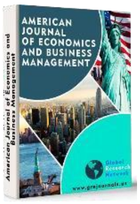

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Article

Central Bank Role in Supervising The Banking System

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Abstract: With regard to the banking sector, the Central Bank monitors the work of banks and makes sure that they lend the funds available to them and invest them in a way that does not harm the funds of depositors and within the policies that follow precautionary measures. The central bank is the one that issues licenses for banks and can withdraw these licenses or impose penalties on violating banks, in addition to its management and control over the banking sector in any country, as it is considered the bank of banks, the central bank is the main department in the country to determine and manage monetary policy in a way that contributes to helping The economy is to achieve the required balance and meet the economic goals that the state aspires to. The idea of central banks is linked to expanding reliance on borrowing to finance trade and commercial exchanges and expanding cash beyond the scope of being covered by precious metals such as gold and silver.

Keywords: Central Bank, Banking System, Central Bank Independence, Banking Operations, Credit

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1. Introduction

The central bank of any country plays a significant role in managing the economy. It is the planner of monetary policy, which is one of the most important economic policies. It also implements this policy, which it has planned and prepared in advance [1]. To implement this policy, the central bank will rely on a set of tools, including (interest rates, exchange rates, open market operations, legal reserve ratio, rediscount rates, and new currency issuance). Through these tools, it controls the amount of cash available within any country.

Since the banking system is one of the most important sectors dealing with money, the central bank plays an effective role in managing and even supervising this sector, a point this research will highlight [2], [3].

In addition, the central bank has an important strategy and procedures that play an effective role in improving the value of the currency and controlling the volume of the local currency to control inflation rates through the aforementioned central bank tools [4], [5], [6].

Thus, the central bank plays an effective role in managing the monetary and banking aspects of any country.

2. Materials and Methods

First: The Research Problem

The research problem emerges through the following questions:

a. Does the central bank have a role in influencing the banking system of any country?
b. What is the extent of this influence?
c. How does the central bank influence the banking system?

Second: The Importance of the Research

The importance of the research is highlighted by understanding the objectives of the Central Bank, its role in monetary policy in general, the tools it uses to manage this policy, and the most prominent tools it uses to manage and monitor the banking system.

Third: Research Objectives

The research aims to:

a. Identify the role played by the Central Bank in influencing the banking system.
b. Identify the direct role played by the Central Bank in influencing the banking system.
c. Identify the tools through which the Central Bank influences the banking system.

Fourth: Research Hypothesis

The research is based on the hypothesis that the central bank in any country has a direct and powerful influence on the banking system, as it is the planner, setter, and implementer of monetary policy.

Fifth: Research Methodology

The research will follow a theoretical (descriptive) approach.

Sixth: Research Methodology

The research will be divided into three sections:

a. Section One: The nature of the central bank, its objectives, and its tools.
b. Section Two: The nature of banks, their objectives, and their activities.
c. Section Three: The role of the central bank in supervising the banking system through its tools.

3. Results and Discussion

Chapter One

What is a Central Bank

The Central Bank

The central bank is the institution responsible for issuing money in every country in the world. It also presides over the monetary system. Therefore, it oversees monetary management and controls all banks operating in the economy. It is the last resort for various banks when necessary, within the framework of the prevailing or existing laws and regulations in each country.

It enjoys sovereignty and independence, and its activities are considered of paramount importance. It is at the head of the banking system and intervenes to direct and monitor various commercial and specialized banks to achieve the desired monetary objectives, employing a range of policies or methods whose importance varies from one economy to another. These methods may affect the volume of credit and lending trends, on the one hand, or direct bank activities towards specific objectives, on the other. Although banks agree on the basis of their composition and practice of banking work, they differ from one another in the type of activity they practice.

Despite the various names given to the central bank, it is generally considered a legal and monetary entity. It is one of the public interests through which the state achieves control over the country's economic life. It is considered a public institution based on its basic elements :

1. Legal independence (legal personality)
2. Financial independence (independent financial liability)
3. Administrative independence, while maintaining a degree of organic connection between it and the state (as the public legal entity representing the people)

The central bank, as its name indicates, occupies a central position in the financial and banking structure of which it is a part. It has distinctive characteristics and properties that are not shared by commercial banks. It is a monetary institution capable of converting real assets into monetary assets and vice versa. It occupies the leading and top position and represents the supreme oversight authority. It is a single institution, and it is often a public institution. This means that the state must own this bank, a necessity dictated by the importance and seriousness of the functions that this bank performs. The goal of the central bank must be the public interest, since in reality the central bank is nothing but a bank that deals in credit, just like other banks, but it differs from them in terms of its ownership, its objectives, and the nature of the operations it carries out, and consequently in terms of the nature of those who deal with it .

