

CHAPTER 2

**REVIEW OF
LITERATURE**

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The chief objective of any research endeavour in reviewing related literature is to justify the rationale of an ensuing study. It provides an overview of historical perspective. In a way, it brings to light, the research trends and problems; critical awareness toward the methodology employed; and an estimation of relationships working along with the variables. And finally the review helps in providing placement and direction for the study to be fitted into the existing body of knowledge.

2.1 INDUSTRIAL DEVELOPMENT AND ECONOMIC DEVELOPMENT :

The economic growth of any country can be judged by testing several parameters. Industrial growth is one of them but the rapid growth of the industry or rapid economic development requires the combination of favourable factors viz. availability of entrepreneurship, skilled personnel, raw materials, power and financial sources, which includes both domestic and foreign capital.

Sometimes it may happen that despite of having good number of entrepreneurs and skilled personnels, country's growth of industrialisation become stagnant due to lack of financing facility. So, it is the finance that plays an important role in the overall development of the country. The finance provided by the financial institutions or financial intermediaries to the industry is called Industrial Finance.

Now-a-days, apart from commercial banks, there are several non-Banking financial institutions who finance the industries. We can also say that the difference

between today's modern banker and a moneylender would be same as the difference between an architect and a brick-layer.

Economic development is a relative term and is used differently by different countries depending upon its stage of development and the contribution of different sectors of the economy in terms of growth rate of national income, per capita income and overall development of the people in general. The development in any country can be brought about by increasing simultaneous investment in different sectors of the economy but due to lack of resources or incapability to utilise the available resources, it becomes very difficult for many countries to achieve expected growth rate. So, it becomes crucial for the economy to decide its priorities and allocate resources to different sectors accordingly. Economists like W.W. Rostow was of the view that each country has to pass through different stages of growth before reaching the developed state of the economy. It implies that all the sectors have their own place in the development of the economy. But recent changes in the world trends have made the world economy to heavily depend upon industrialization for the growth of the economy and to compete successfully in the world economy.

Economic development is defined as a process of increase in real national income over a long period of time. But increase in real national income is not the only criterion to judge economic development. The term economic development has been defined in terms of income as well as social indicators.

- The income indicators are real national income and real per capita income
- The social indicators are satisfaction of basic needs of masses and overall development of human beings.

Thus, economic development can be measured in terms of increase in income, life expectancy, literacy rate, income for decent living, healthy and education facility and decline in infant mortality rate. In recent years, United Nations has defined economic development in terms of Human Development Income. The three major components of HDI are - income for decent living educational attainmen and, life expectancy. The growth rate of economy's development can be measured in terms of its shift from lower index to higher index, which makes some sense because increase in income alone cannot justify the overall improvements in the economy. Until and unless, the fruits of the economic development does not reach masses of the country it cannot be concluded that country is developing.

Economic development can be result of sincere and targetted attempts of the government of the country and the cooperation and contributions of the private sector. It has been found that any country cannot develop if the government policy is not far-sightedly planned. As the government is the main controlling power in the country, the role of government in terms of designing economic policies is important. Although the government can play an important role in bringing economic development, the role of private sector cannot be ignored. The reason is, private sector is more profit oriented, more specialized, more dedicated and more positive results oriented. But private sector cannot contribute significantly if there is no impetus or motivation or direct and indirect help from the government. It has been found in many countries that private investment has played a more crucial role in bringing development rather than public investment. It does not mean that the role of government was insignificant but the policy of the

government favoured private investment, which resulted in high private investment and thereby economic development.

The study of Indian economy shows that the government started economic planning in the year 1951 by giving more importance to agriculture in terms of allocating resources, realising that the vast country would develop only if the country will be self-sufficient in food items. But economic planners came to the conclusion that this country cannot develop without significant growth rate of industrial sector. It is because of this conception, the government of India decided to depend more on industrialisation for faster growth in the country. Keeping these views in mind, the Industrial Policy Resolution of 1956 was introduced classifying industries into three categories - public, private and joint sectors. The major policy decision was again taken in the year 1991 by the Indian government to introduce the policy of Liberalisation, Privatisation and Globalisation. It is because of these policy formulations, Indian economy has seen many private foreign investors attracted towards India leading to substantial increase in investment, competition and availability of latest products in the country.

Economic development of any country depends upon the availability of enough industrial finance at reasonable rate of interest, whereas the availability of finance depends upon the total volume of domestic savings and resources obtained from external sources. The development of industrial sector in Jordan has mainly relied on foreign aid because of scarcity of domestic savings. The reason for low domestic savings and low industrial investment in Jordan is the monetary policy of Central Bank of Jordan without necessary financial controls. The pace of industrial growth in Jordan has not been in accordance with the increase in the population and the ever increasing demand of the

country. According to Sharma, B.P., industrial finance, means, broadly speaking, “the provision of funds needed by industry irrespective of the period for which they are made available”.⁽¹⁾

