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Islamic Monetary Union: Feasibility, Viability, and Sustainability of a New Global Currency

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INTRODUCTION

One can argue that the financial activities of Islamic nations are growing at a rate that, if sustained, has the potential to strongly impact the twenty-first-century global economy. As industrialized economies struggle from a banking crisis and lapses in consumer confidence, the economies of Islamic states, although inextricably linked with Western economies, are undergoing dramatic changes. While the overall size of the Islamic financial market is small in the context of the world's financial assets, the growth of the industry coupled with current trends in infrastructure investment, the development of Islamic finance networks, and progress toward galvanizing regulatory and supervisory systems have bolstered confidence in the potential of Islamic economies.[2] Even though petrochemical production is playing a large role in the reshaping of the economies in the Gulf States, a large share of the new economic renaissance is purely due to changing economic conditions brought about by a fundamental revision in social structures within Islamic nations. In short, the financial activities of Muslims worldwide are shifting in three distinct ways: wealthy Muslims are expanding the diversity of their investment portfolios; there is a rising Muslim middle-class emerging in developed and developing nations; and there is a migration of vast numbers of Muslims into formal banking systems as many previously unbanked Muslims gain access to financial services.

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[1] Managing Director, Maris Strategies Limited, Cambridge, U.K.
[2] Mohammed El Qorchi, "Islamic Finance Gears Up," *Finance and Development*, International Monetary Fund 42.4, December 2005.

The emerging economic environment has created a fertile environment for the development of Islamic finance.[3] In addition to this, the changing wealth of Muslims worldwide can partly be attributed to the rapid growth of the *shari'a*-based banking industry, which has seen a rise of 27.8 percent in *shari'a*-compliant bank assets from USD $500.4 billion[4] in 2007 to USD $639 billion in 2008.[5] The rapid growth can be attributed to three distinct factors: a growth in the number of quality *shari'a*-compliant financial instruments, greater access to financial instruments for Muslims, and the appeal of *shari'a*-compliant financial services to non-Muslims. As the Islamic finance industry grows and matures, it begins to present a greater opportunity for financial innovation whereby Islamic nations seeking to provide a higher quality of life for Muslims globally can establish economic coopetition on an unprecedented scale. Events like the creation of the forthcoming Gulf Cooperation Council (GCC) single currency are perhaps a precursor to a higher degree of economic interoperation between Muslim nations on a larger scale.

The culture of Islam is not new to financial innovations. In our quest for financial efficiencies in today's world, we often overlook the many innovations brought forth from the Islamic world such as the letter of credit (*hawala*), bills of exchange (*siftajah*), specialized trading centers (*fundauq*), and checks (*sakk*), in addition to simple mathematical principles such as Arabic numbers and the zero.[6] Certainly, Islamic financial innovations have played a role in the rise of modern finance. Now, with the sudden rise in significance of Muslim wealth and higher volumes of financial transactions by Muslims worldwide, our attention has shifted to Islamic finance.

Across the globe, market conditions have manifested a wholly new economic environment whereby significant changes in the flow of international capital are enabling Islamic states to redefine themselves and the competitiveness of their nations. What is evident is that the

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[3] Karina Robinson, "Islamic finance is seeing spectacular growth," *International Herald Tribune*, November 5, 2007.
[4] Stephen Timewell and Joseph DiVanna, "Supplement: Top 500 Islamic Finance Institutions," *The Banker*, November 2007, p. 3.
[5] Ibid., p. 4.
[6] S. M. Ghazanfar, "Post-Greek/Pre-Renaissance Economic Thought: Contributions of Arab-Islamic Scholastics During the 'Great Gap' Centuries," in *Medieval Islamic Economic Thought,* ed. S. M. Ghazanfar, London: Routledge-Curzon, 2003, p. 174.

growth of outward Foreign Direct Investment (FDI) from emerging markets has outpaced the growth from industrialized countries in recent years, rising from US$12 billion in 1991 to US$99 billion in 1999 to an estimated US$210 billion in 2006.[7] The transference of the epicenter of capital flows combined with the growth in Muslim wealth and the erosion of the U.S. dollar as the world's primary reserve currency is leading toward a multiple reserve-currency system.[8] One key development is a steadfast collaboration between Muslim nations to strengthen the international Islamic financial architecture with the establishment of the Islamic Financial Services Board (IFSB), the International Islamic Financial Market (IIFM), and the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI). These circumstances have created a set of conditions for Islamic economic unity that begs to be explored. The aim of this paper is twofold: firstly, I aim to examine the feasibility, viability, and sustainability of a union between the 56 nations of the Organization of the Islamic Conference (OIC). Secondly, I propose to analyze the role of innovation and authenticity of Islamic ideals in enabling the economic synergies that guarantee the union. Due to source constraints and the early stage of the research, my analysis will use the current developments in the union of Gulf Cooperation Council (GCC) currencies in a first instance to establish a baseline of understanding.

World leaders, industry analysts, and economists are realizing that in the new emerging global economy, the activities of all nations are directly or indirectly linked to an interoperable transnational network of finance made possible by advances in technologically-enabled infrastructure. Thus economic, monetary, trade, and fiscal policies that are developed under an isolationist philosophy effectively act to diminish the competitiveness of a nation on world markets. Within this emerging state of interdependence, Islamic finance is playing an integral role in reshaping the world's economic activity by acting as a new source of alternative financing for business, governments, and consumers.[9] The emerging economic conditions present Islamic nations

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[7] Multilateral Investment Guarantee Agency, "South-South FDI and Political Risk Insurance: Challenges and Opportunities," Working paper, World Bank Group, January 2008, p. 1.

[8] S. Rajan Ramkishen and Jose Kiran, "Will the greenback remain the world's reserve currency?" *Intereconomics,* May-June 2006, pp. 124–29.

[9] Her Majesty's Revenue and Customs (HMRC), *Impact Assessment of Sukuk (Islamic Bonds) Legislation*, June 26, 2008, p. 2.

with an opportunity to synchronize economic objectives in order to increase their interdependence while simultaneously creating conditions that will elevate the economies of all nations through trade and monetary collaboration.

That said, monetary collaboration and economic union consist of progressive degrees of economic synergies. These are complexes of economic behavior aggregated holistically, unpredicted by the separate behaviors of any single nation-state or group of nations.[10] Simply put, monetary unions are a series of complex relationships that demand a synchronization of monetary, fiscal, and economic policies across multiple nation-states. Under such unions, the economic behavior of each nation in the union is not always predictable when viewed holistically against a global marketplace. As transnational trade agreements become intertwined with economic policy, the ability to regulate economic activity is often neutralized by unseen forces and unpredictable economic events. Therefore, monetary union must be thought of as progressive layers of policies that resemble an onion; peal away each layer and one can develop a topology of how transnational policies interact.

