Exchange Rate Regimes in the OIC Member Countries

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Introduction

An exchange rate can be defined as a price of one country's currency in terms of another currency. Exchange rate regime refers to the system through which this price is determined and it is one of the most important policy instruments of governments. The choice of exchange rate regime has considerable impact on trade in goods and services, capital flows, inflation, balance of payments and other macroeconomic variables. For this reason, the choice of an appropriate exchange rate regime is a principal component of economic management in maintaining growth and stability. However, there is no consensus on how to select an appropriate exchange rate regime and there is not an ideal exchange rate regime suitable for all countries.

Specific country characteristics, policymakers' preferences, credibility of institutions and policymakers can influence the choice of regime. Most important factors influencing the decision are size and openness of the country to trade and financial flows, stage of economic and financial development, structure of trade and production, inflation records and the type of shocks the country faces. Once the decision is taken, a supportive policy environment, which includes prudent macroeconomic policies, consistent monetary policies and credible institutions, is needed for the exchange rate regime to maintain a stable and competitive exchange rate. In the presence of inconsistent policies and fiscal imbalances, crisis would be inevitable under any exchange rate regime.

Among others, exchange rate regimes have been considered as one of the factors in leading to crisis in emerging market economies. Financial and currency crisis in Mexico (1994), Thailand, Korea and Indonesia (1997), Russia (1998), Brazil (1999), and Turkey and Argentina (2001) had severe negative impacts on economic growth. Although it is difficult to attribute any specific role to exchange rate

regimes in triggering the crises, the choice of the regime may significantly affect the course and depth of crises. All above mentioned crises were forced by large capital outflows to abandon an exchange rate target and to move to a more flexible exchange rate regime. Some argued that setting explicit exchange rate pegs was a mistake and other claimed that none of these crises would occur if they had been following explicit policies of tight exchange rate pegs (Frankel, 2003).

Given the importance of exchange rate regimes, this report provides a brief overview of the exchange rate regimes in the OIC member countries. After summarizing the types and advantages of the exchange rate regimes, policy issues in selecting exchange rate regimes will be discussed. Then the current regimes adopted in the OIC member countries will be presented. Before concluding, the discussions on the possibility of a single currency and monetary policy in the OIC region will be summarized.

Taxonomy of Exchange Rate Regimes

Exchange rate regimes can roughly be classified into three categories: fixed (pegged), flexible (floating) and intermediate regimes. Prior to 1970's, most economies operated under fixed exchange rate regime known as the Bretton-Woods system. Under this system, countries fixed their exchange rates against US dollar and the dollar was worth a fixed amount of gold. All participating currencies were implicitly pegged to the gold. The system was broken down after 25 years (1946-1971) but the system of fixed exchange rate remained the preferred regime in many countries. The basic motivation for keeping exchange rates fixed is the belief that a stable exchange rate can facilitate trade and investment flows between countries by reducing fluctuations in relative prices and by reducing uncertainty.

Since 1971, economies have been moving towards flexible exchange rate regimes, where the value of the currency is determined by the market. In this setting, the domestic currency, all else equal, depreciates when demand for the foreign currency increases or supply of the foreign currency decreases and appreciates when demand for the foreign currency decreases or supply of the foreign currency increases.

Although there are slight differences in the classification of the exchange rates[1], the one that is provided by Ghosh et al. (2002) is preferred for the purpose of this outlook. As presented in Table 1, it involves 5 sub-categories and 10 different exchange rate regimes.

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[1] There are alternative classification systems in the literature. Another frequently used classification, preferred also by IMF, involves (ranked on the basis of the degree of flexibility): independent floating, managed floating, crawling bands, crawling pegs, pegged within bands, fixed peg arrangements, currency board arrangements and exchange arrangements with no separate legal tender.

