Central Banking

Courtesy: *Mohd. Ovais (the original author), Tabani School of Accountancy*

1. THE CENTRAL BANKING

1.1 Acts on behalf of the government to supervise, regulate and control the country's banking system. A nationalised corporation run by a board of directions, governor, deputy governor, and some executive directors and part-time directors.

(a) banker to the central government and holds the 'public deposits'. Deposit include the national loans fund, the consolidated fund and the account of the paymaster general

(b) central note-issuing authority in Pakistan.

(c) manager of the national debt i.e. it deals with long-term and short-term borrowing by the central government

(d) the manager of the exchange equalisation account

(e) acts are agent for the government in carrying

(f) supervisor of the banking

(g) informal supervisor of other financial such as the Stock Exchange.

(h) Banker to the commercial banks.

(i) As a lender to the banking system State Bank of Pakistan will provide the money that banks need

The bank as manager of the exchange equilisation account

1.3 the deposits of a country's gold and foreign currency reserves. Used to influence the exchange rate

The bank as supervisor of the banking system

1.4 has the responsibility under the Banking Act for

The bank as lender of last resort to the commercial banking system

1.5 State Bank of Pakistan lends money to the banking system.

(a) supply cash to the banking system, does this by buying eligible bills from the discount houses exchange for 'cash' bills (i.e. debt instruments)

(b) bank will remove excess cash from does this by selling bills to the discount, discount houses obtain interest-bearing bills in place.

Process known as open market operations describes the buying and selling of eligible bills between

Open market operations and short-term interest rates

1.6 Open market operations provide a method of control over short-term interest rates.

1.7 Are traded at a discount to their face value, Interest rates on bills, have an immediate influence on other money.

1.8 If interest rates in the discount market's open market operations went up, soon be an increase in other money market rates, and then the banks', lending rates on bank loans.

1.9 Open market operations are an important feature of the government's monetary policy.

The independence of action of the bank

An adviser to the government, not an agent of the government.

2. STATE BANK OF PAKISTAN (SBP)

2.1 have an independent currency and banking system. Decided with India that the Reserve Bank of India would continue to act as the central bank and as currency authority for Pakistan, by order called "Monetary System and Reserve Bank Order 1947".

(a) the sole not issuing authority in Pakistan
(b) Indian notes will remain legal tender in both Pakistan and India until 30th September, 1948.
(c) Bank of India would transfer the assets of value equal to Pakistani notes to the Government of Pakistan after 30th September, 1948.
(d) Government of Pakistan would also issue coins in the country after 30th September, 1948.
(e) Reserve Bank of India would perform the full functions

Establishment of State Bank of Pakistan

2.2 Reserve Bank of India showed reluctance in solving the banking crises. Refusing to give Rs.55 crore which Pakistan was entitled to share

2.3 The Reserve Bank of India was relieved, the first day of July, 1948, the bank is entrusted with the duty of "regulating the issue of bank notes and keeping of reserve with a view to seeking monetary stability in Pakistan and generally to cooperate the currency and credit system of the country to its advantage, State Bank of Pakistan Act, 1956, “regulate the monetary and credit system of Pakistan and to foster its growth in the best national interest with a view to securing stability fully and utilisation of the country’s productive resources.

Share capital

2.4 Original share capital, three crore of rupees divided into three lac, 51% was contributed by the Central Government and the balance 49% subscribed by the private sector. Upto 31st December 1973, the State Bank was a government-cum-shareholders bank in terms of its original statute. Nationalisation Ordinance, 1974, the State Bank has been a purely government-owned institution. The private shareholders are compensated by the federal government through endowment of negotiable bonds repayable at par at any

Constitution

2.5 Not guided by profit motive in its operation. Foster its growth in the best national interest with a view to securing monetary stability and fuller utilisation.

2.6 Consists of one governor, one more deputy governor and nine directors. Executive committee, empowered to transact business on behalf of the central board of directions. chief executive, governor who controls and directors the affairs of the bank on behalf, has 14 departments, over 5000 persons.

(a) Accounts Department
(b) Administration Department
(c) Agricultural Credit Department
(d) Audit Department
(e) Bank Control Department
(f) Bank Inspection Department
(g) Engineering Department
(h) Exchange Control Department
(i) Legal Division
(j) Public Relations Department
(k) Research Department
(l) Security’s Department
(m) Statistics Department, and
(n) Training Department.