The nation of Jordan is the creation of recent political events. At its birth Jordan inherited very little manufacturing industry. With its small population and low per capita income, Jordan offered only a limited market for domestically produced goods, thus handicapping the establishment of industries operating under economies of scale. Industrialization was also hindered by the high cost of power. Further more, Jordan lacked industrial raw-materials, other than olive oil, tobacco and hides. In this situation, Jordan had to rely heavily on imports for consumer goods, investments goods and inputs into domestic industries. But Jordan was penalized - both as importer and exporter - by the high costs of transport.⁽²⁾

Since its birth in March 1946, Jordan achieved a rapid expansion in economic activity, as reported by the World Bank in 1955 but it was also reported that the expansion of economic activity has been far from sufficient to absorb the increase in the population of the working age.⁽³⁾ But the 1967 war with Israel imposed a heavy burden on Jordan in terms of inflow of refugees from the West Bank and the Gaza strip. Thus, the influx of Palestinian refugees, the meagre natural resources and the high natural rate of population growth compounded Jordan's need for foreign aid for the development of country.

Despite these serious problems, the Jordanian economy, after a sharp recession in economic activity after the war, started recovering from 1968 through the first half of

1970.⁽⁴⁾ The recovery was partly sustained by expansion of the armed forces and expansion both in equipment and manpower which was financed by large grants from Kuwait, Saudi Arabia and Libya. During 1967 and 1968, Jordan increased its already large foreign reserves by over 50% and the Jordan dinar became quite strong on the exchange market. By 1969 industry had largely recovered from the serious slump of the immediate postwar period, although industrial investment remained stagnant. The loss of the petroleum refinery's market in the West Bank was compensated by neighbouring countries. Jordan experienced a boom in housing construction during the same period due to sufficient supply of cement.

Jordan faced another set back in 1970 due to explosion of civil war Palestinian resistance forces and the Jordanian government. The civil war produced a severe, but temporary, setback to the economy. Some sectors, such as manufacturing and agriculture, began to recover in 1971, while other sectors, particularly mining and construction, began to recover in 1972. The government prepared a development plan for 1973-75. The government's efforts were assisted by an increase of over 30% in its foreign aid receipts compared to 1971.

During the same period i.e. beginning of 1972, the rate of inflation, as measured by the change in the Amman consumer price index, accelerated to double-digit levels, with the most rapid price increases occurred in food. In 1974, the economy benefitted from three fortuitous events- an excellent crop year, fortuitious events - an excellent crop year a huge increase in the world price of phosphates, and the indirect impact of the oil-price revolution in the Middle East. The oil-price revolution in 1974 and effect of other factors like increased employment of Jordanians abroad, their increased earnings, and the

perception of greater security for funds invested in Jordan, produced boom conditions in the economy.

In 1975, several new factors were added to continued high receipt of foreign exchange. The reopening of the Suez Canal restored Jordan's direct transport link with Europe through the port of Aqaba. The civil war in Lebanon diverted some economic activities to Jordan.

In 1975-76 a boom in construction, both residential and nonresidential, was seen due to land speculation in Jordan. The construction boom, in combination with the expansion of the armed forces, the restoration of agricultural activity and the outflow of workers to take employment in the oil-producing states, produced an extremely tight labour market.

It was in this setting of tight labour markets, inflation, land speculation, and limitless availability of foreign aid, Jordan presented its five year development plan for 1976-80.

The First Five Year Plan (1976-80) :

The targets set in the First Five year plan (1976-80) were as follows -

- (a) a 12% annual real growth of GDP
- (b) a 16.5% annual real increase in domestic revenues.
- (c) a reduction of the trade deficit from JD 153 milion in 1975 to JD 131 million in 1980.
- (d) a balanced development of all regions.

For achieving these objectives, the government decided to depend on foreign aid and cutting down of government expenditure on defence and public security. The plan put the emphasis on several other measures such as promotion of co-operative societies, development of modern financial instruments and institutions, financial liberalization, vocational training and so on.

But the ambitious five year plan (1976-80) fell short of its objectives in several respects. The targets set for a number of industrial sectors, as well as for mining, electricity and water supply were not met as a result of lower than expected growth in phosphate production and the delays incurred in the fertilizer projects : Construction and agriculture, on the other hand, performed better than anticipated. "Thus, the first five year plan seemed clearly over-optimistic in its aggregate economic projections and over-ambitions in its investments programmes".⁽⁵⁾

The Second Five Year Plan (1981-85) :

The second five year plan (1981-85) was quite similar to the first plan but targets were readjusted to more realistic levels. The plan was founded on at least two main assumptions - first, the maintenance of a mixed economy with a strong private sector, the public sector's role being to create the basic infrastructure for private sector, and second, the continuation of Arab financial support and the promotion of Arab Co-operation.

The second plan mainly focused on large industrial and ~~mining~~ projects including potash plant, cement plant and phosphate mine. But the plan did not neglect medium-sized industries or agriculture. Further, a process of regionalization was envisaged,

dividing the country into planning regions within which social and economic development would be on the basis of indigenous resources and manpower.

Unfortunately, even second plan could not achieve its targets due to the following negative factors -

- (i) The loss of Iraq as an export market
- (ii) Less income from phosphates than expected
- (iii) A dramatic decline in budget aid
- (iv) A decrease in the level of remittances
- (v) The aggravation of Jordan's outstanding debt.

