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Banking In The Middle East

(A study of recent banking trends in eight countries.)

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Introductory Remarks

Modern banking in the Middle East dates from the second half of the last century. The Ottoman Bank in Turkey, established in 1863, is, perhaps, the oldest modern banking institution in the area. Banking has ever since made slow but steady progress, depending upon the pace of economic development in various countries and of the transition from predominantly barter to semi-market economies. More recently, with the emphasis placed on economic development in a number of countries, there have been definite efforts to extend banking services and diversify banking institutions. The improvement has been, however, by no means uniform. In some countries, for example, a nomadic way of life still survives, and there is no regularly organized banking system or paper currency. On the whole, while progress in recent years has been steady, the banking structure of the Middle East still reflects the economic backwardness of the area and the limitations of domestic banking.

Factors Affecting Development of Banking

Various causes have retarded progress in this field. The basic cause has been the primitive, underdeveloped and, until comparatively recently, the almost self-contained nature of the economy in many countries of the region. Nearly 80 per cent of the people live upon agriculture and practise primitive methods of cultivation with extremely low crop yields.1/ Much of the agricultural produce does not enter the market, but is consumed by the producers or bartered for services and other necessities. The monetization of the economy is thus, in varying degrees, incomplete.2/ Most countries export primary commodities and

1/ As an exception, crop yields in Egypt are amongst the highest in the world, but the pressure of population on land is considerable.

2/ The ratio of money supply to national income serves as some guide to the extent of monetization achieved in the economies of different countries. Appendix I summarises the relevant data for 1954. The ratio varies from 7 per cent in Ethiopia to 51 per cent in Lebanon.

are dependent upon imports for the bulk of their finished consumer goods needs. Industrial development is in its early stages. Average per capita income is low and the margin for savings limited.

Mass illiteracy, varying degrees of instability, and the religious attitude toward usury have been other factors affecting the growth of banking. The attitude toward interest is undergoing a change (a distinction is now usually drawn between usury and bank interest), but the rural peasantry is still prejudiced. In the past, the habit of putting savings into hoards of precious metals, or even of currency, has been deeply ingrained. There is some evidence that the relative importance of savings in this form has declined in recent years. There is, however, still a strong preference on the part of those who can save and of the small wealthy class to invest their savings in land, real estate or merchandise. This tendency is largely attributable to the expectation--prevalent for centuries in lands of insecurity and uncertainty--of quick and large profits on capital risks. The tendency to invest in land or real estate is widespread. In Syria, for example, it has been estimated that in the four-year period, 1950-53, nearly 56 per cent of gross private investment was accounted for by housing construction. In Turkey, of the total private investment in 1955, 44 per cent was related to construction, while in Egypt the value of new private buildings (excluding the value of land) accounted for about 50 per cent of gross capital formation during 1954.[1] Thus, while it is true that the over-all volume of savings is limited, the important point is that quite a large proportion of whatever savings accrue is not institutionalised and channelled into uses that add significantly to productive capacity.

Another institutional factor responsible for the slow growth of banking has been the absence of any organised system of indigenous banking practices.[2] In these circumstances, all the pioneering work in the introduction and development of modern banking was performed by foreign banks, mostly British and French. Foreign banks showed their first

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1/ Syria: The Economic Development of Syria - Report of a mission organized by the IBRD; Turkey: Economic Developments in the Middle East, 1945 to 1954 - Supplements to U.N. World Economic Report, 1953-54; Egypt: Economic Bulletin of the National Bank of Egypt, Volume No. 1, 1956.

2/ Although the exact origin of banking is hidden in antiquity, the earliest evidence traces it to the Middle East. The practices of safekeeping and savings banking flourished in the temples of Babylon as early as 2000 B.C. Furthermore, clay tablets discovered in the ruins of Babylonia indicate that credit instruments used in the Ninth Century B.C., in the form of promises and orders to pay gold and silver coins, were the forerunners of promissory notes and bank cheques used today. (Financial Institutions - Boehmler, Robinson, Gane and Farwell.) These practices did not, however, develop in the Middle East through the ages, and the only living remnants today of the ancient art of banking are perhaps the sarrafs in Iraq whose activities, with the recent exodus of Jews from that country, are now of only secondary importance.

interest in the area mainly in the wake of colonial penetration by their countries, but continue to occupy an important and useful position. Without minimizing the extremely valuable contribution they have made, it might be stated that as the main objective of their activities was related to the commercial sector, their operations have been concentrated in a few business centers, have been generally conservative and confined mainly to the financing of foreign trade. As a result, there has been little conscious effort to attract deposits, to spread banking activities in the interior of the country or to diversify banking operations. Agricultural finance has, in general, been neglected. On the whole, these shortcomings should be interpreted as reflecting the deficiencies of domestic banking rather than as a criticism of foreign banks. At the same time, it seems necessary for foreign banks to readjust their policies to the needs of a changing situation.

Recent Developments

With the hard core of a sound banking structure laid by foreign banks, banking has, more recently, received a powerful stimulus from the political and economic changes taking place in the Middle East after World War II. With the achievement of independence by a number of countries, increasing attention is being devoted to economic development. A number of countries have embarked upon programs of basic development (e.g., Turkey, Pakistan, Iran, Egypt, Iraq and Syria). Assisted by fiscal and other incentives provided by national governments, private enterprise has begun to show a marked response toward productive investment. These changes necessarily call for a new approach toward savings and the extension and diversification of banking institutions.

Commercial banking has undergone a rapid expansion in many countries in recent years. A number of new private commercial banks (mostly local) have been established; moreover, some governments have taken the initiative in establishing commercial banks whose capital has been wholly or partly subscribed by them. Available information suggests that in a number of countries a considerable volume of business is now being handled by local banks.

In view of the almost complete absence of organized capital markets in the Middle Eastern countries, most governments have set up specialized financial institutions to provide medium and long-term capital for agriculture and industry, as also for the short-term financing of agricultural operations. Except in one or two countries, the activities of these institutions have so far been limited, but with experience they may be expected to play a more active and vital role in the future.

Scope of Paper

This paper deals with recent banking trends in eight of the Middle Eastern countries with particular reference to the postwar period. The countries concerned are Turkey, Egypt, Pakistan, Iran, Iraq, Syria, Lebanon and Ethiopia which, between them, embrace about three-fourths of the area's total population. In the main, it is proposed to deal with (1) commercial banking; (2) the special financial institutions that have been set up to provide agricultural and industrial credit; and (3) central banking, including a general appraisal of the monetary situation.

I. Commercial Banking

General Pattern

The banking structures of the Middle Eastern countries differ widely. In both Iran[1/] and Ethiopia, the state-owned central banks (the Bank Melli Iran, established in 1927, and the State Bank of Ethiopia, established in 1942) also perform commercial banking functions and hold a predominant position.[2/] In Iran there are five private commercial banks, of which one is a foreign bank, but these account for only about one-tenth of total bank business. Ethiopia has branches of two Italian banks whose activities are now of minor importance. Apparently, the paucity of local private commercial banks has been the main reason for the combination of central and commercial banking functions in the two state-owned institutions in Iran and Ethiopia. Private commercial banking has, however, shown signs of growth in Iran in the last few years.

In the other countries, commercial banking is mainly in private hands. Branch banking is the invariable rule throughout the area. Of the countries where private banks predominate, significant progress has been made in Turkey, Egypt and Lebanon (see Table 1). The principal commercial banks in Turkey include ten Turkish banks and five foreign banks. The Is Bank (partly state-owned) is the largest. Of the foreign banks, the largest and oldest is the French and British controlled Ottoman Bank which also operates in Egypt, Iraq and Jordan. Mention should also be made of the state-owned Sumer Bank which participates in industry, and the Eti Bank which operates state mining enterprises. These banks, although performing some commercial banking functions, are really in the nature of holding companies and are a by-product of the state capitalism introduced in Turkey in 1934.