The emerging global economy is a synergistic progression, a hierarchy of total complex economic behaviors entirely unpredicted by the successive national economic behaviors or collective sets of transnational economic collaborations. As economic interdependence is the new economic reality—one that the United States has yet to acknowledge—the Muslim world is realizing that their economies must no longer be solely dependent on petroleum production. It is through the rising diversification of Muslim national economies that the conditions for economic synergies are rapidly becoming the new reality.

Thus, the twenty-first-century global economy is emerging as one vast heterogeneous interlinked consumer-led financial market. In the new global economy, multinational companies, NGOs, banks, and other financial intermediaries are acting as market aggregators moving products and services across sovereign borders, exchanging capital and commodities seamlessly with lower costs made possible by technology. It is from this rising transnational activity that the concepts of economic and monetary union across the Muslim nations have taken root.

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[10] Adapted from the theory of synergistics by R. Buckminster Fuller, *Synergetics: Explorations in the Geometry of Thinking,* New York: Macmillan, 1975, p. 13.

Just as businesses in a fragmented marketplace realize that collaboration, cooperation, and coopetition provide an opportunity to achieve an economic vitality that is greater than the sum of its parts, Islamic nations are considering economic unions as a means to elevate their domestic economies. Unification through structural reforms and the harmonization of sectoral policies as a process to gain economic stability is dependent on developing a monetary union that has a broad diverse economic base.[11] According to A. A. Wane, diversifying the economic base of the West African Economic and Monetary Union (WAEMU) is the single biggest challenge in stabilizing a union's economic activities. As a result, economists, academics, politicians, and government ministers in Muslim states are pondering the concept of a unifying vision of economic integration that would create a monetary union of Islamic nations enabling a synergy in economic, fiscal, and monetary policies while preserving national sovereignty.

An historical analysis of monetary unions indicates that a common currency should be a by-product of economic collaboration, rather than a single inherent goal. Monetary policy synchronization must consider many factors in order to achieve a balance between fiscal policy objectives, economic goals, and monetary policy criteria. One of the key considerations in the devising of an IMU is the reduction in the possibilities to counteract fluctuations in productivity by monetary policy as labor prices and supply shift irrespective of national borders.[12] In 1992, the Islamic Development Bank (IDB) acknowledged that in the light of the then emerging European Union (EU), OIC member countries should develop a collective strategy in the development of bilateral agreements with the EU to reduce inefficiencies resulting from negotiations between individual nations.[13] As indicated by the IDB, policy coordination is complex and must occur at various levels establishing clear linkages between macroeconomic, industrial, and agricultural policies. Basically, the goal is twofold: increase trade and

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[11] Abdoul Aziz Wane, "West African Economic and Monetary Union (WAEMU) Countries," *International Monetary Fund Research Bulletin* 6.1, March 2005, p. 6.

[12] Mattias Erlandsson, "Nominal Wage Flexibility in a Monetary Union," *Working Paper in Economics*, Göteborg University, 80, September 23, 2002, p. 27.

[13] M. A. Mannan, *Key Issues and Economic Implications of a Unified European Market after 1992 for OIC Member Countries: Options and Response,* Jeddah: IDB, IRTI, 1992, pp. 53–59.

the flow of capital between OIC member nations while simultaneously acting as a single entity to negotiate bilateral agreements with non-OIC nations. Therefore, a key objective is to reduce the complexities of multi-level policy synchronization, which requires new approaches and an innovative process.

This leads us further into the idea of an IMU. The concept of Islamic economic unity is not new. Benjamin Cohen notes that GCC nations under the 1982 Unified Economic Agreement sought "to coordinate their financial, monetary and banking policies and enhance cooperation between monetary agencies and central banks, including an endeavor to establish a common currency" with varying degrees of political commitment over the past twenty-six years.[14] Although some major factors and conditions for Islamic integration do exist among Arab countries, for example, there are significant structural differences among them in terms of political regimes. Many nations in the region can trace their legal heritage to the Napoleonic code, the Ottoman Empire, and to British common law. However, even with structural differences, during the past five years a shift has occurred toward a common approach to financial interactions as seen in the rapid rise in Islamic (or *shari'a*-compliant) banking.

It is from this tapestry of past transnational interactions coupled with the fading influence of European and Ottoman political structures that one can see the common fabric of an economic union. Shared ideals represented in *shari'a* laws and a common need to modernize their economies to a world class standard requires a look at the feasibility of an IMU.

FEASIBILITY

In 2007, the Islamic banking industry experienced its largest annual growth rate of 29.7 percent representing $500 billion in assets (see Table 1). Although relatively small when contrasted against the $17 trillion in total assets of financial institutions worldwide, the industry is the fastest growing segment in the financial markets. The extraordinary growth has also created numerous economic opportunities for transnational finance as the movement of capital across the region is

[14] Benjamin J. Cohen, "Are Monetary Unions Inevitable?" *International Studies Perspectives* 4, 2003, p. 290.

demonstrating the need for greater interoperation between financial institutions, governments, and business.

Table 1: Valuation of Global Islamic Banking Industry

	Value (in millions US$)	Annual Growth Rate
GCC	178,129	39.35%
Non-GCC MENA	176,822	29.87%
Sub-Saharan Africa	4,707	54.90%
Asia	119,346	20.91%
Australia/Europe/America	21,475	5.79%
Global Total	500,481	29.70%

Source: The Banker Magazine & Maris Strategies

Although many OIC countries share a common belief in *shari'a* principles, the governmental structural differences between nations raise the question of whether monetary union has a greater advantage over a simpler currency union. According to George von Furstenberg, "MU [monetary union] is co-managed by its members through a mutually agreed process while CU [currency union] is achieved by unilateral adoption of another country's money and its policy."[15] Thus there are distinct advantages in a monetary union over a currency union for member nations of the OIC that have concerns about a loss of sovereignty represented by the issuance of national currency. That said, if currency union is a long-term goal, monetary union provides an interim step to establish viable economic controls across member nations. Over time, economic policy synchronization can be adapted to best serve the combined interest of members, setting the foundation for a single currency.

The rapid rise and commingling of Islamic and conventional financing activities across the globe is further witness to an acknowledgment of the importance of the role Muslim ideology will play in the twenty-first-century economy. The involvement of Islamic finance in global economic events is rooted deeply in the past,

[15] George M. von Furstenberg, "The Case for Monetary Union Re-examined with the Benefit of the Single Monetary Policy," Working Paper, Indiana University, 2003, p. 1.

beginning with trade and commerce that has spanned the centuries. In contrast to the economic renaissance happening across the Muslim world, during the course of the past few decades the sense of value and equity has changed as the world reinterprets free market capitalism in the early years of the new millennium. It appears that Adam Smith's invisible hand is about to turn a new page in economic history.

