Ideation Center Insight

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Integrating, Not Integrated *A Scorecard of GCC Economic Integration*

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EXECUTIVE SUMMARY

Economic integration offers a range of benefits for countries, primarily by streamlining the flow of goods, labor, capital, and ideas within those countries, and by allowing them to negotiate with global markets as a collective whole. The Gulf Cooperation Council (GCC) is in an excellent position to realize these benefits, as it consists of six dynamic yet relatively small economies. However, although the region has made some progress toward economic integration, the process has recently lost momentum. This Ideation Center Insight analyzes integration efforts in the GCC along five core dimensions: a monetary union; customs and borders; intra-regional investment; joint infrastructure; and knowledge cooperation. Despite the efforts undertaken toward economic integration and the progress achieved to date, our analysis shows that the GCC has fallen short of its ambitious targets on some key parameters. To invigorate the region's commitment to integration, we recommend redoubling efforts toward the monetary union, improving coordination of customs and border policy, promoting greater intra-regional investment, fulfilling joint infrastructure commitments, and increasing collective research and development functions. Despite challenges that integrated regional bodies such as the European Union are now facing, in large part because of the financial crisis, economic integration remains a worthy enterprise for the Gulf states.

THE BENEFITS OF ECONOMIC INTEGRATION FOR THE GCC

With the eurozone running up against new challenges and protectionist tendencies on the rise worldwide, this may seem like an inopportune time to assess and promote the merits of economic integration. Understood as the linking of several national economies into a larger single entity, integration has drawn recent criticism, as regional alliances such as the EU have shown the inevitable strains inherent in grouping countries with disparate agendas. However, this recent history unfairly overshadows the substantial economic, political, and strategic benefits that economic integration has brought about in many parts of the world.

In Europe, for example, the EU common market has directly generated 2.75 million new jobs over a 15-year period and 2.2 percent of additional GDP.[1] These gains were due in particular to the standardization of customs and border regulations, which facilitated the movement of goods, services, and labor between nations. Because integration essentially removes the administrative barriers to commerce, it leads to a larger market and more competition among contiguous economies, resulting in better quality goods and services for consumers at lower prices. In addition, the introduction of the euro and a monetary union contributed to a 5 percent to 10 percent increase in trade.[2]

Another benefit comes in the form of R&D efforts. Integrated regional economies can more effectively coordinate R&D ventures in order to spur economic development[3] and attract further private-sector investments. In the EU, coordinated transnational efforts such as CERN (European Organization for Nuclear Research); the European Space Agency; and the transnational company EADS,

which owns Airbus, have led to substantial gains in the region.

Many of these benefits would directly apply to countries within the GCC, which has been increasing in stature and economic clout recently. Today the GCC is a thriving region with nearly 40 million residents across an area of 2.6 million square kilometers and a nominal GDP of approximately US$1 trillion. Per capita GDP has increased by 45 percent over the past decade, to $42,000 in 2010, and is expected to reach $54,000 by 2015.[4] More important, the GCC controls almost 40 percent of the world's proven oil reserves, 20 percent of gas reserves, and close to 40 percent of the global financial reserves, making it an important financial and economic bloc on the world stage.[5]

The flow of foreign direct investment (FDI) in recent years also shows the increasing relevance of the region. For the entire Middle East and North Africa (MENA), FDI increased roughly sixfold from 2004 to 2008.[6] GCC trade with the emerging markets such as China, India, and other South Asian developing countries has risen by 48 percent from 2005 to 2008,[7] while public and private GCC companies, especially in the telecom sector, have expanded their economic activities across the MENA region and beyond. Additionally, GCC sovereign wealth funds have become global players, investing billions of dollars in Western corporations.

The region has been rising in global prominence in less quantifiable ways as well. Dubai and Abu Dhabi have become internationally renowned for tourism and business, Saudi Arabia is now a member of the G20, and Qatar won the right to host the 2022 FIFA World Cup. These elements will put a spotlight on the GCC, leading to potential economic gains that can be supercharged through better regional coordination among members.

There are two other arguments in favor of integration throughout the GCC region. First, unlike other groups of countries, the six member states have more socioeconomic similarities than differences, sharing a common heritage and history as well as similar types of political systems. Second, oil continues to account for 50 percent of the region's GDP and 80 percent of fiscal export revenues, leaving the GCC members vulnerable to global economic slowdowns. Economic integration has the potential to reduce that vulnerability, by increasing intra-GCC trade, investment, and development, especially in new or emerging sectors.[8]

The six member states have more socioeconomic similarities than differences, sharing a common heritage and history.

THE GCC'S LONG ROAD TO INTEGRATION

On May 25, 1981, the GCC was formed with six member states: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.[9] The organization's founding charter emphasized lofty if somewhat open-ended goals, such as to "effect coordination, integration, and inter-connection between member-states in all fields in order to achieve unity between them."[10] The GCC Economic Agreement, updated in 2001, gives more specific direction, with the goal of creating a customs union, common market, and monetary union. Further goals include joint scientific research and integrated development initiatives in agriculture, industry, education, environmental sustainability, and other fields.

The region has made significant progress in several areas, ranging in scope from an interim customs union to a Gulf poetry forum. In January 2008, the Gulf Common Market was launched, ensuring "economic equality" for GCC citizens, specifically employment rights and free movement of citizens among member states.[11]

A more organic form of integration that has occurred outside of the framework of the formal agreement has also generated benefits for the GCC region. For example, the UAE, and particularly the emirate of Dubai, has benefited from tourism, real estate deals, and business investment originating in other GCC countries. Although this reflects the tourism and investment potential of Dubai, it also stems from policy decisions within the UAE aimed at opening up the country to business opportunities throughout the region. GCC nationals have similar business rights to those of UAE nationals in purchasing real estate in Dubai, for example, and they do not have to secure entry visas; these rights are not afforded to non-GCC nationals.

