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The EU and the GCC. A new Partnership

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The Mediterranean Programme, The Robert Schuman Centre for Advanced Studies, European University Institute, Florence

The EU and the GCC. A new Partnership

Gulf Strategy Paper presented by the

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February 2005

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Printed in Gütersloh, Updated Version, February 2005

The EU and the GCC – an Update

In 2001-2 the Bertelsmann Stiftung, in cooperation with its academic partner, the Center for Applied Policy Research, and the Robert Schuman Centre for Advanced Studies at the European University Institute, animated a working group aiming a proposing a new approach in EU (European Union) - GCC (States of the Gulf Cooperation Council) relations. The working group issued a Policy Paper entitled “The EU and the GCC. A New Partnership”, which was received with considerable interest among scholars and policy makers in both regional groups.

While the main thrust of that paper remains, in our opinion, valid and relevant, undoubtedly the past two and a half years have been very eventful. Rather than redrafting the original paper to take into account the developments since, we have opted in favour of leaving the original text unchanged - adding just a few notes to update a very few factual references - and drafting an update paper to discuss the latest developments.

Executive Summary

In 2001-2, a working group on EU-GCC relations was convened and issued a Policy Paper entitled “The EU and the GCC. A New Partnership”. This update revisits that paper in the light of intervening developments.

We review the consequences of regime change in Iraq and stress that, far from marginalizing the other oil producing states of the Gulf, it further increased their strategic role and value. The process of democratisation and reconstruction of Iraq is a main issue for cooperation between the EU (European Union) and the GCC (States of the Gulf Cooperation Council) in the coming years.

We then review the GCC countries’ progress in the direction of constitutional reform and increased political participation, and note that much more positive developments have been recorded in the GCC countries than in the Mediterranean Arab countries.

With respect to the economy, GCC countries are experiencing a period of rapid growth. The increase in the price of crude oil is a component and one of the drivers of this boom, but it is not the only driver. The process of industrialisation is speeding up significantly, led by a wave of major projects in petrochemicals and other energy-intensive industries such as aluminium smelting and transformation of minerals.

It is with respect to the strength and capabilities of the national bourgeoisie that the main difference between the Gulf and the rest of the Arab countries can be found. The Gulf bourgeoisie has become an autonomous actor, which is in many ways as important as the state in determining the short-term behaviour of the economy.

EU policy towards the GCC needs to be viewed in the context of other EU regional policies and initiatives: the Barcelona Process, the new Neighbourhood Policy, and the US sponsored Broader Middle East and North Africa Initiative.

Following the entry into force of the GCC Customs Union at the beginning of 2003, the main formal obstacle to the conclusion of a free trade agreement between the two groupings has been removed. Concluding this agreement is urgent.

But the EU-GCC relationship is different, and an original formula should be devised to make it fruitful. We propose the following areas for dialogue, and advance specific proposals in each of them:

- Political and security dialogue
- Good governance and human rights
- Human resources and education
- Trade and investment
- Oil and gas
- Financial markets

In comparison with other parts of the world the GCC remains a region of neglect on the part of the Commission. This lack of attention is a strategic mistake that should be remedied soonest.

A major change of tack is required. Substantially greater human resources within the Commission should be devoted to relations with the GCC: a new and imaginative cooperation proposal should be elaborated and put forward that goes much beyond the free trade area.

Cooperation with the GCC is not only required – it is likely to be successful and rewarding, and have potentially positive spill over effects on Mediterranean partners: indeed, it is a prerequisite for successful EU action towards the Eastern Mediterranean and Iraq.

The EU should move quickly, following the historic decision to open negotiations for the accession of Turkey, to integrate the GCC and Iraq in the European neighbourhood Policy (ENP).

While certain aspects of social and cultural norms in some of the GCC member countries are difficult to understand - and even more so to accept -, it is important to recognise that a crucially important phase in the internal political debate has opened in these countries. It is imperative that the conservative and extremist forces are defeated, and Europe can and should play an important role to this effect.

The war in Iraq

By far the most important development impacting on the region since the writing of the original policy paper has been the war and regime change in Iraq. The war and the aftermath of it have profoundly divided the European Union as well as the Gulf Cooperation Council. In both camps, some of the member countries have opposed war, fearing negative consequences on the stability of the region and containment of extremist tendencies; while other have sided with the United States in pursuing regime change in Iraq. These divisions also had the consequence of evidencing the interest in both camps for cooperation between like-minded countries, leading to an intensification of bilateral relations in the context of new alignments.

Notwithstanding such traumatic divisions, all EU and GCC member countries concur that the outcome of the process of building a new democratic, peaceful and stable Iraq is supremely important for both sides.

In 2004, the Bertelsmann Foundation, in cooperation with its academic partner, the Centre for Contemporary Politics Research, and the Robert Schuman Centre of Advanced Studies at the European University Institute, animated the second of two working groups on Iraq. A report was issued under the title "The European Union and Iraq: Present Dilemmas and Recommendations for Future Action". The report stressed that:

“the transition process in Iraq is of crucial importance to the European Union (EU) because of Iraq’s size, its vast oil reserves, its regional importance and its geographic location on the south eastern border of accession candidate Turkey.”

“EU member countries share the following key interests in Iraq:

- Ensuring a stable political process.
- Supporting the reconstruction process.
- Securing the supply of oil at reasonable prices.
- Fostering long-term stability in the Gulf region.

Despite the intra-European disagreements of the past, it is not difficult to see that there exists a very large degree of convergence on the fundamental principles that the EU wishes to uphold for the future of Iraq:

- Iraq’s unity must be preserved.
- Iraq must be governed democratically.
- The system of government in Iraq must be geographically decentralised.
- Iraq must be at peace with all its neighbours.”

In the pursuit of such key EU interests, it is clear that all neighbouring countries, including all GCC countries, have a crucially important role to play. In this respect the report noted: “A third, and possibly most important, field for EU engagement is the regional environment where various EU policies are already in place. (...) The cooperation of Iraq’s neighbours is crucial to any effort to stabilize the situation in the country. Iraq is in many ways dependent on its neighbours, most importantly because of its narrow access to the sea, the vulnerability of its overland oil pipelines and its dependence on the uninterrupted flow of the Tigris and the Euphrates. It has a legacy

of unsettled disputes with most of its neighbours, most notably Iran and has started two wars of aggression in barely a decade (Iran 1980 and Kuwait 1990). The EU should establish an intensive dialogue on the future of Iraq with Iran, Turkey, Syria, Jordan and the Gulf Cooperation Council (GCC) countries. This would include issues such as non-interference in Iraq's domestic affairs and the appropriate policing of borders, as well as commercial and economic cooperation.

In contrast to the US, the EU is uniquely positioned to engage all regional actors:

- Turkey is a candidate for EU membership and a date for the start of accession negotiations will be offered soon.¹
- With Iran, the EU has engaged in the so-called 'comprehensive dialogue' and recently started negotiations on a free trade and cooperation agreement to establish a stable platform for dialogue and cooperation.
- Syria, Lebanon and Jordan are partner countries in the Euro-Mediterranean Partnership (the Barcelona process), which is currently undergoing a process of reformulation in the light of the 'Wider Europe' concept.
- The EU has had a cooperation agreement with the Gulf Cooperation Council (GCC) countries since 1988 and negotiations on a substantially upgraded free trade agreement are close to completion."

It is evident that the war and regime change in Iraq, far from marginalizing the other oil producing states of the Gulf, further increased their strategic role and value. It is hardly possible to conceive of a stabilisation of domestic politics and emergence of an accepted democratic order in Iraq without the participation and active engagement of the GCC member countries, notably Kuwait and Saudi Arabia. In the longer run, it is hardly possible to conceive of a prosperous Iraq without the active engagement of investors from the region, and primarily from the GCC; or without a framework for regional economic cooperation and free trade. The issue of eventual Iraqi accession to the GCC is already on the table and is indeed unavoidable. The process of democratisation and reconstruction of Iraq is therefore a main issue for cooperation between the EU and the GCC in the coming years.

¹ This was in fact decided on December 17, 2004

Political reform in the GCC countries

In the aftermath of the 9/11 terrorist attacks, the statement has often been repeated – primarily but not exclusively by the US Administration – that the root cause of extremism and terrorism is the lack of democratic government in the region. Accordingly, the United States have declared that they intend to forcefully promote the democratisation of the region, even at the risk of an increased level of instability – and indeed to some extent seeking a higher level of instability. Although cloaked in the necessity to strip Iraq of its alleged WMD programme, the war and regime change in Iraq was meant to be a first step in this direction, eliminating one of the most repressive regimes and paving the way to the establishment of a model democracy.

Partly in response to such heightened outside pressure, but also in order to come to grips with the issue of Islamic political extremism, which is now directly challenging the incumbent regimes in the GCC (primarily, but not exclusively in Saudi-Arabia), significant steps have been taken in the GCC countries in the direction of constitutional reform and increased political participation. Indeed, much more positive developments have been recorded in the GCC countries than in the Mediterranean Arab countries: the regime remains strongly authoritarian in Syria, Egypt, Libya and Tunisia; while, if anything, a movement in the wrong direction can be detected in Lebanon and Jordan.

Bahrain

In Bahrain, following the accession to power of Sheikh Hamad bin Isa al-Khalifa, upon the death of his father, a process of political liberalisation was set in motion. In December 2000 Sheikh Hamad assumed the title of King and sponsored a constitutional National Action Charter establishing an elected Council of Deputies and an appointed Shura Council. The Charter was approved by referendum in 2001. Municipal elections took place in May 2002 and saw a clear victory of conservative Shi'a forces. However, the Shi'a later boycotted the elections to the House of Deputies, held in October 2002, which then saw the victory of the Sunni conservative forces. The four main opposition parties boycotting the election objected to the fact that the elected Council of Deputies would have the same powers as the appointed Shura Council. They have since pressed their claim for constitutional reform, including by way of collecting signatures. The government moved against these methods but has initiated discussions in 2004 to reach a compromise on constitutional changes.

The difficulty is that the elected Council of Deputies is dominated by conservative Islamic forces, which are requesting the enforcement of more stringent rules with respect to social norms and dress code than those presently adopted in relatively liberal Bahrain. The equality of powers of the Shura Council has been the tool to prevent conservative Islamists from imposing their views.

Other sources of tension have been the international situation, with popular demonstrations, protesting against the US attack on Najaf in Iraq, being broken up violently by the police, thus forcing the King to sack his Interior Minister. The King then delegated the Crown Prince to launch national dialogues "to achieve political and economic development." This is an attempt to encourage greater corporatist

representation (the King said: “to maintain the participation of various national sectors of traders, workers, university graduates, writers and civil society establishments and getting citizens involved in deep dialogues over the future”).

A very controversial draft law on political associations was introduced, which imposes strict jail sentences of up to life imprisonment on those who violate it. Opposition groups are demanding the legalisation of political parties, but a majority of the members of the Legislative and Legal Affairs Committee of the Parliament voted against a proposed bill in this sense "because it favoured a gradual practice of politics" in the kingdom.

