Istituto Affari Internazionali

The Impact of the Oil Crisis on the MENA Region

by Alice Favazza and Camellia Mahjoubi

ABSTRACT

The countries of the Middle East and North Africa (MENA) region are among the most exposed ones to fallout from a possible global recession due to the economic repercussions of the current COVID-19 pandemic and the recent collapse in the oil prices. Heavily relying on oil revenues, the MENA region oil producers will face long-term challenges from a financial, political, social and security perspective. This situation will also have ramifications for Saudi Arabia-Iran relations and for the post-oil economic plans of some of the MENA countries.

keywords

Middle East | North Africa | Gulf countries | Oil prices | Economy | Coronavirus

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The Impact of the Oil Crisis on the MENA Region

by Alice Favazza and Camellia Mahjoubi*

On 27 April 2020, the Istituto Affari Internazionali organised a virtual expert briefing on the impact of the oil crisis on the Middle East and North Africa (MENA) region. The meeting was part of the ongoing project "Analysis of Areas of State Fragility in Italy's Foreign Policy Priorities" sponsored by the Italian Ministry of Foreign Affairs and International Cooperation and the Fondazione Compagnia di San Paolo. The webinar was held under the Chatham House Rule. In addition to the four panellists (Florence Eid-Oakden, Luca Franza, Giacomo Luciani, Robin Mills), participants included IAI senior researchers as well as international experts and practitioners in the domains of energy dynamics (both global and MENA-specific) and their political-economic impact on this region, crucial for Italian foreign policy.

The webinar began with a review of the current situation. In the middle of the COVID-19 pandemic, oil prices collapsed under combined pressure from supply and demand trends. Demand fell because of the general economic downturn as well as the effects of the lockdown on mobility. On the supply side a price war between Saudi Arabia and Russia has been taking place since 6 March 2020. Tensions led these countries to abandon a coordination that, even with ups and downs, had worked since 2016. Plummeting demand and the devastating effects on the oil sector brought together once again the OPEC+ group, i.e., the OPEC members plus other key oil producers like Russia. On 9 April 2020, the group's members managed to reach an agreement entailing an unprecedented cut in oil production. Parallel to this coordinated cut, a market response is materialising, as some producers are shutting down production given that prices are below their breakeven levels.

However, the agreement had only a very short-lived upward effect on prices, which kept decreasing in the following days. This is due to a number of reasons. First of all, the cut was merely announced on 9 April, only taking effect on 1 May. Secondly, some manifestations of the price war have actually continued, with

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Saudi Arabia selling supplies to India and China at discounted prices. Thirdly, and most importantly, the reduction in consumption (-29 million barrels per day in April) is much larger than the production cuts agreed by the oil exporting nations (-9.7 million barrels per day). Average oil prices have fallen from around 60 dollars per barrel in January to around 20 dollars per barrel in April.

After framing the issue as such, the experts participating in the webinar analysed the impact of low oil prices on the MENA region, by adopting different perspectives regarding its energy, financial, socio-economic, political, regional and international relations ramifications. Even if the MENA countries have (so far) reported fewer COVID-19 confirmed cases compared to other regions of the world, they are suffering from the implications of a "crisis within the crisis".[1] The main issues unpacked in the discussion regarded the effects of the crisis on national economies (including the non-oil sector), political stability and domestic security. Participants identified the major strategies already adopted or in the process of being developed to cope with the crisis domestically, regionally and internationally. Besides such common trends, the experts agreed upon the heterogeneity of both the region and the responses envisaged by different countries. Diverse national conditions brought about distinct constraints and opportunities for the countries affected by the crisis.

Globally, the speakers agreed on the strong impact that the COVID-19-related lockdowns will have on the world's economy. Even assuming a fast recovery of transport services and industrial activities, it is becoming clear that the current recession will have a long tail, with the effects of the crisis probably outlasting the end of the current restrictive measures. In this regard, participants agreed that the IMF projections for the global GDP comeback to pre-crisis levels may be too optimistic. The international financial institution predicted a 3 per cent contraction of the global output for the year 2020, followed by an impressive increase of 5.8 per cent in 2021.[2] Still, a great deal of uncertainty dominates future GDP trends, and the debate about whether the recovery will be V-shaped or U-shaped is still ongoing.[3]

Significant GDP losses are expected this year. In this respect, the IMF estimates a 4.2 per cent decrease in the MENA countries' GDP, worse than the world average.[4] It represents a sharp deterioration from the 2019 IMF forecast, which estimated a 2.1 per cent GDP growth for this group in 2020. Moreover, we can observe a worsening

[1] Luca Franza, "Power Shifts and the Risk of a 'Crisis Within the Crisis': COVID, Oil and the MENA Region", in *IAI Commentaries*, No. 20|36 (May 2020), https://www.iai.it/en/node/11631.

