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AFRICA AND MONETARY INTEGRATION

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THE ROLE OF MONETARY INSTITUTIONS/COMMENT

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CONTRE-RAPPORT/COMMENT

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Rather than comment upon Mr. Letiche's paper in detail I should like to make certain observations on the topic which are based, inevitably, on such experiences with the problem as I have had in Nigeria and other countries. Not that there is complete agreement with everything in Letiche's paper. Both in the first three fourths, which are essentially of a background nature and the last fourth, which containts the positive suggestions there are comments that might be made. But they deal essentially with problems that are ephemeral to the issue at hand. Just to do my duty as a critic I mention two : the comments on the military in the background part (§ 5), or the suggestion to submit policy issues between the Central Bank and the Ministry of Finance to parliament in the substantive part (§ 40), seem in the light of African realities, and by no means only there, somewhat unrealistic. And I suspect that the statement that the "absurdly small national markets hinder economic specialization . . . " (§ 6) is a slip of the pen since in fact they require it. Only if import substitution is considered the major development strategy would this sentence be understandable and such a strategy has on the whole been not a success, to put it mildly. Nor do I find the increase in savings and investments (§ 11) as important as the need to increase productivity which Mr. Letiche rightly puts into the center of his considerations. But on the whole I agree with both the need for and the content of a lengthy discussion of the basic obstacles to development and of the fundamental underlying factor with which monetary institutions have to cope. It seems more constructive to

expand some of the ideas presented rather than be critical in ways which in the final analysis do not carry us any further.

There are domestic and international aspects to monetary integration. Like Mr. Letiche I want to concentrate on the domestic aspects, though the two are of course closely interrelated in fact and in theory. In any case, one can never lose sight of the fact that all economies are open and that the balance of payments presents a real limitation on what can be done, and that the openness of the economy presents both a limitation and an opportunity on the manner in which the productivity of the economy can be, indeed must be, increased.

Mr. Letiche stresses the "essential role of modern financial institutions . . . to help develop and diversify the African economies . . ." (§ 31), the need for "African central banks . . . (to) take a more active role in stimulating economic development and in pursuing monetary policies for a more balanced economy" (§ 32). He stresses the need for the governor of the Central Bank to be an economist as well as to be knowledgeable of the working of financial markets (§ 41). And he makes many important suggestions for its proper role. My own comments will attempt to go deeper into the relation of monetary policy and development, and into the problems of creating working institutions.

It is easy to pass a law establishing an institution, such as a Central Bank. It is not easy to decide what such a central bank in fact should do. The difference between the legal competences given the Central Bank and the actual way in which it can operate, lies in the circumstances of the economy and society in which it is to work. This is, of course, the justification for the pages devoted in Mr. Letiche's paper to the background material to actual monetary policy. Assume for the purposes of the following discussion that growth of the economy has in fact the support of the people and their government. The limitations on the effectiveness of the monetary authorities are given by the low productivity of the economy and its low flexibility which characterizes all African, indeed almost all underdeveloped, economies. The problem of monetary authorities is then to fit into that reality and to operate in such a manner as to enlarge the areas of choice as fast as feasible. This in turn means

the development of policies that raise productivity as rapidly as possible.

The monetary system consists of much more than the Central Bank, in both underdeveloped and in developed countries. Everywhere there is a Ministry of Finance, or more generally the authorities that, in our context, make tax, expenditure, and debt policy. There are commercial banks and a great variety of specialized institutions from development banks to agricultural banks whose primary purpose appears to be to channel funds into sectors that are to be specially helped.

Now one major problem in developing countries is to establish the necessary economic institutions in such a manner that their range of effectiveness increases. Mr. Letiche concentrates on the function of the Central Bank to maintain price stability and to counteract variations in aggregate demand that arise from outside the economy, and these are indeed central problems. Inflation in no country has turned out to be a bed of roses. If you look at the Central Bank instruments, however, it is quite clear that in many African cases either the standard instruments of monetary policy must first be created or, if they exist, they do so only in a rudimentary form. It is further essential to remember the very great institutional differences that exist between the Francophone countries south of the Sahara and the countries of English affiliation.