Thus, by 1983, the recession in the region had filtered through to Jordan and it was clear that the objectives and targets were hopelessly over-ambitious.

The Third Five-Year Plan (1986-90)

The general framework of the plan reflects the aspirations which Jordan strives to attain in the forthcoming period within the scope of the long-term objectives in economic development. The plan was designed to reinforce the national economy's own potential and enhance its efficiency by giving opportunity to individuals and private sector institutions to utilize their capabilities and contribute more effectively to development. The main targets of Third Five Year Development Plan were -

- Realization of GDP growth rate at 5% per annum
- Creation of new employment opportunities in all economic sectors
- To reduce the existing revenues of the central government and curb the increase in its current expenditures.

The plan was designed to realize a balance overall development of all economic and social sectors in all the regions of the kingdom. During this period, The total volume of investments was expected to reach 29% of GDP at market prices.

Thus, the path of economic development of Jordan since its birth to 1985 has been full of constraints and limitations. So it was realized that the main tasks of Jordan's economic planners will be - to reduce the rate of inflation and the cost of living, to be more cost-conscious, to attract Arab investments to encourage Jordanian money to stay at home, to reduce unemployment and to promote further Jordan's regional role. The country cannot afford for long to live on Arab charity and Western loans.

Industrial development is considered to be the key factor in the development of any economy. Besides many problems in Jordan, industrial development has been progressing at a satisfying pace. Industry achieved an average annual growth rate of 20%, exceeding the 17% target set in the plan. Jordan's phosphate-dominated industrial sector was largely engaged in processing raw materials into finished goods for local consumption and exports.

The role of government in the development of the economy has been of a catalyst, stabilizer, supported promoter, and in certain cases a partner.⁽⁶⁾ The main role of the government is to buildup infrastructural facilities, exploit natural resources, attend to planning and exercise some measure of control wherever and whenever necessary. Thus the role of the government can be described as neither socialist nor capitalist, but as an intermediary to maintain balance between economic and social demands.

The government, through the Ministry of Industry and Trade, Controls the important system. Import licenses are freely issued but the constraints is limited to the materials related to public safety and health.

The government may also salvage companies in financial trouble under the Defence Regulations and Economic security Committee. The government grants permits to establish new industries. The government exercises authority and control over public transport and running Royal Jordanian Airlines, though of independent status.

The Jordanian government considers the private sector as a collaborator, supplier, initiator, partenr, financier, taxpayer and earner of foreign exchange, and it treats the independent business community with remarkable deference. The private sector is allowed to conduct any legitimate business subject to regulations, without any administrative or official hinderances. Thus the government encourages the private sector to show some zeal in developing the economy. Government provides tax exemptions under the Encouragement of Investment Law, training for upcoming workers and loans through the specialized credit corporations at reduced rate of interest.

2.2 INSTITUTIONAL ROLE IN INDUSTRIAL DEVELOPMENT OF JORDAN :

The Jordanian banking system comprises of commercial banks, investment banks, Islamic bank, foreign banks and specialised credit institutions. But local banks have the lion's share of domestic business, both in lending and deposit taking. Assets of the Arab Bank group worldwide were almost as large as the assets of the whole Jordanian banking system.⁽⁷⁾

Jordan's economy has been soundly managed over the decade (1970-1980), allowing it to recover from severe shocks in the late 1960's and early 1970's, the most notable of which was the loss of the West Bank in 1967.⁽⁸⁾

The role of foreign aid in the economic development of Jordan has been significant. Jordan's balance of payments lists three sources of foreign aid- the US, Arab countries and other including countries and UN agencies that do not contribute aid to Jordan on a regular basis.

The US interest in extending aid to Jordan follows from American's interest in the Middle East in general. The largest component of US aid to Jordan is economic assistance. This assistance is extended through Agency for International Development (AID) and its predecessor agencies and the food for peace program.

Jordan was one of the founding members of Arab league therefore Jordan always received aid, from Arab nations.⁽⁹⁾ Arab league developed Jordan's potash mines with guarantees that members of the league would cover the expenses jointly with Jordan. Arab aid to Jordan came in the aftermath of the 1967 war with Israel. This aid to Jordan was intended to support the government budget, increase the defensive capability of the Jordanian Army, and enhance the steadfastness of the people of the West Bank. The most important phase of Arab aid to Jordan came after 1973.

2.2.1 Role of Commercial Banking in Industrial Development :

Most economists agree that a sound financial structure is a necessary pre-requisite for successful development. Some see a competitive banking system as the best means of

ensuring efficiency, with the Central Bank determining the rules, whereas some regard private ownership of banks as crucial for successful management.

In Jordan, during the period under study, the commercial banks were privately owned and used to compete with each other for customers. The allocation of commercial bank finance is a matter for the banks, not the government.⁽¹⁰⁾ Nevertheless the banks are the major source of credit in the economy, together with the specialized financial institutional which are also predominantly under private ownership.

