# MONETARY ORGANIZATION
# IN
# SAUDI ARABIA

By

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## PREFACE

The position which Saudi Arabia has assumed in world affairs generally, and especially in the Middle East, within no more than a decade, has attracted widespread attention to this vigorous and rising nation. Unfortunately, this growing interest has not yet led to many serious studies of the various phases of the Saudi economy. Very few studies, in fact, have so far been made. The most important are those of Mr. A.N. Young, chief of the American Economic Mission to Saudi Arabia in 1951, and Dr. A.N. McLeod, the Director of the Economic Research Department of the Saudi Arabian Monetary Agency from 1952 to 1954. However, these studies are now outdated, as they make no reference to the developments which the monetary system has witnessed since 1954. The present work is an attempt to fill this gap.

Because of the paucity of published information, the writer has had to draw intensively on data gathered from the files of the Saudi Arabian Monetary Agency where he served during three years as a member of the Economic Research Department.

As the title implies, the study is confined to the monetary organization in Saudi Arabia. Other aspects of the Saudi economy are only touched upon in so far as they are related to monetary affairs.

The study is divided into three chapters. Chapter I is devoted to a historical background, it covers the period from 1901 to 1952, and is divided into two parts: a description of the monetary organization and an evaluation of it will be divided into two periods.

Chapter II is mainly devoted to a discussion of the monetary reform resulting from the establishment of the Saudi Arabian Monetary Agency. The operations and functions of the Agency are surveyed in some detail.

Chapter III consists of an appraisal of the monetary system and of the Agency's operations and functions, with some recommendations for improvement.

The writer wishes to express his deep gratitude and thanks to Professor Paul J. Klat, his advisor, for his valuable comments, advice and encouragement, and for the real interest which he showed in this work.

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# CHAPTER ONE

## HISTORICAL BACKGROUND

In studying what is known today as Saudi Arabia, it is not possible to treat it as one geographical, political and economic unit. Saudi Arabia is composed of four big provinces: Hejaz in the West, Asir in the South, Najd in the North and Hasa along the eastern coast of the Persian Gulf.

At the close of the nineteenth century, these four Provinces were ruled by different Emirs under the control and supervision of the Sublime Porte in Constantinople. The Najd and Hasa Provinces were ruled by Ibn Rashid, the Hejaz by Sharif Husein of Mecca and Asir by Emir Idrisi.

A variety of coins were circulating in each Province because each had its own commercial, political and geographical contacts. In Hejaz, for instance, were accepted as media of exchange several kinds of coins brought in by pilgrims, such as the Ottoman sovereign, the Majidi silver riyal and its denominations, the Egyptian gold pound and the Egyptian silver riyal, the silver Indian rupee and the Indian qurush, the Burum riyal (a Javian coin), the British sovereign, the French sovereign and the Russian sovereign.(1) Similarly in Najd, the Ottoman

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(1) Al Batouni, Mohammed Labib, Ar-rihla Al Hijazia le Wali An Ne'am Abbas Hilmi Pasha Ath-thani, (Jamaliya Press, Cairo: H 1329), p. 61.

sovereign, the Majidi silver riyals and their denominations, the Indian rupee and the British sovereign, were in circulation, but the predominant coin was the Indian rupee. The reason for this might be that Najd and Hasa were adjacent to areas under British domination, viz, Kuwait and Bahrein,- where the official circulating currency was the Indian rupee. In Asir the Maria Theresa silver coin was the dominant medium of exchange, as it had a common border line with the Yemen, where the Maria Theresa was the major circulating coin.

I. Description

A. The Hashemite Period in Hejaz. (1916-1924.)

Sharif Husein of Mecca, after negotiating with the British, agreed to revolt against the Ottomans in 1916. It did not take him much effort and time to drive the Turks out of the Hejaz and to declare the birth of an independent state known as "The Hashemite Kingdom of Hejaz."

Naturally, this independence brought in its wake financial and monetary problems. The Hejaz, being no longer a tributary state of the Ottoman Empire, had to organize its administration in the light of its new responsibilities.

1. The Hashemite Coins:

As previously stated, the circulating coins in Hejaz were practically all the known coins of the world. But the most "officially recognized" ones were the Turkish coins, especially the Majidi silver riyals and their denominations.(1) The phrase "officially recognized" is used here to denote the coins that were accepted by Government Departments in payment of taxes or for Government services.

Two years after the end of World War I, the Majidi began to lose ground to the then circulating Indian rupee as an officially recognized medium of exchange. As a reaction to the refusal of merchants to accept the Indian rupee (silver and banknote) Sharif Husein summoned all merchants to a meeting presided over by himself and obliged them to sign a guarantee that they would accept the rupee in exchange for their goods. Other foreign currencies, however, could also be accepted at their ruling exchange rates.(2)

In 1334 (1916), Sharif Husein had minted coins of his own. The coins minted were the gold Hashemite dinar, the silver Hashemite riyal, the half-riyal and the quarter-riyal, the nickel qirsh, the half qirsh, the quarter qirsh and the eighth-qirsh.(3) It is unfortunate that there is no

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(1) Al-Qiblah, Vol. 1, No. 11, (Government Press, Mecca, 21/11/1334).

(2) Ibid., Vol. 4, No. 349 (15/1/1338), p. 1.

(3) Nasif, Husein Bin Mohammed, Madi El Hihaz Wa Hadirouh, (Khudair Press, Cairo, 1349), p. 108.

mention in available literature of their respective weights and other specifications. These coins which bore the date 1334 (1916) were not put in circulation until 1923. The Official Gazette writes: "The Government decided on the occasion of Id Al Baya (in 1923) to make the circulation of the Hashemite coins official."(1) These coins had been minted in the Hashemite Mint in Mecca, and their exchange rates were as follows:(2)

| | |
|---|---|
| The Hashemite Dinar...... | 100 Hashemite Qurush. |
| The Ottoman Sovereign.... | 100 Hashemite Qurush. |
| The British Sovereign.... | 112 Hashemite Qurush. |
| The Hashemite Riyal...... | 20 Hashemite Qurush. |
| The Majidi Riyal......... | 10 Hashemite Qurush. |

Four months after putting these coins in circulation, Sharif Husein was obliged to leave Hejaz and Abdul Aziz Ibn Saud entered Mecca on the 8th Jamad Al Awal, 1343 A.H.(1924), and the Kingdom of Saudi Arabia came into existence.

2. Banking.

The Government, in one of its announcements, declared to the public that the Government had no central bank and it did not recognize the operation of any bank in Hejaz.(3)

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(1) Al-Qiblah, Vol. 8, No 721, 2/9/1342 (20.9.1923), p.2.

(2) Ibid., Vol. 9, No 810, 10/1/1343 (19.8.1924), p. 3.

(3) Ibid., Vol. 2, No 172, 4/7/1336 (23.7.1917), p. 2.

This announcement was true in the sense that there was no firm specialized in commercial banking as its sole line of business. However, a British commercial firm with the name of Gelately and Hankey (founded in 1885) had a department for banking in addition to its commercial operations. Its banking functions consisted in financing foreign trade through the negotiation of letters of credit and the settlement of bills for collection, personal transfers of funds and foreign exchange purchases and sales. It is worth noting that the company did not indulge in deposit banking, the reason being that the Islamic Code prohibits interest.(1)

Not all the foreign trade of Hejaz was negotiated by Gelately and Hankey Co. There were other foreign companies, many of them Indian and Egyptian, that had branches in Jeddah. The most important of these companies were the Indian Al Mu'in Trading Company and the Egyptian Arif Naamani Company.

Towards the end of the Hashemite period, two banks were opened in Jeddah. The first was "Bank Lutfallah", and the second "The National Bank."(2) The former was owned by Prince Habib Lutfallah of Egypt and

(1) This question of interest will be discussed in detail later.

(2) <u>Nasif</u>, <u>op.cit</u>., p. 110.

was established for the sole purpose of giving the Sharif Husein loans and credits to carry on war against the Saudis. At the peak of the war, the owner of the bank refused to extend credit to Husein and left for Egypt. The bank, however, carried on its functions until the Saudis closed it, "because the Saudi Minister of Finance thought that the bank was incapable of serious banking work in the country."(1)

The National Bank was no more than a Government agency for changing money. The reason for its establishment was that local coins had depreciated and were selling at less than their official rate. The bank's sole function was to change these coins at the officially specified rates. It did not, however, last long and shut its doors after the defeat of the Hashemites.(2)

3. Jeddah Foreign Exchange Market.

The exchange market was limited in scope. Its only function was the exchange of coins, and the margin of profit to the money-dealer resulted from the difference between the purchase and sale prices. Money-dealers had no foreign balances with correspondents abroad, except for the British firm of Gelately and Hankey. In addition, the market played little role in financing foreign trade,

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(1) Philby, H.S.B., Forty Years in the Wilderness (Robert Hale, Ltd., London: 1957), p. 177.

(2) Nasif, *op.cit.*, p. 179.

but was useful in supplying pilgrims with domestic media of exchange.

As most of the circulating coins were gold and silver, their prices were determined by the silver and gold rates prevailing on international markets. Their metallic values at various times exceeded their face values and wide-scale smuggling used to take place.

At times, coins were traded as pure metal if their intrinsic value was greater than their face value. The Government in 1922 warned the merchants against trading in the Majidi riyals as a commodity and imposed a Customs duty of 50% on imports of Majidis exceeding 5 Majidi riyals.[1] Similarly, pilgrims were not allowed to carry away more than 5 Majidi riyals.[2] In case of major changes in the prices of silver or gold, the Government used to prohibit by decree all exports of coins. In 1922, for example, a decree was passed prohibiting the export of gold.[3]

The internal and external changes in the value of Saudi coins contributed to the instability of exchange rates. In periods of highest demand, especially during the Haj season, certain coins appreciated considerably at the expense of others. It is worth noting that the

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(1) Ibid., Vol. 7, No 611, 27/12/1340 (21.8.1922), p. 1.

(2) Ibid., Vol. 7, No 6 56, 8/6/1341 (25.1.1923), p. 1.

(3) Ibid., Vol. 6, No 566, 7/7/1340 (6.4.22), p. 2.

Department of Finance performed the central banking functions of minting the Hashemite coins, keeping Government revenues and channelling expenditure. These functions were not exercised adequately. The issue of coins was not coupled with a control of the monetary supply, as this was virtually impossible on account of the circulation of other foreign currencies in the local market.

What was undoubtedly the strangest feature of the whole situation was that the Government, after minting the new coinage, made no attempt to insist on it being the only acceptable medium of exchange. It did not even try to make such coins legal tender. The Hashemite coins were left to circulate side by side with the foreign currencies.

The new coins, it seems, were not minted for the purpose of increasing the monetary supply in response to trade needs. They were minted as souvenirs and as symbols of the prestige of the ruler, the Sharif Husein; otherwise, one would question the significance and effect of the minting of such coins, which are said to have been minted in very small quantities.(1)

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(1) Nasif, <u>op.cit.</u>, p. 108.

B. The Saudi Period in Najd and Hasa (1901-1924)

1901 witnessed the occupation of Riyad by Abdul Aziz Al-Saud. As he was wholly pre-occupied with the waging of war against Ibn Rashid in the neighbouring territories, he gave no attention to financial and monetary problems.

As previously stated, the coins circulating in Najd and the Hasa were the Indian rupee, the British gold sovereign and the Ottoman silver and various gold coins. The writings of Amin Ar-Rihani, the famous Arab Historian, show that the Indian rupee was the most dominant medium of exchange in Najd.[1]

There were no banks in Najd, and the volume of foreign trade, compared with that of Hejaz, was insignificant. Furthermore, there were no branches of foreign companies, and no foreign exchange market.

C. The Saudi Period

In 1924, after the occupation of all the provinces which totalled a population of around six million, King Ibn Saud managed to undertake large-scale improvements in his kingdom. In the political field, an absolute monarchy was established; in the economic field, a General Finance Agency was founded to cope with the new

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(1) Ar-Rihani, Amin, Muluk Al Arab (Ilmiyah Press, Beirut, 1929), p. 87.

problems and situations. However, only some of the economic improvements will be discussed here.

1. <u>The Minting of the first Saudi silver riyal</u>

In the early stages of the Saudi reign, all circulating coins were recognized as acceptable media of exchange. The most important were the British sovereign, the silver Majidi riyal, the Hashemite silver riyal and the Indian rupee.

In 1343 (1925), the Government, becoming aware of the shortage of minor coins in the market, minted nickel qirsh, half qirsh and quarter qirsh pieces in Mecca which carried the name of Abdul Aziz Bin Abdur Rahman Al Faisal Al-Saud.(1) These minor coins had the same value as the Turkish qurush and the Hashemite qurush.

One year later, when minor coins were forged, the Government issued the following official announcement:-

"In view of the forging of minor coins, the Government hereby prohibits people from dealing in them and requests that all such coins be handed over in exchange for silver coins."(2)

In the same announcement, the Government ordered the public not to use the Heshemite riyal. All those

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(1) <u>Um-Al-Qura</u>, Vol. 1, No 15, Government Press, Mecca, 24/7/1343 (20.4.1925), p. 3.

(2) <u>Ibid</u>., Vol. 1. No 47, 4/5/1344 (20.11.1925), p. 1.

possessing Hashemite riyals had to exchange them for Majidi riyals from money-dealers. This measure, it is evident, was not due to any economic motives, but to purely political ones.

The Government then ordered all Governmental departments and business concerns to accept the Majidi riyal.

This, however, does not mean that the Majidi riyal became the official coin of the Government. Other gold coins were accepted by both private and public entities and the Government requested that all payments in exchange for goods be made in the following manner: 10% in silver coins and 90% in gold coins.[(1)]

After withdrawing Hashemite coins from circulation the Government minted new silver coins (the Saudi Riyal, the half Riyal and the quarter Riyal). These coins were minted in England, probably because the Mecca Mint had been destroyed during the Saudi invasion of Mecca.

2. The Hejazi-Najdi Monetary Regulation

After the issue of these Saudi coins, "The Hejazi & Najdi Monetary Regulation" was published in the Official Gazette, Um-Al-Qura, in 1927. The most important articles of the regulation were the following:-

Article 2: As from the first of Sha'ban, 1346 (1927) the Majidi will no longer be acceptable

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(1) Ibid., Vol. 3, No 136, 22/1/1346 (22.7.1927), p. 2.

as an official medium of exchange. Saudi riyals and their fractions will replace them.

Article 3: As from the first of Sha'ban, 1346 (1927) the Saudi riyals and their fractions will be put into circulation and will be considered as legal tender. The Saudi coins comprise the following:

i. The Saudi riyal, which is equivalent in weight, size and fineness to the Majidi riyal.

ii. The Saudi half riyal, which is equivalent in weight, size and fineness to the Majidi half riyal.

iii. The Saudi quarter riyal, which is equivalent in weight, size and fineness to the Majidi quarter riyal.

Article 4: The value of the circulating silver coins will be as follows:

i. The British gold sovereign is the standard base for the Saudi silver coins.

ii. The British gold sovereign is to be equal to 10 Saudi silver riyals.

iii. The British gold sovereign equals 110 miri qurush, i.e., 220 darij qurush.

iv. The silver riyal equals 11 miri qurush, i.e., 22 darij qurush.

v. The half riyal equals 5.5 miri qurush, i.e., 11 darij qurush. The quarter riyal equals 2.75 miri qurush, i.e., 5.5 darij qurush.

Article 7: All foreign silver coins, whether Majidi riyals or Maria Theresa, brought into the country will be subject to Customs duties and will be treated as unminted silver bullion.

Article 17: The right to mint Saudi coins, (silver and nickel) is vested exclusively in the Government.(1)

The regulation thus made the bimetallic standard legal. A fixed ratio between silver riyals and the British gold sovereign was established. This measure brought temporary stability to the monetary system. As the circulating coins were full-bodied (i.e., their value was in principle determined by the value of their gold or silver contents) the rates were difficult to maintain because the values of silver and gold were determined by external forces that were beyond the control of the Government. Among these external forces were the international

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(1) <u>Ibid</u>., Vol. 4, No 160, 13/7/1346 (6.1.1927), pp. 2 & 3.

supply of, and demand for, these metals.

Three years later, some silver riyals were smuggled out of the country, when the price of silver made it profitable to do so. The Government, in response, prohibited the export of gold in order to stop the speculation in silver riyals, and ordered all concerned to accept coins at their official prices. Offenders were to be subject to severe punishment.(1)

The new unit of account which was introduced by the regulation of 1927 was the Saudi miri qirsh. The miri qirsh had not been known before and it is interesting to note that no miri qirsh was actually minted. This coin was used as a unit of account for payments to Government Departments, especially of customs duties and tariffs. The qirsh was similar to the Ottoman miri qirsh.

Another strange feature of the regulation was that it fixed the riyal at 11 miri qirsh or 22 darij qirsh. It is, indeed, difficult to explain why it was decided that the riyal should be 22 darij qirsh and not 20. The Hashemite riyal, it will be recalled, was equal to 20 qurush. A possible explanation is that, at the time when the riyal was issued, its nickel equivalent was estimated at about 22 qurush.

The introduction of the silver riyal brought

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(1) Ibid., Vol. 7, No 325, 16/10/1349 (6.3.1931), p. 1.

another problem. At times, when there was a change in the price of silver, the exchange of riyals for other currencies became profitable and was resorted to by money-changers.

In its attempt to put an end to such deals, the Government ordered that all transactions and payments be made in darij qirsh.(1) The official rates of exchange quoted in terms of darij qirsh were as follows:

Saudi riyal............. 22 darij qirsh.

British sovereign.......220 darij qirsh.

Ottoman sovereign.......190 darij qirsh.

Maria Theresa........... 11 darij qirsh.

Indian rupee............ 15 darij qirsh.

It is worth noting that there was no paper currency proper to Saudi Arabia except for foreign paper currencies, brought in by pilgrims, especially the Egyptian banknote and the Indian rupee.

3. <u>The Minting of the New Saudi Silver Riyal</u>

Due to the confusion in the monetary system, the fluctuations in the value of the silver riyal and the speculations of money-changers in silver riyals and gold coins, the Government decided to withdraw the silver riyal and to replace it with another coin of smaller weight and size.

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(1) <u>Ibid</u>., Vol. 7, No 340, 3/2/1350 (15.6.1931), p.2.

The Government in 1354 (1935) minted the new silver riyal and the ministerial declaration No. 10 of 6th Rabi' Al Awal, 1355, contained the following:

> "In view of the fact that new riyals have been put into circulation, (riyals, half riyals and quarter riyals,) and in order to avoid a failure to distinguish between the new half riyal piece and the old quarter riyal piece, because they are indentical in size, the Government requests the public to stop using the old half riyal and quarter riyal pieces as from today. The Ministry of Finance is prepared to exchange them for gold within a period of two months, on the basis of one British gold sovereign for every 20 riyals."[1]

The ministerial declaration made no mention of the old silver riyal, which was left to circulate freely. The difference in weight between the old and the new riyal, though both had the same face value, made for the operation of Gresham's Law. The old riyals were gradually driven out of circulation; they were melted and sold as pure metal.

Though this plan was obviously not sound, it was resorted to because it was difficult at the time to

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(1) Ibid., Vol. 12, No 603, 6/4/1355 (26.6.1936), p. 2.

withdraw the old riyals. Five years later, however, the Government requested the public to hand over the remaining old riyals (inclusive of their fractions), and to take in exchange new riyals. If anyone was caught dealing in old riyals after the end of 1359, he was subjected to prescribed punishment, namely confiscation of the riyals and imposition of a fine amounting to double the value of the riyals.(1)

Thus the old riyal eventually disappeared from circulation and the new riyal became the official national coin and remained as such until October, 1956, when it was withdrawn and replaced by the one riyal pilgrim receipt.

Table I below gives detailed information regarding the specifications of the Saudi coins in circulation in 1952.

