

Optimum Currency Area: The Countries of the Gulf Cooperation Council

by

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I- INTRODUCTION

In May 25, 1981, the countries of the Arab Gulf region; Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, ratified the charter establishing the Cooperation Council for the Arab states of the Gulf (GCC countries hereafter). In their second Supreme Council meeting held in November 1981, the GCC leaders adopted an Economic Agreement setting the stage for a full economic integration. The agreement had set out broad lines for the realization of coordination, integration and cooperation in various aspects of economic affairs. The council has taken the necessary steps toward realizing the different stages of a full economic integration namely, a free trade area, a customs union, a common market and economic union. The intensification of cooperation in the relevant areas has been achieved through the formation of various specialized committees whose goal has been to implement the guidelines of the main constituent bodies of the GCC.¹

As a first step toward economic integration among the countries of the region, a Free Trade Zone was established in 1983. A decision to move ahead with the next phase of integration, through the establishment of a Customs Union, came at the Riyadh Summit of the leaders of GCC countries in 1999. A timetable was approved to establish a Customs Union by the year 2005. Already in their Bahrain summit of the year 2000, the GCC leaders agreed to adopt a common peg for the different currencies of the member states as a preliminary step toward adopting a single currency.

During the GCC summit in December, 2001 in Muscat, the six GCC countries agreed to a joint customs tariff of five percent by the year 2003, two years earlier than originally planned, and voted to create a single currency by the year 2010. As an intermediate stage toward establishing a single currency, they also agreed to have the American dollar as a common peg for their currencies before the end of the year 2002.

The worthiness of establishing a common currency has been traditionally tested against several benchmarks established by the theory of Optimum Currency Area (OCA)

¹ Further details about the achievements and the official documents of the GCC can be found in the GCC Secretariat General web-site at: www.gcc-sg.org.

and developed by Mundell (1961), McKinnon (1963) and Kenen (1969). From this perspective, this paper proposes to develop a general framework to assess the preparedness of the GCC countries for Currency Union.

Section two develops the political and historical background pertaining to the GCC countries and retraces their evolution towards integration. In Section three, I lay down the different aspects and evolution of exchange rate regimes and monetary policies in the area. Whereas the main aspects and contributions to the Optimum Currency Area will be reviewed in Section four, the preparedness of the GCC countries to fulfill the OCA criteria is tested in Section five. Finally, Section six concludes that while GCC countries do not necessarily meet OCA criteria, a properly implemented Currency Union may contribute to enhance economic efficiency in the region.

II – Political and Historical Considerations

Together, the Arab Gulf States constitute 84 per cent of the land area of the Arabian Peninsula, which is located between West Africa and Iran. The strategic position of the Gulf, which has constituted a vital trade and communication link between Europe, Africa and Asia, has made the littoral a key target for centuries of plans for conquest, attacks, invasions and occupations by foreigners. The discovery of huge reserves of oil in the 20th century, moreover, conferred upon the Gulf an unprecedented geostrategic importance that figures prominently in the current defense and security considerations of diverse entities at both the regional and international levels. The Gulf has thus evolved into an area of increased competition, as well as a potential theatre of confrontation among superpowers. For all these reasons, there has been an increased awareness throughout the Arab Gulf States of the need for independence, stability and security in the region. This consideration was the main reasoning behind the development of the Gulf Cooperation Council program².

The GCC was created among States with similar geographic and historical experiences as well as social customs, and it was built upon a substantial base of informal cooperation

² More details in Peterson, (1988)

that had developed among the member States in the years prior to the formation of the Organization. The idea of creating a regional organization was taken up by the leaders of the Arab Gulf States when they convened at the eleventh Arab Summit Conference in Amman, Jordan, from 25 to 27 November 1980. The foreign ministers of the six Arab Gulf States subsequently met at Riyadh on 4 February 1981 to reach formal agreement on the establishment of an international organization among them, and to set the stage for several meetings of an expert committee to work out the substantive and procedural details of the emerging entity.

The GCC Charter³

The principal organizational instrument of the GCC is the Charter, formally concluded on 25 May 1981. Composed of a preamble and twenty-two articles, the Charter sets forth the nature, scope and certain procedures of GCC activity. The basic objectives of the Gulf Co-operation Council are set out in Article 4 of the GCC Charter as follows:

- 1- To effect coordination, integration and interconnection among member States in all fields.
- 2- To deepen and strengthen the relations, links and scope of the co-operation now prevailing among their people in various fields.
- 3- To formulate similar regulations in various fields including the following:
 - i) Economic and financial affairs
 - ii) Commerce, customs and communications
 - iii) Education and culture
 - iv) Social and health affairs
 - v) Information and tourism
 - vi) Legislation and administrative affairs

³See the Gulf Cooperation Council website : www.gcc-sg.org/charter.html

- 4- To stimulate scientific and technological progress in the fields of industry, mineralogy, agriculture, water and animal resources; the establishment of scientific centers, implementation of common projects and encouragement of cooperation by the private sector for the good of their people.

The first two of these objectives are no doubt deliberately general, whereas the rest focus more on the practical means by which overall unity among member states may be enhanced.

The substantive and procedural nature of the GCC is set out in its Charter as well as in a host of subsidiary conventions. The organization consists of four bodies: the Supreme Council, the Commission for Settlement of Disputes, the Ministerial Council and the Secretariat General. In addition, the Unified Economic Agreement (UEA) was concluded between the GCC member states six months after the inception of the organization. The supreme council is composed exclusively of heads of State and is the only body to determine the higher policy for the organization. The function of the Commission for Settlement of Disputes is to provide the Supreme Council with recommendations in cases of disagreements over the interpretation of the Charter or disputes between member states. The principal function of the Ministerial Council is to develop and propose to the Supreme Council the various means by which greater co-operation can be achieved. The headquarters of the Secretariat General is located in Riyadh. It is divided into six directorates or sectors of activity in the areas of political affairs, economic affairs, environment and human resources, legal affairs, financial and administrative affairs, and information.

The Unified Economic Agreement⁴

At the first meeting of the Supreme Council on 25 May 1981, the GCC leaders approved a working paper outlining the basis for eventual economic integration. Two weeks later, on 8 June 1981, the draft was initialed by the Ministers of Finance and Economy, and the agreement was adopted by the heads of State during the Supreme

⁴ See the Gulf Cooperation Council website: www.gcc-sg.org/economic.html

Council meeting the following November. The Unified Economic Agreement (UEA) consists of seven chapters and 28 articles covering GCC economic integration in terms of trade exchange, movements of capital, activities of citizens, exercise of economic activities, coordination of development, technical cooperation, transport and communications, and financial and monetary unification.

