Title: GCC Oil Exporters and the Future of the Dollar
Forthcoming in New Political Economy

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Abstract:

Since the early 1970s, the oil-exporting states of the Gulf Cooperation Council (GCC) led by Saudi Arabia, have played a key role in supporting the value of the US dollar by invoicing oil trade oil in dollars and by investing in US dollar reserves and securities. However, the United States' negative fiscal and current account positions have made many nervous about the sustainability of the US dollar as an international reserve currency. This article asks whether the GCC oil exporters will undermine the future of the dollar. Three factors are considered: the GCC's influence in changing the dollar-based invoicing of oil; emerging patterns in petrodollar recycling; and, the potential for diversification of GCC official reserves. The findings of this article suggest that despite some economic rationales in favour of loosening ties to the dollar, in the short term at least, the GCC will remain loyal to the dollar for political and security reasons.

Keywords: GCC, Petrodollars, Dollar, OPEC, Oil, Saudi Arabia, Gulf

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Introduction

Since the mid-1970s, the value of the United States' dollar has been upheld by a number of domestic and international factors. An often underestimated factor is that oil is sold and traded in US dollars. Arguably, having the dollar used as the 'main invoice currency' for oil makes the trade of this vital resource the new post Bretton Woods' Fort Knox guarantee of the dollar.[1] The world's continued confidence in dollar denominated and US government debt is further supported by the use of petrodollars in oil trade and petrodollar recycling in the global financial system. It is argued that states have partial faith in the value of the dollar because the world's lifeline of fuel and production is purchased and sold using petrodollars. After all, whether measured by value or volume, oil is the most traded good around the world. Consider that, in 2006, the world spent $5.5 billion per day buying crude oil.[2] In effect, the world's oil-consuming states sustain a continued and diversified demand for dollars.

The Gulf Cooperation Council's (GCC) members- Bahrain, Kuwait, Oman, Qatar, the United Arab Emirates, and (lead by) Saudi Arabia- have the largest proven oil reserves in the world and are among the world's largest oil-exporting states (See Table 1). The GCC has historically supported oil-pricing in dollars and helped to reassert the strength of the dollar in the post-Bretton Woods era. Over many years, the Gulf states have accumulated large dollar-based foreign exchange reserves. They have also recycled their petrodollar wealth through purchasing US debt and securities which kept the US dollar less vulnerable to fiscal and inflationary pressures. As oil-exporters continued to accumulate dollars in their reserves and recycle their petrodollars into dollar-based securities, they would have less interest in switching the dollar-based invoicing of oil trade and also have less interest in diversifying their official reserves with non-dollars.

With record high oil prices since 2004, the GCC oil-exporters have been experiencing impressive economic growth. For example, GCC oil earnings averaged $146billion/year in the 1997-2002 period, which more than doubled to $327billion/year in the 2002-2006 period.[3] Oil prices have risen from $20/barrel in 2001, to $60/barrel in 2006, to $130/barrel in mid-2008. If Goldman Sachs analysts' predictions of $200/barrel by end-2008 are materialized, the GCC oil earnings will propel.[4] These oil earning are translating into positive economic indicators for the Gulf. For example, the GCC's real GDP growth rates had increased on average by 3.2%/year from 1999-2002 and on average by 7.1%/year from 2003-2007.[5] The GCC's gross official reserves have also increased substantially: $53.5billion (2003); $67.8billion (2005); $388.4billion (2007); and $514.3billion (estimated 2008).[6]

Enhanced oil-earnings also mean that the six GCC states have burgeoning current account surpluses at $200 billion (2006); in comparison, China has a current account surplus of $250 billion (2006).[7] This has also meant that the GCC have sizeable foreign reserves of which, by some estimates, 60% are held in US dollars. In 2005, GCC and non-GCC oil-exporters' reserves have surpassed the savings of Asian countries (See Figure 1). Moreover, the IMF projects that, over time, oil-exporters (includes non-GCC states) will accumulate more foreign exchange reserves and Asia will acquire less.[8] These foreign exchange reserves actually underestimate the GCC's foreign savings because investment agencies outside the Central Banks, like the Abu

Dhabi Investment Authority and the Saudi Arabian Monetary Agency, professionally manage a large portion of their states' unreported foreign reserves.[9] Hence, it is estimated that the GCC had $1.6 trillion (or 225% of its GDP) to $2 trillion in foreign assets (end of 2006); of these foreign assets, it is estimated that 67% are owned by GCC governments and 33% by private individuals.[10] In comparison, China holds $1.1 trillion in foreign reserves, or 42% of its GDP.[11] Much of this GCC wealth is either earned, saved, or spent in US dollars and hence the GCC are key players in determining the future of dollar stability.

Despite the past three decades of dollar stability, in the last five years there has been a global decrease in the use of the US dollar as a medium of exchange in international trade. Moreover, the dollar's position as a reserve asset is now threatened by a new currency on the block: the Euro (For econometric results by Chinn and Frankel, See Figure 2).[12] The United States' negative fiscal and current account position today has made many nervous about the future of the US dollar as an international reserve currency and has led to the search for potential 'tipping points' where states or market actors might 'cash out' of the dollar system.[13] Some market analysts have predicted a dire and disorderly fall of the US dollar.[14] For many oil-exporters, the slow depreciation of the US dollar has also created an opportunity loss of oil revenues and has created drastic rises in Gulf inflation rates (double-digit inflation in both Qatar and the UAE). Moreover, as the exchange value of the US dollar continues to be erratic, speculators who trade oil on futures markets have reaped an increasing share of the profits made on today's high oil prices.[15] This has led some to suggest that oil-exporters may decide to invoice oil trade in Euros. Abandoning the dollar in the invoicing of oil trade could prompt capital markets and GCC states to unload their dollar-denominated securities and US dollar reserves, subsequently spiralling into an international economic meltdown.[16]

In the search for potential tipping points, this article asks will or can GCC states undermine the future of the dollar? The purpose of this article is to provide a systematic analysis of the role that the GCC states play in maintaining the value of the dollar. More importantly, this article assesses the principal economic, but more importantly perhaps, the political and security determinants of future GCC dollar loyalty. To accomplish these two objectives, this article examines three potential triggers that GCC states might have at their disposal. 1) As oil is priced in dollars, the first section of this article will provide a historical context to how the oil-exporting states, particularly led by Saudi Arabia, have played a key role in pushing for the adoption of the petrodollar. Then, this section considers whether the Gulf states would press for changing the invoicing currency of oil from dollars to another currency, such as the petroeuro. Ending the dollar-based invoicing of oil would be a colossal loss of faith in the dollar as a global reserve currency. 2) For nearly 30 years, the GCC has recycled their petrodollars by purchasing US securities and investments in the United States. This petrodollar recycling has arguably helped preserve the stability of the US dollar. In light of US public and Congressional hostility toward and suspicions of Gulf investment in the United States, the second section of this article examines whether the GCC will shy away from investing in US securities and the United States more generally. 3) The GCC have also accumulated large amounts of US dollar reserves as a result of burgeoning oil prices. Moreover, the Gulf today is undergoing a major economic transformation where Gulf policymakers are intent and keen on diversifying their economies away from a dependency on oil and where Gulf policymakers are pushing through regional integration efforts. The final section of this article assesses the prospects of the GCC maintaining their US dollar holdings in light of efforts to both diversify away from oil and efforts to fulfil their proposed monetary union.

In assessing these three potential triggers, this article will argue that in some cases the GCC is incapable of undermining the dollar, but more importantly perhaps, that the GCC is unwilling to purposefully undermine the dollar because the GCC is ultimately mindful of its precarious security situation. While there are strong economic rationales for why the GCC may find it beneficial to move away from the dollar, the reality is that there are stronger political and security rationales for why the Gulf will remain loyal to the dollar. As long as US military power in the region remains strong, and hence in the short-term at least, the Gulf will stay loyal to upholding the value of the dollar in exchange for US protection under its security umbrella.

