



**Gulf Research Centre Cambridge**  
Knowledge for All

Workshop 10

## **A Debate on Economic Sustainability: In the GCC and Elsewhere**

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### **Abstract**

We constantly use the concept of economic sustainability and link it to diversification, but the meaning of both is not clearly defined. What is the meaning of economic sustainability? As technology and the availability of goods and services constantly evolve, no economy is sustainable in a stationary state. Economic logic rather favors specialization than diversification. Is GDP per capita or GNI per national the correct measure of success? How income distribution impacts sustainability? Do we measure diversification with respect to GDP, exports or government revenue? Or more sophisticated measures based on input-output tables or the products' space? How about backward and forward linkages? The workshop aims at debating all of the above and hopefully clarifying ideas.

## Description and Rationale

### Economic sustainability: measurement and success

What is the meaning of economic sustainability? As technology and the availability of goods and services constantly evolve, no economy is sustainable in a stationary state. Every economy, enterprise, individual needs to constantly evolve and adapt to changing circumstances. What is sustainable today may not be tomorrow: in the debate about sustainability a concept of adaptability is implicit. As we cannot predict the future, and economies are constantly subjected to unforeseen shocks, we do not know what might be sustainable tomorrow, and for how long.

We may know what is not sustainable. Current trends may be clearly unsustainable if extrapolated into the future: this is especially the case with respect to environmental impact and some socio-economic trends such as rising inequalities and poverty. Thus one way to discuss sustainability is to point to aspects, which are clearly unsustainable. All economies display traits that are unsustainable, the question is whether they can be corrected on time before they cause excessive costs (it is very likely that some costs will need to be borne anyhow, before issues are corrected; the question is: what type of costs and how large can they be, before they become acutely “unsustainable”?)

Adaptability is a function of many things. One is tempted to say that it is primarily a function of the ability to identify unsustainable trends early on, and correct them before very large costs are incurred. But this is not easy to measure or discuss with social sciences methods, particularly as a temporal consideration implies uncertainty.

Adaptability is also deemed to be a function of diversification. Per se, economic logic rather favors specialization than diversification – each individual or enterprise should concentrate on what he/she/it can do best, his/her/its comparative advantage. The increasing importance of global value chains for development emphasizes this economic logic, by moving competition from entire sectors to single stages of production, and even individual jobs.

However changing circumstances (movements in terms of trade) can be unfavorable for the given specialization. Economic history provides several examples of the rapid demise of specific industries due to technological progress or exhaustion of natural resources. In some cases economic actors whose specialization has been challenged have successfully reinvented themselves, adapting more or less radically to a new specialization; in other cases this has not succeeded and economic actors have decayed and disappeared. This is the daily reality of Schumpeter’s creative destruction.

At the level of sovereign countries, however, creative destruction is not considered a beneficial phenomenon. Countries are expected to continuously prosper in line with the rest of the world, preferably in a context of progressively narrowing distances in income per capita. If we were to define success in sustainability by the relative dynamic in average income per capita, then undoubtedly the major oil exporters have been extremely successful over the past fifty years, especially if income is defined as GNI, and “capita” are nationals only. Doubts about sustainability must then be understood with respect to the possibility that this trend might be reversed in the future.

However, GNI per capita may no longer be a valid metric, as income inequalities between nations have been closing (the so-called 'great convergence') while those within nations have been growing rapidly. This phenomenon was observed worldwide, and in commodity exporting countries alike.

So is average GNI per national the right measure of success? Unlikely. Is not a concept of disposable income more relevant? How relevant is income distribution? What about participation in the labor force and employment? All of these seem to be relevant aspects of sustainability of an economy in the long run. In other words, we may need to shift from a purely economic to a realistic socio-political concept of sustainability. This however entails a considerable degree of subjectivism, as the tolerance of societies and polities for concentration of income and wealth, or exclusion from meaningful employment, is extremely variable. It shows the need to revalue local contexts to balance the now predominant large-N quantitative analyses.

Sustainability therefore is a multidimensional concept, which does not tolerate a simple measure. Attempts to narrow down the notion of economic sustainability inevitably create excessive simplification and are not useful. The specific dimensions of sustainability have varying importance in different contexts. It is a historical fact that some societies tolerate higher income and wealth concentration, or even absolute deprivation, than others. It is also a fact that similar levels of official debt to GDP ratios or government fiscal deficit have different impact in the perception of sustainability of different economies. Can we find measures of sustainability that are universally valid? Does it make sense to aim at establishing a sustainability index? (The Bertelsmann Stiftung has launched a Sustainable Development Goals Index; the SDGs themselves are a collection of motherhood statements unless they are weighted and prioritized).

## Diversification

Coming back to diversification, this is by far the most commonly referred to metric for sustainability. There are three main indicators of diversification that are frequently referred to:

1. Share of main industry/product group on total value added (GDP)
2. Share of main industry/product group on total exports
3. Share of main industry/product group on total income received by the government

These are obviously by no means the same. Each of the three measures has good rationale, but they do not necessarily converge, nor have univocal meaning.

