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Do the AGCC Economies need a Single Currency? Some Potential Costs and Benefits of a Monetary Union for the Member States of the Arab Gulf Cooperation Council (AGCC)

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Abstract

This paper applies the five tests guiding United Kingdom's policy decision on the European Monetary Union to a Gulf Monetary Union (GMU). The absence of any GMU entry criteria renders these tests vital. Research confirms that though elements and types of convergences are broadly and readily present, future diversification, specialization and differences in factor endowment might wipe out current convergences. Fiscal policy flexibility does not exist and labor market flexibility is limited, but labour mobility is likely to bear some adjustment burdens. The financial market is most likely to benefit from a GMU. Though the FDI is small, AGCC-dispersed and oil-dominated, the GMU is unlikely to change this pattern. It's contribution to growth, stability and employment is subject to a credible monetary policy. Overall, the AGCC countries will incur some costs while benefits are conditional to timing and specific policy efforts in trade, diversification, development of NBFI, financial assets promotion, labour market, fiscal rules and budgetary framework.

Key words: AGCC, Gulf Monetary Union, European Monetary Union, Single Currency, Convergence, Flexibility, Criteria.

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1. Introduction

Since the early 1980s, the AGCC states - Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates - took some steps towards economic integration. Barriers to free movement of capital, goods, labour and natural persons were eliminated. Corporations and individuals were granted national preferential treatment. In early 2003, common external tariffs were imposed under the umbrella of a Customs Union. Since 2000, a significant step has been taken towards the creation of an advanced stage of economic integration - the Monetary Union. At it's meeting in Bahrain in 2000, the Supreme Council of the AGCC agreed to make a working plan and a timetable to establish a single AGCC currency[1] The end of 2002 pegged national currencies of AGCC states to the US dollar. The AGCC monetary authorities are now working to finalize the agreement on the economic convergence criteria (which are not considered as a prerequisite for joining the single Monetary Union but as a tool to assess policies before and after the establishment of the Union), methods of calculation and the levels of these criteria by the end of 2005. The criteria will be fulfilled between 2005 and 2010, during which period a single currency shall be introduced.

The economic convergence criteria, which, for the Gulf Monetary Union (GMU), are tools to assess policies of member countries after its establishment, are not sufficient to assess the case of its formulation. The long term costs and benefits of the Union is the most crucial issue. That is why the paper will analyse some potential costs and benefits of the forthcoming GMU in the six AGCC member states.

The paper will start with a background theoretical analysis to outline the requirements and the theoretical benefits of the Optimal Currency Area and review literature of the AGCC Optimum Currency Area. The testing section will highlight the macroeconomic costs and benefits of introducing a single AGCC currency in terms of capitulating autonomous monetary and exchange rate policies. This section will take up the same five tests that were used to determine UK's membership to European Monetary Union (EMU). It will attempt to find answers as to whether the AGCC economic structures have reasonable comparable convergence by which they can live comfortably with the interest rate imposed by the Gulf Central Bank. It will also ascertain whether these economies have sufficient flexibility to deal with problems that can emerge after the formulation of the GMU. In addition, the test will identify the benefits and costs of strengthening the ability of AGCC states to develop its financial markets, investment, stability, growth and employment. Key economic challenges such as privatisation and diversification from oil and their likely effects on the GMU will also be referred to. The analysis of the results and the policy implications are evaluated in the final section.

2. Literature Review - The Theory of Optimum Currency Area

Robert Mundell first elaborated the theory of Optimum Currency Area in the 1960s (Mundell, 1961, pp. 657-665). A single currency, it was argued, eliminates the need to adjust prices between different economic regions during fluctuations in the exchange rate. Consequently, there are three options to make an economic adjustment. (1) labour must be mobile so workers can move from an area suffering from recession to one that is enjoying an economic boom, (2) wages and prices must be flexible so that the economy can respond to any fluctuation of supply and demand, and (3) there must be some way of transferring resources to the country or region suffering from recession to help it recover from the same.

An Optimal Currency Area is an economic unit composed of countries or regions across which external shocks are sufficiently symmetrical, factor mobility is sufficiently high, real wages are sufficiently flexible and fiscal transfers sufficiently robust to eliminate the need for nominal exchange rate changes within the unit and justify a common monetary policy (Mundell, 1961). Literature has identified different modes of monetary cooperation according to the extent and the degree of cooperation and whether institutions and legal commitments need to be rearranged. The first three arrangements require lesser degree of cooperation, lesser obligations and are partial compared to the advance arrangement of Optimum Currency Area. The first arrangement occurs when currencies of the member countries are freely exchanged at a constant rate (called a Currency Area). The second arrangement is a Monetary Union in which there is one currency and exchange rate vis-à-vis the outside world. The third is an arrangement where monetary markets are unified and currencies and deposits freely move at constant rates. The fourth advanced arrangement is the Optimum Currency Area, which is also called Monetary or Currency Union. The Monetary Union involves not only a unified currency among member states, but also common monetary and banking policies, a pool of foreign exchange reserves dealt with by one central bank, fixed exchange rates, complete currencies convertibility, financial market integration (liberal capital transactions, harmonization of national financial regulations, structures and institutions) and reasonable economic convergence (see, for example, Laabas, Belkacem and Limam, Imad, 2002; Abdul Majeed, Al Saddoun, J. and Hayder, M., Undated).

Traditional theories have attempted to find out some imperative indicators necessary to form an advanced Monetary Union (Ishiyama, Y. 1974; Mundell, Robert, 1961; and Mckinnon, R. 1963). The free movement of factors of production is a vital adjustment mechanism in case of a shock. Then, there will be no need to use an exchange rate as a corrective mechanism. When foreign demand increases for a member (or members) of a Monetary Union this automatically leads to common currency appreciation and inflationary shocks. Adjustments to systematic shocks facing all member countries require common responses, which also entail flexibility in prices and wages. Moreover, when the economy is diversified, it will protect against terms of trade shocks. Hence, since it is unlikely to use an exchange rate mechanism for adjustment, its chances to be a member of a Monetary Union are increased. Likewise, countries with similar economic structures, which are more likely to experience symmetric shocks from common factors, are also less likely to use exchange rates for adjustment. In addition, similar economic structures are followed by similar inflation and unemployment rates and more or less similar economic policies that trade-off between inflation and unemployment (McKinnon, R. 1963). Hence, similar economic fates and indicators do not require a change in the exchange rates of member countries thereby facilitating policy coordination for full monetary integration. Moreover, the greater the dependence of the economy on international trade, the less will be the effects of exchange rates adjustments on the balance of

payments, reducing the negative effects of exchange rate adjustment on inflation and the cost of living (McKinnon, R. 1963, pp. 721-724). This entails that there are strong reasons for open economies to fix their exchange rate via a form of Monetary Union arrangement. Finally, the political will and resolution to achieve a Monetary Union are prerequisites to its success.

