Understanding Regional Integration in the GCC

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I. Introduction

One of the most important trends of the past few decades has been the nearly universal acceptance of Regional Trade Agreements (RTAs) as a part of the multilateral trade negotiations under the World Trade Organization (WTO). The WTO recognizes 233 such RTAs in force in 2012, nearly a fivefold increase since 1990 (WTO 2012). Near universal implementation of them by sovereign states indicates that policy makers see them at least as beneficial, and perhaps more beneficial than multilateral free trade negotiations. The WTO sees RTAs as potentially beneficial, but regards their wide proliferation as harmful to multilateral negotiations, since by their very nature they are discriminatory. However, RTAs are clearly undertaken for both economic and political reasons: the distributional effects of such agreements are always asymmetrical, and there are a myriad of factors that can influence their relative success or failure at integration. To help further the knowledge about factors that influence the development of RTAs, I will be analyzing the Gulf Cooperation Council (GCC) over the last three decades, from 1982 to 2012. The GCC has been much slower to integrate than similar RTAs, despite an upturn since 2001, and has been largely considered ineffective at integrating the policies of its member states. This paper will seek to answer the question: "What political, institutional, and economic factors help explain the progress of the GCC in its integration efforts?" with an emphasis on hindrances to effective regional integration. Answering this question will help policy makers understand crucial factors in the development of RTAs, assuming that RTA integration is beneficial to the overall progress of global free trade.

II. Literature Review

The GCC was established in 1982 between Saudi Arabia, the United Arab Emirates (UAE), Bahrain, Qatar, Kuwait, and Oman. The GCC has progressed from a Free Trade Area (FTA) in 1983 to a Customs Union in 2003 and a Common Market in 2008; plans for a monetary union are now largely stalled in the wake of the global recession. The formation of the GCC is usually understood as a political-military response to the Iran-Iraq War that started in 1980, and the first Unified Economic Agreement was passed the same year. However, economic integration was largely declaratory, and did not show much progress for almost a decade, until after the Second Gulf War in 1991, and even then did not see a significant increase in integration until the early 2000s. Lawson (2012) proposes a four-category typography for RTAs based on: supranational authority autonomy, rules and procedures of decision making, supranational enforcement mechanisms, and degree of interdependence among member states. He classifies the GCC as an FTA/collective security pact that offers initiatives designed to increase interdependence, with supranational authority over several main issue-areas, operating under a veto-system centered on Saudi Arabia (17). Das' (2004) typography for RTAs would put GCC in the categories of hierarchical, as the RTA revolves around Saudia Arabia and the UAE, and political because the main factor holding the RTA together is political ties between rulers in the Supreme Council (14).

Looking at the economic integration of the GCC member countries, it is easy to see that there is room for progress. Researchers frequently use the gravity model as an indicator of the potential for successful integration, and success is usually measured in terms of increased intraregional trade flows in goods and services. The gravity model uses GDP, GDP per capita, population, distance between countries, bordering countries, and language similarities as variables. Although the results are generally strong for this region, there have been disappointing de facto results

(Laabas and Abdmoulah n. date, 7-10). GCC intraregional trade as a percentage of GDP only increased from 5% to 7% from 1982 to 2000, while the average for other RTAs during that period increased to above 30% (Looney 2003, 140). Nechi (2011) points out that intraregional trade has not been consistent or substantial, although the picture looks better for intraregional trade when oil exports are excluded. However, intra-GCC imports are still very low, and are the least significant for the two largest economies, Saudi Arabia and the UAE (97), although they have the most intra-GCC exports (Sahib and Kari 2012, 224-225). The Middle East and North Africa (MENA) region has historically had the lowest share of intraregional trade as a percentage of total trade compared to similarly developed areas. Intraregional trade is highest within sub-national groups, such as the Arab Common Market, Arab Magreb Union, and GCC, reflecting the religious fractures in the region and political-military alliances (Romagnolli and Mengoni 2009, 74). Openness and growth to non-GCC markets has grown faster than for intra-GCC markets, and all GCC countries are still highly dependent on developed countries for exporting commodities and importing consumer goods (Sahib and Kari 2012, 226).

