

Chapter V.

FINANCING THE PUBLIC DEBT

5.1 THE CENTRAL BANK AND THE STATE

The title of this chapter is really too restrictive, for the relations between the central bank and the state are complex and multiple. It does, however, serve the purpose of highlighting the most important financial aspect of the central bank's services to the government.

Everywhere, and in developing economies most of all, the Treasury is the main channel of monetary base creation. This is so for a number of reasons, but they all have to do with massive and growing state intervention in the economy. In Western countries, this has come about as a result of an awareness of the social and redistributive functions incumbent upon government; in socialist countries state direction in all sectors is the very essence of the underlying political ideology; and in the Third World large-scale state intervention is justified by the need to guide and encourage development where private enterprise is normally deficient¹. There is room for arguing about the extent of public

¹ Albert O. Hirschman (*The Strategy of Economic Development*, Yale University Press, 1958, p. 202-05), distinguishes two basic functions of government in development: an inducing and an induced function. Government policies

intervention and its limits (bureaucratization, politization, inefficiency), but there can be no two opinions about the need for impulse and co-ordination by government in Africa. Only a higher authority can fill the gap left by the, often ill-prepared, withdrawal of the colonial executives. It has been, and still is, an exceptionally hard task, and even the most dedicated governments have sometimes found the results disappointing, just because they had to start almost from scratch.

And since the state in African countries has had to take on entrepreneurial functions on such a large scale, it naturally entertains relations of many kinds with the central bank. This is a subject that deserve being treated at length, certainly at greater length than supervision of the banking system. Yet it cannot be done, for the very good reason that in practice the central bank's autonomy *vis-à-vis* the government is usually rather limited, and leaves no scope for such freedom of action and "inventiveness" as exists in other fields. The government has more power, and it can and does — within certain limits, as we shall see — impose constraints upon the central bank¹.

Institutionally speaking, the sphere of competence of the central bank is always strictly defined by law. Legislation likewise covers such matters as the manner of appointment of the Governor and members of the Board of Directors, and specifies the cases in

"must initiate growth through forward thrusts that are meant to create incentives and pressures for further action, and then they must stand ready to react to, and to alleviate, these pressures in a variety of areas."

¹ This holds even when an occasional vacuum at the top, as a result perhaps of political upheavals, leaves the central bank (or, for that matter, any other top-ranking public agency) for some time fairly independent of the public administration.

which prior government approval is needed for certain operations. In case of conflict with general economic policy, it is naturally the central bank which must yield to the Minister of the Treasury (or of Finance, or of some other cabinet minister), because, while the bank is formally independent, it is *de facto* subordinated to the government¹.

In Africa, central banks were born into this situation, which in Europe and North America is the end result of a process which, beginning in the nineteenth century and passing through the two world wars and the great interwar depression, radically altered the balance of forces between the state and the central bank, to the advantage of the former. But there are dangers. The government should not abuse its privileged access to central bank credit facilities, lest the public come to believe that the state can count on practically limitless sources of finance, with all the harmful consequences this might have². All in all, African central banks, barring perhaps the two multinational ones³, are much like those elsewhere — namely, “public financial institutions specialized in the control of money and credit”⁴. As such, they everywhere

¹ R.H. Marshall (“The Underdeveloped Economy: Some Implications for Central Banking”, *Rivista Internazionale di Scienze Economiche e Commerciali*, March 1971, p. 274) speaks of “relative independence *within* the government, with the national government and legislature holding ultimate responsibility for economic stabilization policy.”

² “A chain reaction of deficit budgets, central bank lending, current expansion, inflation and monetary anarchy is therefore conjured up; serious repercussions can obviously follow on the propensity to invest.” Edward Nevin, *op. cit.*, p. 39.

³ See above, section 2.1.

⁴ Giordano Dell’Amore, *Le funzioni delle banche centrali*, *op. cit.*, p. 118.

fulfil the two important functions of advisers¹ and financial agents² of the government.

Everywhere, too, central banks have become deeply involved in technical and advisory functions of development planning, a practice which has swept like wildfire over the entire continent, leaving no country untouched. As Kamarck³ rightly says: "Africa is the continent of economic plans. The Plan has become a symbol of independence." But one can have too much of a good thing, and African governments sometimes seem to rely much too heavily on economic planning, in the conviction that this is indispensable for modern economic management.

