THE MONETARY POLICY OF JORDAN

By

Khaled Falah Madadha

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K.F. Madadha

PREFACE

In 1959, a 'Central Banking Law' and a 'Control of Banks Law' were issued in Jordan. Since 1950, the time when the Jordan currency first came into existence, the domestic activities of commercial banks were uncontrolled by any monetary authority. In other words, a monetary policy in the economy, in the sense of a monetary authority's control over money supply, was lacking. The only sort of monetary policy which is practiced in Jordan, is the control over foreign exchange, which is directed by the Jordan currency Control Department.

Although the Central Banking Law was declared in 1959, the Jordan Central Bank, as an institution, is not established yet. However, the relevance and objective of this study is in the attempt to analyze the future path of the new central bank's policy.

In the first chapter, the achievement of the Jordan economy is pointed out. During the last decade, Jordan experienced a high rate of growth in G.N.P., internal price stability and an increase in exchange reserves.

Chapter two provides an analysis of the Jordan currency, Jordan's relations with the Sterling area, its exchange control system and exchange reserves, its short-term and long-term credit institutions, and its money supply.

In the third chapter, an attempt is made to define the objectives and tools of monetary policy in general. An attempt is made also to point out its potential role and difficulties in Jordan. A short discussion of foreign exchange policy is also given.

The purpose of this thesis is to describe the monetary and exchange system of Jordan, and to show that due to the obvious deficiencies in these systems, the role of monetary policy is limited.

Monetary policy in developing nations is a relatively new field of economic research. Since most of the works on the subject pertain to developed economics, I have encountered a serious shortage of sources for this study. As one of the first attempts to discuss the credit and exchange systems in Jordan, this study does not claim to be either complete or comprehensive. I hope, however, that despite the deficiencies of this study for which I am wholly responsible, it may be a humble contribution in this field of economic policy.

I wish, in this respect, to express my gratitude and sincere thanks to Prof. Edmund Asfour. His precise direction, valuable remarks and sincere patience and supervision, have helped avoid the many pitfalls which this study afforded.

I wish to thank also the following gentlemen, who have provided me with valuable remarks and information, which have greatly enhanced the quality of this research: Mr. Wheathy and Mr. Husein Kasim of the Jordan Currency Board; Mr. Ziad 'Innab of the Jordan Ministry of National Economy; Mr. Suleiman Sukkar the Director of Al-Ahli Bank in Amman; Mr. Ward in the U.S.A.I.D. in Amman; Mr. Takideen in the

Jordan Agricultural Credit Corporation; Mr. Abdullah 'Arafat in the Jordan Development Board; Mr. Tawfic Abu-Sharif of the Arab Bank of Amman.

Khaled F. Madadha

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ABSTRACT

Monetary policy is one part of the general economic policy of any government. It may be defined as the policy of a central bank in either expanding or contracting the supply of money in an economy in order to achieve certain objectives of economic policy. The objectives of economic policy in Jordan are the correction of the balance of trade deficit and the lowering of the level of unemployment. Monetary policy should therefore be coordinated with fiscal policy to attempt a solution of these two problems.

The role of monetary policy in helping to correct the balance of trade deficit can be to enforce more strictly its exchange control regulations. It can also impose upon banks a certain limit to their credit allowances for importers, and as a measure to discourage importation it could require importers to deposit part of the value of the imports with the central bank. The latter could be stipulated when a permit to import is requested by the importer.

A further solution would be for monetary policy to provide fiscal authorities with funds to balance their budget internally and to continue with the public projects which are intended to alleviate the level of unemployment.

In the past, the monetary system under the Currency Board was automatic due to the fact that the Board maintained a 100 per cent foreign exchange cover for note issue, and did not intervene in the

operations of commercial banks. This indicated that no monetary policy existed in Jordan except for the very lenient regulations of exchange control.

Due to successive balance of payment surpluses and to the automacity of the monetary system, Jordan imports increased heavily and assisted in controlling any inflationary tendencies. In the future however, and after the central bank starts its operations, this automacity would be replaced by a managed currency system. The central bank would have the role of controlling the supply of money in the country which previously under the Currency Board system, had been controlled mainly by the balance of payments fluctuations.

It is discouraging, however, to face the fact that the future of monetary policy is not encouraging as a result of the shortcomings in the credit system. The main drawbacks are the lack of a developed money market, the lack of a developed banking habit and the lack of a developed network of specialized credit institutions. Due to these difficulties the traditional weapons of control over credit would be ineffective and the Bank will have to employ more direct credit control weapons. Hence, one of the first duties of the Jordan monetary authorities is to try to eradicate these unfavourable trends so that monetary policy can function more effectively.

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CHAPTER ONE

Basic Features of the Jordanian Economy

I. Introduction

The Hashemite Kingdom of Transjordan before the advent of the Palestinian refugees in 1948 consisted of a small piece of land, poor in resources and in wealth. After the end of the Palestinian War, the remaining part of Palestine was united with Jordan, to form the Eastern and Western Banks of Jordan.

Jordan, with its two banks, constitutes 1,724,868 people, living on an area of land of 37,500 sq. miles. Ninety per cent of this land is uncultivable and only 10 per cent of the arable land is under irrigation due to the prevailing drought, and the lack of enough water for irrigation. The pressure of population on land is very high. Since about 70 per cent of the population live on this poor uncultivable land, the result is the related problems of poverty and low standard of living.

Resources in Jordan, other than phosphate, potash and cement, are not found on a wide enough scale to give rise to an effective industrialization. Capital is scarce; labour is unskilled; entrepreneurship is almost lacking. Government played a great role in the economy. It had to maintain a large army, for fear of an Israeli aggression. It had to spend much on public works, in order to alleviate the unemployment and low standards of living difficulties. This expenditure government was able to cope with, due to the help of foreign loans and transfers.

II. National Income and Growth

Table 1 below, provides a picture of national income trends in Jordan, divided sectorally, showing the industrial origin of gross domestic product in the economy.

The points that one can deduce out of the figures below, are the following:

1. Agriculture, which provides the means of living for two-thirds of the population, is very unstable in its contribution to the G.D.P. in Jordan. This instability is due to the fact that most of the cultivated land is rainfed. In drought years, agricultural income diminishes heavily, such as was the case for the years 1954, 1959 and 1960.

2. The excellent growth in the construction sector is attributed to the increase in residential buildings, and government expenditures on social overhead projects, such as the East-Ghor Canal, the Aqaba Port and the Amman-Ma'an Desert Road.

3. The growth in the services sector is in the main the result of the increasing inflow of tourists to Jordan, and of the increase in government services in the sectors of education and health.[1]

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[1]R.C. Porter, "Economic Trends in Jordan," Beirut: The British Embassy, M.E. Development Division. July, 1961. (Mimeographed), p. 5.

TABLE 1

INDUSTRIAL ORIGIN OF GROSS DOMESTIC PRODUCT(1): 1954-1961

(J.D. Million at Current Factor Cost)

	1954	1955	1956	1957	1958	1959	1960	1961
1. Agriculture and Forestry	14.2	6.2	19.0	12.8	12.9	10.5	13.0	23.1
2. Manufacture, Mining and Electricity	4.2	5.2	6.3	6.8	7.6	7.9	9.1	11.7
3. Construction	1.2	1.5	1.7	1.9	2.4	3.7	3.0	3.4
4. Transport	4.4	5.5	6.8	8.3	9.0	9.7	11.3	12.8
5. Trade and Banking	9.3	9.3	10.5	12.0	14.4	16.2	18.0	22.7
6. Ownership of Dwellings	2.3	2.3	2.9	3.1	3.3	4.2	6.1	7.1
7. Public Administration and Defence	9.1	9.7	11.5	13.3	15.6	16.1	17.6	17.8
8. Services	3.0	3.3	2.7	3.7	3.9	6.0	8.1	8.9
Total	47.7	43.0	61.4	61.9	69.1	74.3	86.2	107.5

Source: 1. R.C. Porter, "Economic Trends in Jordan," Beirut: The British Embassy, M.E. Development Division. July, 1961.(Mimeographed, p.1.

2. The Jordan Government, Department of Statistics, "The National Accounts: 1959-1961," p. 2.

Notes: (1) The above figures for 1959 which Mr. Porter used were later revised in the publication of the Department of Statistics, "The National Accounts: 1959-1961." Hence the reader may notice the discrepancy in the figures for 1959 as given by the two sources.

N.B. In Tables 1, 2, 4, 6, 7, it is Mr. Porter's figures which are used.

4. With reference to the figures on Table 1 it is seen that the average annual rise in G.D.P. at current factor cost over the period 1954-1960 was about 13 per cent.[1] Assuming an annual rise of 3 per cent in population the increase in real per capita G.D.P. was then about 10 per cent. This achievement should not give rise to incredulity, since it was made through foreign assistance, which composes a little less than one-sixth of the G.N.P. in Jordan.[2]

Table 2 below provides another side of this G.N.P. analysis in Jordan.

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[1] Since 1961 was an exceptional good harvest year, the period 1954-1960 was taken as a basis for the above growth calculations.

[2] In 1961, foreign assistance was about JD. 17 million, while the G.D.P. at current factor cost in that year, was about J.D. 107.5 million, as was given in Table 1, above.

TABLE 2

EXPENDITURE ON GROSS NATIONAL PRODUCT
(J.D.Millions at Current Market Prices)

	1954	1955	1956	1957	1958	1959	1960	1961
1. Private Consumption	45.4	47.1	52.9	60.1	67.1	77.1	86.2	99.7
2. Government Current Expenditure	13.7	14.6	16.8	19.7	25.7	26.3	27.7	28.9
3. Gross Private Fixed Capital Formation	2.3	5.3	5.3	5.2	6.9	10.0	11.2	10.0
4. Gross Government Fixed Capital Formation	2.5	2.7	2.7	3.1	4.0	5.3	3.5	4.6
5. Change in Stock	1.1	-2.9	5.7	1.0	-1.7	-3.1	-0.8	2.4
Expenditure on Son-sumption and Gross Capital Formation	65.0	66.8	83.4	89.1	102.0	115.6	127.8	145.6
6. Exports of Goods and Services	6.1	7.3	9.4	10.7	9.9	8.8	12.5	16.5
7. Less imports of goods and Services	-19.8	-26.8	-26.2	-32.4	-36.7	-42.6	-45.7	-45.8
Expenditure on G.D.P.	51.3	47.3	66.6	67.4	75.2	81.8	94.6	116.3
8. Net Income from Abroad	1.1	2.5	1.9	2.7	1.9	1.0	1.1	1.8
9. Expenditure on G.N.P.	52.4	49.8	68.5	70.1	77.1	82.8	95.7	118.1

Sources: 1. R.C. Porter, op. cit., p.6, for the period 1954-1959.

2. Dept. of Statistics, National Accounts, op. cit., p. 1, for the years 1960, 1961.

The points that should be elaborated regarding the above figures of Table 2 are the following: (1) Private consumption was always in - creasing, and constituted most of the G.N.P. In 1954, it constituted 86 per cent, and in 1961, 84 per cent of G.N.P. (2) Gross private fixed capital formation showed a remarkable increase during this period. Thus, while it constituted 4 per cent of G.N.P. in 1954, in 1961 it composed 9 per cent of G.N.P. (3) Total Investment increased from a figure of J.D. 5.9 mill., or 11.5 per cent of G.N.P. in 1954, to a level of J.D. 17.0 mill., or 14.5 per cent of G.N.P. in 1961.

III. Internal Price Stability

Most underdeveloped countries experience a sort of a demand-pull inflation, due to the low productivity and the high marginal propensity to consume of these economies. Jordan, however, did not suffer this inflation, as the figures in Table 3 below may show.

TABLE 3

WHOLESALE PRICE INDEX NUMBERS BY GROUPS IN AMMAN, 1955-1961
(Base 1953 = 100)

	1955	1956	1957	1958	1959	1960	1961
All Groups	91.93	86.69	85.45	91.34	93.30	101.31	87.71
Cereals and Wheat Flour	91.31	83.46	80.31	94.13	98.41	109.96	92.47
Other Food Stuffs	90.52	89.72	97.40	83.21	74.72	74.00	69.04
Building Materials	99.87	105.68	106.11	89.70	92.32	93.96	88.92
Fuels	95.98	98.03	92.23	84.17	88.28	86.46	85.05

Source: Dept. of Statistics, Statistical Yearbook for 1961, p. 115.

The wholesale price index in Amman was thus always below the 1953 price level, except in 1960, due to widespread drought which prevailed in that year. This may show that prices were very stable in Jordan, during the last decade.

The following points are a possible explanation of this internal price stability.

1. The most important factor was the high marginal propensity to import. This tendency developed because there was no strict exchange control on importation. Thus, inspite of the huge level of government expenditures, the demand pressure was alleviated.

2. No sort of a demand-pull inflation took place in Jordan, since money supply was moderately rising, and at even a lower rate than the rate of increase in production. The reasons behind this low increase in money supply are the following:[1] (a) The Currency Board in Jordan, which was responsible for currency issue, maintained a 100 per cent Sterling cover for note issue. Deficit financing was never practiced in Jordan. This implied that the currency issued in Jordan was directly related to the fluctuations in the balance of payments. Since, as I shall try to explain later,[2] Jordan experienced only a small balance of payments surplus, there was no excessive issue of currency which might have caused price instability. The importance of this factor is

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[1]In Chapter Two, Part III, I shall try to analyze the determinants of money supply changes in Jordan.

[2]Part III of this Chapter. See Table 4.

enhanced by the fact that the currency in circulation in Jordan, constitutes almost 55 per cent of money supply.[1] (b) Demand deposits did not increase heavily in Jordan due to the following. First, the lack of a developed banking habit in Jordan accounted for the small number of those who demanded bank loans. Second: the presence of money-lenders other than banks, and the centralization of banks in the main towns further accounted for the low demand for bank loans. Third: Demand for credit for investment purposes is still low in Jordan, due to the lack of inspired entrepreneurship and profitable investment ventures. Fourth: Commercial banks in Jordan held most of their assets in foreign exchange reserves,[2] due to the illiquidity dangers that accompany domestic investment.

3. There was no sort of a cost-push inflation in Jordan in the past decade, due to the high level of unemployment, and the lack of a developed labor union. Although rents and interest rates are high, these constitute only a very small percentage of the costs of production in Jordan.

IV. External Stability

External stability could be the cause and effect of internal stability. It is generally observed that underdeveloped countries often experience internal price instability in the form of an inflation. This inflationary trend causes lower exports and higher marginal propensity to import; the situation is thus translated into external instability.

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[1]See Chapter Two, Part III, Table 17.

[2]For an analysis of commercial banks' balance sheets in Jordan, see Chapter Two, Part II, B. See in particular Table 13.

Monetary authorities are thus put into an embarassing situation. They have either to maintain a deflationary policy, to depreciate their currency value, or to follow exchange control practices.

Jordan, as we have observed in Table 3, did not experience the kind of inflationary pressures that often characterize underdeveloped economies. However, inspite of that, it suffered a chronic imbalance in its current international transactions; an imbalance which has been always corrected with the help of exogenous factors. With this help Jordan was able to balance its current external transactions, accumulate foreign exchange reserves, and preserve the exchange value of the Dinar.

Table 4 below provides a partial picture of what the international transactions in Jordan were during the last 5 years. It is apparently clear that the chronic problem is in the balance of trade. Imports always exceeded exports, and composed almost 30 per cent of G.N.P. over the period 1956-1961. The factors behind this huge deficit, were as follows:

First: Jordan, as already defined, is an underdeveloped economy with a deficient productive capacity. The agricultural sector is underdeveloped and dependent upon rainfall, which in previous years was not enough to produce sufficient food crops. Even in good rainfall years, Jordan has to import wheat and food, to feed the rising number of its population.

Another factor which has induced this huge deficit in the balance of trade, is the increasing import of machines. Thus, the imports of

TABLE 4

JORDAN'S BALANCE OF PAYMENTS: 1956-1961
(In J.D. Millions)

	1956	1957	1958	1959	1960	1961
1. Exports of Goods and Services	9.4	10.7	9.9	8.8	12.5	16.5
a) Exports and re-exports	5.2	5.5	3.5	3.4	3.9	5.3
b) Travel	1.5	1.2	1.2	2.9	3.2	4.3
c) Other Services	2.7	4.0	5.2	2.5	5.4	6.9
2. Factor Income	2.4	2.9	2.0	1.2	1.2	2.0
3. Current Transfers	16.4	19.3	25.1	30.2	26.5	25.7
a) To household	9.1	9.1	8.0	11.6	10.0	9.1
b) To government	7.3	10.2	17.1	18.6	16.5	16.6
A. Current Receipts (1 2 3)	28.2	32.9	37.0	40.2	40.2	44.2
4. Imports of Goods and Services	26.2	32.4	36.7	42.6	45.7	45.8
a) Imports (c.i.f.)	24.6	29.8	34.0	39.4	41.4	40.9
b) Travel	0.9	1.7	1.6	1.9	2.2	2.4
c) Other Services	0.7	0.9	1.1	1.3	2.1	2.5
5. Factor Payments	0.5	0.2	0.1	0.2	0.1	0.2
B. Current Expenditure (4 5)	26.7	32.6	36.8	42.8	45.8	46.0
C. Current Accounts (A B)	1.5	0.3	0.2	-2.6	-5.6	-1.8
Capital Transfers	0.6	2.0	2.0	1.9	3.7	2.8
Private Investment	0.3	0.5	0.6	0.1	0.4	0.5
Official Loans	1.9	-0.6	1.0	0.5	1.5	0.5
Net errors and Ommission	-0.2	-0.5	0.1	0.4	1.9	0.4
Net change in foreign exchange reserves	4.1	1.7	3.9	-0.5	1.9	2.4

Sources: 1. R.C. Porter, op. cit., p. 12.

