CENTRAL BANKING AND ITS PROSPECTS IN THE ARAB COUNTRIES OF THE MIDDLE EAST

MAURICE TABRY

Submitted in partial fulfillment
for the requirements of the Degree
of Master of Business Administration
in the Department of Business Administration of
the American University of Beirut

Beirut, Lebanon

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Preface

Central banks are novelties in the field of economic institutions. The term "central banking" is a creation of the twentieth century. As a matter of fact, many countries of the world, including the U.S.A., have established their central banks only in this century. The Arab countries have recently followed this trend; while some of them have already established central banks, others are still preparing to do so.

A study of these modern institutions, at this stage of development in the Arab countries would be both interesting and useful. Up till now, no comprehensive study of this subject has been made; thus, it will be interesting to throw some light on the problems and prospects of central banking in the Arab countries. On the other hand, such a study might help to stimulate further research in this field, which is gaining importance every day. Having this in mind, the writer proceeded to prepare this paper. Now, that it is finished, the writer hopes that it adds something of value to the knowledge of economic conditions in the Arab countries.

This paper, as its subject indicates, covers central banking and its prospects in the Arab countries of the Middle East. However, not all of these countries have central banks. The only full-fledged central banks existing are in Egypt, Iraq

and Syria. This has confined this study to those three countries, without taking the other countries out of the picture. The economies of Egypt, Iraq and Syria are representative of all the economies of the Arab countries in this area which are classified under the heading "underdeveloped". This fact renders the arguments discussed, the suggestions made and the conclusions reached in this paper applicable to all the Arab countries of the Middle East.

Gratitude is due to the officials of the central banks in Egypt, Iraq and Syria for the information they have supplied the writer with, in the course of the study. Special thanks should go to Mr. Abdul Mun'im Rushdi of the National Bank of Egypt and to Dr. Abdul Razzak Hassan of the Banking Studies Institute in Cairo. To Messrs. Adnan El Farra and Abdul Wabbab Khayyata of the Central Bank of Syria, the writer is deeply indebted for the valuable data they have placed at his disposal.

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M. T.

American University of Beirut

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Abstract

Central banks in Egypt, Iraq and Syria were established after World War II. In Egypt, the National Bank, a private-owned limited company, was converted into a central bank on the strength of Law No. 57 of 1951 which places the central banking functions in the hands of a governmental committee. In Iraq, the National Bank was established in 1947 by Law No. 43 of 1947 as a state-owned bank; later on, it was converted into the Central Bank of Iraq by Law No. 72 of 1956, with a considerable increase in its capital and reserves. In Syria, the Central Bank was established as a state-owned bank, as one of the reformative monetary measures enacted by Legislative Decree No. 87 of 1953, and it started operations on August 1, 1956.

The central banks of Egypt, Iraq and Syria are entrusted with issue and stabilization of currency. The Egyptian currency at present is covered by gold, foreign exchange, and Egyptian Government Treasury bills and securities. The currency laws of Egypt do not provide any ratios that should be kept in the cover. Iraq is still in the sterling area, and its currency is covered by gold and foreign assets the minimum of which should form 70% of the cover, while Iraqi Government securities must not exceed 30%. The Syrian currency is covered

by gold, foreign exchange, commercial bills and loans, and Syrian Government bonds; gold and foreign exchange must not form less than 30% of the cover and Government securities may be included in the cover up to a maximum of £S 60 million. In all three countries, the central banks are entrusted with enforcing foreign exchange regulations. Whereas in Egypt, these regulations are very strict and complicated, in Iraq and Syria the exchange markets are practically free.

As fiscal agents of their governments, the central banks in Egypt, Iraq and Syria act as depositories of public funds. In addition they grant short term advances to their governments, discount treasury bills and hold government securities. Moreover, the central banks are entrusted with the flotation of government loans and with the execution of financial agreements concluded with other countries and with international institutions.

The central banks in Egypt, Iraq and Syria are bankers of banks. In the three countries, the laws empower the central banks to impose a reserve ratio upon the commercial banks which in Iraq and Syria is at present 15% while in Egypt it is 12½%. Moreover, these ratios can be varied. In Egypt and Syria there are no limits to these variations while in Iraq the variation may take place within the range falling between 10 and 15%. The central banks rediscount commercial and treasury bills and extend loans to the commercial banks. However, rediscounting in Egypt, Iraq and Syria is still limited because of the little discounting made and because of the liquid position of commercial banks. This renders manipulation of bank credit by variations of central bank rates difficult. As regards open market operations, the central banks in Egypt, Iraq and Syria cannot use it as a method of credit control because there are no wide security markets existing in those countries. Thus, the classical tools of credit control, namely, the central bank rate and open market operations are out of question at the present time. Variable reserve ratios and qualitative controls present better tools in underdeveloped countries.

The major problems standing in the face of central banking in the Arab countries of the Middle East are: undeveloped money markets, absence of wide security markets, inadequate banking systems and scarcity of reliable data and qualified personnel.

The money markets in Egypt, Iraq and Syria are characterized by the use of banknotes rather than checks in discharging payments. In addition, these markets are imperfect as they allow considerable differences in the cost of credit. Moreover, call loan markets and bill markets are either non-existent or are undeveloped. All these factors limit the ability of central banks to regulate money supply. To develop these markets, the banking habit of the population should be propagated by educational campaigns carried by the concerned authorities. Moreover, credit should be available widely and cheaply to eliminate differences in the cost of credit. In addition, commercial banks should encourage discounting of commercial bills.

Security markets in Egypt, Iraq and Syria are either narrow or non-existent. The corporation form of business is still new and corporate shares and bonds are held by few people. Government securities are also limited and do not enjoy a wide market. This small amount of securities disables the central banks to perform open market operations. The development of wide security markets depends upon the availability of long term capital. Saving institutions should be established and suitable company legislation should be provided. In addition, government securities should be made more attractive to investors and commercial banks.

The banking systems existing in Egypt, Iraq and Syria are inadequate and insufficient. Much credit is supplied outside the banking systems. Moreover, numerous foreign banks are in operation, which resort to their head offices rather than to the central banks. Also, bank credit for agriculture and industry is very little. These factors do not enable the central banks to affect economic activity through control of bank credit. In order to develop the banking systems, new domestic commercial banks should be encouraged by government support and central bank facilities. Moreover, bank credit for agriculture should be provided extensively, systems of supervised credit should be developed and agricultural cooperatives should be formed. Bank credit for industry should be provided through private investment banks that are set with government support and financial assistance. Also, credit institutions should be established to serve other aspects of economic activity.

Statistical data in the Arab countries is unreliable and insufficient. Proper central banking requires reliable current money and banking statistics, in addition to other statistics on the economic activity. Central government offices should be established to collect and coordinate statistical information. Moreover, qualified personnel should be trained on statistical methods and procedures to enable them handle their jobs efficiently. The problem of personnel applies to central and commercial banking too. Central banks should prepare intensive programs to train their staff and should establish banking institutes which will provide training to all banking staff.

In the few years that the central banks in Egypt, Iraq and Syria have been operating, they were effective in arousing the interest of the authorities in monetary institutions. Moreover, these banks are now responsible for the development of their fields of activity which are essential for proper central banking operations. In the years to come, the central banks will have to accompany the development programs that will be carried in the Arab countries and to smooth out any serious economic fluctuations that may result.

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Organization and Administration

A. The National Bank of Egypt

The National Bank of Egypt was formed in 1898 as a joint stock company to perform commercial banking, with a capital of £E 1 million, half of which subscribed by a British financier residing in London and the other half subscribed equally by two non-Egyptians residing in Egypt. The Bank was granted the privilege of note issue in Egypt as soon as it was established, by a Khedival Decree, for fifty years ending in 1948. The management of the Bank was practically in the hands of a special board residing in London entrusted with all the powers needed to decide upon its high policy.[1]

In 1904, the Egyptian Government started negotiations with the National Bank with the purpose of converting it into a central bank, but no result was reached. However, the Bank assumed the position of a central bank on a de facto basis by virtue of the privilege it held. An outstanding achievement of the Bank in this respect was the establishment of clearing houses in 1928 and 1929 which was an important step towards the cooperation between the commercial banks in Egypt at that time.[2]

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1. البنك الاهلي المصرى ١٨٩٨_١٩٤٨ ،
2. Ibid., p. 72. (القاهرة : ١٩٤٨) ص ٩ _ ٢٤

When Britain left the gold standard in 1931, the Egyptian Government sought the advice of foreign experts who recommended the establishment of a central bank. This view had its support in the International Economic Conference of 1933 which recommended the establishment of central banks in all countries. As a result, the Egyptian Government started negotiations with the National Bank, and an agreement was reached, according to which the Bank was to be converted into a central bank. The agreement was ratified by the Parliament in 1940 but the discussion of the draft Law of Central Banking was postponed.[1] According to the agreement, the privilege of note issue was extended for forty years and the Bank was officially considered banker of the Egyptian Government, with an obligation on its part to extend to the Government short term loans not exceeding £E 2 million to meet its temporary deficits. Moreover, the agreement provided for the gradual Egyptianization of the Board and staff and the abolishment of the London Board. Also, it has been agreed to transfer the majority of the Bank shares into nominal shares within a period ending in 1948, and to divide profits of the note issue operations between the Government and the Bank in the proportion of 85% and 15% respectively.[2]

Although the National Bank was not officially declared yet a central bank, it continued to assume central banking powers during World War II. In 1943, the commercial banks in

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1. _Ibid_., p. 105.
2. _Ibid_., pp. 94-101.

Egypt started to deposit part of their cash holdings in it and in the course of the war it administered the exchange control and financed the British forces in Egypt by issuing Egyptian banknotes against British Government Treasury bills deposited in the Bank of England.

In June 1947, an agreement was reached with the British Government, by which Egypt left the sterling area. In order to defend the Egyptian currency, exchange restrictions had to be applied. The National Bank continued to act as the agent of the Government in exchange matters and all other central banking duties. However, the position of the Bank was under discussion by the Egyptian authorities; whereas one view called for nationalization of the Bank, other views recommended the establishment of a new central bank. At last, it was decided to convert the National Bank into a central bank thus taking advantage of its long experience and skill in this important function.[1]

In 1951, Law No. 57 was enacted declaring the National Bank of Egypt as Central Bank of the State entrusting it with the following additional duties:[2]

1. Issue and stabilization of the Egyptian currency.
2. Regulation of credit in all times in the public interest, being the lender of last resort.

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1. مرسي ، فؤاد ، النقود والبنوك في البلاد العربية ـ مصر والسودان (معهد الدراسات العربية العالية ، القاهرة : ١٩٥٥) ص ٧٩
2. Law No. 57 of 1951, article 2.

3. Cooperation with the authorities in matters related to banking and monetary policies.

The capital of the Bank, which was in 1898 one million Sterling pounds, was raised a number of times due to the expansion of activities until the capital settled on £E 3 million in 1905 which is the figure at present. It is divided into three hundred thousand shares of £E 10 each paid up in full.

The management of the Bank, as regards its central banking functions, is entrusted to a Supreme Committee composed in accordance with Law No. 57 of 1951. It consists of seven members, including the Minister of Finance and Economy who acts as chairman. Three of the members represent the Board of Directors of the bank and the rest represent the Egyptian Government. This Committee decides on matters related to money, credit and exchange and all other matters that require agreement of opinion between the Minister of Finance and Economy on one hand and the Bank on the other hand.[1]

The directors of the Bank are elected by the shareholders from persons who have wide knowledge in financial, commercial, industrial, and agricultural affairs. They are fifteen in number and must be Egyptian-born. Their term of office is five years, one fifth of them dropping out and being replaced each year, if they are not re-elected. Every member of the Board of Directors must possess a minimum of one hundred

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1. Law No. 57 of 1951, <u>op.cit.</u>, article 9.

shares to be deposited with the Bank throughout his term of office and he may not fill a position in another company without the approval of the board. The directors elect from among their numer the Governor who is appointed through a State Decree for a period of five years and is eligible for re-election.[1]

Two Government delegates to the Bank are appointed by the Minister of Finance and Economy for a period of five years. Their duty is to see that state decrees and statutes of the Bank are strictly observed and the policy decided by the Supreme Committee executed. They have access to the books of the Bank at all times and their remarks are presented in writing to the Board of Directors which should take them into consideration else the matter is referred to the Minister of Economy and Finance.[2]

The Bank is divided into an Issue Department and a Banking Department. All transactions related to currency issue and reserves are absolutely independent of the general operations of the Bank and are dealt with by the Issue Department.[3] Separate accounts are kept for this purpose and the net profits resulting from the issue operations are divided in the proportion of 85% to the Government and 15% to the Bank. The same proportion applies to the profits or losses resulting from appreciation or depreciation of securities backing the currency

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1. <u>Statutes of the National Bank of Egypt</u>, articles 21-28.
2. <u>Ibid</u>., articles 25 & 26.
3. Law No. 57 of 1951, <u>op.cit.</u>, article 12.

issue. Losses that are due to the placement of gold in the cover are borne by the Bank only to the extent of half a million Egyptian pounds.[1]

The Banking Department of the Bank handles ordinary commercial banking in addition to the other central banking operations. These commercial transactions are separate completely from the central banking activities and do not include small operations, as provided by the Central Bank Law of 1951. Moreover, the Bank is not allowed to pay any interest on demand deposits and it may not use the obligatory reserves of commercial banks deposited with it for its commercial banking operations.

The annual profits of the Bank are distributed in the following order: 4% first dividend on the share capital in conformity with the Bank's Statutes; 10% goes to the statutory reserve until it reaches fifty per cent of the capital; a part of what remains may be transferred to a private reserve to be disposed of later on as decided by the General Assembly of share-holders and in accordance with the proposition of the Board of Directors. At present each of the above mentioned reserves amounts to £E 1,500,000 making a total of £E 3,000,000 which is equal to the amount of capital. The balance of the profits is distributed as additional dividend, and in case the total profits distributed to the share-holders form a percentage in excess of 20% of the paid up capital, a sum equal to the

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1. <u>Statutes of the National Bank of Egypt</u>, article 8.

excess percentage should be paid over to the Government.[1]

Liquidation of the Company is effected at the end of its duration or before that date by decision of the General Assembly. It is stipulated that the Government gets a part of the realized assets after liquidation equal to half of the difference between the total reserves existent at the date of liquidation, after paying off all liabilities, and the total reserves as at December 31, 1949. In addition, the Government receives an amount equal to the annual average of transfers to the reserve accounts during the five years ending in December 31, 1949, multiplied by the number of years that pass between this date and the date of liquidation of the Bank.[2]

B. The Central Bank of Iraq

The Central Bank of Iraq is the new name given to the National Bank of Iraq in accordance with Law No. 72 of 1956 which repeals Law No. 43 of 1947 under which the National Bank of Iraq operated from July 1949 to June 1956. The Law of 1956 sets forth the objects of the Bank as being "to manage the currency and ensure its stability, to influence the credit situation to the country's advantage, to act as banker to the Government and to facilitate internal and external payments."[3] The Law states the duties entrusted to the Bank to attain the above objects, which are briefly stated as follows:[4]

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1. *Ibid.*, article 51.
2. *Ibid.*, article 58.
3. Central Bank of Iraq Law No. 72 of 1956, article 4.
4. *Ibid.*

1. To issue and manage the currency.

2. To purchase, sell and discount commercial and Treasury bills and to grant temporary advances to the commercial banks against certain kinds of collateral.

3. To grant long term advances to semi-government departments; to purchase and sell Government securities and to make temporary advances to the Government to meet temporary budget deficits.

4. To undertake duties arising from international financial and economic agreements.

5. To undertake duties of exchange control and banking control and coordination.

6. To keep the accounts of the Government and semi-Government departments, to undertake transactions connected with Government loans and to advise the Government on matters of currency.

The management of the Bank is entrusted to a Board of Administration composed of nine members including the Governor and the Deputy Governor. The latter two are appointed by the Council of Ministers and by Royal Irada, for a period of five years for the Governor and four years for the Deputy Governor. All the other members of the Board are appointed by the Council of Ministers for a period of four years; they should be persons having specialized knowledge and experience and none of them should be a staff member of a bank. Five additional members are appointed to the Board and are summoned to constitute a quorum for the meetings.[1]

1. _Ibid._, article 5.

The Law provides for the setting up of an advisory council composed of the representatives of the banks operating in Iraq, to discuss general banking affairs. This council is under the chairmanship of the Governor of the Central Bank and is called to meet at his discretion.[1]

The Bank is considered as a Government institution for purposes of tax laws in Iraq.[2] The accounts of the Bank are audited by chartered accountants approved by the Minister of Finance as well as the Auditor General who may audit the accounts if he wishes.[3] The Bank is required to publish a monthly statement of its transactions and an annual balance sheet which should be presented to the Minister of Finance for final approval; if no such approval is secured within sixty days of presentation, the balance sheet is considered final and correct.[4]

The authorized capital of the Bank is fifteen million Iraqi Dinars and that part of the capital which is not yet paid up is guaranteed by the Iraqi Treasury until the whole amount of capital has been paid.[5] The distribution of the annual profits follows this order: fifty per cent of the net profits to be paid to the Government up to one million Dinars and the rest to be obligated to increase the capital until it is fully paid up; after that step is reached, fifty per cent of the net

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1. Ibid., article 7.
2. Ibid., article 10.
3. Ibid., article 11.
4. Ibid., articles 12 & 13.
5. Ibid., article 2.

profits will be paid to the Government up to one million Dinars and the rest will be put in a Reserve Account until that reaches five million Dinars; after the Reserve Account reaches five million Dinars, ten per cent of the net profits will be credited again to it until it is double the amount of the authorized capital and the balance of the net profits is paid to the Government; at last, when the Reserve Account is double the amount of the authorized capital, all the net profits will be paid to the Government.[2]

C. The Central Bank of Syria

The Syrian Monetary Law, enacted in March 1953, has provided a set of reformative rules and regulations that are intended to bring the monetary and banking systems of Syria into consistency with the general trend of economic development in the country. In addition to the new regulations set for Syrian currency and banking practice, the Law of 1953 has provided for the establishment of a State central bank which is empowered to manage the monetary policy of the country in the public interest.

The Banque de Syrie et du Liban, a French company established under the mandate, held a concession which acceeded to it the privilege of note issue and of acting as a fiscal agent of the Government until 1964. In January 1956, the Syrian Parliament ratified an agreement reached with the BSL by which the concession that was held by the BSL was liquidated

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1. *Ibid.*, article 3.

against an annual premium of £S 300,000 paid by the Syrian Government starting from the date of the agreement till 1964, the end of the original concession period.[1] On August 1, 1956, the Central Bank of Syria assumed its duties and the Banque de Syrie et du Liban continued to operate henceforth as an ordinary commercial bank.

The Central Bank of Syria, as stated in the Law, is an autonomous public institution functioning under the supervision and the guarantee of the State and within the general directives issued to it by the Council of Ministers.[2] The objects of the Bank are briefly stated as follows:

1. To exercise the privilege of note issue on behalf of the State.

2. To act as financial agent of the Government and to undertake transactions related to Government loans of all kinds.

3. To undertake duties of the Exchange Office and duties arising from international agreements, on behalf of the State.

The capital of the Bank is £S 10 million, subscribed totally by the State and paid up by installments at the request of the Money and Credit Board which is entrusted with the management of the Bank.[3] This Board has been set up to organize and coordinate the operations of monetary and credit

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1. Law No. 164 of 1956.
2. Legislative Decree No. 87 of 1953, article 61.
3. *Ibid.*, article 63.

institutions in the country, in accordance with the general directives issued to it by the Council of Ministers, for the purposes of: a) development of the money and capital markets; b) stabilization of the Syrian currency and assuring its convertibility to other currencies; and c) expansion of employment possibilities and increase of national income.[1]

The Money and Credit Board is composed of Government officials and of representatives of industry, agriculture, commerce and banking under the chairmanship of the Governor of the Central Bank.[2] They are appointed by the Council of Ministers, with the stipulation that members of the executive and the legislative bodies may not fill such positions. The Board is endowed with extensive powers in the administration of the Bank. It decides on matters of branches and agencies, loans and discount rates, ways of investing the Bank's working capital, and distribution of profits, etc. The secretariat of the Money and Credit Board is performed by the Central Bank of Syria which bears all the expenses and is charged with the remuneration of its members.

The operations of the Bank are run by a Committee of Administration composed of a Governor and three directors.

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1. _Ibid._, article 1.
2. The Law did not specify a definite number for the members of the Money and Credit Board, since that may vary with the number of State credit institutions existing, which are represented ex-officio on the Board. See Legislative Decree No. 87 of 1953, _ibid._, article 2.

The Governor is appointed by the Council of Ministers for a period of five years and is eligible for reelection. The directors are appointed by the Money and Credit Board and hold office for six years, one dropping out and being replaced every two years. The Governor and the directors are not allowed to sit on boards of private business firms.[1]

A Government delegate to the Bank is appointed by the Council of Ministers to make sure that the operations of the Bank are consistent with the Law and interests of the State, and has the right to suspend any decision falling within its sphere of authority, pending the opinion of the Minister of Finance which should be given within eight days, else the decision is put into effect.[2] Furthermore, an inspection committee composed of three members appointed by the Council of Ministers is entrusted with the duty of auditing the accounts of the Bank and certifying its annual statements. The remuneration of the Government delegates and inspectors are borne by the Bank.[3]

The Law stipulates that the profits that result from charging a rate of interest above 5% on loans, discounts and advances, shall be appropriated for promoting the educational standard of the staff and encouraging research studies in the Syrian economy.[4] The net profits of the Bank are distributed

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1. _Ibid._, articles 81-84.
2. _Ibid._, articles 90-91.
3. _Ibid._, article 94.
4. _Ibid._, article 97.

in the following order: a maximum of 1% goes to the Committee of Administration; 6% goes to the benefit of the staff; and the balance goes to a reserve fund until it reaches half of the amount of capital. When this proportion is attained, the balance of the profits is credited to the State after 10% of it is transferred to the reserve fund until this reaches the full amount of the capital of the Central Bank.[1]

D. Similarities and Differences

1. Ownership

The aspect of ownership appears to be the outstanding point of contrast between the National Bank of Egypt and the Central Banks of Iraq and Syria. While the former is a private-owned limited company, the latter two banks were created and are still owned by the state in both countries.

