The Role of Political Factors in Creating a Unified Currency Zone between the GCC Countries

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Abstract

The study dealt with applying the essential criteria to the gulf single currency project of the Gulf Cooperation Council (GCC) to identify the main factors that contributed to its emergence. It shows that this region did not meet the essential criteria used to form a unified working area. Since it has not exceeded the applicable standards, inflation rates have seen disparities among countries, low inter-trade, and concentrated production in oil production. Still, the main factor contributing significantly to the emergence of the Gulf single-currency region is the political factor. The convergence of its political systems and agreements in the face of external and regional challenges is critical in its emergence.

Keywords

Gulf Single Currency Region, GCC, Political Factor.

Introduction

Geographical convergence and cultural and political convergence create a significant factor in creating economic mergers. Bloc countries at different stages of their economic development tend to integrate the economy with other economies. In addition, they tend to form complementarities aimed at obtaining the advantages of trade and financial markets and taking advantage of the benefits of large markets. Economic integration ranges from free trade to customs union in the common need to the highest levels of
integration by establishing a single optimal currency zone by uniting exchange rates and
dealing in a single currency called a specific currency. It is characterized by a legal patent
by a unified central bank that issues it. It acquires the economic and financial privileges
enjoyed by central banks in the United States before the merger. The GCC single-
currency region is a model for forming a monetary union between the six GCC countries.
The political factor and political agreements have contributed to the face of external and
regional challenges. The various elements in work to explain the establishment of the Gulf
currency area overlapped between methodological factors and political factors. These
factors constituted the apparent secondary criterion for pushing the six Gulf states to
adopt the idea of establishing a single currency area. Therefore this research addresses the
study of this ambiguity and the overlap between the factors driving its establishment. The
study is based on the premise that the political factor is a crucial factor and a strong driver
of the emergence of the Gulf single currency region. The study's objective focuses on
determining the essential criteria that led the GCC countries to adopt the draft single gulf
currency and identify the political factor's role as a significant factor in its development.

Literature Review

A Theoretical Framework for the Optimal Currency Area

The concept of the optimal currency area emerged due to the controversy during the
1930s regarding the trade-off between the fixed exchange rate and the flexible exchange
rate and the single currency zone (monetary unit). These monetary unions seek to achieve
critical objectives such as promoting regional trade because it saves the costs of currency-
related transactions and synchronizes economic cycles. Moreover, it promotes exchange
rate and macroeconomic stability, increases transparency in prices, and facilitates the
movement of capital among members. Hagen has defined the monetary union (Agustiar,
2020) as using the same currency by a group of countries or linking those countries to a
fixed exchange rate. The optimal currency area is also known as a region that includes one
country or a group of countries. The costs of abandoning exchange rates as an adjustment
tool are much lower than the benefits of adopting a single currency. The decision to join
the currency zone requires the abandonment of independent domestic monetary policies to
pursue a unified approach, which may require creating a new single currency by a new
and independent central bank or stabilizing the exchange rates of the common national
currencies. Countries will need a typical reserve to support their external positions against
other countries in the latter case. Still, suppose they choose to link their single currency to
a primary currency such as the dollar or the euro. In that case, they will give up their
monetary independence in favor of the primary currency state (Bodea, Garriga, &
Higashijima, 2020). Adopting a single currency means narrowing the ability of the local government to resort to monetary expansion to stimulate economic activity. It also finances its expenditures at preferential interest rates. It corrects the balance of external payments by devaluing its currency and not through a deflationary policy, ceding independence in monetary, credit, and interest rates such as creating money private developing its monetary policy. Financial unity is not limited to being an economic event. Still, it is a significant political indicator as the economy goes beyond politics and includes the features and features of monetary union, which comes (Khan, 2009):

1. Coordinating member states' economic policies to ensure financial and monetary stability to achieve sustainable economic convergence in the single currency area.
2. Creating the structures for the payment system and its settlement systems for the single currency.
3. Adopting banking legislation and standard rules in the field of banking supervision to achieve monetary and financial stability.
4. Establishing a monetary board paves the way for establishing a fully independent central bank to draw up and implement monetary policy and exchange rate policy for the single currency.
5. Issuing a single currency to replace the currencies of member states.

Taylor has developed three key aspects that are at the center of the attention of monetary unions or currency unions:

1. One or several fully convertible currencies at a fixed exchange rate.
2. Union-wide monetary policy that a single central bank determines.
3. Unifying the foreign exchange rate policy.

