Fiscal Convergence and Discipline in the GMU

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FISCAL CONVERGENCE AND DISCIPLINE IN THE GMU

A Thesis
Presented to
the Graduate School of
Clemson University

In Partial Fulfillment
of the Requirements for the Degree
Master of Arts
Economics

by
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ABSTRACT

Although the GCC member states fulfill the GMU fiscal convergence criteria quoted from the EU, this paper indicates that these criteria did not suit the GCC economies. By clarifying the economic differences between the GCC region and the EU, studying the GCC economies fiscal data, and learning from the EU and the GCC member states experiences, the paper finds that: (i) The deficit and debt strategies did not fit the GCC' economics index by requiring economic depended on surplus and lower debt level strategies to design their fiscal criteria. (ii) The GCC government budgets depend highly on oil and gas. The macroeconomic shock that the GCC region may face and its response to them are totally different than what affects the EU. So the GCC member states should have additional fiscal criteria, namely oil and gas sector share criterion and government expenditure, to reduce the potential danger of this dependency. (iii) To achieve and maintain fiscal discipline in the GMU and limit the politic influence and the regional authority on fiscal policies, GCC economies have to promote the permanent role of the criteria and set a strict timetable that cannot be waived whatever the political desires. Furthermore, they need to adopt supranational independent institutions – before creating the GMU--that apply multilateral surveillance on the union economic activities.
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1- INTRODUCTION

For more than 30 years, the six-member states of the Gulf Cooperation Council (GCC) - the Kingdom of Bahrain, State of Kuwait, Sultanate of Oman, State of Qatar, the Kingdom of Saudi Arabia, and the United Arab Emirates (UAE) - have spent considerable effort and made significant progress to achieve the Gulf Monetary Union (GMU) that is not yet built. The GCC member states have adopted the same monetary and fiscal convergence criteria to be fulfilled by the potential candidates for GMU, as the same criteria that the European Monetary Union (EMU) have designed. Thus the main purpose of this paper is to indicate that the current fiscal convergent criteria for the GMU did not suit the GCC economies. Additionally, this paper provides some suggestions regarding the fiscal criteria to put the GCC member states on the right track in designing appropriate fiscal convergence criteria.

Although the EMU -- which is considered the most significant currency union -- could be a good realistic model for the GMU due to its precedence and superiority, the GMU fiscal convergence criteria should not be literally quoted from the EMU criteria. The EMU has to rely on its economic index instead, and that is because:

First, the economy of the European Union and the GCC region are not strictly comparable because the former is at a more-developed stage than the latter. The EU economy’s size and structure are way beyond the GCC economy. In addition, the EU includes economies that are considered among the largest advanced economies in the world such as Germany and France, and it relies on heavy manufacturing sectors and high levels of diversification. However, the GCC region highly depends on rich natural resources in oil, gas, and the activities related to those resources. That
meansthat the microeconomic shocksthat the GCC region may face andits response to them are totally different than what affects the EU.

Second, the European debt crisis, that started in Greece and extended to Ireland, Portugal, Spain, and Italy, hit the Government Finance, namely deficit and debt, which were covered in the EU fiscal convergence criteria. This crisis threatens the whole European area, and perhaps the idea of the GMU. Thus GCC member states need to consider this crisis seriously and take a step back in setting their fiscal convergence criteria.

Third: The weakness of the fiscal discipline and fiscal harmonizing in the EU and the political role in this matter bring other challenges.

This paper will help the GCC member states to be on the right track and redesign their fiscal convergence criteria by finding the most efficient strategies, not the exact fiscal reference values. Moreover, I will advise some methods based on the experience of the EU and GCC member states that will give the GMU fiscal discipline and strong fiscal policy.

The paper is organized as follows. In Section 2, I briefly explain the background of establishing the GMU, and I discuss the importance of the monetary union for the GCC region. In Section 3, I go through the GMU Fiscal Convergence Criteria and of those quoted from the EMU criteria to study their fulfillment in each GCC member state. In Section 4, I discuss the reasons that make the GMU fiscal criteria not suitable for the GCC economies by clarifying the economic differences between the GCC region and the EU. Section 6 is considered the heart of this paper. In this section, I show the real evidence of inadequacy of the GCC fiscal criteria for the GCC economies and find appropriate strategies to adopt for the GMU fiscal criteria
by studying the GCC economies fiscal data and by learning from the EU and the GCC member state’ experiences discussed in previous sections. Section 7 is the conclusion.
2- BRIEF BACKGROUND

In the 32nd Gulf Cooperation Council Supreme Meeting held December 19, 2011, Saudi Arabia's King Abdullah proposed that GCC member states should move from cooperation stage toward union stage, namely confederation. That means that they would coordinate and deal—as a group—with critical issues such as defense, foreign affairs, economic integration, and a monetary union. The GCC formed a specialized committee to study the proposal and give its feedback. In the wake of this decision, urgent appeals have been growing in Saudi and Bahrain to move toward Saudi-Bahrain confederation.

But in fact, this is not the first time that the GCC member states have raised appeals for unity. According to Article 4 in the Cooperation Council Charter, the first objective of the GCC is "To effect coordination, integration and inter-connection between member states in all fields in order to achieve unity between them," and the second objective is “To formulate similar regulations in various fields including economic and financial affairs, commerce, customs and communications, education and culture."

Regarding the coordination of economic affairs, the GCC Unified Economic Agreement was provided in November 1981, shortly after the creation of the GCC, to achieve a goal of full economic integration. Article 22 in this agreement states that “Member states shall seek to coordinate their financial, monetary and banking policies and enhance cooperation between monetary agencies and central banks, including the endeavor to establish a joint currency in order to further their desired
economic integration.”¹ In 2001, GCC leaders went further by updating the GCC Economic Agreement. They agreed to create a customs union, a common market, and a monetary union. They scheduled these goals and determined the fiscal and monetary convergence criteria to achieve the economic and monetary union. They also agreed on other important economics and financial affairs.

Although GCC member states have made significant progress such as launching the custom union in 2003 and common market in 2008, they may be accused of not being serious in their efforts toward monetary union (common currency area) and then achieving the full economic integration. For instance, the UAE (the second largest economy in the region) has withdrawn from the monetary because of the disagreement about the location of the GCC Central Bank (located in Riyadh, Saudi Arabia). Oman, also has withdrawn due to its disability to meet some of the scheduled criteria at the target date. The withdrawal of these two important members (out of six GCC members) could make it difficult for the rest of the GCC member states to create the monetary union. Another example is that all GCC member states peg their currencies to the U.S. dollar, but Kuwait transformed to peg its currency to a basket of major currencies. This lack of unity shows the weakness in political harmony between the GCC member states and may affect the exchange rate convergence criteria. The last example is that the GCC member states agreed to form a monetary union and to adopt a common currency by 2010. The due date has passed, and there is no clear timetable, nor a formal plan, for the forming of such a union.

