

Chapter VI.

THE PROMOTION OF ECONOMIC DEVELOPMENT

What distinguishes — or should distinguish — central banks in developing countries most from those in advanced ones is their greater responsibilities and their more direct involvement in the promotion of economic development. The state has a leadership role in the economy, and in monetary and financial matters this leadership role falls to the central bank as the highest authority. The central bank is in a better position than the Treasury to ensure continuity of action, to supply specific skills and to take an overall view of all the problems involved.

In the context of a financial strategy geared to the government's broader economic policy, development promotion involves, first, mobilizing disposable domestic resources, and, second, channelling them to production units which can invest them fruitfully. This chapter deals with the part played by central banking in the interacting processes of saving, lending and investing, which represent real capital formation in an economic system. If these processes are to be orderly, monetary stability is of the essence.

6.1 SAVING IN DEVELOPING COUNTRIES

There are, of course, theories of saving. These do not concern us here. We are concerned with practical problems. And so let

us plunge straight in with the statement that the growth and better use of domestic savings is Africa's great challenge to backwardness in this, the second development decade, and in the years to come. This is the variable to which attention is reverting now¹, after it was thought in the euphoria following the declarations of independence in 1960 that durable progress could be built mainly upon foreign capital. No-one wants to belittle the useful economic function of such capital inflows, but they do also have serious drawbacks, and so the accent shifted some time ago to means of promoting development "from within". Many African countries have by now adopted a policy of self-reliance.

In consequence, the mobilization of domestic savings has often been discussed in recent years at conferences, meetings and seminars at international and regional level, and these were followed by concrete action on the part of African governments, often in collaboration with specialized institutions of advanced nations².

¹ And this means the attention, too, of economists, as Arnaldo Mauri points out ("Savings Banks in African Countries", in: *The Mobilization of Savings in African Countries*, *op. cit.*, p. 31): "If one reviews the attitude taken by economists towards savings over the past hundred years, one is led to the conclusion that economics, like other disciplines, is not immune from the whims of fashion. Saving was always highly regarded by classical economists as being the impulse factor in any economic system, in the sense that it constituted the basis for capital formation. Yet in the period following the great slump, the concept of saving was, as it were, downgraded in economic thinking, largely as a result of the increasing popularity of Keynesian theories. This trend is now being reversed, and more interest is again shown in the problems of saving."

² For a survey of what has been and is being done see Paolo Mottura, *Savings Mobilization in Developing African Countries*, *op. cit.*, p. 52-55, and Sidney Sherwood, "Techniques for the Mobilization of Domestic Savings: Why and How United Nations Bodies Offer Assistance", in: *The Mobilization of Savings in African Countries*, *op. cit.* Reference will be made more than once to the first of these two works, which is the most up-to-date and complete reference base for rethinking the problem, with all its operational implications.

The work of drawing attention to saving and of educating people to save has only just begun, but the results so far are encouraging and promise to reduce the African countries' foreign dependence.

World bank figures give the following worldwide picture of the relation between saving, investment and gross national product (average for the period 1960-1970):

	Saving per cent of GNP	Gross investment per cent of GNP
Developing countries	15.0	17.8
Africa	13.1	16.7
South Asia	11.3	13.9
East Asia	11.0	15.6
Southern Europe	21.5	24.9
Latin America	16.3	17.7
Middle East	14.8	19.8
Industrial countries	21.7	21.2

In Africa, the rate of saving is lower than the average for developing countries, but on a rising trend, on the average of the years 1961-65 saving was 12.6 per cent of GNP, but subsequently the percentage rose to 14.9 in 1966, 15.9 in 1967, 16.3 in 1968 and 16.4 in 1969. If this trend continues, it should not prove impossible to come close to the goals of the Second United Nations Development Decade. For the developing countries as a whole, these include the following, as set out, e.g., by Tinbergen¹.

(1) The average annual rate of growth of gross product per head during the nineteen seventies should be about 3.5 per

¹ Jan Tinbergen, "Savings and Development. Ways and Means to Achieve the Goals of the Second Development Decade", in: *The Mobilization of Savings in African Countries*, *op. cit.*, p. 117-18.

cent, with the possibility of accelerating it during the second half of the decade. This growth rate would represent a doubling of average income per head in the course of two decades.

(2) The target for growth in average income per head is calculated on the basis of an average annual increase of 2.5 per cent in the population of developing countries, which is less than the average rate at present forecast for the nineteen seventies. In this context, each developing country should formulate its own demographic objectives within the framework of its national development plan.

(3) An average annual rate of growth of at least 6 per cent in the gross product of developing countries during the decade will imply an average annual expansion of:

- (a) 4 per cent in agricultural output;
- (b) 8 per cent in manufacturing output.

(4) For attaining the overall growth target of at least 6 per cent *per annum*, there should be an average annual expansion of:

- (a) 0.5 per cent in the ratio of gross domestic savings to the gross product, so that this ratio rises to around 20 per cent by 1980;
- (b) somewhat less than 7 per cent in imports and somewhat higher than 7 per cent in exports.

Clearly, the United Nations programme relies heavily on domestic saving for achieving the growth targets of 6 per cent for GNP and 3.5 per cent for income per head. By 1980, the ratio of gross domestic saving to GNP is to be 20 per cent, almost as high as in the industrial nations during the sixties. Supposing a country starts with a savings ratio of 15 per cent (Africa is already

ahead of that, as we have seen), an average annual increase of 0.5 per cent in this ratio means that 15.5 per cent of GNP must be saved the following year, then 16 per cent, and so on. But GNP itself is to grow by 6 per cent annually, and so each subsequent year saving must increase by more than 0.5 per cent of the initial income. In our example, the second year's saving works out at $15.5 \times 1.06 = 16.43$ per cent of current income, that is, an increase of 1.43 per cent. This increase is far bigger than can be expected of income growth without special measures to accelerate the formation of savings. Governments and central banks alike will have to make every effort to stimulate and co-ordinate all existing types of saving, in full knowledge of the effects of each.

6.2 TYPES OF SAVING

For the convenience of analysis, types of saving may be classified as follows.

Domestic saving	Forced	{ Taxation Inflation
	Contractual	{ Insurance Social security contributions
	Voluntary	{ Firms Households

(1) *Forced saving*. This term signifies the withdrawal of financial resources from individuals and corporations by state action. This withdrawal may take the form of taxation or of a reduction in purchasing power through inflation.

Taxation, both direct and indirect, is the chief source of revenue for most governments; for the community, it means less

voluntary saving and/or less consumption, thus leaving more resources free for public use.

The primary problems of fiscal policy in relation to development promotion are those concerning the effects of taxation on voluntary saving and the use of tax proceeds.

Regarding the first of these problems, there exists a voluminous literature concerned on the whole with identifying the limit to which taxation can go without generating negative effects on voluntary saving. Obviously an individual forced to pay out increasing amounts in taxes, may not only have to stop putting aside his habitual savings, but may even have to disinvest, to draw on his previous savings, a process known as negative saving¹. To forestall such a situation, the central bank needs to advise the government on the basis of empirical investigations. The level of taxation is normally high in Africa and tax administration, especially as regards direct taxes, is probably not always as efficient as it should be; as a general principle it seems advisable, therefore, to turn rather more to other forms of saving and to promote them by appropriate incentives.

An alternative, or additional, method of collecting financial resources from the public is to float compulsory loans. This has been done by governments both in developed and in developing countries in emergency situations; usually particular sections of the public are required to pay specified sums to the exchequer, to be reimbursed fairly soon (usually in a few years' time)².

¹ See, among others, S. Please, "Saving Through Taxation: Reality or Mirage?", *IBRD-IMF Finance and Development*, March 1967; Ragnar Nurkse, *op. cit.*, p. 145-47; and Paolo Mottura, *Savings Mobilization in Developing African Countries*, *op. cit.*, p. 6 and 10.

² See A.R. Prest, "Compulsory Lending Schemes", *IMF Staff Papers*, March 1969, for a detailed analysis of the implications of such rather exceptional schemes.

The problem of the use of tax proceeds involves the choice of where to invest them for best impulse effect (social overhead capital, public services) and hence comes into the purview of judicious development planning as such. The resources taxed away from the public need not necessarily remain unavailable for subsequent private use; there are a number of ways (government loans or equity participation, mixed public and private ownership, holding companies) in which tax proceeds can be returned, as and when the government chooses, to enterprises wholly or partly in private hands. Or else part of the tax proceeds can be deposited in bank accounts, so that the banking system has more resources from which to extend credit to the private sector without generating inflationary pressures¹.

Not long ago governments were again advised to save more, both through the methods described and through higher current budget surpluses².

Moderate inflation as a means of forced saving may have its advantages and indeed has been so used in many developing countries. This method is regarded as less unpopular than the introduction of new taxes, and it does not need the extensive organization and publicity required for the mobilization of voluntary savings. However, in the long run inflation may well cause as much resentment as higher taxes, especially when its burdens are

¹ See Ragnar Nurkse, *ibid.*, p. 151: "The two components of capital formation, savings and investment, depend on thrift and enterprise; there is nothing to prevent collective thrift from being combined with individual enterprise."

² See J. Van der Mensbrugghe, "Domestic Savings in Developing Countries", IBRD-IMF *Finance and Development*, 1972, No. 1, p. 38-39, and Association of African Central Banks, *Séminaire de Tunis*, 20 novembre - 4 décembre 1972. p. 11-12.

unequally distributed among social classes and eventually fall most heavily upon the shoulders of the poor ¹.

Furthermore, the effects of inflation as a means of forced saving may eventually be neutralized to the extent that it acts as a disincentive on voluntary saving. But this is not a foregone conclusion, for the pattern of interaction is complex and sometimes contradictory. It may happen that the erosion of the purchasing power of money discourages further saving; it may also happen that people withhold more from current consumption in an attempt to maintain intact the real value of their previous savings.

Especially in developing countries, one always has to bear in mind the harmful effects that a high rate of inflation can have on the formation of savings. These should cause most concern in countries where voluntary saving is already fairly high. Then there is the question of the form in which savings are held. Non-monetary saving is still common in primitive economies. Now, it is by no means proved that a high rate of inflation makes people more inclined to hoard, and it is probably true that they do so mostly for a number of other economic and extra-economic reasons; yet it cannot be denied that inflation entails the danger of perpetuating such archaic forms of spontaneous saving. A high rate of inflation impedes the monetization of savings; it generates forced savings at the expense of a more intensive recruitment of voluntary ones, and it also compromises the developing countries' chances of gradually achieving the same sort of monetary and credit organization

¹ Nurkse (*ibid.*, p. 145) adds: "The shifts in income from the poor to the rich, which are a normal point of the process of inflation, make it a wasteful form of forced savings, since the rich may consume some of the extra income coming to them and not save all of it."

which served the advanced nations so well in the historical process of their own economic development.

(2) *Contractual saving*. Strictly speaking, a distinction should be made between contractual and contributory saving. The former rests on an individual's free choice of insuring against certain risks (e.g. life assurance), the latter is compulsory and obliges individuals to insure against specified risks, e.g. social insurance contributions for insurance against sickness, disablement or old age.

Contractual saving is a long-term form of saving involving a definite and continuing commitment on the part of the individual concerned. It is important in the context of a family's long-run aims, such as the purchase of a house or of durable consumer goods (via regular payments on mortgage loans or hire purchase), protection against adversity (insurance premiums), or carefree retirement (pension fund contributions)¹.

In developed countries, especially, many voluntary savers prefer to make arrangements for the regular payment of certain sums. Furthermore, there is evidence to show² that, far from entirely replacing other forms of saving, contractual saving comes out of consumption spending and hence provides a net addition of

¹ See, e.g., Elias Gannagé, *Financement du développement*, Paris 1969, p. 34-44; M.S. Joshi, *The Role of Contractual Saving in the Mobilization of Savings*, IBRD paper, 18 June 1970, p. 20; and two papers by Franco Reviglio, "Social Security: A Means of Savings Mobilization for Economic Development", and "The Social Security Sector and its Financing in Developing Countries", *IMF Staff Papers*, July 1967 and November 1967.

² See P. Cagan, *The Effect of Pension Plans on Aggregate Saving: Evidence from a Sample Survey*, New York 1965. However, the statement in the text cannot be generalized without more disaggregated analysis and investigations referring to developing countries.

resources to the capital market. Saving through insurance premiums, too, is more stable than other forms of voluntary saving. It follows that the savings accruing to insurance companies and pension funds are an important source of investable resources, which can be used to finance medium- and long-term projects without having to worry about liquidity, as banks do. The chief factors which have a bearing on variations in contractual saving are: disposable income, as a measure of the ability to save contractually; marriage and the presence of children, as a measure of the need for contractual saving; and education, as a measure of the perception of this need¹.

It is common knowledge that in the economically most advanced countries contractual and contributory saving take place on a very large scale. In developing countries their relative weight is much smaller, but even here governments have in recent years been paying growing attention to these forms of saving, not least because of the difficulties involved in setting up and strengthening a free capital market as an alternative financial channel. Certainly, social security schemes are bound to gain ground in developing countries, in step with trade unions. Lastly, it must not be overlooked that the financial intermediaries concerned are typically "saver-oriented", which means that they do their best to devise financial assets which suit the requirements of the people whose savings they wish to attract².

There is a case, therefore, for strengthening the institutional channels of contractual saving, without, of course, blocking up other, alternative ways. However, the use of the funds so accruing

¹ W.C. Reher, "A Multivariate Analysis of Contractual Saving", *The Review of Economics and Statistics*, February 1966.

² Joshi, *ibid.*, p. 19.

to the institutions concerned should be placed under the control of the government, or, on its behalf, the central bank.

(3) *Voluntary saving.* The two forms of voluntary saving are corporate saving and household saving.

The former originates in business profits, which, if undistributed, are ploughed back through self-financing. If business profits are understood to mean the profits of both public and private firms, the resulting savings are of very considerable volume in developing countries, for a number of reasons. One of them is the monopoly position occupied by companies in many branches of production; then there are the marketing boards and *caisses de stabilisation* with their particular functions, the tax exemptions and special credit facilities often enjoyed by foreign investors, and finally the low cost of vital factors of production¹. Among the means at the disposal of the central authorities for regulating and guiding the use of corporate saving taxation is the most common and also the most effective².

