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## Banking in Iraq in Relation to Economic Development

The main object of this study is to explore and examine some of the ways which might enable the banking institutions in underdeveloped countries in general, and in Iraq in particular, to play a more effective part in the promotion of economic development. In the first chapter some important economic and social aspects of Iraq are displayed. In the second chapter some examination of the experiences of the Iraqi monetary authorities is made. The banking institutions in Iraq, i.e., the commercial and specialised banks, together with the central bank are discussed in chapter three. In this chapter, the possible contribution of the commercial banks in the promotion of economic development by providing medium and long-term loans to agriculture and industry is discussed. In addition, the possible ways in which some of the specialised banks might increase and improve their services are presented. In chapter four the device of deficit financing is applied to a model which represents underdeveloped countries in general. Chapter five offers an application of the device of deficit financing as shown in the model, adjusted to suit the circumstances prevailing in Iraq. Chapter six presents a consideration of the balance of advantage and disadvantage which may be thought to apply to the use of the device of deficit

financing, especially when it is agreed that one of the possible outcomes is inflation. This is followed by chapter seven where the conclusions and recommendations reached in the light of the study are set out. We then have six appendices, including a statistical one.

The main conclusions are:

1. It may be worthwhile for monetary authorities to consider, very carefully, the possibility of using the device of deficit financing, under certain conditions and within specified limits.
2. In calculating changes in prices the categories of the Quantity Theory of the Value of Money can be usefully employed, particularly if an attempt is made to introduce dynamic elements into the Fisher framework, as is done in this study.
3. It need not be held that moderate inflation must, necessarily, turn into high and hyper-inflation.
4. The commercial banks in under developed countries should give favourable consideration to the making of medium and long-term loans to agriculture and industry.
5. Under normal conditions, particularly of international trading, Iraq may be thought to be in a more favoured position to adopt the suggestions set out in (1) and (4) above, than most other underdeveloped countries. These are perhaps all the more significant for Iraq in that the natural resource, oil, which provides opportunity, is a diminishing or wasting asset.

BANKING IN IRAQ IN RELATION  
TO ECONOMIC DEVELOPMENT



BANKING IN IRAQ IN RELATION  
TO ECONOMIC DEVELOPMENT

A Dissertation Presented

by

ABDULJAWAD NAIEF ALI

B.A. Eco. Baghdad, 1962  
for the Degree of Ph.D of the  
University of Durham.

Durham

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## INTRODUCTION

When an underdeveloped country wishes to execute a programme of economic development, it must consider :-

- (a) The nature and extent of the resources, human, natural, financial ... etc., at its command.<sup>(1)</sup>
- (b) The extent of the minimal programme which it will be expedient as well as desirable to aim at.
- (c) The measures which are open to it to mobilise and utilise the resources which are needed to carry out the programme. In this connection it will no doubt - for this will be likely to hold good of even the least advanced countries which are sufficiently developed and alive to the problems of economic progress - use monetary devices for attaining command over the real resources required.

It will therefore be likely to consider the quantity of funds which will be required to execute the total plan, and the proportion of the funds required, likely to be made available through

- (a) taxation
  - (b) loans (1) internal<sup>(2)</sup> (11) external
  - (c) aid
  - (d) net exports.
- It may well be that the total of funds so thought likely to be available will not equal the total financial outlay required for the programme as envisaged.<sup>(3)</sup> The planning authority must then consider two alternatives :-

- (a) Cutting down the size and quality of its proposals.
- (b) Seeking ~~some~~ means of supplementing in other ways the funds required.

If it should be thought that the programme cannot be cut down without being made inefficient and inadequate, then attention must

---

(1) It may be suggested that a similar need faces any one entering upon a discussion of the subject which is presented in this dissertation. Just as the developing authority must know the facts about the economy which it intends to alter in a significant degree so the observer must know the facts about the economy which is the subject of his considerations. It is for this reason that a good deal of space has been devoted in "chapter one" of this dissertation to the significant physical, economic and social facts of the Iraqi economy.

(2) It will be evident that internal loans will have a close relation to the volume of domestic savings, though that relation may well be far from a simple one.

(3) In addition, of course, to the funds required for normal budgetary purposes.

be given to (b). It will be seen that (b) is reducible to the planning authority financing the minimum required increment of its needs by obtaining credit from its central bank, i.e. by deficit financing. It is thought that these are the conditions and circumstances which apply to Iraq, and it is the purpose of the forthcoming pages to examine the consequences of deficit financing both generally and as applied to the special circumstances of Iraq. It is advocated in this study that the central bank should be the institution to provide part of the funds needed to carry out development programmes.

The commercial banks in Iraq, following the British banking traditions, do not provide, usually, long term credit for agricultural or industrial investment. Therefore, part of the purpose of this study is to examine the possibility of providing long-term credit by commercial banks in Iraq to promote industrial and agricultural investment. The importance of this point could be illustrated if we notice that at the end of 1962, total private savings amounted to (I.D 60.963 mn.) in the form of savings accounts and deposit accounts, which form more than 1/9 of the national income of that year.<sup>(1)</sup> It may be suggested that this is an indication that the commercial banks might use a greater proportion of the funds placed at their disposal by depositors without necessarily infringing the rules of cautious banking: it might be said that either the commercial banks are acting in an excessively cautious manner or that they are missing an opportunity. Then, after discussing the possible contribution of the central and commercial banks in the promotion of economic development; the possibility of a further and more effective contribution of the specialised banks in Iraq is examined. The crux of the problem therefore is to examine, critically, the extent and the methods through which the banking system might be able to contribute to the promotion of economic development in Iraq.

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(1) The Central Bank of Iraq (C.B.I.) Quarterly Bulletin April-June, 1964, and page (48) of this dissertation.

It is not the main aim of this dissertation to concentrate the analysis on the theoretical or all the practical aspects of the monetary and fiscal policies which may be involved. The main object is to examine whether it seems possible or <sup>not</sup> met for the banking system in Iraq to contribute to the economic development of Iraq; and if it does seem possible, which methods should be followed and what, broadly, the possible consequences of using these methods might be. Some consideration will be given in addition to the possibility of applying these methods, with certain adjustments to "underdeveloped" countries, considered generally. Nevertheless, the monetary policy in Iraq is touched upon in those parts of the dissertation where the functions of the central bank of Iraq are discussed. It is through this bank that, whether in connection with the financing of development programmes or whether in connection with the more ordinary and general transactions of the community, that the general oversight and co-ordination of the monetary affairs of Iraq will generally be effected.

It may be safe to say that, although a fair amount has been written about the Iraqi economy in general and the monetary policy and institutions in particular, no study has been made, as far as the present writer knows for the sole purpose of examining the possible contribution, if any, of the banking system in the promotion of economic development. Iraq like other underdeveloped countries, needs capital funds in order to carry out development programmes, and therefore, it is of great importance, whether for Iraq or for other underdeveloped countries, to exploit and consider every possible way through which part of the needed funds might be raised. Consequently, if there is a possibility that the banking system might be able to provide the required funds through a provision which eventually recognisably emerges as deficit financing, and the advantages of using this method under certain conditions and circumstances, outweighed the disadvantages, as this study aims to show, it may be well to consider this possibility to its utmost limit.

While emphasis is placed upon this aspect of banking in the dissertation, and is indeed one of its main concerns, the other and more routine aspects of banking activity are not forgotten. The banks of the banking system as a whole are recognised as conducting the usual activities of banking - receiving deposits, providing cash to their customers as required - making loans and the like: these more usual activities of banks have a constructive auxiliary contribution to make to the economy of a country: the emphasis which is placed upon the provision of credit by the central bank by way of deficit financing is explained by the fact that this procedure is identified in the dissertation as a particular instrument by the use of which economic development programmes could conceivably be helped along. The device is to be used under certain conditions and within specified limits. A model representing underdeveloped countries in general where this device is used, is presented in this dissertation. It is suggested that this model could be adjusted to represent any particular underdeveloped country. Since this dissertation is mainly concerned with Iraq, the use of deficit financing in the light of the circumstances prevailing in Iraq is therefore examined. If the Iraqi authorities should decide to use this device, then it is expected that as a result of the spending of funds provided through deficit financing certain changes will tend to take place. Distributed incomes will tend to increase and in turn, demand for domestic and imported<sup>(1)</sup> consumer's goods, other things remaining the same, will tend to rise. It is expected, and the reasons for this expectation are presented in the model, that producers of domestic goods will try to increase their production to meet part or all of the increase in demand. In trying to do so, it is argued in the model, they will have to train more unskilled labourers, or bid <sup>labour</sup> away from other sectors by e.g. offering higher wages. This train of events is expected to take place during the period when the funds provided through deficit financing are being spent. Moreover, these funds are to be spent on

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(1) The increase in demand for imported goods includes consumer's as well as capital goods, as is shown later.

setting up factories (clothing factories in our model), and workers, managers and other personnel will be needed to run these factories. It is necessary, therefore, to have an adequately full and clear idea about important aspects of the Iraqi economy, aspects such as, manufacturing industry, agriculture, transport, and the like. Furthermore, it is even more important to know something about population, education, and health conditions in order to make an assessment of an important factor of production i.e. labour. In order to give an idea about the structure of the Iraqi economy, the purchasing power and the standard of living of the Iraqis, the national income, regional distribution of this income, and national income per capita are discussed in some detail.

As a result of the use of deficit financing the public debt is expected to, other things remaining equal, increase. Therefore the size of the Iraqi public debt compared with the public debts of a developed country (e.g. the United Kingdom) and an underdeveloped country (e.g. Turkey) is discussed. Demand for imported consumer and capital goods is expected to increase as a result of the use of deficit financing, other things remaining the same, and consequently the demand for foreign exchange will tend to rise. The major source of foreign exchange in Iraq is oil revenues, therefore, a good deal of attention, mainly in the first chapter, is given to the development of oil production, the growth of the associated oil revenues, and the confidence that may be placed in their continuation. Moreover, under certain conditions and relationships between money in circulation and the supply of goods, a degree of inflation is expected to emerge,<sup>(1)</sup> as a result of the spending of funds provided through deficit

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(1) It has to be recognised that the emergence of a measure of inflation introduces the further question of the appearance of a degree of "forced savings" into the situation. It is indeed accepted that this is so but it is not the intention to enter into the discussion of a complex subject and it is suggested that in the present context there is perhaps no need to say more than that inflation - induced by deficit financing - enables the planning authority to reduce the consumption, in real terms, of income receivers below the level which they would voluntarily accept and that the possession of the additional funds by the planning authority enables it to bid away resources from other uses which might conflict with the purposes of the project which has been planned.

financing. This degree of inflation might affect exports, and the balance of payments. Therefore, the Iraqi exports and its balance of payments are discussed in the first chapter.

It is argued in the dissertation, however, that a moderate degree of inflation need not, necessarily, turn into higher degrees of inflation, but that it may be possible to keep it within limits. In order to achieve this aim the monetary authorities should have certain qualities, such as, sense of responsibility, firmness, knowledge and the like; and, even more important, experience. Consequently, some examination of the experiences of the Iraqi monetary authorities is made in the second chapter and in other parts of the dissertation. The banking institutions in Iraq i.e. the commercial and specialised banks, together with the central bank are discussed in chapter three; and in this chapter consideration is given to the extent and effectiveness of central bank control over the other parts of the banking system. The possible contribution of the commercial banks in the promotion of economic development by providing medium and long-term loans to agriculture and industry is discussed. Furthermore, the possible ways in which some of the specialised banks might increase and improve their services are presented.

In chapter four the device of deficit financing is applied to a model which represents underdeveloped countries in general. Chapter five presents an adjustment of the use of the device of deficit financing as illustrated in the model, to suit the circumstances prevailing in Iraq. This is followed by a consideration of the balance of advantage and disadvantage which may be thought to apply to the use of deficit financing in this context, particularly when it is accepted that one of the outcomes is likely to be inflation. Finally, in chapter seven the conclusions and the recommendations reached in the light of the study are presented. We then have six appendices. Appendix one sets out the Anglo-Iraqi agreement of 1947 about the Iraqi sterling assets. Appendix two, presents changes in the volume and composition of Iraqi currency reserves 1947-1960. In Appendix three examples are given, drawn from the writings of various economists,

of the different senses in which the term 'deficit financing' has been used. Appendix four offers a brief justification of the use in the model of the categories of the Quantity Theory of the Value of Money as an expository device for indicating the relationships which exist between money and goods in an economy. It is thought that a statement of this sort is called for in view of the criticism which, in recent years, has been increasingly directed against the formulation of the traditional Quantity Theory. In Appendix five, the nature of inflation and main types of inflation are discussed. Appendix six, is a statistical appendix.

Throughout the dissertation however it has been necessary to face up to the difficult problem - a common problem confronting writers on the economic affairs of underdeveloped countries - of the complete lack of data on some aspects of the subject, inadequate data on others, and the non-comparability of a good deal of statistical material, even when, on the face of things, there would seem to be plenty of it. As stated above, no work, complete in itself, has been written dealing with the contribution which the banking system in Iraq might be able to make in the promotion of economic development, apart from brief discussions about, and description of the Iraqi economy in general and the organisation of the monetary institutions as part of the economy in particular. Consequently, a good deal of reliance has had to be placed on such sources as annual reports and bulletins of the Central Bank of Iraq, and other monetary institutions, together with, Laws, by-Laws, and regulations relating to Banking. There is one section however which is analytical rather than descriptive. This is the section which deals with the expected by-product of using deficit financing, namely inflation. Here, the source materials have, in the nature of things taken the form of books and articles.



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A.J.N. ALI

The Graduate Society,

Durham.

## CHAPTER ONE

## SOME LEADING ECONOMIC AND SOCIAL ASPECTS OF IRAQ

IRAQ is located in the Middle East, with Syria and Jordan to the west, Iran to the east, Turkey to the north, and Saudi Arabia to the south. Geographically, Iraq is located in an important strategic position, because it forms a large part of the bridge between the Indian Ocean and the Mediterranean. The area was known to Europeans, before the emergence of Iraq as a separate state, as Mesopotamia, or in other words; the country between two rivers.

Land and Population:-

The area is (438,446) square kilometres<sup>(1)</sup>; of which 47% is classified as desert<sup>(2)</sup>. The population in the 1947 census was (4.82 mn.) and (6.5 mn.) in the 1957 census; United Nations figures suggest that, on 31 December 1958, the Iraq population was (6.374 mn.) and rose to (7.004 mn.) in 1964; giving an annual rate of increase of (1.7%).<sup>(3)</sup> An Iraqi Economist depending on the (Food and Agriculture Organisation (FAO)'s adjusted population figures, gives the annual rate of increase in population as (1.94%).<sup>(4)</sup>

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(1) Ministry of Planning, Central Bureau of Statistics, Section of Research and Publicity, Statistical Abstract 1963, Government Press 1964, P.39

(2) The Economist Intelligence Unit, Annual Supplement (Iraq), International Division, Spencer House, 27 St James's Place, London, September 1964, P.4

(3) The United Nations Statistical Year Book 1965, Department of Economic and Social Affairs; New York, 1966, P.89

(4) Haseeb, K., The National Income of Iraq, 1953-61, Oxford University Press, 1964, P.16

There was another census in 1965. But due to the military operations in the north at the time, the figure may not be accurate enough, it is therefore not given.

However, if the annual rate of growth of population is (1.7%) or (1.94%), it is high in comparison with Western countries, such as Italy (0.7%), Greece (0.7%) and Belgium (0.7%)<sup>(1)</sup>. Over (4 mn.) persons lived in rural areas in 1964. The labour force i.e. the persons aged between 15-55 was (3,023,770) according to the 1957 census.<sup>(2)</sup> At the end of 1960, an official figure of (1,0760,000) labourers was given; with a (23%) unemployed at the end of 1959 and 19% at the end of 1960<sup>(3)</sup>. Prior to July 14th 1958, Iraq was ruled by King Faisal II, then on July 14th 1958, the government was overthrown by a revolution and a republic was proclaimed. The chief language is (Arabic), and the state religion is Islam. The country is divided into (14) Liwas or provinces, with three desert areas. Each Liwa is divided into (quadhas) (69), and the (quadhas) are sub-divided into (Nahiyas) (169). The (Liwas) vary greatly in the standard of living; as it is shown in the regional distribution of the National Income (on page (53)). The largest province is Baghdad with the highest standard of living; Kirkuk is the major crude oil producer, and to a smaller extent Mosul and Basrah<sup>(4)</sup>. The latter is the only Iraqi port; and the main dates producer and exporter.

- 
- (1) The United Nations Statistical Year Book 1965, Department of Economic and Social Affairs, New York 1966; pp.92-93.
  - (2) This figure was calculated by the writer, from the Annual Abstract, Government Press, 1964. P.
  - (3) The Economist Intelligence Unit, Three. Monthly Economic Review, Annual Supplement, August 1962, P.6
  - (4) The Economist Intelligence Unit, Annual Supplement, (Iraq) August, 1965, P.16

Education and Health Conditions :-

Educational and health conditions are discussed here, because, as the labour force in a country is a factor of production, it is important to know to what extent the labour force is healthy and literate; in order to decide, roughly; the productivity of the workers in different fields of production. Educational facilities in Iraq, until the 1950's were far from sufficient or adequate. This point can be illustrated by the fact that in 1913, for instance, there were only (160) primary schools in Iraq run by the government with (6000) students; out of an estimated population of (2.824.000) in 1930.<sup>(1)</sup> This is compared with (4.125) schools and (914.121) students in governmental, private, and foreign primary schools in 1962-1963. Table (1) (Appendix 6), shows that, the number of teachers in primary schools increased by (82%) in 1956-57, over 1950-51, while the number of students more than doubled. This means that every teacher has a larger number of students, but in 1962-63 the number of teachers rose by 177% while the number of students increased by 145%, which means that the number of students per teacher has decreased. The table shows that the number of teachers in secondary schools more than doubled in 1956-57 over 1950-51 while the number of students was less than doubled during the same period. However, in 1962-1963 the increase in the number of students was higher than the increase in the number of the teachers in the same period. It is evident that, the number of students in higher education in Art colleges and institutions was four and a half the number of the students in Science colleges in 1950-1951; in 1956-57 it was less than one and a half. This is a healthy sign, because, Iraq like any other underdeveloped country, needs engineers, doctors and scientists, as much as, if not more than it needs lawyers.

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(1) Langely, K.M. The Industrialisation of Iraq; Harvard Middle Eastern Monograph Series, 1962, P.11 (This is the nearest available estimate to 1913 period).

(2) The Annual Statistical Abstract, Ministry of Planning, Government Press, 1964

On the whole, it may be safe to say that this table shows that educational facilities in Iraq between 1950 - 51 and 1962 - 63 have increased rapidly in all stages of education.

The first stage of a University City in Baghdad has begun in 1963, with a total estimated cost of (I.D 30 mn.). One of the most important measures, as far as educational facilities are concerned, is the percentage of illiteracy among the population in a country. In 1947 over (91%) of the population was illiterate.<sup>(1)</sup> In 1957, this percentage became (82.7) per cent. This is compared with (73.7) per cent in the United Arab Republic (1960), (61.9) per cent in Turkey (1960), and (13.3) per cent in Spain (1960).<sup>(2)</sup>

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(1) The Economist, Intelligence Unit, Annual Supplement (Iraq) August, 1960. P.5

(2) The United Nations Statistical Year Book 1964, Department of Economic and Social Affairs, New York 1965. PP 692-697.

The figure for Iraq includes population 5 years of age and over. The figure for the U.A.R. excludes alien population (143 312 persons for all ages). The figure for Spain includes Centra and Melilla, and data are based on a 1 per cent sample of census returns.

Table 2 (Appendix 4) shows that between 1953 and 1963, the number of hospitals has increased from (98) to (131); the number of dispensaries from (498) to (801); and the number of hospital beds from (6201) to (13669).

----- The number of dentists more than trebled, and the number of pharmacists more than doubled during the period. The number of doctors increased by (37%) in 1958 over 1953, and by (19%) in 1962 over 1958. The number of nurses and midwives rose from (1347) in 1953 to (1691) in 1963, and hospital staff from (2266) to (3134).

It may be inferred from this table that there was an improvement in the health facilities during the period between 1953 and 1963. The improvement in health facilities is retarded by the lack of piped-water, electricity, and poor housing conditions. According to a survey conducted in 1956, of (740,000) dwellings, more than (500,000) were mud huts, reed shacks and the like; (17.1%) had electricity, and only (21%) had interior piped water supplies. (1)

Campaigns against Malaria and tuberculosis were conducted during the last few years. The work in building a medical city in Baghdad was begun in 1963; a college for the training of nurses was opened in 1962, and a new medical college was opened in Mosul also in 1962. A measure which is used to give an idea about the health conditions in a country, and to show how adequate health facilities are in a country compared with other countries, other things being equal, is inhabitants per physician. In June 1962, there was one physician for each (4900) persons in Iraq, compared with (670) in Argentina, (610) in Italy, and (5700) in Turkey. (2)

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(1) The Economist Intelligence Unit, Annual Supplement, (Iraq) Dec. 1963, P.4

(2) The United Nations Statistical Year Book 1964, Department of Economic and Social Affairs, New York, 1965. PP. 643-650.

Agriculture :-

The Agricultural sector in Iraq is very important, because, agriculture is the main occupation for more than two thirds of the population,<sup>(1)</sup> with an important contribution to the national income. Trade and industry depend to a certain degree on these agricultural products. There are two regions in Iraq; as far as agriculture is concerned, the rain-fed zone in the north, and the irrigated area in the centre and the south of Iraq. The rain-fed area in the north depends on the winter rain; therefore, winter crops are grown in this area such as, barley, wheat, tobacco, and grapes. Citrus fruit is grown in the Diyala Valley in east-central Iraq. The south-central area depends on irrigation from the Tigris and Euphrates and grows dates, rice, and cotton. Usually there is a surplus of barley and sometimes wheat; this depends on the rainfall. Dates are an important export crop and Iraq has been the world's principle producer and exporter of dates for centuries. However, the most striking fact about agriculture and the utilization of cultivable land is that, according to the agricultural census of 1952-53 only (6.4 mn ha ) or a little more than 1/7 of the total cultivable area of (44.4 mn. ha) was actually settled agricultural holdings within the (14) Liwas, and another (12.1 mn. ha) of cultivable land outside these Liwas.<sup>(2)</sup> Furthermore, the average of cultivable land per capita is 3 to 3.5 acres in Iraq, while the Asian average is only (0.5) acres per capita.<sup>(3)</sup>

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(1) As Mr.Simons has said, "Agriculture - with five million out of a population of seven million -". Simons, J.L. Agricultural Development in Iraq, Planning and Management Failures, The Middle East Journal, spring 1965, Volume 19, No.2 P.130.

(2) The Economist Intelligence Unit, Annual Supplement, Iraq, August 1965, P.11

(3) Langely, K.M., The Industrialisation of Iraq, Harvard Middle Eastern Monograph Series, Harvard University Press, 1962. P.7

The farmers in Iraq, usually, leave half of the winter crop zone uncultivated each year, as a means of restoring fertility, because little fertilizer is applied to the soil.

Because of the poor and insufficient drainage, much of the fertile land has gradually gone out of cultivation as a result of accumulation of salts in the soil, and the population previously sustained has moved elsewhere.

#### Agrarian Reform :-

Prior to 1958 the cultivable land was largely in the hands of the absentee city landlords or of tribal Sheiks, and the actual cultivator was usually a sharecropper and often received only 30-40 per cent of the crop . In 1957, the government tried to distribute the (miri sirf) land owned by the government and distributed actually (669.000) hectares, in 25-50 hectare plots.<sup>(1)</sup> But the rich and influential landowners resisted and the programme failed. On September the 8th 1958, the Agrarian Reform Law was enacted. According to this Law the ownership of land is limited to 1,000 Iraqi dunums of irrigated or 2,000 dunums of rain-fed land.<sup>(2)</sup> The rest of the cultivable land was to be distributed among the farmers in areas of 7.5-15 hectares irrigated or 15-30 hectares rain-fed. The landlords were compensated by bonds for (20) years and a 3 per cent interest rate. However, in June 1963, the interest rate was reduced to (2) per cent, and the landlords compensation was divided into two parts : (1) half of it was made payable on demand if less than (I.D 1000), in twenty years if more than that, i.e. between (I.D 1000 - 10.000) and over forty years if it is (I.D 10.000) and over.

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(1) The Economist Intelligence Unit, Annual Supplement, (Iraq and Arabian Peninsula, July 1959, P.8 (1 Iraq hectare or meshar equals 0.62 acres.)

(2) The Economist Intelligence Unit, Annual Supplement, Iraq, August, 1965. P.11



(11) The other half was considered as a loan to the Agricultural Bank against bonds redeemable over twenty years.<sup>(1)</sup> A Ministry called the Ministry of Agrarian Reform was set up in 1958, to carry out the land reform and the distribution of land. The total cultivable area held by landlords and subject to the reform law amounted to (8.5 mn.) dunums.<sup>(2)</sup> As-a result of the relatively large area to be re-distributed, changing of governments and therefore changing of the responsible Minister for Agrarian Reform, and consequent administrative difficulties, the total area distributed among the farmers since the land reform began was only (2.1 mn. hectares). In addition to the distributed area there are (1.66 mn. hectares) which were leased to the farmers but managed by the state on an interim system.<sup>(3)</sup>

Mixed farming is limited, so the government established three animal husbandry stations, and veterinary hospitals. Five state farms, wheat, cotton, rice, sugar beet, and medical herbs, were built and a long term plan to build 3,000 villages in distribution areas was adopted.<sup>(4)</sup> Two major flood control and irrigation projects

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(1) Ibid P.11

(2) Simmons, J.L., Agricultural Development in Iraq, Planning and Management Failures, The Middle East Journal, Vol.19 No.2. Spring 1965, P.131

(3) The Economist Intelligence Unit, Annual Supplement, Iraq, September 1964, P.10

(4) Credit facilities to the farmers are discussed on (PP. 109-111); loans to agricultural co-operatives are discussed on (P.121).

were completed in 1956, namely, the Tharthas on the Tigris and the Habbaniyah on the Euphrates, with a total cost of (I.D 20.5 mn).<sup>(1)</sup> Two large dams have already been completed the "Derbendi Khan", on the "Diyala" (capacity 3.250 mn. C.U.M.) and electricity which can be generated on the waterfalls of this dam is (112.000 Kwh), and the "Dokan" on the "lessec Zab" (capacity 6.800 mn. Cu.M.) generating (200.000 Kwh),<sup>(2)</sup>. In Table (3), (appendix 4) figures are given which show the production of the principle crops in Iraq. The table shows sharp fluctuations in the quantities of crops produced, mainly because of lower rain-fall which affects, especially, the northern rain-fed crop production area. The quantities of barley produced between 1957 and 1964, fluctuated between (733 mn.tons) in 1959 for example, to (1125 mn. tons) in 1962, and the figures of wheat production show, roughly, the same tendency. However, the table shows that date production has been rising during the period between 1960 and 1963.

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(1) Langely, K.M., The Industrialisation of Iraq, Harvard Middle Eastern Monograph Series, 1962. P.120

(2) The Economist Intelligence Unit, Annual Supplement, August 1965, P.14

The growth of the agricultural sector, and its contribution to the national income :-<sup>(1)</sup>

In spite of the fact that the different governments have spent more than (I.D 100 mn.) in terms of construction of dams, irrigations, and setting up agricultural co-operative societies, over the last (10) years, the relative importance of agriculture to the national income is decreasing.<sup>(2)</sup> This point can be illustrated by the fact that, in 1953, the agricultural sector contributed to national product by (29%) and (26.3) per cent in 1962 at current prices, and (32) per cent in 1953, (22.5) per cent in 1962 at constant prices.<sup>(3)</sup> Furthermore, the average compound rate of increase in the agricultural sector in the period between 1953 and 1962, was a little more than (3) per cent at constant prices, while the annual rate of increase for the national income as a whole was for the same period (7.5) per cent at constant prices.

Somebody might argue that the reason for the decline in the contribution of the agricultural sector to the national income is the land-reform, and the confusion which it has led to as far as the re-distribution of land is concerned. This argument is not wholly valid for one important factor in agriculture, among other factors, of course, is the area actually cultivated and the area cultivated for 1963 crop was greater than in the years before 1958, when the land reform law was in fact enacted. The contribution of the agricultural sector to the national income, however, dropped from (32.6%) at (1956) prices in 1953, to only (16.4%) in 1963,<sup>(4)</sup> or from an absolute amount of (I.D 85.700 mn.) out of (I.D 262.8 mn.)

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(1) See Table (4) (Appendix 6).

(2) Haseeb, K., Mem, National Income of Iraq, 1962 and 1963, P.(4).

(3) We excluded 1963, on the grounds that, agricultural products grown in rain fed areas in the north (mainly wheat and barley) were badly hit by the irregular rainfall in this year.

(4) See P. ( 55 ),

in 1953, to (I.D 80.410 mn) out of (I.D 489.5 mn) in 1963. This drop may be explained by the irregular rainfall, and the military operations in the North. Therefore, the five year plan 1965-1969 aims to maintain a percentage of growth of the national income, of (8%) per annum, and includes the lagging sector (agriculture) as well.

#### Transport:-

The importance of an adequate and efficient transport system in a country need hardly be emphasised. An adequate and efficient transport system may facilitate the movement and expansion of internal trade on the one hand, and exports on the other. The Iraqi Government realised that, and, therefore, in 1950 started a road development programme. In that year Iraq had (5000) miles of roads of which (310 miles) were hard surfaced, and (1560 miles) were hard surfaced and macadamised. There was, a single-line track, which connected the northern areas, the oil fields area in Kirkuk and Khanagin, with Baghdad and Basrah. The Tigris and Euphrates were used to a limited extent as water transport, especially between Baghdad and Basrah.<sup>(1)</sup> Iraq is connected with Turkey through a standard-gauge line which runs from Baghdad to Mosul then to the Syrian border, and continues through Turkey. A metre-gauge line links Basrah with Baghdad carrying the major part of Iraq's imports. This line has three branches : one to Kirkuk, another to Arbil, and a third one to Khanagin; (near the Iranian border). A major work is almost completed consisting of the realigning of the existing rail road which connects Baghdad and Basrah and its conversion to standard gauge at a cost of (I.D 29 mn.). A plan to connect Iraq with Kuwait and Saudi Arabia is being considered by the Iraqi Government. In 1966, there was, roughly speaking, a total of (1631 Km.) of rail roads in Iraq. The Government, realising the importance of having an adequate transport system, has allocated a total of (I.D 39 mn.) to rail roads, and (I.D 42.9 mn.) for roads, under the five year 1965-1969 programme. The latter amount was allocated to complete the re-construction of roads and bridges, the improvement of (1000 Km) of minor roads, the

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(1) Langley, K.M., Industrialisation of Iraq, Harvard Middle Eastern Monograph Series, 1962, P.114

construction of (400 Km.) of new roads.

Inland navigation is not without some importance : there is an active merchant fleet consisting of two medium sized vessels, and the building of another (4) is contemplated. Iraq's only port is Basrah in the south, and another port is being built. There are international airports in Baghdad and Basrah. In addition, there are civil airports at Kirkuk and Mosul, the Iraq Petroleum Company (IPC) has its own airport at Kirkuk. (1) —

In 1952, the International Bank for Reconstruction and Development Mission reported that, "The state railways which are the principle means of transport, are also well managed and have been fully able to meet traffic requirements". (2) However, since Iraq is a developing country, and its need for improving and expanding of the existing transport system is growing as its export-import trade, and population are increasing, therefore, it may be suggested here that the planning authorities would be well advised not to neglect the development and improvement of the transport system. The evidence suggests that the authorities are alive to this.

In the light of the above brief account of the land and population of Iraq, it may be safe to conclude that, there has been a significant improvement in health and education facilities in the last decade or so.

However, this improvement mainly took place in urban areas and city centres, especially in Baghdad. In rural areas where there is a great need for health and education facilities, there has not been a significant improvement, at least not to the same extent

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(1) The Economist Intelligence Unit, Annual Supplement to the Quarterly Economic Review, 1966.

(2) Report of a Mission organised by International Bank for Reconstruction and Development, The Economic Development of Iraq, The John Hopkins Press, 1952. P.44

as in the urban areas. The present writer believes that rural areas need more attention than they have received hitherto. This is because about two thirds of the population live in these areas, engaged in agricultural activities which provide a major contribution to the national income. More attention might be paid to direct the emphasis from arts subjects to agricultural, industrial training, and scientific subjects. More attention should be paid to the quality of higher education students than to the quantity as is the case at the moment.

As for the transport system, it is advocated here, that, in order to avoid the duplication in standbys, spares and reserves, the remaining metre lines should be standardised, and in this way Iraq might provide itself with a unified railway system.

### Manufacturing Industry in Iraq.

The contribution of manufacturing industry to the national income of Iraq is not yet large.<sup>(1)</sup> Consequently the Government has been trying to develop and assist this sector. Therefore, it may be useful to touch upon the government's actions to develop industry during the last four decades. These actions may be divided into four stages :-

- (1) In the first stage; the government's actions were administrative only. In 1931, a capital works development scheme was sanctioned.
- (2) In the second stage, the government established an industrial bank as a separate unit, i.e. in 1946; which began to provide loans to industrialists.
- (3) In the third stage the government set up a "Development Board", i.e. in 1951. This Board started to set up industrial establishments directly.
- (4) The fourth stage begins after the 1958 Revolution. In this stage one of the declared economic policies of the Government has been "greater industrialisation". Then in July 1964, (27) relatively large industrial firms were nationalised.<sup>(2)</sup>

In 1959, an Iraqi-Soviet economic agreement became effective. According to this agreement, the Soviet provided a loan of (\$137 mn.), then this figure was raised to (\$ 182.5 mn.). The Soviet also undertook to provide the technical assistance which was needed to promote industry and the execution of the agreement. On the 14th of July 1964, the government nationalised the relatively big industrial firms in Iraq,<sup>(3)</sup>. In order to illustrate the state

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- (1) See table 5 (App.6) which shows value added in industry 1953-1961 and compare with national income figures for the same period on P. (48).
  - (2) This is discussed in a more detailed way on P. (17).
  - (3) Discussed later : See P. (17).

of manufacturing industry in Iraq in the 1950's a reference to the industrial census which took place in 1954, may not be out of place.

Table 6 (Appendix 6) shows that, the total number of employees in manufacturing industry (excluding oil companies employees) was a little more than (90,000) in 1954. The total number of employees, in the oil companies was (15,249) at the same year.

Therefore, the number of employees in the industrial sector according to the 1954 industrial census was (105,540). According to the table it may be safe to conclude that most of the industrial establishments in Iraq in 1954 were small firms, since 93% of the industrial firms employed not more than (5) employees each.

Industrial establishments employing more than (10) employees formed (2) per cent of the total number of firms, but employed (49%) of non-oil industrial employees.

It is necessary to point out that, figures for the 1954 census may not be used as representing the exact industrial situation at that year. These figures may only be used as rough indicators for the following reasons: -

- (1) They do not represent averages as is the case with 1962 figures.
- (2) The enumerators have not had enough time to do their job properly. According to Dr. Haseeb, there were (69) enumerators with (499) hours per enumerator for interviews to cover 1,309 establishments, i.e. (23) minutes for each interview.<sup>(1)</sup>

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(1) For specified criticisms of the 1954 industrial census, see Haseeb, K., *The National Income of Iraq, 1953-1961*, Oxford University Press, 1964, pp. 88-96.



In Table (7) (Appendix 6)

figures are set out which provide a basis for a comparison between the results of the industrial census of 1954, and that of 1962. According to the 1954 industrial census the number of establishments large and small was (22.460), while in 1962 it was (21.373) i.e. a decrease of 5% in the absolute number; but this does not mean at all that the industrial sector is less important in 1962 than it was in 1954. It means that there was a structural change in the industrial sector. This point is illustrated by the fact that in 1954, there were (727) establishments employing (10) persons and more each; while in 1962 there were (1186) such establishments.

Furthermore, in 1954, the number of establishments employing less than (10) persons each was (21.733), while in 1962 there were only (20.191) with a (7) per cent decrease.<sup>(1)</sup> The number of employees rose by (34) per cent in 1962 over 1954, and annual wages by (299) per cent. The value of materials used in production increased by (326) per cent in 1962 over 1954, while total revenue rose by (250) per cent.

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(1) The figures for 1954 census which are mentioned here are derived from table (5) Appendix 6. The figures for 1962 census are derived from :

Ministry of Planning, Central Bureau of Statistics, Section of Research and publicity, Statistical abstract 1963, Government Press 1964, PP. 75-78; (the percentages were calculated by the writer).

Nationalisation :

On the 14th day of July 1964, several socialist Laws were enacted. All non-state owned banks were nationalised and organised in a "General Organisation for Banks". "A general Organisation for Insurance" to include nationalised insurance companies and a third organisation called the "Trade Organisation" to include export-import firms were set up. A fourth organisation under the name of the "Public Establishment for Industry" to include the nationalised industrial firms was established at the same time. Provision was also made for organisations to be re-organised and controlled by "A General Economic Organisation". A total number of (27) industrial firms with a capital of over (I.D 17 mn.) were nationalised. These firms were in:- Jute-weaving, carpet-manufacturing, tanning of leather, vegetable oil extracting, soap-making, match making, foot-wear, cement and asbestos-cement, and cigarettes. No more investment by the private sector in the last three industries was to be allowed. Then there was a change in government, and accordingly in policy. The new government abolished the "General Economic Organisation", and the four organisations controlled by it were attached to competent ministries. This step, in my view, is in the wrong direction, because, whenever government changes, which is not rare in Iraq, the new ministers may follow a different policy. The table which shows value added in manufacturing industry for the years 1953-1961 (Table 5) (Appendix 6), indicates that value added in this sector has been increasing steadily during the period. It rose from (I.D 16.751 mn.) in 1953, to (I.D 47.329 mn.) in 1961, at current prices, and from (I.D 17.002 mn.) to (I.D 44.396 mn.) at constant prices for the same period.

The industrial sector in Iraq, has been growing at a relatively high rate, in comparison with other sectors of the economy. This point can be illustrated by the fact that the net value added in the industrial sector has increased in the period 1953-1961, at an average compound annual rate of (14) per cent at current prices, (1961) (13 per cent in oil refining), and at fixed prices (1956) the rate of increase may be calculated to be (13) per cent per annum (16% in oil refining).<sup>(1)</sup>

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(1) Haseeb, K., The National Income of Iraq, 1953-61, Oxford University Press, 1964, P.87

Foreign Trade and The Balance of Payments<sup>(1)</sup>

Iraq, like most if not all of the underdeveloped countries, depends almost entirely on the exporting of primary products; and importing of manufactured capital and consumer's goods. The main Iraqi exports, excluding oil, are : dates, barley, animal products and cement. These exports finance something like 1/10 at the best and 1/12 at the worst of Iraqi imports depending on climatic conditions and the variation in rain-fall. The rest of the Iraqi imports are financed by oil revenues, as is shown later.

Exports :-

Due to the fact that the Iraqi exports, apart from oil and cement, consist of agricultural products, these exports fluctuate sharply from year to year as Table 8 (Appendix 6) indicates. This table shows that, in 1960, the value of dates exported was (I.D 4.05 mn.) fell to (I.D 2.81 mn.) in 1961, and rose to (I.D 7.05 mn.) in 1962. The value of barley exported rose from (I.D 0.8 mn.) in 1961, to (I.D 6.07 mn.) in 1962. The same point, i.e. fluctuations in the value of a single item of exports from year to year, could be applied to the total value of exports.

In 1961, the total value of exports amounted to (I.D 7.2 mn.) while in 1962 it rose to a total of (ID 18.44 mn.), excluding oil, i.e. more than two and a half times. The important reason was that in 1961, the irregular rain-fall, especially in the rain-fed area in the north, caused a crop-failure, and only a negligible amount of barley was exported. The amount of barley

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(1) It is not within the scope of the present study to give an account of export and import policies, this discussion is merely a simple and brief description of the Iraqi foreign trade and the Balance of Payments for the last few years.

exported in 1962, was, however, valued at more than (I.D 6 mn.) as the table displays. The total values of exports in 1963 and 1964, were lower than the 1962 level for the same reason, i.e. irregular rain-fall; this, and to a certain extent, also, the military operations in the North (the important grain area in Iraq). The only manufactured commodity that Iraq exports is cement. The table shows that exports of cement have been increasing steadily (in absolute value) during the last five years. However, exports are the most important means of obtaining the foreign exchange needed for the importation of capital and consumer's goods.

Therefore, Iraq might be able to obtain more foreign exchange for its exports if raw-materials are turned into, at least, semi-manufactured goods whenever it is possible. For example, instead of exporting dates, it might be more advantageous to export date-syrup or fodder<sup>(1)</sup>. This might provide an indication of what might be done with other products. Finally, it may not be out of place to touch upon the geographical distribution of Iraqi exports (excluding oil).<sup>(2)</sup> The Arab league group is the most important market for Iraqi exports, as the table shows. It is followed by the Sterling Area countries, thirdly by the Socialist countries, and fourthly by U.S.A. and Canada. Table 10 (Appendix 6) shows the geographical distribution of oil exports for the period under review. This table shows that the (E.E.C.) countries claimed the largest share of the exported Iraqi oil. This group is followed by the Sterling Area Countries, and other countries (including Japan, Spain, and others).

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(1) Iraq does, as a matter of fact, export date syrup or (date juice) and fodder, but only in small quantities.

In 1964, for example, a total amount of (282.684 tons) of dates were exported, but only (4.183 tons) of date syrup were exported.

The C.B.I. Quarterly Bulletins, April-June 1966, No.58, P.34.

(2) Table 9 (Appendix 6).

Imports :-

The value of the principle imports of Iraq for the period between 1960 and 1964 is set out in Table 11 (Appendix 6). This table shows that in 1960, the total value of imported capital goods and raw materials amounted to (36%), and the consumers goods to (49%) of total imports.<sup>(1)</sup> However, the importation of capital goods and raw materials showed a tendency to rise in 1962, when it was almost equal to that of the consumer's goods as the table shows, and the percentage was the same in 1963. In 1964, there was a slight increase in the value of the imported consumer's goods as a percentage of total imports, and a slight decline in that of the capital goods and raw materials. Furthermore, the table shows that imports of clothing (piece goods and textile), tea, sugar, and durable consumer's goods ( e.g. radios, T.V. sets, refrigerators ... ) are the most important items in the imported consumers goods. As for the importation of cereals, it depends on the domestic crop each year, i.e. when the harvest is good, only a small quantity is imported, which is the case in 1963, otherwise, large quantities are imported as was the case in 1960 and 1964.

Raw materials, vehicles, and iron/steel, are the most important items among the imported capital goods. Where they come from is indicated in Table 12 (Appendix 6). The table shows that the United Kingdom is the most important country of origin for the imports of Iraq, though this importance is declining. The second supplier is "other sterling area countries", which claim almost the same percentage of total Iraq imports. E.E.C. countries, is the second group of countries as a supplier of Iraq's imports. The U.S.A. and Canada are, together, the third in importance, the socialist countries group is the fourth, and the "other countries" group is the fifth.

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(1) As the table shows, the difference between the value of total imports i.e. 100% and the total of imported consumer and capital goods is covered by an unexplained item, i.e. other commodities.

The Balance of Payments :

As with all countries it is possible to cast the different items which enter into the Iraqi balance of payments into a conventional tabular form. When this is done it is clear that the (1) Iraqi balance of payments is dominated by one or two key influences even though, as again is so often found, it may not be possible to give a precise explanation of each particular item that enters into the make-up of the tabulation as a whole. For example, it is noticeable that the item 'Errors and Omissions' increases from the low figure of (I.D 3 mn.) in 1960 to the region of (I.D 20.24 mn.) by 1963/64, and no precise explanation of this variation can be found.

If however, what is acceptable is not a detailed and precise explanation of each individual item but an indication of the main significant variables in the general position, then these may be summarised as follows :- the net exports in the oil sector cover a major part in some years, and more than enough to cover in other years, the deficit on other items in the export/import relations, and also to meet in most years the interest and dividend payments arising from oil operations. The balancing effect which this brings out means that the rest of the balance of payments tabulation contains items involving only relatively small monetary sums. From this it may not be injudicious to conclude that, as long as oil exports are maintained, which on normal considerations might be thought a reasonable probability, then the Iraq balance of payments, is, perhaps, in a better position than that of many of the underdeveloped countries. Consequently, since it is argued in later parts of this dissertation that oil exports, which represent something between 92% - 94% of total exports, (2) are not likely to be adversely affected by a moderate degree of increase in domestic prices, deficit financing should not be expected to have a serious effect on the Iraq balance of payments, if such a procedure should, in moderation, be adopted.

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(1) Table A (P 22).

(2) See P.(208)

TABLE 'A'

Balance of Payments (I.D. mn.) for the years 1960 - 1964.

Current Account	1960	1961	1962	1963	1964
Exports f.o.b. less imports c.i.f, oil sector	208	212	223	258	281
Exports f.o.b. less imports c.i.f, other. (commercial etc.)	-115	-125	-108	-92	-131
Net : interest and dividends (oil profits etc).	-94	-93	-93	-108	-122
Other goods and services (net).	-6	-8	-13	-20	-20
Private remittances	-1	-1	-1	-	-
Government remittances	-2	-1	-1	-	-
Balance on current account	-10	-16	+7	+38	+8
Capital account (net)					
Private	-	-1	-14	-21	-14
Government	1	1	10	39	10
Assets and liabilities of commercial banks	7	4	-	-1	4
Net IMF position	-1	-	-	-	-
Errors and omissions	-3	-3	-14	-20	-24
Net change in reserves (+ = fall, i.e. drawing on reserves to offset deficit in current plus capital account; - = rise, i.e. utilisation of surplus in current plus capital account to add to reserves).	+13	+15	-18	-3	-24

Source: The Economist Intelligence Unit, Three Monthly Economic Review, Annual Supplement (Iraq),

The Petroleum Industry :

Iraq's export of crude oil has always come from the operations of the (Iraq Petroleum Company) IPC, and its two subsidiaries, (the Basrah Petroleum Company) BPC, operating in the south, and the (Mosul Petroleum Company) MPC, operating in the north. In 1928, the IPC share-holding was given its present shape i.e. 5% Participations and Explorations Corporation (Gulbenkian estate), and 23.75% each Compagnie Francaise des Petroles, Royal Dutch/Shell, Near East Development Corporation, (joint Jersey Standard and Socony Mobil) and British Petroleum Company<sup>(1)</sup>. An agreement between the Iraqi Government and the oil companies was reached in February 1952, to share the profits equally. This agreement was ratified by Law No.(4) of 1952, retroactive to January of the previous year. The profits which are relevant to this agreement are to be calculated before the payment of foreign taxes, taking costs of production as returned, and on the basis of constant values.<sup>(2)</sup> The important fact to be pointed out here is that according to the United Nations experts, the oil companies have had in reality more than 50% :- "...under the equal profit - sharing agreements concluded during 1950 - 1952 between the governments of oil producing areas (including Iraq) and the concessionary oil companies, the parent companies of the latter were able to obtain petroleum at a discount of 15% to 20% from the posted prices. Thus,

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(1) The Economist Intelligence Unit, Quarterly Economic Review, Annual Supplement, (Iraq), August 1965, P.15

(2) EL-Kaissi, F., Critical Analysis of the Central Banking in Iraq, Unpublished Ph.D. Thesis, University of California, August 1957. P.64



profits of the producing companies, and consequently the oil revenues of the governments, were reduced"<sup>(1)</sup>. After negotiations between the Iraqi Government and the oil companies, the latter agreed in 1955 to reduce the percentage discount to 2%. This revision was back dated to 1954. After the 1958 Revolution the government re-started negotiations with the Oil Companies. The major issues which were discussed were :- share participation, release of un-exploited areas, and revision of the 50/50 formula. After prolonged negotiations no agreement was reached.

Therefore, on December 11, 1961 the Iraqi Government issued Law No.80 of the same year, restricting the companies' area of operations to (1938 square km.) which represents 0.5% of their original area.<sup>(2)</sup> Iraq is a founder member of the Oil Producing and Exporting Countries "OPEC" Organisation which was established in 1960, and consists of the following countries :- Kuwait, Saudi Arabia, Iraq, Iran, Lybia and Venezeula. In 1964, the Iraqi National Oil Company (INOC) was set up, according to Law No.(11) of the same year. This company was empowered to engage in exploration, production, distribution and refining of oil for export purpose, but not for the domestic market. Its initial capital was (I.D 25 mn.) to be paid by the Government. Furthermore, the (INOC) was given the right to raise more capital up to three times its initial capital, whether domestically or abroad, whenever it should be necessary. This company was to be controlled by a "Board of Directors" appointed by the Cabinet, made up of six full-time members. The (INOC) was to be attached to the Oil Ministry, and to have the right with the approval of the council of ministers, to enter into contractual

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(1) United Nations, Department of Economic and Social Affairs, Economic Development in the Middle East, 1954-1955, New York 1956 P.66

(2) The Economist Intelligence Unit, Quarterly Economic Review, Annual Supplement, August 1965, P.15

agreements with other organisations concerned with oil, or to participate in other companies. The company is to share its profits with the government 50/50, and neither this company's nor its wholly-owned subsidiaries profits are to be subject to income tax for five years from the date on which these profits are made. The (INOC) has the right to operate in any area or areas in Iraq it may choose, except those allocated to the oil companies under Law No.(80) of 1961. It may be too early to discuss the importance and the possible consequences of the likely operations of this company, on the Iraqi economy in general and on the oil industry in particular. This is because, what counts is not the issuance of a Law, but the actual application of that Law.

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(1) The Economist Intelligence Unit,

Quarterly Economic Review, (Iraq), March 1964, P.10

Oil Refining :

Oil refining, distribution for the domestic market, and storage, is carried out by the Government Oil Refineries Administration which was established in 1952. This Administration was formed after the agreement between the Khanagin Oil Company (KOC) and the Iraqi Government in December 1951. Under this agreement the government bought the refinery, (Alwand Refinery) with an annual capacity of (0.6 mn. tons) and gave the responsibility of running it to (KOC) on a temporary basis. (1)

The largest oil-refinery in Iraq is the "Dura Refinery" near Baghdad, which was set up in 1955, at a cost of (I.D 8 mn.) and an annual capacity of (2.4 mn. tons). A third refinery was established in the Muftiya near Basrah in 1952, with an annual capacity of (0.2 mn. tons). Always state-owned the "Bitumen Refinery" at Qaiyarah (near Mosul) with an annual capacity of (60,000 tons) has been re-operated.

The operation of this refinery was stopped in 1958. In 1964, the total annual output of refined products was (2.7 mn.tons) which is near to the Iraq maximum approximate refining capacity of (2.9 mn.tons). (2)

Table B, P.( 28 ) shows that between 1955 and 1964, with two exceptions, in 1956 and 1957, crude oil production has been increasing steadily: there was a slight decrease in 1956 followed by a sharp fall in 1957 due to the Suez crisis and the destruction of oil installations in Syria. (3) There was only a very

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(1) Haseeb, K., The National Income of Iraq, 1953-1961, Oxford University Press, 1964, P.103.

(2) The Central Bank of Iraq Annual Report, 1964 (in English) Zahra Press, Baghdad, P.23.

(3) Pipelines and 3 pumping stations were affected, for further discussion see p. ( 31), and (PP.32-34)

slight increase in production in 1962 over 1961, perhaps, as a result of the issuance of Law No.80 of 1961, which confined the Oil Companies concessions to about (0.5%) of their original concession area. However, Iraq ranks as the fourth in oil production in the Middle East; and the seventh among World producers, with published proved reserves of (7.5%) of the World total, i.e. (3.419 mn. metric tons) at the end of 1963. Nevertheless, it is very important to realise that oil is a wasting asset and it will not last for ever, and therefore, oil revenues should not be wasted on un-productive projects. It will be wise to make the best use of this wasting asset's revenues. The table shows that except, for the revenues of 1956, 1957 and 1960, revenues have consistently increased. The decline in revenues in these three years might be explained by the same reason mentioned above, i.e. the decline in production. A second reason is the reduction in crude oil prices in 1959 and 1960. (1)

The table shows that the number of Iraqis employed by the oil companies has decreased during the period, apart from a slight increase in 1956, 1958, and 1961. The number of foreigners employed by the oil companies has increased by (8%) in 1956 over 1955, then started to decrease throughout the period. The table shows that the number of foreigners employed by the oil companies in 1955 was (860); this fell to only 201 in 1963, i.e. to less than 25% of the number in 1955. This decrease may be explained by the fact that, in accordance with the Iraqi Government order issued in 1961, that oil companies stopped their exploration. In order to train more Iraqis to work in the oil industry, an institute with the help of the United Nations was set up in 1965. This institute is to train (100) graduate engineers each year in a one year course on the exploration production, and transportation of oil.

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(1) AL-nasrawi, A., Financing Economic Development in Iraq, The role of oil in a Middle Eastern Economy, F.A.Praeger, Publishers, 1967, P.(21).

TABLE 'B'

Crude Oil Production, Revenues, and number of employees  
(Iraqis and foreigners) for the years 1955-1964.

Years	Production of Crude oil (metric tons)	% of change	Revenues equivalent (in mm. U.S.\$) *	% of change	No. of Iraqis employed by oil companies.	% of change	No. of foreigners employed by the oil companies.	% of change
1955	33.2	-	223.37	-	14468	-	860	-
1956	31.1	-7	193.66	-13	14914	3	918	8
1957	21.7	-31	144.20	-25.5	14763	1-	812	-12
1958	35.5	63.5	236.32	64	15166	3	815	-
1959	41.6	17	242.48	2	12808	16-	628	-23
1960	47.3	13.5	266.30	10	12617	1-	442	-30
1961	48.8	3	265.20	-1	12799	1	410	-5
1962	49.0	0.4	266.30	1	12071	-6	208	-49
1963	55.5	13	308.10	16	11352	-6	201	-8
1964	61.3	10.5	320.6	6	n.a.	-	n.a.	-
1965	64.2	4.7	368.5	14.9	n.a.	-	n.a.	-

Source : Compiled from, The Economist Intelligence Unit, Annual Supplement (Iraq), September 1961. P.10, August 1965 PP.16-17, and 1966 P.17. (See note below). The Central Bureau of Statistics, Section of Research and publicity, Statistical Abstract, Government Press (Baghdad) 1956, 1958, 1959, 1962, and 1963. The percentages of change were calculated by the writer.

(\*) Note:- Figures are actual receipts not entitlements, i.e. they include back-payments (e.g. in 1957, 1958). They exclude payments in respect of operations of Khanagin Oil Company (about \$5.2 mn. 1925-51). In 1962 the companies bought £19.2 mn. in foreign exchange into Iraq to meet local expenditure.

So far, only the production, exportation, and agreements between the Oil Companies operating in Iraq, and the Iraqi Government have been discussed. Another important aspect of the subject is the financial and economic impact of oil production and exportation on the Iraqi economy. This impact can be divided into two parts :-

- (1) The revenue paid to the Iraqi Government in the form of royalties and taxes.
- (2) The employment of Iraqis by the oil companies, the payments for the use of port facilities, the purchasing of building materials, and the outlays in respect of freight charges.

It is not necessary to develop any long and elaborate discussion of these matters but certain points are of great importance and should be mentioned, even if only briefly.

- (1) The Iraqi Government divides oil revenues into two parts :-
  - (a) to make a contribution, in fact a major one<sup>(1)</sup>, to the financing of development programmes.
  - (b) To contribute, each year, to the ordinary revenues of the budget.

When a "Development Board" was established in accordance with Law No.23 of 1950, the total amount of <sup>oil</sup> revenues was allocated to the Board. Then this principle was changed shortly afterwards, and 30% of oil revenues were allocated to the government to enable it to carry out minor projects without referring to the Development Board.<sup>(2)</sup>

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- (1) In discussing sources of Financing the Economic plan 1965-1969, it was indicated that "Oil revenues may well amount to I.D 780.0 million and thus plan share thereof will be a round I.D 390.0 million (On the basis of 50% of total revenues).

The Central Bank of Iraq Annual Report 1964, Zahra Press, Baghdad (in English) P.57

- (2) Iversen, C., Monetary Policy in Iraq, published by the National Bank of Iraq 1954, P.109

In accordance with Law No.74 of 1959, an Economic Planning Board was established replacing the Development Board, and in the 1959/60 budget the Board's share of oil revenues was reduced to 50%. The Iraqi Government did not even keep the 50% provision because, "In 1966 the Minister of Finance openly admitted that less than 50 per cent of oil revenues were being utilised for development projects"<sup>(1)</sup>.

All the same it is still safe to assert that oil revenues are a decisive factor in the financing of development programmes in Iraq. The later percentage allocation may be smaller but the absolute amount of funds available at the later years is so much greater than at the beginning of the period the reduction in the percentage figure might by itself easily give a wrong impression.

Even so, the position will need to be watched with caution. Any tendency on the part of the Iraqi Government, such as has been manifest in recent years, to reduce drastically the percentage of oil revenues allocated to the service of development programmes, is almost certain, other things being equal, to retard economic development in Iraq. Furthermore, it should not be forgotten that, as was said earlier, oil is a wasting asset : it would seem to follow from this that a large part of oil revenues should be devoted to productive investment and not dissipated in immediate consumption or absorbed in outlays of a non-productive nature.