In September 2004, the head of the Bahrain Centre for Human Rights, Abdul Hadi Al Khawaja (a Shi'a) was arrested for calling for the resignation of Prime Minister Shaikh Khalifa Bin Salman Al Khalifa, whom he blamed for the country's economic woes. The Centre was also closed down. Demonstrations in support of Al Khawaja have been violently suppressed

In short, the transition to greater democracy in Bahrain is far from being a smooth process: however “the genie is out of the bottle” and it would be difficult to imagine a complete cessation of the experiment.

Kuwait

Kuwait is the country that has had a functioning parliament for the longest time in the GCC. It epitomises the difficulty and contradictions of introducing democratic representation in a traditional rentier state: the government continues to be appointed by the Amir and is dominated by members of the ruling al Sabah family: it does not represent at all the composition of the Parliament, which has always been primarily influenced by conservative Islamists, leading to political stalemate on several key policy issues.

The last elections were held in Kuwait in July 2003, further deepening the divide between the reform-orientated government and the conservative Parliament. On key issues, such as the opening to international oil companies for investment in oil exploration and production; the granting of political rights to women; or the role of the shariah in shaping legislation, the political stalemate continues.

The future of democracy in Kuwait thus appears to be closely linked to the role of the ruling family and its ability to provide political leadership. There is an unresolved succession problem, with both the amir and its crown prince being old and in bad health. The current government for the first time in many years is not led by the crown prince: however the Prime Minister, Sheikh Sabah al-Ahmad al Sabah, will need to display the characteristics of a political leader and “win” the next parliamentary elections, if the stalemate is to be overcome. That the Parliament might prevail, and the ruling family be restricted to a role closer to that of a constitutional monarch, appears at present less likely. In any case, the political debate is lively and open in the country, and calls for more effective democracy may be expected to continue.

Saudi Arabia

Although a limited electoral experiment is expected to take place in Saudi Arabia only in February of 2005 (elections of half of the members of some municipal councils, with exclusion of women from the electorate; at the time of writing, the pace of voter registration demonstrated widespread indifference), the political debate in the country has been increasingly lively since the turn of the century.

The establishment of a Majlis ash-Shura in 1992 has led to the progressive opening of the political sphere, and issues that previously were completely taboo are now publicly discussed.

The debate has been sparked by the budgetary difficulties experienced in the late 1990s (now overcome) and the growing unemployment; by the rapid spread of the internet, satellite TV and foreign-based news channels in Arabic; by the eruption of terrorism at home, which caused very considerable dispute and soul searching; and finally by international circumstances and pressure from the United States.

The regime has attempted to organise the debate by launching a series of National Dialogues (four have been held so far) which have brought to the surface the very significant fault lines which divide Saudi society on issues related to the role of religion, the role of women, the adequacy of education and the numerous idiosyncrasies which characterise the country.

Notwithstanding the jailing of some reformers and the public controversies surrounding court proceedings on their case, the door to political reform remains open. The regime may be expected to move very cautiously - not just because this is the political tradition in the country, but also because it is widely believed that if elections were held they would see the success of conservative and tribal forces. This, as in Bahrain and Kuwait, creates an important contradiction for the liberals who are the main proponents of constitutionalism and democratisation.

In Saudi Arabia, we should expect that political participation will increase and shall be accommodated through a variety of corporatist tools, but formal representative democracy will be implemented only very slowly, if at all. Nevertheless, the current situation represents a complete change from five years ago, and the political debate in Saudi Arabia is possibly the liveliest in the region.

Qatar

The Amir of Qatar frequently speaks out in public in favour of political reform, but actual opening of the political space in Qatar has not been as advanced as in Bahrain or, indeed, in Saudi Arabia. The Amir called for elections to a Central Municipal Council, which were held in 1999. Women were allowed to vote and stand for election but none was elected. Participation in the elections was limited (there were 22,250 registered voters).

Subsequently, a new constitution was approved by referendum in April 2003, and promulgated by the Amir in June 2004, but it will not enter into force until next year. The constitution confirms the powers of the Amir, including the power to appoint 15 out of 45 members of the Majlis ash-Shoura (the rest is to be elected). A majority of two thirds will be requested for the Majlis to approve laws (hence the Amir through his appointed members has a practical veto power...).

The process of democratisation in Qatar must be viewed in the context of the small size of the country's national population, and the even smaller size of the registered electorate. The democratisation process has been so far very much initiated and controlled from the above, but it is there nevertheless.

Oman

Oman has had a consultative council (Majlis ash-Shura) since 1991. Members were initially selected through a two-tier process in which qualified electors in a limited suffrage system elected candidates, and the Sultan then appointed some of these to the Majlis. Progressively, the active electorate has been expanded, and the Sultan has automatically appointed candidates receiving the most votes. The last elections for the Majlis Ash-Shura, held in October 2003, were the first with universal suffrage (including women) and direct election. Nevertheless, the Majlis remains a purely consultative body.

The United Arab Emirates

The potential for a limited opening of the political space, along the lines experimented by its neighbours, is more limited in the UAE for two essential reasons:

- Firstly, the country is a loose federation of emirates, whose key constitutional body is composed of the amirs of the constituent states, and democratisation would have to proceed in parallel at the federal and individual state level; however this is made difficult by the extreme diversity of the states, with Abu Dhabi being by far the most important contributor to the federal budget
- Secondly, the proportion of nationals in the total resident population in the two most important emirates (Abu Dhabi and Dubai) is very low, and elections may seriously complicate the management of relations with the most important groups of foreign residents – some of which have resided in the country for generations, and play an important economic role; practically speaking, informal mechanisms of consultation and representation, which allow foreign residents to have some voice, are likely to continue to prevail.

That said, it should be noted that the system successfully managed the transition in Abu Dhabi and at the federal level upon the death in 2004 of Sheikh Zayed, the founding figure of the federation.

Economic reform and economic growth in the GCC

The economies of the GCC are experiencing a period of rapid growth. The increase in the price of crude oil is a component and one of the drivers of this boom, but it is not the only driver: in fact the picture is much more promising than it would be if this was just another oil-driven flare-up.

A new oil price paradigm

The past 12 months have had a major surprise in store for the member countries of the Gulf Cooperation Council and Iran: while all analysts expected that oil prices would decline because of growing competition from non-OPEC producers, prices have actually climbed – at the time of writing the gain is 60% relative to the beginning of the year. This simple fact is bound to profoundly affect political developments in the region as well as the attitude of outside actors.

The fact that expectations have been proven wrong is especially important, and has profound psychological impact. Until well into the first quarter of 2004 the unanimously held point of view was that OPEC would need to reduce production in order to prevent serious weakness in prices. OPEC did decide to reduce production, although cuts were in fact then never implemented. But - contrary to the expectations and declarations of experts, companies and governments alike - market prices moved higher and higher.

The cause of the surprise is on the one hand an increase in demand much more important than expected, especially in the US and China; and, on the other hand, the realization that, although additional reserves might be physically available in several non-OPEC countries, actually bringing additional supplies to the market is a slow and sometimes difficult process.

Progressively, analysts have proposed the notion that the continuing hike in prices is not a short-term phenomenon, but rather a “paradigm change”. Although the consensus vision remains that prices are bound to decline from the levels they have reached in 2004, nevertheless it is now commonly accepted that they will not return to within the target band of \$22-28, which is still the official policy of OPEC.

This contrasts sharply with the previous consensus view, according to which prices were expected to hedge downwards in the second half of the decade, forcing OPEC to surrender some of their market share. The downward pressure on prices was expected to come from non-OPEC production as well as from increased production in Iraq – forcing OPEC to redistribute quotas. The combination of weaker prices and possibly reduced quotas was expected to put pressure on the financial equilibrium of some OPEC countries, notably the GCC member countries – and possibly create tension across the Gulf, as Iran would not have been willing to reduce production to accommodate Iraq.

In fact, throughout 2004 the governments of the industrial countries, including the US, as well as international organizations such as the IMF and the World Bank, have been calling on the GCC countries to increase their production and urgently invest in increasing their capacity in order to contain the rise in prices.

Consequently, the GCC member countries find themselves in a new strategic environment, in which their domestic fiscal sustainability is essentially assured (although they are not all in the same position: Bahrain in particular may face some problems, and Oman as well) and prospects for the future are reassuring. It is now almost universally expected that the recovery of Iraqi production will be slow, even in the optimistic scenario that sees the country making rapid progress towards political stabilization and the establishment of a legitimate, democratically elected government. Thus the danger of a squabble on oil quotas again spoiling relations between Saudi Arabia and Iran has faded, and the idea that Saudi Arabia might be marginalized as a global supplier of oil, thanks to increased production in Russia and Iraq, has pretty well disappeared from the screen.

It is important to note that the GCC governments are for the time being not reacting to the increase in oil revenue with an increase in current expenditure. They are, on the other hand, adopting very conservative fiscal policies, essentially setting aside much of the additional revenue to pay outstanding debt or accumulate reserves - in some cases, including in Iran, in formally constituted reserve funds. This means that the additional oil revenue is not presently being pumped into the local economies, and is not the primary cause of the higher rate of growth. For sure, the higher oil revenue has an important psychological impact, and contributes to creating a climate of confidence in the future, and encouraging private investment. But beyond this psychological impact we see very little in the way of expansionary policies, although some new investment projects have been announced. The increased liquidity, which is fuelling the economic and financial boom, is essentially private, and has to do with the reduced desire to hold balances abroad.

The new industrialisation wave

The process of industrialisation is speeding up significantly in the GCC, led by a wave of major projects in petrochemicals and other energy-intensive industries such as aluminium smelting and transformation of minerals.

The main driver of this industrial boom is the increased availability of natural gas. In Qatar, the pace of exploiting the huge North Field has significantly quickened, and the country is simultaneously pursuing major projects in the export of gas as LNG, in its transformation into other liquid fuels (GTL) and into petrochemicals. In Saudi Arabia, after a long and difficult gestation four major concessions for the exploration and production of natural gas were granted to Shell/Total, Eni/Repsol, Lukoil and Sinopec. In addition, Saudi Aramco has itself reaped the benefit of the considerable increase in investment in gas, and is now able to guarantee the required supplies to all industrial projects in the waiting line. This is creating a wave of investment in which SABIC is no longer the sole protagonist, but numerous other independent private Saudi companies are also involved.

The GCC states and Iran will thus become the world's largest producer and exporter of petrochemicals and plastics by the year 2005. Cumulative total investments in GCC petrochemical industries stood at \$37bn at the end of 2002. Further investments totalling more than \$40bn were expected by 2010. Annual exports of all

petrochemical products from the GCC have already crossed the 30mn t/y mark. This will increase to 40mn t/y by the end of 2005.²

For aluminium, GCC production capacity is expected to increase from 1.198 million tons currently to 2.8 million tons by the end of the decade, with new projects being launched in Qatar, Bahrain, Dubai and Oman.

