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**More Bang for the Buck in the GCC: Structural Reform Priorities to  
Power Growth in a Low Oil Price Environment**

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I N T E R N A T I O N A L M O N E T A R Y F U N D

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## EXECUTIVE SUMMARY<sup>1</sup>

**The new environment of low oil prices has led to a deterioration in the growth prospects of the Gulf Cooperation Council (GCC) economies.** Movements in oil prices, through their impact on fiscal policy, are often the main determinant of economic activity in oil exporting countries. In the GCC, strong non-oil growth has occurred primarily during periods of high oil prices, and lower growth has coincided with periods of low oil prices.

**The drop in oil prices since mid-2014 is prompting significant fiscal adjustment, which is dampening growth prospects.** While new evidence indicates that fiscal multipliers have fallen in recent years, suggesting inefficiencies in public spending, and that the negative impact on growth as that spending is curbed may be smaller than previously thought, fiscal consolidation will still be a drag on growth. Estimates of fiscal multipliers—the metric that helps assess how much output could fall when government spending falls—are smaller for current than for capital spending.

**In contrast to international experience, past growth in the GCC has been driven by factor accumulation.** Internationally, high and sustained growth has coincided with improvements in total factor productivity. In contrast, high and sustained growth in the GCC has been the result of factor accumulation, both labor and capital, rather than improvements in productivity. This suggests there is scope for structural reforms to boost productivity, which could serve as a new engine for growth in the current low oil price environment.

**Supporting growth prospects in the medium and longer-term in the GCC will require a range of actions:**

- **Designing a growth friendly fiscal adjustment, including through improvements to spending efficiency.** Such an adjustment would target cuts in current spending, spread deficit reduction measures over time in a predictable way, and improve public spending efficiency to ameliorate the impact on growth from fiscal consolidation.
- **Implementing structural reforms to improve productivity.** Product markets reforms—for instance, improving the business environment, reducing trade barriers, institutional reforms to the legal system and property rights, and privatization—should be a priority. Reforms to enhance labor market flexibility and reduce the public-private sector wage gap should also be adopted, although paced over time.
- **Leveraging the experience of the top performers in the region to design and implement structural reforms.** While GCC countries have enacted structural reforms in recent years, survey-based international rankings on structural indicators generally show uneven progress, with the exception of UAE and Qatar. Successes and challenges in the design and implementation of structural reforms in other countries offer extremely useful lessons for those now considering such measures.

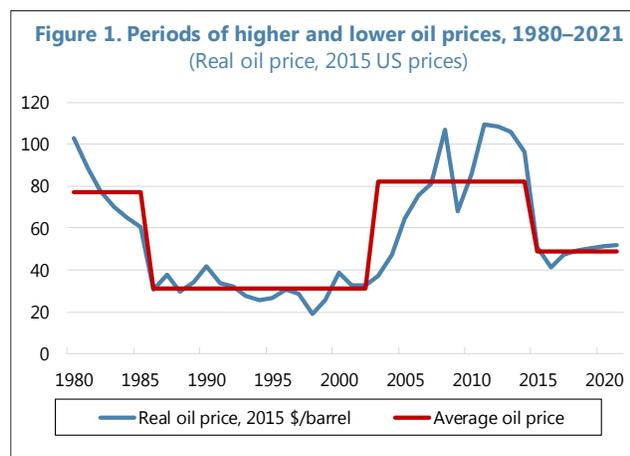
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## A. Introduction

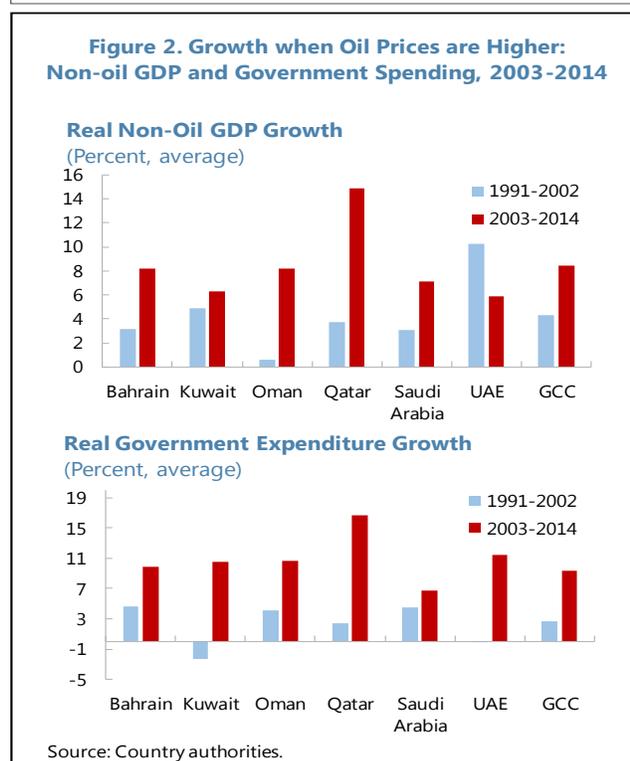
- 1. Economic performance in oil-exporting countries depends significantly on developments in world oil prices, which affect both actual and potential growth.** Several studies have documented the importance of movements in energy prices in determining economic activity. For energy/oil exporters movements in terms of trade and output are more strongly related—particularly in countries with pro-cyclical fiscal policies and less flexible exchange rates—with oil prices changes affecting the economic cycle mainly through their impact on fiscal policy (Husain et al. (2008)). Potential growth also moves with commodity terms of trade, although the impact depends on policies implemented to smooth the shock, including structural reforms to bolster potential growth (see, for instance, Agénor et al. (1999) and IMF (2015e)).
- 2. With GCC economies depending importantly on oil, the drop in oil prices deteriorated fiscal positions substantially, prompting countries to respond with significant fiscal adjustments.** Despite government efforts, progress to further diversify the economy away from oil has been modest (IMF, 2014). On average for the region during 2011-15 oil revenues were close to 80 percent of government revenues, oil exports amounted to 65 percent of exports, and oil GDP represented 45 percent of GDP. The drop in oil prices since mid-2014 has resulted in large fiscal deficits that are projected to continue over the medium-term in most countries, despite fiscal consolidation measures already adopted and in the pipeline (see IMF (2015a), IMF (2016d), and IMF (2016c)).
- 3. The expected environment of low oil prices demands policies to strengthen actual and potential growth across the region.** The GCC growth model, characterized by reliance on oil revenue and foreign labor, has delivered strong economic and social outcomes over several decades. However, with oil prices expected to persist at low levels and growth expected to moderate, there is a need to boost economic diversification and sustainable growth in the non-oil tradable sector, which in turn can help reduce exposure to oil price volatility and generate productive jobs for nationals.
- 4. This paper provides policy advice to help GCC countries identify and prioritize policies to support growth over the medium and longer term.** It provides analysis on the impact of fiscal policy on growth and the sources of growth. It identifies potential reform areas based on GCC countries' performance when compared with peers and international experience. The paper is organized as follows. Section B outlines recent growth development in the GCC. Section C discusses estimates of fiscal multipliers and assesses the impact on growth of the fiscal consolidation plans currently envisaged in the region. Section D provides a comparison of the sources of growth between the GCC and other countries, drawing implications for growth going forward. Section E identifies areas where structural reforms can help boost productivity and growth and suggests an approach for prioritization. The last section concludes.

## B. Growth and Government Spending in the GCC

**5. GCC countries have faced relatively prolonged periods of lower and higher oil prices in the not too distant past.** The fall in oil prices in 1986 marked the beginning of a long period of relatively low oil prices, particularly when compared with prices in previous years (Figure 1). The last period of lower (higher) oil prices lasted broadly between 1986–2002 (2003–14).<sup>2</sup> Most recently, global oil prices have fallen since mid-2014 and are projected to remain near present levels for the foreseeable future.



**6. Non-oil growth in the GCC region has been higher during periods of higher oil prices.** Owing to data limitations, the sample starts in 1991. Average annual oil prices during 1991–2002 and 2003–14 were \$29.5 and \$82.3 per barrel. When oil prices were lower (1991–2002) average annual non-oil GDP growth in the region was 4.3 percent, whereas when oil prices were higher (2003–14) average non-oil growth reached 8.4 percent per year. The UAE is the only country in the region that displays a different growth pattern – it grew faster when oil prices were lower (Figure 2).<sup>3</sup>



**7. However, some slowdown in growth appears to have started in the period after the 2008 global financial crisis (GFC).** While average growth for the GCC during the years before the GFC (2003–07) was 11.8 percent per year, it fell to 6 percent per year during 2008–2014. Non-oil growth fell the most in Oman (9.6 percentage points) and Bahrain (8.2 percentage points), and the least in Saudi Arabia (0.7 percentage points). The average growth

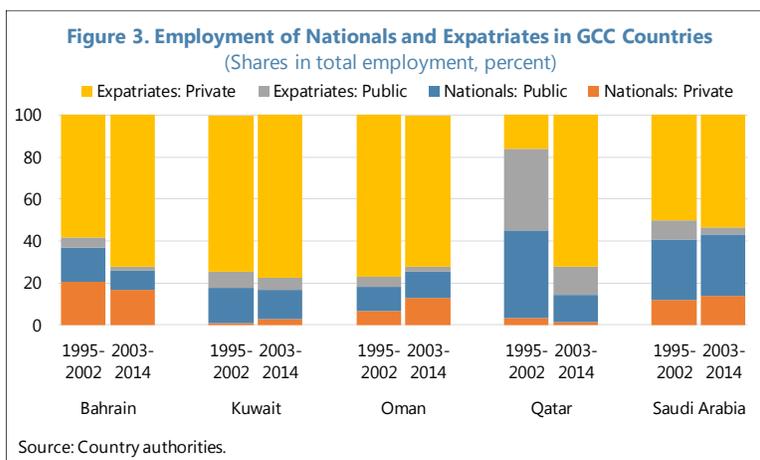
<sup>2</sup> The periods of higher and lower prices are defined to identify relatively longer periods during which there is a more or less clear pattern in global oil prices. Simple tests of structural breaks suggest that new oil price periods started in 1986 (lower oil prices), 2003 or 2004 (higher oil prices), and 2015 (lower oil prices). Other approaches suggest similar dates for “structural breaks”. Oil prices are measured in real terms at 2015 US prices.

<sup>3</sup> For Kuwait and the UAE, the growth pattern is driven by the impact from the First Gulf War (early 90s) and the Dubai World crisis (2009–10), respectively.

rate in the UAE also declined: 10.3 percent (1991–2002), 9.3 percent (2003–07), and 3.4 percent (2008–2014). The slowdown may reflect slower global growth as well as domestic elements such as lower efficiency of public spending, potential crowding out of private sector activity, and insufficient reform effort to improve the attractiveness of the regional economies for investors.

**8. Strong growth during periods of high oil prices has been supported by higher growth in government spending.** Higher oil prices helped governments finance rapid increases in spending. During 2003–2014 the region witnessed a significant expansion in public infrastructure, public sector wage bills, and social transfers, which led to strong growth in non-oil activity, particularly in the non-tradable sector: higher spending growth was positively associated with higher non-oil growth. The average annual growth rate in real (central) government spending was 9.3 percent during 2003–14, compared with 2.7 percent during 1991–2002.<sup>4</sup> However, the link between government spending and non-oil activity appears to have weakened over the period 2008–14 as suggested by the trend in the ratio of average non-oil GDP growth to average spending growth. The ratio falls from 1.58 in 1991–2002, to 1.36 in 2003–07, to 0.62 in 2008–14.

