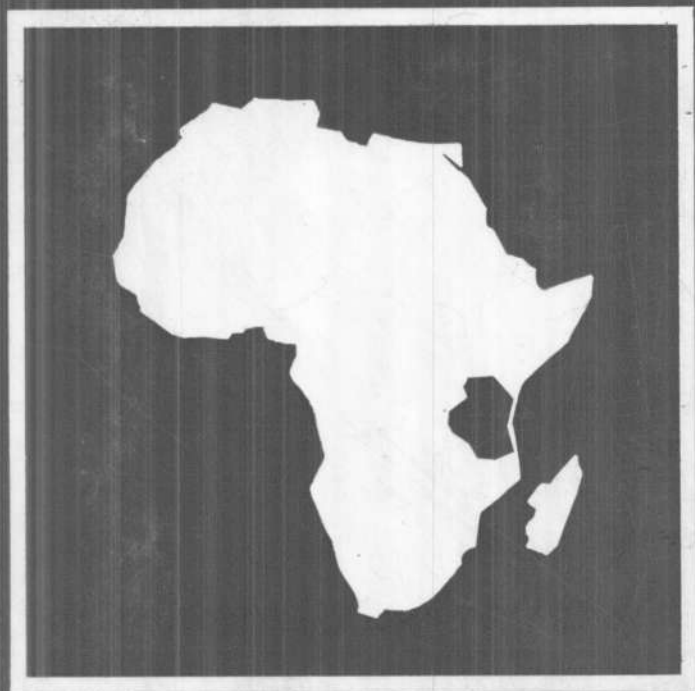


THE CREDIT MARKETS OF AFRICA
A series of monographs under
the general editorship of
Professor Giordano Dell'Amore

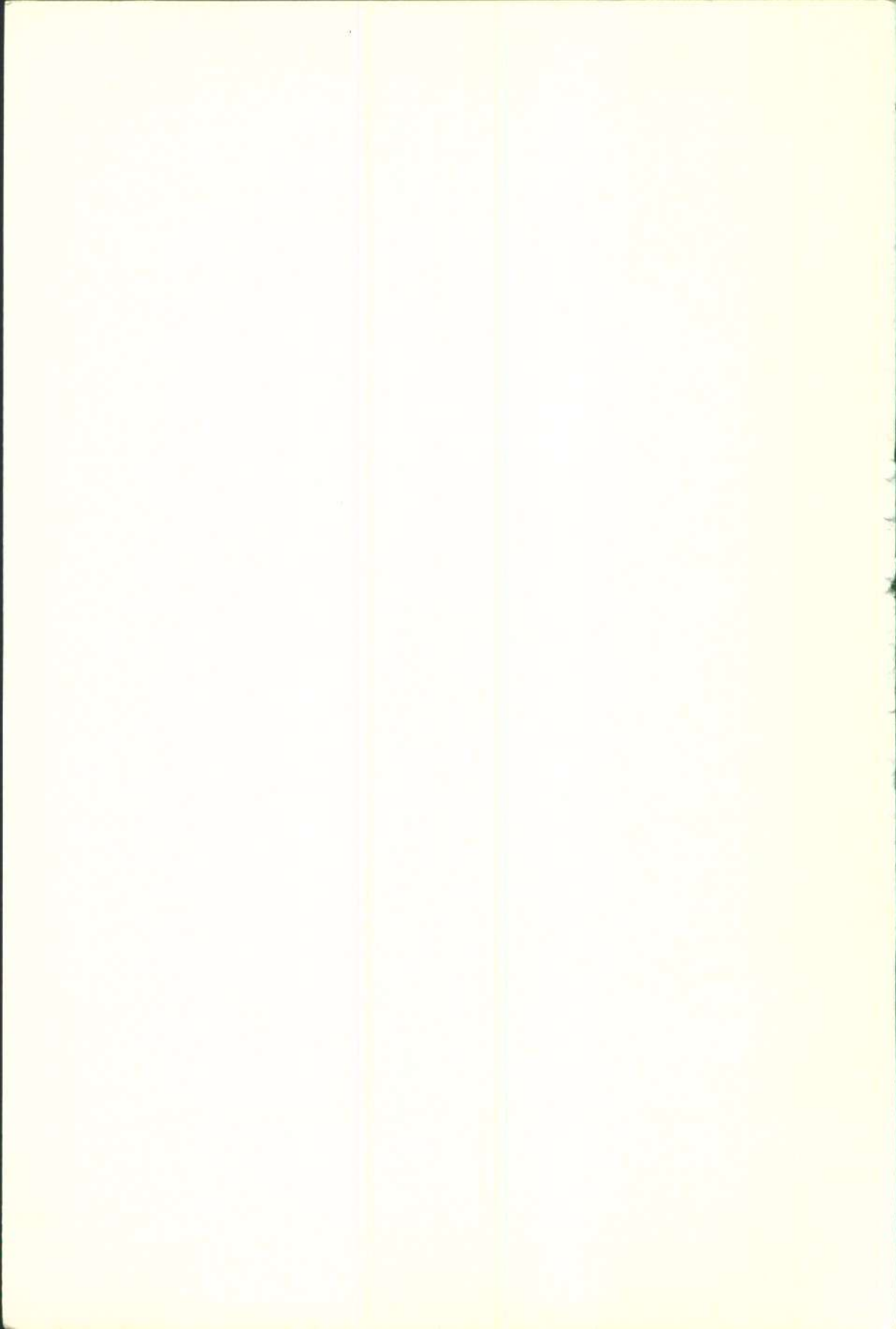
Clara Caselli

THE BANKING SYSTEM OF TANZANIA



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THE CREDIT MARKETS OF AFRICA

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Professor Giordano Dell'Amore

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CLARA CASELLI

THE BANKING SYSTEM
OF TANZANIA

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FOREWORD

Tanzania stands out in the Third World as a country of original political aspirations and as one whose economic and social development, especially since independence, has followed an extremely interesting course. The structure and functions of its banking system, in particular, repay close study, for they throw new light on the functions of the credit infrastructure in the context of a developing economy moving forward from far-reaching nationalization towards steadily more and more comprehensive economic and financial planning.

In the present volume, an introduction outlining the natural, historical and political background of the credit system of Tanzania, is followed by three main parts. The first of these is historical and briefly recalls the main stages of the development of a credit market in the three countries of East Africa — Tanganyika, Kenya and Uganda — up to 1965. Parts Two and Three describe Tanzania's present banking and credit system and discuss problems of monetary and credit policy.

Unlike many another developing country, Tanzania regularly publishes rich and reliable statistics, and its authorities are generous in making original data accessible.

The literature and statistics used in preparing this volume were assembled by me on the spot during a visit to Tanzania and Kenya in August and September 1972. On that occasion I

also collected additional information in personal interviews and had a welcome opportunity to discuss the underlying assumptions and the aims of my work with government officials and bank executives in Tanzania, as well as with faculty members of the University of Dar es Salaam.

Most fruitful of all were my talks with John Loxley, D.A.N. Yona and Pascal Kamuzora, and it is to them that I owe the greatest debt of gratitude. My thanks are due, too, to J.M. Bulemela, C. Kahangi, P.M. Magani, S.P. Madete, S.M. Mbilinyi, and to many other friends in Kenya and Tanzania who have done so much to help me in my research.

CLARA CASELLI

Introduction

NATURAL, HISTORICAL AND POLITICAL BACKGROUND

The structure of any country's credit system¹ is subject to many influences, economic and otherwise. It is almost impossible to understand a credit system and how it works without knowing its background, in terms of the country's geography and natural resources, its economy, history and the political influences at work. It is the purpose of this introduction to outline key aspects of the background of Tanzania's credit system.

Tanzania is one of the largest countries of tropical Africa, and much the biggest in East Africa. With an area of 363,688 square miles, it is bigger than France, Belgium, Switzerland and Italy together². In the east, Tanzania has a coastline on the Indian Ocean and inland it has common frontiers with Mozambique, Malawi, Zambia, Zaïre, Burundi, Rwanda, Uganda and Kenya.

According to the latest official population figures, Tanzania has 13,634,000 inhabitants³. Population density is very uneven.

¹ The structure of a credit system is defined as "the resultant of the heterogeneous jumble of banks, differing in quantitative, locational and qualitative terms, which make up the banking system" (Giordano Dell'Amore, *Economia delle aziende di credito - I sistemi bancari*, Milan, 1969, Vol. 2, p. 695).

² Information for this part is taken from official sources as well as from K.E. Svendsen and M. Teisen, *Self-Reliant Tanzania*, Dar es Salaam, 1969.

³ The United Republic of Tanzania, *The Economic Survey 1971-72*, Dar es Salaam, 1972.

The coastal strip is much the most populous, and the capital, Dar es Salaam, is now a city of between 250,000 and 300,000 people.

However, less than 5 per cent of Tanzania's population live in towns. There are no large urban agglomerations other than Dar es Salaam; most of the towns of a certain size, besides Zanzibar, are clustered along the coastline and in the immediate hinterland (Tanga, Bagamoyo, Morogoro, Lindi, Mtwara, Mikindani) as well as on the shores of Lake Victoria (Mwanza, Bukoba, Musoma). A few towns of more than 30,000 inhabitants are scattered in the north of the country (Arusha, Moshi) and in the central zone (Tabora, Dodoma, Iringa).

Tanzania is largely a country of mountains and high plateaux. Africa's highest peak, the Kilimanjaro, rises in the north, near the border with Kenya.

Basically, five zones may be distinguished in Tanzania: (1) the coastal strip along the Indian Ocean, with a hot and humid climate; (2) an intermediate and extremely varied zone of alternating plains, savanna and mountains (the Usambara Mountains); (3) the Central Plateau - the country's most typical landscape, at altitudes between 2,700 and 3,600 feet; (4) the highlands of over 3,600 feet which break up the plateau, to wit, the Southern Highlands and the Northern Highlands; (5) the low-lying and densely populated area around Lake Victoria.

The most important climatic factor is rainfall, whose amount, geographical distribution and duration set the pattern for agricultural production and for the whole economy. One third of the country has enough rain for intensive cultivation, one third has very little rain, and the remaining third has some, but not very much. It is here that the danger of recurring famine is greatest; the arid zone is so sparsely populated that there need be no concern on this score. Most of the country has only one rainy season, which

lasts from November to March; but in the coastal strip and in the Northern Highlands there are two, the little rainy season from October to December, and the main one from March to May.

In addition to rainfall, agriculture and, with it, the country's economic structure is fashioned by altitude and temperature.

Only one tenth of Tanzania's land is cultivated, the rest is covered by natural vegetation, that is, forest (2 per cent), brush (10-12 per cent), grass and savanna (about one third) and open woods (another third). Of the woods, about one third is systematically exploited for timber on a large scale, and another third is protected as national parks. In all, some 70 per cent of Tanzania's land is neither farmed nor used in any other way.

Crop farming is divided between subsistence crops and cash crops, largely for export.

In recent years, between 50 and 60 per cent of agricultural output was consumed on the producer farms and thus never entered trade, either on the domestic or on the world market. Leaving aside animal husbandry as well as farms other than family enterprises, farmers consumed some 75 per cent of their produce.

The traditional cereal crops are millet and sorghum, which until not long ago between them covered as much area as all others put together. They are grown mostly in the region of Mtwara and in a belt running from Dar es Salaam to Mwanza and east around Lake Victoria. Sorghum is more robust but less well liked, and is used mostly for making beer. During the last ten years or so maize has largely replaced the traditional grain crops, and is today grown wherever soil conditions and water supply allow. Its main use is in flour milling.

Contrary to popular belief, bananas are not an everyday staple food for all Tanzanians. The particular conditions suitable

for bananas occur in only three areas, around Bukoba to the west of Lake Victoria, around Mt. Kilimanjaro, and to the north of Lake Nyasa.

Similarly, rice is grown in only a few areas, and nearly always where natural conditions are suitable. Artificial irrigation is extremely rare and very few farmers know the special methods of rice growing it requires. Rice is most often found in the region of Rufiji and in the surroundings of Dar es Salaam, Mtwara, Kigoma and Mwanza.

Two other agricultural products of some importance are coconuts and cassava. The former are grown mostly in the coastal strip, often in areas where nothing else will grow because there is so much rain. Cassava is not a popular food, but is nevertheless grown on a large scale, because it is robust and the tubers keep well, which makes them an ideal food reserve for the hungry season.

There is a fair amount of stockraising in Tanzania, but mostly of a rather primitive kind. Most often the animals are simply put out to graze, and stabling is common in only a few areas, like the territory of the Chaga people on the slopes of Mt. Kilimanjaro. In recent years a meat canning industry has been growing up, whose products account for 3 per cent of Tanzania's exports.

The overwhelming part of exports consists of agricultural commodities. Some 75 per cent of them are accounted for by five crops, namely, sisal, cotton, coffee, cashew nuts and oilseeds. Other major export items are tea, tobacco, pyrethrum and cloves.

Tanzania is the world's largest sisal producer, with more than one third of world output, and until recently sisal was the country's foremost export earner; but then a big price fall reduced its share in total exports from more than one third to less than a quarter. Sisal still remains the leading industrial crop. It is

grown mostly in coastal areas, to keep down transport costs, and usually on large plantations rather than on small farms.

The second most important export crop is cotton, which, by contrast, is grown exclusively on small family farms south of Lake Victoria. Increasingly more acreage is given over to cotton, and techniques are improving thanks to the existence of a strong co-operative movement.

Third in importance among export commodities is coffee, but its prospects are not as good as for cotton. Coffee, too, is grown mostly on small farms; the best varieties come from the area of Mt. Kilimanjaro, the Southern Highlands and Lake Nyasa, others from around Bukoba and Lake Victoria.

Cashew nuts are gaining ground as an export commodity, together with a special oil extracted from them by a local processing industry, and so are cloves, the leading export product of Zanzibar and Pemba. Two thirds of world output comes from these two islands, but the market is so unpredictable as to make the economy of Zanzibar highly vulnerable.

Among mineral resources, diamonds are the most important. Deposits were first discovered in 1940 by J.T. Williamson near Mwadui, and for many years accounted for 10 per cent of Tanzania's total export earnings. Now the mines are approaching exhaustion and the mining industry's earnings are contributing a good deal less. There is some gold, but again nearing exhaustion. Coal and iron deposits in the south are not yet properly exploited, because of technical shortcomings and deficiencies in the transport system.

The earliest notices about what is now Tanzania, or better, the east coast of Africa, date from the late 1st century A.D., when the sailors' guide known as the *Periplus of the Erythraean Sea* mentioned the existence of high mountains and great lakes

inland. That was about all Europe knew about East Africa until the nineteenth century¹.

On the basis of archaeological discoveries and the accounts of Arab travellers we can reconstruct the outlines of the Zenj empire and civilization, resting on Caucasoid and Bantu peoples intermixed with local aboriginal stock of palaeolithic origin, of whom some traces have been found.

The great period of expansion of the Zenj civilization, from which the name Zanzibar derives, was from the ninth to the thirteenth century, and it coincided with flourishing Arab trade with India, Persia and Arabia. Arab merchants settled in the country and to some extent mingled with the local population. Their fairly large-scale immigration laid the foundations for what later became the Sultanate of Zanzibar.

In 975 Arabs—ore more precisely Arabs, Persians from Shiraz and other Asians—reputedly founded the seaport of Kilwa, and their descendants controlled the entire coastal trade.

In summary, the Zenj civilization can be described as African negro gradually infiltrated by Mohammedan influences, and engaged in fruitful cultural exchange with all peoples with which it came in contact, especially the Indians and, in the fifteenth century, the Chinese.

In the sixteenth century the Portuguese came and conquered, but were unsuccessful in their attempt to take over the trading network of the Zenj people. Their control never extended further than to the islands and a few coastal towns, and even then their rule was troubled by Arab pirates and inland tribes.

¹ For historical accounts, see K.E. Svendsen and M. Teisen, *op. cit.* p. 29-62; L. Cliffe and J.S. Saul, *Socialism in Tanzania*, Dar es Salaam, Vol. 1, 1972, p. 8-79; K.A. Ingham, *History of East Africa*, London, 1962; Roland Oliver and Gervase Mathew, *History of East Africa*, 2 vols, Oxford, 1963.

In 1652 the Arabs reconquered Zanzibar and by the end of the century the Portuguese had been expelled from the whole of the eastern mainland coast, except Mozambique.

The Arab slave trade had been going on for centuries, but was organized in Zanzibar on a really large scale in the nineteenth century. Many slaves, too, were employed on the spot in the clove plantations which had been introduced in the early years of the century. The economy of Zanzibar, from 1840 the capital of the Arab Sultanate, rested almost entirely on slave plantations, the produce of which sustained a flourishing export trade to Europe. This local slave trade continued even after the overseas shipments were stopped.

Arabs likewise gained control of the routes to the interior, through a series of treaties with the Yao and Nyamwezi peoples and the Kingdom of Buganda. They penetrated as far as Lake Tanganyika, where they founded trading posts at Ujiji and Tabora. But they never established a firm hold on these areas, partly because they had trouble with local tribes, and partly because European colonists soon began to make their appearance.

The Berlin Conference of 1884-85 and a number of partition treaties led to the division of Africa into spheres of influence. Tanganyika fell to Germany, Kenya, Uganda and Zanzibar to England¹.

This was the beginning of the German colonial presence in Tanganyika. Before 1884 the Germans had not been much interested, but at the end of that year Dr. Karl Peters landed at Zanzibar with three other young men, their plan being to conclude treaties with local chiefs on the mainland and arrange for colonial

¹ Actually, the island of Zanzibar was initially assigned to Germany, but was exchanged against Heligoland by an agreement in 1889 between Bismarck and Lord Salisbury.

settlement. To this end Peters founded the *Deutsch-Ostafrikanische Gesellschaft*, and in 1888 managed to get from the Sultan of Zanzibar a concession on the mainland coast. The German government encouraged Peters, but were unwilling to assume any direct responsibilities in the venture until they were forced to do so by a local rising, the so-called Arab Revolt. Germany sent 1,000 troops under Captain, later Major, Wissmann in 1889, who two years later took over from the German East Africa Company as Germany's Imperial Commissioner and subsequently Governor.

After some years of uncertainty, a period of reorganization in the colonial administration began in 1898. It is to this period, as we shall see, that the first credit ventures can be dated.

The colonial administration undertook a number of public works and set up many plantations, thus giving a first impulse to economic development. But progress was again interrupted in 1905 by another local revolt, the Maji-Maji Rebellion, which the Germans quickly suppressed.

After the Germans were defeated in the first world war, the Treaty of Versailles gave the whole of East Africa, except Ruanda-Urundi, to the British, which administered it first under a League of Nations Mandate and later under United Nations Trusteeship until 1961.

Tanganyika had suffered greatly during the war, and the British slowly made good the damage. Better schooling and the growth of a co-operative movement eventually prepared the ground for the emergence of nationalism and an independence movement.

The Tanganyika African National Union (TANU) was officially founded on 7 July 1954. TANU, which today is the country's single political party, initially adopted the strategy of condemning British policy at the United Nations, which quickly recognized

the party as a "national movement". Taking advantage of this recognition, Julius K. Nyerere, the TANU Leader, in 1955 and 1956 visited the United Nations, where he successfully mobilized international opinion for his cause.

Although the British backed another, multi-racial, party called the United Tanganyika Party, and although the electoral system was changed in the meantime, the 1958 elections brought Nyerere and his party signal success. After lengthy discussions the British in 1959 came to an agreement with TANU which gave ministerial office to five of the party's representatives.

After TANU had scored another big victory in the 1960 elections, Dr. Nyerere started his constitutional negotiations with the Colonial Office in London, at Lancaster House. The talks were prolonged and difficult, and it was a testing time for the country's economy; but eventually Tanganyika gained its full independence on 9 December 1961.

In the following year Tanganyika proclaimed itself a republic and Dr. Nyerere was sworn in as President, an office he has held since then.

