INTERNATIONAL MONETARY FUND

IMF Country Report No. 25/14

OMAN

SELECTED ISSUES

January 2025

This Selected Issues paper on Oman was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on December 18, 2024.

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International Monetary Fund
Washington, D.C.

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December 18, 2024

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FOSTERING CAPITAL MARKETS AND INSTITUTIONAL INVESTOR DEVELOPMENT IN OMAN[1]

The development of domestic capital markets and non-bank financial institutions in Oman can offer benefits to investors and borrowers alike. Deeper capital markets and a more diversified investor base can improve risk sharing and the efficiency with which capital is allocated to the real economy, boosting economic growth and welfare. Despite recent government-led initiatives to improve investor access and encourage participation by local businesses, capital markets in Oman remain relatively small and illiquid and the investor base remains dominated by domestic banks and pension funds. This paper reviews the experiences of other emerging markets in developing local capital markets, and describes the challenges faced in the development of such markets. The review shows establishing a functioning money and local currency bond market remains a critical first step in successful capital markets' development, while several policy tools beyond tax incentives can be employed to support participation in local markets. Increasing the presence of life insurance companies and reducing information asymmetries would help spur demand from a broader set of institutional investors.

A. Context

1. **Further access to capital markets and development of non-bank financial institutions (NBFIs) would support Oman's efforts to spur private sector investment and strengthen growth**. Well-developed domestic capital markets foster efficient capital allocation along with better risk sharing. In addition, the presence of institutional investors in the form of NBFIs that have different objectives in managing their portfolios could make both the local bond and equity markets more dynamic. These efforts would promote growth by increasing private sector access to finance, including to undertake strategic projects underpinned by Oman Vision 2040 (Sahay and others, 2015a; and IMF MCD REO, October 2024). Efficient domestic capital markets can also help improve the conduct of fiscal and monetary policies (Laeven, 2014).

2. **Capital markets in Oman remain relatively small and illiquid compared to other GCC countries (Kroen, 2024)**. The domestic bond market is small, with activity heavily concentrated in the primary market. Although the primary market for government bonds is seen as transparent and employs market-based pricing, its development is hindered by the sporadic nature of bond issuance that focuses on short-term maturities (Figure 1.1.1). In addition, the secondary market for government securities is almost entirely inactive due to low market liquidity and no market-making system. Non-resident participation remains low due to the illiquidity and regulatory barriers such as the absence of over-the-counter (OTC) trading and lack of a link with Euroclear. Sukuk have only been issued periodically and the stock market significantly lags others in the region in terms of market capitalization and trading volumes.[2] Moreover, stock market capitalization in Oman persists

[1] Prepared by Thomas Piontek.

[2] Sukuks, the Islamic equivalent of bonds, are like asset backed securities each representing a proportional ownership right in tangible assets, services, or a business venture. The return to the investor is linked to the performance of the underlying assets.

at low levels due to factors such as the large share of state-owned enterprises (SOEs) and limited growth in the number of listed firms, despite recent progress with IPOs (Figure 1.1.2).

Figure 1. Omani Bond Issuance and Stock Market Capitalization

Figure 1.1. Number of Bond issuances in Oman
(Number, per year)

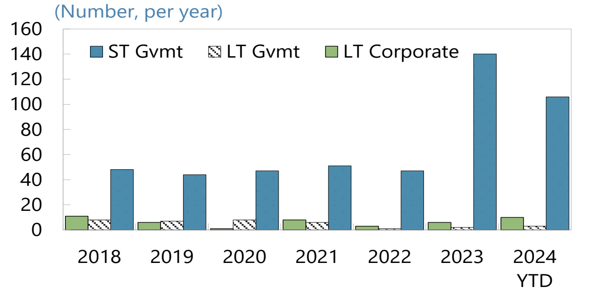
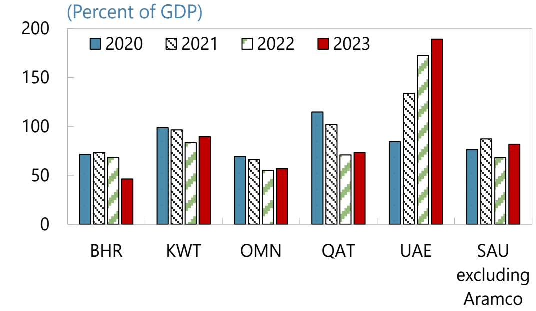


Figure 1.2. GCC: Market Capitalization
(Percent of GDP)



Source: Bloomberg, World Economic Outlook, World Development Indicators, and IMF staff calculations.

B. Recent Capital Markets Initiatives

3. Efforts are ongoing to develop the local currency bond market, supported by Fund technical assistance. A key preliminary step involves reinvigorating the money markets, for which the Central Bank of Oman (CBO) is looking to reintroduce short-term certificates of deposit to improve liquidity management and strengthen liquidity forecasting. Initiatives to enhance local debt market liquidity are underway, including developing a primary dealer system to improve price discovery and enhance market communication through the establishment of a more regular auction schedule. The financial market infrastructure and legal and regulatory frameworks relevant for government securities are assessed as being closer to later stages of development, especially following the issuance of the new Public Debt Law that includes provisions related to governance arrangements, investor relations, liquidity management operations, and Medium-Term Debt Management Strategy preparation.

4. Islamic finance is growing. While overall bond issuance in Oman fell year-over-year in 2023 as the government used its budget surplus to pay down debt, sukuk issuance expanded and has reached about $8 billion outstanding as of year-end 2023 (67 percent sovereign, 33 percent corporates).[3] At the same time, while the Islamic finance industry is becoming a larger source of funding in Oman, the industry remains small compared to other GCC countries, mostly consisting of Islamic banking, and the issuance of sukuk instruments remains sporadic (Figures 2.2.1 and 2.2.2). Ongoing regulatory amendments, including by the Financial Sector Authority (FSA) and CBO, aim to accelerate the development of the Islamic finance by improving transparency and liquidity. The FSA's new Sukuk and Bond Regulation requires issuers to submit a report every year proving the

[3] Fitch Ratings: Oman's Debt Capital Market Contracting Amidst Government Prepayments; Sukuk Share Growing (April 2024).

compatibility of the sukuk with the provisions of Islamic sharia, starting from the sukuk issuance date.[4] The new regulations represent a significant advancement in bringing Oman's debt securities framework closer in line with international market standards and provides clarity to the process and requirements of a debt offering. The CBO is also developing new Sharia-compliant liquidity tools, including Islamic certificates of deposit and treasury bills.

Figure 2. Islamic Finance in Oman

Figure 2.1. GCC Conventional Bond and Sukuk Issuances
(US Dollar Billions, First Half of 2024

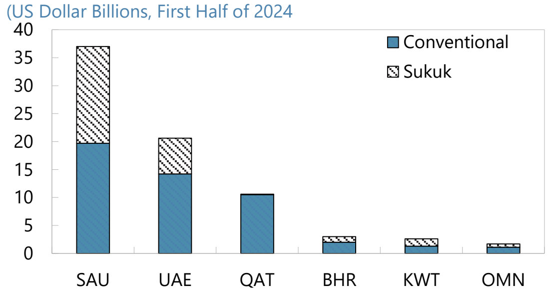
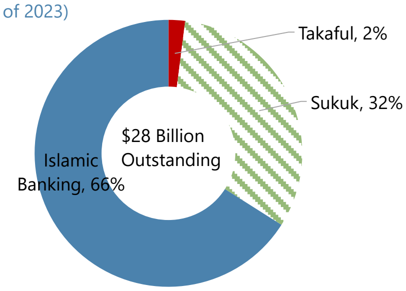


Figure 2.2. Composition of Oman's Islamic Finance Industry
(Percent, End of 2023)



Source: Bloomberg L.P., Fitch, and IMF staff calculations.

5. **Initiatives are underway to enhance access to the domestic equity market and increase its depth and liquidity.** FSA recently announced the Capital Markets Incentives Program (CMIP) that aims to attract private companies to list on the Muscat Stock Exchange (MSX). The CMIP is underpinned by the financial sector development agenda of "Estidamah" and aims to increase the number of publicly traded companies and further deepen the equity market.[5] The CMIP proposes two pathways for firms to list on the MSX: (i) large private and family-owned companies, as well as limited-liability companies, form a new public joint stock company and list on the main MSX market; and (ii) startup companies and small and medium-sized enterprises (SMEs) list on the newly established alternative market within the MSX—called the Promising Companies Market (MSX-AIM).[6] In return, companies participating in the program will receive tax refunds and waivers, fee exemptions, and preferred pricing and fast-tracked financing on certain projects for up to three to five years (Figure 3). In addition, to support the broader objective of improving the MSX liquidity status to emerging market per international index (MSCI and FTSE) requirements, projects have been authorized to establish a broader set of market makers, introduce short selling, margin financing, and securities lending and borrowing to improve market efficiency.

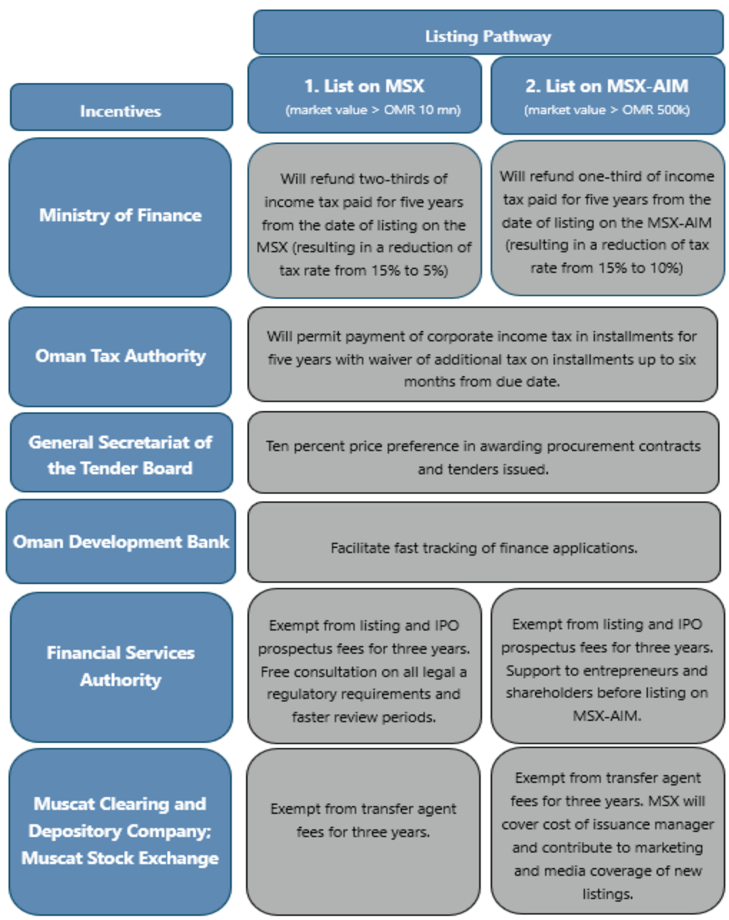
[4] Resolution No. Kh/21/2024 titled 'The Regulation Governing Bonds and Sukuk' (the New Regulations) was published on 21 March 2024 by Oman's Financial Services Authority (FSA).

[5] Estidamah refers to the National Program for Fiscal Sustainability and Financial Sector Development launched by the Ministry of Finance.

[6] A third pathway is available that promotes the conversion of a limited liability company to a public joint stock company to help them gradually implement governance requirements but offers a much smaller incentive package that is only valid for 2 years.

6. Efforts are also advancing towards further opening local capital markets to foreign investors and implementing SOE reforms. To facilitate the flow of foreign direct investments to local capital markets, an initiative is underway to link the Muscat Clearing and Depository Company with Euroclear Bank. This connection would allow for foreign investors to access Omani securities markets and create a wider pool of investors.[7] In addition, progress on reforming the SOE sector has continued, including the development of a unified governance framework for SOEs and further privatization/divestment efforts to open-up more room for the private sector to participate in sectors previously dominated by SOEs. Oman Investment Authority (OIA) was set to list three state-owned assets in the Muscat Stock Exchange in 2024 (for example, OQEP issued Oman's largest IPO ever, raising $2 billion in October), following two successful IPOs in 2023 (raising about $1 billion), which should continue reducing the state footprint while deepening capital markets.

Figure 3. Oman Financial Services Authority: Capital Markets Incentives Program



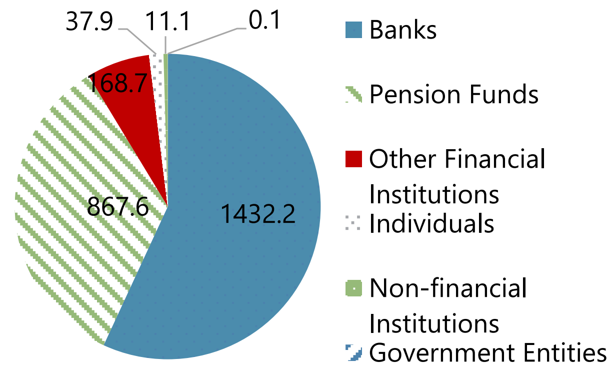
Sources: FSA, GTSB, MCDC, MoF, MSX, OTA, and ODB.

[7] Phase 1 of this link is already operational and allows for Omani investor access to international securities markets.

C. Nascent Non-Bank Institutional Investor Base

7. The investor base in Oman is dominated by banks and pension funds. For example, at end-2023, banks held 57 percent of the outstanding stock of government debt securities, and pension funds held 35 percent (Figure 4).[8] The insurance sector balance sheet is small due to the minimal role of the life insurance industry which is typically larger than non-life industry. Investment funds in Oman are mostly oriented towards equities markets and outward investment, rather than to local fixed income market, but remain small with assets under management of about 1 percent of GDP (Table 1). Retail investors, which hold 0.3 percent of the outstanding stock of government debt securities, are small and have not been a priority in financial market development projects. Nevertheless, there have been some marketing initiatives to access those investors, and efforts to increase financial awareness and literacy in general have also been undertaken.

Figure 4. Investor Base for Oman Government Bonds
(OMR millions, year-end 2023)



Source: CBO
Notes: Other financial institutions include insurance companies, asset managers, and financing and leasing companies.

Table 1. Oman: Size of Mutual Funds and Insurance Companies

Nonbank Financial Institution	Total Count (as of end-2023)	Assets Under Management (as of end-2023 in USD million)
Mutual Funds	22	1505.54
Insurance Companies	17	3214.08

Source: FSA

8. Local capital markets are open to foreign investors, but holdings of government securities are minimal. Foreign investors can participate directly or through investment funds in Oman's capital markets, with no restrictions or limits. In addition, low tax rates, unrestricted capital and profit transfers, and strong investor protection laws have further supported nonresident participation. The MSX foreign shareholding rate reached just over 20 percent at the end of 2023. However, to access the secondary debt market, foreign investors need a local custodian through which to hold their securities. The international standard for government securities markets is to

[8] The dominant role of banks is partly explained by the prudential requirements that they maintain a minimum liquidity coverage ratio and a net stable funding ratio for which government securities are eligible securities. Government securities can also be used to meet part of the reserve requirement (up to 2 percent).

trade OTC, so foreign investors—oftentimes represented by international banks offering custody services—hesitate to accept the requirement to pass their transactions through a broker and be exposed to its credit risk, ultimately discouraging holdings of government securities. Importantly, the initiative to link Muscat Clearing and Depository and Euroclear would greatly facilitate foreign investors' access to the Omani securities market.

