The government's ambitious economic diversification timeline will likely be delayed by uncertainty over the successor to Sultan Qaboos bin Said Al Said and significant funding constraints. As part of Oman Vision 2040, the government is currently pushing strong growth in non-oil sectors, including natural gas production, chemicals, cement, metals and tourism.[1]

Gulf Monitor | John Davies | Economic Diversification

Although the oil sector has underpinned expansion of Oman's economy over the past two decades, this will change as oil output stagnates in the coming years. While oil accounted for almost two-thirds of total goods exports and one-third of GDP in 2018, the IMF expects no growth in output or revenue over the next five years.[2]

To deal with these new economic realities, government policy will continue to prioritise diversification of the economy away from the oil export sector. Diversification initiatives are embedded in the Ninth Five-Year Development Plan (2016-20) and the broader Oman Vision 2040. Broadly speaking, the diversification strategy focuses on three areas:

Attracting foreign capital and expertise into non-oil, export-oriented sectors through a combination of regulatory reform and infrastructure investment. The government's priority sectors include manufacturing, logistics, energy and tourism.
Capitalising on Oman's geographic advantage to develop into a regional logistics hub. In addition to boosting the domestic ports and logistics industry, the government hopes this will create positive spillovers to other domestic industries.
Enforcing local employment and procurement requirements on foreign firms. In so doing, the government hopes that rising profits in export-orientated sectors will permeate across domestic-focussed industries such as retail and real estate.

Political transition risks loom

While Oman's relative political stability in the Gulf is currently attractive to foreign investors, the long-term outlook is more mixed. In particular, there remains uncertainty over the successor to Sultan

Qaboos. At 79 years old the Sultan is childless and has ruled with absolute authority since 1970.

Theoretically, the country's 1996 Basic Statute provides a roadmap for succession, whereby the ruling family (Family Council) would have three days to meet and appoint a successor. In the event that the Family Council failed to agree on a candidate, a sealed envelope containing Qaboos' own preference would be opened. A team of power brokers including the Defence Council, the chairmen of both the Upper and Lower Chambers and three Supreme Court officials would oversee this secondary stage.

In practice, several factors could complicate the process and create a power vacuum. In a worst-case scenario, the resulting competition for power among the ruling elite could undermine both political stability and policy continuity, thus weakening Oman's investment appeal.

Most significantly, the lack of a clear successor to Qaboos will make reaching consensus in the Family Council difficult. According to the Washington Institute for Near East Policy, more than 30 candidates would meet the constitutional eligibility criteria for potential successors. Moreover, elevated regional tensions mean that various Middle East countries could complicate the process by throwing support behind particular candidates. In the event that the Family Council failed to appoint a successor, introducing a diverse cast of political actors to oversee the succession then risks the process being disrupted by a raft of conflicting political objectives.

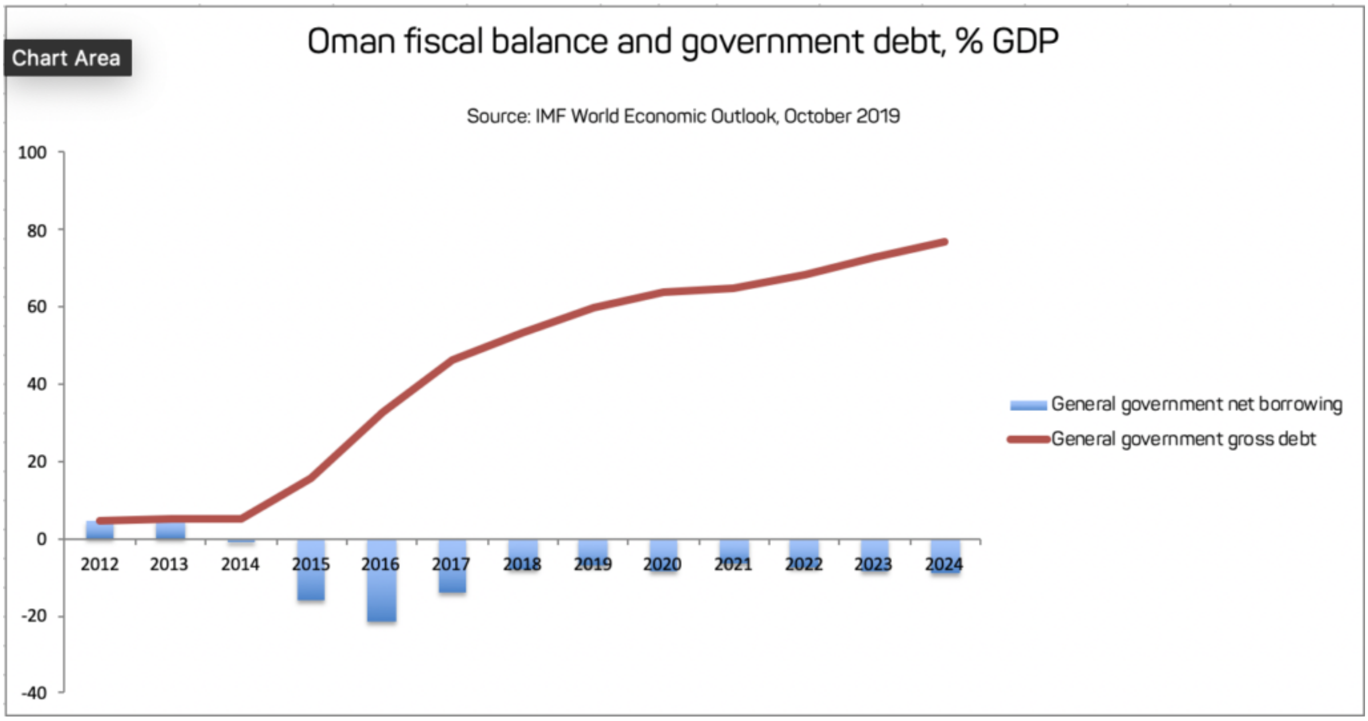
Even if a successor was chosen in a timely and amicable manner, the new Sultan would have a major challenge replicating the authority currently held by Qaboos. As a result, risks to political and social instability would inevitably rise. The centralisation of power around the current Sultan means that no potential candidate would have any significant executive experience. Moreover, economic challenges will be considerable in the coming years, with the IMF forecasting just 2% real GDP growth per year over 2020-24 compared to 3.3% over the previous decade.