During those years of political ferment, far-sighted statesmen were thinking ahead about how to preserve some sort of political and economic union among the countries of East Africa (Tanganyika, Kenya, Uganda, Zanzibar and possibly Nyasaland).

Some promising starts were made with the creation of several common organizations, which still exist, but eventually the idea of a Federation of East African States foundered on political difficulties and the internal resistance of some of the countries concerned, not to speak of growing rivalries among their leaders. Men like Nyerere had placed great hopes in such a federation, which might have played a significant role in the context of Africa and the world at large. But only a small part of these plans were realized

when, in 1964, after the January revolution in Zanzibar and the seizure of power by the Afro-Shirazi Party, the union of Zanzibar and Tanganyika was proclaimed on 26 April 1964. This was the birth of the United Republic of Tanzania.

In turning now to the institutional framework of the country's economy and to its financial institutions, it is indispensable to look first at the general political context and its underlying principles. Tanzania declares itself to be a "socialist" state. This does not mean quite the same as it does in Eastern Europe or in such developing countries as Cuba, China and North Korea, but nevertheless socialism is taken seriously in Tanzania, and certainly more seriously than in some of the Arab countries. It is also a rather original brand of socialism.

President Nyerere feels that no underdeveloped country can be anything but socialist¹, and that for African states socialism provides the only possible way of life and development model. This is so, he argues, because African life as such is traditionally socialist; Africans need no education towards either democracy or socialism, because they are familiar with both as an integral part of their culture.

The greatest challenge to the new African states, more vital even than the struggle for independence, is the achievement of rapid economic development together with the establishment of new values constituting a creative renewal and synthesis of the values of traditional African society. It is as a response to this challenge that Dr. Nyerere conceived his version of socialism, which he calls *ujamaa*²; it rests not on the class struggle or on

¹ J.K. Nyerere, *Scramble for Africa*, Dar es Salaam, 1961, p. 2.

² J.K. Nyerere, *Ujamaa - The Basis of African Socialism*, Dar es Salaam, 1962, p. 1 f.

Marxist ideology, but on the traditional institutions of the "enlarged" family and its underlying principles of equality, freedom and unity¹ expressed in a set of values including security, hospitality, mutual aid, common land ownership, a classless society, etc.

Nyerere is convinced that these values have not been entirely lost in Africa, despite the disruptive influence of colonialism, and that a new society can yet be built upon them. This society, as he sees it, should be animated by the spirit of *ujamaa*, and should take over and incorporate whatever good features can be adapted from European civilization and the colonial past.

Dr. Nyerere expresses his dream in these words: "... a country in which all her citizens are equal; where there is no division into rulers and the ruled, rich and poor, educated and illiterate, those in distress and those in idle comfort ... in this country all would be equal in dignity; all would have an equal right to respect, to the opportunity of acquiring a good education and the necessities of life, and all her citizens should have an equal opportunity of serving their country to the limit of their ability"².

Although for Dr. Nyerere socialism essentially remains an "attitude of mind", the construction of a new society in Tanzania has gone ahead in a very concrete manner on the basis of programmatical declarations immediately put into practice and of well-defined political choices.

A milestone in this progress was the Arusha Declaration of January 1967, which defined the socialist ideology of Tanzania together with the policies by which it could be put into effect with reference to the country's specific needs and objective situation.

¹ J.K. Nyerere, *Freedom and Unity*, Dar es Salaam, 1966, p. 8 f.

² J.K. Nyerere, *President's Address to the National Assembly*, 10 December 1962, duplicated document, p. 9.

This declaration outlines the channels through which the "attitude of mind" can be translated into practice, and it is therefore of fundamental importance for an understanding of the development of Tanzania's economy, including all aspects of the credit system. It certainly marked the beginning of a new political orientation.

The Arusha Declaration¹ begins with a definition of Tanzanian socialism as requiring human equality and dignity, absence of exploitation, and the public control of the major means of production. This last proposition is further developed as implying that "all the major means of production and exchange in the nation are controlled and owned by the peasants through the machinery of their Government and their co-operatives"; and the major means of production are defined as including "land; forests; minerals; water; oil and electricity; news media; communications; banks, insurance, import and export trade, wholesale trade; iron and steel, machine-tool, arms, motorcar, cement, fertilizer, and textile industries; and any big factory on which a large section of the people depend for their living, or which provides essential components of other industries; large plantations and especially those which provide raw materials essential to important industries".

Nationalization is thus a means of constructing the new socialism rather than the implementation of an ideological programme. Nor is government ownership of all the major means of production and exchange enough to make a state socialist; it is also necessary that the government be chosen and led by the peasants and workers themselves. In other words, there can be no socialism without democracy, nor without a new ethical attitude

¹ *The Arusha Declaration and TANU's Policy on Socialism and Self-Reliance*, Dar es Salaam, Government Printer, 1967. A revised English translation is included in Julius K. Nyerere, *Freedom and Socialism, A Selection from Writings and Speeches 1965-1967*, Dar es Salaam, Oxford University Press, 1968.

of the leaders, that is, all those in positions of responsibility in the party and in public administration. In this connection the Arusha Declaration lays down that no TANU or government leader may hold shares in any company, hold directorships in any privately owned company, receive two or more salaries, or own houses which he rents to others.

With reference to economic development, the key word is self-reliance. However, reliance on the country's own human and material resources does not imply rejection of foreign aid; but it does require foreign aid to be so used as to forestall any new form of dependence.

The Arusha Declaration does not belittle the importance of economic development, but it stresses the priority of social aims; similarly, it disapproves of the emphasis placed in the past on industries and expresses a renewed interest in agriculture and the rural society in general.

The Arusha Declaration led to profound changes in Tanzania's economic policy. Two of them need to be discussed here, namely, the extensive nationalization measures in and after 1967, and the principles of economic planning.

The Arusha Declaration was swiftly followed by the nationalization of banks, insurance, import and export trade, milling distribution and other industries, and by the establishment of new public corporations, called "parastatals" (e.g. the National Bank of Commerce, the National Milling Corporation, the State Trading Corporation) which took over the assets and liabilities of existing private firms and set out to rationalize their respective sectors. Another method was for the government or a parastatal corporation (e.g. the National Development Corporation) to acquire the entire equity, or at least a controlling majority holding, in a

number of previous corporations in the sectors of tea, coffee, wheat and cotton¹.

Before going on to discuss planning principles, brief reference must be made to a document approved by the National Executive Committee and published in 1971 under the title *Mwongozo*². This restates the principles of the Arusha Declaration, but, coming some years later, is rather more realistic and hence of signal importance for further implementation³. The document places particular stress on the party's role in the realization of Tanzania's socialist ideals and in the mobilization of the masses to this end. However, though the party is seen as the key instrument in the building of socialism, it is also made clear that if Tanzania's society and economy are to undergo any real change, the primary thrust must come from below, from the people themselves.

The *Mwongozo* outlines two main approaches to effective decentralization of political power, namely, workers' participation in company management, and the creation of more communal *ujamaa* villages throughout the country⁴. The document had very considerable impact, especially as regards the mechanism of economic planning, though it is of course too early to pass judgment on its effective importance and on its place in the economic and political development of Tanzania.

¹ Charles A. Crum, "Administrative formulation and legislative implementation of Tanzania's economic policy", in: Tanzania Investment Bank, *Rasilimali - Tanzania Investment Outlook*, [1972], p. 17-19, and Godfrey M. Chamungwana, "The parastatal system in Tanzania", *ibid.* p. 13-17.

² *TANU Guidelines 1971*, Dar es Salaam, 1971.

³ J.S. Saul, "Planning for Socialism in Tanzania: the Socio-Political Context", in *Towards Socialist Planning*, Dar es Salaam, 1972.

⁴ The United Republic of Tanzania, *The Economic Survey 1971-72*, *op. cit.*, p. 1-6, 57 ff.

The Arusha Declaration had laid down the general lines of socialist development. The main emphasis was on state control over the whole economy, and on the crucial place of agriculture. The Second Five-year Plan (1969-1974)¹ specified the ways and means of achieving these aims. Conflicting needs had to be taken care of, which meant striking "a balance between directly productive investments which can increase our future resources and social investments which meet urgent immediate needs of our people; a balance between short-term results which can be enjoyed now, and making those long-term changes in our economy which are necessary for sustained growth; a balance between investing in those parts of the country which are already fast growing... and those parts which have been neglected in the past and need an extra push"².

The Plan followed up the nationalization programme after the Arusha Declaration with guidelines on the further development of the public sector so created and on the principles of its management. It also gives effect to the Declaration's principle of the primacy of agriculture by defining programmes and services to aid co-operative rural development.

This is not the place to go into details about the Plan's provisions for each separate sector. Where appropriate, these will be discussed later in connection, especially, with the financial aspects of economic planning. But it may be well to summarize the Plan's main principles and general targets, together with its institutional and regional aspects.

¹ Until 1968 Tanzania followed the First Five-year Plan, which was rather vague and not much more than indicative. The first serious attempt at planning stems from the Second Five-year Plan, in 1969.

² The United Republic of Tanzania, *Tanzania Second Five-Year Plan for Economic and Social Development*, Dar es Salaam, 1969, Vol. I, p. XXIV.

The five main principles, in the words of the Plan itself, are as follows¹:

- “(i) *Social equality* - the Plan aims to spread the benefits of development widely throughout society;
- (ii) *Ujamaa* - the Plan emphasizes development of forms of economic activity which encourage collective and co-operative efforts and avoid wide differences of wealth and income;
- (iii) *Self-reliance* - the Plan emphasizes development through maximum mobilization of domestic resources, particularly through mobilization of the people;
- (iv) *Economic and social transformation* - the Plan emphasizes rapid expansion of productive capacity to create the basis for future economic and social transformation;
- (v) *African economic integration* - the Plan emphasizes the extension of economic co-operation with other African States.”

As regards the Plan's more detailed targets, these may be summarized as follows²:

- (1) An annual growth rate of 6.5 per cent in the gross domestic product (the First Plan had envisaged a 6.7 per cent growth rate, but in practice it had turned out to be 4.3 per cent on the average);
- (2) Improved living standards for the population, thanks to a better diet, better clothing, better housing, better education and better health facilities;
- (3) Structural change in the economy with a view to sustained growth over the long period;

¹ *Ibid.*, p. 1.

² *Ibid.*, p. 2. See also I. Livingstone, *Socialist Planning in Tanzania: the Second Five Years*, University College, Economic Research Bureau Paper 69.13, Dar es Salaam, 1969.

- (4) Reduction of imports and expansion of exports, especially to neighbouring countries, in the interests of balance-of-payments equilibrium;
- (5) A shift in strategy from the First Plan, which had concentrated the government's energies on expansion in public investment, in infrastructure and the rural economy, leaving the main thrust in industrial investment to private enterprise, including foreign aid. Now further rural development on a large scale was to be accompanied by increased directly productive investment by the public sector, both in agriculture and in industry, private enterprise no longer being seen as the major investor in these fields. There is also a shift in emphasis: expansion of investment programmes for an arterial transport system and a higher education system is to diminish to the benefit of projects holding out the promise of immediate output increase.

Planning was organized on a centralized basis until July 1972. Each Minister was responsible for a nation-wide plan for the sector within his competence. But after the TANU Guidelines demanded decentralization, the government created district and regional organizations "which are assigned full management responsibilities over a wide range of activities, subject only to overall guidance and co-ordination from the centre."

The activities that have been decentralized are those which have a major bearing on economic development: agriculture, natural resources, water, transport and works, lands, commerce and industries, education and health.

¹ E.A. Mulokozi, "Planning in a system of decentralized development management. The case of Tanzania", in: Tanzania Investment Bank, *Rasilimali - Tanzania Investment Outlook*, January, 1973, p. 3.

The new planning machinery works as follows. The districts prepare and approve local development programmes, which are then submitted to regions for review and approval. In preparing projects, ample room is left for popular initiative at village and co-operative level. District and regional plans are to follow centrally approved planning guidelines, and, once they have the approval of local development and party committees at the appropriate level, go forward to the Prime Minister's Office for integration of all the 18 regional plans into one single consistent "national rural development plan". This in turn will be integrated by the Ministry of Planning with the sectoral (ministerial/parastatal) plans into an overall national development plan.

PART ONE

THE BANKING AND CREDIT SYSTEM
OF EAST AFRICA, FROM ITS ORIGINS TO 1965



Chapter I

THE BEGINNINGS OF MONEY AND BANKING IN EAST AFRICA

1. MONEY

In discussing the days when money first came into use in the territories of East Africa, a distinction must be made between two zones. One of them consisted of the inland areas with a predominance of subsistence economy since time immemorial; here money did not come into use until the nineteenth century. In the coastal strip, on the other hand, the economy had for centuries been based on trade, and money made its first appearance long ago, witness numerous finds of Roman coins, as well as Arab, Portuguese, Persian and Chinese coins dating from the Middle Ages¹.

But money became really important in connection with the area's mainly commercial relations with India and with Indian immigration. This explains why the Indian rupee was the prevalent currency at the time when British colonization began in Kenya and Uganda and when the Germans arrived in Tanganyika.

The British made the use of the Indian currency official in both territories, but soon local rupees began to circulate as well.

¹ The Sultan of Kilwa minted his own copper coinage as early as the 13th century.

These were issued by the Currency Commissioners against sterling, and were fully covered by British government stock¹.

In Tanganyika too, the Indian rupee was the prevalent currency, and the German colonial authorities kept this name for the silver coins of their own issue². In 1905, the *Deutsch-Ostafrikanische Bank* of Berlin opened a branch in Dar es Salaam, which, in addition to carrying out the normal functions associated with commercial banking, held an Imperial concession to issue its own notes and coin³. The notes had metallic cover of at least one third their face value. However, in 1906 this bank got into serious difficulties and was unable to redeem its notes, and for a while the German administration set up its own, temporary mint in the railway workshop at Tabora⁴.

When the East African Currency Board was set up in 1919, four major currencies were thus circulating in East Africa, in addition to shells and livestock, which in many areas continued to be used as a measure of value and, to a lesser extent, as means of payment⁵. These were the Indian rupee, a silver currency resembling the Indian rupee, the money tokens issued by the German administration, and the local rupees issued by the Currency Commissioners.

¹ W.T. Newlyn, *Money in an African Context*, Nairobi, 1967, p. 29 f.

² Silver rupees and divisional coins of 1/64 rupee (see Arnaldo Mauri, "La genesi della banca centrale nel Chenia, in Tanzania ed in Uganda", *Il Risparmio*, No. 1, January 1970, p. 34).

³ H.H. Binhammer, *Commercial Banking in Tanzania*, University College, Economic Research Bureau Paper 69.11, Dar es Salaam, 1969, p. 1.

⁴ D.D. Yong, "The History of the Tabora 15-rupee Piece", *Tanzania Notes and Records*, No. 62, March 1964.

⁵ H.H. Binhammer, *The Development of Central Banking and Monetary Management in Tanzania*, University College, Economic Research Bureau Paper 69.9, Dar es Salaam, 1969, p. 10.

2. CREDIT

The beginnings of credit in East Africa cannot possibly be described with reference to the whole area, but a distinction needs to be made between the countries under British and those under German rule.

(a) *The British zone*

The first bank to do business in the British zone of East Africa was the National Bank of India, which opened in 1896 in Kenya for the purpose of financing trade with India¹. But its name was misleading; it was not an Indian, but a British bank based on London, although it did largely operate in India, where it specialized on financing foreign trade. This limited scope was a common characteristic of all the British-based banks which gradually went into business in the colonial territories at the beginning of the nineteenth century, in the wake of trade expansion.

The National Bank of India was soon followed by the Standard Bank of South Africa, in 1910, and by the National Bank of South Africa², in 1961. Again, both were really British banks operating largely in South Africa³. In practice their business was

¹ It later changed its name to National and Grindlays Bank. See W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 41.

² The National Bank of South Africa was absorbed in 1925 by Barclays, then called Barclays (Dominion, Colonial and Overseas). See W.T. Newlyn, *ibid.*, p. 41, and by the same author, "The Colonial Empire", in: R.S. Sayers, *Banking in the British Commonwealth*, Oxford, 1952, p. 436.

³ The rudimentary conditions in which these pioneering banks had to conduct their business in East Africa can be glimpsed from the following description by J.A. Henry, in *The First Hundred Years of the Standard Bank* (London, 1963, p. 195): "The party reached Mombasa on 3rd December, loaded with branch equipment, including £8,000 in gold coin. Within a week they had

of a fairly limited kind. Although, as "branches", they could have acted with reasonable independence, they were intended, and behaved, chiefly as intermediate links between Europe and South Africa. As J.A. Henry notes ¹, their function was comparable to the parent banks' "agencies" in Hamburg and New York, since they were meant to feed business into the "branches" proper rather than to develop local business.

(b) *The German zone*

As has already been mentioned, the first commercial bank to open its doors for business in German East Africa, in 1905, was the *Deutsch-Ostafrikanische Bank*. It was followed in 1911 by the *Handelsbank für Ostafrika*, which opened a branch at Tanga. The latter had no issuing privilege, and hence acted exclusively as a commercial bank, often in close co-operation with the *Deutsch-Ostafrikanische Bank* ². It dealt mainly with Asian and European clients ³. A third bank was proposed to the German administration by a group of Tanga settlers, who wanted a co-operative bank along the lines of that set up in German South West Africa; but the colonial authorities were against this scheme and it came to nothing.

secured from the Arab Governor the lease of a new three-storey building in the Mombasa bazaar at a rent of £ 16 13s.4d. a month. The ground floor was to be for banking, the first floor for staff quarters, and the top floor was sublet to a business at £ 4 a month. In Nairobi they were not so fortunate. Properties and land appeared to be rising in value, and there was a dearth of suitable premises. They had to content themselves with three ground-floor rooms in a two-storey building, at a rent of £ 10 a month for six months renewable".

¹ J.A. Henry, *ibid.*, p. 223.

² H.H. Binhammer, *Commercial Banking in Tanzania*, *op. cit.*, p. 1.

³ A.R. Roe and M.J.H. Yaffey, "Money and Banking", in: *Economic Problems of Tanzania*, Dar es Salaam, 1968, p. 20-21.

In addition to these two private commercial banks there was an official savings bank in Dar es Salaam, with functions of savings promotion among the local population¹. After the defeat of Germany in the first world war, the German banks were replaced by branches of British banks already operating in Kenya and Uganda. Permission was also given to a Belgian bank, the *Banque du Congo Belge*², which already operated in Ruanda-Urundi, to open two branches, one at Kigoma and one at Dar es Salaam.

3. CONCLUSIONS

In the light of the developments described above, it can be said that as of the end of the first world war the banking system of East Africa began to assume a more unified appearance, corresponding to the political unity of the colonial administration to which the territories concerned were now subject.

The banking system was dominated by the triad of the National Bank of India, the Standard Bank of South Africa and the National Bank of South Africa, which in the course of time, and via a number of transformations, so strengthened their position that they were eventually known as the "Big Three" — by that time under the names of National and Grindlays Bank, Standard Bank and Barclays Bank D.C.O. They remained the pillars of East Africa's credit system until 1965.

¹ Arnaldo Mauri, "Il contributo delle casse di risparmio alla mobilitazione del risparmio in Africa", *Il Risparmio*, No. 2, February 1972, p. 20.

² Ruanda-Urundi, originally a German territory, became a League of Nations Mandate under Belgian administration after the war. Continuing close economic relations among the former German territories, especially via Kigoma and Dar es Salaam, explain why the *Banque du Congo Belge* was anxious to open branches in Tanganyika.

It may be of interest, therefore, to take a brief look at their activities at the beginning of the twentieth century¹. It has already been pointed out that they were largely concerned with financing foreign trade. But it should be added that foreign trade was, at the time, much the most important sector of the economy, to the extent that it was monetized. These so-called expatriate banks, therefore, provided an extremely useful service in developing export crops and in creating a link between the typical subsistence economy of the colonies and the international market. Thereby they certainly helped to accelerate the transformation of subsistence economies into market economies. At this stage, the banks used large amounts of funds drawn from London in financing the collection and export of agricultural commodities, as well as the import and distribution of consumer goods. It was only later that an important change took place in the banks' functions, in so far as they started to collect deposits locally and to invest the bulk of them in London. This meant export of capital of the typical kind so often described by many authors either in general terms or with reference to particular countries.