Egypt has 26 commercial banks, of which 11 are foreign. The largest is the domestically owned Bank Misr which was founded in 1920 and, besides its normal commercial banking operations, has been active in the promotion of industrial enterprises. The bank met with a temporary crisis in 1939 as a result of an overextension of its industrial participation. The central bank of Egypt is the National Bank of Egypt,[3/] a private bank,

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1/ Banking in the modern sense was introduced in Iran in 1889 with the establishment of three foreign banks, two of which were British and one Russian. The British banks have since ceased operations. The Iranian banking law discriminates against foreign banks.

2/ The Bank Melli Iran operates 158 branches and agencies. The State Bank of Ethiopia has 15 branches.

3/ The National Bank of Egypt was established in 1898 as an Egyptian company with half of its capital of £1 million subscribed in London. It was empowered to issue bank notes, make advances to the Government, discount bills and receive deposits. Egyptian Law No. 571 of 1951 changed the *de facto* position of the National Bank as a central bank into a *de jure* position. The Bank remained a private company and, while not being called upon to withdraw from commercial banking, was asked not to open small accounts. The Governor of the Bank is appointed by the Minister of Finance from amongst two nominees of the Bank's Board of Directors.

which has limited its commercial banking activities since 1951 when it was legally vested with central banking functions.

Pakistan has 32 "scheduled" banks[1] with 251 branches which are mainly centered in the larger towns. Only 5 of these banks are incorporated in Pakistan, but their branches number 152. There are also 50 "non-scheduled" banks whose activities, however, are of minor importance. The Government sponsored a commercial bank in 1949, the National Bank of Pakistan, and holds 25 per cent of its share capital. This bank has made rapid progress and is now the largest commercial bank in the country.

There are seven commercial banks in Iraq, of which five are foreign. The largest is the government-owned Rafidain Bank, established in 1941, which, until recently, also acted as banker to the Government. The availability of substantial government deposits for the bank's commercial operations has enabled the Rafidain Bank to consolidate and strengthen its position in recent years. With effect from 1st September 1956, all fiscal agency functions have been transferred to the Central Bank of Iraq.[2]

Lebanon has extensive banking facilities.[3] In this country of 1.4 million people, there are 35 banking institutions, of which 16 are foreign banks. In addition, there are a number of small institutions which are either discount houses or engage in money lending at high rates of interest. Syria had 19 banks in 1955 and all of the 10 larger ones are foreign. One of the foreign commercial banks, the Bank of Syria and Lebanon - BSL, acts in both Syria and Lebanon as banker to the Government, and holds substantial public funds which have been important for its commercial operations. With effect from 1st September 1956, Syria has, however, established an independent central bank (see <u>Central Banking</u>).

The record of banking in the Middle East has been relatively free from bank failures. The predominance of strong foreign banks and the conservative but sound traditions they have established have been the main contributing factors. In part, this has also been due to the general prevalence of branch banking in the area. The presence of a few large

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1/ A "scheduled" bank is a joint stock bank having a paid up capital and resources of PRs 500,000 ($105,042) or more and included in the "second schedule" to the State Bank of Pakistan Order, 1948. Banks with smaller capital and resources are called "non-scheduled" banks.

2/ Prior to 1st September 1956, it was called the National Bank of Iraq. The accounts of the Development Board, whose cash balances have recently been substantially larger than those of the Government, have always been maintained with this Bank.

3/ The banking profession in Lebanon is entirely free and unregulated. Anybody, Lebanese or foreign, can at any time open and operate a bank without any requirements with regard to the legal form of business or minimum capital. Banking transactions are considered as acts of commerce and persons and corporations carrying them out as merchants.

banks with a number of branches has imparted a general strength to the banking system in most countries. The system has, however, the drawback that credit, instead of flowing from the larger towns to outlying places, has generally tended to be concentrated in the former at the expense of the smaller centers and rural areas.

Even in the countries where private banking predominates, the shortcomings of domestic banking are now being remedied through state initiative. But for the prestige and support lent to the newly established local institutions by official participation, they might not ordinarily have been in a position to extend their activities successfully within relatively short periods. In their day-to-day operations, these banks are understood to function on purely commercial lines and free from government interference or directions. As an objective of policy, they are making banking services available to larger sections of the population by opening a network of branches throughout the countries concerned.

<u>Recent Growth in Bank Deposits and Credit</u>

Since the end of World War II, banking resources in the Middle East have been rapidly expanded as both deposits and advances have increased. This trend is illustrated for the years 1948-54 in Table 1. The growing use of banking facilities by the business community has been an important factor in this expansion, but in some countries the recorded figures should also be interpreted as in fact a reflection of the inflationary pressures that have been at work.

Table 1. Commercial Bank Deposits, Advances and Other Data, 1948-1954

(In millions of U.S. dollars)[1]

Country	Population	Private Time Deposits		Total Private Deposits		Deposits per capita	Percentage Increase Private Deposits	Commercial Bank Claims on the Private Sector		Per cent Increase	Central Bank Advances to Commercial Banks	Cash and Reserves
	1953	1948	1954	1948	1954	1954	1948-1954	1948	1954		1954	1954
Turkey	22.5	53[2]	147[2]	339	1052	46	210	297	1333	349	384	146
Egypt	22.6	52	135	677	623	28	-8	244	445	82	34	109
Pakistan	77.4	35	101	245	370	5	51	86	207	142	39	36
Iran	20.3	6	12	88	168	8	91	58	107	84	-	21
Iraq	4.8	20	28	56	81	17	45	17[3]	70	312	-	31
Syria[4]	3.6	13	16	32	45	12	41	45	123	173	5	7
Lebanon	1.4	1	8	61[5]	120[5]	86	100	69[6]	124[6]	79	n.a.	n.a.
Ethiopia[7]	15.0 (approx.)	-	2	12	17	1	42	4	5[8]	25	-	13
Total all countries	167.6	180	449	1510	2476	15	64	820	2414	194		
Total excluding Turkey		127	302	1171	1424		22	523	1081	107		

See footnotes and sources on page 8.

Table 1 (Continued)

1/ Data in national currencies are converted into dollars at a uniform rate for each currency. In each case this is the current par value except for Syria, Lebanon and Iran where the current rate applying to most or all transactions has been used. Consideration of the reasons for and against the use of prevailing exchange rates versus a uniform rate for conversion of data for different periods and countries suggested the use of a uniform exchange rate in the preparation of this table mainly because the use of a uniform rate makes percentage changes in local currency magnitudes equivalent to those in dollar magnitudes.

2/ May include small amounts of time deposits with the central bank.

3/ 1950.

4/ Data for 1952 and 1954.

5/ Includes government deposits with the Bank of Syria and Lebanon.

6/ May include advances to public institutions and government.

7/ Data for State Bank only.

8/ 1953.

Sources: International Monetary Fund, International Financial Statistics; Syrian Council on Money and Credit, Syrian Monetary Accounts; State Bank of Ethiopia.

In Turkey, bank deposits and advances increased steadily between 1948 and 1950, but thereafter expanded much more rapidly when the monetary situation assumed an inflationary trend. Over the period 1948-1954 there was a threefold increase in commercial bank deposits (from $339 million to $1,052 million) and a fourfold increase in credit to the private sector (from $297 million to $1,333 million). In the other seven countries, bank deposits increased during the same period by 22 per cent, from $1,171 million to $1,424 million; on the other hand, credit to the private sector rose sharply from $532 million to $1,081 million, an increase of 107 per cent. As a result, the liquidity of the banking system underwent a substantial decline. The increase in credit in these seven countries was mainly in order to support higher levels of economic activity. The disparity between the relative growth of deposits and of credit is of considerable importance for the future.