There are many different theories about why progress in integration has been so inconsistent and slow for the GCC countries. Nechi (2011) cites: national government control over hydrocarbon production, weak supranational institutions, national competition in industries that would benefit from regional economies of scale, and weak infrastructure as the main hindrances to integration (107). He recommends infrastructure development as the key to intraregional trade growth (103). The GCC tends to agree with him, as evidenced by large regional infrastructural projects in railways, electricity, and pipelines undertaken in the past couple of years (Lawson 2012, 15). Looney (2003) considers the protection of national sovereignty by nationalistic rulers as the main hindrance, evidenced by a lack of progress on collective security arrangements, large state involvement in the economy, and capital controls (140-147). Policy-makers' calculation of integration includes consideration of whether the greater potential threat to their domestic well-being comes from restricting or opening trade (Moran 1996, 193). It seems that, at least up until the reinvigoration of integration after the Unified Economic Agreement of 2001, the rulers of the GCC member countries saw opening their markets as detrimental to their national interest. Similarly, Gowa sees the concern for national security as "the most durable barrier to free trade" (quoted in Moran 1996, 182).

Romagnolli and Mengoni (2009) note a trend of delay and lack of implementation of agreements throughout the MENA region, with a penchant for narrow bilateral openings, a lack of effective dispute settlement mechanisms, and reliance on high level committee meetings for supranational bodies that serve the interests of nations rather than the region (81). They see the GCC as failing the tests for successful integration, with low intraregional trade prior to integration, high heterogeneity of economic conditions between members, similar demand structures, and too much public sector involvement in the economy. These problems hinder development of effective integration despite cultural, linguistic, and religious similarities that promote trade (71). They suggest more integration and privatization in services such as transportation, telecommunications, and finance as the keys to developing deeper integration in the region (76).

Das (2004) claims that welfare gains from integration are highest when the trade barriers being reduced are high, preexisting intraregional trade is high, the trade partners have diversified economies, their domestic prices reflect world prices, and when there is a large country as the focal point for convergence (46). The GCC does not significantly fit any of these conditions except for having high trade barriers that have now been substantially reduced both for members and nonmembers. Panagariya (1999) reminds us that RTAs are not undertaken solely for economic reasons, and that trade policy can be used as foreign policy, forging alliances between nations (97). This is supported by Gowa, who writes that "political-military alliances have a direct, statistically significant, and large effect on bilateral trade" (qtd. in Moran 1996, 182). These alliances promote trade growth because they lessen the security risk associated with trade (Mattli 1999, 31). Clearly, the conservative Sunni monarchies have a reason to band together against what they see as aggressive foreign policies of Shi'a neighbors such as Iran. As previously stated, this regional power struggle is what many see as the impetus for the GCC's creation in the first place.

Mattli's analysis of RTAs in 1999 focuses on regional integration as a dynamic process, not a static event in history. His model fuses elements of functionalism, intergovernmentalism, the society-centered model, and the state-centered model. There is a market for integration, where demand comes from domestic industries and supply comes from governments, with transaction costs as the main driver of demand. The demand side roughly correlates to the society-centered model, so that as businesses expand their market access across borders, there is an associated increasing transaction costs due to economic and political uncertainty produced by foreign regulations and actions. The businesses then lobby their governments to form functional institutions at the supranational level that will absorb these transaction costs, promoting integration. The supply side roughly correlates to the state-centered model, in that political actors are also utility maximizing, and they must be wiling and able to supply these functional institutions, based on their own cost-benefit considerations. The supply of supranational institutions is most likely during times of economic distress, since this makes political actors less autonomous in their decision-making (12-13). Mattli stresses that both the demand and supply side conditions must be met for regional integration to be effective, and the GCC clearly does not fully satisfy all of the stated conditions.

The literature has much to say on the prospects and progress of GCC integration processes, and such analyses are necessary but not sufficient explanations for a case as unique and complex as the GCC. Primarily, there has not been enough focus on the national and sub-national level, and on the economic and political structure of the individual GCC member states. The literature leaves out several key hindrances to integration that will be analyzed in the next section.