**Optimal Currency Area Standards**

The first steps of optimum currency theory began with the ideas put forward by Robert Mundell and then integrated into this theory by another researcher, Ronald. McKinnon.

1. **Robert Mandel's ideas**

On the movement of production factors see and Mandel's research (Grubel, 1970; Medhioub & Jedidia, 2017). Mobility of Factors of Production: These ideas came in the study of Robert Mandel tagged (theory of Optimum Currency Areas) Mundell (1961) published in 1961, which indicated that the single currency means the existence of one central bank (with the power to issue money). However, since the region comprises
several currencies, this requires the cooperation of many central banks to provide them with means of payment, and no central bank alone can expand the requirements more than other banks without losing more reserves and weakening the transferability. Impairing Convertibility and Mandel reached increased monetary integration between currency areas under the movement of production elements. It enables those countries to modify balance-of-payments imbalances without resorting to exchange rate change. Hence, capital mobility facilitates the establishment of optimal currency areas and enhances the free movement of employment between them.

2. Ronald McKinnon's Ideas on Trade Openness

McKinnon (1963) confirmed. In his research (Optimum Currency Areas), I, on trade openness to the ratio of traded goods to output or the size of the foreign trade sector. If the former is the largest, the greater the degree of openness and the higher the exchange system, the more open the economy. The greater the desire of the economy to adopt a fixed exchange system. Accordingly, it increases the optimal interest rate of the currency and reduces the need for monetary policy in rebalancing the external.

On the other hand, the flexible exchange system is the most suitable for closed economies (A. H. Almagtome, Al-Yasiri, Ali, Kadhim, & Bekheet, 2020). McKinnon believes that a small open economy is interested in joining a currency zone to avoid price fluctuations between traded and undressed goods. Therefore, a fixed exchange system will be best suited for the region. Furthermore, a flexible exchange system can be used with the outside world to balance payments and stabilize the region's internal prices. In addition to achieving full employment, McKinnon described Optimality as a region that can also use its monetary and financial policies to achieve those goals (A. Almagtome, Khaghaany, & Önce, 2020).

3. Peter Keenen's Ideas on Diversification of Products

Peter Kenen's ideas in his tagged research The Optimal Currency Areas an Elective View Kenan, Mills, and Campbell (1969) focused on diversifying production and see the main reason for the disruption in payments as partial demand imbalance. A country that produces an extensive range of products will export many different products. Suppose there is a decline in demand for an exporting commodity. In that case, the unemployment rate will not rise as sharply as in the less diversified economy under the t-bit exchange rate system. On these grounds, Keenan concludes that a country with a wide variety of products can afford fixed exchange rates (i.e., an optimal currency area). At the same
time, a less diversified economy will be an optimal area for the flexible exchange rate (Ishiyama, 1975).

4. Haberler's Ideas on Similarity in Inflation Rates

The face of Haberley and Fleming's Marcus Fleming is looking towards a new topic. Inflation The argument supporting the two's focus on inflation is that balance of payments imbalances are often due to different trends in domestic inflation rates in countries due to structural developments, differences in the effectiveness of trade unions, or differences in domestic monetary policies (Gottfried, 1970). As a result, this standard diverts attention from microeconomic imbalances in supply and demand conditions to focus on macroeconomic phenomena (Ishiyama, 1975). External imbalances can be created by the continuing differences in national inflation rates resulting, among other things, from structural developments between countries in the region, differences in labor market institutions, differences in economic policies, and various social preferences (e.g. inflation aversion). Fleming believes that when inflation rates between the region's countries are (low) and similar over time, among these countries. As a result, the terms of trade would remain more or less stable, which would further enhance the current account and trade balance and reduce the need for nominal exchange rate adjustments (Mongelli, 2002). This, therefore, facilitates the formation of the currency area by stabilizing the exchange rate of its constituent countries.

5. Ingram and Saitovsky's Ideas on the Degree of financial Integration

James Ingram moved the analysis from the real side of the economy to the monetary side when focusing on analyzing the degree of financial integration in the currency area and stressed (Johnson & Swooboda, 2013). It is necessary to look at the economic characteristics and not the real economies to determine the optimal size of the Optimum Size of the currency area. Saitovsky (1967) tends to say that the high degree of financial integration does not stop at short-term securities but even long-term securities as a criterion for an optimal currency area. They emphasized that integrating capital markets in a region does not dictate the need for flexible exchange rates. Ingram also states that if financial integration is not enough. Thus, the interest rate structure difference.