There has been a rising trend in "time deposits" which, in most countries, rose faster than "demand deposits". The improvement was more pronounced in Pakistan and Egypt; in Pakistan "time deposits" increased from 16 per cent of total deposits in 1948 to 29 per cent at the end of 1954, and in Egypt from 8 per cent to 22 per cent. In Egypt there has been a considerable shift from "demand" to "time" deposits, since total deposits fell slightly during the period. Time deposits continue to be low in Turkey, Iran, Lebanon and Ethiopia. Despite the recent substantial increase in time deposits for the area as a whole, they were only 19 per cent of total deposits at the end of 1954.

A major factor in the increase in bank deposits has been the expansion in the economies of many countries. An even more important reason in certain countries has been the large government outlays accompanied by central bank financing of these expenditures. The substantial increase in bank deposits in Turkey must be largely attributed to this factor. The same also applies to Pakistan and Iran, although in a smaller degree. In Lebanon, the increase in deposits presumably includes a considerable inflow of capital from the oil-producing countries of the area. As against the trend in these countries, the fall in the level of bank deposits in Egypt reflects the contractionary effect on money supply of large balance of payments deficits during the period under review. More recently, under the impact of fiscal deficits, bank deposits in Egypt have begun to increase.

<u>Relative Importance of Currency and Demand Deposits</u>

In assessing the relative importance of currency and deposits in the Middle East, the following figures relating to the ratio of "demand deposits" to "money supply" are pertinent:

Table 2. Ratio of Demand Deposits to Money Supply[1]

(Per cent)

		Turkey	Egypt	Pakistan	Iran	Iraq	Syria	Lebanon	Ethiopia
Ratio of Demand Deposits to Money Supply	1948	47	62	37	49	26	22[2]	51[3]	32
	1954	65	47	33	50	30	24	60[3]	24
Increase in Money Supply	1948-54	126	-2	41	88	31	43	59[3]	68

1/ Comparison with certain other countries: India (1954) 31 per cent; United Kingdom (1954) 72 per cent; United States (1954) 80 per cent.
2/ 1952.
3/ Money supply and demand deposits include government deposits with the BSL.

These figures underline the fact that, with the exception of Turkey and Lebanon (the Lebanese figures are somewhat influenced by the inclusion of government deposits), there continues to be a strong preference in the Middle East for currency as against bank deposits. The slow growth of the banking habit is evident. In Egypt and Pakistan, the decline in the ratio of demand deposits to money supply is somewhat affected by the larger growth of "time deposits" which have been excluded from Table 2. In Turkey, on the other hand, while there has undoubtedly been a change in banking habits, the apparent improvement in the 7-year period should be regarded with some reserve, as the increase in demand deposits is presumably related to the large increase in bank credit in that country.

Heavy Concentration on Short-term Credit

Commercial banks throughout the Middle East have their activities heavily concentrated on short-term credit and carry only small investment portfolios. Indeed, in most countries, the demand for short-term loans and advances is so high relative to available deposits that there is little room for other more diversified investments. In December 1954 the ratio[1] of "advances and bills discounted" to deposits was 56 per cent in Pakistan, 64 per cent in Iran, 71 per cent in Egypt, and 86 per cent in Iraq. The situation in this respect is somewhat unbalanced in Syria, Lebanon and Turkey, where advances considerably exceed private bank deposits. The corresponding ratio for Syria stood at 273 per cent, for Lebanon 103 per cent, and for Turkey 127 per cent.

1/ The quoted ratios are liable to some error as in some countries figures of bank investments are not available separately. These investments are, however, known to be small.

Lebanon is in a special position in this respect for it finances a not inconsiderable portion of the transit trade for neighbouring countries. Its additional needs for short-term credit are met by the foreign banks drawing on their head offices abroad and by the use of government deposits for the commercial operations of the BSL. In Syria, the gap between the low level of bank deposits and the substantially larger credit needs of the private sector has been filled in the past in much the same manner as in Lebanon, but the need for measures to raise the level of deposits is apparently more urgent in Syria than in Lebanon. During 1954 and 1955 there was also a large and perhaps excessive expansion of credit to the private sector in Syria, and the monetary authority, the Council on Money and Credit, intervened to arrest this trend. In Turkey, the substantial increase in commercial bank credit is part of the prevailing inflationary situation, supported by central bank accommodation.

Commercial bank credit in the Middle East is mainly related to the financing of foreign trade. Apart from accommodation made available to shippers, banks mostly finance merchants on the pledge of stocks and insist on the usual margins. Most of the advances--nearly 90 per cent-- are secured. The provision of working capital to industrial establishments, although still limited, is growing in importance. While complete and accurate data for an analysis of bank advances are lacking, the following information in respect of Turkey, Syria and Pakistan is illustrative of the general picture:

Table 3. Analysis of Commercial Bank Loans and Advances, December 1954

(Per cent)

Country	Commerce	Industry	Agri-culture	Real Estate	Miscel-laneous	Total
Turkey	59	3 1/	31 2/	7	-	100
Syria	70	13	8	n.a.	9	100
Pakistan (Dec.1955)	65	23	2	3	7	100

1/ Does not take into account advances by the Sumer and Eti Banks (Turkey) to government-controlled industrial and mining establishments. These two Banks are really holding companies.

2/ Includes the operations of the Agricultural Bank which is classified as a commercial bank because of certain normal commercial banking operations it undertakes.

The activities of commercial banks play an insignificant role in most Middle Eastern countries in the financing of agricultural operations or of the marketing of agricultural produce. This is one of the serious drawbacks from which bank operations suffer in the Middle East and some way has to be found to overcome this deficiency (see next paragraph). Furthermore, there is no organized link between the banking systems and the indigenous money markets (mostly money lenders). Agriculturists seek loans mainly for consumption purposes and pay exorbitant rates of interest to money lenders. In view of the undeveloped state of indigenous money markets and the social feeling against money lenders, little attempt has been made to establish a link between them and the banking systems and thus to enlarge the credit base. In the circumstances and appropriately enough, the main reliance in the field of agricultural credit is being placed on special financial institutions and the promotion of cooperatives to the extent feasible.

Bill Markets

Bill markets are in a stage of infancy in most Middle Eastern countries. The small volume of bills held by banks indicates that bills do not play any important role in the short-term money markets. Lebanon, with its strong emphasis on foreign trade, constitutes a notable exception; bank credit in this country is generally related to the discounting of bills. In most Middle Eastern countries there is a need to develop a bill market, and central banks could usefully address themselves to this task.[1] In particular, by a greater readiness to rediscount agricultural bills (possibly at rates more favorable than the normal rediscount rates), central banks could induce commercial banks to provide reasonable facilities for agricultural marketing operations. Such a development would not only enlarge the functions of the commercial banks in a desirable and neglected field, but also enable the specialised agricultural credit institutions (see Section II) to concentrate their activities more on the extension of medium and long-term credit for agricultural development.

Investments in Government Securities

For reasons already explained, Middle Eastern commercial banks do not hold any substantial portfolios of government securities. Pakistan, where, at the end of 1954, commercial bank holdings of government securities constituted nearly 45 per cent of bank deposits, is an exception. Most Middle Eastern countries have not, so far, embarked upon any large scale public debt flotations, and in any event, the scope of such operations would, no doubt, be severely limited by the existing volume of bank advances relative to deposits. This situation suggests that public debt operations, if undertaken, may require considerable support from the central banks.

1/ Pakistan has under consideration an interesting proposal regarding the establishment of "discount houses" for expanding the money market. In essence, the scheme visualises the establishment of discount houses by local firms and moneyed individuals. Commercial banks are to participate in the capital subscription and provide rediscounting facilities at concession rates. The State Bank will in turn provide rediscounting facilities to commercial banks. It is stipulated that discount houses should discount bills of trade but not be allowed to accept deposits. The Planning Board has recommended the scheme to the State Bank of Pakistan for further study. (Source: Pakistan First Five Year Plan, 1955-60.)

