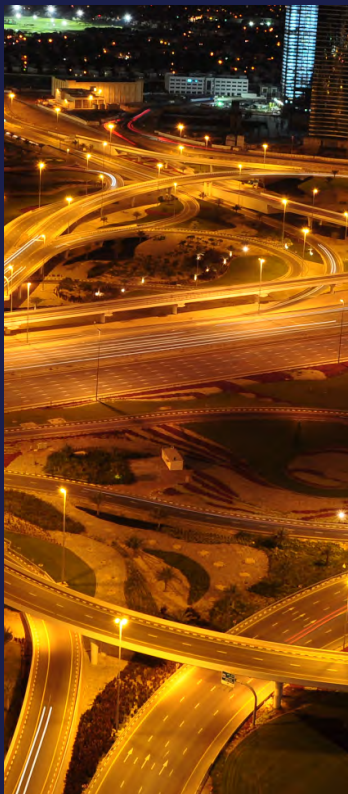




AzalAdvisors

Regional outlook and policy priorities for GCC States

October 2020

ABOUT THIS REPORT

This report has been commissioned and sponsored by Azal Advisors for the benefit of promoting debate on critical issues facing GCC States. The articles have been written by members of Azal Advisors' affiliated expert group specifically for this publication. While guidance has been provided on the broad topics to cover, the views expressed in this report do not necessarily reflect the view of Azal Advisors. Experts bear sole responsibility for the content of this report, with the exception of the introduction and the section describing Azal Advisors and its activities.

TABLE OF CONTENTS

INTRODUCTION	03
---------------------	-----------

LABOUR ECONOMICS & INDUSTRIAL POLICY

Universal Basic Income: a solution for labour challenges in Gulf States? <i>Steffen Hertog</i>	05
Technology dominance as an industrial policy pathway <i>Jean Francois Seznec</i>	10

ENERGY

A strategic approach to decarbonization for GCC hydrocarbon exporters <i>Giacomo Luciani</i>	14
The argument for a Middle Eastern gas grid <i>Kate Dourian</i>	19

FOREIGN POLICY, TRADE & SECURITY

Implications of the US presidential election for the GCC <i>Bernard Haykel</i>	24
Implications of China's 14th Five Year Plan for the GCC <i>Mohammed Turki Al-Sudairi</i>	28

FOOD SECURITY

Food security lessons from Covid-19 <i>Eckart Woertz</i>	34
Climate and environmental preparedness after Covid-19 <i>Martin Keulertz</i>	37

ABOUT AZAL ADVISORS	42
----------------------------	-----------

INTRODUCTION

Azal Advisors is pleased to share this report, a compendium of insights by leading experts on GCC affairs. Addressing burning topics faced by the Gulf's policy makers, these original viewpoints reflect on the challenges faced by GCC States and suggest pragmatic policy-paths to explore.

Covid-19 has taken centre-stage as the defining global event of 2020, and in the process has tested the resilience of Gulf economies to an external shock that has been unprecedented in scale. While it is impossible to predict what the economic aftermath of the pandemic will look like, it has undeniably given a sense of renewed urgency to the imperative for economic diversification among petro-dependent states if they are to achieve economic prosperity while ensuring fiscal sustainability. The crisis has also contributed to a greater realization of what climate change can entail and the need to mitigate its effects – of particular relevance to the Gulf not only due to the direct effect of temperature increases (estimated by the World Bank at 2°C to 3°C by 2050 for the Arabian Peninsula) but also for what it means in terms of the trade dynamics between the Gulf and the rest of the globe: reduced demand for fossil-fuels following an energy-mix that will increasingly favour renewables; reduced supply of food from countries that have been exporting to the Gulf on the back of the climate-driven depletion of their own resources, in particular water; and private capital that is more selective and increasingly conditional on climate

action by those seeking to access it.

The looming US presidential election is a more near-term concern for the Gulf. Many plausible scenarios can unfold with different policy implications notably in terms of security. But whether it is a continuation of the current unpredictable and transactional US administration or the onset of an administration that is expected to practice selective multilateralism, a significant re-engagement in Gulf security by the US will be unlikely. This will place the onus on GCC States and on a politically reinvigorated GCC characterized by mutual trust and pragmatism to enable effective cooperation. GCC States will also need to balance their relationship with China in order to hedge their bets against the ongoing and likely irreversible decoupling between China and the United States.

This report provides initial considerations on some of the above topics and others. While there is no silver bullet to address the region's challenges, we believe that diversified expert viewpoints are critical given the inter-linkages between the economic, environmental, societal and security realms.

Nicolas Dunais
Managing Director



01

LABOUR ECONOMICS & INDUSTRIAL POLICY

**Universal Basic Income:
a solution for labour challenges
in GCC States?**

Steffen Hertog

**Technology dominance as
an industrial policy pathway**

Jean Francois Seznec

Universal Basic Income: a solution for labour challenges in GCC States?

Steffen Hertog

London School of Economics

Topic:

Labour Economics,
Fiscal Balance



A growing number of countries globally are considering and sometimes experimenting with Universal Basic Income (UBI), as an instrument for wealth distribution and social equity. GCC states could be the ideal testing ground for new distributional policies such as UBI which could reduce the fiscal burden of an over-extended public sector workforce while maintaining the social contract.

Introduction

Since at least the 1970s, the social contract between GCC states and their citizens has been based on a unique system of wealth distribution that provides a wide range of in-kind benefits, including free education and healthcare, energy and food subsidies, and housing support. The most important and unusual benefit of all, however, has been an open-ended guarantee of government employment, particularly for male citizens. This has led to significant overemployment in GCC public sectors, with the majority of nationals holding public rather than private jobs – a situation that is almost unparalleled in the world. The only other country with a comparable welfare system is the small Southeast Asian petro-monarchy of Brunei.

While this arrangement has maintained a broad middle class and kept social peace, it has come at inordinate fiscal cost: In Bahrain, Kuwait, Oman and Saudi Arabia, spending on government salaries and benefits now reaches 50% and more of total government expenditure, which is more than twice the share in advanced non-oil countries. While the share is lower in Qatar and the UAE, their wage bills have also been creeping up quickly.

Public employment guarantees have become fiscally unsustainable in an era of double-digit fiscal deficits. They are also highly economically distortive, as they discourage nationals from becoming active in the private economy, resulting in very low overall labour market participation by citizens. They lead to distorted education and skills acquisition choices and, in many cases, unrealistic expectations regarding work hours and working conditions in the private sector. Especially in the GCC countries with relatively lower oil income per capita relatively less oil-abundant Bahrain, Oman and Saudi Arabia, public employment has also become a highly exclusive and inequitable benefit as not all new job seekers have access to it anymore. Finally, excess employment in public sectors has been bad for administrative efficiency, as de facto job guarantees break incentive systems and make targeted, needs-based recruitment difficult.

It is clear that this system cannot continue – but what can replace it? Simply rescinding job guarantees without compensation is not feasible socially or politically: GCC nationals arguably have a moral and political claim to minimal welfare given the riches of their countries. Wages in the low and mid-skilled segments of the local private sector,

moreover, are pulled down by the easy availability of low-cost expatriate labour – another unique feature of GCC labour markets – which makes it difficult for all but the most skilled nationals to compete effectively even if they decide to do so.

GCC economies instead need smart wealth distribution reform, converting spending on surplus public jobs into less distortive, more inclusive and market-conforming welfare mechanisms. The debate on such reforms started across the region after the collapse of oil prices in 2014, and several governments have already experimented with new wealth sharing mechanisms. Some of the debate has been inspired by broader international discussions of a universal basic income (UBI) and other innovative welfare policies, themselves motivated by increasing labour market inequality and threats to traditional employment through automation and artificial intelligence – trends that potentially augment the national employment challenge in the GCC too.

Distributional reforms ideas

There are two basic approaches to distributional reform: unconditional sharing of cash (as through a UBI) or means-tested support payments.

Unconditional cash grants would go to all adult citizens and could serve as a more transparent and inclusive replacement for the wealth sharing implicit in government employment. Such grants should only be available for citizens who do not already hold a government job, thereby incentivizing more entrepreneurial public employees to potentially leave government and try to top up their newly acquired UBI with incomes from private employment or entrepreneurship.

“Golden handshake” policies of early retirement could further help trim the public payroll. New recruitment in government would happen only selectively, leading to significant long-fiscal term savings through gradual, needs-based government downsizing. The leadership would need to give a clear political signal that the government employment guarantee has ended – and stick to this decision. In the short run, complementary financing for a new UBI could be mobilized through energy subsidy reforms, effectively replacing another regressive and distortive, if somewhat smaller, wealth sharing mechanism with a more inclusive one.

“UBI WOULD PROVIDE BASIC SECURITY AND A CLEAR AND TRANSPARENT COMMITMENT TO CITIZEN WELFARE, WHILE BEING LOW ENOUGH TO INCENTIVIZE NATIONALS TO SEEK COMPLEMENTARY PRIVATE INCOME”

The *beauty of a well-designed UBI* would be that it would provide basic security and a clear and transparent commitment to citizen welfare, while being low enough to incentivize nationals to seek complementary private income to reach the middle class lifestyles they desire. Thanks to a UBI, they could do so even with relatively modest supplementary private income.

A second, somewhat less radical approach to distributional reform would be to gradually replace the public sector employment guarantee with **more conventional means-tested benefits**. One version of these would be a basic income guarantee under which welfare payments are phased out with increasing (private) income. While fiscally less costly, such a system would result in implicit taxation of private incomes, thereby disincentivizing private effort compared to a UBI arrangement. To reduce this disincentive effect, at least some of the means-tested benefits could be made contingent on private employment, providing wage subsidies that would again be phased out with

higher wages – similar to the Earned Income Tax Credit in the US or the Workfare Income Supplement in Singapore. Such wage supplements would encourage citizen labour market participation and improve take-home incomes. At the same time, as some of the subsidies would be indirectly captured by employers due to lower gross wage demands, they would help to narrow the labour cost gap with expatriate workers.