9. Still underdeveloped debt markets and systemic excess liquidity have driven a hold-to-maturity culture among investors, as several of the preconditions for liquid secondary markets are not met. These preconditions include i) an efficient money market, including an active interbank repo market, ii) predictable and transparent issuance of a select number of benchmark securities representing a range of different tenors and placed at market clearing prices in the primary market, and (iii) a sufficient number of intermediaries trading non-negligible amounts of securities with standard pricing during agreed times. Bonds are held in hold-to-maturity portfolios at amortized cost, rather than trading books at fair value, thereby avoiding mark-to-market considerations, which are complicated by the lack of a reliable yield curve of secondary market prices/yields. Overall, the absence of developed debt markets means that fixed income-focused institutional investors tend to hold more foreign assets, which reduces their contribution to local capital market development.

10. Further development of the NBFI sector is constrained by concentrated ownership of equities and limited financial literacy. Constraints to financial development outside the banking system are briefly discussed in Box 1. Local equity markets and nonbank financial services develop in a self-reinforcing manner. However, the public sector's ownership of a large share of equities in Oman and limited trading have constrained stock market liquidity (Al Ani and Al Kathiri, 2019). In addition, limited financial literacy and generous pension benefits lower demand for asset management services and insurance products.

Box 1. Constraints on Development of NBFIs in Oman

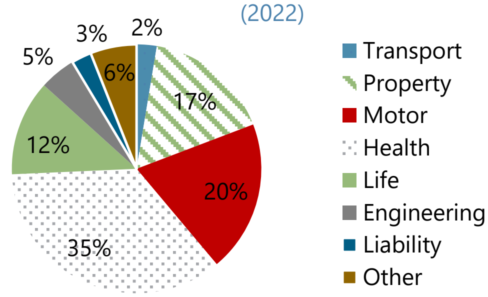
Pension funds are being consolidated but face impediments in asset-liability management due to limits on holding longer-dated debt. Pension fund reform is underway, which is set to consolidate the 11 public and private sector pension funds into one. This reform has created a unified pension system for all workers across all economic sectors and aims to improve the systems long-term sustainability and efficiency in asset management. Current mandates direct pension funds to hold at least 30 percent of their portfolio in local government securities. However, they have an upper bound of 10 percent of their portfolio for their holdings of assets with more than 10-year maturity, which will constrain the demand for longer-term bonds and slow development of a benchmark yield curve.

Facing low stock market activity, limited debt markets, and low financial literacy, asset managers remain small. Asset management remains small in Oman, with assets under management at about 1 percent of GDP in 2023 and mutual funds accounting for most of the investment managers. Concentrated ownership of (large) equities by pension funds and other government entities limits free float, trading, and liquidity. In combination with underdeveloped fixed income markets, this narrows the scope for asset managers to grow. Demand may be low partly because retail investors are unaware of the benefits of investing through mutual funds.

Box 1. Constraints on Development of NBFIs in Oman (concluded)

Beyond short-term property, automobile, and health insurance, demand for insurance products is low. Companies mainly provide property, casualty, and health insurance, with total insurance sector premiums accounting for just over 1 percent of GDP, similar to the GCC average of about 1.5 percent of GDP as of 2022 (Box Figure). The solid social safety net provided by the government to Omani citizens has reduced the need for life insurance cover. The low penetration of life insurance cover also reflects the lack of awareness, incentives, and access for non-Omani residents. There are no tax incentives to use insurance-based savings products.

Distribution of Oman Insurance Sector Premiums
(2022)



Source: FSA

Finance companies' activities remain modest. Oman has five finance and leasing companies with loans concentrated mainly in real estate, SMEs, and personal loans. While the regulatory framework for finance companies appears sufficient, lack of public awareness and high cost of funding are among their main challenges. Funding sources are mainly debt and paid-up capital, which puts them at a disadvantage relative to banks which have access to relatively less expensive demand deposits.

D. Supporting Securities Issuance and International Best Practices

11. As outlined in the Oman 2023 Article IV Staff Report and recent Fund TA analysis, further development of the local currency bond market remains a critical first step in successful capital markets' development. Domestic bond markets are the cornerstone of the financial development agendas in many emerging markets (for example, Malaysia, Mexico, Thailand—BIS, 2020). In several countries, money- and repo-market development (for example, Hungary, Malaysia, Mexico, Thailand) were steps taken to initiate more secondary market trading in government securities. Specific policies include adopting the standards of the General Master Repurchase Agreement and fostering repo market activity in private markets, rather than repos intermediated by the central bank.

12. Improving the government debt issuance strategy would enhance overall transparency and help increase secondary market liquidity. In Latin America, Peru's government bond market faced similar challenges to that of Oman despite also gaining investment grade status. The main issue was low levels of secondary market liquidity due to (i) the fragmented issuance of government securities, (ii) limited predictability in the primary market related to the auction calendar, and (iii) restricted capacity of primary dealers for market making. Several actions were taken to improve the predictability of auctions, including increasing communication with primary dealers and main institutional investors regarding auction demand, and reopening benchmark bonds to reduce the number of outstanding bonds. As a result, secondary market trading activity tripled over 2 years and primary dealers were able to serve their clients better and cover their positions in the secondary market. Many of these same recommendations have been outlined in recent Fund technical assistance covering development of the local currency government bond market in Oman. Taking them onboard would support the development of this market.

13. Oman's Islamic finance market is the smallest in the GCC (Figure 2.1), and the sukuk bond market still faces multiple challenges, including illiquid secondary markets that dissuade participation from a broader investor base. Many Islamic banks and financial institutions tend to participate in Oman's primary market sukuk issuances, but are not active in the secondary market, and tend to hold the sukuk to maturity. This is partially attributable to sukuks being less frequently issued, and the scarcity resulting in holders not willing to sell due to uncertainty about finding a replacement. In addition, while local banks are asked to serve as lead agents at the issuance phase, a lack of market makers in the secondary market continues to hamper liquidity. Similar to the recommendations for the conventional bond market, improving the predictability of sukuk auctions and establishing a set of Islamic financial institutions or asset managers specializing in sukuk as market makers (Saudi Arabia and United Arab Emirates) could greatly improve development of these markets (Kusuma and Silva 2014).

14. While the CMIP may increase the size of the equity market and encourage more public stock listings in Oman, tax incentives for issuers are less common across other jurisdictions and authorities should avoid undue policy uncertainty. A main feature of Oman's CMIP is the corporate tax incentives offered to larger companies that choose to list on the main MSX, and SMEs that list on the parallel MSX-AIM exchange. However, compared to listing programs in other countries, tax incentives to issuers are generally less common (see Table 2 for examples of other tax incentive programs). One drawback to offering overly generous tax breaks to issuers is potentially attracting companies that would otherwise be ill-prepared to access public equity financing. In addition, policymakers and the public may find the loss of immediate tax revenues to be a controversial bet on the future growth of firms listed on these exchanges (Schellhase 2017). For example, Jamaica initially offered a five-year total corporate tax holiday, followed by an additional five years of halved corporate taxes. However, policymakers faced pressure regarding the loss of tax revenues and reduced the package to just five total years. They later considered removing the

Table 2. Oman: Reductions in Corporate Income Tax for Listed Companies
(Regardless of Market Segment)

Country	Nominal Rate	Reduced Rate
Cambodia	20%	10%, for the three years following an initial public offering (IPO)
Fiji	18.50%	10%
Kenya	30%	27%, for the three years following an IPO for companies with at least 27% of issued share capital listed; 25%, for the five years following an IPO for companies with at least 30% of issued share capital listed; 20%, for the five years following an IPO for companies with at least 40% of issued share capital listed;
Morocco	31%	15.5%, for the three years following an IPO
Pakistan	31%	26.4%, for the two years following an IPO

Source: Schellhase 2017; SME Financing through Capital Markets: Final Report, International Organization of Securities Commissions, July 2015; SME Finance Monitor, Asian Development Bank, 2014; stock exchange websites.

incentive altogether but faced significant pushback from the stock exchange and other market participants. Changing policies and uncertainty about the government's commitment to maintain incentives ultimately dampened the ability of the equity market to recruit new listings. In addition, the fiscal implications of tax incentives need to be closely monitored to prevent unexpected future tax expenditures.

15. A number of complementary policy tools have been successful in increasing the number of listed companies on stock exchanges and should be considered. The current CMIP proposal includes other incentives that are common in successful country examples such as reduced listing and IPO preparation fees (Poland and Spain), as well as training to build internal capacity on regular reporting requirements (India, France, U.K., and South Korea). However, Saudi Arabia's Nomu parallel equity market introduced a few additional enhancements that saw market liquidity drastically improve following its initial inception (WFE, Al Athel, 2020). These included lowering the requirement for the total number of public shareholders, improving price stability through intraday price change limits, and improving transparency through an independent research provider.

E. Spurring Institutional Investor Demand and International Best Practices

16. The presence of institutional investors that have different objectives in managing their portfolios would make local capital markets more dynamic. The authorities should support the development of life insurance products that would give rise to strong demand for longer-term bonds. A combination of enhancing the financial literacy and risk awareness framework alongside temporary and targeted tax incentives could help spur demand for insurance products. For example, in several jurisdictions—notably Chile, India, Morocco, and Nigeria—tax incentives mostly in the form of deductions related to life, health and retirement savings products, as well as VAT exemptions for certain lines of insurance, worked well in stimulating savings towards specific pension and life insurance products (Noordhoek and others, 2022). The expansion of the investment-fund segment specialized in fixed income products and further financial literacy programs on equity-based mutual funds could also attract retail investors and induce trading activity (Malaysia, Hashimoto and others, 2021). The development of fixed-income investment funds could be a joint effort of the Oman financial sector authorities (CBO, MoF, FSA) and the investment fund industry (for example, through the Omani Securities Association). Ensuring a link between Muscat Clearing Depository (MCD) and Euroclear and removing counterparty risks with brokers in the secondary market could attract more foreign investors to participate in the local bond market. Moreover, foreign investors can play a critical active role in the development of hedging markets. However, the FSA will need to monitor for new emerging risks amid the ongoing financial development; for example, weighing the trade-offs related to the participation of foreign investors, as they could be more sensitive to global market conditions and amplify local market volatility.

17. While pension funds already play a significant role in local government debt markets, reforms underway to consolidate the pension fund sector should take steps to avoid slowing the development of local capital markets (Khan, Li, and Zhao, 2024 forthcoming). Kazakhstan's policy shift in 2013, to nationalize the management of its pension system and move funds accumulated in private pension funds into a single pension savings fund, provides a good case study on the potential effects of consolidation on capital markets development. First is that tight portfolio restrictions led to an over-concentration of Kazakh pension fund portfolios and reduced benefits to capital market development.[9] Pension funds in Oman also have portfolio allocation restrictions (see Box 1), the alleviation of which would assist in developing longer-dated benchmark yields and growing local equity markets. Second, the consolidation of pension assets in the single pension fund following the reform led to inactivity in domestic capital markets in Kazakhstan. The 2013 policy shift prompted major institutional investors overseeing private pension funds to exit the domestic capital markets, leading to stagnant and non-liquid markets (OECD, 2017).

18. Under the impetus of the planned listing of several SOEs, the equity market would likewise benefit from increased secondary market activity to attract a broader investor base. Satisfying the criteria for inclusion to widely used emerging market equity indices will attract greater non-resident participation, as seen in Colombia, Kuwait, Mexico, Qatar, Saudi Arabia, and United Arab Emirates.[10] For example, Saudi Arabia's Qualified Foreign Investor program was introduced to facilitate participation by international investors in the Saudi capital markets. Through this program, international investors have been provided direct and full access to the Saudi Stock Exchange (Tadawul), and qualifying criteria and foreign ownership limits were eased alongside opening the IPO market to foreign investors. Oman has taken a similar step as local capital markets, both primary and secondary markets, are also fully open to foreign investors. These measures to foster the entry of new market players and enhance secondary market liquidity should also reduce the propensity of investors to buy and hold securities. While broadening the investor base is desirable to achieve investor diversification and mitigate crowding out of bank credit, regulators need to remain mindful of financial stability implications by adapting their regulatory frameworks and increased monitoring of NBFIs and foreign investors. In this context, several key guardrails are essential, including: (1) conducting appropriately resourced and intensive supervisory oversight; (2) incentivizing stronger risk management, especially as participation by nonbank financial institutions increase; and (3) closing data gaps to facilitate appropriate and timely risk assessment by market participants and supervisory authorities.

19. Reducing information asymmetry would stimulate investor interest in the newly proposed MSX-AIM exchange and help establish the market as an alternative source of funding for advanced SMEs in Oman. While tax incentives are common across most jurisdictions for encouraging investment in SME equities (for example, in France, India, Poland, Spain, and U.K.), institutional investors have frequently identified other factors, such as liquidity and transparency of financial information, as determinative of whether they would invest in SMEs (Table 3). Broadening the investor base and better market liquidity usually go hand in hand, but initiatives to improve information disclosure have been found to greatly improve an SME exchange's success due to reduced information asymmetry between SME issuers and investors. For example, Poland's

[9] Pension funds were mandated to invest at least half of their assets in government bonds, and a maximum of 30 percent could be allocated to "Class A" corporate securities.

[10] The MSCI Emerging Market Index already features 4 of the 6 GCC economies. Saudi Arabia reports a substantial pickup in inflows after inclusion to the index (BIS, 2020).

NewConnect alternative exchange nominated authorized advisors to help decide whether a company is ready to access the equity market by overseeing the initial and ongoing listing requirements and providing a stamp of approval for the SME's suitability. In addition, Oman's efforts to create a comprehensive credit bureau (Mala'a) would also serve as an essential tool to address the asymmetry of information in SME financing and could potentially be used by capital markets as an additional tool to assess creditworthiness (IMF, OECD, World Bank, 2015).

Table 3. Which of the following, if any, would persuade you to invest in listed SMEs?

	Retail Investors	Institutional Investors
Liquidity of shares	67%	84%
Regulatory framework	57%	68%
Information disclosure	67%	68%
Tax incentives	52%	53%
Research on SMEs	57%	53%
Lower transaction costs	33%	42%
Investment vehicles	29%	33%
Diversification opportunities	48%	48%

Sources: Schellhase 2017; "SME Financing and Equity Markets," World Federation of Exchanges, 2017
Notes: Though these figures give an indication of what is most important to investors, they should be interpreted cautiously as the sample was relatively small and included survey participants from vastly different market contexts. The sample included 21 retail investors and 19 institutional investors distributed across five countries: Canada, China, Mexico, Nigeria, and South Africa.

