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Recent Tendencies in the International Monetary System and their Impact on Oil Producing Countries (with Emphasis on the Gulf Cooperation Council Member States)*

Najnowsze tendencje w międzynarodowym systemie walutowym oraz ich wpływ na producentów ropy naftowej (z uwzględnieniem krajów zrzeszonych w Radzie Współpracy Zatoki Perskiej)

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Abstract

The article analyses recent tendencies in the monetary system with an emphasis on events taking place in the Gulf Cooperation Council (GCC) member states. The importance of these countries goes far beyond oil deliveries as their surpluses stemming from oil export have become a key pillar in financing the US current account deficit. As these plans are under preparation, different proposals regarding the exchange rate regime are discussed. Countries that would be most interested in GCC plans are other oil producers and members of OPEC in particular. They share the same goals and are considering alternative solutions for both oil invoicing and currency portfolio of their surpluses. Therefore, questions are raised about the ability of the new money to become the currency for both invoicing and investing for these states.

Keywords: currency union, oil prices, international monetary system
JEL: E42, E58, F31, F33, N20, N24

Streszczenie

Artykuł analizuje najnowsze tendencje w systemie walutowym z uwzględnieniem dylematów, przed którymi stoją kraje tworzące tzw. Gulf Cooperation Council. Ich znaczenie dla gospodarki światowej już nie ogranicza się do dostaw ropy, gdyż ich nadwyżki pochodzące z handlu ropą w dużym stopniu finansują deficyt na rachunku obrotów bieżących USA. Zważywszy, że nadal trwają prace nad tą unią, w tekście omawiane są możliwości wyboru różnych rozwiązań dla nowej waluty. Wśród krajów, które powinny być najbardziej zainteresowane planami krajów GCC, są pozostali producenci ropy, zwłaszcza ci zrzeszeni w ugrupowaniu OPEC. Tekst jest próbą odpowiedzi na pytanie, czy nowy pieniądz będzie alternatywą dla USD w zakresie jego funkcji zarówno jako waluty kwotowania, jak i waluty inwestycyjnej.

Słowa kluczowe: unia walutowa, ceny ropy, międzynarodowy system walutowy

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1. Introduction

The main aim of this article is to review recent tendencies in the international monetary system (IMS). The focus of attention will be put on oil producers (mainly major OPEC members) as they are becoming an important contributor in financing the US current account deficit. As oil is still invoiced in the US dollar, there are reasons to believe that the special relationship between the oil producers and the US current account deficit should be preserved. However, is it desirable to preserve the so called petrodollar peg – which means, in this particular case, a monetary framework consisting of domestic currencies being tied to the US dollar. By having their currencies pegged to the US dollar, the current stance has far reaching consequences for both invoicing oil prices and investment strategies of surpluses deriving from oil trade. This article is an attempt to present reasons why it is neither in the interest of oil producers nor the global economy to prolong the existence of this kind of peg. The article is divided to three parts. The first part presents a brief description of the most relevant events taking place in the IMS. The second focuses on efforts undertaken by the Gulf Cooperation Council (GCC) member states aimed at launching a common currency. Reasons behind this initiative will be presented along with the assessment of the feasibility of accomplishing the ambitious target set by the GCC states. Finally, the impact of the GCC states' initiative on the remaining oil producers and members of the IMS will be presented.

2. Trends in the IMS

In March 1973, following the suspension of almost all activities on foreign exchange markets for a few weeks, exchange rates of the major currencies were floated letting the demand and supply set their external price. This unprecedented move was a consequence of failed attempts to revitalize the Bretton Woods system following its demise once the US President Richard Nixon suspended the convertibility of the US dollar into gold on 15 August 1971. The flotation of exchange rates was widely believed to be a temporal decision aimed to let the market set a fair value for each of the currencies. Once this fair value was found, it was widely believed that the exchange rates would be locked once again (Copeland 1994). That never happened and the floating regime has been preserved until now. Among the reasons behind an inability to return to fixed exchange rates was the first oil shock which hit the global economy in the autumn of 1973. In the wake of this external shock, monetary authorities in the major IMS participants, had to concentrate on preserving internal equilibrium of their economies. That could happen only at the expense of external equilibrium leaving no room for any global cooperation aimed to restore the regime of fixed exchange rates To make things worse, the emergence of oil producers with their enormous surpluses inflicted further instability as their switch out of the dollar (just for the same reasons which brought about the first oil crisis) only increased volatility on the markets. Currency preferences of oil producers started to exert influence on the behaviour of some of the exchange rates. A good illustration of the above mentioned trends is the performance of the pound sterling which became the favourite investment currency of oil producers at a certain time. This fact was probably the key factor in delaying the much needed adjustment of the British currency at the turn of 1974 and 1975 (Pietrzak 1984).