Literature also identifies some benefits and costs of Optimum Currency Area to member countries (Ishiyama, Y. 1974, Belkacem and Limam, Imad, 2002). A single currency increases the transparency of prices and reduces the transaction costs of buying and selling goods as it does not need to convert money from one currency to another. It also eliminates the exchange rate risk among countries that share the currency. When a Currency Union exists, countries can no longer use devaluations as a part of their economic policy to gain an advantage over other countries. Moreover, it is easier for the Central Bank, which oversees the Currency Union, to focus on its primary objective: control prices and fight inflation because a single government does not control it. Joining an Optimum Currency Area benefits the high inflation member country with a fixed exchange rate regime and a high ceiling, regulated and credible Optimum Currency Area monetary policy. Optimum Currency Area also reduces the exchange rate uncertainty that hamper trade and investment among member countries by reducing transaction costs of multiple exchange rates (cost of monitoring and predicting exchange rates fluctuations and money conversion). Moreover, bilateral trade between member countries increases although there is some disagreement between writers on the volume of the increase (see, for example, Rose, A. 2000). Another benefit of introducing a single currency is that individuals and corporations will have greater economic choices. The single currency would encourage trade that may in turn force governments to reduce structural barriers to trade. The market reforms that inevitably result from the introduction of a single currency should also be included in the list of benefits.

Although there are many economic benefits from a single currency, several costs too should be considered. The major costs of implementing a single currency are macroeconomic and political. The most outstanding cost of Optimum Currency Area is the loss of national control over monetary and exchange rate policies. This is why the theory of Optimal Currency Area emphasizes the importance of flexible prices, labour mobility and fiscal transfers. After the formulation of a Monetary Union, member countries will adopt one currency and the nominal exchange rate between AGCC currencies will be fixed irrevocably at the entry rate. The interest rate will also be set by the Joint Central Bank on the basis of economic conditions of the member countries as a whole. In addition, member countries will be required to comply with the terms of a Monetary Union's macroeconomic and financial policies[2.] Another effect of the Currency Union will be less regional economic differentiation.

The macroeconomic costs of giving up national monetary control in the context of a Monetary Union depends on the frequency and severity of asymmetric shocks member countries are exposed to and the available adjustment mechanism to mitigate the impact of those shocks, given that the national monetary and exchange rate adjustment mechanisms are not in the hands of any individual member country (Mongelli, 2002). Another cost is imposing penalties on violators (sanction or otherwise). It should be mentioned that the costs and benefits of Optimum Currency Area in the Gulf might not resemble the outcome of the theoretical costs and benefits mentioned above as these countries have special economic conditions.

3. AGCC Optimum Currency Area – Literature review

Literature commenting on the Optimum Currency Area (Monetary Union) in the AGCC council raised conflicting opinions about the benefits and costs of the AGCC Monetary Union (see Jadresic, E, 2002; Igbal Zubair, and Fasano, Ugo, 2003; Oman Economic Review, 2002; and Laabas Belkacem and Limam Imad, 2002). Those who question the need for a common AGCC currency argue that the robust regional trade and volatile currency fluctuations among trading partners, which are the usual reasons for joining a Currency Union, do not exist in the case of AGCC economies. Others argue that the AGCC economies, at least at this stage, lack basic factors such as the differences in the comparative advantages in factors of production and weak intra-AGCC trade leading to a common Monetary Union. Moreover, those who look forward to the establishment of the Union argue that although the structural convergence is high at the moment, it will diminish during the present diversification in the AGCC economies.

Perhaps one of the most comprehensive studies of the AGCC Monetary Union is made by Laabas Belkacem and Limam Imad (2002). Using traditional criteria, they test whether AGCC is an Optimal Currency Area and whether AGCC countries are ready to establish a Monetary Union. According to them the Gulf States are yet to fulfil some necessary pre-conditions. AGCC economies are still oil-dominated. Regional trade is limited and there is no evidence of economic convergence and business cycle synchronization. Nevertheless, a test based on Generalized Purchasing Power Parity shows that real exchange rates are closely related and share the same stochastic trend. The authors argue that the major factor in favour of a Monetary Union is the commitment to fix exchange rates and a strong political will. They also argued that once it is established it could expand intra-industry trade despite the present lack of diversification. A Monetary Union may result in more synchronized business cycles provided the AGCC countries achieve convergence in economic structures and economic policies. Finally, they argue that in order to get full benefit from a Monetary Union, the AGCC countries should lift all restrictions on the free movement of goods and factors of production.

Supporters of a single AGCC currency argue that although it is achievable, its benefits are minimal. The AGCC states, in many respects, are already having a single currency- the US$. The six AGCC states' currencies (except Kuwait which is basket-based and has remained steady against the US$) have been fixed against the US dollar for many years. Hence, US Federal Reserve rather than local central banks fixes the AGCC interest rates. Others, (for example, Finigan, John, 2004, p. 20) added a new dimension to establishing a single AGCC currency: the benefit of facilitating the integration of Yemen, which is not a member of AGCC. Some argue about the negative aspects of AGCC currency. As it was the case when the Euro was initiated, inflation is likely to occur when a single currency is introduced because the purchasing power will be less initially. Others mentioned the difficulties of giving up control of fiscal policy by some AGCC states as a means of enhancing growth and reducing the risk of low oil prices. While others raised the issue of the frequency and severity with which member states (such as AGCC states) are exposed to asymmetric shocks and the adjustment mechanisms available given the impossibility of adjustment in national monetary policies and nominal exchange rates (Mongelli, F., 2002).

The location of the common central bank (the Gulf Central Bank) – to make the monetary policy decisions; supervising payments systems and coordinating financial integration - and the name of the single currency are also mentioned as potential constraints. However, others consider common factors and the weak relative strength of AGCC monetary policy as encouraging factors for the formation of a Monetary Union. They argue that the common historical, cultural, social and political union, the relative unimportance of a monetary policy in the AGCC economies, as well as the possibility of administering the excess oil financial resources jointly by AGCC states after the establishment of a Monetary Union, will not make the loss of power argument a decisive factor to hinder the upcoming GMU (Balassa, B. and Stoutjeesdijk, 1972; Abdul Majeed Al Saddoun, and Hayder, M. undated). Others argue that the degree of AGCC monetary convergence over the past two decades exceeds the convergence achieved in this field by the euro countries prior to the introduction of the euro in 1999 (See for example, Ibrahim, Badr-El-Din, 2004).

To sum it all, the opinions and findings show a considerable agreement on the possibility of establishing an AGCC Monetary Union during the time framework specified, but they cast considerable doubts about the potential benefits when compared to the EMU. Our Negative observations about the AGCC single currency have raised issues without providing analytical answers. Most of these writings represent individual opinions rather than research findings hence they markedly differ in their results. Nevertheless, those arguments will remain controversial until they are subject to solid analysis or solved when a Monetary Union is in operation. This also applies to constraints or the negative effects facing the establishment of the AGCC Monetary Union.

4. Hypothesis and methodology

This paper attempts to focus on testing some major criteria in relation to the costs and benefits of the upcoming GMU. The methods of investigation will follow the same pattern of five tests guiding the UK policy decision on a Monetary Union - convergence, flexibility, investment, financial services and growth, stability and employment (www.official-documents.co.uk/cgi-bin/htm). These five tests, which were announced to the House of Commons in 1997, are:

1. Convergence test: Membership to Monetary Union (MU) entails having a permanent fixed nominal exchange rate with the member countries and a common monetary policy (a single interest rate across all members of the Monetary Union). The convergence test addresses the issue of whether a single interest rate will be suitable for all Gulf area members over a period of time. The test assesses, with reference to past performances and current conditions, about the likelihood of the Gulf Union to be prone to different shocks or different responses to common shocks including the shocks through economic polices.