Similarly, Bahrain's banking sector has benefited from wider economic activities across the GCC.[12] Bahrain has carved out a niche as the regional center for Islamic finance, with 32 such insurance and banking institutions in the country, the largest concentration in the MENA region.[13] The financial sector as a whole

has contributed 30 percent of the country's GDP in past years, although it remains to be seen how this will be affected by events in early 2011.[14]

Yet efforts toward more formal integration have seen mixed results. In particular, a common currency for the region was to have been in place by the end of 2010. That deadline has passed, and there is no clear indication that a single currency will be in place in the next few years. The delays are due in large part to the withdrawal of the UAE and Oman from that agreement, leading to concerns about its viability without two of the GCC's larger economies. Oman cited fears regarding its ability to meet some of the economic criteria, such as a budget deficit limited to 3 percent of GDP, but proposed to join at a later date. The UAE cited disagreements about where the central bank should be located—whether in Saudi Arabia or the UAE—but also kept the door open for joining at some point in the future. Such developments have not precluded the possible expansion of the GCC to include countries far afield, such as Morocco and Jordan.

This confluence of factors has created a unique situation within the GCC. The region has shown admirable growth in the past decade, yet that growth represents the efforts of six individual states, rather than a coherent and aligned group operating as an integrated economic entity. More comprehensive integration has the potential to boost the region's economy much as it did for the EU. In short, there is an opportunity cost to not integrating further.

The Scorecard: Evaluating the Current State of Progress

How does the GCC fare in its ongoing integration process? The grades are mixed when evaluating progress across five core dimensions: the monetary union; customs and borders; intra-regional investment; joint infrastructure; and knowledge cooperation. These dimensions have been chosen to highlight areas that GCC members have declared to be priorities and in which they have already taken action. We determined scores using the following ratings:

1 = Major setback to the goal or stagnation of process
2 = Minimal progress toward goal since last action
3 = Some indication of effort and progress toward the goal
4 = Substantial momentum generated toward the goal
5 = Accomplishment or near completion of the goal

Paths to Integration

The paths to regional integration around the world have been fraught with challenges, often due to competing economic and political objectives between member countries that lead to difficult tradeoffs between national sovereignty and the authority of a supranational union. For example, nearly 10 years after its founding, the African Union has yet to establish an identity. Its most prominent role so far has been in joint peacekeeping operations on the continent. Other bodies, such as the South Asian Association for Regional Cooperation (SAARC) and Mercosur in South America, have substantially longer histories, dating back to the 1980s, yet remain underdeveloped. (Mercosur, along with the Andean Community, will soon be superseded by the nascent Union of South American Nations, which combines the two regional bodies in South America.) Other regional groupings such as the North American Free Trade Association (NAFTA) have been more successful but remain fundamentally limited in scope.

In contrast, the Association for Southeast Asian Nations (ASEAN) and the European Union (EU) reflect more comprehensive integration and warrant comparison with the GCC. ASEAN was formed in 1967 through an agreement between Indonesia, Malaysia, the Philippines, Singapore, and Thailand. The bloc has grown over the years to integrate five additional countries and is now one of the world's largest regional economies, with a combined GDP of nearly US$2 trillion. In 2003 it established the ASEAN Free Trade Area, followed by a similar arrangement with New Zealand and Australia in 2008 and another with China, which launched in January 2010.[i] The China agreement shows the power of such an alliance. Rather than individual countries having to negotiate trade arrangements on their own against such an economic powerhouse, ASEAN serves as a body for developing relations with China from a position of unified strength, including establishing regional treaties.[ii]

