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The Monetary Union of the Gulf Cooperation Council and Structural Changes in the Global Economy: Aspirations, Challenges, and Long-term Strategic Benefits

Dr. Khalid Bin Rashid Al Khater | May 2012

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Abstract

This paper addresses the potential benefits and challenges facing the Gulf Monetary Union project. It also tries to highlight the strategic gains from structural changes in monetary policy strategies in Gulf Cooperation Council (GCC) countries and incorporate them into gains and costs calculations. The paper also reveals the challenges in light of the forthcoming structural changes in the global economy (and the consequences, especially on the US economy and the state of the US currency), and then on the global political stage. These challenges are summarized in three main themes: political will and commitment, institutional sovereignty, and constituent technical requirements.

∗ This paper is based on a lecture given at the "Assessment of the progress of the GCC at the summit in Kuwait" seminar at the General Secretariat of the GCC, in Riyadh, on March 6, 2010.

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Introduction

When looking at the conditions and criteria set by the economic theory for establishing an optimum currency area (OCA), or joining it, the potential for the availability of these conditions is found to be relatively higher in the case of the GCC compared to that of European Union countries.[1] So far, European Union countries have succeeded in their monetary union experience. It is not necessary for all the theoretical ingredients to be available before (*ex ante*) the completion of a monetary union. Some can be achieved as a result of the union and after its completion (*ex post*).[2]

Frame 1: Conditions for an Optimum Currency Area (OCA)

1. Economic openness
2. Mobility of factors of production
3. The degree of economic diversification
4. Similarity (shocks) in production structures
5. Convergence of inflation rates
6. Consistency of fiscal policies
7. Political will

See, for example, Mundell (1961), Fleming (1971), and Bofinger (1994).
There is also a tremendous amount of literature that gives a grim picture about the availability of these conditions and the cost of monetary union in the European case. See, for example: Erkel-Rousse and Melitz (1995), Bayoumi and Eichengreen (1993), Bayoumi and Masson (1995), Atkeson and Bayoumi (1994), Blanchard and Katz (1992).

The GCC started to implement agreed upon practical steps that in order to establish the Gulf Monetary Union, one of the major goals behind the founding of the GCC. The endorsement of the Unified Economic Agreement called for the adoption of the US dollar as stabilizer of currency by the end of 2002, and included the economic

[1] Some economists (see: Meade) saw, beforehand, that the conditions for a single currency are not met in the case of Western Europe, while Feldstein saw it as an economic burden, and does not constitute a common currency area, but that its ultimate goal is a European political union. See: Martin Feldstein, "The Political Economy of European Economic and Monetary Union: Political Sources of an Economic Liability," *The Journal of Economic Perspectives*,11(4), 1997, 23- 42.

[2] Alesina et al. "Optimal Currency Areas," National Bureau of Economic Research Working Paper, No. 9072, 2002, (Cambridge, Massachusetts).

convergence criteria by the beginning of 2005. Shortly afterwards, in December 2006, Oman withdrew from the Gulf Monetary Union, and the United Arab Emirates pulled out in May 2009, following the announcement that Riyadh would host the future Gulf Central Bank as of 2010. Kuwait abandoned its dinar's peg to the US dollar in favor of a basket of international currencies as a major step toward the implementation of economic policy convergence and meeting the membership criteria to join the monetary union, without abandoning the monetary union project.

Currency represents an important symbol of national sovereignty, and the need for political will and resolve is undoubtedly very important for the success and continuity of a monetary union project. Some economists have gone further to claim that a condition for the success of a monetary union is for it to be an intermediate step toward reaching the final goal of political unity.[3] Political commitment will come from the clarity of decision-makers in relation to the advantages and disadvantages of a monetary union. Additional concerns are the potential disadvantages or costs of not forming a monetary union or joining it when it is established. In the case of the European Union, there was clear political persistence and determination by the countries involved to form a monetary union, in spite of the difficulties and problems (economic and political), in addition to governmental and political program changes. This was confirmed again during the recent Greek debt crisis. One of the lessons learned from the European sovereign-debt crisis is the need for high-level coordination between the fiscal policies of member states. This requires a high level of political flexibility, and a waiver of some sovereign issues, particularly in relation to financial and public debt policies. In brief, the sovereignty problem is centered on two issues, namely that national currency is considered a symbol of sovereignty, and necessary for the adoption of independent economic policy (financial, and public debt). If this is the case, is there sufficient justification for independent states to abandon this important symbol for sovereignty and the development of economic policy?

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[3] See, for example, Mundell (1961), who refers to some of these views on the European Economic Union, and Feldstein (1997). It should also be noted that a future European political union is outlined in the Maastricht Treaty. In the same context, Feldstein refers to the memoir of the former governor of the German Central Bank in 1994 Helmut Schlesnger in which he states that economic unity is an essential tool to reach a united Europe. See: Martin Feldstein, op. cit., 23- 42, and R. Mundell, "A Theory of Optimum Currency Areas," *American Economic Review*, 51(4), 1961, 657- 665.

Political will and commitment arise from full awareness of the possible gains and the expected costs of forming a single-currency area. If the ultimate goal is, for example, to pave the way for achieving political unity in the long run (as seen by some in the case of Europe), then it is possible for the introduction of a monetary union, even if it is not justified in economic terms (in the short-term). In this paper, I try to expand on the possible gains and costs of forming a single-currency area for the GCC countries, beyond the traditional boundaries set by economic theory and bearing in mind the structural changes emerging in the global economy, including them in the calculations of the possible gains and the expected costs. In other words, it is important to take into account the negative consequences for the GCC countries of the forthcoming structural changes in the global economy, or at least the cost of the lost opportunity for the GCC countries, if a currency-union area is not formed, for the following reasons:

1. GCC countries cannot overlook structural changes in the global economy and the implications for the GCC countries and their economies. Even if these changes do not harm their economies and gains in the long term, they will undoubtedly miss an opportunity to enjoy a stronger position and greater gains on the future global economic scene. The delay in achieving this goal and catching up with the rest of the world in this area could make the GCC economies pay a high price.

2. Regarding internal costs (i.e., the domestic level for the union's countries, not a system with the outside world), the failure to achieve a monetary union will not open up opportunities or allow these countries (individually) to make amendments to their monetary strategies and follow monetary policies that will be more independent and can be mainly directed at serving domestic economic goals. This could make them lose the gains, characteristics, and advantages that could come from an independent monetary policy. In addition, they could pay a high price as a result of losing the required minimum of independence for monetary policy and continue adopting monetary policies that are unsuitable for the conditions and givens of the present or future economic phase. This is what occurred during the latest round of inflation when there were indicators showing differences between the economic cycle in the GCC countries and the economic cycle in the country to which the currency is pegged (the US), which had significant negative effects on the economies of the GCC countries (represented in higher inflation rates, speculation over their national currencies, and an increase in surplus liquidity).

