THE CENTRAL BANK AND ITS ROLE
IN THE ECONOMIC DEVELOPMENT
OF
PAKISTAN

by

MOHAMMAD RAFIQ KHAN

A Thesis

Submitted in Partial Fulfilment of the Requirements
For the Degree of Master of Business Adminstration,
in the Business Administration Department
of the American University of Beirut,
Beirut, Lebanon.

July 1963

PAKISTAN CENTRAL BANK

Khan

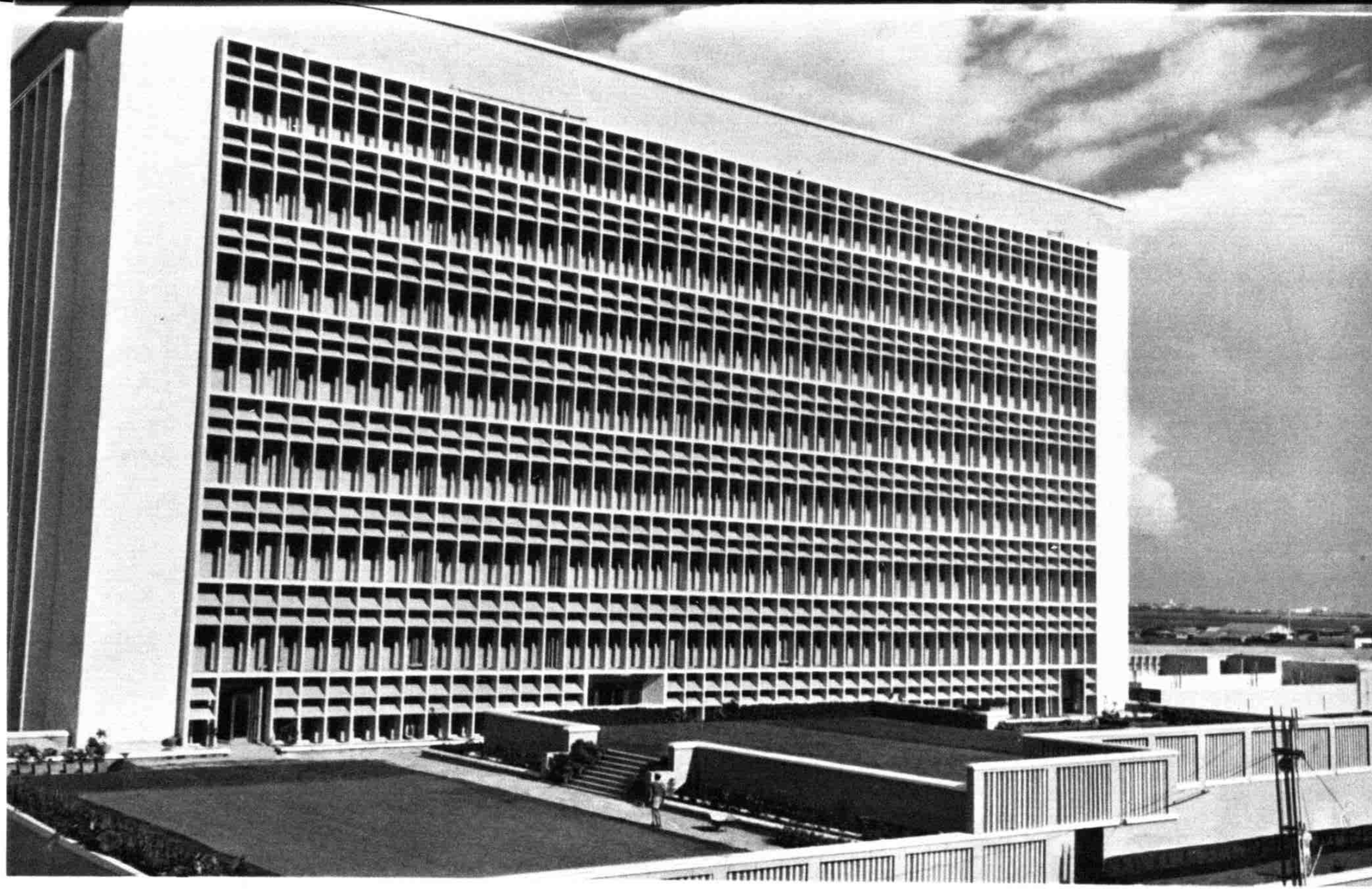
To

My Beloved Mother

And

In Memory of

My Father.



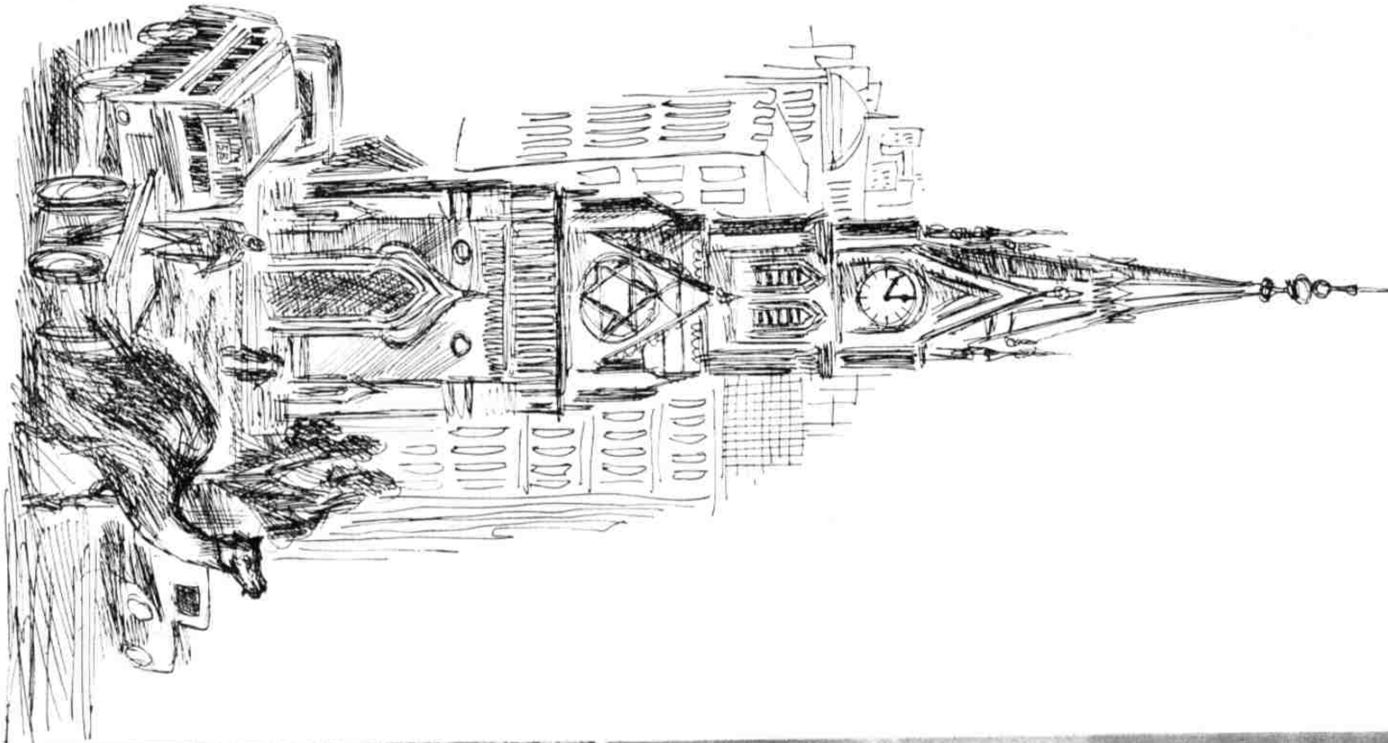
Section of the building seen from the terraced roof-garden on the third floor.

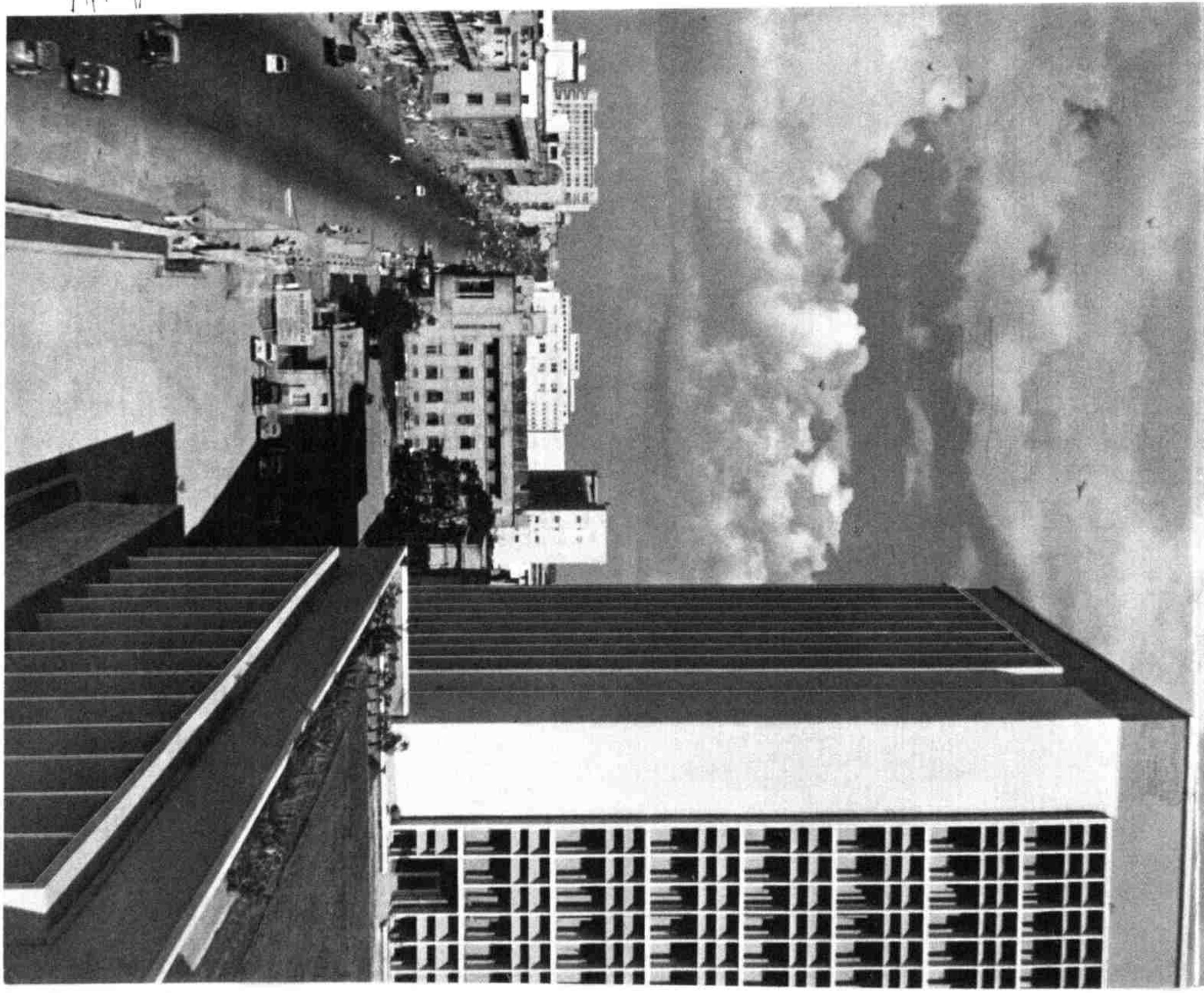
THIS NEW BUILDING

is a symbol of the Bank's growth and of its concern to meet more efficiently the complex demands of a developing economy.

It is built in contemporary architectural style, in the characteristic shell structure of today. Emphasis is on functional utility—not aesthetics, nor architectural luxury. Its 11-storeys providing almost half-a-million square feet of floor space meets the Bank's essential needs of space. It brings under one roof all of its operative and administrative departments scattered so far in three widely apart places in the town. Blending of function in design offers operational convenience; use of modern office technology in its architecture provides a relaxed setting for the busy workers—stimulates efficiency.

Sprawling over most of the fifth floor is the Bank's expanding library housing a stock of fifteen thousand discriminately selected books organised into well-ordered groups for prompt location of subject. The resources of the library are being progressively enlarged to reach a total of fifty thousand books in four years. Its open built-in wood shelves around its fourteen columns makes reference easy and unobstructed. As an incentive to its use, it is specially furnished to create the right atmosphere. Its floors are dressed with agreeable but inexpensive carpets for removing echo and insulating sound. Furniture has been designed for long hours of use for serious study in detached peace. Special space is set apart for newspaper readers of a more varied class. The glass lining of big windows on the West and the South admits enough light. Located in the middle of the building it is conveniently accessible to the entire staff.





ACKNOWLEDGEMENT

I sincerely wish to express my deep gratitude and thanks to Dr. Salim Hoss for his invaluable comments,guidance and suggestions throughout my study. He was my advisor,guide and teacher; he consoled me when I was distressed,encouraged me when I became disappointed. He is the motive force behind the present study.

I am highly indebted to the members of Thesis Committee,Prof. Aziz Marmura and Dr. Mohammad Attaullah for their kindness to agree to go through my Thesis in a very short period, leaving aside their other engagements, to enable me to defend it at the earliest. I am especially grateful to Prof.Aziz Marmura for his keen interest in the progress of my work and for the pains he took to improve the quality of the present study through his very constructive criticism.

I am greatly indebted to Dr. S.A.Meenaiee,Economic Advisor to the State Bank of Pakistan who helped me in securing necessary and relevant material.

I must also express my thanks to Mr. M.M.Malik,Secretary, Institute of Bankers in Pakistan for giving me necessary information in connection with the present study.

It would be unfair on my part if I donot express my gratitude to my friend Mr.Abdul Qayyum of Karachi for the help and assistance, he never grudged in providing. I am also grateful to a number of officials of the State Bank of Pakistan , who were very helpful,co-operative and sympathetic during my visit to Pakistan in June-September 1962.

Mohammad Rafiq Khan.

ABSTRACT

Pakistan asserted her claim to financial autonomy on July 1,1948 when the State Bank of Pakistan took over all functions of central banking from the Reserve Bank of India. The Bank,which came into existence under very unusual circumstances, was faced with the formidable task of organizing central banking services within a very short period of time and simultaneously undertaking certain other duties of altogether exceptional nature.

The sphere of the State Bank of Pakistan's current activity is wide and comprehensive and represents a combination of orthodox central banking functions alongwith manifold operations connected with a variety of developmental and promotional activities. The Bank has the exclusive powers of note-issue in the country. As the central banking authority, the State Bank of Pakistan has been given wide powers of credit control and has been entrusted with statutory responsibility of regulating the monetary and credit systems of the country. Despite wide powers in connection with credit control, the Bank is handicapped by the lack of a well-developed money market in Pakistan in the implementation of its credit policies. Because of such limitations, the Bank has made efforts to achieve the objectives of its credit policy largely through moral suasion and consultations with commercial banks and also through qualitative controls from time to time.

The State Bank of Pakistan provides credit facilities to the agricultural, industrial and real-eatate sectors of the economy through the various specialized lending agencies, which are of great help in the economic development of the country. The Bank as a central banking authority of the country has the statutory responsibilty to administer the foreign exchange system. Exchange control is the chief instrument for safe-guarding the country's foreign exchange resources, and for using them in a manner that is conducive to economic stability and development.

The State Bank has kept the developing economic situation under constant review and appropriate selective credit measures have been taken whenever necessary. By restricting the flow of credit to "undesirable and less essential channels" these measures have gone a long way in diverting credit to high priority developing sectors of the economy.

Thus by creating an atmosphere of stability which inspires the confidence of investors both at home and abroad and by influencing the sectoral distribution of credit in the economy as well as promoting the growth of institutional credit structure in the country, the State Bank of Pakistan has played a very important role in the economic development of Pakistan.

****

TABLE OF CONTENTS

Page

DEDICATION iv

ACKNOWLEDGEMENT v

ABSTRACT vii

INTRODUCTION xii

Chapter

I THE BANKING SYSTEM OF PAKISTAN. 1

II THE ORGANISATION AND FUNCTIONS OF THE STATE BANK OF PAKISTAN. 14

A-Evolution of Central Banking 15

B-Constitution and Organization of Central Bank. 16

C-Responsibilities and Functions 22

State Bank as Banker to Government 22

State Bank as Banker to Banks 23

State Bank as Note Issuing Authority . . . 24

State Bank as Controller of Credit 24

State Bank as Controller of Exchange . . . 24

State Bank as Advisor to Government . . . 25

State Bank as Agency of Economic Development 25

D-Summary and Conclusion. 25

III CURRENCY MANAGEMENT 28

A- Statutory Provisions for Note Issue 29

B- Administrative Arrangements for the Issue of Currency 31

C- Changes in Currency Circulation 32

D- Summary and Conclusion 35

Chapter		Page
IV	CREDIT POLICY OF THE STATE BANK OF PAKISTAN	36
	A-STATUTORY AUTHORITY OF THE BANK	37
	B-CREDIT CONTROL POLICY OF THE BANK	38
	Bank Rate	38
	Open Market Operations	39
	Reserve Requirements	39
	C*THE STRUCTURE OF CREDIT IN PAKISTAN	45
	Agricultural Finance	45
	Industrial Finance	51
	Other Forms of Credit	53
	Real Estate Credit	53
	Commercial Credit	54
	Consumer Credit	55
	D-Summary and Conclusion	55
V	MONETARY DEVELOPMENTS AND POLICY IN PAKISTAN . . .	58
	A-The Behaviour of Money Supply in Pakistan . . .	58
	B-Changes in Money Supply and Its Determinants . .	62
	C-Money,Prices and Exchange Rate	66
	D-Summary and Conclusion	70
VI	EXCHANGE CONTROL OPERATIONS OF THE CENTRAL BANK . .	72
	A-Evolution of the Exchange System in Pakistan . .	73
	B-The Present System of Exchange Control	73
	C-The Central Bank's Role in the Exchange Control	77
	Exports	78
	Imports	78
	Payments for Invisible Trade	79

Capital Remittances 79

D-Summary and Conclusion 80

VII THE ROLE OF THE STATE BANK IN THE ECONOMIC DEVELOPMENT OF PAKISTAN 82

A-The Central Bank and the Money Market 83

B-The Central Bank and the Capital Market 87

C-The Central Bank and the Sectoral Allocation of Financial Resources 92

D-Summary, Conclusion and Recommendations 95

APPENDIX 102

BIBLIOGRAPHY . . . .

* ****************

INTRODUCTION

The term 'central banking' is a creation of the 20th century. As a matter of fact many countries of the world ,including the United States of America, have established their central banks only in this century. The State Bank of Pakistan which is the central bank of the country, was established in 1948 under unusual circumstances. We are interested here in finding out the progress made by the State Bank, as the central banking authority of Pakistan during 15 years of its existence. What were the challenges and how did the State Bank respond to them? What new responses should be developed by it to meet the new challenges? More precisely, what was the kind of job the State Bank of Pakistan was called upon to perform and how well has it discharged it? What are the problems which need to be tackled in future? The main purpose of this study is to answer these questions.

The procession of events that passed immediately after Independence and the injury they inflicted upon the fabric of the economy of the newly born State of Pakistan (Pakistan was established in 1947) are recounted in this study. It appeared as if the entire economic system would come to a collapse. The country-wide riots and blood-shed that followed Independence resulted in the suspension of business of many bank offices which were mostly manned and managed by Hindus. A tottering banking and credit structure was to be salvaged,and since most of the banks were of foreign origin which needed supervision in the country, it was necessary that a central bank should be established.

But the establishment of a central bank in a situation where trained man-power was practically non-existent, was an extremely hazardous venture. The State Bank of Pakistan was set up in the fave of such odds. This study will reveal how the central bank of Pakistan faced all these problems and what role it is playing in the economic development of Pakistan.

In the light of such a study, the writer hopes to be able to suggest some recommendations aimed at improving the efficiency of the central Bank and its role in the economic development of Pakistan.

A great deal of information in this study has been obtained from publications, statistical reports and studies made and published by the State Bank of Pakistan and the Central Government of Pakistan.

Chapter I outlines the main features of the banking system of Pakistan since Independence in 1947 and the new developments and progress made by the banking system since then.

Chapter II gives an idea of the evolution of central banking in Pakistan and deals with the powers, functions and constitution of the Bank.

Chapter III discusses the currency management in the country with special referencecto administrative arrangements for note-issue and changes in currency circulation in Pakistan.

Chapter IV and V analyse the credit policy and monetary development and policy of the central bank of Pakistan.

Chapter VI presents the Exchange Control operations of the State Bank of Pakistan and its role in the exchange control.

Chapter VII studies the role of the State Bank in the economic development in Pakistan . It also presents the summary, conclusions and recommendations concerning the policies and efficiency of operation of the State Bank.

Finally, Appendix I deals with the central banking legislations in the United State of America, the United Kingdom, Australia, Canada and Ceylon in comparison with the State Bank of Pakistan.

A study of the central bank of Pakistan, at this stage of development in Pakistan would be both interesting and useful. Uptil now no comprehensive study of this subject has been made; thus it will be interesting to throw some light on the problems and prospects of the central bank of Pakistan. On the other hand, such a study might help to stimulate further research in this field.

****

CHAPTER I

THE BANKING SYSTEM OF PAKISTAN

- EVOLUTION AND STRUCTURE.

Few newly-born states in the present day world had to face such odds as fell to Pakistan's lot. It was not that the country had to start from scratch; it had to cope with an increasing stream of refugees who had to be provided all possible help.