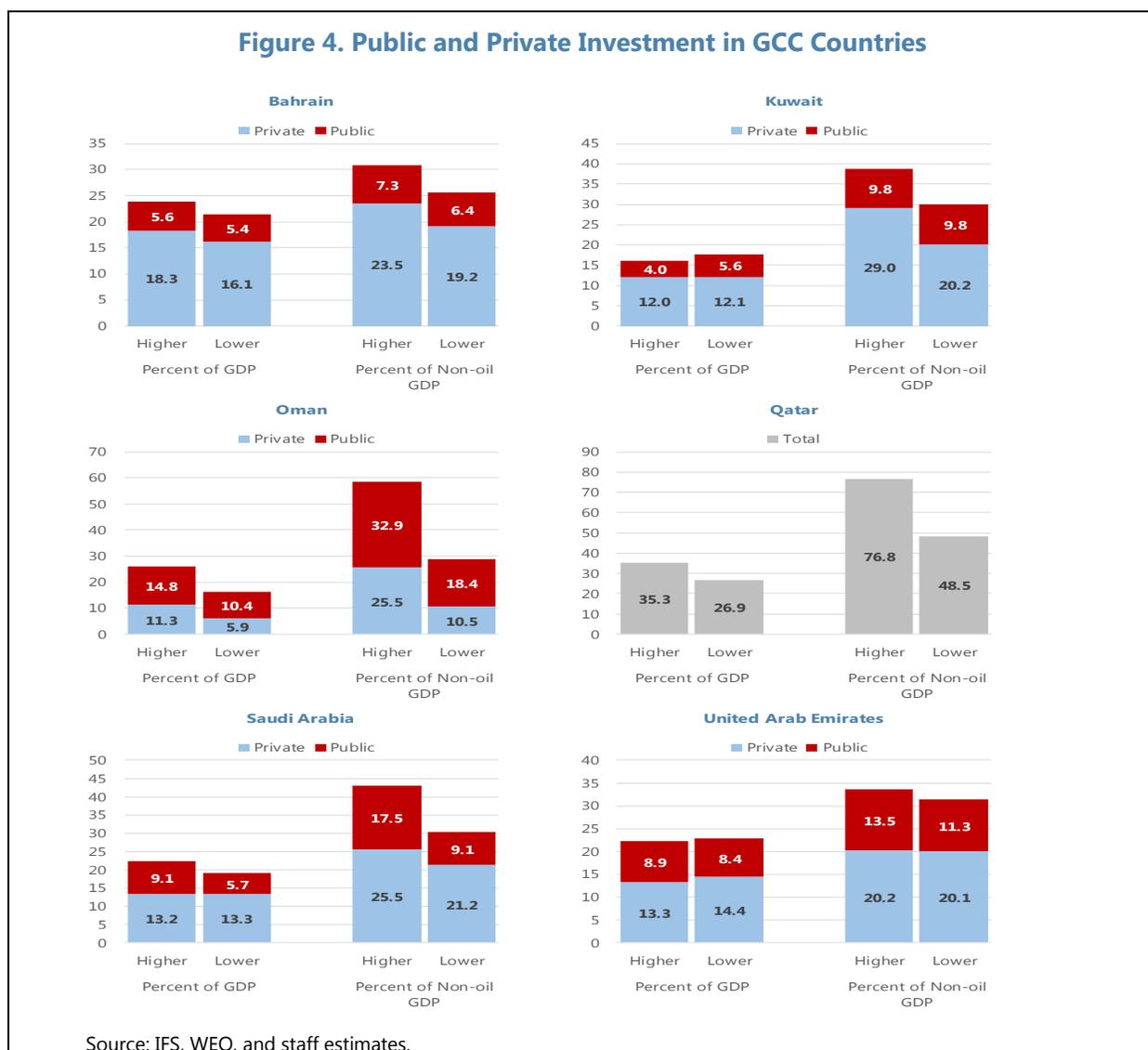
**9. Despite strong growth in the non-oil sector during the period of higher oil prices, job creation for nationals in the private sector remained weak.** Weak links between growth and private sector employment of nationals in the region reflect labor market policies that have used public sector employment of nationals as a way to distribute the oil wealth among citizens, while the private sector labor demand has been accommodated by importing labor (IMF (2013) and IMF (2014)). Between 37 percent (Bahrain) and 87 percent (Qatar) of nationals are employed in the public sector (Figure 3). Behar (2015) documents that higher growth in the GCC non-oil sector does not quickly translate into jobs for nationals. In fact, despite strong employment growth, the share of nationals in total employment has not changed significantly, particularly in Saudi Arabia, Kuwait, and Qatar—it ranges from about 45 percent in Saudi Arabia to about 6 percent in Qatar.



**10. Furthermore, public and private investment in the GCC tends to be positively related with oil prices.** For instance, during 1991–2002 public investment as a share of GDP was on average 4 percentage points lower than during 2003–14. Only Kuwait and the UAE invested slightly more in the former period. Investment to GDP, however, provides a partial view since the movements in the GDP deflator mask changes in investment. Investment as a share of non-oil GDP, a better metric, is

<sup>4</sup> The positive relationship between spending growth and non-oil growth did not hold for Kuwait and the UAE when oil prices were lower, although the spending metric used does not capture expenditures done through GREs or SOEs.

on average almost 15 percentage points lower during the lower oil price period (Figure 4). Higher public investment has been accompanied by higher private investment.



## C. Growth in the Near and Medium-Term: Impact of Lower Oil Prices and Fiscal Adjustment

**11. To reduce the large fiscal deficits resulting from lower oil prices, most GCC countries have embarked on significant fiscal adjustments.** The sharp decline in oil prices that started in mid-2014 has resulted in large fiscal deficits that are projected to continue over the medium-term despite fiscal consolidation measures taken over the last couple of years (IMF (2015a), IMF (2016d)).

**12. Fiscal consolidation policies are likely to have a negative impact on growth.** Public consumption and investment represent close to 30 percent of GDP (2014) on average in the GCC, and almost 40 percent for Oman and Saudi Arabia. Fiscal consolidation efforts, by reducing

government spending, will reduce aggregate demand and economic activity. This effect can be measured through a fiscal multiplier, which is defined as the ratio of a change in national income to an autonomous change in government spending—for instance, a multiplier equal to one implies that if government spending falls by \$1, then non-oil GDP would fall by \$1. Moreover, a tight fiscal environment could affect consumer and business confidence which may negatively affect private consumption and investment and economic activity. Fiscal consolidation measures adopted so far to address the fall in oil prices have contributed to lower non-oil growth across the region (see accompanying paper on “Economic Prospects and Policy Challenges for the GCC Countries).

### 13. The existing literature has discussed extensively the growth impact of fiscal policy.

Blanchard and Perotti (2002), Mountford and Uhlig (2009), and Ilzetzki et al (2013), among others, provide estimates of fiscal multipliers for advanced economies. For emerging markets, recent studies include Kraay (2012), and Hory (2016). A literature review by Batini et al. (2014) emphasizes that fiscal multipliers are found to be lower in emerging and low income countries than in advanced economies—for instance due to inefficiencies of government spending and greater leakage through imports in smaller and more open economies. Short-term spending multipliers for advanced economies range between 0.6 and 1.4 and for emerging markets between 0.2 and 0.5. Non-linearities in the impact of fiscal policy on growth have also been investigated—e.g., whether fiscal multipliers are different in fixed versus floating exchange rate regimes (Ilzetzki et al. 2013), in recessions versus expansions (IMF (2012), Auerbach and Gorodnichemko, 2013), and whether fiscal multipliers have changed over time (Kirchner et al., 2010; Pereira and Lopes, 2014).

### 14. For GCC countries, estimates of fiscal multipliers suggest larger multipliers for capital than for current spending.

Espinoza and Senhadji (2011) and Cerisola et al. (2015) provide

estimates of fiscal multipliers for the GCC, with short-term (one year) spending multiplier around 0.3 and medium-term (three years) multipliers between 0.3 and 1.4, with larger estimates for capital spending than for current spending (Table 1). Updated estimates using an expanded data set up to 2015 produce multipliers of similar magnitude (Annex I). In line with the previous papers, multipliers are larger for capital than for current spending. The short-term multipliers are 0.4 for capital spending and 0.3 for current spending. While current expenditure seems only to affect economic activity in the short term, the medium-term impact of capital spending is found to be larger. The current

spending multiplier is estimated at 0.3, with no statistically significant effects on growth beyond one year; capital spending multipliers are estimated at 0.4 and 1.6 for the short and medium-term

**Table 1. Estimated Fiscal Multipliers for the GCC, 1990-2015<sup>1/</sup>**  
**Impact on Non-oil GDP**

	Capital Spending	Current Spending
<b>Estimates for the GCC</b>		
<i>Multipliers (1990 - 2015)</i>		
Short-term	0.4	0.3
Medium-term	1.6	0.3
<i>Multipliers (2008-2015)</i>		
Short/Medium-term	0.0	0.0
<b>Previous Studies on the GCC</b>		
<i>Espinoza &amp; Senhadji (2011)</i>		
Short-term	0.2 – 0.3	0.2 – 0.4
Medium-term	0.6 – 1.1	0.3 – 0.7
<i>Cerisola et al. (2015)</i>		
Medium-term	1.4	0.7

Source: Staff estimates

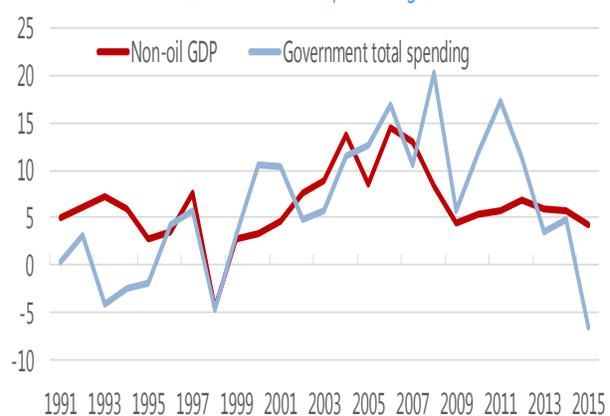
1/ The fiscal multiplier indicates the amount non-oil GDP would change if government spending changes by one unit, controlling for global growth and two lags of Government spending. See Annex I for details.

impact, respectively. The relatively wide range of estimates suggests that the impact of fiscal consolidation on growth could vary across countries depending on its composition—current versus capital spending as well as the type of spending.<sup>5</sup>

**15. From a growth perspective, adjustment should be designed to fall as far as possible on current spending, and complemented by improving spending efficiency, unless capital spending is higher than needed given infrastructure needs.** If the fiscal consolidation measures implied in the most recent baseline projections (an annual average fiscal consolidation of approximately 4.2 percent of non-oil GDP) were to fall on current spending only (for instance, subsidies and transfers, wage bill, spending on goods and services), estimates suggest that the non-oil GDP growth rate could fall on average by about 0.5 percentage points per year during 2016–21. In contrast, if the implied fiscal consolidation were to fall on capital spending only, the non-oil GDP growth rate could fall on average 2.5 percent per year.<sup>6</sup> Improving the efficiency of public spending would help offset the adverse growth impact of spending cuts. Spreading deficit reduction measures over time in a predictable way would also ameliorate the impact on growth by giving the private sector more time to adjust.

**16. It seems, however, that fiscal multipliers may have declined in GCC countries in recent years.** Figure 5 shows a clear positive correlation between government spending and non-oil GDP growth over the past decades, but the relationship appears to have weakened in recent years. While the variations in government spending appear to be closely related to changes in non-oil GDP before 2008, the large increase in government spending since then seems to have had only a limited impact on growth. Using an analytical approach that allows for time varying fiscal multipliers (Annex I), the estimated multiplier in the post-2008 period is not statistically different from zero, although the small sample size is a concern.<sup>7</sup> This suggests that fiscal policy had a less positive impact on growth in recent years and

**Figure 5. Government Spending and Non-oil GDP Growth in the GCC**  
(Percent, GCC simple average)



Source: World Economic Outlook.

<sup>5</sup> In principle, the impact on economic activity could be different if the government cuts spending on goods and services, infrastructure or land acquisitions.

<sup>6</sup> Estimated long-term multipliers from Cerisola et al. (2015) would imply that growth would fall on average by about 1.03 (2.14) percentage points if consolidation were to fall only on current (capital) spending. Based on Espinoza and Senahdji (2011), growth would fall on average between 0.46 and 1 (0.62 and 1.64) percentage points per year if consolidation were to fall only on current (capital) spending.

<sup>7</sup> Given data limitations, these new estimates should be considered as preliminary and suggestive that the impact of spending on economic activity is smaller than previously thought, though not necessarily zero.