3. From the angle of making radical structural reforms, GCC countries cannot achieve liberalization of the exchange rate except by entering into a monetary union, whether for an economic reason, such as creating economies of scale to

reach an effective, independent monetary policy, or for political reasons. One of the direct gains of liberalization of the exchange rate is the freeing of two main tools in economic management that are currently restricted (i.e., the exchange rate tool and the monetary policy tool) in order to use them for economic correction. There are many other indirect goals/gains and it is difficult to mention them all in this paper. Some of them go further than economic gains and goals, including: maximizing the benefit for the GCC countries from their oil wealth and improving their status on the global economic and political scenes.[4]

In this paper, I address the potential gains and the challenges facing the GCC single-currency project. I will try to highlight the strategic benefits of the possible structural changes to the strategy of monetary policy, and include them in the calculation of gains, costs, and challenges. I will try to link the achievement of these gains and the maximizing of their use to justify the costs associated with the formation of a single currency and assist in overcoming the difficulties and challenges that could hinder the process. These can be summarized in three main themes:

1. Political will and commitment: a fundamental, formative challenge. I link this challenge to the long-term strategic gains that GCC countries could achieve, taking into consideration structural changes in the global economy and possible gains in the shorter term. This subject will be addressed in the second part of the paper.

2. Institutional sovereignty: this is connected to the stability and continuity of the single currency (a sovereign and economic challenge that has technical effects and consequences on the stability of a single currency). Here, the European debt crisis and the lessons learned from it will be addressed. This will be addressed in the third part of this paper.

3. Technical requirements and challenges: this subject will be addressed in the fourth part of the paper. It will highlight the infrastructure necessary for the formation of monetary union, including research, statistics, and human resources.

[4] The success of a Gulf Monetary Union could pave the way for a political union in the future. In this context, the economist, Martin Feldstein, emphasizes that it is wrong to think that the economic incentive is the motive behind the formation of the European Monetary Union, and that it is also wrong to believe that in case European monetary integration fails that the economic cost will outweigh the economic benefit. The first and last motive is the political factor.

Political Will, Commitment, and Long-term Strategic Gains

Is there a clear objective behind the establishment of a single-currency area, or awareness of the potential gains and costs associated with it? Has the full extent of the lost opportunity, or the possible disadvantages for GCC countries on not achieving a monetary union in the long term, been recognized? Goals and gains should not be limited to conventional economics set by Optimal Currency Area (OCA) theory. There are known gains from an intra-regional trade boom, the free movement of goods, the factors of production as labor and capital, and the probable results of an expansion in markets and integration. The GCC countries are all producing the same product and do not have a great deal that they can export to each other at the moment, as their production structures are similar and their economies are not currently diverse. However, they can diversify more in the long run, and essentially they have no other choice. At this point, the role of the single currency in the prosperity of intra-regional trade would become clearer.

Frame 2: Currency-union Gains

Internal (among GCC countries):

- Intra-regional trade boom: the free movement of goods, commodities, and factors of production, and conducting economic activities. This will all contribute to: (a) the integration of markets and the distribution and more efficient use of factors of production (provided that barriers are removed), goods, and commodities; (b) the expansion of markets and support for the development of economies of scale, or justifying these industries in terms of cost; and (c) the unification of markets in a single-currency market run by one central bank with one interest rate. In this way, financial markets in GCC countries can turn into one financial market, where a buyer can purchase listed stocks in any market. These benefits can contribute to the diversification and acceleration of GCC countries' economies.
- The control of fiscal policies and the strengthening of the credibility of monetary policy as a result of the controls and standards required by monetary union.

External (GCC countries with the outside world):

- The creation of a unit or an economic bloc that would give GCC countries greater weight at the global level, enabling them to deal with the outside world as a single economic bloc or power.
- It would give GCC countries greater bargaining power, so as to achieve greater gains, not only at the economic level but also at the political level.
- Greater attraction for direct foreign investment through the creation of credible economic policies reinforced by monetary union, as well as the creation of a larger market and a bigger economy.

Beyond the Boundaries of Traditional OCA Theory

Limiting it to traditional gains could lead to the conclusion that the benefits from a Gulf Monetary Union may not be justified from an economic point of view in comparison with the cost, given the high specificity of the economies of the GCC countries. The world is changing and there are structural changes emerging on the global economic scene. This became more apparent with the eruption of the current global financial crisis. Countries that are now, but previously were not, influencing the global economy are competing to make gains on the future global economic scene, and at the same time protecting their status and national economies. These are countries like China, India, Brazil, and Russia. The GCC countries would be a strong economic force if they were or were able to form a single economic bloc. They also have a vast amount of natural resources that the world needs.

The future will see a world of multi-economic powers and alliances and respect will be given to the stronger and fittest, as always. An example is small countries with limited or no natural resources achieving remarkable economic successes and imposing their will on others. These are countries such as Singapore, Korea, Hong Kong, Taiwan (countries of the economic miracle), and before them Japan. On the other hand, there are also countries with natural resources that have achieved significant successes on several levels, including: Malaysia, Mauritius, and Botswana.[5]

Also of importance are the indications and consequences of these changes on the new global economic arena, and then on the global political arena, given the close correlation between the two. The world's economy is multi-polar and will result in a world that is politically and strategically multi-polar.[6] This multi-polarity will witness the ascension of China, India, Russia, the European Union, and Brazil, and the emergence of roles for regional powers like Iran, Turkey, and South Africa. This indicates a decline in the role and influence of the US on the global arena over the next few decades.

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[5] K. Alkhater, "The Rentier Predatory State Hypothesis: An Empirical Explanation of the Resource Curse," (Ph.D. Dissertation, University of California, Irvine, California, 2009), based on Chapter 4 in *Resource Abundant States: The Rentier Predatory State*. Unpublished. Available online at http://ssrn.com/abstract=1733262

[6] This is what many political and strategic analysts are indicating. See, for example, the report of the US National Intelligence Council, 2008.

These changes will produce a new world order that the GCC should pay attention to and make sure it is included in future strategies and policies that are based on two axes: the first to prevent or reduce negative consequences on the GCC countries as much as possible, and the second is to maximize as much as possible any benefits from this new situation. The GCC countries should look to the future in a deeper and more strategic way and plan ways to gain a foothold in the new global economic arena.

In light of these challenges, it has become necessary, now more than ever, to give scientific research its rightful place, to listen to trusted professionals, and make decisions based on scientific evidence and well thought out plans, and to hand economic management over to those who are skilled. It is those who are capable of having a vision for the future and developing the appropriate strategies and plans – or at least advising decision-makers – that will help countries avoid economic catastrophe, or at least reduce costs and maximize gains. The costs should not necessarily be limited to consumers, as decision makers have lately affected many of them. The recent Arab revolutions were initially driven by protests against poor living standards and economic conditions that have accumulated due to misguided polices over a long period of time, although they were soon elevated and tackled issues of democratic freedom. This is natural, given the close connections between the economy and politics. The economy leads to politics and politics leads to the economy.