Interest Rate Structure

The foregoing survey brings into sharp relief the question of interest rates in the Middle East, from the standpoints both of the stimulus they give to saving and of the cost of credit. Interest rates are generally low within the banking system and high outside of it. The following figures illustrate the general pattern of interest rates on bank deposits and advances:

Table 4. Interest Rates on Commercial Bank Deposits and Advances, Yield on Government Bonds and Central Bank Discount Rates

(Per cent)

Country	Sight Deposits	Time Deposits One Year	Short-term Advances Secured	Government Bonds Yield Dec. 1955	Central Bank Discount Rates Dec. 1955
Pakistan 1/	-	2	$3\frac{1}{2}$ to 5	3.15	3
Egypt 2/		$2\frac{1}{2}$	4 to 6	2.83	3
Turkey	$2\frac{1}{2}$	4	7 + commission 3/	4.77 4/	$4\frac{1}{2}$ 5/
Iraq	-	2 to 3	$4\frac{1}{2}$ to 6	n.a.	$2\frac{1}{2}$
Syria	4	n.a.	6	-	$3\frac{1}{2}$ 6/
Lebanon	1 to $2\frac{1}{2}$	3 to $3\frac{1}{2}$	6 7/ + commission 3 7/ to 5	3	-
Iran	-	$4\frac{1}{2}$	6 8/	-	4
Ethiopia	-	$3\frac{1}{2}$	7	-	-

1/ $1\frac{1}{2}$ per cent on 6-months deposits.
2/ Interest on notice deposits 1 per cent.
3/ Legal maximum rate.
4/ October 1955.
5/ Since raised to 6 per cent in June 1956.
6/ For industrial and agricultural purposes $3\frac{1}{4}$ per cent.
7/ Legal maximum rate. Latest market discount rate 5.23 per cent, Feb. 1956.
8/ Bank Melli rate on 31-day bills. For 45-day bills 7 per cent, and 90-day bills 8 per cent.

The lowest rates prevail in Pakistan and Egypt. The larger banks in the other countries, with the exception of Turkey, Syria and Lebanon, usually pay no interest on sight deposits. In Egypt, the interest rates on notice deposits were reduced in January 1955 by members of the Egyptian Bankers Association from 2-2½ per cent to 1 per cent, and on time deposits from 3¾-4 per cent to 2½ per cent. In view of the almost stationary level of bank deposits in Egypt and the growing needs of the private sector, the propriety of making a substantial reduction in interest rates appears doubtful. It would not be unlikely for interest rates in Egypt to harden in the future, in view of the large development program envisaged and the support which the banking system may be expected to provide to the government's borrowing program.[1] In Syria and Iraq, interest rates have shown a tendency to rise during the last two years and it is believed that the banks were thereby able to attract more deposits.

In general, interest rates are lower in countries where deposits are adequate to meet the short-term requirements of trade and business (e.g., Pakistan, Egypt and Iraq), and higher in countries where the demands of the private sector exceed deposits (e.g., Syria, Turkey and Lebanon). In the latter group of countries the prevailing rates are hardly equilibrium rates, for both in Syria and Lebanon the use of government deposits to meet the credit needs of the private sector considerably eases the shortage of funds; in Turkey maximum rates are fixed by law. In Iraq, too, normal interest rates might have been higher but for the use of the government deposits available to the Rafidain Bank for its commercial advances.

It is at first sight not a little surprising that interest rates should be low in an area where the level of savings is inadequate. The explanation is to be found in the narrowness of the sphere within which commercial banks operate in most countries and the conservative safety margins which are normally required. As the demands for financing exports and imports can be satisfied from available deposits, there has been little need to attract larger deposits by offering higher rates. In the past the ability of the foreign banks to draw on their head offices abroad to meet seasonal needs has also been a contributing factor. This is, however, now of diminishing importance except possibly in Syria and Lebanon. Finally, the governments and central banks in some countries have encouraged a policy of low interest rates by commercial banks.

It is possible to maintain that a higher level of interest rates could attract into the banking system some savings which presently go into landed property, real estate or hoards. This would also have a healthy effect on capital formation. To be effective, however, such a policy might call for such a substantial increase in interest rates as would probably be resisted on political, social and fiscal grounds. In the circumstances, most governments are rather likely to rely on tax incentives for promoting particularly desired industrial and other investments. The effects of such policies, while desirable in themselves, are, however, likely to be limited. The

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1/ Since writing this, interest rates on bank deposits have shown a tendency to rise in Egypt during 1956. It is too early to indicate relevant data as interest rates may take some time to stabilize at any particular level.

existing over-all level of deposits and advances, coupled with the present rate of their growth, suggests the desirability of a suitable increase in interest rates, accompanied by an extension of banking services, if progress is to be maintained without adverse effects on monetary stability. If the rapidly growing needs of the public sector are also taken into account, such action appears clearly indicated. In particular, governments would be well advised to pursue a policy of extending savings banking through their post office systems.1/ It needs to be emphasized that despite the recent improvement, the level of savings in most Middle Eastern countries is inadequately low. On the other hand, because of the general dependence on irrigation for supporting the agricultural economy, capital requirements are larger than in most underdeveloped countries. The need for a higher level of savings is thus obvious. In this connection, it also needs to be emphasized that the maintenance of a reasonable degree of monetary stability constitutes an essential prerequisite to the achievement of a higher level of savings. Inflation is likely not only to divert available savings into real estate, merchandise or hoards, but also to distort the whole pattern of development, thus defeating the very objectives which development is intended to serve.

A final word about the prospects of commercial banks diversifying their investment portfolios and participating in medium-term financing of industry and agriculture. The recent trend in some countries in favor of "time deposits" suggests the possibility that commercial banks may be in a position to satisfy part of the medium-term requirements of the capital market. In view, however, of the presence of government-controlled specialized institutions in this field and of the fact that in the interests of a rapid promotion of industry and agriculture, interest rates are being subsidized, the direct activities of commercial banks in this field, although registering some improvement, appear likely to remain limited.

II. Special Financial Institutions

In view of the absence of capital markets in the Middle East and the limited ability of commercial banks to provide support to agricultural operations and industry, the governments of nearly all these countries have sponsored special financial institutions to fill the need. Many of these institutions are a product of the postwar period and draw their resources from sources other than ordinary bank deposits. Their activities may be judged from the following figures:

1/ Of the eight countries under discussion, only three (Egypt, Pakistan and Iraq) have postal savings banks. The rates of interest on deposits are as low as 2 per cent in Egypt and Pakistan, and 3 per cent in Iraq. Outstanding deposits at the end of 1954 stood at LE 26.4 million in Egypt (against LE 29.5 million in 1948); PRs 329 million in Pakistan; and ID 2.3 million in Iraq. Only Pakistan issues Post Office Savings Certificates.