(continued)

points to a low efficiency of fiscal spending.<sup>8</sup> While there are no metrics available to directly assess investment efficiency in the region, Albino-War et al. (2014) finds that there is substantial room to improve public investment efficiency in MENA oil exporters, including in the GCC countries. The significant fiscal expansions in the region since 2008—which translated into higher public employment and investment—might also have crowded out private sector employment and investment. Alternatively, as GCC fiscal spending increased and surpluses shrank, the private sector may have increased overall saving, reducing the impact of spending on aggregate demand (a reflection of Ricardian Equivalence).

## D. Sources of Growth for the GCC Over the Longer Term

**17. Amid significant fiscal consolidation efforts, GCC countries face the challenge to boost actual and potential growth.** The GCC growth model, characterized by reliance on oil and provision of jobs in the public sector for nationals, has delivered gains in economic and social indicators in the past. However, with oil prices expected to persist at low levels and growth expected to decline, there is a need to boost economic diversification and sustainable growth in the non-oil tradable sector, which in turn, can help reduce exposure to oil price volatility and generate productive, private sector jobs for nationals.

**18. In this vein, this section examines the past sources of growth in the GCC and compares them to the international experience.** According to the growth accounting approach, three components—labor, capital, and productivity—contribute to increments in output (GDP).<sup>9</sup> To identify growth sources and constraints in the GCC, this section first explores sources of growth in the GCC during periods of higher/lower oil prices, subsequently it looks into the sources of sustained growth for a large sample of advanced and emerging market economies.

### Sources of growth in the GCC: higher versus lower oil price periods

**19. Non-oil growth in GCC countries has been mainly driven by capital and labor accumulation rather than productivity growth.** Capital and labor have been the main drivers of non-oil growth in the region during the last 25 years, regardless of whether oil prices have been relatively high or low. Labor and capital have accounted (GCC average) for between 75 and 100 percent of growth, depending on the period considered (Table 2). The significant contribution from labor reflects the rapid increase in private sector employment of low-skilled low-wage foreign workers.

**20. However, growth and growth drivers performed better in most GCC countries when oil prices were higher.** The favorable environment created by higher oil prices supports higher public and private investment as well as employment, which improves the contribution of capital and labor

<sup>8</sup> In the GCC, business cycles are closely associated with oil price cycles (IMF, 2015b). The empirical investigation in this paper found little evidence of fiscal multipliers being affected by the level of oil prices.

<sup>9</sup> Growth accounting has been amply discussed in the literature. A comprehensive discussion could be found, for instance, in Jorgenson (1987). Barro and Sala-i-Martin (2004), Chapter 10, discusses the basic growth accounting framework, and Harberger (1998) also offers a brief description of how research on growth accounting has evolved.

to growth. Higher oil prices also favor improvements in TFP, for instance, because higher public infrastructure investment leads to lower production costs in the economy. For most countries in the region, non-oil growth was stronger when oil prices were higher, reflecting significantly larger contributions by labor and capital (Table 2). In the UAE, however, average growth was substantially higher during 1991–2002 supported by productivity performance, coinciding with reforms efforts to diversify the economy away from oil and into petrochemicals, fertilizers, cement, aluminum, tourism, trade and manufacturing.

**Table 2. Non-oil GDP Growth in the GCC: Input Contributions <sup>1/</sup>**  
(Percentage points)

	Average annual non-oil growth, percent	Average contribution to growth, percentage points			Fraction of non-oil growth accounted by labor and capital
		Labor	Capital	TFP	
Full Period, 1991 - 2014					
Bahrain	5.7	3.2	2.2	0.2	0.96
Kuwait	5.6	3.3	0.9	1.4	0.75
Oman	4.4	3.0	2.5	-1.1	1.26
Qatar	9.3	4.8	3.7	0.8	0.91
Saudi Arabia	5.1	1.8	2.0	1.3	0.74
UAE	8.1	5.0	1.8	1.2	0.85
GCC Average	6.4	3.5	2.2	0.6	0.90
Lower Oil Prices, 1991 -2002					
Bahrain	3.2	3.0	1.7	-1.5	1.47
Kuwait	4.9	4.0	0.0	0.8	0.83
Oman	0.6	1.6	2.1	-3.2	6.35
Qatar	3.7	1.1	1.7	0.9	0.75
Saudi Arabia	3.1	1.2	1.6	0.3	0.90
UAE	10.3	5.0	1.4	3.9	0.62
GCC Average	4.3	2.6	1.4	0.2	0.95
Higher Oil Prices, 2003 -2014					
Bahrain	8.2	3.5	2.7	2.0	0.76
Kuwait	6.3	2.7	1.7	1.9	0.69
Oman	8.2	4.4	2.9	0.9	0.89
Qatar	14.9	8.4	5.8	0.7	0.95
Saudi Arabia	7.1	2.3	2.4	2.3	0.67
UAE	5.8	5.1	2.2	-1.4	1.24
GCC Average	8.4	4.4	3.0	1.1	0.87

Source: IMF, WEO, and Staff estimates.

<sup>1/</sup> Labor share in GDP is assumed at 50 percent. Labor shares of 40/60 percent increase/reduce TFP between 0.1-0.2 percentage points.

## Sources of Growth: International Comparison with the GCC

**21. GCC countries could benefit from the international experience regarding the main drivers of sustained growth.** Following Harberger (2005), this section analyzes the sources of growth during high-growth episodes in advanced and emerging markets during 1970–2015.<sup>10</sup> For oil

<sup>10</sup> For each country, the 1970–2015 period is split between high-growth episodes and non-high-growth periods. A high-growth episode is defined as one where GDP growth is greater than 4 percent per year for at least five consecutive years; otherwise, the period is considered a non-high-growth episode. The same criteria are used to define high and non-high non-oil growth episodes. The analysis includes 51 countries, out of 140, which registered at least one high-GDP growth episode, and 22 countries with at least one high-non-oil GDP growth, 11 of which are considered as oil exporters. For GDP (non-oil GDP), the average growth rate is 3.9 (4.3) percent, with median and 75th percentile at 3.9 (4.1) and 6.3 (6.5) percent, respectively. The “4 percent” rule aims to strike a balance between studying too few/many countries if the rule is tighter/softer; the 5-year periods aims to abstract from short-term fluctuation in economic activity and capture growth outcomes over the medium term.

exporters, the discussion focuses on the sources of non-oil growth during high-non-oil growth episodes during 1991–2015; high-growth episodes do not fully coincide with periods of higher/lower oil prices.

**22. International experience suggests that during high and sustained growth episodes, growth comes mainly from total factor productivity.** Table 3 summarizes the breakdown of various country groups' GDP growth into sources of growth. While sustained growth could be driven by factor accumulation and/or productivity growth, for the high and sustained growth episodes identified during 1970–2015, about one-half of the growth is accounted for by TFP (countries identified as having high and sustained growth episodes display median growth of 7 percent per year during these episodes, of which 3.3 percent is from TFP growth). The same pattern emerges when looking at more disaggregated country groups. For instance, TFP contributes 4.3 out of 8.1 percentage points in growth for advanced economies and 3 out of 6.9 points for emerging markets. Productivity is also an important source of growth in MENAP countries.

**23. There is a positive association between the capital and productivity contributions to growth.** During high-growth episodes, productivity contributes more than capital and capital contributes more than labor, with a tendency for relatively higher capital and productivity contributions to coexist, particularly in advanced economies and emerging markets in Asia and Sub-Saharan Africa (Table 3). The positive association between the capital contribution and productivity suggests that favorable opportunities for TFP may increase business profitability and promote investment and capital accumulation, whereas unfavorable opportunities may limit incentives to invest and accumulate capital.

**24. Differences in GDP growth between high-growth episodes and other periods are accounted for mainly by TFP growth, followed by capital accumulation.** On average, the difference in growth between high growth periods and other periods is 4.1 percentage points, of which 2.8 points are attributable to TFP; a similar pattern holds for all country groups (Table 3). These findings also indicate that the differences in labor and capital contributions are relatively small when comparing high and non-high growth periods; for all countries, the differences in the median capital contribution is about 1.3 percentage points, with differences in labor contributions even smaller at 0.4 percentage points.

**25. It is worthwhile to examine the sources of non-oil growth in oil exporters.** Table 4 displays the sources of non-oil growth for oil exporters and indicates the high and sustained and non-high growth periods. High-growth episodes occurred mostly during the high-oil price period (2003–14); non-high growth episodes occurred during the period of lower oil prices as well as after the GFC. On average non-GCC oil exporters display the patterns discussed before: during high-growth episodes TFP/labor are the main/minor growth drivers, there is a positive association between capital and TFP contributions, and when comparing high and non-high growth episodes, differences in growth are explained mainly by differences in TFP performance.

**26. For GCC countries differences between high and non-high growth episodes are explained by either TFP or labor contributions.** Performance in GCC countries is more diverse.

High-growth episodes are characterized mainly by significant labor contributions to growth, which reflects a policy that favors imported labor and relatively higher wages for public sector employees. The positive association between capital and productivity contributions appears absent, except in Kuwait and Oman, suggesting that the link between productivity and investment is missing; when comparing high and non-high growth episodes, growth differences are mainly explained by labor contributions in Bahrain, Qatar, and the UAE, and by TFP in Kuwait, Oman, and Saudi Arabia. The median TFP contribution to growth in GCC countries is lower than for all groups of countries, including emerging oil exporters and MENAP countries. High growth episodes occurred mainly during periods of higher oil prices; if this period were excluded (2003–14) only the UAE would have recorded a high non-oil growth episode. As documented earlier, for most GCC countries and other non-oil exporters, growth slowed down after the GFC.

**Table 3. Sources of Real GDP Growth in Advanced and Emerging Markets, 1970–2015<sup>1/</sup>**  
(Growth rates in percent, contributions to growth in percentage points; median values)

	GDP Growth	Contribution to Growth		
		Labor	Capital	TFP
<b>Advanced, Emerging and Developing Economies</b>				
High-growth Episodes	7.0	1.6	1.9	3.3
Non High - Growth Episodes	2.9	1.1	0.6	0.5
Difference (high minus Non-High)	4.1	0.4	1.3	2.8
<b>Advanced Economies</b>				
High-growth Episodes	8.1	1.4	2.1	4.3
Non High - Growth Episodes	3.5	0.6	0.9	1.1
Difference (high minus Non-High)	4.6	0.8	1.2	3.1
<b>Emerging and Developing Economies</b>				
High-growth Episodes	6.9	1.6	1.9	3.0
Non High - Growth Episodes	2.8	1.2	0.6	0.4
Difference (high minus Non-High)	4.1	0.4	1.3	2.6
<b>Asia</b>				
High-growth Episodes	7.3	1.0	2.5	3.1
Non High - Growth Episodes	2.1	0.7	0.9	0.3
Difference (high minus Non-High)	5.2	0.3	1.6	2.9
<b>Europe</b>				
High-growth Episodes	6.9	-0.6	0.2	5.8
Non High - Growth Episodes	1.5	-0.1	-0.1	1.2
Difference (high minus Non-High)	5.4	-0.4	0.3	4.5
<b>Latin America and the Caribbean</b>				
High-growth Episodes	6.9	2.0	1.4	2.4
Non High - Growth Episodes	2.7	1.2	0.4	0.3
Difference (high minus Non-High)	4.2	0.8	1.0	2.2
<b>Sub-Saharan Africa</b>				
High-growth Episodes	6.3	1.5	2.0	3.0
Non High - Growth Episodes	3.5	1.3	0.5	1.0
Difference (high minus Non-High)	2.7	0.3	1.6	2.0
<b>MENA - Afghanistan and Pakistan</b>				
High-growth Episodes	8.4	2.4	2.2	2.2
Non High - Growth Episodes	3.4	2.0	0.9	0.2
Difference (high minus Non-High)	5.1	0.5	1.4	2.1

Sources: IFS WEO, and IMF staff estimates.

<sup>1/</sup> Labor share in GDP is assumed at 50 percent. Similar results are found if labor shares are 40/60 percent of GDP. A high-growth episode is one when annual GDP growth is larger than 4 percent during at last five consecutive years, otherwise is considered as non-high-growth episodes. Country classification as in WEO.