This gap is especially large in lower-skilled segments of the labour market [see first graph below]. Again, a combination of transfers and market income could together allow nationals to maintain a middle-class lifestyle.

Any of the above scenarios would be cheaper in the long run than mass public sector employment. The schemes are also less distortive of economic incentives, more conducive to private economic activity, more inclusive, and distributionally progressive compared to the status quo. They are also sensitive to the particular social and economic context in the Gulf, where nationals are exposed to particularly harsh competition from low-wage foreigners, justifying levels of assistance that go somewhat beyond what is offered on advanced labour markets that are less reliant on low-cost migrant workers.



Practical experiences and obstacles

Several countries in the region have gathered initial experiences with innovative distributional reforms. In December 2017, Saudi Arabia introduced a “citizens’ account” system that provides mean-tested cash grants to Saudi households to compensate them for energy subsidy reforms and tax increases. While the means-testing has not been perfect, the program has had a positive distributional effect, primarily aiding poorer households, while under the previous energy subsidy system rich ones tended to benefit disproportionately.

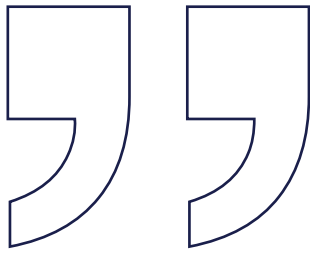
Kuwait has been providing [wage subsidies for nationals in the private sector](#) since the early 2000s, which has helped the country reach higher levels of private citizen employment than in Qatar and the UAE. The system’s efficacy has been undermined by repeated increases of public sector wages, however, and it is not means-tested but rather disproportionately benefits Kuwaitis with higher levels of education. There is also evidence of subsidy fraud, highlighting the need for strict monitoring and sanctioning mechanisms in any such system. Kuwaiti and Saudi technocrats are now discussing UBI and augmented wage subsidy policies internally. While means-tested systems are harder to implement and also are a harder political sell, high-deficit countries like Bahrain, Oman and Saudi Arabia might not have the fiscal luxury anymore to move to a full UBI. For high-rent countries Kuwait, UAE, and Qatar, the UBI option remains feasible and attractive.

In the short- to medium term, the trickiest part of moving to a new distributional system could be the temporary cost of transition. To make public sector downsizing politically acceptable, governments likely have to offer golden handshakes and while UBI or wage subsidies would kick in immediately, the savings from government shrinkage would likely accrue only gradually. In this context, fiscal savings from complementary reforms such as a reduction in energy subsidies could be very helpful: In a [recent research paper on distributional reforms in Kuwait](#), I estimate that the savings from energy subsidy reform alone could finance an ongoing monthly grant of 212 KD per adult (\$692) outside of government.

Outlook

The GCC is coming late to the international debate about welfare innovation but is in fact an ideal testing ground for new distributional policies, given that its existing distributional regime is so distortive. Notably, none of the arguments against universal basic income schemes that are routinely made in the Western context apply in the Gulf: different from OECD countries, a UBI in the GCC would necessitate no new taxes and no new net expenditure; it could instead be financed through reforms of existing distributional structures. While a UBI could create work disincentives in OECD labour markets, the incentive distortions of the status quo in the GCC are significantly worse than they would be under a UBI. Finally, the issue of fairness – why should wealthy citizens also receive UBI? – is much less acute in the GCC given that inherited employment and subsidy systems are quite regressive and disproportionately benefit better-off citizens. A move to a UBI would be distributionally progressive.

Fortunately, the GCC’s current wealth distribution regime is so lopsided that smart distributional reform can produce more winners than losers and still produce long-term fiscal savings. While the GCC has come late to industrialization and economic diversification, it has the potential to become a true global leader on welfare reform.



Smart distributional reform can produce more winners than losers and still produce long-term fiscal savings.”

The Way Forward

In practice, the best policy mix for the GCC is likely to be a combination of different distributional tools, including both conditional and unconditional ones, though probably with a stronger focus on conditional benefits in higher deficit countries. This should not be rushed, however: before settling on a specific package, governments and thought leaders need to increase public awareness about the problems of the status quo and facilitate robust debate about new ideas of welfare reform. Reforming the social contract is a complex undertaking that requires buy-in from a wide range of stakeholders.

Governments willing to consider UBI will want to follow a rigorous approach in the process of designing the policy. This will involve first determining the

optimal number of public sector employees under reasonable assumptions of institutional and individual efficiency levels that can be achieved. It will then require the definition of a process by which the surplus will be migrated to a UBI scheme, privileging a gradual process (e.g. non-replacement of employees retiring, or nudging employees towards early retirement) with the right incentives. The most delicate step will be in setting the UBI level, in a way that is sufficient for a modest middle-class lifestyle yet still creates an incentive for private sector employment. This will also have to account for the varying socio-economic contexts of recipients, requiring the development of complementary payments for those that require it.

Steffen Hertog is an expert in GCC public sector reform, the optimization of the investment environment and labour market economics. He is an Associate Professor of Comparative Politics at the London School of Economics.

Technology dominance as an industrial policy pathway

Jean Francois Seznec
Johns Hopkins University

Topic:
Economic Development,
Industrial Policy



As economic diversification is now in full swing, GCC states will need to avoid the policy shortcomings of previous diversification efforts. In terms of industrial development, this will require a relatively narrow focus on industries where they already have a major advantage, complemented by a major effort to dominate the technologies that make these industries globally competitive.

Review of past attempts at economic diversification

While the last decade has seen a strong impetus for economic diversification away from oil and natural gas by Gulf petromonarchies this diversification effort goes back as early as the mid-1970s when Saudi Arabia launched its development bank and started its petrochemical industry. Similar efforts were undertaken over time in Iraq, Kuwait, Bahrain, Qatar and the UAE. The prevalent idea was to add value to the hydrocarbon molecules, which the Gulf produces at the lowest cost globally. In effect, advanced chemicals from downstream petroleum byproducts can sell for many times the value of the oil or gas needed to produce them. This added value can create jobs in the various chemical and fertilizer plants, but mainly in the related industries and ultimately allow the oil & gas producers to reduce production while generating higher revenues.

Unfortunately, most Gulf countries did not pursue their diversification policy strongly enough. A major factor in limiting this effort was the Gulf states' income-dependence on crude oil extraction by their National Oil Companies. The value-adding petrochemical industries that were created were not subjected to taxation (and neither were citizens), except for the small and ill-defined imposition of Zakat. Hence, state revenues continued to come from oil and gas and thus led to maximizing production of the raw material rather than from added value products. It also indirectly affected the private sector which became increasingly dependent on the state and therefore less entrepreneurial than they could have otherwise been.

State-funded economic development was also unable to create a diversified economy. After the late 1970s, major efforts were initiated to improve the living conditions of citizens, through investments in infrastructure, education and healthcare. Improvement in living conditions was made possible by the massive import of foreign labour, limiting to an extent job prospects for citizens and generating remittances to expatriates' home countries amounting to several billion US dollars annually, thus limiting somewhat investments in the local economies. Finally, social and religious norms also limited economic development opportunities, such as the absence of bankruptcy laws and the strong segregation of sexes in some GCC states.

A renewed diversification impetus

All GCC States have now embarked on high-profile and ambitious economic transformation programs. Some countries have seen more success than others, such as the UAE, whose dependence on hydrocarbons is now the lowest in the GCC. Yet in the case of the UAE this has come at the cost of increasing reliance on foreign workers.

In spite of the aforementioned challenges, there is room for optimism on the region's future. Social changes in Saudi Arabia have been unprecedented in particular with regards to female employment. The UAE is now host to the largest aluminium plant in the world and hosts one of the most advanced logistical hubs globally. VAT taxes have been established, reducing state dependence on income from crude oil exports.

On the other hand, much remains to be done. Reducing state dependency on basic commodities will require that non-oil producing firms be taxed. The private sector will have to be further supported and encouraged, in spite of the suggested new taxes, by removing legal and human resources barriers. Young entrepreneurs will have to be able to start firms easily, while downscaling the size of the expatriate communities will be necessary if only to limit the export of remittances.

Gulf states have a natural advantage in large solar resources, until now vastly underused for a number of technical unresolved issues. A major effort is now under way by ACWA of Saudi Arabia, in a JV with Air Products of the US, to use the solar resources to become the largest supplier of green hydrogen and ammonia in the world. This should make the kingdom a dominant player in the green hydrogen field, which in due course can be developed much further in all manners of downstream productions, [although these still need to be defined](#).

The merger of Saudi Aramco and SABIC also provides [great opportunities for R&D and dominance in the chemical industry worldwide](#). At the time of writing, the likely merger of the Saudi Industrial Investment Group and the National Petrochemical Company (two of the largest private chemical companies in Saudi Arabia) should allow for the private sector to build its own world scale production lines.