Let no-one jump to the conclusion that I am, on principle, against planning; on the contrary, I regard it as most useful, though I also am very conscious of the limitations and difficulties which even the most advanced countries encounter when they try to

¹ Andrew F. Brimmer (*op. cit.*, p. 789) stresses the significance of the central bank's advisory functions in the context of development, and lists five main areas: "(a) policies for domestic stability, with particular emphasis on appropriate fiscal policies;

(b) exchange rate policy, with the objective of maintaining external balance;

(c) the formulation of development plans that are feasible in view of the country's economic and financial resources;

(d) the broad range of policies affecting the climate for investment, both domestic and foreign; and

(e) commercial policy, with particular emphasis on the avoidance of heavy protection so as to orient investment activity towards ventures which, as far as possible, will contribute to the improvement of the country's competitive position."

² In this capacity, there may be some friction between the central bank and the Treasury, unless the sphere of action of both is very clearly defined. See, e.g., Petrus J. Van de Ven and Dirk J. Wolfson, "Problems of Budget Analysis and Treasury Management in French-speaking Africa", *IMF Staff Papers*, March 1969, p. 155-6.

³ *op. cit.*, p. 264-5.

put a plan into effect. It is about African development plans that I have my doubts, which for the rest are amply confirmed by experience. These plans are often unexceptionable from the formal and econometric point of view, but nearly always too complicated and elaborate, impossible to implement in practice, simply not operative¹. Their chief defect is, of course, that they fail to achieve, or at least to achieve fully, the targets they set themselves, and this must be ascribed to the misguided ambition of wanting to have a global plan all at once, jumping all intermediate stages².

One of the trickiest problems is how to finance such plans. Most of them presuppose a large-scale foreign capital inflow under various headings, and these funds are of course outside the control of the recipient country. Admittedly, nowadays governments tend

¹ With so many plans about, there is naturally also a vast literature by now, ranging from bare comments to specialized articles and even big tomes. By way of examples, reference is made to the following: M.M. El-Kammash, *Economic Development and Planning in Egypt*, New York 1968, p. 277-333; Andreas S. Gerakis, "United Arab Republic: A Survey of Developments During the First Five-Year Plan 1960/61 - 1964/65", *IMF Staff Papers*, November 1967; O.B. Forrest, *Financing Development Plans in West Africa*, Cambridge Mass., 1965; R. Farley, *Planning for Development in Libya*, New York 1971; W.J. Keegan, "Tanganyika's Five-Year Development Plan: Sober Realism or Buoyant Optimism?", in: J. Farer, ed., *Financing African Development*, Cambridge Mass., 1965; Rattan J. Bhatia and Peter Engström, "Nigeria's Second National Development Plan: A Financial Analysis", *IMF Staff Papers*, March 1972; G.M. Meier, "La crisi della programmazione nei paesi in via di sviluppo", *Rivista Internazionale di Scienze Economiche e Commerciali*, October 1970.

² A. Waterston points out that on the whole developing countries have fared better, both in the short and in the long run, by first learning to prepare and carry out integrated public investment plans then by going from ad hoc project preparation and execution directly into comprehensive planning. See A. Waterston, *Development Planning: Lessons of Experience*, Baltimore 1965, a monumental work which well repays study and, to boot, contains extensive bibliographical references.

to rely more on domestic funds, but that still leaves the problem of finding the foreign exchange for buying the technology which does not exist at home. In all cases, development is conditioned from outside. Even if all the needed funds are at hand, as in Libya for instance, planning policy is still not out of the woods, because conditions are simply not ripe for the rapid transformation of people's mentality and of the production structure¹. The plans are, by and large, simply an attempt to spell out in a coherent manner what needs to be done in order to improve the people's living conditions. If one were to discuss planning in depth, one would have to do so with reference to the underlying causes of underdevelopment itself — a task beyond the scope of this study.

5.2 PUBLIC DEBT MANAGEMENT

Every year, the government sets out in a budget statement its estimates of revenue and expenditure for the coming twelve months and the actual outcome of revenue and expenditure for the past twelve months. This may or may not be part of the mechanism of planning over several years, but in either case it provides the best figures for an analysis of public sector finance. Subject to the reservation that this is a matter which cannot meaningfully be discussed in global terms for the whole of Africa, it may yet be useful to look at a typical budget, beginning with the expenditure side.

¹ R. Farley (*op. cit.*, p. vi) sums up his conviction as follows: "This examination of the Libyan experience confirms once again that planning, *even under conditions of unlimited supplies of capital*, does not instantly solve the problem of poverty. ... The rigidities inherited from the past are such that Libyan economic performance would remain for a long time exogenously dependent on foreign assistance, particularly in the area of technical personnel assistance."