The functions of the various departments of the central directorate are briefly described below.

3. FUNCTIONS OF STATE BANK OF PAKISTAN

3.1 business and functions, governed by State Bank of Pakistan Act, 1956 and Banking Company’s Ordinance, 1962, operates through two separate departments:

(a) issue department; and
(b) banking departments.

3.2 issue department issue of notes in the country. Banking Department is concerned with the carrying on and transacting banking business.

(a) State Bank as a bank of issue, has the sole right to issue notes except one rupees note and subsidiary coins which are issued by the government. The hank adopted the proportional reserve system for the issue of notes. Currency backing by gold bullion, foreign securities is now fixed at Rs.1200 million through an Ordinance in December, 1965. System of note is known as minimum reserve system. Size of notes issue reflects the public demand for money. Assets of the Issue Department are always equal to liabilities.

(b) Banker to the government. Acts as a banker to the government, balances of the central and provincial governments are deposited with the State Bank does not pay interest on them. The bank administers exchange control on behalf of the government. It carries out exchange, remittances and other banking operations including the management of public debt. Floats new loans on behalf of the central.

(c) Custodian of the cash reserves of the commercial banks in Pakistan. All the scheduled banks are required to maintain with the State Bank of Pakistan at least 5% balance of the replenishes the commercial banks stocks of cash when they are running low.

(d) State Bank as a clearing house. The clearing house is a place where the representatives of commercial banks meet each day to exchange cheques drawn on each other and then settles the differences owed to each other .

(e) Advisor to government. Since, the bank is deeply involved in the money and foreign exchange, its therefore, tender advice on financial and economic matters to the government. It also provides advice to commercial banks State Bank has a direct link with international bodies like IMR, IBRD etc.

(f) State Bank as a lender of last resort. Commercial banks are short of cash reserves due to large debt balances in the inter-bank. It provides cash to the commercial banks by rediscounting bills of exchange, treasury bills and other gilt edged securities.

(g) State Bank as a controller of credit.
   (i) Has wide power to use the instruments of credit control for influencing the aggregate spending, the inflation rate and the balance of payments in the country.

(ii) Uses to tools of open market operations, discount rate and the percentage reserve requirements other minor tools such as issuing directives to restrict bank advances regulating credit in the country.

(h) State Bank and economic growth, playing a significant role in facilitating and fostering economic development and growth of the banking, promotional activities of the bank.

(i) The development of the capital market in the country

(ii) Under the State Bank's Export Finance, provide finance to the exporters at the concessional

(iii) Helped in the establishment of specialised credit institutions for meeting the medium and long-term, IDBP, ADBT, NIT, EPF, (Equity Participation Fund) NDFC, HBFC, ICP

5. CLEARANCE HOUSE

5.1 Association of commercial banks, purpose of interchange and settlement of credit claims. National Bank of Pakistan, as a representative, Pakistan, acts as a clearing house.

5.2 Cheque, as we know, is an effective method of making payments. When cheques are draw on one bank and the holder (payee) deposits the same in his account at the bank of drawer, the mutual obligations are settled by the internal bank administration and there arises no interbank debits from the use of cheques. The total assets and total liabilities of the bank remain unchanged.

5.3 In practice, the person receiving a cheque is rarely a depositor of the cheque at the same bank as the drawer. He deposits the cheque with his bank (other than of the payer) for the collection of the amount. Now, the bank in which the cheque has been deposited becomes a creditor of the drawer's bank. The debtors bank will pay his amount of the cheque by transferring it from cash reserves if there are no offsetting transactions. In the course of everyday life, there are large number of cheques drawn on a bank deposited in other banks. The banks on which the cheques are drawn become in debt to the banks in which the cheques are deposited.

