

## **The GCC: A Regional Approach to Global Economic Cooperation**

I am very pleased to be able to participate in this second Gulf Economic Forum and to have been given this opportunity to address such a distinguished audience. The theme of this conference, “Towards 2000: Investment, Development, and Insurance”, leads me to use this opportunity to share some thoughts with you on how we in the GCC are reacting to current developments on the world economic scene.

The GCC countries have for some time pursued modernization and development, and rightfully earned themselves a distinguished place among developing countries. They have grown from the small, simply structured economies of the sixties into the larger and more complex economies that you see today. In 1975, the total GDP of the GCC countries was around US\$ 67.5 billion. The oil sector contribution in GDP was estimated at an average of 72%. In total GDP rose to US\$ 132.1 billion, and the average contribution of the oil sector fell to 36%.

Furthermore, the GCC countries are coordinating with each other and moving towards establishing a common market; therefore, further progress is anticipated as we consider the benefits of integration into such a market. With the progress made so far, following the integration under the framework of the “Unified Economic Agreement of the GCC”, signed in 1982, I believe we are on course to create the most viable and indeed the most successful economic bloc in the Arab World and the whole Middle East.

The relatively small collective population in the GCC of more than 23 million, coupled with the oil wealth, as those countries possess around 50% of proven world oil reserves, allowed the Gulf states to introduce generous welfare programs in the past. These welfare programs in most GCC countries include free education and health care; subsidized housing, public services and basic commodities; social aid and loan programs; and generous social security and public acquisition systems. This policy of sharing the wealth with the people has led to tight government control over the economy, with the state providing most of the services and producing most of the goods. The public sector has, over time, expanded, and engaged in activities that sometimes fell previously within the domain of the private sector, to the point that public expenditure became almost the sole determinant of the level of domestic economic activity.

This expansion of the public sector in the past two decades was justified by the circumstances and conditions that led to it and was undoubtedly affordable. However, many changes have taken place both domestically and internationally, such as the drop in world oil prices, the economic recession in most industrial countries, the implications of the Iraq-Iran war and later the brutal Iraqi invasion of the State of Kuwait. Not surprisingly, this has entailed a huge financial cost to the GCC countries. These and other factors have caused severe problems to the state budgets in the GCC countries, which started to run huge deficits in the nineties, totaling US\$ 32 billion in 1992, i.e. 16% of GDP on average, against surpluses amounting to US\$ 14 billion 1975, i.e. 21% of GDP on average. Therefore, GCC countries have had to adopt new approaches now in order to meet the challenges facing them.

In consequence, the public sector expansion and state intervention of past years is no longer seen as appropriate to

governments, the public, or to the vast majority of economists alike, and it is certainly not sustainable in the medium term. This change in public opinion has emerged partly as a result of the increased financial burden borne by state budgets, and partly due to greater allegiance to free market ideology, a conviction which is reinforced by the benefits of deregulation and liberalization experienced in both industrial and developing countries, especially in the context of improved services and larger investment opportunities.

The transition from state dominated economy to private sector predominance should open up vast opportunities for private sector participants, including foreign investors, in various industries and sectors. I would include here areas, which traditionally have been state monopolies, such as telecommunications, power generation, and downstream oil industries. Further opportunities for foreign investors may be created in those industries that require advanced technology and know-how.

It is likely that the main thrust of this transition will come from the proposed privatization programs. These plans aim to reduce the state role in domestic economies and develop competitive markets for the private sector, to enhance its role in economic activity. In Kuwait, for example, as part of these plans, the Kuwaiti government intends to withdraw where possible from local companies and encourage foreign investors' participation in those sectors that require particular expertise.

I do not wish to dwell on the advantages and benefits of the privatization strategy, though I would say that, in my view, its success is vital to tackle current economic weaknesses, and reduce the level of public administration.

In this context, I am sure that you are aware of the offset

program which has been adopted by most GCC countries. This program is designed, among other things, to promote economic cooperation between the GCC countries and their trading partners, specifically the industrial countries. We believe there are mutual benefits for both in this system. For foreign suppliers and investors, it opens a window for joint ventures in viable projects and industries in promising sectors. On the other hand, we in the Gulf stand to gain from the advanced technology and technical know-how of our foreign partners. The program is in its early stages and we have much to learn of its operation, but I am sure that as experience grows, its value will become apparent to both sides.