Household saving³ is the type of saving that governments are at present most anxious to promote and mobilize. In Africa national governments no less than the United Nations Economic Commission for Africa and the Association of African Central Banks are fully aware of the importance of this problem in the context of a policy

¹ With particular reference to Africa, see J.C. De Wilde, *The Development of African Private Enterprise*, Washington D.C., IBRD-IDA, December 1971.

² See J. Van der Mensbrugghe, *op. cit.*, p. 38.

³ Everything there is to say on this subject has been said in masterly fashion by Giordano Dell'Amore, especially in *Economia del risparmio familiare* and in *Saggi sul risparmio privato*, both Milan, 1972.

For discussion with particular reference to developing countries, see also Alberto Bertoni, *The Economics of Saving*, Milan 1968; Robert Bistolli, *op. cit.*, p. 79-90; and D. Cissé, *Problèmes de la formation de l'épargne interne en Afrique Occidentale*, Paris 1962.

of self-reliance¹, and regret the fact that for all too long it has been the subject neither of serious research nor of positive action².

Three reasons may be adduced for this neglect: (a) the average amount of personal savings is small and they are often widely scattered; (b) the cost of mobilizing small household savings is very high; and (c) the growth of personal savings depends on the growth of average income per head, and since the latter rises only slowly, the mobilization of such savings can yield appreciable results only in the long period³.

There are, of course, many circumstances in Africa which impede the formation, accumulation and mobilization of personal savings⁴. Among them are the very high proportion of young people in the total population; surviving traditional religious beliefs

¹ A survey of savings facilities in 29 African countries was recently conducted, through questionnaires, by the *Cassa di Risparmio delle Provincie Lombarde*, in Milan; the results were published in 1973 in: Adalberto Alberici and Maurizio Baravelli, eds., *Savings Banks and Savings Facilities in African Countries*. In his Introduction to this volume, Roberto Ruozzi writes (p. xiii): "The most interesting point that emerges from the replies to the questionnaire ... is the extent to which virtually all African countries have become convinced that nothing can replace household savings as a primary source of economic and social development". For comparison, see also the sample survey described in G. Huebner, "Private Savings in Uganda", in: P. Marlin, ed., *Financial Aspects of Development in East Africa*, Munich 1970.

² Actually, a good many special investigations have been carried out in recent years, and some of them led to action by African governments. They will be mentioned later in this chapter as occasion arises.

³ See Paolo Mottura, *Savings Mobilization in Developing African Countries*, *op. cit.*, p. 55-63. After a critical analysis of the three points mentioned in the text, Mottura concludes that their restrictive effect on active savings promotion can in practice be mitigated. The main requirement is a shift in the philosophy of government from investment to saving.

⁴ See Huebner, *op. cit.*, p. 102; United Nations, *Report of the Interregional Seminar on the Mobilization of Personal Savings in Developing Countries*, Stockholm 1971, p. 11; Mottura, *ibid.*, p. 63-68; Hans Greisinger, *Report on Personal Savings in Zambia*, UNDP, December 1970.

and practices which do not encourage thrift (e.g. fatalism); the extended family system; the multitude of indigenous mutual aid societies; the degree of illiteracy and lack of economic and financial education; distrust of financial institutions; the unsatisfactory working of capital markets; lack of economic motivation for saving; the low degree of monetization in certain economic sectors; abuse and misapplication of subsidy policies, especially in colonial days; political instability in many nations; the fear of taxation, which seriously impairs the chances of hoarded goods or bank notes being transformed into more modern forms of saving more profitable for the entire community; the standard model of consumption spending, which is fairly high — either for traditional reasons (expenditure on the occasion of births, weddings and other ceremonial events) or because of growing urbanization; the enduring habit of hoarding or investment in tangible goods as a status symbol, to display one's wealth or social standing to other members of the community; the scarcity of banking services and of financial assets which might attract the disposable cash of individuals.

It is a long list and it proves, if proof were needed, how many formidable obstacles have to be overcome and how many changes are necessary in Africa. In some cases results cannot be expected for generations, because what has to be done is to alter deeply rooted behaviour patterns and mental attitudes. Yet the work must be started now; and a systematic effort, carried forward step by step with perseverance, should yield results even in the short run. It must be remembered that, while the general situation is as described, Africa is in ferment and innovations are springing up and gaining ground, especially in urban areas and in others where the people have already reached levels of knowledge and training unknown in the past.

Even now, therefore, there are fertile fields for government action which, if successful, should have a pump-priming and

cumulative effect in the context, of course, of a more general process of economic development. Leaving aside long-period influence likely to raise household saving (growth of incomes and productivity), let us see by what specific action it can be promoted now. We shall first speak of suitable incentives, and then, in the next section, discuss what types of financial institutions are best adapted to the task.

It is generally agreed that the most powerful incentive to save is a link between the act of saving and its purpose. An individual may be induced to become a saver if today's sacrifice can be shown to be related to a future aim, like building a house, buying consumer durables, or having money available for the education of one's children or for unforeseen expenditures¹. In practice, the best results are obtained by enrolling individuals in some savings scheme for which they undertake to make regular payments, and in fact a number of such schemes — saving for home ownership, for education, for life assurance — already exist in several African countries.

In addition to tax incentives² and to those generated by publicity campaigns³, there are others, among which the most

¹ With reference to the close link between household saving and the use of the money saved, N.G. Krul ("Quelques aspects de la collecte de l'épargne dans les pays en voie de développement", in: *Scritti in onore di Giordano Dell'Amore*, Milan 1969, p. 1154) writes: "Cette relation, qui permet à l'épargnant d'établir un lien simple entre son propre effort et la réalisation d'opérations déterminées, en rapport direct avec sa vie quotidienne, s'est révélée fondamentale en Europe comme en Afrique."

² See, e.g., A.R. Prest, "Fiscal Measures and Capital Accumulation", in: A.N. Agarwala and S.P. Singh, eds., *Accelerating Investment in Developing Economies*, OUP, 1969, p. 446-51.

³ Ruozzi (*ibid.*, p. xix-xx) reports that the results of publicity campaigns in Africa so far were on the whole rather disappointing, partly because they have been few and far between, and partly because, barring rare exceptions, "they almost slavishly copied the models of industrialized countries, and failed to adapt their message to the social and psychological make-up of the local population."

interesting is the remuneration paid on savings of various technical forms¹. Interest rates higher than those now current in Africa need not depress the propensity to invest, as we have seen at the end of Chapter Four; the next question is whether they are a major factor in savings decisions.

Opinions differ on this point. The prevalent view in many African countries is that, providing people have easy access to financial institutions, the most attractive feature of deposits is that they are safe, and next, that they can fairly readily be withdrawn for spending if needed; earnings on deposits are thought to count far less. There are cases on record which seem to confirm this view, but the reason could simply be that interest rates are so very low. The fact remains that large numbers of potential savers certainly are fairly insensitive to the rate of return².

But it is equally true — and I personally share this view — that with interest rates of the order of 2 to 4 per cent one cannot even speak of strategy in this respect, and that there is room for a judicious increase in returns, either by higher interest rates or by prize draws³, or a combination of both. The replies to the

¹ The remarkably sophisticated range of financial assets on offer by financial intermediaries in Uganda is described by G. Huebner, *op. cit.*, p. 149-57.

² For fuller details, see Mottura, *ibid.*, p. 75-76; M. Masini, "Il contributo del sistema bancario alla politica del risparmio nei paesi in via di sviluppo", *Il Risparmio*, September 1970; and Christopher Egbede Enuenwosu, *op. cit.*, p. 11-13.

N.G. Krul (*op. cit.*) rightly states: "En effet, le bénéfice de la sous-rémunération se traduit par une subvention indirecte aux activités favorisées par le Plan, lesquelles sont cependant condamnées à exprimer le coût de la pénurie générale dans leurs prix finaux. En d'autres termes, les épargnants-consommateurs sont victimes à la fois du niveau trop bas des taux créditeurs et du coût trop élevé du capital."

³ According to Mottura (*ibid.*, p. 77), "the ratio between the number of prizes drawn and the number of depositors should be high and the amount of the prizes should be proportionate to the savings deposited. Thus, any single

questionnaire sent out in connection with the previously mentioned survey of savings facilities in Africa showed that many respondents feel "that fairly high levels [of interest rates] would be of effective help in promoting and mobilizing household savings in Africa"¹. One has to think in terms of different sections of the market; the savers most likely to be responsive to such an approach are those in urban areas, where "interest rates can be used effectively by competing credit institutes in their effort to attract savings from the public. This certainly applies to savings already accumulated and invested in financial assets, but interest rates may well in addition constitute an incentive for the formation . . . of new monetary savings." Since in rural areas these incentives are not operative, there is reason to think that the best system would probably be one of regionally diversified interest rates. This would, of course, have to be devised in the light of conditions in each individual country, but the main point is to reconcile the two objectives of safeguarding the economic position of the institutes which accept savings and meeting the motivations of different social groups². In this way, interest rates could be made to increase the "financialization"³ of the saving-investment circuit.

saver would have a reasonable, although uncertain, expectation or remuneration and the incentive would contain only a mild 'speculative' element (which is rather typical of lotteries)."

¹ Ruozzi, in: Alberici and Baravelli, *ibid.*, p. xx-xxi.

² Ruozzi, *ibid.* In the same volume, *passim*, will be found examples of various technical combinations adopted by financial intermediaries in a number of different African countries. For other, similar examples, see *The Mobilization of Savings in African Countries*, *op. cit.*, *passim*, and German Foundation for Developing Countries, *Report of the International Seminar on Mobilization of Savings and Local Credit*, Berlin, October 1972, *passim*.

³ To quote an expression used by Deena R. Khatkhate, "Analytic Basis of the Working of Monetary Policy in Less Developed Countries", *op. cit.*, p. 556.

6.3 THE MOBILIZATION OF SAVINGS THROUGH FINANCIAL INSTITUTIONS

Once a country's government has decided to launch a determined policy of mobilizing savings in general and household savings in particular, the chief responsibility for technical success rests with the central bank. As Professor Dell'Amore puts it¹, "... especially in Africa, it is up to the central bank to promote the formation and productive investment of savings. These latter aims cannot be achieved without central co-ordination on the principle that specialized credit institutes acting in close collaboration have a decisive part to play especially in countries that go in for central planning."

Yet African central banks somewhat neglected this matter until recently, and explain this with reference to most governments' scant interest in raising domestic resources and to the — at least apparently — more pressing problems of short-term economic policy claiming first attention. But now that governments are more anxious to reduce their countries' foreign dependence, there is a new determination to launch a co-ordinated attack on the problems of savings mobilization. This requires, first, the collection of all information which can shed light on the local aspects of these problems, and second, an assessment of the potential role of various types of financial intermediaries in the mobilization of private savings.

One of the major tasks of the central bank in this connection obviously is to impart an appropriate pattern to the structure and functions of the existing system of financial intermediaries, and,

¹ "Banking Policy and Savings Policy in African Countries", *op. cit.*, p. 13. For a more general discussion, see U Tun Wai, *Financial Intermediaries and National Savings in Developing Countries*, New York 1972.

where this cannot be done with full success, to suggest the creation of new ones better suited to the purpose. The following survey of types of financial institutions therefore is intended as a critical appraisal of the operational principles of each, leading up to recommendations fully in line with those of the United Nations Economic Commission for Africa. While my views are necessarily subjective, they coincide on many points with those of other authors.

In terms of sheer numbers and volume of business, the leading financial intermediaries in nearly all countries at present are commercial banks¹. They owe their predominant position to a number of factors, all a heritage of their colonial past, even if they have subsequently been Africanized or nationalized — to wit, a sound reputation of financial integrity, sometimes an extensive branch network², expert staff, close connections with the business community, the capital market and foreign sources of finance, and well-organized internal working arrangements for dealing with all types of deposits and services to customers.

Central banks appreciate the intermediary functions which commercial banks discharge on such a large scale, but also realize that not much can be expected of them in the matter of mobilizing household savings among the poorer classes and hence generally

¹ From among many authors who have written about commercial banks in relation to the promotion of personal savings, reference is made to the following: Arnaldo Mauri, "La promozione del risparmio nei paesi in via di sviluppo", *Il Risparmio*, August 1969, p. 1363-64; M. Masini, *op. cit.*, p. 1688-92; F. Simeone, "La raccolta del risparmio ed il suo investimento nell'industria nei paesi in via di sviluppo", *Rivista di Politica Economica*, December 1963, p. 1768-69; P. Roques, "Le Rôle des banques dans le développement en Afrique", *Nations Nouvelles*, June 1967, p. 14; Giordano Dell'Amore, *ibid.*, p. 3-5; Paolo Mottura, *ibid.*, p. 25-29.

² All too often, however, concentrated in the capital and other major towns. As Dell'Amore points out (*ibid.*, p. 4), "this concentration is often decisive in creating the monetary and credit dualism characteristic of the economy of most [African] countries."

do not even ask them to make any special efforts to this end. The reason for this shortcoming has to do with the type of deposit business the commercial banks go in for, on management principles not very different from those followed by European and American banks in the last century. They like to take in deposits on current account as well as on time, which are usually reasonably high per client, and do not wish to bother with savings deposits, which they consider too costly because of their small unit amounts and the frequency with which tiny sums are paid in and withdrawn.

It cannot be ruled out of course that commercial banks may have a contribution to make to the mobilization of household savings, provided they alter their policies with regard both to deposits and to loans¹, but so far, at any rate, they have not been at all forthcoming and have, on the contrary, entrenched themselves behind long-established habits, traditional operational principles and a conservative mentality.

Even less can be expected of another category of institutions, namely, development banks². This stands to reason in view of the purposes for which they were created: they are supposed to promote fixed investment by long-term loans. Personal deposits are largely useless to this end, and development banks have to raise their funds by other means, like bond issues or borrowing from other intermediaries, from the central bank and from international organizations.