¹ See W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 42-43.

² See, e.g., Arnaldo Mauri, *Il mercato del credito nei paesi sottosviluppati*, Milan, 1966, p. 53 f.; Thomas Balogh, *Monetary and Commercial Institutions of a European Origin in Africa*, Cairo, 1964, p. 12; E. Nevin, *Capital Funds in Underdeveloped Countries: the Role of Financial Institutions*, London, 1963.

Chapter II

THE EAST AFRICAN CURRENCY BOARD

1. BACKGROUND

The East African Currency Board (EACB) was set up in December 1919, "to provide for and to control the supply of currency to the East Africa Protectorate [subsequently the colony of Kenya] and the Uganda Protectorate¹, but did not actually start operating until its constitution, duties and powers were defined in detail in regulations dated 22 May 1920. In that same year it became responsible also for Tanganyika, after a League of Nations mandate had been given to the United Kingdom to administer the ex-German colony.

One of the main reasons for setting up the Currency Board must surely have been the formation of a very large colonial territory under British control, after the dismemberment of the German colonial empire. A joint mechanism of currency issue was clearly going to be of great advantage from the point of view of economic integration within the area, the more so as the system

¹ East African Currency Board, *Report of the East African Currency Board for the period ended the 30th June, 1921*, London, 1922, *Regulations*, Art. 1, Appendix I, p. 7-9. See also *ibid.* p. 2.

of currency boards had been successfully tried out since 1912 in British West Africa¹.

Another reason, no doubt, was the deterioration of the monetary situation of India, as a result of the steep rise of the price of silver on the world market².

The East African Currency Board initially had its seat in London, and later opened branches in Nairobi, Dar es Salaam, Mwanza, Tanga and Jinja. The territories within its competence—originally Kenya, Uganda and Tanganyika—underwent several changes in the course of time, with the entry and withdrawal of different territories³.

In 1936 Zanzibar joined, and in 1943 the East African shilling was introduced as legal tender in British-occupied Italian Somaliland, Eritrea and Ethiopia, as well as in the British Protectorate of Somaliland; actually, it had already been in circulation in all these territories, alongside the Italian lira and, in British Somaliland, with the India rupee. Aden, too, became part of the East African currency area. Ethiopia withdrew in 1945, when the country began issuing its own currency, the Ethiopian dollar⁴, though in effect conversion took several years. In 1950, when former Italian Somaliland became a UN Trust Territory under Italian administration, the Somali shilling replaced the East African

¹ See W.T. Newlyn and D.C. Rowan, *Money and Banking in British Colonial Africa*, Oxford Studies in African Affairs, London, 1954, p. 25 ff.; E. Jucker-Fleetwood, *Money and Finance in Africa*, London, 1964, p. 56.

² Arnaldo Mauri, "La genesi della banca centrale" etc., *op. cit.*, p. 35.

³ See East African Currency Board, *Reports* for various years; Arnaldo Mauri, *ibid.*, p. 36-37; Joachim W. Kratz, *The East African Currency Board*, IMF Staff Papers, Vol. XIII, No. 2, July 1966, p. 229-230; R.G. Ridley, "Eastern Africa", in: W.F. Crick, *Commonwealth Banking Systems*, Oxford, 1965, p. 390.

⁴ Arnaldo Mauri, *Il mercato del credito in Etiopia*, Milan, 1967, p. 281.

shilling there, and Eritrea withdrew from the currency area in 1952. In the meantime, in 1951, the East African shilling had become the sole legal tender in the British Protectorate of Somaliland and in Aden, ousting the Indian rupee. Later, in 1961, British Somaliland left the East African currency area after gaining its independence and joining ex-Italian Somaliland; the new country, the Somali Republic, adopted the Somali shilling as its currency. Aden, finally, stopped using the East African shilling as legal tender in 1965, after joining the Federation of South Arabia, whose currency, as of that year, was the South Arabian dinar; however, Aden did not withdraw from the East African Currency Board, which in any case was fast approaching dissolution.

2. THE MECHANISM OF CURRENCY ISSUE

The East African Currency Board, like other British colonial currency boards¹, constituted a currency system which, though formally independent, was in effect strictly controlled by the mother country. Not only did the Board have its seat in London, but it was under the direct authority of the British government, specifically the Secretary of State for the Colonies, who had powers to issue relevant regulations and to appoint the Members of the Board as well as the Secretary². These were usually chosen

¹ There were three such currency boards, one each for West Africa, East Africa, and the two Rhodesias and Nyasaland, all functioning in almost identical manner. See, in addition to the works quoted two footnotes earlier, also W.F. Crick, *op. cit.*, p. 3 f., and H.A. Shannon, *The Modern Colonial Sterling Exchange Standard*, IMF Staff Papers, Vol. II, April 1952, p. 318-362.

² East African Currency Board, *Report for the period ended the 30th June 1921*, *op. cit.*, p. 7, *Regulations* art. 1-3. See also J.W. Kratz, *op. cit.*, p. 230 ff.

among officials of the Colonial Office, the Office of the Crown Agents, and the Treasury.

The East African Currency Board's main task was to mint coins and print currency notes.

The East African shilling was not the first currency issued by the Board. It was preceded by the florin, whose exchange rate equalled that of the rupee. More than 54 million such florins were issued, 36.6 million of them in notes. The original value of the florin corresponded to 2s. sterling, but towards the end of 1920 an economic depression in East Africa and the fall in the value of the Indian rupee made it extremely hard to maintain this fixed parity with sterling. Accordingly, it was decided in May 1921 to substitute the shilling for the florin¹, at a par value of 20 shillings to 1 pound sterling.

At first conversion proceeded very quickly; it took only a few months to convert the bulk of rupees and florins into the new shillings. This money was obviously owned by the more advanced social classes resident in the major commercial centres. Afterwards things went much more slowly, and it was 1925 before it could be said that the shilling was the only currency circulating in East Africa².

The EACB's principal task was, on demand, to issue at its main offices in the constituent territories notes and coins in exchange for equivalent values in sterling³ lodged with it in

¹ *Ibid.*, p. 3.

² East African Currency Board, *Report for the year ended 30th June 1925*, p. 2; Arnaldo Mauri, "La genesi della banca centrale" etc., *op. cit.*, p. 36.

³ East African Currency Board, *Report for the period ended the 30th June 1921*, *op. cit.*, p. 7 f., *Regulations*, Art. 6, and 7.

London. For these services the Board was entitled to charge a commission, variable at its discretion up to 0.5 per cent. This commission and the Board's other earnings were to cover its operating expenses.

Any profits, net of expenses and of any contributions to colonial governments, were to be credited to a currency reserve fund, the purpose of which was to cover the risk of price fluctuations of the securities in the Board's investment portfolio; losses, in turn, were debited to the same reserve fund. The EACB was allowed to invest its funds in public securities of any part of the British dominions, or in such other manner as the Secretary of State for the Colonies may approve. Within these limits, it was free to invest its funds at its discretion, but it was obliged, subject to any directions from the Secretary of State, to hold a sufficient proportion of its reserves in liquid form. Periodically, the Board had to submit to the Secretary of State a statement of its transactions as well as of the state of reserves and investments, and a statement on currency outstanding, reserves and security holdings had to be published in the official gazettes of member territories. The accounts for all transactions were subject to audit by the Colonial Audit Department¹.

In all, then, the East African Currency Board, like all other British currency boards, acted as an automatic money changer, guaranteeing the continuous convertibility of East African shillings into sterling and *vice versa*. In effect, this was the equivalent of a gold exchange standard, based on sterling rather than directly on gold². Since money was exchanged in unlimited quantities

¹ *Ibid.*, Art. 17-21.

² Actually, it was a gold standard, since sterling itself was based on gold.

and the only concern was to maintain the fixed parity with sterling, the system obviously had purely passive functions. With the local currency firmly tied to sterling, there was in practice no control whatever over the quantity of currency or the volume of credit. Admittedly, the Currency Board was some advance in comparison with the practices of the Currency Commissioners, but it was far from having the attributes of a central bank or, for that matter, even of an issuing bank properly so called.

The passive role of the Currency Board is confirmed by its investment policy. It held exclusively gilt-edged, government or government-guaranteed stock that could easily be sold on the London market. Though not expressly prohibited, the EACB did in practice not invest in securities issued by the constituent territories it served until 1955, when an amendment to the Regulations explicitly allowed of it.

3. HISTORY OF THE EAST AFRICAN CURRENCY BOARD

As the years passed, the EACB underwent a number of major changes, as regards both its structure and its functions. It is perhaps best to distinguish four periods. During a long initial period, from 1919 to 1955, nothing very much changed; some important changes originated in the years 1955 to 1959; in the third period, from 1960 to 1962, the system tried to adapt itself to the new requirements of the constituent territories in view of their approaching independence; and finally the years after 1962, when the Board's activities gradually passed to new, independent central banks¹.

¹ See J.W. Kratz, *op. cit.*, p. 230 ff.

(a) *The years 1919 to 1955*

In its early years, the East African Currency Board differed from all others in that it provided far less than 100 per cent cover for its currency issues. The reason lay in the special difficulties it had to face. Initially, it will be recalled, Indian rupees circulated in Kenya and Uganda, and German colonial coins in Tanganyika. All these had to be replaced, but this was not easy to do because their value fluctuated with the price of silver.

Whereas the West African Currency Board, after its establishment in 1912, had been able to exchange circulating coins at their face value, the EACB did not succeed in doing the same thing, mainly because it could not make suitable arrangements with the governments of India and Germany. The exchange rate of 2s. per rupee soon proved much too high for the silver coins, and their conversion involved the Board in heavy losses. On completion of the conversion of the former currencies to the East African shilling in 1925, the total loss from this operation amounted to more than 35 million East African shillings—more than 31 per cent of the total of 112 million shillings of East African currency outstanding on 30 June 1925¹.

In practice it proved impossible until 1950 to provide 100 per cent cover for the currency in circulation (see Table 1). In addition to the initial losses, the reasons lay in the continuous fall of the volume of currency in circulation after 1926² and in

¹ Arnaldo Mauri, "La genesi della banca centrale" etc., *op. cit.*, p. 40; J.W. Kratz, *op. cit.*, p. 232; East African Currency Board, *Report for the year ended 30th June, 1925*, p. 4.

² A. Mauri, *ibid.*

TABLE 1

CURRENCY ISSUES OF THE EAST AFRICAN CURRENCY BOARD, 1925 TO 1966
(end-June figures in thousand East African shillings)

Year	Notes and coin outstanding (¹)	Currency reserve fund (²)	Coverage (per cent)
1925	112,140	48,920	43.6
1926	106,020	46,400	43.8
1927	105,100	47,380	45.1
1928	101,460	42,920	42.3
1929	101,480	44,040	43.4
1930	93,280	26,020	27.9
1931	79,860	14,020	17.6
1932	71,380	7,120	9.9
1933	77,640	12,840	16.8
1934	83,040	20,560	24.8
1935	85,300	25,760	30.2
1936	102,140	39,080	38.1
1937	120,120	54,600	45.5
1938	130,000	64,700	49.8
1939	130,000	64,400	49.5
1940	138,540	74,820	54.0
1941	164,480	102,200	62.1
1942	281,100	220,000	78.3
1943	422,380	363,280	86.0
1944	496,560	450,520	90.7
1945	567,560	531,240	93.9
1946	490,960	468,120	95.4
1947	487,380	471,560	96.8
1948	473,580	464,720	98.1
1949	544,780	535,240	98.3
1950	591,560	598,800	101.2
1951	787,740	797,700	101.3
1952	966,980	930,400	96.2
1953	972,040	1,006,960	103.6
1954	1,066,680	1,152,380	108.0
1955	1,208,240	1,236,260	102.3
1956	1,214,480	1,226,420	101.0
1957	1,213,800	1,276,860	105.2
1958	1,173,060	1,268,500	108.1

Year	Notes and coin outstanding ⁽¹⁾	Currency reserve fund ⁽²⁾	Coverage (per cent)
1959	1,145,140	1,276,700	111.5
1960	1,208,760	1,336,280	110.5
1961	1,183,460	1,346,960	113.8
1962	1,169,880	1,368,500	117.0
1963	1,337,180	1,504,740	112.5
1964	1,385,820	1,517,660	109.5
1965	1,235,700	1,397,620	113.1
1966	1,125,540	1,236,720	109.8

⁽¹⁾ From 1962 to 1966 this item includes the liquidity reserves of commercial banks deposited with the East African Currency Board.

⁽²⁾ Sterling cash holdings, deposits with commercial banks in London, miscellaneous coins (at bullion value), Treasury Bills (at purchase price), other securities (at market value).

Source: East African Currency Board, *Report for the Year Ended 30th June*, various years.

the economic difficulties engendered by the Great Depression¹. The lowest coverage occurred in 1932; although the currency in circulation had fallen to 71.38 million shillings, the reserve fund stood at 7.12 million and thus provided cover to the extent of no more than 9.9 per cent².

¹ J.W. Kratz, *ibid.*, p. 235.

² This was clearly an abnormal situation. While the Regulations left the proportion of coverage to the discretion of the Secretary of State for the Colonies, they do state that the Board must be satisfied that "reserves are more than sufficient for all the purposes for which such reserves may be required" (Art. 21). As Newlyn points out (*Money in an African Context*, *op. cit.*, p. 39 f.), this rule was interpreted in a restrictive manner, "sufficient" meaning a reserve fund equal to 100 per cent of the currency outstanding, and "more than sufficient" a reserve surplus of about 10 per cent. The East African Currency Board's position until 1950 was clearly out of order, and it had to do its best to lift its reserves to acceptable levels as soon as possible. This explains why until 1951 the Board paid out nothing by way of contribution to the colonial governments, in spite of explicit provisions to this effect in the Regulations (Art. 21).

Since 1930 the East African Currency Board had met requests for exchange by short borrowing in London, where, however, its credit standing was not very high and it was, therefore, unable to raise all the funds it needed. Under pressure from the British government, the authorities in Kenya, Uganda and Tanganyika passed legislation to assume a total guarantee of up to 30 million East African shillings on behalf of the East African Currency Board and to authorize corresponding sterling loans. The effective rate of currency coverage for the first time exceeded 100 per cent in 1950. From that year on, the East African Currency Board distributed some of its profits to the governments of its constituent territories¹.

(b) *The years 1955 to 1959*

During these years the volume of currency in circulation remained fairly stable and coverage was consistently over 100 per cent, with a maximum of 111.5 per cent in 1959. A critical judgment of this situation will be expressed later; for the moment, the point of interest is in what respects this period differs from the preceding one.

In these years the first steps were taken to amend the Regulations so as to make the Board's activities more responsive to the economic needs of the constituent territories. The mechanism of currency issue was made more flexible, and the rules governing the reserve fund were relaxed, especially as

¹ At the end of the financial year 1950/51 three million shillings were so distributed (1,032,000 to Kenya, 1,011,000 to Tanganyika, 852,000 to Uganda, and 105,000 to Zanzibar). Actually, this was not the first distribution, since Zanzibar had been getting small sums ever since 1936 (W.T. Newlyn and D.C. Rowan, *op. cit.*, p. 62-64).

regards its qualitative composition¹. Because of the way in which the Currency Board functioned, the money supply in East Africa was determined essentially by the balance of payments, the public debt and foreign aid and loans, while such other factors as the public's liquidity preference and commercial bank policy had little influence². In practice, money could be issued only to the extent that sterling assets became available for conversion into East African shillings, and as a result the pace of currency issues came to depend largely on autonomous factors not under the control of the monetary authorities of the territories concerned. This may not have been too hurtful for the economy so long as the use of money remained restricted to relatively few population groups and to production for export. But after the second world war these conditions no longer obtained, and as more and more monetary means were needed to keep the economy running the full inadequacy of the Currency Board's mechanism became apparent. Consequently, changes had to be introduced to make the money issue less automatic and more flexible, and also to allow some part of the reserves so far immobilized in London to be invested locally³.

Accordingly, the East African Currency Board was authorized in 1955 to make fiduciary issues up to 200 million shillings,

¹ As has already been pointed out, the Regulations provided that the East African Currency Board could invest some of its reserve assets in "securities of the Government of any part of His Majesty's dominions" (Art. 15), or in others, subject to the approval of the Secretary of State for the Colonies. But again, the British authorities interpreted this rule restrictively, and in effect securities issued by the colonial governments of East Africa were excluded.

² John Loxley, *Financial Intermediaries and their Role in East Africa*, Makerere Institute of Social Research Conference Papers, January 1967, p. 4; J.W. Kratz, *op. cit.*, p. 230.

³ Arnaldo Mauri, "La genesi della banca centrale" etc., *op. cit.*, p. 46.

against securities issued or guaranteed by one of the governments in the East African monetary area¹.

From 1955 on, therefore, the East African Currency Board can no longer be regarded as a mere money changer, converting sterling into local legal tender and *vice versa*. This important change followed a policy statement by the Secretary of State for the Colonies to the House of Commons in December 1954, as a result of which the Regulations of the Currency Board were amended² to allow the Board to extend credit to the governments of the constituent territories by holding government or government-guaranteed securities, corresponding to a fiduciary issue.

The first such investment was in securities issued by Kenya, of which the Board on 30 June 1956 held 3,820,000 shillings, nominal value. In the following year Kenya, Uganda and Tanganyika placed long-term loans with the Board, and by the end of June 1957 the amount of fiduciary issue outstanding had risen to 116 million East African shillings³.

¹ East African Currency Board, *Report for the year ended 30th June, 1955*, p. 4. This ceiling was subsequently raised to 400 million shillings in 1960, to 500 million in 1963 and to 700 million in 1964. The maximum limits for government issues were 197.2 million shillings each for Kenya, Uganda and Tanganyika, 24.5 million for Zanzibar and 84 million for Aden.

² The amendment consists of the addition of the following paragraph: "Without prejudice to the generality of the foregoing, the Board may subscribe for, and buy or sell, and may hold publicly issued securities of or guaranteed by the Government of one of the Constituent Territories or of any authority established to administer services common to two or more of the Constituent Territories provided that the cost price of such securities so held shall not, except with the approval of the Secretary of State, exceed an amount in East African shillings equivalent, at the par rate of exchange on London, to £10 million... sterling".

³ East African Currency Board, *Report for the year ended 30th June, 1957*, p. 7.

In December 1957 the upper limit of permissible fiduciary issue was raised to 400 million shillings, but by 30 June 1958 total loans contracted had not reached more than 126 million, and a year later the utilization ratio was still less than 45 per cent (see Table 2).

In 1959, the East African Currency Board was authorized to acquire local Treasury Bills (within the specified limit for the fiduciary issue to governments), and thus to provide short-term financing to the governments concerned. Uganda and Tanganyika were the first to avail themselves of this new facility. By the end of December 1959 the Board was holding 76 million shillings' worth of Treasury Bills, 46 million of them Ugandan and 30 million Tanganyikan¹.

Table 2 gives details of the Board's fiduciary issue from 1959 to 1966. The figures call for three comments. First, the actual fiduciary issue consistently falls far short of the maximum authorized. Secondly, the share of Treasury Bills rose strikingly in the later years; initially, they accounted for only 23.7 per cent of local government securities in the reserve fund of the East African Currency Board, but on 30 June 1965 the percentage was 56.2. Third, marked seasonal fluctuations in Treasury Bills contrast with fairly stable issues of long-term securities; as a result, the fiduciary issue itself was subject to seasonal fluctuations corresponding to those in the economies of East African countries.

(c) *The years 1960 to 1962*

In and after 1962 major changes were made in the structure and modes of operation of the East African Currency Board, in anticipation of the independence of the constituent territories.

¹ East African Currency Board, *Report for the year ended 30th June, 1960*, p. 12.