To avert a crisis, politicians in many of these countries rushed to increase government spending as a proactive, preventive measure. This was not enough because, in addition to other contributory factors, it can result in the generation of inflationary pressure that would also require proactive treatment through flexible and effective monetary policies. This issue makes it necessary for a review of the current exchange rate system. The spending process should be controlled, balanced, and accompanied by radical reforms, some of which are directly related to markets. In addition to giving monetary policies flexibility to address the inflationary effects of government spending, there should be reform of market distortions and support for competitiveness. There are other reforms that should be made and may need to be addressed by further research. If adequate treatment of such matters does not happen, rapid increases in spending could later generate inflationary pressures that may crush the original desired benefit, if they exceed a reasonable limit, causing prices to increase and with them the cost of living, and the ghoul of inflation would eat up what is left of savings and misfortune occurs.

Here, the story of the Prophet Yusuf, peace be upon him, comes to mind: he said to the king, "appoint me over the world's treasuries, I am a knowing guardian". It is likely that "knowing" here, means the science of forecasting. Yusuf, peace be upon him, predicted the occurrence of two economic periods, and he developed appropriate spending plans and programs for each period. Otherwise, a great disaster would have befallen the land during the recession period, which came following a boom and as a result of economic mismanagement during that period.[7]

It is unfortunate that the science of forecasting, although important, does not receive due attention in the Arab world, where lessons are not learned from history or from others' experiences. Random and reactionary policies are dominant features in many cases. Some of the lessons learned from this story are good planning and efficient

[7] Ibn Kathir indicates in his explanation of the word *aleem* (knowing) that Yusuf has knowledge and insight of what he handles. Shiba ben Noamah said that Yusuf knew about the years of drought. Abdullah Yusuf Ali adds in his translation that Yusuf, peace be upon him, was intentionally asked this question, and the reason was because he, more than others, knew the need to follow austerity measures at the height of a period of boom. These are naturally unpopular policies that could give rise to discontent because they are not understood. Yusuf was fully prepared to take personal responsibility for that instead of putting it upon others. The reason for this was the Yusuf's confidence and knowledge (through his interpretation of the vision) of what would happen after a boom. In any case, I believe that the more accurate meaning of *aleem* here – one that is also supported by the course of events – is the science of prediction in economic terms. It is something that Ibn Kathir generally describes as "insight," and could also be expressed as "vision". See: Ibn Kathir, *Tafsir al-Quran al- Azim*, a report by Sami Bin Mohammed al-Salama, 2nd edition, (Kingdom of Saudi Arabia: Dar Tiba for Publishing and Distribution, 1999).

It may be that that Yusuf, peace be upon him, could be the first macroeconomist who used a counter cyclical monetary policy and it could also be seen as a form of the so-called "leaning against the wind policies," that are macroeconomic precautionary policies that adopt a reduction of expansion in good times to limit the accumulation of macroeconomic imbalances later. These were policies that the Bank for International Settlements called for before the eruption of the recent global financial crisis. See some of the reports and studies emanating from the 78th Annual Meeting of the Bank for International Settlements in Basel, Switzerland, June 28-30, 2008, including the bank's 78th annual report. See also: W. White, "Is Price Stability Enough?" Monetary and Economic Department, Bank for International Settlements Working Papers No.205, 2006.

After the occurrence of the global economic crisis, many advocates of these policies and theorists emerged who criticized expansion policies, particularly the expansionary monetary policy that the US Federal Reserve had adopted during the boom years that preceded the financial crisis, as it was the main factor behind the accumulation of macroeconomic imbalances that eventually led to the global financial crisis. In the story of Yusuf, peace be upon him, the length of each economic cycle is seven years. This is a logical average for economic cycles. Look, for example, at the classification of business cycles in the US by the National Bureau of Economic Research. See also: A. Burns, and W. Mitchell, "Measuring Business Cycles," National Bureau of Economic Research: New York, 1974, http://www.nber.org/cycles/.

management of resources in times of prosperity, as well as being prudent with what the heavens have provided for free.

Perhaps political decision-makers have not yet had the chance to look at the full strategic dimensions and long-term gains that can be achieved from establishing a single-currency area and the negative consequences of not establishing it. This is the responsibility of economic decision-makers in the first instance, and takes us back to the necessity of political decision-makers making good decisions and listening to professionals.

Monetary unions are the cornerstones of an economic union and in an economic union there is also political power. A monetary union would be possible in the case of the GCC if it became a strategic goal and was established on a sound technical basis. A monetary union is the most realistic step that could be taken to pave the way to achieve political integration and make it easier for political union in the future. Although Europe has different races, languages, and even economies to a certain degree, it has so far succeeded in its monetary union because a monetary union in the European case is only a step toward a further strategic objective, which is political unity. An assessment of the long-term benefits that could be achieved from a monetary union, including the calculations of gains and costs, will favor the gains, and, therefore, make it easier for GCC countries give up some sovereign issues, or what seem to be sovereign issues, even if many of them seem to be formal in nature.

There is little to mention about foregoing monetary policy independence as it has been abandoned a long time ago through the linking of exchange rates. This has had implications on economic management and national economies by paralyzing one of the most important tools of economic policy management, which is monetary policy. The availability of political will and the willingness of member states to cede some of the traditional understanding of sovereignty are some of the most important conditions for the success of the monetary union process. This is especially the case in the field of economic policy, and it shows the degree of willingness that is already present to achieve a high level of coordination and consistency between these policies. This is probably the least present in the monetary union area of the GCC, particularly in light of the latest developments in the European Monetary Union (EMU). Abandoning sovereignty in some matters, such as fiscal policies and their coordination, is of vital importance for monetary union success.

Forthcoming Structural Changes in the Global Economy

The global economy is on the verge of structural change. The US economy and the dollar are in a long-term decline. The global financial crisis revealed structural weaknesses in the US financial system. There are signals and indications for a structural problem heralding the US dollar decline, including:

1. The twin deficit, or the double deficit, in the budget and in the US current account. The budget deficit reached 1.3 trillion dollars in 2010, around two-thirds, or 11 percent, of gross domestic product (GDP) in 2010, and this deficit is being financed by issuing US government bonds. The current account deficit has reached $480 billion. These are unprecedented deficits in the history of the US.

2. The US economy's huge debt exceeds $14 trillion, or 100 percent of GDP for 2010. The debt has also been increasing by a daily rate of $4.14 billion since September 2007.[8]

3. It is in the US's interest to have a weak dollar in order to raise their competitiveness in the global export market and reduce imports and the real value of the debt by paying with a weak dollar. The relative improvements in the exchange rate of the US dollar following the financial crisis are subject to the end of the crisis, and are, therefore, temporary and not contrary to it as some believe. The dollar may see such periodic fluctuations, but will fall in the long term under the weight of the US budget deficit, along with the gradual transition of the global economy to the East. The world's confidence in the ability of the US to repay its massive debt may falter and a weak dollar policy may become the default choice of the US administration. The rate of the dollar may fall more than 20 percent in the medium term and collapse in the long term (10 to 15 years).