Over and above this, Pakistan had to find replacements for non-Muslims who were deserting the organisations they were working in and were migrating from this country en mass continuously.

One of the first casualities of this mass migration of non-Muslims from Pakistan was the banking structure of the country. In the pre-Independence era, the territories now comprising Pakistan possessed an adequate and well-organised banking structure. "During the thirteen months that elapsed between the announcement of Partition plan and the establishment of the State Bank of Pakistan,* the country was almost entirely bereft of banking facilities on account of the suspension of business and large scale closure of bank offices which were mostly manned and managed by non-Muslims. The facts of the situation are that the number of scheduled bank** offices declined from 631

---

* The Central Bank of Pakistan is called the "State Bank of Pakistan.

** See page 2

just before Independence to 213 immediately thereafter. The situation was particularly grave in West Pakistan with the number of bank offices declining from 487 to 69."[1]

Muslims were thought as to be not competent enough to engage in banking profession. Consequently, when Independence came, only one out of thirteen banks in Pakistan was owned and run by Muslims exclusively.[2] The negligible role of Muslims in the banking enterprise in the areas now comprising Pakistan may be partly explained by their general economic backwardness and partly by their dis-interest for the profession of banking as such.

The banking system inherited by Pakistan in 1947 was in a state of virtual collapse. There was a mass migration of non-Muslims from Pakistan, which made the banking system incapable of performing its normal functions. The foreign banks also could not perform their usual functions due to the migration of their non-Muslim employees, who were dominating the banking profession at that time. The Eastern wing of the country did not face such a hard situation and the magnitude

---

**(FROM P.1)
Banks operating in Pakistan with a paid-up capital and reserves of an aggregate value of not less than Rs.500,000 and conducting their affairs in a manner, not detrimental to the interests of their depositors, have been declared as 'Scheduled Banks' in terms of section 37(2) of the State Bank of Pakistan Act,1956.Banks other than Scheduled Banks are called 'Non-Scheduled Banks'.

1. State Bank of Pakistan, Twelve Years of Banking in Pakistan (Karachi,Ferozsons Ltd.,1960) p.1

2. Andrus and Mohammad, The Economy of Pakistan, (London:Oxford University Press,1958) p.376.

and the demage done was considerably lesser. The banking activities were reduced, as there was a withdrawal of non-Muslims' deposits, which had transfered to India.[1]

> "Banking facilities were curtailed even for Government business. The Imperial Bank of India which was responsible for Government treasury work as agent of the Reserve Bank of India* had only 19 out-lets functioning in the Pakistan areas after Partition, against 28 offices and 53 sub-offices in pre-Parttion days. Some of these offices were unable to perform Government business due to shortage of staff."[2]

The whole economy was in a perilous state. To put it back to working normally, it was necessary that urgent steps be taken to restore monetary confidence in the country, as well as to start repairing all the damage done by the political upheaval. This was the task which was assigned to the State Bank of Pakistan shortly after its birth. The urgent and most immediate task before the central bank, therefore was, to expand credit facilities to meet the requirements of businessmen, and to rehabilitate the banking system of the country.[3]

When the State Bank of Pakistan came into being on July 1,1948, it gave its full support to the Government of Pakistan in its efforts to rehabilitate the banking system in the country. The business

---

* The Central Bank of India.

1. *Ibid.*, p.376
2. *Ibid.*

3. State Bank of Pakistan, *Twelve Years of Banking in Pakistan op.cit.*,pp.1-2.

community extended its full co-operation to the Government and the central bank, and established two new banks in the country.One Muslim Commercial Bank transfered its headquarters from India to Pakistan. This transfer brought the number of Pakistani banks to four. In 1949, the Government of Pakistan with the help of the State Bank of Pakistan, established a new bank, namely, the National Bank of Pakistan. This bank was set up with a view to taking speedy steps as to meet the urgent and immediate requirements of the country.

In order to overcome the problem of shortage of trained personnel in the banking profession, 100 University graduates were hired by the central bank in 1948 for training under a Bank Officers' Training Scheme, These trainees were given on-the-job training in various commercial banks. Training facilities in leading banks in U.K. were also provided to bright young men.

We have already mentioned that Muslims in the Indo-Pakistan sub-continent were not interested in banking as a profession, but after the Independence, the situation changed and young Muslims showed their interest in the field. In order to have a continous flow of well-trained and qualified bankers, it was thought necessary that Pakistan should establish an Institute of Bankers. Thus, the Institute of Bankers came into existence in 1952.

The Pakistan Institute of Bankers has established Training Centres at Lahore, Karachi, Dacca,Chittagong,Peshawar and Rawalpindi. The lectures are given by the University professors and professional bankers at these centres so as to cover the various subjects for Diploma examination[1]

The training given by the Institute of Bankers in Pakistan is primarily for the clerical staff and the training provided by the State Bank of Pakistan, under the Scheme mentioned above, is for supervisory staff. Under this scheme, the minimum educational qualification for recruitment is a University degree. Selection of the trainees is done on the basis of a written test and later on, the applicants are interviewed by a Board. In order to raise the standard of trainees of the scheme, two bankers' training institutes were established by the central bank of Pakistan in 1959, one at Chittagong (now at Dacca) and another at Karachi.

These institutes are the source of well qualified and trained personnel in banking and are performing a very important function in the field of banking in the country.

The over-all growth in the deposit reserves and loan business of the commercial banks over the period from 1948 to 1960 are revealed in Table I. The table shows an increase of 27.27% in demand deposits and an increase of 845 % in loans and bills discounted during the period under review. Nearly eight-fold growth in time deposits is particularly

---

1. "Local Centres of the Institute", Journal of the Institute of Bankers, (Karachi; Institute of Bankers in Pakistan, January-July, 1962) p.vi

note-worthy.

TABLE 1

DEPOSITS AND ADVANCES OF SCHEDULED BANKS
(July 1948 - January 1960)

Rs.in Crores*

	July 2,1948	January 1,1960
Total Deposit Liabilities	88.05	302.33
Demand:	74.66	200.21
Time:	13.39	102.12
Total Bank Credits:	19.78	169.31
Advances:	19.24	150.00
Bills Discounted:	0.54	19.31

Source: State Bank of Pakistan, Twelve Years of Banking in Pakistan, (Karachi, Ferozesons Ltds, 1959) p.3

Table 2 allows a comparison of the position of the scheduled banks operating in Pakistan on June29,1962 with that at the end of June 1961.

---

* Rs.= Pakistani Currency "Rupee"
One U.S.Dollar = Rs.4.7619
One Crore = Ten Millions.

TABLE 2

POSITION OF SCHEDULED BANKS ON
JUNE 30,1961 and JUNE 29,1962

(Lakhs of Rupees)*

	30-6-1961	29-6-1962
Demand Liabilities	2,14,43	2,44,08
Time Liabilities	1,33,17	1,63,14
Borrowings from the State Bank	33,76	40,32
Cash in hand	8,30	9,52
Balances with other banks in current accounts in Pakistan	5,41	6,10
Investments in Pakistan	1,31,22	1,31,99
Money at call and short notice in Pakistan	15,17	25,48
Advances in Pakistan	2,03,01	2,63,35
Inland and foreign bills purchased and discounted in Pakistan	17,27	22,80

Source: Annual Report of the Board of Directors, State Bank of Pakistan,1961-62,pp.45-46.

From this table, it is clear that during one year,"the total demand and time liabilities of the scheduled banks showed an increase of Rs.596.20 millions of which 299.70 millions were in the form of time liabilities and the rest in demand liabilities. Scheduled banks' balances with the

*10 lakhs = 1 Million.

State Bank of Pakistan increased by 23.20 millions. Their borrowings from the State Bank of Pakistan at the same time showed an increase of Rs.65.60 millions.The increased resources of the banks on account of increase in demand and time liabilities and borrowings from State Bank of pakistan were reflected in an increase in their money at call and short notice and advances which rose by 103.10 millions and 603.40 millions of rupees respectively."[1]

The large-scale textile industry and other consumer industries provided incentive for the expansion of commercial banking in the country. Government of Pakistan's expenditure on economic development and the tendency of urbanization encouraged bankers to open branches in rural areas of Pakistan, so that a net work of bank offices has spread all over the country. The foreign banks also started opening their branches in important commercial centres. The State Bank of Pakistan Order of 1948 was replaced by a new act known as the State Bank of Pakistan Act,1956. The preamble to the Act stipulates that the central bank would take active part in"fostering the growth of the monetary and credit system in the best national interest and would help to achieve a fuller utilization of the country's productive resources." As to strengthen the credit system in the country,the central bank has played an important role in the creation of the Agricultural Bank of Pakistan and the Pakistan Industrial Credit and Investment Corporation (PICIC). An amendment was

---

1. <u>Ibid.</u>, p.46.

passed in 1959 to the State Bank of Pakistan Act,1956, which authorized the Bank to sponsor any bank as to encourage economic development of a specified region. Having these powers at its disposal, the central bank sponsored the idea of a new bank for East Pakistan. In 1959, the Eastern Mercantile Bank came into being in order to meet the demands and requirements of that wing of the country. All these efforts of the State Bank of Pakistan resulted in the impressive increase in banking offices from 195 in July 1948 to 713 in June 1962.[1]

The increase in the number of banks and bank offices is apparent from Table 3;

TABLE 3

EXPANSION OF BANKING FACILITIES IN PAKISTAN
(July 1948 to June 1961)

	AS on 1-7-1948		As on 30-6-1961	
	No.of scheduled banks	No.of Bank offices	No.of Scheduled Banks	No. of Bank* Offices
Pakistani Banks	2	25	10	507
Indian Banks	29	151	10	37
Other countries	7	19	8	36
Total	38	195	28	580

Source: State Bank of Pakistan, Twelve Years of Banking in Pakistan p.3; and Banking Statistics of Pakistan,1960-61,p.vii

1. State Bank of Pakistan Bulletine (Karachi:State Bank of Pakistan September 1962) p.28

* Banking offices include the principal offices as well.

"During the period of 1961-62, the number of banks increased from 28 to 33. During this period the expansion of banking facilities proceeded at a rapid rate. Scheduled banks opened 137 new offices as against 100 during 1960-61, with the opening of 137 new offices and closing of 4 existing ones, the total number of offices of scheduled banks including branches, sub-offices, pay offices, sub pay offices etc., increased to 713 at the end of 1961-62 as against 580 in 1960-61.[1]"

It is clear from Table 3, that the gap created by the closure of Indian bank offices after the Independence in 1947, has been bridged by the branch expansion of the Pakistani banks to a great extent.

There has been an impressive growth in the banking sector in Pakistan since Independence. The total demand and time liabilities of the scheduled bank have increased from Rs.880.50 millions in July 1948 to Rs.3023.30 millions in January 1960. At the same time, the total bank credit has grown from Rs.197.80 millions to Rs.1693.10 millions.[*] [2] There has also been a striking increase in the investments of the banks.

The Pakistani banks are very efficiently meeting the banking and credit needs of the country. They have established 10 branches in various foreign countries.[3] The expansion in the business of Pakistani Banks has paralleled the growth of bank offices. They held 69.8 % of

---

1. State Bank of Pakistan Bulletine, <u>op.cit.</u>; pp.22-28
2. <u>Supra</u>, p.9

* The total demand and time liabilities and the total bank credit of the scheduled banks at the end of June 1962 were Rs.4072.20 millions and Rs.2860 millions respectively.

3. <u>Ibid</u>, p.84.

total bank deposits in Pakistan and 74.07 % of total bank credit there at the end of June 1961.[1]

The over-all growth in the deposit resources and loan business of scheduled banks is given in Table 4.[*]

We have not discussed the Non-Scheduled Banks here, because despite their large number, their role is insignificant in the economy. Moreover, there is a tendency for their number to decrease. These banks decreased from 95 at the end of March 1960 to 42 at the end of March 1962.[2]

In Pakistan, branch banking is practised widely. The largest two banks, namely, the National Bank of Pakistan and the Habib Bank Ltd. operated 150 and 136 branches as of June 30, 1962.

Summary and Conclusions

The banking business in Pakistan has made a very striking progress since 1948. There has been an impressive growth in banking offices from 195 in July 1948 to 713 in June 1962. On the whole, the commercial banking system in Pakistan has successfully completed its first and most important and critical period of development.

As previously noted, the activities of foreign banks in Pakistan

---

1. Pakistan, Government of Pakistan, Ministry of National Reconstruction and Information, Pakistan-Basic Facts (Rawalpindi: Government of Pakistan Press, 1961), p.84

* infra, p.12

2. Ibid p.84.

Table 4

<u>Consolidated Position of Scheduled Banks-Selected Items 1948-61</u>

(In Million Rupees)

Year and Date	Number of Reporting Banks	Liabilities				Assets			Reserves			
									Bank Credit			
		Total Demand Liabilities	Total Time Liabilities	Borrowings from State Bank	Cash in Pakistan	Balance with State Bank & Other Banks	Call Money	Total Investment	Bill Advances	Bill Purchased and discounted	Total Statutory Reserves	Excess Reserves
1948 July 2	30	704.3	134.1	..	41.4	221.9	..	..	192.4	5.4	40.9	181.0
1948 Dec. 30	39	896.5	168.9	..	38.2	137.2	..	..	397.6	12.8	48.2	89.0
1949 Dec. 30	38	903.1	205.8	..	39.8	210.5	..	..	421.6	23.0	49.3	161.3
1950 Dec. 29	33	947.8	232.1	..	50.7	92.8	..	..	722.1	48.2	52.0	40.8
1951 Dec. 28	31	1,212.1	286.0	..	71.6	138.7	..	..	837.0	82.1	86.3	72.4
1952 Dec. 26	31	1,129.4	270.8	..	60.8	79.9	..	..	677.2	115.0	61.9	28.0
1953 Dec. 24	32	1,239.6	352.6	..	39.6	97.5	..	..	669.7	120.6	69.0	28.5
1954 Dec. 31	32	1,250.7	517.8	127.7	54.8	162.1	66.5	720.5	761.1	202.1	73.9	42.4
1955 Dec. 30	32	1,424.3	558.2	178.4	49.5	167.9	38.0	793.9	997.0	164.8	82.4	51.4
1956 Dec. 28	30	1,574.1	609.8	214.4	81.0	186.3	115.4	821.5	1,082.2	154.3	90.9	45.9
1957 Dec. 27	27	1,735.5	674.2	147.1	82.7	170.8	134.8	929.9	1,118.9	149.7	100.3	32.3
1958 Dec. 26	26	1,890.8	735.3	181.4	85.7	192.4	135.6	1,047.5	1,353.0	205.2	109.2	35.1
1959 Dec. 25	29	1,977.4	1,045.9	97.5	56.7	197.5	81.0	1,271.8	1,418.7	201.1	119.7	31.3
1960 Dec. 30	29	2,066.2	1,304.3	411.7	82.5	216.4	203.6	1,339.0	1,854.8	230.0	129.4	34.1
1961 Sept.29	..	2,200.3	1,339.2	366.4	72.8	168.0	202.9	1,321.2	2,042.0	233.5	..	..

Source: Ministry of National Reconstruction and Information, Government of Pakistan, "<u>Pakistan Basic Facts</u>", (Rawalpindi: December, 1961), p. 85.

are limited due to the nature of their operations i.e. finance of export-import trade. In June 1961, out of 580 offices of scheduled banks in Pakistan, 507 were Pakistani banks.* There was a tremendous expansion in the Pakistani banking system and the Pakistani commercial banks are now operating their branches in various foreign countries. The foreign banks were helpful in providing a valuable tradition and a set of principles and practices, which were of great help in establishing the banking system on a sound foundation in the country.

The State Bank of Pakistan, which is the central bank of the country, has developed from a modest beginning in July 1948, into an institution which proved to be highly effective. The evolution, powers and functions of the central bank of Pakistan are discussed in the next chapter.

****

---

* *Supra* p.9 (Table 3)

CHAPTER II

THE ORGANIZATION AND FUNCTIONS OF THE STATE BANK OF PAKISTAN

Prior to the 20th century, there was no clearly defined concept of central banking. It was during the first half of the 20th century that central banks were established in a large number of countries with well defined responsibilities and authorities.

It has rightly been said that " a central bank is so called because it occupies a central or pivotal position in the monetary and banking structure of the country in which it operates.Because it is vested with the authority to exercise a special group of powers -- powers which other banking institutions do not possess or which they possess in only a limited degree -- the central bank is able to profoundly influence monetary and credit conditions and developments. As the special powers of the central bank are designed to enable it to control the volume of hand-to-hand money and of bank credit available in the country, it may be defined as an institution which is charged with the responsibilty of managing the expansion and contraction of the money in the interest of the general public welfare."[1]

1\. Raymond P.Kent, Money and Banking,(New York: Rinehart and Co., Inc.,1949) p. 315

The role performed by a central bank in the economy of a country, and the functions associated with it, have received unprecedent recognition in recent years. A clear and well defined concept of central banking emerged with the establishment of the Federal Reserve System in the United States of America, and the success gained by it in very unfavourable conditions led, after the First World War, to a tendency in other countries for the creation of central banks.[I]

(A) Evolution of Central Banking in Pakistan

The Reserve Bank of India was the central banking authority in the country until 1948, was created in I935 with a share capital of Rs. 50 millions. It was established on the pattern of the Bank of England, with two distinct and seperate departments ----- namely the Banking Department and the Issue Department.[2]

The sub-continent of India and Pakistan was partitioned on August 14,1947 into two parts. The Reserve Bank of India was charged with the responsibility of acting as central bank for India and Pakistan, uptil September 30,1948, when Pakistan was supposed to

---

I. L.S.Ritter, Money and Economic Activity, (Boston: Houghton Mifflin, I96I). pp.402-404.

2. R.S.Sayers, Banking in the British Commonwealth, (London: Oxford University Press, I952). p.22I.

open its own central bank. But during this interim period, Pakistan felt that it should establish its own central bank as soon as possible, as, allegedly,the Reserve Bank of India was not taking into consideration the national interests of Pakistan. So it was decided that Pakistan should start its own central bank as from July 1,1948.[1]

The establishment of a new central bank in the country was a difficult task for the new State of Pakistan.Due to the shortage of trained and qualified banking personnel in the country, certain foreign consultants recommended to the Government of Pakistan the establishment of a 'Currency Board' rather than a central bank. But the Government disregarded this advice and on May 12,1948,"the State Bank of Pakistan Order,1948" was issued and Pakistan started a central bank of its own on July 1,1948.[2]

It would be wrong to maintain that central banking came into being in Pakistan on July 1,1948 with the establishment of the State Bank of Pakistan. The central bank of India i.e. the Reserve Bank of India was acting as the central banking authority for both India and Pakistan from August 14,1947 to June 30,1948 when Pakistan created its own central bank in the country.

(B) Constitution and Organization of the Central Bank

There have been no basic changes in the constitution of the State

1. Ibid., p.261

2. State Bank of Pakistan, The State Bank of Pakistan:Its Gorwth, Functions and Organization,(Karachi,State Bank of Pakistan,1961)pp.3-4

Bank of Pakistan since its establishment. But a few ammendments have changed its'scope of functions and modes of operation' to a significant extent. The State Bank of Pakistan Act 1956 has introduced various important changes in the constitution of the central bank of Pakistan. The new Act requires " the State Bank of Pakistan not merely to ensure monetary stability, but also to foster the growth of the monetary and credit system in the best national interest and to help in the fuller utilization of the country's productive resources."[1]

The central bank of Pakistan has been established as a corporation with a total share capital of Rs.30 millions. The capital is divided into 300,000 fully paid-up shares, each valuing Rs.100.[2] The central Government of Pakistan holds 51 % of the Bank's share capital. The remaining 49 % shares are held by the private share-holders. In addition to the share capital, the central bank had a reserve fund of Rs.56.50 millions as on June 30,1962.[3] The central Government of Pakistan had provided Rs.30 million in the shape of Government securities toward this fund.[4]

In order to facilitate the registration of the share holders, the country is divided into three areas:

i)Karachi Area, comprising the divisions of Karachi, Khairpur, Hyderabad,Quetta and Kalat;

---

1. Ibid, p.7

2. Ibid, p.8

3. State Bank of Pakistan Annual Report 1961-62, (Karachi:State Bank of Pakistan,1962) p.60

4. The State Bank of Pakistan:Its Growth,Functions and Organization op.cit.,p.8

5. Ibid

ii) Lahore Area, including divisions of Peshawar, Dera Ismail Khan, Rawalpindi, Lahore, Multan, Sargodha and Bahawalpur; and

iii) Dacca Area, comprising the whole Eastern wing of the country.

"The share-holders are entitled to dividends at rates to be determined by the central government from time to time, subject to a minimum of 4 percent per annum. The rate of dividend which had remained constant at 4 percent per annum from 1948 to 1955, was enhanced to 4½ percent in 1956, to 5 percent in 1957 and to 6 percent per annum in 1961. The profit remaining after payment of dividends to share-holders is payable to the central government."[1]

The general supervision and management of the State Bank of Pakistan is exercised by the Central Board of Directors. Out of nine directors, six are appointed by the central government and the remaining three directors are elected by the share-holders, one from each Area. The Governor and the Dyputy Governor/Governors participate as the ex-officio members of the Board. The central government of Pakistan can overrule the decisions of the Board of Directors, if there need be.[2]

The Governor of the central bank is the Chief Executive and administers the affairs of the Bank on behalf of the Central Board of

---

[1] Ibid., p.8.

[2] Ibid., p.9.

Directors and performs his activities as assigned by the Board. He is appointed for five years by the central government of Pakistan and may be re-appointed. The Deputy Governors are also appointed by the central government for a period of five years. Their duties are assig -ned by the Central Board. The State Bank at pre-sent has two Deputy Governors, one posted at Karachi (West Pakistan) and the other at Dacca (East Pakistan).