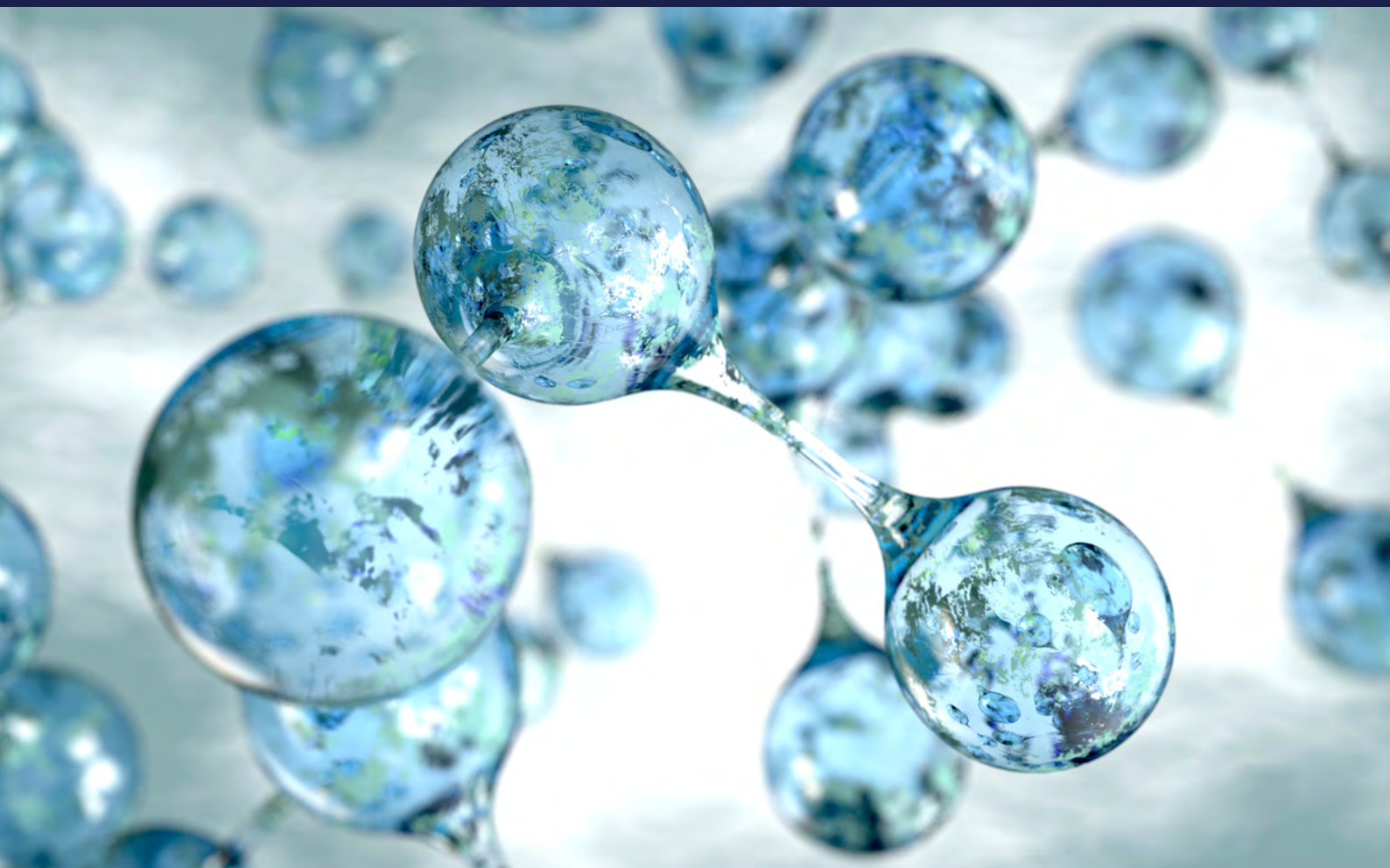


This should make Saudi Arabia a dominant player in the green hydrogen field, which in due course can be developed much further in all manners of downstream productions.”

The Way Forward

Successful economic transformations will require Gulf States to continue modernizing industries where they have natural advantages, such as chemicals, fertilizers, metals, and renewable energy sources. However, it will require that the states and the private sector continue to build upon these advantages in the most profitable manner. Hence, as Saudi firms like SABIC and Saudi Aramco or Universities like KFUPM and KAUST have done in the past, the Gulf states and companies will have to develop their R&D efforts much further and actively seek to control the technologies needed to build upon their natural advantages. Gulf states and the private sector have to become as dominant in new technologies and productions as they are today in hydrocarbons.

Jean Francois Seznec is an expert on chemical and energy-based industries in the Gulf, and their importance in world trade. He is an adjunct professor at the Johns Hopkins School of Advanced International Studies.



02

ENERGY

**A strategic approach to
decarbonization for GCC
hydrocarbon exporters**

Giacomo Luciani

**The argument for
a Middle Eastern gas grid**

Kate Dourian

A strategic approach to decarbonization for GCC hydrocarbon exporters

Giacomo Luciani
Graduate Institute

Topic:
Energy



The global trend of decarbonizing economies is set to have a direct impact on the oil-exporting countries of the Gulf. They can however mitigate and potentially profit from this trend if they act decisively and invest in carbon capture use and sequestration (CCUS) technology, thus securing and projecting a long-term future for hydrocarbons as a valuable and sustainable economic resource.

Strategic options for hydrocarbon reserves

The peak in global oil demand may not be tomorrow, and the decline past the peak may not be precipitous, but oil exporting countries with large untapped reserves should worry equally about the future value of oil or gas that they have in the ground. Oil exporters always needed to think strategically, but in the past the main concern was about the time when oil might run out, and production decline or cease. This led some of the major oil exporters, notably the ones that are members of the GCC, to deliberately slow down the pace of exploitation of their reserves. This attitude was in contrast to private oil companies, as well as national oil companies and a majority of other oil producers, that always aimed at maximizing short-term production and revenue.

The need for strategic thinking has not disappeared, but the concern is today for the possible loss of economic value of remaining reserves, which, according to one theory, runs the risk of never being extracted from below ground. At first sight, this might encourage the holders of such reserves to shift strategy and aim at driving higher-cost competitors out of the market, but this approach has proven to be extremely costly, leading to excessively depressed oil prices. The alternative is defending the value of hydrocarbons in a decarbonizing world, attempting to slow down the pace of substitution with moderate prices, but more importantly also aiming at the decarbonization of hydrocarbons' production and use.

Alternatives to decarbonization

Decarbonizing hydrocarbon production and use entails the systematic, if progressive, elimination of emissions from oil and gas:

- Scope 1 emissions, which are connected to the extraction of hydrocarbons and their transformation into final products
- Scope 2 emissions, which are connected to the generation of electricity used in the hydrocarbons industry
- Scope 3 emissions, which are related to the final use of the products derived from hydrocarbons.

With respect to scope 1 emissions, it is a well-recognized fact that not all oil and gas streams are the same, depending on conditions for extraction, or leakage of gases into the atmosphere. The GCC oil and gas producers are in a favourable position in international comparison, because of the prolific nature of their fields, and the vast investment that has been made to contain gas flaring or venting. Further decarbonization is possible through the capture and utilization or sequestration (CCUS) of the CO₂ generated in the extraction, transportation and refining processes.

Electricity generation (scope 2) in the GCC countries is today almost entirely based on oil or gas. The opportunity of developing renewable sources (solar and wind) or nuclear (also an almost zero-emissions source) has been discussed for years, and ambitious plans announced, but implementation is lagging behind. The UAE is leading the pack in this

respect, but even there more could be done.

It is unrealistic to think that oil and gas in power generation may be phased out anytime soon, but CCUS could be systematically implemented especially in newer plants to progressively reduce the emissions involved.

Finally, scope 3 emissions are the most important size-wise, but also the most difficult to tackle. There are fundamentally three strategies that oil producing countries can follow to be able to claim that they have eliminated scope 3 emissions:

- Turning hydrocarbons into intermediate products that are not destined to be burned as fuel, by integrating downstream into the value chains, towards an increasingly diversified and sophisticated array of advanced intermediary or final consumer products;
Use hydrocarbons locally in energy-intensive transformations coupled with CO₂ capture and
- utilization or sequestration
Turning hydrocarbons into non-carbon, clean-burning fuels – which basically means hydrogen and its non-carbon composites, while also engaging in systematic CCUS.

Assessment

The first strategy has successfully been pursued for years with the development of the petrochemical industry and the progressive integration downstream into higher value-added products. This is sometimes treated as an inferior or insufficient solution, primarily by observers who are not fully

aware of the bewildering array and the advanced technological content of products from the petrochemical industry. The demand for crude oil may well peak, but that for petrochemical products will certainly continue to grow in both quantity and quality. What is needed is the systematic implementation of carbon capture so as to break the association between petrochemicals and high carbon emissions.

The second strategy is also well present in the experience of the GCC countries, but little attention has been paid to presenting the products as low-carbon. This lack of attention risks damaging the future of the industries involved, such as steel or aluminium, in the face of likely recourse of some importing countries to compensatory measures to limit so-called carbon leakage. The EU is likely to impose a Carbon Border Mechanism to make sure that carbon-intensive imports cannot undermine European products that would be subjected to higher carbon prices. In the case of aluminium smelting, which requires large inputs of electricity, competition from Norway, whose electricity genera-

tion is almost completely clean because originating from hydropower, could be a significant problem. It is important to note that the only large carbon capture project in the region is that of Al Reyadah, which captures CO₂ from a factory of Emirates Steel.

The third strategy is more speculative. Hydrogen is increasingly being recognized as the fuel of the future in the Far East, Europe and the United States. But most of the talk and attention is concentrated on so-called "green" hydrogen, derived from electrolyzing water with electricity from renewables (in some versions, also nuclear). A scenario of predominant reliance on green hydrogen would in essence aim at solving the problem of discrepancy between the time profile of availability of supply from non-dispatchable renewables (wind and solar) and the time profile of demand. Green hydrogen, in other words, is essentially a tool for storing electricity from non-dispatchable sources. It would be coherent with a scenario of increasing penetration of electricity in all final uses, including mobility. It is far from ideal for hydrocarbon exporting countries.

