COVID-19, OIL PRICE
CONTRACTION AND ENERGY TRANSITION:
IMPLICATIONS FOR THE GCC STATES AND EUROPE

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Across the world, the perennial perception of the Gulf states is of a region awash with oil and gas, largely cushioned from harsher global economic realities. While this frequent characterisation of wealth and prosperity continues, the truth of the Gulf’s energy riches is more complex, more varied and less certain for the future. As Daniel Yergin observed in an essay for the Wall Street Journal in September 2020:

“There is a looming transition that in the decades ahead will shift the world away from using oil, natural gas and coal. The transition will have an enormous economic impact, but it will also bring about major changes in the map of global power. China is poised to be the big winner, Russia and Middle East oil exporters the big losers.”

This “looming transition” is due primarily to the impact of measures to combat climate change, reduce carbon emissions across the world, and the emergence of competition, both from North American shale and the falling costs of renewables. By the close of 2019, through the efforts of climate change negotiators, the 2016 Paris Agreement, which agreed a long-term temperature goal to keep the increase in global average temperature to below 2°C above pre-industrial levels and to pursue efforts to limit the increase to 1.5°C, was starting to influence how the world’s leading economies were looking to fulfil ‘green agendas’.

In what future historians may see as a pivotal moment of global inflection, the emergence of the COVID-19 virus in January 2020 may also come to be regarded as the accelerant that forced the world to take the threats posed by climate change more seriously and more urgently. It has also led to some predictions that Arab Gulf oil and gas producers are likely to be amongst the big losers through this era of global change. Arguably, the Gulf oil and gas producers are no longer the envy of less wealthy countries. Instead, fossil fuel production is increasingly regarded as a pariah activity: a primary source of climate ills and the slow suffocation, and even destruction, of the planet.

However, this rather binary interpretation ignores what the Gulf states themselves have been doing in terms of rebalancing their economies away from energy dependency and towards a future that may see them becoming less ‘exceptional’ and more closely integrated with the opportunities that are already emerging from the digital era – such as the ‘Fourth Industrial Revolution’.

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2 “The Fourth Industrial Revolution” is a term coined by Klaus Schwab, the executive chair of the World Economic Forum, in 2015. It is now accepted as an abbreviated description of automation of traditional manufacturing and industrial practices, using digital technology. It encompasses the notions of large-scale, machine-to-machine communication, and the internet of things being integrated for increased automation, improved communication and self-monitoring, and the production of smart machines that can analyse and diagnose issues without the need for human intervention.
This paper explores how the contraction of traditional energy revenues, combined with the effects of combating the variety of challenges posed by COVID-19, are likely to influence previous approaches to plans for economic diversification in the Gulf states. The paper considers not only the direct economic impacts of this moment of generational change, but also broader potential consequences for the region and, in particular, the influence that this could have on current and future relations between Europe and the Gulf.

**Background**

There should be no doubt that all six member states of the Gulf Cooperation Council (GCC)\(^3\) have been the beneficiaries of the discovery and exploitation of substantial energy reserves in their respective territories for at least the past half-century. As the following graph based on World Bank estimates from 2011 shows, the myth of the oil wealthy Gulf is essentially a product of the 1970s; an era which saw the OPEC ‘oil shock’ of 1974 which triggered an immediate recalibration of the international desirability of dependency on a limited, and essentially Saudi-dominated cartel of oil-producing countries.

As the graph shows, oil revenues continue to represent significant components of GCC GDP percentages but to varying extents, with Kuwait still the most dependent on oil revenue for its national wealth, while the United Arab Emirates (UAE) has striven to reduce reliance on oil as a component of its national economy, or has been compelled to do so, as in the case of Bahrain.

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\(^3\) The Gulf Cooperation Council (GCC) comprises: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. It was formed in 1981 as a political and economic intergovernmental union, https://www.gcc-sg.org/.
The differing levels of economic dependency are further shown below:

**GDP Composition of Arab Oil Exporters, 2014**

<table>
<thead>
<tr>
<th>Country</th>
<th>Governor</th>
<th>Oil</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>65%</td>
<td>24%</td>
<td>11%</td>
</tr>
<tr>
<td>Kuwait</td>
<td>26%</td>
<td>63%</td>
<td>11%</td>
</tr>
<tr>
<td>Oman</td>
<td>33%</td>
<td>56%</td>
<td>11%</td>
</tr>
<tr>
<td>Qatar</td>
<td>43%</td>
<td>51%</td>
<td>6%</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>45%</td>
<td>49%</td>
<td>6%</td>
</tr>
<tr>
<td>UAE</td>
<td>63%</td>
<td>34%</td>
<td>3%</td>
</tr>
</tbody>
</table>

**Oil and Non-Oil Fiscal Revenue, 2014**

(Percent of total government revenue)

**Oil and Non-Oil Export, 2014**

(Percent of total)

Source: WEO and IMF staff estimates.
These graphs further underline the essential point that, while all members of the GCC continue to benefit from energy revenues as a significant component of their overall GDPs, the dependency quotient varies considerably between different member states.

