Chapter 3

GCC Countries

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Characteristics of GCC States

- The Arab Gulf States of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates are an integral part of the wider Arab regional system.
- They are deeply rooted in Arabic culture and history. They are also an integral part of the Muslim World.
- Yet, these six Arab Gulf states decided to form their own "Gulf Cooperation Council" (GCC) in May of 1981.

What are the main factors that distinguish these states from the rest of the Arab world, Muslim world, and developing countries?

What are the common characteristics of the GCC states that make them different from the surrounding countries such as Yemen, Iraq, or Jordan?

Are they really unique and have common features that make their future unification possible?

May the GCC accept new members in the future?

Let us now discuss some of the characteristics that may be more common among these states than other regional countries.

1. Oil and Gas Reserves: Oil and gas are solely responsible for positioning the GCC states at the center stage of world economics and politics.

   However, we can observe several issues that may not make the oil as the major factor of identifying the GCC states.
   - Not all GCC states are major producers of oil. For example, Bahrain is not a major oil producing country but it is a member of the GCC while some other oil producing countries such as Iraq, Iran are not.
   - Huge oil reserves have been discovered in other areas of the world such as in Central Asia, Africa, and Latin America.

   GCC states can exercise only limited control over the oil market or even oil production itself.

   - For the reasons mentioned above, GCC states have started aggressive policy reforms and structural changes for the aim of diversifying their economies through:
     a. building strong industrial base,
     b. providing the right infrastructure to be a tourist destinations, and/or service and financial hubs as well as trade and transit centers.
2. All GCC States have a monarchy political system.
3. All GCC States have experienced unprecedented socioeconomic transformation that have lead to high levels of living, low, but increasing, levels of unemployment, stable currencies and low rates of inflation.
4. All GCC states are generally small in population, area (except Saudi Arabia), human resources, and natural resources other than oil.
5. Furthermore, a high proportion of foreigners and a distinctly smaller indigenous population. This phenomenon has been reflected in the labor force of these states.

6. The prevailing political and social system of these states is mostly conservative and tribal in nature with strong family and tribal ties. Nevertheless liberal ideas and movements exist in almost all of these states.
7. All these states have common history. Except Saudi Arabia, all had been British colonies. Their economies before oil depended on pearls, diving, fishing, and subsistence agriculture.
8. One of the main concerns to bring these countries together is security.

- GCC states differ from other countries in the following:

I. LDCs experience
  - Poverty
  - Weak infrastructure
  - Political instability and social unrest
  - Lack of security
  - Population

II. DCs experience
  - History of strong industrial base
  - Human capital
  - Military strength
  - Economic diversification
  - Democracy and freedom

III. GCC Countries

- Diversification of GCC Economies
  - GCC states have started diversifying their economies at different paces and different levels.
  - Some have concentrated on establishing a sound industrial base while others emphasize services and foreign sector.

  Agriculture:
  - Three of the six states have some aggressive agricultural policies.
  - Oman, Saudi Arabia, and UAE invested large amount of money in agriculture.

- Oman has a comparative advantage for having relatively larger percentage of arable land and more water reserves than the other two states.
- Saudi Arabia and UAE pay millions of dollars as explicit and implicit subsidies to farmers.
- This policy has been proven to be economically inefficient since:
  1. the cost of agricultural products at macro level is too high relative to that in other countries.
  2. more than 80% of extracted subterranean water has gone to irrigate farms, which has caused a severe shortage in the reserves of subterranean water and make these two states to revise their policies concerning agriculture.
### Industry:
- To some extent, GCC states have a diversified industrial base but mainly focused on basic industries as well as petrochemical industry.
- Saudi Arabia leads GCC states in this matter followed by UAE.
- The share of industry in GDP of each state has been increased in the last decade.
- What types of Industries in Bahrain?

### Services:
- All GCC states have developed their service sector.
- Bahrain is a banking and financial hub in the region, at least until now. (tough competition of USE and Qatar)
- Dubai in UAE is famous for its free trade zone and become a leading trade and transit center.
- Other states are preparing the right infrastructure to be competitive centers in the region.