4.5 This facility of net interbank payments is provided by the clearing house.

4.6 Local commercial banks meet at a fixed time on all, meeting is held in the office of the bank which, cheques payable at other local banks and receive the cheques drawn, A summary sheet is prepared which shows the names of the difference between the totals represents the amount to be paid by particular bank and the amount, The net payments are made issuing a credit voucher on

4.7 The working of clearing house is now explained with the help of an example. Let us assume there are five banks in city and at the end of days operation, the following payments are due to the banks from each other:

Cheques drawn on Package of contents	**Bank A**	**Bank B**	**Bank C**	**Bank D**	**Bank E**	**Total**
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Bank A	-	14,000	20,000	14,000	8,000	56,000
Bank B	10,000	-	12,000	10,000	16,000	48,000
Bank C	6,000	10,000	-	6,000	4,000	26,000
Bank D	4,000	16,000	16,000	-	12,000	48,000
Bank E	8,000	12,000	8,000	18,000	-	46,000
Total	28,000	52,000	56,000	48,000	40,000	224,000

4.8 For clear understanding the table is summarised below:

Banks	**Cheque Received (Debit)**	**Cheque Brought (Credit)**	**Debit Balance**	**Credit Balance**
Bank A	28,000	56,000	-	28,000
Bank B	52,000	48,000	4,000	-
Bank C	56,000	26,000	30,000	-
Bank D	48,000	48,000	-	-
Bank E	40,000	46,000	-	6,000
Total	224,000	224,000	34,000	34,000

4.9 From the above table it is clear that Bank B and C are to pay debit balances of Rs.4,000 and 30,000 respectively (Total: Rs.34,000). Bank A and E are entitled to receive their credit balances of Rs.28,000 and 6,000 respectively (Rs.34,000 in total). Bank D's credit and debit balances are equal. Hence, cheques worth Rs.224,000 are cleared by a more payment of Rs.34,000. The clearing house thus helps in saving a lot of cash reserves and transactions, reduces the number of entries made in the registers and eliminates the unnecessary task of carrying the cheque packages from one bank to another bank.

Merits of clearing houses

4.10 The main advantages of clearing house are as under:-

(a) Settlement of mutual obligations of commercial banks

(b) House provides an opportunity to the commercial, off inter bank debits without making payments in cash

(c) The central bank keeping the cash reserves of the banks

(d) House provides an opportunity to promote the interest of the member banks.

(e) Can also prove an effective device for preventing, competition

(f) Financial stress, the member banks can assist.

5. STATE BANK OF PAKISTAN AS CONTROLLER OF CREDIT

Objectives of credit control

5.1 State Bank of Pakistan Act, 1956 gives special powers to the State Bank to regulate, credit policy pursued, State Bank aims at channelising funds of the commercial banks to productive sectors of the country. It discourages the use of bank loans for non-productive purposes so as to achieve prosperity, stability and the growth of domestic economy. The long term objectives of the credit policy of the State Bank, however, is the promotion of high and stable level of employment in the country.

Instruments of credit control

5.2 main instruments of credit policy applied by the State Bank of Pakistan are now discussed in brief.

Quantitative control

Bank rate

5.3 Bank rate is also called the discount rate. Is the official rate at which the State Bank rediscounts the first class securities at its counter. The bank rate is raised followed by an increase in the discount rate of commercial banks. Discourage in the country and it eventually, bank rate has the opposite effect.

5.4 now charging 10% on rediscounting the first class bills of exchange.
the discount rate has not proved to be an effective instrument of credit
as the bill market is not very organized and soundly
rate weapon is now replaced by the power for the bank to fix its profit sharing ratio in respect of its own financial assistance.

Open market operations

5.5 meant the sale and purchase of government securities in the open market by the central bank of the country. The sale of securities leads to contraction of credit and the purchase, therefore, to the expansion of credit.

5.6 Has been using this weapon to regulate the flow of the credit in the country.

(a) money market is not responsive in Pakistan;
(b) the commercial banks are carrying excess reserves the themselves; and

(c) the marketable securities are inadequate.

Variable reserve requirements

5.7 Effective weapon of credit control of the central bank of a country.
Section 36 of the Act, requires the scheduled banks to maintain at least 5% of demand and time liabilities with it, the power to change the minimum reserve rests with the State Bank.

5.8 The instrument of variable reserve ratio, is used for affecting the liquidity position of the banks and hence their ability to finance. When the reserve requirements are raised by the central bank, thus restricts and expansion of credit in the country. Central bank lowers the reserve ratio. The commercial banks are also required to maintain 25% liquidity ratio on a day to day basis against their time an demand liabilities.

