IN EUROPE’S SHADOW: OBSTACLES TO MONETARY UNION AND COMMON PAYMENT SYSTEMS IN THE GULF COOPERATION COUNCIL

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The paper focuses on the obstacles faced during the last decades in establishing a monetary union and a common payment systems among the countries part of the Gulf Cooperation Council (GCC), and on the feasibility of a new trend for harmonization in such fields. The research emphasises that the adoption of common currency and unified regulations for payments might strengthen the economy of the middle-eastern region and enhance the development of countries that have historically based their politics on the profits originated by oil-refining and gas production.

Starting from the failures in undertaking concrete actions in the mentioned sectors the study will try to shed light on the following aspects: 1) Can the common currency be a valid alternative to the exchange rate arrangements made by the GCC countries? 2) Is the enforcement of monetary union and unique payment systems a fundamental step towards the establishment of an internal market capable to attract more investments in the Region and to booster the Gulf economy?

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References
1. Introduction

The economic cooperation and integration, along with the current attempts to diversify the Gulf economy in sectors others than the natural sources, especially the oil, has been one of the main concerns of the political, economic, social and regional alliance among six Middle Eastern Countries established in Riyadh on 25th May 1981, known as Cooperation Council for the Arab States of the Gulf (hereinafter GCC)\(^1\).

All the development plans recently adopted by the local Governments testify that strenuous efforts are being made to ensure the stability of incomes in the Region and their sustainability for the future. Despite such national endeavours, the inception of an effective common market in the area seems to be a fundamental step for the growth of economic systems whose main strength is the attraction of foreign investors.

Over the last decades the GCC have been undertaking a number of actions for the establishment of a Free Trade Area, a Custom Union, and a Common Market, but the process of unification is still under completion. Indeed, in order to build up a unique economic area two main actions have to be accomplished. The first is the adoption of a monetary union, as alternative to the *de facto* US dollar peg regime for the national currencies, with all the consequential damages related to the large swings in global commodity prices in the short to medium run\(^2\); the second is the enforcement of unified rules for payments, ‘oil in the wheels’ of any internal common market.

Several times the middle-eastern decision makers have discussed the feasibility of such endeavours, but till now no further clear official positions have been expressed. For this reason the paper will firstly examine the obstacles encountered by the GCC in implementing a common monetary


\(^2\) An assessment of the economic implications of exchange rate regime existing in the GCC, can be read in S. BASHER (2015), *Regional Initiative in the Gulf Arab States: the Search for a Common Currency*, *International Journal of Islamic and Middle Eastern Finance and Management*, Vol. 8 No. 2, pg. 185. The Author also suggests some alternatives to the pegging system to the US dollar adopted by all the GCC Members, except for Kuwait.
policy, and then will check over the current status of the single currency agenda.

Inasmuch to steel a wider internal market project and attract more foreign investments in a regional block a second important step is required, that is the enactment of a legal framework for the establishment of a ‘Pan-Arab Single Payment Area’, the study will review the underlined rationale for a regulation in the field of payment services and will scrutinize the goals set out by the Council in this regard.

Conclusively, the paper will provide arguments in support of the harmonization, comparing the Gulf experience with the European Union model, and will offer a template for the GCC countries in the direction of a real economic diversification as basis for the sustainable growth in the Region.

2. Economic Integration among the Gulf States. The Construction Process

Before the discovery of the oil, the economy of the Arab Gulf States relied mostly on pearl fishing, export of typical goods such as dates, trade of gold and re-exporting of items carried from India and Africa, but the finding of the ‘black gold’ between the 1950s and 1970s altered the way of life and transformed these countries from underdeveloped states into developing areas.

Such transformation has been reflected in GCC’s economic objectives, as set forth in four official documents adopted by the GCC Supreme Council, namely the GCC Charter entered into force in 1981, the 1981 Unified Economic Agreement (UEA), the 2001 Economic Agreement, and the 2008 Monetary Union Agreement; a further basic tool for the joint action process is represented by the resolutions of the Supreme Council, especially the one on the creation of a common market issued at its 23rd session, held in Doha in 2002.