2. Flexibility test: Is there a sufficient flexibility to deal with emerging problems? Flexibility means minimizing the costs of adjustment.

3. Investment test: Would joining GMU create better conditions for firms making long-term decisions to invest in each member country by limiting uncertainty, reducing the cost of capital and encouraging cross- boarder investment?

4. Financial services test: How will joining the Union impact the competitive position of each member states' financial services industry?

5. Growth, stability and employment test: Will joining the GMU stimulate trade (with higher investment, currency stability, high level of competition and economic stability through Union policies) promote growth, stability and increase job opportunities?

The economic theory underlying these tests originated from the theoretical works on Monetary Union, especially that of Robert Mendell (Mandell, 1961). It may be stated that all these tests are not equally important for the AGCC countries and due to an absence of data it may not be feasible to fully assess some of them. Nevertheless, preliminary results of the five economic tests will show whether a case for a Monetary Union formulation can be made, as these tests reflect its long-term importance. Moreover, the tests also agree with the foundation of economic policies of the AGCC states. The most important issues of the five tests (investment, competitiveness of financial services, high growth, economic stability and work promotion) are the foundation of economic policy objectives of the AGCC states. All AGCC economies declared diversification from oil and gas, attraction of FDI, decrease in the size of the government sector, labour market reform and coping with population growth as their objectives.

5. Testing

5.1. Convergence

A Monetary Union entails having a permanently fixed nominal exchange rate and a common monetary policy (a single interest rate across all members of the Gulf Monetary Union). The convergence test addresses the issue of whether a single interest rate will be suitable for all Gulf members over a period of time.

Convergence is best understood by its implications for membership to a Monetary Union. As described in the UK study that was conducted in order to see the feasibility of UK membership in the single currency of the EMU (www.official-documents.co.uk/cgi-bin/htm), prospective candidates for a Monetary Union are convergent if they have similar economic structures, so they will respond to the same shocks in a similar way, and are unlikely to be hit by a large number of country-specific shocks. They are non-convergent if they have different structures which imply differing responses to common shocks, greater vulnerability to asymmetric shocks, or that the monetary policy stance suited to one country or region does not suit the others.

5.1.1. Structural Convergence

The structure of the AGCC economies could mean that there will be country-specific developments causing divergence within the Gulf area in future. This is because differences in structures could make one country more vulnerable to shocks that do not affect the rest of the members of a Monetary Union, and consequently it would react differently to changes in economic circumstances that in turn affect the entire Monetary Union. Compatibility of structures will limit the extent of divergences, either from country-specific shocks or responses to such shocks.

Sectoral specialization indicate how specialized an economy is in certain sectors in relation to other countries. Structural features of the economy like sectoral composition and trade patterns condition its shocks and responses. The sectoral share of output and specialization in the Gulf area determines how shocks affecting particular sectors might affect one country more in relation to others and whether this could imply divergent behaviour in future.

INSERT TB 1 HERE.

The table above (Table No 1) shows the present high dominance of oil and gas in the economic structures of AGCC economies, while contributions of the other sectors are more or less comparable.

Convergence can also be seen from the expenditure components of GDP. The outcome of the following table (Table No. 2) is clear: expenditure components of GDP exhibit a similar pattern among the AGCC countries. With one exception of Qatar, private consumption is a dominant expenditures component of GDP, sharing an average of 38%, while other components share an almost similar percentage.

INSERT TB 2 HERE.

The issue is not the convergence in the current but among the dynamic structures. Diversification as well as exhaustion of oil and gas in some AGCC countries in the future may reduce structural similarities. After several years AGCC factor endowment may change as can be seen from the following table (Table No. 3):

INSERT TB 3 HERE.

Among the AGCC countries, Saudi Arabia has relatively huge natural resources, while Bahrain has limited natural resources. However, three AGCC countries Saudi Arabia, Bahrain and Oman together are projected to run out of oil sooner when compared to other countries. Gas reserves are also relatively smaller in Oman, Bahrain and Saudi Arabia and higher in Qatar and Kuwait. These future developments in oil and gas resources might have some bearing on the structural convergence.

The distinct differences in gas and oil reserves can also be seen if we compare the GCC countries with OPEC and world reserves. Table (3) above shows a sharp contrast between GCC countries compared with the world and OPEC gas and oil reserves. These sharp differences will have some repercussions on future developments in oil and gas resources in the region and so the structural convergence. GCC current sizes also shows that the output is not evenly distributed among countries and between GCC countries' populations, with Saudi Arabia came first and share more than 50% of GCC value of output, but comes third (after Qatar and UAE) in percapita income. The sharp differences in population show that the lower GDP countries are not necessarily the lower percapita income GCC countries.

5.1.2. Degree of Openness and Trade Pattern

Trade exposes relative patterns and the degree of openness to trade have an important role in determining how global shocks might affect one AGCC member country in relation to others. The patterns of trade and the degree of openness to trade have an important role in determining how global shocks might affect one member country in relation to the other Monetary Union countries. AGCC trade openness, trade integration and geographical breakdown of trade accounts are investigated in the following table (Table No. 4):

INSERT TB 4 HERE.

Overall, AGCC economies are open, although the degree of openness varies widely between individual countries. Trade openness as percentage of GDP showed that UAE and Bahrain are far ahead on the AGCC average, while the rest are more or less average. There are also sizable variations in the pattern of trade. The geographical breakdown of current account trade (goods and services) showed a relative homogeneous pattern, with some exceptions. The direction of trade is also relatively homogenous, with Asia as a major export destination and Europe and USA as the major areas of import. Japan (with the exception of Bahrain) is the major export trade partner, while EU and USA (with the exception of Oman) are the major import trade partners. Roughly, the EU makes one third of imports, while USA records a 13%.

AGCC trade integration on the other hand is limited, with some exceptions. The most outstanding limitation is in exports, due to the limitation of intra-oil exports and the dominance of oil exports in the AGCC exports. Bahrain and Oman receive a considerable percentage of their imports from the other AGCC countries, while the others receive less than 15% from AGCC countries. In evaluating exports, no country exports more than 10% of its total exports to AGCC countries. However, although it is not clear from the table that non-oil intra-AGCC trade is more than 30%, this is less than the intra-trade for EMU for example, which is almost double the share.

In sum, even if we look at non-oil trade integration between AGCC countries, intra-trade is far from being high and this will limit the benefits from one currency. Moreover, trade shocks that may result from these differences in trade exposures can generate some cyclical divergences. On the other hand, the relatively homogenous pattern of trade with the outside world may transmit asymmetric shocks.

5.1.3. Cyclical Convergence

Short-term interest rates and GDP growth are used widely as a basic indicator of cyclical convergence.