### Tourism:
- Tourism becomes an attractive industry. It has the largest share in GDP of some countries.
- GCC states are not exception in their concern of developing their attractive tourist destinations.
- Dubai is the main tourist destination in the gulf
- All GCC countries are competing to be the tourist destination in the region
- Tourism could be divided to external or internal.
- External may be divided to positive inflow of tourists to the country (by foreigners) and negative outflow of the country (by citizens).
- Because of high income of most of GCC citizens, the outflow is more than the inflow at least in value. But the picture is changing.
- Tourism could also be divided to:
  1. Ecological (environmental) tourism
  2. Commercial tourism
  3. Medical tourism (for hospitals, climate, or minerals)
  4. Entertainment tourism for the sake of changing the routine and visiting new and interesting places.
  6. Sport tourism
  7. Cultural and historical tourism
  8. Official (formal) tourism (meetings, conferences, seminars, workshops, and exhibitions.)
  9. Religious tourism (visit to holy places)
  10. Social tourism (visit to relatives and friends for social reasons.)
  11. Transit Tourism

### The Impact of Oil on Development Process in GCC States
- Oil and gas sector is the major contributor to GDP and main export commodity of GCC states.
- The economies of the GCC states are more or less dependent on revenues generated from oil and gas as well as related petrochemical and refining industries.
- Endowed with large oil revenues, GCC states are not only independent of domestic economy (does not need to resort to taxation as a source of income) but are set to play a leading role in it.
Much of economic and social development in GCC states has been the result of oil revenues received by GCC governments. Oil revenues have lead to capital accumulation in GCC states; but the internal economic conditions were not ready to absorb the whole surplus in domestic investments.

GCC governments distribute a significant part of oil revenues among the national population through availing them of government employment and subsidizing a wide range of goods and services, partly to enhance the population’s standard of living and partly to secure loyalty. Also, GCC governments use oil revenue to expand infrastructure necessary to attract investments.

Since oil prices are in international currencies, mainly in dollars, any fluctuations in the exchange rates of these currencies will affect oil revenues. Furthermore, since GCC states are highly integrated in the global market because of oil, they are highly affected by the problems and crisis of this global market.

Is labor market in GCC states associated with oil revenue or is it affected by other economic and social development? The impact may be of both. In fact the economics of oil is affected by political and numerous other factors. GCC states are striving to diversify away from oil and public sector to industry and private sector. Diversification policies have been proven to be successful to some degree.

Economic activity in GCC states is characterized by:
1. Abundant energy resources
2. Large public sector.
3. Small trade-oriented private sector
4. Substantial openness to the global economy in terms of export revenue.
5. Culture norms shaped by Islamic belief and practice, in addition to tribal traditions and customs.

Since the early 90s, GCC governments start policies designed to:
1. Rationalize government spending
2. Increase sources of non-oil revenue
3. Focus more on long term structural changes
These reforms include:
1. The need for financial market deepening
2. Labor market reform
3. Privatization
4. Addressing the bureaucratic, legal and institutional rigidities necessary for broadening the participation of the private sector in these market-based economies.
5. Addressing some type of political reform

Structural Reform Measures and Role of the Private Sector

• While GCC economies have made substantial progress in improving internal and external balances, large amount of private sector capital invested abroad suggests that deeper structural reforms are needed at the microeconomic level, in conjunction with the maintenance of a predictable macro-environment.

• The success of reform policies depends heavily on sustainability.
  • Sustainability does not imply rigid and fixed policy-making process but rather the creation of a stable, predictable framework in which reform goals and initiatives are clearly defined and articulated.

• Key components of a sustainable policy environment include:
  1. stable macroeconomic policies such as a small fiscal deficit and a realistic exchange rate policy.
  2. a credible and predictable set of microeconomic incentives.
  3. the absence of sharp distributional changes that would create political pressures to reverse the course of reform.

• Gulf private sector firms currently functioning in mixed economies with Keynesian-style aggregate demand policies in which government spending drives the level of economic activities and growth.
  • Government spending as a percentage of GDP is well above average relative to countries at similar level of per capita income.
  • Oil revenues are injected into the non-oil sector through standard Keynesian multiplier effects.

