

ABSTRACTS

The following abstracts are short synopses of articles appearing in the Arabic part of the Review. They are summarized here for the benefit of those who cannot read Arabic. In a like manner, each major English or French article is presented as a short résumé in the Arabic section.

MONETARY POLICY AND ITS APPLICATION IN THE LIBYAN ARAB REPUBLIC

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Summary :

Monetary policy was defined as the way or method through which both the quantity of money in the society and the cost of loans could be changed. It is, therefore, a way of changing the level of expenditure. Monetary policy was also defined as the policy which helps the economy of the country to reach total output with full employment and without inflation. Monetary policy is one of the means of economic policy. The latter has instruments, policies or means which it uses in order to reach its aims. For instance, it uses financial means such as deficit or surplus financing ; or it uses monetary methods such as Bank rate ; or it uses other ways such as changing the economic structure of the country. Economists, therefore, mean by monetary policy, changes in both quantity and value of money. These changes affect the level of production which in turn affects employment. As a result, the purchasing power increases or decreases and prices and demand go up or down.

Central Banks were responsible in the past for monetary policy but since the second World War, many Governments have accepted the responsibility of full employment and taken great interest in monetary policy.

Monetary authorities now choose either an expansionist policy or a restrictionist one. Through the first, prices increase (value of money

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decreases) in order to put life into production, especially if the purchasing power is insufficient to lead to full employment. Some countries applied the expansionist policy but unfortunately it led to inflation without full employment. The second policy (reconstructionist) goes against inflation and high prices. Britain, in 1945 reached that state of affairs, i.e. demand for labour was higher than supply and the result was "over-full employment". Since then Britain applied deflationary credit until it went on occasions away from full-employment and some economists started to talk about "Credit squeeze", which was adopted as a policy whenever there was a deficit in the Balance of payments.

Monetary policy went through several phases :

- (a) First World War : Before that war, economic stabilization was reached through monetary policy. As a result of the great depression, cheap money was used as well as Bank rate, open market operations and changes in reserve requirements. During this phase, financial policy stood on a higher pedestal.
- (b) Second World War : Cheap money was again used with Bank credit to finance the War. Inflation was fought with methods other than monetary.
- (c) After World War II : Cheap money was still in use. During the fifties, some countries returned to monetary policy, others had their doubts about it. However, some countries used elastic monetary policy in order to fight inflation which was caused mainly by :
 - 1. Heavy expenditure to finance the War.
 - 2. Huge losses which required reconstruction.
 - 3. The Korean war, which put heavy burdens on many countries.
 - 4. Huge capital expenditure on social services.

All this enormous expenditure caused money supply to increase proportionately more than the increase in production. The result was

bigger nominal incomes.

(d) The recent revival of monetary policy : Monetary authorities neglected monetary policy and replaced it by financial policy until the fifties. They could not raise Bank rate because they feared a fall in Government Bonds. Banks had already bought huge amounts and would have incurred a heavy loss. In the meantime financial policy suffered from two difficulties :

1. The Budget was presented for one year and it was difficult to change it.
2. The Budget surplus was doomed to be spent because Governments promised their peoples many services.

Therefore, time came for the authorities to return to the instruments of monetary policy, together with financial and commercial policies.

The aims of monetary policy were summarised as follows :

1. Optimum production
2. Full employment
3. Stabilization of prices. New instruments (*) were used such as rationing of credit, direct action and a secondary reserve.

Monetary theory suffered from the following limitations :

1. Difficulties in expansion and contraction :

The Central Bank may aim at deflation through tight money but the banks may sell their Government Bonds ; thus making the Central Bank's policy ineffective.

2. Changes in velocity of circulation :

During inflation, monetary authorities try to reduce the amount of money in circulation but velocity of circulation may increase because of the optimistic outlook of businessmen.

(*) Ordinary instruments included : Bank rate policy, open market operations, moral suasion, eligibility requirements, changes in reserve requirements and supervision.

3. Contradiction of Aims :

The Central Bank may want to increase the Bank rate but the Minister of the Treasury may object because of fear of a decrease in the price of old Govt. Bonds and the necessity of raising the interest on the new Govt. Bonds. (1% per annum cost U.S.A. Govt. 3 billion dollars a year).

