ECONOMICS AND IMPACT ON THE BANKING SYSTEM WITH MONEY

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Abstract

In economics banks are resembled as dam that collects money from society and keep it as small or big deposits. By so doing huge amount of financial resources are created. In economic planning these resources can be used and invested. In other words they can be used in various sectors like agric culture, commerce, industry, production and services. To use these resources appropriately banks are needed to have an effective integrated system. This system is referred to as credit information data which can play a vital role in channeling the resources.

Unfortunately over the past years banks have turned into institutions that serve government. By giving ordered facilities a voluminous amount of resources are wasted. These facilities usually turn into arrear dues so that the government is now the biggest debtor to the banks; otherwise. They could be used to invest and to create job.

Key words: Bank, monetary and banking system, economy, currency and Iran

Introduction

After Islamic Revolution of Iran Monetary and Banking system of Iran has completely changed. Banking system of pre- Revolution which was believed to be usurped one was turned into Islamic Banking. Some public and 32 private and other banks were either merged or turned into a limited number of public banks.

Over the recent years statistics has shown that banking networks have not grown in acceptable alignment with population growth. Due to lack of enough banking units on the one hand and the increase of Rial volume and the number of notes there has been a large crowd in front of delivery counters which has led to time wasting and customers' dissatisfaction on the other hand.

It is interesting to note that the culture to use written money, credit purchase and banking systems have not been developed despite changes in banking systems over recent years. Accordingly voluminous amount of notes and coins are before people and least amount of it at banks. This results in note depreciation and incurs loss to national economy.

Furthermore today banking system has turned into a corresponding bank by doing public services and providing public bodies with huge amount of funds so that government is the biggest debtors to the banks. Speed, quality and having enough financial resources are of great importance in rendering services to customers. Development of monetary and banking systems without supervision of Central Bank affects negatively on inflammatory economy and its continuance can have irreparable effects on the economy.

History of Bank and Money in the World

Banking and commerce has practically existed before the use of money in today concept. In fact since man has produced products to be traded he has felt the need for a means to pay and express value.

The term bank derives its origin from Germen word Bank or French word Banc which means bench. It seems that lenders in Venice were sitting on bench and were exchanging currency. Accordingly the institutes which lend money have been called bank.

Studies show that banking dates backs to nearly 6000 years ago. In Greece Temples did banking. Their remarkable incomes gradually raised the sense of competition and private banking was founded. Deposits are not kept freely in Babylonian Temples. The interest rate for these deposits has been around 20% which were paid by gold or silver. In China banking operations date back to nearly 600 BC. The biggest contribution of Chinese to the banking and perhaps to the human civilization is the invention of paper.

By the discovery of America and emergence of new ways of commercial relations between East and West it spread from Mediterranean coasts to Atlantic coasts, to France, Spain, Portugal and England. In Christianity It has not been forbidden to charge interest. It gave new development to banking activities. Accordingly Venice bank was founded in 1587, Amsterdam bank in 1609, Sweden Bank in 1656 England Bank in 1694 And France Bank in 1716 (Periodical of the Central Bank of Iran, 1995).

History of Money

Around700 BC money was appeared. In Lydia, Asia Minor small bullions made of half gold and half silver with official seal of the ruler inscribed on them were for the first time used to do transactions (Periodical of the Central Bank of Iran 1995).

History of Bank and Money in Iran

Before the establishment of today banking the transactions have been done in traditional ways. A type of credit money which was called Biak was used. The money was issued by exchanger. It was a sort of credit in which the exchanger agreed to pay the money**.**

Banking operations in Iran began in 1887 by the establishment of English bank named New Eastern Bank. Its center was in London and had many branches in Western Asia particularly in India. In Iran it had founded its branches in Tabriz, Rasht, Isfehan, Shiraz and Boshehr. At that time foreigners could freely do trade in Iran. On year after a permit was issued to Paul Julius Freiherr von Reuter (Baron De Reuter)to found Royal bank. It did commercial activities, issued note, managed funds of Iran in domestic and abroad against commission and was exempted from tax. In 1930 the right to issue note to the sum of 200,000 lire was purchased back and transferred to National Bank of Iran. In 1930 a right to found a borrowing bank for duration of 70 years was given to a Russian national named Jacques Poliak off .Russian Czar State bought its whole shares and used it for political purposes. In 1921 it was transferred to Iran and annexed to agriculture Bank in 1933.

Sepah Bank is the first Iranian Bank. It was first founded under Pahlavi name to do the financial affairs of army personnel. Iran-o-Russia Bank was founded to facilitate commercial transactions between the two states. Its total capitals were paid by the Russian state. Pursuant to the Approval of the Parliament this bank was nationalized on Jun.07,1979.

