JCT BIT JOURNAL OF CONTEMPORARY TRENDS IN BUSINESS AND INFORMATION TECHNOLOGY (JCTBIT)

Vol.7, pp.11-18, Dec. 2019

Effect of Oil Prices on GCC Counties: An Overview

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ABSTRACT

Lower oil prices Implies Lower profit margins or can simply be said loss. Low profit will lead to low investment in new projects and existing methods of production or even cutting back the existing projects. Changes in oil prices have significant impact on various macroeconomic variable. It can affect economic growth of a country by affecting consumer spending, production cost, and international trade via exchange rates. GCC countries are rich in oil production which contribute a significant role in their GDP. Lower oil prices affect all GCC counties to some extent. These nations are heavily dependent on oil export. In this paper the author is trying to investigate the likely impact of shock in oil prices on Gulf Cooperative Countries namely Saudi Arabia, Bahrain, Oman, Kuwait, Qatar and United Arab Emirates and how government expenditure and output will change in response to the change in oil prices.

Keywords

GCC, Export revenue, Budget deficit, Oil price, GDP,

Introduction

Gulf Cooperation Council is a regional intergovernmental organization to coordinate economical and political activities. They are highly integrated and forms common market, customs union and also common currency. Their main objectives are to have similar rules and regulations in several areas like trade, tourism, legislations, customs, etc., to set up joint ventures, joined military etc.

Gulf Cooperation Council Countries are rich in oil resources and major part of their revenue comes from oil exports. Four of these GCC countries namely Saudi Arabia, Kuwait, United Arab Emirates and Qatar are the full members of OPEC i.e., Organization of Oil Exporting Countries. OPEC is an intergovernmental organization which was established in 1960 to help coordinate economic policies related to the export of petroleum in member nations. “The Organization ensures a steady supply of petroleum to countries importing oil and aid in securing stable oil prices for exporting countries and investors in the oil market" (OPEC: Brief History, 2018). Due to boom in oil and natural gas revenues this area has some of the fastest growing economies of the world.

Since these countries have the major shares of their GDP from oil, fall in oil prices will have adverse effect on their budget deficit and economic growth. They all were benefited from 2000-2007 boom in oil prices but since 2008 these countries were also greatly impacted by falling oil prices.

The paper will try to answer a couple of questions which constitutes (1) what are the recent evolution of changes in oil prices; (2) what are the main causes of volatility in oil prices in modern years, in particular, after mid-2014; (3) what is the impact of oil price plunge on Gulf cooperative countries on Terms of Trade; (4) policies to overcome the influence of falling oil prices. (6) Effect of oil price drop on GCC GDP.

Research Methodology and data sources

The nature of the study is both qualitative and quantitative. For this study, secondary data has been collected from the reports published by Ministry of Commerce and Industry, Annual reports of US Energy Information Administration, World Bank Reports on GDP Growth, IMF Reports on Middle East Fiscal Challenges, GCC Surveillance Papers. Other sources of data are Union budgets, International Energy Agency (IEA), various web searches like Energy next, click energy and live mint. Data collected from these sources has been represented through simple tools, graphs and statistics in order to depict the meaningful and clear results.

An Overview of GCC Economy

Gulf Cooperation Council Countries shares a common Market with because of which movement of goods and services can take place without any barrier and hindrance. These countries are the major oil exporters and producers and their combined oil production is about 20 percent of the world. They also constitute the gas reserve of 15 percent of the world total. 75 percent of their revenue comes from oil and gas reserves and constitutes 65 percent of total exports. All the member states of GCC are heavily and almost exclusively dependent on oil revenues for public funds. Oil is the centre for their revenue and the main engine for the development of the region.

The economic activities of Gulf Cooperation Council (G.C.C.) countries were trapped to limit to the agricultural activities like production of dates, vegetable and fruits, fishing and exploitation of sea for pearls and other precious commodities. Sea-faring and boat building were also important economic activities, whereas the pearl diving was the major industry in Kuwait and some other G.C.C. countries. After the discovery of oil in 1930s the whole economic structure was altered but this transformation triggered momentum in the oil boom period of 1970s, which created massive financial revenues. The G.C.C. countries, except Bahrain, share only one outstanding characteristic that is oil. These economies are significantly dependent on the depletion and export of a single commodity. The aim of G.C.C. economic policy carries mainly two basic goals.

1. To provide basic infrastructure like building, road, ports, communication network, educational and training facilities etc. this was supposed to make the subsequent economic development feasible by enlarging the absorptive capacity of these economies. This was expected to remove impediments in the way of industrialization as well as existing symptoms of underdevelopment.

2. The fear of oil depletion, however, necessitated creation of some alternative production sectors which could help the economy in maintaining high level of income when oil gets exhausted. This needed a fundamentally original approach keeping in mind the peculiar resource base of these economies and the limitations imposed by that.