Dollar-based Invoicing of Oil Trade

The historic decision by the Organization of Petroleum Exporting Countries (OPEC) to invoice the trade of oil in dollars can be traced back to a set of bilateral deals between the United States and Saudi Arabia (the world's largest oil exporter and producer). The first step towards this historic OPEC decision started in June 1974 with the establishment of the United States-Saudi Arabian Joint Commission on Economic Cooperation. Devised, in part, by US Secretary of State Henry Kissinger, the Joint Commission would facilitate annual meetings between Saudi Finance and US Treasury officials. This Joint Commission also included a special technical group that was staffed by American civil servants who helped US companies to increase their exports to Saudi Arabia. Financed by the Saudi government, the technical group's objectives were to improve bilateral political and commercial relations, promote export of US goods and services to Saudi Arabia, and most importantly to help recycle Saudi petrodollars through the purchase of US goods.[17]

The US-Saudi deal to recycle Saudi wealth into US government bonds would be complemented by a subsequent arrangement. Treasury Secretary Michael Blumenthal, Simon's successor, negotiated an enormously successful deal to have the Saudis sell their oil in US dollars. At the time, Saudi Arabia was the key determinant of oil prices, known as the 'oil marker', and its 'Saudi Light Crude' virtually set oil prices for OPEC and non-OPEC oil producing states.[18] As the largest OPEC producer, the Saudis used their strong influence in OPEC to persuade other members to follow suit; and they did. In 1975, OPEC announced its decision to invoice oil sales in dollars. According to David Spiro, with the US support for Saudi Arabia, the Saudis agreed to sway OPEC decisions away from invoicing oil in a diversified basket of currencies such as the IMF's Special Drawing Rights (SDR).[19]

By upholding the invoicing of oil in dollars, the Saudis also hoped for geopolitical benefits to accrue as well. Specifically, Saudi Arabia and other Arab states in OPEC wanted to be able to influence US foreign policies on the Israeli-Palestinian conflict. After all, Arab states' oil embargo of the United States in 1973 was a direct result of US support for Israel in its 1973 war with the Egyptian-led Arab armies. OPEC's Arab states hoped that by invoicing oil trade in dollars, they would have some leverage over US foreign policies toward the Middle East.[20] Oil-producing states in the Persian Gulf would increasingly have a lot at stake in prioritizing US foreign policy in the region. The Arab oil-producing states of the Persian Gulf became increasingly worried about their internal and external security after a series of momentous regional events: the 1979 Soviet invasion of Afghanistan, the 1979 overthrow of the Iranian Shah by the Islamic Revolution led by Ayotallah Khomeni, and the 1980 Iran-Iraq war. The Arab Gulf states would look to its ally, the United States, for internal and external protection.

The 1980 Carter Doctrine offered to protect the small Arab Gulf states from the potential negative political spillovers of regional conflicts. For example, the United States 're-flagged' Arab Gulf tankers to get oil safely out of the Iran-Iraq war zone. The Arab Gulf states also coalesced to form the GCC in 1981 as a reaction to the regional instability of the times. The GCC goal was to unify their collective security and economic interests.[21] Throughout the 1980s and 1990s, the Persian Gulf region continued to be fraught with geopolitical instability. The small and relatively low-populated sheikdoms of the GCC continued to support the dollar-invoicing of oil in exchange for continued US political-military protection.[22] Specifically, Saudi Arabia wanted the United States to ensure Iranian containment (which Saudi Arabia feared was trying to export its Islamic revolution into Saudi Arabia) and to prevent Iraqi transgression into Saudi oil fields.[23] Saudi Arabia, despite being relatively more populous than the rest of the GCC, also benefited from US military protection because it did not want to risk militarizing a populace that was growing increasingly critical of the state's autocratic monarchy.[24] A demonstration of this US security guarantee occurred in 1991when the US-led coalition helped to protect Saudi Arabia and liberate Kuwait from Iraq's transgressions.

The tacit agreement between the United States and the GCC, on dollar-based invoicing of oil in exchange for military protection under the US security umbrella, had worked well for all parties. However, as a result of the US invasion of Iraq and the widening war on terrorism, the US' relationship with the region has altered in recent years, leading some to question whether oil-producers would consider changing the invoicing of oil into other currencies. Indeed, among oil-producers there have been recent rumblings of discontinuing dollar-based invoicing of oil sales. One could argue that this is not new; after all, when the value of the US dollar started to decline after 1985, OPEC member states had then debated using a multicurrency asset instead of the dollar in oil pricing.[25] So why pay attention to oil-producers? Simply put, because there is now a credible alternative to the dollar: the euro.

The European Union has responded favourably to the idea of strengthening the value of the Euro, and many Asian states have supported the idea as a means of cushioning their economies against the declining US dollar.[26] Petroeuros might be welcomed news to a number of European states, because it could reduce currency risk in oil pricing, add seigniorage, protect terms of trade, and add EU political and economic weight.[27] However, Benjamin Cohen suggests that the Europeans, like the Japanese flirtation with a dominant Yen in Asia, will restrain their ambitions to retain good relations with the United States and the Europeans will not want to undermine the international stability that the greenback has offered historically.[28] Putting European views aside, a number of OPEC and non-OPEC oil producers have advocated and discussed the idea of using the euro in invoicing oil sales instead of the dollar.

OPEC members that have favoured an invoicing change in recent years have included Iraq, Iran, Libya, Venezuela, and the United Arab Emirates. Non-OPEC countries that have also supported the idea include Russia and Malaysia.[29] In November 2000, Saddam Hussein's Iraq became one of the first OPEC members to invoice oil sales in Euros under the UN Oil for Food Program. The Iraqi government used this as a political shot against the United States that, at the time, was enforcing the UN sanctions against Iraq. Selling oil in Euros had an added benefit when the Euro soon appreciated past the dollar. At the time of the US invasion of Iraq, $10 billion was held by the French bank, BNP Paribas, as part of the UN Oil for Food Program.[30] After the US occupied Iraq, the interim Iraqi government quickly returned the sale of oil to dollars.[31] In a more recent challenge to the petrodollar, in 2007, Iran announced that it would no longer accept US dollars for the sale of its oil. By April 2008, Iran's Oil Minister had announced that all of its oil sales were invoiced in currencies other than the dollar.[32] Iran has also tried to convince its fellow OPEC members to follow suit. This begs the question, if OPEC or other oil-producers decided to switch dollar-based invoicing for oil into Euros, will this end the use of the dollar in oil trade? The answer is no, because oil-producing states have lost their power to oil-markets.

Since the 1980s, there has been a marked shift in power from the oil-producing states to the oil-market. Oil-producing states and their state-controlled oil companies had assumed control of oil prices throughout the 1970s, because oil consumption grew rapidly and only Gulf production could meet the world's growing demand.[33] But by the 1980s, OPEC unity and power had weakened. The oil-markets became the new determinants of oil prices and as a result have a stronger say in what currency oil trade will be conducted. What were the historical circumstances that led to this shift in pricing power? According to Edward Morse, the shift of power from states to market was precipitated by the 1981 US decision to deregulate state control over the oil industry. Soon other industrialized countries followed suit. Once oil-consuming states had deregulated control over oil supply and oil imports, oil exporting states were forced to cede oil-pricing to the oil markets.

"One by one, foreign oil exporters discovered they had to change prices with increasing rapidity if they were to maintain market share in the United States. They gave up administered pricing and moved toward market mechanisms, and as they did so, their key competitors in OPEC became vulnerable to the same pressures."[34]

Throughout the Western industrialized states, the strength and influence of oil companies and oil markets grew. This was coupled with the fact that OPEC's share of world oil production was nearly halved as smaller and new competitors entered the production market.[35] Moreover, due to the nationalization of OPEC members' oil industries and to the advancement in upstream exploration and development technologies, oil companies had sought out new, 'frontier oil' in offshore drilling.[36] With rising oil prices, the UK and Norway had oil developments in the North Sea that were becoming increasingly more profitable by the late 1980s.

In response to the new regulatory environment and exploration developments of the 1980s, two oil markets were created: 1) the British North Sea Brent Crude (or Brent for short), traded on London's International Petroleum Exchange (IPE) until 2005 and has since been traded on London's IntercontinentalExchange; 2) the US Gulf crude, traded on the West Texas Intermediate (or WTI) operating out of the New York Stock Exchange. Oil companies now had three means of purchasing oil: a bilateral contract with an oil-exporting country, on the spot or a cash market, or through a futures contract at oil-markets. Oil-markets soon became the primary means of oil trade. How significant are these oil-markets? Consider the fact that in 2003, Brent and IPE had traded the amount of three times the actual oil produced in that same year.[37] Consequently, both of these oil-markets have taken over as the benchmark price of crude oil from the oil-producers.[38] Hence, these oil-markets became the new 'oil markers'.