4. Control of expenditure and not demand only :

Monetary authorities tried to control inflation through correcting "Demand-pull inflation". They should also have taken into consideration "Cost-push inflation".

5. Investment and Monetary policy :

It is doubtful whether monetary policy could limit investment at the time of high prices. Rate of interest is one determinant of investment. Businessmen may still invest according to their optimistic outlook or technological changes.

Monetary Policy had some subordinate factors :

1. Physical controls.
2. Fiscal policy.
3. Hire purchase.
4. Extra deposits with Central Bank.

Because fiscal policy is one of the instruments of economic policy, it is important to refer now to what it involves :

- (a) Balanced Budget.
- (b) Deficit financing.
- (c) Surplus financing.

From the theoretical study, the result is that both monetary and fiscal policies should cooperate with each other. Monetary weapons and fiscal instruments (such as automatic stabilizers) should be used.

As for the L.A.R., it is of great importance for any nation forming its monetary policy, to decide upon :

1. Choosing its aims.
2. Applying and developing the monetary instruments.
3. Relying upon a theory in order to discover the different economic effects.

The study of the supply of money was the first thing for the L.A.R. to do. Every local or international report has mentioned the enormous increase in the supply of money during the last ten years and it looked as if the Central Bank was to blame. From Dec. 1960 to Dec. 70, the supply of money increased from 22 million Libyan Dinars to L.D. 236 millions.

The I.M.F.'s mission observed on 26.6.1968 that the increase of the supply of money was L.D. 33% per annum (between 1965-67), a matter which caused prices to rise. The I.B.'s mission in 1978 found that the supply of resources had increased between 1963 and 1968, by 21% only. Their conclusion was that the supply of money was the main source or reason of inflation. From the Central Bank's reports, we found that the increase in the supply of money (between 1963-67) was 260% whereas that of total expenditure (at current prices) was 118%. It was also proved that the increase of the supply of money was proportionately higher than that of national income although imports were free and restrictions and monetary instruments were both by the Central Bank in order to fight inflationary pressures.

From all the central Bank's reports between 1964 and 1969/70, one notices the lengthy selfdefense put every year by the Bank. The reasons it put forward could be summarised as follows :

- (a) The increase of net foreign assets from the transfers of petroleum companies.
- (b) Limitations and difficulties of monetary policy.
- (c) Increase of both credit and liquidity in commercial banks.
- (d) Monetary policy alone could not improve the situation.
- (e) The rise of prices of goods and services.
- (f) The rise of house rents.

- (g) Maldistribution of labour power and its unproductive employment.
- (h) Increase of Government expenditure.
- (i) The new phenomenon of hoarding by the public.

Although we agree that the Bank of Libya has made terrific efforts and has tried to fight inflation since 1966, yet we should like to put forward the following reservations :

1. It had almost no say before but after the Libyanisation of Banks and the nationalisation of the foreign shares, it had the first word.
2. The Governments in the past did not cooperate with it but the present Government is cooperating to a great extent.
3. House rents were decreased by the revolution.
4. As an economic counsellor to the Govt., the Bank of Libya should now advise it as how to distribute labour power and how to decrease its expenditure.
5. The Bank can choose now its monetary weapons. It has become the real planner and leader. Commercial Banks never used to borrow from it but recently (30.6.70) they borrowed L.D. 2.8. million.

In many of its reports, the Bank of Libya noticed and warned about the increase of credit to the private sector. This made us think about any correlation between private investment and national income. After a long study we came to the conclusion that a small credit to the private sector, caused - after one year - a small increase to the gross national product ; and a bigger credit caused - after one year - a bigger increase.

In the past the Bank of Libya confessed that it was unable to use monetary weapons for many reasons :

- (a) The Law did not back it up.
- (b) The Law of 1963 gave it some weapons but they were weak and ineffective.
- (c) Commercial Banks in the L.A.R. were branches of foreign banks

and obtained what they needed in the way of liquid money from abroad, not from the Central Bank.

- (d) Some authorities in many States wanted to establish Central Banks and put stones in the road of the Bank of Libya.
- (e) The Bank was considered a Central Bank without the support of Law or weapons.
- (f) Public interest was lost many a time between the Bank and the Minister. However, from all points, the picture is now completely different.