On May 05, 1927 The Establishment Permission Act of Melli Bank of Iran was passed to focus its activities on commercial, farming and industrial advances. In accordance with the articles of the association passed in 1938 new missions like protection of money value, currency balance protection, budgeting states credits, supervision over other banks and directing the state economy were assigned to the bank.

In May, 1960 Pursuant to the new articles of the association of Melli Bank of Iran .The missions of the bank were divided between Central Bank of Iran and Melli Bank. Central Bank of Iran was officially opened in Jul.1960 and assumed the responsibility to mange monetary and credit system, to lead and control the state banking networks (Center of Commercial Researches and Studies1992).

Banking System before Islamic Revolution of Iran

By 1978 36 commercial banks with 8000 branches were working in Iran. Out of 36 13 banks were managed by Iran and foreigners partnership (14 to 40 percent of shared were belonged to foreigners, 8 banks were public and 15 private. After Islamic Revolution of Iran all the first and second type are nationalized. After that 6 commercial banks and 3 specialized banks were merged and from 1984 the Act of Usury-free Banking Operation is enforced (Center of Commercial Researches and Studies1992).

International Monetary Fund

The International Monetary Fund (IMF) is an international Monetary and financial organization that was created on July 22, 1944 at the Bretton Woods Conference and The organization's stated objectives are to promote international economic cooperation, international trade, employment, and exchange rate stability, including by making financial resources available to member countries to meet balance of payments needs. It originally had 45 members including Iran. It gives loan to member states having payment imbalances. Financial resources of the Fund are provided by the payment of membership fees and through borrowing from rich states. I its total financial resources amount to $ 90 milliard (Education Bureau of Melli Bank of Iran 1994).

Special Drawing Rights

At first it was a currency basket containing 16 various international currencies. The transaction volume between the states was more than 1 % of international commerce. By 1980 Iran was a member. After 1980 the currencies were reduced to 5 including USA dollar 85%, Mark of Germany 21%, yen 17%, Frank 11% and Pound 11%.

Director General of Central Bank or the Minister of Economy and Finance was the representative. The decision was made by the majority of the board of the directors and at some case by 85 % of the quorum of the majority. USA with 20 % of total votes has practically a right to veto (Education Bureau of Melli Bank of Iran 1994).

Currency and Currency-Related Issues

Currency Resources: Currency Resources of Each State includes revenue from exports, loans from other countries and one way payments. Exports usually are divided into visible and invisible ones

Visible Export: it refers to the export of commodities to other countries by individuals, institute or government. For instance items like petroleum, carpet, minerals, and handicrafts constitute the main Visible Export of Iran.

Invisible Export: it refers to **revenues from a work or services.** For instance interest from investment in abroad and loans to foreign countries. It can be classified into five groups:

1. Revenues from Production Factors (Labor and Capital): Iranian Nationals working as experts, consultant, workers and so on send part of their income to Iran. It is a sort of invisible export.

2. Tourists. It is clear that each tourist has to exchange currency to pay his accommodation, food, transportation and the like.

3. Embassies and Consulates: To pay for their expenses they have to exchange their currency with local one.

4. Loans and Interest from Investment: Loans taken by state and private sector and given to other countries and Interest from investment are regarded as invisible export.

5. One-way receivables or foreign aids: They are regarded as incomes for which nothing has exported or no services rendered like presents, aids received in cash and kind upon occurrences of natural disasters.

Currency Consumptions: It is the reverse flow of the five groups.

Currency Balance: One of the policies that each state should adopt is to balance between its foreign and domestic expenses. Whenever its currency use is higher than its income it means that there is a need to borrow. Today indebted countries are mainly poor and developing countries. Currencies can broadly be divided into convertible and inconvertible Currencies.

Convertible Currencies:

Convertible Currencies are the currencies which can be changed in international monetary and financial markets. It means that Central Bank of the state has accepted its convertibility. In practice those currencies are changeable and transactional which Central Bank of the issuing state agrees to accept and change them without any limit. Yen for example is a changeable currency because it can be transacted in international market and secondly Central Bank of Japan accepts and changes it without any limit. Just declaration is not enough for convertibility. Two other conditions should be met. First it can be used abroad. Second Central and commercial

Bank of other countries keep them as reserve currency. It is noteworthy to state that in 1974-79 Central Bank of Iran declared Rial as convertible currencies. Accordingly it was free to import and export all currencies.

