Productivity growth, diversification, and structural change in the Arab States

Oman Country Profile

1. Introduction

This country snapshot provides a historical overview of Oman's labor productivity trends compared with other GCC economies and the global economy.[1] In addition to highlighting the position of Oman relative to its peers in the GCC and global frontiers in terms of labour productivity, this snapshot documents the trends in labour productivity and multifactor productivity growth and the relative contributions of labour productivity and employment growth to aggregate output growth. The structure of an economy plays a critical role in determining a country's productivity trends, both due to technological change and productivity growth within industries, and the potential for enhancing productivity by shifting resources to more productive uses. Therefore, this country profile also examines the evolution of the structure of Oman's economy, in terms of industry composition of employment and output compared to the GCC average. Finally, a few recommendations for future productivity improvement in the country are derived based on the existing evidence on long-term productivity trends and current economic circumstances.

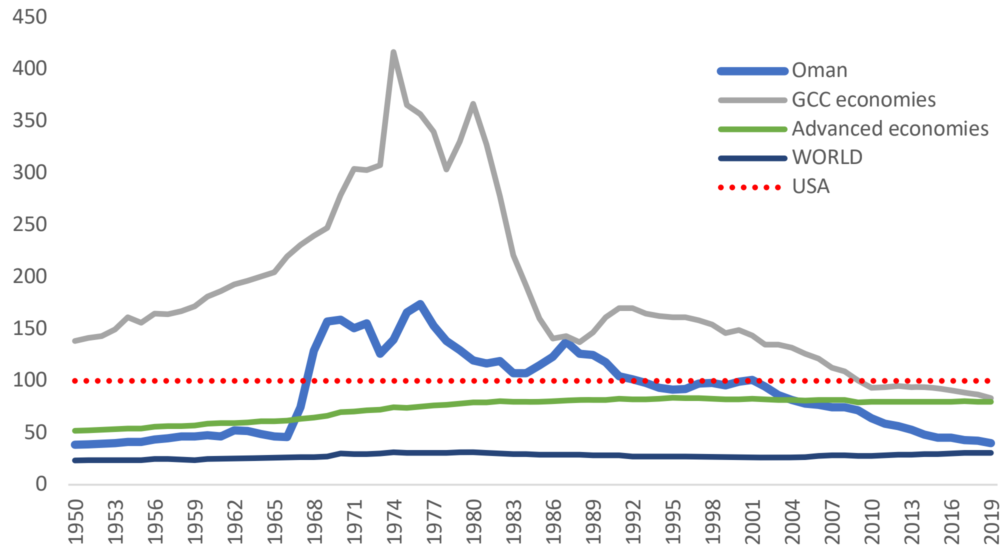
2. Relative Labour Productivity levels

Relative labour productivity levels (i.e., the output per worker in a country relative to a frontier country that is technologically advancing faster) are indicative of a country's productivity catch-up with the global frontier. Figure 1 shows the levels of Oman's labour productivity (output per worker) relative to the United States.[2] In Oman, relative productivity levels were somewhat stable until the mid-1960s and were far below the levels in the GCC, the US, and even lower than the advanced economies average. Although it bypassed the advanced economies levels and even went above the US levels during the 1970s through the early 1990s, it generally stayed below the GCC average. The high productivity levels in the GCC were primarily a reflection of the high oil rent received in GCC's large oil-rich economies' highly capital-intensive oil sector. By the early 2000s, Oman's productivity levels fell below that of the US, and at around the time of global financial crisis, it fell even below the advanced economies' average. Since the early 2000s, Oman has witnessed a continuous fall in productivity levels, following an already falling trend in the GCC since the early 1990s. The decline was so persistent that productivity levels fell below the US level, and since the global financial crisis, it has gone further below the advanced economies' average. By 2019, with its steep productivity loss, Oman's productivity seems to be converging closely to the global average, which includes several emerging and developing economies, thus falling far below the global frontiers. The GCC, in general, and Oman, in particular, appear to be diverging from the global productivity frontiers, widening the negative productivity gap further.

1 In this snapshot, when we refer to the Arab states, it consists of six GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) and six non-GCC Arab countries (Iraq, Jordan, Lebanon, the occupied Palestinian territory, the Syrian Arab Republic, and Yemen). The global economy is an average of 132 countries covered in The Conference Board Total Economy Database.

2 Relative labour productivity level is measured as the amount of output an average worker in Oman produces in a year, compared to the amount of output an average worker produces in the United States.