(2) The oil companies operating in Iraq employ a not insignificant number of workers, relatively to any industrial firm in Iraq. In 1962, for example the number of Iraqis employed by the Oil Companies totalled (12.071), with total annual wages of (I.D 8.096.992). The Iraqis employed by Oil Companies are trained, in most cases, and they

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(1) The Economist Intelligence Unit, Quarterly Economic Review, Annual Supplement, 1966. P.10

become skilled or at least semi-skilled workers, and in this way the limited supply of skilled workers is increased. As for the payments for using port facilities, i.e. Basrah, purchasing of building materials and paying for freight charges there is no available figure at the moment, showing the exact amount paid for these purposes, as far as the present writer knows. The preceding discussion shows the importance of oil to the Iraqi economy as creating revenue on the one hand, and as a relatively large project to provide employment for a not insignificant number of Iraqis on the other. Another important aspect of the exportation of crude oil is that oil revenues are the most important source of foreign exchange, without which it becomes very difficult to carry out development programmes.

Furthermore, oil revenues help to a large extent in ensuring the stability of the rate of exchange of the domestic currency in world financial centres. Consequently, it may be useful, indeed essential, that consideration should be given to the question as to how far Iraq can look forward with confidence to the continuing provision of such revenues from the exportation of her oil.

The flow of Iraq oil from its major field in Kirkuk was stopped twice in the last decade. The major part of the Iraq crude oil exports goes through a pipeline between Kirkuk and Banias on the Mediterranean, passing through Syria.<sup>(1)</sup> In 1956, when Egypt was attacked by France, England, and Israel, the Syrian Army in November of the same year blew up three pumping stations situated in Syria, and part of the pipeline. This was done to prevent the flow of oil from an Arab country, Iraq, to countries which were bombing Egypt at that time. After negotiation between the Iraq Oil Company

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(1) In 1956, the monthly rate of oil revenue to Iraqi Government was nearly (£7 mn.) of which nearly (£6 mn.) was derived from oil flowing from Kirkuk. (Further details about this point is mentioned on P. (32) of this dissertation).



and the Syrian Government the oil flow was restored in April 1958. Iraq lost a total amount of (£56 mn.) as a result of the stoppage of oil.<sup>(1)</sup> It is perhaps possible to justify the action taken by Syria, insofar as it provided help, in however small a way it might be, to a Sister-Arab country which was being attacked by foreign countries. Then the flow of Iraqi oil continued, after repairing the three damaged pumping stations, and the pipeline for (10) years after that without any similar stoppage. But in December 1966, the Syrian Government took unilateral action, and seized properties belonging to the (IPC) after the break-down of negotiations with the (IPC). The purpose was to force (IPC) to pay a higher rate of transit duty and to agree to a re-examination of the rates granted to Syria under the 50/50 agreement of 1955.<sup>(2)</sup> The Syrian Government informed the (IPC) that the loading of crude Iraq oil at Banias would be stopped, until the company paid a total amount of (£3.7 mn.), which, it was claimed, was owing by the company for the period between January and September 1966.

The importance of this to the Iraqi crude oil exports could be illustrated by the fact that, the Basrah oil-fields were producing at an annual rate between (20-22 mn. tons) i.e. equivalent to 40% of total oil revenues: the rest comes from the northern fields. After twelve weeks of negotiations, an agreement was reached in the beginning of March 1967, and the pumping of oil from the Kirkuk field was resumed. According to this agreement the new transit fees became 5s.10d/ton instead of 4s./ton, and loading fees 2s./ton instead of 1s.1d/ton under the 1955 agreement;<sup>(4)</sup> it was agreed to negotiate

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(1) The Economist, March 29, 1958, P.1152, and January 25, 1958. P.299.

(2) According to this agreement the (IPC) is to pay 50% of the profits made by saving in the cost of transportation of oil if carried in another way.

(3) The Financial Times, Thursday January 26th 1967, No.24142. For figures of oil production and revenues see table on P.(28).

(4) The Economist Intelligence Unit, Quarterly Economic Review, March 1967, P.4

with the Syrian Government about the additional amount which Syria claimed that the oil companies owed from the period between 1955 and 1966. Iraqi losses as a result of this (12) week stoppage of oil flow from Kirkuk amounted to (£23½ mn.)<sup>(1)</sup> Accordingly the spending on the development programme was temporarily stopped, and as the Economist Intelligence Unit has said : "No doubt the financial problems arising from the Syrian/IPC crisis will cause some embarrassment to the already over-strained Iraqi treasury by the end of the first quarter of 1967".<sup>(2)</sup> This brief discussion of the stoppage of the flow of Iraq oil twice in (10) year's time may cast some doubt on the reliability of oil revenues for Iraq. If the Iraqi Government wants to safeguard the most important source of revenue and foreign exchange, there are two ways, in my view, which might be followed :-

(1) To negotiate an agreement with the Syrian Government according to which Syria undertakes to consult the Iraqi Government before taking any step in all matters concerning the IPC pipeline. This way is a weak course of action, and there is a great possibility that Syria might not honour such an agreement.

(2) The stronger and safer way would be, the construction of a pipeline between Kirkuk and Basrah and the taking of the necessary steps to improve port facilities in the Persian Gulf. The second suggestion is reported to be under consideration by the (IPC).

The Financial Times reported that, "IPC is seriously considering building a Kirkuk-Basrah pipeline and may go ahead with the project there even if its present conflict with Syria is settled. They explained that the company is already working on future plans which would make it independent of the Syrian pipeline".<sup>(3)</sup>

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(1) The Economist, 4-10 March, 1967, P.854

(2) The Economist Intelligence Unit, Quarterly Economic Review, March 1967, P.3

(3) The Financial Times, Wednesday January 4th 1967, No. 24123.

It has been estimated that the alternative pipeline between Kirkuk and Basrah would cost (£100 mn.)<sup>(1)</sup>. The present writer advocates the Iraqi Government building or contributing to the building of such a pipeline for the following reasons :-<sup>(2)</sup>

(1) Oil revenues to Iraq are too important in providing a major part for financing development programmes, and in contributing to the ordinary budget each year, as was mentioned earlier. Consequently, the access for the Iraqi oil for exports, i.e. the pipeline, is too important to be left at the mercy of another country, i.e. Syria.

(2) Syria, under the new transit fees is getting (£15 mn.) a year. This amount would be paid to the Iraqi Government instead, and would meet the cost of the alternative pipeline in a few years.

(3) Iraq has (3419 mn.) metric tons of proved oil reserves as mentioned earlier,<sup>(3)</sup> and at the present annual rate of exploitation, i.e. a little less than (68 mn.tons a year) the Iraq oil exports are expected to continue, other things remaining the same, for more than (50) years.

Therefore, the guarantee of such a resource of revenue is worth spending (£100 mn.) now, particularly as the sum of (£15.mn) annually which is now being paid to the Syrian Government could be diverted to service the capital costs of providing alternative means, bearing in mind that the construction that would be needed, would not only be the pipeline and its ancillary equipments but also allocations to port installations at Basrah

(4) The building of such a pipeline would provide employment for Iraqi workers during the construction process, and to operate the pipeline after it had been finished. These reasons, in my view, are more than good enough to induce the Iraqi Government to build an alternative pipeline, and to make use of the important source of revenues, as the Economist has said : "Iraq oil is cheap and attractive, the Kirkuk field is among the most prolific in the world and much too good to risk losing".<sup>(4)</sup>

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(1) The Financial Times, Friday January 27,1967, No.24143.

(2) The arguments presented above in favour of constructing an alternative pipeline are purely and entirely based on economic considerations. But it must be borne in mind that sometimes governments make decisions depending on political reasons with little or no regard to economic considerations.

(3) See P.( 27 )

(4) The Economist 4-10 March 1967, P.854

The Public Debt <sup>(1)</sup>

In later parts of this dissertation, the method of deficit financing, under certain conditions and within certain limits is advocated to provide part of the funds needed to finance development programmes in underdeveloped countries. This method is intended to be applicable, with some other modifications dependent on local circumstances, to any underdeveloped country, but it is more particularly related here to Iraq. Consequently if and when a country decides to use deficit financing the procedure will be for the central bank of that country to make available additional credit to the planning and spending authorities i.e. to the government. It is expected, therefore, other things being equal, that the public debt will increase. Accordingly, it is important to know whether that country has a large or small public debt. In order to make a judgement as to whether a country has a large or a small public debt, we should have some sort of measure, to enable us to make a sound judgement. To calculate the percentage of the national debt to the national income for several years in two or three countries, and to make a comparison between the ratio and the increase or decrease of the percentages during the same period in these two or three countries may serve as a very rough measure. It is important to emphasise here, that, if the comparison is to be accurate the comparison should be made between countries which have passed through, roughly, similar circumstances. The greater the similarity, the more accurate the comparison becomes. However, since it is very difficult, if not impossible, to find two countries

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(1) It is not our concern here, to go into any great detail about the composition of the public debt; or the purposes for which the previous loans were used; our main concern is the size of the public debt as a percentage of the national income, together with such examination of the uses to which loan-based financing has been applied as may assist in answering questions concerning the quality of the investments that have been made.

with entirely similar circumstances, it may be useful to compare the Iraqi public debt with that of an underdeveloped country e.g. Turkey. Nevertheless, comparison with a developed country, e.g. the United Kingdom will be made to show that even developed countries may have a large public debt, though the use of the borrowed funds is entirely different. When an underdeveloped country borrows, the loans are usually but not always, used to finance investment i.e. development programmes. But a developed country like the United Kingdom accumulated a large public debt, as the analysis will attempt to show, because it had to finance two major wars.

Table 13, (Appendix 6) shows the ratio of the Net National Debt (NND) to Net National Income (NNI) in Iraq for the period between 1959-1963. In 1959, the (NND) was 6.2% of the (NNI). In 1960, the (NND) rose by (35.2%), the (NNI) by (11.6%), and the ratio became (7.5). In 1961, the (NND) increased by (16.7%), the (NNI) by (10.8%), and the ratio increased slightly from (7.5) to (7.5). In the following year, the (NND) rose by (61.5%) the (NNI) by (8.7%), and the ratio became (11.2), which was relatively high.

There were two reasons for this :-

- (a) the increase of the Treasury Bills from (I.D 20 mn.) in 1961 to (I.D 33 mn.) in 1962, i.e. by (65%).
- (b) the increase in the amounts drawn upon the Soviet loan from (I.D 6.9 mn.) to (I.D 17.3 mn.) i.e. by (150.7%)<sup>(1)</sup>. As may be seen from the table which follows, these two changes had the effect of raising the (NND) from approximately (I.D 36 mn) to approximately (I.D 59 mn). In 1963, the (NND) rose by (35%) while the (NNI) decreased by a little more than 2%. The ratio of the (NND) to (NNI) rose to (15.7). This relatively high increase was due partly to the Kuwaiti loan of (I.D 30 mn) which was fully paid to the Iraqi Government during the year under review, and partly because of the decrease of the (NNI), as mentioned earlier.

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(1) The C.B.I., Quarterly Bulletin, July-September, 1965, Government Press, 1966. P.52

The above analysis has shown that the ratio of the (NND) to the (NNI) rose from (6.2) to (15.7) in five years only. This reflects the Governments' policy after 1958, in issuing more loans internally, and to contract loans externally.

Having said this much about the percentages of change and the growth of the Net National debt as a ratio of the Net National income of Iraq the Net National debt of another underdeveloped country, i.e. Turkey will be discussed in the same way, in order to make a rough comparison. This is done in Table 14 which shows the ratio of the Net National debt (NND) to Net National income (NNI) in Turkey for the period between 1959-1963. The table shows that in 1959, the ratio of the (NND) to (NNI) of Turkey was a little more than 19%. The (NND) rate of increase during the period under review was higher than the rate of increase in the national income. Consequently the ratio of the (NND) to (NNI) rose from (19.1) in 1959 to (29.8) i.e. almost double the ratio of the (NND) to the (NNI) of Iraq. However, it is not justifiable for us to think that only underdeveloped countries have public debts. A developed country, such as the United Kingdom has even a larger public debt as the analysis will show, but we must keep in mind that the United Kingdom accumulated a large public debt, not because she needed to borrow to finance development programmes but to finance two major wars which she had to fight<sup>(1)</sup>. Table 15 shows the ratio of the (NND) as of the (NNI) of the United Kingdom for the years between 1959 and 1963. This table shows that in 1959, the (NND) was (1.4) times the (NNI) of the United Kingdom. In 1960, the (NND) rose by (1.3%), the (NNI) by (6.7%), and the ratio fell to 133. In 1961, the (NND) increased by (5.8%) the (NNI) by (6.9%) and the ratio became 127. In 1962 the (NND) rose by (4.1%), the (NNI) by (6.3%), and the ratio fell to (123.5). In 1963, the (NND) rose by (4.1%), the (NNI) by (6.3%) and the ratio became 120. Now, if we make a comparison between the ratio of the (NND) and the (NNI) both in Iraq and the United Kingdom, we find that the

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(1) It has, of course, been increased considerably in recent years as a result of the nationalisation of various industries and services.

(NND) of Iraq forms a relatively small proportion of the national income (15.7%) in 1963. While in the United Kingdom the (NND) is a large one, because it is even larger than the national income. A consideration of quite a different character is that which is concerned with the use made by a particular country of finance which it has obtained by way of loan. It may, at least, be safe to say that, if a loan is obtained for the purpose of promoting economic development in an underdeveloped country, the project or projects which are to be financed by this loan, should yield enough returns to cover the interest and the instalments of the loan. Otherwise the services of the loan or loans, together with part repayment of capital, will diminish, possibly in a damaging manner, the resources which the country has at its disposal for its capital development programme. Therefore, it may be useful to touch upon the use of the loans obtained by the Iraqi Government in the last few years. Table (C)<sup>(1)</sup> shows the composition of the national debt of Iraq for the years 1959-1965. The variation in the total of Iraqi Government Bonds indicates a tendency to decrease between 1959-1964, i.e. it fell from (I.D 11 mn.) to (I.D 6 mn.), but it rose to (I.D 11 mn.) in 1965. The outstanding figure for the Iraqi Government Bonds represents a total of Bonds issued at different times for different purposes. In 1955 for example the Government issued Bonds with total value of (I.D 4 mn.) for ten years at 3.5% interest for the purpose of financing Oil refineries. In 1956, the Government issued Bonds with a total amount of (I.D 2 mn.) for (15) years at 3.5% interest, and (I.D 1 mn.), bearing the same rate of interest and redeemable in (15) years.<sup>(2)</sup> These two loans were issued on behalf of the

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(1) Table 'C' P.( 42 )

(2) The C.B.I. Annual Report, 1963, Baghdad, 1965 (in Arabic) P.60

Baghdad Municipal Affairs, to be used for the improvement in public utilities. The major holders of Government Bonds are the Central Bank of Iraq (C.B.I.)<sup>(1)</sup> and Government and semi-Government Departments.

The second item in the internal debt consists of the Treasury Bills. These bills are issued for a short time usually (3 months), to cover the current government expenditure, before the receipt of the quarterly oil revenue instalments. The Central and the commercial banks hold the major part of the Treasury Bills, because the minimum value of a Treasury Bill is (I.D 10.000), which is beyond the reach of most Iraqis<sup>(2)</sup>. The table shows the remaining part of a loan granted by the oil companies operating in Iraq after the temporary stoppage of oil exports due to the Suez Crisis. This loan was repaid fully by the end of 1960.<sup>(3)</sup> In 1963, an interest free loan of (I.D 30 mn.) was granted to the Iraqi Government by Kuwait. This loan was made for two purposes :

- (1) To meet the increase in Iraqi Government expenditure.
- (2) To increase foreign assets i.e. the currency cover, in Iraq<sup>(4)</sup>.

Therefore this loan was not used for development purposes, but, nevertheless it was used to stabilise the exchange value of the Iraqi currency which is an important aim by itself. The third item in the table is foreign loans for development. Under this heading the table shows amounts drawn upon a Soviet loan. These amounts were drawn in accordance with an Iraqi-Soviet economic agreement, which was signed in 1959, involving a loan of

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(1) In 1963 the C.B.I. held 41% of total Government Bonds, Ibid P.61.

(2) Ibid P.61.

(3) The Economist Intelligence Unit, Annual Report, 1963, P.16.

(4) The C.B.I. Annual Report, 1963, Baghdad 1965, P.62 (in Arabic).



(I.D 65.3 mn.) bearing an interest rate of 2%. In accordance with the agreement, Russia, is to set up projects agreed upon with the Iraqi Government and to provide the know-how in running the projects in the beginning, and train Iraqis to take over afterwards. Some of these projects have started production, some have not yet been finished. If the purpose of this dissertation were different from what it is, namely the possible contribution of the banking system in Iraq to the promotion of economic development, it would be both useful and necessary to go into details about each project, its productivity, and its likely influence on the Iraqi economy. As it is, it may be enough to attempt to pass a more general judgement on the position. In 1963, there was a poor harvest in Iraq. Consequently, an agreement between Iraq and the U.S.A. was reached. Under this agreement the latter is to provide wheat and tobacco to a total value of (I.D 5.3 mn.) to be paid in (19) yearly instalments. It is obvious that this loan is a loan for consumption purposes.

Nevertheless, it may be safe to say that, it was necessary for Iraq to reach such an agreement because of the crop failure. The last item in the foreign loans for development is the Export-Import Bank loan to finance the instalment of an electrical unit in Baghdad at a total cost of (I.D 3.5 mn.) . In a developing country like Iraq, and indeed in developing countries generally, it is important that there should be at least a minimum provision of energy, whether in the form of electrical energy or any other sort. Energy is the foundation of power and adequate availability of power is a necessity if development programmes are to be successfully executed. This brief discussion of the composition of the Iraqi public debt shows that the Iraqi Government started from

1958 onwards, to borrow from different countries for different purposes. However, notwithstanding the fact that total public debt has increased from (I.D 24.673 mn.) at the end of 1959, to (I.D 131.791 mn.) at the end of 1965, it may be accepted as reasonable to suggest as a provisional assessment of the position, that, having regarded to the still relatively small total of the debt<sup>(1)</sup> and also to the significantly large contribution to public revenues originating in oil payments, the Iraqi Government is still<sup>(2)</sup> in a position which enables her to sustain an increase in international debt, and also external loans, without necessarily incurring great danger to the stability of her economy.

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- (1) It has to be remembered that not until very recently, that Iraq began the practice of accumulating a public debt: even so it is still necessary that regard should be paid to the purposes to which the loans are put.
- (2) It is also noteworthy that a good deal of the debt has been contracted at remarkably low rates of interest.

TABLE 'C'

Iraqi Public Debt as at the end of the Calendar years 1959 - 1965  
( In thousands of Iraqi Dinars ).

Details	Dec 1959	Dec 1960	% of change	Dec 1961	% of change	Dec 1962	% of change	1963	% of change	1964	% of change	1965	% of change
Internal Loans													
Iraqi Government Bonds	11.000	10.200	-7.3	9.400	-7.9	8.600	8.8	7.800	-9.3	6.000	-20	11.000	83.3
Treasury Bills	5.000	15.000	200	20.000	33.3	33.000	65	17.000	-48.5	30.000	76.5	50.000	66.7
Total	16.000	25.200	58	29.400	-16.7	41.600	41.1	24.800	-40.2	36.000	45	61.000	70
Oil Companies	8.673	4.503	-91	-	-	-	-	-	-	-	-	-	-
Kuwait Loan	-	-	-	-	-	-	-	30.000	-	30.000	-	30.000	-
Soviet loan(*)	-	1.654	-	6.684	-	16.477	150	25.045	51.5	32.486	28	34.503	6.1
American Agriculture Surplus Agreement (P.I.480)-	-	-	-	-	-	-	-	1.594	-	4.226	165	3.920	-7.2
Export and Import Banks' loan (1)	-	-	-	-	-	-	-	-	-	0.875	-	2.368	-
Total	8.673	6.157	-29.1	7.093	15	16.477	132.3	56.639	243	67.581	17.7	70.791	5
Foreign Loans	24.673	31.357	27	36.493	16.7	58.077	61.5	81.439	35.5	103.581	27.2	131.791	
Grand Total													

(\*) Amount drawn from the loan less repayments. No instalment was paid off during the years 1960 and 1961

(1) Figures regarding Import and Export Banks' loans are taken from credits and foreign payments section from the Central Bank of Iraq.

Source : The Central Bank of Iraq Quarterly Bulletin, October - December 1963 and 1965, Government Press 1966, P.51

### The National Income of Iraq.

The first estimate of the national income of Iraq was made by the United Nations in 1949. According to this estimate Iraq's national income at that year was about (I.D. 150 mn.). This means, according to Professor Langely that, "the U.N. estimate suggested that per capita income was about \$85;"<sup>(1)</sup> or (I.D. 35) and this is calculated at the devalued rate of the Iraqi dinar, i.e. (\$2.8). Afterwards, three attempts to estimate the national income of Iraq were made; these fall in the period between 1956 and 1964. It is out of the scope of the present study to discuss the methods of calculating the national income accounts; and therefore, this study will be confined to introduction of the results of these three attempts. The first attempt was conducted by Dr. K.G. Fenelon, who was, until the end of 1958, the statistical expert to the Iraqi Government. In 1958, Dr. Fenelon published his estimates for the national income of Iraq for the period between 1950 - 1956, in which the national income was calculated from the expenditure side. His reason for choosing this method was "....The National expenditure approach has been selected because fewer estimates are needed for those earlier years than would be involved in direct income calculations."<sup>(2)</sup>

The second attempt was made in 1961 by the Soviet statistician V.Maniakin, at the request of the Iraqi Ministry of Planning. Maniakin used the production method, and applied

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(1) Langely, K.M., The industrialisation of Iraq, Harvard Middle Eastern Monograph Series, Harvard University Press, Second Printing 1962, P.177 and P.303.

(2) Fenelon, K.G., Iraq, National Income and Expenditure 1950-1956, Al-Rabita Press, Baghdad, 1958.

the marxist concept of national income. Therefore, he divides the national income into two large parts or sectors :- the productive sector, and non-productive sector. In the productive sector he includes, agriculture and livestock industry, oil industry, trade, construction, and road transport. The non-productive sector includes, passenger transport, finance, science research, health, and defence. But as a result of Iraqi Ministry of planning pressure, he included both the productive and the non-productive output in his estimates.<sup>(1)</sup> The third attempt was made by an Iraqi Economist, Dr.K. Haseeb, and his study and estimates were published in a book entitled 'The National Income of Iraq 1953-61'. On the 29th of May, 1964, the same author delivered a lecture to a Seminar arranged by the Economic Research Institute of the American University of Beirut. In his lecture, he gave the results of the 1962 and 1963 estimates on the one hand, and introduced certain revisions of his previous estimates of the national income of Iraq for the period 1953-1961 on the other. The present study, will confine itself to a display of Dr.Haseeb's estimates, for the following reasons :-

- (1) Dr. Haseeb's attempt covers a longer period :- namely the period between 1953 - 1963.
- (2) As Dr.Haseeb has said, "In general I shall follow the recommendations and rules laid down by the Statistical Office of the United Nations in their various publications on the subject."<sup>(2)</sup> This makes it possible to make comparisons with other countries.

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- (1) Maniakın, V., The National Income of Iraq, 1956-1960 (in Arabic) The Ministry of Planning, Central Bureau of Statistics, Iraq. For criticisms of the estimates made by Dr.Fenelon and Mr. Maniakın see, Ashor, I., National Income Statistics in the Arab Countries, Arabic Economic Review (Beirut) June 1962, P.113, Arnest, J., Iraqi National Income Accounts (Iraq) Economist Journal of Iraqi Economic Association April 1962 P.29, and Dr. Haseeb's book, which is mentioned above.
  - (2) Haseeb, K., National Income of Iraq, 1962 and 1963. Lecture delivered to a Seminar arranged by the Economic Research Institute of the American University of Beirut on the 29th May, 1964. P. (1)

(3) In the last chapter of his book, Dr. Haseeb gives a table showing the "Margin of Error" of the value added of each sector; and for the national income as a whole. For example, the margin of error for the national income as a whole lies between (-7) and (+9) per cent for the years 1953-4, and 1958-61. For 1955 it is between (-7) and (+8) per cent, for 1956, between (-8) and (+9) per cent; and for 1957 between (-9) and (+10) per cent.<sup>(1)</sup>

Nevertheless, a reference to the estimates made by Dr. Fenelon, and Mr. Maniakın by way of comparison with those of Dr. Haseeb's for the same period, may be useful. The table which follows,<sup>(2)</sup> shows that, Dr. Fenelon's estimate of the national income of Iraq, for 1953, was (5) per cent more than Dr. Haseeb's for the same year.

However, Dr. Fenelon's estimate for 1956, which is (I.D. 303 mn) is (10) per cent lower than Dr. Haseeb's (I.D. 337.6 mn). for the same year. Furthermore, Dr. Fenelon's estimates give a compound rate of increase in the national income between 1953-56 of (5.4) per cent per annum at current prices, and (3.3%) at constant (1956) prices. Dr. Haseeb's estimates give (11.1%) per annum at current prices; and (8.4%) per annum at constant prices. As for Mr. Maniakın's estimates, these estimates, as far as the national income as a whole is concerned, are lower than Dr. Haseeb, while his figures for the rate of growth are higher for the same period. Maniakın's estimates for 1956 and 1960, at current prices are (13.6%) and (4.2%) less than Haseeb's.

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(1) Haseeb, K., National Income of Iraq, 1953-1961, Oxford University Press, 1966. PP. 181 - 182.

(2) Table D (P. 46 )

Maniakın's estimates give a compound rate of growth of over (10.2%) per annum, at current prices, and about (9.7%) at constant (1956) prices; while Haseeb's estimates give a compound rate of growth of (7.4%) per annum, at current prices, and (5.9%) at constant prices.<sup>(1)</sup>

Table D

Comparison of Estimates of the National Income of Iraq, for the period 1950-1961 (in millions of Iraqi dinars).

YEAR	Fenelon		Maniakın		Haseeb	
	At current Prices	At 1956 Prices	At current Prices	At 1956 Prices	At current Prices	At 1956 Prices
1950	158	165	-	-	-	-
1951	184	179	-	-	-	-
1952	217	199	-	-	-	-
1953	259	276	-	-	243.9	267.8
1954	268	291	-	-	284.0	322.6
1955	289	307	-	-	289.3	299.0
1956	303	303	291.7	291.7	334.8	334.8
1957	-	-	298.0	290.1	357.7	348.4
1958	-	-	318.6	317.8	374.0	363.2
1959	-	-	379.8	373.3	391.6	368.6
1960	-	-	431.0	422.1	437.1	412.7
1961	-	-	-	-	484.2	468.6
1962	-	-	-	-	526.5	503.1
1963	-	-	-	-	515.4	489.5

Source: Lecture delivered by Dr.K.Haseeb to a Seminar arranged by the Economic Research Institute of the American University of Beirut on the 29th May 1964, P.18

- (1) Haseeb, K., The National Income of Iraq, 1953-1961. Oxford University Press, 1964, P.30-32.

It may be useful to point out here, that the comparison between Dr.Haseeb's estimates of the Iraq national income and other estimates, e.g. Dr.Fenelon's, and Mr.Maniakın's may not be absolutely correct in strict terms. This is because, Dr.Haseeb's estimates are liable to a certain margin of error, as he indicates, which make such a comparison correct to a certain limit only. This is not to imply that Dr.Haseeb estimates are less reliable than the others, it

This much having been said about the different estimates of the national income, attention may be concentrated on Dr.Haseeb's<sup>(1)</sup> estimates. The following table shows that the national income of Iraq has been increasing, apart from a decrease in 1955 and 1963 at constant prices, and in 1963 at current prices. The decline in the national income in 1955, was caused by the sharp decrease in the agricultural output, as will be shown later, when the contribution of the different sectors of the national income is discussed. As for the decline in the national income in 1963, this was caused partly by the decrease in the agricultural output; and partly because of the military operations against the Kurdish rebels in the north of Iraq. The table shows that the rate of growth in the national income from year to year is far from being regular. This point could be illustrated by the percentage of increase in the national income. The national income has increased by (21.6%) in 1954 over 1953, while it has increased at current prices only by (1.5%) in 1959; and this is one of the important characteristics of the underdeveloped economies. Furthermore, the table shows that the national income has more than doubled during the period 1953-1963 at current prices, and almost doubled at constant (1956) prices.

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(1) Table E (P. 48 ).

Footnote (1) continued from previous page ... ..

is rather that Dr.Haseeb is careful to indicate margins of error while the others do not: yet from their nature they must be liable to possible error either way, and we are not provided with any indication of the extent to which the margin of error may go.



TABLE 'E'

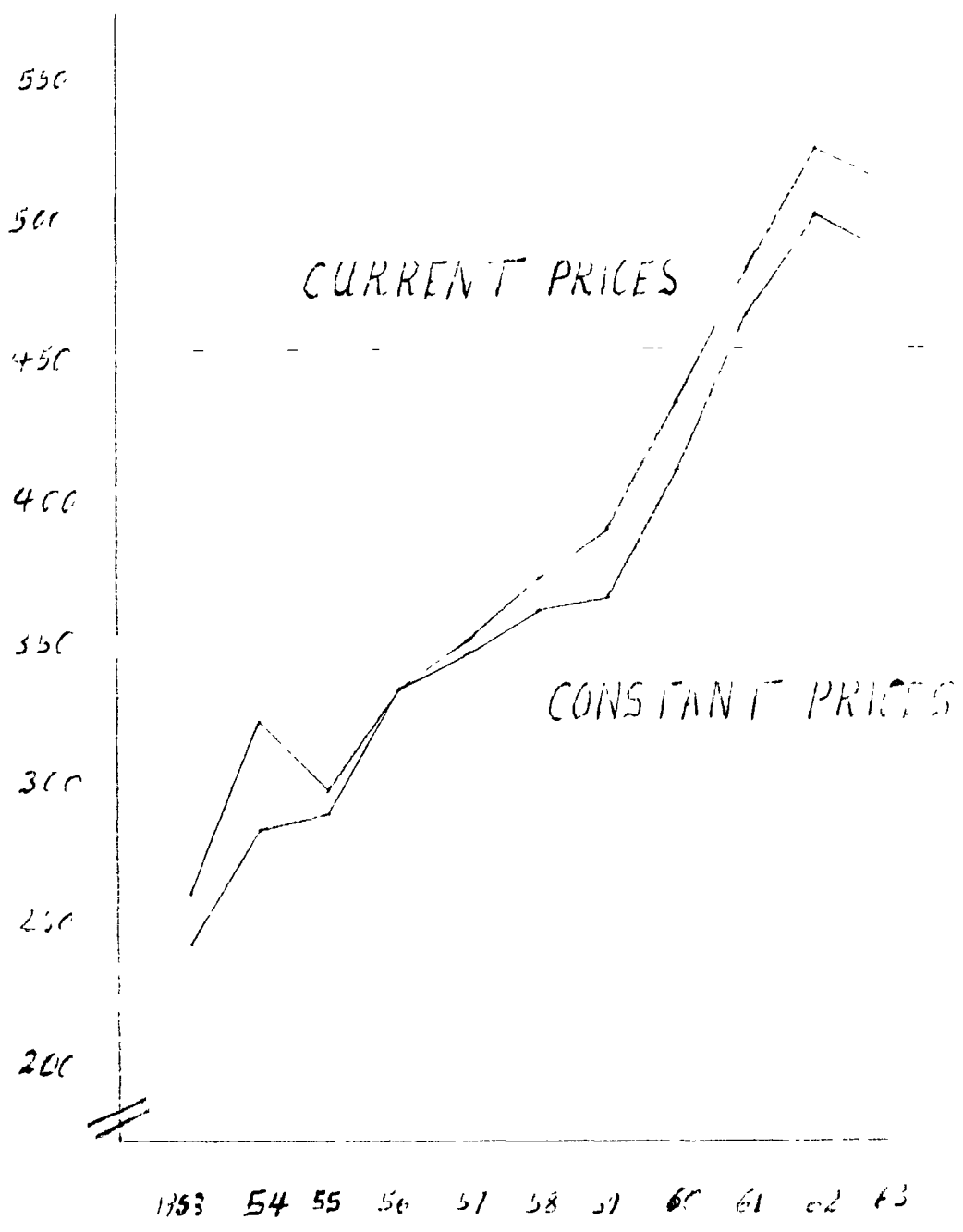
National Income of Iraq (1953 - 1963).

( I.D. mn. )

YEAR	At Current Prices		At 1956	Prices	Implicit <sup>(1)</sup>
	I.D. mn. ---	Percentage of increase over the preceding year.	I.D. mn. ---	Percentage of increase over the preceding year.	1956 = 100 --
1953	244.0	-	262.8	-	92.8
1954	284.0	16.4	322.6	22.8	88.0
1955	289.3	1.9	299.0	-7.3	96.8
1956	334.8	15.7	334.8	12.0	100.0
1957	352.7	5.4	348.4	4.1	101.2
1958	374.0	6.0	363.2	4.2	103.0
1959	391.6	4.7	368.6	1.5	106.2
1960	437.1	11.6	412.7	12.0	105.9
1961	484.2	10.8	468.6	13.6	103.3
1962	526.5	8.7	503.1	7.4	104.7
1963	515.4	-2.1	489.5	-2.7	105.3

Source: Lecture delivered by Dr.K.Haseeb to a Seminar arranged by the Economic Research Institute of the American University of Beirut, on the 29th of May, 1964, P.13.

(1)Dr. Haseeb means by Implicit prices the following :- "Column 6 of the table shows the implicit price index of the national income, with 1956 as the base".



The National Income Of Iraq, for the Years  
Between 1953-1963. At Current and  
Constant (1956) Prices.

One of the important measures of economic development and the standard of living in a country is the national income per capita. Therefore, it is necessary to refer to the following table, which gives the national income per capita for the period between 1953 - 1963.

TABLE 'F'

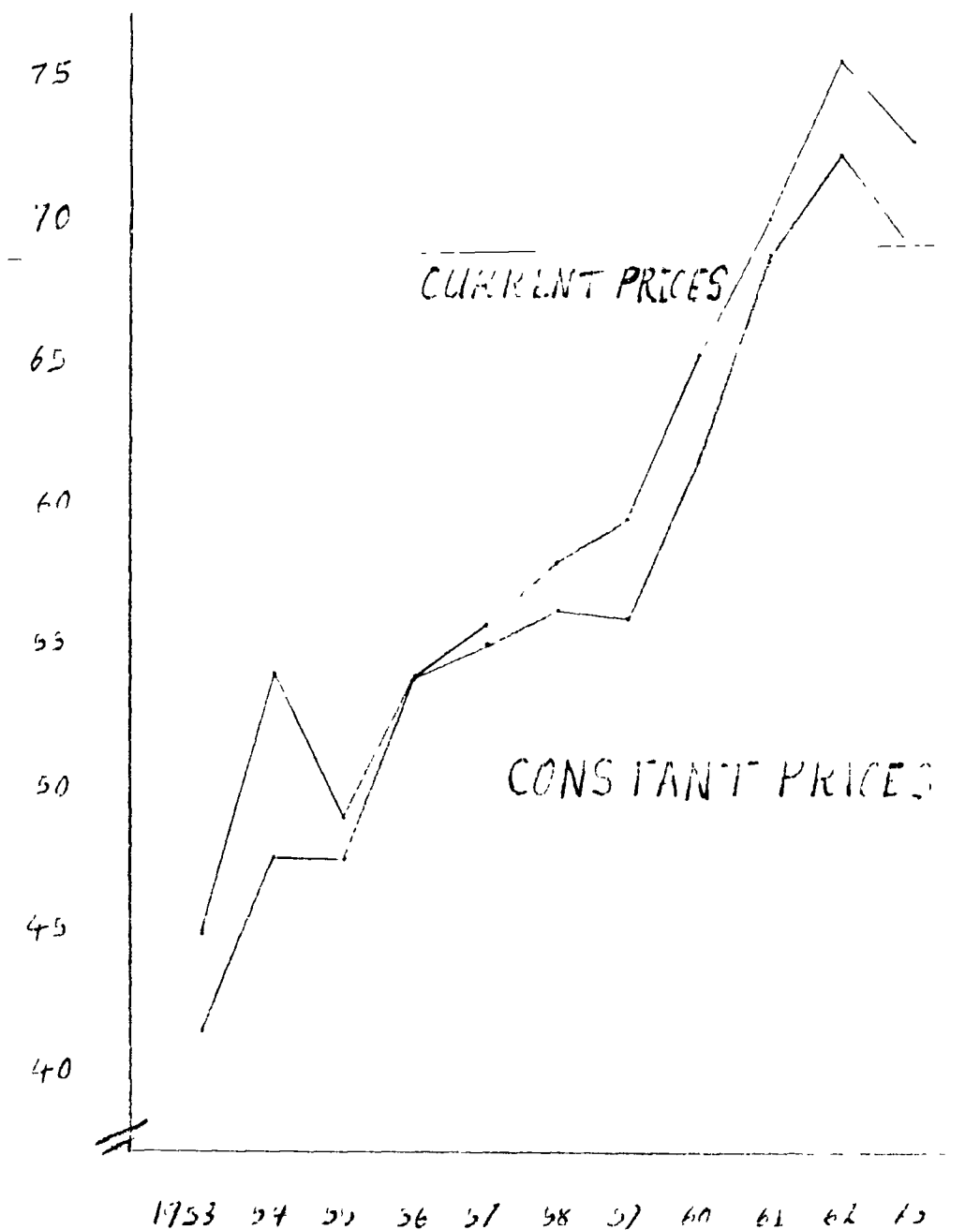
Per Capita National Income 1953 - 1963.

YEAR	National Income (I.D. mn. )		(1) Population (000)	Per Capita Income			
	At Current Prices	At 1956 Prices		At Current Prices		At 1956 Prices	
				I.D.	%increase over preceding year.	I.D.	% increase over precedin year.
1953	244.0	262.8	5832	41.8	-	45.1	-
1954	284.0	322.6	5945	47.8	14.4	54.3	20.4
1955	289.3	299.0	6061	47.7	-0.2	49.3	-9.2
1956	334.8	334.8	6180	54.2	13.6	54.2	9.9
1957	352.7	348.4	6301	56.0	3.3	55.3	2.0
1958	374.0	363.2	6423	58.2	3.9	56.5	2.2
1959	391.6	368.6	6548	59.8	2.7	56.3	-0.4
1960	437.1	412.7	6675	65.5	9.5	61.8	9.8
1961	484.2	468.6	6804	71.2	8.7	68.9	11.5
1962	526.5	503.1	6936	75.9	6.6	72.5	5.2
1963	515.4	489.5	7071	72.9	-4.0	69.2	-4.6

(1) Table 'F'

Source : Mem. by Dr.Haseeb, May 1964, P.14.

The population figures were interpolated from the adjusted 1947 and 1957 censuses of population. The FAO adjusted population figures for 1947 were used (see U.N.Food and Agriculture Organisation, Mediterranean Development Project, Iraq County Report, Rome 1959, P.6). gives a total population of 5.2mn in 1947 compared with 4.8 mn reported in the census. The 1957 Census was also adjusted to exclude the "estimated late registration" after the date of the Census and to include the "actual late registration" and to exclude also Iraq is living abroad at the time of the Census who were not covered by the 1947 Census. The 1957 Census gave 69.000 as living in the deserts. This was distributed between Mosul,



Per Capita National Income, for the Years  
Between 1953 - 1963. At Current and  
Constant (1956) Prices.

The table on page (48) which shows the national income per capita, is of limited use only; the reason is that, the national income per capita in each province or (Liwa ), differs from the others. Consequently, a reference to the regional distribution of the national income may not only be useful but possibly necessary for a correct view of the people in different regions of the country, (1) The table which follows shows the average per capita income, once including oil revenues, and once excluding them for the year 1956. The first column gives national income generated in each province including crude oil revenues which accrue to the government; because, these revenues form a part of the value added of the "Liwas", where crude oil is produced. These revenues have no direct effect on the oil producing regions, but they have indirect effects on the country as a whole; these revenues were therefore excluded in column (3). The column excludes oil revenues in the regions where oil is produced and/or the management or oil-pipelines are located (2) but it includes wages and salaries paid by the oil companies to employees living in the "Liwa " itself. This table shows that average per capita national income (excluding oil) varies to a large extent between different Liwas . While it is (I.D. 73.5 mn.) in Baghdad, it is only (I.D. 21.9) in Nassisiyah.

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(1) Table G (P.53 ).

(2) These Liwas are :-

Kirkuk, Bassah, Mosul, Baghdad and Ramadi.

Footnote Continued from previous page :

Dulaim, Diwanayah and Kerbelain in proportion to the rural population in each of them. The 1957 adjusted figure is 6.3 mn. On this basis the average compound rate of increase is 1.94 per cent per annum.

TABLE 'G'

Regional Distribution of the National Income, 1956.

(\* ) the 1956 figures were interpolated separately from the population of each province in the adjusted 1947 and 1957 Censuses of population.

PROVINCE	National Income (Net National Product)		National Income (excluding Oil Revenues)		Population (*) 000	Average per capita income	
	I.D. 000	%	I.D. 000	%		Including oil Revenues I.D.	Excluding oil Revenues I.D.
	(1)	(2)	(3)	(4)		(6)	(7)
Mosul	30807	9.2	28417	10.7	735	41.9	38.7
Arbil	10769	3.2	10769	4.0	269	40.0	40.0
Kirkuk	51718	15.5	16948	6.4	383	135.0	44.3
Sulaimamiyah	11386	3.4	11386	4.3	295	38.6	38.6
Baghdad	99123	29.6	94407	35.5	1285	77.1	73.5
Diyalah	12188	3.6	12188	4.6	326	37.4	37.4
Ramadi	17472	5.2	7846	2.9	241	72.5	32.6
Hilla	13291	4.0	13291	5.0	348	38.2	38.2
Kerbela	6611	2.0	6611	2.5	216	30.6	30.6
Kut	9297	2.8	9297	3.5	285	34.5	34.5
Basrah	38578	11.5	21220	8.0	495	77.9	42.9
Diwaniyah	12484	3.7	12484	4.7	524	23.8	23.8
Nasiriyah	9832	2.9	9832	3.7	449	21.9	21.9
Amarah	11199	3.4	11199	4.2	325	34.5	34.5
Total	334755	100.0	265895	100.0	6176		

Source: Haseeb, K. (Mem). May 1964 P.27

In order to give a brief idea about the structure of the Iraqi economy and the importance of each sector to the national income as a whole, the table which follows<sup>(1)</sup> gives percentages of each sector's contribution to the national income during the period between 1953 and 1963. As the important sectors of the economy, such as, agriculture, manufacturing, crude oil extraction, are discussed in earlier parts of this chapter, in analysing this table, the discussion will be therefore confined to an indication of the increase or the decrease of each sector's contribution to the national income during the period, without giving reasons for these changes.

This table shows that the largest contribution is made by the agricultural sector, which includes forestry and fishing, in 1953, this being about (29) per cent of the national income.<sup>(1)</sup> But this importance has been declining steadily during the period, with the exception of 1962, when the agricultural sectors' contribution rose by a little over than (2) per cent at current prices and just under (2) per cent at constant prices. Therefore, we find that, the agricultural sector's contribution has decreased from (29) to (20.7) per cent in 1963 at current prices, and from (32.6) to only (16.4) per cent in 1963 at constant prices. The second sector in importance is the crude oil extraction sector. This sector contributed, after adjusting the figures to allow for the oil companies share of profits, about (26) per cent in 1953, and decreased to become a little over (23) per cent in 1963 at current prices. It was (21) per cent in 1953 and increased to become (29) per cent in 1963, and so had taken first place in substitution for the agricultural sector.

Oil refining, which is included in the third sector, namely, manufacturing does not make an important contribution to the national income. Nevertheless, in 1953 it was (0.7) and rose to (1.5) per cent in 1963 at constant prices. The manufacturing sector as a whole contributed (7.2%) in 1953, and (11.3%) in 1963.

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(1) Table H (P. 55 )

(2) It might appear, at first sight, that there is a contradiction between the statement here and the figures in the table. It would seem from the latter that crude oil extraction should have first place. Strictly this is not so for the contribution (net) of crude oil extraction is only seen when income payable abroad in respect of oil dues has been deducted.

TABLE 'H'

Percentage Contribution of Each Sector To The National Product,  
both at Current and Constant Prices.

S E C T O R	At Current Prices				At (1956) Prices				
	1953	1958	1961	1962	1963	1958	1961	1962	1963
1. Agriculture, forestry and fishing	28.9	24.5	23.9	26.3	20.7	24.6	20.8	22.5	16.4
2. Mining and Quarrying									
a) Crude Oil extraction	49.7	44.7	41.0	37.8	44.3	45.8	49.9	46.7	55.3
b) other mining and Quarrying	0.3	0.5	0.4	0.3	0.3	0.5	0.4	0.3	0.4
Total Mining and Quarrying	50.0	44.9	41.4	38.1	44.6	46.3	50.3	47.0	55.7
3. Manufacturing :									
a) Oil refining	0.7	0.9	1.4	1.3	1.4	1.0	1.4	1.4	1.5
b) Other Manufacturing	6.9	7.6	9.8	9.9	9.8	7.7	9.5	9.9	9.8
Total Manufacturing	7.6	8.5	11.2	11.2	11.2	8.7	10.9	11.3	11.3
4. Construction	4.0	6.8	4.3	3.3	3.4	6.5	3.8	2.9	3.1
5. Electricity and Water	0.5	0.6	0.7	0.7	0.7	0.7	0.8	1.0	1.0
6. Transport, Communications & Storage	7.1	6.8	7.9	7.4	7.7	6.4	7.2	7.0	6.8
7. Wholesale and Retail Trade	7.1	7.1	7.3	7.1	6.7	7.1	7.5	7.4	6.6
8. Banking, Insurance, and Real Estate	1.3	2.0	2.2	2.2	2.4	2.3	1.9	1.9	1.9
9. Ownership of Dwellings	3.0	2.1	1.6	1.5	1.4	2.2	1.9	1.8	1.9
10. Public Administration and Defence	7.5	10.0	10.6	11.4	12.9	9.5	10.2	11.0	12.6
11. Services	6.6	7.7	8.3	8.6	9.3	7.3	8.7	8.4	9.0
12. Net Domestic Product at Factor Cost	123.6	121.0	119.4	117.8	121.0	121.6	124.0	122.3	126.3
13. Less Income to Abroad	-23.6	-21.0	-19.4	-17.8	-21.0	-21.6	-24.0	-22.3	-26.3
14. Net National Product At Factor Cost	100	100	100	100	100	100	100	100	100

Source: Haseeb, K. (Mem). May, 1964, P.(19).



The construction sector's contribution fluctuated during the period; it was (4.5) in 1953, rose to (6.5) per cent in 1958, and fell to (3.1) per cent in 1963. Electricity and water sectors' contribution rose steadily during the period from (0.4) in 1953 to (1) per cent in 1962 and 1963.

Transport, communications and storage sector, contributed (7.1) in 1953 and fluctuated during the period to become (6.8) per cent in 1963 at constant prices; and almost the same could be said about the wholesale and retail trade. This sector contributed (7.1%) in 1953 and (6.6%) in 1963, at constant prices.

Banking, insurance and real estate sector, contributed (1.2%) in 1953, rose to (2.3%) in 1958, and fell to (1.9%) in 1963, at constant prices. Ownership of dwellings fell from (2.8%) in 1953 to (1.9%) in 1963, at constant prices. Public administration and defence sector's contribution rose steadily during the period from (8.6) in 1953 to (12.6) per cent in 1963 at constant prices. The last sector is the public services sector. This sector contributed, (7.5) in 1953 and (9.0) per cent in 1963. Having said this much about the contribution of each sector in the national income, a brief reference to the distribution of national income by current factor incomes may be useful. The following table <sup>(1)</sup> shows that agricultural income, as a percentage of total incomes received by factors of production during the period, has been declining steadily. It fell from (28.6%) in 1953 to (21.5%) in 1960, while wages and salaries have been increasing steadily during the period. They rose from (22.6%) in 1953, to (32.2%) in 1960.

The third element is rent, which has been decreasing during the period. It fell from (5.2%) in 1953 to (3.8%) in 1960. Interest represented (1.2%) in 1953, rose to (2.0%) in 1956, and fell to only (0.8%) in 1960. The last element is profits. This element has the largest share of the current factor incomes. It was (42.4%) in 1953, fell to (40.7%) in 1956, and rose to (41.7%) in 1960.

TABLE 'I'  
Distribution of National Income by Current Factor  
Incomes, 1953, 1956, and 1960.

	1953		1956		1960	
	I.D. mn.	%	I.D. mn	%	I.D. mn	%
Agricultural incomes*	70.6	28.6	88.1	26.1	96.5	21.5
Wages and salaries	55.4	22.6	90.1	26.7	145.6	32.2
Rent	12.7	5.2	15.3	4.5	17.1	3.8
Interest	2.8	1.2	6.6	2.0	3.8	0.8
Profits +	104.4	42.4	137.5	40.7	186.7	41.7
Total	245.9	100.0	337.6	100.0	449.7	100.0

\* Including all types of factor incomes.

+ Including earnings of the self-employed.

Profits are estimated before the deduction of income tax, and also undistributed profits and the share of Government and oil companies in profits from crude oil extraction.

Source: Haseeb, K., The National Income of Iraq, 1953-61, Oxford University Press, 1964, P.24

Although the prime concern of this dissertation is to deal with the monetary system and institutions, a reference to the non-monetary, or the subsistence national income may not be out of place. The table which follows<sup>(1)</sup> shows the subsistence national income for the period between 1953 and 1956, at current and constant prices. The table shows that the important contributions to the total subsistence output were made by agriculture. In the manufacturing and the construction sectors, subsistence contributions are not significant. The other, relatively, important contribution is made in the ownership of dwellings. The table shows that, subsistence national income during the period as a percentage of the national income as a whole did not exceed (9.9%) at current prices and (12.2%) at constant prices.

(1) Table J (P. 59)

These figures may surprise economists who have studied the Iraqi economy; as Dr. Haseeb has said, "These results may surprise many economists who have dealt with the economy of Iraq, and who have; tended to exaggerate the importance of the subsistence economy".<sup>(1)</sup>

The foregoing discussion has dealt with various aspects of the Iraqi economy in considerable detail. Consequently it is long and very factual. A justification for this form of treatment is suggested briefly on page (i) of the Introduction; footnote (1). The significance of the facts presented, considered more generally is that the Iraqi economy is shown as having many of the characteristics of an underdeveloped economy, such as, low national income per capita, a relatively very small industrial (manufacturing) sector, a very large agricultural sector and relatively little development in the fields of health, education and other social amenities. This is by no means the whole story however. The Iraqi economy is not without potentialities for possibly considerable development. There is a plentiful supply of cultivable and fertile land: the Tigris and Euphrates, in addition to rainfall, provide Iraq with a good opportunity for agricultural development, both as a basis for export and for maintaining a growing industrial population: high though the natural rate of increase of population it is may still be thought that Iraq faces no problem of overpopulation. In addition Iraq has a very considerable source of economic strength in its oil supplies. Oil provides large amounts of foreign exchange and a source of raw materials and energy. Iraq has had no serious deficits in its balance of payments, and is free from a crippling large public debt. All the same there are certain elements in the situation which could produce difficulty and dislocation. Agricultural output is, to an important degree, dependent upon rainfall: and there can be disturbing variations between one year and another: some of the detailed description in the body of the chapter is intended to bring out this degree of variability. In addition the continuation of revenue from oil deliveries can be threatened by political disturbances. In some degree therefore, Iraq must be regarded as both potentially favoured and yet of some time vulnerable.<sup>(2)</sup> Iraq has a real and urgent need for that degree of stability, whether natural or institutional, on which any economy must depend if it is to progress and develop.

TABLE 'J'

## Subsistence National Income, 1953-6.

( I.D. mn).

	At Current Prices				At 1956 Prices			
	1953	1954	1955	1956	1953	1954	1955	1956
Agriculture :								
Field crops	10.08	12.03	9.77	14.90	13.36	21.39	10.62	14.90
Vegetables	1.23	1.40	0.80	1.41	1.51	2.06	0.82	1.41
Fruit and Dates	0.70	0.70	0.72	0.67	0.73	0.91	0.71	0.67
Livestock	6.81	8.69	6.74	8.95	7.72	9.60	7.05	8.95
Forestry	0.13	0.14	0.16	0.15	0.14	0.15	0.15	0.15
Fishing	0.10	0.13	0.14	0.15	0.13	0.14	0.15	0.15
Total agriculture	19.05	23.09	18.33	26.23	23.79	34.25	19.50	26.23
Manufacturing	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Construction	0.58	0.59	0.60	0.61	0.58	0.59	0.60	0.61
Ownership of Dwellings	4.38	4.49	4.60	4.68	4.36	4.46	4.56	4.68
Total Subsistence <sup>NI</sup>	24.21	28.37	23.73	31.72	28.93	39.50	24.86	31.72
N I	245.8	285.84	291.22	337.64	265.22	322.55	301.44	337.64
Subsistence NI as % of total NI	9.8	9.9	8.1	9.4	10.9	12.2	8.2	9.4
Subsistence value added in agriculture as % of total value added in agriculture.	27.0	27.6	28.5	29.8	27.8	30.1	28.5	29.8

Source : Haseeb, K. The National Income of Iraq, 1953 - 1961.  
Oxford University Press, 1964, P.27

Footnotes (1) and (2) from previous page :

- (1) Haseeb, K., The National Income of Iraq, 1953-1961. Oxford University Press, 1964. P.27
- (2) The greatest dislocation experienced by the Iraqi economy in recent years occurred in 1967. For reasons which it is hoped may be obvious no specific reference to this is made in this dissertation.

## CHAPTER TWO

"THE EXPERIENCES OF THE IRAQI MONETARY AUTHORITIES 1930-1965  
WITH SOME CONSIDERATION OF THE IMPLICATIONS THESE HAVE IN RELATION  
TO THE QUESTION OF THE EFFICIENCY OF THE AUTHORITIES .

The main object of this dissertation is to analyse the contribution which banking systems in underdeveloped countries in general and in Iraq in particular, might be able to make in promotion of economic development. One of the means, the important one in fact, so far as the argument of this dissertation is concerned, is deficit financing. In later parts of this dissertation a model of an underdeveloped country where deficit financing is used to fill a gap between available and minimum financial requirements for a five year development programme is presented.

This is a device which should be used only in specified conditions and within specifiable limits. However, it is assumed, and the analysis throughout the model shows, that a moderate degree of inflation is expected to be brought about as one of the outcomes of using deficit financing. It is argued in this dissertation that it is not always the case that what begins as a moderate inflation will tend to get out of hand and turn into hyper inflation, as the explosive theory of inflation suggests. It is possible to keep moderate inflation under control and within limits. However, one of the most important factors in doing so, is the presence of efficient and experienced monetary authorities. The device of deficit financing is adopted and adjusted in later parts of this dissertation to suit the circumstances in Iraq. Therefore, it is necessary to examine the extent to which the relevant monetary authorities in Iraq may be judged to be efficient and responsible enough to control the expected inflation. To lead up to such an assessment, it is essential to discuss, briefly, the formation and organisation of monetary authorities in Iraq. Furthermore, it is necessary to discuss the situations which these authorities have had to face in the last three decades or so, and to examine decisions taken in important monetary matters, in order to make judgements as to whether these decisions were

the best possible; decisions, such as establishing a currency board and not a Central Bank in 1932, becoming a member of the sterling area in 1941, imposing of foreign exchange control during World War II, issuing internal loans among other means to curb inflationary pressures in 1944 and 1948, establishing a central bank to replace the Currency Board in 1947, leaving the sterling area in 1959, nationalisation of commercial banks according to Law No. (100) of 1964, which gave the Central Bank a wide power to control these banks, and finally the decision to modify these powers according to Law No. (166) of 1965.

The first decision i.e. to establish a currency board and not a Central Bank was taken in 1931, when Iraq was accepted as a member of the League of Nations as an independent state and issued its own monetary unit, i.e. the Iraqi Dinar in the following year. The currency law No. (44) of 1931, decreed that the Iraqi Dinar was to be issued on the bullion exchange standard and to be equal to (7.3223 grams) of fine gold,<sup>(1)</sup> and a Currency Board to be established to administer all matters concerning the currency. But because the United Kingdom abandoned the gold standard, this law was amended by Law No. (101) of 1931. This amendment decreed that Iraqi Dinars should be issued on the Sterling Exchange Standard. According to a second amendment the date of issue was postponed from 1st April 1931, to April 1932. The currency was actually issued and put into circulation at the latter date. The currency in circulation until the issuing of the Iraqi National Currency was the Indian rupee which was on the Sterling Exchange Standard. Therefore, the Iraqi Dinars were issued against the equivalent rupees or sterling value.

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(1) The Iraqi Dinar at present is equal to (2.8828 grams) of fine gold. According to the Currency Act No.(42) of 1947 the value of the dinar was fixed at (3.58134 grammes) of pure gold. In 1949, however, it was depreciated to its present value following the devaluation of the pound sterling.

Establishment and Composition of the Currency Board :-

In accordance with Article (13) of Law No.(44) of 1931, and its amendments of the same year (the Currency Law) it was enacted that a Currency Board should be established, and that this Board should represent the Iraqi Government in all matters concerning the Iraqi National Currency. The decision to establish a Currency Board and not a Central Bank, as some Iraqi politicians suggested was, in my view a right decision. This is because, if a Central Bank was to be set up in Iraq at that time, it would have to be run by foreign personnel and with foreign capital; Iraq could not afford either of these.

The Currency Board however, was, clearly, not regarded as a permanent substitute for a Central Bank, because, Article (24) of the Currency Law No.(44) of 1931, and its amendments of the same year indicated that :-  
if a Central Bank, or any other Bank with authority for issuing currency, should be established in Iraq, the Currency Board's powers and duties should cease and the Central Bank should take them over.

