The Possible Cause and Consequences of Fluctuations in Oil Prices on the Overall Economy of the Middle East

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Chair, Distinguished Panelist, Colleagues, Participants, ladies and gentlemen:

Good Morning: I would like to thank all of you for your participation and contributions to this 28th Annual Conference of the Global Awareness Society, International. It is a pleasure to be here with you in this beautiful city of Marrakech. My purpose here today is to discuss the possible cause and consequences of fluctuations in oil prices on the overall economy of the Middle East.

With oil prices increasing in the past year, it is not hard to wonder what has caused it and just what effect it might have on the economy of oil exporting and oil importing countries in the Middle East.

For the purpose of our discussion today, let me define what countries encompass the Middle East?

The Middle East encompasses the countries located East and South of the Mediterranean Sea, extending from Morocco in the West to Iran in the East. The region includes 24 countries overall. Before the discovery of oil, this region was both socioeconomically and politically underdeveloped. The quality of life was poor, and people were mainly involved in trade. In general, this region had only a few natural resources with land not suitable for growing crops. However, once oil was discovered, the Middle East experienced a great change at both economic and social levels. Today, the Middle East is home to some of the world's largest deposits of oil and natural gas and holds approximately 66% of OPEC reserves. This region can be divided into oil exporting countries that consist of Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, UAE, and Yemen and Egypt, Jordan, Lebanon, Mauritania, Morocco, Sudan, Syria and Tunisia as oil importers.

In the larger context, Afghanistan, Djibouti and Pakistan also fall into this category.

I will analyze how high and low oil prices has affected the performance of oil exporting and importing economies in the past year. High oil prices has resulted in increased revenue for oil exporting countries and these increased growth of revenue has been used to some extent to reinvest into oil production. However, low oil prices in exporting countries has contributed to a budget deficit. On the other hand, higher prices in importing countries has resulted in decline in GDP growth.

However, low oil prices in importing countries have provided subsidies and structural reforms for these nations.

What does the data show?

Economic growth in the Middle East and North Africa (MENA) is to decline from 1.6% in 2018 to 1.5% in 2019, according to World Bank report. The decline is attributed to a combination of slower oil sector growth in some countries and geopolitical tension and risks and civil strife in others. Oil exporters such as Iran, Iraq, Kuwait, Libya and Oman are adversely affected. The IMF now expects growth across the oil exporting countries to be only 0.4%. More specifically, it is projected that Iran's economy is to contract by 6% this year. Economic activity in Iran has come to a halt as a result of severe economic sanctions imposed by the U.S. which are undermining its ability to sell oil overseas. The removal of waiver will further exacerbate the economic conditions. Widespread flooding that devastated towns and rural areas will further contribute to slower growth, higher unemployment, poverty and high inflation. In addition, it is expected that Saudi Arabia growth will decline from 2.4% in 2018 to 1.8% in 2019 and the growth forecast for Algeria, Iraq, Kuwait, Qatar and the UAE are expected to grow by 2.3 – 2.8% this year (2019) compared to 2.7 – 6.5% in 2018. Oman is projected to experience a growth rate of 1.1% this year, a decline of 3.9% from last year (5%).

Examining the oil importing countries, one will find more stable economic conditions, with the economies of Egypt and Morocco expected to obtain a growth of 5.5% in Egypt and 3.2% in Morocco. The increase in growth rate in Egypt is partly the result of domestic reform policies. Mauritania, which depends on iron ore exports, is expected to enjoy strong economic growth. It is expected to grow at 6.4% (GDP growth compared to a previous forecast of 5.2%).

However, the growth rate for Jordan, Lebanon and Tunisia is to decline by 0.1 – 0.3 percentage points. Furthermore, Sudan is expected to suffer from deep recession like Iran. The economy is to contract by 2.3%. Widespread political protests and finally overthrow of former President Omar Al Bashir has further added to uncertainty and political instability.

What are the effects of Higher Prices on Oil Exporting countries?