Funding constraints

In addition to the risk posed by political turmoil, diversification into the new sectors outlined in the development plan may be slowed or scaled back due to funding constraints.

Fast growth of non-oil sectors will require a substantial acceleration in private investment. Regulatory reforms will entice private firms to provide some of the required capital, as has been the case in recent years. According to UN figures, foreign direct investment into Oman tripled between 2014 and 2018 to reach $4.2bn. Most recently, the state relaxed foreign ownership limits in numerous industries in December 2019. Nonetheless, local employment and procurement requirements will raise costs for businesses and ultimately limit the attractiveness of investing in Oman. Meanwhile, slowing economic growth in China will mean that provision of state-subsidised capital for Chinese infrastructure firms operating in Oman will become more constrained.

The limited ability of the state to fill this funding gap means that diversification goals will likely need to be scaled back over the coming years. While government spending will likely be constrained by stagnant oil revenues, the national debt is expected to rise as spending outstrips revenues. The IMF forecasts the fiscal deficit to widen to 8.4% of GDP in 2020 and the MoF expects 80% of this shortfall to be met by increased borrowing. Oman's debt burden has already surged from 4.9% of GDP in 2014 to an estimated 59.9% in 2019 following a collapse in hydrocarbon revenues and is projected to rise to 76.9% by 2023.[3]Structural fiscal deficits and a rising debt burden will gradually push borrowing costs higher and constrain the ability of the state to continue supporting diversification efforts.



Opportunities in priority sectors

While the hurdles ahead may hinder the diversification process, investors may still take advantage of growing opportunities in priority sectors over the coming years.

