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SAUDI ARABIA'S ISLAMIC GROWTH MODEL -- APPLICATIONS TO MONETARY AND BANKING POLICY

Robert E. Looney*

INTRODUCTION

Perhaps no other area of Islamic economic thought has been more misunderstood than that concerning the role of the rate of interest. Any economic system concerned primarily with the welfare of the individual must not only encourage allocative efficiency, but also promote economic growth if it is to avoid social injustice, economic stagnation and widespread unemployment.¹ The method of state allocation utilized in the eastern block countries is one possible way of avoiding the widespread use of interest rates. Given that complete or near complete socialization of the means of production that this system requires is contrary to the individualistic moralistic philosophy of Islam, the Saudi government is, given its concern for the welfare of the economy, left with little choice but to somehow direct savings through the organized capital markets to the private sector.

The difficult problem from, an Islamic point of view arises because the only known method of encouraging the productive use of saving is to raise the interest rate to the point where the discounted marginal social cost of investment is equal to the discounted marginal social benefit of investment.

If the interest rate is not permitted to rise to some positive value to discourage marginal and inefficient projects, it is likely the kingdom's objectives of social justice with material betterment for its citizens will not be met.

* Associate Professor Naval Postgraduate School at Monterey, California, U.S.A.

The simple fact is that the interpretation of Islamic doctrine to abolish the interest rate is not only not as straightforward as it is supposed to be, but quite naive, given the fact that alternative policies may generate greater social inequalities than the existence of interest is alleged to promote--the inequality of income between labor and capital. While accepting the fact that positive interest rates help in achieving economic efficiency and economic growth, Islamic scholars often contend that its use can still not be justified on moral grounds.²

If we accept the fact that given our present state of knowledge, other policy alternatives create economic inefficiency and inhibit economic growth, then it is incumbent that Islamic countries create some sort of institutional arrangement whereby the positive aspects of the interest rate are allowed to function while simultaneously its negative or morally objectionable features are suppressed. The sections that follow attempt to assess the success to which the Saudi authorities have had in structuring an efficient financial system along Islamic lines.

At present the Saudi Arabian financial system comprises five major institutions

1. the Saudi Arabian Monetary Agency,
2. the money changers,
3. the commercial banks,
4. public specialist institutions, and
5. the Islamic banks.

In the discussion that follows, particular attention is given to the latter three institutions, especially with regard to those factors which impinge on the government's ability to stabilize the economy while meeting the major objectives of the country's development plans.

Development of Commercial Banks

Commercial banking in Saudi Arabia grew up largely through the provision of import finance. This type of activity still predominates, although there is a trend toward diversification of bank assets. Deposits are still largely short term, however, and as a result many banks are still reluctant to undertake a very large number of long term commitments. Bid bonds and contract guarantees have become another lucrative area, although bonds for the big contracts must be syndicated abroad (since the Saudi banks do not have a large enough capital base to undertake them).

Despite these changes commercial banking has not expanded as dramatically as the rest of the economy. Several reasons are responsible:

1. Because of restrictions on interest rates, banks have not been able to attract as many funds as would normally be the case.
2. The banking system itself is largely oligopolistic (only two Saudi banks) with little competition to force expanded service and coverage.
3. SAMA has been extremely conservative in issuing new licenses (only one was issued during the last decade).
4. Stiff competition still exists from the money changers who perform many of the services provided for by the banks.
5. Foreign or suitcase banking has become an important element in the system.
6. State owned credit banks are major lenders in certain areas.
7. SAMA has not allowed offshore banks to open, but instead has preferred to see offshore Saudi financing develop in Bahrain with Saudi bank's opening subsidiaries there.
8. Qualified labor is quite scarce with many Saudi families discouraging a career in banking for religious reasons.

Several characteristics set the Saudi Arabian banking system apart from its counterpart in Kuwait, Bahrain and the UAE. These include:

1. the absence of interest rate regulations,
2. the lack of a domestic capital market,
3. the slow progress towards any investment banking activity - relying, that is, on management skills rather than balance sheet optimization.

