

Lecture 15: Macroeconomics & the Gulf



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Growth, Globalization and the Gulf

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Interesting current macro questions for the Gulf

- Use of the oil windfall, as compared to 1970s
 - Consuming, vs. saving.
 - Investing at home vs. abroad
- Whether the GCC countries should / will respond by allowing appreciation against the \$
- Whether the GCC countries should / will proceed with plans for a monetary union
- And if so,
 - what will be the policy regarding external exchange rate?
 - Where will the central bank be located?
 - How will votes be allocated?
 - Will provisions be made for later entrants/exiters?

Use of the recent windfall by oil exporters, as compared to 1970s

- Public finances of the Gulf countries are sometimes secret, so it is hard to tell for sure.
- But apparently in most oil-exporting countries, less of the windfall has been spent than in the 1970s.
- Of what has been spent, more has gone to physical investments than to the conspicuous consumption of the past.
 - How much is being invested in new oil capacity?
 - Dubai has shown how to diversify into services
 - Is Saudi Arabia successfully diversifying into manufacturing?
- Of what has been saved, much is invested abroad.



Monetary Union has advantages

- Promotes trade among members, as much as tripling it, in famous estimate (Rose, 2000);
- also increases international trade overall
- Similar effects on international investment.
- Assuming a reliable anchor currency, MU .reduces inflation



Following the precedent of EMU & the € €, regional groupings around the world are discussing monetary integration

- In East Asia
- In Africa
 - Western
 - Southern
 - Eastern
- Most concretely, in the Gulf
 - with 2010 deadline



Grounds for skepticism

- While European Monetary Union exceeded the expectations of some (American economists) in some respects, it has borne out their skepticism in others:
 - Flexible rates have advantages too
 - Esp. in case of cyclical asymmetries:
Ireland needs high interest rates while Italy needs low rates .
 - EMU lacks the support of the public
 - The Stability & Growth Pact is a failure
- The political impetus for integration is not as strong in other parts of the world (e.g., Asia) as it was in Europe.



Macroeconomic principles illustrated in current Gulf history

- Signs that the Gulf economies may be overheating, as happens often in a natural resource boom
 - “Oil exporters learn to favour investment,” *FT*, Oct. 4, 2005.
 - “Dubai calls a halt to breakneck development,” *FT*, March 23, 2007.
 - “Inflation-hit Saudis plan spending curbs,” *FT*, May 9, 2007 .
- It’s been reasonable to expect appreciation against the \$
 - “The Petrodollar Peg,” Economics Focus, *The Economist*, Dec.7, 2006.
 - “GCC Revaluation Watch,” Brad Setser, Apr.3, 2007. <http://www.rgemonitor.com/blog/setser/187233/>
- Kuwait revalued unilaterally, without warning GCC partners
 - “Gulf rulers agree to keep dollar peg,” Reuters, *The Peninsula*, Qatar, Apr.18, 2007.
 - “Kuwait abandons US dollar currency peg,” *FT*, May 21, 2007.



Is UAE fundamentally well-suited for monetary integration with its neighbors?

Traditional Optimum Currency Area criteria:

- Small size and dependence on trade?
Yes, though not much with GCC
- Symmetric shocks? *Yes, with GCC*
- High labor mobility? *Yes*
- Fiscal transfer system to cushion shocks?
Within UAE?



What about high mineral export share?

- Some confusion regarding what theory says:
 - On the one hand, high tradeable/GDP share => fix (McKinnon, 1964).
 - On the other hand,
 - high terms of trade volatility – from minerals –
=> float, to accommodate external shocks.
 - OCA needs diversification, according to Kenen (1969)
- Resolution:
 - If UAE's trade volatility tends to be correlated with neighbors'
=> support for
 - common currency among members, but
 - one that is flexible vis-à-vis. \$ & €, moving with terms of trade.

Will the GCC monetary union genuinely take place (on schedule)?

- It seems unlikely, given:
 - Oman's defection
 - Apparent disagreement over whether the new currency should be pegged to the \$, vs. appreciated in response to surpluses
 - Unilateral instincts shown by Kuwait
 - Poor record of most proclaimed regional unions (monetary, economic, and political)