**Table 4. Sources of Non-oil Growth in Oil Exporters<sup>1/</sup>**  
 Real non-oil GDP Growth and Breakdown into Labor, Capital, and TFP  
 (Growth rates in percent, contributions to growth in percentage points; median values)

	Non-Oil GDP Growth	Contribution to Growth			Period
		Labor	Capital	TFP	
<b>Oil Exporters</b>					
High-growth Episodes	9.0	3.2	2.3	2.4	
Non High - Growth Episodes	2.7	1.5	1.1	-0.4	
Difference (high minus non-high)	6.3	1.7	1.2	2.8	
<b>GCC Countries</b>					
High-growth Episodes	10.6	5.4	2.7	1.6	
Non High - Growth Episodes	3.1	1.7	1.6	-0.4	
Difference (high minus Non-High)	7.5	3.8	1.1	2.0	
<b>Bahrain</b>					
High-growth Episodes	11.1	7.2	3.8	0.1	2002-2008
Non High - Growth Episodes	3.4	1.7	1.5	0.3	1990 - 2001 / 2009 - 2015
Difference (high minus non-high)	7.7	5.6	2.3	-0.2	
<b>Kuwait</b>					
High-growth Episodes	12.6	4.5	2.0	6.2	2002 - 2007
Non High - Growth Episodes	3.2	2.9	0.6	-0.3	1991 - 2001 / 2008 - 2015
Difference (high minus Non-High)	9.4	1.6	1.3	6.5	
<b>Oman</b>					
High-growth Episodes	7.9	4.1	2.7	1.0	2001- 2014
Non High - Growth Episodes	-0.1	1.6	2.3	-4.0	1991 - 2000 / 2015
Difference (high minus Non-High)	8.0	2.5	0.5	5.0	
<b>Qatar</b>					
High-growth Episodes	13.3	7.4	5.4	0.5	2001- 2015
Non High - Growth Episodes	3.1	1.0	1.3	0.8	1991 - 2000
Difference (high minus Non-High)	10.2	6.4	4.2	-0.3	
<b>Saudi Arabia</b>					
High-growth Episodes	7.4	2.2	2.6	2.6	2004 - 2014
Non High - Growth Episodes	2.8	1.7	1.7	-0.5	1980 -2003
Difference (high minus Non-High)	4.6	0.6	0.9	3.2	
<b>UAE</b>					
High-growth Episodes	10.1	6.4	1.6	2.2	1991 - 2002 / 2003 - 2008
Non High - Growth Episodes	3.1	1.8	2.2	-0.9	2001 / 2009-2015
Difference (high minus Non-High)	7.1	4.5	-0.6	3.1	
<b>Memorandum</b>					
<b>Non-GCC Countries</b>					
High-growth Episodes	6.7	1.8	2.0	3.3	
Non High - Growth Episodes	1.2	1.0	0.4	0.0	
Difference (high minus Non-High)	5.4	0.8	1.5	3.3	
<b>Algeria</b>					
High-growth Episodes	6.4	1.8	2.5	2.2	2001 - 2015
Non High - Growth Episodes	1.4	1.4	0.4	-0.4	1992 - 2000
Difference (high minus Non-High)	5.0	0.4	2.0	2.6	
<b>Iran</b>					
High-growth Episodes	6.9	2.0	2.1	2.8	2000 - 2009
Non High - Growth Episodes	2.7	0.8	0.9	1.1	1984 - 1999/ 2010 -2015
Difference (high minus Non-High)	4.2	1.1	1.2	1.6	
<b>Venezuela</b>					
High-growth Episodes	12.1	1.8	1.8	8.5	2004 - 2008
Non High - Growth Episodes	0.4	1.1	0.4	-1.2	1985 - 2003 / 2009 - 2015
Difference (high minus Non-High)	11.7	0.7	1.3	9.7	
<b>Trinidad and Tobago</b>					
High-growth Episodes	6.4	1.1	1.5	3.8	2002 - 2008
Non High - Growth Episodes	1.0	0.6	0.0	0.4	1982 - 2001 / 2009 - 2015
Difference (high minus Non-High)	5.4	0.5	1.5	3.4	

Sources: IFS, WEO, and IMF staff estimates.

1/ Oil exporters with non-oil GDP data and at least one high-non-oil growth episode include: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE (GCC countries) and Algeria, Iran, Venezuela, Sudan, and Trinidad and Tobago.

## E. Structural Reforms to Support Growth

**27. Potential non-oil growth is expected to fall in the GCC over the medium-term.** Lower oil prices will negatively impact investment and reduce the rate of labor and capital accumulation, thereby slowing down capital and labor contributions to growth. The positive magnitude of the slowdown may be estimated using a production function approach.<sup>11</sup> While results are sensitive to assumptions, they generally anticipate lower potential growth over the medium term (2016–21) in the absence of reforms. In particular, if sources of growth perform as when oil prices were low in the past, potential growth is estimated at 4.5 percent per year during 2016–21 (average for the region). However, potential growth could fall to 3.5 percent if capital grows as in the most recent WEO projections (Fall 2016) and employment growth relies mainly on increasing private sector employment.<sup>12,13</sup> These estimates compare with potential growth of 5.5 percent per year during 2009–14 and represent a significant slowdown in per-capita income growth. IMF (2015e) suggests that potential growth in exporters of energy commodities could fall about 0.75 percentage points, although these results vary considerably across countries. Potential growth estimated using Hodrick-Prescott filters also suggest lower growth of 3.7 percent during 2016–21 (Figure 6).

**28. Structural reforms can help support sustained non-oil growth.** Many countries have recognized the essential role of structural reforms for ensuring durable growth, including countries in the GCC (see, for instance, Yousef, 2004). However, the economic slowdown facing the region stresses the need for additional structural reforms to support growth, boosting TFP, catalyzing private investment, and creating high-paying private sector jobs. There is a large body of empirical analysis that finds a positive relationship between a number of structural reforms and various growth drivers. Harberger (1998, 2005) stresses the need for price stability—which allows a better assessment of relative prices conducive to better investment decisions, and openness to competition from abroad to facilitate international transfer of better technologies and create incentives for efficiency.<sup>14</sup> Mitra et al. (2016) identify eight factors with the strongest links to capital, labor, and productivity, including a competitive business environment, labor market efficiency, and public infrastructure, among others, whereas Albino-War (2014) stresses the potential for improving investment efficiency in the GCC. IMF (2016a) reports that higher quality of institutions, such as public governance, legal systems and property rights, are associated with more efficient allocation of resources—which in turn can boost aggregate productivity, and can also build confidence in the economy and stimulate investment and employment.

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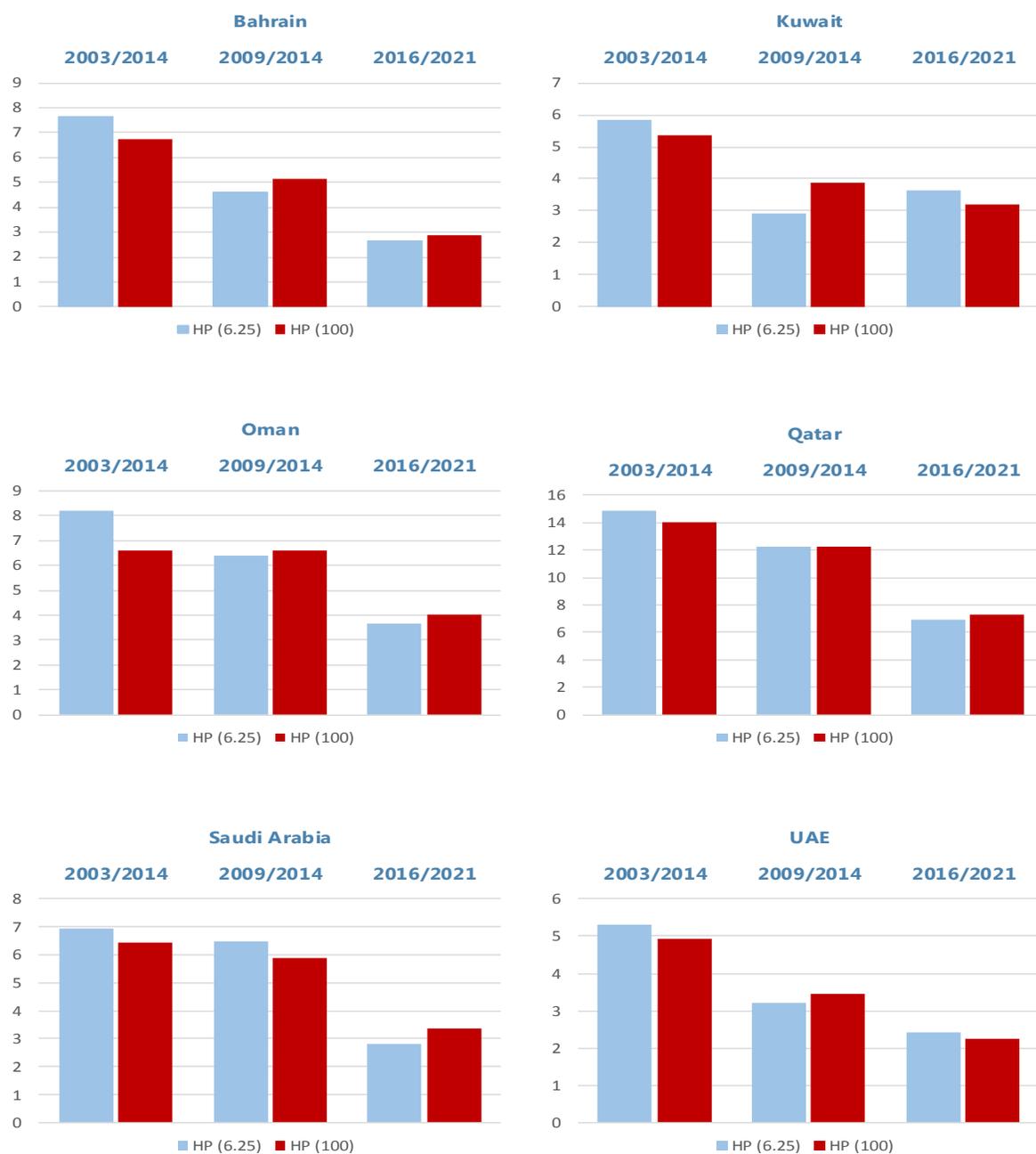
<sup>11</sup> Estimations are based on a standard Cobb-Douglas production function, follow Mitra et al. (2015) assuming factor shares set at 0.5.

<sup>12</sup> Employment of nationals in the private sector is assumed to grow at the same rate as during 2009–14, while public sector employment of nationals is assumed to remain constant during 2016–21. Total employment grows as employment of nationals.

<sup>13</sup> Reflecting fiscal consolidation efforts, average actual growth is expected to be lower than average potential growth over the medium-term.

<sup>14</sup> More open economies, however, are exposed to risks emerging from increasingly inward-looking policies in a number of countries as discussed in the October 2016 IMF World Economic Outlook.

Figure 6. Estimated Potential Non-oil GDP Growth in the GCC



Source: IMF staff estimates.

**29. GCC countries have been implementing structural reforms to support economic diversification and promote private sector growth.** A number of structural reforms have been implemented in recent years under the umbrella of national long-term development plans. Despite progress on some structural indicators, overall there has been little movement in international rankings of GCC countries. The UAE and Qatar have made the most progress, while some of the other countries have lagged behind (Box 1 and Annex II).

### Box 1. Structural Reforms in the GCC Countries

**Several GCC countries have implemented significant structural reforms in recent years.** Reforms have been aimed at supporting economic diversification and creating private sector jobs for nationals. Many GCC countries have streamlined regulatory procedures to reduce the cost of doing business, liberalized foreign direct investment and intraregional trade, privatized state assets in select industries (especially utilities), strengthened financial regulation and supervision, corporate governance and disclosure, deepened financial markets, and invested in technology and physical infrastructure. To shed light on the progress thus far, trends in historical data from the World Economic Forum's *Global Competitiveness Indices*, World Bank's *Doing Business Indicators*, The Heritage Foundation *Index of Economic Freedom*, and World Bank's *Worldwide Governance Indicators* are examined (Annex III). Amongst the GCC countries, the UAE and Qatar have made major improvements, especially since 2008. Saudi Arabia has improved on governance, but has deteriorated on economic freedom rankings. Other GCC countries do not display significant changes given available data. It seems that reform efforts in the region, except in the UAE and Qatar, have stalled or have been insufficient to improve their global standings.