Table 5. Particulars Regarding Paid-up Capital, Outstanding Loans and Advances and Interest Rates of Agricultural, Industrial and Real Estate Banks

	Year of Establishment	Paid-up Capital ($ mil.)	Outstanding Loans and Advances 1954($mil.)	Rates of Interest on Loans and Advances	Remarks
Turkey				See 1/	
Agricultural Bank	1888	88.9	536		
Industrial Develop. Bank	1950	5.6	49		
Real Estate Credit Bank	1927	41.8	121		
Egypt					
Agricultural Credit & Cooperative Bank	1931	4.3	34.0	(Short-term 5%(a) (Med-term 7%(b)	(a) For cooperatives 3 (b) " " 5
Industrial Bank	1949	4.3	5.7		
Iraq					
Agricultural Bank 2/	1940	5.6	6.2 (c)	5%	(c) March 1954. Loans limited to $8,400 per borrower.
Industrial Bank 2/	1940	7.6	6.7 (d)	4% to 5%	(d) Of these, equity investments $3.2 mil.
Pakistan					(e) Total loans to end of Dec. 1955.
Agricultural Development Finance Corporation	1952	6.3	1.2 (e)	5% (g)	(f) Total loans to end of Dec. 1955.
Industrial Finance Corp.	1949	4.2	16.1 (f)	5% (g)	
Housebuilding Finance Corp	1952	6.3	5.3	5% (g)	(g) Medium and long term loans only.
Iran					
Development Plan Bank 3/		0.7			
Agricultural Bank	1933	7.6	14.7 (h)		(h) Outstand. Feb.1955
Mortgage Bank	1938	3.2			
Ethiopia					
Development Bank (for both Agriculture and Industry)	1951	3.1	3.0	7% for industry (i) 6% to 8% for agricul. (j)	(i) For a maximum period of 7 years. (j) Loans extended only 3 to 5 years.
Syria					
Agricultural Bank 4/	1925	8.5	8.4	3% to 6% (k)	(k) Loans against mortgage of crops carry 6% interest. Other loans adequately mortgaged carry interest at 3% for 1 year and 4% for 2 years.
Lebanon					
Agricultural, Industrial and Land Bank 5/	1954	1.6	1.5 (l)	n.a.	(l) As at end of 1955.

See footnotes on page 17.

Table 5. (Continued)

1/ Agricultural Bank: Long-term credits up to 20 years, 3 per cent; medium-term credits up to 5 years for purchase of agricultural equipment, $2\frac{1}{2}$ per cent; short-term credits of less than one year for financing crops, 7 per cent. Industrial Development Bank: Investment credits, 7 per cent. Real Estate Credit Bank: Credits on small housing construction, 5 per cent; credits on other construction, 7 per cent. In addition to the rates stated, all three banks charge rates of 7 to 9 per cent on commercial loans and commission at accepted rates in the market. All rates are subject to a revenue tax of 15 per cent.

2/ Originally established as the Agricultural and Industrial Bank of Iraq in 1937, the Bank was divided into the Agricultural Bank and the Industrial Bank in 1940. The law regulating this division was not, however, put into effect until 1946.

3/ The Bank was established to be a depository of funds held by the Plan Organization and to carry out its banking transactions. Its charter included the provision of financial assistance to private institutions engaged in production connected with the development program, but the Bank has not been active in that capacity.

4/ It is proposed to raise the paid up capital to about $20 million. Six per cent of the proceeds of the agricultural production tax (yield about $0.5 million annually) would be allocated to the Bank.

5/ Of the loanable resources, two-fifths will be for agricultural credit, two-fifths for industrial credit and one-fifth for real estate mortgages. The institution is expected to obtain accommodation from the BSL up to LL 25 million (not exceeding LL 10 million in any one year), subject to guarantee by the Government.

Agricultural Credit

In the field of agricultural credit, notable advances have been made in Turkey and Egypt. In Turkey, the first agricultural credit institutions were small local cooperative banks which merged in 1888 to form the Agricultural Bank of Turkey. This is perhaps the oldest local credit institution in the area. With its present 418 branches and agencies, the Bank has made an effective contribution to the development of agriculture. Its activities have undergone a marked expansion since World War II, when Turkey undertook an active program of agricultural expansion, accompanied by land reforms. The credits extended by the Bank and the cooperatives which it supports rose from LT 31 million in 1937 to LT 641 million in 1951 and LT 1,961 million in 1954. A considerable portion of this credit is in the form of crop loans. In addition to the Agricultural Bank, the Agricultural Equipment Establishment, the capital of which is provided by the Government, supplies cultivators with equipment on credit. Between 1950 and 1953, it financed the purchase of tractors (11,011), harvesters (2,261), fertilizers, etc., of a total value exceeding LT 200 million.1/

In Egypt, the Agricultural Credit and Cooperative Bank in 1931 took the place of the Agricultural Bank of Egypt (established in 1902), which ceased operations in 1930 as a result partly of the difficulties arising from the Five Feddan Law of 1913 which forbade foreclosures in respect of ownership of land of five feddans or less, and thus made it impossible to grant credit on the security of such small holdings. The new bank was exempted from these limitations. For its working capital the Bank depends upon a special appropriation of LE 9 million made available to it by the Government at a special rate of 1 per cent, and upon loans from the National Bank of Egypt. The bank's loans and advances have been steadily increasing in recent years; they amounted to LE 16.4 million in 1953, LE 17.4 million in 1954, and LE 19.5 million in 1955. The bank's operations are, however, heavily concentrated upon short-term advances, and in each of the years referred to its medium and long term loans were less than LE 0.5 million. Most of the advances are related to the supply of fertilizers, improved seeds and other agricultural equipment. Over the years, the bank has made a significant contribution to the raising of agricultural productivity. In addition, it undertakes the procurement of cereals on behalf of the Government which, in the main, are not financed by commercial banks.

The provision of agricultural credit has, so far, received inadequate attention in the other countries. The financial institutions that have been set up are of recent origin and, considering the complexity and magnitude of the task involved, it will be some time before they are able to extend their activities significantly. The absence of an active cooperative movement in most countries further limits the ability of these institutions to reach the agriculturists. Some of these institutions have also been confronted with legal difficulties in making medium and long term loans on the security of land. In a number of cases the existing enactments were intended

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1/ Economic Developments in the Middle East, 1945 to 1954, United Nations Supplement to World Economic Report, 1953-54.

to save landowners from being expropriated of their land by moneylenders; they have, in fact, made it impossible to negotiate loans. Suitable changes are being made to exempt the new institutions from such technical and legal difficulties.

While the basic factor restricting agricultural production is the very low capital investment in land, experience shows that the mere establishment of financial institutions for the purpose may not by itself be enough. In order to make the operations of financial institutions really meaningful, it is equally important to carry out comprehensive programs of agricultural development and to introduce agricultural extension services. To persuade the villager to seek greater efficiency, to use new methods, fertilizers, improved seeds, etc. is not only a technical and a banking problem, but also a social one.

Industrial Credit

In the field of industrial finance, the new institutions (almost all of which have been established within the last eight years) have done fairly useful work within the limitations imposed by circumstances in which they operate. In some countries, e.g., Iran and Iraq, the availability of financial resources in the hands of the public authorities and the concentration of industrial development in the public sector have limited the scope of the operations of the new institutions.

In Turkey, official policy in recent years has been moving away from "etatism" (state capitalism) to the encouragement of private investment. To this end, the Industrial Development Bank was established in 1950; it is under private control and makes available loans and expert advice to industrial undertakings. Part of its capital was privately subscribed and the rest borrowed from the central bank or made available from U.S. aid (Marshall Plan counterpart funds); in addition, loans in foreign exchange ($18 million) were made available by the IBRD. This interesting experiment seems to be proving remarkably successful; the Bank's outstanding loans stood at $49 million in 1954, and 266 enterprises had benefited by its operations.

Reference has already been made to the activities of the Bank Misr in Egypt. In 1954 its equity investments stood at LE 10.8 million. The activities of the newly established Industrial Bank have, so far, been limited. In Pakistan, while the volume of loans made by the Industrial Finance Corporation has not been large, this has not been a factor limiting industrial expansion, for nearly $250 million has been invested in privately owned industrial establishments in the last seven years. The Government of Pakistan is contemplating the establishment of a private industrial bank on the Turkish model with the assistance and cooperation of the International Bank.