¹ There are indeed examples of commercial banks which do keep in step with the times, and then they can be very useful in encouraging personal saving. Cases in point are the innovations introduced by commercial banks in Egypt and in Ethiopia, described, respectively, by Hikmat Said Ahmed Rizk, in "The Mobilization of Domestic Savings in the U.A.R.", and by Taffara Deguefe in "The Mobilization of Savings in Ethiopia", both in: *The Mobilization of Savings in African Countries*, *op. cit.*

² See bibliographical references in Section 2.4 above.

Farm credit is provided by special agricultural credit institutes (and sometimes to some extent also by development banks and savings banks), and one would expect them as a matter of principle not to drain away rural savings to other areas¹. And indeed, if there is no rural saving or if it is latent, agricultural credit institutes should make it their business to promote it. This can be done by establishing a link between saving and loan facilities, by a scheme, for instance, like that tried out in Ivory Coast with the *prêts de soudure*. These "hungry season loans" are consumption credits², and with their help the local agricultural development bank hopes to break down the traditional and very costly credit circuit within a few years and establish a new pattern along the following lines: (a) free the farmer from the grip of moneylenders and their loans at usury rates; (b) make it possible for him to earn enough to get by from one harvest to the next; (c) once he no longer needs bank

¹ Unfortunately, this does happen, as Dell'Amore points out (*Agricultural Credit in African Countries*, *op. cit.*, p. 29): "Even today, institutes specifically created for supplying funds to farmers, still drain away the savings of the rural population. Notwithstanding pressing demand for agricultural credit, these institutes often find it more profitable to lend part of their resources to industrial and commercial firms, their declared intention being to spread their risks and earn higher interest so as to be able to charge correspondingly lower interest on farm loans. This sort of policy is less blameworthy when the firms so financed are concerned with the processing of agricultural produce ... In any event, the drain of rural savings obviously has two unfortunate consequences. It makes inroads into the supply of loanable funds for agricultural improvement, and in the long run also reduces the self-financing capacity of farms and the formation of new savings on the part of the rural population." See also Marco Onado, *Controllo sul drenaggio dei risparmi rurali da parte delle banche commerciali*, unpublished draft paper for the FAO-CARIPLO Study of Agricultural Credit and Savings Problems in Developing Countries, Milan 1973, p. 54.

² For a detailed description of the scheme see Banque Nationale pour le Développement Agricole, "The 'prêts de soudure' of the BNDA", Country Program Paper, Spring Review of *Small Farmer Credit*, Vol. VI, Washington D.C., February 1973, p. 17.

credits, to educate him to set aside what money he has over after covering his immediate needs.

This scheme is only one among many that might be recalled. The point is that the eternally precarious development conditions of farming are not impervious at least to an attempt at solution by methods carefully studied and worked out on the spot and, of course, with constant government support. In Africa, unfortunately, agricultural credit has not grown out of local savings, but rests on state funds. Consequently, farmers do not understand the connection between saving and credit; they regard credit as something extraneous and as their due, and it is not clear to them that credits must be repaid. This explains the long record of failure. It is all to be started again, with saving and savings deposits, which in their turn should be linked with subsequent access to loans¹.

Every government has the choice between a centralized and a decentralized system of credit institutes. The first has the advantage of compact structure which allows effective control of operations, but cannot easily penetrate the rural world. This difficulty might be overcome by opening many branches and with personnel possessing not only technical competence but also the human qualities needed to establish good contacts with farmers. However, such an expansion of facilities is likely to be very costly.

A decentralized system consists of local, independently managed credit institutes, which might subsequently associate in regional and ultimately national federations. Examples abound, from the credit unions of English-speaking countries to the *caisses populaires* of

¹ See A. Daubrey, *La mobilisation de l'épargne pour le développement rural en Afrique*, Paper contributed to the Fifth World Congress on Agricultural Credit, Milan, 17 to 20 September 1973, p. 22; and C. Marzano, "La funzione del risparmio agricolo nelle economie in via di sviluppo", *Il Risparmio*, September 1969.

French-speaking ones, from co-operative societies to rural banks. Such decentralized institutes find it much easier to get on with farmers, because they are, after all, made up of farmers. The chief problems are those of the quality of management, of management control and of management training.

The credit unions mentioned above are small units very common in several African countries, especially in rural areas but lately also in towns. They owe their spread to the spirit of solidarity so often encountered among African peoples, and are, as it were, a formalized expression of the tradition of spontaneous co-operation. There are very many of them, and they work in a very simple way, taking in savings from members and granting them loans, subject to specified criteria.

Because credit unions generally work in areas outside the scope of those served by the branches of big banks, they certainly deserve encouragement. With a view to enhancing their efficiency, however, it would be well to co-ordinate their action at national level, and also with the action of savings banks, which likewise reach down into the countryside. This would also help solve one of the trickiest problems of credit unions, namely, excess liquidity for lack of suitable local investment opportunities¹.

Indigenous credit associations are popular in nearly all African countries, under a variety of local names: *ekub* in Ethiopia, *esusu* in Nigeria, *cilimba* in Zambia, *tontine* in French-speaking countries².

¹ These problems are discussed in detail with reference to Lesotho, a small country where the co-operative movement is of great importance, in Marco Onado and Antonio Porteri, *The Banking System and the Formation of Savings in Lesotho*, Milan 1974, p. 41-58 and 111-21.

² Literature on these indigenous societies is scarce. Some information will be found in Arnaldo Mauri, "Alcune forme tradizionali di intermediazione creditizia in Etiopia", *Il Risparmio*, March 1967; M.R. Jellicoe, *Indigenous Savings*

These are a kind of chit funds, and typically work on the following very simple lines. A group of individuals, all known to each other and of trusted honesty, agree to make regular contributions for a certain period to a common fund, the whole of which is then paid out to one of the members, in rotation. The money is collected publicly at a meeting, and handed over to the person entitled to receive it. Often members trade their entitlements among each other, at a profit.

These traditional schemes belong to a social context in which banking services are still scarce, and go to show that a willingness to save comes spontaneously to the mind of people fully aware of its importance. But organizational weakness threatens the survival and efficiency of this system. Given their undoubted educational and social value, these spontaneous initiatives ought not to be neglected by central and district authorities. If they were properly organized and controlled, these indigenous groups could function as outposts of the credit system and help mobilize household savings from rural areas and low-income townsfolk. Their co-ordination with credit unions and savings banks is certainly advisable.

More than once in the preceding pages it was suggested that, if government efforts to mobilize household savings are to be successful, it is vital to encourage the creation of institutes which link the formation of savings with their use by the same saver himself. From this point of view, there is much to be said for

Associations in Eastern Africa and the Mobilization of Domestic Savings, UN Economic Commission for Africa, 21 October 1961; C.M. Isong, "Modernization of the Esusu Credit Society", Nigerian Institute of Social and Economic Research, *Conference Proceedings*, December 1958; B. Rossignoli, A. Alberici and P. Fabrizi, *Istituzioni tradizionali di risparmio*, Unpublished draft paper for the FAO-CARIPLO Study of Agricultural Credit and Savings Problems in Developing Countries, Milan 1973.

building societies, special credit institutes which, especially in urban areas, finance the construction of low-cost housing for private ownership, so that a family which has set aside part of its income for a number of years eventually comes to own its own home.

But much the most suitable institutes for the purpose in question are savings banks or, better, a model type of combined credit and savings institutes, to co-operate with government authorities in launching programmes for the mobilization of savings¹.

There exist ordinary savings banks in Algeria, Swaziland, Zaire, Rwanda, Burundi, Egypt, Ethiopia, Somalia, Sudan, Ghana and Zambia, and some are in course of establishment in a number of other countries². Some of them have been newly set up, others are the successors of radically transformed previous institutes, notably post office savings banks.

¹ Two authors, among many experts on the subject, may be quoted for exhaustive analysis and description of the characteristics of savings banks. Arnaldo Mauri has for more than ten years been studying the problems of savings promotion in Africa, on behalf of Italian universities and of the International Savings Banks Institute, and a lucid statement of his recommendations will be found in two papers, "La promozione del risparmio nei paesi in via di sviluppo", *Il Risparmio*, August 1969, and, in English, "Savings Banks in African Countries", in: *The Mobilization of Savings in African Countries*, *op. cit.* In his turn, Paolo Mottura has recently completed a study for the United Nations, *Savings Mobilization in Developing African Countries*, *op. cit.*, which is an up-to-date and full survey of all relevant problems. I am in full agreement with both these authors, and shall quote their views liberally.

Two other useful sources of information are: Francesco Arcucci, *Savings Banks and the Mobilization of Savings in Developing Economies*, Milan 1973, and Adalberto Alberici and Maurizio Baravelli, eds., *Savings Banks and Savings Facilities in African Countries*, Milan 1973.

² Among many case studies, reference is made to just a few which I personally have often had occasion to consult on field missions in African countries: John David Owen, "The Swaziland Credit and Savings Bank", *World Thrift*, 1972, No. 1; W. Quade, "Savings Banks in Egypt", *World Thrift*, 1968,

They all have the common aim of promoting household savings, with particular reference to low-income groups; they all accept deposits and lend to small and medium-sized firms, to craftsmen and farmers; and they expand the coverage of banking services in small urban and rural centres. In other words, they try to institutionalize the processes of saving and credit in the non-organized section of the market; though their scope is generally nation-wide, they operate at local level.

African savings banks, like those elsewhere, are in public ownership, are completely autonomous *vis-à-vis* the government (but operate in full compliance with relevant legislation), do not work for profit, and are socially oriented.

As regards geographical coverage, there are two alternatives: (a) one countrywide institute with a dense network of branches, each reasonably autonomous; (b) a system of more or less numerous regional or district savings banks, co-ordinated and controlled by an apex bank. In practice, the pattern usually lies somewhere in between these two extremes and has been chosen in the light of local conditions. In Algeria, for instance, as also in Ghana and Burundi, savings banks work not only through their own branches but also through the post office (mostly for accepting deposits), by virtue of an appropriate agreement with the ministry concerned. Egypt (and now also Sudan, with its proposed new savings bank at Wad Medani) has chosen to set up local savings banks; these

No. 6; H.S.A. Rizk, *op. cit.*; Paolo Mottura and others, *Rapporto della commissione tecnica per la fondazione di una cassa di risparmio pilota a Wad Medani, Sudan*, Milan, December 1970; Joseph Hicuburundi, Speech on the Burundi Savings Bank, in: *The Mobilization of Savings in African Countries*, *op. cit.*, p. 282-86; Sergio Bortolani, "La cassa di risparmio del Ghana", *Il Risparmio*, January 1974; F. Arcucci and C. Demattè, *Rapport préliminaire sur la création d'une caisse d'épargne ordinaire dans la République du Mali*, Milan, February 1973; G. Raggetti, *La riorganizzazione del Post Office Savings Bank del Ghana*, Milan 1972.

initially settled in well at the selected points in urban and rural areas, but then committed a number of errors attributable to unorthodox management. Decentralization definitely is a felt need in Africa¹. Some savings banks use mobile units, sometimes successfully and sometimes not, and others resort to the expedient of keeping local branches open only at certain times (on market days, or during the peak months of harvesting and marketing). On this point, as on others, no generally valid optimum solution can be recommended; each country must structure its savings banks in the light of its own specific requirements.

Functionally speaking, it is almost redundant to stress the particular concern of ordinary savings banks with the mobilization of savings; they do this with the help of a whole range of various types of deposits, ever new incentives, well-planned publicity campaigns, and, last but not least, specially trained personnel.

On the lending side, the essential point is that savings banks should be able to extend loans directly to private enterprise. Otherwise, if they just hand over their funds to the Treasury or to other state agencies, they would not only lose their primary, intermediary and stimulating, function in the market, but they would divert savings to uses not always falling under the heading investment². As regards the duration of loans, the nature of the

¹ Cf. Erwin Sinnwell, "How Savings Banks Operate. Why there is a Need for World-wide Co-operation", in: *The Mobilization of Savings in African Countries*, *op. cit.*, p. 27-28.

² Mottura (*ibid.*, p. 86) summarizes as follows the essential tasks of a model savings and credit institution:

"(a) to exert a 'pulling effect' on idle and potential financial resources, by attracting an ever-increasing number of households into the financial circuits. This action obviously calls for a great amount of preliminary and collateral effort for the establishment of adequate savings facilities and incentives;

deposits accruing to savings banks is such as to make room also for medium- and even for long-term lending, provided, of course, that the total volume of these operations, which usually take the form of mortgage loans, is kept within safe limits. Among recipient sectors, agriculture and housing have strong claims for the bulk of the loans, possibly via savings-loan schemes such as have been successfully introduced in several countries¹.

I cannot do better than to close the discussion of savings banks with a quotation from Arnaldo Mauri²: "I am only too aware of the host of arduous problems which will have to be tackled in order to increase the efficiency of African credit systems. I also realize that such problems cannot be solved in the short run. Far be it from me therefore to advocate savings banks as a sort of panacea. Yet I do believe that something must be done gradually to improve the situation. I am absolutely convinced that dynamic savings banks, suitably adapted to local habits and economic conditions, can be of considerable help in eliminating the current shortcomings of nascent African banking systems, thereby fostering economic and social progress in Africa. Savings banks in Africa will be able to do all the more towards these ends if ... they can count on the co-operation and assistance of similar institutions operating in the developed countries."

(b) to exert a 'pushing effect' on potential and under-developed investment opportunities, by supplying appropriate credit facilities;

(c) to keep the unit cost of financial intermediation as low as possible, to the benefit of all interested parties (savers, borrowers, public authorities), and of the economy as a whole."

¹ See Roberto Ruozi, "Savings Banks and Agricultural Credit", and Johannes Völling, "Savings Banks and Housing Finance", both in: *The Mobilization of Savings in African Countries*, *op. cit.*

² "Savings Banks in African Countries", in: *The Mobilization of Savings in African Countries*, *op. cit.*, p. 54.

6.4 LOCAL MONEY AND CAPITAL MARKETS

Another facet of central bank action for the mobilization of domestic savings is the establishment, consolidation and enlargement of local money and capital markets. These are generally still in their infancy in Africa, though some are more developed than others. Naturally, they belong to the most organized section of the credit market.