Traditionally, current expenditures and investment expenditures are shown separately. The first are universally rigid, and in developing countries more than elsewhere because of the pressure of unemployment which makes governments feel they must quickly create new jobs — which most often means a bloated public administration. The second refer to investment projects selected to put into effect the targets of the plan, and as such are the mainspring and nerve centre of the whole of public development strategy. Given that current expenditure is largely incompressible, it is unfortunately investment expenditure which suffers the most drastic cuts when the sources of finance dry up.

The sources of finance can be classified in two broad categories: current (budget) revenue and public borrowing in the widest sense. Leaving aside the sale of state property or similar non-recurrent operations, which do not amount to much in quantitative terms, the bulk of current revenue comes from taxes and duties¹. Their structure differs from that typical of industrial nations, which are at the end stage of an evolution which goes hand in hand with economic development. According to an interesting classification

¹ For up-to-date information about African tax systems, see International Bureau of Fiscal Documentation, *African Tax System*, Amsterdam 1970, and subsequent additions. This valuable collection, which is published on behalf of the United Nations, contains detailed figures for each individual country and also interesting statistical calculations of the relative share of the major taxes and duties.

Among many works on this subject, the following are recommended for easy reference. H.H. Hinrichs, *A General Theory of Tax Structure Change during Economic Development*, Cambridge Mass., 1966; Jørgen R. Lotz and Elliott R. Morss, "Measuring 'Tax Effort' in Developing Countries", *IMF Staff Papers*, November 1967; Edward A. Arowolo, "The Taxation of Low Incomes in African Countries", *IMF Staff Papers*, July 1968; C. Mansfield, "Tax Structure in Developing Countries: An Introduction", *IBRD-IMF Finance and Development*, 1971, No. 1; Raja J. Chelliah, "Trends in Taxation in Developing Countries", *IMF Staff Papers*, July 1971.

suggested by H.H. Hinrichs, developing countries are traversing one of the central stages of the following five:

- (1) stage 1, when traditional societies rely chiefly on non-tax sources of revenue (such as fees or levies from state monopolies) and/or "traditional direct" taxes (e.g. on land, livestock, agricultural output);
- (2) stage 2, when society begins to break away from the old ways and indirect taxation becomes more important, especially taxes on foreign trade;
- (3) stage 3, when "traditional direct" taxes decline in relation to national income and government revenue;
- (4) stage 4, when domestic production continues to expand, so that internal taxes grow rapidly and, as import substitution industries develop, tend to replace import duties;
- (5) stage 5, when a mature economy adopts the modern system of direct income taxes on individual and corporate incomes.

In Africa, tax structure nowadays approaches the more advanced among these stages, while still retaining some features characteristic of each of the earlier ones. There are still imposts of the traditional type (notably including, in several countries, those on livestock) side by side with both domestic and external indirect taxation and a system of direct taxation which, at least on paper, is as modern as could be. Quantitatively, indirect taxes bring in most — generally more than three quarters of total current revenue. The reasons for this are easy enough to understand: these taxes are fairly simple to collect, and the amounts involved both in foreign and in local trade are very large. On the other hand, income tax, which would do more to satisfy the principles of tax justice, is lagging behind, partly because personal incomes

are so small to begin with and in any case difficult to assess, and also because this is a tax easier to evade.

Leaving aside the problems of a more equitable distribution of the tax burden resulting from such a system, current revenue usually exceeds current expenditure, thus generating a surplus known as public saving¹. This surplus constitutes the first item in the coverage of the other, most important, category of budget expenditure, namely, investment. For this, however, the government has to draw on additional and much more plentiful sources of finance, once it is taken for granted that the budget cannot be balanced anyway².

This leads on directly to public borrowing, which may concern the rest of the world, state agencies, the public, the banking system, and the central bank, depending on where the government turns in its effort to raise the money it needs.

Let us begin with the rest of the world, which heads the list above even though, logically, it would be better to tap internal sources of credit first and to resort to external borrowing only for the remaining gap, given the additional foreign exchange payments involved and their effect on the balance of payments. But in practice the sequence is very often that governments start out with the amount of capital they expect to be able to raise abroad, and then cover the shortfall by domestic loans. What is more, the entire shape of the development plans covering several years, which constitute the reference frame of annual budgets, is

¹ See Chapter Six below.