TABLE 2

EAST AFRICAN CURRENCY BOARD: FIDUCIARY ISSUE TO GOVERNMENTS, 1956 TO 1966
(end-June figures in million East African shillings)

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
Kenya											
Total authorized	...	50	116	118	116	116	112	112	140	198	198
Total taken up	4	38	50	80	76	76	76	76	72	70	70
Amount in Treasury Bills ⁽¹⁾	—	—	—	—	—	—	—	—	—	—	—
Utilization ratio (per cent)	...	76.0	43.1	70.0	65.5	65.5	67.7	67.7	51.4	35.4	35.4
Uganda											
Total authorized	...	68	118	118	118	118	112	112	140	198	198
Total taken up	—	58	58	58	90	68	102	72	74	190	190
Amount in Treasury Bills	—	—	—	—	32	10	44	12	16	130	132
Utilization ratio (per cent)	—	85.3	49.2	49.2	76.3	57.6	91.1	64.3	52.9	96.0	96.0
Tanganyika											
Total authorized	...	56	114	114	114	112	112	112	140	198	198
Total taken up	—	20	16	22	72	88	94	102	94	124	10
Amount in Treasury Bills	—	—	—	—	30	46	54	62	56	90	—
Utilization ratio (per cent)	—	35.7	14.0	19.3	63.2	78.6	83.9	91.1	67.1	62.6	5.1

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
Zanzibar											
Total authorized	—	8	14	14	14	14	14	14	18	24	24
Total taken up	—	—	—	—	6	6	8	12	16	18	8
Amount in Treasury Bills	—	—	—	—	—	—	2	—	4	6	—
Utilization ratio (per cent)	—	—	—	—	42.7	42.7	57.1	85.7	88.9	75.0	8.3
Aden											
Total authorized	—	14	30	30	30	30	48	48	60	—	—
Total taken up	—	—	—	18	18	18	18	18	18	—	—
Amount in Treasury Bills	—	—	—	—	—	—	—	—	—	—	—
Utilization ratio (per cent)	—	—	—	60.0	60.0	60.0	37.5	37.5	30.0	—	—
East African Currency Board											
Total authorized ⁽¹⁾	200	200	400	400	400	400	400	400	500	616	616
Total fiduciary issue	4	116	126	178	262	256	298	280	272	402	272
Amount in Treasury Bills	—	—	—	—	62	56	100	74	76	226	132
Utilization ratio (per cent)	2.0	58.0	31.5	44.5	65.5	64.0	74.5	70.0	54.4	65.3	44.2
Proportion of Treasury Bills in total local securities (per cent)	—	—	—	—	23.7	21.9	33.6	26.4	27.9	56.2	48.5

(¹) On 31 December 1960 and 31 December 1961 the total fiduciary issue to Kenya amounted, respectively, to 116 and 96 million shillings, of which 40 and 20 million, respectively, were against Treasury Bills. These figures do not appear in the table because, by 30th June of the following year, the Treasury Bills had been fully redeemed.

(²) The totals for the years 1957 to 1961 are not the precise sum of the totals authorized for the five separate territories; the difference is attributable to a small amount allocated to Somalia.

Source: East African Currency Board, *Report for the Year Ended 30th June*, various years.

The seat of the Board was transferred from London to Nairobi, and the number of individual Board members raised from four to seven, made up as follows: the Secretary General of the East African Services Organization, as *de facto* chairman, the Permanent Secretaries to the Treasury of Kenya and of Tanganyika, the Secretary to the Treasury of Uganda, the Financial Secretaries of Aden and of Zanzibar, and a technical expert in monetary and credit matters¹. All of them were still appointed by the British Secretary of State for the Colonies, but they were representatives of East African governments. The transfer of the Board's seat from London to Nairobi, too, was a step towards greater independence, since it enabled members to follow economic developments in East Africa at closer range and to maintain more intimate and more frequent contacts with governments, commercial banks and business circles. The EACB was thus in a position to play a more active part in economic and financial affairs and in effect, as will be seen later, became rather more similar to a central bank.

From 1960 on, the East African Currency Board began to undertake new functions. It started to provide seasonal credits for export crops, with the dual aim of promoting exports and acting as a banker of last resort to the commercial banks. Its policies on interest rates and exchange commissions became more flexible, it opened and maintained accounts for the commercial banks in order to facilitate banking operations, it acted as clearing house for banks, and, in order to improve currency distribution, opened new currency sub-centres in remote areas².

¹ East African Currency Board, *Report for the year ended 30th June, 1961*, p. 15; J.W. Kratz, *op. cit.*, p. 234 f.

² In 1963 the East African Currency Board had five currency centres (Aden, Dar es Salaam, Jinja, Nairobi, Zanzibar) and ten currency sub-centres

In order to understand the reasons for these changes and their implications, one has to look back upon the economic situation of East Africa in the early sixties. It was a difficult and precarious situation: capital flight, decline in private investment, massive withdrawals from bank deposits, and, in the 12 months ending June 1961, a fall in the currency in circulation by 24 million shillings, only in part due to the withdrawal of Somalia from the East African currency area. The commercial banks at that time financed the capital outflow to some extent by reducing their overseas cash holdings and expanding their credits to the private sector. This certainly helped to mitigate deflation, but considerably worsened the banks' liquidity position¹. In this situation, the East African Currency Board requested and obtained, from the Secretary of State for the Colonies, permission to discount and rediscount bills and other appropriate instruments issued in connection with specified crops (coffee, tea, cotton, sisal, pyrethrum and cloves). The Board's purpose was to restore the liquidity of commercial banks and at the same time to help along economic recovery by financing the marketing of the most important crops.

These new powers were granted, but only subject to two limitations, namely, that advances of this type must not exceed 100 million shillings, and must not raise the total fiduciary issue beyond the authorized amount.

(Gulu, Kampala and Mbale in Uganda, Kisumu and Mombasa in Kenya, Moshi, Mwanza and Tanga in Tanganyika, Mukalla in Aden and Wete in Zanzibar). (East African Currency Board, *Report for the year ended 30th June, 1963*, p. 1).

¹ East African Currency Board, *Report for the year ended 30th June, 1961* (p. 14), 1962 (p. 17), 1963 (p. 24). To improve the situation the banks raised their minimum lending rate to 7 per cent in July 1960 and to 8 per cent in October of the same year.

In 1960/61 commercial banks made hardly any use of the new discount facility, chiefly because of the high rate of 7 per cent, but began to do so in 1961/62. Even so, the Board's advances to commercial banks (including rediscounted Treasury Bills), never reached high amounts—partly because the EACB accepted only the highest standard of paper, and partly because poor harvests, especially of cotton in Uganda, caused the bill circulation to contract appreciably.

Table 3 shows the amount of refinancing made available to commercial banks by the rediscount of bills issued in connection with agricultural commodities. The succession of end-month figures clearly displays a seasonal pattern, with high points around the turn of each year. One is reminded of the seasonal pattern of the fiduciary issue, but actually in crop-financing there are geographical differences; requirements in Kenya and Uganda reach their peak in the early months of the year, those in Tanganyika in the autumn¹.

The Currency Board's advances were subject to the two conditions that commercial banks use the funds for financing crops, and that they turn to the Board only as a lender of last resort. But allocations were not made on a territorial basis; each bank could draw on the facilities up to a pre-established limit, within which it was free to employ the funds in any of the East African countries. In practice, considerable inter-country transfers took place, to match differing seasonal requirements.

¹ Arnaldo Mauri, "La genesi della banca centrale" etc., *op cit.*, p. 48; A.R. Roe, *Commercial Bank Borrowing and Central Bank Control*, University College, Economic Research Bureau Paper 66.5, Dar es Salaam, 1966, p. 10 ff.; A.R. Roe and M.J.H. Yaffey, *op. cit.*, p. 16.

TABLE 3

EAST AFRICAN CURRENCY BOARD: CROP-FINANCING ADVANCES TO
COMMERCIAL BANKS, DECEMBER 1961 TO JUNE 1966
(end-month figures in million East African shillings)

Month	1961/62	1962/63	1963/64	1964/65	1965/66
July	—	—	—	20.0	38.0
August	—	10.0	9.0	15.0	28.2
September	—	—	0.4	8.6	40.8
October	—	—	0.4	4.8	47.0
November	—	1.0	4.0	12.0	41.8
December	3.2	15.0	4.0	64.0	59.6
January	11.8	24.0	11.4	57.0	63.0
February	3.0	20.0	6.0	40.8	44.6
March	—	—	20.0	31.4	30.0
April	—	—	4.0	18.0	44.0
May	—	—	—	17.0	40.4
June	—	—	15.0	20.2	22.8

Source: East African Currency Board, *Report for the Year Ended 30th June, 1966*, p. 36.

Discount rates fell; the Currency Board lowered its rate from 7 to 5.5 per cent, and the commercial banks theirs from 8 to 7 per cent. Details are given in Table 4 and Chart 1, in comparison with other key rates.

The economic difficulties of the years 1960 to 1962 had, among other things, the effect of reducing government revenue. Hence, governments had more recourse to short-term borrowing from the Currency Board. At the beginning of 1961 the Board's holdings of East African Treasury Bills amounted to 84 million shillings, then dropped to 56 million in June (see Table 2) and rose again to 120 million by the end of the year¹.

¹ Cf. East African Currency Board, *Report for the year ended 30th June, 1962*. It is interesting, too, to look at the changes in the composition of the

TABLE 4

EAST AFRICAN CURRENCY BOARD: EXCHANGE COMMISSIONS AND RATES OF INTEREST, 1955 TO 1964
(end-month figures, per cent)

Year and month	Exchange commission on		Rediscount rate for Treasury Bills	Rediscount and advance rate for crop financing
	purchases	sales		
1955 June	$\frac{1}{4}$	$\frac{1}{4}$	—	—
1960 June	$\frac{1}{4}$	$\frac{1}{4}$	—	—
1961 June	$\frac{1}{4}$	$\frac{1}{4}$	—	7
1962 June	$\frac{1}{8}$	$\frac{3}{8}$	$\frac{1}{2}$ per cent	$5\frac{1}{2}$
1963 June	$\frac{1}{8}$	$\frac{3}{8}$	above the	$5\frac{1}{2}$
1964 June	$\frac{1}{8}$	$\frac{3}{8}$	local tender	$5\frac{1}{2}$
1964 November	$\frac{1}{8}$	$\frac{1}{2}$	rates	5

Source: East African Currency Board, *Report for the Year Ended 30th June*, various years.

In those years the East African Currency Board developed certain guidelines for its lending to governments. One of these was to allocate an equitable share of credit to each government; another was normally to leave an unused margin available for exceptional circumstances; and a third to require all governments to consult the Board before issuing any bonds or bills to it¹.

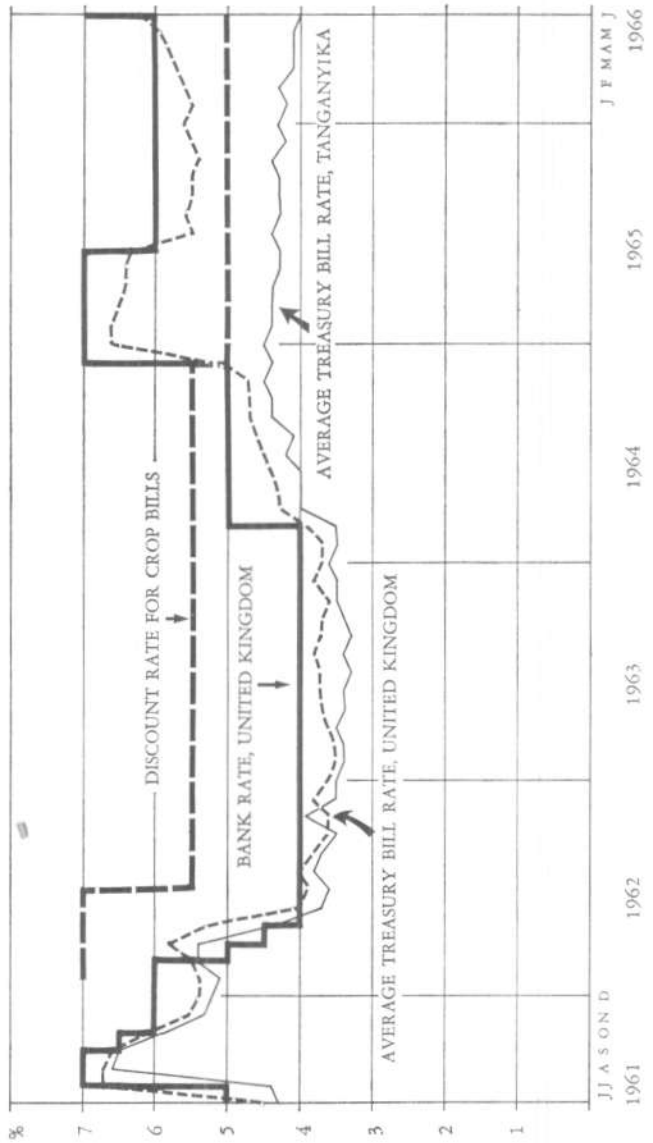
The EACB also tried to devise an equitable formula for sharing the portion of net income to be distributed to member governments. In theory, each government's share should have been proportional to the amount of currency circulating in its territory, but in the

Treasury Bill portfolio. At the beginning of 1961 the Currency Board held 40 million shillings each of Kenyan and Tanganyikan Treasury Bills; in February the Kenya holding was reduced to nil and the Tanganyikan one rose to 52 million, while Uganda appeared with a holding of 34 million.

¹ J.W. Kratz, *op. cit.*, p. 240.

CHART 1

KEY RATES OF INTEREST, 1961 TO 1966



SOURCE: EAST AFRICAN CURRENCY BOARD, Report for the Year Ended 30th June, 1966.

TABLE 5

EAST AFRICAN CURRENCY BOARD: DISTRIBUTIONS TO GOVERNMENTS FROM NET INCOME, FINANCIAL YEARS ENDING 30 JUNE, 1951 TO 1965 (*thousand East African shillings*)

Year	Kenya	Uganda	Tanganyika	Zanzibar	Aden	British Somali- land	Total distrib- uted	Per cent of net income distrib- uted
1951	1,032	852	1,012	106	—	—	3,000	28.1
1952	992	796	884	154	134	40	9,000	16.0
1953	1,590	1,374	1,334	216	416	70	5,000	23.9
1954	3,152	2,550	3,026	342	824	106	10,000	41.7
1955	3,190	2,564	2,770	580	768	128	10,000	34.3
1956	2,518	3,438	2,806	366	730	142	10,000	29.9
1957	4,354	4,428	4,308	546	1,146	218	15,000	35.1
1958	7,036	7,970	6,844	910	1,890	350	25,000	54.9
1959	7,480	7,420	6,912	908	1,828	450	25,000	56.4
1960	6,924	6,890	6,956	866	2,876	492	25,000	47.7
1961	6,952	6,952	6,952	862	2,960	320	25,000	40.0
1962	11,266	11,266	11,266	1,400	4,800	—	40,000	59.3
1963	11,266	11,266	11,266	1,400	4,800	—	40,000	67.0
1964	12,674	12,674	12,674	1,574	5,400	—	45,000	79.3
1965	14,324	14,324	14,324	1,780	5,250	—	50,000	68.8
Total or average	94,750	94,764	93,334	12,006	33,822	2,316	331,000	51.6

Notes: After 1964/65 no further distributions were made. The totals differ slightly from the sum of figures for individual territories, because of rounding.

Source: East African Currency Board, *Report for the Year Ended 30th June*, various years.

absence of accurate statistics¹ it was decided to allocate equal shares of 28.2 per cent each to the three main territories, 3.5 per cent to Zanzibar and 12 per cent to Aden (see Table 5).

¹ It must be remembered that capital and currency transfers within the currency area were not only freely allowed, but in fact took place on a large scale. In such an integrated monetary area it was obviously difficult to estimate precisely how much monetary circulation was pertinent to any one country.

The same formula was used to determine each government's share in the fiduciary issue.

In May 1962 the Board made the first change in its exchange commissions since 1946 (see Table 4). Until then, both the purchasing and the selling rate had stood at 1/4 per cent; now the charge for buying sterling was set at 1/8 per cent, and that for selling sterling at 3/8 per cent¹. The purpose was to encourage capital inflow and discourage capital outflow, and to provide an incentive for exporters to convert their receipts into local currency. This purpose, however, was achieved only to a limited extent. In the same year, too, the Board reserved the right to deal in the exchange market at its discretion.

(d) *The years after 1962*

After the middle of 1962 economic conditions in East Africa improved. Harvests were more plentiful thanks to better weather, confidence revived and with it investment, and rising commodity prices lifted export receipts.

This recovery was reflected in a rising currency circulation from 1962 on² (see Table 1). In this more promising setting, the East African Currency Board decided it was time for another increase in its fiduciary issue (Table 2), and accordingly, in December 1962, raised its limits for crop financing through the commercial banks from 100 to 200 East African shillings. This first step was followed by the Board's raising its ceiling for short-

¹ These changes did not apply to Aden.

² Actually, the rise continued in 1964/65, notwithstanding the apparently contrary figures of Table 1; in that year Aden withdrew from the East African Currency Board, taking £ 11.4 million with it, and the reduction was partly offset by a rise in the currency circulation in the other East African countries.

and long-term lending to government first from 400 to 500 million shillings in 1963, and then to 700 million in 1964, thus lifting the maximum limit for the total fiduciary issue to 900 million. If this margin had been used to the full, the fiduciary issue would have amounted to more than 50 per cent of the currency in circulation; but it was never used to the full, and at their highest, at the end of December 1965, the Board's fiduciary securities amounted to 476 million shillings, or barely 36 per cent of the total currency in circulation — at a moment when the percentage of currency cover stood at one of its peaks (113.1).

Treasury Bill acquisitions continued to fluctuate seasonally, with highs towards the end of the year and lows in June-July. The share of the three major governments varied greatly; in 1964, for example, large amounts of Treasury Bills were taken in from Uganda and Tanzania (which indeed was allowed to exceed its allotted limit), while Kenya issued none — a sign of a relative abundance of liquid funds in Nairobi.

Contrary to the fluctuations in Treasury Bill holdings, the East African Currency Board's investments in long-term securities remained more or less constant (see Table 2). The Board never encouraged long-term borrowing by governments, for fear of tying up resources and impairing flexibility.

The EACB continued after 1962 to distribute part of its profits to government (see Table 5). It also decided to provide for their subscriptions to the International Monetary Fund, the International Bank for Reconstruction and Development, and the African Development Bank¹.

¹ East African Currency Board, *Report for the year ended 30th June, 1963*, p. 19.

A number of new arrangements were made to facilitate and extend the Board's operations with commercial banks. The EACB now accepted promissory notes from the banks' customers as security for advances to the banks, and the banks were allowed to tender their own acceptances¹.

In November 1964, the Board lowered its rate for rediscounts and advances in connection with crop financing from 5½ to 5 per cent, at a time when rates were rising in London (see Table 4 and Chart 1)². The effect was instantaneous. Within a month the Board's crop-financing advances to banks rose more than fivefold, from 12 to 64 million shillings — which was still well below the statutory limit of 200 million. At that time, too, the Board altered its exchange commissions again. In response to the rise of Bank Rate in London from 5 to 7 per cent, the East African Currency Board raised its commission for selling sterling from ¾ to ½ per cent, leaving the buying commission unaltered at ⅛ per cent³. By thus widening the spread between the two rates, the Board hoped to make it less attractive to send funds to London in search of higher rates⁴.

In 1964, the EACB relaxed the link between local rates for Treasury Bills and those in London. From the autumn of 1961 to the beginning of 1964 Treasury Bill rates in East Africa had closely followed those in London, always keeping about ⅛ per cent lower.

¹ East African Currency Board, *Report for the year ended 30th June, 1964*, p. 26.

² East African Currency Board, *Report for the year ended 30th June, 1965*, p. 22 and 28-29.

³ At ½ per cent, the exchange commission was as high as the Board's Regulations allowed.