Lending Activities

While perhaps not expanding as fast as one might have anticipated due to the overall rate of growth of the economy, the sheer size of the expansion of assets in recent years clearly indicates the dynamic conditions prevailing in the country's financial markets. Private sector loans and investments have increased by almost twenty times during the 1965-79 period³

Domestic loans and investments comprised over 40 percent of the banks' assets in 1979. This figure has been relatively constant with fluctuations around 5 percent of this figure through the 1970s. Bank assets are, despite the Islamic preference for direct equity investment, mainly comprised of loans. In fact, Saudi commercial banks like their western counterparts have a strong preference for revolving credit loans rather than longer term commitments.

A breakdown of the lending by the commercial banks shows that, as in most developing countries, trade credit is of greatest importance. This activity accounted

for one-third of total bank loans in 1978. In large part these loans are used to finance local merchant's stocks of imported goods (as they often have to meet the payment to the foreign supplier before the goods are actually sold). Banks can, of course, provide letters of credit and guarantees for imports, but these are usually for only short periods. Saudi imports often require longer periods to turn their stock over. While importers have a number of financial options, it is apparent that the commercial banks are now playing a growth role in this area. Between 1977 and 1978, for example, the value of trade credit increased by over one-third.

The second most important area of bank credit is construction finance, comprising over one-fifth of the banks' total loans in 1978. Commercial bank lending for construction takes place in spite of the activity of the state run Real Estate Development Fund, which provides interest free loans to private home buyers. In addition another agency, the Credit Fund for Contractors, gives highly subsidized short and medium term loans to Saudi building firms. There are a number of areas not covered by the public agencies, however, thus providing banks with a number of profitable lending areas. Housing and other facilities for immigrant workers, for example, are not covered by these funds, and in recent years there has been a boom in apartment building for these workers. In addition, bank lending for the construction of commercial buildings and other urban nonresidential development has filled an area also not covered with public lending.

Finally, in spite of the very generous financial provisions made for manufacturing ventures available by the Saudi Industrial Development Fund, commercial bank lending to industry has been expanding rapidly in both absolute and relative terms. In large part this expansion is a response to several gaps in the government's industrial financing program. The State Industrial Development Fund, for example, provides up to 50 percent of the financing available for the ventures it selects for credit. In addition, these loans are usually only for medium and longer term fiscal capital formation. As a result borrowers have to turn to commercial banks for working capital.

Total foreign assets of the Saudi commercial banks amounted to almost 13 million riyals in 1979. Most of these are in the form of deposits with other banks in the principal world financial centers, particularly London. Saudi Arabia's two indigenous banks have only recently extended their operations outside the country. Their operations are largely confined to the wholesale interbank market rather than retail banking. The foreign assets are largely in the form of liquid placements. Most of these deposits are withdrawable on demand and involve only a few major western owned banks.

Foreign assets of this type do not qualify as reserves with SAMA. Yet, there is no evidence that banks have had much trouble in complying with SAMA's required reserve ratio. These domestic liquid assets were almost as great as loans outstanding in 1975 and 1979. This pattern reflects the commercial bank's tendency to maintain large cash holdings and deposits with SAMA in excess of their reserve requirements. The major component of bank liabilities is current account deposits (on which no interest is paid). The sheer magnitude of these deposits and their growth over the last decade indicate that they are well in excess of what depositors require for transactions or even precautionary purposes. Clearly, many customers are using current accounts for their savings. In doing so they are apparently willing to accept the opportunity costs involved (due to high interest rates abroad and domestic inflation domestically).

Saudiization

In addition to the reasons given above for the slow expansion of banking in the kingdom, foreign banks were somewhat reluctant until quite recently to expand because of the government's Saudiization policy⁴.

Under this plan, majority ownership has been transferred to Saudi nationals with the usual equity pattern being 40 percent to the foreign bank, 15 to 20 percent to the Saudi sponsors, and 35 to 40 percent to the Saudi public.

For several years foreign banks were prohibited from either opening new branches or increasing their capital. Branching restrictions are not in effect for Saudiized banks. Through enabling foreign banks to increase their capital and branches, Saudiization has enabled the foreign banks to begin competing with the two original Saudi banks, National Commercial Bank and the Riyadh Bank⁵.

