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# The Institutional Framework of the Gulf Central Bank

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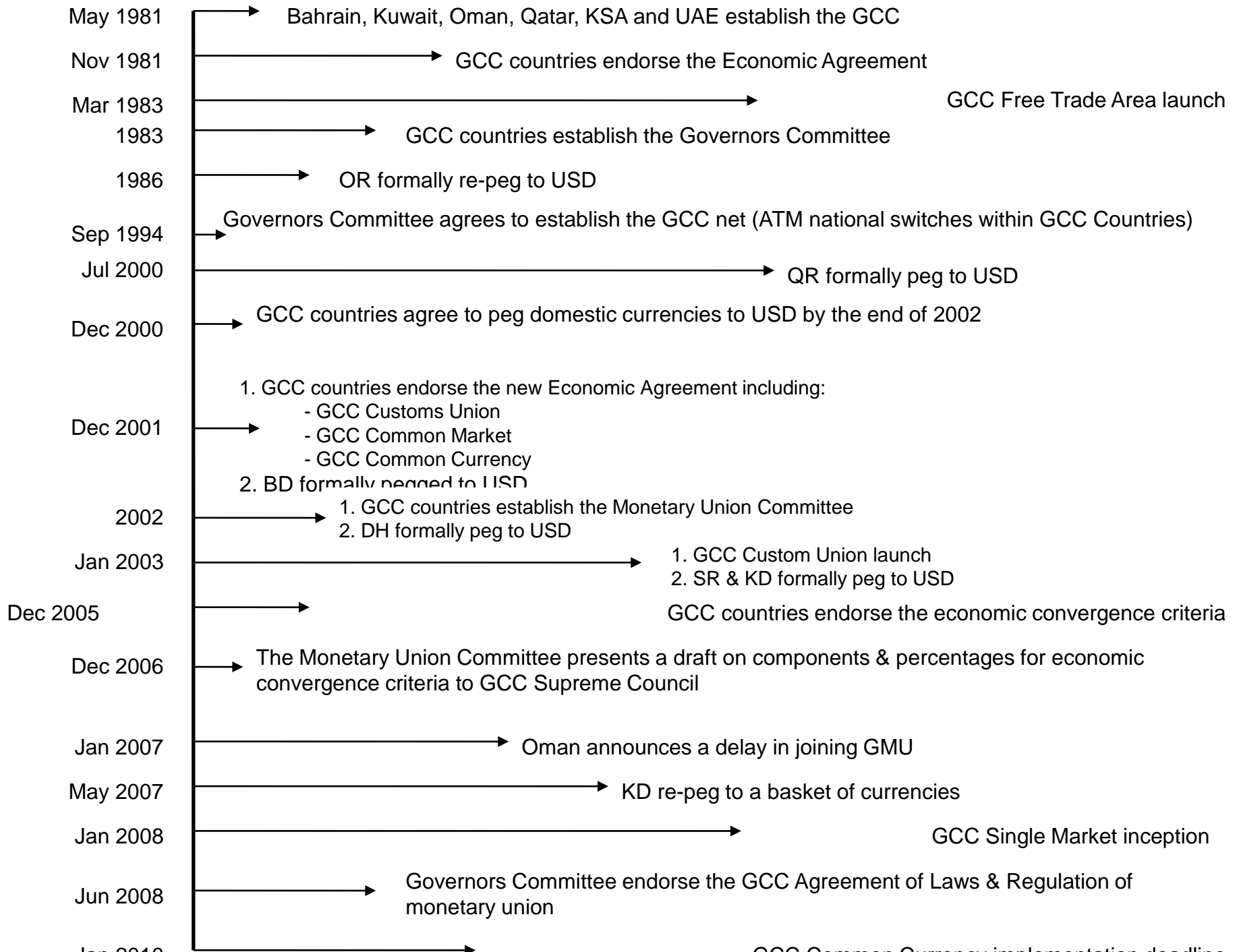
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- This Economic Note contains an extension of the analytic work published in the DIFC Economic Note No.1 issued in August 2008.
- The views, opinions, recommendations and proposals expressed in this economic note are those of the authors and they must not be taken as representing in any way the official position of the DIFC Authority, nor the position of any government, public institution, agency or authority.
- This piece of analysis aims at fostering a debate on the main themes related to the Gulf Monetary Union.