Until 1949, the banking system in Jordan was dominated by foreign banks, mainly British. The first bank to start operations in the country was the Ottoman Bank in 1925. It was followed by the Arab Bank which opened its First branch in Amman in 1934. The next Jordanian Bank to start operations was the Jordan National Bank in 1955. It was followed in 1960 by two other Jordanian Banks, namely, the Bank of Jordan and the Cairo-Amman Bank.⁽¹¹⁾

Jordan is the home of one major Arab international bank the Arab Bank, and eight primarily local banks which served the domestic market until 1983. Most banking business in Jordan involves domestic clients rather than international dealings, except in the case of the foreign banks.⁽¹²⁾

To assess the impact of commercial bank activity on the economy it is necessary to examine the pattern of commercial bank lendings to different sector of the economy. During the period under study, it has been found that a relatively small proportion of commercial bank credit was available for productive activities such as agriculture or industry. The reason is, mainly special financial institutions such as Industrial

Development Bank and Agricultural Credit Corporation fulfilled the financial needs of these sectors. But advances given did not cover the total cost of the projects and borrowers were also expected to obtain some credit from commercial banks. The banks, however were often reluctant to back long-term projects or schemes where collateral could not be offered. The pattern of lending shows that much credit was used to finance trade and construction rather than more directly productive activities such as industry or agriculture.

Thus, the role of commercial banks in providing finance for the growth and development of industrial sector was significant which resulted into low growth of the economy and non-fulfillment of the planned targets. Another reason for its major contribution in industrialization was the government policy of not keeping strict control over the banking system.

2.2.2 Role of Central Bank in Industrial Development :

Central Bank is the apex monetary authority in any country, managing and controlling the entire banking structure. This position of the central bank make it an important component of economic development. Many underdeveloped countries have developed mainly due to effective and integrated role of Central Bank in accelerating the overall growth rate of different sectors of the economy by planning and allocating appropriate proportion of resources of different sectors depending upon the priorities and targets to be achieved in a planned period. Thus, the role of central bank is to facilitate the development of financial markets as well as economic planning in any country.

As far as Jordanian economy is concerned, the idea of central banking is relatively a recent one. The Central Bank of Jordan started its operations from October 1, 1964. It took over the functions of the Jordan Currency Board as well as Currency Control Department of the Ministry of Finance. Laws governing the performance of the banking system in Jordan have been subjected to subsequent amendments necessary for modernizing monetary policy and to bring economic development in the country. The objectives of the Central Bank (Article 4) shall be to maintain monetary stability in the kingdom in accordance with the general economic policy of the government.

The role of Central Bank of Jordan has been more active during the decade (1970-1980) because it adopted a activist policy based on twin pillars of imposing credit and reserve requirement controls on the private banks and issuing new regulations that encourage the flow of money into the banking system and then into productive investments. The legal reserve ratio was lowered by the mandatory investment requirement on commercial banks to invest a fixed percentage of their total assets in government and government-guaranteed bonds.⁽¹³⁾

Central Bank policy in the early 1990s was characterized by attempts to restrain the growth of liquidity while at the same time cautiously relaxing some of the financial regulations. As a result, Jordanian banks performed well in the early 1990s, reflecting the recovery of the wider economy from the financial crisis of the late 1980s.

2.2.3 The progress during different periods :

1973-1980 :

This period witnessed wide economic and social developments in the kingdom with far-reaching effects on the economy.⁽¹⁴⁾ A Three-year Development Plan (1973-75) was drawn up to tackle the problems that arose from the occupation of the West Bank. The plan concentrated on reactivating the economy and increasing employment opportunities by the creation of 70,000 jobs. Actual capital expenditures during the period amounted to 96% of the JD 179 million envisaged by the plan. The real average growth rate of GDP at factor cost during the plan period was 5.9%, as against the target of 8%. During this period, the share of manufacturing and mining sectors increased subsequently, but trade deficit increased in both absolute and relative terms. Its ratio to GDP at market prices reached 55.5% as compared with 37.6% in 1972.

The first five year plan (1976-1980) was formulated in the light of a set of new factors, including a large increase in Arab assistance and loans to Jordan in the wake of the oil boom in the Gulf, and grooming demand for Jordanian manpower in the Gulf countries. The plan envisaged total investments of JD 765 million, evenly divided between the public and private sectors. Economic performance during the plan period yielded annual average growth rate of GDP of 12.1% at factor cost as against the target of 12%. On the whole, the period achieved accelerated growth in the various economic sector, favourably affecting the entire 1973-1980 period. The overall performance during the period was satisfactory, because GDP at factor cost rose from JD 182.2 million in 1972 to JD 893.2 million in 1980.

- Income from manufacturing and mining sector rose from JD 18.5 million in 1972 to JD 167.1 million in 1980, achieving an annual growth rate of 31.7%.
- Investment in construction industry rose from JD 9.2 million in 1972 to JD 97.5 million in 1980, at a growth rate of 27.2% at current prices.
- This was followed by electricity water, transportation and communications sector.