The functions of the Governor also include that of presiding over the meetings of the Central Board of Directors and the Executive Committee. He is also required to preside over the meetings of the General Assembly of share-holders and other general meetings. He has a second or deciding vote in case of a tie in the vote.

The Executive Committee of the Bank, which deals with all matters on bahalf of the Central Board includes the Governor, Deputy Governors and three directors elected by the Central Board representing the three Areas and one member is appointed by the central govern--ment. The term is three years for elected members and the nominated members can be taken out of the Board any time by the Central Government when necessary.

There are three regional Boards, each consisting of two members elected by the share-holders of the region and one nominated by the Central Government. These regional Boards give advice on local matters to the Central Board and their scope of activities is limited to the powers delegated by the Central Board of Directors.

The head office of the Bank is known as the Central Directorate and is located at Karachi. Besides, the State Bank has nine local offices or branches situated at Karachi, Lahore, Rawalpindi, Peshawar, Quetta and Lyallpur in West Pakistan and at Dacca, Chittagong and Khulna in East Pakistan.

The operations of the State Bank of Pakistan are regulated and governed by various Acts and Ordinances promulgated at different dates. These include:[1]

1. Banking Companies (Registration of Branches) Act, 1946;
2. Banking Companies (Inspection) Ordinance, 1946;
3. Foreign Exchange Regulation Act, 1947;
4. Banking Companies (Control) Act, 1948;
5. State Bank of Pakistan Act, 1956;
6. Banking Companies Ordinance, 1962.[2]

The note issuing and banking functions of the Bank are performed through two separate departments known as Issue Department and Banking Department respectively. The two departments maintain their separate accounts and publish these accounts in the Weekly Statement of Affairs and the Annual Balance Sheet of the Central Bank. Table 5 shows the year-end liabilities and assets of the Banking Department of the Bank

---

1. Ibid, p.5

2. State Bank of Pakistan Bulletine, (Karachi, State Bank of Pakistan, July 1962) p.18

Table 5

State Bank of Pakistan: Liabilities and Assets of the Banking Department (Million Rupees)

Year and Date	Liabilities: Deposits: Central Government	Liabilities: Deposits: Provincial Government	Liabilities: Deposits: Banks	Liabilities: Deposits: Total (a)	Total Liabilities or Assets (c)	Assets: Notes	Assets: Provincial Govt. Debt or Balances	Assets: (d) Loans and Advances	Assets: Investment	Assets: Other Assets
1948 July 2	666.3	59.8	215.3	1,008.0	1,931.3	21.9	..	0.8	..	1,009.1
1948 Dec. 31	923.0	63.4	147.0	1,168.7	1,226.0	23.5	..	3.7	78.0	5.3
1949 Dec. 30	480.8	112.1	218.7	856.2	936.1	31.9	..	22.4	279.2	28.9
1950 Dec. 29	640.9	32.0	100.0	806.2	891.7	57.4	..	92.5	150.8	43.8
1951 Dec. 28	582.0	54.1	147.5	827.0	928.5	62.3	..	136.5	126.8	64.1
1952 Dec. 26	377.1	8.5	101.3	525.0	621.6	48.0	4.8	225.6	255.0	85.0
1953 Dec. 25	215.5	20.6	110.2	370.6	472.5	42.5	4.2	44.0	287.4	94.4
1954 Dec. 31	173.0	48.8	122.3	406.1	520.3	89.0	..	238.6	115.1	77.4
1955 Dec. 30	151.7	11.2	130.6	512.5	625.7	83.5	10.9	184.4	238.1	97.7
1956 Dec. 28	432.5	7.6	143.7	615.5	785.8	103.3	..	219.0	347.7	106.2
1957 Dec. 27	764.4	..	154.5	1,012.2	1,147.7	70.1	87.6	182.2	684.2	122.3
1958 Dec. 26	821.9	5.0	152.6	1,035.8	1,196.5	76.1	32.8	276.5	593.0	90.6
1959 Dec. 25	114.3	86.2	168.9	1,128.4	1,312.1	79.7	..	198.7	547.8	97.3
1960 Dec. 30	109.4	3.4	188.7	1,397.1	1,599.2	68.2	6.8	581.2	469.8	96.2
1961 Sept. 30(b)	211.8	23.3	182.7	1,641.8	1,738.3	133.5	..	421.9	924.6	..

(a) Includes some other deposits.
(b) Provisional
(c) Bills payable and other liabilities not shown separately.

(d) Coins, and Government treasury bills and balance held outside Pakistan not shown separately.

Source: Ministry of National Reconstruction and Information, Government of Pakistan, Pakistan Basic Facts, (Rawalpindi: December 1961), p. 85.

from July 2,1948 to September 30,1961.

C. Responsibilities and Functions of the State Bank of Pakistan.

The original functions assigned to the central bank of Pakistan related only to the traditional duties associated with central banking, i.e.note-issuing, acting as banker to the Government including management of public debts,acting as banker to banks, regulating credit etc.,but with the passage of time, the functions of the Bank evolved so as to meet the requirememts of economic development. This evolution has been noticeable since 1951, when the Six Year Development Plan was inaugurated. Thus we can say that the State Bank of Pakistan, beside the usual central banking functions, has engaged in a variety of developmental and promotional programmes. The more important functions of the central bank of Pakistan are discussed briefly in what follows.

(a) The State Bank as Banker to the Government

The State Bank of Pakistan is required by law to hold the cash balances of the central and the provincial Governments. " In terms of section 21 of the State Bank of Pakistan Act,1956, the central and provincial Governments are required to entrust the Bank, on such terms and conditions as may be agreed upon, with all their remittances, exchange and banking transactions in Pakistan. They have to deposit, free of interest all their cash balances with the Bank. They are also required to entrust it with the management of public debt and with the issue of new loans and treasury bill. The Bank makes 'Ways and Means' advances to the central as well as the Provincial Governments which are repayable not later than three months. These advances are made without any collateral security. In addition, loans are also granted to the Provincial Governments against the collateral of central government securities."[I]

(b) The State Bank as Banker to banks

The State Bank of Pakistan is required to maintain a close watch over the activities of the scheduled banks functioning in the country. The scheduled banks are having some specific obligations i.e., maintaining a minimum reserve at the State Bank of Pakistan and they have to provide assurance to the central bank that"their affairs are not being conducted in a manner detrimental to the interest of their depositors." Their paid-up capital and reserves should not be less than Rs. 5,00000. Every scheduled bank is required by law to maintain a minimum of 2 per-cent of its time liabilities and 5 percent of demand liabilities by way of a minimum balance with the central bank of Pakistan.[2]

The scheduled banks are entitled to clearing facilities from the central bank. These banks are also entitle besides rediscounting facilities to get loans and advances repayable on demand or at the end of a specific time. Under section I7(6) of the State Bank of Pakistan Act, I956, the central bank has been empowered to extend loans and advances to the institutions and banks which are established

I. The State Bank of Pakistan, Its Growth, Functions, And Organization, Op.cit., p.I2.

2. Ibid., p. I3.

for the promotion of agricultural and industrial development in Pakistan. The terms and conditions of such loans are decided by the Central Board of Director of the Bank from time to time.

" Although non-scheduled banks are not required by law to maintain any balances with the State Bank of Pakistan, some of them are allowed to keep accounts with it. Such non-scheduled banks are also provided remittances facilities by the Bank at concessional rates. Non-scheduled banks are also allowed the privilage of becoming sub-members of the Clearing Houses."[I]

(c) The State Bank as Note-Issue Agency

The State Bank of Pakistan has the exclusive right to issue notes in the country. This function is performed by the Issue Department of the Bank.

(d) The State Bank as Controller of Credit

We know that a central bank is the controller of the money market and so is the function of the State Bank of Pakistan. In discharging this responsibility, it is expected to keep a vigilant eye on the money market and to take suitable measures to regulate the supply, cost and use of credit. A detailed appraisal of the role played by the State Bank of Pakistan in this field is given in a subsequent chapter.

(e) The State Bank as Controller of Exchange

I. Ibid., p. I5.

The State Bank of Pakistan is required to maintain the external value of the rupee. It is the responsibility of the Bank to take care of the foreign exchange resources of the country. The Bank is authorized to purchase and sell approved foreign exchange. All foreign exchange transactions in the country are made through the Bank. The exchange control operations of the central bank of Pakistan are discussed in details in a subsequent chapter.

(f) <u>The State Bank as Advisor to the Government</u>

The Economic Advisory Service of the Bank has enabled it to formulate well-conceived policies and to tender advice to the Government of Pakistan on matters of economic importance, particularly those relating to monetary and credit problems.

(g) <u>The State Bank of Pakistan as Agency of Economic Development</u>

Apart from the traditional functions usually assigned to a central bank, the State Bank of Pakistan is required to undertake certain other functions aimed at accelerating the growth of the national economy. This is covered by the State Bank of Pakistan Act 1956, which requires the Bank, "to participate directly in fostering the growth of the monetary and credit system in the best national interests and to help the fuller utilization of country's productive capacity." The Bank is also entrusted with the task of ensuring stability in the economy.

D. <u>Summary and Conclusion</u>

Central banking operations in Pakistan, between August 14,1947 and June 30,1948 were the responsibility of the Reserve Bank of India which acted as the central bank of Pakistan during this period, under the arrangements made at the time of Partition. The State Bank of Pakistan was established on July 1,1948 as the central bank of the country.

The State Bank of Pakistan is a corporation having a share capital of Rs.30 millions and the central Government of Pakistan holds 51 per cent of it. The Central Board of Directors which is the highest governing body of the State Bank includes nine directors in addition to the Governor and Deputy Governors, who are ex-officio members of the Board. The governor as the Chief Executive of the Board is responsible to the Central Board. The head office of the Bank, known as the Central Directorate,is located at Karachi. The Bank, in addition, operates nine local offices at different places in the country.

The Note-Issuing function of the central bank is performed by Issuing Department of the Bank and the banking functions through the Banking Department.

The functions of the State Bank of Pakistan are a combination of the orthodox central banking functions and other functions related to a different kind of developmental and promotional programmes.

The more important functions performed by the State Bank include the following:-

a) as banker to the provincial and central Governments;

b) as bankers' bank;

c) as the sole note-issuing authority;

d) as controller of credit;

e) as controller of foreign exchange;

f)as advisor to Government of Pakistan; and

g) as an agency of economic development for the country.

****

CHAPTER III

CURRENCY MANAGEMENT

"Throughout the world at the present time, the authority to issue circulating notes has generally been removed from the commercial banks and lodged in the hands of the central banks. . . . Having a full or near monopoly of the note issue, the central bank is obviously in a position to control the volume of circulating hand-to-hand money. It has the responsibility of providing adequate supply of notes, so that business activity will not be impeded by a lack of medium of exchange, and, at the same time, it must guard against excessive supplies, since redundancy makes for depreciation." [1]

The central Bank of Pakistan has the exclusive right to issue currency in the country. The preamble to the State Bank of Pakistan Act charges the State Bank with the responsibility " to regulate the monetary and credit system with a view to securing monetary stability and fuller utilization of country's productive resources." In the field of currency management, the objective is achieved by regulating the supply of currency in a manner that will provide an efficient payment mechanism and an appropriate supply of money.

The State Bank of Pakistan which was established on the Ist of

---

1. Raymond P.Kent, op.cit, p.318

July 1948, took the responsibility of currency issue from the Reserve Bank of India from the same date. On June 30,1948, there were Rs.515.70 million Pakistan Inscribed notes in circulation(Pakistan Inscribed notes were issued by the Reserve Bank of India). The Government of Pakistan withdrew from circulation and transfered Indian notes in the amount of Rs.1250.20 million to the Reserve Bank of India during the period of July 1,1948 to June 30,1949. This transfer of notes to the Reserve Bank of India gave the State Bank of Pakistan a share in the assets of the Issue Department of the Reserve Bank of India to the extent of Rs.1765.90 million. The Assets,amounting to Rs.1276.70 million, were received by the State Bank of Pakistan from the Reserve Bank of India till March 23,1949, when the Reserve Bank Of India stopped further transfer of assets due to disagreement between the Governments of India and Pakistan on these claims. On various occassions, attempts have been made to settle these claims but no agreement has been reached and Pakistan's claim for the remaining assets remains unsettled.[1]

The process of transferring Indian currency and replacing it by a new and distinctive currency of Pakistan was the most urgent job of the State Bank of Pakistan after its establishment, which it succeeded in discharging effectively in a short time.

A - Statutory Provisions for Note Issue

As has already been said, the Issue Department of the State Bank

---

1. State Bank of Pakistan, The State Bank of Pakistan:Its Growth,Functions and Organization , p.34

issues the bank notes, which is entirely different in the nature of its functions from the Banking Department of the Bank. The Banking Department is responsible for the distribution and withdrawal of currency in the country. The Issue Department can issue bank notes only in exchange for other bank notes or for such coins,bullion or securities as are allowed by the State Bank of Pakistan Act 1956. Under the Act of 1956, the Issue Department should not allow its assets to fall short of its liabilities and a minimum of 30 per cent of the total assets must be kept in gold coins, gold bullion, silver bullion and approved foreign exchange.[1] The rest of the assets are required to be maintained in the form of rupee coins, rupee securities and such bills of exchange and promisory notes payable in Pakistan, as are eligible for purchase by the Act, and also the assets claimed by the State Bank of Pakistan from the Reserve Bank of India. But it has been observed that the bills of exchange and promisory notes have never been a part of the assets of the Issue Department due to the under-developed state of the bill market in Pakistan.

The State Bank of Pakistan has generally maintained a much higher percentage of gold coin,gold or silver bullion and approved foreign exchange against its total liabilities in the Issue Department than what is required by law. Table 4 shows the percentage of these currency reserves to the total over the period 1949-61. This percentage, as can be seen from Table 4, ranged between a low of approximately 35 per

---

1. <u>Ibid</u> , p.35

cent in 1958 and a high (excluding 1949) of over 67 per cent in 1950.

TABLE 6

PERCENTAGE OF CURRENCY RESERVES TO
THE TOTAL NOTES ISSUED.
(June 1949 to June 1961)

As on	Ratio of gold coins, bullion and approved foreign exchange to total notes issued.
June 30,1949	97.71
June 30,1950	67.80
June 30,1951	67.26
June 30,1952	58.75
June 30,1954	40.00
June 30,1956	58.55
June 30,1958.	35.42
June 30,1960	39.10
June 30,1961	41.00

Source: State Bank of Pakistan, Department of Statistics.

B - Administrative Arrangement for the Issue of Currency

The State Bank of Pakistan, as the Note-Issuing Authority is responsible for the supply of currency in adequate quantity. In order to meet this obligation, the Bank has developed the necessary administrative arrangements throughout the country. " At present it is maintaining four offices of issue, namely, at Karachi, Dacca, Lahore and Peshawar, and currency chests with (i) the offices of its agents i.e.

the National Bank of Pakistan and with (ii) Government Treasuries and sub-Treasuries at places where there is no branch of the Bank or its agency. Each office of issue of the Bank is under the charge of a Currency Officer who is responsible for providing adequate facilities for exchange of notes and coins to the public at his office and for maintaining sufficient stocks of notes and coins at currency chests located in the area lying within his jurisdiction. At present there are 247 currency chests spread all over the country."[1]

The National Bank of Pakistan or the Treasury Offices, as the case may be, are responsible for the safe custody of these currency chests. These chests are playing a very important role in the distribution of currency throughout the country and have enabled the Government Treasuries or sub-Treasuries to work with relatively small balances, because replanishment is possible, whenever they confront a shortage of cash balances. This procedure of replanishment is done in accordance with an agreement between the Government of Pakistan and the central bank.

C-Changes in Currency Circulation

Changes in the quantity in circulation have been largely governed by seasonal factors. Pakistan has two distinct seasons, namely, the busy season, extending generally from November to May and the slack season, extending from June to October. The demand for currency during the busy season usually increases considerably

---

1. Ibid, p.37

as during this period, a greater amount of Pakistan's exportable products are harvested,moved and marketed and hence a considerable amount of currency expansion takes place during this period. During the slack period there is a contraction in currency circulation, as there is a return flow of cash to banks.

TABLE 7

INDICES OF SEASONAL VARIATIONS IN
CURRENCY CIRCULATION IN PAKISTAN
(1957 to 1961)

Month	Seasonal Index
January	100.9
February	101.9
March	99.5
April	107.4
May	106.4
June	97.6
July	96.5
August	95.7
September	95.6
October	97.2
November	99.3
December	.102.0

Source: Calculated from the figures taken from the United Nations,Monthly Bulletins of Statistics(New York: United Nations,1956-61)

The seasonal changes in currency in Pakistan are clear from Table 7, The Table shows a peak in April and low in August. It indicates that the Index of currency in circulation at the beginning of the busy season in November was 99.3. It increased steadily from November to May and reached the level of 106.4.The net expansion from November to May is approximately 7.1 per cent. The currency in circulation declined drastically with the start of the slack season in June. It fell from 106.4 in May to 97.6 in June and to 95.6 in September.

Apart from seasonal variations, the volume of currency in Pakistan was growing from year to year. The currency in circulation for the years 1957, 1958, 1959, 1960 and 1961 was Rs.41374 million, Rs.42561 million, Rs.43638 million, Rs.46154 million and Rs,49117 million respectively. There was a net increase of 2.8 per cent, 5.4 per cent, 11.5 per cent and 16.2 per cent during the said years.

Apart from the seasonal factors, however, there are several other conspicuous factors, super-imposed on them, that exert simultaneous influences on the volume of currency in circulation in the country. More important of these relate to the state of over-all economic activity in the country, the price level, the balance of payments position, fiscal operations of the Government and banking habits of the people. The rise in the volume of currency circulation in Pakistan over the above period may be explained in terms of these factors.

The system of decimal coinage has been introduced, on a gradual basis in Pakistan, since January 1,1961, Under the new system, the rupee has been kept the same both in value and nomenclature but has been divided into 100 equal parts, named 'paisas' as against the division into 64 pices. The 'paisa' is the smallest unit of currency in the country. This process of change-over to a full-fledged decimal coinage system is expected to end by December 31,1963.[1]

D- Summary and Conclusions

The central bank of Pakistan has the exclusive power of note-issue in the country. Among the first of its extra-ordinary duties was the replacement of pre-Partition currency and coinage in circulation by fresh and distinctive issues. The operation was highly complex but the Bank was able to cope with it successfully.

The function of note-issue is discharged by the Issue Department of the Bank. Under the existing statutory provisions, it is required that a minimum of 30 per cent of the total assets should be kept in the form of gold coin, gold bullion, silver bullion and approved foreign exchange. In order to provide sufficient supply of currency, the State Bank of Pakistan has developed adequate administrative arrangements throughout Pakistan.

The volume of currency in circulation is subject to seasonal fluctuations in the country. In the busy season,which starts in November and ends in May, the demand for currency increases. As a result, a substantial currency expansion takes place. The currency in circulation in 1957 was in the order of Rs.41374 million and in 1961 it increased by Rs.7743 million i.e. by 16.2 per cent. The Government of Pakistan introduced decimal coinage in the country with effect from January 1,1961.

---

1. State Bank of Pakistan, Report on Currency and Finance 1960-61, op.cit., p.59

CHAPTER IV

CREDIT POLICY OF THE STATE BANK OF PAKISTAN

"Credit is an essential part of monetary management. It plays a predominant role in the settlement of monetary and business transactions of all kinds, and thus represents a powerful force for good or evil. It is thus universally accepted that the creation and distribution of credit, under the existing intricate economic organization,should be subjected to some form of regulation and control. The social and economic consequences of severe fluctuations in the purchasing power of money and in business activity during the past forty years have been further emphasised the need for the regulation of credit in one form or another."[1]

In a developing country which had to start from scratch, the new social,political and economic institutions which came into being have had to shoulder more than ordinary share of the burden to fulfil the tasks assigned to them. The State Bank of Pakistan was no exception. As the central bank of the country it was its duty to regulate monetary and credit systems in the country.In addition to this, the central bank was responsible to promote the growth of the economy so as to secure the fuller utilization of country's productive resources. For all these purposes, the central bank of Pakistan has been provided

---

1. G.P.Gupta, The Reserve Bank of India and Monetary Management (Bombay,Asia Publishing House,1959) p.73

with wi e powers of credit control.

A - Statutory Authority of the Bank

As the central bank of Pakistan, the State Bank is entrusted with statutory responsibilities for regulation of the monetary and credit system in the country. In trying to achieve its objectives, the State Bank establishes what credit polices it deems to be in the national interest. It also supervises the working of credit agencies with a view to ensuring sound and efficient lending in the public interest.

The State Bank of Pakistan Act, 1956 has provided adequate powers to the Bank for the use of all traditional weapons of credit control. Three major quantitative instruments of credit control embodied in the said act are the following:-

i) Bank Rate Mechanism;

ii) Open Market Operations; and

iii) Variable Reserve Requirements.

Besides these quantitative instruments, there are certain qualitative credit control devices which may be used by the State Bank of Pakistan under the provisions of various enactments. It is the duty of each banking company to observe the central bank's instructions. The State Bank is empowered to give directions to the commercial banks as to ;-

i) the purpose for which advances may or may not be made;

ii) the margin to be maintained in respect of secured advances.

iii) the types of transactions into which commercial banks may enter; and

iv) the rate of interest to be charged on advances.

The main objective and duty of the State Bank of Pakistan is to seek to achieve and maintain reasonable financial stability in the country through control of the cost and availability of credit. Its crdit control policy is directed toward the economic development of the country which is discussed in detail in the last chapter.