Credit rationing

5.9 Empowered to place limits on the amount available for each application of loan.

Credit target

5.10 Pakistan has set up National Credit Consultative Council (NCCC) in 1974. The functions of NCCC is to examine overall credit situation in the country and indicate the credit limits for the public and private enterprises. The State Bank of Pakistan sets specific target of funds to be given to agriculture business industry and low cost housing by the commercial banks. If the commercial banks fail to achieve the ceilings, it imposes penalty on them. The defaulting commercial banks shall have to make interest free loan to the State Bank of the amount falling short of the target.

Qualitative controls

Moral persuasion

5.11 Banks are advancing funds for speculative or non-essential, State Bank can persuade and directly appeal to them to follow.

Direct action

5.12 If the commercial banks do not act upon the credit policy of the State Bank, the State Bank is empowered to take action against them.

5.13 Moeen Qureshi made the State Bank of Pakistan an autonomous central bank. Set and implement standards for commercial banks lending view independently.

Prudential controls

Introduction

5.14 With a view to provide for a continued health and viability of financial system, the Prudential Regulations (PR) have been issued in the following areas:

(a) PR issued by State Bank of Pakistan

(i) Corporate and Commercial Banking
(ii) Small and Medium Enterprises financing
(iii) Customer financing

(b) PR issued by Security and Exchange Commission of Pakistan

(i) Non banking finance companies
(ii) Modarabas.

PR for corporate and commercial banking

5.15 These regulations are divided into following categories:

(i) Risk management
(ii) Corporate Governance
(iii) Know your customer & and anti-money laundering
(iv) Operations.

5.16 A brief of the regulations dealing with credit control is as follows.

(a) Regulation R-1
Limited on exposure to a single person: any single person shall not at any point in time exceed 30% of the bank's / DFI's equity, to the condition that the maximum outstanding against fund based exposure does not exceed 20% of the bank's

(b) Regulation R-2
Limit on exposure against contingent liabilities: exceed at any point in time 10 times of its equity.

(c) Regulation R-3
Minimum conditions for taking exposure: give due weightage to the credit report relating to the borrower and his group obtained from Credit statements duly audited by a chartered accountant.

(d) Regulation R-4
Limit on exposure against unsecured financing facilities:
unsecured / clean financing facility in any form of a sum exceeding Rs.500,000/- (Rupees five hundred thousand only) to any one person.

(e) Regulation R-5

Linkage between financial indicators of the borrower and total exposure from financial institutions.

(i) the total exposure (fund-based and / or non-fund based) availed by any borrower from financial institutions does not exceed 10 times of borrower's equity.

(ii) the time of allowing fresh exposure / enhancement / renewal, the current assets to current liabilities ration of the borrower shall not be lower then 1:1.

(f) Regulation R-6

Exposure against shares / tfcs and acquisition of shares

(i) (1) Exposure against shares / TFCS: Banks / DFIs shall not take exposure.

(ii) (2) Acquisition of shares: scripts in excess of 5% of their own equity own equity investment of banks in shares should not exceed 20% of their own equity.

(g) **Regulation** R-7

Guarantees: All guarantees issued by the banks / DFIs shall be fully secured, except in the cases such as bid bonds, performance bonds and guarantees.

(h) Regulation R-9

Assuming obligations on behalf of NBFCS DFIs shall not issued by guarantee or letter of comfort nor assume any obligation whatsoever in respect of deposits, sale of investment certificates, issued of commercial papers, or borrowings of any non-banking finance company.

(i) Regulation R-10

Facilities to private limited company: DFIs shall formulate a policy, duly approved by their Board of Directors, about obtaining personal guarantees of directors of private limited companies.

(j) Regulation R-12

Monitoring: Statements from borrowers that contain a bank-wise.

PR for small medium enterprises financing (SMEs)

5.17 Risk management category (R). For the remaining three categories [i.e. Corporate Governance (G), Anti Money Laundering (M) and Operations (O)]

Prudential Regulations for SMEs Financing, SME means an entity, ideally not a public limited company, which does not employ more than 250 persons 50 persons

(a) A trading/service concern with total assets at cost excluding land and building upto Rs.50 million.
(b) A manufacturing concern with total assets at cost excluding land an building upto Rs.100 million.
(c) Any concern (trading, service or manufacturing) with net sales not exceeding Rs.300 million as per latest financial statements.

