

## Food Security Strategies in the Arabian Gulf Region

*Nadim Khouri, et al.\**

Arab Gulf countries are heavily dependent on food imports. This dependency is expected to continue to rise as a result of rapidly growing populations, improving living conditions, sustained economic/industrial development and depleting natural resources. Moreover, climate change is expected to have a major effect on the region.

To meet their food needs, Gulf countries must rely on international markets, which makes them vulnerable to the vagaries of global food production, trade policies and commodity prices. This is exemplified by the food crisis of 2007/2008, which led Arab Gulf countries to adopt strategies that include building up national strategic food reserves, scaling up subsidies, and acquiring land abroad for agricultural investments through bilateral deals. These measures may have some drawbacks in the longer term; e.g., prices remaining volatile, socio-economic disturbances impacting land deals, trade being affected by international events or conflicts, etc. What is needed is perhaps a multi-pronged food security strategy that builds on elements

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\* This paper was prepared by a joint ESCWA–IFPRI team composed of Vito Intini (Team Leader), Clemens Breisinger, Ivana Brnovic, Fidele Byiringiro, Olivier Ecker, and Kenneth Iversen, under the overall guidance and leadership of Nadim Khouri. Michelle Battat (FAO) and Arani Kajenthira (Harvard Kennedy School) provided valuable advice and insightful contributions.

of the above measures while integrating them in a GCC-wide approach. The analysis contained in this paper leads into a number of promising strategic directions including: (i) assessing the pros and cons of building a regional food reserve to reduce the risk of market disruptions; (ii) investigating challenges and opportunities for a region-wide procurement system based on innovative financial instruments; (iii) consolidating agricultural R&D systems and enhancing their impact; and (iv) achieving more efficient water use through assessing water footprint of production, consumption, and trade patterns.

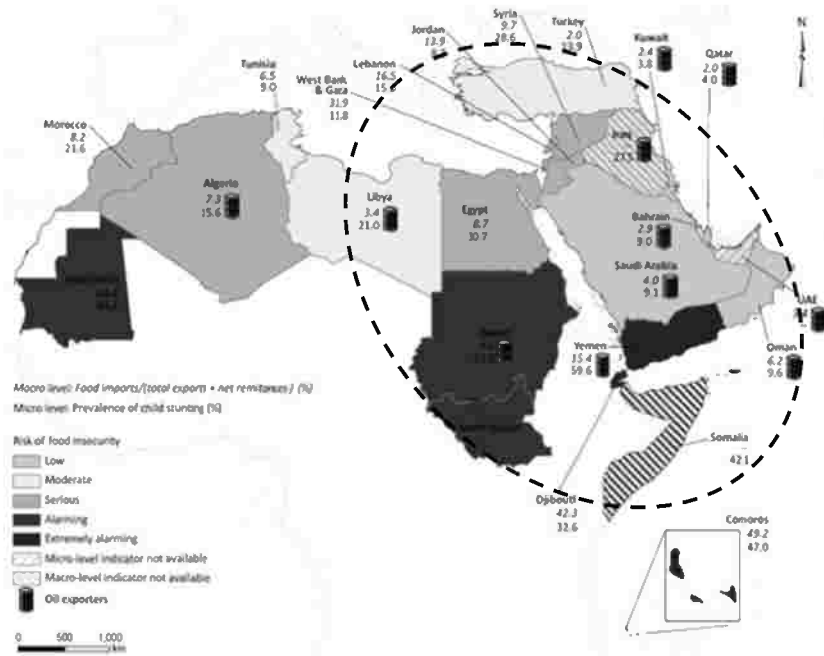
Other crucial elements of a comprehensive food security strategy not specifically addressed in this paper are: the analysis of food subsidy and social protection reform options; promoting comprehensive agricultural and economic development in the areas where comparative advantages lie; and encouraging changes in consumption preferences and nutrition patterns. In addition, given GCC countries' reliance on food production from (often developing) countries with large agricultural potential, smart and cost-effective strategies should be examined on how GCC countries can best engage with such countries.

### *Background*

At a first glance, the Arab Gulf states<sup>1</sup> do not seem to have major food security problems. A recent food policy report produced by the International Food Policy Research Institute (IFPRI) classifies them all as countries with a low risk of food insecurity in comparison to the rest of the region (Figure 8.1).<sup>2</sup> This is because all GCC countries show a relatively strong export performance (especially in terms of oil) compared to the demand for food imports, high and growing per capita incomes, and relatively low levels of malnutrition in the international comparison.

However, when looking behind the aggregate numbers, GCC countries are affected by some "vulnerabilities," especially in a more volatile world, including high levels of food import dependency and a low share of agricultural production.

**Figure 8.1**  
**Food Security in the Arab World and Turkey**



Source: Breisinger, et al., 2012.

Total regional consumption of main food produce such as staples, fruits and vegetables (F&V), meat, eggs, fish, dairy, sugar, and oil has regularly increased from less than 31 million metric tons (mt) in the period 2000–2005 to about 35.5 million mt in 2008, with the share of consumption of cereals hovering at around 44 percent of total GCC food consumption,<sup>3</sup> compared to 26 percent of F&V, and 14 percent of dairy products.<sup>4</sup>

Wheat and rice dominate within the region's cereal consumption patterns.<sup>5</sup> Self-sufficiency ratios are higher in the meat, dairy, and F&V sectors, which also tend to be characterized by less volatile markets.

**Table 8.1**  
**GCC Food Balance in 2008**

|                        | SSR<br>(%)  | Available<br>to<br>consume | Balance         |                 | Imports         |                 | Exports        |                | Produc-<br>tion |
|------------------------|-------------|----------------------------|-----------------|-----------------|-----------------|-----------------|----------------|----------------|-----------------|
| ITEM                   |             | Qty                        | Value           | Qty             | Value           | Qty             | Value          | Qty            | Qty             |
| Cereals<br>(total)     | 15.9        | 15,760.5                   | 3,940.4         | 13,251.3        | 4,082.1         | 13,798.8        | 141.7          | 547.6          | 2,509.3         |
| Wheat<br>and flour     | 59.2        | 3,358.5                    | 440.9           | 1,378.8         | 509.8           | 1,587.5         | 68.9           | 137.9          | 1,989.7         |
| Maize                  | 7.6         | 2,322.9                    | 537.4           | 2,147.3         | 541.3           | 2,162.2         | 3.9            | 14.9           | 175.6           |
| Rice                   | 0.0         | 2,270.8                    | 1,583.2         | 2,270.8         | 1,624.5         | 2,349.3         | 41.2           | 78.6           | 0.0             |
| Barley                 | 0.4         | 7,692.9                    | 1,392.3         | 7,662.7         | 1,394.9         | 7,675.9         | 2.6            | 13.2           | 30.2            |
| Potatoes               | 74.3        | 657.8                      | 66.3            | 169.1           | 82.1            | 224.8           | 15.8           | 55.7           | 488.8           |
| Pulses<br>(total)      | 1.7         | 127.9                      | 63.5            | 125.7           | 77.4            | 147.3           | 14.0           | 21.6           | 2.2             |
| Vegetables<br>(total)  | 70.3        | 4,869.3                    | 513.5           | 1,447.6         | 616.8           | 1,664.5         | 103.3          | 198.9          | 3,421.7         |
| Fruits<br>(total)      | 65.1        | 4,294.8                    | 924.9           | 1,500.8         | 1,089.7         | 1,852.0         | 164.8          | 351.3          | 2,794.0         |
| Sugar<br>(refined)     | 0.0         | 1,757.8                    | 624.5           | 1,757.8         | 1,172.9         | 2,859.4         | 548.4          | 1101.7         | 0.0             |
| Fats & oils<br>(total) | 0.4         | 495.7                      | 340.2           | 258.1           | 674.5           | 580.1           | 334.4          | 322.4          | 2.0             |
| Meat<br>(total)        | 44.4        | 1,933.9                    | 1,900.5         | 1,077.1         | 2,045.9         | 1,153.0         | 145.4          | 75.9           | 857.8           |
| Red meat               | 40.2        | 435.2                      | 740.5           | 260.4           | 786.0           | 285.1           | 45.4           | 24.7           | 174.8           |
| Poultry                | 45.5        | 1,498.7                    | 1,160.0         | 816.7           | 1,259.9         | 867.9           | 99.9           | 51.2           | 682.0           |
| Fish                   | 81.7        | 461.1                      | 145.4           | 84.2            | 430.3           | 202.6           | 284.9          | 118.4          | 376.9           |
| Eggs                   | 89.6        | 259.8                      | 92.4            | 27.0            | 130.4           | 59.9            | 38.1           | 32.9           | 232.8           |
| Milk &<br>dairy prod.  | 25.1        | 4,899.7                    | 1,788.6         | 3,669.8         | 2,392.4         | 5,052.6         | 603.8          | 1382.8         | 1,229.8         |
| <b>TOTAL</b>           | <b>33.5</b> | <b>35,518.3</b>            | <b>10,400.2</b> | <b>23,368.5</b> | <b>12,794.5</b> | <b>27,595.0</b> | <b>2,394.6</b> | <b>4,209.2</b> | <b>11,915.3</b> |

Notes: Qty (thousand mt); value (million USD); self-sufficiency ratio (SSR) is the ratio between domestic production and availability.

Source: staff calculations from Arab Organization for Agricultural Development, "Arab Agricultural Statistical Yearbook," 2009.

Agriculture accounts for only 1–2 percent of the overall GCC GDP and employs less than four percent of the active population in Kuwait and Qatar.<sup>6</sup> The following constraints affect the sector: (i) environmental

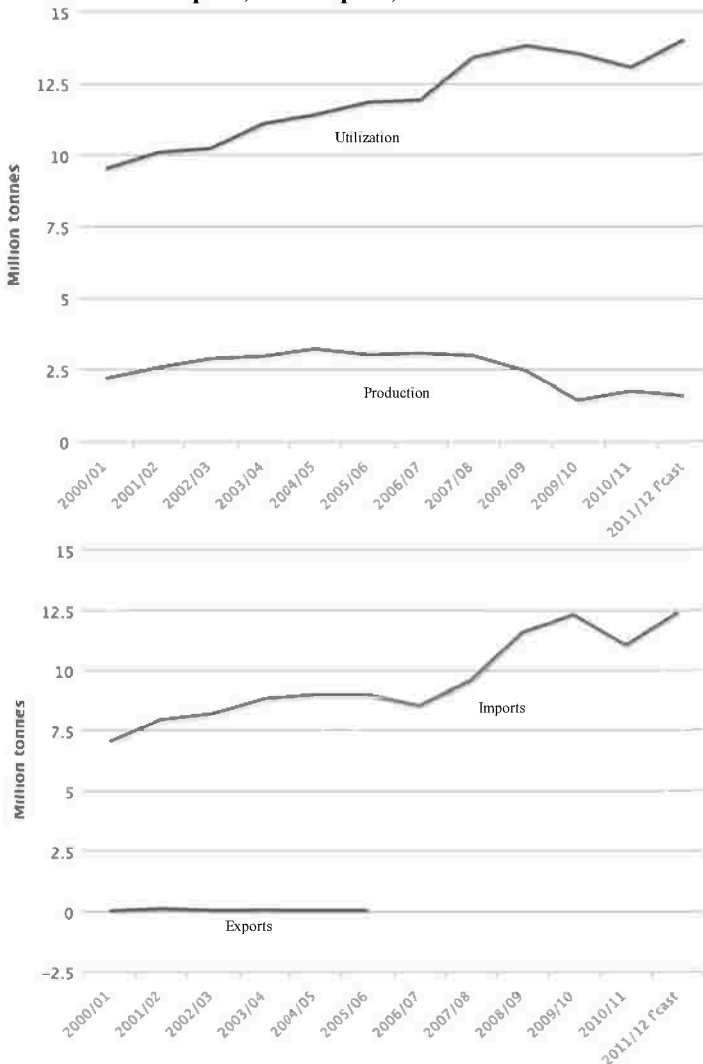
constraints and water scarcity that limit commercially viable primary production potential;<sup>7</sup> (ii) increasing reliance on food imports (60–90 percent of total food demand is met by imports) and consequent exposure to external food price shocks and volatility along with risks of imported inflation and irregular availability of cereals on international markets;<sup>8</sup> (iii) challenges in acquiring farmlands in land- and water-rich countries characterized by poor governance of such resources. The impact of some of these constraints is expected to deteriorate even further given the region’s demographic growth (over two percent, although decreasing, equal to about twice the world average)<sup>9</sup> and increasing urbanization patterns,<sup>10</sup> as well as its trends in dietary characteristics.<sup>11</sup>

