

PLANNING FOR ECONOMIC DIVERSIFICATION IN OMAN

BY

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I. INTRODUCTION

This paper is not about the review and analysis of past diversification efforts, though main achievements will be briefly presented. It is not also about identifying the priority sectors that have the potential for diversification or about defining which strategy should Oman follow. The paper does not aim at identifying the reforms needed in the labour or Omanization policy and the kind of training programs to be implemented for skill development in order to achieve economic diversification.

The paper will analyze the conditions for successful economic diversification plan and strategy and which, some of them, were not well defined in the Oman Vision 2020. It will focus on the importance of designing a specific strategy for economic diversification, to be translated into an action plan with proper indicators and a monitoring and evaluation system. The paper will discuss the two following options and their implications: should the strategy be based on job creation by favouring nationals over expatriates or be based on enhancing competitiveness of non-oil sectors through the use of cheap foreign labour? The other choice in the diversification plan should be between a non-oil export-oriented strategy or an import-substitution, or a combination of both.

The paper will tackle the issue of the establishment of an institutional structure for the implementation of the strategy. It will elaborate on some of the main conditions for a successful economic diversification strategy: (1) Integration of skills development into sectoral policies, particularly in priority sectors that have the potential to contribute to economic and export diversification; (2) Creation of an enabling business environment; and (3) A well-functioning and quality government institutions with emphasis on governance.

II. ACHIEVEMENTS TO DATE

Oman exerted serious efforts to diversify its economy. The Vision 2020 covering the period 1996-2020 contains strategic objectives encompassing various priority themes including the development of the manufacturing sector, tourism, infrastructure, the services sector, etc... and human resource development.

The vision 2020 anticipates significant structural change in the economy, by forecasting a net increase in non-oil GDP from 62.4% during the period 1991-1995 to 81% in 2020. Oman faces however serious challenges in view of the fact that, instead of increasing its share, non-oil GDP recorded a steady decline since 1995 reaching 52.9 % in 2010. In view of this diversification trend, it is doubtful that the target of 81% can be reached in 2020.

The share of manufacturing in total GDP almost doubled during the period 1996-2010, reaching 10% in 2010. Around 50% in the growth of the manufacturing sector, however, is attributed to downstream petroleum activities, adding thus value to oil, with little change recorded in economic diversification. Vision 2020 forecasts an increase in the share of industry in GDP from 16.7% in 2010 to 29 per cent in 2020; industry includes manufacturing, construction, mining and quarrying and electricity and water.

When looking at exports structure, we find that little change occurred since the promulgation of the vision 2020. The share of non-oil exports to total exports increased during a period of 15 years from around 20% in 1996 to only 26.8 % in 2010. Again, the growth of exports can be attributed mainly to export of downstream petroleum products.

Pattern of Structural Changes throughout the Five-Year Plans

	1976-1980	1981-1985	1986-1990	1991-1995	1996-2000	2001-2005	2006-2010***	2010
Non-oil/GDP	43.5	48.9	57.8	62.4	61.1	58.1	57.3	52.9
Manufacturing/GDP	0.7	1.7	3.2	4.1	4.5	8.3	10.4	9.5; 16.73(a)
Non-oil Exports/ Total Exports*	3.8	7.3	9.7	19.4	22.4	19.1	23.1	26.8
Non-oil Revenues/ Total Revenues**	7.8	11.3	17.9	21.1	24.5	23.4	23.0	24.0

Reference: Ministry of National Economy, Oman, The Development experience and investment climate, 2008; and Ministry of National Economy & Central Bank of Oman.

* Including re-exports

** After transfers

*** Average 2006-2010, (calculated by author on the basis of data provided by Ministry of National Economy, National Accounts Bulletin, 12th issue, April 2012)

(a) Industry includes manufacturing, construction, mining and quarrying and electricity and water

Since the start of the implementation of the Vision in 1996 and until 2010, Oman support to the private sector was rather modest. The contribution of the government budget to support the private sector didn't exceed 9% of total expenditures in the 2010 budget as compared to 4.2% in

2006¹. The development of a diversified economy would depend on the extent to which the government budget will increase its contribution to support the private sector.

III. CONDITIONS FOR SUCCESSFUL ECONOMIC DIVERSIFICATION PLAN AND STRATEGY

When planning for economic diversification, a number of factors are critical to the success of diversification:

1. Designing an economic diversification strategy taking into consideration the available human capital and the potential for skill development as well as the potential for specific non-oil based sectors to compete in the local and international market
2. Investing in human capital that responds to the needs of priority economic sectors
3. Creating an enabling business environment that would provide the conditions for the growth of the private sector away of hydrocarbon-based activities
3. Developing quality government institutions to aid the diversification process

Other factors such as building adequate physical and social infrastructures to support diversification efforts will not be addressed in this paper, in view of the fact that these factors have been well addressed by the Omani government.