Composition of The Currency Board.

Article (14) of the Currency Law of 1931, provided as follows :- A Currency Board is to be set up by a Royal Decree. This Board shall be composed of :

- (a) Two members to be chosen by the Iraqi Government.
- (b) Two members to be chosen by the Eastern Bank, the Ottoman Bank, and the British Bank for Iran and the Middle East, as long as these banks were operating in Iraq.

It was intended that these three banks should agree among them to choose two members; if they could not reach an agreement, each of the first two banks should choose one member, then the second and the third bank should choose one member each, and so on.

This arrangement was to be followed until the banks reached an agreement among themselves. It was further intended that one member should be chosen either by the Bank of England or the League of Nations' Financial Committee at the Iraqi Government's request. The Iraqi Government was given the power to choose one of the members to be a Chairman of the Board. Each member should be appointed for <sup>a</sup> three year term, and each could be reappointed on future occasions without any limit being set to their number.

The Minister of Finance was to decide the remuneration to be paid to each member of the Board. This is the way in which the Currency Board was intended to be composed according to the Currency Law; but what actually happened was rather different. Regarding the first two members of the Board, the Iraqi Government usually appointed a British person with knowledge and experience in economics and financial matters as one of them. The second member was usually the Iraqi General Consul in London, i.e. a politician with little or no knowledge of economics or banking. The three banks then operating in Iraq, i.e. the Eastern Bank, the Ottoman Bank, and the British Bank for Iran and the Middle East, were branches of British owned banks. Therefore, these three banks agreed among them upon two



members to represent them on the Currency Board. As for the fifth member, this member was to be chosen either by the league of Nations' Financial Committee or by the Bank of England. However the British Government expressed the Bank of England's readiness to choose a member as its representative on the Currency Board, and the Iraqi Government agreed to that request.<sup>(1)</sup> The Iraqi Government had responsibility for the Currency Board's activities and these activities were answerable to Parliament through the Minister of Finance. But notwithstanding this link of responsibility, the Iraqi Government was left without right to refuse the members chosen by the commercial banks and the Bank of England. The Iraqi Government was represented on the Currency Board by one Iraqi member only, because the other member to be chosen by the government has been always British with knowledge of economics and banking. While this may seem to leave the Iraqi Government, as the sovereign power so to say, merely on the fringe of control, it reflects two things :-

- (a) the dependence of Iraq on foreign experts at that time.
- (b) In so far as the Iraq Government accepted this arrangement and showed itself ready to allow the Bank of England to nominate the right people to take charge of matters concerning the Iraqi Currency, this shows the dependence of Iraqi authority on the British Monetary Authorities at that time. Bearing in mind that Iraq was an emerging country which took its dependence recently, with no great knowledge of how to administer a national currency problem, it may be safe to say, the Iraq Government had had not much choice but to accept this arrangement, which may reflect sound sense, as far as the financial and economic side of the matter is concerned.

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(1) EL. Kaissi, F., Critical Analysis of Central Banking in Iraq, Un-published Ph.D. Thesis, University of Southern California, 1957, PP. (109 - 111).

Tasks and powers of the Currency Board :

Article 16 of the Currency Law of 1931, indicates that the Currency Board's duties were as follows :-

- (a) The Currency Board's main responsibility was to be, in consultation with the Iraqi Government, to provide for and to control the supply of currency, and to ensure its stability.
- (b) The Currency Board to be, in consultation with the Irāqī Government, responsible for making all necessary arrangements for the issuing, or re-issuing, of paper money and minting and supplying of coins and paper money.
- (c) The Board to be regarded as authorised to issue, re-issue and cancel paper money withdrawn from further circulation, for the destruction of such paper money, and to keep records for the issue, cancellation, and re-issue of cancelled paper money. The Board to be responsible for keeping un-issued but minted money, and to provide the necessary equipment for keeping un-issued but minted money, and to provide the necessary equipment for minting, keeping, and cancelling the currency.
- (d) The Board was required to establish a "Currency Reserve Fund", and to keep this reserve in such a way as to ensure the exchange of the currency according to Law.
- (e) The Board's income resulting from the sale of coins and paper money to be allocated - after discounting the expenditure and the Iraqi Government's share - to the Currency Reserve Fund's balance.
- (f) The Board was required to invest its assets in securities of/or guaranteed by, states, with a currency convertible directly into gold or pounds sterling, and to keep a monetary reserve, sufficient for the convertibility of the currency whenever necessary.
- (g) The Board was required to make the necessary arrangements for choosing a suitable place to keep its securities subject to any directions of the Iraqi Government.

The Indian rupee which was in circulation prior to the issuance of the Iraqi National Currency was abandoned by the public gradually, and was completely forbidden by Law in 1933. Article (2) of Law No.(4) of 1933 forbade the public to accept Indian rupees as means of payment. The Board was empowered to establish a Currency Reserve Fund in order to be able to exchange or demand the Iraqi currency equivalent to the value of sums of pounds sterling paid to the Board in London. According to Article 19 of the Currency Law of 1931, the Board was required to maintain a monetary reserve of not less than 100% of notes and coins in circulation, and a special reserve against unexpected declines in the prices of securities constituting the monetary reserve fund. The Board may pay part or the whole of its profits to the Iraqi Treasury. Thus the Board had the choice of whether to pay or not, and what amount was to be paid to the Iraqi Treasury. The Board was required to use its earnings to strengthen its reserves as long as it might be necessary to do so. Accordingly, the Board during the first two years of operation 1932-1933 and 1933-1934 kept its profits and used them in strengthening its reserve funds. But from 1935 until the beginning of World War II, the Board paid various sums to the Treasury amounting in all to (I.D. 306,000). Since the beginning of World War II, and until the establishment of the central bank of Iraq in 1947, the Board paid to the Treasury a fixed amount of (I.D 60,000) each year<sup>(1)</sup>. Article 20 of this law deals with the Board's accounting and auditing duties as follows :

The Board was required to submit to the Minister of Finance a half-yearly statement of the position of the Currency Reserve Fund on the last day of each six months including a statement of securities and the amount of coinage and notes in circulation.

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(1) EL.Kaissi, F., Critical Analysis of the Central Banking in Iraq, Unpublished Ph.D.Thesis, University of Southern California, August 1957, P.114

A copy of the statement was to be sent to the Comptroller and Auditor General who in turn submits it to Parliament. The Board was required furthermore, to submit to the Minister of Finance an annual statement of its transactions during the preceding year. In this way the government was responsible to Parliament for the Currency Board's activities.

Article (21) of the Currency Law indicates that The Board was required to make up and publish in the official Gazette a monthly abstract, showing the whole amount of the coinage and notes in circulation on the last day of each month, and the total amount of the Currency Reserve Fund on the said days. This was in addition to a half-yearly abstract showing the nominal value, price paid, and latest known market price of the securities forming the investment position of the Reserve Fund. These monthly and half-yearly abstracts indicating the money in circulation and the Reserve Fund's securities prices which the currency Board had to publish, according to the above article, gave to a certain extent a clear idea about the currency position in Iraq at the time of their issuance.

Article 23 states that :-

(a) The Board is empowered to appoint officers for the discharge of duties in connection with currency according to this Law.

(b) The Board appoint these officers at such rates of salary as the Board thinks suitable, subject to the approval of the Iraqi Government.

The Board is required to choose one or more banks operating in Iraq as its agent in Iraq. Consequently, the Board appointed an official in Baghdad to carry out transactions such as issuing, re-issuing, cancelling and keeping accounts of the currency in circulation in Iraq. The Board appointed another official in London as the currency agent, to be in charge of keeping the unissued currency. The Eastern Bank's branch operating in Iraq was chosen by the Currency Board as its agent in Baghdad. The Board chose London as its head office, and appointed the currency officer as its representative in Iraq.

Notes issued and the Reserve :-

The pound sterling was convertible to gold bullion, thus the Iraqi Dinar was, indirectly, convertible to gold bullion. But before the issuance of the Iraqi currency which was delayed to April 1932 England had abandoned the gold bullion standard, and this step was followed by Iraq, as mentioned earlier, and the Currency Law No.44 of 1931 was amended by Law No. 101 of the same year. This law removed the gold bullion standard and adopted the sterling exchange standard itself. The Currency Board was empowered to issue an equivalent value of Iraq Dinars against the pounds sterling which it received. Thus neither the Iraqi Government nor the Board could increase the supply of currency in circulation unless the Board received an equivalent amount of pounds sterling.

Reserve requirements:

According to article 19 of the Currency Law of 1931, and its amendments, the Currency Board was required to keep a minimum ratio of 100 between the value of money in circulation and its reserve. There was no upper limit for this ratio, it could reach even 200%. Section 2 of article 16 of the same law indicates that the Board was required to invest its assets in 'securities of or guaranteed by states with a currency convertible into gold or pound sterling', as mentioned above.

The reserve, as such, was mainly composed of sterling securities and a small percentage of liquid assets and silver. This article excluded the Iraqi Government's securities from currency cover which was limited to gold and foreign securities in theory, and to British and British colonial securities in practice. This gave the British Monetary Authorities the power to control Iraq's payment for her exports and any other international payments. This was because, Iraq could obtain foreign exchange, excluding sterling, only through the British Monetary Authorities. Furthermore, the Iraqi

Monetary Authorities were not put in a position which enabled them to use open market operations even in a limited way, as it may have been, as an instrument for influencing the total money supply in Iraq. The Currency Board, according to this article, had no choice but to invest currency cover in securities of the British colonies, instead of investing it in Iraqi Government securities, which would have been more advantageous to Iraq. In addition, the Currency Board was required to hold a proportion of its reserves in cash form, in order to be able to meet the demand for convertibility of Iraqi Dinars to Sterling and vice versa, without being forced to sell part of its securities at possibly unfavourable prices. Therefore the Board's main function was to administer the currency, and to change on demand pounds sterling to Iraqi Dinars, and vice versa. An important criticism which may be pointed out here is that the Board was not in a position to increase or decrease money in circulation consistently with the general economic situation in Iraq, as should have been the case.<sup>(1)</sup>

The Currency Board's activities may be best examined if they are divided into two periods; the first period starting from its establishment in 1932 and until the beginning of World War II. The second period starts from the beginning of World War II, and ends in 1947, with the establishment of the National Bank of Iraq to which the Currency Board's duties and power were given. According to the Currency Law No.(44) of 1931, and its amendments, the Iraqi National Currency was to be issued and put into circulation in April 1931; but because of the 1929 crisis, the Board advised the Government to delay the issuance of the new currency. Therefore, the currency was actually issued a year after the date originally intended, i.e. in April 1932. At this date the new currency was minted in London and

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(1) This point is discussed further on PP.74.75 ). See also, Shehab, F., Oxford Institute of Statistics Bulletin. Basil Blackwell, Vol. 21, 1959, PP.( 295-296).

shipped from London to Baghdad, and was kept at the Board's agent's building in Baghdad, i.e. the Eastern Bank. The new currency was distributed among the financial institutions, and sub-Treasurers of the Government. The new currency was accepted, with some reservations, by the public as a replacement for the Indian rupees which were in circulation before the distribution of the Iraqi National Currency. The new currency started to replace the Indian rupees, and the Iraqi Government started to export the Indian rupees to India, at an exchange rate of 75 fils for each rupee.

In June 1932, for instance, the amount of exported Indian rupees totalled (32,909,864 rupees) i.e. (I.D. 468,236)<sup>(1)</sup>. Then in 1933, the circulation of the Indian rupees as means of payment was forbidden. The Iraqi currency should, according to the Currency Law of 1931, and its amendments, be backed by at least 100% as a minimum ratio between the currency in circulation and its reserve. The Currency Board was required to invest these assets in securities of or guaranteed by states with a currency convertible directly into gold or pound sterling. Consequently, the reserve was composed mainly of sterling securities with a small percentage of liquid assets and silver. The table which follows shows that the reserve ratio to money in circulation was always 100% or more. This illustrates that, in 1933, i.e. a year after the introduction of the new currency in Iraq, currency in circulation amounted to (I.D. 2.363 mn.).

In 1934, it became (I.D. 3.174 mn) i.e. an increase of (33.8%) over the preceding year. In 1935 currency in circulation rose by 14%, in 1936, by 6%, and in 1937 money in circulation increased by a further 30%. This increase in the circulation of the Iraqi Dinars after 1933, is of course the more emphatically revealed in the figures because the Law of 1933 had forbidden the circulation of Indian rupees.

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(1) Jalili, A., Monetary System of Iraq, Cairo : Methba at Nehthat Misir, 1946. (in Arabic), P.138, and EL-Kaissi, F., Critical Analysis of Central Banking in Iraq, Un-published Ph.D. Thesis, University of Southern California, 1957, P.120.

The domestic circulation had therefore to consist wholly of Iraqi Dinars.

The second reason may lie in the increase in the value and prices of exports, especially cereals, due to favourable climatic conditions in these years.

In 1938 the amount of money in circulation fell by 10% below 1937. This was due to the failure of the harvest in that year. In 1939, money in circulation increased by about 6% but the absolute figures were still below 1937, as the table shows.

Table "K"

Currency liabilities and reserve of  
Iraq Currency Board, 1933 - 1939.

(in thousand Iraqi Dinars)

Year	Currency liabilities	Percentage of increase over preceding year	Reserve*	Reserve ratio to currency liabilities %
1933	2.363	-	2.898	122
1934	3.174	33.8	3.199	101
1935	3.714	14	3.308	102
1936	3.938	6	4.104	104
1937	5.113	30	5.172	100.2
1938	4.628	-10	4.845	105
1939	4.883	6	4.956	102

The Percentages of increase (third column) were calculated by the writer.

\* - Currency in circulation and reserves as at June 30th of each year.

Source: El-Kaissi, Critical Analysis of Central Banking in Iraq, Unpublished PhD Thesis, University of California, 1957, P.124



The Currency Board's activities between 1940 and 1947 :-

Iraq, like all other countries, suffered, during World War II, from inflationary pressures. The table which follows shows that in 1939, currency in circulation in Iraq totalled (I.D. 4.956.234). If you consider this figure as a base i.e. (100) in order to measure the changes in the quantity of money in circulation, we find that in 1940, this amount had increased by 31%. In 1941, currency in circulation rose by a further 26%. This increase could be explained by the rising prices of imports which consisted of manufactured goods, because the industrialised countries diverted their productive apparatus, to a large extent, to produce certain goods for war. The rising cost of freight played its part also in the rise of the prices of imported manufactured goods. Therefore, the increase in prices during 1940 was not sharp, as compared with most other instances of inflationary pressures under the influence of forces released by major wars, and because of World War II, it should not be regarded as unusual: indeed Iraq may perhaps be regarded as having been affected by it only slightly, for it did not affect Iraq directly, until the end of 1941. At the end of 1941 and the beginning of 1942, the allied forces started to be stationed in Iraq in large and increasing numbers. In order to meet the expenditure of these forces the British Government, whenever it needed Iraqi dinars, gave the Currency Board in London British Government securities and took Iraqi dinars in return.

In the years 1941, 1942, 1943 and 1944, the expenditure of the allied forces stationed in Iraq amounted to 8.1, 15.4, 30.0, and 10.4 million pounds sterling respectively.<sup>(1)</sup> This expenditure amounted to a total of (£63.9mn.) in four years, which raised the Currency Board's sterling assets to (£43.5 mn.) at the end of 1945, in addition to assets of firms, concerns and

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(1) United Nations, Economic Conditions in the Middle East, 1950 (New York, 1951). P.77

commercial banks at an estimated sum of (£26 mn.), which brought Iraq's total assets to about (£70 mn.)<sup>(1)</sup>. Consequently, the table shows that, currency in circulation rose by 73% in 1942, and as much as 116% in 1943. This was due to the large increase in demand which was not met by a parallel and corresponding increase in production, for Iraq, as an underdeveloped country, lacked the necessary skilled labour, capital and entrepreneurs.

The only alternative way was to increase imports. But the securities which were held by the Currency Board in London were blocked by the British Government because of the war. Consequently, Iraq could not increase its imports in any case, and was not allowed to import more than a limited amount, in order to restrict the spending of scarce foreign exchange. The Iraqi Government, in order to absorb part of the purchasing power from circulation, issued in 1944 a twenty-year lottery loan, and an ordinary three year bond loan, which were easily absorbed by the public.

Therefore, the currency in circulation in 1945 rose by 1% only and even fell by 1% in 1946. In 1947, owing to a crop failure and increasing imports of manufactured goods the inflationary pressures continued inspite of the government's deflationary measures<sup>(2)</sup> and money in circulation decreased by only 5%. In 1948, the Government floated bond loans amounting to (I.D. 5 mn.) and a large part of this loan was taken up by the commercial banks operating in Iraq, and by the Currency Board. At the end of 1948, the Currency in circulation fell by 10%. In this year the Arab-Israeli war broke out, and as a consequence there was a sharp cut in private investment, thus, in the absence of other offsetting forces, demand decreased considerably and prices started a downward movement<sup>(3)</sup>. The table which

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(1) Bell, W., The Sterling Area, Clarendon Press, 1958, P.22

(2) See P. ( 75 ).

(3) EL. Kaissi, Critical Analysis of Central Banking in Iraq, un-published Ph.D. Thesis, University of Southern California, 1957, P.130

follows also displays the wholesale prices, and changes in them during the period in question, but it should perhaps be noted that in inflation, prices do not rise in the same degree for all goods, therefore using them as indicator in an inflationary situation is only of limited value. The table shows that if the prices were 100, in 1939, in 1940 they rose by 38% and continued to rise until they reached as high as (534) at the end of World War II, i.e. 1944, where the prices were more than five times what they were in 1939. Prices, then started a downward movement; the government's measures began to take effect, and the war came to an end. Then in 1947, prices started to rise again, and this upward movement continued during 1948. In 1949, prices resumed their downward movement. As for the third measure, i.e. the cost of living, there are no data available for the years 1939, 1940, 1941, 1942, 1943 and 1944. Then in 1945, the Principle Bureau of Statistics started to publish a cost of living index.<sup>(1)</sup>

The table ~~discloses~~ that if the price-index in 1939 is 100, then in 1945, it became 584, i.e. about six times greater. In 1946, there was a slight decline, to be followed by a rise from (567) in 1945, to (601) in 1946 and to (673) in 1948. In 1949, prices declined slightly to 540, i.e. to about five and a half times what they had been in 1939. The Government had tried to control prices by means of price ceilings, subsidies, and increased taxes. These measures were only of limited use, because of the lack of qualified and able administrative personnel, illiteracy among the public, and the shortage of supply of goods.

The absence of a monetary authority, i.e. a Central Bank, which, had it been in existence, would have helped to a great extent in applying the Government's monetary policy, made the position even more difficult for the government in its aim of controlling prices effectively. The point of this discussion about the Currency Board's activities during World War II, and the further period of three years afterwards, is that the Board is seen to have no authority whatsoever

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(1) Ibid, P.125 : also see Table L (P.76) of this dissertation

over the control of money in circulation; the Board acted as a lending body to the British Government without regard for the domestic Iraqi economic situation which, in fact, suffered a great deal from the sharp inflation which developed.

It is perhaps significant that the Iraqi Government is to be noted as using rightly, an internal loans policy for the first time in 1944, to control an inflation : and even more significant that it may be thought to have achieved a certain amount of success, relatively considered, if all circumstances are taken fully into account. This is an aspect of the situation that may perhaps seem to have a certain amount of relevance when, later in this dissertation, consideration is given to the way in which deficit financing may lead to inflation, and therefore may bring forward the question of how such inflation may be kept under control.

Table "L"

Volume of Currency in Circulation and Indices of Cost of  
Living and Wholesale Prices in Iraq, 1940 - 1949.

Year	Currency in circulation I.D. mn.	% of increase over preceding Year.	Cost of living	Wholesale Prices.
1939	4.883	-	100	100
1940	6.413	31	n.a	138
1941	7.993	25	n.a	179
1942	13.933	73	n.a	383
1943	30.041	116	n.a	590
1944	41.306	38	n.a	534
1945+	41.906	1	584	503
1946x	41.401	-1	567	482
1947	39.066	-5	601	527
1948	35.112	-10	673	558
1949	n.a	n.a (1)	540	463

Source :

A table compiled from EL.Kaïssi, F., Critical Analysis of Central Banking in Iraq, unpublished Ph.D. Thesis, University of Southern California, 1957 P.131, and the percentages of increase (third column) and currency in circulation between 1939-1945 were derived from, Dr.Jalili's book, Monetary System of Iraq, (Cairo : Netba' at Nehthat Mısır, 1946), P.216. From 1946 to 1949 figures were calculated by the writer according to figures of currency reserve and percentages given in the EL.Kaïssi thesis mentioned above.

+ Year ending June 30.

x Year ending March 31.

(1) n.a. = not available.

Iraq's formal entry into the Sterling Area.

With the establishment of a wholly Iraqi (Dinar) currency in April 1932, interconvertibility between the Iraqi Dinar and the pound sterling was retained; in addition, as was mentioned earlier, the Currency Board was required to restrict the investment of its holdings of currency reserve assets to sterling securities to be kept in London. Consequently, Iraq was practically a member of what was known later as the sterling block or the sterling area. This is consistent with what A.R.Conan has said, in general terms about the sterling area: "An association of the United Kingdom with certain countries whose trade is financed mainly in sterling, and whose reserves are mainly held in sterling".<sup>(1)</sup> On December 22nd 1941, the Iraqi Minister of Finance declared that Iraq would become a member of the sterling area.<sup>(2)</sup> It may be pointed out that, each country before World War II was free to adopt the sterling exchange standard or not to do so. Then at the outbreak of World War II, and for the purpose of exchange control the British Monetary Authorities made a series of re-shapings in the sterling area. It was composed of the Belgian Congo, Iceland, Palastine, Jordan, Egypt, Iraq, The free French Territories and the countries of the British Empire at that time, (excluding Hong Kong, New Foundland, and Canada).<sup>(3)</sup>

The decision of the Iraqi Monetary Authorities, i.e. Minister of Finance, to become, formally, a member of the sterling area may be judged in the light that Iraq was practically a member of the area, and this decision only made it formal. So this decision, and the consequences which followed as a result of Iraq's membership in the area, as discussed briefly later on. was, on

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(1) Conan, A.R., The Sterling Area, Macmillan & Co. Ltd., 1952, in the Introduction, P.VIII.

(2) AL-Waquayia' Al-Iraqiya, No.1983 Dec. 22nd of 1941, Declaration of Iraq's Entrance in the Sterling Area, Baghdad, The Government's Press, 1941.

(3) EL-Kaissi, F., Critical Analysis of Central Banking in Iraq, un-published Ph.D. Thesis, University of Southern California, August 1957, P.134-135.

balance, less advantageous to the Iraq's interests. This is because, Iraq had had to suffer inflation, among other things, just because the British Monetary Authorities paid for allied troops stationed in Iraq British Government Securities in exchange for Iraqi Dinars. The Currency Board was compelled to act in this matter as a lending agency to the British Monetary Authorities, regardless of the situation developing in Iraq at that time.<sup>(1)</sup> However, prior to 1939, there were no restrictions on foreign exchange dealings between countries on the sterling standard and other countries.

In 1939, such restrictions were imposed according to agreement between the British Government and the relevant countries. In 1941, Iraq was excluded from the Sterling Area, due to misunderstanding between the United Kingdom and Iraq, and consequently the British Treasury declared the Bank of England to be the only authority, as far as any transactions with Iraq were concerned. This situation lasted for a few weeks only, then the normal relations between the two countries were restored; Iraq was re-admitted to the Sterling Area, and her frozen assets accordingly freed.<sup>(2)</sup>

The Iraqi Government had the authority under Foreign Exchange Control Law No.71 of 1941, to exercise exchange control, starting November 24th, 1941. For the purpose of executing Foreign Exchange Control as required by the law, it was decided to set up a committee, under the name of the "Foreign Exchange Committee". The composition of this committee has a certain amount of relevance and influence in relation to the question of how far the Iraqi authorities were in a position where they might be likely to gain an experience and knowledge of monetary administration. The committee

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(1) These points are discussed in a fairly detailed way. See PR 73-75)

(2) The Times, May 6th 1941, and also, May 8th, 1941, 96, the Economist May 17th 1941, P.662, and :

Shehab, F., Oxford University Institute of Statistics Bulletin, Basil Blackwell, Vol. 21, 1959, P.295.

was to consist of (4) members, including the chairman. One member was to represent the licensed dealers in foreign exchange, i.e. the commercial banks then operating in Iraq, and this member was to be appointed by the Minister of Finance in consultation with the commercial banks. A second member was to be appointed by the Minister of Finance to represent the Ministry of Finance : a third member was to be appointed by the Minister of Finance in consultation with the Baghdad Chamber of Commerce to represent the chamber : as for the fourth and chairman, he was to be appointed by the Council of Ministers. Full authority in matters concerning foreign exchange was vested in this Committee: <sup>(1)</sup> the Minister of Finance was given the duty of defining which, from time to time, should be the sterling area from the Iraqi point of view, of deciding the value of export trade so far as, in practice, this could be done, and finally of indicating the bodies which would be regarded as 'licensed' under the Act Detailed rules and provisions were laid down <sup>(2)</sup> with regard to the

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(1) Law No. 71 of 1941.

(2) Article (1) Section (2) of this law defines foreign exchange as :-  
 "The payment of any currency, bill, credit, or account through any currency medium different from the Iraqi dinar, or pound sterling, or any other sterling area currency, as defined by the Minister of Finance".

Article (3) Section (1) of this law indicates that :-

"It is prohibited to buy or sell or borrow, or donate any of the assets mentioned in Article (1) section (2) of this law, unless to or from a licensed person by the Minister of Finance".

The Article (1) section (3) defines a licensed person as :-

"A licensed person is, any person to whom the Minister of Finance delegates the power to deal in Foreign exchange."

Article (5) of this law decrees that remittances might be required for :-

(A) payments for any form of trade or transactions performed in Iraq, such as profit, freight, and revenues.



footnote continued :

- (B) Capital remittances, which were permitted in exceptional circumstances, or before the issuance of this Law.
- (C) Travelling expenses, and petty private remittances.

Furthermore Article (8) of this law indicates that :-  
Export transactions should be executed according to the conditions and the requirements imposed by the foreign exchange Committee.

The Foreign Exchange Law No. (71) of 1941 was amended by Law No. (30) of 1942 :

The amendment indicates that :-

"The Minister of Finance is authorised to ask all those who have remittances - except the licensed bodies - to sell him their holdings of foreign exchange at the price which he publishes accordingly, excluding foreign nationals of countries with similar currency regulations".

conduct of transactions, the handling of their proceeds, and, in due course, for the control and suppression of speculative transactions including the possible flight of capital from the country.

As the World War continued, other special arrangements were put into practice. According to these arrangements, each non-sterling area country had a special account, from which payments could be made to any other sterling area member country, or from one person to another provided that the two were residents in one country; but payments could not be made to non-sterling area countries. In post war years, the United Kingdom has had to face two problems :-

(1) The War debts represented by the increase of other sterling area members' sterling assets from just under (£500 mn.) in August 1939, to (£3500 mn.) in early 1947.<sup>(1)</sup>

(2) The problem of dollar shortage.

Regarding Iraq, Iraq's sterling assets rose from (£4.79 mn.) at the end of 1939, to (£70 mn.) in 1945, including the accumulated assets of firms and commercial banks.<sup>(2)</sup> During part of the post war period, the United Kingdom blocked the sterling assets of overseas members of the sterling area, and the convertibility of the pound to hard currencies, such as U.S. dollars, was forbidden. To overcome the dollar shortage, the United States granted the United Kingdom a loan of (\$3,750,000,000) to be repaid in fifty years.<sup>(3)</sup>

(1) Crump, N., The A.B.C. of Foreign Exchange, Macmillan and Co. Ltd., 13th Ed., 1963, pp.222-24.

(2) Shehab, F., Oxford University Institute of Statistics Bulletin, Basil Blackwell, Vol. 21, 1959, PP. 295 -

(3) Crump, N., The A.B.C. of Foreign Exchange, Macmillan and Co. Ltd., 13th Ed., 1963, PP.296 - 297.

According to this Anglo-American loan agreement, it was proposed that a certain proportion of the blocked balances of the overseas members of the Sterling area should be at once available for the current transactions of these members, and be convertible into American dollars one year after the agreement.<sup>(1)</sup> Thus, the British Government began to negotiate with overseas sterling area member countries for the release of the balance of blocked assets.

Regarding Iraq, an agreement between Iraq and the United Kingdom was reached on August 13, 1947, to release some of her blocked sterling assets to be effective from July 15, 1947.<sup>(2)</sup> This agreement was similar to those concluded with other sterling area member countries. Under this agreement two accounts were set up, to be called No.(1) and No.(2) accounts. No.(1) account was to represent the freed balances :- all current expenditure was to be subtracted from it, and all current earnings were to be added to it.

No.(2) account was to represent the blocked account. The No.(2) (blocked) account was dealt with in considerable detail : The details are set out in the Appendix.<sup>(3)</sup> The immediate consequence of the agreement was that Iraq was put in a position where she was able to use her earnings of sterling from current transactions taking place on or after the date of the agreement (July 15th, 1947), for a wide range of uses. The amounts were to be transferred to Account No.(1) and Iraq was regarded as entitled to import from any currency area, even including the hard currency area. Actually the 1947 agreement was never put into practice. The convertibility of the sterling was suspended on August 20th of the same year : the Anglo-Iraqi agreement of July 1947 had had hardly time to come alive, some alternative arrangement was clearly necessary.

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(1) EL. Kaissi, F., Critical Analysis of Central Banking in Iraq, unpublished Ph.D. thesis, University of Southern California, 1957, pp. (149-150).

(2) Ibid. P.150

(3) Appendix No.(1).

Consequently, in November 1947, a temporary agreement between Iraq and the United Kingdom was reached. According to this agreement the convertibility of the sterling in No.(1) account was suspended and the maximum sum which Iraq could withdraw from that account, to be used to finance day-to-day transactions with the hard currency area countries, i.e. the U.S.A., Netherlands, Belgium and Switzerland, was fixed. This agreement was to be effective for the period between July 15, 1947, to June 30, 1948, but actually it was renewed three times after 1948.

(1)

The table which follows shows that at the day on which the Anglo Iraqi Agreement was to be effective, i.e. July 14, 1947, the total sterling assets held by the National Bank of Iraq (established in the same year) and commercial banks operating in Iraq was (£57.904 mn.).

The volume of sterling assets held by Iraqi institutions varied a good deal in subsequent years. Some variations are to be explained by the outbreak of war (e.g. the Arab-Israeli war in 1948) (or again of disturbance caused by the Suez crisis in 1956); some are to be explained by crop failures, or increased imports which may or may not be associated with crop failure, but usually are. A new element was introduced, however, in 1951 when Iraqi currency reserves were held for the first time in assets other than sterling: the amount of foreign assets was small and did not increase by very much in subsequent years: a further new element was introduced in 1955 when as a result of a new agreement between the National Bank of Iraq and the British monetary authorities, a part of the Iraqi reserve was, for the first time, held in gold. Reserve in the form of non-British assets and of gold did not increase significantly until 1958. There were clearly complications developing in the relations between Iraq and the U.K. and these became explicit in June 1959, when Iraq withdrew from the Sterling Area. The decision of Iraq to withdraw from membership of the sterling area was clearly of major significance. An attempt

to assess the justification for withdrawal may perhaps provide a good opportunity of finding a pointer to the larger question in the back-ground as to whether the Iraqi monetary authorities may be judged to have acted in a responsible and knowledgeable way in their conduct of Iraq's monetary affairs since 1945. In some ways Iraq may be thought to have been unfortunate; for example, a very favourable monetary agreement reached in July 1947, was rendered null and void so far as Iraq was concerned, not because of any weakness in her own position but because of the weakness of the British financial position, ending in devaluation of the pound sterling and the re-introduction of monetary stringency not only for Britain herself but also for her partners in the sterling club.

These events which led up to the withdrawal of Iraq from membership of the Sterling area inevitably present the question whether this decision was wise or not. Reference is frequently made in this dissertation to the importance of attempting to make some assessment of the efficiency and sense of responsibility of the Iraqi monetary authorities. If deficit financing, with its concomitant inflation, is to be used then it is important that the monetary and other authorities should, by their integrity and competence, command general respect. An assessment of the wisdom or otherwise of the decision to withdraw from the sterling area is clearly very relevant to the wider question. An assessment of this sort however cannot be made adequately within the space of a brief paragraph or two. Yet to deal with the question adequately would entail the risk of breaking the sequence between the experiences of the monetary authorities, already dealt with, and the account of the development of other monetary institutions, e.g. the Commercial Banks and the specialised banks, which follows. There is an awkward problem of choice which has to be faced here: perhaps an acceptable, if not necessarily ideal solution, would be to indicate briefly here what the broad lines of such an assessment would be and to introduce the more detailed presentation of the assessment in some more

convenient place later on. But such an expedient might still have the disadvantage of requiring a fairly long statement for if a judgement was expressed it might be thought necessary that the judgement should have some supporting argument. Thus the sequence might be broken and, in addition, leave the important question still unsolved of where the extended treatment might most reasonably be presented. If it is clearly recognised that --- there still remains to be presented detailed and fairly long account of the development of various banking institutions then possibly the more appropriate solution would be to deal with the question of assessment completely at this point, if only on the grounds that it is better to bring it in once and deal with it comprehensively, rather than be compelled to bring it in twice, and on the first occasion ~~avowedly~~ <sup>avowedly</sup> incompletely.

Table "M"

Iraq's Sterling and other Foreign Exchange Assets  
In the period between 1947-1960.

Periods	Sterling Assets	Percentage of increase	other foreign Assets	Percentage of increase	Gold	Percentage of increase
July 14, 1947	57.904	-	-	-	-	-
Dec. 31, 1947	57.194	2-	-	-	-	-
Dec. 31, 1948	44.292	23-	-	-	-	-
Dec. 31, 1949	43.159	3-	-	-	-	-
Dec. 31, 1950	49.435*	14	-	-	-	-
Dec. 1951	48.783	-	1.687	-	-	-
Dec. 1952	59.282	21.5	2.733	16.2	-	-
Dec. 1953	80.154	35.2	3.075	11.2	-	-
Dec. 1954	100.000	24.7	2.7	8.7-	-	-
Dec. 1955	115.400	15.4	4.7	74	3.0	67
Dec. 1956	122.300	6.0	6.6	40	5.0	40
Dec. 1957	93.000	9.3	9.3	41	7.0	71
Dec. 1958	84.030	9.04-	10.5	13	12.0	150
Dec. 1959	39.400	53.0-	23.3	122	30.0	11
Dec. 1960	22.100	56.0-	15.6	29-	35.0	11

Source: A compiled table from Annual Reports of the Central Bank of Iraq, for the years between 1950-1960.

\* This figure includes cash balances of No.3 free account, which represents a loan to the Iraqi Railways.

Percentages were calculated by the writer.

Appraisal of the action of Iraq in withdrawing from membership of the sterling area :-

In order to assess the significance of the changes which have taken place since the second World War, as far as the sterling area is concerned, it is necessary to consider the United Kingdom's position as a major financial and economic power before the war and the decline of this power after the war. This is because what is or was advantageous to a country at a given time and in particular circumstances might become less advantageous or even harmful for the same country under different circumstances, and at a different time. It follows that the usefulness to any particular country, of being a member of the sterling area is bound to depend upon circumstances :- circumstances can change, and so, accordingly, could the usefulness of membership.

(1) Changes in Great Britain's position and importance in the world :- Great Britain, was, until the outbreak of the second World War, the major power in the World, with London as the most important financial centre. England was a large creditor in world transactions; and the pound sterling was accepted as an international means of payment. In a situation such as this, smaller and newly independent countries overseas, found it advantageous to have strong financial and trading ties with Great Britain. For primary producing countries in particular, it was an advantage to be able to export their products to Britain's large and growing market, <sup>(1)</sup> to meet their needs of manufactured goods, whether consumer's or capital goods; by importing from Britain, to use the British Banking and money market systems, by adopting a Sterling Exchange Standard at the beginning and becoming full members of the sterling area at the end.

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(1) Or to each other's market.



(2) At the beginning of World War II, restrictions were imposed on the foreign exchange transactions of members. A Capital Issues Committee was set up in London whose permission was necessary before capital issues could be presented on the London capital market. The expenditure of the British and the allied troops stationed in any country which was a member of the sterling area, had been met by British Government Treasury Bills. After the war the situation was very different. Great Britain had accumulated a large short-term debt: Paris and New York, particularly the latter, had increased considerably in strength as international financial centres. The attractiveness of the British market diminished under the competitive force started by a large and growing American market. The smaller countries have, after the war, alternatives, and the advantageousness of membership became to some countries at least more questionable. One of the arguments in favour of membership in the sterling area was, that overseas member countries had free access to London money and capital markets. The reason is that, the argument goes, the British Monetary Authorities had hitherto put no restrictions over capital movements from Britain to overseas sterling area member countries.<sup>(1)</sup> But latterly restrictions on foreign issues on the London capital market have been imposed, and actually used. In 1949, the Union of South Africa, was forbidden to borrow from the London capital market, until a gold agreement between Britain and the Union was reached<sup>(2)</sup>. During the second World War, capital issue was forbidden without approval of the Capital Issues Committee, to prevent any borrowing not in the United Kingdom's interests. Therefore, England had used the weapon of giving permission to a member of the sterling area, namely, the Union of South Africa, to raise capital funds in the London capital

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(1) Bell, P.W., The Sterling Area in the Post War World, the Clarendon Press, 1958. P.26.

(2) Ibid, P.27

market to bring pressure upon that country to sign an agreement. There is no guarantee, whatsoever, that similar restrictions might not be imposed on any other member, whenever Great Britain wants to bring pressure upon that member in order to make her do what is best for England's interests. Furthermore, membership in the sterling area by itself is not necessarily enough to enable any member to borrow from the London capital market; the soundness of any member's economy is, at least, as important. In addition to this, countries which are not members in the area may be allowed to borrow from the London capital market. The second argument in favour of the membership in the sterling area is that, members of the area are able to make payments to other countries by using British banking facilities. Accordingly, there is no need for any member of the area to have special payments agreements with other countries.

This advantage, in my view, is of a very limited use only because there is no reason why Iraq, or any other member in the area, should not have special payments agreements with any country, when it is necessary. Another argument which could be brought about in favour of membership in the area is that, as there is a fixed rate of exchange between the pound sterling, and other sterling area member's currencies, it follows that the foreign trade between Great Britain and other members will be facilitated and stabilised. This is because there will be no fluctuations in foreign exchange rates within the area. Another point which could be adduced in favour of this argument is that, England was a member of these European Payments Union, and has continued as a member in the later evolved forms which monetary association in Western Europe has taken; therefore the Sterling Area is also a member of these associations. This gives the overseas member countries the advantage of using Sterling to pay for their imports from any European member countries; i.e. a wider range of countries with which to carry out foreign trade.<sup>(1)</sup> The argument will hold true, if all

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(1) El. Kaissi, F., Critical Analysis of Central Banking in Iraq, unpublished Ph.D Thesis, University of Southern California, 1957. P.285

foreign trade transactions of the members in the Sterling Area are carried out among themselves and/or with the member countries of the European Payments Agreement. But suppose that a member of the area, Iraq for instance, wanted to import certain capital goods needed for a certain project. Considering the prices and the quality of both American and other countries' goods of that type, Iraq found it more advantageous to import the Japanese goods. Japan is neither a member of the Sterling Area nor the European agreement on payments, and therefore there is no fixed exchange rate between the Yen and the Sterling or the Iraqi Dinar.

But the exchange rate is decided in the international financial centres freely. Therefore, it may not be as useful as it seems to be, to have a fixed rate of exchange between Sterling and the Dinar or any other member's currency, when foreign trade transactions are carried out between a member on the one hand and a non-member on the other. Furthermore, if the British Monetary Authorities decided to devalue the pound sterling, for reasons concerning the British economy only, all other currencies which are linked to it will suffer the consequences of such an action; and the purchasing power of these currencies relatively to non-member's currencies will be reduced. This is not an imaginary assumption, because, the devaluation of sterling in 1949 may serve as an example. When, on September 18th of that year, the British Monetary Authorities decided to devalue the pound, to become equal to (\$2.8 dollars) instead of (\$4.03 dollars), i.e. by 30%, the purchasing power of sterling assets held by members of the area was reduced by the same percentage. Consequently, it may not be unreasonable to conclude that, membership in the sterling area is not, necessarily, an effective way in helping to realise stabilisation in member's economies; as Professor A.C.Day has said, "the sterling area is not likely to be as satisfactory an instrument for introducing a higher degree of stability into the economies of its members as it was in the thirties".<sup>(1)</sup> Another argument which could be brought

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(1) Day, A.C.L., The Future of Sterling, Oxford, The Clarendon Press, 1954, P.95

against membership in the area is the stipulation that overseas members of the area should keep most or all of their currency reserves in sterling assets, and in London. Consequently, the British Monetary authorities have the power to block the sterling assets of any member of the area, and for any reason, whether political or economic. This was actually done in the post war period, when the sterling assets held by some of the sterling area member countries were blocked. In 1950, the Iranian sterling assets held in London were blocked, because Iran nationalised the Anglo-Iranian Oil Company. In July 1955, the Egyptian Sterling assets were blocked, after the nationalisation of the Suez Canal Company<sup>(1)</sup>. Regarding Iraq, her sterling assets were blocked three times. The first time was in May 1941, following a misunderstanding between the United Kingdom and Iraq, which lasted for a few weeks only. The second time was in the post war period, with other members, such as, India, Pakistan and Ceylon.<sup>(2)</sup> The third time was in July 1958, for political reasons, i.e. after the 14th of July 1958 Revolution, and this lasted for three days only.<sup>(3)</sup>

#### Conclusions :-

The general conclusion which seems to emerge from these circumstances is that before the Second World War it was relatively more advantageous for smaller countries to be members of the Sterling Area than it was after the war. In keeping their currency reserves in London and in accepting a situation in which it was necessary to ask for permission to be granted by the British Authorities in order to raise loans in the London money market, overseas members of the Sterling Area gave the United Kingdom a powerful weapon, which could

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(1) EL.Kaissi, F., Critical Analysis of Central Banking in Iraq, Unpublished Ph.D Thesis, University of Southern California, August 1957, P.279.

(2) Bell, P.W., The Sterling Area in the Post War Period, The Clarendon Press 1958, PP.22-23.

(3) Shehab, F., Oxford University Institute of Statistics Bulletin, Basil Blackwell Oxford Publisher. Vol. 21, 1959. P.306

be used and, as was mentioned earlier, actually was used, to bring pressure to bear upon them. Nevertheless, because of the absence of more useful alternatives, overseas members have, in general, maintained their membership in the area; the export of these primary products to a large and growing British market, together with the opportunity to use British banking facilities has provided inducements of sufficient strength to counteract the forces which otherwise might have induced withdrawal.

It is a question of where the balance of marginal advantage might be judged to lie. As A.C.Day has said, "there is no longer 'unquestionable justification for slavishly following sterling'<sup>(1)</sup>. For one thing, the circumstances of the United Kingdom have changed a good deal in the post war period: Great Britain has become a debtor country, on short period account at any rate: the attempt to maintain the stability of sterling as an international medium has involved the United Kingdom in great difficulty; sterling assets of some of the members have at times been blocked; her position as a major power, both politically and financially, has been challenged by the growing strength of Russia and America. So far as Iraq is concerned the balance might be reasonably thought to be just on the other side of the margin and if economic considerations support such an assessment the political considerations, in the more intensely self-conscious nationalism of the period, supply a re-inforcement of any inclination there might be to consider withdrawal. Iraq has evolved monetary mechanisms more capable of dealing with the contemporary tasks of control than her earlier mechanisms were : her oil resources, disregarding, for the moment, the special threat<sup>(2)</sup> which arises, or might arise, from the attitude of Syria, provide Iraq with a means of covering import costs and safe-guarding the stability of the value of the "Dinar" in the foreign exchange market which puts her in a special position as compared with other small countries of the Sterling Area. To be outside the Sterling Area

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(1) Day, A.C.L., The Future of Sterling, Oxford, The Clarendon Press, 1954, P.77

(2) Or from other causes of a political nature.

may be likely to yield a freedom of manoeuvre which membership would tend to limit, possibly adversely : the ability to obtain ample supplies of foreign exchange through the sale of oil may provide a means of maintaining monetary command over real resources to a great extent than membership might be likely to assure.

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## CHAPTER THREE

## BANKING INSTITUTIONS IN IRAQ

The Commercial Banks in Iraq :-

Prior to July 1964, there were eleven commercial banks operating in Iraq with (88) branches including head offices. Three of these were wholly Iraqi banks,<sup>(1)</sup> two of them had a majority Iraqi shareholding, the others were the local branches of five foreign banks. In addition there were a number of sarrafs (Individual money lenders and exchanges).<sup>(2)</sup> In July, 1964, a law concerning the nationalisation of the commercial banks, the relatively large industrial establishments, big export-import firms, and insurance companies was enacted. In accordance with this law (No.100 of 1964), an organisation called the "Public Organisation for Banks" was established, to re-organise and control the nationalised commercial banks. In August 1964, it was announced that all nationalised banks would be amalgamated into four groups<sup>(3)</sup>:-

The Baghdad Bank group, Iraqi Credit Bank group, Commercial Bank group, and Rasheed Bank group.

(1) One of them is the always state-owned Rafidain Bank.

(2) There were (19) sarrafs in 1959. Their total paid up capital and reserves in December 1963, was (I.D. 0.722 mn.)

Source : The Central Bank of Iraq annual report 1959. P.13 and the Quarterly Bulletin July-September 1964, No.51. P.18.

(3) The always state-owned Rafidain Bank is not included in these groups.

The commercial banks in Iraq perform all the usual services offered by similar institutions in other countries. They discount bills for exporters, open letters of credit for importers, provide remittance facilities within Iraq, and from it, to the financial centres outside, make loans against acceptable security; and accept deposits. The commercial banks in Iraq restrict themselves, usually, to short-term assets: as a student of the problem has said : "In keeping with the British custom in banking practice, they restrict themselves to short term assets and self-liquidating loans."<sup>(1)</sup> It may be that this leaves a gap in credit or capital provision which should be filled. This is a question which it would be difficult to discuss here without intruding into the sequence of what is intended at the moment to be simply a description of the relevant banking institutions in Iraq.

The possibility of providing long-term credit to agriculture and industry, by the commercial banks, is discussed later. According to article (11) of Law No.100 of 1964, The Central Bank of Iraq was empowered to appoint and/or remove the managers, general managers, delegated and deputed to the Banks attached to the organisation, and to determine their power and duties. The Central Bank may relieve the President and all or some of the members of the Board of Directors of their duties and may appoint a provisional Board. This article enables the Central Bank to control the commercial banks in a direct and potentially effective way. The commercial banks, therefore, have no choice but to carry out the instructions of the Central Bank, within the lines of the monetary policy which the Central Bank thinks is best for the country's interests. The Central Bank, before nationalisation, had little or no power over the local branches of foreign banks. These foreign banks had the largest share of the banking activities in Iraq; as Dr.EL.Kaissi has said, "...the branches of British banks are the largest, most predominant and the oldest in operation".<sup>(2)</sup> This was because, the five local

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(1) EL.Kaissi,F., Critical Analysis of Central Banking in Iraq, un-published Ph.D. thesis, University of Southern California, 1957, p. 68

(2) Ibid P.67



branches of foreign banks operating in Iraq, used, naturally, to take orders from their head offices, and to ask for help whenever it was necessary. They did not go to the Central Bank of Iraq as the lender of last resort. However, as the Government changed, Law No.100 was amended by Law No.166 for the year 1965. The "Public Organisation for Banks" (POB) was changed into the Public Establishment for Banks (PEB). This establishment was attached to the Ministry of Finance instead of the Economic Organisation which, under the new law, was abolished.

The Law No.166 of 1965, weakened the control of the Central Bank over the commercial banks to a certain extent. Nevertheless, it may be safe to say that, the Central Bank still has the power to control the commercial banks' activities, in a more effective way compared with its power before the nationalisation of the commercial banks. This is because the Central Bank has the power to supervise and inspect the commercial banks: as is explained in the Industrialist :- "The relation of the Central Bank with these banks is confined to supervision and inspection of some of their activities, especially those dealings with foreign exchange and credit policy"<sup>(2)</sup>. This is less rigorous and direct, in the sense that the Central Bank's power of removal of commercial bank officials has gone : but the areas of commercial bank activity over which the Central Bank has powers of supervision and inspection are clearly of considerable importance where control of the monetary position of the economy is concerned.

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(1) Ibid P.64

(2) The Iraqi Federation of Industries, the Industrialist, No.4, 6th year, Dec.1965, P.39 (the English Section).

Distribution of Assets :-

The commercial banks in Iraq follow the British banking traditions in holding a high percentage of their assets in liquid form.<sup>(1)</sup> These assets, namely, cash, deposits of commercial banks with the Central Bank, gold, and short term investments of various sorts, including Treasury Bills amounted to 30% of the liabilities in December 1961, excluding capital reserves and per contra items.<sup>(2)</sup> However, this percentage fell to 23% in December 1964.<sup>(3)</sup> There were special reasons for this fall and at a later date, i.e. December 1965, the percentage reached 25%.<sup>(4)</sup> Disregarding the abnormal movement of December 1964 and considering only the general level at which the percentage seems to move it may still be thought that the degree of liquidity tends to be high. Other writers have commented upon this feature of the banking position in Iraq: for example Professor C. Iversen, in his book "Monetary Policy in Iraq" (1954) said "The most conspicuous characteristic of the position of the commercial banks is their high degree of liquidity".<sup>(5)</sup> If we add to this point the fact that in December 1964, currency in circulation formed (61.5%)<sup>(6)</sup> of the money supply, we can reasonably conclude that the Iraqi economy is to a large extent a cash economy. The banks have a relatively high percentage of their holdings in liquid assets because the possibility of a large scale withdrawal of cash in such an economy may be

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(1) Professor R.S.Sayers defines liquidity as: "the word that the banker uses to describe his ability to satisfy demands for cash in exchange for deposits".

Sayers, R.S., Modern Banking, sixth edition, Oxford, at the Clarendon Press, 1964, P.(177). In the same book, P.(38) Professor Sayers indicates that : "... 'the liquid assets, defined to include 'cash', money at call, and 'bills discounted' in the comprehensive senses described above, should not in the monthly statements fall below 28 per cent".

(2) The Central Bank of Iraq, Quarterly Bulletin, No.47, 1963, P.(20).

(3) See P.(132)

(4) The Central Bank of Iraq, Quarterly Bulletin No.58, 1966, (P.18).

(5) Iversen, C., Monetary Policy in Iraq, published by the National Bank of Iraq in 1954, P.(28).

(6) Table "N" on Page (102) shows that currency in circulation at the end of December 1964 was (I.D. 98.8 mn.) out of a total amount of (I.D. 161.7 mn.) i.e. (61.5%).

probable than it is in other countries, where the use of cheques is more general. Nevertheless, this tendency of the commercial banks in Iraq to keep a high percentage of their holdings in liquid assets should be kept within certain limits. This is because the commercial banks may play an important part in the promotion of economic development in Iraq. This could be done, as is discussed later, by granting medium and long-term credit to industry, which means that the bank's assets will tend to be less liquid. The consolidated statement of commercial banks of Iraq, shows that, the total of fixed liabilities, namely, the paid-up capital, reserves, and un-distributed profits increased steadily between 1961 and 1964. This means that the banks ability to meet unexpected withdrawal was getting better, other things being equal. The total deposits (Government and clients i.e. 8 + 9 + 11 + 12 + 13 in the table) amounted to (I.D 65.9 mn.) in 1961 and rose to (I.D 72.4 mn.) in 1962.

The increase took place in spite of the decrease in the government's deposits (8 + 9). There was an increase in customer's deposits which covered the decrease in the governments' deposits. In 1963, the governments' deposits rose by (5.6), while customers' deposits fell by (9.5%), and the total deposit by 6%. The table shows that customers' current accounts fell by (-9.3%), and time deposits by (11.2%). This was a result of the political changes which took place in the year under review. However, savings accounts rose by (9.5%) in 1963 over 1962. There were two reasons for that :-

- (a) the increase in the interest rate to 4%.
- (b) the negligible effect of the 1963 political changes on the small savers.<sup>(1)</sup> In 1964, the governments' deposits at the commercial banks rose by (14.5%), customers' deposits by (1%) and the total by (2.4%). The table shows that on the assets side, the deposits and investment abroad fell by (-5.7%) in 1962 over 1961, while they rose

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(1) The C.B.I. Annual Report 1963, Baghdad 1965, P.34

by (8%) in 1963. This could be explained again by the uncertainty which followed the 1963 revolution which caused the banks' investment abroad to increase. In 1964, investment and deposits payable abroad fell by (-13%) as a result of the nationalisation of the commercial banks in mid 1964, as mentioned earlier. The total of the discounted bills, guaranteed and non-guaranteed advances ( 13 + 14 + 15 ) which represent investment in the private sector, is the most important credit activity provided by the commercial banks in Iraq. The total of discounted bills guaranteed and non-guaranteed increased by (3.3%) in 1962 over 1961, and by (3.3%) in 1963 over 1962, and by (5.4%) in 1964 over 1963.

The table shows that the amount of Iraqi Treasury bills held by the commercial banks had a tendency to fall, and the same is true about the Iraqi Government Bonds.

The amount of other loans and advances extended to Government and semi-Government departments, showed a tendency to increase steadily between 1961 and 1963, then there was a sharp increase by (193%) in 1964. Having said this much about the liabilities and assets of the Commercial banks in Iraq for the last four years, it may be useful to discuss the supply of money in Iraq between 1960 and 1965.

Money Supply between 1960 - 1965.

In discussing money supply in Iraq, it may be useful to point out that, the (C.B.I.) in its quarterly bulletins and annual reports includes time deposits and saving accounts as part of the total supply of money in circulation. The (C.B.I.) does not explain on what grounds these items are included. The present writer does not agree with this practice. This is because one of the main functions of money is its use as a medium of exchange. The question therefore is : is it possible to consider time deposits and savings accounts as a medium of exchange ? Or in other words is it possible for (A) to pay (B) for a commodity by giving him a cheque on his time deposit account ? The answer to this question is, of course, no. This is because it is possible to draw on a time deposit account only after giving a fixed notice, or by asking for the bank's permission at the cost of losing some part of interest due to the deposition or after the elapse of a certain time.<sup>(1)</sup> The same may be applied to saving accounts. Therefore these two accounts may be called quasi-money, as T.W.Newlyn has said, "Broadly speaking, however, current accounts have the status of money and deposit account that of quasi-money."<sup>(2)</sup> It may be worth mentioning here that there is one Iraqi economist also ~~who~~ does not include deposit and saving accounts when he defines money : as he has said, "The term money means coins and bank notes and demand deposits with the commercial banks".<sup>(3)</sup>

It is advocated in this study, that the (C.B.I.) should not include deposit and savings accounts in its definition of money supply. Now, using the (C.B.I.) concept of money, the table which follows shows money supply in Iraq for the period between

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(1) Newlyn, W.T., Theory of Money, Clarendon Press, Oxford, 1962. P.(7)

(2) Ibid P.8

(3) El. Kaissi - Critical Analysis of Central Banking in Iraq, un-published Ph.D thesis, University of Southern California, 1957, P. (254).

1960 and 1965. This table shows that, the total money supply has increased from (I.D 130.3 mn.) in 1960 to (I.D 182.9 mn.) in 1965, i.e. by (40.8%), while foreign assets and gold reserves held by the (C.B.I.) and the commercial banks rose from (I.D 106.2 mn.) in 1960 to (I.D 116.1 mn.) in 1965, i.e. by (9.4%). This means that the expansion in money supply was not matched to the same extent by an increase in the holdings of foreign assets. The increase in total supply of money during the period under review was due to a large extent to the increase in the currency in circulation.

There was a relatively large increase in savings deposits during the period and this increase is the second in importance after the increase in circulation, as the table shows. However, there was a relatively large drop in current and time deposits in 1963, compared with 1962, due to political changes in that year. Nevertheless the amount of savings rose by 7% in 1963 over 1962; political changes which took place in that year, did not have the effect of weakening small savers confidence; and this tendency for saving to rise continued in 1964 and 1965. Having said this much about the ordinary services which the commercial banks in Iraq provide, and the supply and cover of money in circulation, it may be useful to discuss the possibility of commercial banks contributing to the promotion of economic development in Iraq, and with necessary adjustments in any underdeveloped country. For this purpose, the methods which the German banks followed in the nineteenth and twentieth century may serve as a guide. These methods are discussed very briefly in the next section.

Table "N"

Money Supply<sup>(1)</sup> With The Public for the years 1960-1965.  
(In Millions of Dinars)

	Dec 1960	Dec 1961	% of change	Dec 1962	% of change	Dec 1963	% of change	Dec 1964	% of change	Dec 1965	% of change
Net Currency in Circulation	73.4	75.2	2.5	79.8	6.1	96.3	21.9	98.8	2.6	112.6	14
Current Deposits of the Public With Commercial Banks and Sarrafs.	31.6	30.9	-2.3	35.2	14	31.5	-10.3	29.3	-6.9	30.4	3.4
Time Deposits with Commercial Banks and Sarrafs.	6.0	6.3	5	8.0	27	7.1	-11.2	7.1	-	7.4	4
Savings Deposits with Commercial Banks and Postal Saving System.	19.0	20.7	8.8	23.7	14.4	25.3	7	26.5	5	32.5	22.6
Total	130.3	133.1	2.1	146.7	10.2	160.2	9.2	161.7	1	182.9	13.2

Source: Quarterly Bulletin of the Central Bank of Iraq, Nos. 47 and 56. Al-Tamaddun Printing House, Baghdad.  
(percentages were calculated by the writer).