¹For further details about the GCC history, documents, and the GCC Unified Economic Agreement, visit GCC Secretariat web-site at: www.gcc.sg.org
In addition, the GCC member states, due to the high dependency on oil and gas, are facing specific challenges that oil prices are volatile, and oil and gas are exhaustible. Moreover, they are facing other challenges that threaten the idea of a GCC monetary union. The more significant one is the debt crisis in Europe. Recent events in Europe, particularly intermittent debt crises and the need for bailouts of several EU members, have led some to question the wisdom of a common currency across diverse economies, creating even more uncertainty about the future of a single GCC currency (Shediac et al., 2011).

In research on the GCC economic integration, I determined the feasibility of the monetary union for the GCC member states by combating its benefits and costs on the GCC region. Some results of evaluating the feasibility show that the GMU, on one hand, would eliminate uncertainties of exchange rate movements in the market, foreign exchange costs of intraregional transactions, and speculative capital flows within the region. The GMU, also, would increase competition, levels of intraregional trade, investment and growth. Furthermore, the fiscal discipline due to the unified monetary union policies would result in a lower inflation and interest rate in the region. On the other hand, joining the monetary union (MU) may bring in some costs such as loss of independent control over monetary and fiscal policies of the individual members. Another cost is that imbalances in any member of the region may cause loss of union credibility, and/or facing negative direct/indirect macroeconomic effects. What has happened in the EU due to the crisis in Greece and other EU members may happen in the GCC. In general, I can say that the advantages of the MU for the GCC region exceed the disadvantages.
Although the GCC economic researchers spent a lot of effort to justify the importance of the MU for the GCC region, The GMU will certainly be established due to the region’s political will and the need to survive. As well as the case for the EU, the political events were the main motivation that stimulated the GCC leaders to move toward the GCC integration and to achieve the regional unity. Historically, the GCC Council was created in 1981, to confront the regional conflict of Iran-Iraq war, and because of the fear of the Iranian revolution export.

In 1990, the concept of unity was again raised because of the occupation of Kuwait by Iraq which threatened the survival of the GCC monarchies. Recently (2011/2012), the surrounding political turmoil of Arab revolution (Arab spring), especially in Bahrain, and the Iranian threats and interventions led the GCC member states to consider unity once more. These challenges have also created other proposals such as adding Moroccan and Jordanian monarchies to the union.

The GCC Monetary Union (GMU), if it is created, could be the second most important supranational monetary union in the world after the EMU. In addition to its political importance, the GMU could benefit its own countries, Arab and Muslim countries in general that may qualify it to play a leading role in the world. Thus, the main goal for the GCC member states is to enhance the integration and interconnection between them in all fields toward the achievement of the unity.

Coordination of the economic affairs and the economic integration are the most

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2 (Georgios Kouretas, 2010) indicate that "One should not forget that the euro project seems to be mostly a political construction and not an economic one". (Loukas Tsoukalis, 2010) also indicates that "Economic and monetary union was the offspring of the Franco-German couple, President Mitterrand and Chancellor Kohl to be precise. It was about high politics and peace on the continent, much less so about economics."
important roles toward this goal, and the monetary union is considered as the last building block of economic integration among the GCC member states.

The question should not be asked about the wisdom of the monetary union for the GCC region’s member states, but how could they create an efficient one. They have to be careful and more serious in developing their economic policies and strategy. They also need to test carefully their readiness to achieve this goal. Moreover, they should know how to benefit from the experiences of similar unions like the EMU.
3-THE GMU FISCAL CONVERGENCE CRITERIA
(Following the EMU footsteps)

The GMU fiscal convergence criteria--namely public deficit and debt reference values--have been literally quoted from the EMU convergence criteria (Maastricht Convergence Criteria) which is considered as the most important step toward European Monetary Union and the adoption of the Euro. Maastricht Convergence Criteria, addressed in Article 121 of the Maastricht Treaty (1991/92), were designed to measure the readiness of the European countries to join the union and required to be fulfilled by the potential candidates.

3-1- Fiscal Convergence Criteria

Maastricht Convergence Criteria can be divided into two fiscal and monetary convergence criteria. The fiscal convergence criteria which this paper is concerned about are:

**Government Deficit:** The annual government budgetary deficit ratio to the gross domestic product (GDP) should not exceed 3% at the end of the previous fiscal year (except in exceptional and temporary cases).

**Government Debt:** The gross government debt ratio (public debt ratio) to the gross domestic product (GDP) should not exceed 60% at the end of the previous fiscal year. If the target ratio cannot be achieved for specific reasons, it should approach the reference value with satisfactory speed.

3-2- Fulfillment of the Fiscal Convergence Criteria

Indeed, unlike the European case, the GCC member states have not just achieved the fiscal convergence criteria, but have considerably surpassed them. Regarding the government deficit criterion, table 1 below shows that rather than
being around the reference deficit value (3%), the GCC member states (except Bahrain) have achieved budget surpluses. Bahrain, though, may face some problems in the future due to the difference ratio between its budgetary deficit ratio and the rest of the GCC member states. In terms of public debt criterion, we can see that all the GCC member states have a low public debt ratio to the GDP. Bahrain and Qatar have higher debt ratios compared to the other, but still they are considerably lower than the reference debt value (60%).

Table 1: Fulfillment of the fiscal convergence criteria for GMU member states in 2011

<table>
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<tr>
<th></th>
<th>Bahrain</th>
<th>Kuwait</th>
<th>Oman</th>
<th>Qatar</th>
<th>Saudi Arabia</th>
<th>Emirates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Deficit (%GDP)</td>
<td>-2.287</td>
<td>31.04</td>
<td>9.815</td>
<td>7.761</td>
<td>15.231</td>
<td>11.023</td>
</tr>
</tbody>
</table>

Overall, it can be concluded that all the GCC member states are eligible to join the GMU in terms of Fulfillment Fiscal Convergence Criteria due to their compliance with them.

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3 Source: International Monetary Fund, World Economic Outlook Database, April 2012.

4-WHY THE EMU FISCAL CONVERGENCE CRITERIA ARE NOT APPROPRIATE FOR THE GMU?

The European Monetary Union (EMU)\(^4\), also called the Eurozone area, is the most important supranational monetary union in the world. It represents the biggest economic integration step in the EU by adopting a common currency (the Euro) and applying a single monetary policy controlled by the ECB.\(^5\) The EMU, due to its precedence and superiority, could be a good realistic model for the GCC member states as they are establishing their own GMU. The GCC member states can study and learn from the EMU experience about how to create the monetary union and how to coordinate the economic policies to set the required convergence criteria toward a successful monetary union. Moreover, they can benefit from the useful ideas from the EMU to confront the challenges that the GMU may face. However, the GCC member states should not have the exact fiscal criteria, and they have, instead, to show more seriousness designing their own criteria that go with their macroeconomic index.