IV. DESIGN OF A DISTINCT ECONOMIC DIVERSIFICATION STRATEGY

In Oman, economic diversification is considered as one of the main objectives for the achievement of the Vision for Oman's Economy, and is formulated as part of the various economic development plans. Oman intended to achieve the objective through providing appropriate conditions for the realization of the economic diversification and encouraging the establishment of an effective and competitive private sector.

A major gap in the Vision 2020, however, is the lack of a specific strategy for economic diversification, to be translated into an action plan with proper indicators and a monitoring and evaluation system. The various development plans consists of a juxtaposition of projects in the various socio-economic sectors with little coherence and integration between them. The Vision does not indicate clearly what are the measures needed to provide the appropriate conditions for the realization of the economic diversification.

¹ Central Bank of Oman, Annual Report, 2010

In order to move to a diversified economy, Oman would need to choose the right diversification strategy. Should the strategy be based on job creation by favouring nationals over expatriates or be based on enhancing competitiveness of non-oil sectors through the use of cheap foreign labour? The first option would entail investing heavily on education to develop the needed skills, and the development and promotion of sectors that are skill-based, such as the financial sector and technology and knowledge-based activities, the competitiveness of which is based more on quality than price. Under this option, it would be difficult to achieve competitiveness in the short-term, as skill development is a long process. This option would be therefore more sustainable for the Oman economy in the long-term. The second option would entail the development of competitive sectors based on the use of foreign cheap labour, the sustainability of which is not evident in the long-term, and would negatively affect job creation among Omanis. This option is inevitable in the short and medium term; it has the advantage of providing the private sector with knowledge, skills and experience in the management of enterprises. It is worth for Oman to examine the combination of both options and balance between them.

The other choice to make and which is related to the above-mentioned options of economic diversification strategy is between a non-oil export-oriented strategy and an import-substitution, or a combination of both. The investment made by Oman in petrochemicals and chemicals for export purpose cannot be considered as a real case of a diversification strategy, since this strategy is adding value to hydrocarbons and still based on capital and energy-intensive rather than on human capital and job creation which are critical for economic diversification. Such a diversification would be carried out mainly by the private sector and would require investment in non-hydrocarbon-based sectors or activities. A non-hydrocarbon export-oriented strategy would be difficult to implement in the short-term if based on Oman labour which cost is relatively high. In fact, export diversification strategy will face problems in a resource-based economy such as Oman which strong currency would reduce its competitiveness in the international market. In the short-term, Oman would need to continue using cheap foreign labour in order to achieve export competitiveness. In the medium and long-term, developing Omani skills would help in developing knowledge-based activities that have potential for competitiveness in the local and export market.

An import-substitution strategy which entails obviously the establishment of activities across all economic sectors would require strong support of the government to the private sector in the short-term. Though conflicting with WTO rules, an import-substitution strategy based on the protection of some sectors from foreign competition can help in achieving diversification, but at a higher cost for consumers. The experiences of Chile, Indonesia and Malaysia are worth mentioning since these three dependent-resource countries succeeded in diversifying their economies when adopting at the beginning of their diversification programs an import-

substitution strategy and protected their economics from foreign competition²; such strategy was abandoned in 1973. In Chile, the share of mining products in total Chilean exports declined from 85.5 percent in 1970 to 58.7 percent in 2008, while the share of manufactured goods in total exports increased from 11.6 percent to 35.3 percent³.

V. IMPLEMENTATION STRATEGY

The strategy should be developed with the identification of priority sectors and themes, an institutional structure and an implementation model. Priority sectors that have potential for diversification and competitiveness need to be identified, taking into consideration the available Omani skills.

The preparation of the strategy and its implementation needs to be carried out not just by the government but also with the engagement and mobilization of all relevant stakeholders including the private sector and NGOs. Each of the key stakeholders (government, private sector and NGOs) should be requested to identify how they will contribute to the strategy according to each one's respective mandates. Oman is to establish a body or special unit that will be in charge of the diversification and coordinate the contribution of all relevant stakeholders to the implementation of the strategy. A monitoring and evaluation system is to be devised to track the progress made and difficulties encountered, and to ensure the objectives and outputs of the strategy are implemented effectively and efficiently.