A few aspects of industrial finance in the Middle East deserve mention. First and foremost, it is important in most countries to overcome the shyness which limits the participation of private capital in industrial ventures, and to build up an enterpreneur class. In order to attract private capital into the industrial field, it may be necessary in some cases for the State to sponsor certain projects itself in association with private capital, or to admit private capital after the projects have started functioning. The experience of Pakistan in this respect has been valuable. Second, in most countries, the financial institutions should be well equipped to offer technical advice to the projects they are expected to finance.

Finance is an important factor limiting the scope of the activities of both Agricultural and Industrial Banks. Being unable to attract sufficient deposits or to borrow in the local markets, these banks have looked mainly to their governments or central banks for financial assistance. In essence, therefore, their activities have to depend mostly on central bank credit which has to be rationed within an over-all program of development. In such a situation, the utilisation of the local currency proceeds of U.S. commodity aid programs, which are available to most countries in the Middle East, could provide a valuable base for the provision of agricultural and industrial credit on a more adequate scale than is presently the case. The basic problem of developing capital markets needs, in any case, to be tackled in order to achieve self-reliance in the long run. This question is essentially linked up with the establishment and growth of savings institutions, e.g., savings banks, life insurance institutions, investment houses, in which nearly all Middle Eastern countries are deficient, and to which increasing attention needs to be given. Furthermore, the special financial institutions which have been set up have so far been content to play the role of a distributive agency. It is perhaps time that, instead of merely looking to their governments or central banks for financial support, they should also make a serious effort to attract time deposits and tap the money markets, as far as possible, at suitable rates of interest.

III. Central Banking

Central banking in the Middle East is of recent origin, most central banks having been established within the last fifteen years.1/ The principal need in most countries was for agencies to manage the currency and foreign exchange reserves, act as banker and creditor to governments, and promote the growth of banking. This was met in Iran and Ethiopia by the establishment of banks to perform both central banking and commercial banking functions. In Syria,2/ until recently, and in Lebanon, limited central

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1/ Central Bank of the Turkish Republic 1931; Bank Melli Iran 1928; Bank Da Afghanistan 1941; State Bank of Ethiopia 1942; State Bank of Pakistan 1948; National Bank of Iraq 1949 (now called Central Bank of Iraq); National Bank of Egypt 1951 (de jure status as central bank).

2/ Until the establishment of the new central bank (September 1, 1956), the Council on Money and Credit determined monetary policy. Exchange reserves were kept by the Exchange Office.

banks, is also entrusted with central banking functions, can hardly be expected to function smoothly at all times. Furthermore, such an arrangement cannot inspire the necessary confidence in the banking system as a whole. It is perhaps partly with such considerations in mind that Syria has established a separate central bank, the Central Bank of Syria, with effect from September 1, 1956. The speeches made at the time of the establishment of this bank also suggest, however, that a full-fledged central bank has come to be regarded as one of the hallmarks of national sovereignty and independence.

Lastly, in regard to the wider question of the maintenance of monetary stability, as the concluding portion of this paper indicates, monetary and price stability has, with a few exceptions, so far, been fairly well maintained in the area. The main expansionary trends in some countries stem from large government outlays on economic development (mostly on long-term schemes of basic development), unaccompanied by a commensurate growth in real savings and an adequate inflow of capital. In the circumstances, heavy reliance has been placed in some countries on central bank financing of development expenditures. Except in the oil-producing countries, this is likely to remain the key problem facing most central banks in the Middle East. It is pertinent that under the stress of this problem and profiting from the experience of the last few years, most governments and central banks are beginning to give increasing attention to the formulation of more definite monetary policies involving closer coordination in the fiscal and credit fields.

<u>Currency Management</u>

The statutes of most central banks in the Middle East require the maintenance by the central bank of proportional reserves of gold and foreign assets (see Appendix II). On the whole, these reserve requirements permit as much flexibility as is consistent with the maintenance of currency stability. The locking up of minimum reserves in the manner required by these statutory limitations may impose a rigidity upon the currency system which in certain emergencies might be harmful, especially in countries such as those in the Middle East, where current exchange earnings are likely to be affected by wide fluctuations in production and in prices. There is a certain lack of logic in a rule which forbids the use of reserves for the purpose for which they have been accumulated, the protection of the value of the currency. In the circumstances and in order to provide for necessary flexibility in the note issue, the reserves actually held must in practice usually exceed the prescribed minimum. However, in countries where the masses of the population are illiterate, prudence requires that special precautions shall be taken to establish and maintain their confidence in the note issue; the legal reserve requirements are apparently intended to provide the assurances necessary for this purpose. In Iraq, the minimum cover in gold and foreign exchange is as high as 70 per cent; in view, however, of Iraq's growing oil reserves, this requirement is not likely to affect the flexibility of the note issue. In some countries a temporary suspension of the statutory requirements is permitted in certain circumstances. The provision, embodied in the statutes of Pakistan and Lebanon, which permits the central bank to include short-term commercial and agricultural bills as part of its statutory reserve, not only permits flexibility in the note issue and in bank credit, but also encourages the development of a bill market.

Commercial Bank Reserves, Open Market Operations, Discount Rates, etc.

Except in Lebanon and Ethiopia, the commercial banks are required to maintain minimum reserves with their central banks. These minimum reserves vary from 2 per cent on "time deposits" and 5 per cent on "demand deposits" in Pakistan to about 15 per cent in the other countries (details in Appendix III). In prescribing reserve ratios, most countries draw no distinction between "time" and "demand" deposits; with the growth of time deposits, such a distinction may be desirable. The reserve requirements have not, so far, been put to any effective use as a tool of monetary policy and their primary objective has been to ensure safety of deposits and bank liquidity. In a few cases, however, the ratios have been varied; reserve requirements in Syria were raised from 10 per cent to 15 per cent in 1955 when commercial bank advances showed an undue increase, and in Egypt they were lowered from 15 per cent to 12½ per cent in 1954 when commercial banks were in need of larger funds. In Iran, interest of 1 per cent is allowed on bank reserves, and in Iraq one-third can be lodged in the form of government securities. In Turkey, bank reserves are deposited with the Amortization Fund1/ which uses them for the financing of state-owned enterprises, a practice which is scarcely consistent with the purpose for which such reserves are required. In view of the limited use made of the discount rate by Middle Eastern countries and the narrow scope for open market operations, variable reserve ratios could be used by central banks as an instrument of monetary policy with considerable effect. This suggests a wider and more flexible delegation of powers to central banks in prescribing reserve requirements as the needs of the situation warrant.

In some of the Middle Eastern countries, commercial bank advances undergo a marked seasonal variation, which is greatest in the winter months (October-March). On the other hand, bank liquidity is highest in the period April-August. The banks are thus in need of some accommodation from the central banks in the busy winter months and need suitable avenues for short-term investments in the slack season. Egypt and Pakistan (and to some extent, Iraq) are typical instances. Ordinarily, open market operations and the availability of Treasury bills could play a useful role in such a situation because of the automaticity with which the seasonal stringency of funds could be relieved in the winter months and short-term investments provided in the slack season. However, because of the absence or narrowness of government security markets, which itself is mainly due to the low level of bank deposits, open market operations are at present not of any significance except perhaps in Pakistan. Treasury bills are issued in Egypt and Pakistan, but their volume is limited. The low rates of interest at which Treasury bill tenders are accepted may have been partly responsible for the low offerings by commercial banks. In these countries, there is some further scope for developing Treasury bill markets, provided interest rates are suitable, but at least for the time being, the development of such a market would be intended to meet the needs of the short-term money market rather than to satisfy the governments' cash requirements. In most other countries, i.e., Lebanon, Syria, Turkey, the issuance of Treasury bills does not, in present circumstances, appear feasible.

1/ The banks have the option of depositing their reserves with the Amortization Fund or investing them in government bonds. They have preferred the Fund as this enables them to earn a higher return.

