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How members of the Gulf Cooperation Council can diversify their economies.

by Samer Bohsali, Per-Ola Karlsson, and Rawia Abdel Samad

Economic diversification is high on the agenda of all the countries in the Gulf Cooperation Council (GCC): Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE). Even before oil prices dropped in mid-2014, their leaders recognized that their economies relied too heavily on the oil and gas industry. Nonetheless, although the share of non-oil GDP has steadily increased in each of these countries, their exports and government revenues remain concentrated on oil and gas. These sources have long funded infrastructure and social services and paid public-sector wages. Lower oil prices have thus resulted in a fiscal crunch, adding urgency to the need to transform.

GCC leaders already know that economic transformation is not a simple undertaking. It requires a holistic approach incorporating a variety of measures. For example, in April 2016, Saudi Arabia released Vision 2030, a sweeping diversification blueprint sponsored by Deputy Crown Prince Mohammed bin Salman. To rebalance the Saudi economy away from oil, it sets ambitious goals: increasing the share of non-oil exports from 16 percent to 50 percent, and raising the private sector's contribution to GDP from 40 percent to 65 percent. Such plans are critically important not just for economic growth, but also for the ambitions of millions of young people in the region.

As they implement diversification measures, GCC countries should keep in mind three key principles. First, upgrade the strategic management of local enterprises so these organizations become world-class. Second, use digitization to leapfrog over the early stages of economic development. Third, build a skilled labor force that is capable of continuous learning.

Illustration by Martín León Barreto

World-Class Organizations

As John Jullens, a leading PwC commentator on emerging economies, points out, one of the best ways to improve any economy is to develop the effectiveness of local company management. By promoting disciplined strategic management, GCC governments could help develop world-class companies within their borders. This would foster more vibrant industries, promote local content creation, spawn advanced technologies and innovation, and provide new high-paying job opportunities.

Until now, many GCC companies have benefited from expanding local markets and country-specific competitive advantages, such as access to cheap natural resources and expatriate labor. This has often allowed them to avoid laying the foundations for global competitiveness or developing their capacity for innovation. But those past advantages are already eroding, and the GCC must rapidly develop the ability of its companies to compete.

As an initial step, GCC companies need to build the kind of distinctive capabilities that set them apart from others. These are complex, cross-functional combinations of processes, skills, knowledge, tools, and organizational designs put in place to consistently deliver a strategic outcome. To build and deploy these capabilities, companies often have to rethink their operating models, process design, use of technology, and human resources practices. A great capability in delivering customer satisfaction, for example, requires employees with a high level of autonomy who can make decisions on behalf of their customers without waiting for approval.

Next, many GCC companies, especially those whose governments retain large ownership stakes, need better governance systems. The GCC includes about 650 state-owned enterprises, and the state is a shareholder in 78 of the top 100 listed companies on GCC stock exchanges. As an owner, a GCC government often has considerable influence on board member selection and should secure the right membership. Board members should be aware not just of finance and government concerns, but also of relevant business, technology, and human capital issues. Governments can also benefit from establishing a centralized agency through which they can exercise their ownership rights in enterprises more effectively and transparently.

Digital Leapfrogging

Digitization has become the single most important enabler of innovation, competitiveness, and economic growth in emerging economies. GCC countries are poised to succeed here because they are relatively unbound by legacy systems. They can spring over traditional stages of economic development by adopting leading-edge technologies such as cloud computing systems, data analytics, integrated digital operations, and advanced user interface design.

Leapfrogging digital technology can speed economic transformation. In healthcare, many GCC countries are considering national electronic health records, implementation of which ordinarily takes years. But because they lack a legacy system, they can design a state-of-the-art system from scratch. The system could store, share, and analyze health data in the cloud. The benefits would include treatments tailored to individual patients and better early disease detection. GCC leaders can also adopt blockchain, a recently developed technology that uses a public ledger system to securely record and transfer health data with a much lower administrative burden.

Estonia represents a model for GCC countries. Beginning in 1992, after the collapse of the Soviet Union, Estonia began changing from a struggling economy with antiquated technology to a global digital leader. The country capitalized on its educated workforce to build a strong skill base in computer and IT management. Rather than adopting systems that would soon become obsolete, Estonia went straight for the latest technology. It embraced the Internet as a vehicle for the government's operations (putting in place, for example, one of the world's first paperless land registries).

Estonia currently has one of the most advanced e-government systems in the world. This includes a single digital ID that enables citizens to access all of its secure services. Estonia produces more startups per person than any other country in Europe and offers an e-residency program to entrepreneurs worldwide so they can establish businesses in the country without physically moving there.

An Estonia-style approach in the GCC would involve building digital ecosystems in which innovation can thrive. This would require investing in smart infrastructure, platforms, and services; making key data sets open and publicly available; upgrading the legal and regulatory framework; and nurturing digital talent. Dubai has already begun moving in this direction. Its 3D printing strategy, launched in April 2016, aims at positioning the emirate as a leading hub of the technology in three key sectors: construction, medical products, and consumer products. By 2030, it expects 25 percent of its buildings to be 3D printed.

Because they lack a legacy system for electronic health records, GCC countries can design a state-of-the-art system from scratch.

The Future-Proof Workforce

A capable and flexible workforce, with people who learn continuously and can adapt to any technological future, is a vital resource for any economic transformation plan. World-class companies need skilled employees who innovate and take risks. Because they cannot afford to ignore sources of skilled talent, GCC governments should heighten their efforts to integrate women and young people into the labor market.

At present, too many people do not participate in the economy. Their "idle" status means they are not active in employment, education, or training. Women and young people, totaling 60 percent of the eligible population, have the lowest participation rates. In Saudi Arabia, a quarter of the youth population is idle. GCC governments can help by encouraging digital entrepreneurship, particularly through social media. Already there is a rising tide of startups from the region, such as women's businesses in Saudi Arabia that use social networks like Instagram. Governments can also help women by discouraging attitudes that make it difficult for them to work, and promoting flexible employment models.

Governments also need to encourage nationals to make up a larger proportion of the private-sector workforce, which is dominated by expatriates. New policies should make working for private companies more attractive to nationals by, for example, closing the gap between public- and private-sector wages.

Another gap exists between the technological and managerial skills of many GCC nationals and the skills increasingly needed in business today. According to a recent World Economic Forum report, the GCC employment outlook in professional services and public administration — currently the largest pool of jobs for nationals in the region — is negative, whereas fast-growing areas such as digitization face a shortage of skilled labor. Companies in the GCC already seek employees skilled in information security, programming, and interface design. Job postings for these digital skills on LinkedIn represent 10 percent of overall job postings in the GCC, which is higher than their 7 percent share in the U.S. market.

If ignored, this skill gap will widen, and the best way to address it is through short- and medium-term training initiatives. Existing GCC educational reforms are still important, but they can take decades to have an impact. New, urgent initiatives should focus on targeted vocational education and training, ideally in collaboration with companies and academic institutions.

All three of the principles discussed above have one premise in common: The present fiscal crunch is an opportunity for GCC governments to transform their economies. With a shift in attitude they can lower their dependence on commodities. They can instead move into the future as balanced, stable economies enjoying sustainable growth. +

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