² This matter is discussed at length in O. Makalou, *L'équilibre budgétaire dans les pays en voie de développement: cas particulier des états d'Afrique noire*, Paris 1970. In particular, the author states (p. 172) that "l'équilibre budgétaire dans les pays sous-développés n'est bien souvent atteint qu'au prix d'une dépendance économique vis-à-vis des pays industrialisés."

strongly conditioned by the inflow of foreign capital, so much so that the priority scale of future performance is often established in the light of the characteristics and the nature of foreign capital flows¹. For the moment it is enough just to mention the problem, which will be discussed more fully in Chapter Seven, in connection with external development finance.

So much, then, for the time being, about finance flows from the rest of the world, which, though varying from one country to another, are always relatively large in Africa. The government can, in addition, turn to domestic sources of credit, and does so in various combinations changing over time. Normally, all the sources mentioned are drawn on simultaneously. It is worth pointing out that, to the extent that this serves to mobilize resources which otherwise would remain idle for lack of private entrepreneurship, public domestic borrowing is indeed a duty for any government seriously intent on promoting development in the broadest sense. But two reservations are in order: first, this drain must not absorb all the funds of the capital market, and second, it must not be allowed to generate inflationary pressure. Leaving the second proviso for the general discussion of inflation in Africa (Chapter Six), the first statement is tantamount to saying that there would be cause for concern if private enterprise were handicapped, in addition to all the other reasons, also because of excessive government borrowing. Thanks to its position of pre-eminence in the economy, the state might well leave little margin for other entrepreneurs, except for the indirect support given to them via the effects of public investment.

¹ Erin E. Jucker-Fleetwood (*Money and Finance in Africa, op. cit.*, p. 275-7) rightly stresses how important it is for the recipient country to have a good credit standing internationally, so that it can count on a steady inflow of foreign capital.

One prescript, therefore, is perfectly clear. Apart from the few African nations which have adopted a totalitarian or *dirigiste* attitude to the economy and whose governments therefore need be concerned only with the effects of their action in the sole public sector, all other governments which preside over a mixed economy, have to be constantly alert to the limits and repercussions of their intervention, lest they contribute to stifling private enterprise, which already for other reasons is hemmed in on all sides. In Africa, all these problems are even harder than elsewhere, because of the massive presence of foreign capital, which might require a different attitude. This, too, will be taken up later.

As to the different sources of funds to which the government can turn, state agencies certainly are easy of access. Some of them are institutionally concerned with taking deposits from the public (post office savings banks), others accumulate often enormous funds before any of them have to be spent (pension and social security funds, government insurance companies), and yet others earn profits from a variety of economic activities (government-controlled and parastatal enterprises). To all these the government can turn with a request — or sometimes a more or less veiled demand — for funds, most often in the form of selling them government stock.

In this transfer of money from the subordinate units of the public sector to the central apex, the problem of how much is expedient has to do not so much with inflationary pressure, since the financial assets concerned are not newly created, as with the destination of the funds. Is it right, and up to what point is it right, that the state should spend money not originating in its own budget? The answer is certainly in the affirmative if this displacement of funds serves to activate them in the income circuit

of projects contributing to economic development; the answer is doubtful when those agencies which provide the government with funds would themselves be in a position to use them fruitfully (a very good case for transforming postal savings banks into independent ordinary savings banks); and the answer is in the negative if a forced withdrawal of funds prevents adequate self-financing and forces unsound management upon state agencies.

The root of the problem lies in the degree of independence which the government allows state agencies at the moment of their creation and which subsequently prevails in practice. If the government takes surplus cash away from state agencies without channelling it back to them in other ways (e.g. by increasing their endowment funds), this is an expression of a strongly centralizing policy and of the fear that other centres of power may some day gain enough strength to be hard to control; if, on the contrary, the government is moderate in its financial demands on state agencies, this means that definite responsibilities have been delegated to them and that they are trusted to discharge them competently.

After the rest of the world and state agencies, the third source of funds for the government is the public. In industrial nations this section of the market provides funds on a fairly large scale, given the existence of a host of economic units in surplus and free to choose whether to lend these surpluses either to other private firms (in deficit) or to the government. The long-run trend is towards mounting absorption of these funds by the public sector (Italy is a typical example), which needs to float an increasing amount of bonds in order to cover its enormous financial requirements. In Africa the situation is different. First of all, the private sector is smaller, both because so many functions are assembled in the public sector of the economy, and because incomes

are often so low in absolute terms. In addition, even economic units which have more money than they spend on consumption have a low propensity to save, for a number of social, cultural and historical reasons; there is even less inclination to entrust a cash surplus to anyone else, and in any event the notion of investing one's savings in modern ways, such as subscribing government bonds, for instance, has not yet entered the mental scheme of a large part of the population. In this field highly important tasks await the central bank, for it can, and should, suggest to the Treasury appropriate types of issues and create among the public a favourable climate for investment in financial assets¹. Be that as it may, for the time being the private sector does little in a direct way to finance the public debt. Another form of forced loan, a kind of floating debt due to delayed government payments, eventually does more harm than good².