After a third of century gone, oil producers are again emerging as decisive players in the IMS (IMF 2006). The fortunes of current system seem once more to hinge on the US current account deficit or rather the ability to finance it. Therefore, more and more economists tend to compare the current system with what used to take place in the IMS in the late sixties of the previous century. That is why, it is very common to describe the current episode in the history of the IMS as the Bretton Woods 2 system (BW2), even in spite of differences in exchange rate regimes and adjustment processes between the two episodes. The US current account deficit has approached levels close to 6.0% of GDP which amounts to something less than USD 900 billion. In the last ten years, three different episodes can be distinguished during which different agents were helping to cover this deficit. Until the turn of the centuries, it was the unprecedented performance of the US economy and its ability to attract FDI and other capital flows which made the process of financing this deficit possible (which at that time stood at approximately 4% of GDP). During the first few years of the new century the emergence of Asian central banks made it possible for the trend to continue. Originally it was Japan, quickly followed by other countries and China in particular, to purchase significant amount of the US dollar denominated assets. The foreign reserves of these countries rose to unprecedented levels (with Chinese reserves breaching a psychologically important barrier of USD 1,000 billion last October 2006 and the latest figures pointing at an astonishing USD 1,200 billion). The zealous approach towards buying American assets was brought about by the fear of seeing Asian currencies again becoming overvalued. By purchasing this significant amount of the US assets, the monetary authorities not only prevented domestic currencies from excessive appreciation but exposed themselves to fierce criticism because of not having taken on an appropriate burden of the adjustment. This criticism comes mainly from Europe and the USA. The former argues that by not letting their currencies to appreciate, it is Europe which is solely taking the whole burden (stemming from the falling dollar) on her shoulders. The latter believes that almost endless purchases of the US dollar assets prevent the US currency from depreciating towards levels which could prove helpful in boosting the US export and thus reduce the US deficit.

This criticism regardless of the source of its origin seems to be biased. An eventual appreciation of Asian currencies could generate a significant slowdown of these economies and it is rather questionable that the slowdown is a better option for the global economy once it is compared with what is presently taking place across the world. Last but not least, Asian purchases prevented the US dollar from an abrupt downward adjustment whose consequences would be extremely negative for the whole system. This kind of logic falls on "deaf ears" of all the important Washington based lobbies, which are still pointing at China as their favourite scapegoat. Most importantly, continuous pressures on China are even more surprising as Asian economies are no longer the key agent in financing the US deficit (The Economist 2006).

The threefold increase in the price of oil between 2002 and 2006 – although little felt from the point of view of inflationary pressures so far – seems yet again to have far reaching consequences for the way current IMS is working on (The Economist 2007). In 2001, the cumulative oil producers' surpluses amounted barely to one fifth of the US account deficit (Toloui 2007). Five years later the same proportion has increased towards two thirds of the whole current account. Therefore, oil producers became the key element in prolonging the existence of what is called the BW2.