The Three-year Development Plan (1973-75) and the First Five-Year Plan (1976-80) highlighted the necessity for developing an institutional frame work for the banking system with regard to savings and credit, in addition to improving existing banking facilities. The main objective of Monetary Policy was bidirectional - on the one hand fighting inflation by restricting the ability of banks to lend, through imposing credit controls, raising mandatory cash reserves and lowering the ratio of credit to deposits to control liquidity growth, and on the other hand, to adopt measures to facilitate the development process, permitting a selective easing of restrictions, whenever credit was required for development projects. In addition to these measures aimed at increasing savings and time deposits of commercial banks and the Housing Bank. These measures increased savings and time deposits from JD 33.4 million in 1972 to JD 520.40 million in 1980, at an annual growth rate of 41%.

1981-85 :

The seventies highlighted the ability of Jordan's econoy to respond to change and its capacity to absorb investments and realize high economic growth rates. The real annual growth rate of GDP at market prices amounted to about 13.9% during the period 1975-80, which brought about an enormous rise in remittances by Jordanians working

abroad and an increase in Arab official aid during 1981-85. The Second Five Year Plan (1981-85) was formulated in an atmosphere of optimism. However, actual economic performance fell below the plan's projections as a result of negative trends in the economies of the Gulf states leading to a decline in domestic and external demand. Moreover, the wars in Lebanon and the Gulf gave rise to a new set of conditions during this period,

- GDP at market prices did not exceed 5.3% annually, as compared to the target of 11.1%.
- The growth rate of industrial sector did not exceed 4.9%, as against targeted rate of 17.8%. The shortfall is ascribed to underutilization of the productive capacity of a number of large new industries including potash, cement and fertilizers.
- During the same period the total value of actual investments was only 78.9% of the plan target.
- Public sector investment amounted to JD 58.4 million as against the target to JD 42 million whereas private and mixed sector investments totalled JD 540 million, as compared to a target of JD 716.8 million.
- Some of the industries established during the same period, especially the larger ones, encountered difficulties arising from global economic development, mismanagement, economic recession, changes in demand and supply pattern, a rise in global production of raw and intermediate goods, etc. affected the exports prices of potash, phosphate and fertilizers and reduced the profitability of Jordanian companies producing these materials.

During the period (1981-85) the annual average increase in money supply was 7.4% mainly because of increase in currency held by public. Meanwhile the annual rate of increase in demand deposits was 5.4% during 1981-85. During the period under discussion, the country enjoyed a high degree of price stability.

Jordan experienced rapid economic growth during the 1950's, 1960's and 1970's as part of a general work trend in the Middle East region (The Hashemite kingdom of Jordan : A Political and Economic Survey) but the period between 1977 and 1982 is described as the "boom years" when the productive base grew and public finance performance were strong, inflation relatively low and the external debt within manageable size. The reason of this positive growth can be attributed to heavy remittances by Jordanians working abroad and an increase in Arab aid. During the same period the government continued encouraging the role of private sector in the ownership and management of industries and services. In 1985, privatization was formally launched as a government policy. It has been found and expected that industrial sector comprised of mining, manufacturing, water and electricity, has played and will play the role of main driving force behind the country's economic development.

Industrial production recorded a slight improvement as evidence by the production index for important industries prepared by the Central Bank of Jordan which reached 173.6 as of December 31, 1985 as compared to 173 on December 31, 1984 (1979=100). The reason for this growth was significant due to increase in the output of some industries like potash (+86.87%), Iron (+20.32) and textiles (+71.10%) along with

decrease in the output of other industries such as chemical acids (-15.65%), cigarettes (-18.51%), sole leather and wool (-32.26%).⁽¹⁵⁾

The report published by The Economist Intelligence Unit (EIU) on the basis of information provided in the Central Bank of Jordan monthly bulletin, reported that industrial production increased marginally by 1.4% in 1986 but the production of building materials fell by nearly 4.8% , with only iron output increasing. The main contribution being phosphates and electricity generation, the overall performance of manufacturing was not good.⁽¹⁶⁾

1981-90 :

Economic performance during the second half of the 1980's was mixed. GDP decreased by 4.1% between 1985 to 1989. But Jordanian economy showed signs of recovery since mid 1989 as a result of the fiscal, monetary and trade policies adopted by the government within the economic adjustments programme.⁽¹⁷⁾ However, second half of 1990 was worst for the kingdom because of Gulf Crisis, the subsequent war and economic sanctions, and political, social and economic transformation in Eastern Europe and former Soviet Union.

The report⁽¹⁸⁾ published by the World Bank to assist the Government of Jordan in assessing the prospectus for small and medium scale industries (SMIs) sector described the recent trends in the economy and the industrial sector in particular. According to the report -

- the SMI's amounted to a small portion of the Jordanian economy and its total share was only 7.2% of GDP.

- the SMI sector grew by over 18% per annum during 1975-82
- the economic recession in 1983 exposed the major structural weaknesses in the SMI sector.

It was suggested by the World Bank that in order to enable the Jordanian SMI sector to realize its full potential, its overall competitiveness must be increased by a package of measures that restructure the incentives facing the sector as well as offer institutional support to overcome some of the long-standing structural weaknesses. Restructuring would involve

- a reduction in the level of protection to SMI sector as a whole
- elimination of the tariff exemptions for institutions
- rationalization of the tariff structure to make it non-discriminatory
- a reform of the investment licensing system to allow resources to flow to more efficient firms.

