

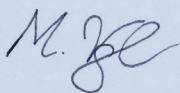
Regional Integration Observer

Vol. 3 No. 2

August 2009

Editorial

For decades, the Gulf has been known primarily for its oil and resource richness. Still today, the six Member States (United Arab Emirates, Bahrain, Saudi Arabia, Oman, Qatar, Kuwait) of the Gulf Cooperation Council (GCC), provide more than 60% of the world's oil. In recent years, the Gulf region has become popular for its booming cities such as Dubai, however, lost in its elevation to an international center for finance and business, is that in the Gulf area, regional integration also plays an important role that has accompanied and facilitated all these other processes. Against this background, the current edition of the Regional Integration Observer focuses on this very dynamic region. In the Gulf countries, conditions for strong regional cooperation are very good. All GCC Member States share a common language, a common religious belief, as well as a similar economic structure. Against this background and, with the movement from a free trade zone in 1983, to a common market and a planned monetary union, the GCC is one of the most economically integrated regions in the world, apart from the European Union (EU), and moreover, is the EU's major trading partner in the Arab world. However, regional political differences have often impeded deeper integration or at least slowed its pace. From a practical and theoretical perspective, the new ZEI Regional Integration Observer provides a comprehensive overview of the current state of affairs in the GCC. This article critically assesses the developments in the main areas of cooperation and the wide spectrum of policy fields addressed reflects ZEI's interdisciplinary approach. We offer renowned authors with academic and practical backgrounds, also from the region itself. With their intense knowledge and everyday experiences, we hope that they will supply the reader with information beyond the normal scope.



Matthias Vogl, Junior Fellow at ZEI



Mrs Amal Al-Ahamad, Head of the liaison office of the Cooperation Council for the Arab States of the Gulf, on the right, and José Manuel Barroso. © European Commission

The Making of a Currency Union in the Gulf region

* Nasser Ibrahim Al-Kaud

The idea of issuing a single currency for the Cooperation Council for the Arab States of the Gulf (GCC) began with the birth of the GCC. The main two documents of the Council, the GCC Charter and the Unified Economic Agreement (signed in 1981), refer to guidelines for the basic characteristics of an economic cooperation and integration program for the GCC States, among other areas targeted by the Council. The Unified Economic Agreement refers to stages of integration. It addresses, in detail, a free trade area and a unified customs tariff, and more briefly, the requirements of a common market and of an economic and monetary union. In this regard, Article 22 of the Unified Economic Agreement states that "[a]ll Member States shall coordinate their financial, monetary and banking policies and increase the level of cooperation between monetary agencies and Central Banks, including the unification of currency, to complete the economic integration sought between them". Work towards achieving monetary integration between the GCC States started in 1983. Within the framework of the Council, a committee of governors of the Monetary

Agencies and Central Banks of the GCC states was formed with the aim of implementing the provisions of Article 22 and coordinating monetary and banking policies. Subcommittees of the governors' Committee were also formed to study the technical aspects of cooperation and coordination in these fields. From 1985 to 1987, as a first step towards a GCC single currency, the governors' Committee conducted intensive consultations among Member States regarding a common peg for their currencies. A system of Special Drawing Rights (SDR) was proposed as a common peg, but failed to secure a unanimous vote.

Given the relative stability in cross exchange rates of the GCC States' currencies during the 1980s and 1990s, and since a monetary union and a single currency are deemed to be an advanced integral stage that is commonly preceded by, according to the economic theory, other stages of integration such as a free trade area, a customs union and a common market, the prevailing opinion in the Council during the 1990s was that the time had not yet come to discuss the details of establishing a monetary union and issuing a single currency. Accordingly,

the Finance Ministers and Governors of the GCC States decided to postpone this discussion until the end of the decade.

The timeframe for the monetary union

The issue of a single GCC currency was revisited at the 21st GCC Summit, which was held in Manama, Bahrain, in December 2000. By this time the GCC was progressing with the customs union and Member States were coordinating economic policies, while another regional grouping, the European Union, had successfully introduced the Euro. At the 21st Summit, the GCC Member States agreed to adopt the US Dollar as a common peg for their currencies, while the GCC Finance Ministers and Governors were directed to set up a timeframe for establishing a monetary union and issuing a single currency. This timetable was prepared and then approved by the Supreme Council during the 22nd Summit, which was held in Muscat, Oman, in December 2001. The timetable confirmed the adoption of the US Dollar as a common peg for the GCC currencies and set a timetable for implementing this by the end of 2002. It also called upon Member States to reach agreement on convergence criteria for the financial and monetary stability to ensure successful Monetary Union by the end of 2005, in preparation for launching the single currency no later than January 1, 2010.

Implementation steps towards the GCC monetary union

In order to implement the timetable set by the GCC Summit, the following steps had been taken:

- By the end of 2002, the six GCC member States formally pegged their currencies to the US Dollar (in May 2007, Kuwait returned back to peg the Kuwaiti Dinar to a special basket)
- A High Level Technical Committee composed of the Central Banks and Finance Ministries was formed in 2002 to undertake preparation for and examine the issues related to, the Monetary Union and submitting proposals to the Governors' Committee.
- A Monetary Union Unit was created at the

GCC Secretariat in 2003, to conduct research and provide technical support to the relevant committees.