(B) Credit Control Policy of the Bank

The primary methods available to the State Bank of Pakistan for regulation of the volume, as distinct from the allocation, of credit are the bank rate, open market operations, and variable reserve requirements.

(a) Bank Rate

By offering rediscounting facilities, the State Bank of Pakistan provides the member-banks with additional means for the conversion of certain of their earning assets into cash in times of need.

The bank rate was used as a tool of credit control only once in the history of the State Bank of Pakistan to date. In October 1958, when Martial Law was imposed in the country, the Government of Field Marshal Mohammad Ayub Khan stopped deficit financing and took several steps to check the inflationary trend in the country. It was considered most apporprite at that time to raise the bank rate as to support the anti-inflation policy of the new Government. As a result, the bank rate was raised for the first time from 3 percent to 4 percent from January 1, 1959. Since then the bank rate has remained unchanged.[1]

---

1. State Bank of Pakistan, The State Bank of Pakistan, Its Growth, Functions. And Organisation: Op.cit., pp. 67-68.

(b) Open Market Operations

Open market operations, in the context of monetary policy, relate to the dealings in securities in the market with a view to regulating the supply of money. In 1951, the Bank purchased a fairly substantial amount of securities from the market to enable the banks to meet the increased credit needs arising from the Korean War boom. Open market operations in substantial volume were also undertaken during the year 1958-59 as an anti-inflationary measure . The net sale of Government securities by the Bank during this period amounted to Rs. 45.10 million.[1]

(c) Reserve Requirement

Minimum reserve requirements were originally introduced to achieve three objectives:[2]

i) "to ensure the liquidity and solvency of individual banks and therefore, of the banking system as a whole;"

ii) to supply the central bank with adequate resources for its local operations;

iii) to provide the central bank with resources to keep the volume of money and credit in the economy under control.

However, with the passage of time, the first two objectives are considered less important than the third one. The main purpose of legal minimum requirement is to provide the central bank with an additional

---

1. State Bank of Pakistan, Report on Currency and Finance, op.cit (Karachi: State Bank of Pakistan, 1958-59) p.37

2. G.P.Gupta, op.cit.;pp.155-56

tool of credit control.

Under the original State Bank of Pakistan Order of 1948, every scheduled bank was required to maintain with the State Bank of Pakistan a balance, the amount of which at the close of business on any day was to be not less than five per cent of its demand liabilities and two per cent of its time liabilities in Pakistan. By an amendment to the Order in 1949, which has been incorporated in the State Bank of Pakistan Act,1956 (Section 36), the central bank of Pakistan has been empowered to vary this ratio by notification in the official Gazette.[1] It would thus be observed that under the existing legislation no maximum is specified for the reserve requirement. It can be varied to any extent to suit the exigencies of varying situations. But in the context of the country's economic development, the State Bank has not so far considered it necessary to use this quantitative instrument of credit control. The prescribed ratio has remained unchanged since the inception of the State Bank about fifteen years ago.

According to a news breadcast from Radio Pakistan on July 26, 1963, the Board of Directors of the State Bank of Pakistan has decided that all commercial banks are required to maintain a balance of five per cent for both time and demand liabilities with immediate effect. This is for the first time in the history of the State Bank of Pakistan that the reserve requirements have been changed in order to check

---

1. State Bank of Pakistan Act 1956, Section 36(2).

inflationary tendencies in the country.

(d) Qualitative Credit Controls

It has been observed that the State Bank of Pakistan has preferred to use qualitative instruments of credit control than quantitative measures, as these measures are most suitable for Pakistan in view of its under-developed economy.

The State Bank did not impose any restrictive measures till September 1949, as the conditions prevailing at that time demanded no interference by the central bank. There was no inflationary tendency in the country due to a liberal import policy and insufficient credit facilities after the partition of the sub-continent of India and Pakistan. It was rather considered desirable that the credit facilities should be expanded in the country so as to give a push to the economy. Thus it was the duty of the central bank of Pakistan to provide facilities for the urgent needs of the businessmen which encouraged credit expansion in Pakistan during this period.

In September 1949, the Covernment of Pakistan did not devalue its currency with the devaluation of Sterling. This encouraged importers and huge import orders were placed with borrowed funds. This resulted in diverting a sunstantial amount of credit from the export business to the import business and the export trade suffered greatly. The State Bank considered these activities of importers a direct threat to the foreign exchange reserves of the country and imposed various restriction aiming at two things:

i) improving the balance of payment situation; and

ii) checking the speculative tendencies in stock exhanges[1]

In order to check the increase in imports the State Bank, in 1950, asked the banks that letters of credit opened by importers should be covered by a deposit of at least 35 per cent of the value of imported goods. This limit of 35 per cent was later raised to 75 per cent. " These orders were soon reinforced by a circular issued by the Bank in September 1950, impressing upon commercial banks the necessity of providing adequate credit facilities for the export trade. They were advised to review the existing credit limits with a view to reducing them whenever possible, and also to exercise extreme care in sanctioning new limits so that funds could be released for financing the export trade."[2]

The Korean War brought a great boom in the export business of Pakistan and the prices of cash crops (namely, Cotton and Jute) rose considerably. This resulted in a substantial increase in money supply due to an improved balance of payment position and increased bank credit (which was Rs.85 million in 1949-50 and rose to Rs.491 million in 1950-51)[3]. Hence Pakistan was facing the threat of inflation. In order to make credit restrictions more effective, it was decided by the bank that advances against stocks of imported goods should not exceed 50 per cent of their values and unsecured advances were not allowed to be made to the importers. In November 1952, when the Open General

---

1. Muhammad Uzair, Some Aspects of Bank Credit in Pakistan (Karachi: Institute of Public and Business Administration, 1959) p.26

2. State Bank of Pakistan, The State Bank of Pakistan: Its Growth, Functions and Organization; op.cit., p.64.

3. Andrus and Mohammad, op.cit., p.366

License (OGL)* was suspended, it was thought that these restrictions were not needed and were withdrawn.

The suspension of Open General License diverted funds from the import trade to the stock market and there developed intensive speculative activity in Stocks, "the State Bank, in June 1955, directed banks to refrain from making advances against the security of shares of a company in anticipation of their allotment unless the borrowers made a cash deposit of 50 per cent or more of the application money. They were also asked not to make unsecured advances to borrowers seeking to apply for allotment of shares in a company."[1]

Due to increased Government spending and restricted imports, the country was facing inflation. In order to check the inflation, the central bank asked the banks in June 1957 that advances should be made only to the extent of 60 per cent of the value of imported manufactured goods, bullion, food grains and oil-seeds. The main purpose of these restrictions was to channel the credit to more urgent and essential purposes. A circular letter was issued to all banks regarding these restrictions.[2] Meanwhile, the Authorized dealers (appointed by the State Bank and required to hold a license to deal in foreign exchange) were also directed that letters of credit should be opened only when the importers can deposit

---

* At the time when the OGL was in practice, there were no import restrictions in Pakistan.

1. State Bank of Pakistan, The State Bank of Pakistan:Its Growth, Functions and Organization, op.cit.,p.66

2. State Bank of Pakistan, Circular No.BCD (1)4/16-57 (Karachi: State Bank of Pakistan,June29,1957)

I5 percent of the value of the import bill. These restrictions were imposed in order to prevent the banks from channelling their loans for non-seasonal finance. These restrictions of the central bank were quite effective and such advances declined by I3.78 percent by May, I958. In January, I958, the Bank imposed additional restrictions and asked the banks not to advance more than 60 percent of the market value of shares of Joint Stock Companies.

"These restrictions achieved considerable success in curbing bank advances for speculative purposes, and were withdrawn only after the promulgation of Martial Law in October, I958, when, owing to a vigorous drive launched against hoarding, black marketing and smuggling, the price level showed a perceptible downward trend making it un-necessary to keep these restrictions in force any longer.[I]"

The State Bank of Pakistan in January. I960, used another method of selective credit control when it was observed that there was a great amount of credit extended against shares. In order to prevent this tendency, the Bank instructed the commercial banks that credit should only be provided against newly floated shares if 50 percent of the price was provided by the prospective subscribers from their own resources. They were further direted to restrict their advances against imported manufactured consumer goods upto the 60 percent of the value of such goods. Unsecured loans

---

I. State Bank of Pakistan, <u>The State Bank of Pakistan, Its Growth, Functions And Organisation</u>, op.cit., p.65.

for imports were stopped altogather. A limit of Rs. 50,000 was placed for secured advances to a single party. In oreder to protect the small importers advances upto Rs. 25,000 were exempted from the 40 percent margin requirement. Further relaxation was given to East Pakistani traders in April, I963 so as to encourage the development of that wing of the country. In August, I96I, the restrictions imposed in connection with advances against shares of companies were withdrawn.

Though the State Bank of Pakistan enjoys wide powers of credit control in the country, yet the scope of these controls is limited due to lack of a developed money market. The Bank rate tool is not very effective as it is not capable of producing the desired effects and also the instrument of open market operation is not used frequently due to lack of a well- developed bill market. In addition to this, we should not forget that the market for Government securities is very limited and passive. Only institutional investors hold these securities.

The State Bank of Pakistan has relied mainly on moral susion and consultation with commercial banks and also on qualitative controls in order to achieve its objectives of credit control in the country. It is interesting to point out that the commercial banks have always shown great co-operation with the central bank of Pakistan in order to control credit in the country.

(C) The Structure of Credit in Pakistan

(a) Agricultural Finance

Agriculturalist in Pakistan ordinarily do not have sufficient capital of their own to finance production and marketing, and have to borrow from whatever sources are available to them. The supply of institutional credit is not adequate and Government funds* available for agricultural loans are limited. Hence recourse has to be made by farmers to individuals like relations and friends, landlords, money-lenders and merchants.

Institutional credit in Pakistan occupied rather a major position. No commercial banks existed in the rural areas in pre-partition days, nor did they lend against land or fixed assets. Moreover, they were fully occupied with commercial and indutrial credit, and were not interested in agricultural finance.[I] The co-operatives advanced I3 to I4 percent of loans in West Pakistan, while in East Pakistan they were mostly in-operative and advanced only a nominal (0.6 percent) amount of rural credit.[2] Thus, the lack of agricultural finance was provided by the sources, such as, relatives, friends, landlords and merchants, while the rest was provided by the Government, the co-operatives and the banks. The traditional money-lenders disappeared from Pakistan with the migration of the professional money-lending classes after Indepedance in I947. Although their rate of interst were usurious and the methods questionable, they used to play a role which would otherwise have remained unfilled. A new class of indigenous money-lenders is now coming into existence although their number is not

---

* The Central Agricultural Ministry and Departments of Agricultural in the two provinces provide loans to farmers on a limited scale.

I. Government of Pakistan, <u>Credit Enquiry Commission Report</u>,(Karachi: Manag -er, Covernment of Pakistan Press, I960). pp. 8-IO.

2. <u>Ibid.</u>, p. IO.

yet large and the volume of their operations not important.Merchants and commission agents, who arrange the marketing of the produce,play a limited part in financing agriculture, particularly in the course of marketing operations.They often advance short-term loans a few months before harvest on the condition that the produce will be sold to or through them.[1]

The other important feature is that relations and friends, including the farmers and land-lords provide almost two-thirds of agricultural credit, generally without interest.[2] While the spirit of the felow-feeling and mutual help is appreciated, there is growing tendency of demanding the mortgage of land as security for loans. There is often a provision that in case of failure to repay within a stipulated period, the land would be transferred to the creditor.As the borrowers are usually small holders and agriculture very much depends on the vagaries of nature, a a number of them default. This results in the transfer of land to the creditors, who might originally have been sympathetic to the needs of their friends and relations but ultimately dispossess the borrower of his land. Being interest-free, such loans are highly attractive: a serious problem is, however, bound to arise if these become common and ultimately result in the small farmer losing his agricultural holding and becoming a landless peasant. In the past, land-lords and proprietor also provided some credit to their tenants both in cash and kind. With the introduction of land reforms, there is a danger that land-lords may not be interested

---

1. State Bank of Pakistan, Twelve Years of Banking in Pakistan op.cit. p.16

2. Government of Pakistan, Credit Enquiry Commission Report, op.cit. p.9

in advancing agricultural loans in future. Therefore,the sources of credit may dry up in the course of time.

Agricultural loans are granted by the Government under the Land Improvement Loans Act of 1883 and Agriculturists Loans Act of 1884.[1] The former is to cover long-term loans for the improvement of land on permanent basis, and, under the latter, short-term loans are granted for current agricultural needs.

Institutional credit for agriculture,to whatever extent it is available, is provided mainly by the co-operative Societies. In West Pakistan, from 1947 to 1957, the number of co-operative societies has increased from 245,994 to 375,276. According to the Credit Inquiry Commission, seven per cent of the rural families are served by primary agricultural credit societies of the country's population living on agriculture.[2]It would seem therefore,that although the co-operative movement is more than 50 years old in the Indo-Pakistan sub-continent and almost all the co-operative in the past took place in the credit field, it has not succeeded in making a real contribution to the provision of credit. The lack of suitable training facilities for the co-operative staff and workers, and even insufficient appreciation of the co-operative principle and philosophy have resulted in the slow progress.

The State Bank of Pakistan is charged with special responsibility in the field of Agricultural Credit. It has created an Agricultural Credit

---

1. Ibid,p.14

2. Ibid,p.25

Department. The functions of the Department are:[1]

i) to maintain an expert staff to study all questions of agricultural credit and available for consultation by the Central Government, Provincial Governments,Provincial Co-Operative Banks and other bankingg organizations;

ii) to co-ordinate the operations of the bank in connection with agricultural credit and its relations with the provincial co-operative banks and any other organization engaged in the business of agricultural credit; and

iii) to provide finance to farmers through extention of credit to the co-operative banks and other agencies doing business in the field of agriculral credit.[2]

In 1951, the State Bank of Pakistan helped in creating the Agricultural Development Finance Corporation (ADFC) but the Corporation was not successful in the beginning of its existence. In order to strengthen the institutional frame-work in the field of agricultural credit, the State Bank of Pakistan helped in establishing the Agricultural Bank of Pakistan (ABP) which came into being in 1957. The Agricultural Development Finance Corporation and Agricultural Bank of Pakistan were merged into one organisation in 1961 on the recommendation of the Credit Inquiry Commission and is now known as the Agricultural Development Bank of Pakistan.(ADBP)[3]

---

1. State Bank of Pakistan Act,1956,Section 8(3).

2. State Bank of Pakistan, Twelve Years of Banking in Pakistan, op.cit.,p.17

3. S.A.Meenai,Credit and Monetary Situation in Pakistan,(Karachi: State Bank of Pakistan,1962) p.37

The State Bank of Pakistan is playing a very important role in the field of agricultural credit in the country. During the period 1959-60, the total agricultural credit provided by different agencies was Rs.186.60 million and over 47 per cent of this amount was providedd by the State Bank to these agencies. In 1960-61 and 1961-62, the State Bank provided 80 per cent and 86 per cent of the total loans paid by Agricultural Bank of Pakistan.[1] It is clear from this discussion that the central bank of Pakistan has a big share in the provision of agricultural credit in the country.

The Agricultural Development Bank of Pakistan extends credit in cash as well as in kind to farmers and to cottage industries too. The checking facilities are provided by the bank in rural areas and farmers have access to the facilities of fixed deposits and savings bank accounts extended by the bank to them. It has been reported that the rate of interest (five per cent per annum) charged by the Agricultural Development Bank of Pakistan is one of the lowest in the world in the area of agricultural credit.[2]

" During the calender year 1961, the Agricultural Development Bank advanced loans amounting to Rs.68.50 million as compared to Rs.60.20 million in 1960 and Rs.31.90 million in 1959. During the first three months of 1962, a sum of Rs.22.30 million was advanced. At the time of merger, the Bank had 47 branches , five sub-branches and 22 pay-offices

---

1. Ibid.,pp.38-39

2. State Bank of Pakistan, Twelve Years of Banking in Pakistan, op.cit.,p.33

spread all over the country. After the merger, the existing branches and pay offices were re-organized. At present it has 93 offices of which 51 are located in West Pakistan and 42 in East Pakistan." [1]

(b) Industrial Finance:

Funds are needed for fixed capital and working capital requirements in the field of industry. There are various lending agencies in Pakistan which are engaged in the area of industrial credit. Industrial working capital is amply provided by commercial banks, co-operative banks, Provincial Government Department of Industries, Insurance Companies and specialized credit agencies.[2]

The role of commercial banks in industrial credit is limited due to the nature of commercial banks operations. Demand deposits dominate in the structure of their deposit liabilities and the banks generally do not willingly extend credit other than short-term loans to industries. It has been estimated that the commercial banks' share is 10.6 per cent of total working capital invested in industries in the country.[3]

The Central Ministry of Industries and Provincial Departments of Industries do provide credit for the medium and short-term needs of various industries but their role is very limited in this direction.

---

1. Pakistan Publications, Pakistan 1961-62 (Karachi: Ferozesons Ltd., 1962) p.31

2. State Bank of Pakistan, Twelve Years of Banking in Pakistan, op.cit. p.18

3. Ibid, p.19

The role of Insurance Companies is also negligible and they generally invest in Government Securities.

The Pakistan Industrial Finance Corporation (PIFCO) came into being in 1949 with the object of meeting the medium and lond-term requirements of industries in the country. The Corporation has played a very important role in the industrial development of the country through the extention of credit to many industries. It has been engaged in providing credit in the amount of Rs.270 million during the 12 years of its existence, ending on 30 June 1961, to a wide range of industries in the private sector of the economy.[1]

The Credit Inquiry Commission recommended the re-organiztion of the Pakistan Industrial Finance Corporation and from July29,1962 the Corporation was re-named as the Industrial Development Bank of Pakistan. The Bank is charged with the responsibility of providing medium and long-term credit to various industries.

The Pakistan Industrial credit and Investment Corporation (PICIC) is another important lending agency in the area of industrial credit. It was created in 1957 with the special responsibilty that the agency will not only provide loans but will also take active part in equity capital and will encourage and co-ordinate the foreign capital in Pakistan. Private investors from U.S.A., U.K.,Canada, Japan and West Germany hold 40 per cent of the shares of the Corporation and the remaining

---

1. Pakistan Publications, <u>Pakistan,1961-62</u>, <u>op.cit.</u>,p.30

60 per cent shares are held by Pakistani citizens.[1]

There is no fixed rate of interest charged by the Corporation but terms and conditions are decided on the basis of each application. "Total commitments since the inception of the Corporation upto the end of 1961 amounted to Rs.202 million in respect of 202 projects of which the equivalent of Rs.169.40 million were in foreign currencies and Rs. 30.80 million in local currency. In addition to the above, loans aggregating Rs.57.30 million for 30 more projects were sanctioned but loan agreements had not been signed by December 31,1961"[2] The Industrial Credit institutions are receiving loans from the State Bank of Pakistan on a continuous credit line basis, which is sanctioned by the Bank according to the needs of these institutions from time to time.

(c) Other Forms of Credit

(i) Real-Estate Credit:" The construction of new houses was relatively neglected in the Indo-Pakistan sub-continent during the War years, The demand for housing facilities,on the other hand,continued to grow rapidly during period on account of increasing population, war time inflationary pressures and accelerated urbanization. While Rent Control Acts adopted in various big cities provided relief to the middle class urban dwellers, little incentive was left for new construction or even for proper maintenance."[3]

---

1. Ibid p.30

2. Ibid

3. State Bank of Pakistan, Twelve Years of Banking in Pakistan; op.cit. p.43

The Partition of the sub-continent made the housing problem very acute. Millions of refugees crossed borders from one country to another. In order to meet this challenge, the Government of Pakistan created an organization known as House Building Finance Corporation (HBFC) in November 1952, for extending credit facilities for the construction of houses. Beside this Corporation, such facilities are also provided by a large number of registered co-operative housing societies throughout the country. The Government of Pakistan and some semi-public organizations also extend credit to their employees for the construction houses. The Corporation has so far provided credit facilities in 70 major cities of Pakistan.

ii)Commercial Credit: Small firms have difficulty in meeting the security requirements of lending institutions. In Pakistan, the small borrowers under such difficulties have to depend upon the merchants or the middle men for credit, who charge high rates of interest. While the small businessman is gradually emerging in the commercial field, the difficulties in the way of his getting all the credit which he needs, still persist. The Credit Inquiry Commission has reported that at the end of March 1959, 63 per cent of bank advances were given to only 222 parties involving Rs.100,0000 and above. In contrast to this, advances upto Rs.25,000 to small traders were only 5.6 per cent of total bank advances. But it is interesting to point out that the State Bank of Pakistan, through consultation with and co-operation of banks, has tried to narrow down this gap between these two extremes. The results are quite encouraging and by the end of March 1962, the number of loan accounts below Rs.25,000 had increased from 37,275 in March 1959 to 71,802. The percentage of such loans to total loans has also increased from 5.6 per cent to 8.4 per cent during these three years. Though during the same period, the number of loan-accounts consisting of Rs.1000000 advances have increased from 222 to 333, the percentage to total advances has decreased from 62.7 per cent to 56.6 per cent.[1] It is hoped that this trend will continue and with the opening of many bank branches in the rural areas, this will change the loan distribution in the country. The leading banks of Pakistan are making great efforts to bridge this gap and are extending their full co-operation in this direction.

(iii) Consumer Credit: There is a constant demand in Pakistan for funds to meet personal expenditure on social activities, litigation, education, illness and house repair. This demand is mostly met through non-institutional sources of credit, as commercial banks in Pakistan generally do not provide facilities for consumer credit.