The term "central bank" was not originally given to this type of bank. Rather, it bore the name of the country in which it was located, and sometimes the name "national bank," "reserve bank," as in India, or the Federal Reserve System, as in the United States. This distinction stems from the importance given to each function depending on the country and the circumstances of its establishment. However, everyone agrees that the central bank is at the head of the country's banking system, oversees the country's credit and banking policy, and supervises its implementation. Unlike commercial banks, its goal is not profit, but rather contributing to economic activity in a manner consistent with the country's economic objectives and in the public interest.

So what is a central bank?

Some economists have attempted to define the concept of a central bank, but the multiplicity and diversity of these definitions points to the difficulty of the task, as each definition focuses on one of the central bank's functions to the exclusion of others, as is evident from the following definitions.

For example, Vera Smith defined central banking as "a banking system in which a single bank has sole authority to issue money." She emphasized the function of issuing money, while A. Day viewed the central bank as "the one that regulates monetary policy and works to stabilize the banking system." He focused on the task of stabilizing the banking system.

Jauncy defined it as "a bank whose primary operation is clearing," with the settlement of interbank accounts being the basis for its definition.

Shaw, on the other hand, believed that "the real, and at the same time, very sufficient, function of the central bank is credit control."

The Bank for International Settlements, in its statute, went in the same direction, defining the central bank as “a bank entrusted with the task of regulating the volume of currency and credit in the country in which it is located.” Perhaps the most comprehensive definition offered is that provided by Muhammad Zaki Shafi’i: “The central bank is the body that issues banknotes, ensures, by various means, the foundations of the banking system, and is entrusted with supervising the credit policy of the country, with the significant effects of this policy on the economic and social spheres.” This definition is comprehensive in that it does not focus on one function of the central bank alone, and it almost encompasses all the characteristics of the central bank, which, in their entirety, form the framework defining the nature and character of the monetary entity known as the central bank.

From what was mentioned above, the central bank can be defined as (the central bank is responsible for the banking system of the country, and is responsible for the credit and banking policy in the country and supervises its implementation). From here, the central bank can be defined as (the central bank represents the bank that has an independent legal personality, and derives its existence as a public institution and carries out all its work in accordance with the provisions of the law, and has the right to own and dispose of its property, and to contract and file lawsuits and have them filed against it in its name and have its own seal and be exempt from all taxes, fees and stamps). In other words, the official issuing institution for foreign currency, the issuance of which is governed by many economic and financial variables and requirements.

Second: A Historical Overview of the Origins of Central Banks

The first central bank appeared in Sweden in 1668, aiming to secure state financing in exchange for the privilege of issuing currency. Britain established its second central bank in 1694, established by royal decree to finance the king's treasury in exchange for the right to issue currency. The nineteenth century was also marked by many countries granting an existing bank the sole right to issue banknotes or to assume the primary issuance function. The state may have facilitated the establishment of a new bank with special powers and privileges, accompanied by varying degrees of government control and oversight. In most jurisdictions, the central bank emerged as a commercial bank, distinguished by the government's allocation of deposits or the privilege of issuing banknotes.

In any case, the central bank became the government's banker and financial agent, later acquiring other functions developed and practiced by the Bank of England throughout its long history. By the beginning of the twentieth century, virtually all European countries had an issuing bank, in addition to some countries in the East and Africa. However, in the countries of the New World and some countries of the Old World (such as India and China), central banks were not known until the twentieth century. After the Bank of England, central banks were established in Europe during the nineteenth century. The Bank of France was established in 1800 and was closely linked to the government since its inception. The Dutch Central Bank was established in 1814. Then came the establishment of the banks of Norway, Denmark, Belgium, and Spain during the years 1817, 1818, 1850, and 1856, respectively. The German Reichsbank was established in 1875, and the Japanese Central Bank was established in 1882. As for the United States of America, the panic that occurred in 1907 led to the establishment of a new system of central banking in 1913, in the form of twelve Federal Reserve Banks, each with authority over a specific region, with a Federal Reserve Board to coordinate between them, headquartered in Washington.

The International Financial Conference hosted by Brussels in 1920 had a significant impact on the spread of central banks to monitor the issuance of currency and serve international cooperation, which led to the establishment of central banks not only in the formerly independent countries that did not have central banks, but also in many newly independent countries (former Soviet Union countries) or even those with self-rule. In order to touch more on the emergence and development of central banks, we will discuss below in some detail the most important and influential central banks in the art of central banking. This concerns the central banks of England, France and the United States of America. The motive behind the establishment of central banks was the desire of governments to intervene in banking activity and organize and manage currency issuance operations, which were previously undertaken by commercial banks. Therefore, at the beginning of their establishment, central banks were called (issuing banks) because they took on the task of issuing currency and organizing it within the limits and conditions determined by the government. Then, central banks gradually took on the task of supervising banking and directing it in a manner consistent with the goals of the state’s economic policy, in addition to other responsibilities and tasks.