Table II suggests two points. First, from 1949 up to 1955 there has been a considerable increase in the quantity of riyals in circulation. The reason seems to be the rapid growth of the Saudi economy, due to the increased revenues from oil which amounted, in 1955, to about U.S.$ 400,000,000. Previously, Saudi Arabia had been dependent almost exclusively on pilgrimage as the primary source of revenues. Pilgrims' expenditures were

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(1) Ibid., Vol. 17, No 841, 4/1/1360 (31.1.1941) , p. 2.

## TABLE I.

### Specifications of Saudi Arabian Coins

| Item | Quarter-Qirsh | Half-Qirsh | Qirsh | Saudi Riyal |
|---|---|---|---|---|
| **Gross weight** | | | | |
| grains | 65.6 | 84.8 | 100.0 | 180.0 |
| troy oz | 0.137 | 0.177 | 0.209 | 0.375 |
| grams | 4.25 | 5.5 | 6.5 | 11.6638 |
| **Composition** | | | | |
| silver | - | - | - | 0.91666 |
| copper | 0.75 | 0.75 | 0.75 | 0.08333 |
| Nickel | 0.25 | 0.25 | 0.25 | - |
| **Fine Metal content** | | | | |
| grains | - | - | - | 165.000 |
| troy oz | - | - | - | 0.34375 |
| grams | - | - | - | 10.6918 |
| **Diameter** | | | | |
| inches | 0.83 | 0.94 | 1.06 | 1.20 |
| millimeters | 21.00 | 23.90 | 26.90 | 30.50 |
| **Thickness** | | | | |
| inches | 0.070 | 0.068 | 0.064 | 0.075 |
| millimeters | 1.78 | 1.73 | 1.63 | 1.9 |

Source: Files of the Saudi Arabian Monetary Agency.

Table II below gives an approximate estimate of the amounts of riyals that were minted:

TABLE II

Amounts Coined:

| Year | 1/4 Rls | 1/2 Rls | 1 Rls | Cumulative Total |
|---|---|---|---|---|
| 1934 | N.A. | N.A. | N.A. | ---------- |
| 1935 | N.A. | N.A. | N.A. | ---------- |
| 1936 | N.A. | N.A. | 2,500,000 | 2,500,000 |
| 1937 | N.A. | N.A. | 3,000,000 | 5,500,000 |
| 1938 | N.A. | N.A. | 1,310,698 | 6,810,698 |
| 1939 | N.A. | N.A. | 389,302 | 7,200,000 |
| 1940 | N.A. | N.A. | 1,000,000 | 8,200,000 |
| 1941 | N.A. | N.A. | N.A. | 8,200,000 |
| 1942 | N.A. | N.A. | N.A. | 8,200,000 |
| 1943 | N.A. | N.A. | N.A. | 8,200,000 |
| 1944 | N.A. | N.A. | 30,000,000 | 38,200,000 |
| 1945 | N.A. | N.A. | 17,000,000 | 55,200,000 |
| 1946 | 2,000,000 | 1,000,000 | 9,288,000 | 65,488,000 |
| 1947 | 1,000,000 | 500,000 | 14,212,000 | 80,200,000 |
| 1948 | nil | nil | 3,300,000 | 83,500,000 |
| 1949 | nil | nil | 60,000,000 | 143,500,000 |
| 1950 | nil | nil | nil | 143,500,000 |
| 1951 | nil | nil | 50,000,000 | 193,500,000 |
| 1952 | 4,000,000 | 2,000,000 | 75,000,000 | 270,000,000 |
| 1953 | nil | nil | nil | ---------- |
| 1954 | nil | nil | nil | ---------- |
| 1955 | 4,000,000 | 2,000,000 | 48,000,000 | 320,500,000 |
| | 11,000,000 | 5,500,000 | 315,000,000 | 320,000,000 |

N.A. = Not Available.

Source: Young, Arthur N., "Saudi Arabian Currency & Finance". Middle East Journal, Vol. 7, Nos 3 & 4, 1953, with the exception of the figures for 1955, which were taken from the files of the Saudi Arabian Monetary Agency.

estimated in 1953, by the Economic Research Department of the Saudi Arabian Monetary Agency at about \$ 42,000,000.[1] If it is assumed that the figure applies for the years preceeding the oil discovery, the increase in public revenues becomes evident.

Second, some of the totals given in the table do not represent actual silver riyals in circulation. Indeed, an "undetermined amount had been smuggled out of the country at various times when the price of silver abroad made it profitable to do so, or used as a source of silver by local silversmiths, or hoarded."[2]

4. The Riyal's Exchange Rate

No statistics of exchange rates are available. The only available data are the riyal-sovereign exchange rates from 1946 to 1953. (See Table III).

As shown by Table III below, the rate of exchange varied between 74 S.R. and 40.16$\frac{1}{2}$ S.R. In the last three years of this period, the range was between 62.5$\frac{1}{2}$ S.R. and 40.16$\frac{1}{2}$ S.R., and the average rate in October, 1952, was 43.5$\frac{1}{2}$ S.R.

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(1) This estimate suffers from a major limitation. A large number of the persons included were not bona fide pilgrims but had come to seek employment in the rapidly expanding Saudi economy.

(2) Mcleod, A.N., Money and Banking in Saudi Arabia, (unpublished report) July 29th, 1953, p. 1.

## T A B L E  III

### Sovereign Riyal Rates of Exchange at Jeddah, 1946-1952

(British Sovereign (George head) in terms of Riyals.)

| 1946 | High | Low |
|---|---|---|
| January .. | 74.00 | 70.00 |
| April..... | 80.75 | 72.36 |
| July...... | 68.68 | 61.50 |
| October... | 67.50 | 60.50 |

| 1947 | High | Low |
|---|---|---|
| January... | 68.50 | 67.50 |
| April..... | 66.91. | 60.00 |
| July...... | 64.50 | 61.75 |
| October... | 68.00 | 66.50 |

| 1948 | High | Low |
|---|---|---|
| January... | 68.00 | 63.25 |
| April..... | 64.68 | 63,25 |
| July...... | 65.00 | 62.00 |
| October... | 57.50 | 54.25 |

| 1949 | High | Low |
|---|---|---|
| January... | 52.50 | 48.00 |
| April..... | 53.50 | 50.00 |
| July...... | 49.50 | 47.50 |
| October... | 49.25 | 46.50 |

| 1950 | High | Low |
|---|---|---|
| January... | 58.75 | 57.50 |
| April..... | 54.50 | 53.50 |
| July...... | 49.50 | 47.50 |
| October... | 49.25 | 46.50 |

| 1951 | High | Low |
|---|---|---|
| January... | 46.25 | 42.25 |
| April..... | 48.25 | 46.25 |
| July...... | 46.00 | 44.91 |
| October... | 47.00 | 46.00 |

| 1952 | High | Low |
|---|---|---|
| January... | 45.14 | 44.82 |
| April..... | 44.91 | 44.36 |
| July...... | 43.00 | 40.75 |
| October... | 43.26 | 40.07 |

| 1953 | High | Low |
|---|---|---|
| January... | 41.25 | 40.41 |
| April..... | 39.43 | 38.91 |
| June...... | 38.43 | 37.93 |

(Source: Young, A.N., <u>op.cit.</u>, p.364.)

These fluctuations occured despite the fact that the Government had in July 1948 fixed the riyal rate of exchange vis-a-vis the sovereign at 65 S.R. (George Head) and 63 S.R. (Queen Head).(1)

During World War II and in view of the rise in the value of the British sovereign, the Government declared to the public that all transactions must in future be undertaken not on the basis of the gold sovereign but rather on the basis of the silver riyal. The declaration made null and void all transactions negotiated in terms of gold coins.(2)

5. The Banking System

Banks that operated in Saudi Arabia during this period were many and the expansion in the banking business reflects the importance which the kingdom assumed after the discovery of oil.

Previously, it was stated that the British firm of Gelately and Hankey handled some commercial banking business. The firm went on dealing in banking throughout this period and did not stop its activities until 1955. The first foreign bank that operated in Saudi Arabia was the Dutch Netherlands Trading Society, which was established on

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(1) Um-Al-Qura, Vol. 25, No 1216, 25/7/1367 (7.2.1948), p.2.

(2) Ibid., Vol. 17, No 809, 15/5/1359, (21.6.1940), p.5.

November 15th, 1926. Next, the French Banque de l'Indo-chine started operations in May, 1948. The same year two national companies were established to deal in banking business. The first was "The Partnership of Saleh and Abdul Aziz Kaki and Salem Bin Mahfouz", (known today as the National Commercial Bank,) and the other the "Bank Ibrahim Ismail Zahran". One year later, the Jordanian Arab Bank established a branch in Jeddah, so did the British Bank of the Middle East in April 1950. In September, 1950, the National Bank of Pakistan was established. Throughout this period, the Egyptian Misr Bank operated sporadically, especially during the Haj season.(1)

The operations of these banks were centered only on the international aspects of banking, such as the transfers of funds, the negotiation and settlement of letters of credit, the settlement of bills for collection, and exchange purchases and sales. These banks held considerable sums on deposit for customers, and settlements of transactions by means of checks were common; but in general people preferred to hold their resources in cash rather than leave them on deposit with banks. Time deposits were not known and no rate of interest was given. Most deposits were on current account. Banks did not make loans or credits to

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(1) Twitchell, K.S., Saudi Arabia, (Princeton University Press) 1953, p. 123.

customers as the charging of a rate of interest was strictly prohibited. Despite that, banks used to allow for overdrafts in their customers' current accounts and to charge a rate of interest recorded in their books as "commission."

Banks rarely discounted bills, as these were not used in financing domestic trade. However, in matters of foreign trade, Saudi merchants had become increasingly familiar with such bills as the volume of foreign trade expanded. Foreign exporters, upon developing full confidence in their Saudi customers, used to accept bills of exchange in payment for their goods. Foreign exporters used to discount such bills with their bankers at home and at the time of maturity the Saudi merchants would remit the requested amount through their bankers in Saudi Arabia.

The two national banks, namely, the Partnership of Saleh and Abdul Aziz Kaki and Salem Bin Mahfouz and the Bank of Ibrahim Ismail Zahran indulged in ordinary commercial business. The former was famous for its trading in jewellery. The latter traded mainly in imports from the Sudan, and acted as agent for several foreign establishments.[1]

The National Bank of Pakistan, at this period, continued its operations, serving the needs of the annual

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(1) Saudi Arabian Ministry of Trade, Report 1955, p. 282 (Arabic.)

pilgrims from Pakistan. These operations consisted of cashing checks of Pakistani pilgrims drawn on it by its head office in Pakistan.

There were no other kinds of banking, such as investment, agricultural, industrial and real estate banking.

The Government did not interfere in the operations of banks. There was no Central Bank to regulate monetary policies. Government interference went no further than the stabilizing from time to time of the riyal-sovereign rate of exchange in response to changes in the prices of precious metals in world markets. In 1949, for instance, the Government attempted to establish a riyal-sovereign peg; a minimum quotation of 55 S.R. per sovereign was set and the export of sovereigns was prohibited except under license.[1]

As the Government's revenue in foreign exchange was rapidly increasing in 1947 and four-fifths of it was in dollars, the Government felt the need for establishing a fixed rate of exchange for the dollar. "A new monetary programme has been recently inaugurated in Saudi Arabia. The fixed rate of exchange between the riyal and the U.S.$., which had been 4 riyals to the dollar prior to May 1st, 1949, was discontinued in favour of a day to day exchange rate to be determined by the Minister of Finance."[2]

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(1) International Monetary Fund, International Financial News Survey, Vol. 11, No 6, Aug. 11th, 1949, p. 45.

(2) Ibid.

6. Central Banking Functions

As previously stated, there was no Central Bank in Saudi Arabia. Some central banking functions, however, were undertaken by different private and public entities.

In the early days of the Saudi reign, the "General Finance Agency" was established with the following functions:(1)

(1) the collection of revenues and the channelling of public expenditure

(2) the minting of Saudi coins ( the silver riyals and nickel qurush)

(3) the supervision of pilgrimage matters

(4) the undertaking of public works requested by the Government

(5) the undertaking of all official purchases

(6) the management of the public debt.

In 1351 (1932), the General Finance Agency was transformed into a Ministry of Finance. The functions of the Ministry were not different from those of the Agency.(2) It undertook the following central banking functions:-

(1) the minting of riyals according to its own estimates of the needs of the country

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(1) Hamza, Fuad, Al Bilad Al Arabiya As-Saudiya. Um-Al-Qura Press, Mecca, 1355, p. 156.

(2) Um-Al-Qura, Vol. 9, No 407, 29/5/1351 (30.9.1932), p. 2.

(2) the control of the internal and external debts

(3) the management of revenues and expenditures.

In view of World War II conditions, the Ministry, in an attempt to protect the national coins from the then rising prices of gold and silver, prohibited the import and export of all metallic coins. Also, in collaboration with the Middle East Supply Centre in Cairo, it regulated the importation of goods and their distribution to local merchants. At the same time, it formed a "Price Control Committee" to check any rise in prices.

In 1948, three important Departments were established within the Ministry:

(1) The Minerals and Companies Office, the function of which was to regulate the operations of concessionaire companies.

(2) The Constructive Projects Office, the function of which was to undertake all development projects.

(3) The Exchange Control Office, with the two functions of controlling banking operations and issuing import and export licences.[1]

The Exchange Control Office did not interfere with banks and money-changers nor did it carry out a co-ordinated

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(1) Ibid., Vol. 25, No 1209, 28/6/1367 (7.5.1948), p.2.

monetary policy. It merely issued import and export licences. In 1949, it announced that the export of Egyptian banknotes was subject to the control of the Office. A licence was to be given to those wishing to export or transfer these notes. Banks were also requested not to negotiate the transfer of any such accounts to Egypt, except by means of a licence from the Office.[1] At the request of the Egyptian Government imports of Egyptian banknotes were also prohibited.

Following upon the increase in oil revenues in 1947, the Ministry entrusted to the Banque de l'Indochine and to the Netherlands Trading Society the task of keeping its foreign balances. These banks were chosen because they were, at that time, the only two foreign banks in Saudi Arabia. Foreign balances were sold to them and to other banks and money-changers against riyals, in accordance with the dollar free market rate of exchange. Thus the Government's revenues in foreign currencies were handled by these two banks, which in return used to charge a commission on services rendered to the Government, such as the opening of letters of credit and transfer of funds. Moreover, these banks used to undertake all Government purchases from abroad. "The Principal bank was the Netherlands Trading Society, which has done extensive business

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(1) Ibid., Vol. 26, No 1268, 5/8/1368 (1.7.1949), p. 3.

for the Saudi Arabian Government through many years. It has handled, up to date, all the funds dispensed in Saudi Arabia by the Mining Company and many of the transactions of the Oil Company."[1]

In addition, the Ministry relied upon Al-Kaki & Salem Bin Mahfuz Co. to pay and transfer funds locally, especially to remote places of the Kingdom where it had no district offices.

7. The Jeddah Money Market

In view of the fact that Jeddah is the financial centre of Saudi Arabia, due to its being the main port on the Red Sea coast, it abounded in money-changers and dealers. Important as the money-changers were for the services they rendered to the pilgrims, their main function was to exchange foreign currencies into local coins. In general, the Government did not prevent pilgrims from bringing any coins which they desired.

The market was free in the sense that there was hardly any Government intervention in its operations.

In the early years of Saudi rule, the regulation and supervision of money-changers was entrusted to the Trade Council: a private entity that was established by the Government to regulate and supervise all matters relating to trade. The Council comprised a President and six

(1) Twitchell, op.cit., p. 124.

Members appointed by the King. The President, as well as the Members, were supposed to have wide experience in commercial affairs and to be of good repute and character.[1]

The Government in 1931 issued a "Trade Regulation" to regulate all trade transactions. Article 36 of the regulation defined a money-changer as a man whose occupation was to exchange coins or banknotes. Anyone who wanted to open a shop for changing money had to submit an application to the Government. The latter, in turn, made full investigation of the applicant through the municipality and other money-changers. If and when the authorities were satisfied, his name was recorded in the Register of the Trade Council and he was granted a licence.

The Trade Council, apart from registering the names of money-changers, did nothing to control and supervise them. Article 41 of the aforesaid regulation made it clear that money-changers were responsible for their own business and the organization of their account books.

It is worth noting that banks were not included in the regulation's definition of money-changers. But it was the duty of the Trade Council to investigate all disputes arising between banks, money-changers and other commercial concerns.

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(1) Um-Al-Qura, Vol. 7, No 366, 8/8/1350 (18.12.1931), p. 3.

With the rapid expansion of the Saudi economy, money-changers began to buy foreign exchange from commercial banks and to keep foreign balances abroad. These balances were used for the transfer of funds either for personal or commercial purposes.

Government interference with the market did not go beyond the prohibition of the export and import of foreign currencies. However, the Government used to request money-changers to adhere to the officially fixed rates of exchange for certain foreign currencies.

8. The Public Debt.

At the dawn of the Saudi era, when the Saudi economy was dependent on pilgrimage, the Government budget ran into many deficits, due to the expenditures of the Royal Court and to the cost of maintaining a huge administration to cover the vast territory of Saudi Arabia. These deficits were met by internal loans. Loans were obtained from reputable merchants, either in cash or in kind; that is to say, merchants used to supply the Royal Court with food and other essential commodities on credit. No rate of interest was paid in such cases, but merchants, of course, used to charge a price higher than the prevailing one.

Another peculiar way of obtaining credit was for the Government, not to pay its employees the full amount of their salaries, the difference being kept by the Government, to be paid when budgetary revenues allowed.

No foreign loans were resorted to before World War II.[1] Mention must, however, be made of subsidy paid by the British Government to King Ibn Saud as a gift. It was said to amount to 20,000 British sovereigns annually.

The following procedure was followed for the repayment of internal loans:

(1) To merchants having lent funds to the Government, the Ministry used to give transfer orders on the Customs Department. Those holding these orders were entitled to a 25% deduction from the customs duties they had to pay on their import. This deduction was considered an instalment payment by the Government on its debts.

(2) Government employees whose salaries were not fully paid could also take transfer orders on

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(1) In 1932 the Official Gazette, Um-al-Qura, Vol. 8, No. 383 of 7/12/1350 (13.4.1932), contained the following declaration: "In an official announcement made by the official Publications Office, the Government has declared that it has not received any loan from any foreign government and that it is anxiously looking for the help of any Moslem, be he King or Emir or merchant, to enable it to overcome the present crisis. The terms of the loans would be favourable to the lender and must at the same time preserve the rights of the Government and its national independence."

the Customs Department. Those who were not themselves dealing in importation, had to arrange with merchants to accept the transfer order. The Ministry would then make the order in the name of those merchants, who thus became entitled to a 25% deduction on their customs duties. Transfer orders were not negotiable.(1)

During the Second World War, when the Government revenue from pilgrims was almost cut to nothing, the Government requested the Arabian American Oil Company (Aramco) to grant them advanced payments. From that time onwards, Aramco became the primary source for Government loans. The Import-Export Bank granted the Government loans of U. S. $ 2,536,000 in 1951 for various development projects.(2)

All these foreign loans were subject to interest, though the Government continued to prohibit local banks from charging interest on local loans.

II. Evaluation

The main defects of the dual monetary system, with the silver riyal and the British gold sovereign, could be

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(1) *Ibid.*, Vol. 6, No 392, 13/2/1351 (17.6.1932), p. 2

(2) Twitchell, *op.cit.*, p. 177.

summarized as follows:

1. The bulkiness of the riyal presented a difficulty in the settlement of large accounts. It was both difficult and inconvenient to have large payments effected in silver riyals, because of the large weight of such coins and the time taken in counting them. This may explain, <u>inter alia</u>, why foreign currencies were circulating freely. The British sovereign, for instance, was commonly used for large payments. Furthermore, the riyal, being split into 22 darij qurush and 11 miri qurush, formed an impediment to sound arithmetic and accounting procedures.
2. The currency was highly inelastic, i.e., the amount in circulation could not be readily adjusted to meet the needs of trade. In case the Government wanted to increase the quantity in circulation, it could not do so except after the lapse of considerable time. What made this even worse was the seasonal nature of the Saudi Arabian economy. Much capital had to be tied up in the form of silver coins to meet the peak seasonal demand and would later lie idle for months. During the season of peak demand from pilgrims wishing to obtain silver riyals in exchange for foreign

currencies, riyals became scarce and appreciated substantially in value.(1) When the pilgrimage season was over, the demand for riyals slackened and their supply became far greater than the current volume of business warranted. Moreover, considerable amounts of riyals were smuggled abroad when prices on foreign markets became favourable.