Would Brent crude or IPE change to using the euro? What might prompt these oil-markets to use euros instead of dollars? As most of the oil traded at Brent Crude is refined in European refineries, some suggest that without the cooperation of Norway and the UK in pricing oil in Euros, the Brent Crude market's incentive to switch currencies remains low.[39] Consequently, some argue that the impetus to switch Brent Crude trades to the Euro could be realised if, or when, Norway (not a member of the EU) and the UK (an EU member) were to adopt the euro. This was echoed by OPEC's Head Market Analyst, Javad Yarjani, who pointed out that "...a lot depends on Britain and Norway in determining what their level of EU integration will be, and whether their marker crude, Brent, could be traded in euros"[40] Putting aside the future of European integration, this article points out that oil-markets will be less inclined to adopt the euro as long as the dollar remains the preferred currency in international capital markets. Using long-term future contracts, these oil markets are highly institutionalized and integrated in international financial markets.[41] Since the dollar is the "incumbent currency in international finance", it would be highly unlikely that the oil-markets would choose to price oil in any other currency. [42] Can oil-producers choose to invoice oil trade in one currency and the oil-markets sell oil in another currency? This is also highly unlikely, because oil-producers would then assume some currency risk with changing exchange rates.

In fact, by OPECs own account, they are unable to make a currency switch without the oil-markets. These were pointedly made by Javad Yarjani, Head Market Analyst of OPEC, in 2002:

> "Because crude oil contracts are currently traded in dollars, and the prices of OPEC crudes are determined by using complex formulas derived from marker crudes, such as Brent and WTI, there is not much the Organization can do unilaterally until, and unless, there is a switch of denomination in these markets. OPEC has no control over the quotations of these marker crudes, whereas, in the past the Organization did set the official selling prices. That has all changed with the introduction of market-related prices which saw the system change from a seller's to a buyer's market, or at least where market forces now dictate prices. Moreover, the entire infrastructure of the oil market has been based around the dollar, and that will be hard to displace." [43]

Oil-producers have lost pricing power to the oil-markets and would not want to assume currency risk to invoice oil trade in an alternate currency. Are there alternatives or competitors to the oil markets? In an interesting development, Iran created an oil market called the Iranian Oil Bourse (IOB) to trade oil in euros.[44]

The IOB is on Kish island (a free-trade zone in the Persian Gulf) and started trading petrochemicals in February 2008. Although Iranian officials had previously stated that the IOB would trade petrochemical products and not crude oil, few doubt that crude oil trading will be a key part of the IOB plan. However, if Iran were to sell all of its crude oil on the proposed IOB, this would amount to a mere 5% of world oil production.[45] Regardless, the IOB will not be a major competitor to Brent or IPE. As Robert Looney notes, Iran's attempt to create a euro based oil-market will have limited impact, because Iran cannot offer market traders a safe investment climate. Iran's government is riddled with corruption, instability, and lacks transparency. Iranian state-owned enterprises continue to dominate domestic economic activity, leaving foreign and private property rights unprotected. Finally, Iranian capital markets remain underdeveloped and foreign investment perceives Iran to have a high country risk. [46] Traders will feel safer trading oil on Brent and IPE because of Western government oversight and protection.

In summary, OPEC, Saudi Arabia, and the GCC no longer determine what currency to invoice their oil trade, because oil-pricing is determined by oil-markets.[47] The latter are highly institutionalized capital markets that prefer to deal in US dollars. Similarly, oil-producers would not be willing to incur currency risk to invoice oil-trade in a currency not used in the oil-markets.[48] While the GCC may not be capable of undermining the dollar by changing the dollar-based invoicing of oil trade, this paper examines two further possibilities: will the GCC uphold the dollar by continuing to recycle petrodollars in dollar investments and will the GCC diversify its dollar reserve holdings.

Recycling Petrodollars in US Securities and Investments

Since oil is priced in dollars and GCC oil-export companies are primarily state-owned, the Gulf states have a significant amount of petrodollars to invest and recycle. Since the 1970s, Gulf states have recycled their petrodollars in dollar-based assets and securities, particularly in US Treasury Bills, which has invariably supported the greenback. In light of recent Congressional and public anxieties over Gulf investment in the United States, this section examines the question whether the Gulf will continue to invest their petrodollars in US securities and investments.

Under the rubric of the 1970s US-Saudi forum, US Treasury Secretary William Simon made a secret agreement where the Saudis could buy US Treasury bills not yet publicly auctioned to help finance the US' growing debt.[49] A dominant view of petrodollar recycling describes the 1970s as a period when OPEC financial wealth was deposited into commercial banks and then, in turn, lent or recycled to developing oil-consuming countries. Instead, David Spiro demonstrates how the United States and the Saudis negotiated the recycling of Saudi oil dollars into the US bond market. Spiro argues that the United States had believed that the interbank market was failing and there was little faith in the international capital markets' ability to efficiently recycle OPEC oil wealth. The US government decided to unilaterally guide this recycling by selling US government debt to the Saudis.[50] The Saudis agreed to conditionally purchase US securities as long as the amount purchased was kept confidential.[51]

The petrodollar influx into US government bonds had kept interest rates low and promoted American consumer consumption, thereby keeping Americans content and stimulating non-inflationary growth. Moreover, despite the high number of dollars in circulation outside of the United States, international faith in the US dollar had remained high. Subsequently, the United States has been effectively printing money to finance its deficit, and arguably its military ventures, with little international recourse on the value of the dollar.[52] For the Saudis, petrodollars reinvested into US government bonds allowed them to avoid currency risks of conversion and gave them access to secure investment in the United States. The same economic benefits were to be realized by other Arab states in the Gulf as well as they also invested heavily into the United States.

Attempts to track the whereabouts of petrodollar investments has always been difficult, particularly in the United States because the US government has guaranteed Saudi Arabia and other GCC states some anonymity. By aggregating the amount of all oil-exporters' dollar holdings and investments in the United States, the United States had avoided breaking down holdings on an individual country basis. This had served to attract Gulf petrodollars and to help sustain the value of the dollar.[53] In a 1974 letter, Assistant Secretary of the Treasury Fred Bergsten commented on the depth of GCC investment and on the rationale behind the assurance of anonymity: "…holdings by foreign official institutions of the principal Middle East oil producing countries generally account for 90% or more of the total holdings of each of these countries. Consequently, publication of data by country would effectively disclose the holdings of the official institutions in each country."[54] Since the 1970s, with oil earnings in dollars and US promise of anonymity, GCC states have invested heavily into US Treasury bills, US banks, and US direct investment. This has helped the US financial system and the US dollar, such that when in 1979 Congress attempted to force disclosure of the GCC's assets in the United States, New York Federal Reserve Bank Chairman Paul Volcker wrote to the GAO to voice his disagreement: "It is hard to see what interest, including that of disclosure, would be served in that event but there would be obvious drawbacks from the standpoint of US financial markets and institutions, and perhaps repercussions on the dollar itself."[55] During the oil price hikes of the 1970s, the US government and the Gulf states managed to mute the debate on disclosing their holdings. After 9/11, however, there has been renewed domestic pressure on the US government to again limit, disclose, and scrutinize Gulf investment in the United States.

