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Abstract

The paper analyses the issues surrounding the planned implementation of the Gulf Dinar among the six members of the Gulf Cooperation Council (GCC) – the United Arab Emirates, the State of Bahrain, the Kingdom of Saudi Arabia, the Sultanate of Oman, the State of Qatar and the state of Kuwait. The paper will begin with laying down the foundation of attempting to draw any similarities and differences in terms of each country's economic fundamentals. It will then assess the grand idea for a monetary union by looking at the pros and cons, intra-regional trade, labour and capital movement and the political will of all six GCC countries. Updated issues that may have hampered the introduction of the Gulf Dinar will then be analysed by looking at the economic convergence criteria and its implications. Comparison with the European Monetary Union will be made throughout the paper, where necessary. The paper ends will then come out with a number of suggestions that may improve the implementation of the Gulf Dinar. Lastly, the paper will discuss the political implications of the implementation of the Gulf Dinar as the sole currency for the Gulf countries.

Keywords: Gulf Dinar, GCC, Khaleej Dinar, Monetary Union, European Union

1. Introduction

The creation of a monetary union for the GCC member countries had actually been mooted as early as 1975 when four of the GCC members attempted to reach a monetary coordination towards realising a single monetary union. However, the attempt proved unsuccessful and later put to rest (Alreshan, 2010)[1]. The drive to have a single currency within the region was put back to life when the GCC's Unified Economic Agreement (UEA) was ratified in 1982[2]; a year after the GCC was formed. However, it was only in 2000 that the Supreme Council of the GCC mandated the Committee of Monetary Agencies and Central Bank Governors and the Financial and Economic Cooperation Committee to draw up a working plan and a timetable to establish a single currency. This resulted in the establishment of high level technical working group to study the requirements of a monetary union. Initial results were then presented at the GCC Supreme Council meeting in Muscat in December 2001. It is at the Muscat summit that the Heads of States agreed on the following (Siegfrid, 2005):

- By the end of 2002, all national currencies of GCC countries shall be pegged to the US dollar.
- By end of 2005, Financial and Economic Cooperation Committee and the Committee of Monetary Agencies and Central Bank Governors shall agree on economic convergence

[1] It was between 1975 and 1978 that the four member countries i.e. Bahrain, Kuwait, Qatar and the United Arab Emirates attempted to form a monetary union.
[2] Article 22 of the UEA states that "The member states shall seek to coordinate their financial, monetary, and banking policies and enhance cooperation between monetary agencies and central banks, including an endeavor to establish a common currency in order to further their desired economic integration".

criteria and other technical matters with the aim to introduce a single currency simultaneously.
- Between 2005 and 2010, the GCC members shall strive to fulfil the criteria.
- In January 2010, a single currency shall be introduced.

However, the goal towards monetary unification hit a snag when Oman announced in 2006 that it would not be able to meet the target date and proposed that other GCC members to move ahead with the monetary union; with Oman's intention to join at a later date. Later in May 2007, Kuwait decided to abandon their US dollar peg in their attempt to reduce inflationary pressure at the time. Kuwait's decision to abandon the US dollar and move to peg the Kuwait dinar to a basket of international currencies was seen as a blow to one of the declarations made at the Muscat summit; i.e. "all national currencies of GCC countries shall be pegged to the US dollar". In November 2007, the UAE central bank announced that the UAE would consider switching from a US dollar peg to a currency basket if the US dollar continues to weaken (Buiter, 2007). The UAE then pulled out of the project in May 2009 in protest to the proposed site of the new joint central bank in Saudi Arabia. On 16 March 2010, Reuters reported that Oman's central bank Executive President Hamood Sangour al-Zadjali as saying that Oman is not reconsidering joining the Gulf monetary union.

Obviously it has not been smooth sailing for the *Khaleeji*, and it came as no surprise that when 2010 came, the Muscat declarations seemed far from being a reality. In fact, Mohamed al-Mazrooei, GCC Assistant Secretary General for Economic Affairs told Reuters that "*I personally expect the single currency to be launched in 2015, if we step up the efforts and the work of various committees*".[3] With the pullout of Oman and UAE, it is now in the hands of the other four GCC members to push through with their agenda. The proponents of a GCC monetary union may be feeling a little bit too optimistic for the prospect of its own monetary union by looking at the success story of the European monetary union (EMU), but one has to remember that the European Union (EU) was founded more than 50 years ago before the Euro currency came into existence. (Buiter, 2007)

This paper analyses the issues surrounding the planned implementation of the Gulf dinar among the GCC members. Assessment on the plan for the Gulf dinar, its state of readiness, as well as issues surrounding its delay in introducing the dinar will be covered in this paper. Comparisons to the EMU experience will also be made especially in the area of economic convergence. Suggestions will also be included in the paper with respect to the currency peg of the Gulf dinar. Lastly, the political implications under fiat money system and under real commodity peg will be included in the paper as well.

2. Overview on the GCC member countries

This section reviews the main features of the six GCC countries' economies that may impact the planned monetary union. They are among others, discussions on the state of economy of the GCC as a unit *vis-a-vis* the global economy, economic openness of these economies, similarities and differences between the GCC economies, level of intra-trade activities between the GCC economies, oil and gas dependence and the level of financial markets sophistication between the six GCC countries.

2.1. GCC in the global economy

As of 2009, the GCC as a whole has a population of 41 million and an average GDP (Nominal) per capita of USD35,496 (CIA). In terms of the number of inhabitants, the GCC pales in comparison to the world's 6.8 billion population. However, in terms of GDP per

[3] Reuters, 2010

capita, the combined average of the GCC GDP per capita is more than 3 times the world's GDP per capita of USD10,500. Even the Euro zone's GDP per capita in 2009 is lower than the GCC at USD32,700. In terms of the combined GDP in the GCC, it has increased tremendously from USD11 billion in 1971 to USD821 billion in 2007 (Alreshan, 2010). Recent growth for the GCC has also been rather commendable amidst the bleak global economic landscape last year., the GCC recorded a decent economic growth of an average 1.6 percent compared to the global economic contraction of 1 percent and the Euro zone growth of -4 percent last year[4]. See Table 1 for selected key economic data for the Gulf States.

	2006 GDP[1] (USD billion)	2009 Population[2]	2009 GDP (Nominal) per capita (USD)[3]	2009 GDP (real) growth rate[2]
UAE	168	4,789,395	46,584	-4
Bahrain	178	728,709	24,355	2.9
Saudi Arabia	450	28,686,633	14,871	-0.6
Oman	36	3,418,085	18,718	2.6
Qatar	42	833,285	75,956	9.2
Kuwait	90	2,692,526	32,491	-0.7

Table 1: Selected key economic data for the GCC member countries
Sources: [1](Buiter, 2007)' [2](CIA)' [3](International Monetary Fund, 2010)

2.1.1. Oil and gas

Statistics show that as at the end of 2008, the Middle East has about 60 percent of the world's oil reserves; and GCC collectively accounts for about 40 percent of the world's proved oil reserves. So naturally the Middle East controls the lion share of the world's oil production at 31.9 percent and within the Middle East, GCC produces 22.6 percent of total global oil production as at end of 2008 (BP). Therefore, since oil and gas plays an extremely important role in the GCC[5], member countries have consciously taken steps to diversify their economies as they look at other sectors of the economy such as tourism, manufacturing and banking. Among the factors[6] that made policy makers in the GCC realised for the need to push for economic diversification are:

- The fact that oil resources will not last forever and the never-ending search for alternative energy will put pressure to carbon energy.
- Realisation that oil will not be able to continue to boost economic growth at the same pace it did in the 1970s and the start of 1980s within the GCC region.

2.1.2. Wealth

Without doubt, much of the Gulf's wealth is due to its exploits of rich natural resources in oil and gas. Since the GCC has relatively smaller population with the lion's share of the global oil and gas reserves, it makes the GCC has the highest energy reserves on a per capita basis. Where per capita oil reserves are more than five times higher than in Venezuela, over 30 times higher than in Russia, and over 150 times over than the United States (Siegfrid, 2005). As such, due to GCC's dependence on oil and gas, their combined wealth is highly correlated

[4] According to CIA Factbook 2009 statistics
[5] Oil and gas contributes more than one third of GDP in the GCC. See (Siegfrid, Regional Monetary Integration in the Member States of the Gulf Cooperation Council, 2005).
[6] See (Alreshan, GCC monetary union, 2010)

with oil price as well. Chart 3 shows the level of dependence of each GCC country on oil revenues in terms of percentage over total revenue.