   There are now critical voices being voice regarding the trends that kept the dollar at a high exchange rate over the last three decades, asking for the pursuit of policies to reduce the value of the dollar in order to level the US balance of trade, which has been suffering from a sway in balance to the disadvantage of the US, and support

[8] The source of data for the budget deficit is the US Treasury website, www.treasury.gov/pages/default. The current account deficit is the writer's estimate based on the Bureau of Economic Analysis data. The source of data for the national debt is the US National Debt website, www.billing.com/debt_clock.

the competitiveness of US companies in the long term.[9] In the short to medium term, there are calls for reducing the value of the dollar to solve the current unemployment problem through supporting exports and industry and thus creating jobs. There is also the possibility that a global currency war may erupt. This could make the GCC part of a war they have nothing to do with, and subject to the fluctuations in exchange rates. Some explain the non-interference of the US Federal Reserve as a policy to prevent further decline in the value of the dollar, and as an attempt to keep interest rates very low (almost zero), especially considering the statements by its officials in support of this policy, and the pumping of massive amounts of liquidity into the banking system. All of these signal a reduction in the value of the dollar as well as support the financial sector.

4. The lack of confidence of the outside world in the US dollar stems from the enormous deficits the US economy is suffering from and the continued borrowing and accumulation of debt; these are matters that concern many and cast a dark shadow over the future of the dollar, particularly as the US has experienced difficulties in maintaining its value during most of the last decade.[10] These factors will increase the efforts of countries with major economies to diversify their reserves, as seen by China's request to find an alternative reserve currency to the dollar. If the US continues to spend and borrow at the same rate, and the Federal Reserve continues to follow an expansionary monetary policy, the US dollar's status as a global reserve currency will continue to decline. It is possible that the dollar will lose its status as the main global reserve currency, or even collapse, with the return of the economic situation to how it was before the current global financial crisis, and the decline in global demand for liquidity. If investors' worries increase as a result of the growing of trade deficit and debt, and this is reinforced by the continued weakness of the dollar, it could in turn lead to the recalculation of expectations, and perhaps to a panic that could call for the ditching of the dollar, and thus its collapse.

   Even if the US succeeds in managing an exit strategy from the situation created by the financial crisis, by smoothly absorbing the vast amount of surplus liquidity, with

[9] This is what the economist Kevin Young from the University of California, Berkeley, lately called for.

[10] Carbaugh and Hedrick say that the US dollar lost around 33 percent of its value against major currencies during the period 2002 to 2009. See: R. Carbaugh, and D. Hedrick, "Will the Dollar be Dethroned as the Main Reserve Currency?" *Global Economy Journal*, 9(3), 2009.

the decline of the effects of the financial crisis, the dollar is on the verge of facing increasingly complex problems and difficulties in maintaining its status as the world's main reserve currency. Some of these problems are:

a. The growing belief is that a reserve currency system based on debt will generate a weak currency. It will make the currency susceptible to fluctuations, which in turn will destabilize the global financial trading system and become a vehicle for transporting imbalances across the global economy, leading to a spread of financial crises across the world. The governor of China's Central Bank, in March 2009, essentially requested this same thing – the adoption of the special drawing rights (SDR) as a reserve alternative to the dollar, citing the weak dollar as the root cause of the current global financial crisis. This request was supported by India, Brazil, and Russia. Russia went even further and announced the abandonment of the dollar as its main reserve currency. The main reason for the accumulation of US dollar reserve balances across parts of the world is a reflection of a deeper crisis in the global monetary system that has led to a reserve imbalance due to what is known as reserve anxiety, rather than a result of a high volume of world trade and an increase in the number of countries as some claim. This is the same anxiety that led countries – especially those in East Asia that experienced a severe financial crisis in the late 1990s – to accumulate large amounts of reserves in fear of crises.[11]

b. The Triffin Dilemma, in short, reflects an impossible duality that faces the world's reserve currency, and is represented by its response to the global demand for liquidity, which requires its current account to be in deficit, while maintaining confidence in that requires a current account surplus.

c. The reserve currency dilemma is the problem that the monetary authority of the reserve currency country faces, and is represented by the authority's inability to reconcile goals for the local economy and the fulfillment of its responsibilities to supply the world's reserve currency needs.[12] For example, the monetary policy needed to fight domestic inflation could lead to a failure to supply liquidity to other countries in the world, and vice versa. Encouraging

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[11] See for example: S. Aiyar, "An International Monetary Fund Currency to Rival the Dollar? Why Special Drawing Rights Can't Play that Role," *Center for Global Liberty and Prosperity*, The CATO Institute, Washington, D.C., www.cato.org

[12] Ibid.

domestic economic growth through monetary expansion may provide the world with more liquidity than it needs.

d. The strong economic growth in emerging economies in East Asia, the evolution of financial markets in these countries, the high returns on their investments, the consequences of the financial crisis represented by foreign investors' diminishing trust in the American financial market, and the risks that surround some foreign investments in the US after the events of September 2008 are all factors that together reduce the desire of foreign investors to invest in US markets or to keep dollar assets. They also impede the flow of capital to the US that is needed to finance the current account deficit, which leads – on the contrary – to the movement of capital abroad, and, thus, to a further decline in the exchange rate of the dollar.[13]

These factors have pushed many economists to call for a radical reform of the current global reserve system and a review of the entire global monetary system. The point is that linking the world's reserve currency to one country will be difficult to continue with and pressures will increase, creating a reserve currency that is not linked to a single currency and diversifying the reserve currency.

5. Signs for the emergence of structural problems in the US economy include the weakness of the dollar, and some of the factors causing its weakness can be seen as a reflection of deeper problems and challenges for the US economy. The main signs can be summarized as a continuing decline in the volume of production parallel with a reduction in the volume of exports. Consumption is also constantly growing and the American people – according to some American experts – have become the biggest consumers in the world, and this consumption is being financed by debt.[14] On the other hand, there has been an increase in the volume of imports, internal and external budget deficits, and foreign debt, and has reached the point that the US has become a net borrower, the largest borrower in the world. Have aging symptoms begun to show on the US economy, in terms of the economy reaching the stage of high mass consumption as a result of growing income and wealth? When this advanced stage in standards of living is reached and productivity and income are reduced, the way to maintain this level of consumption and

[13] K. Alkhater, S. Basher, and E. Elsamadisy, "The Incidence of Surplus Liquidity in Qatar during the Pre-Crisis Period: Sources, Implications, and Management," In preparation. Department of Research and Monetary Policy, Qatar Central Bank, 2011.

[14] Consumption may have been reduced now as a result of the late financial-economic crisis of 2007-2010, but it is not yet clear if this behavior is temporary or will continue in the long term.

standard of living is through borrowing. In contrast, the Chinese economy is growing steadily with increases in income, tax capacity, and exports (China became the largest exporter in the world), with continuing surpluses in the current account, and the transformation of China from a borrower to a net lender. China has now become the largest lender and the United States, in contrast, has become the largest borrower, and the dollar's share as a global reserve currency decreased to 65 percent, in 2009, from 80 percent in the 1970s. The Chinese economy is expected to reach the size of the US economy in a decade or two because of its continuing strong growth. China has taken Japan's place as the second largest economy in the world in terms of GDP. It is clear that the US economy is suffering from a lack of competitiveness or a reduction in competitiveness compared to the Chinese economy and that of other major emerging economies. This will inevitably continue for at least three main reasons: (a) the general spread of knowledge and technological progress, leading to countries with emerging economies catching up with those that are more advanced and shrinking the difference between these countries; (b) the huge labor force in China and other countries with emerging markets like India, particularly since they have the capacity and capability to acquire high skills. The interaction of this factor with the development of production techniques will lead to lower production costs, an increase in productivity, and, ultimately, to an improvement in competitiveness and the creation of global markets for these countries' products. In addition social, demographic, and economic pressures, inside, and strategic, political pressures and incentives from outside will drive these countries to compete to occupy a stronger position on both the economic and political international arenas; and (c) there is also a structural problem on the supply side that the US economy is suffering from, but there is no room in this paper to address this in detail, though I will mention some of these problems in brief: a deficiency in education and health care systems, labor market distortions, some of which were the result of shocks from the changes in stocks and technological products markets, and the movement of multinational corporations to outside the US. These sectors are in need of structural reforms in the long run. The labor force in the affected sectors is also in need of rehabilitation and redistribution to other sectors and added to that are the reforms required for the financial sector in the short to medium term.