- In view of the studies prepared by Member States, the GCC Secretariat, the European Central Bank (ECB) and the International Monetary Fund (IMF) met on the Monetary Union requirements and convergence criteria, and after intensive discussions on these issues, the GCC Member States agreed in May 2007, on the following monetary and fiscal convergence criteria:

Monetary Criteria (Entry Criteria):

- a) Inflation rates (CPI): The inflation rate in any Member State must not exceed 2 percentage points over the weighted average of inflation rates in all Member States.
- b) Interest rates (short-term rates, for 3 months): The interest rate in any Member State must not exceed 2 percentage points over the average of the three lowest interest rate Member States.
- c) Foreign currency reserves available to the Monetary Authority: each national Monetary Authority must have enough foreign reserves to cover four months of imports.

Fiscal Criteria:

- a) Fiscal deficit: Annual fiscal deficit for any Member State must not exceed 3 percent of the GDP when the oil price is at the reference oil price or more, otherwise, it will be adjusted according to an agreed upon formula.
- b) Government debt: debt must not exceed 60 percent of the GDP for central government and 70 percent of the GDP for general government.

GCC Monetary Union Agreement and statute of the Monetary Council

At the 29th GCC Summit, which was held in Muscat, Oman, in December 2008, the GCC Member States had concluded a Monetary Union agreement and agreed upon the statute of the Monetary Council. This agreement was signed in June 2009 by four GCC Members (Bahrain, Kuwait, Qatar and Saudi Arabia). The Agreement outlines the basic principles and features of the Monetary Union that include:

1) coordination of economic policies to achieve a high degree of economic convergence throughout the single currency area; 2) to establish payment and settlement systems necessary for issuing the single currency and 3) establishment of a monetary council which would prepare for the establishment of a Central Bank as an independent institution that will design and implement the monetary policy and the exchange rate policy of the single currency.

The Agreement refers to the tasks and objectives of the Monetary Union institutions: the Monetary Council and the Central Bank that will be located in Riyadh. Article (6) of the Agreement outlines the objectives and tasks of the Monetary Council as follows:

Article (6)

Objectives and Tasks

The primary objective of the Monetary Council is to prepare the necessary infrastructure for establishing the Monetary Union, especially the establishment of the Central Bank and, lay down its analytical and operational capacities through:

1. Enhancement of cooperation among National Central Banks (NCBs) with a view to creating appropriate conditions for the establishment of the Monetary Union
2. Development and coordination of the monetary policies and exchange rate policies for national currencies until establishment of the Central Bank
3. Following up the adherence to the prohibition on NCBs lending to public entities in Member States and developing appropriate rules of procedures
4. Drawing up the necessary legal and organizational framework for the CB to carry out its tasks in cooperation with NCBs
5. Development of necessary statistical systems with the goal of achieving the objectives of the Monetary Union
6. Preparation for the introduction of the banknotes and coins of the single currency and developing a uniform framework for the introduction and circulation of the single currency in the single currency area

New ZEI Publication - Die Europäische Sicherheits- und Verteidigungspolitik. Politikformulierung im Beziehungsdreieck Deutschland - Frankreich - Großbritannien.

By Andreas Marchetti, ZEI Schriften, Vol. 70, Baden-Baden: Nomos Publishing House, 2009, 378 pages, ISBN 978-3-8329-4530-5

Since 1998, the European Union (EU) has been enhancing its crisis prevention and crisis management capacities. Despite the continuous development of the European Security and Defence Policy (ESDP) and the conduct of civil as well as military missions, the aims of major EU member states do not necessarily coincide. Because of the intergovernmental setup of ESDP, the author investigates why and how the policy has been developed over the past ten years, focussing particularly on France, Germany and the United Kingdom, without, however, neglecting the role of EU institutions. The study first examines the motivations formulated on an inner-state platform in order to illustrate how these have been influencing the modalities to formulate the ESDP on the EU level. With regard to the concrete effects of the ESDP, the study reveals how far the results and the national commitments correspond to the initial motivations. This enables a further systematisation of factors that can be considered essential for a member state to take a lead role within the EU. This systematisation hints well beyond the ESDP.

7. Ensuring readiness of the payment and settlement systems related to the single currency
8. Following up fulfillment by the Member States of their obligations to the Monetary Union and the introduction of a single currency, in particular those related to the economic convergence criteria
9. Setting the timeframe for the introduction and circulation of the single currency
10. Making recommendations to the GCC on the legislation required for establishing the Monetary Union and the CB and introducing the single currency.