(1) According to the Central Bank of Iraq Bulletins the supply of money consists of :-

- (1) Net currency in circulation, (2) Current and time deposits with commercial banks (clients accounts),  
(3) Savings Accounts.

The percentage changes relate to the immediately preceding year.

The possible contribution of the commercial banks to the promotion of economic development in Iraq:-

The organised capital markets in the developed countries, have been the most important, if not the only, source of providing long-term loans for fixed investment in industry, though it has to be recognised that in recent years companies and in the U.K., some nationalised industries, have built up a proportion of their own capital funds out of current revenue. The lack of such organised and developed capital markets in underdeveloped countries makes it difficult, if not impossible, for industrialists to satisfy their needs for long-term credit for expansion and for improving their firms. Commercial banks in underdeveloped countries are the financial institutions through which savings, in the form of deposits, are kept. But, these banks in most, if not all of the underdeveloped countries which follow the British banking traditions, usually confine their loans to short-term loans only: and Iraq is one of these countries. Commercial banks in underdeveloped countries could and should play a more positive part in the promotion of economic development in these countries, such as the part played by commercial banks in European countries in general (except the United Kingdom) and in Germany in particular in the nineteenth and twentieth century. P.B. Whale points out that there are important differences between commercial banking in European countries and the United Kingdom. "In the main these differences may be defined by saying that the continental banks are less specialised, and combine with short loan other functions, particularly the equipment of undertakings with permanent capital".<sup>(1)</sup> Commercial banks in underdeveloped countries might well be encouraged to consider shifting their emphasis from mainly financing foreign trade to the financing of domestic and probably more productive transactions such as granting medium and long-term loans to industrialists and farmers. Such banks, in underdeveloped countries, especially where they are state-owned, as is the case in Iraq, should not consider making higher

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(1) Whale, P.B. Joint Stock Banking in Germany, Macmillan and Co. Ltd., 1930 P.(1) in the Introduction.



profits as the main object, but should aim to contribute as far as possible in assisting economic development. In countries such as Germany, commercial banks played an important role in promoting industry in the beginning of the industrial development by providing long-term credit for these industries, in a way that, according to S.N.Ghosal, and M.D.Sharma, "... scarcely a single important company has been found without the collaboration of a bank ..."(1)

Therefore, it may be useful to make a brief assessment of the German banking experience and methods of financing and assisting industry during the nineteenth and the twentieth century. In the first half of the nineteenth century, Germany was a comparatively poor country, depending, mainly, on agriculture, with little capital invested in manufacturing industry.<sup>(2)</sup> The lack of capital which was badly needed by industrial firms was the major problem which the German industrialist had had to face.<sup>(3)</sup> The small savers were thinly spread all over the country, and had no experience in industrial investment. At this time a number of joint stock banks were established in different parts of Germany.<sup>(4)</sup>

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- (1) Ghosal, S.N., and Sharma, M.D., Economic Growth and Commercial Banking in a Developing Economy, India a case study, Scientific Book Agency, Calcutta, 1965. P.5
- (2) Bruck, W.F., Social and Economic History of Germany from William II to Hitler 1888-1938. A comparative study, Oxford University Press, 1938, P.81
- (3) Ibid.
- (4) They were the "Bankverein of A. Schaaffhausen" in Cologne in 1848, the Bank "für Handel und Industrie in" Darmstadt in 1853 the "Berliner Handels-Gesellschaft" in 1856, and the Diskontogesellschaft in 1851;
- Encyclopedia of Social Science Volume II, the Macmillan Company, April, 1931, P.436.

Industrialists, due to the difficulties in obtaining the needed funds to finance expansion, and/or improve their firms, asked the commercial banks to provide these funds. Therefore, German bankers started to provide funds for industrialists, either by granting them long term loans or by the issue of shares and bonds under a leading banker's name. This was to assure the public of the soundness of their investment; if a leading bank was seen to be participating in financing that investment, then confidence might be instilled. However, the bankers used to conduct a thorough investigation about any industrialist who applied for a loan. After satisfying themselves completely about the soundness of the investment in that particular project, they would grant the loan.

In opening a current account, or granting a loan for an industrialist, a bank used to have a certain degree of influence on the establishment owned by that industrialist. As Dr. Jeidels has said, "The industrial current account is the pivot of all transactions between bank and industry; promotion and issue transactions, direct participation in industrial undertakings, and co-operation in management through Boards of supervisors, these stand in very many cases in a close causal sequence with bank credit".<sup>(1)</sup> When a customer wanted to open an account with a bank and the provision of credit by the bank was envisaged as a normal part of the relationship which was being established he was asked to signify his approval that the bank had the right to manage the current account involving, possibly, the purchasing and selling of securities as well as the making and receiving of payments. Furthermore the bank advised its customers about the possibilities of investing in various sorts of capital - using projects. If an industrial firm borrowed from a bank, the bank reserved the right of having a representative on the "Board of Supervisors" of that firm, and to demand, when necessary, the issue of new capital, or, in extreme cases, the change of the industrial firm into a joint stock

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(1) Whale, P.B., Joint Stock Banking in Germany, Macmillan and Co., Ltd., 1930, P.52. (This quotation was taken by Whale from Dr. Jeidels Book : Das Verhaltnis, der deutschen Crossbanken zur Industrie, P.50.

company as a way of liquidating its assets. When the Reichsbank was established i.e. after the Franco-Prussian War, with the task of supervising and co-ordinating the credit form system in its banking credit form, it started to discount industrial bills as well and came to be called the "industrialist banker's bank"<sup>(1)</sup>. The German banks, before World War I, used to charge interest at 1% higher than bank rate (provided that a minimum of 5% was kept) when the customer was in debt, and give interest between 1-1½ less than the bank rate when the client was in credit.<sup>(2)</sup> Therefore, the German Bank followed a different method than that followed by the British banks; as W.F.Bruck has said, "Unlike the deposit banks in Britain, German banks (in addition to their regular banking business) have been the main financiers of industries"<sup>(2)</sup>. However, the expansion of long-term industrial loans has been criticised on the grounds that the deposits in such a case may be endangered. But the many decades of banking experience in Germany proved that the risk in granting long-term industrial loans is not much more than the risk in granting ordinary short-term loans. Because of that, several European countries followed the German model, and even an Asian country i.e. Japan, did so. Because of the lack of a capital market in Iraq, individual small savers, are not able, even if they want to, to invest their savings in industrial investments. Instead, they deposit their money with commercial banks in the form of savings in fixed and current accounts. These banks use the major part of their resources in financing foreign trade transactions.<sup>(4)</sup> In December

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(1) Bruck, W.F., Social and Economic History of Germany, 1888-1938, Oxford University Press 1938, P.88

(2) Ibid, P.89 (3) In so far as they use them.

(4) El.Kaissi, Critical Analysis of Central Banking in Iraq - Unpublished Ph.D thesis, University of Southern California, 1957, P. (70)

1963, the total amount of deposits i.e. fixed and current customer's deposits (excluding Government and semi-Government deposits) was (I.D 58,971 mn.)<sup>(1)</sup>. This figure represented a little more than (8.7%) of the net national income of that year. In the year under review the liquidity ratio of the commercial banks was 28%, which is a high percentage. However, if the monetary authorities in Iraq, decide to adopt the German methods, broadly speaking, in allowing the commercial banks to contribute in a more effective way in financing industry, these methods should be studied carefully, and the necessary adjustments should be introduced. It is not in the least advocated here that the monetary authorities in Iraq should copy, literally, what has been done in another country. Nevertheless, these authorities may realise the great potentialities which may be explored in using commercial banks more effectively in assisting economic development; as S.N.Ghosal and M.D.Sharma have said, with regard to India, "In fact, from the earliest it was realised that unless the banking system was geared to the task of development it would not be possible to carry through the work of economic planning".<sup>(2)</sup>

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(1) The Central Bank of Iraq, Quarterly Bulletin, October-December, 1965, No.56, Government Press 1966, P.21. A total amount of

(I.D 5 mn.) which represents client's deposits with sarrafs and Post Office Savings deposits is not included in the figure in the text, on the grounds that we are discussing the possibility that commercial banks may provide more long-term loans to industry; and not with the Post Office Saving System or Sarrafs. (Sarraf's licences were cancelled anyway after nationalisation of commercial banks).

(2) Ghosal, S.N., and Sharma, M.D., Economic Growth and Commercial Banking in a developing Economy, India a case study, Scientific Book Agency, Calcutta, 1965. (Preface).

The Non-Commercial Banks :-

The non-commercial or specialised banks in Iraq provide medium and long term loans; they are, and always were, state-owned banks. These banks accept deposits from the public and the Government. In 1963, they had a total amount of Government and Quasi Government Deposits of (I.D 9.161 mn.), and the relatively very small amount of (I.D 0.309 mn) as customer's current and savings accounts.<sup>(1)</sup> In the same year, these banks had a total paid-up capital and reserves (including profit and loss account of (I.D 32 mn.), and (61) branches all over Iraq.<sup>(2)</sup>

These banks are :-

Industrial, Agricultural, Mortgage (real estate), Mortgage (moveable property), and Co-operative Banks.

(1) The Agricultural Bank :-

In accordance with Law No.(51) of 1935, the Government established an Agricultural and Industrial Bank. This Bank was entrusted with a two fold task : the assistance of both agriculture and industry. After a short time it was realised that it would be better to separate the two functions of the Bank. Consequently, in 1940 there was a law dividing this bank into two parts :- the Agricultural Bank, and the Industrial Bank. But, because of the Second World War, the actual operating separation took place six years later, i.e. in 1946.

The Administration of the Agricultural Bank :-

The Agricultural Bank is governed by a "Board of Directors" which consists of seven members, including the General Director of the Bank. The Ministries of Agriculture, Finance, Land Reform, Economics, Labour and Social Affairs, have each a representative.<sup>(3)</sup> Two members represent

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(1) See table No.( 19 ) which shows the Consolidated Statement of the specialised Banks. Appendix 6.

(2) The Central Bank of Iraq, Annual Report, 1963, Baghdad 1965, P.42 ✓

(3) With the Agricultural Bank, as with other specialised banks mentioned later, one of the appointed members will be nominated to serve as General Director.

the farmers : there are two reserve members. The General Director and all members are appointed for terms of four years, half of the members retiring every two years.

Capital Structure :-

The capital of the Agricultural-Industrial Bank when it started operations in 1936 was (I.D 150.000). The nominal and the paid-up capital, after the separation of the two functions of the Agricultural-Industrial Bank, were increased many times, until in 1963 the nominal capital had been raised to (I.D 10 mn.) and paid-up capital to (I.D 6.403 mn.)<sup>(2)</sup>.

The functions of the Agricultural Bank :-

According to the Laws of the Agricultural Bank the object of the Bank is "to assist agriculturists and to promote and improve agriculture"<sup>(3)</sup>. In fulfilling these functions the Bank is active in :- granting medium and long-term loans to farmers, selling on deferred payments implements or manure, cattle, seeds, selling agricultural products on behalf of farmers, and hiring out agricultural equipment for the use of the farmers. Furthermore, the Agricultural Bank was entrusted with the tasks of helping in setting up co-operative societies for farmers, establishing and directing establishments for the grading and cleaning of agricultural products, and stores and warehouses for the storage of these products. The Agricultural Bank has the task of promoting agricultural developments by, for example, making advances to such sorts of processing, or marketing activity as may be likely to extend and co-ordinate the sale of farm products. The agricultural bank grants loans for general agricultural purposes up to (I.D 1000) and to

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(1) EL-Kaissi, F., Critical Analysis of Central Banking in Iraq, un-published Ph.D Thesis, University of Southern California, 1957, PP. 79-80

(2) This amount includes the sum of (I.D 2.976 mn.) which was allocated for making advances to farmers for the winter season of the financial year 1959/1960.

(3) The Agricultural Bank, Annual Report, 1962-1963, Baghdad 1963, P.9 (English Section).

(I.D 1200) for the purchase of agricultural machines and implements. The Bank charges 5% interest on its loans. It is suggested that the Bank should distinguish between loans for different purposes, as was the case until 1960, when the Bank used to charge 5% interest for various agricultural loans, 4% on loans to cotton merchants, and 3% on loans guaranteed by the Government.<sup>(1)</sup> The policy of charging different rates of interest for different purposes is advocated here because, sometimes, it is necessary to induce certain group of farmers to grow a certain crop, and this could be done by granting them loans bearing lower rates of interest on the condition that the loans should be used for growing that particular crop. The farmer who applies for a loan is required to offer security to safeguard the position of the Bank. The loans are required by the laws under which the Bank operates to be secured, and normally they are, by claims on agricultural products, machines and implements, immovable properties, shares and bonds, guarantees of the Higher Body of the Agrarian Reform, and properties of agricultural establishments.<sup>(2)</sup>

The Agricultural Bank's reports do not give any figures for bad debts; they only show in the balance sheet a figure representing the doubtful debts. This figure was (I.D 9,000) in 1964/65.<sup>(3)</sup> In the same year the outstanding figure for loans extended by the Agricultural Bank was (0.878 mn.). In other words the provision for doubtful debts represented a little more than 1%, which is not, by any means, a high percentage. However, it is suggested here that the Agricultural Bank should give figures for bad debts for each year, keep an eye on the development of bad debts, and take the necessary measures, such as asking for better securities before granting any new loans, when the

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(1) The Agricultural Bank Annual Report, for the years 1959, 1960 and 1961, Baghdad, 1961, P.22

(2) Ibid, PP.8-9

(3) The Agricultural Bank Annual Report.

percentage of bad debts to outstanding loans increases. Farmers borrow from the Agricultural Bank for the purpose of improvements in buildings, buying machines, execution of small irrigation projects on the one hand, to buy seeds, fertilizers, and cattle on the other. In the latter case the loans may be repaid in a relatively short time. In the former case, however, the period for repayment which is at present 10 years might well be extended to (12) or (15) years as might be thought necessary. The table which follows discloses the number of farmers who borrowed from the Agricultural Bank and the total amounts of advances involved.<sup>(1)</sup> This table shows that there were large increases both in the number of transactions and in the amount of advances between the date of establishment of the Agricultural Bank and the present time. The table discloses that in 1946-47 the number of advances increased by (107.4%) over 1941-42, while the amount of the advances rose by a little more than 482% for the same period. Therefore, it may be safe to say that this reflects the fact that the tendency was for the rate of increase in the number of borrowers to be much less than the rate of increase in the sums borrowed. In 1960-61, the number of advances rose by (135.6%) over 1956-57, but the amount of advances fell by more than 25%. This may be explained by the fact that the Bank followed the policy of granting smaller loans to a larger number of farmers<sup>(2)</sup>. Furthermore, the table shows that in 1960-61 the number of advances was only (2390). A possible implication of this figure is that, the Bank failed to reach a large number of farmers who presumably needed the Bank's help. This is in accordance with other evidence<sup>(3)</sup>. The solution may lie in the increase of the Agricultural Bank's capital, and the opening of more branches throughout the country (i.e. more than one branch in large agricultural provinces i.e. in the north).

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(1) Figures in the table are chosen by the writer to give an idea about the number of farmers and advances involved during the period between 1936-37 and 1960-61 for every fifth year and not for each year.

(2) The number of small borrowers as a percentage of the total number of borrowers, rose from 73% in 1956-57 to (90%) in 1960-61. The Agricultural Bank Annual Report, 1959, 1960 and 1961, Baghdad 1961. P.26

(3) Such as the admission of the Bank in one of its reports, which indicates that one of the difficulties which the farmers have to cope with is the long procedure which has to be followed by applicants for grants, and the other is the insufficient number of branches in the liwas. The Agricultural Bank's Annual Report 1959, 1960, 1961, Baghdad 1961, The Arabic Section P.16



The Industrial Bank :-

This Bank was established, as a separate unit in 1940, but because of the Second World War, did not start operations until 1946.

The Administration of the Bank :-

The Industrial Bank is governed by a "Board of Directors" consisting of six members, including the General Director of the Bank as Chairman. One member of the Board has to be an industrialist, a second one a representative of the merchants, and the other four members, drawn from particular Ministries, are elected in a manner similar to that employed in the case of the Agricultural Bank.

Capital Structure :-

The Bank had a nominal capital of (I.D 3 mn.) and paid-up capital of (I.D 2.3 mn.) in 1954.<sup>(1)</sup> In addition the Bank has the power of borrowing from the public, banks, government, and semi-government agencies. In 1961, the nominal capital was raised to (I.D 8 mn.), the paid-up capital to (I.D 4.750 mn.).

The objects of the Bank :-

The Industrial Bank has many functions. In general terms the Bank was entrusted with the task of developing and assisting industry, and of carrying on banking business related to this purpose.<sup>(2)</sup>

The Bank was permitted to :-

- (1) establish industrial enterprises directly on its own account.
- (2) sponsor and subscribe to public and private companies.
- (3) make loans to industrialists who wished to set up new factories, expand, or improve their existing ones.

(1) Iversen, C., Monetary Policy in Iraq, Published by the Central Bank of Iraq, 1954. P.33

(2) The Industrial Bank, Annual Report for the years 1959-60 / 1960-1961, In Arabic P.(1)

- (4) make advances against imported raw materials and exported products.
- (5) act as an agent for the importation of machinery, tools and the like.
- (6) grant loans to factory owners, for the purchase of machinery and raw materials.
- (7) engage in all banking activities that would facilitate industrial transactions.<sup>(1)</sup>

Moreover, the Industrial Bank provides (for a small fee) an advisory service to :

- (a) the management of any project facing financial or technical problems.
- (b) Individuals who want to establish new plant or plants. In addition, the bank inspects the projects to which it has provided loans, to secure the good use of the loans, and to advise the management of the project or projects, when it is thought necessary, to adopt more efficient methods of managing their enterprises<sup>(2)</sup>.

The Bank charges 4% interest on its loans. One of the important aspects of the Bank's operations in the repayment by borrowers of its loans. However, the Industrial Bank in its report, does not give figures for bad debts. It only gives figures representing actual payments of loans as a percentage of due instalments. Then it indicates that some of the borrowers were given an extension for the period during which they should pay their debts to the Industrial Bank, because of difficulties. It is advocated here that the Industrial Bank should give figures for bad debts each year, and these figures should be kept in close check, in order to make the necessary arrangements to reduce their amount when it starts to rise in an alarming way. In 1962, the Bank had shares in (16) projects, namely :- Iraq Cement, Vegetable oil extraction, the national leather industry, the Iraqi Marble industry, River dredging and reclamation, National Insurance, the Iraqi Jute industry, the Date industry, the Baghdad Bakery, The Estate Industry, Iraq Gypsum, the light industry sector, Re-Insurance, Iraq spinning and weaving, Grain Trading and Milling, and "Imara" Industries.<sup>(3)</sup> The Industrial Bank participation in these Industries and projects has been very successful. It does not necessarily follow that the Bank caused their success but it may well have strengthened them sufficiently so as to be capable of going ahead and making a

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(1) EL-Kaissi, F., Critical Analysis of Central Banking in Iraq, Un-published Ph.D Thesis, University of Southern California, 1957, PP.86-87.

(2) Said, W.A., The Credit System in Iraq, Un-published B.litt.Thesis, University of Oxford, 1964.

(3) Ibid, P.83

success of themselves in a way which might otherwise not have been possible. The notion that the industrial Bank's participation in industries has been very successful could be illustrated by the fact that, while the total amount of loans granted by the Industrial Bank between 1947/48 - 1960/61 was (I.D 8.5 mn.) the total amount of accumulated profits was (I.D 1.831 mn.) i.e. 21% profit. Furthermore, this high percentage of profit may indicate that industrial investment in Iraq is a profitable field for investors. However, it must be remembered that the "Industrial Bank" was established for the purpose of assisting industry and not for the purpose of making high profits. Therefore, it is suggested that the Industrial Bank should help small scale industries more effectively even if the opportunity for making profits should for that reason become less. The Industrial Bank should participate in industries which help the economy as a whole even if these industries make no profits in the beginning, or even losses. The Industrial Bank should extend its services by opening more branches throughout the country. Be that as it may, it may be more useful at this point to discuss the total amount of loans granted by the Bank in the last few years. In the table which follows<sup>(1)</sup> figures are set out for all the specialised banks : the figures for the loans extended by the Industrial Bank, may be picked out relatively easily. The table shows that, after an increase of (23.4%) of the total loans extended by the Industrial Bank in 1962 over 1961, this total started to fall. It fell by 24.7% in 1963, rose slightly in 1964, and fell again by (12.5%) in 1965. The decrease in the loans extended by the Industrial Bank in 1965 may be explained by the fact that some of the projects in which the Bank had shares were nationalised and the Bank was not then compensated for its shares in the nationalised establishments. It is suggested here, that the authorities should compensate the Bank as soon as possible, in order to enable it to grant loans to industry at the same rate or, better, perhaps, at a higher rate than before nationalisation.

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(1) Table No.( 20 ) The loans extended by specialised banks Appendix 6.

(3) The Mortgage Bank (real estate) :-

The Mortgage Bank was established by the Government in 1948 under Law No.(18) of the same year, but started operations in 1950.

The Bank's Administration :-

The Mortgage Bank is managed by a "Board of Directors" consisting of five members including the General Director, appointed by the Minister of Finance. One of the members represents the Ministry of Housing and Works, two represent the Ministry of Finance, and the remaining two are appointed on the basis that they have experience in real estate and construction transactions. In addition to the five original members there are three additional or reserve members. These members are appointed for a period of three years. The Board of Directors has the power of determining, from time to time, the rate of interest, issuance and sale of debentures, opening of branches, writing-off bad debts, if there are any, and all matters concerning the officials working for the Bank. The Minister of Finance is authorised to object to any decision taken by the Board of Directors within a week's time of the making of the decision. If the Minister of Finance and the Board of Directors do not agree upon any matter, the matter should be submitted to the Council of Ministers whose decision is final. According to Law No.(80) of 1956, all decisions made by the Board of Directors should be submitted to the Minister of Finance whose approval is necessary to carry out these decisions.<sup>(1)</sup>

The Capital Structure :-

According to Law No.(18) of 1948, the nominal capital of the Bank was (I.D 1 mn.) to be provided by the government as an interest free loan, but the paid-up capital was only (I.D 1500). However, the Bank

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(1) Estate Bank, Annual Report 1959-1960, AL-Hassan Press, Baghdad, P.6 (in Arabic).

borrowed a total amount of (I.D 250,000) from the National Bank at 3% interest. In 1952, the nominal capital was raised to (I.D 2 mn.) which was fully paid. Furthermore, in 1956, the Bank obtained a loan of (I.D 5 mn.) from the "Development Board". Hitherto the Bank was to pay 75% of its net profits to the Government but in 1956 and according to Law No.(80) of the same year, this percentage was reduced to 25% and the remaining part of its profits, if any, was to be added to its capital, until such time when its paid-up capital equalled its nominal capital. When that happens, then 50% of net profits is to be paid to the government and the remaining 50% is to be held as reserves.<sup>(1)</sup> However, in 1960, and under Law No.(18) of the same year, the nominal capital was raised to (I.D 15 mn.) and was fully paid up by including the Development Board loan as part of the capital. In 1965, the nominal capital was raised again to (I.D 20 mn.) and the paid up capital to (I.D 16.854 mn.).<sup>(2)</sup> In addition the Bank has borrowed from different sources, such as, the postal saving system, the Central and Commercial Banks, a total amount of (I.D 9.130 mn.) which was what it stood at in 1965. The Bank accepts time deposits which, in the same year, amounted to (I.D 7.944 mn.).

The Bank's objects and operations :-

The Bank was established in the first place to provide owners of dwelling houses who have obtained loans at a high interest rate, with loans bearing lower interest rate. In 1952, and 1953, the Bank's Law was amended and new tasks were added; these tasks are :-

(1) building on its own, modern dwelling houses and selling them or renting them to government officials.<sup>(3)</sup>

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- (1) Estate Bank, Statistical Report for the period between 1949-50/ 1959-60, local Administration Press, 1962, P.10 (in Arabic).
  - (2) Estate Bank, The Annual Report, 1964-1965, local Administration Press, P.7 (The Arabic Section).
  - (3) In fulfilling this task the Estate Bank started to build and sell houses to low-income groups of the community, with a total number of (1500) houses in 1961. These houses were sold, at cost price, to be paid in annual instalments over (25) years at (2%) interest rate. Said, W.A., Credit System in Iraq, un-published B.litt.Thesis, University of Oxford, 1964.

(2) establishing co-operative mortgage on building societies, or companies for the sale and purchase of immovable properties, and the construction of houses, and other buildings.

(3) advancing loans on security of fixed property, and encouraging new building activities on the part of private individuals. The Bank charges (4.5%) interest for loans not exceeding (I.D 500), (5.5%) for loans not exceeding (I.D 1000), and (6%) for loans exceeding (I.D 1000). Loans should be repaid in (12) years, and a maximum amount of (I.D 1500) was fixed for each borrower.<sup>(1)</sup> In its annual report of 1964/65 (Loss and Profit Account) the Estate Bank did not return any bad debts for that year.<sup>(2)</sup> This might seem to give support to the notion that borrowers have been paying back their loans satisfactorily. However, it must be born in mind that the Bank sometimes, according to its regulations, extends the period of repayment when the borrower cannot pay the due instalments on time. It would be rash therefore to assume that the absence of "bad debts" indicates a satisfactory rate of repayment by borrowers. That a strictly cautious interpretation should be applied is suggested, by the fact that in 1963/64 the ratio of received loans to overdue loans was (80%).<sup>(3)</sup> The Estate Bank is an important financial institution in Iraq, whose operations may have an important impact on the Iraqi economy as a whole. This importance may be illustrated by the fact that in 1965 for example, the total<sup>of</sup> loans granted by this Bank was (I.D 9.998 mn.) out of a total amount of (I.D 23.498 mn.) granted by the Agricultural, Industrial, Mortgage (for movables) and Co-operative Banks<sup>(4)</sup>, or

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(1) Estate Bank, Annual Report 1963-1964, Local Administration Press 1965, P.14 (the Arabic Section).

(2) Estate Bank, Annual Report, 1964-65, Local Administration Press P.31 (in Arabic).

(3) Estate Bank, Annual Report, 1963-1964, Local Administration Press 1965 P.6 (the English Section).

(4) The (C.B.I.) Quarterly Bulletin, July-September 1966, (No.59) P.20

(42.5%). Therefore the Bank's operations should be directed not as a separate unit, but within the broad lines of the monetary policy, in a way which serves the whole economy and not only the Bank.<sup>(1)</sup> Furthermore, this Bank should extend its operations to all parts of the country, and to lower-income groups in the society. This is because lower - income groups in Iraq live in houses which could not be considered as meeting the basic requirements of a house.

(4) The Credit Mobilier , [The Mortgage (moveable property) Bank]:

The Credit Mobilier is a mortgage bank providing credit against moveable properties. This Bank was established by the Government in 1951, and started operations in the same year.

The Bank Administration :-

This Bank is managed by a Board of Directors consisting of five original, including the General Director, and two additional or reserve members. The General Director and the members are appointed by the Minister of Finance, for terms of four years, half of the members retiring every two years.<sup>(2)</sup>

Capital Structure :-

According to Section (A) of Article (2) of Law No.(14) of 1951, and its amendments, the nominal capital of this bank was (I.D 1 mn.). At the beginning of 1954, the paid-up capital was (I.D 0.6 mn.), raised to (I.D 1 mn.) at the end of the same year.<sup>(3)</sup> In 1958, and according to Law No.(32) of the same year, the nominal capital was raised to (I.D 2.5 mn.) and paid-up capital to (I.D 1.25 mn.), increased to (I.D 1.5 mn.) in 1963. In addition the Bank obtained

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(1) This point is discussed further, shortly afterwards. See PP ( 133 - 134 ).

(2) The Mortgage Bank (Moveable property) Annual Report 1959-60, 1960-61, under the heading "Board of Directors" (in Arabic).

(3) The Mortgage Bank (Moveable property) Annual Report 1954-55, Government Press 1955, P.4 (in Arabic).

loans from various governmental bodies, e.g. from the (C.B.I.) and the Rafida in Bank. In 1963, these loans amounted to (I.D. 1.2 mn.). The third source of funds for this bank is the deposits of the government and semi-government institutions. These deposits amounted to (I.D. 2.58 mn.) at the end of 1963.<sup>(1)</sup>

The Functions of the Bank :-

The Credit Mobilier Bank was established for the purpose of providing loans against moveable property, e.g. precious metals, to any suitable applicant. However, the Government employees and officials are able to obtain loans from this Bank against personal guarantee of another government official or employee who has been in the Government's service for some years. In 1952, the maximum amount of each loan increased from one hundred to one thousand Iraqi Dinars, and the rate of interest was reduced from 4% to 3% per annum.<sup>(2)</sup> A startling fact about the Credit Mobilier is that, this Bank made losses during the years 1959, 1960 and 1961. These losses were met by reducing the capital reserves. In 1959, the capital reserves were (I.D. 107.076), fell to (I.D 93.309) i.e. a loss of (I.D 13.767), and to (I.D 87.164) in 1961, i.e. a loss of (I.D 6.145). In 1962, the Bank made a profit of (I.D 18.708).<sup>(3)</sup> Since the Bank, in its reports, does not give any figures for bad debts, therefore, a possible explanation of the losses in 1959, 1960 and 1961, is that the Bank pays a higher interest rate for the loans it obtains, and does not

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(1) The Mortgage Bank (Moveable property) Annual Report 1961-62, 1962-63, AL Jamhoria Press, PP.15-16 (in Arabic).

(2) EL-Kaissi, F., Critical Analysis of Central Banking in Iraq, Un-published Ph.D Thesis, University of Southern California, 1957, P.96

(3) Credit Mobilier Bank, Annual Report, AL-Jamhoria Press, 1961-62 and 1962-63, (in Arabic). The differences in capital reserves, not indicated separately by the Bank in its report, have been calculated by the writer.



charge high enough interest rates to its debtors to cover its expenditure and the payment of interest to its creditors. However, it is advocated here that the Bank should give figures of bad debts each year. Furthermore, since this Bank provides loans for consumption purposes i.e. unlike the Agricultural, Industrial and Estate Banks, therefore, it may be suggested that this Bank is not justified in making losses, and that it should conduct its operations in a more cautious way.

(5) The Co-Operative Bank:

--- The Co-Operative Bank was established by the government in 1956, according to Law No.(65) of the same year. This Bank was entrusted, at first, with two tasks; to provide the co-operative societies with credit; and to carry out their banking business. In 1959, and according to Law No. (163) of the same year, the Co-Operative Bank was entrusted with three more tasks; these were; (1) to provide the co-operative societies with financial and technical assistance, and encourage the establishment of more co-operatives, (2) to supply these societies with warehouses for the storage of their goods and products, and (3) to take part in the projects set up by them.

The Administration of the Bank:

The Co-operative Bank is managed by a "Board of Directors" consisting of five members including the General Director of the Bank. Two members of the Board have to be members of co-operatives which deal with the Bank. There are four reserve members. The General Director and all members are appointed for terms of three years.

The Capital Structure:

The nominal capital of the Co-operative Bank was (I.D 0.250 mn.), 49% of which was to be provided by the co-operative societies, and the remaining 51% by the government. The paid-up capital, however, was only (I.D.0.040 mn.) all provided by the government.<sup>(1)</sup> In 1959, the nominal capital was raised to (I.D. 1 mn.). In 1961, the co-operative societies subscribed, for the first time, to the amount of (I.D. 0.027 mn.), out of a paid-up capital of (I.D. 0.425 mn.). In addition, the co-operative societies deposited a total amount of (I.D. 0.020 mn.) at the end of the same year.

The Bank's Operations:

The Co-Operative Bank's activities are not confined to any particular type of co-operative. The Bank deals with, building, agriculture and

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(1) The co-operative societies did not participate in the capital of the Co-Operative Bank as they should do according to Co-Operative Bank Law, until the end of 1961, when they participated by less than 5% of the paid-up capital of the Bank.

consumers co-operatives; as shown in the table below.<sup>(1)</sup> This table discloses that the building societies claim the largest share of the loans provided by this bank, followed by the agricultural then consumer co-operatives. The Co-operative Bank does not follow any specific rules about interest rate to be charged, or the term or size of bank loans. Such decisions about each case are made after considering the case.

Table (O) Amount and Distribution  
of loans by the Co-operative Bank  
(as at the end of 1961)<sup>(2)</sup>.

	Total Value of Loan (I.D).	Percent of Total
Agricultural	74.185	15.8
Consumer	22.700	4.8
Building	373.012	79.4
	469.895	100.0

Source : Said, W.A., The Credit System in Iraq, un-published  
B.litt. Thesis, University of Oxford, 1964.

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- (1) Figures represent loans extended to these societies by the Co-operative Bank since its establishment until end of 1961.  
(2) Title by present writer.

The Co-operative Bank's activities reflected in its outstanding loans have been increasing sharply. Table No. ( 20 ) Appendix 6. which shows the loans extended by the specialised banks reveals that the amount of loans extended by the Co-operative Bank rose by (123%) in 1962 over 1961, then after a slight increase in 1963 over 1962, and no increase in 1964 over 1963, it rose by about (146%) in 1965 over 1964, which was a very sharp increase indeed. Furthermore, the table shows that, the total amount of outstanding loans extended by the Co-operative Bank in 1965 was five times the amount in 1961, and this increase is higher than any to be found among the other specialised banks. The Co-operative Bank is like the other banks whose position has been reviewed in not disclosing the amount of "bad debts". Again it is advocated that it would be desirable for such disclosure to be made. If this is done then the community generally may be able to assess more firmly the outcome of the banking operations which are taking place. These increases may reflect the notion that the authorities realise the importance of the role which the Co-operative Bank may be able to play in the promoting of the existing co-operative societies, and the setting up of new ones, especially the agricultural co-operatives. This is because, a large number of the previously wage-earning or share-cropping farmers now have their own land, but are not able to provide the capital needed. Therefore, the agricultural co-operatives may prove to be very useful in meeting this shortage, even if its extent may be limited.

Having said this much about each of the specialised banks in Iraq, it may be useful to discuss the effects of the operations of these banks as a whole on the Iraqi economy.

The table which follows <sup>(1)</sup> presents the consolidated statement of specialised banks in Iraq. The table shows that the capital and reserves of these banks have been increasing steadily. They rose from (I.D 24,093) mn. in 1961 to (I.D 33.078 mn.) in 1965. The profits of the specialised banks show a steady increase between 1961-1964 with a slight decrease in 1965. It is evident that the Government and quasi-Government deposits have been increasing steadily. They rose from (I.D 7.129 mn.) in 1961, to (I.D 13.081 mn.) in 1965. Also that the current and saving accounts and time deposits are, relatively speaking, not important. Other deposits showed a tendency to fall between 1961 and 1963, then they started to rise in 1964 and 1965. Table No.( 20 ) discloses the loans extended by specialised banks between 1961 and 1965. This table shows that, the Estate Bank loans almost doubled between 1961 and 1965, with a decrease of (21.2%) in 1962 over 1961. The loans extended by the Agricultural Bank fell by almost a third (32.8%) in 1963 below 1962, and more than a third (34.3%) in 1965 over 1964. This may be explained by the fact that the total amount of repayments in 1963 fell to (I.D 298.703) against a total amount of (I.D 376.104) in 1962. This was due to the postponement of the instalments to be repaid by farmers to the bank. <sup>(2)</sup> As for the Industrial Bank's loans, the table shows that, the total amount tended to rise in 1962 over 1961 but fell in 1963 over 1962. Then, after a slight increase i.e. (2%) in 1964, it fell again by (12.5%) in 1965. This could be explained by the fact that the

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(1) Table No. ( 19 ) consolidated statement of specialised Banks  
Appendix 6.

(2) The Agricultural Bank annual Report, 1963, Baghdad 1963, English  
Section P.8

industrial Bank's operations were affected by the nationalisation of the big industrial firms in which the Bank had shares, and has not been compensated for even yet. The table shows that the Mortgage Bank's loans increased steadily but moderately throughout the period. The loans extended by the co-operative bank rose sharply in 1962 over 1961 (123%) and very moderately in 1963 over 1962. In 1964 there was no change, then a very sharp increase (145.6%) in 1965 over 1964. This sharp rise may be explained by the Government's desire to encourage the co-operative societies among farmers as an effective method of raising production in agriculture. The table shows that the total loans extended by specialised Banks in Iraq, rose steadily but mostly between 1961 and 1963, then there was a sharp increase of (33.3%) in 1964 over 1963, and again a modest increase in 1965 over 1964. It is suggested here that the five specialised banks, due to the important impact of their lending operations on the Iraqi economy, should present a greater degree of co-ordination among themselves as a group. Furthermore, each bank should calculate carefully the difference between the amounts which it lends during a certain period, a year for example, and the amount it receives. This is because if the bank lends more than it receives as payments of instalments by borrowers, there will be, other things being equal, a net increase in distributed incomes and effective demand. This may not be desirable if the monetary authorities are trying to limit credit at a particular time, and in a particular situation.

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(1) The relationship between the specialised banks and (C.B.I.) is discussed on PP( 133-134 )

### The Central Bank of Iraq (C.B.I.) :

The (C.B.I.) is the central instrument of control of the monetary authorities in Iraq and must be counted as itself an important part of the total pattern of authorities. But before discussing this important institution, it may be useful to outline broadly, the requisites for completely successful action in control. These requisites are :

- (1) Knowledge (the technique).
- (2) the instruments of control.
- (3) some experience in working the instruments.
- (4) a strong sense of responsibility which would be likely to promote swift, careful, but firm action as against action that was delayed from laziness or indifference, or action that was not carefully thought out, or action that was feeble in its application.

Discussion of the (C.B.I.) may make clear how far the above requisites could be regarded as existing in Iraq. The establishment of a Currency Board in 1931 was not on a permanent basis, as was mentioned earlier. Therefore, in 1947, the Law No.(43) of the same year was passed, according to which the National Bank of Iraq was set up. But the Bank did not start operations until 1949. The time between the passing of the Law and the actual establishment of the Bank was spent on the preparation of building and personnel. This Bank took over the duties and powers of the Currency Board which was abolished. However, in 1956, the Law No.(72) of the same year was enacted, and the name of the National Bank was changed to the Central Bank of Iraq (C.B.I.).

### The Administration of the C.B.I.

According to Article (5) of Law No.(72) of 1956, the (C.B.I.) is managed by a Board of Directors consisting of nine members including the Governor and Deputy Governor. The Governor, is appointed by the Council of Ministers for a period of five years. Members of the Board

of Administration are appointed by the council of Ministers for a period of four years, and this Council chooses the Deputy Governor from among the members of the Board of Administration of the Bank. The Governor, Deputy Governor, and Members of the Board are eligible for re-appointment for an unlimited number of times, and are not removable during their term of office, unless any of the persons mentioned above should be convicted by a competent court. Each member is required to have a proven financial experience and specialised knowledge of economics; and is not an official or manager of a bank.<sup>(1)</sup> Half of the Members of the Board of Administration are due to retire every two years. In addition to the nine original members, paragraph (f) of Article (5) of Law No.72 of 1956 decrees that : "Five additional members shall be appointed to the Board of Administration by decision of the Council of Ministers for a period of four years. They shall be summoned for the purpose of constituting a quorum for the meetings".<sup>(2)</sup> The Iraqi legislation did not neglect the importance of the co-operation of the Central Bank and banks operating in Iraq. Therefore, according to Article (7) an Advisory Council was to be established. The chairman of this Council should be the Governor of the Central Bank, and its members should be the representatives of the Banks operating in Iraq. In accordance with Article (8) of Law No.72 of 1956, the Board of Administration of the Central Bank is free to make decisions in administrative and financial matters, and in accordance with this Law and Regulations. If the Governor of the Bank and the Board of Administration disagree upon any policy matters, the Minister of Finance may adjudicate in the dispute. If the Minister of Finance does not agree with the Governor's view about the matter, he may submit the dispute to the Council of Ministers whose judgement is final. If the

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(1) This restriction has only applied since 1956. Up to that date personnel of sufficient skill and experience were not easily to be found and bank officials or managers were not excluded. Even though a case could be made out for this practice, based on necessity, it was strongly criticised by Iversen in his report of 1954 and it was subsequently dropped.

(2) Central Bank of Iraq, Laws, Regulations and Ordinances, Baghdad, 1965. P.14

Board of Administration and the Minister of Finance disagree upon any matter, the dispute may be submitted to the Council of Ministers, which has the final decision in all matters except two. These exceptions are first, the application of Regulations for service in the (C.B.I.) and second the "Exchange Control Law", in which the Board of Administration has the final decision.

#### Capital Structure of the C.B.I. :-

The original nominal capital of the C.B.I. was (I.D 5 mn.) and the paid - up capital (I.D 2.5 mn.). In 1956, the authorised capital was raised to (I.D 15 mn.), and the paid-up capital to (I.D 4.2 mn.). The difference between the authorised and the paid-up capital is guaranteed by the Iraqi Treasury until such time as the nominal capital of the Bank is fully paid-up. According to Article (3) of Law No.72 of 1956, 50% of the net profits of the Bank are to be paid to the Government, provided that this amount does not exceed (I.D 1 mn.). The remainder of net profit is to be added to the paid-up capital until the difference between this and the nominal capital is eliminated.

#### The Organisation of the (C.B.I.) :-

The C.B.I. is made up of three departments :-

- (1) The Chief Cashier's Department, which is divided into four Directorates :- the Issue, the Vault, the Banking, and Foreign Exchange.
- (2) The Department of Statistics and Research, which has three sections :- the Statistical, the Foreign Relations, and the Research.
- (3) The Department of Control of Banking.

Having said this much about the Board of Administration, capital structure, and organisation of the (C.B.I.), a reference to its functions may, perhaps, be judged necessary.



Functions of the (C.B.I.) :-

According to Article (4) of the Central Bank of Iraq Law No.(72) of 1956 :- "The objects of the Bank shall be to manage the currency and ensure its stability, to influence the credit situation to the country's advantage, to act as banker to the Government, and to facilitate internal and external payments ...". In the process of attaining the objects set out in the Law the (C.B.I.) :

(a) is placed in a position which enables it to supervise and control the commercial banks operating in Iraq. (b) is entrusted with the control of the foreign exchange situation through its function of facilitating and controlling external payments, and (c) acts as the responsible agent for carrying out obligations arising from international agreements concerned with financial and economic matters. The process of supervision and control is further strengthened by reason of the (C.B.I.'s) function in keeping Government and semi government accounts, and acting generally as the Government's financial agent. Furthermore, the (C.B.I.) is required to advise the Government on such matters as may influence the stability of the Iraq currency.<sup>(1)</sup> In order to elucidate the position and importance of the (C.B.I.) its relationship with the following bodies and activities will be discussed :-

- (1) the (C.B.I.) as controller of the commercial banks<sup>(2)</sup>.
- (2) the (C.B.I.) as controller of the specialised banks.
- (3) the (C.B.I.) as controller of foreign exchange.
- (4) the Iraqi Government.
- (5) the possible contribution of the (C.B.I.) in the promotion of economic development, by providing part of the capital funds needed for economic development, i.e. from the government point of view, deficit financing.

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(1) The Central Bank of Iraq, Laws, Regulations, And Ordinances, Baghdad 1965, PP. 12-14.

(2) The Sarraf's activities are not included here, because of their minor importance. See p.( 94 ).

(1) The (C.B.I.) as controller of the commercial banks in Iraq :-

The relationship between the (C.B.I.) and the commercial banks operating in Iraq, may be considered in relation to two distinct periods :-

(a) The first period between 1949 (when the (C.B.I.) started operations) and mid-1964 (when commercial banks were nationalised).

(b) between mid-1964 and the present time after the nationalisation Law had been amended.

(a) The first period, 1949 - mid-1964 :-

Since the discussion of the relationship of the (C.B.I.) with the commercial banks in the first period is useful only as a back-ground to the present situation, it will not be necessary to discuss it other than briefly. In accordance with Article (IV), Section (5) of the Law of the Central Bank of Iraq No.72 of 1956 :- "the C.B.I. is given the power to control banks and sarrafs and co-ordinate their operations". Consequently, the C.B.I. should have been in a position which enabled it, legally and theoretically, to control the commercial banks and sarrafs operating in Iraq. But what happened in practice was different. This is because, the (C.B.I.) had not been able to use the instruments normally used by Central Banks in an effective way. One of the instruments, for example, is variations in Bank Rate. The (C.B.I.) could not use this instrument effectively during the period in question, because, commercial banks operating in Iraq were, and still are, in a highly liquid position. Therefore, whenever they needed cash, these banks utilised their liquid reserves without going to the Central Bank. Furthermore, the five local branches of foreign banks could borrow from their head-offices whenever they needed to. This point could be illustrated by the fact that, during the period 1949-1955 the (C.B.I.) neither made loans to commercial banks nor discounted commercial paper.<sup>(1)</sup> As for the use of the other

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(1) EL-Kaissi, F., Critical Analysis of Central Banking in Iraq, unpublished Ph.D Thesis, University of Southern California, 1957, P.229. However, in 1960 the commercial banks used the (C.B.I.) as a lender of last resort when their liquidity ratio fell from (59.4%) in December 1959 to (50.3%) in July 1960, this decrease in liquidity ratio worried the commercial banks. The (C.B.I.) in an attempt to attract the commercial banks to borrow from it, raised the maximum percentage of (eligible) bills which each bank is allowed to re-discount at the (C.B.I.) from (15%) to (20%)

instruments, such as open market operations, they were also of limited use. This was due to the lack of a well-developed and organised capital market in Iraq : and the existence of such a market is of vital importance for the use of this instrument. A third weapon theoretically available to the (C.B.I.) is "Variation of Reserve Ratios". Again, as will be seen from the detailed discussion given below, this instrument was not, in practice, of great use. Each commercial bank operating in Iraq was required to keep at the (C.B.I.) a minimum reserve of (15%) of the total amount of fixed and demand deposits excluding those of the Iraqi Government. Of this reserve 2/3rds at least was required to be in the form of Iraqi notes and coins, and the remaining part in the form of Iraqi Government securities and Treasury bills. The (C.B.I.) power as far as variation of this reserve ratio went, was confined to being able to vary the ratio between (15%) and (10%) after giving notice to the commercial banks, at least two months ahead. It seems to be the case that the margin of variation between 10% and 15% did not give the central bank a great power to manoeuvre, judging by the fact that this range was increased after nationalisation,<sup>(1)</sup> which means that the Iraqi monetary authorities wanted to have a larger range of reserve minimum and maximum variation. As for the last instrument, i.e. "moral suasion and directions", this method was not very effective either. It was not effective because five of the commercial banks operating in Iraq claiming the largest share of banking activities were local branches of foreign banks, which naturally enough, paid more attention to making profits than to following, voluntarily, a policy which was best in the interests of Iraq. From this brief examination it may be safe to conclude that the (C.B.I.) in the first period, i.e. between the time it started operations in 1949, and mid 1964, had had no effective control over the commercial banks operating in Iraq.

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(1) See p.(131)

footnote continued from previous page :-

of bank's deposit liabilities on the one hand, and lowered its discount rate from 3 to 2½% on the other. The commercial banks reacted favourably. The advances granted to commercial banks against government securities and other papers, after the declaration of the measures amounted to (I.D. 0.4 mn.), rose to (I.D. 5.5 mn.) during 1960. However, it may still be safe to say that the (C.B.I.) discount rate has not had much effect on rates charged by the commercial banks: as W.A.Said has said; "the rates of interest charged by the banks on various transactions have no relation whatsoever to the discount rate of the (C.B.I.)".  
 Said, W.A., The Credit System in Iraq, Un-published B.litt.Thesis, University of Oxford. 1964.

(b) The second period : mid 1964 - to the present time :-

In July, 1964, Law No.(100) of the same year concerning the nationalisation of the commercial banks operating in Iraq was enacted. The nationalised banks were amalgamated into four banks<sup>(1)</sup>. An organisation called the Public Organisation for Banks (POB) was established. The (C.B.I.) was given strong control over this organisation. This point could be illustrated by Article (11) of Law No.(100) of 1964, which lays it down that :- "The Central Bank of Iraq shall appoint and/or remove the managers, general managers, delegated and deputed to the Banks attached to the organisation, and shall determine their power and duties. The Central Bank may relieve the President and all or some of the members of the Board of Directors of their duties and may appoint a provisional Board". This article gives the (C.B.I.) a tight control over the commercial banks, may be more power than most, if not all, of the central Banks in the non-communist countries. Therefore, it may be safe to say that the relationship between the (C.B.I.) and the commercial banks is a reversal of that which prevailed before the nationalisation of the commercial banks. According to Article (5) of Law No.100 of 1964; the (POB) was to be controlled by a "Board of Administration", this "Board" to consist of the Governor of the (C.B.I.) as an ex-officio president, his Deputy and Directors General of nationalised banks as members. The (C.B.I.) has the authority according to "Banking Control Law" No.(97) of 1964, to fix the amount of all or some of the assets to be held by each bank, sarraf, or a group of banks or sarrafs, or all banks or sarrafs, as cover for their deposits, expressed as a proportion or proportions of total deposits by regulation, without the latter having to be referred on each occasion to the legislature. Furthermore, the new Law, unlike the abrogated Law No.(34) of 1950, empowered the (C.B.I.) to specify the percentages of assets which each bank or sarraf should deposit with the (C.B.I.). This percentage was raised from 15% to 20%. The latter percentage is to consist of :- 10% as money to be deposited with the

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(1) See P.( 94 )

(C.B.I.) by each bank or sarraf, 5% in the form of Treasury Bills, and the remaining 5% in the form of other monetary assets.<sup>(1)</sup> It is not without significance to note that the (C.B.I.) used this instrument in 1964. It used its powers in a discreet and discretionary way. After nationalisation depositors with the commercial banks grew a little more cautious, perhaps even suspicious of their banks, and as a result tended to increase the rate of encashment of deposits. The result of this upon the reserves of the commercial banks was to reduce their liquidity ratio from 28% at the beginning of 1964, i.e. before nationalisation to 20% immediately after nationalisation. If the government had required the commercial banks to place a sum equal to 20% of their deposit liabilities with the (C.B.I.) then this would have subjected the commercial banks to a strain at both ends of their accounts, so to say. The tightening of their position would have been very clearly evident and this might well have intensified the sensitiveness of the public in their attitude towards the banks. In these circumstances the (C.B.I.) reduced the reserve requirement from (20%) to (15%) and in this way gained two things at the same time. In the first place it relieved the immediate cash stringency for the commercial banks and in the second place it showed the public generally insofar as they might be disposed to notice such things, that the government and (C.B.I.) were watching the monetary situation closely and were prepared to act without too much regard to rigid requirements if circumstances might seem to call for a more flexible treatment. This relaxation continued for two months as from the 2nd of September 1964, and was extended later till May 3rd, 1965. With regard to other instruments of control there was no change. The discount rate for example, was kept the same, i.e. (4%) : as also the limit of discount at (15%) of deposits, in accordance with the Law. The commercial banks

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(1) The (C.B.I.) Annual Report 1964, Zahra Press, Baghdad, PP. 322-33 (in English).

operating in Iraq have the liberty to go to the (C.B.I.) and may re-discount Treasury Bills, to any amount, at whatever may be the prescribed rate prevailing at the time. In 1964, the rate was (3 $\frac{3}{4}$ %). Moreover, the (C.B.I.) holds itself ready to grant advances to commercial banks on the security of long term bonds, valued at market rates or nominal rate, whichever is the less, charging a rate of interest for the provision. In 1964, the rate was 5%<sup>(1)</sup>.

(2) The (C.B.I.) relationship with the Specialised banks :-<sup>(2)</sup>

The relationship between the specialised banks and the (C.B.I.) is rather different from that between the commercial banks and the (C.B.I.). Subject to the approval of the Minister of Finance, the Boards of Directors of the specialised banks decide the rates of interest to be charged to borrowers from time to time. They then inform the (C.B.I.) of their decision : but the (C.B.I.) has no power to affect rates of interest charged by the specialised banks, unless these exceed (7%)<sup>(3)</sup>. However, the (C.B.I.) might be able to limit total amounts lent by the specialised banks in one case only i.e. when these banks want to borrow from the (C.B.I.) in order to expand their lending operations. Otherwise these banks can expand their lending operations to the extent they want, the only limitation being available resources.<sup>(4)</sup> This means

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(1) Ibid P.(33) and P.(38).

(2) So far as the present writer is aware no publication is available which deals with this relationship. Some of the points mentioned above are based on correspondence which the writer has had with the Director of the research and Statistics Department of the (C.B.I.)

(3) EL,Kaissi F., Critical Analysis of Central Banking in Iraq, unpublished Ph.D Thesis, University of Southern California,1957. P.78

(4) This does not mean however that the specialised banks are able to conduct their operations without any outside control whatsoever. They are subject to the over-riding approval and supervision of the Minister of Finance. So far as the Minister of Finance is in close co-operation and consultation with the (C.B.I.), it follows that the (C.B.I.) is able to make itself aware of the circumstances in which the specialised banks are operating and it would, presumably, make its influence felt indirectly, through advice and opinions which it might conceivably express to the Minister.

that provided they work within these limits, the (C.B.I.) is not able to control them for it has no power to tell them what not to do. The specialised banks in Iraq are in a position which enables them to expand their total loans to the public, and the (C.B.I.) has no direct power to tell them not to do that. It is advocated here however that, although there is this indirect safeguard provided, consideration should be given to the desirability of making the influence of the (C.B.I.) over the specialised banks more explicit and direct in the matter of interest rates and lending operations. Furthermore, the specialised banks, usually lend during any given period, a year for example, more than returns from outstanding loans. This expansion takes place without much consideration being given to the general economic situation at the time, though this might possibly require limiting total credit granted by these banks. The factors taken into consideration are, as a general rule, the available resources of a specialised bank, and the number of borrowers at any particular time. It is advocated here, that a "Board of Directors" consisting of the "General Managers" of the specialised banks and a chairman representing the (C.B.I.) should be set up. This Board should meet regularly, say once a month, or whenever necessary.

It could serve two purposes :

- (1) The co-ordination of the specialised banks' activities as a whole in relation to the Iraqi economy in general.
- (2) The conducting of the activities of the specialised banks within the broad lines of the monetary policy which the (C.B.I.) is following at a particular time. The representative of the (C.B.I.) being chairman, should be able to give a clear picture to the General Directors of the specialised banks, i.e. the members of the Board, whether they should expand, limit, or keep the same amount of loans granted by them during the relevant period.
- (3) The (C.B.I.) as controller of foreign exchange :-

Before discussing the control of foreign exchange in Iraq, it may be useful to define the term "foreign exchange control". P.Einzig defines exchange and foreign control as : "Exchange control is every form of

intervention with the tendencies affecting exchange rates".<sup>(1)</sup> The Law No.(71) of 1941, was the first Law which introduced foreign exchange control in Iraq. At first a committee called the "Exchange Control Committee" was in charge of the execution of the exchange control. Then in May 1950, the (C.B.I.) was given the power and responsibilities of applying the Exchange Control Law; and in practice, the duties were exercised through the Directorate of Foreign Exchange. All foreign exchange transactions had to go through licensed dealers and persons especially authorised by the (D.B.I.). During 1958 and 1959 licensing was extended to include all imports. The importation of some items was prohibited, in order to encourage and protect domestic industry. Importers were required to be members of a Chamber of Commerce and import licences were given to importers in accordance with their financial standing and previous transactions. As a result of Iraq 's withdrawal from the sterling area, a new Exchange Control Law was enacted in 1961. Article (8) of this Law outlines the (C.B.I.'s) policy regarding foreign exchange. It indicates that; "The Board of the (C.B.I.) shall allocate the foreign exchange required for payments arising out of import and other transactions, in accordance with the monetary reserve position and in conformity with the development of the national economy". In 1963 restrictions on the importing of 132 articles were lifted among them drugs, fertilizers, and agricultural machinery, subject to the approval of the competent relevant ministry. A list containing (67) of prohibited items was, however, issued, and the list was extended to (85) items in 1965.<sup>(2)</sup> Thus exchange control was introduced and developed not simply to administer the available resources of foreign exchange but also to assist in the providing of protection to certain domestic industries which were thought to need it.

(4) The relationship of the (C.B.I.) with the Iraqi Government and (5) the possible contribution of the (C.B.I.) in the promotion of economic development:

For reasons which will be clear from what is said below these two sets of relationships may be taken together.

(1) Einzig, P., Exchange Control, London, Macmillan and Co., 1934, PP. (9-10).

(2) The Economist Intelligence Unit, Annual Supplement, (Iraq), 1966, P.(31).



As the Law now stands the government is not entitled to borrow from the (C.B.I.) except for the purpose of covering temporary and short-run shortages of funds. This is laid down in Article (4) Section (V) of Law No.(72) of 1956; advances should not exceed a total amount of 10% of revenue in the budget of any one particular year and repayment of each advance should normally be made at the end of the financial year in which the loan had been taken up. This article was designed in this way in order to prevent the government from financing large deficits in ordinary expenditure on a permanent basis. This limitation has an obvious bearing upon the power of the Government to take up funds from the (C.B.I.) by way of a deficit financing arrangement in order to use the resources of the bank to provide part of the funds needed for a capital development programme. If funds, by way of deficit financing on this long term basis were to be provided by the (C.B.I.) then it would seem that special provision would have to be made under the Law in order to legalize the situation. This is a matter which is given further consideration later in this dissertation where the possibility of using the (C.B.I.) for the specific purpose of providing a part of the funds needed for capital development is examined in more detail. Finally, a reference to the assets and liabilities of the (C.B.I.) for the last four years may be useful in rounding off the discussion.