▶**Figure 1: Relative Levels of labour Productivity (US=100)**



Note: Labour productivity levels are calculated in purchasing power parity terms for individual economies as GDP per worker and are expressed as a percentage of productivity level in the United States. For the list of countries used to obtain the aggregates of World, and Advanced economies, please see Appendix Table 4 in ILO (2022) [3]. GCC economies consists of Bahrain, Kuwait, Oman, Qatar, Saudi and The United Arab Emirates.

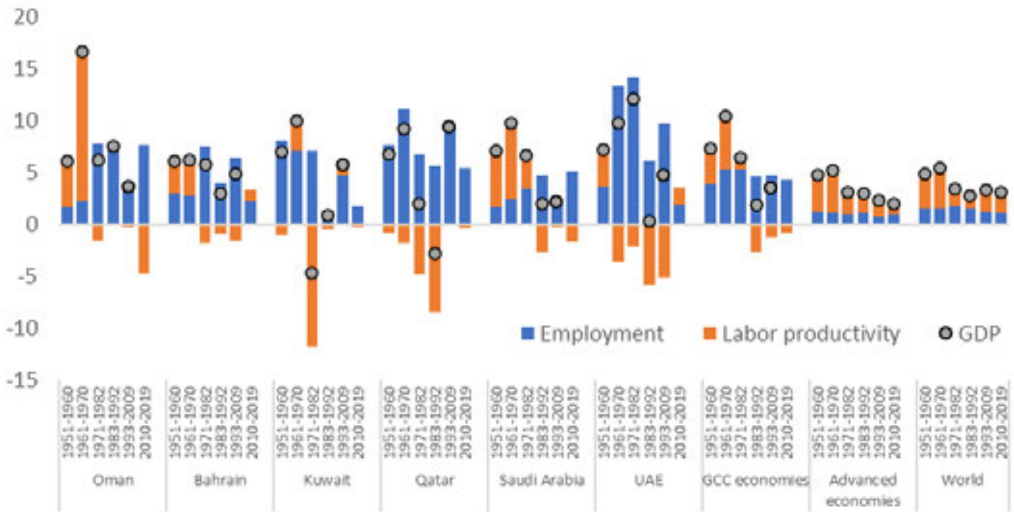
Source: The Conference Board Total Economy Database, April 2021.

▶ 3. Labour Productivity growth: Labour productivity vs. Employment

The output of an economy can be increased by adding more workers, increasing working hours, or raising worker productivity. The fall in relative productivity levels in GCC, in general, and Oman, in particular, was partly due to relatively faster productivity gains in the US but more due to consistent deceleration in Oman and the GCC. In most GCC economies, productivity growth has hardly been positive since the 1970s. On average, all GCC economies had a negative productivity growth during the last fifty years. A few exceptions were in Oman from 1983 to 1992 and Kuwait during its post-war reconstruction period. More recently, Bahrain and the UAE have been showing some recovery and catch-up. At the same time, Oman remains the worst-hit country in the region, with its average output per worker shrinking by nearly 5 percent per year in the last decade.

3 ILO (2022), "Productivity growth, diversification and structural change in the Arab States", https://www.ilo.org/actemp/publications/WCMS_840588/lang--en/index.htm

▶ **Figure 2. Contribution of labour productivity growth and employment growth to GDP growth**



Notes: All growth rates are calculated as log changes. Regional growth rates are a weighted average of individual countries, using nominal value added weights. For other notes, please see Figure 1.

Source: The Conference Board Total Economy Database, April 2021.

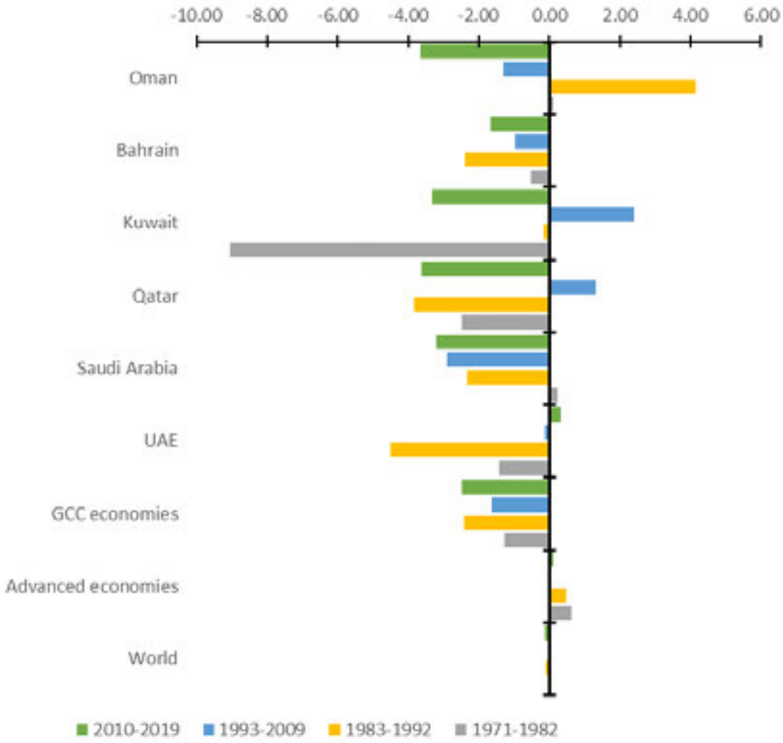
In contrast to the global economy average, where economic growth was mainly driven by improvements in productivity, the GCC countries, including Oman, seem to have relied more on employment to sustain their growth, especially since the 1970s. The compromise on productivity, and the over-reliance on job creation to attain economic growth, is more prominent in Oman compared to other GCC economies in the most recent decade.