Table 1: Classification of the Exchange Rate Regimes

Classification	Sub-classification	Regime	Main Characteristics
Pegged Regimes	Hard Pegs *Exchange rate is pegged in a manner that makes a change in parity or an exit from the regime extremely difficult and costly*	Dollarization	A foreign currency is used as a legal tender, even though in some cases domestic coins are used. Monetary policy is delegated to the anchor country. Seigniorage accrues to the issuing country.
		Currency Boards	The exchange rate is pegged to a foreign (anchor) currency, with the regime and the parity enshrined in law. The law would also specify a minimum amount of international reserves to be held by the central bank to back a certain percentage of a pre-specified monetary aggregate. Main difference from dollarization: seignorage accrues to the home country.
		Monetary Union	A group of countries uses a common currency issued by a common regional central bank. Monetary policy is determined at regional level; seignorage accrues to the region. No option to adjust par-values internally; externally, the monetary authority issuing the common currency can pursue any exchange rate policy.
	Traditional Pegs *Currency is linked to a single foreign currency or to a basket of currencies. Cost of adjusting the parity or of abandoning the regime is lower than in the case of hard pegs*	Single Currency Peg	The exchange rate is pegged to a fixed par-value to a single foreign currency. The central bank is expected to trade at the announced par-value, but the rate is generally adjustable (through discrete devaluations or revaluations) in case of fundamental disequilibria. Credibility is greater the higher the level of central bank reserves, but generally reserves do not fully cover all domestic liabilities, leaving some room for discretionary monetary policy.
		Basket Peg	Similar to single currency peg, except that the currency is pegged to a basket consisting of two or more currencies. Basket can be designed according to country-specific criteria or be a composite currency (SDR, or previously ECU). For country-specific baskets, basket weights may be publicly known or be secret, and may be fixed or variable.
Intermediate Regimes	Floats with rule-based intervention *Exchange rate is not pegged at a specific rate, but the central bank intervenes in a predetermined manner to limit exchange rate movements*	Cooperative Regimes	Cooperating central banks agree to keep the bilateral exchange rates of their currencies within a pre-set range of each other. Policy instruments include adjustment of domestic monetary policy as well as (joint and coordinated) intervention. Arrangement can impose constraints on monetary policy, the severity of which depends on the relative position of the various currencies.
		Crawling Peg	The exchange rate is determined in a rule-based manner, typically adjusting at a predetermined rate or as a function of (actual or expected) inflation differentials. Par value can be set with regard to a single currency or a basket of currencies. In some cases, crawling pegs are combined with bands. Specific design features (such as the degree of adjustment, and the length of time between adjustments) determine whether the system resembles more a fixed or a flexible exchange rate.
		Target Zones and Bands	Exchange rate is allowed to fluctuate within a pre-set range; endpoints (which, in the case of bands are fixed, in the case of target zones are a policy goal) defended through intervention. There may be intra-band intervention to avoid excess pressure at the margin. In some cases, bands are combined with crawling pegs (crawling bands). Degree of exchange rate flexibility is determined by the width of the band or target zone.
	Floats with discretionary intervention *Exchange rate floats but is influenced by significant official intervention*	Managed Floating	Exchange rates are free to move according to supply and demand. Authorities have a view on the desired level and path of the exchange rate and intervene, but are not bound by any intervention rule. Often accompanied by a separate nominal anchor, such as an inflation target.
Floating Regimes	Free Floats *Exchange rate is allowed to float freely and the central bank does not intervene in the foreign exchange markets.*	Independent Floating	The exchange rate is determined in the foreign exchange market based on daily supply and demand with minor or no official intervention. Requires little or no official reserves. Exchange rate regime places no restrictions on monetary policy, which often follows an inflation-targeting framework.

Source: Ghosh *et al.* (2002).

Advantages and Disadvantages of Various Exchange Rate Regimes

Given the impact of exchange rate regimes on economic activities, the selection of the appropriate regime must be based on careful investigation of the pros and cons of each alternative regimes and main economic fundamentals. As listed in Table 2, each type of regimes comes with major benefits and vulnerabilities. A closer look at the table indicates that floating regimes are more appropriate for developed countries, while intermediate regimes are better options for developing countries with open economies and sufficiently developed financial sectors. In case of less integration with the world economy and lack of monetary discipline, soft peg regimes appear to be preferable. Hard peg regimes are generally an option for countries with high inflation and low credibility.