**Table 8.2****Arable Land and Agricultural GDP in GCC Countries**

| Country      | Arable land (%) | Contribution to GDP (%) |
|--------------|-----------------|-------------------------|
| Saudi Arabia | 1.7             | 2.7                     |
| UAE          | 0.8             | 0.9                     |
| Kuwait       | 0.8             | 0.3                     |
| Qatar        | 1.6             | 0.1                     |
| Bahrain      | 2.9             | 0.5                     |
| Oman         | 0.1             | 1.4                     |

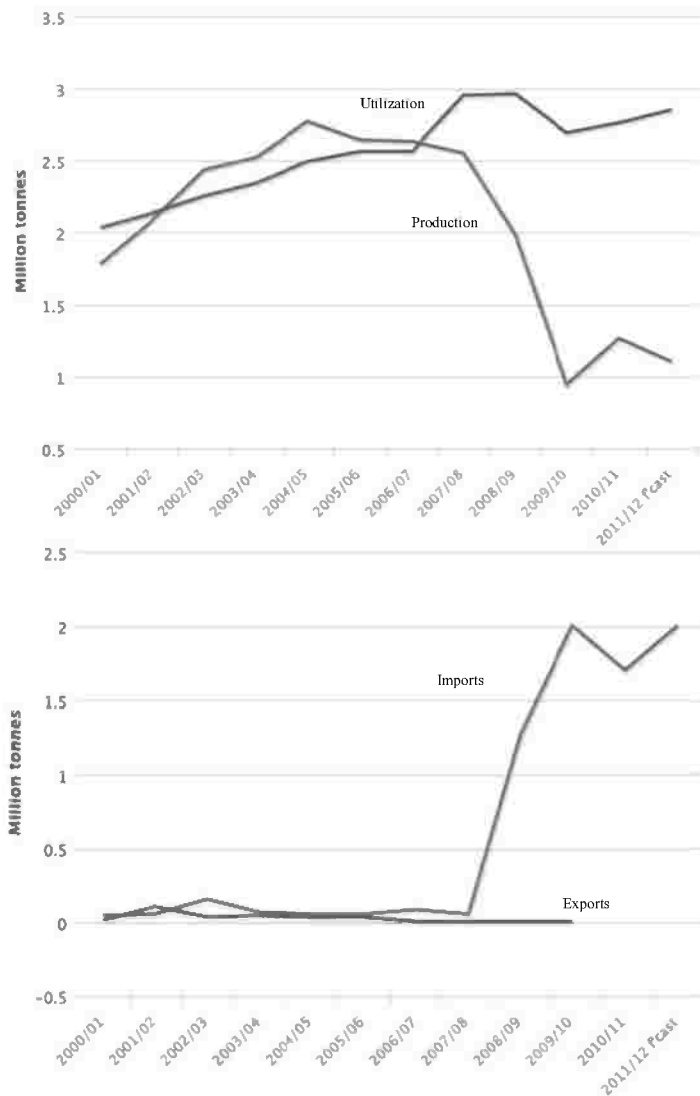
Source: FAO, Bloomberg, as reported in Alpen Capital Group. “GCC Food Industry,” June 28, 2011 (<http://www.alpencapital.com/Me-gcc-food2011.htm?height=400&width=900>).

**Figure 8.2**  
**Trends in Cereal Production, Utilization (consumption),**  
**Import, and Export, Saudi Arabia**



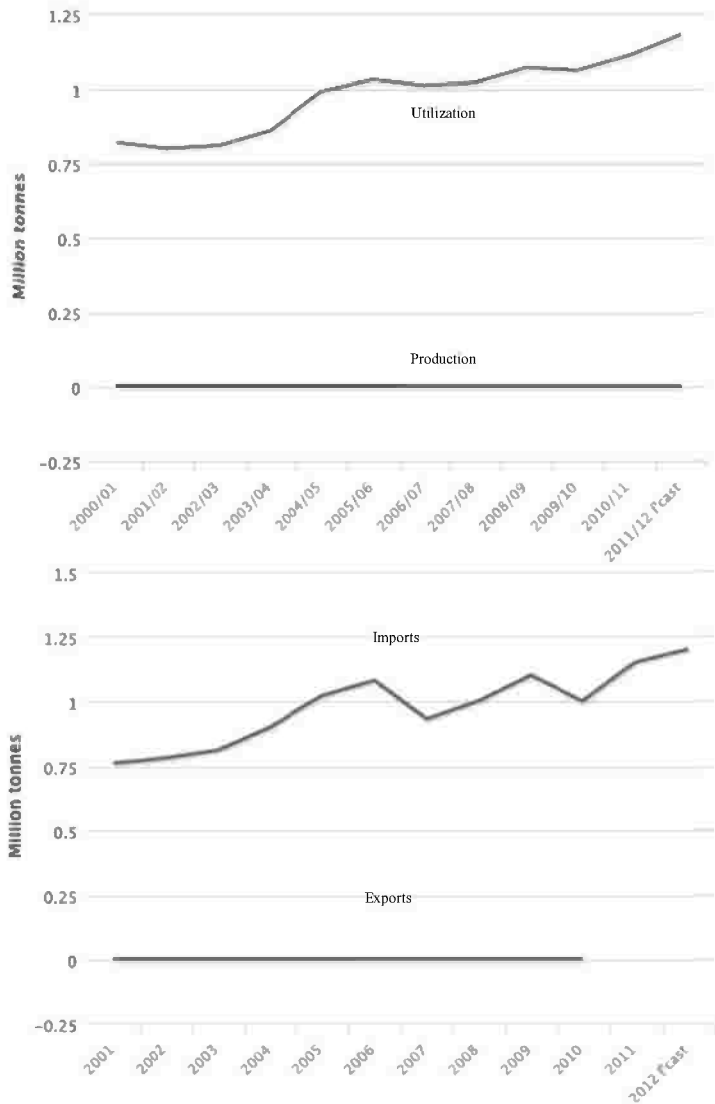
Source: Data from UN Food and Agriculture Organization (FAO), Central Bureau of Statistics.

**Figure 8.3**  
**Trends in Wheat Production, Utilization, Import,**  
**and Export, Saudi Arabia**



Source: Ibid.

**Figure 8.4**  
**Trends in Rice Production, Utilization, Import, and Export, Saudi Arabia**



Source: Agricultural Market Information System (AMIS) Statistics database [prototype]; (<http://statistics.amis-outlook.org/data/index.html>), accessed on March 25, 2012.

As a result, the food import bill has constantly increased over the last decade, with Saudi Arabia and the UAE accounting for almost half (equal to US \$5.8 billion) and over one quarter (\$3.5 billion) of the bill, respectively. With food normally accounting for more than 20 percent of the consumer price index (CPI), GCC inflation spiked in 2008 as a result of the food crisis.<sup>12</sup> In addition, these countries have pegged exchange rate regimes that, on the one hand, provide macroeconomic stability but, on the other, limit autonomy of their monetary policy, thereby limiting the array of choices to neutralize inflation transmission channels from imported food and mainly relying upon non-market administrative measures to mitigate inflationary pressures such as subsidies and other transfers.

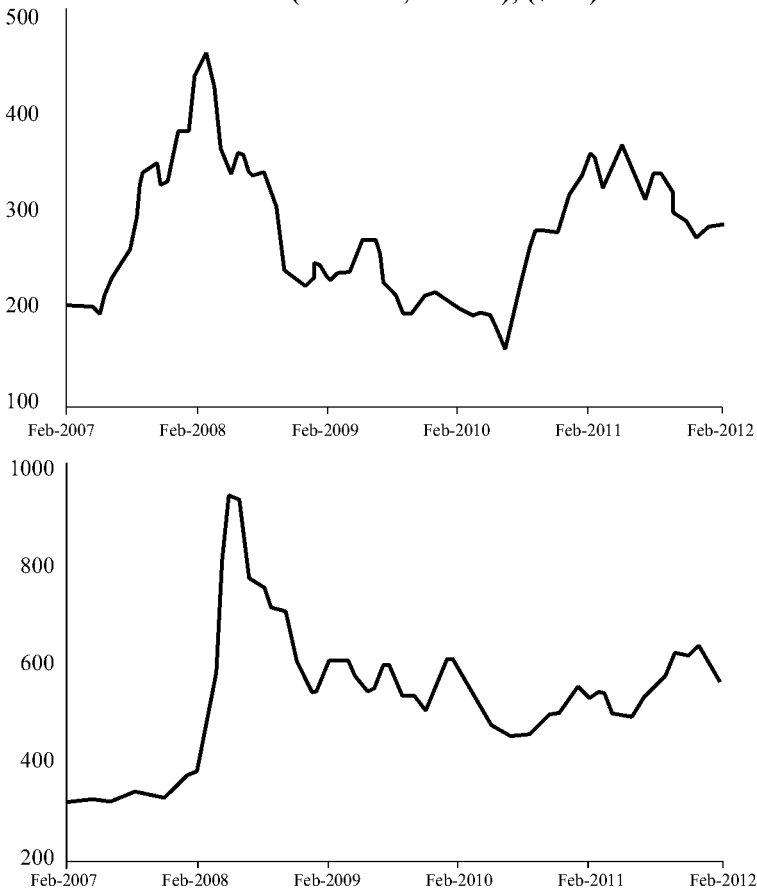
The GCC states are price-takers, and therefore their consumers are relatively more exposed to international price fluctuations. All these countries have pass-through effects of an increase in world food prices with coefficients above 0.2 (Bahrain and Qatar are above 0.3) and, in the case of the UAE, above 0.4.<sup>13</sup> Most reports predict that the volatility of global food prices is likely to remain high in the years to come.<sup>14</sup>

The most recently reported cereal prices (February 2012) have remained higher than the pre-2008 crisis level (2.27 times 2005 average prices).<sup>15</sup> The high pass-through effects are likely to have relatively higher impacts in the cereal sector, since demands for wheat (by the Arabs) and rice (by the Asian Diaspora) are relatively inelastic, resulting in limited substitution even when prices are high.<sup>16</sup> However, from an overall microeconomic perspective, the share of household expenditure is relatively lower in the GCC countries thereby reducing the overall impact of food price rises (see Figure 8.5). Moreover, from a macroeconomic perspective, and consistent with IFPRI's food security typology for the Arab world, recent cereal price hikes do not constitute a problem for GCC countries, as a co-movement of oil and cereal prices has been noticed when the oil price is above \$50.<sup>17</sup> In this situation, the inflow of oil revenues is much higher than expenditures on cereal imports, resulting in a decisive surplus in the balance of payments.

The major determinant of micro-level food security is poverty, and a key indicator is the nutritional status of children. Despite the relatively high

per capita GDP, child malnutrition persists in many Arab Gulf states, and the Human Development Index (HDI) values are lower than expected when considering per capita GDP levels. For example, in Saudi Arabia, Bahrain and Oman, around nine percent of children are estimated to be malnourished (Figure 8.1); and while Qatar and the UAE have the highest and third highest per capita incomes globally (2008, purchasing power parity), they only rank 37 and 30, respectively in the 2011 HDI.

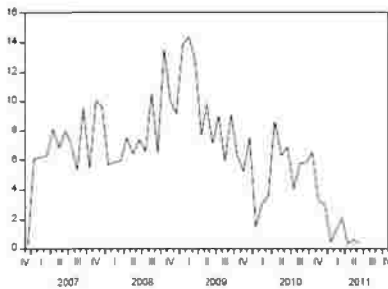
**Figure 8.5**  
**Price Trends for Wheat (US hard red winter, top)**  
**and rice (Thai 5%, bottom); (\$/mt)**



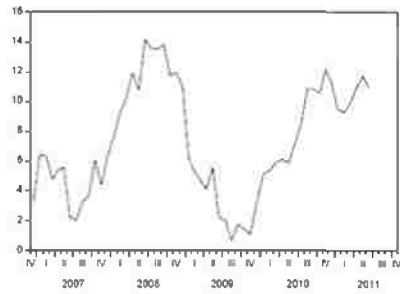
Source: World Bank, "Commodity Markets Review," no. 121, February, 2012.