▶ 4. Multifactor productivity growth

Multi-factor productivity (MFP) growth is an important indicator of technological change and overall efficiency improvement.[4] MFP growth has been negative throughout the last 50 years in the GCC across the board. Interestingly, Oman was an exception in the 1980s, during which its MFP growth was positive, even while the labour productivity growth was not improving. This indicates the country's poor performance in enhancing capital investment intensity of production. Moreover, it has lost that MFP steam since the 1990s. During the last decade, only UAE had a minor positive MFP growth in the entire GCC, whereas the adverse trend in MFP continued in all other countries, including Oman. The productivity trends in the GCC are a story of poverty amid plenty - these countries do have the capital to invest in productivity-enhancing technologies. However, several institutional and organizational backwardness contributes to their weaknesses in doing so.

4 MFP is generally measured as a residual after allocating output growth accrued due to the accumulation of factor inputs (e.g., labour and capital) to input growth. A multitude of factors, including technology and innovation, macroeconomic and business climate, market conditions, and institutional factors, can influence changes in MFP.

▶ **Figure 3. Multifactor productivity growth**



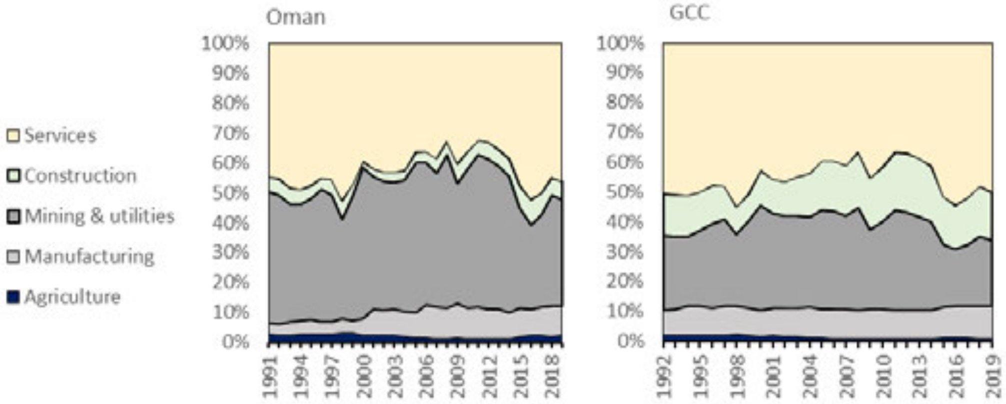
Notes: Multi-factor productivity growth rates are calculated using a growth accounting equation as a residual after accounting for the contributions of capital and labour inputs to GDP growth. For other notes, please see Figure 1.

Source: The Conference Board Total Economy Database, April 2021.

▶ 5. Industry composition of employment and output

Enhancing productivity growth and levels can be achieved by moving workers to high value-added and more productive sectors of the economy, such as manufacturing. For the GCC economies, gaining from structural transformation would require diversifying resources away from the oil sector to the non-oil sector and creating productive jobs in the non-oil economy, particularly in the private sector. In Oman, the manufacturing sector generates 10 percent of the national GDP and creates less than 4 percent of all jobs. While the output share of the sector expanded about three times over the last three decades, the employment share increased by just above two times from 1991. The mining and utilities sector, which produces more than one-third of total output, creates less than 7 percent of total jobs - indeed quite higher than the manufacturing sector. But the jobs in the mining and utilities sector expanded only less than two times. In contrast, the job share of the construction sector, which slightly expanded its output share over the three decades, has increased by about 12 times - thus becoming one of the highest employed sectors, driving productivity down. The service sector also employs proportionately more workers than output, possibly due to the large government sector. The employment expansion in the construction and mining & utility sectors was higher than the output expansion, which might be contributing to the continued productivity erosion in the economy. The dynamics in the GCC were not any different, with manufacturing seeing very limited expansion in both output and employment, whereas jobs expanded more rapidly in the mining & utilities sector. Clearly, an important constraint for the region in general, and Oman in particular, is in diversifying their economic activities and creating more jobs in the productive sectors of the economy