After 9/11, US Congressional members, officials, and pundits have blamed Saudi Arabia and their political autocracy for the rise of terrorist networks throughout the Middle East. Many have even argued that Saudi political elites helped fund Osama Bin Laden and Al-Qaeda in Afghanistan and are to blame for the 9/11 attacks. Moreover, Congressional members viewed Saudi Arabia's refusal to allow US forces to use Saudi air bases in attacking Afghanistan as yet another form of indignation. But, to Congressional members the final blow to Saudi-US relations has been the US war in Iraq, which Saudi and Gulf regimes have opposed.[56]

Congress would vet much of its anger toward the Gulf regimes in its opposition to Dubai Ports World's acquisition of the British owned Peninsular and Oriental Steam Navigation Company (P &O). In March 2006, Dubai Ports acquired P&O operation of US ports in New York, New Jersey, New Orleans, and Miami. Bending to Congressional concerns over national security, Dubai Ports sold its acquired ports to an American owner. Many have warned that GCC governments, in response to the Dubai Ports fiasco, would shy away from investing and recycling their petrodollars in the United States. To illustrate, Chairman of the National US-Arab Chamber of Commerce had noted:

> "There is a firm belief among virtually all Arab investors of my acquaintance that a definite political risk is to be assumed for any direct investment in the United States in any sector for any amount and virtually anywhere in this country. It is not a risk guaranteed to occur, like an exchange conversion problem might be in another country. It

> is a latent risk, but one that could explode suddenly and make the political and 'cultural' context so challenging as to moot the investment."[57]

Similarly, Morgan Stanley's President of the Middle East division had stated "[with] the Dubai ports fiasco, they're [Gulf investors] saying 'we don't need the hassle'".[58] A year after the Dubai Ports controversy, there has been renewed anxieties over the activities of Sovereign Wealth Funds (SWF). The UAE's Abu Dhabi Investment Authority (ADIA) is the largest sovereign wealth fund and controls approximately $875 billion in assets. Critics of SWF have warned that these government-owned investment funds would be guises for geopolitical influence in US corporate governance and US economic policy.[59] As US Treasury Secretary Henry Paulson has noted, there is increased Gulf worry about the rising tide of US protectionist sentiment in the United States.[60] Coupled with Gulf fears that their US assets may be sequestered after Congressional 'witch-hunts' on Arab investments, there is a general sentiment that the GCC are less confident in investing in the United States. With added scrutiny of GCC investments in the United States, are there shifts in GCC petrodollar recycling that could undermine the dollar?

As noted, GCC states are generally secretive about their capital outflows. US Treasury figures, moreover, greatly underestimate Gulf deposits in US securities and investments. This is because the Treasury department does not track capital that is flowing through intermediaries and third party investment managers in the United Kingdom, Switzerland, or Asia- something Gulf states have been resorting to in trying to mask the extent of their investments.[61] Of the GCC's $542billion of capital outflows, the United States is the recipient of $300billion in the years 2002 to 2006 (Table 2). Of the few estimates available, the Institute of International Finance (IIF) has broken down estimates of GCC capital outflows in US securities and investments for years 2002 to 2006 (Table 3). The IIF data shows that up to 2006, the GCC were still investing confidently in dollar-based assets. Based on market assessments, however, there are three new trends in GCC petrodollar recycling taking place in the past two years that are not yet reflected in IIF figures: 1) GCC capital surpluses are being increasingly invested in regional and domestic projects, 2) GCC capital outflows are shifting into Middle East and Asian investments, 3) GCC states are diversifying their US investments with less US securities and more global corporate acquisitions. What these new trends mean for the dollar will be discussed in turn.

One of means that the GCC have been recycling their petrodollars has been through the 'absorption channel': financing domestic investment and consumption. Consequently, the GCC states are undergoing a 'construction boom' and an era of 'megaprojects', pouring money into local infrastructure and development. GCC countries are investing heavily into domestic real estate, capital markets, tourism, health care, education, and banking, such that "only the GCC states enjoy the status of higher-rated sovereigns."[62] This is explained, perhaps, by the depreciation of local currencies and reduced external purchasing power of GCC states that are pegged to the dollar.[63] But, many within the GCC business community have argued the local investment is also being spurred by both "push" and "pull" factors: the added risk of investing in the United States, the general public opposition to the US war in Iraq, and the pressure to diversify their economies away from oil.[64] The Gulf is undergoing a slow but significant shift in carving a new identity for itself- a 'rebranding' of sorts.[65] Promoted by a young, entrepreneurial, and western-educated class of individuals, Gulf citizens are demanding that its government invest more into its people.[66] Moreover, Gulf citizens do not want a repetition of the 1970s when oil wealth was recycled into Western banks; this time, Gulf citizens are expecting their governments to invest in its their future.

A second means that the GCC have been recycling their petrodollars in recent years has been through dollar-denominated assets and securities in the Middle East and Asia. It is estimated that 11% of Gulf outward investments have gone to the Middle East and another 11% to Asia. (Table 2). Gulf investment in the Middle East, particularly in Egypt and Jordan has accelerated in the past few years. There have been high profile Gulf acquisitions of telecommunication companies and financial companies in the region. Large Gulf real estate and tourist projects are also on the rise in Egypt and Jordan. While difficult to assess and measure, the IMF has noted a surge in capital market activity in Cairo, Amman, and Casablanca, that are in most part attributed to Gulf investment in Middle East stocks.[67] As the IMF Middle East department chief noted "We see a lot more investment with hedge funds in dollars or deposits in banks in Beirut or Egypt…they haven't gone out of dollars but not holding so much treasury bills and deposits in US banks."[68] Similarly, Gulf investment in Asia, dubbed the 'new Silk Road', is also a new trend. The Dubai International Financial Center (an international finance center) has boasted that it expects GCC investment into Asia to increase to $250billion, which would account for 30% of expected outflows. [69] Besides the attractive returns on Asian investments and the increased trade and people ties between these regions, analysts suggest that the GCC investors have a higher risk tolerance for investing in emerging market economies throughout Asia. [70] Much of Gulf investment is going into Asian real estate, followed by tourism and energy sectors.[71] Indeed the GCC states are not only investing more at home and less in the United States, but also throughout the Middle East and Asia.

Finally, GCC states are no longer content with holding US securities, as they had done throughout the 1970s; today, the GCC are diversifying their US investments with less US securities and more global corporate acquisitions. The GCC are diversifying their asset preferences with nearly half in short-term US securities and the other half in corporate acquisitions and long-term US securities. In contrast, Russia directed nearly 80% of its capital outflow to short-term US securities.[72] Based on Bloomberg's database on global mergers and acquisitions, it is estimated that the GCC acquired $24billion worth of companies' shares in 2005 and a similar amount in 2006.[73] This is a remarkable increase considering that the GCC acquired only $900million in 2004 and sold company shares for negative holdings in 2002 and 2003.[74] The GCC are buying high profile companies and include hotels (Fairmont and Travelodge), financial firms (Citibank, Carlyle, and Deutsche Bank), telecom firms (CelTel, Mobitel, Turk Telecom, and PTCL), and even museums like the Tussauds Group.

What do these three trends suggest about Gulf loyalty to the dollar? Clearly, these trends will mean less GCC money is being injected into US debt which may have negative repercussions on US interest rates and overall US economic growth. The GCC states are not directly undermining the value of the dollar, but the United States' domestic sentiments have shifted petrodollar recycling away from the United States. This may lead to a negative reaction in both global financial markets and in future GCC policy decisions. In the final section of this paper, the question of what might be the future policy choices affecting the GCC's reserve holdings is addressed.

Diversification of the GCC's Official Reserves

In this section, the article considers the final GCC trigger that could undermine the US dollar: GCC diversification of its official reserves. The economic rationales for diversification are related to GCC efforts to both internally harmonize and integrate their economic policies and to diversify their oil-dependent economies. After successfully completing a customs union in 2003 and a common market in 2008, the GCC states have plans to unify their currencies by 2010.[75] This enhanced regional integration has contributed to members' impressive economic growth, enhanced external trade, and improved intraregional trade. Spurred by skyrocketing oil prices, the GCC states' official reserves are also ballooning. It has been estimated that 60% of the Gulf's asset portfolio is dollar-denominated.[76] In choosing an appropriate reserve currency strategy, GCC policymakers will likely consider a number of economic factors: the valuation of the proposed monetary union's currency, the GCC's trading patterns, and the prospects for economic diversification. These three factors are discussed in turn.

On the Gulf's monetary policies, for decades many of the GCC countries had unofficial pegs to the US dollar.[77] Depending on US monetary policy had worked well for many Gulf countries because they were 'small, open, and financially immature'.[78] However, with soaring oil prices, a falling value in the US dollar, and a current US monetary policy that is counterproductive to Gulf interests, the GCC countries' peg to the US dollar is now deemed to be a problem. In particular, inflation has become a serious domestic issue; particularly because most of the arid Gulf countries are highly dependent on food imports. Due to rising inflation, a number of GCC countries have faced domestic pressure to loosen the dollar peg. Consequently, the IMF has recommended and cautioned that unless oil-exporters adopt an exchange rate regime that better varies with the price of oil, oil-exporters will continue to face adjustment through inflation.[79] Jeffery Frankel has also suggested that the oil-exporting countries consider a peg to a basket of currencies that includes the price of oil.[80] Prominent economists, including former Federal Reserve Chairman Alan Greenspan and Nobel Laureate Professor Joseph Stiglitz, are recommending the Gulf consider a revaluation of their currencies to stem the rising tide of inflation in the region.[81] The Gulf peg to the dollar has, however, prevented these necessary economic adjustments.