⁴ East African Currency Board, *ibid.*, p. 30 f.

But when Bank Rate was raised, first to 5 per cent in February 1964 and then to 7 per cent in November, the East African Currency Board successfully intervened to prevent local rates from rising as sharply (see Chart 1).

4. CRITICAL APPRAISAL OF THE ROLE OF THE EAST AFRICAN CURRENCY BOARD FROM ITS ORIGINS TO 1966

While over the years some major changes took place in the structure and functions of the East African Currency Board, as described above with particular reference to the more recent years, changes of far greater import occurred in the political map of East Africa, as one after the other of its countries gained independence¹.

The Board was trying to adapt its activities to the changing institutional setting, but meanwhile East Africans began the great debate as to whether it was expedient for the new countries to keep a joint monetary and credit system, and if so whether it should be managed by one central institute, or whether it was better to have an independent central bank in each country. The latter solution won the day, and the three governments of East Africa set about establishing independent credit systems, profoundly differing from each other in some respects. It is of interest at this point of our discussion to see whether this decision rested on economic reasons connected with the structure and working of the East African Currency Board, or whether motives other than economic were decisive.

¹ Tanganyika became independent in December 1961, Uganda in October 1962, Kenya and Zanzibar in 1963. In 1964, finally, Tanganyika and Zanzibar combined in the new United Republic of Tanzania.

To answer this question we must make up our minds about the East African Currency Board's actual and potential role in the economy of the East African countries at the time. In particular we must ask (a) whether, after the reorganizations in the years 1955 to 1966, the Board was on the way to transforming itself into a central bank in the full meaning of the word, and (b) what contribution it made, or could have made, to balanced economic development in all East African countries.

Of course, a negative reply to the first question and an equally negative judgment with respect to the second, would not be enough to prove the case for separate central banks and separate credit systems. It would still have to be shown that it was totally impossible, by any reform whatever, to transform the Currency Board into a central bank, and also that a unitary system would definitely not have been conducive to economic development in the East African countries.

Obviously, then, the decision to go ahead with the creation of separate systems must to some extent have been independent of any views about the efficiency of the Currency Board, or rather, this was only one of the contributing factors among others of a political nature, such as nationalist aspirations or basic differences of opinion about the political orientation of individual countries.

So far as the activities of the Currency Board from its origin to 1955 are concerned, they were undeniably nothing like those of a central bank. The Board was a mere issuing agency with very little independence, whose sole concern was to guarantee the automatic conversion of sterling into local currency and *vice versa*.

Some reference has already been made earlier (3 (b) above) to certain criticisms that can be levelled against the Currency

Board's operations up to 1955, mainly on account of the rigidity of the issue mechanism and of the investment of reserves¹.

The first criticism rests on the circumstance that with an issue mechanism like that of the East African Currency Board it is impossible to adjust the currency issue to the economy's requirements, since it depends exclusively on the balance of payments, without any chance of domestic control with a view to offsetting any undesirable effects of the external payments situation. Now, this automatic mechanism could not have been discarded, for indeed it was one of the pillars of the whole sterling exchange standard. In other words, one of the main purposes of the whole system was precisely to maintain continuous balance in the external position.

Nor can it be denied that such a system may well hold back expansion, in so far as balance-of-payments surpluses do not allow money creation in adequate volume, especially in view of the growing extension of the money economy.

It is true that in forming an opinion of the East African Currency Board's activities until 1955 with reference to this aspect, one would have to take account also of the commercial banks' contribution to the money supply², which must have been considerable, though in the absence of public statistics it can only be guessed. The fact remains, however, that at least until 1933 the currency circulation kept declining uninterruptedly. Surely, the backwardness of the economy and the limited use of money (almost

¹ See W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 30 ff.; John Loxley, *Financial Intermediaries and their Role in East Africa*, *op. cit.*, p. 4; J.W. Kratz, *op. cit.*, p. 232, and, above all, Arnaldo Mauri, "La genesi della banca centrale" etc., *op. cit.*, p. 43-45.

² W.T. Newlyn, *ibid.*, p. 32.

exclusively in export trade) cannot have ruled out the appearance of deflationary effects¹.

Although postwar statistics are not altogether reliable, either, they do seem to point to a steady deflationary trend. At that time the rigidity of the mechanism of currency issue definitely was an obstacle to economic development in East Africa and the effect was exacerbated by the commercial banks. Table 6 shows the time series of the ratio of two monetary variables to gross domestic product, namely, the money supply, that is cash plus demand deposits at banks, and the volume of demand deposits alone. Both ratios declined continuously until 1955, and this must surely be taken as a sign of deflationary tendency. The word tendency is used deliberately, because the figures are not good enough for precise quantification; probably GDP is underestimated² in comparison with money supply³. But careful estimates⁴ suggest that the average annual growth rate of GDP in East Africa from 1946 to 1954 was, at 3.61 per cent, consistently higher than the rate of expansion in money supply (2.31 per cent), while time and savings deposits were still growing only slowly.

The second criticism that can be levelled at the East African Currency Board for its activities up to 1955 concerns the handling

¹ Arnaldo Mauri, *ibid.*, p. 45.

² Otherwise it would be hard to explain the extraordinarily high ratio of money supply to GDP in the immediate postwar years, which in some cases looks like exceeding 80 per cent.

³ H.W. Ord, "The Growth of Money Income in East Africa", *The East African Economic Review*, Vol. 9, No. 1, June 1962.

⁴ George M. Lomoro, *Monetary Expansion in an East African Development*, East African Institute of Social Research Conference Papers, No. 62, January 1965, p. 5.

TABLE 6

RATIO OF MONEY SUPPLY (M) AND OF DEMAND DEPOSITS (D) TO GROSS DOMESTIC PRODUCT (Y) IN EAST AFRICA, 1946 TO 1964

Year	East Africa		Kenya		Uganda		Tanganyika	
	M/Y	D/Y	M/Y	D/Y	M/Y	D/Y	M/Y	D/Y
1946	0.68	0.50	0.85	0.59	0.48	0.21	0.62	0.35
1947	0.63	0.41	0.82	0.60	0.46	0.23	0.52	0.29
1948	0.54	0.37	0.70	0.53	0.38	0.20	0.46	0.30
1949	0.46	0.30	0.58	0.42	0.34	0.18	0.42	0.26
1950	0.46	0.32	0.55	0.41	0.36	0.22	0.44	0.30
1951	0.42	0.27	0.56	0.42	0.27	0.13	0.40	0.25
1952	0.44	0.29	0.56	0.41	0.36	0.21	0.38	0.23
1953	0.45	0.28	0.55	0.38	0.35	0.18	0.41	0.24
1954	0.40	0.28	0.57	0.41	0.33	0.18	0.38	0.22
1955	0.38	0.26	0.55	0.38	0.32	0.15	0.38	0.21
1956	0.35	0.23	0.46	0.30	0.29	0.13	0.32	0.16
1957	0.33	0.21	0.43	0.30	0.27	0.11	0.30	0.15
1958	0.30	0.19	0.40	0.26	0.26	0.11	0.29	0.15
1959	0.28	0.18	0.42	0.28	0.24	0.11	0.29	0.15
1960	0.27	0.17	0.36	0.23	0.21	0.08	0.26	0.15
1961	0.27	0.17	0.36	0.23	0.22	0.09	0.32	0.19
1962	0.27	0.17	0.38	0.25	0.24	0.11	0.32	0.28
1963	0.28	0.18	0.37	0.13	0.24	0.13	0.35	0.13
1964	0.26	0.17	0.35	0.12	0.25	0.12	0.33	0.13

Note: The figures for separate territories must be regarded as less precise than those for East Africa as a whole, in so far as each territory's money circulation is calculated by dividing total East African currency in circulation in proportion to territorial monetary GDP figures. This had to be done because of a complete lack of relevant statistics. On the methodology used, see George M. Lomoro, *Monetary Expansion in an East African Development*, East African Institute of Social Research Conference Papers, No. 62, January 1965, p. 4. For Zanzibar, there are virtually no figures at all; such as are available, are included in the East African totals and also under the heading Tanganyika.

Sources: Compilation from data given by H.W. Ord, "The Growth of Money Income in East Africa", *The East African Economic Review*, Vol. 9, No. 1, June 1962, for the years 1946 to 1951; by Alan T. Peacock and Douglas G.M. Dosser, *The National Income of Tanganyika, 1952-54*, Colonial Research Studies, No. 26, London, Colonial Office, 1958, for the years 1952 and 1953; annual reports of the East African Currency Board; East African Statistical Department, *East African Economic and Statistical Review* and *Quarterly Economic and Statistical Bulletin*, various dates.

of its reserve fund. We have already commented upon the very high ratio of currency coverage, especially after the last war, and upon the composition of reserve assets, which completely excluded any securities issued by East African governments. The point of interest in the present context is that in effect the Currency Board was thus draining away funds from East Africa to Great Britain and other parts of the empire, as indeed were the commercial banks and other credit institutions as well ¹.

From 1955 on, as we have seen, the Currency Board's activities broadened considerably. Its new functions can be summarized as follows:

- (a) Operations of fiduciary issue within specified limits, which were progressively raised up to 700 million East African shillings;
- (b) To cover the above, acquisition of securities issued by East African governments, beginning with medium- and long-term securities but eventually extending to Treasury Bills;
- (c) Rediscount of bills for the commercial banks in connection with crop-financing and marketing credits, up to a ceiling of at first 100, and later 200 million shillings;
- (d) Acting as a clearing house for commercial banks and as a repository for their free liquidity reserves.

It can legitimately be said that during the sixties the East African Currency Board was increasingly transforming itself into a central bank, with the powers, and subject to the limitations, typical of such institutions in developing countries. The process was fostered by a number of organizational changes, such as the transfer

¹ Arnaldo Mauri, *ibid.*, p. 45.

of the Board's seat from London to Nairobi and the more frequent appointment of Africans to top jobs, and was certainly manifest in the operational changes briefly outlined above. In practice, the Currency Board was in a position increasingly to exercise functions of monetary and credit policy. It had powers to manipulate the discount rate and to engage in open market operations¹, though not to regulate reserve requirements; it had discretion to shape its own policy in its lending to East African governments, and up to a point was able to control the activities of the banking system.

In comparison with the typical functions of central banks², especially in developing countries³, there can be no doubt that institutionally speaking the East African Currency Board had, over the years, gradually been endowed with the means of playing an active part on the credit markets of East Africa. Admittedly, it did not have all the powers a central bank needs for efficient operation, but further steps in the same direction could certainly have completed the transformation.

The institutional premises were there, then. It remains to be seen how and to what extent the Board used its powers, and with what effect on economic development in the territories concerned. The first point to note is that the Board on the whole used its powers sparingly. Its fiduciary issue and, with it, its holdings of East African securities, always remained well below the permissible

¹ In practice, this right was never used because of the inadequacy of the stock market so frequent in developing countries. See Arnaldo Mauri, *Il mercato del credito nei paesi sottosviluppati*, op. cit., p. 31-32.

² See Giordano Dell'Amore, *Le funzioni delle banche centrali*, Milan, 1968, p. 37 ff.; id., *Economia delle aziende di credito - I sistemi bancari*, op. cit., p. 842 ff.

³ Arnaldo Mauri, *ibid.*, p. 27 ff. and bibliography.

limit¹, and were geared not so much to the financial and development needs of the countries concerned as to their budget. Similarly, the commercial banks' crop-financing facilities were rarely used to an extent of more than 30 per cent (see Table 3). The Board was rather more successful in attracting the liquidity reserves of commercial banks. Although there was no system of official reserve requirements, the banks voluntarily deposited anything between 25 and 50 per cent of their liquidity reserves with the Currency Board, in exchange for refinancing facilities and clearing settlements². It can be said that, especially from 1962 on, when independence came to the countries of East Africa, the East African Currency Board definitely tried, and in part succeeded, to create a system of monetary control and credit independent of London.

Let us take another look at the figures of Table 6. In the years 1955 to 1964, the ratio of money supply to GDP continued to decline, though even more slowly than before. This is not a common occurrence in developing countries, where this ratio usually rises with the spread of the money economy³. In the case of East Africa, there seem to be two reasons why this ratio kept diminishing. First, there was the deflationary effect of the Currency Board mechanism, which meant that the rate of expansion in money supply fell short of the growth rate of GDP and of the economy's development needs, and secondly the fast growth of time and savings deposits.

¹ For a comprehensive assessment of the activities of the East African Currency Board, see also W.T. Newlyn, *Finance for Development*, Nairobi, 1968, p. 20-21.

² H.L. Engberg, *Banking in East Africa*, New York, 1964, p. 54 ff.

³ See Arnaldo Mauri, *ibid.*, p. 13-14.

As regards the first point, the annual average rate of growth of the gross domestic product in East Africa was 1.45 per cent during the period 1955-64, and that of the money supply 1.10 per cent. It can be seen from Table 6 that the fall in the M/Y ratio was largely due to that part of the money supply which consists of demand deposits at commercial banks; the ratio of Currency Board notes to GDP dropped from 12 to 9 per cent between 1955 and 1964, i.e. by one fourth, whereas the D/Y ratio declined during the same years from 26 to 17 per cent, i.e. by about one third. This does not prove, of course, that the deflationary effect of the Currency Board's activities ceased during those years, even though it had been weakening ever since 1955, nor that the reduction in the ratio was due exclusively to the formation of non-money deposits. This is shown by the slow rate of growth of the note issue after 1965 and the behaviour of the M/Y ratio¹.

It hardly needs mentioning that with the progressive opening of East African economies to the outside world, the deflationary effects of the Currency Board's action became more and more damaging, since they represented a strong obstacle to economic development and to the monetization of the economy.

As regards the second point, the growth of near money, it is a fact that from the fifties non-banking financial intermediaries began to develop in East Africa, and especially in Kenya, with the result that time and savings deposits expanded and the share of commercial banks in the system's total liquidity declined. It has

¹ As we shall see in discussing the money supply in Tanzania after the creation of the Bank of Tanzania, the M/Y ratio tended to rise fast, thus making good the shortage and deficiencies left over from the previous system.

been estimated¹ that time and savings deposits expanded at an average annual rate of 1.56 per cent in East Africa after 1954².

In conclusion, we may say that the East African Currency Board's attempt to create a monetary system more flexibly responsive to the needs of the economy was only partly successful. The same applies to its efforts to create a credit system independent of the United Kingdom. True, the Board did manage to persuade the commercial banks to deposit with it some of their liquidity reserves, and in 1964 it successfully applied monetary policy to counteract the effects of rising interest rates in London and to stem the capital outflow; nevertheless, the banking system as a whole still had very close connections with London and was not easily amenable to effective and full control by the Currency Board.

The fact remains that, too slowly perhaps and with more or less serious deficiencies, the East African Currency Board was gradually turning itself into a joint central bank for all the East African countries, until the process was abruptly stopped in 1966. And the reasons why this happened had more to do with politics and economic policy than, strictly speaking, with the actual mechanism and functioning of the Currency Board.

¹ George M. Lomoro, *op. cit.*, p. 5. See also J. Loxley, *Financial Intermediaries and their Role in East Africa*, *op. cit.*, p. 17 ff.

² This is an extremely interesting development, the like of which is not easily found elsewhere in developing countries. Usually, the multiplication of non-banking financial intermediaries and the formation of large non-money deposits are features of a more advanced stage of development. This is why normally the M/Y ratio does not begin to rise until after a certain threshold of development has been passed. Yet the countries of East Africa certainly were—and are—still far from breaking out of their situation of underdevelopment, as becomes only too clear if one looks at their economies and at the three countries' successive efforts and experiments in the field of economic and financial policy.

5. THE CREATION OF NATIONAL CENTRAL BANKS

While the East African Currency Board was thus restructuring itself, economists, financial experts, East African governments and officials of the Currency Board itself were debating the post-independence shape of the monetary and credit system of East Africa.

The question was first seriously discussed as far back as 1953, by W.T. Newlyn and D.C. Rowan, in *Money and Banking in British Colonial Africa* (*op. cit.*). With reference to the situation of the East African banking system as it was in 1951, the two authors concluded that there was no case, in the short run, for central banking in East Africa. They added that this might well change in the future with the development of the use of bank credit, with the increasing complexity resulting from local borrowing by East African governments, and with the emergence of indigenous banks. If central banking did become necessary in the future, the authors suggested that in view of the existing close economic and monetary links it would "undoubtedly" be best to have one central bank serving the whole currency area.

The debate flared up in the declining years of the colonial regime, with approaching independence. In Kenya, especially, there was considerable discussion among unofficial members of the Legislative Assembly. The Uganda government asked its then Economic Adviser W.T. Newlyn for advice¹. In his report, the first in-depth study of the question, the author to some extent changed his previous views as expressed in 1953, or at any rate had become convinced that the future he had foreseen had now

¹ W.T. Newlyn, *Economic Policy in Uganda*. Report of the Economic Adviser, Entebbe, Ministry of Finance, 1959.

arrived. He points out realistically that conditions had changed since 1953, that bank credit had expanded very greatly, that commercial banks were exhibiting evidence of autonomous behaviour likely to lead to trouble, that governments had commenced local borrowing on a considerable scale. So he now saw a strong case for a central bank: "It is my opinion that if East Africa were a single political unit there would be no doubt whatever but that a central bank should be set up with the minimum delay, with the intention of adopting an independent monetary system based on sterling. But East Africa is *not* a single political unit...".

But, as the author pointed out on a later occasion¹, "the sting lay in the tail". Although a considerable measure of economic integration had been achieved, political union of the new independent countries seemed very very far off in those years. In each of the three countries there were strong political personalities with nationalistic leanings², and moreover the leaders of Tanganyika and Uganda were afraid of "white domination" by Kenya³. Everybody took it for granted that a common central bank would have its seat in Nairobi, and there were misgivings lest Kenya should influence monetary policy to its own advantage.

On the other hand, it was obvious that very damaging consequences would follow if the existing single currency area were broken up completely at once. A compromise seemed necessary⁴, and W.T. Newlyn suggested one⁵.

¹ W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 72.

² Arnaldo Mauri, *Le genesi della banca centrale*, etc., *op. cit.*, p. 55.

³ W.T. Newlyn, *ibid.*, p. 72.

⁴ H.H. Binhammer, *The Development of Central Banking and Monetary Management in Tanzania*, *op. cit.*, p. 1.

⁵ W.T. Newlyn, *Economic Policy in Uganda*, *op. cit.*, p. 68.

His proposal was that each territory should have "its own Central Bank covering the 'non-control' functions, but excluding external contacts and interterritorial co-ordination... In addition there would be set up on a regional basis an East African Reserve Board which... would take over the functions of the Currency Board and would have the power to control currency issues. Banking policy, on broad lines, would also be determined by the Board... Within these broad limits the territorial Central Banks would have some room for movement... The Reserve Board would implement its monetary policy through the powers of the territorial Central Banks."

This Newlyn proposal clearly owes much to the Federal Reserve System of the United States. He meant the Reserve Board to be independent of government, and he wanted it to have prestige at home and abroad, especially in London¹. Furthermore, he wanted a flexible system, which could be adapted later as and when local needs required².

The Newlyn compromise was not adopted, and the discussion continued. In 1960 the Tanganyika government commissioned a

¹ "The Reserve Board would need to be independent of governments and if it were accepted as such it would cut through many of the political difficulties which might otherwise arise. The Chairman would be expected to give top level advice to the territorial governments even (in Montagu Norman's phrase) 'to the point of nagging', and would, via the Board, co-ordinate government borrowing in the East African markets. Furthermore, as Chairman of the East African Reserve Board he would have considerable status and would be able to exert some weight in London and elsewhere" (*Ibid.*, p. 73).

² "Such a compromise would seem to offer the best prospect of flexible development and would not beg the territorial/regional question for the future. It would be possible to move from this compromise situation either to one in which the territorial Central Banks become branches of a Regional Central Bank or to a position in which the currency area splits up and the East African Reserve Board 'withers away'." (*Ibid.*, p. 73).