The fact that integration and coherence amongst the GCC States in the economic field constitutes one of the main goal of such regional alliance has been made clear since the enactment of the institutional charter, whose art. 4 identifies the main objectives of the GCC by making a precise reference to the development of uniform rules in the field of economic and financial
affairs, trade and customs\textsuperscript{3}. Moreover, the 1981 Unified Economic Agreement, legal basis for the establishment of a Free Trade Area, since its Preamble points out that the main aim of such agreement is ‘to develop, extend and enhance the economic ties [among the member states] on solid foundations, in the best interest of their people and for the sake of working to coordinate and standardize their economic, financial and monetary policies, as well as their commercial and industrial legislation, and customs regulations’. The said Agreement, as declared by the GCC representatives, constitutes the core of the integration program that has been developed in details over the twenty years following the establishment of the GCC, which includes:

1. Achieving economic nationality among the GCC citizens.

2. Achieving the economic integration among Member States in gradual steps, beginning with the establishment of the Free Trade Area, the Customs Union, the Common Market and ending with the establishment of the Monetary and Economic Union and the necessary common institutions.

3. Convergence and unification of laws, regulations and strategies in the economic, financial and trade areas.

4. Interconnecting the infrastructures in Member States, particularly in areas of communications, electricity and gas and promoting the establishment of joint ventures\textsuperscript{4}.

\textsuperscript{3} Art. 4 of the GCC Charter, available at http://www.gcc-sg.org/en-us/AboutGCC/Pages/Primarylaw.aspx (Accessed on 3 July, 2016) establishes the objectives of the GCC as follows: ‘The basic objectives of the Cooperation Council are as follows: (1) To effect coordination, integration, and interconnection among member states in all fields in order to achieve unity among them. (2) To deepen and strengthen relations, links and areas of cooperation now prevailing among their people in various fields. (3) To formulate similar regulations in various fields including the following: (a) Economic and financial affairs. (b) Commerce, customs and communications. (c) Education and Culture (d) Social and health affairs. (e) Information and tourism. (f) Legislative and administrative affairs. (4) To stimulate scientific and technological progress in the fields of industry, mining, agriculture, water and animal resources, to establish scientific research, to establish joint ventures and encourage cooperation by the private sector for the good of their people.’

\textsuperscript{4} See the GCC official website at http://www.gcc-sg.org/en-us/CooperationAndAchievements/Achievements/EconomicCooperation/JointActionProcess/Pages/TheUnifiedEconomicAgreement198.aspx (Accessed on 3 July, 2016). The FTA exempted industrial, agriculture, and natural resources from custom duties, but these products must acquire a certificate of origin from the competent authority before entering the GCC. With this step the GCC countries became a single body of customs towards the outside world, since the tariffs on foreign goods will only be taken once in the entry point, and all these goods can move among the GCC duty-free. However the first port that collects the goods is responsible for the inception of the foreign goods and ensure that the goods are legal, fulfilled
Additionally the 2001 Economic Agreement, while trying to implement the joint economic process in the Gulf and shift the action from the stage of coordination to the following stage of integration, lays down the ground for the Customs Union, enforced starting from 2003, and tills the soil for further developments towards the creation of a Common Market. Such goals have been bolstered in the closing statement of the 23rd Session of the GCC Supreme Council, which has given the directives to meet the prerequisites of the Common Gulf Market as soon as possible -in any case not later than the year 2007-, and has adopted a mechanism for following up the progress of the Common Market, within a fixed time frame.

The first step for the enforcement of the economic integration program is the achievement of the ‘economic citizenship’, that is to say the realization of a fully equal treatment among GCC nationals in all economic fields in the Member States, starting from the ‘four freedoms’ listed as follows by art. 8 of the 1981 Agreement:

1. Freedom of movement, work and residence.

all required documents and meet the custom duties. The Agreement entered into force in March 1983 and lasted about 20 years till the end of 2002, when it was replaced by the GCC Custom Union.