The table which follows shows the assets and liabilities of the (C.B.I.) between 1962 and 1965. The table shows that the liabilities of the issue department represented in issued currency have had a tendency to rise during the period under review. This increase was relatively high in some years (20%) in 1962 over 1963 over 1962, and low in other years (2%) in 1964 over 1963. The table shows somewhat sharp changes in foreign assets and Iraq Government securities, and relatively mild changes in gold bullion holdings. Paid-up capital shows a tendency to rise during the period, it rose from (I.D 10.5 mn.) in 1962 to (I.D 14 mn.) in 1965, but the reserve maintained its level during the period. Current accounts fluctuated during the period up and down, but other accounts showed a tendency to rise. On the assets side of the banking department, foreign assets showed a very sharp increase in 1963 over 1962, and a sharp fall

down in 1964 over 1963. Iraq Government bonds fell from (I.D 10.601 mn.) in 1962 to nil in 1963, then rose to (I.D 4.963 mn.) in 1964. The table shows that in 1964, the (C.B.I.) followed an easier credit policy which caused an increase of (40%) of loans and advances in 1964 over 1963. Re-discounts and advances showed a tendency to rise during the period. It is a not unreasonable inference from the course these figures take to suggest that the commercial banks began to go to the (C.B.I.)-more than, at earlier dates, they had been in the habit of doing. The (C.B.I.) publishes a "Quarterly Bulletin" to display its activities on the one hand, and the general economic situation on the other, together with annual reports for the same purpose. It is suggested here that the (C.B.I.) might make more of these reports, e.g. by expanding their scope and role, in the enlightenment of the general public on domestic economic matters. Furthermore, more efforts might be made to narrow the time-lag between the publication of a report and the period it deals with<sup>(1)</sup>. The research department in the Bank should be strengthened by acquiring more economists in different fields in order to be able to contribute towards the elucidation of some of the more pressing economic problems in Iraq.

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(1) The 1964 Annual Report, for example, was published at the end of 1966.

DEFICIT FINANCING AS MEANS OF PROMOTING ECONOMIC DEVELOPMENT IN AN  
UNDERDEVELOPED COUNTRY.

The main object of this study is to discuss the banking system in Iraq, the ordinary services which it provides, the possibility of improving these services, and to examine the contribution that the banking system might be able to make to the economic development of Iraq. The banking system, the ordinary services it provides, and the possibility of improving them, were discussed in the last chapter. The present chapter deals with the contribution that part, indeed an important part, of the banking system i.e. the Central Bank, might be able to make to the promotion of economic development. One of the main obstacles in the way of the promotion of economic development in underdeveloped countries is the lack of sufficient capital funds needed to finance development programmes ; as E.M.Bernstein has said, "the inability to finance the necessary level of investment - is the principle economic limitation on the rate of development"<sup>(1)</sup>.

The capital funds needed for economic development can be provided in a variety of ways<sup>(2)</sup>. One way is through the use of the banking system and deficit financing, the means being the provision of bank credit to the developing authority, and this in turn may be recognised as meaning that investment, other things being equal, is being taken beyond the limit indicated by the total real savings in the community as determined by the previously existing relationships. This process of financing through the expansion of bank credit while serviceable, within limits, is not without its dangers. Under certain relationships between money in circulation and

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(1) Bernstein, E.M., Financial Problems of Underdeveloped Countries, General Problems of Financing Development Programmes, The Journal of Finance, Vol. XII, 1957, Edited by Harold G. Fraime and Carl A. Dauten, The American Finance Association, P.167

(2) These ways are discussed shortly afterwards on PP.( 147-149 )

the supply of domestic and imported goods and services, and in the light of the existing propensities to consume, an increase in the price level might be engendered and this must be recognised as inflation. Inflation, if it is not checked and controlled by the monetary authorities, could turn into hyper-inflation with harmful effects on the economy. It follows that the expansion of bank credit should be conducted with due regard to the need for observing responsibly cautious limits. These limits should be defined as carefully as possible by the monetary authorities; in other words, the aim should be a moderate degree of inflation and no more. In this chapter, therefore, the possibility of using deficit financing as a contributor in financing economic development is discussed, first, in general terms. Since Iraq is an example of an underdeveloped country it will then be the aim to examine the position in Iraq. The term "possibility" is used deliberately, because each country has its special circumstances, and what is possible and / or useful to country (A) in its special circumstances, might be impossible and / or harmful to country (B) with its different circumstances. The term "contributor" is similarly used deliberately : it is not the intention to suggest that deficit financing should be the sole means of financing economic development : as suggested later<sup>(1)</sup>, there are various ways in which finance might, and indeed should, be provided; deficit financing is only one amongst several means. The planning authorities will be allowed in this study to use deficit financing at the expense of creating a controlled degree of inflation, among other means of raising capital funds needed to finance economic development. The discussion of the device of deficit financing is limited to "underdeveloped countries" because the use of expansion of bank credit to raise capital funds certainly has advantages, but surely has also disadvantages and it is in underdeveloped countries

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(1) See Pp (147 - 149)

in particular that the disadvantages might be likely to present themselves more strongly. Nevertheless, underdeveloped countries, because of the scarcity of, and their great need for, capital funds to finance development programmes, might well consider the possibility of raising part of the funds needed through expansion of bank credit and its concomitant deficit financing. This is because these countries might find themselves facing a situation in which they have to choose between holding back from a particular development project because of the lack of capital funds, or using deficit financing in spite of its disadvantages. Developed countries can, however, look forward with greater assurance to the continuation of their economic growth because they have passed through a stage during which a self-generating mechanism has been evolved, and they have reached a self-sustaining growth stage in their economies. <sup>(1)</sup> Consequently, developed countries are not forced to use a method in raising capital funds which involves such inflationary risks. This is not to say, though, that these methods do not, from time to time, take a form which does involve the risk of inflation. It all depends on the degree of development which they are contemplating and the flow of saving, together with the degree of taxation, which these communities will tolerate.

Furthermore, most of the developed countries, are capital exporting countries, which means, considered generally, that they have more than their current needs of capital funds, while it is extremely difficult, if not impossible, for underdeveloped countries to provide enough capital funds to finance development programmes. As Professors Bernstein and Patel have said : "Whatever other measures the underdeveloped countries could and should undertake, they will be

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(1) Rostow's phrases are used here, and elsewhere in this dissertation (see PP. 142, 143 and 145), for convenience of presentation, but it is not to be understood from their usage that the Rostow hypothesis is necessarily accepted as valid in all respects.

unable to provide themselves with adequate resources for development out of their own savings. Their real level of income is low and their need for investment is too great to enable them to meet in full their own capital requirements"<sup>(1)</sup>. (underlining not in the original). In this study, a model in which deficit financing is used as a contributor in financing a five year development programme in an underdeveloped country is set out in the fourth chapter. Reference will also be made to the adjustments which might need to be made in the model in order to suit some particular underdeveloped country e.g. especially Iraq, and this is done in the fifth chapter.

As a result of using this method, i.e. deficit financing, a degree of inflation is expected to emerge, as the analysis will attempt to show. Therefore, a brief idea of different approaches to the definition and interpretation of inflation, is given in the appendix. Furthermore, it may be wise to discuss the advantages and disadvantages of inflation, or to be more precise, the advantages and disadvantages of moderate inflation, and this is carried out in the sixth chapter, under the title, deficit financing and the degree of inflation. It may be wise to end this introductory note on the use of expansion of bank credit as a means of part-financing of economic development, involving as it does not merely the possibility but the probability of inflation by admitting openly that the majority of economists hold views which are opposed to such methods because of their inflationary outcome. As P.Einzig has said : "the major part of post war literature is characterised by an anti-inflationary bias as strong as the earlier anti-deflationary bias had been".<sup>(2)</sup>

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(1) Bernstein, E.M., and Patel, I.G., Inflation in Relation to Economic Development, International Monetary Fund Staff papers, Vol. II, 1951-52, PP. 397-398.

(2) Einzig, P., Inflation, Chatto and Windus, London, 1952, P.81

A MODEL OF AN UNDERDEVELOPED ECONOMY WHERE DEFICIT FINANCING IS USED AS A CONTRIBUTOR IN FINANCING ECONOMIC DEVELOPMENT.

One of the basic differences between developed and underdeveloped countries is that developed countries have passed through a stage during which a self-generating mechanism will have come into existence in their economies, while underdeveloped countries have not. Professor W. Rostow's theory of development is, of course, the one which expresses this notion in its most rigid form. We are not necessarily bound to accept the full rigour of his argument,<sup>(1)</sup> nor indeed need we accept his suggestion of necessity in connection with a country's passage through the various stages.<sup>(2)</sup> The process of economic development in a country is a much more flexible thing than Rostow suggests. All the same there is a broad element of truth in his contribution and some of the insights which he expresses command respect : for example the underdeveloped countries have not yet built into their economic mechanism those propensities and tendencies which, once established, serve to provide momentum

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(1) Criticisms of Rostow's theory of the stages of development, can be found in a book by G.M. Maier, entitled "Leading Issues in Development Economics", Selected Materials and Commentary, New York / Oxford University Press 1964, PP. 23-41. And G.L.S. Shackle, The Nature of Economic Thought, Cambridge, At the University Press 1966. PP. 291-295.

(2) That it is not, necessarily the case that every under-developed country should pass through a take-off stage is well illustrated by the fact that some countries, such as Canada and Australia, have entered the stage of high consumption before reaching maturity.

W.W. Rostow, The Stages of Economic Growth, Cambridge University Press 8th Printing 1963, The Chart in the Preface.

in the growth process; secondly it is indeed true that a country needs to be in a position to provide a significant flow of savings from its own income stream, in order to sustain progress on the basis of its own resources : this much may well be accepted, and there is a rough rule of thumb validity, when rates of population growth are taken into account, about his statement that one of the important requisites for the take-off stage, among others, is that a minimum of 10% of net national income should be invested each year :<sup>(1)</sup> if we think of such a country developing its own power to sustain growth, then it follows that sooner or later the country will need to provide a flow of savings equal to 10% of its national income.

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- (1) On the basis of a statement by Professor Rostow when he gives the figure 3 : 1 to 3.5 : 1 to represent the average capital / output ratio in underdeveloped countries, if national income per capita is to increase, then the rate of population growth per annum should be less than (2.9%). This is because if it were (2.9%) then  $2.9 \times 3.5 = 10.15\%$  of net national income in a country should be invested each year just to keep the existing level of national income per capita constant, other things remaining the same. But if the rate of growth of population is, say, (1.6%) per annum, then only  $3.5 \times 1.6 = 5.5\%$  of net national income should be invested each year to keep the existing level; and the national income per capita will tend to rise by  $4.4 \div 3.5 = 1.25\%$  each year if 10% of net national income is invested. It must be borne in mind that most of the underdeveloped countries have annual rates of population growth of more than (1.6%)

Rostow, W.W., The Stages of Economic Growth, Ninth Printing, Cambridge University Press, 1963, P.37



It is now our intention to set up a model for an underdeveloped country, which, though it does not represent any particular country, nevertheless, its inter-related parts may be thought to behave and function in a way which does not differ in any significant respect from countries which could be described in specific real terms, and one of them might be Iraq.

Now let us assume that the planning authorities in an underdeveloped country (let us call it Era) want to carry out its first development programme. Let us further assume that it is due to start next year, say year (n), and that it is envisaged as a five year programme. If its economy, with its inter-related parts, is thought of as a model then it is necessary to build certain values into the model initially : some of the variables which are significant in the working of the model must be presented in quantitative forms : the necessary assumptions are as follows :-<sup>(1)</sup>

1. The net national income at the end of year (n-1) is (800 mn.) in money terms.
2. Money in circulation at the end of year (n-1) is (400 mn.). Thus the income velocity of money in circulation is  $800 \div 400 = 2$ .
3. At the end of year (n-1), the general price level (P) is indicated by the index 100.
4. With regard to consumer's goods, the marginal propensity to import is entered as  $1/5$  and is assumed to remain so for the next 4 years, until the domestic economy is itself capable of producing a quantity of consumer's goods, previously imported.

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(1) It should be stated that while, on realistic grounds, an underdeveloped economy at the rudimentary level which is suggested, would be likely to contain a subsistence sector, the quantitative assumptions which are given apply only to the non-subsistence sector.

5. The average propensity and marginal propensity to consume, are both  $9/10$ , and the average propensity to save and the marginal propensity to save, are therefore  $1/10$ , and are assumed to remain so, during the period of the programme.
6. It is accepted that a little manufacturing industry is in existence.
7. The economy is in equilibrium, that is savings = investment ( $S = I$ ) at the end of year  $(n-1)$ .
8. The population increases by  $(2.9\%)$  per annum. <sup>(1)</sup>
9. The average capital : output ratio in the different sectors of the economy and throughout the next five years is  $3.5 : 1$  <sup>(2)</sup>.

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(1) There are underdeveloped countries with a higher rate of increase in population, such as, Syria  $(3.2\%)$ , per annum, and Venezuela  $(3.4\%)$  per annum. Meanwhile, there are underdeveloped countries with a lower rate of increase, such as Iraq  $(1.7\%)$  per annum, and Argentina  $(1.6\%)$  per annum. Thus, the figure  $(2.9\%)$  has been chosen in our model to represent, very roughly, an average rate of population growth in underdeveloped countries.

Source: The United Nations Statistical Year Book, 1965, New York 1966, P.87-91 where the above figures represent Annual rate of increase 1958-1963.

(2) Professor Rostow maintains that, a ratio of  $3 : 1$  to  $3.5 : 1$  for incremental capital/output ratio seems realistic as a rough bench-mark until we have learned more about capital/output ratio on a **sectoral** basis.

W.W.Rostow, The Stages of Economic Growth, Ninth Printing, Cambridge University Press, 1963. P.37

In order to maintain the existing national income per capita, a total amount of  $3.5 \times 2.9 = 10.15$  or 10% of the net national income should be spent on investment every year. However, the goal of the development programme envisaged is to raise real national income per capita by (4%) a year. Therefore, to achieve this target, (24%) of the net national income, i.e.  $3.5 \times 2.9 + 3.5 \times 4 = 10 + 14 = 24\%$  should be invested each year, under the conditions and circumstances prevailing at that time. In other words  $800 \times \frac{24}{100} = (192 \text{ mn.})$  in money terms, should be invested.

On such a basis the situation, other things being equal, would be one in which the general price level remained the same. The planning authorities, however, have adopted the view that the general level of prices may be likely to rise and they have, therefore, allowed for some degree of rise in their figures for the amounts to be spent during each year of the programme.<sup>(1)</sup> They assume that prices may rise by 1% annually and they therefore plan that if (192 mn.) is to be spent during the first year, then  $(192 + 1.92) = 193.92$  (say 194 mn.) should be allocated as investment spending in the second year. Applying the same percentage rise they allow for (196 mn.) i.e.  $(194 + (194 + \frac{1}{100}))$  in the third year of the development programme. The problem that now presents itself is how to raise a total of (980 mn.) in monetary terms to be spent during the five years of the programme :

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(1) According to E.M. Bernstein : "The rapid increase in investment in an underdeveloped country must involve some rise in prices and wages in the industries most affected by the development programme".

Financial Problems of underdeveloped countries, General Problems of financing development programmes, The Journal of Finance, Vol. XII, 1957. The American Finance Association.

The ordinary methods of raising such an amount would be :- net amount of tax revenue (after allowing for ordinary expenditure), net domestic savings (after allowing for hoarding), net value of exports over imports, and foreign loans and grants. A fifth method which may be applied in case of necessity, is borrowing from the Central Bank, i.e. expansion of bank credit. The planning authorities, in (Era), knowing their economy, have thought that the following figures may represent amounts of capital funds which could be provided through the four methods mentioned above.

(1) Taxation : revenue within the next five years is estimated to be (910 mn.) in money terms. They considered this figure as a reasonable one which could not be increased without the risk of harmful effects on the economy. In other words the figure could be considered as a maximum taxable capacity. This phrase, as H. Dalton has said is, "a common phrase but a dim and confused conception".<sup>(1)</sup> Nevertheless the important point here is that (910 mn.) in money terms is the maximum amount which the planning authorities expect the tax revenue to amount to within the next five years. As Professor Higgins points out, "For any country at each point of time there is some maximum taxable capacity, a ratio of tax collection to national income, that will maximise the growth of national income over some planning period".<sup>(2)</sup>

The planning authorities recognised that, out of the (910 mn.) in money terms, (587 mn.) is expected to be allocated for normal public expenditure, and (323 mn.) could be allocated to contribute towards the financing of the development programme.

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(1) Dalton, H., Principles of Public Finance, 23rd Impression, Routledge and Kegan Paul Ltd., 1961, P.17

(2) Higgins, B., Government Finance and Economic Development. Edited by A.T. Peacock, and G. Hauser, O.E.C. Paris, 1965, PP. 25-26.

Furthermore, the planning authorities expect tax revenue to increase as a result of spending additional amounts on investment which leads to an increase in distributed incomes and profits, other things remaining the same. It follows that even if the existing taxation system is maintained tax revenues will tend to rise. Consequently, in the first year (60 mn.) in money terms is the estimated contribution of tax revenue to the development programme, (61 mn.) in the second, (64 mn.) in the third, (66 mn.) in the fourth, and (72 mn.) in the fifth.<sup>(1)</sup>

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- (1) Taxation in underdeveloped countries includes the revenue from concessions of foreign companies regarding the utilization of natural resources in these countries. Antonin Basch, for example, in discussing revenue from petroleum in oil-exporting countries maintains that, "Such revenues have been received in various forms - royalties, profit sharing, income tax and special exchange profits (buying foreign exchange from oil companies at a lower rate than the selling rate)".

Basch, A., Financing Economic Development, The Macmillan Co., New York, 1964, PP. 80-81.

Our analysis is not, at the moment, confined to any particular group of underdeveloped countries, but refers to underdeveloped countries in general : it may however also be borne in mind that consideration will later have to be given to the position of Iraq and it is for this reason that this reference may perhaps be regarded as allowable.

(2) Domestic Savings :- On the basis of the assumption of an average and marginal propensity to save of 1/10, the planning authorities calculate domestic savings to be :  $800 \times \frac{1}{10} = (80 \text{ mn.})$  in money terms, at the end of year (n-1) i.e. the <sup>100</sup>year which precedes the beginning of the development programme. But as the national income is expected to rise, as a result of the execution of the development programme, other things being the same, the planning authorities allow for an increase in savings. Furthermore, it is estimated that something like (35 mn.) in monetary terms is expected to be hoarded by income receivers each year throughout the development programme.<sup>(1)</sup> Consequently, it is expected that the net amount of savings available to be channelled into productive investment will tend to be (45 mn.) in money terms in the first year, (47 mn.) in the second, (51 mn.) in the third, (54 mn.) in the fourth, and (59 mn.) in the fifth year.<sup>(2)</sup> In other words net domestic savings are expected to provide a total amount of (256 mn.) in money terms during the five years of the programme.

(3) Net Value of exports over imports :- Analysing the average level of exports during the last five years, and taking into account the possible changes in the amount and structure of exports during the next five years, the planning authorities estimate that the surplus value of exports over imports other than capital items may provide an average amount of (22 mn.) in money terms a year, or a total of (110 mn.) in the next five years.

(4) Foreign Loans and grants :- Taking into account all the possibilities of obtaining grants and loans, from foreign, private investors, governments, and international organisations, the planning authorities come to the conclusion that, a reasonable figure of (70 mn.) in money terms may be obtained through this method during the next five years; in other words an average of (14 mn.) per year.

- 
- (1) The assumption concerning hoarding is based upon the commonly accepted view that in an undeveloped country there will tend not only to be a strongly ingrained propensity to hoard but also that the percentage of hoarding of any new income that may become available to income-receivers might tend to be high.
- (2) The increase in net savings is not to be interpreted as due to a decline in the amounts hoarded but to an increase in the total sums withdrawn from the income flow out of which, of course, with hoardings remaining the same, as the national income increases.

Consequently, on these calculations the position is that, the total estimated amount to be provided by ordinary methods is (759 mn.) in money terms during the next five years, out of a total amount of (980 mn.) which should be provided as a minimum, to finance the development programme. This means that there is a gap of (221 mn.) in money terms between the estimated revenue to finance the programme and the actual minimum amount needed.<sup>(1)</sup>

----- If, therefore, as has been assumed, the programme of development which has been envisaged is not, for whatever reason, easily reduced financially without serious damage to the whole, then the planning authorities will find themselves compelled to choose between two things :-

(a) Put aside for the time being all idea of economic development on the grounds that :

(i) all the ordinary and usual methods of raising capital funds to finance the development programme have been exploited to their maximum limit.

(ii) No scaling down to smaller proportion is possible, the plan being regarded as representing minimum requirements, anything less being ruled out as inoperable.

(b) Use deficit financing<sup>(2)</sup> while recognising quite clearly that this device is likely to have inflationary consequences. For this reason it is also recognised that this way of raising capital funds

(1) That is if we assume that the purchasing power of domestic currency will tend to depreciate by only 1% a year, as indeed is assumed earlier, but as the planning authorities have decided to use deficit financing, as mentioned shortly afterwards, it is expected that the general price level may rise by more than that : for a detailed discussion of this point see (PP. 190 - 191 ).

(2) The term deficit financing in this study is used to mean : "Net additional credit made available to the planning authorities by a central bank in a country, being the intention that it should be used for the purpose of providing part of the capital funds needed to carry out a development programme". This is not the only sense in which the term can be used: indeed different writers have used the term in different ways: some discussion of these differences in usage is given in Appendix (3).

involves a certain element of risk. How risky in fact it will prove to be, will depend on the circumstances of the country which has decided to adopt the device of deficit financing. Here we will assume that the planning authorities of Era, knowing the circumstances of their economy, will shape some notions of what the consequences of deficit financing might be : we will assume that having analysed, as best they can, the public's confidence in the domestic currency, the availability of foreign exchange, and the time-lag between an increase in demand for and the supply of domestic and imported goods and services, they have reached the conclusion that an increase of 10% a year in money in circulation would not involve great risks. Thus, the planning authorities - either the Government itself or authorised in this action by the government - would request the central bank to hold itself ready to make available an increase in drawing rights involving, by the end of the period, a year for example, an expected increase in the aggregate money supply <sup>(1)</sup> of the order of approximately 10% overall.

There are various ways in which a central bank could increase the funds at the disposal of a spending authority, they are :-

- (a) Through advances to the banking system.
- (b) Re-discount of government securities held by commercial banks.
- (c) A decrease in the minimum legal reserve requirement of the commercial banks.
- (d) lending directly to the government.

In the situation now considered, it is visualised that the central bank lends directly to the government, as the planning and spending authority, and that the funds provided by the central bank through credit expansion will be diffused through the system as the spending requirements of the plan are met. Money in circulation is expected to rise, other things being equal, as a result of spending an additional 10% a year. Therefore, the absolute amount of the 10% will tend to rise. Consequently the planning and spending authority is allowed to draw :-

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(1) By 'money supply' is meant the total of cash, notes, and demand deposits.



$400 \times \frac{10}{100} = (40 \text{ mn.})$  in money terms from the central bank during the first year of the programme, and  $420 \times \frac{10}{100} = 42 \text{ mn.}$  during the second, 44 mn. during the third, 46 mn. during the fourth and 49 mn. during the fifth, as the following table shows.

The figures which have been entered into the calculations of the planning authorities would, if assembled and tabulated take the following form :-

Table (P)  
Financial requirements and sources of funds of a  
five year development programme in (Era).

Year	Net taxation for Development	Net domestic Savings	Net exports over imports	Foreign loans and grants	Deficit Financing
n	60	45	22	14	40
n + 1	61	47	22	14	42
n + 2	64	51	22	14	44
n + 3	66	54	22	14	46
n + 4	72	59	22	14	49
Total	323	25'6	110	70	221

If this amount of money is spent during the year, demand for goods and services, will increase by the same amount, i.e. (40 mn.) in money terms during the first year for example, It follows that assuming that production and imports were constant, the marginal propensity to consume were unity, then the general price level will tend to rise from (100) to :

$$P = \frac{MV}{T} = \frac{440 \times 2}{800} = \frac{880}{800} = 110 \quad (1)$$

(1) This is expressed in terms of the quantity theory of the value of money, and the figure (2) represents the average velocity of money in our model, with respect to final income : for further discussion of this procedure see P.P(167-169).

This is not what actually will tend to happen, because, when demand for domestic and imported goods rises, profits will tend to increase, and if this increase continues for an extended period, producers of domestic goods and services will try to get a larger share of profits by trying to increase their production, to satisfy part or all of the increase in demand.<sup>(1)</sup> Another part of the increase in demand is expected to be satisfied by an increase in imports (as for the proportion of this part, it depends on the marginal propensity to import, and the availability of foreign exchange). A third part is expected to be saved by the income receivers. Nevertheless, the general price level may tend to rise if only part of the increase in demand could be satisfied. This calls for the consideration of several questions. Firstly, will the increase in the general price level, in so far as there is any, affect the volume of exports, by weakening the competitive power of these exports in the world market ? Again will creditor countries prefer not to lend to underdeveloped country (Era), because of the possible weakness of the domestic currency compared with other currencies ? Thirdly, will the original increase in the general price level, in so far as there is any, induce a further increase in prices, i.e. engender a cumulative inflation ? Fourthly : is the real national income likely to increase as a result of spending these funds ? Finally, after a rise in the general price level, will the planning authorities have to pay higher prices for the factors of production which are needed to carry out the development programme ? These, and other questions, will be looked at throughout the analysis; for the time being it is assumed that there will be no, or a negligible, effect of the rise in the general price level on exports, foreign loans, and the cost of carrying out the development programme; if a different view is held at any point it will be mentioned.

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(1) This behaviour of the producers is explained on P (157)

The main purpose of this analysis is to discuss the possibility of an increase in production and national income of an underdeveloped country, by an expansion of bank credit according to a carefully studied plan, and under the strict control of the monetary authorities. The discussion will therefore be confined to the effects of spending the funds which are to be raised through deficit financing, and not to the spending of the whole amount of funds which are to be spent each year under the programme. The planning authorities decided to spend funds provided through deficit financing on setting up such projects as might tend to result in an increase in the production of goods for which the demand is large and expected even to increase in the future, and not being satisfied at the moment by domestic production. Therefore, after analysing the supply of, and the demand for, clothing in the domestic market, the planning authorities, make the assumption that demand for clothing at the end of the fourth year of the programme ( $n + 3$ ) may be (80 mn.) worth in money terms at the expected market prices of that time.

Operating at their maximum capacity the existing clothing factories are calculated to be capable of supplying only (17 mn.) worth of the expected total demand : the remainder (63 million worth) would have to be satisfied by imported clothing.<sup>(1)</sup> Therefore, the planning authorities decided to set up (10) clothing factories, with a total annual production of (63 mn.) worth of clothing.<sup>(2)</sup>

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(1) The value is expressed in terms of the prices which are expected to have been created by the deficit financing by the end of the planning period.

(2) It is assumed here that the planning authorities in underdeveloped country (Era) (in our model) decided to spend the capital funds provided by deficit financing on the setting up of clothing factories. The ground for this is that according to the United Nations experts, the cotton textile is :- "a labour-intensive industry with fairly modest capital requirements, standardized machinery and readily available raw materials, serving a demand that is urgent and generally inelastic, often a pioneer in the industrialization process".

The process of setting up these factories is to be financed by the funds raised through expansion of bank credit, i.e. deficit financing. The planning and spending authorities, it has been arranged, are to receive a (10%) of money in circulation from the central bank at the beginning of each year of the development programme, by making available an increase in drawing rights covering this amount. This amount, it was decided, is to be spent on three categories :-

(1) The construction of buildings for the factories, houses for the workers, to be, in the factories, and the required roads, in order to connect these factories with the sources of raw materials, and market centres, with estimated total cost of (100 mn.) in money terms.

The process of construction of these factories and other buildings, it was planned, will start at the beginning of the first year of the programme, and be due to be completed by the end of the fourth year. The total cost i.e. the (100 mn.) is to be spent during a four year period, i.e. (25 mn.) a year.

(2) The importation of capital goods (weaving machines) with a total cost of (72 mn.) in money terms. The planning and spending authorities agreed to pay to the capital exporting country this amount in the following way : (15 mn.) at the beginning of year (n), (17 mn.) at the beginning of year (n + 1), (19 mn.) at the beginning of year (n + 2), and (21 mn.) at the beginning of year (n + 3). In return, the capital exporting country has agreed to the supply delivery, and installation of a specified number of a certain type and size of weaving machine.

(3) Working capital of (49 mn.) in money terms (i.e. an average of (4.9 mn.) for each factory, which is to be provided at the beginning of the fifth year of the programme. By this time, the buildings are expected to have been completed, the machines delivered and installed, and workers and managers trained and ready to run these factories.

Let us assume that the construction firm estimated that out of the (25 mn.) in money terms which is to be spent on building the factories and other buildings (15 mn.) is to be paid as wages during each year, and the rest, i.e. (10 mn.) is to be paid for the building materials producers. Thus the total increase in distributed incomes will be (25 mn.) in money terms, a year. At the end of the first week, if the workers are paid weekly, the newly employed workers will receive their wages and start to spend them, on consumer's goods and services, domestic and imported. Consequently, demand for consumers goods will tend to rise. The retailers in the consumption sector face this increase in the first two or three weeks by allowing their stock of consumer's goods to run down.

When this increase in demand continues, the retailers increase the quantities which they usually order from the wholesalers, in order to replenish their stock, on the one hand, and to meet the continuing increase in demand on the other. The wholesalers face this increase in demand from retailers by running down their stock of consumer's goods at first. But as this increase continues for several weeks, the wholesalers increase their usual orders for the producers of consumer's goods for the domestic market. Thus demand pressures will be developed in the domestic market which, under certain circumstances, could have the affect of inducing a rise in prices in the consumer's goods sector. The consumers goods producers satisfy the increase in demand by the wholesalers at the beginning, by running down their stock of consumer's goods. As the increase in demand for consumer's goods continues for an extended period, producers, as their stocks of these goods are running down, start to think about expanding their productive capacity. Meanwhile, as a result of the continuing rise in demand, turnover tends to increase. It follows that other things being equal, profits per unit of capital employed will tend to rise, simply because of the increase in the rate of use of the fixed capital. Consequently, producers of consumer's goods start to gain higher than the normal rate of profits which has been ruling before the

increase in demand took place. Consumers will bid against each other for short supplies, while sellers will be induced to charge more per unit. Eventually, consumer's goods producers will try to increase their production in order to satisfy the increasing demand and get a larger share of profits.<sup>(1)</sup>

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(1) In the above analysis it is indicated that, producers of consumers goods in underdeveloped country-(Era) will try to increase their production in order to satisfy part or all of the rise in demand, and get a larger share of profits and not only to sell their products at higher prices. This is due to two reasons :

- (i) Competition among themselves.
- (ii) Competition of imported goods, in so far as these may be good substitutes for domestic goods.

However, it may be difficult for producers in an underdeveloped country to increase their production, especially in a short period, because, there may be "bottlenecks" such as, the training of the required additional number of workers needed for expansion and they may have to face the problem of a possible shortage of foreign exchange needed for importation of capital for expansion. Nevertheless, it is by no means impossible to increase the production of consumer's goods in an underdeveloped country to a limited extent in the short term and to a larger extent in the long-term as the analysis will attempt to show. To support this view an example of what actually happened in an underdeveloped country i.e. Iraq is given here :- "The Iraqi Spinning and Textile Fattah Pasha and Jute (nationalised) companies, together with the Medical Cotton Administration, expanded their productive capacities by adding new production units, other concerns in the private sector also followed suit during the year".

The Central Bank of Iraq, Annual Report, 1964, Zahra Press, Baghdad. p.21.

However, there are economists who do not agree with this view, such as, Professor A. Lewis, Theory of Economic Growth, Unwin University Books, 6th Impression, 1963, P.218



velocity of money in circulation is assumed to be 2. This is intended to indicate that money in circulation enters into the transactions sequences of the economy in such a way that final income is increased to the extent of twice the amount of money that is available and used. This may be further expressed as meaning that the volume and frequency of transactions into which money enters maintain that constancy which will keep the income velocity of money at 2, precisely. This of course involves a very simplifying assumption about the transactions velocity of money but it is necessary if the figure of 2 for the income velocity of money is to be accepted as a correct figure for inclusion in the model. Therefore it seems logical to say that only two stages of the multiplier are expected to operate during the year. Consequently, if the multiplier is to have its full effects on the economy, the additional amount of increase in money in circulation should change hands (10) times, and in our model it will have taken ten stages, i.e. five years for the process to register its full effects. In the second stage (1.8 mn.) in money terms will tend to be saved (i.e. 1/10 of the 18 mn.) and (3.2 mn.) (16.2 x 1/5) will tend to be spent on imported consumers goods. The rest, i.e. (13 mn.) in money terms is expected to be spent on domestic consumer's goods. Therefore, the total increase in demand for domestic consumers goods 18 mn. in the first stage + 13 mn. in the second stage = (31 mn.) in money terms.

The increase in demand for imported consumer's goods will tend to be = 4.5 + 3.0 = 7.5 in money terms.

As for savings, the increase in savings will tend to be :-

$$2.5 + 1.8 = 4.3 \text{ mn. in money terms.}$$

This much for the changes on the demand side: now what may be supposed to be likely to happen with regard to the supply of domestic goods during the first year of the development programme ?



It is suggested that we can envisage producers of domestic consumer's goods in (Era) as being divided into two groups, from the point of view of their capability to increase their production.

Group A :-

Producers in this group are assumed to be able to increase their production in the short run, that is during the first year of the development programme in our model, merely by using their existing fixed capital, e.g. by employing more of the variable factor, i.e. labour. We assume further that this group controls 50% of the total production of consumer's goods in (Era)<sup>(1)</sup>.

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(1) It may be safe to say that in any underdeveloped country where little industry is in existence, as is the case in most if not all of underdeveloped countries, some of the producers, at a given time, are not producing at their maximum capacity for a variety of reasons, such as the lack of sufficient effective demand for their products, or a temporary breakdown of a number of machines, or simply because production of a certain commodity has just started, and time is needed before production reaches its maximum limit. The last case may be illustrated by the following example :- A clothing factory in Iraq (Mosul Liwa) started operation in 1957-58, at a total production in the weaving department of (lb) 473,102). The figure rose to a total amount of 4,948,043 in four years time i.e. in 1961-62, in the clothing department total production in 1957-58 was (5,848,215 sq. yards) rising to (19,917,876) in 1961-62. Other examples could be found in various issues of the "Industrialist", a quarterly review issued by the Iraqi Federation of Industries. The above example was taken from issue No.(4), Sixth Year, Dec, 1965, P.66 (the Arabic section).

Therefore it may be safe to assume that producers in this category are able to increase their production in the short run, without necessarily incurring proportionate increases in costs. On the other hand, some of the producers may not be able to increase their production, unless they increase both their fixed and variable capital. In some underdeveloped countries it may be the case that a number of producers controlling 60% of total productive capacity of consumer's goods can increase their production, and the group controlling 40% cannot, and it might just be the opposite in another country. The figure 50% therefore, has been chosen for the sake of simplicity only, as indicating the normal relationship between the two groups.

Group B :-

In order to increase their production, producers in this group have to increase both their fixed and variable capital; that is they can increase their production only in the long-run, since changes in fixed capital are necessary to increase production. It follows therefore that this group control the remaining 50% of the productive capacity of consumer's goods in (Era)-

Thus producers in group (A) recognising that they are running out of stock recognise at the same time that they can meet the increasing demand by utilising their existing equipment more intensively and need only employ the appropriate additional quantities of skilled and unskilled labour. As the supply of skilled labour in underdeveloped countries is limited, it follows that higher wages might have to be offered to attract skilled labourers from other sectors of the economy on the one hand, and some resources devoted to the training of unskilled workers on the other. The supply of unskilled labour in underdeveloped countries tends to exceed the demand to a large extent, because of the relatively high percentage of unemployed and under-employed persons in such countries. Therefore, producers in group (A) are expected to be able to satisfy their need for unskilled labour at the going rate of wages.<sup>(1)</sup>

Now what will tend to happen to cost of production of group (A), when they try to increase their production by employing more labour ?

The importance of trying to find out what will happen to the cost of production is that it is necessary to attempt to know

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(1) Lewis, W. A., Economics Development With Unlimited Supply of Labour, Manchester School of Economics and Social Studies, Vol. XXII, 1954, PP.91-139, and Vol. XXVI, 1958, P 1-32.

more precisely how unit cost may be likely to vary as output is increased. This is because, the generally accepted theory indicates that relative to a given scale of fixed investment in buildings, warehouses and the like, increasing output can be obtained up to a certain volume of output at diminishing unit cost but that beyond that point unit cost will tend to rise. The orthodox and generally accepted presentation of this pattern of relationship is as follows:-

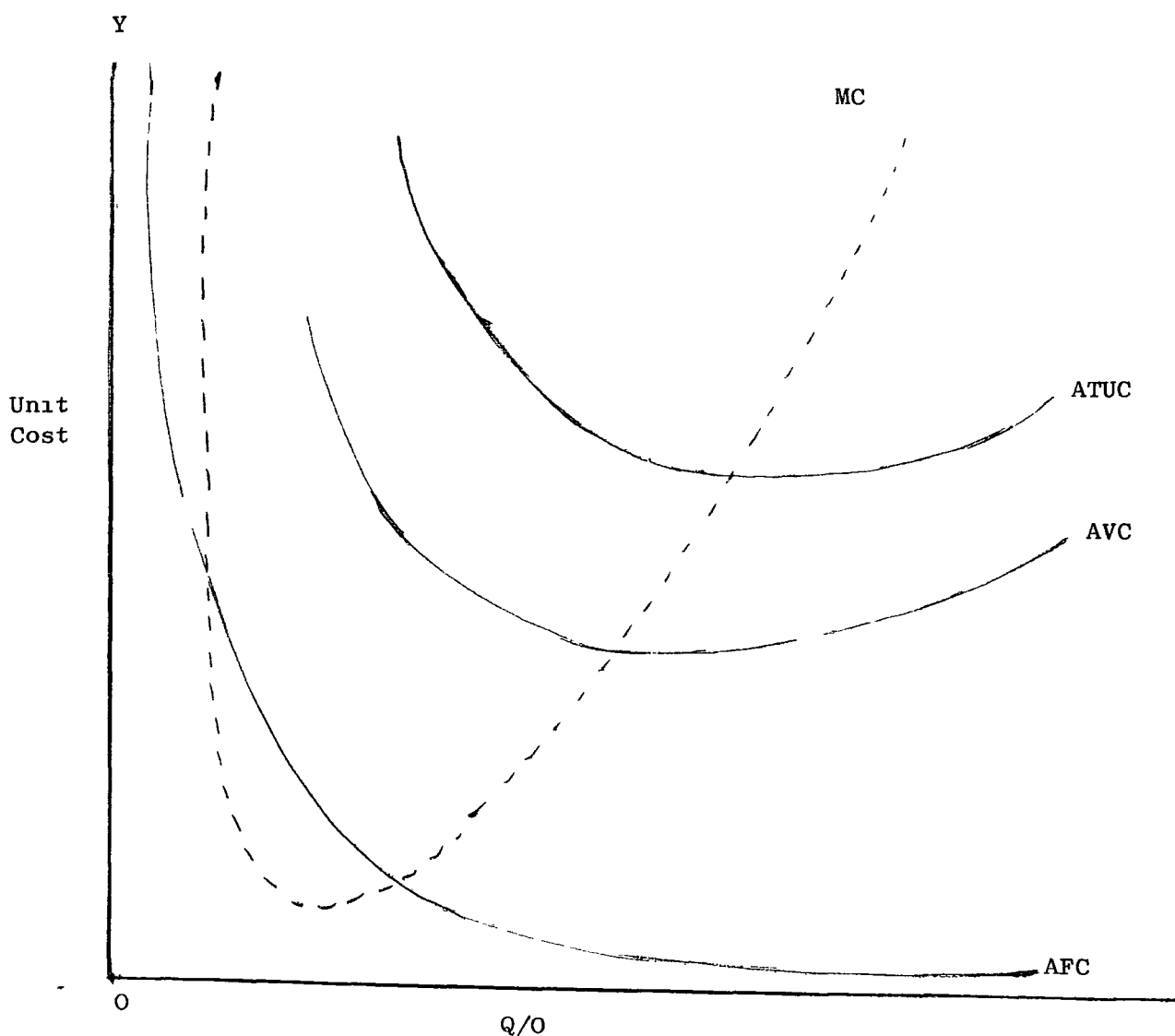


Figure 3

Average and marginal cost curves

A more recent and, as yet, perhaps not generally accepted presentation is that of Andrews'. He presents the relationships as follows:-<sup>(1)</sup>

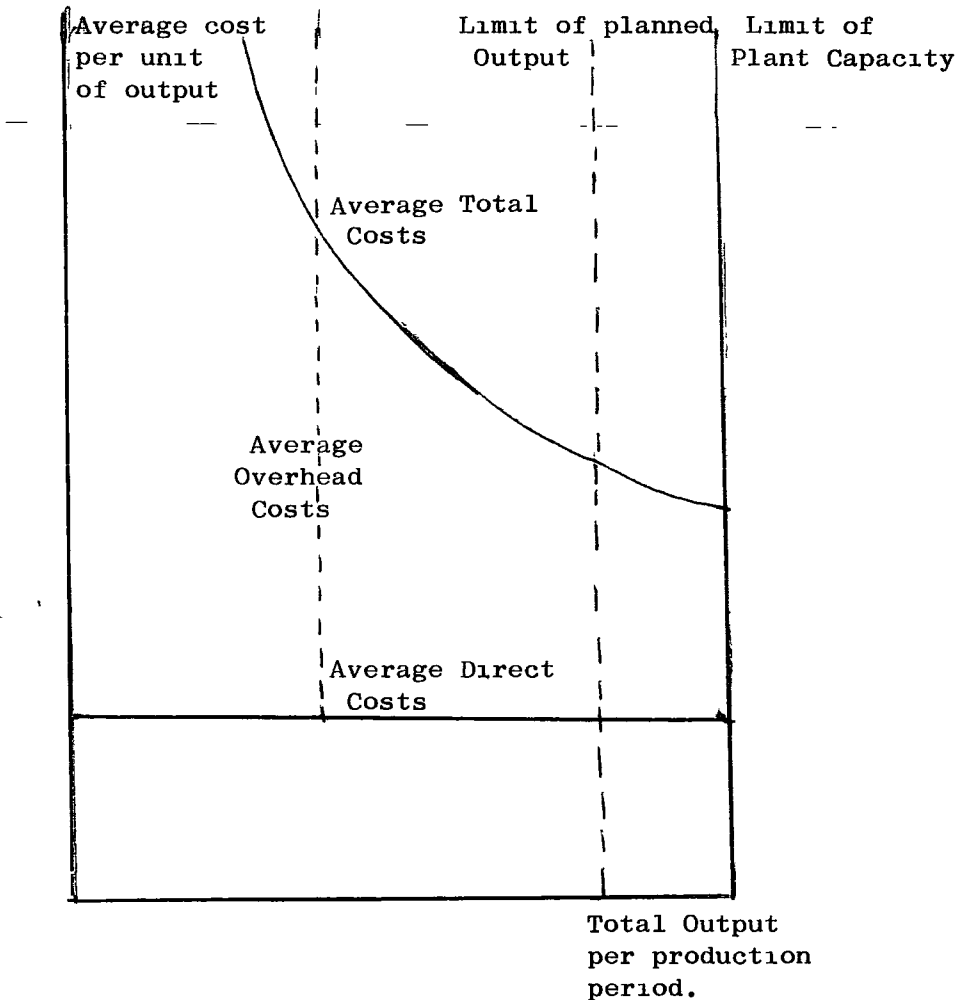


Figure 4

Variation of Unit Cost under assumed limits of plant capacity.

The diagram is taken from an article by P.W.S. Andrews titled, "The theory of the individual business". In Oxford Economic Papers, New Series, Volume 1, 1949, Clarendon Press, P.61

(1) In the above mentioned article, Andrews gives more sophisticated diagrams, but since the diagram drawn here serves our purpose, therefore, there was no need to draw a more complicated one. The first stage/ footnote continued on next page.

There is something to be said for both these models of presentation and both enable the relationship of the various forces to be understood but it is perhaps the case that the more recent treatment of what is happening in manufacturing situations enables our understanding to be a little deeper. Both approaches to the situation will be applied to the position in which our two groups of producers (A) and (B) are presented as finding themselves but the analysis will end by working more in terms of the Andrews model than in that of the conventional text-book.

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footnote continued from previous page :

The first stage in elaboration of the diagram might be, for example, to show how unit cost might increase if output was increased between the two limits of planned output and plant capacity. The amount of such increases would depend upon the particular productive circumstances in which the producers were placed. A general indication of the possibility of such increases occurring has been given in the description of the position of the producers in group (A). The essential point which Andrews intends to convey is that at a certain level of output a point is reached beyond which the firm cannot go, even at any cost : a productive barrier, so to say, has been reached which imposes an absolute and final constraint upon the firm.

In figure No. ( 3 ), the different curves show the course of different sorts of unit costs as output, conditions of technique remaining the same, is varied. The average fixed cost per unit of output is shown as approximating to a constant value after a certain amount of output has been reached ; this is explained by the spreading of a fixed total of capital cost over an increasing number of units of output. Average variable cost per unit of output is not capable of this order of variation though it may be expected that as a greater number of units is turned out, some economies in production may be realised, though it may be expected that if the output were taken beyond a broadly definable zone difficulties of organisation and control might well result in average variable costs rising. Average variable costs can be legitimately depicted then by a line which presents a slight gradient on either side of a minimum cost point or zone. Average total unit cost is thus seen as the result of a simple vertical addition of the (AFC) and the (AVC) curves. It is perhaps not necessary, since this is not a theoretical treatment of costs, to seek to add comment about the movement of marginal cost, beyond saying, simply, that a marginal cost curve, if introduced, would be thought of as, first falling sharply and then rising possibly quite sharply for large quantities of output, and passing through the minimum points of the (AVC) and (ATC) curves.

Let us assume that producers in group (A) in our model are producing that quantity of output for which (AVC) is a minimum. It follows that the variable cost of producing additional output beyond point (C) will rise. Average variable cost will tend to rise because the marginal cost of further output will be greater though until the minimum total unit cost of output has been reached unit cost will still be below total average unit cost because (Afc) continues to

fall, even though only by a little. Further assumptions are firstly that producers in this group encounter no difficulties in connection with their capital requirements - which will, in the circumstances, clearly only be in respect of circulating or working capital, - and secondly that this group is able to increase its production in the short run sufficiently to meet 50% of the increase in demand for consumer's goods. <sup>(1)</sup> The reason for this inability to go beyond 50% is that they meet operating difficulties as they increase the intake of labour and materials into their existing fixed investment: the limit of 50% is taken chiefly for simplicity and convenience and not because it is assumed that any such limit arises precisely from the relation between capital inputs and their enterprise. If costs and prices are assumed to remain constant during the first year of the programme, then we have only the simple calculation  $31 \times \frac{50}{100} = 15.5$  to do to arrive at the enlarged output for which, in money terms, producers in group (A) would be responsible. But evidently the average cost of production for group (A) will tend to rise; let us suppose that the increase is by 5%. The market previously consuming (X), would, if prices remained constant, be prepared to increase their requirements by  $\frac{X}{2}$  (i.e. 50%), so asking for  $X + \frac{X}{2} = 1\frac{1}{2} X$ . But since prices have risen they will not be prepared to increase their requirements by the full amount X but only by something less than  $\frac{X}{2}$ . This may be taken as indicating that while at constant prices they would have been prepared to take  $1\frac{1}{2} X$ , at rising prices they would be damped back, so to say, and cease asking for more at something less than  $1\frac{1}{2} X$ . It follows therefore, that if the

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(1) This is because we assume that producers in group (B) are notable to increase their production during the first year: therefore we only concern ourselves with increase of production as far as group (A) is concerned during the first year of the development programme.

increase in prices is incorporated in the new price of output then the 50% of the increase in demand can be met by a rise in production equal to :

$$15.5 - (15.5 \times \frac{5}{100}) = 15.5 - 0.8 = 14.7$$

expressed in aggregate money terms. This represents the sales value of the actual increase in production which has been induced. Producers in the consumption sector may now be envisaged as trying to get a larger quantity of factors of production in their attempt to increase their production, by offering higher wages for skilled and semi-skilled workers, and probably, higher prices for raw materials. In this way the increase in prices in the consumption sector may, dependent on sector proportions, be expected to induce a rise in the general price level, because each sector will tend to try to bid up the prices in order either to get a larger share of the limited factors of production, or maintain the existing intake. It follows that, if this analysis is to be conducted any further, it is necessary to calculate the change in the general price level at the end of each year of the development programme. In doing this use will be made, with certain modifications, of what is basically a simple version of the Quantity Theory of the value of Money. In the note which is added as Appendix four on this procedure it is suggested that the Quantity Theory may perhaps be accepted as an expository device. But while it may have properties which enable it to serve in this way it has also to be remembered that it may also have disadvantages. It is essentially a static construction : it is this aspect of it that Gilpin is referring to when he draws attention to the way in which the symbols in the notation stand for fixed parameters. In the analysis which follows there is a departure from a strictly static description of the pattern of relationship. An attempt is made to include various changes which might be expected to arise in the course of events as people observed what was happening and made decisions in the light of their observations which altered the outcome in the pattern of relationships from that which would have come about if a purely static relation had been maintained. The model is essentially static : it then seeks, in a way intended to be realistic, to introduce these changes which observation of human



beings in their social and business relations might be reasonably expected to be initiated, and finally to calculate the consequences quantitatively. The model is thus made to contain dynamic elements. As a result the calculations involved become more complicated, and, more important, perhaps, numerical equalities between various magnitudes which might have been expected on a static view do not reach equally within the limits of the model. Not only are changes introduced which, in effect, alter the parameters, but there is a lag built into the model as well. (1) It is assumed, for example, that the multiplier effects of deficit spending will work themselves out in (10) stages over a five-year period. It follows from this that only the spending injections of the first year work out their full effects. Over-all, there is a lagged deficiency equal to about 40% of the full influence of the deficit spending. There are other ways in which features are introduced into the model which have dynamic implications. For example :- (1) the increase in demand which occurs is expected to be met partly by increased domestic production and partly by increased imports (2) it is assumed that some part of the full increase in demand cannot be satisfied with goods because of bottlenecks in domestic production and shortage of foreign exchange for imports (3) changes in prices and business activity are expected to induce changes in expectations which themselves induce changes in interest rates and the willingness to hold money as compared with goods. The equation used is the familiar Fisher equation,  $MV = PT$  and each symbol is used in the Fisher sense except that T is interpreted as always bearing that relation to other components and to National Income that it may be taken as the shadow, so to say, of National Income itself and, V is regarded as indicating the income-velocity of money (2). The income-velocity of money

(1) At first sight it might seem necessary to deal with the funds taken up from the current-income flow by taxation as a "leakage" in this build-up of income. However, since a government obtains its revenue to spend, the simplifying assumption is adopted here that over a succession of periods what is taken up (i.e. abstracted) will be balanced by what is spent (i.e. put back). There are several reasons for thinking that the match might not be precisely complete (through rising prices for example), but, equally, there is reason to think that in an underdeveloped country the differences might be very slight and may be neglected so as to avoid complicating further a model which is already fairly complicated.

(2) Here the aggregate money value realised in the total flow of transactions (T) is built into the equation "net" and not "gross". What is indicated by the "net" aggregate is the income realised by the various agencies through whose activities the transactions have been carried through.

is taken as 2 and T is therefore interpreted as always having that size which will, in the last analysis, yield a National Income equal to twice the volume of money in circulation. This is an extension of the Fisher form but there is a need to find a means of calculating not only the level of prices but also the size of National Income expressed in prices. This assumption about T seems to yield these results. Thus, part of the increase in demand which is assumed to be satisfied by an increase in domestic production of consumer's goods, and part, dependent on the availability of foreign exchange, by an increase in imports : a third part is expected to be saved. If increases in domestic production, imports and savings are not, collectively, big enough to absorb the initial increase in spending power then, other things remaining the same, the prices of "some" consumer's goods will tend to rise. If the equation is extended to provide room for these additions then it is suggested it should take the form :-

$$P = \frac{MV}{T + (G^+ + I^m)}$$

where (G +) is the increase in domestic production of consumer goods and (I<sup>m</sup>+) is the increase in imports of consumer goods.

As a result of these various assumptions the general price level, where a net additional amount of (25 mn), provided through deficit financing is

spent by the planning and spending authority, is expected to become (provisionally) :

$$\begin{aligned}
 P &= \frac{MV}{T + (G^+ + I^m)} \\
 P &= \frac{421 \times 2}{800 + (14.7 + 7.5)} \\
 &= \frac{842}{822.2} = 1.0243
 \end{aligned}$$

The general price level index is thus assumed to be (100) at the beginning of the first year of the programme, therefore :

1.024 x 100 = 102.4 This increase in the general price level may not of course be the only change taking place : there can be a number of associated effects undergoing change at the same time.

This is because, when prices start to rise and are expected to continue for an extended period, people may start to borrow money more than they would if prices are not expected to keep their upward movement. This could be explained by the fact that it is profitable to borrow money at the ordinary ruling interest rate, and when at the end of the period the principle is paid, its purchasing power has become less than it was at the beginning of the period as prices increase. Therefore, if the ruling interest rate is (5%) at the beginning of a period, and the general price level increases by (2%) during the period, the real interest rate will be only (3%). It follows that, as more money is borrowed and spent demand increases and the general price level will tend to rise. The original increase in

- (1) If there were no savings (and hoardings) money in circulation would have become  $400 + 25 = 425$  mn., but (4.3 mn.) is saved (marginal propensity to save  $1/10$ , and the above figure represents total savings taking place as a result of two stages of the multiplier). Consequently money in circulation is expected to become 420.7 or for simplicity (421 mn.), (1.9 mn.) is expected to be hoarded, i.e. withdrawn from circulation, and (2.3 mn.) is expected to be spent on investment during the next time period, i.e. with a lag.

the general price level was calculated to be (2.4) by the end of the first year of the programme, but as a result of the additional rise in demand which is expected to be induced by the original rise demand may tend to increase further by, say, a third of the initiating demand, i.e.  $2.4 \times \frac{1}{3} = 0.8^{(1)}$ . The general price level at the end of the first year, on the analysis so far, could possibly be  $2.4 + 0.8 = 3.2\%$

A question might be raised here, that is, : why we assumed that the additional increase will be a third of the original increase, and not equal, or even more than that ? To answer this question, it is necessary to discuss the expected behaviour of money lenders and money borrowers when the general price level starts to rise and is expected to continue in its upward movement for an extended period.

At first, money lenders may think that the increase in the general price level will not continue for an extended period in the future; therefore, they charge the normal going rate of interest. When they begin to hold the view that prices may be likely to continue in their upward movement for an extended period of time, they will tend to re-adjust the rates of interest they charge. They will be likely to do so to an extent which will yield to them the same level of interest rate, in real terms, as would have been realised if prices had remained constant. Therefore, there are no windfall profits to be obtained by seeking to buy at one (lower) level of prices and sell at another (higher) level of prices, and the speculative demand for funds is eliminated from the total pattern of demand which is present.

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(1) The analysis will attempt to show that it is not possible for the additional increase in demand to equal the original increase. Consequently, an arbitrary decision may be made as to the size of the fraction provided that it is significantly less than unity. But it is expected that the additional increase will be moderate i.e. a third of the original increase, for example, because the original increase is by only (2.4%) which is by no means a high increase. It is possible that no additional increase at all should arise, but since the case of the use of deficit financing is to be presented in its strongest possible terms, an allowance is made as for a possible additional increase in demand. In this way it is thought that the danger of minimising the disadvantages of deficit financing will be avoided.

An opposing argument against this, of course, is that in times of inflation it may be possible to make profits, merely by borrowing at current interest rates, buying stocks of goods and/or raw materials with the funds so borrowed and selling them at higher prices at the end of a brief period of hoarding. The argument against this way of reasoning is that as money lenders foresee the increasing demand for money on the supposition that inflation is likely to continue for an extended period of time, they tend to raise the money rates at which they are prepared to lend until a point is reached where the real interest rate implied by the transactions is such that the rate of profit to be obtained is no greater than could have been obtained if the inflation had not happened.<sup>(1)</sup> The other point which could have an effect on the demand for goods is people's desire to hold cash. When people hold cash they are losing the interest which could have been made, if they had lent their money. But people hold cash because it is necessary to hold a certain amount of cash in order to facilitate transactions on the one hand, and to use it for speculative purposes on the other.

In a period of stable prices, if the interest rate is (5) per cent, then the cost of holding cash is (5) per cent as well. If prices increase by (4) per cent during the period, then the cost of holding cash will be  $5 + 4 = 9$  per cent, if and only if the interest rate remains constant during the period. But if interest rates increase during a period from 5% to 9%, while prices remain constant during the period, then the cost of holding cash will be 9%; even if prices were constant. Consequently, an increase in the cost of holding cash could be brought about merely by an increase in rates of interest and not only by an increase in the general price level.<sup>(2)</sup> The increase in the cost of holding cash might cause, to a limited extent, a reduction in people's holdings of cash, but this might not

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(1) R.G. Lipsey, *Is Inflation Explosive?* The Banker, Edited by Wilfred King, Vol. CXI, 1961, October, PP. 673-674.