Table 2: Exchange Rate Regimes: Main Advantages and Disadvantages			
	Country Circumstances	**Main Advantages**	**Main Disadvantages**
Floating Regimes	Appropriate for medium and large industrialized countries and some emerging market economies that are relatively closed to international trade but fully integrated in the global capital markets, and have diversified production and trade, a deep and broad financial sector, and strong prudential standards.	More easily deflect or absorb adverse shocks. Not prone to currency crisis. High international reserves not required.	High short-term volatility (excessive fluctuations may be dampened in the case of lightly managed float). Large medium-term swings only weakly related to economic fundamentals. High possibility of misalignment. Discretion in monetary policy may create inflationary bias.
Intermediate Regimes	Appropriate for emerging market economies and some other developing countries with relatively stronger financial sector and track record for disciplined macroeconomic policy.	Limited flexibility permits partial absorption of adverse shocks. Can maintain stability and competitiveness if the regime is credible. Low vulnerability to currency crisis if edges of the band are soft.	Lack of transparency because criterion for intervention is not disclosed in managed float, and broad band regimes are not immediately identifiable. This may lead to uncertainty and lack of credibility. High international reserves are required.
Soft Peg Regimes	Appropriate for developing countries with limited links to global financial markets, less diversified production and export structure, shallow financial markets, and lacking monetary discipline and credibility. Countries stabilizing from very high level of inflation	Can maintain stability and competitiveness if the peg is credible. Lower interest rates Provides a clear and easily monitorable nominal anchor Allows high inflation countries to reduce inflation by moderating inflationary expectations.	Prone to currency crisis if the country is open to international capital markets. Encourages foreign debt. High international reserves are required. Little shock absorptive capacity. Shocks are largely absorbed by changes in the real sector.
Hard Peg Regimes	Appropriate for countries with a history of monetary disorder, high inflation, and low credibility of policymakers that need a strong anchor for monetary stabilization.	Provides maximum credibility for the economic policy regime. Can facilitate disinflation. Not prone to currency crisis. Low transaction costs, low and stable interest rates. Lack of monetary discretion eliminates inflationary bias.	Central bank loses its role as lender of last resort. Higher probability of liquidity crisis. Low seigniorage under currency board, no seigniorage in the case of dollarization. No shock absorptive capacity. Shocks have to be fully absorbed by changes in economic activity. Exit from dollarization is very difficult.
Source: Yagci (2001), World Bank			

Policy Issues in Selecting Exchange Rate Regimes

Except in floating and hard pegged regimes, active management of the exchange rate is required. The government and monetary authorities try to control the exchange rate to maintain a competitive national economy. By providing an additional strong policy tool, active management can help developing countries to correct misalignment and to influence the balance of payments, trade flows, investment, and production. However, this is not the only issue in selecting exchange rate regimes. Credibility of monetary authorities, volatility and misalignment of the exchange rates and vulnerability of the regime to crisis and shocks are among the major concerns in selecting an exchange rate regime.

Credibility: Credibility comes at the cost of flexibility. Fixed exchange rate regime provides more credibility with almost no flexibility, because loose monetary policy would lead to an exhaustion of reserves and collapse of the fixed exchange rate regime. Flexible exchange rate, on the other hand, provide maximum discretion for monetary policy, but restraints need to be put on authorities to ensure that discretion is not misused and policies remain consistent and sustainable. Otherwise, the degree of discipline and credibility would decrease with a rise of flexibility.

Volatility: High short term volatility comes with the flexible regimes. High capital mobility eases the adjustments in international portfolio allocations, paving the way for large volatility in developing countries with shallow financial markets. High volatility in turn increases uncertainty, transaction costs and inflation and thereby discourages trade and investment. Moving from flexible to fixed regimes leads to reductions in the degree of volatility. The hard peg regimes with strong and credible institutional arrangements warrant nominal exchange rate stability. Going one step further and introducing common currency would eliminate transaction costs and promote trade and investment between participating countries. The intermediate regimes, on the other hand, can establish a proper balance between exchange rate stability and flexibility.