Articles 1-7 provide for the establishment of a GCC free-trade zone and significantly, refer to products manufactured in the GCC States (with value-added of not less than 40 per cent of their final value) as “national” products. The Agreement goes on to stipulate that “products that are of national origin shall receive the same treatment as national products” and “will be exempted from customs duties for third-party States, in accordance with article 4, are to be unified.

Therefore, in addition to providing for a free-trade zone, the provision allows for customs federation agreement. Moreover, the Agreement calls for the creation of a “collective negotiating force” to enhance the GCC collective trade position with external States.

Articles 8 and 9 of the UEA confer wide-ranging economic prerogatives on GCC nationals in all member States, providing for freedom of movement, work and residence, right of ownership, freedom to engage in economic activity, and free movement of capital. The effects of these measures are not only noteworthy from an economic and financial standpoint. The extensive contact and interaction between nationals of the GCC States that are subsumed in the provisions have profound social and political implications. The signatories are also bound by the Agreement to pursue coordination of development and industrial policies. The Agreement calls for standardization of industrial legislation and regulations, in addition to the allocation of industries according to relative advantages and economic feasibility. In order to enhance intra-GCC cooperation the member Governments pledge in Article 12 to encourage joint ventures.

In the vital domain of oil, Article 11 binds the member States to endeavor to reach a unified approach in all aspects of oil industry, as well as to formulate common policies with respect to external organizations and groups of States.

The Agreement also extends to technical cooperation by promoting research and development, transfer of technology (in part by the conclusion of uniform agreements

with third-party States), and training programs. Human resources policies are also to be harmonized, and harmful competition among States is to be avoided, partly through the joint classification of professional occupations and activities.

In the realm of financial and monetary affairs, Articles 21-23 call for the institutionalization of cooperation in financial, monetary and banking policies by providing for cooperation between monetary authorities and central banks, including the establishment of common currency. Furthermore, the member States pledge to coordinate both internal and external investment policies.

Thus, the Agreement presents a virtually all-encompassing structure upon which the economic interaction between the GCC states is to be based. Although the various components of the Agreement are admittedly ambitious and long-range in nature, it is equally clear that the provisions contain built-in qualifiers regarding their eventual implementation. The terms “seek” and “endeavor” used throughout the Agreement in reference to the unification of vital sectors and policies illustrate this point. In this respect, article 24, which governs execution of the Agreement, explicitly provides that “any member State may be temporarily exempted from applying such provisions....as may be necessitated by temporary local situations in that State or specific circumstances faced by it”.

Evolution of the GCC Integration

The evolution of the GCC traversed a number of stop-and-go phases that can be summarized as follows⁵:

- February 1981 – May 1983: This period was characterized by the initial burst of multilateral activity among GCC member States. In addition to the Charter and the Unified Economic Agreement, the Ministerial Council recommended the adoption of a Common External Tariff, and the Supreme Council approved plans to integrate regional air defense.
- Fall 1983 – June 1989: A period of stagnation. Virtually no effort was made during this period to unify the monetary systems of the six member States. In

⁵ Lawson (1994) provides an interesting account for the GCC integration efforts and the impact of diverse internal and external elements on its evolution.

early 1988, Saudi Arabia raised customs duties from 7 to 12 per cent on most imported goods, while increasing tariffs from 10 to 20 per cent on re-exports entering the Kingdom through Port Rashid in UAE. Bahrain meanwhile, adopted new regulations authorizing government agencies to discriminate in favor of domestic products so long as the price differential between locally-produced items and equivalent imports remained less than 10 per cent. Even when GCC Ministers of Industry proposed in June 1989 that tariffs should be regularized among member States, GCC Finance Ministers, who recommended that different products should continue to be treated in different ways, rejected the proposal. The Supreme Council endorsed the Finance Ministers' recommendation, once again postponing discussion of a unified customs agreement among the six.

- Fall 1990 – winter 1992: A second demonstration of unity took place among the GCC states after Kuwaiti-Iraqi tensions flared into a war in the fall and winter of 1990-91. The December 1990 meeting of the Supreme Council adopted the Doha Declaration, which pledged the six to redouble their efforts to achieve the strengthening of cohesion and solidarity, the consolidation of basis of cooperation and the promotion of coordination among the GCC member States in all fields.

At the end of November 1991, GCC Trade Ministers met in Qatar to discuss ways of accelerating the formation of a customs union. In mid-December the governors of the six central banks announced that they intended to issue a single currency by the year 1999. Prospects for a unified currency brightened when Kuwait decided to join the other GCC States in pegging the value of the Kuwaiti dinar to that of the US dollar.

- Spring 1992 – September 1994: By spring 1992, the postwar flowering of economic multilateralism had begun to wither. The GCC Ministerial Council decided in early June that no customs union could be established in the region until at least year 2000. Moreover, after the September 1994 conference of the GCC Finance Ministers, it was declared that finding a fixed exchange rate for the GCC was no longer the priority it had been some years before.
- Mid 1990s – December 2000: The mid-1990s witnessed a renewed burst of economic multilateralism. In September 1994, the Bahrain chamber of Commerce

opened a center for the arbitration of commercial disputes among GCC members. At the end of 1994 GCC member States agreed to permit the unrestricted use of cellular phones across their common borders. About the same time, special GCC commissions approved measures to equalize handling charges for the unloading of cargo at local airports and to give GCC citizens the right to buy and sell corporate shares offered in any GCC stock market. During the Finance Ministers Meeting at Riyadh in March 1995, it was agreed to link automated teller machines throughout the GCC to eliminate restrictions that prevented citizens from applying for loans at GCC banks outside their home States.

- May 1998: GCC countries decided to establish a customs union and united tariffs in the very near future, and announced that it was planned to establish a major strategy to diversify the Gulf economies and motivations to set up a united financial market.
- December 2001: The Supreme Council Meeting decided to advance the launching of a GCC customs union to 1 January 2003 and reaffirmed the launch of the single currency by 1 January 2010 at the latest.