German banker, Erwin Blumenthal, to report on the question of setting up a central bank in East Africa. This report was published in 1963 and in effect served as working paper for the subsequent discussions between the Finance Ministers of Kenya, Uganda and Tanganyika.

Blumenthal strongly warned the Tanganyika government against any attempt to establish an independent currency and central bank. Instead, he proposed a two-tier system consisting of a central bank for East Africa and of state banks performing a number of central bank functions in each country. The central bank was to issue the common currency, pool and manage gold and foreign exchange reserves, exercise liquidity control with respect to the national state banks and to the entire credit system, and lay down general directives for monetary policy¹. The author himself likened his proposed scheme to the West German system prior to 1957, with the two levels of the *Landeszentralbanken* and the *Bank Deutscher Länder*.

The Blumenthal proposal differed from Newlyn's in so far as it provided less operational independence for the local central banks. However, if either scheme had been put into practice and political conditions had remained what they were at the time, the result would have been much the same, since no doubt sooner or later both schemes would have evolved in the direction of having one single central bank, leaving the national banks to become mere branches in the end².

At first it looked as though the Blumenthal proposal had good chances of being adopted, since political opinion had veered towards

¹ Erwin Blumenthal, *The Present Monetary System and its Future: Report to the Government of Tanganyika*, Dar es Salaam, 1963, p. 75.

² Arnaldo Mauri, "La genesi della banca centrale" etc., *op. cit.*, p. 59.

unity and integration, and indeed the leaders of the three East African countries in June 1963 signed a joint statement expressing their intention to federate. But soon new political and military differences arose, and in 1964 the government of Tanganyika again took up the idea of setting up an independent central bank. The Finance Minister, Paul Bomani, in agreement with the Finance Ministers of Kenya and Uganda, requested the International Monetary Fund (IMF) to send a mission to East Africa to advise on the future organization of banking and monetary matters.

But on the eve of the arrival of the IMF mission, which was headed by Jan Mladek, the Uganda government published a statement on 2 February 1965¹ in which it announced its own intention to set up the Bank of Uganda and to endow it with central bank functions either on its own account or as agent for an East African Reserve Bank to be created. This statement, while apparently inspired by Newlyn's ideas, in effect meant that Uganda was determined to go its own way, for the declarations of principle regarding monetary and political union have the hollow sound of pure formality. This Uganda statement in practice doomed the Mladek mission to failure, since its immediate effect was to stiffen the attitude of the other two countries, especially Tanganyika. The IMF mission was soon made aware of this. Everybody appeared to

¹ The statement is reproduced in the East African Currency Board's *Report for the year ended 30th June, 1965*, p. 78. The key passage reads: "To perform such central banking functions as will be reserved to it under the East African Reserve Bank constitution; and to act as the sole agent for the East African Reserve Bank within Uganda. The aforementioned in no way detracts from the government's declared policy of co-operating with Uganda's East African partners in the maintenance of an East African common currency and market. The Minister for Finance is due to start discussions with the IMF team of experts on the drafting of a constitution for the East African Central Reserve Bank".

agree on the expediency of a unified currency system, but it was pointed out that this required as a prior condition that the three governments be willing to co-ordinate and integrate their respective policies on private and public investment planning, taxation and budget management.

The Tanzania representative argued that most of these conditions were absent, and could be created only by political union. Since this seemed unattainable, at least in the near future, the only alternative was to set up independent central banks, providing at the same time for frequent consultation and formal co-operation among them ¹.

When the work of the IMF mission concluded on 12 February 1965, it had in practice achieved nothing ². The team departed, and with it the last hope of preserving the common currency system and of creating any kind of institutionalized co-ordination of monetary policy in East Africa. The intention to establish national central banks was announced simultaneously by the Finance Ministers of Kenya, Uganda and Tanzania in their budget speeches ³ on 10 June 1965.

¹ These views were expressed by the Finance Minister, Paul Bomani, in a broadcast speech on 13 June 1965, which is reproduced in H.E. Smith, *Readings on Economic Development and Administration in Tanzania*, Dar es Salaam, Institute of Public Administration, 1966, p. 120-124.

² Witness the final passage of the joint communiqué issued by the IMF mission and the three Finance Ministers: "... with the assistance of the International Monetary Fund experts the outstanding issues were clarified and are being referred to the respective Governments. It is expected that with the continued assistance of the International Monetary Fund it will be possible to resolve them in the near future." (The communiqué is reproduced in the East African Currency Board's *Report for the year ended 30th June, 1965*, p. 4-5).

³ Extracts from these speeches are reproduced *ibid.*, Appendix XII-XV, p. 80-86.

In quick succession, the three countries approved legislation to establish their own central banks — Tanzania in January 1966, Kenya in March, and Uganda in May. The three banks officially started their activities on 14 June, 14 September and 15 August 1966, respectively ¹. The three governments agreed on arrangements for the liquidation of the East African Currency Board and for the replacement of the existing currency by new issues of notes and coin. The new currencies were all equivalent to the East African shilling with a par value of 0.124 414 grams of fine gold per currency unit, and it was agreed that they should be freely convertible and transferable within East Africa.

Monetary union was at an end. The three governments now each had power to control the money supply, administer their own exchange reserves and control the credit system ². Yet they tried to preserve the existing common market arrangements and, if possible ³, to create new machinery for co-operation. In November 1965 a special commission, the Philip Commission, was set up for the express purpose of examining ways and means of saving and strengthening the East African Common Market and Common

¹ East African Currency Board, *Report for the year ended 30th June, 1966*, p. 29.

² See A.R. Roe, *Commercial Bank Borrowing and Central Bank Control*, *op. cit.*, p. 1; W.T. Newlyn, *The Significance of Separate Monetary Systems in East Africa*, Makerere University College, East African Institute of Social Research Conference Papers, No. 350, January 1966, p. 8 f.

³ Collaboration among the three central banks received a rude shock when, in 1967, the Bank of Tanzania introduced partial exchange control *vis-à-vis* Kenya and Uganda. This measure was abrogated after the signature of the Treaty for East African Co-operation in June of the same year. See Bank of Tanzania, *Economic and Operations Report*, June 1967, p. 20; I.N. Resnick, *Convertibility in East Africa. The Tanzania Position*, Makerere Institute of Social Research Conference Papers, January 1967.

Services Organization. Among other things, the Commission was to make proposals on how to deal with the consequences of the break-up of the currency union¹. The Commission's work led up to the Treaty for East African Co-operation, signed at Kampala on 6 June 1967.

The Treaty contains a section on money and credit², but it is drafted in rather general terms. Obviously, it proved extremely difficult to reach agreement on this point³. The Partner States are called upon to "harmonize their monetary policies to the extent required for the proper functioning of the Common Market"; they undertake to conclude agreements through their central banks, to exchange each other's currencies at official par values without any exchange commission, and to allow free current capital transfers. In case of balance-of-payments difficulties each Partner State was first to have recourse to IMF facilities, and thereafter credit was to be made available by the others up to one sixth of the value of exports from the lending to the borrowing country during the most recent 12-month period.

The Governors of the three central banks immediately acted on the Treaty's provisions and arranged for regular meetings at which to consult with each other and to co-ordinate and review their monetary and balance-of-payments policies. Each bank opened a current account for the two others in order to facilitate settlements among the three states.

¹ See East African Currency Board, *Report for the year ended 30th June, 1965*, Appendix XII, p. 79.

² *Treaty for East African Co-operation*, Nairobi, Government Printer, 1967, Chapter VII.

³ Witness the fact that the Treaty provides for only one single common institution, the East African Development Bank.

In the years that followed, however, the political, economic and monetary links between the three East African countries weakened. Far from approaching anything like an integrated monetary and credit area, the situation evolved in the opposite direction. Today, political and economic differences have become so profound that it is no longer possible to speak of East Africa as one area. Each country has its own financial structure, often differing greatly from that of the others, and pursues its own, independent monetary policies. Co-operation among the states themselves has been falling into abeyance.

6. TRANSITION FROM THE EAST AFRICAN CURRENCY BOARD TO INDEPENDENT CENTRAL BANKS

The East African Currency Board's report for the year 1964/65 briefly reviews the circumstances which led to the decision to break up the currency union, and then discusses the problems and difficulties arising from the change in the system of currency issue. The report also recapitulates the Board's own proposals, the previous year¹, for transforming itself into what to all intents and purposes would have been a central bank. The idea had been to strengthen the Board's authority and to provide it with powers of credit and liquidity control; at the same time, the Board had suggested changes in the mechanism of credits to governments and the creation of a common East African Treasury Bill.

However, the Board recognized that its proposals failed, like all others designed to establish a common monetary mechanism,

¹ East African Currency Board, *Report for the year ended 30th June, 1965*, p. 5.

and had rather harsh words to say about the attitude of the three governments¹.

In the end, however, the Board put forward realistic proposals for such changes as might facilitate the establishment of the new central banks and currency conversion.

The conversion procedure was extremely simple. Each central bank issued its own notes and coins and withdrew those previously in circulation; the money so withdrawn was immediately handed over to the East African Currency Board against an equivalent amount in sterling or local securities², no commissions charged.

The Currency Board did not, therefore, immediately close down. Instead, it assumed entirely different functions. It no longer issued any money, and ceased to acquire fiduciary assets and to renew existing credits; instead, it had to take care of conversion operations and to liquidate its security portfolio. It gradually dismissed many of its staff, and closed down its sub-centres.

¹ East African Currency Board, *Report for the year ended 30th June, 1964*, p. 11-15. Note especially the following passage: "The root cause of the failure stands out clearly. Each country has wanted, in general terms, to preserve the benefits of a common currency, but there has not been a collective and unqualified acceptance of what a currency union requires in terms of the sharing of sovereignty over a wide range of bread and butter matters and in terms of the limitations which this sharing must impose on national economic policies and ambitions."

² Even before conversion began, the three central banks were allocated the following assets (in East African shillings):

	Tanzania	Uganda	Kenya
Safe custody deposits with banks	5,241,000	267,500	690,500
Board's sub-centres	5,978,000	6,790,000	2,135,000
Balances in Dar es Salaam, Jinja and Nairobi	3,781,000	2,942,500	4,000,000
	15,000,000	10,000,000	6,825,500

(East African Currency Board, *Report for the Year Ended 30th June, 1966*, p. 16).

TABLE 7

EAST AFRICAN CURRENCY BOARD: CONVERSION OF NOTES, COINS AND COMMERCIAL BANK BALANCES, 1967 TO 1971

(end-June cumulative figures in thousand shillings)

Year	Kenya	Uganda	T a n z a n i a			Total
			Tanganyika	Zanzibar	Total	
1967	335,440	292,080	327,740	18,680	346,420	973,940
1968	378,540	334,200	350,180	20,900	371,080	1,083,820
1969	387,140	342,820	357,880	21,140	379,020	1,108,980
1970	388,400	345,080	359,540	21,200	380,740	1,114,220
1971	388,900	345,900	359,760	21,220	380,980	1,115,780

Source: East African Currency Board, *Report for the Year Ended 30th June*, various years.

The Board intended to be helpful and equitable, as is evident from the following passage in its 1965/66 report¹: "...the Board saw it as its obligation —

- (i) to assist the new institutions wherever possible with advice, manpower and accommodation and by providing certain essential services;
- (ii) to ensure that there should be uniformity of treatment of the problems of Currency Board relations with the new central banks and uniformity of procedures in dealing with the conversion operations and the transfer of assets;
- (iii) in these matters, as an international institution with a wider membership than East Africa alone, to have regard for the interests of all its constituents."

Conversion proceeded at a fairly brisk pace, as can be seen from Tables 7 and 9, and in any event the notes were withdrawn much more quickly than had been expected. By agreement of the

² *Ibid.*, p. 2.

TABLE 8

EAST AFRICAN CURRENCY BOARD: COMPOSITION OF CURRENCY
CONVERSIONS UP TO 30 JUNE 1971
(*thousand shillings*)

	Kenya	Tanzania	Uganda	Total
Bank balances	15,500	24,900	11,160	51,560
Notes	340,980	301,500	299,500	941,980
Coins	32,420	54,580	35,240	122,240
Total	388,900	380,980	345,900	1,115,780

Source: East African Currency Board, *Report for the Year Ended 30th June, 1971*.

TABLE 9

EAST AFRICAN CURRENCY BOARD: NOTES AND COINS IN CIRCULATION,
1967 TO 1971
(*end-June figures in thousand shillings*)

	1967	1968	1969	1970	1971	Amount deemed unre- coverable
Notes	134,961.40	37,803.94	33,796.90	31,838.04	31,059.06	27,000.00
Coins	108,139.64	79,193.56	58,041.50	54,270.32	53,501.60	46,000.00
Total	243,101.04	116,997.50	91,838.40	86,108.36	84,560.66	73,000.00

Source: East African Currency Board, *Report for the Year Ended 30th June, 1971*.

three governments, the Currency Board's notes ceased to be legal tender as of 14 September 1967, but the central banks continued to exchange both notes and coins.

By now conversion to the new currencies can be regarded as completed (see Table 9), and since the second half of 1971 there has been nothing left to do for the Currency Board. On 1 January

of that year, the three central banks themselves took over responsibility for the redemption of such of the Board's currency as was still in circulation, and the Currency Board closed its centres at Mombasa, Nairobi, Jinja and Dar es Salaam. It kept only a handful of staff at Nairobi, and even that last office was being closed down in October 1972. The Board's last report is that for the year 1971/72.

Chapter III

COMMERCIAL BANKS AND OTHER FINANCIAL INSTITUTIONS IN EAST AFRICA, 1919 TO 1965

1. COMMERCIAL BANKING UP TO 1950

The banking system of East Africa, as we have seen, began to assume a unitary aspect after the first world war, thanks to the leadership of the so-called Big Three, all of them branches of British banks: National and Grindlays, Standard, and Barclays. The story of East Africa's credit system until at least the second world war largely coincided with that of the three largest expatriate banks.

Initially the three banks concerned themselves chiefly with financing the marketing and export of agricultural commodities as well as the import of consumer goods, predominantly with British funds.

With the development of the local economy, the three banks' functions gradually changed. They became typical deposit banks, soliciting deposits locally and investing in London any surplus funds left over in excess of local loans. For a long time they were, in effect, exporters of capital from East Africa to Great Britain¹.

Actually, the banks were unable to find satisfactory investment opportunities locally for their deposits for two reasons, both

¹ W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 48; George M. Lomoro, *op. cit.*, p. 2 ff.

connected with the conditions of credit supply and demand at the time.

On the supply side, the banks applied the same standards of credit-worthiness to their local lending as were customary in England, but these must have been to some extent inappropriate in countries at a so much lower stage of development. There were, to be sure, certain advantages but also many disadvantages in the rigorous application of high standards of integrity¹ typical of the East African banking system from its very beginnings. Only one case of bank failure is on record², and this fact surely testifies to the integrity of the bankers and must have helped to create confidence in the system; but on the other hand the strict observance of particular banking principles ended up by making the banks' operations totally inappropriate in the East African economic setting and with reference to local development needs.

For example, it was a basic rule of the expatriate banks to grant credit only against such security as would have been considered first class on the British market. This was all very well for a country like England, where there were plenty of eligible real and financial assets, but was simply not workable in East Africa where the only real asset was land — and this was unacceptable as security for bank loans, partly because, traditionally, English banks did not like mortgage lending, and partly because anyway in most cases title to the land either did not exist at all or else the documents were insufficient for the ascertainment and transfer of property³.

¹ W.T. Newlyn, *ibid.*, p. 43.

² W.T. Newlyn and D.C. Rowan, *op. cit.*, p. 219.

³ As W.T. Newlyn (*ibid.*, p. 44) points out, the expatriate banks might well have adopted a more flexible attitude if they had drawn on the memory of their own origins as country banks. However, the early English country banks were different in several respects. First of all, they worked on the basis of personal contacts between bankers and potential customers and secondly, their less rigorous

Finally, the banks lacked the network they would have needed for local credit expansion.

On the side of demand for credit, it must be said that there simply were not enough investment opportunities in an economy at so low a stage of development.

The point is well illustrated by a comparison of the typical composition of bank assets in England and in East Africa at the time. For English banks, advances normally accounted for barely more than half their total assets, whereas the other half consisted of cash, money market assets and readily marketable securities; in East Africa, by contrast, there was for a long time simply no liquid earning asset available, and neither local securities nor a security market. This made it impossible for the banks to keep their position completely independent of Great Britain, for in the absence of liquid earning assets locally the banks had to rely on the London market with its ample supply of such assets.

Thanks to their ready access to the London market, the banks in East Africa were able to provide a range of banking services which would have been impossible for a self-contained banking system; but as a result it became the essential characteristic of banking institutions that they were mere extensions of the financial

standards led to numerous banking failures, which undermined the public's confidence for quite some time. As regards the first point, the expatriate banks in East Africa did try to establish contacts with local customers, especially with the Asian community, to which end they employed Asian brokers to collect information on the credit-worthiness of potential borrowers; but the great bulk of the local population remained beyond the reach of such attempts. With reference to the second point, it is a fact that in a developing country bank failures have the immediate consequence that people lose confidence both in money and in credit, and so create obstacles to the monetization of the economy and to its very development. It follows that in developing countries there is much to be said for a policy of absolute banking integrity. (On the whole question of England's early country banks, on which much has been written, see L.S. Pressnell, *Country Banking in the Industrial Revolution*, Oxford, 1956).

system of the United Kingdom, on which they depended for all decisions of monetary policy. It must be added that such a system could hardly have worked without the Currency Board mechanism, which ensured the maintenance of the parity between the East African shilling and the pound. Only because there was no exchange risk were the banks able to cover their liabilities in East Africa (and elsewhere in the sterling area) with assets held in London¹.

A second important characteristic of East Africa's banking system was that it consisted largely of branches of banks operating in a large number of different countries, British colonies or former colonies, and were all linked with their home base by many financial and operational ties.

To sum up, it can be said that because of a number of circumstances both on the supply side and the demand side of bank credit, commercial banks in East Africa in effect for years placed the bulk of their investments abroad, especially in the United Kingdom, to the detriment of local lending. This statement can be statistically proved. In 1938 deposits totalled less than 80 million shillings, and the ratio of local earning assets to total assets was less than 40 per cent², whereas the remaining 60 per cent of assets consisted of cash and external balances³. Until the second world war, then, the commercial banks in East Africa had plenty of deposits for which they could find no remunerative employment locally.

Local credit ceased to expand altogether during the war. Import restrictions led to permanent export surpluses, with the

¹ W.T. Newlyn, *Finance for Development*, *op. cit.*, p. 20.

² W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 46.

³ Newlyn lumps cash reserves and external balances together in the one "local earning assets ratio", because thanks to the Currency Board mechanism there was no exchange risk and the two types of assets were perfectly convertible into each other.

TABLE 10

COMMERCIAL BANKS: RATIO OF LOCAL EARNING ASSETS TO TOTAL ASSETS, SELECTED YEARS 1938 TO 1965
(end-year figures)

Year	East Africa	Kenya	Tanzania	Uganda
1938	0.39	0.40	0.52	0.22
1945	0.12	0.13	0.10	0.13
1955	0.77	0.78	0.76	0.63
1960	0.99	1.10	0.91	0.84
1965	1.01	0.97	0.87	1.13

Source: Compiled from data in *East African Economic and Statistical Review*.

result that the banks acquired even more reserves abroad and found less and less opportunity for local lending because of the general decline both in the rate of investment and in consumer goods imports, not to speak of the almost complete concentration of commodity exports in government hands.

Small wonder that by 1945 the banking system was even more flush with liquidity than in 1938, and the local earning assets ratio had fallen to 12 per cent ¹. There clearly was an enormous potential for credit expansion. This did in fact take place after the war. Within a few years, by 1949, the ratio had climbed back to its prewar level of 39 per cent, and advances had increased to £ 19 million. Soon the banks' greater willingness to lend locally, combined with the increase in promising investment opportunities associated with the faster pace of economic development, caused the proportion of local assets to rise quickly ² (see Table 10).