5 See Art. 1 of the Agreement, available at https://www.gcc-sg.org/eng/, which states that: ‘Trade between the GCC member States will be conducted within the framework of a customs union that will be implemented no later than the first of January 2003. It shall include, at a minimum, the following: i. A common external customs tariff (CET). ii. Common customs regulations and procedures. iii. Single entry point where customs duties are collected. iv. Elimination of all tariff and non-tariff barriers, while taking into consideration laws of agricultural and veterinarian quarantine, as well as rules regarding prohibited and restricted goods. v. Goods produced in any Member State shall be accorded the same treatment as national products.’

6 Art. 3 of the Agreement asserts the principle of equality in the treatment of the citizens of all Member states in all economic activities, and concludes by stipulating that ‘Member States shall agree to complete implementation rules sufficient to carry this out and bring into being the Gulf Common Market.’

7 See http://www.gcc-sg.org/en-us/Statements/SupremeCouncil/Pages/TwentyThirdSession.aspx (Accessed on 4 July 2016). The resolution identified a time schedule for completion of the requirements of the GCC Common Market, as follows: a) Equal treatment shall be accorded to the GCC citizens by 2003 in the field of employment in the private sector, Stock ownership, formation of corporations and elimination of relevant barriers. b) Equal treatment shall be accorded to the GCC citizens by 2005 in the field of government jobs, social insurance and pension and elimination of relevant barriers. c) Competent committees shall complete all requirements to ensure achievement of the GCC Common Market by 2007 at the latest. Subsequently, the Secretariat issued two further resolutions declaring the official launch of the Common Market and the need for specific rules and procedures.
2. Right of ownership, inheritance and will.

At a later time, the 2001 Economic Agreement tended to the direct implementation of the concept of economic nationality as tool for the achievement of a real Common Market, by according the GCC nationals residing in any Member State the same treatment granted to its citizens without differentiation or discrimination in ten general economic fields, included movement, residence, work, real estate ownership, capital movement, tax treatment, education, health and social services. Thereafter the Council has entrusted the Financial and Economic Cooperation Committee, composed of the Ministers of Finance and Economy, with the duty to undertake the necessary actions towards the enforcement of such provisions.

3. A Monetary Union for the GCC: Adelante Pedro, con Juicio.

Both a blessing and a curse of the joint economic action, the introduction of a monetary union has been an overriding concern of the GCC since its early stage, because it represents the ultimate goal of an economic process that have already fully experienced three of the classical degrees towards the integration, namely the Free Trade Area for the period 1983-2002, the Custom Union in 2003 and the Common Market in 2007, and is now halted at the fourth stage which stipulates the need for unified monetary, banking, and fiscal policies and issuance of a single currency.

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Despite the signature of a specific agreement in December 2008, the adoption of the common currency is still far from the concrete implementation due, on one hand, to the fear of some of the Members to give away part of the wealth connected to the higher value of their national currencies and to surrender part of the domestic monetary sovereignty; on the other hand, because of the existence of bitter contrasts on establishment and location of the central institutions which will be in charge with the power to administer the new currency and the related policies.

Indeed the project of monetary union and single currency seems to be the hard core of the GCC ‘dream’ since it has been expressively mentioned even before the enactment of the Monetary Union Agreement, as it is evident by analyzing the two previous economic agreements that make a clear reference to the necessity of a unique monetary policy as final goal of the economic integration in the Middle East\(^\text{10}\).

Composed of 28 provisions, the GCC Monetary Union Agreement firstly lays down the legal and organizational foundations towards a concrete unification, through the implementation of the following basic principles:

1. Coordination of economic policies in order to achieve a high degree of convergence throughout the single currency area.