Hopefully, these initiatives will, in turn, allow realistic and substantial reductions in public expenditure, as well as improve productivity and economic performance.

The concept of foreign investors' participation in local economic activity, whether in industrial sectors or services sectors, has recently gained increased momentum. Efforts are being exerted to encourage foreign investments by making the region even more attractive to potential investors.

Needless to say, creating competitive markets with an expanded private sector role requires a number of reforms in areas such as improvement of market structures, elimination of price distortions caused by subsidization policies, revision of some of the existing legislation, and the development of financial intermediaries with improved efficiency.

Here, I would like to emphasize the role that monetary authorities can play in facilitating this transition of the economy. Naturally, these monetary authorities are and indeed should be primarily concerned with the effective functioning of their respective financial markets. However, they also need to

ensure that financial institutions can fulfill the function of financial intermediaries in channeling deposits and savings toward investments to meet the capital costs of the economy. I believe, therefore, that monetary authorities will need to act as a catalyst in persuading financial institutions to **improve and widen financial services and create new financial instruments** to help these developments. The authorities, as they **promote development of capital markets** will of course need to **expand the coverage of their supervision** to ensure the soundness of all financial institutions so that there is consistent support for the privatization movement and the increasing demand for capital to expand the private sector.

These functions may appear to fall beyond the traditional role of central banks and monetary authorities. However, this is not a new concept. Indeed as far back as 1921 Mr. Montagu Norman, the Governor of the Bank of England, included in his definition of the general principles of central banking the need to assist banks in the development of their country's business and economic resources. The seventh of these principles said, "A central bank should be the banker of all other banks in its own country and should assist them to develop its business and economic resources".

This developmental role of a monetary authority can be as important as its monetary and regulatory roles. By adopting a coherent strategy of widening and deepening financial markets, and encouraging savings mobilization with more flexible maturity profiles and better choices for savers and investors, a more supportive market can be established.

Monetary authorities in both developing and developed countries have been performing this role in various ways, whether or not such objectives were explicitly stated in their statutes. It is, after all, a logical extension of the goal of

monetary stabilization in the long run. Maintaining the long-term growth of the monetary and credit aggregates commensurate with economy's long-term growth potential means using monetary policy to implement basic national economic goals. These goals are not attainable without the unaided efforts of the private sector and the existence of an efficient transmission mechanism for monetary policy.

Monetary authorities in the GCC countries have shown awareness of their developmental role and are endeavoring to develop their financial markets. Most of these authorities have introduced new financial instruments such as public debt instruments, comprising both treasury bills and bonds, in addition to promoting the establishment of mutual funds and other financial instruments.

However, a careful and sensitive approach to the working of the market is essential if the monetary authority is to take initiatives without producing perverse reactions, and deal efficiently with disturbances that arise from time to time in these markets. This sensitivity can be developed only through experience and must be supported by a steady flow of information and coordination with regional monetary authorities and relevant international organizations. The resulting experience of a monetary authority in markets, along with competence economic analysis, will enable it to participate in the formulation of overall economic policy.

Cooperation among monetary authorities and coordination of their regulatory and monetary policies can indirectly, also have beneficial developmental effects. Since the advent of the international debt crisis in 1982, monetary authorities in the industrial countries have embarked on the momentous task of setting international standards for sound banking and financial institutions. The resulting Basle Committee recommendations

prompted widespread financial reforms in various countries and profound institutional changes took place in international financial markets.

In this context, the GCC monetary authorities have intensified efforts to develop existing institutional structures and enhance supervisory procedures, rules and regulations, in order to adapt to international standards and future directions. These concerted efforts include implementation of relevant international accounting standards and Basle Committee recommendations concerning capital convergence, capital adequacy, and credit concentrations.

To illustrate the outcome of these concerted efforts, in Kuwait for example, banks have become subject, since the liberation of the State of Kuwait from the brutal Iraqi occupation, to more demanding standards in three key areas, which are:

**First: Disclosure of Financial Information:**

All Kuwaiti banks, as of the 31st of December 1991, must produce the financial information in their annual reports in accordance with the International Accounting Standards, aiding the investor in making a better judgment on the financial position of Kuwaiti banks in comparison to their international competitors. We believe that following the steps that have been taken, our banks are now able to stand on their own and should be judged accordingly.