Thus, interest rate policy requires the existence of a bill market and of borrowers. In my *Planning without Facts* I have described how such a market for Government paper was gradually being built in Nigeria, together with the beginnings of a stock market for long term private and Government paper(1). Counteracting fluctuations in aggregate demand requires a market for paper. If, as was the case in Nigeria, there are large foreign assets held by various public and private institutions, the concentration of reserves in the hands of the Central Bank allows initially an easy substitution of domestic Government paper for foreign assets. But once that process has been finished, the creation of a further market for paper requires that

(1) W.F. Stolper, *Planning without Facts*, Harvard University Press, 1966. See also R.C. Porter, "Birth of a Bill Market", Discussion Paper No. 11, CRED, Ann Arbor, Mich. 1970. Forthcoming, *Journal of Development Studies.*

ways are found to spend the money sensibly and economically. Such a market is being built up in many countries. The problem is really this : what has to be done to make it increasingly effective ? And to answer this question, it is really necessary to define briefly what is meant by the word "effective".

One meaning consists in creating outlets for private individual and business savings. A second meaning is to create conditions which allow a country to expand its spending through taxation and lending in response to its own economic conditions with decreasing limitations to its actions arising from abroad. This incidentally does not necessarily mean that the spending is for purely domestic purposes. In many small countries such as Togo or Dahomey, there are severe limits to such a counteracting policy. Even in bigger countries the internal market and hence the possibility of spending for purely internal purposes is severely circumscribed by the low productivity of the economy. It does mean to allow the economy to adapt quickly by increasing its internal flexibility. A third meaning is to provide a system where (primarily) investors can receive funds for expansion and operations. These functions are not independent of each other.

In Anglophone countries (where the chief characteristic relevant in the present context is that each country has its own central bank taking the place of a currency board that was at one time common to several of them) the outlet for savings may mean in the first instance the sale of Government paper. This is likely to affect primarily large institutional savers, though there is some evidence that individuals also have purchased such paper. And there is certainly evidence that individuals have purchased small denomination shares in companies in whose earning ability they had confidence.

Mr. Letiche suggests that the Central Bank should finance some Government activities, as is indeed the case everywhere (§ 33). The problem for the Central Bank is in the first instance to decide how many bonds it is in the interest of the economy to buy. It is not my purpose here to point out that in times of stress, such as a civil war, the Central Bank can hardly avoid major inflationary financing. In normal times there may or may not be conflicts between the views of the monetary and fiscal authorities. But on principle it is likely

that they will agree that financing by the Central Bank should, in the first place, be a matter of residual purchases until the paper can be sold to private savers ; that in the second place, the expansion of the money supply should be held down to the "needs" of the economy created by increasing monetization of former subsistence transactions and the effectiveness of overall spending. There will necessarily be a difference between essentially short term ways and means advances (often legally restricted to, say, 10% of tax revenues and to not more than a year) and the financing of development through long term paper. There will initially be room for expansion through substitution of Government paper for foreign exchange as a reserve of its currency as mentioned before.

The Central Bank has next an influence on the commercial banks and money in circulation through its rediscounting facilities. In Francophone countries interest rate policy plays no role in this; in fact its use is also moderate in Anglophone countries. There is simply the problem of reserve creation which is in fact linked with the kind and amount of financing which the banks or other financial intermediaries are expected to do. The banks in turn may finance all sorts of things. The eligibility requirements in their turn are determined by what may be losely termed "national priorities". One point I want to stress, however, is that the monetary authorities cannot, as they do in developed countries, stress the purely quantitative aspects of control while relegating the qualitative aspects to an essentially secondary role. It is difficult politically and practically to choke off excess demand simply by raising the discount rate, for example. Instead, if the lending operation of the Central Bank is not to become a bottomless pit, it must ensure that the banks lend for projects likely to pay off, i.e. to generate a return flow of funds and eventually an increase in available funds through profitable investments. This approach, it will be noticed has a strong resemblance to the "banking" as against the "currency" approach to monetary theory. It is, I believe, no accident that it does so, and it is a pity that the common sense of the banking principle, namely that the primary purpose of the banking system should be to help create a productive economy, got mixed up with the quite wrong proposition that as long as one stuck to the banking principle there could be no inflation.