Third: Central Bank Independence

Many economists have called for the independence of the central bank from the government, given that its complete subordination to government authorities has led to excessive borrowing from the central bank and the resulting deterioration of many countries' currencies, particularly during the period between the two world wars.

Furthermore, despite its monopoly on currency issuance and the state's contribution to the exchange of aid and advice, the central bank should not be a government agency. Rather, it should remain an independent body. This independence does not prevent it from cooperating with the Ministry of Finance, but it is not considered a branch of the government apparatus.

Therefore, its activities should not be hindered or obstructed by controlling government intervention. However, the expression of the independence of the central bank is a relative expression, as the government has absolute authority to appoint legal currency and amend its laws. Therefore, the independence of the central bank is a relative independence that results in reducing the degree of government interference in organizing the internal business of the bank. As for its general policy, it must be set in agreement with the government, and no other situation can be imagined in contemporary economic conditions. The appendix to Order No. 56 of 2004 stipulated the legal status and independence of the central bank in Article No. 2 (Agency).

1. The Central Bank of Iraq, established pursuant to the Central Bank of Iraq Law, Law No. 64 of 1976, as amended from time to time, is a legal entity with full capacity to contract, litigate, be sued, and perform its functions stipulated in this Law and other laws. In carrying out its functions, the Central Bank of Iraq may:
   a. Acquire and manage property.
   b. Appoint employees, determine their duties, and determine their entitlements.
   c. Determine and finance its budget. Nothing in this Law shall be construed as preventing the Central Bank of Iraq from maintaining its status as a legal entity under a previous law, nor shall this Law contain anything that shall be construed as interfering with the authority, rights, duties, or obligations of the Central Bank of Iraq stipulated in a previous law, except as specifically provided for in this Law.
2. The Central Bank of Iraq shall be independent in its endeavors to achieve its objectives and carry out its tasks, and shall be subject to accountability in accordance with the provisions of this Law. “The Central Bank of Iraq shall not receive any instructions from any person or entity, including governmental bodies, except as otherwise provided in this Law. The independence of the Central Bank of Iraq shall be respected, and no person or entity shall seek to improperly influence any member of any decision-making body of the Central Bank of Iraq in relation to the performance of his duties towards the Bank, and no person or entity shall interfere in the activity of the Central Bank of Iraq”.

In addition to respecting this independence and in accordance with Article 26 of the above law, which prohibits the Central Bank from lending to the government or any public body owned by the state, directly or indirectly, with the exception of purchasing government securities within the framework of market operations, the Central Bank has also become independent in its tools and no longer uses financial leverage to finance the budget deficit, as was the case during the past two eras, to meet the needs of public spending in a manner that led to the elements of stability in the economy, the decline of growth and the deviation of investment opportunities.

In an attempt to confirm the independence of the Central Bank, a special law was issued that clarifies the method of appointing the Governor of the Central Bank, whereby he is appointed upon the proposal of the Prime Minister and the approval of the House of Representatives, and he must have experience in banking, financial or economic affairs. The two Deputy Governors are also appointed upon the proposal of the Governor and the recommendation of the Council of Ministers and the approval of the House of Representatives, and they must have experience and expertise in banking, financial and economic affairs.

It is worth noting that in 2003, the Coalition Provisional Authority issued an order that included measures to ensure the independence of the Central Bank of Iraq. It stipulated the following: "The Central Bank shall be empowered to determine and implement monetary and credit policy without the approval of the Ministry of Finance... Matters of determining and implementing monetary and credit policy shall be decided only by members of the Central Bank of Iraq's management, who hold positions at the

Central Bank of Iraq and work there with the approval of the Administrator of the Coalition Provisional Authority".

As we have previously seen, the monetary authorities work to achieve a set of objectives, the most important of which are growth and monetary stability. In this case, the monetary authority suffers from a conflict of objectives, as accelerated growth is often accompanied by high rates of inflation and price instability, while moderate prices are accompanied by a stagnation in economic activity and growth. Economic opinion has concluded that maintaining price stability has become the primary objective of monetary policy, which in turn has become the primary function of the Central Bank.

Therefore, the central bank must have the appropriate climate to perform its role in a manner that enables it to achieve this goal. Hence, the problem of the central bank's dependence on political authority arose as a result of the ineffectiveness and inefficiency of monetary policy, especially in the field of combating inflation, which often results from the phenomenon of financing the general budget deficit imposed by governments on the monetary authority.