Elements of Global Economic Importance of the GCC

The GCC has a small population of 32 million, with 21 million in Saudi Arabia alone⁶. It has 45% of the world proven oil reserves as indicated in table 1, 56% of it is being located in Saudi Arabia. Around 19% of the world oil production comes from the GCC, as shown in table 2, while Saudi Arabia's share accounts for 58% of total GCC output. In addition the GCC has 15% of the world proven natural gas reserves as shown in table 3; Qatar alone possesses 37% of these reserves. However natural gas production of GCC countries accounts for approximately 5% of total world production as indicated in table 4.

⁶ Klein et al. (2000) : A symposium that dresses a detailed picture and analysis of the GCC economic issues.

Table 1
GCC, OPEC and World Proven Crude Oil Reserves
(Billion Barrels at the End of the Year)

	1995	1996	1997	1998	1999
Bahrain	0.21	0.21	0.21	0.16	0.15
Kuwait	96.5	96.5	96.5	96.5	96.5
Oman	5.24	5.25	5.4	5.4	5.4
Qatar	4.5	4.5	4.5	4.5	4.5
Saudi Arabia	261.45	261.5	261.5	261.5	263.5
UAE	98.1	98.1	98.1	98.1	98.1
Total GCC	466	466.06	466.21	466.16	468.15
OPEC	816.07	818.66	821.48	817.92	819.92
World	1046.33	1048.34	1050.98	1051.74	1033.55
GCC as % of OPEC	57.1	56.9	56.8	57.0	57.1
GCC as % of World	44.5	44.5	44.4	44.3	45.3

Source: The Organization of the Arab Petroleum Exporting Countries, 2000, www.oapecorg.org

Table 2
GCC, OPEC and World Crude Oil Production
(Thousand Barrels/Day)

	1995	1996	1997	1998	1999
Bahrain	146	157	163	183	176
Kuwait	2007	2011	2107	2051	1882.9
Oman	852	885	904	899	895
Qatar	390	407	609	613	632.5
Saudi Arabia	8023	8102	8012	8280	7699.6
UAE	2160	2160	2160.7	2244	2060
Total GCC	13578	13722	13955.7	14270	13346
OPEC	24914.5	24787	25773.9	28098	26531.6
World	66533.5	68067	70069	73460	72238.2
GCC as % of OPEC	54.5	55.4	54.1	50.8	50.3
GCC as % of World	20.4	20.2	19.9	19.4	18.5

Source: The Organization of the Arab Petroleum Exporting Countries, 2000, www.oapecorg.org

Table 3
GCC, OPEC and World Proven Natural Gas Reserves
(Billion Cubic Meters at the End of the Year)

	1995	1996	1997	1998	1999
Bahrain	139	132	142	118	110
Kuwait	1494	1489	1480	1480	1480
Oman	782	800	805	805	805
Qatar	8500	8500	8500	8500	8500
Saudi Arabia	5264	5705	5777	5777	5777
UAE	5859	5784	6000	6003	6003
Total GCC	22038	22410	22704	22683	22675
OPEC	59973	64208	64485	64431	65263
World	148982	151053	151992	150149	150286
GCC as % of OPEC	36.7	34.9	35.2	35.2	34.7
GCC as % of World	14.8	14.8	14.9	15.1	15.1

Source: The Organization of the Arab Petroleum Exporting Countries, 2000, www.oapecorg.org

Table 4
GCC, OPEC and World Natural Gas Production
(Billion Cubic Meters / Year)

	1995	1996	1997	1998	1999
Bahrain	10.4	10.2	10.6	11.1	11.1
Kuwait	10.9	10.9	10.9	10.9	10.9
Oman	6.9	7.3	10.3	10.5	10.5
Qatar	18.8	18.8	23.7	26.2	26.2
Saudi Arabia	74.0	77.7	47.6	49.8	49.8
UAE	40.9	46.5	48.1	49.0	49.0
Total GCC	161.8	171.4	151.2	157.4	157.5
OPEC	550.7	579.9	562.9	568.3	n.a.
World	2757.7	2884.9	2856.9	2921.8	n.a.
GCC as % of OPEC	29.4	29.5	26.9	27.7	n.a.
GCC as % of World	5.9	5.9	5.3	5.4	n.a.

Source: The Organization of the Arab Petroleum Exporting Countries, 2000, www.oapecorg.org

Oil is still the dominant factor in the GCC States' economies. Thus oil revenues play an essential role in the development of those countries. Nevertheless, oil revenues fluctuate

according to the different and price levels. Table 5 illustrates the instability of GCC oil revenues during 1995 – 1999. These reached a peak in 1996, yielding US\$ 90.2 billion, after which they declined by 35% to reach US\$ 58 billion in 1998. However the higher oil prices prevailing in 1999 boosted oil revenues by 30% to reach US\$ 75.5 billion.

Table 5
GCC States Crude Oil Export Revenues
(Current US\$ Million)

	1995	1996	1997	1998	1999
Bahrain	1100	1320	1200	800	1270
Kuwait	12052	14132	13467	8390	10362
Oman	4754	5883	5784	3706	5511
Qatar	2600	3800	4660	3110	3833
Saudi Arabia	42700	50050	48220	31980	43187
UAE	13350	14980	15270	10260	11300
Total GCC	76556	90165	88601	58246	75463

Source: The Organization of the Arab Petroleum Exporting Countries, 2000, www.oapec.org

GCC Economies

Saudi Arabia is the largest GCC country, constituting 83.5 per cent of the total GCC land area. Table 6 illustrates the distribution of GDP among GCC member States during 1995 – 1999. The share of Saudi Arabia declined from 56.8 per cent in 1995 to 54.6 per cent in 1999; this benefited both the UAE and Qatar, since their shares rose to 20.5 and 4.5 per cent respectively in 1999 from 19 and 3.6 per cent in 1995. However, the share of the remaining three member states remained constant.

Table 6

Distribution of Gross Domestic Product among GCC Member States
(Percentage of total)

	1995	1996	1997	1998	1999
Bahrain	2.6	2.4	2.4	2.7	2.7
Kuwait	11.8	12.2	11.5	10.9	11.6
Oman	6.1	6.1	6.1	6.1	6.1
Qatar	3.6	3.6	4.3	4.5	4.5
Saudi Arabia	56.8	56.4	56.3	55.4	54.6
UAE	19.0	19.2	19.4	20.4	20.5
GCC	100.0	100.0	100.0	100.0	100.0

Source: *The Organization of the Arab Petroleum Exporting Countries, 2000, www.oapecorg.org*

In 1998, the growth rates in the GCC States, which were only 2.5 per cent on average, were lower than in developing countries, where the growth rate was 5 per cent, and in Asian countries 7 per cent. Table 7 shows that per capita output for the GCC members declined from US\$ 8.6 thousand in 1995 to US\$ 7.9 thousand in 1999. The highest per capita figure among GCC member States was US\$ 20.6 thousand in Qatar in 1999, followed by Kuwait with US\$ 12.5 thousand, the UAE with US\$ 10.6 thousand, Bahrain with US\$ 10.2 thousand, Oman with US\$ 6.7 thousand and Saudi Arabia with US\$ 6.5 thousand.