Islamic finance is emerging as a highly fragmented industry with distribution capabilities not currently aligned with the vast numbers of Muslim populations. What is needed at this stage of development is innovation, and yet there is a misconception in the industry about invention and innovation. Invention is the creation of something new; innovation is the application of financial instruments to the communities served. Innovation strives to create social financial cohesion, not simply by inventing new financial instruments but by applying existing products in new ways, to new markets and new segments of the population.

Innovation and authenticity are needed for a monetary union to be viable because unions are complex sets of interoperating obligations between nation-states formulated to better their respective societies, codified by constitutional principles, and implemented by rigorous adherence to economic objectives. Innovation is the glue that holds the industry together.

The Vision of an Islamic Monetary Union

During the October 2005 OIC meeting in Makkah, Saudi Arabia, the *OIC Ten-Year Programme of Action to Meet the Challenges Facing the Muslim Ummah in the 21st Century* was proposed to promote greater unity among Islamic nations, calling for economic cooperation between OIC member states in the form of an "Islamic Common Market" by establishing free trade areas between member states, the facilitation of the freedom of movement of business and investors across borders, imposition of a common external tariff system against third countries, and the promotion of electronic commerce. One of the expressed goals of the OIC ten-year plan is economic cooperation between Muslim nations: "priority must be given to enhancing economic cooperation, intra-OIC trade, alleviating poverty in OIC Member States, particularly in conflict-affected areas, and addressing issues related to globalization, economic liberalization, environment, and science and technology."[16] Within the OIC plan, resolution I.1 calls for member states to ratify existing trade and economic agreements and to implement relevant provisions of the OIC Programme of Action to Strengthen Economic and Commercial Cooperation among Member States.[17]

Subsequently in December 2005, Pakistan's Prime Minster Shaukat Aziz put forth a vision to promote greater unity, social cohesion, and economic cooperation within the Muslim *umma*. These broadly defined visions of Islamic economic unity have set in motion more in-depth discussions on how to achieve policy synergies that would elevate local economies, increase cross-border trade, promote transnational finance, and protect member nations from asymmetric economic shocks.

During 2006 and 2007, the GCC made varying degrees of progress toward its objective of a single currency by 2010, realizing that monetary integration is a multifaceted process of monetary policy alignment affected by the economic ambitions of each nation coupled with a dynamically changing demand for petroleum products. Although media coverage of Islamic economic unity across the GCC and beyond to other nations may wax and wane, regional leaders, policymakers, and central bankers continue steadfastly to explore each issue toward a determined set of long-term goals.

Goals

The classic goal of monetary policy is to promote maximum output and employment while sustaining stable prices. The objective of Islamic economic unity is to address the root problems of cross border trade, to create economies less dependent on oil or any single commodity, to raise economic activity to levels on par with larger nations and to protect weaker members of the union from adverse economic conditions. In an Islamic context, the goal of monetary policy is to

[16] OIC Summit: Ten-Year Strategic Action Plan, Public Statement: Royal Embassy of Saudi Arabia, Washington, D.C., December 8, 2005.
[17] Tan Sri Dr. Ahmed Mohamed Ali Al-Madani, "Progress and Achievements under the Organization of Islamic Conference Ten-Year Programme of Action," Paper presented at the International Forum on the Makkah Declaration: Implementing the Economic Agenda of the Muslim World, Kuala Lumpur, September 1–3, 2007.

maximize social welfare while maintaining a regime that encourages price stability and the efficient use of money.[18] The long-term goals of monetary policy and synchronization between Muslim states are twofold: the efficient spatial and inter-temporal allocation of resources and the creation of a foundation for real economic growth by controlling inflation. That said, the more dynamic aspect of monetary policy is to achieve the stabilization of nominal income during periods of asymmetric economic shocks. To address how monetary union can do this, first we must look at monetary union in a theoretical context, namely as a process of economic integration and policy synchronization between member countries.

Monetary policy seldom alters a nation's economic output, levels of employment, and pricing of goods and services directly. Central bankers act to influence indirectly the economic activity of a nation through the manipulation of interest rates. Thus, the question of an interest-based economy rises to the forefront of any discussion on IMU. Policymakers are asking if an IMU should be based on non-interest capitalism and, if so, whether such a form of capitalism can co-exist within an interoperating global economy. Even more importantly, with the absence of interest rates as a mechanism to influence the economy, they ask what other controls would need to exist to provide an appropriate set of tools for central bankers. Thus, an IMU can only be feasible if the member nations believe that monetary policy implementation will provide the tools to influence economic stability and offer protection against asymmetric economic shocks, regardless of whether the national economy is interest-based, non-interest-based, or in a transitional state converting from interest to non-interest-based, as we will see.

Monetary unions are a complex set of interoperating obligations between nation states formulated to better their respective societies, codified by constitutional principles and implemented by rigorous adherence to economic objectives. Simply, monetary unions are constructed by establishing a set of rules creating economic synergy between one or more nations whereby the coordination of political, monetary, and fiscal policy objectives creates an economic entity where the aggregated sum of economic activities has a value greater than the sum of the activities of the individual member nations. IMU is no exception to this premise. Discussions of IMU are not centered on a

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[18] Peter Bofinger, *Monetary Policy: Goals, Institutions, Strategies and Instruments,* Oxford: Oxford University Press, 2001, p. 128.

nostalgic search for past economic glory, nor are the underlying principles of Islamic finance as an economic system based on equitable exchange between parties solely a simple reaffirmation of a fundamental belief in Islam. IMU is about securing a future of Muslim societies in economic terms that ensures economic viability while preserving Muslim ideals. The establishment of an economic system unfettered by the same constraints that have evolved from conventional interest-based economies is one clear objective of an IMU.

The feasibility of an IMU brings forth two central questions: (1) can an economic system be constructed, operate, and achieve long-term viability without using conventional interest rate mechanisms as a prime tool to regulate economic activity; and (2) can national objectives be synchronized to serve the needs of individual nations while acting to simultaneously improve the diverse economic conditions of all nations?

Because national economies need a higher degree of policy synchronization to achieve monetary goals, central banks will need to redefine their roles to reduce the time between policy proposals and implementation of policy objectives. Paul Volcker (former chairman of the U.S. Federal Reserve) argued:

> We sometimes forget that central banking, as we know it today, is, in fact, largely an invention of the past hundred years or so, even though a few central banks can trace their ancestry back to the early nineteenth century or before. It is a sobering fact that the prominence of central banks in this [twentieth] century has coincided with a general tendency towards more inflation, not less. By and large, if the overriding objective is price stability, we did better with the nineteenth-century gold standard and passive central banks, with currency boards or even "free banking." The truly unique power of a central bank, after all, is the power to create money, and ultimately the power to create is the power to destroy. . .[19]

[19] Address by former Federal Reserve chairman Paul Volcker to a group of central bankers in July 1994, cited by J. Ernhart, "Paul Volker on the Reckless Inflationary Nature of Central Banks," *Vigilant Investor,* October 2006, available at http://www.ernharth.com/vi/2006/10/19/paul-volker-on-the-reckless-inflationary-nature-of-central-banks/ (accessed February 2009).