Hence, the issue of central bank independence imposed itself as a necessary condition and the main guarantee for the central bank's ability to formulate and implement its monetary policy in a way that achieves price stability while maintaining the value of the currency. An independent monetary authority is more capable of achieving the set economic goals because it is far from political contradictions. It can also publish and provide monetary and financial information to the public based on the logic of the necessity of transparency, which enhances the credibility of central banks. In what follows, we attempt to understand what is meant by central bank independence and the reasons for calling for it before moving on to the criteria for independence with some examples of selected banks.

Chapter Two

The Theoretical Foundation of Banks

The Nature, Objectives, and Activities of Banks

First: The Origins of Banks

Banks went through various stages of development until they reached their current form. Below, we review the evolution of the banking mechanism until it reached its current form [7].

Banking activities were initially limited to the process of saving. Some people had surplus funds that exceeded their current needs. It was natural for them to keep them until a reason arose to use them. However, the process of saving was accompanied by risks resulting from the possibility of losing this money, or a portion of it, due to theft, loss, damage, or other causes [8].

The need arose for a safe place to keep this money and protect it from the negative effects of the previous risks. A group of people (money changers) appeared who provided this service to people in exchange for a commission they received from them as compensation for the saving process. The owner of the money obtained a document proving that he had placed this money with the money changer [9].

When a specific need arose for the owner of this money (for example, he might need to buy clothes), he would return the document to the money changer and obtain in exchange the money he had previously placed. Then he would take this money and give it to the clothing merchant to take in exchange for his need [10]. This merchant, in turn, would place this money with the money changer to keep it in exchange for a commission he paid him.

It is noteworthy here that the money changer's source of income is solely from the commissions he receives from depositors for safekeeping. We also note that at this stage, to facilitate the exchange process, it is possible to replace the money owner's visit to the money changer and obtain his money in exchange for returning the documents [11].

The money changer can then go directly to the merchant, give him the documents, and obtain the clothing he needs in exchange. The transfer of documents from the money changer to the merchant means the transfer of ownership of the funds held by the money changer from their original owner to the merchant, thus eliminating the need to return to the money changer to provide the documents and obtain the funds. This results in an increase in the money changer's wealth due to the commissions he receives. It also results in an increase in the balance of funds deposited with the money changer for safekeeping, with this balance remaining stable and not changing significantly as a result of replacing transactions with documents [12].

This situation prompted the banker to think about how to benefit from this balance of money, so he began to give it to people in exchange for interest. As a result, the banker's wealth increased further due to his obtaining a new source of income.

He began to receive returns twice on the same money: once from the party that deposited the money as compensation for the storage process, and once from the party that borrowed it in the form of interest. This situation prompted the banker to think about how to increase the balance of money he had to lend it and obtain more interest [13].

He first reduced the commission for the storage process to encourage individuals to save with him. As a result of competition and the banker's desire to obtain more money, he reduced the commission even more until it reached disbursement. However, competition continued and the desire to increase the balance allocated for lending to people continued, so the banker began giving to individuals to save their money with him [14]. Thus, the banker moved from a situation in which he received a commission for the storage process to a situation in which he paid people to encourage them to go to him to save their money with him. The banking business arose as an intermediary between parties with a financial surplus and parties with a financial deficit, and the banker's returns are realized from the difference Between what he pays to depositors and borrowers [15].

Second: The concept of banks.

It can be said that there are several meanings for banks, but most of them converge toward the same goal. Therefore, it can be said that banks mean:

1. Bank: A financial institution that acts as an intermediary between economic units with a financial surplus and economic units with a financial deficit. It also invests and provides banking services.
2. Banking laws: A set of rules and regulations that regulate the activities of banks and their relationship with each other, with the central bank, and with the governing authority.
3. Banking system: Includes the set of banking institutions and laws.

Several definitions of banks have been provided, including classical and modern ones. From a classical perspective, a bank can be said to be an institution that acts as a financial intermediary between two main groups of clients [16], [17]. The first group has surplus funds and needs to preserve and develop them. The second group consists of clients who need funds for purposes, most importantly investment, operation, or both.

A bank may also be viewed as an organization that exchanges financial benefits with groups of clients, provided that it does not conflict with the interests of society and is consistent with the ongoing changes in the banking environment. From a modern perspective, a bank can be viewed as a group of financial intermediaries that accept deposits paid on demand or for specific terms. It engages in domestic and foreign financing operations and services to achieve the goals of the development plan and state policy, supporting the national economy, and undertaking financial savings and investment development operations at home and abroad, including contributing to the establishment of projects and the required commercial and financial banking operations, in accordance with the conditions determined by the central bank.

