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Economic wisdom tempers Gulf approach to oil bounty

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Between 2002 and mid-2008, oil prices steadily rose, which has strengthened the key macroeconomic indicators in the six GCC countries.

The real gross domestic product growth reached an average of 8 per cent a year over the 2002-2007 period, with foreign reserves, investments, and budgets showing equally solid performance. As a result, average GDP per capita across the six countries grew about 32 per cent in the 2002-2007 period, according to the IMF.

Economic theory says that a temporary income windfall will largely be saved, while a permanent windfall will largely be consumed.

How did the GCC countries behave in response to the recent oil price increase?

As shown in the Table, GCC countries have recycled their oil revenues through three main channels: one trade channel (the import of foreign goods and services) and two financial channels (the asset accumulation channel and the debt reduction channel).

Starting with the financial channels, Saudi Arabia registered the highest reduction in its public debt, followed by Qatar and Kuwait. By contrast, UAE has accumulated new debt (domestic and foreign) largely to finance its mega infrastructure projects. On average, since 2002 GCC countries managed to lower their level of public debt to an average of 12 per cent in 2007, compared with an average of 69.9 per cent in the 1998-2002 period.

This was not due only to an increase in oil income. In recent years GCC governments have become more cautious in their spending. For example, between 1969 and 1976, the compound annual growth rate of Saudi Arabia's income was 57 per cent, while the same rate for state expenditure was 55 per cent, implying that almost all the additional income in this period of oil price increases was spent immediately.

By contrast, between 2002 and 2008, the growth rate of Saudi Arabia's income was 31.5 per cent, while expenditure growth was only 14 per cent annually, implying that more than half of the annual additional income has been saved. Similar trend is also observed in other GCC states. Clearly, the GCC states have drawn lessons from their past extravagance. The increase in oil prices had a dramatic impact on the external economic position of the GCC countries. The accumulation of financial assets in GCC states took in the form of foreign exchange reserves (held by central banks) as well as assets accumulation by public (sovereign wealth funds) bodies.

There appears to be some differences between the pattern of oil revenue recycling through the financial channel in the 1970s and early 1980s and the most recent episode of high oil prices. In the former period, oil revenues were mainly recycled in the form of foreign exchange reserves and deposits with international banks. Whereas, in recent times portfolio investment in the form of sovereign wealth funds (SWFs) has played a greater role.

The SWFs of the four GCC states (UAE, Saudi Arabia, Kuwait and Qatar) are estimated to have had assets in excess of $1.5 trillion (Dh5.5 trillion) before the start of the financial crisis in August 2008. If investments of individuals and private institutions are added to the SWFs, the estimated foreign investment by the GCC states exceeds $3 trillion.

However, the recent financial crisis has had a huge toll on GCC's investments, both domestically and internationally. According to the estimates by Mohammad Al Sabah, the Foreign Minister of Kuwait, the GCC countries had lost over $2.5 trillion in just less than four months of the crisis. Nevertheless, the part of the SWFs was used to finance anti-crisis measures locally. For example, recently the Qatari government bought real estate loans worth 15 billion Qatari riyals (Dh15 billion) from nine local banks in order to prop up the recession-hit real estate sector.

Earlier, the Qatari government bought 20 billion riyals of banks' local equities portfolios and then their non-yielding investment portfolios (other than real estate loans), worth 6.5 billion riyals.

Paul Krugman, who won last year's Nobel prize in economics for his work on trade, wrote in 1993, "What a country really gains from trade is the ability to import things it wants. Exports are not an objective in and of themselves; the need to export is a burden that a country must bear because its import suppliers are crass enough to demand payment." Krugman's view seems to dominate the economic realities in the Gulf countries.

The imports of GCC countries have increased substantially over the last few years. In absolute terms, imports of goods are services by the six GCC countries increased from $99 billion in 2002 to $253 billion in 2007. UAE and Saudi Arabia together account for over 75 per cent of the additional amount of imports over the period 2002-2007.

There has also been a noticeable shift in the source of GCC imports, with Asia expanding its share at the expense of the United States. From 1997 to 2006, GCC imports from the United States declined from 16 per cent to 11 per cent, while imports from Asia increased from 26 per cent to 31 per cent. In particular, imports from China rose from 4.4 per cent to 8 per cent during this period. Imports from the EU remain in the first place with a share of 32 per cent.

Summing up, the GCC countries have accumulated a huge volume of oil revenues, and despite the recent decline in oil prices, abundant revenue inflow is expected over the next few years.

The breakdown prices of oil per barrel that balances 2009 budgets are: $36 for the UAE; $38 for Qatar; $48 for Kuwait; $51 for Saudi Arabia; $71 for Oman; and $73 for Bahrain. The top priority in these countries should be enhancing institutional capacities to manage oil revenues by balancing between creating jobs and improving living standards.

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Table: Petrodollar recycling in GCC countries, 2002-2007

	Exports (mn bbl)	Oil export revenues (bn US dollar)		Foreign reserve (bn US dollar)		Imports (bn US dollar)		Govt, debt to GDP (percent)	
	2007	2002	2007	2002	2007	2002	2007	2002	2007
Bahrain	0.2	1.8	5.1	1.7	4.1	5.0	10.2	32.1	19.6
Kuwait	1.9	13.4	48.5	9.3	16.8	9.0	19.2	29.9	7.0
Oman	0.6	7.5	15.9	3.2	9.5	6.0	12.4	23.3	6.3
Qatar	1.2	7.6	31.3	1.6	9.4	4.1	19.9	47.9	8.9
KSA	7.8	62.2	202.0	20.8	34.0	32.3	89.4	96.9	18.7
UAE	2.6	18.1	67.5	15.2	77.2	42.7	101.6	5.2	10.6

Source: European Central Bank WP No. 1012, February 2009.