Concrete steps towards the establishment of a monetary union for the Gulf Cooperation Council countries

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The United Arab Emirates (UAE) has a population of about 4 million, with a per capita GDP in 2001 of $17,000. The country has one of the most diversified economies in the Gulf region. Indeed, the share of the oil and gas sector has been limited to around 30%.

The dedication of the leadership to development and economic freedom are at the origin of this success story. The country is now host to 16 “free zones” where businesses can be established without complicated administrative procedures. Indeed, about 3,500 companies from all over the world have set up in these zones. Jebel Ali is now the world’s largest free zone with over 2,400 companies from over 80 countries. Innovative development projects include the Dubai internet and media cities, the Dubai International Financial Centre and a new metal and commodities centre.

The UAE economy was ranked 14th worldwide in 2001, according to the Heritage Foundation’s Index of Economic Freedom. Fund transfers abroad are totally free. Foreign banks are active in the UAE. The UAE joined the World Trade Organization in 1996, and is confident that its economy is in a position to face the challenges of international competition.

Sequencing of economic and monetary integration in the Gulf

In the GCC countries,[1] economic and monetary integration are proceeding hand in hand. Indeed, the adoption of the single currency is conceived as a way to enhance economic and monetary integration. In the GCC case, monetary union is preceding economic integration.

The anchor currency

A decision was already taken in December 2001 to adopt a fixed peg to the US dollar for all GCC countries. Indeed, this currency has been a de facto anchor in the past for all GCC members except Kuwait, whose currency does not fluctuate much against the dollar either. The fixed peg of the GCC currencies to the dollar has served the economies quite well. First, as exports are priced in dollars, fluctuations of the dollar against other major currencies will have a minor impact on the GCC currencies. Second, the peg to the dollar is a stabilising influence for government budgets as oil and gas are major sources of revenue. These reasons would indicate that the dollar will be the anchor currency when the currency union is established in 2010. But they do not exclude a later shift to another anchor (such as the euro) or a float of the currency.

Convergence criteria

According to the agreed agenda, the observance of convergence criteria will start in 2005. The process of choosing these criteria and studying the appropriate way to implement them is currently underway. The criterion for the budget deficit could refer to a fixed maximum limit as a percentage to GDP. Alternatively it could be expressed as a permissible limit (1 or 2 percentage points) above the average ratio of the other members. A target for the public debt could be expressed as a declining range, with a final target in the order of 60-70% of GDP. With a fixed peg to the dollar, interest rates should be aligned to the interest rates in the United States.

[1] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE.

Institutions

A special commission of the Governors of the GCC central banks and monetary authorities was set up to coordinate and follow up on all matters pertaining to the monetary union, including the convergence criteria.

It is likely that the relationship between the future Gulf Central Bank and the central banks of the member countries will be similar to that now existing between the corresponding institutions within the euro area.

Conclusion

The adoption of a monetary union in the GCC is a very specific experiment, in that all members already rely on oil and gas as their major export. They all strive to diversify their economies, and they have all adopted a fixed peg to the dollar years before the adoption of a single currency. The challenge now is to take advantage of all these elements and accelerate the process of monetary and economic integration.