2. Jordan Dept. of Statistics, "National Accounts" 1959-61, p.9.

producer's goods constituted 25% of all imports in 1952, 32% in 1955, 35% in 1958, and 38% in 1959.[1]

Jordan imposes exchange control on both current and capital accounts, as shall be enumerated fully in Chapter Two.[2] Jordan protects local production also through a system of tariffs and quotas. Inspite of this protection, imports have always increased since 1950, except in the year 1961, which was a good harvest year.

Jordan imports agricultural products, textiles, machines and minerals. About 21 per cent of its imports come from the Arab countries, 30 per cent from other Middle Eastern countries, and 12 per cent from the U.S.A.

In contrast to the numerous import items, Jordan exports are few. Jordan's exports in descending order of importance are: (1) Agricultural products such as tomatoes and water-melons. (2) Phosphates. (3) Food products. (4) Leather products. (5) Livestock. Thirty-seven per cent of the exports are phosphates, and 50 per cent are agricultural products.[3]

Since most of Jordan's exports are non-durable agricultural products, most of the customers are Arab neighbouring countries. Thus, about 66 per cent of Jordan's exports are imported by the Arab countries, 8.3 per cent by India. Exports to the Eastern Bloc have increased from 8 per cent of all exports in 1955 to 28 per cent in 1960.[4]

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[1] Sirhan, Ghazi, "Economic Development in Jordan", (Unpublished M.A. Thesis, Dept. of Economics, A.U.B.; 1961), p. 53.

[2] See Appendix C concerning the most important exchange control regulations in Jordan.

[3] Union of Arab Chambers of Commerce, Industry and Agriculture, Annual Report for 1962 (Tunis: 1962), p. 205.

[4] *Ibid.*, p. 28.

Other than the aspect of exports and imports the balance of payments in Jordan showed the following trends which can be seen in Table 4 above: (1) The net goods and services balance was always in deficit. However, this deficit was less than the balance of trade deficit, the corrective item being the increasing revenue from tourism. (2) Private remittances have increased in importance, the largest component being the remittances of Jordanians working in Kuwait. (3) Official transfers constitute the largest corrective item in the balance of payments. It is constituted of U.S. and U.K. aid for the budget, and U.N.R.W.A. transfers. Because of private and official transfers, the huge deficit in the goods and services balance is always nearly closed, even showing a surplus in some years. (4) The capital account constitutes foreign private and official loans. When they are added to the current account, a surplus of foreign exchange reserves appears in the balance of payments figures. Thus, we may notice that in all the period shown in Table 4 above, a surplus was always apparent, except for the year 1959, which was a bad harvest year.[1]

The main conclusion that one may draw from the above analysis is: Jordan was able in the past decade to balance its international transactions, accumulate exchange reserves, and stabilize the Dinar's exchange value, largely with the aid of external factors.

V. Labor Unemployment in Jordan:

Although Jordan has witnessed a noticeable G.N.P. growth of

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[1] In Chapter Two, Part I, C, b, I shall discuss fully the question of foreign exchange reserves. See Table 12.

about 10 per cent annually, more than one third its labor force is still idle. The influx of the Palestinian refugees in 1948 accentuated this problem. Estimated labor force in Jordan is about 398,000. Out of this, 279,000 are working, and 119,000 are largely unemployed.[1] The level of unemployment is thus about 7 per cent of total population, and one third the labor force.[2]

The distribution of the employed labor force in 1960 is given in Table 5 below:

TABLE 5

DISTRIBUTION OF EMPLOYED LABOR IN 1960

Agriculture	150,000
Public Administration and Defence	75,000
Industry	22,000
Building and Construction	18,000
Commerce and Services	14,000
Total	279,000

Source: J.D.B., The Five Years Plan for Economic Development (Amman: 1961), p. 359.

Agriculture, public administration, and defence employ the largest part of the employed labor force in Jordan. Most of the

[1]In a Report issued by the Jordan Development Board on manpower resources, labor force was calculated to constitute those between 15-60 years of age. Half of this figure were males, and are all included in the labor force; only 10 per cent of the females were included in the labor force. See: J.D.B., "Manpower Survey," 1960, p. 15. (Manuscript.)

[2]Although it is believed that this figure for unemployment is unnecessarily over-estimated, yet the fact remains that the unemployment level in Jordan is high.

The Dept. of Statistics is publishing a final report on the census of population and housing which is not available up to now.

unemployed labor is made up of Palestinians, who would starve without the U.N.R.W.A. subsidies which they receive. It is estimated that refugee labor in Jordan constitutes almost half of the labor force.[1]

VI. The Allocation of Effective Demand Expenditures in Jordan:

Resource mal-allocation is a wastage that all economies try to avoid. This question has a special significance in underdeveloped countries, where most of the private capital generally either flows out of the country, or is invested in other socially unproductive ventures.

In Table 2 above, it was shown that consumption constituted 86 per cent, and Investment 14 per cent of expenditure on the G.N.P. in Jordan.

The financing of capital formation in Jordan is shown in Table 6 below.

The figures in Table 6 below, show the following trends: (1) Private savings fluctuated in Jordan between the period 1954-1961 depending upon weather conditions. They dropped in 1959, which was a bad harvest year, and increased tremendously in 1961, which was a good harvest year. (2) Government savings started to assume importance in the last four years, due to the increase of foreign assistance to Jordan.

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[1] I.B.R.D., Economic Development in Jordan (Baltimore: John Hopkins University, 1957), p. 444. This was the most recent figure that was available.

TABLE 6

FINANCING OF GROSS DOMESTIC CAPITAL FORMATION
(In J.D. Millions)

	1954	1955	1956	1957	1958	1959	1960	1961
1. Government Savings	-1.4	-0.8	-1.0	-0.1	1.9	5.2	3.7	3.8
2. Private Savings	8.0	3.3	16.3	10.0	7.9	4.1	4.6	11.4
3. Deficit of Nation on Current Account	-0.5	3.0	-1.5	-0.3	-0.2	2.6	5.6	1.8
4. Net errors and Omissions	-0.2	-0.4	-0.1	-0.3	-0.4	0.3	-	-
Gross Domestic Capital Formation	5.9	5.1	13.7	9.3	9.2	12.2	13.9	17.0

Sources: 1. R.C. Porter, op. cit., p. 11; for the period 1954-1959 (inclus.)

2. Dept. of Statistics, The National Accounts, p. 3; for the years 1960, 1961.

The question now is to see how this capital formation is allocated in Jordan, so as to determine whether there is any capital mal-allocation. Table 7 below provides a picture of capital-allocation in Jordan.

TABLE 7

COMPOSITION OF GROSS DOMESTIC CAPITAL FORMATION
(In J.D. Millions)

	1954	1955	1956	1957	1958	1959	1960	1961
1. Fixed Capital Formation	4.8	8.0	8.0	8.3	10.9	15.3	14.7	14.6
a) Construction and Work	3.2	4.9	5.3	5.6	7.1	10.6	8.7	9.1
b) Transport Equipment	0.9	1.9	1.6	1.4	1.9	2.4	1.4	1.6
c) Machinery and other Equipment	0.7	1.2	1.1	1.3	1.9	2.3	4.6	3.9
2. Changes in Stocks	1.9	-2.9	5.7	1.0	-1.7	-3.1	-0.8	2.4
3. Total Gross Domestic Capital Formation	5.9	5.1	13.7	9.3	9.2	12.2	13.9	17.0

Sources: 1. R.C. Porter, op. cit., p. 11; for the period 1954-1959.

2. Dept. of Statistics, The National Accounts, p. 4; for the years 1960, 1961.

Note: Construction and Work above constitutes: (a) Dwellings. (b) Non-residential buildings. (c) Other construction and works.

Most of the capital formation during the whole period was as the above figures show, directed to construction, and specifically into construction of residential buildings. Mr. R.C. Porter describes capital formation in the period 1954-1959 to be as follows: "The most significant feature of capital formation over the period is the very large increase in the value of construction and works. A considerable proportion of this increase is the result of an increase in private residentials construction which, according to the statistics of building licenses, more than doubled in volume.[1] This is true for the years 1960 and 1961 as well, since in these two years investment in dwellings constituted 43 per cent and 35 per cent consecutively of total investment in construction.[2] A large part of this is expended on luxury residences which is a social mal-allocation of capital considering the desperate need of Jordan for productive capital.

As regard consumption expenditures, figures do not indicate heavy lavish or conspicuous consumption in Jordan. Thus, it is calculated, that in the years 1959, 1960 and 1961 consecutively, expenditure on necessities in Jordan, such as food, clothing, furniture, housing, personal care and health, constituted 81 per cent, 76 per cent and 79 per cent of total private consumption expenditures.[3]

VII. Distribution of Wealth and Income:

One of the main features that distinguish underdeveloped economies is the wide discrepancy in wealth and income between the rich and the poor classes. Since land is the main source of wealth, the salient features of distribution in these economies are the disparities in land ownership, the high rents, and the very low agricultural wages.

Disparities in land ownership in Jordan are not severe, according to the Development Bank's Report figures. Although the I.B.R.D.

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[1] R.C. Porter, op. cit., p. 10.

[2] Dept. of Statistics, The National Accounts, op. cit., p. 4.

[3] Ibid., p. 6.

figures are related to the year 1950, they do not differ greatly from present conditions, since land distribution has even improved since 1950.[1]

TABLE 8

LAND DISTRIBUTION IN JORDAN

Land Holdings	As % of total holdings	As % of total area
Less than 100 Dunums each	85	36.6
Between 100-500 Dunums each	13.5	38.5
More than 500 Dunums each	1.5	25.3

Source: I.B.R.D., Economic Development in Jordan, op. cit., p. 130.

The above figures do not show signs of land mal-distribution, since only 1.5 per cent of the total holdings were more than 500 Dunums each, while 85 per cent were less than 100 Dunums each.

The real mal-distribution in Jordan is that between the rural and the urban sectors of the economy, as may be demonstrated in the following figures:

[1]This is the most recent available reference concerning land distribution in Jordan.

TABLE 9

INCOME FROM WAGES IN JORDAN IN 1959

	Wage Bills (In J.D.Mill.)	No. of earners (000's)	Earnings per head
1. Agriculture	0.75	14	54
2. Manufacture and Mining	1.6	14	114
3. Wholesale and Retail Trade	0.8	5	160

Source: R.C. Porter, op. cit., p. 15.

The above figures show that the earnings per head in the commercial sector were almost three times those in the agricultural sector.

Mr. Porter estimates that the disparities in earnings per head, between the rural and the urban sectors, have increased over time. He maintains that, while the ratio of urban: rural incomes per head in 1954 was 294: 73, this ratio increased to 425: 48 in 1959;[1] in other words, this ratio has increased from 4: 1 in 1954, to almost 9 : 1 in 1959.[2]

VIII. Concluding Remarks:

To recollect what has been analyzed in this chapter it is relevant to point out the following remarks:

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[1]R.C. Porter, op. cit., p. 14.

[2]This huge decline in rural incomes may be attributed partly to the fact that 1959 was a bad harvest year, yet, it should be noticed that 1954 was a good harvest year and still agricultural incomes compared very unfavourably with the income of the urban sector.

1. Although Jordan is an underdeveloped economy with poor natural resources and very low savings and capital formation, yet it has achieved a remarkable annual growth of about 9.5 per cent in its G.D.P. at current factor cost, over the period 1954-1960. This was brought about with the aid of foreign advances, rather than with domestic capital formation.

2. Foreign advances also enabled the economy to enjoy foreign exchange stability, to accumulate foreign exchange reserves, to import heavily and thus to alleviate the demand pressure on resources, with the result that the economy enjoyed an internal price stability.

3. Unemployment is the worst problem in the Jordan economy.

4. One of the persisting problems in the Jordan economy is the socially distressing condition of the Jordanian farmers and the Palestinian refugees, and the wide gap in incomes between the rural and the urban sectors of the economy.

CHAPTER TWO

The Monetary and Banking Systems in Jordan

I

The Monetary System in Jordan

I. A. The Development of Jordan Currency:

Until World War I, the currency circulating in Jordan was that of Turkey. After the expulsion of Turkey in 1917, the Egyptian currency and the British Gold Sovereign began to circulate. In 1927 the Palestinian currency was declared legal tender by the British administration, which at that time was ruling Transjordan and Palestine under a League of Nations Mandate. However, the amount of Palestinian currency in circulation remained low due to the people's preference for holding gold-coins, and to the self-sufficiency of the Bedouin economy. Nevertheless during World II, currency in circulation increased from L.P. 0.5 mill. at its beginning, to L.P. 5 mill. in 1948.[1]

Under the British Mandate Transjordan became automatically a member in the Sterling Bloc, and had also to ensure foreign exchange control, beginning in 1939.

Although Transjordan got its independence in 1946, an independent currency was not issued, and there were no plans put for its issue, until the British Mandate over Palestine came to an end in 1948.

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[1] A.K. Salehdar, "Financial Institutions in Jordan," - Typescript - (I.M.F., Middle East Dept., 1957), p. 9.

In 1949 the Palestine Currency Board was liquidated, after the termination of the Arab-Israeli War.

In 1949, the first monetary law in Jordan was declared, which was the Temporary Law for Jordan Currency.[1] It announced the birth of the Jordan Dinar which was to replace the Palestine pound in circulation. A Jordan Currency Board was also formed. The Dinar was to replace the Palestine pound which was fully backed by sterling, at a rate of exchange of 1 = 1. The Palestine currency which was withdrawn, was redeemed by the Palestine Currency Board. The new Dinar was to be backed with 100% Sterling Assets. Jordan thus remained on a sterling exchange standard.

After October 1, 1950, the Dinar was the only currency in circulation. By the end of March 1951, currency in circulation amounted to about J.D. 8.9 mill.[2]

In 1952, the Jordan Government agreed with the Ottoman Bank, that the latter would be the government's bank, in which it would keep its deposits, and through which it would make its expenditures.

Jordan joined the International Monetary Fund (I.M.F.) in 1952, and the International Finance Corporation in 1956. The quota with which Jordan first subscribed to the I.M.F., was $ 3 mill.; 3% in gold, and the rest in local currency. Jordan, however, raised its quota to $ 4.5 mill. in 1960, paying 25 per cent of the increase in gold.

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[1]See Appendix A.

[2]From a lecture about "The Monetary System of Jordan," given by Mr. Wheathy, the Bank of England's representative in the Jordan Currency Board, in the Training Program which was conducted by the J.D.B. in 1963.

Jordan's quota was \$ 6.3 mill. in 1961, and \$ 8 mill. in 1962, with the Dinar constituting about 82.5 % of the quota. Jordan, however, has not drawn upon its quota since it joined the Fund.[1]

In 1957, the Currency Board was transferred from London to Amman. The Board consisted of a Jordan Government representative, the Bank of England representative, and chairmen from three banks. Between 1957-62, the Board in London was represented by an Investment Committee which was entrusted to invest Jordan's official reserves in the U.K. This Committee was dissolved in October 1962, and the Bank of England replaced it as a banker for the Board.[2]

In 1959, a Central Bank Law was issued, but the Bank has not been established until now. The Central Bank, when established, will assume the roles of both the Currency Board, as currency issuer; and the Currency Control Dept., as exchange controller. In 1959, also, a Banks Regulation Law, and a Control of Foreign Exchange Law, were passed.

I. B. The Jordan Currency Board:

In Jordan there are two authorities which play the role of a central bank; namely, the Currency Board and the Currency Control Department. The Currency Control Department is responsible for the implementation of exchange control regulations. Its functions shall be described later, when discussing the exchange control regulations in Jordan.

The Currency Board, according to the Temporary Law for Jordan

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[1] I.M.F., International Financial Statistics, May 1963, p. 167.

[2] Wheatly's Lecture, op. cit., p. 2.

Currency,[1] is the sole authority responsible for the issue and redemption of currency. It keeps the cover of its note issue in 100% sterling assets in London. The main jobs that the Currency Board performs are two: (1) The issue of currency, and the investment of the cover in sterling securities. (2) Redemption of currency, giving Ŀ 1 for every Dinar that is redeemed.

