

# THE ROLE OF COMMERCIAL BANKS IN ECONOMIC DEVELOPMENT OF PAKISTAN

BY

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The bank is an institution which trades in money and credit. Banking has played very important role in economic development of various industrialised countries of the world. They render very useful services to the development of developing countries like Pakistan. Schumpeter considered the banking system as a key agent alongwith the entrepreneur in the process of economic development.<sup>1</sup>

The banks create credit which is the life blood of trade and industry and mobilizes the possible resources of the country for the development of industry, agriculture and other sectors of the economy. The effective performance of banks can greatly help economic growth. As financial intermediaries, they can effectively mobilize ideal funds which could be got allocated through them to effective investors in productive projects promising high rates of social returns.

As creators of purchasing power, they are in a position to redirect real resources into productive uses. Carmon while studying the role of banking in economic development of England, Scotland, France, Belgium, Germany, U.S.S.R and Japan developed a "structural functional" concept of banking in economic development showing that the structural characteristics of the banking system and the laws, regulations and customs that govern its behaviour will normally be important determinants of its effectiveness in bringing about economic development.<sup>2</sup>

Any plan of economic development needs capital. No economic development of sizeable magnitude is possible unless an adequate supply of capital is made available. A very important factor of underdeveloped trait of an underdeveloped economy is deficiency of capital which is the result of small savings made by the community. There are certain reasons for small savings in Pakistan; firstly there is a historical and cultural tendency for high consumption among the people of the country, because of feudal structure of society and feudal outlook of the people instead of a modern business approach of life. The characteristics of low savings in public are lower than many other developing countries. Table No.1 reflects the detailed information about saving ratios.

Backward economies hardly save 5% of their national income against the 12% to 15%<sup>3</sup> desired rate of savings and investment. In 1950 Colin

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Clark estimated about 12.5% rate of the capital saving for China, India and Pakistan, with the purpose to get their increasing labour force absorbed and maintain the achieved rate of increase in productivity.<sup>4</sup> In underdeveloped countries the current rate of capital formation is extremely small, as well as the rate of capital accumulation is also very low. For example, in India and Pakistan ratio of gross investment is only 6 to 7 percent of the gross national product as compared to Indonesia i.e 5%, United States, Canada and East European countries i.e 15% to 18%<sup>5</sup> Thus the serious capital deficiencies in underdeveloped countries are reflected in the small amount of capital equipment, limited knowledge, partial training and small use of scientific methods per worker creating handicaps to smooth process of economic development. Realizing this, the commercial banks can play a crucial role in this respect.

### GROWTH OF COMMERCIAL BANKS IN PAKISTAN

At the time of inception of Pakistan there were only two commercial banks namely Habib Bank Limited, which was set up in 1945 with its Head Office at Bombay (India) and the Australasia Bank Limited which was established in 1944.<sup>6</sup> The Muslim Commercial Bank was organized in 1948.<sup>7</sup>

The period from 1950 to 1955 was the most important in the economic history of Pakistan. During this period the initial phase of commercial activity, which had been stimulated by the shortage of essential consumer goods in the economy, was followed by the industrial phase, when the textile and other industries were set up comparatively at a low cost. Pakistan started basically as an agricultural country, became semi-industrialised one, which it still happens to be today. Thus the growth of commercial banks was encouraged due to the requirements of the development of national economy.

The period of 1958-60, was an important era of the banking sector which witnessed the emergence of three banks; the United Bank Limited, the Commerce Bank Limited and the Standard Bank Limited. The number of Pakistan Commercial Banks was 13 by the early 1970s.<sup>8</sup> After nationalisation relatively smaller banks were merged, in larger banks and the number of banks on the whole reduced from 13 to 5.<sup>9</sup>

The commercial banks were nationalised with effect from January 1, 1974.<sup>10</sup> The main objective was to increase their efficiency by distributing the bank credit equitably and by directing banking activities towards national economy.

The commercial banks have recorded a substantial growth after nationalisation. The number of branches of the five nationalised commercial

banks rose from 3030 to 6172 during 1973 to 1985.

The total assets increased by 132% from Rs.125,783.3 million to Rs.292,359.2 million, advances by 127% from Rs.51290.5 million to Rs.116545.5 million and profits by 126% from Rs.668.5 million to Rs.1513.4 million during 1980 to 1985.