Acting in their own interests, the Gulf states could loosen their peg to the US dollar and slowly shift their reserves out of dollars- or 'passive diversification'.[82] Indeed, there have been murmurs that the GCC central banks would be shifting their reserves away from dollars. For example, the UAE Central Bank Governor announced in March 2006 that it would diversify 10% of its foreign exchange holdings from dollars to euros.[83] Again, in March 2007, the CEO of the Dubai International Financial Centre suggested that the UAE would be buying more Euros and more Yuans.[84] The fear is that this activity may lead to market signalling where speculators sell-off US dollars in the global marketplace. Countless bank and market analysts have advised the GCC to consider shifting towards a more diversified reserve portfolio and an appreciation of local currencies against the dollar.[85] Whether the GCC states will continue to peg to the US dollar has become an important issue of larger systemic proportions.

Consequently, GCC monetary meetings have become closely watched events by market analysts. In preparation for the monetary union, GCC states have been trying to coordinate their monetary policies. Invariably the debate has centred on what value the proposed common currency, referred to as the *Khaleej Dinar,* ought to take.[86] While the GCC has not yet formally stated what the proposed *Khaleej Dinar* will be pegged to, all indications point to the dollar.[87] Most GCC governments have argued that continuing the proposed pegging of the *Khaleej Dinar* to the US dollar is beneficial because oil receipts are already billed in US dollars. Analysts warn, however, that this could artificially depreciate the *Khaleej Dinar* when the US economy is strong since GCC and US economic growth are negatively correlated.[88] This type of vulnerability has been highlighted in recent years as the dollar experienced real depreciation and oil prices showed real appreciation. Moreover, when examining future GCC trading patterns, there are stronger economic arguments to be made in support of having the proposed *Khaleej Dinar* to be closely aligned to the euro or to a diversified basket of currencies as opposed to the dollar.

Oman was the first of the GCC countries to bend to domestic pressure against the dollar peg. To the surprise of many, in December 2006, Oman announced that it would not be able to meet the terms of the proposed common currency. Many believed that Oman removed itself from the currency union to eventually anchor its currency to the Euro or a basket of currencies instead of the depreciating dollar. [89] Similarly, in May 2007, Kuwait decided to end its peg to the dollar and to revert to using a basket of currencies. Both countries are diversifying their economies and have suffered high import prices from its peg to the dollar. While other countries have not followed suit, internal pressure on policymakers to reconsider their dollar pegs have continued to mount. Bahrain's finance minister, in December 2007, reportedly told the Bahraini legislature that Bahrain needed to consider de-pegging from the US dollar.[90] In January 2008, a prominent chief economist of a partially state-owned Saudi bank also called on the government to consider a currency revaluation in an effort to stem rising inflation.[91] In that same month, Qatar's oil minister and deputy prime minister suggested that Qatar would be reconsidering its peg to the dollar.[92] While denied by GCC members, most analysts would argue that due to continued inability of the members to agree on a valuation of the common currency and current troubles with pegging to the dollar, meeting the common currency deadline of 2010 now appears to be highly unlikely.

In choosing an appropriate reserve currency strategy, another economic consideration that GCC policymakers will likely consider will be its future trading patterns. Currently, the GCC trades mainly with Europe and Asia, and only 10% of its imports come from the United States (See Figure 3). As the Euro continues to appreciate relative to the dollar, as it has since 2002, importing from Europe continues to be more expensive for GCC states and less competitive for Europe.[93] There is good reason for the GCC states to closely align their currency with Europe as opposed to the United States. After all, the EU is the second largest investor in the Gulf States (ahead of Japan and second to the United States), the Gulf States invest heavily in Europe, and Europe is the largest export market for GCC petroleum goods.[94] Moreover, cross-investment between the EU and the GCC is growing and diversifying beyond petroleum products at faster rates than between the US and the GCC.[95]

While the United States has signed bilateral free trade agreements with two of the smaller GCC members (Bahrain and Oman), these are likely to produce a hub and spoke trading arrangement and will have a minimal effect on US-GCC trading patterns.[96] Moreover, the Saudis have viewed these US bilateral free trade agreements as threats to their hegemony in the region and their response has been to anxiously promote GCC integration.[97] The US bilateral agreements with the smaller GCC members are not expected to improve bilateral trading relations or foster stronger trading ties with the United States. On the other hand, the EU-GCC trading relationship has been strong and will intensify as a free trade agreement is expected to be signed in 2008. The EU-GCC free trade agreement will cement strong complementary trading patterns in manufactured goods and may in the long term improve ties in services, banking, and portfolio investments, where there is a strong potential for growth, but which remain off the table for now.[98] The future of GCC trading relations will be an important consideration in GCC policymakers' strategy in optimizing its reserve currencies.

Prospects for economic development in the Gulf are a final factor that GCC policymakers will likely consider in choosing an appropriate reserve currency strategy. The GCC today is undergoing a notable shift in its economic orientation. While the region's trade structure is currently dependent on oil, GCC states are trying to become more diversified as oil exports diminish.[99] Oil reserves are drying up; in the cases of Bahrain, Oman and Qatar, for example, this may occur within the next twenty years. GCC states are intent on diversifying their economies in an effort to move away from a dependency on oil. Consequently, GCC states have been liberalizing their domestic regulatory space, joining the World Trade Organization, and supporting private sector investment. Take United Arab Emirates' recent efforts to diversify its economy, where the Emirates are trying to make their arid and sparsely populated state into a commercial, service, real estate, and banking hub that will act as a conduit between the Eurozone and Asia. How useful to realizing diversification away from oil will it be for the GCC to remain pegged to the US dollar? In an effort to realize diversification, there will continue to be domestic pressure on the GCC states to diversify its reserve holdings and slowly anchor their common currency to a diversified basket of currencies with a more significant euro holding. Again, this is also in light of GCC efforts to promote stronger intraregional integration and to enhance economic ties with Europe and Asia.

Why have the GCC authorities not stated a switch to another anchor, like the Euro? It is argued that the GCC authorities will continue to politically support the US dollar for the continued US military protection in an unstable and volatile region. While there are viable currency alternatives to the US dollar, there are no alternatives to the US military security umbrella or to the US' 'emirates strategy' of defending Gulf monarchs.[100] The EU remains strategically divided and militarily limited with respect to being able to show dominance or offer protection in the Gulf.[101] The GCC's decision on what currency to peg the proposed *Khaleej Dinar* will have more to do with Gulf security than with economics.[102] The Gulf region remains highly volatile with an unstable Iraq, a fragile Afghanistan, a hard-line Iran, an unresolved Israeli-Palestinian conflict, and the rise of radical Islamists in Saudi Arabia and neighbouring countries. The GCC's public authorities remain highly dependent on the United States for both internal and external security that cannot be replaced by the EU 'civilian power'. Until geopolitical stability is achieved, the GCC will peg their proposed currency to the dollar. As the recent split of Oman from the currency union and the Kuwaiti return to a basket peg may have demonstrated, the GCC will be facing tough choices about whether the GCC's economic decisions will be more influenced by geopolitics or by economics.

Conclusion

In answering the overarching question of this paper, it is argued that the GCC states are on the one hand incapable, and the other unlikely, to directly undermine the future of the dollar. This was examined through three possible GCC points of leverage: dollar-based invoicing of oil, recycling of petrodollars, and reserve holdings.

First, the GCC states, led by Saudi Arabia, have lost control over oil-invoicing to oil markets, a trend that started in the early 1980s. In the 1970s, the Saudis, as a key member and arguably the 'oil-marker' of OPEC, played a pivotal role in ensuring that oil-pricing was set in US dollars. Similarly, GCC states were supportive of oil pricing in dollars in exchange for protection provided by the US security umbrella. In recent years, Iraq and Venezuela have mildly challenged oil-pricing in dollars, but Iran's plan for an oil bourse was a challenge to undermine the pricing system. That said, Iran's underdeveloped capital market system and poor governance structures will keep many investors away from using the proposed bourse. Saudi Arabia, perhaps the most influential OPEC member, has supported the status quo. Moreover, OPEC strength in oil markets has greatly diminished since the 1970s with the introduction of Russia, Norway, and offshore UK drilling into the market. As power shifted away from OPEC and states, oil-pricing control moved into the hands of oil future markets. As long as the financial capital markets still trust the value of the US dollar, it is unlikely that oil markets will make the switch to pricing in euros.