Article (14) of the Agreement outlines the objectives and tasks of the Central Bank as follows:

Article (14)

Objectives and Tasks

The primary objective of the Central Bank shall be to ensure price stability in the single currency area through optimal utilization of the economic resources to ensure economic stability. The tasks of the CB entail the following:

1. Defining and implementing the monetary policy of the single currency, including exchange rate policy, and ensuring compatible implementation in the single currency area through NCBs
2. Managing the foreign cash reserves of the single currency
3. Issuing banknotes and coins denominated in the single currency
4. Enhancing effective operation of the infrastructure of the payment and settlement systems within the single currency area
5. Performing the operational, statistical and advisory functions necessary for the CB to exercise its tasks and carry out its duties
6. Developing general rules for prudent supervision of financial institutions

Steps to be taken

The Monetary Union will be established as soon as the Monetary Union Agreement is ratified by the contracting parties. It is anticipated that ratification of the Agreement will take place during this year, to be followed by the establishment of the Monetary Council by the end of 2009 or early next

year (2010). The Monetary Council will perform the tasks vested unto it, as mentioned above. The technical committees (the Monetary Union Committee, the Supervision Committee and the Payment Committee) had done a lot of preparation for several tasks of the Monetary Council. The Central Bank to be established will supersede the Monetary Council after meeting its objectives and tasks, upon a resolution by the GCC Summit.

Conclusion

The GCC Monetary Union is planned to crown the economic integration stages that began with the Free Trade Area (1983), the Customs Union (2003), the Common Market (2008) and lastly, the Monetary Union that will start with the establishment of the Monetary Council in 2010, which would prepare for the establishment of the GCC Central Bank.

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Conditions of an Optimal Currency Area

* András Inotai

The emergence of the theory of optimal currency areas (OCA) has been inspired by the works of Friedman¹ and Meade (1957), but has been formulated using the substantial contributions of Mundell², McKinnon³ and Kenen in the 1960's. At that time, the environment was characterized by the Bretton Woods fixed (but adjustable) exchange rate regime, the capital controls dominating in many countries and the start of the process of European integration.

The original concept is based on assessing the costs and benefits of giving up exchange rate flexibility as an instrument for dealing with balance of payments shocks. In case that the demand for exports from a particular country decreases, a real depreciation might be needed to maintain the balance of payments equilibrium and full employment. Thus, it is argued that when dealing with balance of payments shocks, exchange rate depreciation and appreciation respectively, can reduce the impact on unemployment and inflation, in particular under sticky nominal wages. Relinquishing this important stabilization instrument would only be justified in a homogeneous environment with high factor mobility, where shocks are symmetrical and well correlated. In such an environment the benefits of exchange rate flexibility would no longer be required, while the benefits of monetary union could be taken advantage of.

The theory also focuses on the debate on the merits of fixed versus flexible exchange rate regimes and the choice of a country's

exchange rate system. This is needed to calculate the costs and benefits of a common currency, because a monetary union is the strongest form of fixed exchange rate systems known. A group of countries that may potentially gain from forming a monetary union should be closely connected through trade and capital flows. It is argued that the fixed exchange rate regime and a single currency in particular, promote economic integration and groups countries together into a common and larger monetary area (or at least entails the possibility of a high degree of monetary integration). However, this process is accompanied by a loss of discretion in monetary and other macroeconomic policies of individual countries. Opting for a flexible exchange rate system takes out integrative advantages, but preserves individual countries' rights to pursue independent monetary and other macroeconomic policies.

The original theory on OCA relies on the hypothesis of stationary expectations on the price level, interest rate and exchange rate (even if the exchange rate was allowed to float). Thus, it is argued, that it is relevant to apply common shocks as a criterion in determining the size of currency areas. Mundell adjusted the OCA theory by dropping the assumption of stationary expectations and instead focusing on exchange rate uncertainty. According to his earlier work, asymmetric shocks disqualify regions from being optimal currency areas.

His later contribution centers the attention on explaining how a single currency could help reduce the effects of such shocks by

portfolio diversification and "economizing" on foreign exchange reserves.

McKinnon unambiguously disproves one of the core assumptions of Mundell's early work, namely the post-war Keynesian belief that national monetary and fiscal policies could successfully be used to adjust aggregate demand as a reaction to shocks. In the original OCA theory, relinquishing this instrument is the main argument against adopting a single currency. Mundell and Friedman considered that the autonomy of monetary policy could best defend domestic price levels and that a floating exchange rate would naturally reflect (via depreciation and appreciation) the stance of domestic monetary policy. The exchange rate volatility and currency crises in the 1970s and the 1990s however, brought additional scrutiny on the benefits of floating exchange rates, thus making the original OCA theory less persuasive.

In his later studies, Mundell put more emphasis on the advantages of a common currency in the context of a future of monetary integration in the European Economic Community. He added new arguments to support the idea of monetary unification: risk pooling, using foreign currency-denominated reserves more effectively as a result of internationalization of foreign trade, and economies of scale due to lowering the costs of financial transactions. At the same time, he discouraged the idea of introducing a common currency for territories not being part of a political union because of limitations to fiscal distribution and factor mobility.