This means that the bank provides whatever financial services it can provide through its available resources, which represent solutions to the renewed and changing financial problems of its potential customers [18], [19]. Here, the customer obtains the benefit represented by the solution to his financial problems, and the bank benefits through the material and moral compensation it receives from its customers.

The entire society also obtains a benefit from the bank's activity represented by facilitating and stimulating financial transactions for all parties of society, which works to advance and grow the national and global economy. This meaning contains within it the concept of the comprehensive bank. The comprehensive bank means that the bank provides any solutions to its customers' financial problems on the terms of achieving profits and achieving the interest of society [20]. This meaning also contains within it the modern concept of marketing, which means exchanging benefits with groups of potential customers in light of achieving the interest of society and adapting to the constantly changing environment.

It is noted that the main objective of the transformation into a comprehensive bank is to generate flexibility and a mechanism that enables the bank to adapt to the change occurring in the banking environment, as well as to face the expected competition, especially after the implementation of the part of the GATT agreement on the liberalization of trade in services, including banking services, where among what it entails is the freedom of entry of any foreign bank into any market as long as it operates in a transparent manner, does not dump, and maintains respect for the civil law of the country, but rather operates in it with market efficiency [21], [22]. The following is a figure that illustrates the environment for comprehensive banks.

It is noted that the shift from the traditional concept of banking to the modern concept of a comprehensive bank requires a set of pillars, both at the state level and at the level of the banking system, as well as at the level of the bank's internal environment. We explain these pillars below:

1. **At the state level**:
   a. Providing factors that raise the level of market efficiency.
   b. The presence of a strong, independent central bank that is developed in line with the development of banking.
   c. The presence of a national money network and an electronic clearing house at the Central Bank linked to the stock exchange, the Egyptian Clearing Company, and the International Clearing House.
   d. Eliminating interest rate distortions and relying more on indirect monetary policy tools.
2. **At the banking system level**:
   a. Linking Egyptian banks to the national money network and the electronic clearing house of the Central Bank.
   b. Creating a new operating environment.
   c. Working to raise the level of banking awareness among individuals in society.
   d. Preparing to face global banking competition and avoiding isolationism.
3. **At the internal environment level:**
1. Increasing the level of competition that banks face.
   a. Diversifying the financial services provided by banks to address customers' financial needs and using banking marketing research to achieve this.
   b. Improving the quality of banking services.
   c. Accuracy of transactions.
   d. Psychological and material comfort that customers feel inside and outside the branches.
   e. Convenient working hours for customers.
   f. Expanding the bank's branches to bring them closer to customers.
   g. Prompt service delivery.

h. Good customer service.
i. Good appearance of bank employees, especially those on the front lines.
j. Managing the bank's resources efficiently to achieve the goals of profitability, risk, continuity, and growth.
k. Building reputation and trust in the bank.

2. Connecting the bank to a unified national financial network linked to the international financial network to facilitate and expedite comprehensive customer services [23].
3. Connecting banks to the Central Bank.
4. Developing the creative thinking of bank employees to contribute to providing modern technology and services that meet customer needs and the overall development of the environment.
5. Using appropriate competitive strategies.

It is noted that failure to adopt the modern concept of banking leads to a number of risks, the most important of which are:

1. The bank's competitiveness declines, which in turn impacts profits and increases risks.
2. Financial transactions for individuals and organizations may shift away from the banking system, especially with the growing role of the Internet as a global financial and marketing medium.
3. The country's economy is affected by the decline in the performance of the banking system. The more active the banking system, the more this is reflected in increased financial transactions within the economy, and thus, greater growth in national income.

"Regardless of the definitions given to a bank, Egyptian law has set the following conditions for an institution engaged in banking activities":

a. The institution must take the form of a joint-stock company.
b. The paid-up capital must not be less than a certain amount determined by law.
c. The bank's primary business must be to collect temporary, urgent savings from the public for the purpose of distributing them to others for use.

Third: The Importance of Banks.

The importance of banks in the modern era is evident primarily in the large balances of small deposits compared to the savings generated from large amounts of money [24], [25]. This is due to the following:

a. Without this intermediary, the owner of the money must find the desired investor, and vice versa, on terms that suit both.
b. Without banks, the risk is greater for an economy involved in a single project.
c. Due to the diversity of banks' investments, they distribute risks, making it possible to engage in high-risk projects.
d. Due to the large size of their balances, banks can engage in long-term projects.
e. Bank intermediary increases the liquidity of the economy by offering cash-like assets that generate returns, which reduces the demand for money.
f. By offering investors diverse financial assets with different risks, varying returns, and varying terms, they accommodate and respond to all desires.
g. Encouraging primary markets that invest and issue financial assets that individuals shy away from for fear of risk.