Vulnerability to crisis and shocks: Although the main argument in favour of pegged regimes is their ability to induce discipline and make the monetary policy more credible, it is the soft pegged regimes that are most vulnerable to currency crisis. Another argument for fixed exchange rate regimes is that they preclude speculative bubbles. At the end, the choice of the regime must depend on the characteristics of the country in question. If the country is subject to many external disturbances, it is more likely to want to float its currency. On the other hand, exposure to many internal disturbances is likely to lead countries to prefer pegged regimes.

Macroeconomic policies: The exchange rate regime is one of the many macroeconomic policy instruments available to governments in maintaining external and internal balances. Monetary and fiscal policies should comply with the choice of exchange rate regime. Pegged regimes, for example, require full commitment of monetary policy when there is substantial openness to international capital markets. Under some circumstances, capital controls can be a useful instrument to tame speculative flows, protect against excessive movements in the exchange rates and reduce the vulnerability of soft pegs to currency crisis.

The Impossible Trinity: The theory of the impossible trinity demonstrates that a country cannot pursue three goals related to exchange rate regime simultaneously. These are fixed exchange rates, monetary autonomy and free capital flows and only two of the three goals are attainable. Countries then should decide which one to give up. A country in a monetary union gives up monetary

discretion, while a country strongly integrated in the global capital markets is likely to give up fixed exchange rate.

All these factors should be taken into consideration while making decision on the appropriate type of exchange rate regime. In addition to these factors, other country specific factors may considerable affect the decision-making process. Each country needs to assess what kind of factors should be taken into account. In the light of these observations, we now turn to the exchange rate regimes in the OIC member countries.

Exchange Rate Regimes in the OIC Member Countries

There is usually substantial difference between what countries say they do and what they actually do, that is between *de jure* and *de facto* classifications. It is observed in the literature that countries that say they allow their exchange rate to float mostly do not, and countries classified as pegged have in fact occasional realignments.[2] In an attempt to explain this behavior, Alesina and Wagner (2006) investigate the properties of countries that renege on announced exchange rate regimes. They found fear of pegging and fear of floating that are associated with the quality of institutions and economic management. Countries that display fear of pegging (do not keep to an announced peg) tend to be those with poor institutions, as it is related with poor economic management and economic instability is incompatible with monetary stability and exchange rate pegs. On the other hand, countries with good institutions display fear of floating (float less than they announce) and try to limit exchange rate fluctuations. The authors explain this behavior as that wide fluctuation in exchange rates will be considered by the markets as an indication of poor economic management. These studies provide some explanations on the differences between the exchange rate regimes that is announced and that is implemented.

For this reason, it has been a common approach to classify the countries in terms of the regimes they actually follow. In this regard, Table 3 reports the regimes that are followed by the OIC member countries as of the end of 2008 described in IMF "Classification of exchange rate arrangements and monetary policy frameworks" data (explanation of the terminology used in this table is provided in Box 1). Although it is the most up-to-date data, it refers only to the end of 2008. Therefore, changes in the exchange rate regimes in 2009 and after are not captured in this study.

Starting with dollarization, there is no OIC member country having exchange arrangements with any separate legal tender, in which the currency of another country circulates as the sole legal tender (dollarization). This indicates that no member country preferred to surrender the independent control over domestic monetary policy. According to the latest data available, there are 10 countries in the world in this category of exchange rate arrangement.

Brunei Darussalam and Djibouti have had currency boards since their independence. In this arrangement, domestic currency is issued only against equivalent foreign exchange. By adopting currency board arrangement, these countries leave little scope for discretionary monetary policy by eliminating traditional central bank functions, including lender of last resort. There are 11 other countries in the world having the same exchange rate policy.

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[2] Klein and Marion (1997) report that the average duration of pegs among the Western hemisphere countries is about 10 months.

