

# BAHRAIN—AN INTERNATIONAL FINANCIAL CENTRE

THE Bahrain market is still young and developing. Some of its constituents have taken firm roots, others are emerging and still others are likely to come into existence in course of time. The development so far has been encouraging and we nurse the hope that still more can be achieved through persistent efforts directed at further improving the environment for growth.

A remarkable feature of Bab-al-Bahrain is the shape of its arch. It is in the form of a cycloid—the curve traced by a fixed point on a moving wheel. The gateway is thus symbolic of Bahrain because around it everything moves—moves on the wheel of progress. And in this mobility banks do play a significant and continuously expanding part.

Located within 20 miles of the eastern industrial province of Saudi Arabia, Bahrain is approximately 30 miles to the west of Qatar, 270 miles southeast of Kuwait and 270 miles north-west of the United Arab Emirates. Thus lying in the centre of the Gulf, surrounded with sweet water and the sea, the island has tended to be an ideal trading post since times immemorial. Its sea-faring and adventurous people controlled the trade between Indus Valley and Mesopotamian civilizations as far back as the third millennium B.C. The use of coins, possibly in preference to barter, was in evidence from the days of Alexander the Great. In more recent times, its rich merchants are said to provide financial accommodations to local authorities—a function performed by central banks in the present day context. It is, therefore, tempting to conclude that the "seeds of banking" were sown before the advent of the 20th century, which took some considerable time to germinate.

Banking in a formal sense but rudimentary form started in Bahrain when a branch of the Eastern Bank was opened in 1921. This was followed by the appearance of the British Bank of the Middle East in 1944, the National Bank of Bahrain in 1957 and the Arab Bank Limited in 1960.

Slow as the banks were to emerge on the national scene upto late nineteen sixties, they were sufficient to cater to the needs of those days. The demands on them were then elementary i.e. financing of trade and providing deposit facilities for the customers. Surpluses of foreign exchange would routinely get invested in U.K. treasury bills or government securities in accordance with Sterling Area arrangements. However, these pioneers did witness the gradual change of the economy from pearl fishing to oil and later the transformation of the island into a service centre—a process which originated with the setting-up of the tropospheric scatter station on Jabel al-Dukhan for telecommunication links with the States of the lower Gulf.

The old order started to yield place to the new scheme of things about sixteen years ago when in 1965 the Bahrain Dinar was introduced in replacement of the Gulf



Mr. Abdulnabi Al Sho'ala, Education Minister of India Mrs. Sheila Kaul, when the delegation called on the Minister to discuss educational facilities in India.

Rupree. With the slowly declining oil reserves, the Government also became increasingly conscious that reliance on a single commodity was contrary to the long-term interests of the State and took a series of judicious steps to diversify the economy. The availability of Saudi crude in adequate quantities to supplement the output of the Bahrain field led to the construction of oil refinery, the existence of natural gas in Khuff zone opened the way for setting-up the aluminium smelter, the relatively calm and shallow sea presented natural advantages for the establishment of dry dock facilities and the near absence of bureaucratic impediments fostered the growth of free industrial zones. In all these ventures, the Government played an active and leading role.

What made the switch over a living reality was in no small way due to the availability of educated manpower which started to develop with the establishment of Hedaya Khalifa, the first boys modern school in 1919 followed by the first girls school (Hedaya Khalifa-il-Banat) in 1928. Other factors conducive to the change were the political acceptability of Bahrain by the surrounding Arab states in particular and the Arab world in general, freedom from corporate, withholding or personal taxes, an efficient airline, adequate airport facilities for stopover of aeroplanes of numerous other companies, a neatly bridged time zone between the East and the West, dependable telecommunication, telephone and postal services, reasonably pleasant living conditions, a time-honoured commercial tradition and the tolerant attitude of the citizens towards expatriates.

As the tempo of activity gathered momentum, the establishment of banks grew markedly fast so that between 1969 and 1977 as many as 15 new commercial banks opened their doors. In addition, two specialized banks namely the Housing Bank and the Bahrain Islamic Bank came into existence in 1979. With few exceptions, these banks are "unit" offices. While the physical size of the State does not permit extensive branch network, this limitation is a blessing in disguise because inter-office accounts within the confines of the island are easily reconcilable and interbank transac-

Deputy Chairman and four other members, who are appointed for a renewable term of three years by Amiri Decree on the recommendation of the Finance Minister and the Council of Ministers. The day to day work is conducted by the Governor (formerly the Director General) who is appointed by a decision of the Council of Ministers on the recommendations of the Board. The organisational set-up currently comprises seven Directorates whose staff is selected and appointed in accordance with the frame-work of rules and regulations governing appointments of government employees.