Financial resources are short, in absolute terms; as in all developing countries, furthermore, disposable funds are unsuitably distributed among different types of investment. In other words, what little capital there is, is often not used optimally, because of the lack or deficiency of financial structures¹. Small wonder, then, that some domestic funds go abroad in search of the greater safety and liquidity, and the higher yields, offered by the more sophisticated capital markets of industrial countries. Other funds are hoarded in various forms², and yet others, while invested at home, go to projects not particularly high in the planners' scale of priorities.

¹ E. Christian and P. Pagoulatos ("Domestic Financial Markets in Developing Countries: An Econometric Analysis", *Kyklos*, 1973, No. 1, p. 86) come to the conclusion that: "The level of domestic financial development is a significant constraint on the rate of capital formation."

² Gold hoarding is discussed in an article by Anand G. Chandavarkar, "The Nature and Effects of Gold Hoarding in Under-developed Economies", *Oxford Economic Papers*, June 1961. Having put in proper perspective the harmful effects of this form of saving, which defies the Keynesian analysis of liquidity preference, the author predicts (p. 146) that it is unlikely to stop very soon: "...any scheme for the mobilization of gold hoards will always encounter the fundamental objection that so long as the major portion of hoarding demand emanates from non-monetary motives, it is idle to expect any substantial response to such schemes, however attractive the terms of the assets into which gold is to be converted."

In Africa, a number of reasons have combined to lessen the urgency of establishing capital markets. On the side of demand, both the public and the private sector of the economy often drew on external sources of finance, the first through bilateral or multilateral loans, the second via foreign parent companies or commercial banks. These practices admittedly attracted fresh funds to the country, but they also increased its dependence on foreign capital and delayed the emergence of local capital markets. On the side of supply, the chief constraints have to do with low income per head of the population, and with the slow pace at which the public's investment preferences change in modern directions.

The usefulness of strong local money and capital markets is obvious: they can reduce distortion in external flows, increase the supply of circulating capital, and make it possible to determine the real cost of credit¹. Financial intermediation matches the requirements of investors and credit users, in terms of types of financial instruments, maturities, yield and liquidity. Diversification of financial assets goes hand in hand with development².

¹ See P. Perera, *Development Finance: Institutions, Problems and Prospects*, New York, 1968, p. 85-90.

² Anand G. Chandavarkar ("How Relevant is Finance for Development?", *IBRD-IMF Finance and Development*, September 1973, p. 14-15) describes this parallel process as follows: "One sign of economic development is 'product-differentiation' — as people become better off they demand a wider variety of goods. On the financial side, an analogous process of asset-differentiation also takes place or else has to be deliberately induced, thereby leading to growth not merely of money but also of quasi-money (e.g., savings and time deposits with banks) and financial assets. In a sense, asset-differentiation is implicit in the very nature of the development process, because once the limits of self-finance are reached the (net) investing units have to raise external funds through sale of financial instruments (in the 'differentiated' forms of debt, equity, or preferred stock) to the (net) saving units in the economy. It is at this stage that the process and policy of financial 'intermediation' (mediating between ultimate lenders and borrowers) is peculiarly relevant for the development process."

The leading role in all this falls to the central bank. The central bank alone, as a government institution, has the resources and the competence to take charge of the continuous operational intervention required. The first thing that needs to be done to consolidate a market, as will be seen presently, is to endow the instruments in which it deals with the important attribute of negotiability.

In this matter as in others, central banks in English- and in French-speaking Africa follow a different approach. Under British influence, the major English-speaking countries tried, with varying success, to set up embryonic money and capital markets, and in a few cases even a stock exchange; French-speaking countries felt less need for such arrangements. The difference is rooted in Africa's colonial past. In the Anglo-Saxon tradition the market was always extolled as the natural and most efficient mechanism for catering to the respective requirements of firms, banks, and the central bank itself; the French philosophy in Africa always leaned more towards *dirigisme* in financial policy, and relied on the refinancing machinery of the central bank for balancing the various types of financial supply and demand. As time goes on, the now independent policies of the new sovereign states will no doubt diminish the present disparities.

Although no strict demarcation line can be drawn between money and capital markets and they have many points of contact and overlapping, it will be convenient to discuss them separately.

The existence of financial assets at sight or at short notice provides a ready haven for the liquid funds which are — relatively speaking — abundant at times in African countries because of the seasonal pattern of agricultural production. There is always cash wanting temporary investment between one marketing season and the next. Demand for more long-term instruments could be met

by some device of conversion, thus reconciling different individual requirements¹.

An organized money market should help not only business and financial institutions, but also the central bank itself in giving effect to its liquidity policy. This statement is unassailable in theory, provided only that the market is efficient enough. I cannot agree with the contrary argument of R.A. Sowelem, who, admittedly with reference to a now superseded historical and economic context, prefers recourse to the markets of the former colonial power².

Some countries — notably Nigeria since 1962, but also Tunisia since 1963 and Sierra Leone since 1964³ — have a call money market, which works through a special call money fund administered by the central bank. Any spare cash a bank may have can be paid in and earn interest at a rate generally 1 point below the Treasury Bill rate.

Treasury Bills are the most common form of short-term paper, both in English- and in French-speaking Africa. They are, as it

¹ "If sufficient short-term funds are available at any one time, the provision of suitable assets may convert a series of short-term investments into a supply of relatively long-term finance. The turnover of short-term assets may be fairly high for individual investors, but for the economy as a whole a substantial volume of them may well be permanently demanded, so opening up a source of long-term finance." (Edward Nevin, *op. cit.*, p. 90).

² Sowelem (*op. cit.*, p. 314-21) was writing in 1967, on the experience of the Federation of Rhodesia and Nyasaland in the years 1952-63. Looking to the future, he came to the conclusion that the then current efforts in Central Africa and elsewhere in the world to develop local money markets were not justified from the point of view of their potential usefulness in giving effect to central bank policies. It may well be that the financial instruments of a country like Great Britain are safer, but to rely on them can only impede progress towards financial independence, which is precisely the title of Sowelem's book.

³ See C.V. Brown, *The Nigerian Banking System*, *op. cit.*, p. 162-63, and G. Dell'Amore, "Banking Policy and Savings Policy in African Countries, *op. cit.*, p. 14.

were, the nucleus around which other, new instruments can cluster in the future. They run for a year or less, and in some countries are issued by weekly or fortnightly public auction. The rate of interest they carry may be an indicator of current liquidity conditions. The central bank organizes the machinery of offer and dealings, and in addition must stand ready to take up Treasury Bills as collateral against advances.

While the short-term market is of interest primarily to banks, the market for medium- and long-term funds serves a much wider public. The circumstances that contribute most to the formation and consolidation of these markets in developing countries (and indeed also in financially advanced ones) are:

- (a) the formation of household savings on a sufficient scale;
- (b) economic and political stability in the country;
- (c) an inclination of individuals and institutions to invest in financial assets, which presupposes a modicum of economic understanding;
- (d) reasonably stable purchasing power of money;
- (e) equitable legislation regarding ownership and circulation of bonds, company law and taxation¹.

A stock exchange in the true sense of the word is the final stage of several through which transactions in long-term debts and credits pass on their way to sophistication. Personal transactions will no doubt prevail for some time, until eventually they are depersonalized by bond issues². Trading might initially take place once a week, with representatives of banks and other financial

¹ See Giorgio Tagi, "Considerazioni sulla efficienza del mercato finanziario in un paese ad economia sottosviluppata", in: *Scritti in onore di Giordano Dell'Amore*, Vol. III, Milan 1969, p. 2287-90, and P. Perera, *op. cit.*, p. 77-82.

² "In the case of a loan, the debtor undertakes to repay it, usually according to an agreed schedule to which he must adhere strictly. In general the tax and

institutions meeting in premises made available by the central bank. There will not be many deals at first, if only because government bonds are at present largely taken up by institutional investors who usually keep them until they fall due.

Since on most African capital markets virtually the only securities traded are government bonds, because they alone offer some guarantee of safety to the novice investor, the central bank has to give the most careful consideration to every aspect of a forthcoming issue — that is, its connection with public debt policy and the Treasury's requirements, the overriding need to create a general climate propitious for bond investment, the public's and the banks' preference for one type of paper rather than another. The first of these aspects is often a constraint on the central bank, because its action must first and foremost fit into a pattern of permanent collaboration with the Treasury, even if this means imperilling monetary stability¹.

The creation of a climate propitious for security investment involves, in the most immediate sense, not so much guaranteeing the debtor's solvency (given that the debtor is the state or some public agency), but arranging for an orderly functioning of the market by a judicious policy of keeping bond prices stable. In other words, the investor must be made to realize that by shifting from traditional to modern forms of saving he gains an economically highly significant advantage, i.e. liquidity. Just because the

other charges payable on a loan contract rule out frequent substitutions of debtors and creditors in the course of the contract's long life. The situation is quite different if the borrower raises funds by floating a bond issue, for it is then perfectly easy for a third party to step in at any time." (G. Tagi, *ibid.*, p. 2282).

¹ "Everywhere the Treasury tends more and more to turn the central bank into a mere agent of public debt policy." (G. Dell'Amore, *Le funzioni delle banche centrali*, *op. cit.*, p. 66).

For the relations between central bank and government see Chapter Five.

convenience of liquidity must, among other things, also counterbalance a natural distrust of new forms of investment, a market support policy is surely vital in the early stages of any capital market¹. I cannot go along with the contrary opinion of C.V. Brown², even though I do realize that a market support policy may cause disruption and may unjustly penalize investors if it were suddenly abandoned because, for instance, of unwelcome repercussions emanating from foreign capital markets³.

As regards investors' preferences, it is worth mentioning how popular premium bonds have proved in some countries, no doubt

¹ Edward Nevin (*op. cit.*, p. 98) draws an interesting parallel between the bond market and the foreign exchange market: "It is likely to prove necessary for the authorities to maintain a market in their own securities, offering to purchase its public debt issues at a lower range of prices and to sell at an upper range. This is no more than is commonly done by many central banks in order to maintain a reasonably stable exchange rate for their own currency in guaranteeing to buy and sell within a range of prices announced from time to time and, of course, modified from time to time to take heed of current market conditions."

² Writing about the Nigerian banking system (*op. cit.*, p. 160-61), he says: "... the entire policy of market support is unfortunate. It is presumably designed to encourage the holding of Government stock, but may well have the opposite effect. The author asked an expatriate banker why he didn't put money into a 6 per cent 1979 stock on an overnight basis, as this is a more favourable rate of interest than either Treasury bills or call money. The banker replied that his bank would not hold more than a token amount of Government stock on any basis because he assumed that sooner or later the central bank would realize the folly of supporting the market and his bank could not stand the risk of capital loss that this would entail. Support of the market also makes investment in Government stock unattractive by keeping the yield down. Finally the policy is ill-advised because if and when it is abandoned it may cause the less sophisticated members of the public to lose confidence in the Government."

³ Italy in recent years suffered the ill effects of the sharp rise in interest rates on competing capital markets abroad and the Bank of Italy was forced — e.g. in 1970 — to discontinue its policy of supporting public bond prices. But this was an effect of the interdependence of advanced capital markets and is not likely to occur at present in African countries, though even there (illegal) capital transfers abroad are not uncommon.

because they appeal to the gambling instinct of the population. In Ghana¹, for instance, there are loan issues giving each holder the chance to win in an annual prize draw. A few of the prizes are very high, and there are numerous smaller ones. If after two years a holder has won nothing, he may sell his bonds — but not before, because the whole point of these premium bonds is to induce people to hold them for a certain time. In Zambia, on the other hand, there are three-year premium bonds carrying no interest, but taking part in a prize draw every two months; on maturity the bonds are redeemed, regardless of whether a prize has been won or not. These bonds are very popular with the public, but the government itself keeps down the issues for fear of competing too much with the traditional lottery, which brings in conspicuous amounts and has the extra advantage that the capital need not be repaid.

No African country has so far found it expedient to issue index-linked bonds, such as have been common for some time in Latin America and have recently made their appearance also in some industrial countries. Inflation, barring a few short-lived occasions, has not so far assumed such dimensions in Africa as to make it advisable to link the value of financial assets to some price index².

In French-speaking Africa, the Treasury commonly issues *bons d'équipement*, which, for instance, in the five countries of the Central African Monetary Union, are two-year certificates carrying 3.60 per cent interest. Their subscription is compulsory,

¹ See Erin E. Jucker-Fleetwood, *The Monetary and Financial Position of Ghana and Nigeria*, Basle Center for Economic and Financial Research, June 1960, p. 10, and Sergio Bortolani, "La cassa di risparmio del Ghana", *op. cit.*, p. 67.

² For a discussion of this problem with reference to developing countries, see K.B. Lall, "Countering Inflation: The Role of Value Linking", *IBRD-IMF Finance and Development*, June 1969.

in accordance with certain ratios, for some categories of investors like banks, post offices, stabilization funds and pension funds, as well as for some high-income individuals and corporations. At redemption date, only those holders are entitled to repayment who have invested in specified sectors; other holdings are converted into a 10-year issue carrying only 1.50 per cent interest. The purpose of these compulsory loans is to enhance the economic potential of the countries concerned, but the results do not always work out that way¹.

6.5 STOCK EXCHANGES IN AFRICA

Even among the few countries in Africa where the capital market is reasonably well organized, not all have yet gone so far as to set up a stock exchange. Those that have it are Egypt, Ethiopia, Ghana, Kenya, Mauritius, Morocco, Nigeria and Tunisia. By way of example, a few of these, for which reliable data are available, will be discussed at the end of this section; but first it will be convenient to look at the more general aspects of the problem², with particular reference to the promotion of entrepreneurship in Africa.

¹ Lorenzo Frediani (*The Banking System of Gabon and the Central Bank of Equatorial Africa and Cameroon, op. cit.*, p. 113-14) rightly points out that the practice of placing *bons d'équipement* with deposit banks not only generates inflationary pressures in so far as investment is financed with borrowed funds, but also means that the Treasury is financing long-term requirements with short-term funds — an inherently dangerous situation in terms of monetary base expansion.

² A useful introductory work often quoted in the literature is K. Doodha, *Stock Exchange in a Developing Economy*, Bombay University Press, 1962, which deals with the Indian experience during the years 1958-1962. For Africa, see P. Turot, "Le marchés financiers dans les pays sous-développés africains", *Banque*, December 1961 and January 1962.