Table 7

GDP and GDP Per Capita in GCC Member States
(Current US\$ million)

	1995	1996	1997	1998	1999
<i>Bahrain</i>					
GDP	5,850	6,102	6,350	6,184	6,772
GDP Per Capita	10,104	10,170	10,242	9,632	10,183
<i>Kuwait</i>					
GDP	26,554	30,653	30,020	25,323	29,574
GDP Per Capita	13,910	14,638	13,590	11,151	12,505

<i>Oman</i>					
GDP	13,803	15,278	15,838	14,162	15,634
GDP Per Capita	6,465	6,898	7,020	6,190	6,724
<i>Qatar</i>					
GDP	8,138	9,059	11,298	10,460	11,475
GDP Per Capita	16,642	17,939	21,644	19,406	20,601
<i>Saudi Arabia</i>					
GDP	127,811	141,322	146,494	128,377	139,206
GDP Per Capita	6,798	7,305	7,324	6,212	6,525
<i>UAE</i>					
GDP	42,807	47,994	50,394	47,366	52,134
GDP Per Capita	17,755	19,360	19,205	17,063	10,573
<i>GCC</i>					
GDP	224,963	250,408	260,394	231,872	254,795
GDP Per Capita	8,546	9,193	9,223	7,946	7,919

Source: The Organization of the Arab Petroleum Exporting Countries, 2000, www.oapecorg.org

Among the GCC countries, Bahrain's economy is the most diversified, with its dependence on oil reduced to levels that accounted for only 13.1 per cent of the GDP in 1998. However, in 1999, owing to higher oil prices, its share increased to 16.5 per cent. The share of the mining sector (mostly oil and gas) in the GDP of the UAE reached 27.4 per cent in 1998. In other GCC countries, the mining sector's share ranged from 56.4 per cent in Saudi Arabia to 29.6 per cent in Kuwait.

The investment ratio to GDP in the GCC countries averaged 20 to 23 per cent during 1970 – 1999, which is below the level of developing countries. This was mainly due to the low participation of the private sector in the economic activity of the GCC countries⁷. Industrial activities that have emerged during the last decades include the

⁷ Apart from this "Crowding out effect" of private investment, the literature distinguishes other transmission mechanisms between large resource revenues and poor performance. Stevens (2003) provides an excellent survey.

petrochemical industry, energy-intensive industries (such as aluminum, cement, iron and steel), the gas-based industry and light industries.

III – Monetary policies and exchange rate regimes

Over the past two decades, the GCC countries have taken important steps to achieve economic and financial integration among them. They have lifted formal impediments to the free movement of national goods, labor, and capital across these countries, and have similar policy preferences in a number of areas. In particular, these countries have been successful in maintaining price and nominal exchange rate stability, as well as open trade regime and liberal capital flows. In addition, they have in place an open-border foreign labor policy to ensure sufficient supply of labor at internationally competitive wages, with expatriate workers accounting for the largest share of the labor force in non-oil activities. The GCC countries success in maintaining for several decades a de facto fixed exchange rate in the face of significant global crude oil volatility owes much to this policy framework. However, some differences in economic performance and policy preference have emerged over the past decade⁸.

Inflation

Inflation, as measured by the consumer price index (CPI), has traditionally been low in the GCC area, but it differs across countries. From 1991 to 2002, Bahrain, Oman and Saudi Arabia experienced the lowest consumer price inflation in the region: less than 1 percent a year on average. In the same period, the United Arab Emirates experienced the highest consumer price inflation: 3.5 percent a year. As a result, inflation differentials have led to diverging paths for CPI-based real effective exchange rates during the past decade, with Kuwait, Qatar and the United Arab Emirates experiencing appreciation, Oman, depreciation and the other GCC countries, relatively stable real effective exchange rates (Table 8).

⁸ Fasano and Iqbal (2002), p. 4.

Exchange rate regimes

Most currencies of GCC countries have been formally pegged to the SDR, except the rial Omani, which has been pegged to the U.S. dollar since the 1970s, and the Kuwaiti dinar, which has been pegged to an undisclosed basket of currencies of its main trade and financial partners. However, de facto, most GCC currencies have been pegged to the U.S. dollar at a fixed parity for much of the past two decades. Since 2002 and early 2003, all these currencies have become officially pegged to the U.S. dollar in line with GCC countries commitments in the road toward a monetary union.

Table 8

GCC Countries: Real Effective Exchange Rates and Inflation Volatility, 1991-2002

	Real Effective Exchange Rate			CPI-Inflation		
	Average Change (Yearly %)	Standard deviation	Coefficient of variation	Average Change (Yearly %)	Standard Deviation	Coefficient of variation
Bahrain	-0.33	4.81	-14.44	0.56	1.39	2.50
Kuwait	1.19	4.31	3.62	1.73	2.60	1.11
Oman	-0.65	4.01	-6.20	0.18	1.74	9.55
Qatar	1.04	4.92	4.72	2.06	2.34	1.13
Saudi Arabia	-0.46	4.34	-9.40	0.64	2.14	2.94
UAE	2.18	4.90	2.24	3.53	1.55	0.44

Source: Reproduced from Fasano (2003)

Monetary Performance and Policy

The lack of monetary policy autonomy, under liberal capital flows and the pegged exchange rate regime in place in GCC countries, has resulted in similar nominal short-term interest rates across the area and in a narrow spread over comparable U.S. securities, except in Kuwait. In the latter, probably reflecting a higher exchange rate risk under a basket peg, interbank interest rates have been, on average, 100 basis points above similar U.S. dollar denominated assets during the second half of the 1990s, compared with less

than 20 basis points on average for the other GCC countries over the same period. However, because of inflation differentials, real interest rates have varied across GCC countries.