Recent Evolution of changes in oil prices

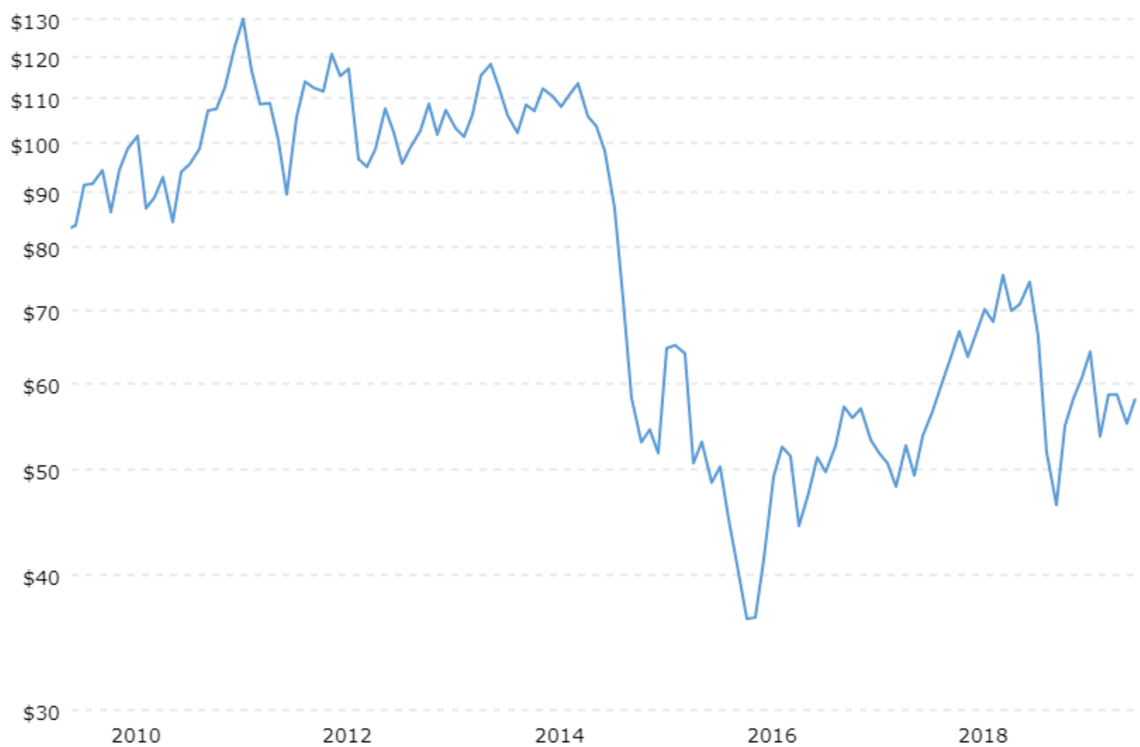
Table (1)

Crude oil prices annual data

Year	Average Closing Price	Year Open	Year close	Year high	Year low	Annual % Change
2010	$79.48	$81.52	$91.38	$91.48	$64.78	15.10%
2011	$94.88	$92.59	$98.83	$113.39	$75.40	8.15%
2012	$94.05	$102.96	$91.83	$109.32	$77.72	-7.08%
2013	$97.98	$93.14	$98.17	$110.62	$86.65	6.90%
2014	$93.17	$95.14	$53.45	$107.95	$53.45	-45.55%
2015	$48.72	$52.72	$37.04	$61.43	$34.73	-30.70%
2016	$43.58	$36.76	$53.72	$54.06	$26.21	-45.03%
2017	$50.84	$52.23	$60.42	$60.42	$42.53	12.47%
2018	$64.90	$60.37	$45.41	$76.41	$42.53	-24.84%

As can be seen clearly from the above table that prices begin to fall from the year 2014 (June) and 2015 (January). Before this the prices were nearly stable since four years i.e., from 2011 to 2014. the fall in oil prices was the third largest since a period of over thirty years. This scenario was very much symmetrical with the episode in 1985-86, which was due to the huge increase in supply of oil from non-OPEC countries and a sudden and jerky change in the policies of OPEC. This decrease in oil prices was much more than the commodities price since a long time.

Monthly average price of crude oil fell from $112 per barrel to $32 per barrel between June 2014 and March 2016.The decline was the 60 percent between these periods. The prices were little stable in the first half of the year 2015, which was $ 60 per barrel. Oil prices started falling from the mid May 2015 and continued falling, it becomes $26 per barrel on January 29th 2016. Oil prices increased slightly in March 2016 and reaches $ 38 per barrel.



Source; macrotrends.net

Factors causing changes in oil prices

Various factors contribute in the volatility of oil prices. Following are the major ones;

1. **Production of oil Globally**: Increase in the production and supply of oil from the other countries also can be a major cause of the fall in oil prices in the world. Oil production was increased globally due to the United states development of its shale oil production, thus forces oil prices down. As per the data provided by EIA (Energy Information administration), United states production of crude oil was increased to 67 percent from 2011 to 2015. It makes Us the largest oil producer than the Saudi Arabia and Russia in the World. Libya, Saudi Arabia, Iraq were also producing more than the expected during the same period which does affect prices.