- Chronology of the GMU**
- Four critical elements**
- Overview of US Fed and ECB**
- Options for the GCB**
- Strategic Issues on GMU and GCB**
- Conclusions**

- The GCC countries, *de facto*, have been tied in a quasi-monetary union as their currencies have been strongly pegged, formally or informally, to the US dollar since the early 1970's
- Gulf Monetary Union moves the GCC countries from a monetary union in which they did not enjoy any monetary autonomy, to an arrangement in which monetary policy can be more readily tuned to countering inflation, addressing economic fluctuations, adapting to business cycle developments and reacting to changing global economic conditions.
- GCC should act as a 'monetary bloc' to counter the winds of globalization, international financial turmoil and widespread volatility of commodity and financial markets



- 1. *Modus operandi* Institutional and governance framework to ensure smooth, transparent and effective decisions in the conduct of monetary policy and other central bank policies, i.e. the *modus operandi* of the GCC Central Bank.
- 2. INFLATION TARGETING: While a fixed peg to the US dollar provided for monetary and price stability in the past, structural changes, growing economic and trade diversification with Asia (increasingly the main trade and investment partner) and weakness of the US dollar on international markets, provide the rationale for a change in policy towards inflation targeting, with monetary policy geared to maintaining inflation within an announced target range.
- 3. STATISTICAL CAPACITY: GCC countries will need to greatly improve their statistical capacity, in order to provide harmonized, comparable economic and financial data, to support the GMU and the Gulf Common Market.
- 4. MARKET INFRASTRUCTURE: The GMU, needs to be supported by investments in financial infrastructure (including legal and regulatory), payment systems and the development and linkage of money markets and capital markets.

- Federal Reserve Board (6 Governors plus the Chairman) located in DC runs the national system
- Federal Open Market Committee, i.e. Federal Governors & Presidents of the 12 Regional Banks, decide over monetary policy at regular meetings every 6 weeks
- Voting rights for Regional Feds Presidents are assigned on a rotating basis (except New York Fed)
- The President in between meetings can change interest rates by 50 bp on his own initiative
- US Fed Chairman is appointed by the US President subject to a Senate confirmation for 4 years. He appears at regular hearings in Congress.
- US Fed has banking supervision responsibilities

- The Executive Board formed by the President and 5 members runs the Eurosystem from Frankfurt
- The Governing Council, i.e. the Executive Board plus the Governors of the national Central Banks in member countries decides over monetary policy every month
- The GC decided on a one-man one-vote rule
- The President cannot decide autonomously on interest rates without the approval of the Governing Council
- The President is appointed by the European Council for an 8 year non renewable term
- The President appears at regular hearings of the EU Parliament and holds a monthly press conference
- The ECB does not have banking supervision powers



## Council of Governors

- National Central Bank and Monetary Authorities Governors meet periodically to decide over monetary policy, but a supranational Central Bank is not instituted
- The President is chosen by Heads of States as a *primum inter pares*, possibly among the Governors
- Governors have equal voting rights, but the President has the casting vote and is the official spokesperson.
- A Secretariat helps the President to coordinate with national Governors, set up the Agenda of the meetings and manage the flow of information
- Meetings are held each time in a different city on a country rotation basis.

## Fully-Fledged Gulf Central Bank

- Supranational Gulf Central Bank is instituted with an full time Executive Board at the helm, permanent staff and autonomous resources
- Capital of e.g. US\$1 billion; international reserves = 3 months imports
- Monetary Policy Council, i.e. the EB plus the Governors of National Central Banks and Monetary Authorities are entrusted with all major decisions
- Additional non voting members can be added or external experts can be invited to brief the MPC on specific issues
- Emphasis on transparency with regular press conferences and frequent communication to markets and public
- Publication of minutes under “Chatham House rules”

- **Option 1:**

One man- one vote rule, President holding casting vote

- **Option 2**

Executive Board members have 20% of the voting rights, governors' rights depend on GDP share in the total

- **Option 3**

Executive Board members have 20% of the voting rights, governors' rights are based on a quota system based on economic criteria: GDP, trade, population, size of financial markets, etc.