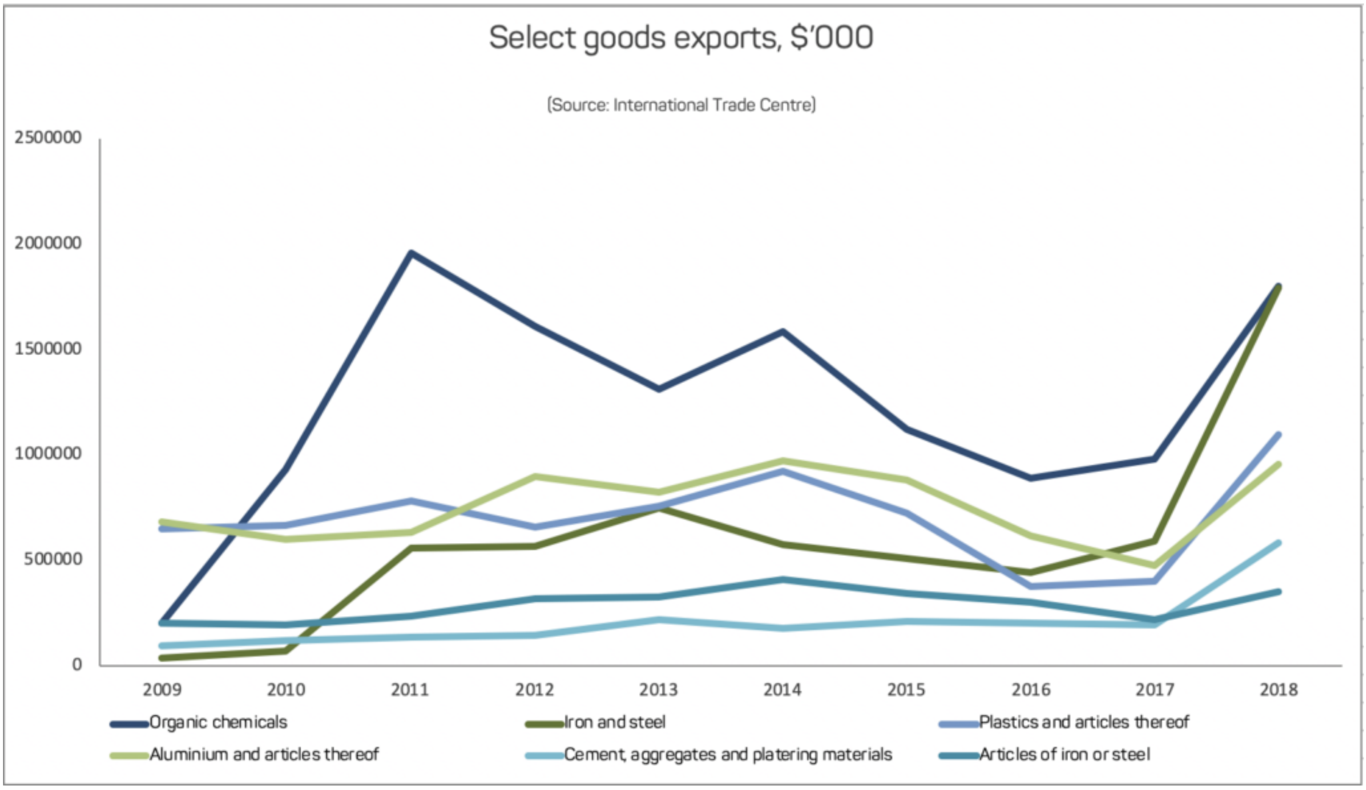
Natural gas: The outlook for natural gas production in Oman is positive, in line with the country's sizeable reserves and the strong investor interest in the market. Production has risen sharply in recent years, underpinned by the start-up of the Khazzan-Makarem tight natural gas field in 2017. BP has confirmed the development of the second phase of the Khazzan project (known as Ghazeer), which is scheduled to come on-stream in 2021 and deliver an additional 5.1bn cu metres of gas in addition to the 10bn cu metres currently in production. Besides the Khazzan reservoirs, there are a handful of other domestic gas projects which have the potential to support production growth over the coming years.

Liquefied natural gas is already Oman's second-largest export behind oil, accounting for 12% of total exports in 2018. While increasing domestic gas production will help sustain exports over the coming years, rapidly rising demand from the country's industrial and power sectors will mean that a larger share of production is diverted to serve the domestic market.

Industrial exports: Export-orientated manufacturing and processing is considered a central pillar of economic diversification in Oman. As such, the government and foreign players alike are investing heavily in developing industrial projects across the petrochemicals, cement, chemicals and metals sectors.[4]