There are many reasons that support this argument. Some of interesting points showing bellow:

4-1- The differences of economy between the EU and the GCC region

It is worth mentioning that study of the EU and other experiences in dealing with the GMU project will save time and effort, and will help to avoid similar problems that they are facing. However, the adoption of a cut-and-paste strategy is considered as one of the main reasons that threaten the establishment or success of the GMU project. The GCC member states seem to not take the fundamental differences

\(^5\)The European Central Bank.
between themselves and the EU into account when they set up the fiscal convergence criteria. Some of these differences are shown below:

- With a combined population of 45.9 million inhabitants, the GCC region as a whole is considered as one of the most powerful economics in the world because it has the largest oil reserves and produces an aggregate GDP of 1.37 trillion U.S. dollars\(^6\). However, the economy of its six member states together is not strictly comparable, which consists of 17 out of 27 of the EU countries with a combined population of over 500 million inhabitants, and an aggregate of the largest nominal world gross domestic product (GDP) of over 12 trillion U.S. dollars\(^7\). The EU represents approximately 20% of the global GDP and includes economies that are considered among the largest advanced economies and some of the most credible and powerful ones. So, it is not reasonable that the GCC member states rely on the same exact fiscal policies reference values as the EUM ones.

- The economic structure of the GCC region does not definitely match the EU one, thus the economic performance and policies of the GMU have to correlate with its member states’ economic structure. The GCC member states need to understand that the causes and consequences of fluctuation in their GDP and the determinants of their economic growth are totally different than the ones that the EU is facing. The EU relies on heavy manufacturing sectors and high levels of diversification. In contrast, GCC region highly depends on rich natural resources in oil, gas, and the activities related to those resources. Laabas and Limam (2002) mention that

\(^6\)Source: www.gcc.sg.org

\(^7\)World Economic Outlook Database, October 2012 - International Monetary Fund.
“Despite many efforts at diversifying their economies, GCC countries remain heavily dependent on oil. On average oil represents more than 80 percent of export receipts and budget revenues, respectively.” This information means a low level of diversification and higher vulnerability for the GCC region to external shocks. Therefore, since oil and gas play an extremely important role in the GCC, member countries have consciously taken steps to diversify their economies as they look at other sectors of the economy such as tourism, manufacturing and banking (Abdelghani et al., 2011).

- Unlike the EU case, high dependency on oil reduces the differences among the GCC member states on their economic structure. However, Sturm and Siegfried (2006) indicate that, “Both the pace and direction of economic diversification will probably differ in the future between GCC member states, and will thus reduce the structural similarities between their economies.” Subsequently, the GCC member states’ economic forecasts and models (fiscal policies in our case) have to rely on their economics indexes.

- Regarding the EU fiscal convergence criteria, the big question we should ask is: Why does the EU set a deficit reference value of 3% and debt reference value of 60%? “P. De Grauwe emphasizes that in the 1990s, in the EU countries the average value of the public debt share in GDP may have been at the level of 60% and that was the reason why this value was adopted as a reference index.” In accordance with the economic studies in Germany, the achievement of this value requires the deficit reverence value to not exceed 3%. Bukowski (2006) indicates

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that “These values were adopted due to the insistence of Germany. They were to prevent the situation in which the excessive growth of budget deficits and public debt would not lead to an increase in interest rates in the entire Union’s area to the detriment of the countries of lower interest rates at the moment the Union was created. Germany was among those countries.” So what if Germany was not among these countries? Are the EU members going to set different strategies such as balance or surplus strategies rather than a deficit one?

This argument leads us to ask the GCC member states the same realistic question that we asked before: Why do they set a deficit reference value of 3% and debt reference value of 60%?

4-2- The EU debt crisis: (Large public deficit and debt)

The European debt crisis that started in Greece and extended to Ireland, Portugal, Spain, and Italy, threatens the whole Euro area, and perhaps the idea of the GMU. The European leaders, at the beginning, did not realize the risk that this crisis may cause and did not take the right action to stop it. Nowadays, they have found that the problem is going deeper and deeper, and the risk that the whole Euro area will be harmed is fairly high. EU leaders’ responses are yet to stop it.

Many researchers have been trying to determine the causes of the crises to help the EU members create an appropriate solution. They have found that the large ratio of sovereign debt in Greece and other affected European countries that occurred from annual accumulation of consecutive fiscal deficits are the most influential reason that led to the European debt crisis. Kouretas (2010) claimed that "The public deficits in conjunction with declining external competitiveness played a decisive role on the deteriorating fiscal stance of the Greek economy.” The Greek government
actually failed to meet its intertemporal budget constraints and that led its public debt to reach unsustainable levels in the long-run.

In the case of economic and monetary unions such as the EU for instance, the unsustainable debt position maybe fatal for the whole union, in the sense that the continuing increases in debt of a given country will push the other member countries to implement deflationary policies (Abdelghani et al., 2011). Economic experts have warned that the Greek debt crisis may become a prelude to the sovereign debt spread everywhere. In fact, Ireland, Portugal, Spain, and Italy are suffering from permanent budget default right now and that will affect the union badly if they do not take the right action.

The European crisis concentrated in the Government finance issues (debt and deficit) and that means one or both of the two scenarios can be: either the European-affected countries did not fulfill the fiscal convergence criteria or the fiscal discipline (fiscal stabilization) for the affected members was insufficient which means that the EMU needs to be supported by better fiscal policy framework. Indeed, the both scenarios were showing. Some European countries had problems with meeting fiscal convergence criteria at the time of joining the EMU. For instance, Herz and Kotios (2000) found that in the reference year 1999 of Greece entry to the EMU, "The debt ratio was 104.4%, well above the 60% reference value (but below the debt ratio of the EMU members Italy and Belgium). As the debt ratio has been declining since 1997, the European Council (ECOFIN) made the decision in November 1999 that Greece does not have an "excessive deficit" and is therefore in compliance with the public finance criterion."
However, unfulfillment of the fiscal criteria is not the only reason that caused the crisis. For instance, some irresponsible countries that have a poor management of public finances have spent too much and borrowed too much taking advantage of being part of the union that included strong economies like France and Germany. They ended up having too much debt relative to their economies then failed to generate enough economic growth to make their payment (fiscal undisciplined). Studying the Greek case, Kouretas (2010) pointed out that "Increased public expenditure in recent years led to dramatic increase in borrowing requirements and high levels of accumulated public debt."

In an attempt to mitigate the effects of the crisis, the EU decided to buy consistent amounts of government bonds as a last resort. Greece too proceeded to implement the policy of austerity in order to reduce the level of government expenditure. Furthermore, economists advised some proposals to mitigate the effects of the crisis or at least help the EU to avoid a similar one. Kouretas (2010) argued that "the solution to the Greek problem in the long run would be to redesign its economic and fiscal policies." In a different perspective, Ngai (2012) said that "a permanent solution to the debt crisis may not perhaps come through fiscal policy constraints, but perhaps through “Eurobonds” or fiscal union that allows for large transfers between countries." There are many ideas similar to these that have been mentioned in different ways.