6. The Political Factors

Political factors and consensus are of a high level of importance in forming the single currency zone. There must be political will on the part of leaders in the participating countries' governments, and there must be popular support in support of this. Without
political will and popular support, the commitment to the monetary union will be incomplete, which could lead to the demise or suspension of monetary union, as the consensus of political wills is an essential prelude to belonging to the currency union. Furthermore, coordination among member states is the prerogative of leaders. This may not be common among the public, but convincing them of the benefits of the Union is especially important, which comes from the commitment and dissemination of political leaders to this task.

The bottom line is that the various economic and monetary indicators and standards alone are not enough to give the foundations for the formation of the optimal currency zone but must have the political will and conviction of the public to unite monetarily and participate within the region.

Gulf Cooperation Council Reasons for the Emergence

Internal and external factors were intertwined in the emergence of the Gulf Cooperation Council, representing internal factors in the convergence and similarity in the said countries' cultural, intellectual, social, political, and economic environment. Arabic was the only official language in dealing and understanding, and speakers were associated with deep academic connections and complete emotional response. The Islamic religion of the peoples of these countries has been the focus of the rapprochement between the people of the Arabian Gulf and the cradle of unity between them. As for the political side, the political systems of the Gulf states are similar. The monarchy or the princely system prevails, which means the governance concentration in one family and the rule is genetic. As for the economic aspect, the countries mentioned have participated in their reliance on oil as the primary source of revenues and national income and the main component of their gains and national income. The oil industries have been mainly involved in amputation, chemicals, etc., and chemicals (Al-Wattar, Almagtome, & AL-Shafeay, 2019). The external factors that led to the emergence of the GCC idea were the fall of the Shah of Iran in 1979 and the emergence of a revolutionary regime in Iran, and the fear of expanding Iran's thorough to neighboring countries. The ensuing Iran-Iraq war broke out in 1980 when the Gulf Arab states felt threatened to keep their property together to create a unified front for their everyday security needs to protect their sovereignty (Bianco & Stansfield, 2018).

The unified challenges and the interlocking of relations between the Gulf States contributed to the emergence of the Gulf Cooperation Council as a regional organization, which began the idea of its establishment in 1980. Still, it was introduced in 1981 and
included the mechanism for establishing the Council's advisory body and the semi-annual consultative summit.

The GCC aims to implement a range of steps, including:

1. Achieving coordination, integration, and interdependence among member states, deepening ties and links and aspects of cooperation in all areas between their peoples to achieve their unity.
2. Develop similar economic, commercial, financial, social, scientific, health, media, cultural, legislative, customs, and transportation systems.
3. Promoting scientific and cultural progress in industry, mining, agriculture, water, and animal resources, establishing scientific research centers, and establishing joint ventures.

**GCC Economic Achievements and Obstacles**

The GCC emerged from the Unified Economic Agreement in 1981, the most prominent of which was:

1. Liberalization of bilateral trade.
2. Establishing a union with the outside world reduces the differences between customs duties imposed between member states on imports.
3. Standardize the treatment of GCC citizens about the free movement of people products, means of production, transportation, housing, and work.
4. Unifying economic, financial, and monetary policies and working to unify the currency.
5. Production coordination, joint industrial projects, and the unification of oil policies to achieve productive entanglement and joint development by establishing the Free Trade Area customs union and the Gulf common market.

To continue the GCC's economic aspect, the financial Agreement was concluded in 2001, which reduced barriers to capital and labor flows within the Gulf Cooperation Council (Martini, Wasser, Kaye, Egel, & Ogletree, 2016). This paved the way for establishing several federations, such as the Gulf Industrial Consultancy Region, the Gulf Port Federation, the Gulf Federation of Trade and Industry, and joint marketing 2008. Therefore, the rapprochement between the GCC countries has resulted in the emergence of the monetary union project (single currency area) as stipulated in the 1981 Consolidated Economic Agreement in Article 22. The agreement of the European Union countries to issue their single currency (euro) and the benefits achieved had an additional
impetus for the Gulf states. The GCC countries fixed the exchange rate of their currencies in US dollars from January 1, 2003, excluding Kuwait, which reconnected its currency to a basket of currencies in 2008. Riyadh has been chosen as a place to establish the Central Bank of the Gulf despite the reservation of the UAE, which considers it the most worthy of the height of the Gulf Central Bank based on its comparative advantage in this sector and its experience in the financial industry and the opening of its economy to the world economy. Still, those who chose Saudi Arabia were based on several factors, most notably the weight of the Saudi economy, which represents 52% of the total size of the Gulf economy, and the proportion of Saudi cash, which means 70% of the Gulf cash. However, the Gulf single currency application faced many economic and political obstacles, most notably the disagreement on establishing a Gulf central bank and its headquarters. How this bank is managed, the distribution of voting rights on its decisions, the agreement to withdraw national currencies and replace those of individuals, banks, and institutions in the single currency, and the willingness of the Gulf states to give up some aspects of monetary independence. According to the existing apparent differences in the local Gulf currencies' fate and the single money's relationship to the dollar.