III. Analysis

Three factors that are significant to the development of the GCC have been largely overlooked in the literature. This reveals a bias to think of all regions in terms that are familiar to Western analysts, while sometimes ignoring the unique, underlying social, cultural, political, and economic structures in which many RTAs operate (including the GCC). First, there has been little examination of the role that the highly centralized and nepotistic political systems in the area have in resisting delegation of authority to supranational institutions. Second, the economic structure of the GCC countries is stratified in a way that is foreign to the West, especially in terms of its labor force. The composition of the labor force makes the government unaccountable to labor, restricting citizens' demand for integration. Third, the means of interdependence in the region are not customary in the Western world, in that the state leads the way in investment and joint ventures. Also, the common practice of measuring the depth of integration based on intraregional trade flows overlooks the fact that much of the growth in intra-GCC economic interactions occur primarily as foreign direct investment (FDI) in non-tradable sectors, such as construction, infrastructure, retail, and real estate.

The institutional structure of governance in the GCC makes it hard to fulfill Mattli's (1999) supply side conditions: that political actors must be willing and able to accommodate demand for supranational, transaction cost-reducing institutions. The GCC countries are among the last remaining monarchies in the world, and as such, political power is heavily concentrated in the hands of the respective ruling families. There are few, if any, conduits by which public opinion, labor concerns, or business interests outside of those associated with the ruling families can reach their governments. These rulers are jealous of their national sovereignty, and are not quick to relinquish control over economic matters, let alone political matters. The tendency in the region for negotiations to be restricted to high-ranking cabinet officials, most of whom are members of the royal family, means there is not a large differentiation in opinion between representatives, and they are unlikely to take drastic measures. Another reason that the monarchs are hesitant to give up sovereignty is the importance of domestic economic policy autonomy to appease restless populations during periods of low oil prices. Ironically, integration in the GCC has often deepened in response to periods of economic crises, which supports the hypothesis that governments are more receptive of public opinion during uncertain times and seek to boost the economy to appease them (Looney 2003, 151). In fact, the greatest steps towards integration have taken place since the Unified Economic Agreement of 2001, when rulers agreed that diversification away from oil should be a main priority, and external threats in the form of increased extremist and US involvement in the area called for greater solidarity in security and economic matters (138).

Second, the economic stratification within the GCC countries is institutionalized in a way not seen in the West. The labor market and the concentration of capital showcase this phenomenon clearly, as explained by Hanieh's neo-Marzist analysis in 2010. The majority of the labor force in the GCC countries is migrant labor with no political or civil rights. These workers are not citizens, can be fired and deported at the first signs of unrest, have no political power, and no way of organizing for bargaining. This migrant labor generally came from the rest of the MENA region up until the 1980s but was seen as too religiously charged, and so was deported and replaced with immigrant labor from South Asia, which is less involved in the sectarian religious struggles of the area. Public industries are the largest employers of citizens in the GCC, and women's participation in the labor market is severely restricted, more by culture than by law.

Haneih (2010) explains that capital markets in the GCC countries reinforce this tiered labor market. The nationalization of the oil industry after independence has allowed enormous rents to be captured by the governments of GCC countries. Capital accumulation by the ruling family and those allied to them has enabled this strange bifurcation of labor and quelled unrest, since the people have no say in the government and most citizens are dependent on the public sector. Capital accumulation in the private sector has largely occurred in "downstream industries" related to oil, and the unique economic phenomenon created by this capital accumulation has contributed to the third common misunderstanding of the GCC economies: the importance of public-private ventures and FDI in promoting integration and growth.

Strategic trade theory is a key tenant of the GCC countries' development strategies. Investment is largely undertaken in public-private ventures, as states partner either with national capitalists or FDI. The states relies on huge construction projects to modernize and develop their economies, and this has led to competition in sectors that would be more efficient if they could harness the economies of scale provided by cross-national plant-building and infrastructure projects. Recently, some progress has been made in such cross-border infrastructure projects in electricity, railroads, and oil production, but more effort is needed to fully integrate and develop the region (Lawson 2012, 15). So called, "downstream industries" that rely on low energy prices, such as aluminum production, steel production, and chemicals, as well as sectors that hinge on real estate markets such as construction and transportation have been the biggest beneficiaries of public-private partnerships. Joint ventures on such projects have faltered in periods of low oil prices, further stressing the need for less public involvement and diversification away from oil. This could free up state revenues for investments in education, infrastructure, and research and development.