It is worth mentioning the case of Botswana which constitutes an interesting example to learn lessons from. After more than two decades of implementation of their diversification programs, Botswana failed to move away from its dependence on a single resource, diamonds, in view of the lack of a well-designed diversification strategy and inadequate monitoring mechanisms as well as the absence of critical mass of entrepreneurs and adequate skilled human resources. Such failure led Botswana to develop recently a diversification strategy, the Economic Diversification Drive (EDD) 2011-2016. The specific objectives of the strategy are to develop globally competitive sectors; diversify exports and export markets through a vibrant and globally competitive private sector; develop goods and services that comply with local and international standards; and develop an entrepreneurship culture for business growth and enhanced citizen participation in the economy⁴.

Botswana has identified seven thematic areas to achieve economic diversification:

² Akram Esanov, Revenue Watch Institute, Economic diversification in resource-dependent countries: its dynamics and policy issues, 2011

³ Akram Esanov, Revenue Watch Institute, Economic Diversification: Dynamics, Determinants and Policy Implications

⁴ Botswana, Ministry of Industry and Trade, Economic Diversification Drive, Medium to Long-Term Strategy 2011-2016, July 2011.

- Sectoral Development and Business Linkages
- Export Development and Promotion
- Investment and Finance
- Quality Control, Standards and Production
- Technology Development, Innovation and Transfer
- Research and Development
- Entrepreneurship development

In addition to the seven EDD Thematic Areas, the Strategy covers four important areas, namely, the EDD Strategy and Poverty Eradication Initiative; the EDD Institutional Structure; the EDD Implementation Model; and the Role of the Private Sector in the EDD Initiative.

What characterizes Botswana strategy is not just the identification of priority thematic areas but more significantly the creation of mechanisms, particularly the EDD institutional structure which is crucial for the successful implementation of the economic diversification strategy. The Ministry of Industry and Trade was selected as the lead Ministry to chair the National Economic Diversification Council (NEDC) consisting of concerned government agencies, the private sector and civil society. Key stakeholders were identified and will contribute together to the achievement of the strategic objectives. The stakeholders participated also in the formulation of the strategy; this would ensure ownership by all segments of the society. The NEDC will provide strategic direction and guidance to the EDD Secretariat and the Thematic Teams. The EDD Unit will be the Secretariat for the Council and the Thematic Teams, and will be empowered and resourced to ensure the full implementation of the strategy.

VI. INTEGRATION OF SKILLS DEVELOPMENT IN SECTORAL POLICIES: A PRE-REQUISITE FOR SUCCESSFUL ECONOMIC DIVERSIFICATION

Though the various Oman's development plans emphasized the importance of improving education and developing a skilled labour force, such efforts are associated more with the current needs of the labour market than with a vision of an economic diversification strategy that would define future labour demand according to the identified competitive sectors. The lack of adequately trained labour is a major supply side constraint, reducing the competitiveness of companies and hindering development of new export sectors. Successful exporting requires specific skills. Investments in human capital have proved to be in other countries a major factor in the development of export-oriented industries. The availability of well-trained labour is a pre-requisite to attract Foreign Direct Investment, which also increases the country's ability to absorb new technology.

Labour policy constitutes, in fact, the most highly contested issues between the private sector and the government. One of the issues is the Omanization policy that restricts the employment of

cheap foreign labour by setting the percentage of Omani employees required in each of the professions and fields in the private sector. Though, as part of the Omanization policy, the Ministry of Manpower supports Omani job seekers through vocational training, the private sector complains that the trained Omanis do not meet the requirements and the needs of the private sector. The government also requires that the employees in the private sector be provided with equal treatment to those in the public sector, which leads to increased costs for the private sector, thus affecting its competitiveness.

A survey conducted by ILO in 2011 on a sample of 150 firms⁵ confirms that 66 per cent of respondents believe that Oman's labour legislation that companies must comply with is a constraint on enterprise growth. Overall, 26 per cent of respondents feel that workers in Oman do not have the skills demanded by business. This is followed by 41 per cent of respondents who believe that workers in Oman to some extent have the skills required by business but feel there are significant skill deficits.

The other issue is the government decision in February 2011 to increase the minimum wage by 43 per cent for nationals working in the private sector in view of the high cost of living and increase in consumer prices. The dramatic increase in the minimum wage which can be attributed to the increasing fear of the government of social and political protests witnessed in other Arab countries has affected the competitiveness of the private sector.