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\(^{10}\) Art. 22 of the 1981 UEA states that ‘Member States shall seek to coordinate their financial, monetary and banking policies and enhance cooperation between monetary agencies and central banks, including the endeavor to establish a joint currency in order to further support their economy.’ Moreover, art. 4 of the 2001 Economic Agreement establishes: ‘For the purpose of achieving a monetary and economic union between Member states. Including currency unification, Member states shall undertake, according to a specific timetable, to achieve the requirements of this union. These include the achievement of a high level of harmonization between Member states in all economic policies, especially fiscal and monetary policies, banking legislation, setting criteria to approximate rates of economic performance related to fiscal and monetary stability, such as rates of budgetary deficit, indebtedness, and price levels.’
2. Creation of common financial infrastructures related to payment systems.
3. Adoption of uniform banking legislation as legal basis of the monetary and financial stability.
4. Establishment of a Monetary Council as preliminary body before the creation of a Central Bank.
5. Introduction of a single currency as replacement of the national currencies.\(^\text{11}\)

In six detailed Chapters the Agreement further sets out rules, methods, and procedures for the realization of the single monetary system in the Gulf to be enforced by 2010. Subsequently, in 2009 the GCC Member states have decided the establishment of a Monetary Council to serve as a transition body in preparation for the issuance of the common currency.

Furthermore in the GCC summit held in December 2011, Bahrain, Kuwait, Qatar and Saudi Arabia agreed on the establishment of a unified Central Bank operating from the year 2015 along with the national central banks in tune with shared monetary policies. The project has been not carried out yet, and notwithstanding the above mentioned regulatory actions, the Gulf Arab States are still in search for a common currency.

The causes of such a debacle can be variously identified by observing the inherent nature of the regional block, which does not properly constitute a union comparable to the structure of the European Union, but is rather a coalition among countries geographically close that are characterized by shared identity, tradition, culture, religion, language, social structure and similar governmental systems. Consequently, in case of disagreement, each States is free to pull back from the talks and take independent decisions as deemed appropriate for its nation.

Another reason why the plan has reached a deadlock is represented by the fact that, even though the economic harmonization has been a major goal of the GCC since the beginning, the Council has been conceived as a regional security alliance amongst countries continuously threatened by conflicts for the power-sharing.\(^\text{12}\)

\(^{11}\) See Art. 3 of the Agreement.
\(^{12}\) The conflicts that have driven the Gulf Countries into the GCC are: the Islamic Revolution in Iran and the Soviet invasion in Afghanistan in 1979, and the Iranian-Iraqi war in 1980. On the historical background of the Council, see S. TAKAJI (2012), *Establishing Monetary Union in the Gulf Cooperation Council: What Lesson for Regional Cooperation?*, Asian Development Bank Institute, Working Paper Series, No. 390, pg. 3. The Author also suggests that the GCC is unique for the fact that the survival of the existing monarchic regime appears to have been the primary motive of its launch.
Some scholars support the idea that in order for the monetary union to succeed it is fundamental the creation of a fiscal union, which could lead to the collection of money in a special ‘anti-crisis fund’ to be used for covering the economic and social costs of unforeseen crisis, and avoiding the risk of debt crisis seasoned in other unified economic areas, such as the European Union. Others stress that although the monetary union in the Gulf makes good economic sense, the project faces significant headwinds in terms of low intra-regional trade, lack of supranational political institutions and gaps in research capacity.

Indeed, one of the main bone of contention among the political leaders is represented by their unwillingness to renounce to the monopoly over the national banking policies, and to the power of issuing money, classical examples of the mastery and influence exercised by any government on the domestic and international market.