Mr. Wheatly, the present representative of the Bank of England on the Currency Board, explained the Currency Board's operations in a lecture which he gave on the Training Program which was sponsored by the Jordan Development Board in January 1963.[2] He said: "Take first an issue to the Ottoman Bank, who are Government Bankers; they know that a demand for currency will arise at, for example, the end of a month when government salaries are paid, and they therefore estimate roughly how much is going to be needed. They then instruct their London Office to transfer Sterling from their account to the Bank of England, for account of the Jordan Currency Board to the amount of dinars required, plus a commission of 1/8%; on receipt of advice from the Bank of England that the money has been received, the Currency Board in Amman transfers Jordan Dinar notes and coin to the amount required from the vaults in the Ottoman Bank to the Ottoman Bank Cashiers. Thus the operation is complete. The Currency Board has received Sterling from the Ottoman Bank and has paid out the equivalent in dinars."[3] The notes and coins issued, are produced in London, and

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[1]See Appendix A, for the important provisions of this Law.

[2]Wheatly's Lecture, "The Monetary System of Jordan," <u>op.cit.</u>,

[3]<u>Ibid.</u>, p. 4.

shipped on demand to the Currency Board in Amman.

The redemption phase is the reverse of the issue phase. It takes place as follows: "A bank finding itself with more dinars than it requires, therefore, decides to pay them back to the Currency Board which, in exchange, provides them with the sterling countervalue by instructing the Bank of England to pay the London branch or correspondent of the bank concerned."[1]

The Currency Board's job in other words is similar to a money-exchanger. "It is unable to exercise any influence on the supply of money or credit in Jordan, either directly by its own operations or indirectly by influencing or controlling the operations of commercial banks."[2] Money supply in Jordan, as we shall see later, is affected mainly by the balance of payments position, and by commercial banks' credit to the private sector.

The Currency Board's accounts are made up of two branches: (1) The Currency Reserve Fund. (2) The Currency Fund Income Account.

The Currency Reserve Fund's assets include, at present, securities at cost in London less an Investment Reserve,[3] and U.K. Treasury Bills at cost, time Deposits with Ottoman Bank, Cash in Hand. The liabilities are the currency in circulation plus the balance of Income Account.

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[1] Ibid., p. 4.

[2] I.B.R.D.Report, Economic Development in Jordan, op.cit., p.366.

[3] The Investment Reserve, are the funds which are reserved against a possible fall in the market value of the sterling securities. See, Currency Board, Annual Reports; 1956-1962.

The Income Account of the Currency Board is a profit or loss statement. The expenditures are:[1] (1) The cost of printing notes and minting coin, (2) Cost of transport, insurance, (3) Currency Agents fees and expenses, (4) Fees of members of the Board, and salaries of the officers, (5) cost of destroying concelled notes, and audit expenses. The revenue is composed of the following: (1) The interest received on investment in securities, (2) The interest on bank deposits, (3) Interest on Treasury Bills, (4) Commission on currency issue and redemption.[2]

The balance of Income Account which accrues after expenditures are made, is the net profit of the Board. Out of it, an Investment Reserve is set aside as was explained above, and the remaining surplus is credited to the account of the Jordan Treasury.

In Table 10 below, the gross and net profits of the Currency Board since 1956 are shown.

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[1] _Ibid._, _Annual Reports_; 1956-1962.

[2] According to the Currency Law of 1949, annexed in Appendix A, the Currency Board receives 1/8% on the issue and redemption of currency through telegram. On redemption through mail, it receives 1/16%.

TABLE 10

GROSS AND NET PROFITS OF THE JORDAN CURRENCY BOARD
(In J.D.)

Year (ending March 31)	Gross Profits	Investment Reserve	Net Profits
1956	376,675	2,992	373,683
1957	488,265	5,533	482,732
1958	607,652	437	607,215
1959	632,303	5,877	626,426
1960	593,458	8,520	584,938
1961	719,781	3,302	716,479
1962	798,842	6,582	792,260
Total	4,216,976	33,243	4,183,733

Source: Jordan Currency Board, Annual Reports, 1956-1962.

It is clear that income which accrued from investment, increased steadily during the period. Thus the Jordan Treasury benefited since 1956 to the extent of J.D. 4, 183,733.

In Table 11 below, the composition of the Currengy Board's investments in the U.K. assets is shown.

TABLE 11

INVESTMENTS AND RETURNS OF THE JORDAN CURRENCY BOARD
1958 - 1962
(Years ending in March 31)
(In Ƀ or J.D. 000's)

Investments	1958		1959		1960		1961		1962	
	Value	Return	Value	Return	Value	Return	Value	Return	Value	Return
1. UK Securities at cost value	10,350	309.2	10,350	312.7	10,350	349.7	10,850	363.6	11,350	376.1
2. UK Treasury Bills	5,100	227.7	5,500	259.9	6,600	190.2	6,850	303.2	8,100	348.3
3. Time Deposits in the Ottoman Bank	1,900	80.9	1,700	63.6	1,500	46.7	1,500	63.4	1,500	69.6
Total	17,350	617.8	17,550	636.2	18,450	586.6	19,200	730.2	20,950	794.0

Source: Jordan Currency Board, Annual Reports: 1958-1962.

The above figures show, the following points: (1) Most of the Board's investment was in U.K. securities, although its policy in the period under investigation was to increase its investment in U.K. Treasury Bills. (2) Investments increased, pointing to the fact that currency issue has also increased staedily.

The rates of return for the Board's investment, calculated as total returns: total investments, for the period 1958-1962, were as follows:

1958	1959	1960	1961	1962
3.5	3.6	3.1	3.8	3.7

The cover to Jordan's currency is thus composed of 100% sterling assets. Due to this composition of the cover, the increase in currency issue was low in the previous period, since the balance of payments' surplus was also low.

It should be noted that the cover to a currency, has the following uses:[1] (1) It limits money supply increases, and hence limits the impetus to inflationary trends. (2) It provides currency with flexibility in that when agricultural and industrial bills are put in the cover, the increase in money issued is linked directly to the increase in production. (3) The monetary authorities can use this cover to implement their policies. Thus, they may want to encourage certain credit by holding specific securities of specific institutions in the cover. (4) The cover is used as an international means of payment to meet temporary deficits in the balance of payments. In other words, a cover has the advantage of providing currency with safety, and flexibility.

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[1] 'Isam 'Ashour, Lectures on Money and Credit in the Arab Countries (Cairo: 1962), p. 31. (Arabic Book.)

The Jordan cover provides the currency with safety, but not with flexibility, since, as it stands now, it only combines (1) and (4), but not (2) and (3).

In the words of the I.B.R.D.: "The present requirements of a 100% sterling reserve for the currency issue not only precludes the Currency Board from providing rediscount facilities for domestic bank assets, but also involves the immobilizing of an equivalent amount of sterling whenever there is an expansion of the currency issue."[1]

The recommendations of the I.B.R.D. were that the Jordan currency cover should consist of the following: gold, foreign exchange, commercial banks assets, Jordan Treasury securities, and government-guaranteed securities of development banks and institutions.[2] Inspite of these recommendations, the new Central Bank Law of 1959, provided for a 100 per cent foreign exchange and gold cover, and did not provide for a fiduciary issue. The cover to the currency, as stipulated in Article 28 of this Law,[3] was to be composed of the following: (1) Gold. (2) Currencies convertible into gold. (3) Sterling balances. (4) U.K. Treasury Bills. (5) Sterling securities guaranteed by the U.K. Government.

Although a cover of 100% foreign exchange supplies the currency with stability, yet, nevertheless, it renders the currency issue completely dependent upon the balance of payments fluctuations, thus, limiting the power of monetary authorities in controling money supply.[4]

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[1]I.B.R.D., op. cit., p. 375.

[2]Ibid., p. 376.

[3]See Appendix B.

[4]This point is fully developed in Chapter Three, Part II.

Whenever the balance of payments shows a surplus, the currency issued increases. The reverse takes plae when there is a balance of payments deficit.

In the past--as Table 4 shows--the Jordan balance of payments tended toward a suplus, so the issue of currency increased steadily (see Table 12). The automaic relationship has helped Jordan to achieve two beneficial results: (a) It has avoided the excessive issue of currency and has thus enabled Jordan to preserve its internal monetary price stability, and (b) It has avoided the excessive issue of currency and has thus enabled Jordan to conserve its limited foreign exchange reserves.

As previously stated, the disadvantage of this automatic relationship is that it almost completely limits the power of monetary authorities to control the supply of money. It thus inhibits the power of the central bank in providing deficit finance for the government to enable it to decrease the level of unemployment in the economy.

I. C. The Foreign Exchange System

The Jordan currency was issued in 1950, as a non-convertible currency, and on a sterling exchange standard.

As a matter of convenience, this subject of the exchange system shall be divided into three parts: (1) The relation of Jordan with the Sterling Area. (2) The foreign exchange reserves. (3) Foreign exchange control.

a. Jordan and the Sterling Area:

Transjordan under the British Mandate was automatically joined to the Sterling Bloc in 1931, which since the end of World War II, was called, the Sterling Area.

The most important features of membership in the Sterling Area are the following:[1]

(1) Member countries have to maintain a stable exchange rate between their currencies and the Sterling pound. Stability in this sense, however, does not imply rigidity, since independent member countries are not obliged to follow the Sterling devaluation or appreciation. Many member countries, thus, did not devalue their currencies when the U.K. devalued the pound in 1949.

(2) Member countries maintain a free transfer of payments for current and capital purposes in the area. On the other hand, members restrict payments to non-residents of the Sterling Area, especially those payments that are made in hard currencies.

Member countries in the area enjoy thus preferential trade allowances and are provided with the opportunity to expand their production for exports. They also enjoy under this regulation a free access to London's money market--in other words, member countries can borrow freely from London's money market, and thus are helped to stimulate their investment projects.

(3) Member countries deposit their hard currency earnings in a "dollar pool", which is located in London. The U.K. permits these countries, however, to draw upon these reserves, but with certain limitations.

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[1]The literature on the Sterling Area is not extensive. Some of the best books on the subject are: Conan, The Sterling Area (London, 1952); Conan, The Rationale of the Sterling Area (London, 1961); R.C.L. Day, The Future of Sterling (London, 1954); Judd Polk, Sterling, Its Meaning in World Finance (New York, 1956).

The presence of this dollar pool allows member countries to enjoy the advantage of holding a lower margin of reserves than they would if this pool did not exist. This happens because member countries can draw upon their reserves in the pool whenever they are threatened with a short-run deficit difficulty.

(4) Member countries of the Area, have similar international trade policies and exchange control regulations. In the past, the U.K. used to perform all the trade agreements of the member countries.

(5) Member countries conduct their international payments in sterling. This means that it is necessary for the official and bank reserves to be mostly held in sterling. The effect of this on Jordan is demonstrated in Table 12.

Nowadays almost all of the above features of the Sterling Area, are either less important, or non-existing. Thus, stability at par value with the pound is not maintained; exchange control regulations are different in different member countries; exchange control now is even imposed by members on payments to other members of the Area; independent member countries are nowadays reserving their earnings of hard currency, and not depositing them in the dollar pool, as they used to do in the past.

Inspite of this, the Sterling Area still exists as a wide payments union since the alternatives are not so encouraging. That is to say that there are many difficulties that confront member countries in case they decide to leave the area.

In Jordan's case, there are many factors which indicate that it did not derive much benefit from its membership in this area. This was so, because foreign American aid helped Jordan to correct its balance of trade deficits and hence it relieved Jordan from dependence upon the Sterling Area to sell its exports, to borrow from London's money market, or to draw upon its reserves in the dollar pool.

This same trend, however, is not expected to manifest itself in the future. Foreign aid is slowly decreasing, and the future development plans for Jordan forecast the country's complete self-dependence by 1970. This may lead to a situation wherein Jordan's future foreign exchange difficulties may impose upon it a greater dependence on its ties with the Sterling Area, because of the three main benefits that may accrue from this membership, which are the following: (a) The access to London's money market. (b) The dollar-pool reserves. (c) The preferential trade agreements that may allow Jordan to sell its exports.

If Jordan leaves the area, now, this would entail the following: (a) Jordan itself has to perform its exchange control and trade agreements. This would require efficient personnel which Jordan lacks at present. (b) Jordan would loose access to London's money market and dollar pool, and thus would have to maintain higher reserves to face its future difficulties. With regard to Jordan, such an accumulation of reserves would be difficult to maintain. (c) There is a further danger in that, if Jordan would leave the area suddenly, the U.K. might block its reserves as it did in the cases of Iraq and Egypt.

Alternatively, if Jordan leaves the area now, it benefits in that it achieves a full convertibility of its Sterling assets. As it remains a member in the area, its assets are inconvertible, while, after the U.K. declaration of the full convertibility of the Sterling pound for non-residents after 1958, it could convert its sterling balances if it were an outer Sterling Area country.

To conclude: The main problem facing monetary authorities in Jordan is that of securing sufficient exchange reserves to face the huge balance of trade deficit. In the past, Jordan's membership in the Sterling Area has not helped it to gain this objective, due to the presence of foreign aid. But, as such aid is not expected to flow as before, and until Jordan secures self dependence in 1970, it may find it pertinent to remain in the area in order to derive the benefits accruing from its membership therein.

b. <u>The Foreign Exchange Reserves of Jordan</u>:

As was indicated in the analysis of Jordan's balance of payments, Jordan was able to balance its international transactions and to accumulate exchange reserves, with the help of foreign loans and assistance. Jordan was able to stabilize the value of its Dinar through two factors: (1) Foreign assistance. (2) The internal price stability which Jordan enjoyed in the previous decade, as pointed out in Table 3 above.

The Table below shows the trend of foreign exchange reserves in Jordan over the period 1958-1962.

TABLE 12

GROSS FOREIGN EXCHANGE RESERVES IN JORDAN
(In J.D. 000's)

End of Year	1958	1959	1960	1961	1962
A. Jordan Currency Board					
Sterling	16,331	15,981	16,397	17,967	20,235
B. Commercial Banks					
Sterling	13,071	13,542	13,450	15,696	19,985
U.S. Dollars	974	570	533	291	147
Arab League Currencies	305	154	132	70	43
Other Currencies	47	12	155	22	133
Total	14,397	14,278	14,270	16,079	20,308
C. Government					
Sterling	-	-	1,000	530	-
D. Grand Total	30,728	30,259	31,667	34,576	40,543
Increase (+) or decrease per year		-469	1,408	2,909	5,967

Source: Jordan Currency Control Dept., Banking and Foreign Exchange Statistics: 1958-1962 Reports.

The deductions that one comes out from studying the above figures are the following: (1) Jordan was able to increase its receipts of foreign exchange annually. One of the factors that accounted for the increase in foreign exchange reserves was the budget surpluses. The accumulation of these surpluses was due to the fact that the government always overestimated its future budgetary deficits and hence overestimated its demand for foreign aid.

The reserves of commercial banks increased also because the country enjoyed successive balance of payments surpluses. Banks kept their reserves in foreign exchange and foreign assets due to the lack of eligible and profitable domestic assets in which to invest. (2) The Jordan Currency Board reserves, which represent the cover, except for the year 1959, increased steadily. This points to the fact that currency issue increased also. (3) Commercial banks are not allowed, as may be seen above, to keep their exchange balances in hard currencies, due to exchange control regulations. (4) Both public and Private foreign exchange reserves in Jordan are nearly sufficient to meet a 16 months deficit in Jordan's balance of payments; or, are equal to nearly one year's imports.[1]

c. Exchange Control in Jordan:[2]

Exchange control regulations in Jordan and the whole Sterling Area have been imposed since 1939. It is now administered in Jordan, by the Currency Control Department, on both current and capital accounts.

Prior to 1955, there was no other rate for foreign exchange in Jordan, except the official rate at which J.D. 1 = Ŀ 1 = $ 2.8. Most of the market foreign exchange transactions, prior to that time, were made through Beirut's exchange market. In 1955, however, Jordan organized a free market to deal with the Arab League Currencies.

A system of import licenses that are liable to import fees, was also introduced in 1955. The purpose of the organization of the free market, and the import fees, "was not only to develop an organized

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[1]See the analysis of Jordan's balance of payments in Chapter One, Part III, Table 4.

[2]See Appendix D.

free market in Syrian and Lebanese pounds, and to simplify the exchange system by reducing the number of rates applicable to imports, but also to reduce the spread between the free market rate and the official rate, and to differentiate more sharply the transactions taking place in the two markets."[1]

Fees on payments that took place at the free rate were put at 4% for imports, and 0.5% for invisibles. Their initial purpose was to close the gap between the free and the official rates. They are nowadays collected for revenue purposes, since the market rate for the Arab League Currencies was abolished in December 1961.

In December 1961, multiple exchange practices were almost liquidated when the free rate for payments in Arab League currencies was abolished, and these payments have had to take place since then at the official rate.

Jordan's domestic production is protected through tariffs and quotas, in addition to the import fees charges. Hence, if a commodity is not produced, it is included in the free import list. When local production begins, the item is placed on a prohibited import list until local capacity production is reached. After this stage of capacity is reached, a tariff is raised to provide the necessary protection, and the item is restored to the free import list.[2]

Jordan also signed a number of bilateral trade agreements with India, Yugoslavia and some Arab countries to foster its local production,

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[1] A.K. Salehdar, "Financial Institutions in Jordan," op. cit., p. 13.