The transformation from an ordinary currency to a hard currency historically occurs after a surplus in current accounts for a sufficient period of time. Accordingly, a country becomes a net lender. Carbaugh and Hedrick say that Britain achieved the status of net lender in the 19th century and the US in the early 20th century, and after that the markets recognized their currencies as hard currencies. There is no consensus on specifying the period in which the dollar replaced sterling as the leading reserve currency, but there is little doubt that this happened in the first half of the 20th century.[15] With reference to these historical examples of changes in the reserve currency, it can be deduced that the Chinese currency is on its way to an easy transition from an ordinary currency to a hard one and that the dollar is on its way to losing its status as the world's reserve currency.

GCC Countries and Problems Being Pegged to the Current Reserve Currency

The effect of pegging the currencies of GCC countries to a weak reserve currency that is prone to sharp fluctuations in the future can be looked at from four angles:

First is the impact of the differences between the economic cycle of the GCC countries and that of the US, and the implications of these for economic management, and the creation of imbalances in the overall economy (the dilemma of a fixed exchange rate under the desynchronization of economic cycles). The United States emerged from World War II in 1945 responsible for almost half of the world's production. This ratio has been decreasing, until it reached less than 20 percent before the current global financial crisis; along with it came a reduction in the volume of its exports. Both of these issues point to several things:

a. The weight of American demand for factors of production and raw materials, especially oil, is shifting to other countries especially those in the east.

b. The shift in the world's demand for oil from the US to China, India, and other Asian countries will lead to weakening the link, or even to a de-link, between the cycle of oil prices and the US economic cycle, and will make the GCC prone to the demand shocks of these countries.

c. This in turn will lead to a difference between the economic cycle of the US and the economic cycle of the GCC countries that depend on oil and peg their currencies to the US dollar. It seems that the more reduced the size of the US economy, the bigger the gap is between the economic cycles of these two regions.

[15] For further discussion and references on this subject, see: B. Eichengreen and M. Flandreau, "The Rise and Fall of the Dollar, or When did the Dollar Replace Sterling as the Leading Reserve Currency," *European Review of Economic History*, 13, 2009, 377-411.

d. This will also lead to problems in the management of the macroeconomic policies of the GCC countries in the future, and set alarm bells ringing for the forthcoming Gulf Central Bank whose main goal will be price stability. It will also lead to a monetary policy dilemma between these countries and the US, and to a failure to achieve macroeconomic goals. It could also create imbalance and instability in the overall economy that could have an adverse effect on the national economies of these countries. This is indeed what happened during the last economic cycle that preceded the financial crisis in mid-September 2008, as the circumstances and economic data in GCC countries required contractionary monetary policies (contraction by raising interest rates), to balance the impact of the expansionary fiscal policies of these countries and reduce inflationary pressures. Instead of that, or at least instead of keeping monetary policies neutral, they were moving in the opposite direction, or expansion, having central banks in the GCC countries cut their interest rates. They were forced to keep up with the expansionary monetary policy of the US Federal Reserve because their currencies are pegged to the US dollar. This contributed to increased inflationary pressures on these countries and finally exposed the national currencies of GCC countries to speculative transactions.[16] These problems are common in fixed exchange rate systems. If the markets view the credibility of the pegging process and the ability of countries to keep to it in the future with suspicion, this can lead to speculative transactions on the pegged currency. This is what happened to the currencies of GCC countries in the period that preceded the current global financial crisis after exchange rate systems showed stability and high credibility over two decades or more, when there was a balance between the economic cycles of the US and the GCC countries. No matter how long the credibility period of pegging is, it remains vulnerable to shocks and crises in the long run that may not necessarily be the result of economic factors.

Additionally, the erosion of asset values denominated in the reserve currency is a natural result of the continued deterioration in the exchange rate of the US dollar against other major currencies. In light of the above analysis, the US dollar is a candidate for further decline in the future. It is, therefore, better for GCC countries to seek to diversify their global reserve portfolios in the long term to reduce this impact

[16] This expansionary monetary policy that was pursued by the US Federal Reserve early in the last decade faced bitter criticism from many people on the basis that it was the main factor that led to the accumulation of macroeconomic imbalances that eventually led to the bursting of the real estate bubble and its transformation into a far-reaching global financial crisis.

and prepare for the transition to an exchange rate system that gives a greater degree of independence for their monetary system.

The impact of inflation due to the exchange rate pass-through occurred as a result of the deterioration in the exchange rate of the US dollar against the non-dollar currencies of the GCC's trading partners. Since GCC countries import most of their consumer goods and even capital goods, and considering that the volume of imports from the US is decreasing in favor of imports from other countries, the value of the import bill on GCC countries and the rates of inflation domestically rises, as seen during the last cycle of inflation.[17]

Lastly, one must consider the impact of sharp fluctuations in the dollar exchange rate, which is volatile even with the general downward direction the value of the dollar is taking. This volatility is also affected by many factors, including: rumors, political unrest, currency speculation, the price of oil and raw materials, and the performance of other economies (Europe, East Asia, and Latin America). Whenever any of these economies gain strength, the dollar weakens. These fluctuations have an effect on inflation rates through stimulating inflationary expectations. It also creates a state of uncertainty and instability for investors, and disrupts investment and growth. The strong inverse relationship between oil prices and the US dollar exchange rate that characterized the period before the current global financial crisis led to reduced income for GCC countries from oil exports compared to what they should have been in the absence of the inverse relationship. This complex relationship, which started to emerge in early 2004 and continued until the eruption of the global financial crisis in September 2008 will not be discussed here.[18]

The bottom line is summarized by the following questions: what is the size of the additional gain that will be achieved from a monetary union without liberalization and

[17] S. Basher, and E. Elsamadisy, "Country heterogeneity and long-term determinants of inflation in the Gulf Arab States," (Manuscript, Department of Research and Monetary Policy, Qatar Central Bank), 2010.

[18] The interested reader can refer to the following studies:

J. Jackson, "The U.S. Trade Deficit, the Dollar, and the Price of Oil," Congressional Research Service 7-5700 (RL34686), 2010, www.crs.gov.