The central bank of the IMU (or a collection of central banks operating as one entity) must establish a baseline of value in which the new currency will be constructed. Then the conversation turns to gold, silver, or a commodity as a basis of a new regional currency. Historically no currency has ever survived long-term as an international currency when accompanied by high inflation. Moreover, one of the prime concerns of the IMU is establishing controls to regulate inflation through mechanisms that synchronize monetary, fiscal, and economic policies, making currency union a by-product of the unification process. Over the past 200 years, countries producing great currencies have avoided inflation by maintaining the gold or silver content, with devaluation or debasement a comparatively infrequent phenomenon. The lower the rate of inflation, the lower the cost of holding money balances and the more of them will be held.

The key point is that with gold or silver, currencies have a fall-back value if the state collapsed. Moreover, a monetary union under the right economic conditions can act as a catalyst for closer political union by creating a process that rapidly brings into focus any mounting economic crises. The goal of an IMU is predicated on predictability and consistency in monetary policy. Interoperation with conventional economies presents a clear dilemma for the basis of such a union: interest or non-interest.

Two Forms of Union

In the context of member states in the OIC, two distinctly different forms of monetary union must be considered: unilateral union (sometimes called dollarization) or multilateral union. In its early stages of union, unilateral monetary policy presents a higher degree of difficulty in gaining consensus between member states. Although unilateral union can be accompanied by an increase in the mobility of capital across member countries and new levels of monetary policy discipline, it can also reduce the effectiveness of inflation controls (as found in Latin American countries) by deflating the real value of public debt.[20] Therefore, multilateral monetary policy in a form similar to the EU provides a foundation for discussion on consensus building between member states. Regardless of their form, the technical

[20] Oya Celasun, "Inflation and Disinflation," *International Monetary Fund Research Bulletin* 6.1, March 2005, p. 2.

mechanisms needed for monetary union exist today, and they are well known. A growing body of knowledge from the European unification provides us with templates and decision criteria, which can be easily modified to accommodate the idiosyncrasies of transnational Islamic finance. European unification has demonstrated that although the goal of monetary policy is to make each member nation better off, achieving this symmetrically may not be possible due to variations in national incomes, debts, and other exogenous factors. Thus, in a union of Muslim nations, monetary policy must factor income instability and disproportionate income levels of single-commodity nations (oil production) in a way that provides a buffer to weaker members by protecting them from asymmetric economic shocks.

Conventional Union or Interest-free Union?

As far-reaching as an IMU may appear, the basic premise of an economic system free of interest should not be summarily dismissed. In the 1930s, John Maynard Keynes reviewed the work of finance theoretician Silvio Gesell, entitled *The Natural Economic Order*.[21] Among a series of debatable arguments, Gesell put forward a theory describing interest as belonging to the quality of money, being purely a monetary occurrence setting a limit on the growth rate of real capital. In Keynes's view, a non-interest-based economic system warranted closer examination.[22] This raises an important question for academics, *shari'a* scholars, and policymakers: is an Islamic monetary system the same as Gesell's proposal?

Gesell's evaluation of zero-interest economies advocated that money should be used to stimulate consumption rather than to earn interest. If one looks at the fundamental tenets of the Islamic value proposition, zero-interest is based on the idea that the time value of money (profit) is acceptable, but the monetary value of time (interest) is not. Margrit Kennedy examined Gesell's economic model, updating his ideas with factors more relevant to the emerging economic

[21] Silvio Gesell, *The Natural Economic Order,* Frankson, Texas: TGS Publishers, 2004 (reprint of 1920 edition).

[22] John Maynard Keynes, *The General Theory of Employment, Interest, and Money,* New York: Prometheus Books, 1997, pp. 353–58 (reprint of 1936 edition).

condition of the twenty-first century.[23] The most relevant aspect of their observations to the formation of an IMU is the correlation between the exponential growth of financial assets and debts and the environmentally-destructive "growth imperative" driving the real economy, along with suggestions for overcoming the growth imperative and efforts to combine land and monetary reform ideas with proposals for an ecologically-based tax system.

Feasibility over Time: A Six-Step Process

Economic integration is a process of establishing bidirectional agreements that can be expanded in scope and complexity to engage nations in higher degrees of economic synergies in a seven-step process, including preferential trade regimes, free trade areas, customs unions, common markets, monetary unions, and economic unions. The least complex agreement is a preferential trade system. During the past twenty years, Muslim states have been establishing various forms of agreements engaging trade partners through the reduction of tariffs and other protective measures in certain sectors or products. The OIC put forth an initiative to initiate a preferential trade regime among its member states by January 1, 2009. More recently, free trade areas such as in the Bahrain, Kuwait, Malaysia, Pakistan, Saudi Arabia, United Arab Emirates, and Yemen, to name a few, have been established, removing numerous barriers to trade (tariffs, quotas, other non-tariff barriers) and facilitating greater incentives for transnational transference of goods and services. However, to date, the prime beneficiaries of free trade areas appear to be Western multinational corporations with marginal increases in trans-Islamic trade.

Customs unions, which have been established in various Muslim states, on the other hand, require the implementation of a common external tariff system in addition to the removal of trade barriers. As the value of the US dollar wanes there is a resurgence of talks on additional development of the regional common market, which would add free movement of production and labor across member states, increasing the depth of customs unions. Recent discussions in the GCC center on monetary union and the implications of adoption of a common currency

[23] Margrit Kennedy, *Interest and Inflation Free Money: Creating an Exchange Medium That Works for Everybody and Protects the Earth,* Okemos, Michigan: Seva International, 1995.

by 2010 across member states. One could argue that once implemented, the GCC monetary union could act as the foundation for a broader regional union or perhaps the start of the IMU.

Therefore, to achieve a truly transnational economic union across Muslim nations, the member states must adopt common fiscal, monetary, financial, and commercial policies and common rules of competition.

