Journal of Economic Policy Reform
Vol. 11, No. 2, June 2008, 123–134

Is EMU a viable model for monetary integration in the Arabian Gulf?

Emilie Rutledge*

Department of Economics and Finance, College of Business and Economics, UAE University, Al Ain, United Arab Emirates

The Gulf Cooperation Council (GCC) intends to form a monetary union using the EMU process as a blueprint, including a set of Maastricht-style convergence criteria. Yet, as the 2010 deadline approaches, few of the necessary institutional preparations have been made. This paper argues that while GCC leaders considered the economic case (on the whole beneficial) they neglected to fully consider the political implications of monetary union. It concludes that devolving decision-making powers to pan-GCC institutions, the need for greater levels of budgetary transparency and fiscal discipline may presently be considered too costly for the region's ruling elites.

Keywords: monetary union; economic integration; economic policy objectives; Gulf Cooperation Council states; comparative studies

JEL Classification: E52, F15, E61, O53, o57

Introduction

In 2001 the leaders of the Gulf Cooperation Council (GCC) states – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates – reaffirmed their regional economic integration plans and laid down some concrete steps for establishing a single regional currency by 2010. If successful, this monetary union (MU) would undoubtedly be the second most significant in the world. As well as owning 40% of the world's proven oil reserves and almost one quarter of the world's proven natural gas reserves (BP 2007), the GCC has amassed a stock of foreign assets amounting to nearly $1.6 trillion (Institute of International Finance 2007).

The intention to form a single currency, however, predated the 2001 summit by exactly 20 years. The formation of the GCC and the signing of the 1981 Economic Agreement marked the beginning of the bloc's economic integration aspirations with the ultimate aim of creating a common market and a shared currency. It was not until the 2001 summit though, after a decade of depressed oil prices and rising national unemployment, that the GCC once again saw the utility of economic integration as a means of diversifying away from an over dependence on oil. The new Economic Agreement stated that "For the purpose of achieving a monetary and economic union between Member States, including currency unification, Member States shall undertake, according to a specified timetable, to achieve the requirements of this union" (GCC Economic Agreement 2001, Article 4).

In the years immediately following the document's ratification several steps were taken, a customs union was launched in 2003 and, in the same year, Kuwait joined the other GCC states in pegging its currency to the US dollar and in 2005 provisional convergence criteria

*Email: e.rutledge@uaeu.ac.ae

ISSN 1748-7870 print/ISSN 1748-7889 online

DOI: 10.1080/17487870802213878
http://www.informaworld.com

were agreed upon by the region's central bankers. Nevertheless since the current oil price boom, 2002 to present, the pace of progress has faltered. As of August 2007 five of the six GCC states still officially plan to adopt a single currency. Oman opted out citing a lack of tangible progress in late 2006.

GCC leaders have acknowledged the influence of the European experience in their decision to form a MU. Saudi Arabia's King Abdullah said "the example of the European Union is a model to follow" (Al-Saud 2002). The European Central Bank (ECB) has provided consultation for the GCC secretariat and the GCC central bank governors have provisionally accepted Maastricht-style convergence criteria. However, in the light of the very different economic, institutional, cultural, legal and political contexts of the GCC states compared with those of the euro zone, it is questionable as to whether EMU is a viable model for the GCC states to emulate.

Lack of tangible progress to date may in part be due the current oil price boom – huge current account surpluses reduce incentives to enact reform. Another consideration is that while it seems GCC leaders considered the economic implications of a potential MU on the whole advantageous, the necessary political reforms, involving the forgoing of some decision-making powers, increasing levels of budgetary transparency and greater levels of budgetary scrutiny, were not fully considered and may now be acting as disincentives.

To date, much of the research related to GCC MU has focused on the economic case for or against the project (Laabas and Limam 2002; Darrat and Al-Shamsi 2005). However, given the highly centralized nature of the GCC economies and their monarchical political regimes, it is arguably the political-economy factors that are likely to have greater bearing both for the likelihood of MU coming into being and the potential success of the future single currency if it is indeed launched.

This paper seeks to address this issue by examining the degree to which the GCC has thus far met what we term the European "criteria" for MU and the prospects for meeting them before the 2010 deadline. First it assesses the GCC's institutional preparations for MU, in particular the setting up of a common market, establishing a GCC Central Bank and a regional statistical body. The second part of this paper examines whether the GCC economies are likely to be able to meet the provisional fiscal and monetary convergence criteria on the basis of their past performance and addresses the appropriateness of these criteria for the region's economies. Finally it gauges the extent of political commitment to GCC MU, utilizing primary evidence derived from interviews with a panel of regional experts, including regional policy makers, central bankers, economists and academics (Rutledge 2007).