	2003	2004	2005	2006	2007
Bahrain	73.0	72.6	75.7	77.1	80.1
Kuwait	88.7	91.2	94.4	93.6	93.1
Oman	70.1	71.9	70.1	64.8	62.1
Qatar	64.1	66.0	67.1	64.6	60.7
Saudi Arabia	78.8	84.1	89.4	89.7	87.5
UAE	73.7	77.4	69.4	81.9	77.1

Table 2: GCC oil revenue to total revenues (percentage)
Source: Gulf national central banks

2.1.3. Trade

As far as international trade is concerned, the GCC economy as a whole is a rather open economy with certain countries like UAE and Bahrain registering trade surpluses between 2003 and 2007. See Table 3 for degree of economic openness for each individual GCC country. This degree of openness is valued by the percentage of import and export values over the country's GDP.

	2003	2004	2005	2006	2007
Bahrain	128.5	133.0	145.9	150.7	136.2
Kuwait	66.1	69.4	75.1	70.5	76.6
Oman	85.5	89.4	89.5	91.3	101
Qatar	76.9	77.1	83.4	88.9	90.1
Saudi Arabia	62.9	69.3	76.1	78.8	84.3
UAE	134.0	152.0	145.2	149.7	164.3

Table 3: Degree of openness in GCC countries (percentage)
Source: Gulf national central banks

As we can see from Table 2, easily more than half of the revenues for each GCC members are from oil and gas; as such we can deduce that the GCC exports mainly oil and gas to register the trade surplus. In fact, over 65 percent of total GCC exports are oil and gas products. Meanwhile, the GCC imports a high proportion of consumer and capital goods as a result of the scorched climate condition and the low share of manufacturing. In terms of trading partners, Asia especially Japan, South Korea, Singapore and China are top export destination with more than half of GCC exports goes to Asia; followed by the EU and the US at 11 and 12 percent, respectively (Siegfrid, 2005).

2.2. Similarities and differences between GCC countries

The six GCC countries share the same Arabic language, religion, geographic location and topography, and to certain extent culture and history. The GCC also shares similar economic structure that is blessed with an abundance of oil and gas reserves, which translates into trading nations that depends heavily on oil and gas (even though at varying degrees between the 6 countries). As the GCC are rather heavily dependent on oil and gas as exports, they also share the same structural economic problems; hence creating the similar need for economic diversification. Human capital seemed to be a similar problem within the GCC where their private sector depends rather heavily on foreign expatriates, who are less costly than employing nationals. It is estimated that the number of foreign workers in the Gulf to be in the region of 13.9 million in 2007 (Alreshan, 2010). As the GCC pushes for more diversification in its economy from oil and gas, it is conceived that the level of sophistication of its financial market is rather low. It was only in recent times that countries like Bahrain and UAE (Dubai) put in commendable and serious efforts to be at the forefront of Islamic banking.

There are of course some differences between the economies of the GCC that may impact the monetary union. One of them is size and population, Saudi Arabia is by far the largest with population size of 28 million and accounting for more than half of total GCC GDP. The other five countries are considerably smaller in terms of population and output. Another difference is the level of oil and gas reserves between the GCC members. More importantly, the projected depletion of reserves varies between these countries. Bahrain and Oman top the list as both are projected to fully deplete their oil reserves the fastest by 2011 and 2022, respectively and gas reserves by 2012 and 2060, respectively. (Siegfrid, 2005). These differences brought about another differing factor between the GCC members that the economic diversification efforts are at varying degrees. As such, we can see a more advanced financial market in Bahrain and more intense tourism promotion by Oman.

2.2.1. Oil and gas endowment by country

Compared to the other GCC members, Saudi Arabia leads the charts in having the most oil reserves. In fact, from Chart 1 we can see that Saudi Arabia's oil reserves constitute more than half of the GCC oil reserves. If we look at oil reserves per capita, Oman and Bahrain have the lowest. But more importantly, at current production levels, oil will be depleted soonest in Oman and Bahrain, during the next two decades. Meanwhile Qatar tops the charts of having the most gas reserves at about 18 percent of world reserves with its projected reserves to last until the next 800 years, at current production level. Bahrain again faces severe depletion issues as its gas reserves will run out within an estimated less than ten years. Even though the GCC as a whole rely heavily on oil and gas, if we look individually, the amount of reserves and projected depletion of its oil and gas reserves differ between the GCC members. As such, GCC governments have started to diversify their economies into banking, tourism, and manufacturing – but at varying levels of intensity.

2.2.2. Trade patterns of GCC member countries

Since the GCC members produce largely the same competing products rather than complementary ones, they tend to look elsewhere than the GCC itself as export destinations. This scenario resulted in rather low intra trade activities between the six GCC members. It was suggested that since intra-trade is low between the GCC, it would then be good motivation for the GCC to push through the successful introduction of the *Khaleeji* as the monetary union would then be able to promote more intra-trade activities. See Table 4 for intra-trade ratios among GCC members.

	Bahrain	**Kuwait**	**Oman**	**Qatar**	**Saudi Arabia**	**UAE**	**Average**
2003	15.4	4.8	17.3	7.5	4.8	5.5	9.2
2004	16.6	4.6	16.3	8.4	4.9	4.4	9.2
2005	18.5	4.4	16.4	10.0	4.6	4.5	9.7
2006	18.6	4.6	15.2	10.0	4.8	4.7	9.7
2007	19.2	4.7	15.0	8.6	5.1	4.7	9.6

Table 4: Intra-trade ratios among GCC members
Source: Directions of trade statistics, IMF

As far as economic openness is concerned, the GCC as a whole is a rather open economy with average trade surplus of 20 percent of GDP over the last five years (Siegfrid, 2005). See Table 3 for degree of economic openness in individual GCC countries. As pointed out earlier, GCC exports mainly oil and gas and imports high degree of consumer and capital goods. The gulf states imports about one third from the Euro zone and over one third from Asia, while only 9 percent from the US.

2.2.3. Financial markets

The level of sophistication of the financial market within the GCC varies largely due to the diversification efforts by each member. As explained earlier, the different levels of intensity in diversifying each member's economy partly due to the level of oil and gas reserves and projected depletion of the oil and gas reserves. As such, it came as no surprise when Bahrain, which will use all its oil and gas reserves the earliest, is seen to serve as the regional banking hub. In fact Bahrain has been positioning itself as an Islamic banking centre – competing head on with Malaysia. Bahrain's banking assets exceed 800 percent of GDP, well surpassing GCC average bank asset over GDP of only 122 percent. Saudi Arabia, which has the largest oil reserves within the GCC, has only about 62 percent Bank asset over GDP.

The stock market also saw Bahrain being one of the leaders as total market capitalisation (stock market capitalisation to GDP) is 163 percent, only to be topped by Kuwait at 171 percent. Unlike the stock market, the bond market is still at its infancy stage. Bonds issued by entities within GCC were only recorded at less than 3 percent of GDP. (Siegfrid, 2005).

In the next section, we attempt to analyse the Gulf monetary union in terms of costs and benefits for the GCC member countries and the GMU as a whole.

3. Assessment of the Gulf Monetary Union

3.1. General costs and benefits of a gulf monetary union

Using a single currency in GGC countries will bring in many advantages beside reducing such unnecessary cost involved in using different currency. Mundell (1961) stated that adopting a single currency enables countries to eliminate transaction costs and uncertainties of exchange rate movements in the market and helps predict future exchange rates. Most of these costs are associated with exchange rate transaction of bid-ask spreads. A single currency will provide a significant result to small open economies to trade among each others and reduce barriers between them. Cost saving could result in more output and more Varity of products and gains customers satisfaction and needs.

According to Alkholifey (2010), the foreign exchange rate risk could be eliminated by adopting a single currency in majority countries, which is considered a major obstacle to trade between different markets. Additionally, the common currency will contribute effectively to the development and integration of financial markets, especially the bond market and the stock market. Furthermore, this pure integration would result in a positive effect at the level of monetary and fiscal policies that will infuse transparency and financial discipline at the regional level, which is a necessary condition for financial stability in the region.