[2] International Monetary Fund (IMF), "The Great Lockdown", in *World Economic Outlook, April 2020*, https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020.

[3] For an overview of the possible recovery scenarios see, Jeff Greenberg and Joe Seydl, "The Shape of the Recovery", in *JP Morgan Insights*, 14 April 2020, https://privatebank.jpmorgan.com/gl/en/insights/investing/tmt/the-shape-of-the-recovery.

[4] IMF, *Regional Economic Outlook: Middle East and Central Asia*, April 2020, p. 1, https://www.imf.org/en/Publications/REO/MECA/Issues/2020/04/15/regional-economic-outlook-middle-east-central-asia-report.

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of state finances and rising debt levels across the region. The average fiscal deficit in MENA oil exporting countries is expected to reach 12 per cent of GDP in 2020. Oil revenues, which are key for MENA oil exporting countries, are declining.

The pandemic has also impacted on the domestic non-oil economy, paralysing several sectors in many countries including tourism, retail and services. Non-oil GDP growth is expected to slow down even more than oil-related one. Small and medium-sized enterprises (SMEs), with less buffers than larger companies, have been hit particularly hard. This is a crucial aspect if we consider the significant role played by SMEs in key-driving the economic diversification of the region.

The crisis affects other energy sectors in addition to crude oil. The gas sector, which constitutes an important part of the energy-related GDP output (especially in Qatar), has been following the same path as oil. Asian LNG prices for instance fell below 2 dollars/MMBtu.[5] Losses are also expected in petrochemicals, aluminium and, in general, other components of the global energy value chain.

Net oil importers are an integral part of the MENA region. For these countries, the current crisis represents a double-edged sword. Lower oil prices, at least in the short term, are having some positive effects on countries such as Morocco, Lebanon and Jordan. However, the overall impact of the crisis will most likely be negative for net oil importers as well. The reasons lie in the deep economic interconnections existing between oil exporters and importers. Not only through labour remittances but also in view of the key role as partners and project funders played by the oil exporters, the economic performance of net importers is deeply dependent on the performance of wealthy countries in the Gulf. Hence, it is reasonable to expect a spill-over effect of the oil crisis onto the whole region, including the net oil importers.

Concerning the domestic sphere, participants agreed on the necessity of adopting a variety of stimulus policies, ranging from cuts in non-essential expenditures to liquidity injections and seeking external financial support. Given the distinct ways in which the crisis is impacting oil exporters and oil importers, the economic policy responses have likewise differed throughout the region. Indeed, Gulf Cooperation Council (GCC) oil exporters have introduced fiscal measures averaging 3.8 per cent of GDP, as well as liquidity supports of about 2 per cent of GDP.[6] However, although deemed necessary, the extent to which those policies can be sustained over time will depend on the strength of the buffers that those countries hold, such as the level of diversification of the economy and the availability of Sovereign Wealth Funds.

The picture painted for the oil importers in the region, most of which had already experienced sluggish GDP growth in 2019, was unanimously a rather grim one due

[5] MMBtu stands for one million British thermal units.

[6] IMF, *Regional Economic Outlook: Middle East and Central Asia*, cit., p. 3.

to their limited capacity to respond to the crisis and the resilience and stability of their political systems (or lack thereof). While those countries have introduced unprecedented domestic measures to contain the spread of the virus, going as far as imposing nationwide curfews in some cases, this has laid bare the structural weaknesses of their social security systems and their limited fiscal spaces, which are key to provide an adequate response to a crisis like the one at hand. Indeed, with more limited funds than their oil exporter counterparts, those countries have nevertheless introduced a variety of economic stimuli – averaging some 44 billion US dollars[7] – to relieve the economic grievances hitting particularly the poorest and most vulnerable segments of their populations.

Each country has instituted a combination of policies such as: targeted transfers for vulnerable households using the existing social safety nets as was the case in Morocco, Tunisia and Egypt;[8] cash transfers to unemployed workers, assistance to SMEs in key sectors, monetary policy as well as a very critical foreign borrowing in already tight global financial markets. That being said, for policymakers the challenge remains how to support the recovery in the long run with lower resources and a higher public and external debt. In this context, navigating the post-Corona hardships with limited policy options will require a vigilant fiscal consolidation package and gradual macroeconomic stabilisation policies.