The National Bank of Egypt started as a foreign owned commercial bank with shares being held by non-Egyptians. Later on in 1940 the Bank was required to transfer the shares to nominal shares, as well as steps were taken to Egyptianize the Board of Directors and the staff. This requirement did not involve any transference of shares to Egyptians but it subjected all transactions of shares to the approval of the Board of Directors which had to be composed of Egyptians. Up to December 1956, the majority of the shares were still owned by foreigners but the Board of Directors and the staff were composed of Egyptians.

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1. Ibid., article 99.

The idea of nationalizing the Bank was always under discussion as it was looked upon as a foreign institution operating for its private interests. In 1940 the Egyptian Government thought of buying its shares but the transaction was considered too costly, and moreover, the Government wanted to keep the Bank independent of Government influence which might jeopordize its reputation abroad. After World War II, the argument for nationalization was enhanced by certain acts of central bank nationalization in foreign countries such as in England, France and Australia. The National Bank was declared officially as a Central Bank in 1951, yet it was not nationalized but a close Governmental control was applied on its central banking functions.

On January 15, 1957, Law No. 22 was enacted providing for the Egyptianization of all foreign banks in Egypt. Consequently, the shares of the National Bank owned by foreigners will have to be transferred to Egyptians sooner or later. However, those shares that were owned by British and French subjects were already sequestered by the Government before the Egyptianization laws were enacted. Those sequestrated shares were bought later on by the Economic Organization, which is the official Government authority set to manage the investment of public funds. By this measure, the Government has become a shareholder of the National Bank of Egypt for the first time.

As regards Iraq and Syria, the establishment of the Central Banks at the initiative of the state was a natural outcome of the necessity of such institutions, which were considered complementary to the political independence.

2. Administration

The Governor of each of the Central Bank of Egypt, Iraq and Syria is appointed by the Council of Ministers for a period of five years. In all of these states the Governor is also the Chairman of the Board of Directors. The Central Bank Law of Syria has specifically stated that the Governor of the Bank is ex-officio the Chairman of the Money and Credit Board which performs the duties of the Board of Directors of the Bank. As regards Egypt and Iraq, the Bank Laws there do not require the Governor to be the Chairman of the Board although it permits it explicitly. Commenting on the Iraqi legislation, Iversen believes that the Board should be independent completely of the management of the Central Bank and that the Governor, who is in fact the chief executive, should be responsible to the Board; he has even questioned whether the Governor should be allowed to be a voting member of the Board.[1]

The powers entrusted to the Governors of the National Bank of Egypt, Central Bank of Iraq and Central Bank of Syria differ in scope and magnitude. As regards, Egypt the Governor is a member of the Supreme Committee which governs central banking affairs under the chairmanship of the Minister of Finance and Economy. In Iraq the Governor has been entrusted

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1. Iversen, Carl, A Report on the Monetary Policy in Iraq, (National Bank of Iraq, 1954), p. 284.

with immense powers and the Law has provided him with the right to refer any difference of opinion between him and the Minister of Finance to the Council of Ministers.[1] This right is being criticized on the basis that the Minister of Finance is responsible for the financial policy of the State and that he should be the last resort in all financial affairs. In Syria the Central Bank Law has provided the Governor with all the executive powers needed for an efficient administration, yet the Money and Credit Board can grant the Committee of Administration the power to over-rule the Governor in certain matters; in any case, the decisions of the Money and Credit Board and the Central Bank of Syria are always subject to the right of veto held by the Minister of Finance.

The members of the Board of Directors of the National Bank of Egypt are subject to the Company Law which applies to all the other limited companies. The Law of 1951 has provided for two representatives of the Board of Directors in the Supreme Committee in addition to the Governor, out of a total of seven members. It is noted here that the commercial banks are not represented on this Committee. In Iraq, the new Central Bank Law has disposed of the representatives of the commercial banks on the Board of Administration and provided instead an advisory council of commercial banks with no executive powers, which will be called to meeting by the Governor of the Central Bank;

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1. Central Bank Law No. 72 of 1956, article 9.

moreover, the Law of 1956 does not permit any executive of a bank to be a member of the Board of Administration. This disposition, although recommended originally by Iversen, has been criticized by other writers on the subject, who claim that the commercial banks in Iraq should still be represented on the Board to make use of their banking experience.[1] The new Law leaves it to the Governor of the Central Bank to make the utmost use of the valuable experience and advice of the commercial banks in Iraq. In Syria, the Central Bank Law has provided for the representation of the banks on the Money and Credit Board in addition to industry, agriculture and commerce activities which are also represented.

3. Capital, Reserves and Profits

The capital of a central bank is fixed in the light of three factors: the initial expenses required, public confidence in the banknotes and operations in the money and capital markets.[2]

In Egypt, Iraq and Syria, the initial expenses of the Central Banks have already been incurred and public confidence in the national currencies have already been established. It remains to relate the capitals of these banks to the financial operations they are expected to perform.

In Egypt, the Central Bank has to provide for the

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1. From an unpublished memorandum presented by Mr. M.A. Al-Chalabi to the Iraqi Minister of Finance, on the subject of the proposed Central Bank Law of 1956, before it was passed.
2. Kisch, C.H. & Elkin, W.A., Central Banks, (London, Macmillan: 1928), p. 40.

seasonal financing of the cotton crop, which it has been doing satisfactorily until now with a total capital and reserves of £E 6 million. However, the Central Bank in Egypt is being charged with duties to finance state credit institutions by granting them long term loans and by underwriting their bond issues. Thus, the financial obligations of the Central Bank are increasing and might require an additional amount of capital to fulfill.

In Iraq, the Central Bank has been placed as the official source of financing state-owned banks and semi-government institutions. Law No. 72 of 1956 requires the Bank to grant long term advances to semi-Government departments and allows it to purchase Government and Government-guaranteed securities in considerable amounts. These requirements necessitated a large increase in the capital and reserves of the bank, the total amount of which will ultimately reach ID 45 million, as has been provided by the Law.

As regards Syria, the Central Bank has to provide sufficient funds to finance the agricultural seasons. The paid up capital of £S 10 million might be sufficient for the transactions that are being performed at present. However, the Central Bank Law of 1953 provides for the purchase of Government and Government-guaranteed securities by the Central Bank. In this case, the Bank will be acting as a financier of Government institutions and thus, an increase of capital might become necessary, as has been recognised in the Supporting Reasons of Legislative Decree No. 87 of 1953.

4. Audit and Supervision

The appointment of independent auditors and the insistence on the publication of regular returns are among the necessary conditions for the conduct of central bank affairs.[1]

The Central Bank Laws in Egypt and Iraq have provided for the appointment of independent auditors approved by the Minister of Finance. In Syria, the Law has specified the appointment by the Council of Ministers of an audit committee of three persons including a member of the Judiciary Accounting Council. As regards publicity of Central Bank statements, the laws in Egypt, Iraq and Syria require the publication of an annual balance sheet; in addition, a weekly statement is required in Egypt, a monthly statement in Iraq and a bimonthly comparative statement in Syria.

An additional safeguard has been provided in Egypt and Syria. In Egypt the Law of 1951 provides for the appointment of two State Commissioners to supervise the execution of the Law and the enforcement of the policy of the Supreme Committee. The National Bank is required to pay £E 1000 annually for their services to the Minister of Finance. In Syria, a State Commissioner is appointed by the Council of Ministers for the same purpose, and his renumeration is borne by the Bank. While the appointment of State Commissioners in the National Bank of Egypt is a necessity due to the private ownership of the Bank

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1. Ibid., p. 62.

and its exercise of commercial banking operations, it may be questioned whether the appointment of State Commissioners in the Central Bank of Syria is needed, since the Law entrusts the representative of the Minister of Finance in the Money and Credit Board with practically the same powers entrusted to the State Commissioner.[1] As to the responsibility of the Banks of Egypt and Syria to bear the expenses of the State Commissioners, some writers on the subject believe that it is preferable to have the State pay for the remuneration of such officials as this will emphasize its responsibility and prestige.[2]

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1. Supporting Reasons for Legislative Decree No. 87 of 1953.
2. Kisch & Elkin, op.cit., p. 68.

CHAPTER II.

Functions

A. Note Issue

1. The National Bank of Egypt

The National Bank of Egypt was the first to introduce banknotes in Egypt at a time when gold currency was used to discharge day to day transactions. From 1898 until 1914 the notes were not legal tender but were redeemable into gold on demand. At the outbreak of World War I the authorities in Egypt feared a rush on the gold reserves of the Bank and as a precaution, the Government declared the notes of the National Bank to be legal tender and relieved the Bank of redeeming them into gold. This measure was declared to be temporary at that time but it set the cornerstone of the present monetary system in Egypt.

Another important decision was taken by the Egyptian Government in 1916. The war needs of Britain drained the gold reserves in the Bank of England and consequently, British Treasury Bills replaced gold in the currency cover of the Egyptian banknotes. A close link between the sterling pound and the Egyptian pound was established; anybody could get Egyptian pounds from the National Bank of Egypt on deposit of sterling pounds in the Bank of England, and anybody could get sterling by depositing Egyptian pounds in the National Bank of

Egypt. As a matter of fact, the British forces in the Middle East were financed by this method during the two world wars giving rise to big amounts of accumulated sterling balances of Egypt at the Bank of England and to big issues of Egyptian notes which led to inflation in the postwar years. In 1947, Egypt decided to leave the sterling area; the free exchange of sterling for Egyptian pounds and vice versa ceased and the Egyptian pound was quoted independently in the world markets for the first time.

Egypt became a member of the International Monetary Fund in 1945, and the gold value of the Egyptian pound was set by the Fund as 3.67288 grams or 4.133 U.S. Dollars. In 1949, the sterling pound was devalued and the Egyptian pound was devalued in the same proportion. The gold value was put at 2.55187 grams or 2.87156 U.S. Dollars. This adjustment resulted in a surplus of £E 11,760,711 over the amount of gold necessary to cover the issued banknotes. This surplus was allocated to finance Government development projects which would lead ultimately to the improvement of the balance of payments which, in turn, would support the Egyptian currency.[1]

Until 1948, the cover of the Egyptian currency was composed mainly of British Treasury bills and securities. In 1948, a law was passed repealing the decision of 1916 which permitted sterling assets to replace gold in the cover. From

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1. Law No. 57 of 1951, article 14 as amended by Law No. 70 of 1953.

that time on, gold was gradually placed in the cover until the Central Bank Law of 1951 was enacted.

The Central Bank Law of 1951 confirmed the privilege of note issue held by the National Bank until 1980,[1] and declared the notes issued by the Bank as legal tender acceptable to the Government in the settlement of its debts.[2] The Law provided that the notes in circulation had to be covered by a) gold; b) foreign exchange and foreign securities; and c) Egyptian Government Treasury bills and securities. Moreover, any notes issued after the Law of 1951 was enacted, i.e., March 29, 1951, had to be covered by one of the following constituents: a) gold; b) foreign exchange and securities convertible into gold; c) Egyptian Government bills and securities.[3] However, the currency laws did not provide any minimum or maximum limits for any of these constituents. As regards Treasury bills, the Law of 1951 empowered the Minister of Finance to issue a maximum amount of £E 100 million, to be placed in the cover, whenever that is needed. The counter-value of these bills was to be credited to the Minister of Finance just for record purposes, without being subject to withdrawal. However, Law No. 242 of 1955 increased the maximum issue to £E 200 million and allowed the Government to utilize the counter-value of Treasury bills placed in the cover, in financing the various

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1. *Ibid.*, article 12.
2. *Ibid.*, article 14.
3. *Ibid.*

projects. This provision opens the door in the face of the Treasury for deficit financing which the currency laws of 1951 tried to avoid. Although deficit financing might be beneficial in stirring up economic activity, yet it all depends upon the discretion of the authorities which might tend to overuse this method in financing public projects.

Table 1

The National Bank of Egypt - Issue Department

Composition of Currency Cover as at Dec. 27, 1956

	Amount in £E million	% of total
Gold	60.5	26.0
Foreign exchange and foreign securities convertible into gold	10.3	4.3
Egyptian Government Treasury Bills	118.5	50.9
Egyptian Government Securities	8.2	3.5
Foreign Government Securities	35.5	15.3
Total	233.0	100.0

Source: The Egyptian Official Gazette, Jan. 1957, No. 3.

The figure in the table above show that total gold and assets convertible into gold formed about 30% of the cover. This ratio has been quoted in the laws of modern monetary systems such as that of Syria. However, the laws of Egypt do not specify any minimum proportion that should be held at all times. There is no harm in the absence of such a provision as long as the monetary authorities keep a reasonable minimum proportion of gold and free foreign exchange in the cover. But the temptation of utilizing this source of funds exists at all times. Such an action might be too risky to undertake in a country like Egypt, which is liable for drastic disturbances in its balance of payments due to its dependence on cotton exports. In case such a disturbance comes, gold and foreign exchange should be sufficient to settle international obligations. Thus, it is advisable that a minimum proportion of gold and foreign currency be emphasized in the currency laws.

The next important item in the cover is the Egyptian Government Treasury bills. The ratio at that date exceeded 50% which indicates an excessive use of these bills for purposes of the cover. It is noteworthy to mention that this ratio in December 1954 was only 25%, and in December 1955, 27%. A major reason for this increase of Treasury bills in the cover, is the war events in Egypt which necessitated increased issues of Treasury bills to meet most of the increased issues in banknotes. From the period October 25,1956 to November 8, 1956, banknote issue jumped from £E 217 million to £E 231 million and the Treasury bills jumped from £E 107 million to £E 116 million.[1] Aside from the abnormal conditions,

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1. National Bank of Egypt, <u>Economic Bulletin</u>, 1957, No. 1.

Egyptian Treasury bills are being used increasingly as a method on deficit financing. More than 90% of the issues are being purchased by the National Bank directly from the Treasury. This practice might entail inflationary pressures which will, in turn, affect the value and stability of Egyptian currency.

An outstanding provision has been lately introduced in the Egyptian currency issue. By virtue of Law No. 50 of 1957, banknotes issued by the Issue Department may be covered by Government guaranteed paper and by commercial bills discounted by the National Bank. There is no doubt that this provision secures an automatic link between the amount of issued banknotes and the financial needs of business. Thus, the seasonal requirements of banknotes in Egypt will be met by rediscounting commercial bills at the central bank. When these bills are settled, the corresponding banknotes will come back to the vaults of the Central Bank.

Egyptian currency is defended by strict exchange control that has been applied intensively since 1947, after Egypt left the sterling area. The exchange control was regulated by Law No. 80 of 1947 which provided for the appointment of a Government official to supervise the execution of the regulations as carried out by the Central Exchange Control Department in the National Bank of Egypt. The system of exchange control is based upon payment agreements that result in a number of different exchange rates quoted for the Egyptian pound. The following procedures will give an idea about the complications of this system.[1]

1. An Egyptian "export pound" was introduced in 1949 to provide for dollars and certain other imports goods in Egyptian pounds. The Egyptian pounds thus acquired from exporting goods to Egypt could be utilized afterwards for payment for the goods imported from Egypt. This procedure created a market for Egyptian "export pounds" outside Egypt where the value of these pounds fluctuated according to supply and demand.

2. A "B" pound procedure was introduced in October 1950 to neutralize the difference between the Swiss franc and the Egyptian pound and to establish a smooth payment system between Switzerland and Egypt. The envisaged mechanism of the procedure was as follows: normal trade and payment transactions had to be carried and invoiced in Egyptian pounds. Since the Swiss exporters would like to obtain Swiss francs against the Egyptian pounds traded in, then would develop a free market with fluctuating rates for £E in Zurich. It was the interest of the Swiss Government to have a moderately devalued £E to enable the Swiss spinners to buy Egyptian cotton at favourable prices, without pricing out Swiss goods from the Egyptian market. The rate of the "B" pound has been stabilized by Swiss banks in the interest of Swiss economy. Moreover, safeguards were introduced in the agreement by keeping

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1. Koestner, N., "Exchange Control", Banking Studies Institute, (Cairo, 1956), p. 21.

large Government and other orders outside the scope of the "B" pound. On the other hand, the Egyptian Government was offered facilities to earn Swiss francs by the proviso that a certain percentage of cotton exported to Switzerland had to be paid for in Swiss francs instead of "B" pounds. The "B" pound was later on applied as to the Belgian franc and the Dutch florin.

3. In February 1953 the entitlement procedure was applied. This meant that the exporter of Egyptian good became entitled to repurchase a fixed percentage of the repatriated proceeds of the foreign exchange surrendered to the Control, and was entitled to resell the amount thus repurchased in the market at a premium.

At the end of 1956, the money supply in Egypt amounted to £E 511 million, out of which £E 233 million were issued notes.[1] As has been mentioned above in this section, the seasonal variations of the notes in circulation follow the seasonality of the cotton crop, thus increasing around December and decreasing afterwards. Moreover, the limited use of bank credit can be seen from the high ratio of notes to the total national income of Egypt estimated in 1954 at £E 867 million.[2] This ratio which is more than one quarter of the National income gives a clear idea of the excessive use of notes when compared with the ratio in more advanced countries where it is one tenth or less.

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1. N.B.E., Report of the Fifty-Seventh Ordinary General Meeting, 1956.
2. N.B.E., Economic Bulletin, 1957, No. 2.

2. The Central Bank of Iraq

The Indian Rupee was the official currency of Iraq since the British occupation in 1917 and until 1931. Law No. 44 of 1931 introduced the Dinar as the standard of currency to replace the Indian Rupee and fixed a gold value for the new unit so that the monetary system of Iraq would be on a gold exchange standard. This principle was never applied, since in September of that year Britain abandoned the gold standard and an amending Law was passed to meet the new situation. On April 1, 1932 the Iraqi Currency Board took over the issue of the new currency in Iraq against prepayment of sterling in London at the rate of one Dinar for one pound sterling. The currency cover consisted of sterling securities, except such portion as was found necessary to retain in cash.

In 1947, Currency Amendments Law No. 42 was enacted, establishing a new basis for the Iraqi currency and entrusting the issue function to the National Bank of Iraq, at present called the Central Bank of Iraq. The Currency Law of 1947 fixed a gold value to the Dinar in conformity with the rules of membership in the IMF. This value was changed as a result of the devaluation of the sterling pound in September 1949, and settled on 2.48828 grams for the Dinar. The Law of 1947 provides, furthermore, that the currency in circulation must be covered by gold, foreign assets and Iraqi Government securities. The ratio of gold and foreign assets must form at least 70% of the cover, while the ratio of Iraqi Government securities must not exceed 30%. By this way, a certain degree of elasticity of currency issue was introduced, after the rigid rule of 100% sterling exchange has been applied since 1931.

The figures of December 1956, as shown in the following table, reveal that the amount of gold and foreign assets in the cover was much more than the legal requirement. On the other hand, the amount of Iraqi Government securities at that date, was relatively small and far from the 30% margin provided by the laws.

Table 2

Central Bank of Iraq - Issue Department

Composition of Currency Cover, December 1956.

	Amount in ID million	% of total
Sterling assets	42.2	77.7
U.S. Dollars	3.1	5.7
Gold bullion	5.0	9.2
Iraqi Govt. bonds	4.0	7.4
Total	54.3	100.0

Source: Central Bank of Iraq, Quarterly Bulletin, 1956, No. 20.

The high ratio of sterling assets in the cover, is a feature of the membership of Iraq in the sterling area. This question has been the subject of a controversy in Iraq for some time. Whereas one group argued that Iraq should leave the sterling area, because of the risks involved in being dependent on one foreign currency, another group saw in this action economic disadvantages which are not in favour of Iraq. Iversen's view on this subject was that "Iraq should not leave the sterling area - in so far as the question is to be decided upon purely economic grounds." His alternative solution of the problem of currency cover was an arrangement with Britain "according to which Iraq, while still drawing from the central pool the dollars needed at the same rate as before, could retain its own current dollar earnings for a certain period with a view to the establishment of an independent Iraqi gold or dollar reserve."[1] The monetary authorities have adopted this view and are acting accordingly in the policy of diversification that is being followed. In addition to the sterling assets in the cover, dollar assets are being accumulated gradually and gold bullion has been placed in the cover for the first time in the monetary system of Iraq. The gold was purchased from the Bank of England in 1955 with a value of ID 5 million, ID 3 million of which were delivered in 1955 and the rest in 1956.

An additional safeguard of the Iraqi currency is provided by the exchange control which is undertaken at present by the Central Bank. The regulations of foreign exchange

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1. Iversen, op.cit., p. 274.

provide that all foreign currencies, including sterling, are considered foreign and thus, all payments in foreign currencies are subject to special permission.[1] The control of foreign currency receipts is effected by requesting the exporters to sign undertakings to submit their foreign currencies to the Central Bank. The trend in recent years was to grant foreign exchange facilities which would increase importation to the country. Thus, in 1954, the Central Bank took several measures in this respect some of which were the following:[2]

1. Extension of the duration of foreign exchange licences.

2. Grant of authority to the commercial banks to do business with scarce currency countries without recourse to the Central Bank.

3. Extension of the commercial banks' powers to import from other areas.

The total amount of currency in circulation in December 1956 was ID 53.7 million.[3] Compared with the national income of Iraq, estimated at ID 150 million, this amount seems to be greater than that in more advanced countries. The reason lies in the limited use of bank credit in Iraq and in the

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1. Law No. 18 of 1950.
2. National Bank of Iraq, Annual Report, 1954, p. 21.
3. Central Bank of Iraq, Quarterly Bulletin, 1956, No. 20.

hoarding of paper notes according to primitive ways of saving.