Table 3: Exchange Rate Regimes in the OIC Countries

Exchange rate arrangement (Number of countries)	Monetary Policy Framework						
	Exchange rate anchor				Monetary aggregate target	Inflation targeting framework	Other[1]
	U.S. dollar (21)	Euro (12)	Composite (8)	Other (1)	(8)	(3)	(4)
Exchange arrangement with no separate legal tender (0)	-	-	-	-	-	-	-
Currency board (2)	Djibouti	-	-	Brunei	-	-	-
Other conventional fixed peg arrangement (33)	Bahrain Bangladesh Guyana Jordan Kazakhstan Lebanon Maldives Oman Qatar Saudi Arabia Sierra Leone Suriname Tajikistan Turkmenistan United Arab Emirates Yemen	Benin[2] Burkina Faso[2] Cameroon[3] Chad[3] Comoros Côte d'Ivoire[2] Gabon[3] Guinea-Bissau[2] Mali[2] Niger[2] Senegal[2] Togo[2]	Kuwait Libya Morocco Tunisia	-	Sierra Leone	-	-
Pegged exchange rate within horizontal bands (1)	-	-	Syria	-	-	-	-
Crawling peg (3)	Iraq Uzbekistan	-	Iran	-	-	-	-
Crawling band (1)	-	-	Azerbaijan	-	-	-	-
Managed floating with no pre-determined path for the exchange rate (14)	Kyrgyz Rep. Mauritania	-	Algeria	-	Afghanistan Gambia Guinea Mozambique Nigeria Sudan Uganda	Indonesia	Egypt Malaysia Pakistan
Independently floating (3)	-	-	-	-	-	Albania Turkey	Somalia[4]

Source: IMF, Classification of Exchange Rate Arrangements and Monetary Policy Frameworks, Data as of April 31, 2008

1/ Includes countries that have no explicitly stated nominal anchor, but rather monitor various indicators in conducting monetary policy.
2/ The member participates in the West African Economic and Monetary Union.
3/ The member participates in the Central African Economic and Monetary Community.
4/ As of end-December 1989.

Majority of the OIC member countries are classified under "other conventional fixed peg arrangements". 32 countries peg their currencies at a fixed rate to another currency or a basket of currencies. 16 of these countries peg to the US dollar, 12 to the euro and 4 to currency composites. 8 of the countries that peg to Euro (Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo) are member of the West African Monetary and Economic Union and use the West African CFA franc and 3 countries (Cameroon, Chad and Gabon) are members of the Central African

Economic and Monetary Community and use the Central African CFA franc.[3] In these regimes, although there is no commitment to keep the parity irrevocably, the monetary authorities stand ready to maintain the fixed parity through direct (e.g., open market operations) or indirect (e.g., aggressive use of interest rate policy) interventions. Though limited, flexibility of monetary policy is greater than in the case of currency boards, because traditional central banking functions are still possible. There are 36 other countries pursuing same exchange rate policy in the world.

Syria is the only country with an arrangement of pegged exchange rates within horizontal bands. Under this arrangement, the value of the currency is maintained within certain margins of fluctuation of at least ±1 percent around a fixed central rate or the margin between the maximum and minimum value of the exchange rate exceeding 2 percent of the fixed central rate. There is a limited degree of monetary policy discretion, depending on the band width. The interest in this regime is not high in the world and only 2 other countries follow the same arrangement.

In crawling peg regimes, the currency is adjusted periodically in small amounts at a fixed rate or in response to changes in selective quantitative indicators. The rate of crawl can be set to generate inflation-adjusted changes in the exchange rate, or set at a preannounced fixed rate and/or below the projected inflation differentials. Maintaining a crawling peg imposes constraints on monetary policy in a manner similar to a fixed peg system. Along with 5 other countries in the world, Iraq, Iran and Uzbekistan are the three OIC countries using crawling peg regimes. Iraq and Uzbekistan adjust the exchange rates against US dollar, while Iran adjusts against a composite of foreign currency basket.

There are only 2 countries in the world having an exchange rate regime with crawling band and Azerbaijan is the only OIC country in this category. Having similar fluctuation margins with pegged exchange rates within horizontal bands, in exchange rate regimes with crawling band, the margins are additionally adjusted periodically at a fixed rate or in response to changes in selective quantitative indicators. The degree of exchange rate flexibility and policy independence is a function of the band width. The commitment to maintain the exchange rate within the band imposes constraints on monetary policy.