As it stands now (1980), the two Saudi banks still dominate the financial system. Combined they account for approximately 70 percent of the country's commercial bank assets, 80 percent of its deposits, and approximately 90 percent of all commercial demand accounts⁶.

The dominant position of the two Saudi banks may diminish as the Saudiized banks pursue an aggressive policy of opening new branches and generating loans. Due to the relatively long time needed to build branch offices and train new staffs, it may be five to ten years before competition in banking increases by a substantial amount.

Bank Profitability

The basis for Islamic banking and the prohibition of interest is the belief of the Moslem that capital itself should not generate a profit without any human effort being exerted. Financial gains, either through interest bearing deposit accounts or interest charging commercial loans, are referred to as "riba" by Islamic banks and are strictly forbidden by the Qu'ran. Islamic law, however, does not imply that banks must receive negative or extremely low rates of return on equity. Under the "Mudaraba" system (otherwise known as profit sharing), it is possible for banks to do extremely well financially.⁷

Islamic codes do however permit banks to lend capital to entrepreneurs with the understanding that the bank will receive a certain fixed percentage of the profits generated by the loan. Banks stand to make a large profit through this practice, or conversely they share the loses if the new venture proves a financial failure. The Mudaraba system, therefore, assumes that a social balance is struck between the value of capital and the value of human endeavor, a balance that in no way reduces the overall level of investment that would likely take place under alternative western type banking practices.

Many of the Ribah-free banks (RFBs) operating in Saudi Arabia provide a full range of normal commercial banking services. Credit provision and trade financing are undertaken on a profit sharing basis, while transfers, foreign exchange, checking accounts, and other non-credit services are provided on a commission or fee basis. Fees for services are permitted by Islamic codes if they are payment for services that involve a real exertion or effort on the part of the bank⁸. In short, there is no inherent reason why Islamic restrictions should limit bank activity or profitability.

Official data collected by SAMA does in fact confirm that the kingdom's commercial banks are quite lucrative (as evidenced by three key ratios): (1) return on assets (ROA); (2) return on equity (ROE), and (3) leverage--the ratio of total assets to the equity of the bank's shareholders or partners. The most important indicator of bank profitability is return on assets.

According to the most recent financial statements of the banks, the ROA of the two Saudi banks averages 2.6 percent. This is approximately 70 percent higher than the average 1.5 percent generated by the Saudiized banks. When the leverage factors of the banks are incorporated and the ROA is calculated, the difference between the two classes of banks is even more dramatic. NCB has the highest ROA at 47 percent.

Three of the four Saudiized banks on the other hand average about 20 percent⁹.

Clearly, the Saudi banks operating with their massive deposit bases and low costs of funds are able to produce profitability ratios far in excess of the Saudiized banks. Although the relative size of the Saudi banks alone accounts for some of the difference in figures, the fact that they are the sole bankers in many locations in the kingdom (the Saudi banks have approximately 70 percent of all branches in the kingdom) must also contribute to their relative success.

Finally and probably most importantly, the Saudi banks seem to have an advantage in obtaining funds. While the Saudi banks do not specify the cost of funds (the amount banks must spend to maintain their deposits), a reasonable proxy for the cost of funds (COF) for comparative purposes can be derived by dividing total service charges (which include interest paid on savings accounts) by total funds. The calculation of COF indicates that the funds of the Saudi banks cost approximately half what funds cost the Saudiized banks. Individual comparisons are even more dramatic. While Riyadh Bank's funds cost approximately 0.7 percent, those of Bank al Saudi al Hollandi cost 2.2 percent¹⁰. This is a difference of over 200 percent. By comparison the cost of funds for most U.S. banks during 1979 was in the neighborhood of 10 percent.

The relatively low cost of funds must in part account, therefore, for the high profitability of Saudi banks. In spite of their low cost of funds, the Saudi banks are not all that aggressive in making loans. Loans and advances as a percentage of total deposits is much lower than for Saudiized banks. NCB, for example, loans only 36 percent of its deposits, while the Saudi French Bank and the Saudi British Bank advance 83 to 84 percent of their deposits, respectively¹¹.