D- Summary and Conclusions

The State Bank of Pakistan, as the central banking authority in the country, enjoys wide powers of credit control and has the statutory responsibilities for regulating the monetary and credit system in the country. Beside the traditional weapons of credit control

---

1. S.A.Meenai, op.cit. , pp.84-89

the central bank of Pakistan has been given extensive powers of qualitative credit control. Inspite of so much powers, the State Bank is hindered in the implementation of its credit control policies by want of a well-developed money market in Pakistan. Due to this obstacle, the Bank has made efforts to achieve the objectives of its credit policy largely through moral suasion and consultation with commercial banks and also through qualitative control from time to time.

The central bank of Pakistan has established an Agricultural Credit Department. During the period of 1959-60, the total agricultural credit provided by different agencies was Rs.186.60 million and over 47 per cent of this amount was provided by the State Bank to these agencies. In 1960-61 and 1961-62, the Bank providedd 80 per cent and 86 per cent of the total loans extended by the Agricultural Bank of Pakistan. The Agricultural Bank of Pakistan(now Agricultural Development Bank of Pakistan) receives loans and advances from the State Bank of Pakistan through a line of credit by the Bank from time to time.

The Pakistan Industrial Finance Corporation* has contributed greatly in the field of industrial credit during its 13 years of existence in the order of Rs.270 million. The Pakistan Industrial Credit and Investment Corporation (1957) has made total commitments since its inception upto the end of 1961 amounting to Rs.202 million. Out of this amount, the equivalent of Rs.169.40 million were in foreign exchange. These Corporations (The Pakistan Industrial Finance Corporation(PIFC)

---

*After re-organization in July 1961, the Corporation was merged in the Industrial Bank of Pakistan (IDBP).

and the Pakistan Industrial Credit and Investment Corporation -PICIC) are given loans and advances by the State Bank of Pakistan through a continuous line of credit.

The House Building Finance Corporation(1952) has so far extended credit facilities to 70 major cities of Pakistan;a line of credit by the State Bank is always at its disposal for extension of loans. Efforts are made by the State Bank of Pakistan to meet the needs of small borrowers Consumers' credit granted by the banksis insignificant and such needs are met from non-institutional sources.

****

CHAPTER V

MONETARY DEVELOPMENTS AND POLICY IN PAKISTAN

A- The Bahaviour of Money Supply in Pakistan

It has been observed that people in Pakistan have a great preference to the use of currency over the deposit money. This is mainly düe to the lack of banking facilities and the lack of appreciation of the use of deposits as a means of payments. Consequently, it has been very difficult for the central bank of Pakistan to exercise effective credit control by regulating the credit institutions, more particularly of commercial banks.

The money supply, as used here, is composed of currency in circulation (which is arrived at by deducting currency held by the State Bank of Pakistan and currency in the tills of scheduled banks from currency outstanding at a specified date), demand deposits of the private sector and other deposits with the State Bank of Pakistan.* Table 8 shows the trend of money supply in Pakistan. The total money supply was Rs. 2634.90 million on December, I948, and Rs. 576I.80 million in December, I959 as compared with Rs. 6095.30 million in July, I962.

---

* The 'Other Deposits' with the State Bank of Pakistan's are the deposits of the Central and Provincial Governments excluding I.M.F. Account No. I and special U.S. Commidity Aid Accounts.

Table 8

MONEY SUPPLY

(Rupees in lacs)**

Last Friday	Currency				Deposits		
	Currency Outstanding	Held by State Bank of Pakistan	In Tills of Scheduled Banks	Currency in Circulation (1-2-3)	Demand Deposits (General)	Other Deposits with S.B.P.@	Money Supply (4 + 5 + 6)
	1	2	3	4	5	6	7
December, 1948	176,37	2,37	3,21	170,79	89,17	3,53	263,49
December, 1949	181,07	3,19	3,93	173,94	88,63	4,45	267,02
December, 1950	209,99	5,74	5,06	199,19	90,72	3,34	293,25
December, 1951	260,13	6,23	7,16	246,74	119,03	4,01	369,78
December, 1952	225,97	4,80	6,08	215,08	102,27	3,49	320,84
December, 1953	245,39	4,25	3,96	237,18	115,14	2,10	354,42
December, 1954	271,84	8,90	5,48	257,46	117,04	5,87	380,37
December, 1955	312,25	8,35	4,95	298,95	132,63	5,35	436,93
December, 1956	365,05	10,34	8,10	346,61	142,97	2,69	492,27
December, 1957	373,58	7,02	8,27	358,30	156,21	8,85	523,36
December, 1958	390,39	7,62	8,57	374,20	170,86	5,14	550,20
December, 1959	398,07	7,98	5,67	384,43	187,13	4,62	576,18
December, 1960	433,32	6,83	8,25	418,24	193,28	4,70	616,22
July, 1961	401,76	17,80	6,79	377,17	201,78	4,73	583,68
August, 1961	396,80	15,75	7,09	373,96	201,13	4,82	579,91
September, 1961	391,83	13,36	7,28	371,19	201,88	4,85	577,92
October, 1961	396,84	13,94	7,00	375,89	202,74	5,06	583,69
November, 1961	401,89	8,52	7,24	388,13	203,52	5,28	596,93
December, 1961	428,92	12,34	11,15	405,42	210,00	5,12	620,54
January, 1962	433,99	13,48	8,07	412,44	206,91	4,19	623,54
February, 1962	429,07	15,65	8,13	405,29	213,37	4,14	622,80
March, 1962	429,19	16,67	7,60	404,92	215,93	4,11	624,96
April, 1962	426,18	17,76	7,88	400,54	209,83	4,16	614,57
May, 1962	425,89	18,12	8,20	399,56	211,07	4,44	615,07
June, 1962	410,88	14,81	9,52	386,54	219,01	4,93	610,48
*July, 1962	405,87	16,98	8,23	380,66	224,04	4,83	609,53

@ Excluding I.M.F. Account No. 1 and Special U.S. Commodity Aid Accounts.

* Provisional.

Source: State Bank of Pakistan Bulletin, September, 1962, p. 69

** 10 lacs = 1 million

Table 9 shows the yearly rate of expansion or contraction of currency in circulation and deposits in Pakistan.

TABLE 9

CURRENCY IN CIRCULATION AND DEPOSITS IN PAKISTAN

(December 1948 to December 1961)

Last Friday	Currency in Circulation	Expansion(+) Contraction(-)	Deposits	Expansion (+) Contraction(-)	Changes in Total Money Supply.
December, 1948	1707.90	-	927.00	-	-
December 1949	1739.40	(+) 31.50	930.80	(+) 3.80	(+) 35.30
December 1950	1991.90	(+) 252.50	940.60	(+) 9.80	(+) 262.30
December 1951	2467.40	(+) 475.50	1230.40	(+) 389.80	(+) 865.30
December 1952	2150.80	(-) 316.60	1057.60	(-) 172.80	(-) 489.40
December 1953	2371.80	(+) 221.00	1172.40	(+) 114.80	(+) 335.80
December 1954	2576.60	(+) 202.80	1229.10	(+) 56.70	(+) 259.50
December 1955	2989.50	(+) 412.90	1379.80	(+) 150.70	(+) 563.60
December 1956	3466.10	(+) 476.60	1456.60	(+) 76.80	(+) 553.40
December 1957	3583.00	(+) 116.90	1650.60	(+) 194.00	(+) 310.90
December 1958	3742.00	(+) 159.00	1760.00	(+) 109.40	(+) 268.40
December 1959	3844.30	(+) 102.30	1917.50	(+) 157.50	(+) 259.80
December 1960	4182.40	(+) 338.10	1979.80	(+) 62.30	(+) 400.40
December 1961	4054.20	(-) 128.20	2151.20	(+) 171.40	(+) 43.20
Total Expansion From 1948-to 1961		(+) 2346.30		(+) 1324.20	(+) 3670.50

Source : Derived from Table 8.

The average rate of expansion of currency, deposits and total money supply during the period of I3 years (i.e. 1948 to 196I) is I4.9 percent, 7.9 percent and 6.3 percent respectively.

Tables 8 and 9 show that the currency outstanding more than doubled within a period of ten years (i.e. 1948 to 1958). The tremendous expansion in money supply is due mainly to the following factors :-

i) Deficit financing ;

ii) Korean War Boom; and

iii) Increasing banking habits.

The Central Government incurred a fiscal deficit during the First Five Year Plan* period. During the Second Five Year Plan** a deficit of Rs. I000 million has been proposed.*** So it is clear that deficit financing is a major cause of the expansion of money supply in Pakistan. Table 9 shows a sharp increase of Rs. 865.30 million in the total money supply by December, I95I. The main reason for this rise was the favourable balance of payments position made possible by the Korean War Boom.

The sudden end of the War brought a slump in Pakistan's exports. During the year I952 and I953, the supply of money increased at a decreasing rate. The subsequent years witnessed a constant increase in money supply due to rising capital expenditures by the Government of Pakistan.

---

* I955-60.

** I960-65.

*** The policy of the present Government of Ayub Khan is to discourage deficit financing.

(B) Changes in Money Supply and its dterminants

Table IO provides a balance sheet analysis of changes in money supply from I955-56 to I96I-62.

As is revealed by Table IO, changes in money supply, were brought about by four main groups of factors which may be identified with:-

i) Domestic Private Sector;

ii) Government Sector;

iii) Foreign Sector; and

iv) Other Factors.

The Domestic Private sector as a source of monetary changes indicates changes in the scheduled bank advances to private sector and their investments in private securities. The net position in the domestic private sector is arrived at by making adjustment for shifts to time deposits. Government sector shows credits obtained by the Central and Provincial Governments from scheduled banks and the State Bank of Pakistan adjusted for the changes in their cash balances. Further adjustment is made for changes in counterpart funds i.e. funds against the sale of commidities receiveed under the U.S. Aid. The foreign sector indicates changes in State Bank of Pakistan's holding of gold and foreign assets and authorised dealer's foreign balances. ' Other factors ' is in the nature of a residual balancing item and represents other minor factors which have some influence on the level of money supply but are not of sufficient importance to be seperately classied.

Table 10

The Determinants of Changes in Money Supply
(1955 - 1962)

(Rupees in crores)*

	1955 -56	1956-57	1957-58	1958-59	1959-60	1960-61	1961-62
Changes in Money Supply	+ 65.34	+ 45.40	+ 35.14	+ 19.79	+ 29.60	+ 2.57	+ 22.35
Determinants of Changes							
Expansion (+) Contraction (-)							
1. Domestic Private Sector	+ 9.95	+ 23.70	+ 4.15	- 0.42	+ 35.75	+ 41.65	+ 69.02
Adjustment for shift to time Deposits	- 4.44	- 0.48	- 13.16	- 5.32	- 19.26	- 28.15	- 27.96
Net Private Sector	+ 5.51	+ 23.22	- 9.01	- 5.74	+ 16.49	+ 13.50	+ 41.06
2. Government Sector	+ 32.15	+ 86.21	+ 70.65	+25.03	+ 12.40	+ 37.20	- 11.41
Adjustment for accumulation of counterpart funds.	- 15.52	- 44.61	- 3.58	- 2.68	- 15.79	- 26.41	+ 40.37
Net Government Sector	+ 16.63	+ 41.60	+ 67.07	+22.35	- 3.39	+ 10.79	+ 28.96
3. Foreign Sector	+ 44.45	- 21.71	- 28.23	+12.17	+ 22.02	- 11.95	- 7.90
4. I.B.R.D. Indus A/C	-	-	-	-	-	-	- 18.61
5. Other factors	- 1.25	+ 2.29	+ 5.31	- 8.99	- 5.52	- 9.77	- 21.16
Total Expansion	+ 65.34	+ 45.40	+ 35.14	+19.79	+ 29.60	+ 2.57	+ 22.35

Source: State Bank of Pakistan letter No. Dr-Ms/48/2847-63
dated 30th April, 1963.

* 1 Crore = 10 millions.

There was a net expansion of Rs.653.40 million in the money supply during the 1955-56 as indicated by Table 10. The factors responsible for such a huge increase in money supply are increasing economic activity on account of industrialization,an impressive increase in the private investment and increased developmental expenditure by the Government of Pakistan. Another important factor which was responsible for the impressive increase of money during the year 1955-56, can be identified with the increase in the rupee price of important exports. The net expansion during the year 1956-57 in the total money supply was in the order of Rs.454.00 million. The domestic private sector and the Government sector are two main groups which have an expansionary influence on the money supply, which amounts to Rs.648.20 million but there is contradictory effect of foreign sector to the extent of Rs.217.10 million. In the year 1957-58, the Government sector had an expansionary effect of Rs.670.70 million while there was a contractionary influences of Rs.90.10 million and Rs.283.30 million by the domestic private sector and the foreign sector respectively.

Money supply recorded an increase of Rs.197.90 million in the year 1958-59 which compared with an expansion of Rs.351.40 million in the year 1957-58. During this period the rate of monetary expansion slowed considerably. This took place despite the fact that the foreign sector exerted an expansionary influence of Rs.121.70 million during this period in sharp contrast to the contractionary influences of Rs.217.10 million and Rs.282.30 million in 1956-57 and 1957-58 respectively. The decline in the rate of increase of money supply was a result mainly of a marked improvement in Government finances. The net expansionary influences of the Government sector amounted to Rs.223.50 million only as compared to Rs.416.00 million and Rs.670.70 million in 1956-57 and 1957-58 respectively.

"A continuous rise in money supply since 1955-58 has been a major source of concern. The uncontrolled rate of expansion which continued in the succeeding years had to be arrested by the introduction of several measures in the monetary field."[1] The expansion in the total money supply during the year 1959-60 was in the order of Rs.296.00 million, and out of this monetary expansion of Rs.296.00 million,Rs.220.20 million was contributed by the foreign sector only, while the Government sector has a contractionary influence to the extent of Rs.33.90 million.

" It is noteworthy that the domestic forces operating on money supply have remained powerfully expansionary, Both the private sector credit expansion and the fiscal operations of the Government have contributed to the rise in money supply on an increasing scale. The expansionary influence exercised by the extention of bank credit to private sector was of the order of Rs.41.65 Crores during 1960-61 and Rs.69.02 Crores during 1961-62. At the same time,the contribution made by the Government sector was Rs.10.79 Crores in 1960-61 and Rs.28.96 Crores in 1961-62. The rate of monetary expansion has already picked up perceptably and the indications are that the prospective situation may be characterized by an even more rapid pace of monetary expansion.

---

1. Pakistan Publications, Pakistan 1959-60, (Karachi: Pakistan Publications October 1960.) p.20

This assessment is largely based on the fact that while the domestic expansionary forces continued to be as powerful as before, the country is making serious efforts to balance its external payment position."[1]

It is clear from Table 10 that during 1960-61, the total money supply increased only by Rs.25.70 million, while it increased by Rs.296.00 million during the period of 1959-60. The annual average expansion was Rs.414.20 million in the preceding four years. The monetary expansion was declining although the Government sector (adjusted for accumulation of counter-part funds) produced a net expansionary influence of Rs.107.90 million in 1960-61, as compared with the contractionary influence of Rs.33.90 million in the preceding year. The more important reasons for the sharp decrease in the rate of increase in money supply for the year 1960-61 was the changed position of the foreign sector, which had a contractionary influence to the extent of Rs.119.50 million. Another factor for this decline in monetary expansion in 1960-61 was the decreased expansionary effect of credit to the domestic private sector. Although there was an expansion of Rs.416.50 million in bank credit, this expansionary influence was counter-balanced substantially by accumulation of Rs. 281.50 million in time deposits. Thus the net expansionary influence exercised by the domestic private sector was only Rs.135.00 million in

---

1. Speech delivered by Mr. S.A.Hasnie, Governor of the State Bank of Pakistan at the 14th Annual general meeting at Lahore on September 1, 1962.

1960-61 as against Rs.164.90 million in 1959-60.

There was a tremendous increase in the total money supply in 1961-62 in the order of Rs.223.50 million, as compared with a modest expansion of Rs.25.70 million in the preceding year. The main factor for the increase of money supply in 1961-62 was the increase in deposits by Rs. 203.60 million during this period. Out of Rs.203.60 million of deposit money, Rs.199.40 million was in the form of demand deposits at the scheduled banks and the remaining were in the shape of 'other deposits' with the State Bank of Pakistan, which rose by Rs.4.20 million. It is interesting to note that currency in circulation also increased by Rs.19.70 million over the year. At the end of June 1962, currency in circulation was 63 per cent of total money supply as against 68 per cent, 67 per cent and 65 per cent during the years 1956-57,1957-58 and 1960-61 respectively.

The banking habits of the people of Pakistan are increasing and this trend is clear from Table 11 which shows Clearing House Returns from 1948 to 1962. Table 11 indicates that while the number of Clearing House Returns in December 1948 was 74090 amounting to Rs.35.07 million, it increased in August 1962 to 3,66,728 amounting to Rs.144.10 million i.e. an increase of 25.3 per cent and 33 per cent in the number of returns and amounts respectively.

C - Money, Prices and Exchange Rates

The Governor of the State Bank of Pakistan has rightly said

TABLE 11

CLEARING HOUSE RETURNS
(1948 to 1962)

(Amount in lakh of rupees)

Total for the Month of	Total	
	Number	Amount
Dec. 1948	74090	3507
Dec. 1949	106014	4431
Dec. 1950	121910	5228
Dec. 1951	123635	6350
Dec. 1952	157697	5252
Dec. 1953	177095	6423
Dec. 1954	181773	5915
Dec. 1955	201494	7682
Dec. 1956	201893	8144
Dec. 1957	213881	8187
Dec. 1958	229293	9284
Dec. 1959	274672	15145
Dec. 1960	321005	141 76
Dec. 1961	323473	12972
Dec. 1962	366728	14410

Source: State Bank of Pakistan Bulletin,
(Karachi State Bank of Pakistan, October 1962)
p.45

that," The complaints regarding the decline in demand are a familiar feature of the stabilization phase following a period of protracted inflation. It is understandable that marginal and inefficient units which drew their sustenance from inflationary demand and the rising price level, should feel the pinch, after the cessation of this artificial support. Competition exerts a strong pressure for rationalization of cost structure and for the efficient organization of industries. This is a painful process for some and evolves protests in the beginning from the affected quarters."

The Governor further stated that ," strangely enough, there are equally vociferous complaints that the price level is still high, that the consumer is not getting adequate relief from the burden that the past inflationary process had imposed upon him and that price of articles of daily use other than certain food grains, continues to rise. While medley of protests can be taken as an indirect testimony of the balance that is being maintained in the economy between the forces of inflation and deflation, may I take this opportunity of dispelling certain confusion regarding our price objectives? Our intention is to maintain overall price stability in the sense that pressures of demand on the resources should not be excessive. This does not imply any attempt to deliberately depress the price level which would have deflationary consequences for thec economy and tend to retard investment activity within the frame-work of overall price stability, individual prices or groups of prices may tend to move in different directions in response to change in their demand and supply position. Changes in relative prices are necessary to bring about re-adjustment in the allocation of resources in line with the priorities set by the Government. The main objective is to maintain a stable balance to avoid sharp trends in any one direction."[1]

Table 12 shows the changes in the Cost of Living indices for industrial workers and Table 13 gives the trend in the comsumer price index. We observe that the general cost of living from the period of 1951-52 to 1960-61 has risen by 29 per cent and the consumer price index has increased by 31.1 per cent. During the year 1961-62, prices generally remained stable. The cost of living index for industrial workers at Karachi was 130 (1948-49 taken as 100), i.e. an increase of 2.4 per cent. The consumer prices index for clerical employees of the Government and commercial establishments at Karachi was 117 (1956 taken as 100) i.e. an increase of 1.7 per cent.

We all know that it is difficult for a country to always maintain external as well as internal balance under changing conditions and the country has to forego one on occassions to achieve the other. Just after October 1958, when Field Marshal Mohammad Ayub

---

1. Ibid.

Table 12

General Cost of Living Indices for Industrial Workers at Selected Centres
(April, 1948-March, 1949=100)

PERIOD	Karachi	Lahore	Sialkot	Khewra	Narayenganj
1951-52 (July-June Average)	100	93	83	94	105
1952-53 -do-	107	99	92	112	109
1953-54 -do-	111	101	92	99	102
1954-55 -do-	107	96	85	98	88
1955-56 -do-	107	94	84	97	105
1956-57 -do-	113	102	94	104	109
1957-58 -do-	123	111	102	107	116
1958-59 -do-	118	103	99	101	117
1959-60 -do-	125	111	108	109	123
1960-61 -do	127	119	117	121(a)	123
1960: July	129	113	118	116	125
August	126	115	118	120	124
September	126	115	117	118	124
October	127	114	117	123	124
November	126	116	118	124	123
December	127	117	118	127	121
1961: January	127	121	117	b	120
February	127	123	119	b	119
March	128	123	119	b	121
April	128	123	116	b	122
May	127	122	114	b	126
June	129	120	112	b	131

(a) Average of six months.
(b) Discontinued.

Source: Report on Currency and Finance, Karachi: State Bank of Pakistan, 1960-61, p. 111

Table 13

Consumers' Price Index for Government and Commercial Employees (Clerical) at Karachi

(Base: 1956=100)

PERIOD	General Index	Food	Clothing and Footwear	Housing and Household Operation	Miscellaneous
1950	90	92	77*	91	90
1951	91	94	80*	91	92
1952	96	103	79*	93	92
1953	98	102	97	95	94
1954	98	100	96	95	96
1955	97	97	93	96	97
1956	100	100	100	100	100
1957	107	109	119	103	100
1958	110	114	130	100	102
1959	106	114	107	98	98
1960	115	125	127	101	99
1960: July	116	127	125	103	99
August	115	127	125	102	98
September	115	127	125	101	98
October	115	127	124	101	97
November	115	127	123	101	98
December	114	126	123	101	98
1961: January	114	125	122	100	98
February	115	126	125	101	97
March	116	128	126	102	98
April	116	129	125	102	98
May	117	132	123	102	98
June	118	133	123	102	98

* Excluding Footwear

Source: Report on Currency and Finance, Karachi: State Bank of Pakistan, 1960-61, p. 112.