¹ W.T. Newlyn, *ibid.*, p. 47.

² The reason why the local earning assets ratio was so high in some years and occasionally even exceeded unity, is that the "external balances" in the denominator were sometimes negative, when the expatriate banks had overdrafts with their London parent banks.

2. COMMERCIAL BANKING 1950 TO 1965

During the nineteen fifties and up to about 1965 East Africa's banking system changed radically. Deposits expanded and so did local loans, bringing liquidity reserves down; governments came to figure prominently both among depositors and borrowers; bank money accounted for a rather high proportion of the money supply compared with the East African Currency Board's money issues; high balances were maintained regularly on interbank accounts, and inter-country lending followed a strongly marked seasonal pattern.

Behind these functional characteristics were a number of structural factors, such as continued dependence on the British credit market, a high degree of integration of the three East African countries' banking systems, and the leading position of Kenya *vis-à-vis* Uganda and Tanzania.

(a) *Expansion of local lending*

Rising world prices for some of East Africa's export commodities caused the gross national product of the three countries to rise rapidly and with it demand for credit expanded. The commercial banks were able to meet this credit demand thanks to the branch network which by now they had built up, and also because they were applying less restrictive standards to their lending and were trying to reduce their risks by such devices, for instance, as lending to co-operatives¹.

Local advances rose from 440 million East African shillings in 1950 to more than 2,450 million in 1965, and concurrently reserves in the form of cash and liquid balances abroad kept shrinking (Tables 10 and 11).

¹ W.T. Newlyn, *Finance for Development*, *op. cit.*, p. 22.

TABLE 11

EAST AFRICAN COMMERCIAL BANKS: COMPOSITION OF ASSETS, 1959 TO 1965

(end-month figures in million East African shillings)

Year and month	Cash 1	Balances abroad 2	Total reserves 3 = 1 + 2	Local advances 4	Total assets 1 + 2 + 4
1959 December	134	242	376	1,372	1,748
1960 June	118	— 42	74	1,538	1,612
December	148	— 120	28	1,514	1,542
1961 June	112	140	252	1,372	1,624
December	128	90	218	1,564	1,782
1962 June	92	48	140	1,542	1,682
December	142	128	270	1,702	1,972
1963 June	96	56	152	1,816	1,968
December	128	— 48	80	1,990	2,070
1964 June	102	— 128	— 26	2,126	2,100
December	152	— 176	— 24	2,414	2,390
1965 June	110	— 126	— 16	2,452	2,436

Source: *East African Economic and Statistical Review*.

The increase in local assets was entirely attributable to loans to the economy, because, in the absence of a sufficiently active securities market there was no chance of investing in securities or in other readily marketable local assets. The banking system, therefore, still had to cover its liquidity requirements abroad.

(b) *The growth of deposits*

From 1938 onwards, the public's deposits with commercial banks kept growing steadily. By 1946 they amounted to twice the prewar total, and then rose by another 60 per cent between 1946 and 1950, and by 111 per cent between 1950 and 1965 — which means annual average rates of increase of 16 and 7.4 per cent,

TABLE 12

EAST AFRICAN COMMERCIAL BANKS: GOVERNMENT DEPOSITS AND ADVANCES, 1959 TO 1965

(end-year figures in million East African shillings)

Year	Deposits with banks	Advances from banks	Balance
1959	244	96	148
1960	230	110	120
1961	382	262	120
1962	572	308	264
1963	564	366	198
1964	820	542	278
1965	1,026	668	358

Source: *East African Economic and Statistical Review*.

respectively¹. In comparison with the rates of increase in the banks' local lending, deposits are seen to have surged ahead in the years 1938 to 1946, and then to have settled down to a more moderate pace of expansion between 1950 and 1965. It was, of course, this very spurt of deposits between 1938 and 1946 which created the conditions for a potential expansion of local lending. As Table 15 shows, the loan/deposit ratio climbed almost uninterruptedly from 1959 to 1965, and throughout was very high².

In the breakdown of deposits shown in Table 13, it is striking to see the high proportion of deposits other than those on sight — in 1965 they amounted to almost one quarter of demand deposits, and the figures would be higher still if public deposits were left out. A large part of these time and savings deposits belonged to

¹ However, these high rates owe much to inflation; in real terms, the increases were no doubt much lower.

² Actually, in East Africa the most significant ratio is not that of loans to deposits, but of local earning assets to total assets. More will be said presently about this latter ratio.

TABLE 13

EAST AFRICAN COMMERCIAL BANKS: COMPOSITION OF DEPOSITS, 1946 TO 1965
(end-year figures)

Year	Demand deposits		Other deposits		Total million shillings
	million shillings	per cent	million shillings	per cent	
1946	666	85.8	110	14.2	776
1947	772	86.4	122	13.6	894
1948	886	87.7	124	12.5	1,010
1949	898	88.5	116	11.5	1,010
1950	1,152	90.4	122	9.6	1,274
1951	1,342	87.8	186	12.2	1,528
1952	1,514	89.5	178	10.5	1,692
1953	1,372	85.2	238	14.8	1,610
1954	1,612	87.5	230	12.5	1,842
1955	1,676	87.0	250	13.0	1,926
1956	1,418	80.8	338	19.2	1,756
1957	1,402	77.5	408	22.5	1,810
1958	1,376	74.3	476	25.7	1,852
1959	1,502	75.3	492	24.7	1,994
1960	1,354	77.6	392	22.4	1,746
1961	1,542	76.5	474	23.5	2,016
1962	1,676	74.3	580	25.7	2,256
1963	1,810	74.5	418	25.5	2,428
1964	2,160	80.6	520	19.4	2,680
1965 (June)	2,206	81.8	492	18.2	2,698

Source: Compiled from data in *East African Economic and Statistical Review*.

Africans, and this fact speaks well for the commercial banks' efforts to familiarize the indigenous population with the institutions of the credit system and to promote local saving.

Structurally speaking, the expansion of deposits and credit was matched by network diversification. Local earning assets were five times as high in 1964 as they had been in 1950, and so was the

number of bank branches, having risen from 64 to 326. There were some who felt that this was too much, that indeed East Africa was "overbanked", and in support of this argument pointed to the steeply falling ratio of deposits to number of branch offices and, more generally, to gross domestic product¹.

Furthermore, several new credit institutes had sprung up after 1951, so that the banking system was no longer dominated exclusively by the Big Three. Alongside National and Grindlays Bank, the Standard Bank and Barclays Bank D.C.O. others entered the market, and not all of them conformed to the established pattern of the expatriate banks. Seven banks set up business in East Africa between 1951 and 1965; they are listed below in chronological order of entry.

Nederlandsche Handel-Maatschappij (1951)

Bank of India (1953)

Bank of Baroda (1953)

Habib Bank (Overseas) (1956)

Ottoman Bank (1958)

Commercial Bank of Africa (1962)

Uganda Commercial Bank (1965).

Among these institutions, the Commercial Bank of Africa was the first venture in — at least partly — indigenous banking, in so far as a small proportion of its capital was put up by Tanganyika co-operative societies. But the first entirely indigenous bank in

¹ John Loxley, *Financial Intermediaries and their Role in East Africa*, *op. cit.*, p. 7 and 13-14. Loxley gives the following figures:

	1954	1962	1964
Deposits per office (million shillings)	16	7	7.4
Deposits per cent of GDP	33.1	26.6	25.3

These figures differ from those shown for the demand deposits/GDP ratio in Table 6; the reason is that Loxley considers not only demand deposits, but all types of deposits with commercial banks.

TABLE 14

EAST AFRICAN COMMERCIAL BANKS: TERRITORIAL DISTRIBUTION OF DEPOSITS, 1946 TO 1965
(per cent)

Year	Kenya	Uganda	Tanganyika and Zanzibar
1946	61.4	14.4	24.2
1947	64.0	15.0	21.0
1948	60.4	13.9	25.7
1949	57.2	16.8	26.0
1950	52.7	19.8	27.5
1951	54.7	19.1	26.2
1952	51.9	23.0	25.1
1953	52.2	21.7	26.1
1954	57.4	20.0	22.6
1955	60.1	18.0	21.9
1956	58.5	18.5	23.0
1957	58.5	16.5	25.0
1958	56.4	18.6	25.0
1959	57.2	16.9	25.9
1960	57.7	15.4	26.9
1961	52.0	15.6	32.4
1962	52.4	15.4	32.2
1963	51.0	15.4	33.6
1964	51.8	16.7	31.5
1965	50.0	20.0	30.0

Source: Compiled from data in *East African Economic and Statistical Review*.

East Africa was the Uganda National Bank, a commercial bank set up by conversion of the Uganda Credit and Savings Bank which dated back to 1950¹.

¹ The Uganda Credit and Savings Bank collected a total of 34 million East African shillings in savings deposits, but its lending activities were more those of an investment bank and it did not cover the full range of services typical of deposit banks (W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 55). See also John Loxley, *Financial Intermediaries*, *op. cit.*, p. 11, and Arnaldo Mauri, *La promozione del risparmio nei paesi in via di sviluppo*, Milan, 1969, p. 20-21.

TABLE 15

EAST AFRICAN COMMERCIAL BANKS: LOAN/DEPOSIT RATIO, 1959 TO 1965
(per cent)

Year	Loan/deposit ratio
1959	68.8
1960	86.7
1961	77.6
1962	75.4
1963	82.0
1964	90.1
1965	90.1

Source: Compiled from data in *East African Economic and Statistical Review*.

But all these new institutions altered merely the qualitative features of the East African credit system; quantitatively speaking, they attracted only a small share of total deposits. It is for this reason that the development of the banking system has been described essentially with reference to the Big Three.

Another point of interest from the structural point of view is the geographical distribution of deposits among the three East African countries (Table 14). Kenya always heads the list, and though its share in total deposits declined, it never fell below 50 per cent.

The outstanding structural factor which emerges from an examination of the loans and deposits of commercial banks in East Africa are the high degree of concentration both institutionally and geographically speaking.

(c) *The fall in liquidity reserves*

As the volume of lending expanded almost uninterruptedly, with the sole exception of the years 1957, 1958 and 1960, so the level of the commercial banks' liquidity reserves kept falling until

eventually, in 1964, reserves became negative — meaning that the banks had net debit balances abroad (Table 11).

The commercial banks were in fact able to overdraw on their London head offices, and thus to finance credit expansion in East Africa, which shows up statistically in a local earning assets ratio exceeding 100 per cent in 1965 (Table 10).

The explanation for these developments lies in some part in a change in the banks' own attitude. Before the fifties, the commercial banks tailored their credits to their external balances, in the sense that they did not expand their local lending by more than in strict proportion with the growth of their London balances; thereafter they broke this link, and their advances expanded much more than in proportion to reserves¹. But there is also a second explanation, and that is the capital flight from East Africa which began at the end of 1959. In Kenya, for example, deposits fell by 132 million shillings in 1960, while credits rose by 90 million — which must have meant a capital outflow of something like 222 million shillings².

The fact of negative reserves after 1964 needs some comments. To the extent that the banking system's overdrafts in London remained unutilized for certain periods, they can be regarded as reserves; but they still carry a minus sign, and negative reserves are the difference between these overdrafts and total cash reserves. The question arises whether this overdrawn position was likely to become a permanent feature of the situation in East Africa, or whether it was seasonal or else due to special factors such as for instance, capital flight. Certainly negative reserves did become a permanent feature after 1964, even though their amount was subject

¹ W.T. Newlyn and D.C. Rowan, *Money and Banking in British Colonial Africa*, *op. cit.*, p. 150-160.

² W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 49.

to fairly wide fluctuations. There were some who regarded this situation as quite unsound and wished it to be reversed¹, but others viewed it without concern, on the argument that the overdrafts of East African banks were to be considered as that part of their capital which was invested in East Africa and which, because of the international character of these banks, did not figure as such in their balance sheets. As Newlyn points out, the ratio of debit balances in London to total assets was indeed a good deal higher than the banks' capital/asset ratio if referred to their London-registered capital and their total assets throughout British territories, but it was still lower than is usual in underdeveloped countries².

Nor was this the only advantage for East Africa. If these overdrafts had actually at some point been replaced by capital liabilities, this would have left the banks with the problem of finding enough flexible and liquid assets.

Behind this operational peculiarity of the East African banking system's liquidity reserves, we can detect the structural factor of the banks' close dependence on their British home base. This changed over the years. From about 1950 on, the expatriate banks ceased to export local funds via the purchase of British securities, and indeed the capital flows changed direction, since the United Kingdom, by covering the local credit expansion, was in effect investing in East Africa. But this, of course, meant even closer integration, since the liquidity of East Africa's commercial banks came to depend entirely on decisions taken in London. The result was that the banks lost even more of what little independence they had, and there was even more justification than before for regarding them as a mere extension of the British banking system.

¹ See *Radcliffe Report, Minutes of Evidence*, Questions 4367/76.

² W.T. Newlyn, *ibid.*, p. 49.

The fact remains that this system did have very real advantages for East Africa. Certainly, when monetary and banking independence eventually followed political independence, the cost for the East African countries was high in terms of the loss of all these facilities on the London market and of having to find other means for solving the problem of bank liquidity.

(d) *Deposits and advances from and to government*

Deposits and advances classifiable as public likewise expanded (Table 12), although the strikingly high figures are largely due to the system of government accounting for payments and receipts. The existence of numerous separate accounts dispersed through the government service and throughout the country meant that large debit and credit balances outstanding among them were not offset against each other. As a result the volume of deposits and advances in East Africa is somewhat overstated; in 1965, for example, government deposits are shown as amounting to 38 per cent of total deposits, but in terms of net balances the figure was only 13 per cent.

(e) *The place of bank money in money supply*

The figures for the composition of the money supply in East Africa (Table 16) show that from 1956 on the proportion of currency (notes and coin) remained fairly stable around 35 per cent. This is a reflection of the stable ratio between subsistence transactions and money transactions.

The cash proportion is, in any case, very low in comparison with other underdeveloped countries and testifies to the greater spread of bank money in the monetized sector of East African economies; by way of comparison, here are the 1963 figures for a few other countries (per cent): Ethiopia 74, Ghana 56.5, Nigeria

TABLE 16

COMPOSITION OF MONEY SUPPLY IN EAST AFRICA, 1946 TO 1965
(per cent)

Year	Notes and coin	Demand deposits at commercial banks
1946	38.7	61.3
1947	35.2	64.8
1948	31.1	68.9
1949	34.9	65.1
1950	31.1	68.9
1951	34.3	65.7
1952	34.6	65.4
1953	37.4	62.6
1954	35.8	64.2
1955	39.2	60.8
1956	43.2	56.8
1957	43.5	56.5
1958	43.0	57.0
1959	40.0	60.0
1960	43.4	56.6
1961	40.7	59.3
1962	39.2	60.8
1963	40.1	59.9
1964	37.3	62.7
1965	33.5	66.5

Source: Compiled from data in *East African Economic and Statistical Review*.

63, Somalia 55.9, Sudan 58, and Egypt 66.9¹. The greater use of bank money can no doubt be explained by the existence of a large, entirely monetized sector concerned with foreign trade and by the expatriate banks' predominance therein. The other countries listed above were in general less developed financially and had less complete bank coverage, and in none of them did the expatriate

¹ John Loxley, *Financial Intermediaries*, *op. cit.*, p. 13.

banks have as much influence as they had in East Africa from the beginnings of colonization. However, in comparison with more advanced countries, East Africa's ratio is still a good deal higher than average, no doubt because banks have not yet expanded sufficiently in rural areas. As for differences among the three East African countries themselves, Loxley¹ gives the following estimates of the ratio of currency to total money supply for 1964: Kenya 27 per cent, Tanganyika 38 per cent, and Uganda 47 per cent. As was only to be expected, Kenya used most bank money at the time, and Uganda least.

(f) *Large interbank balances*

Interbank balances within each of the three countries were regularly very high. One of the reasons for this, according to Newlyn², lay in clearing delays which meant that interbank items were credited to an account some time before they were debited to the account from which payment was made, or else a bank with which a cheque was deposited regarded it as a claim against the bank from which payment was to be collected for some time until the cheque was actually presented. The great distances and poor communications helped to push up the amount of such transit items. In the case of Kenya, however, there was an additional factor. Although a clearing house had been established in Nairobi, which calculated daily balances for all the branches of banks in that city, there was an arrangement under which settlements were not effected daily but at the mutual convenience of both banks concerned. This was an important arrangement, from the structural point of view, since it represented, in effect, an informal system

¹ *Ibid.*, p. 13.

² W.T. Newlyn, *Money in an African Context*, *op. cit.*, p. 53.

of interbank loans or a sort of embryonic money market¹. In practice banks were thus not obliged to settle their balances with the rest of the banking system at once; creditor banks found a remunerative placement for otherwise unproductive funds, and debtor banks could draw on cash when they needed it. A considerable part of these interbank balances could, therefore, be regarded as a sort of permanent revolving fund, on which the banks could draw to meet their cash needs.

(g) *Inter-country banking relations and the seasonal lending pattern*

Another structural feature of major interest is the existence, at the time, of high balances due by or to banks in other East African countries. This signifies inter-country lending on a considerable scale, largely from Kenya to the other two countries and often in connection with seasonal credit requirements.

In Kenya itself the distribution of new credits over the year shows no marked seasonal pattern, no doubt because of the more uniform climate and the smaller comparative weight of the agricultural sector. In Uganda, there are peaks in January, February, April and May, and in Tanzania in January and, above all, from July to December.

These seasonal differences created the conditions for large capital flows between Kenya, Uganda and Tanzania. These did much to solve recurring liquidity problems, especially in the latter two countries, but did not altogether prevent the occasional liquidity squeeze, which might be quite serious in Tanzania and still considerable in Uganda, but least so in Kenya. There is a close connection between interbank flows among the three countries of

¹ On the concept and composition of the money market, see Giordano Dell'Amore, "I mercati monetari nel processo evolutivo dell'economia creditizia", *Il Risparmio*, No. 1, January 1970, p. 7 ff.

East Africa and their foreign balances, for Tanzania and Uganda solved their residual liquidity problems by borrowing directly in London¹ (see Table 18). One extremely interesting point is that Kenya often borrowed more abroad than she needed and thus channelled additional amounts to the other two countries². It will be seen from Table 17 that Kenya's foreign indebtedness fluctuated more sharply than that of Uganda and Tanzania, and moreover appears related with the seasonal pattern of requirements in the latter two countries.

Two conclusions may be drawn from the structural point of view. First of all, we have here yet one more proof of the absolute preponderance of Kenya over Uganda and Tanzania, and secondly there is evidence of a very high degree of integration among the banking systems of East Africa. It would simply not do, in these circumstances, to treat credit problems in isolation for each of the three countries; it is a fact that until 1965 East Africa was one unitary area so far as credit is concerned, just as — and because — it was a unitary monetary area.

This conclusion is supported by Newlyn, who, in *Finance for Development*³, marshals statistical data to prove the high degree of integration among the banking systems of East Africa.

¹ See A.R. Roe, *Commercial Bank Borrowing and Central Bank Control*, *op. cit.*, p. 4-10.

² However, the relevant statistical data have to be taken with a grain of salt. First of all one can never be quite sure on what principles interbank and foreign movements of funds are imputed to any one of the three countries, since the whole of East Africa is more or less treated as one area. Secondly, one reason why Kenya's foreign balances appear at such high figures is that so far as the three big British banks were concerned, any inflow of funds from abroad was preferably credited to the Nairobi branches, even if the money was from the outset earmarked for Uganda or Tanzania.

³ *Op. cit.*, p. 31-37.

TABLE 17

COMMERCIAL BANKS: NET FOREIGN SURPLUSES OR DEFICITS, 1950 TO 1965
(end-year figures in million shillings)

Year	Kenya	Tanganyika	Uganda	East Africa
1950	468	88	86	642
1951	418	84	84	586
1952	472	96	164	732
1953	450	92	150	696
1954	340	86	148	574
1955	204	54	54	212
1956	164	88	102	358
1957	74	12	84	170
1958	172	38	40	252
1959	168	42	32	242
1960	— 132	2	8	— 120
1961	— 20	96	14	90
1962	80	62	— 16	126
1963	— 24	50	— 80	— 48
1964	— 308	118	16	— 176
1965	— 6	40	— 128	— 94

Source: Compiled from data in *East African Economic and Statistical Review*.