**Figure 8.6**  
**Food Price Trends in GCC Countries**  
**(December 2006 – April 2011, % change year-on-year)**

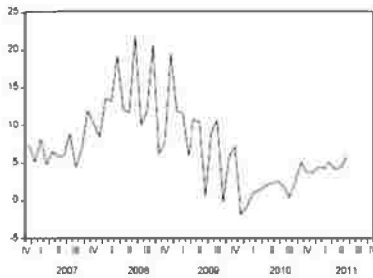
Bahrain



Kuwait



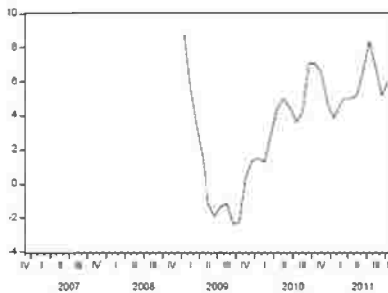
Qatar



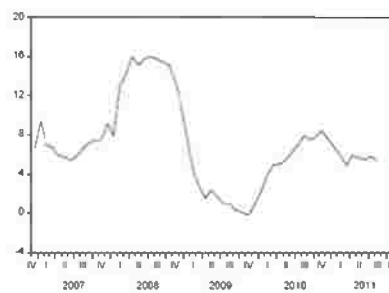
Oman



UAE



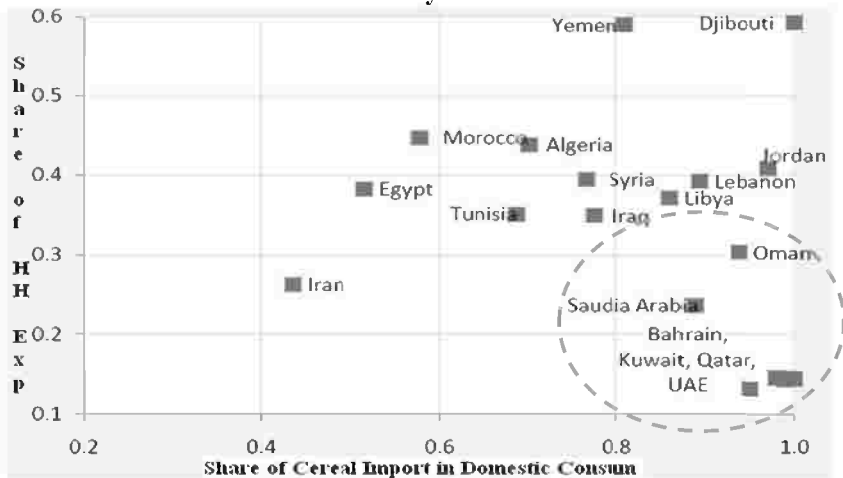
Saudi Arabia



Source: E. Ianchovichina, et al., "How Vulnerable are Arab Countries to Global Food Price Shocks?" World Bank, 2012.

**Figure 8.7**

**Household- and Country-level Vulnerabilities**

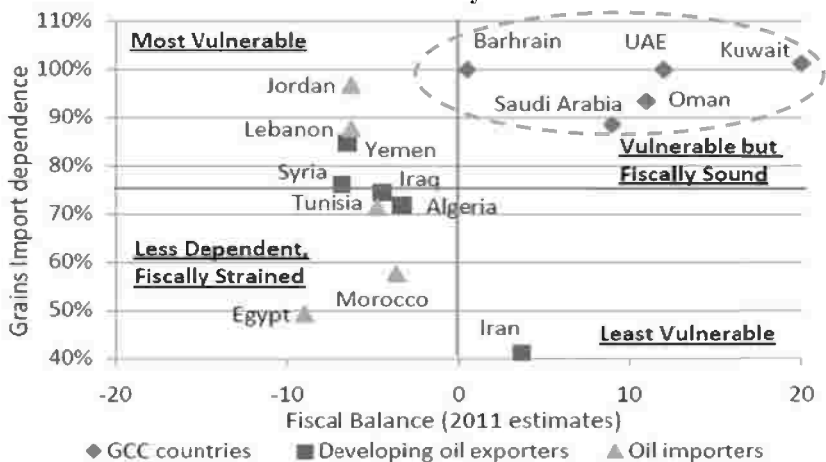


Notes: Share of household (HH) food expenditure in total HH consumption.

Source: adapted from World Bank, "Regional Economic Update: MENA Facing Challenges and Opportunities," Middle East and North Africa Region, 2011.

**Figure 8.8**

**Macro-level Grains Vulnerability of MENA Countries**



Source: adapted from World Bank, op. cit., 2011.

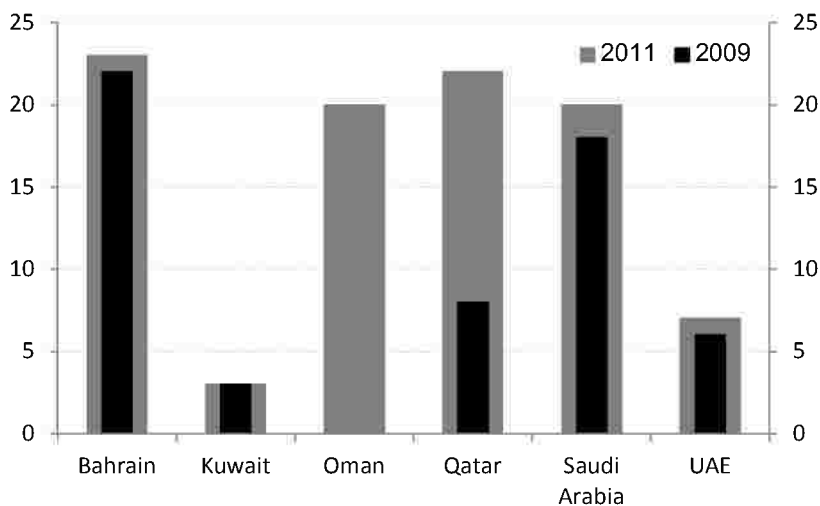
**Table 8.3**  
**GDP per Capita (PPP, 2005 US\$) and HDI, 2011**

|              | GDP per capita |      |  | HDI   |      |
|--------------|----------------|------|--|-------|------|
|              | Value          | Rank |  | Value | Rank |
| Bahrain      | 23,755         | 44   |  | 0.806 | 42   |
| Kuwait       | -              | -    |  | 0.757 | 63   |
| Oman         | 24,646         | 41   |  | 0.702 | 89   |
| Qatar        | 77,108         | 1    |  | 0.825 | 37   |
| Saudi Arabia | 20,565         | 50   |  | 0.760 | 56   |
| UAE          | 51,361         | 3    |  | 0.835 | 30   |

Notes: GDP data available for 209 countries and HDI data for 174 countries.

Source: Based on World Bank, “World Development Indicators 2012” (<http://data.worldbank.org/data-catalog/world-development-indicators>), and United Nations Development Program (UNDP), “Country Profiles and International Human Development Indicators” (<http://hdr.undp.org/en/data/profiles/>), accessed March 2012.

**Figure 8.9**  
**Perceived Food Insecurity (% of population)**



Source: Based on “Gallup World View” (2012).

**Table 8.4****Government-supported Initiatives following the Food Crisis**

|         | Economic Support                          |               | Consumer Support        |                             |                    | Production Support |                   |            |               |                            |                |
|---------|-------------------------------------------|---------------|-------------------------|-----------------------------|--------------------|--------------------|-------------------|------------|---------------|----------------------------|----------------|
|         | Reduction/suspension of taxes and tariffs | Food Reserves | Price Controls/ Subsid. | Cash Transf./Wage Increases | Food Ration/stamps | Input Subsid.      | Subsidized Credit | Land Deals | Support Price | R&D and Extension Services | Infrastructure |
| KSA     | ✓                                         | ✓             | ✓                       | ✓                           |                    | ✓                  | ✓                 | ✓          | ✓             |                            | ✓              |
| Bahrain |                                           | ✓             | ✓                       |                             | ✓                  | ✓                  | ✓                 | ✓          | ✓?            |                            | ✓              |
| Oman    |                                           | ✓             | ✓                       | ✓                           |                    | ✓                  | ✓                 | ✓          | ✓?            | ✓                          |                |
| Qatar   | ✓                                         | ✓             | ✓                       |                             |                    | ✓                  | ✓                 | ✓          |               |                            |                |
| Kuwait  |                                           | ?             | ✓                       | ✓                           | ✓                  | ✓                  | ✓                 | ✓          |               | ✓                          |                |
| UAE     | ✓                                         | ✓             | ✓                       | ✓                           |                    | ✓                  | ✓                 | ✓          |               |                            | ✓              |

Source: ESCWA data.

Data from the Gallup World Poll suggests that at least one-fifth of the people in Bahrain, Oman, Qatar, and Saudi Arabia consider themselves food insecure. The level of perceived food insecurity suggests a consistent deterioration over the recent period, with the share of food insecure people increasing by 1–3 percent in Bahrain, Saudi Arabia, and the UAE, while it almost tripled in Qatar. This deterioration is likely to be a result of the combined effects of the global crisis and food price spikes.

To address these various sources of food insecurity, government-supported initiatives have drastically expanded in the wake of the global financial crisis, which caused steep job losses in the GCC countries because of their high exposure to credit financing (particularly domestic property loans) and global markets.<sup>18</sup> The labor market was hardest hit in Dubai because of the sharp contraction in the real estate sector. The job cuts have been particularly tough for many expatriates, who typically lack

social security and unemployment benefits and are most likely to be affected by price surges.<sup>19</sup>

Main GCC agricultural policy support actions have included:

- Unregulated well digging.
- Subsidized inputs (fertilizers, seeds, veterinary services, and, in the case of Saudi Arabia, farmland).
- Consumer price support.
- Lower taxation for farmers.

Price stabilization through food subsidies has been the favored approach in the past. However, this does not remove the price risk; it only transfers the risk to the government and tax payers through subsidy pay-outs, which often tend to be untargeted and inefficient.

The most recent literature<sup>20</sup> has identified three thrust areas to pursue in order to improve food security in the GCC and wider Arab region: (i) strengthening safety nets, and access to education and health (including family planning) services; (ii) enhancing agricultural production through investment in infrastructures and R&D based on economic, social, and environmental sustainability principles; and (iii) reducing exposure to market volatility through a mix of government- and market-based interventions. In the remaining part of this study, we will utilize these thrust areas as a multi-pronged analytical toolkit that could be used to enhance food security through a regional lens.

After investigating future trends in the region's food security, we will analyze potential key components of a GCC-wide food security strategy. The paper will then attempt to assess the pros and cons of building a regional food reserve as an instrument to tackle potential cereal market disruptions. Next, it will investigate challenges and opportunities for a region-wide procurement system based on innovative financial instruments. The final two sections of the study will focus on the consolidation of agricultural R&D systems, and an analysis of current water use through assessing water footprint and water balance of production, consumption, and trade patterns in the region.

### *The Future of Food Security in the Arab Gulf Region*

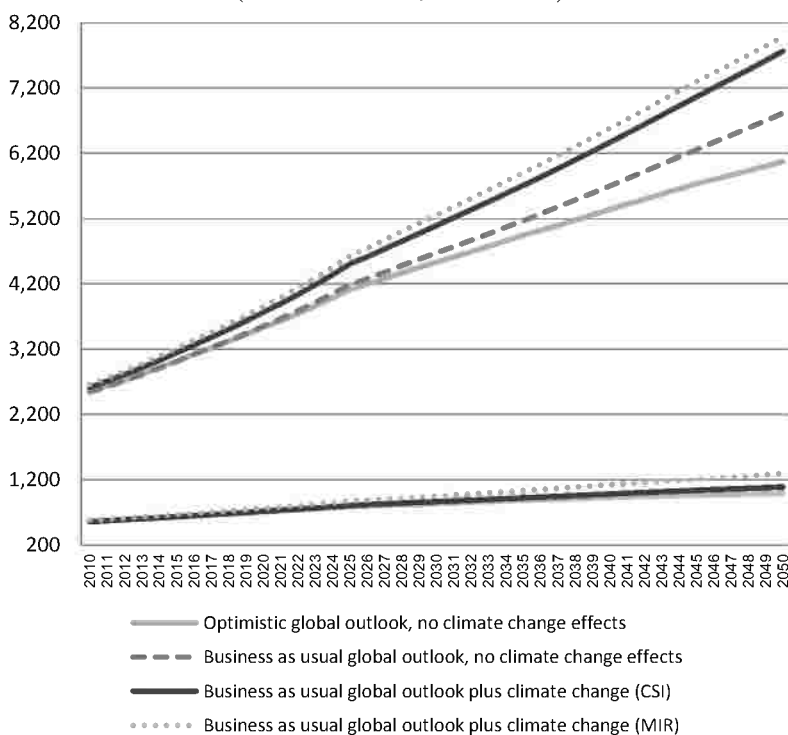
Food import dependency in Arab Gulf states will further increase in the future; the size of the increase will depend mostly on external factors. Figure 8.10 shows how demand (the higher series) and production (the lower series), in monetary terms, are likely to change under four different scenarios: the first scenario describes an optimistic outlook, where population growth in Gulf countries and globally is modest and economic growth is high.<sup>21,22</sup> The next series depicts a scenario where population growth and economic growth in Gulf Arab states and the rest of the world follow the same trend as in the past (business as usual, no climate change effects), while whereas the next two scenarios take the effects of climate change into account (using two different models). Results show that even under the optimistic scenario, the annual value of cereals consumed in the Arab Gulf states will increase from \$2.5 billion in 2010 to about \$4.5 billion in 2030, up to \$6.1 billion by 2050 (in real prices). Under the business-as-usual scenario, the consumption of cereals in Arab Gulf States will almost triple to \$6.8 billion.