Relevant literature

Several papers have examined whether EMU represents a model for monetary integration in other regions. Wyplosz (2006) examines whether EMU is a "blueprint" for deep integration among Asian countries and finds that the European way of integration is not the only way or necessarily the best way to reach the goal of economic integration. While acknowledging that European integration is a historical and momentous achievement, Wyplosz warns that other regions seeking to integrate may not be able to simply emulate it – and perhaps, should not.

A European Central Bank working paper (Dorrucci *et al*. 2002) discusses the lessons from European integration for Latin American countries. The authors conclude that one important lesson from Europe is the importance of institutional integration. They argue that intensifying institutional integration, for instance through the creation of a common market and the co-ordination of monetary and exchange rate policies, has an important role to play in deepening the process of regional economic integration.

Dorrucci *et al*. also emphasize the critical importance of sustained political commitment to the process of economic integration in any given region. Indeed, much of the literature relating to the achievements of European integration highlights the importance of political unity among the member states of the MU. It is clear that the strong political will to form a MU in the case of Europe has been able to override the fact that the euro zone in many instances is not a model Optimum Currency Area (OCA). As most region-specific analysis concludes that the GCC is not an OCA (Laabas and Limam 2002), it follows that a strong political commitment to the project needs to be present. Willett (2000) contends that the European political elite ignored warnings which indicated that the region was not an OCA and that MU would only have net benefits for some countries. De Grauwe (1992) finds that EMU appears to be welfare-enhancing for a core group of members, but such a welfare case cannot be made across all member states, while Feldstein (1997) claims that the driving force behind EMU was primarily political and not based solely on economic merits.

Several papers have dealt with the prerequisites for a GCC MU, without any discussion as to whether or not such preparations are feasible within the context of the region and therefore are likely to be undertaken. With regard to GCC MU, Fasano (2003) suggests a number of prerequisites along European lines, including choosing quantitative convergence criteria, fiscal rules, policy convergence, institutional design and development and complementary structural reform.

Several papers by the International Monetary Fund (IMF) focus on the need for improving data provision across the GCC states as an essential part of the process of forming a MU (Al Mansouri and Dziobek 2006; Krueger and Kovarich 2006), while an ECB report (Sturm and Siegfried 2005) recommends that in advance of GCC MU national and supranational institutions must be strengthened and national policies coordinated. In particular Sturm and Siegfried highlight the importance of setting up a supranational monetary institution at the GCC level in order to support the single monetary and exchange rate policy of the union.

Institutional preparations

Pan-regional institutions play an important role in strengthening the overall cohesion of a given MU as well as ensuring its credibility. In the case of Europe, supranational institutions played a key role in the integration process. Leblond (2004) argues that without pan-European institutions, such as the European Commission and the European Monetary Institute (the precursor to the ECB) EMU would not have become a reality. Without effective and independent supranational institutions there can be no “third-party” enforcement of the monetary union project (Mattli 1999).

It has also been argued that the “rentier” characteristics of the GCC states arising from their continued dependence on hydrocarbon revenues have hindered the development of an effective, independent and strong institutional framework, both at the national and GCC level (Al-Qudsi 2006). The GCC Secretariat is the main supranational institution but is generally considered as being devoid of any real autonomy or policy-making influence.

According to Balassa (1961) there are five stages of increasing degrees of regional integration: a Free Trade Area, a customs union, a common market, an economic union (including some harmonization of economic policies) and finally complete economic integration. EMU is somewhere between stages four and five, whereas the GCC states to date are stalled at stage two. The GCC leaders have been unable to agree on the establishment of vital intra-GCC institutions such as a regional statistical agency and a GCC central bank, while the setting up of an effective common market has been stalled by failure to complete the customs union.

The customs union and the common market

A single currency should not be launched without there first being an effective single market: without it many of the benefits of MU will not be realized and many of the costs will be amplified (Cecchini 1988). Of course the European single market was far from complete when the euro was launched; nevertheless it covered the majority of manufactured goods and many services. The final communiqué of the GCC's 2006 summit said that a common market would be in place before the end of 2007, but as the launch date approached it seemed unlikely that the common market could be established as scheduled. Nevertheless, in January 2008 it was announced that the common market had been launched. Despite taking some steps towards its completion, such as enacting legislation to facilitate the free movement of labour and capital, it remains to be seen whether or not a meaningful and comprehensive common market will be completed in the near future as several challenges remain.