Even though the few stock exchanges that exist are small, far more has been done to organize them in English-speaking countries than in French-speaking Africa south of the Sahara, where no encouragement has been given to any such venture. Admittely, the countries concerned are among the smallest and most backward in Africa, but at least in Ivory Coast, Senegal, Zaire and Madagascar the public authorities might have begun working in this direction.

With reference to the experience of existing stock exchanges and to some projects afoot for their creation elsewhere, the following suggestions may be useful¹.

(a) Government stock, which accounts for the bulk of transactions, should not be held for long periods in the portfolio of the central bank (though other considerations are obviously relevant here as well, such as financing the public debt and supporting bond prices).

(b) On the side of the supply of corporate bonds and shares, it would be well to encourage the establishment of semi-public companies, joint ventures with foreign groups, and companies in which the state takes an equity stake, so as to give confidence to potential investors.

(c) On the side of capital supply, there is a case for indicating the minimum amounts of securities to be taken up by institutional investors. Among these, pension funds and life assurance companies are the most suitable holders of fixed-interest securities, but a vital part can be played by development banks (or, as the case may be, the development department of the central bank) and by holding companies in the orderly disposal of their equity holdings, once the firms concerned are strong enough.

¹ See Turot, *op. cit.*, p. 28-29, and the excellent paper by Edward A. Arowolo, "The Development of Capital Markets in Africa, With Particular Reference to Kenya and Nigeria", *op. cit.*, p. 462-69.

(d) Foreign companies and those which are joint ventures in which the local government has a stake along with foreign interests, should be asked to make share issues simultaneously on the local market and on some stock exchange abroad, so as to give more credibility and security to the issue.

(e) Taxation should not fall unduly heavily on security investment compared with alternative forms (it would seem that so far taxation has not, in fact, had an appreciably deterrent effect on purchases).

(f) For many African countries the only sort of stock exchange that would make sense is a regional one, though this does presuppose a certain degree of economic integration. This may be a long road, but not one without issue, given that there already are such groupings as the East African Economic Community, the countries using the CFA franc, the Maghreb countries and the Arab countries more generally.

(g) Any government really seriously intent on fostering an organized capital market must be prepared to intervene more or less constantly via the central bank, which should have powers of supervision and of issuing directives from time to time (including those having to do with exchange control and with capital movements in and out of the country).

The succinct list above should make it clear how many conditions have to be met for a stock exchange to work well and to have a chance of growing. What is more, these conditions concern the much wider field of government industrial and financial policy as a whole. This being so, it is hardly surprising that by and large results have not been spectacular so far. Nevertheless, there seems no ground for asserting that in Africa the establishment of stock exchanges would aggravate the dualism of the credit

market¹; efforts to reduce the disparity between the two sections of the market are more likely to be successful if they work in the direction of limiting the area of the traditional section and drawing it into the modern one, than if they fail to arrange a better organized and more efficient meeting ground for capital supply and demand.

Of the two compartments of a securities market — government stock on the one hand, and private or semi-private bonds and shares on the other — the first has much the richer supply, for the reason mentioned more than once: the role of the state in the economy, the Treasury's requirements, the greater trust placed in government-guaranteed securities.

The other compartment encounters more difficulties, which have to do with the whole problem of entrepreneurship in Africa². Getting a stock exchange quotation for bonds and shares, and selling them to the public, is the end stage of a process which government should foster by measures of various kinds, institutional, economic and financial alike³. Native entrepreneurship is notoriously weak

¹ See Mottura, *Savings Mobilization in Developing African Countries*, *op. cit.*, p. 43.

² This subject, merely touched upon in the text, is treated fully in all its aspects — economic, social, historical and future — in a number of excellent works, among which reference is made to the following: T. Geiger and W. Armstrong, *The Development of African Private Enterprise*, Washington D.C., March 1964; P. Marris and A. Somerset, *African Businessmen: A Study of Entrepreneurship and Development in Kenya*, London 1971; J.C. De Wilde, *The Development of African Private Enterprise*, *op. cit.* The last-named, which was commissioned by the World Bank, gives an up-to-date picture of the overall situation as it was in 1971, and in the second volume furnishes detailed information on 15 countries.

³ A good case study of Ghana is S.M. Spangler, "Promoting Private Enterprise in Less Developed Countries", in: J. Farer, ed., *Financing African Development*, Cambridge Mass., 1965, p. 130-43. The same problem arises for countries with a socialist economy, as is made plain in M. Roemer, "African Socialism and the Private Sector", *ibid.*, p. 111-21.

in Africa, mainly for historical reasons; it contrasts sharply with the greater efficiency and more solid organizational basis of foreign enterprise, so that once again we find a situation of distinct dualism¹.

Apart from the big firms in the public sector, those needing most help are the small and medium-sized ones which are the backbone of the only sort of enterprise which has any chance of expansion in Africa for years to come. Governments realize that they have not given enough consideration to this aspect of domestic development, and have lately been giving thought to what more incisive action they can take. Significantly, the Association of African Central Banks thought it advisable to study this problem in depth, on the basis of a critical assessment of the experience of member countries, and even outlined an appropriate strategy and action programme².

¹ This dualism is apparent in the market both for capital and for skilled personnel. In the words of G. Pfeffermann ("Men and Machines in Africa", IBRD-IMF *Finance and Development*, March 1974, p. 9): "Expatriate firms have access to financial markets in developed countries. Their investment decisions are related to the terms prevailing in Europe and North America. Indigenous firms have little access to the financial markets and find it extremely hard, if not impossible, to finance long-term investment. For them even local credit may be scarcer than for expatriate firms, whose perceived creditworthiness may be better."

Dualism in the market for managerial labor exacerbates dualism in the capital market. Expatriate firms that operate on a fairly large scale, and have their roots overseas, have access to European and American markets for managers and highly qualified technicians. Local firms are in no such position: they cannot hire expatriate labor as they are usually unable to offer competitive wages or guarantee stability of employment. Moreover, the small scale of most local firms, and of the markets in which they operate, does not make specialization at the managerial and technical level economical."

² The Association organized two seminars, one at Tunis, 20 November to 4 December 1972, and open to all members, and the other, for the West African Sub-Regional Committee alone, at Freetown, 26 to 30 November 1973. Among the papers submitted to the former, which dealt also with other subjects, two are

In the first place, local enterprises have to be protected against foreign competition, by giving them an exclusive right to engage in certain economic activities (as has been done in Nigeria, Senegal and Ghana). Secondly, the mechanism of channelling credit to local enterprises¹ needs to be improved by

- (a) setting up specialized institutions such as credit guarantee funds, promotion boards, industrial development banks, technical and managerial training schools;
- (b) tighter state control over the banking system;
- (c) the adoption of bank regulations designed to favour indigenous entrepreneurs; and
- (d) enhancing the functions of the central bank.

The first of these means of intervention aroused particular interest, because many countries have set up such credit guarantee funds and believe in their efficacy. While conceding that such funds are undoubtedly useful, attention was drawn to their limitations, to wit, the scarcity of financial resources at their disposal,

particularly relevant; one is by the representative of the central bank of Sierra Leone: A.T.B. Taylor, "Problèmes, voies et moyens de promouvoir l'esprit d'entreprise chez les africains: l'expérience de l'Afrique de l'Ouest", and the other is Banque du Maroc, "Le crédit à la petite et moyenne entreprise en Afrique". Both are published in: Association of African Central Banks, *Séminaire de Tunis*, 20 novembre - 4 décembre 1972.

The Freetown Seminar, on the Problems, Ways, and Means of Promoting West African Entrepreneurship, had 19 papers submitted to it.

¹ "In the great majority of cases African businessmen consider financing their principal problem. Financing difficulties, however, often reflect more basic problems of inadequate managerial and technical skills or the insufficient justification of projects submitted for financing. Experience in Africa has amply demonstrated that the provision of financing can be very wasteful unless it is accompanied by measures to assess the capacity of the entrepreneur, to provide necessary assistance in management and production techniques and to resolve marketing difficulties." (J.C. De Wilde, *ibid.*, p. 17).

the danger that banks may be less careful in risk appraisal, and the fact that such funds can at best meet only part of the problem and can do nothing towards the solution of another highly important one, which is technical and managerial training¹.

After this brief digression on the state of private entrepreneurship, let us now return to African stock exchanges and look in more detail at those of Morocco, Nigeria, Kenya and Tunisia. In Ghana the Stock Exchange Act of 1971 provided for the establishment of a stock exchange at Accra, but to my knowledge this has not been followed up so far, perhaps because of the intervening political changes².

Leaving aside South Africa and Rhodesia, the oldest African stock exchange is that of Casablanca. Morocco boasts of a deeply rooted banking and financial tradition, and as early as 1929, in Protectorate days, the banks set up a private sort of stock market under the name of *Office de Cotation des Valeurs Mobilières Marocaines*³. This gradually grew in importance, thanks not least to the interest of French business circles, until it gained official

¹ Case studies of credit guarantee funds in two countries will be found in BCEAO, "Fonds de garantie des crédits aux entreprises ivoiriennes", *Note d'information et statistiques*, January 1974, and "Bank of Ghana: Its New Role in the Development of the Economy", *Ghana Economic Review* 1971-72, Accra 1972, p. 240-41.

² In the spring of 1971 the then Governor of the Bank of Ghana wrote: "...the establishment of a stock exchange in Ghana would bring in a number of benefits which could not otherwise be secured. The major advantages are: matching projects with funds, hinging flexibility to the portfolios of institutional and individual investors, spreading the benefits of ownership of industries throughout the community, protecting the investor and enabling him to realize his investment quickly, and making the current value of every listed security known publicly." (J.H. Frimpong-Ansah, "Stock Exchange in Ghana", *Bank of Ghana Quarterly Economic Bulletin*, July-September 1971, p. 23).

³ See V. Nesci, *op. cit.*, p. 335-43.

recognition in 1943. But then the stock exchange went under in the political upheavals leading up to independence in 1956, and was not reopened until some ten years later as part of a new government drive to mobilize savings for corporate use.

After the establishment of the *Société Nationale d'Investissement* in 1967, a reform transformed the stock exchange into a corporation under public law, with its own juridical personality and financial autonomy. Within five years, the volume of business transacted there had grown fivefold. In 1971, the total turnover was 62 million dirham, of which 12 million government stock, 5 million company bonds and 31 million shares, plus 12 million's worth of unlisted bonds and shares which changed hands in direct dealings on the stock market. The main shortcoming, perhaps, of the Casablanca stock exchange is that the equity section is too thin; in spite of new issues, the supply of shares falls far short of investment demand especially on the part of Moroccan banks and financial groups.

The Lagos stock exchange¹ dates from 1961, when it was set up on the recommendation of a special government-appointed committee. On the Nigerian capital market the central bank had always been very active, especially as regards government stock. Its initial large-scale subscriptions created a need for a secondary market, mostly involving institutional investors. However, both these and private investors were on the whole more attracted by the higher yields obtainable on the bonds and shares issued by

¹ See Edward A. Arowolo, "The Development of Capital Markets in Africa, with Particular Reference to Kenya and Nigeria", *op. cit.*; D.R. Gustafson, "The Development of Nigeria's Stock Exchange", in: J. Farer, ed., *Financing African Development*, *op. cit.*; Authority of the Council of the Lagos Stock Exchange, *The Lagos Stock Exchange*, Lagos 1969.

TABLE 8

TRANSACTIONS AT THE LAGOS STOCK EXCHANGE, 1961 TO 1969

Year	Government	Industrial	Total	Government as percentage of total
Number of transactions				
1961	92	242	334	27.5
1962	175	520	695	25.2
1963	295	414	709	41.6
1964	404	581	985	41.0
1965	391	627	1,018	38.4
1966	501	595	1,096	45.7
1967	336	427	763	44.0
1968	286	360	646	44.3
1969	307	246	553	55.5
Value (thousand Nigerian pounds)				
1961	701.4	49.7	760.1	93.5
1962	2,115.9	165.3	2,281.2	92.8
1963	4,868.3	323.1	5,191.4	93.8
1964	5,909.5	1,036.6	6,996.1	84.5
1965	7,194.9	734.8	7,929.7	90.7
1966	7,613.1	534.7	8,197.8	92.8
1967	6,051.7	195.0	6,246.7	96.9
1968	6,291.4	105.3	6,396.7	98.4
1969	8,095.0	90.0	8,185.0	98.9

Source: Central Bank of Nigeria, Annual Reports 1961 to 1969.

private companies, both foreign and local¹. Nevertheless, turnover remains small, as is only too obvious from the figures of Table 8. The number of transactions is almost pathetically low (between 300

¹ "The existence of a private securities market has proved useful at this stage of Nigeria's development both because it provides an incentive for foreign investment by reducing the foreign investor's capital commitment and because it provides an effective way to nigerianize the capital structure of new and existing firms." (Gustafson, *ibid.*, p. 187).

and 1,000 in a whole year); another striking feature is the overwhelming share of government stock in the total value of turnover. The setback in 1967 must have been due to the civil war. Some twenty companies are quoted, and while this represents so many steps in the right direction, it is clearly not enough to generate business on a continuing basis.

In Kenya the capital market expanded in very different conditions. The initiative came, in the nineteen fifties, from the private sector, which, admittedly, coincided with the large expatriate community of European or Asian origin¹. These people had the technical skill to run an organized market, and put into it the money they earned in industrial and farm production.

The Nairobi stock exchange itself was set up in 1954, without premises of its own; instead, dealings were arranged in the offices of the six authorized stockbrokers. The system is still the same, though now there is talk of putting up a building soon for the stock exchange. At first once a week, and now every day, the brokers publish a list of deals and prices. The biggest operators are insurance companies, investment trusts and other institutional investors, though individual investors also make their appearance. There are no records of turnover, as at other stock exchanges, but there is reason to believe that the figures are fairly low.