Recognising the need to diversify their economies away from sole energy dependency, GCC member countries have more recently pursued programmes of economic reform with varying degrees of success and vigour. Each of these is focused on reducing dependency on energy revenues and using existing oil wealth, much of it deposited in a diversity of sovereign wealth funds and state-owned investment vehicles, to drive the development of new areas of economic activity. The policies are directed at creating new sources of sustainable income and provide widening opportunities for employment, particularly amongst the younger segments of the Gulf’s indigenous population.

At the start of 2020, two separate but related events occurred concurrently which threatened both to have a profound impact on the near-term health security and economic stability of the Arab Gulf and accelerate the process of economic transformation from energy dependency to knowledge-based economic sustainability.

In March 2020, with the early impact of COVID-19 starting to be felt across several European countries, Russia, not an OPEC member, decided not to renew its previous undertakings to constrain its energy production, despite continuing encouragement from the GCC and other OPEC member-states. It seems that President Putin had decided that further agreement on restricting output, and the continued buttressing of oil prices that this aimed to deliver, was benefiting North American shale producers to the detriment of Russia. This failure to conclude a new agreement unnerved energy markets, already anxious because of the COVID-19 pandemic, and precipitated a further sharp fall in the price of oil.

This was a significant moment for global energy markets which, for the previous four years, had grown accustomed to OPEC+ production constraints maintaining the price of a barrel of oil in the region of $60 to $70 (all prices are USD). In the run-up to the critical 6 March meeting, Saudi Arabia had made clear that despite being OPEC’s last remaining ‘swing producer’, it would not make deeper, unilateral production cuts to make up

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* A ‘swing producer’ is a supplier of any commodity, controlling its global deposits and possessing large spare production capacity. A swing producer is able to increase or decrease commodity supply at minimal additional internal cost, and thus able to influence prices and balance the markets, providing downside protection in the short to middle term.
for the loss of Russia from previous OPEC+ agreements. Russia also indicated that it would be able to accept lowered oil receipts if this meant putting pressure on the North American competition. The immediate effect was a 9 per cent fall in the price of Brent crude to $45 per barrel.

This seemed to play to Moscow’s plan with some analysts predicting that this fall in output price would tip many US shale producers into bankruptcy. Columbia University’s Jason Bordoff was quoted in the Financial Times saying: “At a time when shale producers face much tighter capital constraints to keep up output, a price war may push US oil companies already at the risk of bankruptcy over the edge.”

This new round of oil price skirmishing could hardly have been more poorly timed. While the prospect of a sudden glut of unconstrained production certainly made an impact on the competition in North America, it also came as the COVID-19 pandemic was starting to deliver a major demand shock to global oil markets. Still unaware of the wider impact the coronavirus would subsequently have, Saudi Arabia, together with its fellow Gulf states, decided to retaliate against Russia by flooding the market with supply, apparently in the hope of forcing an early rethink in Moscow, while at the same time maintaining their market share. By mid-March, the price of Brent crude had sunk to around $30 per barrel; a level that was widely seen as still acceptable in the near term by many energy market analysts “unless this whole virus impact on the global market and consumer confidence triggers the next recession.”

When the full severity of COVID-19 was realised in the latter half of March, and worldwide ‘lockdowns’ curtailed or halted completely many areas of economic activity, the price of oil was still hovering around $30 per barrel. Recognition that the rapid onset of severe, acute economic contraction would mean even less demand for oil, the price on global markets cratered, at one point taking West Texas Intermediate (WTI) into negative territory as sellers were in effect invited to pay for the storage of unsold output. On 20 April, for the first time in history, WTI closed at minus $37.60 per barrel. This was widely noted by energy markets and Gulf leaders alike as a portent of things to come.

The outlook for oil and gas

As well as having a marked impact on global demand for oil and gas, the onset of the coronavirus pandemic in early 2020 magnified concerns over the looming impact of climate change and further global economic recession. Since the Paris Agreement in 2016, the world has witnessed accelerating international co-ordination to constrain and reverse climate change with pledges to become ‘carbon neutral’ by the middle of this century – just 30 years hence. Meanwhile, the rapid emergence of shale oil and gas enabled the United States (US) to return to being a net energy exporter in 2019 for the first time in nearly 70 years, and a strategic competitor rather than a compliant customer for the rest of the world, as shown below.

For the Gulf states, this has not only led to unaccustomed economic pressures but also an acknowledgement that previous concerns about the seemingly distant prospect of ‘peak oil’ may be much closer than previously recognised. As the authors of a 2018 BP report on peak oil argued: “The significance of peak oil is that it signals a shift in paradigm – from an age of (perceived) scarcity to an age of abundance – and with it is likely to herald a shift to a more competitive market environment. This change in paradigm is also likely to pose material challenges for oil-producing economies as they try both to ensure that their oil is produced and consumed, and at the same

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time diversify their economies fit for a world in which they can no longer rely on oil revenues to provide their main source of revenue for the indefinite future.”