Inconvertible Currencies:

Limitation of currency resources of many countries has caused many countries to control the currency expenses. Central Bank of these countries refuses to change currencies. Accordingly their currencies are not basically purchased.

Methods of Currencies Rate Calculation:

Fixed Exchange Rate or Single Exchange Rate

In this method one Fixed Exchange Rate is declared and supported. It brings about remarkable stability and trust in transactions. It is practical when the state currency reserves would be outstanding and public and economic condition to be in a state to attract foreign currencies.

Various rates System or multi-rate System

Based on this method for various markets and purposes various rates are determined and fixed. For instance for some sectors or activities supported by government a preferred or formal rate is devoted and for some other sectors or activities another rate is used.

Floating Rate System: it is referred as wavy rate. In this system rate is changing and depends upon supply and demand. From 1978 member states of IMF do not define their money with gold. Gradually they turned to floating rate (Tabatabei, 1995).

Weakening or strengthening Value of National Money

Weakening refers to the increase of the number of the units of national money while strengthening refers to the decrease of the number of the units of national money against a single currency.

Consequences of Cheapness of Foreign Currencies against Rial

A. Domestic Products become uncompetitive: the first Consequence Cheapness of Foreign Currencies against Rial is that domestic industries are not capable of competing with the same importing goods. For example domestic wheat production cannot compete with importing wheat in terms of price. If each ton of wheat costs$ 200 then the cost price of each ton of wheat with the price of 1000 Rial will be 200,000 Rial i.e. 200Rial per 1 kg. If we calculate the purchase price of 1 kg to be 400 Real**,** we may come this mistaken result that importing wheat is much cheaper. While it is clear that if dollar exchange rate to Rial is calculated to be 300 Rial per dollar, 1 kg of importing wheat costs 600 Rial which is much higher than the domestic wheat.

B. Not encouraging Non- Petroleum export
Cheapness of foreign currencies incurs loss to Iranian exporters and its direct impact is that the state export remains limited. For this reason Non- Petroleum exports has never met the state import needs.

The study of Foreign trade of Iran over 80 years by taking Petroleum into account shows that the best economic year has been 1953 in which Non- Petroleum export has been 2.6 milliard Rial more than import.

Generally Speaking during 80 years only in 1931, 1941, 1952, 1953 and 1954 Iran had a positive balance while in all other years import has always been more than export. The worst one has been 1983.

C. In appropriate Distribution of Income: Cheapness of foreign currencies has negative impact on income distribution for two reasons:
   1. City dwellers consume more importing goods than villagers. Accordingly it is more to their benefit.
   2. Non- Petroleum export depends more on agriculture and its cheapness incur more loss to this sector.

D. Tendency of Country toward Investment Consuming Industries: During the past years official currency rate has been fixed while workers' wage has constantly risen and Labor law has increased employee's liability to worker. These have led investors toward investment consuming industries.

E. The noticeable difference between official currency rate and open market rate entices many to take advantage of this difference. Two illegitimate operations can be mentioned in this regard.

1. Over Invoicing:

Some importers reports higher prices and then spend it in open market. By so doing they profit from the difference of the rates.

2. Under invoicing

Some exporters invoice lower prices than the real one. Accordingly they get more currency and use the extras for their own benefits.

Advantages of Low Exchange Rate

1. Inflation Prevention: Low Exchange Rate against Rial means more inexpensive import into Iran. It is clear that high Exchange Rate has direct impact on goods import. It costs higher to import. At present most importing goods are necessary goods or capital mediating goods therefore Inflation pressure would be higher. Furthermore the rise of importing goods will affect on the price of domestic products.

2. Protection of Political and Economic Dignity and Prestige

Money value weakening costs much. It has negative impacts. States and policy makers attempt to avoid it. Even those who believe in weakening national money value prefer indirect method.

Constant weakening of Official Value

As stated official weakening leads to the support of domestic industries. Under it they can compete with foreign industries. However experiences show that after a while or due to mutual weakening by foreign countries or adjustment of domestic industries with conditions of after weakening and price rise new weakening seems necessary. Countries like Turkey, Brazil, Argentine and Mexico that have weakened their money value have done it reputedly.

Purposes of Currency Limitations:

A. To get rid of balance deficit of international payments
B. Prevention of Capital escape
C. Support of domestic industries
D. Facilitation of economic growth
E. Income for State

State Currency Policies

By 1974 fluctuation of foreign value of Rial depended on dollar value changes in world markets .in Dec.1974 Central bank of Iran cut the fixed relation of Rial to Dollar and declared that Rial value will be calculated based on the right to draw.