In spite of the aforementioned discrepancies in finalizing the take-off of the single currency agenda, it is unquestionable that the introduction of a unique currency may solve some of the problems experienced in the GCC countries as consequence of the floating exchange rate regime, due to the fact that the adoption of a shared monetary system assures at least cost savings, price transparency and the overall stability of prices. Moreover, by the medium of a monetary union the Gulf Governments could increase their import purchasing power and products differentiation, attract a higher volume of foreign direct investments and, more in general, propel the local wealth through a joint development plan based on the diversification of the

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13 In this regard see S. BASHER, cit., pg. 189, who, by examining the European debt crisis, conclude that ‘A common monetary policy may sometimes fail to stabilize asymmetric shocks across members, which makes the case for insurance arrangements among members to provide transfers to countries in more dire circumstances. A fiscal union thus works as an automatic stabilizer across regions, providing adequate buffers against asymmetric macroeconomic shocks in a currency union.’


15 One of the reasons for the stall in the negotiations regarding the monetary union has been the withdrawal from the project in 2009 of Oman and the UAE, which disagreed with the choice of placing the headquarters of the future Central Bank in the Kingdom of Saudi Arabia.
economic activities as response to the concerns on the remaining quantity of ‘black gold’ and gas in the Region.

In any case it has to be noted that, while negotiating on the effective possibility to create a central institutional apparatus for monetary cooperation, each Member State is currently fabricating provisional internal solutions for the reduction of the dependence on a limited number of exports commodities. The local decision makers have in fact launched development plans and national economic strategies –known as ‘visions’– for the realization of sustainable and stable incomes no longer stuck on the oil-refining and gas extraction, but mainly focused on pioneering private investments, increased levels of innovation, and enhanced percentage of non-oil exports.

4. Common Rules for the Payment Systems: Here We Go!

When it comes to undertake actions towards the creation of a regional economic space, one of the aspects to be considered in order to strengthen the commercial transactions is the elimination of barriers to cross-borders payments, which can add costs for consumers and businesses. This is especially true in countries that recently declared sustainability, fairness and competitiveness as the three guiding principles for the implementation of their turnover. The enforcement of harmonized rules in the banking sector is truly a priority to legal systems that strive for becoming the hub of the international business activities through the attraction of foreign direct investments.

The debate on such aspect has only been incidental over the years, and no specific legislation has been introduced at GCC level. Very few references to the necessity of a unified regulation in the field of payment systems can be traced across the economic and monetary agreements in force. In particular, the 1981 UEA states in the Preamble that one of the objectives of the

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17 On this point, see the visions published by each GCC country, cit.
regional block is the convergence of the laws and strategies on the economic and financial services; in a couple of provisions it also states that the Members shall seek for coordination with regard to the financial, monetary and banking policies, and shall enhance the cooperation between monetary agencies and central banks. The same principles are fully reaffirmed as milestones in the 2001 Economic Agreement as well as included within the basic principles of the Monetary Union Treaty, which lists among the tasks of the Monetary Council to be put into place the “ensuring of readiness of the payments”, and entrusts the constituent Central Bank with the duty of “enhancing effective infrastructures for payments in the single currency area”. However right now the regulation in the sector is left to the national legislations, and there is no common ground for building up a legal framework at GCC Level.

Indeed a broad overview on the payments and security settlement systems in the Middle East Region reveals that the Arab regulatory asset is one of the weakest in the World, and that the majority of the concerned countries rely mostly on cash and cheque to initiate all large value payments, circumstance that makes difficult the achievement of efficiency and risk control. Additionally, it is clear the absence in the Region of specialized agencies and supervisory bodies, and even in the cases in which the central bank is the authority entrusted with the power to supervise the payments, its activities target only the efficiency and reliability, without considering the ancillary set of issues strictly related to a payment system, such as the promotion of competition in the relevant market and the protection of consumer interests.