U.S. primary energy overview, 1950-2019
quadrillion British thermal units

The Gulf states have pursued differing approaches to how best to leverage their energy wealth to shift the balance of their economies. Many of these economic strategies are outlined in the various ‘Vision Programmes’ that have been published or updated in recent years. However, before moving on to consider how effective these proposed changes of economic direction are likely to be, it is important to understand the extent to which the production and export of oil and gas will continue to be an important contributor of national wealth across the Gulf states.

On 14 September 2020, BP published its ‘Energy Outlook 2020’. As ever, the energy conglomerate sought to offer an assessment of future demand for energy across the world and to consider the outlook for global energy markets. Importantly, while acknowledging the predicted fall in demand for carbon-producing fossil fuels, BP’s researchers emphasised that “Global energy demand continues to grow …. driven by increasing prosperity and living standards in the emerging world.” This conclusion is underscored by the most recent historical assessment of global energy consumption from the International Energy Agency (IEA).

However, BP’s research team also concluded that the “demand for oil will fall over the next 30 years. The scale and pace of this decline are driven by the increasing efficiency and electrification of road transportation.” They also pointed out that the “outlook for natural gas is more resilient than for oil,

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underpinned by the role of natural gas in supporting fast-growing, developing economies as they decarbonise and reduce their reliance on coal, and as a source of near-zero carbon energy when combined with Carbon Capture Use and Storage (CCUS).”

**Total energy supply (TES) by source, World 1990-2018**

Importantly, both BP’s Energy Outlook 2020 and the International Energy Agency’s (IEA) latest ‘Global Energy Review 2020’\(^9\) concluded that demand for oil and gas will not collapse completely, and indeed will almost certainly continue to expand in the near-term, once the coronavirus pandemic is resolved, driven by the requirements of global economies that have yet to embrace carbon neutrality and see gas in particular as the optimum bridge to reducing existing carbon footprints.

In its latest ‘Outlook’, BP set out three alternative energy scenarios for the future. In each of these it has assumed that demand for oil will diminish over time. While wealthier economies are pursuing electrification as the optimal means of fulfilling ‘green agendas’, it remains clear that aviation, shipping and some road haulage will continue to rely on oil-based fuels well into the latter half of this century. Even in BP’s most ‘green’ scenario, oil is still predicted to be contributing 20% of the global energy mix in 2050 – the year the Paris Agreement has set as the goal for carbon neutrality.

Moreover, the outlook for Middle East producers is even more positive than the average picture, with BP estimating that the Arab Gulf will continue to output 45% of global oil supply until at least 2050 in its ‘business-as-usual’ scenario, and still delivering 37% of global output even in the greenest ‘rapid-transition scenario’ envisaged by the Paris Agreement. However, as Kate Dourian has argued: “There is a tipping point beyond which there will be no further demand growth.”\(^10\) It is evident that that tipping point may not be reached for at least another 30 years but it remains important to recognise that Arab Gulf leaders have already accepted that energy dependency is neither sustainable over the long term, nor desirable in terms of maintaining economic and social stability.

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In November 2020, OPEC announced that it accepted that the combination of the prolonged, counter-coronavirus ‘lockdown’ restrictions, particularly across Europe, and weaker consumption in the Americas, meant that global demand for oil will be even weaker than the reduced predictions made at the start of the year. As the Wall Street Journal noted,

“OPEC deepened its forecast for a drop in global oil demand in 2020 by 300,000 barrels a day to 9.8 million barrels per day, a 10% drop on last year’s levels. The cartel also softened its forecast rebound in demand for 2021 by 300,000 barrels a day.”11

While demand from China in 2020 has rebounded to its third-highest level on record, this has not offset much weaker levels of demand from traditional OPEC markets and it is also important to recall that China has itself committed to carbon neutrality by 2060.12 In turn, this again seems to underline the key point that regardless of rising demand from increasingly vigorous Asian markets, this appears insufficient to return oil prices to the peaks last seen in the wake of the economic crises of 2008 and 2009, and at the break-even levels demanded by Arab Gulf economies.

This time around, it seems that the coincident pressures of adapting to climate change and the emergence of fracked alternatives in North America are firmly pointing the way to sustained, downward pressure on the value of energy, particularly oil, emphasising once more that failure to diversify the oil and gas economies of the Gulf could ultimately result in HH Sheikh Rashid bin Saeed al-Maktoum’s famously mordant prediction that: “My grandfather rode a camel, my father rode a camel, I drive a Mercedes, my son drives a Land Rover, his son will drive a Land Rover, but his son will ride a camel.”13 The late Ruler of Dubai is seen to have understood the economic precariousness of relying solely on oil as a source of revenue and set about the early economic diversification of Dubai accordingly.


GCC States: Vision programmes and economic ambition

The COVID-19 pandemic emerged at a moment when the world was already focusing more intently on the challenges posed by climate change on one hand, and long-term shifts in energy generation and usage on the other. Both climate and energy policies have emerged as transnational political issues, not just in the European Union (EU) where its “Green Deal for Europe” was central to the 2019 parliamentary election manifestos, but also in the US where the debate about the impact of climate change is set to return to prominence following Joe Biden’s election as President of the United States. Even in China, so-called decarbonisation measures are being debated in preparation for the next round of five-year economic planning – the 14th Five Year Plan: 2021-2025.