3. There were wide fluctuations in the exchange rates of the riyal vis-a-vis foreign currencies. It was previously stated that the Government failed to maintain a fixed rate between the silver riyal and the British sovereign, for the obvious reason that the values of gold and silver were beyond its control. Table III showed the wide fluctuations in the riyal-sovereign rates during the period 1945 to 1953. With regard to the rates of exchange of the riyal in terms of the U.S. dollar, "the value of the riyal ranged between nearly U.S. $ 0.30 and less than U. S. $ 0.20 from 1946 to 1952."(2) The effects of these fluctuations were the following:-

(a) The fluctuations were disturbing to Government

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(1) McLeod, op.cit., p. 4.

(2) Ibid., p. 3.

finance. Beginning with 1947, about four-fifths of the Government revenue have been in foreign exchange, mainly dollars. Since a large part of such revenues had to be converted into riyals in order to meet domestic expenditure by the Government, the latter was by no means able to draw up its budget with any assurance, owing to the constantly fluctuating rates of exchange.

(b) Fluctuations of the type described above were furthermore detrimental to foreign trade, because of the country's overwhelming dependence on imports. Exchange instability brings to foreign trade an element of risk and uncertainty. To compensate for this, traders have to be allowed larger profit margins. They naturally pass on this added cost to the public or the Government (as a buyer of imports) in the form of higher prices.[1]

(c) Exchange fluctuations made the two predominant media of exchange, the riyal and the British sovereign, highly unstable in terms of each other. (See Table III on Page 24.) At times, the riyal's exchange rate in terms of the sovereign gave a margin of profit to money-

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(1) Young, A.N., Saudi Arabian Currency and Finance, in Middle East Journal, Vol. 7, Nos 3 & 4, 1953, p. 369.

dealers and banks. Besides, the riyal and sovereign were not interchangeable at any par rate. The public had to pay rates of exchange which covered the profit of the dealer or bank.

4. There was no banking legislation to regulate and organize the operations of commercial banks. In the absence of any co-ordinated national monetary policy, banks which were branches of foreign establishments and therefore followed the dictates of their head offices could hardly be expected to produce on their own initiative any policy primarily designed to aid the economic development of Saudi Arabia.
5. The system clearly lacked an organization which could formulate monetary and fiscal policy and which, at the same time could assume responsibility for the regulation of the operations and functions of banks.

# C H A P T E R TWO

## MONETARY REFORM

### I. Central Banking

#### A. Reasons for the Establishment of the Saudi Arabian Monetary Agency

As a result of the defects that were discussed in the previous section, the prevailing monetary system could not cope with the new developments in the Saudi Arabian economy after the discovery of oil. The need for an institution to act as a central bank became pressing, particularly for the following reasons:

1. Financial Reasons

   (i) The stability of the currency necessitated the existence of reserve funds to be operated and held by a Government agency.

   (ii) The Government felt the need of entrusting the function of minting coins and handling the manufacture, shipment and issue of all coins to a separate, specialized body.

   (iii) Banks and money dealers could not be left to operate freely, and some sort of regulation or control was necessary.

2. Fiscal Reasons

   (i) The growth in oil revenues made the previous public finance machinery inadequate. In fact, "an organization that sufficed for the more simple society of the Saudi Arabia of a dozen years ago and a yearly budget of S.R.25 million, (say $ 7 million,) could not properly handle a budget more than twenty-five times as great."(1)

(ii) Foreign exchange had by now become a major problem. Careful handling of foreign exchange as well as careful use of funds by a Government agency was important to the country's progress. Apart from saving for the Government the amounts paid as commission to the Netherlands Trading Society and the Banque de l'Indochine for services rendered to the Government, (in effecting foreign exchange transfers and conducting purchases abroad,) the Central Bank will be in a position to take measures to stabilize and strengthen the value of the national currency.

(iii) With the large expansion of the Saudi Arabian economy, the Government found itself faced with new, highly technical and intricate problems in the monetary and financial field. A well-

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(1) Young, <u>op.cit.</u> p. 372.

qualified and specialized Government
body was needed to give advice and help
to the Ministry in solving these problems.
Some of these problems were the building
up of local currency deposits, the control
of Government expenditure, the stabilization
of the riyal's exchange rates and other
related matters.

In view of all these problems, the Government sought the advice of outstanding financial experts abroad. Mr. Arthur N. Young, head of the U.S.Financial Mission to Saudi Arabia, was requested to make a study of the financial and monetary conditions in Saudi Arabia and to draw up a detailed plan for the creation of a Central Bank. Arriving in Saudi Arabia in 1951, Mr. Young, after many discussions held with the King, Minister of Finance, and other officials, submitted to the Minister of Finance his report. In this report, Mr. Young suggested a plan for the establishment of a "modified central bank". The recommendations were accepted by Saudi officials and Mr. Young was requested to proceed with drawing up of a detailed plan for a central bank and to suggest its by-laws and charter. After the completion of the plan and its approval by the Minister of Finance, King Abdul Aziz Bin Saud in two Royal Decrees, Nos 30/4/1/1046 and 30/4/1/1047 of 25th Rajab, 1371 (April 20th, 1952,) sanctioned the creation of an institution to be called "The Saudi Arabian Monetary Agency", (referred to hereinafter as the Agency) and approved its by-laws and charter. Six months after the promulgation of these decrees, the Agency started operations in Jeddah on Muharram 15th, 1372, (4th October, 1952.)

B. Objects and Functions of the Saudi Arabian Monetary Agency

Article 2 of Royal Decree No 30/4/1/1046 of April 20th, 1952, stipulates that the functions of the Agency shall be: First:- To strengthen the currency of the State and to stabilize its value and to fix this value in relation to foreign currencies.

Second:- To aid the Minsiter of Finance in centralizing the receipts and expenditures of the Government and in controlling expenditures in accordance with the items of the authorized budget.

The Agency shall make no charges against either receipts or payments and shall not act in any manner which conflicts with the teachings of the Islamic Law.

The Agency has thus been entrusted with a twofold role; controller of currency affairs, and fiscal agent to the Government. As to the former, the Charter of the Agency gave a detailed list of the functions to be undertaken by the Agency. Article 4 of the Charter provided for the following functions:-

a) To stabilize and maintain the internal and external value of the currency.

b) To hold and operate any monetary reserve funds as separate funds earmarked for monetary purposes only.

c) To buy and sell on the Government's behalf gold and silver coin and bullion.

d) To advise the Government about new coinage and to handle the manufacture, shipment and issue of all coins; it being known that coins would be issued only through and at the request of the Agency.

e) To regulate commercial banks, exchange dealers and money changers as may be found appropriate.

With regard to its role as a fiscal agent, the Charter assigned to the Agency the following functions:

a) To receive and act as depository for all revenues, including receipts from concessionaire companies, from customs, from the Hajj and from other sources, and to maintain deposit accounts under such heads as the Government through the Minister of Finance may direct.

b) To act as agent for the Government in paying out funds for purposes duly approved by the Government through the Minister of Finance.

Furthermore, Article 7 of the Agency's Charter stipulated that: "......The Agency shall not undertake any of the following functions:-

a) Paying or receiving interest.

b) Receiving private deposits.

c) Making advances to the Government or to private parties.

d) Engaging in trade or having an interest in any commercial, industrial, or agricultural enterprise.

e) Buying or holding fixed property, except what the Agency reasonably needs for its operations.

f) Issuing currency notes.

Thus, the Agency could be considered as performing "all the functions of a central bank that are appropriate or necessary in Saudi Arabia, where bank credit is virtually non-existent".[(1)]

It may be interesting to explain the reasons which led the Government to debar the Agency from performing certain functions. With regard to the prohibition of paying out or receiving interest, it is not difficult to find the version in the Quran that condemns usury. Although some Moslems make a distinction between interest charged on capital for consumption and capital for production and condemn interest charged on the former only, others do not allow for any differentiation between various types of interest rates. "In Islam, every interest, even if it is

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(1) McLeod, A.N; Proposals for Monetary and Banking Progress in Saudi Arabia, Washington, D.C, October, 1955, p. 3. (unpublished paper.)

at the lowest rate, is forbidden."[1] This view is adopted by Saudi Arabia and interest is prohibited on strictly religious grounds.

With regard to the prohibition against receiving private deposits, it was deemed important for the Agency to avoid any competition with operating commercial banks, as its success largely depends on their effective co-operation. Similarly, "the Agency, in buying and selling foreign exchange, should ordinarily deal with banks and leave to these the dealings with private parties, whose credit standing and needs they can readily appraise."[2]

Furthermore, the Agency was not permitted to engage in trade or to have any interest in any commercial, industrial or agricultural enterprise, or to buy or hold fixed property, because "the capital of the Agency must be kept liquid and not be tied up in investments."[3]

As it was proposed by Mr. Young, the Agency was not authorized to issue currency at the very outset of its operation. The reasons given by Mr. Young were that "Saudi Arabia has long been used to metallic money and under existing conditions it will be wise to continue a "hard money" system."[4]

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(1) Qureshi, Anwar Iqbal, Islam and the Theory of Interest ( Sh. Muhammad Ashraf, Lahore, 1945), p. 95.

(2) Young, op.cit. p. 373.

(3) Ibid.

(4) Ibid.

In conclusion, the Agency could be considered as a preliminary step towards monetary reform. Indeed, the establishment of the Agency marks the first sound foundation for monetary and banking progress.

## C. Administration and Organization

The Saudi Arabian Monetary Agency is a Government institution, the capital of which is entirely subscribed by the Government. The Agency is a corporation administered and controlled by a Board of Directors. The Governor, on the other hand, is the chief executive officer of the Agency.

### 1. The Board of Directors

Article 8 of the Agency's Charter states that the Agency shall be under the control of a Baord of Directors who shall be generally responsible for its efficient administration and operation and shall have such powers as are necessary and appropriate to that end. The Board of Directors may make such rules and regulations as it may consider necessary and appropriate to the conduct of the work of the Agency in accordance with this Charter.

The Board comprises a President, a Vice-President, the Governor of the Agency and two other members. All the members of the Board are appointed by Royal Decree upon nomination of the Minister of Finance. The Charter did not mention the term of office of the Board.

The duties of the Board of Directors as stipulated by the Agency's by-laws are the following:-

a) The Board shall meet when convened by the President or Vice-President. Meetings shall be held as frequently as may be necessary to discharge the responsibilities of the Board.

In the absence or incapacity of the President, the Vice-President will act for him.

Three members of the Board will constitute a quorum.

b) The President and the Governor shall constitute the Policy Committee of the Board. Actions and decisions of the Policy Committee on substantive matters shall be subject to confirmation by the Board.

c) The Board shall issue such rules and regulations as it considers necessary or appropriate for the conduct of the work of the Agency.

The First Board of Directors was formed of the Minister of Finance as President, the Deputy Minister of Finance as Vice-President, the Governor and Vice-Governor of the Agency, and two other members representing commercial banks.

The Board of Directors, though in theory the governing body of the Agency, did practically nothing to perform the functions entrusted to them. Indeed, it was reported that not a single meeting of the Board was held and the policies carried out by the Agency in the first two years were formulated by the Governor with the consent of the Minister of Finance.

2. <u>The Governor</u>

The most important powers, duties and functions of the Governor, as stipulated by Article 6 of the Charter, are the following:-

a) The execution of policies and measures approved by the Board or the Policy Committee and, subject to any such policies and measures as may be applicable, the direction, supervision and control of the operation of the Agency and its internal management and administration.

b) The preparation of the Agenda for meetings of the Board.

c) The appointment of such officers, employees and servants as he may consider necessary; the suspension, removal, replacement and re-instatement of the same as the circumstances may warrant; the determination of their salaries, wages or other remuneration and their terms and conditions of service, and the allocation of their duties and responsibilities.

d) The utilization of the funds of the Agency for the purpose of meeting all expenditures or liabilities incurred in the management, administration and operation of the Agency and in the exercise, performance and discharge of the functions and responsibilities of the Agency under the decrees governing the Agency.

The Governor is appointed by Royal Decree upon the nomination of the Minister of Finance.

The aforesaid functions of the Board of Directors and the Governor show that the Agency is an autonomous entity whose plans and policies are drawn up by the Board, not by the Minister of Finance.

3. Internal Organization of the Agency

The Agency is divided into two main divisions: the Banking Department and the Economic Research Department. The former's function is to organize and regulate Government accounts, foreign exchange operations, and Government purchases and transfers. The latter's function is confined to the collection and compilation of data needed by the Government and the Agency in formulating and carrying out their financial and economic policies.

a. The Banking Department

The Banking Department of the Agency is composed of the following sections:-

(i) The Accountancy Section. Its main function is to keep record of all daily operations.

(ii) The Documentary Credit Section. Its main function is to negotiate Letters of Credit on behalf of the Government.

(iii) The Transfers Section. It has as its function the transfer of foreign exchange needed by the Government for non-imports such as transfers to Saudi Embassies and Legations abroad. Internal transfers to cover expenditure to all departments concerned is also conducted by this section.

(iv) The Current Account Section. It keeps the Government accounts.

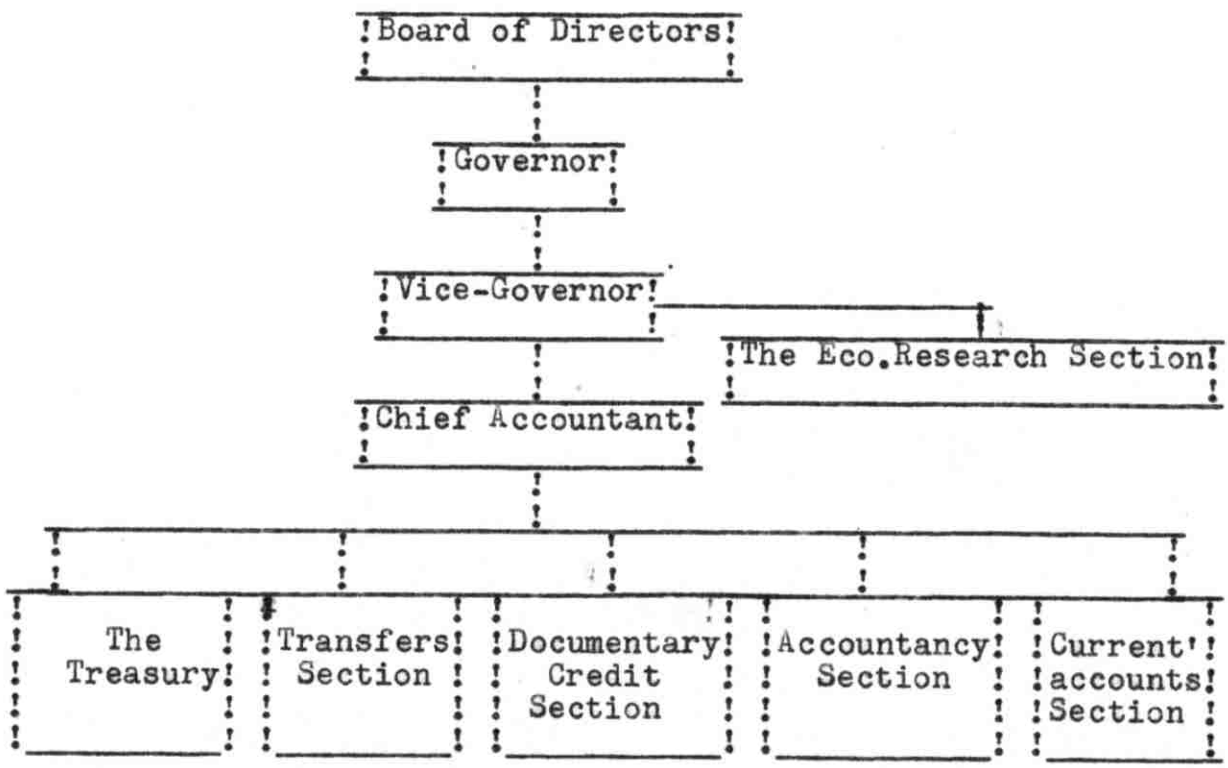
(v) The Treasury.

These five sections are under the direct supervision of the Chief Accountant and his assistant. Thus the functions of the Banking Department are confined to following sound accounting practices.

It is worth noting that when the Agency started issuing the Pilgrim Receipts, no department for issue was established; and matters related to their issue were left to be handled by the following sections:- the Treasury, the Accountancy Section and the Economic Research Section. Until now, (1958) there is no Issue Department in the Agency.

b. The Economic Research Department:

In the Charter of the Agency, the establishment of an Economic Research Section was included in the Agency's operations. In its early stages, the Department conducted many studies under the direction of Dr. A.N.McLeod of Canada. After his resignation in 1954, the various studies were discontinued and the Department thereafter undertook no serious studies. Its main function is now the collection and compilation of some monetary and banking statistics. The Agency's Head Office is located in Jeddah and its branches are in Mecca, Medina, Tayef, Riyad and Dammam.



D. Capital

In view of the fact that Saudi Arabia did not have a well-developed financial and banking system, ownership of capital was entirely left to the Government. In supporting this view, Dr. Young stated: that: "full ownership by the Government would further the Agency's position as a public institution which should not aim at profit....private interests could be recognized by inclusion of non-Government members among the Directors."(1)

This obviously explains why the Board of Directors is wholly appointed by the Government.

The authorized capital of the Agency is 500,000 Saudi Arabian Sovereigns. (20,000,000 Saudi Riyals.) It was provided in full by the Government before the Agency began its operations.

As the Agency refrained from dealing in public deposits and from receiving or paying interests, its expenses were met by a reasonable charge on services rendered to the Government, such as the conversion of foreign exchange into local currency, the transfer of funds within the country, the opening of letters of credit and the transfer of funds abroad.

The capital, however, was increased by the following amounts: 2 million riyals, in 1373 (1954), 3 million, in 1374 (1955), and 3 million in 1375 (1956), thus totalling 28 million.(2)

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(1) Ibid., p. 375.

(2) This information is taken from the Agency's files.

These amounts added to capital were converted from the annual net profit account. In 1376 (1957), the net profit of the Agency was transferred to the account of the Ministry of Finance. The explanation might be that the Ministry was in need of funds to meet the growing deficit in its budget.

E. Operations Undertaken by the Agency

It becomes obvious now that the Agency was assigned to undertake two main functions; the first related to currency, namely the strengthening and stabilizing of the national currency; the second referred to fiscal matters, namely, acting as a fiscal agent by helping the Government to centralize receipts and expenditures. It is necessary now to see what has been done by the Agency to perform these functions and what measures were taken.

1. Strengthening and Stabilizing the Saudi Currency

a. The Issue of the Saudi Sovereign

The project of issuing the Saudi Sovereign was begun before the establishment of the Agency, but its integration into the monetary system was worked out by Mr. Young, and its issuance postponed until the establishment of the Agency. It is interesting, however, to discuss the reasons behind the minting of the Saudi Sovereign. Mr. Young, in his recommendations for the improvement of the monetary system, stated that the basic problem which must be discussed before anything else was the choice of a monetary standard. Such a choice was to be made from the following alternatives:-

(i) Some form of Bi-metallism.

(ii) An improvement in the working of the dual system in practice.

(iii) Basing the currency on silver riyals.

(iv) Using the British sovereign as a base.

(v) The adoption of the Gold Standard, based on $ 35 per ounce.

(vi) The introduction of a new gold coin with a provisional relation to the riyal, together with maximum stability in foreign exchange to be brought about by the Monetary Agency.