As part of the common market it will be important to have a level playing field for businesses across the bloc and this will involve the harmonization of national ownership and investment legislation. Various markets will also have to be opened up to regional competition. Moreover, a functional common market necessarily includes the completion of the stalled 2003 GCC customs union. When the customs union was launched in 2003 it was viewed as a major achievement on the path towards MU. However although the bloc agreed to harmonize external tariffs at 5%; the customs union has yet to be fully finalized. This is in large part a result of Bahrain's decision in 2004 to sign a bilateral Free Trade Area (FTA) with the USA, which Saudi Arabia viewed as a "clear violation of the GCC's economic accords and decisions" and impeding "the progressive steps needed to achieve full GCC economic integration" (*Arab News* 2004). This implies that unless the other states also agree a similar FTA with the USA, the third and final stage of the customs union – abolishing the customs functions of the intra-GCC border offices – cannot be completed. This is because the other GCC states will have to levy tariffs on US goods arriving as intra-GCC imports from Bahrain. In October 2005, Oman followed Bahrain and became the second GCC state to sign a FTA with the USA. It is worth noting that soon after this Oman pulled out of the MU project altogether.

The disharmony in trade policy across the GCC states represents a significant stumbling block to the common market and the full economic integration of the GCC states. In the absence of harmonized trade policies it will be much harder for the GCC states to act as a regional economic bloc in international dealings and negotiations. Moreover, if the will to coordinate economic policies does not exist then it is hard to envisage how the deep integration intrinsic to MU can be achieved.

A GCC central bank

The EMU experience clearly shows that substantial preparation time is needed to establish a single central bank. The European Monetary Institute was set up as a precursor to the European Central Bank and was tasked with carrying out technical research and making monetary preparations four years prior to the electronic launch of the euro and six years before its general circulation. It is generally accepted that to have a viable MU there needs to be a supranational central bank so that decision making on the single monetary and exchange rate policy is centralized (Sturm and Siegfried 2005).

The GCC initially planned to keep their existing central banks, but following advice from the ECB eventually agreed in principle to create a single GCC central bank. This will inevitably involve relinquishing some monetary policy decision-making powers, decisions on its mandate, organizational structure and legal set up, but to date these have yet to be agreed upon. Most of the debate regarding the central bank thus far has centred upon the somewhat trivial issue of its location (*Gulf News* 2006). Qatar had proposed setting up a currency board (*Gulf Times* 2007), similar to that which it operated with the Emirate of Dubai between 1966 and 1973. But such a regime cannot be considered to be significantly different to the status quo or as a serious substitute for MU.

Presently, cooperation between GCC monetary institutions takes place through biannual meetings of the Central Bank Governors' Committee. Additionally, a technical committee meets several times during the year and reports to the aforementioned committee (Rutledge 2007). In 2002 the Supreme Council established a Monetary Union unit to be based at the GCC secretariat tasked with harmonizing the GCC's money market instruments.

In order to establish a MU along European lines, pan-GCC decisions will have to be taken on the distribution of seigniorage revenues and management of foreign exchange reserves as well as contentious political-economy decisions such as the voting structure of the future monetary policy committee. In the case of EMU, each member state was given equal voting powers regardless of their economic mass. But as Saudi Arabia's position within the GCC is even more significant than that of Germany within EMU, there is a compelling case for allowing Saudi Arabia proportionally more voting power. While such a voting structure may not be particularly appealing to the smaller GCC states, anything else is unlikely to be acceptable to Saudi Arabia.

A GCC statistical agency

In the EMU process various institutions were involved in the collation of comparable regional statistics long in advance of the euro's launch. In 1992, a Working Group on Statistics was set up which liaised with the Statistics Division at the European Monetary Institute.

Common statistical standards, timely data disclosure and a high level of transparency are all vital for managing a joint currency, yet presently GCC data sets are considered by many economists to be inadequate (Al-Qudsi 2006; Dyer and Yousef 2007). For example, at present there is no consistency between GCC states in measuring CPI with different base years and baskets of goods being employed and according to the IMF, GCC inflation is being underestimated because it is calculated using an outdated formula (*Khaleej Times* 2007). Furthermore, there is a fundamental problem in the region with off-balance sheet accounting and fabrication of budgets reportedly common practice (Khalaf 2002). In the lead-up to MU all five states will need to individually enact reforms and coordinate institutions to ensure they meet agreed standards. Krueger and Kovarich (2006) argue that significant lead time to build the institutional capabilities and legal infrastructure for comprehensive data collection will be required.

In an IMF working paper, Al Mansouri and Dziobek (2006) draw directly on Europe's experience in preparing its statistical base for MU and recommend that a GCC regional statistical agency, modeled on "Eurostat" should be established. They recommend that "Gulfstat" should be tasked with developing a common methodology for collecting, standardizing and harmonizing data across the GCC. Ultimately such information gathering could be carried out by a GCC central bank but in the interim, data must start being collated, otherwise it will be almost impossible to assess any regional progress towards meeting convergence targets, and therefore meeting the criteria will continue to be open to interpretation.