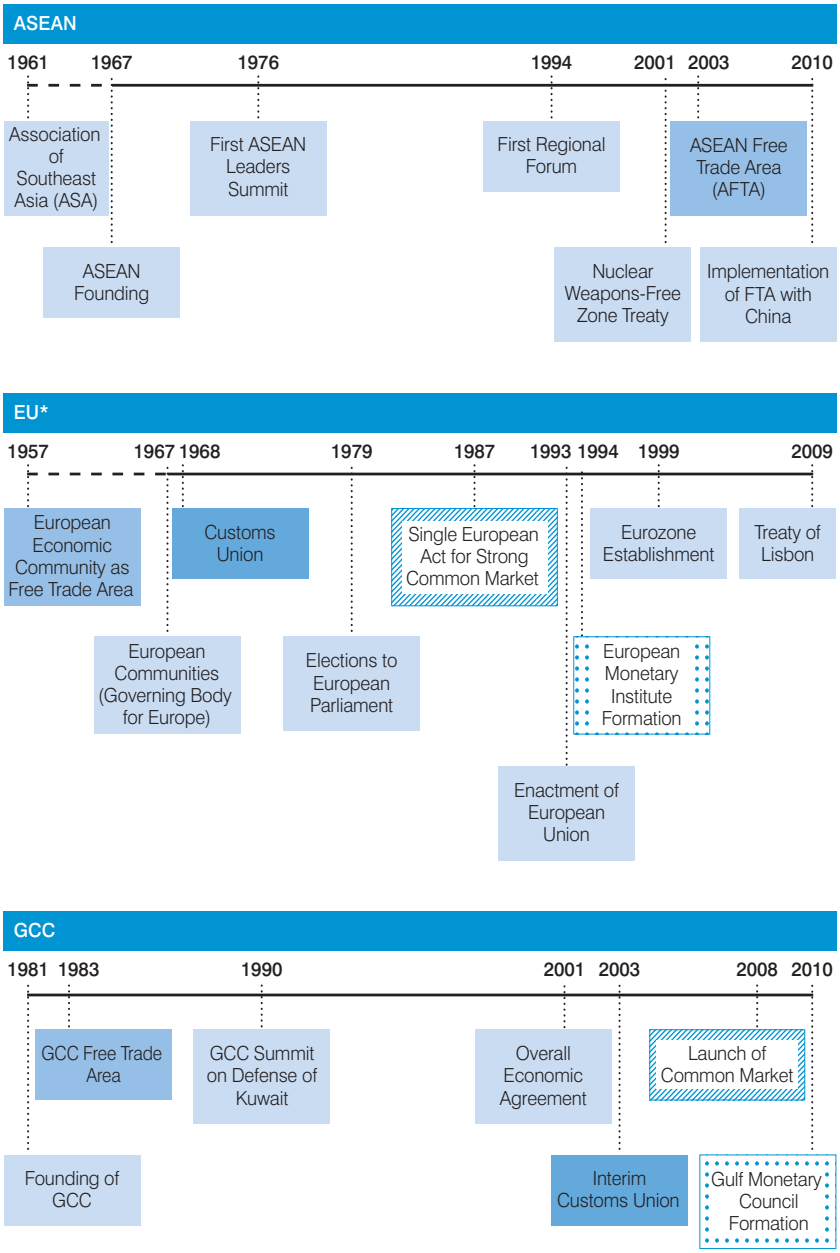
The EU developed out of two economic organizations that date back to 1957, but it did not unify under a common currency for member states until 1999. This relatively long time line underscores the concept that true integration and a common market for goods and services require more than agreements—they require an extensive institutional and legal framework, complemented by real socioeconomic reforms in member nations. And even with those conditions in place, complications can still arise, such as those the EU now faces due to the Greek financial crisis and high debt-to-GDP ratios in several other states across the eurozone.[iii]

When comparing the GCC to the EU and ASEAN, it is clear that progress toward integration follows not only different time lines but also different paths (*see Exhibit A*). The European Union is the only regional alliance to employ a common currency, but that process took decades of planning. ASEAN still has not been able to agree on the standard for a monetary union or even a common market. At the same time, in the last two decades, ASEAN and the EU have developed far more in terms of political cooperation, especially on regional issues. Despite the relatively slow progress of the GCC to date, it is still within the rough benchmarks established by these predecessors.

[i] "China-ASEAN free trade area starts operation," *China Daily*, January 1, 2010. (http://www.chinadaily.com.cn/china/2010-01/01/content_9255011.htm)
[ii] ASEAN Secretariat website page, providing numerous links to information and news about the ASEAN–People's Republic of China relationship. (http://www.aseansec.org/4979.htm)
[iii] Anand Menon, "What lessons can be learnt from the EU experience of the implementation of regional integration?" The Economic Commission for Latin America, 2005. (www.eclac.org)

Exhibit A
GCC Integration Efforts Are Relatively Young

KEY EVENTS ACROSS REGIONAL BODIES



* Prior to enactment of the EU in 1993, the regional body was the European Communities, which was a governing structure of three different European organizations.
Source: Booz & Company

MONETARY UNION

OVERALL SCORE	TRENDING	KEY OBSERVATION
2.8	↔	- Targeted date for common currency was 2010; now pushed back.

SUB-DIMENSIONS

a. Negotiations toward single currency

SUB-SCORE	TRENDING	KEY OBSERVATION
3.0	↔	- Two member states, Oman and the UAE, have withdrawn from the planned Gulf Monetary Union (GMU). However, the remaining four have signed the GMU agreement.

b. Monetary and fiscal policy coordination

SUB-SCORE	TRENDING	KEY OBSERVATION
3.0	↔	- The national currencies of five states are de facto pegged to the U.S. dollar, and currency union convergence criteria are aligned. However, the GCC has not formalized more substantive policies during the convergence process.

c. Establishment of institutional infrastructure

SUB-SCORE	TRENDING	KEY OBSERVATION
2.5	↑	- Precursor to a central bank, the Gulf Monetary Council was established and meets regularly. However, financial sector harmonization remains a work-in-progress with payment systems and regulatory legislation not yet fully integrated.

At the GCC summit in December 2001, the six member states voted to establish a unified currency by 2010. A new currency union would entail a GCC-level central bank that would manage fiscal policy across the Gulf, marking a major milestone toward political and economic integration. However, in both areas—currency and a region-wide central bank—the GCC has seen limited progress thus far.

Five of the member states (excluding Kuwait) now peg their currency to the U.S. dollar[15]—the planned peg for the common regional currency—which will allow for a smoother transition than other economic blocs such as the EU have experienced. In

addition, the GCC states have met most of the economic preconditions of a union. For example, official reserves in five of the six countries represent a minimum of four months of imports, and all six GCC states have a stated fiscal deficit less than 3 percent of GDP, public debt levels below 60 percent of GDP, and comparable interest rates.[16] Inflation is the sole area in which GCC countries diverged during the pre-crisis period. Worth noting is that the U.S. dollar peg has automatically put the five GCC countries that link their currency to it in compliance; however that linkage has brought risks as well. The precipitous rise in regional inflation prior to the 2008 global financial crisis exposed the GCC to currency exchange vulnerabilities and prompted Kuwait to switch to a basket of currencies.