The leaders of the Gulf states perceive a world that was already changing around their region, sweeping aside the old certainties of energy wealth and leverage. They also see a world in which traditional security guarantees of Western countries, particularly the US, are weakening and should no longer be relied upon. They perceive Asia as the newly rising focus of economic might and ultimate power in the 21st century. And closer to home, they see the old threat posed by Iran overlaid by equally pressing challenges from neo-Islamism and an interconnected world that challenges the traditional precepts of Islam and embraces external cultural influences that continue to dilute the traditional values of the region.

Gulf leaders also face pressing problems closer to home from young populations that chafe against the constraints of orthodoxy and not only want but need the challenge of new and more meaningful life opportunities. The Gulf region as a whole is challenged, like many other parts of the Arab world, by a so-called ‘youth bulge’.

In October 2014, a team of researchers from the World Economic Forum (WEF) produced a report entitled: “Rethinking Arab Employment – A Systemic Approach for Resource-Endowed Economies”.14 As the authors pointed out at the time, in the GCC states one-third to one-half of their populations are under 25 years of age. But as the authors also observed: “this vast reservoir of latent talent has been hindered by high youth unemployment which could turn into a ‘youth liability’.”

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More recent statistical analysis by Statista published in May 2020\textsuperscript{15} revealed the extent of youth (defined as 15 to 24 years of age) unemployment amongst GCC nationals across the member states:

**Share of employed youth in the Gulf Cooperation Council in 2017, by country**

![Graph showing the share of employed youth in the Gulf Cooperation Council in 2017, by country.](https://www.statista.com/statistics/688544/gcc-share-of-unemployed-youth/)

It is evident that encouraging new economic opportunities in which young people can turn their education into productive and fulfilling employment remains an important goal. It also seems that while the years of strong energy revenues enabled the rapid economic expansion of the GCC and substantial job creation, much of this was to the benefit of people from overseas who were employed in the region’s private sectors on mostly short-term contracts, while young nationals preferred the stability, assurance and relatively high levels of remuneration in public sector employment.

Analysis carried out by the Gulf Labour Markets and Migration (GLMM) programme in 2017 again emphasised the Gulf states’ continuing reliance on expatriate workers in its labour markets\textsuperscript{16} leading to increased competition for employment in the private sector and again tends to reinforce young Gulf nationals’ preferences for employment in secure public sector jobs which are largely barred to non-Gulf nationals. However, this tendency towards a preference for employment in the public rather than private sectors also militates against younger Gulf nationals contributing to the entrepreneurial expansion of Gulf economies. This also runs counter to Gulf leaderships’ visions for the future direction of their countries as vibrant, knowledge-based economies, embracing entrepreneurism, developing high-tech industrial initiatives to increase international competitiveness, and reducing reliance on energy as the primary source of national wealth.

At their core, each of the Gulf national ‘Vision Programmes’\textsuperscript{17} recognises that reliance on energy revenues is not sustainable for the long term. Not only is the elimination of worldwide use of fossil fuels a primary focus of climate change campaigners but it is also understood that so-called ‘rentier’ economic models that rely on revenues from energy production are socially regressive. As


\[\text{\textsuperscript{16} “Percentage of Nationals and Foreign Nationals In GCC Countries’ Populations.” Gulf Migration, https://gulfmigration.org/media/graphs/Graph1\_09\_05\_2017.pdf, data from 2010-2016.}\]

HRH Prince Mohammed bin Salman, the Crown Prince of Saudi Arabia, emphasises in the introduction to his country’s Vision 2030:

“We are determined to reinforce and diversify the capabilities of our economy, turning our key strengths into enabling tools for a fully diversified future. As such, we will transform Aramco from an oil-producing company into a global industrial conglomerate. We will transform the Public Investment Fund into the world’s largest sovereign wealth fund. We will encourage our major corporations to expand across borders and take their rightful place in global markets.” ¹⁸

The UAE’s Vision 2021 launched in 2010 is even more explicit, declaring:

“The global economy will witness significant economic changes in the coming years and the UAE Vision 2021 National Agenda aims for the UAE to be at its heart. As a result, it focuses on the UAE becoming the economic, touristic and commercial capital for more than two billion people by transitioning to a knowledge-based economy, promoting innovation and research and development, strengthening the regulatory framework for key sectors, and encouraging high value-adding sectors. These will improve the country’s business environment and increase its attractiveness to foreign investment.” ¹⁹

And Kuwait pursues a similar line in its ‘Kuwait Vision 2035’:

“Kuwait’s 2035 vision aims on transforming Kuwait into a financial and trade hub regionally and internationally, and becoming more attractive to investors. Where the private sector leads the economy, creating competition and promoting production efficiency. Under the umbrella of a supporting institutional body, which accentuates national values, preserves social identity and achieve social development. As well as providing an essential structure to cultivate a business friendly environment.” ²⁰

Oman also focuses on economic diversification to achieve inclusive and sustainable development in its Oman 2040 Vision declaring:

“This Vision lays down the foundations for an empowered knowledge-based society whose members are creative, proud of their identity and culture, committed to their civic duties and values and living in dignity and sustained well-being; a society endowed with leading healthcare system, an active lifestyle and an inclusive education for lifelong learning to develop skills for the future, promote scientific research, build national capabilities and achieve economic growth and social well-being”. 21

Qatar’s National Vision 203022 similarly emphasises sustainable development, economic diversification and the maintenance of high standards of living for its citizens. In common with the other Gulf states, it sets out five major challenges facing Qatar:

- Modernisation and preservation of traditions.
- The needs of the current generation and future generations.
- Managed growth and uncontrolled expansion.
- The size and quality of the expatriate labour force and the selected path of development.
- Economic growth, social development, and environmental management.

