Policy Brief

REPLICATING THE SUCCESS OF THE EUROZONE IN THE GCC: A COMMON CURRENCY AREA

SUMMARY

Since the establishment of the GCC in the early eighties, GCC states cooperated in many fields to achieve shared visions of a prosperous future that followed the emergence of oil. Arguably, the millennium was the turning point of the GCC's economic growth, particularly after significant developments.

The GCC embarked to create a monetary union for the Gulf region through the adoption of the Monetary Union Agreement, which the GCC states have yet to implement.

The aims of this policy brief are (1) to highlight the importance of a common currency for the GCC, (2) to discuss the potential of a common currency area for the GCC, and (3) to provide recommendations for further economic integration through a monetary union akin to the Eurozone.

Since its start, the GCC has identified economic cooperation and integration as one of its main goals. It expressed these desires first in the 1981 revised Unified Economic Agreement, which laid the groundwork for trade exchange, the rights to freedom of movement, freedom of capital, and freedom of exercising economic activity. Moreover, it included provisions on financial and monetary cooperation, transport and communication, technical cooperation, and coordination of development. The GCC revised this agreement in 2001. The GCC states adopted a new economic treaty that added more provisions and more detailed rules than its predecessor.

Nevertheless, the GCC is still not as integrated economically as the European Union. The question that arises here is what the GCC can do to achieve the EU's level of integration and whether such integration would be beneficial. The current level of monetary integration in the GCC does not achieve the optimal degree of economic cooperation among the GCC states.

> **"As a common language facilitates effective communication among people, a common currency could promote trade and investment among countries."**

Source: ADB Working Paper - Costs and Benefits of a Common Currency for ASEAN

INTRODUCTION

In 2008, GCC states signed the GCC Monetary Union Agreement, which focuses on the establishment of the Monetary Council. The Council is mandated with carrying out its tasks until the establishment of the Central Bank of the GCC. Its primary objective is to prepare the necessary infrastructures for establishing the Monetary Union, especially the establishment of the Central Bank, and laying down its analytical and operational capacities. The agreement included provisions for the creation of a single currency for all GCC states. Additionally, it included provisions for the creation of a Central Bank, which would work to ensure price stability in the single currency area through optimal utilization of the economic resources that would ensure economic stability. However, none of the provisions for the creation of the central bank and the single currency were implemented and the plan for further economic integration through a single currency was halted.

WHY A COMMON CURRENCY?

1

A common currency in the GCC will enhance trade among the nations by eliminating currency conversion costs and decreasing the fixed and variable costs associated with exports. Moreover, it will provide a stable market for trade within the region. With GCC states moving towards diversified economies, trade in non-hydrocarbon products will propel the benefits of increased regional trade. As indicated by Figure 1, intra-regional trade in the Eurozone increased over the years especially since the Euro was adopted in 1999. Such a growth in trade could potentially be witnessed in the GCC region as well with stronger monetary integration.

2

A common currency induces more intra-regional trade, which results in an increase in the choice of products available to consumers in the market. A common currency, therefore, also further increases the standard of living of consumers in the GCC economy.

3

A common currency allows for greater price transparency. It will prove beneficial to firms sourcing raw materials from different countries within the GCC. Additionally, the price comparison among GCC states becomes easier. The result is increased efficiency for producers, which leads to greater incentives to invest in growth opportunities across the GCC.