After the Libyan Revolution a question arose "Is it necessary to use monetary weapons after the Libyanisation of all the Banks?" We say yes for the following reasons :

- (a) Banks in the L.A.R. have not become branches of the Central Bank.
- (b) There are private shareholders in the Banks, and some members of the Boards of Directors from the private sector and the use of weapons is necessary.
- (c) What would be the rate of interest if the basis was not set by the Central Bank ? Businessmen would like to know before they borrow.
- (d) Many people started to hoard money and embarrassed some Commercial Banks. To deal with the situation, the Central Bank reduced the cash reserve (October 1970) from 25% to 15%.
- (e) It is important for the Commercial Banks to know the discount rate, amongst many other things.

What can the Central Bank choose as its weapons ?

1. *Bank-rate* : The Bank of Libya has a long history with the Bank-rate. It was always ineffective as a weapon because the Banks did not respond to it. Now it could be effective but the Bank preferred to use cash reserve. We suggest that it should increase the interest rate for savings. It could then absorb a part of the purchasing power and use capital formation for development.

2. *Discount* : There is no discount market (proper) in the L.A.R. but the Banks replace that market. In June 1969 all the Banks discounted over L.D. 14.7 million in bills of exchange. It is a new instrument in the L.A.R. but the Banks are new too. We believe that the discount market will grow and the Banks will ultimately shelter under the Central Bank and go for re-discount.
3. *Open Market Operations* : We leave this till later because we shall suggest the creation of a financial market.
4. *Cash Reserve* : Banks were always lucky with extra cash above the cash ratio. They had L.D. 5.6 million extra in April 1970 but after that the public started to hoard money withdrawn from the Banks and liquidity suffered, hence the reduction of cash ratio from 25% to 15% as previously mentioned. Again, the velocity of circulation was 2.6 in April 1969 and was reduced to 0.9 in October 1970.
5. *Moral Suasion* : This was almost the only weapon available to the Bank of Libya but now it is perhaps the last one because the Bank can use many other weapons.

We suggest to the Central Bank the use of the following weapons :

1. *Limitation of credit* : Banks could, during inflationary pressures, give credit to their clients up to 60% or 70% of what they used to get. This method has proved practical in many countries.
2. *Another Cash Reserve* : This is another way to fight inflation.
3. *Direct Action* : This was very successful in some countries but it should not be used in the L.A.R. unless there is a real need.
4. *Open Market Operations* : The Law allows the Government to issue Bonds up to 10% of the note issue and we suggest that the Government should take advantage of it, although it does

not need to borrow, because of the following reasons :

- (a) The public will share with the Government the financing of projects.
- (b) An opportunity for the investment of surplus money.
- (c) The share market is the best way of knowing the prices of shares and bonds.
- (d) The central Bank can buy or sell Government Bonds and, therefore, use this weapon as an economic stabilizer.
- (e) This is an elastic weapon. It could be used and it could end on such a date and hour in order to reduce or increase money with the public.
- (f) It is a very effective weapon to be used against the Commercial Banks.

In the old days, the Bank of Libya held it against the foreign branches that they financed the safe, well guaranteed, profitable and short periods operations or loans such as the financing of foreign trade. We are asking now - after the Libyanisation and nationlisation - "Will the Central Bank allow the commercial Banks to finance long period productive projects in industry, agriculture, tourism etc. ?" The British Banks used not to give loans to such purposes and for long periods until the Big Depression of the thirties when the Government encouraged the Bank of England and the Commercial Banks to finance industry and they both formed two big companies which bought the bonds of the industrial concerns. The Mc Millan Committee in 1931 established the bases of cooperation between industry and commercial banks. In 1945 the Bank of England helped industry through two big companies of which the majority of shares are owned by the Bank. Therefore, Britain, the country of traditions, left the old theory and allowed the Banks to help industry. The European Banks were always helping long period projects. The question now is. "Will the Bank of Libya allow the Banks to assist long period projects ?" The L.A.R. is very enthusiastic about development plans and industrialisation. In our view, the Banks should be encouraged to go into that field.