Finally, Bahrain articulates similar themes in its Bahrain Economic Vision 2030 originally published in 2008, addressing the need to move beyond energy dependency:

“We aspire to shift from an economy built on oil wealth to a productive, globally competitive economy, shaped by the government and driven by a pioneering private sector – an economy that raises a broad middle class of Bahrainis who enjoy good living standards through increased productivity and high-wage jobs. Our society and government will embrace the principles of sustainability, competitiveness and fairness to ensure that every Bahraini has the means to live a secure and fulfilling life and reach their full potential.”23

While each of these ‘vision programmes’ emphasises the ambition to encourage entrepreneurism, to diversify, to encourage the growth of the private sector and to embrace meritocracy, the combination of recent falls in the value of energy revenues, the impact of the COVID-19 pandemic and the economic crisis it has triggered around the world, suggests that levels of unemployment, particularly amongst the younger generations of GCC citizens, are likely to become more acute unless more assertive action is taken now to redress the economic balance.

While critics of the Gulf have long focused on the undesirability of rentierism, it may be argued that the region has benefited from low-tax environments, particularly with regard to attracting foreign talent, and the ability to pursue long-term economic development projects without the interference of short-term political cycles and the near-term economic expediencies that these tend to generate. Accordingly, while it is common for economists24 to criticise the Gulf states for relying too heavily on their energy resources, it also seems fair to acknowledge that for at least the past decade, Gulf leaders have acknowledged this vulnerability and started to introduce economic reforms that shift the balance away from energy dependency.

During the years of the most recent oil boom, from 2008 to 2014, the Gulf states had both the opportunity and incentive to pursue reforms that would reduce reliance on energy production and enable the transition to more sustainable models of economic activity. However, despite the development of vision plans and programmes, it may be argued that this opportunity was not seized with the urgency and commitment to achieve desired outcomes.

In January 2021, with oil prices again rising to $50 per barrel, but relying on costly OPEC+ constraints on oil production (the January 2021 OPEC+ decision to continue voluntary constraints to the end of March are assessed to be costing Saudi Arabia $3 billion in foregone revenue), it seems that this opportunity may no longer be available to any of the Gulf states. Instead, they are now faced by the prospect of having to augment oil revenues with support from sovereign reserves; patently neither a desirable nor sustainable option. Accordingly, this suggests that the Gulf states are feeling under increasing pressure to accelerate the process of economic transformation and to shift the balance of energy dependency.

The impact of climate change and the coincidence of the COVID-19 pandemic

It is already apparent that the economic impact of the coronavirus pandemic will be profound. Equally, the slower, but even more serious impact of measures designed to ameliorate the effects of climate change are likely to have even deeper global economic consequences.

The October 2020 report from the IEA suggested that, due to the impact of COVID-19, the overall demand estimate for 2020 will be 91.7 million barrels per day (mb/d) against an equivalent figure for 2019 of 100.1 mb/d – a fall of 8.4 mb/d. And while the IEA has predicted a rebound in 2021, this is likely to be weaker than would otherwise be the case with a forecast estimate of 97.2 mb/d. In the same report, the IEA concluded: “The longer term offers little encouragement for producers; the curve shows prices not reaching $50/bbl until 2023.”

The COVID-19 pandemic has pushed all the Gulf’s economies towards the brink of recession with the latest report from the International Monetary Fund (IMF) estimating that the economies of the GCC will contract by an average 6.6% in 2020 (Saudi Arabia 5.4%, United Arab Emirates, 6.0% and Oman 10%), although they are also forecast to see a strong rebound in 2021 with average economic growth expected to be around 2.3%. This IMF projection is based on an average price of a barrel of oil in 2020 at $41.69, rising to $46.70 in 2021. Again, it is important to note that even if oil prices recover in line with IMF predictions, the average price of a barrel of oil in 2021 will remain well below the levels previously regarded as vital if previous levels of public and social provision are to be maintained.

The IMF’s latest assessment underscores the perception that the MENA region, and the Gulf states, in particular, have reached a point of inflection whereby economic diversification away from reliance on energy production is no longer merely a desirable objective but essential.