Petrochemicals and aluminium are just two major export-orientated industries: they are especially worth mentioning because of the protectionist attitude taken by the EU, but they are not isolated cases. After two decades of gestation and mixed results, the process of industrialisation and economic diversification now appears to have substantially accelerated in practically all GCC countries

Economic reforms and the boom of financial markets

In parallel, economic reform is also progressing, more slowly than some people may have expected or wished - but is progressing nevertheless. The cumulative impact of reforms in the past four or five years, together with the expectation that more is in the making, and the feeling of strength that is given by high oil prices, contributes to sustained growth in the private sector. The Saudi stock market index increased 88% in 2004, after increasing 76% in 2003. This is a sign of abundant liquidity chasing a limited supply of assets, and opens the door to the possibility of further privatisation and/or reorganization of private sector ownership patterns. The wealth effect of the stock market increase in the first 11 months of 2004 was alone equivalent to some \$140 billion.

Real growth has not yet sufficiently picked up to materially contribute to reabsorb the unemployment problem, which remains a serious concern and a potential source of instability. Further reform progress is required in order to fully mobilize the potential of the Saudi private sector and achieve real growth rates of the order of 6-7%, but this objective is not impossible to reach.

Elsewhere in the Gulf, the economy is also doing well. The relentless Dubai boom continues apparently unabated, and has a pulling effect on the neighbouring Emirates; the combination of increased oil revenue in Abu Dhabi and the continuing growth machine of Dubai has created a unique equilibrium and “division of labour”, which

² Some of the major projects in the pipeline are as follows:

- In addition to SABIC expansions, Saudi Aramco and Japan's Sumitomo are planning a 1.2mn t/y ethylene cracker and downstream units for completion in 2009.
- The National Petrochemical Industrialization Company and Saudi International Petrochemical Company are planning two crackers of 1mn t/y each in the kingdom.
- The privately-owned Saudi firm, Project Management and Development, is planning a 1.3mn t/y cracker complex and amines plant to produce 3mn t/y by 2010.
- Kuwait's Equate joint venture with Dow expects to have a second ethylene cracker on-stream by the end of 2007.
- Qatar is building two crackers, with capacities of 1.3mn t/y and 1.4mn t/y, due on-stream by 2009 and 2011.
- In the UAE, Borealis and ADNOC are planning a 1.2mn t/y cracker to come on-stream in 2009.
- In Oman, Dow and the Omani government have announced plans to build and operate a world-scale petrochemicals complex.

Downstream of these new crackers, petrochemical producers and their joint-venture partners in the GCC will bring on-stream an additional 10.4mn t/y of polyethylene between now and 2010.

translates into continuing positive results. The UAE stock market rose by 24.2 % in 2003, and 95 percent in 2004. The SHUAA Capital Index for the whole of the GCC rose by 62% in 2004.

As mentioned above, the increase in liquidity that is fuelling the economic and financial boom is primarily connected to the desire to rely relatively less on placements abroad for the private sector's balances. While it would be a gross exaggeration to say that Gulf financial investment in the US has been massively reduced following the 9/11 terrorist attacks, it can hardly be disputed that the appetite for US assets has decreased, and the wish to invest within the GCC has increased.

According to Abdul Rahman Al-Jeraisy, chairman of the Council of Saudi Chambers of Commerce and Industry, "Saudi investments abroad are estimated at between \$800 billion and \$1 trillion and most of these funds are concentrated in the United States and Europe". It is easy to see how just simply repatriating the revenue from such huge accumulated holdings might suffice to create a boom in the Saudi economy. "Many Saudis have invested in stocks and real estate as they are the easiest markets," Jeraisy said. "The decision taken by a number of Saudi businessmen to invest their money in the Kingdom has made Saudi Arabia one of the countries with highest liquidity".

When we add the parallel holdings of the private sector from other GCC countries, we come to an estimate exceeding \$ 1.5 trillion. The desire among GCC businessmen to invest more in the GCC itself is evident. In fact the Saudi private sector complains that the slow pace of economic reform is pushing Saudis to invest in Dubai: businessman Abdul Mohsen Al-Hokair, chairman of Al-Hokair Group, said in a recent press statement that more than 2,500 Saudi companies had chosen to establish investment projects in Dubai rather than Saudi Arabia during the past three years. He blamed bureaucracy, complex regulations and slow decision-making process for the massive exodus of capital.

The new Arab bourgeoisie

It is with respect to the strength and capabilities of the national bourgeoisie that the main difference between the Gulf and the rest of the Arab countries can be found: in the Gulf, a major transformation has been taking place over the past thirty years. In the beginning, the state was all-powerful: it controlled all the oil rent, and there was not much outside of that worth controlling. The private sector was not really capable of any independent action or decision-making. Through the process of rent circulation, however, over the years the situation has been reversed. The state today is still very powerful, because it continues to enjoy fundamental, and in most cases total, fiscal autonomy; undoubtedly, though, the private sector in Saudi Arabia and other Gulf countries has become even stronger than the state. Today, the Gulf bourgeoisie is no longer dependent on the state, and has become an autonomous actor, which is in many ways as important as the state in determining the short-term behaviour of the economy.

In the Gulf the respective roles of the state and private sector are undergoing a process of redefinition. The private sector, not the state, must be the primary engine of growth, and economic reform must continue notwithstanding increased oil revenues in order to empower the private sector to perform this role.

In parallel with the redefinition of the boundary between the public and private sectors, we witness a period of greater fluidity in the political institutions of the Gulf than in the rest of the Arab countries. Political openings still are very timid and extremely cautious, but they exist. In contrast, in Mediterranean partner countries we witness political stagnation at best, if not a reinforcement of authoritarian practices.

This consideration is important because if Europe wishes to promote political change via economic liberalisation, we must have a strategy targeting the bourgeoisie. If we were to draw a map of the Arab bourgeoisie which takes into account the number, financial and managerial capabilities, and integration in the globalisation process of the Arab entrepreneurs, we would come to the conclusion that the bulk of this social force is located in the Gulf. It is only by engaging the Gulf bourgeoisie in the process of economic liberalisation of the Mediterranean Arab countries that we can create a more competitive and dynamic environment in the latter.

Mobilising the Gulf entrepreneurs (one hesitates to use 'bourgeoisie' here because many call themselves princes...) poses some difficult problems in terms of defining political strategies and political loyalties. It requires accepting the Arab region as a whole as Europe's neighbour, rather than just a subsection of it; and accepting the conclusion that, while pan-Arabism may be disqualified and dead in its original form, a process of economic integration encompassing all Arab countries remains a necessary objective.

The new prominence of the Gulf Arab private sector will affect the character of intra-Arab relations. If the private sector, the Arab business elite, is to be expected to be the main driver of both economic development and democratisation, then it must be kept in mind that the Arab private sector and business community is, in fact, primarily Gulf Arab. It is so either by nationality, because the business leaders hold the passport of one of the Gulf countries, or by "residence", because many of the Jordanian, Syrian, Lebanese, Egyptian business people have made their fortune in the Gulf.

This is not the only aspect in which the Gulf is becoming hegemonic in the Arab context, but certainly it is one of the most striking aspects. The Gulf has a long way to go before it becomes hegemonic in science or culture. But in business, its dominant role cannot be questioned. And, to the extent that an entrepreneurial business sector is the key to development, the Gulf will increasingly be the economic leader in the Arab context. Finally, if the growing role of the private sector will indeed translate into increased participation and some democratisation, the gap in business culture may translate, at some point, into a gap in political development.

The United States and the European Union drive to promote democracy through the use of economic tools (trade liberalisation, openness to international investment, better investment climate through greater transparency and governance) will pose a threat to all regimes in the region, and will force them to adapt to new conditions. It is not certain that they will be able to adapt and, therefore, crises are possible. What is interesting to note, nevertheless, is that different regimes come to this critical juncture in widely different postures.

The patrimonial monarchies of the Gulf maintain the substantial advantage of their continuing access to the oil rent. They will still need to introduce taxes, primarily in order to target the oil rent (which is in the nature of the liquidation of a wasting asset) to investment rather than to current expenditure. Still, the oil rent will continue to be there, allowing for crucially important flexibility in the conduct of public finances.

Even if all of the oil rent comes to be exclusively targeted to investment, the private sector and the population at large will continue to benefit from it. Part of the drive to reduce current expenditure will translate into privatisation and other policies aimed at transferring some of the tasks currently carried out by the government to the private sector. The private sector is strong and keen to invest at home, meaning that all conditions for the success of such policies exist.

The same is not true for the non-oil countries in the region. Their authoritarian governments enjoy no fiscal flexibility at all, and will be forced to progressively surrender their residual instruments of control over the economy. The tools of repression will remain the only ones left in their hands, subjected to constant criticism from the US and Europe. They can attempt to speed up reform – i.e. increasingly rely on private and international investment - but their domestic private sectors are weak and frequently antagonised: they have neither the tools nor the will to be the protagonists of the next phase in their countries' political and economic development. Hence, implementing economic reforms inevitably means surrendering the control on the national economy to foreign investors: either multinational corporations or Arab investors from the Gulf countries. Will the latter alternative be preferred to the former?

Consider Iraq. In theory, Iraq has the potential to be a leader in the region: it will enjoy a very significant oil rent, and it offers numerous investment opportunities. In due course it will recreate a strong private sector. But how long will all of this take? How long before capital accumulates in competent private Iraqi hands that they may be comparable to the business sector of the GCC states? Certainly not less than two decades. In the meantime, the opening up of Iraq will constitute a massive opportunity primarily for Gulf Arab investors: even multinational corporations are more likely to become involved through their Gulf Arab partners than directly, at least in the initial phase.

This will considerably increase the degree of freedom that the Gulf Arab private sector enjoys in pursuing its political agenda. Gulf Arab entrepreneurs will have plenty of opportunities for pursuing their political agenda regionally, in ways which might not be immediately acceptable at home. In this way, as well as simply pursuing the profit motive, the Gulf Arab private sector may be progressively become more Arab and less Gulf, i.e. become involved in Arab countries outside the Gulf, and transform itself into the leading constituency of regional integration based on private economic ties rather than nationalism – a phenomenon which might be called “Post-Pan-Arabism”.

The EU should shape its strategy towards the GCC, Iraq and the Mediterranean Arab countries in a coherent framework that aims at facilitating this process, rather than creating barriers to it.

The evolution of EU's policy towards the region: from the Barcelona process to the European Neighbourhood Policy, and the Broader Middle East and North Africa Initiative

The EU policy towards the GCC needs to be viewed in the context of other EU regional policies and initiatives. The Union has for decades had an evolving policy in place directed to the Mediterranean partner countries. More recently, the concept of Wider Europe and the Neighbourhood Policy has been inaugurated. At the same time, the United States have launched the concept of the Broader Middle East and North Africa Initiative, which was retained by the G8 Summit of Sea Island in June 2004. This section briefly reviews and discusses the mutual interrelationship between these different policy concepts, and how they impact on EU-GCC relations.