The first standard was not recommended because of the difficulty of having a fixed ratio between gold and silver, due to the fluctuations in metal prices since the end of the War. "Since the end of the War the ratio between gold and silver per ounce in free markets ranged from 45:1 to 100:1."[1]

The second standard was not recommended on the grounds that, in so far as the British sovereign was not a national coin of Saudi Arabia, the Government could not

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(1) Young, op.cit., p. 376.

control its value.

The silver standard, moreover, would not give a real solution. Apart from the fact that there is today no country in the world that is on the silver standard, there is no means of controlling the price of silver in markets abroad. "There are no present or prospective national or international policies that give any confidence in silver's future stability such as might justify any country in choosing it as a monetary standard."[1]

A gold standard at $ 35 per ounce proved inadequate to the requirements of Saudi Arabia. Apart from linking the currency system of Saudi Arabia to the dollar, the "full-bodied" gold coins, at this value of $ 35 per ounce, would, if issued, disappear from circulation. The reason being that the free market price of gold per ounce then was higher than 35 $. It ranged between $ 37 and 38.[2]

In view of the various difficulties outlined above, Mr.Young eventually recommended the following steps:-

a) The introduction of the Saudi Arabian gold sovereign as an initial step towards an improved monetary system.
b) Linking this Saudi sovereign to the riyal with reservations.
c) Maintaining the value of the currency in foreign exchange by operations of the Monetary Agency to check undue fluctuations.

(1) Young, <u>op.cit.</u>, p. 377

(2) <u>Ibid.</u>, p. 545.

In accordance with this scheme, the Agency introduced the Saudi Gold Sovereign as the first measure to improve the monetary system. The Saudi Sovereign gradually replaced the British Sovereign as a medium of payment.

In its Communique No. 1 of October 22nd, 1952, the Agency fixed the exchange of sovereigns for Saudi riyals at a ratio of 1 to 40. In the Communique, the Agency declared that this rate would be maintained unless rendered impracticable by major changes in the world prices of gold or silver.

The Saudi Sovereign is of the same size, weight and fineness as the British Sovereign.

Following are the specifications of the Saudi Sovereign:-

TABLE IV

SPECIFICATIONS OF THE SAUDI SOVEREIGN

| | | | |
|---|---|---|---|
| **Gross Weight** | | **Diameter** | |
| Grains............ | 123.2744 | inches.... | 0.87 |
| Troy oz........... | 0.256822 | millimetres | 19.00 |
| grams............. | 7.98805 | | |
| **Composition** | | **Thickness** | |
| Gold.............. | 0.91666 | inches..... | 0.070 |
| Copper............ | 0.08334 | millimetres | 1.74 |
| **Fine Metal Content** | | | |
| grains............ | 113.001 | | |
| Troy oz........... | 0.235418 | | |
| grams............. | 7.32233 | | |

(Source: Saudi Arabian Monetary Agency Files.)

The export of the new sovereign was prohibited under penalty of confiscation; while the export of foreign gold coins was freely permitted subject to customs regulations and licensing by the Agency.

The Agency was also requested by the Ministry of Finance to keep a separate reserve fund for the purpose of sustaining the value of the Saudi Arabian gold sovereign. The reserve fund must be equal to the difference between the intrinsic value of the sovereign plus its cost of insurance and freight and the officially set price, i.e., its face value. For every Saudi sovereign the former was 30.954 S.R., while the latter was 40.00 S.R. The difference of 9.046 S.R. represented the seigniorage received by the Government. This Currency Reserve Fund had to be kept in U.S.dollars and/or gold in banks of high standing in the name of the Agency. Thus, in theory, an exchange reserve of 100% is maintained to back the sovereign, the seigniorage reserve, together with the gold content of the coins themselves, providing for full cover for all circulating Saudi sovereigns.

It is interesting, however, to investigate why the rate of 1 to 40 was chosen. Three main factors lie behind this choice.

(1) It was found that the specified rate must be higher than the bullion gold price. On the basis of the

price of gold bullion in free markets, which in September, 1952, ranged between \$.37 and \$.38, the sovereign's gold content was worth between \$ 8.70 and \$ 8.95.[1] If this price were adopted, there would have been a great danger of smuggling the sovereign outside the country. Hence, the specified price had to be above the bullion price so as to discourage any attempt to export it. Indeed, at 40 riyals, the sovereign valued at the official price of 3:15¼ for the dollar, had a value of U.S.\$ 10.80, which was equivalent to a gold price of about \$ 42.05 per ounce. This was obviously higher than the ruling free market rate.

(2) The rate was recommended on the grounds that it must be lower than the rate at which the British sovereign was circulating, otherwise the Saudi sovereign, being a new and unproven coin, would not be readily acceptable to the Saudi public. Furthermore, a rate higher than that of the British sovereign would give fruitful grounds for counterfeiting. In 1952, the yearly average of the exchange rate of the British sovereign was around U.S.\$ 12.00,[2] evidently higher than the Saudi sovereign.

(3) The choice of this rate was designed to give a pattern of rates between the U.S.\$, the Saudi Riyal and the Saudi sovereign that could be maintained by the Agency, barring substantial changes in the world prices of gold

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(1) Ibid., p. 544.

(2) Ibid., p. 366.

and silver. This, however, will be discussed more fully later.

Having thus established a fixed rate between the sovereign and the riyal, the Agency started putting the new sovereign into circulation. Table V below gives the accurate amounts of the minted Saudi sovereigns.

TABLE V

Saudi Gold Sovereigns

| Year | Amounts which arrived in Saudi Arabia |
|---|---|
| 1951 | 100,000 |
| 1952 | 1,000,000 |
| 1953 | 1,400,000 |
| 1954 | nil |
| 1955 | nil |
| 1956 | nil |
| 1957 | nil |
| | 2,500,000 |

(Source: Saudi Arabian Monetary Agency files.)

By the end of 1953, serious trouble developed over the Saudi sovereign in the form of good imitations of the genuine coins.[1] The official Gazette, Um-Al-Qura, announced that a gang who had been engaged in counterfeiting Saudi sovereigns were arrested in Beirut and that some of the forged coins were circulating in the Kingdom.[2]

It is not difficult, however, to trace the factors which encouraged the counterfeiting of the Saudi sovereign. They were as follows:-

(1) The bullion price of the gold content of the sovereign as already stated was lower than its face value. It should be recalled that the bullion value was around \$ 9, while the face value was fixed at around \$ 11. This obviously made it a profitable business to counterfeit the Saudi sovereign.

In addition, "the fall in free market gold prices from the middle of 1952 to the middle of 1953 had much to do with making the circulation of counterfeit Saudi sovereigns profitable."[3]

(2) When the rate of exchange of the sovereign vis-a-vis the riyal was fixed at 40 riyals, the British sovereign,

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(1) McLeod, <u>op.cit.</u>, p.3.

(2) <u>Um-Al-Qura</u>, Vol. 30, No 1487 of 30.10.53 (22/2/1373), p.l.

(3) <u>Mcleod</u>, <u>op.cit.</u>, p. 4.

it will be remembered, was circulating at S.R. 45.14, (the yearly average for 1952,) while in December, 1953, it was circulating at S.R. 36.195.(1) The U.S. $ equivalent of this rate was $ 9.99, which was by far lower than that of the Saudi sovereign, which was approximately $ 10.85. This difference made re-minting the British sovereign into good replicas of the Saudi sovereign a profitable business, (yielding an approximate profit of 8%). As a net result of this, the Agency withdrew all Saudi sovereigns from circulation in January, 1954, and requested the public to return all sovereigns to the Agency.

### b. Stabilization of the Exchange Value of the Riyal

In November, 1952, the Agency stabilized the exchange rate of the riyal at approximately $ 0.272 (U.S.$). "Initially, the Agency undertook to keep the rate between 3 riyals 15 qirsh and 3.17 to the dollar in transactions between the public and the banks, or approximately U .S. $ 0.2716 to 0.2651 per riyal. Within a few weeks, the spread was narrowed to 3.15 - 3.15½ or U. S. $ 0.2716 - 0.2699 per riyal."(2)

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(1) The source of these quotations is the files of the Saudi Arabian Monetary Agency.

(2) McLeod, op.cit., p. 3.

The rate of 3.15 represented the buying price of banks from the Agency; $3.15\frac{1}{2}$ represented the banks' selling price to the public. Thus banks charged $\frac{1}{2}$ qirsh for every dollar sold by them. This difference was designed to cover the banks' services and running costs.

It is important to see why the Agency stabilized the exchange rate of the riyal at this rate. Mr. Young, in his report, stated that the following criteria were applied to the choice of the above-mentioned rate:

A. It should be as near as practicable to rates prevailing in the past, to which the public were accustomed.

B. It should be as little vulnerable as possible to any change in the silver price that is now foreseeable.

C. It should be a level which the Agency would be able to maintain, subject to major changes in the external or internal value of silver.

D. It should have a convenient ratio to the new sovereign.

Indeed, the specified rate was very near to the rates prevailing before the stabilization of the riyal. For example, the monthly average value of the dollar, from July, 1951, to December, did not exceed S.R. 3.15, and did not fall lower than S. R. $3.13\frac{1}{2}$. Similarly, from

January, 1952, up to September, the highest rate quoted was S. R. 3.17, the lowest S. R. 3.10½.(1) Hence, the rate of 3.15, as maintained by the Agency, was practicable and advisable.

With regard to the prices of silver, from July, 1952 up to October, the New York silver price was U.S.$ 0.83¼ per ounce. As the riyal contained 0.34375 ounces of silver, its bullion parity at the above New York market rate was U.S. $ 0.286. In the meantime, the riyal's mid-month value ranged from U.S.$ 0.272 to 0.290 in Jeddah market during the period from July to October 1952.(2)

Thus, the specified rate was roughly in line with the international prices of silver.

The rates of exchange of other currencies were allowed to find their own level in accordance with the customary market procedures.

On November 2nd, 1954, the official rate of the dollar was changed to S.R.3:16½ (Buying price) and S.R. 3.17 (Selling price.) The reason behind the exchange was not known; but it was unofficially reported that the new Minister of Finance aimed at increasing Government revenue. It will be recalled that the Agency converts Government foreign exchange into riyals through selling the former to banks and receiving riyals instead.

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(1) Young, op.cit., p. 541.

(2) Ibid.

The increase in the official rate thus gave an increase in revenue to the Government. There is no other satisfactory explanation of this change, in view of the fact that there were practically no major changes in the silver prices in the international markets at that time.

In March, 1955, the Agency stabilized the exchange rate of the £ sterling at 10 riyals 7.5 qirsh (Buying price) and S.R. 10.9 (Selling price.) This rate was chosen on the basis of the International Monetary Fund's declared par value of the sterling in terms of the dollar. At the official rate of U.S.$ 2.80 per £ sterling and U.S.$ 0.27 per riyal, the £ sterling equalled approximately S.R. 10.4. The 3 qirshs difference with the official buying price is charged by the Agency to cover its expenses.

In accordance with the Agreement negotiated between Saudi Arabia and France, the riyal's exchange rate in terms of the French franc was fixed at F. Fr. 93.3333 per riyal.

It is worth noting that the three above-mentioned currencies were only stablized because Saudi Arabia's earnings from concessionaire companies are paid in these currencies. In 1955, the Government's foreign exchange earnings were as follows:(1)

| | |
|---|---|
| U.S.$ .......... | 167,000,000 |
| £ sterling ..... | 33,000,000 |
| French franc ... | 1,212,000,000 |

Up to now, these are the official rates of the coins concerned.

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(1) Saudi Arabian Monetary Agency's files.

In Sha'ban, 1374 (April, 1955), when the Royal Decree prohibiting the transfer of funds abroad was introduced, a black market emerged with rates higher than the official ones.

At the start of 1956, serious trouble developed and silver riyals were smuggled outside the country on a large scale. This smuggling was mainly due to a sudden change in the price of silver in New York. The price of an ounce jumped from U.S.$ $0.85\frac{1}{2}$ to U.S.$ $0.90\frac{3}{4}$, at the close of 1955.(1) Thus the riyal's bullion silver price became approximately U.S.$ 0.31, while its monetary value, i.e., face value, was approximately U.S.$ 0.27, a difference of 4 cents.

Among the factors accounting for the rise in silver prices was the deal which Saudi Arabia made with the Bank of Mexico for minting 50 million Saudi riyals. The deal "drew down Mexican silver stocks so far that, early in March, 1955, the Bank of Mexico announced that it would have to withdraw as a supplier for the world market. It had been stabilizing the price since January 16th, 1953, at 85.25 cents an ounce for silver. This made only 11,000,000 ounces left and the Bank had commitments to

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(1) The New York Times, The Story of Money too good to last, by Burton Crane; Vol. CV, No. 35820, February 19, 1956, p. 1.

supply 17,000,000 (50 million riyals) to Saudi Arabia and 1,500,000 ounces a month to West Germany."[1]

As a result of this, "more than 4,000,000 ounces, according to metal brokers and foreign exchange dealers, have reached New York."[2] Hence, Saudi riyals were smuggled outside Saudi Arabia on a large scale.

The Government, in meeting this critical situation, took the following two measures:-

1. The export of riyals was strictly prohibited, under penalty of confiscation. Furthermore, internal transfers of amounts exceeding 5,000 silver riyals were made subject to a licence from the Agency.

2. The Government decided to withdraw silver riyals from circulation and to replace them by the one riyal paper pilgrim receipt. The new one riyal receipt was actually put into circulation in May, 1956 (Thoul-Qida, 1375).[3]

In conclusion, it may be said that the minting of the 50 million riyals in 1955, as shown above, was a grave mistake on the part of the Government. This will be discussed in detail in the next chapter.

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(1) Ibid.

(2) Ibid.

(3) Um-Al-Qura, Vol. 33, No 1621, 13.11.1375 (22.6.1956), p.l.

### c. Issue of Pilgrims' Receipts

The third measure taken by the Agency for the improvement of the monetary system was the issue of pilgrim receipts. The introduction of these receipts began on and after Thoul-Qida, 1372 (on July 25th, 1953).(1) Receipts were issued in denominations of 10 riyals. The purposes of introducing the receipts were the following:-

1. For their personal convenience, pilgrims coming to Mecca will be permitted to exchange their own currency holdings for riyals in the form of paper currency instead of having to carry the full amount in gold or silver coin. In addition, for the further convenience of pilgrims, the denomination of each note is printed on it in six different languages; Arabic, English, Urdu, Iranian, Indonesian and Turkish.

2. The issue of pilgrim receipts would give flexibility to the monetary system. During the pilgrimage season, the increased demand for the riyal raises its rate of exchange, while the issue of these paper receipts avoids the excessive use of the silver riyals. In this way, the Agency was able to stabilize the exchange value of the riyal and to check seasonal fluctuations.

3. The issue of receipts enabled the Agency at the same time to hold the dollar-riyal exchange rate firm and to

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(1) McLeod, op.cit., p. 7.

keep the rates of other currencies on the local market in line with the rates on other markets.

Contrary to the commonly held belief, the pilgrim receipts must not be considered as currency papers. The reason for this is that, at this time, the Agency was forbidden to issue currency papers. Moreover, the receipts, though they were accepted by the public as a medium of exchange, did not fulfil the conditions of a paper currency, especially that of being legal tender. Legally, there is no law that forces the acceptance of these receipts. Therefore, the receipts, as declared by the Agency, "will serve the same purposes as travellers' checks and will be handled in much the same way. The only difference is that it will not be necessary to endorse the receipts before using them."(1)

In brief, the receipts were designed to save the pilgrims the effort of carrying large sums of gold or silver coins, and to enable the Agency to stabilize the internal and external value of the riyal.

At the very outset, the Agency used to keep a 100% reserve for all circulating receipts; but when circumstances changed, for reasons to be discussed later, the Government resorted to printing as a source of revenue.

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(1) International Monetary Fund, International Financial News Survey, Vol. VI, No 6, August 7th, 1953, p. 44.

The pilgrim receipts were welcomed and well received by the pilgrims, by merchants and by the general public.

Table VI below gives the accurate amounts of pilgrim receipts printed:-

T A B L E VI

Printed Pilgrim Receipts

| Year | Amounts Printed | Amounts put into Circulation | Cumulative Total in Circulation |
|---|---|---|---|
| 1372 (1953) | 50,000,000 | 25,000,000 | 25,000,000 |
| 1373 (1954) | 125,000,000 | 93,000,000 | 118,000,000 |
| 1374 (1955) | 100,000,000 | 146,000,000 | 264,000,000 |
| 1375 (1956) | 300,000,000 | 150,000,000 | 414,000,000 |
| 1376 (1957) | 200,000,000 | 361,000,000 | 775,000,000 |
| Grand Total | 775,000,000 | | |

(Source:- Saudi Arabian Monetary Agency Files.)

The table shows the tremendous amounts of pilgrim receipts in circulation. This formidable increase could be explained on the grounds that a huge deficit was incurred in the budget. The second reason was the shortage in the foreign exchange earnings due to the repayment of Government loans, the extensive royal purchases in foreign currencies for the construction of palaces and the like. For instance, loans taken by the Government in 1374 (1955) amounted to U.S.$ 57,000,000 and in 1375 to U. S. $ 105,000,000. On the other hand, a loan of U.S.$ 10,000,000 was granted to Yemen in 1955, and one of U.S.$ 15,000,000 was granted to Syria in 1955.

The settlement of loans, as well as spending on consumption, decreased the yearly earnings of the Government in foreign exchange and at the same time no control was effected over public expenditure, which was increasing at a formidable rate to meet the extravagance of the King in building tens of palaces. The Government had thus no other alternative but to resort to foreign borrowing and to the printing press.

The third reason for the increase in the amount of pilgrim receipts circulating was the disappearance of the silver riyal due to its smuggling abroad, as already stated.

The fourth reason was that, although a 100% cover for the pilgrim receipts issued was to be maintained by the Agency, no 100% cover was, in fact, ever kept. It will be recalled that the cover was to consist of Saudi sovereigns, Saudi riyals and foreign exchange.

In July, 1957, the cover against the 775,000,000 pilgrim receipts in circulation was approximately as follows:(1)

| | | Riyal Equivalent |
|---|---|---|
| 2,000,000 | Saudi Sovereigns | 80,000,000 |
| | Saudi silver riyals | 100,000,000 |
| | Foreign exchange | nil |
| | T o t a l | 180,000,000 |

With regard to foreign exchange, there was no separate account for pilgrim receipts cover and in July, 1957, the Ministry's account with foreign banks in U.S.$ and sterling was overdrawn. Hence, there was practically no foreign exchange to back the pilgrim receipts; and the coins kept in the vaults of the Agency comprised approximately 24% only of the 775,000,000 circulating pilgrim receipts. Had the 100% cover been adhered to by the Agency, the presently circulating figure would have been more than halved. Further discussion on the importance of the receipts cover will, however, be postponed to the next chapter.

2. Means of Stabilizing the Saudi Currency

Having thus discussed the measures taken by the Agency to strengthen and stabilize the currency, it remains to examine the means by which the Agency was able to stabilize and strengthen the internal and external value of the riyal.

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(1) These figures are taken from the files of the Saudi Arabian Monetary Agency.

In view of the fact that the Saudi Arabian coinage is a "full-bodied" one, it was difficult, if not impossible, for the Agency to stabilize the internal and external value of the riyal, in face of major changes in the price of silver or gold, outside the country. In the absence of major changes in silver prices, the Agency succeeded in maintaining the official rate. The procedure followed was simple. As the Agency was responsible for the minting of riyals and the printing of pilgrim receipts, it used to release riyals or pilgrim receipts if the riyal's exchange value tended to rise, and vice-versa.(1)

In addition, in cases where no newly-minted riyals were available, the Agency used to stabilize the official rate through the manipulation of foreign exchange. If, for instance the riyal's exchange value tended to rise, the Agency would sell foreign exchange to banks against Saudi riyals. Conversely, if the rate of exchange tended to fall, the Agency would withhold selling foreign exchange until the rate was brought back to its official level.