In managed floating, the monetary authority tries to influence the exchange rate without having a specific exchange rate path or target. Indicators used by the monetary authority in managing the rate are largely judgmental, including balance of payments position and international reserves, and there is not necessarily an automatic adjustment mechanism. In this category, there are 44 countries in the world, 14 of which are OIC member countries. This policy is implemented under different monetary policy frameworks by the member countries.

Excluding Somalia, for which recent data not available, there are only two OIC member countries that the IMF classifies as independently floating, Albania and Turkey. As mentioned previously, in independently floating regimes, the exchange rate is determined at the market and there may be high short term volatility. Interventions in the foreign exchange market, therefore, aim at moderating the rate of change and preventing undue fluctuations in the exchange rate, rather than at establishing a level for it. There are 37 other countries in the world with independently floating exchange rate regimes, majority of them are high-income countries.

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[3] CFA stands for Communaute Financiere de l'Afrique in French. CFA has a fixed exchange rate to the euro as 100 CFA = 1 former French franc = 0.152449 euro; or 1 euro = 655,957 CFA.

BOX 1: De Facto Classification of Exchange Rate Regimes and Monetary Policy Frameworks

The classification system is based on the members' actual, de facto arrangements as identified by IMF staff, which may differ from their officially announced arrangements. The scheme ranks exchange rate arrangements on the basis of their degree of flexibility and the existence of formal or informal commitments to exchange rate paths. It distinguishes among different forms of exchange rate arrangements, in addition to arrangements with no separate legal tender, to help assess the implications of the choice of exchange rate arrangement for the degree of independence of monetary policy. The system presents members' exchange rate regimes against alternative monetary policy frameworks in order to highlight the role of the exchange rate in broad economic policy.

Exchange rate anchor

The monetary authority stands ready to buy or sell foreign exchange at given quoted rates to maintain the exchange rate at its predetermined level or within a range (the exchange rate serves as the nominal anchor or intermediate target of monetary policy). These regimes cover exchange rate regimes with no separate legal tender, currency board arrangements, fixed pegs with or without bands, and crawling pegs with or without bands.

Monetary aggregate target

The monetary authority uses its instruments to achieve a target growth rate for a monetary aggregate, such as reserve money, M1, or M2, and the targeted aggregate becomes the nominal anchor or intermediate target of monetary policy.

Inflation targeting framework

This involves the public announcement of medium-term numerical targets for inflation, with an institutional commitment by the monetary authority to achieve these targets. Additional key features include increased communication with the public and the markets about the plans and objectives of monetary policymakers and increased accountability of the central bank for its inflation objectives. Monetary policy decisions are guided by the deviation of forecasts of future inflation from the announced inflation target, with the inflation forecast acting (implicitly or explicitly) as the intermediate target of monetary policy.

Other

The country has no explicitly stated nominal anchor, but rather monitors various indicators in conducting monetary policy. This is also used when no relevant information on the country is available.

Source: IMF website on "Classification of exchange rate arrangements and monetary policy frameworks"

A Common Currency and Monetary Policy for the Member Countries?

Before concluding, it is worth to have a quick look at the discussions on the possibility of single currency – Islamic dinar – in the OIC region. Under the Islamic gold dinar, the aim is to have a common gold exchange, using gold as the common accounting unit for trade. Several justifications have been offered by the Muslim scholars for Islamic Gold Dinar. Some argued that it is part of the Islamic belief; others argued that the current monetary and banking system is unjust and inherently

unstable. Another strong argument is to be less dependent on the US Dollar as an international currency. Dr Mahathir Mohamad, the former Malaysian prime minister, proposed the introduction of Islamic Gold Dinar that could help unite Muslim countries after attending an OIC summit in 2002. Mahathir considered utilizing the gold dinar as a trade instrument amongst OIC member countries to settle bilateral and multilateral trade payments, thereby eliminating foreign exchange risk and establishing a tangible defensive solution to currency manipulation and speculation far removed from the real economy.