1. **Operations** would be in charge of the periodic liquidity auctions, foreign exchange interventions, middle and back office and GCC-wide payments systems.
  2. **Legal** would draft the regulatory/administrative circulars and the decrees pertaining to various areas of central banking and possibly financial market supervision.
  3. **Research and Statistics** would be in charge of business cycle analysis and longer term studies constituting the backbone of the briefing material for the MPC members; the statistics function would ensure uniformity in data reporting and dissemination of the relevant figures to the decision makers and the markets in a timely fashion.
  4. **Banknotes** would take care of the design, printing, circulation of currency and anti-counterfeit measures.
  5. **External Relations** would be in charge of relationships with outside institutions, the markets, the media and the public at large.
- The President or the Vice President should also oversee the internal organization, i.e. human resources, budgeting and internal audit, IT functions.
  - Banking supervision could be added within three years

- Credibility requires that GCB be viewed as a strong, independent and well managed institution with a strong political backing
- New currency will be a major world currency with an appeal as reserve currency for central banks and global asset managers
- GCB will become the ‘voice’ of the GCC on global economic issues and look after the interest of its member countries in global markets and institutions (IMF, BIS)
- Financial markets take assurance that the currency value is guaranteed by an institution committed to maintaining low inflation => inflation targeting framework
- A new institution can adopt the best international practices in governance and attract top professionals

- The Gulf Central Bank will be closely watched by international markets who therefore expect that it adopts a **communication style and monetary policy regime that abides by the highest standards** and is in line with the major and most respected central banks in the world.
- The effects of the monetary union in the Gulf will **be widely felt in international markets**. The creation of a new strong currency, whose stability is guaranteed by oil wealth and increasingly by financial wealth, will attract sizeable capital inflows from all over the world and provide a safe haven for investors when commodity prices spike or when security tensions arise.
- In the medium term, it might lead to the GCC common currency serving as a **international reserve asset** for other countries, notably the Arab countries and oil importers. Similarly, the quotation of reference-oil prices might gradually be expressed in the new currency instead of US dollars. This will increase the seignorage revenues of the GCC countries, but more importantly **it will raise the international profile of the GCC states as a whole**.

- When launched, the GMU would represent a major event on the international scene. It will be the second most important supranational union in terms of GDP. It will be a remarkable feat in a region, the Middle East, where economic and financial cooperation has not been a major feature of economic relations.
- A monetary union among Gulf countries will be a shining example of leadership and teamwork, commanding the attention and respect of the international community.
- The creation of a Gulf Central Bank, would constitute the first supranational institution in the Middle East to wield a significant power outside the realm of national authorities.
- GCB would foster further institutional cooperation and economic integration among GCC countries.
- This transfer of powers signals mutual trust among member countries. Trust is fungible. Once established in one area, it can serve as a foundation for cooperation in others, e.g. Establishing “Gulf Stat”

- A monetary Institute as a precursor the GCB is not necessary. GCB should be operational as soon as possible to test its decision making process and its functioning
- Design of banknotes can be decided at a later stage. The euro started circulating three years after the EMU launch
- Location of the GCB can be decided without much fuss and some departments can be decentralized, e.g. banknotes, operations and banking supervision
- The amount of FX reserves can be set at 3 months import equivalent as established in the convergence criteria



- This is a historical opportunity for the GCC to create a GCB and a strong common currency that would be effectively backed by their great natural resource wealth and growing financial wealth.
- We need to foster the sense of approaching a ‘defining moment’: the establishment of a Gulf Central Bank under the management of an Executive Board and Presided by a well respected figure.
- A GCB and currency union in the GCC would be one of the crucial factors helping member countries face up to the challenges posed by globalization and current international financial turmoil.
- The GCC countries would have an institution providing them with a role and ‘voice’ in the world’s changing economic and financial geography.
- A GCB with a monetary policy geared to targeting inflation would generate investor confidence in GCC financial markets and create an international reserve asset for oil importing countries, a natural hedge against inflation and commodity price volatility.

# Thank You!

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