In the last decade the spread between the highest and the lowest short term (3 months deposit rates) is 4 to 0.8 percentage points. The absolute range of interest rate is narrowed at 1.8 percentage points in the course of the past three years (Finigan, John, p. 14). Interest rates in AGCC countries are affected by the changes in US interest rates and, to a lesser extent, by the development of oil prices. Oil price increase widens the spread between AGCC interest rates. Moreover, AGCC interest rates are known to move in line with US interest rates, and the spread between the two rates is generally low. This is a reflection of the credibility of the exchange rate when AGCC national currencies are linked to US$.

GDP growth rates in the AGCC countries on the other hand show some correlations over the past few decades, as they critically depend on oil price movements, which tend to be almost similar in all cases. Our calculations of the annual average growth rates between 1995 and 2000 is more or less similar being 0.07% in Bahrain, 0.08% in Kuwait, 0.09% in Oman, 0.20% in Qatar, 0.27% in Saudi Arabia, and 0.13 in UAE. The co-movement of GDP growth rates exist despite the difference in growth cycles in some AGCC countries due to factors such as the development of natural gas sector in Qatar during mid-1990s and Iraq invasion of Kuwait in the early 1990s. The co-movement of non-oil GDP growth cycles is less correlated in non-oil GDP than total GDP. Table (5) show the non-oil GDP growth rate (NOGDP) for the six GGC states over the period 1996-2003. The differences between the annual higher and lower non-oil GDP growth rates tends to be higher and in the range of -0.006 in Qatar (between 2001-2002) and 0.622 in UAE (1996-1997).

5.1.4. Endogenous convergence

The act of joining a Monetary Union may lead to changes in economic structures and business cycles. This concept is known as endogenous convergence. If the economic structures and business cycles of the countries in a Monetary Union converge over time, the potential costs of membership to the Monetary Union are reduced. However, while convergence of structures can help reduce the incidence of future shocks after entering the EU, it cannot elevate the potential shock of entry to a Monetary Union itself. Different drivers of endogenous convergence potentially operate over different time periods. The immediate effects of the entry may change the macroeconomic policy environment creating a common monetary policy and a permanently fixed nominal exchange rate. Over the short to medium term, firms and households would gradually adapt their behavior to the new economic environment - for example, the removal of barriers such as exchange rate transaction costs is likely to promote trade and investment within the Currency Union. Over the longer term an increase in cross-border trade and investment will lead to greater integration of economic structures. This might induce a change in the industrial landscape with more specialization in production (www.official-documents.co.uk/cgi-bin/htm).

The economic structures of AGCC countries, as we have identified, are mostly similar and energy is a leading sector that drives government expenditure. Finigan, John, (2004, pp. 14-15) showed high correlations between AGCC economic growth rates. The coefficients of correlations of economic growth rates between various pairs of AGCC countries are positive, except in the case of Bahrain and Kuwait. Moreover, the coefficients of determinations of economic growth are greater than 65%, except for Kuwait. These results vindicate the convergence of the current AGCC business cycles.

Greater trade and investment within a Monetary Union, combined with higher levels of competition as a result of price transparency and more integrated markets, may result in increased industrial specialization, where regions specialize in certain types of economic activity. With the permanent elimination of exchange rate risk, firms will have greater certainty about relative costs. In these circumstances, they may concentrate on production where they have a comparative advantage and can best exploit the economies of scale. Another source of potential medium and long-term

convergence is through financial structures. Greater financial market integration and greater similarity of financial structures could promote convergence of business cycles.

5.2. Flexibility

Flexibility ensures durable convergence. It relates to the resilience of the economy and its ability to adjust rapidly while minimizing disruption. Sustainable and durable convergence is a pre-condition for realizing the potential benefits of membership.

The assessment of the flexibility test considers the following key issues and questions:

1. Flexibility and adjustment mechanisms in the Gulf answer the questions: How does flexibility and adjustment work in AGCC countries? What are the adjustment differences within the Gulf member countries? Is the non-exchange rate flexibility of AGCC economies sufficient? How would the formation of the Gulf Monetary Union (GMU) affect overall flexibility?

2. Market flexibility answers the question: How flexible are Gulf labour, product and capital markets?

3. The potential for fiscal flexibility answers the question: What role does fiscal policy play in adjusting to shocks? Can it be enhanced in the Gulf member states?

5.2.1. Labour market flexibility

The current policies for integration and harmonization of AGCC economies are discussed in the AGCC Charter, the Unified Economic Agreement and at the Head of States Summit held in Muscat in 2001. The AGCC Charter emphasizes coordination and strengthening relations, similar regulations in economic, commerce, financial affairs, tourism education, cultural, social and administrative affairs and establishment of joint ventures. These objectives are further re-emphasised in the 1982 Unified Economic Agreement as it calls for free trade, freedom of movement, work and residence and better treatment for AGCC nationals in ownership, inheritance and exercise of economic activities and coordination of monetary policies. The outcome of Muscat AGCC Summit in 2001, in its statement the "Economic Agreement between the States of the Cooperation Council", has gone further to include some measures of common external tariffs, single entry point principle, implementation of the Custom Union by January 2003, harmonization of all product standards, national treatment of AGCC capital/investment/employment/ownership of real estates and equity and complete integration/harmonization of regulation of financial markets.

AGCC countries are characterized by high population growth averaged at 3.5% per year in the last decade. The result is a very young population as around 40% of the population are below 15 years of age. The economies of AGCC countries rely heavily on expatriate labour force mainly because they are highly skilled and qualified. The number of nationals in the total population differs widely in AGCC countries (24% in Kuwait, 26% in UAE, 38% in Kuwait, 60% in Bahrain and over 70% in Oman and Saudi Arabia) while the average is around 70% (UNDP, 2002). The share of national population in the workforce is lower. Figures for the number of unemployed nationals are not readily available. The United Nations (2002) estimated unemployment figures in the AGCC

countries to be 17.2% in Oman, 15.0 in Saudi Arabia, 7.1% in Kuwait, 5.1% in Qatar, 3.1% in Bahrain, 2.6% in UAE. The Arab Human Development Report (UNCTAD, 2002) estimated a rapid growth rate of population to reach 44 million by 2020. The problem of unemployment of nationals represents a real challenge. To tackle it, the AGCC government restrict public sector employment to nationals by creating quotas. Sticker work permits for the employment of expatriates are imposed in the private sector. Market regulation policies also rely on the education and training of nationals. It is observed that the education levels differ widely in the AGCC countries. While education and enrolment is relatively advanced in Bahrain and Qatar, it lags behind in other countries.

Labour market in the AGCC is divided between nationals and expatriates. The high share of expatriate labour force adds a great deal to its flexibility, as the number of expatriates can be adjusted in response to shocks. Nevertheless, the public and private sector vary in flexibility. While nationals are the bulk of the rigid public sector employees, expatriates are mainly employed in the private sector. Dominance of the public sector in all AGCC economies hinders flexibility of labour and capital markets. The nationalization process will reduce the flexibility of the labour market, as a national labour force will increase wage rigidity and job protection.

The current labour mobility is restricted by the absence of free migration of expatriates between AGCC member states. There are no common visas or residence permits for expatriate workers. Cross border mobility is most likely to become an important factor of adjustment mechanism after the formation of a Monetary Union. The high degree of linguistic homogeneity will facilitate national labour movements provided legal obstacles are removed.