Khan's Government came into power in Pakistan, the Government had to push up exports and also to limit imports strictly. This measure was adopted in order to increase the foreign exchange reserves of the country. This resulted in an increase of money supply without a parallel increase in the supply of goods. Now that the Government of Pakistan has been assured of a higher level of foreign exchange earnings, increasing attention is being paid to internal balance and greater amount of exports are allowed in the country, in order to reduce the shortage of commodity supply.

We have observed that though during the I96I-62, the expansion in money supply was in line with the growing economy of the country, yet it is better to be vigilent on these matters, as we know that price movements are quite sensitive to inflationary pressures and it is desireable always to be cautious that such tendencies are not allowed to acquire momentum.

(D) Summary and Conclusions

A major function of the State Bank of Pakistan is to regulate the money supply in the best interest of the country.* For this purpose, the State Bank of Pakistan is given wide powers to influence the availability, cost and use of credit in the country.

The average rate of expansion of currency, deposits and total

---

* The best interest of the country is the fuller utilization of the country's productive resources while striving for monetary stability.

money supply from I948 to I96I is I4.9 per cent, 7.9 per cent and 6.3. per cent respectively. Changes in money supply, were bought about by four main groups of factors, which may be identified with:-

i) Domestic Private Sector;

ii) Government Sector;

iii) Foreign Sector; and

iv) Other factors

The General Cost of living from I95I-52 to I960-6I has increased by 29 per cent and Consumer's Price Index for the Government and Commercial Employees rose by 31.1percent during the same period.

The State Bank of Pakistan has been careful to see that the quantity of money supply is brought under control and inflation avoided as far as possible and efforts are always made to manupulate the money supply according to the needs of the country.

****

CHAPTER VI

EXCHANGE CONTROL OPERATIONS OF THE CENTRAL BANK

"Exchange control may be defined as governmental action to regulate exchange rates and to restrict the use of the means of international payment. The actions which a government may take to control exchange include the following: the establishment of official rate which residents of the country must pay to obtain foreign currencies, the rates at which they must sell whatever foreign currencies came into their possession, and the rates at which residents of the other countries be permitted to acquire domestic currency (that is, the currency of the controlling country); other operations------- aside from the setting of official rates------- to influence exchange rates, the adoption of regulations to acquire residents of the country to surrender to the government, whatever foreign currencies they hold; the allocation of supplies of foreign currencies to applicants for it according to a system of priorities; the enforcement of restrictions upon the use of domestic currency by foreign holders; and the negotiation of agreements with other governments by which payments among them are arranged according to a specified procedure."[I]

Exchange restrictions were for the first time extensively imposed during the period of I930's depression. It was again during World War II that various countries of the world imposed exchange restrictions.[2] It has been rightly said that, " at the end of hostilities one might expect a gradual return to prewar peace time pattern. But the disruptions of the

---

I. Raymond P. Kent, op.cit., pp. 520-2I.

2. L.V.Chandler, The Economics of Money and Banking, (Newyork: Harper and Brothers Publishers, I959). p. 500.

last war (World War II) were so enormous that a return to anything like a free exchange market of the prewar type appears to be indefinitely delayed, if indeed, it will ever be accomplished."[1]

(A) Evolution of the Exchange System in Pakistan

Under the foreign exchange system all foreign exchange earned either through exports or other sorces has to be handed over to the controlling authorities in the country. Then this foregn exchange is allocated to various needs according to their relative importance from the point of view of national interests.

It was during World War II that the foreign exchange restrictions were imposed in the sub-continet of Indo-Pakistan. The rules and regulations concerning these restrictions were provided in the 'Financial Provisions of the Defense of India Rules', and it was later extended through Foreign Exchange Regulation Act, I947. At first, exchange control was imposed on transctions with countries outside the Sterling Area only, but later on it was also extended to Sterling Area countries.[2]

In 1947, Pakistan inherited foreign exchange control from undivided India. From August 14,1947 to June 30,1948, the Reserve Bank of India as the central banking authority of Pakistan, also had taken care of the exchange control operations in the country.

B- The Present System of Exchange Control

Since July 1,1948 the State Bank of Pakistan, as the central

I. R.G.Thomas, Our Modern Banking and Monetary System, (Newyork: Prentice-Hall Inc., I952). p. 527.

2. State Bank of Pakistan, The State Bank of Pakistan, Its Growth, Functions and Organisation , op.cit., p. 54.

banking authority of the country, has been administering the foreign exchange resources under the Foreign Exchange Regulation Act of 1947. The main objective of exchange restrictions in Pakistan is to see that all the foreign exchange earned is properly accounted for and allocated to various competing needs according to their importance from the point of view of the national interest.

The objects of the Foreign Exchange Regulation Act, 1947 may be defined as follows:

i) First, to bring about and maintain equilibrium in the balance of payments with the rest of the world. This can only be achieved in conjunction with the Chief Controller of Imports and Exports of Pakistan, whereby a system of control of both imports and exports is established;

ii) Secondly, to control gold, dollar and sterling reserves with the Bank of England;

iii) to control the movements of capital; and

iv) last but not the least, to preserve the stability of the external value of Pakistani rupee.

The day to day application of the control is in the hands of the State Bank of Pakistan, which acts as the banker to the Government as well as its advisor on matters of financial policy. The State Bank of Pakistan may delegate some of its authorities to the scheduled banks of the country by granting licences. Such licences to deal in foreign exchange are usually and normally granted only to the scheduled banks which satisfy the Bank that they have an adequate trained staff and have made sufficient arrangements to conduct their dealings in foreign exchange satisfactorily and will be able to comply with the requirements of the administration of exchange control. The central bank may refuse to grant, or may withdraw if already granted, an authorization to deal in foreign exchange without having to give any reasons. The administration of exchange control is exercised by the Bank through its Exchange Control Department. The State Bank of Pakistan has delegated authority to almost all the scheduled banks in the country to deal in foreign exchange as its agents. These banks are referred to as 'authorized dealers in foreign exchange.'[1]

The Act of 1947 has made the Ministry of Finance of the Central Government of Pakistan responsible for the control of foreign exchange resources of the country. It has the powers to fix buying and selling rates of foreign currencies, and to prescribe standard methods of payments. The central bank of Pakistan is the agent of the Ministry of Finance and performs all functions as assigned by the Ministry of Finance or the Act of 1947.

The high powered committee called 'the Exchange Control Committee' is responsible for the broad allocation of foreign exchange expenditure, This Committee is appointed by the Government of Pakistan and consists of heads of various ministries and the Controller of Exchange from the central bank. The State Bank of Pakistan administers the actual transactions of foreign exchange within the broad allocations

1. State Bank of Pakistan, Summary of Foreign Exchange Regulations in Pakistan (Karachi:State Bank of Pakistan,1961) p.1

made by the Exchange Control Committee.

Pakistan as a member of Sterling Area has the following obligations:[1]

i)Maintenance of the the country's Foreign Exchange reserves in Sterlings;*

ii)Maintenance of exchange rate vis-a-vis Sterling; and

iii)Surrender of most of the non-sterling areas' currencies to the area's pool.

Pakistan as a member of the International Monetary Fund (IMF) has to:-

i) keep the exchange rate of Pakistan rupee stable and within the prescribed spread of one per cent on either side of the accepted parity;

ii) avoid any multiple rate practice;

iii) pratice multi-lateralism in its international trade;

iv) lift exchange restrictions as quickly as the balance of payment position permits; and

v) avoid discriminating exchange practices.

Pakistan has the previlege, as a member of the IMF to request the Fund for help in times of temporary balance of payment difficulties.

---

1. State Bank of Pakistan, The State Bank of Pakistan:Its Growth,Functions, and Organization, op.cit., p.55

* The main reserve of foreign exchange is in Sterling but Pakistan does maintain Reserves in gold and Dollars with Bank of England.

C- The Central Bank's Role in the Exchange Control

All transactions of foreign exchange in Pakistan are conducted through various 'authorized dealers' who are appointed by the central bank. These dealers are directly responsible to the State Bank for all dealings in foreign exchange and are required to submit various periodical returns on prescribed forms so as to facilitate the supervision of the central bank.

The State Bank of Pakistan is responsible to sell approved foreign exchange at rates fixed by the Central Government of Pakistan. The Bank is required to get the necessary permission of the Central Government of Pakistan in order to deal in certain foreign currencies.

Under the Foreign Exchange Regulation Act 1947, all foreign exchange and foreign shares and securities have to be declared and/or surrendered to the central bank or its authorized dealer in return for Pakistani currency. In addition to the authorized dealers in foreign exchange, the central bank of Pakistan has also appointed money changers in various parts of the country for the convenience of the tourists. These money changers are authorized to purchase foreign currencies and foreign currency instruments.

It is interesting to note here that the administration of invisible payments is the responsibility of the central bank of Pakistan but the Bank does not have any direct control of imports and exports, which is the responsibility of the Ministry of Commerce and Trade of the central Government. The State Bank has only the responsiblity to supervise the prescribed methods of payment for imports and surrender of export proceeds.

(a) Exports: Under the system presently in vogue, export receipts are to be repatriated to Pakistan within the prescribed duration of four months from all countries except India and within two months from India. Those exporters who do not surrender the declared foreign exchange within the prescribed period, are prosecuted under the Foreign Exchange Regulation Act,1947. This system is operated with the help of the Customs Authorities. The exporters are provided with export declaration forms at the time of export and these forms are deposited with the Customs authorities. The collection of the export proceeds is done through an authorized dealer who also receives copies of shipping documents and relevent documents from the exporters.These various forms and documents are also sent by the exporters to the central bank for making due checks with the originals sent by the Customs authorities. This procedure enables the Bank to carry out its responsibilities in the collection of export proceeds within the prescribed period. In order to check the possibility of under-invoicing, the exporters of raw cotton and raw jute are required under the law to get the export price checked by the central bank before the Customs authorities can allow their exports to pass through the custom formalities.

(b) Imports

All imports in Pakistan are subject to licence with the exception of goods for defence purposes, goods imported by Government departments and personal effects etc. All import licence applications are forwarded to the Government of Pakistan through the authorized dealers in foreign exchange. When an import licence is issued by the Government, foreign exchange payment becomes automatic. Generally, there is no permission for advance payment,but in special cases such as the import of capital goods etc.the central bank may issue, authoriztion for part of the value of goods. The authorized dealers are not allowed to open letters of credit or make payments unless the import licences are registered with the State Bank of Pakistan.

(c) Payments for Invisible Trade

As mentioned earlier, paymemts for invisible trade are controlled by the State Bank of Pakistan. The control over these payments vary with the foreign exchange position of the country. There is a great effort on the part of the Government of Pakistan to provide facilities for current transfers. But the Government is very careful in granting such facilities, and only in genuine cases, such as business travel, Hajj Pilgrimage, education and medical treatment. Exchange facilities in such cases are granted on individual basis.Remittances to India are subject to special regulations and are on reciprocal basis.Foreign investors can transfer current profits without any restriction to the country of origin of the capital.[1] All invisible receipts should be surrendered to the central bank at the official rate within a period of one month.

(d) Capital Remittances: Foreigners with the exception of Indians are

---

1. State Bank of Pakistan, Summary of Foreign Exchange Regulations in Pakistan, op.cit.,pp.16-17

allowed to remit their real or genuine savings in full. The rules in connect -ion with Indian nationals are based on reciprocal basis. The foreign investments made by foreigners after September 1954, can be transferred to the extent of the original investment.These investments must be made in approved industrial enterprises. The profits reinvested can also be repatriated in the same way as the original investment.

D- Summary and Conclusions

One of the important functions of the central bank of Pakistan is to maintain the external value of the currency of the country. In 1947, Pakistan inherited foreign exchange control from undivided India. It was during World War II that the foreign exchange restrictions were imposed in the Indo-Pakistan sub-continent. The administration of the foreign exchange resources of the country is the responsibility of the central bank of Pakistan under the Foreign Exchange Regulations Act,1947. The main objective of exchange restrictions in Pakistan is to see that all foreign exchange earned is properly accounted and allocated to various competing needs according to their importance from the point of view of national interest.

The State Bank of Pakistan has delegated authority to almost all the scheduled banks in the country as its agents to deal in foreign exchange. These banks are referred to as 'authorized dealers in foreign exchange'. The central bank supervises the operations of these dealers by asking them to submit periodical returns. All exports from Pakistan are declared on prescribed forms to the Customs authorities.The copies of these forms are also sent to the State Bank of Pakistan.For all commercial imports, a licence is needed which is issued by the central Government of

Pakistan. When a licence is issued, the payment becomes automatic. Remittances of a personal nature are either subject to quotas or are permitted on their individual merits.

****

CHAPTER VII

THE ROLE OF THE STATE BANK IN THE ECONOMIC DEVELOPMENT OF PAKISTAN

The role of the central bank in a country's economy is determined by the stage of its development and the character of financial stability. The main task of the State Bank at its inception was not so much the control of credit in the traditional sense as the rehabilitation, improvement and development of the credit structure through which control could be exercised.

We all know that for the economic development of the country, it is very essential that a country should have a sound and strong banking system supported by a dynamic central bank. In Pakistan, the State Bank of Pakistan Act, 1956 clearly defines the role of the central bank in the economic development of Pakistan. The preamble of the Act states that it is the responsility of the State Bank of Pakistan as the central banking authority in the country to regulate the monetary and credit system of Pakistan and to foster its growth with the aim of securing monetary stability and fuller utilization of country's productive resources.

For the speed economic development of a country like Pakistan, there is great need that the country should have adequate credit facilities. Credit is the back-bone for development; it is needed in all spheres of economic activity. If there is a shortage of supply of credit in a country, the growth process will be crippled. The State Bank of Pakistan as the central bank of the country is playing a very important and constructive role in fostering the growth of the monetary and credit system on sound foundation, which is of great help in the economic development of Pakistan.

A-The Central Bank and the Money Market.

For the purpose at hand, the term, money market may be defined, " in a narrow sense , as referring to the organization for the lending and borrowing of short-term funds through the use of such instruments as commercial bills of exchange, short-term government securities, bankers' acceptance etc."[1]

At the time of the inception of the State Bank of Pakistan in 1948, there was no money market in the real sense. The banking system of the country was dislocated due to the partition of Indo-Pakistan sub-continent. So it was the duty of the State Bank to take immediate steps in this direction. The Bank adopted several measures to rehabilitate the banking system in the country. There was a great shortage of banking personnel and in order to over-come this problem, the State Bank immediately organized a training programme. An Institute of Bankers was also created in 1952 to spread banking education.The Bank also established two training centres in the country so as to get a continous supply of qualified and trained personnel in the field of banking.

The promotion of a bill market in the country was considered

---

1. S.N.Sen, Central Banking in Under-developed Money Market (Calcutta: Bookland Limited,1952) pp.13-14

an important task for the State Bank. " To promote the bill method of finance, the State Bank introduced a Bill Market Scheme in August 1952, under which advances are made to scheduled banks on demand promisory notes, supported by usance bills of a maturity not exceeding three months. The purpose of the scheme is to encourage commercial banks to induce their clients to convert a part of their cash credit into usance bills, and thus to popularize the system of usance bills in the country."[1]

In order to promote the Scheme at the initial stage, the central bank of Pakistan undertook the responsibility to provide funds at a rate of half percent below the bank rate.* It also undertook the responsibility to bear half the cost of stamp duty incurred by the banks in connection with the Scheme. The concession of half percent was withdrawn in December 1956 but the State Bank still continues to bear half of the cost of stamp duty.[2]

In the initial stage of the Scheme, there was lack of interest in it but with the passage of time, it became quite popular in commercial cricles and the banks now make greater resort to loans under this Scheme. Borrowing from the State Bank under 'Bill Discounting Scheme' has steadily risen as is evident from Table 14.

Though there is a growing accomodation under the Scheme as is clear from Table 14, the original purpose of the Scheme has not been fully realized. The main purpose behind this Scheme was the growth of a bill

---

1. Bill Discounting Scheme in Pakistan, Eastern Finance, (Karachi: Nov.1961) p.16

* This concession was only in case of genuine trade bills of 3 months duration and for all other purpose the Bank Rate remained fixed.

2. *Ibid*, p.16

market in the country. The reason for not realizing the original purpose of the Scheme are partly historical and partly economic. In the first place, people are reluctant to use bills as a satisfactory instrument of credit. Other reasons are shortage of licensed warehouses and lack of specialized institutions which could rate the credit worthiness of the borrowers and /or accept the bills themselves.

TABLE 14

SCHEDULED BANKS' BORROWINGS
UNDER
THE BILL DISCOUNTING SCHEME
(1953 to 1959)

(Millions of Rupees)

Years	No.of Borrowing Banks	Total Amount of Borrowings
1953	2	12,4
1954	4	296.1
1955	5	497.0
1956	9	349.3
1957	11	538.4
1958	10	516.3
1959	5	278.7

Source: Eastern Finanve (Karachi:November 4,1961) p.16

Genuine trade bills are ordinarily a very important outlet of short-term investment by commercial banks. The Credit Enquiry Commission has proposed certain measures to make bills attractive. These are:[1]

i) Establishment of two Discount Houses in the country, one in each province. These Discount Houses will provide guarantees to the commercial banks for the quality of the bills;

ii) Establishment of a number of licensed warehouses in the country. These warehouses, by issuing warehouse receipts, would facilitate the expansion of credit on the collateral of such receipts;

iii) Exemption of promisory notes upto Rs.25000 from stamp duty thus providing encouragement for the use of such bills in Pakistan.

It is hoped that when these steps are adopted, they will provide an important boost to the growth of a bill market in the country and thus to the development of a healthy and sound money market in Pakistan.

The State Bank has been playing an important role in meeting the short-term credit needs of the commercial banks through 'Bill Discounting Scheme' and 'borrowings against Government Securities'. The maximum sanctioned limit of credit to the commercial banks by the central bank of Pakistan in the year 1958-59 was Rs.761.70 million and this limit was increased to Rs.1273.20 million in the year 1961-62. This shows the keen interest taken by the central bank in assisting the commercial banks in meeting their short-term credit needs. This assistance was so liberal that the commercial banks could not make use in full of this help offered to them by the State Bank. As has been mentioned above, the

---

1. Government of Pakistan, "Credit Enquiry Commission Report" op.cit. p.189.

maximum limit sanctioned by the State Bank for the year 1958-59 was Rs.761.70 million, out of this amount only Rs.270.20 million was used. Similarly, during the year 1961-62 the maximum amount sanctioned was Rs.1273.20 million and only Rs.730 million was used.[1]

B-The Central Bank and the Capital Market

The capital market in the sense used here refers to the market for long-term funds.Of course,it is often difficult to draw a clear line of demarcation between the money market and the capital market in a given economy.Sometimes the same agency takes part in the activity of both the markets.Nevertheless,the distinction is useful from analytical point of view.[2]

"In most countries, the Government constitutes an important source of demand for funds. This would be for defence purposes or for social and economic developments.In many under-developed economies, however, the government's demands on the capital market are largely for the purpose of economic developments ; in many of these the extent of state participation in economic development is of substantial dimensions. The government has been investing not only on such economic over-heads as transport,irrigation,and power development, but on basic and sometimes even consumer goods industries. Therefore,

---

1. S.A.Meenai, Op.cit.,p.35.

2. S.L.N.Sinha, The Capital Market of India,(Bombay: Vora and Co. Publishers PVT Ltd. 1960) p.1-2

substantial sums are required from the capital market."[I]

Pakistan too has started an ambitous programme of economic development and the Government is investing in this programme a substantial amount of money. In the First Five Year Plan period (I955-60), out of a total investment of about Rs. I0,800 million, Government's investment was about Rs. 7500 million.[2] In the Second Plan (I960-65), out of a total estimated investment of Rs. I9,000 million, the Public sector will contribute Rs. II,500 million.[3] To fulfill such huge demand from the public sector, substantial funds are needed from the capital market.

In connection with the sources for the capital market, in Pakistan as elsewhere, the institutional media stand out the more important. As regards equity capital, the individual investor is very important and plays a dominent role. The banks, insurance companies and provident funds are the more important institutional investors but their investments are limited to only Government securities. There are also some specialze lending agencies, which have been establised with the support of the Goverment and the State Bank of Pakistan. These institutions provide facilities for long term loans for differnt fields of endeavour such as Agriculture and Industry etc.

Under the State Bank of Pakistan Act I956, the central bank of Pakistan has powers to provide loans and advances to any institution specially created

---

I. Ibid., p.4.

2. Government of Pakistan, The First Five Year Plan- I955-60, (Karachi: National Planning Board, I957). p. 24.

3. Government of Pakistan, The Second Five Year Plan- I960-65, (Karachi: Planning Commission, I960). p.II.

for the purpose of promoting agricultural and industrial development in Pakistan. The State Bank has used this power extensively and has provided loans and advances to various institutions which are engaged in the development of Agriculture and Induatry in the country.