Therefore, with these tools, the Agency succeeded in checking fluctuations in the riyal's internal or external value, until the establishment of the foreign exchange control in April, 1955. As a consequence, a black market came into being. Today (July, 1958), the official rate

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(1) McLeod, op.cit., p.2.

of the dollar is S.R. 3.17, while its black market rate falls within the range of S.R. 5.11 and S.R. 6.00; that is, with an approximate difference of 2 riyals or 53% over the official price.

Furthermore, the Agency was partly able to prevent any fall in the value of the silver riyal because of the Stabilization Agreement held with the U.S. Under that Agreement, a fund of nearly U.S.$ 5,000,000, derived from the receipts of Lend-Lease silver supplied during World War II to provide Saudi Arabian silver currency against payment in dollars, was available for the purchase of riyals at the equivalent of a silver price of $ 0.75 per fine ounce.(1)

In June 1958, royal decree No. 40 of 7.11.1377 (6.6.1958)(2) was passed as a further measure to stabilize the Saudi currency which has been considerably depreciating due to the increased demand for foreign exchange, the black market and the Government's excessive expenditure. The Agency, as stipulated in article 3, was authorised to buy and/or sell gold or foreign exchange for the purpose of stabilizing the Saudi currency. Such an act, article 3 added, must be undertaken in accordance with the terms

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(1) Young, op.cit., p. 543.

(2) Um-Al-Qura, Vol. 35, No 1720, 19.11.1377 (6.6.1958), p.4.

and conditions laid down by the Minister of Finance and National Economy.

With this new measure for stabilizing the currency, the Agency, it is hoped, will be successful through its intervention in the market, in establishing one sole rate of exchange and to gradually check the prevailing high black market rate. This, however, will be thoroughly discussed in the next chapter.

3. Regulation of Commercial Banks and Money Dealers

The first step taken by the Agency in regulating banks and money dealers was that all operating banks in Saudi Arabia were requested to register with the Agency.

Having completed the registration of all banks, the Agency, in its Communique No 2 of October 22nd, requested all registered banks to submit monthly reports, giving the following information regarding their activities, as from September, 1952:

a. Foreign currencies which the bank has either bought or sold during the month, and, for British sovereigns, the opening balance in that currency, purchases, sales, and closing balance.

b. Documentary letters of credit issued during the month, classified by term (30 days, 60 days, 90 days, etc.).

c. Documentary letters of credit repaid.

d. Documentary letters of credit lapsed or cancelled.

e. Bills for collection negotiated and settled.

f. Monthly statement of account (Balance sheet).

Meanwhile, money dealers were requested to submit the following information:

(i) Addresses of principal and branch offices.

(ii) Capital employed.

(iii) Approximate annual volume of business.

These statements were only designed for research purposes, especially for the compilation of monetary and banking statistics, to help the Agency in formulating its policies. The relation between the Agency and commercial banks had been somewhat narrow in range, being mainly concerned with purchases and sales of foreign exchange against riyals.

With the introduction of the foreign exchange control, the Agency requested all banks to submit a fortnightly statement showing the amounts transferred, names and purposes of transferers, and currencies through which the transfer was effected. Banks, at this time, were permitted to set aside 5% of the amount of foreign exchange purchased from the Agency for the purpose of personal transfers. The remaining 95% were exclusively designed for trade; that is to say, the opening of letters of credit and settlement of bills for collection. Trade operations were submitted in monthly, detailed statements, showing the names of the negotiators of letters of credit, duration, kind of commodity, name of foreign exporter, and the amount of the letter of credit. The same information was submitted by banks in monthly reports, regarding repaid letters of credit as well as settled bills for collection.

From these statements, the Agency was able to see how banks used to dispose of foreign exchange sold to them in the manner outlined above. Unfortunately, the Agency's supervision of banks was ineffective, due to shortage of well-trained staff.

With the increased applications of foreign banks to open branches in Saudi Arabia, the Minister of Finance and National Economy, in his letter No 7950 of 18/7/55, addressed to the Agency, ordered that the following measures be taken in organizing and regulating the opening of new banks in Saudi Arabia:

a. Banks applying to establish branches in the Kingdom must submit an application to the Agency.

b. The application must be referred to the Minister, together with a statement of the Agency's views.

c. Before giving official approval, the Agency must be sure that the authorized officers of the bank have duly signed the "Bank Guarantee."

It is worth repeating that there is no bank legislation to regulate banks' operations and functions. The "Bank Guarantee" was no more than a temporary arrangement for the regulation of opening new branches. The items included in the "Bank Guarantee" were the following: (1)

a. All importations undertaken by your branch should be subject to the official tariff system, other Governmental taxes, fees and costs, as at present stipulated and as will be stipulated in future.

b. Your branch should abide by the Zakat and Income Tax Regulations, and in every case, including their application to your foreign employees, and the stamp regulations on all payments.

c. Your branch should be subject to local jurisdiction and to all current regulations and instructions, including that which is going to be provided or modified later.

d. All disputes or problems of all kinds, arising between your branch and individuals - official departments included - inside this kingdom should be presented to the responsible and authorized Saudi departments, each within its Governmental specialization. These depart-

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(1) Addressed to the Headquarters of the bank requesting the establishment of a branch in Saudi Arabia.

ments are the final reference and place where an administrative, judicial and economic solution could be reached.

e. The Bank should submit a material or nominal guarantee to convince responsible authorities in the Ministry of Finance of the nature of the work, and of all other branches to be established due to expansion; with the proviso that this guarantee will remain in effect as long as your branch is functioning in this kingdom.

f. Your branch should not employ other than Saudi subjects; but in case of difficulty in securing such, after advertising for the vacant posts in local papers, the branch, limited by its need, is permitted to recruit from outside. Those recruited must fulfil the conditions of entrance into this kingdom and residence in it, in accordance with the special regulations governing the latter.

g. In all its transactions, the branch should not deviate from the Islamic Code. In case the Government understands that something of this sort is undertaken, it will, in the first instance, warn the branch. The Government then will have the full right to undertake all measures that will put a stop to such transactions.

h. Your branch should be prepared to extend to the Saudi Government the same treatment given by your headquarters, or by any other branch, in matters of priority in transactions and special facilities.

4. <u>The Agency as the Fiscal Agent of the Government</u>

As noted previously, the second function of the Agency was to act as a fiscal agent to the Government. The Agency, indeed, acted as a depository for all revenues, including receipts from concessionaire companies, from customs, from the Hajj, and from other sources. Furthermore, the Agency acted as an agent for the Government in paying out funds for purposes approved by the Minister of Finance.

In addition, the Agency undertook the negotiation of foreign and domestic public debts, on behalf of the Ministry of Finance.

Until the end of 1954, the date when the new Minister of Finance, Sheikh Mohammed Surour As-Sabban, was appointed by the King, the Agency's fiscal function went beyond the mere centralization of Government receipts and expenditures and assisting in their control.

"The Agency has saved the Government substantial sums of money in various operations, including measures to meet governmental financial needs when they have temporarily exceeded the immediately available resources."(1) The Agency's advice was also sought by the Government in dealing with contractors and concessionaires, and it assisted the Government in arranging its expentiture on a basis consonant with anticipated revenues.

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(1) McLeod, *op.cit.*, p. 8.

With the appointment of the new Minister, the aforesaid fiscal functions were merely reduced to the centralization of revenues and expenditures. The Agency, as we shall see later, lost its independence and became a tool in the hands of the Minister. In order to ensure entire control of the Agency, the Minister played a considerable role in amending the Agency's Charter. As a result, the Royal Decree No 17/9/8762 of May 30th, 1955, came into existence. This, however, will be discussed later. The Agency, managed by one of the Minister's closest men, the Vice-Governor, was in no position to object to the terribly increasing expenditure of the Government or even to warn the Minister of the inevitably disturbing results of such an excessive increase.

Though the Minister of Finance drew up a budget for the year 1374 (1955), that budget was never adhered to and expenditure was allowed to exceed revenues.

In November, 1957, the third amendment of the Agency's Charter came to the force and the Agency again asserted its independence and ceased to be a tool in the hands of the Minister.

## II. Commercial Banking

The period after the establishment of the Agency was characterized by an expansion of commercial banking and the establishment of national banks and branches of foreign banks. Two reasons account for that expansion. The first was the growing need for banking facilities in the expanding Saudi economy, especially for financing foreign trade. The volume of foreign trade was swelling rapidly, due to the increase in population that was caused by the large-scale immigration of Arabs from neighbouring countries, especially Yemen and Hadramaut. Secondly, the incredibly high rate of profits rendered by the banking business attracted foreign banks and encouraged the emergence of national banks.

In the course of his work with the Saudi Arabian Monetary Agency for three years, the writer had the opportunity of studying monthly reports of banks submitted to the Agency. The profits stated in bank statements were incredibly large. For instance, the profits realized by the Cairo Bank in 1956 amounted around S.R. 5,000,000 and that of the National Commercial Bank to more than 10,000,000 riyals. The profits included the following items:-

1. Difference in exchange.
2. Commission (including interest).
3. Profits realized from trade transactions.

In the first item, illegal operations by the banks in selling foreign exchange at the black market rate are included.

Table VII below shows national as well as foreign banks that were established after the opening of the Saudi Arabian Monetary Agency:

TABLE VII

COMMERCIAL BANKS OPENED AFTER OCTOBER, 1952

| Name | Nationality | Date of Establishment | Capital | Location |
|---|---|---|---|---|
| Cairo Bank | Egyptian | July, 1954 | 100,000 L.E. | Jeddah |
| Lebanon & Overseas Bank | Lebanese | Feb., 1955 | 500,000 L.L. | Jeddah |
| Misr Bank | Egyptian | July, 1956 | 2,000,000 S.R. | Jeddah |
| The First National City Bank of New York | American | Jan., 1956 | .... | Jeddah |
| Riyad Bank | Saudi Arabian | July, 1957 | 50,000,000 S.R. | Jeddah |
| National Bank | " " | Jan., 1958 | 10,000,000 S.R. | Jeddah |

(Source: Saudi Arabian Monetary Agency files.)

It is worth noting that most of the operating banks have branches in important towns of the kingdom, namely in Dammam and Khober in the Eastern Province and Riyad in the Najd.

The commercial banking functions cited in the first chapter were still undertaken by the operating banks after the establishment of the Agency. But due to financial and rate of exchange stability, deposit banking has materially expanded and thus enabled banks to serve the business community increasingly well to the benefit of both.

With regard to credits and loans, banks are still prohibited from charging any interest for reasons already discussed. Despite that, there are indications that banks are granting credits of a considerable size and charging interest in the form of commission.

In recent years, the two large national banks, the National Commercial Bank and the Riyad Bank, have indulged in contracting business and the construction of huge buildings for sale or rent as might be found more profitable.

Other kinds of banking, namely investment, agricultural, industrial, savings, are still non-existent. Also, the function of discounting commercial bills of exchange is not undertaken by operating banks, as such bills are not dealt with on the local market.

## III. Exchange Control

Prior to April, 1956, there was practically no foreign exchange control. The operations of banks as well as of money dealers in foreign exchange were left undisturbed. Exceptions were made for the import and export of foreign coins and bank notes, which were subject to prior licence from the Agency. As has been already stated, imports and exports of Saudi Arabian sovereigns and silver riyals were strictly prohibited, except for small quantities of silver coin in border traffic.[1] Thus, utilization of foreign exchange in personal transfers and other trade uses (Documentary Credits and Bills for collection) was left free without any intervention by the Government. Pilgrims, too, were free to bring unlimited amounts in any form of currency. The Agency, for the convenience of pilgrims concerned, used to send pilgrim Receipts to the Central Banks of Pakistan, Egypt, and Iran, which in turn were to supply their pilgrims with them. Pilgrims of these countries were prohibited from bringing with them any foreign currency, as they were carrying Saudi Pilgrim Receipts. This measure is resorted to yearly by the Agency.

A. <u>The Royal Decree No 17/1/3/1387</u>

On the 30th of Sha'ban, 1374 (23.4.1955), the Royal Decree No 17/1/3/1387 was passed ordaining the non-exportation of funds from the Kingdom, except for the purpose of trade and the importation of goods and requiring the return of funds invested abroad.[2]

The Decree requested the Prime Minister (Prince Faisal), to carry out the Royal order and to take all measures necessary for its execution.

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(1) International Monetary Fund, <u>Sixth Annual Report on Exchange Restrictions</u>, 1955, p. 381.

(2) <u>Um-Al-Qura</u>, Vol. 37, No 1563, 6.9.1374 (29.4.1955), p. 2.

The reasons given by the Decree were that, "contrary to public interest, people have gone too far in taking the country's funds and wealth for investment abroad. These people have no conscience and lack self-confidence." "As all know", the Royal Decree adds," we are opening the doors of our country for the development of national wealth in constructional projects and factories and are rendering help and facilities in customs and other things. We are doing all that to promote and raise the standard of the country and to develop the wealth of its citizens. That being the case, we cannot allow the flight of considerable funds from the country for investment abroad, because such a movement indicates lack of confidence in oneself and in the Government."

Thus the Royal Decree recognized the existence of a capital flight from the kingdom. At this stage of the present enquiry, no attempt at the evaluation of the above-mentioned reasons will be made. Much will be said, however, in the next chapter. Attention will be focussed here only on the measures taken to put the Royal Decree into effect.

At the request of the Minister of Finance and National Economy, the Agency in its letter No 3/2857/155B of 14/9/1374 (7.5.1955), requested banks not to use more than 15% of all foreign exchange sold to them by the Agency for personal transfers, such as supporting families abroad, medical treatment, tourism and travel. A week later, the percentage allowed was changed from 15% to 5% in accordance with the Agency's letter No. 3/5471/155B of 25/9/1374 (18.5.1955). The remaining percentage (95%) was to be used for purposes of trade and importation of goods only. In the same letter, the Agency requested banks to submit a fortnightly statement showing the amounts transferred, purposes, names of transferers, and kind of foreign currency used.

Furthermore, the Agency in its letter No 4/563/45B of 16/2/1375, held all banks responsible for any violation of the above-mentioned regulations and announced that, in the case of discovery of any violation, the Agency would not hesitate to take the necessary corrective measures. Among these was the threat that the Agency would stop selling foreign exchange to the violating bank or suspend its operations.

Due to the increased demand for foreign exchange and the banks' fear of exceeding the permitted 5% for personal transfers, the Minister of Finance authorized the Agency to issue transfer licences on banks. The Agency's transfer licences, together with the 5% disposed of by the banks, formed the only official sources for personal transfers.

It is worth noting that neither the Ministry of Finance nor the Agency cared to take any effective measures to control the ways the banks used to dispose of foreign exchange alloted to them. All detailed, fortnightly and monthly statements of banks used to find their way to the files with no action taken on them whatsoever. This naturally encouraged banks to violate the foreign exchange regulations and to take effective part in the growing black market.

As there was no definite regulation to govern the transfer of funds, confusion took place and the way was open for high officials to seize the opportunity for their own personal benefit.

B. <u>Import Restriction</u>

In November, 1956, after the Suez Crisis, the Ministry of Finance in its letter No 3990/2 of 28/3/1376, addressed to the Agency, prohibited the transfer of any funds abroad, either for trade or personal purposes. This, however, was taken as an emergency measure. The Ministry also forbade the importation of goods except under a licence to be given by the Ministry to merchants. With regard to personal transfers, the Agency was authorized by the minister to grant the licences to applicants.

Again, there was no definite regulation to govern either Import Licences or Personal Transfer Licences. All of that was left entirely to the judgment of the officers of the ministry and the Agency.

In December, 1956, import licences were no longer required for most commodities. Then the import restriction was restored, and the Royal Decree No 30/3/3/2392 of 24/11/1376 (May, 1957), put this into effect. The reason for that was the shortage of foreign exchange and the Government's interest in rationing available exchange for legitimate purposes.

As a consequence, the Government formed Import Committees in all important centres of the kingdom. The function of these committees was not more than the granting of licences to merchants.

With the coming of Prince Faisal into power early in March 1958, drastic changes in administration, political organisation and financial matters were introduced. In the financial field, many measures were undertaken. Some of these measures were those introduced by the Royal Decree No. 39 of 7/11/1377 (20/5/1958),[1] ordering the abolition of the import committees and their replacement with import offices. The function of the import offices as stipulated in article 3 of the decree was the following:

> "The function of the import offices is to issue the necessary licences to enable commercial banks to open letters of credits or to accept bills for

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(1) Um-Al-Qura, Vol. 35, No 1720, 19/11/1377 (6/6/1958).

> collection, for articles mentioned in Article 4 of this regulation at the official rates of exchanges.

In addtion, article 1, stipulated that import offices must be established in Jeddah, Riyad and Dammam under the supervision and control of the "General Director of Imports"; who must be appointed by the Prime Minister upon the nomination of the Minister of Finance and National Economy.

As far as their functions are concerned, Import Offices do not basically differ from the previous Import Committees.

The innovation introduced by the Royal Decree was the anticipated planning for the use of foreign exchange for trade and importation purposes. Article 4 of the Decree stipulates that:

> "The Ministry of Finance and National Economy, after consulting the Governor of the Saudi Arabian Monetary Agency undertakes to fix a minimum amount of Foreign Exchange necessary to meet the importation of all goods needed by the country such as food, clothing, medicaments and other articles mentioned below for every period of three months. The Import Offices

> must be notified in advance, before the first of Muharram, the first of Rabi II, and the first of Rajab, and the first of Shawwal, of the amounts of foreign exchange allocated for each period. The total amounts of foreign exchange must be distributed among the three Import Offices on the basis of official estimates (1) including the new requirements that arise in any of these provinces. The articles permitted are the following:
> Rice, cereals, sugar, flour, dukhun, maize, barely, lentils, kushari, beans, chick-beans, sesame, butter, tea, coffee, cardamom, harricot-beans, meat & sheep, vegetables, oils, dairy products, cloth used by masses, provided the price of which must not exceed 2 riyals a meter, medicaments, machinery, and agricultural and industrial machinery.

Contrary to the previous instructions, Saudi traders are allowed to import any articles not included in the list above provided that they manage, on their own responsibility, to secure the necessary foreign exchange. Hence, article 8 stipulates that:

> Other articles that are not prohibited and that are not mentioned in this regulation,

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(1) Article 9 stipulated the Import Offices will issue licences on the basis of traders' yearly average importation out of the last three years.

are to be freely imported without any licence, provided that the Agency is not obliged to secure foreign exchange to cover surch articles."

C. <u>Personal Transfers</u>

With regard to personal transfers, the Minister of Finance in his letter No 1257/2 of 14/6/1376 (1957,) issued the following instructions:

1. Non-Saudis are allowed to transfer without the permission of the Agency their earnings in the Kingdom, whether they are employees, owners of capital invested in the Kingdom or professional workers having shops of their own, in accordance with the following terms and conditions:-

a. <u>Employees</u>

Employees were authorized to remit not more than 70% of their net monthly earnings, provided they obtained a certificate from the Income and Zakat Department showing their incomes and certifying that they had paid their taxes.

b. <u>Professional Workers</u>

Professional workers were allowed to transfer not more than 70% of their net monthly income, provided they obtained a certificate from the Income and Zakat Department, showing their incomes

c. <u>Foreign Owners of Capital</u>

These were permitted to transfer all their net profits, provided that the amount of the yearly profits remitted did not exceed 15% of the woring capital and provided they presented to the bank a certificate from the Income and Zakat Department.

2. The Saudis

Saudi Arabians are allowed to remit without permission from the Agency any amount they need in accordance with the following terms and conditions:

a. For purposes of tourism or medical treatment, Saudis are allowed to transfer an amount of not more than 10,000 Saudi riyals per annum, provided they present to banks certificates confirming that they have paid the Zakat or Jehad tax.

b. For purposes of supporting Saudi families dwelling abroad or for educational purposes, Saudis are permitted to transfer not more than 2,000 S.R. per month, after payment of the Zakat and Jehad tax.