The currency in circulation amounted to about one-third of the total money supply, which was in December 1956, ID 167.8 million.[1] However, the proportion of demand deposits to the total money supply, has been increasing rapidly in the recent years, due to the increase of Government and semi-Government deposits in the commercial banks and in the Central Bank. This is not to say that the increase of private deposits was negligible. This increase was due to the rise of the income level, the increased use of credit and the reduction of hoardings. Until now, the turnover of the private deposits has been more than the public deposits. This is due to the fact that a substantial part of the latter has been waiting for utilization in the public projects that have not yet been put into execution.[2]

3. The Central Bank of Syria

In 1918, the British and French forces occupying Syria established the Egyptian pound as legal currency in replacement of the Turkish note. In 1920, Syria was placed under the mandate of France which had to buy Egyptian pounds in order to meet the heavy expenditures of the French troops in Syria. As a result, the French Government established a new Syrian paper currency based on the French franc and conferred the privilege of issuing the new currency on the Banque de Syrie, a French company affiliated to the Ottoman Bank.[3]

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1. Ibid.
2. N.B.I., Annual Report, 1954, op.cit., p. 8.
3. Himadeh, Said B., Monetary and Banking System of Syria, (Beirut, 1935) pp. 61-63.

In 1924, a convention was concluded between the states falling under the French mandate, on one hand, and the Bank on the other, by which the franc exchange standard was sanctioned and the Bank was granted the exclusive privilege of note issue for a period of fifteen years starting April 1, 1924 and was given the name of the Banque de Syrie et du Grand Liban. According to the Convention, the notes in circulation were limited to £S 25 million covered by a reserve composed of the following items: a) an obligatory deposit in francs at the French Treasury in Paris, amounting to at least one third of the note issue; b) commercial paper in an amount not exceeding 7% of the notes in circulation; c) an optional current deposit at the French Treasury, which, together with the commercial bills was not to exceed 22 per cent of the total issue; d) short term bonds issued or secured by the French Government; e) gold or foreign government securities payable in gold.[1]

During the period 1920-1926, the Syrian currency suffered from the fluctuations of the French franc until in 1928, France adopted the gold bullion standard and, consequently, the monetary system of Syria settled on a gold exchange standard, until 1936 when France abandoned the gold bullion standard.

In 1939, the privilege of note issue held by the Banque

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1. Himadeh, op.cit., p. 71.

de Syrie et du Liban was extended for twenty five years by a Decree issued by the French High Commissioner after the Syrian Parliament was dissolved due to political dispute. During World War II, the Allied Forces occupied Syria and declared it a member of the sterling area. The big amounts of sterling and American dollars currency spent by the Allied Forces in Syria were handed to the Exchange Office which issued Syrian banknotes in replacement thereof while the Free French Government was utilizing the foreign exchange and placing French francs instead. The amount of Syrian currency issued by this way was £S 800 million, the counterpart of which was utilized by the French Government and constituted a debt in favour of Syria.

In 1944, an agreement was concluded between Syria and France, whereby the Syrian currency was given a specific value in terms of sterling; the French Government guaranteed the value of the franc in the cover in case any devaluation took place and maintained the convertibility between the Syrian currency and the sterling.[1]

The French Government stood up to its obligations when the franc was devaluated in 1945, by depositing a sum of francs in the Syrian Currency cover to maintain the value of the Syrian Currency in terms of sterling. In March 1946, the French Government abolished the convertibility that was existing between the Syrian currency and sterling, and dec-

1. Ibid., p. 273.

lared its unwillingness to guarantee the sterling value of the Syrian currency. These measures were met by objection from the Syrian authorities and after long negotiations with France, during which the Syrian pound was given a gold value by the IMF, an agreement was reached in 1949 whereby Syria left the French franc area and became independent in its foreign exchange policy. Consequently, the Syrian Government issued Decree No. 76 of March 1950 which defined the status of the Syrian currency in accordance with the 1949 agreement, and declared that the note issue is undertaken by the State and that a private institution may be delegated to issue the currency on behalf of the State;[1] thus, the Banque de Syrie et du Liban continued to practice note issue.

In March 1953, Decree No. 87 was enacted setting a new basis for the Syrian monetary system and entrusting the note issue function to the Central Bank of Syria whenever this latter starts its operations. The privilege of note issue held by the Banque de Syrie et du Liban was liquidated by an agreement concluded in July 1955 and ratified by the Syrian Parliament on January 21, 1956.[2] The agreement provided for a transition period of six months during which the Banque de Syrie et du Liban prepared for transferring the issue functions to the Central Bank of Syria, which assumed its duties on August 1, 1956.

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1. Article 4.
2. Law No. 164 of 1956.

The Currency Law of 1953 states that the right to issue notes is held by the State and that the Central Bank is delegated to enjoy this right in as far as banknotes are concerned, while the issue of gold and currency coins is entrusted to a Government agency attached to the Central Bank to secure centralization of issue. According to the Law, the cover of the Syrian currency shall be composed of the following items:[1]

1. Gold at the official parity of 405,512 milligrams of gold to the Syrian pound. This rate may be revalued in exceptional cases by decision of the Money and Credit Board; and all profits and losses that result of any revaluation of gold and foreign currency is debited or credited to the State accordingly. Gold and foreign exchange must not form less than 30% of the cover.

2. Foreign exchange and assets held by public institutions and foreign banks to the credit of the Central Bank; commercial bills of exchange drawn in foreign currency on residents of other countries; short term paper issued by other countries and international organizations such as the IMF and IBRD and advances made to the Syrian Exchange Office.

3. Commercial bills drawn in local currency; loans and advances of fixed maturity if held against a mortgage of gold bullion, state guaranteed bonds, commercial bills,

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1. Legislative Decree No. 87 of 1953, articles 21-36.

warrants and goods. Loans and advances made to state credit institutions may be included in the cover if issued against collateral acceptable to the Money and Credit Board.

4. Public bonds, loans and advances. Amongst them is the public debt up to a maximum of £S 220 million; an advance to the State not exceeding 10% of the current budget revenue; state bonds issued for subscription in the IMF and IBRD; treasury certificates and bills not exceeding £S 60 million.

The following table shows that on December 20, 1956, the cover of the Syrian currency consisted of three main items: a) gold and foreign exchange; b) loans to industry, agriculture and trade; and c) Government bonds and loans. At that date, gold formed 27.6% of the cover while loans to the private sector formed 26.8% and loans to the Government sector 45.6%.

Table 3

Central Bank of Syria

Composition of Currency Cover as at Dec. 20, 1956

	Amount in £S million	% of total
Gold and foreign exchange	171.2	27.6
Loans to industry, agriculture and trade	169.2	26.8
Government bonds & loans	287.0	45.6
Coins	0.1	-
Total	627.5	100.0

Source: The Official Gazette of the Syrian Republic, May 1957, No. 23.

Literally speaking, the ratio of gold and foreign exchange shown in the table above is below the 30% legal requirement provided in the laws. From the practical point of view, this small difference between the actual ratio and the legal ratio is insignificant and might be due to the day to day fluctuations in the amount of foreign exchange held by the Exchange Office, at the time the above statement was drawn. Furthermore, the cover of the Syrian currency applies to the demand deposits as well as the notes.[1] Thus, the amount of gold and foreign exchange as at December 20, 1956, constitutes in fact about 40% of the notes in circulation at that date. This ratio provides a satisfactory base for the currency by standards of modern monetary systems, and meets the requirements of safety and elasticity of currency issue.

Elasticity of currency issue has been secured further by including loans to the private sector in the cover. This item acts as an automatic link between the amount of currency and the financial needs of the Syrian economy, which is characterized by seasonal fluctuations. Moreover, the laws provide maximum maturities of these loans,[2] which ensure the liquidity required in the items of the cover.

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1. *Ibid.*, article 21 (3).
2. *Ibid.*, article 28 (2).

The public loans and bonds in the cover do not necessarily imply deficit financing. As a matter of fact, the figure quoted in the table above, includes an amount of £S 220 million representing an old public debt that has been blocked in the cover permanently. The only way deficit financing may be performed is by including in the cover a maximum amount of £S 60 million in Treasury bills and securities, as has been provided in the laws. As at December 20, 1956, no such item appeared in the cover. Thus, the above item of loans to the Government sector provides a sound and safe component of the Syrian currency cover.

The Syrian currency has been supported by exchange restrictions, which at present are being managed by the Central Bank through the Exchange Office. However, these restrictions do not jeopordize the free exchange market that exists in Syria, but provide minimum safeguards of the currency whenever that is needed. The principle of exchange control in Syria requires that the foreign exchange proceeds of certain Syrian exports be repatriated and declared to an approved commercial bank. These proceeds can be utilized by the Syrian exporter to cover his own imports, else they should be sold to the bank. The Exchange Office enters the foreign exchange market as a buyer or a seller in order to stabilize the value of Syrian currency vis-a-fis the exchange rates of principal currencies. Until now, the Exchange Office has been successful in achieving the required stabilization, without affecting the freedom of the exchange market.

In December 1956, the figures show that out of a total money supply of £S 787 million,[1] the currency in circulation was £S 448 million making a ratio of 57 per cent. This indicates the limited use of checks to discharge payments. The same conclusion can also be drawn by comparing the amount of currency in circulation with the total national income of Syria, which is estimated at £S 1750 million.[2] Whereas, in more developed countries, the currency in circulation forms about one tenth of the total national income, in Syria it forms about one quarter, a ratio that prevails in most of the underdeveloped countries.

4. Similarities and Differences

The main similarities and the chief differences between the issue functions of the Central banks of Egypt, Iraq and Syria, are briefly stated as follows:

1. The issue function in Iraq and Syria is a state privilege handled by state-owned central banks while in Egypt, the privilege of note issue has been conferred on the National

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1. This figure is composed of total currency in circulation, demand deposits of the Central Bank, and demand deposits of the principal banks operating in Syria. See Central Monthly Bulletin of Current Statistics, February, 1957.
2. As mentioned in the report presented by the Syrian Minister of Finance to the Parliament on the financial conditions of the State in 1956.

Bank for a temporary period ending in 1980. The reason for this arrangement is the commercial nature of the National Bank. This fact reflected also on the way profits of note issue are divided. In return for this privilege, the Bank pays the State 85% of the profits of note issue, while profits of commercial operations go to the shareholders. In the case of Iraq and Syria, no distinction is made between the profits of note issue and other profits of the central banks. These profits are dedicated to build up adequate reserves and some of them are divided between the State and the central bank according to certain methods of profit-sharing that are prescribed in the laws.

2. The currency covers in Egypt, Iraq and Syria are similar in that all of them include gold, foreign assets and government securities. In addition to these elements, the laws of Egypt and Syria provide for the inclusion of commercial bills and loans, while in Iraq no such provision exists. Thus, in Egypt and Syria the amount of note issue has been automatically linked with the financial needs of business. This is of special significance since these financial needs follow the seasonal fluctuations of agricultural crop in both countries. In Iraq, the amount of notes in circulation depends more on the public expenditure of oil revenues, than on the needs of private business. However, the lack of a provision to include commercial bills in the cover, is a disadvantage of the Iraqi note issue with respect

to its elasticity.

3. The laws of Egypt do not prescribe a minimum ratio of gold and foreign exchange in the cover, while in Iraq and Syria the laws prescribe a minimum ratio of 70% and 30% respectively. The ratios are decided in Egypt by agreement between the National Bank and the Minister of Finance and with the approval of the President of the Republic. The reasons why the laws of Egypt do not prescribe minimum reserves may be to secure a maximum degree of flexibility in the note issue. On the other hand, the advantage of minimum reserves is to inspire public confidence in the notes and to meet any emergencies that may appear. However, the Egyptian notes have been since 1951 covered by gold and foreign exchange at a ratio of not less than 30%. Thus, a minimum ratio has been followed although the laws do not prescribe it.

4. In Syria, the laws of the cover apply to the demand deposits of the Central Bank in addition to the notes issued, while in Egypt and Iraq the laws apply only to the notes. In this question, the Syrian provision is more realistic than that of Egypt or Iraq. The demand deposits of the Central Bank are subject to withdrawal at any time and in this case, notes are automatically issued to pay the depositors. Therefore, there is no reason to exclude the demand deposits from the conditions applied to the note issue.

5. The Central Banks of Egypt, Iraq and Syria are entrusted with the administration of exchange control. This duty is supplementary to note issue in the sense that it

contributes to the stability of local currencies against outside pressure. Whereas in Egypt strict exchange control is applied, in Iraq and Syria more freedom is provided. In Iraq, all foreign currencies should be submitted to the Central Bank but more import facilities are being provided. In Syria, a free exchange market exists while the Exchange Office stabilizes the exchange rates by intervention. The existence of different exchange regulations in the three countries is due to the different factors existing in each of them, namely, the monetary system, the balance of payments and the economic policy of the country.

6. The proportion of notes in circulation to the total money supply in Egypt, Iraq and Syria ranges between one third and one half. This high ratio indicates the limited use of bank credit in discharging monetary obligations. The same conclusion can be drawn from the proportion of notes in circulation to the national income in the above three countries. This proportion is about one fifth while in more advanced countries it is less than one tenth. It is noteworthy to mention that a part of these notes does not actually circulate, but is hoarded according to primitive methods of saving. The other fact that should be mentioned is the existence of a barter trade in some of the small areas of the Arab countries which are still outside the money economy.

B. <u>Fiscal Agent of the Government</u>

1. <u>The National Bank of Egypt</u>

The Central Bank Law No. 57 of 1951 and the Statutes of the National Bank of Egypt stipulates the following duties to be performed by the Bank in its capacity as a fiscal agent of the Egyptian Government:

1. To act as a banker of the Government; this entails granting advances, discounting Treasury bills and holding Government securities.

2. To float Government loans and act on behalf of the Government in redemption of such loans.

3. To execute, on behalf of the Government, the financial agreements concluded with other countries and with international institutions.

As a banker of the Government, the National Bank has been keeping the funds of the Government and semi-Government institutions ever since it was established. In addition, it may grant the Government short term advances to meet seasonal deficits in the budget. The laws prescribe that these advances must not exceed 1/10 of the total amount of the budget, the figure of the budget to be calculated on an average of the three past years.[1] The Government made use of this provision and obtained advances on the budget several times, as has been mentioned in the Bank reports of 1952 and 1953.

The National Bank is required to discount Treasury bills and hold Government securities. The laws do not prescribe any limit for such holdings. However, Law No. 242 of

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1. Law No. 57 of 1951, article 15.

1955 authorizes the Minister of Finance to issue a maximum amount of £E 200 million in Treasury bills. This may be considered as the only limitation of the Government power to borrow from the Bank against Treasury bills. It is worthy to mention here, that in December 1956, the total amount of Treasury bills held by the Bank in the note cover and in the Banking Department amounted to £E 132 million, which formed about 90% of the total amount of Treasury bills outstanding at that time.[1]

The National Bank has been holding in the recent years increasing amounts of Egyptian Government securities. In addition to the Government securities held in the cover according to the laws, Government-guaranteed securities are now allowed in the cover by virtue of Law No. 50 of 1957. Also, the Government is authorized to issue bonds within the limits of £E 150 million repayable in fifteen years for the purchase of sterling from the Bank to cover external expenditure relating to development projects.[2] These provisions indicate the tendency of the Government to utilize the Central Bank funds in financing capital investment.

The issue of Treasury bills and the flotation of Government loans are undertaken by the National Bank. The importance of these services can be seen through the figures

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1. N.B.E., Economic Bulletin, 1957, No. 1.
2. Law No. 243 of 1955.

of public loans outstanding, which at the end of 1956 reached £E 174.7 million, while the Treasury bills outstanding reached £E 146.0 million. These services apply also to the semi-Government institutions such as the Credit Agricole et Cooperatif d'Egypte. This bank secured in 1956 a loan of £E 20 million from the National Bank which retained the right to float the corresponding bonds at a suitable time.[1]

According to the laws, the National Bank executes the financial agreements concluded between Egypt and other countries. This duty involves the Bank in accounting for these agreements, handling clearing accounts and effecting settlements. Moreover, the Bank acts as an adviser to the Government in all matters of banking and finance. This includes foreign loans and dealings with international financial institutions such as the IMF and the IBRD, a recent example of which is the amount of $ 30 million purchased from the IMF with Egyptian currency, in September 1956 and February 1957.[2]

2. <u>The Central Bank of Iraq</u>

The Central Bank Law No. 72 of 1956 prescribes the following duties to be undertaken by the Bank in its capacity as a fiscal agent of the Government:

1. To act as a banker keeping the funds of the Government and semi-Government departments.

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1. N.B.E., <u>Report of the Fifty-Seventh Ordinary General Meeting</u>, 1956.
2. <u>Ibid</u>.

2. To transact in Treasury bills and Iraqi Government securities and to make advances to the Government to meet temporary deficits in the budget.

3. To undertake transactions relating to public loans of all kinds.

4. To undertake duties arising from International economic and financial agreements.

The funds of the Iraqi Government were kept originally by the Rafidain Bank, a state-owned institution established in 1941 to exercise commercial banking. In 1947, the National Bank Law was enacted stating that the Bank should be the depositor of Government Funds. But these funds continued to be deposited in the Rafidain Bank, after the National Bank started operations in July 1949, probably because of the influence of the Rafidain management in official circles. This situation jeopardized the position of the National Bank as the central bank of the country, and had the effect of reducing the Rafidain's dependency on it. This was of special significance since the Government funds were increasing as a result of the increasing oil revenues of Iraq, although only 30% of these revenues are credited to the Government ordinary accounts while the rest goes to the Development Board. At last, in May 1956, a Royal Irada[1] was issued ordering the transfer of all Government funds held by the Rafidain Bank

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1. Royal Irada No. 383 of May 6, 1956.

to the National Bank of Iraq within a period of six months. In December 1956, the funds were already transferred except for the fixed deposits which remained in the Rafidain Bank until the due dates of withdrawal. To compensate for the loss of liquid assets of the Rafidain Bank, the Board of Administration of the National Bank decided in June 1956 to grant it a loan of ID 5 million at 2½% interest. However, the action of transferring the funds brought about many protests from the business circles in Iraq which had close ties with the Rafidain,[1] but this step was considered inevitable for the proper functioning of the central banking authorities.

The Law of 1956 provides that the Central Bank of Iraq buys, sells or discounts Iraqi Government Treasury bills maturing within three months.[2] Moreover, it provides that the Bank may grant advances to semi-Government departments for a period not exceeding ten years and purchases Iraqi Government securities maturing within a period of fifteen years; the total advances and securities held as such may not exceed three times the authorized capital of the Bank.[3] In December 1956, the Central Bank of Iraq held ID 21.7 million in Iraqi Government bonds out of total assets of ID 156.5 million, while no Treasury bills were outstanding at that time. As

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1. انظر مذكرة غرفة تجارة بغداد المقدمة الى رئيس الوزارة ، التجارة ، عدد آذار ــ حزيران ١٩٥٦ ، ص ١١٦ .
2. Law No. 72 of 1956, article 4 (2) (iii).
3. *Ibid.*, article 4 (2) (iv).

to the advances made to semi-Government departments, these were only ID 450,000. This relatively small amount of advances made by the Central Bank, may be explained by the loans that have been extended to the semi-Government departments by the Development Board.

In addition to the above mentioned credit facilities to the State, the Law of 1956 provides for temporary advances to the Government to meet temporary deficits in the budget revenue; the amount of such advances may not exceed 10% of the total budget revenue for the year and should be settled at the close of the year in which it is made.[1] Until December 1956, the Government had not resorted to these short term advances.

The issue and flotation of public loans have been entrusted to the Central Bank. This includes all the services required for managing internal loans made to the Government and semi-Government departments as well as the foreign loans. As a matter of fact, the Central Bank of Iraq took part in concluding the major foreign loans secured by Iraq such as the Railways loan, concluded in 1949, and the Tharthar loan, concluded in 1950.[2]

The duties related to the international economic and financial agreements were assumed by the Central Bank since 1949. In addition, the Bank advises the Government on the rights and duties of membership in the IMF and the IBRD,

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1. _Ibid_., article 4 (2) (v).
2. N.B.I., _Annual Report_, July 1949 - Dec. 1950, p. 11.

and furnishes these institutions with any information and statistical data requested by them.

3. The Central Bank of Syria

The duties undertaken by the Central Bank of Syria in its capacity as a fiscal agent of the Government, are stated briefly as follows:

1. To act as the banker and treasurer of the State, and also to all public departments unless the Minister of Finance should dictate otherwise.

2. To float Government loans and act on behalf of the Government in redemption and conversion of such loans; and participate in negotiations for foreign loans.

3. To participate in negotiations and execution of clearing and payment agreements, and to help the Government in its relations with international monetary and banking institutions.

According to Legislative Decree No. 87 of 1953, the Central Bank of Syria is the banker and financial agent of the State and all public institutions,[1] so that the management of State funds will be performed by one authority in the public interest. The Bank will also be the State treasurer, and in this capacity it is subject to the general accounting rules of the State. Moreover, the Bank may be called upon to

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1. Legislative Decree No. 87 of 1953, article 67.

manage the branches of the Agricultural Bank and the branches of other State financial institutions,[1] to help in cutting down the administrative expenses of the State. Other duties that have been entrusted to the Bank are the management of a "Guarantees and Deposits Fund" and a "Savings Fund", until it is found worthwhile to create for them autonomous departments.[2]

As a state banker, the Central Bank of Syria is under obligation to finance the State in long and short term credit. The laws specify the following public debt items acceptable in the currency cover:[3]

1. A total debt of £S 220 million, representing the loans that were extended by the Issue Department of Banque de Syrie et du Liban to the State institutions.

2. Cash advances to the State Treasury up to one tenth of the actual revenues of the previous fiscal year, and repayable during the current fiscal year.

3. Treasury bills issued to cover the losses incurred in the official changes of gold and foreign exchange values held in the cover, and to cover the losses incurred by the Exchange Office operations performed on behalf of the State. Also, Treasury bills issued to cover the State subscription in the IMF and IBRD are included in the cover.

4. Treasury bills, certificates and bonds issued by

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1. Ibid., article 69 (3).
2. Ibid., article 69 (2).
3. Ibid., article 35.

the State or guaranteed by it, up to a limit of £S 60 million.