Kenen (1996) argued further that trade in goods and services especially among small firms will be enhanced, this would lead to intensify competition among the firm operating in producing same products and increase allocative efficiency. Rose (2000) found out a large positive relationship in his research regarding the countries using common currency among them in export and import activities, which could help them reduce their exchange risk sometimes to zero, beside fixed exchange rate regime. In this system, transparent pricing would be favourable to many small firms to operate without no peruse of large firms competitors. When adopting a GGC common currency as stated by Frankel (1999), monetary policy makers would gain more credible and strong exchange rate commitment, furthermore, monetary union arrangements are less subject to attacks by speculative practices. Benbouziane, Benhabib & Benamar (2009) mentioned that as well, common currency has all advantages of being a major attribution to all money function in general such as being an acceptable medium of exchange, unit of account and store of value. Furthermore, eliminate a capital flows between the partner countries and discourage speculative attacks. There will be no more need to save some international reserves for transaction within the zone.

On the other hand the costs of adopting a single currency, are mainly relinquishing monetary autonomy. There will be less autonomy control by monetary and exchange policy over members countries. These costs are more likely to be disapprobatory to these dissimilar shocks to member GGC economies. In other word, costs tend to lower the flexibility of factor markets, as this implies a difficulty of adjustment to shocks. Benbouziane, Benhabib & Benamar (2009) argue that fiscal policy is fully effective under fixed exchange rate regime and not true policy implementing in GGC countries due to their isolation economy. There is possibility of increasing unemployment rate within the countries, when adopting such common currency. This is due to the assumption of low inflation and external surplus, which could stabilize the economic condition in one hand and cause a problem on the other hand for long- run. With the monetary union there would be no need for action by central bank or monetary policy maker to interfere in the policy or take unilaterally initiative to altering exchange rate in single currency or changing the interest rate.

3.2. Business cycle synchronization

The synchronization of member countries business cycles is probably one of the most evocative concerns in adopting single currency in GCC. According to AlKholifey (2010), countries with highly correlated business cycles tend to have a higher propensity to join in a monetary union for their response to shocks which tend to be symmetric too. Joining a monetary union could help a country which most likely to be affected by shocks, to soften it for instance. Since majority GCC countries are the main producers of Oil and gas in the region, which is highly exposed to the shocks. The similarity functions of GGC economies and nature of their geography which sum them into the same conclusion and results.

3.3. Intra-regional trade

With intra-trade agreement, GCC countries will have more advantage in diversifying their operation risk and generate high revenues by developing more industrial sectors and produce under cost management due to the use of same currency. The implementation of common currency would encourage the trade among the GCC countries to produce competitive products with high quality.

Operating cost in GCC countries which used single currency would be low compared to other countries which operate under pressure of high cost. Monetary union gains economies of scale when the border barriers are eliminated and whole region becomes one market. As result of more competition between suppliers whom compete among themselves resulting in a high benefits to consumers. In addition, there would be more flexibility toward price set by the suppliers in the market.

The main factors influencing implementation of common currency in GCC countries is the benefits that could be generated from transaction costs reduction due to one economy. Economies of GCC countries are similar in nature, and would be a common advantage to trade more effectively when adopting single currency. The citizens of GCC countries would enjoy more luxury and friendly atmosphere and would be able to strengthen their economies compared to outside countries.

3.4. Stable exchange rates

Majority of GCC countries have pegged their currency to US Dollar to eliminate exchange risk and have more flexibility in foreign market. GCC countries have to keep some reserve amount of US dollar for their transaction settlement in US Dollar. As result of the pegging, GCC currencies were demonstrated by a history of synchronization of exchange rate movement against US Dollar and stable cross exchange rate

Adopting a single currency could totally eliminate a risk involved in exchange rate of currency. It seems that a single currency could promote a better trade efficiency between the GCC member countries. Therefore, GCC countries will have over control of maintaining credibility of their fixed exchange rate arrangement by avoiding the devaluation option even in periods of very real depressed oil prices.

3.5. Labour and capital movement

One of GCC countries call for freedom to work in any GCC country without restriction or discrimination. This will provide an easy movement of capital and labour among the countries, beside same languages and cultural advantage which allowed a flexibility movement of labour easily as compared to the European monetary union for instance where there are many different spoken languages. On the other hand, AlKholifey & Alreshan (2010) argued that most of labours in GCC countries are foreign expatriates, who are claimed less salary and cost. Furthermore, he estimated that the number of foreign workers in the Gulf at about 13.9 million in 2007.

Recently, GCC government has spent much capital to educate their citizens to fit the needs of market labours; therefore, they could manage to reduce the foreign workers by replacing them with citizens. GCC countries can adopt one salary system approach whereby all governments should pay similar salaries to workers. This will allow them to have fair salary payment to the workers in the GCC countries. The movement of labour would be easy, when there is an increase of production in one particular country and call for more labour. The size of GCC countries is reflecting actually the demand of consumption of each citizen.

3.6. The political will

Overall experience of GCC politics, there were not much conflict among them. This shows a strong relationship and support to unite under single currency. When looking at European political aspects as stated by Wyplosz (2001) who declared that Europe’s lesson number 1 is that what matters is a political will to seek closer economic and financial integration, but not tied to any precisely defined plan and schedule.

GCC could learn more from European political and adopt different methodology to avoid political conflicts that may arise from different thoughts and beliefs, but since they have the same languages, culture and open economy among them. Therefore, this will reduce the barriers.

In the following section, we will discuss the convergence criteria set by the Gulf Monetary Union as well as their implications in contrast with the convergence procedure settled by the European Union.

4. The Gulf monetary union convergence criteria as compared to the European Monetary union

A monetary union in the classical literature as well as in the contemporary practice is a successful and beneficial process, in the sense that it solves many problems and encourages the social and economic well being not only within the member countries of the union, but also in these countries' economic partners, as well as the in the developing countries that may benefit from the improvement of the economic conditions within the leading countries in forms of financial aids for instance. Though, we should recognise that monetary unions involve some issues that may arise because of several reasons, one of which is the economic convergence and the way it was planned, that is why in the next section, we will highlight the criteria of convergence set by the GMU member countries and their implications especially in regards to the monetary and fiscal policies, the regional central banking with a unified central bank, the exchange rate regime and the foreign exchange reserves requirement as well as the issues related to the seigniorage revenue and how it should be allocated among the GMU member countries.

To enrich the analysis and make it more significant, we will try to make a constructive comparison with the EMU which was considered a successful experience until now, inspite of the recent debt crisis in Greece.

4.1. Assessment of the convergence criteria

In the context of the EU, the nominal convergence established by the Maastricht treaty is based upon four main criteria; the first is the inflation rate which should not exceed the lowest inflation rate among the first three members by more than 1.5%. The second criterion is regarding the interest rate i.e. the long-term nominal interest rates should not exceed the average interest rate of the first three member countries by more than 2%. The third criterion emphasises the exchange rate stability whereby the normal fluctuation margins expected by the exchange mechanism of the European Monetary System should be maintained for at least two years before the assessment. The fourth and last criterion is in regard to the public deficit and debt, whereby the deficit of each and every member country should not exceed 3% of the real GDP, and on the other hand the public debt should not exceed 60% of the GDP of each member country. However, an exception has been made regarding the last criterion i.e. countries with a deficit exceeding 3% of the GDP are allowed to join the EU if it is proven that this excess is just temporary and will not continue further.

The Maastricht treaty refers only to the nominal convergence, however in the case of Central and Western Europe countries wishing to join the EU, with different economic and political structures, it is necessary to consider the real convergence as well; the latter includes the degree of openness of the economy, the weight of the bilateral trade with the EU as a portion of the total external trade of the respective country, the economic and political structure, the GDP per capita, etc.

The strongest refutation however against the Maastricht convergence strategy is that it may make convergence of countries with weak currencies more difficult to achieve. In addition, the criteria are interrelated in some way. A country that fails to undertake a credible disinflationary strategy, because of its infamous record of inflation, is more likely to experience an increase in its real interest rate, as the decline in the observed inflation is not matched by a decline in market expectation of inflation. This in turn will increase the debt burden, which might force the authorities to increase taxes in order to meet the debt GDP criterion (De Grauwe, 1995).