Although these countries have gradually taken a number of steps to enhance their capacity to implement a market-based monetary policy, differences remain in the set of monetary instruments currently in place across the GCC area. Bahrain⁹, in particular, has made a relatively rapid and smooth transition to using indirect instruments for liquidity management through the sale of government paper and secondary market operations consisting mainly of repos with commercial banks. Oman and the United Arab Emirates partially rely on issuance of certificates of deposits by the central bank to control liquidity. Other GCC countries implement monetary policy by applying reserve requirements and through the use of prudential ratios (such as loans/deposits ratio) to penalize excessive lending. Direct instruments (interest rate and credit ceilings on certain types of credit) continue to play some role in Kuwait and Oman. Central bank independence is not yet officially preserved in the law of any GCC country. Nevertheless, in most of these countries, considerable independence is de facto established by the strict limits or even prohibition in a few cases on central bank lending to government. In addition, the price and exchange rate stability objectives, liberal capital flows, as well as large foreign financial assets in some countries have insulated the national central banks from pressures created by the governments' need to finance fiscal deficits.

IV – Optimum Currency Area: Definition and Potential Benefits and Costs

First, it is important to clarify some of the concepts often used in the literature of Optimum Currency Area (OCA). Broadly speaking an OCA is “a region for which it is optimal to have its own currency and its own monetary policy”¹⁰. Therefore, OCA can

⁹ Fasano (2003) provides complete details about monetary policy instruments used in the GCC countries, in particular table 4.2. See also Jbili et al (1997).

¹⁰ Frankel and Rose (1996), p.14.

interchangeably be called Monetary or Currency Union. It involves monetary integration, a single currency and a common central bank controlling the pool of foreign exchange reserves and administrating monetary policy for the union. Monetary integration involves the irrevocable fixing of the exchange rates, full and complete convertibility of currencies, financial market integration (measures to liberalize capital transactions and harmonize national financial regulations and structures of institutions), the complete liberalization of current transactions and a common monetary policy¹¹. In the present paper, it is assumed that Currency Union is the arrangement that the GCC countries are trying to achieve.

Optimality of a Currency Union is often measured by the realization of several criteria that determine a priori the likely success of an OCA. These criteria evolve around how integrated countries of the potential group are with one another in terms of trade and other economic relationships as well as the extent of correlation in their business cycles and similarity of shocks they are subject to. An OCA is desirable to the extent that it allows exchange rates to be fixed and therefore reduces exchange rates uncertainty that hampers trade and investment. OCA is also desirable to the extent that it reduces transaction costs associated with multiple exchange rates. These costs relate to monitor exchange rates fluctuations, cost of information to predict their movements, the cost of currency conversion, and the cost associated with the need to keep and manage reserves for intra-regional trade. OCA also allows some economies of scale to take place in terms of freeing idle reserves, enhancing the role of money as a unit of account and as a means of payment. In addition, OCA may help reduce the ability of speculators to affect prices and disrupt the conduct of monetary policy and economize on reserves in case of offsetting payments imbalances.

A further advantage of an OCA is that it may reinforce discipline and credibility of monetary policy especially in inflation-prone countries. The credibility of monetary policy can be enhanced by attaching the latter to a low-inflation anchor currency. This was for instance the case of the high inflation European countries of Italy, Spain and Portugal in the 1970's that wanted to tie their respective exchange rates to that of Germany for its credibility for fighting inflation. Equivalently, countries adopt a common

¹¹ Tavlas (1993), p.665.

currency and fix its parity against a major currency as a way to attach credibility to a fixed-exchange rate regime by surrendering the power to alter rates.

The main disadvantages of an OCA is the loss of independence of monetary and exchange rate policies and, to some extent, of fiscal policy. Considering a situation of perfect capital mobility where interest rates ought to be tied to international interest rates, exchange rates are irrevocably fixed against one another; any increase in money stock will result in balance of payment deficits due in part to portfolio reallocation effect. The monetary and exchange rate instruments play an important role in economic adjustment as stabilizers. When countries are involved in hand-tying institutional arrangements such as the ones related to an OCA, they give up these important policy instruments resulting in important output and employment losses. However, this apparent cost is mitigated to the extent that shocks for all the countries in the region tend to be symmetric so as to justify a common response, or if there are mechanisms making the adjustment to such shocks occur more promptly. This would be the case if prices and wages are very flexible or if labor and capital are mobile across members of the OCA. The cost of losing monetary policy autonomy could also be very high in countries relying on seigniorage revenues such as the case for countries with underdeveloped tax systems¹².

Other costs emphasized in the literature are those associated with coordinating policies¹³ and those associated with the possible break down of the Currency Union. The latter costs are often factored in the OCA agreement by making it difficult for countries to exit or to break the rules such as through imposing sanctions on violators. This is, for instance, the case of the European Monetary Union (EMU).

¹² Tavlas (1993), p.673.

¹³ Among the most pressing questions would be how to deal with the asymmetry between centralized monetary policy making and decentralized economic and fiscal policy. Member countries will have to overcome this tension by closely coordinating decentralized economic and fiscal policy at the Union level.

The Classical Optimum Currency Area Theory

Mundell (1961): Labor Mobility

In the 1950s series of papers, Mundell questioned the prevailing Bretton-Woods exchange rate arrangements in which fixed but adjustable exchange rates prevailed. These papers identify adjustment problems under this regime and argue in favor of flexible rates. Mundell (1961) acknowledges that proponents of flexible exchange rates argue that “depreciation can take the place of unemployment when the external balance is in deficit, an appreciation can replace inflation when it is in surplus” (p.657). But he investigates not only the problem whether a country should opt for flexible or fixed exchange rates, but also whether countries are the proper units, which can use the advantages of different exchange rate arrangements. Mundell asks if flexible exchange rates are more advantageous than fixed rates, does it follow that all currencies in the world should be flexible?

Mundell observes that there would be a major difference “between adjustment within a currency area which has a single currency and a currency area involving more than one currency; in other words there will be a difference between interregional adjustment and international adjustment even though exchange rates, in the latter case, are fixed” (p.658). To illustrate this observation Mundell introduces three examples of adjustment in different areas affected by asymmetric demand shocks. The first example considers two independent countries with national currencies, when each country consists of one region (itself). The second example considers one country, with one currency and two distinct regions. The third example considers two countries with independent currencies and two regions, where both regions run across countries.

In the first example, Mundell begins considering two countries. Assume that the asymmetric demand shock negatively affects country B. To the extent that prices are allowed to rise in A the change in the terms of trade will relieve B of some of the burden of adjustment. However, it is possible that the unemployment pressure in B cannot be eased by increasing prices in A, if A’s central bank will tighten the credit to restrain the

inflationary pressure. Thus the adjustment falls on B itself, if prices in B cannot decrease then the adjustment happens through decrease in employment.