(2) *Ibid*, P.675

cause a flight from cash on a large scale; as Professor Lipsey has said, "but few people would expect it to cause a cumulative flight from cash of the sort that might spark off a hyper-inflation; if this is accepted then it must surely also be conceded that the movement from a stable price level to a steady inflation is unlikely to cause such a cumulative flight from cash".<sup>(1)</sup>

The above-analysis has shown that the general-price level will tend to increase by (3.2%) which is, it may not be unreasonable to say, a moderate increase. Therefore, it is not expected to cause a sharp reduction in people's desire to hold cash and to try to hold part of their wealth in the form of goods, among other assets, instead of cash. This partial shift from holding cash to holding goods, limited as it may be, will tend to cause a further increase in demand, which leads to a further increase in the general price level in the magnitude of say, (5%) of the original increase. It follows that the total increase in the general price level at the end of the first year of the development, is expected to be : <sup>(2)</sup>

$$3.2 + \left( 3.2 \times \frac{5}{100} \right) = 3.2 + 0.16 = 3.36 \text{ or for simplicity, } 3.4 .$$

This figure represents the expected increase in the general price level which is assumed to have been 100 at the end of year (n-1), and it thus becomes  $100 + 3.4 = 103.4$ . The total amount of money in circulation will tend to become (421 mn.) The National Income will tend to increase by a total amount of (22 mn.) and becomes (822 mn.).<sup>(3)</sup> If the increase is to be calculated in real terms which would be equivalent to thinking of it in constant prices, an allowance should be made for the increase in the general price level which has taken place.

(1) Ibid, PP. 675-676.

Though whether the speculative motive for holding money will be strong in a country, such as Iraq, may be doubted.

(2) On the basis, that is, of the assumptions and expectations which have been induced in the exposition of the model so far.

(3) For a general explanation of why it is not 842 mn. see p.(189)

During the second year of the programme, the planning and spending authority will pay another (25 mn.) in money terms to the constructing firm, and the firm will continue to spend on the building of the factories and other associated buildings, as assumed earlier. The spending of the new (25 mn.) will tend, other things remaining the same, to increase distributed incomes. In other words, demand for consumer's goods (domestic and imported) will tend to rise. This increase in demand will tend to initiate an increase in the production of the consumer's goods (within the limits of the productive capacity of producers) on the one hand, and in the importation of these goods on the other. As for the demand side, it is assumed that the average propensities and marginal propensities to save, consume, and import will remain constant throughout the five years of the programme. <sup>(1)</sup>

The additional amount which was spent during the first year has passed through two stages of the multiplier, and it is expected that it will go through a third and fourth stage during the second year. Therefore, this amount should be taken into account when the increase in demand during the second year is calculated. Consequently, the total increase in demand in the second year should be calculated as follows :-

1.8 mn. in the first stage + 13 mn. in the second stage = 31 mn. in money terms (with 7.5 mn. increase in demand for imported goods and 4.3 mn. in savings out of which 1.9 is hoarded).

The third and fourth stages of the amount spent during the first year :-

9.4 mn. + 6.8 = 16.2 mn. (with 4 mn. increase in imports and 2.2 mn. increase in savings, out of which 1 mn. is hoarded).

The total increase in demand for domestic consumer's goods is expected to be :-

$31 + 16.2 = 47.2$  or (47 mn.) in money terms.

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(1) The marginal propensity to import is assumed to shift from 1/5 to 1/6 during the fifth year of the programme, as a result of the increase in the production of domestic consumer's goods, which is expected to take place during the fifth year of the programme.

Now what about the supply side ? As it may be recalled, we have allowed for the increase in imports, and therefore the figure (47 mn.) represents the net increase in demand for domestic consumer's goods. Producers in group (A), we assume, are still able to increase their production, during the second year, by employing more of the variable factor, i.e. labour, but at a higher cost per unit. This is because, as the analysis has shown the general price level at the end of the first year has increased by (3.4%).<sup>(1)</sup> It follows that factors of production will tend to cost more than they did during the first year. We assume further that group (A) will tend to reach its maximum capacity of production by the end of the second year which means that if producers in this group want to increase their production they have to increase their fixed capital as well as their variable capital. As we have assumed earlier that this group controls 50% of total productive capacity of domestic consumer's goods, we may carry the assumptions consistently through and say that they will try to increase their production proportionately. We assume average total cost per unit to rise by (10%). If this increase in cost of production is incorporated in the new prices of the output, then the demand as far as group (A's) share is concerned can be met by an increase in production equal to :-  $47 \times \frac{50}{100} = 23.5$  mn. the demand which group (A) is trying to satisfy.

$23.5 - (23.5 \times \frac{10}{100}) = 23.5 - 2.4 = 21.1$  or for simplicity 21 mn. This figure represents the selling value of the actual increase in production for group (A) at relevant prices. Now, we assume that producers in group (B) have ordered capital goods from a capital goods

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(1) It is assumed, for simplicity, that the increase in money costs is evenly and uniformly diffused through the system and that no alterations in the underlying real relations between resources and their uses takes place.



exporting country, during the first year, when the demand for consumer's goods began to take place. It follows that, as far as the capital goods are concerned, the effects of ordering these goods will be felt by the capital exporting country, and will increase exports of these goods, other things being equal.

As for the supply of other factors of production in "Era" the analysis has shown that there is unlimited supply of unskilled workers who could be trained on the job. We assume that raw materials are available domestically, and that producers in group (B) are able either to borrow the required funds for expansion, or they can provide these out of their own resources.

When producers in group (B) expand their production, during the second year after the increase in demand took place in our model, there are three possibilities in relation to costs of production per unit :-

- (1) rising long run costs, which means that as output expands costs per unit increase.
- (2) falling long run costs; as output expands costs per unit fall.
- (3) constant long run costs, as output expands costs per unit remain constant.

If these variations are described in terms of what is known as 'economies of scale', then the situation is that, if a firm increases its input by X amount of factors of production then output might increase less than proportionately, or more than proportionately or in the same proportion relative to the inputs. Now, the firms in our model are expected to pay higher prices for factors of production than they did in the previous period, as a result of the increase in the general price level. We will assume however that costs per unit for group (B) in the longer run will tend to rise on the one hand, and that on the other as far as the "economies of scale" are concerned, an increase in input by (X) will tend to yield an (X) increase i.e. a proportionate increase, in production.

We will assume that costs per unit for group (B) will tend to rise by (15%). If prices remained constant, the proportionate increase in production, for group (B), would be : (bearing in mind that the total increase in demand for consumer's goods during the second year is (47 mn.) :-  $47 - 23.5 = (23.5 \text{ mn.})$  the demand in money terms which group (B) is trying to satisfy. Cost of production per unit for group (B) is expected to rise in the beginning, because of the expansion in the capital invested which was required for importation of capital goods and perhaps, a larger working capital. This increase is assumed to be by (15%). Consequently, producers in this group are expected to increase their production by :- (valued at the new, i.e. higher, selling prices) :

$23.5 - (23.5 \times \frac{15}{100}) = 23.5 - 3.5 = (20 \text{ mn.})$  in the relevant money terms. This is because, it is expected that the increase in cost of production will be incorporated in the new prices of output. It follows that the total increase in production of domestic consumer's goods for both groups during the second year of the development programme will tend to be :  $21 + 20 = (41 \text{ mn.})$  in money terms, and valued at the new, i.e. higher, selling prices which is induced by the change in demand and cost of production. Consequently, the general price level at the end of the second year (n + 1) will tend to be :-

$$P = \frac{MV}{T + (G^+ + 1^+)^m} \qquad P = \frac{443.4 \times 2}{823 + 41 + 11.5}$$

$$P = \frac{886.8}{875.5} = 1.0129 \text{ or } 1.013$$

The general price level at the end of the first year was 103.4, therefore it becomes (provisionally)  $1.013 \times 103.4 = 104.78$  or 104.8.

The original increase in the general price level by the end of the second year will thus emerge as 4.8%. By this time, it may be safe to say that money lenders may have come to the conclusion that,

the tendency for prices to rise is going to continue for an extended period, depending on their observation during the first year of the plan, and therefore, they tend to raise the rates at which they are prepared to lend, up to a point ~~where the~~ real interest rate is equal to that which was ruling before inflation took place. It follows that the speculative motive which encouraged people to borrow money at a low level of real interest rate and buy goods and/or raw materials and sell them at higher prices after a short period and make windfall profits during the first year, and cause a further increase in demand and prices during the first year, is no longer in existence during the second year.

Therefore, the possibility of a further increase in demand and prices, as far as the speculative motive is concerned, during the remaining period of the development programme, will tend to be negligible. Now we are left with another factor which might cause a further increase in demand and prices, namely, people's desire to shift part of their cash holding into other forms of wealth, in periods of rising prices. This motive is expected to exist as long as prices continue in their tendency to rise. Furthermore, it is expected that this motive is encouraged by people's expectations of the length of the period over which prices will tend to continue in their upward movement, and whether this movement is expected to become a sharp or steady one. It follows that this motive will not tend to cause a relatively large increase in prices as a result of an increase in demand, if the general price level is rising steadily. With these considerations in mind we will assume that people's desire to change part of their cash holdings into goods and other forms of wealth in (Era) during the second year of the programme will tend to cause a further increase in the general price level by (5%) of the original increase, that is

$$4.8 \times \frac{5}{100} = 0.24 \text{ or } 0.2$$

Therefore, the total increase in the general price level will thus be :-

$$104.8 + 0.2 = 105^{(1)} \text{ Money in circulation becomes } 443.4 \text{ or for}$$

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(1) The increase in the general price is calculated to include accumulated increases during the period of the programme and not each year by itself.

simplicity (443 mn.) and national income (in monetary terms) :  
 $822 + (41 + 11.5) = 874.5$  or (875 mn.)

At the end of this year producers in group (A) are expected to order capital equipments because they have reached their maximum productive capacity on the one hand, and they expect that the demand for domestic consumer's goods will tend to continue in its upward movement for a future period on the other. Furthermore, we assume that it will take a year for delivery and installation of the capital equipment, and therefore producers in group (A) will be able to increase their production only at the beginning of the fourth year of the programme.

During the third year of the programme, the constructing firm will spend another (25 mn.) in money terms. Consequently, demand for consumer's goods (domestic and imported) will tend to rise, other things remaining constant, by a total of :-

- (1) The first and second stages of the amount which was spent during the third year :-  $(18 + 13 = 31 \text{ mn.})$
- (2) The third and fourth stages of the amount spent during the second year :-  $9.4 + 6.8 = 16.2 \text{ mn.}$
- (3) The fifth and sixth stages of the amount spent during the first year :-  $4.9 + 3.6 = 8.5 \text{ mn.}^{(1)}$  and the total increase in demand for domestic consumer's goods during the third year of the programme is expected to be :-  $31 + 16.2 + 8.5 = 55.7 \text{ mn.}$  or (56 mn.) in money terms and, so we account for the demand side. As for the supply side, producers in group (A) it is assumed, are not expected to be able to increase their production because they have reached their maximum productive capacity at the end of the second year, and have ordered capital equipment. Therefore, only producers in group (B) are expected to increase their production proportionately with their productive capacity:

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(1) All stages are shown on the diagram opposite to page 48.

We have seen that the total increase in demand for domestic consumer's goods will tend to be (56 mn.) in money terms at the going prices, out of which 50% i.e. (28 mn.) is expected to be satisfied by increase in production of group (B). Producers in group (A) will try to increase their production proportionately with their productive capacity as demand for domestic consumer's goods rises. Average total cost of production per unit for this group will tend to increase by say 10%. This increase in cost of production is expected to be incorporated in the new selling price, because demand is increasing and there is a shortage in the supply of domestic consumer's goods. Therefore, producers in this group will try to increase their production by  $28 - (28 \times \frac{10}{100}) = 28 - 2.8 = 25.2$  or (25 mn.) in money terms worth of consumer's goods valued at the new selling price induced by changes taking place. The general price level at the end of the third year of the development programme is expected to become :

$$P = \frac{MV}{T + (G^+ + L^m)} \quad P = \frac{467.3 \times 2}{875 + (25 + 14^{(1)})}$$

$\frac{934.6}{914} = 1.021$  As the general price level at the end of the second year is 105, therefore it becomes :-

$$1.021 \times 105 = 107.205 \quad \text{or for simplicity } 107.2$$

It may not be unrealistic to hold that by this time the people in (Era) have formed a fairly firm view about the course of prices and have observed that the increase in prices has not been sharp. They may well hold that this is likely to be the trend, at any rate in the immediate future. For that reason it may be safe to assume that prices will not be pushed up to a higher level merely because of the desire of people to shift part of their wealth from cash to goods. Money in circulation then becomes (467 mn.) and national income in money terms (914 mn.)

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(1) See diagram on PP. (193-4) where, increases in imports for different stages are shown.

During the fourth year of the development programme, the planning and spending authority, will pay the constructing firm the last installment, and the latter will spend it during the year. Under the agreement between the planning authority and the constructing firm, the latter should complete the construction of the buildings for the factories, and associated buildings. Therefore, the constructing firm will spend another (25 mn.) during the fourth year for fulfilling this purpose.

As a result of spending of the (25 mn.) during the fourth year and the lagged effects of the amounts spent during the previous three years demand will tend to increase by :-

- (1) the first and second stages of the amount spent during the fourth year (n + 3) :

$$18 + 13 = 31 \text{ mn.}$$

- (2) the third and fourth stages of the amount spent during the third year (n + 2) :

$$9.4 + 6.8 = 16.2 \text{ mn.}$$

- (3) the fifth and sixth stages of the amount spent during the second year (n + 1) :

$$4.9 + 3.6 = 8.5 \text{ mn.}$$

- (4) the seventh and eighth stages of the amount spent during the first year :-

$$2.6 + 1.9 = 4.5 \text{ mn.}$$

Therefore, the total increase in demand for domestic goods will tend to be :-

$31 + 16.2 + 8.5 + 4.5 = 60.2$  or (60 mn.) in money terms. Producers in group (A) are assumed to have finished the process of importing, installing of new capital equipment, and the training of the required number of new workers needed for expansion.<sup>(1)</sup>

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(1) It may be recalled that producers in group (A) are assumed to have reached their maximum capacity at the end of the second year of the programme, and ordered capital equipment at that time because they have expected that the increase in demand will continue for an extended period in the future.

Producers in this group, are expected to increase their production proportionately with their productive capacity i.e. by

$$60 \times \frac{50}{100} = 30 \text{ mn. worth of consumer's goods valued at the prices}$$

prevailing at the end of the third year. We assume that cost of production for this group will tend to rise by 15%, and the average cost per unit by 10%<sup>(1)</sup> which means that the actual increase in production valued at the new selling price, after the incorporation of the increase in cost of production, will tend to be :-

$$30 \times \frac{10}{100} = 30 - 3 = (27 \text{ mn. in money terms at the new price}).$$

As for group (B), we assume that, producers in this group are not able to increase their production, because they have reached their maximum productive capacity. The increase in production of consumer's goods during the fourth year of the programme is expected to be :-

27.0 in money terms and at the new selling prices.

- (1) If we were dealing with a developed country which has not reached full employment, cost of production, in such a case as the one mentioned above, may be expected to go down or at least remain constant, but as we are dealing with an underdeveloped country, bottlenecks should be taken into account. Even if we were dealing with a developed economy, however, bottlenecks or other influences might well engender rises in unit costs if aggregate output was at a level fairly close to a level which might approximately be described as "full employment".

As for the other part of the increase in supply, i.e. imported consumer's goods, the total increase in demand for imported consumer's goods will tend to be : (15 mn.). But, we assume that during the fourth year, due to a shortage in foreign exchange, the actual increase in importation of consumer's goods will not be by (15 mn.) but by (9 mn.) only. The general price level at the end of the fourth year of the programme will tend to be :

$$\begin{aligned}
 P &= \frac{MV}{T + (G^+ + 1 \frac{m}{+})} \\
 &= \frac{491.6 \times 2}{914 + (27 + 9)} \\
 &= \frac{983.2}{950} = 1.0338
 \end{aligned}$$

The general price level at the end of the third year was 107.2 therefore it becomes :  $107.2 \times 1.0338 = 110.82$  or for simplicity 110.8. Money in circulation becomes (491.6 mn.) and national income (in money terms (950 mn.)). During the fourth year we assume that there will be no, or negligible additional increase in demand and in turn on prices as a result of people's desire to shift part of their cash holding into other forms of wealth, because they have felt confirmed in their view that prices will not tend to rise sharply.

At the beginning of the fifth year, the planning and spending authority receives (49 mn.) in money terms from the central bank in the form of drawing rights on the bank. We assume that, the payments for capital goods have been finished and the capital equipment has been delivered and installed on time, and the necessary near-by roads have been completed. Therefore, the whole (49 mn.) in money terms will be allocated as working capital for the new established clothing factories, as was originally planned.

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(1) Some underdeveloped countries, such as Iraq, are not expected to face a serious shortage of foreign exchange in ordinary circumstances, but others may face such a shortage.



The planning authority should have finished the training of the required workers and managers needed to run these factories. The distributed income during the fifth year is expected to increase by (49 mn.) in money terms which is expected to be paid as wages, as a result of the spending of working capital, and for the suppliers of raw materials, fuel and other requirements for the production process. The increase in demand for domestic consumer's goods as a result of the remaining stages of the amounts spent during four years of the programme will tend to be :-<sup>(1)</sup>

the third and fourth stages of the amount which has been spent during the fourth year that is :-  $9.4 + 6.8 = 16.2$  mn. The fifth and sixth stages of the amount which has been spent during the third year that is :  $4.9 + 3.6 = 8.5$  mn. The seventh and eighth stage of the amount spent during the second year :-  $2.6 + 1.9 = 4.5$  mn. And the ninth and tenth stage of the amount spent during the first year :-  $1.4 + 1 = 2.4$  mn.

The total increase in demand for domestic consumer's goods during the fifth year (n + 4) of the programme is expected to be (as far the lagged effect of amounts spent during the first four years of the programme are concerned).<sup>(2)</sup>

$$16.2 + 8.5 + 4.5 + 2.4 = 31.6 \text{ or } (32 \text{ mn.}) \text{ in money terms.}$$

(1) The ~~new incremental~~ propensity to import is assumed to shift from  $1/5$  to  $1/6$  this is because when clothing factories start production during the fifth year at their full capacity there will be no need to import clothing anymore, because it is possible to satisfy demand for clothing by domestic production. Therefore, the stages of the amounts which have been spent during the four years of the programme will be calculated by using the new ~~propensity~~ marginal propensity to import, that is  $1/6$  instead of  $1/5$ .

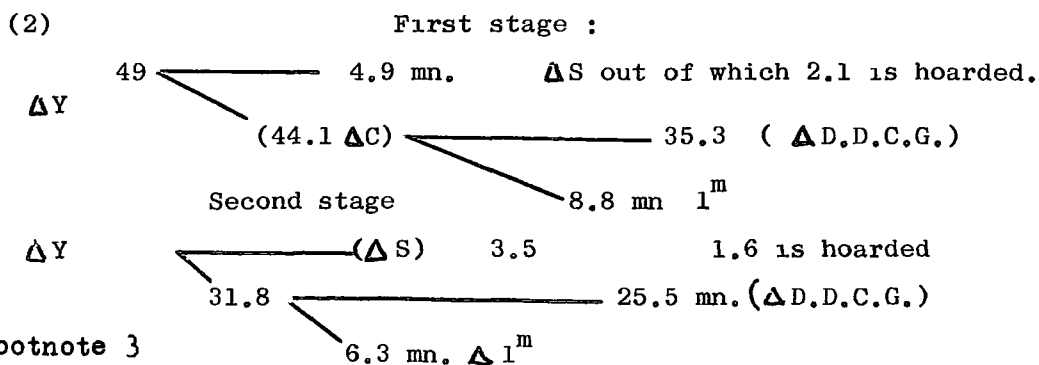
(2) It may be recalled that marginal propensity to import has changed and shifted from  $1/5$  to  $1/6$  during the fifth year (n + 5) and calculation has been done according to the new propensity.

In addition, the spending of the (49 mn.) in money terms, as a working capital during the fifth year of the programme is expected to cause an increase in demand for consumer's goods. Therefore, distributed incomes will tend to rise by (49 mn.), in addition to the rise as the result of the lagged effects of the amount spent during the previous four years of the programme. Therefore, (4.9 mn.), i.e.  $(49 \times \frac{1}{10})$  will tend to be saved by income receivers, and (44.1 mn.) to be spent on consumer's goods (domestic and imported). The newly established clothing factories are not expected to operate at their maximum capacity during the first year of their establishment. Therefore, it may be safe to assume that the newly established clothing factories will not operate at their maximum capacity immediately after they start production, but say 76% of their maximum capacity, which is  $63 \times \frac{76}{100} = 47.58$  or (48 mn.) in money terms worth of clothing during year  $(n + 4)$ .<sup>(1)</sup> As production of domestic consumer's goods (i.e. clothing) increases, imports of clothing are expected to fall, other things remaining the same.<sup>(2)</sup> Consequently, we assume that demand for imported consumer's goods is expected to shift from  $1/5$  to  $1/6$ , Starting with year  $n + 5$ , in year  $n + 4$  the total amount of (15.5 mn.) is expected to be spent on imports (out of the 49 mn.).<sup>(3)</sup>

Savings will tend to increase by (8.4 mn.) out of the (49 mn.) out of which (3.7 mn.) is hoarded, and an increase of  $35.3 + 25.5 = 60.8$  or (61 mn.) in demand for domestic consumer's goods in the two stages during the year is expected to be initiated.<sup>(3)</sup>

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(1) Assuming that everything goes actually as it was originally planned, which is not always the case as the next chapter will attempt to show.



For footnote 3  
see page 186.

The total increase in demand for domestic consumer's goods during the fifth year of the programme is expected to be:-

$32 + 61 = 93$  mn. in money terms, and the total increase in demand for imported consumer's goods of (23 mn.).

This much for the demand side; what now of the supply side? The analysis has shown that the newly established clothing factories are expected to increase the supply of domestic consumer's goods by (50.4 mn. in money terms worth of clothing during year (n+4). Producers in group (A) are assumed to be able to increase their production proportionately with their productive capacity i.e. by :

$32 \times \frac{50}{100} = 16$  mn. if cost of production and prices remain constant. But it may perhaps be more realistic to say that as a result of shortage of skilled labour, and/or capital, cost of production may increase, say, by 10%, and this increase will be incorporated in price. Therefore, producers in group (A) will tend to increase their production by :-

$16 - (16 - \frac{10}{100}) = 16 - 1.6 = 14.4$  mn. in money terms of goods valued at the new price. Producers in group (B) are assumed to have finished the process of training of new workers, importing and installing of new capital equipment needed for expansion, and are able to increase their production proportionately, but at a higher cost, say 5%. When the increase in cost is incorporated in the new price, then producers in group (B) will tend to increase their production by :

$16 - (16 - \frac{5}{100}) = 16 - 0.8 = 15.2$  mn. in money terms of goods valued at the new price. Total increase in production of consumer's goods during the fifth year is expected to be :

$48 + 14.4 + 15.2 = 78$  mn. in money terms at (n + 4) prices. The general price level will tend to rise by :

$$\begin{aligned}
 P &= \frac{MV}{T + (G^+ + 1^m)} \\
 &= \frac{531.6 \times 2}{951 + (78 + 23)} \\
 &= \frac{1063.2}{1052} = 1.0104
 \end{aligned}$$

(3) Problems of excess supply will be likely but it is expected they will be solved in the sixth and subsequent years.

The general price level at the end of the fourth year ( $n + 3$ ) was (110.8) thus  $110.8 \times 1.0104 = 111.95$  or approximately (112) at the end of year ( $n + 4$ ). Money in circulation is expected to become (531 mn.) national income (1052 mn.) in money terms.<sup>(1)</sup>

Now that the sequence of each of the five years of the programme have been dealt with one by one it may be useful to collect together all the changes which have taken place into one comprehensive table. This not only provides an opportunity of showing at one glance what the total effect has been but also of including such additional explanations of the relationship between the figures of the various columns as may be necessary for the sake of completeness in explanation. The table reveals that at the end of year ( $n - 1$ ) money in circulation is (400 mn.), the national income (800 mn.), and the economy is in equilibrium i.e.  $S = I$ .

---

(1) It is expected that there will be future increases in national income during the next four years, other things remaining the same, as a result of the increase in expenditure which has taken place during the period of the programme. This increase will tend to become less and less, until it works itself out. Furthermore, it may be safe to say that the general price level will tend to fall during the next year, other things remaining equal.

Table (Q)  
Changes in the key variables in the model at end of  
each year of the five year development programme

End of year	Money in Circulation	Increase in demand for domestic Consumer's Goods	Increase in demand for Imported Consumer's Goods	Increase in production of domestic Goods.	National Income (In Money terms)	Index of the General Price level.	Increase in Savings
n - 1	400	-	-	-	800	100	-
n	421	31	7.5	14.7	822	103.4	2.4
n + 1	443	47	11.5	41	875	105	3.6
n + 2	467	56	14	25	914	107.2	4.3
n + 3	491.6	60	9 <sup>(1)</sup>	27	950	110.8	4.7
n + 4 <sup>(2)</sup>	531.2	93	23	78	1052	112	10.3

(1) Increases in savings shown in the table do not include hoardings.

(2) As is shown in the model; (49 mn.) is to be spent during the fifth year instead of the (25 mn.) which is to be spent during each year of the four years of the programme.

(3) The increase in demand for imported consumer goods during the fourth year of the programme would, on the model values attributed to the propensity to imports (that is for consumer goods) be (15 mn.) but it is assumed that in this year a shortage of foreign exchange imposes an unexpected obstacle to the full amount of importation and the increase is in fact only (9 mn.)

After the spending of (25 mn.) provided through deficit financing, demand for domestic and imported consumer's goods increases, other things remaining the same. Since the model is built in a way to represent relationships and circumstances prevailing in underdeveloped countries in general, therefore it may be reasonable to expect that some producers are able to increase their production in the short run (group A in the model) to meet all or part of the increase in demand, and some producers are able to do so only in the long-run (group B in the model). It is further expected, that the increase in demand for imported consumer's goods could be met<sup>(1)</sup>. Now the table shows that money in circulation at the end of year (a) becomes (421 mn.). If this is multiplied by (2), then the national income should have become (842 mn.) but the table shows that, it became ( 822mn.) instead. The reason is that the increase in the national income, in our model, has been calculated to include the increase in the production of domestic consumer's goods on the one hand, and the increase in the importation of these goods on the other. The unsatisfied demand will tend to cause an increase in prices in the consumption sector at first, which leads to an increase in the index of the general price level. The same way of reasoning may be followed to explain the difference between larger increases in money in circulation and the smaller increases in national income for the second, third, and fourth year of the programme. However, during the fifth year, the new established factories start production, though not at their maximum capacity, and this increase in production will meet the increase in demand which is expected to be initiated as a result of the spending of (49 mn.) as a working capital for these factories, together with the lagged effect of the amounts spent during the first four years of the programme. Therefore, on the basis of the expectation and assumptions which have been included in the building of the model, the table discloses that, at the end of the fifth year of the programme, prices will tend to rise by a smaller amount it, and it may be reasonable to expect that they will tend to fall during the next year, other things remaining the same.

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(1) In our model, we assume that due to a shortage of foreign exchange in the fourth year of the programme, it is possible to satisfy part only of the increase in demand for imported consumer's goods.

The analysis in our model has shown that the general price level will tend to rise gradually during the period of the execution of the five year development programme. This increase in the general price level, it may be rightly argued, will tend to raise the amount of capital funds, in money terms, to command the originally planned amount of real resources needed for the execution of the development programme as a whole, other things remaining the same.

This argument may be valid, but only to a certain extent, as the following points may be taken into account :-

(1) the general price level is expected to rise gradually during any year of the programme as a result of the spending of capital funds provided by deficit financing, other things being equal. Therefore, if the general price level at the beginning of year (n) of a development programme was (100) then the expected increase will tend to take place gradually during the year and becomes (103.4) at the end of the year. The planning authorities are expected to be able to command factors of production at prices prevailing at the end of the previous year. It may be safe to say, that the planning authorities are expected to increase their spending in money terms in our model during year (n) by :

$3.4 \div 2 = 1.7\%$  in order to command the same amount of real resources, and the same is true for the other years of the development programme.

(2) It is expected that the planning authorities are going to enter into contracts with domestic and/or foreign firms concerning setting up different projects under the development programme. The contracting firms are expected to undertake the setting up of projects after estimating the expected depreciation in the purchasing power of the domestic currency, depending in that on the average increase in the last few years on the one hand, and taking into consideration the possible changes in prices after the execution of part of the development programme on the other.

Therefore, it may be safe to assume that the planning authorities will not tend to bear the full increase in prices, during the planning period, because contracts to set up projects would have been agreed upon at the beginning of the period, though it is not difficult to think of circumstances in which the outcome would be different.

(3) It is expected that, as distributed incomes increase as a result of spending net additional funds, tax revenues, other things remaining the same, will tend to rise, even if the existing taxation rates remain the same. This expected increase in tax revenues may meet part of the funds needed to enable the planning authorities to command the same amount of the originally planned factors of production. It has already been mentioned that an increase in savings will take place.<sup>(1)</sup>

The above analysis has shown that at the end of the fifth year the general price level will tend to become approximately (112) i.e. an increase of (12%) in five years or 2.4% a year, as a result of the spending of capital funds provided by the central bank in our model, other things remain the same. This increase in the general price level may be well considered as moderate if not modest. The above analysis has shown that under the assumptions and conditions given in our model, the general price level did not tend to rise much during the fifth year, i.e. when the newly established clothing factories started production, even when they are not working at their maximum capacity. Furthermore, the analysis has shown that the degree of increase in prices depends upon many factors such as, the percentage of increase in money in circulation, flexibility of the

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(1) Table ( P ) P. ( 152)



productive apparatus to increase production, the average propensity and marginal propensity to save, and the availability of foreign exchange to finance the increase in imports. Therefore, we have a mild degree of inflation in our model on the one hand, and a net addition in real terms to the national income on the other,

Furthermore, the above analysis has shown that the increase in expenditure beyond the real savings in a country where natural and human resources are not fully utilized has induced producers to expand their scale of production to meet the expanding demand. In order to expand their production, producers of consumer's goods employed more unskilled labour and trained them on the job. Therefore, the level of employment will tend to rise, and more unskilled labourers become skilled. Nevertheless, producers have to face difficulties in trying to increase their production, or as they are usually called "bottlenecks", such as the shortage of skilled labour, and the difficulties in importation of capital equipment .

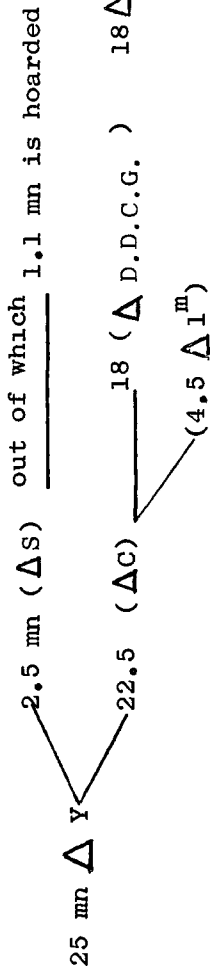
It might be difficult to overcome these difficulties but it is not in any case impossible to train unskilled workers, or borrow part or all of the required funds for the expansionary process. Then during the fifth year, and if everything goes according to the programme, the clothing factories will start to satisfy all domestic need for clothing, and there will be an increase in the productive capacity, and employment. A certain amount of foreign exchange will be saved and spent on importation of capital equipments needed for other projects instead of spending it on importation of consumer's goods.

In reality, sometimes everything goes as it was originally planned, but sometimes it does not.

Now, what are the possible difficulties or "bottlenecks" which might arise in our model, and what are their possible effects on the production and the general price level ?

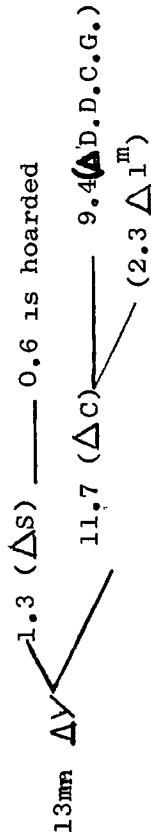
This question will be discussed in the next section of this chapter.

Stage (1)

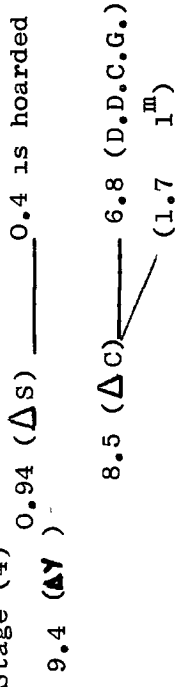


Stage (2)

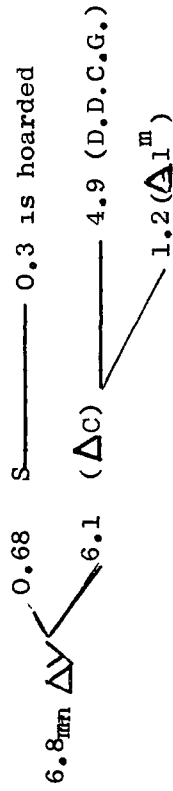
Stage (3)



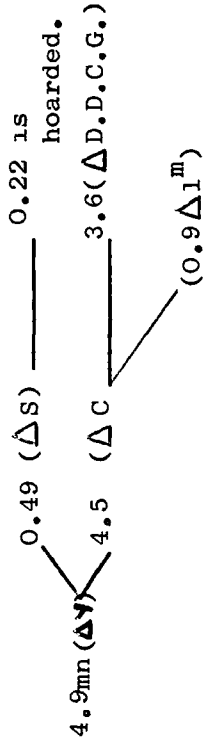
Stage (4)



Stage (5)



Stage (6)





The above analysis has dealt with using the funds obtained through deficit financing by expansion of bank credit to finance the setting up of (10) clothing factories within the five year development programme's period. This process, as the analysis has shown, resulted among other things, in net addition to the national income. It was assumed that the setting up of these factories would be carried out according to the plan; and no allowances have been made for the possibilities of difficulties arising. Perhaps this might be assumed criticised as being unrealistic, for difficulties, particularly in an inexperienced country entering into a phase of experimental development, should perhaps be regarded as more, rather than less, likely, to arise. The absence of allowance for possible difficulties however is adopted deliberately in order to keep the model as simple as possible, without attempting to build into it every small variation that it might be more realistic to envisage. There are many such small quantitative variables that might have been built into the model if a very close representation of real-life situations was intended.

In our model, for example, in the process of setting up (10) clothing factories, difficulties might arise from the capital goods exporting country's side, or from the capital importing country's side.

There are various ways in which difficulties might arise in the capital exporting country; some of them are :-

(1) The workers in the particular weaving machine firms, or in the particular sector, that is the weaving machines manufacturing firms, might have a strike during the four years' period of the agreement. The strike if it did happen, would tend to lead to a delay in the delivery of the machines to the capital importing country, for a period of one month, or several months,<sup>(1)</sup> depending on how many strikes, and for how long each strike lasted. Consequently, (Era) might receive the machines months after the agreed date of delivery, which means that the clothing factories would start production months after the planned date, even if everything else went as it had been planned.

(ii) Another possible delay could occur, as a result of a shortage in the supply of labour, and/or raw materials in the capital exporting country.

This might be more likely to happen if the latter had reached or was about to reach a full employment stage, either in all sectors of its economy, or in the manufacturing sector only. It follows that it might become difficult for the weaving machines manufacturing firm to get the required raw materials, and/or labour, and this could lead to a delay in production which could be a month, or several months,<sup>(2)</sup> depending on how severe this shortage was.

In a situation such as this it might be difficult for the firm manufacturing weaving machines to replace its own sort of equipment from the capital goods firms, which supply it, because these latter firms might themselves be experiencing an abnormally severe pressure of work.

(iii) After the weaving machines have been completed, the manufacturing firm has to deliver them to the capital importing country. Sometimes it is difficult to make the arrangements to carry and deliver the goods, because of shortage of ships normally available for such business. This difficulty could delay the delivery, a month<sup>(3)</sup>, or again a few months depending on how difficult it is to deliver these machines.

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(1) "or less", of course : the words are not intended to imply that delays of less than a month could not occur: or other labour troubles e.g. go-slow.

(2) similarly as in (1).           (3) As in (1) and (2).

Difficulties which might arise from the capital importing country's side:-

After the order for a certain type of weaving machine has been placed by the planning authorities in (Era) the weaving machine manufacturers may be expected to get down to the task of fulfilling the order. Suppose, however, that the planning authorities in (Era) decide, after further consideration that it might be more advantageous to order a different type of weaving machine, either, perhaps, with larger capacity or at some lower prices. This could lead to delays of a month or few months, again dependent on circumstances. Difficulties might arise out of changed political relations between the countries concerned : it might be that negotiations would have to be opened with another country as supplier : thus whether the new negotiations would be with the same or with another country would depend upon the nature of the political circumstances. This would tend to delay the delivery of the machines for a month or several months, dependent on the difficulty to which the exporting country was subjected.

(ii) Under the agreement between the capital goods exporting and capital goods importing countries, the latter has agreed to pay (15 mn.) in money terms a year, and for four years.

Payments could be made in a variety of ways : it might be specified that payment should be made in a particular type of foreign exchange, e.g. dollars or pounds sterling : payments might have been agreed in the domestic currency of the importing country : it could even be the case that the capital exporting country had agreed that some part of the debt due might be covered by the provision of a specified quantity and quality of agricultural or mineral product. If, however, crop failures occur then, in the event that payments had been provisionally accepted in terms of agricultural products, the machine - importing country might find itself in the position of

not being able to meet its obligations. Since we have already assumed at the outset of this discussion that (Era) is not able to obtain any additional loans from any source, ever and above those which it has already obtained, there would be bound to be difficulty in the relations between the importing and the supplying countries. Uncertainty as to the ability of the importing country to meet its obligations might well lead to the supplying country checking deliveries for a time.

Such a check in the flow of machines delivery would necessarily cause delay in the putting of the machines into use, as planned, in the importing country.

(111) The planning authorities, would and indeed should, seek to train the required workers and managers to take over the factories, when they are completed. Owing to the fact that some or all the new workers and managers have had no previous experience in such lines of production, total production, in the first few months, might be expected to be lower than the planned one. It follows that part of the demand will necessarily continue to be dependent on imported clothing ; either this, or some part of the demand for clothing will have to go unsatisfied.

(1v) If the newly established factories are to depend on domestic raw materials, fuel and energy, the flow of these, might not be kept going, and production might suffer as a result of shortage of any of these things.

(v) The construction of buildings for these factories might not be completed at the planned date even if the machines have been delivered at the due time according to the plan.

Now what are the consequences of such a delay ?

The consequences of such a delay might be :-

(a) That the workers and managers who have been trained in the previous period and are ready, by the end of the fourth year of the plan, to take over the factories, will be, in case of delay which is due to one or more of the above difficulties, unemployed, until the factories start production.

(b) Importation of clothing will continue as usual, and the foreign exchange which was planned to be paid for importation of capital goods for other projects, will have to be paid for importation of clothing instead. Either this, or consumers would be put to the no doubt resented constraint of not having as great a supply of clothing as usual to meet their needs. A deficient supply of clothing would probably introduce rationing, or high prices, or both : and both would tend to be unwelcome to the consuming public, particularly if they had been led to believe that the programme was aimed at supplying their needs at the customary level from domestic production.

(c) The working capital of (48 mn.) will remain idle as long as the factories have not started production. This is because, it is supposed to be provided at the beginning of the fifth year, and spent on new materials which are needed for workers and managers who will run the factories.

The above analysis has been conducted in general terms to be applied to underdeveloped countries in general. It is not unreasonable to suggest that our model could be adjusted to particular circumstances of any underdeveloped country, the figures which have been given in the analysis being replaced by the actual figures, or by figures which are more realistic in the light of the circumstances of any one particular country. At any rate the same way of analysis and reasoning which has been used throughout this analysis as so far developed could be applied with appropriate modifications to any actual countries that might be selected for examination.

If it was found that underdeveloped country (A) could provide only a limited amount of foreign exchange each year, a larger part of capital funds provided through deficit financing would have to be spent domestically.



In underdeveloped country (B) it might be found that, consumers goods production could be increased easily and in a relatively short period, while it might take a longer period to do that in country (A). It follows that country (A) might have to import consumer's goods in a higher proportion than country (B) when, other things being equal, the demand for these goods rises. Consequently, adjustments could be made to our model in order to bring it as near as possible to the actual circumstances of any particular underdeveloped country. However one of the main objects of this dissertation is to discuss the possible contribution of the banking system in Iraq to the promotion of economic development in that country. Therefore, the possible consequences of using funds provided by the Central Bank of Iraq, to cover part of the capital requirements of a development programme will be discussed in the next chapter.

## CHAPTER FIVE

DEFICIT FINANCING FOR THE PROMOTION OF ECONOMIC  
DEVELOPMENT IN THE LIGHT OF THE ECONOMIC  
CIRCUMSTANCES IN IRAQ

Let us assume that, the planning authorities in Iraq have decided to introduce the method of deficit financing to provide part of the financial requirements of a five year development programme. If it should be thought that this implies treating a course of action as something new when in fact it might be thought it had already been adopted, it is perhaps sufficient to point out by way of defence that while the Iraqi Government has indeed used deficit financing in one sense, especially after 1958, the procedure then adopted was very different from that employed in the model. The method of deficit financing actually used by the Iraqi Government, especially after 1958, has in a special way, been by allowing the estimated expenditure in a certain financial year to surpass the estimated revenue for that year. The ordinary expenditure of the government includes expenditure on defence, education, health, ... i.e. ordinary spending: as M. Haq points out, "In some countries budget deficits are taken to mean deficit on current (or "revenue") account . . ." <sup>(1)</sup>. In the present study, it is suggested that Iraq may use the method of deficit financing in a carefully planned way, within limits, and under certain conditions, for the purpose of providing part of the capital requirements of a development programme, through the provision of bank credit.

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(1) Haq, M., Deficit Financing In Pakistan, 1951-60, in collaboration with K. Khanam, Monographs in Economics of Development. The Institute of Development Economics, Old Sind Assembly Building, Binder Road, Karachi, Feb. 1961, P.2.

One method which may be followed when a government wants to borrow from the central bank is to ask the latter to accept government securities on the backing of which increases in paper money could be made. This method, according to Kulkarni<sup>(1)</sup>, is more suitable for underdeveloped countries where the using of cheques is limited and most transactions are performed by means of paper currency. If the degree of development is very small this may well be true; but if there is a central bank in being, with an assortment of commercial banks around it then its validity may be smaller: this sort of banking structure will tend to indicate a more than merely rudimentary degree of development. If this reservation is accepted then the mechanism which may be thought both the more appropriate and the more likely will be the provision by the Central Bank of overdraft facilities for the Government of which the latter will then make use for the purpose of paying the bills which arise in the normal course of carrying the development programme through. This is the sequence of events which is envisaged in this dissertation: it is a process which is regarded as beginning by the Government (i.e. the Planning Authority) negotiating with the Central Bank such additional overdraft facilities (or drawing rights) as are thought necessary for the fulfilment of the development programme. It is also envisaged that deficit financing will tend to induce inflation: it is not argued, that

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(1) Kulkarni, R. G., Deficit Financing and Economic Development, with special reference to Indian Economic Development, Asia Publishing House, London, 1966, pp. 14-15.

deficit financing will necessarily and always induce inflation. There may be circumstances when deficit financing can be used without inflation presenting itself as a related outcome. If, for example, there are labour and other resources which can be relatively easily applied to productive uses then it may be possible for output to expand proportionately with the increased funds. This would seem to be a position accepted even by Lewis<sup>(1)</sup>, which is the more remarkable in that he seems to wish to define deficit financing and inflation in overlapping terms. It is also interesting to note that this would seem to mean that Lewis is, explicitly or not, committing himself to some form of the Quantity theory of the value of money as an explanation, suitably qualified of course, of the way in which prices tend to be formed. Suitably qualified, therefore, it is accepted that as prices rise because of this, the money-using public will request more notes for carrying through its normal transactions: the process by which such increases in the note circulation are brought about is not followed up in detail in the dissertation. It is assumed that the procedure adopted by the monetary authorities for providing the additional notes will conform to the practices which are accepted as normal in their country. There is another aspect of "deficit financing" which should be noted. Until recently, the term deficit financing was used to describe a situation in which a government spends more than its current revenue during a certain period, regardless of the

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(1) Lewis, W.A., Development Planning, the essentials of economic policy, London, George Allen and Unwin Ltd., 1966, PP.130-131

way in which the funds were spent. In the post Keynesian period, however, more attention has been paid to the inflationary effects of government budget deficits. The central requirement has been to examine the impact of overall imbalance between ex-ante national income and ex-ante national expenditure in a country during a certain period.<sup>(1)</sup> This implies that in recent years, a budget deficit has been regarded as including the deficit on both the capital and the revenue accounts: in short the reference has been to the overall deficit (or surplus).

Funds provided through deficit financing could be used for different purposes. R.G. Kulkarni, for example, refers to three situations where deficit financing may be used:

- (1) during a depression period,
- (2) during a war period,
- (3) for economic development.<sup>(2)</sup>

The use of deficit financing during a depression period may be confined to developed countries. This is because during a business cycle or a major depression, which occur from time to time in developed countries, a not insignificant part of the productive capacity is idle, due to lack of sufficient effective demand for certain goods. The government in a situation like this might try to promote

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- (1) Haq, M., Deficit Financing in Pakistan, 1951-60, The Institute of Development Economics, Binder Road, Karachi, Feb. 1961, P.2
  - (2) Kulkarni, R.G., Deficit Financing and Economic Development, Asia Publishing House, London, 1966, PP.30-33

economic activity by following a cheap credit policy. If this policy fails, then deficit financing may be used not only to restore a higher level of economic activity during a business cycle, but also to modify harmful effects of a depression.

During a war period governments of developed as well as underdeveloped countries, use deficit financing to meet part of the increasing expenditure on war efforts which could not be met by ordinary methods of raising revenues such as, taxation, loans, fees, and the like. Furthermore, governments in a war period offer higher prices for factors of production.

Deficit financing for economic development may be used by both developed and underdeveloped countries. But if it is thought that developed countries are, generally speaking, capital exporting countries, and their main concern is economic stability, though more recently there has been increasing emphasis on attaining some desired rate of growth, then it may be safe to say that the use of this device may be confined to underdeveloped countries, as is indeed being suggested in this dissertation.

The concept of deficit financing used in this dissertation is thus deliberately narrow and specific: an indication of the intention to make it so was given earlier.<sup>(1)</sup> So far as the spending of funds provided through the device of deficit financing is concerned, the term is used to indicate the securing, by a spending (Developing) Authority, of some part of the funds needed for its development programme, from its Central Bank. This usage matches the situation which is described by "Kulkarni" as his "third" situation.<sup>(2)</sup> It is expected that under certain conditions and relationships between the quantity of money in circulation and the quantity of available goods and services at a given time, a degree of inflation may be initiated. The analysis in earlier parts of this dissertation has shown that inflation can be kept within certain limits and need not, necessarily, turn into higher degrees of, or cumulative, inflation. Now let us assume that, one of the consequences of using deficit financing in Iraq is expected to be an average annual increase in the general price level of the order

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(1) See P. (150)

(2) See PP.(204-205).

of 4% - 5% per annum, and, further than this, it is expected that this degree of inflation can be kept within these limits.

The questions now are :-

- (1) What are the expected effects on the Iraqi exports, and the balance of payments, and the availability of foreign exchange ?
  - (2) To what extent will producers of domestic consumer's goods are able to increase their production when demand rises ?
  - (3) Is there any indication from the past experience, as far as available data and publications show, suggesting that the Iraqi monetary authorities are not able to handle such a situation ?
- The following section will attempt to answer these and similar questions by discussing the expected impact on each of the above items, in turn.

(1) Exports : The main items in the Iraqi exports are :-  
crude oil, wheat and barley, and cement.

(a) The Crude Oil : crude oil is produced, transported, and sold by foreign companies operating in Iraq under certain conditions. The crude oil prices are decided by oil companies in accordance with the cost of production in different oil-exporting countries on the one hand, and the total supply and demand for oil in the world market, on the other. In other words, the quantity and prices of oil exported have little or nothing to do with domestic prices in an oil exporting country, in this case Iraq. This point may be illustrated by the following example.

If domestic prices in Iraq rose by 5% for instance as a result of the use of deficit financing to provide part of funds needed for a development programme, there might be a possibility of the employees of the oil companies operating in Iraq demanding higher wages. Let us assume further, that the employees of the oil companies demand an increase in their wages by 5% to keep their real wages unchanged and that the companies will agree to that promptly. Now, the question is how would this affect the exports of Iraqi oil ?



In order to answer this question, it may be necessary to know the number of workers in the oil companies and their total wages. In 1962 for example the number of persons employed by the oil companies was (12.138), and their annual wages amounted to (I.D 8.096.992).<sup>(1)</sup> The selling price of the oil exported in that year was (I.D 225.378.000).<sup>(2)</sup> Consequently, if the employees of the oil companies were given a 5% rise in their wages, cost of production would have risen by :

$$\frac{5\% \text{ of their total annual wages in 1962}}{\text{The selling price of oil produced in 1962}}$$

That is :

$$\frac{0.404.849}{225.378.000} = 0.0018.$$

$$= 0.002 \quad \text{or} \quad \frac{2}{1000} = \frac{1}{500} \quad \text{which may be}$$

considered as a negligible increase in cost of production of exported oil. Consequently, it may be safe to say, that a moderate increase in domestic prices in Iraq which is expected to cause an increase in wages of employees by oil companies, other things being equal, will tend to have a negligible or no effect on the exportation of crude oil. The importance of crude oil exports to total exports may be illustrated by the fact that in 1962, crude oil exports contributed 92.1% of total exports, and rose to 94% in 1963.<sup>(3)</sup>

(b) Dates and Barley :-

Apart from crude oil and cement, the Iraqi exports are agricultural products, which depend heavily on the climatic conditions and the amount and regularity of rain-fall, especially in the rain-fed area in the north. As the table (3) App.(6) shows, total export

(1) Central Bureau of Statistics, Ministry of Planning, Annual Abstract, Government Press 1964, P.77

(2) Central Bank of Iraq, Quarterly Bulletin, April-June 1963, No.46. P.52

(3) The (C.B.I.) Annual Report 1963, (in Arabic) Baghdad, 1965. P.64

fluctuates from year to year. In 1963, for instance, the value of exported barley fell from (I.D 6.07 mn.) to (I.D 0.83 mn.) as a result of irregular rain-fall. In other words, even if we suppose that barley prices in the world market have risen during 1963, it still remains the case that Iraqi barley would have been controlled much more emphatically and forcibly by national conditions: they could not have controlled the rain-fall: consequently the only thing they could have done if world prices had risen would have been to draw upon their stocks of barley, assuming that they had any, in reserve to draw upon. The other important item is the export of dates. The exports of dates are organised and controlled by the "Iraqi Dates Administration". This organisation, usually, buys dates from individual dates' producers and tries to sell the product in bulk quantities to other countries at negotiated prices. This organisation makes reductions in prices when it is necessary. In 1963, for example the average price per ton was 14% lower than that of 1962. This was due to :-

- (1) The existence of large stocks in the United Kingdom and other Western European countries from the 1962/63 season.
- (2) The reduction in the price of Iraqi dates in markets where there is a competition by other date-producers like Iran for example. <sup>(1)</sup>

(C) Cement :- The government through the "Cement Marketing Board" organises the quantities and, to a certain extent, prices of the exported cement. It does so in accordance with the markets of the importing countries. It does not always follow, as far as the exports of Iraqi cement are concerned that higher prices will tend to have limiting effects on export. This point may be illustrated by the fact that in 1962, (142.700 tons of cement were exported at a total value of (I.D 0.624 mn.) or (I.D 43 per ton). In 1963, the amount of cement exported was doubled i.e. (289.400 tons), at a total value of (I.D 1.4 mn.) i.e. (I.D. 48.4) per ton.

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- (1) The Central Bank of Iraq Annual Report 1963, Baghdad 1965 (in Arabic), P.65.
  - (2) Ibid P.65 figures for Iraqi Dinar per ton were calculated by the writer.

This brief analysis of the possible effects of an increase in the general price level on Iraqi exports has shown that, the possible effects on crude oil and cement are negligible, and that Iraqi agricultural exports are more dependent on climatic conditions, than on moderate increases in domestic prices.

(2) The availability of foreign exchange, and the effects on the balance of payments :-

The analysis in earlier parts of this dissertation has shown that, as a result of the spending of capital funds provided by deficit financing, demand for domestic and imported consumers goods is expected to increase. In addition demand for imported capital goods is expected to increase as well, when producers of domestic consumer's goods try to increase their productive capacity by importing capital equipments. Therefore, it is expected that, the combined effect of an increase in demand for imported consumer and capital goods will tend to increase the need for foreign exchange. The Iraqi Government receives its share of oil-revenues in foreign exchange, e.g. Sterling. This source of foreign exchange is, to a large extent, steady, continuous, and increasing.<sup>(1)</sup> Consequently, it may be safe to say, that, on all normal reckonings, Iraq should not be expected to face a serious shortage of foreign exchange and an unfavourable balance of payments, as a consequence of an increase in the rate of importation of consumer's and capital goods.

(3) The Iraqi Government controls the relatively large industrial firms in Iraq.

Therefore, the planning authorities are in a position which enables them to plan the expansion of production of consumer's goods

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(1) The security of this important source of revenue and foreign exchange to Iraq is discussed on PP. ( 31 - 34 ). It may be worth mentioning here, that if the flow of exported Iraqi oil was stopped for one reason or another, this would be likely to have for reaching damaging effects on the Iraqi economy, with or without the use of deficit financing.

beforehand. Thus when demand increases as a result of the spending of the funds provided by the Central Bank, it should be possible to satisfy part or all of the increase in demand. This point may be illustrated by what actually happened in 1964. According to the Central Bank of Iraq's report : many of the nationalised industrial enterprises had been operating, prior to nationalisation, below their full productive capacity - "But when these firms were nationalised the Economic Organisation which controls them, managed to make several factories, e.g. cement, oil seeds and detergents factories - reach a point of full productive capacity and thus lowered unit production costs and raised profitability."<sup>(1)</sup>

(4) The banking system in Iraq is state-controlled.

All the foreign and non-government owned banks were nationalised in July 1964. An organisation called the "General Organisation for Banks" was established, changed in 1965 to "Public Establishment for Banks" to control the commercial banks. This Establishment, is under the control of the Central Bank. As was mentioned earlier the Central Bank of Iraq is in a position which enables it to exercise effective control on the banking system.<sup>(2)</sup> As for the question whether the monetary authorities in Iraq are efficient and responsible or not, there is no complete answer for this question. Nevertheless the following indicators may serve as rough measures in trying to reach a judgement.

(1) The stability of the domestic currency internally and externally.

(a) Internally : this point may be illustrated by the following table which shows changes in price indices for the last five years.

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(1) The Central Bank of Iraq Annual Report 1964, Zahra Press, Baghdad (in English) P.19.

(2) See P# (131-133).

This table shows that, taking 1958 as a base year, cost of living in Baghdad for all items rose from (104) in 1961 to (109) in 1965, i.e. an average increase of 1 point a year. The food index rose from 109 in 1961, to 116 in 1965, i.e. an average increase of less than 1.5 point a year: the wholesale (general) index rose from 113 in 1961 to 115 in 1965, i.e. less than 0.5 point a year. These figures show that there was no sharp increase in prices in Iraq for these five years. Some credit may be given to the monetary authorities in Iraq for that.

Table "R"

	Price Indices*				
	monthly averages      1958 = 100				
Cost of living: Baghdad	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
All items	104	104	108	108	109
food	109	109	116	117	116
Wholesale: general	113	111	115	121	115

Source: the Economist Intelligence Unit, Annual Supplement, 1966, P.30

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\* As for the reliability of these figures, they are used by the International Monetary Fund and the Economist Intelligence Unit; it may therefore be safe to say that they might be considered as acceptably reliable or at any rate not so un-reliable that it would be safer not to use them at all.

(b) Externally : In order to illustrate this point, it may be sufficient to quote the "Economist Intelligence Unit" as stating : "Iraq left the sterling area on June 23rd, 1959, but the dinar is at par with the pound sterling I.D 1 - U \$ 2.80) and has very similar international free rates".<sup>(1)</sup> (underlining not in the origin).

(i) The foreign banks and other firms nationalised in mid 1964, were fully compensated, within a year of the nationalisation.<sup>(2)</sup> This may reflect the point that the authorities in general and monetary authorities in particular had acted in a responsible way.