The Barcelona Process

Having reached its tenth anniversary, the Europe-Mediterranean Partnership is in the process of being profoundly reviewed. While the “ring” of association agreements has now been painstakingly completed, the perspective of establishing a Mediterranean free trade area hardly appears to be any closer. Some of the Mediterranean Partner countries continue in fact to run substantially closed economies, dominated by pervasive administrative controls and direct state intervention.

In other areas, the success of the EMP has been even more limited. The idea of establishing a Charter for Mediterranean security had to be abandoned in the face of continuing tensions and paralysis of the Middle East Peace process, and the promotion of democracy and human right has also hardly registered any significant success.

The very strategic concept of the Mediterranean partnership has been eroded. The idea that a significant degree of regional cooperation between the 12 partner countries could be established under the aegis of the EU has floundered. Of the 12 partner countries, two (Malta and Cyprus) have become members of the Union and a third one (Turkey, which alone accounts for a third of Mediterranean GDP or population) is embarking on accession negotiations.

The remaining countries are all Arab, except Israel: the Arabs have always viewed the Mediterranean framework as a ruse to force cooperation with Israel on them, and at the same time to consolidate divisions within the Arab region which they would like to see healed and overcome. True, there is a tendency among Arabs to attribute all ills to the presence and conduct of Israel, ignoring the conflicts, which frequently antagonise neighbouring Arab countries. In fact, one reason why it has proven so difficult to promote regional projects within the Mediterranean Partnership is also that relations between Arab neighbours continue to be difficult – notably in the Maghreb. That said, the fact remains that the attempt to promote greater regional integration has had very little success indeed, and one sees little prospect of an improvement in this respect.

Europe's Neighbourhood Policy

Faced with the unsatisfactory outcome of the EMP, the European Commission has launched the concept of Europe's Neighbourhood Policy (ENP), which encompasses the Mediterranean Partner Countries with the addition of Libya, and joins them with Europe's neighbours to the East, notably Belarus, the Ukraine, Moldova and the Caucasus. In fact, the original concept of the Neighbourhood originated from the latter, and was then extended to the Mediterranean.

The distinguishing characteristic of the ENP is that it no longer aims at stimulating regional cooperation, but puts the emphasis squarely on bilateral relations and on selective extension of the EU acquis to encourage economic and political transformation. It is thus an approach that recognises differences, rather than aiming at overcoming them, and graduates benefits as function of progress.

This approach fits very well the requirement of those Mediterranean countries that were especially uneasy with the regional integration component of Barcelona, notably Israel and Morocco. However, it offers very little to, and is likely to solicit no interest on the part of other countries, such as Syria or even Lebanon, not to speak of Libya.

With respect to Iraq and the GCC, the ENP simply has a blind spot. True, it would not have been possible for the Commission to prejudice the decision of the European Council regarding the opening of accession negotiations with Turkey: hence we still are in a situation in which technically we do not know for sure whether the neighbourhood will be Iran & Iraq, or Turkey (but we accept that Syria is a neighbour).³ True also, the Commission and Javier Solana have in other documents acknowledged the need for a strategy towards the countries "East of Jordan", which presumably includes the GCC. Nevertheless *rebus sic stantibus* the ENP has nothing to propose with respect to the Gulf, i.e. Iran, Iraq or the GCC.

In this respect, the ENP has the same fundamental defect that the EMP had before it, that is, it divides the Arabs and puts the various Arab countries in different baskets, rather than proposing an integrated approach to them. While this may not be a problem for Morocco - or indeed for the Maghreb as a whole, leaving for a moment aside the conflicts that further divide this sub-region - it definitely is a problem for Egypt and the rest of the Mashreq, and is in contradiction with the analysis of the new Arab bourgeoisie that we proposed above.

Including Iran, Iraq and the GCC countries in the ENP will allow pursuing a flexible strategy for the Arab region as a whole - which requires a more sophisticated combination of rewarding countries which proceed with reform, while maintaining a regional framework.

³ Although formally the end result of Turkey's accession negotiations remains unprejudiced, and theoretically we shall know if Turkey is member or neighbour only ten years from now, it should be expected that the Commission will in fact start considering Turkey as a member, and Iran, Iraq and the GCC as part of the neighbourhood. It is worth noting that the great weakness of the "privileged partnership" that some in Europe would wish to offer to Turkey in lieu of membership is exactly that it is hardly distinguishable from what is on offer to neighbours - at least theoretically.

The US Middle East Initiative and Broader Middle East and North Africa Initiative

In parallel, the United States have launched their own Middle East Initiative (MEI), and have later sponsored the so-called Broader Middle East and North Africa initiative (BMENA).

The MEI is a framework within which the United States propose to conduct their relations with the Arab countries, based on economic and political reform, and offering the establishment of bilateral free trade areas between the US and individual Arab countries, which would progressively come to form a US-Middle East free trade area. BMENA is an initiative sponsored by the US in the context of the G8, to which those European member countries that are also members of the G8 have adhered in principle (the Commission too participates in the G8, however what the status of the BMENA is in terms of Common European policy is not clear at this stage).

The US approach in many ways resembles the EU precedent (the MEI having perhaps more in common with the ENP, and BMENA more in common with the EMP, but it is a tenuous difference). It has the advantage of potentially applying to all Arab countries, and in this respect it is superior to the ENP, which is expected to apply to only some Arab countries. Participation in the BMENA remains vague, because of differences between the US, which would like to include Afghanistan and Pakistan (and of course shun Iran); and the EU, which is resisting such a broad definition. But there is no doubt that all Arab countries would be included. In fact, one of the first bilateral free trade agreements has been signed with Bahrain. At the same time, the MEI takes in no account regional efforts at integration. Thus, while the EU has for more than a decade postponed the negotiation of the EU-GCC free trade area originally envisaged by the 1988 cooperation agreement, with the justification (or the excuse?) that the GCC had not yet constituted a Customs Union; the US, by signing a separate free trade area with Bahrain now that a GCC Customs Union has officially been created (since 2003), appear to be intent on torpedoing the GCC effort, or at least demonstrating that it exists only on paper.

Such cacophony of competing and contrasting initiatives is bound to generate confusion and stimulate opportunistic behaviour on the part of individual governments in search of petty immediate benefits. It is therefore all the more urgent that the EU establishes a coherent strategic framework that encompasses the whole of the Mashreq, not just the Mediterranean riparian countries; and that it engages in dialogue and negotiations with the United States to pursue a proper regional approach.

The bilateral approach based on graduating benefits on the basis of the desired performance, “picking winners” and isolating “enemies” or recalcitrant partners, is a non-starter. Attempts at promoting one country as the role model, while isolating another, will backfire, and will hinder the recreation of the economic space in which the new Arab bourgeoisie can generate growth. Individual countries have limited viability if isolated from the regional context, and the notion that the best friends of the US are Bahrain and Qatar hardly needs to be commented. Only a regional approach in which all key players, including the more difficult ones like Syria, are encompassed has a chance to create the conditions required for the economic and political transformation of the region.

The EU-GCC negotiations

Following the entry into force of the GCC Customs Union at the beginning of 2003, the main formal obstacle to the conclusion of a free trade agreement between the two groupings has been removed. Negotiations have therefore started, and the Prodi Commission had hoped to be able to conclude them before the end of its mandate. This has unfortunately proven impossible.

We remain of the opinion that, while the conclusion of a free trade agreement is obviously important – if for no other reason, because the matter has been on the table for so long – still it is not the sole nor the first priority in the required EU-GCC dialogue. We believe that the EU-GCC relationship is different from the relationship between the Union and any other region or group of countries, and an original formula should be devised to make it fruitful.

In what follows, we comment on the areas for cooperation originally proposed in our EU-GCC policy paper.

Political and Security Dialogue

The original paper called for the progressive establishment of a new “Gulf Conference for Security and Co-operation” (GCSC). The war in Iraq in 2003 has created an unprecedented window of opportunity for regional cooperation, and the preconditions for the creation of new security arrangements in the Gulf and beyond. The demise of the regime of Saddam Hussein means that one of the biggest barriers to closer security and political links in the Gulf has finally been removed. It is now up to the regional states themselves and the international community as a whole to ensure that this golden opportunity is grasped, and that the region manages to consolidate its recent gains and creates the conditions for a peaceful and prosperous future for all of its citizens.

It is arguable that this is the only way in which regional states will be able to develop a set of goals, which they can to a large extent claim as their own, rather than those developed by outside powers, and principally the U.S. The system should aim to reduce significantly the foreign presence in the Gulf region. This will ease the burden on foreign actors, especially the U.S., in both financial and military terms, and make a contribution to stability. However, in order to preserve the latter, there will still be a need for a reduced presence of foreign actors and the positive contribution they can make.

The current system, which came into being after the British withdrawal from East of Suez, is based on a balance-of-power approach accompanied by a growing U.S. military presence, especially in the 1990s. Perpetuating this approach for the foreseeable future does not seem feasible, and is becoming increasingly counterproductive. It has also become an expensive exercise for the U.S., whose forces are already stretched thin. In addition, their presence on the ground has fuelled popular discontent in the host countries. For this reason the establishment of an indigenous, Gulf-based security system with only a limited presence of external powers would be a positive-sum game for all concerned. Iran would warmly welcome

any reduction of the foreign military presence in the region. Iraq, at least in the medium term, is bound to demand a withdrawal of foreign troops from its soil. And in the GCC countries there is a growing recognition that to perpetuate the present system will do more harm than good.

A future Gulf security system should be based on the following principles:

- *Inclusiveness*: It should comprise all the riparian countries of the Persian Gulf as well as all significant external actors.
- *Comprehensiveness*: It should be based on a broad understanding of security, which includes not only narrow military concerns, but also soft security issues such as terrorism and domestic reform.
- *Flexibility*: It should consist of different working groups which will cover relevant issues with flexible participation by various different countries
- *Separation*: It should not be based on automatic linkage to progress in other sub-regional contexts, especially the Arab-Israeli conflict

By acting quickly, the EU and the GCC could create the momentum for steps leading towards an inclusive Gulf security system. The EU and the GCC need to formulate a specific strategy designed to establish security collaboration. On the one hand such a strategy must take into account the need for differentiation and the requirements of individual countries in the region. On the other hand, it needs to establish a solid basis for cooperation on a collective level. To this end, a permanent security dialogue between the EU and the GCC countries should be initiated.

Good Governance and Human Rights

As underlined above, the political climate has considerably evolved in the GCC countries in the last three years, making greater European involvement in dialogue on good governance and human rights even more urgent. Conditions today are very conducive to establishing this dialogue, because an internal debate on some of the key issues has already developed, and a dialogue with Europe could be offered as a contribution and enrichment to an existing, indigenously generated debate, rather than as outside interference. There is a thin line distinguishing between legitimate engagement on issues of common interest and unacceptable outside interference, a line on which not all actors in the GCC countries are likely to agree. It will therefore not be easy to propose initiatives that may be effective rather than counterproductive; the fact that these initiatives may come from Europe, rather than the United States, is under present circumstances possibly an advantage.