The banking system's contribution to the coverage of the public borrowing requirement, by contrast, is more considerable. Not only do the banks have more disposable funds, they may also be obliged to invest part of them in specified ways. The means which a government, or a central bank on its behalf, can employ to this end are well known: rules about obligatory reserves or the liquidity ratio, directives concerning the distribution of bank credits, various measures of channelling credit in the desired direction

¹ See Chapter Six below.

² "It arises from a government's failure to pay for purchases made or services received. The resulting 'floating debt' may work a considerable hardship upon unpaid employees and sometimes upon suppliers caught unaware. A government with a bad payment record, however, will pay an implicit — and often quite high — interest cost for such a floating debt, as contractors and suppliers will tend to pad the prices quoted for future government business to compensate for anticipated delays." (J. Levin, "The Management of Public Debt in Developing Countries", *IBRD-IMF Finance and Development*, June 1970, p. 35).

(selective controls, discrimination in interest rates, requirements for making bills eligible, rules concerning real security for loans, etc.). In one way or another, a government's main problem when it draws on the credit facilities of the banking system, especially of the commercial banks, is to know the potential inflationary impact this might have. This involves finding out whether the funds made available to the government have been diverted from lending to other production sectors, whether they are supplied directly or indirectly by the central bank, what is the economic system's liquidity position, and what type of expenditure is to be financed by these funds. The whole subject of inflation by deficit spending touches upon one of the sorest points in the whole of the developing countries' political economy, given the enormous tasks of governments and their responsibility in the promotion of economic growth. This whole problem will be discussed in the last section of Chapter Six.

Credit from the banking system may be an alternative to credit from the central bank, but in practice is nearly always additional to the latter, especially when the government has come near or indeed has reached the legal limit of its borrowing from the central bank. These limits are explicitly laid down by law in all African countries, and, while they may be modified or rolled over and hence are no foolproof guarantee of sound public finances, they nevertheless do prevent reckless borrowing without let or hindrance¹. After all that has been said about the relative scarcity

¹ To quote Nevin again (*ibid.*, p. 40): "It is obvious that legal provisions in themselves can ultimately give no real protection to investors against the abuse of a central bank's powers. No sovereign government can bind its successors; what has been written in one law can always be changed, or eliminated, by another. In the last resort, investors have to rely only on the good sense and probity of the government of the territory and on nothing else; solvency and

of domestic sources of funds, it stands to reason that in developing countries the central bank must contribute proportionately far more to financing the public debt than it does in industrial countries¹.

Technically, a distinction can be made between two broad categories: overdrafts on current account, and the purchase of government securities. For both the law sets limits usually defined with reference to budget revenue (of the preceding year, over an average of past years, or estimated for the current year), and normally not exceeding 50 per cent of it overall. Overdrafts are allowed only for temporary cash deficiencies of the Treasury, due to time-lags in receipts and disbursements; but even this flexible form of borrowing nearly always ends up by becoming rigid and permanent. Although the law always specifies when, at the latest, such debts have to be repaid (within a given number of days, e.g. 240, or before the end of the current financial year or not more than a given number of months thereafter), deferment is not precluded *a priori* and there is nothing to prevent new borrowing as soon as the old debt is repaid. Rarely (e.g. in Kenya) the borrowing ceiling is expressed in absolute amounts, and, unless these are not changed every now and then, this is obviously a more restrictive limit, because it may well happen that in the course of time government requirements will grow and the value of money fall. While all these limitations probably do effectively restrain governments in normal conditions, the obstacle can in an

sound finance cannot be provided by statute. ... At the same time, it is seldom easy to change laws quickly; legislative provisions do at least give cautious investors the assurance that matters can be changed only after the (usually cumbrous) process of legislative enactment has been duly observed — with all its publicity, debate and opportunity for pressure, protest and perhaps escape."

¹ Figures for a sample of countries are given in R.W. Goldsmith, *Financial Structure and Development*, Yale University Press, 1969, p. 160-63.

exceptional situation quickly be removed by *ad hoc* measures — witness the case of Ghana, where in the troubled years in the middle sixties the government raised a “special loan”¹.