(ii) Furthermore, there has been no indication as far as the present writer knows from his readings in available publications, that the monetary authorities in Iraq have taken an irresponsible course of action, or acted in a way which reflects their inefficiency. Finally, it may perhaps be accepted as a reasonably safe conclusion from these considerations that, if deficit is to be used at all to provide part of the total of funds needed for a development programme then the conditions and circumstances prevailing in Iraq are at any rate not inimical to such a practice and may even indeed, be regarded as mildly favourable. If this is so, then provided the extent to which deficit financing is used is kept within modest limits and provided various necessary precautions are taken, deficit financing could be employed in Iraq, without, necessarily involving the Iraq economy in any great threat of instability or danger. In expressing this conclusion it is recognised that careful note should be taken of the shock to the Iraqi economy which might be administered by a

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(1) The Economist Intelligence Unit, Annual Supplement, 1966. P.28

(2) Report (in Arabic) submitted by Dr. K. Haseeb, Deputy President of the Economic Organisation in July 1965, under the title : "Results of application of Social Decisions in the first year".

loss of oil revenues such as occurred, for a brief while this year, as a result of the action of the Syrian Government in stopping the flow of oil from Kirkuk to Banias. Some fairly detailed consideration of this issue is given on PP. (31 - 34), and it is perhaps unnecessary to repeat the argument here. If it were not for the exceedingly great dependence of the Iraqi economy on the maintenance of the oil flows of its oil into world markets, and its dependence, therefore, on the maintenance of ordered and reasonable stable political relations, one would have little or no hesitation in agreeing with Kulkarni that "deficit financing may be regarded as a positive instrument for promoting development on a planned basis",<sup>(1)</sup> and, further, that of the various underdeveloped countries Iraq was probably in a stronger position than most in being able to make use of it.

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(1) Kulkarni, R.G., Deficit Financing and Economic Development, Asia Publishing House, London, 1966.

## CHAPTER SIX

DEFICIT FINANCING AND THE  
DEGREE OF INFLATION

In the present study, it is regarded as a permissible practise that underdeveloped countries should raise part of the required funds for economic development through an expansion of bank credit, even though this might tend to initiate a degree of inflation. The quantity of new purchasing power released within the system by the expansion of bank credit should however, be closely limited. It is suggested that, unless there are strong reasons for something different, the expansion of bank credit should not be by more than approximately 10% of the money in circulation.<sup>(1)</sup> It is accepted that there will be consequences of this action. We recognise the danger of over simplifying a situation where, during a certain period in which these funds are spent, the general price level will tend to increase. We are not suggesting in the least that this constancy on the part of other variables is likely to happen in real world situations : this simply takes the relation as the only one which can be carefully indicated. In real world situations, however, variables will not stay impounded, and constant in this way. Other variables will respond. As the analysis in the earlier parts of this study has shown production will tend to increase to meet part of the increase in demand which may be induced by the increase in money in circulation. An increase in imports will meet another part of the increase in demand, and a third part of the increase in demand which has not been met will tend to induce an increase in prices.

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(1) The figure (10%) of the money in circulation has been chosen, because if it is less than (10%) say, 5% it will not have a significance importance as a contributor in financing development programmes, and if it is more than (10%), say (15%), it might tend to initiate a high degree instead of a moderate degree of inflation.



A question might be raised here : Why is it not possible to meet the increase in demand to the full extent by an increase in production ?

The answer to this question is that :- production in underdeveloped countries could be increased only to a certain extent when demand increases, because of the "bottlenecks" in these economies, such as, the lack of skilled and semi-skilled labour, difficulties in importation of capital goods and the like. These are points which have been presented and discussed in earlier parts of this study.

Thus part of the increase in demand for consumer's goods, which it is not possible to satisfy, will tend to lead to an increase in the prices of consumer's goods.

In this way an effect in terms of a rise in prices will tend to be experienced in the consumer's goods sector. If the relationships in our model are considered it will be recalled that the increase in prices did not exceed 3% per annum even though the initiating expansion in bank credit had been of the order of 10% of money in circulation. It may be remembered that some economists, such as B.Higgins, consider countries which have had an average increase in the general price index of between 3 and 7 per cent per annum to be classifiable as countries with a record of "moderate" inflation.<sup>(1)</sup> The percentage mentioned above as applying to our model evidently falls within this class. It is equally important however, and this is a central point in the argument developed in this thesis, that inflation which begins by being "moderate" should keep moderate and that this should be achieved through the continuous check imposed on the quantity of monetary flows by the monetary authorities.<sup>(2)</sup> It is important that this should be achieved for, if moderate inflation

(1) B. Higgins, Government Finance and Economic Development,

Edited by A.T.Peacock and G.Hauser, O.E.C.D., Paris 1965, P.42

(2) In the last analysis, of course, the check that needs to be embodied is upon the total flow of spending within the economy and this in fact, however, in Keynesian terms, involve a watch upon the strength of the flow of spending for consumption purposes.

turns into high or hyper-inflation then the balance of advantage that may be thought open to underdeveloped countries in financing their development programmes will be lost. An underdeveloped country is likely to be in need of all possible means of going ahead with its development programme and if there is any advantage in using the device of deficit financing it would be a pity if this should be thrown away because the degree of inflation was not kept sufficiently restricted.

As may be seen from what Einzig has written on inflation and inflationists, this is a real and not an imaginary possibility: quite diverse movements cannot be ruled out : "They are vaguely aware, however, that a slow and well-regulated increase of prices through inflation could not continue for ever. It might easily degenerate into a run-away inflation or it might provoke reaction in the form of deflation"<sup>(1)</sup>. Furthermore, part of the purpose of the present study is to examine the use of deficit financing, with a possible moderate degree of inflation only, being brought about as an instrument in economic development. It has to be recognised that, insofar as the countries concerned are exclusively underdeveloped countries, the possibility of moderate inflation turning into hyper inflation may be great; greater at any rate than if the argument was concerned with the position of a mixed assortment of countries, some of which were matured and developed. This is because of the limited capacity of the productive apparatus, and the possible inefficiency of monetary authorities in underdeveloped countries, which is generally agreed upon.<sup>(2)</sup>

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(1) Inflation, Paul Einzig, Chato and Windus, London, 1952, P.141.

(2) United Nations, Department of Economic Affairs, Methods of Financing Economic Development in Underdeveloped countries, Lake Success, New York, 1949, P.19.

This argument ignores the fact that, if moderate inflation is to turn into a hyper inflation, an increasing and continuing flow of money would have to be provided. This is because, as Professor A. Day states: "An inflation can always be brought to an end if the supply of money is limited".<sup>(1)</sup> This increasing and continuing flow of money is necessary to enable producers to pay higher and still increasing prices of factors of production, and consumer's to buy goods and services at prices which also are higher and still increasing. Examination will now be made of the ways in which money supply and/or the velocity of money in circulation could be increased. The two ways in which this may be done are :-

- (A) Expansion of bank credit, by the issue of more notes or by the creation of additional bank loans by the banking system.
- (B) Increase in the velocity of money in circulation, and to a small extent dis-hoarding of currency.

As for the possibility of increasing money by expansion of bank credit, which is in fact our case, governments in most of the underdeveloped countries are the bodies which carry out development programmes. In most such countries too, the central bank will either be a national bank or, if not, then working very closely in relation to the government. The Government will be likely also to have had some part in shaping the relations between the Central Bank and other banks in the country. Through the controls exercised by the Central Bank, the government is thus provided with a means of controlling the creation of bank credit by the non-Central Bank part of the system. Consequently, the increase in money in circulation is or should be under the control of the monetary authorities and its increase should not go, or go by very much, above the limit which was

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(1) Day, A.C.L., Outline of Monetary Economics, Clarendon Press, Oxford, 1958, P.252

defined by the authorities in the first place. Dependent on their foresight, and the efficiency of their instruments of control, the planning authorities should thus through their Central Bank be able to impose on the banking system broadly the appropriate percentage of expansion in bank credit which has been planned, for the outcome of this analysis is that, in theory at any rate, the unlimited supply of money which is necessary to turn "moderate" inflation into hyperinflation should not come about, for if it does, then it would be plain that the monetary authorities had acted either irresponsibly or inefficiently.

(B) As for the changes in velocity of money in circulation and hoarding of currency, these depend on the general public's confidence in the government and in the domestic currency, as also on the demand for money for transactions and speculative purposes. If production, during a certain period, a year for example, was constant, other things remain the same, the volume of transactions will not effect the velocity of money. If production increases however, during a certain period, then assuming the relationship between the variables remains constant, the volume of transactions will tend to increase, and this increase will require either an increase in the quantity of money in circulation, or in the velocity of the money which is already in circulation, or a certain percentage of increase in both. When the planning authorities, in our model, start to spend the funds which are raised through expansion of bank credit, the general price level will tend to increase less than proportionately. The reason for this is that, as the analysis in the previous chapter has shown, production of consumer's goods will tend to be increased and so part of the increase in demand will be met by an increase in production. It is possible also that the rise in prices will induce the release of forces which will tend to operate to keep the rise in prices in check. For example as in the beginning

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(1) limit in the model as not exceeding 10% of the money in circulation.

of the process, prices start to rise and create situations in which producers and money borrowers add to their borrowings so, as money lenders begin to realise that the increase in the price level is continuous and likely to remain so they will tend to raise interest rates and so check the process. One effect of the increase in prices, will, other things remaining the same, be a tendency for profits to increase and, as this is seen, investors will seek to participate in the expansion of existing investments and the creation of new ones. In one way or another the forces of expansion will tend to press on existing labour supplies and, as far as may be possible the level of employment will tend to rise, or, if not this, then the number of existing employees will be worked more intensively. In a situation, where employment is increasing, more income is being distributed, production is expanding, and the inflation experienced is not acute, nor showing signs of becoming so, it is not to be expected that the general public will lose its confidence in the domestic currency. The general public might well begin to lose its confidence if the increase in the general price level is very rapid, i.e. a case of high or hyper-inflation, but not in a case of a moderate and steady increase in prices.

The same reasoning could be applied to dishoarding of currency. Hoarders are not interpreted as being automatic hoarders and completely insensitive to the effect of price increases on the value of their hoards though it may well be the case that some of the hoarders do display this characteristic: it may also well be the case that hoarders begin to recognise the disadvantage to themselves of adding further to their hoards only after some degree of time lag. As for the diverse movements, such as deflations for example, it is the expectation that governments will only be disposed to use a deliberately deflationary policy when their fear that inflation is proceeding so vigorously as to suggest the threat that it may, unless something drastic is done, get out of control. Hence if inflation remains moderate, there is no need to use deflationary methods, and consequently there is not much fear

of the possibility that inflation might provoke the sort of deflation which Einzig suggests. The conclusion that, moderate inflation might conceivably be kept from developing into a high degree of inflation could be strengthened by drawing upon a study which Professor R.G. Lipsey has made. Professor Lipsey argues against an explosive theory of inflation. This theory suggests that above a critical rate of inflation, inflation tends to become cumulative. But Professor Lipsey is at pains to argue that inflations do not necessarily tend to become hyper ones. Professor Lipsey's argument against the explosive theory of inflation is in two parts : in the first one he analyses the role of interest rates in an economy which is moving from a steady price level situation to a situation where the general price level is increasing, and where the impact of inflation on cash balances is relevant.<sup>(1)</sup> Then he concludes that, "... provided the governments' actions are such as to cause only a steady inflation, there is no reason to expect that the actions of private individuals, who anticipate this inflation, will convert it into an explosive one".<sup>(2)</sup>

In the second part of his argument against the explosive theory of inflation, Professor Lipsey analyses historical facts concerning twenty countries and covering 40 years.

The list of these countries includes ten of the South American countries where a situation of high or hyper inflation has existed,<sup>(3)</sup> In addition to these countries, the United States, United Kingdom, New Zealand, Canada, France, Sweden, Denmark, Greece, Finland, and India, are included as well.

(1) See pp. (172-173).

(2) Lipsey, R.G., Is Inflation explosive ? The Banker, Vol.CXI, 1961. Oct. P.667

(3) The South American Countries which are included are :-

Argentina, Brazil, Chile, Bolivia, Colombia, Ecuador, Paraguay, Peru, Uruguay, and Venezuela.

Ibid, P.679

This list of countries includes underdeveloped, as well as developed countries; it includes that is, countries at different levels of economic development.

Professor Lipsey concludes, after analysing the figures of rates of inflations in these countries, and displaying observations in two charts that,

"... the evidence for the 20 countries studied is definitely against the explosive theory. No general tendency for inflations to explode is apparent in the experience of these countries - despite the fact that many of them, the South American ones in particular, have experienced sustained major inflations of the order of 20 per cent or more per annum.<sup>(1)</sup> The actual record of the last (40) years lends no support to the thesis that beyond a certain critical level inflations, necessarily tend to become cumulative."<sup>(2)</sup> One of the important points in the present study is that, when governments in underdeveloped countries decide to use deficit financing as a contribution in financing economic development, the generating of a certain degree of inflation must be accepted. The important thing is to ensure as far as possible that moderate inflation will go on being moderate inflation. The considerations just presented, together with the arguments offered by Professor Lipsey show clearly enough, it may be thought, that this can be done. As Professor Lipsey himself says :- "... We must not argue against a policy of X per cent inflation on the grounds that it will not stay at X per cent, because our interpretation of the actual, real world evidence is that it is quite possible for Governments to keep inflation at X per cent if they so desire".<sup>(3)</sup> Professor Lipsey's analysis and the empirical study of

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(1) B.Higgins classifies, Argentina, Brazil, Chile, Bolivia, Paraguay, Uruguay, as countries in hyper inflationary i.e. over 15 per cent per annum group for the period between 1950-1961, and Bolivia, Colombia, Peru in high inflationary groups i.e. 7-10 per cent per annum and only Venezuela in the NO sustained inflationary group for the same period. B.Higgins Government Finance and Economic development, Edited by A.T. Peacock and G.Hauser, O.E.C.D. Paris 1965. PP.41-43.

(2) Ibid P.681

(3) Ibid P.681

the actual facts lead to the conclusion that it is not outside the bounds of possibility that governments in developed or underdeveloped countries should be found capable of maintaining, at any rate approximately so, the degree of inflation which has been decided in advance by the planning authorities.

The above analysis does not suggest that explosive inflations are impossible, because explosive inflations could be brought about in a country if the government followed a policy of ever increasing supply of money in circulation to finance its deficit spending. Inflation could be kept moderate only if the monetary authorities followed a policy of keeping this inflation moderate.<sup>(1)</sup> An argument in favour of using deficit financing as a contributor in promotion of economic development in underdeveloped countries, which is our case, is that these countries in general have a high proportion of unemployed or under-employed labour and natural resources. If additional jobs and new forms of enterprise are to be created in underdeveloped countries then more capital funds need to be raised and invested. The amount of capital to be raised will depend upon the project which is envisaged. Much the same requirement exists if national resources are to be exploited. But most if not all of the underdeveloped countries are not capable of raising enough capital funds for this purpose. Despite the risks of using financing methods which introduce inflation it is nevertheless one possible way in which part of the funds needed to utilise idle natural and human resources may be raised. Another possible argument which could be offered in favour of devices which introduce a moderate inflation is that during a period of moderate inflation, risks tend to be low, failures few, and almost everything that is produced can be sold at a reasonable profit<sup>(2)</sup>. Producers are able either to accumulate funds needed for expanding their activities, or they may find it possible

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(1) Ibid P.677

(2) Inflation, Paul Einzig, Chatto and Windus, London, 1952, P.139



to borrow them from the banking system, on advantageous terms. Thus production and distributed incomes will tend to increase, and this increase will continue steadily as long as demand continues to increase. As the profits increase, more funds which could be canalised to investment will tend to be created. Professor Bronfenbrenner says : "A slow inflation or even a rapid one in its early stages induces labourers to work more intensively for real incomes which are no higher and which may be lower than their previous level. To a lesser extent owners of land and capital may be induced to put their property to work intensively in the same way when money incomes rise".<sup>(1)</sup> Underlying this process is evidently a shift in the distribution of total income in favour of those whose incomes arise mainly or wholly as profit.

As always, one must look for arguments on the other side. One argument which could be directed against the preceding analysis is that, during an inflationary period the organisation of production tends to become less efficient because of the ease with which the increase in cost of production can be transferred to the consumers, by raising prices. Producers may be tempted to be less watchful in their use of labour, machines, and raw materials, and thus part of these resources will be wasted, and possibly concern about the quality of production may become less responsible and less keen.<sup>(2)</sup> There is a further point which could be made to support the argument that during an inflationary period, production may be less efficiently organised. It is that producers may tend to start new investments, which would not have been profitable if inflation had not been in existence; in other words there may be a tendency towards the misallocation of resources. This argument might be considered, to a certain extent, valid only in high and hyper-inflationary periods

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(1) Government Finance and Economic Development, Edited by  
A.T. Peacock, and G. Hauser O.E.C.D. Paris 1965, P.23

(2) Inflation, P. Einzig, Chatto and Windus, London, 1952, P.142

and not in a moderate inflation period. This is because in a moderate inflation where the increase in the general price level is in the region of 3% to 7% per annum, profits are increasing certainly, but only to a small extent. When prices are increasing cost of production will tend to rise at the same time, or with some lag, for while there may be a wind-fall element in profits, producers have to pay higher wages, higher prices of raw materials, and their profits would not be expected to be high enough to allow them to be as wasteful in using factors of production as the above argument might suggest, because if they do so their profits will tend to decrease. Furthermore, competition among producers of similar goods will tend to play its part in forcing a certain producer or producers to reduce cost of production, or otherwise he or they will lose their competitive power in favour of other producers with lower cost and hence lower prices. The same reasoning could be applied to the new investments, where producers must compete with, either, old producers of the same goods or with imports.

A fourth argument in favour of moderate inflation is that moderate inflation is beneficial for productive classes, such as business men and investors (except, possibly where the latter are concerned with fixed interest bearing securities) upon whom production of goods and services depends. This is because when prices rise a shift in real income from consumers in general including wage earners, to recipients of profits takes place. This shift in income is an advantage and stimulus in inducing business men to expand their existing investment, or start new ones.<sup>(1)</sup>

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(1) Inflation In Relation to Economic Development, E.M. Bernstein and I.G. Patel, I.M.F. Staff papers, Vol.2., 1952, Washington D.C., P.380

Consequently, moderate inflation, after it is initiated in our model by expansion of bank credit might have, in addition to raising funds to finance economic development, a positive effect on investment; as Dr. H.S.Odeh concluded from his study of the impact of inflation on the level of economic activity, "... inflation had a negative effect on investment in Chile, while the more moderate inflation in Brazil between 1939 and 1956 had a favourable effect on investment".<sup>(1)</sup> (underlining not in the origin).

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(1) Odeh, H.S., The Impact of Inflation on the level of Economic Activity, Rotterdam, 1963 : quoted in these words in :- Government Finance and Economic Development, Edited by A.T.Peacock, and G. Hauser, O.E.C.D., Paris 1965, P.21

## CHAPTER SEVEN

## CONCLUSIONS AND RECOMMENDATIONS

The main problem presented in this dissertation is the scarcity of capital funds needed to finance economic development in underdeveloped countries in general, and in Iraq in particular. One of the mechanisms through which part of the funds needed for development might be provided is the banking system. The banking system in Iraq consists of three parts, viz : the commercial banks, the specialised banks, and the central bank. The contribution of each part in financing economic development is discussed. The commercial banks are the financial institutions which are used by small savers as places where they can keep their savings.<sup>(1)</sup> Small savers in Iraq, as in most other, if not all underdeveloped countries do not generally invest their savings in industrial or agricultural investments : either their resources are too small, or they are not sufficiently trustful of such investment forms, or some blend of both : in any case such countries do not have a developed and organised capital market : and this is true of Iraq in particular. The commercial banks in Iraq, and most of the underdeveloped countries, provide, normally, loans on a short-term basis, against acceptable collateral security, to businessmen and other suitable customers : such loans might be used both in foreign and domestic trade dependent upon the particular circumstances of the borrowers. In so far as this indicates the normal activity of the commercial banks the question arises whether they should not engage in loan making activities going beyond these usual limits by providing medium or even long-term loans to agriculture and industry.

This raises complex and difficult issues. If it should be suggested that they should take banking practice in the United Kingdom as their guide then this model would indicate that they were acting

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(1) Over the full range of saving some small savers will of course use other financial institutions e.g. savings banks, and others may probably not use banks at all.

correctly in refraining from becoming committed to medium and long-term transactions. If, on the other hand, it should be suggested that they should take banking practice as it has been developed in Germany as their guide then their model would not warn them against these longer term commitments : it would indeed encourage the practice of longer-term lending. A question of wider significance, however, is whether it is wise for a government, particularly one acting under conditions of relatively low economic development, to take the practice of other countries, probably with quite different patterns of economic evolution, as a guide in its own policy-making. It may be wiser for a country to take note of practices elsewhere only in the most general senses and then to make its policy decisions in the light of its knowledge of the situation within its own borders and what seemed to be the local possibilities. In Iraq for example it would need to be recognised that there are already in existence specialised banks which have been charged with the responsibility of providing long-term finance to agriculture and industry.<sup>(1)</sup> It would need care to avoid unnecessary duplication of function. If the specialised banks have been established specially to fulfil this function, then there would seem to be little need to give duties to the commercial banks for which they were not originally designed and in the exercise of which they have little or no experience. In addition it would be essential that the commercial banks, if they did involve themselves in long-term commitments, should exercise the greatest caution against investing an unduly large parts of the funds for which they are responsible to their depositors and shareholders in unsecured or insufficiently secured long-term loans which might endanger the safety of their funds, including their deposits.

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(1) Viz: The Industrial Bank and the Agricultural Bank. There are other specialised banks it is true : but it is doubtful whether we should regard these latter banks as being connected sufficiently closely and directly to the tasks of economic development as this term is defined generally, for inclusion in the argument presented here. The section above therefore is concerned solely with the Industrial Bank and the Agricultural Bank.

Considerations which would have considerable weight in reaching a judgement on the question of the desirability or otherwise of the commercial banks involving themselves in long-term lending transactions would be :

(A) The attitude of the managers of the commercial banks with regard to the administration of the funds they can deploy.

(B) The extent to which the specialised banks mentioned above are providing a full and adequate cover of the need which they were designed to meet. As to the first, in so far as the banks are part of a nationalised banking structure it may be suggested that they will be readier to assist the development of their national economy than perhaps they might be if their main intention was that of maximising bank profits. The sacrifice of profits might not however be a very considerable one. If the specialised banks, particularly the Agricultural Bank, do not make contact as yet, with more than a small fraction of the total potential field of users of funds, and if the commercial banks through their branches have a contact at more points with the potential user of funds then, provided reasonable caution is exercised in the granting of the loans, the outcome might be such a more efficient use of farm resources in particular as would enable the agriculturist to pay a rate of interest to the bank which would be a greater contribution to bank profits, possibly, than could be obtained from other ways of lending.

This is evidently a comment which is relevant to (B) above as well as to (A). If the action of the commercial banks in extending their loans to agriculturists results in bringing more cultivators within the benefits of bank aid and if the specialised banks, as is thought to be the case, do not, as yet, bring in more than a small fraction of potential borrowers, then it is possible for an improvement in bank profits to take place at the same time as an improvement in the commercial banks might be used in this way to supplement not only the activity of the Agricultural Bank in its relations with farmers but also to supplement the activity of the Industrial Bank in its relations with industrialists.

The commercial banks would be expected, of course, to continue providing short-term credit to farmers and industrialists in order that the necessary supply of circulating capital might be maintained.

In this way the commercial banks might conceivably make a more effective and profitable use of the funds placed at their disposal and the specialised banks would have their activities supplemented in ways which, in general, might be likely to lead to an improvement in the use of resources in the economy generally. There is no reason why this supplementation of the work of the specialised banks by the commercial banks should lead to a curtailment of the freedom of action for the specialised banks.

The supplementation by the commercial banks might indeed provide the specialised banks with a relaxation of pressures and the opportunity to develop their special functions more effectively.

The device of deficit financing is however one which calls for cool responsibility and self control. Other things being equal, funds made available through deficit financing will tend to have inflationary consequences and inflation, as is well known, can be like a fire, a highly dangerous master. It needs to be used with caution, with careful regard to the circumstances in which its effects will be felt, and also with an eye to the moderate limits to which inflation might be permitted to go. It was with this need for caution in mind that a model employing the device of deficit financing and involving a certain amount of inflation was incorporated in the main body of this dissertation.<sup>(1)</sup> It is not necessary to describe again, in detail, the features of the model but it may perhaps be accepted as necessary that the implication of what was presented in the model should be made explicit. This is a task to be undertaken with regard to underdeveloped territories in general and Iraq in particular. The general case may perhaps be dealt with relatively briefly. It is recognised that inflation has proved a scourge in many countries and at many times. It is recognised that responsible authorities in different countries should keep themselves alive to its dangers and spend time and effort in thinking out ways in which inflation can be held in check. We cannot withhold sympathy even from those who like Governor Horowitz, express themselves in terms almost of passion on the subject of inflation for they have lived through inflationary experiences that have disrupted once stable economies.

All the same we need not take fright at the phenomenon of inflation : we may take encouragement from the views expressed by Lipsey on the subject, particularly as his generalisations are based on studies of countries where monetary expansion might well have been expected to

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(1) It should be noted that the model while an imaginary construction, was nevertheless so constructed as not to differ very much from the conditions which would be likely to be encountered, considered generally, in underdeveloped countries. The sizes of the significant variables were selected with an eye to the size which these components in an economy tend to have in actual countries. Such variables as to the rate of growth of population, the capital/out ratio, and the propensities or to hoard were given a quantitative expression which, it was hoped, would be a reasonably close expression of what might be found in such countries, even though never quite precisely a match of the conditions of any particular one of them.



erupt into hyper-inflation, yet did not. With Lipsey we may hold that inflation, beginning by being moderate need not inevitably explode into hyper-inflation. Given the appropriate controls and coolness of policy, inflation which begins by being moderate may end by remaining moderate. It may not be without significance that some of the arguments presented by "Day" on the subject of inflation can be brought in to supplement the views expressed by Lipsey. Professor Day suggests that it is always possible to end inflation if the supply of money is limited. In our model, the planning authorities add to the flow of spending by additional credit drawing facilities with the central bank equal to 10% of the money in circulation each year. If the planning authorities ceased to use such additional facilities, as is indeed suggested in the model, then new inflationary impetus is reduced to zero. In this way what is suggested as happening in the model complies with Professor Day's conditions for the ending of inflation.

It may be reasonable to argue, in the light of arguments presented earlier, that, if the Iraqi planning authorities decided to use the device of deficit financing to provide part of the financial requirements to finance a development programme there are more favourable circumstances in Iraq than in many other underdeveloped countries. When demand increases as a result of the spending of funds provided through deficit financing<sup>(1)</sup>, three possible situations may be envisaged:-

- (1) That the total increase in the production of domestic and the importation of consumer's goods tends to surpass the increase in demand for these goods, so that, other things being equal prices will tend to fall.
- (2) That the total increase in the production of domestic, and the importation of consumer's goods, tends to equal, approximately, the increase in demand for these goods, and other things remaining the same, there will be no tendency for prices to change.

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(1) Or any net increase in spending during a certain period compared with a previous period. But we are concerned here with the effects of spending funds provided through deficit financing.

(3) That the total increase in the production of domestic and the importation of consumer's goods will be less than the increase in demand for these goods. In an underdeveloped country like Iraq the third situation is the more probable one, because of the existence of "bottlenecks"<sup>(1)</sup>. This case was adopted throughout our model, where we assume that only 50% of the producers in the consumption sector are expected to be able to increase their production proportionately when demand increases. Consequently, since it is not possible to meet the total net increase in demand for consumer's goods, prices, other things being equal, will tend to rise in the consumption sector at first, and this will tend to lead to an increase, though a smaller one, in the general price level.

How large this increase will be, will depend on :-

- (a) The degree of increase in prices in the consumption sector.
- (b) How many goods and how important these goods are within the consumption sector.
- (c) The sector proportions ; i.e. how large the consumption sector is, compared with other sectors in the economy. Now, if we assume that, the final outcome was that, the general price level in Iraq rose by 3% a year i.e. a moderate degree of inflation, during a five year development programme, what are the possible consequences of such an increase on exports, balance of payments, the foreign exchange situation, and domestic currency. Furthermore, are the monetary authorities in Iraq, reasonably capable of handling such a situation in a way that may be likely to keep moderate inflation moderate.

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(1) This of course will depend on the size of the net increase in spending and demand during a period. If the required increase is only 2% or 3%, then it may not be difficult to meet this increase. Producers of consumer's goods may have to face "bottlenecks" when they want to increase their production by say (10%) or (15%) in a short period.

The most important item in the Iraq exports is oil; it represents 92% - 94% of total exports. The analysis in earlier parts has shown that a moderate increase in domestic prices will tend to have no, or a negligible, effect on oil exports. The remaining items of the Iraqi exports are agricultural products, except, cement. Again the analysis has shown that the Iraq agricultural exports depend more on climatic conditions than on prices in the World market. As for cement, its price is decided by the "Cement Marketing Board" in accordance with the supply of, and the demand for, cement in the domestic market and the market provided by importing countries. In the light of these considerations it may be reasonable to say that a moderate increase in prices will tend to have no or a negligible effect on the Iraqi exports. Now, as a result of the increase in distributed income, demand for domestic and imported goods increases. Since it is not expected that Iraq, like many underdeveloped countries, is able to produce capital goods, therefore, demand for domestic goods will tend to be confined to consumer's goods only. Demand for imported goods will tend to take two forms :-

- (1) increase in the importation of consumer's goods.
- (2) increase in the importation of capital goods in order to be able to meet the increase in demand for domestic consumer's goods by an increase in production.

In general terms it would seem to follow from the generally accepted logic of economic theory that, if national income rises, then, other things remaining the same, imports will tend to increase also, though not necessarily in the same proportion. Indeed such a linkage between income variation and variation in the volume of imports is at the core of Keynesian theorising about the propensity to import. It is important, however, that a final view should be based on the evidence which can be brought together to show the actual relation between national income and imports for a particular country over a particular period. This is to try to reach a conclusion on the empirical evidence that can be found. The table which follows aims to do

precisely this for Iraq over the period 1959 to 1963 inclusive. It shows the absolute and percentage changes in national income and imports of consumer's goods, and total imports for the period mentioned. From it, it can be seen that, changes in imports of consumer's goods do not appear to have any regular and identifiable correlation with changes in the national income. This may be explained by the following reasons :-

(1) Large stocks of imported consumer's goods in one year, may cause a decline in the importation of consumer's goods during a following year. This is because demand in a following year could be met by decreasing stocks of a previous year. Therefore, if national income increases at the end of a year by 9%, for example, imports of consumer's goods may not increase at the same rate, or may even fall, as is the case in 1962, shown in the table.

(2) The other reason may be, of course, that more consumer's goods are produced domestically, either by expanding existing industry or starting new ones. In such cases more demand can be met by domestic consumer's goods, which leads, other things being equal, to a decrease in imports of consumer's goods even if demand for consumer's goods in general, i.e. imported and domestic, increases.

(3) An increase in the national income may be brought about as a result of an increase in other sectors, or greater increase in other sectors compared with the consumption sector. This means that national income as a whole in a country can increase by say, (10%) while the consumption sector by, say, (4%).

(4) Imports of foodstuffs and the like may increase in a certain year because of a crop failure, which leads in turn to an increase in imports while the national income as a whole may decrease at the end of that year.

(5) If the economic affairs of the community are closely controlled by the government under some form of central economic planning, then variations in imports can easily occur for which the reasons lie in political decision making. There is no reason at all to suppose that there will be a close correlation between national income and imports within the context of a system administered in this way.

In the light of the considerations presented above, it may perhaps, be safe to say, that, there is no strong relationship between changes in national income and changes in imports of consumer's goods. This may not be true if changes in total imports are considered in relation to changes in national income.

The table also discloses that the increases in national income were accompanied by increases in total imports though not at the same percentage, for the years 1959, 1960 and 1961. In 1962 inspite of an (8.7%) increase in the national income of that year, total imports fell in absolute and percentage terms.

However, the decrease in the national income of 1963 was accompanied by a decrease in total imports, again not by the same percentage. Consequently, it may be safe to say that, there may be a stronger relationship between changes in national income in Iraq, and changes in total imports, than between national income and imports of consumer's goods, though even then, it is not by itself a strong relationship.

Table (S)  
Imports as ratios of National Income  
For the years 1959-1963.

Year	National Income at current prices (NI)	Imports of consumer's goods MT	% of change in NI	% of change in MT	Imports of consumer's goods as percentage of NI.	Imports of consumer's goods + imports of other commodities.	% of change (7)	Column (6) as percentage of column (1)	Total imports	% of change (10)	Column (9) as percentage of column (1)
+	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1959	391.6	46.5	-	-	11.9	62.4	-	15.9	99.4	-	25.1
1960	437.1	60.8	11.6	30.7	13.8	79.4	27	18.2	124.3	20	28.7
1961	484.2	65.2	10.6	7.2	13.5	85.0	7	17.5	133.5	7.4	27.6
1962	526.5	54.3	-8.7	-17	10.3	74.2	-15	14.1	127.7	-4.5	24.3
1963	515.4	47.8	-2.1	-12	9.3	66.1	-11	12.8	112.5	-12	21.6

Source : The (C.B.I.) Quarterly Bulletins No.45 January - March 1963 pp.30-31 and No.56 October - December 1965 pp.28-29. All percentages were calculated by the writer.

The combined effect of an increase in demand for the importation of capital and consumer's goods, to the extent it did occur, would tend to increase the need for foreign exchange.

The analysis of the Iraq balance of payments has shown that the net exports in the oil sector cover a major part in some years and more than cover in other years, the deficit in other export/import relations. The oil revenues in the last decade were continuous and, generally speaking, increasing. They rose from (U.\$ 223.37 mn.) in 1955, to (U.\$ 368.5 mn.) in 1965. However, there was a slight fall in 1956, followed by a sharp decrease in 1957, due to the Suez crisis, and the destruction of the pipeline passing through Syria. The safeguard against a future stoppage of the Iraq oil exports, which actually took place twice, in 1956 and 1966,<sup>(1)</sup> would be the construction of an alternative pipeline which would run from the oil fields in the North to the Iraqi port "Basrah" in the South as suggested earlier. All things considered, Iraq should not be expected, in ordinary and normal circumstances, to face a large shortage of foreign exchange, and in turn a serious deficit in its balance of payments, when deficit financing is used, with inflation as its expected outcome.

In earlier parts of this dissertation, the discussion of the experience of the Iraqi monetary authorities including the decisions these authorities have taken in the last three decades, has shown that these authorities have handled the situations confronting them in a reasonably responsible and knowledgeable way. Furthermore, the analysis has shown

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(1) See PP.( 31 - 34 ) of this dissertation.

Disturbances to oil revenues could, of course, arise for various reasons: any major disturbance to the normal economic life of the community could be damaging. If, for example, there should be any protracted or severe disturbance arising from the relations between the Government and any disaffected elements in the state then instabilities could hardly be avoided. Since, however, the scope of this dissertation is regarded as excluding the discussion of political problems in Iraq, which would, in any case, need a knowledge of political analysis, possible disturbances, such as, for example the Kurdish problem, are not discussed.

that in the last five years between 1961-1965, such increase in prices as there was, was very moderate. To some extent this may be attributed to the actions of the authorities. In 1963, for example, the government decreed a 25% reduction in the then existing rate of rent. In 1964 this was followed by decrees by the "Economic Organisation" reducing the prices of essential consumer's goods such as foot wear, vegetable oil, soap and the like, consequential upon increases in production after nationalisation. With regard to exchange rates the general tendency has been for the value of the Iraqi dinar in the different financial centres to lie close to the dollar value of the pound sterling.<sup>(1)</sup>

Therefore, if it can be expected that the Iraqi exports, balance of payments, and availability of foreign exchange, will be affected only in a small or a negligible way as a result of a moderate increase in prices, then it may be safe to say that there is no strong reason to suppose that the public's confidence in the domestic currency is likely to be weakened as a result of the use of deficit financing. In earlier parts of this dissertation, the arguments show that the state-owned Central Bank of Iraq, has a reasonably effective control over the state-owned banking system. It may be perhaps safe to say that the (C.B.I.'s) power over the nationalised banks is effective enough to direct their activities in a way which does not contradict the policy which the (C.B.I.) is trying to follow. It may therefore, perhaps, be concluded that if the Iraqi planning authorities decided to use deficit financing to provide part of the financial requirements for a development programme, and provided that this device is used with extreme caution, and within definable limits, then the circumstances and conditions prevailing in Iraq are not unfavourable; as a matter of fact they are to a reasonable extent favourable, and it would seem to be a great waste if, after careful consideration, the Iraqi authorities did not exploit the use of this device since, Iraq, like all underdeveloped countries needs to use every possible way to finance its development programmes.

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(1) See Economist Intelligence Unit report as quoted earlier.



Recommendations :

In the light of the points discussed and the arguments presented in this dissertation the following recommendations may be made :-

(1) That the commercial banks in Iraq should give favourable consideration to all medium and long-term loans to agriculture and industry, within cautious limits and following sound banking practices, such as keeping their liquidity at a level which enables them to meet any cash withdrawal in normal circumstances.

(2) That the specialised banks should extend their services to cover a larger number of prospective borrowers. In addition, a "Board of Directors" consisting of the General Directors of the specialised banks should be set up. This Board ought to meet regularly, say, once a month, to discuss the general policy which should be followed by these banks. It would act as an instrument both for the co-ordination of all relevant information and for the better co-ordination of activities. Furthermore, the (C.B.I.) should be given a more direct and effective control over the specialised banks, and the setting up of such a Board for the specialised banks would facilitate such a step.

(3) That the Iraqi monetary authorities should study very carefully the possibility of the use of deficit financing to provide part of the capital funds needed to finance development programmes in Iraq, and that they should not necessarily take the rigid and un-yielding view that this method of financing with its tendency to induce inflation, should be regarded as one which no careful authority would think of employing.

(4) Since oil revenues represent the major source of revenue and foreign exchange, therefore it is necessary to safeguard this source against any possible disturbance. This could be accomplished by constructing an alternative which would run through an Iraqi territory instead of running through a Syrian territory, as is the case at the moment.

(5) That one important requisite in the conduct of monetary policies, particularly if deficit financing on a moderate scale should be adopted is an adequate supply of trained and knowledgeable personnel. The Iraqi authorities should therefore consider whether it might not be to their interests to construct and maintain a programme for the training of such personnel. Such a programme would involve the selecting and sending of a number of suitable young persons each year to approved centres of specialised learning, i.e. to places with a reputation for learning in monetary affairs and the general principles and practice of central economic planning, and also for sending selected bank employees, from all types of bank, for refresher and special courses from time to time. In this way not only might the knowledge and skills of Iraqi personnel be increased but they would have an enlarged opportunity to meet banking personnel in other countries. Such contacts once established, could conceivably be extremely useful to Iraq in times of financial strains.

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APPENDIX NUMBER ONE

THE AUGUST 1947 ANGLO-IRAQI AGREEMENT.

Appendix No.(1)

The August 1947 Anglo-Iraqi Agreement.

According to Article (1) of this agreement the  
Number (2) Account should be credited with :-

- (1) All holdings of sterling assets of the Government of Iraq, the Iraq Currency Board, and each office in Iraq of any other bank, at the close of business on July 14th, 1947.
- (2) Interest received by the Iraq Currency Board on its Sterling assets after July 15th, 1947.
- (3) Transfer from other No.(2) accounts.
- (4) Any sums paid to the Iraqi Government by the British Government, on or after July 15th, 1947.
- (5) The proceeds at maturity or on realisation of any investment purchased in accordance with established customs with funds standing to the credit of a number (2) account.
- (6) The net capital movement from the countries of the sterling area to Iraq.
- (7) Such other transfers, as might be agreed upon by the contracting Governments.

Then Section (4) (b) of this Article indicates that this account, i.e. No.(2) account, should be debited (credited) to No.(1) account, with the following balances :-

- (1) To each bank in Iraq, the release of an amount equal to the outstanding liability as at the close of business on July 14th, 1947, provided that this account did not exceed the amount of the sterling assets held by that bank as of the above date.
- (2) The release of the following amounts to the Iraq Currency Board;
  - (a) The sum of fifteen million pounds over a five year period.
  - (b) The equivalent of any portion of the scarce currency provided in the Scarce Currency Agreement of May, 1945, (as finally extended in February, 1947) which was not spent before July 15, 1947.

- (c) The sum of five million pounds as a special provision to facilitate for the Government of Iraq the transaction to the new circumstances.
- (d) The sum of two million pounds as a working balance to meet any temporary shortage in the means of payment.
- (e) A sum equivalent to a special proportion of the interest earned on the sterling assets.
- (3) The release of other sums to meet various obligations, the most important of which were :-
- .... the repayment of advances made to the Government of Iraq by the oil companies, the repayment of the debt of the port of Basrah, the fulfilment of obligations entered into with the Government of Iraq before July 15, 1947, and the cost of surplus military stores, equipment or fixed assets disposed of by the Government of the United Kingdom to the Government of Iraq before that date and of these which will be disposed of to the Government of Iraq or the public after that date. <sup>(1)</sup>
- (4) The release of amounts equivalent to the net capital movement from Iraq to other countries of the sterling area. <sup>(2)</sup>

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(1) National Bank of Iraq, Annual Report, July 1947 - December 1950, Baghdad : The Times Printing and Publishing Co., Ltd. P.43

And :-

(2) El Kaissi, Critical Analysis of Central Banking in Iraq, unpublished Ph.D. Thesis, University of Southern California, 1957 PP.151 - 153.

APPENDIX NUMBER TWO.

CHANGES IN THE VOLUME AND COMPOSITION OF  
IRAQI CURRENCY RESERVES 1947/1960.

Appendix No. (2)

Changes in the volume and composition of Iraqi Currency reserves 1947/1960.

The table on P.(86) shows that on July 14th, 1947 total foreign assets (sterling) held by the Iraqi Monetary Authorities was (£57.904 mn.). Between July 15th, and December of 1947, this amount fell by 2%. At the end of 1948, the balance decreased sharply from (£57.194 mn.) to (£44.292 mn.) i.e. by 23% below end of 1947.

This sharp decrease may be explained by many reasons, viz :-

- (1) The outbreak of the Arab-Israeli war in that year.
- (2) The crop failure.
- (3) The embargo on exports of wheat and barley, and
- (4) The increasing imports of that year.

At the end of 1949, the holdings of sterling assets rose by 14%. This increase was due to the cessation of the Arab-Israeli war, restrictions on imports, and good harvest. In 1951, the total balance of sterling held by the National Bank of Iraq and the commercial banks was (£48.783 mn.) and for the first time other foreign exchange holdings were introduced and amounted to (I.D 1.687 mn.) In 1952, the sterling assets rose by (21.5%), while other foreign exchange rose by (16.2%). In 1953, owing to the new oil agreement and increasing oil royalties sterling assets increased by about (35.2%) other foreign exchange by (11.2%). In 1954, the increase in sterling assets continued, to reach (£100 mn.) i.e. an increase of (24.7%) over 1953, while other foreign exchange fell by (8.7%). In 1955, sterling assets rose by (15.4%), other foreign exchange by (74%). It is worth mentioning here, that for the first time a gold reserve of (3 mn.) was held.

This was the outcome of agreement between the National Bank of Iraq, and the British Monetary Authorities. Under this agreement the National Bank of Iraq was allowed to buy (5 mn.) worth of gold over two years; to be held as part of its currency reserves. In 1956, there was an increase of (6.6%) in the sterling assets, (40%) in other foreign exchange, and (66%) in gold holdings. In 1957, there was a sharp decrease in the holding of sterling assets i.e. by (24%), while other foreign exchange holdings continued to rise (it rose by 40%) and so the gold i.e. (40% too). The decrease in the holdings of sterling assets was due to the Suez crisis and the sharp decrease of oil exports from (31.1 mn. tons) in 1956 to only (21.7 mn. tons) in 1957. The decrease in the holdings of sterling assets continued in 1958, (they fell by a little more than 9%); while holding of other foreign exchange continued to rise (it rose by 13% and the gold by 71%). Sterling assets held by the Iraq Monetary Authorities fell from (£84.03 mn.) in 1958, i.e. before the withdrawal to only (£39.4 mn.) after the withdrawal, i.e. a decrease of 53%. Iraq's holdings of other foreign exchange rose by about (122%) and gold reserves by 150% in 1959, over 1958. The Iraqi Government continued to run down her sterling assets on the one hand and increase gold and other foreign exchange on the other. Consequently, in 1960, Iraq's sterling assets fell to no more than (£22.1 mn.), i.e. by 44% on the preceding year. But in 1960, Iraq's holding of other foreign exchange fell by 29%, and only the gold reserves rose by (11%) over the preceding year. The fall in Iraq's holdings of other foreign exchange in 1960, apart from the decrease in the sterling assets which was based on government' policy, was due to crop failure in that year, and a deficit in the balance of payments.



APPENDIX NUMBER THREE

THE CONCEPT OF "DEFICIT FINANCING" AS IT  
APPEARS TO BE INTERPRETED BY  
DIFFERENT ECONOMISTS.

Appendix No. (3)

The Concept of "deficit financing" as it  
 appears to be interpreted by  
 different economists.

The literature on financing economic development in underdeveloped countries and the use of the device of deficit financing in developed as well as underdeveloped countries is considerable, therefore we cannot in an appendix such as this one review systematically the whole range of this literature. This appendix aims only at indicating the concept of deficit financing as used by some economists. Of these, some, however, use the term deficit financing without defining in what sense they are using the concept, as is shown later. In my view, it is indeed important for a writer to define in what sense he is using any term to which more than one meaning could be attributed. However, there are other economists who do define their use of deficit financing when they mention the concept. Professor W.A. Lewis in his book "Development Planning"<sup>(1)</sup> seems to use the term inflation as a substitute for deficit financing. He compares taxation with, not deficit financing, but inflation, as a source of finance; he points out that, "though taxation may also raise prices, it is nevertheless from the economic point of view greatly superior to inflation as a source of finance for capital formation".<sup>(2)</sup> Professor Lewis does not

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(1) Lewis, W.A., Development Planning, The essentials of economic policy, George Allen and Unwin, London, 1966.

(2) Ibid, P.136

Professor Lewis may have wanted to refer to "forced savings" realised through inflation, but if that was his aim there is no clear indication that it was this that was in his mind.

seem to keep clear enough the distinction between the device of deficit financing which provides the necessary monetary command over resources and the inflation, which under certain conditions is the possible outcome of the use of this device. Professor Lewis seems to hold the view that it would be unwise for most underdeveloped countries "to launch upon an inflationary course because they could not control it".<sup>(1)</sup> The arguments in this dissertation, however, show that inflations do not necessarily, get out of control but it is possible for a moderate degree of inflation to be kept moderate.

Nevertheless, Professor Lewis still thinks that, "... one cannot rule out the possibility that some of the better organised societies can safely finance some capital formation by the creation of money".<sup>(3)</sup> P.T.Bauer, and B.S. Yamey in their book "The Economics of Underdeveloped Countries,"<sup>(4)</sup> do not define deficit financing in a specific way. Nevertheless, they refer to "budget deficits as a means of raising the rate of capital formation"<sup>(5)</sup>. They seem to hold the view that the use of deficit financing in underdeveloped countries tends to initiate inflationary pressures. It may be that they are correct enough in the light of a good deal that has happened in the monetary experiences of countries, whether developed or underdeveloped, but from

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(1) Ibid P.136

(2) See PP.(218-223 ) of this dissertation.

(3) Lewis, W.A., Development Planning, The essentials of economic policy, George Allen and Unwin, London, 1966, P. 136

(4) Bauer, P.T., and B.S., Yamey, The Economics of Underdeveloped Countries, Cambridge University Press, 1959.

(5) Ibid P.(204).

the stand point of theory there is perhaps a need for more cautious phrasing. The use of deficit financing might or might not initiate inflationary pressures. This depends on many factors, such as, how large is the amount of funds provided through deficit financing as a percentage of total funds spent by the government during a period, how often this device is used, i.e. is it used in period (A) and not in (B) but (C) or is it used throughout the periods A,B, and C, to what extent is it possible to increase the production of domestic and imported goods and services to meet part or all of the increase in demand caused by the spending of funds provided through deficit financing, and so on. Then P.T. Bauer and B.S. Yamey, present arguments in favour of and against inflation. Finally, they express the view that; "the scope for inflationary finance as a source of capital formation in underdeveloped countries is severely limited".<sup>(1)</sup>

H. Myint in his book "The Economics of the Developing Countries",<sup>(2)</sup> discusses the use of deficit financing, and tries to present a case where deficit financing may be used. He points out that, in order to have a faster overall rate of growth, the agricultural sector (being the slowest moving sector) should be stimulated. In a situation like this there are two ways he suggests which could be followed; Myint calls these, negative and positive incentives; negative incentives are e.g. forcing the farmers to sell their products to the authorities, or imposing appropriate taxation. The positive economic incentives would involve a diversion of a considerable part of resources from the capital goods sector to the

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(1) Ibid P.207

(2) Myint, H., The Economics of the Developing Countries, Hutchinson, London, 1964.

consumer's goods sector, with the inevitable consequence of having a slower rate of growth for the economy as a whole. In a situation such as this, Myint goes on, many economists considered the use of deficit financing to be an instrument for transferring the "disguised unemployment" from the agricultural sector to more productive employment such as building of roads or carrying out irrigation schemes. Myint then points out that these economists argue that, the inflation which is initiated by the use of deficit financing is self-destroying because production in agriculture and other sectors will increase when the capital projects financed in this way are completed. However, in order to have a self-destroying inflation it is much safer, in my view, to spend funds provided through deficit financing on a carefully selected type of project which would use domestic raw materials, available skills, and capital goods if possible, and go into production in a relatively short time. Possible examples are, footwear, clothing, and the like. However, if the aim was to spend these funds in the agricultural sector, they could be spent on projects with quick returns such as, improving the quality of the seeds, small irrigation projects, and similar means for increasing output.

B.Higgins, in an article in a book titled, "Government Finance and Economic Development,"<sup>(1)</sup> argues that the problem of financing a development programme is that "of using the fiscal system, on both the expenditure and tax side, to capture resources for the purposes of the development programme: to divert them from production of consumer's goods other than those implicit in the growth path selected and

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(1) Higgins, B., Government Finance and Economic Development, Edited by A.T. Peacock, and G. Hauser, O.E.C.D., Paris 1965.

priorities assigned; and also to divert them from investment projects, public or private, with lower priorities than those included in the plan." (1) He then goes on to argue that it is always possible to obtain domestic financial resources as long as the central bank in the country is state-owned. But the problem is that at some point the rate of growth of the money supply will tend to exceed the rate at which goods are being made available, and this leads to a rise in prices in a way which may not be healthy for carrying out a development programme. Professor Higgins then goes on to present arguments in favour of and against inflation, which are not our concern in this appendix.

A.R. Prest, in his book "Public Finance in Underdeveloped Countries"<sup>(2)</sup> points out that as long as the national income of a country keeps increasing there will be increases in tax revenues more than proportionately even if the existing taxation system is maintained. Thus the government will be able to finance its increasing long-run expenditure obligations. But if as a result of a crop failure or a reduction in demand for exports, national income decreases more than proportionately, and the government cannot reduce its expenditure by the same percentage of decrease in its revenues, then there will be a budget deficit. If a government uses internal borrowing to finance a deficit, then there will be a risk of initiating balance of payment disequilibria or inflationary pressures or both. Prest then argues that "a moderate degree of inflation may do more good

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(1) Ibid P.18.

(2) Prest, A.R., Public Finance in Underdeveloped Countries, Weidenfeld And Nicholson, 1962.

than harm by stimulating investment, redistributing incomes etc., and balance of payments troubles may be cured by exchange rate adjustments, direct control etc."<sup>(1)</sup> The foregoing description of Prest's arguments shows that he was thinking of deficit financing to be used to bridge a gap between revenues and expenditures. These expenditures are ordinary expenditures i.e. on ordinary government services. In this dissertation the use of deficit financing, suitably qualified, is advocated to be used to provide part of the funds needed for carrying out a development programme and not for ordinary government expenditure. The other aspect of the subject which Prest discusses is the ability of governments in underdeveloped countries to borrow from the banking system. Prest maintains that the important factor is not the making of arrangements between the government, the central bank, and the commercial banks. If we assume that a government does have a tight control over the banking system, the decisive factor affecting money supply may still be the balance of payments.

This case is especially obvious in countries where a large part of gross national product is generated through exports, and these exports fluctuate within a wide range from one year to another. The second important factor is the ability of commercial banks to have access to external funds - "as is so often the case".<sup>(2)</sup> Prest seems to make a rather discouraging judgement when he concludes his argument by saying; "... it seems as safe a bet as can be made on these matters to wager that it will still be a long time before governments of underdeveloped countries can have the ready

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(1) Ibid PP. 109-110

(2) Ibid P. 104

facilities for short - or long-term borrowing which we take for granted in Western countries".<sup>(1)</sup> This, in my view, is a harsh judgement, especially when Prest himself admits that many underdeveloped countries have more developed banking systems, when he says; "Although there are many underdeveloped countries, especially in Latin America, Asia and the Middle East with more highly developed monetary and banking systems than those we have been considering, ..."<sup>(2)</sup> However Prest modifies his harsh judgement when he indicates that "there are some countries in the underdeveloped class where the monetary system is firmly under Government control. A good example is India, ..."<sup>(3)</sup> Mrs. Hicks in her book "Development Finance"<sup>(4)</sup> refers to the use of deficit finance for a different purpose. She argues that savings in development countries should not be treated as negligible by asserting that people in these countries are too poor to save; "Even poor Indian peasants have been found to save a substantial proportion of their meagre incomings, voluntarily reducing their living standards almost below subsistence level in order to keep a reserve. West African cocoa farmers were also found to have a high propensity to save".<sup>(5)</sup> The important factor is how to increase the amount of these savings, and even more important is how to make them available for investment. One of the methods of making these savings available for investment, Mrs. Hicks suggests, is by means of deficit finance. In this case the government

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(1) Ibid P.105

(2) Ibid P.103-104

(3) Ibid P.104

(4) Hicks, U.K., Development Finance, Planning and Control. Clarendon Press, Oxford, 1965.

(5) Ibid PP. 47-48.



either borrows from the central bank or prints notes in order to be able to spend more than its revenues would allow.

If the government borrows from the central bank it, usually, pays a very low interest rate, and when it prints notes, it even pays no interest at all. However, there are restrictions concerning the repayment and amount of loans provided by central banks to governments in underdeveloped countries. As a result of the spending of funds provided through deficit finance, distributed incomes and in turn demand rise, other things being the same. Those receiving new money will have command over economic resources. This rise in spending will result in a pressure on goods and services, and this leads, probably, to some degree of increase in prices. People whose incomes did not rise will find themselves getting a smaller amount of goods and services than they could previously get, and this is forced saving. It is expected, however, that in the process of transferring command over economic resources, those receiving the command over economic resources will use them in more productive ways than those who are no longer command there resources. Mrs.Hicks goes on to point out that in principle this process takes place to a certain degree in any economy. "It is even probable that in most circumstances a certain amount of new investment will result from the deficit finance, over and above what would have taken place in its absence."<sup>(1)</sup> Mrs.Hicks then goes on to discuss the effects of the use of deficit finance on, what she calls, development economics which is not our concern in this appendix.

P.Hasan in his book; "Deficit Financing and Capital

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(1) Ibid P.48 - 49.

Formation", <sup>(1)</sup> defines deficit financing for the purposes of his study as; "net creation of credit in the government sector". <sup>(2)</sup> He points out that his definition is more limited than one usually used in describing the industrialised countries where the term deficit financing means the size of the total budget deficits. Hasan goes on to indicate that deficit financing is an important variable in underdeveloped countries because, of the fact that "most of the public debt in these countries is held by the banking system and the possibilities of borrowing from the non-bank sector are often limited." <sup>(3)</sup> If Hasan is trying to say that if it is possible for the government to borrow from the non-bank sector, then it can still be considered as deficit financing, he is open to challenge: in my view, if the government borrows from the non-bank sector it is not possible to consider that as deficit financing. This is because, if the government borrows from, say, individuals or companies, then it will be a process of transferring command over economic resources from the private sector to the government. Hasan, then indicates that his definition of deficit financing "includes government borrowing from the central bank (including decline in government cash balances) as well as from commercial banks". <sup>(4)</sup> Hasan does not clarify the point that he makes, that if the government spends its own cash balances it is a deficit financing. This, in my view, is not valid; because if a government spends in period (B) what it has accumulated out of

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(1) Hasan, P., Deficit Financing and Capital Formation, the Pakistan Experience 1951-59, The Institute of Development Economics, Bunder Road, Karachi, 3, 1963.

(2) Ibid. P.3

(3) Ibid. P.4

(4) Ibid. P.4

its revenues in the form of cash balances in period (A), then it is not deficit financing. But if the government during any period prints more notes than the usual requirements of ordinary increases in money in circulation, and without a similar increase in currency reserves, then it is deficit financing. This is because money in circulation represents governments' (or the central bank's) liabilities towards the public. However, he covers himself as far as borrowing from the commercial banks is concerned by indicating that "the supply of credit by the commercial banks to the government is assumed not to involve a curtailment of their credit to the private sector".<sup>(1)</sup> M. Haq, in his book "Deficit Financing In Pakistan",<sup>(2)</sup> points out that, it is difficult to single out one definition of deficit financing as a generally accepted one. The important requirement, however, he goes on, is that when this term is used in a particular study, it should be clearly indicated in what sense the concept is used and the reason or reasons for that. In his study he chose two concepts. The first concept is that "deficit financing is the net borrowing of the government from the banking system". He includes in this definition government's borrowing from the central bank as well as commercial banks. In his second definition, Haq confines the borrowing of the government from the State Bank alone, "deficit financing is the net borrowing of the government from the State Bank alone".<sup>(4)</sup> Haq, then claims that these definitions have an important advantage;

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(1) Ibid P.4

(2) Haq, M., and K. Khanam, Deficit Financing in Pakistan, 1951-60, The Institute of Development Economics, Bunder Road, Karachi, 1961.