Apparently, these ratios reflect a major difference in philosophy between the Saudi and Saudiized banks. While the Saudi banks are content to loan a relatively small percentage of their deposits, the Saudiized banks are aggressively granting loans to gain an increased market share. The disparity between loan deposit ratios may narrow as the Saudiized banks increase their deposit base through their planned branch expansion.

Clearly, this deposit pattern benefits the banks and is a major reason for their high profitability. The value of time and saving deposits in which a fixed commission is paid in lieu of interest to the depositor (in accordance with Saudi law) remains relatively modest. There seems little desire on the part of customers to switch

from demand to time deposits. The banks for their part seem reluctant to promote alternative methods of saving.

Reluctance of the banks in promoting savings makes a certain amount of sense given the greater profitability on current account deposits. However, expansion in savings deposits might not necessarily be at the expense of their current accounts. Large volumes of Saudi funds are held overseas. Some of these would likely flow into saving if the terms were improved. Clearly, the banks are aware of this. A major explanation of their lack of enthusiasm for savings promotion must be concern over antagonizing the more conservative sections of the community. Vigorous promotion by offering high premiums for savings may be viewed as an indirect form of interest. Sanctions might follow even though religious principle would not be undermined (so long as the higher charges are not passed on the borrowers). The banks' long run strategy should be one of education. i.e., since Muslim concern is with any hardships that might be inflicted on the latter, the banks should stress the fact that potential gains might be made by depositors as long as the gains are not at anyone else's expense.

To conclude with the problems listed above, the main trouble for commercial banks in the post-oil boom has not been one of attracting funds but finding good borrowers. Total assets and liabilities from the commercial banks in 1974-75, for example, went up by 55 percent and the money supply increased by 40 percent. With the government responsible for about 80 percent of domestic spending, the banks have not so far played a big part in medium or longer financing and loans for construction. But as the pace of economic development increases, there are signs that some of the liquidity is being mopped up. Deposits in commercial banks rose by 55 percent in 1974-75, while loans and advances to the private sector soared by 90 percent.

Specialized Banks

Specialized banks in Saudi Arabia serve a two-fold function. First, they are primarily a conduit for fiscal policy and are, therefore, essentially government agencies. Secondly, they are complementary to the commercial banks in that they provide long term financing. Short term financing, the essence of banking, is left to the commercial banks.

The function of the government funded credit institutions is to provide long term financing to certain sectors of the economy given a high priority by the government. Many projects funded by these institutions are not economically justified and,

therefore, would not have been undertaken without that in 1987/79 alone, these institutions disbursed approximately SR 17 billion or just slightly less than the SR 20 billion total loans outstanding of all commercial banks in the kingdom.

Islamic Banks

Granted that private initiative will provide the dynamic element in an Islamic growth model, the central question arises: what specific policies should the government adopt to encourage investment? Furthermore, given the value of investment required to produce preassigned levels of output, the next fundamental question is how should the savings be generated to sustain such investment?

The process of savings formation can essentially take two forms: (1) the government may directly generate the requisite funds (through oil revenues as in Saudi Arabia's case) and by encouraging private savings and making these funds available to investors through the capital market, or (2) alternatively the government may encourage corporate savings. In the latter case savings are generated within the private sector by a combination of fiscal, price and wage policies, all tending to increase undistributed corporate profits (which are then assumed to be reinvested). In this method the investors are also the savers. Because the first of these two policies relies on interest rates, these may be incompatible with the Islamic view of basic economic processes.

The dilemma for Saudi policy makers arises from the fact that the first policy, although relying on the interest rate to mobilize private savings, results in a more equal distribution of income than the second. The second policy deliberately fosters extreme inequalities of income and wealth, and thus the dilemma.

An innovative way of reconciling this problem has been through the creation of a new type of bank — the Islamic bank run on the principles of Shari'a law.