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18 Cfr. Artt. 21 and 22 of the Agreement.
19 Cfr. Art. 4 of the Agreement.
20 Cfr. Art. 3 of the Agreement.
21 Cfr. Art. 6, point 7, of the Agreement.
22 Cfr. Art. 14, point 4, of the Agreement.
Nevertheless, due to the stall in the single currency project, the establishment of a ‘Pan-Arab Single Payment Area’ might constitute the only chance to bring the banking sector to a new common starting point, by encouraging the equal treatment -in terms of costs and time- for cross-border and domestic payments, and by promoting the modernization of funds and securities transfers, with the final goal of relaunching the creation of an effective internal market in the Gulf.

For this to take effect a minimum legal framework is required and, due to a lack of precedent legislative measures in the neighborhood, the best example to follow is undoubtedly the European payment system regulation, culminated with the recently adopted directive on the payment services, which sets novel common standards for payment transactions and instruments.24

The enforcement of legislations for cross-border payments and the identification of improvement measures capable to foster safety, efficiency and integrity, and to regulate governance and risk management in a strategic regional block like the GCC, can be reasonably the right path to pursue in order to enhance economic integration and interdependence in the Gulf legal systems. In fact, the cooperation among regulators is an essential component of the payment infrastructure and the oversight function, especially in the attempt of drawing foreign investors into a legal and safety regulatory environment. However, since this field is still underdeveloped in the concerned States, the only feasible solution for the time being seems to be the negotiation of banking arrangements between the countries involved, strategy that can lead to a costly and convenient mechanism for customers and business activities.

5. Pave the Way: GCC and European Union Compared

The introduction in the GCC of common regulations for the monetary, banking, and fiscal sector can be described as an epic tale characterized by a huge delay in establishing the monetary union, and in putting into circulation the single currency, more than once proclaimed as driving change by the local leaders. Such kind of economic process is not new in territories close to the Arab Gulf, since in other regional areas, namely Africa and East Asia, comparable plans have been developed. In any case the European Union represents without a doubt the principal model to look at in deciding the route to take for a revamp, due to the advancement in its implementation.

On the basis of all the above considerations and in light of the lively debate showed up in Europe in the aftermath of the widespread ‘Brexit’ phenomenon, it is worthy to raise some questions: Is the harmonization still a feasible and profitable project for the GCC countries? Is the unity a great chance or rather a deadly weapon for these countries?

A joint starting point for any reasoning in this matter is that the Cooperation Council is already in a monetary union with the US dollar since the decision taken by the local governments to peg their currencies to the American money system, and is exposed to the potential losses connected to the frequent inflation of the dollar. Consequently, one of main arguments in favor of the unification is the urgent necessity to reduce the dependence of the Gulf from the incomes of third parties, and to decrease the impact of foreign economic shocks on its wealth.

Among the other supporting reasons it should be included the high degree of homogeneity of the GCC Members in all respects, such as the religious, cultural and linguistic linkages; the similarity of social conditions; the commonality of regulations; and the nature of the contemporary economic challenges, with particular reference to the circumstance that the GDP heavily derives from hydrocarbon-related activities and from the international trade. Most importantly, the increase in the bargaining power with the major economic blocks and the attraction in the local market of more import and export activities, which will follow from a full economic integration, represent the landing place of the shared ambition pursued in the last 35 years in the Arabian Peninsula.

Until now a mixture of economic and political factors has obstructed the realization of the unique monetary scheme. The fear of losing the autonomy over monetary and fiscal policies, and of surrendering a portion of the sovereignty to centralize supra-national entities authorized to make decisions
in case of disputes are surely the main causes of the past failure. Therefore it is licit to ask: What is next?

In the described scenario the only key to success is the will of the regional leaders. The will to finally chase the harmonization in the economic and financial affairs enumerated in all the objectives and goals of the agreements in force, and the will to put effectively into effects the GCC economic action process that is still only on paper, by firstly building strong institutional bodies like a Central Bank, which should formulate and implement monetary and banking measures. The reference is already available and at least two motives argue in support of paving the way towards the European model: the establishment of both regional alliances for a similar exigency, that is the security, and a shared vision clustered around the protection of four main freedoms in their respective internal economic spaces.
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