(3) Ibid P.2

(4) Ibid P.3

"The significance of these definitions lies in linking deficit financing directly with the money - creating effects of government operations".<sup>(1)</sup> However, Haq, does not define deficit financing in a way which indicates the use of the funds obtained through this device, and in my view he should have done so. This is because, it is as important to indicate the use of funds provided through deficit financing as to indicate the methods which a government can use to get these funds. G.Patterson in an article in the "Journal of Finance"<sup>(2)</sup> defines deficit financing for the purpose of his article as; "a net increase in the amount of money in circulation, such increase being the result of conscious governmental policy designed to bring about economic activities that the officials believe desirable and that otherwise would not have taken place. (Thus, it is assumed deficit financing is not offset by taxation, tighter bank credit, etc.) ..."<sup>(3)</sup> This definition implies that a government plans to increase money in circulation aiming at a higher level of economic activity. However, this definition does not clarify the way in which this increase in money in circulation is expected to be brought about. Patterson goes on and explains what he means by underdeveloped countries and (which is not our concern in this appendix) the purpose of using deficit financing in these countries; "... the purpose of deficit financing is to secure a rapid economic development;

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(1) Haq, M., and K. Khaman, Deficit Financing in Pakistan, 1951-60, Bunder Road, Karachi, 1961, P.3

(2) Patterson, G., The Journal of Finance, Edited by H.G. Frain, and C.A. Dauten, The American Finance Association, Vol. XII, 1957.

(3) Ibid P.178

that is, drastically and quickly to alter the economic structure".<sup>(1)</sup>

There is a fairly extended account of what the term may be thought to cover in Kulkarni.<sup>(2)</sup> Some use has already been made in the main body of this dissertation of his point of view;<sup>(3)</sup> it may therefore be sufficient here to indicate the broad range of situations which his term covers. In a strictly academic sense his description may be thought appropriate. Deficit Financing has indeed over a long period of time been used to refer to such situations as he describes. There is a close similarity in fact between the situations which Kulkarni describes in some detail and the situations which rather more broadly are presented by A.Gilpin in his Dictionary of Economic Terms; "Deficit Financing The financing of a budget deficit by the Government by means of borrowing against the issue of Government securities, that is by increasing the National Debt (q.v.). A budget deficit is incurred as a means of stimulating the economy through increased Government expenditure".<sup>(4)</sup> Whatever the form, however, in which the change may be made, by issuing more money in the form of notes or simply by governmental spending which exceeds the current inflow of revenue, made possible by the provision of bank credit, the essential feature of the situation is that an imbalance has been set which has, as its

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(1) Ibid. P.178

(2) Kulkarni, R.G., Deficit Financing and Economic Development, Asia Publishing House, London, 1966.

(3) See P.(202, and PP.204-206) of this dissertation.

(4) Gilpin, A., Dictionary of Economic Terms, Butterworths, London, 1966, P.47.

ultimate effect an increase, currently, in the rate of flow of expenditures against the currently available supply of goods and services. The important thing is that when a term is used which has many meanings or applications, a clear statement should be made of the sense in which it is intended to use the term and this sense should be consistently maintained. In this dissertation the device of deficit financing is linked narrowly and specifically to the financing of a development programme, though this is not to be understood as implying the belief that the wider range of reference of the concept is necessarily invalid.

APPENDIX NUMBER FOUR

A NOTE ON THE USE OF THE QUANTITY THEORY  
OF MONEY IN THE MODEL.

Appendix No. (4)

A note on the Use of the Quantity Theory  
of Money in the Model.

The Quantity Theory of Money is adequately described by Gilpin (including his reference to the deduction that may be made) as, "A theory developed by the American economist Irving Fisher (1867-1947), the essentials of which are contained in the equation:

$$MV = PT$$

where M = the amount of money (bank notes, etc. plus bank deposits); V = the velocity of circulation; T = total number of trade transactions; and P = general price level.

From this equation it may be deduced that with V and T constant, an increase in M must result in an increase in P. With V and P constant, an increase in M could be offset by an increase in T. With both P and T constant, a decrease in M could be offset by an increase in V. If T is constant, an increase in P may be due to an increase in M or V, or both. The equation is useful in indicating the relationship between the four parameters".<sup>(1)</sup>

All the same it has to be recognised that in recent years a great deal of criticism has been levelled at the theorem; so much that it would not be unreasonable at all to form the conclusion that the theory had been discredited. For example, when Pen has described what he calls the "naive"

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(1) Gilpin, A., Dictionary of Economic Terms, Butterworths, London, 1966, P.173



quantity theory and said of it that "this "naive" quantity theory obviously does not give a proper picture of reality",<sup>(1)</sup> he goes on to describe, briefly, "the new variant of the quantity theory ... which is connected in particular with the name of the American Irving Fisher ..."<sup>(2)</sup> and the attempt, later, by Marshall and Robertson, at Cambridge "to replace the velocity of circulation by the concept 'cash balance', i.e. money's time of rest, so to speak".<sup>(3)</sup> He is prepared to agree that a certain verbal elucidation is achieved, by this Cambridge version but he is, in the end, no more prepared to accept it than he is the Fisher version which it was intended to replace: "I cannot see what theoretical benefit is gained from replacing a quantity by its reciprocal"<sup>(4)</sup>; he says; and to him this seems to be the final word that need be said. But it is a complex subject and criticism of the Quantity Theory has a long history as indeed has acceptance of the legitimacy of a good deal of the criticism even by those who would put forward some form of Quantity Theory themselves. For example, Marshall in 'Money Credit and Commerce' P.(48) says "this Quantity doctrine is helpful as far as it goes but it does not indicate what are the other things" (in his characteristic way he has just completed a statement of the Quantity Theory which was carefully guarded by the phrase 'other things being equal') "which must be assumed to be equal in order to further the proposition and it does not explain the causes which govern the rapidity of circulation". Later, he says, "it is almost a truism".<sup>(5)</sup>

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(1) Pen, J., Modern Economics, Penguin Books, 1965, p.158

(2) Ibid p.158

(3) Ibid p.161

(4) Ibid p.162

(5) Marshall, A., Money, Credit, and Commerce, Macmillan and Co., London 1923, P.48

D.H. Robertson in his book "Money" expresses a similar guarded acceptance of the propositions indicated by the Quantity Theory and concludes his chapter on the Theory with the words: "The Quantity Theory of money remains as a dowdy but serviceable platitude"<sup>(1)</sup>. On the other side we may recall the views of Keynes that "where there is full employment prices will change in the same proportion as the quantity of money"<sup>(2)</sup> (though he immediately produces a number of reservations which weaken the force of his assertion), and also the sophisticated defence of the theorem in a suitably elaborated form which has been put forward by M. Friedman<sup>(3)</sup>. Clearly there is a good deal of controversy concerning the validity (respectability almost) of the Quantity Theory and the rival formulation which would express itself in terms of Keynesian aggregates and use a flow of funds approach. Not only has the controversy been going on for a long time but, despite the vigour with which opponents of the Quantity Theory express themselves it is not dead yet. In this dissertation however, the aim has been to find a convenient and acceptably valid expository device through the use of which the relationship between the variables in the model could be displayed. Recalling the words of Gilpin "The equation is useful in indicating the relationship between the four parameters". The parameters of Gilpin's expression are the categories M, V, P, and T of the model, with T suitably defined so as to be consistent with the interpretation of V as the income velocity of the money supply and not its transactions velocity. In all models, whether they use the categories of the Quantity Theory or the symbols which denote

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(1) Robertson, D.H., Money, Nisbet, Cambridge, At the University Press, 1922.

(2) Keynes, J.M., "The General Theory of Employment, Interest and Money". Macmillan, 1936, P.296.

(3) Friedman, M., Studies In the Quantity Theory of Money, With Essays by Milton Friedman and others, Chicago, University of Chicago Press, 1956.

the aggregates of the Keynesian and post Keynesian approaches, it is necessary for assumptions to be made so that the model can be stabilised. It is in this manner that the categories of the Quantity Theory have been used in the model. It is accepted that the various categories are interdependent and can influence each other; as Pen has said "It is not the accuracy of the equation of exchange that is attacked, but the use made of it. The equation suggests that  $M, V, T$ , and  $P$  are independent of each other. This suggestion is misleading"<sup>(1)</sup>. There is no intention whatsoever of presenting the monetary equation as though it indicated a cause - and - effect relation between the variables - certainly not a rigid causal connection between  $M$  and  $P$ . It is presented and used simply as a convenient expository device. It has been said the Quantity equation can tell us no more than we ourselves read into it; this view is accepted un-reservedly. This is precisely how the equation has been used in the model and an important part of the exercise was indeed to fit quantities into the boxes indicated by the categories, so to say, on the basis of assumptions which had already been made.

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(1) Pen, J., *Modern Economics*, Penguin Books, 1965, pp.(159-160), (translated from the Dutch by T.S. Preston).

APPENDIX NUMBER FIVE

THE NATURE OF INFLATION, AND MAIN TYPES OF  
INFLATION DEFINED.

## APPENDIX (5)

## "THE NATURE OF INFLATION, AND MAIN TYPES OF INFLATION DEFINED"

The first concept of inflation, the old one, is based on the quantity theory of money. Under this concept of the theory of inflation, an increase in the quantity of money is the central factor which leads to inflation. Under the cruder and earlier forms of the theory, the variables other than (M) and (P) were assumed to remain constant, thus (P) varied directly and proportionately with (M). In the more sophisticated formulations of the theory some allowance was made for the possibilities of variations in production and output but it was still the basic assumption that for inflation to be induced the variations in the other variables should not be such as to offset the variation in (M). If some measure of variation in these other variables is accepted then (P) will tend to rise under the stimulus of an increase in (M) but not proportionately. Professor Pigou, for example, regards the increase in the quantity of money as the most important and a sufficient factor to induce inflation. As he indicates "aggregate money income will be increased ... either if the stock of money is increased ... or if the proportion of money income to stock of money is increased ... inflation can only come about as a concomitant of one or both of these types of change". (1)

Consequently, when the quantity of money increases, according to this concept of inflation, the general price level rises, causing inflationary pressures. The position would be presented in the form  $MV = PT$ , where : M = is the quantity of money in circulation together with the available bank credit : V = velocity of money in circulation P = Prices, T = volume of transactions during a certain period (a year for example): if V and T are taken to be constant,

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(1) Quoted in : Zawadski, The Economics of Inflationary Process, Weidenfeld and Nicholson, 1965, P.17

then an increase in M leads to a rise in price (P) that is :

$$M V = P T$$

Under this concept of inflation, if the monetary authorities in a country increase the quantity of money by spending central bank, or other bank credits, during a depression then, provided a rise in general prices is induced, the action and the ensuing situation, would logically, have to be called "inflationary". From this it is clear that the essential condition to be satisfied before a situation may, strictly, be called "inflationary" is that there should be a rise in general prices. If there are unused resources which the spending on the basis of credit brings into active use then it does not necessarily follow that prices must rise. Indeed it is an essential part of Keynesian doctrine in the general theory that, provided there is not unduly close pressure on available resources then the effect of the spending will be observable in an increase of output and employment and not an increase in prices. The more rigid and crude version of the Quantity Theory is indeed, open to another objection : namely, that if the velocity of circulation of money increases, M remaining the same, then inflation can be brought about. The Quantity Theory has been described, not without good reason, as a platitude and a tautology. Indeed it is, for in real world situations the variables tend to vary all together, though it may well be that a leading factor in the engendering of inflationary situations is the variation in the quantity of money, for this can so easily be varied by the appropriate activities of the monetary authorities themselves. If inflation is thought of as a relative rise in general prices then it has to be admitted, odd though it may seem, that "inflation" can arise even if the quantity and velocity of money in circulation remain the same: this could happen if, at the same time, the supply of goods and services declined. Inflation has thus arisen as a result of a change initiated on the side of goods and services and not on the side of money supply. It is plain that the price level is to be seen, in the last analysis, as the product or outcome of the other three forces which are given a place in the "quantity" expression. It is at bottom, so far as analysis is concerned, <sup>not</sup> a matter of deciding which for



Another treatment of the theory of inflation in a closed economy was conducted by Ralph Turvey; he defines inflation as :  
 "... a process resulting from competition in attempting to maintain total real income, total real expenditure and/or total output at a level which has become physically impossible, or in attempting to increase any of them to a level which is physically impossible".<sup>(1)</sup>  
 Finally an attempt to touch upon the meaning of terms like, deflation, disinflation and reflation, may not be out of place. The concept deflation could be considered, broadly, as opposite to inflation. Deflation does not mean any fall in the quantity of money, or in the general price level, but, "deflation, is present, however, when contraction results from a deliberate act of policy, outside the normal course".<sup>(2)</sup> Therefore, deflation could be brought about when the government wants to bring it about, unlike inflation. Deflation could be brought about to serve a certain purpose or certain purposes, such as, to restore some pre-existing rate of exchange with other currencies, which was the case when the Bank of England held discount rate high, prior to 1925, for the purpose of strengthening the position of the pound sterling against the dollar.<sup>(3)</sup> As for the concept of disinflation, P. Einzig defines "disinflation" as, "efforts to check a rise in prices or reverse an inflationary rise which has already taken place".<sup>(4)</sup> Finally, the third concept is "reflation" which means, "... a particular instance of inflation undertaken on certain particular occasions with a specific intention and subject to a predetermined limit".<sup>(5)</sup>

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(1) Quoted in : K.K.F. Zawadski, The Economics of the Inflationary Process, Weidenfeld and Nicholson, 1965, P.20

(2) A.C.Pigou, Economics in Practise, MacMillan and Co. Ltd., London, 1935, P.87

(3) Ibid, P.87.

(4) P.Einzig, Inflation, Chatto and Windus, 1952. PP.22-23.

(5) A. Pigou, Economics and Practice, MacMillan and Co. Ltd., London 1935, PP. 91-93.



The monetary authorities take this course of action in a situation where prices have fallen below the trend, due to a cyclical depression as is shown in the diagram below<sup>(1)</sup>. Such a situation has harmful effects on the economy, these are :- firstly, the increase in the real value of internal and external, public and private debt, in terms of appreciated money. Secondly, wages will not tend to fall when prices fall, and therefore cost of production will tend to rise, and in turn will tend to cause unemployment. Thirdly, the government will be obliged to pay the same rate of wages and salaries, and pensions as before the full in price has taken place, which means that the government is paying more than before in real terms.

It must be emphasised, however, that if the fall in prices is due to an improvement in agricultural or industrial technique, or, if, with all other things remaining the same reflation is introduced to restore a previous price level than there should not, necessarily, be harmful effects on the economy indeed, considered generally the effects should be beneficial.

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(1)

the trend of the  
general  
price level.

deflation

the general price level  
is below trend due to  
cyclical depression.

inflation

reflation

spending by the government  
and/or monetary authorities.

Figure No.(7)

Relation of reflation to variations from a trend.

### The Main Types of Inflation :

Inflation is a phenomenon which fundamentally arises as a result of an alteration in the rate of flow of money relative to the rate of flow of goods and services. The presence and course of inflation will be seen in the movement of prices. But since it is a phenomenon which depends upon the relation between the money flow and the goods flow, it follows that the rising prices, by which inflation will be made manifest, may be the outcome of changes initiated from the side of money or from the side of goods and services (with a suitable assumption about the other so that the activating origin of the inflation may be located) or both, acting together. In the last analysis inflation will be the outcome of disproportionate changes on the one side as compared with the other. It is thus possible to recognise inflation in different forms, but in order to warrant the common appellation, all must have special features in common. In all types of inflation, inflation ensues only because monetary expenditure can be raised, whether by an increase in the money supply by expansion of bank credit and/or printing more paper money, or by an increase in the velocity of money in circulation, or both, or by a decrease absolutely or relatively in the supply of goods and services, even if the quantity and velocity of money in circulation remain constant, or increased by more than the increase in the supply of goods and services. The main types of inflation are :-

#### (1) Hyper Inflation.

In this type of inflation prices rise astronomically mainly because people, depending on their previous experience, expect prices in certain situations to rise and continue to do so for an extended period. These situations are such as <sup>are</sup> created by a political upheaval, or war. Therefore, if people expect prices to rise, they may start to purchase goods in the immediate present, and keep them for consumption in the future, or shift part of their cash holdings to foreign exchange, or precious metals.

The process could also be started and sustained if the general public lose confidence in a government and its monetary policies. However, demand for goods and services will tend to rise. As for the production, i.e. the supply side, producers who expect increases in price will tend to prefer to stock part of their production than produce for the current needs of the market. It follows that the larger the anticipated rise in prices, the higher and wider the gap between the quantity of goods supplied and goods demanded.

Consequently, there will be an excess demand, which will tend to lead to a rise in expected profits, wages, and prices. If this rate of price rise is to become a case of hyper-inflation, two conditions must be fulfilled :-

Firstly, people's expectations of the increase in the price level in the future, and the difference between the existing general price level and the expected higher price level, ought to continue for a reasonably long period. It follows that consumers will tend to buy and store goods for the future, and producers will tend to store part of their current production, hoping to sell it at higher prices shortly afterwards.

Secondly, an increasing and continuing flow of money needs to be provided in order to enable producers to pay higher prices for the factors of production on <sup>the</sup> one hand, and consumers to pay higher prices for goods and services on the other.

This flow of money could be supplied by expansion of bank credit and/or increase in the velocity of money in circulation. It is highly likely that the needs of the community for currency will bring about an increase in the volume of bank notes printed and put into circulation by the monetary authorities. Therefore, hyper-inflation could be initiated either as a result of expansion in bank credit, to a large extent, as a result of a sharp change in the expectations of consumers and producers, or both. An extreme example of hyper-inflation is the German one of 1922-1923.

It is typical that once initiated it tended to increase at an increasing rate and that its composition contained all three elements mentioned above, namely an increase in printed notes, an increase in bank credit and an increase in the velocity of circulation. It is extreme, however, and so, in a sense, untypical in that it was moved along by a complex of political forces engendered by the international dislocations of the immediate post war years, aggravated by an acute cyclical depression.

(2) Cost-push inflation :

Professor R.G. Lipsey distinguishes between two theories of inflation, cost-push and demand-pull, "Looking at the causal sequences involved, the cost-push theory says that it is increase in factor prices that causes increases in final goods prices, and that these changes in factor prices can occur independently of the state of excess demand ...."<sup>(1)</sup> Now if we examine the production process we can recognise that incomes received by suppliers of factors of production, in the form of wages, interest, rent and profits, represent cost of production on the one hand and purchasing power on the other. There are various complications in the situation, however: in the first place these incomes received by suppliers of factors of production are not quantitatively of equal importance in the total make-up of aggregate income, for example, wages and salaries form more than (60%) of direct cost in manufacturing operation. In the second place there may be quite a complex relation between the movement of payments to a factor or factors and the movement of prices. For example, H.G. Moulton shows that in the period 1933-1957 the rise in hourly wages in the U.S.A. was more than double the rise in wholesale prices.<sup>(2)</sup> He explains why prices did not rise at the

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(1) Lipsey, R.G., An Introduction to Positive Economics, Weidenfeld and Nicholson, 1963, P.434.

(2) Moulton, H.G., Can Inflation Be Controlled, George Allen and Unwin, 1958, PP.159-162.

same rate as wages: the reason lay, he says, in "improvements in operating efficiency". Nevertheless, when cost of production rises as a result of, say, an increase in wages and salaries above the increase in productivity, producers in order to maintain the same margin of profits will see no alternative but to raise prices. Once started, this movement will tend to continue; an increase in wages and salaries will tend to be followed a rise in cost of production; then prices will tend to rise again and the familiar cost/price spiral will be clearly seen.

### (3) Demand-pull inflation :

The demand-pull theory of inflation reverses the order of causation which is followed by the cost-push theory. The demand-pull theory maintains that, "... it is increases in the demand for final goods (consumers goods or investment goods) that cause increases in their prices, these prices increases cause a rise in the demand for factors of production which, in turn cause an increase in factor prices, thus it is increases in the level of goods prices which cause increases in the level of factor prices".<sup>(1)</sup> Now in the Keynesian model, as mentioned earlier, when effective demand exceeds effective supply of goods and services, then provided previously unused resources are available, employment and output rise; but if full employment has been reached, prices increase, or in other words inflation will be brought about. Furthermore, inflation could be brought about, even if full employment has not yet been reached, as was shown earlier in the diagram in footnote on page ( 270 ). In a country which has reached its full employment point, however, for practical purposes this may be defined, any increase in investment by the government, other things being the same, which is financed by deficit financing, above attempted savings, must tend to lead to an increase in the general price level, i.e. inflation, and an inflationary gap

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(1) Lipsey, R.G., An Introduction to Positive Economics, Weidenfeld and Nicholson, 1963, p.434

will come to existence. As to the nature of an inflationary gap the most illuminating discussion of it would seem to be that presented by Professor Bent Hansen.<sup>(1)</sup>

After discussing different concepts and describing research studies by various American economists, and the investigation by "Konjunkturinstitut", he arrives at the conclusion that, the above investigators seem to indicate that the inflationary gap in the commodity markets can best be described in the following terms : "the inflationary gap in the commodity markets = The active attempts to purchase commodities - the value of the available quantity of commodities".<sup>(2)</sup> There are means by which the monetary authorities might make an approximate measure of the inflationary gap, in order to see the extent to which attempted investment exceeded attempted savings. In discussing this a numerical example may not be out of place. Let us assume that in country (A) the national income, when full employment has been reached is (600 mn.) in money terms, which consists of consumption, and savings or investment. Let us assume further that a total amount of (540 mn.) in money terms has been spent on consumer's goods and services. It follows that the remaining part, i.e. the (60 mn.) should be spent on investment private and public, if the economy is to be in an equilibrium, under the conditions of full employment. Now, let us assume that the government needs more goods and services and finances this being met by deficit financing, say, (10 mn.) monetary unit. Hence, the total investment will be (70 mn.) monetary units which exceeds savings, which is expected to be (60 mn.) only at this given level of the national income. It follows that total monetary expenditure on consumption and investment, exceeds the capacity of the national resources of country (A): in other words total effective demand exceeds total supply, which in turn, leads to a rise in the general price level, i.e. inflation. Now if marginal propensity to consume is  $\frac{3}{4}$  the

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(1) The concept of inflationary gap was used originally by J.M.Keynes in his pamphlet, How to Pay for the War, Chapter IX, "Voluntary Saving and the Mechanism of Inflation". MacMillan and Co.Ltd., London 1940, as reported to by :

Bent Hansen, The Theory of Inflation, George Allen and Unwin Ltd., London, 1951. P.61

multiplier will be :  $\frac{1}{1 - \frac{3}{4}} = \frac{1}{\frac{1}{4}} = 1 \times \frac{4}{1} = 4$ , and the

size of the gap will be  $4 \times 10 = 40$  mn. It follows that the spending of the extra (10 mn.) in money terms on investment, has led to a rise in national income in money terms from (600 mn.) to (640 mn.), while the real national income has not changed at all. Hence, the increase in spending on investment above real saving, if full employment has been reached, would tend to lead to nothing but an increase in prices.

#### (4) Open and Repressed Inflation :

If there is a tendency for the general price level to rise freely in a country and according to the supply of, and demand for, goods and services, without an intervention by the monetary authorities, then inflation is called, as such, an open inflation. If the monetary authorities hold prices down, then inflation will be called repressed or suppressed inflation. The monetary authorities can hold prices down in different ways, such as by the imposition of controls, the effect of which is that expenditure on current production is halted temporarily, thus preventing the initial stage of the increase in prices from taking its course, or by diverting demand from one type of commodities or output to another. There is no reason in theory why these two methods should not be used together, and in practice, it would very probably be the case that in fact they were. Another method which could be used to repress an inflation in its first stages is the fixing of an upper limit for the prices of consumer's goods. Nevertheless, even if monetary measures are successful in keeping the general price level down, this success would tend to be temporary only: prices will, sooner or later tend to rise. (1)

Another method which could be used as an alternative to fixing maximum prices might be to introduce rationing. Each consumer might be allowed to buy a certain amount of a certain commodity during a fixed period a week, for example. Thus in this way the total demand for any commodity could be controlled. In later phases of inflation, prices could be held down either by imposing high taxes, or, provided this suited the government plans in other respects, by reduction in government expenditure; but this again would clearly only be possible within a context of very considerable central control. (2)

(1) Unless, of course, there is an extremely rigid and successful authoritarian control over the economic movements of an economy.

(2) Day, A.C.L., Outline of Monetary Economics, Oxford, 1958, PP.257-261.

(5) Moderate Or Mild Inflation :

The above types of inflation are not desirable, and generally the monetary authorities try, using every possible way, to avoid measures which might initiate inflation of one of these types. This is because in relation to the types of inflation mentioned, the harmful consequences are likely to outweigh any possible gain that might come from their existence. Moderate inflation means, in contrast, a steady, slow, controlled, and well regulated increase of prices, and it is this concept of inflation which is used in the present study. It is suggested that monetary authorities in underdeveloped countries should, subject to certain safeguards, be permitted to use deficit financing as a means of financing their national development programmes. It is expected that when deficit financing is used, within limits, prices will tend to rise, but only to a certain extent, and it is assumed that it is the intention of the monetary authorities to keep this increase in prices moderate.

How far the intention to keep inflation moderate can be realised in practice is a matter on which no general statement can be made. Much will clearly depend upon the particular circumstances of different countries. In this dissertation attention has been directed in particular to the economic circumstances in Iraq.



APPENDIX NUMBER SIX

STATISTICAL APPENDIX.

TABLE NO. (1)

Development of Iraq Educational facilities for the period  
between 1950-1951 and 1962-1963.

Details	1950-1951	1956-1957	% of change	1962-1963	% of change 1956/57
No. of primary schools, Governmental, Private, and foreign.	1.101	1.861	69.0	4.125	121.7
No. of teachers in primary schools.	6.367	11.607	82.2	32.193	177.4
No. of students.	180.779	373.384	106.5	914.121	144.8
No. of Secondary schools, Governmental, Private and foreign.	95	210	121.1	446	123.8
No. of teachers and lecturers in secondary schools.	999	3072	207.5	6730	119.1
No. of students in secondary schools.	22.706	65.690	188.3	172.652	162.8
No. of students in Art Colleges and institutes.	3882	3198	-17.6	7250	126.7
No. of Graduates.	930	697	-25.1	2647	279.8
No. of Students in Science Colleges and institutes.	895	1945	117.3	3535	81.7
No. of Graduates.	115	231	101.0	537	132.5
No. of lecturers in colleges and institutes.	n.a.	n.a.	-	1008 (1)	-

Source: A table compiled from, Government of Iraq Statistical Abstracts for the years 1952-1953, 1959, and 1963,  
and the Educational Census of 1962-63, Government Press, Baghdad, P.3. All percentages were calculated  
by the writer.

(1) Including (371) foreigners.

n.a. = not available.

TABLE NO. (2)

Development of Iraq's Health facilities during  
the period between 1951 - 1963.

Details	1953	1958	% of change	1963	% of change over 1958
No. of Hospitals.	98	123	25.5	131	6.5
No. of Dispensaries	n.a.	498	-	801	60.8
No. of beds	6622	9236	39.5	13669	48.0
No. of Nurses qualified and trained, and midwives.	1347	1631	21.1	1691	3.7
No. of Doctors.	874 (x)	1192	36.4	1436	20.5
No. of dentists.	81	112	38.2	231	106.3
No. of Hospital staff (1)	2266	2279	1	3134	37.5
No. of Pharmacists.	260	378	45.4	528	39.7

Source :- A table compiled from the Governments Annual Abstracts for the Years, 1953-4 PP.227-230,  
1959 P.330, and 1963 PP.(242-245) All percentages were calculated by the writer.

(1) Hospital staff includes, dressers X-Ray, Radiographers, laboratory assistants, Health officials, dental Practitioners, Inspectors dressers, Vaccinations, inspectors, and sanitary visitors, both private and officials.

(x) including (85) foreigners.

TABLE (3)

PRODUCTION OF PRINCIPAL CROPS ('000 metric tons)  
HARVEST IN QUOTED MONTHS OF YEARS STATED  
FOR THE YEARS 1957 - 1964

Years	1957.	1958.	% of 1959. change		% of 1960 change		% of 1961 change		% of 1962 change		% of 1963 change		% of 1964 change	
Barley (Apr-June)	1305	954	-26.9	733	-30.2	804	9.7	911	13	1125	23.5	790	-29.8	623
Wheat (May-July)	1118	757	-32.3	657	-13.2	592	-10	857	45	1085	26.6	488	-55	807
Dates (Aug-Oct.)	323	324	-	450	39	270	-40	200	-25.9	350	75	420	20	300
Rice (paddy)														
(Aug-Oct.)	154	137	-14.9	92	-29.7	118	28	68	-47.5	113	66.2	143	26.5	184
Tobacco (Aug-Oct.)	5	5	-	11	120	12	9.1	10	-16.7	8	-20	7	-12.5	10
Cotton (lint)														
(Aug-Oct.)	14	12	-14.3	8	-33.3	5	-37.5	9	80	8	-11	3	-62.5	11
Pulses (chiefly Spring).	34	22	-35.3	27	22.7	25	-7.4	32	28	19	-40.6	17	-10.5	n.a.

Source: The Economist Intelligence Unit, Annual Supplement, (Iraq) International Division, Spencer House,  
27 St James' Place, London, 1963 P.10 and 1966 P.14

n.a. - not available.

The percentage changes relate to the immediately preceding year.

TABLE NO.(4)

Value added<sup>x</sup> in Agriculture, Forestry, and  
Fishing 1953 - 1963 (I.D '000).

Year	At Current Prices	At Constant 1956 Prices.
1953	70.610	85.700
1954	83.750	113.820
1955	64.350	68.400
1956	88.070	88.070
1957	110.320	116.510
1958	91.450	89.160
1959	80.730	66.480
1960	96.520	76.250
1961	115.510	96.900
1962	138.560	113.350
1963	106.540	80.410

x Net of depreciation.

Source : Haseeb, K., The National Income of Iraq, 1953-1961  
Oxford University Press, 1964, P.33 and his Mem,  
National Income of Iraq, 1962 and 1963. PP. 15-16.

Figures for 1962 and 1963 only were taken from  
Dr. Haseeb's Mem.

TABLE NO.(5)

Value Added <sup>x</sup> in Manufacturing Industry, 1953 - 1961.

(I.D '000)

Year	At Current Prices.			At 1956 Prices.		
	Manufacturing (except oil- refining)	oil-refining	Total	Manufacturing (except oil- refining)	oil-refining	Total
1953	16.751	1.731	18.482	17.002	1.731	18.733
1954	18.211	2.213	20.424	19.059	2.213	21.272
1955	21.967	2.359	24.326	22.231	2.359	24.590
1956	26.322	2.607	28.929	26.322	2.607	28.929
1957	28.149	3.038	31.187	26.797	3.038	29.835
1958	28.464	3.479	31.948	27.954	3.748	31.702
1959	35.482	4.205	39.687	33.929	4.476	38.405
1960	43.613	5.166	48.779	42.062	5.456	47.518
1961	47.329	5.397	52.726	44.396	5.708	50.104
(1) 1962	52.330	6.910	59.240	50.020	7.060	57.080
1963	50.370	7.090	57.460	48.140	7.240	55.380

x Net of depreciation.

Source : Ibid P.86.

(1) Figures for 1962 and 1963 were taken from Dr.Haseeb's mem. pp. 15-16.

TABLE NO. (6)

Size Distribution of Industrial Establishments in 1954,  
(x)  
(excluding oil industry)

Number of workers	Number of establishments	% of the total	Number of workers	% of total employment in the industrial sector.
1	10.157	45.0	10.157	11.0
2	5.651	25.1	11.302	12.2
3	2.805	12.4	8.415	9.3
4	1.383	6.1	5.532	6.1
5	804	3.5	4.020	4.5
6-9	933	4.1	6.455	7.2
10-19	433	2.0	5.718	6.3
20-99	199	0.8	8.185	9.1
Over 100	95	0.4	30.507	33.8
Total	22.460	100.0	90.291	100.0

Source : Industrial Census of Iraq, 1954, and K.M.Langely, The Industrialisation of Iraq, Harvard Eastern Monograph Series, 1962, P.90.

(x) The Number of workers in oil industry is given on page ( 28 ).

TABLE NO.(7)

Industrial Censuses 1954 and 1962.

Details	Units	1954 <sup>(1)</sup>	1962	% of change
Average number of establishments.	No.	22.460	21.373	-4.8
Average number of employees.	No.	90.291	120.787	33.8
Annual Wages	I.D.'000	5.756	21.966	281.6
Value of fuel	I.D.'000	771	2814	264.9
Value of lubricating oil	I.D.'000	n.a.	485	-
Value of electricity used in production.	I.D.'000	225	1011	349.3
Value of materials used in production.	I.D.'000	15.024	63,117	320.1
Total revenue	I.D.'000	39.198	137.315	250.3

Source : The table compiled from Iraq Ministry of Economics Statistical Abstract 1955-56, Zahra Press Baghdad 1956, P.100 and P.105, Iraq Ministry of Planning, The Monthly Industrial Survey 1962, PP.7-10, and K.Haseeb, The National Income of Iraq 1953-1961, Oxford University Press 1964, P.91  
All percentages were calculated by the writer.

(1) It is useful to point out that figures for 1954, do not represent averages, because the Census started on December 12th, 1953 and finished before April in all provinces except two. Figures for 1962 represent averages based on 12 monthly returns. The importance of this fact is that, ice-making factories do not work in the winter and ice factories, therefore, close at this season.



TABLE NO.(8)

Value and percentages of the principal Exports (In million Iraqi dinars)

Percentages are calculated by the writer(excluding oil exports)

The percentage changes relate to the immediately preceding year.

	1960	% of total exports	1961	% of total exports	1962	% of total exports	1963	% of total exports	1964	% of total exports
Dates	4.05	54	2.81	40	7.05	38	9.03	57	6.15	43
Barley	0.10	-	0.80	11	6.07	33	0.83	5	0.50	4
Raw wool	0.91	12	0.92	12	1.06	6	2.10	13	1.84	13
Raw cotton	0.27	4	0.24	2	0.36	2	0.23	2	0.64	5
Live animals	0.02	-	0.08	1	0.08	-	0.04	-	0.05	-
Hides and Skins	0.62	9	0.58	8	0.96	5	0.99	6	1.19	8
Oil seeds	0.20	3	0.16	2	0.50	3	0.16	1	0.40	3
Cement	0.57	8	0.71	10	0.62	3	1.38	9	1.91	13
Fodder	0.38	5	0.44	6	0.40	2	0.49	3	0.54	4
Other grains	-	-	-	-	1.06	6	0.05	-	0.16	1
Other commodities	0.37	5	0.49	8	0.28	2	0.49	4	0.83	6
Total	7.49	100	7.23	100	18.44	100	15.79		14.21	100
Oil exported	222.63		223.01		223.74		258.97		281.76	
Grand Total (1)	230.12		230.24		242.21		274.76		295.97	

Source : The Central Bank Bulletins, April-June 1963 and October-December 1965, Nos. 46 and 56. P.35 and 33.

Al Tamaddun Printing House, Baghdad, and The Government Press, Baghdad 1966.

(1) Some of the relatively unimportant items are not included, therefore figures represent grand total are slightly lower than those given in the above mentioned source.

TABLE NO. (9)

( Exports)(excluding oil companies)  
 ( per cent of total value)  
 (Geographical Distribution)  
 for the years 1960-1964.

	1960	1961	1962	1963	1964
United Kingdom	8.80	2.96	5.88	5.64	3.36
Other Sterling Area Countries	19.89	18.57	13.15	16.27	23.60
Total of Sterling Area Countries	28.69	21.53	19.03	21.91	26.96
U.S.A. and Canada	11.21	8.11	12.64	12.80	6.41
E.F.C. Countries (1)	6.11	3.35	22.39	2.89	2.40
E.F.T.A. Countries	1.07	3.45	7.22	1.72	1.68
Socialist Countries	17.95	22.65	17.99	26.28	19.86
Arab league Countries	31.80	37.21	19.25	32.05	39.99
Other Countries	3.17	3.70	1.48	2.35	2.70
Total	100	100	100	100	100

Source : The Central Bank of Iraq Annual Report 1963, Baghdad 1965, P.235 for the years 1960-1963, Bank Quarterly Bulletin No.56, 1965, P.32.

(1) The countries indicated by the initial E.F.C. and E.F.T.A. respectively are not spelt out in detail: it is thought that the countries for which they stand are known well enough now for this not to be necessary.

The percentage changes relate to the immediately preceding year.

TABLE NO. (10)

## The Geographical Distribution of Oil Exports

(Per cent of the total) for the years 1960 - 1964.

	1960	1961	1962	1963	1964
United Kingdom	17.56	14.31	16.13	15.59	19.46
Rest of Sterling Area Countries	2.37	5.20	4.64	6.32	7.72
Total of Sterling Area Countries	19.93	19.51	20.77	21.91	27.18
U.S.A. and Canada	2.43	2.74	0.33	0.20	0.34
E.F.C. Countries	57.27	59.19	60.48	57.84	47.93
E.F.T.A. Countries (1)	2.71	3.21	3.25	3.55	3.56
Socialist Countries	0.29	0.49	0.66	0.64	0.57
Arab league Countries	0.24	0.30	1.20	0.79	1.02
Other Countries	17.13	14.56	13.31	15.07	19.40
Total	100	100	100	100	100.00

Source : The Central Bank of Iraq, Annual Report 1963, Baghdad 1965, P.236 for the years 1960-1963, and the percentages for 1964 were calculated by the writer depending on the figures given by the Central Bank Quarterly Bulletin No.56, P.35.

(1) Excluding the United Kingdom.

The percentage changes relate to the immediately preceding year.

TABLE NO. (11)

Value and percentage of principal imports (excluding oil companies) for the period between 1960 - 1964 ( in million of Iraqi dinars).

	1960		1961		1962		1963		1964		1965	
	Value	% of total imports	Value	% of total imports	Value	% of total imports	Value	% of total imports	Value	% of total imports	Value	% of total imports
Consumer's goods	59.44	4.9%	63.59	4.9%	52.70	4.3%	46.49	4.2%	64.43	4.5%		
Tea	8.22	7	8.57	6	8.20	7	8.76	8	8.26	6		
Sugar	8.02	7	7.73	6	5.90	5	4.07	4	10.78	7		
Fruits & Vegetables	4.13	3	3.35	3	3.25	3	3.58	3	4.44	3		
Cereals	8.18	7	14.13	11	4.39	4	2.45	2	9.71	7		
Cotton & Rayon (Piece goods)	12.31	11	11.25	9	11.37	9	11.45	11	12.77	9		
Other Textile & Clothing	2.26	2	2.00	2	1.88	1	1.75	1	2.36	2		
Chemical & Pharmaceuticals												
Products including soap and essential oils.	4.27	3	5.12	4	5.83	5	4.64	4	4.68	3		
Vegetable oil.	1.80	1	1.76	1	1.62	1	2.15	2	2.50	2		
Durable consumer's goods. Radios, T.V. Sets and parts. Refrigerators and working machines, fans, Vacuum cleaners and Glass ware.	10.25	8	9.68	7	10.26	8	7.64	7	8.93	6		

The percentage changes relate to the immediately preceding year.

Continued :

TABLE NO.(11) Contd.

Value and percentage of principal Imports (excluding oil companies)  
for the period between 1960 - 1964 ( in million of Iraqi dinars ).

Continued :

	1960	% of total imports	1961	% of total imports	1962	% of total imports	1963	% of total imports	1964	% of total imports	1965	% of total imports
Capital goods	43.32	36%	46.88	36%	51.58	41%	44.58	41%	55.36	38%		
Boilers & Machinery	5.64	5	3.95	3	4.69	3	5.16	5	4.75	3		
Other machines	3.65	3	5.69	4	8.22	7	7.52	7	7.13	5		
Electrical machines	4.76	4	4.04	3	5.03	4	5.02	4	10.74	7		
Vehicles, trucks and parts	9.98	8	11.41	9	11.22	9	10.05	10	10.89	7		
Iron/Steel	9.29	8	11.27	9	12.48	10	8.07	7	9.94	7		
Raw materials, such as, paper, canned food, Tanning and dyeing etc:	10.00	8	10.54	8	9.94	8	8.80	8	11.91	9		
Other commodities	18.58	15	19.75	15	19.93	16	18.30	17	23.60	17		
Total :	121.34	100	130.22	100	124.21	100	109.41	100	143.39	100		
(1)												

Source : The Central Bank of Iraq Quarterly Bulletins January - March 1963 (No.45), P.32, and April - June 1965 (No.54) Government Press Baghdad 1965, P.28. All percentages were calculated by the writer.

(1) Some of the relatively unimportant items were not included, therefore, figures represent total are slightly lower than those given in the above mentioned source.

The percentage changes relate to the immediately preceding year,

TABLE NO. (12)

(Imports)(excluding oil companies) per cent of total value).

## Geographical Distribution for the years

1960 - 1964.

	1960	1961	1962	1963	1964
United Kingdom	16.99	15.99	15.33	14.70	12.40
Other Sterling Area Countries	16.17	16.19	13.19	15.98	15.50
Total of Sterling Area Countries	33.16	32.18	28.52	30.68	27.90
U.S.A. and Canada	12.26	12.11	11.88	11.43	14.50
E.E.C. Countries	21.76	21.5	22.55	20.18	19.00
E.F.T.A. Countries (1)	7.13	6.97	8.30	7.62	6.98
Socialist Countries	11.43	13.80	17.00	20.54	17.00
Arab League Countries	4.26	3.62	3.65	5.19	5.62
Other Countries	10.0	9.82	8.10	4.36	9.00
Total	100	100	100	100	100

Source : The Central Bank of Iraq, Annual Report 1963, Baghdad, 1965, P.234 for the years 1960 - 1963, percentages for 1964 were calculated by the writer depending on the figures given by the Central Bank Quarterly Bulletin No.56, 1965. P.27

(1) Excluding the United Kingdom.

The percentage changes relate to the immediately preceding year.

TABLE NO. (13)

The Net National Debt As a Ratio of the Net National Income of Iraq, for the years between 1958 - 1963. (1)

YEAR	Net National Debt in 000 of Iraqi dinars at Dec 31st of each year (N.N.D.)	% of change over the preceding year	Net National Income in 000 Iraqi dinars (NNI) At Current Prices.	% of change over preceding year.	(NND) as % of (NNI)	% of increase in the ratio of (NND) to (NNI).
1959	24.673	-	391.600	-	6.3	-
1960	31.357	27.0	437.100	11.6	7.2	14.3
1961	36.493	16.4	484.200	10.8	7.5	4:2
1962	58.944	61.5	526.500	8.7	11.2	49.3
1963	79.845	35.5	515.400	-2.1	15.5	38.4

Source : Compiled table from the National Income of Iraq, the table on page (48) of this dissertation, and the Central Bank of Iraq, Quarterly Bulletins Nos, 45 P. 51 , and 50 P. 51

All percentages of change, and ratios were calculated by the writer.

(1) Figures for the National Income of Iraq are not available for the years after 1963, while they are available for the Public debt and shown on table (42) of this dissertation.

The percentage changes relate to the immediately preceding year.

TABLE NO. (14)

The Net National Debt As a Ratio of the Net National Income of Turkey, for the years between 1958 - 1963.

YEAR	Net National Debt in thousand millions Turkish Lires at end of year. (N.N.D.)	% of change over the preceding Year	Net National Income in thousand millions (T.L.) (NNI) At Current Prices	% of change over preceding Year	(NND) as percentage of (N.N.I.)	% of increase in the ratio of (NND) to (NNI).
1959	8.0	-	41.8	-	19.1	-
1960	9.3	16.3	44.4	6.2	20.9	9.4
1961	12.7	36.6	46.5	4.7	27.3	30.6
1962	14.9	17.3	52.1	12.0	28.6	-4.8
1963	17.6	18.1	59.1	13.4	29.8	4.2

Source: United Nations Statistical Year Book 1965, New York 1966, P. (639) for the Public Debt figures, and P. (545) for the National Income figures. All percentages in the table were calculated by the writer.

The percentage changes relate to the immediately preceding year.



TABLE NO. (15)

The Net National Debt as a Ratio of the Net National  
Income in the United Kingdom for the years 1958 - 1963.

YEAR	Net National Debt in (£000'000) (N.N.D.)	% of change over the preceding Year	Net National Income in (£000'000) (N.N.I.)	% of change over the preceding Year	(NND) as percentage of (NNI)	% of increase in the ratio of (NND) to (NNI)
1959	27.376	-	19.532	-	140.4	-
1960	27.732	1.3	20.835	6.7	133.0	5.0-
1961	28.251	1.9	22.270	6.9	126.7	4.7-
1962	28.674	1.5	23.211	4.2	123.5	2.5-
1963	29.847	4.1	24.680	6.3	120.9	2.1-

Source: Central Statistical Office, Annual Abstract of Statistics, London, Her Majesty's Stationary

Office No. 102, 1965. P 294 for the National Income Figures, and page (262) for the  
National debt figures. All percentages in the table were calculated by the writer.

The percentage changes relate to the immediately preceding year.

Table No. (16)

## Consolidated Statement of Commercial Banks

(In Thousands of Dinars) for the Years  
1961-1965.

## LIABILITIES

	1961.	1962.	% of change	1963.	% of change	1964.	% of change	1965.	% of change
1. Paid-up Capital	8.516	9.205	8.1	10.250	11.4	10.374	2.1	10.124	-2.4
2. Reserves	3.215	3.977	23.7	3.928	-1.2	4.411	12.3	4.548	3.1
3. Provisions for income tax and other provisions and profits ready for distribution.	1.151	1.036	-9.0	1.198	15.6	1.130	-6.7	2.503	121.5
4. Balance of Profit and Loss A/C	1.377	1.646	19.5	1.661	-1	1.343	-19.1	0.984	-26.7
5. Debit Balances with branches in Iraq.	9.138	10.736	17.5	11.558	7.7	13.298	15.1	19.517	46.8
6. Debit Balances with licensed Banks in Iraq (Liquidation Accounts.	1.190	1.517	27.5	0.496	-227.0	0.495	-	3.152	536.8
7. Debit Balances Abroad.	1.011	0.968	-4.4	0.915	-5.5	0.653	-28.6	0.946	44.9
8. Government Departments Deposit -Current Accounts.	3.456	3.041	12	4.194	37.9	4.922	17.4	6.318	28.4
9. Government Department Deposit -Time Deposits.	10.140	8.437	-16.8	7.917	-6.2	8.875	12.1	10.917	23.0
10. Deposit against Guarantees and Credits.	8.652	6.499	-24.9	7.838	20.6	8.298	5.9	9.227	11.2
11. Current Accounts.	29.089	33.078	13.7	30.036	-9.2	28.959	-4.6	30.402	5.0
12. Saving Accounts.	16.876	19.866	17.7	21.841	-9.2	23.033	5.5	28.612	24.2
13. Time Deposits.	6.336	8.019	26.6	7.095	-11.5	7.094	-	7.370	3.9
14. Other Deposits.	1.700	1.453	-14.5	1.737	19.5	1.828	5.2	3.304	80.7
15. Other liabilities.	6.585	7.425	12.8	7.085	-4.6	9.634	36.0	9.699	1
16. As Per Contra	85.326	98.858	15.9	107.819	9.1	115.635	7.2	139.665	20.8
17. Total	193.758	215.761	11.4	225.568	4.5	239.982	6.4	287.388	19.7

(297)

ASSETS

	1961.	1962.		% of 1963.		% of 1964.		% of 1965		% of change
				change		change	change	change		
1. Notes and Coins in cash.	3,702	3,940	5,143	6.4	30.5	4,749	4,088	-7.7	-13.9	
2. Credit Balances with branches in Iraq.	8,728	11,009	11,003	26.1	-	12,525	20,023	13.8	59.9	
3. Credit Balances with licensed banks in Iraq.	1,533	1,646	0,956	7.4	-41.9	0,992	4,271	3.8	330.5	
4. Deposits with the Central Bank of Iraq.	12,971	11,721	11,653	9.6	-1	13,367	17,949	14.7	34.3	
5. Current Account (a)	8,534	7,849	8,598	-8	9.5	10,187	13,197	18.5	29.5	
6. Iraqi Treasury Bills (b)	2,220	1,677	1,061	-24.5	-36.7	1,330	1,250	25.4	-6.0	
7. Iraqi Government Bonds (c)	2,217	2,195	1,994	-1	-9.2	1,850	3,502	-7.3	89.3	
8. Deposits and Investment payable abroad.	12,292	11,997	12,932	-2.4	7.8	8,917	9,995	-31	12.1	
9. Government Investments and loans.	2,300	3,773	1,535	64.0	-59.3	4,413	15,806	187.5	258.2	
10. (a) Iraqi Treasury Bills.	1,700	2,450	0,200	44.1	-	-	-	-	-	
11. (b) Iraqi Government Bonds.	0,059	0,030	-	49.2	-	-	-	-	-	
12. (c) Other loans and advances extended to Government and semi-Government Departments.	0,541	1,293	1,335	139.0	3.2	4,413	15,806	230.6	25.8	
13. Discounted Bills.	20,514	28,861	24,800	16.3	3.9	25,784	21,987	4.0	-15.7	
14. Guaranteed Advances.	13,459	12,139	11,901	-9.8	-2	14,006	11,790	17.7	-15.8	
15. Non-Guaranteed Advances.	25,815	26,245	27,632	1.7	5.3	28,043	28,047	1.5	-	
16. Other Assets.	7,118	10,571	10,194	48.5	-3.6	11,551	13,667	13.3	18.3	
17. As Per Contra.	82,326	98,859	107,819	20	9.1	115,635	139,665	7.2	20.8	
18. Total	193,758	215,761	225,568	11.4	4.5	239,982	287,288	6.4	19.7	

Source: The C.B.I. Quarterly Bulletin, October - December 1963 (No.48) P.14 and April - June, 1966 (No.58) pp. 14-15.

Percentages were calculated by the writer.  
The percentage changes relate to the immediately preceding year.

Table No. (17)

## Foreign Assets and Gold for the Years

1960 - 1965.

(in thousands of Dinars)

	Dec. 1960	Dec. 1961	% of change	Dec. 1962	% of change	Dec. 1963.	% of change	Dec. 1964.	% of change	Dec. 1965	% of change
Foreign Assets	55.579	45.330	-18.4	32.352	28.6	68.697	112.3	47.702	-30.6	60.998	27.9
Gold	34.996	29.980	-16.9	34.924	16.8	34.924	-	39.927	-	43.520	9.0
Total	90.575	75.310	-16.9	67.276	-10.7	103.621	54.0	87.629	-15.4	104.518	19.3
Foreign Assets	15.284	11.282	-26.2	11.030	-2.2	12.017	8.9	8.264	-32.2	11.444	38.5
Commercial Banks	0.347	0.440	26.8	0.574	30.5	0.839	46.2	0.423	-49.6	0.112	-73.5
Total	15.631	11.722	-25	11.604	-1	12.856	10.8	8.687	-32.4	11.556	33.3
Foreign Assets	70.863	56.612	-20.0	43.382	-23.4	80.714	86.1	55.966	-30.7	72.442	29.4
Gold	35.345	30.420	-14	35.382	16.3	35.763	1.1	40.350	12.8	43.632	8.1
Total	106.206	87.032	-18.1	78.880	-9.4	116.477	47.7	96.316	-17.5	116.074	20.5

Source: The C.B.I. Quarterly Bulletins October - December 1963, P.10 and October - December 1965 P.10 (1965)

Percentages were calculated by the writer.

The percentage changes relate to the immediately preceding year.

Table No. (18)

Number and Value of Advances (in Iraqi dinars) granted by the Agricultural Bank for selected years.

Financial Year	Number of Cases	% of change	Total amounts in Dinars	% of change	average size of loans	Remarks
1936-1937 (1)	228	-	40,024	-	176	of which 55 transactions with collateral security totalling 14,890 Dinars.
1941-1942	310	36.0	40,850	2.1	132	
1946-1947	643	107.4	237,797	482.1	370	of which 29 transactions with collateral security totalling 2,570 Dinars.
1951-1952	789	22.7	263,693	10.9	334	including 61 transactions under Government guarantee totalling 15,178 Dinars to small exploiters.
1956-1957	1763	123.4	750,028	184.4	425	
1960-1961	2390	35.6	559,457	-25.4	234	

Source: Agricultural Bank of Iraq Annual Report, for 1959, 1960, and 1961, PP.13-14, English Section. Baghdad, 1961.

(1) At this time the Bank had twofold task, i.e. to give advances and loans to Agriculturists and Industrialists.

Table No. (19)

## Consolidated Statement of Specialised Banks

In thousands of Dinars.

At the end of December of each year.  
For the years 1961 - 1965.

Liabilities	1961	1962	% of change	1963	% of change	1964	% of change	1965	% of change
Paid-up Capital Reserves	24,093	25,040	3.9	30,677	22.5	31,945	4.1	33,078	3.5
Provisions for Income Tax and other provisions.	0.214	0.209	-2.3	0.213	2	0.211	1-	0.259	22.7
Account of Profit and Loss A/Cs.	1.137	1.278	12.4	1,307	10.2	1,426	9.1	1,358	4.8
Debit balances with Branches and Banks in Iraq.	0.123	0.163	32.5	0.209	28.2	41,045	1964	45,479	10.8
Debit Balances Abroad	-	-	-	-	-	-	-	-	-
Gov and Quasi-Gov Deposits.	7.129	8,577	20.3	9,161	6.8	10,346	13	13,081	25.6
Deposits against Guarantees and Credits	-	-	-	0.007	-	0.078	1014	0.102	30.8
Current and Saving Accounts	0.097	0.274	182.5	0.309	12.7	0.407	31.7	0.735	80.6
Time Deposits	0.007	0.057	714.3	0.072	26.3	0.107	48.7	0.176	64.5

Continued :

Liabilities	1961	1962	% of change	1963	% of change	1964	% of change	1965	% of change
Other Deposits	-	-		0.012	-	0.013	8.3	0.012	-8.3
Other liabilities	13.947	12.606	-9.6	9.415	-25.3	13.779	47.3	14.687	6.6
As Per Contra	-	0.729	-	0.333	-54.3	0.528	58.6	0.567	7.4
	46.747	48.933	4.7	51.715	5.7	99.885	93	109.534	9.7

Source: The Central Bank of Iraq, Quarterly Bulletin No. 47 1963, and No.59 1966 P.(16)

The percentage changes relate to the immediately preceding year.

Table No.(20)  
 The Loans Extended By Specialised Banks  
 for the period 1961-1966  
 In thousands of Iraqi Dinars (1)

	1961	1962	% of change	1963	% of change	1964	% of change	1965	% of change
Estate Bank	5.278	4.213	-21.2	6.097	44.7	9.049	48.4	9.998	10.5
Agricultural Bank	0.764	0.986	29.1	0.613	-37.8	1.336	117.9	0.878	-34.3
Industrial Bank	0.968	1.195	23.5	0.891	-26.4	0.909	2	0.796	-12.4
Mortgage Bank	8.058	8.692	7.9	8.832	1.6	9.784	10.8	10.548	7.8
Co-operative Bank	0.245	0.535	118.4	0.520	-2.8	0.520	-	1.277	145.6
Total	15.313	15.921	4.2	16.953	6.5	22.598	33.3	23.497	4

(1) Figures have been rounded, and percentages were calculated by the writer.

Source: The C.B.I. Quarterly Bulletins October - December 1963, and October to December 1965, Baghdad 1966 P.22 and 21 respectively.

The percentage changes relate to the immediately preceding year.



ASSETS AND LIABILITIES OF THE CENTRAL BANK OF IRAQ  
FOR THE YEARS 1962 - 1965  
(in '000 I.D.)

		Dec. 1962	Dec. 1963	% of change	Dec. 1964	% of change	Dec. 1965	% of change
Issue Department	Liabilities							
	Currency in circulation	83.760	101.461	21.1	103.520	1.9	116.694	12.7
	Cash in Bkg. Dept.	1.395	1.248	10.8	1.213	-3	—	—
	Total	85.155	102.709	20.6	104.733	2	116.694	11.5
	Assets							
	Foreign Assets	28.600	48.920	80	38.220	-22	38.193	—
	Gold Bullion	34.924	34.924	—	39.927	11.4	43.492	10.8
	Silver in Coins in Stock	0.265	0.252	-6	0.232	-8	0.191	-18
	Iraq Govt. (⌘) Securities	21.366	18.613	12.9	26.354	40	34.818	32
	Total	10.500	12.250	21.4	14.000	15	15.000	7
Banking Department	Liabilities							
	Reserve	1.692	1.692	—	1.692	—	1.692	—
	Current Accounts	30.704	27.447	10.6-	31.999	17	32.144	—
	Other Accounts	21.843	25.263	15.3	27.449	9	48.319	70.6
	Total	64.739	66.652	2.9	75.140	12.6	97.155	30
	Assets							
	Foreign Assets	3.752	19.777	530	9.482	-52	0.794	-92
	Iraq Govt. Bonds	10.601	—	—	4.963	—	19.131	400
	Loans and Advances	27.060	24.478	10-	35.305	40	42.950	21.6
	Cash in Bkg. Dept.	1.395	1.248	11-	1.213	-3	—	—
Re-Discounts of Advances	2.188	3.359	53	4.371	30	1.833	-56	
Total	19.743	17.790	10-	20.806	—	32.447	56	

(⌘) Comprises Iraqi Government Bonds and Iraqi Treasury Bills.

Source: The Central Bank of Iraq Quarterly Bulletin No.50 1964 P.9 and No.59 1966 P.9

The percentage changes relate to the immediately preceding year.

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