5.2.2. Capital market flexibility

The capital market in AGCC is limited in size and is inflexible. Participation in local capital markets is largely restricted to nationals only. Rules in all AGCC countries require a majority of national ownership in all corporations. Investment in low and secondary bond markets has not developed. Stock market capitalization ranges from 12% of GDP in Oman to 106% in Kuwait and between 40-80% in other countries. In all AGCC countries, bank assets (which are more than 100% of GDP in all AGCC countries except Bahrain in which it exceeds 1000%) exceed stock market capitalization (AMF, www.amf.org.ae). The same applies to capital of non-banking financial institutions (insurance, capital markets, pensions' funds and finance companies) which are also limited in size and inflexible.

5.2.3. Fiscal policy flexibility

The major characteristics of fiscal performance that limit fiscal flexibility can be summarized as follows:

1. Variations of fiscal deficits. AGCC countries have registered fiscal deficits on their overall balance and for non-oil deficit to non-oil GDP, without stability in these ratios. The following Table No. 5, shows the annual percentage changes in total expenditures (E), oil price (OP), oil and

gas revenues (OGR), non-oil revenues (NOR), fiscal balance (FB), non-oil fiscal balance (NOFB) and non-oil GDP (NOGDP). The main conclusion is that there is not only substantial variation in the degree of annual percent change in fiscal balance (FB) and non-oil fiscal balance (NOFB) in all AGCC countries, but also between AGCC countries.

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2.Variation in the degree of procyclical fiscal policy.

Procyclicality can be measured by the following three sets of correlations:

2.a. Correlation coefficients between percentage change in expenditures (E), percentage change in fiscal balance (in GDP percent) (denoted by FB); percentage change in non-oil fiscal balance (denoted by NOFB), percentage change in oil prices (denoted by OP) and percentage change in oil and gas revenues (denoted by OGR).

2.b. Correlations between the percentage change in non-oil fiscal balance (denoted by NOFB), the percentage change in oil and gas revenues (denoted by OGR), and percentage change in oil prices (denoted by OP).

2.c. Correlations between the percentage change in fiscal balance (in GDP percent), (denoted by FB) and the percentage change in oil prices (denoted by OP)

These correlations should be positive for budget procyclicality. Table No.5 above, tests these correlations for fiscal procyclicality in the six AGCC countries during the period 1996-2003.

The first set of correlations, although not very high, is nevertheless positive, except the correlation between E and NOFB. They are in the range of (0.24), (-0.24), (0.32), and (0.35) respectively. This result can be interpreted to mean fiscal procyclicality. Results of the second set of correlations shows that NOFB and OP is, as expected, positive (0.01), but very weak. The second test of correlation between NOFB and ORG shows small (but negative) correlations for three AGCC countries out of six, while in three countries it is positive. The overall average result is small negative of (-0.14). The third set of correlation of FB (in GDP percent) and OP is positive, as expected. This correlation is high reaching (0.67) on average. This vindicates that oil price is the major influential factor of fiscal balance in AGC countries, notably in KSA, Qatar and UAE. Table (5) also clearly shows sharp variations between procyclicality correlations among AGCC countries.

3. Negative relationship between non-oil revenue (NOR) and non-oil GDP (NOGDP).

This negative relationship can be seen from Table No. 5 (above) which shows that the correlation between NOR and NOGDP is negative in four AGCC countries and on an average. The registered average correlation between NOR and NOGDP is (-0.25) over the period 1996-2003.

4. No use of fiscal policy rules: No AGCC country uses fiscal rules based on any fiscal aggregate such as non-oil fiscal balance in their budget documents. They all depend on the absolute fiscal stance.

5. Variations between AGCC countries in medium budget target expenditure frameworks. Some AGCC countries have initiated medium budget target or expenditure framework and some have established stabilization and fund saving to bridge the gap in financing any shortfalls in oil revenues. In Oman and Bahrain budget plans are made for five and four years respectively. Kuwait is planning to start the process in 2006, and Saudi Arabia and UAE have initiated it recently. Since a lack of medium term budget framework will not allow AGCC countries to phase or spread fiscal responses to shocks over time it will restrict fiscal flexibility.

6. Variations in stabilization and saving funds: Oman has established a stabilization saving fund (the State General Reserve Fund) in which revenues above the budgeted oil price are transferred. Kuwait established a General Reserve Fund to smooth the impact of fluctuating oil prices on government spending. It also established a Fund for Future Generations in which 10% of the government revenue is transferred. Emirate of Abu Dhabi has a stabilization fund known as Abu Dhabi Investment Authority. Bahrain is planning to establish a stabilization fund in 2004. Qatar and Saudi Arabia, however, have none.

7. Deviations between the approved and actual budget estimates: Deviations between approved and budget estimates are caused by many factors such as unrealistic revenue projections due to oil price fluctuations, underestimation of expenditures, extra budgetary activities and lack of medium term budget framework. These deviations complicate fiscal flexibility especially when oil prices are low.

5.3. Investment

The assessment of the investment test will be confined to show the impact of the exchange rate on FDI.

The Arab world not only received a tiny proportion of global FDI without any visible spillovers, but also experienced steady reduction in the share of net inflow of FDI from 2.6% of the total net flow of the global FDI in mid-1970s to 1980 to only 0.7% during 1990-98. More than half of it comes from the region (intra-Arab investment), (UNDP, 2002). According to UNCTAD figures (UNCTAD, 2001), the cumulative stock of intra-Arab investment between 1985-2001 is US$17 billion, whereas overseas Arab investment was estimated to be over US$1.3 trillion. More than 80% of FDI in the Arab world is concentrated in five countries two of which are AGCC countries (Saudi Arabia and Bahrain). Out of 16 Arab countries from which data of average annual net FDI flows are used, between 1996-2000, Saudi Arabia comes first, Bahrain third, Qatar sixth, UAE eighth, Kuwait tenth, and Oman thirteenth. AGCC countries collectively share 50% of the Arab FDI in 2000. The UNCTAD data of 2001 identified that there is a sharp difference in the FDI/GDP ratio among AGCC countries. In Bahrain, the ratio in 2001 is 74%, followed by Saudi Arabia (16.6%), Oman (12.6%), Qatar (11.9), UAE (3.9%), and Kuwait (1.4%). The current FDI in the AGCC countries is concentrated in the hydro-carbonic sector, and (to a lesser extent) the manufacturing and services sector of tourism, telecommunication and banking.

The share of foreign investors in AGCC countries is subject to some limitations. Although the rule of 51% foreign investment is applied in Kuwait, Qatar, UAE and Oman, foreigners can hold a share of more than 51% and even up to 100% in special circumstances and projects. With the exception of Saudi Arabia, there are no government regulations to impose national management. Moreover, value added should not be less than 40% to enjoy full tax exemption as profit remittance abroad is allowed in all AGCC countries (GOIC, 2001). After the establishment of a Monetary Union capital market, reforms will give a push to FDI in the AGCC countries. The stock markets in the AGCC at the moment are not active. There is an urgent need to formulate the transparency of the regulatory processes, protection of property rights and an effective resolution of disputes.