Mundell then, in the second example, discusses the impact of asymmetric demand shock on two regions of the same country. Asymmetric demand shocks affects negatively region B. As a consequence inflationary pressure occurs in A and unemployment pressure in B. The central bank can ease the pressure in B by increasing money supply in the country as a whole, which aggravates inflationary pressures in A, but by turning terms of trade against B may correct the employment problem in B.

In the inter-regional adjustment the trade-off between inflation and unemployment ensures that the unemployment in region B is prevented by the willingness of the central bank to inflate in region A. Mundell warns that this logic cannot be stretched too far, i.e. it does not follow that if the world would consist of one country with one currency, then unemployment could be prevented by pro-inflationary policies of the world central bank. The reason for it is that the world as a whole is not an optimum currency area.

In the inter-national adjustment example, if other adjustment mechanism would not work, it would be indeed flexible exchange rates, i.e. depreciation in B and appreciation in A, which may bring back the equilibrium. But one may ask whether flexible exchange rates help to ease the adjustment costs of asymmetric demand shocks in all cases when national currencies are involved, in other words are optimum currency areas identical with countries? Mundell answers that optimum currency areas are identical with economic regions, which he defines by the labor inter-regional mobility. In support of his argument Mundell brings up the third example of adjustment to asymmetric shock.

In the third example he assumes two countries, US and Canada and two regions East and West, where regions run across these countries. East in both countries produces cars, while West timber. As a result of an asymmetric shock leading to unemployment in the East, central banks in both countries should attempt to react using monetary policy. This expansionary monetary policy leads to inflationary pressures in the Western regions. If inflation is prevented in both countries then unemployment in both of them cannot be avoided, and vice versa. In this example it is not clear which country should devalue, in other words flexible exchange rates would not bring the equilibrium back. Mundell concludes that both countries do not form optimum currency areas.

This example weakens the case for the flexible exchange rates. However the argument for flexible exchange rate is still valid, but only if currencies are organized on regional and not on the national basis. It seems that this observation is the core of Mundell's argument: flexible exchange rates between two countries are not preferable to fixed exchange rates if the countries themselves do not form optimum currency areas.

If the only goal pursued is that of economic stability in Mundell's sense then the greater the number of currency areas connected with flexible exchange rates the better. But should every little place with immobile labor be considered optimum currency area and should it have its own currency? This would be the answer if stability (low adjustment costs to asymmetric shocks) is the only criterion according to which we judge the usefulness of currency. "...if then, the goals of internal stability are to be rigidly pursued, it follows that the greater is the number of separate currency areas in the world, the more successfully will these goals be attained" (p.662). However if we consider the costs of having many currencies then some trade off needs to be found.

Mundell makes some additional arguments against the possibility of extremely large number of currency areas. Besides the costs of money changing, a large number of currency areas would mean that market for foreign exchange would be very thin.

In summary: the argument for flexible exchange rates stands on the closeness with which countries correspond to regions. If a nation is an economic region with internal factor mobility and external factor immobility, then the argument for flexible exchange rate holds. If nations are not close to regions, then fixed exchange rates can do as well as the flexible ones. In Mundell's words: "I have argued that the stabilization argument for flexible exchange rates is valid only if it is based on regional currency areas. If the world can be divided into regions within each of which there is factor mobility and between which there is factor immobility, then each of these regions should have a separate currency which fluctuates relative to all other currencies" (p.663).

McKinnon (1963): Degree of Openness

In his 1963 article McKinnon considers the openness of the economy – defined as the ratio of tradables to non-tradables – as the crucial criterion of optimality of currency

areas. His argument is that the more open is an economy, the more it should be inclined to use fixed exchange rates, in other words flexible exchange rates are more advantageous for fairly closed economies.

Consider a small country in which the ratio of exportables, X_1 and importables, X_2 to non-tradables X_3 is rather high. Under flexible exchange rate arrangements, the price of exportables, P_1 and importables, P_2 expressed in terms of domestic currency varies with the exchange rate, while P_3 may be assumed constant. Consequently, in a small open economy, fluctuations in the exchange rate contradict the effort to maintain stable price level. The picture is different in a large country with sizable production of non-tradables. The devaluation will have an effect on P_1 and P_2 but the effect on the general price index will be lower than in the case of small open economy. McKinnon argues that "...if we move across the spectrum from closed to open economies, flexible exchange rates become both less effective as a control device for external balance and more damaging to internal price stability". Thus small open economies may find it beneficial to join larger currency areas.

McKinnon makes a case that economies with a high ratio of tradables to non-tradables should rely more on fiscal and monetary policies than on exchange rates to cure the balance of payments disequilibria. When a trade deficit exists only a relatively small reduction in spending will be necessary to bring adjustment, when the economy is open. As exportables and importables are a large part of total spending, a relatively small reduction in demand, for example, would be sufficient to release exportables from domestic consumption and to reduce imports, thus improving the trade balance. Thus small countries which extensively trade find it beneficial to form currency areas.

McKinnon raises another point which favors fixed exchange rates in small open economies: the higher probability of the absence of money illusion. The presence of money illusion is what allows flexible exchange rates to perform their stabilizing function. McKinnon argues that in the highly open economies the money illusion is the lowest.

There is an additional argument, which connects size of the country with optimum currency area issues. In a large area it may be easier to keep the value of money in terms of a representative bundle of economic goods. McKinnon specifies that "if the area under

consideration is sufficiently large so that the body of non-tradable goods is large, then pegging the value of the domestic currency to this body of non-tradable goods is sufficient to give money liquidity value in the eyes of the inhabitants of the area in question". It means that for small countries to efficiently peg their currencies the existence of stable large countries is required.

Kenen (1969): Degree of Product Diversification

Kenen in the above mentioned article suggests production diversification as a characteristic for optimum currency areas. He writes that a well-diversified economy will not often confront a change in demand for its export products, more specifically "...a well diversified national economy will not have to undergo changes in its terms of trade as often as a single product national economy" (P.49). In well-diversified economies the importance of asymmetric shocks would be of lesser significance than in less-diversified economies:

"A country that engages in a number of activities is also apt to export a wide range of products. Each individual export may be subject disturbances, whether due to changes in external demand or in technology. But if those disturbances are independent, consequent on variations in the composition of expenditure or output, rather than massive macroeconomic swings affecting the entire export array, the law of large numbers will come into play. At any point in time, a country can expect to suffer significant reversals in export performance, but also enjoy significant successes. From the standpoint of external balance, taken by itself, economic diversification, reflected in export diversification, serves, ex ante, to forestall the need for frequent changes in the terms of trade and therefore, for frequent changes in national exchange rates" (P.49).