Second, the GCC states have traditionally supported the greenback through recycling petrodollars into US securities and investments. In recent years however, US-GCC relations have deteriorated. Despite a friendly US president, one could argue that relations will likely continue to deteriorate with the next US administration, which may be less friendly to Gulf interests than President Bush has been. While the GCC economies have been growing and current account surpluses mounting, there is a clear shift in where GCC states are recycling their petrodollars. Due to the perceived negative US domestic reaction to Gulf investment in the United States, the GCC states are shifting petrodollar recycling away from US securities and investments to other investments in the Middle East and Asia, to intraregional investment, and to acquisitions of global companies. This may provoke problems in the future value of the dollar if GCC states are shying away from recycling dollars into US securities. If there are fewer clients willing to buy the US' debt, there will be further erosion in the confidence placed in the dollar but, it is likely not going to be a political calculation on the part of the GCC.

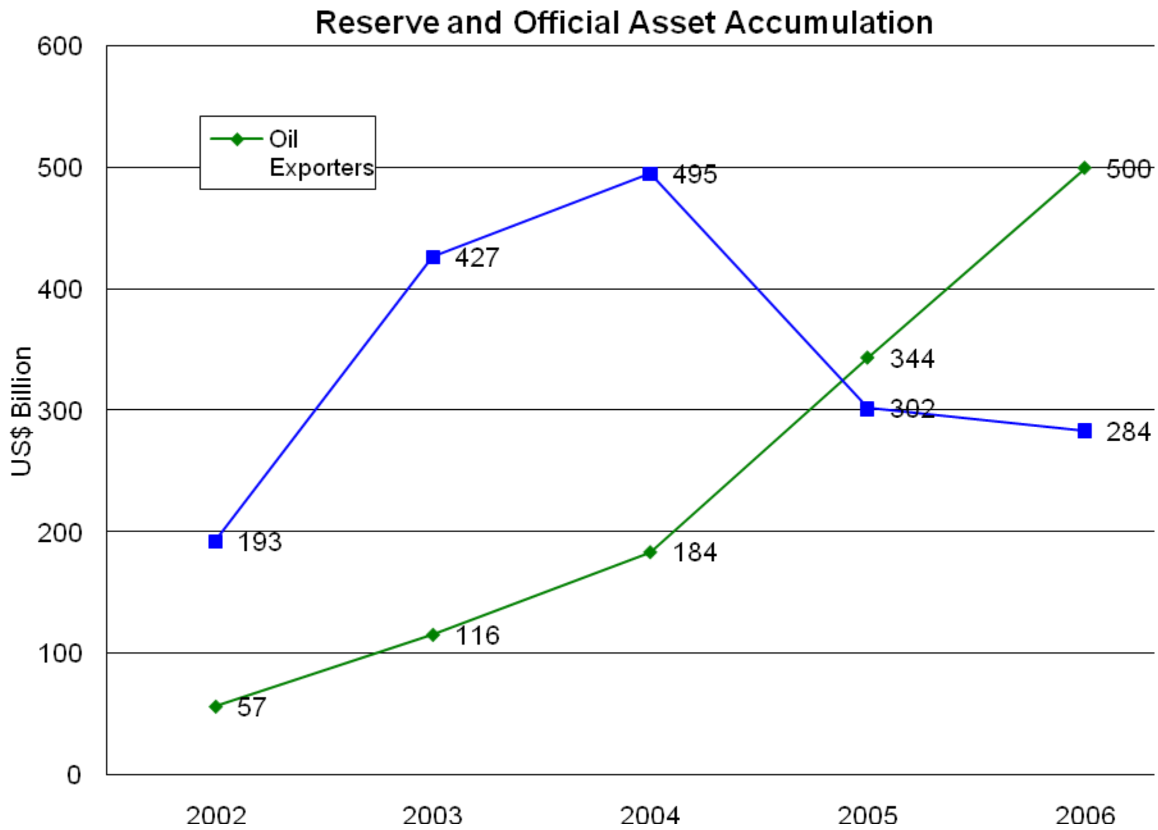
Third, the future of GCC reserve holdings look to be more diversified as the region is enhancing trade ties with Europe and Asia, and undergoing a reorientation of their economies away from oil. GCC decisions about what their future common currency will be pegged to will be a key factor in determining further GCC policy choices. Strong economic arguments can be made for why the GCC states would prefer a *Khaleej Dinar* that is closely aligned with the Euro as opposed to the dollar. Oman and Kuwait's recent decisions to break away from the currency union demonstrate the soundness in moving away from a dollar peg. However, the US security umbrella remains a decisive factor for why GCC states and, in particular Saudi Arabia, which is most threatened internally and externally and which leads the GCC, would not give up on the greenback and why GCC public authorities would keep with pegging their currency to the dollar. Again, there may be long-term pressures to diversity the *Khaleej Dinar* away from the dollar toward the Euro, as trade links with Europe are enhanced. For now, the GCC will stay loyal to the dollar to preserve its internal and external security. Geopolitics, rather than economics, will dictate Gulf dollar loyalty.

Table 1: Top World Oil Net Exporters, 2006 (thousand barrels per day)

Country	Thousand Barrels per day	Percentage of Top 15 Oil Net Exporters
Saudi Arabia	8525	21%
Russia	6866	17%
United Arab Emirates	2564	6%
Norway	2551	6%
Iran	2462	6%
Kuwait	2340	6%
Venezuela	2183	5%
Nigeria	2131	5%
Algeria	1842	5%
Mexico	1710	4%
Libya	1530	4%
Iraq	1438	4%
Angola	1379	3%
Kazakhstan	1145	3%
Qatar	1032	3%
Total (Top 15)	39698	100%

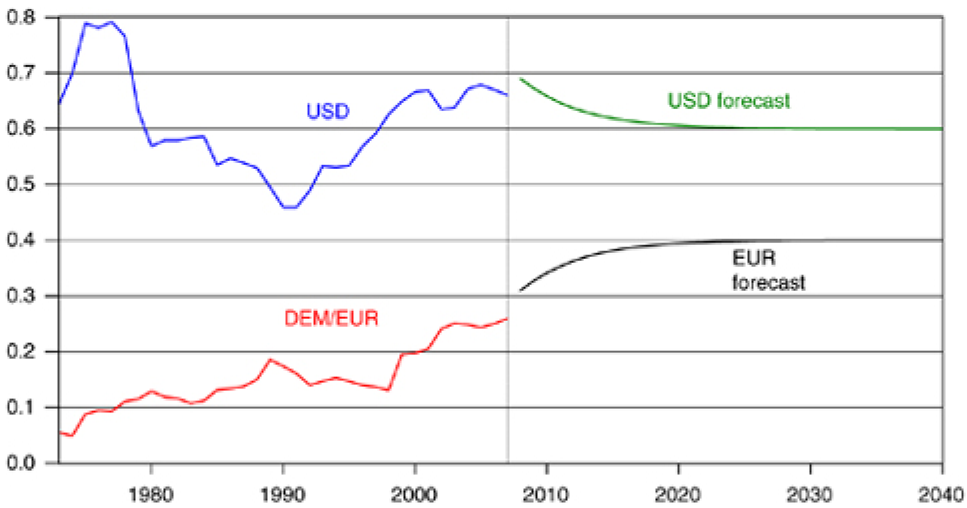
Reference: Energy Information Administration, Country Energy Profiles
http://tonto.eia.doe.gov/country/index.cfm

Figure 1: Oil Exporters versus Asian Official Reserves



Reference: Petrodollars, Asset Prices, and the Global Financial System, Ramin Toloui, Capital Perspectives, PIMCO, January 2007

Figure 2: Forecasting the Dollar versus the Euro*



*based on accession countries that join European Monetary Union in 2010, but the United Kingdom does not join and "currencies depreciate at the 20-year rate experienced up to 2007"

Taken from: Menzie Chinn and Jeffrey Frankel, 'Why the Euro Will Rival the Dollar'. *International Finance* 11 (1), 49-73.