In order for the dialogue to be fruitful, it will have to be “explicitly two-way and rest on persuasion rather than pressure” as advocated in our original paper. It is extremely important that the dialogue is based on the premise that democracy and respect of human right is an objective that should be achieved progressively, and that the path to it may be diverse. The dialogue should consist primarily in explaining the multiplicity of solutions that have been adopted in the European experience to solve various political and constitutional problems, and offer technical assistance in devising solutions adapted to the specific conditions of the GCC countries.

In this respect our original suggestion was that the EU should:

“Offer to share European experience with governments engaged in discussing, designing or implementing electoral principles or procedures, and constitutional reform - in the conviction that the process of European integration and the diversity of EU member states provide valuable experience in government reform. Moreover, the EU should foster the study of politics as a discipline and understanding of European politics, e.g. through the establishment of Centres of European Studies at Gulf universities, support the expansion of Gulf studies in Europe including the stimulation of joint research projects and inviting trainees and young scholars to EU institutions.”

This suggestion remains entirely valid and should be forcefully pursued.

The proposed cooperation in reforming the legal and law-enforcement system remains more of a challenge, but the active debate on jail conditions, on police behaviour and on the adequacy of shariah judges, which is currently almost every day in Saudi newspapers, certainly offers an opportunity for an exchange of opinions and experiences.

Finally, the debate on the role of women is now wide open in the GCC, and a civil society dialogue on women and their problems with respect to work, political representation, dealing with divorce and other common problems, may very fruitfully be engaged.

We also must engage in a dialogue on religious tolerance, which is likely to see grievances on the part of the GCC concerning the treatment of Moslems in Europe, and issues such as admissible dressing codes, in addition to European grievances concerning religious exclusivism in the GCC.

In all policy debates in the GCC, one sees a constant search for benchmarking and best international practices. At the same time, Gulf societies view themselves as unique and different, and on this basis sometimes refuse international experiences: nevertheless engaging in the discussion of which are best practices and valid international benchmarks on matters related to democracy and human rights is a very significant and potentially very fertile terrain.

Human Resources and Education

Our original paper stated: “The new EU-GCC Partnership should attribute the greatest importance to co-operation in the field of education. This is in many ways more urgently needed than co-operation in trade, finance or energy. The very high priority attributed to co-operation in education should be made into the distinguishing feature of the new EU-GCC Partnership, and generous financial means should be made available to substantiate it.”

The importance of cooperation in education has been amply underscored by events in the last few years. In its drive to combat Islamic terrorism, the United States have laid a lot of importance on the educational system and reform of the curriculum. While initially this provoked a defensive reaction, notably in Saudi Arabia, subsequently the need to reform the educational system has very much become a focus for the domestic debate in the GCC member countries.

These countries have always attributed great importance to education, allocating to it a very significant share of the government budget – indeed a higher share than in most industrial countries – yet the results have not always been in line with expectations. The inadequacy of the school curriculum at all levels is faulted for the problem of unemployment among young nationals, while the number of employed expatriates is continuously on the rise. Increasingly, it is also argued that the educational system harbours some extremist educators who foster an ideology of intolerance, laying the basis for violent or terrorist behaviour.

The key problem in this respect is that education is a generational system (i.e. one generation educates the next) and the extent to which certain skills or cultural content can be proposed to the next generation is limited by availability in the previous generation. It is therefore not always possible to effectively reform the curriculum and introduce scientific knowledge and languages (the two key propositions for reform) considering the dearth of available instructors in these areas. While teachers can be – and are – hired internationally, knowledge of Arabic restricts the pool from which one could draw, and employment conditions (relatively poor pay, posting in remote locations) further discourage the more open minded and cosmopolitan individuals. In short, the system ends up being over focused on religion and prone to intolerance because it attracts especially this brand of educators. Paradoxically, it is the very universality of the system – i.e. the fact that education is made available to most youngsters, and a lot of attention has been given to meeting the quantitative demand – that makes it more difficult to change and improve the quality.

The need to prioritise education cooperation is therefore very clear. It is only in the context of an ambitious and multi-faceted cooperation effort that the tide can be reversed. All tools need to be deployed simultaneously: from the preparation of educational programs based on TV and use of personal computers, or the posting of educators and consultants at all levels, to the circulation of educators and students.

The EU should mobilise existing national technical cooperation agencies and other appropriate NGOs to establish a more convenient channel to encourage instructors to accept postings in the region, in particular in connection with the teaching of languages, mathematics and the natural sciences.

Instructors from the region should be invited to visit educational institutions in Europe and observe European best practices. We have unresolved problems in our own countries with respect to certain aspects of the curriculum, in schools either specifically devoted to, or anyhow widely frequented by Moslem students, and the existing open debate may be extended to some participants from the region.

For higher education institutions, notably universities, twinning programmes should be established. Here one cannot but note that in the last few years the number of American Universities in the GCC has multiplied: to the American University of Sharjah, founded in 1997, American universities have been added in Dubai (American University in Dubai), Kuwait (American University of Kuwait) and Qatar (Carnegie Mellon University Qatar Campus). Dubai is also launching the Dubai School of Government, in association with the Kennedy School of Government at Harvard University.

In contrast, apart from the case of the Gulf University in Bahrain, which has an agreement with the University of London, European educational institutions are simply absent from the region. The EU should aim at establishing at least one

European University in each of the GCC member countries, in cooperation with major European universities. It should be stressed that local demand for quality higher education is very significant and bound to increase, and the GCC governments do not shy away from spending on education. The budgetary implications for the EU of pursuing the stated objective might very well be limited, but it is unlikely that European universities will be interested in participating in the creation of affiliate or associate institutions in the region, unless this is a specific political goal of the Union, and a competition is set up to select those European institutions that will be called to implement the programme.

Trade and Investment

The GCC Customs Union has formally come into force on January 1, 2003. However, besides the unification of external tariffs, very little appears to have happened in the way of effective implementation of a customs union. The main difficulty is that the GCC secretariat appears to have neither the administrative capabilities nor sufficient delegation of powers from the member countries to issue common rules for customs procedures, progressively dismantle internal customs controls, and negotiate with external actors on behalf of member countries.

A first priority for EU-GCC cooperation would therefore appear to be engaging in extensive technical cooperation concerning the implementation of the Customs Union. In any case, the conclusion of a free trade agreement between the EU and the GCC should not be postponed pending the resolution of the administrative problems that are hindering the practical implementation of the GCC Customs Union, but should serve to encourage progress in this direction.

The issue of Saudi membership in the WTO also is still not resolved. The EU and Saudi Arabia signed an agreement concluding the bilateral market access negotiations for the accession of Saudi Arabia to the WTO on September 1 2003. However, Saudi Arabia still has to conclude the equivalent agreement with the USA, and until that is done it cannot become a member of the WTO. One may note that the EU in turn is requesting Saudi membership in the WTO as a prerequisite for concluding a free trade agreement with the GCC, hence de facto granting to the US the power of veto on this agreement.

The issue of double pricing of LPG continues to mar relations with Saudi Arabia. This refers to the fact that LPG exported (almost exclusively to the Far East) is priced on the basis of its value as premium clean fuel, and the Saudi Contract price is a benchmark in the market. However, LPG sold domestically to petrochemical users is priced differently, indexed to the price of naphtha in Japan (naphtha is the dominant petrochemical feedstock in Japan and Europe). This practice has been represented as a form of subsidy, which in the opinion of this writer it is not at all.

This is not the place to discuss the details of a question that is technically quite complex – but the broader political significance of it should be underlined. The point is, that obviously the GCC countries enjoy a comparative advantage in the transformation of hydrocarbons into basic petrochemical products. This advantage exists primarily because plants located in the region will have access to abundant feedstock that does not need to travel, and will offer steady withdrawal of it, reducing the exposure of the producer to the vagaries of the international market. Encouraging downstream integration of the oil producing countries into refining and

petrochemicals or into other energy intensive industries is essential to enhancing the incentive for Gulf producers to increase their capacity in line with the growing global demand.

As detailed in a previous section, the GCC petrochemical and basic industries are experiencing rapid expansion, and this is not confined to Saudi Arabia. This is a positive development that will facilitate cooperation with the region. While the bulk of GCC petrochemical and basic industries' exports has so far gone to the East, and is likely to continue to do so, it is inevitable that the European producers will increasingly feel the competition. Should then the European Union defend its producers by adopting protective trade policies?

In fact, because of the inevitable deterioration of the competitiveness of European basic petrochemicals, we currently witness the disengagement of major European oil and chemical firms from basic petrochemicals. The major Dutch producer, DSM, sold its operations to Saudi Arabia's SABIC in April 2002. The joint venture between Shell and Basf – known as Basell – has been put on sale. Bayer will float its basic petrochemicals arm LANXESS in January 2005, and the management of this new company has announced that it may not continue to operate in some lines of business, including plastics, because of their structural weakness. In Italy, Eni has first tried unsuccessfully to sell its chemical business to SABIC (being beaten in the race by Dutch DSM), and more recently has simply let its chemical business slowly to wither away. As the experience of SABIC with DSM proves, a takeover on the part of Gulf owners may very well open the door to new investment and capacity expansion. The difference is that Gulf petrochemical investors are keen about the business, which they perceive as of strategic importance to them, while evidently the old European owners simply consider their petrochemical business as a source of headaches and are trying to get rid of it.

It is quite possible that, as the incumbent European owners wish to sell, other Gulf petrochemical producers might be the buyers. However, SABIC has already done its move, and a further acquisition on their part might be vulnerable to objections from antitrust authorities in Brussels. Other potential petrochemical investors in the Gulf are for the time being considerably smaller and may be afraid of potential political and administrative implications.

Rather than insisting in stonewalling Saudi Arabia with the excuse of double pricing, the EU Commission should move imaginatively and aim at stimulating the establishment of dynamic partnerships between the orphaned European petrochemical producers and potential Arab investors. Europe has a long-term interest in enjoying competitive supplies of petrochemicals, and encouraging expansion of Gulf production capacity and the engagement of Gulf companies in investment in Europe is functional to this strategic goal.

Oil and Gas

As illustrated in a previous section, after a decade or longer characterised by price optimism - mostly based on the observed improvement in technology for exploration and production of oil and gas, which translated in declining cost for the marginal oil barrel produced, leading in turn to the expectation that supply would grow faster than demand - the oil price paradigm has recently changed. The market has come to realise that the cost of the marginal oil barrel is not the significant determinant of oil prices, because numerous economic and non-economic obstacles prevent supply from increasing at the same rapid pace as demand, and the price will therefore remain well above marginal cost. Experts increasingly debate whether non-OPEC or even global oil production will soon reach its physical peak, then slowly but regularly decline. But even if this Malthusian point of view is rejected, it is increasingly clear that non-OPEC production is unlikely to grow as rapidly as demand notwithstanding the large profit margin, and the world will increasingly rely on OPEC, specifically on the Gulf producers. There simply is no reasonable scenario, even incorporating increasing energy efficiency and reliance on alternative sources of energy, which does not come to the conclusion that the world will increasingly rely on Gulf oil in the coming decades. In these conditions, prices are likely to remain on the high side.