**The UAE and Qatar have seen strong gains in competitiveness over the past decade, while gains in Saudi Arabia and Bahrain have been more modest.** Based on the *Global Competitiveness Indices* (GCI) data, the United Arab Emirates, followed by Qatar have seen the largest improvement, with performance strengthening across most pillars of the index. Ranking improvements in Saudi Arabia and Bahrain have been more modest, with Bahrain especially held back due to a large deterioration in the macroeconomic environment. Kuwait has seen a marginal deterioration in its GCI ranking, while Oman has seen a large drop. In both countries, the deterioration has occurred across a number of the pillars of the index. Areas where at least four of the six GCC countries have made headway include institutions, infrastructure, higher education and training, goods market efficiency, market size, business sophistication, and innovation.

**Progress in streamlining the business environment seems to be more uneven.** Based on the *Doing Business Indicators* (DBI) data, only the UAE saw an improvement in most areas. Other countries saw a little overall improvement or a slight deterioration. On the positive side, most GCC countries made improvements to the procedures for starting a business and enforcement of contracts. However, the GCC countries fell short when compared with other countries, regarding procedures for trading across borders, while access to credit and resolving insolvency remained difficult despite policymakers' efforts. Nonetheless, the range of DBI rankings—overall rankings range from 31 for the United Arab Emirates and 101 for Kuwait—suggests there may be scope for GCC countries to learn from each other.

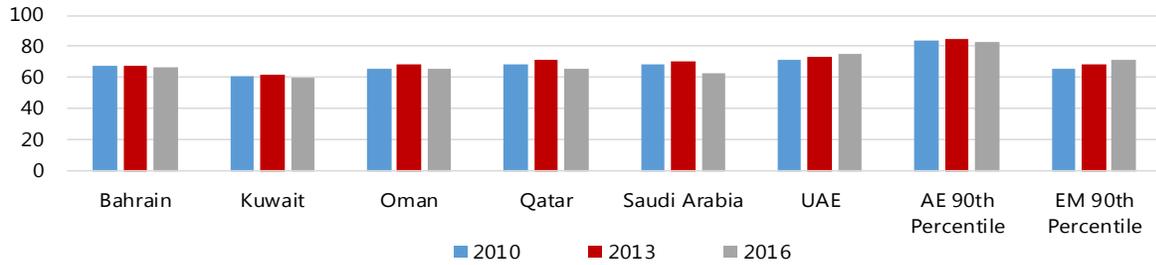
**Qatar and the UAE have seen strong gains in the economic freedom ranking since 2008.** The *Index of Economic Freedom* shows that Qatar and the UAE have substantially improved their scores in areas such as property rights, business, labor, trade, investment and financial freedom. Bahrain has recorded a modest improvement in its ranking largely driven by improvements in labor and investment freedom scores. Oman has recorded improvements in business and investment freedom, albeit its overall ranking slightly deteriorated due to lower scores in other areas. Kuwait and Saudi Arabia's overall rankings fell despite some improvement in investment and financial freedom, with Kuwait recording deterioration in property rights and labor freedom scores, and Saudi Arabia seeing lower scores for property rights, business and labor freedom.

**The GCC countries' performance has been mixed in terms of governance reforms.** The *Worldwide Governance Indicators* suggest that Qatar, the UAE, Saudi Arabia, and, to a lesser extent, Oman, had some improvements in the areas of government effectiveness, regulatory quality and rule of law during the last decade. During the same period in those three areas Bahrain's scores were broadly unchanged, while Kuwait's scores deteriorated.

### Box 1. Structural Reforms in the GCC Countries (concluded)

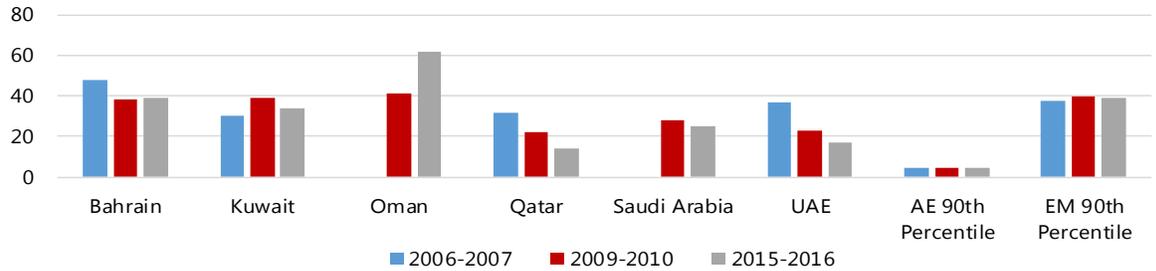
#### World Bank Doing Business Indicators

(Overall distance to frontier<sup>1</sup>)



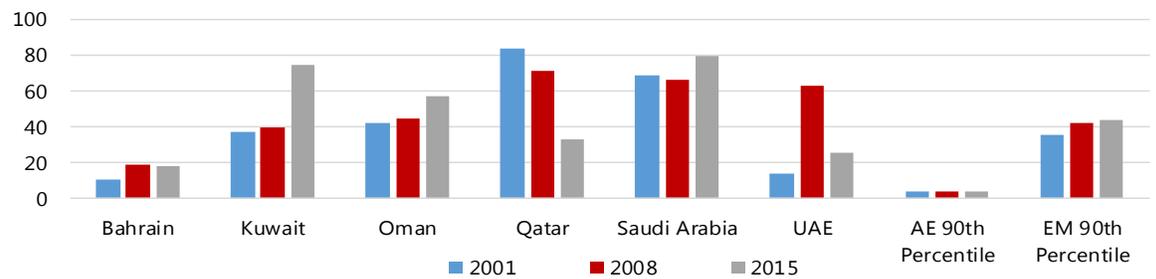
#### Global Competitiveness Indicators

(Overall rank<sup>1</sup>)



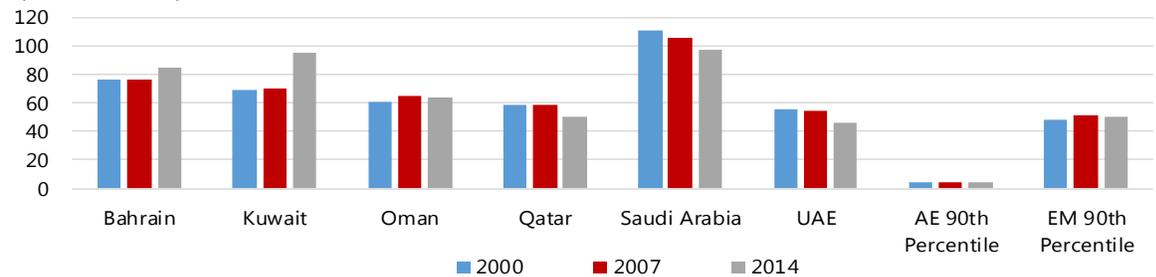
#### Heritage Economic Freedom Indicators

(Overall rank<sup>1</sup>)



#### Worldwide Governance Indicators

(Overall rank<sup>1</sup>)



<sup>1</sup> For Doing Business Indicators, a larger value is better. For the rest, lower values are better, with rank 1 being the best. Sources: World Bank Doing Business Indicators; World Economic Forum Global Competitiveness Index; Heritage Economic Freedom Indicators; and Worldwide Governance Indicators.

## International Experience: Structural Reforms, Productivity, and Growth

### 30. Key lessons can be drawn from the international experience with structural reforms.

IMF (2015c) surveys the literature and examines reform patterns for 108 countries—33 advanced economies (AEs), 53 emerging markets (EMs), and 22 low income and developing countries (LIDCs)—during the period 1970–2011. The study covers structural reforms in 10 areas, ranging from trade and financial sector reforms to institutional reforms, to reforms relating to the functioning and regulation of markets. The main findings from this study are:

- **Potential reform payoffs vary across country groups.** Structural reform needs vary across different stages of development. The strongest payoffs to EMs come from market deregulation (promotion of competition and relaxing employment protection regulations) and infrastructure investments, followed by financial sector reforms (privatization, stronger financial sector supervision and capital market development) and institutional reforms (legal system and property rights). Advanced economies, by contrast, benefit most from increasing R&D spending.
- **Large-scale reforms have a positive relationship with post-reform productivity growth.** Reforms that involve large-scale spending (on infrastructure or R&D) may yield higher benefits if implemented gradually, while most other reforms yield a positive relationship with productivity growth when implemented through a “big-bang” approach. Nevertheless, a lesson from unsuccessful cases is that effective implementation requires careful prioritization—for example, very rapid liberalization can be problematic and lead to excesses if appropriate regulation is not first put in place (IMF (2015d)).
- **Even larger productivity payoffs are observed when multiple reform episodes occur in parallel.** When countries undertake reforms in several different areas, as in a “Reform Wave”, there is a substantial uptick in the 5-year average TFP growth rates across all groups of countries. These productivity gains outstripped those associated with individual reform episodes, suggesting reforms can have complementary effects. The most common reforms to occur in waves were financial sector (both banking system and capital market development), legal system, and trade reforms.
- **Sound macroeconomic policies and fiscal structural reforms help ensure the sustainability of reforms.** In almost all cases of large scale reforms, fiscal structural reforms are considered to have played a pivotal role in stabilizing the macroeconomic situation. Most often this involved a combination of measures to strengthen tax administration, public spending efficiency, and fiscal frameworks.

## Comparative Analysis of Structural Strengths and Weaknesses

**31. To identify potential areas of reform in GCC economies the paper performs a comparative analysis of structural strengths and weaknesses.** The analysis uses a comprehensive set of structural indicators.<sup>15</sup> However, these indicators are based on surveys, which may provide an incomplete assessment of important structural characteristics.

**32. At an aggregate level the various indicators suggest that the GCC countries lag behind top performers in advanced economies (AEs) and emerging markets (EMs).** Performance by GCC countries is compared with top performance by AEs and EMs (top 20<sup>th</sup> percentile). Benchmarking to top performing AEs and EMs helps to identify areas of potential reforms. At the aggregate level the various indicators suggest that on average the GCC countries lag substantially behind top performers in AEs in most areas; when compared with EMs, GCC countries also fall short in several areas, even though income per-capita in the GCC is substantially higher than in the EMs (Table 5, Figures 7, 8, 9, and 10). Within the GCC, the UAE and Qatar are best ranked countries, suggesting scope for other countries to learn from their experience (Table 6).

**Table 5. Rankings on Overall Structural Indicators and GDP per Capita:**  
Advanced Economies, Emerging Markets and GCC Countries

	Advanced Economies (Top 20th Percentile <sup>2</sup> )	Emerging Markets (Top 20th Percentile <sup>2</sup> )	GCC		
			Min	Median	Max
Doing Business Overall Rank <sup>1</sup>	9.4	67.0	101.0	69.0	31.0
GCI Overall Rank <sup>1</sup>	7.8	57.4	62.0	29.5	14.0
Index of Economic Freedom Overall Rank <sup>1</sup>	8.8	63.6	75.0	42.5	18.0
WGI Rank (average of the six ranks) <sup>1</sup>	7.8	85.6	118.0	89.5	57.0
<i>Memorandum items</i>					
GDP per capita, U.S. dollars	51,208	8,626	16,698	26,434	68,940

Source: World Bank Doing Business, 2016; Global Competitiveness Index, 2016; Heritage Index of Economic Freedom, 2016; Worldwide Governance Indicators, 2015 Update.

1/ Lower ranking values are better.

2/ The top 20 percent of rankings are lower than, or equal to this value. The top 20 percent of GDP per capita values are greater than, or equal to this value.

**Table 6. Ranking for Selected Structural Indicators Among GCC Countries <sup>1/</sup>**

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
Doing Business Overall Rank	65	101	70	68	82	31
GCI Overall Rank	39	34	62	14	25	17
Index of Economic Freedom Overall Rank	18	74	52	34	78	25
WGI Rank (average of the six ranks)	99	110	80	64	118	57
Global Innovation Index	57	67	73	50	49	41
ICT Development Index	27	46	54	31	41	32

Source: World Bank Doing Business Indicators; Heritage Foundation Index of Economic Freedom; Worldwide Governance Indicators Project; World Economic Forum Global Competitiveness Index; Cornell University, INSEAD, and World Intellectual Property Organization; and International Telecommunications Union.