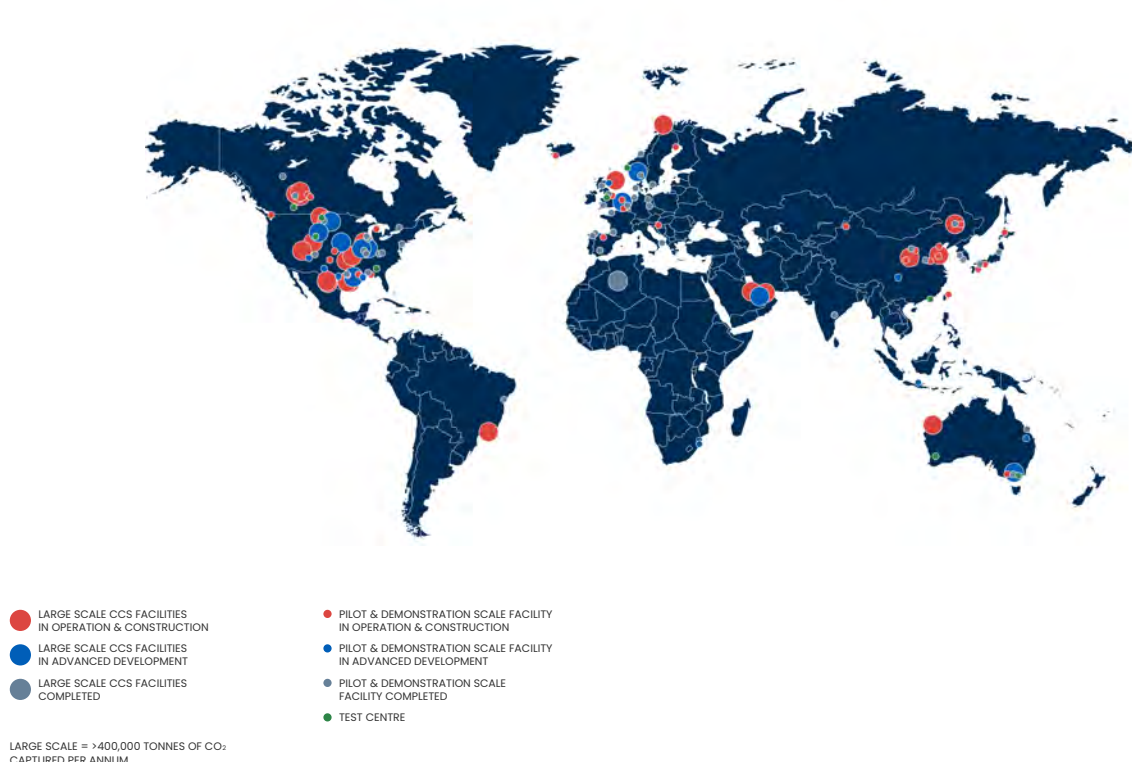


Figure 1: Global CCS facilities in operation, construction and development in 2019. Reproduced with the kind permission of the Global CCS Institute



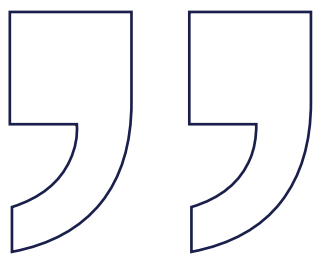
The rationale for blue hydrogen paired with CCUS

The alternative is “blue” hydrogen, produced from hydrocarbons subjected to steam re-forming, with capture and use or sequestration of the CO₂ which is the inevitable by-product of the process. Today, blue hydrogen is much less expensive and potentially much more abundant than the green variety, opening the door to the progressive transformation of gas networks into hydrogen distribution tools, and substituting for liquid fuels in mobility uses or power generation, either through clean burning in turbines, or through fuel cells. The birth of a full-fledged hydrogen economy necessitates both blue and green hydrogen, letting technology and production costs decide which of the two should prevail.

In this latter perspective, the opportunity for the hydrocarbon exporting countries is to progressively become producers and exporters of blue hydrogen (possibly also green, in a more distant future). This again entails emphasis on CCUS, as otherwise the production of hydrogen would add to emissions rather than subtract from them. As light hydrocarbon molecules contain more hydrogen than heavier ones, it is mostly the gaseous fractions that would be used to produce hydrogen. But these are the same molecules that are also cracked to produce petrochemicals; therefore, a choice may become necessary at some point between producing hydrogen or petrochemicals. Also, hydrogen is needed to crack the heavier molecules and improve the production of lighter cuts in the refining process. Hence the perspective of becoming hydrogen exporters impinges upon the composition of available hydrocarbon streams and may be relevant only for countries that have excess availability of natural gas.

What emerges clearly in this discussion is that a strategy for defending the long-term value of hydrocarbons must in any case be based on major efforts towards carbon capture, utilization or sequestration. This is a widely recognized conclusion, and CCUS has attracted growing attention in the GCC countries over the years. In 2017, Suhail Al Mazrouei, the UAE Minister of Energy and Industry, at the 7th ministerial meeting of the Carbon Sequestration Leadership Forum (CSLF) in Abu Dhabi stated that CCUS projects across the world should scale up 100 times to meet the challenge of decarbonization: so far there is no signal that any dramatic upscaling is in the making at all. To the contrary, the lack of initiative and commitment to large-scale pilot projects undermines the very credibility of the technologies involved in CCUS.

The major GCC oil exporters certainly are amongst the parties that have the strongest interest in demonstrating that CCUS is a valid and real alternative for decarbonization. It is impossible to project a long-term future for hydrocarbons as valuable economic resources otherwise. International oil and gas companies are finding it difficult to justify investment in CCUS on a commercial basis, except for those situations in which CO₂ is produced jointly with oil and gas and its capture and reinjection in the field is a prerequisite for the production of the hydrocarbons. As private companies are responsible for delivering value to their shareholders, it is understandable that they take the attitude of waiting for governments to adopt regulations that will justify investment in CCUS before taking the plunge. But governments of fossil fuel exporting countries (including major exporters of coal) have a strategic interest in demonstrating the viability of CCUS, and should take the plunge even if projects cannot today be proven to be commercially viable.



The strategic defence of hydrocarbons' economic value requires the massive mobilization of capital and credible leadership and coherence to acquire legitimacy in the global drive towards decarbonization. ”

The Way Forward

The strategic defence of hydrocarbons' economic value certainly requires massive investment: in CCUS projects, in clean power generation from renewables and nuclear, in the industrial transformation of hydrocarbons into non-fuel products, in other energy-intensive industries, and finally in the production and export of hydrogen and some of its non-carbon composites. This requires the mobilization of private as well as public, and national as well as international, investment. Such mobilization is possible if a credible narrative is proposed. After all, there are huge vested interests in the preservation of the hydrocarbon industry globally, not just in the major oil and gas exporting countries. The potential is there, but its realization requires credible leadership and coherence to acquire legitimacy in the global drive towards decarbonization.

Professor Luciani is an expert in the geopolitics of energy with in-depth experience of the GCC. He is an adjunct professor at the Graduate Institute and the Scientific Director of the Master in International Energy of the Paris School of International Affairs at Sciences-Po

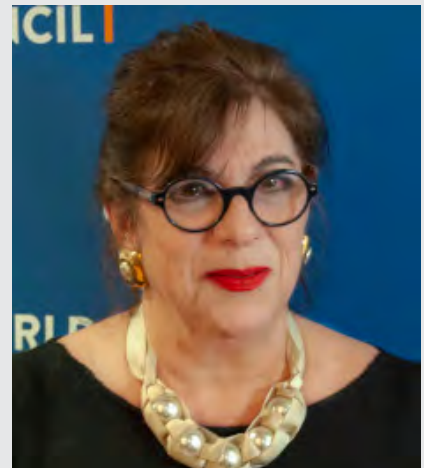
The argument for a Middle Eastern gas grid

Kate Dourian FEI

Independent energy consultant

Topic:

Energy



Covid-19 has accelerated the will of many countries to engage in a “green recovery” aiming at a reduced reliance on fossil fuels (in particular oil and coal). Given the abundant gas reserves in the Gulf and the Eastern Mediterranean and the need for a pragmatic approach to climate change mitigation, Gulf countries could lead the development of a regional gas-grid across the Middle East, allowing for a corresponding increase in the use of gas for power generation. In a later stage, this infrastructure could be used to transport hydrogen.

A siloed and inefficient approach to gas infrastructure investments

Arab Gulf States are pursuing independent gas infrastructure projects. Kuwait, for example, has struggled to meet gas demand and is importing LNG from the global market and is likely to have to rely on LNG imports until at least 2035. Iraq finds itself in the paradoxical situation where it flares natural gas from oil wells while importing both gas and electricity from Iran at huge cost to its already strained economy. In Saudi Arabia, the focus has shifted to more upstream investment in both conventional non-associated and unconventional gas but that too comes at a very high cost when it would make more sense to import gas and lock in current low prices rather than invest in overseas assets. The UAE, once a net exporter of gas, is now a net importer and while it is developing its sour gas reserves, it will take time to achieve its goal of becoming a significant exporter again. Its current imports, which averaged 12.9 bcm in 2017 are set to increase as new receiving terminals come online. Oman's LNG exports have dwindled in recent years, but it is investing in new capacity that will generate additional supply that is expected to be used in priority for LNG exports and to satisfy domestic demand.

Natural gas as a transitional step to climate change mitigation

Given that two of the world's largest gas reserves are to be found in the Middle East and that the East Mediterranean is emerging as a significant gas hub, it is time to consider how best to pool these resources and create a regional gas market that would benefit all countries and make for a more equitable distribution of wealth. That would require a unified price structure across the region and the elimination of domestic subsidies. Current price levels would make it easy for governments to do away with remaining price controls as they have done in the past during weak price cycles. Developing a regional grid would serve all countries in the region more than the unilateral approach that is being adopted, particularly now with uncertainty about future demand for natural gas given rising concerns about methane emissions and moves by the EU and others to phase out the use of natural gas in power generation. Unlike crude oil, natural gas is a regional story and despite the expected reduction in demand in Europe and the US, it is still the only fossil fuel that is forecast to increase its share of the global energy mix by 2050 at the expense of both coal and oil. With the energy transition now underway,



GCC gas production and consumption in 2019 vs consumption in 2040

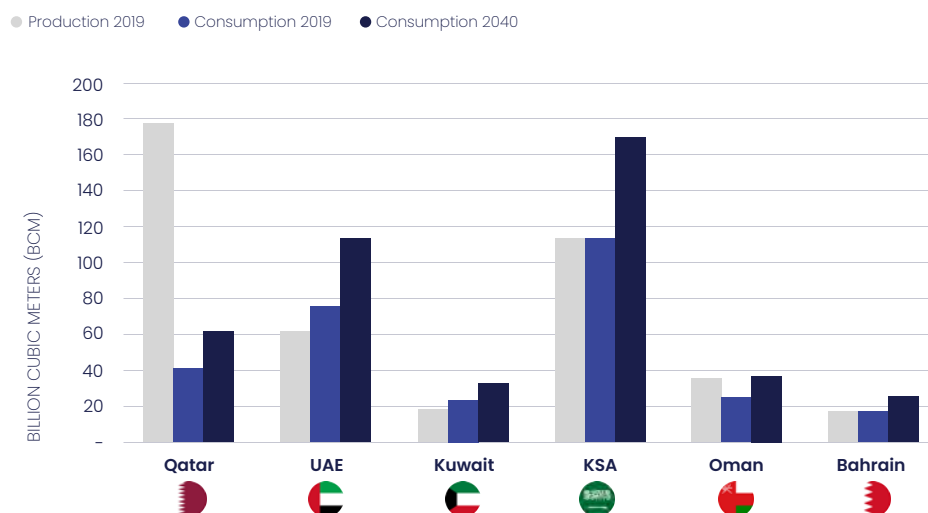


Figure 2:
GCC gas production and consumption volumes in 2019 vs projected consumption volumes in 2040.
Sources: BP Energy Outlook 2020, IEA.