As for the Gulf Monetary Union, it has adopted the same convergence criteria stated in the Maastricht treaty in for the EU, namely, interest rate, inflation rate, public debt as well as the public deficit, taking into account the same convergence benchmarks, in regards to the interest rate, public debt and public deficit, however, the GMU opted for 2% as inflation rate benchmark instead of 1.5%, furthermore, GMU has opted for the foreign exchange reserve as a way to ensure the monetary convergence and stability instead of the exchange rate itself used in the case of the EU.

In the next sections we will discuss every convergence criterion in the context of the Gulf Union as compared to the EU.

4.1.1. Inflation rate

In the context of monetary unions, it is important to take into account the inflation rates of the potential future members, in the sense that the increase in the general level of prices in a member country implies that the purchasing power in this country's currency will decline, which may subsequently cause price instability within the union. This measure was put in place in order to prevent the monetary and price instability.

The European Monetary Union was not made immediately after the establishment of the European Union in 1957. Since 1970, the establishment of the European Economic and monetary union was considered, but starting from 1972, there was a huge monetary instability, this is why the monetary union has been postponed.

The European monetary system in 1979 came out with ECU (European Currency Unit), which is a virtual money comprising a basket of values, in order to limit the exchange rates fluctuations among the member countries' currencies, prior to the monetary union.

The EMS with its ECU solution performed well, but it did not solve the issue of free circulation of capital within the European zone, which is why in 1989, Delores report recommended the economic and monetary union to be made in three phases, whereby the first phase strengthens the monetary cooperation. The second phase emphasizes the currencies' convergence and puts in place respective institutions and regulations, while in the third and last phase of course there should be the emergence and appearance of the Euro.

For the inflation rate requirement as stated above and which should not exceed the lowest inflation rate among the first three members by more than 1.5%, it is set as part of the second phase. In the early years of the Euro adoption, the member countries' inflation rates were highly volatile, in the case of Portugal for instance, the inflation rate was between 1.89% and 29.3% from 1980 to 1998. In 1999 when the country adopted the Euro as the sole currency, the inflation rate was about 2.1% which matches the EU requirement and from then on, it started to be less volatile. In the case of Greece the inflation rate was very high amounting to 24.7% in 1980, but the country could control it to reach 3.6% in 2001 when the country adopted the Euro, and since then it was maintained approximately at the same level.

As for the countries that have not adopted the Euro yet, Czech Republic, Estonia, Lithuania and Sweden fulfil perfectly the criterion of inflation rate, but on the other hand, Latvia, Hungary and Poland do not fulfil the price stability requirement.

In contrast with the EU experience, the gulf union potential member countries have registered stability in terms of price levels, and this is mainly due to their flexible trading system as well as the relative strength of the US Dollar, since all the GCC countries' currencies are pegged to US dollar except Kuwait.

If the inflation rate requirement is that it should not exceed the weighted average inflation rate among the GCC countries by more than 2%, then only Qatar and UAE have not conformed to this condition, which is in fact due to the high spending by these two countries.

Compared to the EU member countries before joining the union, the GCC member countries' inflation rates were less volatile, even though Qatar and UAE do not satisfy this requirement, this will be an incentive for them to control their inflation rates to see them more stable after adopting the *Khaleej Dinar*.

4.1.2. Interest rate

Interest rates are, arguably, one of the most important macroeconomic variables. They provide a key transmission channel for the propagation of shocks throughout the economy, and play a fundamental role in asset pricing (Edwards, 1998).

In regards to the interest rate convergence, both the EU as well as the GCC countries, have used the same benchmark i.e. not more than 2% of the average interest rate in the member countries. However, the EU convergence is based on long term interest rate while the GCC convergence is based on the short term interest rate.

If the sixteen countries using the Euro now could adjust their interest rates in such a way that it will conform to the EU requirements, some of the new countries that have joined the European Union such as Poland or Hungary still did not reach the suitable level of interest rate above mentioned, while all the others fulfil perfectly this criterion.

Due to the dependence of the GCC countries' currencies on the US dollar, notably by pegging the former to the latter, the GCC countries' interest rates have registered a high positive correlation with the US interest rates.

Currently, all the GCC countries fulfil the interest rate convergence requirement, however the decision made lastly by the Kuwaiti government to peg its currency to a basket of anonymous currencies may break down this high correlation.

The difference at this level lies in the fact that the EU convergence is based on the long term interest rate, which involves long term risk premiums in the area, while the GCC union is using the short run interest rate, which makes the EU convergence more significant as compared to the GMU.

4.1.3. Foreign exchange reserve

To ensure the monetary stability, the EU and the GCC have used different criterion, the former opted for a requirement of at least two years spent within the EU, while the latter has chosen the foreign exchange reserve, in such a way that each country's monetary authority should hold a sufficient amount of foreign reserves of no less than four months worth of imports. However, after the European monetary union has been achieved, the ECB starts managing the foreign currency reserves of the member countries as part of the price stability strategy decided by the union.

It is noteworthy that for this criterion to be met by both EU member countries as well as GCC it is just a matter of time. For instance Romania or Bulgaria that have joined the EU in 2007, were already satisfying this criterion by 2009, the same applies to some extent in the case of the GCC countries, where some of them are still in the process of generating the four months worth of imports, while some others have already satisfied this criterion.

It is worth mentioning that the decision at this level on which measure to implement is directly related to the exchange rate regime chosen by either union on the one hand. Since the GCC have opted for the US dollar peg, then they need to consolidate their pegging and face any attempt to speculate on the coming *Khaleej Dinar*. In other words, the GMU exchange regime is depending on the US dollar as well, meaning that an alignment of the member countries with the GMU exchange rate regime requirement may not be secure and wise enough because there are involvements of external threats as well i.e. US dollar fluctuations and speculation for instance.

However, the flexibility aspect of the exchange rates adopted by the EU and the alignment strategy implemented make the foreign exchange reserves less relevant, because the member countries are given a predetermined period of time to bring their exchange rates to a suitable level vis-à-vis the EU requirements.

4.1.4. Annual government deficit and debt

The public deficit and debt convergence criterion which was required similarly by the EU as well as the GCC union is to ensure overall stability and development as well as to prevent debt crises, in the sense that the public deficit in most cases is covered by public debt, meaning that a country with continuing deficits will tend to borrow more, causing many negative consequences such as the intergenerational transfer of debt, the increase of borrowing cost, the opportunity cost incurred by missing the chance to develop the respective country's own economy.

In the case of economic and monetary unions, EU for instance, the unsustainable debt position maybe fatal for the whole union, in the sense that the continuing increase in debt of a given country will push the other member countries to implement deflationary policies, since the needy country will rely on the union financial markets to solve its debt problem, causing the increase of interest rate in the other member countries. Furthermore, if a country which is issuing too much debt defaults, the other member countries will be forced to bailout by virtue of not been affected through a domino effect for example.

For the European countries to join the EU and be part of the Euro users and for the GCC countries to join the GCC union and be part of the *Khaleej* Dinar users, their public debt and deficit should not exceed respectively 60% and 3% of the annual GDP.

In order to reduce their net indebtedness, most of the European countries, notably Germany, Austria, etc. Have taken draconian and serious measures, however some other countries have resorted to creative accounting operations with all its negative effects on the transparency of public accounts. Such operations are mostly based upon sale of assets, exclusion from public sector consolidated accounts, subsidies recorded below the line, as credits or capital subscriptions and differences between accrual and cash accounts. Koen & Noord (2005) estimated that, thanks to such operations, over the years 1997-2003 Greece, Portugal and Italy were able to reduce net indebtedness respectively by 18,7, 5,3, and 4,7 of GDP. It is worth mentioning that currently, Italy and Greece have the highest debt to GDP ratio within the EU amounting to 115 and 108 respectively.

The same reasoning above mentioned for the public debt implies in the case of public deficit as both components are related, where some countries have converged properly, while some other have relied on creative accounting to adopt the Euro, which explains actually the excess deficit in the case of Italy and Greece. As for the newly adhered countries, Czech Republic, Hungary and Poland do not fulfil this criterion yet, the question at this level is whether the convergence will be done in a total compliance with the general European and ethical rules or a mere creative accounting will be utilized? This will be probably answered by the future events.

For the GCC countries, they have done considerable efforts which have resulted in a full compliance regarding the public debt and deficit criterion, however they should maintain this level of indebtedness and deficit notably by limiting external borrowing otherwise the whole union will be affected.