The Findings

Analysis of the Criteria Used in the Establishment of the Gulf Monetary Union

1. The Movement of Gulf Citizens and Goods between the GCC Countries

Table 1 shows the growing movement of citizens between GCC countries, reflecting the consolidation of the economic reality represented by the Cooperation Council as economic interests become increasingly intertwined and the number of citizens moving between GCC member states increases. The number of Gulf mobiles increased significantly (17.8) million in 2013, compared with about 10.7 million in 2004, an increase of 66.3 percent, while the number of citizens on the move was limited to 4.5 million in 1995. As for the movement of goods, the declaration of the customs union in 2003, which included a strategy for the movement of goods between GCC countries, specified the transition mechanism implemented in the implementation of Article 1 of the GCC countries' Economic Agreement. This aims to bring the GCC countries under one wall to the outside world, i.e., customs duties are met once, and goods are transported between member states without meeting other tariffs. The share of each member state is addressed through clearing, and the customs union guarantees a set of measures, including (Osman, Gachino, & Hoque, 2016):
1. A unified tariff on the outside world.
2. Customs regulations and procedures.
3. One entry point at which the standard customs duties are collected.
4. The movement of goods between GCC countries without customs or non-tariff restrictions with notable exceptions such as prohibited or restricted goods.
5. The treatment of goods produced in any state of the Council is equivalent to national products.

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2. Trade Openness

Economic policies were adopted by the Gulf Cooperation Council (GCC) of the Free Trade Area in 1983 and then the Customs Union in 2003. As a result, in 2005, the trade value between member states rose to 106,446 million dollars in 2012 due to removing trade barriers and facilitating products and goods, including GCC countries. However, when comparing the volume of inter-GCC trade and foreign trade with the world. Bilateral trade has been low compared to the importance of trade between these countries with the world, with foreign exchange in 2016 and 2017 (928.) 4, 995.5 billion U.S. dollars compared to bilateral trade, which amounted to (117.1,123.6) billion U.S. dollars for the same years (Al-Badi & AlMubarak, 2019).

As for bilateral exports, after reaching 2984 (2,963) million dollars, they rose to 37,314 million dollars in 2007 and then rose significantly to 60,402 million dollars in 2012, an increase of 61.8 percent from 2002. Inter-import imports increased significantly from $2,963 million in1984 to $26,190 million in 2007 to 46,044 in 2012, an increase of 74.1 percent compared to 2007.
3. Inflation in the GCC

Table 3 shows that inflation rates in the GCC countries were low and close (2000-2003), ranging from -0.3 to (3.2). However, the disparity became apparent in subsequent years as the GCC countries were divided into two groups, the first group, characterized by low inflation rates, including Saudi Arabia, Kuwait, Oman, and Bahrain, with inflation rates not exceeding 10 percent. The decline is due to the availability of open trading systems with the flexibility of the labor market and limited high fuel costs at the level of domestic prices. In contrast, the second group with high inflation included Qatar and the United Arab Emirates, where inflation rates approached 14% due to the high prices of real estate rents and housing units in the United Arab Emirates and the high supply of cash in each of them (Hassan, Sanchez, & Hussain, 2010).

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4. Productive Diversification

Oil production is the primary source of national income for the GCC countries, as well as the possession of three Gulf states (Saudi Arabia, Kuwait, and the United Arab Emirates) with oil reserves of up to 100 billion barrels, ranking them first in the world in terms of oil reserves (Al-Maamary, Kazem, & Chaichan, 2017).

5. Economic Integration

The GCC sought to encourage the establishment of joint ventures and increase bilateral investments that contribute to the integration of the GCC countries in many areas. It enables the citizens of the Natural Council to invest, establish companies, and trade shares without distinction or discrimination in the treatment to achieve the development of these markets, provide new products and develop the needs of Sukuk and sand that contribute to economic growth (Gengler & Lambert, 2016).