The new Islamic Development Bank, headquartered in Jeddah and capitalized in great part with Saudi money, is an example of this innovation in banking. Its director indicated on occasion that only 20 percent of its future business will be in interest free loans. The remainder is likely to be in the form of free or limited partnerships. If a lender becomes a partner, he or it can legitimately under Shari'a law accept part of the profits of the enterprise. Clearly, this procedure circumvents the interest restriction.

Among the other activities of the Islamic Development Bank are: (1) participating in capital projects; (2) extending loans to institutions and productive projects in

member countries; (3) extending financial assistance in various forms for economic growth and social progress; (4) helping in international trade between member countries and in the production of commodities, and (5) extending technical assistance, particularly in training personnel, in economic development, research, banking and other economic activities in accordance with the Shari'a¹².

Broadly speaking, Islamic banks maintain three types of accounts: (1) nonprofit accounts with a very small minimum deposit from which withdrawal can be made at any time; (2) profit sharing deposit accounts with a modest minimum balance from which withdrawal can be made annually (or at shorter intervals), and (3) social services funds, consisting of gifts from which payments are made in emergencies such as accidents involving participants. The profit made by these is said to be enormous for both profit sharing depositors and stockholders.

Traditionalists who aspire to restore Islam to its original purity and escape from alien influences have cited Islamic banks as proof of the suitability and adaptability of the Islamic doctrine to the needs of modern times. The sponsors of these banks argue that the Islamic banks are not much different from the familiar western banks. The only difference is that they are not based on fixed rates of interest on loans or on despoils, which from their point of view are usurious under the Shari'a law. The regular banks they argue not only deal in money but also invest in agricultural, industrial, commercial and human projects. Therefore, Islamic banks can deal and invest in such projects but without the use of usurious interest rates¹³.

Efficiency of Monetary Policy

Throughout the postwar period there has been a growing awareness of the importance of monetary policy in the progress of economic growth stimulated by research and debates concerning the role and effectiveness of money and monetary policy. While the issues have been discussed at length, both at the university and government levels, the role that monetary policy can play remains a subject of dispute among academicians and policy markers alike¹⁴.

Although the issues concerning the influence of monetary aggregates on production, employment, and economic growth has not been settled to everyone's satisfaction, all parties at least agree that the monetary and real sectors of an economy are invariably interconnected. In nations the economic activities of which are built upon the revenue of a single commodity, such as oil, and in which all the

revenues accrue to the government, the need to disburse the huge revenues renders the entire economy dependent on government budgetary policies. As a result, both monetary and fiscal policies determine the level of production, consumption, and investment in such economies. As is the case in most surplus funds countries, the monetary and fiscal policies of Saudi Arabia are so closely related that they can be taken as one and the same thing, for the flow of money into the economic system depends on the extent to which the Saudi Arabian government spends from its oil revenues.

With regard to countries like Saudi Arabia whose money and capital markets are extremely limited and in the process of evolution, the debate is not so much concerned with the intricacies of the transmission process but tends to be more policy oriented. Here primary concern is more with the manner in which monetary policy can be used to achieve economic objectives; in this connection there is also disagreement as to the extent which these policies can be effective, given the prevailing economic conditions. In general, there has been a tendency to attribute a low importance to monetary policy in Saudi Arabia because the public sector so dominates economic activity. Largely because of inflation, there has been renewed interest in developing a more active role for monetary policy in the kingdom.

Obviously, given the institutional setting of SAMA, the question immediately arises as to whether the agency has enough tools at its disposal to perform the normal tasks involved in an activist monetary policy. For example, in the usual situation, if a central bank determines that it should tighten or raise interest rates and thereby slow the economic growth of the country, it has three major actions available. First, it can raise reserve requirements. Second, it can raise the interest rate for borrowing from the discount window. Third, it can conduct open market operations by selling (and purchasing) government securities, and thereby decrease (and increase) the cash in the system as the securities are paid for (sold) and money transferred to (from) the government.

As noted, SAMA has evolved to the point where it performs many of the traditional central bank functions, such as serving as the government's fiscal agent, managing the country's foreign exchange reserves and supervising the commercial banks. Nominal money is created primarily by government spending (government consumption is paid for in cash) and to a lesser extent through the creation of excess commercial bank reserves (which may lead to additional lending).