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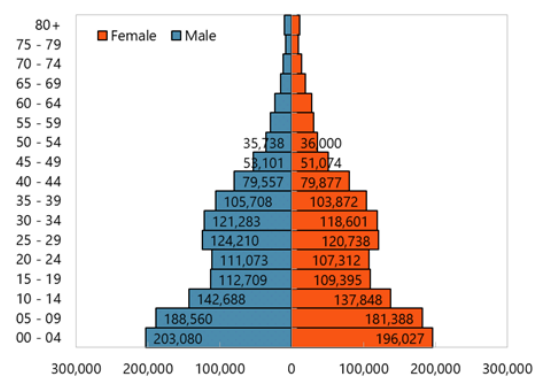
LABOR MARKET DYNAMICS IN OMAN[1]

The prevalent strong preference for public sector employment among young Omanis, coupled with demographic pressures and medium-term fiscal sustainability objectives amid economic diversification away from hydrocarbons, underscores the urgency to pivot towards a more dynamic private sector that attracts Omanis towards private sector jobs. This note delves into recent developments and structural idiosyncrasies in Oman's labor market, highlighting distinct segmentation and limited mobility, which disincentivized upskilling and impeded sectoral labor reallocation. The analysis reveals that comprehensive reforms are needed to narrow the public-private wage gap, boost private sector employment for nationals, and elevate overall productivity. These include aligning wages with productivity, improving vocational training, fostering female labor market participation, and enhancing labor market mobility for expatriate workers. Implementing these measures is pivotal for Oman to realize its Vision 2040 objectives, transitioning towards a knowledge-based economy, and achieving sustainable nonhydrocarbon growth.

A. Introduction

1. **The Omani economy needs to create more than 220 thousand jobs for nationals over the next eight years**. Approximately 550 thousand Omanis will enter the working age population by 2032. Taking into account the prevailing participation rate (67 percent) and the replacement of retirees (approximately 10 thousand annually), around 220 thousand new jobs will need to be created by 2032, against 103 thousand newly created jobs for Omanis during 2012-2019. While it continues to be a preferred destination for young Omanis, using the public sector as an employment vehicle is no longer a feasible option under current efforts to entrench medium-term fiscal sustainability while reducing reliance on hydrocarbon revenues.

Figure 1. Omani Population by Age Group and Gender, 2020



Sources: NCSI; and IMF staff calculations.

2. **The private sector in Oman continues to depend heavily on expatriate workers.** Access to low-cost, low-skilled workers from South Asia, together with flexible contractual terms, enabled the nonhydrocarbon economy to expand while complying with quota (Omanization rates) requirements. The low labor costs associated with these expatriate contracts have increased the

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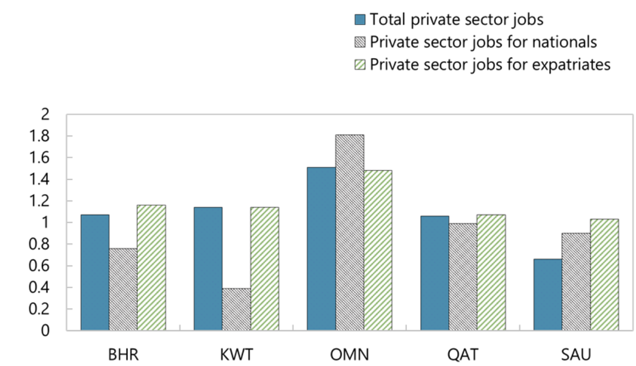
competitiveness of nonhydrocarbon sectors and boosted profit margins by driving wages downward, particularly in labor intensive sectors. As a result, expatriate employment became more responsive to nonhydrocarbon growth than in other GCC economies, rendering expatriate workers the overwhelming majority in the private sector. Additionally, this has facilitated the nonhydrocarbon sector's rapid adaptation to terms of trade shocks under the fixed exchange rate regime, as detailed by Fasano and Goyal (2004).

3. Policymakers in Oman, like in other GCC countries, continue to heavily rely on administrative measures, such as quota requirements, to enforce employment of nationals in the private sector. These quotas are unevenly enforced across countries in the region and tend to be firm-size and occupation specific. They are less stringent for small and medium-sized enterprises (SMEs), as well as in occupations that are less attractive to nationals such as lower-skilled jobs. On the other hand, quota requirements are higher for administrative and managerial occupations. These quota requirements complement wage-subsidy measures, which, although used much less extensively than in neighboring countries, aim to incentivize firms to favor the employment of nationals by reducing cost differentials with expatriates.

Figure 2. Elasticity of Private Sector Employment to Nonhydrocarbon GDP

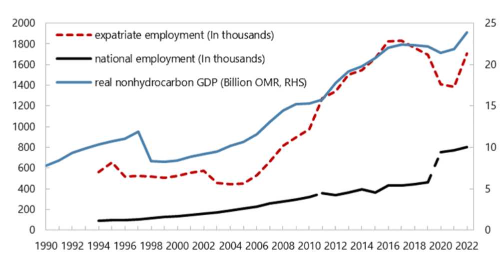
(In percent)



Sources: Country authorities and IMF staff calculations. Note: The elasticity is estimated from OLS regressions of the logarithm of employment on the logarithm of non-hydrocarbon GDP, for the years 1990-2022, except for Oman where regression coefficients are estimated for the period 1990-2019. It represents the percentage change in employment as a result of a one percent increase in non-hydrocarbon GDP.

4. Ongoing diversification initiatives, outlined in Oman Vision 2040, offer significant prospects for generating attractive, high-skilled employment opportunities for Omanis. Nonetheless, to reap the full benefits of these diversification efforts, enhancing and broadening the skillset of the Omani workforce through upskilling and reskilling measures is critical. Additionally, it is imperative for the government to find a balance between integrating Omanis into the private sector and ensuring the labor market

Figure 3. Output and Total Employment in Oman



Sources: NCSI and IMF staff calculations. Note: The dashed portion in the black line reflects the structural change in the data due to the inclusion of Omanis working in the armed forces and in the family sector to overall employment from 2020 onward.

remains flexible enough to draw in foreign investment and skilled expatriate professionals. The envisaged transformation of the nonhydrocarbon economy, which continues to rely on low-skilled expatriate workers to expand, requires broad efforts to address existing bottlenecks in the labor market.

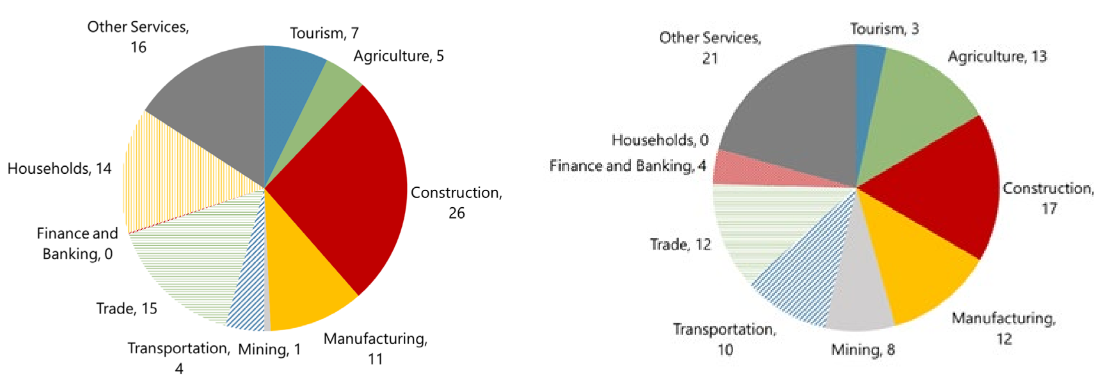
5. Against this background, this note discusses labor market challenges, recent trends and initiatives, and proposes complementary policies to address lingering bottlenecks. Section B analyzes Oman's labor market structure while identifying its main bottlenecks. Section C discusses recent trends, policy measures, and summarizes findings of recent analytical work on the impact of labor market policies in the GCC. Section D concludes and discusses policy recommendations.

B. Labor Market Structure and Bottlenecks

6. The labor market in Oman exhibits distinct segmentation. While 56 percent of the Omani workforce finds employment within the private sector,[2] public sector jobs remain a favorable destination for Omanis given the continued job security, higher remuneration, and more relaxed work arrangement. Using educational attainment as an indicator of skill level, expatriate workers predominantly occupy the lower-skilled job spectrum (IMF, 2021), making up 68 percent of Oman's overall employed labor force, and 86 percent of private sector jobs. Moreover, employment among Omanis in the private sector is more diversified, with significant participation in construction, agriculture, and manufacturing sectors. In contrast, expatriate workers primarily find employment in construction, domestic labor, and trade. Regarding sectoral employment shares, the share of Omani workers is high (exceeded 70 percent of total workers) in sectors primarily dominated by state-

Figure 4. Distribution of Workers in the Private Sector, 2023

(a) Omani Workers (Percent of Omanis working in the Private Sector) | (b) Expatriate Workers (Percent of Expatriates working in the Private Sector)



Sources: NCSI; and IMF staff calculations.

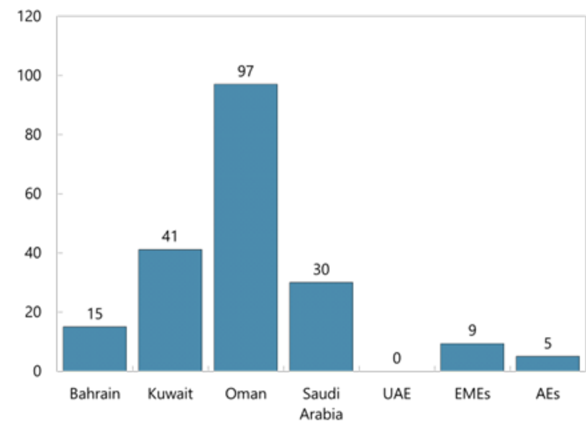
[2] Jobs in the private sector include positions within OIA-affiliated entities, which are governed by the labor law. Employment in the public sector is regulated by the civil service law.

owned enterprises (SOEs), including electricity and mining. Conversely, Omani workers constituted less than 15 percent of the workforce in sectors such as tourism, construction, and real estate.

7. Omanis command higher salaries in the private sector. Staff estimates that their wages are, on average, around twofold higher than those of expatriate workers occupying similar roles. This wage disparity is more pronounced in jobs requiring low to medium levels of skill, as inferred from educational attainment, particularly among male workers (IMF, 2021). The wage gap in these segments is largely attributed to the high reservation wage driven by public sector salaries, the lack of a minimum wage for expatriate workers, and the large supply of expatriate labor. The latter exerts a downward pressure on private sector salaries, rendering these roles less appealing to Omanis and deterring many employers from hiring them unless enforced by the prevailing quota system.

Figure 5. Public Wage Premium

(In percent, 2023 or latest available data)

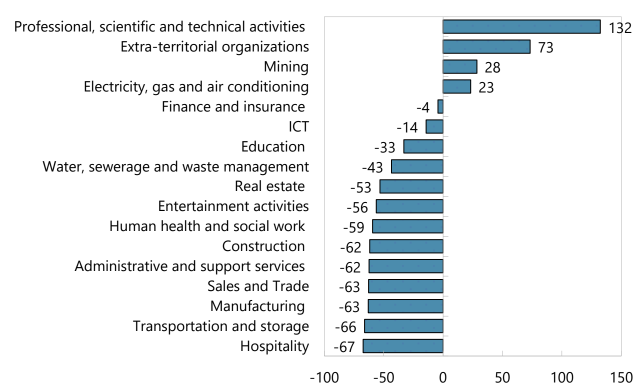


Sources: NCSI, IMF FAD Expenditure Assessment Tool and IMF staff calculations. Note: The wage premium is calculated for citizen workers only. While the most recent data for Saudi Arabia is from 2019, public sector wage employment growth suggests that the public sector wage premium has been trending downwards post 2019.

8. Public sector jobs are better remunerated and offer high job security. High salaries and generous benefits are another contributing factor to the public-private wage gap. As mentioned above, elevated public sector salaries raise the reservation wage expectations for private sector positions to be deemed attractive, leading to distorted incentives that result in mispricing of labor and fragmentation of the labor market (IMF, 2018). The substantial wage disparities observed between private and public sector jobs, as well as between Omanis and expatriates within the private sector, indicate a low substitutability between Omani and expatriate workers at current wages, especially in lower-skilled jobs.

Figure 6. Average Wages Across the Private Sector, 2023

(Percentage difference compared to public administration)



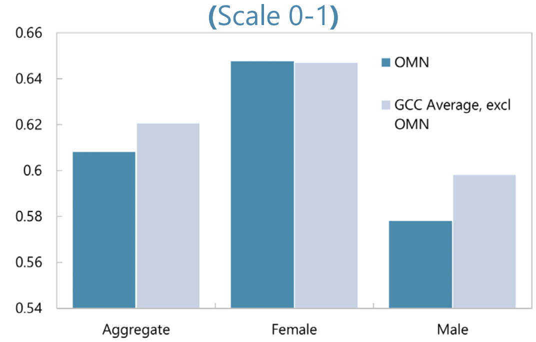
Sources: NCSI; and IMF staff calculations.

9. Oman's education system and the level of educational attainment among its citizens fare below its regional counterparts, and significantly below those observed in emerging markets and advanced economies. Despite Oman's commendable progress in enhancing its educational system, both the overall quality of education and enrollment to higher education remain inferior to those seen in other GCC countries, as evidenced by lower human capital that can be attained by children in Oman compared to peers, and lower average scores on the TIMSS mathematics scale. Moreover, the educational paths predominantly chosen by Omanis are still tilted towards humanities and business administration rather than science, engineering, and technology fields, as in other GCC countries (Arezki et al., 2018). Furthermore, enrollment rates in vocational education represents less than 2 percent of enrollment in higher education. All these factors have led to a discrepancy in the skills required by the private sector and those available in the labor market, especially for jobs that demand medium to high levels of skill.

10. The female labor participation rate has shown significant improvement over the recent years, yet it remains below that of men and other GCC economies. Overall female labor market participation rate stands around 32 percent in Oman in 2023, in stark contrast to the 89 percent for men. This discrepancy is particularly striking given that women tend to perform much better than men in educational attainment and outperform them in test scores. Omani women also hold much fewer senior and

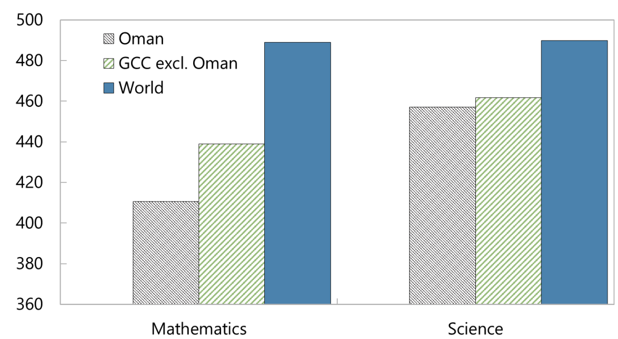
Figure 7. Human Capital Index, 2020

(Scale 0-1)



Sources: World Bank; and IMF staff calculations.

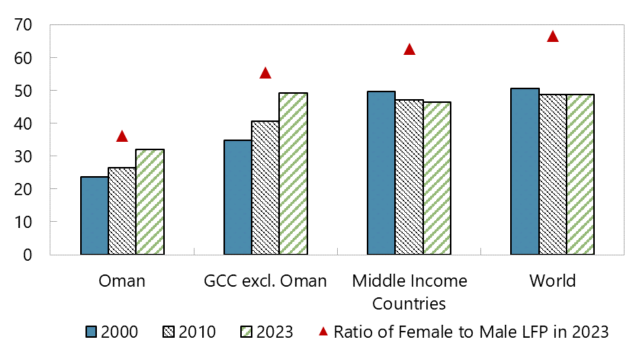
Figure 8. Average Scores of Grade 8 Students on TIMSS Mathematics and Science Scales (2019)



Sources: International Association for the Evaluation of Educational Achievement (IEA), Trends in International Mathematics and Science Study (TIMSS), 2019; and IMF staff calculations.