The crucial role of Saudi Arabia in stabilising markets has become all the more evident in 2003 and 2004. The Kingdom has increased production to compensate for the loss of Iraqi production during and in the aftermath of hostilities, and has announced plans to expand its production capacity to meet growing global demand and at the same time maintain a margin of unused capacity for addressing possible emergencies. No other producing country is in a position to do the same.

However, the extent to which Saudi Arabia might wish to increase production in the long run remains problematic. The Kingdom has announced plans to increase its production capacity from the current level of 10.5/11 million, to 12.5 million b/d. It has provided details on its reserves to assert that it will be able to sustain this level for 50 years at least. It has further expressed its readiness to eventually increase capacity to 15 million b/d if world demand so requires. However, it is clear that the Kingdom would not find it in its best interest to increase capacity beyond this level, as this would entail too much of a shortening of its production horizon. However, several long-term scenarios of future global oil supplies hypothesize considerably higher levels of production for Saudi Arabia.

The European Commission has continued the dialogue with the GCC on oil and gas matters in the context of the EU-GCC meetings of energy experts - the 7th in the series took place in Brussels in February 2004. In parallel, the Commission has supported the EUROGULF project in the context of the Synergy programme. The EUROGULF project is a research effort carried out by a consortium comprising the Robert Schuman Centre of Advanced Studies at the European University Institute, the Oxford Institute of Energy Studies, the Energy Policy Unit at the National Technical University of Athens and ECONERGY sal of Beirut.

This project is expected to support some of the main policy indications that were included in our original paper, notably:

- The problems with the functioning of the international oil market are discussed in detail and proposals are put forward to remedy those problems, in particular with respect to encouraging the development of a Mediterranean-based physical market for oil, allowing secondary trading of crude exported by the major GCC producers, and use auctions in the place of, or in parallel with, indexation to prices of reference crude oils for primary sales of GCC crude oil.
- With respect to stockpiles, the importance of maintaining a margin of unutilised capacity in the major producing countries – Saudi Arabia first and foremost – is underlined; the increase in “traditional” strategic stocks is criticised; and proposals are put forward for the sharing of the burden of accumulating more flexible stocks in appropriate locations along the supply chain.
- The importance of vertical integration of oil producers into downstream transformation of oil into refined products, petrochemicals and other energy products is underlined – this connects with the need to reverse the protectionist attitude of the Union with respect to petrochemical exports, as stressed in a previous section.
- With respect to gas exports, the expected substantial increase of LNG exports from Qatar is an important development. The establishment of a pipeline from the Gulf to Europe remains problematic, and Iran may be said to have acquired an advantage over the GCC countries in this respect. However, the argument in favour of establishing a gas grid connecting the GCC countries and establishing a single GCC gas market remains cogent, but meets continued resistance in some of the member countries of the grouping.
- The potential for cooperation in the rational use of energy, renewable energy sources and carbon sequestration in connection with the development of refining, petrochemical and other energy intensive industrial poles is underlined.

Since our original policy paper was drafted, the International Energy Forum Secretariat has been established in Riyadh, and the International Energy Forum again met in Amsterdam.

In short, an EU-GCC dialogue on oil and gas issues is necessary and also potentially fertile, in the sense that there are technical steps that may be undertaken to improve the functioning and stability of markets and the way we deal with emergencies, which would contribute to reducing the perception of insecurity that is common – indeed on both sides, Europe worrying about continuity of supplies, and the GCC worrying about continuity of demand.

Financial Markets

Our original policy paper already noted that: “the GCC has the most developed financial markets in the Arab World”. Developments in the past three years have further strengthened this conclusion. The pace of deepening in the GCC financial markets has indeed been quite significant, being driven by the reorientation of Gulf investors’ preferences in favour of placements in the GCC and away from international financial markets, the US first and foremost; privatisation of state-owned enterprises and corporatisation of family-owned economic groups; regulatory reform concerning financial markets; and finally the significant financing requirements to sustain major projects underway in the region (in electricity generation, desalination, petrochemicals, basic industry, transportation and so on).

Major developments were recorded especially in Saudi Arabia, where:

- New banking licenses were granted to foreign banks (such as Deutsche Bank) and banks from other GCC countries
- The government stepped in to curb the activities of traditional money exchangers, and led a group of them to merge and form a new Islamic bank
- New regulations were adopted for capital markets and a capital markets authority was established
- The door was opened to the establishment of a proper and competitive insurance sector

Other GCC capital markets have always suffered from fewer restrictions, and experienced further deepening. There is increasing integration of GCC financial markets, with growing cross investment and expansion of the more successful institutions.

In the light of these developments our original suggestion, that the EU should establish co-operation in the regulation of banking and other financial intermediaries, remains important. Although it is generally assumed that financial markets are much more closely integrated than the markets for goods, and that money travels freely across boundaries, in fact there is a lot of potential for establishing a common financial space between the EU and the GCC.

The stock market boom and regulatory improvements in many GCC countries may be vulnerable to a change in investors’ sentiment unless the market is widened with new assets and new participants. In this respect we should stress the recommendation that the Union should “pursue greater integration of capital markets through cross listing of major Gulf companies and the provision of technical assistance to Gulf markets on the part of the major European exchanges; improve conditions for electronic trading of European stocks in the Gulf and promote the opening of Gulf stock markets to European investors under conditions of stability and transparency”.

Cooperation at the level of central banks is also important, and significant contacts have already been established. Following its decision to achieve monetary union by 2010, and the successful introduction of the Euro as the currency of a majority of the EU member countries in January 2002, the GCC has initiated cooperation with the European Central Bank, in particular concerning the definition of convergence criteria ahead of monetary union. An important conference on “The Euro, the Mediterranean and the Gulf” was organised by the Greek Presidency in Athens in February of 2003.

It is noteworthy that this conference should not target only the Mediterranean countries, but also the Gulf: for the first time, a concept of Mediterranean enlarged to the Gulf was used in an official event concerning a matter of priority for the Union, i.e. the international role of the Euro.

The wish to diversify investment away from the United States is not exclusive to private investors: it appears that GCC central banks have modified the composition of their reserves, reducing the incidence of dollar-denominated assets. Obviously the weakness of the dollar has not gone unnoticed in the GCC member countries, and a debate is underway whether Gulf currencies should continue to be pegged to the dollar. It is unlikely that we shall witness any radical change in the short and medium term, but the weakness of the dollar, if it were to persist, would certainly be an incentive to progress towards monetary unification, and this in turn might open the door to a loosening of ties to the dollar and a somewhat closer relationship to the euro (and the Far Eastern currencies, especially if China too were to abandon its dollar peg). The evolution of the international currency system is, in short, another important issue area for EU-GCC cooperation.

In conclusion

In the past three years negotiations between the EU and the GCC for the conclusion of a free trade area have advanced, the EU has opened a representative office in Riyadh and the need for closer EU-GCC cooperation has been recognised in official EU documents. Nevertheless, in comparison with other parts of the world the GCC remains a region of neglect on the part of the Commission.

For the reasons that we put forward in our original policy paper, and which recent events only reinforced, we believe that this lack of attention is a strategic mistake that should be remedied soonest.

A major change of tack is required. Substantially greater human resources within the Commission should be devoted to relations with the GCC: a new and imaginative cooperation proposal should be elaborated and put forward that goes much beyond the free trade area; representative offices must be opened also in other GCC capitals besides Riyadh; and the political profile of the relationship should be substantially increased.

Cooperation with the GCC is not only required – it is very promising. Cooperation with the GCC is likely to be successful and rewarding, and have potentially positive spill over effects on cooperation with most Mediterranean partners: indeed, it is a prerequisite for successful EU action towards the Eastern Mediterranean and Iraq.

The EU should move quickly, following the historic decision to open negotiations for the accession of Turkey, to integrate the GCC and Iraq in the ENP. There is no valid reason not to integrate these countries in the ENP framework: their economies are closer to European standards, and their political systems more open and dynamic than those of several countries that already are in the ENP framework.

While certain aspects of social and cultural norms in some of the GCC member countries are difficult to understand, and even more to accept, with European eyes, it is important to recognise that a crucially important phase in the internal political debate has opened in these countries. It is imperative that the conservative and extremist forces are defeated, and Europe can and should play an important role to this effect.

The EU and the GCC. A new Partnership

- Original Version of March 2002 -

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INTRODUCTION¹

In the process of progressively defining its Common Foreign and Security Policy, it is time for the European Union (EU) to focus on the Gulf region. In the wake of the September 11 terrorist attacks and the regional realignment stimulated by the campaign against terrorism, an intensification of EU engagement in the Gulf region is imperative. A full-fledged Common Strategy toward the Gulf will have to include the EU's position towards Iran, Iraq, Yemen and the countries of the Gulf Cooperation Council (GCC).² As a first step towards this goal, this paper focuses in particular on the relationship with the GCC, drawing on several background papers prepared by distinguished experts exploring various fields of EU-GCC co-operation.³

The relationship between the EU and the GCC and its member countries has been of low intensity, and reflects neither the geographic proximity nor the vital links in several fields existing between the two sides. The involvement of certain EU member countries has been very substantial both historically and in recent times, but it has not led to significant involvement on the part of the EU as such. It is striking that the Gulf region is the only part of the world where the EU Commission does not have any diplomatic delegation. The existing co-operation agreement between the GCC and the EU of 1988 essentially failed to spark any meaningful co-operation.

There are several reasons for the underdevelopment of GCC-EU relations. First of all, the GCC as a regional organisation does not match the EU in its objectives and institutions. The GCC originated as a security pact and has made progress in economic co-operation, but has not yet succeeded in establishing a common market. In contrast, the EU is based on economic co-operation and is over time progressively developing a foreign policy and security dimension. On some of the issues of great importance for both sides - e.g. energy - neither the EU nor the GCC enjoy a strong mandate. Because of the importance of issues that have remained primarily under the control of EU member governments, bilateral relations have prevailed - sometimes with mercantilist undertones, especially in the field of arms trade - that tended to hamper common EU action. In the case of other regions, specific member countries have promoted a greater involvement of the EU, but the same phenomenon has not taken place for the Gulf.

¹ This document results from a joint initiative of the Robert Schuman Centre for Advanced Studies at the European University Institute and the Bertelsmann Foundation in collaboration with the Bertelsmann Group on Policy Research at the Center for Applied Policy Research who organised several meetings of a group of European experts and diplomats in Florence and Munich from March to November 2001. The final drafting, which reflects as best as possible the comments and suggestions that came from the participants, was prepared by Giacomo Luciani and Felix Neugart.

² The Gulf Cooperation Council formed in 1981 is constituted of Saudi-Arabia, Kuwait, Bahrain, Qatar, the United Arab Emirates and Oman.