It is also important to recognise that the economic sectors which the Gulf nations have previously prioritised in their early ‘Vision Plans’ as the focus for economic diversification have themselves proved especially vulnerable to the impacts of a global pandemic. As the IMF reflected in its October 2020 regional outlook:

“The coronavirus disease (COVID-19) pandemic may inflict a deeper and more persistent economic impact than previous recessions in the Middle East and Central Asia (MCD) region did, as the unique characteristics of a global pandemic shock collided with long-standing vulnerabilities in the region. In particular, the region’s large exposure in the hard-hit services sector (including tourism), strained corporate balance sheets, low ability to work from home, and dependence on remittances will weigh heavily on recovery prospects. Real GDP in the region could remain below pre-crisis trends for a decade. As the pandemic continues, policymakers must carefully balance preserving livelihoods, minimising [economic] scarring, and promoting recovery, without hampering necessary reallocation [of investment].”

The triple impact of COVID-19 on Gulf economic activity, the recent declines in oil revenues, and the near-certainty of a deep global economic malaise means that the Gulf states may no longer have the luxury of time to effect the required economic transition. In turn, this is likely to have important repercussions for relations between the Gulf and the rest of the world – not least with Europe.

**Consequences for Europe-GCC relations**

It seems that the Gulf states have arrived at a moment of key importance for their future economic well-being and international relationships. Not only is the long-term outlook for oil and gas likely to have a negative impact on revenue streams for all the Gulf states, but it may also constrain the region’s capacity to exert strategic leverage through the traditional means of international energy markets. On top of this, as the previous paragraphs have made clear, the impact of the COVID-19 pandemic and the longer-wave challenges of climate change have brought the Arab Gulf states to a moment that will require some key decisions to be taken. Against this backdrop of generational change, it is salient to consider how this may affect Gulf-European relations in the years ahead.

Too often, it seems that the Gulf’s relations with the rest of the world are seen most particularly through the prism of its ties with the United States. Given historic US security guarantees to the region, as well as the Gulf’s role as a formerly vital source of energy for America, this relationship has provided a rich seam for academic study and accordingly, it is hardly surprising that Gulf foreign relations are most frequently understood in terms of transatlantic ties to the US.

However, as previously noted, successive US administrations have made clear the American desire to reduce strategic engagement in the region. In particular, the ultimately unsuccessful campaign to “liberate” Iraq in 2003 and the ensuing, deadly mayhem this unleashed, combined with the similarly costly and questionably effective campaign to eliminate extremist influence in Afghanistan, has left ordinary Americans with diminished appetite for further interventions in the MENA region.

At the same time, international relations between European countries and their Gulf counterparts over the past two decades have tended to manifest mostly in terms of separate bilateral relationships, and economic and post-colonial ties. In particular, it may be argued that the relationship between the European Union (EU) and the GCC has been predicated primarily on the pursuit of a Free Trade Agreement.  

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29 The EU and Gulf Cooperation Council launched negotiations for a Free Trade Agreement (FTA) in 1990. The FTA is proposed to provide for a progressive and reciprocal liberalisation of trade in goods and services between the two trade blocs. However, the negotiations have faced several challenges, and were effectively halted in 2008, when the GCC countries suspended all ongoing negotiations in which they were involved.
However, as the EU has long pointed out, even without an FTA in place, the GCC collectively already represents the fourth largest export market for the EU and its member states. In 2017, the total value of trade in goods amounted to €143.7 billion, with EU exports to the GCC totalling €99.8 billion. Even when viewed solely in economic terms, the EU-GCC relationship continues to be of considerable importance to both sides, notwithstanding the other dimensions of EU-Gulf relations in the diplomatic, strategic and cultural arenas.

**Total goods: EU Trade flows and balance, annual data 2009 – 2019**

Now, it seems that the twin impostors of a global pandemic and climate change may offer a unique moment for Europe and the Gulf to reassess their significance to each other and to consider how they might take shared advantage of this moment of opportunity, as well as international anxiety.

First, it is worth noting that both Europe and the Gulf have shared the ordeal of the COVID-19 pandemic. They have imposed similar travel and movement restrictions on their populations, explored similar approaches to limiting the impact of the disease through a combination of ‘lockdowns’, business closures, social distancing and mask-wearing. Both regions have exchanged information and data on treatments and prospective vaccines. In short, the pandemic has provided a moment of shared, if unwanted, experience. Given the much closer geographic proximity of Europe to the Gulf, it is apparent that this has brought the two regions closer together in terms of their understanding and shared experience. Arguably, this provides a platform on which to continue to build stronger economic and societal ties.

Shared concerns, as well as appreciation of the opportunities, arising from climate change may also offer a further platform on which Europe and the Gulf can build a new and stronger relationship. Central to this would be the resuscitation of the stalled EU-GCC talks to conclude an FTA between the two blocs. The world has changed significantly since the GCC withdrew from the original talks in 2008; not over political differences linked to human rights issues, as is often suggested, but because at the time the GCC was insistent on retaining the right to impose tariffs on European imports. Over the past year alone, there have been clear signals from both sides that the situation has changed over the ensuing 12 years and there is rekindled enthusiasm to follow this route. Again, it seems that the GCC countries are acknowledging that energy revenues no longer provide the economic buffer they did a decade ago and that there are clear advantages in gaining preferential access to a European market that is 10 times larger than the GCC.
Omar al-Ubaydli, argues that in the decade since the two sides last sat down to pursue the possibility of an FTA, the GCC’s situation has changed considerably. Accordingly, he suggests that: “Securing an FTA with the EU would be a successful result for the GCC, especially considering the current climate of protectionism and isolationism. Although officials familiar with the process indicate that an FTA will take time due to its complexity, the Gulf countries are meanwhile engaged in long-term plans as they continue to restructure their economies and diversify their exports.”