The impact of the exchange rate stability on FDI is unlikely to be enormous, as it functions on multiple factors besides the exchange rate. Moreover limitations to the share of foreign investors in AGCC countries are also related to capital restriction and inactivity of the stock markets.

5.4. Financial Services

The assessment of the financial services test takes up two issues. The first is regarding the future drivers of the Gulf financial services. It assesses how the drivers are shaping the development of the Gulf financial services sector. The second is the costs and benefits of a Monetary Union for the Gulf financial markets.

The driving factors of a financial sector development are macroeconomic stability, financial sector competition, transparency and a well-developed institutional and legal framework (Creane, S. et al, 2003, p. 1). The IMF study of the MENA region identified six major financial development themes: (1) the development of monetary sector and policy, (2) banking sector size, structure and efficiency, (3) quality of banking regulations and supervision, (4) development of non-bank financial institutions (NBFI), (5) financial openness and (6) institutional environment (Creane, S, p. 2). Based on quantitative and qualitative data during 2000-2001 a comprehensive weighted index were computed from these themes. All AGCC countries' financial development is ranked high, scoring above 6 (out of 10) on an average. Their strength was in financial openness, regulation and supervision (all score 8.9). Other themes core over 7, except institutional environment and non-bank financial sector which score (5.9 and 6.7 respectively).

The policy outcome of the above result is that the provision of an attractive climate for the AGCC financial sector is one of the most important requirements for a Monetary Union. The inter-regional competition and open market policy for foreign banks (in accordance of WTO requirements) will most likely consolidate national banking in the AGCC. Mergers between Gulf commercial banks would make them more efficient and competitive and therefore strengthen their ability to compete with international banks and support privatisation and diversification of economic structures of AGCC economies. The Monetary Union is also required to develop both the non-banking financial institutions (insurance, capital markets, pensions funds and finance companies) and an institutional banking environment. Moreover, the future drivers shaping the development of AGCC financial system under globalisation are most likely to be openness and integration of the world capital markets. These benefits are most likely to come through on condition that the trading barriers of financial assets and currencies are removed and an assurance that the currency exchange rate system operates freely.

It is most likely that the GMU will compel AGCC economies to adopt common legal and judicial banking regulations and develop their capital and investment laws, diversify the non-bank financial institutions, integrate the AGCC capital markets, enhance financial competition and spread innovation and technological change across the Single Currency Area. Moreover the GMU is also expected to encourage AGCC commercial banks' mergers to strengthen competition with foreign banks in the region.

5.5. Growth, stability and employment

Macroeconomic stability (fiscal policy stability, sustainable public debt and so forth) cannot be isolated from credit monetary policy framework. There is a strong consensus that such credibility is best achieved by delegating the operation of monetary policy to an independent central bank, which is less vulnerable than the government to the suspicion that it would sacrifice its long-term monetary stability goals by making a short-term dash for growth at the expense of future inflation.

There will be, no doubt, a potential impact of Gulf Monetary Union on trade, competition, productivity and growth. It includes (1) enhancing competition to improve flexibility in product and capital markets and promote greater business efficiency and consumer choice (2) promoting enterprise by removing the market barriers that deter entrepreneurship and prevent new firms from developing and growing (3) supporting science and innovation to harness the potential of new technologies and to provide more efficient ways of working (4) improving skills among young people and the adult workforce to generate a flexible and dynamic labor market and (5) encouraging investment and better investment decision-making through stronger local and national capital markets. Membership could affect all these drivers of productivity either directly or indirectly. Joining a Monetary Union would remove any barriers to trade between AGCC countries, enhance competition and stimulate investment by aiding the integration of capital markets. It could also help to spread innovation and technological change across the single currency area.

It is not possible to diverge the employment rates within a Monetary Union because the rate of employment is largely dependent upon the fiscal stance, as governments in AGCC countries are major employers. Nevertheless, empirical research confirms that sharing a common currency does not imply sharing the same unemployment rate. Indeed, unemployment rates can vary more between regions of the same currency area than they would across different currency areas. However, as a result of growing unemployment, creating employment opportunities for nationals in the AGCC economies form an integral part of the policy objectives of these countries and it cannot be overlooked.

6. Analysis of results and policy implication

In general, structural convergence does not seem an impediment to create, sustain and benefit from an AGCC Monetary Union. Nevertheless, the future structural development may be an obstacle to achieve structural convergence. Hence the issue is not convergence of current structures but about dynamic structures. Diversification as well as exhaustion of oil and gas in some AGCC countries in the future may reduce structural similarities. These future developments might have some bearing

on the structural convergence. Convergence can also be seen from the expenditure components of GDP. Expenditure components of the GDP exhibit a similar pattern among AGCC countries. Private consumption is a dominant expenditures component of GDP, sharing over 30%, while other components share almost a similar percentage. If we look at non-oil trade integration between AGCC countries intra-trade is a weak factor that minimizes the benefits of one currency. Nevertheless, non-oil intra-AGCC trade could be enhanced in the light of a Monetary Union provided there is a diversification of the economies. If low intra-trade is due to the similarity of factor endowment (oil and gas), any hope for improvement is limited within the present economic structures of AGCC countries. In this case, AGCC countries need to achieve an intensive specialization and output diversification as well as technical industrial sophistication in order to enhance intra-trade. However, if low intra-trade is partly a result of trade barriers, this may be eliminated by a Monetary Union or by new policies to remove trade barriers. Nevertheless, further work remains to be done to answer these questions before any result is ascertained.

AGCC countries differ sharply in their fiscal performance and fiscal adjustments. Fiscal adjustment varies between AGCC countries in the face of large oil price changes. In the face of a large drop in oil prices, such as in 1998, some AGCC countries resorted to financing from official assets, while others mobilized non-oil revenues. In a high oil price era, since 2000, responses differ markedly between high total spending (out of non-oil GDP) and accumulation of net financial assets. Moreover, fiscal policies, (despite the creation of the Custom Union on January 1, 2003) remain the least coordinated policies of the Gulf-Cooperation Council countries.

Some fiscal stance characteristics show that the oil-dependant AGCC countries exhibit weak fiscal flexibility and different responses to fiscal shocks. AGCC economies are strongly oriented towards oil and gas. This can be seen from the share of oil and gas sector in GDP, the share of oil exports in total exports and the share of oil revenue in government revenue. Oil and gas sectors contributed roughly over 40% in AGCC output while oil income contributed around 80% of government revenues. Oil exports accounts for over two-third of total AGCC exports (see for example, Fasano, U. and Iqbal, Zubair, 2003, p. 2). The high contribution of oil and gas to total government revenues severely affects budget balances via oil price volatility. Fiscal flexibility is constrained by a high dependence on oil as well as oil price movements, that is fiscal outcomes are affected by common factors and convergence is less marked. While fiscal outcomes in the AGCC countries are similar, the level of deficits and surplus varies among countries and so do public debts.