Table 2: GCC Estimated Geographical Distribution of Capital Outflows, 2002-2006 (billions of dollars)

U.S.	300
Europe	100
Middle East and North Africa	60
Asia	60
Other	22
Total	*542*

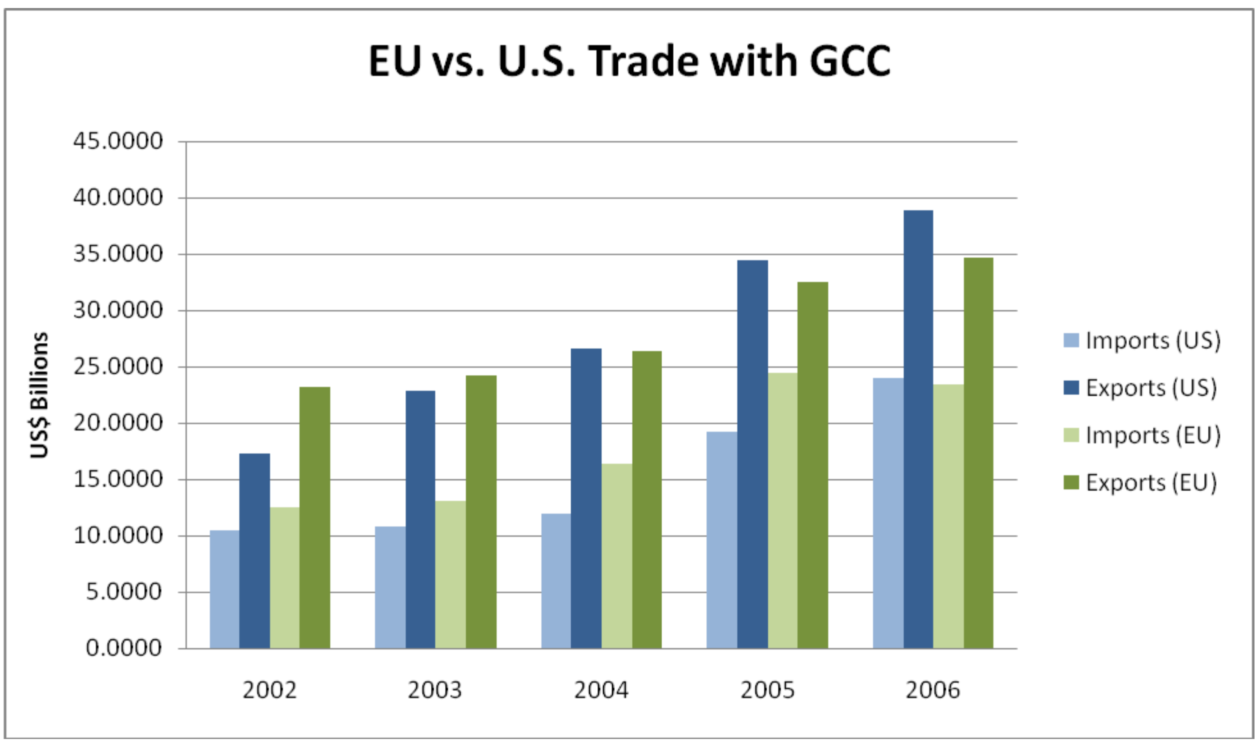
Source: Regional Briefing Gulf Cooperation Council: Tracking GCC Petrodollars, The Institute of International Finance Inc., May 2007

Table 3: GCC: Tracking the Disposition of the Current Account Surplus (billions of dollars)

	2002	2003	2004	2005	2006	Total
Current Account Surplus	***25***	***53***	***89***	***167***	***208***	***542***
Change in U.S. equity holdings	-7.8	5.5	23.4	13.8	29.5	64.4
Change in long term U.S. debt	14.4	-13.1	6.9	18.7	41.4	68.3
Change in short term U.S. debt	2.0	8.6	5.3	6.1	23.5	45.5
Change in net U.S. bank deposits	0.8	3.6	-1.0	-0.6	-1.9	0.9

Source: Regional Briefing Gulf Cooperation Council: Tracking GCC Petrodollars, The Institute of International Finance Inc., May 2007

Figure 3: GCC Trade with the US and EU



Source: US Census Bureau, Foreign Trade Investment, 2008.

NOTES

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[11] International Institute for Finance. Regional Briefing Gulf Cooperation Council, 31 May 2007. http://iif.com/emr/emr-af

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[15] The IMF has also argued that the high oil prices cannot be explained by the 'fundamentals' and points to market speculators as a key factor in higher prices. See IMF. *Regional economic outlook* , 2008. p. 27.

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[18] Edward Morse, 'A New Political Economy of Oil?,' *Journal of International Affairs*, Vol. 53, No. 1 (Fall 1999), p.4.

[19] David E. Spiro, *The hidden hand of American hegemony: petrodollar recycling and international markets* (Ithaca, NY:Cornell University Press, 1999), pp. 105-126.

[20] Musa Essayad and Donald Marx, 'OPEC and optimal currency portfolios,' *Oil, Gas, and Energy Quarterly*, Vol. 49, No. 2 (2001), pp. 363-384; See also Oystein Noreng, 'Oil, the Euro, and the Dollar,' *Journal of Energy and Development,* Vol. 30, No.1 (2004), pp. 53-80.

[21] See Bessma Momani, 'Reacting to Global Forces: Economic and Political Integration of the GCC' *Journal of the Gulf and Arabian Peninsula Studies,* January 2008.

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[23] Gregory Gause, 'Relations between the Gulf Cooperation Council States and the United States,' *Gulf Research Center*, Dubai, 2004.

[24] Simon Bromley, 'The United States and the Control of World Oil', *Government and Opposition,* Vol. 40, No. 2 (2005), p. 244.

[25] Essayad and Marx, 'OPEC and optimal currency portfolios', pp. 364-384.

[26] Essayad and Algahtani, 'Policy Issues Related to Substitution of the US Dollar in Oil Pricing', p.72.

[27] See Noreng, 'Oil, the Euro, and the Dollar', pp. 53-80;

[28] Benjamin Cohen, 'The Geopolitics of Currencies and the Future of the International System,' Paper prepared for a conference on *The Geopolitics of Currencies and Oil*, Madrid, 7 November 2003, pp. 18-19.

[29] Russian President Putin first alluded to the idea of using petroeuros instead of petrodollars in 1999 during an EU meeting in Helsinki, and again in a news conference with the German Chancellor in Yekaternburg in 2003. In the later meeting, Putin remarked: "We do not rule out that it [petroeuro] is possible. That would be interesting for our European partners…but this does not depend solely on us. We do not want to hurt prices on the market," quoted from Catherine Belton, 'Putin: Why not price oil in Euro?,*' Moscow Times*, 10 October 2003, p. 1.

[30] William Clark, *Petrodollar Warfare: Oil, Iraq and the Future of the Dollar* (Gabriola Island: New Society Publishers 2005), p.31.

[31] As US rationales for war in Iraq have continued to be exposed for naught- weapons of mass destruction, Iraqi connection to 9/11, spreading democratization in the Middle East- radical critics have charged that the real motivation behind the war in Iraq was to prevent other OPEC members from also selling oil in euros; see Clark, *Petrodollar Warfare: Oil, Iraq and the Future of the Dollar,* p. 31.

[32] 'Iran Ends Oil Transactions in US Dollars,' *The Associated Press,* 30 April 2008.

[33] Gause, 'Relations between the Gulf Cooperation Council States and the United States', pp. 17-18.

[34] Morse, 'A New Political Economy of Oil?', p. 13.

[35] Kamran Dadkhah, 'Futures market for Crude Oil,' in Siamack Shojai and Bernard S. Katz (eds), *The Oil Market in the 1980s* (New York: Praeger, 1992), pp. 210-211.

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[37] Elitza Mileva and Nikolaus Siefried, 'Oil Market Structure, Network Effects and the Choice of Currency for Oil Invoicing', *Occasional Paper Series* (Frankfurt: European Central Bank 2007).

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[39] Robert Looney, 'A Euro-Denominated Oil Bourse in Iran: Potential Major Force In International System?,' *Gulf Research Centre*, Dubai, 2006, p. 8; Noreng, 'Oil, the Euro, and the Dollar', p. 40.

[40] Javad Yarjani, Head of the Petroleum Market Analysis Department, OPEC, 'The Choice of Currency for the Denomination of the Oil Bill', Speech given at Oviedo, Spain at a meeting on *The International Role of the Euro*, convened by the Spanish Minster of Economic Affairs, 14 April 2002.