[2] Jordan Development Board, "I.M.F. papers of 1961", p. 6.

and in particular to help marketing its phosphates. These agreements stipulated preferential treatment in questions dealing with customs duties and import licenses.

To conclude this discussion of exchange control in Jordan: (1) Jordan is imposing a system of tariffs, quotas and exchange control, to limit the drain on its exchange reserves, and to protect its domestic production. In the I.M.F. Article XIV of the Articles of Agreement, the Fund allowed Jordan, as well as many other countries, to impose exchange control upon their current payments. (2) Exchange control regulations, however, are not strictly enforced in Jordan. Payments for imports and invisibles are allowed freely, and are liable to very low license-fees. It is certain that a heavy amount of capital leaks out of Jordan into other countries, and in particular to Lebanon. (3) Jordan was able to accumulate exchange reserves, and to stabilize its Dinar value, through foreign assistance, and not through exchange control regulations. Due to this foreign assistance, the Dinar's market rate was almost equal to the official rate in the last few years. The Dinar's rate against the dollar was as follows for the period 1955-1962 in Beirut's exchange market:

1955	1956	1957	1958	1959	1960	1961	1962
2.58	2.58	2.54	2.64	2.69	2.77	2.80	2.79

(4) Inspite of the relative unimportance of exchange control as a foreign exchange policy in Jordan, it has to be maintained so that it may be used as a buffer against future foreign exchange difficulties. People have become used to these controls; a fact which would alleviate the burden

of a possible stricter exchange control in the future. Some of the potential dangers that threaten the exchange reserves of Jordan are the following: (a) The possibility of a future cut in foreign assistance. (b) The future pressure on exchange reserves, which would be induced by the heavy government expenditure contemplated in the long-term development plans of Jordan. (c) The possibilities of either a sterling devaluation, or a depreciation in the value of Jordan's foreign assets in London's money market.

II

The Banking System of Jordan

II. A. Introduction:

The growth of banking in Transjordan took place during the Second World War. The U.K. also helped in the formation of banks in Jordan to finance Jordan's imports from the U.K. However, the remarkable growth in banking activities in Jordan took place only when deposits in Palestinian banks were withdrawn, and shifted to Jordan in 1948 as a result of the Arab-Israeli war.

In the last few years, Jordan has witnessed a growth in its banking system, shown by the opening of new banks, and by the increase in deposits and credits of the existing banks. Today, there are eight commercial banks in Jordan, two specialized credit banks and three government institutions which specialize in long-term credit.

Most of the Jordan banks, as is the case in most underdeveloped economies, are commercial in nature, and interested mainly in financing trade. Due to the lack of domestic money and capital markets, most of these banks' assets are foreign. Until recently also, most of these banks were branches of foreign banks. Today, however, out of the ten banks which are found in Jordan, five are foreign. Two of these five are British, one Iraqi, one Lebanese and one Egyptian.

In Jordan, the banking habit, in the sense of people depositing their money with banks, and accepting banks loans in deposits rather than in cash, is still relatively weak. This underdeveloped banking habit is now, however, slowly progressing, and people, encouraged by the high rates of interest paid by banks, are tending more and more to save their money in these banks.

II. B. Commercial Banks:

In Jordan, there are now eight banks which specialize in short-term credit.[1] In the following Table, a consolidated balance sheet of commercial banks is provided.

The analysis of commercial banking in Jordan is based upon the figures that are provided in the table below. The most important features that should be stated are:

1. In Table 13 below, it may be noted that the assets and liabilities of the banking system expanded by almost 100% between 1956-1962. The most important items of the assets side being the foreign assets, and the claims on the private sector.

2. One of the astonishing points is the amount of foreign exchange assets that are held by banks. This fact can be explained by the following: (a) The lack of profitable domestic assets that can be held, and the lack of an organized money market in which banks can invest their proceeds. (b) Banks keep some of these balances to finance importation. (c) The absence of regulation on commercial banks by any monetary authority, except that of the Currency Control Department, regarding exchange control. (d) The fixed rate of exchange between the

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[1]These banks are: The Lebanese Intra Bank; Iraqi Rafidain Bank; Middle Eastern Bank, and the Ottoman Bank, both of which are British; the four Jordanian banks are the Amman-Cairo Bank, Jordan Bank, Arab Bank and Al-Ahli Bank.

TABLE 13

CONSOLIDATED BALANCE SHEET OF JORDAN COMMERCIAL BANKS
(In J.D. Millions)

End of Period	1956	1957	1958	1959	1960	1961	1962
Assets	19.53	22.86	26.54	28.14	31.82	35.72	42.55
1. Cash[1]	2.22	0.92	1.17	0.71	0.77	1.00	1.19
2. Foreign Assets[2]	8.36	11.17	14.40	14.28	14.27	16.08	20.31
3. Claims on official entities	0.69	0.73	0.83	0.80	0.94	0.58	0.76
4. Claims on private Sector	7.48	10.04	10.13	12.35	15.84	18.06	20.29
Liabilities	19.53	22.86	26.54	28.14	31.82	35.72	42.55
1. Public Deposits[3]	8.40	9.21	12.12	12.69	14.69	15.81	19.12
a. Demand	5.57	3.80	4.21	5.22	6.65	7.90	7.53
b. Time	2.83	5.41	7.91	7.47	8.04	7.91	11.59
2. Private Deposits	7.68	9.83	10.09	11.08	12.76	14.94	19.76
a. Demand	5.15	6.59	6.75	7.12	8.51	9.33	11.47
b. Time	2.53	3.24	3.34	3.96	4.25	5.61	8.29
3. Foreign Agencies Deposits	0.27	0.40	0.25	0.27	0.14	0.15	0.22
4. Non-resident banks Deposits	0.23	0.03	0.05	0.09	0.11	0.13	0.11
5. Liabilities to share-holders	2.95	3.39	4.03	4.01	4.12	4.68	3.34

Source: Jordan Currency Control Dept., Banking and Foreign Exchange Statistics. (Monthly Reports).

Notes: (1) This includes cash with the Ottoman Bank, cash in banks' vaults, and claims on non-resident banks.

(2) These are the foreign exchange reserves of commercial banks, as was shown in Table 3 above.

(3) Public deposits include Government, Public Services and Public Administration Deposits.

Sterling pound and the Dinar provides security against fluctuations in the value of these balances. (4) Political instability in the country.

On the other hand, banks holdings of local currency are very low. The ratio of local cash reserves to total demand deposits, as can be noticed from figures of Table 13 above, was as follows:

1956	1957	1958	1959	1960	1961	1962
43 %	14 %	17 %	10 %	9 %	10 %	10 %

The reserves ratio was as low as 10%, considering the amount of local currency only.

If one includes foreign exchange assets with local currency in the computation of the reserves ratio, this ratio in Jordan will then be very high.[1] Thus, whereas in 1959, the ratio of banks local currency + banks foreign assets to total deposits, was 62.3% in Jordan, it was 59% in Iraq, 51.4% in Sudan, 38.1% in Syria, 32.4% in the U.A.R. and 32.3% in Libya.[2]

Since the greatest part of banks' assets is held in sterling, and since banks prefer to hold these assets in short-term claims, the return on these assets is not high. This was one of the factors that impelled Jordan banks to demand high rates of interest against their domestic investment. Another two factors that contributed to the rise in the rates of interest were: (a) The fact that rates paid by banks on time deposits are high, due to the competition of commercial banks in

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[1]This is not far from the truth, since Jordan commercial banks either hold their exchange assets in Sterling pounds, or in short-term sterling assets.

[2]Isam Ashour, op. cit., p. 88.

attracting these deposits. (b) The low supply of banks' credit does not match with the high demand for it. Borrowers accept to pay high interest rates due to the lack of other sources of finance in the economy.

Due to the above three factors, banks' rates of interest reached about 4 to 7% on advances, and 6 to 9% on over-drafts.[1] When a commission of 1% is added, the effective rate may reach to as high as 10%.

3. The third feature that may be noticed through a study of banks' balance sheets in Table 13 above, is the growth of credit advanced to the private sector. This fact can be partially explained by the increase of private deposits, the favourable foreign exchange position, and the increasing number of banks. Most of the credit to the private sector is advanced on a short-term basis, and for the financing of imports, which have risen considerably in recent years. A large amount of banks' credit is advanced also to the real-estate sector.

In Table 14 below, a division of credit in Jordan as to the kind of security advanced against the loan, is provided.

It is quite clear, from the figures of the table, that most of banks' credit in Jordan is given as advances, although discounted bills rose at a faster rate. Most of the advances given are against personal signature, and as overdrafts. The ratio, however, of total overdrafts to total credit is decreasing. While in 1956, this ratio was 4.36:7.48, it declined in 1962 to 8.60:20.29.

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[1] David Noursi, "Jordan and the Sterling Area", p. 100.

TABLE 14

BANKS CREDITS TO THE PRIVATE SECTOR IN JORDAN
(In J.D. Millions)

	1956	1957	1958	1959	1960	1961	1962
1. Bills Discounted	1.51	2.20	2.68	3.51	4.74	5.38	6.09
2. Loans and advances to private firms and individuals	5.97	7.84	7.47	8.84	11.10	12.68	14.20
a. Against goods	0.14	0.21	0.30	0.13	0.37	0.43	0.51
b. Against mortgages	1.03	1.20	1.08	1.24	1.34	2.03	2.31
c. Against other real assets	0.44	1.08	1.03	1.28	1.91	2.56	2.78
d. Against personal guarantees and overdrafts	4.36	5.35	5.06	6.19	7.48	7.66	8.60

Source: Jordan Currency Control Dept., Annual Reports on Banking and Foreign Exchange Statistics.

4. The fourth feature of banks assets and liabilities in Jordan, is the growth of both private and public deposits over the period 1956-1962, which can be noted in Table 13 above.

Concerning private and public deposits in Jordan, and depending upon the figures that were provided in Table 13 above, the following facts emerge: (a) The first important feature of deposits in Jordan, is the growth of time deposits. Out of the total deposits of J.D. 16.08 mill. in 1956, time deposits composed only J.D. 5.36 mill., a ratio of almost one third. In 1962, however, out of a total deposits of J.D. 38.88 mill., time deposits composed J.D. 19.88 mill., a ratio of more than one-half. The increase in government time deposits accounts for this rise.

A rise in time deposits constitutes a contractionary trend of money supply. (This postulation will be explained later in the discussion of money supply in Jordan.) Their importance in economic growth, however, is immense since they constitute the mobilized savings of the community that banks can direct into long-term ventures.[1] (b) Another fact which emerges from an analysis of commercial banks liabilities, is the growth of private deposits. Inspite of that growth, Jordan ranks the second lowest among Arab countries, after Syria, in the ratio of demand deposits to total money supply.[2] The cause for this is the deficiency of the banking habit, as people still have a high cash preference. Another cause is the people's fear of taxation, and the political instability. Still a third cause for this low ratio, given by a writer on the subject, is the following: "The political situation and the experience of depositors after the war between the Arab states and Israel have not been conducive to a growth in bank deposits, especially in West Jordan."[3] (c) Another important point to be noticed in analyzing deposits, which are shown in Table 13 above, is that public deposits in Jordan, compose around half the total deposits. This increase in time deposits over the last period,

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[1]It is a fact, that in low-income countries, the growth of time deposits tends to be higher than that of demand deposits. Low-income groups tend to keep their money where they can earn interest on it.

[2]Ashour, op. cit., p. 55.

[3]A.K. Salehdar, "Financial Institutions in Jordan," op. cit., p. 16.

has contributed to banks' reserves, and has accounted for the rise in banks' credit.

Public deposits increased due to successive accumulation of budgetary surpluses, which in turn were induced by the increase in foreign aid to Jordan. Most of these deposits are held in the Ottoman Bank which accounts for the large increase in the reserves of this bank. These deposits would be transferred to the Jordan Central Bank after its inception, a proceeding which would deprive commercial banks of a huge source of finance and simultaneously increase the reserves of the Central Bank.

Before winding up this part of the analysis, I would have to make some remarks concerning the "Regulation of Banks Law" which was declared in 1959. A discussion of this Law is necessary for the main theme of this work, concerning the future of monetary policy in Jordan.

II. C. Control of Banks Law of 1959:[1]

The "Control of Banks Law" which was issued in 1959 provides the Central Bank with sufficient legal power and control over banks to conduct an efficient monetary policy. Still, four years have elapsed since the Law was declared and the Jordan Central Bank has not yet been brought into existence. This implies also that no control of banks has until now been practiced. Nevertheless, it is worth analyzing this Law, since this analysis is most useful for our main subject of research; namely, the future monetary policy for Jordan.

[1]Most important articles of this Law are annexed in Appendix C.

The following points are the most pertinent: 1. Article Four of the Law stipulates that the minimum paid up capital for Jordanian banks should be J.D. 250,000. The minimum working capital for a foreign bank's branch in Jordan should also be J.D. 150,000.

In Syria, the corresponding minima are L.S. 1.5 mill. (slightly less than J.D. 150,000) for local banks, and L.S. 500,000 (almost J.D. 50,000) for the branches of foreign banks. In Iraq, the minimum capital set by Law is I.D. 250,000 (almost J.D. 250,000) for local banks.[1]

Regarding this minimum capital provision, it can be seen that the Jordan Law was similar to, if not more severe than, the other Arab Laws.

2. Article 7 of the Law stipulates that a bank should form a reserve fund by transferring 25% of its gross profits to this reserve, as long as the reserve is less than half-the paid up capital. After that limit is reached, 10% of the profits shall be transferred to the Fund, until it reaches an amount equal to the paid up capital of the bank.

In Syria, the corresponding laws provide for a transfer of 10% of profits until the reserve reaches 25% of the paid up capital. A part of this Fund is to be invested in government bonds. In Iraq, the corresponding Law provides for a transfer of 10% of profits until the Fund reaches the sum of 50% of the paid-up capital of the bank.[2]

It is apparent then, that in this respect, the Jordan Law is also more conservative than those in the neighbouring Arab countries.

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[1]Ashour, op. cit., p. 59.

[2]Ibid.,

3. As regards the legal cash reserve requirements, the Law does not assign any specific ratio. However, the Central Bank Law, under Article 37,[1] gives the right to the Central Bank not only to assign the ratio of cash of banks to their total assets, but also gives it the right to assign the ratios of different assets of the banks to their demand liabilities.

This Article of the Central Bank Law provides the Bank with a good controlling weapon over the level and type of credit in Jordan. The Bank, under Article 37, can use selective credit control besides its other traditional weapons of control.[2] Under Article 10 of Banks' Control Law,[3] commercial banks should present a monthly balance sheet to the Central Bank. This helps the Bank to control credit and to conduct an effective policy.

II. D. <u>Specialized Credit Institutions</u>:

In outlining the salient features of commercial banking in Jordan, it has been shown that most of the credit that commercial banks advance is to finance imports. Commercial banks find it unprofitable to extend credit to industry and agriculture, because they fear defaults, and because of the long period of maturity of such credit. Yet what Jordan needs most is this long-term credit, which helps in pushing up the level of production.

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[1]See Appendix B.

[2]The traditional weapons of central banks are the bank rate, minimum cash reserve ratio, and open market operations.

[3]See Appendix C.

Governments in most underdeveloped economies have either themselves contributed the whole paid-up capital for the specialized credit institutions, or shared with private capital in their establishment.

In Jordan, there are five specialized credit institutions.[1] Two of these are banks, and the other three are government development institutions. The banks are the Development Bank, and the Mortgage Bank. The three public institutions are the Agricultural Credit Corporation, the Industrial Development Fund, and the Municipalities-loans Fund. The two latter institutions are under the control and patronage of the Jordan Development Board. There are a number of agricultural cooperatives which advance agricultural credit but shall not be mentioned since they now receive their funds from the Agricultural Credit Corporation, which is the highest authority in the country for the supply of agricultural credit.

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[1]The Five-Year Plan for development which appeared in 1962 has planned for the establishment of more long-term credit institutions. It has envisaged the establishment of the Industrial Development Corporation which would be a government institution, designed to advance credit to industrial projects by participating wholly or partly in the projects' equities. The plan also envisaged the establishment of the Municipalities Development Bank to give credit for development purposes. Another project the plan included in is an investment company to be called "The International Investors Company," which would try to sell its equities for Jordanian emmigrants abroad, and use the proceeds for domestic investment. See, Five Years Plan, op. cit., pp. 309, 314.

However, since the Five-Year Plan is replaced now by a Seven-Year Plan, which has not as yet been published, it is not known whether these projects would be included in the new plan.

a. <u>The Agricultural Credit Corporation</u>:

It is quite true that "the most difficult credit problem in Jordan has been and continues to be in the area of agricultural credit."[1] The difficulty envisaged in agricultural credit is the extreme fluctuations in rainfall, with drought conditions being the rule rather than the exception. Since 90% of cultivated land is rainfed, most Jordan farmers are not able in drought conditions to repay the loans that were extended to them at the beginning of the season. Over time, the farmer's debts accumulate. Also, he has no sufficient mortgage to give against any new loans. The result is, he does not get the necessary funds to allow him to produce. The defaults in payments are also great, a fact which does not encourage any agricultural credit institution to advance new credit.