Evidence of fragmented movement toward Islamic economic unity can be seen by the rising number of economic agreements between Muslim nations such as the GCC's new Economic Agreement enhancing and strengthening economic ties among member states. During the first two decades of the GCC existence, the Supreme Council, during its annual meetings, approved resolutions to promote "joint economic actions such as the GCC customs union, the common market, development integration, and the economic and monetary union."[24]

Another consideration in the formation of an IMU is the mismatch between the relative economic size and voting rights of member nations in the early formation of the union and resolving the same inequalities with future members in the union. Achieving an optimal representation and voting rights in the process of setting policy will be a key point of discussion on the overall feasibility of the IMU. Voting rights in the IMU, as in other unions such as the Euro, will strive to insulate common monetary policy from the influence of a dominant member or members who may try to alter policy as a reaction or overreaction to any idiosyncratic national economic shocks.[25]

Therefore, the feasibility of an IMU centers on achieving consensus on the economic goals of the union and its interconnection with the rest of the world during the pursuit of objectives based on *shari'a* principles coupled with a monetary basis (interest or non-interest) on which the union is founded. As Islamic national economies become increasingly co-dependent, the need for monetary, economic, and fiscal policy synchronization moves from a theoretical daydream to

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[24] Abdulrahman bin Hamad al-Attiyah, *The Economic Agreement Between the GCC States*, The Cooperation Council for the Arab States of the Gulf (GCC) Secretariat General, 22nd Session, City of Muscat, Sultanate of Oman (December 31, 2001).

[25] Helge Berger and Till Mueller, "How Should Large and Small Countries Be Represented in a Currency Union?" *Public Choice* 132.3, September 2007, pp. 471-84.

a demand of modern economic survival. What is missing for economic unification is political will.

VIABILITY

IMU viability is based on participating nations meeting a stringent set of economic criteria. These include price stability (capped inflation rates), low government budget deficits (Euro 3 percent of GDP), a ceiling on national debt (Euro 60 percent of GDP), exchange rate stability (a precursor to union), and highly synchronized economic, fiscal, and monetary policies actively balancing a series of cross border economic factors. Unlike the EU, the convergence of interest rates in an IMU would take a significantly different path, as many countries operate under mixed Islamic/conventional systems. Therefore, interest rates would have to be engineered out of the system over time to achieve union without slowing down current economic growth.

An IMU, although not explicitly advocated by Prime Minister Shaukat Aziz, would act as a mechanism to give a sense of purpose, bringing Muslims together into an economic system in which a transnational fiat currency would reflect a diverse set of social values. If considered as a next step in a long process toward economic homogeneity, an IMU would elevate the GCC union to a larger regional economic agenda whereby nations with significant Muslim populations might find long-term monetary stability by participating in a wider economic base.

However, economists rightly argue that three key factors will act to undermine an IMU: little or no cross-border trade benefits, a feeling of loss of control on setting central monetary policy, and difficulty in integrating multiple political agendas that—if the Euro is a good example—have produced varying degrees of economic protectionism.[26] Transnational trade across Muslim nations must be significantly higher (perhaps 30–40 percent) to have any appreciable benefit for ultimate monetary union.

Kuwaiti economist Hajjaj Bukhdur observed that the slow transition toward GCC union has been a product of individual nations having "an unwillingness to relinquish even a part of their sovereignty

[26] Raymond J. Ahearn, "Trade Conflict and the U.S.-European Union Economic Relationship," CRS Report for Congress, Document Number RL30732, April 11, 2007, p. 17.

which is essential for integration," which may act to dissipate any aspirations of an IMU.[27] Alternatives such as structuring the central bank as a board of governors that is hosted annually on a rotating basis can be explored to placate fears of a single nation dominating monetary policy with its own domestic objectives. Within a scheme where a virtual central bank would meet several times a year to set policy, existing central banks would remain intact to execute policy, monitor economic activities relative to transnational objectives, and assist in the synchronization of monetary policy to domestic fiscal and economic policy objectives. The key is to construct the central bank and other organizations to facilitate the transition to an IMU based on the best lessons learned from the United States and the Euro. Political implications and the sense of a "loss of sovereignty" may present an opportunity for organizations such as the OIC, the IDB, and others to play a new role in the redefinition of the rules for interchange within the IMU and the interoperation of the IMU with the conventional twenty-first-century economy.

Perhaps the most applicable lesson learned from the Euro in the establishment of an Islamic common market is the need for an establishment of clearly defined rules on the acceptable behaviors of member nations and the boundaries of unacceptable actions.[28] Thus, the harmonization of regulatory frameworks, legislation, and trading standards demand that a supranational law-making body is essential for IMU viability.

Simply put, monetary unions are constructed by establishing a set of rules creating economic synergy between nations whereby the coordination of political, monetary, and fiscal policy objectives creates an economic entity in which the aggregated sum of economic activities has a value greater than the sum of the activities of the individual member nations. The IMU is no exception to this premise.

The misalignment between the current Islamic financial capabilities and the centers of Islamic populations indicates a greater need for integration on the most basic economic activities such as

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[27] "Rift over FTA could harm Gulf economic integration," *Khaleej Times,* December 23, 2004.

[28] W. Th. Douma and N. A. Mansourian, "Commercial and Political Impact of Globalisation on the OIC: The European Union Experience," Working paper, Asser Institute, Den Hague, The Netherlands, available at www.carsicm.ir/icmroot/public/Events/Tehran2000-9-27/Articles/2Teh6A.pdf (accessed February 2009).

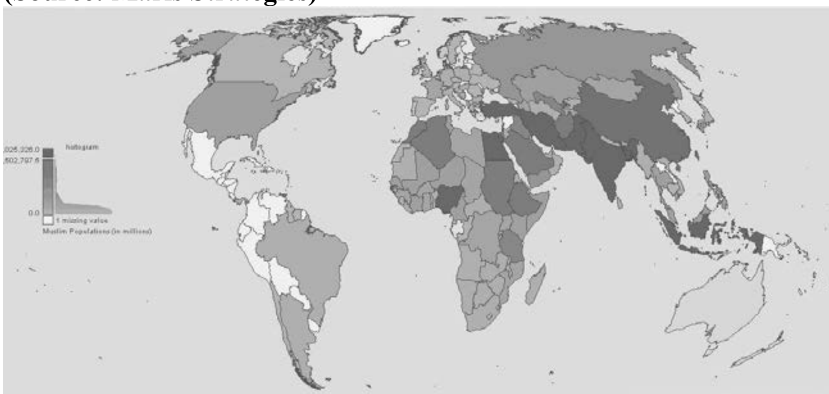
commercial banking, migrant remittances, and transnational trade. Alignment will only come from innovation as institutions learn how best to deploy and apply the growing array of financial instruments.

An examination of the distribution of *shari'a*-based banking services worldwide shows that although the Islamic finance industry is growing, the majority of the capabilities of the industry are not located in nations with dense Muslim populations, as illustrated in Figure 1.

Figure 1: Distribution of *Shari'a* Compliant Assets 2007 (Source: Maris Strategies)

When contrasted against the distribution of Muslim populations worldwide (illustrated in Figure 2), one can see that indeed there is a clear mismatch between Islamic finance capacity and serviceable populations. This can be attributed largely to the infancy of the industry and the need for more infrastructures throughout the regions.