Minor Role of the Discount Rate

The discount rate[1] has, so far, played a minor role in most Middle Eastern countries. While a few changes in the rate have been made in certain countries, its significance as an instrument of monetary policy has not been important. For one thing, the short term money markets in the area are hardly analogous to their counterparts in more developed countries, and for another, the very nature of commercial bank operations in the Middle East, with their heavy emphasis on the export sector, does not call for the frequent use of the discount rate. Thus, in Pakistan, Iraq, Iran and Ethiopia, the discount rates have not undergone any change in the postwar years. In Egypt, except for a few months in 1952 (July/October) when the discount rate was raised by 1/2 per cent, it has remained unchanged at 3 per cent since 1951 when the National Bank of Egypt began to quote a rate. In Syria, the discount rate was raised on a selective basis in 1955 from 3 per cent to $3\frac{1}{4}$-$3\frac{1}{2}$ per cent, but the increase was not large enough to be fully effective. In Turkey, it was raised from 3 per cent to 4.5 per cent in June 1955 and to 6 per cent in June 1956. In view, however, of the somewhat deep-seated inflationary situation in Turkey, an increase in the discount rate is hardly likely to be effective unless accompanied by other far-reaching measures involving a cutback in investment, deficit financing and the over-all volume of credit.

The generally low discount rates in the Middle East are a reflection of the low interest rate patterns within the banking system and are indicative of a desire to follow cheap money policies. There is thus a conflict between the provision of cheap credit (including the governments' own credit needs) and the need to stimulate savings. In the light of the earlier discussion on interest rates, it may be useful for central banks to review their discount rate policies. For the promotion of development with stability, the balance of advantage seems to be with policies which promote a larger flow of savings, and to that extent less reliance on central bank financing.

The traditional weapons of monetary policy cannot in present circumstances be expected to play any significant role in Middle Eastern economies. In the circumstances, the main reliance in controlling credit will continue to be placed on measures of selective credit control.[2] Within these general limitations, the recent fall in bank liquidity in most countries, however, suggests that variable reserve ratios and changes in discount rate (whenever considered necessary and appropriate) are henceforth likely to prove more effective than they might have been in the past.

1/ For prevailing discount rates, see Table 4.

2/ This has reference to the use of selective credit controls as purely short-term expedients. For the general use of such controls in developing economies, see I. G. Patel, "Selective Credit Controls in Underdeveloped Economies," International Monetary Fund, Staff Papers, Vol. IV, No. 1 (September 1954), pp. 73-84.

Banking Control

Banking control is exercised on a limited scale in most countries, but increasing attention is being given to it in view of the recent establishment of a number of local banks, some of which have given indications of unsound banking practices. In most countries, commercial banks are required to render periodic returns of their affairs to the central banking or monetary authorities. In a number of countries there is a need for comprehensive banking legislation independent of the company laws which presently also apply to banks. Pakistan has partially met the deficiency through a special law (the Banking Companies' Control Act), which vests in the State Bank wide powers of inspection and banking control in order to ensure the development of sound banking practices. Iraq, and more recently Syria and Iran, have passed comprehensive legislation to regulate the establishment and activities of commercial banks. Encouragement of the growth of sound commercial banking throughout the economy is a subject which needs greater attention on the part of central banks in the Middle East.

General Appraisal of Monetary Situation

The statutes of most central banks in the Middle East place particular emphasis on maintaining the value of currencies and the maintenance of monetary stability. An evaluation of the position in this respect would embrace the whole field of fiscal operations, balance of payments and monetary policy. The following figures for the years 1948-54 relating to money supply and the activities of the banking system are illustrative of the general picture:

Table 6. Money Supply, Volume of Bank Advances to the Public and Private Sectors, Movement of Gold and Foreign Exchange Reserves, Price and Cost of Living Indices, 1948-54

(Money Supply and Bank Advances in millions of U.S. dollars[1/])

Country	Money Supply 1948	Money Supply 1954	Increase (%)	Commercial Bank Claims on Priv. Sec. 1948	Commercial Bank Claims on Priv. Sec. 1954	Commercial Bank Claims on Government 1948	Commercial Bank Claims on Government 1954	Central Bank Claims on Government 1948	Central Bank Claims on Government 1954	Increase (+) or Decrease (-) in Gold and other foreign assets 1948-54	Index of Wholesale Prices 1948 (1953 = 100)	Index of Wholesale Prices 1954 (1953 = 100)	Cost of Living Index 1948 (1953 = 100)	Cost of Living Index 1954 (1953 = 100)
Turkey	611	1382	126	297	1333	102	210	281	555	-64	93	112	89	110
Egypt	1071	1030	-2	244	445	17	29	34	132	-366	93	97	95	96
Pakistan	570	806	41	86	207	n.a.	129	53[2/]	306	-467[3/]	n.a.	n.a.	89	94
Iran	166	312	88	58	107	-	-	76	150	-60	89	118	94	118
Iraq	137	179	31	17[2/]	70	10	5	17[2/]	28	+75	125	96	137	98
Syria[10/]	86	123	43	45	123	26	11	53	67	+27	-	-	100[7/]	89[8/]
Lebanon	118	188	59	69[4/]	124[4/]	n.a.	n.a.	n.a.	n.a.	+ 1	128	92	114	95
Ethiopia[5/]	37	62	68	4	5[6/]	-	-	13	28[6/]	+33	88[9/]	76[9/]	n.a.	n.a.

1/ See footnote 1/, Table 1.
2/ 1950.
3/ The decline includes also the loss occurring because of the devaluation of sterling and the Indian rupee in September 1949.
4/ May include advances to public institutions and government.
5/ Data for State Bank of Ethiopia.
6/ 1953.
7/ 1949.
8/ Retail price index.
9/ Averages of export and import price indices for 1950 and 1954.
10/ Figures are for 1952 and 1954.

Sources: International Monetary Fund, International Financial Statistics; Syrian Council on Money and Credit; Syrian Monetary Agency; State Bank of Ethiopia.

Price trends in the Middle East in the postwar period have necessarily to be considered in the light of war-time developments. During the war almost all Middle Eastern countries experienced inflation, to a greater or lesser extent, due to the increased pressure on domestic resources unaccompanied by any corresponding inflow of supplies. This increased demand took the form of heavy direct military expenditures or purchases by the armed forces and larger export surpluses resulting from increased demand for their products. Various forms of price and other controls were attempted but these failed to prevent substantial price increases. By 1948, however, the cost of living was rising less steeply and a reasonable degree of price stability was restored. Larger availabilities in the postwar period, coupled with the availability of substantial exchange reserves accumulated by most countries during the war, helped restore prices (which during the war had risen from three- to tenfold) to a level more in line with world prices. The raw materials boom in 1950 and 1951 (resulting from the Korean War), which also affected import prices, again introduced inflationary pressures for a time, but by the middle of 1952 its effects had subsided. During this period a number of countries increased duties on raw material exports in order to minimise the inflationary impact of the commodity boom.

In more recent years, it appears that, except in Turkey, where a fairly serious inflation continues, monetary stability has been fairly well maintained in the area. The volume of bank advances to the private sector has, in general (and with the exception of Turkey), supported the genuine needs of expanding economies. In countries where money supply has risen at a fast pace, this has been accompanied by substantial central bank financing of public expenditures (Turkey, Pakistan and Iran).

More specifically, in Egypt, Iraq, Syria, Lebanon and Ethiopia there has been a remarkable degree of monetary stability in the period. Iraq has enjoyed the happy position of being able to finance its large public outlays almost entirely from her growing oil income. Thus, while the money supply has increased, it has been possible to maintain price stability ever since 1952 through a liberalisation of imports. Prudent fiscal and commercial bank policies and ability to draw on large exchange reserves accumulated during the war have also enabled Egypt to maintain monetary and price stability during the period under review. As in some of the other countries, the task of monetary management is likely to become more difficult in Egypt, once the development program gets under way and the exchange reserves are depleted.