The effects of climate change will further raise the value of cereals consumed in Arab Gulf states, while the local production of cereals under all scenarios will lag behind rapidly rising demand. Compared to the business-as-usual scenarios, the annual value of cereals consumed in Arab Gulf countries is projected to increase by \$1–1.2 billion by the year 2050, depending on the climate change scenario. The production side cannot keep up with this rapid increase in demand. Under all four scenarios, cereal output increases because of assumptions about technological change and the increase in cereal prices. Yet, cereal output only reaches \$1–1.3 billion in 2050, or \$5–6.7 billion less than projected aggregate demand.

The total annual demand for food commodities consumed in the Arab Gulf states is projected to more than triple from \$14 billion to \$44 billion between 2010 to 2050. Figure 8.11 shows the results for different food commodity groups from the business-as-usual scenario, excluding the impacts of climate change. The strongest increase in demand from the Arab Gulf countries is projected for meat and F&V. In relative terms, the top three items are meat, vegetables and sugar, for which demand is projected to be about 3.5 times higher in 2050 than in 2010. These results are mainly driven by the fact that (a) populations grow, (b) per capita incomes increase,

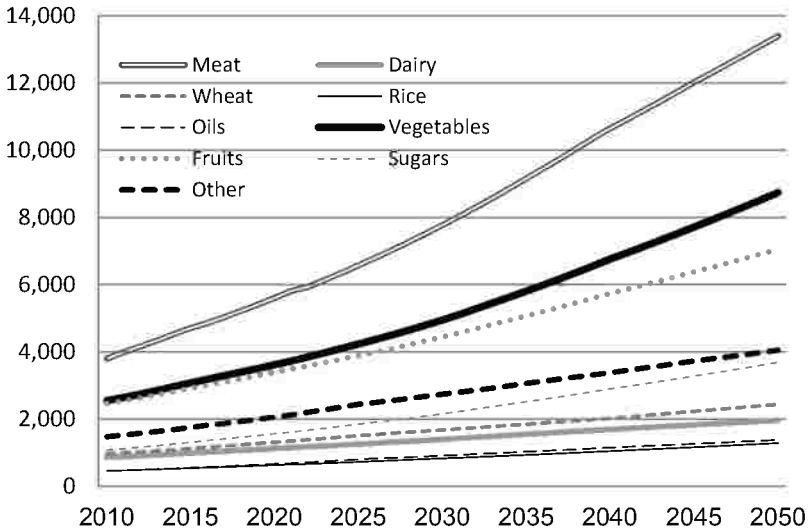
and (c) consumption shifts from staple crops such as cereals to more high value foods such as meat and vegetables. These three effects occur in the Gulf Arab states and in the rest of the world, thus increasing the world market prices for foods and therefore also the domestic prices in the region. If climate change effects are also taken into account, the costs of importing food to the region will likely further increase.

**Figure 8.10**  
**Projected Cereals Demand and Supply for Gulf Countries**  
**(in million USD, 2010–2050)**



Notes: Arab Gulf countries include GCC plus Yemen. CSI and MIR are two out of 22 global climate models used in the Fourth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC).

Sources: Authors' compilation based on Nelson, G.C., et al., "Food Security, Farming and Climate Change until 2050: Scenarios, Results and Policy Options," IFPRI Research Monograph no. 172, 2010.

**Figure 8.11****Projected Food Demand in Gulf Countries (million USD, 2010–2050)**

Notes: Gulf countries include GCC plus Yemen.

Source: Ibid.

However, the Gulf states spend little of their earnings from exports and remittances to import food (Saudi Arabia spends only four percent, Bahrain 2.9 percent, the UAE 3.4 percent, Oman 6.2 percent, Kuwait 2.4 percent and Qatar two percent). Thus, while the value of exports keeps up with the increasing costs of food imports, no change in macro food security is expected.

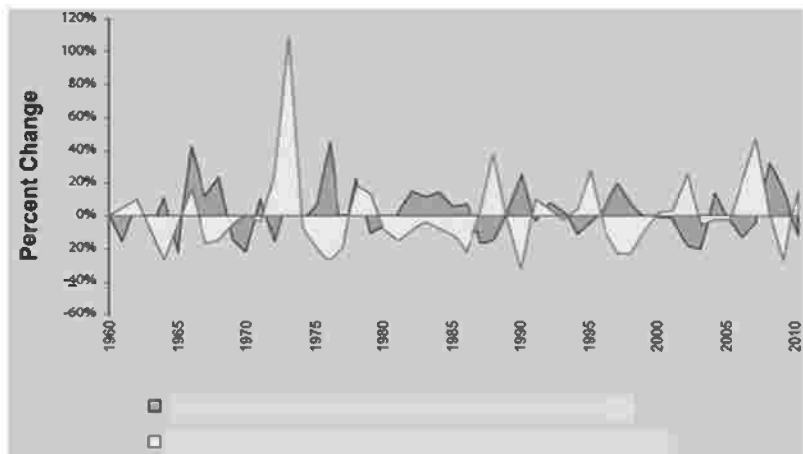
### *Do GCC Countries require a Regional Strategic Reserve?*

Cereals are the food group that was most affected by the 2007–2008 food crisis. Conventional wisdom has it that many concurrent factors contributed to the crisis, among which serious deficiencies in the quality of information, particularly with respect to the levels of global stocks (stock-to-use and major exporters' stock-to-disappearance ratios)<sup>23</sup> and short-term forecasts. All spikes observed in the last four decades have been associated with low stock ratios (Figures 7.12).<sup>24</sup> This, together with market thinness,<sup>25</sup> lack of capacity

in analyzing early warning signs, uncoordinated and nervous policy actions, has contributed to excite the markets even further.

**Figure 8.12**

**Speculative Trends of Changes in Wheat Stocks and Prices**



Notes: correlation is  $-0.8$ .

Source: World Bank as reported in United Nations Food and Agriculture Organization (FAO), "Near East Food Security Update," 2012.

Wheat accounts for more than half of GCC cereal consumption. Only Saudi Arabia imports around two million mt, and is projected to import over three million mt of wheat after the phase-out of domestic wheat production taking place from 2016 onward.<sup>26</sup> The region relies primarily on South Asia (India and Pakistan) for rice imports, and the EU, Australia and Canada for wheat imports.<sup>27</sup> Given regional economic and production characteristics, as well as the world grain market trends, the region is highly vulnerable to both supply and price risks.<sup>28</sup>

As in many countries, there is little information on stocks in GCC countries. Oman and the UAE seem to have each established national cereal reserves equivalent to 3–6 months of their national demands. Saudi Arabia has a policy of holding wheat reserves of at least six months of domestic consumption that can rely on 12 silos with a total

storage capacity of about 2.5 million mt.<sup>29</sup> Over one million tons of rice is imported (mainly from India) annually to Saudi Arabia, and rice reserves amount to less than one fifth of this quantity. Many GCC countries are planning to increase their storage capacity (double in the cases of Bahrain and Qatar, and more than three times for Oman; see Figure 8.13).

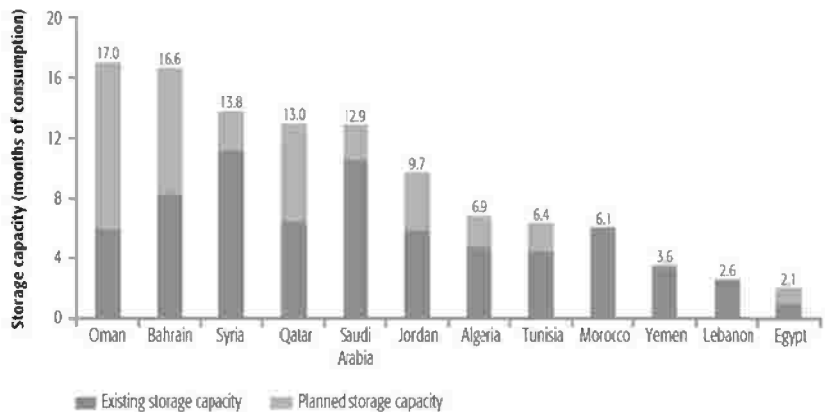
**Table 8.5**  
**Cereal Stocks in Saudi Arabia (million metric tons)**

|        | 2008–2010 | 2011 <sup>i</sup> | 2012 <sup>ii</sup> |
|--------|-----------|-------------------|--------------------|
| Cereal | 3.5       | 3.4               | 3.3                |
| Wheat  | 1.4       | 1.9               | 2.2                |
| Rice   | 0.2       | 0.2               | 0.2                |
| Barley | 1.8       | 1.3               | 0.9                |

Notes: (i) estimate; (ii) forecast.

Source: UN Food and Agriculture Organization (FAO), “Food Outlook,” Rome, November 2011.

**Figure 8.13**  
**Planned Increases in Storage Capacity in the Arab World**



Source: United Nations Food and Agriculture Organization (FAO) and World Bank, “The Grain Chain, MENA Region,” 2012.

Historically, however, national food stocks<sup>30</sup> have not shown great success in reducing price volatility – and particularly price spikes – in view of their often limited capacity when compared with the size of the markets they are supposed to calm, and the limited market information pool they are based on. Storage in the Arab region costs on average of \$2.15 per mt/month.<sup>31</sup> Based on available data, Saudi Arabia has storage costs slightly below this benchmark (\$1.9), while in Qatar the average is over \$3.3.<sup>32</sup> Therefore, if Saudi Arabia imports three million tons of wheat per year (likely lower-end scenario soon after 2016) and wants to keep its current 10-month average of strategic stocks, this will result in at least \$50 million per year in storage costs.<sup>33</sup>

Reducing import risks would clearly entail a multi-pronged strategy that includes trade openness,<sup>34</sup> functioning and integrated supply-chain logistics and infrastructures, and an effective procurement and hedging strategy. These three thrust areas show the potential importance of international or regional coordination mechanisms. In addition, some think tanks and scholars, including IFPRI,<sup>35</sup> have suggested, as a forth pillar, that an international food reserve would help prevent overshooting of cereal prices based on the following three-pronged approach:

- An small international physical stock for food emergencies composed of basic grains dislocated in strategic locations around the world and managed by the World Food Program.
- A global reserve to ease excessive national hoarding and able to quickly respond to supply shocks.
- An international fund or virtual reserve that operates on the financial markets to curb excessive speculation and price volatility.

This long-awaited international food governance is far from implementation.<sup>36</sup> However, regional cooperation among GCC countries on IFPRI's above-proposed policy actions could prove itself as an intermediate option. A regional grain reserve would provide GCC countries with critical lead-time to secure alternative wheat supplies in times of crisis. Despite being the largest importer of wheat, the Arab region holds only a small share of the world's wheat stocks. Such

reserves, if equipped with sufficient capacity, would allow inter-temporal arbitrage that would normally smooth supply responses and would also offer psychological relief that may prevent hysteric hoarding.<sup>37</sup> Therefore, the following questions naturally arise: could GCC countries move in this direction by establishing a regional reserve given that they historically view food security as a national security issue? Would such a reserve help stabilize the regional market? And what are its preconditions?

The first consideration to make is that determining the optimal level of strategic reserves is difficult, as it depends on the combination of underlying factors such as extent of import dependency, vulnerability to supply and price shocks, rigidity of demand, availability of alternative food items, tolerance to risk, etc. Thus, building a comprehensive model to support decision making on stock sizes under different scenarios would be the best first option to support decision making. In the absence of such a tool, we can draw on global experiences. It is broadly accepted worldwide that reserves should be equal to at least three months of domestic consumption, so as to give enough lead-time to import and distribute new stocks purchased from international markets. The second consideration is that the optimal location for the storage is usually at the port of entry, so as to tap into economies of scale. Third, it is of the utmost importance that a set of clear principles and rules are established, including a domestic price ceiling that will trigger the release of reserves, target reserve levels, purchasing modalities, rate of replenishment,<sup>38</sup> viable ownership models, and so on.<sup>39</sup> Fourth, the independence and wider governance arrangements of the agency that manages the reserves is crucial in order to allow it to professionally and effectively administer them (although based on politically-driven strategies and principles).<sup>40</sup>

In the case of the GCC, setting a price band would not make much sense, as the threshold price aims at stabilizing the price for producers. Therefore, a price band would be more easily administered as it would only have a ceiling that will trigger the drawdown. It is also advisable to select a relatively high level of the ceiling which would prevent the reserve from turning into a safety net instrument rather than a supply stabilization tool.