Figure 2: Distribution of Worldwide Muslim populations (Source: Maris Strategies)



As the capabilities of the Islamic finance industry grow, an increasing share of the industry's capacity will be dedicated to facilitating cross-border activities. The need for Islamic economic synchronization is made clearer by evidence of rising transnational financial activity, for example in the Gulf with the rise in the number of GCC citizens owning real estate in other member states (see Table 2)

Table 2: Number of GCC Citizens Owning Real Estate in Other Member States in 2006 (Source: The Cooperation Council for the Arab States of the Gulf–Secretariat General).
* 2005, ** 2004

	Total	Kuwa-iti	Qatari	Omani	Saudi	Bahraini	Emir-ati
UAE*	2,113	855	144	123	704	287	
Bahrain	975	487	105	18	262		103
Saudi Arabia	256	221	9	0		21	5
Oman	2,944	1,008	66		22	895	953
Qatar**	115	63		3	4	30	15
Kuwait	217		1	0	191	15	10
Total	6,620	2,634	325	144	1,183	1,248	1,086

Further evidence of the growing need for transnational facilitation under a common set of economic policies can be seen in the rising number of licenses granted to GCC citizens to practice economic activities in other member states—as illustrated in Figure 3—and the steady rise in intra-GCC trade, which has increased steadily since 1990, illustrated in Figure 4.

Figure 3: Number of Licenses Granted to GCC Citizens to Practice Economic Activities in Other Member States
(Source: The Cooperation Council for the Arab States of the Gulf – Secretariat General)

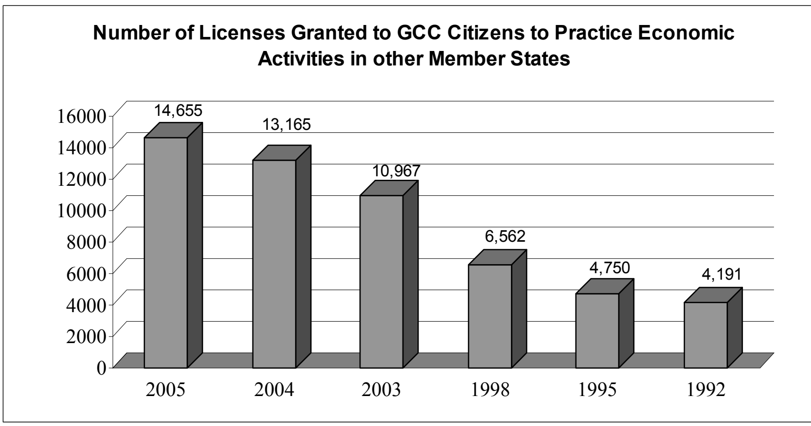
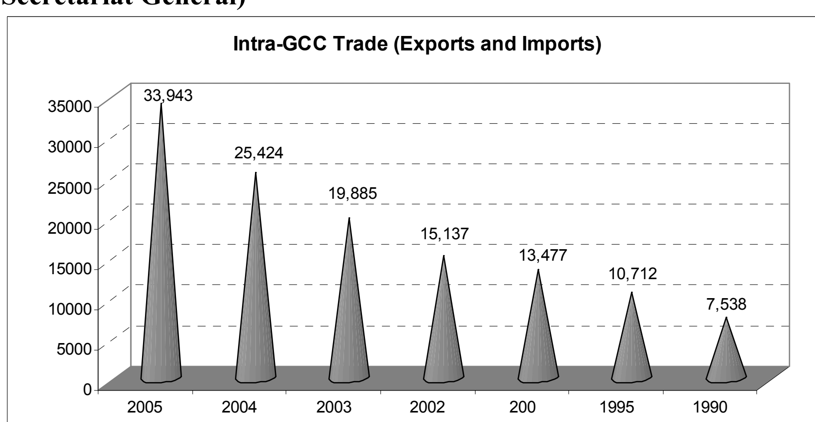


Figure 4: Intra-GCC Trade (Exports and Imports)
(Source: The Cooperation Council for the Arab States of the Gulf – Secretariat General)



As one can see from the previous figures, transnational trade in the GCC is still far below a level that would make even a Gulf-centric IMU sustainable under ideal conditions. Transnational trade across Muslim nations must be significantly higher, perhaps 30-40 percent, to be viable and to have any appreciable benefit for ultimate monetary union. Countering the feeling of loss of control can be addressed through the experimentation of new forms of structural agreements that engage members instead of creating a sense of economic isolation because of domestic protectionism.

That said, the synchronization of multiple political agendas, agreements, and policies seems extraordinarily complex, and indeed it needs to be factored when examining the feasibility of monetary union. The relationships between different nation states in the union are factored against the degrees of political difficulty and the time and duration in which they are engaged between member states, as illustrated in Figure 5. What the figure shows is that at each stage of interaction between member nations, the degree of complexity rises due to numerous agreements involving multiple nations. As the integration of economic, fiscal, and monetary policy objectives become more synchronized, the total number of aggregate agreements is reduced. Simply put, each nation will have similarly-constructed agreements with each other and with key external non-IMU nations that will act over time to consolidate the total number of independent relationships requiring an agreement. That said, perhaps we are already on the journey toward unification as the emerging global economy unfolds as a synergistic progression of relationships between member nations. One can see in Table 3 below that between GCC nations, the process of policy alignment has been occurring over a long period.

Figure 5: Layers of Economic Collaborative Complexity (Source: Maris Strategies)

Table 3 - Implemented Steps and Agreed Objectives (Source: Khalfan M. Al Barwani)

1983	Established a free trade zone
1999	Agreement on custom union
2000	Agreement is concluded to adopt a common peg as a step toward creating a unified currency in 2010
2001	Accord reached on a joint custom tariff of 5 percent
2002	US dollar is selected as intermediate peg to the six currencies
2003	Joint custom tariff of 5 percent is implemented
2004	Formal adoption of the US dollar as intermediate peg; Agree in "principle" on key convergence criteria: size of budget deficit, inflation rate, interest rates, foreign reserves, and ratio of public debt to GDP
2007	Envisages a common market
2010	Projected implementation of a unified currency

However, monetary unification has challenges such as the requirement of a diverse set of national economies not currently found in the homogeneous petroleum-based economies of the Gulf. As economic interdependence is the new economic reality, the GCC is realizing that creating diversified economies is a basic requirement for synergistic policy coordination.

Therefore, viability is accomplished in two ways: (1) by innovation in how Islamic finance is applied to Muslim communities; and (2) by establishing the proper control mechanisms and refining them over time. Viability of the union in the context of how common economic objectives will unify member nations must be focused on the relative economic stability of each member state as their economies mature and become increasing more interdependent.[29]

SUSTAINABILITY

Now let us turn to sustainability, a much more controversial aspect of any monetary union. Sustainability depends on many factors, as an IMU engages in an increasingly more complex number of agreements between member nations and non-IMU nation-states, as illustrated in Figure 6.