It is rather interesting to look at the composition of securities quoted on the Nairobi stock exchange. At the end of 1968 there were altogether 160 items, of which more than 60 were government stocks of Kenya, Tanzania, Uganda and the East African Community;

¹ See Edward A. Arowolo, *ibid.*, and E.J. Pauw, "Banking in East Africa", *op. cit.*, p. 231-33. Furthermore, the official yearbook of the Nairobi stock exchange publishes the balance sheets of quoted companies as well as other information on listed securities.

but now this attempt at channelling dealings in the public securities of a whole region through one stock market is feeling the ill effects of nationalism especially in Uganda and Tanzania. The remaining 100 items in 1968 were ordinary and preference shares, as well as some loan issues, all of private companies — which bears witness to the development of the private sector in Kenya and to the role of Kenyan entrepreneurs.

The latest of the four stock exchanges to be set up is that of Tunisia¹. It was established by law on 28 February 1969, and opened its doors for business in May 1970. Unlike most other stock exchanges, the Tunis one concerns itself not only with regular dealings in quoted securities, but also with all security transactions anywhere in the country, which have to be notified to it for ratification. The idea is to protect sellers and buyers against abusive speculation.

Prices are made twice a week by the ten authorized brokers, all of them Tunisian banks and finance companies. The twenty or so shares listed are representative of different sectors of production. The number of transactions is remarkably high in comparison with the other stock exchanges discussed, as can be seen from Table 9. In addition, there is a big equity turnover on the unofficial market, involving shares to be officially listed at a later date.

To sum up this brief survey of organized capital markets, it is clear that a country needs to be financially rather advanced before it can set up a real stock exchange. Even where this has been done, the scale of operations is small, as is evident in the low number of listed stocks, transactions and operators. None the less the future

¹ See J. Noireau, "La Bourse de Tunis", BCEAO, *Note d'information et statistiques*, July 1972, p. 14, and Paolo Mottura, *The Banking System of Tunisia, 1956-1970*, *op. cit.*, p. 200-202.

TABLE 9

TRANSACTIONS AT THE TUNIS STOCK EXCHANGE, MAY 1970 TO MARCH 1972

Transactions	Officially quoted securities				Unquoted securities subject to notification				Grand total
	state	bonds	shares	total	state	bonds	shares	total	
	May to December 1970								
Value (dinars)	438,678	14,539	62,417	515,634	389	6,244	310,602	317,235	832,869
Number	52,828	3,000	7,202	63,030	17	1,108	44,910	46,035	109,065
	Year 1971								
Value (dinars)	747,009	31,328	213,605	991,942	27,509	8,304	1,884,547	1,920,360	2,912,302
Number	59,049	6,814	27,734	93,597	434	395	264,375	265,204	358,801
	First quarter of 1972								
Value (dinars)	182,771	884	151,045	334,700	3,496	3,376	234,827	241,699	576,399
Number	21,322	170	18,069	39,561	87	232	27,499	27,818	67,379

Source: J. Noireau, "La Bourse de Tunis", BCEAO, *Note d'information et statistiques*, July 1972, p. 9.

development of African economies has much to gain from the consolidation of at least some modern financial circuits. Even if today only a fraction of disposable funds finds its way to the stock exchange, its very existence is bound, in time, to attract more and more demand and supply to a common meeting place. It is up to the competent authorities, including especially the central bank, to support the market by appropriate intervention, and above all to keep a close watch over it so as to prevent the stock exchange from becoming the playground of dangerous speculative manoeuvring on the part of certain groups — an occurrence not unknown in other parts of the world.

6.6 INFLATION AND DEVELOPMENT

In developing countries, then, the central bank has a leadership role to play in the mobilization of domestic savings and in the enlargement of capital markets. One of the essential conditions for the success of these endeavours is relative monetary stability, because of its beneficial effects both on saving and on the allocation of investment.

Inflation is a big subject, and just now a very topical one both in industrial and in developing countries. In an attempt to limit the discussion to the immediate concerns of this book, we have to consider at least two questions:

- (a) What is Africa's experience with inflation?
- (b) Has inflation in Africa been involuntary or deliberate?

The answer to the first question is that, barring a few particular and short-lived cases, Africa has never known inflation on the scale of Latin America and some Asian countries. Figures for the rise of the consumer price index in selected countries over the

TABLE 10

INDEX OF CONSUMER PRICES IN SELECTED AFRICAN COUNTRIES, 1964 TO 1970 (1963 = 100)

Country	1964	1965	1966	1967	1968	1969	1970	Increase 1963-1970	Average annual increase
Egypt	103.7	119.2	129.8	130.7	135.8	140.4	145.8	45.8	7.0
Cameroon	105.6	107.8	110.3	114.1	116.5	118.1	121.4	21.4	2.6
Central African Republic	110.0	120.4	120.4	123.7	132.2	132.2	—	32.2	4.4
Chad	107.7	114.4	121.3	125.2	126.5	131.1	142.3	42.3	5.8
Gabon	103.0	105.7	109.8	112.1	114.4	117.5	122.0	22.0	2.8
Ethiopia	—	—	126.8	127.8	128.0	129.8	143.0	43.0	4.1
Ghana	112.2	140.8	148.0	139.3	153.2	160.5	166.5	66.5	9.1
Kenya	99.9	103.5	108.6	111.1	111.9	110.8	113.2	13.2	2.2
Libya ¹	103.9	109.9	118.9	123.1	128.4	138.6	141.0	41.0	6.2
Madagascar	100.8	105.2	108.4	109.3	110.3	114.5	117.8	17.8	2.8
Morocco	104.0	107.6	106.5	105.7	106.1	109.3	110.7	10.7	1.1
Nigeria	101.1	105.1	115.2	110.9	113.0	121.5	138.3	38.3	6.2
Sierra Leone	111.5	116.6	121.7	127.6	129.3	133.7	143.8	43.8	5.4
Somalia	113.1	127.7	123.6	123.2	127.4	135.7	136.3	36.3	3.9
Sudan	103.9	101.4	103.2	114.4	103.0	116.0	—	16.0	2.4
Tanzania	102.0	108.0	113.0	116.0	120.0	122.0	125.0	25.0	3.8
Tunisia	104.2	111.1	115.5	118.8	121.7	126.7	128.1	28.1	4.0
Uganda	109.0	127.0	122.0	128.0	124.0	139.0	152.0	52.0	7.2
Ivory Coast	101.3	102.7	108.4	110.9	116.7	122.0	133.5	33.5	5.4
Senegal	104.0	106.0	109.0	108.0	109.0	113.0	116.0	16.0	2.0
Upper Volta	101.8	101.2	103.5	99.0	98.9	108.3	110.2	10.2	1.4
Zambia	103.2	111.1	122.9	129.0	143.0	146.5	150.5	50.5	7.9

¹ 1964 = 100.

Source: IMF.

period 1964 to 1970¹ are shown in Table 10; in no case is the annual average increase even as high as 10 per cent.

There are several reasons for this, and they will become apparent presently. But one of them, which is common to many African countries, can be picked out at once: adherence to a currency area. It meets the eye that the biggest monetary disturbances occurred in those countries which, in the course of the last ten or fifteen years, obtained complete monetary autonomy along with political independence (e.g. Zaire and Ghana). By contrast, belonging to the sterling area or the franc zone (not to speak of the Portuguese escudo) imposed upon the former colonies a strict discipline in financial, foreign exchange and budgetary policy. There simply was not too much room for uncontrolled money creation. This was good for stability, but it meant interference in the new sovereign states' internal affairs, a veiled perpetuation of the evils of colonial domination².

¹ Regarding the imperfection of price indices as a measure of inflation, Joseph O. Adekunle ("Rates of Inflation in Industrial, Other Developed, and Less Developed Countries, 1949-65", *IMF Staff Papers*, November 1968, p. 531) rightly points out that "... the existence or absence of inflationary pressures is not, of course, necessarily indicated by marked upward movements of price indices, such as the cost-of-living index. Reserve and exchange rate changes may absorb some of the inflationary pressures in some countries during particular periods. Also, price movements may be repressed in different degrees in different countries at different times. Therefore, price changes alone may not indicate fully the degree of inflationary pressure. Nevertheless, relative price increases provide at least an a priori indication of whether inflationary pressures have been more prevalent in one group of countries than another."

For purposes of his analysis, the author classifies annual increases in the price index as follows:

- up to 2 per cent: relative price stability;
- 2 to 5 per cent: mild inflation;
- 5 to 10 per cent: moderate inflation;
- more than 10 per cent: strong inflation.

² For inflation in Zaire (then Congo Kinshasa) between 1960 and 1969, full documentation and a most careful analysis will be founded in B. Ryelandt, *L'inflation*

So much for the extent of inflation in Africa generally. Rather more needs to be said about the second question, whether such inflation as did occur in African countries was deliberate or not. Or, to spell the question out more fully: were the inflationary pressures which African countries experienced in some way exogenous to government intentions, or were they the result of definite economic policies? The distinction, of course, is much neater in theory than in practice, but it certainly does seem that both types occurred. Involuntary inflation may be due to profound internal change — when it is sometimes called mutational — or it may be imported; deliberate inflation, via deficit financing, is one aspect of the much-debated question of the relationship between inflation and growth. In the following discussion of different types of inflation, as classified above, specific reference will be made to Africa and to implications for central banking.

“Mutational inflation” is a latent kind of inflation which occurs in countries launched on a process of development. It is

en pays sous-développés, Paris 1970. In all post-independence Africa, Zaire suffered the most violent inflation, and Ryelandt's book is, to my knowledge, the most detailed account of it.

Towards the end (p. 418-19) the author traces the relations between inflation, monetary independence and colonial domination: “Le Congo indépendant a été un cas particulier et extrême en Afrique (encore que la situation de la Guinée offre des similitudes avec la sienne), en ce sens que les bouleversements liés avec l'accession à la souveraineté y ont été plus profonds et plus brutaux qu'ils ne l'ont été dans la plupart des autres pays et qu'ils se sont accompagnés de virulentes pressions inflatoires.

Si le phénomène congolais a pris un caractère presque caricatural, c'est en raison des circonstances d'une décolonisation mal préparée et manquée, en raison de ses grandes dimensions et de son importance internationale en Afrique. Si par contre d'autres pays africains, qui ont connu des transferts de revenus rappelant ce qui s'est passé au Congo, n'ont pas subis les mêmes poussées inflatoires, ni les mêmes désordres, c'est bien souvent parce qu'y ont survécu certaines formes de présence coloniale, dont la persistance place ces pays à l'autre extrême des possibilités d'évolution.”

associated with the historical transition of society and more particularly of the economic system from an archaic, almost wholly closed, model to a modern model based on industrialization and exchange¹. Inflationary pressures originate simultaneously in the profound regional and sectoral disparities arising from the spread of the development process and from economic and social structural transformation. As the wage and money economy gains ground in a rural sector still largely based on subsistence farming, regional inflations occur. In the more advanced centres and in areas directly affected by a development pole, the prices of goods begin to rise in a disorderly and convulsive fashion, without any relation to the cost system. As the development process spreads, all these partial inflations multiply and merge.

According to the interpretation of the structuralist school, of which more below, these inflationary pressures are rooted in the sharpening contrast between the demand for goods and their supply, at sectorial and at regional level. With more sophisticated ways of life, people's needs diversify and intensify under the impact of the demonstration effect, which is especially active in African countries. But expansion of demand soon encounters the barrier of shortage of disposable resources, aggravated by the low price elasticity of supply. This rigidity derives from deficient sectoral

¹ "Inflation in developing countries is what the French call *un phénomène de mutation*, a phenomenon of change, and of a kind of change not easily comparable with the slow structural transformation that has taken place in past centuries in the economy of now mature countries. Long-term self-sustained growth is one thing, the spurt of a developing economy another, and the two processes cannot be viewed in the same terms. In the one case there is a gradual development of resources preceded by capital accumulation and the accomplishment of civilization, in the other development is imposed without the prior existence of indispensable prerequisites." (Marialuisa Manfredini, "L'inflazione nei diversi gradi di sviluppo economico", *Rivista Internazionale di Scienze Economiche e Commerciali*, January 1972, p. 48).

and geographical mobility of goods and factors of production, in virtually permanent conditions of full employment of capital and skilled labour and almost complete lack of the organizational and technical capacity necessary for any development process involving rapid industrialization and rationalization of agriculture.

This kind of inflation, therefore, is cognate with the development process itself, and to some degree is present in all developing economies. Much the same can be said of the other type of involuntary inflation, imported inflation. All African economies are open — some more and some less so — and depend heavily on the rest of the world from the commercial, financial and monetary point of view. We shall look first at the external constraints on national development policies, leaving the effects of domestic inflation on the balance of payments to be discussed later. Once again, the distinction is not at all watertight, since obviously there is interaction between the two sets of effects.

In the world at large, the overwhelming majority of African countries, and of developing countries generally, have very little influence on international trade and financial flows. If inflationary pressures arise in the rest of the world (meaning in the first place the Western industrial nations), these invariably are transmitted to the smaller countries, owing to the system of fixed exchange rates and more or less free trade, which sooner or later lead to a natural levelling of prices¹. It is common knowledge that this has happened

¹ See Bent Hansen, *Inflation Problems in Small Countries*, Cairo, National Bank of Egypt, 1960, p. 15.

As Roberto Ruozzi (*Gli effetti dell'inflazione sulla gestione delle aziende di credito*, Paper contributed to a Round Table on the effects of inflation on banking, Parma, May 1974, p. 27) astutely points out: "At international level, too, one might therefore apply Aujac's thesis on the behaviour of social groups. It is evident that if, at national level, inflation eventually damages the social groups which have least power, at international level those it hurts most are the developing

in consequence of the excessive permissiveness of the Bretton Woods system in allowing surpluses and deficits to accumulate, of the faster pace of price increases in the leading reserve currency country (the United States) from the middle sixties on and also in other countries (France and the United Kingdom) whose currencies serve as a standard for African ones, and finally of the boundless expansion of international liquidity (mostly US dollars) in the last few years¹.

All this has worked in the direction of propagating inflationary pressures from one country to another, including Africa, where they were superimposed on those already pushing up prices domestically. This can be taken as a general description of the inflationary climate generated by the imperfect working of the international monetary system, quite apart from various other pressures and distortions.

