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THE BANKING SYSTEM AND SAVINGS POLICY IN DEVELOPING COUNTRIES (*)

In trying to assess what the banking system can do in developing countries to stimulate household savings and to put them to productive use, we must first be clear about what we mean by household savings and survey the means by which attempts are made to promote them in line with the priorities of development policy. Only then can we form a reasoned judgment about the situation of any given country and about the urgency of public intervention.

1. HOUSEHOLD SAVINGS IN THE CONTEXT OF DEVELOPMENT POLICY

The most common objection to savings promotion by banks in developing countries is that average incomes per head are very low. But apart from the fact that the level of *per capita* incomes, as given by available statistics, often is not as great an obstacle to savings as is thought,¹ it is a singularly inappropriate indicator in developing countries, though it may be a good one in economically advanced ones. Reference to average income per head suggests the

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notion of margins of disposable income as a source of financial savings. But in real terms savings are ultimately the net increment in a nation's stock of capital goods; it follows that the whole problem of the introduction of financial assets and more particularly of financial investment of savings at the level of elementary units can be considered only in connection with the social will and the technical capacity to alter the structure of consumption, and with it of the production system, in the direction of progress. In practice the diffusion of financial assets and the structure of the production system are interdependent, but unlike economically advanced countries, developing countries certainly are also short of the previously mentioned social will and technical capacity.²

In fact it is not so much the level of incomes which impedes the formation of savings that can be used for development but the form of incomes and, more generally, the way in which the structure of production in underdeveloped countries is reflected in the economic processes, also at the household level.

When we talk of household saving in developing countries, we have to think of economic sectors which thrive at the margin of or outside the economically advanced ones.³ In these sectors labor specialization is all but unknown, technology is primitive, monetary trade is limited, social cohesion maximizes security of livelihood. Under such circumstances there is not much psychological inducement towards capital accumulation. Furthermore, technical opportunities for accumulation are limited, both from the point of view of saving behavior and for what concerns — often in the same context — investment in physical capital.⁴ It is important, therefore, to create economic structures which would turn saving into a functional behavior also within family units. Such innovations would make available for development both new savings and existing savings for which so far no more productive use can be found.⁵

What is needed in order to make household saving a functional part of capital accumulation, is a policy designed specifically to

encourage the evolution of the traditional sectors of backward economic conditions necessary for investment and, on the other, the transformation of existing savings into savings which are transferable to such investment.

Such policies need to be based upon more searching studies of the economic relationships characteristic of any country's less developed regions than economists alone can provide without the help of other disciplines.⁶ Where such studies have been undertaken, they have shown that economic behaviour is just one element in an essentially unitary cultural complex, so that little can be achieved by intervention in isolated sectors.⁷ They have also demonstrated the crucial importance of the processes of transition from a subsistence economy to a market economy, from a barter to a money economy, and of those by which a wage-earning labour force comes into existence. Evolution in traditional societies is handicapped not so much by their capacity to change, which is often strong, but rather by lack of impulses adapted to their understanding and thus capable of calling forth a positive reaction from them.⁸

A policy to promote household saving involves, in practice, such things as the establishment of appropriate institutions and a functional reorganization of the banking system, and this may seem only a small part of the overall policies by which a developing country must try to meet its own needs. However, our analysis of the problem has drawn attention to much broader aspects of the development process; household saving is seen to be most important precisely in the conditions of developing countries, and its promotion by such means as are mentioned above assumes then particular value.

This qualitatively so important problem does not lack equally significant quantitative aspects. In most cases household savings make a massive contribution to total capital accumulation,⁹ even though only a small proportion is transferable or in any case employed in productive activities in line with development targets.¹⁰

This implies that neglect of household saving, in the sense in which the term is used in this paper, means neglect, too, of the economic behaviour patterns which are typical of any given underdeveloped country and indicative of its population's most urgent needs. Household saving is a matter of the highest relevance to policies regarding economic and social inequalities as well as to the choice of sectors where economic growth is to be stimulated.

In developing countries the economic dualism common to all economic systems¹¹ is much more marked because of the pattern of economic enterprise dictated by anxiety to close the gap which separates them from more advanced countries, by such urgent problems as the supply of capital goods or competitive exports and by foreign investment.

The marked economic dualism of developing countries may have a factual and functional foundation in their relations with the world at large, but so far as these countries themselves are concerned it assumes significance to the extent that it can stimulate quicker progress in the most backward sectors. If it fails to do that, economic dualism brings benefit only to a small fraction of the population and, moreover, can generate only the sort of growth that cannot be sustained for long, because it is not accompanied by matching advances in education, institutions and economic structures.

Even in the case of inevitable dualism in an economy, policies specifically concerned with the backward sectors are needed precisely in order to initiate their transformation and to create the cultural, institutional, technological and other conditions for a ready response to impulses emanating from the modern sector.¹²

It follows that a policy to promote and mobilize household savings in a developing economy has the closest affinities, and indeed virtually coincides with overall development strategy involving all economic policy choices. What support, then, can be expected from the banking system? Clearly, its contribution is no more than com-

plementary, and as such can be fully effective only if it follows (and perhaps stimulates) a whole series of broader choices; but, subject to this reservation, the banks can render an important service by widening the range and quickening the pace of development, especially in the long run.

2. THE FUNCTION OF BANKS IN THE MOBILIZATION OF HOUSEHOLD SAVINGS

The existence of modern economic institutions is a condition favourable to economic growth, but their significance as a development factor depends on the extent to which they in fact draw into an advanced context those very economic activities for which a development problem is perceived.¹³ One of the ways in which banks in developing countries can prove themselves to be an efficient institution is precisely the promotion and mobilization of household savings.

As financial intermediaries, banks perform, often simultaneously, a whole set of complementary functions. In logical order, the first point to stress is that banks need appropriate policies not only for attracting deposits, but for their investment. In macro-economic terms it is productive investment that qualifies the results of saving at the level of elementary units and transforms savings into a contribution to the nation's real capital accumulation, and for this reason productive investment must be guided by knowledge of the development needs of the environment which generates the household savings deposited with banks. If banks possess and act upon such knowledge, they can play a vital role both in stimulating the propensity to save and in creating the conditions for a positive response to such impulses (note the connection with what has been said earlier about the form of incomes and the structure of the production system as obstacles to the formation of savings that can be used for development).

From the logical point of view, appropriate investment activity (flanked by a set of more comprehensive economic and social policy measures) must be seen as a stage preceding the supply of deposit funds and indeed necessary to it, in so far as investment plays the dominant part in shaping an economic environment in which it is possible not only to save, but to save in such forms as allow of productive use.

Since modern economic activities require a large volume of funds raised on the credit market, it is clearly of the highest importance that savings should be transferable.¹⁴ Savings policy must be concerned with raising not so much the total volume of savings, but the proportion of transferable and then productively invested savings generated mainly by the transformation of the economy's more backward sectors. This is the wider significance of the mobilization of household savings in developing countries.

With reference to the financial activities of banks, it is rightly asserted that:¹⁵ "Whereas the increase in productivity in the economy determines the potential rate of growth in saving, the existence of an appropriate and adequate financial network determines the actual flow of such funds." This implies also appropriate banking policies concerning depositors. The structure and functions of banks need to be so fashioned¹⁶ as to offer savers the most convenient conditions as regards ease of access to banking services, security and ready withdrawal of deposits, interest paid on deposits, and technically well organized accessory services.¹⁷

Their acceptance of deposits puts the banks in a good position to discharge the very necessary educational function of awakening social conscience to the role of saving in the nation's economic development. Banks should also try to provide more information about the institutionalized financial uses of financial savings and about the supply of credit on the organized market.