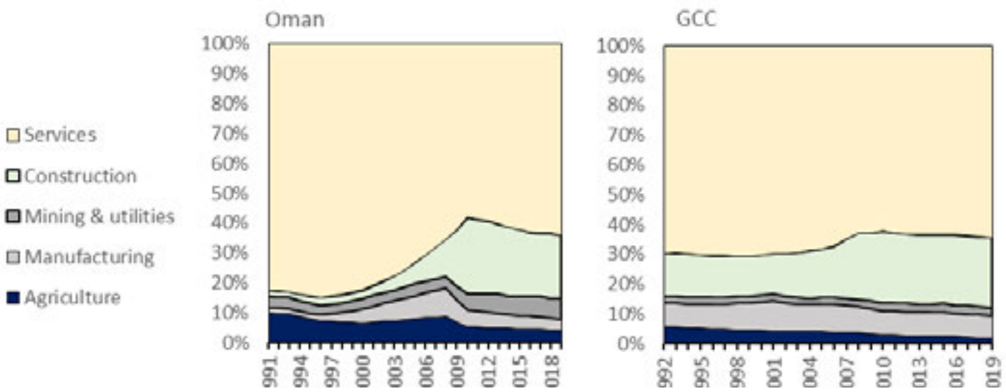
▶Figure 4: Output share of industries



Note: See Figure 1.

Source: UNNAS, ILOSTAT.

▶ Figure 5: Employment share of industries



Note: See Figure 1.
Source: UNNAS, ILOSTAT.

Recommendations

Investing in technologies, and diversifying the economy

- Being a country that has lost its productivity steam the most in the GCC, Oman needs a turnaround in its continuously worsening productivity trends.
- Two critical factors for Oman that could help improve productivity, as in other GCC economies, are to increase investment in modern and clean technologies and accelerate diversification and structural change.

Addressing the issues of a dual labour market

- Creating productive jobs for nationals while recognizing the dual structure of the labor market that features the co-existence of an expensive native workforce and cheaper expatriate workers is a significant challenge for the country.
- Addressing this challenge without compromising productivity would require creating a more competitive job market, where workers are incentivized to work in the private sector.
- Government should recognize the needs of the private sector while devising policies to create productive employment for the native population, as direct substitution of expatriate workers with natives may lead to a loss of competitiveness of private sector firms.
- The continued efforts to diversify the economy to absorb new entrants to the labour market, creating productive jobs for them by fostering private sector investment, would help improve productivity.

Education and skills policies

- Investing in knowledge capital, skills development, and information and communication technologies to improve productivity are essential.
- This would also require increased attention to re-skilling the native population to match their skills with the needs of the private sector.
- Increased engagement between the private sector, governments, policymakers, business organizations, and educational and VET institutions in stimulating a better-coordinated investment atmosphere is important for the private sector to develop productivity-oriented business strategies.
- While realizing the country's several challenges, private businesses in Oman can also focus on improving their productivity by upgrading business strategies, improving management practices, and engaging with government in devising policies that stimulate a better investment climate.

Sectoral policies

- Government may need to initiate policy reforms after consulting social partners to improve the business climate and reallocate resources to the most productive sectors of the economy.
- The potential for the manufacturing sector needs to be realized, particularly with an export orientation.

Trade and regional integration

- Given the small size of individual economies in the GCC, including Oman, stronger integration of the region would be helpful for all countries. Therefore, attempts to integrate the region's economies into a single market might incentivize private sector enterprises to seize economies of scale and raise productivity.

Supporting gender equality and women in business and management

- As women entrepreneurship and women-led enterprises could be further developed in Oman, measures through skills development, businesswomen network development, entrepreneurial educational and mentorship programmes as well tackling social norms and cultural barriers are needed and can contribute to the diversification process.

Management practices

- Upgrade management practices and production processes for the transition towards a net zero carbon emissions economy and focus on resource efficiency.

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