Figure 9. Female Labor Force Participation Rate

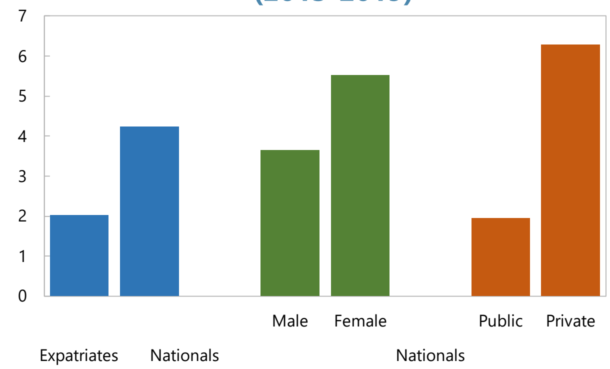
(In percent)



Sources: ILO Modelled Estimates and Projections database (ILOEST); and IMF staff calculations.

managerial roles, which could discourage them further from entering the labor market and investing in skill development. The government has recently introduced social protection and labor market reforms aimed at encouraging greater participation of women in the workforce.

Figure 10. Annual Employment Growth in Oman (2013-2019)



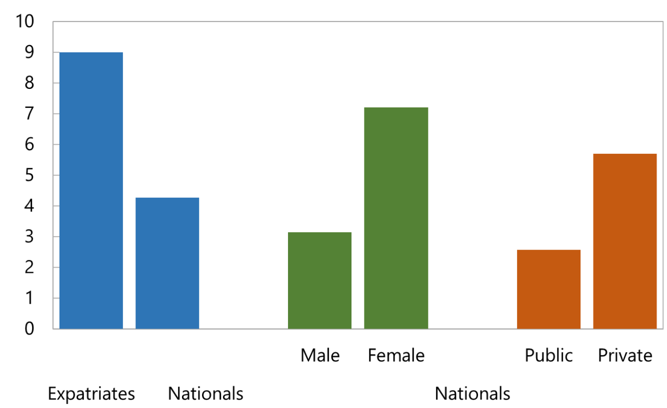
Sources: NCSI; and IMF staff calculations.

11. Another key bottleneck in the labor market is limited mobility. Until recently, the recruitment process for expatriates hindered their mobility due to the requirement to remain with their initial employer for 12 months before qualifying for an unconditional job transfer. These restrictions incentivized firms to hire expatriates rather than Omanis because of their lower bargaining power, depressing their wages, and acted as a deterrent for low-skilled Omani workers who might otherwise seek employment in the private sector. Limited mobility also eliminates market incentives, such as promotions and higher wages, disincentivizing expatriate workers from upgrading their skill set to acquire better-paid jobs, causing stagnation in productivity growth in nonhydrocarbon sectors as previously documented (Ismail and Troug, 2023).

C. Labor Market Trends and Recent Policy Measures

12. The pre-pandemic (2013-2019) employment landscape for Omanis experienced significant structural changes, affecting both men and women. While expatriates continued to constitute the backbone of the private sector workforce, employment grew more than twice as fast for Omanis than for expatriates. Employment growth among Omanis highlighted a notable inclination towards the private sector. For instance, employment growth was four times higher in the private sector (44 percent) than in the public sector (12 percent) between 2013 and 2019, accounting for over 80 percent of jobs created for Omanis. The inclusion of women into the workforce was particularly significant, albeit from a low starting base. Employment growth for Omani women was almost 60 percent higher than that for men during that

Figure 11. Annual Employment Growth in Oman (2020-2023)
(In percent)



Sources: NCSI; and IMF staff calculations.

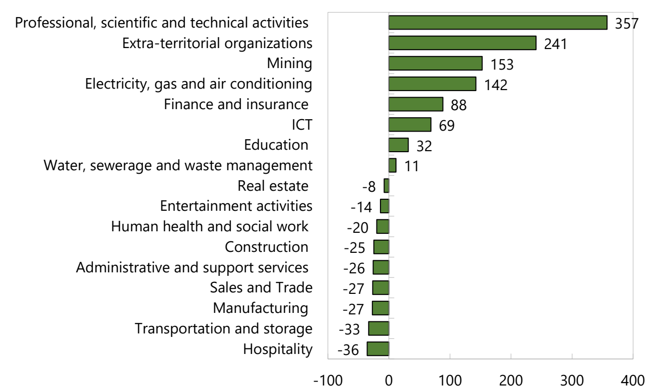
period.[3] Together with employment growth tilted towards the private sector, the share of Omani women working in the private sector grew from 33 percent in 2013 to 45 percent by 2019. In comparison, the share of men working in the private sector increased from 57 percent in 2013 to 62 percent in 2019.

13. These labor market trends favoring private sector employment and greater participation of women in the workforce continued following the COVID-19 pandemic, albeit with some differences. Compared to the pre-pandemic period, employment grew more than twice as fast for expatriates than for nationals. Among Omanis, employment growth remained driven by the private sector, which grew more than twice as fast (18 percent) than public sector employment (8 percent). In addition, employment growth for Omani women accelerated following the pandemic and reached 23 percent between 2020 and 2023, twice as high as for men (10 percent).

14. Sectoral employment data suggests that most private sector jobs created for Omanis over the last decade were in a few industries dominated by SOEs and in low-paid jobs. Jobs for Omanis were expanded primarily in construction, manufacturing, mining, administrative support, and financial services. New jobs were also created in the hospitality sector, reflecting Oman's rising attractiveness as a tourist destination. However, jobs created in the construction, manufacturing, and administrative support industries—comprising the majority of jobs created in the private sector over the last decade—tended to offer compensation below the Omani private sector average, suggesting that they are primarily occupied by low-skilled workers. The sectors mentioned above (except for financial services), as well as the transportation and trade sectors, were also among the largest contributors to employment gains in the aftermath of the COVID-19 pandemic, confirming a trend in job creation driven by relatively low-skilled, low-paid jobs.

Figure 12. Average Wages Across the Private Sector, 2023

(Percentage Difference Compared to the Private Sector Average)



Sources: NCSI; and IMF staff calculations.

15. More recently, Oman has undertaken notable measures to reinforce social protection and upgrade labor laws. Oman enacted a new social protection law in July 2023, creating a unified system that merges government-supported social protection programs and social insurance under the Social Protection Fund, providing a range of benefits both for Omanis and for expatriates. An upgraded labor law followed, aimed at enhancing job prospects for Omanis in the private sector.

[3] Compared to 2013, employment for Omani women was 38 percent higher in 2019. For men, employment grew by 24 percent. Out of the 43 thousand newly created jobs for Omani women between 2013 and 2019, only around one quarter were in the public sector. For men, only one fifth of the 60 thousand newly created jobs were in the public sector.

16. The new laws aim to make the labor market more flexible. The new laws standardize social insurance by ensuring equal pension rights across public and private sectors, mitigate the fragmentation of the pension system, promote remote working options, and add some labor protection provisions for expatriates. They broaden the scope of insurance benefits to cover maternity and paternity leave, sickness, and employment injury benefits, including for expatriates and, starting in 2026, they will shift end-of-service expatriate indemnities to the Provident Fund, managed by the Social Protection Fund. The enhanced provisions for maternity leave to 98 days and the introduction of paternity leave will contribute to a rise in female labor force participation. The laws introduce measures to support gender equality and social protection for women, including survivor benefits and a universal pension for the elderly, addressing deep-rooted disparities.

Box 1. Oman's New Labor Law: Moving Towards International Standards

Oman's new Labor Law, effective from July 26, 2023, was established by Royal Decree 53/2023, marking a significant overhaul of the Sultanate's labor regulations to align them with the Oman Vision 2040 goals and international labor standards. This comprehensive reform introduces several key changes across various dimensions of employment law to foster a labor environment that balances the needs of employers and employees and promote Omani private sector employment.

Omanization initiatives. The law strongly emphasizes "employment is a right for Omanis", mandating employers to formulate and gain approval for an Omanization plan from the Ministry of Labor, aimed notably at promoting Omanis to leadership positions. The law ensures that if an Omani worker is dismissed for poor performance, they must be replaced by another Omani. Additionally, the law restricts the termination of Omanis in favor of expatriates under similar competencies in case of any workforce reductions, illustrating the government's commitment to enhancing employment opportunities for its nationals.

Collective dispute resolution. A departure from the previous practice, where Omani courts handled employment disputes, the new law introduces arbitration for collective disputes through the Collective Labor Disputes Arbitration Committee, providing a framework for amicable resolutions.

Revamping employment contracts. The law includes anti-discrimination clauses and introduces modern work arrangements such as remote work. Fixed-term contracts have been adjusted with a provision that they do not automatically transition to indefinite term contracts unless employment persists beyond five years.

Introduction of redundancy. For the first time, redundancy due to "economic cause" is recognized, granting employers the flexibility to manage workforce adjustments, subject to approval from an interministerial special committee that also includes the Chamber of Commerce and the General Federation of Workers.

Expanded leave provisions. The law broadens statutory leave, introducing several new scenarios and extending existing ones to align leave provisions more closely with international norms. This includes extended maternity and sick leave, paternity leave, and special provisions for nursing workers and unpaid leave for childcare.

Retirement and expatriate worker benefits. The retirement age will gradually increase until it reaches 65 for men and 60 for women, with an adjustment in early retirement eligibility and benefits. The law also enhances benefits for expatriate workers, introducing sickness and injury benefits and overhauling the end-of-service grant to a funded account system.

17. Omani policymakers have more recently put a greater emphasis on incentives to hire nationals, in addition to long-standing administrative measures.[4] These incentives include:

- **Time-bound subsidies to employers**. They are meant to lower the relative costs of employing Omanis compared to expatriates. As such, the Ministry of Labor (MoL) introduced during the pandemic a wage support scheme, so far only covering under 4 thousand workers, whereby the government subsidizes OMR 200 per month of a worker's salary for a period not exceeding two years. This subsidy is raised to OMR 400 per month for SMEs and is targeted at workers with at least a vocational diploma.

- **Upskilling initiatives to better match Omani jobseekers' skillset with private sector needs**. The government covers the cost of training courses that are provided to job seekers, with some training schemes guarantying a job offer upon completion, and a monthly allowance during training. Monthly training allowances are also offered to new hires working in firms that wish to provide training themselves, with more generous subsidies for SMEs, where wages are entirely covered by the government during the first year of employment.

18. In their current form, incentives-based policies are unlikely to have a large effect on Omanis' participation in the private sector. The wage support scheme covers less than 1 percent of employed Omanis, while upskilling initiatives have so far benefited a limited number of workers. This is in contrast with neighboring economies such as Bahrain, where the National Employment Program (NEP) subsidizes nationals' employment for the first three years, or Kuwait and the United Arab Emirates, where a permanent subsidy to employ nationals is in place, whose cost is partly covered by expatriate fees.

19. Employment quotas for nationals could be costly and inefficient for firms as they distort their optimal hiring choices. While these costs must be balanced against potential long-term welfare gains for nationals resulting from higher skill accumulation, quantitative evidence for Saudi Arabia (Peck, 2017) shows that the enforcement of quotas comes at a large cost for firms and aggregate employment. While the number of Saudis employed in the private sector went up notably following Nitaqat's implementation, expatriate employment decreased by up to 15 times as much as the increase in Saudi employment.[5] Related research (Cortés et al., 2023) also highlights the damaging effects of quota enforcement on the performance of exporting firms due to a higher wage bill adversely affecting their competitiveness in international markets: The Nitaqat policy was

[4] Newly introduced measures include disqualifying companies that fail to meet Omanization quotas from participating in public procurement.

[5] While the Nitaqat policy is estimated to have created 63 thousand jobs for Saudi citizens, the program is estimated to be responsible for decreasing total employment by 948 thousand workers and causing 11,000 firm exits (a 50 percent increase in exit rates), presumably driven by effects on firm profitability.

associated with a reduction in firm headcount, an increase in the probability of firm exit, and a decrease in the probability of continuing to export, and in the volume of exports.[6]

D. Policy Recommendations

20. The new Social Protection and Labor Laws are a step in the right direction to tackle long-standing challenges in the Omani labor market. While the laws help address some of the bottlenecks identified in this note, their impact could be significantly strengthened through additional, complementary policies.

21. Supporting the alignment of wages in the public and private sectors more closely with productivity could enhance the attractiveness of private sector employment. While the new Labor Law puts a greater emphasis on improving productivity at work and aligning wages with performance in the private sector, an equivalent approach should be sought under the forthcoming adoption of the Public Employment Law and follow ongoing efforts under the Ejada[7] system to ensure that a rating scale, incentives, and promotion are aligned to performance. Ensuring that public sector wages and benefits are based on productivity could reinforce the attractiveness of private sector jobs for Omanis.

22. Active labor market policies should be strengthened and scaled up to reduce the skill mismatch with private sector needs. There is a pressing need for the education system to evolve to develop the necessary tools to equip students with the skills demanded by the private sector. This includes fostering critical thinking capabilities and cultivating leadership qualities that are essential for effective collaboration in work settings. Existing training initiatives have so far benefited a limited number of workers and should be scaled up. Adopting a dual-education system that merges vocational education with on-site training, in collaboration with the private sector, would help reduce skill gaps. Furthermore, continuing to enhance the quality of educational institutions will help attract young Omanis to pursue majors in technology and science, areas that will play a critical role to diversify Oman's economy.

23. Efforts to boost the participation of women in the labor market should be accelerated. Despite considerable advancements over the past two decades, further policy actions are needed to facilitate and empower Omani women in the workforce. These could include scaling up investment in early childhood education, enhancing access to financing for female entrepreneurs, expanding leadership programs under the Royal Academy of Management for aspiring Omani women to

[6] Consistent with Peck (2017), Cortés et al. (2023) also show that the number of foreign workers decreased disproportionately to the number of Saudis hired. In addition, they found that lower-skilled and lower-paid Saudi workers substituted for expatriates to meet quota requirements as average wages of Saudis decreased despite a higher wage bill. They also found persistent effects of the Nitaqat policy 3 years after policy announcement.

[7] Ejada is a system launched in 2022 to measure individual and institutional performance in public administrations. It aims to align, through incentives, employee performance with the objectives of the government organization.

ascend to senior positions, and further investing in digital infrastructure to facilitate flexible work arrangements under the new Labor Law.

24. Firms should be given the opportunity to expand according to business needs, while allowing quotas-based measures to gradually support the integration of Omanis in the private sector. To avoid the potential damaging impacts of a strictly enforced quota system, firms should be allowed to hire expatriates freely when needed. They could be required to pay a fee for each expatriate hired over and above the quota requirement. In turn, these revenues could be channeled towards skill development of nationals. In addition, incentive-based policies should be narrowed to sectors with low quota requirements, to lower their fiscal costs.

25. Lastly, enhancing labor market mobility for expatriate workers could help drive aggregate productivity up and attract more skilled expatriates. Further enhancing labor mobility and adopting a more flexible migration policy would underpin market incentives, such as promotions and higher wages, to drive competition between Omani and expatriate workers. This could encourage to invest in skill development and draw a greater number of mid to high-skilled expatriate workers, helping support the transition towards a knowledge-based economy and boosting prospects for aggregate productivity gains.