Having said so, it is worth noting that GCC incomes are strongly influenced by exogenous volatile oil prices; hence the deficit to GDP indicator might not provide a satisfactory gauge. GDPs in oil producing countries fluctuate widely from year to year, which makes a country's deficit closer to sustainability in favourable oil price conditions even if there is no change of policy stance (Chalk, 2001).

4.2. Convergence implications

Beside the convergence criteria above mentioned and that is compulsory to fulfil in order to join the EU or GCC union, there are some other features that need to be fulfilled but with a lower degree of importance, so to speak. These features will be discussed in the next sections.

4.2.1. Monetary and fiscal policies

By definition, different countries will have different monetary and fiscal policies depending on their circumstances, monetary and fiscal preferences and so on, however, in the context of economic and monetary unions, the harmonisation and/or standardization is a must for the countries willing to join an economic and monetary union especially regarding monetary and fiscal policies.

The European Union countries were no exception of the general rule above mentioned, however, after the establishment of the European Central Bank, the monetary policy of the EU was based on a quantified definition of price stability and risk analysis as regards to the new monetary policy strategy adopted by the ECB as well as responsibility, independence, transparency and communication.

The price stability consists practically in price index progression along a one year period that should be maintained below 2% in the medium term. To achieve this stability level, the ECB has applied economic and monetary risk analysis by following the economic evolutions as well as monetary tendencies within the EU member countries.

The ECB which is responsible for the price stability within the EU is recognized as an independent entity which is not subject to any eventual pressure or influence by any possible parties. The independence aspect of the ECB is directly related to the ECB transparency and communication which will help the public at large evaluate the ECB performance and results as well as the decisions made by the latter.

Regarding the fiscal policy in the EU, it is mainly concerned with indirect taxes i.e. VAT, special taxes on fuel, drinks and tobacco, etc. Since these have a direct and immediate effect on the internal market. On the other hand, the intervention on the direct taxes is much more limited as compared to the indirect taxes.

One of the objectives of the internal market is to ensure the free circulation of goods and services as well as capital within the EU. Because of the independence and neutral fiscal policy applied in the EU, The member countries have heterogeneous fiscal policies, depending on their history and their national traditions. On the other hand, the decisions are made based on the unanimity which actually limits the possibilities of harmonisation between the member countries; however. The latter may deform the nature of this circulation and exchanges, but to prevent this risk, the member countries have decided to harmonize their indirect taxes, since the fiscal competition among the member countries contributes to the progressive convergence of the EU in terms of fiscal policies.

Harmonization of indirect taxes actually in this context does not mean standardization, since the rates are not similar in all the member countries. Every country is implementing a standard VAT of at least 15% and a reduced rate of at least 5% applicable to some activities or products with a social or cultural aspect. The standard rates are between 15% in Luxembourg and 25% in Sweden. As in France for instance, the standard VAT rate is about 19.6% and the reduced rate is 5.5%.

As the EU member countries are related among them, no one of them can modify the tax rates unilaterally, for instance, a country wishing to reduce its VAT tax rate should first ask for the accord of his economic partners. If for example Spain wants to reduce the VAT tax on restaurant services, then it should take permission from all the EU member countries.

For the direct taxes as mentioned earlier, the harmonization still very limited. The main European rules regarding the direct taxes has been put in place in order to avoid the double taxation on companies especially for the mother companies having subsidiaries in other member countries. The direct taxation is meant also for the harmonization of savings' fiscal policy, since the European citizens are benefiting from the free circulation and are free to deposit their money in any of the member countries since the launching of the EU. But overall, the fiscal policy harmonization in terms of the direct taxation is applied in order to establish a European cooperation and fight against fiscal frauds.

However, in the case of GCC, it is worth mentioning that the *Khaleej* countries can be seen as less effective as compared to countries with floating exchange rates mechanisms, and this is not due mainly to the exchange rate *per se* but it may be due to the economic features of these countries, for instance, crude oil and natural gas constitutes the main source of income and foreign exchange reserves which is one of the main convergence criteria discussed above, furthermore, as compared to some developed countries such as US, GCC member countries do not possess a developed and established secondary capital market which constitutes a weakness of the union.

As it was in the case of EU, the main objective of the monetary policy of the GCC union is to achieve price stability within and between the member countries, even though the current monetary instruments are not as efficient as they normally should be. And this price stability of course should be controlled by the GCB.

When looking to the fiscal policies of the GCC countries, it is noteworthy that they unanimously have a high degree of expenditures, which may in some years reach 71% of the total spending, on the other hand, the high dependence of the GCC countries on the oil and gas revenues makes their economic and political as well as fiscal situation subject to the oil and gas price fluctuation.

Since the monetary and fiscal policies are highly related and given that the GCB will be responsible in controlling the price stability within the union, then as matter of fact, collaboration in terms of fiscal policies would help the GCB achieve successfully its objectives, otherwise, monetary and fiscal problems may emerge with the adoption of the *Khaleej Dinar*.

In this context, AlKholifey and Alreshan (2010) stated that there are a number of fiscal issues that need to be addressed by GCC countries:

- With the efforts being made by some GCC countries to ameliorate their overall tax systems, issues of tax coordination might arise.
- To maintain harmony over various expenditure policies especially the rising current spending (e.g. direct and indirect subsidies) and avoid unbalanced economic growth among GCC economies, ex ante coordination is considered necessary.
- To bring stability to GCC revenues and suppress GDP volatility, an issue of creating a multilateral oil stabilization fund could be viable.

4.2.2. The Central Banking System (CBS)

When opting for monetary and economic union, the issue is not only how to settle the union central bank that will replace the countries' central banks, but also to look into the structure of central banking to be implemented which includes the union central bank as well as the national central banks.

In the case of the EU, the European System of Central Banks (ESCB) comprises the European Central Bank (ECB) as well as 27 National Central Banks (NCB) representing the 27 member countries of the EU. The ECB directory members are nominated through unanimous agreement, by the member countries or governments' presidents with recommendation of the European Union Council.

One of the main functions of the ESCB is to elaborate the monetary policy in the Euro zone. Subsequently, the ECB executes the decisions made by the ESCB while the NCB are meant to make these decisions applicable nationally. Thus, as stated above, the main objective of the ESCB is to maintain price stability in the Euro zone as well as ensure a stable growth of the EU. Furthermore, the ESCB holds and manages the official resources of the member countries that have adopted the Euro especially the foreign exchange reserves.

The monetary policy of the ECB is based upon three main rates, from the lowest to the highest rate, namely, deposit rates, refinancing rate which is the most important one, and the last is the marginal loans rate.

A subgroup of the ESCB has been created and named Euro System; it includes the central banks of the Euro zone and it has been established because most of the European countries that had reputation of being Euro users, actually have not adopted it yet.

The GSCB will normally follow the model established by the EU i.e. a central banking system including the Gulf Central Bank (GCB) as well as the National Central Banks (NCB), even though there is quite a number of differences between the two cases, the main one being the political orientations of the GCC member countries as compared to the EU member countries, where the former are mainly sovereign countries, that may want to make a pressure for the monetary policy to be decentralized, and which may actually constitute a threat to the stability within the EU.

For that matter, GCC member countries are required to settle this issue and determine clearly the structure of the GSCB, and the bodies it will include as well as the functions of each of them and all the details as regards to the nomination of the GSCB members.

Another important issue is regarding the independence of the GSCB which we have highlighted earlier and which is actually common between the EU and the GMU, since for the central bank or the system of central banks to achieve successfully its pre-determined objectives, there should be a total independence from any possible influence. At this level, some authors consider that the political influence is the highest threat to the CBS independence, meaning that a total separation between politics and the monetary policies will give a higher performance of the GSCBs.

4.2.3. Pooling Foreign Exchange Reserves

In addition to the foreign exchange reserve requirement above mentioned and which is a formal procedure prior to the GMU adhesion, the GCB requires the contribution in terms of foreign exchange reserves whereby every member country should contribute based on its weight in the union, and this is due mainly to the fact that the fixed exchange rate regimes forces the central banks to hold enough reserves of foreign currencies allowing them to intervene in the market to maintain the considerable and suitable level of exchange rates.

As we have mentioned earlier when we have discussed about the CBS, the European Union basically has followed the same reasoning and has allowed the European Central Bank to manage the foreign currencies reserves of the member countries in order to maintain the stability of the overall economy.

