Monetary Union in the Gulf: Prospects for a Single Currency in the Arabian Peninsula

By Emilie J. Rutledge (Abingdon & New York: Routledge, 2008), 224 pp. Price HB £75.00. EAN 978–0415459426.

The idea of having a single currency for the Gulf Co-operation Council (GCC) has been debated for over a decade, a debate partly prompted by the introduction of the euro and the comparison drawn in the region between the GCC and the European Union as economic blocs. Ultimately it was politics, not economics, which was the major factor determining which EU members signed up for the euro, and the same will apply in the GCC if the single currency actually happens.

Although there will not be a single GCC currency by the original January 2010 deadline, the publication of Emilie Rutledge's study is timely as there has been increasing discussion of its costs and benefits. At a meeting in December 2008 the GCC heads of state agreed that although a single currency cannot be issued by January 2010 due to the lack of time, the deadline should be retained for monetary union.

The key issue is, of course, what is meant by monetary union, which usually refers to the adoption of a single exchange rate, having identical interest rates and using common instruments of monetary policy. The six GCC states satisfy none of these conditions. Although five of them peg their currencies to the US dollar, Kuwait decided in 2008 to adopt a trade-weighted basket instead, and shows no sign of abandoning this. The interest rates at which the central banks are prepared to lend to commercial banks—a key determinant of monetary policy—also vary: despite coordinated interest rate cuts, most recently by 50 basis points in February 2008, as the global financial crisis worsened, GCC central banks resorted to unilateral action, with the UAE being more conservative in cutting rates than Saudi Arabia, partly reflecting the higher (though falling) rate of inflation in the UAE.

The merit of Emilie Rutledge's study is that it provides a lasting framework to evaluate the on-going discussion of GCC monetary union and single currency issues. When analysing economic policy, it is often tempting to look only at the latest pronouncements and the most recent events rather than at the inherent benefits and costs and the longer term context in which decisions take place. That is why a focus on theory is appropriate in an academic study, and in this case Emilie Rutledge draws lessons from optimal currency theory, which has much relevance for the GCC in suggesting the key issues to address. The most important implication of optimal currency theory is that monetary unions are most likely to be successful if there is a high level of economic integration between the participating countries.

Emilie Rutledge examines the extent of intra-GCC non-oil trade as an indicator of economic integration and finds this is highest for Oman, given its close trading links with Dubai, and Bahrain given its connection across the causeway to Saudi Arabia. It is also interesting to note that between a fifth and a quarter of Saudi Arabia's non-oil exports are to its GCC partners, reinforcing the case for a single currency from the perspective of Riyadh.

The GCC is not merely a free trade area and customs union, but a common market where local citizens can move freely and there are no controls over capital movements. In practice, although GCC citizens travel around the region for business and as tourists, virtually none want to work or settle outside their countries of origin, largely because of strong family ties. The substantial expatriate workforce, accounting for over 60 percent of the total, is more mobile, but they are not free to move between GCC member states for employment without returning first to their home countries. Ironically, as Emilie Rutledge points out, the policy of replacing expatriates by local nationals could actually reduce labour mobility and limit the gains from a monetary union.

Throughout the study Emilie Rutledge is meticulous in searching out and using data, but in many areas, notably capital movements, the available data is severely limited. Evidence on the extent of intra-regional portfolio investment is presented, but much of this is from Bahrain and the UAE, with little data from the other GCC states. There is increasing cross border activity by GCC banks, and a 'GCC Net' electronic payments system has been introduced for debit and credit card transactions. Overall the evidence presented supports Emilie Rutledge's conclusion that as far as labour and capital markets are concerned, conditions are favourable for a successful monetary union, but the limited trade integration will restrict the benefits.

The examination of the policy pre-requisites for monetary union is exhaustive and includes consideration of institutional preparations, including that for a central bank for the GCC. Since the book was written this issue has been discussed at GCC ministerial meetings, and there appears to be broad support for a central bank, but no agreement about its location. The GCC Secretariat is located in Riyadh, but five of the six GCC states would like to host the new central bank and its associated statistical agency that Emilie Rutledge rightly sees as important.

As part of the study, which is based on a successful doctoral thesis submitted to Durham University, Emilie Rutledge conducted semi-structured interviews and focus groups to elicit the opinions of key GCC decision makers, including central bank officials. Although these were conducted in 2005, and the data analysis mostly covers the period from 1996 to 2006, the findings are unlikely to have changed if the study had been undertaken more recently. Indeed, the global recession and the subsequent capital losses suffered by the GCC sovereign wealth funds have made investment in the region appear more attractive than investment outside, and the short term collapse in oil prices highlights the need for the economic diversification that a monetary union can facilitate.

Overall Emilie Rutledge's study makes an important contribution towards an understanding of the significance of GCC monetary union. Although the US dollar has regained some of its pre-eminence amongst risk-adverse investors and central banks, the challenges facing regional groupings such as the GCC have become more complex given the changing international economic order and the rise of Asian trade. There is a strong case for a coordinated response, and the governments of GCC states seem to recognize that despite political differences they have much to gain from participating in a wider internal market and acting jointly on external issues. The GCC has been the most successful, indeed arguably the only successful, regional grouping in the Arab and wider Islamic world. A monetary union would be a crowning achievement, bringing significant benefits to the countries involved, and providing the world with a currency that central banks and other institutions might want to hold as a reserve that could be used to hedge oil pricing risks.

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