**Second: Capital Adequacy:**

All Kuwaiti banks, as of December 1992, have to comply with the Basle Capital Accord and maintain a minimum risk assets ratio of 8%. This ratio is monitored quarterly by the Central

Bank of Kuwait and all local banks are currently maintaining a comfortable margin in excess of the required ratio.

**Finally: Credit Concentrations:**

Tighter credit concentration regulations were issued in November 1993. These regulations closely follow the guidelines set in 1991 by the Basle Committee. Credit facilities to a single borrower may no longer exceed 10% of capital in its broad definition of the lending bank regardless of any securities presented by the borrower.

The Central Bank of Kuwait continues to refine its approach to other supervisory matters, paying close attention to recommendations by the Basle Committee, and working closely with the other GCC central banks and monetary authorities in this regard. These changes take time to introduce but the resolve exists to bring our financial system fully in line with the standards set internationally.

The cooperation among monetary authorities in the GCC forms part of our efforts to create the Gulf common market. The emergence of the GCC as a regional trade bloc is a natural progression in view of the international trend towards forming regional economic blocs that facilitate free movement of goods, capital, and labor. This trend towards building regional blocs is driven as much by pure economic motives as by other political considerations. The most compelling of these motives is to capitalize on the resulting economies of scale, so as to shake off rigidities impeding structural adjustment and market reform. We also seek to ensure that we are in a position to make a proper contribution to international economic affairs and, therefore, be able to defend the interests of the region more effectively.

The free trade areas and agreements that are appearing around the world are, to a certain extent, a manifestation of global economic cooperation. Regional free trade agreements are in some ways a short cut to liberalization of the global economy.

I think that these agreements have been formulated regardless of the delay in concluding the Uruguay Round of the General Agreement on Tariffs and Trade. Although this delay could have been a precipitating factor, other reasons, over and above the motives that I have mentioned earlier, such as the world economic slowdown, the emergence of the unified Europe, and the breakdown of the former USSR, have been equally important in our desire to develop our own region.

In our view, regionalism is not a synonym for protectionism or isolationism, but rather a faster approach and a better route to global economic cooperation. We see it as leading to the integration of international trade, and not as a pretext for implementing protective policies.

The Gulf common market, as defined in the Unified Economic Agreement, has made headway toward regional cooperation, but more work remains to be done to bridge the currency and customs gap. Progress is underway, albeit somewhat slowly, but it is hoped that the Gulf common market, with more than 23 million consumers and strong purchasing power, will be established soon.

The recent successful conclusion of the extended Uruguay Round of trade negotiations between the members of GATT (including Kuwait from this region), which should be ratified by members during 1994 and implemented as of next year, is not only a victory in the struggle for advancing global trade

liberalization, but also a spur for us to complete our regional arrangements.

Despite general contentment with the GATT rules, we expect that their implementation will be fraught with difficulties in the short term. This is especially so in developing countries, where a gradual approach will be essential to ensure a smooth introduction. For example, in our case, opening up financial sectors abruptly to foreign competition can have catastrophic effects on domestic financial institutions. We are therefore, looking at the impact of limited foreign participation in existing financial institutions in the first instance, but this should not be seen as protectionism but simply a different way of reaching the same objective.

The GCC countries have always had open trading systems: the trade tariffs that are applied are effectively among the lowest in the world. Unfortunately, the policies of some of our trading partners tend to discourage our exports of crude oil, refined products and petrochemicals, by imposing unjustifiably high taxes that restrict demand for these exports in their countries. This in turn reflects negatively on our economies since these exports are our main source of national income. For example, one needs to look no further than the proposed carbon tax in the EC and the energy tax in the USA. It is our view that these taxes contradict the spirit, if not the letter, of the GATT agreement. Such taxes will unnecessarily increase the prices of fuel for the consumers and in effect form a barrier that will limit access for our oil exports to those markets by imposing discriminatory taxes under the pretext of environmental protection. I reiterate the objection of the GCC to these taxes, which will have clearly adverse effects on both oil producers and consumers.

We live in changing times, and we in the Gulf must learn to

come to terms with the new environment in which we operate. Change is not made easy in any part of the world, and its management is crucial to its acceptance. Over the past 25 years, we in the Gulf have experienced as much change as any other region and it is a tribute to the resilience of our people and their leaders that stability is maintained in the region. We know there are changes ahead, some of them significant, but our past experience will help us to face these as successfully as we have dealt with challenges in the past. I have an optimistic view of the GCC's future and recommend it to you today.

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