Although GCC member states have fulfilled the fiscal convergent criteria, they need to consider this crisis seriously, and take a step back in the development of economic integration strategies precisely in the government finance issues. Indeed, they have to spend more effort adopting deficit and debt reference values
when they redesign their fiscal convergence criteria to avoid a similar crisis. Moreover, GCC member states must take the government expenditure issue into account in designing of the GMU fiscal convergence criteria due to its obvious influence on the doubling of the crisis.

4-3-The weakness of fiscal discipline and fiscal harmony in the EMU (The role of political intervention)

The fiscal convergences criteria have been imposed on the EMU to achieve the fiscal discipline and fiscal stability in every member states and ensure the fiscal harmonizing (coordination) among them by creating compatible fiscal policies and preventing or reducing the political intervention in the union. However, the reality did not align with the objective of the fiscal criteria. Many researchers blame the EU crisis on the weakness of fiscal discipline and the lack of harmonizing its policies and mechanisms. Despite high-level commitments, the original sin of the crisis laid in the decision to harmonize monetary policies without harmonizing or strengthening Eurozone fiscal policies (Valiante, 2011). The Eurozone needs stronger and common regulatory mechanisms for financial markets (Tsoukalis, 2010). In general, Kouretas (2010) claimed that "The current debt crisis have shown that a reform of current EU mechanisms must be put in force, otherwise the stability of the Eurozone will be jeopardized and the euro currency itself will be negatively affected."

It is commonly known that political objectives are not quite convergent with economic ones (Bukowski, 2006). Thus, there is no doubt that the European political intervention, conflicts, mismanagement, and the lack of credibility contributed significantly and directly in reducing the level of fiscal discipline in the union. Cline (2011) indicates that the European sovereign debt crisis is a crisis of confidence. The
political conflicts and interventions have had the largest influence that caused the union mismanagement and led to the lack of credibility, and thus the crisis of confidence.

There is much evidence to support this argument. For instance, Loukas (2010) mentioned that "observers have suddenly discovered that Greek governments had been (shall we say?) economical with the truth and flexible about the way they handled statistics. They are also finding out that international banks had helped to camouflage public debt." Another example is what I mentioned in the previous section about the European Council that decided to accept Greece as a member of the EMU even though it had an excessive debt ratio.

Italy\(^9\) also was not eligible to meet the fiscal convergence criteria, but the EMU members were unable to exclude it from the union due to its political importance. Last, but not least, are the irresponsible expenditure and borrowing policies that some affected countries have adopted taking advantage of being a member of the European Union.

Although the establishment of the EMU has been based on the guarantees of stronger countries such as Germany and France, the political conflicts, mismanagement, and the lack of credibility may influence negatively on these guarantees and reflect on market prices; therefore, leading them to withdraw capital and investments to other regional areas of the global economy that will compounding the problem. Most of the EU crisis research focused on reducing the authority of the regional institute on the union economic decisions and creating supranational

\(^9\)This information translated from an Arabic recourse: Lamis Farahat (Elaph newspaper), 2012: Secret government documents lights on the disadvantages of the euro.
institutions that handled the economic issues in the union. Lavrač (2004) noted that
"In contrast to monetary policy, fiscal policy remains in the hands of the member
states, but it should be limited by the common EU institutions, so that over-
expansionary national fiscal policies would not spill over into negative consequences
for the single monetary policy and stability of the single currency."

As I mentioned earlier in the background section, the decision of the GMU
was made due to political will and the need of improvement and survival. However,
political intervention, conflicts, and the desire to control and influence on economic
policies, as what it shown in the European case, were the most important reasons that
caused the union mismanagement and led to the lack of credibility, thus the crisis of
confidence. The ball is now in the court of GCC leaders. They need to submit
supranational and strict fiscal policies that cannot be exceeded, and reach political
compromise among their countries to achieve the goal of closer fiscal integration and
strong monetary union or monopolize the decisions and face the weakness of fiscal
and probability of fiscal crisis as the EMU did.

All of these reasons above answer this section’s question. So, the GCC
member states should redesign their fiscal convergence criteria taking into account
the economic differences, EU crises, and the political role on the fiscal discipline and
fiscal harmonizing.
5- DIFFERENTIAL RESPONSE TO SHOCKS OF GCC AND EU ECONOMIES  
(Practical evidence) 

The message from the discussion above is that monetary union criteria adopted in the EU countries are not applicable to GCC. I argue that higher dependence on the oil sector in the GCC member states was one of the most significant reasons. I conjecture that unlike the EU, the common shocks hitting GCC economies are shocks to oil prices. Next, I further investigate the relationship between oil prices and GDP in GCC versus EU countries. In particular, I first look at how Log GDP per capita responds to oil prices. Since GDP might have a trend, I include a linear trend in the GCC regression.

Formally, I estimate the following relation for each of six GCC countries:

\[
\text{Log GDP}_{i,t} = a + C_t + b \text{Log Oil Price}_{i,t} + e_{i,t}
\]

Table 2 below shows estimation results. Increases in oil price are associated with higher GDP in most GCC countries. The highest effects are observed for Bahrain and Qatar. Table 3 presents the estimates of the same regression for some EU countries and Russia. I selected France and Germany because they are considered the largest advanced economies in the EU and the world. Greece and Italy, on the other hand, were selected for being among the EU members hardest hit by the debt crisis. Russia, in contrast, matched the EU economy structure; at the same time, it is considered as one of the important natural gas exporters.

The relation between oil price and GDP is completely different in EU: larger prices are associated with GDP going below the trend. Russian GDP seems, on the other hand, to go above the trend as for GCC countries.
I also looked at the relationship between GDP growth rate and oil prices by estimating the following equation:

\[ \text{DLogGDP}_{i,t} = a + b \text{ Log Oil Price}_{i,t} + e_{i,t} \]

Here, DLog GDP is the difference between t+1 and t log of GDP. By looking at table 4 and table 5, clearly there is a differential impact of oil prices on oil exporters and non-oil exporters. EU countries’ growth rates respond negatively to higher oil prices, whereas GCC and Russian GDP seem to grow faster when oil prices are high.