In terms of monetary policy, the GCC established a Gulf Monetary Council (GMCO) in early 2010—an important first step toward a regional authority that can set policy for all six members as a single economic entity. The GMCO has already held its inaugural meeting, demonstrating that the institutional infrastructure for a currency union is coming together. Also, past efforts by national central banks to implement the Basel II regulatory standards show evidence of increased integration in the financial sector. Despite this progress, however, the financial sector in GCC countries—on which the success of the monetary union hinges—requires more concrete efforts toward integration. Harmonizing the payment and regulatory systems across the GCC is the most important step. This is a significant undertaking that will require a great deal of effort from the technical working groups responsible for implementing such measures.

A more significant setback for a monetary union was the withdrawal of two states from the proposed common currency. In 2007, Oman announced it would no longer take part, citing the need to maintain control over fiscal policy at the national level. Two years later the UAE, the region's second-largest economy, followed suit. 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.

Given the GCC's current membership of only six states, it is difficult to envision building both a monetary union and currency regime without two of its stronger members. Such an effort could ultimately have an adverse effect by creating a two-tiered structure of integration (i.e., several elements that include Oman and the UAE, and several that exclude them). However the GCC leadership remains optimistic and is keeping the debate and discussions regarding future integration efforts open for all member states. This optimism seems to extend to the GCC population at large and the business community in particular. A recent survey indicates that nearly half of UAE-based companies support a return of the UAE to a GCC common currency regime at some future date.[17]

Looking ahead, several intermediate steps will aid efforts to forge a common currency and effective monetary policy for the region. First, it is critical that member states provide incentives for the GCC financial sector in order to establish a robust system of payments and strong links among their financial markets, by harmonizing legal and regulatory infrastructures. To that end, the GCC countries should invest in compatible statistical institutions at both the national and regional levels, perhaps akin to the Eurostat of the European Union.[18] The ability to gather and analyze macroeconomic data is a key requirement for harmonizing regulatory policies and risk management practices—as the Greek debt crisis in the EU shows.

Second, although the dollar peg has proven to be a functioning nominal anchor in the current market, that may not be the best long-term policy. The GCC's economic and financial landscape is likely to shift dramatically over the coming decade, due to factors such as the rise of trade and investments with Asian countries, emerging markets, and the European Union, compounded with the GCC's own diversification strategies. Lessons learned from the past decade, such as the "imported" inflation resulting from the decline of the dollar and limited monetary policy flexibility, should lead to a robust debate on the best exchange rate regime. At a minimum, the right technical, institutional, and operational capabilities must be put in place to allow for such a shift.

The ability to gather and analyze macroeconomic data is a key requirement for harmonizing regulatory policies and risk management practices.

CUSTOMS AND BORDERS

OVERALL SCORE	TRENDING	KEY OBSERVATION
3.0	↑	- Customs union authorized in 2003; although intra-GCC trade remains below 10% of all trade, new efforts are under way to open borders.

SUB-DIMENSIONS

a. Removal of intra-GCC tariffs

SUB-SCORE	TRENDING	KEY OBSERVATION
3.0	↔	- Tariffs on intra-GCC imports cut to zero on most goods but not always uniformly applied in practice.

b. Harmonization of customs procedures

SUB-SCORE	TRENDING	KEY OBSERVATION
2.0	↑	- Customs union established in 2003 but GCC yet to agree on customs duties sharing on goods entering the GCC, as well as regulations at each crossing. Plans are currently under way to resolve all outstanding border issues by 2015.

c. Free movement of businesses

SUB-SCORE	TRENDING	KEY OBSERVATION
4.0	↑	- GCC nationals are able to establish businesses in each member state, especially in UAE.

d. Free movement of people and labor

SUB-SCORE	TRENDING	KEY OBSERVATION
3.0	↑	- Equality in pursuing employment was helped by enactment of the Unified Law of Insurance Protection. In practice, cross-GCC employment remains somewhat limited (27,000 jobs as of 2007).

The GCC Economic Agreement calls for a customs union and common market, with common customs regulations and procedures, and zero intra-GCC tariffs. It also allows for largely unrestricted economic activity across the region, including capital movement, formation of corporations, pursuit of employment, and so forth.[19] This score looks at the physical movement of goods, people, and commercial entities within the GCC.

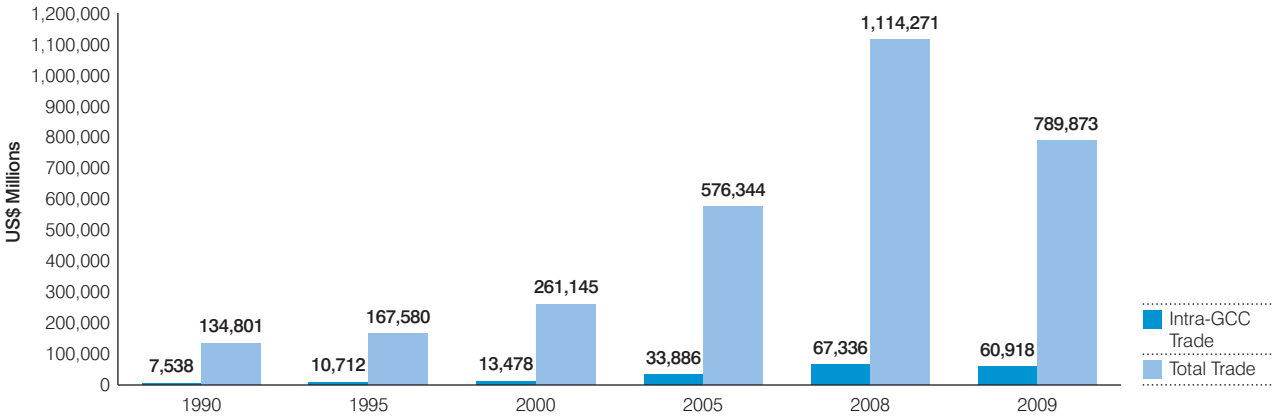
Intra-GCC trade has grown tenfold since the organization's founding in 1981.[20] Trade flows improved significantly among GCC countries,