As regards lending by banks devoted to the promotion and mobilization of household savings, one specially suitable category

of borrowers is that of small enterprises in farming, industry, crafts and trade. In developing countries, where the small family business is the typical form of enterprise in large sectors of the economy, it is also the source of the bulk of household savings, so that the economic area of the origin of deposits and of the destination of loans should often coincide. The transformation and modernization of small firms in developing countries requires functionally appropriate banking, alongside comprehensive action in the field of technical and administrative training and research on suitable development strategies for various sectors.¹⁸ Financial support is complementary, but important.¹⁹

If, furthermore, a bank lends to members of the same economic and social group to which the savers belong, it thereby creates a constructive image of banking as an institution, and so helps to develop more advanced economic behaviour patterns by making people directly aware of the role of saving in economic development. Experience shows that small family enterprises are more willing than most to save and more responsive to incentives to do so. To the extent that bank lending helps families to undertake a productive project, it tends to alter the pattern of income use in the direction away from consumption and hoarding and towards strengthening the enterprise.²⁰

Finally, the autonomous processes of credit expansion confer flexibility upon the economic system and sometimes give it a useful impulse by making it possible to step up investment quickly; but to a great extent these processes can take place only if, on the one hand, banks are capable of discharging monetary functions, and on the other, the economic environment is such that people understand and eagerly take advantage of the credit instruments upon which these monetary functions rest.²¹ From this point of view, too, everything that is done, which improves also the efficiency of banks, to encourage the emergence of small modern enterprises, helps the mobilization of savings.

So far as savings policy in developing countries is concerned, then, banks can be assigned the following functions: to draw into the credit system such household savings as already exist in suitable form (which is done by attracting and accepting deposits), to help transform the conditions of household saving, to finance production, and to give impulse to the emergence and functioning of mechanisms capable of enhancing the efficiency of the economic system (all of which is done by bank lending). Clearly the lending policies of banks are of eminent importance and are closely complementary to their deposit policies.

3. THE PRESENT SITUATION: WHAT BANKS DO TO MOBILIZE
HOUSEHOLD SAVINGS IN DEVELOPING COUNTRIES

Having outlined what can be expected of the banking system of developing countries in the context of their savings policy, we must ask what has been the institutional response to this challenge. How well adapted are the banks in fact to the mobilization of household savings? The situation differs, of course, from one country to another, but a few common features may be picked out, especially with reference to those countries which have most recently become independent.

The two factors that have done most to fashion the organized credit systems of developing countries are foreign relations and public intervention. In a broader context, the fact that these systems operate in an underdeveloped economy causes the credit market to be far more dualistic than it is in economically advanced countries.²²

The first of these factors has to do with the effects of colonialism as one of the historical, or indeed present, causes of the structure of many underdeveloped economies. Economically speaking, the colonies were just part of a system centred on the metropolitan economy; they were a source of minerals and agricultural commodities, as well as of labour. The problem of how the subject

territories could and should function independently simply did not arise, and the evolution of indigenous elements was conceived and allowed exclusively in terms of the rational of the system as a whole. The distinction between the metropolitan and the colonial territories was one of geography and race. Economic activities located in the colonies found in the mother country all the supporting services they needed, more especially a capital market and a banking system, of which no more was required than a geographical extension and purely formal adjustment of its activities.²³ Functional complementarity found expression in the concentration of capital supply on metropolitan markets, and in a high degree of specialization in the production of dependent territories. The consequent distorting effect on colonial economies was further reinforced by the rigid limitation of commercial bank lending to profitable export finance, and by the systematic drainage of local savings via the investment abroad of reserves and even of temporarily liquid funds, which led to capital shortage for local projects for diversifying the colonial economy.²⁴

In such an historical and economic setting there is clearly no point in trying to look for the banking system's development functions in the sense outlined earlier. But even political independence was never followed at once by radical changes in the structure of production, and the survival of certain types of economic relationships perpetuated their complementary institutions. With reference to commercial banks it may be said that these former typical exponents of the colonial institutional order became the chief architects of present credit systems, thanks both to their sheer quantitative predominance and to their influence upon the general approach to credit problems in developing countries. Originally, it must be remembered, the rational of commercial banking in the colonies rested upon the existence of an outside capital market on which long-term funds could be raised, and upon a supply of outside managerial capacity for the efficient organization of production by bor-

rowing firms. This explains why banks applied such strict standards to their loans and why they refused to lend for the medium and long term, but these conditions obviously have very little relevance to the present-day realities of economic development. If commercial banks discharge no other function than to provide a mechanism of payment, they have little to contribute to development strategy.²⁵

On the other hand commercial banks are the repositories of the bulk of deposits in developing countries.²⁶ The reasons for this include their sound reputation of financial integrity, their sometimes extensive branch network, their expert staff, their multiple and close connections with the business world, the capital market and often with foreign sources of loan capital, and sophisticated techniques for handling various types of deposits.²⁷

However, a large part of commercial bank deposits comes from modern sectors, which means that banks take advantage of favourable but rather circumscribed development episodes. The banks pay much less attention to small savers, especially in areas distant from the major industrial and commercial centres. They take in money on current accounts as well as on time deposits, provided a high balance is maintained, but small deposits are considered too costly because of frequent movements around a low average balance per account.²⁸ Nor so the banks do much to expand their geographical coverage, for fear that new branches may initially earn little or no profits.²⁹ Interest paid on deposits is not attractive either, especially in the absence of the ancillary services and credit relations available to large depositors.

Even if banks become more active in taking in deposits, which they often do once potential saving reaches a sufficiently attractive level without their having done anything to stimulate it, this is not very helpful unless at the same time they reshape their own structure and functions, for the result may then merely be a systematic drainage of capital from the regions and economic sectors which most need it.

It is certainly possible, then, for commercial banks to do a lot more for development and in particular for the mobilization of household savings, especially once it is recognized that credit functions must no longer follow principles suitable only for dealing with a modern economy. The range of borrowers needs to be widened in terms of size of firm and economic sectors, which means a change in the overall conditions of eligibility for loans, and more medium- and long-term credit needs to be extended — but none of these things can be done unless the banks reorganize themselves, especially as regards the number and competence of their personnel and the adoption of new deposit techniques.³⁰ Public intervention will often be required to enable banks to take on new types of risks. Similarly, the domestic employment of temporarily liquid resources via investment in public or private bonds can be promoted by more far-ranging government action designed to organize a securities market.³¹

Private banks and foreign banks are not the only sinners. Where governments have nationalized commercial banks, or taken them under public control or have set up new ones, all the best intentions of making them more responsive to the national interest have hardly ever led to any significant departure from the credit policies and principles we have had occasion to criticize.³² The contradiction between ends and means has often been overcome by the establishment of preferential circuits, in essence a method of pre-selection of credit applicants.³³

This behaviour of the public authorities for the sake of keeping capital costs low at least for certain projects, as well as the coherence of the foreign commercial banks with a system of economic relationships unconnected with the basic problems of economic development, are the chief reasons why interest rates are kept below the level dictated by real capital needs and by the effective conditions of capital supply in developing countries.³⁴ Capital supply at current rates of interest is available only to traditionally creditworthy borrowers and to such activities as fall within the limited choices of the

government departments responsible for the economy's management.³⁵ It is a delusion to hope to obtain capital on the same conditions for projects in sectors where development involves more difficulties and hardships. All this naturally is an obstacle both to saving, and to savings promotion by the banking system. The banks' investment policy itself precludes faster expansion, and one of the conditions which might attract savings to the institutions (interest payment on deposits) is powerless in the face of all the practical and psychological obstacles.