• GCC governments have generally relied more heavily on fiscal rather than monetary policy to stimulate the economy.
  • At the micro level, government spending influences private sector activities directly through subsidies on land and utilities, and indirectly through the provision of basic physical infrastructure.
External Balances

• The GCC states have been traditionally market-oriented and well integrated into the global economy as demonstrated by:
  – the maintenance of low tariff bereties,
  – high rates of export growth
• Average measure of openness for the GCC states based on the ratio of exports and imports to GDP are roughly 70% for the whole region.
• All GCC countries are members of WTO

In the medium term, trade liberalization initiatives will also reinforce the need for domestic fiscal reforms associated with raising user fees for services and the gradual removal of subsidies.
• Over the long term, openness to trade enhances economic reform policies and accelerates domestic growth by eliminating distortions between domestic and international prices of traded goods.

The benefits to these countries are:
1. openness to foreign competition,
2. knowledge,
3. resources,
4. Stimulate the development process as the creation of dynamic comparative advantage.

The important byproducts of enhancing multilateral trade and investment are:
1. The acceleration of learning,
2. Technological diffusion,
3. Positive spill over associated with the formation and functioning of production and marketing networks,
4. Access to technological capacities,
5. Credible commitments to foreign investors.

How Gulf States can benefit from Globalization

• What is Globalization?
• Is it a new or old concept?
• Is it to support capitalism? Americanism?
• Is it to spread the western cultural (American in particular)?
• Is it good or bad?
• Is it just an exchange of goods and services?
• Is it an integration of all markets in the world?
• Is it a conflict between civilizations particularly between Islam and Christianity? Or
• Is it a new way to control the nations of Asia, Africa & Latin America?

Globalization is..........
• Do we have to be really scared of globalization?
• What Gulf States want can be summarized as the following
  1. Security
  2. Economic welfare
  3. Preserving their identity (Gulf, Arabs, Muslims, ...?)
• To achieve the previous objectives, there are five challenging issues for the future of GCC countries:
  1. Oil as a depleted source of income.
  3. The nature of education systems and their objectives and output.
  4. Women situation in the Gulf
  5. Water crises.

• How GCC countries can pursue a process of economic reform to restructure the current situation in accordance with the above issues?
• How GCC can benefit from their current economic situation to find future alternatives?
• How to improve the population structure of each GCC country and among the countries so there will be a freedom of movement, job opportunities?
• How to depend more on high technology that will help reducing the huge expatriates’ inflow?

Localization (Nationalization)
• Localization is the process of replacing foreign labor with nationals in all economic aspects.
• More than % of labor force in GCC countries are foreigners. The need for foreign labor force is due to:
  1. About 50% of total national population is under 15 year old.
  2. The low participation rate of women in labor force.
  3. The rapid economic growth and ambitious development programs during the two previous decades.

• There is a growing necessity in the region to reform and re-evaluate employment policies for nationals in order to encourage efficient and productive participation.
• The majority of nationals are securing employment in the public sector
• Private sector is looking for maximization of profit.
• In order to do that they have to maximize revenue and minimize cost.
• One way to minimize the cost is to have inexpensive, qualified, and stable human resources.

• Expatriates:
  1. Majorities have specific short-term objectives to achieve and then go home.
  2. Opportunities increasing at home
  3. Migration to industrialized world. A long term objective.

• Locals:
  1. Privileges at home are higher than anywhere else
  2. Standard of living is high
  3. Social security is high
  4. Future prospects are encouraging

4. Social attitudes towards work, especially toward technical and manual jobs.
5. Political instability in the region, which stimulates the building of armies and security forces.
6. Mismatch between increasingly technical labor demand of the private sector and the traditionally liberal arts orientation of university graduates.
Forecasts:
• More than 90% of the expatriates are from Asian countries. Asian economies are growing at an accelerated rate. Economic growth absorbs workforce. ⇒ Reduced availability of qualified Asian work force.
1. GCC economies have relatively stabilized. Peak and surges are not expected in the foreseeable future. Inflow of expatriate work force can be predicted, planned and controlled.
2. Immigration laws and regulation has been tightened up. ⇒ Reduced inflow of expatriate workforce
• The results of (1) and (2) will lead to localization