<table>
<thead>
<tr>
<th>Table 2: Level of GDP and Oil Price: GCC members: Detrended</th>
</tr>
</thead>
<tbody>
<tr>
<td>VARIABLES</td>
</tr>
<tr>
<td>-----------------</td>
</tr>
<tr>
<td>log_price</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Year</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Constant</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Observation</td>
</tr>
<tr>
<td>R-squared</td>
</tr>
<tr>
<td>Country</td>
</tr>
<tr>
<td>Trend in GDP</td>
</tr>
<tr>
<td>Notes</td>
</tr>
</tbody>
</table>

Notes: Sample includes GCC countries for the years 1982-2009. Standard errors robust to heteroscedasticity are reported in parenthesis. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.
Table 3: Log of GDP and Oil price: EU and Russia: Detrended

<table>
<thead>
<tr>
<th>VARIABLES</th>
<th>(6)</th>
<th>(7)</th>
<th>(8)</th>
<th>(9)</th>
<th>(10)</th>
</tr>
</thead>
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<tr>
<td>log_price</td>
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<td>-0.039***</td>
<td>0.108***</td>
<td>-0.062***</td>
<td>0.517***</td>
</tr>
<tr>
<td></td>
<td>(0.007)</td>
<td>(0.011)</td>
<td>(0.014)</td>
<td>(0.012)</td>
<td>(0.065)</td>
</tr>
<tr>
<td>Year</td>
<td>0.016***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>-0.017**</td>
</tr>
<tr>
<td></td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.008)</td>
</tr>
<tr>
<td>Constant</td>
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<td>-25.477***</td>
<td>-25.513***</td>
<td>-25.278***</td>
<td>40.826**</td>
</tr>
<tr>
<td></td>
<td>(1.095)</td>
<td>(1.280)</td>
<td>(1.374)</td>
<td>(1.804)</td>
<td>(14.822)</td>
</tr>
<tr>
<td>Observations</td>
<td>28</td>
<td>28</td>
<td>28</td>
<td>28</td>
<td>20</td>
</tr>
<tr>
<td>R-squared</td>
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<td>0.965</td>
<td>0.968</td>
<td>0.947</td>
<td>0.839</td>
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<tr>
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<td>Germany</td>
<td>Greece</td>
<td>Italy</td>
<td>Russia</td>
</tr>
<tr>
<td>Notes</td>
<td>Trend in GDP</td>
<td>Trend in GDP</td>
<td>Trend in GDP</td>
<td>Trend in GDP</td>
<td>Trend in GDP</td>
</tr>
</tbody>
</table>

Notes: Sample includes some EU countries and Russia for the years 1982-2009 (Russia after 1991). Standard errors robust to heteroscedasticity are reported in parenthesis. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.

Table 4: Growth in GDP and Oil Price: GCC members

<table>
<thead>
<tr>
<th>VARIABLES</th>
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<th>(16)</th>
<th>(17)</th>
<th>(18)</th>
</tr>
</thead>
<tbody>
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<td>log_price</td>
<td>0.000</td>
<td>-0.018</td>
<td>0.035*</td>
<td>0.064**</td>
<td>0.017</td>
<td>0.009</td>
</tr>
<tr>
<td></td>
<td>(0.017)</td>
<td>(0.034)</td>
<td>(0.019)</td>
<td>(0.027)</td>
<td>(0.016)</td>
<td>(0.016)</td>
</tr>
<tr>
<td>Constant</td>
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<td>0.077</td>
<td>-0.090</td>
<td>-0.164*</td>
<td>-0.044</td>
<td>-0.028</td>
</tr>
<tr>
<td></td>
<td>(0.053)</td>
<td>(0.121)</td>
<td>(0.061)</td>
<td>(0.093)</td>
<td>(0.058)</td>
<td>(0.054)</td>
</tr>
<tr>
<td>Observations</td>
<td>28</td>
<td>23</td>
<td>28</td>
<td>23</td>
<td>23</td>
<td>23</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.000</td>
<td>0.006</td>
<td>0.111</td>
<td>0.183</td>
<td>0.028</td>
<td>0.012</td>
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<td>Kuwait</td>
<td>None</td>
<td>Oman</td>
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<tr>
<td>Notes</td>
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<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

Notes: Sample includes GCC countries for the years 1982-2009. Standard errors robust to heteroscedasticity are reported in parenthesis. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.
Table 5: Growth in GDP and Oil Price: EU and Russia

<table>
<thead>
<tr>
<th>VARIABLES</th>
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<th>(12)</th>
<th>(13)</th>
<th>(14)</th>
<th>(15)</th>
</tr>
</thead>
<tbody>
<tr>
<td>log_price</td>
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<td>-0.007</td>
<td>-0.005</td>
<td>-0.021**</td>
<td>0.073***</td>
</tr>
<tr>
<td></td>
<td>(0.006)</td>
<td>(0.009)</td>
<td>(0.011)</td>
<td>(0.009)</td>
<td>(0.023)</td>
</tr>
<tr>
<td>Constant</td>
<td>0.055**</td>
<td>0.036</td>
<td>0.034</td>
<td>0.079***</td>
<td>-0.233**</td>
</tr>
<tr>
<td></td>
<td>(0.020)</td>
<td>(0.028)</td>
<td>(0.034)</td>
<td>(0.027)</td>
<td>(0.081)</td>
</tr>
<tr>
<td>Observations</td>
<td>28</td>
<td>28</td>
<td>28</td>
<td>28</td>
<td>19</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.174</td>
<td>0.029</td>
<td>0.010</td>
<td>0.236</td>
<td>0.275</td>
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<tr>
<td>Country</td>
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<td>Germany</td>
<td>Greece</td>
<td>Italy</td>
<td>Russia</td>
</tr>
<tr>
<td>Notes</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

Notes: Sample includes some EU countries and Russia for the years 1982-2009 (Russia after 1991). Standard errors robust to heteroscedasticity are reported in parenthesis. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.
6- APPROPRIATE STRATEGIES ADOPTING THE GMU FISCAL CRITERIA

Although all the GCC member states fulfill the fiscal convergence criteria--namely public debt and deficit criteria literally quoted from the EMU, they should take into account all the differences between their region and the EU-mentioned earlier--redesigning the GMU fiscal convergence criteria. They, indeed, have to spend more effort finding the right fiscal strategies that fit their economic index. The main goal here is to help the GCC member states to be on the right track and redesign their fiscal convergence criteria by finding the most efficient strategies, not the exact fiscal reference values. Precisely, I want to help them to find the most suited government finance strategies rather than the debt and deficit ones they have. Moreover, I want to add more fiscal criteria that relates to the government budgetary which is considered as a fundamental motive to government finance. The issues that will be discussed in this regard are arranged as follows:

6-1: First issue: Provide appropriate government finance strategies

The reference debt and deficit values in the GCC fiscal convergence criteria are literally quoted from the EMU criteria. It is understandable that the EMU fiscal convergent is on default strategy due to its members’ deficit budgetary situation as I mentioned earlier, but the question can be raised here is: why the GCC countries chose the same strategy while they have a budget surplus now? And why do they set a debt reference value of 60%?