S. Jen, "On the Link between the Dollar and Crude Oil," Bluegold Capital Management LLP, Unpublished report, November 20, 2009.

independence of the monetary policy in the first phase? This is the minimum,[19] since if the maximum that is achieved by a monetary union is continued pegging to the dollar, as some believe, then what benefit will a monetary union give to the present situation? The GCC is already in a state of monetary union with the US through being pegged to the US dollar, the exchange rates are known and stable, and the national currencies of GCC countries are practically unified and there is no risk from internal exchange rate fluctuations as they are equal to zero.

There is also a significant technical problem that will face the future Gulf Central Bank. How will it be able to achieve the main goal set by the Monetary Union Agreement, which is to achieve stability of prices for the single-currency area? What is theoretically agreed upon and what is known from the long experience of central banks the world over is that generally an independent monetary policy and an independent central bank are needed for this goal to be achieved. This was the case with the Bank of England, the European Central Bank, and the German Central Bank (Bundesbank), previously.

It is noteworthy that the Qatar Central Bank has followed an independent monetary policy since the global financial crisis in September 2008 when the bank did not follow the interest rates set by the US Federal Reserve and, until recently, kept them to pre-crisis levels. This tight monetary policy stance contributed to reducing rates of inflation, which were 15 percent at the end of 2008, the highest in GCC countries, to 5 percent by the end of 2009, the lowest over the GCC countries in that year.

Independent Monetary Policy Gains

What is required is a monetary policy primarily directed toward serving the domestic economic goal, which is price stability. This policy must be relatively independent from US monetary policy and free from being at the mercy of the global circumstances of the US dollar's market exchange rate whenever possible.

The Monetary Union Agreement states that the goal of the monetary union policy is to guarantee the stability of prices in the single-currency area. Reduced and stable prices have many benefits, including:

[19] A partial independence of monetary policy can be realized by starting to de-peg currencies from the US dollar and peg them to a basket of currencies of which the US dollar is one.

1. The management of an independent monetary union policy, with a strong and independent central bank that is directed toward serving domestic economic goals, means controlling everything. The goal of achieving price stability requires that an independent central bank undertakes strict measures, such as:

    a. Control over the money supply;
    b. Credit control;
    c. Regulation of micro-prudential policies, risk rates, and ceilings imposed on banks and financial institutions; and
    d. Control of fiscal policies, public spending, and public debt policies (macro-prudential policies).

    All of these factors can contribute and lead to financial and monetary stability, the reduction of inflationary pressures, and controlled, continuous, and balanced growth. This can encourage direct foreign investment and accelerate the diversification process of economies.

2. A bigger and longer-term goal is complete independence from the monetary policy (liberalization of the exchange rate), which requires that GCC countries should price their oil exports, or at least invoice its revenues, in the unified currency.[20] The currency cannot be floated in another way because of the weakness in the non-oil based export market of GCC countries, and, consequently, the lack of the possibility of demand on the unified currency. If oil was priced in the unified currency, a managed float, or even a free float of the currency, could be achieved without having to link it to the currency of any other country. This would lead to countless benefits in turn.[21]

    In addition to primarily serving domestic economic goals, complete independence of monetary policy can contribute to the following:

    a. The use of the exchange rate as a tool for economic correction through raising or lowering the exchange rate to counter inflationary pressures, and

[20] This was suggested in public for the first time on Al-Jazeera's *Al-Hasad* program on July 2, 2009.

[21] Pricing: listing the price and collecting revenues in the unified currency; invoicing: listing the price in the US dollar and collecting in the unified currency.

improve the competitiveness of countries that are members of the Gulf Monetary Union.

b. Liberalizing the exchange rate would help the process of economic diversification by raising the efficiency of new production units, thereby increasing competitiveness locally and abroad. This efficiency would be achieved as a result of low and stable prices that will give more competitive capabilities to the domestic product (more cost efficient, more specialization).

c. Creation of a main international reserve currency may potentially be in great demand, and many central banks would use it as part of their reserves. Thus, the single currency could have a place among the global reserve currencies. When a strong international reserve currency is created from the unified currency, it would be the pinnacle of the single currency.

d. It would undoubtedly give the GCC countries greater weight in global economic and political arenas. It would also allow them to deal with the outside world as a unified economic power bloc. It would also grant them bargaining power and enable them to achieve greater economic and political gains.

Possible Disadvantages of Monetary Union

The question could be asked: is it possible for a single currency to have a negative effect on some of the GCC countries, as happened previously in Germany, when they were negatively affected by the French economy, or Greece's debt crisis negatively impacting other members of the European Union? The answer is that yes this is possible because a monetary union project is one of partnership and solidarity. Just as there are common advantages, there are also common disadvantages. In some cases, macroeconomic imbalances can spillover from one union member to another and then to the rest of the members. This demonstrates the importance of understanding the consequences, and the need to take responsibility for the decisions and policies taken by an individual member that could have negative effects on the rest of the members. It could be useful to impose sanctions on any member who does not comply with the standards of economic integration and financial regulations that could cause the instability of the single currency and damage the economies of the other member countries. This is a single economy, albeit under separate political entities with the same number of financial policies. However, it is also a single monetary policy just like it is a single economy. The central bank works as one monetary market in times of crisis, and one country might be able to cope with the crisis better than another. This is natural, as sacrifices have to be made. In such cases, countries with surpluses can bear the cost of adjustment that results from the countries suffering the crisis, provided that the crisis is not the result of a breach in the standards of financial regulations and economic integration or of fraud (moral hazard), and herein lies the importance of transparency. It may be very useful to create a mechanism that would take action over financing and control during times of crises that could affect the stability of the common currency. It would also be useful for all members of the union to be informed about this in advance, before joining the monetary union. Political decision-makers' knowledge and awareness of the objectives and possible disadvantages of this project is very important for its success. The cost of not forming a Gulf Monetary Union or not joining it could be greater in the future than it is now, in light of future developments in the global economic arena.

Institutional Sovereignty and Lessons Learned from the Euro Zone Crisis

The successive events in the euro zone since the advent of the sovereign debt crisis in Greece, and the fear of its specter over other countries, were for the most part the result of excessively cheap (low interest rate) borrowing by PIIGS countries (Portugal, Italy, Ireland, Greece, and Spain). They benefited from not only the protective umbrella of the euro, but also the mood of recklessness prevailing in international and multinational banking during the boom period preceding the financial crisis in 2007. This was the situation that the latest financial crisis has revealed. In this way, these countries violated financial regulations that are set forth in the Maastricht Treaty for stability and growth, and exposed the stability of the euro to danger.[22] This means that the fiscal coordination under the framework of Maastricht was not enough to safeguard the stability of the European Monetary Union (EMU). Immediately prior to this, Dubai's debt crisis occurred and is still fresh in people's memories. The GCC countries should be very aware of these experiences and draw appropriate lessons from them. What was learned during the first ten months of the European sovereign debt crisis was greater

[22] Note: PIIGS countries are Portugal, Ireland, Italy, Greece, and Spain. The breach of the terms of financial discipline has reached such a large scale to the extent that it has been rumored that Greece – in collusion with some international banks – provided disinformation in order to join the euro zone.

than had been learned during the previous ten years that had passed without a global financial crisis.