1/ Based on the latest available rankings. The best ranking is 1.

<sup>15</sup> Annex III provides a more detailed description of the indicators used in the comparative analysis.

**33. A disaggregated study of structural indicators provides more details on possible reforms areas.** The main findings are:

- **Regulation and Business Environment.** Business-friendly procedures, high quality industry regulation and strong legal systems promote competition and an efficient allocation of resources. Most GCC countries rank below AEs and EMs top performers on aspects related to starting a business, getting electricity, resolving insolvency, and enforcing contracts (Figure 7); on business freedom most GCC rank below AEs comparators and very close to EMs top performers (Figure 8). Regarding regulatory quality—which captures perceptions of the ability of the government to formulate and implement sound policies and regulations that promote private sector development—they also fall short of AEs top performer rankings (Figure 10).
- **Trade liberalization and openness to foreign investment.** Higher openness to trade and investment can boost efficiency due to competition, innovation and knowledge absorption. Despite progress in intraregional trade arrangements, trading across borders (Figure 7) and investment freedom (Figure 8) appear to be falling behind both AEs and EMs top performers. The Service Trade Restrictions Index also points to a restrictive environment in the GCC countries when compared to high-income OECD countries, especially in telecommunications, financial, and professional services.<sup>16</sup>
- **Labor markets and human capital.** Improvements in human capital are essential to enable the creation of attractive private sector jobs for nationals. GCC countries exhibit notable gaps with respect to AEs top performers on aspects of higher education and training (Figure 10) as well as regarding human capital and research (Figure 11). More flexibility in wage bargaining-setting mechanisms as well as in employment protection regulations (such as hiring and lay off regulations) can contribute to better employment outcomes and improve productivity. Labor market efficiency indicators for Kuwait, Oman, and Saudi Arabia rank below EMs top performers (Figure 10).
- **Institutions.** Better public governance, legal systems, and property rights lead to more efficient allocation of resources and higher investment. Indicators (Figure 9) for government effectiveness and rule of law show that all GCC countries lag behind AEs top performers, with the gap especially large for Kuwait and Saudi Arabia; only the UAE ranks very close to AEs top performers in terms of government effectiveness. Regarding property rights, while the majority of GCC countries rank higher than EMs top performers, there are notable gaps when compared to the AEs benchmark, especially in the case of Saudi Arabia and Kuwait (Figure 8).
- **Infrastructure.** Public infrastructure not only improves the capital stock, but also promotes private investment and productivity. The GCC countries in general have relatively developed infrastructure. All of them rank at or above EMs top performers and UAE and Qatar rank on par with the AEs top performers (Figure 10).

<sup>16</sup> The World Bank's Service Trade Restrictions Database includes 103 countries and covers five sectors (financial services, telecommunications, retail distribution, transportation, and professional services a) and 19 subsectors. See Borchert et al. (2012). For GCC countries the surveys were collected in 2008 and the UAE was not included.

- **Technology and innovation.** Adoption of modern production methods by acquiring existing knowledge, importing physical capital (for instance, via FDI which can be a major source of technology and skills transfer), or getting involved in R&D activities, allows economies to boost productivity. Among GCC countries, Kuwait and Oman, are noticeably below the AEs benchmark on indicators of technological readiness and business sophistication; Saudi Arabia displays a smaller gap. Regarding the development of information and communication technologies (ICT) GCC countries score below the AEs top performers (Figure 11).
- **Banking system and capital market development.** Efficient financial markets and adequate access to financial services facilitate investment through efficient allocation of capital and transformation of savings. The GCC countries have relatively well developed financial markets; still, some financial market aspects related to getting credit and protecting minority investors may require further work as suggested by gaps when compared to both AEs and EMs top performers (Figure 7).

**34. The detailed analysis of structural indicators supports the conclusion of significant potential for structural reforms in the GCC.** The majority of the GCC countries lag behind the top performing AEs and EMs in several areas. The above analysis allows to identify areas with the most significant gaps. Doing Business indicators display large gaps in areas of resolving insolvency, getting credit, and trading across borders; Economic Freedom indicators suggest gaps in the areas of property rights and investment freedom; Global Competitiveness indicators exhibit gaps regarding innovation, technological readiness as well as higher education and training. There are also gaps when assessing the rule of law, regulatory quality and government effectiveness, except in the UAE. The latter stands out among GCC countries with scores very close to (and in some cases at) the levels of AEs top performers for many indicators. Given that the UAE shares a cultural and legal background with other GCC countries, there may be lessons in the design and implementation of reforms. A recent example of further reforms in UAE is the bankruptcy law expected to become effective in 2017 which will reduce the risks of doing business in the country. Similarly, laws on the resolution of insolvency are currently under consideration in other GCC countries.

### **Prioritization of Reforms in the GCC**

**35. GCC countries should focus on reforms to create a favorable environment to improve productivity and foster private investment.** This will not only boost growth, but also enable the private sector to create attractive opportunities for employment of nationals.

**36. In line with international experience, GCC countries could benefit from enacting structural reforms on a large scale and as part of a “Reform Wave”.** Bundling reforms together provides positive benefits. Although this varies by country across the GCC, each country has several areas with scope to enact structural reforms. As reforms are bundled together, they should be accompanied by complementary policies and customized to country circumstances. In this context, the experience of the United Arab Emirates may help in customization.

**37. Product market and institutional reforms should be a priority.** Although there is little empirical analysis on prioritizing structural reforms in oil exporters, we consider that GCC countries are likely to be close to emerging markets in the structure of their economies. This suggests that payoffs are likely to be strongest from product market reforms—reforms that focus on business competition and regulations—and from institutional reforms to the legal system and property rights. In this context, improving the business environment and reducing trade barriers in the GCC (including in the services sector) is likely to help boost competition. Privatization may also be important as a way to boost competition given the large role of the public sector in GCC economies, but will need to be designed to ensure adequate post-reform regulation. As these reforms are undertaken, it will be important to ensure continued access to credit to optimize the expansionary effects of product market reforms in the short term (IMF 2016d). These reforms will need to be supported by strong corporate insolvency frameworks and the development of markets for distressed debt. The reforms are not free of implementation challenges—such as building of court capacity to handle bankruptcy procedures—which should be taken into account by policy makers.

**38. Labor market reforms should be designed in light of the specific features of GCC labor markets and paced over time.** Promoting greater labor market flexibility (wage setting mechanisms, employment protection regulations) can boost the effectiveness of macroeconomic policies in smoothing the impact of shocks. In the GCC, the distortions created by high public sector wages and employment of nationals will need to be addressed through determined but gradual reductions in public sector employment through attrition and narrowing of the wage differential between the public and private sectors (IMF, 2014). At the same time, attracting higher skilled foreign workers and improving the skills of nationals can help boost productivity. Reforms to employment protection for nationals in the private sector may prove contractionary at the current juncture as economic conditions are weak, and should be enacted in conjunction with a strengthening of active labor market policies (IMF, 2016e). Efforts to strengthen human capital should be stepped up as this is an area with significant weakness in the GCC.

**39. Macroeconomic stability is vital to the long-term success of any reform effort and to a macroeconomic turnaround.** Given the magnitude of the fiscal challenges, fiscal structural reforms should be an important component of the reform strategy. While many GCC countries have already implemented significant subsidy reforms, additional measures to raise non-oil revenues are needed to support growth-enhancing public investment in a time of lower oil prices. Policies to foster private sector investment to complement public investment, for instance, through Private-Public Partnerships (PPPs) could also be considered with appropriate safeguards to limit fiscal risks (IMF, 2014b). At the same time, reforms to strengthen the fiscal framework—would support public expenditure efficiency and growth (Albino-War et al., 2014). Fiscal policies and projections should also be communicated clearly to stakeholders to build political support for reforms and reduce investor uncertainty.

## F. Conclusions

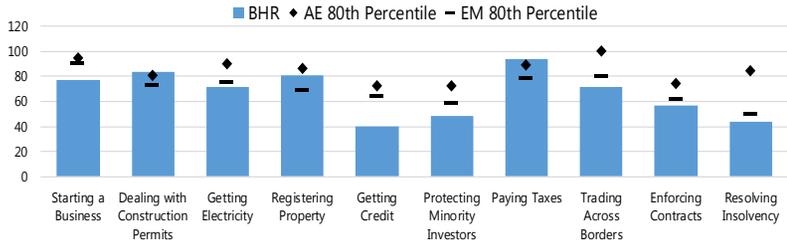
**40. The lower oil price environment has created significant challenges for growth in the GCC.** The needed fiscal consolidation to address the deterioration in fiscal balances across the region could affect growth adversely. New evidence suggests that fiscal multipliers have fallen in recent years, indicating that the negative impact of the fiscal adjustment on growth may be smaller than previously thought. Fiscal multipliers are smaller for current than for capital spending. These findings suggest that to minimize the contractionary impact, fiscal consolidation efforts should target cuts in current spending, improve capital spending efficiency, and spread fiscal consolidation measures over time in a predictable way.

**41. To support high and sustained growth, GCC authorities should implement productivity enhancing structural reforms.** International evidence indicates that high and sustained growth comes mainly from improvements in total factor productivity—which could support capital accumulation—and structural reform efforts are positively associated with growth. In contrast, high and sustained growth in the GCC countries has historically been the result of factor accumulation rather than improvements in productivity.

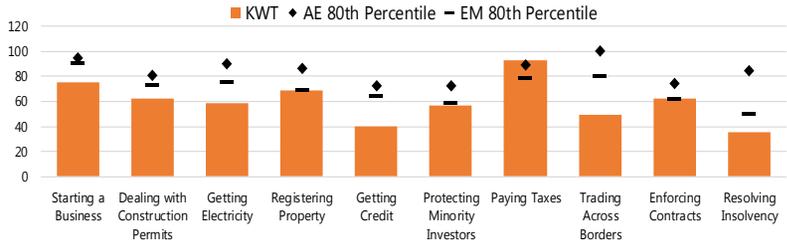
**42. A comparative analysis of structural indicators points to significant potential for structural reforms in the GCC countries.** The GCC countries lag behind top performing advanced economies and emerging markets in a number of areas. Opportunities for catching up with global top performers fall in areas of resolving insolvency, getting credit, trading across borders, property rights, investment freedom, innovation, higher education, rule of law, regulatory quality and government effectiveness. This suggest that there is scope in the GCC countries for structural reforms in these areas to boost productivity and growth in the current low oil price environment. Product market reforms—for instance, improving the business environment, promoting competition, reducing trade barriers, strengthening property rights, as well as institutional reforms—should be priorities. Reforms to ensure adequate access to credit, a strong corporate insolvency framework and the development of markets for distressed debt should also be pursued. Labor market reforms, particularly oriented to gradually reducing public sector employment and narrowing the wage differential between the public and private sectors, should be essential components of the growth strategy. Macroeconomic stability should be maintained supported by strong fiscal frameworks and clear communication strategies.