One possible reason for the GCC's lack of progress to date in this regard is that increased public scrutiny of budgets, which will undoubtedly be necessary in order to monitor adherence to fiscal policy rules, may be considered as an unacceptable intrusion by some ruling elites. Indeed, Mundell (1997) argued that wanting to protect the secrecy of national statistics may be a strong rationale against joining a MU.

Fiscal and monetary convergence criteria

At a meeting of GCC Central Bank Governors in September 2005, it was provisionally agreed that they would adopt European style convergence criteria which included inflation and interest rate convergence targets, capping budget deficits at 3% of GDP and keeping gross government debt to below 60% of GDP (see Table 1). An additional target for foreign reserves was also added to cover four months worth of imports. While the Maastricht convergence criteria were firm and unconditional requirements, the GCC's convergence criteria are more likely to be merely targets.

As of 2006, only two GCC states – Kuwait and Saudi Arabia – met all of the criteria. The UAE and Qatar are both in breach of the inflation criterion and have been for several years, while Bahrain and the UAE are in breach of the foreign reserves to imports criterion. An empirical analysis of GCC economic data since 1980 illustrates the serious difficulties which these economies will face in trying to meet Maastricht-style criteria. During that period, for example, the UAE and Qatar would have broken the criteria very frequently and more than any other GCC state (see Table 2).

Table 1. GCC convergence criteria compared with EMU's Maastricht criteria.

Criterion	Maastricht	GCC
1. Exchange rates	Exchange rate fluctuation within the normal margins for 2 years without any devaluation against any other member states currency	Long term stability of GCC exchange rates has meant that this criterion has not been considered[a]
2. Foreign reserves	No such criterion	Foreign reserves to cover 4 months of imports
3. Interest rates	Long term interest rates must not exceed more than 2% of that of the three best performing countries (in terms of price stability)	As Maastricht, but for short term interest rates (3 months)
4. Inflation rates	Inflation rates must not exceed more than 1.5% of the average of the three best performing countries	As Maastricht
5. Fiscal deficits	Government deficits must not exceed 3% of GDP[b]	Budget deficit must not exceed 3% of GDP when oil prices are $25/b or above[c]
6. Fiscal debt	Government debt must not exceed 60% of GDP	Government debt must not exceed 60% of GDP for the general Government and 70% of GDP for the central Government.

Source: Compiled by author.

Notes: [a]This may now need to be reconsidered following Kuwait's reversion to a basket peg in May 2007 and the announcement by GCC central bank governors in September 2007, that each state may pursue individual exchange rate policies in order to tackle rising inflation; [b]This rule, however, was not binding under certain economic circumstances (see Eichengreen and Wyplosz 1998); [c]This is based on OPEC basket price. If prices fall below $25/b, the maximum deficit is based on the formula: $\text{Deficit}(t) = 3 + 3[\,(25 - \text{Price}(t-1)) / 25\,]$.

Table 2. Number of historical convergence criteria breaches, 1980–2006.

Criterion	Bahrain	Kuwait	Oman	Qatar	SA	UAE
Foreign reserves	8	1	9	8	2	10
Interest rate	0	3	0	0	0	0
Inflation rate	6	15	3	21	2	23
Fiscal deficit	5	12	18	13	16	20
Fiscal debt [a]	0	0	0	0	8	0
Total breaches [b]	19	31	30	42	28	53

Source: Author's calculations.
Note: [a]Fiscal debt data starts from 1997; [b]Each breach represents one criterion being broken in one year, therefore if two criteria were broken in every year since 1980 the country would have 54 breaches in total.

Of the five Maastricht criteria, only two will be relatively easy to achieve in the long run: exchange rate stability and interest rate convergence. All six sovereign currencies already exhibit a high degree of exchange rate stability given their historical pegs to the dollar. Even the currency of Kuwait – which in 2007 abandoned the dollar peg in favour of returning to a basket peg – exhibits a high degree of stability due to a heavy dollar component. Given the region's fixed exchange rates the GCC have also provisionally agreed to the criterion of holding reserves equal to cover four months of imports, which can be considered as a prudent step towards supporting the single GCC currency. However, only Saudi Arabia and Kuwait have held sufficiently large reserves to achieve this criterion for prolonged periods without breaching it.

As a consequence of their shared peg against the dollar, GCC interest rates have also shown a considerable degree of convergence over the period of study, with local interest rates moving in line with US rates, and concomitantly with each other. The GCC interest rate spread has narrowed over time, and was just 0.73% in 2006.