The main source of funds for the Banks is the deposits, which they receive from their customers. These had grown from Rs.84557.2 to Rs.200089.6 million by 137% during the same period. The fixed deposits continued to constitute the major share of total deposits that is 45 percent, saving deposits 33.14 percent and current deposits 21.86 percent.

The other source of funds for the banks equity (paid-up capital and reserves) of all commercial banks increased from Rs.13.15 million in 1980 to Rs.6533 million in 1985, depicting a rise of 375%. The detailed information is given in table No.II.

### THE ROLE OF COMMERCIAL BANKS IN ECONOMIC DEVELOPMENT

The most important role that commercial banks play in economic development of the country is allocation of resources. Every single loan or investment decision made by a banker influences and determines the pattern of allocation of resources, namely the sectors, the parties and the regions to which financial resources are being allocated by commercial banks. The banks are rightly regarded as an engine of economic growth in respect of supply of funds; their own operation to some extent is affected by the types of economic structure and pattern of economic growth.

In Pakistan the growth of industrial sector, that is manufacturing industries, expanded substantially during the decade of the 1960's. However, during the decade of 1970's, and mid 1980's industrial sector, agriculture, construction, services etc, were given loan facilities for development by commercial banks. Loan advances to agriculture sector which constituted about 1% of the total loans in the middle of the decade of the 1960's gradually assumed greater importance with the passage of time. The share of agriculture was about 3% in 1972.<sup>12</sup> It rose to 16.37 percent in 1985. The share of manufacturing industries in total lending increased from 39.48 percent to 50.38 percent, construction grew slightly from 2.14 percent to 3.25 percent. The ratio of commercial sector increased from 26.90 percent to 29.49 percent in 1981 but further declined to about 19.93 percent. Similarly it would be noticed that the share of services had increased slightly in the total bank lending from 12.44% in the year 1976 to 16.45% in 1981 and it declined to 0.92 percent in 1985. The detailed information is given in table No.III.

The study and analysis of dynamic pattern of bank lendings in volume

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and direction is providing guidelines to bankers and policy makers. The changes in pattern of lending should be read and analysed with relationship of the changes in comparative economic structure of the country that is like increase in the share of agriculture sector in total lending and corresponding decline in the share of agriculture sector in the GNP, because trade of bank lendings is subject to socio-economic variable of a country.

Money supply is directly linked with the functions of the banks in the shape of their nature of lending money to the concerns, the money supply should be accommodated with sharp progressive increment in the GNP, otherwise the supply of money will disturb the price level and economic structure of a society, very popularly known as Inflation. For further statistical information and sources, see table No-4 and 5.

The monetisation of a society is also providing an important parameter in the economic development of a society, because people can deposit and borrow relatively in a higher ratio and thus its positive role in economic development can easily be mobilized and achieved.

In Pakistan the position has been reversed. Deposits constitute 2/3 of total money supply whereas currency in circulation constitutes only about 1/3 of the total money supply. Thus it proves that the role of bank deposit in overall economic activities of Pakistan has increased substantially.

## OBSERVATION

During the period when the commercial banks were privately owned the productivity of worker was strongly linked with the wages and other benefits of the worker. There was a period when the bank officers seemed to be relatively better in the fields of competition, salesmanship, courtesy and personality. Naturally after nationalisation the wages are being fixed by an administrative order consequently overlooking the individual productivity and ability of a worker.

The bank deposits and borrowings are also severely affected by the nationalisation of the banks because the private organiser has relatively more interest and direct incentive with the better dealings in the direction of deposits as well as borrowings.

## CONCLUSION

Percentage share of loans to agriculture sector grew from 10.15 to 16.37, percentage share of the loans to manufacturing sector from 39.48 to 50.38, construction sector from 2.14 to 3.25. Percentage share of loans to commerce sector declined from 26.90 to 19.93 and percentage share of loans to service sector also decreased from 12.44 to 0.92 during 1976-1985.

Growth of credit in agricultural sector generates a useful proposition

of rural banking system, for the enhancement in agricultural loans has a positive and strong relationship with the growing rural banking activities at village level.

Comparative study between the formation of agricultural loans and industrial loans will give birth to another proposition, that is, steadiness of received industrial loans and loans mentioned for construction sector, due to the facilitating floating of foreign and invisible resources such as remittances of Middle-East earnings which played a positively benefiting role in the process of construction and industrialisation in Pakistan.

Decline in the loans share of the commercial sector has a negative role in the economic development of Pakistan, because the volume and value of trade and commerce have increased manifold from 1976 to 1985.

