price shock is equivalent to 15 per cent in GDP, a major shock.

While some GCC ministers have been vocal in the media that their countries' development spending is on track despite falling oil prices, stock markets have declined on the prospect that lower oil prices means lower government spending and hence lower economic growth and company earnings.

GCC countries also face pressure from their peg to the US dollar that has appreciated more than 10 per cent against all major countries (EU, Japan and others). This implies a loss of competitiveness for GCC countries which hurts their non-oil sectors including manufacturing, tourism and other services.

Dubai is suffering because of Russian sanctions and the falling Ruble, which have negatively impacted Russian tourist flows, while European tourists feel the pinch of a depreciated Euro and anemic growth.

GCC countries thus face both the pressure of lower oil government and export revenue as well as a loss of competitiveness due to the appreciating US dollar.

HOW SHOULD THE GCC ADJUST TO THE NEW PARADIGM?

Avoid Pro-Cyclical Fiscal Policies: GCC countries have limited economic policy choices given their pegged exchange rates to the US dollar, resulting in a lack of monetary policy independence. Their only policy tool is fiscal policy.

The setting of fiscal policy is crucial. GCC nations need to avoid abrupt spending cuts that result in pro-cyclical fiscal policy as happened in past episodes of declining oil prices in the 1980s. Past policy choices exacerbated the negative shock from oil price falls: Lower government spending led to a shrinking of the non-oil sector, compounding the contraction in the oil sector and leading to a fall in overall growth.

GCC fiscal settings and outcomes will also reverberate across the region. In particular, GCC growth has spillover effects on Middle Eastern countries that are labour exporters to the GCC.

A repeat of past pro-cyclical policies would negatively impact labour exporting nations (Egypt, Jordan, Lebanon, Yemen and others) resulting in falling remittances, tourism and capital investment from the GCC at a time of turmoil and geopolitical instability. It is also likely that foreign aid from the GCC will shrink, adding to the economic problems of the transition countries.

Instead of a pro-cyclical policy option, GCC countries need to adjust spending programmes gradually and reduce the size of government to the extent that the decline in oil prices is more likely to be permanent.

Remove fuel subsidies and shift spending to productive investments: GCC countries need to shift spending towards job-creating, growth-lifting expenditure towards infrastructure, build human capital and development spending that crowds-in the private sector and launch public-private partnership (PPP) programmes and privatisation.

In particular, there is an unprecedented opportunity to remove subsidies and wasteful social support schemes. Fossil fuel subsidies account for about 10 per cent of the GCC's combined GDP, a major drain on government budgets. The sharp fall in oil prices provides a 'perfect storm' opportunity to remove fossil fuel subsidies.

A good example is Indonesia: On January 1, President Joko Widodo abolished the fuel subsidy which was costing $19.6 billion or 15 per cent of the state budget, more than three times the allocation for infrastructure (such as roads, water, electricity and irrigation networks) and three times spending on health. This courageous reform was undertaken in a country where around half of its 250 million people live with an income at or below $2 per day. By comparison, GCC countries are enormously wealthy with per capita incomes some 20 to 30 times that of Indonesia.

The GCC should follow Indonesia's lead and abolish oil subsidies, let domestic oil prices reflect international prices and free up budgetary resources for economic and social development.

The GCC needs to diversify the sources of government revenue: They must reduce their over-reliance on oil revenue, which represents some 85 per cent of overall revenues.

This requires fiscal reform and can be achieved by (a) adjusting the prices of public utilities (electricity, water, transport) in line with underlying costs, (b) introducing a broad-based VAT, say at 5 per cent that could raise up to 3 per cent of GDP in revenue, and (c) imposing new excise taxes on gasoline, diesel, tobacco, alcohol and similar products.

The GCC can run budget deficits: Last, but not the least, there is no problem with running budget deficits as long as this does not threaten long-term fiscal sustainability. GCC countries have low levels of debt.

The fall in oil revenues is the perfect opportunity to finance budget deficits by issuing Treasury Bills and government bonds and Sukuk in local currency. Issuing medium and long-term bonds and Sukuk instead of the practice of using current revenue should finance infrastructure and development projects. This policy change would give a big push to developing local currency financial markets.

A HISTORIC OPPORTUNITY

The collapse of oil prices should be used by GCC countries to undertake economic and fiscal reforms that could simultaneously lead to diversification of government revenue, reduce dependence on oil revenue, help develop local financial markets and remove distortions to production and consumption resulting from oil subsidies. The starting point should be to abolish oil and gas subsidies. GB

	REVENUES	EXPENDITURE	BALANCE
Dubai	Dhs 41bn (11 per cent yoy)	Dhs 41bn (9 per cent yoy)	Balanced budget
Iraq	IQD 100trn	IQD 123trn	-IQD 23trn
Oman	OMR 11.6bn (-1 per cent yoy)	OMR 14.1bn (+4.5 per cent yoy)	-OMR 2.5bn
Kuwait	KWD 12.05bn	KWD 19.07bn (-17.8 per cent yoy)	-KWD 8.23bn
Saudi Arabia	SAR 715bn (-33 per cent yoy)	SAR 860bn (+0.6 per cent yoy)	-SAR 145bn