However, inflation is a criterion of serious concern. Since 1980 there has not been a single year in which all five states would have met the criterion, which stipulates that inflation levels must not exceed 1.5% of the average of the three best performing members (see Figure 1). The UAE, followed by Qatar and Kuwait have breached the rule

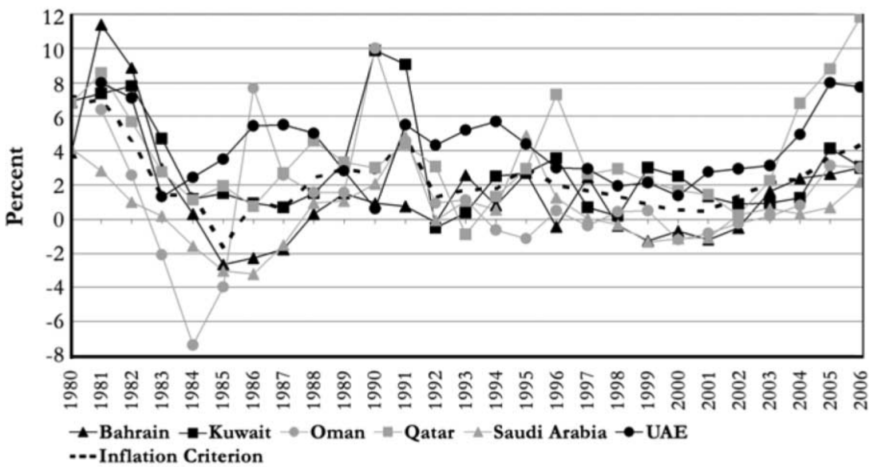

Figure 1. GCC inflation rates and the convergence criteria rule.
Source: IMF World Economic Outlook 2007 and author's calculations

most frequently. In fact, the last time the UAE would have been able to meet the target was in 1990. The GCC can be segmented into two inflationary groups, a low inflation bloc – Bahrain, Oman and Saudi Arabia – and a high inflation bloc – Qatar, Kuwait and the UAE. Inflation divergence has once again widened during the current oil price boom, reaching almost 10% in 2006. Even after considering Frankel and Rose's (1997) proposition that convergence may be endogenous to the process of forming MU, it is difficult to conceive how inflation rate differentials of this magnitude could be tolerated in advance of forming MU.

Of course, inflation differentials were also a cause for concern in the run up to the launch of the euro. As the launch date approached, member states adjusted their fiscal and monetary policies in order to meet the rules and rates began to converge (Egert *et al*. 2004). However, the GCC's policy of fixed exchange rates has meant that monetary policy tools cannot be used to achieve price convergence in the lead up to MU. Nevertheless with the political will, tighter fiscal discipline could certainly be used to this end.

The fiscal rules in the EU Maastricht Treaty, later enshrined in the Stability and Growth Pact (SGP) were designed to prevent undisciplined spenders "free-riding" on the credibility of other more fiscally prudent members (Eichengreen and Wyplosz 1998). Measures and safeguards to restrict the level of government budget deficits, and debt, are considered critical to the sustainability of a MU.

After several years of high oil prices all five GCC states are currently able to meet the fiscal rules, however in the past these rules would have been repeatedly broken, despite a minor adjustment to the rule allowing a slightly larger deficit when oil prices fall below $25/b. During the second half of the 1980s and for a large part of the 1990s, GCC governments recorded budget deficits far exceeding the 3% deficit rule due to a prolonged period of low oil prices (see Figure 2). Repeated budget deficit offenders have been the largest GCC economies – the UAE and Saudi Arabia. GCC fiscal policy management continues to be problematic, the income base of regional governments is very narrow depending largely on income derived from oil and gas revenues (which constitute approximately three quarters of government revenues) and fiscal policy is highly pro-cyclical (Fasano and Wang 2002). Similar procyclical fiscal policies were identified in several EMU states prior to the euro