The loan share for services which increased from 12.44% to 16.45% during 1971-1981 period, started declining due to population growth in the country during the corresponding period.

To get the desired results of banking-pushing the economy forward achieved, one may not overlook the importance of the role played by the efficiency, skill and interestedness of managers and entrepreneur in the performance of the duties assigned to them. Their intensively pursued activity in the fulfillment of the fixed targets in the field of banking-cum-credit mobilisation may help to achieve the set goals of their role in the economic development of Pakistan, fully realized with practical fruition.

TABLE NO.1

RATIO OF SAVINGS TO GDP COMPARATIVE FIGURES OF  
SOME SELECTED COUNTRIES

COUNTRY	PER CAPITA INCOME DOLLARS	RATIO OF SAVINGS TO GDP (IN PERCENTAGE)
Burma	170	18
Zaire	220	13
India	240	20
Srilanka	270	14
Tanzania	280	8
Pakistan	300	6
Niger	330	21
Indonesia	430	30

SOURCE:-

Pakistan and Gulf Economist, Karachi, January 15-21, 1983, P.19.

TABLE-II

## COMPARATIVE POSITION OF COMMERCIAL BANKS

(Rs in million)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
1. Authorised Capital	370.8	3,774.0	3,774.0	3,774.0	3,774.0	3,774.0
2. Paid up Capital	221.0	2,029.2	2,029.2	2,029.2	2,029.2	2,029.2
3. Equity	1,315.0	310.80	3,476.4	4,459.9	5,325.0	6,533.0
4. Deposits	84,557.2	93,697.1	117,117.4	159,661.9	175,085.7	200,089.6
5. Fixed deposits	30,461.7	34,892.1	45,690.3	70,616.4	78,427.2	90,041.8
6. Saving deposits	31,221.5	35,746.6	43,799.5	54,408.8	58,536.3	66,302.6
7. Current deposits	22,874.0	23,058.4	27,627.6	34,636.7	38,122.2	43,745.2
8. Fixed deposits as % of total deposits	36.03	37.24	39.01	44.23	44.79	45.00
9. Saving deposits as % of total deposits	36.92	38.15	37.40	34.08	33.43	33.14
10. Current deposits as % of total deposits	27.05	24.61	23.59	21.69	21.78	21.86
11. Advances	51,290.5	59,243.9	72,393.3	19,623.3	100,464.2	116,545.5
12. Advances as % of total deposits	60.66	63.23	61.81	57.39	57.38	58.25
13. Investments	23,513.7	26,462.1	29,395.6	39,923.2	35,076.3	44,754.6
14. Investment as % of total deposits	27.81	28.24	25.10	25.00	20.03	22.37
15. Total assets	125,783.3	139,932.1	170,833.3	225,334.3	3246,711.2	292,359.2

16. Total income	8,912.6	10,386.6	12,662.6	14,605.8	18,409.4	20,911.4
17. Total expenditure	8,244.1	9,589.8	11,651.4	13,331.2	16,825.2	19,398.0
18. Total expenditure as % of total income	92.50	92.32	92.01	91.27	91.39	92.76
19. Net Profit (B.T)	668.5	796.8	1,011.2	1,274.6	1,584.2	1,513.4
20. Net Profit (B.T) as % of total income	7.50	7.67	7.99	8.73	8.61	7.24
21. Net profit (B.T) as % of total deposits	0.79	0.85	0.86	0.80	0.90	0.76
22. Net Profit (A.T)	171.0	234.3	450.3	774.2	963.2	1182.1
23. Net Profit (A.T) as % of total income	1.92	2.26	3.56	5.30	5.23	5.65
24. Net Profit (A.T) % of total deposits	0.20	0.25	0.38	0.48	0.55	0.59
25. Establishment expenditure (Salaries & Allowances)	1,583.0	1,820.5	2,202.0	2,645.1	3,316.7	3,741.3

Source :- National Bank of Pakistan, Monthly economic letter, Vol:13 No.11, Karachi November, 1986, P.24

(Rs in million)

