The Gulf Cooperation Council monetary union: a Bahraini perspective

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1. Bahrain and monetary union in the Gulf

The Gulf Cooperation Council (GCC) was formed on 25 May 1981 to encourage policy coordination, integration and unity among the member states.[1]

The Bahraini dinar has been pegged to the US dollar at the rate of $1 = BHD 0.377 since 1980. Interest rates track US dollar rates with a small margin. The experience of Bahrain in pegging to the dollar, and the benefits it has provided, have long influenced our thinking towards supporting monetary integration within the region.

2. Factors supporting Gulf monetary union

Experience has proved that countries with fewer disparities in their economic structures and systems are more likely to succeed in achieving economic integration and monetary union. Viewed in this context, the GCC countries readily recommend themselves for organisation into a Gulf monetary union. There are many similarities among them:

- The six countries form a contiguous chain of neighbouring states bordering the Arabian Gulf.
- Their peoples share a common language, religion and traditions.
- Oil exports, which are priced in US dollars,[2] are a major source of government revenue for all, accounting for 92% of government revenue for Kuwait, 81% for Saudi Arabia, 77% for Oman, 76% for the United Arab Emirates, 74% for Bahrain and 56% for Qatar (which has extensive natural gas revenues).
- Generally speaking, the GCC countries impose no, or very low, income taxes. Central government budgets are generally maintained in balance or with small deficits. Customs duties are low on most products.
- While inflationary experience has varied among the GCC countries, all of them have been following anti-inflation policies, such as a fixed exchange rate against the US dollar. There are no exchange controls or restrictions on investments and capital flows. Governments in the GCC countries follow open economic policies and allow the free flow of capital and convertibility of currencies.

Examination of the structure and operation of the economies reveals substantial similarities. Likewise, the economic and financial policies followed by the respective governments and monetary authorities are quite consistent. There appear to be no major conflicts about policy objectives. Internally, domestic fiscal and monetary practices are generally conducive to investment. Externally, the authorities follow policies to promote an open trade system.

[1] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

[2] This means that local currency devaluation is unlikely to boost exports.

3. The benefits to the GCC's members of economic and monetary integration

The most important direct benefits of economic and monetary integration are similar to the ones which favoured the creation of the euro:

- The elimination of currency transaction costs will result in savings in both time and money. For small and medium-sized companies operating across the Gulf but lacking the necessary expertise in cash management services, it eliminates the cost of converting money from one national currency to another.
- The elimination of exchange rate risk would encourage increased intra-Gulf trade and investment.
- Greater transparency in pricing, improved business competitiveness and simplification of procedures and operational issues would generate benefits for the Gulf's consumers.
- Fiscal discipline by member countries would contribute towards a lower inflation and interest rate environment within the GCC. Within the euro area, monetary union has encouraged a trend towards declining budget deficits and more prudent fiscal policies.
- At the micro level, the Gulf currency would have a long-term impact on major regional banks. The impact would be felt on cash and treasury businesses. A single currency encourages more efficient use of cash. The costs of hedging against exchange rate volatility would be vastly reduced.
- An enlarged, unified GCC market, whose present GDP exceeds $300 billion, would offer new trading and investment opportunities. This, in turn, would attract more foreign direct investment, especially from multinational corporations targeting regional manufacturing and services sectors.
- The Gulf monetary zone would represent what is potentially the Middle East's largest and most liquid capital market. Foreign and local institutional investors would be able to target the Gulf market as a whole. Thus, portfolio managers and private investors wanting greater exposure to the region will be able to choose freely from stocks without having to take on additional currency risk.

4. The Muscat summit of 2001

The GCC held its 22nd summit in Muscat on 21 December 2001. The final session began with the leaders signing an agreement for economic union among the member countries. The agreement was reached in order to activate economic integration between the GCC states and to enhance the progress being made towards establishing a common market and monetary and economic union. The agreement represents a significant step forward and supersedes the economic agreement ratified by the GCC in 1981.

The new agreement called for the establishment of a customs union for the GCC states that would come into effect in January 2003, rather than 2005 as previously agreed. It stipulated that the standard customs tariff should be 5% on all commodities imported from outside the customs union. The establishment of the GCC Customs Union will coincide with the implementation of the World Trade Agreement in 2003. Five GCC states have already joined the international agreement and the sixth is on its way to joining. The Customs Union will make the GCC states a single homogeneous entity with which other economic groupings can deal. It will help to activate intra-GCC trade, facilitate the transfer of goods and services between GCC states and attract foreign investors into the region by offering better economic returns on their investments.

The new agreement also contains clauses relating to the establishment of a monetary union of GCC members and the launch of a single currency. It specified a timetable for the monetary union, by instructing the Commission of the Governors of Monetary Institutions and Central Banks to apply the previous decision relating to the adoption of the US dollar as a common basis for GCC currencies by the end of 2002. It also directed the Financial and Economic Cooperation Committee to agree on the measures of economic performance needed for the monetary union to succeed by the end of 2005 with a view to launching a single currency in January 2010. All the GCC states, with the exception of Kuwait, have currencies currently pegged to the US dollar. We believe that linking the GCC currencies to the US dollar paves the way for a single currency that would promote intra-GCC trade and boost the GCC economies. It would also create favourable conditions for dealing with international economic blocs.