There are reasons to believe that the majority of oil producers (mainly based in the Middle East) may be interested in prolonging the existence of the BW2. After all oil is still being invoiced in the US dollars and judging upon the history nothing points in the direction of altering it. Even a hardly foreseeable decline of the strength of the US economy would not prevent a global use of the American currency. The British pound preserved its dominant position in the IMS until the early fifties and that in spite of the UK economy having been outpaced by the American economy at the beginning of the 20th century. The efficiency and high degree of the US financial market are yet another reason for justifying the thesis about the US dollar's potential to preserve its dominant position in the IMS. During the last 35 years there was at least one moment when the OPEC members were considering a switch from the dollar towards an alternative currency, i.e. at the turn of 1977 and 1978 when the value of the American currency almost went into the free fall (Amuzegar 1978). Ultimately, it was only the failure to reach a unanimous consensus among the OPEC members which helped the dollar to preserve its status. At that time, the erosion of the dollar's internal value triggered by high inflation hit the world's largest economy. Nowadays inflationary risks seem to be still under control although some worrying signs are being observed (i.e. rising food prices). However, it is the threat of a drastic depreciation of the dollar that may trigger debates with regard to moving away from the US currency. With oil producers acting as a pillar of the dollar based BW2, and as long as they continue in this role, a threat of the dollar's drastic fall seems to be questionable.

Therefore, oil producers have reasons to insist on sustaining BW2, but this explains the reasons only partially. To make this analysis more precise and consistent, it is worth considering the alternative cost of preserving the petrodollar peg. Attention will be focused on the GCC states. Some of them are already experiencing high inflation and resorting to further purchases of the US asset can only aggravate the situation. The risk of increasing price level is of relevant importance as there is ever more evidence that the official indicators tend to underestimate inflation in the region. For instance according to alternative indicators, the rate of inflation in the UAE is running at about 15% (Dizmen 2006) annually. And the latest food price rises worldwide may only aggravate the trend. By tying their currencies to the US dollar, these countries are importing credibility from the US. However, as long as there is no cycle convergence between the US and the GCC states, this kind of import may expose the GCC economies to big cycle divergence. Although it cannot be taken as a rule, higher oil prices usually trigger the threat of recession and therefore prompt the Federal Reserve to cut rates. The same scenario generates huge windfalls gains for the GCC and in their case more restrictive monetary policy would be desirable. Finally, it should be noted that the peg to the US currency gives no room to resort to an independent monetary policy and such a policy seems to be essential in the GCC efforts aimed at diversifying their domestic economies. To conclude, the GCC states seem to be paying a high price (from the point of view of the macroeconomic policy) to see their oil revenues free of the exchange rate risk.

Nevertheless, there is one more element which hinders the consideration of abandoning the US peg. This element is sensitive in nature as it is the fear that this kind of decision may be perceived as a politically driven one. Additionally, it may exacerbate already sensitive relations with the US. Political factors should never be underestimated. For the predecessor of the BW2 (the original BW system) it was the pressure of France to convert the US dollar assets into gold that practically heralded the end of the system. Now, there are some countries which are considering a move away from the dollar and their reasons are not merely confined to economic factors. The extremely unpopular US foreign policy can only hasten such a decision. In order to avoid a situation where an exit from the US dollar would be perceived as a politically driven decision, far reaching analyses are needed to convince others that this exit is primarily an economic decision and its benefits are not confined only to the GCC states. In fact, such a decision is in the interest of the US and the global economy. By prolonging the existence of the BW2, the GCC states are merely postponing the adjustment of the US economy. In the economy nothing lasts for ever as the hailers of the so called New Economy had an opportunity to convince themselves in 2001. Therefore, an adjustment to the US economy in order to decrease the current account deficit is inevitable. Delaying it (by the GCC states further financing the deficit) will make this adjustment more abrupt and painful with dire consequences for the global community. That is why preserving the current status quo is dangerous and the GCC countries should be encouraged to implement changes instead of being condemned for implementing them.

3. The concept of currency union and the GCC states' efforts to implement it

Currency union is nothing new for the international monetary system. Historians give different examples ranging from the currency unions implemented on American soil during the times of British empires towards similar agreements pursued at the time of respective unifications (Italy and Germany) which took place in the 19th century. Nevertheless, all such examples are of more value to historians than to economists. For the latter only two monetary unions established in the 19th century matter: the Latin Monetary Union and the Scandinavian Monetary Union. The former comprised France, Belgium, Switzerland (hence they used to have the same name for their domestic monetary units), Italy and Greece while the latter consisted of Sweden, Norway and Denmark. The Latin Union was driven more by political factors as France perceived the creation of such a union as a way to expand French influence in Europe. On the other hand, the Scandinavian union was based more on economic factors. Both unions disintegrated in the first half of the last century (Kowalewski 2001).