The theory evolved on a large basis especially in the 1990s as a result of profound changes in economic and financial globalization. The majority of the studies are aimed at empirically confirming the advantages of creating new or expanding existing single currency areas. The theory also reflected the progress in establishment of the European Monetary Union (EMU) and later in the context of its expected enlargement. Regardless of basic re-examinations of the theory made by the originator and research done by Ching and Devereux, almost all of the empirical study is based on Mundell's early findings. The assumption is regularly made that the asymmetry of shocks the country is exposed to is the key argument for not qualifying to joining a monetary union. The smaller the asymmetry, the more the country is judged appropriate for becoming a member of a monetary union.

The OCA is defined as the optimal geographical area for a single currency, or for several currencies, whose exchange rates are irrevocably pegged. The single currency or the pegged currencies, fluctuate jointly with other currencies. The borders of an OCA are determined by the autonomous countries choosing to participate in the currency area. The theory applies not only to countries, but also to any regional configuration in general, for example, within the United States with all states using the same currency. There is an important difference between a currency union that creates a common new central bank and a new currency to cover a group of countries by dollarization or euroization, which means the simple adoption of another country's currency or the common currency of a regional monetary union. In a currency union, all countries included participate in shaping monetary policy for the area covered by the union.

The study of the conditions under which a group of countries should band together to create a monetary union, forms the core substance of the theory of an OCA. Countries closely linked to each other through trade and capital flows is a necessary, but not a sufficient condition for them to abandon their currencies, adopt a common currency and give up monetary policy discretion. Mundell's theory on OCA teaches that a group of countries will benefit from using a common currency, provided three conditions are in place: 1) the countries involved should not be hit by asymmetric shocks; 2) there is a high degree of labor mobility and/or wage flexibility among them and 3) there is a centralized fiscal policy in place to redistribute financial or other resources. By going deeper into the economic analysis of OCA, several new criteria became apparent. In its different versions, the theory on OCA emphasizes several criteria (structural characteristics like size, openness, export structure, production structure, labor mobi-

lity, price and wage flexibility) of an economy to define the optimality.

Later on, additional criteria on similarity of shocks and monetary transmission mechanisms have been taken into consideration. The criteria are still central in the debate on monetary integration. It must be noticed that the five Maastricht Treaty criteria the EU countries, used to determine membership in the European Monetary Union (EMU), are very different from Mundell's research outcomes. The EMU calls for convergence in inflation, interest rates, deficits, debts and exchange rate stability preceding membership. None of these criteria fall under Mundell's version of the OCA.

1. Price and wage flexibility.
2. Mobility of factors of production.
3. Financial Market Integration.
4. The degree of economic openness.
5. The diversification in production and consumption.
6. Similarities of inflation rates.
7. Fiscal integration. Political integration.

First, using these criteria helps to assess to what extent the country is exposed to unexpected events, so-called asymmetric shocks that affect its economy more than the rest (country-specific balance of payment disturbances). Second, these criteria help assess whether the country is in a position to respond to asymmetric shocks with alternative mechanisms of balance of payments adjustments, if the exchange rate is fixed. As a result, sharing the OCA criteria reduces the need to apply nominal exchange rate adjustments within the currency area because the impact of some types of shocks are diminished. Countries forming a currency area expect benefits to exceed costs.

During the 1970, the theory on OCA evolved taking into account the worldwide experience with floating exchange rates. New practical issues came to the surface in order to answer the question on whether the economic integration among a group of countries creating an internal market is to be backed by fixed exchange rates between their national currencies (EMS) and later by adopting a single currency within the zone (EMU). The main question is when should a country join a monetary integration process and thus expand its monetary area? Evaluating the expected costs and benefits, a country (e.g. the United Kingdom) may decide whether and when to join a monetary integration process (or not to do so). Concerning the criteria for an OCA, it is difficult to measure and to evaluate their proportionate weight. This makes it difficult to communicate the OCA theory as an undisputable construction. In practical terms, this means that one can draw different borders for a currency area by using different OCA characteristics or by weighting each factor differently.

The "problem of inconclusiveness" has been outlined⁴ as OCA criteria may lead to different conclusions. For example, being quite open in terms of reciprocal trade among a group of countries, this country should consider a fixed exchange rate regime or even monetary integration with its main trading partners. The "problem of inconsistency" has also been brought up. For example, according to the openness criterion, small, more open economies, should adopt a fixed exchange rate or even participate in a monetary union.

It has been argued that on the basis of the OCA theory, economists and policy-makers could not find clear answers to the question as to whether Europe should proceed towards complete monetary integration, and which countries would be suitable to join. Examining the practical application of the OCA theory, it has been stated that it provides insufficient background for assessing the costs and benefits of economic and monetary union and for defining the optimum economic and monetary competencies of a given "area" such as the EU, and it is thus unable to define exactly which countries should share a single currency. For this reason, the EMU question has become more complex than the question of how to define the OCA in practical terms.