According to the Law of 1953, the Central Bank of Syria is entrusted with all the operations connected with the State loans. Apparently, this duty is of notable importance as the Law limits the possibilities of deficit financing and emphasizes the need to develop a security market in Syria which will supply the Government with the needed capital. The organization and management of public debt has been regulated by Law No. 89 of 1955. According to this Law, the public debt has been entrusted to a Public Debt Department in the Ministry of Finance, to be run by a committee of State officials including one of the staff members of the Central Bank. Moreover, the provisions of the Law cover all the details related to the issue of public bonds and their redemption, which are necessary for the proper organization of a market in Government securities.

As regards bilateral agreements, the Central Bank acts on behalf of the State in executing their financial aspects. In addition, it represents the State in dealings with the international financial institutions and advises the Government on its rights and duties pertaining to the membership in such institutions.[1]

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1. Legislative Decree No. 87 of 1953, article 66.

4. Similarities and Differences

The similarities and differences between the functions of the Central Banks of Egypt, Iraq and Syria as fiscal agents of their Government can briefly be stated as follows:

1. The Centrals Banks of Egypt, Iraq and Syria are depositors of public funds and bankers of their Governments. In this capacity, they are in a position to advise the authorities in financial matters, especially those arising from the impact of public expenditure. Moreover, the holding of public funds is an advantage, in that the Central Banks can use them to carry transactions in the money and capital markets whenever that is necessary. Another advantage of being bankers of their Governments, is the training gained by the central bank staff in the conduct of practical banking operations, which will qualify them to become better central bankers in the future.[1]

2. The obligation of the Central Banks of Egypt, Iraq, and Syria to extend credit to their governments, has been prescribed explicitly in the laws of the three countries. The three Central Banks are required to discount Treasury bills, hold Government securities and grant advances to cover temporary deficits in the State budget. However, some differences lie in the limitations of State financing. Whereas the

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1. Sayers, R.S.,"Central Banking in Underdeveloped Countries," National Bank of Egypt, Fiftieth Anniversary Commemoration Lectures, (Cairo, 1956), p. 12.

Central Bank laws of Egypt do not prescribe any limits to the central bank holdings of Treasury bills and Government securities, the laws of Iraq provide for a maximum of 30% of the currency cover to be composed of Iraqi Government securities. In addition to the provision of the cover, the laws of Iraq provide that the total advances made to semi-Government institutions together with the investment in Government securities must not exceed three ti es the authorized capital of the Central Bank of Iraq. In Syria, the public debt items allowed in the assets of the Central Bank are limited to the items provided in the laws and mentioned in the previous section of this thesis.

It may be seen from the above provisions that the Egyptian laws provide a wider margin of discretion to the management of the Central Bank in matters regarding the financing of State institutions, than those of Iraq and Syria where limits have been provided.

3. The Central Banks of Egypt, Iraq and Syria are entrusted with the flotation of public loans and the execution of financial agreements with other countries. The National Bank of Egypt has been handling public loans since a long time, while the Central Banks of Iraq and Syria did not have much experience in this function. This is due to the relatively short time these two banks have been in operation and to the insignificant volume of Treasury bills and Government securities that have been issued yet in Iraq and Syria.

As to the financial relations with other countries, the three Central Banks are similarly entrusted with the duty of advising their Governments in these relations, supervising the execution of the agreements, and acting on behalf of their governments in performing the rights and duties of membership in the international financial institutions.

C. <u>Regulation of Credit</u>

1. <u>The National Bank of Egypt</u>

The Central Bank Law No. 57 of 1951 entrusts the National Bank with the regulation of credit in the country in the public interest especially in times of economic disturbances. This power of regulation will be discussed in the light of the following weapons of control, which are usually entrusted to a central bank in this respect:-

1. Variations of the bank rate.
2. Open market operations
3. Variations of the obligatory reserve ratio
4. Banking control.

The effectiveness of the Bank rate as a method of credit control depends largely on the amount and frequency of banking transactions performed between the commercial banks and the National Bank. These transactions take the form of loans and re-discounts arising from commercial operations. In Egypt, these operations are concentrated on short term financing of internal and external trade, the leading item of which is cotton. During the period stretching from November to February each year, cotton merchants resort to the commercial banks in order to pay for the crop they have purchased. To meet this demand or credit, which is usually embodied in a demand or banknotes, the commercial banks resort to three ways: a) reduction of their excess cash balances in the National Bank; b) liquidation of some of the Treasury bills they hold; and c) borrowing from the National Bank.[1] Thus, the need for central bank credit arises only at the height of the cotton season, while in other periods of the year, a considerable degree of liquidity prevails in the commercial bank assets. When Egypt was still a member of the sterling area, the liquid funds were invested abroad, but now in the presence of exchange controls, these funds are kept in cash while some of it is invested in Egyptian Government Treasury bills. In the recent years, borrowing from the National Bank has been increasing gradually; at the end of 1954, the advances to the commercial banks amounted to £E 12.9 million, while in 1955, they were £E 13.2 million, and in 1956, £E 18.4 million.[2]

Discounting in Egypt suffers from the relative limited use of commercial bills in internal trade transactions. It follows that little rediscounting is done at the National

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1. N.B.E., Report of the Fifty-Fifth Ordinary General Meeting, 1954.
2. N.B.E., Annual Reports, 1954-1956.

Bank at present. The Bank has taken several measures to encourage this service. In 1952, it reduced the minimum amount per bill eligible for rediscount from £E 250 to £E 50, and agreed to consider bills maturing in more than three months; and in 1953, it showed readiness to rediscount Treasury bills presented by banks at a rate lower than the official rate charged on commercial bills. Thus, at present, the minimum re-discount rate of the National Bank for commercial bills with a bank signature is 3%, while that for Treasury bills is 2¼%. These measures may have had some effect on the volume of re-discounting done at the National Bank. In the recent years, an increase of bills rediscounted at the Bank is noted; at the end of 1954, the total amount was £E 1.4 million, while in 1955 it was £E 3.8 million and in 1956, £E 5.3 million.[1]

From the above, it appears that the commercial banks' recourse to the central bank is not regular. It comes only as a last measure after their cash balances are reduced and their holdings of Treasury bills are liquidated. Thus, a manipulation of the Bank rate can only be effective to contract credit at the height of the cotton season. But this contraction at such a time will be absurd due to the necessity of financing the cotton season at any cost. Moreover, the borrowers may not react to any manipulation in

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1. <u>Ibid.</u>

the Bank rate; the structure of the economy being not perfectly competitive, both exporters and importers will shift the higher charges of borrowing to the cotton producers and consumers simultaneously.[1]

The Bank rate in Egypt was manipulated only once with the purpose of influencing the credit conditions in the country. In 1952, Egypt followed the example of other countries which raised the rates of interest to effect deflationary trends. The rate was raised from 3% to 3½% on eligible commercial bills, but this rate was lowered again to 3% after few months and remained so until now.[2]

Open market operations have not been performed yet in Egypt. And it is improbable that such operations be used in the near future for purposes of credit control. The reason lies in the narrowness of the security market. In the stock exchanges in Cairo and Alexandria, the transactions in securities are handled by few people for speculative purposes. Moreover, the amount of eligible securities in Egypt is relatively limited and are kept as permanent investments. As regards Treasury bills, these are held mostly by the National Bank while the commercial banks hold only a few. At the end of 1956, the National Bank held £E 137.5 million of Treasury bills out of a total of £E 146.0 million; the holdings of the commercial banks at

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1. Fahmy, H., "The Technique of Central Banking in Egypt," _Middle East Economic Papers_, 1954, p. 66.
2. N.B.E., _Report of the Fifty-Third Ordinary General Meeting_, 1952.

that date were £E 6.8 million only.[1] Thus, it appears that any buying or selling of securities done by the Bank to influence the cash position of the commercial banks can hardly be successful, especially as such transactions will affect the interest rates on government securities which the authorities are eager to stabilize.

The Central Bank Law of 1951, requires the commercial banks to keep a certain proportion of their deposits as cash reserves in the National Bank. However, the Law did not specify any range within which this ratio may be changed, but kept that in the hands of the Supreme Committee on Money and Credit.[2] The habit of keeping a part of the commercial bank deposits as cash reserves in the Bank has been in practice long before it was stipulated in the laws. In 1943, a gentleman's agreement was reached between the Bank and the clearing banks in Egypt, whereby the latter agreed voluntarily to deposit a certain proportion of their deposits in the Bank.[3] This agreement was held until the Central Bank Law of 1951 was enacted, which enforced this practice on all the commercial banks.

Until now, the reserve ratio has been varied only once in September 1954. At that time it was lowered from 15% to 12½% to enable the commercial banks to expand their credit, and is still so at present. It is to be noted here that the cash balances of the commercial banks kept at the

1. N.B.E. Economic Bulletin, 1957, No. 1, pp. 63, 67 & 70.
2. Law No. 57 of 1951, article 19.
3. N.B.E., Economic Bulletin, 1953, No. 1. p. 14.

National Banks are most of the time well above the obligatory reserve ratio. In December 1956, this ratio was 18.4%, while in December 1955 it was 22.2% and in December 1954, 17.0%.[1] This fact renders the manipulation of commercial bank reserves difficult unless this ratio is varied considerably. However, it is an established fact that this method of credit control is one of the most effective methods in underdeveloped countries such as Egypt. The importance of reserve ratios has been noted by the National Bank itself in its 1951 report.

Until July 1957, little control over the commercial banks was exercised by the Central Bank. The Law of 1951 requires the commercial banks to submit periodical statements,[2] and adhere to a liquidity ratio and a reserve ratio imposed by the central bank.[3] In July 1957, a new law was enacted empowering the Central Bank to issue directives for the qualitative control of bank credit.[4] Apparently, these controls are necessary for Central Bank operations in underdeveloped countries such as Egypt, since it gives the central bank direct authority over the volume and quality of credit when the classical tools are ineffective.

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1. N.B.E., Annual Reports, 1954-1956.
2. Law No. 57 of 1951, article 21.
3. Ibid., article 20.
4. For details see the section on banking systems.

The National Bank of Egypt retained its commercial banking operations after it has been converted to a central bank. Some eminent writers on central banking believe that direct operations of the central bank are necessary to secure direct touch with the market and to help in spreading banking services in an underdeveloped country. By this token, the commercial operations of the Bank may be advantageous if undertaken with the view of serving public interest. As a matter of fact, the Law of 1951 forbids the Bank to undertake "small operations"[1] but the definition of these operations was left to the Supreme Committee. Moreover, the Law of 1951 forbids the central bank to recieve interest on demand deposits or to use commercial bank balances in its commercial operations.[2] At present, these operations include all sorts of operations done by the commercial banks, subject to the above provisions. The Bank has followed the policy of withdrawing from the smaller commercial business in accordance with the law and closed in the last few years its London Office as well as some of its small branches and sub-agencies.[3]

2. The Central Bank of Iraq

The weapons of credit control placed in the hands

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1. Law No. 57 of 1951, article 16.
2. Ibid.
3. N.B.E., Report of the Fifty-Sixth Ordinary General Meeting, 1955.

of the Central Bank of Iraq can be stated as follows:

1. To fix the interest rates on discounts and loans made to commercial banks.

2. To sell and purchase securities in the open market.

3. To fix the obligatory reserve ratio imposed upon the commercial banks within definite ranges specified by law.

4. To undertake banking control.

Central Bank Law of 1956 prescribes the credit facilities that may be granted to the commercial banks. These facilities include all transactions in commercial bills carrying two reliable signatures and maturing within 90 days.[1] Furthermore, the Bank may grant advances for a period not exceeding three months against Iraqi Government Treasury bills.[2] Also, the Bank stands ready to grant advances at a rate which is at least one percent higher than the official rediscount rate for three months bills against a) gold; b) Iraqi Government bonds maturing within 10 years up to 80% of their market value; and c) eligible bills up to 60% of their nominal value.[3]

The little use made by the commercial banks of the Central Bank facilities renders the Bank rate ineffective as a tool of credit control. As a matter of fact the first rediscounting ever made by the Bank was in 1956, while no

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1. Lw No. 72 of 1956, article 4 (2) (ii)
2. _Ibid_., article 4 (2) (iii)
3. _Ibid_., article 4 (2) (vi)

advances or loans have been made to any commercial bank up to December 1956. The reasons for the reluctance of the commercial banks to resort to the Central Bank may be explained in the relative liquidity of the commercial bank assets. This liquidity is due to two factors, one internal and one external. The internal factor is the conservative policy followed by the commercial banks in their lending operations. An example of this policy can be found in the credit crisis of 1955, when the merchants could not easily dispense with their accumulated stocks. At that time, the Central Bank took some steps to facilitate credit for the commercial banks, but these preferred to contract their credit rather than make use of the Bank facilities.[1] The other factor that contributes to the liquidity of the commercial banks, is the fact that most of the large banks operating in Iraq, are branches of banks incorporated outside the country. Thus, in case a need for credit arises, they call on their head offices rather than resort to the Central Bank.

From its side, the Central Bank shows interest to develop the rediscounting habit and to encourage the commercial banks to use its credit facilities. In June 1956, the Bank declared its willingness to rediscount bills to any commercial bank in Iraq up to 10% of the total outstanding deposits at that bank, with the possibility of increasing

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1. N.B.I., Annual Report, 1955, p. 7.

this proportion to 20%. Moreover, the Bank fixed a rediscount rate (3.5%) for the first time in the history of the Central Bank.[1]

Open market operations cannot be performed at the present time due to the non-existence of a security market in Iraq. The corporation form of business organization is not prevalent yet, so that the supply of eligible securities is limited. Moreover, few Government bonds are traded in the market while no Treasury bills are outstanding at present. The only organized dealer in securities is the Rafidain Bank which has a special department for this prupose. Thus, the lack of a developed security market deprives the Central Bank of Iraq of an important weapon of control at present and in the near future.

The obligatory reserve ratio has been specified by law to range between 10% and 15% of the total deposits of the commercial banks.[2] One third of this ratio may be deposited in Government securities while the rest should be in Iraqi currency. The ratio has always been 15%, but it is too short to influence the cash reserves of the commercial banks. Thus, the only way to make this ratio effective is to raise the limit of variation considerably, or, to abolish

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1. Allus, Y., Money and Banking in Iraq, unpublished M.B.A. thesis (Beirut, American University, 1957), p. 141.
2. Law for the Control of Banking No. 34 of 1950, article 9 (1).

any limits and keep that in the hands of the Central Bank. In an underdeveloped country such as Iraq, this weapon of control is most effective since it bears directly upon the commercial banks' ability to extend credit.

Banking control in Iraq is regulated by Law No. 34 of 1950, which prescribes the conditions to establish commercial banks and the limits of their operations. The details of this law will be discussed later on in this thesis. For our purposes at present, we are interested in the aspects of control exercised over the commercial banks by the Central Bank. Apparently, this control does not exceed the audit and inspection operations. The banks are required to submit financial statements to the Central Bank at regular intervals and may be subjected to spot checks by representatives of the Central Bank.[1] Thus no powers are entrusted to the Central Bank to effect variation in the volume of bank reserves except the variable reserve ratio.

Some control over bank credit can be exercised by the Central Bank through the non-commercial state banks. As these banks acquire loans from the Bank to expand their activities, the Bank may influence the volume of their credit extended to the public through variations in its terms. Moreover, the Bank may effect some qualitative controls by giving priority to one bank dealing with agricultural credit

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1. Ibid., articles 17-21.

for example, and lesser facilities to another dealing with credit for real estate.

At present, the Central Bank of Iraq faces a serious problem of credit control. The increasing oil revenues of Iraq have induced the Government to increase public expenditures enormously. This applies both to the Treasury and to the Development Board which controls 70% of the oil revenues of Iraq. Such an increase in public expenditures may bring about inflation which will place the Central Bank in a difficult position. To reduce this risk, it is imperative that close coordination of activities exist between the three groups involved in monetary policy: the Treasury, the Development Board, and the Central Bank. Without such a coordination, it will not be possible for the Central Bank to execute a sound monetary policy for the country.

3. The Central Bank of Syria

The Central Bank Law No. 87 of 1953 places in the hands of the Central Bank the following powers to regulate credit in the country:-

1. To fix the interest rates applicable to rediscount and loan facilities extended by the Bank.

2. To buy and sell securities in the open market whenever that is possible.

3. To fix certain ratios and maximum limits that affect the volume and quality of commercial bank credit in Syria.

4. To undertake direct operations with the public in special circumstances.

The Central Bank undertakes to discount, purchase and sell commercial bills and to grant loans and advances to finance commercial, industrial and agricultural operations. The Bank Law of 1953 provides the following conditions in this respect:[1]

1. The commercial bills must be drawn in Syrian currency.

2. The loans and advances must be made for a limited time and should be granted against the security of a) gold; b) Government bonds; c) commercial bills; and d) other collateral acceptable to the Bank, especially goods and warehouse receipts.

3. The maturity of commercial bills and the duration of loans mentioned above, must not exceed 120 days. This may be extended to 300 days by decision of the Bank, in case these credit facilities relate to agricultural and industrial activities.

On August 1, 1956, the Bank declared the rates of interest it charges for its credit facilities. The discount rate ranges between 3% and 3½% depending upon the category of bills, while the rates for loans and advances are 3¾% for

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1. Article 28.

those maturing in less than 120 days, and 4¼% for all others.[1]

Although a considerable amount of central bank credit is being extended to the commercial banks in Syria at present, yet a variation in the Bank rate may not bring about a variation in the volume of bank credit. The reason being that the money market is not sensitive and a large differential exists between the interest rates charged by the commercial banks and that charged by the Central Bank. Moreover, private money lenders occupy a dominant position and charge usurious rates for the money they lend. Thus the money market is uncoordinated, and consequently, a small variation in the Bank rate will not affect the volume of credit tangibly.

The rediscount rate was manipulated once in 1955 to contract credit, in conjunction with other credit control measures. These measures were effective enough at that time, but it is doubtful whether the rediscount rate would have been effective had it been used as a sole measure of control at that time.

As a lender of last resort, the Central Bank of Syria played a decisive role during the monetary crisis that resulted from the war conditions in Egypt in the last quarter of 1956. At that time, depositors rushed to the commercial banks to withdraw their deposits, and consequently, the banks

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1. مصرف سورية المركزي ، دائرة التسليف ، تعليمات تطبيقية رقم (١٢) .

fell into a tight cash position. The Central Bank stepped in and took extraordinary measures to face the situation, which were mainly the following:[1]

1. Raising the maximum amount of credit allowed previously to some of the banks.

2. Granting loans to the banks which did not possess negotiable instruments and which have extended to their customers unsecured credit and overdrafts.

The Central Bank was able to overcome the crisis and to avoid serious consequences that would have taken place were it not for its intervention at the right time.

As regards open market operations, it is out of question at the present time in Syria. No organized security market exists although some small scale transactions are held in Damascus and Aleppo. There are no Treasury bills issued yet and Government indebtedness until now has been held in the form of loans and advances from the Central Bank. In order to create a market for Government securities, the banking laws impose upon the commercial banks to invest their statutory reserves in Government or Government-guaranteed bonds.[2] These bonds may not be mortgaged or sold unless the Central Bank permits so.

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1. الجمهورية السورية ، مصرف سورية المركزي ، دليل التسليف الصادر في ٢١/ ١١/ ١٩٥٦ ص ٨ و ٩ .

2. Legislative Decree No. 87 of 1953, article 117.

The Central Bank of Syria is empowered to fix a range of obligatory ratios which affects directly the commercial banks' ability to extend credit and which provides safety and liquidity of the bank assets. The following are the ratios that can be imposed upon the commercial banks upon the approval of the Minister of Finance:[1]

1. The ratio of the bank's capital and reserves to its total deposits.

2. The ratio of the bank's liquid assets or part of them to its current deposits.

3. The ratio of the bank's capital and reserves to its total assets or part of them

The Central Bank is also empowered to enforce the following measures within the above mentioned provisions:

1. Fix a total amount of loans and advances that the banks are not allowed to exceed as of a certain date.

2. Determine the proportion of permissible increase in total loans and discounts or certain types of them.

3. Prescribe minimum downpayments for certain types of letters of credit.

4. Fix maximum maturity dates for discounts and loans

5. Prescribe the maximum amount of credit that can be extended to one person in relation to the bank's capital and reserves.

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1. <u>Ibid.</u>, article 119.

6. Determine the amount of cash reserves that should be deposited with the Central Bank.

The recognition of quality controls as tools for credit control is an interesting aspect of the Central Bank of Syria. As a matter of fact, these tools were implemented by the Money and Credit Board in mid-1955. At that time a monetary crisis developed due to over-importation coupled with a failure in the crop season. The authorities took several measures to stabilize the situation, some of which were the following:[1]

1. The downpayments on commercial letters of credit was fixed at a minimum of 30% of the value of imports and 15% of the basic imports.

2. The Banque de Syrie et du Liban was not allowed to rediscount commercial bills arising from retail transactions or to accept as collateral any commercial paper maturing in more than 15 months.

3. The discount rate applying to consumption transactions was raised while that for productive transactions was lowered. Moreover, the cash ratio was raised from 10% to 15%.

The measures mentioned above were effective enough in combatting the monetary crisis of 1955 and proved the

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1. From the report presented by the Syrian Minister of Finance to the Parliament on the financial conditions of the State in 1955.

success of the central banking tools that were used for the first time in the history of Syria.

The Central Bank is not allowed to perform direct operations with the public. However, exception to this rule may be allowed in special circumstances and with the approval of the Minister of Finance. These special circumstances are any one of the following:[1]

1. To counteract any attempts of monopolistic practices on the part of the commercial banks.

2. To provide banking services in areas where no commercial banks exist.

3. To extend credit facilities to certain field of activity which the Government sees necessary for public interest.

4. <u>Similarities and Differences</u>

The major points of comparison and contrast between the functions of the central banks of Egypt, Iraq and Syria as regulators of credit can be stated as follows:

1. Variations of the Bank rate will not bring about expansion or contraction in the volume of credit in Egypt, Iraq and Syria. The pre-requisite for the effectiveness of the Bank rate as a tool of control is the existence of a highly developed money market. In the three countries in question, the commercial banks are not dependent on the central banks

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1. Supporting Reasons to Legislative Decree No. 87 of 1953.

so that a manipulation of the Bank rate will not affect their liquid position materially. Moreover, the borrowers are not sensitive to small variations in the interest rates and they can shift the additional cost of credit to the producers and consumers. The only effect variations of the Bank rate may have in Egypt, Iraq and Syria is purely psycholgocial as such variations will act as indicators of economic activity.