S.A. Meenia has righatly stated that," a stage seems to have been reached when the banks are finding it difficult to cope fully with the credit demand from the private sector and have had to depend heavily on the State Bank assistance for the purpose. Under the circumstance, it is understandable that the banks are reluctant to convert their present holdings of Government securities into new issues as maturity dates are reached, not speak of the possibility of additional cash subscriptions."[I]

It has been observed that the commercial banks' investment in the Government securities have been reduced in recent years. During the period of I959-62, the increase in investment in the Government securities was Rs. I64.70 million, while the increase in the preceeding three years was Rs. 293.20 million.The credit to Government in June 1957 was Rs.54.40 million, while it was Rs.326.60 million in June 1962. There is a substantial increase in credit to the Government within this period.This credit is used by the Government in State trading in textiles, imports on Government account and Jute finance.

There is only one well-organized stock Exchange in Pakistan, which is situated in Karachi. There are other centres such as Lahore and Dacca where unorganized dealings in stocks are carried out but the volume

---

I. S.A. Meenai, op.cit., p. II7.

of their transactions is limited. The State Bank of Pakistan took special interest in the creation of the Karachi Stock Exchange,which was established in 1947 but was registered in 1949 under the Companies Act,1913 as adopted by Pakistan. The Karachi Stock Exchange deals in both gilt-edged securities and also the equity issues of public enterprises. In 1949, when it was registered, it had only nine members but the number has since risen to nearly 270.[1]

"In 1948, a securities market was virtually non-existent and gilt-edged stocks were treated by banks and other institutional investors as unmarketable. The State Bank, which as central banking authority was charged with the management of the debt, adopted suitable measures for fostering the gilt-edged section of the stock exchange. It laid down a procedure for the purchase and sale of Government securities through approved brokers,and as a result the market broadened gradually and it became possible to purchase and sell securities within a reasonable limits with the support of institutional investors.Moreover, the State Bank through a judicious policy of open market operations, sought to keep the gilt-edged market on an even keel with a view to minimising undue fluctuations in security values."[2]

The State Bank of Pakistan has also helped the establishment of specialized lending institutions in the country for financing the long-term requirements of agriculture and industry. These are :-

i) Agricultural Development Finance Corporation (1952)

---

1. Andrus and Mohammad, <u>op.cit.</u>, p.400

2. <u>Ibid</u>, p.401

ii) Agricultural Bank of Pakistan(1957);

iii) Agricultural Development Bank of Pakistan (1961) ;

iv) Pakistan Industrial Finance Corporation (1949);

v) Pakistan Industrial Credit and Investment Corporation (1957);

vi) Industrial Development Bank of Pakistan (1961);

vii) House Building Finance Corporation(1952);

viii) Pakistan Industrial Development Corporation (1950); and

ix) National Small Industries Corporation (1959)

Following the recommendations of the Credit Enquiry Commission, the Agricultural Development Bank was established by the merger of the former Agricultural Development Finance Corporation and Agricultural Bank of Pakistan. Also the Industrial Development Bank of Pakistan was established in 1961,as a result of the re-organization of the former Pakistan Industrial Finance Corporation.

Role of these the institutions,except the Pakistan Industrial Development Corporation (PIDC), has already been discussed. The PIDC was established in 1950 with the purpose of promoting industries in the public sector. The PIDC has played a leading role in the industrial growth of Pakistan and till February 1962, it had undertaken the establishment of 55 mills or factories in different industries. The investment in these projects in the majority of cases was advanced wholly by the PIDC but in some cases it had made partner-ship arrangements with private enterprise. "During the year 1961-62, PIDC's completed projects were expected to produce goods worth of Rs.904 million and earn foreign exchange to the extent of Rs.452 million, registering an increase of Rs.116 million and Rs.12 million respectively over the preceding year."

To sum up, the State Bank of Pakistan, apart from the traditional functions of central banks, has actively made efforts to induce and promote the growth of the institutional frame-work of the money and capital markets in the country and this contributions has been of great significance in economic development of the country.

C-The Central Bank and the Sectoral Allocation of Financial Resources.

It is interesting to note that in some years, there was a greater of bank credit to some sectors of the economy than other sectors before 1959.* Before 1959, the 84.4 percent of the total bank advances was taken by commerce and manufacturing industry, 3.5 percent by agriculture and 11.7 percent by the other sectors. But with the efforts of the Government and the State Bank of Pakistan, the situation has changed. Since 1959, there has been constant tendency to bridge the gap between commerce and manufacturing industries on the one hand and agriculture on the other. The position on March 31, 1962 for the sectoral break-down was as follows:

i) Commerce and Manufacturing Industry . . . . . 70.7 %

ii) Agriculture .. . . 8.2 %

iii) Other sectors . . . . 21.1 %

Table 15 shows the distribution of scheduled banks' advances, by major activities. It is clear from this Table that the bank credit has increased substantially to the agricultural sector, which was Rs.41.1 million

* For the purpose of analysis, the period of 1959 to 1962 has been taken.

Table 15

Scheduled Banks Advances by Major Economic Groups
(March, 1959 to March, 1962)

(Rupees in millions)

Major Economic Group	31.3.1959	31.3.60	31.3.61	31.3.62	Increase over 31.3.59	% share in total advances as on 31.3.59	% share in total advances as on 31.3.1962
1. Agriculture, Forestry Hunting & Fishing	41.1	59.6	74.5	216.4	+ 175.3	3.5	8.2
2. Mining & Quarrying	5.3	14.2	15.7	14.9	+ 9.6	0.5	0.6
3. Manufacturing	451.8	551.2	677.4	887.5	+ 435.7	38.3	33.5
4. Construction	18.4	14.8	13.5	21.0	+ 2.6	1.6	0.8
5. Electricity, Gas Water & Sanitary Service	4.8	3.6	13.0	27.1	+ 22.3	0.4	1.0
6. Commerce	548.8	720.9	806.5	985.9	+ 437.1	46.5	37.2
7. Transport, Storage, and Communications	21.3	13.4	26.7	51.4	+ 30.1	1.8	1.9
8. Services	40.3	74.6	147.1	217.2	+ 176.9	3.4	8.3
9. Employees and Activities not adequately described	47.1	95.8	63.5	225.5	+ 178.4	4.0	8.5
10. Unclassified	0.1	0.2	-	-	- 0.1	-	-

Source: S.A. Meenai, "Credit and Monetary Situation in Pakistan," (Karachi: State Bank of Pakistan, September, 1962), pp. 8-9.

in March 1959 and increased to Rs.216.40 million in March 1962. There was an increase of 96.4 percent in the manufacturing sector, which rose from Rs.435.7 million in 1959 to Rs.887.5 million in 1962. But it is to be noted that though there was a substantial increase of bank advances to this sector, its ratio to the total advances has decreased: in 1959, it had 38.3 percent of the total advances but in 1962, it had only 33.5 percent of the total advances. Table 15 also reveals that bank credit to the commercial sector increased by 79.6 percent i.e. from Rs.548.8 million to Rs.985.9 million during the three years. But the share of the commercial sector to the total bank advances has fallen from 46.5 percent in 1959 to 37.2 percent in 1962.[1]

The State Bank of Pakistan is playing an important role in the sectoral distribution of bank resources in Pakistan.The central bank has made efforts to find out new channels to provide funds to agriculture and industry, and to provide funds to these fields through the policy of selective controls, to fields desirable in the frame of planned economic development. The Bank, through its Agricultural Credit Department, has provided credit to various institutions which are engaged in fostering the growth of agriculture in the country. The State Bank of Pakistan, as the central banking authority of the country, took special interest in the formation of the Agricultural Development Bank of Pakistan and the Industrial Development Bank of Pakistan and

---

1. Ibid., pp.9-10.

it has extended a continous line of credit to these institutions, which in turn provide credit to the Agficultural and Industrial sectors of the economy in the country.

D- Summary, Conclusions and Recommendations:

Banking in Pakistan has made a very significant progress since I948, when the State Bank of Pakistan came into being. The bank offices have risen from I95 in July I948 to 7I3 in June, I962 and 707 are the branches of Pakistani banks i.e. 90 percent of total banks in Pakistan. Their share is 70 percent and 73 percent in total bank deposits and total bank credit in the country respectively. The central bank of Pakistan has undergone a tremendous development since its inception in July 1948. The sphere of the Bank's current activity is quite wide and comprehensive, and provides a combination of the orthodox central banking functions alonwith manifold operations connected with a variety of develomental and promotional programmes.

The central bank of Pakistan has the exclusive power of note issue in the country. This function is carried out by the Issue Department of the Bank. In order to ensure an adequate supply of currency in various places in the country, the bank has developed adequate administrative arrangements throughout Pakistan. The volume of currency in Pakistan is subject to seasonal fluctuations. There is an increased demand for currency in the busy season which starts in November and ends in May. This increased demand induces expansion in the currency during this period.

During the slack period which starts in June and ends in October, the reverse process takes place, due to a return flow of cash to banks in the country.

The central bank of Pakistan enjoys wide powers of credit control and has the statutory duties for regulating the monetary and credit system in the country. One of its primary objectives was to promote economic stability within the frame-work of the Government's fiscal policies. Due to lack of a developed money market in the country, the State Bank of Pakistan is hindered in implementing its credit control policies. Because of such obstacles, the central bank has continuous efforts to achieve the aims and objectives of its credit policies mainly through moral suasion and consultations with commercial banks and also through qualitative controls.

The scope of Government securities as secondary reserves is limited due to the lack of a developed money and capital markets. Though the commercial banks do maintain reserves of Government securities and indulge in sales and purchases of these securities but their scope is limited due to inadequate volume of such securities.

The State Bank has helped the establishment of several specialized institutions in the country for providing credit to long term needs of agriculture, industry and house building sectors.The Bank has been helping these specialized lending agencies through the extention of a continuous credit line.

One of the important functions of the central bank of Pakistan is to regulate the money supply in the interest of economic stability of the country. In this regard, the Bank has been given wide powers to influence the availability, cost and use of credit in the country. The Bank, since its inception in 1948, has manipulated the supply of money according to the needs of the country quite satisfactorily, as is evidenced by the monetary stability attained by Pakistan, specially after the Revolution of October 1958.

Like central banks in most other countries, the State Bank of Pakistan has been entrusted with the control of foreign exchange. Because exchange control is apt to have repercussions on various spheres of economic activity,any policy affecting the foreign exchange system cannot be formulated in isolation of and without taking into consideration the overall economic policies. The broad allocations of the country's foreign exchange expenditure is done through a committee consisting of heads of various Ministries and departments.The State Bank and authorized dealers in foreign exghange are required under the State Bank of Pakistan Act,1956,to sell approved foreign exchange at rates fixed by the Board of Directors of the Bank.

It is encouraging to note that inspite of its early engagements in promoting the banking system on sound lines,the State Bank has not neglected its role as an agency for economic development. It has always been careful in this regard and has restrcited the flow of credit to 'undesirable and less essential channels'. through the use of various credit controls at its disposal. This has made possible the flow of bank resources to the high priority developing sectors of the economy.

We all know that the creation of an atmosphere of stability is very essential for the economic development of a country, This stability inspires the confidence of the investors both at home and abroad,and by influencing the sectoral distribution of credit in the economy as well as promoting the growth of the institutional credit structure in the country, the central bank of Pakistan has been quite effective in the promotion of economic development in the country.

In Pakistan the banking system consists of Scheduled and Non-scheduled banks. The Non-scheduled banks are not under the control of the central bank of Pakistan and their activities are not regulated by the State Bank.* Though their operations in Pakistan are very limited, and their number is decreasing with the passage of time, yet it is important that the central bank of Pakistan should have some sort of control over their activities so as to protect depositors., and enhance its power to regulate monetary and credit conditions.

It has been observed that Pakistani banks are generally owned by a group of people, or group of families, who also have vested interest in various industries in the country. This tendency if allowed to continue, may become dangerous for the economic development of Pakistan, as these groups will use their positions for the purpose of strenthening and

---

* There has not been a single banking failure since the inception of the State Bank of Pakistan.

promoting their own enterprises and neglect others. Sometimes there is also danger of political exploitation of banks by these groups. In order to avoid, such situation, the Government of Pakistan should give powers to the State Bank so that it may be in a position to take necessary action in the event of any commercial bank falling a victim to mismanagement resulting from such factors,The Credit Enquiry Commission in 1959, proposed the establishment of a ' Deposit Insurance Corporation along the lines of U.S. system but this corporation has not been created so far. The establishment of such a Corporation is necessary to create confidence in depositors in the country's banking system. Though the banking system in Pakistan is very strong due to proper inspection extended by the central bank of Pakistan, it is important that the Government of Pakistan should set up 'the Deposit Insurance Corporation' as soon as possible so as to further inspire the confidence of the people in the banking system and promote the banking habit of the people.

Though we have witnessed that the banking system of Pakistan has undergone a tremendous growth in a very short span of time , still the banking facilities are inadequate to cater for the needs of all sections of the population in the country.There is an urgent need for establishing new bank offices in the interior of Pakistan. With increased economic development in the country, the credit requirements would also increase. Such requirements should be met by the banking system. It is the duty of the central bank to increase banking facilities in the country in order to fulfil the growing requirements of economic development.

There is a great need that the central bank of Pakistan should endeavour more to develop the money market in the country. It should make efforts to popularize the bill of exchange and treasury bills so as to develop the money market. It is necessary for the proper development of the money market as well as the capital market that the country should have a supply of marketable assets. In Pakistan, such assets consist only of Government securities and the operations of these securities are also limited due to the under-developed nature of money and capital markets.

For the purpose of furthering the development of money and capital markets in Pakistan, the Credit Enquiry Commission in 1959 suggested the establishment of new financial intermediaries such as Discount Houses and 'People's Finance Corporation' under the leadership of the central bank of Pakistan. These institutions will guarantee the loans obtained by the small businessmen.

There is only one organized Stock Exchange at Karachi in Pakistan which is not sufficient to meet the growing needs of business in the country. The Second Five Year Plan of Pakistan has stressed that there should be a well-organized stock exchange at every big commercial centre in Pakistan. It is therefore recommended that the central bank of Pakistan should come forward and help in the establishment of such stock exchanges in major commercial centres in the country. Such exchanges are indispensable for the economic development of Pakistan.

The objective before Pakistan to-day is to maintain a high rate of economic growth within the frame-work of economic stability. The State Bank as the central bank of Pakistan has endeavoured to play an active role in this direction .

****

APPENDIX I

COMPARATIVE STUDY OF CENTRAL BANKING LEGISLATION IN PAKISTAN, CANADA, AUSTRALIA, CYELON, UNITED STATES OF AMERICA AND UNITED KINGDOM

A-ITRODUCTION

The State Bank of Pakistan is the youngest central bank (with the exception of the central bank of Ceylon) among the central banks compared in this study. Following are the dates when these banks were established:-

i) State Bank of Pakistan . . . . July 1,1948.
ii) Bank of Canada . . . . 1934.
iii) Commonwealth Bank of Australia*. 1911
iv) Bank of Ceylon . . . . August 28,1950.
v) Federal Reserve System . . . . December 23,1913.
vi) Bank of England . . . . 1694.

Central banking as we know it, is a recent innovation. With the exception of Bank of England, all the above central banks were established very recently. The central banks of Pakistan and Ceylon are the youngest. The Bank of England, though established in 1694, has evolved as a central bank in the full sense of the term only in the last few decades. The Commonwealth Bank of Australia was established as a trading bank but it assumed the functions of central banking in 1924. The central bank of the United States of America is also the product of the year 1913.

---

* Since January 14,1960, the Central Bank of Australia is called the Reserve Bank of Australia under the Reserve Bank Act 1959.

We are interested in this short study in the legislations governing these central banks and shall compare these laws with those in force in Pakistan. Hans Aufricht, the IMF expert has rightly pointed out that "in view of the ever-increasing importance of central banks as the focal points of national and international money and credit conditions, the organic laws which govern the structure, power and functions of individual central banks are of special interest. Apart from primarily organizational matters, they usually regulate the relationships between the central bank, on the one hand, and the government and other banking institutions, on the other. These organic laws also furnish the legal frame-work for the exercise of the central bank's discretionary functions and, at times, set forth the guiding principles for central bank action in the field of credit control."[1]

In Pakistan, Canada and U.S.A., there are separate central banking laws, namely the State Bank of Pakistan Act, 1956; the Bank of Canada Act 1934 and the Federal Reserve Act, 1913 respectively. In Ceylon, the central banking law is combined with monetary and banking provisions. The Bank of England is administrated not by a specific law but by various statutes and a 'charter'. The central banking law in Australia does not pertain exclusively to central banking. It also deals with two other banking institutions in Australia, namely the Commonwealth Trading Bank and the Commonwealth Saving Bank.[2]*

---

1. Hans Aufricht, Central Banking Legislation, (WASHINGTON D,C. International Monetary Fund) 1961, p.xvii.

2. Ibid, p.xviii.

* Since January 14,1960, there is a specific central banking law in Australia known as the Reseve Bank Act,1959.

The banking system in the U.K., the U.S.A., Canada and Austrialia is well-developed and the central banks are very effective in controlling the supply of money and the credit situation in these countries. Pakistan and Ceylon are developing countries, but as far as central banking is concerned, Pakistan is better off then Ceylon as Pakistan has a relatively better banking system then Ceylon, where there are very few banks and all are almost foreign banks. Therefore, the central bank of Pakistan is in a better position to control the activities of the commercial banks then the central bank of Ceylon.

B- Organization and Management of Central Banks

The Chief Executive of all the central banks is the Governor except in the U.S.A. In Pakistan, he is appointed by the Central Government(section* IO (3)). The Governors of the central bank of Ceylon and Austrilia are appointed by the Governor-General (SectionI2(I)) and Section 21(1) respectively.) In case of the U.K., he is appointed by Her/His Majesty (Section 2(2)). In Australia and Canada, the Governor of the central bank is appointed for a term of seven years; in the United Kingdom and Pakistan, for five t years and in case of Ceylon, the term is six years; and in all cases,he is eligible for re-appointment. The governor is the presiding officer/ chairman of the Board of Directors in all these banks. The central Board of Directors is the governing body of these banks and consists of ten,fifteen, eighteen, three, and ten members in Australia,Canada,the U.K.,Ceylon and Pakistan respectively.In the

---

* All these'clauses'and'sections' of central banking laws of the various countries are taken from the book " Central Banking Legistation"prepared by I.M.F.

U.S.A., there is a Board of Governors consisting of seven members appointed by the President of the United States and confirmed by the Senate. These members are appointed for a term of I4 years with the duration so arranged that one retires every two years. The Board of Governors is the governing body of the Federal Reserve System. The central banking arrangement is different in the U.S.A., where for purposes of administration the whole country is divided into I2 districts, in each of which is so-called Federal Reserve Bank. All the I2 Reserve Banks are corporations. Each Federal Reserve Bank has its own Board of Directors comprising nine members. Of these, three are appointed by the Board of Governors in Washington and six members are elected by the member banks. Except Canada, all the members of Board of Directors are voting members. In the case of Canada out of I5 members, one is not entitle to vote (section 5(2)). He is a nominee of the Ministry of Finance. In the United Kingdom, the Governor shall not have any vote, except where there is an equality of votes.[I] The Governors of central banks of Pakistan, Austrialia and Canada have a second or casting vote in case of equality of votes. In all these countries, the majority principle applies. It is interesting to note that no central banking legistation provides so much responsibility in the hands of so few persons as is done in Ceylon, where only three are the members of the Board. Out of these three members, the Governor and the other member is appointed by the Governor-General and the remaining third member is the Permanant Secretary to the Ministry of Finance and is considered a link between the Board and the Government of Ceylon. In such cases, there is

---

I. Section 6(3) of I946 Charter of Bank of England.

always danger of misuse of power and there is a need of enlarging the Board of Directors.

There are no special board/boards in Austrilia, Ceylon, the U.S.A., the U.K. and Canada but Pakistan has three special Boards and are called Local Boards (section I2(I)). The function of these Boards is to advise the Central Board of Directors on only such matters as may be asked and the Local Boards are responsible for the duties assigned to them by the Central Board. Each Local Board has five members, two are elected by the shareholders of the Area and thre are appointed by the Central Government of Pakistan as to provide necessary representation of territorial or economic interests. The legal Head Offices of the central banks of Pakistan , the U.S.A.,Austrilia, Canada, and Ceylon are Karachi, Washington D.C.* , Sydney,* Ottawa, and Colombo. The Head Office of the Bank of England is London but there is no legal requirement to this effect.

The authorized capital of the central banks of Pakistan, Canada , the U.K. and Ceylon is Rs. 30 million, $ 5million, Sterling I4,553,000 and Rs. I5 million respectively. The capital of the central bank of Austrilia is not specified in central ban-king legislation. The minimum capital for each of the I2 Reserve Banks in the United States is fixed by law at $ 4,000,000 and is contributed by the member banks of the district which it serves. With the exception of Pakistan and the United States. all the central banks of these countries are fully owned by the Governments. In Pakistan, the Government's ownership is 5I per cent. The Government can [illegible]

---

* Head Office is not located in the c Capital of the country.

increase its share of ownership but under section 4(I) of the State Bank of Pakistan Act, I956 , it cannot reduce the ownership from 5I per cent. The central banks of Austrialia and Ceylon are wholly owned by their Governments since their establishment,, but the central banks of the U.K. and Canada were orignall fully owned by private investors and gradually became fully owned by the State. The Federal Reserve Banks in the U.S.A. are owned by their member banks of the district which they serve.

All the central banks of these countries may open branches, offices and agencies in their countries and aboard with the approval of the Central Board of Directors and in some cases,with the approval of the Central Government.

A very unique feature of the Canadian Central Bank is that the Governor has the veto power over any decision of the Board of Directors or of the Executive Committee. The Section 14(1) states that, "the Governor , or in event of his absence or incapacity, the Deputy Governor only, has power to veto any action or decision of the Board of Directors or the Executive Committee, and if this veto power is exercised, the Governor or Deputy Governor, as the case may be, shall within seven days inform the Minister(Finance) in writing of the circumstances and the Minister shall submit the veto to the Governor in Council who may confirm or disallow the veto." No other central banking legislation has given veto power and this power is something very unique in central banking legislation.

