

Executive Summary

White Elephants on Quicksand: Low Oil Prices and High Geopolitical Risk

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In “White Elephants on Quicksand: Low Oil Prices and High Geopolitical Risk,” authors Hany Abdel-Latif and Mahmoud El-Gamal critically analyze an oft-held assumption promoted by wealthy Arab Gulf states and their less wealthy neighbors: namely, that investment in construction “mega-projects” will achieve its desired effect of economic growth, including diversification of oil exporters’ national economies and weaning said economies away from dependence on oil exports. They reach the conclusion that this strategy is unlikely to succeed through a quantitative study examining how heightened geopolitical risk, coupled with lower oil prices, hampers the economic potential of these “white elephant” projects. Grandiose “Vision 2030” plans by Gulf monarchies and their neighbors, which have been secondary beneficiaries of petrodollar flows through investment and worker remittances, are thus misguided efforts to save their nations from the inescapable “quicksand” that is their all-too-heavy reliance on fossil fuels.

One possible alternative suggested by the authors’ analysis lies in the maxim of “differentiation in industrial policies with an eye to regional economic integration.” Repeated attempts at economic diversification in the region have failed because they have been limited to individual national scopes without coordination with neighboring countries. Worse yet, many industrial policies have aimed to replicate, and thus compete with, success stories in neighboring countries, which diminish returns on all national investment. The region remains as disintegrated economically, in terms of intraregional trade, as it was when economists argued for greater integration a quarter-century ago.

The authors argue that regional countries’ massive projects, following the dream that “if you build it, they [foreign direct investors] will come” have failed because the global decline in oil prices since 2014 has made cheap capital in the region more scarce, which has, in turn, eliminated international investors’ primary incentive to invest in the region, despite its lack of stability and rule of law. In particular, Arab Gulf states have pursued stand-alone building projects instead of responding to the negative effects of low oil prices by making longer-term investments in human capital and working to bolster regional trade. Ultimately, the authors underscore that as “the golden age of oil has passed,” oil exporting nations are recognizing the salient need for economic diversification. In the case of many wealthy Arab Gulf states such as Saudi Arabia and the United Arab Emirates, however, the convergence of low oil prices and political risk that besets them means that economic diversification calls for much more than intra-nation construction ventures (Qatar is slightly different in the short to medium term, as its wealth is based in natural gas, but the longer term problems are identical).

While such national ventures might seem appealing on paper in national strategic plans, they are often superfluous and do not facilitate the broader economic

integration of these nations into the region and the world. An alternative vision would be a coordinated regional industrial policy that aims to replicate some features of the “flying geese” phenomenon of East Asia during the 1980s and 1990s. Technological leaders like Israel, together with strategic regional investment of regional capital, can play a modified version of Japan’s role in Asian success. Laggard nations learn to fly first by trading with other countries in the region, until economies of scale and competitiveness levels allow them to compete more effectively in global markets. In this scenario, investments in regional country A are coupled with the initial security of exporting products to regional country B, and vice versa. The flock may thus attempt to fly to greater heights together, instead of each undercutting the competitive advantage of others by trying to leapfrog in their misguided race for foreign direct investment—thereby attracting the worst forms of the latter, which seek merely to exploit the region’s cheap capital and market inefficiencies for short-term gain, leaving the region worse off in the long run.