An individual, if he or she meets the above criteria, can also be categorized as an SME.

5.18 A brief of the regulations dealing with credit control is an follows:

(a) Regulation R-1

Source and capacity of repayment and cash flow backed lending to the identified.

(b) Regulation R-2

Personal guarantees: All facilities except those secured against liquid assets, extended to SMEs shall be backed by the personal guarantees of the owners of the SMEs.

(c) Regulations R-3

Limited on clean facilities secured solely against personal guarantees, on a SME up to Rs.3 million provided that funded exposure should not exceed Rs.2 million.

(d) Regulation R-4

Securities: Relaxation in Regulation R-3, for facilities upto Rs.3 million, all facilities over and above this limit shall be appropriately secured as per satisfaction of the banks/DFIs.

(e) Regulation R-5

Margin requirements: Banks/DFIs are free to determine the margin requirements on facilities provided by them to their clients taking into account the risk profile of the borrower(s) in order to secure their interests.

(f) Regulation R-6

Per party exposure limit: The maximum exposure of a bank / DFI on a single SME shall not exceed Rs.75 million.

(g) Regulation R-7

Aggregate exposure of a bank / DFI on SME sector shall not exceed the prescribed limits.

(h) Regulation R-8

Minimum conditions for taking exposure: DFI should give due weightage to the credit report relating to the borrower and his group.

(i) Regulation R-9

Proper utilization of loan: The loans have been properly utilized by the SMEs and for the same, acquired / obtained.

(j) Regulation R-10

Restriction on facilities to related parties: On a SME in which any of its director, major shareholder holding, any family member of these persons is interested.

PR for Consumer Financing

5.19 Financing allowed to, personal, family or household needs.

(i) Credit Card mean cards, which allow a customer to make payments on credit. Supplementary credit cards shall be considered part of the principal borrower. Corporate Card will not fall under this category and shall be regulated by Prudential Regulations for credit cards shall also be applicable on charge cards, value cards and BTF (Balance Transfer Facility).

(ii) Auto loans mean the loans to purchase the vehicle for personal use.

(iii) Means loan provided to individual for the

(iv) Personal loans mean the loans to individuals for the payment
Running Finance / Revolving Credit to individuals.

That any financing facility, other than SMEs Financing, above, shall be governed by the Prudential.

5.19 These are divided into following categories.

(a) Regulations (general concept)
(b) Regulations for credit cards
(c) Regulations for auto loans
(d) Regulations for housing finance
(e) Regulation for personal loan including loan for the purchase of consumer durables.

5.20 A brief of the regulations dealing with credit control is as under:

(a) Regulation R-1

Extended by banks/DFIs to their directors, major shareholders, employees
persons shall be at arms length basis and on normal terms.

(b) Regulation R-2

The prescribed limit on exposure against total consumer financing shall not be exceed.

(c) Regulation R-3

Total financing facilities to be commensurate with the income.

(d) Regulation R-4

General reserve against consumer finance: General reserve at least equivalent to 1.5% of the consumer portfolio which is fully secured and 5% of the consumer portfolio which is unsecured.

(e) Regulation R-5

Bar on transfer of facilities from one category to another to avoid classification: transfer any loan or facility to be classified

(f) Regulation R-6

Margin requirements: Determine the margin requirements on consumer facilities provided by them to their clients taking

PR for non banking financing companies (NBFCs)

5.22 Non Banking Financial Institutions (NBFIs), Companies (NBFCs) and are being regulated, November 15, 2002, information, returns and statements to SECP and Credit Information Bureau, in the same manner.

5.23 Part II of these rules applies to borrowing facilities for (a) corporate borrowers.

5.24 A brief of the conditions is as follows:

(a) Limit on NBFC's exposure to a single person: NBFC to any single person shall not at any point in time exceed 30%, Exceed 20% of the NBFC equity.

(b) Minimum conditions for grant of financing facilities.

(i) Fund/non-fund based facility exceeding, Information Bureau of the State Bank of Pakistan. If the credit report indicates.

(ii) Obtain copy of accounts relating to the business of each.

(iii) Ensure that the Loan Application Form prescribed/devised by a modaraba is accompanied, "Borrower's Basic Fact Sheet'.

(c) Borrower's equity and total exposure from financial institutions: Borrower from institutions does not exceed 10 times.