The first lesson to be learned is that the fiscal convergence criteria, which were given to the GCC, have been shown by the experiences of the European Union to be insufficient and unsuitable. The Gulf Monetary Union agreement was formulated in light of the EMU experience, of which a great deal had been transferred to the GCC, including sufficiency with regard to coordination between the fiscal policies of the member states in what was called the "Euro convergence criteria" – a budget deficit of 3-6 percent of GDP and a public debt of approximately 60-70 percent of GDP.

These two conditions are not enough to stand as a framework for coordination between the fiscal policies of member states and coordination between the fiscal policies of member states and the independent, unified monetary policy drawn up by an independent central bank. This would need to be a policy that would be independent, as outlined by the union's agreement, which states that the main goal of the Gulf Central Bank is the stability of prices in the single-currency area. Meeting the criteria to join the monetary union, such as the inflation criterion, requires coordination between fiscal policy and monetary policy in an individual country before starting to launch the single currency. In fact, this is also not enough for achieving monetary and price stability in an individual country as proven by the last cycle of inflation in most of the GCC countries.

Paying attention to and absorbing the lessons learned from the recent case of the EMU and should encourage the Gulf Monetary Union to do the following: (a) review the current framework for coordination between the fiscal policies of union members, and (b) develop a framework for coordination between all fiscal policies and the unified monetary policy across the Gulf currency area. In light of the absence of an opportunity to have a (federal) monetary union policy in the single-currency area at the moment, it is necessary to have high levels of consultation, coordination, and agreement between the finance ministries of member states, at least concerning budgets in the medium turn. An effective and binding mechanism should be found for monetary coordination and discipline: transparency, coordination, control, and commitment, respected by all the states and binding for all.

There are direct monetary effects of government spending in the countries that are part of the Gulf Monetary Union that are represented by an increase in money supply and credit rates. The governments sell a share of their proceeds in foreign currency to finance the public spending program. The non-hydrocarbon deficit in each country is, thus, positively and strongly linked to the economic deficit in each country. Since the Gulf Central Bank and the central bank systems in the single-currency area will inevitably monetize the macroeconomic deficit in the single-currency area, coordination between the unified monetary policy and the fiscal policies is imperative, particularly in relation to the following matters:

a. Domestic public debt policy and its relationship to the economic cycle: it is, at the moment, counter-cyclical and I suggest it should be pro-cyclical (i.e., borrowing in good times and paying in times of recession). This requires good planning for the government spending process, efficiency in the exploitation and management of hydrocarbon revenues, and the creation and effective management of stabilization funds.

b. The nature of local public borrowing: non-direct borrowing from the banking system (competing with the private sector) and resorting instead to the securitization of public debt (i.e., issuance of bonds and selling them in the markets).

c. The size and timing of domestic government spending: coordination between the ministries of finance and the central bank concerning the times and size of spending is necessary for the sound and efficient management of liquidity.

d. Holding government deposits in central banks: this makes them one of the tools for liquidity management

To achieve a high degree of coordination between these policies, I propose the establishment of a supra-national economic council. The council's membership should consist of member finance ministers and a governor, or a board of governors/board of directors, of the unified Gulf Central Bank. The council would undertake medium-term financial planning (spending), plans to borrow locally to partially finance budgets (domestic debt), and plans for partial funding of the budget from the proceeds of government exports and/or income from foreign investments in foreign currencies (e.g., financing from the income coming from oil or foreign currency investments). After adoption by the currency union's economic council, these programs must be binding on member states. There must be clear rules about not just the extent of amendments to these plans and programs during application, but also the way they are achieved. The monetary council should fulfill its role, and undertake the necessary studies and research to come up with clear visions and specific recommendations in this regard.

Technical Challenges and Requirements

The Scientific Research System and Qualified Technical Personnel

Another essential and very important condition, which has not, to date, received enough attention and interest, is the establishment of a monetary union on a sound and strong basis from the outset, along with the provision of sufficient strength and credibility for the single currency from the time of its inception. It is of no less importance than the lessons learned from the euro zone crisis, which reaffirms its importance in the case of the GCC countries. This condition is the availability of a research infrastructure and scientific research system for it to be built upon. This will produce a strategy and management of the single-currency policy, with maintenance of monetary and financial stability across the monetary union area that is now not available, in addition to the availability of databases for the required quality and transparency.

Central banks are institutions of high competence with advanced technical and specialized scope. There is a necessity for central banks to undertake a technical role in the field of research, which no other party can undertake on their behalf. This is by virtue of their competence and excellence in inputs and the experience required by the nature and specialization of the field of work. They have the main role in economic intellectual leadership and have a greater contribution to make in the field of research and guidance in this area. The challenge of the particularity of GCC countries' economies that require additional efforts to more conventional cases can be added to this. The central banking system's research infrastructures and production are still modest and do not meet the demands and challenges of the establishment of a monetary union area.

So far there is no accumulated research stock that can be relied upon at this crucial stage because efforts have not yet been made to meet the necessary technical needs for building a monetary union at the current time. Perhaps because monetary management is marginalized due to the fact the currency is pegged and prevails over long periods, scientific research activities have been neglected. This is because of the reliance on a monetary policy that is imported from the US, is pegged to the US dollar, and foregoes an independent monetary policy.[23] Thus, this factor did not create motivation for the need for a research and development process.

Another factor that needs attention is the importance of focusing on elevating the scientific and specialization levels when choosing those running these important institutions. It is also important to ensure that those in charge of these institutions are in possession of the necessary competencies. Central banks are important and crucial organizations as they organize and supervise an important, specialized, and professional private sector. These banks should therefore be on the same level as those they are supervising (note that the economic and financial analyses of some commercial banks are considered better quality than those of their central banks in most of these countries). This requires removing central banks from the circle of administrative democracy, which usually characterizes the public sector, to a level that is more independent, specialized, and skillful in its handling of personnel and employment of human resources. Complete independence is needed for the success of central banks – theoretically and practically – not only in relation to economic and banking policies, but also administratively. Achieving the first requires achieving the second. There are additional challenges that are caused by the structural changes in the global economy, and the creative initiative this requires, and the need to make amendments to the strategies and methods of managing monetary policies. This is a matter that requires a degree of competence. Under these circumstances, the traditional solution is to resort to third parties to carry out these critical functions, although they do not necessarily carry them out with the required quality and efficiency or the required credibility in some cases.[24] Even if this method serves some temporary goals, it takes away the central banks' opportunity to develop their own national research strengths.

[23] This is an indication of the mimicking of the Federal Reserve's policy and changes in interest rates.

[24] Compare here, for example, the insistence of the US and the relevant international institutions to press China and other countries (Egypt, for example) to free their exchange rates while insisting on advising Arab Gulf countries to continue pegging their currencies to the US dollar. There are many other questions over the advices given by some international institutions to third world countries.