4.2.4. Seigniorage revenue distribution

Seigniorage is usually defined by reference to a supposed earlier stage in which full-bodied coins were minted by the State. Each coin would contain an amount of precious metal equal in value as a commodity to the coin's exchange value as well as to the value stamped on the coin. The State's mint would accept gold for coining, assessing a fee, called a seigniorage charge. So long as that fee exceeded the mint's costs, the State would receive net revenue from its minting operation i.e. seigniorage revenue (Wray, 2002).

In the case of the European Union, the seigniorage revenue generated from the Euro issuance is distributed to the national central banks of the member countries that have already adopted the Euro based instantaneously on their GDP as well as their respective population proportions, which means that it is maybe subject to review in case the member countries agree to do so. As for the countries that have newly joined the Euro zone, it is expected that they will get a higher benefit as compared with their current seigniorage revenue, Hansen and King (2004) follow the same reasoning and state that currency demand in the new member countries is expected to increase relative to the present group of euro countries. This basically means that the demand will increase also outside the EU with its new members given the economic and trading partnership of the EU member countries with other non member countries.

As for the GCC countries, they are expecting to base their seigniorage revenue distribution on the monetary base growth, which is subject to debate since member countries may find it easy to increase their monetary base in order to get a larger share of the seigniorage revenue.

As far as the seigniorage revenue distribution for both the unions is concerned, the EU method has more significance and seems to be more reasonable, on the one hand because it is based on the real GDP and the populations proportions that cannot be falsified or manipulated by member countries, and on the other hand because this basis is subject to change anytime the member countries find it adequate to do so.

4.2.5. The exchange rate regime

The choice of the exchange rate regime is highly important especially in the case of economic and unions. It considers the economic policy of the countries as well as their macro-economic modes of adjustment. It considers also the economic partners of these respective countries that are sensitive as regards to the consequences of the potential exchange regime on their relative competitiveness, thus, the exchange rate regimes determine the conditions of the international integration of the economies.

The member countries of the EU have chosen a flexible exchange rate regime, and they seem to be convinced with the adequacy of their choice, Lorenzo Bini Smaghi[7] stated in the 2007 annual Meeting that this was the obvious decision to take and he added that it would have made no sense at all to create the euro and then subject its monetary policy to external rather than internal requirements.

For the European countries that have joined the EU lately, although their current exchange rate regimes are totally different, this does not mean that they will certainly have misalignment problems, by reference to the Portugal, Spain or Greece previous successful experiences.

Although the GCC countries did not officially opt for either exchange rate regime, the fact that all member countries except Kuwait have pegged their national currencies to US dollar, is a sign that among other regimes, the dollar peg may be the preferable to the GCC member countries, that have made their decision based on the assumption that the US dollar will keep strengthening. This potential decision is also proven by the fact that the member countries have put in place some measures that are compatible with the US dollar peg, such as their fiscal policies or the accumulation of the foreign reserves for instance.

This choice of the GCC member countries has taken into consideration not only the economic aspect of the regime but also the political dimensions that is basically why the GCC countries seem to be attached to this regime, where they have stated in several occasions that they are not willing to change their exchange rate regime unless the GCC union decides on another regime.

As stated earlier, since the GMU are more likely to opt for US dollar peg, then it is relevant for them to understand the implications of their decision as well as implement properly the foreign exchange reserve requirement along with any other adequate measures for them to avoid shocks that may hit the US dollar especially in the current circumstances.

Furthermore, the GCC member countries should make sure that the convergence procedure is done in the best manner, whereby there should be no creative accounting to skip the official adhesion procedure. Greece and Italy lesson for instance should be learnt in order to not commit the same fatal mistakes.

[7] Member of the ECB Executive Board

In the following sections we will expose some of the suggestions that may be helpful for the GMU to enhance its formation in terms of exchange rate regime as well as in terms of risk management.

5. Suggestions for improvement of the Gulf Monetary Union

5.1 Suggestions in terms of the exchange rate regime

5.1.1 Currency Basket Peg

A basket peg could serve as a cautious strategy towards a more flexible exchange rate policy. With a basket peg, the main anchor properties of an exchange rate peg could be retained, while at the same time gaining some adaptability to the adverse effects of swings among the value of the major reserve currencies. The volatility of the nominal effective exchange rate would be reduced, benefiting external trade and balance sheet stability. For example, a peg to the SDR would result in lower volatility of oil export receipts relative to the dollar peg.

Implementing a basket peg may be a useful way to introduce more flexibility of the exchange rate in a gradual manner, which would allow private market participants to learn to manage and live with foreign exchange risk. Compared to fixing to a single currency, pegging to a basket of currencies has the disadvantage that traders will have to bear the exchange rate risk. And in relatively underdeveloped financial markets hedging exchange rate risk would be difficult and costly. On the other hand, pegging to a single major currency allows market participants to take advantage of instruments available for that major currency. What probably matters most is the extent of the higher exchange rate risk versus the reduced cost from lower exchange rate volatility.

One disadvantage of basket pegs is that they may reduce the microeconomic and informational benefits of maintaining constant at least one bilateral exchange rate relevant for price comparisons and economic transactions. Also, basket pegs tend to be less transparent and more difficult to explain to the public. The weights attached to the basket will have to be managed and lack of transparency could encourage speculative behavior, as the example of Kuwait shows.

One simple approach would be to peg to a transparent basket consisting only of the US dollar and the euro. It would be simple to interpret, would reduce monetary dependence of the GCC on the US Federal Reserve, cover most transactions in goods, services, and financial instruments (now in the US dollar and the euro area), and allow for the use of both dollar and euro hedging instruments to efficiently manage financial risks given the considerable depth in euro financial instruments (Khan, 2009).

5.1.2. Pegging to the export price of oil

Pegging the domestic currency to the export price of the main export product (PEP) has sometimes been suggested for small open economies that are relatively specialized in the production and export of a particular mineral or agricultural commodity. The argument for PEP is that it simultaneously delivers automatic accommodation to terms-of-trade shocks, as floating exchange rates are supposed to do, while retaining the credibility-enhancing advantages of a nominal anchor, as dollar pegs are supposed to do (Frankel and Saiki, 2002). A peg to the price of oil would allow the real exchange rate to move in line with the real price of the main export commodity. Essentially, it would decouple oil exporters' monetary policies from those of oil importers.

But there are several important qualifications and drawbacks attached to this type of exchange rate policy. First, the GCC countries taken together account for a sizeable part of total world output and exports. Therefore, the small economy assumption is not applicable in the case of the GCC, as the price of oil cannot be regarded as exogenous. Indeed oil can be seen as a major international currency in itself, and pegging their national (fiat) currencies to their own (commodity) currency would not anchor the GCC countries' currencies to something truly exogenous.

Second, it is questionable whether an automatic adjustment to terms-of-trade shocks would be effective under a PEP system. For example, an adverse terms-of-trade shock (a decline in oil prices) would, under the PEP, result in a real depreciation. However, with oil production in most GCC countries constrained by capacity and extraction limits, as well as by the OPEC quota system, all adjustments would have to come through expanding non-oil exports or cutting imports. However, in the GCC, non-oil exports depend on hydrocarbon production for inputs, and are therefore not independent from the level of oil and gas production.

Third, pegging to the price of oil would make import prices highly variable, as well as create significant volatility for other sectors of the economy. For example, a consequence of high oil prices would be a real appreciation, which would raise the cost of other exports and dampen the diversification effort. In particular, the prices of non-pegged tradable goods would be destabilized in terms of domestic wages and nontraded goods, which could lead to adverse Dutch disease effects when oil prices rose. In the event of a decline in oil prices, it is unclear whether the oil peg would permit sufficient depreciation of the national currency to accommodate the adverse change in the terms of trade and stabilize export earnings. Further, it can be argued that a gradual adjustment in the real exchange rate may be preferable until the terms-of-trade shift appears permanent. In any event, with daily fixing of the exchange rate, PEP requires transparency and credibility that may take time to establish.

5.1.3. Commodity basket peg

Basically the alternatives above mentioned are more suitable and desirable as exchange rate regime for the expected launch of Gulf Dinar as compared to the Dollar peg regime. But in contrast with an oil backed currency, the latter is much more suitable for many considerations especially the Oil reserves that the GCC countries possess, however, a currency backed by only one commodity can be more exposed to speculative attacks as compared to currency backed by a dozen or so of commodities. That is why we strongly recommend the GCC member countries to issue their common currency in a commodity basket backed aspect.