RESERVES TO ANNUAL PRODUCTION RATIOS (2019)

139	94	92	53	19	6
-----	----	----	----	----	---

natural gas remains the environmentally acceptable bridge fuel until renewable energy capacity can be sufficiently expanded in the Middle East. By way of illustration, the Italian oil major Eni has pledged to become carbon neutral, yet its strategy will see an increase in production of natural gas as part of the process. Total, on the other hand, is investing more in electricity generated from renewable energy as part of its strategy to decarbonize its business.

There is also an undeniable environmental benefit in reducing the amount of crude oil and other liquid fuels burned for power generation in many Gulf countries. Recent months have seen a marked increase in the amount of crude oil burned for electricity generation, while associated gas production has declined along with falling crude oil production to meet OPEC targets. As temperatures continue to increase, demand for energy to power air conditioning units in the region is bound to grow, worsening the carbon footprint of Gulf countries. With 30% lower CO₂e emissions per unit of energy produced and significantly lower nitrogen oxide and sulphur dioxide emissions, gas could serve as a transitional energy source on the path towards full decarbonization. The availability of gas would also serve to develop a regional hydrogen industry, while the gas pipeline infrastructure could be used for hydrogen transport when and if the time comes for substitution (assuming widespread green hydrogen production).

An opportunity and a precedent for success

There are signs that GCC gas integration is gaining traction but geopolitical considerations and tensions within the region will make it difficult to achieve a true regional gas hub, which would require far more supply liquidity than presently available. However, there is perhaps too much focus on downstream oil refining and petrochemicals integration, with natural gas increasingly being diverted into petchems production. There is a risk of overcapacity and producers need to be cautious about banking too much on growth in demand for plastics should more countries ban single use plastics. The current situation, where demand has soared during the pandemic, should not be interpreted as the start of a new trend. More than 40% of plastics production goes to packaging and if that disappears, it would lead to a decline in demand for petrochemicals, one of the key drivers of future oil demand along with heavy transportation and aviation. As a result, more gas supply would be available. Finally, the addition of new gas from the East Mediterranean and the proliferation of both fixed and floating LNG receiving terminals in the region will allow for an expansion of gas trade within and beyond the Middle East. This will require investment in pipeline infrastructure to connect more countries to existing gas grids.

Given the relatively short distances involved, the investment outlays are not likely to be huge. Gas infrastructure can also be repurposed in the future if necessary, to carry clean energy vectors like hydrogen.

There is a precedent to successful interconnection in the Gulf region. The GCC Interconnection Authority (interconnected power-grid between GCC states) has made some progress in interconnectivity and cross border trade has risen significantly in recent years though there is scope for more to be done.

In 2019, the GGCI reported that there were 1,800 incidents where the interconnected grid prevented interruption in the MENA region and avoided black-outs and shutdowns. An increase in the volume of cross border electricity trade can optimize energy sources across the GCC. Opportunities are being explored to interconnect with other countries, namely Iraq and Jordan. Peak load occurs in the summer and there is excess capacity in the winter that can be utilized if there is wider access.



Natural gas remains the environmentally acceptable bridge fuel until renewable energy capacity can be sufficiently expanded in the Middle East.”

The Way Forward

Interconnecting national gas grids across the region can provide flexibility and affordability in a context where intermittent energy sources are being deployed more rapidly to meet climate goals. It would also provide a balancing mechanism where there is a deficit of or surplus renewables capacity, leading to enhanced security of supply by optimizing the delivery of energy across the region resulting in savings for all parties. The economic development benefits would also be substantial.

While current geopolitical tensions make the realization of a regional gas-grid challenging, there is a clear rationale to further explore the economic, social and environmental benefits of such a project as a step-ping-stone to energy transition. This could start through the establishment of a robust governance structure to guide cooperation between GCC and other Middle East governments and research institutions in order to align on a common set of objectives and conduct a feasibility study to determine the economic and financial viability of the project.

Kate Dourian is a fellow of the Energy Institute and a regional manager for Middle East and Gulf States at the World Energy Council. She has more than 30 years of experience in MENA energy markets, including with Platts and the International Energy Agency.



03

FOREIGN POLICY, TRADE & SECURITY

Implications of the US presidential election for the GCC

Bernard Haykel

Implications of China's 14th Five Year Plan for the GCC

Mohammed Turki Al-Sudairi

Implications of the US presidential election for the GCC

Bernard Haykel
Princeton University

Topic:
Security,
Foreign Affairs



The US elections present the GCC countries with potential challenges regardless of the outcome. On balance, the Gulf states would prefer a Donald Trump victory because it is easier to deal with an incumbent leader, who, despite being transactional and capricious, is still committed to the view that Saudi Arabia and the other GCC states are strategic allies and that the US has vital interests in the region that need protecting.

Trump vs. Biden

A victorious Trump will insist that in return for maintaining strong relations the Gulf states must continue purchasing weapons, make investments in America, pay for US military assistance, limit oil production to help the US energy industry, and establish more open ties with Israel. Unlike Trump, Joe Biden--as his principal advisor Anthony Blinken has indicated--will be guided by a return to the Obama policy of appeasing Iran, restricting arms sales to the GCC, insisting on a quick end to the war in Yemen and, finally, the upholding of human rights, especially for women. Whatever the outcome of the election, and despite their differences, both Republicans and Democrats will also have to accommodate an American public that is exhausted by overseas military interventions and seeks to diminish the US's global footprint, in particular in the Middle East. The GCC countries will have to contend with all these competing views and demands.

America's isolationist impulse is reinforced by the public's view that the US has become energy self-sufficient because of the shale oil and gas revolution of the last decade--the dominant feeling is that the Middle East's energy reserves have become unnecessary for America's econom-

ic wellbeing. This is a mistaken assessment since oil remains a globally priced commodity and Middle Eastern production--in particular the volume of output from the GCC--remains vital to the welfare and survival of US producers as well as to the stability of the global economy. The oil price crisis in March 2020 illustrated this point well with the result that Trump had to appeal, repeatedly, to Saudi Arabia to cut production to help save the US energy industry. Like Trump, Biden also understands this fundamental feature of energy markets and will therefore be cautious not to alienate the Kingdom and its Gulf allies. Still, America's isolationist impulse is getting stronger and in practice this will mean that the US will be a less reliable partner for the GCC regardless of who is in power in the White House.

Congress

The November election is not only about the fate of the presidency. Which political party gains a majority in Congress will also have consequences on American policies toward the GCC. For instance, a Democrat majority in the Senate will certainly lead to considerable pressure to restrict arms sales to the GCC countries as well as to insist on human rights as an important element in foreign policy. The Democrats are also more likely to side with Qatar, which has cultivated them very actively since 2017.



Whereas the continuation of a Republican majority in the Senate will mean that such restrictions and pressures will not be exerted. In short, Republicans are stronger supporters of maintaining robust bilateral ties with the GCC countries, and they are more vigilant about containing Iran and restricting Russian and especially Chinese influence in the Gulf.

Iran

President Trump's principal advisors on the Gulf and Iran—Jared Kushner, Mike Pompeo and Elliot Abrams—are all strong advocates of closer relations with the GCC and are hawks when it comes to Iran. Yet, Trump might still try to obtain a meeting with the Iranian president, mainly as a publicity stunt—his public image as an international negotiator remains a top priority. Even so, without a renegotiated and broad agreement with Iran, one that goes beyond the nuclear issues, Trump will not lessen the economic sanctions against Tehran. Iran will have to provide substantive concessions in a revamped deal of the nuclear agreement (JCPOA). Such concessions would involve, in addition to more restrictions on the nuclear program, limitations on ballistic missile production as well as drone and cruise missiles, and a reduction of support for proxy groups around the region (e.g., the Houthis and Hezbollah). All this will involve high sacrifices for Iran and thus a new deal with Trump is very unlikely to be concluded.

Similarly, a quick resumption of the JCPOA deal between Iran and the Democrats cannot be taken as a given. Although the Democrats wish to re-join the JCPOA, doing so will not be easy because Iran will insist on a new set of conditions that Biden cannot simply agree to. First, Iran will demand a form of reparations to compensate for the punitive regime it had to endure under Trump. The Iranian Revolutionary Guard Corps (IRGC), which is poised to take over fully the regime in Tehran, will insist on this. Second, Iran is perceived by many Americans as having negotiated the nuclear deal in bad faith. It used the funds it received from the Obama administration to entrench further its influence and domination over Iraq, Syria, Lebanon and parts of Yemen. In each of these it has spent billions of dollars supporting its proxies, providing weapons and training. Furthermore, Tehran has continued to develop its missile and drone programs, whose remarkable efficacy and destructiveness was on full display during the 14 September 2019 attack on the Saudi oil installations. And while it can be argued

that Iran has done all this to protect itself from American, Israeli and Saudi hostility, it is broadly identified in the US as a destabilizing actor in the region and with a clear aim to see the US withdraw completely from the Gulf. Biden will not be able to pretend, as the Obama administration often hinted, that a renewed agreement will help change the nature of the Mullah's regime. And this is all the more so as the IRGC openly becomes the dominant actor in Tehran.