Pakistan and Canada only have the Executive Committees which have the same powers as Central Board of Directors, except when the Board of Directors is in session. Under section II (I) of the State Bank of Pakistan Act, I956, the Executive Committee is composed of the Governor, Deputy Governor, three directors elected by the Central Board from three Areas. In Canada, the Executive Committee consists of the Governor, the Deputy Governor and one director selected by the Board (section I3 (I)). In the U.S.A., there is a Federal Open Market Committee, consisting of I2 members. Of these I2 members, 7 are the members of the Board of Governors and the remaining five are elected by the Reserve Banks. No such Committee is found in Pakistan, Austrilia, the U.K., Canada and Ceylon, where similar matters are handled by the Central Board of Directors. The Federal Open Marker Committee is responsible for all changes in the System's portfolio of Government securities and all the Reserve Banks have to carry out all the decisions taken by this Committee on open market operations.

C- Scope of Authority

The State Bank of Pakistan has two distinctive departments----namely, the Issue Department and the Banking Department. This distinction is borrowed from the Bank of England, which is the oldest financial institution in the British Commonwealth. The function of the Issue Department is note-issuing, whereas the Banking Department deals with all other functions in the country. Besides these two departments, the Bank has an Agricultural Department, which provides credit facilities to these institutions which are engaged in the development of agriculture in the country. The Reserve Bank of Austrialia also has an Issue Department (section 33 (I)), which is seperate and distinct from other department. The Bank under the Reserve Bank Act, I959 has established a Rural Credit Department, which is on the same line as the Agricultural Department of the State Bank of Pakistan and performs the same functions. In the central banking legistation of Canada and Ceylon, there is no mention that which department performs the note-issuing function of these banks, though they have the exclusive right to issue notes. Though there is a detailed description of the functions of these banks in connection with note-issuing, it seems that the functions of note-issuing and banking are not seperate and distinct as is in the case of Pakistan, the U.K. and Austrialia.

The State Bank of Pakistan under section 30 (I)(a) is required to maintain 30 per cent of assets of the Issue Department in gold coin, gold bullion, silver bullion or apporved foreign exchange, this requirement is to cover the Bank's liability against its notes in circulation. The minimum statutory requirement can be suspended with the apporal of the Central Government of Pakistan (section 3I). "Unser section 2(I) of the Currency and Bank Notes Act, I954, gold coin and gold bullion for the time being in the Issue Department of the Bank of England form part of the statutory note cover. In accordance with section 2 (7) of the same Act, the period during which the fiduciary issue may stand at amounts continuously exceeding sterling I,575 million has been extended for two years from March I4th, I960." The statutory requirements for the maintainance of minimum reserves in gold or foreign exchange are unknown for Austrialia, Canada and Ceylon. In the U.S.A., the Reserve System must have gold certificate reserves of not less than 25 per cent of its total notes in circulation.

The commercial banks in Pakistan are required to maintain a reserve of 5 percent and two percent on their demand and time deposits respectively. This limit is a minimum and can be varied from time to time, but since 1948, when the central bank of Pakistan was established, the ratios have been constant.* In Canada, this ratio is 15 percent on all deposits which is agreed on by the Bank of Canada and the chartered banks since May 31,1956. In Australia the central bank fixes an amount which should be lodged with/by it the commercial banks. This is called the 'special account'. During 1960, it was 17.5 percent on Australian deposits. In U.K. too, there is no such fixed ratio. In this connection, IMF expert Hans Aufricht has stated that "under 'the special deposit regime' instituted in 1958, the Bank of England calls from time to time on the banks concerned (the 11 London clearing banks and five Scottish banks), informing them of the precise amount that each is required to deposit and the date or dates on which 'special deposits' are to be made at the Bank of England. Upto the end of 1960, the calls on London clearing banks were, on each occassion, for one perecent of total gross deposits." The range for the Ceylones banks is 10 to 40 percent and five to 20 percent for demand and Time deposits respectively, though in actual practice it is 12 percent and 5 percent respectively. It is interesting

---

* A uniform rate of five percent of both demand and time deposits has been prescribed since July 26,1963 by the Central Board of Directors.

to note that the central bank of Pakistan had never changed till recently the reserve requirements since its inception in 1948, while other central banks have changed these reserve requirements from time to time.

The history of member bank reserve requirements in the U.S.A. is well-depicted by the following Table:-

TABLE 16#

MEMBER BANK RESERVE REQUIREMENTS OF FEDERAL RESERVE SYSTEM IN THE U.S.A.

(Percent of Deposit)

Effective date of change	Net Demand Deposits			Time Deposit	
	Central Reserve City Banks	Reserve City Banks	Country Banks	Central Reserve & Reserve city Banks	Country Banks
Dec.31,1948	26	22	16	7½	7½
Aug.18,1949	23	19	12	-	5
Jan.11,1951	23	19	13	6	6
July 1,1953	22	19	13	-	-
July 29,1954	20	18	12	-	-
Feb.27,1958	19½	17½	11½	-	-
Dec.1,1960	16½	-	-	-	-
April 1,1962	16½	16½	12	5	5
May 1962	*				
Minimum	*10	*10	7	3	3
Maximum	22	22	14	6	6

Souce: Federal Reserve Bulletine (Washington: Board of Governors, May 1962) p.591.

* "Before July28,1959, the minimum and maximum legal requirements for central reserve city bank were 13 and 16 percent respectively and the maximum for reserve city banks was 20 percent."

\# "All required reserves were held on deposit with Federal Reserve Banks from June 21,1917 until late 1959. Since then, member banks have also been allowed to count vault cash as reserves as follows: Country banks - in excess of 4 and 2½ percent of net demand deposits effective Dec.1,1959 and Aug.25,1960 respectively, Central Reserve City Banks - in excess of 2 and 1 percent effective Dec.3,1959 and Sept. 1,1960 respectively. Effective Nov.24,1960 all vault cash."

A distinction between the reserve requirements for central reserve city banks and reserve city banks has been dropped since April 1,1962. As Table 16 shows, the reserve requirements for both central reserve city banks and reserve city banks,as of May 1962,could be set within a range of 10 percent as a minimum and 22 percent as a maximum and the range for the country banks was 7 to 14 percent. As to time deposits, the legal reserve rwquirements could be varied within a range of 3 percent as a minimum and 6 percent as a maximum for all banks,

If the commercial banks in Pakistan donot maintain the prescribed reserve requirements, then "such scheduled banks may be ordered by the Bank to pay to the Bank in respect of suvh day penal interest at a rate three percent abvove the bank rate on the amount by which the balances with the bank fall short of the fixed minimum." This rate can be increased to five perecent if the said balance is not maintained. And if inspite of this penalty of interest payments, the minimum reserve is not maintained then the Director/Directors and officers of the Bank will be liable to a fine of Rs.500 each day and if all this is not carried out, then the bank can prohibit the banks to accept fresh deposits and defaulting officers will be fined Rs.500 each day until the default is discontinued.* The Monetary Law of 1949 in Ceylon under Section 96(1)(2) states that the defaulting bank should "pay to the central bank interest on the amount of the deficiency at such rate not exceeding one-thirtieth of percentum per day as may be so prescribed." If the the bank continues to default,then the

---

*Section 36(4)(5) of the State Bank of Pakistan Act,1956.

Monetary Board of the central bank of Ceylon can issue an order to the defaulting bank to stop making loans and investments and can prohibit the distribution of net profits to the share-holders.

All the central banks under discussion have the traditional weapons of credit control and their use differs with the nature of their money and capital markets. These bank also do have certain selective credit controls which again differ from country to country according to the specific needs of these countries. In Pakistan, special credit restrcitions have been imposed from time to time in order to channel credit into essential and productive uses and stop the flow of credit to unessential and speculative channels. In the U.S.A. also, in addition,to the traditional tools of credit, the Federal Reserve System has special powers to regulate the credit terms and conditions on which all the transactions relating to stock market securities are financed. On various occassions,the Federal Reserve System has been given powers to prescribe terms and conditions regarding the extention of consumer credit and certain real estate credit. Such powers are also at the disposal of the central banks of the U.K.,Australia,Canada and Ceylon.

These central banks have powers to inspect the books of any commercial bank at any time and if any commercial bank is found defaulter, it can be closed by the central bank. The central banks generally send their auditors to check the accounts of business dealings of the commercial banks. In all cases the supervision on commercial banks is quite strict. The central bank of Pakistan and Ceylon have established separate Departments for such purposes.

D-Disposition of Profits

As regards the distribution of net profits, the State Bank of Pakistan Act, 1956, Section 52 clearly states that, "after making provision for bad and doubtful debts, depreciation in assets, conribution to staff and a superannuation funds, and such other contigencies as are usually provided for by banks, these shall be paid to the stock-holders out of the net annual profits a dividend on the shares at a rate to be fixed by the central Government from time to time,* which shall not be less than 4 percent per annum.Any surplus remaining there-after shall be paid to the central bank." As the central banks of the U.K., Australia, Canada and Ceylon have no private share-holders, so there the question of dividends does not arise. In Australia, the Treasurer,after consultation, with the Board, fixes the amount of net profits, which will be placed to the credit of the Reserve Bank Reserve Fund and the rest shall be paid to the Commonwaelth.[1] (section 30 (a)(b)). Under section 63 (a)(b) of the Reserve Bank Act, I959 the one-half of the net profit of the Rural Credit Department shall be placed to the creditt of the Rural Credits Development Fund and the other half shall be placed to the credit of the Rural Credit Department Reserve Fund. In Canada there is a Rest Fund, if this Fund is less than the paid-up capital of the Bank,

---

* At present, the rate of dividend is at 6 percent per annum.

1. The Commonwealth Trading Bank, the Commonwealth Banking Corporation, the Commonwealth Saving Bank and the Commonwealth Development Bank.

the I/3rd " shall be given to the Rest Fund and remaining shall be paid to the Receiver General and placed to the credit of the Consolidated Reserve Fund." But if the Rest Fund is not less then the paid-up, then one-fifth of such net profits will go to the Rest Fund, until this Fund becomes five times of paid-up capital and the remainder will go the credit of the Consolidated Reserve Fund and if the Rest Fund is not less than five times of the paid-up capital, the full net profit shall be placed to the credit of the Consolidated Reserve Fund. In Ceylon, the net profit is used to liquidate the Monetary Adjustment Account* and the remaining surplus shall be used as to make the total capital accounts of the Bank equal to the amount of " I5 per centum of the difference between the total assets of the Bank and it assets in gold and in foreign exchange." The remainder, if any, will be placed at the credit of the Consolidated Fund after the approval of the Finance Minister. (section 39(a)(b)(c)). The Federal Reserve Banks in the U.S.A. usually withheld a certain part of their profits as reserves. The stockholders are paid a cumulative dividend of 6 per cent per annum and small payments are made to the U.S.Treasury and the rest is retained as surplus by the Reserve Banks.

The distribution of net profits by these central banks is done in such a way as to strengthen the financial standing of these banks. In Pakistan, after distribution of the dividends to the share-holders, the rest of the surplus is paid to the Central Government, which if desire can allocate this amount to the Reserve Fund and also to the

---

* It is a Suspence Account . Any extra-ordibary expense can be charged to this Account and should be amortized within five years (Sec. 40)

Rural Credit Fund,which is done from time to time. But the Central Government has no statutory obligation to allocate the surplus to these Reserves every year.Though it has allocated to these Reserves whenever there was a need to do so. But in case of Australia,Canada and Ceylon, we find that there are very specific allocations of the net profits of these central banks.

E-State Relationship with Central Banks

Edward Nevin has rightly pointed out that,"an important question in the establishment of a new central bank is that of its relationship with the Government. To some extent the treatment of the question is dependent on the political philosophy of those responsible for the creation of the bank; advisors inclined towards what may loosely be called right-wing views will lay heavy stress on the virtues of independence of thought and attitude in a central bank,while those of left-wing opinions will stress the inevitability of a high degree of integration between the monetary measures applied by a central bank amd the level of income and employment, for which ultimate responsiblity must be clearly rest with Government and cannot be devolved on any independent agency."[1]

Nowadays, there is tendency that a central bank should be owned jointly by both the government and the private stock holders.The private stock holders will have their own directors on the Board,who will ensure

---

1.Edward Nevin,Capital Funds in Under-Developed Countries,(London: Macmillan and Company Ltd.) 1961, p.36

independence from the government. It is argued that a central bank will not be effective in maintaining the level of employment,prices,income and out-put, unless there is some government's control over the activities of the central bank. The independence is needed by the central bank in connection with" its staffing and administration and day-to-day policy are concerned."[1]

In the U.S.A., the Board of Governors has the exclusive right with regard to changes in reserve requirements for member banks and margin requirements on stock-market transactions. The Federal Reserve Banks have the authority over member banks' borrowing and the Board of of Governors only supervise such matters. The Discount Rate changes are made jointly by the Board of Governors and the Board of Directors of the Reserve Banks. The authority over open market operations is niether with the Board of Governors nor of the Board of Directors of the Reserve Banks but with the Federal Open Market Committee. But in the case of other central banks under consideration, all these matters are decided by their Board of Directors.

In comparing the various central banks, we find that the central bank of Pakistan is the only Bank which is jointly owned and managed by the Government and the private stockholders, other central banks (with the exception of the Federal Reserve Banks) are fully owned by their Governments and are fully controlled through Board of Directors appointed

---

1. *Ibid.*,pp.36-37.

by these governments. In Pakistan, there are members elected by the share-holders and others appointed, by the Central Government. The experience of Pakistan has been very successful and there is not a single instance in the history of the State Bank of Pakistan that it has neglected its role as an agent of the Government and as a custodian of banking system in Pakistan. The Federal Reserve Banks in the U.S.A. are owned by the member-banks which have contributed their capital. Their affairs are controlled by the Board of Governors from Washington D.C.

The central banks in Pakistan, the U.K., the U.S.A.,Australia, Canada and Ceylon are bankers of their Governments and advise them on certain important economic and financial matters. They all provide loan facilities to their Governments. The State Bank of Pakistan makes loans and advances to the Central and the Provincial Governments, under the heading 'ways and means advances' which are payable in three months and in Ceylon and Canada, the period is six months. In Australia, the Reserve Bank can take loan under the Section 60 which states that " the Treasurer may, from time to time, out of the moneys legally available,lend to the Bank, for the purpose of the Rural Credits Department, such amounts, and subject to such terms and conditions,as are agreed upon between the Treasurer and the Board, but the total of the sums so lent and not re-paid shall not any time exceed three million Pounds."

If there is a difference of opinion between the Government and the Board regarding some action, then the Treasurer will try to resolve this difference and if he is unable to resolve this difference, then the Board will supply its statement to the Treasurer regarding the difference. On the receipt of this statement, the Treasurer will make a recommendation to the Governor General, who will decide finally after consultation with the Executive Council. The Board will, then, be informed of the decision and the Government will take full responsibility of such a decision. The Treasurer will submit to the Australian Parliament copies of the documents connected with such a decision.

It is clear from the above, that the decision taken by the Government in connection with any action is the final and it can impose such decisions on the Board of Directors whenever there is such need. The Government and the central banks are closely related and for the successful implementation of fiscal and monetary policies, the help of the central bank is indispensible.

F-<u>Summary and Conclusions</u>

The State Bank of Pakistan is the youngest central bank (with the exception of the central bank of Ceylon) among the central banks, compared in this study. Pakistan, the U.S.A., Canada and Australia have specific central banking laws. The Chief Executive of the central banks in Pakistan, Canada, Australia, the U.K. and Ceylon is the Governor of the bank, who is appointed for a term of five to seven years, as the case may be. In the U.S.A., the Board of Governors is the governing body of the 12 Reserve Banks. The Governor in all cases presides over the meetings of the Board of Directors.

There are no special Boards in Australia, Ceylon,the U.K., the U.S.A. and Canada but Pakistan has three special Boards,which are known as 'Local Boards'.All the central banks with the exception of the central banks of Pakistan and the U.S.A. are fully owned and controlled by their respective Governments. The Central Government of Pakistan owns fifty one percent of the shares;the rest is owned by private stock holders.The Governors of all the central banks have the power of casting a second vote in case of equality of votes, and the Governor of the Canadaian central bank has the veto power which is very unique in the central banking legislation.

All the central banks have the powers of Credit Control and supervision over the activities of the commercial banks. These banks can make loans to their Governments for a certain period.The Government plays the dominant role in actions of the central banks and is the final authority in all cases.But there is always danger of political intervention with the affairs of the central bank where too much control is left in the hands of the Government. Pakistan, has a happy combination of both government and private control, which has proved very successful since the establishment of the State Bank of Pakistan in July 1948.

****

BIBLIOGRAPHY

Books

Andrus and Mohammad, *The Economy of Pakistan*, London: Oxford University Press.1958

Aufricht, Hans, *Central Banking Legislation*, New York:United Nations,1961.

Chandler L.V., *The Economy of Money and Banking*, New York: Harper and Brothers Publishers,1959.

Gupta, G.P., *The Reserve Bank of India and Monetary Management*, Bombay:Asia Publishing House,1959.

De Kock,M.H., *Central Bankn𝗂ng*, London: Staples Press Limited, 3rd. ed.,1954.

Kent, Raymond P., *Money and Banking*, New York: Rinehart and Company Inc. 1949.

Nevin, Edward, *Capital Funds in Under-developed Countries*, London: Macmillan and Company Ltd.,1961.

Ritter,L.S. *Money and Economic Activity*, Boston,Houghton Mifflin,1961.

Sayers,R.S.(ed) *Banking in the British Commonwealth*,London: Oxford University Press,1952.

__________ *Modern Banking*, London: Oxford University O Press, 3rd.ed.,1958

Sen,S.N. *Central Banking in Under-developed Money Markets* Calcutta: Bookland Limited,1952.

Sinha,S.L.N., *The Capital Market of India*, Bombay: Vora and Co.,Publishers PVT Ltd.,1960.

Thomas, R.G., *Our Modern Banking and Menetary System*, New York: Prentice-Hall Inc.,1952.

Official Publications

Government of Pakistan *Pakistan- Basic Facts*, Karachi: Ministry of National Reconstruction and Information,December 1961.

__________ *Credit Enquiry Commission Report*, Karachi:Manager, Government of Pakistan Press,1960.

__________ First Five Year Plan of Pakistan, Karachi: Manager, Government of Pakistan Press, 1955.

__________ Second Five Year Plan of Pakistan, Karachi: Manager, Government of Pakistan Press, 1960.

__________ Pakistan Statistical Year Book, 1958, Karachi, Manager, Government of Pakistan Press, 1961.

__________ State Bank of Pakistan Act. 1956; Karachi, Manager, Government of Pakistan Press, 1956.

State Bank of Pakistan, Twelve Years of Banking in Pakistan, Karachi, Ferozesons Ltd., 1959.

__________, Annual Reports of the Board of Directors; Karachi, State Bank of Pakistan, 1957-58 to 1961-62.

__________, State Bank of Pakistan Bulletins, Karachi, State Bank of Pakistan, July 1962 to November 1962.

__________, Banking Statistics of Pakistan 1960-61, Karachi, State Bank of Pakistan, 1961.

__________, The State Bank of Pakistan, Its Growth, Functions and Organisation, Karachi, Karachi, State Bank of Pakistan, 1961.

__________, Report on Currency and Finance, Karachi, State Bank of Pakistan for the years 1954-55, 1958-59, 1960-61.

__________, Summary of Foreign Exchange Regulations, Karachi: State Bank of Pakistan, 1961.

__________, Speech of the Governor of State Bank of Pakistan in the Annual General Meeting, Karachi, State Bank of Pakistan, September 1, 1962

__________, Papers on Pakistan Economy, Karachi, State Bank of Pakistan, 1958.

__________, State Bank of Pakistan Circular No. BCD/(1)4/16-57; Karachi, State Bank of Pakistan, June 29, 1957.

__________, State Bank of Pakistan Circular Letter No. Dr-Ms/48/2847-63 dated the 30th April 1963.

Meenai, S.A., Credit and Monetary Situation in Pakistan, Karachi, State Bank of Pakistan, 1962.

Other Sources

Pakistan Publication, Pakistan 1961-62, Karachi: Feorzsons and Co.Ltd. 1962.

Anwar, Abdul Aziz, Impact of Inflation on Various Classes of Society, Punjab Board of Economic Enquiry Lahore, 1961

United Nations, Monthly Bulletin of Statistics, New York: United Nations, 1956-61.

Federal Reserve System, Federal Reserve Bulletin, Washington: Board of Governors, May 1962.

Periodicals

Journal of Institute of Bankers in Pakistan? Karachi: Institute of Bankers, January-July, 1962.

Eastern Finance Karachi: Monthly, November 4, 1961.

Economist London: Weekly, December 21, 1961.

NIPA Reporter Karachi: Monthly, October 1962.

DAWN Karachi, Daily, November 4, 1961.

Unpublished Works

Muhammad Uzair, Some Aspects of Bank Credit in Pakistan, Unpublished Master Degree Thesis, Karachi: Institute of Public and Business Administration, University of Karachi, 1959.

Interviews

Dr. S.A. Meenai, Economic Advisor to the State Bank of Pakistan, Karachi.

Mr. Said Ahmad Controller of Exchange Control Department, State Bank of Pakistan, Karachi.

Mr. Z. Haq, Chief Officer, Agricultural Credit Department, State Bank of Pakistan, Karachi

Mr. M.M. Malik, Secretary Institute of Bankers in Pakistan, Karachi.