In Syria there was a considerable expansion of commercial bank credit in 1954 and 1955, which, coupled with a bad harvest, seemed to threaten monetary stability. Although price stability was maintained, this was achieved at the expense of a large use of exchange reserves. Bank advances were in no small measure related to consumer installment credit. The Council on Money and Credit took measures, including selective credit control, imposition of margins on the opening of letters of credit and a slight increase in the discount rate, to meet the situation. As a result of these measures and a better harvest in 1956, the position has since been restored to normal. In Pakistan, substantial government outlays on development, accompanied by public debt operations financed by the banking system, including the central bank, have been the main factors leading to an increase in money supply. In the initial stages, monetary stability was maintained by drawing on sterling balances, but as these were depleted, prices of consumer goods began to rise substantially during 1954. The situation has since been relieved by U.S. assistance and rising domestic production. In Iran, as well, substantial budgetary deficits financed by central bank accommodation have been the main cause of the inflationary trend. The situation has since improved as a result of U.S. assistance and the resumption of oil production.

The foregoing survey indicates that the record of the monetary authorities in maintaining monetary stability has, with one or two exceptions (viz. Turkey), been satisfactory. As stated earlier, the main threat to monetary stability arises or is likely to arise from too rapid programs of expansion undertaken by the public authorities. This essentially involves a task of matching projected outlays with available resources, both domestic and foreign. To lift the level of real savings by a combination of fiscal and monetary policy is part of this problem. The central banks in various countries have repeatedly drawn attention to the dangers inherent in the public authorities undertaking programs more ambitious than the availability of real resources. As to whether the voice of the central banker would prove effective remains a question, but in any case a more effective coordination of fiscal and monetary policies appears indicated. Amidst the understandable urge for economic and social development, it is a realism on the part of the fiscal authorities and the level of foreign aid which are likely to be the principal factors in maintaining economic development with monetary stability and thus avoiding social discontent.

APPENDIX I.

Money Supply and National Income, 1954

Country	Currency	Money Supply end of year (Millions)	National Income Estimates (Millions)	Money Supply / National Income x 100
Turkey	LT	3,869	14,326	27
Egypt	LE	359	855	42
Pakistan	PRs	3,859	18,156 1/	21
Iran 2/	Rls	12,280	122,800	10
Iraq 2/	ID	47	152	31
Lebanon	LL	608	1,192	51
Syria	LS	435	1,611	27
Ethiopia 3/	Eth$	154	2,200	7

1/ Year ending March 31, 1954.
2/ 1949.
3/ 1952.

Source: Money Supply: International Monetary Fund, International Financial Statistics; Syrian Council on Money and Credit; State Bank of Ethiopia.
National Income: Pakistan, State Bank of Pakistan; Iran, Iraq, United Nations Statistical Office, National and Per Capita Incomes of Seventy Countries in 1949; Syria, International Monetary Fund Document No. SM/56/5; Turkey, Lebanon, United Nations Statistical Office, Statistics of National Income and Expenditure, May 1956; Ethiopia, State Bank of Ethiopia; Egypt, Republic of Egypt, The Budget Report for the Year 1956/57.

APPENDIX II

Currency Cover

Country	Minimum Legal Provisions	Actual Positions Dec.31, 1955	Remarks
Turkey	None.	-	No legal limitation on note issue. Volume of notes issued determined by Board of Directors of Central Bank of Turkey.
Egypt	Note issue must be covered by an equivalent holding of gold, foreign assets and government paper.	Gold and foreign assets 68%; government paper 32%.	The proportions of the components of the note cover are not fixed; they are subject to agreement between the National Bank of Egypt and the Ministry of Finance.
Pakistan	30% in gold, silver, sterling or approved foreign exchange; balance in rupee coin, government and commercial paper eligible for purchase by the State Bank of Pakistan.	Gold and approved foreign assets 57%; domestic assets 43%.	Gold and foreign assets in the statements of the State Bank as being held by the Reserve Bank of India pending their physical transfer are included in monetary reserves.
Iran	40% in gold and foreign assets, balance in government paper and Crown Jewels.	Gold 38%; foreign assets 2%; government paper 60%.	Of the gold and foreign assets, a minimum of 87.5% must be in gold; the foreign assets must be freely convertible in gold. Increase in currency above level of June 29, 1954 limited to increase of the equivalent of $30 million in gold and foreign assets.
Iraq	70% in foreign assets; balance in Iraqi government securities.	Foreign assets 85%; gold 6%; government securities 9%.	The law does not provide for gold as a component of the cover. The Central Bank has, however, recently begun to acquire gold.
Syria	30% in gold and foreign assets; balance in government and commercial paper.	Gold and foreign assets 23%; government obligations and guarantees 77%.	This requirement is recent, and pending attainment of the 30% level, law permits a minimum of 10% in gold and foreign assets.
Lebanon	50% in gold and foreign assets; balance in Treasury bonds and commercial paper.	Gold 95%; Treasury bonds 5%.	A minimum of 30% of the total cover must be in gold.
Ethiopia	30% in gold, silver and foreign assets; balance in Treasury bills.	Gold, silver and foreign assets 51%; Treasury bills 49%.	

APPENDIX III

Reserve Requirements of Commercial Banks

Country	Minimum Reserve Requirements	Position on Dec. 31, 1955	Remarks
Turkey	Government paper and deposit with central bank equivalent of 20% of demand, time and savings deposits.	n.a. 1/	May be increased to 25%.
Egypt	Deposit with the National Bank of Egypt equivalent to 12½% of private deposits.	23%.	-
Pakistan	Deposit with State Bank of Pakistan equivalent to 5% of demand liabilities and 2% of time liabilities.	7% of total demand and time liabilities (excluding inter-bank transactions).	These reserve requirements apply to scheduled banks and they hold a preponderant share of private deposits.
Iran	Deposit with the Bank Melli Iran equivalent to 15% of demand deposits and 5% of time and savings deposits. (Reserves bear 1% interest.) These requirements do not apply to the Commercial Department of the BMI. Foreign banks have separate ratios determined by the Bank Control Board.	Deposits of commercial banks with the BMI were 65% of the banks' total demand and time deposits. 2/	In addition, a commercial bank's short-term assets, including credit with the BMI, must not be less than 40% of its short-term liabilities. This provision applies to the Commercial Department of the BMI.
Iraq	Deposit with the Central Bank of Iraq equivalent to 15% of private deposits.	24%.	A minimum of 66.67% of the reserves must be in Iraqi currency; balance in Iraqi government bonds.
Syria	Cash in till plus deposit with the Bank of Syria and Lebanon equivalent to 15% of demand deposits.	29%.	There are no reserve requirements for time and savings deposits.
Lebanon	None.	n.a.	No regulations covering reserve requirements.
Ethiopia	None.	-	The State Bank of Ethiopia, which is the central bank, holds over 90% of private deposits.

See footnotes on page 32.

APPENDIX III (Continued)

1/ Commercial banks' deposits with the Central Bank and their total holdings of government paper added up at the end of 1955 to 28 per cent of their deposit liabilities. But this percentage does not reflect correctly the position of reserves held against deposits, since the total of government paper also includes reserves that are maintained against legally required capital reserves. Separate data on reserves maintained against deposits alone are not available.

2/ Judging by the requirements of the private sector in Iran and the high interest rates prevailing outside the banking system, the level of excess reserves on deposit with the Bank Melli is somewhat surprising. Apparently, however, prospective borrowers do not have an adequate security to offer and the newly established commercial banks are unwilling to take undue risks.