About the purchase of government securities there is rather more to say, because in this matter the central bank acts, from case to case or often jointly, in three capacities: it buys government stock, places it with other buyers, and supports its price. As buyer, the central bank in effect does much the same as it does by letting the Treasury overdraw its current account, namely, it finances government borrowing by the creation of new money. To safeguard the formal independence of the central bank, the statutes often lay down that its maximum permissible holdings of government paper must be so computed as to include direct subscription from the Treasury, purchases on the market and securities lodged as collateral for advances to banks. Often a distinction is made as to maturities: Treasury Bills on the one hand, which are much the most plentiful, and government bonds on the other, which may not be acquired if they have less than a specified time to run.

The central bank's conspicuous and continuing absorption of government paper rules out open market operations in the narrower

¹ The circumstances of this loan are explained by N. Ahmad, *Deficit Financing, Inflation and Capital Formation: The Ghanaian Experience 1960-65*, Munich, 1970, p. 46: “The need for this special loan arose towards the end of 1965, when according to the statutory regulations the repayment of a sum of £ G 20 million in respect of Ways and Means Advances became due. The proceeds from the special loan were used by the Government to meet its outstanding obligation to the Bank of Ghana. In effect, the special loan was yet another device invented by the Government to keep its borrowing from the Bank at a high level without contravening the statutes of the Bank of Ghana. It is also noteworthy that the sum of £ G 20 million repaid to the Bank of Ghana was immediately funded into 5 per cent stock 1967/68 and 6 per cent Special Stock 1975/80. Since a major part of these stocks was probably taken over by the banking institutions, the exercise perforce led to an increase in the Government's indebtedness to the banking system.”

sense, quite apart from the other reasons which do so in African countries (see section 4.4 above). There is in all economies a negative correlation between financing the public debt and maintaining the internal value of money, but most of all in developing countries, because of the necessarily leading part played by the public sector in the growth process. And public expenditure is, of course, an important weapon of countercyclical policy in a phase of recession, but unlike industrial nations, developing ones soon come up against the unsurmountable barrier of limited technology as well as entrepreneurial and organizational capacity, which is why African countries remain so largely dependent upon abroad.

The central bank's functions of placing government paper and supporting its price, finally, are vital for the development and consolidation of local capital markets. The first involves taking care of the technicalities of an issue, making sure of its orderly distribution and, above all, guaranteeing its large-scale subscription by the banking system, to which end the central bank can use its powers to oblige banks to invest part of their obligatory reserve in government paper, or it can apply moral suasion or introduce extraordinary requirements¹.

The second of these functions involves the purchase of further securities, this time on the market, in order to support the price of those offered for sale. In theory one might expect that the central bank would at times sell on the market so as to even out

¹ "But often this guaranteed placing turns into direct purchases on the initiative of the banks themselves, which often prefer to do this rather than risk that subscriptions by the public make an inroad into existing deposits or impede the inflow of new savings, which might be attracted by the higher interest rate on the government issue." (Giordano Dell'Amore, *Le funzioni delle banche centrali*, *op. cit.*, p. 65). However, this statement applies rather more to advanced than to developing countries.

prices when they are too high, but in practice all that ever happens is that the price has to be propped up when investors wish to liquidate their holdings before maturity. Even in countries which do have a stock exchange, the secondary market is extremely restricted, especially on the demand side, and so the central bank often has to step in as the sole buyer. In Africa, however, this does not happen too frequently, since government bonds are held mainly by the banking system, other financial intermediaries and public institutions. The first two are in any case under the direct control of the central bank, which can relieve them of any liquidity squeeze by a judicious dose of advances; and the third are often asked at the time of original purchase to keep the bonds until they fall due, so as to forestall any kind of disturbance.

Yet there would surely be a case for price support of this kind, if only to give private investors confidence in approaching the capital market; they might thus be made to appreciate that bonds carry a higher yield than bank deposits, not to speak of hoarding, and that they entail no appreciable loss of liquidity because they can at any moment be turned into cash again. A case in point is the stock exchange of Nairobi, which deals in securities of the three nations belonging to the East African Community (Kenya, Tanzania and Uganda). Each country's central bank is in constant touch with stockbrokers, to whom it gives instructions regarding the amount of its own government's paper which it is prepared to buy, and the price at which it will do so. Even though transactions of this kind are on a fairly small scale at present, it is interesting that such supra-national arrangements should have been made for the very useful spread of bond investment.