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In February 2020, the then EU Trade Commissioner, Phil Hogan, travelled to the UAE and declared publicly that the EU was open to reopening talks with the GCC. He told reporters that talks about an EU-GCC FTA should begin “sooner rather than later.”

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While the ensuing experience of the coronavirus pandemic may have thwarted further direct efforts to initiate fresh talks about free trade, it seems increasingly evident that the GCC recognises the desirability of concluding an FTA with the EU. The Gulf states desire both preferential access to the large and valuable European market and a route to the EU’s increasingly knowledge-based trade and commerce as part of efforts to build similar digital industries as the bedrock of the Gulf’s future economy.

Arguably, it is similar thinking that has led the UAE and Bahrain to sign agreements with Israel in September 2020 to normalise relations between historic adversaries. While international observers have tended to posit this seismic development in terms of shared enmity towards Iran, the rapid pursuit of a host of economic developments in the final months of the year suggest that for both Arab Gulf states the most important factor has been securing access to Israeli markets and the further development of knowledge-based industries. To this end, the UAE’s two largest banks, First Abu Dhabi Bank and Emirates NBD have signed memoranda of understanding with Israel’s largest banks: Bank Leumi and Hapoalim.

A further factor that is increasingly seen to be driving relations between Europe and the Gulf is climate change and the development of the ‘green agenda’. As has already been discussed, the long-term impact of climate


31 Badam, Ramola Talwar, “EU says it is open to free trade deal with GCC.” The National, 18 February 2019, https://www.bilaterals.org/?eu-says-it-is-open-to-free-trade.
change on future demand for Gulf energy is likely to be negative and profound. And while emerging techniques such as carbon capture and the development of hydrogen power offer potential routes to ‘clean’ uses for oil and gas, it remains evident that the international climate agenda is focused primarily on the development of carbon-free, alternative sources of renewable energy. This seems likely to result in a long-term downward drift in demand for oil and gas, with obvious concomitant impacts on the long-term value of fossil fuels.

However, what seems to be less widely acknowledged are the predicted direct impacts of climate change on the Gulf states themselves unless concerted, international action is forthcoming. It is already the case that the high desert temperatures and aridity of the Gulf region mean that GCC states have become increasingly dependent on power to drive air-cooling systems and to deliver expensive desalinated water. Moreover, most of the major centres of population in the Gulf states are in low-lying coastal areas. This means that the countries of the Arab Gulf face a double challenge from the growing need to maintain alternative sources of cheap power and the threat from rising sea levels directly attributable to future climate change.

A final area in which Europe and the Gulf could and should consider closer alignment is in their mutual pursuit of economic transformation through knowledge, artificial intelligence (AI) and embrace of digital innovation that has come to be called, ‘The Fourth Industrial Revolution’ – or 4IR.32

Ahead of assuming the presidency of the G20 in 2020, Saudi Arabia established a branch of the Switzerland-based ‘Centre for the Fourth Industrial Revolution’ (C4IR),33 a network of technology-governance hubs working in association with the World Economic Forum. This initiative followed the UAE’s lead in establishing the Gulf region’s first C4IR in April 2019. The UAE centre focuses on three areas of future governance: AI and machine learning, Blockchain logistics and Precision Medicine.

It is suggested that the establishment of these two Gulf-based C4IRs again demonstrates the direction that the Gulf states are taking as they seek to transform their economies, away from oil dependency and towards longer-term stability through innovation and the development of knowledge-based economies. As the WEF explains: “The possibilities of new 4IR technologies, deployed appropriately, should be used as the baseline to reinvent the way we operate in the new context: everything from government services, education and healthcare, to the way business interacts and provides value to its customers.” It is hardly surprising that the Gulf states have recognised the opportunities inherent in this latest stage of global industrial development. Moreover, with relatively small populations, little in the way of industrial legacy, aside from energy production, and high levels of existing wealth, the opportunities and visions that are seen by its advocates have led to early embrace by Gulf states.

At the same time, it is similarly evident that Europe is embracing and adapting to the changes and opportunities being wrought by the 4IR. In 2017, the European Patents Office (EPO) published a study that highlighted the acceleration in the development of 4IR inventions and technologies. As the study observed at the time: “The massive deployment of the Internet of Things (IoT) – the host of everyday objects connected to the internet and each other – is leading us into a Fourth Industrial Revolution (4IR). By 2025, it is estimated that 26-30 billion devices in the home and

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32 As the European Commission explained in its strategy “Shaping Europe’s digital future”: “The Fourth Industrial Revolution aims to leverage differences between the physical, digital, and biological sphere. It integrates cyber-physical systems and the Internet of Things, big data and cloud computing, robotics, artificial-intelligence based systems and additive manufacturing. Compared to previous industrial revolutions, the fourth one is evolving at an exponential rather than at a linear pace.”