(d) Financial indicators of the borrowers: Debt-equity ratio of the borrower current liabilities ratio is not lower than 1:1.

(e) Margin against facilities: Minimum margins shall be maintained against various facilities and all guarantees will be backed by 100% realizable securities.

(f) Facilities against Shares / TFC's and acquisition of share: NBFC shall not take exposure against the security of shares / TFCs issued by them.

PR for Modarabas

5.25 Part II of these rules applies to borrowing facilities for (a) corporate borrowers an (b) individual borrowers.

5.26 A brief of the conditions is as follows:

(a) Limit on modaraba's exposure to a person: Point in time exceed 30% of the modaraba's equity, exceed 20% of the modaraba's equity.

(b) Minimum conditions for grant of financing facilities

(i) To give due weightage to credit report relating to the borrower and his group obtained from Credit Information Bureau of the State Bank of Pakistan.

(ii) While granting any facility to the customers other than individuals, modaraba shall obtain copy of accounts relating to the business of each of its borrower for analysis and record.

(c) Linkage between a borrower's equity and total exposure, moderabas shall ensure that the total exposure availed by any borrower from financial institutions does not exceed 10 times of borrower's equity as disclosed in its financial statements.

(d) Financial indicators of the borrowers: equity ration of the borrower does not exceed 60:40 and current assets to current liabilities ratio is not lower than 1:1

(e) Margin against facilities: Margins shall be maintained against various facilities and all guarantees will be backed by 100% realizable securities:

(f) Facilities against Shares / TFCs and acquisition of shares: Modarabas shall not take exposure against the security of shares /TFC issued by them.

(g) Regulations for Housing Finance for individuals

(i) The maximum per party limit in respect of housing finance by the modarabas will be Rs.7.5 million.

(ii) Modarabas are free to extend mortgage loans for housing, for a period not exceeding twenty years. Modarabas should be mindful of their adequate asset liability matching.

(iii) The house financed by the moderabas shall be mortgated in modaraba's favour by way of equitable or registered mortgage.

(iv) Modarabas shall either engage professional expertise or arrange sufficient training for their concerned officials to evaluate the property, assess the genuineness and integrity of the title document, etc.

(v) The housing finance facility shall be provided at a maximum Loan to Value ratio of 85:100 (85%)

(vi) The housing finance facility shall be provided at a maximum of Income to installment ratio of 3:1.

6. CENTRAL BANK AS THE GOVERNMENT'S BANKER

6.1 Central bank in each country, has now been assigned the responsibility of acting as fiscal agent to the government. Previously, this duty was performed by a large number of government treasuries spread all over the country. The services performed by treasuries for receiving, holding and disbursing of government funds were dissatisfactory. The treasury office established at different places were expensive to operate. The net movement of coins and paper money into and out of the treasury were also risky. It was, therefore, decided that the central bank should be given the privilege and also the responsibility to deposit free of interest all the cash balances of the government and in lieu therefore perform some fiscal functions for the government. These functions in brief are as under:

(a) Central Bank as government's banker. The central bank acts as a banker to the government. It deposits free of interest all the cash balances of the government. In return, it performs all the services which a commercial bank ordinarily does for its customers. It receive on deposits, income taxes, customers and other internal revenues taxes. It also undertakes the work of collection of cheques and drafts drawn on other banks and provides cash to the government. The bank pays salaries, pensions, reliefs, public works, etc., on behalf of the government. It transfers funds from one part of the country to another or from one account to another for the government. The central bank grants short-term loans to the government against government securities. In time of emergencies like war or depression, it makes extraordinary advances to the government. The bank charges no commission from the government for all these banking services rendered by it.

(b) Bank as agent of the government. The central bank acts as agent of the government. It is entrusted with the issued of new loans and treasury bills on behalf of the government. It pays interest on the public debt and redeems maturing securities. It also underwrites securities of the government. The central bank also acts as agent in gold and foreign exchange transactions for the treasury. It also buys and sells foreign exchange on its own account and as agent for the treasury. It services as depository of IMF and IBRD.