especially after the Customs Union agreement of 2003. For example, intra-GCC non-oil exports between 2004 and 2008 (prior to the world financial crisis taking its toll on the GCC economies) increased by 27 percent annually, compared to only 20 percent for the rest of the world over the same period.[21] That said, intra-GCC trade has never exceeded 10 percent of total nominal trade value for the region[22] (*see Exhibit 1*). According to organizations such as the Federation of GCC Chambers of Commerce and Industry (FGCC-CI), the recent growth in regional trade stems primarily from growth in overall trade, rather than through dedicated efforts to reduce trade barriers in the GCC. Indeed, the share of intra-GCC, non-oil trade also remained below the 10 percent mark.[23] By comparison, blocs such as ASEAN and EU-15 generate 23 percent and 57 percent, respectively, of their overall trade from within the region.[24] GCC countries may want to consider introducing value added taxation (VAT) similar to that of the European Union sometime in the future. This can help generate additional revenues for GCC member states and, by taxing imports, can keep the system fair for GCC producers and generate more interregional trade.[25]

A key theme of the GCC Summit of December 2010 was the need to continue removing the customs and non-customs barriers among member states and to further develop mechanisms to boost intra-GCC trade. However, actual results on the ground

Exhibit 1
Intra-GCC Trade Is Rising but Small Compared to Total Trade

INTRA-GCC TRADE VS GCC TOTAL TRADE, 1990–2009
(EXPORTS AND IMPORTS, IN US$ MILLIONS)



Source: GCC Common Market: Facts & Figures 2009; GCC Statistical Abstract, December 2010 (for 2008 and 2009 intra-GCC trade figures), http://sites.gcc-sg.org/dlibrary/download.php?B=264; Euromonitor International 2010 (for GCC total trade figures); Booz & Company Ideation Center analysis

have been inconsistent. Disagreements have arisen over issues such as the sharing of tariff revenues and wait times at border crossings. In addition, some trade restrictions that the GCC has eliminated are still unofficially enforced. For example, imported goods should be assessed tariffs only at the first GCC point of entry, and not when subsequently traded among member states. However hidden fees are sometimes still charged, according to the FGCC-CI.[26] Nevertheless, the willingness among GCC countries to remove these obstacles remains strong. Indeed, news reports from a recent meeting of GCC finance ministers indicate a determination to resolve all outstanding customs issues by 2015.[27]

Regarding labor flow, the GCC common market, established in January 2008, freed citizens to seek employment in the private and public sectors, incorporate businesses, and establish residence in any of the six GCC countries. In the UAE, the number of students from other GCC countries rose by 6 percent in one year, from 2008 to 2009. Similarly, the number of long-term residences of non-UAE GCC nationals rose from 5,600 to 7,600 during the same period, and 1,884 GCC nationals received commercial and professional licenses in 2009.[28]

For the overall region, the numbers are somewhat less compelling. As of 2007 just 27,000 GCC nationals, a mere 0.2 percent of the estimated labor force of about 15.6 million, were working

Imported goods should be assessed tariffs only at the first GCC point of entry, and not when subsequently traded among member states.

full-time in other GCC member states (i.e., outside of their home countries).[29] This number is expected to increase, however, given a recent decision to allow GCC companies to open branches in member states, which will likely foster more movement of citizens across borders in the region.

One clear priority is to establish unified technical standards for more trade goods (currently about 3,000 products are covered).[30] Similarly, GCC countries should further reduce non-tariff barriers between states (e.g., transaction costs that result from administrative delays and long customs-clearance procedures); do away with current preferential policies and requirements; and implement an integrated customs system for the region.

Several member countries have already begun to automate their customs procedures, yet these efforts must be coordinated to create a single GCC-wide window in which all member states can share trade information and documentation. This requires further simplifying and standardizing the customs processes and data, and exchanging information across borders, among other steps. In addition, a single-window environment will require substantial legal infrastructure to standardize trade laws and regulations for the region as a whole. Yet such efforts will pay significant economic dividends by further reducing the administrative barriers to commerce.

Another critical strategy for the growth of intra-regional trade and movement of labor and business is building complementary economies. This means adopting structural economic reforms that allow the private sector a larger role in the economic landscape. It also entails crafting government regulations and policies that can help liberalize targeted economic sectors, and providing incentives for regional and foreign investments needed to vitalize untapped sectors of the GCC economies.

INTRA-REGIONAL INVESTMENT

OVERALL SCORE	TRENDING	KEY OBSERVATION
3.0	↑	- GCC-based entities are increasingly looking to invest regionally, with significant activity in the telecom sector. Between 1990 and 2003, intra-GCC FDI was estimated at $3.6 billion. Since 2003, intra-regional investments have more than quadrupled.

