameliorate the economic instability inherent in such dependence on a primary commodity.
2. Economic diversification efforts started with the development of the physical and social infrastructure, and have since included the establishment of heavy industries and a fairly broad manufacturing base, as well as the development of commercial and services activities. In recent years, increasing attention has also been given to the privatization of public sector companies and enterprises, in order to expand the role of the private sector in the GCC economies, as well as open up the economies to foreign investment. There have also been gradual, but rather hesitant moves to reduce domestic subsidies.
3. The preceding analysis of those policies and measures shows that they have achieved mixed results so far and that much more, in fact, needs to be done if the GCC countries are to break away from their heavy dependence on oil and the impact of future oil price fluctuations on their economies.
4. The relative contribution of the oil sector to GDP has dropped sharply in all the GCC countries since the 1970's and the proportion of the labour force employed in industry and/or services has risen significantly in most cases. The contribution of non-oil exports to total exports more than tripled in Bahrain and Oman between 1980 and 1997 and nearly doubled in Saudi Arabia from 1985 to 1996. However, by 1996, oil exports still accounted for an average of nearly 83 per cent of the total exports of Bahrain, Kuwait, Oman, Qatar and Saudi Arabia, compared with an average of 90 per cent in 1985.

The contribution of oil and gas revenues to total Government revenues in Kuwait, Oman, Saudi Arabia and the United Arab Emirates dropped from an average of nearly 89 per cent in 1980 to 77.5 per cent in 1997, but remains very high even at this reduced level. This keeps public revenues and Government expenditures in the GCC countries largely subject to conditions in the world oil market. While the recent sharp rise in oil prices has helped save public finances in the region from the crises situation reached at the end of 1998, it also carries with it the risk of lulling the GCC Governments into the comfort of reducing the pace of economic restructuring and avoiding the sometimes difficult decisions that have to be made in this regard. In any case, the past should be a guide, in the sense that a retrospective look at the last 16 years will show that periods of rising oil prices and revenues have always been followed by equally sharp declines.

5. Broadly, therefore, the GCC countries have no option but to continue the process of economic diversification. Current conditions in the oil market and the resultant improvement in the economic situation in the GCC countries can be used to advantage as a solid backdrop for a continuation of the process of economic diversification. The basic future policy requirements in this respect include the following:

(a) Speeding up privatization programmes, including the privatization of the main public utilities and large industrial enterprises, such as the petrochemical industries, and the promotion of independent projects and private sector participation in the next generation of mega-projects. The main objectives of privatization—namely, the reduction of the role of the public sector in the GCC economies and the promotion of private sector activity and competitiveness—remain far from full realization;

(b) The improved economic outlook in the region should help make financial markets in the GCC countries more receptive to the issue of shares, which will be part of privatizations. Financial markets need to be reformed, however, and their role and efficiency improved. Necessary reforms include the opening up of all GCC stock markets to foreign investors, the introduction of world standard share-trading systems and procedures, and the application of modern market regulations that ensure transparency and adequate legal safeguards for investors;

(c) Domestic subsidies should be reduced and many of them should eventually be eliminated, on the basis of priorities and a timetable that takes into account social and political opposition to their removal. Industries and other productive activities that depend on the comparative advantage of the GCC countries in

low-cost hydrocarbon and energy supplies need to be made more efficient and competitive by charging them prices of feedstock and energy that are closer to actual market prices. The successful privatization of power utilities in the region, in any case, will require the removal of heavy subsidies on power charges and the introduction of a system of bulk rates to industry, similar to those applied in many other developing and developed countries. In all cases, the GCC countries will need to avoid the development of economic activities that depend on heavy subsidies for their survival. The experience of Saudi Arabia with agricultural subsidies shows that this can be a costly and ultimately useless exercise;

(d) In line with the above, there is need for a reassessment of industrialization policies in the GCC countries in coming years. As explained above, such policies have concentrated since the 1970s on building the broadest manufacturing base possible—including import substituting industries—sometimes at heavy cost in terms of subsidies, tax exemptions and other benefits. As the GCC countries open up to the world market and move to join the WTO, the main priority of future industrial policies should be to ensure the creation of viable, internationally competitive manufacturing industries that depend solely on the comparative advantage of the GCC countries in resource endowment. The coordination and integration of industrialization projects among the GCC countries, which have been much proclaimed but elusive goals over the last three decades, should also be a priority for the future. As has often been argued in the past, such coordination is necessary to prevent duplication of economic diversification projects among the different GCC countries and to look at the economic viability of such projects in terms of the overall GCC market;

(e) One of the major challenges that face the GCC countries in coming years is to provide economically productive employment opportunities for their growing national labour force. This is especially so, given that the privatization of public sector enterprises is expected to release substantial numbers of excess labour employed in those enterprises, resulting in undesirable social and political consequences. Diversified economic growth should help absorb an increasing proportion of the national labour force in the medium to long term. In the shorter term, however, the GCC countries need to speed up programmes to replace expatriates with nationals in both the public and private sectors. Furthermore, if the objectives of those programmes are to be achieved at minimum economic cost, in terms of efficiency and productivity, priority should be given to the training of nationals at all levels and to the quality of education. Among other things, this latter objective should include the institution of educational programmes that create the types of skills that are specifically required in the GCC labour markets;

(f) Given the fact that non-oil revenues still account for a small share of total Government revenues in most GCC countries, much more needs to be done in the coming years to develop non-oil revenue sources. Among other measures, this should include a reduction of tax holidays and exemptions and possibly the introduction of a value-added tax.

6. Needless to say, some of the policies suggested above may have a negative short-term impact on the private sector in the GCC countries, which has become habituated to generous Government support. Nonetheless, they are necessary for the growth of solid well-diversified economies able to accommodate themselves in the increasingly efficient and open world economy.



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