Databases

Equally as important as research is the availability of databases that are comprehensive, detailed, timely, high quality, and transparent. Calculation methodologies should be standardized to have sound comparisons, particularly in relation to the real sector's databases, local produce, and inflation. Furthermore, appropriate methodologies and calculation methods should be used and old methodologies updated as some are invalid and do not meet the needs of the current phase and developments in the region's economies. It may be useful to create a unified statistical system at the level of monetary union, like Eurostat, with the task of coordinating efforts, data collection and inspection, and standardization of methodologies and other statistical functions that meet the requirements of a common monetary policy and the Gulf Central Bank. Sufficient historical data series to conduct the necessary studies and draw significant conclusions and recommendations are not likely to be available and this could represent a challenge.

Frame 3 displays the technical requirements that should be addressed and made available for a monetary union and the Gulf Central Bank to be able to carry out its role in issuing the single currency and managing a unified monetary policy in the monetary union area. Some other benefits that could be achieved from a monetary union are a rise in the performance and productivity of relevant national institutions, and an increase in the efficiency and quality of outputs and services. This would without a doubt benefit the national economies and the quality of services provided by institutions in these economies. It will also help increase and encourage the competence of other government institutions.

Frame 3: Technical research and the requirements that need to be addressed

1. What strategy of unified currency policy to guarantee price stability in the single-currency area will be followed by the central bank to achieve its final objective outlined by the Monetary Union Agreement?
2. What is the theoretical and operational framework that the central bank will draw upon to achieve a unified monetary policy?
3. How will they manage daily liquidity in a single-currency market?
    - What models will be used to predict liquidity?
    - What are the monetary tools that will be used and are required to be available and how will they be used in monetary management and daily liquidity management?
4. Studying inflation:

- What sources of inflation are in the union's countries?
- How is it measured?
- How can they predict it?

5. Studies on the coordination between the unified monetary policy, financial policies, and public debt policies in the union's countries (macro-prudential policies) before and after the launch of the common currency (i.e., in the monetary council and central bank stage).
6. Preparation of studies related to systems of supervision and control over the financial sector, the development of ratios, supervisory standards, and risk ceilings (micro-prudential policies), as well as specifying the roles of the Gulf Central Bank and the local central banks.
7. Preparation of integrated databases sufficiently far in advance to prepare the studies mentioned above, particularly on liquidity and monetary management.
8. Preparation of studies related to payment systems.
9. Designing of technical training programs and training teams to manage the exchange rate and monetary management, particularly liquidity and interest rates.
10. Public education programs
11. Issuance of the single currency:
    - The currency would be used as a unit of account for a period of time prior to actual issuance.
    - The Gulf Central Bank puts forward the single currency for circulation parallel to other states' currencies, and this ends the role of the Monetary Council.

Conclusion

Practical experience has proven, once again, what has been formerly put forward by economic theory – will and political commitment are a prerequisite for the creation and success of a monetary union between independent political entities. Even if the rest of the political and technical conditions for the establishment of a monetary union are met, a decisive political will is still a main factor, if not the core factor, for the establishment of a lasting monetary union. Political will comes from the decision-makers' clarity of vision in relation to the objectives and benefits to be gained from joining the monetary union, and from highlighting the disadvantages or costs of not joining or establishing it. The structural changes that are starting to appear on the global economic arena are likely to broaden the scope of economic goals and benefits that could be achieved by the Gulf Monetary Union, in addition to other dimensions, and to perhaps raise the issue of the possible costs for these countries in the case of the union not being established. GCC countries, which hold the largest proven oil reserves in the world, can find themselves a better status on the future global arena if they work to form an economic bloc or force with a single currency and an independent monetary policy (or to gradually transform into an independent power over a planned period of time).

The important issue that should not be circumvented here is the structural shift of change in economic powers. The global economy began years ago to move to the East, and it seems to be continuing to do so. Emerging economies in the East are developing quickly and very high growth rates are being achieved even under the current severe economic crisis, which points to a future in which there are multiple centers of economic powers and, later, political powers. If GCC countries are to gain a foothold in this dynamic global economy, it is necessary that:

- GCC countries succeed in creating a common-currency area with an independent monetary policy;
- The single currency – when the Gulf Central Bank is established – should at its launch have the lowest rate of inflation possible in the monetary union area;
- The single currency should be strong with a high exchange rate at its launch; and
- The unified currency should gain strength in a relatively short time to be able to occupy position as one of the major currencies and an international reserve currency. If this is achieved, it will lead to:

  a. Significant international demand on the securities issued by the governments of member states, and on any government securities that could be issued by a governmental body that represents member governments with a solidarity guarantee. It is expected that this demand will grow to include central banks, particularly banks that rely heavily on the oil and gas of the union's member states.

  b. In such a situation, it is expected that some countries, especially those in the Arab Levant, will peg their currencies to a unified Gulf currency.

  c. Over the passage of time, and if the Gulf Monetary Union succeeds, particularly after the accession of Oman, the United Arab Emirates, and maybe Yemen, there are prospects for developing it further.

In parallel to the aforementioned constituent challenge that is represented by the need for the presence of a decisive political will beforehand, there are two other challenges facing the launch of the single currency and representing a challenge to its stability and continuity after its launch. One of these is institutional and related to foregoing some sovereign issues, while the other is purely technical. On the institutional, sovereign level, what has been learned from the sovereign debt crisis of the euro zone is that what constituted the text of the GCC countries' Monetary Union Agreement concerning the conditions related to ratios of budget deficit and public debt to GDP, which imitated the provisions of the Maastricht Treaty, is no longer enough to guarantee the stability of the single currency. There is an urgent need for high-level coordination between the fiscal policies of member states within a broader and more comprehensive framework on one hand, and the need for coordination between fiscal policies and unified monetary policy on the other.

In this regard, this paper makes the following suggestions and recommendations:

Firstly, the establishment of a supra-national economic council that could take the name of the "Supranational Economic Council for the Single-Currency Area" needs to happen. The council's membership should consist of member finance ministers and a governor (or a board of governors/board of directors) of the Gulf Central Bank. The council would take care of the following:

1. Medium-term fiscal plans;
2. Developing plans for partial funding of budgets from the sale of proceeds received in foreign currencies in the medium-term;
3. Developing plans for partial funding of budgets without local borrowing in the medium term;
4. Developing plans and programs for securitization of domestic public debt, as well as limits on direct borrowing from the domestic banking system;
5. Coordinating and unifying the domestic public debt cycle so that it keeps pace with the economic cycle; and
6. Allowing central banks to address these issues since spending in GCC countries has direct monetary effects. Coordination between fiscal policies and the unified monetary policy.

These plans and programs should be binding on member states and clear rules should be drawn up about the extent of any amendments to those plans and programs (medium-term) during application and the way amendments are carried out.

Secondly, they need to create a mechanism, a fund, on the level of the single-currency area (supranational) with the task of financing and controlling interventions in case a crisis occurs in one of the member states that may result in a macroeconomic imbalance in the rest of the union's countries and affect the stability of the common currency.

Thirdly, they need to establish a central statistical apparatus at the level of the monetary union system with the task of undertaking the statistical requirements for the management of a unified monetary policy in the monetary union area. The monetary council should fulfill the role that it has been established to do and complete the necessary research and studies to provide clear visions and specific recommendations concerning the previous proposals, and the technical needs outlined in Frame 3.

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