Another element of public intervention in the credit markets of developing countries is the establishment of development banks. These are directly concerned with quickening the pace of economic development and growth.³⁶ But apart from indirect effects, they do little for the promotion and mobilization of household savings. Given that development banks mostly operate with public funds or foreign capital, they have neither any incentive for trying to attract deposits of their own, nor ample freedom of choice as regards their investments.³⁷ In any event, sound management is difficult enough for development banks, at least in the early stages, seeing that they have to initiate large-scale projects in an extremely backward economic setting; and this has led them to apply even more rigid standards to loan applications and to finance only big firms and major projects.³⁸ In the extreme case, development banks may altogether lose the character of credit intermediaries, especially as regards their access to domestic capital supply and their preferential lending. However, their activities may be a necessary condition for effective mobilization of household savings by other categories of banks.

Yet a third element of public intervention in the credit market, and one that is specifically concerned with people typically having no access to banks, is the widespread system of post office savings banks. Their business is handled by post offices, and thanks to the dense network of these, post office savings banks often offer the only facilities for small savers dispersed in outlying areas to make

any deposits at all. Since there are so many branches, the total supply of funds accruing to them may be quite considerable, and up to a point fairly stable. Unfortunately, post office savings banks lack other important conditions for efficient mobilization of household savings: their deposit techniques are not sufficiently diversified, they cannot pay attractive interest rates on deposits, and they cannot lend directly to local borrowers.³⁹ Were it not for their geographical coverage, which certainly helps to tap the savings of otherwise neglected sectors, the post office savings banks could be classed with the other institutions forming part of preferential circuits, for their funds are usually channelled to the Treasury (which may even use them for current expenditure), to an intermediary institution which in turn redistributes them among other public agencies, or to commercial banks.⁴⁰

The same applies, *a fortiori*, to such other savings banks as do not have an independent investment policy, even though they are not connected with the postal administration.⁴¹

On the other hand, the value of penetrating the less advanced sectors of developing economies by means of other types of savings banks, saving and loan associations, credit co-operatives, building societies or agricultural credit institutes is often underestimated or belittled, without taking account of the attendant difficulties and of the kind of results to be expected. Certainly the latter are less conspicuous than those that can be achieved in areas where development involves less drastic changes. In the light of what has been said earlier, however, it is obvious that whatever little one may think of the present status of such credit institutions in no way detracts from the functions which could rightly be assigned to them.⁴²

There are many reasons to explain the present unsatisfactory situation of institutions of this kind. The system as such is often made up of units established one alongside the other without any overall strategy, so that their resources are wastefully dispersed

and their impact is diminished.⁴³ Nor have they been properly integrated with the banking system as a whole, which might have helped to make them more efficient.

Individually speaking, these institutions are not always organized on lines appropriate to their cultural environment.⁴⁴

Because credit institutions do not pay enough attention to the characteristics of the economic and social environment in which they have to operate, they are not readily accepted by local communities and their business is precarious; state help could create the preconditions for an efficient handling of credit functions, but often all it achieves is to multiply bureaucracy.⁴⁵

As regards unofficial credit, money-lenders usually do not take in other people's money to finance their loans, but in most developing countries there are private associations which in effect mobilize their members' savings, albeit in a setting of traditional economic relationships. Rotating credit associations, for example, far from losing ground, enjoy vigorous growth and are a genuine expression of the reactions of a traditional society to economic impulses from modern sectors; their greatest significance lies in easing social and cultural change in response to economic problems and processes.⁴⁶ They have given proof of their own adaptability by financing modern activities as well. As a manifestation of spontaneous and constructive adaptation of traditional patterns, rotating credit associations have something to teach such official institutions as may be set up for the explicit purpose of dealing with economically backward communities deeply rooted in indigenous culture.⁴⁷

All in all, we must conclude that the banking system at present contributes little to the mobilization of household savings in developing countries. The whole problem of household saving, at least in the terms here outlined, often receives scant attention, since it is not associated with any prospect of spectacular and immediate results, requires dense coverage and involves structural adaptation.

There is a yawning gap between the organized and the non-

organized credit market, and this can best be bridged by broadening the qualitative range and adapting the functions of existing institutions. This is much more important than their formal transformation and promises to make them play a much bigger part in development and thus to reshape the development process as such.

Qualitatively speaking, then, the banks' institutional purposes and their activities need to be adapted to the mobilization and utilization of savings. But there are also quantitative aspects, as regards both network distribution and co-ordination among institutes operating in any one sector. From this latter point of view, close co-operation among the various types of institutions concerned with the mobilization of savings would surely enhance the efficiency of them all and avoid duplications, and at the same time increase the usefulness of each specialized type of action.

Given the far-reaching economic and social implications of savings policy, and the importance of preventing the perpetuation of a dualistic credit market, savings institutions should aim at integration and fruitful co-operation with the banking system as a whole, thereby enriching it with their knowledge of real development needs.

4. INTEREST RATES

While effective mobilization of household savings in developing countries certainly requires deliberate government support backed by a set of appropriate measures, it also demands more independent vitality on the part of the credit institutions. The system of credit distribution through preferential circuits needs to be at least partially dismantled, for it fails to draw into the development process precisely those sectors that most stand in want of it, and the institutions meant to serve them need to be integrated with the banking system as a whole. One of the means of achieving these two purposes is a modification of the interest rate structure.

In developing countries, the wide range of risks deriving from the very nature of the ongoing growth process is often not reflected in a correspondingly broad spectrum of interest rates; on the contrary, we find polarization at the two extremes.⁴⁸ On the organized credit market, loan conditions are similar to those common in economically advanced countries and interest rates barely higher; outside the organized market, loans for any kind of purpose can be obtained often without security at all, but at exorbitant rates.⁴⁹

At the same time, preferential circuits are totally inaccessible for any kind of operation which does not conform with the whole set of rules governing access to the organized market. We have already seen that this curtails capital supply to large sectors of underdeveloped economies.

Official institutions charge low rates and shun chancy investments; but in a developing country it would be more to the point to lend to a group of borrowers who, while risky, are prepared to pay a high enough interest rate to cover any possible loss through default.⁵⁰

The problem is a general one. Development involves new economic activities more risky than traditional or already established modern ones, and this new dynamic process sets the conditions at which the nation's savers are prepared to finance real capital accumulation. Many developing countries suffer not so much from an overall imbalance between capital demand and supply, as from restricted availability of capital due to the low level of interest rates. If interest rates were raised, there would be room for a larger volume of investment and hence of capital accumulation, or in any case for a different distribution of capital accumulation.⁵¹ And since the pace of development is set by capital accumulation, the problem clearly is how to increase the latter — within certain limits even regardless of the cost involved.⁵²

The above argument is not invalidated by the fact that developing countries often have not enough technical and economic

capacity to employ disposable funds in productive investment. It is this very deficiency which makes the development process so hazardous. What counts is that many entrepreneurs should be willing to try their hand at something new, and that they should be offered an opportunity to do so provided they are prepared to pay the proper cost.⁵³

Of course, if banks adopt a more flexible policy with regard to the credit applications they accept and the interest rate they charge, they must never go so far as to endanger the safety of their deposits; but subject to this reservation, such a policy can do much for successful promotion of household saving. By financing a different and wider range of investment, banks can raise the potential formation of savings, and there is an advantage, too, in not channeling savers' funds to the preferential circuits which only in some cases, and then indirectly, enable people to perceive the benefits of forgone consumption.