Going further, by analyzing the GCC member states’ budgetary situation, chart 1 in the next page shows that since 1999, the GCC member states (expect Bahrain and Oman in 2002 and 2008, and Saudi Arabia in 2008) have been
experiencing budget surplus. The case of Oman and Saudi Arabia in 2002 and 2008, respectively, could be acceptable as they coincided with the global economic crisis. Nevertheless, all GCC member states (even Bahrain) have not been going beyond reference deficit value (3%). Moreover, in regard to public debt, chart 2 shows that although Saudi Arabia and Qatar had very high public debt levels around 1999, since that time, the ratio of public debt to the GDP in all the GCC member states had been decreasing steadily until 2008. While there was a subsequent increase again after the global economic crisis in 2008, they still have remained at low levels below the reference debt value (60%).

This analysis shows that the fiscal convergent criteria did not fit the GCC' economics condition and did not depend on GCC economies index. Moreover, these criteria require economic conditions lower than what the GCC country already achieved which will not encourage them to spend any effort to generate economic growth, as well as, improve the union in general. That in the end may lead to a fiscal problem.

Here, I am not going to give the exact reference values that the GCC should adopt. I recommend them to set a surplus and low debt level strategies rather than the government finance strategies they have. The economists in the GCC member states have to work on providing appropriate reference values that work with their economies.
There is a lack of data in some countries before 1999.

* Source: International Monetary Fund, World Economic Outlook Database, April 2012.
* I chose the period (1999-2011) Based on available data\(^\text{10}\).

\(^{10}\) There is a lack of data in some countries before 1999.
6-2 The second issue: Additional fiscal criteria
(Government budgetary: revenue and expenditure)

Fiscal policy depends on government budgets. More specific, it depends on the government’s adjustment of its revenue and expenditure (spending) in order to influence a nation’s economy. Deficit/surplus levels, therefore, as well as the debt levels, are actually the effects of government influence on the nation’s economy by increasing or decreasing the level of its revenue and expenditure. However, neither the EU nor the GMU have leaned on the government revenue and expenditure levels when they set up the Monetary Union Fiscal Convergence Criteria and they are content with government finance strategies only. So the big question here is: Should we add the government revenue and government expenditure to the GMU fiscal convergence criteria?

6-2-1 Government Revenue

Government revenue in any country, in general, depends on taxation or non-tax revenues such as revenues from sovereign wealth funds, government-owned corporations, government services fees, aid, etc. However, governments from all the GCC member states depend on rich natural resources in oil, gas and the activities related to these resources as main sources of their revenue. The data from 2001 to 2011, in chart 3 ensures this fact. It is evident that oil and gas revenues have contributed massive levels to total governments’ revenues in all GCC member states (even Qatar which has the lowest level compared to the rest). Oil and gas revenues reach high levels (70%) in most of the GCC member states. Since 2004, Kuwait and Saudi Arabia have attained a fabulous level (90%). The UAE, Oman, and Bahrain did
not go lower than (65%). The lowest level was around (45%) in 2009, reached by Qatar and still considered high.

Due to the high dependency on oil and gas revenues, the GCC member states are facing specific challenges that oil prices are volatile (short-term challenges) and oil and gas—natural resources—are exhaustible (long-term challenges). Oil reserves have the following expected depletion dates: Saudi Arabia, 2110; Bahrain, 2011; UAE, 2110; Oman, 2022; Kuwait, 2121; and Qatar, 2049 (Al yafai, 2012). Therefore, the question we should ask is what is going to happen if the oil and gas run out or the price of them goes down sharply (oil price shock)?

* Source: Arab Monetary Fund & GCC member states National Authorities

Ministries of Economy and Finance in all GCC member states.
There is no doubt that the GCC member states must take this issue into account in the design of the GMU fiscal convergence criteria even though it would be difficult for them to set a specific oil revenue reference value due to the global importance of oil sector which is strongly influenced by global markets’ volatile demands and prices. It would be easier, instead, to set a specific reference value of oil and gas sector share of the total GDP of GCC member states. Chart 4 presents the high levels of oil and gas sectors in all of the GCC member states, except for Bahrain and the UAE, which exceeded (40%) after 2004. It also presents the volatility of oil and gas shares that clearly presented in 2009!

The idea of oil and gas share reference value is to maintain low levels of convergent and stable oil and gas sector share between and within the GCC member states. In other words, obligate GCC member states to raise the level of the non-oil sector share to the GDP, which pushes them for economic diversification (increase the degree of commodity diversification). Diversification at the end will lead to greater market openness, higher involvement of the private sector, such as the industrial sector, in the GCC economies which have very limited scale of diversification. In addition, it will create new jobs, and create and improve fiscal policies such as taxation policies. It will, in general, push up the GCC member states’ economic growth.
As a result, the government burdens (expenditure), such as salaries of government jobs which is considered as the major burden on government expenditures in GCC economies, will decrease, thus the non-oil and gas revenues will contribute higher levels to total governments’ revenues.

6-2-2 Government Expenditure

The Maastricht Convergence Criteria provided countries such as Italy and Greece with the incentive to cut down on their public expenditures and debt levels in order to meet the criteria for entering the Euro (Ngai, 2012). However, these criteria were not a sufficient deterrent in controlling irrational spending policies in the affected European countries, which in turn were the cause of the EU debt crisis in line with the other

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12 Bahrain – Central Informatics Organization, Qatar - Statistic Authority, Saudi Arabia – Central Department of Statistical & Information, ministries of Economy and Finance in the UAE, and Arab Monetary Fund.

13 There is a lack of oil sector information, and there are some differences on oil share % data depending on the source. I did not find the data of oil sector for Kuwait in 2011, Oman in (2010, 2011), and the UAE in 2011.

14 Arab Monetary Fund.
reasons mentioned earlier. In the GMU case, moreover, the government expenditure growth in all of the GCC member states tends to go sharply with the oil price cycles due to the high dependency of government budgets on the oil sector. Thus, unlike the European case, controlling the spending policies will not be an issue nowadays due to the high oil revenues. However, that may cause unbalanced spending policies once the oil revenues decline! It would be too difficult for the GCC member states to reduce their government’s expenditure levels at that time, which leads to higher levels of deficit and debt.

The data of the GCC governments’ expenditures from 1999 to 2011, presented in chart 5 shows that the level of government expenditure is not stable in each country. It is clear that the expenditure levels and levels of oil and gas revenues shown above tend to move in parallel, which basically confirms the fear of unbalanced spending policies if oil prices declined sharply for any reason. In addition, chart 5 also shows the big disparity in the spending levels between the GCC member states. Saudi Arabia and Kuwait, for example, have reached the highest level of government expenditure (60% of Kuwait’s GDP in 1999, 60% of Saudi’s GDP in 2009) while the UAE has maintained the lowest level among the GCC member states. The increased instability and disparity of government expenditure levels in and among GCC member states will create a good atmosphere for irrational spending policies, and will increase the risk that any imbalances in spending policies in any member will affect the rest of the union member states. The idea here is to set a government expenditure reference value to maintain low convergent and stable government expenditure levels between and within the GCC member states. Therefore, that goal will rationalize the spending policies, decrease the potential risk
of oil price shocks, and it will obligate GCC governments to find alternative sectors to share their burdens with. In addition, it will have positive effects on monetary policies such as maintain or decrease the level of inflation in GCC member states.