Khalid Moh'D Jamil (1990) in his doctoral thesis reported⁽¹⁹⁾ that

- restructuring of the institutional setup for industrial finance is needed so as to bring about the best and most efficient allocation of funds in order to bring about rapid industrial growth as envisaged by the plans.
- Major part of the reduction in the industrial production was mainly due to the lower external demand and mounting competition from imported substitutes, which need to be controlled in order to encourage the local industries and to save foreign exchange from flying out of the country.

- Small scale sector should concentrate on intensive labour industries. Manpower education and training should help to use the human capabilities in SSI more than in highly developed technologies.

2.3 ROLE OF NON-BANKING FINANCIAL SECTOR IN INDUSTRIAL DEVELOPMENT OF JORDAN :

The growth of non-banking financial institutions in developing countries have contributed substantially in bringing economic development in general and industry in particular. The increasing importance of non-banking institutions is seen by many as a potential threat to monetary stability, thus requiring the monetary authorities to exercise some degree of control over their activities. But in underdeveloped countries, non-banking financial intermediaries are still at an early stage of development, constituting only a small part of the financial system. Commercial banks are still by and large the predominant element in the financial system. In Jordan, the size of non-banking financial institutions is still relatively small as compared with the commercial banks. Enough number of highly developed specialised institutions similar to those available in developed countries, such as finance houses, investment trust companies, unit trusts and specialised investment agencies are still non-existent.

Apart from the Housing Bank and Industrial Development Bank of Jordan, which have been active in mobilising funds in addition to its role in extending credit, none of the specialised credit institutions showed any interest in attracting domestic savings. Thus, it can be concluded that the existence and operations of such institutions have not been significant.

The failure of the free forces of the market mechanism to develop an adequate network of non-banking financial intermediaries resulted in creating certain financial gaps in the financial structure, which seriously hindered the growth of developing economies. To achieve the set development objectives, development planners in these countries emphasised the necessity of bridging such gaps by deliberately creating specialised financial agencies to perform specific important functions. The development of some basic sectors, such as agriculture, manufacturing and housing has been given special attention in most developing countries within comprehensive development programmes. These sectors, however, suffered from a lack of adequate finance necessary for their development. Commercial banks were generally reluctant to finance these sectors, mainly because of the long term nature of the credit required and because of the high risk involved in financing such activities.

Development planners in Jordan have placed more emphasis on the non-bank financial sector as an essential instrument for achieving the country's development objectives. The establishment of this sector and its activities were largely assisted and promoted by successive development programmes, and by government legislation and other fiscal incentives.

2.3.1 Industrial Development Bank of Jordan (IDBJ) :

The IDB was established in 1965 to undertake the activities previously undertaken by the Industrial Development Fund and the Development Bank of Jordan, which had both been responsible for industrial financing. The former Industrial Development Fund was established in 1957 to finance manufacturing and tourism

activities, whereas the Development Bank of Jordan was created as early as 1952 to extend agricultural and industrial credit. Due to lack of resources and duplication of efforts, both agencies were unable to meet the increasing needs of manufacturers, which finally led the government to amalgamate them in one main institution capable of rendering adequate assistance to the manufacturing sector. Clearly, this situation greatly hindered the development of viable manufacturing projects, which led the plan to strongly recommend the establishment of a new specialised institutions capable of assisting and promoting this sector. The proposed institution was expected to assist manufacturers by providing them with the required financial as well as technical assistance, thereby encouraging private investors to channel further resources into this priority sector.

The Government responded quickly to the above recommendation. One year after launching the Plan, the IDB was created as a mixed enterprise, with the Government financing one third of its authorised capital of JD 3.00 million. In order to encourage the private sector to subscribe the remaining JD 2.00 million, the Government, firstly, paid in its whole share of capital and, secondly, guaranteed a minimum dividend of 6% per annum on shares held by the public and, finally, it exempted these dividends from income tax. In case profits were insufficient to cover the minimum dividend, the Government also guaranteed to pay the difference. By 1977, the share capital of the private sector was fully subscribed, thus encouraging the IDB to raise its authorised capital to JD 6 million in order to mobilise further funds for industrial investment.

Upto 1975, the activities of the IDB were mainly confined to financing large-scale industry and well established enterprises able to give the necessary technical

documentations and to provide the required collateral. However, a development bank cannot ignore the essential needs of small scale industries, especially in countries where these occupy an important part in the economy. This is the case in Jordan in which the manufacturing sector is composed mainly of small scale industries and handicrafts. The number of large scale establishment (employing over 100 each) accounted for 15, or only 0.2% of the total number of Jordanian industries. Enterprises employing between five and ninety nine persons were 580 in number, comprising 8.8% in relative importance of the total. Small scale industries (those operating with less than four persons each) formed the dominant share of 91%, or a total of some 6,000 concerns. The Plan recommended that a special Fund within the IDB should be established with an initial capital of JD 0.30 million to finance small scale businesses against comparatively lower interest rates. Following this recommendation, the Small Scale Industry and Handicrafts Fund was established within the IDB in 1975.