Clear symptoms of BW weakness in the early 1960s led economists Robert Mundell, Roland McKinnon and Peter Kenen to provide a theoretical background for a currency union. They are recognised as authors of the optimal currency areas – a theory which focuses on labour mobility (Mundell 1961), economy's openness (McKinnon 1963) and sensitivities towards asymmetric shocks (Kenen 1969). Fulfilment of all the above mentioned criteria makes the implementation of a union easier but should not be perceived as a prerequisite. The best illustration is the implementation of the European Economic and Monetary Union (EMU) in spite of the fact that several of its members had not fulfilled the criteria stemming from optimal currency area. The creation of a currency union by promoting trade among its participants should also protect member states against tensions outside the union. It seems evident that the example given by the EMU started to inspire other nations, including the GCC states.

Arguments in favour of the currency union in the GCC region are strong. These economies share a lot of common economic features and above all have the same priority, i.e. the need for a diversification of their domestic economies. Common cultural and historical background should make the task of accomplishing common economic policies even easier. Obviously, there are differences between these economies but their scale and magnitude should not be perceived as a serious obstacle in achieving a single currency.

The GCC initiative to introduce a currency union is a logical continuation of the unification process which goes back more than a quarter of the century. On May 25th, 1981, the authorities of Saudi Arabia, Kuwait, Qatar, Bahrain, Oman and the United Arab Emirates set a framework which was supposed to foster economic integration and achieve unity on all fronts. The framework was ratified in 1982 and already at that time the idea of monetary integration was on the agenda. It was not until late 2000, however, that more decisive steps were taken that were aimed to achieve monetary integrity. In December 2000, the Supreme Council of the GCC requested that working plans should be presented. In spring 2001, special working groups were set to explore all the conditions needed to implement the union. The results were presented in Muscat in December 2001. According to the scenario presented in Muscat, the currency union was supposed to be introduced in 2010. Until the end of 2002 all the currencies of the GCC should be pegged to the dollar (Rutledge 2004). The last country to switch to the US dollar peg was Kuwait. However, in May 2007, this country decided to return to the idea of basket currency (Kerr 2007)[1]. The decision was made without previous consultations with the remaining GCC states and therefore Kuwait's action is widely perceived as a big blow to the efforts aimed to accomplish monetary unification in the region. The behaviour of the authorities in Kuwait may indeed cast shadow on the concept of cooperation but does not necessarily mean its abandonment. Continuing weakness of the US dollar is only aggravating inflation pressures in the region (Wörtz 2007). The return to a basket could and should give rise to discussions about a common basket for all currencies taking part in the project.

The second half of the first decade of the 21st century is supposed to witness achieving a sufficient degree of economic convergence that is indispensable to introduce a currency union. With less than 3 years to go, there remain some details which need to be fixed.

[1] On July 13th, 2007, the press announced there was yet another revaluation of the Kuwaiti dinar against the USD. According to the Financial Times, there was a 0.4% revaluation as a result of which the new value of the Kuwaiti dinar was set at USD/KD 0.2869. The website of the Central Bank of Kuwait does not offer any information about the decision but the quotation of its currency is in line with the one given by the Financial Times.

Table 1. *Exchange rate regimes options for the GCC states*

The GCC Initiative			
Loose Agreement (option 1)	**Currency union pegged to one currency (option 2)**	**Currency union pegged to the currency's basket (option 3)**	**Currency union with floating exchange rate (option 4)**
1) no central bank 2) aimed at eliminating transaction costs 3) of psychological importance 4) of little importance from the macroeconomic point of view	1) single currency and one central bank 2) gains from the seigniorage 3) will trigger macroeconomic costs 4) no exposure to FX risk	1) offers more flexibility in con ducting monetary policy 2) will lead to FX risk and force members to hedge against it	1) allows to pursue independent monetary policy 2) should deliver highest immunity to the tensions taking place in the IMS 3) enough potential to become a reserve currency in the future 4) its implementation should take place beyond 2010

Source: own compilation.

However, Oman's recent decision to withdraw from the project casts certain shadow on the feasibility of this deadline. Regardless of the delay caused by Oman's withdrawal, no time should be wasted if the missing details are to be worked out in time. The most important issue to be solved yet is the choice of an exchange rate regime to be applied following the implementation of the currency union.