Localization does not mean only replacing people but true participation in the work.
• It means a continuous development of national human resources to be ready to participate in job market and the development of the nation
• Bahrain has become one of the successful countries to implement localization effectively (e.g., Tamkeen, LMR).
• It is your task to read about the role and achievements of Tamkeen and LMR. This is part of your final exam (Hint: Search in Google for articles and visit the websites of Tamkeen and LMR)

The Role of Women in Development
• Women participation in the labor force (as a percentage of the total labor force) in the GCC countries are low compared to other developing countries.
• Lower female participation is attributed to the socio-cultural and religious systems and values prevailing (However, the impact of these factors varies from one country to another).
• Lack of financial motives is also a strong reason for women’s low rate of participation.

Horizontal expansion: has been somewhat overcome.
• Vertical expansion into leading positions: not yet
• Bahrain: highest
• Saudi: lowest
• The promotion and encouragement of female participation in the labor force is crucial for reducing dependency on migrant labor.
• But, the most important question is: what is the role of women?
• Is it just the participation in the job market per se?
• Is it raising the children and making the husband’s life more comfortable?

A Common Currency of the GCC Countries
• The six members of the Gulf Cooperation Council (GCC)—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates plan to introduce a single currency.
• A single currency would establish a large and strong economic entity that is to impose itself on the world economies supported by more than 40% of world reserves of oil,
• The presence of a single currency will make the GCC negotiating power more effective in order to achieve economic gains and political gains.

The plans for monetary integration between these six countries date back to the inception of the GCC in 1981, and the endorsement of the unified economic agreement in 1982.
• The process toward economic integration had gone slowly but, as we will see later, it gained momentum in 2001, culminating in the ratification of a new economic agreement.
• The major steps towards the common currency union can be summarized as follow:
1. Muscat Summit at the end of 2001 had agreed to establish a monetary union with a single common currency by the first of January 2010. This summit had approved the timetable for the establishment of the monetary union and the single common currency, and of applying the dollar as a common peg for the currencies of the GCC countries by the end of 2002.

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2. The member States made decisions to peg their currencies the U.S. dollar before the end of 2002. In January 2003, the GCC countries formed a customs union and applied a common external tariff. On the same date, these countries formally pegged their currencies to the U.S. dollar.

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• The introduction of the GCC single currency will necessitate the creation of
  1. a single GCC central bank,
  2. a single GCC monetary policy, and
  3. the choice of a common GCC exchange rate regime.

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3. In preparation for the launch of the currency in no later than the first of January 2010, the new agreement sets a specified timetable to achieve the requirements of the monetary union, which include
1. the harmonization of all economic policies, particularly fiscal and monetary policies,
2. the standardization of banking regulations
3. the meeting of the convergence criteria.
4. and how to calculate and descent before the end of 2005

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4. The Supreme Council had adopted in Abu Dhabi summit in December 2005 recommendations of the committee on Financial and Economic Cooperation and the Committee of Governors on the criteria of economic performance that need to converge to the success of monetary union which includes: the monetary criteria: Inflation and interest rates and the adequacy of reserves of foreign currencies; and the financial criteria: the proportion of the annual deficit in government finance and public debt ratio to gross domestic product.

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5. Riyadh Summit (Jaber Summit), which was held in December 2006, had directed the Ministers of Finance to complete the steps to establish the monetary union and a single currency in accordance with the scheduled time, which was approved in the Muscat summit in 2001, as well as to intensify efforts to reach agreement on the regulations and the necessary documents to stay on schedule.

• Jaber Summit also authorized Ministers of Finance to agree on the standards of convergence criteria for economic performance, which includes:
a. The inflation rate in any of the Member States should not exceed the weighted average of the inflation rate of the GCC plus two percentage points (2%).

b. The interest rate in any GCC country should not exceed the average of the lowest three short-term rates in the GCC plus two percentage points (2%).

c. The monetary authority’s reserves of foreign exchange in each of the Member States must be adequate to cover the commodity imports for a period not less than four months.

d. The percentage of the annual deficit in government finance to gross domestic product in the Member States should not exceed (3%) of GDP, with the ability to modify this ratio for the low price of oil below a certain level according to the formula agreed upon, so as to take the impact of oil on the economies of the GCC countries in mind.

e. The public debt ratio of general government (all the institutions and agencies of the State) should not exceed 60% of the GDP,

f. The public debt ratio of the central government shall not exceed (70%) of the gross domestic product.