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FOSTERING ENTREPRENEURSHIP AND SMES TO SUPPORT ECONOMIC DIVERSIFICATION IN OMAN[1]

The transition to a vibrant economy under Oman Vision 2040 and the urgency to develop a more dynamic private sector that can absorb the entry of a young and educated labor force both stress the need to empower SMEs, which play a large role in supporting job creation and nonhydrocarbon activity in Oman. This note takes stock of the role of small and medium-sized enterprises (SMEs) in Oman, identifies past and current bottlenecks that hinder entrepreneurial dynamism, and documents recent reforms aimed at lowering the costs associated with doing business, facilitating access to finance, and enhancing the integration of SMEs into value chains. The analysis suggests that policies complementing existing initiatives, through a private sector driven credit guarantee scheme, by adapting insolvency frameworks tailored to SMEs, and supporting linkages between SMEs and multinational enterprises in Special Economic Zones (SEZs), could help maximize long-term gains to SMEs and the broader economy.

A. Context

1. SMEs are expected to play a key role in supporting long-term growth and job creation in Oman.[2] Oman aims to diversify its economy away from hydrocarbon production towards a private sector and knowledge driven economy that is competitive internationally, as stated in its national strategic plan, Oman Vision 2040. Concurrently, the economy will need to create around 30 thousand new jobs annually between 2024 and 2032 to absorb the entry of a young and increasingly educated labor force, which cannot longer rely on public sector jobs amid efforts to entrench fiscal sustainability (IMF, 2024a). As such, SMEs, which represented around 98 percent of firms, contributed to about 33 percent of nonhydrocarbon GDP, and employed 76 percent of the private sector workforce in 2023, are poised to play a larger role in Oman's diversification.[3]

2. Oman has experienced a decline in firm entry throughout the last decade. The startup rate, measured by the share of newly registered limited liability companies, has been on a downward trend in Oman during 2006-2020, falling from 14.5 percent in 2006 to 6.5 percent in 2020. A similar trend can be observed among all newly registered establishments through 2021, including when grouped by size as identified by initial capitalization levels (Figure 1).

3. SME activity rebounded in the post-COVID 19 period. The SME share of the private sector workforce increased from 68 percent in 2020 to 76 percent in 2023, mainly reflecting the expansion of small firms. Similarly, the SME contribution to nonhydrocarbon GDP slightly increased

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[1] Prepared by Bilal Tabti.

[2] In Oman, SMEs (micro, small and medium enterprises) are defined as firms with less than 151 employees or OMR 5 million in revenues.

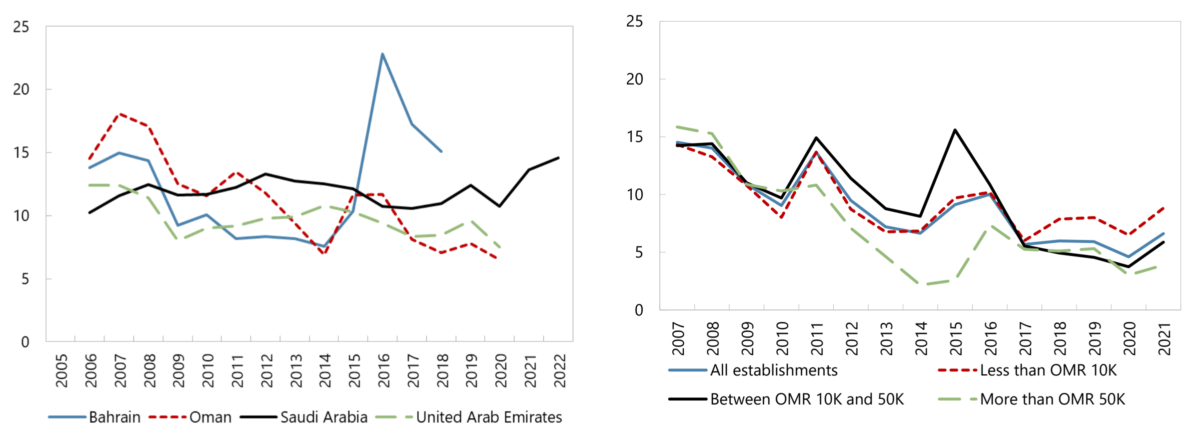
[3] Most of these firms operate in the wholesale and retail trade, construction, and manufacturing sectors.

following the pandemic to almost 33 percent (Table 1), but it remains well below that of other peers (for example, UAE's level at 64 percent in 2022).[4]

Figure 1. Startup Rates Across GCC Countries

(Newly registered firms/establishments in percent of total firms/establishments)

(a) Limited Liability Companies **(b) Establishments in Oman by Initial Capital**



Sources: World Bank, Global Entrepreneurship Database, NCSI, and IMF staff calculations.

Table 1. SMEs Contribution in Oman

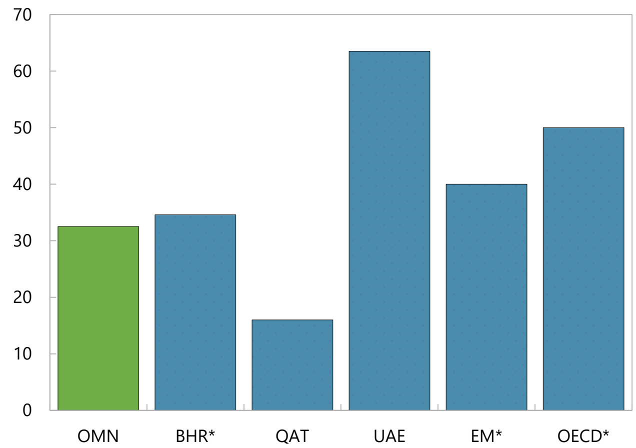
	2020	**2023**
SME (% nonhydrocarbon GDP)	31.3	32.5
SME Employment Share	68.4	75.7
o/w micro	35.1	35.9
o/w small	23.8	31.3
o/w medium	9.5	8.5
SME Rate	99.6	99.7
o/w micro	88.2	85.6
o/w small	10.4	13.3
o/w medium	1.0	0.8

Source: NCSI and IMF staff calculations.

Note: Employees and firms in public administration are excluded from calculations.

[4] See [Small and Medium Enterprises | The Official Portal of the UAE Government.]

Figure 2. SMEs Contribution to GDP Across Countries
(Percent of nonhydrocarbon GDP, unless otherwise stated*)



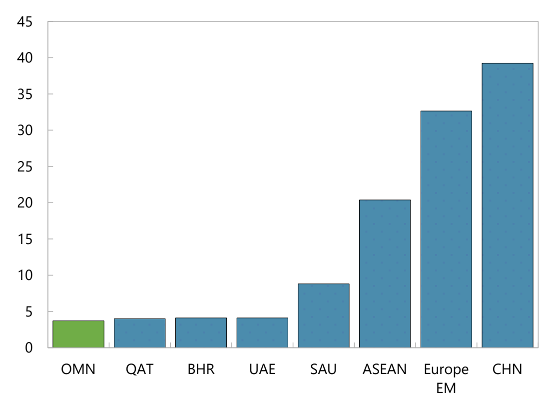
Source: NCSI; Ministry of Finance and National Economy (BHR); Qatar Chamber of Commerce; Ministry of Economy (UAE); World Bank; OECD and IMF staff calculations.
Note: *are in percent of total GDP.

B. Obstacles to SME Development

4. SME growth and entrepreneurship have been hindered by several obstacles in Oman. In particular:

- **Limited access to credit.** As in many other emerging markets and developing countries (EMDEs), entrepreneurs planning new business ventures and SMEs' expansion projects have faced constraints in access to finance through commercial banks, owing to higher risk (as non-performing loans are estimated at almost one third of total loans to the sector), imperfect information about business prospects, and lack of collateral. While the Central Bank of Oman (CBO) has long recommended a floor of 5 percent of commercial banks' loan portfolio to be allocated to SMEs, this has only reached 3.7 percent in 2022 (Figure 3), highlighting the need for additional initiatives that can help crowd in commercial banks.

Figure 3. Credit to SMEs
(Percent of total commercial bank loans)



Source: CBO; IMF Financial Access Survey; Qatar SME lending report; Saudi SME Bank; and IMF staff calculations.

- **Risk-taking is insufficiently encouraged**. On one side, insolvency legislation in Oman does not provide for a path towards financial rehabilitation to struggling entrepreneurs wishing to return to business activity and it was until recently, difficult for distressed business owners to restructure company debt while continuing their operations. On the other side, existing legal forms of incorporation used to impose a high capital threshold to register as a limited liability company, and thus disincentivized self-employed individuals and small business owners to separate their personal assets from their businesses. These bottlenecks highlight the importance of reducing administrative and legal costs to support SMEs and young entrepreneurs. As in other GCC countries, relatively high salaries and job security offered by the public sector have also acted as an additional deterrent to risk-taking and calls for encouraging a more entrepreneurial mindset among young Omanis.

C. Recent Policy Actions

5. **The Omani authorities started enacting key reforms in recent years to tackle several of the shortcomings previously identified.** A Bankruptcy Law was introduced in 2019 to allow distressed companies to continue operating under certain conditions. In the same year, a new Commercial Companies Law was also introduced (replacing the old 1974 Companies Law) to facilitate the incorporation of One-Person Limited Liability Companies and a Credit Bureau (Mala'a) was established to enhance credit decisions by alleviating asymmetric information constraints. The Invest Easy One-Stop Shop was launched in 2021 to facilitate doing business in the country. Home businesses and freelancers are also now able to benefit from a commercial registration number.

6. **The SME Development Authority (Riyada) has launched a wide-ranging array of initiatives to ease SMEs' access to finance, in partnership with Oman Development Bank (ODB).** Riyada's funding is provided for a variety of purposes, including: (i) working capital and fixed assets acquisition; (ii) supporting businesses in increasing their in-country value (ICV); and (iii) accompanying firms in business incubators. More than 400 projects have been financed since 2022, for a total of OMR 38 million. Riyada has also launched this year a grants system to support innovative and high-tech SMEs and provided support to 67 projects so far; and is currently working on enabling Family Offices to support SMEs as Angel Investors. ODB also offers loan facilities to support micro projects (up to OMR 20 thousand) and SMEs (up to OMR 250 thousand). Trade credit insurance for SMEs doing business domestically and abroad is also available through Credit Oman, a government-owned entity. In addition, the recently launched OIA's Future Fund Oman, an OMR 2 billion growth fund focused on investing in nonhydrocarbon private sector industries, targets 10 percent of its investments in SMEs—reaching OMR 60 million as of September 2024.

7. **Several private sector initiatives to expand access to finance continue to play a pivotal role and are expected to grow further in the future.** Bank Muscat, with IFC support, was a pioneer in Oman in providing collateral-free lending to SMEs through its "al Wathbah" program over a decade ago, alleviating one of the biggest hurdles facing entrepreneurs. The SME Development Fund, an entity owned by both public and private stakeholders and established in 2014, provides subsidized credit for asset acquisition or project financing (up to OMR 500 thousand). SMEs have also been able to access crowdfunding since 2021, with 9 platforms registered so far. Going forward, capital markets and private equity are expected to play a key role in the SME financing landscape, through the establishment of a parallel stock market for emerging businesses,

including SMEs, and an investment company focused on providing financing to SMEs in industries targeted by Oman Vision 2040.

8. **Better integration of SMEs into the business landscape is ongoing.** SMEs are exempt from registration fees on Esnad—the electronic platform for government tenders—and benefit from a preference for government procurement contracts within a 10-percent price differential. The Public Authority for Special Economic Zones and Free Zones (OPAZ) has several programs in place to better integrate SMEs into value chains of Special Economic Zones (SEZs), targeting 10 percent of contract values to be allocated to SMEs. OPAZ has also dropped markedly registration and service fees for SMEs within SEZs.[5] In cooperation with OPAZ, Riyada has established SME incubators to take advantage of knowledge diffusion through FDI and has increased access to finance to SMEs operating in SEZs through the Tawasul Fund, in partnership with ODB.

D. Policy Priorities: Building on the Reform Momentum

9. **Ongoing reforms are steps in the right direction, but more remains to be done.** Encouraging risk-taking by reducing the costs associated with business failure and enhancing access to finance will foster entrepreneurship, while supporting linkages with leading foreign firms will help SME grow.

Encouraging Risk-Taking

10. **Modernizing insolvency frameworks would help foster innovation and encourage entrepreneurship**.

- **Tailoring insolvency procedures to SMEs.** The newly introduced restructuring procedure in Oman does not cover businesses in operation for less than two years and post-bankruptcy rehabilitation lacks debt forgiveness. Entrepreneurs would thus benefit from additional amendments to bankruptcy legislation, similar to those adopted in Bahrain, by (i) considering a streamlined and less costly procedure for SMEs, and (ii) offering a path of financial rehabilitation to business owners by allowing non-consensual debt relief (Box 1). Insolvency procedures for SMEs should also allow entrepreneurs to remain in control of the business, given their importance in business operation compared to larger firms (World Bank, 2022). These actions could help entrepreneurs venture into riskier activities that ultimately stimulate innovation and productivity growth, while preserving creditors' rights. Evidence suggests that reforms aimed at streamlining the reorganization process are associated with stronger firm recovery (Gine and Love, 2010).

- **Adopting an Early Warning Tool.** To complement insolvency legislation reforms, an Early Warning Tool aimed at identifying debtors' emerging difficulties to support early interventions

[5] Registration fees for SMEs within SEZs dropped from OMR 1 thousand to between OMR 30 and 40, while OPAZ service fees were reduced by 50 percent (see Public Authority for Special Economic Zones and Free Zones).

to avoid insolvency could also be considered, drawing from the experience of Denmark and France (World Bank, 2022).

Enhancing Access to Finance by Mobilizing the Private Sector

11. Initiatives to support access to finance would gain from being more market driven. Oman has undertaken considerable efforts to support access to finance, but many remain concentrated in public financial institutions, which may possess neither the expertise in screening and monitoring businesses nor the same proximity to enterprises as private banks.

12. To strengthen incentives for commercial banks to expand credit to SMEs, a well-designed credit guarantee schemes (CGS) could be implemented to alleviate collateral constraints.[6] CGS present several attractive features. One key advantage is that they enable to push the risk frontier more effectively than commercial banks, because they allow governments to spread risks that insufficiently developed financial markets cannot bear, while leveraging the private lenders' superior ability to screen and monitor entrepreneurs (Anginer et al., 2014). Empirical evidence is consistent with the effectiveness of CGS in supporting SMEs' access to finance (Zecchini and Ventura, 2009).[7]

13. Credit guarantees can differ depending on public policy objectives as well as the firms and sectors targeted. Important considerations in the design of CGS include the coverage ratio and the CGS ownership structure:[8]

- **Guarantee coverage**. Partial guarantees (less than 100 percent) are important to mitigate moral hazard and incentivize adequate monitoring from commercial banks. However, partial guarantees may not help reach all business segments. In nascent industries and sectors considered as priority by Omani policymakers, a full coverage may need to be assessed. For instance, in Korea, the Technology Guarantee Fund was created to facilitate financing for new-technology firms, which may cover up to 100 percent of the loan, while also assisting with business prospects evaluation and technology appraisal (OECD, 2013). This reveals that while standard CGS can reach most SMEs, in some cases moral hazard and financial sustainability considerations are outweighed by the need to support innovative entrepreneurs. Similarly, in the US, the coverage ratio of credit guarantees under the "7a" loan program is higher for smaller

[6] Survey evidence of CGS across European countries (Chatzouz et al., 2017, ECBI, 2014) show that the primary failure they address is the lack of collateral for SMEs and young businesses (rather than information frictions), by providing mostly guarantees for investment or working capital loans.