The "currency principle" nevertheless remains essential in two respects, but it is likely to appear in a slightly different place in underdeveloped than in developed countries. In developed countries with their flexible economies and their thousands of economic analysts who understand market signals, fiscal and monetary policy will set the interest rates. Price changes will affect the real rates. In underdeveloped countries the proper "shadow rate" for projects, and more realistically the interest rate structure tends to be fixed directly by Government, e.g. the planners, and the wage structure is basically affected by budgetary action. Both these actions have a profound influence on how many and what projects will be profitable and hence "bank eligible"; and will thus implicitely affect the quantity of loans, the amount and kind of paper that can be issued, the manner in which monetary institutions begin to work.

A second aspect relates to the financing of agricultural crops. In the Anglophone countries with their marketing boards which used to finance the crops, the determination of the producer price (which is really a taxing decision with considerable political undercurrents) together with the expected size of the crops will determine a large part of the monetary circulation. In Nigeria, the beginnings of a bill market were created by the rediscounting facilities for export crop financing, which required that the Central Bank had some say in the setting of producer prices. Something similar has to happen for the financing of the import trade, as the domestic banking system takes the place of the semiautomatic short term capital flows of what previously was dependent branches of foreign banks. Mentioning taxation brings out the large extent to which monetary and fiscal policies are substitutes for each other in the circumstances of many African countries. It is clear that the monetary authorities must be interested as much as planners or the rest of the Government in the productive use of all funds and in limiting financing to what makes economic and social sense. There is a limit to the extent in which banks or other intermediaries can be used as simple transmission belts for the spending of tax resources. The limit is simply the extent to which taxes can be spent in the form of subsidies. Yet this function of the banking system is all too frequently the case, particularly with loans to agricultural cooperatives and small industries that never repay, but also to public utilities

that could easily be made contributors to instead of consumers of public funds.

In too many underdeveloped countries this is exactly what the institutions are. In some, like Tunisia, they are Government owned ; in others, like Nigeria they are private. In either case they do little or nothing to increase available savings and are paid for a more or less efficient way to distribute Governmental largesse raised by taxation or foreign loans.

In Francophone countries south of the Sahara, there is at least on the surface the institutional difference that several countries have a common Central Bank. There is also the second institutional difference that French practice has been to give very detailed lines of credit by sector, bank and even individual borrowers. Interest rates are not used to allocate resources. In general, whatever seems profitable at, say, 3% is automatically financed, with French aid standing by. I need not go further since I am happy to note that M. Pierre Sanner of the West African Central Bank is with us, from whom I learned all my wisdom in the first place.

There are only two points I want to make in this connection. First, the French system makes the decision on the interest rate inside the banking system, basically, I suppose after consideration of the volume of aid contemplated. It makes the financing directly dependent on the viability of the project. And it stands ready to finance any amount thus made eligible. In the English system the same decision is made, or probably made, slightly differently in the context of the balance of payment. In effect, however, in this respect and despite the substantial institutional differences, the two systems work (and are intended to work) essentially in a similar manner.

In the Anglophone system the fiscal and monetary authorities must be conscious of the balance of payments and must restrict their lending to avoid substantial internal price rises and excess demand for foreign exchange. I do not wish to enter here into questions of exchange control versus devaluation, etc. because these questions are really peripheral to the subject matter at hand. I am willing to agree for the purposes of the present discussion (though not necessarily in any real situation) that inflationary finance is defensible even with price rises and exchange control as long as it succeeds in

raising savings and in increasing the efficient employment of these savings. My views are that in fact there are rather narrow limits, but as indicated, this is peripheral to the present discussion. The point I want to make in the present context is that in the Anglophone system the government can force the Central Bank into substantial inflationary financing, and that its real limitations come from the facts of the balance of payments, the competitiveness of exports and the needs to import complementary factors. On the other hand, there can be no balance of payments crisis in the Francophone system. Once it is agreed that a project can be financed by the banking system with the blessing or direct intervention of the Central Bank, the foreign exchange is automatically guaranteed by France, and on generous terms at that. But, of course, once more the institutional difference hides a real similarity. Since France can hardly be expected to make infinite amounts of French francs (and, as long as the French franc is convertible, infinite amounts of foreign exchange) available, the controls on the total amounts to be financed are built into the system by much stricter limitations on Government borrowing from the Central Bank. Depending on the institutional setup, the same problem will arise either as a balance of payments crisis, or as budgetary crisis.

This brief discusison indicates the close connection that exists between tax policy, farm price and wage policy, the productivity of investments, a defensible allocation of resources in general and the development of monetary institutions. Monetary integration can, I believe, be sensibly achieved only in such a general economic context.

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