6-2-3 Oil price influence (real evidence); Oil price shock(2008-2009 recession)

I mentioned earlier that GCC governments’ revenues have a high dependency on oil and gas sector and their expenditure levels move in parallel with levels of oil and gas revenues. This means that oil price shock may cause unbalanced revenues levels and unmanageable fiscal policies in the GCC member states which leads them to enter a recession. From recent past experience, chart 6 indicates that the price of oil has increased gradually since 2001 until it reached the highest level ever (100$/barrel) in mid-2008. That explains the budget surplus situations (chart 1) in all GCC member

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states except Bahrain—the state with the lowest oil reserves—and the gradual decrease in their debt levels until they reach the lowest level in 2008 (chart 2). The biggest issue here is that international oil supply was not enough against high international oil demand, especially in China which gained higher oil consuming power at the expense of global markets that led to massive price rises. What happened in late 2008?

Many countries in the world suffered a recession due to several economic reasons such as the mortgage crisis, downfall in valuations and liquidity, rising oil prices, and their oil demand has decreased as well. As a result, oil prices dropped sharply from 100$/barrel to around 60$/barrel in 2009 as shown in chart 6. The big question here is what happened to the GCC member states?

* Source: EIA (Energy Information Administration)
In chart 1, from 2007 to 2008, the budget surplus in Saudi Arabia, the UAE, Oman, and Bahrain have reached the highest levels; these countries (from 2008 to 2009) then faced a sharp decline in their budgets, going to deficit levels. Qatar’s budget surplus remained stable from 2007 to 2009 and increased slightly from 2008 to 2009, while Kuwait has faced a big decrease in its budget surplus from 2007 to 2008, then increased again from 2008 to 2009. Charts 3, 4, and 5 could explain what happened.

The huge increase then decrease of oil price in 2008 was a turning point in the GCC economies. The high oil prices led to increased oil sector share in all GCC member states. Saudi Arabia, the UAE, Oman, and Bahrain took advantage of this increase and raised their government expenditures (unmanageable fiscal policies), which led them to difficulty in bearing the burdens when under budget deficits when oil prices dropped sharply in 2009. Kuwait and Qatar were safe. In fact, their budgets got higher in 2008. Kuwait was more rational than the rest of the countries dealing with the high oil prices in 2008, thus its government expenditure was stable from 2008 to 2009. Qatar, on the other hand, increased its government expenditure at that time, but due to the decreasing policies on the oil revenues to the total government revenues that it determined, Qatar maintained on budget surplus levels. Chart 6 shows that oil prices increased again after 2009, which returned the GCC member states to a budget surplus situation and saved them from entering a recession. The most important question we should conclude with is: What was going to happen if the oil price did not rise again???

Based on all of the above factors, I recommend that the GCC member states should redesign their fiscal convergence criteria by adding the oil and gas sector share
criterion and government expenditure. The GCC member states should provide appropriate reference oil sector share and government expenditure values that should not be exceeded. I believe that action will reduce the gap between the members with regard to spending policies, increase the degree of economic diversification, increase the investment, and activate the role of the private sector in the members’ economies. Overall, these criteria will enhance the economic growth for the whole region.

In this regard, GCC member states can study and benefit from the case of the UAE economy which is considered the second largest economy in the GCC region, and has maintained the lowest government expenditure levels and the lowest oil sector share among the GCC member states (except Bahrain). In addition, it has the most stable debt level in the region.

6-3 The third issue: Fiscal discipline and harmonizing (Limit the role of politics)

As I mentioned earlier, the decision of the GMU was made due to political will and the need to improve and survive. However, the political influence, the regional authority on fiscal policies, and the political conflicts surrounding these countries as I mentioned in section 2 show a lack of seriousness of the GCC member states to achieve the GMU and may lead to the lack of credibility—thus, the crisis of confidence. The ball is now in the court of GCC leaders: either they submit to political compromise and achieve the goal of closer fiscal integration and strong monetary union or monopolize the decisions and face the probability of a crisis as the EMU one. Learning from the literature review on the experience of the European political landscape, I came up with several lessons that may help to set an optimal management and increased union credibility, and therefore, achieve the goal.
6-3-1 The first lesson: Promote a permanent fiscal criteria

Fiscal convergence criteria for the GCC member states were designed as required criteria to join the GMU, but they also could play a useful role as permanent criteria. This role can ensure sustainable fiscal convergence and help to avoid any regional undisciplined fiscal policies that may lead to a crisis similar to the EMU one.

The debt data shown earlier in chart 2 indicates that the very different levels of debt in Saudi Arabia, as an example, between 1999 and 2011, and between them and the UAE debt levels present an unclear picture about the stability of fiscal public policies, and underlines the importance of the continuance of the fiscal criteria. This unclear picture warns of the possibility of increasing debt levels in the future after joining the union due to the historical unstable fiscal policies, as well as to the absence of policies that control and determine the behavior of GCC members regarding the debt decision.

6-3-2 The second lesson: Determine a strict timetable

GCC member states have to determine an exact timetable of GMU establishment that cannot be manipulated. They have expended considerable effort to achieve the GMU; however, they need to show seriousness in these efforts through a set of scheduled steps and adopting a deadline to create the GMU. Moreover, they should not rush to the establishment of the union. They also should provide that the fulfillment of the convergence criteria, after re-evaluating them, is a condition that cannot be waived for the potential GMU member. In other words, it is not necessary for the six members to join the GMU at the same time while some of them do not fulfill the criteria. The union should not tolerate any joining of the members that
donot meet the criteria even if the target date has passed and whatever the political
desires and the circumstances.

6-3-3 Thethird lesson: Independence decision

Adopting independence decision-making mechanismsshould be considered as
one of the most important basic pillars that influence the credibility of the GCC, as
well as increasedeconomic and fiscal integration in the GMU. The economic decision
in the GCC region remains in the hands of national economic governments which
may cause political conflicts and mismanagement. Indeed, that is what actually
happened when Kuwait, for example, decided in 2007 to peg its currency to a basket
of international currencies while all national GCC members were pegged to the U.S.
dollar. The UAE too has withdrawn from the monetary union in 2009 because of the
disagreement about the location of the GCC Central Bank. Before achieving the
monetary union and adopting a common currency, GCC member states need to limit
the political influence by adopting different supranational institutions and agencies
under the GMU in a framework of multilateral surveillance that can set and improve
the harmonizing and/or standardizing fiscal and monetary policies, and help the union
to face any potential crisis.