The problem with measuring diversification with respect to composition of GDP is that the latter is measured in current prices, and is therefore a function of changing terms of trade as much as, or more than, of the prosperity of each individual industry. Hence decreasing diversification may be the outcome of improving terms of trade of the leading industry, itself a manifestation of its growing competitive advantage rather than the opposite.

The problem with measuring diversification with respect to composition of exports is that it should at least be set against the degree of openness of an economy, i.e. share of total exports and imports on GDP, and of the balance of trade (a country with a large trade surplus is presumably in a better position to withstand a decline in the demand for its main export product).

The problem with focusing on fiscal revenue is that countries do not normally balance their budgets; have very different rigidities on the expenditure side (state employment? subsidies? weapons? capital expenditure?), and very different potential for substituting one source of revenue with another one. Furthermore, new sources of revenue are only developed when needed: it is very difficult to increase taxation or reduce expenditure when revenue is pouring in in abundance, simply on the basis of the assumption that sooner or later (when?) this may change and one should be prepared. While theoretically often favorable, such measures are practically too controversial on political and social grounds to be implemented (whether in commodity exporting countries or so-called 'diversified economies').

More sophisticated attempts to measure diversification are based on input-output tables (how closely intertwined are the different sectors in the economy? or are most

intermediate cells simply empty?) or on Hausmann's and co. products space ("similarity" of sectors).

Measures of diversification are also deeply dependent on classification: what is our unit of observation? Inevitably, we use standard existing statistical classifications such as SITC. But not only there is profound difference in measuring diversification at one, two, three or more digit level; at each level, groupings display much different diversity in each group. "Passengers vehicles" is obviously a much more diverse lot than "petroleum distillates". Much statistical analysis of the resource course is conducted on the basis of a "primary" or "mineral products" category; with no attention to whether there is one main mineral or several, and what characteristics they have.

Diversification is also a function of the stage considered in the value added chain. Oil production may be considered a uniform activity, but moving upwards or downwards from oil production in the value chain increases diversification very significantly. Already oil refining is a significant step in moving from a single to multiple different products; in any case moving further into basic and even more secondary petrochemicals adds formidable diversification in terms of technology, products, markets etc. Stating that moving from the production of crude oil to the production of paints or pharmaceuticals from methanol is no diversification because "when oil will run out" it won't be able to continue is rather ludicrous. Most industrial plants are not supposed to have a productive life of more than twenty-thirty years (or, in fact, less) and oil will not run out anytime soon.

## **Anticipated Participants**

It seems therefore imperative to move beyond simple statements and broad generalizations, and engage in a rigorous debate to better define economic diversification and sustainability.

The workshop is designed to attract a significant number of critical scholars willing to engage in this difficult debate and help define economic sustainability. Entries can be either theoretical, or case studies of an individual country set against the theoretical discussion, or finally comparative analyses of several cases. Explorations of individual dimensions of sustainability in historical and comparative perspective would also be welcome.

Papers on the role of specific sectors e.g. education or financial intermediation, for the sustainability (adaptability) of an economy may also be relevant.

While the workshop is part of the GRM, our interest does not focus exclusively on the Gulf countries. Reference to other regions, notably Southeast Asia, Africa, Latin America or Russia, is also interesting, especially if some comparison with the case of the Gulf countries is established.

## **Workshop Director Profiles**

**Prof. Giacomo Luciani** leads the Master in International Energy at the Paris School of International Affairs, Sciences Po; and is adjunct professor of interdisciplinary studies at the Graduate Institute of International and Development Studies in Geneva. In 2010-13 he was Princeton Global Scholar at the Woodrow Wilson School of Public and International Affairs and the Department of Near Eastern Studies. His work has focused on the political economy of the Middle East and North Africa, and the economic development of the Gulf countries. With Hazem Beblawi, he edited a book on “The Rentier State” (1987), which is frequently cited as one of the origins of the concept. More recently, he edited “Resources Blessed: Diversification and the Gulf Development Model”. His latest edited book, “Combining Economic and Political Development”, discusses economic policies to support democratic transitions and address popular expectations.

**Tom Moerenhout** is a researcher at the Graduate Institute for International and Development Studies in Geneva, Switzerland. He has worked as visiting scholar at Columbia University’s Political Sciences Department and Center on Global Energy Policy (2015-2016), and as Saudi-Aramco fellow at the Oxford Institute for Energy Studies (2016-2017). Professionally, Tom has worked for the Global Subsidies Initiative of the International Institute for Sustainable Development since 2010. Most recently, he has contributed to in-country energy subsidy reform programs in Egypt, Iraq, Iraqi Kurdistan and India. He has cooperated with various organizations such as World Bank (ESMAP), OECD, OPEC, UNEP and IRENA. His research is predominantly on the political economy of subsidy and taxation reforms in a context of sustainable development and with an emphasis on energy. At the moment, Tom’s research is on (1) a large comparative analysis of energy subsidy reform episodes, (2) perceptions on taxation and (gasoline) subsidy reform in Nigeria (for the Tax Commission of the Nigerian Economic Summit Group), and (3) commercial and industrial interests in the context of electricity pricing reform in Uttar Pradesh, India.

## **Selected Readings**

To come