The implementation of GCC's commodity basket backed currency should be backed by a standardized basket of the most important commodities mainly Oil and other commodities (e.g., gold, wheat, copper, etc). It would, therefore, be conceptually similar to a fully backed gold standard, but in the case of the commodity basket peg, the backing would consist not of one single commodity but of a number of main international commodities, including gold. Since it is fully backed by a physical inventory of commodities, the commodity basket peg would be a secure, robust and credible payment and provide a stable international mechanism for contractual and payment purposes worldwide.

This kind of currency is designed as an inflation-resistant currency by its very composition. Inflation is always defined as "the changes in value of a basket of goods and services." By selecting the appropriate ingredients to be placed in the basket, the commodity basket peg can automatically protect and be protected against inflation. On the other hand, it provides a robust international standard of value.

The commodity basket peg automatically tends to counteract the boom and bust fluctuations of the business cycle, thereby improving the overall stability and predictability of the world's economic system. When the business cycle is weakening, corporations customarily have an excess of inventory and a need for credit. These corporations would immediately spend the commodity basket currencies, say, to pay their suppliers, so as to avoid the demurrage charges[8]. Suppliers, in turn, would have a similar incentive to pass on the demurrage-charged currency as a medium of payment. The spread of this currency (with its built-in incentive to trade) would automatically activate the economy at this point in the cycle.

The demurrage feature of the commodity backed currency would provide a systematic financial motivation to realign financial interests with longer-term interests. This is in direct contrast with what happens today with conventional national currencies. The discounted cash flow of conventional national currencies with interest rates systematically emphasizes the immediate future at the expense of the long-term. The same discounted cash flow with a demurrage charged currency produces the exact opposite effect. The use of the commodity basket peg for planning and contractual purposes will therefore reduce the conflict that currently prevails between the stockholder's financial priorities and the long-term priorities of humanity as a whole.

By looking to the "real" aspect of the commodity backed currency –backed by real commodities- and its demurrage fees, as compared to the fiat money dominating nowadays, one can clearly perceive the long list of benefits that *Khaleej* Dinar backed by a basket of commodities can provide for the whole world.

5.2. Suggestions regarding risk preventing and rescue plans

5.2.1. GCC's Crisis Fund

The Geek debt crisis has bared a shortcoming of the EU's monetary union. While sound finances are needed to underpin the euro's stability, the rules limiting government deficits have not been enough to keep some countries from running up large amounts of debt. Nor is there an oversight procedure to ensure sound policies are implemented. In the Greek debt crisis, Germany and other euro nations have urged Greece not to go to the IMF for a bailout loan. Such a possibility is widely seen as embarrassing in euro zone capitals and damaging to the euro area's credibility. The crisis exposed severe defects of the euro zone, including lack of economic governance in the single currency club and no collective solution to prevent a possible debt default in a member like Greece from threatening overall stability.

The GCC should plan to create a Gulf Monetary Fund (GMF) to better coordinate the economies of the member countries that use the *khaleej* Dinar and prevent financial debacles such as the Greek debt crisis from undermining the credibility of Europe's single currency. The idea is that Greece's case must not happen with GCC and they must reinforce economic policy coordination.

Gulf Monetary Fund have to establish details of how much money a future GMF could command or what its shareholders structure would look like based on their financial pledges to the fund.

However, the questions of course must be asked: who pays in, how does one pay in, how independent is it from the (Gulf) Commission? And so on.

Urging the idea for some time, Gulf Monetary Fund could bail out troubled governments, and then use the threat of cutting off rich member support payments to force them to bring spending practices into line. And the GMF could set up the possibility of an orderly default for an indebted state in which the GMF could offer Islamic bonds to holders of defaulted debt, limiting the crippling ripple effects of a default.

5.2.2. GCB's Unit for monitoring and risk preventing

GCC member countries need to co-ordinate their efforts to devise a new common banking policy to enable national banks to face any fresh crisis in the global financial system or crisis

[8] whose holding costs accumulate over time

of any member. Banks in the GCC should learn lessons from the latest global economic turmoil and stick to known investment standards and shun derivatives and other high risk instruments.

The GCC central banks should set up a unit to monitor and prevent any risk of default, crisis, etc. They should work on the monitoring and assessment of GCC's members and guard themselves against future crises. They have to abide by known investment criteria and avoid harmful speculation in the local and external markets, and in investing in high-risk derivatives.

The GCC central banks should have somewhat sought to co-ordinate their efforts before the crisis, they should have expand this co-ordination and double their efforts to support protection in crisis. The GCC monetary authorities are urged to devise new banking policies that will open a wider horizon for financial and banking co-operation in the region.

GCC central bank should control the impact of the crises and default problems. This mechanism would involve stronger governance of regional banks to ensure they are better protected against bad debt and other crises in the future. It should have joint plan to force GCC banks to set aside sufficient provisions against non-performing loans to counter new default problems.

In the next sections we will discuss the political Implications under fiat money system and real commodity peg for the Gulf Monetary Union to see the opportunities and threats in the context of an unstable international environment.

6. Political implications

As it was mentioned in the previous pages that Gulf Cooperation Council has agreed to issue a new currency namely Gulf Dinar by the end of 2010 after a long journey that has started in 1983 when they signed in the first time a free-trade area. There is no double surrounding that Gulf Dinar will bring a lot of benefits to the GCC countries and its people in terms of cost reduction and cross border trades and it will eliminate risk exchange between local currencies. However the question is; whether it has to be flexible or pegged to Dollar, a basket of currencies or oil market price. While some experts have suggested that the new currency should be backed by oil since gulf countries control 45% of the world's known oil reserves because this is high enough to gain people's confidence to accept Gulf currency as global currency as compared to U.S dollar.

In this part, it is rational to focus in a more details on political implication of issuing Gulf Dinar as Fiat money or oil backed. So, In the absence of Soviet, the United States of America becomes the only super power in the world and its eye has been focusing on gulf region to put its hand on oil reserve of the gulf countries, therefore since the Gulf war two in 1991 to rescue Kuwait, U.S has found a reason to stay in the Gulf region to secure itself the share of oil. in the current political environment issuing a new common currency in Fiat form for GCC union is much more applicable because the United States of America will move to protect the position of the Dollar as a global currency and as a medium of exchange in international trade transactions and it has a big influence on the GCC decision making to prevent the idea of Gulf Dinar backed by oil. So, in that sense, assuming that the gulf dinar will be pegged either to Dollar or basket of currencies including dollar as it was proposed by the GCC countries and then, it will give a dollar the sustainability to remain a global currency, moreover it will continue pricing oil in Dollar instead of Gulf Dinar. In this case, there will not be much fundamental economic and political changes in the region and the rest of the world since it will be pegged to Dollar or basket of currencies. In other words, the dinar will lose its role to serve as means of payment intentionally for the reason that we are accepting to price oil in Dollar rather than Gulf Dinar. It is useful to note that the moment that they issue Gulf Dinar and link it to the price oil, it will attract the world financial institutions to accept it as a global new reserve currency because of the amount of oil and gas reserve that the GCC has.

Hammoudeh (2007) stated that the results from the assessments of both the effects of the Dollar and Euro zones suggest that the GCC economies seem to be driven by terms-of-trade and domestic shocks. In that sense, a more flexible exchange rate regime may be more suitable to the GCC area. The study suggests that Gulf Dinar will better adopt flexible regime instead of pegging to Dollar or basket of currencies, so as above mentioned, one of the suitable way for the GCC countries is to link the Gulf Dinar to oil price which will give the new currency a chance to be accepted as global reserve currency and to gain a strong position in the world politically and economically and that to bring justice to all citizens.

6.1. Commodity basket peg

The world has been seeking peace and equal opportunities to all mankind around the world. Under the fiat monetary system it is impossible to realize these objectives and the principle of *Maqasid Shariah,* causing the world to fall into several wars since the early twenties and even before, until today. The history is a good teacher, according to Norburn (1975), if there is peace in the world it must start in the United State of America with economic justice. The first and the greatest step must be the establishment of a new monetary system, a system in which every citizen would have an equal voice in the issue of money and an equal benefit from that issue.