SUB-DIMENSIONS

a. Volume of cross-border FDI

SUB-SCORE	TRENDING	KEY OBSERVATION
3.0	↑	- The GCC telecom sector witnessed over $14 billion in cross investments between 2004 and 2009.

b. M&A volume in key sectors

SUB-SCORE	TRENDING	KEY OBSERVATION
4.0	↑	- M&A activity has been strong, with recent boosts in the telecom sector.

c. Cross-listing of equities in stock exchanges

SUB-SCORE	TRENDING	KEY OBSERVATION
2.0	↓	- Five stock exchanges cross-list their stocks in other exchanges, but few stocks are actually traded across borders, and there are no plans for a common stock exchange.

The GCC has witnessed an unprecedented rise in intra-regional investments over the past eight years. In previous decades, FDI flow between GCC countries was minimal—only $3.6 billion between 1990 and 2003, for example, or a mere 2.9 percent of the aggregate regional FDI outflow of $125 billion.[31] However, since the surge in oil prices beginning in 2003, the amount of cross-border investments has increased significantly, especially in the telecom sector.

Specifically, the UAE's Etisalat-led consortium invested $3.25 billion to acquire the second mobile license in Saudi Arabia in 2004. In 2007, Qatar Telecom acquired a controlling interest for $3.8 billion in Wataniya Telecom (Kuwait's second-largest mobile operator) through the consortium led by Kuwait Projects Company. Kuwait's Zain invested a record $6.1 billion in 2007 to get a share of the Saudi mobile telecom market. Saudi Telecom Company invested $900 million in 2007 and $230 million in 2009 in the telecom sectors of Kuwait and Bahrain, respectively.[32]

Indeed, intra-GCC M&A activity has been quite robust across all industry sectors, growing to $26.4 billion between 2000 and 2008 (*see Exhibit 2*).[33]

Yet this increase in regional investment has happened despite a lack of formal coordination, and overall financial integration for the region remains inconsistent. Sovereign wealth funds of member states are now famous for investing large sums overseas, yet they have not seen significant cooperative activities regionally, which hampers their ability to leverage their collective resources on investments in regional industry.

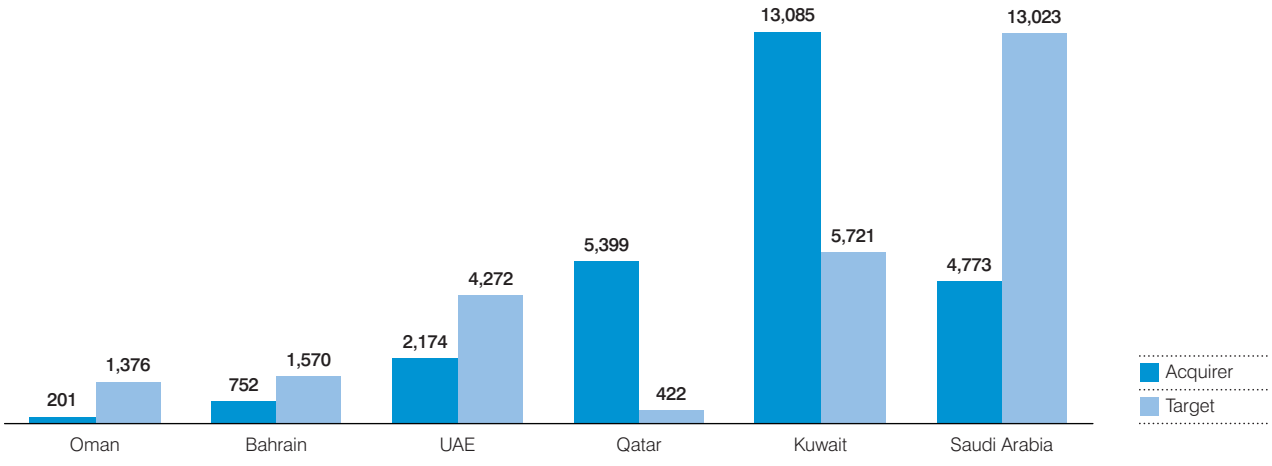
Banks—with the notable exception of Bahrain's vibrant financial sector—remain primarily government owned and highly concentrated, with little inter-GCC competition and insignificant cross-border investments. According to the International Monetary Fund (IMF), foreign assets and liabilities still form a relatively small share of the total balance sheet for GCC banks.[34] This has been exacerbated by billions of dollars (and trust) lost in the wake of the financial crisis due to GCC banks' exposure to risky corporate and high-net-worth GCC clients.

In addition, although five of the stock exchanges in the GCC (Bahrain, Kuwait, Qatar, Dubai, and Abu Dhabi) have the capability to cross-list some of their stocks on other exchanges,[35] in reality this practice is quite limited. The first such dual listing did not happen until 1999, and today just 39 equities, out of a total of 696 GCC companies, have cross-listings, mostly between Bahrain and Kuwait.[36] The UAE recently proposed an integrated Gulf stock exchange, but the idea has yet to gain traction.

To further enhance intra-regional investment, the GCC should work to harmonize laws on the investment and ownership of GCC companies in all sectors. The recent GCC Supreme Council decision in December 2010 to allow regional businesses to establish branches in other member states on an equal footing with national firms is an important first step. The GCC should also encourage foreign direct investment, and it should promote and grow the private sector, with a particular emphasis on measures to diversify national economies away from their reliance on hydrocarbon revenue.