3. For amounts exceeding the aforesaid limits, applicants must obtain a licence from the Agency.

Finally, a regulation governing personal transfers was introduced. Yet, the regulation was incomplete and suffered many defects, the most important of which was that it gave banks their freedom to deal direct with the public. Banks, lacking an effective control from the Agency, indulged in black market exchange operations. In addition, the amounts allowed for Saudis were rather big; and Saudis who had never transferred any amounts abroad started taking transfers and selling them in the black market.

D. The Establishment of Foreign Exchange Control Dept.

Upon realizing the incompleteness and inadequacy of the promulgated foreign exchange instructions, the Minister of Finance thought of establishing a Department for Exchange Control. The Royal Decree No 30/4/1/2552 of 18/12/1376 on Foreign Exchange was passed and as a consequence a Foreign Exchange Control Department was established in July, 1957.

The Decree made many changes in the instructions cited above, and added many new articles.

In Article 4, for instance, banks were requested to supply the Foreign Exchange Comptroller with daily statements of foreign exchange received by them from the Agency or from other sources and the funds transferred abroad. The decree, in Article 7, prohibited the importation of Saudi currency (silver or gold or pilgrim receipts), except with the permission of the Minister of Finance. Passengers coming into the Kingdom or leaving it are allowed to take Saudi paper currency with an amount not exceeding 500 Saudi riyals.

The decree also made it clear that transfers of foreign exchange must be undertaken through registered banks and at the official rate. Thus, money dealers have been legally prevented from dealing in foreign exchange operations.

Article 9, however, gave a detailed list of amounts allowed for the Saudis and for foreigners in the Kingdom. The permitted amounts for the Saudis are as follows:-

1. 3,000 S.R. annually for each individual leaving the Kingdom for purposes of tourism, commercial business and medical treatment, provided that applicants submit certificates clarifying their purpose in travelling.

2. 6,000 S.R. per annum for students studying in Arab or Eastern countries and not more than 12,000 S.R. for students studying in Europe or America.

3. 500 S.R. monthly for supporting relatives dwelling abroad.

4. 2,000 S.R. monthly for supporting families abroad or 50% of the salary if the Saudi is an employee.

Transfers are not permitted except upon the presentation of authentical documents convincing the Exchange Control Department of the legality of the transfer.

With regard to foreign residents, the following amounts were permitted:

1. <u>For Employees</u>

50% of the salary per month if the employee's family is in the Kingdom, or 70% if the family is dwelling outside the Kingdom. In addition, the employees are allowed to transfer in full their salary during their leaves.

2. For Professional Free Workers

50% monthly of their net income. Agents of foreign transport companies are permitted to transfer the net value of tickets sold in the Kingdom after paying all due taxes.

Foreign owners of capital invested in the Kingdom will be treated in accordance with the articles of the regulation governing investment of foreign capital approved by Royal Decree No 21/1/2325 of 20/9/1376, (April, 1957.)

One of the most important innovations of the Royal Decree was that it established the "Foreign Exchange Control Committee." The functions entrusted to the Committee were the following:

1. Giving advice on subjects referred to it by the Comptroller.

2. Making the necessary recommendations for issuing instructions in accordance with the decree.

3. Making recommendations for executing penalties as provided for in the decree.

4. Making recommendations for amending or cancelling Foreign Exchange Control Regulations.

All these recommendations must be referred to the Minister of Finance for approval, exception made for the 4th function, which must be approved by the Council of Ministers.

The Committee is formed of seven members. A representative is appointed by the Council of Ministers. The Foreign Exchange Comptroller sits ex officio. Then there is a representative from each of the following Departments: the Ministry of Commerce, General Directorate of Economic Affairs, the General Directorate of Customs, the Agency, and a Legal Expert appointed by the Minister of Finance and National Economy.

Hence, with the enforcement of the Royal Decree, the utilization of foreign exchange was regularized and the prevailing confusion was nearly brought to an end.

It is worth noting that there was never a measure in the whole history of Saudi Arabia as disturbing as the enforcement of foreign exchange control in April, 1955. It produced serious repercussions on the internal monetary and economic system. The Agency, as a consequence, was unable to check the growing activities of the black market, or to maintain a unified exchange rate for the riyal. Incidentally, the black market rate of the U.S.$ was 4 riyals in 1955, 5 riyals in 1956 and around 6 riyals in 1957.

In addition, with the imposition of the foreign exchange control, there emerged a serious capital flight, especially by the princes and merchants. This capital flight represented an increased demand for foreign exchange, thus inducing a considerable rise in the riyal's rate of exchange in terms of foreign currencies.

The Exchange Control was also detrimental to trade. Merchants no longer able to obtain the desired foreign exchange at official prices, resorted to the black market, thus compensating for the difference in the form of higher prices.

E. Abolition of Foreign Exchange Department

Recently (June 1958) the above mentioned instructions and regulations were amended and the Royal Decree No. 40 of 7/11/1377[1] (20/5/1958) sanctioned the abolition of the Foreign Exchange Department and entrusted the function of controlling Foreign Exchange again to the Agency.

Foreign Exchange, it was stipulated, will be allocated into the following

a. To settle the import of articles mentioned under Article 4 of the Royal Decree No. 39 of 7/11/1377 (Import Regulation).

b. To cover the transfers of non-Saudi employees in accordance with the prevailing regulations

(1) Um-Al-Qura, Vol. 35, No. 1720,19/11/1377 (6/6/1958),p.4.

and instructions.

c. To meet Government transfers abroad, provided such transfers must be within the allocated funds permitted by the budget.

For other uses, however, Article 2 of the Decree stipulated that "the values of all goods and services and other transfers contrary to what stipulated in Article 4 , are to be settled through the free market without any licence".

Following the policy of rationing foreign exchange for duly approved ends Article 6 of the Decree stipulates that:

> "before the start of every quarter of the year, the Minister of Finance after consulting the Governor of the Monetary Agency and the General Director of Imports is to fix the amount of foreign exchange assigned to the importation of goods and personal transfers for non-Saudi Government employees, and to advise all concerned departments of that."

Thus, the Royal Decree recognised the operations of the black market; and held the Government irresponsible for supplying it with foreign exchange to cover transactions not permitted by her.

Further investigation of the effects of the exchange control on the monetary system will be postponed to the next chapter.

## IV. Amendment of the Agency's by-laws and Charter

With the appointment of Sheikh Mohammed Surour AS-Sabban as Minister of Finance and National Economy at the beginning of the year 1374 (1955), changes in the financial and monetary field were introduced. These changes, pertaining to the monetary field, were the introduction of Exchange Control in April, 1955, and the amendment of the Agency's by-laws and Charter. In the previous pages the former was discussed. Now the amendment of the Agency's Charter will be surveyed.

Prior to this, however, the reasons calling for the amendment will be reviewed. One of the reasons for the amendment was that the Minister wanted to assume entire control and supervision of the Agency and to ensure that it carried out policies drawn up by himself. The second was that the popularity gained by the circulation of pilgrim receipts and their welcome by the public made the issue of paper currency feasable. High officials in the Ministry have by now been convinced of the importance of replacing pilgrim receipts by genuine paper currency. Thus the Charter of the Agency, that prevented it from issuing paper currency, had to be amended.

### A. The Royal Decree No. 17/9/8762

The Royal Decree No. 17/9/8762 of 8/10/1374 (30.5.1955), came into existence, confirming the Minister's entire control of the Agency and entrusting the Agency with the function of issuing paper currency.

1. <u>Amendment of Functions</u>

The following item was added to Article 4 of the Charter of the Agency:

> "....to issue currency notes after the approval of the Council of Ministers and after the issue of a Royal Decree authorizing the issuance of notes in accordance with the regulations to be stipulated thereafter."

2. <u>Amendment of Organization and Administration</u>

Article 2 of the decree under discussion added the following amendments to Article 8 of the Agency's Charter.

a. The President of the Board of Directors will undertake the representation of the Agency in relations with other persons, including representation through counsel; will be responsible for convening the meetings of the council and will supervise the execution of the Board's decisions. In the event of the absence of the President or his incapacity, for any reason, the Vice-President shall act on his behalf.

b. The President, within the limits of the Agency's Charter and the Board's decisions, will have full right to undertake all necessary measures to carry out the objects and functions of the Agency. He is also given full authority to use the Agency's funds to meet expenses required for its administration and the expenses that the execution of such functions and objects might require. The President can delegate the Vice-President to act on his behalf on all or some of his duties.

c. Without prejudice to the above-mentioned, the Governor is entrusted only with administering and controlling the internal operations of the Agency and the control and regulation of employees.

Thus the Minister of Finance, being ex officio President of the Board of Directors, assumed full control of the Agency's operations and functions. The Governor, on the other hand, became in charge of internal administration, having no effective part in drawing up the policies of the Agency.

Article 4 of the Decree stipulated that the appointment, promotion and termination of services of the Agency's employees will be by the Minister of Finance and National Economy. Junior clerks, as well as servants, will be appointed or have their period of service terminated, by the Governor.

Furthermore, Article 3 of the Royal Decree replaced Article 10 of the Agency's Charter. It reads as under:

"The Board of Directors shall be formed from -

1. The President. (The Minister of Finance.)
2. The Vice-President.
3. The Governor.
4. The Deputy Minister of Commerce.
5. The President of Jeddah's Chamber of Commerce.
6. A Saudi merchant of repute to be nominated by the Minister of Finance for one year."

It is interesting to note that no meeting of the Board of Directors was ever held and the Agency's policies were exclusively formulated by the Minister of Finance and National Economy. The Agency ceased to participate in the formulation of financial and monetary policy and became an ordinary department of the Ministry, wholly occupied with the centralization of Government receipts and expenditures, and the supervision and management of the printing of pilgrim receipts to meet increasing Government expenditure.

In the fall of 1957 things became worse and the severity of the crisis was increasingly realized by the Government. Some of the characteristics of the crisis were the shortage in foreign exchange, inflation, the depreciation in the value of the riyal, and the growing public expenditure on conspicous consumption. All of these had serious implications for the Saudi economy and an immediate solution became imperative.

At the King's special request, Dr A.Z.Sa'd, the Governor of the National Bank of Egypt, was invited to study the situation and to give his recommendations. As Dr Sa'd's report and recommendations were not released it is very difficult to make even a fair guess at their purport. However, one of the outcomes of Dr Sa'd's recommendations was the Amendment of the Agency's by-laws and Charter, and the sanctioning of the "Saudi Arabian Coin" regulation No 24 of Jamad 23, 1277 (November, 1957). In view of the fact that the regulation was not published in the official Gazette, Um-Al-Qura, it is not possible to say anything about it. The Arab Press, however, published an announcement that the Saudi Arabian Government would shortly be issuing a paper note, the "Saudi Dinar"; but unfortunately no detailed information is available at present. In fact, the Agency has not printed any of these Saudi Arabian Dinars yet and they are not expected to circulate shortly.

The reason for this amendment was the desire to put an end to the Minister's control of the Agency and to restore the latter's earlier independence. A further reason was that, by this time, the need for an effective control of banks and the control of expanding credit as a check on inflation became an immediate necessity.

B. <u>The Royal Decree No. 23</u>

Hence, the Royal Decree sanctioned the Charter of the Saudi Arabian Monetary Agency by Regulation No. 23 of Jamad 23, 1377 (November, 1957).

1. <u>Amendment of Functions</u>

The new objects of the Agency, as stipulated by the above-mentioned regulation in Article One, will be as follows:

a. To issue and stabilize the Saudi Arabian currency and to maintain its internal and external value.

b. To act as the Government bank.

c. To regulate commercial banks and exchange dealers.

Article 3, however, gave a list of the functions to be undertaken by the Agency. There has been no change in the functions, except the cancellation of items (c) and (d) of Article 4 of the Charter (see p. 42 and their replacement by item (c) that reads as follows:

"To mint, print and issue Saudi currency
and other related matters in accordance

> with the Saudi Arabian Currency Regulation No. 24 of 23 Jamad, 1377."

Furthermore, Article 3 added the following function to the previous functions of the Agency:

> "To request commercial banks to keep with the Agency a stable balance in a certain ratio of their deposits. The Agency will fix this ratio from time to time when circumstances change, in accordance with a decision by the Minister of Finance at the request of the Agency. Every bank must carry out strictly all instructions given in this respect."

Undoubtedly, such a function gives the Agency an effective tool to carry out assigned monetary policies. The importance of the reserve ratio for a banking system like that of Saudi Arabia needs no comment. Besides its ability to contract or expand the volume of credits, the Agency will be able to strengthen the currency's cover with the amounts deposited with it.

As the above regulation has only recently been enforced, it is too early to form any judgment as to the steps and measures to be undertaken by the Agency for its execution. For instance, the new Saudi currency has not yet been printed and the percentage reserve requirement not fixed. It is unofficially reported that it will be somewhere around 10% of banks' deposits.[1]

2. Amendment of Capital

Article 2 of the regulation stipulates that the Agency is not allowed to have any capital. The Agency's present capital must be returned to the Ministry of Finance.

It is very difficult to give a satisfactory explanation of this. Central banks cannot operate without capital. Hence, it is very difficult to see how the Agency will be able to undertake its function of stabilizing the currency.

3. Amendment of Organization & Administration

The most important change caused by the aforesaid regulation was that the Minister of Finance ceased to be ex officio the President of the Board of Directors. Article 9 of the regulation states that "The Board of Directors shall comprise:

a. The President. (The Governor.)

b. The Vice-Governor; and 3 other members,

to be individuals possessing a wide experience in commercial and financial affairs, provided that they are not Government employees."

At the request of the Minister of Finance, the Governor will be appointed by a Royal Decree for five years.

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(1) Interview, Assistant Manager of the Riyad Bank of Khobar, March, 1958.

Moreover, the Governor was entrusted with new duties and functions. Article 10 of the regulation stipulated that the Governor is responsible for running the Agency and representing it in legal matters, and appointing a Vice-Governor through a Royal Decree.

Undoubtedly, the new regulation is to be considered as a wise step on the part of the Government. The Agency, being the Central Bank of Saudi Arabia, must not be dominated and controlled by the Government. May be, Saudi Arabia's tragic experience furnishes us with a proof that under no circumstances must central banks be totally controlled and supervised by the Government.

# CHAPTER THREE

## EVALUATION

The previous two chapters discussed in detail the historical development, and described the functioning of the Saudi Arabian Monetary System. In this chapter, attention will be centered on an analysis and evaluation of the system.

As previously stated, the Saudi Arabian Monetary Agency rendered useful services in the monetary field. The functions which it undertook and the operations which it performed marked a sound step forward in the monetary development and progress of Saudi Arabia.

But was the Agency successful in performing the functions entrusted to it? The present discussion will be an attempt to answer this question, although it must be admitted at the very outset that to do so involves great difficulties. One difficulty is the impracticability of laying down a standard by which the Agency's operations could be judged. There is no universally accepted criterion, unfortunately, for central banking functions. Standards are bound to differ from one country to another. Therefore, the operations of the Agency will be valued on a strictly legalistic basis, i.e., whether the Agency succeeded in achieving the objectives laid down in its charter and by-laws.

## I. The Monetary Standard

### A. Bimetallism

In an attempt to stablize the internal and external value of the Saudi riyal, the Agency in 1952 issued the Saudi sovereign. This issue of the Saudi sovereign with a fixed rate of exchange vis-a-vis the silver riyal legalized the bimetallic standard.

It has been shown previously that the introduction of the Saudi sovereign was intended to serve as an initial step towards the improvement of the monetary system and the stabilization of the exchange value of the Saudi riyal. It is worth noting, however, that the standard that operated in Saudi Arabia was not the bimetallic standard proper. The main limitations on the functioning of the standard were the following:

1. Exports and imports of Saudi silver riyals were prohibited.

2. There was practically no mint to permit free and unlimited melting of gold and silver coins.

3. The gold sovereign was linked to the riyal with certain reservations. That is to say, the Saudi sovereign was not defined in terms of grains of pure silver and no cross rate was established on that basis. In addition, the sovereign was intended simply to establish a rate of exchange between the U.S.$ and the riyal.

4. The fixed ratio of the sovereign in terms of the riyal was maintained through the intervention of the Saudi Arabian Monetary Agency. Indeed, with the means of stabilizing the riyal exchange value discussed previously, the Agency intervened to keep the specified ratio whenever circumstances called for such action.

In view of these limitations, the standard could hardly be described as bimetallic. It should be remembered, however, that this semi-bimetallic national system represented a natural development in the monetary history of Saudi Arabia. Prior to the introduction of the Saudi sovereign, the silver standard was in operation. Compared with such a mono-metallic system, the bimetallic standard had the following advantages:

1. It provided convenient, full-bodied coins for both large and small payments.

2. It tended to stabilize exchange rates of the Saudi riyal with other foreign currencies.

3. Generally speaking, it tended "to provide a standard money with more stable purchasing power than would result from the use of a mono-metallic standard."(1) This conclusion is usually defended on the ground that,

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(1) Chandler, L.V., <u>The Economics of Money and Banking</u>, Harper & Bros, publishers, New York, 1953, p. 104.

under bimetallism, supply and demand conditions determine the values of the two metals. This, it is claimed, allows for less fluctuations in the supply of, and demand for, the two metals, in so far as such fluctuations tend to "average out."

Despite these advantages, the standard had many defects, the most important of which were the following:

1. Being largely dependent on full-bodied coins, the system was not able to survive any major change in the prices of gold and silver in international markets. In this condition one has only to recall the disturbing experiences which were encountered, namely the counterfeiting of the Saudi sovereign and the large-scale smuggling of the silver riyal.

2. It is commonly alleged by many critics that the bimetallic standard "proves to be, not double standards, but alternating gold and silver standards, with one metal driving the other out of circulation."[1] True enough, the experience of Saudi Arabia provides another proof of the validity of this criticism.

3. The inelasticity of the supply of gold and silver is the most serious drawback of bimetallism. The Agency could not adjust easily the monetary supply to the needs of trade as the ordering and minting of silver and gold coins take considerable time.

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(1) Ibid.

4. Saudi Arabia was probably the only country in the world that was on a bimetallic standard. In order to operate well, bimetallism must be adopted by several countries, because "a nation cannot hope to keep both metals in circulation if the relative value placed on them at the mint differs significantly from those fixed by the mints of other countries."(1)

B. The Paper Standard

In view of these difficulties, bimetallism broke down in Saudi Arabia. Realizing the problems arising from the failure of bimetallism, the Agency issued the pilgrim receipts, which are in effect "representative full-bodied money", or simple warehouse receipts for riyals. Apart from the previously discussed reasons for the introduction of pilgrim receipts, one important objective in issuing them was to accustom the Saudi public in using a national paper currency. Though the receipts were not to be considered as paper currency, for reasons already discussed, they marked a step towards preparing the Saudi public for the acceptance of such a currency.

The large success of the issue of the pilgrim receipts and the public's enthusiasm and readiness to to use them enabled the Ministry of Finance and the Saudi Arabian Monetary Agency to take the necessary

(1) Ibid.

steps for the issue of paper currency. "Indeed, the public treated the pilgrim receipt as if it were a currency note, which it was not, and did not purport to be; logically, therefore, it was highly desirable to protect the public by replacing the issue by a fully safeguarded currency." (1)

The steps that were taken to issue the paper currency were the following:

1. The Minister of Finance requested the Saudi Arabian Monetary Agency in 1953 to draw up a draft currency decree. Dr. A.N.McLeod, Director of the Economic Research Department, proceeded with the plan and completed the draft currency decree late in July, 1954. The draft decree was submitted to the Minister of Finance, but no action was taken until November, 1957, when the so-called "Saudi Arabian Coin" regulation was promulgated.

2. The Agency's charter was amended to permit the Agency to issue paper currency.

It should be recalled that the new Saudi Arabian Coin Regulation No. 24, that was published on Jamad 23, 1377 (November, 1957), established the paper standard with the "Saudi Dinar" as legal tender. Again, as this regulation was not published in the Official Gazette, Um-Al-Qura, it is very difficult, to say anything about

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(1) McLeod, op.cit., p. 5.

it, beyond the fact that, at present, the Saudi Dinar has not been printed and is not expected to circulate before the lapse of a considerable period of time.