Even in good rainfall years, as one writer notes,[2] the peasant has to lower his prices in order to market his produce, taking into consideration the facts of competition for the sale of products, and the high costs of transportation. Storage facilities to combat price fluctuations is clearly one of the most important necessities.

Before 1960--the year when the Agricultural Credit Corporation came to existence--agricultural credit was extended by the Agricultural Bank, the cooperatives and the Development Board.

The Agricultural Bank was created in 1922. Its main activities

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[1]Jordan Development Board, <u>Five-Year Plan</u>, <u>op. cit</u>., p. 304.

[2]A.K. Salehdar, "Financial Institutions in Jordan," <u>op. cit</u>., p. 21.

were limited to individuals. The maximum amount which it used to lend was J.D. 1000, for not more than 10 years, at a rate of interest ranging between 4 and 6%. Repayment was to be made in instalments at the end of the harvest.[1] The Bank suffered, however, from the following shortcomings:[2] (1) It fell under political pressure, and advanced loans accordingly. (2) It did not advance enough long-term loans. (3) Its working capital was relatively insufficient to face agriculture's needs for credit.

The government realized the importance of the problem of agricultural debts, and enacted laws to prevent foreclosure of the collateral land, in case of default on loans. In 1952 government also organized cooperatives to cope with farmers' needs for credit and assistance. Agricultural cooperatives in Jordan now number about 245.

In August 1960, the Jordan Government established the Agricultural Credit Corporation, which replaced the Agricultural Bank and the Rural Development Board in advancing credit to agriculture. It was to have a capital of J.D. 7 mill., and to advance short-and long-term loans for a period not exceeding 20 years, the Corporation liabilities being all fully guaranteed by government.[3] The loans extended were for land improvement and reclamation, afforestation, purchase of animals, purchase of machines, irrigation projects, and housing for farmers.

In the Table below, a balance sheet of the Corporation's operations for the year ending in March 31, 1962, is shown.

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[1] Ibid., p. 22.

[2] David Noursi, "Jordan and the Sterling Area," op.cit., p. 113.

[3] Ashour, op.cit., p. 115.

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[1] _Ibid._, p. 22.

[2] David Noursi, "Jordan and the Sterling Area," _op.cit._, p. 113.

[3] Ashour, _op.cit._, p. 115.

TABLE 15

BALANCE SHEET OF THE JORDAN AGRICULTURAL CREDIT CORPORATION

(For the period ending in March 31, 1962)

Liabilities	J.D.	Assets	J.D.
1. Capital	4,750,243	1. Cash in Bills & Bank	581,498
2. Reserved Capital	18,011	2. Fixed Accounts	10,684
3. Current Borrowers account	102,875	3. Loans	4,313,341
4. Deposits	38,452	4. Furniture	3,671
5. Other Revenue	19	5. Cars and Other	2,817
6. Interest of Rural Development Dept.	5,577	6. Unguaranteed loans	3,204
7. Accounts of other branches with Amman's branch	542	7. Loans to branches	211
		8. Accounts of Amman's branch with Karak's branch	100
		9. Reserves from loan collection	193
8. Total Liabilities	4,915,719	10. Total Assets	4,915,719

Source: Agricultural Credit Corporation, Annual Report for 1961-1962 (In Arabic), p. 49.

The facts that can be deduced from the above figures are: (1) Although the authorized capital of the Corporation is J.D. 7 mill., yet the paid-up capital was, until the end of the year 1961-1962, only J.D. 4,750,243. This amount is not sufficient to cope with the problems of the outstanding agricultural debt, and the need for agricultural credit for production purposes.

The lack of a money or capital market in the economy, is a bottleneck that almost brings to a standstill any efforts aimed at encouraging private capital investment in the equities of the Corporation. Yet, in my opinion, it is one of the duties of the new Central Bank to try to market the equities and bonds of this Corporation, either by itself financing part of the capital funds, or by forcing banks to hold the securities of this Corporation as part of their total assets.[1] Since the liabilities of the Corporation are guaranteed fully by the government, it is not a dangerous investment if commercial banks utilize part of their excess reserves in holding medium term assets of this Corporation. This is a fundamental necessity, since, after all, agriculture constitutes the backbone of Jordan's productive capacity. (2) A second feature of the above balance sheet is that the cash: liabilities ratio of the Corporation was about 12%; while on the other hand, more than 90% of the Corporation's capital was given

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[1]The Central Bank has the power, by Law, to perform both of these functions. Article 22 of the Bank's Law gives it the right to purchase the securities of agricultural institutions for a period not exceeding 9 months. They are not put in the cover, since the cover is constituted of foreign securities only.

Article 37 of the same Law allows the Bank to assign the ratios of the commercial banks' assets.

as loans to agriculture. 123,279 borrowers benefited from the loans of the Corporation,[1] until the end of the year 1961-1962.

Out of the total profits realized by the Corporation, 85% are retained to capital, and 15% to a reserve capital. In 1961-1962, the net profits that the Corporation realized were J.D. 96,274, as compared to J.D. 31,019 net profits of the year 1960-1961.[2] When the net profit of J.D. 96,274, is compared with the paid-up capital of J.D. 4,750,243, the resulting ratio is as low as 2%. However, this low ratio was not unexpected considering the numerous defaults in the repayments of loans and interests.

b. The Industrial Development Fund:

There is no well organized industrial credit institution in Jordan, comparable with that for agriculture. Before the creation of the Development Board, in 1954, there was a small Fund which advanced credit to industry. In 1957, this small industrial fund was joined with a tourism fund, to form the Industrial Development Fund, which was incorporated in the Jordan Development Board. The capital of the Fund was J.D. 421,382, financed by the U.S.AI.D.[3] Any increment to capital was to be from the retained interest rates collected from borrowers. The rate of interest on loans ranged between 3 and 6%; but since 1958, it has been stable at 6%.[4]

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[1]Jordan Agricultural Credit Corporation, Second Annual Report for the Year 1961-1962, p. 15. (In Arabic).

[2]Ibid., p. 55.

[3]The United States Agency for International Development, known previously as the United States Operations Mission (U.S.O.M.).

[4]Industrial Development Fund's Report about its operations until the end of December, 1961. (Typescript).

The Fund advanced loans which aimed particularly at helping import-replacement, labour-intensive industries, and hotel construction. The following figures may provide us with a partial picture of the Fund's operations since 1952:[1]

	No.	Value (In J.D.)
Loans to industry	153	266,677
Loans to tourism	34	248,969
Total loans	187	515,646

It is apparent, from the above figures, that the Fund's operations were of relatively small importance, since, on the average, its loans annually amounted to about 18, with a value of J.D. 50,000.

c. Arab Land Bank:

The Arab Land Company was established in 1951 by the Arab League, for the purpose of purchasing Arab lands in Palestine.[2] The headquarters are in Cairo. Its branch in Jordan has two divisions; namely, a commercial division, and a mortgage division which advances loans to building. The commercial division of the Bank has accepted deposits of a value of J.D. 863,841 in 1960, and J.D. 960,135 in 1961. Its total credit in 1960 was J.D. 1,007,236, and J.D. 1,037,673 in 1961.[3]

d. Development Bank:

The Development Bank was organized in November 1951, to advance credit to agriculture, industry and real-estate. It was mainly

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[1] Ibid., p. 3.

[2] Harris, Jordan, op. cit., p. 145.

[3] Arab Land Bank, Annual Report - Year 1961.

financed by the Government and U.N.R.W.A., in order to help provide employment for the Palestine refugees. Its subscribed capital was J.D. 500,000. The government contributed J.D. 50,000, commercial banks contributed J.D. 50,000, and U.N.R.W.A. J.D. 400,000.[1] The authorized capital of the Bank is J.D. 1 million.

The Bank advances loans for long-term projects for a period which may reach 10 years, at a rate of interest that is below 6%. The Bank is conservative in its policy, and demands substantial security against its loans; "it presents, however, an excellent record in the prompt repayment of its loans."[2]

The Bank's Report says in explaining its policy of granting loans: "Before any loan is finally granted the borrower has to satisfy us through U.N.R.W.A. that an agreed number of refugees will be employed. It is estimated that since the inception of the Bank over 3,156 refugees have thus found employment."[3]

In the following Table, the loans that the Bank has advanced since its inception in 1951, are shown.

It is apparent from the figures below that most of this Bank's credit in the eleven years of its functioning, was advanced to agriculture.

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[1]A.K. Salehdar, op.cit., p. 23.

[2]Harris, Jordan, op.cit., p. 145.

[3]Development Bank, Annual Report for 1962, p. 7.

TABLE 16

JORDAN DEVELOPMENT BANK LOANS
(Years 1951-1962)

Type of Loan	No.	Value (In J.D.)
Agricultural	622	764,550
Industrial	38	211,310
Building	25	34,100
Total	685	1,009,960

Source: Development Bank, Annual Report for 1962, p. 6.

e. The Municipalities - Loans Fund:

This Fund was created by the Jordan Development Board, and financed by the U.S. Operations Mission in Jordan. The purpose behind its inception was to encourage and advance credit to the local Municipalities, for long-terms, and at low rate of return. The Fund gave as credit for this purpose about J.D. 311,283, in the year 1961-1962.[1]

II. E. Features of the Credit System in Jordan:

It is generally agreed that a developed credit system has the following correlations:[2] (1) A developed banking habit, such that demand deposits are considered by people to be as liquid as cash, and

[1]The Jordan Development Board, The Annual Report: 1961-1962, (An Arabic manuscript).

[2]See for example: Muhamet Z. Shafi'y, An Introduction to Money and Banking - In Arabic - (Cairo: Dar Al-Nahda Al-Arabia, 1962), p. 230.

such that people choose to employ their funds in banks where they can earn interest on them, instead of keeping them in idle balances. An undeveloped banking habit was described by some writers[1] as the "external drain"; a drain, in other words, on the cash that banks may hold, since, with this undeveloped banking habit, people choose to have their loans in cash rather than in current deposits. (2) A developed money market, where banks can discount their bills when they are in need of liquidity, and where they can invest their funds in what they may think to be a profitable investment. (3) An efficient Central Bank which can control the credit system, and provide banks with liquidity whenever they are in need of it.

In Jordan where the banking habit is still undeveloped, both the money market and the Central Bank are still non-existent. Thus, one can say that the Jordan credit system is greatly underdeveloped.

To summarize the shortcomings of the credit system in Jordan, the following points are most important: (1) Most of the commercial banks advances are used to finance foreign trade rather than production. (2) Inspite of the expansion of demand deposits, people, still have a high cash preference. Thus, most of the money supply in the economy is made up of currency, rather than demand deposits. This will handicap the future operation of the Jordan Central Bank, since the Bank can only control banks' credit, which, as aforementioned, constitutes a low percentage of the money supply. (3) Another factor which contributes to the lack of a banking habit, is the centralization of banks

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[1]K.C. Chacko, Monetary and Fiscal Policy of India (Bumbay: Vora and Co., 1957), p. 143.

in the biggest cities. With a limited banking service in rural areas, a lot of capital remains in the form of hoardings. On the other hand, the rural population remains uninformed about banking services, and thus continues to hold its money in cash, rather than in demand deposits. (4) Banks' reserves increased tremendously due to the balance of payments surpluses, budgetary surpluses and the rise in private deposits. But commercial banks did not invest these proceeds in Jordanian assets, and instead, invested in foreign exchange and foreign assets. (This accounts for the high figure for foreign assets shown in Table 13 above). In the future, it is possible that these assets would decline due to a decrease in favourable tendencies in the balance of payments. The central bank could also encourage banks to invest locally in short-term Treasury Bills and long-term credit institutions bills. (5) Long-term credit institutions in Jordan are still in the initial stage of growth. Their capital is still insufficient to face the outstanding agricultural indebtedness, and the needs of an efficient industrialization scheme. Although there are three Jordan development institutions which advance credit to agriculture and industry; yet, until now, their total paid-up capital has not exceeded J.D. 6 mill.[1]

Two of the shortcomings that characterize long-term credit institutions are: (a) Since their loans are long-term, the lending institutions demand a substantial security against the loan. Both the substantial security that is demanded, and the long time that elapses before the loan is advanced to the borrower, force the borrower to

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[1]The Arab Land Bank's capital for its Jordan branch is not known, so it is not included in the above.

rely on commercial banks and money-lenders for his loan. (b) The long-term credit institutions do not try to create a money market for their securities, and the securities of the projects that they finance.

Due to the lack of a developed money market in Jordan, there is still a large number of farmers who depend for their loans upon money-lenders, who extract from them usurious rates of interest.

(6) The lack of a developed money market in Jordan has resulted in the following: (a) It inhibited the diffusion of capital between the different sectors of the economy, and thus in turn led to the existence of different rates of interest. These rates are extremely high in the rural sector which thus inhibits agricultural development. (b) The lack of a money market renders the traditional central banking weapons of control ineffective. The central bank cannot purchase or sell securities in sufficient amount to affect banks reserves due to the lack of such securities. Also, it cannot affect other rates of interest in the economy through the changes in its Bank Rate.

III

Money Supply in Jordan

I found it pertinent to conclude my discussion of money and banking in Jordan by a discussion of the determinants of changes in money supply, since it is this factor which the Central Bank tries to alter in order to formulate its monetary policy.

Money supply is usually defined as the total currency in circulation plus the demand (current) deposits, at a given point of time. Some countries include time and government deposits as a constituent of money supply, since they consider them just as liquid as demand deposits. But the traditional definition considers only current deposits as part of money supply, since they are accepted as a means of payment. Any factor which causes a change in currency and demand deposits of a country, is thus a factor which changes money supply.

The factors that induce a change in demand deposits and circulating currency, are usually made up of the following elements:[1] (1) Changes in net foreign assets.[2] (2) Changes in Jordanian assets (i.e. credit in J.D. to the private sector), (3) Changes in Government and banks cash,[3] (4) Changes in Public Deposits, (5) Changes in private time deposits.

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[1]These elements are usually computed through an analysis of the assets and liabilities of the banking system and the Currency Board. An increase in assets is expansionary, while an increase in liabilities is contractionary. See: Ashour, op.cit., p. 131. See also: I.B.R.D. Report on Jordan, op.cit., p. 373.

[2]Net foreign assets in the case of Jordan constitute the Currency Board's cover and the sterling exchange and assets of commercial banks. Both of these are affected by the balance of payments condition.

[3]Foreign assets of the Currency Board (i.e. currency issued), minus, cash in banks and government's vaults, equals currency in circulation.

The following Table shows the changes in money supply, together with the determinants of these changes, for the period 1957-1962.

The Table below is very important for an analysis of the future of monetary policy in Jordan. Hence it is important that a detailed examination be made of it. Regarding these factors, I shall make the following remarks:

(1) Money supply increased steadily at an average rate of slightly less than 10% per annum. Demand deposits grew at a rate higher than that of currency in circulation. While in 1957 the ratio of currency to total money supply was about 68%, this ratio declined to 62% in 1962. This shows that a banking habit is slowly developing in the economy.

(2) Over the period 1957-1962, money supply increased by J.D. 9.21 mill. The most important expansionary factors were the increase in foreign assets, and the increases in bank credits to the private sector. Both of these increased by J.D. 13.75 mill., and J.D. 10.25 5 mill. respectively. The contractionary factors, on the other hand, were government deposits and time deposits. Both of these increased by J.D. 9.91 mill., and J.D. 5.05 mill. respectively.

(3) Another important feature of money supply in Jordan, is the high correlation between the increase in foreign assets and the increase in money supply.

Thus in 1959 when there was a deficit in the balance of payments, currency in circulation increased slightly. While in 1962, the balance of payments showed a huge surplus, the currency in circulation, and hence money supply, increased enormously. The accumulation of foreign assets enabled commercial banks to increase their domestic loans and

TABLE 17

FACTORS AFFECTING CHANGES IN MONEY SUPPLY IN JORDAN
1957-1962
(In J.D. Millions)

	Dec. 1957	Dec. 1958	Dec. 1959	Dec. 1960	Dec. 1961	Dec. 1962
1. Net Currency in Circulation	14.71	15.16	15.27	15.63	16.97	19.04
2. Private Current Deposits	6.59	6.75	7.12	8.51	9.33	11.47
3. Total Money Supply	21.30	21.91	22.39	24.14	26.30	30.51
4. Changes in Money Supply during the year	1.59	0.61	1.48	1.75	2.16	4.21
Factors Affecting Changes						
5. Increase in Foreign Assets	0.87	3.94	-0.47	1.41	2.91	5.96
6. Increase in Bank Credit to the Private Sector	2.56	0.11	2.20	3.49	2.22	2.23
7. Increase (-) in Public Deposits	-0.80	-2.91	-0.57	-2.00	-1.12	-3.31
8. Increase (-) in Private Time Deposits	-1.71	-0.10	-0.62	-0.29	-1.36	-2.68
9. Other Assets and Liabilities(1)	0.67	-0.43	0.94	-0.86	-0.49	2.01

Source: Currency Control Dept., Banking and Foreign Exchange Statistics.