The UAE, Bahrain and Israel Agreements

The recent agreements to establish a formal relationship between Israel and the UAE as well as with Bahrain are widely perceived as a gift for Trump since he can claim this as a foreign policy win before the November elections. However, these agreements are also supported by Biden since any US president must be in favour of normalization and peace between Arab countries and Israel. These agreements are ultimately driven by the state and security interest of the Gulf states and Israel and not by US electoral considerations. These countries want to break with the paralyzing political dynamics of the past—those centred on Arab nationalism, resistance to the West and the Palestinian cause—and wish to build a prosperous future based on commerce, technological innovation, and mutual security. This breakthrough also has the tacit blessing of Saudi Arabia and represents a major development for the region. Other countries such as Oman are likely to follow in the UAE and Bahrain's footsteps, although not Saudi Arabia because of its status as global Muslim leader and because its own population is not ready for such a dramatic change in foreign policy. These agreements bring into the open the split between the major countries of the Middle East. On one side are Turkey, Iran and Qatar all hoping that the forces of Islamism and anti-Westernism will prevail, despite the significant differences between them. On the other side are the UAE, Bahrain, Israel, Saudi Arabia as well as Jordan and Egypt who wish to maintain American hegemony over the region. If Trump wins, the pro-American side led by Israel and the UAE will be given a huge boost and the divisions between the two camp will become more prominent. One consequence of this is that Turkey and Qatar will be pressurized by Trump to choose sides. A Democratic win is likely to give the Turkish and Qatari-led camp more leeway to continue pursuing their Islamist policies.

The Way Forward (the Biden hedge)

A Biden victory will mean that America will become a less reliable ally for the GCC countries, especially for Saudi Arabia, and the US will generally reduce its involvement in the Middle East. This could spell greater instability for the region. It is not a coincidence that the Obama period was accompanied by the period of greatest chaos in the region—the Arab Spring and its effects—and this was in part because Obama signalled a reduction of involvement by the US in the region's affairs. A similar dynamic under Biden will strengthen the already existing policies of Gulf states to hedge their position by diversifying their international relationships, in particular with China. The regimes' security and survival will become an even greater priority. More than increased commercial relations with China, we will see even more weapons systems being bought from China and joint manufacturing of these in the Gulf, as well as greater collaborations on major infrastructure projects such as nuclear and solar power and the mining of minerals. The Chinese are already in the enviable position of having both Iran and the GCC bidding for greater cooperation and exchange while the US sees its influence receding.

A Biden administration, which resumes negotiations with Iran, will put pressure on Saudi Arabia to end the war in Yemen as well as restrict arms sales. This is one reason why an immediate Saudi push to end the war in Yemen will help pre-empt the Democrats. This can help create an opening for Riyadh to cultivate the Democrats who feel resentful by the exclusive relationship Saudi Arabia has fostered with Trump. The release of political prisoners before the election in November is also another way to pacify the Democrats and other critics in the West. Of course, a Saudi agreement with Israel before the November elections would force the Democrats to adopt a more positive policy vis-à-vis the Kingdom, but this is unlikely to happen for the reasons mentioned earlier. As a rule, it is always best for the GCC countries not to be identified too closely with one party in the US but instead to try to cultivate bi-partisan support. The November election offers an opportunity to do just this—build constituencies across the political divide in America that see long-term value in maintaining robust and strategic relations with the GCC.

”

An immediate Saudi push to end the war in Yemen will help pre-empt the Democrats.”

Bernard Haykel is a professor of Near-Eastern Studies at Princeton University. He specializes in the socio-political dynamics, history and identity of GCC countries and in particular Saudi Arabia.

Implications of China's 14th Five Year Plan for the GCC

Mohammed Turki Al-Sudairi
University of Hong Kong

Topic:

Foreign policy,
Trade and security



In light of China's expected push to full technology independence, GCC States would be well advised to conduct thorough reviews of the security implications of their technological partnerships with China, if only from the perspective of the ramifications this may have on their relationship with the United States.

2021–2025 Five Year Plan:

A focus on stability, resilience, and technological advancement

China's upcoming 14th Five Year Plan (FYP), which will outline the basic direction of party-state economic policies for the period of 2021–2025, is expected to be unveiled in October 2020 during the fifth plenum of the current Central Committee of the Communist Party of China (CPC). A longer development plan leading up to 2035 is also expected to be presented then. While the full-details of the FYP have not yet been released, official statements following CPC-level 'economic work meetings' and, more recently in August, solicitations of public and scholarly input on the FYP draft, offer some insights into its overall thrust. Beyond affirming the economic goals set by the CPC – doubling the GDP in the period of 2010–2020 and achieving the status of a 'modestly prosperous society' (小康社会) in time for the party's centennial in 2021 – the upcoming FYP is unlikely to contain radical departures from the basic economic policy line adopted by the Xi Jinping administration:¹

- There will likely be no infrastructure-focused stimulus package akin to that which followed in the wake of the 2008 financial crisis. The legacy of that package, in addition to stop-gap measures adopted at the time, left the party-state contending with a legacy of heavy debt at the provincial government-level which has been repeatedly described by the Chinese leadership as a 'grey rhino' (灰犀牛) – a longstanding threat to the health of the economic system. The Xi Jinping administration has prioritized, with some degree of success, debt management, conducting anti-corruption inspection tours related to government borrowing, imposing debt ceilings, and pushing local government financing vehicles (entities used by provincial governments to get-around borrowing limits) to become profitable and independent, among other policies. The relative stability of the Chinese economy well into the COVID-19 crisis mitigates against a major stimulus package: according to the most recent IMF forecast, growth in China in the second quarter is rebounding at 11.5% in comparison to -1.6% during the first quarter.
- Nevertheless, we should expect some fiscal assistance to the economy in the upcoming FYP. In response to COVID-19's impact on the domestic economy, the Standing Politburo of the CPC emphasized in a meeting held in April 2020 that cadres were responsible for safeguarding the 'Six Stabilities' (六个稳定) and 'Six Guarantees' (六个保证)². This means that there is strong political commitment to ensuring that real economic pressures – felt particularly by the 'drifting populations' (流动人口) of migrant workers and among whom unemployment figures are estimated to vary between 30 to 70 million – do not translate into unrest against the party-state. Sustaining businesses will thus be a major priority: as Premier Li Keqiang declared during the final session of the delayed National People's Congress in May 2020, the party-state is intending to offer combined cuts (tax exemptions, lower interests, waived welfare fees, reductions in utility costs) to businesses and factory-owners totalling some USD 559 billion.

¹ Among these policies are the continued centrality of the anti-corruption campaign, enhancing state administrative capacities and responsiveness to businesses, increasing the efficiency and profitability of state-owned enterprises while continuing to penetrate the private sector, and more broadly, tackling poverty, building a basic welfare security net, carrying out a careful re-structuring of the Chinese economy aimed at transforming it into a high-tech and consumptionary-centred model.

² Stability in employment, finance, trade, foreign investment, domestic investment and expectations about the economy; Guaranteeing employment (for the population), livelihoods (of the population), the integrity of the market, food and energy security, supply chains and grassroots organizational operations.



- The slogan of ‘dual circulation’ (双循环), increasingly invoked by the Chinese leadership, will likely be included in the FYP. Of interest is the internal circulation aspect which refers to encouraging greater reliance on domestic consumption as an engine for economic growth.³ Despite continuous party-state efforts since the Hu Jintao administration to engender greater internal consumption, success has remained elusive in that regard (estimates vary between a 1%-2% to 7% increase in the period of 2010–2020). Calls for de-coupling and supply chain security by other advanced economies (of which the ongoing trade war with the United States is the most serious) and the uncertainty of the global order are pushing Chinese leaders to invoke the Maoist slogan of national ‘self-reliance’ (自力更生). In some respects, this emphasis on internal consumption is a hall-mark of the Xi Jinping administration’s thinking on economic issues: its multi-year long urbanization and poverty-alleviation campaigns, targeting some 60 million people under the poverty-line, are aimed at ‘unlocking’ new engines of consumptionary growth for the economy, particularly in the more undeveloped or economically stagnant non-coastal provinces.
- Backing of the continued development of China’s technological infrastructure will likely be prioritized in the upcoming FYP. The American campaign against multiple Chinese tech-giants such as Huawei, ZTE, Tencent and ByteDance, among others, hand in hand with greater scrutiny of technological and scientific links between the two states (and American allied third parties), is pushing Chinese elites towards acknowledging the need for technological de-coupling and independence to weather American interdicts against them. Open commentaries in Chinese media describe this de-coupling as a painful sacrifice that will likely hurt or slow Chinese development for a decade, but one that will ultimately reap-fruit and enable the country to emerge as a major technological superpower. Aspects of the ‘Made in China 2025’ plan, downplayed a few years ago due to growing criticisms from industrial powers, will probably surface within the context of the FYP as such. In addition, new digital initiatives – such as digital currency – will be given considerable attention.

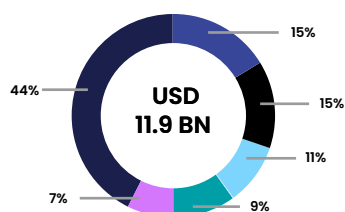
³ External circulation refers to continued reliance on other markets/foreign economies, albeit under conditions of protectionism and increasing barriers to trade.

In all, the policy direction we should expect to see in the upcoming FYP is one that emphasizes stability, immunity from external vulnerabilities (through greater emphasis on internal sources of growth), keeping provincial-level debt in-check, while also continuing technological upgrade. While there is always the possibility of a 'black swan' (黑天鹅) upending the Chinese economy, it has nevertheless shown a capacity to weather the upheaval caused by global crises like COVID-19 as well as sustained challenges like the American-led trade war. Growth will likely continue into the foreseeable future, albeit at a more decelerated pace of 4%-5% per annum.