Some important restriction on SAMA remain, however. The agency may not extend credit to the government or to private entities (including banks), and because it

may not contravene Islamic laws, it may not use the discount rate as an instrument of monetary policy.

These restrictions obviously place limitations on SAMA's ability to implement monetary policy. They also cast some doubt as to the capability of the country under certain circumstances in being able to achieve its major economic objectives. The seriousness one attaches to this problem depends in large part on the empirical relationships in the kingdom between government spending, the money supply and macroeconomic aggregates--an area in which there is considerable controversy.

Because SAMA is not a lender of last resort in the traditional sense (it will not discount commercial paper), reserve requirements are the only major tool at its disposal. Clearly, this has restricted the agency's ability to stabilize the economy. It is not clear, however, that given the fact that it can inject funds into the system by placing government funds in its deposits at commercial banks it is unable to pursue some sort of activist policy. SAMA can also regulate the money supply through modifying capital flows in and out of the kingdom.

In this regard Saudi monetary policy, because of the unregulated domestic interest rate, has much more flexibility than that of most other Gulf states. In particular Kuwait and the UAE governments have tended to regulate domestic interest rates quite arbitrarily at very low levels. With international rates much higher, arbitrage has resulted in a large exodus of capital from these countries and continues to be a major problem. Saudi Arabians' strong feelings against interest rates seem to moderate the outflow from the kingdom. In addition, the government by regulating its expenditures has controlled the growth of the money supply more tightly than the other Gulf centers. The result has been that SAMA has been able to control capital outflows somewhat, and in fact, uses them as a policy tool. For example, one way SAMA reduces the domestic money supply is to simply let capital outflows occur when inflationary pressures are building up. With these flows, the money supply can be contracted simply by not putting any more money into the system and relying on the outflow to continue.

Despite the controlled capital flow innovation, SAMA has relied by far on changes in reserve requirements as its major monetary tool. Changes in reserve requirements influences the currency issue indirectly; i.e., an increase in reserve requirements causes commercial banks to increase their demand for reserves and thus sterilizes the effects of any increase in government spending. In this situation a reduction in government deposits is matched by an increase in bank deposits at SAMA leaving the amount of currency unchanged.

While reserve requirement changes are effective, there may be limits on its use. By the late 1970s, for example, de facto reserve requirements were between 40 and 50 percent. At these levels any significant increase might weaken the banking system and prevent it from playing a significant role in the economy. There are, however, several possible innovations in SAMA's policy that are consistent with Islamic law and at the same time capable of stimulating growth without inflation. For example¹⁵:

1. set a target growth of currency equal to the real growth of the economy;
2. control its spending so that it conforms with the targets established for currency growth;
3. encourage private purchases of foreign assets in amounts which are consistent with the economy's domestic financial needs through the development of a new riyal denominated certificate.

These certificates could be developed and managed along the following lines:

1. SAMA establishing a special account to which it could transfer a certain share of its foreign assets;
2. SAMA being prepared to sell the riyal denominated certificates in an amount equal to the local currency value of the foreign assets in the special account. If these certificates were purchased by the government, they would be paid for by a reduction in government deposits at SAMA with no initial effect on reserve money or currency. If the certificates were purchased by the public, they would be paid for by both currency and checks which, via a reduction in bank reserves, would reduce the amount of reserve money and currency in the hands of the public.
3. These certificates would not pay interest directly, but would simply pass through the income received by SAMA on the foreign assets in its special account. In addition, because the certificates are denominated in local currency, there would be no foreign exchange risk to the purchaser. These characteristics would make the pass through certificates desirable to hold by the public.
4. Government purchases of the certificates would not immediately affect the level of reserve money, because the reduction in government deposits at SAMA would be matched by an equal and opposite increase in the number of certificates which SAMA would maintain for the government. However, in the event that the government runs a budget deficit at some future time, the certificates would provide a method of financing other than through SAMA. The government could sell the certificates to the public in an amount equal to its deficit. This would be non-inflationary because the funds which the government would put into the economy would be matched by funds withdrawn via public purchase of certificates from the

government. This procedure can be contrasted with the current situation where any government budget deficit would be financed, in effect, by a money creation process which would represent a net increase in public liquidity in the form of reserve money. Thus the current procedure potentially could be far more inflationary than the certificate plan.