Thus, Kenen argues that product diversification decreases the likelihood of asymmetric shocks and that it also alleviates their negative effect. Thus, fixed rates are "most appropriate – or least inappropriate-" to well diversified economies.

The core of this argument rests on the idea that positive changes with respect to some exports will be offset by negative changes with respect to others; as demand for some increases, the demand for others falls. The more diversified are export products, the greater will be this offsetting mechanism. A country that produces a wide variety of

goods will experience a slower decrease in overall production, if in the outside markets the demand for its goods decreases. Thus, a country with a low degree of product diversification will need flexible exchange rates to cushion it from outside shocks, while a highly diversified economy may find it beneficial to form a currency area. This is where Kenen (1969) departs from Mundell's (1961) view and where he specified in his concluding remarks that "...It is also a prerequisite to the internal factor mobility that Mundell has emphasized, because a continuum of national activities will maximize the number of employment opportunities for each specialized variety of labor" (P.54).

Optimality Criteria

Several factors have been identified in the literature for determining whether a country is ready to join an OCA. These factors are related to the characteristics that would make stable exchange rates and currency union more desirable. These are as previously argued: Factor mobility, openness and the degree of commodity diversification.

Factor Mobility

In case of a shock, if two countries are highly integrated in the sense that labor and capital can freely move from one country to another, there will be a lesser need for the country affected by the shock to use the exchange rate as a corrective tool. From this perspective, factor mobility plays the role of a substitute to the exchange rates, or monetary policy for that matter, as an adjustment mechanism should a shock occur. Therefore countries with more mobile factors of production are better candidates for Currency Union.

Openness

A small country that is largely dependent on international trade is more likely to be affected by exchange rate fluctuations and uncertainty since a large portion of its goods is tradables. McKinnon (1969) argues that the exchange rates in the case of a small

open-economy becomes redundant as an instrument to correct balance of payments problems. In this case, the exchange rate is strongly linked to the price level in the economy to the extent that any variation in the exchange rate is translated into variation in costs. Hence, the exchange rate becomes an ineffective tool to improve competitiveness. In addition, for a small open economy where a large part of consumed goods are imported and in the absence of domestic substitutes, the exchange rate becomes an ineffective corrective tool given the inelastic demand for imports. For all these reasons, it is easier for a small open economy to enter into a currency union.

Degree of Commodity Diversification

If an economy is more diversified, it is better insulated against terms of trade, and other, shocks, and hence is less prone to use the exchange rate to mitigate the impact of the shock. Therefore, countries with diversified economies are better candidates for Currency Union.

Other factors are:

Similarity of Production Structure

Countries that share common production structure are more likely to experience symmetric shocks and to exhibit high covariation in economic activities. They are less likely to use their exchange rates as an adjustment tool and hence are better candidates for Currency Union. It should be noted that structural shocks could also be symmetric (or correlated), in addition to similarity of economic structure, because of dependence on common foreign shocks such as the fluctuation of the price of oil in international markets.

Price and Wage Flexibility

The flexibility of prices and wages obviates the need to alter the exchange rates in case of shocks. Countries with flexible prices and wages are more inclined to engage into Currency Union arrangements that would restrict the use of exchange rate as an adjustment tool. In this case, the flexibility in prices and wages act as a substitute for a nominal exchange rate variation.

Similarity of Inflation Rates

Similar inflation rates signal similarity in structure and in the conduct of economic policies. This would be desirable for countries that would like to coordinate their policies to achieve the requirements of a Currency Union. In fact, the much cited Balassa-Samuelson effect¹⁴ explains the different rate of inflation between different countries even assuming the same monetary policy. It is argued that productivity tends to be higher in high growth countries than in low growth ones and that this tendency is more pronounced in the tradable than in the non-tradable goods sector. Assuming perfect international capital mobility, wage equalization across sectors in each country and the law of one price for tradable goods, this pattern of productivity differentials between sectors and across countries will lead to higher non-tradable goods prices in high growth countries. It is suggested that higher productivity in the tradable goods sector will bid up wages in that sector and, with labor being mobile, wages in the entire economy will rise. Producers of non-tradables will be able to pay the higher wages only if the relative price of non-tradables rises. Therefore, countries with a higher ratio of non-tradable to tradable goods will have a higher price level, which may be translated by a higher inflation rate for a period of time, for the high growth countries in the single currency union.

¹⁴ Attributed to Balassa (1964) and Samuelson (1964)

Degree of Policy Integration

The similarity of policy attitudes is an important indicator for the potential success of policy coordination that will be required to achieve full monetary integration. Haberler (1970) raises the point that it is not the characteristics of the economy, but the similarity of policy attitudes, which creates the conditions for a flourishing currency area. In addition, it is generally held that similarity of monetary and fiscal policies between member countries can create equilibrium whatever the characteristics of the currency area, thus generating an efficient outcome.

Political Factors

The success of Currency Union would depend to a great deal on the political will and resolve of member countries to achieve the goal of Currency Union. Experience has shown that the political factors might be more important than the economic criteria.

V - GCC Countries and the Optimality Criteria for OCA

The purpose of this section is to verify whether the criteria mentioned above qualify the GCC countries for OCA.

Factor Mobility

Articles eight and nine of the Unified Economic Agreement between the GCC countries have allowed for the free movement of capital and labor across GCC countries and the freedom to exercise economic activities. The work of many specialized committees has also forged the way toward concretizing the very principles established by the agreement. However, looking at the extent of joint venture and labor movement among GCC countries, it is clear that factor mobility cannot be relied upon as an alternative adjustment mechanism to the exchange rate. GCC still impose restrictions on

ownership and type of activities that GCC nationals could exercise. On the other hand, labor market regulation and institutions are not very similar. This, in addition to factors related to welfare state; preclude labor from moving across GCC countries¹⁵. Most GCC countries have segmented labor markets with limited labor mobility. This reflects wage rigidities, skills mismatch, and institutional and cultural factors. Better educated new entrants to the national labor market have been traditionally attracted to the public sector because of higher wages and benefits, job security, and social status associated with government employment. At the other extreme, private sector activities have relied heavily on imported labor that is readily available on the basis of fixed-term contracts and at wages in many cases lower than those in the public sector.