The study of the OCA characteristics is by necessity, backward-looking. For this reason, in the second half of the 1990s, several authors began raising the issue of the endogenous effects of monetary integration: i.e., whether sharing a single currency may set in motion forces bringing countries closer together (De Grauwe, Mongelli). The perception is that a single currency contributes to increasing the integration of Euro area countries over time, thereby improving the ranking of one or more OCA criteria. The OCA theory is the analytical basis for the monetary integration within the EU. This is particularly true when assessing the costs and benefits of enlarging the EMU. The theory of OCA is an instrumental framework for discussing the issue on the proper range of a currency area and provides an analytical basis for the monetary integration within the EU.

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Costs and Benefits of Regional Integration in the Gulf Region

**Ebtisam Al Kitbi*

Ever since the establishment of the Arab League in 1945, integration has been a major goal for the Arab World. The most successful, to date, has been the Gulf Cooperation Council (GCC) which was formed to integrate six Gulf countries (United Arab Emirates, Bahrain, Saudi Arabia, Oman, Qatar, Kuwait) of similar political, social, and economic systems. The GCC Charter, ratified in May 1981, commits the six signatories to implement measures “to affect coordination, integration and interconnection between the member states in all fields in order to achieve unity among them.” Any region needs a framework in which intra-regional issues — political, security or economic — can be addressed on a regular basis. There are three reasons which can be identified as to why countries seek greater regional integration:

- (i) To make economic welfare gains,
- (ii) To increase the region’s collective political bargaining power in extra-regional issues, and
- (iii) To achieve other non-economic national goals, such as meeting security concerns and preventing future conflicts.

Regional integration is good politics: it meets political needs, such as security or enhanced bargaining power, and it satisfies influential lobbies. Indeed, the purpose of integration is often political, and the economic consequences, good or bad, are side effects of the political payoff. However, there is another and more worrisome reason why regional integration is good politics. This is because those economic effects that are most apparent—larger markets and economies of scale—happen to be favorable. Other effects however, make the net economic impact of integration ambiguous, but these are often overlooked in political discourse. So, regional integration is good politics partly because it is “sound bite economics,” based on only those effects that are easiest to grasp. Sometimes the net effects will be highly favorable, but sometimes “sound bite economics” is seriously misleading because the illusion of gain collides with the reality of large costs and major redistributions. The combination of political payoffs and sound bite economics is tempting, and goes far to explain the popularity of regionalism. Regional integration may also be good economics, but the impetus for integration has usually not been the economics. Sometimes, good politics delivers bad economics. The economic effects can vary enormously depending upon the characteristics of the country, the countries it chooses as partners, and the detailed design of the integration arrangement. Only by attending to these economic choices can the political momentum behind

regional integration avoid the risk of driving an economy into costly mistakes.

Regional integration in the Gulf region has been the subject of much speculation since the inception of the Gulf Cooperative Council. Although initially created to oppose Iranian and Iraqi hegemony in the Gulf, the GCC became the medium for a more cohesive bloc promoting political, economic, and security cooperation among member states. However, the quest to combine these states into one unit has experienced notable successes and failures. The process of integration is separated by intermittent lengthy periods of dormancy. Only crises activate the process of integration. However, several profound advantages would accrue if the GCC realigned into a more interconnected union. Specifically, regional integration should succeed because:

- A collaborative security arrangement could enhance regional stability, and protect energy infrastructure.
- Increased economic amalgamation would enhance influence and bargaining power on the international economic stage.
- A common cultural, religious, social, and political identity amongst the member states implies minimal social barriers to melding

Although rich in oil reserves, the GCC economies are constrained in their development effort by two obstacles: the scarcity of natural resources other than oil and the small size of the market due to their sparse populations. These economies have lost a significant share of their oil market to other countries because: they have failed to diversify on any scale as can be seen from their total dependence on crude oil exports; they have experienced increasing budget deficits, and they have begun to face rising unemployment among nationals in a region that is highly dependent on migrant workers. Given this lack of progress towards achieving their development goals, the GCC countries can realize both static and dynamic gains, and thus improve their human and physical resources. However, realizing these gains without reducing the welfare of the rest of the world, their approach to regional integration is compatible with the principles and regulations of the World Trade Organization (WTO). Since the countries at hand have been in a free trade area since the formation of the council, the next step in their integration is the formation of a customs union. A customs union between the countries of the region can be both beneficial to the economies of the member countries and conducive to multilateral trade for many different reasons. First, members of the WTO are permitted to pursue any form of regional integration as long as they do not result in higher trade barriers

against non-member countries. Second, a customs union between the six GCC countries will facilitate the negotiations with the WTO since these countries will have one team representing them instead of negotiating bilaterally. Third, regional integration will enlarge the local market and enable the member countries to take advantage of economies of scale and to industrialize more efficiently. An enlarged market increases the competitive edge between producers and attracts investment both from inside and from outside the newly formed regional bloc. Fourth, by intensifying their regional bloc, the GCC countries can reduce the probability of conflicts among themselves and their neighbors. Such integration raises the level of interaction and trust among the people of the member countries, increases the stake that each country has in the welfare of its neighbors, and increases the security of access to the neighbors strategic raw materials. Finally, regional integration is expected to expand trade among member countries since it implies the removal of tariff and non-tariff barriers to trade and it will also strengthen their bargaining position vis-à-vis the rest of the world.