CONCLUSIONS

In spite of its growth, the banking system remains less sophisticated than the market it serves. There is little computerization, no secondary market for money market instruments, and a still somewhat passive monetary authority. This environment has led to wide and dangerous swings in the system's liquidity. There are signs, however, that the industry is addressing these issues. In particular, SAMA, while not yet assuming all of the traditional functions of a central bank, is nevertheless beginning to play a more role in managing the kingdom's monetary affairs. In addition, it seems clear that Islamic practices do not place any particular insurmountable constraints on the financial system.

Given Saudi Arabia's high growth rates, relatively tranquil social and political atmosphere, one must come to the conclusion that at a minimum there is nothing apparently adverse associated with the Islamic growth model. At best it might be possible to attribute considerable amounts of the kingdom's economic success to the application of this model. Other middle eastern countries should be cautious, however, before seriously considering adopting some of the kingdom's Islamic based economic policies.

Moslem scholars argue that the Islamic economic system is uniquely designed to minimize if not eliminate built-in contradictions and inequalities such as those characteristic of both capitalist and communist economic systems. In this regard the internal social and political stability of the kingdom appears to stem from the fact that through both the foresight of its leaders and their ability to combat inequality through programs made possible by oil revenues, they have already made genuine accommodations between the country's societal institution whereby people live and function with cultural and religious values that give life meaning and worth.

Islamic scriptures are not explicit as far as the economic foundations of Islamic scriptures are concerned. A reading of these sources provides some principles for behavior and a few constraints on human action. They should rather act as a code of moral behavior rather than a code of economic behavior. Saudi Arabia's economic

system and its Islamic growth model are unique to that country's history and institutions. Adaptation of the system by other countries might lead to an internally inconsistent conglomeration of economic policies. Any attempts to artificially telescope the evolutionary process involved in framing rules of the game in a real life Islamic society is fraught with great dangers. A sensible government will have to exercise utmost caution in forming economic policies for the simple reason that they undoubtedly do not have as many degrees of freedom as the Saudis.

NOTES

1. Syed Nawab Haider Naqui, "Islamic Economic System: Fundamental Issues," *Islamic Studies* (Winter 1977): 335.
2. For an excellent summary of these positions, see Syed Nawab Haider Naqui, "Ethical Foundations of Islamic Economics," *Islamic Studies* (Summer 1987): 105-136.
3. The following figures on bank operations are from SAMA, *Annual Report*, pp. 25-41.
4. J. Tripp Howe, "Saudi Banking," *Saudi Business and Arab Economic Report* (June 6, 1980): 22-29.
5. John Whelan, "Al-Bank Al-Saudi Al-Fransi: Fully Committed to Saudiisation," *Middle East Economic Digest* (July 1980--Special Report): 69-70.
6. J. Tripp Howe, "The Riyad Bank" *Saudi Business and Arab Economic Report* (May 9, 1980): 20-21.
7. Mohammad Mohsin, "Feasibility of Commercial Banking without Rate of Interest and Its Socioeconomic Significance," *Islamic Quarterly* (December 1978): 151.
8. *Ibid.*, p. 152.
9. Howe, "The Riyad Bank," pp. 20-21.
10. *Ibid.*
11. *Ibid.*
12. Adel Bishtawi, "Arab Banking Survey", *Saudi Business and Arab Economic Report* (October 5, 1979): 13-15.

13. Mohsin, "Feasibility of Commercial Banking," p. 157.
14. For a good summary of this debate, see Tom Cargil, **Money, the Financial System and Monetary Policy** (Englewood Cliffs, N.J.; Prentice Hall, 1979), Ch. 17.
15. The following is based on Michael Keran and Ahmed al Malik, "Monetary Sources of Inflation in Saudi Arabia," Federal Reserve Bank of San Francisco, **Economic Review** (Winter 1979): 17-19.