(c) Bank as a financial advisor. The central bank performs a very important function by acting as financial advisor to the government. Though the government has its own staff for giving advice on matters of economic policy, yet it obtains advice from the central banks also. The central bank is constantly in touch with the money, securities and foreign exchange market conditions in the country. It, therefore, gives advice to the government in its debt management, foreign exchange transactions, deficit financing, devaluation of the currency, trade policies, mobilisation of savings, agricultural and industrial credit, etc. The central bank also acts as fiscal agent for various agencies and corporation established by the government.

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

7.1 The role of the State Bank of Pakistan is not confined now to the regulation of overall supply of credit in the country. Its aim is to create a machinery which helps in mobilising domestic resources. These resources are directed into productive channels, helping in the establishment of specialised financial institutions for carrying out development programmes in various sectors of the economy, holding the price line, increasing employment and maintaining equilibrium in the balance of payments. The role of State Bank of Pakistan is, therefore, promotional and developmental. The State Bank of Pakistan since its establishment in July, 1948 has taken the following measures for promoting economic development in the country.

(a) Growth of banking system. At the time of partition, there were only two Muslim scheduled banks, Habib Bank Limited, and Australia Bank operating in Pakistan. The State Bank immediately after its establishment in 1948, took up the herculean task in building up a sound banking system in the country. The start was made with the establishment of National Bank of Pakistan in 1949. Since then the total number of domestic commercial banks and foreign banks have increased to 25 and 19 with 8326 and 74 braches respectively in operation in the country. These banks are paying a prominent role in the mobilisation of saving in rural and urban areas an disbursing credit for promoting developing in the country.

(b) Assistance to specialised financial institutions. The State Bank of Pakistan is providing assistance to specialised financial institutions for enabling them to extend adequate finance to different sectors of economy. The loans are given to Agricultural Development Bank of Pakistan (ADBP) for financing seasonal agricultural operations and for development of agriculture. The House Building Finance Corporation (HBFC), Industrial Development Bank of Pakistan (IDBP), National Development Finance Corporation (NDFC), Investment Corporation of Pakistan (ICP) and Federal Bank of Cooperative also get financial assistance from SBP.

(c) Monetary and credit policy. The bank is pursuing a monetary policy which aims at:

(i) checking inflationary pressure; and
(ii) ensuring adequate availability of bank finance for productive activities in general and the priority sectors in particular.

(d) Export finance scheme. Under the State Bank Finance Scheme, the banks are providing finance to the exports at the concessional rates. The refinance, in turn, is provided by the State Bank at low rate of interest.

(e) Credit targets for priority sectors. The State Bank gave targets to commercial banks for providing small loans in the fields of business, industry, agriculture, housing every year. The prescribing of credit target for priority sectors have greatly helped in raising production.

(f) Islamisation of financial system. As a part of the government policy, the State Bank of Pakistan has prepared and implemented a programme of Islamic modes of financing, from July 1, 1985. All financing and loaning operations of the banks conform to the Islamic system. The non-bank financial institutions like the ICP, NIT, SBFC, BEL (Banker Equity Limited) have also converted to entire investment operations on an interest free basis.

(g) Establishment of banking publicity board. The State Bank Limited to set up Banking Publicity Board in 1959 for developing banking habit among the people and for mobilisation of savings in the length and breadth of the country.

(h) Managed float. The SBP fixes the Pakistan's rupee exchange parity against the basket of currencies. Pakistani rupee has been made fully convertible on current account from July, 1994.

(i) Training scheme. The State Bank started a training scheme for imparting banking knowledge to the persons working in the banks and to those who are to join banks as their profession. The training scheme was a success and it produced a large number of trained bankers of financial experts for the various banking concerns.

(j) State Bank and autonomy. The State Bank now regulates 137 financial institutions in the country the breakup of which is as follows:

Domestic Banks	25
Foreign Banks	19

Modaraba Companies	52
Leasing Companies	29
Investment Banks	12
Total	137

The SBP should have constitutional powers to dictate monetary policy. It should be an independent institutions offering expert counsel with powers to implement them.

7.2 Those who oppose this view are of the opinion that ultimate decision-making powers for guiding and managing the economy should rest with the democratic government of the country. It is correct that the ultimate decision making power should be government of the country but the policies which shape the level of inflation and interest rate should lie with the central bank. If the central bank's autonomy is chipped away, then the demand for budgetary support to centre and provinces will continue rising leading to inflationary pressure in the country.

Courtesy: *Mohd. Ovais, Tabani School of Accountancy*