In fact procyclical fiscal polices are related to the low share of non-oil revenues in total revenues, the governmental role in employment, social benefits and subsidies, and the lack of medium term budgetary framework that spread out fiscal risks over number of years. Nevertheless, to remove procyclicality of budget policy and to insulate budget from oil price volatility, AGCC countries need to work with fiscal rules such as budget deficit rules (non-oil deficit to GDP rule), debt rules (ceilings on net or gross debts), spending rules (overall or components of spending), or establish stabilization and saving funds or both.

Although the current fiscal flexibility is weak and the process and the results are markedly different between individual countries, diversification and privatisation have been declared as key policies. Diversification efforts in banking, tourism, and transport in Bahrain are underway, while the similar efforts are being made in tourism, petrochemicals, construction, trade, financial and

communications centres, and transport in UAE. Oman has succeeded to a certain extent in diversifying into gas-related industries and tourism and Saudi Arabia into petrochemical manufacturing, minerals, power, infrastructure, industry and services. Qatar is focussed on natural gas, commercial, IT and financial centres. Diversification and privatisation drive may lead to possible future changes in the economic structures of AGCC economies, and might reduce structural similarities enjoyed by them today. If a diversification drive leads to different economic structures, this may result in giving an increasing importance to tools apart from nominal exchange rate adjustments. It may also lead to an establishment of an intra-AGCC fiscal transfer to smooth the adjustment mechanism under a single monetary policy, and/or support AGCC efforts of ensuring flexibility of labour and product markets as an alternative adjustment tool, after the establishment of a Monetary Union. In our view, price flexibility in product and factor markets will become an important adjustment tool after its establishment. Nevertheless, removing barriers to movement of goods, services, labour and capital to enhance their flexibility may not completely substitute the absence of budget flexibility in AGCC economies.

A Monetary Union will probably have some limited effects on the share of FDI provided some other FDI incentive factors get through. By removing exchange rate volatility and transaction costs within the Gulf area and by boosting price transparency, a Monetary Union can have some positive impact on returns on investment and size of FDI. AGCC countries have relatively similar exchange rate arrangement in which all currencies are pegged to US$. Nevertheless there are more FDI enhancing factors than exchange rate invariability. A fixed exchange rate is not likely to make much difference in FDI in AGCC countries, as much as a Monetary Union's related uncertainty (not evident before the Unions' establishment) that hamper investments such as reduction of transaction costs associated with the multiple exchange rate. AGCC countries are now having an exchange rate union because their currencies are pegged to US$. Perhaps the GMU can enhance credibility of monetary policy and can reduce inflation to comparable and manageable levels in some relatively high inflation AGCC countries. Though the overall result seems positive it is minimal. Further assessment of the investment test need to identify the position of exchange rate stability as determinants of investment for firms in each country separately.

Challenges to the AGCC financial service under globalisation are most likely to be openness and integration of the world capital markets. Significant gain from a Monetary Union could be achieved in deepening financial markets. This requires the removal of trading barriers of financial assets and currencies and making sure that the currency exchange rate system operates freely. The GMU can integrate capital markets, enhance financial competition, spread innovation and technological change across the single currency area, encourage AGCC commercial banks' mergers, strengthen competition with foreign banks in the region, and create common and effective legal and judicial regulations for the AGCC banking and credit policies.

The analysis concludes that AGCC countries will incur some costs of having a joint Monetary Union. Though a Monetary Union is necessary to achieve the national economic objectives of AGCC economies, it is not sufficient. The overall potential economic benefits of the AGCC Monetary Union at the moment seem to be less significant, as the present exchange rate risk in AGCC economies is minimal. Some benefits are expected to come through, but they might take time and (probably a lot of effort in line with the above recommendations) before the AGCC countries can realize the full benefits of a Monetary Union.

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Table (1): GDP by Economic Activities (at Current Prices, 2000)- (in Percent)

Description/Countries	Bahrain	Kuwait	Oman	Qatar	KSA	UAE	Average
Agriculture	0.70	0.30	2.00	0.40	4.90	3.50	4.00
Petroleum & Mining	28.00	48.20	48.80	58.40	37.10	33.70	39.00
Manufacturing	11.40	10.60	5.40	5.80	9.70	13.40	10.00
Electricity, Gas & Water	1.40	0.80	1.00	1.10	0.40	1.80	1.00
Construction	3.60	2.00	1.90	3.40	5.90	6.50	5.00
Wholesale & Retail, Hotels & Resturants.	10.00	5.80	11.20	5.40	6.80	10.50	8.00
Transport, Communications & Storage	7.00	4.70	5.90	3.40	4.10	6.70	5.00
Finance & Insurance Services	21.40	5.50	3.50	3.00	4.70	4.10	5.00
Real Estates Services	9.10	….	5.50	3.90	6.10	7.40	6.00
Government Services	15.20	20.70	12.20	13.90	16.90	9.90	13.00
Other Services	7.90	….	1.60	6.10	2.00	2.10	4.00
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Own calculations from figures obtained from "AGCC Statistical Bulletin", 2001.

Table (2): AGCC: Expenditure components of GDP (2002).

Description/Countries	Bahrain	Kuwait	Oman	Qatar	KSA	UAE	Average
Private consumption	47.10	40.70	34.10	18.80	37.40	50.50	38.10
Government consumption	17.60	22.10	23.10	23.10	26.50	16.30	21.50
Capital formation	16.80	11.10	12.80	20.10	18.40	23.20	17.10
Exports-Imports (goods and services)	18.50	26.00	21.00	38.00	17.70	9.70	21.80

Source: AGCC National Central Banks, "Annual Reports"; "Al-Khaleej Economic Report", 2002,2003, p. 171.

Table (3): GCC Endowment and Economic Sizes

Description/Countries	Proven Oil Reserves	Per Capita Oil reserves	Est. Oil Reserve Lifetime	Proven Gas Reserves	Proven Gas Percapita (Millions	Oil Extraction Cost	GDP	Non-Oil GDP	Population	Per capita GDP
	(billions barrels of oil)	(Thousands barrels of oil)		(Millions Cu. Ft/day)	(Million Cu. Ft/day)		(bill. US$, 2002)	(%)		(thousands US$)
Bahrain	0.15	0.20	78.00	38.00	50.70	3.00	7.90	72.00	0.75	10.50
% of world reserves (2002)	….			….						
% of OPEC	….			….						
Kuwait	96.50	43.90	131.00	1,882.90	855.90	1.70	37.80	51.80	2.20	17.20
% of the world	9.00			0.90						
% of OPEC	13.40			1.80						
Oman	5.70	2.40	38.00	904.00	376.70	6.00	19.80	51.20	2.40	8.30
% of the world	0.60			0.50						
% of OPEC	0.70			1.00						
Qatar	4.50	7.80	89.00	632.50	1,090.50	12.00	16.40	41.60	0.58	28.30
% of the world	1.40			14.80						
% of OPEC	2.00			29.20						
KSA	263.50	12.00	89.00	7,699.60	349.80	1.50	188.40	62.90	22.01	8.60
% of the world	24.60			3.70						
% of OPEC	31.00			7.30						
UAE	98.10	29.70	103.00	2,060.00	624.20	2.60	70.50	66.30	3.30	21.40
% of the world	7.50			3.50						
% of OPEC	11.50			6.90						

Sources: AGCC "Statistical Bulletin", 2001, and "Arab Joint Economic Report", 2003.