Related to the resilience and sustainability of the political systems, a parallel was drawn between the economic conditions existing prior to the Arab Spring (crash of the tourism industry, rising unemployment and pressure on foreign-currency reserves) and the current ones, and there is enough historical precedent to suggest that they might set the stage for a new wave of upheavals in the region.[9] The long-lasting effects of the crisis are of particular concern to countries that were already experiencing social unrest before the coronavirus outbreak such as Algeria, or a mix of popular protests and an unprecedented economic collapse such as the cases of Lebanon and Iraq. These countries will most likely have to deal with a resurge in protests once the pandemic is brought under control, if not before.

Despite all current speculations, a high level of uncertainty still prevails with regards to conflicts in the region and how they would be affected by the current crisis. There is no simple correlation between low oil prices and conflict, but there can be links. One possible outcome – the more optimistic one – would be that, succumbing to their domestic economic pressures, there would be a retrenchment by the main actors from the region's proxy-wars (for example Libya, Syria and Yemen), and leaning in the direction of accepting compromises. The other scenario is that the crisis would instead act as a conflict multiplier, pushing the different actors to consolidate their regional influence and gains, including the

7 Ibid, p. 3.

8 Ibid, p. 11.

9 Jason Pack and Nate Mason, "Could Coronavirus Lead to an Arab Spring 2.0?", in *Middle East Institute Articles*, 25 March 2020, https://www.mei.edu/node/81013.

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military ones.

Another important issue unpacked during the webinar was the increasingly significant role of China in the MENA region, raising questions about whether its "mask diplomacy" announces a new strategic orientation. The participating experts wondered whether China will feel the appetite to purchase oil at this low price to strategically increase its reserves. A further dimension related to the Chinese role in the domestic economy of the MENA countries concerns the growing presence of Chinese businesses and networks in sectors such as e-commerce and livestreaming, which have been growing in double digits in the past two years in the MENA region, and which could announce a potential rise in Chinese FDIs in the region.

All things considered, participants observed that the situation remains critical throughout the region. Regardless of general trends, every country will be impacted differently by the crisis. For this reason, the experts turned to some highlights by country. More in detail, scenarios for Saudi Arabia, the United Arab Emirates (UAE), Iraq and Iran were emphasised during the discussion.

Saudi Arabia, the state with one of the largest buffers in the region, has introduced very extensive stimulus packages. However, the oil production decline will determine a contraction in the country's economic growth both in the oil and the non-oil sectors. As far as its strategic framework is concerned, Vision 2030 would not be much impacted by the current crisis except for a minor slow-down in its implementation. This is due to the fact that now, more than ever, the diversification of the economy is an imperative.

As for the UAE, in addition to the standard problems facing all the oil exporters in the region, the issue of diversification is closely related to the basic structure of the country's population, of which an alarming 85 per cent are expatriate workers without whom the growth model would come under extremely high pressure. This entails that the country will have to reconsider various aspects of its model and reinvent itself.

The case of Iraq is particularly critical. The country is in an exceptionally difficult position on all fronts. Since last year, the country's domestic stability has been rocked out by massive protests. Discontent is spreading throughout the country, fuelled by the government's failure in delivering better standards of living. In the middle of this political turmoil, the oil crunch has hit the country. As the other oil exporters, Iraq has committed to production cuts but, by the same token, the situation in the country is quite exceptional. Iraqi state-operated production is small. To respect the output commitments, the government must persuade international oil companies to reduce their productions, inevitably paying a compensation in turn for their cuts. Another crucial aspect is the country's dependence on Iranian gas. Due to the current crisis, in March 2020, the United States granted Iraq a 30-days waiver to keep importing gas from its neighbour, despite American sanctions. Of course, being stuck in the middle of US-Iranian

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tensions contributes to heightening the level of pressure on the country, which is already facing high degrees of instability from a domestic politics perspective.

As mentioned, given the heterogeneity of the region, some countries are likely to experience less severe economic and social consequences than others. A case in point is Iran. If from the point of view of the pandemic the country is among the hardest hit in the Middle East, from the political and economic perspectives Iran may be in a better position to cope with the current crisis. The country's oil exports have already been reduced by US reinstated sanctions, with China remaining one of its few customers. Many years of sanctions fuelled a diversification of the Iranian economy, which today appears quite self-sufficient if compared to its counterparts in the region. Politically speaking, it seems quite unlikely that the current crisis will bend the Iranian Islamic Republic to its knees. In this respect, as on several other occasions, the government's repressive apparatus has proved capable in dealing with domestic instability.

In conclusion, the insights discussed during the expert briefing point to a gloomy scenario for the MENA region in the coming months and years due to the overlapping impact of the health, economic, financial and socio-political crises. This is likely to exacerbate local, domestic and regional tensions at a moment in which a lack of attention and resources on the part of some external stakeholders, including some European countries, might further reduce their level of engagement with some MENA countries and endanger our national interests and priorities.

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