Figure 7. Selected Doing Business Indicators, 2016

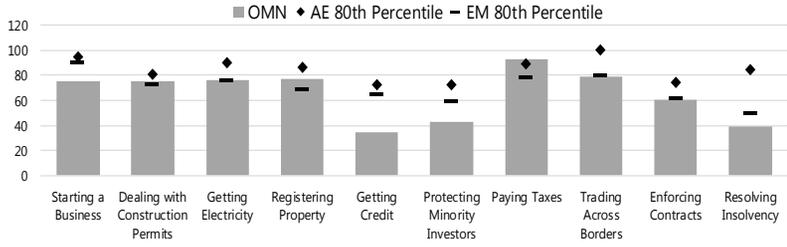
**Bahrain**



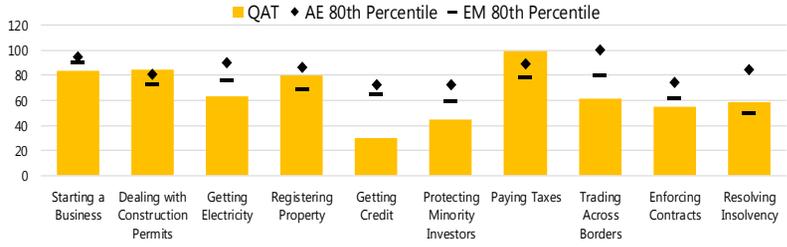
**Kuwait**



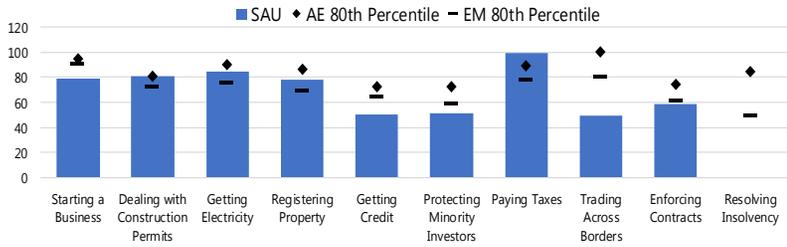
**Oman**



**Qatar**



**Saudi Arabia**

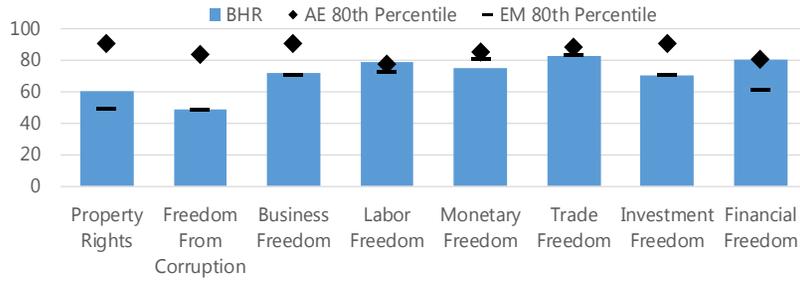


**United Arab Emirates**

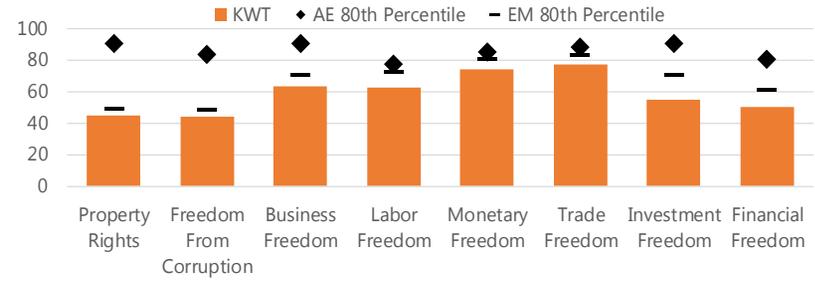


Figure 8. Selected Economic Freedom Indicators, 2016

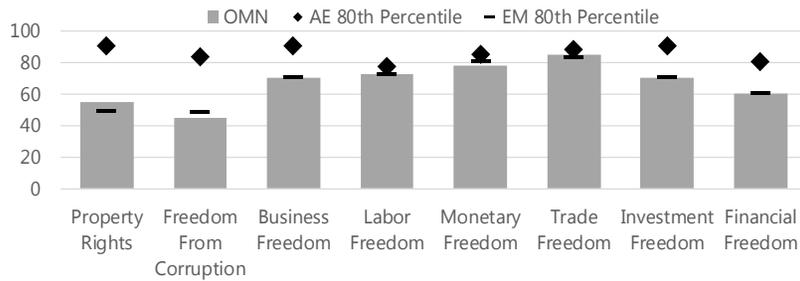
**Bahrain**



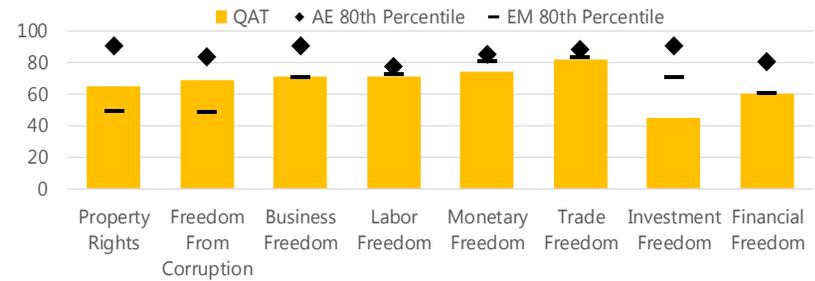
**Kuwait**



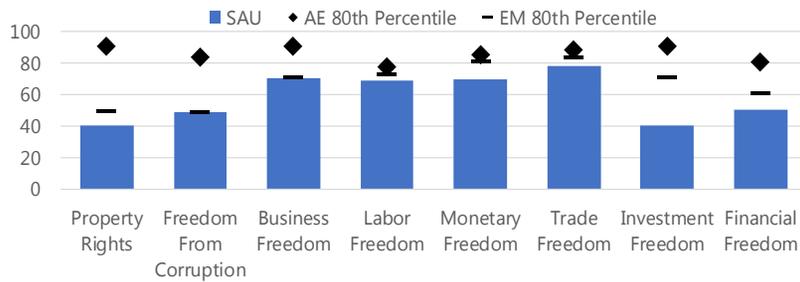
**Oman**



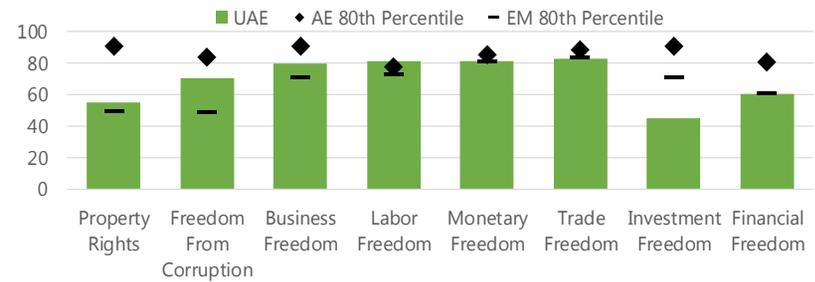
**Qatar**



**Saudi Arabia**



**United Arab Emirates**



Source: Heritage Economic Freedom Indicators, 2016.

Figure 9. Worldwide Governance Indicators



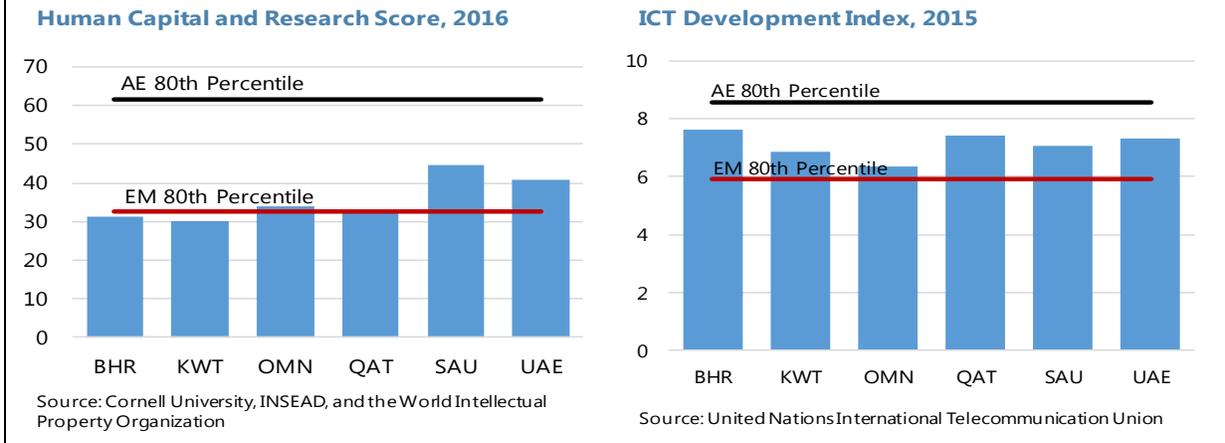
Source: Worldwide Governance Indicators 2015 Update

Figure 10. Global Competitiveness Indicators



Source: World Economic Forum Global Competitiveness Index.

**Figure 11. Human Capital and ICT Development Indicator for the GCC**



## Annex I. Estimation of Fiscal Multipliers for GCC Economies<sup>17</sup>

**The updated estimation of fiscal multipliers draws on Espinoza and Senhadji (2011).**

The empirical approach is based on a panel data analysis and estimates the following equation:

$$Y_{it} = \alpha + \beta \sum_{l=0}^2 G_{it-l} + \Theta \sum_{l=0}^2 D \cdot G_{it-l} + \varphi_i + \varepsilon_{it} \quad (1)$$

Where  $Y$  is real non-oil GDP,  $G$  real government spending (capital or current spending), and  $\varphi$  captures the countries fixed effects.  $D$  is a dummy variable which takes the value of 1 between 2008 and 2015, and 0 otherwise.  $\varepsilon$  is the error term, and  $\alpha$  a constant. The interaction between government spending and the dummy variable aims at assessing potential nonlinearities in the growth impact of fiscal policy, particularly when comparing multipliers before and after 2008. We control for contemporaneous and up to two lags of government spending, in order to assess its impact on growth in the medium/long term. Variables are expressed in first log differences to insure stationarity.<sup>18</sup> The estimation of equation (1) can suffer from an endogeneity bias, due to a reverse causality between government spending and economic activity. The so-called *automatic stabilizer* is one possible channel of the bias, while an endogenous fiscal policy (for example, a systematic countercyclical fiscal policy) is another possible channel. In both cases, the bias will result in an underestimation of the fiscal multipliers. As argued by Espinoza and Senhadji (2011), those channels can be ruled out in the case of the GCC since fiscal policy affects growth mainly through government spending, essentially driven by oil revenue and assumed to be autonomous. In addition, there is no evidence that fiscal policy is countercyclical in the GCC countries.

**The exercise estimates two models, a linear and a non-linear model.** For the linear model, equation (1) is estimated without the interaction terms, whereas the non-linear model adds the interaction between spending and the dummy variable to the baseline. Table 1.1 summarizes the estimated multipliers.

**The results provide strong evidence that fiscal multipliers have declined in GCC countries in recent years.** For the linear model results show current spending multipliers at 0.3 in the short term (estimated coefficients for the first and second lags are not statistically significant). In line with the existing literature, capital spending has a larger impact on growth, with multipliers estimated at 0.4 in the short-term and 1.6 in the long-term. When estimating the non-linear model, the marginal effect of the post-2008 period is negative and statistically significant (except for the contemporaneous impact of capital spending) which translates into fiscal multipliers that are not statistically significant different from zero for both current and capital spending. This implies no significant impact of fiscal policy on economic activity in the post-global financial crisis period, which may be explained by low efficiency of public capital spending, a crowding of private

<sup>17</sup> This research builds on an ongoing work on fiscal multipliers in the GCC by A. Fouejieu and A. Sadeghi.

<sup>18</sup> The estimated elasticities based on the OLS panel fixed effects are used to compute the multipliers as follows:  $X = \beta / (G/Y)$ , where  $X$  is the multiplier,  $\beta$  is the elasticity, and  $G/Y$  is the ratio of government spending to non-oil GDP. The short term multiplier relies on the contemporaneous impact on growth of changes in spending (i.e. the elasticity associated with  $G_t$ ), while the long term multipliers accumulate the impact over the three periods (i.e. the cumulative elasticity associated with  $G_t$ ,  $G_{t-1}$ , and  $G_{t-2}$ ).

consumption, investment and employment, and/or a larger leakage through imports. The results, however, should be interpreted with caution since they may be affected by the relatively small post-2008 sample size.