All countries in the Gulf Cooperation Council (GCC) are dependent on the production and sale of oil. These countries, which include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE, have economies that are almost exclusively driven by oil revenue and when oil prices shift, their economies experience dramatic changes. Higher oil prices translates into more revenue for the same amount of oil. A portion of this extra revenue generated as a result of higher oil prices can be reinvested in oil production, another portion of revenue to reduce fiscal deficit. Higher oil prices could also attract others to enter the market, in this case, in the U.S. and Russia which in turn could result in a lower demand for oil from Middle Eastern countries.

What are the effects of lower prices on Oil Exporting countries?

When the market price of oil drops, major exporters tend to see a decrease in revenue. These economies are left with less capital, thus reducing their GDP, and their buying power and economic growth tends to slow down. In addition, when the market price of oil drops, those in the supply chain, being extractors, refiners and shippers have less incentive to continue operations, as they will receive less benefit. This slowdown in growth will affect the health of corporations and individuals alike and they will suffer. With lower revenue from oil exporting, jobs related to this sector will become scarcer and the government as a major employer will no longer be able to employ many university graduates in the oil sector and will add to high unemployment in this sector.

What are the effects of higher prices on Oil Importing countries?

Higher oil prices will cause a slight decline in GDP growth, an increase in account deficits (when a country spends more on oil than it receives on exports), increased GDP, an

increase in the level of unemployment, a decrease in aggregate spending, a decrease in a country's economic growth and an increase in the level of prices as a result of lower production of goods and services (Excess Demand and shortage of supply). Higher prices will adversely affect the countries' currencies and decrease private investment.

What are the effects of lower prices on Oil Importing countries?

While oil exporting countries may see a decrease in revenue, this negative impact is outweighed by the positive impact on other countries. At micro level, oil importing countries will see either savings from lower prices or increased consumption with the same spending habit, which increases utility. For industries who use oil as a major input for their products, the lower prices will result in a lower cost of production and lower selling prices, benefiting the consumer. At macro level, lower oil prices may create favorable conditions for subsidy reform that may support growth and job creation. Lower oil prices could result in decrease in investments and expatriate remittances received for oil exporting countries.

Oil price volatility has affected other economic indicators, like unemployment. A young and growing population (60% of the population under age of 30) with the unemployment rate of 10.6%. There are few opportunities to find work for both youth and women. Women are nearly 3 times less likely than men to seek work and when they work, women are nearly 2 times as likely to not get a job. Young people are 3 times likely to be unemployed than adults. The youth unemployment rate is the highest in the world. It is between 30 – 45%. Even though youth are educated, 30% of them are neither in education nor in work. The region has the greatest legal and institutional barrier for women and only about ¼ of women seek jobs, the lowest rate among the world's regions.

A large share of people rely on informal work and work in rural areas (Rural 72%). Citizens in rural areas are twice likely to be poor with limited access to healthcare and education. Many jobs are low paid and 22% of MENA workers make less than $3.10 per day. Many rely on government jobs and private sector has not been the engine of job creation as private sector firms are too small and small and medium sized firms do not create enough jobs and they do not have access to finance as loans to small and medium-sized firms amounted to 2% of GDP. Many people in the region also lack access to finance. Nearly 70% of adults in the region do not have a bank account and only 8% of adults in the region

obtain loan through formal financial institutions. Corruption is a major business constraint and between 60 – 90% of people think that “Wasta” (connections) rather than merit is critical for getting a job. Foreign Direct Investment has declined (-53%). This region also has not benefited from technological wave and only 6% of the population has access to broadband.

Another factor that represent risk to the Middle East and North Africa’s growth prospects besides fluctuations in oil prices is the increase in geopolitical tensions. MENA carries a heavy burden of conflict and refuges. While MENA accounts for only 10% of the World population, it hosts 44% of the World’s people displaced by conflict. For example, in Syria, 6 in 10 people live in extreme poverty and armed conflict has forced more than 10 million children out of school in MENA region.

What lies ahead and how to obtain better results?

Political problems are still an issue for many countries around the region, including Libya, Syria and Yemen. Slow economic growth are adding to the political instability of the region, where high unemployment and corruption were behind the initial stage of the Arab Spring revolutions (which began in Tunisia in late 2010) and then spread to Bahrain, Egypt and Syria. The widespread protests that have been sweeping across Algeria and Sudan could be the start of a second Arab spring.