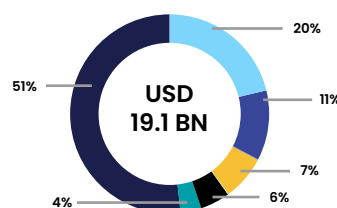
Implications for the GCC

This bodes well for the states of the Gulf Cooperation Council (GCC) – particularly Oman, Qatar and Saudi Arabia – that are heavily reliant on the Chinese market (and which have benefited both from the imposition of sanctions on Iran in 2018 and the massive spike in demand from Chinese private refineries earlier this year). Looking ahead however, China will continue to seek to diversify its energy sources away from the Gulf (a process already underway for several years) and continue to support the electrification of its transportation system, alternative energy generation, and greater energy use efficiency (all of which dovetail with its technological goals).

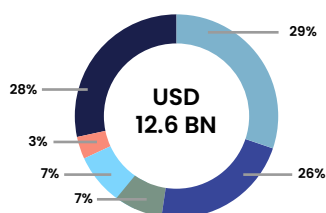
Total KSA imports from China, 2008



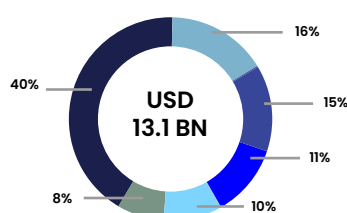
Total KSA imports from China, 2018



Total KSA imports from USA, 2008



Total KSA imports from USA, 2018

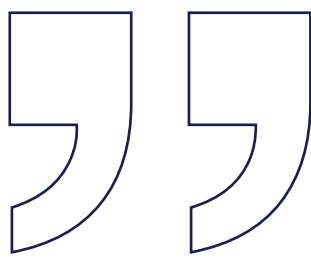


- Nuclear reactors, boilers, machinery
- Ships, boats, and floating structures
- Furniture, bedding, mattresses
- Electrical equipment
- Arms & amunition
- Apparel & clothing
- Aircraft & parts
- Iron & steel
- Iron or steel articles
- Vehicles
- Other

Figure 3: Comparison of Saudi Arabia's imports from China and the USA, 2018 vs 2008, top five goods by value. Saudi imports of strategic goods from China have displaced American ones in the course of the decade. For instance the value of electrical equipment imported from China tripled to almost \$4BN and is now three times higher than imports from the US. Source: Data extracted from the Observatory of Economic Complexity

The Way Forward

While the Chinese state has shown a commitment to supporting its technological giants, GCC States may want to conduct thorough reviews of the security implications of their technological partnerships with China (e.g. Huawei 5G deployments, Sino-Saudi nuclear cooperation, Saudi cooperation on the use of Chinese GPS-equivalent satellite systems like Beidou), if only from the perspective of the ramifications this may have on their relationship with the United States. Sino-American relations, which are currently the worst they've ever been since the normalization of bilateral ties in 1978, will probably continue to deteriorate: this will force the GCC to contend with binary choices (mostly emanating from Washington) over whether to choose Chinese or American technologies.



GCC States may want to conduct thorough reviews of the security implications of their technological partnerships with China.”

Mohammed Al Sudairi is a post-doctoral fellow, Institute for Humanities and Social Sciences in the University of Hong Kong



04

FOOD SECURITY

Food security lessons from Covid-19

Eckart Woertz

Climate and environmental preparedness after Covid-19

Martin Keulertz

Food security lessons from Covid-19

Eckart Woertz

University of Hamburg,
German Institute of Global
and Area Studies (GIGA)

Topic:

Food Security,
Trade



To achieve food security, Gulf leaders will need to ensure a robust management of food value chains, ensure functioning multilateral frameworks and rapidly address domestic malnutrition issues through targeted policies.

A resilient food-supply

Past approaches to food security in the countries of the Gulf Cooperation Council (GCC) were informed by concerns about food availability. They aimed at domestic self-sufficiency and self-sufficiency by proxy (via farmland investments abroad). These strategies largely failed to meet expectations: water scarcity significantly compromised agricultural production while farmland investments abroad did not match ambitious related announcements due to a complex mixture of commercial, socio-economic and political factors: today, they do not contribute meaningful quantities to the Gulf countries' food imports.

The failure of such strategies prompted a shift of focus instead towards value chain management as a means to secure food availability. Rather than trying to fight food import dependence, the Gulf countries have now accepted this reality and in consequence have managed food value chains and their international linkages. As a result, Gulf countries are today much more resilient to global food crises. They have increased storage to bridge supply shortfalls, diversified providers, streamlined sanitation measures and eased import flows by changing the requirement for all goods to be labelled in Arabic. Internationally, stocks of staple foods are higher, and markets better supplied than during the global food crisis of 2007/08. Some food exporters such as Ukraine and Vietnam have announced quotas, but price spikes and outright export restrictions have not occurred so far. Political awareness about the detrimental effects of such restrictions has also grown.

Globally, the impact of COVID-19 has been most severe in traditional and transitional food value chains, such as household microenterprises on the one hand and small and medium-sized enterprises and wet markets on the other: informal and labour-intensive, they bring together large numbers

of workers in crowded spaces – at considerable risk of contagion and with ensuing shutdowns and labour shortages. The capital-intensive farming of staple crops will be less affected in comparison. The labour-intensive cultivation of fruit and vegetables will likely fare better as well, as it is subject to less labour density than the traditional and transitional downstream value chains. This all means that the Gulf countries find themselves in a relatively privileged position: their global supplies of agricultural products are unlikely to dry up in the foreseeable future, while their modern food value chains that are dominated by supermarkets and capital-intensive processing plants are less vulnerable to COVID-19-related disruptions.

Food challenges on the horizon

COVID 19 has prompted a shift of focus in Gulf countries' food security strategies towards value chains and food diplomacy that has been in the making over the past decade. Domestic endeavours to get "more crops with less drops" with the help of modern technologies such as drip irrigation and hydroponics will provide only a fraction of their total food needs. The self-sufficiency dreams of yesterday are gone for lack of water. This leaves agricultural investment, but here the focus has shifted as well – and for good reasons – from politically controversial and risky farmland investments in food insecure countries to value chain investments further downstream and farming joint ventures in developed agro markets.

Gulf countries remain nevertheless vulnerable to the consequences of COVID-19. The pandemic has emphasized the risk that malnutrition poses to populations with high levels of obesity and diabetes. Additionally, food accessibility for vulnerable population segments such as migrant labour has proved to be another key issue. Finally, the risk of illiquidity in the food-market created by the rush to stock-up food remains real.



The Way Forward

To address current challenges and vulnerabilities, Gulf countries should consider:

1. Significantly enhancing efforts to combat food-related epidemics, through a combination of public communications and policy interventions. These would include community-level awareness-raising and parent-education as well as behavioural-change nudges through targeted campaigns; greater oversight and regulation of school meals along with enhanced physical education classes at school; and expanding the successful excise tax on sugar-sweetened beverages to other carbohydrates and sugar-rich foods. Significant economic benefits could be reaped from the expected improvement in public health.

2. Further leveraging multilateral bodies to lobby for affordable food imports, such as the World Trade Organization and the G20, following the approach of

the Net Food-Importing Developing Countries (NFIDC) that formed an interest group within the General Agreement on Tariffs and Trade negotiations. Additionally, multilateral initiatives such as the Agricultural Markets Information System (AMIS) could increase market transparency and dampen food-price volatility.

3. Changing labour regulations and developing assistance programmes and safety nets to address the challenges faced by the more vulnerable population segments. Supplementing the successful value chain investments with food diplomacy and adapted domestic policies for citizens and migrant workers is likely to increase the food resilience of Gulf countries.



The pandemic has emphasized the risk that malnutrition poses to populations with high levels of obesity a diabetes.”

This brief is partially adapted from Woertz, Eckart. Wither the self-sufficiency illusion? Food security in Arab Gulf States and the impact of COVID-19. Food Security 12, 757–760 (2020).

<https://doi.org/10.1007/s12571-020-01081-4>

Eckart specializes in food and energy security. He heads the GIGA Institute of Middle East Studies, a member of the Leibniz Association. He is also a professor at the University of Hamburg for Contemporary History and Politics of the Middle East.

Climate and environmental preparedness after Covid-19

Martin Keulertz

American University of Beirut

Topic:

Food Security,
Trade



While GCC states have proven food-resilient during Covid-19, the looming effects of climate change on food security warrant efforts to develop adapted environmental and trade policies. In particular, GCC states need to place more emphasis on trade relations, yet also understanding the climate risks in producing countries to ensure future supply chain sustainability and thus food security

Background

When Covid-19 started hitting in earnest during spring 2020, a major global concern was the potential disruption to food trade. GCC Economies in particular feared a re-run of the 2007/08 and 2010/11 food price spikes which had caused tremendous challenges on the world food markets and risky domestic social challenges in the Gulf. At that time, economies that had been historically able to rely on imports without much disruptions felt a crunch on the world markets through the physical scarcity of staple foods. One consequence of these food crises was the investment in overseas' agricultural land (in particular in East Africa), which turned out to be too controversial and economically futile. Fortunately, and thanks to functioning global supply chains, the 2007/08 and 2010/11 scenarios were averted with the advent of C-19. In fact, global food trade has remained remarkably resilient until now.

Yet, the changing climate with more prolonged heat waves affecting the GCC and therefore a nearly impossible environment to produce agricultural crops will only relegate the problem into the future with the exception of indoor farming, which although promising, is unlikely to address domestic needs. The GCC economies will continue to rely on food imports to ensure food security. However, what is often missing is the careful assessment of supply chain sustainability in light of climate and environmental change.