Four of five top biggest challenges facing the Oman economy given by the respondents of the ILO survey were related to labour legislation and skills of the labour force; these are:

1. Lack of skilled local workforce (difficult to recruit the right people)
2. Omanization laws (compulsory to hire locals, difficult to meet targets)
3. Labour legislation (new minimum wage, sponsorship for expatriates)
4. Education and training system (current system does not meet businesses requirements, poor system).

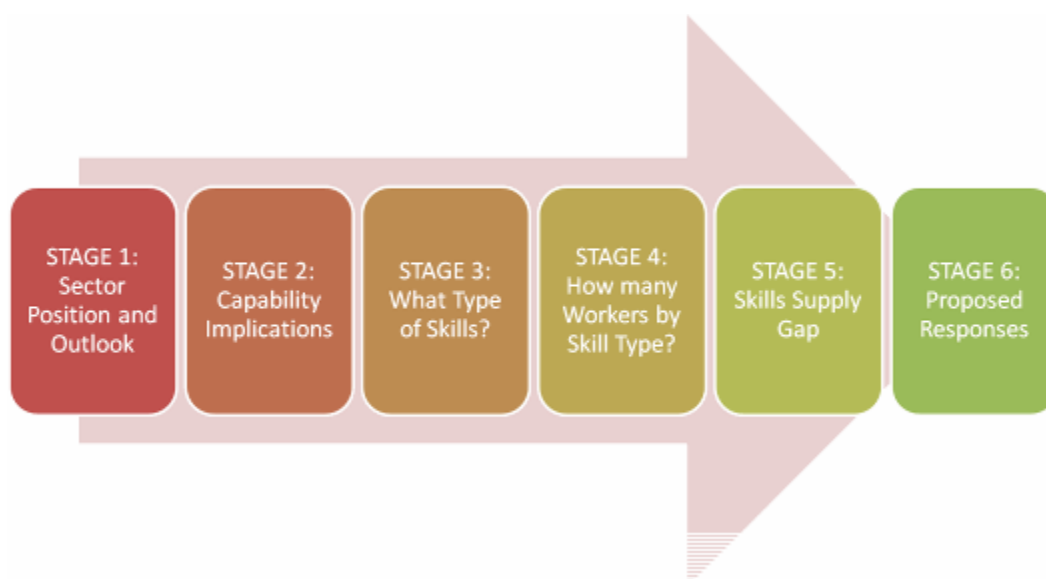
The above-mentioned issues constitute major constraints for the success of economic diversification. There is a need that the government and private sector agree, through consultations, on common grounds with regard these issues, which are a prerequisite for enhancing economic diversification. Labour legislation and education and skills development programs need to be therefore revised within the context of the diversification strategy. Lessons learned from other resource-dependent countries confirm that investments in human capital have

⁵ ILO, The Sultanate of Oman, The enabling environment for sustainable enterprises: An "ESEE" Assessment, Geneva, 2011

been a major factor in developing high-tech industries in Indonesia and Malaysia and increasing exports⁶.

ILO has recently developed in this regard a methodology that provides strategic guidance for the integration of skills development into sectoral policies, particularly in selecting sectors that have the potential to increase exports, contribute to economic diversification and employment creation.

The methodology called: Skills for Trade and Economic Diversification (STED), consists of six stages⁷:



Stage 1: Identify the most promising sectors that have the potential to be competitive in the local and world market

Stage 2: Define the business capabilities firms need in order to achieve competitiveness: what capabilities firms need to develop in areas such as marketing, sales, logistics, product development, etc...

Stage 3: Identify the type of skills businesses need among their workers in order to develop their business capabilities as identified in stage 2

Stage 4: Identify the demand and supply of required skills

Stage 5: Identify critical gaps in skills

⁶ Akram Esanov, Revenue Watch Institute, Economic diversification in resource-dependent countries: its dynamics and policy issues, 2011

⁷ ILO, Skills for Trade and Economic Diversification (STED), www.ilo.org/STED

Stage 6: Formulate concrete recommendations at the policy, institutional and enterprise level to fill the gaps in skills

In the last stage, recommendations at the policy level include the introduction of possible changes in the labour market (and Omanization policies) and the development of specific training programs that meet the market needs. At the institutional level, recommendations cover the strengthening of relevant institutions in the provision of training programs, while at the enterprise level recommendations would include skills development such as on-the-job or in-house training.

VII. CREATING AN ENABLING BUSINESS ENVIRONMENT

Since diversification will be carried out mainly by the private sector, improving regulations and adopting measures to improve the business environment are essential for the implementation of the economic diversification strategy.