Table (4): Trade openness, trade integration and geographical breakdown of trade accounts.

(in Percent)

Description/Countries	**Bahrain**	**Kuwait**	**Oman**	**Qatar**	**KSA**	**UAE**
Trade Openness.	129.00	75.50	80.50	77.50	60.20	121.70
(Trade as% of GDP, Average, A271996-2001)						
Exports:						
AGCC countries	8.40	1.00	10.10	5.70	5.60	5.80
Other Arab countries	1.60	1.70	2.50	1.70	4.60	1.10
Other Islamic countries	4.90	8.00	4.30	2.10	5.10	3.90
EEC	5.10	11.40	1.50	3.10	15.60	4.30
USA	4.80	11.50	1.20	3.60	16.00	1.70
Japan	4.00	22.80	22.70	43.10	15.30	20.30
Other countries	71.30	43.50	57.60	40.70	37.80	63.00
Total	100.00	100.00	100.00	100.00	100.00	100.00
Imports:						
A+A17GCC countries	24.50	11.10	39.10	14.90	4.70	8.40
Other Arab countries	3.40	11.10	6.10	8.60	5.40	1.20
Other Islamic countries	3.10	6.40	4.60	3.40	4.00	9.20
EEC	29.30	29.90	20.70	43.60	29.50	33.20
USA	10.10	13.10	6.80	6.00	18.90	9.70
Japan	3.80	13.60	16.20	8.70	9.20	9.10
Other countries	25.80	14.80	6.40	14.80	28.20	29.20
Total	100.00	100.00	100.00	100.00	100.00	100.00

Table No. (5): Testing for procyclicality in A+A54GCC countries

KUWAIT		Annual	change	in:			
	E	OP	OGR	NOR	FB	NOFB	NOGDP
96 - 97	0.023	-0.011	-0.185	-0.122	-0.095	-0.042	0.049
97 - 98	0.016	-0.347	-0.297	0.360	-0.121	0.023	-0.024
98 - 99	-0.008	0.423	1.127	-0.148	0.301	-0.014	0.050
99 - 2000	-0.205	0.527	-0.056	-0.055	0.018	1.334	0.048
2000 - 2001	0.489	-0.150	-0.001	0.856	-0.101	-4.328	0.016
2001 - 2002	-0.379	0.070	0.016	-0.112	0.090	0.434	0.073
2002 - 2003	1.051	0.136	-0.46	-0.188	-0.338	-3.405	0.064
UAE							
	E	OP	OGR	NOR	FB	NOFB	NOGDP
96 - 97	-0.111	-0.072	0.111	-0.073	0.071	0.122	0.653
97 - 98	0.124	-0.334	-0.380	0.109	-0.128	-0.129	-0.222
98 - 99	0.008	0.434	0.100	-0.088	0.018	-0.045	0.034
99 - 2000	0.327	0.534	1.138	-0.599	0.176	0.599	0.820
2000 - 2001	0.001	-0.131	-0.139	2.475	-0.134	-2.478	-0.305
2001 - 2002	-0.092	0.035	-0.208	-0.040	-0.007	0.107	0.053
2002 - 2003	0.037	0.136	0.382	0.158	0.057	1.999	0.058
OMAN							
	E	OP	OGR	NOR	FB	NOFB	NOGDP
96 - 97	0.024	-0.041	0.181	0.001	0.038	-2.030	0.069
97 - 98	-0.037	-0.360	-0.278	0.176	-0.062	0.097	0.034
98 - 99	0.019	0.456	-0.034	-0.007	-0.009	-0.037	-0.022
99 - 2000	0.137	0.484	0.425	-0.081	0.030	-0.247	0.063
2000 - 2001	0.077	-0.139	0.086	0.193	0.007	-0.052	0.123
2001 - 2002	0.027	0.056	0.169	0.235	0.050	0.030	0.030
2002 - 2003	0.166	0.145	0.017	0.352	0.005	-0.049	0.065
BAHRAIN							
	E	OP	OGR	NOR	FB	NOFB	NOGDP
96 - 97	0.121	-0.045	0.075	0.181	1.333	-0.085	0.034
97 - 98	-0.100	-0.376	0.393	0.029	**-66.00**	-0.470	0.195
98 - 99	0.027	0.517	0.432	-0.019	0.090	0.208	-0.122
99 - 2000	0.087	0.566	1.059	-0.022	0.023	-0.431	0.059
2000 - 2001	-0.069	-0.149	-0.121	0.092	-0.002	-0.039	0.041
2001 - 2002	0.238	0.085	0.029	0.087	-0.002	-0.328	0.068
2002 - 2003	0	0	0	0	0	0	0
QATAR							
	E	OP	OGR	NOR	FB	NOFB	NOGDP
96 - 97	0.192	-0.057	0.281	-0.003	0.000	0.002	0.025
97 - 98	-0.044	-0.364	-0.232	-0.232	-0.080	-0.481	0.174
98 - 99	0.107	0.446	0.226	0.263	0.043	-1.101	0.006
99 - 2000	0.055	0.563	0.636	0.295	0.125	0.000	0.046
2000 - 2001	0.121	-0.116	-0.162	0.481	-0.075	0.010	0.086
2001 - 2002	0.144	0.037	0.225	0.444	0.088	0.019	-0.006
2002 - 2003	-0.006	0.047	0.033	-0.088	-0.009	-0.060	0.032
KSA							
	E	OP	OGR	NOR	FB	NOFB	NOGDP
96 - 97	0.117	-0.037	0.177	0.056	0.006	-0.134	0.069
97 - 98	-0.141	-0.356	-0.500	0.354	-0.063	0.269	0.011
98 - 99	-0.033	0.430	0.306	-0.302	0.029	-0.096	0.027
99 - 2000	0.280	0.565	1.053	0.015	0.092	-0.361	0.032
2000 - 2001	0.084	-0.150	-0.142	0.014	-0.071	-0.10	0.032
2001 - 2002	-0.085	0.062	-0.097	0.060	0.010	0.115	0.030
2002 - 2003	0	0	0	0	0	0	0

CORR / COUNTRIES	KUWAIT	UAE	OMAN	BAH	QAT	KSA	AVR
E / OP	-0.19	0.44	0.50	0.42	0.18	0.57	**0.32**
E / OGR	-0.35	0.68	0.57	0.03	0.36	0.84	**0.35**
E / NOFB	-0.86	0.19	0.11	-0.12	0.18	-0.94	**-0.24**
E / FB	-0.72	0.35	0.40	0.55	0.29	0.58	**0.24**
NOFB / OP	0.37	0.37	0.08	0.23	-0.23	-0.76	**0.01**
NOFB / OGR	0.24	0.45	-0.32	-0.42	0.13	-0.91	**-0.14**
FB / OP	0.49	0.78	0.42	0.59	0.82	0.91	**0.67**
NOR / NOGDP	-0.71	-0.64	0.24	0.21	-0.49	-0.13	**-0.25**
NOFB / NOGDP	0.10	0.43	-0.21	-0.88	-0.05	-0.44	**-0.17**

Source: Own clculations from data obtained from AGCC national banks' Annual Reports, different issues.