[7] Firms in Italy which benefitted from CGS exhibited higher leverage and lower borrowing costs than otherwise similar firms. Survey findings from Western Europe indicate that banks also report that the main value-added of CGS is that they lower borrowing costs and enable to reach SMEs with riskier projects or lower collateral requirements (Chatzouz et al., 2017).

[8] See World Bank (2015).

loans, hinting at the need to reach the smallest firms that could face more acute financial constraints.[9]

- **Ownership structure**. Private sector involvement tends to be associated with better financial performance (Beck et al., 2010).[10] Full private ownership through mutual guarantee schemes (MGS) could also be considered. A notable example is the *Confidi* system in Italy, formed by over 200 local mutual guarantee schemes that vary in their sectoral and geographical coverage and are owned by local enterprises. They have an information advantage about business prospects and can induce peer pressure and are more involved in credit assessment than public CGS (OECD, 2013). The organization of MGS could be considered in industries where there is a sufficiently developed ecosystem of local enterprises that can assess small enterprise business prospects.

14. Mala'a's continued reforms to become a full-fledged credit bureau would maximize the gains of insolvency and financial access reforms. Information collected by the credit bureau should be fully utilized for the appraisal of creditworthiness of loan guarantees. Leveraging information on personal credit history would also complement personal insolvency legislation as it could help secure creditors' rights, while encouraging risk taking.

15. Scaling up FinTech could support small business lending. Ongoing efforts under the CBO's FinTech Accelerator Program to establish an ecosystem of Fintech startups—currently supporting two startups focused on microfinance and loan-based crowdfunding—should continue to enhance SMEs' financial inclusion. FinTech loans can have a catalytic effect on firms' future access to finance as they tend to be junior unsecured loans. Beaumont et al. (2024) show that in France, access to FinTech loans was used to acquire new assets that could then be pledged as collateral for bank credit. They reported a subsequent significant increase in bank credit. FinTech loans were also used to substitute for expensive short-term financing.

Helping SMEs and Entrepreneurs Grow

16. Efforts to strengthen the integration of SMEs into SEZs value chains should be accelerated. The diversity of industries across SEZs presents a unique opportunity for SME growth. Current pilot initiatives to facilitate the integration of SMEs in SEZs should be further expanded. Efforts should particularly focus on connecting large multinational enterprises operating in SEZs with SMEs, by identifying the needs of the former and helping the latter acquire the knowledge and skills to supply large foreign firms. Local SMEs in Oman would benefit from policies that enhance spillovers from multinational enterprises (MNEs) by strengthening linkages between them and by increasing local SME capacity (OECD, 2023). These policies could include:

[9] See Types of 7(a) loans | U.S. Small Business Administration, where the coverage ratio is 85 percent for loans under $500 thousand and 75 percent otherwise. In addition, collateral is not required for loans under $50 thousand.

[10] Similarly, Chatzouz et al. (2017) indicate that while most CGS in Western Europe are publicly owned, many do not operate for profit.

- Support in technology acquisition, digitalization (IMF, 2024b), and R&D across SMEs, for instance, through grants and business incubators. Efforts to increase productivity among domestic SMEs could later be complemented by support in reaching export markets, including through financial assistance, marketing local companies abroad, and helping entrepreneurs connect with foreign enterprises and investors.[11]

- Increasing the skillset of labor in SMEs, and encouraging labor mobility of expatriates (IMF, 2024a). This could involve wage subsidies or time-bound cash grants for SMEs to hire skilled foreign workers or with specific skillsets and backgrounds, as well as incentives to encourage high-skilled expatriates working in Oman create SMEs within SEZs. For Omanis, collaboration between universities and SEZs could be enhanced, by collaborating with MNEs in SEZs to identify future workforce needs and adapt program courses to businesses requirements and by incentivizing internships of students in local SMEs and foreign MNEs to build human capital.[12]

- Identifying collaboration opportunities between local SMEs and large MNEs and helping the former acquire the knowledge and skills to meet production requirements for foreign companies. The Invest Oman initiative could be leveraged to promote domestic SMEs, connect them with foreign MNEs, assess their needs and support upskilling of local firms to meet them, as implemented in other country cases, such as by the Investment Development Agency in Portugal (OECD, 2022).[13]

[11] In Czechia, Czech Match helped SMEs connect with foreign partners through advisory services and a one-week acceleration program abroad, while the Czech Accelerator program supported domestic SMEs by providing space in foreign incubators. In the Slovak Republic, the Investment and Trade Development Agency designed an "Online B2B matchmaking" tool to help firms find customers abroad (OECD, 2024).

[12] In Portugal, the *Inov Contacto* program managed by AICEP (Trade and Investment Agency) supports high-skilled graduates in conducting a short-term internship in a local firm followed by a longer-term internship in a multinational company abroad, together with a training course on international management (OECD, 2022).

[13] The "Suppliers Clubs" initiative of AICEP helped match foreign and domestic firms to collaborate on joint projects, and provided financial support to help local SMEs meet foreign firms' requirements.

Box 1. Corporate Bankruptcy Reform in Oman

Oman's new Bankruptcy Law became effective in 2020 (Royal Decree 53/2019) and offers the possibility for distressed business owners to restructure their debt while continuing operations. The restructuring process is expected to occur with minimum court supervision, facilitated by the Ministry of Commerce's role as a mediator, and does not require a high threshold of creditors to agree. However, some caveats exist:

- The company needs to be in operation for at least two years, potentially discouraging new entrepreneurs to start riskier projects.

- Even if a majority of creditors agree to restructure the company debt, the agreement does not bind non-participating parties to the agreement.

The two other alternatives present in the law are (i) bankruptcy, and (ii) preventative composition. Bankruptcy in Oman, as in several other countries in the region, does not imply debt forgiveness. Preventative composition, unlike restructuring, happens under court supervision and requires a majority of creditors holding two thirds of claims to consent to a settlement, and is binding to all creditors. However, like bankruptcy, it does not lead to non-consensual debt discharge.

The law, in addition to the new, out-of-court restructuring procedure discussed above, no longer imposes civil disabilities to bankrupt owners of liquidated companies. However, creditors remain entitled to enforce their claims following the post-bankruptcy period (3 years), and the law does not feature a simpler procedure for small businesses that address characteristics specific to SMEs such as greater creditor disengagement and lower business sophistication. Simpler procedures would be particularly beneficial to SMEs given that they tend to be more vulnerable than larger businesses to economic downturns and less willing to attempt insolvency procedures due to high costs and documentation requirements, preventing a reallocation of resources following liquidation. Oman could draw from Bahrain's example:

In 2018, Bahrain became the first country in the region to allow individual entrepreneurs to be discharged of their debt following bankruptcy, under certain conditions. In addition, the country has enacted provisions that directly benefit small businesses below an asset threshold of BHD 10 thousand. Specifically, the bankruptcy procedure no longer requires a trustee or a creditor committee. It allows reorganization plans to be adopted by a simple majority and empowers the court to impose a plan that pursues the best use for the debtor's assets, while shortening timelines for dispute resolution. Financial support is also provided to small business debtors to cover their bankruptcy proceedings expenses.

Oman would benefit from introducing a bankruptcy reform that provides a streamlined procedure for SMEs in line with international standards (United Nations, 2024), including with lower documentation requirements, supervision by insolvency specialists, simplified procedures for business liquidation and reorganization, simpler plan approval mechanisms, minimal use of courts and financial support to small businesses to start the bankruptcy procedure (World Bank, 2022).

Sources: Curtis, Mallet-Prevost, Colt & Mosle LLP; Kilborn, 2020; United Nations, 2024; World Bank, 2022.

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EMBRACING DIGITALIZATION TO ACCELERATE OMAN'S ECONOMIC TRANSFORMATION[1]

Oman has set digitalization as a key pillar of its economic transformation agenda—Oman Vision 2040—, with various strategic initiatives being deployed to achieve the overarching goal of increasing the contribution of the digital economy to overall gross domestic product from its current level of about 2 percent to 10 percent by 2040. This paper: (i) takes stock of the state of digitalization in Oman, with a view of identifying areas of strength, but also pointing to gaps, notably relative to regional peers; (ii) provides an illustration of potential gains from enhanced digitalization; and (iii) highlights policy priorities that can support the authorities endeavors in advancing their digitalization agenda. The findings suggest that while Oman has progressed well on some aspects of digitalization, such as internet penetration and 4G and 5G population coverage, it still needs to deploy additional investments and efforts to match its GCC peers on several other aspects. Further efforts are particularly needed to raise internet connection speed, increase the prevalence of advanced ICT skills among the population, usher in digital innovation, and promote e-commerce. The analyses indicate that enhanced digitalization, can, in turn, engender substantial gains. Going forward, policy priorities to entrench the digital transformation and achieve its targets include further upgrading the digital infrastructure, increasing R&D spending, and expanding funding opportunities for digital start-ups and SMEs.

A. Context

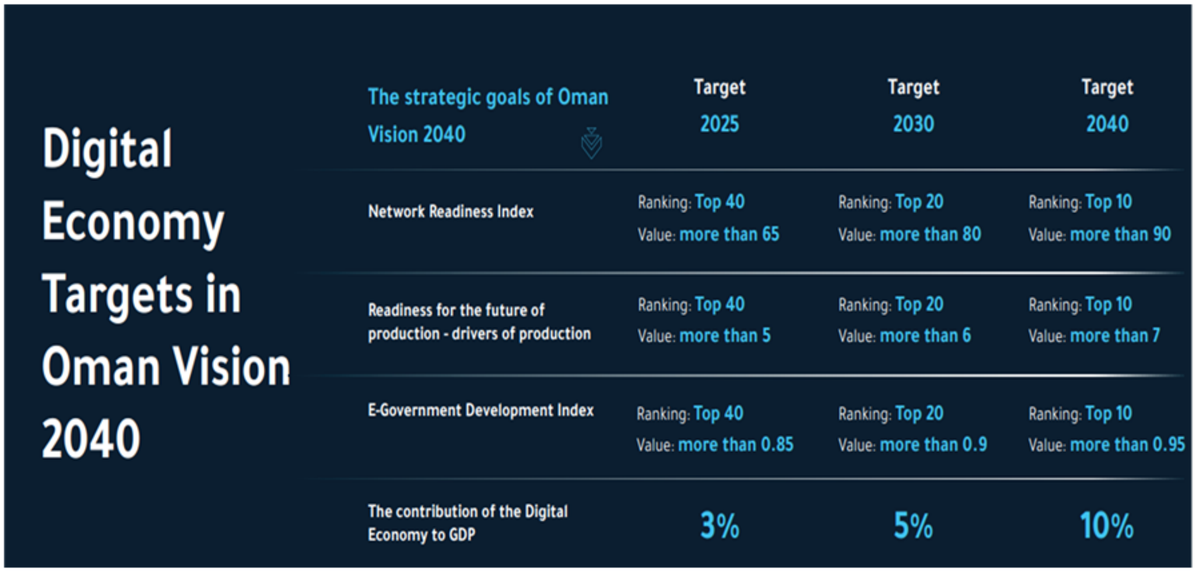
1. **Rapid adoption of digitalization is transforming societies and economies across the globe.** Digitalization, which broadly refers to the process of utilizing digital technologies to transform traditional processes, systems, or businesses into digital formats, is marking a profound shift in how individuals, businesses, and governments operate. Recent years have seen a remarkable increase in the importance of digitalization, driven by advancements in technology and the ubiquitous penetration of the internet as well as global events such as the COVID-19 pandemic, with profound and far-reaching effects on productivity, employment, economic growth, financial inclusion, and governments' effectiveness in delivering services, managing resources, and engaging with citizens.

2. **Digitalization stands as a key pillar of Oman's economic transformation agenda.** Underpinned by its Vision 2040, Oman has embarked on an ambitious reform agenda aiming at reducing its reliance on hydrocarbons and creating a more sustainable, more inclusive, and knowledge-based economy. Among other transformative means and goals, Oman seeks to scale up digitalization, harness digital technologies, and develop local capabilities in innovation and creativity. In this context, the government has recently launched the "National Digital Economy Program", which aims to provide a strategic direction for the development of the digital economy and increase its contribution to Oman's Gross Domestic Product (GDP) from its current level

[1] Prepared by Mohamed Belkhir.

estimated at 2 percent to 10 percent by 2040. In addition, this program aims to advance Oman's global ranking in various digital economy indicators identified in Oman Vision 2040, such as the e-government development index and the network readiness index (Figure 1).

Figure 1. Digital Economy Targets in Oman Vision 2040



3. **Oman's digitalization agenda covers a broad range of areas.** To achieve the targets of the National Digital Economy Program, the authorities have designed a set of medium-term programs aimed at fostering the adoption and localization of digitalization in various areas. These programs include the: (i) Digital Government Program; (ii) Digital Infrastructure Program; (iii) Digital Industry Program; (iv) E-commerce Program; (v) Artificial Intelligence and Advanced technologies Program; (vi) Space Program; and (vii) Fintech. Each of these programs has specific targets to be achieved within a certain time horizon. For example, the Artificial Intelligence (AI) and Advanced technologies Program aims to increase the number of startups specialized in AI technologies' development and SMEs providing AI-related services by 20 percent annually, while the Digital Industry Program aims to attract 5 global tech companies to establish operational units in Oman by 2025 and the Fintech program targets the licensing of 500 fintech operators by 2040.

4. **This paper provides an overview of Oman's progress on digitalization, quantifies potential gains from enhanced digitalization, and highlights policy priorities going forward.** The paper first sheds light on Oman's progress in recent years on various dimensions of digitalization, including digital infrastructure, skills, innovation, e-government, fintech, and e-commerce, while also pointing to gaps relative to regional and international peers, and highlighting potential for improvement going forward. It then provides an illustration of the gains that Oman could reap from enhanced digitalization; specifically, we use empirical analyses to quantify gains from enhanced digitalization in terms of government effectiveness and GDP per capita. Finally, the

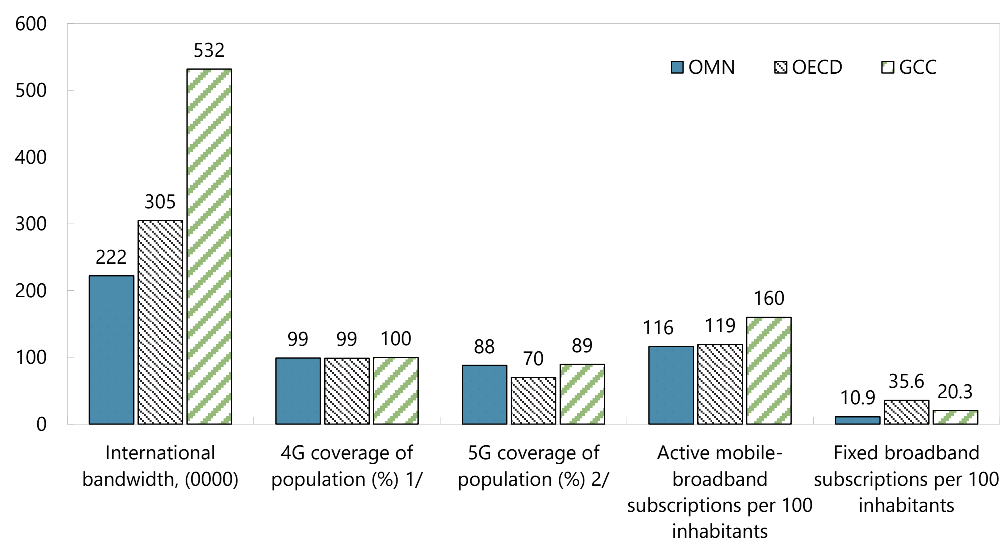
paper lays out a set of policy recommendations intended to support the authorities' endeavors in accelerating digitalization and maximizing the benefits thereof, while also minimizing potential risks.