Fourth: Bank Objectives.

The bank's financial activity aims to maximize the wealth of project owners, or in other words, maximize the value of shares in the stock market, thereby maximizing the wealth of owners. Maximizing wealth is achieved by maximizing revenues, reducing expenses, or both.

Fifth: Types of Banks.

Countries differ in their economic systems, and consequently, banking systems differ from one country to another. The banking system in any country consists of a number of banks, each with its own set of types and specializations.

The most important types of these banks are:

1. Central banks.
2. Commercial banks.
3. Islamic banks.
4. Specialized banks, which consist of:
    a. Industrial banks.
    b. Agricultural banks.
    c. Real estate banks.
5. Savings banks.

Sixth: Bank Functions (Banking Operations):

Banking operations represent the set of activities undertaken by bank employees and management to achieve the bank's objective (profit). We will review these operations below:

First: Accepting Deposits:

1. Definition of a deposit: It is an amount of money placed in a bank by natural or legal persons under specific conditions. These conditions include the amount of the deposit, the interest rate, the withdrawal method, and, in some cases, the conditions for disposing of the deposit in Islamic banks.
2. Types of Deposits:
    a. Term Deposits: These are placed in the bank for a specific period of time and may only be withdrawn after the expiration of the deposit period. In some cases, they may be withdrawn with the bank's approval, but they do not receive any interest.
    b. Notice Deposits: In this type of deposit, the depositor must notify the bank of their desire to withdraw the deposit before a specific period agreed upon with the bank's management. As with time deposits, the depositor can withdraw the deposit without prior notification to the bank, and they also do not receive interest.
    c. Demand Deposits: These are placed in the bank, and the depositor has the right to withdraw them at any time without prior notification to the bank.
    d. Savings Deposits: These are placed in the bank primarily by small savers. They represent a type of savings program targeting low-income individuals.

In terms of time period, deposits can be divided into long-term deposits, medium-term deposits, and short-term deposits. Considering the above types of deposits, we find that the interest rate is higher on term deposits compared to other types of deposits. Why? This type of deposit provides the bank with the ability to finance long-term investments that require a long payback period but offer a high rate of return. The bank cannot use other types of deposits to finance these investments for fear of withdrawal requests.

As for savings deposits, their interest rates may sometimes be equal to or higher than those of term deposits. Why? Because the goal of this type of deposit is to encourage low-income individuals to save their surplus funds, regardless of their amount, in the bank. Note that there is a specific ceiling on the amount a customer can deposit in these types of deposits.

a. Sources of Deposits: The bank obtains deposits from various sources, the most important of which are:
b. The household sector.
c. The government sector.
d. Private sector companies.
e. Public sector companies.

Second: Granting Credit:

1. Definition of Credit: It is the trust granted by a bank to a customer, resulting in that customer obtaining cash or non-cash facilities from the bank.
2. Types of Credit Facilities: Credit facilities are divided into direct (cash facilities) and indirect (non-cash facilities).
3. Direct Credit Facilities: The most important types are:
   a. **Loans:** A loan is an amount of money obtained by a natural or legal person from a bank under specific conditions. These conditions include the loan amount, repayment period, installment value, interest rate, guarantees, and late payment penalties.
   b. **Grants:** A grant is an amount of money provided by a bank to one of its customers on a one-time basis, interest-free.
   c. **Discounting of Commercial Papers**: This means that an exchange customer obtains the value of the commercial paper as its beneficiary before its maturity date by presenting it to the bank, and the bank agrees to transfer its value to the customer before its maturity date in exchange for a commission received by the bank. When the due date arrives, the bank presents the commercial paper to the person on whom it was drawn to obtain its value.
4. **Indirect Credit Facilities**: The most important types are:
   a. **Documentary Credits**: This is a letter issued by a bank based on the request of the customer (the person ordering the credit), in which the bank pledges to pay another party (the beneficiary of the credit) a sum of money upon presentation of documents proving compliance with the terms and conditions contained in the letter of credit. The documentary credit is used to settle commercial transactions as a guarantee for the rights of the seller and buyer.
   b. **Bank Guarantee**: This is a pledge issued by a bank for a specific period of time, whereby the bank guarantees a person (the customer) to another party (the beneficiary) that it will pay the beneficiary a specific amount (the value of the guarantee), if the customer fails to fulfill their obligations to the beneficiary during the guarantee period.