After Islamic Revolution of Iran, hostage taking of USA Embassy personnel and freezing its reserves in US banks Central bank of Iran adopted new policies. To encourage Non- Petroleum export in 1980 two exchange rate system was adopted by the Central Bank of Iran. In 1981 currency purchase from export has remarkably increased; however, it was not successful in 1982. The reasons can be found in war breakout and the difference between free market rate and preferred rate. The adoption of new policies led to Non- Petroleum export. On the other hand due to the lack of control over export currencies rate, price of importing goods against expert the price of the permit to use currencies from experts for the purposes of import increased. Although Non- Petroleum export is increased, domestic price of exporting goods is increased as well due to the limitation of exporting capacity which led to higher inflation.

In 1987 income from Petroleum export increased compared to 1986; however, currency and commercial policies like the past years were to save currencies and to allocate limited resources to the import of basic goods and to develop Non- Petroleum export.

In 1988 importing some necessary goods without currency transfer was freed. During 1978 - 1988 currency gain from Petroleum sale have always been under fluctuation and due to decline of Petroleum price and its sale price the balance of currency has not had a fixed trend and economic and banking system did not have stability and the desirable growth. In1978, 1979 and 1980 currency balance grew due to the rise of petroleum price and then declined because of revolution. In 1979 it reached to the lowest amount and from1980 up to 1982 increased again. The reason was the export increase. And from 1982 onward it had a decreasing trend due to remarkable decline of income from petroleum.

Dramatic fluctuation of currency incomes affect on the state economy by affecting on budget. With regard to the fact that the government income from tax is not noticeable in budget structure, currency incomes and its Rial value constitute its main part. Accordingly when it declines, the government turns to loan from the Central Bank and solve the budget deficit. Government debt to the Central Bank began in 1980. It was 217milliard Rial and with annual growth rate of 21% reached to 1826 milliard Rial in 1988. GDP had 1.3% negative growth on average each year and population growth was 3.2 %. Accordingly the loam and its injection into the society led to cash volume and total demand. And Since Total supply had not only growth but declined the price increased with a dramatic rate (Ghadiriasl ,1989).

Characteristics of Advanced Banks: With regard to rapid changes and advance of technology future banks can be imagined to have interesting Characteristics. In developed countriesthey are more imaginable.

In the 10 coming years those banks which constantly learn and change while providing services to their customers and small economic entities and can continue to have a performance higher than medium and attend actively in developed market can be a vanguard . They can provide various products and services which meet the financial needs of customers.

They come to the conclusion that their customers are their capital. Therefore attempts are made to meet their needs as follows:

-Provision of services everywhere and every time

-Provision of services at desirable level and appropriate price

-Provision of services under outstanding, valid and organized brand which is different from the competitors

-Customers are viewed not in group but individually

Future banks turns date into knowledge and avail it to their customers and staff.

-Data processing operations and other technological information- related operations are greatly focused upon.

-They relied upon technology more than before.

-They change customers’ view to the organization

-Their efficacy increase while the number of staffs decrease

-The number of staffs decreases 40 to 50 %. They will be educated people

-50% of them work part-time

-They will have three types of staffs: representative of customer’s services, middle managers, transaction processors

-Decision making is centralized by information technology and facilities are given to customers immediately after request.

-Loan is given to the customers based on their reputations, behavior and risk

-Recovery of dues are different for different persons and depends on the records existed in the bank. Non-Recovery declines dramatically (Tabatabei, 1995).

Future Vision

Future banks will have the following changes compared to the present ones:

Branches: The number of Branches declines dramatically and normal transactions and money transfer will be done by telephone and self-service banks. They will be used for more complicated transactions

Non-Branch Distribution mechanisms: They include telephone, multimedia counter in supermarket, cash dispenser and home banking

Head Office: It grows small to great extent and covers the sectors like policy making, credit, customers' communication center , customers' data base, product back up and information system back up.

Information Processing Center: It grows big and probably it will be given to large firms with higher capabilities (Tabatabei, 1995).

Conclusion:

Studies show that successful countries in economic release and structure adjustment have all used appropriate financial means. In Iran there is a very high potential of monetary facilities. Just a small proportion of it is before banks; however, a large share is wandering in informal and unknown markets.

Development of monetary institutions out of Central Bank supervision and control has had negative effects on the economy over the recent years. Therefore it is necessary for the Central Bank as a supervising body to play a more active role in supervision and control.

Furthermore a great number of experienced staffs have retired recently. In human resource department the need to train newly hired staffs is highly felt.

In brief to improve banking system management weaknesses should be solved and in appointing people to sensitive positions specialized qualifications should have been prioritized.

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