It is most striking that with so little time left, the GCC countries have not made final decisions yet and the variety of choices (depicted in the table below) under consideration is so wide.

The four proposed solutions presented in the above table go (left to right) from the least ambitious towards the most challenging monetary framework. Option 2 will be eliminated, if the GCC states decide to follow Kuwait's shift. From the point of view of the GCC states implementing the most ambitious solution would be in their best interest. These countries, however, do not seem prepared well enough to face all the challenges stemming from a potential introduction of this solution. Fully floating exchange rate requires highly liquid financial markets. Although some efforts have already been undertaken to ensure liquidity, they do not seem sufficient to afford the implementation of a floating rate. Moreover, with less than three years to go and in the absence of precise plans concerning a supranational central bank, it is almost certain that there is not enough time to implement this particular framework. As mentioned earlier, there are doubts whether the deadline of 2010 will be met at all. These doubts arise not only because of Oman's withdrawal from the project. It is the whole history of integration processes in the region which points towards scepticism when it comes to the assessment of integration processes. In spite of having excellent circumstances to launch such processes (common language and cultural background), the current record has been extremely moderate. The launch of a common market was foreseen for 2007 and it has already been delayed by at least 14 months. Furthermore, there is a socio-political dimension to the dynamics of integration which is based on the decision-making processes (Kneissl 2006). The rule of law and a sufficient degree of participatory democracy are indispensable for the accomplishment of integration. The various phases of enlargement of the European integration are based on such legal and political requirements, contained in the so-called Copenhagen criteria. The union of Egypt and Syria pushed by the then Egyptian president Gamal Abdel Nasser initiated in 1958 was de facto dissolved in 1961. It remains only in name as the United Arab Republic, or U.A.R. is still used in the official name of both countries.

Finally, it seems that under the present circumstances, the new GCC currency would be excessively dependent on oil and a rupture of this link could only be brought about by diversifying the economy prior to introducing the single currency. This may look as a contradictory statement as the process of diversification of domestic economies in the region is among the most important elements underlying a potential exit from current dollars peg. Nevertheless, efforts to diversify domestic economies along with a transition from the present dollar peg to a floating exchange rate have to be gradual. Achieving both of them in the foreseeable future seems highly unlikely. That is why when it comes to the choice of an exchange rate regime, the GCC countries should opt for a less ambitious framework but a more feasible one. Under the present circumstances, it seems that the currency union pegged towards the basket of different currencies seems to be the most appropriate solution. This kind of monetary framework gives little room to conduct a fully independent monetary policy but at the same time, it limits risks of a scenario under which a flotation of the exchange rate may get out of control. Simultaneously, it does not inhibit the GCC countries from discussing further stages of monetary cooperation. Therefore, the latest decision taken by Kuwaiti authorities should not be condemned. It can be perceived instead as a trigger point which can set the GCC states on a right track.

Pegging the new currency to the basket would also be desirable for other reasons. This proposal would give more room for pursuing an independent monetary policy than the single peg (regardless of whether it is the dollar or the euro). There would be certain import of credibility taking place as decisions on the level of interest rates in the countries forming the basket would be of high relevance for the GCC countries. That would imply a gradual transition from the current solution (where the room to use independently interest rates hardly exists) towards a fully independent floating. Exposing the exchange rate fully to the law of demand and supply (without any reference point) would be dangerous. Most countries that opted for an exit from the hard peg toward floating rate did achieve it gradually. In other words, experience is needed in order to pursue a monetary policy under a fully floating exchange rate. And the transition period seems to be a perfect opportunity to gain this experience.

By moving towards the currency union, several elements need to be borne in mind. The GCC states, in spite of being perceived as a fairly homogeneous region (because of having stable exchange rates), differ in a number of aspects. There are at least two factors which make them different from one another. The first factor deals with time horizon regarding their ability to deliver oil to the world market (in other words, the amount of proven oil reserves). While Bahrain and Oman are expected to see depletion of their reserves within the next fifteen years, Kuwait and the UAE should approach the same point well into the next century (Sturm, Siegfried 2005). The second factor refers to the efforts aimed to diversify domestic economies. The diversification process was started some time ago but with the help of different strategies and at a different pace. As a result, some economies have become less dependent on oil (for instance Bahrain and the UAE) than others.