**Table 8.6**  
**GCC Logistics Performance Index Comparisons**

| Country     | LPI  | Customs | Infrastructure | International shipments | Logistics competence | Tracking & tracing | Timeliness |
|-------------|------|---------|----------------|-------------------------|----------------------|--------------------|------------|
| Korea, Rep. | 3.64 | 3.33    | 3.62           | 3.47                    | 3.64                 | 3.83               | 3.97       |
| UAE         | 3.63 | 3.49    | 3.81           | 3.48                    | 3.53                 | 3.58               | 3.94       |
| Bahrain     | 3.37 | 3.05    | 3.36           | 3.05                    | 3.36                 | 3.63               | 3.85       |
| Kuwait      | 3.28 | 3.03    | 3.33           | 3.12                    | 3.11                 | 3.44               | 3.70       |
| KSA         | 3.22 | 2.91    | 3.27           | 2.80                    | 3.33                 | 3.32               | 3.78       |
| Brazil      | 3.20 | 2.37    | 3.10           | 2.91                    | 3.30                 | 3.42               | 4.14       |
| Mexico      | 3.05 | 2.55    | 2.95           | 2.83                    | 3.04                 | 3.28               | 3.66       |
| Qatar       | 2.95 | 2.25    | 2.75           | 2.92                    | 2.57                 | 3.09               | 4.09       |
| Oman        | 2.84 | 3.38    | 3.06           | 2.31                    | 2.37                 | 2.04               | 3.94       |

Source: World Bank, Logistics Performance Index database, March 2012.

Since Saudi Arabia is the largest cereal market in the region and has the largest reserve capacity and a lower average cost, it would make sense that the potential regional reserve system centers around such a country. However, from a logistics standpoint this country is not among the region's top performers and lags behind the UAE, Bahrain, and Kuwait. Indeed, recent analysis suggests that the Kingdom's costs of port logistics, inland transport, and management are about 50 percent higher than those of its neighbors.<sup>41</sup> Investment to improve logistics infrastructure in the Kingdom will not only reduce cereal import supply chain costs – which would offer great opportunities for smoothing domestic fluctuations – but will also benefit other industries that are likely to use the same transport corridors and storage facilities.

Policy makers will need to carefully assess the potential impact of public stocks on private grain traders. Public stocks will have to be rotated

in order to minimize spoilage (i.e., releasing reserves and replenishing them with new stocks). These releases will have to be conducted in a way to avoid crowding out effects<sup>42</sup> by: (i) releasing grains at market prices; (ii) re-exporting the released grains so as not to impact the domestic market;<sup>43</sup> (iii) auctioning the stocks among the private traders; (iv) combining the strategic grain reserves with food aid for other Arab and African countries that are mostly vulnerable such as Sudan or Yemen.<sup>44</sup>

The reserve could be governed jointly by the GCC countries with the support of specialized international agencies. The management body of the reserve would have legal custody of the reserve stocks and would be responsible for the following:

- Setting a high enough price ceiling so that it will not disrupt market dynamics and will only address serious price spikes.<sup>45</sup>
- Monitoring international and regional market conditions and early warning indicators on a continuous basis.
- Adjusting price ceilings according to changes in market conditions.
- Managing stock rotation.
- Establishing a balanced mix of physical and virtual reserves.
- Having sufficient multi-annual funding so that market operations can be effectively carried out.

The regional stock and related food security information systems could also support other food-insecure Arab countries with more limited administrative and financial capacities during crises.

### *The Potential Role of Financial Instruments*

In principle, physical stocks can be more efficient and effective if they function in coordination with a system of “virtual reserves” that are managed through financial instruments. Risk management using financial instruments has become a quite common strategy. Several industries have embraced the use of futures markets to manage price risk. For example, the airline industry frequently uses forward and futures contracts to fix the price of fuel in the future in order to increase the predictability of cash flow.<sup>46</sup>

Financial instruments may be grouped into two main categories: exchange traded contracts (futures and options)<sup>47</sup> and over-the counter instruments (forwards and swaps). The table below summarizes the purpose, advantages and disadvantages of these different financial instruments. Selection of the appropriate instrument must be tailored after identification and quantification of the risk, since there is no “one-size-fits-all” solution for risk management.

**Table 8.7**  
**Snapshot of Relevant Financial Instruments.**

| <b>Instrument</b> | <b>Purpose</b>                                                                                                                                                                                                      | <b>Benefit</b>                                                                                                                                                                                                                                | <b>Disadvantage</b>                                                                                                                                                                                                                                      |
|-------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Futures           | <ul style="list-style-type: none"> <li>• Hedge price risk</li> <li>• Lock in value of inventories or finance part of storage costs</li> </ul>                                                                       | <ul style="list-style-type: none"> <li>• No need to negotiate contract specification</li> <li>• Minimal counterparty risk</li> <li>• Delivery is not necessarily implied</li> </ul>                                                           | <ul style="list-style-type: none"> <li>• Working capital is frozen up in margins</li> <li>• Possibility of profiting from favorable spot market developments is lost</li> </ul>                                                                          |
| Options           | <ul style="list-style-type: none"> <li>• Obtain protection against unfavorable price movements while retaining possibility of benefitting from favorable ones</li> </ul>                                            | <ul style="list-style-type: none"> <li>• Available in standardized form on exchanges</li> <li>• No funding risk: the costs of protection are known up-front</li> <li>• Possibility of benefitting from favorable price movements</li> </ul>   | <ul style="list-style-type: none"> <li>• Up-front premiums can be expensive, especially in times of volatile prices</li> </ul>                                                                                                                           |
| Forwards          | <ul style="list-style-type: none"> <li>• Facilitate planning and marketing</li> <li>• Lock in future prices</li> </ul>                                                                                              | <ul style="list-style-type: none"> <li>• Tailor-made for the needs of the contracting parties</li> <li>• Ensures physical market delivery of the commodities needed</li> </ul>                                                                | <ul style="list-style-type: none"> <li>• Major counterparty risk</li> <li>• Possibility to profit from favorable spot market developments lost</li> <li>• Pricing not transparent</li> </ul>                                                             |
| Swaps             | <ul style="list-style-type: none"> <li>• Guarantee income streams of operations</li> <li>• Obtain easier and cheaper access to capital by securing future cash flows</li> <li>• Lock in long-term prices</li> </ul> | <ul style="list-style-type: none"> <li>• Combination of price-hedging and securing investment</li> <li>• Long-term and tailor-made</li> <li>• Less-strict margin calls</li> <li>• Low administrative burden and known counterparty</li> </ul> | <ul style="list-style-type: none"> <li>• Counterparty risks</li> <li>• High design/set-up costs</li> <li>• Difficult to assess the “fair” price for the deal</li> <li>• Possibility of benefitting from favorable price movements may be lost</li> </ul> |

Source: Adapted from UN Conference on Trade and Development (UNCTAD), “A Survey of Commodity Risk Management Instruments,” 1998.

Financial instruments are increasingly used by grain-importing countries with the aim of locking in volume, quality, and price of imports 3–18 months in advance of delivery. This can help counterbalance short-term speculation and therefore smooth prices. Futures and options are the two main types of financial instruments commonly used in agricultural commodity markets.

Recent studies suggest that spot prices tend to be discovered in futures markets and therefore futures could potentially be used to address excessive spikes in grain prices through their signaling effects. Although such derivatives are seldom used in the region, other governments have successfully used them as risk management tools.<sup>48</sup> They can either be managed directly by government institutions or by private partnering companies within a clear reporting and oversight mechanism.

The World Bank, FAO and IFAD<sup>49</sup> present an interesting simulation for Egypt, which imported seven million tons of wheat from November 2007 to October 2008, at a cost of around \$2.75 billion. Simulations show how Egypt could have reduced the import bill by using either futures or options, and a discretionary or non-discretionary approach to hedging.<sup>50</sup> They estimated that Egypt could have reduced the import bill by around \$600 million during that period.

The main obstacles to the use of financial instruments for food price risk management are: financial capacity, technical skills,<sup>51</sup> volume of trade, liquidity and access to credit, stable import needs, and low exchange rate fluctuations. All of these obstacles could be overcome in the GCC countries, which have fiscal space, an educated labor force, a fixed exchange rate policy, and a low share of domestic production that does not vary according to climatic trends.<sup>52</sup>

A particular challenge related to the use of financial instruments in the GCC countries is how to ensure they are Shariah compliant. Although the elimination of risk is desirable under Islamic law, conventional derivatives contracts are not accepted by many Shariah scholars. However, it should be noted that Shariah compliant derivatives exist and therefore the instruments highlighted in this paper are relevant in the Shariah context, but their specific format should be developed by the Islamic banking community.

**Figure 8.14****Shariah Compliant Derivatives**

From the standpoint of Islamic law, financial contracts must satisfy a number of requirements, which are often not present in conventional derivatives. Most Shariah scholars maintain that derivatives are priced according to assets that are not in the possession of the seller, therefore violating the *hadith* principle. Shariah also prohibits *gharrar* (exposing oneself to excessive risk) and *riba* (paying or receiving a premium or interest). Legal scholars also claim that derivatives encourage speculative behavior akin to gambling (*maisir*). Despite these objections, scholars and practitioners acknowledge the important benefits of hedging instruments and the opportunity cost imposed by the lack of Islamic hedging tools. Recently, so-called synthetic derivatives, which are close equivalents of conventional derivatives have been developed. Another important step has been the Tawawwut (hedging) Master Agreement which standardized Shariah compliant swap-based hedging transactions. Users of derivatives should demonstrate that their transactions constitute true hedging behavior and the use of derivatives is more likely to gain the approval of Islamic scholars if changes in asset value can bring some kind of benefit to both parties.

Source: A. Jobst and J. Sole, "Operative Principles of Islamic Derivatives: Towards a Coherent Theory," IMF Working Paper, WP/12/63, 2012.

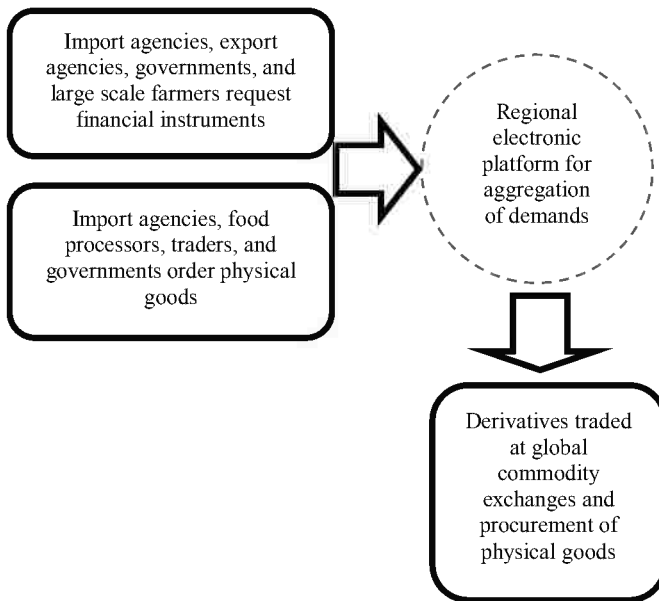
A regional approach could help overcome the remaining barrier related to the volume of trade, since financial contracts are often traded with large volumes that might be too large for the smaller GCC countries. For example, wheat future contracts are of a minimum of 5,000 metric tons, which is similar to the total monthly wheat import of Bahrain. A regional approach can also provide other benefits in terms of economy of scale for training, research and operational cost. The regional approach might also be valuable for negotiations, especially in terms of over-the-counter instruments which are negotiated bilaterally.

The GCC countries could also make joint use of the global commodity exchanges in order to hedge their food price risk. A regional approach might be useful to obtain the necessary volume of trade and would offer cost reductions. Research in supply chain management has focused increasingly on strategic management of procurement operations

through purchasing consortia where different entities combine their individual needs to gain the increasing pricing, quality and service advantages associated with volume buying. Electronic purchasing consortia, employing ICT-based communication infrastructure, enable the efficient coordination of different entities at a low transaction and communication cost.<sup>53</sup>

**Figure 8.15**

**Regional Aggregations of National Demands**



Such systems are already in practical use for various purposes and could be adjusted to serve as a platform for risk management for different import and export agencies, farmers, governments and other entities that seek to hedge their food price risk. The different entities would place an order for a quantity of a specific commodity to be hedged. The orders from different entities would be aggregated before derivatives are traded on a global commodity exchange. This would enable small and large entities alike to manage their food price risk, without incurring large upfront investment and overhead costs. GCC countries face a number of

supply and price risks and therefore a mix of various hedging instruments with different maturity mix could serve their purposes.