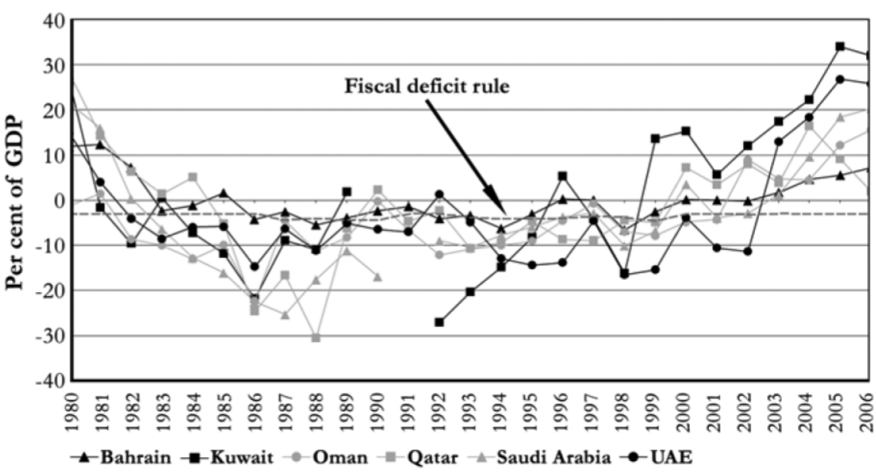

Figure 2. GCC government deficits to GDP ratios and the convergence criteria rule.
Source: GCC Economic Integration Department, Central Bank Reports and IMF Regional Economic Outlook 2007

and the fiscal prudence rules contained in the SGP were designed in order to limit this practice (Jaeger 2001).

Given the procyclicality of their fiscal policies in the past, the GCC have in the past not been able to generate sufficient surpluses to cover the deficits during periods of low oil prices. Nevertheless, since 2003 all five states would have been able to meet the deficit to GDP criterion. The experience of EMU has shown that even diversified economies can face great difficulty in meeting the deficit to GDP ratio with several euro zone countries breaking the criterion. Consequently, in 2005 the Stability and Growth Pact was reformed allowing for a series of economic exceptions to the criterion and making the fiscal criteria somewhat less rigid. Formulating fiscal criteria that are appropriate for the region's economies – perhaps focusing on the non-oil budget – is more important than borrowing EMU's rules which in any case proved to be impractical for Europe.

Turning to the debt to GDP criteria, most GCC states have been within the limit of the 60% debt to GDP ratio, with the notable exception of Saudi Arabia. Up until 2005 Saudi Arabia's debt to GDP ratio had been well above the limit, with its debt reaching as high as 102% in 1999. Nevertheless, the Kingdom has recently reduced its debt to GDP ratio substantially to 28% in 2006. According to the available data all five states now comfortably meet this criterion. The EMU economies are developed and diversified economies where limitations on public debt to GDP can be justified. However, public debt is not necessarily a bad thing for transitional economies so long as the borrowed capital is being used to invest in income-generating industries. It is questionable therefore, whether it is in the economic interests of the GCC to simply adopt EMU's 60% rule and not devise a rule more suited to the characteristics of their transitional economies. A distinction or clause to differentiate between future income-generating borrowing as opposed to borrowing to cover recurrent expenditure would therefore be more appropriate.

Political commitment to monetary union

In a region not known for its government accountability or transparency it is somewhat difficult to judge the level of political commitment to the GCC MU. However, the lack of tangible progress in terms of regional economic integration since 1981 certainly seems to suggest some political misgivings about the project. Evidence from regional interviews also indicates that the political commitment to see the process through may be waning. The largest proportion of experts interviewed believed that the 2010 launch date for MU would not be achieved and that it would be delayed (Rutledge 2007).

In the case of Europe any reading of the relevant literature (see Feldstein 1997; Willett 2000) makes it clear that both the formation of a common market and the establishment of MU were driven primarily by a political imperative rather than being based on economic merits alone. The evidence from EMU therefore suggests that the motivation behind establishing MU is a major factor determining political commitment. EMU has been seen by some observers as a means to achieving lasting peace through greater political cohesion in Europe and indeed such rationale was initially stated by the architects of EMU. Willett (2000) argues that the process of economic integration in Europe which culminated in a single currency secured primary national security and foreign policy goals for its main architects. The EMU experience indicates that the stronger the role of political, as opposed to economic, considerations in motivating the participants of a potential MU, the stronger will be the commitment to the process of implementing it.

Admittedly the evidence for this proposition is scant since there have been so few MUs formed from scratch, but, as we have said, the experience of EMU certainly supports it and furthermore the experience of other MUs does not contradict it. The CFA Franc Zone in West and Central Africa, which has existed for over half a century, is a legacy of the monetary institutions that were in place during French colonial rule, therefore membership of the union has been exogenous to economic considerations (Fielding and Shields 2005). In addition, the East Caribbean Currency Board also evolved from a colonial past and colonial monetary institutions that of the British Caribbean Currency Board.

It may be revealing therefore that, in a survey of regional experts carried out by the author, the largest proportion, 33%, felt that the motivation behind establishing GCC MU was based on economic considerations, followed by 25% who thought the motivation was political and 22% who believed that emulating the success of the EMU was the main source of motivation, while the remainder considered a combination of factors to be the motivation. Indeed the unsteady rate of progress towards MU illustrates the primary role of economic considerations, with commitment to achieving integration inversely related to the price of oil.