It is worth noting that the silver riyal and the Saudi gold sovereign are no more in active circulation. These coins were withdrawn from circulation immediately after the troubles which developed with them. At present, the circulating media of exchange are the pilgrim receipts of various denominations.

With the new regulation and the issuance of paper currency, the defects of the bimetallic standard from which Saudi Arabia suffered considerably can be easily remedied. Apart from enabling the Government to control the monetary supply, the paper standard saves the Government the losses which it used to incur in face of major changes in the prices of gold and silver in international markets.

This type of gradual development to a paper standard is sound and seems adequate for the monetary conditions of Saudi Arabia.

## II. <u>Financial Objectives of the Agency</u>

### A. <u>Stabilization of the External and Internal Value of the Currency</u>

The most important objective of the Agency was the stablization of the external and internal value of the currency.

From 1952 to 1955 the Agency was successful in stabilizing the Saudi riyal rate of exchange in terms of three important foreign currencies, namely, the U.S. dollar, sterling and the French franc. The results of this stability were the encouragement of foreign trade and the expansion in deposit banking, which grew rapidly during this period.

With the introduction of the Royal Decree prohibiting the export of funds from Saudi Arabia in April 1955, the Agency failed to maitain the official rates of exchange. Hence, a black market developed and a black market rate was established at levels higher than the official ones. This, however, was discussed in the previous chapter.

### B. Reasons for the Inability of the Agency to Maintain the Official Rates

The reasons for the emergence of the black market and the inability of the Agency to maintain the official rate are not difficult to trace. The most important reasons were the following:

#### 1. Changes in the Price of Silver

The major changes in the prices of silver at the close of 1955 made it very difficult for the Agency to maintain the official exchange rate. It should be borne in mind that the official rate of the riyal was U.S.$ 0.27, while the riyal's bullion silver price was approximately

U.S.$ 0.31, a difference of 4 cents. Furthermore, and as pointed out in the second chapter, the Saudi Arabian deal with Mexico for minting 50,000,000 Saudi riyals was responsible for the further rise in the price of silver. The deal, by itself, was not a sound step. It was not dictated by any economic motive but rather was undertaken as a means of providing souvenirs of His Majesty King Saud. In the Royal Decree No. 30/4/1/967 of 15/6/1374 (February, 1955), authorizing the Minister of Finance and National Economy to mint the 50,000,000 Saudi riyals, the following reason was given:

> "The 50,000,000 Saudi riyals must be kept as cover for the circulating pilgrim receipts."

Moreover, the Minister of Finance and National Economy in a statement to the Press, declared that "the purpose of minting these riyals is to secure an additional quantity for circulation and to bear His Majesty's emblem."(1)

In fact, the riyals were put into circulation immediately after their arrival from Mexico.

2. Foreign Exchange Control

The Royal Decree prohibiting the transfer of Saudi funds abroad was largely responsible for the creation of a black market and the emergence of black

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(1) Al-Bilad-As-Saudiya, No. 1785, 5 Rajab, 1374 (27.2.1955), (daily newspaper).

market rates of exchange. With the increased demand for foreign exchange on the part of princes, merchants and foreigners, the Agency was in no position to maintain the official rate of exchange.

Before proceeding with the analysis of the disturbing effects of the imposition of foreign exchange control on the monetary system of Saudi Arabia and on the stability of its national currency, it may be advisable to question the validity of the reasons put forward by the Government to justify the imposition of this control.

The reasons given by the Royal Decree No.17/1/3/1387 of 30/8/1374 (April, 1955), were the following:

a. To stop the export of Saudi capital.

b. To encourage domestic investment, while discouraging investment abroad, for purposes of economic development.

As to the first, the export of Saudi capital is not bad _per se_. On the contrary, with the limited investment opportunities available in Saudi Arabia, investment abroad may be favourable. This limitation of the field for investment in Saudi Arabia is due, _inter alia_, to the lack of technological knowledge and to the high costs of production. Investment opportunities which are presently offered to Saudi investors are found largely within the trade and construction sectors, but due to the highly competitive nature of these sectors, profits are not large. Thus Saudi capital seeks more profitable investments abroad.

In addition, Saudi investors are showing no serious interest in industrial projects, despite the help and guidance that Aramco promises to give for such projects. It is not difficult to find the explanation for such an attitude. It is mainly due to the lack of technological progress and the absence of effective government protection of infant industries.

The encouragement of domestic investment and the discouragement of capital movement could be attained through more other effective ways than foreign exchange control. To name but a few, there are the following alternatives:

a. The protection of the local industries' products, either through prohibitive tariffs or by the limitation of the import of competing products.

b. The grant of Government subsidies for desirable projects.

c. The construction of roads to connect the various parts of the Kingdom so as to enlarge the local market.

With the measures described above the Ministry would have been able to cope with the situation without resorting to foreign exchange control, which, as declared by the Royal Decree, was not imposed to correct a disequilibrium in the Balance of Payments.

In addition, it may be said that the existence of a disequilibrium is not likely to justify by itself the imposition of foreign exchange control if other alternatives are helpful. With reference to Saudi Arabia such alternatives might be the restricting the import of certain commodities, especially those designed for conspicuous consumption and the limitation of government expenditure.

In fact, contrary to the aims of the Royal Decree, the flight of capital continued at an even higher rate than before. From the very outset, the machinery of control was defective and left many loopholes for princes, merchants and others to transfer abroad considerable amounts of foreign exchange.

The immediate effects of the imposition of the foreign exchange control were the following:

a. Black market rates were established at higher levels than the official ones. The reason for the emergence of such secondary rates were:

(i) the vast increase in the demand for foreign exchange caused by the fears of merchants and foreigners that things would get worse and that they could no longer use their funds abroad, either for personal or trade purposes.

(ii) the increased Government expenditure (including the construction of palaces and the extravagance of the Royal Court), which made the percentage of foreign exchange available to the private sector for meeting trade obligations smaller than before; merchants resorted to the black market in order to meet their obligations in full.

(iii) the increased political tension in the area, following the Suez Crisis, which made the spectre of a third world war loom nearer. Consequently, Saudi merchants caused heavy pressure on foreign exchange resources through their increased orders for importation of goods, in an attempt to accumulate more inventory for an anticipated emergency. In response to this, the Government was obliged to enforce import exchange control restrictions, in November, 1956, in addition to the foreign exchange control which has been in force since April, 1955, as noted above.

(iV) foreigners working in Saudi Arabia who had accumulated large sums of money were looking for foreign exchange in the black market, as foreign exchange regulations did not permit them to transfer except part of their monthly earnings rather than their accumulated funds.

It is worth noting that, while the demand increased considerably, the supply of such exchange was decreasing. The monthly earnings of Saudi Arabia, had become smaller than before, because an appreciable amount had to be deducted from these earnings as instalment payments on previous loans and interest payments on these loans. In addition, large amounts of foreign exchange were given as loans or, sometimes as grants, to other Arab countries, especially the Yemen and Syria. Similarly, during the Suez Crisis, Saudi Arabia gave Egypt dollars against a non-resident account opened in Egyptian pounds in favour of Saudi Arabia.

As a result of this the rate of exchange of the riyal depreciated considerably in the foreign exchange markets, such as in Beirut (see Table on the next page).

The table shows that the rate of exchange of the riyal in the Beirut money market depreciated from the middle of 1955 up to 1957, (the period in which the demand for foreign exchange increased considerably).

TABLE VIII

BEIRUT MARKET RATES FOR SAUDI RIYALS

(End of Month)

| | LP |
|---|---|
| **1953** | |
| January | 95 |
| June | 95 |
| December | ---- |
| **1954** | |
| January | ---- |
| June | 84 |
| December | 87 |
| **1955** | |
| January | 87 |
| June | 85.50 |
| December | 82.50 |
| **1956** | |
| January | 82.75 |
| June | 82.50 |
| December | 67.50 |
| **1957** | |
| January | 69 |
| June | 63 |
| December | 64.50 |

(Source: "Al-Hayat Newspaper", Beirut.)

The implementation of foreign exchange control was detrimental to foreign trade in Saudi Arabia. The Saudi Arabian economy, being entirely dependent on imports, suffered from the rise in the exchange rate and the day-to-day fluctuations in the black market rate.

In addition, the shortage of foreign exchange, caused by the factors discussed above, acted as an impediment to financing all imports desired by Saudi merchants and importers. The net result of this was a considerable rise in the prices of imported goods.

## III. The Inflationary Issue of Pilgrims' Receipts

### A. Factors Conducive to the Inflationary Issue

It was shown in Table VI above how the issue of pilgrim receipts increased in a remarkable way from 1955 to 1957. The amount of pilgrim receipts in circulation in 1955 was 264,000,000 Saudi riyals, while in 1957 it rose to 775,000,000. The reasons for this increase were summarized in the second chapter, but will now be investigated in greater detail.

#### 1. Deficit in the Budget

As there is virtually no published information regarding the Government Budget, it is difficult to hazard a guess at the exact magnitude of the deficit.

The deficit in the budget, caused by an excess of Government expenditure over revenue, must be accounted for by:

a. The extravagance of the Royal Court and expenditures on the construction of huge palaces in Jeddah and Riyad.

b. The increase in expenditure as a direct consequence of Saudi activities in political matters abroad.

c. The lack of an effective budget control to personal expenditures from exceeding allocated funds; side by side with this should be mentioned the corruption in the administration.

d. The undertaking of big projects by the Government, especially the project for the Holy Mosque in Mecca.(1)

The budget deficit was met by foreign loans, by the issue of pilgrim receipts and by internal loans.

In recent years, the Saudi Arabian Government has been borrowing from abroad on an extensive scale. Foreign creditors, naturally, have become progressively stricter in their terms and conditions, with the inevitable result that this source of revenue is diminishing. The Saudi Arabian Government is now faced with a huge accumulation of loans for redemption. No exact figures concerning these loans are at present available; but the total has been variously estimated between 300,000,000 dollars and 500,000,000 dollars.

To meet its increasing expenditure, the Government

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(1) The funds allotted for this project amounted to 500,000,000 riyals over a period of five years.

turned to the printing of pilgrim receipts. It should be recalled that, in 1956, 300,000,000 Saudi riyals were printed and in 1957, 200,000,000.

Finally, when the Government realized the bad implications of resorting to the printing press, they started borrowing from banks and wealthy merchants in Saudi Arabia.

2. The Shortage of Foreign Exchange

The reasons for the shortage of foreign exchange were the following:

a. The repayment of Government loans and the payment of interest on these loans.

b. The increase in Government purchases in foreign currencies.

c. The granting of loans and the increase in Saudi financial obligations towards other Arab countries, especially the Hashemite Kingdom of the Jordan.

d. The reduction in oil production resulting from the Suez crisis.

It should be recalled that Saudi Arabia, after cutting political relations with both Britain and France, cut off the flow of Saudi Oil through the pipeline to the Bahrein Refinary on November 6th, 1956 and was not resumed except in March 9th, 1956. Similarly the Saudi

Government banned British and French tankers from using Saudi ports.

Unfortunately, local public expenditure was not adjusted to the situation created by these increased loans and commitments but continued to rise. Hence, the Governments's only alternative was the renewed printing of pilgrim receipts.

### 3. The Disappearance of the Silver Riyal

The rise in the bullion silver price on the New York market has been discussed above. With the disappearance of the silver riyals and their large-scale smuggling, the need for printing more pilgrim receipts to replace them grew more pressing. Consequently, the one-riyal pilgrim receipt was printed to replace the disappearing silver riyal in 1956.

### 4. Pilgrims' Receipts Cover

As previously stated, the failure to adhere to the 100% cover was partly responsible for the increased amount of pilgrim receipts in circulation. In fact, it was shown in the previous chapter that the coins kept in the vaults of the Agency comprised approximately 24% only of the total pilgrim receipts in circulation.

It may be questioned whether the cover has any significant economic importance. The answer to that is briefly, that the currency cover has two important functions; it stimulates public confidence in the national currency and it acts as a limitation on the amount of money that can be issued by the monetary authorities.

Experience has shown that the maintenance of a currency cover in Saudi Arabia is vital, because the public has no confidence in the pilgrim receipts, due to their inflationary issue. Secondly, the cover should act as a check on excessive printing of receipts or paper currency. Therefore, it seems desirable that a 100% cover should be kept in gold, silver and foreign currencies, apart from the above-mentioned reasons, on the following grounds:

(i) The reserve thus constituted becomes an emergency source of foreign exchange, available for future use if economic misfortunes occur. For example, in the event of a reduction in oil royalties, such a reserve would be extremely useful. "Saudi Arabia's present prosperity is linked to the Government's royalties and tax revenues from the oil industry to an extent that is, perhaps, unrivalled anywhere else in the world ... Were anything to cut off or severely reduce in proportion the oil revenues, no other known resources of the country could

> provide the people with anything remotely approaching the current level of real income."[1]

However, it should be noted that a 100% cover, either for the pilgrim receipts or for the new Saudi currency, could not be maintained at present, owing to the shortage of foreign exchange and the depletion of the stocks of silver riyals and Saudi sovereigns kept as cover in the Agency's vaults. It has been reported unofficially that in recent months the Agency has been meeting the requirements of Government expenditure in silver riyals and Saudi sovereigns because there is a dearth of pilgrim receipts. It is clear, therefore, that the figures given previously for the riyal and sovereign cover, which amounted to 180,000,000, do not bear any relation to the correct figure at present, which is far less than 180,000,000 Saudi riyals.

The economic implications of this inflationary issue of pilgrim receipts were the following:

(i) There was a tremendous increase in monetary supply, for which there was no correspondingly proportional increase in the volume of trade, which was handicapped by the shortage of foreign exchange.

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(1) McLeod, <u>op.cit</u>., p. 8.

(ii) The resultant rise in prices affected adversely the purchasing power of the Saudi riyal.

In view of the difficulties surveyed above, the agency was unable efficiently to perform its function of stablizing the internal and external value of the Saudi riyal. The directors of the Agency, in fact, felt helpless to take any action in these matters since the factors involved were naturally beyond their control.

## IV. Recommendations for Stabilizing the Currency

The instability in the value of the Saudi riyal, it should be recalled, was due to the changes in the prices of silver on the international markets, the imposition of foreign exchange control and, lastly, the inflationary issue of the pilgrim receipts.

### A. Changes in Silver Prices

It is not proposed to discuss here the measures to control the fluctuations in the prices of silver on the international markets, for two cogent reasons. First, the Saudi Arabian Government can take no effective action to influence such fluctuations, since current silver prices on world markets are determined by world-wide conditions of supply and demand. Secondly, the Saudi Arabian Government is planning to print the new currency, the "Saudi Dinar", in which case discussion of changes in silver prices would become irrelevant.

B. Exchange Control.

With regard to foreign exchange control, the writer is inclined to think that the disturbing effects of such exchange control which were experienced after its imposition in Saudi Arabia indicate that foreign exchange control should be gradually lifted, in order that Saudi Arabia may revert to the traditional conditions of a free market. Such a step would undoubtedly take some time. Meanwhile, the argument for a free market is strongly supported by the following factors:

1. With the present defective administrative machinery, no exchange control authority could effectively attain its goal. This contention is borne out by unofficial reports that considerable amounts of funds were transferred illegally from Saudi Arabia, despite the strict measures that were applied by the Agency or Department of Foreign Exchange Control.

2. It has been argued elsewhere that foreign exchange control was not undertaken with the aim of restoring a disequilibrium in the balance of payments, but rather to check the flight of capital abroad. To achieve this latter objective there are a number of alternatives to which the Saudi Government could turn.

3. It will be very difficult, if not impossible, for the Agency to stabilize the exchange value of the Saudi currency if two distinct rates are prevalent in the country, namely, the official rate and the black market rate.

4. Since nearly all the Government's revenues are in foreign exchange, especially in U.S.$ and £ sterling, the need for exchange control is open to question. That is to say, Saudi Arabia, unlike Egypt, for instance, could easily finance imports and other services by foreign exchange, provided that measures are taken to check extravagance in Government expenditure and to ensure the proper rationing of foreign exchange for legitimate needs.

In view of these facts, the lifting of foreign exchange control appears highly desirable. This control has been in operation, however, for a considerable time (since 1955) and there would be some difficulty in reversing the process. Moreover, until corrective measures can be taken which would guarantee an abundance of foreign exchange for trade needs and to meet all the Government's foreign obligations, it would seem that the present exchange control must remain in force.

That is not to say, however, that there is no room for improvement in the present control system. The following suggested modifications could be adopted:

(i) The Agency must appoint chartered auditors to inspect the accounting books of banks. At present, no such system of inspection exists. The Agency's supervision of banks takes the form of checking the daily statements submitted by the banks showing the amounts transferred by them. These statements are not generally correct and certainly do not represent the actual operations undertaken by the banks.

(ii) As, in Saudi Arabia, all foreign exchange is received by the Agency, all payments by banks and others must be conducted by the Agency. In this way, banks could not negotiate any deal and could only dispose of foreign exchange allotted to them by the Agency and the Import Offices for duly approved purposes.

Such suggested measures would no doubt involve problems in the administrative field, but these could easily be surmounted.

By such measures, the Agency could guarantee that foreign exchange is used solely for legitimate needs, and the flow of foreign currency or exchange to the black market via the banks could be checked. Hence, the black market would be crippled and foreign exchange would be legally channelled.

C. The Inflationary Issue of Pilgrim Receipts

With regard to pilgrim receipts, it is not difficult to devise measures for checking their inflationary issue.

Economists have put forward various schemes, all of which fall nuder the two headings of monetary policy and fiscal policy.

It is interesting to investigate the possibilities of applying these two policies to suit the requirements of Saudi Arabia.

1. Monetary Policy.

To begin with, monetary policy is not likely to have any effective role in checking inflation in Saudi Arabia. The reason for this is that there is practically no room for using the classical instruments of monetary policy. Open market operations and the manipulation of bank rates could not be resorted to because there are no Government bonds or securities, and because there would be strong opposition on religious grounds to the lending or borrowing of money at interest. The only tool left is the manipulation of the reserves which the Agency may oblige all banks to deposit with it.

In view of the fact that a reserve requirement has not yet been fixed by the Agency, and bearing in mind that the Agency itself is indebted to banks, no effective action could therefore be taken to control the volume of monetary supply. Furthermore, a necessary pre-requisite for monetary policy is the existence of a body of accurate, statistical information, regarding the magnitude of the monetary supply. There is virtually no published statistical information available on this subject. The only available information is the quantity of money in circulation. The monetary supply is defined as, at any time, the total of coin, currency and demand (checking) deposits. The Agency made an attempt to compute checking deposits for all banks, but this attempt ended in failure. The banks complained to the Minister of Finance on the grounds that such a request from the Agency violated the secrecy of their clients' accounts. Although this complaint was ill-founded, the Minister of Finance and National Economy, in his letter No. H/1/40/14 of 5.1.1376 (1956) requested the Agency to stop bothering the banks with such requests.

Hence, there are not very favourable prospects of carrying out successfully a monetary policy in Saudi Arabia.

2. Fiscal Policy

The alternative method of checking the inflationary issue of pilgrim receipts is by using the instruments of fiscal policy. In Saudi Arabia, fiscal policy, compared with monetary policy, seems to have a better prospect of success. The fiscal measures which are recommended to check the current inflation in Saudi Arabia are the restriction of public expenditure and the increase of tax rates.

a. Restriction of Public Expenditure

The immediate effect of such an action would be to reduce the monetary supply and thus reduce the purchasing power of the public, in an attempt to check the rise in prices.

It is worth noting, however, that the restriction of public expenditure in Saudi Arabia is not an easy task. Indeed, it is extremely difficult. This has been realized by nearly all the economists and financial experts who have been summoned by the Government to study the situation and draw up recommendations and suggestions for improving the country's economic condition. These difficulties are social and political in nature.

The regime in Saudi Arabia is an absolute monarchy; the King is the head of the State and the source of all power. For example, the King's orders for funds to finance Royal consumption can never be rejected or queried by any superior authority. Undoubtedly, such a rigid system is at present acting as a serious obstacle in the path of monetary and economic improvements.