An integrated electronic platform could also include the procurement of physical goods. The regional approach will have some implications on the terms of procurement as the countries will have to coordinate procurement needs and tender dates. The regional electronic platform could facilitate this coordination between countries. Orders for physical goods could also be channeled through an electronic system and after aggregation orders could be placed on the global markets. This would facilitate price risk management as well as to ensure the delivery of physical goods.

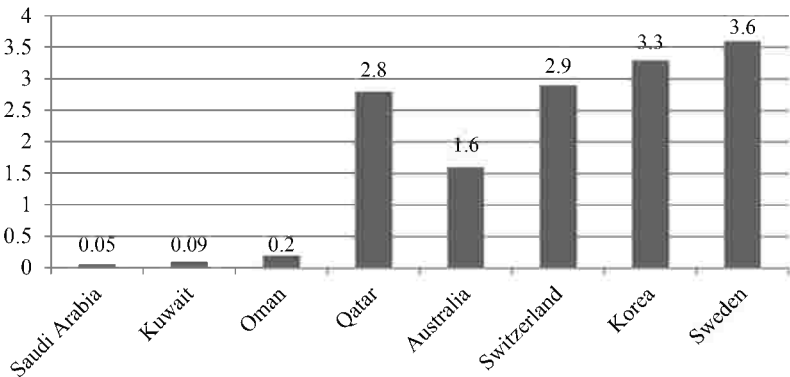
### *A Region-based Agricultural R&D System*

Worldwide, investments in agricultural research and development (R&D) proved to have high rates of return (RoR). The median of RoR estimates is 48 percent for research per year, and 62.9 percent for studies that improve extension services. These estimates have not changed significantly over time.<sup>54</sup> However, current trends show a misleading picture of global public investments because the increasing financial contribution to R&D in agriculture has been concentrated in just a few countries.<sup>55</sup> As agricultural development is highly dependent on R&D, a key component of the regional strategy proposed in this paper is thus a joint agricultural innovation system in the Gulf region that may also benefit other food insecure Arab countries.

In the past two decades, much has been done in GCC countries to stimulate regional research and innovation. A regional GCC patent office has been established for technical and scientific research and to facilitate technological transfer. The International Center for Agricultural Research in the Dry Areas (ICARDA), through its Arabian Peninsula Regional Program (APRP) has not only been dedicated to research, but also to strengthening institutions and capacities, developing human resources, and information technology. Countries have been individually investing in national food security programs, in infrastructure such as Agro-Industrial Parks in Qatar, in education through partnerships with international universities, research centers and international organizations.

Despite these initiatives, innovation system indicators in GCC countries show low performance. The first challenge facing agricultural R&D is the lack of data on public spending. Despite this constraint, the limited evidence suggests that R&D public investment in agriculture is significantly low. In the absence of specific data, overall R&D public spending has been examined.<sup>56</sup> Here, it emerges that GCC countries have allocated significantly low expenditures to R&D. For example, in 2007 selected Gulf states spent (as a percentage of GDP) 0.05 percent on R&D (Saudi Arabia), 0.09 percent (Kuwait), and 0.2 percent (Oman). With the exception of Qatar, the region spends well below developed countries in this area (Figure 8.16). ICARDA's study of national innovation systems in GCC countries shows that the lack of financial resources in Bahrain, UAE and Oman represents a major constraint. APRP has been supported by two international funds – the International Fund for Agricultural Development (IFAD) and the OPEC Fund for International Development – and only one Arab fund, the Arab Fund for Economic and Social Development.

**Figure 8.16**  
**R&D spending as % of GDP (2007)**



Sources: Data for Saudi Arabia and Kuwait from: World Bank, "Research and Development Expenditure (% of GDP)"; (<http://data.worldbank.org/indicator/GB.XPD.RSDV.GD.ZS>). Data for Oman and Qatar are unofficial estimates from T. Andersson, "Natural Resource Dependency and Innovation in the GCC Countries," IGI Global, 2012; others are from J. Cukier, "Big Variations in R&D Spending," OECD Factblog, May 27, 2010; latest available year is 2007.

Private R&D in agriculture is also limited. Economies characterized by capital-intensive industries and services provide generally less, if not insufficient incentives for private sector R&D investments.<sup>57</sup> A very limited private sector engagement in total R&D expenditure is observed. In Saudi Arabia, private sector spending in R&D activities reached a mere 10 percent of the total in 2007, with a predominant concentration in the oil sector.<sup>58, 59</sup>

The knowledge and innovation rankings of GCC countries are significantly low. The UAE and Qatar are among the Gulf countries with somewhat higher ranks in the knowledge economy index, while Oman and Saudi Arabia are ranked the lowest.

Excluding growers and extension agents, the number of researchers in agriculture in the region appears significantly low for its population. On the quality of the scientific research institutions, some countries perform better, namely Qatar and Saudi Arabia, while Bahrain showed the lowest performance.

Effectiveness of innovation systems does not only depend on mere investments and individual researchers but also on the environment in which they operate. An effective innovation system provides an enabling environment for actors across the chain to interact and coordinate collective actions.<sup>60</sup> To assess the environment for an agricultural innovation system in GCC, the indicators presented in Table 8.9 are examined.

**Table 8.8**  
**GCC Rankings on Knowledge Economy and Competitiveness**

| Country/Index | Knowledge Economy Index KEI | Pillar 1 : Education | Pillar 2: ICT | Pillar 3: Innovation | Quality of scientific research institutions | University-industry research collaboration |
|---------------|-----------------------------|----------------------|---------------|----------------------|---------------------------------------------|--------------------------------------------|
| Bahrain       | 49                          | 60                   | 40            | 80                   | 112                                         | 101                                        |
| Kuwait        | 52                          | 76                   | 46            | 70                   | 83                                          | 99                                         |
| Oman          | 66                          | 86                   | 76            | 71                   | 63                                          | 53                                         |
| Qatar         | 44                          | 67                   | 27            | 48                   | 32                                          | 38                                         |
| Saudi Arabia  | 68                          | 80                   | 52            | 86                   | 37                                          | 37                                         |
| UAE           | 45                          | 79                   | 21            | 46                   | 53                                          | 39                                         |

Sources: World Bank Institute, knowledge assessment methodology [KAM] ([www.worldbank.org/kam](http://www.worldbank.org/kam)), 2009. Quality of scientific research institutions and university industry research collaboration were taken from: Klaus Schwab (ed.), "Global Competitiveness Report 2009–2010," World Economic Forum, Geneva, 2009.

**Table 8.9****An Agricultural Innovation System: Regional Indicators**

|                                    |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Knowledge transfer</b>          | <p>Openness to international research, accumulated knowledge and expertise:</p> <ul style="list-style-type: none"> <li>Increasing imports of knowledge and expertise through partnerships with foreign universities, research centers and experts.</li> <li>The provision of training for researchers, growers and extension agents. Developed by ICARDA's APRP, there exists a system in place for knowledge transfer across the chain in the region, although at an embryonic stage, that could be strengthened further.</li> </ul>                                                                                                                                                                                                                                  |
| <b>Linkages and infrastructure</b> | <p>Mixed picture with promising initiatives on the ground:</p> <ul style="list-style-type: none"> <li>Establishing a network for researchers and scientists in the region via regional programs such as that of ICARDA.</li> <li>University–industry research collaboration in agriculture is relatively weak.</li> <li>ICT is a critical platform for innovation systems and some countries have made a significant progress in ICT, notably Qatar and the UAE.</li> <li>In the current inter-regional cooperation dialogue with the EU's INCO-NET (international cooperation network), GCC countries are defining common interests and research areas where food and agriculture are on the menu.<sup>61</sup></li> </ul>                                            |
| <b>Policies and governance</b>     | <p>Weak policies, but some institutional set-up in place. General lack of governance persists:</p> <ul style="list-style-type: none"> <li>Research in agriculture in most countries remains traditional, with a lack of vision and priorities. No clear distinction between research policies and those meant to enable adoption of improved technologies and practices. The research agendas are not based on a commodity chain approach.<sup>62</sup></li> <li>The GCC patent office has granted over 1,800 patents to date, with only 0.01 percent of those related to agricultural activities, including water improvement and chemical related activities.<sup>63</sup> Data on granted patents in the three national patent offices is not available.</li> </ul> |

Regional cooperation in research and innovation can enhance the pool of resources, in particular specialized financial resources and know-how. In other words, the high risks of investments in R&D and innovation are significantly reduced through diversification of resources, and efficiencies are achieved through the resulting economies of scale.<sup>64</sup>

One of the examples of a cross-border cooperation system in research and innovation is the European Union. The European innovation system comprises an overall framework and various programs which have led to the creation of several supporting funds – the European Institute for Innovation and Technology and the European Research Council – and several other coordinating mechanisms. The European model confirms that innovation occurs in an institutional, political and social context and that learning is facilitated by a regional research and innovation governance framework.<sup>65</sup>

GCC countries have great potential for regional cooperation in research and innovation. Besides geographic proximity and the social and political contexts set through the Gulf Cooperation Council, the countries have financial resources and have shown their openness toward striving for knowledge generation and transfer.

These establishments would satisfy three main pre-conditions for effective coordination:<sup>66</sup> appropriate incentives through the joint R&D fund; a committed and capable leadership of high-level decision-makers and regional experts; and an enabling environment, through the regional program, where stakeholders would interact and coordinate their activities. Consolidation of financial resources across sectors needs to be encouraged to tackle the complexity and multi-sector nature of food security effectively. Contributions should not only come from the six governments, but also from the GCC quasi-public development funds, *ad-hoc* research funds and the private sector.

In an attempt to get an idea of a benchmark for an R&D fund in agriculture, we compare the GCC countries with Australia,<sup>67</sup> a country with a research intensity ratio of five percent,<sup>68</sup> spending on R&D totaling 1.6 percent of GDP, and with 6.5 percent of its total R&D expenditure allocated to agriculture (\$723 million).<sup>69</sup> We compared the size of Australian R&D expenditure to total R&D expenditure of the four GCC countries (with available data).<sup>70</sup> We found that Australia spent US \$9.8

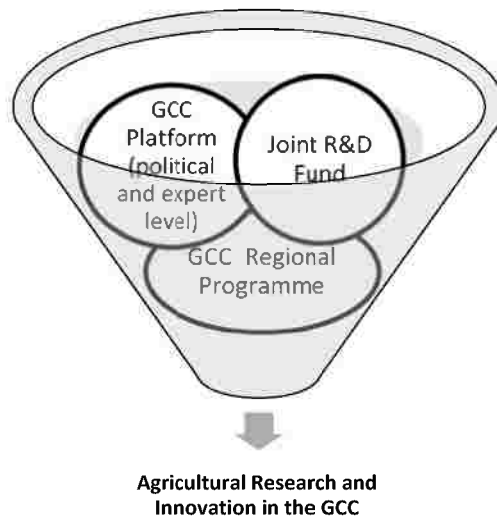
billion more on total R&D than the four GCC countries combined. Australian R&D spending in agriculture alone was equivalent to 75 percent of the total expenditure on R&D by the four GCC countries lumped together. Finally, if we were to take Australian R&D expenditure in agriculture as a minimum yearly contribution to the joint R&D fund, the GCC countries would each be required to contribute roughly \$120 million per year. If all the funding institutions, both public and private, joined forces and consolidated their payments to the joint R&D fund for agriculture, this minimum target could be met.

A regional fund could provide two types of services:

- Competitive grants/loans to stimulate and create demand for innovative research in agriculture; fellowships for PhD and post-doctoral research in agriculture at foreign universities to enhance knowledge transfer to the region; support to foreign researchers willing to focus on research in the GCC; grants/loans for agricultural research in reputable institutes abroad with established capital from GCC countries.
- Grants/Loans to enhance absorptive capacities (similar schemes exist in the Arab Fund for Economic and Social Development). Funding of feasibility studies and project preparations, seminars and conferences, institutional support and training, general studies and research.

R&D system performance is linked to strong governance. Examples of strong governance referred to here are independent legal entities with their own governing boards, and various mechanisms to ensure accountability. Autonomous governance would involve representatives of each participating sector in its governing board and supervisory board. The governing board would have responsibility for all strategic decisions, aligned with the objective of the fund to safeguard resources for research and extension in agriculture. This board should be accountable and legally liable to a supervisory board comprised of members and beneficiaries. The composition of the governing board should include a wide range of skills and competences—from specialized knowledge in agriculture to the expertise required to oversee all the functions performed by the fund.