Furthermore, despite minor border disputes, none of which have ever led to armed conflict, the GCC states face no major political imperative to integrate for security reasons alone. Indeed there is already some cooperation on regional security issues, with the establishment of a regional 'Rapid Reaction Force'. Nevertheless regional security concerns over Iran's domineering role in the region were considered to be the major impetus behind the formation of the GCC itself (Aarts 1999). Therefore the current political turbulence in the Gulf – the sectarian power struggle in Iraq and Iran's stand-off with the USA – may bring the GCC countries to a greater awareness of the overall gains that can be obtained from much greater economic, and political, integration, of which the formation of successful MU is but one part, albeit a very important one. In other words, as the long run political and geostrategic pay-off from MU becomes more apparent, so the political commitment to pushing ahead with the MU project will increase.

Conclusion

Despite intending to emulate the EMU blueprint, viewing it as "a model to follow", it is clear that to date the GCC has made little tangible progress. Indeed with Oman's unilateral opt-out and Kuwait's recent move away from the collective dollar peg, the 2010 deadline looks increasingly unrealistic, regardless of the long term economic and political benefits of deep economic integration. Therefore the EMU model cannot be considered viable for the GCC at present.

EMU does however still provide some valuable lessons and guidelines. First and foremost there needs, above all else, to be a strong political desire and/or motive to enter into a MU; considerably more important than the economic merits *per se*. Secondly the creation of strong supranational institutions with adequate levels of autonomy and decision-making powers will also be essential, for anything but the loosest of MU arrangements. Finally the GCC should devise its own convergence criteria – targets are not good enough – and base these on the bloc's distinctive characteristics, not those of the industrialized euro zone.

It is evident that since the start of the current oil price boom GCC inflation rates have continued to diverge and rigid fiscal rules which ignore the hydrocarbon-dependent nature of these transitional economies are likely to be even less workable than they have been in the euro zone. Due to the high degree of resource dependence and boom-bust cyclicality of the GCC economies, their ability to meet fiscal deficit and debt criteria continues to depend on the prevailing price of crude oil. This raises serious doubts as to the viability and appropriateness of adopting convergence criteria which have simply been copied and pasted from EMU.

The success of EMU has in large part been attributed to the existence of effective supranational institutions which supported the setting up of the common market and single currency and acted as a "third-party" enforcer for implementing agreements. The GCC have yet to establish a strong institutional framework for MU which does not bode well for progress on the stalled customs union, establishing a meaningful common market and the creation of a single GCC central bank, let alone setting up a regional statistical agency.

Based on the experience of EMU, this paper has argued that there is a strong linkage between the presence of a political motive to establish MU and the political commitment to the project. Available evidence suggests that there is presently little political motivation behind the GCC's stated aim of economic integration. While in the past the GCC seems to have been motivated by the economic case and the relative success of the euro zone, the current oil price hike has undoubtedly reduced the imperative to move towards economic integration at present.

It may also have become apparent to the GCC's ruling elites that following the model of EMU – involving a coordination of macro-economic policies, building of supranational institutions, as well as limits on fiscal spending and public scrutiny of national budgets – will necessarily entail compromises over their sovereignty; something which it seems they currently consider too high a price to pay. They may now only reconsider the EMU model seriously if they are faced with another protracted economic downturn, as was the case in 2001.

References

Aarts, P., 1999. The Middle East: a region without regionalism or the end of exceptionalism? *Third World Quarterly, Journal of Emerging Areas,* 20(5), 911–925.

Al-Mansouri, A.K.L. and Dziobek, C., 2006. *Providing official statistics for the common market and monetary union in the Gulf Cooperation Council (GCC) countries – a case for 'Gulfstat'.* IMF Working Paper WP/06/38. Washington, DC: International Monetary Fund, February.

Al-Qudsi, S.S., 2006. *Unemployment evolution in the GCC economies: its nature and relationship to output gaps.* Labour Market Study No. 22, Center for Labour Market Research & Information, June.

Al-Saud, A.A., 2002. Address to the Gulf Cooperation Council. *Middle East Policy,* IX(1), March.

Arab News, 2004. Saud slams neighbors for undermining GCC solidarity. Available from:http://www.arabnews.com [accessed 6 December 2004].

Balassa, B., 1961. *The theory of economic integration.* Homewood, IL: R.D. Irwin Inc.

BP, 2007. *British Petroleum statistical review of world energy, 2007.* Available from: http://www.bp.com/productlanding.do?categoryId=91&contentId=7017990 [accessed 23 July 2007].

Cecchini, P., 1988. *The European challenge 1992: the benefits of a single market.* Aldershot: Wildwood House.

