Summary

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Spotlight: Aligning Fiscal Policy with Economic Growth **9 May**

Key points

- Fiscal discipline and economic growth can work together provided the impact of consolidation is compensated for by investment, especially in new areas.
- Finance ministries are realising they need to go beyond thinking about funding to becoming solutions ministries.
- While growth is nearly always important, engineering reforms and saving in the right periods are critical for long-term growth.
- Governments can't necessarily take risks with money but can create an ecosystem making it easier to invest.
- Diversification, with its push to increase non-oil income, reflects the GCC's orientation towards the future.

Synopsis

The GCC region is undergoing significant change, oriented towards the future. How can policy-makers make both fiscal policy and economic growth work?

Fiscal discipline and growth can work together provided consolidation is compensated for by investment. This should come not just from finance and foreign direct investment, but especially in new areas. Lessons are being learned from the past. "If you look at the region, it's quite impressive – the vision, the foresight by the authorities and the attention they give to promote diversification to create the engines for long-term growth. Bahrain and the region are moving in the right direction," said Michèle Lamarche, Global Head of Sovereign Advisory, Lazard Frères, France. Bahrain looked at all projects, removed the bottlenecks with the ministers, and put together a set of plans worth $32 billion for execution over seven years. This effort is creating non-oil economic growth. H.E. Shaikh Ahmed bin Mohammed Al Khalifa, Minister of Finance of Bahrain, described the three-phase approach. First, the $32 billion in investments will help update industries. Second, work will go into ensuring the country's laws meet best practice, including those regarding bankruptcy. Third, emphasis will be placed on jobs and creating a competitive environment in which workers keep the economy moving ahead.

In fact, finance ministries are realising they need to go beyond just thinking about funding to becoming solutions ministries. The opportunity lies in other sectors, such as healthcare and social services. "It's a new world, an interesting challenge and hard work," bin Mohammed Al Khalifa added. Governments can't necessarily take risks with money but can create an ecosystem making it easier to invest, as part of their increasing role as regulators versus operators. The government of Kuwait in particular is an enabler by giving the private sector more room. Governments are also exiting sectors they were managing less inefficiently as operators. Some of these sectors, such as telecoms, have among the highest internal rates of return opportunities for investors. For sovereign funds, governments must ensure they avoid crowding out the private sector; having members on the boards who are from the private and public sectors can greatly help. The policy of emphasising growth by solely increasing spending on investment is not sustainable, as evidenced by the 2008 financial crisis. "It affects indebtedness and the future generations that may be faced with the debt," noted H.E. Mohammed Boussaid, Minister of Finance and Economy of Morocco.

While growth is nearly always important, engineering reforms and saving at the right time are critical for long-term growth. In fact, "history has shown the problems are always the same," said Lamarche. It is essential to take advantage of the periods when it's possible to save and create funds, to be prepared to start difficult reforms when needed. "It's a recipe for the authorities to have a vision, understanding the long-term engines of growth, and to move during the good times so that you can resist downturns much better," she added.

A focus on expenditures and even value-added tax (VAT) are also part of the equation. Becoming more efficient means looking at margins. In addition, a policy of subsidising may be useless because a low-income and a high-income citizen benefit differently. "We need to get the subsidy to those who need it," said Boussaid. A GCC agreement to introduce VAT is meeting some resistance, given government overspending. "To convince the legislative body, we have to show we've looked at expenses. It's a debate that can occur anywhere," said H.E. Dr Nayef F. Alhajraf, Minister of Finance of Kuwait. However, looking beyond taxation and at having good education and medical services is indispensable. "Are we teaching [students] the right skills?" asked bin Mohammed Al Khalifa.

Diversification, with its push to increase non-oil income, reflects the GCC's orientation towards the future. Diversifying the economy in Morocco, for example, meant developing sectors that could be competitive, such as agriculture. Now, the country's automotive sector is important for exports. The diversification efforts in Bahrain from 2002 to 2016 in non-oil sectors led to GDP growth of 7.5% per year over a decade and a half. Currently, "three-quarters of economic activity is unrelated to oil," said H.E. Shaikh Salman bin Khalifa Al Khalifa, General Director, First Deputy Prime Minister's Office, Bahrain.

The overall situation clearly represents an opportunity for Bahrain and most GCC countries – the opportunity to identify alternative sources of revenues, question the quality of expenditures and, above all, drive the region's long-term development.

Session panellists
H.E. Shaikh Salman bin Khalifa Al Khalifa, General Director, First Deputy Prime Minister's Office, Bahrain
H.E. Dr Nayef F. Alhajraf, Minister of Finance, Kuwait
H.E. Mohammed Boussaid, Minister of Finance and Economy, Morocco
Michèle Lamarche, Global Head of Sovereign Advisory, Lazard Frères, France
H.E. Shaikh Ahmed bin Mohammed Al Khalifa, Minister of Finance, Bahrain

Moderator: **Nik Gowing**, Professor, Broadcaster and Journalist, United Kingdom

Disclosures
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