<b>Estimation Results for the GCC, 1990-2015</b>				
<b>Non-oil GDP versus government spending</b>				
(Dependent variable: non-oil GDP; variables in log-differences)				
	Capital spending		Current spending	
	Linear	Nonlinear	Linear	Nonlinear
	(1)	(2)	(3)	(4)
Contemporaneous	0.041** (0.018)	0.034 (0.022)	0.096*** (0.035)	0.130 (0.070)
First lag	0.066*** (0.019)	0.094** (0.034)	0.053 (0.035)	0.144* (0.066)
Second lag	0.054*** (0.017)	0.067** (0.021)	0.021 (0.034)	0.076 (0.065)
Contemporaneous*Dummy		-0.002 (0.042)		-0.058* (0.023)
First lag*Dummy		-0.120* (0.052)		-0.187*** (0.036)
Second lag*Dummy		-0.078** (0.027)		-0.091*** (0.022)
Global GDP growth	0.013*** (0.003)	0.013*** (0.003)	0.010*** (0.003)	0.007 (0.004)
Constant	0.018* (0.010)	0.019* (0.008)	0.026** (0.011)	0.035*** (0.004)
Observations	133	133	133	133
R-squared	0.224	0.297	0.146	0.235
Adjusted R-squared	0.168	0.258	0.0832	0.192
Number of countries	6	6	6	6

Source: IMF staff estimates.  
 OLS panel fixed effects estimates. Robust standard errors in parentheses. \*\*\*, \*\*, \* indicate statistical significant at 1, 5 and 10% respectively. The dummy variable takes the value of 1 for the period 2008 - 2015, and 0 otherwise.

## Annex II: Long-term Economic Development Objectives in the GCC

All countries in the GCC region have issued vision statements that describe their development aspirations for the medium or longer term. These visions guide current and future policy actions necessary for countries to achieve their development goals. The period covered varies by country. Some countries operationalize their Visions through a series of development plans, which include policies to help achieve their long-term goals. For instance, the (most recent) Kuwait Development Plan (KDP) 2015–20 and Saudi Arabia’s National Transformation Program (NTP). While variations exist across countries, Visions aim for globally competitive economies diversified away from hydrocarbons, national populations with strong human capital working in the private sector, and development of high-productivity industries and services that require high-skilled labor. The main elements in the GCC countries’ Visions are summarized below.

**Bahrain.** The Economic Vision 2030 for Bahrain, launched in 2008, targets economic diversification and is supported by a national development strategy (2015-18) that proposes actions aimed at improving the business environment. It aims to double real disposable income for each Bahraini by 2030 by building a productive and globally competitive economy driven by the private sector, and using competitiveness, fairness and sustainability as guiding principles. It acknowledges the increased global competition facing Bahrain and the role innovation and productivity have as critical sources of comparative advantage.

The diversification strategy is embedded in three policy areas that support Vision 2030: Economy, Government, and Society. On the Economy, the focus is on enhancing productivity and skills, capitalizing on existing high-potential sectors that are independent of oil, and capturing emerging opportunities by expanding knowledge-based sectors. On Government, the Vision calls for an efficient and effective government that is more productive and accountable, provides for a regulatory system that facilitates growth, has public finances that are sustainable and depend less on oil revenues, and supplies world-class infrastructure. On Society, the Vision aims for high standards of social assistance to all Bahrainis, including access to quality health care, a first-rate education system, and a safe and sustainable living environment.

**Kuwait.** Kuwait Vision 2035 aims for a competitive and efficient private sector led economy transformed into a financial and trade center. It also aims for developing human capital, creating a modern legal framework, and providing adequate infrastructure. In February 2016, the government announced reform plans aimed at bolstering the fiscal position and fostering private sector development and diversification.

The reforms, which are set to be implemented over the next 5 years under a schedule that remains to be fully specified, are organized around 6 pillars: (i) fiscal reforms, (ii) role of the State in the economy, (iii) private sector development, (iv) citizens’ participation (v) labor market and civil service reform, and (vi) supporting institutional reforms. Fiscal reforms include current spending rationalization, reforms in wages and subsidies, introducing VAT, implement a business profit tax

reform, and increase prices for government provided services. Economic reform also includes structural, legislative, and institutional reforms to improve the investment environment and attract national and foreign capital. Diversification and private sector development reforms are focused on privatization/PPPs, business climate reforms, and an education overhaul.

**Oman.** Vision 2020, launched in 1996, outlines the country's economic and social goals: maintain economic and financial stability, reshape the role of government and broaden participation of the private sector in the economy, diversify the sources of national income, globalize the economy, and upgrade the skills of the national workforce and develop human resources. Oman's 9th Development Plan (2016–20), the final component of Vision 2020, aims to tackle oil dependency by reducing the share of the oil sector in the economy through an ambitious diversification strategy. Work has also started on a new long-term strategy, Vision 2040.

The plan aims to boost the non-oil economy by targeting five sectors: manufacturing, logistics, tourism, fisheries, and mining. The plan emphasizes the need for the private sector to drive economic growth and job creation, which would be underpinned by improving the business environment, the development of SME's, a privatization program and further development of Public Private Partnerships (PPP's). In terms of job creation, the five targeted sectors are labor-intensive, while the strategy aims for higher participation of Omanis in the private sector, notably by targeting jobs currently occupied by foreign workers with a medium-level skill-set.

**Qatar.** The Qatar's National Vision 2030, released in 2008, aims for transforming the country into an advanced economy providing for high standards of living for all its people, including future generations. It seeks to attain the right pace of economic growth in a country that has exceptionally high reserves of natural resources with a small national population. The Vision rests on four pillars: human development, working towards an advanced educational and health system, with increasing participation of Qataris in the labor force; social development, pursuing an effective social protection system, a sound social structure, and a significant role in the international community; economic development, aiming for a sound economic management, responsible exploitation of oil and gas resources, and a suitable economic diversification; and, environmental development, seeking to preserve and protect Qatar's environment by balancing economic growth and social development needs.

The authorities have imposed a voluntary moratorium on further LNG export capacity, and embarked on a public investment program to support diversification. Strategic priorities include education (Education City), sports (various championships incl. 2022 FIFA), transport (Qatar Airways), finance (Qatar National Bank—the largest MENA bank), and culture (museums). Public finance reforms have also been implemented to increase spending efficiency, including an outline of the medium-term fiscal framework.

**Saudi Arabia.** Saudi Arabia Vision 2030, released in April 2016, is supported by three pillars: Saudi Arabia's status in the Arab and Islamic worlds, a determination to become a global investment powerhouse by diversifying revenue sources, and the transformation of the Kingdom into a global logistical hub exploiting its strategic location. The policies that will help achieve the goals of Vision

2030 are to be set out in a series of policy plans. The first—the National Transformation Program (NTP)—was released in early June. It lays out 178 strategic objectives with over 340 targets and benchmarks for 24 ministries and government entities to be achieved by 2020.

The objectives in the NTP and other forthcoming policy plans that support Vision 2030 will broaden and deepen the ongoing reforms. Vision 2030 and the National Transformation Program set out a wide ranging agenda to diversify the economy, increase the role of the private sector, and increase the employment of Saudis. Economic targets in labor market, trade, fiscal, FDI and SME sectors have been announced. One of the key economic targets of the NTP is to increase the share of the private sector to 65 percent of GDP from 40 percent currently; the SME sector contribution is targeted to be increased from 20 percent of GDP to 35 percent. The plan envisages a greater role for the private sector also through privatization and expanding the use of PPPs, with a view to increasing efficiency and productivity and increasing job opportunities for nationals in the private. Fiscal consolidation is proceeding, energy and water prices have been increased, key performance indicators introduced for ministries, management of public investment strengthened and reforms to increase foreign investor involvement in the capital markets announced.

**The UAE.** The UAE Vision 2021 aims for the country to be among the best countries in the world by its golden jubilee. Although considering new goals in terms of economic diversification by 2050, Vision 2021 is supported by four aspirational objectives for the UAE to be an ambitious and confident nation grounded in its heritage, a strong union bonded by a common destiny, become a competitive economy driven by knowledge and innovation, and develop a nurturing and sustainable environment for quality living supported on education, healthcare, infrastructure, and the environment. The Vision rests on a sound results-oriented management framework.

The UAE has pursued an outward-oriented development strategy, based on an open trade regime and unrestricted capital outflows complemented with large strategic investments in ports, airports and airlines, and an international financial center and an active industrial policy in petrochemicals, aluminum, and steel.

## Annex III. Description of Selected Indicators Used in the Comparative Analysis

### Doing Business Indicators

Starting a business	Procedures officially required, or commonly done in practice, for an entrepreneur to start up and formally operate an industrial or commercial business, as well as the time and cost to complete these procedures and the paid-in minimum capital requirement.
Getting electricity	Procedures required for a business to obtain a permanent electricity connection and supply for a standardized warehouse including applications and contracts with electricity utilities, all necessary inspections and clearances from the distribution utility and other agencies, and the external and final connection works.
Getting credit	Measures the legal rights of borrowers and lenders with respect to secured transactions through one set of indicators and the reporting of credit information through another.
Protecting minority investors	Measures the protection of minority investors from conflicts of interest through one set of indicators and shareholders' rights in corporate governance through another.
Trading across borders	Measures the time and cost (excluding tariffs) associated with three sets of procedures—documentary compliance, border compliance and domestic transport—within the overall process of exporting or importing a shipment of goods.
Enforcing contracts	Measures the time and cost for resolving a commercial dispute through a local first-instance court.
Resolving insolvency	Studies the time, cost and outcome of insolvency proceedings involving domestic entities as well as the strength of the legal framework applicable to liquidation and reorganization proceedings.

### Index of Economic Freedom

Property rights	Measures the degree to which a country's laws protect private property rights and the extent to which those laws are respected. It also assesses the likelihood that private property will be expropriated by the state and analyzes the independence of the judiciary, the existence of corruption within the judiciary, and the ability of individuals and businesses to enforce contracts.
Business freedom	Measures the extent to which the regulatory and infrastructure environments constrain the efficient operation of businesses. The quantitative score is derived from an array of factors that affect the ease of starting, operating, closing a business.
Financial freedom	An indicator of banking efficiency as well as a measure of independence from government control and interference in the financial sector. It looks at five broad areas: the extent of government regulation of financial services; the degree of state intervention in banks and other financial firms through direct and indirect ownership; government influence on the allocation of credit; the extent of financial and capital market development; and openness to foreign competition.
Investment freedom	Evaluates a variety of regulatory restrictions that typically are imposed on investment such as National treatment of foreign investment; Foreign investment code; Restrictions on land ownership; Sectoral investment restrictions; Expropriation of investments without fair compensation; Foreign exchange controls; and Capital controls.
Labor freedom	A quantitative measure that considers various aspects of the legal and regulatory framework of a country's labor market, including regulations concerning minimum wages, laws inhibiting layoffs, severance requirements, and measurable regulatory restraints on hiring and hours worked, plus the labor force participation rate as an indicative measure of employment opportunities in the labor market.

### Annex III. Description of Selected Indicators Used in the Comparative Analysis (concluded.)

<b>Worldwide Governance Indicators</b>	
Government effectiveness	Government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
Regulatory quality	Regulatory quality captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
Rule of law	Rule of law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.
<b>Global Competitiveness Index</b>	
Health and primary education	The indicators focus on incidence of certain diseases and their business impact, infant mortality, life expectancy, and primary education.
Higher education and training	The indicators focus on education system including secondary and tertiary education, math and science, business schools, internet access at schools, and training.
Technological readiness	The indicators focus on availability of latest technologies, firm-level technology absorption, FDI and technology transfer, internet users, fixed broadband internet subscriptions, internet bandwidth, and mobile broadband subscriptions.
Business sophistication	The indicators focus on local supplier quantity and quality, state of cluster development, nature of competitive advantage, value chain breadth, control of international distribution, production process sophistication, extent of marketing, and willingness to delegate authority.
Innovation	The indicators focus on capacity for innovation, quality of scientific research institutions, company spending on R&D, university-industry collaboration on R&D, government procurement of advanced technology products, availability of scientists and engineers, and patent application.
Financial market development	The indicators focus on availability and affordability of financial services, financing through local equity market, ease of access to loans, venture capital availability, soundness of banks, regulation of securities exchanges, and legal rights index.
Infrastructure	The indicators focus on the roads, railroads, ports, air transport, electricity supplies and telecommunications network.
Labor market efficiency	The indicators focus on labor-employer relations, flexibility of wage determination, hiring and firing practices, redundancy costs, effect of taxation on incentives to work, pay and productivity, professional management, capacity to attract and retain talent, and female participation in labor force.

Source: World Bank Doing Business Indicators; Heritage Foundation Index of Economic Freedom; Worldwide Governance Indicators Project; and World Economic Forum Global Competitiveness Index.

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