High loan rates furthermore make it possible to pay adequate interest to depositors. Whether and to what extent this affects the willingness of people to deposit their savings with an institution is a matter on which opinions differ. In many developing countries the general view is that, so long as people have fairly easy access to institutions where they can deposit their money, safety is the main incentive for doing so, followed by ease of withdrawal. Interest earnings count much less (except for those in the higher income brackets), and often indeed less than the chance of obtaining a credit or some tax relief. There are cases to substantiate this view, but then the reason may have been that interest rates were low anyway or were raised only a little. The opposite view, that higher rates should be paid on deposits, does not lack advocates.⁵⁴

Even in an underdeveloped economy, after all, the rate of interest is only one of several conditions relevant for a depositor, and its relative weight in the whole set of direct and indirect advantages offered by institutions is bound to vary. To discover what

determines these variations, it may be interesting to look at the actual conditions surrounding the processes of income production, saving and investment.⁵⁵

In a backward economy, where the product of innumerable small family enterprises reaches the market in individually small quantities, investment automatically follows saving, and the two processes cannot be distinguished with reference to the income portions set aside for precautionary or prestige reasons, or indeed instinctively. With such a production pattern it is not possible to mobilize funds beyond those that are hoarded, and these presumably often fall short of the total savings generated by the family enterprise. Now, the incentive to reinvest savings in one's own enterprise derives from the returns that can be earned by the typical production processes of a backward economy, and the only condition required for hoarding to fulfil its purposes, is safe preservation of the capital set aside (the amount of which likewise depends upon the same factors which influence the reinvestment share of total saving). In these conditions the rate of interest on deposits does nothing to determine the total volume of saving, but has some power to attract hoarded funds to credit institutions; these funds are most responsive to safety, ease of access to an institution, and ready withdrawal.

The rate of interest can become one of the effective determinants of the propensity to save (and to deposit) only if the structure of the production system changes. The introduction of production methods making more use of capital goods, product specialization, increased employment of non-family labour, the growth of markets and of the money economy all have their effect also on the nature of saving. Direct reinvestment opportunities may often prove ill adapted to the new scale of economic activity and cease to count for the propensity to save. It is at this stage of economic development that education for saving becomes important, together with

the whole set of methods by which savings are channelled to the banking system. This is the right stage in which to introduce the concept of financial investment of income withheld from consumption.

In a transition period, however, when there is still scope for some reinvestment in the family enterprise, the rate of interest becomes relevant for people's propensity to save and for their willingness to deposit their money with a credit institution. Indeed, adequate remuneration of deposits may even speed up the transformation of the production system and thus cumulatively enhance its own effectiveness.⁵⁶ In a still rather backward economy investment returns play a major part in determining the use of income withheld from consumption, given that both the processes of saving and of traditional investment are more or less automatic and the advantages to be derived therefrom are normally plain to see. These advantages may be quite considerable, in that they are often obtained in a setting of economic processes which, while primitive, are perfectly adapted to environmental conditions; in any event, they cannot easily be compared with any degree of accuracy with those obtainable from financial investment of savings, since people lack the economic understanding to compare disparate elements. The interest paid on deposits must be quite high, therefore, if its advantages are to be plain enough to act as an incentive.⁵⁷

Poor returns may sometimes be offset by the opportunity of obtaining credit on favourable terms. This makes it easier for people to appreciate the advantages to be derived from dealing with a credit institution, and fosters a gradual transition from traditional to more modern patterns of business management. More generally, credit provided for members of the same community in which deposits originate, or perhaps for projects of joint utility, is an incentive to save which can add much to the attractiveness of the other conditions offered to depositors.

In the still rather primitive setting considered so far, then,

investment returns certainly are important for the propensity to save, in so far as they serve as an indicator of the capacity of one form of investment to fulfil the functions of security or production which savings are assigned in the family enterprise. But once these functions can no longer be fulfilled within each separate economic unit this indicator is replaced by another, namely, visible proof that they are efficiently discharged by credit institutions. It follows that more importance comes to be attached to conditions other than mere investment returns, such as safety in providing for future needs, ready availability in case funds are needed to meet emergency expenditure, saving schemes with a fixed target, or combined saving-and-loan schemes designed to improve the saver's real income or to help him achieve some specific purpose (purchase of a house, education of his children, etc.). If different forms of investing his savings offer a saver equal results with reference to the above purposes, investment returns clearly are the element which governs his preference for one or the other of the various possibilities, while they have only a minor influence on the propensity to save, which ultimately determines the total volume of saving.⁵⁸

FOOT-NOTES

¹ See Arnaldo Mauri, "Les Caisses d'épargne et les pays en voie de développement", Paper read at the 17th International Course for Savings Banks Managers, held in Santiago, Amsterdam, International Savings Banks Institute, 1967, p. 3 f.

The fact that services produced by the tertiary sector represent only a small fraction of national income illustrates merely one aspect of the narrow range of consumption in backward countries. Dynamically speaking, there will indeed be strong pressure for increasing consumption, but on the other hand its initially low level leaves a wide margin for saving. The point is to achieve a certain income growth together with controlled expansion of consumption. To this end it is not good enough to consider saving as a residual; what is needed is a policy to stimulate saving by making families actively want to do so, not to speak of the broader purposes to be discussed later in the text.

² From the dynamic point of view, too, the problem of saving is different in the two types of countries. In advanced countries, the decision to alter the distribution of the real product as between consumer goods for the home market and capital goods, in the sense of increasing the share of the former, can be taken and made effective just because of the large volume of savings previously accumulated, and hence because of the existing structure of the production system. Leaving foreign savings aside, the margin of possible change is the narrower, the lower is the degree of economic development, for then there are nowadays only two alternatives: economic stagnation, which precludes even the growth of consumption, or a change in the production system by means of an increase in real savings.

³ Of course, there are major differences in the situation of developing countries, but that described in the text is typical. The needs of the most backward sectors should inform the interpretation and solution of the whole set of problems.

⁴ The family enterprise remains the typical production unit in subsistence economies and is very common in developing countries. "The income capacity of [family] enterprises is intimately connected not only with the personal abilities of the members of the family, but also with their spirit of sacrifice. Therefore, business costs and earnings cannot be separated from household consumption patterns in these enterprises the capital comes most often from the family's ploughing back the savings so painfully accumulated." (Giordano Dell'Amore, *Economia del risparmio familiare*, Milan, Giuffrè, 1963, p. 98). In this light it is legitimate to treat as one both saving by households and saving by family enterprises, especially in developing countries.

⁵ Typically, in developing countries, there exists a large volume of savings which should be usable for purposes of development, but is in fact lost to it through, e.g., capital flight, conspicuous consumption as a status symbol, too much investment

in land, and hoarding. All these are, at least to some extent, due to the reasons indicated in the text.

Much the same can be said of the existence of unutilized production capacity in the traditional sectors of an underdeveloped economy.

⁶ On the need for such studies, Basil S. Yamey has some interesting comments: "Perhaps the most important explanation of the self-imposed isolation of the economists in their work in the study of underdeveloped economies has been their tendency to concentrate on aspects of economic organization and on sectors of activity where it might seem that little is to be learnt from the work of anthropologists. The heavy concentration of interest on problems of external trade, public finance and industrialization may serve as examples of this tendency... Thus, for example, there has been much concern with the export marketing of crops and the control of their prices. But by contrast it has been rare for economists to probe very far into the organization of the production of the crops and the earliest stages of their marketing and related activities ... One may go further and suggest that this has been harmful to their work even in their chosen fields, because the indigenous and non-indigenous sectors are not rigidly separated but interpenetrate each other ..." (Basil S. Yamey, "The Study of Peasant Economic Systems: Some Concluding Comments and Questions", in: Raymond Firth and Basil S. Yamey, eds., *Capital, Saving and Credit in Peasant Societies*, London, Allen & Unwin, and Chicago, Aldine, 1964, p. 377, 378).