Within this overall picture, a distinction needs to be made between surplus countries and deficit countries. The former are in a minority in Africa; they owe their external surplus to the export of one major commodity, e.g. Libyan oil and Zambian copper.

countries, whose already dramatic internal problems are further aggravated." (The work to which Ruozi refers is Henri Aujac's, "Une hypothèse de travail: L'inflation, conséquence monétaire du comportement des groupes sociaux", *Economie Appliquée*, April/June 1950; English translation by A.C.L. Day, "Inflation as the Monetary Consequence of the Behaviour of Social Groups: A Working Hypothesis", *International Economic Papers*, No. 4, London, Macmillan, 1954).

¹ The subject of the relationship between inflation and the international monetary system is vast, but only indirectly relevant to the argument in the text. The literature, too, is vast; as a useful selection, reference is made to the following: Otmar Emminger, "L'inflazione e il sistema monetario internazionale", *Bancaria*, October 1973; S.I. Katz, "Imported Inflation and the Balance of Payments", New York University, 1973; Harry G. Johnson, "Secular Inflation and the International Monetary System", *The Journal of Money, Credit and Banking*, February 1973; Sergio Bortolani, *L'inflazione e l'attività bancaria internazionale*, Paper contributed to a Round Table on the effects of inflation on banking, Parma, May 1974.

The main effect here is an automatic expansion of domestic liquidity via the conversion of foreign-exchange export receipts into national currency through the central bank (which, however, can wholly or partly neutralize this extra liquidity or withdraw it from circulation by other means)¹. Secondly, uncontrollable fluctuations in foreign exchange earnings due to variations in international demand for the commodities concerned, caused instability and difficulties in the conduct of the economy, and the resulting succession of inflationary and deflationary pressures was harmful for development. Finally, capacity to import without foreign-exchange constraints was unable, by itself, to absorb excess domestic demand, because bottlenecks delayed foreign supplies and thus unleashed further pressures on prices already being pushed up by other forces².

But the more frequent case in Africa is a deficit in external payments. This, too, transmits foreign inflationary pressures via the price mechanism. However, the effect on domestic liquidity works in the opposite way, in so far as local currency accrues to the central bank for conversion into foreign exchange. Shortage

¹ This is not always possible. In Libya, for instance, monetary policy was unable to combat inflation because foreign exchange earnings were the main channel of monetary base creation and the central bank had to convert into Libyan pounds all the foreign exchange inflows approved by the government. See A.R. Bengur, "Financial Aspects of Libya's Oil Economy", *IBRD-IMF Finance and Development*, March 1967.

² This happened in Zambia, a case described in C. Harvey, "The Control of Inflation in a Very Open Economy: Zambia 1964-69", *Eastern Africa Economic Review*, June 1971. With soaring copper prices it was reasonable to look forward to "development with unlimited supplies of capital". But some obstacles got in the way, including the diversion of transports (so as to avoid passing through Rhodesia and South Africa, for political reasons), the shortage of real capital within the economy, and personnel and organizational deficiencies in the public administration. On top of all that a rise in miners' wages pushed up wages generally.

of foreign exchange is the barrier against which domestic monetary demand comes up, under the added impact sometimes of deliberate expansionary policy. We shall presently return to this formidable constraint on any strategy for accelerated development. For the moment it still needs to be mentioned that the financing of African deficits by aid (grants, but mainly loans) from the rest of the world did indeed bring immediate relief to the balance of payments, but in the long run aggravated foreign dependence as African countries accepted increased interference in their domestic affairs in exchange for the possibility of diminishing the pressure of domestic demand on foreign supply. This has enabled many governments to give free rein to the consumption demand (not all for goods of primary necessity) of the population, especially in towns, and has thus helped them to stay in power.

The final point to mention in connection with imported inflation is the effect of the recent oil crisis on African countries. This is bound to have lasting consequences on developing no less than on industrial economies¹. The oil situation certainly opens up new prospects, directly for those countries which possess oil, and indirectly through the lesson it holds for other primary producers of vital agricultural and mining commodities. The immediate lesson is that a trial of strength or, one might say, the use of blackmail, can achieve concrete results vainly pursued in the past through negotiations at UNCTAD, GATT and elsewhere. In the last ten to fifteen years the Third World has given proof of maturity and reasonable unity in formulating its demands regarding foreign trade ("trade not aid" is the current philosophy), but it has had the bitter experience of seeing the industrial nations concede only

¹ Sergio Bortolani, "Inflazione e riflessi monetari internazionali della crisi petrolifera", *Economia Pubblica*, July 1974 (offprint).

crumbs by way of negotiation, leaving the basic imbalance all but unaltered.

To this extent the oil crisis may have had a salutary psychological effect. But the question remains what net benefit can be expected from a sudden rise in the terms of trade for primary producers. Politically speaking, their bargaining power is certainly enhanced. But commercially speaking the initial improvement is bound, sooner or later, to be followed by a readjustment of the prices of all imports until a new equilibrium point is reached, which will be higher in monetary terms but probably not far displaced in real terms.

Developing countries which produce neither oil nor any other commodities likely to become suddenly scarce are in a much worse position, and they include the majority of African countries. They cannot — or at least not fully — compensate the rise in the cost of oil imports by an adequate increase in the price of their export products (especially if these happen to be agricultural commodities), first of all because there is usually no demand for these products in Arab countries, and secondly because the industrial nations which normally use these commodities try to protect their domestic producers and/or to organize substitution.

The oil deficit hits developing and industrial countries alike, but unlike the latter, the former have no chance of re-equilibrating their trade balance in the medium run; on the contrary, the gap is bound to widen as the prices of imported manufactures and capital goods rise in their turn. That leaves only one place to look for a solution, namely, the other section of the balance of payments: capital movements. But is it at all likely that African countries will be able to finance their trade deficit by borrowing on international capital markets? The intuitive answer is No, and for

at least two reasons: African countries already have huge external debts, and (barring exceptions) they do not have the same credit standing which enables industrial nations to raise foreign loans.

It is by no means to be excluded *a priori* that these countries will remain in deficit, that they may have to reduce their standard of living even further and see their painfully initiated development compromised; but one would like to think that this will not happen. The question then is how to fund the debts these countries are incurring¹. Basically, the present imbalance can be righted only by export receipts; but some readjustment can be expected in the long run through investment by multinational companies, through transfers from Arab oil producers, and through special drawing rights (if any).

But what is the price for this possible readjustment? The price is that economic development, though possibly fast, will more than ever depend on foreign influences, and the African nations' position of inferiority will be perpetuated. A policy of self-reliance and the painstaking labour of gradually acquiring technology and learning bring less spectacular immediate results, but provide a much more solid foundation for lasting and less unbalanced growth.

Other aspects of external constraints on African economies will be discussed later. In the meantime we have to consider the type of inflation which is an expression of deliberate policies to speed up economic development by monetary means². Can inflation foster economic development? And if so, up to what point?

¹ The short-term problem could be solved, for developing and industrial countries alike, by putting into effect a proposal now under study by the IMF, whereby the IMF itself would provide additional credit facilities to countries in difficulties because of the higher price of oil.

² Among general works on the subject, reference is made to: E.M. Bernstein and I.G. Patel, "Inflation in Relation to Economic Development", *IMF Staff*

For a long time the answers to these questions were all answers of theory and controversial at that, because representatives of various schools (monetarists, structuralists, sociologists) built different interpretative models which naturally led them to different conclusions.

More recently, some empirical comparative research has been done, and this provides a much better frame of reference for our subsequent analysis. In 1959, U Tun Wai¹ found no systematic relation in his investigation of a sample of 31 underdeveloped countries. A year later, Bhatia² studied long-period data for 5 industrial nations and arrived at the same result. A much fuller study was made by Dorrance³, who covered some 50 countries, industrialized and otherwise, and measured development in terms of *per caput* income. His results suggest that there is something to be said for mild inflation, though they are not conclusive⁴.

Papers, November 1952; Henry J. Bruton, *Inflation in a Growing Economy*, Bombay University Press, 1961; Graeme S. Dorrance, "The Effect of Inflation on Economic Development", *IMF Staff Papers*, March 1963.

¹ U Tun Wai, "The Relation between Inflation and Economic Development: A Statistical Inductive Study", *IMF Staff Papers*, October 1959.

² Rattan J. Bhatia, "Inflation, Deflation and Economic Development", *IMF Staff Papers*, November 1960.

³ Graeme S. Dorrance, "Inflation and Growth: The Statistical Evidence", *IMF Staff Papers*, March 1966.

⁴ "It is possible to conclude from these data that the rate of inflation may influence progress. Declining prices or unduly low price increases appear to be associated with low rates of growth. Relatively slowly rising prices — particularly in the wealthier countries — may have a stimulating effect. However, if the rate of inflation exceeds a certain (unspecified) rate, rising prices discourage economic development, and rapid inflation seriously inhibits growth. On the basis of these data, it is not possible to conclude that the rate of price change will determine the rate of economic growth." (Dorrance, *ibid.*, p. 94).

Adekunle¹ adds that during the period he surveyed, the years 1949 to 1965, the rate of inflation was generally lower in the less developed countries (except for six in Latin America) than in others. More recently, Thirlwall and Barton² compared the data for 51 countries, taking real development without corrections for population movements, and classifying countries according to their level of development and rate of inflation. They found: (a) for countries with relatively high productivity (*per caput* income in excess of 800 dollars in 1963), a positive correlation between inflation and development; (b) for countries with moderate inflation (price increases between 3 and 10 per cent annually) investment of a larger share of GNP than in countries with stable prices; (c) for countries which experienced inflation of more than 10 per cent annually, harmful effects on development, investment and the balance of payments.

The empirical data at hand create a strong presumption, though they do not quite prove, that "some moderate degree of inflation is inevitably associated with any development policy designed effectively to mobilize economic resources for purposes of expansion; but any policy which deliberately chooses to create development by inflation, generally ends up by slowing down rather than speeding up development"³. It is clearly a question of degree. Beyond a certain point (which is not the same in all countries), deliberate inflation, in interaction with involuntary inflation, produces adverse effects.

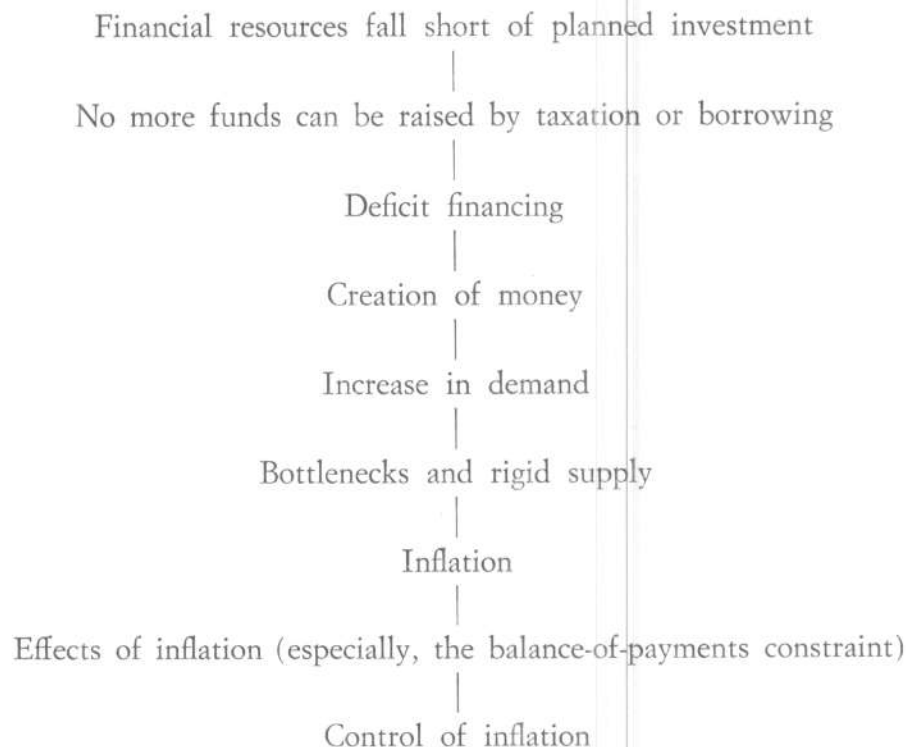
¹ Joseph O. Adekunle, "Rates of Inflation in Industrial, Other Developed, and Less Developed Countries, 1949-65", *op. cit.*, p. 550.

² A.P. Thirlwall and C.A. Barton, "Inflazione e sviluppo: raffronti internazionali", *Moneta e Credito*, December 1971.

³ Ruozi, *ibid.*, p. 29.

For purposes of further analysis, consider the following diagram.

INFLATION AND DEVELOPMENT: DEFICIT FINANCING



(1) *Financial resources fall short of planned investment.* Let us begin at the beginning. Planning sets targets for future years, and specifies by what investment projects they are to be achieved. Part of them is left to be financed by the private sector, and part — much the larger, in developing countries — falls to the public sector. Normally, investment requirements exceed disposable financial resources.

(2) *No more funds can be raised by taxation or borrowing.*

This financial gap is in the first place, and to the extent possible, bridged by taxation and borrowing. Both sources, as we have seen, are drawn on systematically by African governments. But taxation cannot (and is not intended to) go beyond breaking point lest the population react in unpredictable ways, and that is why governments often resort to the general withdrawal of resources from the public by inflation¹.

Borrowing, in its turn, encounters an internal limit in the structure of personal and corporate incomes, and in the consequent difficulty of selling government stock to the public. External borrowing is acceptable to the extent that it has no unduly burdensome strings attached to it, but in any case only if it can be repaid. Otherwise the financial, and hence also the political and social, imbalances forestalled by accelerated development are simply put off until later.

¹ Two African examples may be cited. R.W. Norris, "On Inflation in Ghana", in J. Farer, ed., *Financing African Development*, *op. cit.* p. 103, states that "...monetary policy in Ghana is being called on to fill an essentially fiscal-policy role. When taxation is not adequate to balance government revenue and expenditure, money is being created to fill the gap. Because of the desire of the government, particularly at the outset of the ambitious Ghanaian Seven-Year Development Plan, to stimulate economic activity through government expenditure, it appears unlikely that the gap will shrink. Therefore, a rapidly increasing money supply appears to be assured for Ghana over at least the next few years."