**Figure 8.17**  
**Framework of a GCC Agricultural Innovation System**



1. **GCC R&D Fund for Agriculture** to ensure increased financial support for R&D activities based on regional priorities in agriculture.
2. **GCC Platform for Agriculture at political and expert level** to decide on research priorities and research policy instruments for the region.
3. **Expansion of ICARDA's Arabian Peninsula Regional Program** to further build on the areas and priorities decided by the GCC Platform for Agriculture.

To ensure coordination and consensus-based priority setting, a platform of regional experts and high-level political representatives is desirable. However, the sustainability of the system is not guaranteed without stable public sector support.<sup>71</sup> Therefore, political support and commitment are critical in defining policy frameworks and institutionalizing various coordination mechanisms. The main role of

the platform would thus be to set priorities and regional strategies for agricultural research, as well as to revise them based on regular progress assessments.<sup>72</sup>

The network established by ICARDA's program could serve as a starting point for region-wide governance of scientific and technical expertise. Building on the established coordination mechanisms of this program, a stronger platform will allow actors from across the chain to further strengthen regional research capacities and human resources through education and training, and to improve agricultural extension. This program should also involve the private sector across the chain (besides growers, producer organizations, agro-processors, importers, input suppliers, other credit agencies, standards agencies, etc.) and ensure their presence at all levels of coordination.

Some of this coordination should emerge spontaneously once appropriate incentives are put in place (sustainability of funding through the joint R&D fund), as well as regional priorities and strategy have been defined through policies and instruments. Innovations do not require thorough advanced planning. Once the enabling environment has been established, creative actors across the chain guide adaptation and elicit changes in their organizations.<sup>73</sup>

### *The Water–Food Security Nexus*

Most of the water utilized in GCC countries comes from rain, springs, groundwater reserves, and increasingly from desalination, while to a lesser extent from treated wastewater. The agricultural sector accounts for the overwhelming majority of the withdrawal of water resources, followed by the domestic and then the industrial sectors. While water demand is rising rapidly in all sectors, it is increasing the most in the domestic sector as a result of population growth and changing living standards.

Without rainwater,<sup>74</sup> GCC countries are water deficient by more than 19 bcm meaning that they are withdrawing more water than they are replenishing. This is worrisome, particularly with regards to groundwater resources, as they are the main source of water that most GCC countries rely upon. With the advent of climate change, additional pressure on water resources is expected.

**Table 8.10**  
**Water Resources Availability in GCC (MCM/yr)\***

| Type of water resources    |                  | Bahrain | Kuwait  | Oman   | Qatar   | KSA       | UAE    | Total            |
|----------------------------|------------------|---------|---------|--------|---------|-----------|--------|------------------|
| Rainfall                   |                  | 63.1    | 2156.0  | 38690  | 857.7   | 126,800.0 | 6,521  | <b>175,088</b>   |
| SGW**                      | Surface water    | 4.0     | 0       | 1,050  | 0       | 2,200.0   | 150    | <b>3,404</b>     |
|                            | Groundwater      | 112.0   | 20.0    | 1,300  | 58.0    | 2,200.0   | 120    | <b>3,840</b>     |
| Non-conventional           | Wastewater       | 61.9    | 250.0   | 37     | 58.0    | 547.5     | 289    | <b>1,243.4</b>   |
|                            | Desalinated      | 102.4   | 420.2   | 109    | 180.0   | 1,033.0   | 950    | <b>2,794.6</b>   |
| SGW+ non-conventional      |                  | 280.3   | 690.2   | 2,496  | 296.0   | 5,980.5   | 1,509  | <b>11,252</b>    |
| Total supply with rainfall |                  | 343.4   | 2,846.2 | 41,186 | 1,153.7 | 132,781.0 | 8,030  | <b>186,340.3</b> |
| Withdrawal                 | Agricultural     | 159.2   | 491.9   | 1,168  | 262.0   | 20,830.0  | 3,312  | <b>26,223.1</b>  |
|                            | Industrial       | 20.3    | 23.3    | 19     | 8.0     | 710.0     | 69     | <b>849.6</b>     |
|                            | Domestic         | 177.9   | 448.3   | 134    | 174.0   | 2,130.0   | 617    | <b>3,681.2</b>   |
| Total withdrawal           |                  | 357.4   | 963.5   | 1,321  | 444.0   | 23,670.0  | 3,998  | <b>30,753.9</b>  |
| Balance                    | without rainfall | -77.1   | -273.3  | 1,175  | -148.0  | -17,689.5 | -2,489 | <b>-19,501.9</b> |
|                            | with rainfall    | -14.0   | 1,882.7 | 39,865 | 709.7   | 109,111.0 | 4,032  | <b>155,586.4</b> |

Notes: (\*) million cubic meters/year; (\*\*) surface and ground water.

Source: UN Food and Agriculture Organization (FAO), Aquastat Database, 2012 (<http://www.fao.org/nr/water/aquastat/main/index.stm>), accessed February 2012.

Average GCC per capita water consumption hovers at around 800 m<sup>3</sup> per year (which is higher than Japan or China) while there is much less total renewable water per capita. Regional water demand is expected to double by 2030. This prospect, together with low groundwater recharge ratios, heralds a gloomy picture.

**Table 8.11**  
**Water Resources and Withdrawal in GCC (2003–2007 average)**

|              | Annual Renewable<br>Water per Capita (m <sup>3</sup> ) | Annual Water Withdrawal per<br>Capita (m <sup>3</sup> ) |
|--------------|--------------------------------------------------------|---------------------------------------------------------|
| Bahrain      | 125.3                                                  | 386.0                                                   |
| Kuwait       | 8.2                                                    | 441.0*                                                  |
| Oman         | 546.7                                                  | 515.8                                                   |
| Qatar        | 49.2                                                   | 376.9                                                   |
| Saudi Arabia | 94.1                                                   | 928.1                                                   |
| UAE          | 27.7                                                   | 739.5                                                   |

Notes: (\*) Data for 1998–2002.

Source: FAO, Aquastat Database, op. cit.

Compared to other countries, the GCC states tend to have a large water footprint, which is not in line with the prevailing scarcity of water resources.<sup>75</sup> For example, the GCC water footprint is much larger than most other countries reported in Table 8.13, when agriculture is not taken into account, while these are not water scarce countries.<sup>76</sup>

**Table 8.12**  
**Water Footprint: World Comparisons (1996–2005)**

| Country/<br>Region | Production (m <sup>3</sup> /yr/cap) |          |          | Consumption (m <sup>3</sup> /yr/cap) |          |          | Total |
|--------------------|-------------------------------------|----------|----------|--------------------------------------|----------|----------|-------|
|                    | Agriculture                         | Industry | Domestic | Agriculture                          | Industry | Domestic |       |
| GCC                | 589                                 | 27       | 116      | 1835                                 | 75       | 118      | 2761  |
| ESCWA              | 978                                 | 64       | 75       | 1463                                 | 40       | 64       | 2683  |
| Australia          | 7001                                | 22       | 58       | 2128                                 | 129      | 58       | 9395  |
| Brazil             | 2647                                | 46       | 56       | 1926                                 | 46       | 56       | 4775  |
| Germany            | 637                                 | 42       | 27       | 1259                                 | 140      | 27       | 2131  |
| Netherlands        | 336                                 | 18       | 10       | 1259                                 | 198      | 10       | 1829  |
| Turkey             | 1629                                | 37       | 63       | 1510                                 | 70       | 63       | 3370  |
| USA                | 3289                                | 246      | 111      | 2398                                 | 334      | 111      | 6489  |

Source: M.M. Mekonnen and A.Y. Hoekstra, “National Water Footprint Accounts: Production and Consumption; Vol. 1: Main Report,” Research Report Series No. 50, UNESCO-IHE, University of Twente, The Netherlands, 2011.

Water footprints related to agricultural activities take the largest share of the total water footprint of the region, accounting for 88 percent (with the highest rates in the UAE, Oman, and Saudi Arabia) despite the fact that the sector contributes only 1–2 percent of the region’s GDP. The

water footprint related to agricultural, industrial and domestic sectors for the period 1996–2005 in the GCC was 22.2 bcm per year, of which 27 percent was from rainfall, 50 percent from ground and surface water, and the remaining 23 percent from desalination and wastewater.

**Table 8.13**  
**Water Footprint in the GCC (1996-2005)**

|                                      | Agriculture   | Industry     | Domestic     | Total         |
|--------------------------------------|---------------|--------------|--------------|---------------|
| Production (m <sup>3</sup> /yr/cap)  |               |              |              |               |
| - Rainfall                           | 200.4         | --           | --           | 200.4         |
| - SGW(*)                             | 349.8         | 1.4          | 12.0         | 363.2         |
| - Wastewater                         | 39.2          | 26.0         | 103.9        | 169.2         |
| - Sub-total                          | 589.4         | 27.4         | 115.9        | 732.8         |
| Consumption (m <sup>3</sup> /yr/cap) |               |              |              |               |
| - Internal                           | 478.2         | 13.6         | 117.9        | 609.7         |
| - External                           | 1357.3        | 61.6         | --           | 1418.9        |
| - Sub-total                          | 1835.4        | 75.3         | 117.9        | 2028.6        |
| <b>Total water footprint</b>         | <b>2424.8</b> | <b>102.7</b> | <b>233.8</b> | <b>2761.3</b> |

Notes: (\*) = surface and ground water.

Source: Mekonnen and Hoekstra, op. cit.; and ESCWA calculations.

The largest segment of the water footprint of the region results from the consumption of goods and services – 73 percent of the water footprint – while productive activities account for the remaining 27 percent.

The virtual water flow for the period 1996–2005 for the GCC was positive and amounted to about 33 billion cubic meters per year or approximately 1,000 cubic meters per year per capita.<sup>77</sup> Keeping in mind the fact that GCC countries are well below the severe water scarcity threshold of 500 cubic meters per year per capita in terms of water availability, the importance of virtual water for the region becomes apparent. Of the above virtual water flow, about 73 percent is accounted for by rainwater (mostly as a result of imported rain-fed products such as cereals), 15 percent by surface and ground water, and 12 percent by wastewater. The largest share of the virtual water flows

in the GCC is related to international trade in agricultural related products (96 percent), while trade in industrial products represented the remaining four percent.<sup>78</sup>

**Table 8.14**  
**Virtual Water in the GCC (1996–2005)**

|                                       | Agriculture |           | Industry | Total  |
|---------------------------------------|-------------|-----------|----------|--------|
|                                       | Crops       | Livestock |          |        |
| Water import (m <sup>3</sup> /yr/cap) |             |           |          |        |
| - Rainfall                            | 756.8       | 243.9     | --       | 1000.7 |
| - SGW <sup>(*)</sup>                  | 218.9       | 27.5      | 9.6      | 256.0  |
| - Wastewater                          | 103.6       | 9.3       | 118.0    | 234.0  |
| - Total                               | 1082.3      | 280.7     | 127.7    | 1490.7 |
| Water export (m <sup>3</sup> /yr/cap) |             |           |          |        |
| - Rainfall                            | 164.5       | 39.5      | --       | 203.9  |
| - SGW <sup>(*)</sup>                  | 73.7        | 9.1       | 4.9      | 87.8   |
| - Wastewater                          | 28.9        | 2.3       | 75.6     | 106.8  |
| - Total                               | 267.1       | 50.9      | 80.5     | 398.5  |
| Balance (m <sup>3</sup> /yr/cap)      |             |           |          |        |
| - Rainfall                            | 592.4       | 204.4     | --       | 796.8  |
| - SGW <sup>(*)</sup>                  | 145.1       | 18.3      | 4.7      | 168.1  |
| - Wastewater                          | 77.7        | 7.1       | 42.5     | 127.2  |
| - Total                               | 815.2       | 229.8     | 47.2     | 1092.2 |

Notes: (\*) = surface and ground water.

Source: Mekonnen and Hoekstra, op. cit.