⁷ See Clifford Geertz, "The Rotating Credit Association: A 'Middle Rung' in Development", *Economic Development and Cultural Change*, Vol. X, No. 3, April 1962, p. 241-42: "The reason why a saving income ratio of a particular country living above the subsistence level is what it is, rather than larger or smaller than it is, is dependent, as Henry Bruton has pointed out, on 'the general pattern of mores and the social structure which govern all aspects of social behaviour'. Consequently it is evident that an effort to change the ratio demands an attempt to change the general pattern of mores and social structure." Similar comments can be found in Richard D. Lambert and Bert F. Hoselitz, *Le Rôle de l'épargne et de la richesse en Asie du Sud et en Occident*, Paris, UNESCO, 1963, *passim*, and Firth and Yamey, *op. cit.*, *passim*.

⁸ Moreover, impulses emanating from the modern sectors of the economy are often not devised specifically for the development of traditional sectors and therefore call forth irrelevant or counterproductive responses. The introduction of the use of money, for example, makes it easier to save in so far as it allows of greater accumulation, but often, especially at first, integration with modern economic activity was so scant that money incomes served exclusively as a means of payment for goods other than traditional ones.

As Giovanni Arrighi (*Sviluppo economico e sovrastrutture in Africa*, Turin, Einaudi, 1969, p. 237) observes: "The social structure of traditional economies, while

maximizing security, encourages the adoption of a somewhat limited time horizon in the distribution of the produced surplus among consumption, unproductive saving and productive saving. In other words, peasants still largely using pre-capitalistic production methods are likely to have a strong preference for immediate consumption and often for unproductive hoarding which by maintaining or strengthening social cohesion, safeguards the particular type of security inherent in the traditional system. Most probably this preference will only be reinforced by the peasants' encounter with the sophisticated consumption patterns of industrial systems."

The absence of institutions guaranteeing social security comparable to that offered by the traditional environment makes people think of the modern environment solely in terms of consumption possibilities, and strengthens their ties with the traditional environment.

⁹ For statistics of the volume of household savings and deposits in developing countries, see, e.g. United Nations, *World Economic Survey 1965*, New York, United Nations, 1966, and Nicolas G. Krul, "Sviluppo, congiuntura economica e formazione del risparmio dal 1965 al 1968", *Il Risparmio*, May 1969. Note also the following interesting, and perhaps surprising, observation by Balbir S. Sahni (*Saving and Economic Development*, Calcutta, Scientific Book Agency, 1967, p. 112): "... some of the findings of the study would favour a greater emphasis on voluntary saving. This is true more so in view of the fact that 70 to 80% of the saving in India are attributed to the household sector and the major increase was recorded in this sector."

¹⁰ This is the reason for the widespread scepticism with which economists regard the contribution made by spontaneous household saving to capital accumulation in developing countries. It is also the reason why government intervention tends to favour more public saving. But, quite apart from the technical and environmental factors which have made the results of efforts in this direction rather disappointing (see United Nations, *op. cit.*, Vol. I, p. 21, Tables 1-5), there is always one valid objection against them, as expressed, e.g., by Clifford Geertz (*op. cit.*, p. 241): "Neither large-scale international capital transfers nor improvements in the terms of trade can, in themselves, bring about domestic capital accumulation in the absence of effective efforts to raise the level of domestic saving. In part, such saving can be realized by means of taxation programs, the compulsory sale of government securities, economies in government expenditure, and other fiscal measures; but in the long run these financial mechanisms will not in themselves bring about the one change which is essential if development is to have a firm basis ... a change in the propensity to save on the part of individual members of the population. Unless the basic savings habits of the people of a country can be altered, the prospects for sustained economic growth are dim indeed."

¹¹ Charles P. Kindleberger defines a dual economy as "an economy with different marginal efficiencies of identical factors in different parts of the economy"

(*Economic Development*, Second edition, New York, McGraw Hill, 1965, p. 258). See also Albert O. Hirschman, *The Strategy of Economic Development*, New Haven, Yale University Press, 1958, p. 125 f. One aspect of dualistic economies is the type of firms to be found there, which, as will be seen presently, is important from the point of view of the mobilization of household savings. See, for instance, Eugene Staley and Richard Morse, *Modern Small Industry for Developing Countries*, New York and London, McGraw Hill, 1965, p. 1 and 22: "... at the beginning of industrialization, and for considerable part of the transition period from premodern to modern economy, earlier forms of small industry predominate. These are non-factory forms, cottage industry and artisan work. An important aspect of the problem facing development planners is how to guide the transition from traditional to modern small industry." ... "Modern industry is thus, in its first manifestations, not a gradual evolution from the prevailing traditional industry but a sudden jump to quite new methods, an importation. Thus, large factories develop ahead of small factories." Hirschman suggests a new approach to the problem of economic dualism, to be seen not as a negative residual of the development effort, but as "an attempt by the economy of an underdeveloped country to make the best of its resources during a transitional phase". (*op. cit.*, p. 132).

¹² Arrighi (*op. cit.*, p. 237-38) defines the problems involved in the promotion of productivity rise in African farming as follows: "(a) to create incentives for the exploitation of potential, now unused, productive capacity in the shape of land or working time, (b) to increase the productive uses of the surplus produced in the traditional sector, so as to generate a continuous rise in the productivity of labour. The first problem concerns the relationship between the modern and the traditional sector, that is, the type of surplus absorption in the modern sector most likely to maximize the incentives to raise productivity in the traditional sector. The second problem has to do with the type of organization of production and institutions in the traditional sector that is most likely to call forth the desired response to the impulses transmitted from the modern sector." The author says that because nearly all the traditional economies of Africa still have a certain margin of unutilized capacity, the first problem is much the more important; but here it will be argued that the solution of the second problem is a condition for the efficacy of the incentives with which the first problem is concerned.

¹³ While this may seem a glimpse of the obvious, the history and present state of many institutions in developing countries are often full of contradictions; as an example, we may quote Walter T. Newlyn (*Money in an African Context*, Nairobi, OUP 1967, p. 2): "... modern financial institutions were introduced into African economies while they were still, basically, at a stage of barter...". The point will be taken up later; here it is enough just to mention why such situations came about: the imposition of external economic systems upon the national economies of developing countries, and the discontinuity of government intervention to stimulate economic growth.

¹⁴ Note the following comments by Antonin Basch (*Financing Economic Development*, New York, MacMillan, 1964, p. 4 and 5): "An overall estimate of resources expected to be available for investment must be supplemented by an indication of the sources of saving. Only then can one project the use of gross capital formation for investment in various fields... When an expanding volume of transferred savings becomes available to private and public borrowers, investment flexibility is established." On the typical forms of the use of household savings in India, and on their scant transferability, see Balbir S. Sahni, *op. cit.*, p. 73-75.

¹⁵ *ibid.*, p. 72.

¹⁶ For detailed discussion of savings banks with particular reference to their special capability to promote household saving in developing countries, see Arnaldo Mauri, "The Promotion of Thrift and Savings Banks in Developing Countries", in: *Ninth International Savings Banks Congress, Rome, 6-8 May 1969*, Geneva, International Savings Banks Institute, 1969 (published in this same volume).