33 The World Economic Forum Centre for the Fourth Industrial Revolution is a hub for global, multi-stakeholder co-operation to accelerate the benefits of science and technology, https://www.weforum.org/centre-for-the-fourth-industrial-revolution/about.
workplace will be equipped with sensors, processors and embedded software, all connected to the IoT. In the same report, the EPO published a graph showing the steady growth in 4IR developments over the previous 25 years, and suggested that this was only likely to increase exponentially over the next decade:

**4IR patent applications at the EPO 1991-2016**

![Graph showing the steady growth in 4IR patent applications at the EPO from 1991 to 2016.](image)

As 2020 drew to a close, it was clear that the year’s global pandemic had led many more political leaders, scientists and business innovators to consider how the world should adapt to challenges which are global in nature; not least the prospect of another disease pandemic in the future but also the still looming threat posed by climate change. Again, this offers the potential for closer partnership between Europe and the Gulf in pursuing mutually advantageous innovation in the 4IR arena.

A possible starting point could be in the development of improved digital infrastructure between the two regions and the expansion of joint enterprises. As Sanjeev Khagram wrote for the ‘Economist Intelligence Unit’ in April 2020: “This coronavirus crisis should spur us all to explore a new form of globalisation for the 21st century, one that prioritises collective investment in global public goods—including technological and ethical goods—to the benefit of all. Such global integration must enable diverse stakeholders from across the public, private and non-profit sectors worldwide to work more effectively and sustainably together.”34

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CONCLUSION

It is becoming ever clearer that the Gulf states, however reluctantly, are being compelled to confront the simple fact that the era of abundant supplies of oil and gas to maintain their wealthy economies, provide generous ‘cradle to grave’ subsidies to their citizens, and exert geostrategic leverage, is passing.

Where previously the GCC’s interests were primarily driven by a desire to leverage energy wealth to forge strong political and strategic ties with the outside world, in the era of climate change, competition from North American shale and the challenges of an under-employed but burgeoning youth population, there is now increasing acceptance that energy dependency is no longer viable or even desirable in the long term. The GCC is increasingly becoming motivated not only by the need to transition beyond energy wealth but also to provide wider and more exciting life opportunities for its citizens.

One of the big prizes for the GCC of closer ties with the EU would be gaining improved and preferential access to Europe’s large and valuable market for goods and services, which at almost $19 trillion in 2018 is over 10 times larger than the GCC’s combined economic wealth. This underscores the desirability of a renewed focus on the completion of an EU-GCC FTA.

The onset of the COVID-19 pandemic and the growing awareness of the even more serious potential consequences of climate change should serve to emphasise further the vital importance for the Gulf states of making the difficult transition from easy energy wealth to reformed economies that can take maximum advantage from engagement in the 4th Industrial Revolution. No-one should underestimate the challenges involved in refocusing economic activities, building new digital infrastructure, and reforming education systems to deliver people with the knowledge, skills and risk-taking temperament to flourish in more competitive environments. Inevitably, there will be losers as well as winners as a result of this profound period of change, and these people will need to be supported.

Through the various Vision plans that have been announced by all the Gulf states, it is now evident that early recognition by the UAE that reliance on oil and gas was unsustainable over time, is increasingly shared across all the countries of the region. However, to conclude that this is a moment of force majeure would be to misrepresent the outlook of Gulf leaders. Instead, it seems that the opportunity to align previously rentier economies with international norms based on new economic developments is being enthusiastically embraced.
The comforting cushion of oil and gas revenues for all the Gulf states will continue to be a factor well into the second half of the 21st century, and probably beyond. The dash from carbon is more likely to be a slow-paced withdrawal. It will be a long time before aircraft cease flying on kerosene and ships are no longer powered by heavy fuel oil. In the meantime, technology to capture carbon may give a new lease of life to future demand for oil and gas, but the direction of travel seems to be set.

This provides not only a moment of exciting opportunity for the Gulf states to reorientate their economies to provide more varied opportunities for new forms of wealth-generating activity but also to expand potential employment sectors to address the inherent challenges of a restless youth sector with self-evident societal benefits.

While it may be argued that the impact of COVID-19 has given an unexpected spur to this process, it is also important to understand that this is where the Gulf states want to be heading, both to align more closely with international norms and to tackle issues that still threaten to destabilise the region if not addressed.

As a close neighbour, Europe has a potentially prominent and important role to play in supporting this economic transition. At its crudest, it remains a large and vital market for the Gulf, with the additional benefits of long-standing historical ties and shared understanding. But Europe is also an important would-be partner in the expansion of the 4th Industrial Revolution. And if Europe does not respond positively and in equal measure to this valuable opportunity, it seems likely that it will only encourage the Gulf states to look east rather than west for their future prosperity. This is a ‘win-win’ opportunity that should be seized enthusiastically and proactively in both Europe and the Gulf.