In Zaire, then Congo Kinshasa, the disturbances following the declaration of independence (1960) led the governing class to launch a policy of raising wages and subsidies in an attempt to gain the support of certain pressure groups. This, together with the cost of the war, caused public expenditure to soar, while the breakdown in public administration compromised the orderly collection of taxes, which in any case were much reduced by the secession of Katanga and South Kasai. So a huge amount of paper money was printed. See M. Isralson, "Les finances publiques congolaises et l'inflation", *Revue de la Banque*, 1965.

(3) *Deficit financing.* If the government spends more than its revenue, the resulting budget deficit has to be financed somehow. This is what is meant by deficit financing, though the term is variously defined¹.

(4) *Creation of money.* It should be made clear at the outset that in developing countries the money supply can increase without inflationary effects provided that:

- (a) the increase is connected with a rise of national income in real terms and satisfies a rising transactions demand for money;
- (b) it goes into hitherto still unmonetized sectors;
- (c) it is hoarded, as frequently happens (though in this case there is a potential inflationary danger at the moment when the hoarded money gets back into circulation).

Furthermore, the low credit multiplier may induce the central bank to be rather generous in issuing bank notes, since it knows that secondary expansion will be slight.

This being said, we can return to the ways open to government for financing its deficit. There are three of them: recourse to the private sector (domestic and foreign), recourse to the banking system, and recourse to the central bank.

Access to the public's resources has already been mentioned. It should be added, though, that the incidence on prices in that case depends on the income effects of public investment compared with

¹ See, e.g., Hans W. Singer, "Deficit Financing of Public Capital Formation, with Special Reference to the Inflationary Process in Underdeveloped Countries", in: A.N. Agarwala and S.P. Singh, eds., *Accelerating Investment in Developing Economies*, *op. cit.*; W.H. White, "Measuring the Inflationary Significance of a Government Budget", *IMF Staff Papers*, April 1951; S. Mittra, *A New Horizon in Central Banking*, London 1967, p. 147-63.

those of alternative private investment¹. Government borrowing from the banking system does not increase the money supply so long as the sums concerned replace private sector borrowing. If on the other hand, as often happens, the banks have excess reserves and use them to buy government stock (which can then be placed with the central bank as collateral for advances), expansionary effects will ensue. Finally, direct recourse to the central bank implies ever new creation of money and a high inflation potential. The last-named method is the one most often and most largely used by governments deliberately aiming at financing development by inflation².

(5) *Increase in demand.* Public expenditure creates additional demand, which activates the Keynesian investment multiplier only to some limited extent, given the lack of plant and hence of unused capacity. So there is an excess of demand which cannot immediately be satisfied and this pushes up prices; however, this price rise should stop or at least diminish later, as and when the supply of goods and services increases thanks to output increments made possible by the new investment.

The monetarist school attributes the chief responsibility for the inflationary process to the monetary authorities, in so far as they allow development programmes to be financed by an expansion of the money supply. This view has its main proponents among

¹ Conceptually speaking, Mittra (*ibid.*, p. 155) explains that "if government investment is in the nature of social overhead capital, and private investment is aimed at increasing the future production of consumer goods, an increase in effective demand resulting from the money income generated by public expenditure without a corresponding increase in consumer goods will constitute a significant factor in generating inflation in the economy."

² See N. Ahmad, *Deficit Financing, Inflation and Capital Formation: The Ghanaian Experience 1960-65*, *op. cit.*, p. 25-46, and John H. Adler, "Fiscal Policy in a Developing Country", in: Kenneth Berrill, ed., *Economic Development with Special Reference to East Asia*, London 1964, p. 308-11.

central bankers and in the International Monetary Fund; it interprets inflation in developing countries as an overall monetary imbalance, which finds expression in a tendential excess of aggregate demand in relation to the volume of disposable resources.

It is worth mentioning also the view of the so-called sociological school, if only because of how well it fits at least one African case, to be described presently. This school places the accent on the behaviour of social groups in response to income distribution. Different social groups use their power and bargaining strength to obtain a growing share of total income, or at least to defend their existing share. They do this by a series of actions and reactions, and it is these which cause or at least give a decisive impulse to the inflationary process, which thus comes to owe more to cost-push (via wage claims) than to demand-pull.

What happened in Zaire in the troubled post-independence period until the stabilization of 1967 seems to be a typical case of demand inflation, reinforced by the social component mentioned above. The new government, free of all monetary links with Belgium, undertook a large-scale redistribution of incomes to the benefit of African nationals, and first and foremost those directly or indirectly dependent on the public administration. Action by this pressure group and by others as well led the government to satisfy them all by printing more money ¹.

¹ Ryelandt (*op. cit.*, p. 237) comes to the following conclusion about the origin of inflation in the former Congo Kinshasa: "...dans la mesure où elle déplaçait de façon plus ou moins consciente les revenus, elle a été le reflet de l'évolution politique, de la décolonisation, qu'elle a matérialisée sur le plan du niveau de vie personnel. Mais il faut bien reconnaître en même temps qu'elle a été largement le résultat et l'expression d'un chaos structurel, d'une absence de finalité unique ou cohérente dans la société congolaise. Loin de représenter une tendance, fût-elle maladroite, vers la réalisation de buts économiques, elle a découlé des conflits anarchiques des groupes sociaux et de l'effondrement d'une organisation économique."

(6) *Bottlenecks and rigid supply.* The investment multiplier, as we have seen, works only to a limited extent in developing countries, because of certain deficiencies in the structure of supply. Bottlenecks in the underlying economic structure and the rigidity of real supply are indeed, in the view of the structuralist school, the deepest root of inflation¹. Although most of the work of structuralists refers to conditions in Latin America, it is more widely applicable; the main point is that the analysis shifts from the global to the sectoral level in an attempt to identify the underlying deficiencies in each case: bottlenecks in agriculture, instability of exports, fluctuations in demand, shortage of foreign exchange, distortions in industrial production, urbanization. By thus outlining zones of stress, the structural approach makes a valuable contribution to our knowledge of the mechanisms which propagate and contain the inflationary process, and helps us to assess its incidence on production, accumulation and consumption².

Structural elements are certainly not as virulently active in Africa as in Latin America, or rather, they are not solely responsible

¹ Both the monetarist and the structuralist school have a good many adherents. Without mentioning any names here, given that the brevity of the exposition in the text hardly warrants it, the reader is referred to the bibliography reproduced in Elias Gannagé, *op. cit.*, p. 214-16, and L. Gangemi, "Lineamenti di politica della moneta, del credito, della banca e delle assicurazioni nei paesi in via di sviluppo", in: *Scritti in onore di Giordano Dell'Amore*, Milan 1969, p. 1116.

As Ruozzi (*ibid.*, p. 14-15) points out, the "structuralist" interpretation of inflation in developing countries must not be confused with the "structural aspects" of world inflation, such as they are described by the author on p. 15-20, where he takes up and recasts the theories of a number of other economists.

² However, the econometric comparison presented by Victor Argy, "Structural Inflation in Developing Countries", *Oxford Economic Papers*, March 1970, would seem to divest structural elements of any relevance in the explanation of the different rates of inflation in the 22 countries under consideration.

for the milder forms of inflation in Africa, but they do play some part. They are one facet of the phenomenon, the other being the deliberate injection of excess money into the economic system¹.

(7) *Inflation*. The sequence set in motion by deficit financing, having traversed the stages briefly summarized above, leads up to inflation. Inflation, therefore, inevitably occurs when a development process is launched, though it is not a necessary condition of it². The problem then is to know the "critical" rate of inflation, so as to be able to judge whether the effects of inflation are, on the whole, good or bad. Haberler puts the figure at 10 per cent, but it really needs to be determined separately for each country in the light of its degree of development and special characteristics. Thirlwall and Barton found in their empirical study³ that the effects of inflation are the less pronounced and predictable the more a country is poor (and many African countries come very low down the list, both in absolute terms and in international comparisons). This correlation may be due to two main reasons: (a) the capacity of inflation to pinpoint bottleneck situations, and (b) the likelihood that in poor countries development depends

¹ Again with reference to Zaire, see Ryelandt, *op. cit.*, p. 235-36, and P. Nbagui, *L'inflation dans les pays en voie de développement*, Société Royale d'Economie Politique de Belgique, December 1972, p. 34.

² As Manfredini (*op. cit.*, p. 69) points out, "...inflation is inevitable only because the development process has been started exogenously and is accelerated artificially. If it were necessary, then it would have occurred likewise in the slow economic evolution which in the now mature economies led to expansion via the accumulation of productive resources in the course of the natural transition from primary activities to secondary and tertiary ones."

Much the same views are expressed, also with reference to underdeveloped countries, by Sir Sydney Caine, "La funzione della politica monetaria nei paesi sottosviluppati", *Bancaria*, July 1961.

³ *op. cit.*, p. 426-27.

less on investment in capital goods and more on a reorganization of factors of production and on efficiency gains.

(8) *Effects of inflation.* Empirical research, then, has shown that "strong" inflation is decidedly harmful for development. When a government goes in for deficit financing, it knows what adverse effects follow from vigorous inflation. Even the advocates of deficit financing recommend a "moderate" rate of price increase, but only too often this gets out of control and gathers pace as time goes on. This certainly is the biggest risk in using inflation as a weapon for accelerating development.

The three worst consequences of rapid inflation are that

- (a) the structure of relative prices deviates from the desired pattern, so that the authorities have to intervene and keep down some basic prices, for reasons of social policy; but thereby they inhibit growth in the sectors concerned and eventually the distribution of resources undergoes serious distortions;
- (b) voluntary saving is discouraged and, consequently, there are incentives for the unproductive use of resources in the form of hoarding, speculative stock-building, the purchase of foreign assets and real estate;
- (c) the pressure of consumption demand not matched by a corresponding real increase in supply because of the bottlenecks and rigidities mentioned, falls instead on the balance of payments, whose position deteriorates in more than one respect.

First of all imports rise, provided of course there are enough foreign exchange reserves. Barring the exceptional African countries with an ample surplus in their external payments¹, all others have

¹ Where foreign exchange reserves may mitigate domestic inflationary pressures.

to reckon with the balance-of-payments constraint even at times of natural, unforced development, so that any additional pressure generated by deliberate inflationary policies aggravates the situation even in the short run¹. Exchange control, import restrictions of various kinds, devaluation of the national currency, import substitution by local production (after some time) — all these are ways by which the authorities try to alleviate the impact of domestic inflation on the balance of payments.

Exports, too, suffer, especially if they happen to be new. Uncertainty about exchange rates is superimposed upon uncertainty about domestic prices, the local currency is usually overvalued for some time before the central bank decides to alter the exchange rate, and in any case it is more profitable to divert a larger part of the output to the domestic market where monetary demand is strong. If rapid inflation goes on for any length of time, furthermore, it has adverse effects on the structure of investment and makes it hard for exporters to replace obsolete plant and machinery².

¹ The crucial part played by the balance of payments in Ghana's inflation is highlighted by N. Ahmad, *op. cit.*, who concludes (p. 123): "The resort to deficit financing therefore generally necessitates both quantitative restrictions on consumer goods imports and exchange control. Admittedly these corrective measures, combined with increased tariffs and other tax restraints, can be helpful in both relieving the pressure on the balance of payments and allocating a greater share of available foreign exchange resources for investment. It must be emphasized, however, that in view of the structural characteristics of a developing country, it is not easy to suppress the demand for imported consumer goods beyond a certain limit.

In Ghana the efficacy of the restrictive measures was circumvented partly by the overriding need for imported food and partly by the failure of the government to restrain its own consumption."

And indeed, we might add, all the world knows what formidable difficulties that country had to contend with in the early seventies.

² On this point, see Gertrud Lovasy, "Inflation and Exports in Primary Producing Countries", *IMF Staff Papers*, March 1962.

Lastly, there are adverse effects on capital movements, too. There is an implicit incentive for capital exports to those foreign countries where the situation is more stable and sound (exchange controls are of questionable efficacy in such cases) and a disincentive for capital inflows from the rest of the world, because of the uncertainties and risks of investment in the country concerned. It is not so easy to say *a priori*, on the other hand, what influence domestic inflation is likely to have on intergovernmental capital movements, since these are often ruled by a less than wholly economic logic.

The situation is quite different, and the judgment less harsh, when inflation is mild — provided, of course, it remains so and is kept under control by the monetary authorities. Moderate demand inflation¹ keeps resources fully employed and encourages entrepreneurs to produce up to full capacity utilization, without fear of deficient demand depressing real growth. But even then inflation can in time be absorbed only on condition that the sectors penalized by it are willing indefinitely to transfer real income to investors, that the latter (first and foremost the state) use the resources in projects of high social priority, and that foreign exchange reserves do not run out too soon².

(9) *Control of inflation.* The remedies proposed for combating, or at least containing, inflation in developing countries all display their kinship with one or the other of the two extremes, the monetarist and the structuralist school. For the first the most important thing is stabilization, to be carried out at global level

¹ See Thirlwall and Barton, *op. cit.*, p. 423.

² Hla Myint (*The Economics of Developing Countries, op. cit.*, p. 143-46) rightly draws attention to the fact that inflation cannot easily be self-destructing in developing countries.

through monetary restrictions; the second recommends removal of the system's structural deficiencies, involving especially an increase in the elasticity of supply of consumer goods. In this view, the root of the problem lies in the real factors of the economy, not the monetary ones.

In practice, corrective action on a comprehensive scale requires an attack on both, without ever forgetting the underlying truth of underdevelopment, which is that there exist no magic formulae for fast progress. The growth process is slow, laborious and dialectical. Any radical attempt to force the pace, to create domestic purchasing power out of nothing or to draw in too much capital from abroad, is bound, after an initial phase of facile success, to produce lasting ill effects, and these in turn lead to political upheavals and more external constraints.

Ever since independence, nearly all African countries have gone through a succession of attempts to set in motion a process of accelerated development, most often by the second method. After an initial period of euphoria several African nations are now giving proof of more maturity and show themselves willing to accept growth rates which, while less spectacular, are feasible predominantly by domestic means.

Mutatis mutandis, the lesson of underdevelopment is applicable also to more than one industrial country in the nineteen seventies — including Italy. There really are striking analogies. Both may well receive foreign aid from one source or another in a critical situation, but ultimately the responsibility for any country's independent development rests with its own people.