³ These background papers are being published as seven titles in the Policy Papers series of the Robert Schuman Centre for Advanced Studies at the European University Institute in Florence. Titles include:

1. E. Brodhage and R. Wilson "Financial Markets in the GCC: Prospects for European Cooperation"
2. G. Nonneman "Governance, Human Rights and the Case for Political Adaptation in the Gulf: Issues in the EU-GCC Political Dialogue"
3. G. Luciani, G. Nonneman, R. Wilson "EU-GCC Co-operation in the Field of Education"
4. G. Nonneman with A. Ehteshami and I. Glosemeyer "Terrorism, Gulf Security and Palestine: Key Issues for an EU-GCC Dialogue"
5. M. Chatelus, G. Luciani, E. Rhein "EU-GCC Co-operation in the Field of Energy"
6. M. Chirullo and P. Guerrieri "GCC-EU Relations and Trade Integration Patterns" Hard copies of the above may be requested from the Robert Schuman Centre, PDF copies can be downloaded from the web at

It is therefore appropriate to reflect on how to shape these vital relations, in the medium and long term, in such a way that both sides may draw optimum benefits.

A new departure in EU-Gulf relations requires a new set of premises. The EU should start looking at its relations with the GCC as a sui generis partnership that should be based on fostering key common interests of the two sides, and compromising on points of inevitable conflict. The GCC countries are only partially comparable to other developing countries and must not be approached solely with classical development tools. GCC interests have to be taken into account and co-operation has to be based on fields of mutual interest and costsharing between the parties. First and foremost, the EU should show its determination to intensify its relations with the GCC countries through the opening of an EU delegation in the GCC, preferably in Riyadh.

As indicated, in spite of major progress made in the last decade the capability and coherence of the EU's Common Foreign and Security Policy is limited, most strikingly in the military sector. Specifically, the weak mandate of the EU commission in several important fields hinders the EU's capability for consistent action. Therefore, a detailed division-of-labour between the EU and national governments has to be agreed upon, in order to ensure implementation.

WHY THE GULF MATTERS

The countries of the Gulf Cooperation Council are of enormous strategic importance for the European Union. Their importance is even bound to increase in the 21st century.

- Islam, one of the great monotheistic faiths in the world, originated some 1380 years ago in the Arabian peninsula, which has maintained spiritual significance for over one billion Muslims all over the world. The cities of Makkah and Madina are the holiest sites in Islam and are visited by millions of believers, including many Muslims from the EU, especially during the annual haj pilgrimage.
- The GCC countries are of overwhelming importance for the global supply of fossil energy. They account for almost half of global oil reserves and about 15% of natural gas reserves, although presently their share in global production is significantly smaller. Due to their enormous reserves and the comparatively low production cost, the importance of the GCC countries for the global supply of energy is expected to increase in the near future, in line with the projected growth in demand from industrialising economies. This poses several questions: will the Gulf producers be willing substantially to increase their production levels, given that in some cases the resulting revenue may go well beyond their needs? Will appropriate channels for managing the huge implied investment effort created? Will global dependence on Gulf oil and gas not grow beyond what may be considered safe levels?
- The GCC countries have engaged in a determined and relatively successful effort to achieve development and diversification of their economic base. Their political systems have shown remarkable stability over the last decades, combining traditional values with modern elements. This is not just a function of the large cash inflow triggered by the increase in oil prices, as the failed example of several other oil-rich developers proves. Yet, GCC countries are not as rich as commonly perceived, per capita income is generally lower than in Western industrial countries. Furthermore, the GCC countries always substantially maintained a free trade environment and are progressively eliminating remaining limitations originally intended to protect domestic investors. With the exception of Saudi Arabia, they are already members of the WTO, and Saudi Arabia is expected to gain membership soon. The GCC has the most developed financial markets in the Arab World owing to the oil wealth in the region, the free convertibility and stability of the currencies and the relative openness of the economies to international trade. Finally, these governments wish to integrate into the emerging system of global governance, and are keen to adapt their policies to the best international practice, within the limits imposed by some special cultural traits of the countries in question.
- The GCC countries have been witnessing varying degrees of evolution towards widening participation. The traditional social contract has been challenged by the combined impact of the evolution of oil prices and markets, globalising pressures in the world economy, the population explosion and social change. The growing size and complexity of these societies also means that traditional channels for airing grievances, and traditional bases of legitimacy, are decreasingly able to assure popular acquiescence. GCC states also have significant human rights problems, although these vary from state to state. Many of the problems stem from conservative patriarchal social values rather than from government abuse.

- The fact that the Gulf countries have created a regional organisation, which already guarantees freedom of movement, residence and establishment among its members, and will achieve a Customs Union by 2003 under Muscat agreement reached on 31 st December 2001 makes it into a natural partner for the EU, although there is no perfect parallelism between the GCC and the EU. As regional integration within the GCC will progressively deepen, it will be possible for the EU to deal with a single interlocutor, characterised by considerable homogeneity in social, political and cultural systems.
- The GCC countries have consistently supported the policies of the West and have never resorted to violent means for the resolution of conflicts. They have shown moderation with respect to the position of Israel while at the same time upholding their position with respect to the need for a peace based on international law and UN resolutions. Thus, the GCC countries have proven to be an anchor of stability in a troubled environment where peace has been repeatedly challenged, most dramatically by the expansive design of the Iranian revolution in 1979, and by the Iraqi attack on Kuwait in 1990. They have on several occasions resorted to international arbitration to resolve their bilateral disputes and have accepted the decisions of the International Court of Justice in this respect.

Main Objectives

The European Union has the following goals for its policy towards the GCC:

- Fostering long-term stability in the region, for any conflict threatens to interrupt the stable supply of oil and gas and jeopardises the global economy.

Stability implies the recognition of the territorial integrity of each of the regional states within their present borders and the establishment of a mechanism for the peaceful resolution of conflicts. For this to succeed it is imperative to bring Iraq back into the international community as a partner fully respectful of international law and the integrity of its neighbours, and to encourage the further re-integration of Iran.

- Supporting the path of development chosen by the GCC countries through intensive co-operation in the fields of economic diversification, investment and education. The success of the GCC countries' development effort could prove to be contagious and positively influence all neighbouring countries, including those in the Mediterranean region. The EU should encourage the development of GCC political systems aimed at implementing the values of good governance and respecting human rights while avoiding anything that might be perceived as a patronising attitude.
- Assuring the stable supply of oil and gas at reasonable prices through a dialogue focusing on reducing market volatility and improving price stability, investment in the oil and gas sector in the GCC and development of natural gas supply routes to the EU. The EU shares with the GCC countries a strong concern to keep energy prices in a range that will simultaneously encourage energy conservation, the rational utilisation of traditional fossil fuels and the development of non traditional fuels and other sources of energy.
- Reinforcing the European Union's presence in the GCC, reflecting the strategic importance of the Gulf region, in order to foster mutual understanding and convergence of interests, and to share in its rising prosperity. This requires an increased commitment towards the region on the diplomatic, economic and cultural planes.

AREAS OF CO-OPERATION

a) Political and Security Dialogue

The GCC countries and the EU attach highest importance to the co-operation in political and security issues, especially in the light of the recent terrorist attacks on the United States of America. Security and stability in the Gulf region can only be assured by the co-operation of all riparian states in a framework that defines principles to ensure the maintenance of peace in the region and instruments for the peaceful resolution of regional conflicts. Any such framework will have to take into account the EU's efforts at regional integration in the Mediterranean basin, mainly through the Euro-Mediterranean Partnership, and links to neighbouring geopolitical areas such as Central Asia and the Horn of Africa.

- The EU should pursue a close dialogue with the GCC states over Gulf security, aimed at bringing Iraq, Iran and Yemen into a Gulf-wide security system. The EU should explore the idea of a Gulf Conference for Security and Co-operation (GCSC). This organisation should include all the riparian states and be devolved into subject-specific working groups on issues like arms control, resolution of territorial disputes, economic co-operation, energy and water. The EU should function along with the US and Russia as a facilitator for the establishment of this framework and as an observer of its proceedings. The GCC has contributed to the peaceful solution of territorial disputes among its member countries. Furthermore the EU member countries should set the future sale of weapons systems to the GCC against the background of the development of an EU-wide approach to Gulf security.
- Although there is no agreed international definition of terrorism this should not inhibit dialogue with the GCC on this issue on a pragmatic basis. There will be scope for agreement on controlling financial flows to groups recognised by both sides as terrorist and on the common threat which terrorism poses. We should recognise that the GCC may raise issues with respect to “terrorist” operating freely in European countries, and attempt to link this with dissidents. The EU should not shy away from this debate. This links with the question of human rights. Our ability to extradite individuals is ultimately linked to the establishment of the rule of law, recognition of human rights and freedom of expression in GCC countries. Increasingly GCC countries' willingness to co-operate in the international campaign against terrorism will be a determinant in the EU relationship with the Gulf.
- The EU has developed a significant *sui generis* partnership with Iran since the election of President Khatami in 1997. This comprehensive dialogue covers global issues (terrorism, human rights and proliferation), regional issues (Gulf, Central Asia and MEPP) and areas of co-operation such as drugs, refugees, energy, trade and investment. -There is a lack of any contractual relations for the time being, although preparations for negotiations towards a Free Trade and Co-operation Agreement are under way. Therefore relations between the EU and Iran are more intensive but less institutionalised than relations with the GCC. The EU should pursue a policy of convergence in its relations with the two regional actors aimed at establishing a regional security framework as outlined above.

There are at present no contractual relations whatsoever between the EU and Iraq. The EU should move towards a swift implementation of a regime where restrictions on Iraqi non-military imports are lifted. At the same time military controls must be kept in place, and WMD monitoring needs to be reestablished. Given the transatlantic differences the EU should agree with the United States on a common agenda for a *post-Saddam* era in Iraq,

regardless of when and how it comes about. Conditions could be outlined under which an Iraqi government could be reintegrated into the international community, and receive the support required for the reconstruction of its infrastructure. These principles should include (1) continuation of Iraq as a single, independent state, (2) substantial progress towards democratic, accountable institutions, as signalled in particular by the dismantlement of instruments of mass repression and acceptance of freedom of expression (3) federalism or decentralised government institutions which take into account the rights of minorities (4) the recognition of the territorial integrity of adjoining countries, and (5) the abandonment of efforts to acquire weapons of mass destruction and a substantial scaling down of military expenditure as a whole.

- It is in the EU's as well as in the GCC's interest to support Yemen's regional integration and to stabilise Yemen domestically to avoid a failed state scenario in the most populous and economically weak country on the Arabian peninsula. EU support for Yemen's integration with the GCC states contributes to improve the political stability and economic development of the whole area. Therefore, the EU should welcome the GCC's recent decision to respond to Yemen's application for membership with a strategy of close co-operation. The establishment of a Euro-Yemen Partnership Agreement would be a clear signal of the EU's support for the integration of the region and is comparatively easy to achieve. This would involve the renegotiation of the existing EC-Yemen Co-operation Agreement, parallel to the Euro-Gulf Partnership negotiations.
- Putting an end to Israeli-Palestinian conflict is a joint interest of the GCC countries and the EU. The European Union should seek the support of the GCC countries in promoting a just resolution of the Israeli-Arab conflict, including of the Palestinian question, based on the long-standing and wellknown positions of the EU.⁴ Yet, the development of a security and cooperation framework in the Gulf region should not be made dependent on progress in the Israeli-Arab peace process.
- Offer to share European experience with governments engaged in discussing, designing or implementing electoral principles or procedures, and constitutional reform - in the conviction that the process of European integration and the diversity of EU member states provide valuable experience in government reform. Moreover, the EU should foster the study of politics as a discipline and understanding of European politics, e.g. through the establishment of Centres of European Studies at Gulf universities, support the expansion of Gulf studies in Europe including the stimulation of joint research projects and inviting trainees and young scholars to EU institutions.
- Offer support for the reform of the legal and law-enforcement system of the GCC members. The EU and the GCC countries should collaborate in judicial training and penal reform including professional training for lawyers in the courts, training in international law; and training in human rights law. The EU should support activities to train military and police personnel in human rights issues and in civil-military and community-police relations.