An open skies agreement for commercial air traffic and an agreement allowing GCC nationals to have the same privileges as natives of other GCC states would also be helpful. The latter would enable them to set up and run businesses without needing to search for local partners, to trade in each other’s financial markets and to invest on better terms in real estate throughout other GCC countries. That, in turn, would also allow for surplus capital in the richer GCC states to be invested more easily inside poorer markets. That, in turn, would create real development in the latter, while bringing returns to investors, thereby creating a situation that benefits everyone concerned. A common GCC foreign policy stance would also carry more weight internationally. Later, a common defence policy might also be initiated, leading to compatible weapons systems and helping with economies of scale during arms purchases. People-to-people ties are perhaps the most crucial aspect of integration. Some initial steps that could be taken in this regard include the creation of Gulf equivalents to Europe’s Champions’ League football tournament and Eurovision song contest. Another would be an end to all restrictions on marriages between GCC nationals from different countries. A more significant undertaking in this direction could be to modify textbooks throughout the GCC in order to include common civics lessons — ones that would reflect a shared past and a common future. The end goal would be the creation of a common Gulf identity.

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Oil, Security, and Trade in the Gulf: Europe in Search of a Strategy

* Thomas Demmelhuber

In December 2008 something unusual happened in the history of EU trade negotiations with third countries: after almost two decades of negotiations, the GCC countries unilaterally suspended the talks for a free trade agreement (FTA) with the EU, based on resentments over the EU's code of conduct during the proceedings. The low profile of the EU in the Gulf compared to other world regions (e.g. the Southern Mediterranean) is surprising if one looks at the comprehensive EU agenda of interests. First, the Arab peninsula and Iran are home to around 60 per cent of all proven crude reserves on the globe. Second, security and stability in the Gulf region are more than ever on the agenda after the toppling of the Iraqi regime in 2003. Since then, the regional security discourse has been correlating with an increasing powerful role of Iran that tries to present itself as the new powerbroker in the Gulf region and beyond. Third, the trade volume between the EU and the GCC has been increasing rapidly over the last years and reached 92 billion Euros in

GCC - Facts and Figures

Members

United Arab Emirates, Bahrain, Saudi Arabia, Oman, Qatar, Kuwait - Population: 36.2 Million

General

- Founded on May 25, 1981
- Economic Agreement signed December 31, 2001
- GCC Customs Union (2005)
- Common Market (2008)

Main objective

Focus lies on enhancing and strengthening economic ties among Member States, and harmonizing their economic, financial and monetary policies, their commercial and industrial legislation and customs laws.

Basic principles

- Coordination, integration and interconnection between Member States in all fields
- Formulating similar regulations
- Fostering scientific and technical progress

Institutions of GCC

- The Supreme Council (Heads of State)
- The Consultative Commission
- The Ministerial Council
- Secretariat-General

Source:

<http://www.gcc-sg.org/eng/index.php>

2007 (EU trade surplus). Fourth, the Gulf region is on its way to becoming the future political and economic hub of the Middle East. This initial setting of interests has not been translated into a more diverse, institutional network of relations between the two regional blocs yet.

Europe's low profile

During the 1990s, Europe's role in the Gulf comprised a limited political and economic engagement within the region. Relations were based on the 1988 Cooperation Agreement between the EU and the GCC. Successive EU/GCC joint cooperation committees (established under the 1988 agreement with 19 meetings so far) registered limited progress. Throughout those years the slow progress of political and economic institutionalization was explained by GCC representatives by a lack of negotiation mandate. They argued that the GCC as a regional, intergovernmental body of six sovereign national states was not authorized to deal with such high-level issues independently. This standoff seemed to come to an end in the wake of the 2001 terrorist attacks with both sides agreeing on a common objective to boost relations in all fields. An intense debate within the EU decision-making bodies subsequently re-emerged on how to fight terrorism in a region that was home to a stunning majority of the 9/11 perpetrators. It was the beginning of EU attempts to upgrade its foreign policy toward the Gulf region more comprehensively. The EU confessed the serious neglect of the Arab peninsula leading to the 2004 EU Strategic Partnership with the Mediterranean and the Middle East, in which the EU emphasized its commitment to advance its partnership with the Gulf countries. Yet, the latter fell short of prior hopes. Even though there have been some signs of intensifying relations and increased efforts to deepen the political, economic, and security interactions of Europe with the region (e.g. establishment of an EU delegation office in the Saudi capital Riyadh, 2004) there is still no concrete, concerted EU policy in the Gulf beyond the thriving bilateral activities of some EU members (UK, France, Germany et al.) especially in terms of economic and financial cooperation.

Searching for reasons

Lack of geopolitical proximity: Compared to the Southern Mediterranean where EU member states are directly affected by security risks such as illegal migration, from an EU perspective, the Arab Gulf is perceived as a faraway region. Thus, in particular the southern EU members (Spain, Italy, and Greece) want the whole community to concentrate primarily on the most pressing problems along their coastlines.