B. Digitalization Trends: Where Does Oman Stand?

Digital Infrastructure

5. Oman continues to upgrade its digital infrastructure. Securing high quality digital infrastructure is key to improving coverage, quality, and affordability of digital connectivity and the overall development of telecommunications and internet markets. The latest available data suggest that while Oman matches GCC and international peers on some digital infrastructure indicators, it still needs to catch up on several others (Figure 2). Oman has achieved about 100 percent 4G coverage, while along with other GCC peers, it is ahead of the average OECD country on 5G coverage—88 percent of the population versus 70 percent. Gaps relative to the GCC average, however, remain on international internet bandwidth capacity and mobile and fixed broadband subscriptions, suggesting that additional investments and upgrades to regulatory frameworks are needed for Oman to bring its digital infrastructure up to levels reached by its immediate neighbors.

Figure 2. Selected Digital Infrastructure Indicators, 2022



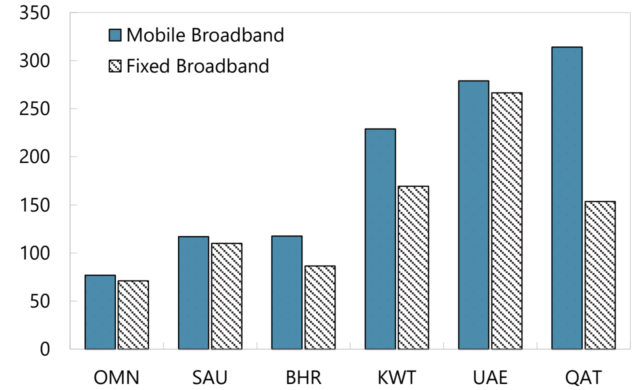
Sources: International Telecommunications Union (ITU) and IMF staff calculations.

1/ Refers to the percentage of inhabitants that are within range of at least a 4G/ LTE mobile-cellular signal, irrespective of whether or not they are subscribers.

2/ Refers to the percentage of inhabitants that are within range of at least a 5G mobile-cellular signal, irrespective of whether or not they are subscribers.

6. Internet penetration in Oman is among the highest in the world, while further efforts are needed to increase connection speed. Data suggests that as of early 2024, about 98 percent of Oman's population used the internet, making internet penetration rate one of the highest in the world. During the same period, active cellular mobile connections amounted to the equivalent of 151 percent of the total population. With median mobile (fixed) internet connection speed at 77 (71) Mbps in April 2024, however, Oman ranks 38th globally and stands way behind its GCC peers, three of which are the world's medalists, suggesting that further upgrades to the digital infrastructure and additional regulatory and policy measures are needed to increase internet connection speed (Figure 3).

Figure 3. Median Internet Connection Speed (Mbps), April 2024

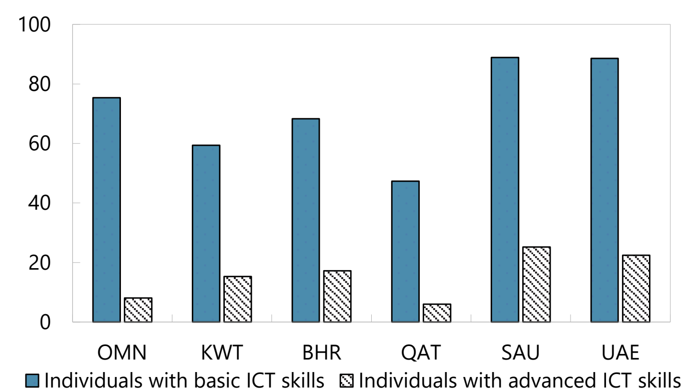


Note: Values in boxes indicate the country's global ranking for the mobile broadband internet connection speed.
Source: Speedtest Global Index and IMF staff calculations.

ICT skills and Digital Innovation

7. More remains to be done on upskilling the labor force in information and communication technologies (ICT). The proportion of youth and adults with ICT skills is one of the indicators commonly used to monitor countries' progress on Sustainable Development Goals (SDG target 4.4.1). With 75 percent of individuals possessing basic ICT skills in 2020-21, Oman exceeded by far the average for advanced economies (AEs), but has further room for improvement if compared to GCC frontrunners (Saudi Arabi and the United Arab Emirates). As of 2020-21, the proportion of individuals with advanced ICT skills, which are most critical for the emergence of a sizable digital economy, stands, however, at 8 percent, below levels seen in most GCC countries, indicating that further efforts are needed to increase the prevalence of advanced ICT skills among the nationals and to attract foreigners equipped with such skills (Figure 4).

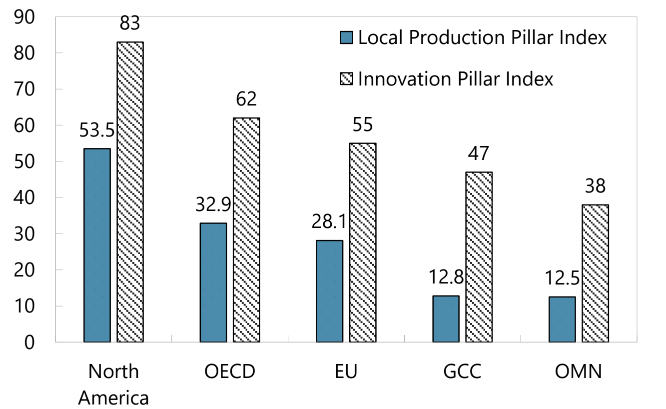
Figure 4. Share of Individuals with ICT Skills
(Percent of Total, 2020/2021, Latest Available)



Sources: International Telecommunications Union (ITU) and IMF staff calculations.

8. Oman needs to step up efforts and resources to boost innovation capacity and support the local production of digital goods and services. Oman made laudable progress over the past few years on its ranking in the Global Innovation Index compiled by the World Intellectual Property Organization, rising from 80th in 2019 to 69th in 2023 among about 130 countries. Despite recent progress, Oman's score on the Innovation Pillar Index suggests that it still needs to take bold policy actions to elevate its innovation capacity to higher levels, including increasing R&D investments, developing digital talent on a larger scale, and providing support to domestic digital entrepreneurs. Such actions are also likely to bolster the country's digital goods and services' production, which remains subdued when benchmarked against such global leaders as North America and the European Union; with a local production index of 12.5, Oman is also slightly below the GCC average (Figure 5).

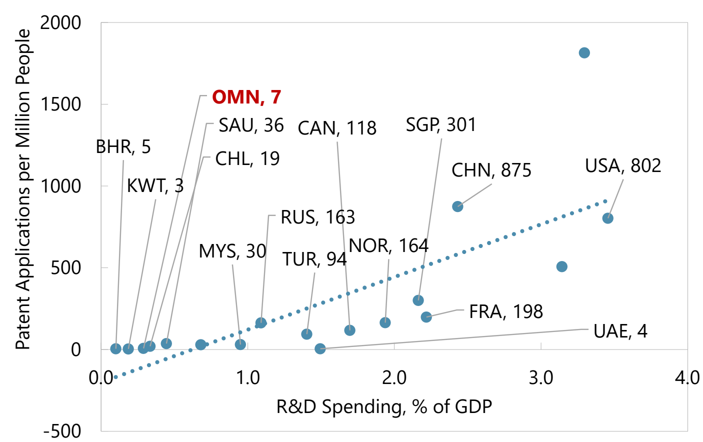
Figure 5. Local Digital Production and Innovation Pillar Indices, 2020



Source: Global S&P, PwC Strategy & Analysis, and IMF staff calculations.

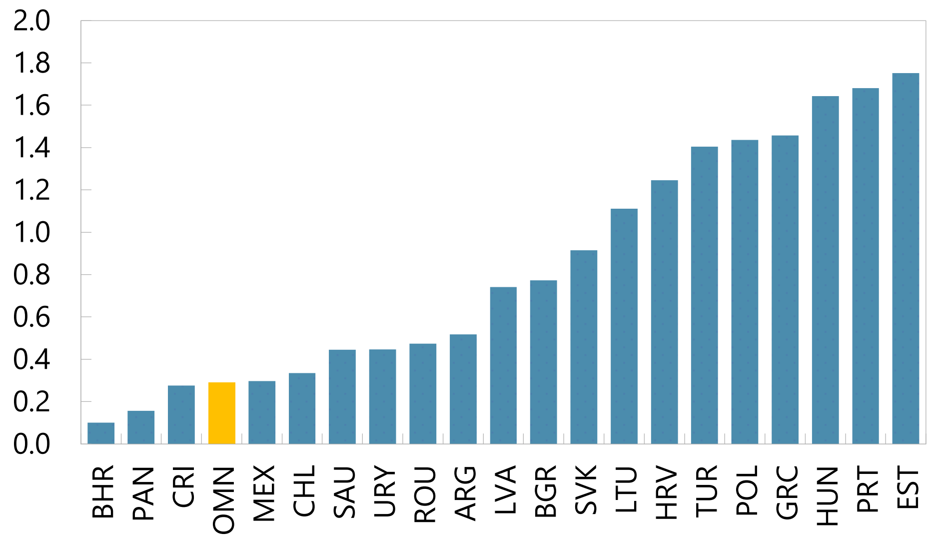
9. Scaling up R&D spending would support innovation in Oman, including in digital activities. Digital innovation on a large scale by domestic companies is essential for driving economies to the technological frontier, enhancing productivity, and fostering the development of a knowledge-based economy. This, however, requires a high level of R&D spending. Oman's number of patent applications is comparatively low, including relative to other resource-rich countries such as Chile, Malaysia, Norway, and Russia, suggesting limited capacity to innovate (Figure 6). Oman's R&D spending stands currently at about 0.3 percent of GDP, which is one of the lowest among countries with comparable income, indicating that there is scope for increasing it (Figure 7). Boosting R&D spending, particularly in digital sectors, has the potential of fostering a thriving innovation ecosystem that supports the creation and production of digital goods and services on a scale that can help in achieving Oman's digital economy targets.

Figure 6. Patent Applications vs. R&D Spending
(Latest Annual Observations)



Source: Richie et al. (2023); IMF staff calculations.

Figure 7. R&D Spending
(In percent of GDP)



Note. The chart represents R&D spending (in percent of GDP) in Oman and in the 20 countries with the closest GDP per capita to Oman in 2023, those immediately below (10 countries) and above (10 countries) Oman's per capita income.
Sources: Richie et al. (2023), IMF WEO data, and IMF staff calculations.

Government Digitalization

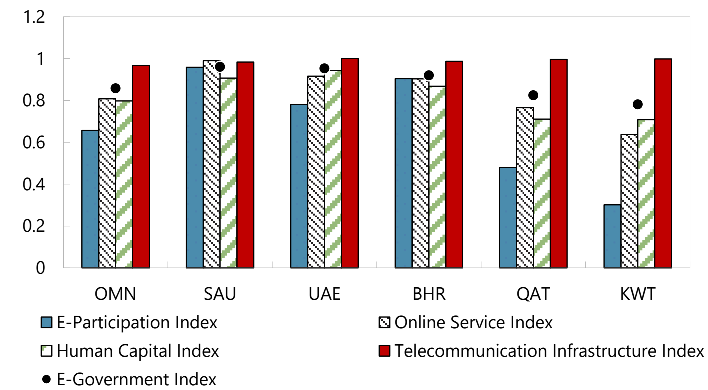
10. Oman has recently made notable progress in digitizing its government services. Digitalization of government services will support enhancing the quality of public services provided to citizens, streamlining government processes, and fostering efficiency and transparency. Boosted by the Government Digital Transformation Program launched in 2022 by the Ministry of Transport, Technology and Information Technology—set to run until 2025 with an estimated investment of $442 million—Oman now ranks 41st on the United Nations' E-Government Index, up from 50th in 2022 (Figure 8). With this important leap, Oman stands at only one place short of its 2025 target (40th globally). Notwithstanding this progress, Oman has still scope for improving its e-government performance, including to catch up with GCC top performers (Bahrain, Saudi Arabia, and United Arab Emirates). A similar assessment can be made based on the GovTech Maturity Index (Figure 9).[2]

[2] The GovTech Maturity Index (GTMI) was developed by the World Bank as part of the GovTech Initiative to introduce a measure of GovTech maturity in four focus areas—*supporting core government systems, enhancing service delivery, mainstreaming citizen engagement, and fostering GovTech enablers*—and to assist practitioners in the design of new digital transformation projects. Constructed for 198 economies, the GTMI is the most comprehensive measure of digital transformation in the public sector. The 2022 version of the GTMI constructed by the World Bank is a simple average of the normalized scores of four components: (i) CGSI: The Core Government Systems Index (17 indicators) captures the key aspects of a whole-of-government approach, including government cloud, interoperability framework and other platforms, (ii) PSDI: The Public Service Delivery Index (9 indicators) measures the maturity of online public service portals, with a focus on citizen centric design and universal accessibility, (iii) DCEI: The Digital Citizen Engagement Index (6 indicators) measures aspects of public participation platforms, citizen feedback mechanisms, open data, and open government portals, and (iv) GTEI: The GovTech Enablers Index (16 indicators) captures strategy, institutions,

(continued)

A closer look at its components indicates that additional efforts are especially needed to enhance digitalization aspects related to public participation platforms, citizen feedback mechanisms, open data, and open government portals.

Figure 8. 2024 E-Government Development Index: OMN and Other GCC Countries



Source: UN E-Government Knowledgebase.

11. Government procurement in Oman has been fully digitized. As part of the government's efforts to embrace digitalization to enhance the transparency and efficiency of its operations, Oman's Tender Board has recently completed the digitalization of all tendering and procurement processes in the government sector. The e-tendering system now makes it possible for government entities to prepare, float, evaluate and award tenders online, while also allowing suppliers and contractors, including SMEs to register, submit bids, and track bids' status electronically.

12. Ongoing efforts and initiatives would provide further impetus to the digital transformation of government services. Recent initiatives to increase data dissemination and citizens engagement, including the launching of the e-Government Services Portal and Oman Open Data Portal, are testimony to the authorities' commitment to accelerating government digitalization and would further boost Oman's regional and global standing on e-government indicators.

laws, and regulations, as well as digital skills, and innovation policies and programs, to foster GovTech. For details, please see GTMI (worldbank.org).

Figure 9. Digitalization of the Government Sector GovTech Maturity Index and Sub-Components

Notes: Each of the reported indices varies between 0 and 1, with larger values indicating a higher level of government digitalization.