2.3.2 The Amman Financial Market :

The importance of a stock exchange for a country's economic development lies in its potential role as a catalyst by which the long term savings of the community can be converted into productive real investment.⁽²⁰⁾ Given this important function, many developing countries have emphasised the development of a domestic securities market as an instrument for promoting growth, without sometimes proper examination of the expected benefits and opportunity costs that this process may involve, particularly as the benefits accompanying the introduction of such institutions in developing countries can be greatly limited by the prevalence of an underdeveloped economic and financial environment.

As is the general case in developing countries, Jordan's Stock Exchange followed a supply-leading pattern of evolution, and was further encouraged by Government legislation and promotional policies. The necessity of introducing such a specialised institution was repeatedly emphasised by development planners, as shown by the country's three development plans of 1964, 1973 and 1976. Although the creation of a domestic securities market was recommended in the Seven Year Plan as early as 1964, the actual establishment of this institution took place only in 1976, when a special law creating the Amman Financial Market (AFM) was passed.

In recommending the creation of a domestic capital market, the Seven Year Plan of 1964 noted :

"considering the state of recent economic and financial development in Jordan, serious efforts must be made to encourage and accelerate the growth of a capital market in the country. Although the development of such an institution is essentially a slow process, its early establishment would be instrumental in orienting Jordan's financial structure to the long term growth requirements and potentialities of the economy".⁽²¹⁾

Important studies have been undertaken by many economists to examine the constraints and the conditions necessary for the introduction of a capital market in the particular environment of a developing economy. One such study by Arolow⁽²²⁾ outlines some of the necessary pre-conditions for a reasonably workable capital market to emerge in a developing economy. These are related to both sides of the market - the supply of capital market instruments by various deficit units, and the demand for them made by different surplus units. On the supply side, there should be a large supply of securities

and new issues available on a regular basis. On the demand side, there has to be (a) a fair degree of monetization of an economy to permit a sufficient inflow of savings in financial forms. (b) There is a need for a certain degree of sophistication of behaviour among investors, which directs their investments towards holding long term financial instruments vis-a-vis physical assets and short term monetary assets. In addition to supply and demand factors, Arolow added a further condition that a network of financial institutions must be either in existence or developed in order to facilitate and promote capital market activities.

The general opinion of different researchers and economists regarding the role of non-banking financial intermediaries and capital markets give mixed views.

According to S.L.N. Simha⁽²³⁾, fundamentally the capital market is not different from any other market. The market mechanism is essentially called for, because of the fact that we have an exchange economy with specialization of functions. In the present day world, to a considerable extent the people who initiate investment activity do not have funds for the purpose, while there are also people who save but who have no desire to utilize their savings directly for investment activity in the sense of establishing a factory or any other business enterprise.

R.H. Patil⁽²⁴⁾ in article highlighted the increasing reliance of private sector industries on borrowings from institutions rather than on equity capital and borrowing from the market. The excessive reliance on borrowed funds is said to result from the concessional rate of interest charged on the loans by financial institutions.

M.P. Chitale⁽²⁵⁾ in his special article mentioned that according to an RBI study of 1950 medium and large public companies (non-financial and non-government), each with a paid up capital of Rs. 1 crore and above during the period from 1970-71 to 1975-76, D/E ratio declined from 43 per cent in 1970-71 to 40.8 per cent in 1975-76. (Finances of medium and large public limited companies, 1975-76; RBI Bulletin, September, 1977).

A study conducted by B.M. Jani⁽²⁶⁾ on impact of developmental finance on small scale industries in Saurashtra shows that 25.70% of total finance was in the form of owned capital of entrepreneurs whereas 74.30% was a loan finance. Which shows that most the small scale industries depend on financial institutions for their financial requirements. Therefore the state financial corporations should provide enough finance to such small scale industries for the overall growth of the economy.

M.P. Chitale⁽²⁷⁾ in his reply to Patil's rejoinder and Bhole's comments, considered that the growth of risk capital or owned capital is the kingpin for swift and efficient development of business and industry. He was of the view that it is sad that the general investing class, and even the industrial employees who can invest, have kept themselves away from participation in industrial securities. To cultivate the habit of making investment in industrial securities among different social groups is a social problem, in much the same way as a shift from agriculture to industry is a social problem.

Dr. P.S. Lokanathan⁽²⁸⁾ mentioned the importance of industrial finance in terms of long term requirements of the industry. He was of the view that initial capital can be raised from the public in the form of ordinary and preference shares. But between the

stage of promoting of the business and its ultimate ownership in the hands of the investing public, there is a definite time lag and some machinery is needed to fill the gap. For this, the two methods are open either alternatively or combination.

1. Some of the bigger joint stock banks may adapt themselves to undertake the mixed banking characteristic of Germany and other continental countries, and/or
2. A special institution may be established by banks themselves as a subsidiary on which industrial interests too may be represented.

Along with this, the role of State can also be employed with advantage to the country. There are no industrial institutions at present which can give to industry the long-term credit it requires. Even the Industrial Bank of Japan started with a large government subsidy which has played a large part in the industrial development of the country. These views justify that growth of financial institutions is necessary for the development of the industry but the support of the government can play an important role in the efficient functioning of these financial institutions.