Note: (1) These are the other assets and liabilities of the Currency Board and Commercial Bank. The most important components of these "other assets and liabilites", are banks' cash, and loans to official entities.

also enabled the government and the private sector to increase their deposits with commercial banks, which resulted in an increase in banks liquidity.

The relation between the balance of payments and money supply is explained in the following passage: "If total foreign expenditure exceeds total foreign receipts, there are two automatic reactions; firstly, there is a fall in the sterling assets of the banking system to the extent that excess imports are paid for from deposits with the banks and secondly, to the extent that imports are paid for from cash in the hands of the public."[1]

The high correlation between the balance of payments and money supply limits the power of the central bank tremendously because money supply in such a situation is independent of the operations of the central bank. Also, the fact that currency in circulation constitutes a higher percentage in money supply than demand deposits intensifies this tendency--in other words--it is an automatic system. If there is a balance of payments deficit, currency in circulation and banks credit decline, which in turn, induces a decline in expenditure. As a result, importation may decline and the deficit in the balance of payments is corrected, but only at the cost of internal deflationary incomes and prices.

These were the most important four factors that affected changes in money supply in Jordan. It is pertinent, in this part of

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[1] Wheatly's Lecture, "The Monetary System in Jordan," op. cit., p. 6.

analysis, to determine which of these factors the new Central Bank can control, to implement its future policy.

1. Article 37 of the Central Bank Law put at the discretion of the Bank, a very efficient tool which helps it to implement its policy. This article reads as follows: "Every bank carrying on business in Jordan under the Banking Law shall hold as part of its assets all or any of the items enumerated in Section (b) of this Article to an amount which shall be prescribed by the Board and published in the official gazette. Such amount shall be expressed in the form of a percentage or percentages of the specific assets to the Bank's sight and time liabilities, either jointly or separately, and such percentage or percentages may be varied from time to time by the Board."[1]

The important conclusion to be drawn out of this Article, is that the Central Bank is given the right to assign, not only the minimum cash reserve ratio of banks in Jordan, but also the proportions of the other forms of assets that banks can hold. The Bank, endowed with this Article's power, can control the ratio of banks' reserves, and thus can control the changes in banks' credit, which is one of the determinants of money supply changes.

2. The "foreign assets" determinant of money supply, on the other hand, depends upon the balance of payments condition. As regards this, the Central Bank, may have the following corrective measures: (a) It can change the exchange value of the Dinar (b) It can

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[1]See Central Bank Law, Article 37, Appendix B. Part (b) of the same Article assigns the assets that banks may hold.

change the short-term rate of interest. (c) It can control the payments of foreign exchange.

First: The Central Bank, under present conditions, cannot change the value of the Dinar, since: (1) The Dinar is on par value with the Sterling pound. (2) It is on par value with the dollar, under the I.M.F. provisions, and cannot be changed except with the consent of the Fund.[1]

Second, any changes in the short-term rate of interest are ineffective, since the private inflow and outflow of hot capital in Jordan is negligible.

Exchange control is implemented nowadays in Jordan, but its effect upon the international transactions of Jordan is small. In reality, what is protecting the Dinar's exchange value, and preserving the exchange reserves in Jordan, is not exchange control, but mainly foreign assistance.

The conclusion is that, although the Jordan Central Bank is not able to control the primary repercussions of the balance of payments, it is, however, able to control the secondary effects of these fluctuations upon the banks' reserves.[2] For example, if, due to a drop in foreign assistance or to a bad harvest year, the balance of payments shows a deficit, then, if the central bank does not wish to transfer this tendency to the internal economy, it could decrease the cash reserve requirements of commercial banks. If this does not encourage banks to extend their credit, the Bank may directly provide

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[1]This point is explained fully in the part dealing with recommendations for the future foreign exchange policy in the Third Chapter.

[2]The essence of monetary policy is in the Central Bank's control over banks reserves. This point is fully explained in Chapter Three.

short-term loans. Simultaneously, the Bank could strengthen its control on foreign exchange and advise the government to strengthen its commercial policy regulations, so as to correct the initial unfavourable tendency in the balance of payments. If, on the contrary, the balance of payments showed a surplus and the Bank did not like to waste these reserves through commercial banks increased credit, with the corresponding increased imports, it could raise the reserve requirements to very high limits. This policy is more successful because banks respond directly to a policy of credit restriction.

3. The changes in private time deposits depend mainly upon three factors: (a) Banks' rate of return on time deposits, compared with the rates of return for other securities. (b) People's liquidity preference. (c) Political stability in the country.

The Central Bank, can control changes in private time deposits by changing the bank's rate paid against it, which is better accomplished through its direct control, rather than through the ineffective traditionary weapons of control.

4. Changes in government's deposits are induced by fluctuations in government's deficit or surplus. These primary changes, are thus out of the reach of the Central Bank's control. The secondary repercussions which these changes induce in money supply, can be controlled by the Bank, through the provisions of Article 39 of the Central Banking Law,[1] which assigns for the Central Bank, the duty of keeping government's deposits.

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[1]See Appendix B, Part VIII.

To conclude, the Jordan Central Bank can control the secondary rather than the primary changes in both the government deposits and the balance of payments; also its control over changes in banks' credit to the private sector, and in private time deposits, is partial rather than complete.

CHAPTER THREE

I

Objectives, Deficiencies and Weapons of Monetary Policy in Jordan

I. A. Definition of the Objectives of Monetary Policy:

Monetary policy is one part of the general economic policy of any government. To attempt a definition of monetary policy, one can say that it is the manipulation by a central bank of the money supply of an economy for the achievement of certain economic objectives. One writer has defined it as, "the action taken by any government institution--usually a Central Bank--in attempting to control the volume, availability and cost of bank credit through changes in the volume and nature of the reserves of the banking institutions by regulating the volume and nature of its own assets."[1]

There is no consensus of opinion as to the objectives of any monetary policy. One author defines them to be the following: "The objectives of monetary policy are many and obvious, although the methods by which it is sought to attain them can be reduced to a choice between two: should the volume of purchasing power in the country be reduced? or should measures be taken to encourage its expansion?"[2]

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[1] Emin Barjum, Monetary Policy in an Underdeveloped Economy (University of Pennsylvania; 1962), p. 9.

[2] J.L. Hanson, Monetary Theory and Practice, (London: Macdonald and Evans L.T.D., 1962), p. 249.

For another writer, there are major and minor objectives of monetary policy.[1] To him the major objective is the stabilization of business activity. The minor objectives he regards to be the following: (1) The protection of the monetary standard. (2) The stabilization of the money market. (3) The granting of assistance to the government to enable it to meet its fiscal requirements.

The International Bank's Report on Jordan attempts a definition of the objectives of a monetary authority. It says: "public confidence in the safety and stability of the currency is a valuable asset in furthering a country's economic development and preservation of this confidence should be the first aim of a monetary authority."[2]

Another writer supplies a specific role for monetary policy in underdeveloped economies: "...the role that monetary policy can play, on the one hand, in conserving the limited exchange availabilities and, on the other hand, in directing investment funds towards satisfying the more important development needs."[3] Others stress the necessity of reducing the unequal distribution of income and wealth.[4]

Mr. K.C. Chacko, another writer on the subject, notices that the

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[1]Raymond Kent, Money and Banking (Cincinnati: South Western Co. 1959), p. 419.

[2]I.B.R.D. Report on Jordan, op.cit., p. 377.

[3]Edmund Asfour, Syria: Development and Monetary Policy (Cambridge, U.S.A.: Harvard University Press, 1959), p. 107.

[4]Paul Trescott, Money, Banking and Economic Welfare (New York: Mc-Graw Hill, 1960), p. 504.

objectives of monetary policy have undergone several changes through time.[1] At the initial stages of the creation of central banks, monetary authorities were interested mainly in maintaining stability of incomes and prices. Later they were interested in growth aspects and unemployment problems. It is just recently that monetary authorities began to care for the social and welfare aspects of growth.

The fact is that when countries were on the gold-standard before 1914, the role of monetary policy was limited to the preservation of the gold-standard rules. Internal conditions were sacrificed to keep the external payments position in balance. When the gold-standard was suspended, the role of central banks was extended as they began to attach importance to the internal fluctuations in incomes and prices.

Recently, the trend is for monetary policy to aid fiscal and other government policies to achieve growth and stability. The role that monetary policy can play being more toward helping achieve the stability rather than achieving growth.

To recapitulate, the objectives of economic policy in Jordan should be the correction of the balance of trade deficit, and the lowering of the level of unemployment. It is only through a proper co-ordination of both fiscal and monetary weapons that Jordan can correct these unfavourable tendencies.

Before the 1930's, the period of the Great Depression in most of the developed nations of the world, monetary policy was considered

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[1]K.C. Chacko, The Monetary and Fiscal Policy of India.

to be more effective than fiscal policy. This was so since, before 1930, the Classicists were interested in maintaining stability in exchange rates based upon the gold-standard rules, and in controlling inflation. In the Great Depression, however, monetary weapons such as the Bank rate, open market operations and the reserve ratio, were unable to foster investment and consumption. As a result of this failure, Keynes attacked monetary policy, and aimed at replacing it with fiscal measures intended to foster effective demand.

Keynes maintained that any injection of money supply into the economy is absorbed by speculators, who expect that the rates of interest will rise, and hence that the prices of securities will decline. It is due to this embarassing situation, or to what Keynes calls the 'liquidity trap', that the injected money supply is held in inactive balances, and thus does not lower interest rates or encourage investment and demand. An expansionary fiscal policy is, on the other hand, more effective in stimulating investment and demand. This is so, since the government collects the balances that were held previously for speculation, and spend them on public projects that stimulate investment directly.

The MacMillan Report of 1931 held the same view as to the ineffectiveness of monetary weapons in stopping a depression. The ineffectiveness of an increase in money supply in fighting a deflation is due to the fact that in a deflation, the marginal efficiency of capital is low. Thus, no matter how much credit is eased, investors will not borrow, realizing the prospective low returns of their investment. On the contrary, an increase in government expenditures on public works, and a cut in taxes, directly foster general demand.

Monetary policy, however, regained its importance soon after the inflationary trends of world War II and the Korean War. The superiority of monetary to fiscal measures in curbing an inflation may be attributed to the fact that high taxes and low government expenditures are not as acceptable to the people, and not as flexible, as stricter credit terms.

It may be concluded that for a policy which aims at reducing unemployment and stimulating general demand, while at the same time keeping inflation under control, a coordination of both fiscal and monetary measures should be instituted. In the case of a country like Jordan, where it is difficult for the government to spend more than it earns, monetary weapons can aid fiscal measures in achieving these ends.

Before discussing the requirements for a sound monetary policy in Jordan, the main limitations to the effectiveness of the monetary weapons in Jordan shall be discussed. Next, I shall point out how the Jordan Central Bank can face these limitations, in order to achieve price stability, national income growth, and less unemployment, without any drain on foreign exchange reserves.

I. B. The Shortcomings of Monetary Weapons in Jordan:

The shortcomings of monetary weapons in Jordan are two: (1) The general shortcomings of monetary weapons. (2) Shortcomings related to Jordan's economy in particular.

Monetary weapons are divided into three categories: (1) General quantitative credit control weapons, which include the Bank rate, open market operations and the reserve ratio. (2) Selective credit control weapons. (3) Direct credit control weapons.

The Bank rate is the rate of rediscount that a central bank charges. Its effectiveness is manifested through its influence upon the movement of the other rates of interest in the money market. In a period of low effective demand, the central bank lowers its rate in order to encourage commercial banks to rediscount their bills with the central bank; thus to increase their liquidity and encourage them to advance more credit. A lower Bank rate, also, encourages borrowers to borrow more on favourable credit terms.

The limitations that the central bank encounters in its use of the Bank Rate weapon are numerous. In a contractionary policy, the Bank Rate has to be a penal rate, and above the rates that commercial banks charge for their loans. This discourages banks from borrowing from the central bank, and hence limits their reserves and credit availability.

Such a policy is very difficult in Jordan, where, as was shown, banks maintain huge excess reserves which they can utilize to increase their credit. Unless, therefore, other weapons are employed, which can wipe out these excess reserves, any rises in the Bank Rate fail to achieve a squeeze of credit.

A decline in the Bank Rate fails to achieve expansion similarly, due to the following: (1) The lack of eligible domestic assets which banks can offer to the central bank for rediscount. (2) Banks in general, are averse to being indebted to the central bank, no matter how low the Bank Rate is. (3) The lack of eligible and profitable domestic assets, in which banks can invest their increased reserves. (4) The presence of other important factors that affect investment, such as the marginal efficiency of capital.

Due to these reasons, the use of the Bank Rate in Jordan is limited in scope and efficiency. The use of this weapon, has to be accompanied by the use of other weapons that may alleviate its ineffectiveness. The only use to which this weapon may be put is as an index for commercial banks. It shows these banks the general monetary policy trend and may thus encourage an adequate response.

Open market operations are more effective than the Bank Rate in developed money markets. In an underdeveloped money market such as Jordan's, these operations are as ineffective as is the Bank's rate policy. Due to the absence of a money market and the lack of significant private savings, the Jordan Central Bank will be faced for a very long period after its establishment, with paralysis in the field of open market operations. In addition, open market operations will face other general difficulties, if in the future, a security market develops in Jordan. These are as follows: (1) First, there is the danger of the fluctuations which these operations induce in the prices of government bills. The sale of these securities on a large scale is not favored by the government, since it lowers the prices of these securities. (2) The excess reserves which commercial banks hold, as is the case with Jordan banks, set another limitation to the effectiveness of these operations in controlling credit. The central bank needs to sell a large amount of securities to be able to decrease the excess reserves of these banks. In Jordan, it should take a long time, before government securities become available in a large volume. (3) The effectiveness of an expansionary policy through these operations is limited due to the lack of eligible assets in the market. This weapon is also limited by the amount of reserves that the central bank has. This is so, since under the present Central Bank Law, such assets can only be held in the Banking and not in the Issue Department, of the Bank.

The manipulation of the reserve ratio of commercial banks is the most effective among the various quantitative weapons. This is so, since the central bank can directly expand or contract commercial banks' excess reserves.

Selective, rather than quantitative, credit control weapons are used to encourage or discourage certain kinds of credit, without affecting all the sectors in the economy. In developed econonomies they were used to curb credit for speculative purposes, real-estate, and consumers durable goods. In Jordan, they may be used to encourage credit for agriculture and industry, and discourage credit for importation. The difficulty with this weapon is an administrative one. Monetary authorities, in using this weapon, are not sure whether credit given for one allowed purpose, is not used by the borrower for another prohibited purpose; or that the issued credit does not set free other monetary resources, which the borrower may now use for the prohibited purposes.

Direct credit control is used usually in underdeveloped money markets where the general credit control weapons are ineffective. The central bank uses its moral suasion in transmitting its policy to banks. It may intervene directly by giving directives to banks concerning banks maximum assets, or minimum capital to assets ratio, or the rates of interest that may be given or charged by banks. Or sometimes, the central bank may find it necessary to intervene in the market, by giving credit itself, or accepting public deposits.

This was a short analysis of monetary weapons and their main limitations. I shall now analyze the main handicaps that confront the Jordan Central Bank in implementing its prospective policy, with attemps for their solution.

I.C. An Attempt to Solve the Main Handicaps that Confront Jordan's Monetary Authorities:

The main bottlenecks that may limit the efficiency of monetary policy in Jordan can be listed as follows:

1. A large section of the economy is still non-monetized, since a large part of the agricultural crops are consumed by their producers, and not offered for sale. It is apparent then, that one of the duties of the government is to assist marketing boards, and agricultural co-operatives in marketing products for farmers, so as to monetize the subsistence sector of the economy.

2. Another difficulty, one experienced by most underdeveloped countries is the effect which fluctuations in the balance of payments may induce in internal income and prices.[1] Monetary policy cannot

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[1] In Chapter Two, Part III, I pointed out that one of the four determinants of changes in money supply in Jordan were the balance of payments fluctuations.

control the primary effects of these fluctuations, as these are only affected by exchange control and commercial policy regulations. What the central bank can control are the secondary effects of these fluctuations, upon the reserves of commercial banks. Thus, if the balance of payments shows a surplus in a certain year, and banks reserves increase thereby, monetary authorities can raise the reserve requirements of commercial banks, so as to compell them not to transfer the rise in their reserves, into a rise in their credit. Alternatively, if the balance of payments shows a deficit, the central bank can decrease the reserve requirements of commercial banks, while simultaneously applying its selective credit control weapon which should aim at two things: (a) The control of tendencies toward an expansion of banks credit for importers. The Bank, may even, strengthen its control on the outflow of foreign exchange, to correct the initial tendency in the balance of payments. (b) To encourage the advances to long-term credit institutions, which may on the long-run reduce the deficit in the balance of payments, and at the same time increase investment and production.