Sources: World Bank and IMF staff calculations.

13. The CBO's Fintech Framework and Roadmap launched in 2022 aims to support the creation of a comprehensive and nurturing fintech ecosystem in Oman. It aims to enable fintech startups, SMEs, and banks in developing innovative solutions that can support access to finance and foster economic diversification. Among other initiatives, the Fintech Framework and Roadmap aims to provide a fintech-enabling regulatory framework, including through potential revisions to the current Banking Law, and to increase the pool of talent that can nurture the creation of a vibrant fintech sector. The CBO has notably partnered with academic institutions, such as Sultan Qaboos University and the College of Banking and Financial Studies, to develop courses and diploma in financial innovation and technology, but also to leverage their research and development capabilities to advance its fintech agenda. In 2022, the Central Bank of Oman also signed a Memorandum of Understanding (MoU) with Oman Telecommunications Company (Omantel) Innovation Labs to conduct an Accelerator Program aimed at supporting fintech startups. Four Omani startups (which provide Buy-Now-Pay-Later, Microfinance, and Loan-based Crowdfunding) were accepted and accelerated during the first cohort of the six-month program and successfully graduated in September 2023 to join the Fintech Regulatory Sandbox program. In March 2022, the Capital Market Authority approved the licensing of the country's first global crowdfunding platform operator.

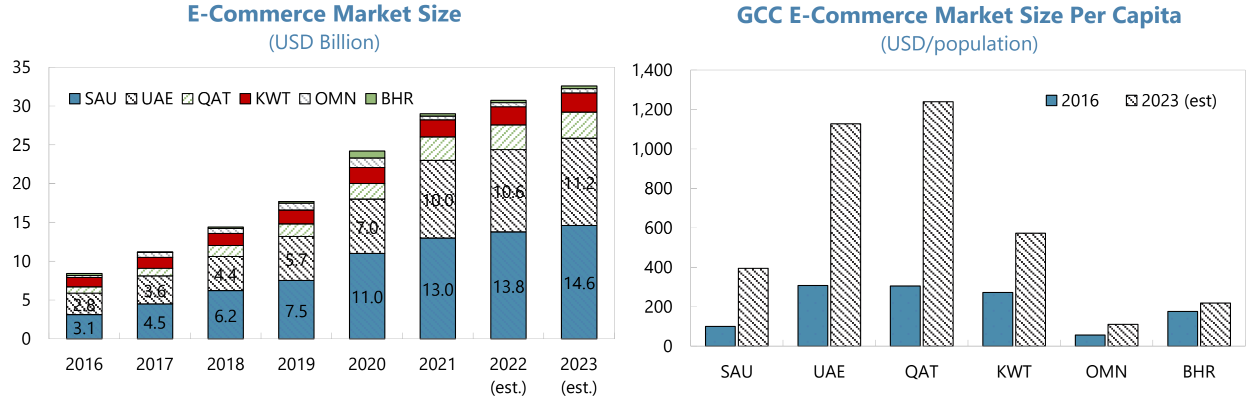
E-Commerce

14. The e-commerce market in Oman has scope for substantial growth in the years ahead. The e-commerce market in Oman accounts for only 1 percent of total retail sales, with a size estimated at about $0.66 billion in early 2024, behind all other GCC countries in per capita terms, but has ample opportunities to grow (Figure 10). With a very high internet penetration rate (close to 100 percent) and smartphone use, ongoing efforts to scale up IT infrastructure, growing availability of digital payment means, and steady economic growth, the e-commerce market is poised to grow fast over the coming years. Some estimates point to a doubling of its size by 2029.[3] The authorities' recent efforts to create a legal and regulatory environment that fosters the development of e-commerce and protect consumer data and confidentiality will also likely strengthen this market.[4]

[3] E-commerce in Oman is expected to increase from $0.66 billion in 2024 to $1.24 billion in 2029 according to a recent report by Modor Intelligence Research agency.

[4] In September 2023, the Ministry of Commerce, Industry, and Investment Promotion issued Oman Ministerial Decision No. 499/2023 to regulate the practice of e-commerce activity in the Sultanate of Oman.

Figure 10. E-Commerce Market Size in Oman and other GCC Countries



Source: AT Kearney; IMF staff calculations.

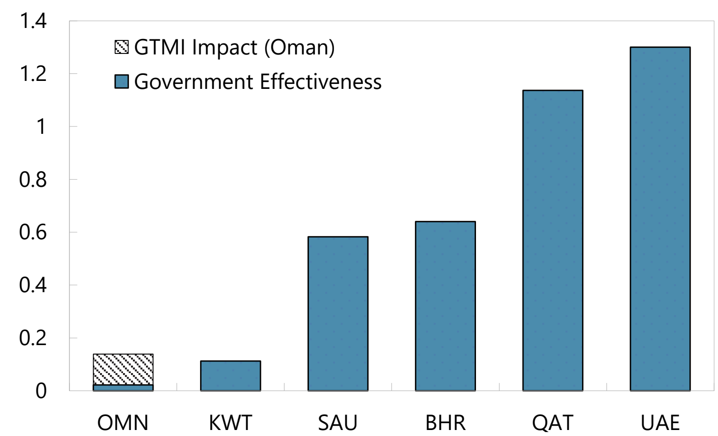
C. Quantifying Gains from Enhanced Digitalization

15. This section provides an illustration of potential gains that could accrue from higher levels of digitalization in Oman. It builds on methods and results reported in a recent IMF paper, which uses yearly country-level data over the period of 2000-2022 to assess the impact of digitalization in GCC countries ("Digital Transformation in the Gulf Cooperation Council Economies – 2024").

16. Oman's government effectiveness could gain from further enhancing digitalization of government services. Government effectiveness is a multifaceted concept that refers to the ability of a government to carry out its functions and responsibilities efficiently and successfully. It encompasses various aspects of governance, including the capacity to formulate and implement policies, deliver public services, enforce laws, maintain stability, and foster economic and social development. Government effectiveness is commonly measured using the World Bank's Government Effectiveness Index, which ranges between -2.5 and 2.5, with higher values attributed to more effective governments. Despite recent progress, Oman still scores well below all its GCC peers on this index, highlighting the need for additional policy actions to improve its government's effectiveness. Among other actions, embracing digital technologies is likely to result in greater efficiency, transparency, and accessibility of government services, ultimately leading to a higher score on the Government Effectiveness Index.

17. An increase in the GovTech Maturity Index (GTMI) from its current level to the average level of Saudi Arabia and the United Arab Emirates would raise Oman's Government Effectiveness index by a significant amount (Figure 11)**.** A global sample-based cross-country regression analysis where the Government Effectiveness index is regressed on GTMI and control variables (see more details in IMF, 2024) suggests that a one unit increase in GTMI leads to a gain of 1.03 units in the Government Effectiveness index. Accordingly, an increase in Oman's GTMI from 0.84 (its 2022 level) to 0.97 (Saudi Arabia and UAE's average 2022 level) would increase Oman's Government Effectiveness Index by 0.14 points, a significant improvement, considering its low initial score of 0.02 (2022 level).

Figure 11. Government Effectiveness Gains from Digitalization



Notes: GTMI: GovTech Maturity Index ranges between 0 and 1, with larger values indicating higher maturity of government digitalization. Government Effectiveness is an indicator that measures the quality and credibility of public services. It ranges between -2.5 and 2.5, with larger values indicating better quality government services. Bars represent 2022 levels. The line pattern portion of the "OMN" bar represents the increase in the Government Effectiveness indicator that Oman would gain from scaling up its government digitalization (as measured by GTMI) from its current level (2022) to the average level of Saudi Arabia and the UAE (the highest among GCC countries).
Sources: World Bank and IMF staff estimations.

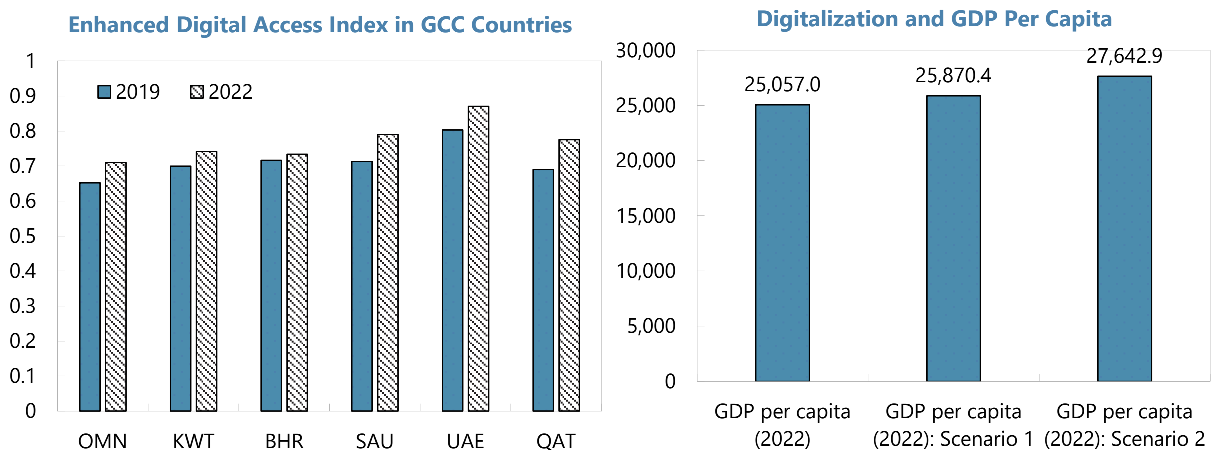
18. Enhanced digitalization accelerates economic growth. Digitalization has the potential to accelerate economic growth through different channels, including by fostering innovation, developing human capital, expanding market access, improving financial inclusion, and increasing productivity. An increasing body of literature documents evidence of a positive association between measures of digitalization and countries' economic performance. A cross-country regression analysis using a global sample where GDP per capita growth is regressed on the Enhanced Digital Access Index (EDAI) points to a positive association between a nation's digital capabilities and its economic performance.[5] Specifically, estimations indicate that a one unit increase in EDAI accelerates per capita income GDP growth by 0.7 percentage points, *ceteris paribus* (see IMF, 2024, for more details).

19. Upgrading digitalization has the potential to yield important gains in terms of per capita income in Oman (Figure 12)**.** Despite progress made recently, further efforts are still to be deployed for Oman to close the gap with GCC peers on digital infrastructure—as measured by the EDAI—, which could translate into higher national income. Specifically, our estimations suggest that Oman's 2022 GDP per capita could have been about $813 ($25,870 – $25,057) higher had its 2021

[5] The Enhanced Digital Access Index (EDAI) is a composite index that covers five key aspects of a country's digital infrastructure and inclusivity: availability of infrastructure, affordability of access, digital knowledge of the population, quality of ICT services, and internet usage (including access to high-speed internet).

score on the EDAI been equal to Saudi Arabia's (0.75).[6] It could have been even higher (by about $2,586) had its 2021 EDAI score been at the UAE's level (0.85).

Figure 12. Digitalization and GDP Per Capita in Oman



Note: GDP per capita (2022) is the actual GDP per capita of Oman in 2022 in US$. GDP per capita (2022)-scenario (1) is an estimate of Oman's GDP per capita in 2022 had its Enhanced Digital Access Index been equal to Saudi Arabia's a year before. GDP per capita (2022)-scenario (2) is an estimate of Oman's GDP per capita in 2022 had its Enhanced Digital Access Index been equal to the UAE's a year before.
Sources: World Bank and IMF staff calculations.

D. Conclusion and Policy Recommendations

20. The momentum of digitalization in Oman has accelerated recently. The increasing number of digitalization strategic initiatives being carved out—with some moving to the implementation stage—points to the authorities' commitment to take digitalization in Oman to the next stage and to ensure it is integral to its economic transformation agenda. The announced ambitious digitalization programs cover a wide range of sectors and fields, including infrastructure, government, finance, artificial intelligence, space, and the broader private sector. Tangible progress has been made on various digitalization aspects. Internet penetration along with 4G and 5G population coverage are among the highest in the world. Significant strides have been made to digitalize government services, with government procurement, among others, being fully digitized. Yet, gaps remain, indicating a need for further policies and actions for Oman to elevate its digitalization infrastructure and ecosystem to a level that can foster the emergence of a vibrant digital economy as envisioned in Oman Vision 2040. Our empirical analyses suggest that efforts and investments to enhance digitalization are worthwhile, as they can confer significant benefits to the country.

[6] The EDAI variable is included in the regression equation with a one-year lag (that is, GDP per capita growth in 2022 depends on the 2021 EDAI score).

21. Further upgrades to the digital infrastructure remain necessary. While Oman has made progress in improving its internet infrastructure, the international bandwidth is still low compared to the OECD average and significantly low when benchmarked against the GCC average, resulting in relatively slow internet connections. Weak international bandwidth particularly relative to neighboring countries, might weigh on Oman's regional competitiveness by potentially dissuading technology companies and other bandwidth-intensive operators from settling their operations in Oman, resulting in lost jobs, income, and government revenues. A strategy combining regulatory measures and investments, including in extensive fiber optic networks, would enhance bandwidth capabilities, leading to faster internet speed, improved connectivity, and a more robust digital economy. Public-private partnerships can be deployed to support this endeavor, considering the heavy cost of such investments. Expanding a high-speed internet-enabling infrastructure to geographical areas and communities beyond the country's major urban areas will be key to avoid a digital divide and nurture the emergence of an inclusive digital ecosystem.

22. Higher spending on R&D and on advanced ICT skills' development would foster innovation and support the emergence of a competitive and job-rich digital economy. Oman's R&D spending is one of the lowest among countries with comparable income, implying that there is scope for scaling it up as part of the economic transformation agenda. While the public sector could initially provide the bulk of additional R&D funding, the private sector should be incentivized to gradually increase its R&D investments. The latter typically involve high costs and risks, particularly related to return uncertainty, but the government can alleviate them by providing private firms with various incentives, including grants and subsidies, intellectual property protections and simplified regulations, encouraging collaboration between private firms and public research institutions (e.g., through PPP), government procurement policies that prioritize innovative products, and immigration policies that facilitate the entry into Oman of talented researchers and scientists. Updating curricula to ensure access to quality STEM programs and align them with emerging technologies, while also promoting digital literacy from an early age and offering continuous professional development opportunities (e.g., coding boot camps) would support the development of advanced ICT skills among a larger share of the population.

23. Expanding funding opportunities for digital start-ups and small and medium-sized enterprises (SMEs) would be key. The development of a vibrant digital start-up and SME ecosystem will be essential to ignite innovation and accelerate digital economic growth. However, this requires easy access to finance, which remains challenging for Omani startups and SMEs operating in the presence of a financial sector whose depth and breadth remain to be developed further. Existing funding schemes, such as the Innovation Development Oman (IDO) and the Oman Technology Fund—both under the Oman ICT Group (ITHCA)—may not be sufficient to cover the demand for growth funding if digital startups and SMEs are to increase in number and size going forward. Recent initiatives to expand funding opportunities, including the launch of Future Fund Oman where 10 percent of the funding envelope will be dedicated to startups and SMEs is a welcome step. Yet, more is needed. Developing an active local venture capital sector that can consistently support the creation and growth of startups and SMEs is paramount. Accelerating progress in developing fintech will also help in expanding fundraising opportunities for innovators.

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