6. Benefits and Costs

The benefits of establishing a single currency are supporting and developing regional exchanges between these countries by eliminating risks of monetary nature, stimulating capital flows, and increasing the region's negotiating power. This trend improves the conditions of investment and financial employment of those countries, improves the conditions of assets and financial employment of those countries, and provides the potential for integrated development projects. However, as for the costs of the single currency project, it is to cede monetary sovereignty in favor of the authority charged with issuing the single currency and drawing monetary policy. Most economists believe that surrendering the financial aspect is a relative issue in the Gulf states because of the ineffectiveness of monetary policy (Siddiqui Ahmed, 2013).

7. Political Factors

The six GCC countries are characterized by relative cohesion that swings according to the GCC's underlying circumstances and policy options, regional governments, and forces outside the region. The GCC countries are meeting on critical issues underway. It cooperates to strengthen its overall capacity, but the Member States are vulnerable to working on contradictory objectives in periods of low cohesion. While infighting may emerge in the form of apparent rifts, factors that strengthen GCC cohesion include the need for the six countries to stand together to counter mutual security threats and a common interest in protecting their royal political identity (Martini et al., 2016).
1. The joint Al Jazeera Shield forces were established in 1982, forming a military force under Saudi command, characterized by a small number. Moreover, it lacks defensive doctrine and training, as maneuvers are carried out every two years, and their weakness appeared when they did not intervene in the face of Iraqi forces when they entered Kuwait in 1990.

2. It represented the nucleus of the political and diplomatic movement that rejected Iraq's entry into Kuwait and demanded an immediate, unconditional withdrawal of Iraqi forces.

3. After US forces entered Iraq in 2003 and Ahmadinejad was elected president of Iran, GCC countries grew increasingly concerned. Saudi Arabia submitted a proposal calling for the adoption of central command and decentralized forces.

4. It was then developed in 2006 into the Joint Island Shield forces and strengthened with a naval and air effort to increase its combat efficiency, ensuring the implementation of the tasks of improving and supporting the national armed forces of the GCC countries in a way that is important (Martini et al., 2016).

5. A joint defense charter was adopted in 2000, based on the fact that any attack on any member state is an attack on all member states, thus shifting from military cooperation to joint action between GCC countries. It was based on the principle that the attack on any member state was an attack on all member states (Bianco & Stansfield, 2018). Followed by the adoption of the defense strategy at the 30th session in 2009 to build a joint defense system for the Council through which to strengthen and coordinate its integration, interdependence, and development of its capabilities to defend its sovereignty, stability of its interests, and cooperation in meeting challenges, crises and disasters, and the protection of the monarchy in the region during the Arab revolutions in 2011, reflecting the focus of the Council's work on military issues and the fight against insurgency and terrorism in a big way.

6. The GCC countries provided political, economic, and security support to Bahrain to eliminate the 2011 uprising, considering that the security and stability of the GCC countries is an integral part, as Saudi and UAE forces, with Kuwaiti support, entered Bahrain at the request of the then King of Bahrain (Khoja et al., 2017).

Conclusion

Regional and international conditions and challenges have contributed to creating political convergences and security and military agreements for the Arab Gulf states, which established a Gulf Cooperation Council to strengthen the military, security, and economic partnership and cooperation to meet these challenges. It sought to achieve political unity by establishing military forces for joint defense (Island Shield) and concluding
agreements for military cooperation. Still, on the economic side, the customs union, the Gulf market, and the monetary union were established to be the beginning of entry into the gulf single currency area as stipulated in the agreement (1981 in article 22). Therefore, the main political factor was the emergence of the Gulf currency zone project. It does not meet the criteria for evaluating the optimal currency area despite the decisions taken by the Council to ensure equal dealing with Gulf citizens in all GCC countries and freedom of movement approved by the Cooperation Council. These measures enable the citizens of the Natural Council to invest, establish companies, and trade shares without discrimination in the transaction. However, it did not exceed the main criteria for the specialty of the Arab Gulf states in their specialization in oil production and the lack of diversity of their production structure, as well as the disparity in inflation rates and volatility and the weakness of bilateral trade between GCC countries compared to foreign exchange with the countries of the world. Therefore, the main political factor is the first and primary catalyst for creating the Gulf single currency zone.

References