The central bank cannot permit such a deficit to manipulate itself into a general squeeze, since although this deficit leads to an automatic correction in the balance of payments, it does this at the expense of increasing deflation and unemployment in the economy.

3. The absence of a banking habit on a wide scale, thus causing a currency drain for the banks in Jordan, is one of the most important problems which the Jordan Central Bank should try to solve.

Mr. Eugene Klise[1] has supplied a formula regarding the effect of this external drain upon the ability of banks to create credit out of a certain amount of excess reserves. An external drain is supposed to mean the desire of people to maintain their liquidity in cash rather than in demand deposits.

Mr. Klise's formula is the following:

$$L = \frac{E(1 + C)}{r + C}$$

Where L is the maximum amount that the banking system can lend with its excess reserves.

E are bank's excess reserves.

C is the ratio of currency to demand deposits.

r is the average reserve requirements.

The formula was meant to show that the higher the external drain (C), the lower is the power of banks to expand credit (L).

To provide a mathematical example, let us assume that banks were able to have J.D. 10 mill. as excess reserves. Let us assume also that they are required by law to set 20 per cent of their deposits as reserves. The ratio of currency to demand deposits in Jordan is about 1.2.[2]

Thus $E = 10$

$C = 1.2$

$r = 0.2$

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[1]Eugene Klise, Money and Banking (2nd edition; Cincinnati: South Western Publishing Co., 1959), p. 136.

[2]See Chapter Two, Part III, Table 17.

By solving for L in the formula, its value approaches a level of J.D. 15.7 mill. With J.D. 10 mill., as excess reserves, the banking system would thus be able to expand credit by J.D. 15.7 mill. only.

If, however, the banking hhbit develops more in the future, and the ratio of currency to demand deposits drops to 0.5, and assuming r and E to remain constant, L rises to about J.D. 21.4 mill., when solving it in the formula.

The above example shows us how far the currency drain in Jordan can limit the power of banks in creating credit. In other words, the currency drain weakens the power of the central bank also in controlling credit through its control over banks reserves.

4. The most significant difficulty that confronts monetary authorities in Jordan, is the lack of a money and capital market in the economy. There are several ways through which a central bank can encourage the establishment of a money market: (a) The central bank could encourage government to set out a securities exchange office to deal with the sales and purchases of securities. (b) It could impose upon banks to hold government bills as part of their legal reserve requirements. (c) It could encourage the use of more exchange bills in trade. (d) The central bank could encourage banks to advance their credit in discounts rather than in overdrafts. (e) The central bank, and the government, could encourage the corporate form of business in Jordan, in order to create a stock market.

A developed money and capital market will have the following advantages in Jordan: (a) It leads to a decline in hoarding, and to an increase in savings and investment. (b) It leads to an increase in the supply of eligible assets and bills, and hence to a higher effectiveness in the use of the traditional weapons of control of monetary policy. (c) It leads to a reduction in banks excess reserves, and therefore compells them to seek the central bank to increase their liquidity, and hence also strengthen the use of the Bank Rate weapon. (d) It leads to a proper diffusion of funds, such that any change in the banks rates of interest is transferred to other parts of the economy through the power of demand and supply. This leads, in turn, to an equalization of short-term interest rates in the economy.

5. The excess reserves that are held by the banking system in Jordan present another difficulty which limits the effectiveness of monetary weapons.[1] The Jordan Central Bank will be able to solve this problem by imposing upon banks high reserve requirements. At the same time, it can allow banks to hold government and long-term credit institutions bills as part of their reserves.

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[1]A computation of a figure for excess reserves in Jordan is difficult to make, since almost all of banks reserves are in foreign cash and assets. There are no available figures as to the composition of these reserves and assets. We can, however, reach to an approximate figure through certain assumptions.

Thus in Table 13 above, if we assume that legal reserve requirements are 20% of private demand deposits, these legal reserves in 1962 are then equal to J.D. 2.25 mill. If we assume also that 50% of banks foreign assets are in cash, these cash assets are then equal to about J.D. 10 mill.

The conclusion is that, according to the two above limiting assumptions, there are about J.D. 8 mill. of excess reserves with the banking system in Jordan.

6. One of the shortcomings of the Jordan credit system is the excessive credit that is advanced by banks for importers. Although the real problem is in the high marginal propensity to import, still the central bank could help fiscal policy to correct this tendency.

The central bank could correct this by setting a ceiling on bank credit advanced to importers. Or, it can use another weapon that is used by central banks in underdeveloped countries, which is the predeposit requirement. That is to say, the importer is required here, to deposit with the central bank part of the value of the imports he is demanding, at the time he asks for the import permit.

The above are the most important problems that will face the Jordan Central Bank, in formulating its future policy. The presence of all these handicaps supports the pessimistic views that are often made regarding the role that monetary policy may play in underdeveloped countries. Thus, one writer has argued that: "Monetary policy in the great majority of underdeveloped countries has been, and of necessity must be, relatively limited in role, scope, and effectiveness in view of the many institutional obstacles which it faces."[1]

Inspite of these numerous difficulties, the Jordan Central Bank should act rapidly and with no waste of time. It should, as pointed out, try to solve these difficulties, so that it may then begin functioning for an efficient monetary policy.

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[1] Arthur Bloomfield, "Monetary Policy in Underdeveloped Countries," Public Policy Yearbook, Volume VII, 1956, p. 453.

II

Recommendations for an Efficient Prospective Monetary Policy in Jordan

Having defined the objectives, the weapons and the shortcomings of monetary policy in Jordan, it is my purpose now to try to give in outline form, the recommendations for an effcient prospective monetary policy in Jordan.

The first step for the Jordan Central Bank to undertake, is to try to define and set out its long-term objectives. As pointed out earlier, monetary authorities should assist government in trying to solve the main outstanding economic problems in Jordan; namely, the problems of unemployment, the balance of trade deficit and the low standard of living.

Capital formation, and hence growth, took place in the last decade in Jordan with the aid of exogenous factors. Since Jordan depends on foreign aid to balance its international payments and its government budget, the aim of economic policy is to try to close both of these deficits by the year 1970.[1] It is believed that this could be achieved in several steps: (a) An increase in taxation higher than the increase in government expenditure. This would lead to a reduction in imports and budget deficit. (b) A stress on agricultural development, since it is the area that is most likely to contribute to

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[1] Through several interviews in the Jordan Development Board, this was pointed to be the aim of the Seven-Year Plan of Jordan. The plan is not published yet.

exchange reserves. (c) The encouraging of private capital formation at the expense of lower private consumption expenditures.

All of these courses of action, if accomplished as planned, would lead to a lower rate of national income growth than was achieved in the last decade. They may even accentuate unemployment difficulties. The role of fiscal policy in these development plans is greater than that of monetary policy. Both policies should, however, be coordinated to achieve the ends of economic policy. The central bank in working to aid the achievement of these ends, can do the following: (a) It can strengthen its control over importation and capital outflow. (b) It can help in agricultural and industrial development by requesting from banks to hold the assets of long-term credit institutions as part of their legal reserves. (c) It can provide the government with un-excessive deficit finance, so as to help it balance the budget.

2. In Jordan, a policy of monetary contraction is easier to achieve than a policy of expansion. Thus, if the central bank wishes to squeeze credit, it can impose upon banks high reserve requirements, and it may pay these banks interest rates against these deposits, so as to allow them reasonable returns. Banks, finding themselves with very low excess reserves, are forced henceforth to contract their credit. An expansionary policy, on the contrary, is very difficult. If the central bank lowers the reserve requirements of banks, this is not sufficient incentive for a credit expansion since banks prefer to hold their assets in foreign reserves and assets, due to the lack of eligible and profitable domestic assets. Even if banks were ready to increase their domestic investment, there is still the difficulty

of finding the profitable and safe investment, since there are other factors than credit availability that determine investment decisions, such as the marginal efficiency of capital.

3. A very important task for the Jordan Central Bank to perform, is to foster investment and national income. In this respect it is vital that the Central Bank encourages long-term credit institutions by either holding their bills, or participating in their equities.[1] The Bank, empowered with Article 37 of the Central Banking Law, can also impose upon banks to hold the bills of these institutions as part of their assets. However, since the marginal propensity to import is high, and the elasticity of production is low, the central bank should take care that no excessive credit be given, so as to prevent an inducement to price and foreign exchange rate instability.

4. Concerning the cover to note-issue in Jordan, the Central Bank Law of 1959 provided for a 100 per cent convertible foreign exchange cover.[2] The Law, thus, provided stability but not elasticity of cover. In this respect, it is my contention to propose a change in this provision, and to recommend the introduction of fiduciary issue in Jordan, provided that it is not allowed to exceed a certain limit. No underdeveloped country in the world is attached so much to stability, at the cost of elasticity in the cover, as is Jordan.[3]

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[1]I have enumerated in Chapter Two, Part II. D, above, the difficulties which encounter the operations of long-term credit institutions in Jordan. The Central Bank's duty is to provide these institutions with liquidity.

[2]See Appendix B, Article 24.

[3]See Isam Ashour, op. cit., p. 151.

The advantages of an inexcessive fiduciary issue in Jordan, may be the following: (i) In a country such as Jordan where most of the government revenues are composed of foreign grants and loans, and where the possibility of extending taxation is limited by the low standard of living, the Central Bank should come to the aid of fiscal policy. The Central Bank may achieve two purposes by introducing deficit finance: (a) It provides government with resources to finance development sectors, which are not approached by private enterprise, either due to their expensive production costs, or to their low prospective profitability. The Central Bank should, however, be careful to advance credit only to government ventures which are of low capital: output ratio, in order to minimize inflationary pressures. (b) When a central bank holds government bills in the cover, it encourages banks to invest in these bills, which is a step for the development of a money market in the economy. (ii) The second advantage of a fiduciary issue is to introduce flexibility in the cover by making the rise in money supply correspond with the growth in production. (iii) Money supply in Jordan consists of currency in circulation more than of demand deposits.[1] If the cover to note issue is to consist of 100 per cent foreign exchange, money supply in the economy, and hence incomes and prices would be greatly influenced by the balance of payments fluctuations. Monetary authorities are thus handicapped since the greater part of money supply is out of their control. (iv) Another argument for a fiduciary issue in Jordan is that it enables the central bank to rediscount more assets, and hence strengthens

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[1]Almost 55 per cent of money supply in Jordan is made up of currency in circulation. See Chapter Two, Part III, Table 17.

its open market operations weapon. The reason is that, so long as the Central Bank Law stipulates a 100 per cent foreign exchange cover, the Bank can hold Jordan domestic assets only in its Banking Department. The extent of its purchases would hence be limited by the level of its Banking Department reserves.

On the other hand, there are two disadvantages to a fiduciary issue of currency: (a) It may lead to excessive supply of money which would accentuate the balance of payments deficit. (b) There are some who argue that a 100 per cent foreign exchange cover would provide confidence in the currency.

To answer these two arguments: It should be emphasized that any fiduciary issue should be in-excessive, and a provision for a maximum limit should be stipulated in the Law. In addition, through a coordination of monetary and fiscal policies, a proper allocation by the government of the induced resources for investment purposes, can be reached, and simultaneously a stricter control on foreign exchange can be instituted.

As to the confidence in the currency, this is mainly determined by the price level in the economy. So long as the fiduciary issue is inexcessive, and so long as importation and unemployment are as high as they are at present, there are no dangers that may threaten the confidence in the currency.

5. It is recommended that a coordination of monetary and fiscal policies in Jordan should be aimed at by the government and the new Central Bank. It is also advisable that the central bank's governor, or deputy-governor, be one of the members of the Development Board.

Monetary and fiscal policies in Jordan, can work together to achieve both growth and stability objectives. The role of monetary policy is to provide fiscal authorities with inexcessive deficit finance, and to control the inflationary tendencies that may result hereby.

6. Money supply is made up of currency in circulation, and private demand deposits.[1] Since almost about 95% of the currency issued by the Currency Board is in circulation,[2] and since about 55% of money supply in Jordan is composed of currency in circulation,[3] the result is that a little more than 50% of money supply in Jordan is completely determined by the balance of payments fluctuations.

The new Central Bank Law provides for a 100% foreign exchange cover, which implies that almost 50% of money supply in Jordan is completely independent of the central banks control. The central bank's control over the other part of money supply, namely demand deposits is also limited by the numerous shortcomings of the monetary weapons, and the monetary system in Jordan.[4]

One of the potential remedies for this, is for monetary authorities to change the cover requirements, and introduce in the cover government and specialized credit institutions assets, so as to allow the central bank some control over currency issue.

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[1]Part III of Chapter Two above provides an analysis of money supply in Jordan.

[2]Currency issued - banks cash = Currency in circulation. Jordan banks' holdings of domestic cash is negligible as we saw in Table 13 above. Thus, out of a total currency issue of J.D. 16.4 mill., only J.D. 0.77 mill. was held by banks in 1960; J.D. 0.99 mill. out of J.D. 17.97 mill. in 1961; and J.D. 1.19 mill. out of J.D. 20.24 mill. in 1962.

[3]See Table 17.

[4]See Parts I.B. and I.C. of Chapter Three.

7. It is pertinent, to close this list of recommendations for a future monetary policy in Jordan, with an analysis of the most effective weapons of monetary policy that could be used.

In my discussion of the weapons of monetary policy in Jordan, in Part I.B. of this Chapter, I pointed out the difficulties that are encountered, at least for the short-run, by monetary authorities in using their quantitative weapons of the Bank rate and open market operations. The most effective weapons that may be used are the reserve requirements, selective credit control and direct credit control.

The necessity of direct intervention in the credit market, is imposed upon the central bank, by the relative inefficiency of the traditional credit control weapons. The Jordan Central Bank can benefit from the experience of other countries in the use of direct control weapons. An example is provided in England, where 'Treasury Directives' are used, by which the government advises, or even orders banks to stop lending in certain sectors, for the nation's interest.[1]

To conclude, a writer recommended for the situation that: "...the central bank in the underdeveloped money markets should have as few 'don'ts' as is possible."[2]

These are the important recommendations concerning the prospective monetary policy in Jordan. The analysis will be now directed to a discussion of the external side of this issue; namely, to what should be the potential foreign exchange policy of Jordan.

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[1] J.L. Hanson, Monetary Theory and Practice, op. cit., p. 77.

[2] Sen, op.cit., p. 157.

III

Foreign Exchange Policy

The aims of any foreign exchange policy are two: (1) To increase the foreign exchange reserves, or to control their depletion. (2) To protect the liquidity, safety and profitability of these reserves.

In the case of surplus countries, the second objective is as strong, or even stronger than the first. Jordan is an example of a chronic sufferer from deficits, and it is to the correction of this that any foreign exchange policy should direct its attention.

In the analysis dealing with Jordan's exchange system it was pointed out that the presence of foreign aid has helped Jordan to protect its external balance, and also that Jordan's membership in the Sterling Area did not help it much to achieve an increase in its reserves. Yet, it was shown that Jordan may be in need in the future of the advantages accruing to it due to its membership in the Area.

In the analysis of foreign exchange control in Jordan, it was also shown that there are many difficulties which may cause a drain on Jordan exchange reserves. Some of these difficulties are the expected cut in foreign assistance, the danger of unfavourable weather conditions, the fear of political disturbances which may hinder the inflow of tourists and the future development expenditures that are contemplated.

Actually, the only weapons that any foreign exchange policy can manipulate to control this unfavourable drain of exchange reserves, are the following: (1) Deflation. (2) Devaluation. (3) Exchange control. A deflationary policy in Jordan is un-realistic since it will accentuate the unemployment problem and may lead to social disturbances.

A devaluation of the Jordan Dinar is not possible either since the Dinar is at par value with the Sterling pound under the Sterling Area regulations, and is at par value also with the dollar under the I.M.F. regulations.

The only remaining policy for Jordan is to maintain its control on importation and capital outflow. This is largely the role of monetary policy. Simulatneously, the role of fiscal and development policy is to develop the sectors that promise the highest export-content, the import-replacement industries and the lowest import-content industries. This is believed to be the aim of the future development plans of Jordan.

The role of monetary policy, as was mentioned, is to maintain its control on foreign exchange[1] and to control any excessive credit advanced by the banking system for importation. Exchange control did not contribute in the past to the achievement of the first objective of exchange policy due to the lack of need for it, since the external balance was achieved through foreign aid. However, since such foreign aid is not expected in the future to flow as it used to, monetary authorities should consider the possibility of maintaining stricter exchange control.

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[1]I.M.F. Article XIV of the Articles of Agreement allows deficit countries to maintain exchange control on their current accounts for a transitionary period that may be prolonged subject to the Fund's agreement.

This deals with the first aim of exchange policy. The second objective of such a policy is the protection of the safety, profitability and liquidity of exchange reserves. Liquidity in this sense implies convertibility, and safety implies the non-existence of devaluation or blocking risks. Jordan reserves are all in sterling, and although they earn a profit, they are not completely convertible. As to the element of risk, this is found in whatever currency the reserves are held. The only solution to this risk element is a diversification of exchange reserves, rather than holding them all in sterling. Such a policy, however, would entail Jordan leaving the Sterling Area. Such a decision has to be made only when Jordan is in complete independence of the benefits that accrue to it as a member. Since its membership may help it in the future to achieve the first and more important objective of exchange policy, the decision as to its membership regarding the second objective remains of secondary importance.