Oman's rank

Oman has continuously improved the business environment and took several steps to reduce the regulatory burdens on firms, simplifying regulations and procedures and reducing cost for doing business. According to the World Bank "Doing Business Index", Oman has improved significantly its overall doing business ranking from 114th in 2007 to 57th in 2010 and 47th in 2013 (total countries: 183), as compared to 22 ranking for Saudi Arabia, 26th for the United Arab Emirates and 82 for Kuwait. When reviewing the data on Starting a Business Index which measures all procedures required to start up and operate an enterprise, Oman is ranked 73th in 2013, performing better than Kuwait (142 ranking) and Saudi Arabia (78), but less than UAE (22)⁸.

When considering Small and medium enterprises, the findings indicate that, according to the survey conducted by ILO on a sample of 150 enterprises in 2011, the majority of respondents (70%) believe that the regulatory environment makes it difficult for small businesses to compete with large businesses. This is considered as one of the major reasons why young Omanis do not start a business.

Entrepreneurship

The other major constraint for starting a business is the lack of entrepreneurship. The development of entrepreneurial culture among young Omanis is a major prerequisite for starting a business. The reluctance of Omanis to start a business is due to the fact that they have a preference for waged employment and particularly for an employment in the public sector.

⁸ IFC and World Bank, Doing Business 2013, www.doingbusiness.org

About 33 per cent of firms of the sample of ILO survey consider this reason as the main factor, while 22 per cent believe that young Omanis lack of good business ideas. Other reasons given by respondents were the difficulties to deal with the authorities and the reluctance to take risks. Forty one per cent of respondents believe that young people in Oman have a positive or very positive attitude towards entrepreneurship. This is followed by 34 per cent of respondents who feel young people have a neutral attitude.

Oman has a number of initiatives to support entrepreneurs and the development of the private sector is acknowledged in the 8th Five Year Development Plan (2011-2015) as well as in the previous development plans. The respondents of the survey were almost divided about the existence of an adequate support for individuals looking to establish a business. There are no special programmes to promote entrepreneurial culture, in terms of developing creativity, risk taking, motivation, etc...

Governance

Quality of institutions can be considered as one of the major factors that may hinder or facilitate economic diversification. Oman achieved significant progress in building government institutions up to international standards. Good governance, fighting corruption, achieving transparency and effectiveness of government institutions are pre-requisites for a successful implementation of the economic diversification strategy.

International data indicate that overall, Oman achieved relatively satisfactory performance with respect to governance, though in its annual “Corruption Perceptions Index”, Transparency International ranked Oman 50th out of 180 countries in 2011, a noticeable decline from its 28th place ranking in 2005⁹. Oman’s ranking with regard a number of governance indices is in some cases better than UAE¹⁰:

- Government effectiveness 66th as compared to 78th for UAE
- Rule of law: 67th as compared to 65th for UAE
- Control of corruption: 61 as compared to 82 ranking for UAE
- Regulatory quality which reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development: same ranking for Oman an UAE (63rd)

⁹ Transparency International, Corruption Perceptions Index, www.transparency.org

¹⁰ World Bank, Worldwide Governance Indicators, 2012 Update, www.govindicators.com

VIII. RECOMMENDATIONS

Oman exerted serious efforts to diversify its economy during the past 20 years. Achievements today were not impressive despite that economic diversification was set as one of the objectives of the Vision 2020 (1996-2020). Little structural economic changes were recorded since 1996. In order to move to a diversified economy, Oman would need to:

1. Prepare and plan for the right economic diversification strategy through the mobilization of all relevant stakeholders from the public and private sector as well as the relevant civil society organizations. The stakeholders should be engaged in the formulation as well as the implementation of the strategy.
2. Establish a body or special unit that will be in charge of the diversification and coordinate the contribution of all relevant stakeholders to the implementation of the strategy. A monitoring and evaluation system is to be devised to track the progress made and difficulties encountered, and to ensure the objectives and outputs of the strategy are implemented effectively and efficiently.
3. Integrate skill development into the diversification strategy by developing skills in high priority sectors as identified in the strategy
4. Improve business environment and enhance the quality of government institutions through achieving good governance, transparency and effectiveness, which are pre-requisites for a successful implementation of the economic diversification strategy.
5. Give particular attention to the promotion of entrepreneurship at all levels of the education system and vocational schools, in order to provide youth Omanis with the motivation and entrepreneurial skills (creativity, risk taking, etc...) to start a business instead of looking for a secure employment in the public sector.