6. The Committee of Governors have agreed in 2006 that the European Central Bank shall be asked to prepare study on legislative and regulatory framework for the new common monetary authority given the conditions that have been approved by the Committee.

- The study, which has been completed, addressed the aims, functions and organizational structure of the Central Bank of the Gulf, and the relationship of the respective national central banks.

7. During that time:

- The state of Oman announced that it will not join the single currency as the economies of the region are simple and the features enjoyed by the local current currencies may disappear in the event of a single currency, as well as the loss of control in national monetary policy
- The State of Kuwait de-pigged its dinar of the dollar and linked it to a basket of currencies in contrast to the Member States.

- Although UAE was the first that made a request to host the headquarter of the GCC Central Bank in 2004, Bahrain, Qatar, and KSA expressed their desire to host the headquarter of the Central Bank during Muscat summit in 2008
- UAE openly declared that it is highly disturbed by this competition, especially since they have long been the only country to apply for hosting.
- There are other contentious issues on the single currency relevant to the name of the currency, which ranges up to now between the Gulf, Dinar and Rial, and its value against the dollar.

- The monetary union among Gulf countries requires several conditions to become the “Optimal Currency” region; namely, that

  1. the degree of trade exchange between the participating countries should be high,
  2. More economic openness among the union members,
  3. Low restrictions among the countries,
  4. The inflation rates should be close among GCC countries,
  5. More similarities in economic conditions
• Economic Benefits of the Currency Union:
• The single common currency will bring potential economic benefits to the countries of the GDP that will contribute to increase the efficiency of the GCC countries, as well as broaden their degree of economic integration and to develop their non-oil economies. Some of the potential benefits may include:
  1. Eliminates Currency Conversion Cost
  2. Reduction in costs which relates to monitoring exchange rate fluctuation, predicting exchange rate movement and the need to keep and manage reserves for intra-regional trade.

3. Economies of scale may be generated from reducing the number of Central Banks in the region, and the rise in terms of freeing idle reserves and enhancing the role of money as a unit of account and as a means of payment.
4. Increase trade between GCC Countries: This is obvious, as countries share the same currencies; buying from another a member country would be just like buying from the same country, without the need to calculate the difference in exchange rate.

5. Promote intraregional investments and may also attract investment by foreigners in the regions because of the elimination of exchange risks and reduction in currency conversion cost, and therefore enhance the development of its non-oil economy.
6. The monetary union can also help the Gulf states to develop regional money markets, which give to GCC countries more tools to influence the monetary policy through intervention buying and selling securities.

7. The existence of a monetary union will help to stabilize inflationary expectations, which makes the economic environment more flexible and more attractive for domestic investment and FDI.
8. Introducing a common currency will be associated with the pursuit of a common monetary policy, and more disciplined fiscal policies. This will improve the reliability of the economic policies pursued in the region, and ensure Macro-economic Stability.
9. The strength of a single Gulf currency will help the movement of capital between the countries of the Council and ease the dealing with global financial markets.

• Economic Costs of the Currency Union:
• The members will have to accept that the currency unification will bring some macroeconomic cost such as:
  1. Each member country of the GCC will lose the ability to set a self-regulating monetary policy and to adjust exchange rates. However, this will not be of much significance as these countries have already been coordinating their monetary, financial and other policies and their exchange rates have remained almost unchanged for a prolonged period under a similar pegged exchange rate regime, except for the Kuwaiti dinar.

• A member country may suffer because of another country member:
• For example, although Bahrain maybe satisfied with the existing monetary and exchange rate arrangement, the union may decide to modify it because another member faced with financial difficulties.
• One of the ways that would enable countries in the region to isolate themselves from the problems of the U.S. economy is to link the Gulf currency to a basket of major currencies instead of linking its destiny to the dollar.