The emphasis on joint ventures and massive construction projects makes intra-GCC FDI the main driver of integration and growth. Sovereign wealth funds are directed towards infrastructure, religious groups, and foreign acquisitions, while huge private equity pools finance industrial construction, real estate development, and retail sectors. Laws restricting imports except through official channels have allowed capitalists to capture exclusive agency rights for foreign commercial goods, crippling the domestic commercial goods markets, and making GCC populations dependent on imports. The standard measures of integration judge intraregional trade based on the gravity model show predictably low levels of integration in the GCC. However, this model ignores the importance of FDI, which is the main driver of growth in these countries. Capital flows were liberalized in 2001, and there has been a huge expansion in the aforementioned sectors, which are largely in the non-tradable sector of the economy. Hanieh (2010) states that internationalization in the GCC is, "exemplified through the interpenetration… of Gulf capital-groups" (61). Analysis that ignores the importance of capital flows rather than commodity trade in the development and deepening of integration in the GCC misunderstands the economic relations that are enabled by strong capital centralization in this area of the world.

IV. Implications for the Main IPE Ideologies

These findings have direct implications for the three main international political economy ideologies: liberalism, mercantilism, and Marxism. For liberalism, this research shows that a reliance on openness and market incentives for domestic actors can have a positive correlation with interdependence, integration, and openness to trade. Also, the government should play less of a role in GCC economies, to allow foreign and private investment to take the place of public-private ventures, and to forego policies that distort market forces and real prices in the area. These approaches in the long term could result in higher GDP per capita growth, more FDI for development, a more efficient allocation of national and regional resources, and higher standards of living.

For mercantilism, the research suggests that nationalism and an overreliance on strategic trade theory have harmed regional integration in the GCC. Highly concentrated power resources in the hands of the ruling families and their allies have made them jealous of their sovereignty as a means to achieve wealth, power, and security in a volatile region. Also, domestic autonomy is crucial to help quell domestic unrest during the budget slumps associated with oil price drops. Further diversification of the economy, and less reliance on oil rents for government revenues can help break this mercantilist trend and deepen integration.

For Marxism, it is clear that the current social relation of labor and capital in the GCC countries is highly exploitative. Foreign investment and interest in the region is exploitative as well, as countries seek oil deals and support the status quo power structures of the monarchies to maintain stability. Liberalizing labor market relations and loosening capital controls to allow more private investment could help reverse the suppression of citizens and foreign labor in these countries. This in turn could give the domestic population more of a say in the politics of their country, which has been shown to increase demand for integration. Although this process may not be palatable to the elites of the GCC, after a difficult period of transition, it would quicken the development of their countries, and attract FDI.

V. Conclusion

The GCC faces many challenges to its development as a functioning, growth-promoting regime of supranational political and economic integration. However, progress towards the stated goals of the GCC has accelerated in the last decade, as a result of focusing on diversification away from oil, supporting public-private partnerships that reach across borders, institutionalizing a customs union and common market, and loosening capital controls. There are several policies that the GCC could take to continue this positive trend of integration, while achieving economic growth, national security, and domestic stability.

First, efforts at economic diversification must continue. The private sector must be able to adequately respond to market incentives, and be allowed to expand across national boundaries. Investments in education and human capital must improve in order to meet the needs of a twenty-first century economy. Second, labor reform should allow citizens and noncitizens alike greater mobility, opportunity, and equality. This will grow domestic markets, attract FDI, and allow economies of scale to take hold in a consumption-based society. Third, capital controls must continue to be loosened to allow for cross-national FDI, and regulations must be standardized (which will involve a struggle between the Saudi Arabian and UAE governments about whose model of development is best). This will allow the countries to grow together, rather than encourage the skewed distribution of resources towards the richest parts of Saudi Arabia and the UAE. The public sector should take a back seat in investments outside of public goods, to allow market incentives to take effect. Finally, nepotism and corruption must be tackled in a fair manner. The people of the GCC need to know that there are economic opportunities available to them outside of what the government can provide, and they must be given a greater say in the way their countries are run. This process will be a long and difficult one, but beginning the process of political liberalization could be the most important step towards effective economic integration.

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