Darrat, A.F., and Al-Shamsi, F. 2005. On the path of integration in the Gulf region. *Applied Economics,* 37, 1055–1062.

De Grauwe, P., 1992. *The economics of monetary integration.* Oxford: Oxford University Press.

Dorrucci, E., Firpo, S., Fratzsher, M., and Mongelli, P., 2002. *European integration: what lessons for other regions? The case of Latin America.* ECB Working Paper No. 185.

Dyer, P. and Yousef, T., 2007. Will the current oil boom solve the employment crisis in the Middle East? *In: The Arab World Competitiveness Report 2007.* Geneva: World Economic Forum.

Eichengreen, B., and Wyplosz, C., 1998. Stability pact: more than a minor nuisance? *Economic Policy,* 26(April), 65–113.

Egert, B., Ritzberger-Gruenwald, D., and Silgoner, M.A., 2004. Inflation differentials in Europe: past experience and future prospects. *In*: *Monetary policy and the economy.* Austria: Austrian Central Bank. 1, 47–72.

Fasano, U. and Wang, Q., 2002. *Testing the relationship between government spending and revenue: evidence from GCC countries.* IMF Working Paper 201. Washington, DC: International Monetary Fund, November.

Fasano, U. and Staff Team, 2003. *Monetary union among member countries of the Gulf Cooperation Council.* Washington, DC: International Monetary Fund.

Feldstein, M., 1997. The political economy of the European Economic and Monetary Union: political sources of an economic liability. *The Journal of Economic Perspectives,* 11(4), 23–42.

Fielding, D. and Shields, K., 2005. The impact of monetary union on macroeconomic integration: evidence from West Africa. *Economica,* 72, 683–704.

Frankel, J.A. and Rose, A.K., 1997. Is EMU more justifiable ex post than ex ante? *European Economic Review,* 41, 753–760.

GCC Secretariat General, 1981. *Unified economic agreement.* Riyadh: GCC Secretariat General. Available from: http://www.gcc-sg.org [accessed 20 October 2006].

GCC Secretariat General, 2001. *The economic agreement.* Riyadh: GCC Secretariat General. Available from: http://www.gcc-sg.org [accessed 20 October 2006].

Gulf News, 2006. GCC Central Bank to be located in Abu Dhabi. 19 September. Available from: http://www.archive.gulfnews.com/articles/06/09/19/10068601.html [accessed 6 December 2006].

Gulf Times, 2007. GCC may set up currency board to manage union. 24 February. Available from: http://www.gulf-times.com [accessed 24 February 2007].

Institute of International Finance Inc., 2007. *Capital flows to emerging market economies.* Available from: http://www.iif.com/press/press+44.php [accessed 8 December 2007].

Jaeger, A., 2001. *Cyclical fiscal policy behavior in the EU countries.* IMF Country Report No. 01/201. Washington, DC: International Monetary Fund.

Khalaf, R., 2002. Saudi Arabia urged to speed up economic reform. *Financial Times,* 23 October.

Khaleej Times, 2007. UAE inflation surges 9.3%. 20 June. Available from: http://www.khaleejtimes.com/DisplayArticle.asp?xfile=data/theuae/2007/June/theuae_June545.xml&section=theuae [accessed 20 June 2007].

Krueger, R. and Kovarich, E., 2006. *Some principles for development of statistics for a Gulf Cooperation Council currency union.* IMF Working Paper 38. Washington, DC: International Monetary Fund, June.

Laabas, B. and Limam, I., 2002. *Are GCC countries ready for currency union?* Kuwait: Arab Planning Institute.

Leblond, P., 2004. Completing the Maastricht Contract: institutional handicraft and the transition to European Monetary Union. *Journal of Common Market Studies,* 42(3), 553–572.

Mattli, W., 1999. *The logic of regional integration: Europe and beyond.* New York: Cambridge University Press.

Mundell, R.A., 1997. Updating the agenda for monetary union. *In*: M.I. Blejer, J.A. Frenkel, L. Leiderman, and A. Razin, eds. *Optimum currency areas: new analytical and policy developments.* Washington, DC: IMF.

Rutledge, E., 2007. *A Gulf Cooperation Council Currency union: appropriateness and implications.* Unpublished thesis. University of Durham.

Sturm, M. and Siegfried, N., 2005. *Regional monetary integration in the member states of the Gulf Cooperation Council.* Occasional Paper Series, no. 31. Frankfurt: European Central Bank, June.

Willett, T.D., 2000. Some political economy aspects of EMU. *Journal of Policy Modeling,* 22(3), 379–389.

Wyplosz, C., 2006. Deep economic integration: is Europe a blueprint? *Asian Economic Policy Review,* 1, 259–279.