2. The possibility of credit control through open market operations is still far in Egypt, Iraq and Syria. As a matter of fact the only security market that exists is in Egypt while in Iraq and Syria no security markets exist yet. Even in Egypt, the security market is too narrow to allow open market operations. The central bank there cannot guarantee the existence of ready buyers and sellers at any time. Moreover, big deals in securities will cause wide price variations in the assets of the central bank. In addition, such deals in securities will distort the interest rates on government bonds which the authorities are eager to stabilize.

3. Variations in the reserve ratio stand as an effective means of control over the volume of commercial bank credit. Whereas in Egypt and Syria, no limits for such variations are specified by law, in Iraq the Central Bank can vary the reserve ratio within a range of 10% - 15%. To be effective enough as a tool of credit control, the variations in the reserve ratio should be free to swing within a wide range, as only by this way, the cash reserves of the commercial banks can be manipulated tangibly. In underdeveloped money and

capital markets such as those existing in Egypt, Iraq and Syria, the variable reserve ratio should serve as a sharp tool of control.

4. Credit control can be enhanced by providing the central bank with powers over the quality of commercial bank credit. The Central Bank of Syria and lately the National Bank of Egypt are provided with qualitative controls while the Central Bank of Iraq is not. These controls place the central bank in a position to direct economic activity in the country in the channels it desires. In the U.S.A. qualitative controls have been applied successfully on the fields of credit that relate to financing stock market transactions and to consumer instalment credit.[1] In imperfect money and capital market such as those of Egypt, Iraq and Syria, qualitative controls are apt to get quicker results than the classical tools.

5. The question of performing direct operations with the public differs as between the Central Banks of Egypt, Iraq and Syria. In Egypt, this right is allowed to the National Bank except for the small commercial operations. In Iraq, the Central Bank is denied this right totally, while in Syria such operations may be performed in special circumstances. This whole question is still the subject of contro-

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1. Sayers, R.S., Modern Banking, (London, Oxford University Press: 1954) pp. 269-276.

versy between monetary theorists. The argument against the provision of ordinary banking services is based on two points: a) that the central bank would be unfairly competing with the commercial banks because of the big supply of money under its disposal on which no interest is paid; b) that disturbance in the money supply come in case a transfer of money is done from a commercial bank's customer to a central bank customer and vice versa, due to the money creating nature of central bank credit.[1]

The above argument will not hold if the commercial banks in the country are few and their services cover only a small part of the field. Moreover, the main purpose of any direct operations performed by the central bank will be to preserve public interest and not to earn profits, thus no competition with the commercial banks should necessarily result. Reflecting on the conditions in Egypt, Iraq and Syria, it may be said that direct operations with the public will be advantageous to pursue in special circumstances. In this respect, the laws of the Syrian Central Bank provide a happy medium and may be considered wise and necessary. However, no correct evaluation may be made except after these operations are carried empirically.

6. In Egypt, Iraq and Syria, regulation of credit

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1. <u>Ibid.</u>, p. 293.

must be performed with the cooperation of the financial departmen s of the governments. The structures of the economy in the three countries are characterized by large variations in the balances of payments. All of the three countries are exporters of few primary products: agricultural products in Egypt and Syria, and oil in Iraq. This, it is imperative for the central banks to control the foreign exchange in order to stabilize the exchange rates. As a matter of fact, such control is provided in Egypt, Iraq and Syria with different degrees. Moreover, the central banks in the three countries need to control any inflationary and deflationary pressures that may show up because of the disturbances in the balances of payments. In addition to the tools of control that can be utilized by the central banks, the central banks have to secure the cooperation of the governments as regards public expenditure. By affecting a surplus or a deficit in the government budget, the authorities can bring about the desired effects on the volume of credit in the country. This problem is most obvious at present in Iraq, where the huge public expenditures by the Government and the Development Board may result in inflation. In such a case, a coordination of policy between the central bank and the government departments is necessary to overcome the economic disturbances.

CHAPTER III.

Problems and Prospects

A. Money Markets

The money market is the collective name given to the institutions and instruments through which trading in short term loanable funds is performed. The institutions of the money market include the lenders and borrowers of short term funds such as the central bank, commercial banks, discount houses, etc. The credit instruments handled in the money market are composed of highly liquid paper convertible into cash within a short period, usually not exceeding one year. Some of these instruments are bills of exchange, treasury bills, short-term bonds and similar papers.

At any given time, the point of equilibrium between the supply and demand of short term funds is the ruling interest rate. The small differences between the rate at which short-term funds are borrowed and the rate at which they are lent, constitute the source of income for the dealers in the money market. Therefore, any variation in the interest rates is quickly felt by those dealers who will transmit these variations to the various fields of economic activity. The long term rates will soon follow the pattern of the short rates with due effects on prices, incomes, production and trade.

In the following discussion, the money markets and the capital markets will be taken separately, with respect to the services they render to central banking operations. Whereas in the money market the interest rate constitutes the main cost of the funds traded in, the capital market depends on many factors of which the interest rate is of a lesser importance than the profitability and security of the investment involved. However, it is hard to draw a distinction between the money market and the capital market as the two are interrelated and transactions made in one market are often completed in the other. It is enough to say that while the money market is concerned primarily with short term funds, the capital market deals in long term funds obtained by the sale of securities for investment purposes and government financing.

1. The Money Market and the Bank Rates

The first condition for a developed money market is an efficient and adequate commercial banking system which pools the supply of the short term loanable funds and distributes them to the various sectors of the economy.[1] In this capacity, the commercial banks will act as a screen reflecting the general trends of the money market and transmitting it to the central bank. These, in turn, will formulate

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1. Sen, S.N., Central Banking in Undeveloped Money Markets, (Bookland Ltd., Calcutta: 1952) p. 15.

the credit policy in accordance with this information and will take the necessary action affecting the cost and availability of bank credit as the situation commands.

Secondly, there exists in the developed money market specialized dealers in the different forms of loanable funds with ample liquid resources to meet any expected demand. Each group of these specialized dealers forms a sub-market by itself and it is essential that these so called sub-markets are integrated in such a way as to secure mobility of rates and funds between them, reflecting the trends prevailing in each.

Thirdly, a developed money market is sensitive to the impact of international influences and attracts funds from abroad to be invested in highly liquid assets. The more developed money markets usually act as exporters of capital.

These conditions are not enough for the existence of an organized money market, unless they are supplemented by other markets which have attained a considerable degree of development such as the securities market, the foreign exchange market and the commodity market, the growth of which depends on the degree of economic development of the country.[1]

Given such a developed money market, the central bank can manipulate credit by varying its discount rate. A variation in this rate will be followed by corresponding variations in the short term rates prevailing in the money market

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1. Ibid., p. 20.

for different obligations. This will have the effect of cheapening or raising the cost of credit with due influence on domestic level of prices, costs, production, and trade, and which will help to correct any disequilibrium in the balance of payments.

Certain conditions should be satisfied for the success of a discount rate policy; firstly, the central bank rate should have a decisive influence on credit conditions within its area of control; secondly, there should be considerable elasticity of prices, wages, production, and trade which makes them responsive to a change in credit conditions; thirdly, the international flow of capital should not be restricted.[1]

It is worth mentioning that the effectiveness of a discount rate policy as an instrument of credit control has declined after World War I for several reasons. The decline in the use of domestic and foreign bills of exchange and the predominance of government securities as secondary reserves in the commercial banks have contributed to the decline in its influence. Also, the political and economic complications in various countries have led to a redistribution of capital markets accompanied by rigidity in the economic structure with respect to prices, wages, and production, which reduced the importance of discount rate policy. Moreover, the development

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1. Kock, M.H. de, Central Banking, (London, 1954), p. 153.

of other fields of control have caused a further contraction in its use.[1]

This is not to say that the discount rate method is no more useful in monetary policy. Its effectiveness will depend on the special circumstances prevailing in the money market and on the other methods of credit control that are used in conjunction therewith; also, the prevailing phase of the trade cycle and the fiscal policy of the government are outstanding factors that influence the effectiveness of the discount rate at any time.

2. <u>The Money Market in Egypt</u>

The movement of short term loanable funds in Egypt is characterized by a seasonal cycle that accompanies the marketing of the cotton crop. The volume of credit reaches its maximum in December and then falls until it is at its minimum in August of every year. The reason being that cotton merchants need to finance their purchases of cotton, so, they resort to the commercial banks where they can get loans and advances against the collateral of cotton produce at their disposal. After that, the cotton is sold to outside importers against foreign bills of exchange that are discounted by the commercial banks until final settlement is effected by the foreign importers. Thus, in the months following December,

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1. *Ibid.*, p. 172.

an inflow of money goes into Egypt and the short term credit acquired by the cotton merchants is completely settled. The surplus of money that accumulates in the vaults of the commercial banks will be partly invested in Egyptian Government Treasury bills and partly deposited in the National Bank. Thus, it is natural to observe a high reserve ratio kept by the commercial banks during the summer months. During the cotton season that follows the summer months, the cash balances of the commercial banks at the National Bank are reduced and the Treasury bills are liquidated to meet the demand on credit. Also, some rediscounting and borrowing from the National Bank is done to meet the needs if necessary.

The following table shows the seasonal variations in the amount of note circulation, total deposits, loans and advances, and discounted bills.

Table 4

Main Items of Money and Short-Term Credit in Egypt

(in millions of £E)

Date	Note Circulation Egypt and Sudan	Total Deposits[x] Egypt & Sudan.	Loans by commercial banks in Egypt	Bills Discounted by commercial banks in Egypt
31.12.52	193.7	218.5	102.7	10.8
31.8.53	168.8	238.4	64.5	21.1
31.12.53	178.5	229.8	101.8	12.7
31.8.54	156.2	234.3	78.5	22.9
31.12.54	176.7	255.6	126.7	17.6
31.8.55	154.7	274.6	93.4	25.0
31.12.55	174.2	273.0	126.8	20.7
31.8.56	163.7	268.8	92.9	30.3
31.12.56	214.8	284.8	142.9	22.7

x The fixed deposits are included in the money supply in accordance with the definition given by the National Bank of Egypt in the Economic Bulletin Vol. VI No. 1 of 1953, p. 27.

Source: N.B.E., Economic Bulletins, 1953-1957.

The table above shows clearly the seasonal fluctuations in the banknote circulation, while such fluctuations do not appear in the deposits. This is due to the fact that the financing of the cotton crop is still being done through the banknotes rather than transfer of bank deposits. The figures of loans and advances show a greater amplitude in its movements than the notes in circulation. As to the bills discounted, it is noted that they move in an opposite direction to the loans. This is explained by the fact that as banknotes flow to the country-side in the beginning of the cotton season, the local merchants are replenished, and consequently they become in a position to liquidate their bills.[1]

The major lenders in the money market of Egypt are the Central Bank and the commercial banks, while the borrowers are the Egyptian Government and the individual merchants.

The Central Bank in Egypt stands ready to rediscount eligible bills and to grant loans to the commercial banks. The rediscount rate of the Treasury bills was at the end of 1956, 2¼% while the rate for eligible commercial bills and loans was 3%. As has been mentioned before, the need of the commercial banks in Egypt to the Central Bank arises only at the height of the cotton season, while in the other seasons the commercial banks are in a fairly liquid position. Thus, a manipulation of the Bank rates can be effective only during the cotton season. As a matter of fact, the Bank raised the rediscount rate once in 1953 to 3½% but lowered it again to 3% after few months. Also, the Bank has taken in the recent years several measures to develop a money market in Egypt, as was mentioned previously.

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1. N.B.E., <u>Economic Bulletin</u>, 1953, No. 1

The other group of lenders in the Egyptian money market are the commercial banks, which are mainly concerned with short term financing of internal and external trade. The busy season of the commercial banks is the cotton season when bank credit is extended mainly through short term loans at a rate of 4-6% depending upon the solvency of the borrower and the value of the collateral. As regards discounting commercial bills, the local trade in Egypt utilizes bills only to a limited extent, so that few bills find their way to the portfolios of the commercial banks. The reasons for the undeveloped state of the bill market are listed by Issawi as follows: a) the scarcity of acceptable trade bills; b) the restricted volume of municipal and government borrowing; c) the reluctance of drawers to see their bills circulating; d) the complicated litigation process concerning bills and e) the large volume of dishonoured bills.[1]

On the demand side of the money market, the Egyptian Government plays a leading role. However, most of the short term credit it needs, is supplied by the Central Bank which holds at present more than 90% of the issued Treasury bills and stands ready to grant the Government short term advances to meet temporary deficits of the budget. In this respect, it is noted that the commercial banks in Egypt did not yet

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1. Issawi, Charles, Egypt at Mid-Century, (Oxford University Press, London: 1954), p. 218.

get used to hold Treasury bills as secondary reserves as is the case in more advanced countries. In the season following the sale of the cotton crop, the surplus reserves are kept as cash balances in the vaults of the commercial banks and in the National Bank, while few Treasury bills are added to their portfolios. Moreover, these Treasury bills are liquidated during the cotton season to enable the commercial banks finance the cotton crop.

3. The Money Market in Iraq

The increase in the oil revenues of Iraq in the recent years, has caused a proportional increase in public and private expenditure which necessitated an increase in the means of payment. This increase in the means of payment took form in the amount of banknotes in circulation and in the demand deposits at the commercial banks, with a tendency to utilize more of the former than of the latter. This is due to old habits of the population which are still prevailing.

The lenders of short term loanable funds in Iraq are the Central Bank, the commercial banks and the <u>sarrafs</u> while on the borrowers side there are the merchants and to a limited extent the Iraqi Government.

The Central Bank of Iraq is a lender of last resort and stands ready to rediscount eligible bills and to extend the commercial banks short term loans. However, the facilities of the Central Bank were until now of limited use to the commercial banks. The first time any rediscounting was made by the Central Bank was in 1956, and as a matter of fact no official rate was declared until that year, when the Central Bank took several measures to encourage rediscounting and short term borrowing.

The commercial banks in Iraq supply short term credit through discounts and advances. The discounts are handicapped by the narrowness of the bill market in Iraq and the preference of the borrowers to obtain credit through advances and overdrafts. However, there was a tendency of both items to increase in the last few years as shown in Table 5 below.

Table 5

Main Items of Money and Short-Term Credit in Iraq

(in millions of ID)

End of Year	Currency in Circulation	Total cur. & Saving A/C's in Com. Banks	Loans of Com. Banks	Bills discounted by Com. Banks
1952	30.0	14.8	9.0	1.7
1953	34.3	18.2	12.1	3.3
1954	41.2	21.7	19.5	5.3
1955	43.1	24.0	23.0	8.0
1956	48.5	28.2	23.3	9.5

Source: Annual Reports and Quarterly Bulletins of the Central Bank of Iraq (1952-1957).

The sarrafs in Iraq supply short term funds to the borrowers who cannot resort to the commercial banks because of the risk involved. The sarrafs consequently charge a higher rate of interest than that charged by the commercial banks and sometimes they resort to the commercial banks to discount some bills after they add their signature on them. Other sarrafs who are unlicensed extend credit at usurious rates of interest which are far higher than the maximum legal rate specified in Iraq at 7%.

On the borrowers side, the merchants are the main group utilizing short term credit to finance their internal and external trade. As regards the Iraqi Government, it seems that it did not have a need to borrow yet from the money market because of the financial resources at its disposal at the present time. Whereas there are some Iraqi Government bonds outstanding,[1] no Treasury bills are outstanding at present. However, the Iraqi Treasury might issue in the near future to some Treasury bills for purposes to monetary policy and to develop a money market in Iraq, as has been recommended by Iversen.[2]

4. The Money Market in Syria

In Syria, the use of checks to discharge payments is still limited as is the case with other underdeveloped countries. The demand deposits as on December 1956 formed about on third of the notes in circulation, whereas in more advanced countries demand deposits are in multiples of the

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1. See details in the section on security markets.
2. Iversen, opcit., pp. 207-208.

notes due to progressive ways of settling obligations through bank accounts. The following table shows clearly the trend of the main items of money and short term credit in Syria.

Table 6

Main Items of Money and Short-Term Credit in Syria

(in millions of £S)

End of Year	Notes in Circulation	Demand Deposits x	Bills Discounted x	Advances and Loans. x
1951	248	185.1	33.6	109.2
1952	239	198.6	34.6	179.5
1953	277	265.2	74.6	144.3
1954	356	274.0	133.3	260.7
1955	346	273.9	169.5	236.3
1956	436	152.9	192.7	226.3

x Amounts are for the principal banks operating in Syria.

Source: Statistical Abstracts of Syria and the General Monthly Bulletins of Current Statistics, 1953-April 1957.

The Central Bank of Syria and the commercial banks are the main suppliers of short term funds. The Central Bank started operations on August 1, 1956, assuming the functions of a full-fledged central bank and a lender of last resort. It stands ready to rediscount eligible bills and to extend loans to the commercial banks at the official interest rates. The function of the Central Bank as a lender of last resort was proved during the crisis that came as a result of the war conditions in Egypt in the last quarter of 1956. The Central Bank at that time extended credit facilities to the commercial banks to enable them meet the withdrawal of deposits, and thus was effective in overcoming a serious monetary crisis.

The commercial banks in Syria are mainly interested in short term financing of local and foreign trade. Even their credit to agriculture and industry takes the form of renewable short term paper which is a characteristic of short term credit. The competition between the commercial banks is keen and the interest on loans and advances ranges between 5% and 7% while the interest paid on current deposits reaches 4%. Whereas a considerable amount of commercial bills are discounted at the commercial banks, the loans and advances are still dominant. The expansion of short term loans in 1955 resulted in mid-1955 in a monetary crisis due to the over-importation of articles that could not be marketed due to a failure in the agricultural season. The monetary authorities at that time adopted several measures of credit control to check the expansion of bank credit in spite of the protests of the Syrian merchants.

The third group of lenders are the merchants and the professional money lenders who deal mainly with the agriculture sector. These lenders rely on their own financial resources and charge interest rates that are far above the 9% legal maximum.

On the borrowers side, the merchants are the main group while the Syrian Government did not yet resort to short term loans from the money market. No Treasury bills have been issued yet in Syria, although the Monetary Law of 1953 empowers the Treasury to issue its bills up to a maximum of £S 60 million. The only internal debt of the Syrian Government is an old debt of £S 220 million secured from the Banque de Syrie et du Liban, blocked in the cover of the Syrian currency at present.

5. Prospects

It is obvious that the conditions that would satisfy the existence of developed money markets in Egypt, Iraq and Syria are lacking. The following are the general features of the above mentioned money markets:

1. The use of checks to discharge payments is still limited in relation to the use of notes. Not only that, but in some areas of the Arab countries gold coins are still in use and some barter trade is still prevalent, which is indicative of the ignorance of the population and their distrust of bank notes. These factors limit the dominance of bank credit

as a means of payment and in turn, limit the ability of the central bank to manipulate the money supply by expanding or contracting bank credit.

2. The money markets are imperfect, permitting the existence of wide differences in the cost of credit. Besides the banking system, there exist in the Arab countries the private money lenders and merchants who supply credit at usurious rates of interest in spite of the maximum legal rates that are allowed by the laws. The differences between the interest rates in the money markets renders them unsensitive to a manipulation of the central bank rate which is usually a small fraction of the prevalent rate.

3. The absence of call loan markets is a serious handicap to the effectiveness of central bank policy. The call loan markets provide good outlets for short term investment of commercial bank funds. In developed money markets, this investment is made usually to discount houses which earn the small differences between their rates of discount and the rates charged by the commercial banks. Thus, the call loan rates reflect quickly the manipulation of the central bank rate and transmits that to the other markets of short term loanable funds with due effect on the volume of credit. The absence of such markets in the Arab countries results in the accumulation of idle funds in the commercial banks and thus renders them less sensitive to a manipulation of the central bank rate.

4. The bill markets in the Arab countries are not yet developed, due to the habits of the population and their distrust of commercial bills to settle obligations. This had resulted in limiting the outlets for commercial bank funds and in turn, reducing the dependency of these banks upon the central bank to rediscount commercial bills to secure liquid funds. As regards Treasury bills, they are only developed in Egypt and even there, the commercial banks do not hold them as secondary reserves.

5. None of the Arab countries in question is a repository of international funds and movements of short term capital. In a developed money market such as London, the manipulation of the central bank rate will have an effect on the export and import of capital seeking investment, with due effects upon the volume of credit inside Britain. The absence of these conditions in the Arab countries is a further drawback of the effectiveness of the central bank rate in changing the volume of credit.

It is worth mentioning that the monetary authorities in Egypt, Iraq and Syria have already utilized the central bank rate as a tool of credit control. In Egypt the central bank rate was manipulated in 1952 to fight the inflationary pressures that were prevailing, and in Syria, the rate was manipulated in mid-1955 to check the expansion of bank credit, while in Iraq an official central bank rate was declared in June 1956.

Although the effect of the manipulation of the central bank rate in Egypt and Syria cannot be traced, yet the mere declaration of official rates has a considerable significance. Firstly, the declaration of an official rate indicates the range of rates at which the public is supposed to borrow short term funds in the market. Secondly, it indicates to the commercial bank the price at which they can obtain central bank credit. Thirdly, it has a psychological effect on the money market; it is a signal of the credit situation in particular and of the economic conditions in general.[1]

The money markets in Egypt, Iraq and Syria are undergoing rapid development. The above mentioned features of these markets should not cause any misunderstanding as regards this point. In the three countries, the authorities are becoming more conscious of the importance of monetary institutions. Full-fledged control banks exist at present in those countries with full powers provided to them by legislation. In addition, good banking legislation have been provided in Iraq and Syria. In Egypt, the foreign banks have been Egyptianized and a recent law for banking control has been enacted. As to the existing banking systems in Egypt, Iraq and Syria, they are growing rapidly by virtue of the inreasing number of domestic commercial banks and through the state-owned banks that are being established.

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1. Kock, op.cit., p. 167.