Lack of consensus: In the aftermath of 9/11

Further Publications of Thomas Demmelhuber at ZEI:

Discussion Paper C 159 (2006): The Euro-Mediterranean Space as an Imagined (Geo-)political, Economic and Cultural Entity.

Discussion Paper C 170 (2007): The European Neighbourhood Policy (ENP) and its Implementation in the Southern Mediterranean. The Case of Egypt.

the debate rallied around the split inside the EU with some member states rejecting the military invasion of Iraq and with others standing side-by-side with the US. There was also another striking point of contention on how to formulate a long-term strategy vis-à-vis the Gulf. The EU was not speaking with one voice as there were too many dissenting voices among the then 15 member states (plus discordant EU institutions). Meanwhile, the UK and France retained significant bilateral relations with the Gulf States that were hardly integrated into an overall EU concept.

Lack of strategy: The EU is now facing the result of the decade-long low profile in the region. It does not show the flexibility to come up with an alternative foreign policy concept that might work in the Gulf. The EU strategy in the Southern Mediterranean is based (despite other diplomatic rhetoric) on a political and socioeconomic asymmetry that somehow eases a unilateral agenda setting or the usage of political conditionality. Such a discourse asymmetry is not given face-to-face with the Gulf region where the counterparts expect the EU to be on a par with them. Hence, the EU has not sufficiently taken into account the aforementioned geostrategic shift in the region with the Gulf region becoming the new political and economic hub of the Middle East.

This strategic policy failure has paved the way for other actors, such as Asian states, to increase their political and economic stakes in the region (e.g. Chinese-GCC free trade talks have been underway since 2004). The EU has lost much of its appeal as a strategic partner. Even the tiny French military base opened in 2009 in Abu Dhabi (UAE), does not make any difference as it is the sole result of strong, bilateral UAE-French relations, which are not integrated into a concerted EU policy. Moreover, diversification of their partners seems to be the key word for the ruling dynasties in order to decrease one-sided dependencies.

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The Shift of GCC Foreign Policy towards Asia

* *Abdullah Baabood*

For the oil dependent GCC states, diversification has been the *modus operandi* for their economic policies. In addition to attempts at diversifying their local economic base beyond that of oil, GCC states have also been broadening their horizons toward global markets and, since the end of the Cold War, they have been expanding their relations with international actors beyond the US and traditional European partners.

In view of its geographical proximity, old and historical 'silk route' trade connections between the Gulf and Asia did exist in the past, however, because of 20th century colonial rule and Cold War politics, the two regions became mostly disengaged. Even as late as the 1990s, the relationship was largely unremarkable and confined to bilateral trade in oil, expatriate remittances and conventional diplomatic relations.

Globalization, following the end of the Cold War bi-polar world, ushered in a new multi-polar global system with its complex web of interconnectedness and interdependencies between states, markets and societies. The recent 'Asian Miracle' and its remarkable economic success in this century, dubbed the 'Asian Century'- underpinned by demographic factors, attracted the Gulf to Asia. This process was accelerated after the events of 9/11 and subsequent US policies towards the region.

In recent decades, Asia has become an increasingly important force in the global economy. Its contribution to world output has doubled since 1950, it now accounts for over one-fifth of world exports, and currently attracts around a third of direct foreign investments in all emerging markets.

Asia's economic growth has added to its thirst for sources of energy and the GCC states, which hold the largest reserves of oil and gas in the world, have been happy to supply it. As a result, the GCC exports more oil to Asia than to Europe and North America combined. The fact that three-fourths of the energy exports from the Gulf are destined for markets in Asia, underscores the rising importance that the region has for the fast growing Asian economies. In recent years, the dynamics of trade in energy has undoubtedly and increasingly drawn GCC and Asian countries towards each other and led to more extensive inter-regional co-operation.

Trade between the two regions has been expanding at 30 percent annually. Since 2006, Asia as a whole has overtaken the EU as the largest trading partner of the GCC and as of 2007, Asia accounted for 55 percent of the GCC's total trade of \$758

billion. Exports from the GCC countries to Asia have also been growing over the years and now constitute more than two-thirds of their exports, compared to 16% and 13% for Europe and North America, respectively.

As a natural outgrowth of the steadily deepening economic links between the two regions, the IFF has estimated that Gulf-based investors invested US\$60 billion, or 11% of GCC total investments in Asia during 2002-2006. The GCC announced some US\$150 billion in long-term infrastructure investments in Asia in 2005-06. And while the scale of investment lags behind trading ties, state investment agencies are actively scanning the market for quality assets in Asia and the total amount is expected to grow.

The geopolitics of energy has also brought the two regions closer in terms of regional security cooperation and there has been steady, incremental progress in the building of personal and institutional relations. This was nurtured by numerous exchange visits by heads of states and other senior official delegations as well as by progress with negotiations on a number of GCC Free Trade Areas with several Asian states (e. g. China). The rapidly growing GCC-Asia relationship continues to offer the GCC diversification of its international relations as a supplement to, but not a supplanting of, existing partners.