Third/Investment:

1. **Definition of Investment**: Investment refers to the funds that a bank directs to invest in various areas other than granting credit, including the purchase of government stocks and bonds and contributing to the establishment of projects.
2. **Types of Investments a Bank Can Make**:
   a. Investing in government-issued instrument and treasury bills.
   b. Investing in government-issued bonds to finance specific objectives (housing bonds).
   c. Investing in shares of companies listed and unlisted on the stock exchange.
   d. Forming investment funds.
   e. Undertaking investment projects or becoming a partner in them.
3. Providing Banking Services:
   a. Definition of Banking Services: Banking services refer to the set of businesses that a bank offers to its customers (excluding the three banking operations mentioned above) in exchange for certain commissions.
   b. Types of Banking Services:

Traditional Banking Services: These are characterized by the following:

   a. Provided by all banks.
   b. Provided to all customers.
   c. Require no capital (does not require bank financing).
   d. Rapid turnover (carried out by the bank and requested by customers several times throughout the year).

Examples of traditional banking services include bill payment services and providing account statements to customers.

Non-traditional Banking Services: These are characterized by the following:

a. Provided by some banks.
b. Provided to some customers.
c. Require capital (does not require bank financing).
d. Not fast-moving (implemented by the bank and requested by customers a limited number of times during the year). Examples of non-traditional banking services include: (economic feasibility studies for customers, managing customers' assets, selling customers' assets, leasing safes).

Note: The concept of traditional and non-traditional banking services is a relative concept; what is traditional today was non-traditional in the past (for example: ATM service has become traditional today after it was non-traditional in the past), and what is traditional in one place may be non-traditional in another place (for example: safe deposit box rental service is traditional in countries with developed banking systems and non-traditional (or even non-existent) in countries with less developed banking systems.

Section Three

The Role of the Central Bank in Supervising the Banking System Through Its Instruments

First: The Functions of the Central Bank

Central banks around the world today perform similar functions aimed at achieving the public good. However, the exercise of these functions varies from one economic environment to another. Modern central banks perform all or some of the following functions:

a. Issuing legal tender banknotes under certain restrictions consistent with transaction needs.
b. Providing banking services to the government, which has led the central bank to be called the "bank of the government."
c. Providing banking services and providing assistance to commercial banks, which is why the central bank is called the "bank of banks," emphasizing this function.
d. Managing the country's foreign exchange reserves and monitoring foreign trade conditions to contribute to the stability of foreign exchange rates.
e. Monitoring credit, both quantitatively and qualitatively, and directing it to serve the established monetary policy. The central bank is therefore a (usually) governmental institution that dominates the country's monetary and banking system. It is responsible for issuing currency and acting as the government's financial agent, in addition to monitoring banking institutions and the credit process to support economic growth and monetary stability. We will discuss these functions in detail below, in the order we outlined above. Because credit control represents the core of our work, we will return to it in more detail in the next chapter.

Second: Central Bank Tools and How They Work:

There are two types of tools available to the Central Bank, namely:

Quantitative (indirect) control tools over bank credit: The monetary authority, represented by the Central Bank, influences the volume of credit (i.e., the volume of lending and borrowing operations) through traditional quantitative means (policies), enabling it to control the money supply and, consequently, influence economic activity. These basic monetary policies are as follows:

1. **Discount Rate and Interest Rate Policy**: The discount rate is the rate at which commercial banks discount commercial papers offered by their customers. Since commercial banks resort to the Central Bank to rediscount commercial papers, the rate at which the Central Bank discounts these papers offered to it by commercial banks is called the rediscount rate. The rediscount rate represents

the interest rate charged by the central bank on loans granted to commercial banks.

Under inflationary conditions, the central bank will resort to raising the rediscount rate, thereby increasing the cost to commercial banks of obtaining loans. Consequently, commercial banks will be reluctant to rediscount the commercial papers they hold, and their available liquidity for lending will decrease, forcing them to raise the interest rate on loans they make available to their customers. This will result in a decline in demand for bank credit by individuals, businessmen, and institutions.

Consequently, total spending will decline, contributing to a reduction in inflationary pressures. Furthermore, interest rates on demand and time deposits will increase the volume of deposits and freeze a portion of purchasing power, thus reducing total spending. In conditions of economic contraction, the central bank can reduce the rediscount rate, which reduces the cost of obtaining loans. Commercial banks resort to providing more commercial papers in their possession to discount them at the central bank, thus increasing the liquidity available to them for lending, and the interest rate on their loans and on demand and time deposits decreases, which encourages businessmen to increase demand for credit, and thus the volume of total spending increases, which contributes to achieving economic recovery.