[41] Mark Irvine, 'Long Shot: The prospects for a Conversion to Euro Pricing in Oil Markets' *Elements* (Spring, 2005).

[42] Mark Irvine, 'Long Shot: The prospects for a Conversion to Euro Pricing in Oil Markets'.

[43] Yarjani, 'The Choice of Currency for the Denomination of the Oil Bill.'

[44] Iran has already started to trade oil in Euros in bilateral contracts with the EU and has a $70 billion gas deal with China (the second largest oil-consumer), but pricing remained set in US dollars. In December 2006, Iran also announced that its Central Bank would replace all dollar assets and future foreign transactions with euros.

[45] Looney, 'A Euro-Denominated Oil Bourse in Iran: Potential Major Force In International System?' p. 8.

[46] Looney, 'A Euro-Denominated Oil Bourse in Iran: Potential Major Force In International System*?*' p. 8.

[47] It should be noted that because oil-pricing is more market based, the kind of state bargains used to decrease oil prices are now less successful and that oil markets are more vulnerable to political crises and risk in oil producing states. So, oil markets can lead to steep increases in oil prices despite consistent supply because risk is factored into oil prices.

[48] Irvine, 'Long Shot: The prospects for a Conversion to Euro Pricing in Oil Markets'.

[49] Spiro, *The hidden hand of American hegemony: petrodollar recycling and international markets*.

[50] Spiro, *The hidden hand of American hegemony: petrodollar recycling and international markets*, p.37.

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[52] See Looney, *A Euro-Denominated Oil Bourse in Iran: Potential Major Force In International System?*' p. 8.

[53] See Government Accounting Office (GAO), 'The US-Saudi Arabian Joint Commission on Economic Cooperation', (Washington, DC: US GAO, 22 March, ID 79-7, 1979).

[54] GAO, 'The US-Saudi Arabian Joint Commission on Economic Cooperation', p. 36.

[55] GAO, 'The US-Saudi Arabian Joint Commission on Economic Cooperation', p. 48.

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[64] See 'Gulf Investments and Its Trends,' *Gulf Industrial Bulletin* (Doha: GOIC 2006), available at http://www.goic.org.qa/relatedDocs/GIB/GIB66_E.pdf

[65] See Andrew Cooper and Bessma Momani, 'The Challenge of Re-branding Countries in the Middle East: Opportunities through New Networked Engagements versus Constraints of Embedded Negative Images,' Paper presented to the *International Studies Association Annual Conference*, San Francisco, March 2008.

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[68] Moin, 'Gulf Cooperation Council Goes for Growth,'

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[70] EIU, 'Near East meets Far East: the rise of Gulf investment in Asia'. p.5.

[71] EIU, 'Near East meets Far East: the rise of Gulf investment in Asia'. p.7.

[72] Ramin Toloui, 'Petrodollars, Asset Prices, and the Global Financial System' Capital Perspectives, PIMCO, January 2007, p.6.

[73] 'Regional Briefing Gulf Cooperation Council: Tracking GCC Petrodollars', The Institute of International Finance, May 2007. p. 4. http://iif.com/emr/emr-af/

[74] 'Regional Briefing Gulf Cooperation Council: Tracking GCC Petrodollars'. p.4.

[75] Ugo Fasano and Zubair Iqbal, 'Common Currency,' *Finance and Development*, Vol. 39, No. 4 (2002), are optimistic that with added institutionalization, like the creation of a regional central bank, the GCC's currency unification should produce positive results. For GCC currency unification to succeed, as some economists have argue, the GCC needs to liberalize capital and labour mobility, have flexible prices and wages, and have a fiscal transfer system; see 'Lyons Raises Doubts over GCC Common Currency,' *Middle East Economic Digest (MEED),* Vol. 50, No. 6 (2006), p. 24.

[76] See Brad Sester, 'The Case for Exchange Rate Flexibility in Oil-Exporting Economies', *Policy Brief*, Peterson Institute for International Economics, November 2007.

[77] Kuwait which had used a basket of currencies, aligned its currency closer to the dollar in preparation for the currency union in 2003 and then again de-pegged its currency in 2007.

[78] 'The Dollar: Time to break free' *The Economist*, 22 November 2007.

[79] 'Regional Economic Outlook: Middle East and Central Asia,' *IMF Working Paper*, IMF, Washington, D.C., 2006, p. 3.

[80] Jeffrey Frankel, 'A Proposed Monetary Regime for Small Commodity Exporters: Peg to the Export Price', *International Finance*, Vol. 6, No. 1 (March 2003), pp. 61-88.

[81] See 'UAE Rejects calls to drop the dollar,' *Khaleej Times*, 29 February 2008

[82] See Economist. 'Countdown to lift-off,' *The Economist*, 22 November 2007.

[83] Outside the GCC, moreover, Syria also announced that it would use euros in government transactions as opposed to dollars and a number of other Middle East central banks hinted of adopting similar policies in reaction to the failed ports deal. See Philip Thornton, 'Arab central banks move assets out of dollar,' *The Independent*, 14 March 2006.

[84] Veronica Brown. 'DIFC CEO sees more Gulf FX moves away from dollar' *Reuters*, 25 March 2007.

[85] See Sester, 'The Case for Exchange Rate Flexibility in Oil-Exporting Economies'; Gerard Lyons, 'Middle East must loosen ties to the dollar,' *The Financial Times*, 6 December 2007.

[86] The name for the proposed currency has yet to be decided upon. Some media reports have referred to it as the Khaleej Dinar, although this will be a contested term.

[87] 'Regional Currency Areas and the use of Foreign Currencies,' *BIS Papers*, No. 17 (2003), available at http://www.bis.org/publ/bppdf/bispap17.pdf

[88] Emilie Rutledge, 'Gulf Monetary Union is a cracking project?,' *Gulf News*, 16 December 2006; See also Menegatti and Setser, ''Are GCC Dollar Pegs and Impediment to Global Adjustment? And Does Pegging to the Dollar Make Domestic Sense?'

[89] Gaurav Ghose, 'UAE Doubts union deadline,' *Gulf News* 18 December 2006; see also Rutledge, 'Gulf Monetary Union is a cracking project?'.

[90] Mohammed Abbas, 'Bahrain to ditch dollar peg, report claims' *Reuter*, 11 December 2007.

[91] Andrew England, 'Saudis urged to revalue riyal' *The Financial Times*, 13 January 2008.

[92] Simeon Kerr, 'Qatar considers dropping dollar peg' *The Financial Times*, 30 January 2008.

[93] Oystein Noreng, 'Oil, the Euro, and the Dollar,' Journal of Energy and Development 30/1 (Autumn 2004) pp: 53-80.

[94] Henner Furtig, 'GCC-EU Political Cooperation: Myth or Reality?' *British Journal of Middle Eastern Studies*, Vol. 31, No. 1 (2004), p.30.

[95]Furtig, 'GCC-EU Political Cooperation: Myth or Reality?' p. 30.

[96] Bessma Momani, 'A Middle East Free Trade Area: Economic Interdependence and Peace Considered,' *World Economy*, Vol. 30, No. 11 (2007), pp. 1682-1700.

[97] Bessma Momani, 'Reacting to Global Forces: Economic and Political Integration of the GCC,' *Journal of the Gulf and Arabian Peninsula Studies*, Vol. 38, No. 128 (2008).

[98] Agata Antkiewicz and Bessma Momani, 'Pursuing Geopolitical Stability through Interregional Trade: The EU's Motives for Negotiating with the Gulf Cooperation Council (GCC)', *CIGI Working Paper* 31, Waterloo: Centre for International Governance and Innovation, 2007.

[99] Daniel Hanna, 'A New Fiscal Framework for GCC Countries Ahead of Monetary Union,' *International Economics Programme* Vol.6, No. 2 (2006), p 7.

[100] See Marc O'Reilly and Wesley Renfro, 'Evolving Empire: America's 'Emirates' Strategy in the Persian Gulf', *International Studies Perspectives*, Vol. 8, No. 2 (2007), 137-151.

[101] Furtig, 'GCC-EU Political Cooperation: Myth or Reality?', p. 30.

[102] Eckart Woertz, 'The Role of Gold in the Unified GCC Currency,' *Gulf Research Centre*, Dubai, 2005.