Great Financiers have circumvented that right and have usurped that power. They create the nation's money by simply writing entries in ledgers. No longer is its standard of value stable and used chiefly for their own private profit. Through their manipulations of money, property is forcibly taken from the labourers and the wealth of the world is concentrated into fewer hands. Achieve peace for mankind, requests not just to be just to citizens of your country but also requests to let every country in this world free to design its own monetary system that reflects its value and bring equality to its members. The main political implication in the case of a Gulf Dinar backed by oil, is the potential decline of US Dollar and subsequently the emergence of china as global super power economically and its necessity of energy in the world.

6.2. The decline of the dollar

The U.S economy has gone through a deep recession since the collapse of Lehman brothers in the last quarter of 2008 after subprime mortgage crisis that led the whole financial system to fall into systematic risk and then demise of major banks into bankruptcy. Furthermore the U.S current account has been experiencing a trade deficit since 1985, it means that U.S imports are far more than exports and it finances its deficit by issuing debt instruments dominated in U.S Dollar and its current account deficit has reached U.S $3 trillion with rest of the world especially China and Japan.

In addition every citizen today in the U.S is fully indebted, so no one is willing –and able- to have a loan even though the interest rate is low. This leads to low production and increasing unemployment rates, to mention but few. The failure of banks and financial institutions is another factor that gives a negative image. This indicates that the whole U.S.A -government, corporate and individuals- have been fully indebted. Duncan (2005:88) found out that with the dept equivalent to 60% of GDP and huge unfunded contingent liabilities for the social security system, the U.S government`s financial position is not good. The U.S. government can be relied on to spend enough to stave off economic collapse.

During Great Depression, President Roosevelt addressed his nation, "we have nothing to fear, but fear itself". Today, the only reason to fear is not fear itself. There is a high possibility that a derivatives market meltdown could cause a global systemic banking collapse that no government could afford to repair. These are a clear signs that the dollar is going to lose its value as well as its role for a world trade currency and medium of exchanges, so that when the people lose confidence in Dollar's purchasing power, the Dollar will collapse and the global economy will pay the price because of the Dollar's position as world reserve currency.

6.3. The emergence of China as the next super power

In the recent decades, China has become one of the highest exporting countries in the world because of its comparative advantage of low cost of labour and its huge human capital resources, therefore its economy has been growing within a double digital this will give china its powerful role to play in the world. Das (2006: xii) has predicted that the Chinese economy has made the most rapid and far-reaching economic transformation in history. It is giving unambiguous and comprehensible indications of emerging as a key actor on the global economic stage in the foreseeable future.

Accolades from academics and business professionals are well-deserved. Some of them even see in it a rising, if nascent, economic super-power, which is gearing up for a new geo-political role that is providing soft leadership to Asia in the future. There is no doubt about the emergence of China where the average income of Chinese citizen has risen from US$717 in1980 to US$4,726 in 2003 and its exports and imports increased in average annual rate of 10.2 percent and 9.4 percent and the most important thing is that the share of exports in gross domestic product augmented from 13.9 percent in 1985 to 30.1 percent in 2003.

Edmonds *et al* (2008:169) stated that one of the challenges that China is facing is the shortage of oil supply that will affect its production that can further affect negatively its economic development to maintain its level of exports. Gokay (2006:141) mentioned that China becomes the world’s second largest importer after the USA. The China’s government estimates that it will need 600m metric tons of crude oil a year by 2010, more than the triple of its expected output because the rapid expansion growth requests increasing demand on oil to satisfy its need. In other words, China’s economic growth which is more based on manufacturing will be dependent mainly on oil.

6.4. The big opportunity for GCC countries

GCC was established in 1983. The union has a vital position to play a better economic and political role in the world because of its huge hydrocarbon reserve and its geographical position. Moreover, the similarity of culture, language and economy should be positive factors that can serve for a successful new currency. Taking into account all these factors, the Gulf Dinar has a big chance to serve as the global reserve currency.

Overall, In the light of a collapsing Dollar, the increasing energy need of China, recent problem that has been faced by Euro and the huge oil reserve of Gulf countries that can boost a public confidence in their new issued currency so the next debate should be directed to the ideal decision of the gulf ruler, Whitman (2006: 28) stated that the reality is that national economies are hostage of oil, and that oil has become the new commodity measurement of value. In these conditions, the ability of a state to hold oil in reserve by either actually possessing it or securing access to it, reflects the history of modern finance that conditioned the value of a national currency on the ability of state to acquire and hoard gold and silver. Therefore, oil will set the value of the currency.

Furthermore; the Gresham law says that “bad money drives out the good one”; or that in a contrast with unsecured paper currency and a commodity based currency -the more valued commodity- will be hoarded and tends to disappear. In other words, without any doubt oil will become a future currency in 21th century after people have lost confidence in paper money. Therefore, the rational decision to be taken by GCC authorities is to decide its new currency to be backed by oil because of the huge oil reserve that they have and the experience of unsecured currencies failure so, the moment Gulf Dinar is linked to oil, it can take position of international currency and all central banks around the world will demand it as reserve to pay for trade transaction and it will serve as a good store of value and unit of account and the gulf countries will become one of the a key players economically and politically in the 21th century.

7. Discussions and Conclusion

The GCC monetary union will bring many benefits not only to the GCC member countries but also to non member countries, especially Muslim and developing countries, in the sense that many Muslim –and developing- countries today are still not only receiving financial aids from the United states, but highly depending on these aids[9]. This let these countries following the US rules to some extent, which means that for the time being they cannot enjoy a total independence, whether economically, financially, politically or even socially and culture-wise.

Having said so, we submit that a GCC monetary union is a must, with a *Khaleej* Dinar backed by a basket of commodities whereby Oil should have the greatest weight among the commodities comprised in this basket so that Muslims will acquire back their bargaining power as it always was many centuries back, at the meantime, it is necessary for the GCC countries to strengthen their economies by developing the other sectors as well, and stop depending on the Oil revenue as Oil itself is not eternal.

On the other hand, the GCC countries have the similarity advantage, in contrast with other regions where the economy, language, culture, nature, weather, etc...are totally different, the GCC countries are very much similar, and this in fact is a tool that should be used by these countries in order to strengthen their economic and political cooperation in the benefit of their benefits as well as the tiers countries once again.

The European monetary union should be a benchmark for the GCC countries, i.e. the latter should consider this experience with its pros and cons, negative and positive points. For instance the Greece debt crisis should be analysed, understood and subsequently the necessary measures should be put in place in order to prevent this from happening, even though some authors argue that the pre-announced bailout plan maybe fatal for a monetary union, in the sense that it will encourage the member countries to venture into high risk investments and subsequently become more exposed to default, we still believe that a well established and regulated pre-designed bailout plan will have more pros than cons. One way to do it will be to determine a maximum level of investment risk the member countries can venture in, as well as to fix a maximum amount to be given out to help the defaulting member countries.

Furthermore, the funds used to bailout should be contributed annually as percentage of GDP and invested by a special body under the Gulf Central Bank, notably in investments with relatively low level of risk. The profit from these investments will be distributed based on the member countries contribution to the fund, and a determined portion of the profits will be kept by the GCB to rescue any of the member countries in case of financial problems.

Another fact that the GCC countries should consider is the creative accounting practices that let some countries join monetary unions without effectively fulfilling the convergence criteria decided by the union, which was the case actually for some of the European union member countries prior to the adhesion[10] and which is basically one of the roots of the problems occurring currently in the European Union. The GCC member countries

[9] Jordan is an example

[10] Italy, Greece and Portugal for instance, (Noord, 2005)

should make sure that the convergence criteria should be satisfactorily fulfilled without recourse to unethical practices that are actually a threat for the whole GCC union in the sense that it may cause its collapse.

With the current international circumstances, the world political and economic picture is most likely to change. For many years we have been looking at the United States of America as the world superpower not only politically but economically and financially as well with its currency which is so far highly demanded by the entire world. As we have analysed earlier, China is the expected emerging superpower notably to replace the United States of America. However, as the world become more and more depending on Oil and the global race to acquire the most possible of Oil reserves is becoming more and more ferocious, we submit that the GCC member countries have a very important role to play and a very high opportunity to be one of the political and economic leaders in the international level especially if their monetary union is done the way we have conceived it i.e. with a *Khaleej* Dinar backed by a basket of commodity with notably the highest weight given to Oil.

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