To make the IMU truly sustainable long-term, Muslim nations must overcome several fundamental problems found in monetary unions. These range from the accountability of the central bank to any single national legislature, to how to synchronize fiscal policies to ensure regional stability, and agreements on technical issues such as the size of budget deficits and the maturity profile of public debt.[30]

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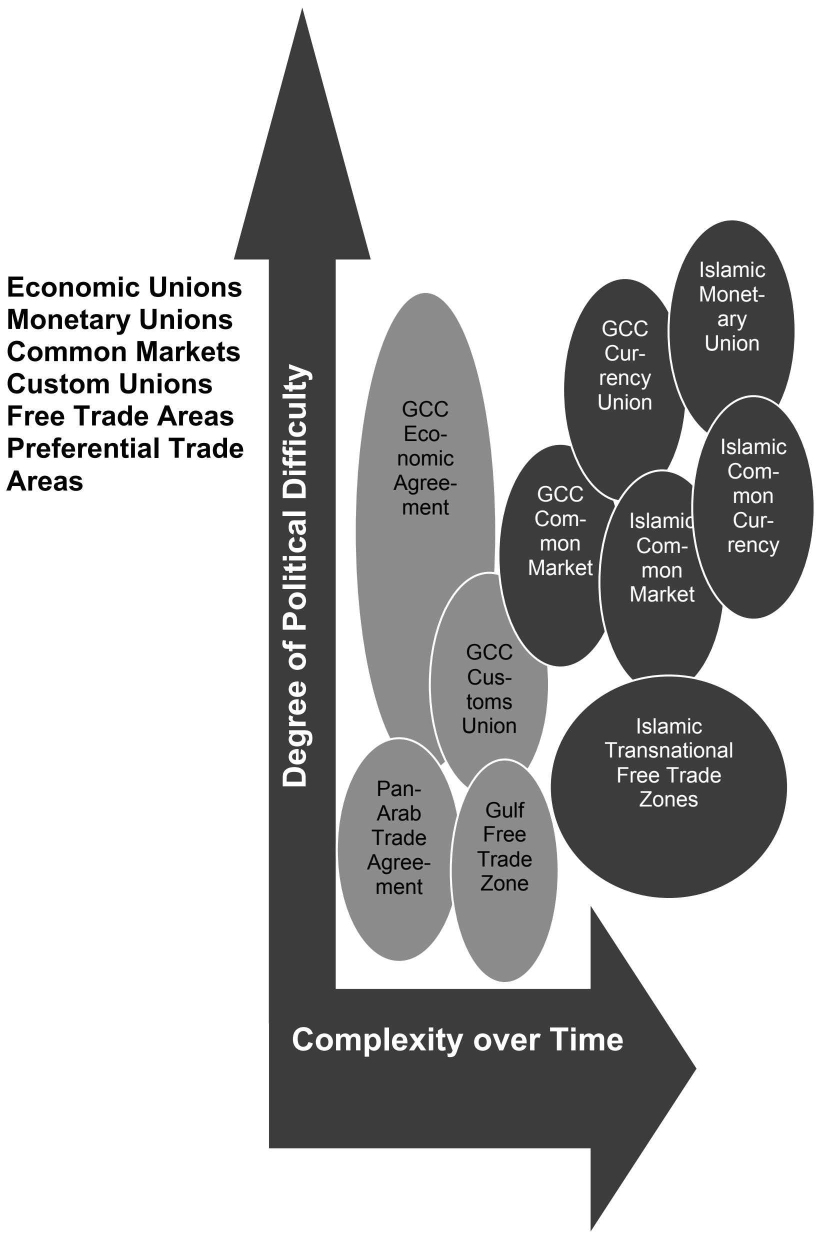
[29] Berger and Mueller, “How Should Large and Small Countries Be Represented in a Currency Union?” p. 471.

[30] Tim Congdon, “EMU: Can Monetary Union Work Without Political Union?” Open Lecture, University of Edinburgh, November 16, 2000.

Figure 6: Future Stages of IMU Development (Source: Maris Strategies)



The classic goal of monetary policy is to promote maximum output and employment while sustaining stable prices. The objective of Islamic economic unity is to address the root problems of cross-border trade, establishing economies less dependent on oil or any single commodity, raising economic activity to levels on par with larger nations, and to protect weaker member of the union from adverse economic conditions. In an Islamic context, the goal of monetary policy is to maximize social welfare while maintaining a regime that encourages price stability and the efficient use of money. The long-term goals of monetary policy synchronization between Muslim states are to create a foundation for real economic growth by controlling inflation. That said, the more dynamic aspect of monetary policy is to achieve the stabilization of nominal income during periods of asymmetric economic shocks. The key lesson to learn from other monetary unions is to develop a process that balances the overreaction to economic shocks, which are typically voiced by national authorities (due to re-election worries) in an effort to shape policy favoring their domestic agendas at the expense of the common needs of the union, with sound policy and mechanisms that lead to stabilization quickly. Bottazzi and Manasse argue that central monetary policy should overreact to large symmetric shocks (multi-nation) and underreact to small asymmetric shocks (domestic single country).[31]

In a theoretical context, monetary policy seldom alters a nation's economic output, levels of employment, and pricing of goods and services directly. Central bankers act to influence indirectly the economic activity of a nation through the manipulation of interest rates. Thus, the question of an interest-based economy rises to the forefront of any discussion on IMU. As said above, policymakers are asking if an IMU should be based on a form of non-interest-based capitalism and whether such a form of capitalism can coexist within an interoperating global economy. Even more importantly, with the absence of interest rates as a mechanism to influence the economy, they ask what other controls would need to exist to provide an appropriate set of tools for central bankers.