⁴ cf. especially the declaration of the European Council of Berlin (1999) on the Middle East Peace Process.

- Seek a stipulation on co-operation with civil society in future EU-GCC agreements and inclusion of some GCC initiatives among the portfolio of the European Initiative for the Democracy and Human Rights (EIDHR) for a broad dialogue between representatives of civil society is necessary to identify common ground and reduce mutual distrust. It should stimulate exchanges and networking at all levels, e.g. parliamentarians, young leaders, academics, journalists and other professionals. The EU and the GCC should collaborate in women's professional educational programmes and support for local NGO activities aimed at women's issues.

c) Human Resources and Education

The importance of investment in education has always been clear to all of the GCC governments, and substantial funds have in fact been channelled to improve the human capital of these countries. Starting from a very low level – one in which the vast majority of the population was illiterate – major progress has been accomplished, though much still remains to be done. The demand for improved education services is evident and will be there for a long time to come. In this context, co-operation in the field of education and human resources is of crucial importance for the long term, possibly the most important item for future EU-GCC relations. Investment in this sector will contribute to the political and economic development of the GCC countries and ultimately to regional stability.

The new EU-GCC Partnership should attribute the greatest importance to co-operation in the field of education. This is in many ways more urgently needed than co-operation in trade, finance or energy. The very high priority attributed to co-operation in education should be made into the distinguishing feature of the new EU-GCC Partnership, and generous financial means should be made available to substantiate it.

Therefore the EU should:

- Strive to attract GCC students to EU universities. The EU should play a promotional role by improving information and facilitating the overcoming of the language barrier. Offering financial support should generally not be contemplated, yet should not be ruled out in cases in which students that the European institution deems worthy cannot get support from their own countries.
- Encourage twinning arrangements to improve the quality of teaching in the GCC universities, especially in technical fields such as engineering, medicine, architecture and economics. Twinning arrangements should include the temporary posting of European instructors in GCC universities, and may envisage a shorter (e.g. 1 year) presence of the Gulf students in Europe (on diploma and masters programmes).

d) Trade and Investment

The EU and the GCC are currently negotiating a Free Trade Agreement (FTA) which will, in parallel with the WTO accession of Saudi-Arabia, open the GCC countries to international competition and communication, eventually promoting economic reform and social change. It is thus part of a broader project aimed at integrating the GCC countries into a globalised world. The prospect of international investment in GCC economies will contribute to an improved business climate, reinforce the rule of law and generally accelerate the process of domestic reform. Furthermore, the FTA will strengthen the GCC institutionally and transform it into a sizeable market. Taking into account that the FTA negotiation process has to be linked to the WTO framework, the EU should:

- Encourage GCC regional integration to facilitate negotiations by reducing differences in tariffs and regulations among the GCC countries and creating one interlocutor. The agreement for the GCC to bring forward its date for the completion of the customs union to the 1st of January 2003 is welcome, as is the implementation of a unified tariff of 5%, rather than the more complex dual tariff scheme originally proposed for 5.5 and 7.5 percent bands on basic commodities and luxury goods respectively. The EU should offer its rich experience in regional integration to support this process and to strengthen GCC multilateral institutions.
- Support the accession of Saudi Arabia to the WTO by engaging in cooperative diplomacy to find a swift solution to the outstanding problems preventing a positive conclusion of negotiations. Signing the WTO treaty will also boost the negotiations for the FTA.
- Establish a Free Trade Area with the GCC countries covering all industrial products without exceptions, preferably already in 2003 in conjunction with the completion of the GCC customs union. This Free Trade Area should be aimed specifically at enhancing intra-industry integration, both horizontal and vertical, by supporting greater freedom of investment, including in the services sector. Co-operation with the GCC authorities will be fundamental to achieve an optimal implementation of the new investment legislation and to raise the awareness among EU companies of the opportunities offered by all the GCC countries.
- Establish co-operation for the enforcement of intellectual property rights in line with best international practice.
- Integrate the future EU-GCC free trade area horizontally with the emerging free trade area in the Mediterranean; this will give a powerful push to free trade between the GCC and the Southern Mediterranean countries and have a positive impact on regional Arab co-operation. In fact, an EU-GCC FTA is expected to become a reality well before the Mediterranean FTA, and may well act as a catalyst to overcome residual resistance to the latter.
- Establish an EU-GCC business dialogue to foster business contacts and encourage the business sector to formulate proposals for administrative and regulatory improvements. The EU should also offer its technical advice and assistance in areas like standards, legal frameworks, banking surveillance, central banking, administrative rules and procedures.

e) Oil and Gas

Though the market for oil is global in nature, a regional dialogue between the EU and the GCC may contribute to improving European and global energy supply conditions, and should be pursued. This dialogue does not exclude parallel initiatives promoted from other institutional forums, and should be coordinated with the latter. In particular, the IEA should be encouraged to pursue

dialogue with OPEC along the same lines proposed for the EU-GCC, and the proposal, put forward by Saudi Arabia, to establish a permanent secretariat to the Energy Forum - that last met in Riyadh in November 2000 - should be carefully considered. Nevertheless, the geometry of such alternative discussion forums would not be the same as a EU-GCC dialogue, and the latter would have the advantage of setting energy in the context of broader co-operation for development and stability in the region, a difference which has considerable importance.

The EU-GCC dialogue should be based on a mandate to achieve the following:

- All parties agree that the price of oil should be set by market rather than administrative mechanisms. However, the oil market as presently organised is highly imperfect and lacks transparency. Only a small percentage of crude exchanged internationally is actually traded on the market. The bulk of it, and notably almost all Gulf exports, is exchanged outside the market on the basis of a system of reference pricing which lacks rational foundations. This structure tends to contribute to the volatility of prices and market insecurity. Therefore, widespread misgivings exist about the current functioning of the international oil market and pricing mechanisms, and many believe that improvements to transparency and efficiency of the market would be possible. The EU and the GCC should jointly study initiatives to propose, implement or promote the required changes.
- Both the EU and the GCC agree that prices should not be “too low” – which would be negative for conservation and the development of alternative energy sources – nor “too high” – which would lead to slower economic growth and possibly large reserves of oil being left in the ground. Furthermore, both sides agree that price volatility should be contained if possible, as it has important negative effects on the real economy. This common ground may be enough to start a meaningful dialogue about prices, in view of progressively narrowing differences and improving mutual understanding.
- Security of supply is a corollary of reliable markets and stable prices. Maintaining the required excess capacity – for the production and transportation of crude oil and the refining of products – is a source of additional costs that will not be borne by private profit maximising operators. The EU and the GCC should agree on ways to address security of supply at the regional level. This includes establishing guidelines for the accumulation and liquidation of stockpiles, and supporting investment in transportation facilities in order to avoid bottlenecks or emergencies.
- System stability is improved by vertical integration in both directions: oil producing countries should be allowed and indeed encouraged to integrate downstream through their national oil companies to gain more direct contact with the final consumer and acquire a more direct interest in the economic well-being of the importing countries; and the international oil companies based in the major industrial countries should be allowed to invest upstream in the producing countries. Negotiating an appropriate instrument to regulate and protect cross investment in energy is an important objective.

- The EU is expected to increasingly rely on gas to cover its energy needs. Diversification of suppliers and connecting to the European market increasingly distant suppliers are required to foster security of supply of gas. The EU should launch an initiative following in the footsteps of INOGATE to support the creation of long distance export pipelines from the GCC to serve the Mediterranean Partner countries and connect into the European grid.⁵
- In a closely integrated world economy negative externalities for the environment affect both suppliers and consumers. The EU and the GCC should start a dialogue on collaboration to minimise the danger for the environment through energy production and trade, especially by ensuring the implementation of the Kyoto Protocol on the reduction of emissions.

f) Financial Markets

The GCC markets are essentially national, although Bahrain has emerged as a significant regional financial centre. Nevertheless, the GCC has the most developed financial markets in the Arab World. This is largely a consequence of the oil wealth in the region, the free convertibility and stability of the currencies and the relative openness of the economies to international trade that requires financing. The EU should offer co-operation to enhance the integration of Gulf financial markets with European and global markets in order to facilitate the financing of investment projects in the Gulf, and possibly in the Mediterranean and other industrialising countries of common interest. With their traditional emphasis on providing finance to capital-intensive “old economy” industries, in particular in the small and medium size enterprise sectors, European financial institutions have an important experience to share with their GCC counterparts. On the other hand, given the importance of private Gulf placements into the European financial markets, greater integration will also facilitate market efficiency and convergence of interests. The EU should:

- Establish co-operation in the regulation of banking and other financial intermediaries. Regulatory issues in the GCC differ from those in the European Union, but there are many areas of shared interests, e.g. in respect of rating systems or the application of specific Basle II-requirements, which offer wide scope for co-operation with agencies in Europe such as the Financial Services Authority in the United Kingdom, that liaises with Gulf central banks in any case regarding banks from the region with a presence in London.
- Establish co-operation between the ECB and GCC Central Banks in the light of the former’ experience in managing the single currency, and of the GCC countries’ stated aim to maintain fixed parities between their currencies as a move towards a regional currency union, which under the Muscat agreement will be established in 2010.

⁵ The recently published Communication from the Commission to the Council and the European Parliament on “European Energy Infrastructure” comes to the same conclusion and proposes the TEN programme with revised priorities as the key instrument to pursue this goal. It mentions, in particular, the need to establish an interconnection between Turkey and the European gas network to facilitate imports of gas from Central Asia and the Middle East. However, the initiative can only be effective in the long run if it is undertaken in the context of dialogue with potential exporting countries to ensure that the complete infrastructure chain is put in place.

- Pursue greater integration of capital markets through cross listing of major Gulf companies and the provision of technical assistance to Gulf markets on the part of the major European exchanges. Improve conditions for electronic trading of European stocks in the Gulf and promote the opening of Gulf stock markets to European investors under conditions of stability and transparency.
- Promote the further opening of financial markets in the Gulf to European banks and other intermediaries taking into account the WTO and the FTA framework as a tool to favour increased competition, improved services and greater integration with the European financial markets.
- Support the growing use of the Euro as a reserve, trade and investment currency also for transactions between the two regions.