Current trade patterns for key commodities

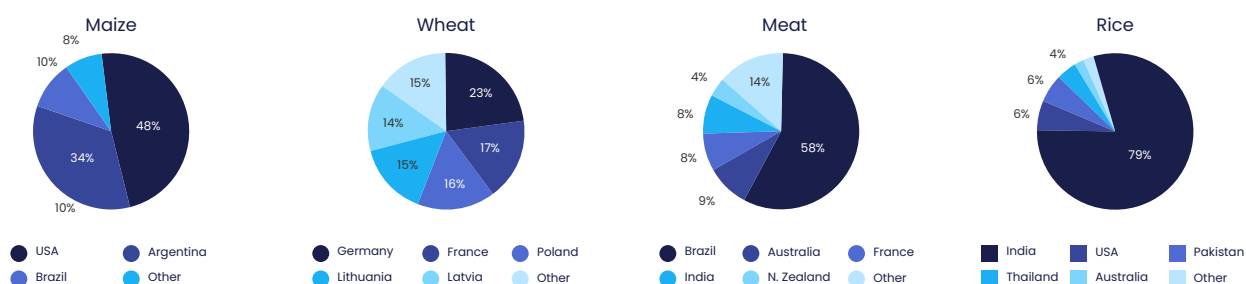
Contrary to the C-19 pandemic, climate change allows more time for economies to prepare themselves for the drastic challenges to come. In the GCC context, this means the region will have to explore candidate options as soon as possible. Amongst them is technological innovation. For example, water security can be improved by further investing into research and development and engaging in international technological partnerships to make desalination and wastewater treatment plants more efficient. Some food can be produced through water-efficient methods including expensive hydroponics production.

Indeed, there could be more food production of maybe 20% or 30% against currently produced volumes in the GCC. However, it will not suffice to feed the growing populations in the GCC. Hence, the much more complex and challenging part will be to reassess the trading relations at a time of climate change as trade will be the cornerstone of any climate mitigation policy. For instance, at present, GCC states import cereals from around the world. However, what has not been taken into account by GCC governments is that the effect of climate change will negatively affect the production of crops in food exporting countries, thus affecting the ability of GCC states to import them in sufficient quantities.



At present, countries like Saudi Arabia and the UAE import their food requirements from various countries around the world. The figures below illustrate the trade picture in maize, wheat, meat and rice for the year 2018. Net-exporting countries such as the United States, Brazil, or India play an important role in both countries' food security. The UAE displays a high dependency on the Russian Federation, its major provider of wheat. In Saudi Arabia, European countries such as France, Germany, Latvia and Lithuania are the key providers of wheat. Both KSA and the UAE are heavily dependent on specific countries for specific agricultural commodities. While this can seem expected upon a first view for instance in the case of rice, a deeper analysis of the top rice-exporting countries shows that while India does indeed lead with an export volume of 11.7 MMT (Million Metric Tons), Thailand is not far behind with 11.1 MMT of exports in 2018 (Source: Tridge). As such, there appears to be an over-dependence on India, even if there may be fallback agreements with other countries.

KSA Imports



UAE Imports

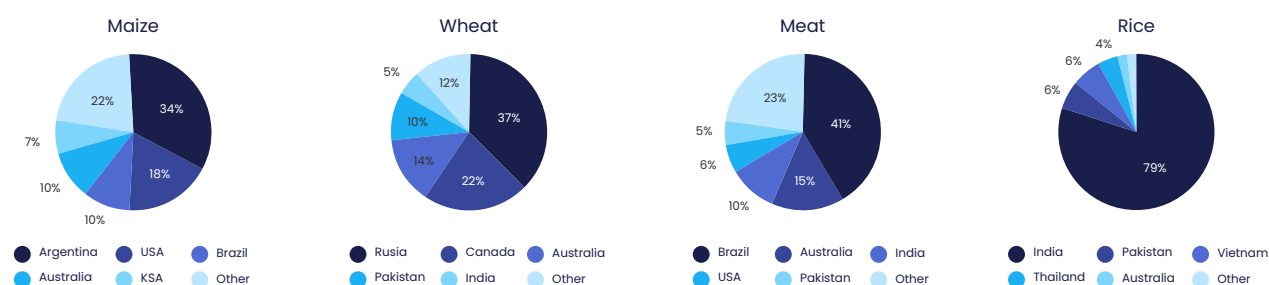


Figure 4: Food import concentration of Saudi Arabia and the United Arab Emirates for selected agricultural goods, based on price of goods traded. Source: developed based on data from Resourcetrade.Earth 2018

The picture is more worrying when climate risks are incorporated in food-exporting economies. In particular, India, Australia, Pakistan, Russia, France, Germany and even the United States may face agricultural production challenges resulting from climate change, as seen in Figure 5. For example, the leading export regions in India are West Bengal, Uttar Pradesh and Punjab, which all face increasing water scarcity. Export controls would be the first measures to be applied if climate events limited production, hence India may not be a safe import option if the water and climate crisis further unfolds.

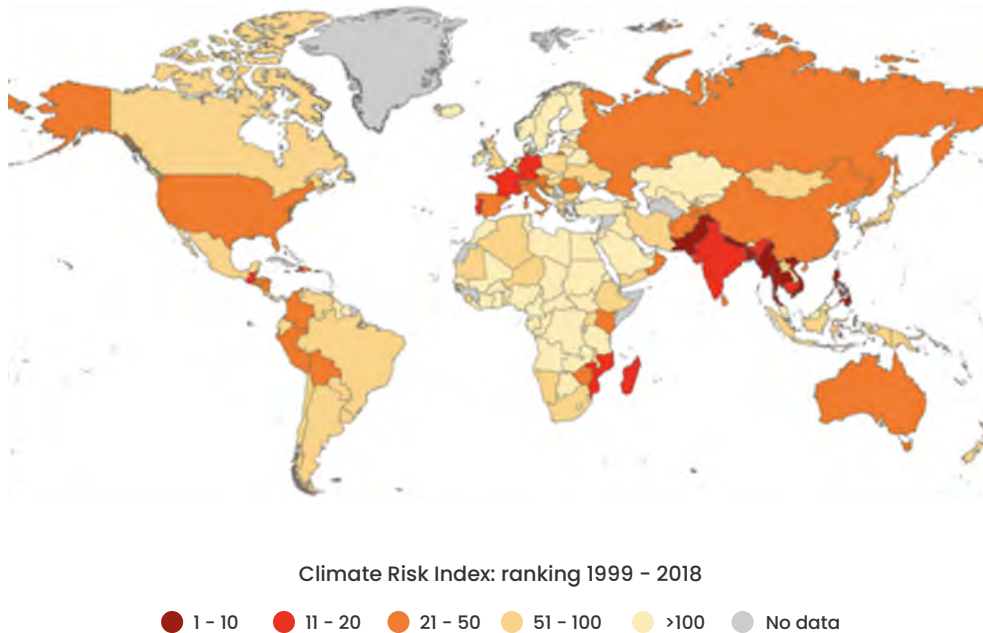


Figure 5: Climate risk ranking 1999–2018. Source: Global Climate Risk Index 2020

”

Covid-19 should serve as a wake-up call for GCC decision-makers to further invest in climate-proof trade policies and tools to understand climate risks.”

The Way Forward

GCC States need to do more than pool financial resources to adapt themselves to the future. What is more important is to understand and address the foreign policy dimension that particularly affects trade policies. In order to enhance the food resilience of GCC states, coordinated foreign policy efforts have to be made to address climate change in a way that serves their national and regional interests. This means the time is ripe to carefully assess future trading relations in light of climate and environmental change. For example, future trade with India may be reassessed on the basis of potential production shortages due to increasing water shortages in the North of India. Climate proofing of trade can be achieved through using state-of-the-art databases and models to understand where the GCC may have to diversify trading relations to avoid a climate crunch.

Shrinking natural resources such as food, water but also biodiversity will force GCC states to change not just their domestic but also foreign policies. While they have long been able to rely on safe food imports from other parts of the region, climate change will test the resilience of trade links. C-19 has provided a sudden experience of how global affairs can quickly change and what future challenges may be ahead of import-dependent countries. C-19 should serve as a wake-up call for GCC decision-makers to further invest in climate-proof trade policies and tools to understand climate risks that can lead to diversified supply chains to ensure undisrupted future food imports.

Martin Keulertz specializes in food & water security and agricultural policy in the MENA region. He is an Assistant Professor in the Food Security Programme at the American University of Beirut.

ABOUT AZAL ADVISORS

Azal Advisors provides strategic advice to senior decision-makers in GCC governments. We are backed by a committed group of more than 40 globally recognized subject matter experts affiliated with Azal Advisors who play an outsized role in the delivery of our assignments. They have in-depth experience of the region and provide us with an unparalleled breadth and depth of policy knowledge, including in economics, trade, foreign affairs, resilience and public governance. Azal's management, composed of ex management consulting partners, coordinates content production with our advisors to jointly formulate clear and actionable recommendations.

We believe in the unique value of being able to provide a multidisciplinary expertise to senior decision-makers in GCC governments. The diversity of our advisors provides us with more than one viewpoint and the ability to ascertain second and third order consequences of key decisions. We strive to build trusted long-term relationships with our clients through highly pertinent, thoroughly researched, pragmatic and frank advice.

AzalAdvisors

www.azaladvisors.com
info@azaladvisors.com
PO BOX 502064
DUBAI, UAE

Azal Advisors is the trading name of Azal Consulting FZE, an entity registered in the Umm Al Quwain Free Trade Zone, United Arab Emirates

Copyright © 2020 Azal Consulting FZE

All rights reserved. This report may not be reproduced or redistributed, in whole or in part, without the written permission of Azal Consulting FZE. While every effort has been made to ensure the accuracy and reliability of the information and analysis contained in this report, we cannot provide any warranty for the same. Azal Consulting FZE accepts no responsibility for any reliance placed on the views and recommendations contained in this report, or for any loss that may arise as a result of the information contained in this report. The material contained in this report should not be used or considered as, and does not constitute, a solicitation for the services of Azal Consulting FZE.