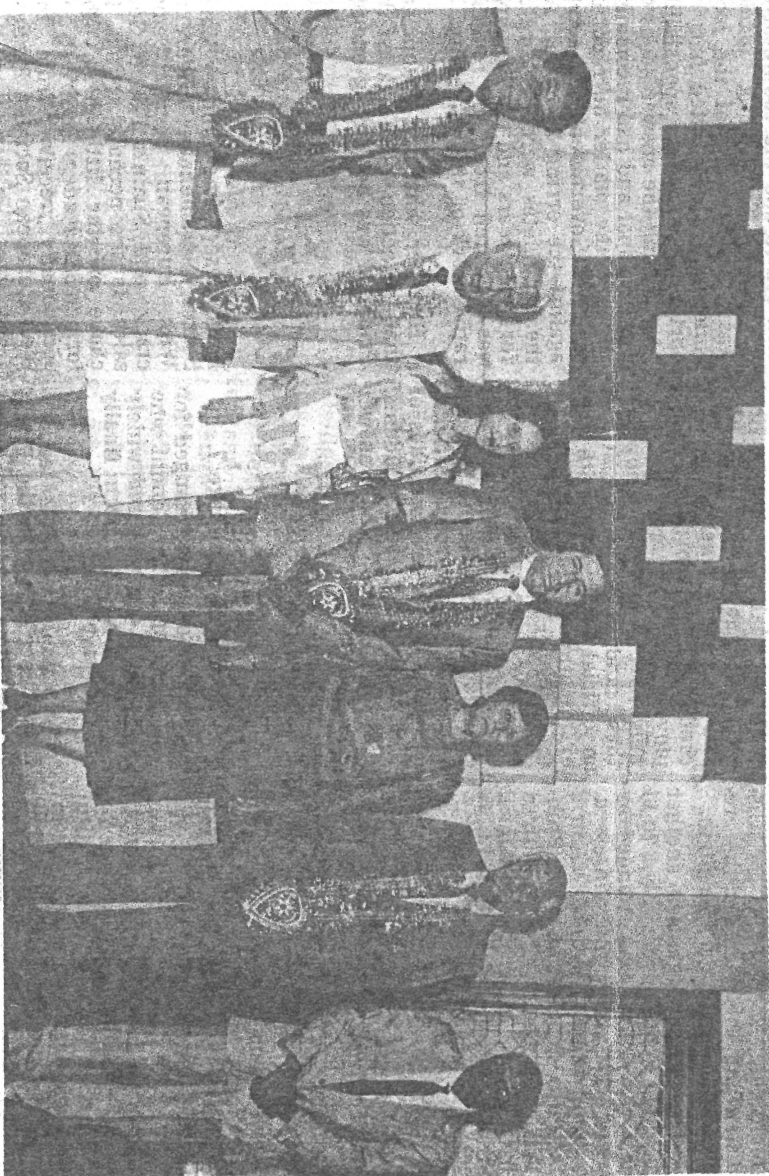
The BMA law sets out in detail the powers and responsibilities of the Agency. It contains, inter alia, provisions for granting operating licences of banking firms, for types of business that they may or may not conduct, for composition of their capital and reserves, for the right of inspection by the Agency, for setting reserve and liquidity ratios and for conditions bearing on insolvency and liquidation of such firms if need arises.

Although the Agency allows lot of freedom to banks and pursues an open door policy, the main thrust of its objectives has been concentrated on regulating the issue and circulation of Bahrain currency, orderly operations of foreign exchange, maintaining the value of the currency and ensuring monetary stability, organizing banking business and controlling the banking system, directing bank credit in accordance with the policy objectives of the State and fostering the growth of money and capital markets.

issue of Dinar notes against Dollars and conversely their withdrawal made it necessary for the agency to announce buying and selling rates on a daily basis. The course made it possible for the BMA not only to operate directly in the foreign exchange market but also to set the margins on rates within reasonable limits.

Initially, BD was linked with Pound Sterling and later with U.S. Dollar. The devaluation of the former in 1967 and of the latter first in 1971 and then in 1973 resulted in substantial losses to the Currency Board and the banks. Moreover, it was amply demonstrated that the value of foreign reserves cannot be safeguarded by linking the Dinar to a currency whose value is likely to change either because of sustained balance of payments disequilibrium or due to speculative flights of capital. Bahrain Dinar is now linked with SDR while the Dollar serves as the intervention currency.

Keeping in view the size of the domestic market, the Agency stopped granting additional licences for commercial banks after 1976, despite the fact that it continued to receive applications for such permission. In fact the search for footholds in Bahrain had become pronounced much earlier because after the increase in the price of oil, the Gulf countries around Bahrain, like other oil producers, had become recipients of substantial funds and bankers felt that they could play a role in channeling them by their physical presence in the area. Oil revenue, not required for immediate use, was indeed flowing to the international markets.



From left to right Mr. Hussain M. Aryan, Mr. Yousuf Ahmed Al-Saei, Mrs. Al Sho'ala, Mr. Abdulnabi Al Sho'ala, Mrs. Al Jishi, Dr. Kasul A. Al Jishi and Mr. Jyva Lal Jain.

of currency to money supply was indicative of the degree of success achieved in exercising control, in inculcating banking habits and in channeling surplus purchasing power to productive uses, this was by no means sufficient. Accordingly, the Bahrain Monetary Agency was created by Amiri Decree No. 23 of 1973 as a legal entity with extensive central banking powers.

The Agency is administered by a Board of Directors consisting of HE the Prime Minister as the Chairman, HE the Finance Minister as the

Soon after its establishment, the BMA took over the functions of the Currency Board, which was constituted in 1965 to issue and control the Bahrain Dinar. The clearing settlement accounts previously maintained by commercial banks with the National Bank of Bahrain were moved to the Agency. As the balances on these accounts can only be created against sales of foreign exchange by banks or by the Government to the BMA, the currency cover in foreign exchange was continued to be maintained at 100 per cent of the note issue. The

in Europe and America. At the same time, Arab institutions were getting increasingly conscious about the safety and liquidity of these funds but existing banks in the Middle East and for that matter in Bahrain were not sufficiently equipped to handle these large amounts. The agency, therefore, invited applications from banks of international standing to open operational offices in Bahrain for wholesale "offshore" banking business. The initial response to the invitation as well as the progress over time has been encouraging.