A number of advantages have been offered by the proponents for the proposed Gold Dinar. Meera and Aziz (2002) note these advantages as follows:

- The Dinar system will eliminate money creation/destruction.
- The dinar could easily play the role of a preferred global currency.
- Speculation and arbitrage will not be possible, further strengthening and stabilizing the economy.
- The Dinar system will create a harmonious relationship between the monetary sector and the real sector.
- A single currency will facilitate trade among the OIC countries

BOX 2: The Gulf Cooperation Council (GCC) Monetary Union

GCC was formed on 25 May 1981 to encourage policy coordination, integration and unity among six member states of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. These six countries are part of the OIC and they have signed agreement for economic union in 2001, progressing towards establishing a common market and monetary union. The GCC envisioned a single currency in January 2010. All the GCC states, with the exception of Kuwait (which de-pegged from US dollar in June 2007), have their currencies currently pegged to the US dollar since 2001. Oman, however, dropped out of plans for the Gulf Monetary Union in December 2006. This move was followed by the United Arab Emirates, which pulled out of plans for the Gulf Monetary Union in May 2009. (This move appeared to be linked to the decision that the monetary council would be located in Saudi Arabia's capital, Riyadh).

For the time being, the remaining four other GCC states appear to be committed to pursuing the single currency. Bahrain, Kuwait, Qatar and Saudi Arabia announced the creation of a Monetary Council, a precursor to a united Central Bank, on 15 December 2009. The 2010 deadline would be extended to a date to be determined by the Monetary Council. The first Monetary Council meeting was held on 30 March 2010, chaired by Saudi's Central Bank Governor who serves as the Council's first chairman for a one-year term. Two other meetings were held subsequently in 2010 (in May and August respectively) in preparation for the establishment of a central bank for the member countries of monetary union and for choosing a currency regime.

Source: Lee (2011), pp.1575-1576.

The literature examining the attractiveness of the OIC economies to an alternative exchange rate arrangement (a monetary union) is not voluminous. Among the very few studies, Lee (2011) empirically assesses the suitability of 24 OIC economies for potential monetary integration on the basis of their symmetry in macroeconomic disturbances.[4] He found that in comparison with the EU

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[4] The greater symmetry in underlying shocks among the OIC economies makes them better candidates for monetary integration. In general, the trade intensity, the similarity of the shocks and cycles, and the degree of factor mobility are three important interrelationships particularly analyzed among potential members for an Optimum Currency Area

countries, the underlying structural shocks in OIC are less symmetric with a larger size on average. His results suggest that it is less feasible for the entire OIC to form a currency union, but some sub-groups among some OIC countries with highly symmetrical permanent supply shocks would be more suitable candidates for a currency union. Currently, the most serious effort is taking place among GCC countries to have a common currency and monetary authority (see Box 2). The six-nation project, which has been in the works since 2001, has been afflicted by delays and debate over technical issues.

This result indicates that if the OIC countries are committed to pursuing the Gold Dinar or any sorts of monetary integration, much work needs to be done to reduce the disparities and to induce the co-movement of business cycles. In this regard, increased trade integration within the OIC may generate more highly correlated business cycles and makes them better candidates for monetary union. This implies that the OIC countries could enhance their economic cooperation through trade in order to synchronize their business cycles.

Concluding Remarks

Whether a country should choose a pegged or floating exchange rate, or some intermediate regime, is one of the oldest, but also one of the most important policy questions in economics. Many countries have run into crises that disrupted their growth process because they simply made a bad choice.

Each exchange rate regime has its own pros and cons and they can be appropriate for some countries. The choice of appropriate regime cannot be made independently of knowledge of the circumstances facing the country in question. No single regime is right for all countries and for a given country, no single regime may not be right at all times. Regime choices are generally influenced by macroeconomic indicators, including inflation rates and the availability of international reserves.

This outlook report provided only a summary of the properties of different exchange rate regimes, their advantages and disadvantages and classification of member countries under different regimes. The choices of the OIC member countries differ quite a lot. Majority of the countries (40) have some sort of pegged exchange rate regimes. Remaining 17 countries have relatively more flexible exchange rate arrangements. Their performance under different exchange rate regimes is another research question that is needed to be answered in future studies.

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