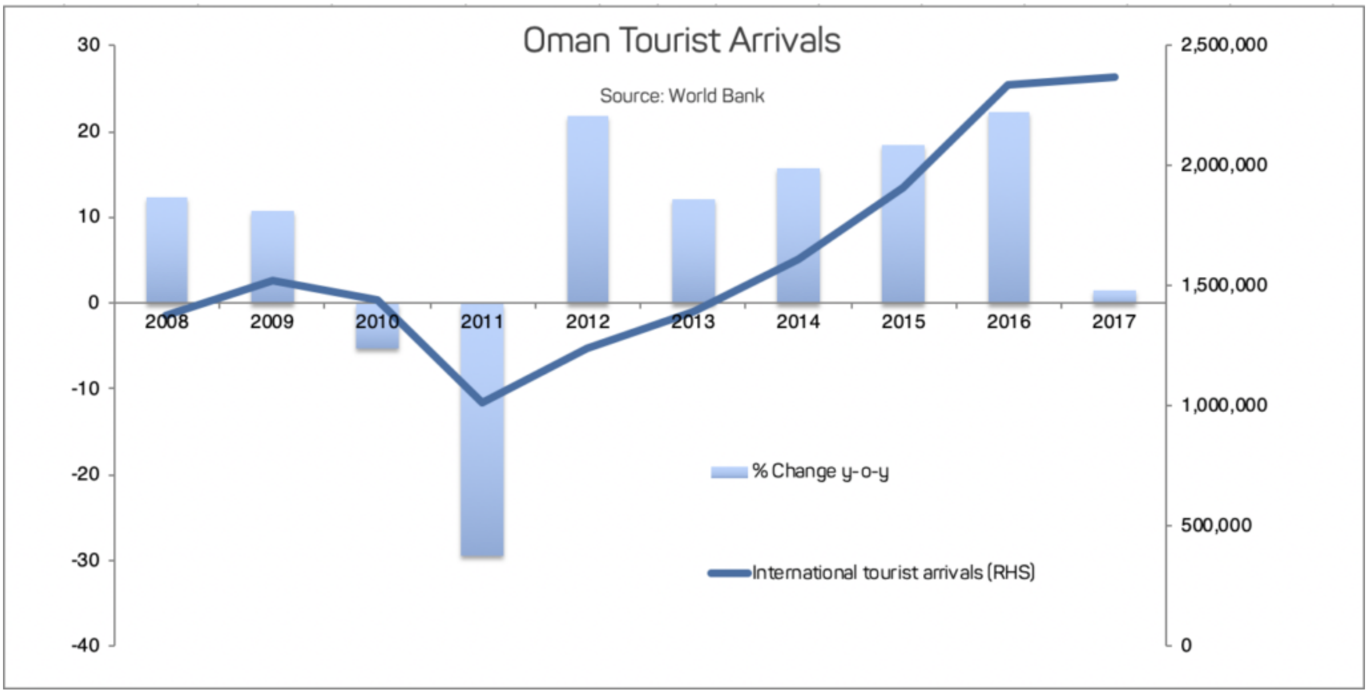
Key projects in Oman's development plan		
Infrastructure	Industrial	Tourism
Water transmission pipelines, including Sohar-Ibri, Sohar-Barka, and Gubrah-Seeb	Salalah Ammonia Project	Mina Sultan Qaboos Waterfront Project
Sharqiyah Expressway Project	Ras Markaz Crude Oil Storage Terminal Project	Little India Tourism Complex
Adam-Thumriat Road Dualisation Project	Salalah Liquefied Petroleum Gas Project	Marina Duqm Project
Sinaw-Mahout-Duqm Road Project	Liwa Plastics Industries Complex Project	
Barka-Nakhal Road Dualisation Project	Copper Mining Project in Al-Mudhaibi	
Ibri-Yangul Road Dualisation Project	Duqm Refinery Project	
Bulk Liquid Berth at Duqm and Salalah Ports	Fisheries Industrial Complex at Duqm SEZ	
Completion of implementing berths at Salalah Port	Sebacic Oman Bio-Refinery	
Completion of implementing Commercial Berth at Duqm Port	Shomookh Complex for Mining Industries	
Development of Shinas Port	Expansion of Rusayl Industrial Estate (first phase) and Sohar Industrial Estate.	
Special Economic Zone of Duqm		

While non-hydrocarbons accounted for less than 30% of total exports in 2018, exports of organic chemicals, iron and steel, aluminium, cement and plastics have risen sharply over the last two years. The gradual realisation of the strong pipeline of industrial projects, along with the development and expansion of industrial zones in the country, will drive additional non-hydrocarbons export growth.



Tourism: Oman has gained popularity as a tourist destination due to its relative political stability and security when compared to regional neighbours. Adding to the attraction are the country's five UNESCO-listed World Heritage sites—the highest number in the GCC region and equal to Saudi Arabia.[5]

The government is keen to foster this reputation, capitalising on the labour intensiveness of the sector and the positive spillover tourists can bring in terms of retail and trade.



Construction: The diversification of the Omani economy, particularly via the development of the gas, tourism and industrial sectors, will create widespread investment opportunities in the domestic construction market. Furthermore, investment into auxiliary infrastructure, including into the utilities and transport infrastructure segments will be needed to support growth in these sectors (see projects table). The country will likely be able to capitalise on its considerable expertise in applying the public-private partnership model to develop infrastructure projects.

In particular, ports infrastructure is a bright spot for investors given the country's strategic location and government aims to emerge as an industrial and logistics hub.

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Footnotes:

[1] For the purposes of this article, natural gas and chemicals are treated as non-oil sectors

[2] IMF World Economic Outlook Database, October 2019

[3] IMF World Economic Outlook Database, October 2019

[4] Information in Table 1 sourced from the Oman Ministry of Finance

[5] UNESCO ‘World Heritage List’, https://whc.unesco.org/en/list/&order=region