The question of enhancing the development of the money markets in the Arab countries should be discussed within the limits of practical possibilities. It is out of question for the Arab countries and for other underdeveloped countries to strive for money markets such as those existing in London and New York. The latter markets have reached their unique position because of the unique position of the two cities in international financial dealings.

Broadly speaking, the existence of developed money markets in the Arab countries will depend upon the total economic development which will raise incomes and standards of living. However, the authorities can take certain measures to enhance the development of money markets. These measures are briefly stated as follows:

1. To encourage the use of checks, the governments in the above mentioned countries will be helpful if they start discharging their payments by checks and particularly the salaries of the civil servants. Also, the authorities in the Arab countries in cooperation with the banks should campaign for saving and time deposits by various methods such as the payment of considerably higher rates of interest on such deposits and by attaching to them a lottery feature such as that followed in Japan. Moreover, the establishment of postal saving offices should be widespread and may help to attract the savings of the low income groups.

2. The authorities in the Arab countries should seek

to increase the volume of available credit. Such credit facilities will ultimately eliminate the need for the merchant money lenders who charge usurious rates of interest. As a result, the rates of interest in the money market will stabilize on a uniform level, which will enable variations in the Bank rates to have some effect. The authorities can provide credit by encouraging the establishment of credit co-operatives, savings banks and commercial banks. Moreover, the authorities can step directly into the field by establishing state-owned banks which will provide cheap credit for the various fields of economic activity.

3. The bill markets can be developed by educating the public to the use of commercial bills. The commercial banks can help in this concern by showing preference to extend credit through the discount of bills rather than through loans and advances. Also, the governments can encourage the use of bills by reducing the fiscal charges attached to it.

The central banks in the Arab countries can take several measures to develop the bill markets. As regards commercial bills, the central banks can grant re-discount facilities that will encourage the commercial banks to hold trade bills such as reducing the amount per bill eligible for re-discount and by considering bills of long maturities. The holding of Treasury bills can be enhanced if the central bank declares its readiness to buy the bills from third parties at a moderate rate of interest, as has been done by the National Bank of Egypt in 1954.

B. Security Markets

While our study of the short term money market was related to the use of the central bank rate as a method of credit control, our interest in the capital market lies in the institutional framework that this market forms for the use of open market operations as a tool of credit control.

1. Open Market Operations and the Security Market.

Open market operations mean the purchase and sale of securities in the open market by the central bank with the purpose of affecting the volume of money in the interest of economic stability. The primary effect of such operations falls upon the prices of securities, and consequently, upon their yields which represent the prevailing interest rates in the market; a variation in the interest rates means a variation in the cost and availability of credit. The indirect effect of open market operations falls upon the cash reserves of the commercial banks, thus reducing or increasing their ability to extend credit. If the central bank wishes to expand credit, it buys securities from dealers and pays them by checks on itself. The checks deposited with the dealers' banks are credited on the books of the central bank accordingly, and thus these banks are enabled to expand credit in multiples of the central bank credit they acquired. If the central bank wishes to contract credit, it sells securities in the open market with due effects on their interest rates and the cash reserves of the commercial banks.

In an expansionist policy, open market operations have a definite advantage over the manipulation of the central bank rate. If the central bank rate is lowered, the commercial banks cannot be forced to expand their credit accordingly while a purchase of securities in the open market will have the effect of directly increasing the balances of the public in the commercial banks. The sellers of securities will receive the checks of the central bank drawn on itself in settlement of the sale and as soon as they deposit these checks in their banks, their accounts will be automatically credited and more money will be placed at their disposal. Thus an expansion of credit results in spite of any counteraction that the commercial banks may show.

There are always conditions that have to be satisfied for successful open market operations. The assumptions that should be made here are: a) that the quantity of money will tend to change in the trend that is aimed by open market operations; b) that the commercial banks will increase or decrease their credit in accordance with the change in their cash reserves; c) that the public demand for bank credit will change in accordance with the change in its cost and availability.

The above conditions are liable to pressures from disturbing factors. An inflow of foreign capital or an expansion of public expenditure at a time when the central bank sells securities to contract credit, will keep the quantity of money in the market as it is, thus neutralizing the effect of open market operations. Or else, the commercial banks may not vary bank credit in accordance with a change in their cash reserves, as such a policy may be affected by other considerations. Moreover, the circulation of money and credit does not have a constant velocity, and it always depends on the reaction of the people which is governed by factors beyond the central bank's control.

However, other things being equal, the existence of a broad security market will supply the central bank with a tool of credit control through open market operations. The security market is the market of long term capital and it consists of stocks and bonds of corporations, government bonds and treasury bills and all other paper that represents financing in medium and long term investments. The supply and demand for capital require the existence of highly organized institutions, such as big corporations, investment banks and stock exchanges.

In developed security markets, three groups of dealers exist. In the first place, there are the investment banks that underwrite the issue of new stocks and bonds and their distribution to the public. Some of these firms buy the securities of a new corporation and take title to them, selling them afterwards in the market at a premium. In the second place, there are the stock exchanges which are concerned with transactions in securities that have already found their way into the hands of the investors. The stock exchanges assist in the distribution of investment and provide the investors with a means to convert easily their securities into cash at a minimum of loss and sometimes at a profit. Also, it is easier for the government and business corporations to sell their new stocks and bonds in the stock exchanges in as much as their investors can sell their old securities to buy new issues. A further advantage of stock exchanges is that business concerns will find it easier to get short term loans from the commercial banks when the marketability of their stocks at the stock exchanges provides a proof of their credit worthiness. The third group of dealers in the market are the brokers in securities which are not listed in the stock exchanges for one reason or another. It is noted that transactions in U.S.A. Government securities are almost exclusively handled in this over-the-counter market even though they are listed on the New York Stock Exchange. Securities of companies which do not favour speculation and those held by families and small groups are also handled in this market.[1]

In addition to the open market operations that the central bank undertakes to change the volume of credit are the operations in the foreign exchange market. The central bank can utilize its reserves of gold and foreign currencies to support the exchange rates in the open market and thus bring about the desired conditions of inflow or outflow of capital. These direct operations depend upon the funds at the disposal

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1. Kent, R., Money and Banking, (Rinehart & Co., Inc., New York: 1949), p. 631.

of the central bank and can only be effective if they are supplemented by other measures of credit control. Moreover, such direct operations can be carried only in free exchange markets where the rates are decided mainly by forces of supply and demand.[1]

2. The Security Market in Egypt

The security market in Egypt is characterized by the existence of organized stock exchanges that have been operating since 1903. The operations in these stock exchanges are confined to the paper of Egyptian companies and Egyptian Government securities. Before the securities are listed in the exchange, the companies are required to present satisfactory statements that are examined by the executive committee of the stock exchange, which is composed of representatives of the brokers' association, of bankers and of a government controller who has the right of veto.

The stock market in Egypt is active but narrow. In 1955, the total market value of Egyptian securities quoted in the stock exchange was £E 362.8 million out of which £E 111.0 million were Egyptian Government bonds.[2] In that year, the turnover in Government securities marked £E 26 million, their nominal value being £E 25.5 million; the turnover in other securities marked £E 89.1 million, their nominal value being

1. Cf. Plumptre, A., Central Banking in the British Dominions, (The University of Toronto Press, Toronto: 1947) pp. 20-23.
2. N.B.E., Economic Bulletin, 1956, No. 2, p. 210.

£E 41.5 million. However, the transactions in the stock exchanges are, until now, restricted to a few favourites and a considerable part of company stocks is concentrated in few hands of big subscribers or are kept permanently as investments.[1] This renders the security market unsuitable for open market operations which, until now, have never been performed by the Central Bank. The non-Government securities represent the stocks and bonds of joint stock companies which total 600 in Egypt with a total capital investment of £E 500 million, and only one third of which are listed in the stock exchange. The formation of joint stock companies, especially the industries has been enhanced recently in Egypt by the Government. Official committees and institutions were set up to study the projects and establish the new companies which are financed partly by the Government and partly by the public. Moreover, the Industrial Bank in Egypt has been supported by the Government to enable it increase its participation in the newly established companies either by granting loans or by shareholding.

The formation of joint stock companies has been encouraged by legislation. The Companies Law No. 26 of 1954 which replaced Law No. 138 of 1947, provides the following advantages with respect to the joint stock companies:

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1. Ibid., p. 149.

1. It simplified the procedure of registration by limiting the number of days during which Government authorization should be given to 45 days.

2. The nominal value of shares has been lowered from £E 4.- per share to £E 1.- This measure will attract the small investors.

3. The Law provides that a minimum of 49% of the shares must be offered for subscription to Egyptians for a period of one month.

4. The Law requires the newly established companies to publish essential details in their prospectus and in their annual statements, in order to protect the investors from fraud.

In addition to the above, the formation of joint stock companies has been encouraged indirectly by regulations exempting them from some categories of taxes and from custom duties on machinery and equipment needed for national production as well as raw materials used by local industry.

As regards Government securities, the Egyptian Government has long been in the habit of issuing loans to finance its development projects and Treasury needs. This trend has been using since the Revolution of 1952, as the Government became more interested in financing development projects through domestic borrowing. At the end of 1956, the outstanding debt of the Egyptian Government was £E 174.7 million of loans in addition to an amount of £E 146 million of Treasury bills.[1] It is interesting to note that the last issues of the Production Loans have been quickly covered, which indicates the confidence of the population in the Government stock. The Treasury bills are mostly held by the Central Bank while a few are held by the commercial banks, in spite of the rediscount facilities offered by the former and its measures to develop a market in Treasury bills.

3. The Security Market in Iraq

In Iraq, a security market is hardly in existence. The dealers in securities can be classified into three groups. The Central Bank deals with Government securities by reason of its function as a fiscal agent of the Government. The Rafidain Bank acts as intermediary between buyers and sellers of securities through a special department for that purpose established in 1954. At last, there are some few private brokers in securities.

The corporation system of business organization is still new in Iraq. The shares of the existing corporations are very closely held either by few shareholders or by family groups. These shares are rarely put in the market since the stockholders keep them as permanent investment. The corporation system of business organization has been pushed by the Industrial Bank, a state-owned institution established in 1940. This Bank extends facilities to industrial concerns either by

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1. N.B.E., Economic Bulletin, 1957, No. 1

direct participation or by granting them long term loans. Until 1955, the Bank held shares of 13 joint stock companies, the total value of which amounted to ID 1.63 million. In addition, it extended loans and documentary credits to a big number of concerns. The total loans amounted at that time to ID 1.3 million and the total documentary credits ID 1.1 million. However, the Bank is being criticized for its policy of holding the shares it acquires too long rather than selling them in the market. If this weakness is amended in the near future, the Industrial Bank can be effective in establishing corporations which in turn will feed the security market with stocks and bonds.

A relatively small amount of Iraqi Government bonds are outstanding at present. At the end of 1956, ID 12 million of these bonds were outstanding of which the Central Bank held ID 7.06 million. The commercial banks and the sarrafs held ID 2.55 million, 60% of which were deposited in the Central Bank as part of the legal reserves. The balance of the bonds were in the hands of Government agencies while the public held only 12% of their total amount.[1]

4. The Security Market in Syria

At present, no security market practically exists in Syria except for some small scale transactions that are per-

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1. Allus, op.cit., p.24

formed between the restricted shareholders of joint stock companies. The stocks and bonds of the existing companies are held either by family groups or by few shareholders who keep them for investment.

As regards Government securities, the only amount existing is a total debt of £S 220 million that is held permanently in the cover of the Syrian currency. The loans of the Syrian Government have been always in the form of advances from the BSL which held the privilege of note issue until August 1, 1956. Moreover, the recent reform in the money and banking system of Syria prepares the ground for the issue of government securities. The Monetary Law of 1953 requires the banks in Syria to invest their obligatory reserves in Syrian Government bonds with the obligation that these bonds cannot be sold or mortgaged except with the permission of the Money and Credit Board.[1] Moreover, Law No. 89 of 1955 was enacted prescribing the management of public debt and the issue of Government securities.

5. Prospects

Being pools of available capital for investment, the security markets are directly related to the level of savings which constitute the main source of capital in the country. In the Arab countries, savings are short of the needs of investment. This is particularly the case with the private

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1. Legislative Dedree No. 87 of 1953, article 117.

sector since in some oil producing countries, such as Iraq, the ratio of savings is very high in spite of the underdeveloped conditions prevailing, due to the oil revenues that are received by the Government and channelled into investment projects. In general, the ratio of savings to national income in the Arab countries does not exceed 5% while in the advanced countries it reaches 15%. Out of this small ratio of savings, a considerable amount is hoarded by the population, so that the part that is invested does not exceed the natural increase of the population, and thus, the general standard of living remains as it is.[1]

With such a low level of savings, the authorities in the Arab countries should take the initiative to raise this level and provide capital for investment. One way to do it is by inducing people to consumer less. This can be done by limiting the importation of consumers' goods or by raising some taxes that will not lead to a reduction in the standard of living, such as the income tax and the inheritance tax. However, these measures may not lead to any increase in savings and may have an unfavourable effect upon the present standard of living.

The other way to mobilize savings is through the creation of institutional means which will induce the population to save voluntarily. Although this means cannot be developed in a short time, yet it is the only natural means to channel

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1. حماده ، سعيد ، "تمويل الانماء الاقتصادي في البلاد العربية"، الابحاث ، ايلول ١٩٥٣ ، ص ٣١٧ .

the savings into institutions that will in turn invest these savings in profitable securities and these help in creating a security market. These institutions take the form of savings banks, insurance companies, postal savings systems, and social insurance or provident funds. The authorities in the Arab countries can help to create these institutions by suitable legislation, by direct action and by cooperation with the existing institutions to educate the public on savings.

Going a step further, we find that the growth of security markets depends largely on the dominance of the corporation form of business organization. It is noted that the security markets in Europe have developed at the time of development of the corporation systems. In the Arab countries, the corporation system is not sufficiently widespread due to two main reasons:

1. The lack of entrepreneurship spirit and managerial abilities in the Arab countries. The corporation system of business organization requires creativeness on the part of promoters who have enough confidence and training to start a big business that requires a high degree of efficiency in planning and execution. The importance of entrepreneurship in economic development should not be underestimated, and some economists believe that it is the "missing link" in the Arab countries.[1] The characteristics of entrepreneurial pattern

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1. Meyer, A.J., "Entrepreneurship; The Missing Link in the Arab States", Middle East Economic Papers, 1954, p. 121.

in the Arab East are to be found in the family firm, lack of concentration on one line, joint ventures, deficient methods of book-keeping and mangement, inability of business firms producing similar products to combine in association for the purpose of promoting their business, and other symptoms that are associated with the backward stage of social and economic structure prevailing in the Arab countries.

2. The corporation form of business is a developed pattern that arises in industrialized communities which have attained a high standard of living and technical skill. The Arab countries have agricultural economies where old systems of land tenancy and cultivation prevail. Such societies do not form a proper atmosphere for the development of business organization. It is to be noted that the prevalent corporations in the Arab countries at present are public utilities such as water and electricity, or services such as banking, insurance and transportation.

The authorities in the Arab countries should take the initiative in setting up the necessary organization for the promotion of investment projects. The most practical way to do it is to establish Government Boards which will prepare the necessary studies to set up projects which will be owned partly by the government and partly by the public. To start with, the government will float the majority of the shares of the newly established corporations in the market. Those shares that are not sold should be purchased by the governments in order to set the corporations on their feet. After some time, the authorities will sell some of their holdings in the market, and the proceeds will then be taken to establish new corporations and so on. That is to say, the authorities in the Arab countries are called upon to play the part of long term financiers and investment bankers.

Also, the authorities in the Arab countries can encourage the formation of corporations through suitable legislation. The companies Law No. 26 of 1954 in Egypt provides a good example in this respect. The important points that should be satisfied in company legislation are: a) the simplification of the procedure of registration; b) the obligatory issue of the shares to the public through an authorized bank; c) the reduction of the nominal value of the share to the minimum in order to attract small investors; d) the safeguard of the interests of the shareholders by all means possible. Moreover, the legislation can cover exemptions from certain categories of taxes for the first years of the company operations and other exemptions from custom duties on equipment and machinery.

The discussion above was concentrated on the corporation securities. The other main constituent of the security market are the Government Treasury bills and bonds. The Treasury bills are promissory notes of the Treasury to pay a stated sum of money at a certain date of maturity, which is usually not more than three months off. The Treasury bills ~~are usually not more than three months off. The Treasury bills~~ are usually issued by tender at par value and are handed over to the highest bidder, the difference between the actual money paid for it and their par value being the short term interest rate prevailing in the market. Any time the authorities wish to expand credit, they buy the bills and pump money in the market. However, the success of open market operations in Treasury bills depends on many factors, namely, "a sufficient volume of Treasury bills; a regular flow of maturities; the offer of bills periodically on a tender basis under the aegis of the central bank which should be allowed to tender; the use by banks of Treasury bills as secondary reserves; and an undertaking by the central bank that it would always be prepared to discount Treasury bills for third parties at a rate not far removed from the current rate at which such bills are issued."[1]

As was mnetioned earlier, no Treasury bills are outstanding at present in Iraq while in Syria no such bills have been issued whatsoever. As regards Egypt, a considerable amount of Treasury bills is outstanding but mostly held by the Central Bank. The Central Bank in Egypt has taken measures to encourage the banks to hold Treasury bills by offering them a favourable discount rate, but it seems that the banks are not yet in the habit of holding them as a secondary reserve. This should be enhanced by legislation which will oblige the commercial banks to invest part of their liquid assets in Treasury bills. In Iraq, the obligatory reserve ratio carried by the banks may include Treasury bills and Government securi-

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1. Kock, op.cit., p. 218.

ties up to one third.

The other category of Government securities are the long term bonds issued to finance development projects and public investment. The obstacles in the way of marketing Government bonds in the Arab countries are: a) the bonds do not carry term attractive enough to the public; b) lack of capital markets and saving institutions and c) lack of confidence in the governments. These obstacles can be tackled by government action in different ways although the matter of confidence comes only gradually. The following are some ways that can be followed by the authorities in this respect:

1. To provide that the bonds will be redeemed at intervals, to assure the investor a maximum degree of liquidity.

2. To issue the bonds to finance specific projects which impress the community.

3. To have the bonds issued to bearer and to have them carry a lottery feature.

4. To exempt the interest on the bonds from income tax.

5. To impose upon the insurance companies, saving institutions and banks to invest their surplus reserves in Government securities.

C. Banking Systems

The purpose of this section is to relate the banking structures in the Arab countries with central banking functions. Apparently, the banking relations of a central bank are mainly concentrated on the commercial banks dealing with short term credit. The reason being that these banks are the intermediary between the central bank and the money market, which reflects the conditions of credit in the country. Howver, we have chosen in addition to discuss medium and long term banking institutions because of their increasing importance in supplying the required credit in the Arab countries. Also, because of the special interest of the authorities in these countries to establish state-owned institutions of this nature.

1. The Central Bank and the Banking System

The effectiveness of the central bank depends mainly on the amount of contact it has with the money market. On the basis of this contract, a monetary policy can be formulated and executed, which will affect the level of prices, incomes and production.

The first and foremost means of contact with the money market is the banking system, by virtue of its ability to create credit on the basis of a smaller amount of cash money. The link between the banking system and the central bank can only be established if the former keeps close contact with the latter, resorting to it frequently and depending upon it for its needs for liquid assets. Thus, the more advanced the banking system is in a country, the more influence it commands over the various fields of economic activity. On the other hand, its dependence on the central bank will place in the hands of the latter the power to regulate bank credit with due effects on economic activity.

Control of the market can be performed by affecting the cost of credit through the rediscount rate. In underdeveloped countries, the rediscounting habit is not dominant and thus the effect by a change in the rediscount rate of the central bank will be insignificant.

Another way of control of bank credit is through open market operations. We have seen in the previous section that these operations cannot be carried in narrow security markets such as those existent in underdeveloped countries.

Therefore, other ways have to be developed to establish central banking control on the cost and availability of credit. In underdeveloped countries, the following ways may stand to be the most effective:-

1. The central bank may step in the credit market through direct operations. These operations will provide the central bank with the necessary contact with the market and enables it to execute whatever monetary policy it formulates. Although direct operations contradict te classical theory of central banking, yet it has definite advantages if performed

moderately and cautiously. Professor Sayers believes that the central bank should help in spreading banking services in underdeveloped countries through its performance of ordinary banking business. He believes that "... the evidence warns us to be cautious in developing the ordinary banking business of a central bank, rather than to say that there should be no such business."[1]

The central bank can reach the same goals through state-owned banks which perform ordinary banking business. In this case, the central bank will have to secure close coordination of policy and operation with these banks.

2. The central bank can act directly upon the amount of bank credit through variable reserve ratios. In order that this weapon be effective for control, banks should (a) determine their lending policies on the basis of their cash reserves; and (b) they should be in the habit of maintaining reasonably fixed ratios between their deposits and cash balances. Although these two conditions may not be strictly adhered to in the banks of underdeveloped countries, yet these banks will have to give some consideration to their cash reserves in any policy they follow.

3. The central bank may be given the power to control the lending operations of banks. This can be performed by

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1. Sayers, Central Banking in Underdeveloped Countries, op.cit., p. 9.

fixing portfolio ceilings and by the variation of obligatory ratios of bank assets. By this way, a variation will be effected not only in the total volume of bank credit, but also on the quality of credit. Qualitative controls is a necessary supplement for the weapons in the hands of the central bank in underdeveloped countries. In such countries, there is always a tendency for bank credit to be concentrated on few items of trade. Most of these countries are at present undertaking development programs, and it is necessary that the monetary authorities channel the financial resources in the right direction.

4. The central bank may be given other powers of control over the banks. One of these powers is control over the interest rates paid by the banks on their deposits and the rates charged by them on loans and advances. Such a control will induce liquidity and solvency of banks. Moreover, it is necessary to keep down the lending rates of the banks and to secure a parallel movement of these rates with the variations of the central bank rates.

Another method of control is found in fixing limits for certain kinds of investments made by banks. These investments may not be within the requirements of liquidity and solvency such as investment in immovable property by commercial banks or investment in foreign securities and similar others.