Sustainability becomes more complex as economic integration is a process of establishing bidirectional agreements that can be expanded in scope and complexity to engage nations in higher degrees of

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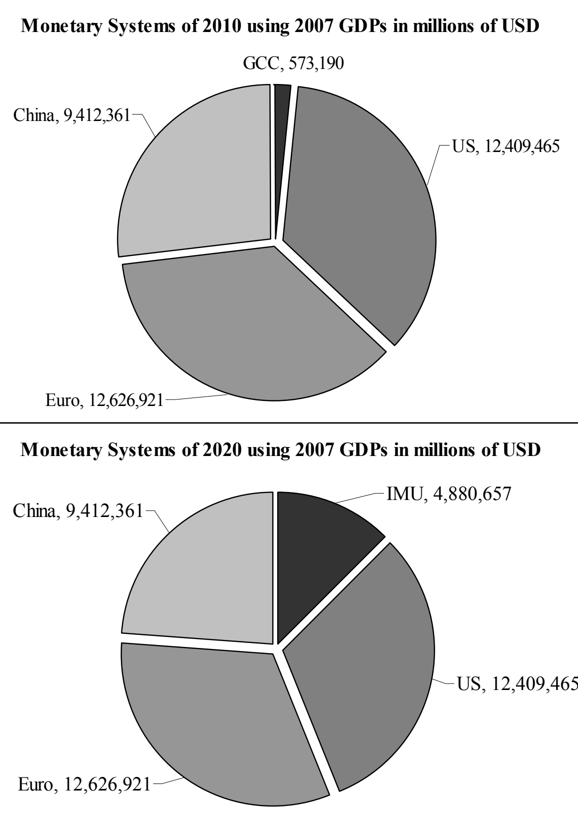
[31] L. Bottazzi and P. Manasse, "Asymmetric Information and Monetary Policy in Common Currency Areas," Working Papers Series 217, Milan, Innocenzo Gasparini Institute for Economic Research, July 2002, p. 17.

economic synergies. Evidence relative to the GCC indicates that the rising number of transnational agreements in the form of preferential trade areas, free trade areas, and customs unions is already laying the foundation for long-term sustainability. However, to date, the prime beneficiaries of free trade areas appear to be western multinational corporations with only marginal increases in trans-Islamic trade.

Assessing the theoretical aspects of the IMU in the context of the developing GCC monetary union and the future state of unification across the OIC member nations, one can see in relative terms the impact of an IMU in world markets, as illustrated in Figure 7.

Figure 7: Theoretical Impact of IMU (using 2007 GDP figures as a baseline) (Source: Maris Strategies)



Using 2007 GDP figures as a baseline to understand the relative strength of a theoretical IMU on today's world markets, Figure 7 represents the relative impact of the 2020 IMU if it existed today. As the value of the US dollar wanes, there is a resurgence of talks on the development of the regional common market, which would add free movement of production and labor across member states, increasing the depth of customs unions. Recent discussions in the GCC focus on monetary union and the implications of adoption of a common currency by 2010 across member states. Since the GCC nations share a common economic export (oil) and international oil trade is largely dollar-denominated, the initial currency will try to maintain a close peg to the U.S. dollar; however, as GCC economies become more diversified, a more flexible exchange rate policy will be required.[32] According to Rose and Engel, members of a currency union tend to have more highly synchronized business cycles as a direct result of increases in trade between member nations.[33] One could argue that, once implemented and as the Gulf economies diversify, the GCC monetary union could act as the foundation for a broader regional union or perhaps the start of the IMU.

Evidence of movement toward Islamic economic unity can be seen in the rising number of economic agreements between Muslim nations. What is needed for sustainability, I argue—somewhat against the current—is authenticity, a clear distinction of the inherent value of Islamic finance beyond simply enabling Muslims to practice their faith.[34] Authenticity is a reaffirmation of Islamic ideals manifested in a socioeconomic system that demonstrates to the world a viable sustainable alternative to the incumbent financial system. Socioeconomic systems like socialism and capitalism are sustained or fail based on an underlying ideology. The degree of success within a socioeconomic system (its sustainability) is manifested by the trustworthiness of the economic activity within the systems, and based

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[32] George T. Abed, S. Nuri Erbas, and Behrouz Guerami, "The GCC Monetary Union: Some Considerations for the Exchange Rate Regime," Working Paper, International Monetary Fund, WP/03/66, April 2003, pp. 4–6.

[33] Andrew K. Rose and Charles Engel, "Currency Unions and International Integration," *Journal of Money Credit and Banking* 34.3, August 2002, pp. 821–22.

[34] Iraj Toutounchian, *Islamic Money and Banking: Integrating Money in Capital Theory,* Singapore: John Wiley and Sons, 2009, is a good study of the issues involving Islamic banking and Islamic ethics that go beyond the remit of religious morality per se.

on how the systems interoperate in external global market conditions. In short, markets and economies are sustained when people and businesses have faith in their socioeconomic system. The sustainability of an Islamic Monetary Union will be the result of a steadfast adhesion to Islamic ideals, which in turn establishes market fidelity. Thus, if the authenticity of Islamic ideals is maintained, the fidelity of the market will be sustained because the people within the socioeconomic system have faith and trust in the execution of market activities.

If I were asked to draw a picture of where we are today in the process of economic unification, the image of a lone tower crane in the desert symbolizes that we are building the foundation of an economic entity that we have yet to define. Nonetheless, history is littered with failed monetary unions.

Even loosely constructed, monetary unions will work while economic activity is experiencing steady growth. At the same time, history also points out that monetary unions fail if they do not achieve political union and a high degree of economic convergence.

CONCLUSIONS

In conclusion, monetary unions are a complex set of interoperating obligations between nation-states formulated to better their respective societies, codified by constitutional principles, and implemented by rigorous adherence to economic objectives.

Discussion about an IMU has largely been the intellectual pursuit of academics, *shari'a* scholars, bankers, and a few policymakers, with the sceptics outnumbering supporters by a vast majority. Talk of Keynesian economic theories, interest-free monetary systems and synchronizing fiscal and monetary policies to interoperate all seem insurmountable obstacles to the IMU. However, the "equitable exchange of value" between parties as a fundamental tenet of *shari'a* principles may be a prescription to redress the vast inequalities created in the current global economic conditions.

An IMU is feasible because the technical mechanisms required exist today. What is missing is political determination to make it work. Fiscal, economic, and monetary policy synchronization is difficult but not impossible. Viability, on the other hand, demands innovation, a fundamental rethinking of how Islamic institutions engage the communities in which they serve, and the establishment of control mechanisms that build consumer confidence and market quality. The sustainability of an IMU will be determined by the authenticity stemming from the industry's ability to maintain the fidelity of Islamic values and *shari'a* principles.

An IMU is not a nostalgic search for past economic glory, nor are the underlying principles of Islamic finance as an economic system based on equitable exchange between parties solely a reaffirmation of a fundamental belief in Islam. An IMU is about securing a future of Muslim societies in economic terms that ensures economic viability while preserving Muslim ideals. The IMU is not a clash of ideological constructs that is determined to usurp the incumbent financial systems; it is rather a process that re-evaluates the nature of exchange within a broader context of fairness between social classes. The IMU is part of a political resolve that determines the acceleration or diminution of economic unification between Muslim states. In the final analysis, one could make the case that perhaps if monetary policy synchronization already existed, political differences between Muslim states would lessen over time.

Conceivably the IMU—or at least the discussion of economic unity—acts as a catalyst to bring a new level of global economic power to the nations that are willing to operate within a new set of interoperating objectives. Initiatives such as the GCC monetary union and the dream of an IMU give Muslims a concrete vision of a possible economic future.