¹⁷ One very useful service rendered by banks is the diffusion of instruments of payment used both in the exchange of goods and services and in financial transactions. Such instruments are needed for the indirect financing of investment and increase the total volume of lending, but they also increase disposable savings. As Chintaman D. Deshmuk ("Politica monetaria ed altri strumenti di intervento in una economia in via di sviluppo", *Bancaria*, April 1966, p. 428) rightly points out, the very variety of financial instruments and assets, and their differentiation by degree of risk and rate of interest, induces a higher volume of saving. The possession of such financial assets furthermore helps to minimize, if not to eliminate, income uncertainties, so that income recipients can save more despite the low level of their personal income.

¹⁸ For the quantitative extent of small industry in developing countries see Staley and Morse, *op. cit.*, p. 8; for the functional characteristics which warrant special study, and for classification thereof, see *ibid.*, p. 2 f. The authors also state firmly: "Major types of development measures for small industry begin with the management triad of industrial counseling services, training for entrepreneurs-managers and supervisory personnel, and industrial research services." (*ibid.*, p. 25).

¹⁹ The conditions for the formation of an entrepreneurial class are not equally propitious at every level. There are cases where the entrepreneur may create or discover new markets, and others where the very chance of finding new entrepreneurs depends upon the possibilities of organizing new markets. These two observations suggest that it may be easier and more fruitful to aim initially at a large number of small entrepreneurs. This is in any case the only category of entrepreneurs likely to emerge at all at the level of what is virtually self-education, but if there are enough of them, they constitute a market of numerous buyers and sellers and as such can call forth new ventures and offer opportunities of mutual complementarity.

²⁰ On the strong propensity to save of people directly engaged in some productive activity, see E.H. Whetham and J.I. Currie, *The Economics of African Countries*, CUP 1969, p. 177, and Margaret Katzin "The Role of the Small Entrepreneur", in: Melville J. Herskovits and Mitchell Harwitz, eds., *Economic Transition in Africa*, London, Routledge & Kegan Paul, and Evanston (Ill.), Northwestern University Press, 1964, p. 179-198).

Basil S. Yamey (*op. cit.*, p. 381) distinguishes a "demonstration effect" and an "aspiration effect", which latter concept certainly seems applicable to the small entrepreneurs of developing countries. See also Raymond Firth, "Capital, Saving and Credit in Peasant Societies: A Viewpoint from Economic Anthropology", in: Raymond Firth and Basil S. Yamey, eds., *op. cit.*, p. 26.

²¹ Banking channels must also be able to retain the funds deriving from loans by non-bank intermediaries. This is a necessary condition for the full effectiveness of non-bank credit expansion in a system where deposit banks have already exhausted their own credit potential (on the expansion effect, see Walter T. Newlyn, *op. cit.*, p. 14-15). Even where non-bank financial intermediaries are well integrated with the banking system, this condition is not easily met precisely in those environments which stand most in need of development.

²² On the concept of dualism in the credit market, together with a study of credit markets in developing countries, see Arnaldo Mauri, *Il mercato del credito nei paesi sottosviluppati*, Milan, Giuffrè, 1966, p. 16, 18, 19.

²³ The only demands of the overall economic system on its internal financial relationships were a perfectly stable exchange rate between the metropolitan and the colonial currency, and safety of the banks operating in the colonies. See Thomas Balogh, *The Economic Impact of Monetary and Commercial Institutions of a European Origin in Africa*, Cairo, National Bank of Egypt, 1964, p. 11.

²⁴ On the export of savings from colonies, see Balogh, *ibid.*, p. 12.

There are many other aspects of interaction between financial and structural dependence: on foreign exchange policy and the stunted powers and functions of central banks, see Balogh, *ibid.*, p. 23, 31; on the impact of monopoly in the supply and distribution of international means of payment on the trade flows of dependent countries, see Diallo Maka, "Structure monétaire, commerciale et bancaire des pays d'Afrique tropicale", *L'Actualité économique*, 1969, No. 4, p. 714 f.; on triangular trade, *ibid.*, p. 776; on the advantages and disadvantages deriving from the existence of very large areas of trade and free capital circulation, *ibid.*, p. 717, 725-27.

The problem of financial independence as a condition of balanced economic growth was one that concerned also the immigrant population of colonial settlers, but there is no room for doubt as to who the beneficiaries of development were to be in this case. With reference to Rhodesia, this argument is discussed by R.A. Sowelem in *Towards Financial Independence in a Developing Economy: An Analysis*

of the Monetary Experience of the Federation of Rhodesia and Nyasaland, 1952-63, London, Allen & Unwin, 1967.

²⁵ For a somewhat traditional account of the functions assigned to commercial banks in developing countries, see G.I. Williamson, *The Role and Practices of Commercial Banks and Other Institutions in Financing Development*, Cairo, National Bank of Egypt, 1965, p. 8-12, 24. Critical observations will be found in Diallo Maka, *op. cit.*, p. 720 f., and also in a study by the Research Department of the National Bank of Egypt (*Economic Bulletin*, Vol. XVII, No. 3, 1964), entitled "A Comparative Study of Banking Systems. III. The Developing Countries". An interesting example is the following: in the countries belonging to the West African Monetary Union (Dahomey, Ivory Coast, Mauritania, Niger, Senegal, Togo and Upper Volta) 66.4 per cent of all credits granted by credit institutions (and the Treasury) in 1967 came from commercial banks, and of all non-Treasury credits outstanding 79.9 per cent were for the short term, 10.9 per cent for the medium term, and only 9.2 per cent for the long term (Banque Centrale des Etats de l'Afrique de l'Ouest, *Rapport d'activité* 1967, Paris, 1968, p. 64).

²⁶ United Nations, *op. cit.*, p. 35,36; Nicolas G. Krul, "Sviluppo, congiuntura economica e formazione del risparmio dal 1965 al 1968", *op. cit.*, p. 79 f.; Franco Simeone, "La raccolta del risparmio ed il suo investimento nell'industria nei Paesi in via di sviluppo", *Rivista di Politica Economica*, December 1968, p. 1768-69.

²⁷ United Nations, *ibid.*, p. 35.

²⁸ See Arnaldo Mauri, "The Promotion of Thrift and Savings Banks in Developing Countries", *op. cit.*, par. 32. The same situation prevails even where the share of savings deposits is high in the absence of a capital market or stock exchange (see Pierre Roques, "Le Rôle des banques dans le développement en Afrique", *Nations Nouvelles*, June 1967, p. 14).

²⁹ United Nations, *op. cit.*, p. 29.

³⁰ "Commercial banks are a substantially underutilized potential source of industrial short-term and medium-term finance in most industrializing economies ... Normal incentives typically pull commercial bank resources toward forms of lending that have higher turnover or deposit generation. To stimulate bank lending to industry, particularly to small firms, other incentives and aids are necessary, such as favorable rediscount policies and collateral requirements, and training of industrial loan appraisal officers" (Staley and Morse, *op. cit.*, p. 371). See also Robert W. Davenport, *Financing the Small Manufacturer in Developing Countries*, New York and London, McGraw Hill, 1967 (with reference to commercial banks, Chapter 7; for examples of specific cases, p. 56 and 293-94).

³¹ For the beneficial effects of the introduction of public securities in stemming the seasonal outflow of funds from commercial banks, see Research Department of

the National Bank of Egypt, *op. cit.*, p. 293, 298. On the organization and functions of a capital market in developing countries, see Edward Nevin, *Capital Funds in Underdeveloped Countries: The Role of Financial Institutions*, London, Macmillan, 1963, p. 95 f.