A third method of control is the right to inspect the financial records of banks and to request information from them. Through these records, the central bank will have full knowledge of the market. In addition, this information is necessary for the execution of control over the banks.

2. The Banking System in Egypt

Until January 15, 1957, banking practice in Egypt was not regulated by a comprehensive legislation. The banks which were in the form of joint-stock companies, were subject to the Company Law. The Central Bank Law of 1951 included few articles dealing with commercial banks. In these articles a commercial bank was defined as any person, natural or juristic whose main activity is the acceptance from the public of deposits payable on demand or at a fixed date. Moreover, the Law of 1951 imposed upon the commercial banks a reserve ratio, a liquidity ratio and periodical statements to be submitted to the Central Bank.[1]

On January 15, 1957, Law No. 22 was enacted. The Law provided that all banks in Egypt must take the form of Egyptian joint-stock companies fully owned and managed by Egyptians. Moreover, the Law provided that a bank must have a minimum paid up capital of £E 500,000 and that its shares must be nominal and owned by Egyptians at all times.[2] The object of the Law was to effect the Egyptianization of foreign banks

1. Articles 19 & 20.
2. Article 1.

within a period of five years[1], and it was supplementary to the sequestration of British and French banks in Egypt effected late in 1956.

On July 20, 1957, a new Law for banking control was enacted. The main provisions of the Law are the following:

1. The National Bank of Egypt, in its capacity as central bank of the State is empowered to control the quantity, quality, and cost of credit in accordance with the requirements of the various fields of economic activity.[2]

2. The Central Bank affects the registration of banks if it is organized in accordance with the Law, namely, joint-stock company of £E 500,000 capital owned by Egyptians.[3]

3. The Central Bank is empowered to lay general directives for the control of commercial banks. The control measures include liquidity requirements, fields of investment forbidden and ceilings for certain kinds of loans and investments.[4]

4. The Central Bank is empowered to lay general directives for the control of non-commercial banks, as regards conditions of deposit, conditions for participation in the establishment of other institutions, and the maximum amount of bonds that may be issued by these banks.[5]

5. The Central Bank may carry credit transactions with the banks that fall subject to this Law. The interest rates and discount rates on these transactions are decided

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1. Article 2.
2. Article 1.
3. Article 2.
4. Article 3.
5. Article 4.

by the Bank depending upon the nature, duration and need for these transactions and in accordance with the credit policy that is followed.[1]

The above legislation eliminates the foreign banks in Egypt. As a matter of fact, commercial banks in Egypt were either branches of banks registered abroad or locally registered banks owned and managed by non-Egyptians. To give an idea of the significance of foreign banks, it has been noted that at the end of 1956, "foreign banks were controlling some £E 100 million of deposits out of a total of over £E 195 million for all commercial banks, while their discounts and advances reached some £E 76 million of a total of £E 158 million."[2]

Compared with advanced countries, the banking habit in Egypt is still underdeveloped. This can be drawn from the ratio of notes in circulation to total bank deposits. In June 1956, the ratio of the latter to the former was 1.08 while at the same date the ratios for U.S.A. and Britain were 3.79 and 2.07 respectively.[3] Moreover, the seasonal fluctuation of notes, as was mentioned previously, is indicative of the preference to use cash money instead of bank deposits to meet the requirements of the cotton season.

The little use of bank deposits is due to several social

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1. Article 5.
2. N.B.E., Economic Bulletin, 1957, No. 1, p. 38
3. Figures are taken from the United Nations Statistical Yearbook, 1956.

Currency & cred.
bank deposits

and economic factors. These factors were mentioned by Issawi as follows: "the absence of a large and prosperous middle class; the prevailing traditions of conspicuous consumption, especially among the rich; the prevalent illiteracy and distrust among the poorer class; the preference shown for investment in hand or hoarding of gold; the emphatic Koranic prohibitions against usury, only partly offset by Mohammed Abdu's fetwa authorizing the taking of interest on Post Office Savings Bank deposits; the absence, until 1937, of any legislation regarding the drawing of cheques, leading to a general distrust of cheques and reluctance to open bank accounts; and finally, not least important, the fact that until quite recently and more particularly before the date of Misr Bank, few bank managers (who were almost foreigners) were able to establish close contacts with Egyptians and persuade them of the advantages of opening an account."[1] Needless to say, that these factors are losing significance due to the reforms introduced during the last few years. In his address to the Parliament in July 1957, President Abdul Nasser mentioned the fact that the total bank deposits of Egyptians rose from £E 200,-700,000 in 1952 to £E 262,500,000 in 1957.

The banking system in Egypt can be classified according to the kind of credit involved, namely, commercial, agricultural, mortgage and industrial.

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1. Issawi, op.cit., p. 215.

Commercial banks deal mainly with the financing of the cotton season stretching through the last quarter of the year. Financing of cotton takes the form of loans and advances to the cotton merchants. In the period following December, the commercial banks are replenished as the cotton proceeds start pouring in until banks reach their highest degree of liquidity around August.

The activities of commercial banks in Egypt can be illustrated by the following aggregate balance sheet of commercial banks.

Table 7

Aggregate Balance Sheet of Commercial Banks in Egypt as at December 31, 1956

Assets	£E 000's	% of total
Cash	6,818	2.4
Balances with the NBE	39,953	10.8
Other items of cash nature	1,337	0.4
Bills discounted	22,779	8.2
Instruments and securities	28,766	14.4
Correspondents	20,941	7.5
Loans and advances	142,946	51.6
Other assets	13,162	4.7
Total assets	276,701	100.0

Liabilities	£E 000's	% of total
Paid-up capital	11,051	3.9
Reserve funds and undivided profits	11,389	4.1
Cheques, drafts, etc. outstanding	2,311	0.8
Correspondents	19,803	7.1
Current deposits	139,730	50.5
Time, saving and other deposits	55,444	20.1
Borrowings	18,530	6.8
Other liabilities	18,444	6.7
Total liabilities	276,701	100.0

Source: N.B.E., Economic Bulletin, 1957, No. 1.

It is noted from the above table that the outstanding activities of these banks are the acceptance of deposits and the extension of loans and advances, while the discounting of bills is a secondary item. Moreover, the ratio of liquid assets to current deposits was at that date well above 30% which is considered very adequate.[1] This liquidity ratio rises considerably during the export season, as cash balances are accumulated by the commercial banks. The liquidity of commercial bank assets can also be drawn from the reserve ratio held by these banks which was in August and December 1956, 23.3% and 18.4% respectively,[2] while the legal ratio during that period

1. Cf. Sayers, R.S. Central Banking After Bagehot, (Oxford, 1957), pp. 101-107.
2. N.B.E., Economic Bulletin, 1957, No. 1, p. 70.

was only 12.5%.

Agricultural credit in Egypt is handled mainly by the Credit Agricole et Cooperatif, originally founded in 1931. The Government owns 51% of the capital of this bank while the rest is owned by other banks and cooperatives. Its services include advances to peasants and cooperatives, distribution of seeds and fertilizers, etc. The operations of the Bank have expanded greatly and several loans have to be secured from the National Bank. In 1956, Law No. 382 was enacted allowing the Bank to issue Government-guaranteed bonds of 3% interest up to £E 20 million. The National Bank covered the issue already and will sell the bonds at a future time.

Mortgage credit in Egypt was in the hands of powerful foreign banks, the most important of which was the Credit Foncier Egyptien. This bank was founded in 1880, its loans in December 1956 amounting to £E 12 million.[1] Another foreign bank was the Land Bank of Egypt. Both of these banks were sequestrated by the Government. In addition to the above, there is the Credit Hypothecaire Agricole d'Egypte, which is a state-owned bank that extends advances against first mortgages.

Industrial credit is handled by two big institutions Misr Bank and the Industrial Bank. Misr Bank is originally a commercial bank established in 1920 and since that date it

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1. N.B.E., Economic Bulletin, 1957, No. 1, p. 39.

supported industrial growth in Egypt by direct participation, advances and industrial loans. It is a perfect example of mixed banking; it borrows on short term and lends on long. At present, Misr Bank controls almost half of the total deposits in Egypt, and the Misr group comprises more than 20 companies with capital and reserves exceeding £E 20 million.

The Industrial Bank started operations in 1949 with a capital of £E 1.5 million, 51% of which owned by the Government. It serves industry through direct participation, granting loans and supplying them with raw materials and equipment. Under the Republican Regime, the requirements of industry necessitated consolidation of the Bank. It was granted loans at low interest rates by the National Bank and Government agencies. The Government declared its readiness to guarantee loans granted by the Bank up to £E 5 million. Moreover, a system of close cooperation was developed between the Bank and the commercial banks to facilitate rediscounting of bills at the Central Bank.[1] Thus, the Industrial Bank entered a new era of activity under the supervision of the Government to assist the growing industry in Egypt.

An outstanding feature to be noted about the banking system in Egypt at present, is the increasing Government interest in its development. This interest was expressed by the Egyptianization of foreign banks, which eliminated a serious

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1. Cf. The Industrial Bank, The Development of Industrial Credit in Egypt, (Cairo, 1956), pp. 11 - 25.

problem in the face of chanelling funds into the right direction. Moreover, the Government has enacted new legislation which places in the hands of the Central Bank large powers to control the quality and quantity of bank credit. Also, the Government is encouraging the establishment of new commercial banks; one of its achievements in this field is the establishment of the Republic Bank which started operations in 1956 with a capital of £E 1 million, 25% of which subscribed by the Government.

3. The Banking System in Iraq

Law of Banking Control No. 34 of 1950 provides the basis and conditions of banking practice in Iraq. Commercial banks must be organized in the form of a limited company, while *sarrafs* can take any legal form of business organization.[1] The minimum capital requirement for a bank is ID 250,000 fully paid up[2] while for *sarrafs* it ranges from ID 12,000 down to ID 3000 according to the place of operation.[3]

The Law provides the following conditions for the activities of commercial banks:

1. Commercial banks are required to keep 15% of their total fixed and current deposits at the Central Bank.[4] One third of this ratio may be in the form of Government securities.

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1. Article 1 (2) & (3).
2. Article 4 (1) & (2).
3. Article 4 (4).
4. Article 9 (1).

Moreover, the Central Bank may lower this ratio to 10% at its own discretion.[1]

2. A bank must not accept deposits more than sixteen times its capital and reserves held in Iraq.[2] Moreover, commercial banks must hold at least 50% of their total deposits in certain assets payable in Iraq by residents of the country.[3]

3. Commercial banks are not allowed to invest any part of their assets in idnustrial, agricultural or real estate shares or bonds of foreign companies or of foreign governments.[4]

4. No bank is allowed to extend a credit facility to any person that will involve the bank in a liability of more than 20% of its capital and reserves. This percentage may be exceeded with the approval of the Central Bank.[5]

5. A minimum of 10% of the net annual profits of banks must be alloted in capital reserves, until these reserves equal at least 50% of their paid-up capital of the banks.[6]

6. Banks must submit to the Central Bank periodical financial statements. Also, the Central Bank retains the right to delegate any person to check upon the activities of banks whenever that is necessary.[7]

It is noted that the above Law of Banking Control

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1. Article 10 (1).
2. Article 8 (8).
3. Article 9 (2).
4. Article 12.
5. Article 14 (1).
6. Article 16.
7. Articles 17-20.

lacks the necessary emphasis on two of the important tools of credit control: variable reserve ratio and qualitative credit controls. The reserve ratio, as provided in the Law can be varied only within a range of 10 to 15%. As was mentioned before in this thesis, the ratio at present is 15%, yet no tangible influence has been noted on the amount of bank credit. Consequently, it may be advantageous to raise this upper limit or abolish it completely from the Law. As to qualitative credit controls, they are absent from the Law. Their importance in underdeveloped countries has already been noted, and it is necessary that provision is made for it.

The banking habit in Iraq is still undeveloped for practically the same social and economic factors that were mentioned for Egypt. Although there has been an improvement in the recent years, the banking habit is still behind that ruling in Egypt. In June 1956, the ratio of deposit money to currency in circulation amounted in Iraq to 0.52 while in Egypt it was 1.08.[1]

The banking system in Iraq can be classified into the kinds of credit handled by banking institutions, namely, commercial, agricultural, real estate, mortgage and industrial credit.

Almost two thirds of the commercial banks in Iraq are

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1. Figures are taken from the United Nations <u>Statistical Yearbook,</u> 1956.

branches of non-Iraqi banks. Commercial banking activity includes financing of foreign trade, accepting all kinds of deposits, making loans and advances, and discounting bills. Moreover, commercial banks invest a good percentage of their assets in foreign securities, mainly British, as appears in the table below; however, these investments are required by the Law not to exceed 50% of their total deposits. Also, a part of their investments is made in Iraqi Government bonds up to the limit allowed by the Law to be included in the legal reserve ratio. The table below shows clearly that the liquidity ratio of commercial banks in December 1956 was well above the requirements of liquidity and safety.

A notable feature of commercial banking in Iraq is the Rafidain Bank which is a state-owned institution established in 1941 to carry out commercial banking. The paid-up capital of the Bank was in December 1956, ID 1 million in addition to a reserve fund of ID 2 million. Until May 1956, the Rafidain was the formal depository of Government funds in addition to its wide commercial banking activities.

Agricultural credit is supplied mainly by the Agricultural Bank, a state-owned institution that started operations in 1947 on the strength of Law No. 18 of 1940. The capital of the Bank has been raised several times until it reached ID 2 million. However, the Bank used to acquire loans from Government departments including the Central Bank. The object of the Bank is to assist agriculturalists by providing them with credit facilities. Until now, its operations were not very successful. The reasons being the profit seeking policy followed, the strict regulations for credit extension, and the priority given to big landowners.[1] Moreover, the Bank undertook several small industrial projects which failed completely. At present, the Bank is meeting an increasing demand on agricultural credit which will oblige the Bank to seek new financial sources and may be to establish branches in the agricultural area.

The Real Estate Bank is another state-owned institution that started operations in 1950 on the strength of Law No. 18 of 1948. The authorized capital of the Bank is ID 10 million and it secures loans from the Central Bank and other Government agencies. The object of the Bank is to grant loans for new building activity and to build on its own account dwelling houses to be sold by instalments to Government officials and to other persons who earn a limited income. Until now, the Bank was active and its operations were in the favour of the middle income-groups rather than the low-income ones.

Mortgage credit is supplied by the Mortgage Bank, a state-owned institution established in 1951 by Law No. 14 of 1951, amended later by Law No. 21 of 1952. The capital of the Bank is now ID 1 million fully paid up. The object of the Bank is to lend money to Iraqis with limited income. Until now,

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1. الجليلي ، عبد الرحمن ، محاضرات في اقتصاديات العراق ، (معهد الدراسات العربية العليا ، القاهرة : ١٩٥٥) ، ص ٥٩ .

Table 8

Consolidated Balance Sheet of Commercial Banks in Iraq as at December 1956.

Assets	ID mill.	% of total
Cash	5.2	7.5
Deposits with Branches & Banks in Iraq	6.1	8.8
Deposits with C.B.I.	6.4	9.3
Government Loans	1.1	1.6
Private Loans	23.3	33.6
Discounted Bills	9.5	13.9
Deposits & Investments Abroad	12.7	18.3
Other Assets	5.0	7.0
Total Assets	69.3	100.0
Liabilities		
Paid-up Capital & Reserves	7.8	11.3
Provision for Income Tax & Others	0.5	0.7
Balance of Profit & Loss	1.0	1.4
Debit Balances with Branches & Banks in Iraq	7.5	10.8
Debit Balances Abroad	1.2	1.7
Govt. & Quasi-Govt. Deposits	8.2	11.8
Deposits against Guarantees & Credits	6.9	9.9
Current & Saving Deposits	28.2	40.7
Fixed Deposits	4.1	6.0
Other Liabilities	3.9	5.7
Total Liabilities	69.3	100.0

Source: Central Bank of Iraq, Quarterly Bulletin, 1956, No. 20.

the majority of the borrowers were Government employees, since they can acquire the loans on the basis of their signatures only. The amount of a loan ranges between ID 10 and ID 1000 repayable within 2 months and one year. These loans are used for consumption purposes and help to rule out the need for usurious money lenders.

Industrial credit is supplied by the Industrial Bank, which is a state-owned institution established on the strength of Law No. 12 of 1940 and started operations in 1948. The fully paid up capital of the Bank in 1956 was ID 3 million, while the authorized capital was ID 8 million. The object of the Bank is to develop and assist industry through loans and direct participation. At the end of 1956, half of the paid up capital was invested in large industrial companies, however, the Bank is criticized for its profit seeking policy, its reluctance to sell the profitable shares it holds and its interest in large enterprises only. The increasing interest of the Government in industry will definitely lead to the provision of more industrial credit and consequently to a revision of the policy followed by the Industrial Bank.

A new feature of credit in Iraq is cooperative credit which will be supplied by the Cooperative Credit Bank, a state controlled institution established on the strength of Law No. 65 of 1956. The object of this bank is to perform banking services to cooperative societies which will own 49% of the capital. The initial capital of the Bank is set by Law at ID 250,000 to be raised later on to ID 3 million.

The banking system in Iraq is composed of a variety of commercial banks of different nationalities, and a significant chain of Government banks that deal with all kinds of credit. The state-owned banks have helped greatly to spread banking services. However, these banks are still far from supplying the required credit in the country, especially as this requirement is increasing due to the tangible rise of incomes and expansion of economic activity. With this era of expansion, the Government must take every measure to encourage the establishment of local commercial banks in Iraq and to provide the state-owned banks with sufficient financial resources.

4. <u>The Banking System in Syria</u>

Banking practice in Syria is regulated by a comprehensive legislation that was enacted by Legislative Decree No. 87 of 1953. The main provisions of the banking law can be summarized as follows:-

1. A bank is defined as an institution that accepts demand deposits or time deposits with a maximum maturity of two years, to be invested in banking operations for its own account.[1] Banking operations include discounting, granting loans and advances, operating in foreing exchange, issue private and public bonds and similar other things that are speci-

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1. Article 104 (1).

fied in the law.[1]

2. Institutions that fall subject to this law can start operations only after the Minister of Finance decides to register it in the formal register of the Government Commissioner to Banks and after this decision is published in the Official Gazette. A bank may be dropped out of the register upon the recommendation of the Money and Credit Board in case it violates the regulations or when its liquidity and safety are endangered.[2]

3. A commercial bank that is formed as an individual proprietorship or a partnership must have a minimum paid up capital of £S 1 million, while a joint-stock bank must have a minimum paid up capital of £S 1.5 million. Any bank that has offices operating outside Syria, must allocate a minimum capital of £S 1.5 million for its operations in Syria and must keep separate books for these operations.[3]

4. In addition to the obligations imposed on companies by the Commercial Code, a minimum of 10% of the annual net profits of banks must be allotted to a Special Reserve Account, until this amounts to 25% of its capital for Syria. Moreover, the banks are required to invest their legal reserves in State bonds; they may not dispense with these bonds unless with the approval of the Money and Credit Board.[4]

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1. Article 104 (2).
2. Articles 106 & 109.
3. Articles 114 & 115, as amended by Decree No.2504 of 1955
4. Article 117.

5. Commercial banks are not allowed to handle operations which are not banking proper such as trading in goods and jewels, and investment in real estate. Moreover, joint-stock banks are not allowed to invest more than 40% of its funds in shares of non-bank companies, or in bonds issued by such companies.[1]

6. Commercial banks are subject to quantitative and qualitative controls imposed upon them by the Central Bank, as was mentioned previously. Also, they are required to submit to the Central Bank monthly and annual statements on their financial position, and all other statements required.[2] Furthermore, every commercial bank must appoint an auditor who will submit a quarterly report of his findings to the Government Commissioner to Banks.[3]

7. A Government Commission to Banks is established in the Central Bank. The duties of this Commission are to effect control and coordination of the bank auditors, to investigate matters relating to safety and liquidity of banks, and to organize banking statistics. The remuneration of the Commission staff is borne by the banks in accordance with the decision of the Minister of Finance.[4]

At present the total number of registered banks in Syria are 22, 7 of which are branches of foreign banks, 9 are

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1. Article 120.
2. Article 126.
3. Article 131.
4. Articles 136 - 140.

branches of Arab banks, and 6 are Syrian domestic banks. Thus it is apparent that banks incorporated outside Syria are dominant. On first thought, such a situation looks to be a disadvantage from the central banking point of view. Any need for liquid assets that might arise will lead the foreign banks to seek recourse at their head offices. Obviously, this reduces the dependency of commercial banks on the local central bank. However, judging from the operations of 1956, these foreign banks were glad to get the support of the Central Bank of Syria to replenish their cash reserves. And as a matter of fact, the Central Bank officials are showing their uneasiness to the increasing dependency of these banks on the Central Bank.

The banking system in Syria is composed mainly of commercial banks, which are involved in financing the import export trade. Table 9 below gives an idea of the activities of these banks. Apparently, they are involved mainly in the acceptance of deposits, extending loans and advances, and discounting bills. The liquidity ratio in December 1956 was around 30% which is quite satisfactory. On the whole, commercial bank credit in Syria is insufficient to finance the import and export operations emanating from the agricultural seasons. In 1956 the Central Bank had to allocate to the commercial banks huge funds to be used for financing the agricultural crop. These funds amounted to £S 285 million, out of which were £S 30 million for the state agricultural bank and the rest for the commercial banks. After the war events in Egypt in November 1956, the Bank allocated additional funds to those commercial banks which showed interest to expand their credit.[1]

Agricultural credit is supplied at present by three sources: the Agricultural Bank, the commercial banks and the professional money lenders. The Agricultural Bank is a state-owned bank that was established in 1937. The Bank is supplied with funds from the Central Bank to cope with the increasing demand on agricultural credit. However, the services of the Bank reach only landlords who can afford to supply the Bank with collateral for the loans they get from it. The commercial banks in Syria extend seasonal credit to farmers with good credit standing on the basis of discounted bills that are usually renewable. The money lenders supply agricultural credit in Syria at usurious rates of interest. These lenders extend credit to farmers who cannot secure credit from the Agricultural Bank and the commercial banks.