TABLE 18

SOURCES OF FINANCE FOR PEAK SEASONAL CREDITS IN TANZANIA AND UGANDA, 1961 TO 1965
(peak-month averages in million shillings)

Year	T a n z a n i a			U g a n d a		
	East African interbank balances	Foreign balances	Total	East African interbank balances	Foreign balances	Total
1961	4	16	20
1962	8	42	50	—	2	2
1963	2	40	42	38	8	46
1964	24	28	52	22	10	32
1965	16	44	60	40	30	70

Source: A. R. Roe, *Commercial Bank Borrowing and Central Bank Control*, University College, Economic Research Bureau Paper 66.5, Dar es Salaam, 1966, p. 9.

But if this is so, we must ask what effect the break-up of the monetary union had on the cohesion of the banking system. The answer is that it marked the beginning of a process of separation and differentiation, structural as well as functional. The interbank flows which had grown so much not least thanks to the absence of any exchange risk, fell off rapidly and Nairobi soon ceased to be the redistributor of financial resources among the countries of East Africa. There can be no doubt that monetary separation caused the loss of considerable economies of scale in the banking system, and thus became yet another source of friction in the working of the common market.

However, this book is concerned, not with a comparative analysis of the banking systems of the three East African countries, but with the banking system of Tanzania. It is to this that the rest of the book, from Chapter 4 on, will be exclusively devoted. Since 1966 the history of banking in East Africa has indeed split into three separate and diverging streams, and there is no longer any point in discussing the three countries as one single whole.

It remains to say a few words of critical appraisal about African commercial banking until that time. Certainly, banking in East Africa was more advanced than elsewhere on the continent, in terms both of the volume of the supply of funds and of network coverage — as indeed is confirmed by the high proportion of bank money in the money supply.

Less favourable judgment must be passed on other aspects of commercial banking in East Africa. The range of the banks' business was limited; they closely followed the traditional lending policies of all British expatriate banks, which meant that they financed mainly commerce rather than agriculture and industry, and the import of consumer goods rather than of capital goods

for development. Although in later years there was some shift in their lending towards credits to industry and for development capital, the commercial banks still limited themselves to short-term lending and thus did little or nothing to help along economic development¹.

Nor is this all. There are some who argue that East Africa was so overbanked as to make it difficult for non-bank financial intermediaries to develop as fully as they should²; there was no room for the profitable employment of further additional deposits, it was said, and the only solution was to develop money markets and create the conditions for the growth of less liquid assets³.

However that may be, it is certain that if the system had continued by its own impetus, without the break that actually occurred in the monetary and credit union, serious difficulties would soon have cropped up. A supranational institution cannot exercise effective control over commercial banks so long as these can readily draw on funds both elsewhere in East Africa and in London. There were neither any official reserve requirements, nor anything like an efficiently organized money market or security market.

It need hardly be added that these difficulties were by no means charmed away by the creation of separate monetary and credit systems. On the contrary, they turned up in force and created very serious problems for the nascent central banks of the three countries.

¹ See George M. Lomoro, *op. cit.*, p. 3.

² John Loxley, *Financial Intermediaries and their Role in East Africa*, *op. cit.*, p. 7.

³ As we shall see presently, many specialized non-bank financial intermediaries had sprung up after the second world war.

3. NON-BANK FINANCIAL INTERMEDIARIES, 1950 TO 1965

(a) *Insurance companies*¹

Insurance companies in East Africa experienced uninterrupted growth after the end of the second world war. By 1964, their local assets amounted to almost 666 million shillings, largely in the form of government securities, mortgage loans, equities and real estate (Table 20). Some 75 per cent of these assets were held in Kenya, and the rest in roughly equal parts in Uganda and Tanzania. On the other hand, only 55 per cent of net premiums originated in Kenya, so that there must have been a flow of insurance funds to Kenya from the other two countries, as indeed was only to be expected since the head offices of many of the companies were in Nairobi. Reinsurance accounted for some of these flows, but not for very much, since most of such business was contracted on the London market.

In addition to these inter-African movements of funds, there was a steady outflow of insurance money from East Africa to abroad, mostly London. In the absence of any statistics before 1959, it is impossible even to estimate what sums may have been involved; for the period 1959 to 1964 it can be calculated that the net outflow was some 104 million shillings.

An interesting point emerges from the comparison, in Table 19, of the figures for "investable surplus" and those for "increase in local assets". The first item is calculated by subtracting the sum of gross claims, management expenses and net reinsurance transfers from the sum of gross premium receipts and income from assets. Failing other data, it may be presumed that this surplus was available for investment. But the Table shows that only a

¹ See John Loxley, *ibid.*, p. 7 ff.

TABLE 19

AGGREGATE BUSINESS OF EAST AFRICAN INSURANCE COMPANIES, 1959 TO 1964
(thousand shillings)

Year	Gross premiums	Gross claims	Management expenses	Net reinsurance transfers	Income from assets	Investable surplus	Increase in local assets
1959	218,076.24	80,482.72	51,822.70	13,829.26	19,317.26	91,258.82	—
1960	236,284.20	99,292.16	58,263.36	18,611.18	24,891.88	85,009.38	102,950.76
1961	235,447.00	118,033.78	63,057.98	14,012.38	28,537.04	68,879.90	28,143.52
1962	262,237.60	119,317.70	71,071.52	25,640.28	30,339.60	76,547.78	14,237.92
1963	249,036.28	115,503.50	68,486.58	16,690.46	32,880.64	81,236.30	14,510.74
1964	263,902.94	135,889.30	74,508.44	15,182.18	37,980.94	76,243.96	— 6,649.46

Source: *East African Insurance Statistics*, various years.

TABLE 20

EAST AFRICAN ASSETS HELD BY INSURANCE COMPANIES, 1964

	Thousand shillings	Per cent
Mortgages and loans	186,840	28.08
Government and local government securities	228,960	34.41
Treasury Bills, Development Bonds	220	0.04
Stocks, shares, debentures	74,280	11.16
Real estate	66,220	9.95
Cash	38,740	5.82
Agents' balances, outstanding premiums	45,780	6.88
Other assets	24,360	3.66
Total	665,400	100.00

Source: *East African Insurance Statistics*, 1964.

fraction of the amount concerned was invested locally; the difference — some 234 million shillings between 1960 and 1964 — must be presumed to have been invested abroad.

This figure, of course, is only a guess. It includes such funds as the insurance companies sent abroad for building up a general contingency reserve, and also such expenses as were incurred by overseas offices for the administration of East African business. In any case, securities are valued at market prices, so it is impossible to know whether they have gained or lost value in the course of the year. On the other hand, income from assets invested abroad must have been considerable, but was not paid out to East African branches.

Another method for calculating the outflow of insurance funds from East Africa might be the following. Fairly reliable estimates put the total of net premium income (gross premiums less gross claims) for the period 1954 to 1964 at 1,600 million shillings; deducting from this the total of management expenses over the same period, at some 730 million shillings¹, and local investments at 660 million, one is left with about 200 million unaccounted for. In addition, local assets must have earned as much again over the whole period. On this calculation the total outflow between 1945 and 1964 would work out at something like 400 million shillings².

Rather more than half of this sum, so Table 19 suggests, left East Africa in the years 1960 to 1964. As J. Loxley concludes: "Since no one knows the true extent of East African premiums invested in London, these and the income they earn need never be repatriated and can be assumed to be lost to East Africa for ever³."

¹ This extremely high figure is said to be due to high agency commissions.

² John Loxley, *ibid.*, p. 8; M.J.H. Yaffey, *Tanzania's Balance of Payments 1966-1971*, University College, Economic Research Bureau Paper 66.2, Dar es Salaam, 1966, Annex 6, p. 1.

³ John Loxley, *ibid.*, p. 9.

Life assurance accounted for about half of total annual premiums and the total amount insured in 1964 was 3,260 million shillings, on 136,428 policies — representing just 0.5 per cent of the population. The practice of insurance was not at all widespread as yet, especially among the African population, not least, perhaps, because insurance companies were subject to very strict regulations which made canvassing difficult for them. The 1945 “Control of Life Assurance Business with Natives Ordinance” in Uganda, and the “Control of the Business of Life Assurance with Africans Ordinance” in Kenya, of the same date, had introduced a whole series of controls, licences and permissions. Until the early fifties, at any rate, insurance companies, like commercial banks, largely served the expatriate community rather than Africans, with whom, admittedly, it was more difficult to do business because of such problems as identification, age estimation and the drawing up of life tables. This was why the National Insurance Corporation was set up, to promote insurance among the local population, but up to 1965, at any rate, it was too small to compete successfully with foreign companies.

(b) *Building societies*¹

In 1959, the five building societies² operating in East Africa had 208 million shillings of deposits between them. By 1962, this total had fallen to 90 million, whereas total mortgage assets had declined by only 12 million from their 1959 level of 180 million shillings (see Tables 21 and 22). The reason was the general capital flight of 1960, which hit building societies as much as commercial

¹ John Loxley, *ibid.*, p. 9 ff

² First Permanent Building Society, Kenya Building Society, Savings and Loan Society, Kentanda Mutual Building Society, and East African Building Society.

TABLE 21

BUILDING SOCIETY ASSETS AND LIABILITIES, 1958 TO 1963
(*thousand shillings*)

Year	Society (1)	Deposits and shares		Mortgages	
		per society	total	per society	total
1958	FP	42,880		40,420	
	KBS	45,060		43,280	
	SLS	78,367	166,307	63,729	147,429
1959	FP	64,980		54,780	
	KBS	49,400		41,880	
	SLS	93,649		83,555	
	KMBS	60		—	
	EABS	580	208,689	460	180,675
1960	FP	58,740		62,940	
	KBS	40,240		42,900	
	SLS	59,843		84,824	
	KMBS	340		80	
	EABS	580	159,743	480	191,224
1961	FP	33,620		61,707	
	KBS	27,680		39,680	
	SLS	43,360		78,716	
	KMBS	320		140	
	EABS	580	101,560	380	180,623
1962	FP	27,659		59,217	
	KBS	17,620		36,120	
	SLS	43,341		72,719	
	KMBS	220		140	
	EABS	900	89,720	616	168,812
1963	FP	26,709		55,446	
	KBS	17,207		31,339	
	SLS	47,081		65,592	
	KMBS	180		140	
	EABS	1,970	93,147	1,210	153,727

(1) Abbreviations: FP = First Permanent; KBS = Kenya Building Society; SLS = Savings and Loan Society; KMBS = Kentanda Mutual Building Society; EABS = East African Building Society.

Source: Annual reports of the Registrar General, Kenya, annual reports of building societies, various years.

TABLE 22

SPECIAL ASSISTANCE RECEIVED BY BUILDING SOCIETIES, 1961 TO 1964
(thousand East African shillings)

	1961	1962	1963	1964
First Permanent (31 December)				
Assistance from:				
Banks	4,774	549	1,440	—
Cereals and Sugar Finance Corporation	8,400	—	—	—
Kenya government	5,400	5,000	5,000	5,000
Tanganyika government	—	3,000	3,000	3,000
Northern Rhodesia government	—	19,613	19,056	18,500
Commonwealth Development Corporation	17,200	24,806	14,573	11,866
Total	35,774	52,968	43,069	38,766
Kenya Building Society (31 December)				
Assistance from:				
Banks	6,600	6,520	7,000	6,300
Norwich Union	60	2,180	4,613	4,143
Commonwealth Development Corporation	12,400	13,000	16,642	15,441
Total	19,060	21,700	28,255	25,884
Savings and Loan Society (31 March)				
Assistance from:				
Commonwealth Development Corporation	4,033	11,700	10,000	4,000
Pearl Assurance	8,558	12,400	12,400	5,000
Total	12,591	24,100	22,400	9,000

Source: John Loxley, *Financial Intermediaries and their Role in East Africa*, Makerere Institute of Social Research Conference Papers, January 1965, p. 22.

banks. But while the latter could fall back on overdrafts at their head offices in London, the building societies were able to avoid calling in loans prematurely only by borrowing heavily abroad. As the tables show, there was no new lending on the part of building

societies, except for rather small amounts by the East African Building Society.

The First Permanent and the Kenya Building Society were both reconstituted as limited liability companies, the former in 1961 and the latter in 1963, and taken over by the Commonwealth Development Corporation (CDC), which later declared its intention to run them both down. The Savings and Loan Society, too, took up loans from the CDC and also from Pearl Assurance, but successfully paid them off as mortgages matured; nevertheless, it was taken over in 1965 by Pearl Assurance, which thereupon deposited 2,800,000 shillings as a form of special financial assistance to build up liquidity margins; thanks to this, the company — alone of the whole group — was able by 1966 to exceed its 1959 level of deposits.

The societies' business was largely concentrated in Kenya. The Kenya Building Society operated only in that country, the Kentanda Mutual and the East African did operate throughout East Africa but their business was always on a rather small scale¹, and a mere 15 per cent of the business of Savings and Loan was with Tanganyika and Uganda. Only the First Permanent operated on any scale throughout East Africa. The territorial distribution of its assets and liabilities in 1962 and 1963 (Table 23) shows clearly that Uganda and Tanganyika, too, were affected by the 1960 capital outflow², but much less than Kenya³.

Further capital outflows were occasioned by the repayment of foreign assistance during the 1960 crisis, but this time the

¹ The Kentanda Mutual went out of business in 1965.

² Mortgage loans outstanding exceeded deposits in those years.

³ John Loxley, *ibid.*, p. 9-10.

TABLE 23

FIRST PERMANENT (EAST AFRICA) LTD.: TERRITORIAL DISTRIBUTION OF BUSINESS, 1962 AND 1963
(thousand shillings)

Countries	1962				1963			
	Deposits		Mortgage loans outstanding		Deposits		Mortgage loans outstanding	
	amount	per cent	amount	per cent	amount	per cent	amount	per cent
Kenya	27,639	39.6	59,217	52.1	26,709	36.7	55,445	54.0
Tanganyika	28,453	40.8	38,030	33.6	31,441	43.2	33,397	32.5
Uganda	10,734	15.4	14,944	13.2	11,839	16.2	12,628	12.3
Zanzibar	2,893	4.2	1,335	1.2	2,846	3.9	1,228	1.2
East Africa	69,719	100.0	113,526	100.0	72,835	100.0	102,698	100.0

Source: First Permanent Ltd., Reports.

outflow could be planned in an orderly way in relation to the scheduled repayments of mortgage loan holders.

In November 1965 the Commonwealth Development Corporation and the Kenya government announced the establishment of the Housing Finance Company of Kenya, with a capital of £ 50,000, of which 60 per cent owned by the CDC and the rest by Kenya. The company was to reorganize the whole building society sector.

(c) *Post office savings banks*¹

Post office savings banks were set up in all three East African countries during the interwar period; the aim was to provide, as the statutes put it, "a ready means for the deposit of savings and so to encourage thrift". Throughout the period under consideration,

¹ John Loxley, *ibid.*, p. 11 ff.

TABLE 24

POST OFFICE SAVINGS BANK DEPOSITS, SELECTED YEARS 1950 TO 1965
(end-year figures)

Year	Kenya			Tanganyika			Uganda		
	No. of accounts	Total deposits '000 sh.	Dep. per account sh. 2 : 1	No. of accounts	Total deposits '000 sh.	Dep. per account sh. 2 : 1	No. of accounts	Total deposits '000 sh.	Dep. per account sh. 2 : 1
	1	2	2 : 1	1	2	2 : 1	1	2	2 : 1
1950	140,567	137,900	981	59,493	35,700	600	76,641	31,620	413
1955	216,545	206,120	951	86,209	52,100	604	97,869	50,460	205
1962	428,535	124,980	292	152,153	31,240	205	137,017	27,220	199
1965	...	93,900	32,740	23,330	...

Sources: Annual reports 1950, 1955, 1962; *East African Economic and Statistical Review*, June 1966.

1950 to 1965, the number of their depositors increased uninterruptedly, but total deposits fluctuated around a general downward trend (Table 24).

Under the original savings bank legislation, not more than one third of total assets was to be invested in local government securities, and although this rule was subsequently relaxed¹, as much as 80 per cent of total assets were still held in sterling in 1962 — another appreciable capital drain. Roughly the same proportion was maintained until 1965, presumably because the prices of British securities had fallen and the holders were therefore unwilling to sell them for conversion into local assets; nor was there any room for new domestic investments, since deposits kept on falling.

¹ E.g., in Uganda the permissible proportion was raised to 50 per cent in 1958.

Loxley lists the following four reasons for the fall in total deposits and in deposits per account:

- (i) the post-1955 growth of other financial intermediaries, especially building societies, which offered a much higher rate of interest than the 2½ per cent paid by the post office savings banks;
- (ii) increased competition from commercial banks, which, since 1956, always paid higher rates than the post office savings banks;
- (iii) the capital flight during the 1959-1961 independence negotiations, which cost the post office savings banks almost 70 million shillings (43.68 million in Kenya, 11.56 million in Uganda and 13.68 million in Tanganyika);
- (iv) the fact that, because of their dense network (633 offices in 1964) the post office savings banks attracted a lot of new African depositors, whose average individual accounts were much lower than those of the Europeans and Asians they replaced¹.

Because the post office savings banks were unable to sell their sterling securities without major losses, they got into such liquidity difficulties that government had to intervene. On 31 December 1962, accumulated deficiencies on reserve account amounted to 32 million shillings in Kenya, to 12 million in Uganda and to 5.2 million in Tanganyika, that is, respectively,

¹ Loxley (*ibid.*, p. 12) gives the following figures for the average size of new deposits (in shillings):

	Kenya	Uganda	Tanganyika
1950	282	216	226
1955	276	276	204
1962	104	112	90

26, 35.1 and 16.5 per cent of the post office savings banks' total assets in those countries.

In addition to these financial difficulties there was the economic problem of low interest earnings on sterling securities acquired in the early fifties. Up to December 1962, the respective governments had financed accumulated deficits of 4.78 million shillings in Kenya, 2.64 million in Tanganyika and 0.184 million in Uganda. With such low interest earnings, the post office savings banks were unable to offer higher rates on deposits, and hence to hold their own against competition from commercial banks and building societies.

From 1962 on the British securities gradually matured and were replaced by local ones, but nevertheless the savings banks were unable to break out of their essentially static situation or to make any effective contribution to the promotion and mobilization of savings in East Africa.

(d) *Conclusions*

In spite of the setback around 1960, the period 1950 to 1965 as a whole was one of reasonable expansion for non-bank financial intermediaries, notwithstanding such drawbacks as undue foreign dependence, the predominance of Kenya over the other East African countries, the low proportion of indigenous clients and patent inability to do anything effective in the way of mobilizing savings and initiating a process of development.

Looking at the credit structure of East Africa as it was at the end of 1965, one cannot but conclude that while existing financial institutions were inadequate at the time, it seemed imperative to set up new non-bank intermediaries to cope with specific problems. The substitution of local for foreign assets by commercial banks

had probably reached its maximum by then and there were no further local investment opportunities for additional deposits, so that the liquidity of the banking system would have increased and the velocity of circulation of demand deposits decreased. The ensuing deflationary effects were avoidable only by the creation of appropriate non-bank financial intermediaries, such as investment or unit trusts¹, development banks, etc., and by the development of money markets and stock markets².

¹ It was reported in the autumn of 1966 that one such unit trust had failed so far to attract African investors. Governments also took expert advice and initiated consultations with a view to setting up a National Provident Fund.

² John Loxley, "East African Stock Exchanges", in: P.A. Thomas, ed., *Private Enterprise and the East African Company*, Dar es Salaam, 1969, p. 174 ff. Stock exchange expansion, in its turn, raised the problem of creating types of institutional investors subject to public control.