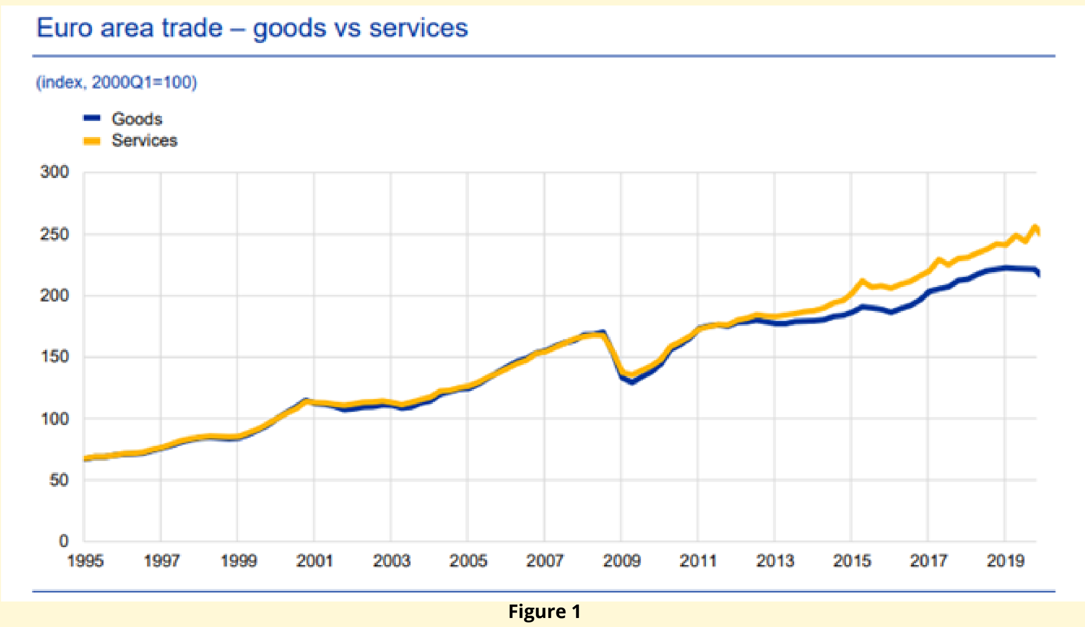

Figure 1

Source : ECB Occasional Paper Series - The Impact of The Euro on Trade: Two Decades into Monetary Union

PROSPECTS OF A CURRENCY UNION IN THE GCC

MAASTRICHT CRITERIA

An assessment of whether the GCC can adopt a model similar to the Eurozone reveals that all GCC states fulfil the Maastricht criteria as set out in the Maastricht Treaty to promote the EU's Economic and Monetary Union. These criteria broadly include inflation rate, government debt, budget deficit, consistent exchange rate, and long-term interest rate. Research has indicated that GCC states can implement the Eurozone model and such an implementation would be beneficial to the GCC states' economies.

OPTIMUM CURRENCY AREA

Additionally, the GCC's economy possess all the necessary characteristics required to form an Optimum Currency Area (OCA). The first criterion is openness to trade with an average degree of openness at 65%. GCC states fulfil the openness to trade criterion. The second criterion includes shock synchronization among the Member States. An analysis of the co-movement of macroeconomic variables among the GCC nations indicates that these countries have a considerable level of symmetry in reaction to economic shocks. However, the final criterion with respect to labor mobility within the GCC is not sufficiently fulfilled and hence the member nations could pursue further integration of their labor markets.

Therefore, the similarity in terms of the structure of GCC economies facilitates easier convergence of monetary policies and the arrangements that currently exist enhances the possibility of collaboration.

RECOMMENDATIONS

The GCC's Monetary Council could collaborate with the European Central Bank in transfer of knowledge and expertise regarding the:

1

Setting up of a currency union

A common currency within the GCC to enhance and stabilize the economy among member states by renegotiating the implementation of the GCC Monetary Union Agreement. This single currency will help and benefit the GCC from any potential risks happening in the future due to the countries' currencies being pegged with the USD.

2

Establishment of a Central Bank

The establishment of a Central Bank within the GCC to implement a common monetary policy and adopt the proposed common currency that will ensure price stability through optimal utilization of the economy and ensure the economic stability of the member states. This creation of the CB should allow the GCC to collaborate closely with the EU's Economic and Monetary Union to exchange knowledge and benefit from their expertise.

3

Adoption of a Digital Currency

An adoption of a unified digital currency within the GCC as a means of payment for fast and easy transaction among member states. This will benefit the GCC's economy, mitigate economic risks, and facilitate faster domestic or cross-border payments and settlements. The GCC should consider taking steps in this approach and engage in drafting policy measures to ensure its safety.

CONCLUSION

To conclude, the common currency system would have many advantages if the EU experience was introduced in the GCC. As seen since the signing of the GCC Monetary Union Agreement, the actions in this regard have not lived up to the intended aspirations. As explained in this brief, the possibility of implementing the single currency project is within grasp, and the GCC should implement it in light of the current political realities to ensure greater security for its economy. This will have a positive impact on the people living in the GCC region. Decision makers should consider accelerating the policy development process for the establishment of the Central Bank to replace the Monetary Council that, in turn, will speed up the issuance of the common GCC currency.

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