Turning the situation around requires regimes reforms and policies to promote access and create economic opportunities for all people. The reforms should address the following:

Investment in education. The labor force is inadequately educated and do not possess technical skills. Modernize the educational system, increase access to vocational training, apprenticeships and internships. Provide more relevant education to prepare youth and other workers for private sector jobs. Schools should be reformed so that it is aligned better with private sector needs. Government should design policies that promote youth employment.

Government should also design policies to eliminate gender disparities, that is, strengthen women’s legal rights, provide access to childcare, parental leave and safe public transportation.

Furthermore, policies that will institute hiring quotas, employment subsidies or tax incentives for businesses to increase formal employment could result in substantial economic growth. The region could gain 1 trillion in total output over a decade.

Improve rural access to quality education, health, water, power, sanitation, roads and social safety net programs. Foster rural development through better physical and digital connectivity.

Better integrate refugees to the education system and labor markets and seek more international financial support to help refugees.

Increase spending on social safety nets.

Target subsidy to the poor by developing cash transfers to them where possible.

Improve efficiency in distribution and inform potential recipients about the programs.

Improve access to Finance.

Expand access to finance by developing and strengthening alternatives to bank financing (only 10% of firms use banks to finance investment) promote competition in the financial sector, strengthen Islamic finance, develop microfinance, improve financial literacy and implement fintech (mobile banking, e-banking, e-wallets)

Reform the tax system and make it more equitable.

Since the tax collections are too low to fund higher growth spending, a broad based tax system that generates the necessary resources is essential to economic growth. The tax system needs to be more progressive, VAT rates for basic food items reduced and property and wealth taxes developed. Exemptions, tax concessions and tax holidays should be reduced and tax codes simplified, taxpayer services improved and tax administration strengthen to improve compliance and reduce evasion.

Corruption needs to be controlled and Governance improved.

Combat corruption, strengthen anti-corruption agencies, improve the effectiveness and independence of the Judiciary, improve the quality of regulation and streamline public administration process.

Develop policies to enhance gains from trade.

Remove tariffs and non-tariff barriers internally and ask for a reciprocal agreement with EU on reducing their high tariffs, quotas restriction and farm subsidies.

Transition to more eco-friendly energies to achieve economic diversification is crucial to developing a sustainable economy. Saudi Arabia, the UAE, Jordan and Morocco are developing renewable energy programs to cut oil usage and production. This should reduce the impact on the environment and also catalyze these countries' economic development.

Fluctuations in oil prices have caused many Gulf oil exporters to diversify their economies and to move away from reliance on oil exports and to create employment in non-oil sector.

Conclusion

As mentioned, the MENA countries are greatly impacted by the changes in oil market. Oil dependency continue to support their economies. Since many Middle Eastern countries are not diverse, and depend heavily on the oil market, fluctuations in oil prices affect their countries' economies overall. Higher oil prices bring more revenue and strengthen their economies, while lower oil prices cause them to suffer. The impact of fluctuations in oil prices is not the same, however. High oil prices in exporting countries allow for a growth in oil production and real GDP growth and part of the revenue growth can be used to reduce deficits and enlarge fiscal surpluses. High prices in oil importing countries does not benefit these countries as they need to increase their non-oil activities to generate more revenue to balance out the income lost from oil activities. Low oil prices could result in low GDP growth and increased unemployment since there would be a decrease in labor markets of oil production from oil exporting countries, while oil importing countries can take more advantage from lower oil prices due to lower costs of fuel and can improve their GDP and economic growth.

Oil price volatility has affected other economic indicators like unemployment, expenditure on education, health and subsidy to the poor. Both oil exporting and importing countries could increase their economic growth if they were to design policies to enable greater inclusion of people in the region, promote access and support disadvantaged groups.

These reforms include, access to finance, better trade policy, reduction of corruption, better governance, improvement in business investment, more equitable tax system,

investment in education, strengthening women's legal rights, foster rural development, transition to a more eco-friendly energies and meet the needs of refugees and better integration of refugees in the education and labor markets.

Political problems, unrest and other risk factors are adding to uncertainty on MENA outlook for 2019 and beyond. Mounting geopolitical tensions in the area combined with oil price volatility could undermine the reforms mentioned above.