Vinod Dhall⁽²⁹⁾ quoted that at all India level, there are three institutions, viz. IDBI, IFCI, and ICICI which provide finance to industry. There is also a specialised institution for sick industries, i.e., Industrial Reconstruction Corporation of India (IRCI). All these institutions give direct assistance to large industrial projects. According to him, there had been a rapid growth in the volume of assistance given by financial institutions during 1970-71 to 1979-80. Out of the aggregate sanctions of all financial institutions upto the end of March 1980 amounted to Rs.9,136 crores. Out of this amount, the aggregate sanctions in 1979-80 alone were Rs.1,906 crores as compared to Rs.254 crores in 1970-71.

S.S. Narta and Devinder Sharma⁽³⁰⁾ conducted a study in Himachal Pradesh to know the effect of development banks in a particular state on industrial growth and came to the conclusion that finance is the lubricant of the process of economic growth. When finance is made available, industrial activities can be initiated which give rise to new investment opportunities towards industrialization. In Himachal Pradesh, four development banks have been set up to assist the industrial sector. The financial role of these institutions is meagre in the state in comparison to the total assistance of development banks of the country. Therefore, the immediate need is to enhance their share in the state by involving the local and regional level organisations and institutions to budget the gap with industrial enterprises.

This signifies the importance of State level development banks in providing finance to industrial enterprises. According to them, these State level banks are actually the backbone of industrial strength of the state. These are the only institutions which extend direct financial assistance to all enterprises within the state and they support the industrial communities through concessional finance activities for the rehabilitation and revival of industries. It has been found that these banks have risen nearly five to six times between 1980-81 to 1989-90.

The Reserve Bank of India⁽³¹⁾ conducted a country-wide survey to know the financial assistance given by financial institutions to small scale industrial units during 1977-78. The survey covered a sample of 12,356 units with an original investment not exceeding Rs.1 million in plant and machinery. It was found that financial institutions advances on a long-term basis were merely 10.6% against the value of net fixed assets of

the small units, which otherwise they can give upto 75% of the net value of fixed assets. It was evident that neither the financial institutions nor the banks were fully meeting the long-term requirements of the small units.

It was also evident that although the average amount of sanctions by all SFCs had been going up, but contrary to expectations, the SFCs thrust towards a relatively small size among the SSI enterprises has not yielded satisfactory results.

Ziab Annab⁽³²⁾ wrote in his book that the industrial sector in Jordan has access to financing through commercial banks; Industrial Development Bank; Finance companies and other non-banking institutions but most of the long-term requirements are met by IDB of Jordan. By the end of 1987, the net loan approval by IDB amounted to 1,187 loans totalling JD 85.4 million. Through its policy of encouraging and promoting industrial projects, IDB participated in the equity capital of many projects. By the end of 1987, IDB has subscribed in the establishment of 30 projects with total equity investment of JD 4.89 million.

He was of the view that although IDB of Jordan has played an important role in the development of industries in Jordan but the financial constraints like total absence of necessary studies of projects submitted to financing institutions, delays in execution of projects, lack of planning at the operational stage of the project, etc. have lead to the failure of the objective to be achieved. It reveals that many industries found themselves, right from the start of a couple of years later, faced with liquidity problems leading to unbalanced capital structure.

It does not mean that there is no prospect of industrial development but smallness of the market and dependence on imported raw materials restrict the industrial growth.

Mazur M.P.⁽³³⁾ conducted a research study in 1969 and 1976 to know the impact of different sectors on the development of Jordan. He conducted his research study covering different periods of time and came to the conclusion that although industry has accounted for a small share of total output or employment, it has contributed significantly to growth during some periods, particularly 1959-66. Nonetheless, the industrial sector in Jordan remains more important for its potential than its past or current role in the economy. Based on the statistical data, he was of the view that the growth of the industrial sector began to accelerate after 1972 due to return of normal internal and external political conditions. Public policy measures directly affected industrial financing in several ways, most significantly through government purchase of shares, loans by semi-public Industrial Development Bank, and government assistance in arranging financing from domestic and foreign institutions.

Tsuneo Mortia⁽³⁴⁾ was of the view that the history of economic reforms in Hungary shows that the reintroduction of a system of commercial credit and a capital market are inevitable if a development of commodity production is needed in order to catch up with the development of the world markets. It has been proved that a so-called regulated or controlled socialistic market mechanism does not ensure flexible adjustment to world markets and rapid development of commodity production. He reported that all existing socialist countries have again to choose the way to a credit economy so long as

they to intend to develop commodity production, irrespective of their desire to attach the adjective 'Socialistic' to it or not.

Mathias Bruch⁽³⁵⁾ tried to examine the gap between formal financial institutions and the informal and unsophisticated nature of many, if not most, small scale establishments. From the results of a micro survey it is found that there are mechanisms at work which are selective among Small Scale Establishments with respect to the occurrence of formal lending than among large establishments. Discriminate analysis reveals that small size as such is not sufficient to exclude small scale establishments from formal credit.

The results obtained suggest that formal credit should be made available to small scale establishments but along with this, what is more essential for policy makers to do, is to create an economic environment where private initiative and ingenuity are adequately rewarded.

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