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Participants of the Academy with Alexander Count Lambsdorff, Member of the European Parliament, Monika Pottgiesser, GTZ, Prof. Dr. Matthias Winiger, Rector of Bonn University, and Prof. Dr. Ludger Kühnhardt, Director at ZEI.

ECOWAS-ZEI Academy in Comparative Regional Integration

From 16-28 March 2009, the Center for European Integration Studies (ZEI) together with German Technical Cooperation (GTZ) and the Economic Community of West African States (ECOWAS) hosted the first "ECOWAS-ZEI Academy in Comparative Regional Integration".

This two-week special training program aimed to intensify the commitment for regional integration in West Africa. Participants were the heads of the ECOWAS National Units within the 15 member states and high-ranking civil servants from the different ECOWAS institutions in Abuja, Nigeria. Listening to a series of lectures in Bonn as well as in Frankfurt

and Brussels held by international experts coming from politics, academia and think-tanks, participants had the opportunity to reflect upon new information and to discuss their own ideas of how to give West African regional integration further incentives. The main topics of discussion were, for example, the establishment of a regional monetary union, the relationship between ECOWAS and the EU and the realization of an "ECOWAS of the people" by 2020.

The academy was sponsored by GTZ with funds of the German Ministry of Development and Economic Cooperation.

Three Questions to Dr. Christian Koch, Gulf Research Center, Dubai

Since 1988 the Gulf Cooperation Council and the European Union have been working on the conclusion of a Free Trade Agreement. After halting the negotiations at the end of last year, the last EU-GCC Ministerial Meeting in April in Muscat brought new rapprochement. Are there serious prospects for the resumption of negotiations? Which points are still the most critical and what can be done to resolve them?

There should be no doubt that there continues to exist a commitment by both sides – the GCC as well as the EU – to conclude the long awaited free trade area negotiations and come to an agreement as soon as possible. While negotiations have been suspended, informal discussions in fact continue between the two sides. While it is often mentioned that there are several issues to be resolved, it basically boils down to two items: export duties and the often referred to human rights clause.

The latter issue, i.e. the resistance by the GCC states to have a conditionality clause included when it comes to human rights, can be resolved with the right wording and both sides have worked toward this. Given that the GCC has accepted the fact that such clauses are standard as far as the EU is concerned, the principle objection does not exist any longer and therefore this will not be an obstacle that cannot be overcome.

The more serious issue is the one on export duties where the GCC has insisted on no further concessions and stating that it will go along with WTO rules on this issue. Because the EU fears a precedent here that might apply to other free trade area negotiations it conducts, it has so far refrained from accepting the GCC position, in turn, being the principle reason the negotiations have been suspended. In order to resolve this, the European Commission needs to create an internal consensus that EU flexibility will be possible. If that is not possible, then another possibility would be to exclude the export duty clause for the moment and allow the agreement as such to proceed without final agreement on this issue. A statement could be made by both sides



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indicating that negotiations on export duties will continue. Whether this is acceptable to the EU side however is questionable and until a greater degree of flexibility becomes visible, the trade deal will remain in limbo.

2. The GCC successfully established a common market among its Member States in 2008. What are the most important cornerstones of this market and what are its positive effects until now?

Here, it needs to be clearly stated that while the common market was announced with great fanfare at the end of 2007, the majority of decisions to actually proceed with implementation have not been acted upon yet as of mid-2009.

For the moment, significant administrative and technical issues remain to be resolved especially when it comes to enabling legislation at the national level. Instead, the common market needs to be viewed very much as a project in the making and as such it was from the outset more a statement of political will to further integration within the

GCC at all levels than necessarily immediate economic reality.

Furthermore, it fulfills the objective of the charter of the GCC in that “coordination and integration between Member States in all fields, leading to their unity” should be sought. In this context, there has been some tangible progress that has been achieved, for example, when it comes to free movement and residence. Without a doubt, as the institutionalization process in the GCC proceeds and matures, so will the ability to fulfill the objectives of the common market project.

3. The current economic crisis is hitting Europe hard. What is the effect of the crisis on the Gulf region and what does the GCC do to handle negative consequences?

The Gulf region is certainly not immune from the negative impact and consequences of the current global financial and economic crisis. The fast-paced developments that one has grown accustomed to in the past years have been impacted as the project finance sector has tightened, as banks have come under increased scrutiny for their lending practices and as governments in general have had to tighten belts due to the significant decline in the price of oil on which national budgets still depend to a large degree. At the same time, the fact that the GCC states have been able to accumulate huge financial surpluses over the past years, has meant that much of announced government spending has continued. Overall, there is a broad commitment to maintain investment in various infrastructure and other economic diversification projects and as such the governments are ready to incur short-term budget deficits to promote continued growth. Moreover, the medium-to-long-term prospects are positive with demand for oil set to expand as the worldwide recession comes to an end.

IMPRINT

ISSN1996-9678
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The Regional Integration Observer is published three times a year. Authors are responsible for the views expressed in their contributions.