All these structural differences imply challenges as far as the ability of these economies to withstand asymmetric shocks in the future. The rather similar structure of domestic economies enjoyed nowadays by the GCC will most probably disappear as time progresses. Therefore, more deliberations should be held to minimise negative effects stemming from potential asymmetric shocks. That is why the fiscal stance of the GCC states should be monitored more closely. Periods of high oil prices tend to generate budget surpluses while subdued prices tend to generate deficits. Once again the magnitude of a pro-cyclical element differs across the region. In 1998, when the oil prices suffered a serious decline, the size of fiscal deficits in Bahrain, Oman and the UAE was well above 5% of the GDP and Qatar and Saudi Arabia were close of reaching 10% of the GDP. At the beginning of this century, just prior to the current oil “bonanza”, low public debt levels in the UAE, Bahrain and Kuwait (well below 30% on the average) contrasted sharply with the same indicator for Saudi Arabia where it stood at well above 80 % (Sturm, Siegfried; 2005). Therefore, these countries seem to be in need of making their income revenues less depended on oil and thus diminishing the pro-cycle element in their respective fiscal policies. This is another argument in favour of a less ambitious but more feasible solution when it comes to choosing the exchange rate regime.

4. Consequences for the OPEC states and other oil producing countries

Events taking place in the GCC states seem to be of enormous importance from the point of view of the entire IMS. With significant portion of the US current account deficit financed by the GCC states which are in possession of one of the most strategic commodities, the change of their monetary stance may have far reaching consequences. Efforts to implement a currency union by the GCC countries should be monitored particularly by other OPEC member states. After all, there are a lot of similarities between the GCC states and the remaining OPEC members. Almost every OPEC member generates windfall gains from oil export and deliberates about the way of maximizing its profits. Above all, OPEC members are most probably pondering over potential alternatives when it comes to the invoicing currency of their oil trade. The present slide in the value of the US dollar should enhance such discussions. Consulting on monetary affairs goes beyond the OPEC’s mission but not finding consensus regarding currency issues may cast further doubts on the OPEC ability to reach unanimous decisions. Oil is still invoiced in dollars but some countries are keen to move away from invoicing oil in the US currency in favour of other currencies. The majority of these signals come from Teheran where the authorities are boasting about distancing themselves from the dollar when it comes to the structure of oil revenues and foreign reserves.

During the speech inaugurating his new term, the president of Venezuela announced the intention to introduce a single currency for the region. At present, however, it seems highly unlikely that the plans will be carried through in the foreseeable future. Nevertheless, the creation of networks delivering oil on preferential terms in Latin America may be the first step in the direction of fostering economic cooperation which one day may lead to the introduction of a common currency in the area. This, however, seems to be a remote perspective.

While Iran's and Venezuela's intentions to move towards the euro can be explained upon the combination of economic and political factors, there are members that may favour a switch towards the euro merely for economic reasons. That group consists of countries, in particular Algeria and Libya, for which European markets are the key markets. As a result, there are more and more arguments enabling to pave the way for OPEC states to launch a discussion about currency issues. For the time being the choice will be between the euro and the dollar. What will happen if the third currency (the GCC states' currency) is launched? Will the new currency offer a feasible option for oil trade? Will the new currency become an option for other countries when it comes to investing the so called trade surpluses? Regarding the latter question, it is difficult to make reliable assessments as the majority of oil produces is most unwilling to disclose any element of their investment strategies. Therefore, more attention should be focused on the former question. When it comes to the idea of invoicing oil in the potential GCC currency, chances are limited at present, but there is some room to see an increase in the importance of this currency in a more distant future.