On April 18, 1957, Law No. 377 was enacted for a new Syrian Agricultural Bank that will replace the present one. The Bank will perform all lending operations leading to the production and marketing of agricultural crop. Moreover, the Bank will give special attention to the establishment of agricultural credit cooperatives and cooperative farms, and

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1. From the report submitted by the Syrian Minister of Finance to the Parliament on the financial conditions of the State in 1956.

Table 9

Consolidated Balance Sheet of Commercial Banks in Syria as at December 1956

Assets	£S 000's	% of total
Cash	30,622	5.9
Balances with C.B.S.	27,655	5.2
Gold & Foreign Exchange	362	0.1
Fiscal stamps	55	0.1
Credit Balances with Banks	33,836	6.5
Correspondents	33,861	6.5
Short Term Receivables	33,281	6.4
Bills Discounted	82,093	15.8
Loans and Advances	226,300	43.6
Securities	445	0.1
Assets of Liquid Nature	23,251	4.5
Fixed Assets	9,527	1.8
Profit & Loss	17,353	3.3
Total Assets	518,641	100.0
Liabilities		
Provision for Income Tax etc.	132	0.1
Debit Balances with Banks	109,608	21.1
Correspondents	94,67[illegible]	18.2
Current Liabilities	3,658	0.7
Saving Deposits	4,321	0.8
Current Deposits	176,471	34.0
Short term Bills Payable	336	0.1
Other Liabilities	52,037	10.0
Capital & Reserves	53,056	10.3
Profit & Loss	24,348	4.7
Total Libabilities	518,641	100.0

Source: Unpublished information acquired from Central Bank of Syria.

will give them priority in the granting of loans. The capital of the Bank is fixed at £S 100 million to be covered totally by the State. In addition, the Bank is allowed to issue short and long term bonds, the total of which may not exceed the total amount of capital and reserves of the Bank. As regards the lending policies, the Bank is subject to the general directives of the Money and Credit Board.

Industrial credit in Syria is available only through Government guaranteed loans that were started in 1949 and enabled the commercial banks to extend credit to large industrial companies at reduced interest rates (4%). However this scheme wa stopped in 1952 after the total amount of such loans reached £S 16 million. It was revived again in 1954 with restrictions. At present, the total amount of Government guaranteed loans outstanding to industry is £S 6 million.

It is to be noted that no institutions are available in Syria for mortgage credit, real estate credit and industrial credit. Steps are being taken to start an industrial bank but no other institution is contemplated at the present time. This lack of medium and long term credit is a serious drawback of the banking system in Syria. As such institutions are not usually started by private enterprise, the Syrian Government is expected to establish them. This will depend upon the availability of financial resourcers at the disposal of the Government.

5. Prospects

The effectiveness of central banking operations depends to a large extent upon the degree of development in the banking system existing. From this point of view, the following features of the banking systems in Egypt, Iraq and Syria are noted:

1. The major portion of investable capital is still outside the scope of the banking systems. The reasons lie basically in the social and economic conditions prevailing. However, these conditions are undergoing quick improvement due to the spread of education and the interest of the governments in development projects, which will raise the general standard of living. These improving conditions will lead to more enlightment and conviction in the uses of banking. But, at present, savings are still hoarded, bank credit is not extensive, and business is financed by private savings of investors in addition to the money-lenders who charge exorbitant interest rates.[1]

The above situation reduces the amount of credit control that can be exercised by central banks. Even if the central banks succeeded to control and regulate bank credit, it still fails to affect the general level of economic activity

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1. Himadeh, op.cit., p. 282. Although Prof. Himadeh's observations date back to the 1930's, yet these observations can be applied at the present time on Egypt, Iraq and Syria.

due to the "free capital" that falls beyond the control of the banking systems.

2. Commercial banking in Egypt, Iraq and Syria is regulated at present by good legislation. This legislation was enacted in Iraq in 1950, in Syria 1953 and in Egypt in 1957. In the three countries, the legislation is quite comprehensive. It regulates matters relating to formation of banks, capital requirements, registration, operation and control. This legislation establishes a sound basis for banking practice and safeguards the interest of related persons whether they be depositors, stockholders or correspondents. Consequently, more confidence can be held in the banking systems and more banking business will be performed as a result.

Aside from protecting the interests of related persons, banking legislation in Egypt, Iraq and Syria, provides the commercial banks with advantages. These advantages arise from the services of the central banks, which are extended to the banking systems. The various methods of control exercised by the central banks, place the commercial banks in a position of easiness in the face of any possible changes in economic activity, which might affect their safety. Moreover, the existence of the central banks as lenders of last resort, enables the commercial banks to expand their operations more than they would have done in the absence of central banks.

3. The dominance of foreign banks in Iraq, Syria and until recently, in Egypt, creates a special problem for

the local central banks. These banks not only outnumber the domestic banks but they have the support of huge capitals in their countries of origin. Their main interest is financing export import trade between their countries of origin and the countries in which they operate. Thus, their services are always confined to a limited group of businessmen of good reputation, while their interest in attracting local deposits is only secondary. However, the World War II brought some changes in their field of operation as many of these banks had to rely on local business to keep themselves busy. So that in the post-war period, the foreign banks were already involved in local business and had to accommodate themselves to local conditions and business practice. Consequently, their need for their head offices was reduced to matters of high policy. However, there always lies the possibility that the foreign banks may not channel credit in those activities most needed in the countries of operation. Moreover, they may not conform to the monetary policy imposed by the newly established central banks in Egypt, Iraq and Syria. This is what led the Egyptian Government to Egyptianize all foreign banks in Egypt. In Iraq and Syria, the problem is still existent but has been limited by legal provisions imposed by banking legislation. These provisions detach the foreign banks from their head office and subjects them, together with the domestic banks, to the control powers of the central banks in the two countries.

4. Bank credit for agriculture is still insufficient.

The main sources for agricultural financing at present are: private capital of big landowners, money-lenders and state agricultural banks. State agricultural banks suffer from insufficient resources which come mainly from direct Government contribution, and from their services to big landowners who can comply with their conditions, which the small peasants cannot.

The importance of this problem cannot be underestimated, since the largest portion of the national income in Egypt, Syria and Iraq (other than oil) comes from the agricultural sector. Consequently, the central banks in these countries cannot possibly be effective in a money market which lacks rediscountable agricultural paper provided by the banking system. Because in such a situation, the central banks will be ignoring the major sector of economic activity, which they are eager to regulate.

5. Bank credit for industry is being provided solely by state-owned banks in Egypt and Iraq, while in Syria an industrial bank is to be established shortly. These state-owned banks are operating with capital supplied to them by the governments and by loans secured from the central banks. Thus, their resources are limited and their services are limited to few large enterprises while small enterprises are left behind. The undeveloped stage of industrial bank credit affects unfavourably the supply of stocks and bonds, which are essential for central bank operations, as was discussed in a preceeding section.

The development of the banking system in a country is usually an offspring of the general development in its social and economic conditions. In the Arab countries dealt with in this thesis, there has been considerable improvement in these conditions that started with their political independence. The governments of these countries have been taking the necessary measures to raise the standards of living and to provide the countries with the institutions that help to do it. Thus, central banks were established in Egypt, Iraq and Syria and their powers were imposed upon the commercial banks in order to enable them to control bank credit. Henceforth, banking matters are receiving more attention and new regulations are enacted every now and then. An outstanding evidence of this situation is the Egyptianization of foreign banks for purposes of public interest.

Therefore, there is every reason to believe that the banking systems in Egypt, Iraq, and Syria, are on the way of development and growth, after the foundations have been laid for that. However, the governments and the central banks in these countries have a responsibility to lead this development and patronize it. The policy to be followed in this concern may be on the following lines:

1. Efforts should be made to establish new domestic commercial banks. This will be advantageous in two respects: first, to provide additional means for marketing and distributing "free capital", and, secondly, to have the domestic banks

absorb the greater amount of banking business so that the influence of the foreign banks is reduced to a minimum. The encouragement of domestic commercial banks be done by several measures. One of these is by direct participation of the governments as was done in the case of Rafidain Bank of Iraq and in Republic Bank of Egypt. Another way is through Government subsidy of new commercial banks, and through provision of rediscounting facilities.[1] Other ways may be found in the reduction of capital requirements and exemption from taxes for the first few years of operation.

2. Bank credit for agriculture should be provided extensively and cheaply. A practical way to provide to do that in the Arab countries is through credit cooperatives. These cooperatives will secure loans collectively from the agricultural banks and will distribute the loans according to the financial needs of the peasants. Moreover, the cooperative members will replace the original lender in supervising the expenditure since all of them are liable for its prepayment. In the course of time, these cooperatives will raise their own sources of finance so that they will not need to resort to outside institutions.

In addition to the credit cooperatives, systems of supervised credit should be developed in the Arab countries. These systems involve loans and technical guidance for the

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1. Cf. Sayers, Modern Banking, op.cit., pp. 295-297.

borrowers. But its efficiency will depend upon the quality of consultants who will assist the farmers in planning their farm business and supervise the use of the loans. Thus, these programs require two kinds of expenditures: first, the funds to provide for loans and second, the expenditures incurred in training agricultural technicians. Apparently, these systems will have to be undertaken by the governments and attached to the state agricultural banks existing in the Arab countries.

3. Industrial credit may be provided by industrial finance corporations. These corporations should be privately owned and managed to keep it away from government intervention, which is usually resisted by private industry. However, the governments would assist in the establishment of these corporations by extending them long term advances through the central banks or other agencies. Moreover, it is necessary that these corporations establish a body of technical staff which will render technical assistance to industry in addition to the financial assistance. This assistance will help the manufacturers to improve their methods and increase their productivity. Also, the technicians should be ready to appraise the profitability of new industrial projects, in the view of providing them with financial assistance either by direct participation or by loans and advances.

4. Coordination between the central banks and the other state-controlled banks should be secured. The operations of these banks have monetary implications which fall within the

photo + conclusion

sphere of the central banks. Consequently, the credit policy of these banks should be in accordance with that of the central banks. One way to affect such a coordination is to have the central banks as shareholders of these institutions represented on their boards of directors. A more direct way is to subject these institutions to the policy directives issued by the central banks.

D. Statistics and Personnel

The existence of an efficient system of money and banking statistics is a prerequisite for central banking operations. Moreover, a monetary policy cannot be formulated and executed without a complete knowledge and comprehension of economic activity in the country, which can only be transmitted through sufficient and reliable statistics.

The central bank laws of Egypt, Iraq and Syria require the commercial banks to submit periodical financial statements and any other statements requested by the central banks. However, an elaborate system of money and banking statistics have been developed in Syria which is worthy of special notation. In March 1953, upon the recommendation of an IMF official, the Syrian Government requested the commercial banks to file monthly reports starting March 1953 and to submit the returns of 1951 and 1952. In November 1954, the Law of Banking Statistics was enacted[1] in accordance with the provisions of Legislative

1. قرار وزير المالية رقم ٢٤٩٠ / و

Decree No. 87 of 1953. This Law requires the commercial banks in Syria to submit detailed information about their financial position on special forms supplied by the Monety and Credit Board. These forms spell out all the details of the assets and liabilities of the commercial banks, their foreign exchange position, their debtors and creditors position, their letters of credit, etc. This system has been applied efficiently in Syria and forms a good example that may be imitated by the neighboring countries. As a matter of fact, U.N. experts have already advised the authorities in Iran and Pakistan to send some trainees to Syria for this purpose. It should be noted here, that the effectiveness of these statistics depend upon the existence of trained personnel who can interpret them intelligently, and are able to make the right decisions.

As mentioned above, money and banking statistics, should be supplemented by general statistics that cover the various fields of economic activity, such as, national income, commerce, agriculture, industry, balance of payments, prices, employment, etc. Such statistics in Egypt, Iraq and Syria are at present insufficient and unreliable. The main reasons may be stated as follows:

1. The reluctance of the population to submit correct information, for reasons of illiteracy and ignorance. Also, a big sector of the population are reluctant to disclose information for fear from utilizing this information in purposes which they do not favour, such as military service, taxes, etc.

This fear is deeply rooted in the experience of the Arab population under the foreign rule that prevailed a long period of time.

2. The government statistical departments in the Arab states suffer from insufficient funds for proper operation. The reason lies in the underestimation of the usefulness of statistics on the part of the authorities. Thus, these departments are being run by unqualified personnel who lack the theoretical and practical training in this field.

3. The reluctance of private institutions in the Arab countries to compile statistical information. In advanced countries, such institutions as companies, banks, universities and chambers of commerce are eager to compile data in their fields of operation and to transmit it to the public. In this way, they will be contributing to the supply of reliable information that can be utilized by all interested parties.

In the recent years, there has been an increasing interest in statistics in the Arab countries. This interest can be seen in the reports and recommendations presented by various bodies for the improvement of statistical methods. The IBRD reports to Iraq and Syria include specific recommendations on this subject. Moreover, the conferences held by the Arab Chambers of Commerce stress the importance of statistics and request the local chambers to participate in statistical research and to cooperate with local government departments in this respect. Also, the problems of statistics were discussed by the Arab Public Administration Conference of 1955, and specific recommendations for development in this field were adopted.[1]

The development of statistics in the Arab countries involves two main problems: organization and personnel. The organization problem should be solved by detaching the decentralized statistical offices from the different government departments, and bringing them together in an independent central statistical office which plans and coordinates the collection of statistics. As regards training, the Arab governments should establish for that purpose statistical institutes and should send bursaries abroad for specialization. Moreover, a great need for middle technicians will arise to conduct the field work. The training of this group may be done on the job by experts who can be secured from international organizations and from other countries.

The problem of training statisticians is similar to the problem of training staff to run the central banks in the Arab countries. Central banking is an art that should be handled by an elite of highly trained staff in bank management, finance, foreign exchange, etc.

The basic principle for staffing the central banks is the independence of central bank personnel from the ordinary regulation of civil service. It is necessary that these central banks develop their own personnel scales and training methods.

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1. Arab Public Administration Conference, (Cairo, 1955), p. 11.

Being highly technical people, the senior officials of these banks must be paid salaries that are compatible with their qualifications. Moreover, candidates to these posts should be carefully examined as to their theoretical and practical background. It is noteworthy to mention here, that the Central Bank of Syria has established its personnel status on the above mentioned grounds. In addition, the Central Bank Law provides for a special reserve to be expended on training of its personnel and on research in Syrian economy.[1]

Training of the new staff in the central banks may be performed by the following ways, which have been followed by the Central Bank of Syria and proved successful:[2]

1. Training in central banks of other countries.

2. Training in local central banks under the supervision of foreign experts.

3. Training in local commercial banks, for familiarization with the local markets.

In addition to the above, it is advisable that the central banks take the initiative in establishing banking institutes such as the Banking Studies Institute in Egypt.[3] Such institutes will provide training for the personnel of the central banks, government financial departments and all other banks in the country. These institutes exist in most

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1. Legislation Decree No. 87 of 1953, Art. 97.
2. From an interview with Mr. Adnan Farra, Secretary of the Syrian Money and Credit Board.
3. Cf. Institut Des Etuds Bancaires (Le Caire, 1955), Preface.

of the advanced countries, and proved instrumental in raising the standard of banking staff.

C O N C L U S I O N

The establishment of central banks in Egypt, Iraq and Syria came as a result of the developing economic and political conditions in these countries. The economic significance of central banks has been recognized long ago by advanced countries and by the various international economic conferences that recommended central banks in all countries of the world. Moreover, the advantages of central banking were empirically proved during and after World War II, as central banks were extremely helpful in war finance and foreign exchange problems. Thus, central banks became symbols of economic stability. This trend urged the Arab states to establish central banks to make use of their stabilizing functions and to emphasize the countries' political independence from foreign rule.

On the initiative of the governments, new central banks were set up in Iraq and Syria, while in Egypt the National Bank was converted officially into a central bank. These banks were provided with full-fledged powers to conduct their operations in accordance with conventional central banking theories and practices. The functions of currency issue and stabilization were soon undertaken by each of these banks. Moreover, the new central banks undertook the function of the fiscal agents of the governments, serving their loans and undertaking their international financial relations. However, the new central banks faced difficulties in assuming other central banking functions. The commercial banks in Egypt, Iraq and Syria did not yet get accustomed to rediscounting and resorting to the central banks for credit. This makes regulation of credit by the central banks difficult. Thus, a major central banking function remains unperformed in the short run, due to undeveloped monetary institutions.

The money markets in Egypt, Iraq and Syria are characterized by the use of banknotes rather than checks in discharging payments. In addition, considerable differences in the cost of credit exist which renders these markets imperfect. Also, no call loan markets exist, while the commercial bill markets are still undeveloped. All these factors limit the power of the central banks to affect the cost and availability of credit through variations in their interest rates.

The security markets in Egypt, Iraq and Syria are either narrow or non-existent. The corporation form of business organization is not prevalent yet so that business securities are limited and are being held mostly by few people for purposes of permanent investment. Government securities are also limited and do not enjoy a wide market. This dearth of securities does not enable the central banks to influence the volume of credit through open market operations.

As regards the banking systems existing, it can be safely said that they are still inadequate and insufficient. The major portion of "free capital" in Egypt, Iraq and Syria is still outside the scope of the banking systems. Moreover, numerous foreign banks exist, which resort to their head offices rather than to the local commercial banks. Also, bank credit for agriculture and industry is still insufficient relative to the growing demand for it. These factors prevent the central banks from controlling credit with the purpose of affecting economic activity.

In such underdeveloped countries, one might argue whether it is necessary to have central banks, and whether central banks can be of any use in economies which do not have developed financial organizations? This argument is still put forward at the present time and, as a matter of fact, is the subject of a big controversy for contemporary economists.

It is true that a central bank cannot operate properly in the absence of a developed financial system in the country. But it is true also that in an underdeveloped country, financial institutions cannot be left to develop alone for two reasons: First, they may take too much time as compared to the speed required in economic development, and, second, these institutions may be organized in a way which might not be suitable for the general monetary structure. Thus, the establishment of a central bank should be the first step in the development of the financial organizations in the country. This central bank will, in turn, help to develop its field of activity.

In order to develop the money markets in Egypt, Iraq and Syria, the banking habit of the population should be more propagated. Although this depends to a large extent on the social and economic conditions, yet the authorities should take necessary measures to push it through. Educational campaigns can be carried by the central banks, commercial banks and the governments concerned; postal savings offices should be also established to receive small savings. In addition to developing the banking habit, the authorities should provide more credit facilities to the different sectors of the economy at low interest rates in order to rule out the differences in interest rates prevailing in the market. Moreover, the use of commercial bills should be encouraged by suitable legislation and by the preference shown by commercial banks for discounted bills rather than advances and overdrafts.

The development of wide security markets depends upon the existence of a market in long term capital. This market deals with trading in corporation shares and bonds on one hand, and government bills and securities on the other. In order to develop the corporation form of business, suitable legislation should be enacted which will induce wide ownership and safeguard of shareholders' interests. Moreover, the authorities in Egypt, Iraq and Syria will have to start these corporations on joint ownership with private investors. As regrds government treasury bills, the central banks should encourage the commercial banks to hold these bills by offering them suitable rediscount rates. Government long term bonds should be made attractive to the public by various ways such as lottery features, payment of high interest rates and by obliging banks and saving institutions to invest in them part of their reserves.

The banking systems in Egypt, Iraq and Syria should be able to market and distribute the majority of "free capital". The establishment of domestic commercial banks can be encouraged through subsidies, credit facilities and government participation. Moreover, agricultural credit should be made available widely and cheaply by increasing the financial resources of the existent state agricultural banks, by establishing systems for supervised credit, and by encouraging credit cooperatives. As regards industrial credit, private industrial banks should be established with the financial support of the governments; these banks will have to provide technical assistance to industry in addition to financial assistance. Other credit institutions should be encouraged by the governments such as mortgage and real estate banks.

The central banks in the Arab countries need to be run by efficient staff and through reliable statistics of economic activity. These aspects cannot be underestimated and their development should receive the greatest care and attention. The training of central banking staff can be done either abroad or on the job under supervision of foreign consultants. Moreover, banking studies should be encouraged in universities and institutes to prepare candidates for posts in central and commercial banks. As regards statistics, systems should be developed to supply the central banks with reliable current information about the position of commercial banks. In addition, the governments should establish central offices which compile and coordinate statistical data collected by the various government departments on the various fields of social and economic activity.

In Egypt, Iraq and Syria, the central banks are at present undertaking all kinds of measures to develop their fields of activity. Central bank rates were declared and established; commercial banks are being encouraged to rediscount commercial bills and to resort to the central banks for credit; banking control is provided by the central banks to safeguard the interests of depositors and shareholders; and additional weapons of credit control are being placed with the central banks such as variable reserve ratios and qualitative controls. Moreover, the central banks in Egypt, Iraq and Syria have already succeeded in convinging the authorities in these countries of the uses of central banking and the need to develop financial organizations. This can be seen clearly in the recent amendments of central bank laws in Egypt and Iraq and in the establishment of state-owned banking institutions. This increasing interest in monetary structures will definitely enhance the influence of central banks in regulating economic activity.

In the coming few years, the Arab countries in question will be involved in development projects undertaken by the governments. The central banks will probably have to take part in these development schemes in different ways. First, the banks will have to provide services related to loans secured by the governments to finance development projects, in their capacity a fiscal agents for their governments. Moreover, the central banks may be resorted to for inflationary financing to the extent allowed by currency laws. Second, it will be the duty of central banks to check any inflationary trends that may appear. This is just a probability as such trends need not necessarily show up; the increased public expenditure may mobilize human and material resources to an extent that the monetary demand is matched with sufficient supply of goods and services. Third, the central banks will have to extend easy credit to the private sectors through the commercial banks. This will be necessary to supplement the expenditure made in the public sectors, in order to provide for a balanced growth in the economies.

A last word remains to be said: it is an established pehnomenon that a central bank is the product of growth and experience. From this point of view, the central banks in Egypt, Iraq and Syria are still in their initial stage. However, if serious efforts will be exerted on the part of these banks and if the cooperation of the concerned authorities can be secured, one can safely be optimistic about their future. The rising economic and political consciousness of the Arab population, is a further impetus for their growth which, it is hoped, will ultimately lead to the amalgamation of these separate banks into one united central bank serving one United Arab State.

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