Openness

The GCC countries are considered among the most open economies in the Arab region. Openness is traditionally measured by the ratio of trade (imports + exports) to the Gross Domestic Product (GDP). Table 9 gives the openness measures for the GCC countries. These ratios vary from one country to the other. The high ratios observed for GCC countries reflect in part the nature of their factor endowment, being primarily oil-exporting countries. It also reflects the heavy reliance of these countries on imported consumer and capital goods owing to the limited availability of domestic substitutes. These factors combined limit the effectiveness of the exchange rate as a tool to improve competitiveness or to reallocate resources among sectors.

¹⁵ Jbili et al (1997), p.10.

Table 9
Openness of GCC Countries
(Ratio of Trade to GDP)

YEAR	Bahrain	Kuwait	Oman	Qatar	S.Arabia	UAE
1980	226.50	90.00	84.56	90.90	88.98	96.05
1985	169.03	75.63	77.14	68.86	52.66	69.30
1990	164.21	56.50	67.67	70.98	65.47	83.28
1995	131.97	77.46	68.67	84.53	61.13	85.40
1996	145.59	75.89	71.63	73.08	62.62	85.69
1997	130.98	74.53	71.77	62.97	61.06	89.17
1998	109.40	72.46	70.03	74.23	55.50	87.02
Average (1980-1998)	153.95	74.64	73.07	75.08	63.92	85.13

Source: World Bank, World Development Indicators, 2000.

Degree of Commodity Diversification

Despite many efforts at diversifying their economies, GCC countries remain heavily dependent on oil. On average oil represents more than 75 percent of export receipts and budget revenues, respectively¹⁶. This shows the higher level of export concentration of GCC countries and hence the limited diversification and higher vulnerability of these countries to external shocks. Even the non-oil sector in GCC is perceived as an enclave whose development depends to a large extent on the performance of the oil sector. Productive activities in the non-oil sector are very limited and a high share of the non-oil aggregate value added originates mainly from trade and business services. As a consequence, the economies of the GCC remain vulnerable to the fluctuation of oil prices in international markets. However, despite being exposed to frequent terms of trade shocks, GCC countries adopt a common policy stance in which the exchange rate is not considered as a policy instrument that can be adjusted in case of adverse oil shocks. In fact, the adjustment operates mainly through the Government expenditures instrument

¹⁶ Sassampour (1996), p.22.

Similarity of Production Structure

Broadly speaking GCC countries have the same production structure with a dominant oil-sector and a limited non-oil sector dominated by trade and financial and business services. The sectoral distribution of GDP¹⁷ shows the degree of similarity in productive activities. Coupled with the dominance of oil, the similarity of production structure is likely to entail symmetric shocks that would eventually call for common policy reactions among these countries. As previously argued, this sort of shocks would render exchange rate mechanism less efficient in the adjustment process and hence, would favor joining OCA.

Price and Wage Flexibility

Prices and wages do not adjust systematically to accommodate frequent oil shocks. Government expenditures are the main stabilizer of economic activities during recessionary oil markets. In fact, during periods of declining oil prices, cuts in government capital outlays were typically the first line of defense rather than reducing government current outlays, such as the wage bill. Fasano (2001, p. 6) argues that wages in the GCC countries tend to grow continuously despite negative external shocks to the economy. In other words, wages and prices display limited flexibility in adjusting to various shocks. To the extent that oil price variations affect the GCC countries asymmetrically, the lack of price and wage flexibility does not favor the formation of an optimal currency area.

Similarity of Inflation Rates

GCC are not inflation-prone countries as noted by Fasano (2002). However, inflation rates seem to be pro-cyclical picking up at periods of oil price hikes and decreasing during periods of oil price slumps. Inflation rates across GCC countries are

¹⁷Jadresic (2002), p.13.

not highly correlated despite a relative similarity in the conduct of macroeconomic policies namely, fiscal, monetary (P.15) and exchange rate policies¹⁸. This might seem to suggest that inflation differentials among GCC countries reflect a difference in the microeconomic determinants of inflation (i.e. factors affecting the supply of and demand for goods and services) notably, the presence of price inertia.

Degree of Policy Integration

Many efforts have been deployed by the GCC countries to reinforce commonalities and coordinate many facets of economic and social policies. Article 4 of the GCC charter stipulates, among other things, the formulation of similar regulations in the economic and financial affairs. The main policies that call for coordination in the context of currency union have already common features in the countries of the region. For instance, monetary and exchange rate policies in the GCC countries are commonly centered around maintaining a wedge between domestic and foreign interest rates in order to stabilize the exchange rate and stem capital outflows or portfolio reallocation in favor of foreign assets.

Political Factors

GCC leaders have shown a strong commitment to this regional grouping. This commitment stems from the many common traits shared by GCC countries notably the similarity in their political, social, demographic and cultural structures¹⁹. Despite the fact that the process of economic integration has incurred minor setbacks and decelerations, it did not affect the resolve of GCC leaders to reinforce cooperation and move ahead with economic and political integration. Even if integration is moving at a much slower pace than is generally hoped, GCC countries are often praised for taking a pragmatic approach

¹⁸ While similarity in policy preference is well documented in the case of the GCC countries (see Fasano 2002, 2003), calls for structural adjustments to alleviate the lack of wage and price flexibility and other institutional obstacles have recently emerged within the challenges of establishing consensual criteria in the path towards monetary integration (see for example Jadresic 2002).

¹⁹ Jadresic (2002), p. 21.

consisting of progressively reinforcing commonalities rather than hastily imposing unrealistic conditions to achieve such integration.

VI- Conclusion

Judging by the OCA criteria proposed in the last section, the prior conditions are not all favorable for a Currency Union within the GCC countries. In fact, five criteria are in favor of a Currency Union (Openness, similarity of production structure, similarity of inflation rates, degree of policy integration and political factors) whereas; three factors are not (Factor mobility, degree of commodity diversification and price and wage flexibility). Jadresic (2002) suggests however that the eventual replacement of the current individual currencies of the GCC countries by a common regional currency can be a worthwhile objective. He emphasizes the implementation aspect suggesting that “..if implemented properly will contribute to enhance their general economic efficiency, deepen regional integration, and foster the development of the non-oil economy”²⁰. Therefore the Currency Union must be seen as only one component of a much broader integration effort.

²⁰ Jadresic (2002), p.25.

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