³² Sometimes it was decided to broaden the range of credit facilities in terms, say, of maturities, destination of loans, or eligibility, but the banks were not reorganized with a view to taking on new types of risk. The new bankers forgot that their predecessors were able to work with traditional structures precisely because they limited themselves to specific lending operations and thus kept within an economic setting which suited them. The failure of such ill-conceived experiments invariably causes bankers to re-introduce strictly traditional management principles.

³³ The existence of preferential circuits in bank lending may cause resources to be diverted under pressure from special interests, or even to non-economic purposes. Here is a warning by Nicolas G. Krul ("Mais ils préfèrent encore l'usurier", *Le Journal des Caisses d'Epargne*, December 1969, p. 783): "En revanche — et le marché inorganisé prouve bien que cela est possible — il conviendrait d'éviter la tentation des taux bas, les circuits privilégiés entraînant manifestement un gaspillage des capitaux rares dû à ce que la concurrence se place sur le terrain de la recherche des avantages particuliers et non sur celui de la productivité."

³⁴ It is often said that one of the major "benefits" of the presence of foreign banks is precisely that they keep interest rates down by forming a bridge between the credit markets of developing and of advanced countries; see, e.g., U Tun Wai, "Interest Rates in the Organized Money Markets of Underdeveloped Countries", *IMF Staff Papers*, Vol. V, No. 2, August 1956, or Edward Nevin, *op. cit.*, p. 46. But the characteristics of these financial relations, especially as regards interest rates, are rational only in the setting of advanced countries; in developing ones, low rates are charged only within the preferential circuits, leaving excluded all those enterprises and activities which, because of the radical change development might represent for them involve risks, maturities and sometimes returns in sharp contrast with the conditions in which official credit institutes operate.

³⁵ The contrast with the position of businessmen forced to turn to the non-organized credit market is most glaring where the relative abundance of capital supply on the organized market makes it possible, say, to lend at 6-7 per cent for real estate speculation commonly yielding something like 25 per cent annually (See Arnaldo Mauri, "The Promotion of Thrift", *op. cit.*, par. 71).

³⁶ For a discussion of development banking, see Giordano Dell'Amore, *Economia delle aziende di credito*, Vol. II, *I sistemi bancari*, Milan, Giuffrè, 1969, p. 202 f., and Marco Onado, "Le banche di sviluppo nei paesi africani: Aspetti istituzionali", in: *Scritti in onore di Giordano Dell'Amore*, Vol. III, Milan, Giuffrè, 1969, p. 1567 f.

³⁷ In connection with deposit policy, see Arnaldo Mauri, *ibid.*, par. 36; Antonin Basch, *op. cit.*, p. 319; United Nations, *op. cit.*, p. 34. On investment policy, see Giordano Dell'Amore, *ibid.*, p. 211, and Norman L. Hicks, *The Role of Credit in Ghana's Economic Development*, Accra, USAID Mission to Ghana, 1968, p. 10.

³⁸ See Staley and Morse, *op. cit.*, p. 371.

³⁹ See Arnaldo Mauri, *ibid.*, par. 34.

⁴⁰ How unrational the preferential circuits may be is illustrated by the following example, from the Ivory Coast. Post office savings are redistributed through a chain of intermediaries at the following rates of interest (figures supplied by the POSB in 1969): the depositor is paid 3.35 per cent by the post office savings bank, the latter gets 4.40 per cent from the *Caisse Autonome d'Amortissement* (an apex institute), which in turn lends at 5.50 per cent to the *Crédit de la Côte d'Ivoire*; the final beneficiary of a housing loan from the *Crédit* has to pay between 5.5 and 7 per cent annually. The 4.40 per cent which the post office savings bank gets leaves it with a loss (covered by the Ministry of Posts and Telecommunications), so that it cannot afford to offer savers a higher rate. On the other hand, the low rate charged to final borrowers, while it gives a boost to housing and is an incentive for other businessmen perhaps more sensitive to interest rates than post office depositors, also works to the advantage of speculators, who earn investment returns of no less than 25-30 per cent annually.

Suitably reorganized, savings banks using the post office network could clearly become an important factor in the mobilization of household savings in developing countries. A proposal to this effect is outlined by Arnaldo Mauri, *ibid.*, par. 51.

⁴¹ Mauri, *ibid.*, par. 48. Decentralization of investment by savings banks, on the other hand, enables them the better to assess and meet local capital needs, makes people more aware of the collective benefits to be achieved by forgoing consumption, and enhances the management's sense of responsibility — all of which helps to create the kind of mentality essential for economic development (see Giordano Dell'Amore, "Sistemi", *op. cit.*, p. 289-91).

⁴² By way of corroboration of this view, we may quote Gunnar Myrdal (*An International Economy*, London, Routledge & Kegan Paul, and New York, Harper, 1956, p. 360, footnote 32): "The building up of a variety of institutions, serving the purpose of promoting individual savings, and organizing them and making them fruitful to the saver and to the community, should be given a high priority in every development plan. To be effective, the institutions have to be adapted to different individual needs and possibilities and must fit into the community patterns: they must aim at encouraging planned and 'goal-directed' savings. Even if, at least in the

beginning, the financial results would not constitute more than a trickle of new capital disposal, the effects in rationalizing attitudes and mobilizing ambitions might be crucially important."

⁴³ See Mauri, "The promotion of thrift", *op. cit.*, par. 30.

⁴⁴ With reference to India, M.L. Dantwala ("Institutional Credit in Subsistence Agriculture", *International Journal of Agrarian Affairs*, December 1966, p. 58, Note 1) reports the following remarks by an expert on Indian credit problems: "Institutionalized co-operation presupposes a certain progressiveness, self-reliance and organized mutual action on the part of members. Where the process of development has to be initiated in advance of development of these qualities among the people concerned, some more direct and simplified modes of reaching the individual farmers have to be followed. This is as true of credit as of other essential developmental services. Arrangements cannot be fully institutionalized. They tend to lean in initial stages more on external action than on internal initiative and responsibility. The results are not as satisfactory as they would be in developed stages. In developing agrarian communities there is the inescapable problem of starting from a pre-institutionalized stage, and leading them on to a developed and institutionalized stage. No one type of action can serve all such needs, but a state-supported semi-autonomous organization ensuring such immediate results as are judged to be practicable, and providing a built-in arrangement for eventual transformation into a fully functional organization, would appear to be the most promising course to follow." For selection criteria with respect to the establishment of different types of institutions, see *ibid.*, p. 59.

⁴⁵ Dantwala (*ibid.*, p. 61) describes how the weakness of institutional credit and the prospering of money-lenders are part of the very nature of subsistence agriculture: "As is well known, numerous farming units in India have a labour surplus. Under the circumstances, a major part of borrowing for household expenditure is unrelated to production requirements. To expect the credit agency to meet the 'full' requirements of the borrower would be tantamount to making it responsible for sustaining unemployment. However, if what is suggested is that the credit agency should meet the full requirements only for 'production' purposes, it will not be able to satisfy the 'total' requirements of borrowing of those farmers whose household expenditure is not covered by legitimate return to the input of family labour into farming... The transition from money-lender credit to institutional credit has, therefore, to be a process simultaneous with the transformation of subsistence agriculture into commercial agriculture. Attempts to pre-date either cannot succeed." It follows that credit facilities need to be accompanied by structural change. A similar argument is put forward by H.B. Shivamaggi, "Provision of Credit for Small Cultivators: Reconsideration of the Problem", *Indian Journal of Agricultural Economics*, July-September 1963.