Now we look into the Libyan Budget. It is well known that unbalanced Budgets have a bigger effect upon national income, employment and prices. The question is, "Are there important items in the Libyan Budget that can affect the Libyan Economy?" From a study of the Budgets between 1965 and 1969, we came to the following conclusions :

- (a) Any item is proportionately small if compared with petroleum duties.
- (b) The biggest items are customs and import duties but each is only about one-tenth of the total Budget. The Libyan Government should reduce these two items because :
 - 1. It is not in dire need of money.
 - 2. The Government should raise the standard of living of consumers by not taxing them.
 - 3. Such dues increase prices and raise the cost of living.
- (c) Direct taxes are still about one-twentieth of the total Budget, and could not be used as automatic stabilizers.
- (d) During high prices, the Government should reduce expenditure.

The Libyan Balance of Payments is favourable but we could not trace any monetary or fiscal policies. The development plan is in need of such policies. We recommend :

- (a) Limitations of inflationary pressures.
- (b) Increase of supply of goods and services, not only price control.
- (c) Taxing the unforeseen profits.
- (d) Redistribution of wealth.
- (e) Establishment of Savings Banks, share market etc. in order to develop the economic foundation of the economy and transfer saving into investments.
- (f) Coordination between commercial, fiscal and monetary policies.
- (g) Reform and re-adjustment of all customs dues.

As far as public expenditure and Government are concerned, we suggest :

- (a) Increase of incentives for production in order to avoid an increase of demand which leads to demand-pull inflation.
- (b) A study of the market prices and the reasons for their increase.
- (c) Full statistical data from 1964 should be available to research workers.

Now we come to the note-issue of the Central Bank. Libyan banknotes are covered by 25% in gold, 10% in Libyan Bonds (not used) and 65% in foreign bonds. The writer suggests 35% in gold for special reasons, knowing all the same that :

- (a) 25% is enviable.
- (b) We do not worship gold and we know that the Balance of Payments, increase of G.N.P. and national income are good measurements for the national economy.
- (c) The increase to 35% will reduce interest gained by the Libyan Government from foreign bonds.

However, we have the following reasons :

1. Each country - if it could - would like to reach a bigger percentage of cover in gold.
2. Covering by Sterling or Dollars exposes the cover to a capital reduction if : Sterling or the Dollar is devalued.
3. Any other currency is exposed to the same things, i.e. capital loss and reduction of interest.
4. The Libyan Government may enter a war or may disagree with the petroleum companies or face any crisis. Then it could find some 10% or 15% in gold to sell in time of need.
5. For any difference of views, the foreign countries could confiscate the cover.
6. The I.M.F. imposes an important condition that every member should pay 25% of its quota in gold. Therefore, gold is still the best international commodity.

7. At the time of this research (April 71) the price of an ounce of gold was 38.90 dollars.

Finally the writer suggests the gradual cancellation of the Libyan Exchange Control for the following reasons :

1. Most Libyan income comes from petrol and this is in the hands of the Government.
2. It is not very probable that Libyans would transfer their wealth abroad because investment is much more profitable in Libya. Even if it did happen, it would be small amounts.
3. The Government allows the foreigners now to transfer 60% of their earnings and there are no foreign capitalists in Libya.
4. Libya has the biggest amount of gold and foreign currency in Africa. In January 1971, it held 1712 million dollars in gold and foreign currency.
5. Exchange Control, therefore, is waste of time for both officials and businessmen.
6. Libya should not be compared with other developing countries which have huge populations and scarcity of foreign currencies.
7. If exchange control is gradually cancelled, Libya will benefit by :
 - (a) The value of the Libyan Dinar will rise.
 - (b) If Libya becomes a free financial market, like Lebanon, it will attract huge amounts of foreign currencies.
8. Exchange Control was established in September 1955 when Government Revenue was 13.3 million Dinars. How would this be compared with 426 million Dinars in 69/70 ?
9. We understood that in 1964, the Bank of Libya made a statistical study and found that only 2% of transfers are

refused !! If the number is 4% or 6% now, is it worth all this trouble ?

The big problem that faces the L.A.R. is how to invest its accumulated capital.

To end we must say that monetary policy could be a debatable subject. In that respect, Professor Paish said in March 1971, "It is difficult to know the Government policy and perhaps the Government itself does not know it".