Exhibit 2
M&A Activities in GCC Countries

VALUE OF GCC MERGERS AND ACQUISITIONS 2000–2008
(IN US$ MILLIONS)



Note: Numbers are rounded off.
Source: Dealogic Analytics; Booz & Company Ideation Center analysis

JOINT INFRASTRUCTURE

OVERALL SCORE	TRENDING	KEY OBSERVATION
3.6	↑	- Multi-billion dollar projects in oil and gas, railroads, and electricity have been announced, and several significant milestones have been reached.

SUB-DIMENSIONS

a. Oil and gas projects

SUB-SCORE	TRENDING	KEY OBSERVATION
3.5	↔	- Completion of Dolphin Gas Pipeline is a singular achievement in cross-border oil and gas projects in the GCC.

b. Rail projects

SUB-SCORE	TRENDING	KEY OBSERVATION
3.5	↑	- $25 billion GCC railway project has raised expectations, but planned operation projected in 2017.

c. Electricity projects

SUB-SCORE	TRENDING	KEY OBSERVATION
4.0	↑	- The interconnection project was conceived at the inception of the GCC and Phase I realized in 2009.

d. Roads and bridges

SUB-SCORE	TRENDING	KEY OBSERVATION
4.0	↑	- Road connections receiving investment with added boost from Qatar's successful bid to host the FIFA World Cup in 2022.

e. Aviation infrastructure

SUB-SCORE	TRENDING	KEY OBSERVATION
3.0	↔	- Hard infrastructure, such as airports, is under construction in individual countries. Most GCC countries, with the exception of Saudi Arabia, have signed some form of open skies agreement. However, the region has not yet fully implemented such an agreement.

Joint infrastructure is the area of integration in which the GCC has made the most progress, with several large multinational projects in a number of sectors now under construction. For example, the Interconnection Project, a new $1.4 billion electricity grid implemented by the GCC Interconnection Authority (GCCIA) will initially link Saudi Arabia, Bahrain, Qatar, and Kuwait in a northern grid, then Oman and

UAE in a southern grid; a third phase will connect the two grids. In the oil and gas sector, the $10 billion, 360-kilometer Dolphin Gas Pipeline carries natural gas from Qatar to the UAE and Oman. Many analysts have posited that the success of this initiative will pave the way for other gas pipelines in the region.[37]

In transportation, Qatar and Bahrain are planning a $4 billion causeway and high-speed rail link that will connect the two countries. Bahrain and Saudi Arabia already share the King Fahd causeway, which was built in 1986 and which the countries are planning to expand. Oman is planning a super-expressway connecting Muscat and the UAE that should be open by 2015. And the GCC as a whole is planning a 2,117–kilometer railway network to be built by 2017, with an estimated cost of $25 billion.[38]

In terms of aviation infrastructure, the UAE, Bahrain, Qatar, Kuwait, and Saudi Arabia are making major additions to their existing airports, and all (with the exception of Saudi Arabia) have signed some form of an open skies agreement. However the GCC is still waiting for an open skies agreement that will permit fully free movement of people and goods within the region, a notable lack that the Director General of the International Air Transport Association (IATA) called "disappointing" in October of last year.[39]

Many of these projects are extremely ambitious—current infrastructure plans in the region have been valued

at more than $1 trillion—at a time when some construction efforts in the region and worldwide have been subject to delays or cancellations. In Kuwait, Qatar, Saudi Arabia, and the UAE, for example, only 15 percent of the value of ongoing infrastructure projects in 2007 and 2008 was actually spent.[40] While many of these issues were triggered by the financial crisis and the subsequent contraction of credit, bureaucratic hurdles due to a lack of integration in the region have also slowed the construction process.

Moving ahead, joint infrastructure in the region will receive a boost from the recent announcement that Qatar will host the 2022 FIFA World Cup. The event will focus world attention on the GCC—not only Qatar but other countries in the region, which may host early-round matches—and serve as an external deadline by which key projects must be completed. In fact, the GCC's Supreme Council gave directives after the December 2010 summit to speed up implementation of infrastructure projects such as the GCC railway.

The region must also build on the success of interconnection projects, such as expanding the electricity grid to include Oman and the UAE by the end of 2011. Finally, the GCC should consider creating an infrastructure "monitoring board"—similar to the current ministerial and technical committees created to implement the provisions of other agreements—to evaluate and spur progress on large-scale regional infrastructure projects.

Joint infrastructure in the region will receive a boost from the recent announcement that Qatar will host the 2022 FIFA World Cup.

KNOWLEDGE COOPERATION

OVERALL SCORE	TRENDING	KEY OBSERVATION
2.3	↔	- Individual countries, particularly Saudi Arabia, the UAE, and Qatar, are investing heavily in education and R&D, but have shown minimal effective collaboration on joint projects.

SUB-DIMENSIONS

a. Regional education initiatives

SUB-SCORE	TRENDING	KEY OBSERVATION
3.0	↔	- The Arab Bureau of Education for Gulf States (ABEGS) was established in 1975 with several regional education initiatives, but results thus far have been modest.

b. Civilian nuclear research program

SUB-SCORE	TRENDING	KEY OBSERVATION
1.0	↓	- The planned GCC-wide project for the development of nuclear energy has been shelved.

c. Joint R&D and regional technical institutes

SUB-SCORE	TRENDING	KEY OBSERVATION
3.0	↔	- Individual GCC countries are investing in technical institutes but not on a collaborative basis.