2. **World Consumption of Oil:** Reduction in Oil prices can also be due to the decline in the consumption of oil globally. Economists all over the world also debated that the fall in oil prices could be because of the lower economic growth in Asia and Europe, combined with policies aiming at enhancing energy efficiency. That lead to a lower demand and hence lower consumption.

3. **Inventories or Stock of Crude Oil:** According to EIA (Energy Information Administration) database, about 1 Mbl/d in 2014 and 2 Mbl/d in 2015 were stocked which causes a huge supply in oil market.

4. **Rate of Exchange**: There was change in US Dollar exchange rate during the period. Since US dollar have always been the chief currency for trading oil globally, it is argued that swing in US dollar exchange rate may cause fluctuations in oil prices. Due to appreciation in USD, crude oil becomes costlier for the rest of the world which causes reduction in the demand side and thus lower oil prices.

Effect of Oil Prices on Gulf Cooperative Countries Terms of Trade

Table (2)

	Change in net oil export (US$ m/n)	Change in net oil export (%GDP)	Change in fiscal balance (percent GDP)	Change in fiscal balance (USD m/n)
Saudi Arabia	-63082	-8.2	-15.1%	-103114
Oman	-12235	-14.9	-15.2	12866
Bahrain	-29	-0.1	-7.7	-2602
UAE	-39440	-9.6	-10	-41.655
Kuwait	-30051	-16.2	-21.9	-40050
Qatar	-8741	-4.1	-15.1	-19193

Source: World Bank staff estimates. The assumption of $65 Brent crude oil and no policy change are used for projections.

The above table shows the effect of falling oil prices on GCC's oil trade.

Policies to overcome the impact of Falling Oil prices in GCC

Monetary Policies: From the perspective of monetary policies, drop in oil prices lead to a reduction in global inflation in the period of 2015, resulting the low or even negative inflation. Because of this central banks adopts policies that focuses on the factors that causes oil shocks (Demand and Supply). The authorities in GCC countries are continuing their efforts to fortify their AML/CFT frameworks. Due to the structure of GCC their currency peg remains appropriate.

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Fiscal Policies:

In developing countries, government provides a large amount of subsidy on fuel to their population and some countries it is more than 5 percent of their GDP. this makes them able to Carry down more energy-intensive activities. Drop in oil prices trim back the need for subsidies in fuel and this emerges as an opportunity to cut down the subsidy or an overall reform in subsidies. This will lead to a broad and imperishable shift towards more market based oil prices and subsequently remove all the inefficiencies and impairments regarding subsidy. "Fiscal resources released by lower fuel subsidies could either be saved to rebuild fiscal space lost after the global financial crisis or reallocated towards better-targeted programs to assist poor households; support critical infrastructure and human capital investment". (global economic prospectus,2015)

Effect of oil prices on GCC GDP

Percentage change in real GDP

	2013	2014	2015	2016	2017	2018
UAE	5.8	3.3	3.8	3.0	1.3	3.4
Saudi Arabia	2.7	3.7	4.1	1.7	0.1	1.1
Qatar	4.4	3.7	3.6	2.2	2.5	3.1
Oman	4.4	2.5	4.2	3.0	0.0	3.7
Kuwait	4.0	0.6	2.1	2.5	2.1	4.1
Bahrain	5.4	4.4	2.9	3.0	-2.5	1.7

Percent Change in real oil GDP

	2013	2014	2015	2016	2017	2018
U.A.E	3.1	0.4	5.4	3.8	-2.9	3.2
Saudi Arabia	1.6	-2.1	5.3	3.8	1.9	0.9
Oman	0.1	-1.7	4.2	2.6	-2.8	4.0
Qatar	1.0	-0.6	-0.5	-0.1	0.4	1.4
Kuwait	-1.8	-2.1	1.1	2.0	-6.0	4.6
Bahrain	15.3	3.0	-0.1	-0.1	-0.3	0.0

ISSN: 2521-3288

Percentage change in real non-oil GDP

	2013	2014	2015	2016	2017	2018
U.A.E	7.0	4.6	3.2	2.7	3.3	3.4
Saudi Arabia	6.4	4.9	3.2	0.2	1,7	1.3
Qatar	10.4	9.8	8.2	5.6	4.6	4.7
Oman	7.9	6.7	4.2	3.4	2.5	3.5
Kuwait	4.0	5.0	3.5	3.2	3.5	3.5
Bahrain	3.1	4.7	3.6	3.7	3.1	2.1

Conclusion

Reduction in oil prices is epochal but not new. The reason for such decline was a policy change of OPEC combined with an increment of oil supply in all over the world. Thus drop in oil effect have varying effect on both oil importing and oil exporting counties. Oil importing countries will have a favorable effect on their GDP, Current account, and trade balance whereas oil exporting counties will have adverse effect on their current account and terms of trade. But this will also lead to fuel subsidy reform in oil exporting counties and thus can re-allocate their resources and diversify their production and other revenue sectors.

ISSN: 2521-3288

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