As mentioned before, the GCC currency should, for the time being, be pegged to the currency basket. There is no doubt that both the US dollar and the euro would be the key currencies in this basket. Their presence gives enough potential to the GCC currency to become a viable solution to the endless disputes whether oil should be settled in dollars or in euros. Nevertheless, the discussed currency structure should not be merely confined to the euro and the dollar. It is in the interest of the GCC states to implement a wider currency diversification. A significant share in the oil demand's growth comes from Asia thus giving strong arguments for including some of the Asian currencies in the basket. This pioneer step could lead to a wide reshuffle in the IMS aimed to enhance the significance of currencies other than the US dollar and the European based monies. If such a solution works, the new GCC currency will have even more potential to become an interesting option for all those who are seeking their currency portfolio diversification. However, there are major weaknesses which may derail this alternative as it would be up to the market participants to choose the currency of their oil transactions. The initial years of the GCC new currency's functioning on the market will most probably be tough. Market participants usually display some inertia which inhibits them to switch from one currency to another in a short time. In addition, the US dollar market offers such a high degree of liquidity that trying to switch to another currency (upon economic factors) may result extremely difficult.

In the short term the future for the GCC currency union does not look bright (from the point of view of invoicing oil trade but the long term future looks more encouragingly. Nowadays, there is a wide geographical diversification of oil supply. However, in the years to come this diversification will shrink as more and more oil proven reserves will be depleted. Therefore, it may make sense to look at countries which have the largest oil proven reserves. Out of five largest owners of oil proven reserves, three come from the GCC. In other words, oil deliveries from the Middle East can be easily substituted by oil from a different part of the world. In 50 years' time the room for this diversification will almost cease to exist, thus giving more room for the GCC states to settle oil trade in their own currency. Obviously, the feasibility of this scenario will hinge upon a number of factors. The world is in possession of unconventional oil but the exploration of this kind of oil is expensive and therefore leaving owners of conventional oil reserves in a privileged position.

In summary, there are a lot of reasons for watching the GCC initiative closely. The initiative should also be perceived as part of the oil producers' efforts to address challenges stemming from the current oil "bonanza" in a proper manner. They seem to be well aware of the fact that the lack of a consistent strategy may lead to a repetition of past errors. Moreover, with the increasing share of oil producers in the global economic growth (by becoming the chief creditors of the US current account deficit), their eventual debacle could prove costly for both the world economy and the IMS. Fortunately, there is a widespread belief that oil producing countries have learnt the lessons from the seventies of the last century where oil revenues led to unsustainable profligacy. On this occasion unwise consumption seems to be out of question. A lot of countries are using revenues to repay their debts. The most publicised case of the debt repayment effort was undertaken by Russia, especially with regard to the Paris Club debt repayment. Such an initiative is not, however, limited to Russia. A similar strategy has been pursued by Nigeria. Some countries are using oil to boost their social programmes with Venezuela being the best example. But much of windfall gains are being invested in a different kind of assets. There are differences regarding the scale of risk aversion. Russia, along with some OPEC members, has resorted to rather conservative strategies. However, the most recent Russian decision to change its strategy of managing a stabilization fund (by shifting part of the fund assets to equity exposure) is signals a movement towards less conservative strategies aimed to ensure higher rate of returns (Tassel, Chung 2007). Saudi Arabia opts for medium risk. The least risk-averting players are the authorities in some of the GCC states. Such a conclusion can be drawn from the observation of some funds' performance (rather aggressive investment pursued by the Kuwait Investment Authority, Abu Dhabi Investment Authority or Qatar Investment Fund). Among funds from other countries that pursue aggressive strategies is the Norway Government Petroleum Fund.

Therefore, accusing oil producing countries of excessive profligacy seems to be misplaced on this occasion. Nevertheless, it still remains to be seen if the current efforts suffice to protect oil producers from an IMS' turmoil. The high degree of secrecy of the majority of the above described sovereign wealth funds (swf) may pose challenges as well as threats. However, the world attention should not only focus on these efforts. An action, more globally concerted, is required. The current status quo in the IMS seems to be dangerous. With oil exporters supporting the BW2 no one is safe. On the other hand, oil producing countries cannot be blamed for the US deficit. They can only be blamed if they decide to continue preserving the current situation. Having their currencies tied, in most cases, to the US dollar will not make their task of diversifying domestic economies easier. And the US current account deficit has reached such a magnitude that far reaching adjustments to the US economy seem to be unavoidable. By financing the US deficit further, oil producers may merely postpone the adjustment and thus make it more painful. This scenario would be in no one's interest.

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