Among the social and cultural factors which hinder the Government in the restriction of public expenditure is the fact that the King and the Royal Court make no distinction between their personal expenditure and State finance. It is claimed that the King considers the revenues of the State as his own personal property. Such a state of affairs discourages any hope of an effective restriction of public expenditure.

A new development took place, however, in March, 1958. The King, for political reasons, granted to his Prime Minister extensive powers and entrusted new functions to him. The Prime Minister, Prince Faisal, gave most of his attention to monetary affairs. Upon completing a re-organization of the administration, of the Council of Ministers and other related matters, Prince Faisal directed his attention to financial matters. The Minister of Finance and National Economy left Saudi Arabia on sick leave. The Governor and the Vice-Governor of the Saudi Arabian Monetary Agency resigned and were replaced by qualified foreign experts.

Furthermore, all matters related to financial and monetary policy were made the definite responsibility of the Prime Minister. The Royal Decree No. 380 of 22 Shawal, 1377 (11.5.195), amending the statutory powers of the Council of Ministers, stipulated the following:

> Article 28: The financial affairs of the State are vested in the Council of Ministers.
>
> Article 29: The Government is not authorized to negotiate any loan except after the approval of the Council of Ministers and the permission of the King through Royal Decree.
>
> Article 37: The Council of Ministers authorizes an annual budget for the Government, containing the estimated amounts of revenues and expenditure for the year. The budget will then be submitted to His Majesty the King for approval. The approval of the budget must be obtained at least one month before the beginning of the financial year.
>
> Article 38: No addition to the budget will be permitted except in accordance with a specified regulation or by a decision of the Council of Ministers.(1)

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(1) Um-Al-Qura, Vol. 35, No. 1717, 27 Shawal, 1377 (16.5.1958).

With this strict regulation, and with all financial affairs controlled and managed by the Council of Ministers, not by the King or the Minister of Finance as was the earlier practice, hope was revived of a sound policy to restrict public expenditure. Yet this hoped-for success in restricting public expenditure is not expected to materialize very shortly, for the reason that most Government expenditure is conducted on a contractual basis. Furthermore, the high level of expenditure could not be easily reduced, in so far as it has been maintained for years at its present high rate. However, with Prince Faisal's coming to power, things are expected to change and it is anticipated that a policy of "tightening the belt" will be followed.

b. <u>Increase in Effective Tax Rates</u>

The second measure that is usually devised for checking inflation is to increase the effective tax rates. As far as Saudi Arabia is concerned, this tax instrument is of no practical significance.

At present there are the following types of taxes:

(i) <u>The Zakat Tax</u>. This is a religious tax which is collected from Saudi Arabians.[1]

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(1) Article I of Royal Decree No. 17/2/28/8799 of 8th Ramadan 1370 (15/6/1951), stipulates that moslem Zakat imposed on money, goods, cattle, the produce of land is one fourth of the tenth, i.e., 2.5 percent.

(ii) Income Tax. This is collected from foreigners and is levied on their earnings in Saudi Arabia.

During the Suez Crisis, the Government imposed a new tax on Saudi Arabians known as "Jihad Duty", (Defence Tax,) for defence purposes. In the same time, the rate of income tax on foreigners' earnings was increased.

The Jihad Tax was cancelled in June, 1957, and was not replaced by any other type of tax.

The limitations on the use of taxes as an instrument of fiscal policy are the following:

(i) The prevailing machinery for collecting taxes, "The Income and Zakat Department", is very defective for administrative and technical reasons.

(ii) Tax evasion is possible and frequent, as most Saudi merchants and traders do not keep regular accounting records to show their actual profits or losses.

Thus tax increases are not likely to be used effectively as part of a fiscal policy to check inflation.

3. Other Measures.

Other measures, however, might prove helpful in checking inflation in Saudi Arabia.

a. Maintenance of a 100% Cover for Pilgrim Receipts or Saudi Currency

This will have the effect of stopping new attempts to print more pilgrim receipts, if not of actually reducing the present volume of currency in circulation.

b. Meeting the Shortage of Foreign Exchange

The shortage of foreign exchange, as previously stated, was one of the factors that forced the Government to resort to the printing press to meet its growing expenditure. It should be recalled that the Agency sells foreign exchange to banks so as to secure local currency for meeting public expenditure. With any shortage in foreign exchange, this process is disturbed and the Agency is doomed to fail in securing local currency to meet Government expenditure.

Therefore, the present shortage in foreign exchange must be met as a step towards stopping the Government from resorting again to the printing press.

The shortage in foreign exchange could be met through the following:

(i) Foreign Borrowing.

This does not seem desirable, as the Government is heavily indebted. The Government however has been aware of this fact, and, as published in the official gazette, Um-Al-Qura, decided to stop domestic and foreign borrowing as a means to meet public expenditure.[1]

(ii) Increasing the oil royalty that the Government takes from Aramco, or increasing the corporate tax paid by the Company.

As such a step mainly involves political issues, it therefore falls beyond the scope of this enquiry. Hence, any recommendation would seem irrelevant for the purpose of this study.

(iii) Careful rationing of foreign exchange for the immediate needs of the community. This step has, in fact, been taken by Prince Faisal. For instance, the Royal Decrees Nos. 39 and 40 of 7/11/1377 (20/5/1958) stipulated that foreign exchange would only be used for the importation of essential commodities, Government transfers abroad, and for personal transfers by foreign employees. It should be recalled that the import of cars has been stopped for six months.

In conclusion, there is hardly any prospect of the successful application of a monetary policy which might

(1) Ibid.,Vol.35, No.1720, 19/11/1377 (6.6.1958), p. 1.

remedy the inflationary situation in Saudi Arabia. Tax increments are also not promising. The remaining alternative is thus the restriction of expenditure, a policy which is not believed to be, for reasons already discussed, a powerful weapon for the attainment of the goals of fiscal policy, in Saudi Arabia.

### 4. Membership in the I.M.F. and I.B.R.D.

Saudi Arabia's membership in the International Monetary Fund could be partly regarded as a step towards stabilizing the exchange value of Saudi currency in terms of other foreign currencies. This is so because the fund has the financial machinery to help the members to maintain free and stable exchanges by supplementing their gold and foreign exchange resources in case of need.

It is worth mentioning that Saudi Arabia became a member of the I.M.F. and I.B.R.D. in August, 1957. "The quota for Saudi Arabia in the International Monetary Fund is U.S.$ 10,000,000 and its subscription to the capital stock of the Bank (I.B.R.D.) is 100 shares with a total par value of 10,000,000."(1)

Up to the present date, July, 1958, no par value for the Saudi riyal has been established by the Fund.

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(1) I.M.F. International Financial News Survey, Vol. X, No. 9, 30th August, 1957, p. 65.

V. The Regulation of Commercial Banks

In its early stages the Agency did practically very little to regulate and supervise the operations of commercial banks. It will be remembered that the Agency requested all banks as well as money dealers in Saudi Arabia to register with it and to submit monthly statements of their operations. These statements, as stated previously, were designed to serve for statistical purposes.

During this period, however, further measures for regulating the operations of banks proved to be of no immediate urgency. But when foreign exchange control was imposed, effective measures to control the banks' disposition of foreign exchange became pressing. Again, no thorough control was carried out by the Agency, and banks were only requested to submit a fortnightly statement of the amounts of foreign exchange used for personal transfers.

With the establishment of the Foreign Exchange Control Department as an autonomous entity, the Agency abandoned its function of controlling and checking the banks' operations in foreign exchange to the newly established Department. But early in June, 1958, the Exchange Department was abolished and the Agency again assumed the function of controlling foreign exchange.

As stipulated in its charter, the Agency possesses the authority to introduce and enforce measures for the supervision and control of banks. Such measures would include some of the following:

A. <u>The Regulation of the Establishment of New Banks</u>

It has been argued elsewhere that the existing "Bank Guarantee", which regulates the establishment of banks, was no more than a temporary arrangement, and defective in many respects. First, the "Bank Guarantee" includes no strict requirements for the setting up of a bank. There is no mention, for instance, of the amount of initial working capital. Secondly, it contains nothing that would protect the interests of depositors. Thirdly, it does not define the exact operations to be undertaken by the bank. In this connection, it should be borne in mind that some banks have been indulging extensively in other than banking practices, especially contracting and other commercial business activities. Finally, the Guarantee fails to set out a proper definition of a bank. In any other part of the world, where the borrowing and lending of money at interest is the major function of a bank, it is not difficult to arrive at a proper definition of a bank. In Saudi Arabia, on the other hand, it is very difficult to distinguish between money-changers and exchange dealers, on the one side, and banks on the other. "Many small-scale dealers appear to do a sort of retail the authority to introduce and enforce measures for the supervision and control of banks. Such measures would include some of the following:

A. <u>The Regulation of the Establishment of New Banks</u>

It has been argued elsewhere that the existing "Bank Guarantee", which regulates the establishment of banks, was no more than a temporary arrangement, and defective in many respects. First, the "Bank Guarantee" includes no strict requirements for the setting up of a bank. There is no mention, for instance, of the amount of initial working capital. Secondly, it contains nothing that would protect the interests of depositors. Thirdly, it does not define the exact operations to be undertaken by the bank. In this connection, it should be borne in mind that some banks have been indulging extensively in other than banking practices, especially contracting and other commercial business activities. Finally, the Guarantee fails to set out a proper definition of a bank. In any other part of the world, where the borrowing and lending of money at interest is the major function of a bank, it is not difficult to arrive at a proper definition of a bank. In Saudi Arabia, on the other hand, it is very difficult to distinguish between money-changers and exchange dealers, on the one side, and banks on the other. "Many small-scale dealers appear to do a sort of retail business, buying exchange from the regular banks .... and re-selling it to the general public. Some of the larger houses may maintain balances in the major trading centres of the world, and may accept deposits from local businessmen. They may also be able to effect international transfers in essentially the same way as recognized banks, by making use of mutual drawing rights on a pre-arranged basis with similar houses in neighbouring countries."[1]

In its present form, therefore, the Bank Guarantee is of no practical importance and some form of banking legislation must be passed to correct the above-mentioned defects. The need for such legislation is dictated by the fact that the banking business is closely bound up with considerations of public interest. Moreover, proper banking legislation would guarantee the existence of a sound banking structure.

In addition, the suggested banking legislation must not overlook the following points:

1. According to the procedure followed in other countries, the types of assets to be held by the banks must be clearly defined. This is, of course, usually done to protect creditors against losses caused by bank insolvency. For instance, the wrong practice followed

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(1) McLeod,, op.cit., p. 12.

by some banks in Saudi Arabia, (especially the National Commercial Bank), in holding real estate as bank assets must be stopped. For "Bank holdings of real estate other than banking premises are ordinarily forbidden or limited in quantity. Those assets fluctuate too much in value to be considered as appropriate assets for banks."(1)

2. As a further protection for their depositors, banks must be requested to keep reserve requirements against coins and deposits. The effect of this will be to promote the safety and liquidity of the banks.

3. Minimum capital requirements must be laid down for banks desiring to establish branches in Saudi Arabia or for national banks to be established. Dr A.N. McLeod, in February, 1954, drew up a draft regulation for the establishment of banks in Saudi Arabia and Items (a) and (b) of Article Three read as follows:

> "... They - the applicants for the establishment of a bank - must obtain the subscription of a capital of not less than one million riyals, of which 50% shall be paid up in cash and deposited with the Saudi Arabian Monetary Agency in a special account in the name of the proposed bank.
>
> ... If the proposed bank is to be organized as a partnership, the applicants must submit

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(1) Chandler, <u>op. cit</u>., p. 240.

> a certified copy of the partnership agreement to the Saudi Arabian Monetary Agency. Each partner must subscribe not less than 100,000 S.R. to the capital of the proposed bank."(1)

B. Inspection

Up to the present date, the Agency has not attempted to carry out any inspection of recognized banks. Bank inspection should be considered as an effective step "for the dual purpose of ensuring compliance with the applicable legal provisions and with the directives issued by the Monetary Agency, and of providing the depositors with more protection than they now have against possible malfeasance or misfeasance on the part of the banks."(2) Such a step is not difficult to take, being mainly dependent on the employment of qualified auditors.

C. Cash Reserves

It was previously stated that the regulation No. 23 of Jamad, 1377 (November, 1957), stipulated that all banks were requested to keep with the Agency a stable balance in a certain ratio to the deposits in the bank. The reasons behind such a request were the following:

1. The reserve requirement is expected to help

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(1) McLeod, op.cit., p. 38.

(2) Ibid., p. 17.

the Agency in contracting the money supply and to act as an anti-inflationary device. In addition, the reserve ratio increases the portion of the total assets of the banking system that would be under the direct control of the Agency.

2. The reserve requirement will enable the Agency to strengthen the currency cover, as it increases its resources.

3. The reserve requirement will save the Agency paying considerable amounts of debts to registered banks.

It is worth noting, however, that the Agency is faced with certain complications in the application of cash reserves. Such complications arise out "of the fact that the banks carry deposit balances not only in local currency but also in a large number of foreign currencies. There are easily a score of currencies in which a significant volume of deposits is held, including British sovereigns, U.S. dollars, sterling, Egyptian pounds, Lebanese pounds, Syrian pounds and East African shillings."(1)

D. Clearing House

With the increased use of checks and drafts as a means of payment, the need for establishing clearing balances with the Agency seems highly desirable. The establishment of a clearing house will undoubtedly render

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(1) McLeod, *op.cit.*, p. 18.

good results and will enable each bank to clear its collections against all other local banks through the Agency, instead of clearing individually as is done now.

An attempt by the Agency to assume the functions of a clearing house for banks began in 1953 and 1954. Explanatory consultations were held with some banks, but "it was concluded, however, that the current volume of clearings did not justify the step at that time."(1) Today, the current volume of clearings is sufficiently expanding, due to the public's increased use of, and familiarity with, checks and drafts, to justify a new serious attempt at establishing a clearing house.

VI. The Agency as a Fiscal Agent

As stipulated in the charter, the Agency's second objective is to act as the fiscal agent of the Government. The Agency succeeded in carrying out this function. All Government revenues and expenditures are centralized with the Agency. Furthermore, the Agency conducts, on behalf of the Ministry of Finance, all matters related to Government purchases and foreign borrowings.

It is worth noting, however, that the Agency's function does not go beyond the mere centralization of Government revenues and expenditure. The Agency, for

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(1) *Ibid*, p. 19.

instance, has no authority to control Government expenditure when it exceeds allotted limits.

In view of the fact that the control of the budget has recently been vested in the Council of Ministers, there seems to be no real need for the Agency to participate in controlling the budget. The Agency can, however, write to the Council of Ministers, stating its views and recommendations, when expenditure by Ministries and Government departments exceeds the amounts allotted in the budget.

The Agency can thus aid the Council of Ministers in undertaking effective control of expenditure and in carrying out a policy of retrenchment.

VII. Secondary Recommendations

In ending this chapter, mention must be made of some recommendations regarding the organization and administration of the Agency.

The Agency, as previously stated, regained its independence through Regulation No. 23 of Jamad, 1377 (November, 1957). This will undoubtedly force the Agency to reconsider its present internal organization and administration. Some of the steps recommended are the following:

1. The Agency needs a well-trained staff to improve its present efficiency and to ensure the

effective operation of the Agency.

2. With the new function of issuing Saudi paper currency, the need for establishing a Separate Issue Department becomes pressing. The services which would be rendered by the establishment of such a department are numerous. Apart from regulating the printing and issue of the currency, the Department could keep reliable statistical records of the exact amount of currency in circulation, and in the vaults of the Agency. Furthermore, in the event of any forging of the Saudi currency, the Department could easily discover such forging by checking the serial numbers of the currency kept in its record.

3. The Board of Directors, being the governing body of the Agency, must prove its existence. Regular meetings must be held and the Board should take an effective part in monetary decisions and the formulation of monetary policy. To ensure such participation, the writer recommends that all the Agency's decisions and instructions should be the responsibility of the Board and not merely stem from the Governor of the Agency.

4. Careful attention should be paid to the Economic Research Department. A Director with suitable academic qualifications must be recruited, and he should have the assistance of a well-trained staff who are able to deal with statistical and economic research work.

# CONCLUSION

In previous chapters it has been pointed out that Saudi Arabia is at present faced with serious problems which require immediate solutions. Naturally, such problems are not purely economic in origin, but involve many perplexing cultural and social factors. The cultural and social aspects were neglected on the grounds that any detailed analysis of them would evidently lie beyond the scope of this enquiry. The rigidity of the political system; the unparalleled role of religion, which dominates every aspect of Saudi life; the relatively small percentage of educated persons among the population; these and other aspects of the Saudi social structure ought not to be neglected when writing about the Kingdom. In this study, however, they were referred to ohly in so far as they shed light on monetary affairs and decisions.

Despite the complications involved, the recommendations suggested for solving the present problems in Saudi Arabia were mere alternatives which Government policy might follow. It should be recalled that much stress has been placed on fiscal policy, rather than monetary policy, to cope with the inflationary issue of pilgrim receipts and the shortage of foreign exchange. Among the fiscal measures discussed, attention was focussed on the restriction of expenditure as an effective device in any anti-inflation campaign in Saudi Arabia.

It is interesting to note that the recent attempts made by Prince Faisal to check the notorious Saudi extravagance and to direct foreign exchange to cover the country's immediate needs represent a step in the right direction. Yet the Prince is still confronted by many difficulties. There is, for example, the immense expenditure of the Royal Family. Contracts already made for the construction of royal palaces in Riyad or for other public projects must be fulfilled. Moreover, the Premier faces internal opposition stemming from the King's junta and chancellors.

This is not to say that the position is beyond hope. On the contrary, Prince Faisal is fully aware of this situation and he boldly agreed to deal with it. Energetic, enthusiastic and anxious to save his great father's heritage, Prince Faisal settled down to fruitful work sooner than had been expected.

As a first step, the organization of the Council of Ministers was amended to suit the new requirements. Monetary affairs, as well as the drawing up of the budget, were made the responsibility of the Council.

As a second step, foreign exchange was rationed and used only for the importation of essential commodities, the personal transfers of non-Saudi employees and necessary transfers by the Government abroad. For instance, the importation of cars was stopped for a period of six months, and this ban is liable to be renewed.

The indications are that Prince Faisal's task has just begun. The issuing of Royal decrees and proclamations is all very well; but what is vastly more important is putting them into effect. The experience of Saudi Arabia suggests that the execution of orders and instructions was never completed and sometimes ended in failure. This was mainly due to the serious defects of the administration. Unless there is some improvement in the administrative machine, Prince Faisal's measures will not attain the desired ends. Such improvement implies the recruitment of well-trained staff, the re-organization of the bureaucratic machine and a general rise in the level of efficiency. Prince Faisal has already taken certain steps in this direction.

In conclusion, as all the measures taken by Prince Faisal are recent, it is too early to hazard even a fair guess about them. In so far as they are taken in the right directions, it is expected that they will meet with success.

In Chapter III it was argued that foreign exchange control must be gradually lifted when circumstances permit. In fact, with the promulgation of Royal Decree No. 40 of 7/11/1377 (20.5.1958), which abolished the Foreign Exchange Department and transferred its functions to the Agency, and also recognized the free market, such a plan has already been adopted. The present aim of the Government is the gradual lifting of foreign exchange control. The effects of such a return to a free market have been discussed previously in detail.

In addition, the improvements and constructive measures which the Council of Ministers, headed by Prince Faisal, will take will assist the Agency to stabilize the national currency, a task which it was unable later to accomplish in full.

Finally, it should be noted that the earlier pessimism which was induced in the minds of most observers of the Saudi Arabian scene, when they saw the direction in which the Kingdom was being driven by excessive expenditure and extravagance, is gradually giving way to a limited optimism, which is the re-action to Prince Faisal's assumption of greater powers. The Prince is seen as the saviour of his country. Indeed, he is regarded as the only remaining hope for Saudi Arabia.

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