ADVANCED CLASSIFIED BY ECONOMIC GROUPSTABLE-3

<u>ECONOMIC GROUPS</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
1. Agriculture, Forestry hunting and fishing.	2210.1 (10.15)	2582.6 (10.18)	2442.5 (8.57)	2905.7 (8.33)	2899.2 (7.18)	2736.5 (5.44)	5701.7 (12.74)	6981.5 (12.41)	9883.5 (13.57)	1451.9 (16.37)
2. Mining & Quarrying.	188.2 (0.86)	373.6 (1.47)	241.7 (0.85)	309.7 (0.89)	200.4 (0.50)	323.6 (0.64)	1072.1 (0.40)	9.40 (1.67)	1150.7 (1.58)	798.6 (0.91)
3. Manufacturing.	8592.3 (39.48)	10822.7 (42.67)	11464.8 (40.22)	13915.1 (39.89)	14615.1 (36.23)	18188.9 (36.19)	22873.0 (51.12)	28491.6 (50.65)	37066.6 (50.80)	44184.0 (50.38)
4. Construction.	463.7 (2.14)	694.4 (2.74)	908.1 (3.18)	769.2 (2.21)	1117.3 (2.77)	1014.0 (2.02)	1184.7 (2.65)	1230.3 (2.19)	2165.1 (2.97)	2854.5 (3.25)
5. Electricity, Gas, Water and Sanitary Services.	140.2 (0.64)	91.3 (0.36)	187.6 (0.66)	253.0 (0.73)	252.3 (0.62)	466.6 (0.93)	1194.6 (2.67)	1676.9 (2.98)	1878.2 (2.57)	1683.5 (1.92)
6. Commerce	5845.6 (26.90)	6146.1 (24.23)	7889.1 (27.67)	9927.6 (28.46)	10662.4 (26.43)	14819.6 (29.39)	9152.6 (20.46)	11576.6 (20.58)	14086.0 (19.30)	17451.5 (19.93)
7. Transport, Storage & Communication.	262.8 (1.21)	363.4 (1.43)	349.7 (1.23)	396.2 (1.13)	885.5 (2.20)	789.4 (1.57)	524.4 (1.17)	1373.7 (2.44)	1462.6 (2.00)	1525.4 (1.74)
8. Services.	2707.6 (12.44)	2605.1 (10.27)	2843.0 (9.97)	3323.3 (9.53)	5617.8 (13.93)	8265.0 (16.45)	524.2 (1.17)	558.9 (0.99)	932.4 (1.27)	804.1 (0.92)
9. Others.	1345.3 (6.18)	1685.9 (6.65)	2179.4 (7.65)	3081.4 (18.83)	4091.2 (10.14)	3654.3 (7.27)	2514.7 (5.62)	3421.1 (6.09)	4335.5 (5.94)	4011.7 (4.58)
Total	21764.8 (100)	25365.2 (100)	28505.9 (100)	34881.3 (100)	40341.2 (100)	50254.8 (100)	44742. (100)	56250.7 (100)	72970.2 (100)	87696.1 (100)

SOURCE

i) State Bank of Pakistan, Annual Report 1984-85 Karachi, 1985, Statistical Section, p. 42-45.

ii) State Bank of Pakistan, Annual Report 1985-86, Karachi, 1986, Statistical Section, p. 36-39.

Percentage is shown in ( )

TABLE NO.4

BANK DEPOSITS AS COMPARED TO MONEY SUPPLY & GDP

( AMOUNT IN MILLION RUPEES )

PARTICULARS

	<u>YEAR 1974</u>	<u>YEAR 1982 (MID-YEAR)</u>
Gross National Product	81.058	315,033
Total Money supply (Monetary Assets)	28.000	112,305
Deposit Money	18.397	75,487
Stage of Monetisation (GNP-Money Supply)	34.54%	35.65%
Banking habit (Ratio of Money to GNP)	22.97%	23.96%
Banking development (Ratio of deposits to total Money supply)	65.70%	67.22%

SOURCE:: Pakistan and Gulf Economist, Karachi, January 15-21, 1983,  
P.18

TABLE NO.5

GROWTH IN DEPOSITS OF COMMERCIAL BANKS:1964-81

( AMOUNT IN MILLION RUPEES )

<u>DEPOSITS</u>	<u>1983</u>	<u>1984</u>	<u>INDEX 1973-100</u>
Habib	54967	61933	909.70
National	40611	44415	661.41
United	41503	44631	753.68
Muslim	15705	16934	895.89
Allied	6875	7183	754.40
	159,661	175,097	785.63

SOURCE: i) Pakistan and Gulf Economist, Karachi, January 15-21, 1983,  
P.18  
ii) Economic Journal, United Bank Ltd, Number 5, Karachi,  
May, 1985, P.14.

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