There is a question of to what extent the prevailing water scarcity is reflected in the price of water in the GCC countries and in their production patterns. Given the fact that externalities and scarcity are seldom included in the price of water, most particularly for agricultural water, it cannot be expected that production and trade patterns will automatically account for regional water scarcity patterns.<sup>79,80</sup> Therefore, the import of virtual water is often unrelated to relative water scarcity.<sup>81</sup>

Moreover, as a development tool, irrigation can also have developmental opportunity costs, as it involves the transfer of resources from other activities to subsidize the schemes, though without adding significantly to domestic value added.<sup>82</sup> The resources mobilized to promote irrigation – financial and others – could be used more effectively in supporting other economic areas

such as agricultural R&D, agro-processing, or in assisting producers of such commodities as fruit and vegetables or fisheries so they could adopt more efficient production techniques.<sup>83</sup>

**Figure 8.18**

**Fertilizers and Water Returns**

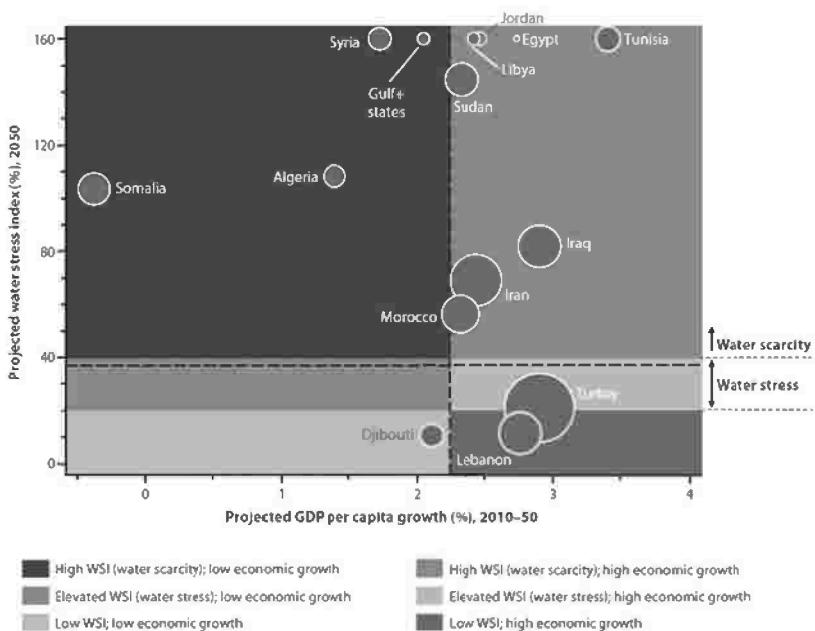
Although the application of fertilizers can improve yields and returns to water, this is not always an economically viable option, particularly in dry climatic zones, as some fertilizers – e.g., nitrogen – do not respond well when annual rainfall is below 900 mm. Irrigation poses serious environmental risks (increased salinity, drop of the water table, etc.) and high costs, while the use of desalinated water, despite becoming gradually competitive with groundwater withdrawals, is not a viable alternative either because one needs to add high energy, the environmental impact of its processing cycle, as well as high transport costs to inland areas. Thus, small increases in yield levels would have to be expected, which would not be sufficient to generate enough gains to pay for the cost of fertilizers let alone other costs such as irrigation and water.

Projections of IFPRI's IMPACT model indicate that the Gulf+ countries (GCC+Yemen) are following a growth path of inefficient water use, where water stress levels are far above regional and world averages. In addition to sea water desalination, improving water use efficiency and waste water recycling should be considered within a package of measures to promote sustainable growth.<sup>84</sup>

Figure 8.19 shows the relationship between projected water stress in 2050 and projected long-term economic growth from 2010 to 2050. Water stress in a country is measured by the Water Stress Index (WSI)—an index developed by Veolia Water (2010). A country is considered “water stressed” if the WSI value is between 20 and 40 percent, and “water scarce” if the index value is above 40 percent. The volume of a bubble is proportional to the total internal renewable water resources per capita in 2010. The dashed horizontal line represents the global average WSI value projected for 2050. The dashed vertical line represents the global average economic growth rate projected for 2010–50.

The GCC countries will hence have to switch in the long run from productive efficiency to allocative efficiency. Productive efficiency implies that current users would endeavor to use their water more efficiently through the adoption of techniques such as drip irrigation to replace flood irrigation while, on the other hand, allocative efficiency requires that the available water is used in areas where it could be the most efficient. Thus, water would have to be re-allocated within agriculture as well as to sectors such as industry or domestic, where it would have a much greater value and could generate more income from a unit of water than cereal production<sup>85,86</sup> (see Figure 8.20 for an example).

**Figure 8.19**  
**Water Stress and Economic Growth Outlook**



Notes: Gulf+ states include GCC and Yemen.

Source: C. Breisinger, O. Ecker, P. Al-Riffai, and B. Yu, "Beyond the Arab Awakening: Policies and Investments for Poverty Reduction and Food Security," IFPRI Food Policy Report no. 25, 2012, based on IFPRI's IMPACT model estimation.

**Figure 8.20**  
**Allocative Efficiency**

Wheat yields in the GCC and other selected countries are as follows: Kuwait (3.5 mt/ha), Oman (3.6), Qatar (3.0), Saudi Arabia (6.5), United Arab Emirates (2.6); and then Canada (2.8), France (7.0), United States (3.1) and the world average (3.0).<sup>87</sup> Wheat production in Canada, France and USA is largely rain-fed, while in GCC countries it is irrigated. Generally speaking, under irrigated conditions yields tend to be well above average and in our case they will be assumed at an average of about 5 mt/ha, assuming that an adequate amount of fertilizers is used. This production will require about 7,500 cubic meters of water per hectare. At an average 2012 price of \$300 per mt of wheat, the value added to each cubic meter of water is thus \$0.2 (\$1,500/7,500 m<sup>3</sup>). In contrast, about 333 cubic meters of water are needed to produce one mt of melons. In 2011, one ton of melons was worth \$575,<sup>88</sup> for a value added of about \$1.7 for each cubic meter of water consumed, which is nearly ten times more efficient than producing wheat. This is an example of allocative efficiency that could be expected by switching crops.<sup>89, 90</sup>

**Table 8.15**  
**Water Use Efficiency for Selected Commodities**

|                                                    | <b>Wheat</b> | <b>Beef</b> | <b>Poultry</b> | <b>Milk</b> | <b>Melon</b> | <b>Oranges</b> | <b>Aluminum</b> |
|----------------------------------------------------|--------------|-------------|----------------|-------------|--------------|----------------|-----------------|
| Yield*                                             | 5,000        | 210         | 1.6            | 7,000       | 30,000       | 20,000         | 1,000           |
| Price (\$/Ton)                                     | 300          | 4,500       | 2,000          | 421         | 575          | 750            | 2,203           |
| Water (m <sup>3</sup> /kg)                         | 1.5          | 20.6        | 5.5            | 0.748       | 0.333        | 0.4            | 0.005           |
| Total water consumed                               | 7,500        | 4,317       | 8.8            | 5,236       | 9,990        | 8,000          | 5               |
| Total value**                                      | 1,500        | 945         | 3.2            | 2,945       | 17,250       | 15,000         | 2,203           |
| Value added per unit of water (\$/m <sup>3</sup> ) | 0.20         | 0.22        | 0.36           | 0.56        | 1.73         | 1.88           | 441             |
| Efficiency to wheat                                | ---          | 1           | 2              | 3           | 9            | 9              | 2,203           |

Notes: (\*) kg/hectare for crops, kg/animal for livestock and output for aluminum; (\*\*) \$/hectare for crops and \$/ton for livestock and aluminum.

Sources: UN Food and Agriculture Organization (FAO). FAOSTAT, 2012 (<http://faostat.fao.org/default.aspx>); M. Krieth, "Water Inputs in California Food Production," Water Education Foundation, 1991; G. Lucier and L. Glaser, "Vegetables and Melons Outlook," VGS-3445, ERS, USDA, Washington DC, 2012; and A. Earle, "The Role of Virtual Water in Food Security in Southern Africa," Occasional Paper No. 33, Water Issues Study Group, SOAS, University of London, UK, 2001.

In most parts of the region, water consumption is not properly billed and therefore is heavily affected by generalized free-riding problems. Moreover, indiscriminate incentives – such as price support, subsidized credit, and energy subsidies (Table 0.16) – encourage excess water use for irrigation. Consequently, water consumption continues to increase.

**Table 8.16**  
**Water Irrigation Subsidies**

|              | Price Support | Subsidized Credit | Energy Subsidies |
|--------------|---------------|-------------------|------------------|
| Saudi Arabia | X             | X                 | X                |
| Bahrain      |               | X                 | X                |
| Oman         | X             | X                 | X                |
| Qatar        |               | X                 | X                |
| Kuwait       |               | X                 | X                |
| UAE          | X             | X                 |                  |

Source: Breisinger, et al, “Food Security and Economic Development in the Middle East and North Africa,” IFPRI Discussion Papers 985, 2010.

Traditionally, governments have focused on increasing the supply of fresh water by identifying and developing new sources of water supply, regardless of cost. GCC countries have been increasingly turning to options such as desalination<sup>91</sup> and treatment and reuse of wastewater<sup>92</sup> to complement the usual methods of water supply, i.e., groundwater pumping, rainwater and runoff harvesting, and so on. However, now emphasis should be increasingly devoted to managing water demand through innovative policies and programs that promote more desirable patterns and levels of water use.

Water would need to be priced at a rate that reflects its scarcity in order to encourage productive efficiency. Doing so would encourage farmers to switch to productions that are less water intensive or crops that have a higher market value. Such a move would constitute a first step towards a gradually more radical allocative efficiency.

Moreover, a number of water-saving initiatives can be taken as follows:

- Adopt regulations and subsidies to help shift from flood irrigation to modern water-saving technologies such as drip, sprinkler, fertigation, and hydroponic irrigation. These modalities allow localized application of both water and fertilizers resulting in their savings and lower environmental impact.
- Water cost recovery through metering and billing.
- Heavily invest in wastewater collection, treatment, and redistribution.<sup>93</sup>
- Raising awareness and community participation.

### *Closing Remarks and Next Steps*

Given the globalized markets characterizing the cereal sector and consequently the limited capacity of the small GCC countries to effectively stabilize them, the regional level takes particular prominence because of the interconnectedness of challenges and markets in the GCC region.

A multi-pronged and multi-scale strategy is therefore advisable to effectively address food security concerns in this region. Analysis conducted in this paper leads into the following strategic directions: (i) assessing more thoroughly a regional food reserve to reduce potential market disruptions; (ii) investigating opportunities for a region-wide procurement system based on innovative financial instruments; (iii) consolidating agricultural R&D systems and enhancing their impact; and (iv) achieving more efficient water use and governance through assessing water footprint of production, consumption, and trade patterns.

The implementation of viable safety nets and sustainable land deals abroad are crucial complementary tools for an effective and comprehensive food security strategy. If well-targeted, safety nets may be less costly than establishing strategic reserves,<sup>94</sup> but they do not protect consumers from potential cereal supply shortages and resultant panic that often results in hoarding or pilferage in times of acute crisis. Knowing that such reserves are available may prevent potential panic and reduce future market disruptions.

Below are some immediate key steps to move in the proposed direction, divided into two main clusters:

### **1. Data Collection, Feasibility Studies and Future Research Activity**

- As a matter of priority, consumer price statistics and price monitoring systems in the GCC should be strengthened in order to allow a proper analysis of price trends and their impact on the vulnerable income groups.
- Systematically use such data for the design and implementation of evidence-based and accurately targeted safety net systems.
- More research is needed in analyzing food price transmission channels and dynamics, as well as their tendency toward downward stickiness in the GCC countries.
- Conduct a feasibility study on the potential realization of a GCC-wide grain reserve including suitable governance options.
- Conduct a feasibility study on the opportunity of establishing a GCC-wide harmonized and, eventually, joint cereal procurement system based on an integrated platform.
- Further investigate the basis risk constraining potential hedging strategies for specific cereal markets in the GCC.
- More research is also needed on the trade-offs between water use in agriculture, residential and industrial use, taking into account new technologies available for wastewater treatment and reuse.
- Make more systematic use of water footprint and water balance analytical toolkits in the food security policy discussion.
- Finally, regional dietary patterns of over-consumption of food items such as sugar, cooking oil, and meat with high fat content can increase the risk of obesity, coronary disease, diabetes mellitus, and colon cancer. This is an area that deserves closer investigation.

## **2. Short- and Medium-term Policy Actions**

- Small GCC countries such as Qatar and Bahrain could benefit from importing cereals on vessels shared with larger countries such as Saudi Arabia or the UAE.
- Consolidate grain purchases around a few reliable traders that can reduce risks of non-compliance with procurement contracts.
- Target investment in key bottlenecks in supply-chain logistics and infrastructures.
- Have a regional discussion and adopt clear proposals on how to make commodity-based financial instruments compliant with cultural and religious criteria, and start reforming the legal and regulatory framework accordingly.
- Increase budget allocations and strengthen the governance of the regional agricultural R&D system, capitalizing on already existing initiatives such as ICARDA's APRP, in support of sustainable agricultural and water-saving R&D activities.
- Gradually move towards economically and environmentally viable water governance arrangements, including better cost recovery through metering and billing.
- Sustainable and evidence-based strategies should be further examined on how GCC countries can best engage in land deals with developing countries endowed with large agricultural potential.
- But first and foremost, a food security regional platform could be created and could serve as a vector for policy discussion of all the above-mentioned actions that may eventually feed into a region-wide food security strategy.