Individually, GCC countries have built impressive new educational institutions and invested heavily in research and development (R&D) in recent years. In Oman, the Knowledge Oasis Muscat serves as a home for technological innovation. In Saudi Arabia, King Abdul Aziz City for Science and Technology (KACST) is part of a multi-billion dollar R&D effort in the kingdom. Complementing that is the King Abdullah University of Science and Technology (KAUST), with its $10 billion endowment. The Qatar Science and Technology Park (QSTP), part of Qatar Foundation, is becoming an international hub (but with a limited non-Qatar GCC presence) for joint ventures, particularly to develop new healthcare and energy technologies. And the UAE established new entities such as Masdar and Dubai TechnoPark to spur innovation through R&D.

On the education front, the region established the Arab Bureau of Education for the Gulf States (ABEGS) back in 1975. Based in Riyadh, the organization aims to advance and reform the education system in GCC

countries and Yemen, by promoting cooperation among member states, implementing educational programs and activities, and developing high education standards.

Yet despite several successful initiatives—for example, the establishment of the Arab Educational Training Center for Gulf States in Qatar, the Gulf Arab States Educational Research Center in Kuwait, and the Arabian Gulf University (GCC University) in Bahrain—the overall region has fallen short of its vision for an integrated, high-quality education system.

For example, standardized international tests scores for eighth-grade students show that GCC countries are significantly behind other nations in math and sciences, yet the region has not launched any unified programs to address these issues. Nor has it developed a school policy that can help meet some of the challenges in pre-tertiary education schools. There are no common GCC-wide programs for digital education content and services. In higher education, the establishment of foreign university satellites in countries like Qatar and the UAE has attracted higher education students from across the GCC. At the same time, competition among regional institutions has hindered their mutual cooperation.

To address such issues, GCC countries should continue their cooperative efforts with the EU to develop integrated programs that fit the region's culture and background. For example, the GCC may want to consider developing regional programs such as the EU's Comenius and Erasmus programs for school and higher education, respectively. These programs afford students, teachers, and other education stakeholders a range of options such as study and work visits as well as the ability to network between academic institutions.

In R&D, the GCC has not developed a flagship regional institute for joint R&D spending akin to that of the EU, despite the common economic and social interests of member states. Indeed, joint-research initiatives have been the exception rather than the rule—isolated to a few local institutions such as the Qatar National Research Fund and local institutions within Dubai that have initiated Gulf-wide research.

Nuclear energy is a good example. In 2006, the GCC floated a proposal for a joint program in civilian nuclear research to meet the region's growing energy needs. (Our scorecard lists the nuclear program as a separate sub-dimension, outside of regular R&D, because of its presumed prominence when announced.) But by 2010, each country had decided to develop its own independent nuclear program.[41] As a result, any prospects for joint research and to develop common technology were essentially scuttled.

Although state-level R&D efforts can spur competition, they can also create the risk of cannibalism and overlapping technologies in the absence of any regional coordination. Moreover, individual member states will face high hurdles from global competition, whereas a unified GCC will be able to compete more effectively. Accordingly, the GCC should establish a regional research institution, akin to the European Research Council, to promote, fund, and assess collaborative projects that can enhance socioeconomic collaboration between member countries. The region also needs to involve the private sector in R&D projects. This can be achieved through incentives that give the private sector the opportunity to contribute to transnational research and development, such as Europe's CERN.

OVERALL GCC INTEGRATION

OVERALL SCORE	TRENDING	KEY OBSERVATION
2.9		- Although the GCC has stumbled before reaching some key milestones, such as launching a monetary union and fostering knowledge cooperation, the momentum toward an integrated union is increasing.

The GCC has come a long way since its founding in 1981, yet this scorecard of core issues shows that there is much work remaining before the region is truly integrated. On the largest and most significant indicators, the GCC is simply not meeting its targets. In particular, the setback over the monetary union and the withdrawal of Oman and the UAE from the currency regime puts a cloud over the entire integration effort. In that and other areas, GCC member states have shown a tendency to revert to national rather than regional priorities.

Despite this, however, we believe that the region will move steadfastly toward integration. Indeed, given the current climate with its imperative to increase reform measures across the Middle East and the GCC in particular, member states are redoubling their efforts to reach integration goals at all levels of socioeconomic activities. This will no doubt help increase economic welfare and put the region on a path toward higher economic prosperity.

CONCLUSION

When the EU was established, European countries flocked to join, and many had to wait until they satisfied certain economic conditions. That situation is reversed in the GCC—the economic conditions already exist for the most part within member states, yet the belief that economic integration is a critical path for success needs to be strengthened. As trade increases between the region and the rest of the world, continuing to function as a collection of small, independent economies rather than an integrated whole will carry a significant opportunity cost.

Only by aligning their common interests will the members of the GCC be able to negotiate favorable agreements with larger economic counterparts such as the EU and ASEAN. Similarly, although countries in the region might make technological strides through isolated education and R&D efforts, they will accomplish far more by working in concert. Centralized coordination will prevent the duplication of efforts and ensure the most effective use of R&D resources. And for those ideas that succeed, a common market throughout the region will ensure the greatest possible customer base—and fewest impediments across borders. To that end, GCC member states must work on increasing economic activities within this common market through region-wide complementary economic and financial initiatives such as manufacturing and Islamic finance that will serve to increase trade and investment between member states.

The GCC region has reaped substantial benefits from closer integration since its establishment in 1981. Ease of investment and trade has allowed firms to profit and has improved the GCC's overall economic welfare. As global economic competition intensifies, GCC countries must not only strengthen efforts toward a monetary union but also strive toward wider economic integration, which will enable the six member states to better face future socioeconomic challenges.

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Endnotes

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