⁴⁶ Clifford Geertz (*op. cit.*) defines a rotating credit association as "... a device by means of which traditionalistic forms of social relationship are mobilized so as to fulfil non-traditionalistic economic functions ... an 'intermediate' institution growing up within a peasant social structure, to harmonize agrarian economic patterns with commercial ones, to act as a bridge between peasant and trader attitudes toward money and its uses." (p. 242). "It ... mobilizes familiar motivations and applies them to unfamiliar purposes, while serving at the same time to reconstruct these motivations on a more flexible basis. The *arisan*, *ko*, *hui*, *dashu* or *esusu* is essentially, then, an educational mechanism in terms of which peasants learn to be traders, not merely in the narrow occupational sense, but in the broad cultural sense; an institution which acts to change their whole value framework from one emphasizing particularistic, diffuse, affective ties between individuals, to one emphasizing — *within economic contexts* — universalistic, affectively neutral, and achieved ties between them" (p. 260). For an appreciation of the work of rotating credit associations in Nigeria, alongside modern credit institutions, see M.O. Ijere, "Credit Development in Nigerian Agriculture", *Nigerian Journal of Economic and Social Studies*, July 1963, p. 219. For an extensive bibliography on the subject, as well as for a discussion of the situation in Ethiopia, see Arnaldo Mauri, *Il mercato del credito in Etiopia*, Milan, Giuffrè, 1967, p. 337 f.

⁴⁷ Clifford Geertz (*op. cit.*, p. 242) says that while the establishment of Western-type institutions was not altogether efficacious, they have on the whole proved disappointing, "... because the impersonality, complexity, and foreignness of the mode of operation of such 'capitalist' institutions tends to make traditionalist peasants, small traders, and civil servants suspicious of them... What seems to be needed, particularly in the early stages, is an institution which can combine local popular appeal with the sort of savings effects a developing economy demands; an institution which can act as an educational mechanism for a people moving from a static economy to a dynamic one, at the same time as it operates to bring about the restriction of increased consumption such a transformation implies."

⁴⁸ "In a logical credit structure, there should be a range of interest rates that will cover the range of risk present in the economy. This is particularly necessary in the less developed world where the risks of doing business are greater than in the developed world. However, it appears that often it is the developed countries which have a more sophisticated range of credit institutions capable of offering loans along the whole spectrum of interest rates roughly from 6 to 30 per cent." (Norman L. Hicks, *op. cit.*, p. 4).

⁴⁹ With reference to the usury rates common on the non-organized market, Nicolas G. Krul ("Mais ils préfèrent toujours l'usurier", *op. cit.*, p. 778) observes: "La raison de l'insuccès des légistes à faire coïncider le fait et le droit tient au caractère très particulier de la formation des taux sur le marché inorganisé, laquelle

n'est qu'en partie l'expression d'une concurrence imparfaite, ou, si l'on veut, d'un monopole discriminatoire." The author argues that while on the side of credit demand the determining factor is the opportunity cost, or the marginal efficiency, of a loan for the borrower, there are four factors on the supply side which determine the average and marginal cost of the loan: monopoly profit, the opportunity cost of the money lent, the cost of loan administration and the cost of the risk involved. With reference to opportunity cost, he says (*ibid.*, p. 779-80): "Le marché monétaire-financier organisé (qui existe quand-même partout) n'y reflète qu'imparfaitement le rapport entre les prix présents et les prix futurs, c'est-à-dire l'élément d'anticipation. Etant dominé par le capital commercial, ce marché est incapable d'imposer son arbitrage à un marché rigide de biens de loin plus important et sur lequel toute variation de l'offre ou de la demande provoque immédiatement des fluctuations extrêmement fortes." The money-lenders, who operate with limited capital funds, discount all that in the face of the risk of loss deriving from their having already committed their funds.

⁵⁰ Again Norman L. Hicks may be quoted (*op. cit.*, p. 9): "In general bankers seem to feel that an unknown borrower could not be trusted, regardless of how high the interest rate might be set. The concept of investing in a group of borrowers willing to accept a 15 to 20 percent interest rate and having a 10 percent default rate as a profitable enterprise for the bank was not accepted by the bankers interviewed."

⁵¹ Low interest rates not only lead to concentration of bank loans in "safe" sectors (which often have little relevance for development), but induce these to favour projects with a high capital/output ratio, which really are out of place in an economic environment where capital is the scarcest factor and labour the most plentiful.

⁵² However, the problem of capital costs looms large with respect to foreign loans, because of the burden of interest on the balance of payments. On the other hand, high interest rates help to attract more foreign capital.

⁵³ As Franco A. Grassini points out ("Alcune osservazioni in tema di gestione dell'impresa industriale nei Paesi sottosviluppati", *Il Risparmio*, July 1964, p. 1142), there certainly is some credit demand that is left unsatisfied by official supply, and ready to pay interest at rates a good deal higher than on the organized market. See also Norman L. Hicks, *op. cit.*, p. 17, and Nicolas G. Krul, "Mais ils préfèrent encore l'usurier", *op. cit.*, p. 783.

Basil S. Yamey (*op. cit.*, p. 384) suggests that the study of how borrowers adapt to contact with credit institutions "... should also throw much needed light on the real burden (as distinct from the apparent burden as indicated by the contract terms) of private loans. The fact — if it is such — that some borrowers prefer to borrow on

apparently more onerous terms from private lenders would suggest that the real terms as seen by the borrowers in question were lighter for the private loans (though it may of course reflect no more than fear of contacts with authority)."

⁵⁴ See E.g. Antonin Basch, *op. cit.*, p. 185; Nicolas G. Krul, "Sviluppo, congiuntura economica e formazione del risparmio", *op. cit.*, p. 789 (and other authors cited by Krul) and Arnaldo Mauri, "Les Caisses d'épargne et les pays en voie de développement", *op. cit.*, p. 12.

⁵⁵ The following considerations rest on the assumption of constant purchasing power of money, especially in cases where the degree of economic understanding enables people to realize the adverse effects of monetary depreciation on existing savings.

⁵⁶ In this process, increased credit supply plays its part, too, for it gives those producers who are best placed to adopt more modern methods a chance to supplement the resources they have saved with borrowed capital. Credit policy clearly has important effects on the social structure of developing societies.

⁵⁷ A nominal interest rate of, say, 3 or 4 per cent annually on a low average balance is not much of an incentive, especially in comparison with the returns of direct reinvestment, albeit in a setting of traditional economic relations and satisfactions.

⁵⁸ It may be of interest here to report the results of a survey of motives for saving and of preferred methods of saving in India (National Council of Applied Economic Research, *Urban Household Saving Survey*, 1961), as quoted by Balbir S. Sahni, *op. cit.*, p. 76: "Analysis of the ratings of these motives revealed that the strongest motive for saving is the desire to make provision for emergencies. The second most important motive is saving for old age and the third for children's education. Each of these three can be considered as an important motive which might prompt households to save, as much more than 50 per cent of the households mentioned each of them either spontaneously or rated them as very important... The survey also revealed that nearly 31 percent of urban households preferred to invest their saving in business, 22 percent in housing and other real property, including agricultural land, 13 percent in bank deposits, 8 percent in small savings ... and less than 2 percent each in gold, payments to life insurance and provident funds ... Furthermore, profitability seemed to be far the most important motive determining saving preferences. Safety is another significant consideration for most people and liquidity ranks third. The chief motive for investing in business, farmland and securities appeared to be profit, while safety is the major reason for keeping savings in the form of bank deposits, contractual payments and real property."