These safeguards must be adoptedbecause institutions and agencies are
recognized as independent entities which are not subject to any influence by regional
government, and can be divided into several institutions. The first proposed
institution is the Gulf Monetary Fund (GMF) that will take the responsibility of
fostering the monetary cooperation, securing financial stability, facilitating
international trade, reducing the government deficits to keep GCC members from
running up large amounts of debt, and designing a well-established bailout plan. In
addition, these safeguards will prevent a potential financial crisis thus avoiding a lack
of credibility. In the Greek debt crisis case, Germany and other Euro nations urged
Greece not to go to the IMF for a bailout loan. Such a possibility is widely seen as
embarrassing in Euro zone capitals and damaging to the Euro area's credibility
(Abdelghani et al., 2011).

The second proposed institution is the Gulf Central Bank (GCB) that focuses
on monetary policies by maintaining price stability in the GMU and ensuring a stable
growth as well as managing the official resources of the GCC member states. The
GCC member states have agreed on such an institution, but the idea here is to adopt it
before the creation of the monetary union according with the agreed timetable.

Last, but not least, the third proposed institution is Gulf Statistical Institution
(GSI) that transfers data collection from the hands of regional Ministries of Economy
and Planning to its own hand. The GSI will play an important role in providing
regional governments in the union, GMU institutions, and the market with real and
honest data that is not subject to manipulation, thus identifying risks that may the
Union may face before they escalate, as well as increasing the level of credibility.
Economic experts in the GCC region may come up with other ideas that support and
improve the coordination among the GCC member states, increase the level of
credibility, and entrench the concept of independence.

6-3-4 The fourth lesson: The union authority

GCC member states are obligated to help any member facing an economic
problem to maintain and enhance the economic power and the credibility of the
GMU. In contrast, GMU will have to have a supranational authority over all member
states that will impose upon them to not manipulate or mess with the monetary and
fiscal policies they agreed on. GCC member states can create an Economic-Political Assembly under the GMU--in collaboration with the GMF and GCB--that applies strict penalties up to withdrawing membership against any member that violates union economic policies. Moreover, this Assembly can increase the harmony between the GCC governments. In addition, it identifies and approves the agreements and economic decisions based on the guidance and data of independent institutions mentioned above.

6-3-5 The fifth lesson: Omission of political motivation

Although the GMU is an economic construction, regional and international political events are considered as major motivations and the biggest catalysts for its establishment. The GCC member states need to be more mature dealing with the political circumstances. GCC member states should not rush to establish the GMU; they have to be precise in determining rational economic policies with the omission of political influence. On the other hand, GCC member states need to be more serious achieving their goal (the monetary union). They have to strengthen their efforts and adhere to the union establishment timetable regardless on the good or bad regional and international political events.
7- CONCLUSION

The GCC member states have not just achieved the fiscal convergence criteria that were required to be a potential GMU member, but considerably surpassed them. Though these criteria are literally quoted from the EMU criteria, they do not fit the GCC’s economics condition and index which make them inappropriate for the GMU and they do not suit the GCC economies. The GCC member states show enough seriousness designing the GMU fiscal criteria by taking into account all differences between their regional economy and the EU.

The EU economy’s size and structure are beyond the GCC economy. The EU relies on heavy manufacturing sectors and high levels of diversification and is considered as one of the largest advanced economies in the world. However, the GCC region highly depends on rich natural resources in oil, gas, and the activities related to these resources, which means that the microeconomics shocks the GCC region may face and its response are totally different than what has affected and will affect the EU. Moreover, the European debt crisis that started in Greece and extended to Ireland, Portugal, Spain, and Italy threatens the whole Euro area, and perhaps the idea of the GMU. In addition, the weakness of the fiscal discipline and fiscal harmony in the EU, and the political role in this matter bring other challenges.

This paper is designed to help the GCC member states to be on the right track and redesign their fiscal convergence criteria by finding the most efficient strategies, not the exact fiscal reference values. In this regard, I conclude that instead of adopting fiscal criteria that depend on deficit and high debt level strategies, GCC needs to adopt criteria that depend on budget surplus and lower debt level strategies. The question that could be raised to the economist in the GCC region is: what are the...
appropriate reference surpluses and debt values that GCC member states can
determine in their new design of the fiscal convergence criteria? In addition, due to
the high dependency of government budgets on oil and gas, GCC member states
should take into account oil and gas revenues—which considered as a main resource
for the GCC government revenues—and the government expenditure designing their
fiscal criteria to avoid any oil price shock influence as the one that happened in 2008.
The GCC member states should provide appropriate reference oil sector share and
government expenditure values that should not exceeded. An additional question for
the economist in the GCC region: what are the appropriate reference values of oil
sector share and expenditure? In this regard, GCC member states can study and
benefit from the case of the UAE’s economy which is considered as the second
largest economy in the GCC region, and which has maintained the lowest government
expenditure levels and the lowest oil sector. In addition, it has the most stable debt
level in the region.

The economists have to work on providing appropriate reference values of the
levels of debt, surplus, government expenditure, and oil and gas shares that work with
the GCC economies.

Regarding the fiscal discipline and the role of politics in it, this paper advises
learning from the EU and the GCC member states’ experiences in a way to reach
fiscal discipline and strong fiscal policy in the GMU. In fact, the political will and the
need of survival are the main motivations that stimulate the GCC leaders to move
toward the GMU, thus to achieve a regional unity. However, political intervention,
conflicts, mismanagement, and the lack of credibility contribute significantly and
directly in reducing the level of fiscal discipline in the union. Thus GCC member
states have to limit the political influence and the regional authority on fiscal policies, and increase the harmony among them by promoting the permanent role of the financial criteria. Furthermore, they have to determine an exact timetable of union establishment that cannot be manipulated. However, they should not tolerate any members joining that did not meet the criteria even if the target date has passed and whatever the political desires and the circumstances. Moreover, they need to adopt an independent decision-making mechanism and limit the political authority on economic decisions. A way to achieve that goal is that GCC members must adopt supranational independent institutions before creating the GMU that will apply multilateral surveillance on the Union’s economic activities. Indeed, several proposed institutions could help the Union to reach the goal of independency such as Gulf Monetary Fund (GMF), Gulf Central Bank (GCB) which is already processing, and the Gulf Statistical Institution (GSI).

Although GCC member states are obligated to help any member facing an economic problem, they have to have a supranational authority (Gulf Economic-Political Assembly) that requires all members to not manipulate or mess with the monetary and fiscal policies they agreed on. This Assembly will increase the harmony among the GCC governments, and identify and approve the agreements and economic decisions based on the guidance and data of independence. Last, but not least, GCC member states should not rush to establish the GMU because of political influence. However, they need to be more serious achieving their goal (the monetary union) regardless on the good or bad regional and international political events.

The ball is now in the court of GCC leaders. Either they submit to political compromise to achieve the goal of closer fiscal integration and strong monetary union
or they monopolize the decisions and face the probability of a crisis such as occurred for the EMU.
8. REFERENCES


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