2. **Open Market Operations Policy**: This refers to the central bank's entry into the monetary and financial market as a seller or buyer of certain government bonds and securities (short-term treasury bonds and bills). In the event of an economic recession, the central bank enters the monetary or financial market as a buyer of government bonds and securities, whether held by individuals, commercial banks, or institutions (in exchange for checks drawn on the central bank).

Naturally, sellers of government bonds and securities will deposit the checks with commercial banks for collection from the central bank. When commercial banks present these checks to the central bank for collection, the central bank deposits the check amounts in the commercial banks' accounts, thus increasing the deposits of these banks with the central bank and their cash reserves.

This helps commercial banks expand the volume of credit and loans to their customers, which leads to an increase in total spending in society and achieves economic recovery. In addition, when the central bank enters the financial and monetary market as a buyer of government bonds and securities, the prices of these bonds and securities will rise, leading to increased demand for their sale and the conversion of these bonds and securities into liquidity available to commercial banks, thus increasing their ability to expand credit.

This will result in a decrease in the prevailing interest rate in the monetary market, which will lead to an expansion in total spending on new investments and an increase in effective demand. However, in conditions of inflation, the central bank will adopt a contractionary monetary policy, meaning it will enter the monetary market as a seller of some government bonds and securities, which will lead to a decrease in their prices, which will entice people to buy them. The central bank will thus absorb a portion of the liquidity available to commercial banks, thus reducing the ability of these banks to provide credit and lending, which will result in a decrease in total spending (or total demand), a reduction in inflation, and an increase in prices.

3. **Legal (mandatory) cash reserve policy**: According to the Central Bank's regulations for supervising commercial banks, commercial banks are obligated to maintain a certain percentage of their total deposits with the Central Bank as a mandatory legal reserve, which is included in the total deposits (current, time, and savings deposits).

Central banks pay special attention to ensuring that each commercial bank pays its cash reserve at the end of each month. The cash reserve is calculated based on the monthly average of its deposits for that month. If a commercial bank fails to pay its reserve, the

Central Bank imposes a higher interest rate on the remaining amounts to encourage commercial banks to pay their legal cash reserve. This policy is the most important means that enables central banks to directly control the ability of commercial banks to pay.

The Central Bank resorts to reducing the legal reserve ratio, while in inflationary conditions, it raises this ratio to reduce the ability of commercial banks to inject credit.

4. **Direct Supervision Tools**: Direct supervision refers to the set of direct measures and procedures taken by the Central Bank regarding financial and banking institutions and agencies with the aim of achieving monetary policy objectives. The effectiveness of these procedures is linked to the Central Bank's position and the extent of its primary influence over the banking system. The Central Bank performs the following:
   a. Convincing banks and providing them with advice and counsel regarding its investment and credit orientations in general.
   b. Direct intervention, when necessary, to impose certain restrictions and conditions on banks' credit and investment activities, such as setting the maximum limit for loans extended to certain sectors, determining the ratio of bank capital to cash reserves that banks must adhere to, and other measures that the Central Bank deems necessary to ensure the achievement of its monetary objectives.
5. **Qualitative control tools**: These tools aim to influence the quality of bank credit, regulate banking investment operations, and direct them to serve the purposes of monetary policy, and consequently, the state's general economic policy. In accordance with these tools, the Central Bank performs the following:
   a. Determine the interest rate on loans and advances and the interest rates on late payments.
   b. Determine the areas and activities within which banks may engage in credit activity. This means excluding areas and activities that the Central Bank does not wish to finance, through the Central Bank's use of what is known as discriminatory interest rates.

4. Conclusion

a. The central bank plays an important role in any country's economy. It (issues legal tender, manages the country's foreign exchange and gold reserves, provides banking services to the government, and supervises the banking system).
b. Commercial banks play an important role in any country's economy. They (accept deposits from individuals and the government, invest a portion of the deposits in various economic activities, and provide various banking services).
c. The central bank plays an important role in managing any country's banking activity and supervising the work of commercial banks through a set of tools, which are of two types: direct and indirect.

Recommendations

a. The government should grant the central bank a role in planning, formulating, and implementing monetary policy for any country, by granting it operational independence. This ensures that monetary policy in any country is managed scientifically and practically, in accordance with economic logic.
b. The government should grant the banking system a major role, as it represents the economic sector that collects savings from individuals and the government, and then invests them in various economic sectors.
c. The necessity of the central bank exercising its supervisory role over the banking system to ensure that banking activity is directed in a manner that serves the country's economic and developmental objectives.
d. The central bank's supervisory role over the banking system provides individuals with reassurance regarding their deposits (given that banking activity is closely

monitored by a reputable government agency). It also provides borrowers with reassurance (through the knowledge that their investments are managed by a reputable government agency).

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