The decision as to the diversification of reserves versus their existence in one form of currency, depends upon the efficiency of the money markets in different countries. Such an analysis is out of the domain of this research.

IV

Conclusion

The objectives of monetary policy should coincide with the objectives of the general economic policy of any economy. In Jordan, the aims of economic policy are directed towards the solution of two problems: the deficit in the balance of trade and the high level of unemployment. The new central bank should thus try to help fiscal policy to attain these objectives.

Under the Currency Board System, in the past, Jordan maintained a 100 per cent sterling cover for its currency. Due to the large inflow of foreign aid, Jordan was able to accumulate exchange reserves, to balance its government budget and to achieve a remarkable rate of growth. Due to the automacity of currency issue, the surpluses in the balance of payments allowed Jordan to increase its imports, and hence to enjoy an internal price stability. In the future, these favourable tendencies are not expected to be manifested. The managed currency, under the central bank, has thus a twofold responsibility: (1) To provide government with deficit finance so as to help it to reduce the foreign budgetary aid. This deficit finance also enables the government to maintain the public projects that may alleviate the level of unemployment.

The central bank can assist the government directly by holding its securities, or indirectly by requesting from banks to utilize part of their accumulated excess reserves in holding government securities.

(2) The second responsibility of the central bank is to follow stricter exchange control on imports and capital outflow, which is a necessary policy notwithstanding the difficulties that may befall Jordan in case of a sudden cut in foreign aid.

The future role of monetary policy in Jordan is not encouraging, at least in the short-run, due to the institutional difficulties in the monetary and banking systems. The lack of a money market, of a banking habit and of a developed system of specialized credit institutions, are only three of these difficulties.

As a result of the above, the control of the central bank over money supply is ineffective. So that it may be able to control the changes in money supply, the central bank has to control the changes in currency in circulation and in demand deposits. Over both of these elements, its future control would be partially effective. The case is that the currency in circulation (which constitutes 55 per cent of money supply in Jordan), depends mainly upon the balance of payments fluctuations. On the other hand, the central bank's control over banks credit is handicapped by many institutional difficulties which characterize the credit system in Jordan. Until the central bank overcomes these difficulties, its monetary weapons would be, for a long period, the arbitrary weapons of selective and direct credit control.

Due to these unfavourable facts, in addition to the shortage of the trained personnel, the role of the Jordan central bank at its initiation would not be one of control, but rather one of trying to solve the deficiencies of the Jordan money market.

Inspite of these facts, the inefficiency of the future monetary policy in Jordan can be alleviated through a proper coordination between monetary and fiscal policies. Neither one of these can work alone, unless buttressed by the other. Fiscal policy can achieve expansion more effectively than a contraction. This can come about since an increase in taxation is not an elastic and publicly acceptable job. On the other hand, monetary policy achieves contraction more effectively than expansion, since the central bank can raise banks reserve requirements to high levels, and hence contract their credit advances. Conversely, no matter how much it reduces these requirements, banks would not increase their internal investment so long as profitable and eligible domestic assets are lacking.

APPENDIX A

"Temporary Law for Jordan Currency."[1]

Article No.

2 Beginning with a date to be assigned by the Cabinet, the Jordanian Dinar will replace the Palestinian pound in circulation.

6 A Currency Board is to be formed of a Chairman and four members, and are elected by the Council of Ministers.

7 The functions of the Currency Board are the following: (a) Minting and printing notes and coins. (b) Cancellation of unusable currency. (c) Safekeeping of stock of currency not in circulation. (d) Establishing a Currency Reserve Fund in which the cover to the currency issued is kept. (e) Maintaining a Currency Fund Income Account, and crediting it with revenues other than "the sterling received against the issue of notes and coins, and to debit it with all expenditure incurred other than the expenditure arising from the redemption of currency notes and coins." (g) Investing its assets in sterling securities and safeguarding these securities.

16 Beginning with a date to be prescribed by the Council of

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[1] This Law was issued as Law No. 35 in 1949. It was amended by Law No. 53 in 1949. The amendment is included in this summary.

The number before every item refers to the number of the Article in the Law. Only the important articles are included here.

Ministers, the holder of Palestinian Currency may exchange it for Jordan Currency, at the rate of L.P. 1 for J.D. 1.

17. Jordan currency is issued against pre-payment of Sterling in London, at the rate of Ŀ 1 for J.D. 1. The Board's commission should not exceed 1%.

18. Redemption of currency can be made against Sterling at the rate of Ŀ 1 = J.D. 1, and at a commission rate which should not exceed 1%.

19. Funds of the Board above the amount needed for redemption, and an amount left as an Investment Reserve, are paid to the Government.

Note: The source of the above important articles of the Law was a typescript written by A.K. Salehdar. See: IM.F., A.K. Salehdar, "Financial Institutions in Jordan," 1957, pp. 25-30.

APPENDIX B

"The Central Bank Law of 1959."[1]

Part I. General

Article 6. The objectives of the Bank shall be the regulation of currency issue, the preserving of monetary stability, the maintenance of the external value of the Dinar, the control of credit, and the regulation of governments deposits and accounts.

It will carry these objectives in the following ways: (a) By regulating the quantity and quality of credit, and by regulating the rates of interest. (b) By adopting certain measures to deal with economic crises. (c) By supervising banks. (d) By the management of Government's foreign exchange reserves.

Part II. Capital and Reserves

Article Seven: "The authorized capital of the Bank shall be J.D. 1 million, which shall be fully apid by the Jordan Government."

Eight: Net profits of the Bank (excluding those which are given to the government by the Issue Dept.), are transferred to a General Reserve Fund, until this Fund amounts to 100% of the Bank's capital.

Nine: When the Reserve Fund is more than 100% of the capital, and until it reaches an amount equal to twice the capital, only 10% of net

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[1] I have only summarized the most important Articles of the Law.

profits are transferred to the Fund. The remaining 90% are paid to the Government.

Part III. Administration

Eleven: "The Board shall consist of a Governor, a Deputy Governor, and five other members."

Twelve: The Governor, or the Deputy Governor, shall be in control of the administration of the Bank, and may exercise full powers and decisions of the Bank; but, are answerable to the Board for their actions.

Thirteen: The Governor and Deputy Governor are appointed by the Council of Ministers. They should have excellent financial experience.

Fourteen: Members of the Board should not be members of Parliament, or Government officials.

Fifteen: Members of the Board cease to perform their duties, if they were found to be: (1) Medically unfit. (2) Bankrupt. (3) Guilty of crime.

Part V. Operations of the Bank

Twenty-two: The Bank is authorized to perform the following functions: (a) Issue Currency. (b) Issue demand drafts and remittances. (c) Purchase and sell gold. (d) Accept money deposits. (e) Purchase, sell, discount, re-discount commercial bills of 3 months maturity. (f) Purchase, sell, discount, rediscount bills "drawn or issued for the purpose of financing seasonal agricultural operations or the marketing of crops, and maturing within 9 months", provided these kinds of bills "shall not exceed 50% of the total amount of the Bank's portfolio of inland bills and notes". (g) Purchase, sell, discount or rediscount government Treasury Bills of 3 months maturity. (h) Purchase and sell long-term Government Securities maturing within 10 years, provided that this investment should not exceed four times the paid-up capital and reserve funds. (i) Undertake the issue and management of public debts. (j) Purchase and sell foreign currencies, and foreign bills of exchange (including foreign Treasury Bills), of 93 days maturity. (k) Act as an agent for any foreign monetary authority. (l) Grant advances against government bills of 30 months maturity. (m & n) Grant advances and over-drafts for not more than 3 months period, at a minimum rate of interest of at least 1% above the Bank's official rediscount rate, against the following securities: (1) Gold. (2) Government Securities of 10 years maturity, provided that the advance does not exceed 60% of the market value of the security. (3) Bills of exchange, provided that the advance does not exceed 60% of the nominal value of the security. (4) Commodities, provided that the advance is not more than 60% of the current value of these commodities. (q) The Bank should promote the establishment of a clearing system. (r) Act as a Government's Agent.

<u>Twenty-four</u>: "The Bank shall, at all times, make public its minimum rate for re-discounts."

<u>Twenty-five</u>: The Bank may not perform the following: (a) "Grant accommodation to the Government either directly, except as provided in Article 40, or indirectly except as provided in Article 22 (g), (h), (i) and m (2)" by any way of lending. (b) "Engage in trade, or have otherwise a direct interest in any commercial, agricultural, industrial or

other undertaking, except such interest as the Bank may in any way acquire in the course of the satisfaction of debts due to it provided that all such interests shall be disposed of at the earliest suitable opportunity." (c) "Purchase the shares of any banking company or of any other company, or grant loans upon the security of any shares."

Part VI. Currency Issue

Twenty-Six: The Bank is the sole issuer of currency in Jordan.

Twenty-Seven: The accounts of the Issue Dept. are separate from the other accounts of the Bank.

Twenty-Eight: (A) The cover to the currency issued shall be 100% composed of the following: (1) Gold. (2) Currencies convertible into gold. (3) Sterling balances. (4) British Government Treasury Bills. (5) British Government Securities, or securities guaranteed by that Government; provided these do not exceed 70% of the total assets, and of not more than 5 years maturity. However, the Board can allow a maximum of 20% of total assets to be held in securities of 15 years maturity.

(C) The liabilities of the Issue Dept. are the amounts of currency in circulation.

(D) The annual net (assets-liabilities), minus a deduction for an Investment Reserve, shall be distributed as 80% to Government, and 20% to the general revenue of the Bank.

Thirty-Five: Jordan currency is issued against pre-payment of Sterling in London, at the rate of £ 1 = J.D. 1. The maximum commission charged is 1%.

Thirty-Six: Currency is redeemed against telegraphic or mail transfers payable in Sterling in London, at the rate of £1 = J.D. 1. The maximum commission taken is 1%.

If the reserves of the Issue Dept. prove to be insufficient for redemption, "the balance required shall be a charge on the general revenue of the Government."

Part VII. Relations with Banks

Thirty-Seven: "Every Bank carrying on business in Jordan under the Banking Law shall hold as part of its assets all or any of the items enumerated in Section (B) of this Article to an amount which shall be prescribed by the Board and published in the official Gazette. Such amount shall be expressed in the form of a percentage or percentages of the specific assets to the Bank's sight and time liabilities, either jointly or separately, and such percentage or percentages may be varied from time to time by the Board." (B) "The specific assets of any bank referred to in Section (A) of this Article shall be: (1) Jordan Currency. (2) Cash with other banks. (3) Balances with correspondent banks. (4) Money at call. (5) Government Treasury Bills maturing within 3 months. (6) Re-discountable commercial and agricultural bills. (7) Balances and money at call in the U.K. (8) "Bills of exchange of less than 3 months maturity, payable in the U.K. (9) U.K. Treasury Bills of not more than 93 days maturity.

Thirty-Eight: The Bank shall form clearing houses to facilitate the clearing of cheques between banks. The banks forming the Clearing House shall appoint the manager of their House.

Part VIII. Relations with the Government

Thirty-nine: The Bank shall undertake the banking and remittance transactions of the government, and keep its deposits.

Fourty: The Bank may give advances to the Government in case of a budget deficit, for an amount not exceeding 10% of Government's revenue. The loans should be repayed at the end of that specific fiscal year.

Fourty-two: The Bank shall not receive remuneration for its services in keeping and disbursing Government monies; nor shall it give interest against Government deposits.

Fourty-four: The Bank is responsible for the issue and management of internal public debts.

Notes:

1. The Law was approved by the Council of Ministers in 1959, but the Central Bank as an institution is not found yet.
2. The Law was amended in 1960. I have included the amendments with the above original Law.
3. Parts IV, IX, X, XI, were not included in the above summary of the Law, since they are not pertinent for our analysis. Part IV deals with the Staff; Part IX with different Accounts and Statements; Part X deals with the winding-up of the Bank; Part XI deals with transitory provisions.

APPENDIX C

"Control of Banks Law of 1959"

Article Four: (a) The minimum paid-up capital of a bank is J.D. 250,000. (b) The minimum paid-up capital for foreign banks is J.D. 500,000. At least J.D. 150,000 shall be remitted as a working capital for this bank's branch in Jordan.

Six: (a) 1. The credit and advances given by any bank should not exceed 20% of the paid-up capital, but may be increased to 50%, at the consent of the Minister of Finance. This provision excludes transactions between banks and the purchase or discount of exchange bills.

2. "No bank shall purchase, acquire or lease real estate except for the purpose of conducting its business or housing its staff."

3. Banks shall not engage in trading, nor own shares in agricultural or industrial undertakings "except such interest as a bank may acquire in the course of the satisfaction of debts due to it, provided that all such interest shall be disposed of at the earliest suitable opportunity."

The Central Bank may, however, agree to share-holding of banks in assigned ventures which should not exceed 15% of the paid-up capital of the bank.

4. "No bank shall grant an advance or a credit facility against the security of its own shares."

5. Unsecured loans exceeding 5% of the paid-up capital of the bank, should not be made unless approved by two thirds of the bank's board members.

Article 6: (B) The bank should present a report about the unsecured loans that it has advanced. The Minister of Finance, can, through the advice of the Central Bank, prohibit the bank from making such loans.

Seven: Every Jordanian bank should transfer to a reserve fund, not less than 25% of its gross profits, so long as the fund is less than 50% of the paid-up capital. After that limit, and until the fund amounts to 100% of thepaid-up capital, only 10% of gross profits are transferred to the fund.

Seven: (B) The above provision of this Law applies also to branches of foreign banks in Jordan, unless these branches can satisfy the Minister of Finance that they hold sufficient reserves.

Nine: The bank should publish its balance sheet in a local newspaper.

Ten: (A) Every bank should present to the Central Bank: (1) A monthly report of its balance sheet. (2) A quarterly analysis of its advances.

(C) The Central Bank has the right, under Article 37 of the Central Bank Law, to assign the banks' cash reserve ratio.

Eleven: The Central Bank informs the Minister of Finance, if it finds that a bank's assets, are insufficient to cover its liabilities. The Minister then, appoints a person to examine the bank's books.

Twelve: An examination of a bank's books may be ordered by the Minister on application of those who hold not less than one third of the bank's shares, or those who hold not less than one half of the bank's deposits.

Notes: Those Articles of the Law that were not listed above, are either unimportant, or unsuitable for our part of the research.

APPENDIX D

"Exchange Control Regulations in Jordan."[1]

Exchange Control: It is implemented by the Currency Control Department.

Prescription of Currency: Proceeds of exports and invisibles must be collected, and surrendered as follows: From Sterling Area residents in Sterling or Dinar. From non-Sterling Area residents in Sterling, Dinar or any specified currency.

Import Payments: Imports of certain items; (as cement, arak, monalcoholic drinks, cigarettes, buses, diesel-engined cars, lorries, carbonic acid), and imports from Israel are prohibited.

Imports of industrial machinery require approval. Imports of fruits and vegetables are exempt from licenses. All other imports, except those under agreements, are liable to licenses.

A fee of 4% is paid on licenses demanding exchange. A fee of 0.5% is paid on licenses without exchange.

Payments for invisibles:

1. All payments for invisibles are subject to exchange control approval.

2. Aside from government payments, and payments for education purposes, a fee of 0.5% is paid on all other permitted payments.

3. Payments for these invisibles are approved: income of non-residents and their savings; remittances to refugee dependents; expenses for Jordan residents traveling abroad; expenditures for education,

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[1]All of the listed exchange control regulations were taken from I.M.F. reports on exchange restrictions. See: I.M.F., Report on Exchange Restrictions of 1962, pp. 214-218.

medical treatment, business expenses, and approved insurance payments.

4. Any person should not carry with him when leaving the country more than J.D. 25 or equivalent in foreign currency. Foreigners could take out foreign currency brought out with them previously.

Jordanian tourists abroad are allowed J.D. 12 a day in U.S.A., and J.D. 8 a day in other countries, for a period of one month in any one year. Jordanians going out for business are allowed J.D. 16 a day in U.S.A., and J.D. 12 in other countries, for a period of 3 months in any one year. For travel to Arab countries, a Jordanian cannot carry with him more than J.D. 100 in cash.

Export Proceeds: Export proceeds exceeding J.D. 20 should be surrendered, and their foreign exchange revenues also surrendered, except proceeds of exports of fruits and vegetables, and other perishable commodities to certain neighbouring countries. Exports to Israel are prohibited.

Proceeds from Invisibles:

1. Receipts from invisibles in convertible currencies including sterling, must be surrendered to an authorized bank.

2. Travelers entering Jordan may bring in a maximum of J.D. 100 in Jordan currency notes, and any amount in foreign currencies.

Capital:

1. Capital may be imported freely, but exports of capital require approval.

2. Current income arising from non-resident investments in Jordan, and profits may be remitted easily in the currency of the original investment. After one year, repatriation of the capital is permitted in four annual installments in the same foreign currency of the original investment.

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