THE ROLE OF FINANCIAL INSTITUTIONS IN THE ECONOMIC DEVELOPMENT OF SIERRA LEONE

by

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THE ROLE OF FINANCIAL INSTITUTIONS IN THE ECONOMIC DEVELOPMENT OF SIERRA LEONE: SUMMARY

This study deals with the nature and operations of financial institutions in Sierra Leone during the period 1960 - 1970.

Growth of the Sierra Leone economy is constrained by the scarcity of capital, the virtual absence of entrepreneurs and the low per capita income for about 70% of the population who live on subsistence agriculture. However, there is scope for the development of the agricultural sector and agro-based industries because of the availability of unused fertile land and the abundance of labour. In fact, the development of the agricultural and small-scale industries sectors have been the declared objective of government policy. Consequently, our assessment of the contribution of financial institutions to economic development is centered on the extent to which these institutions have been successful in mobilizing domestic financial resources and the extent to which these resources have gone into the agricultural and small-scale industries sectors.

Chapter I examines the main features of the Colonial Monetary System of which Sierra Leone was a part until 1963; it indicates why that system was adequate for the needs of that period and emphasizes the constraints on that system once political independence had been achieved. Chapters II to VI analyse the functioning of the various financial institutions with special emphasis on the sources and uses of funds. The relative importance of the various financial institutions in the provision of development finance is assessed in Chapter VII. Chapter VIII examines the role of monetary management in the light of the balance of payments constraint and in Chapter IX we put forward proposals which aimed at improving the efficiency of the financial

sector by mobilizing more domestic financial resources for productive investment. The conclusions of our study are summarized in Chapter X.

Since the monetary and financial system must be evaluated within the context of the economy of which it is a part, Appendix I describes the structure of the Sierra Leone economy and examines the implications of the structural features for the financial sector. Appendix II attempts to assess the unsatisfied demand for credit in the agricultural and small-scale industries sectors.

The study postulates that the country will have to rely increasingly on domestic sources for financing development and that this involves the institutionalization of domestic savings and their utilization for productive investment. In our examination of this proposition two main themes emerge: The first is the need to increase the flow of financial resources to activities and sectors considered of strategic importance for economic development. The second is that the scope for traditional monetary policy is very limited and that emphasis must be placed on management of the level and flow of external reserves.

In order to show that the development of the financial sector is an important condition for Sierra Leone's economic development, we establish (a) that there is an unsatisfied demand for credit, and (b) that there is a potential supply of financial resources from within the economy. We point out that the main financial institutions in the country began operations during the colonial period when the emphasis was not on economic development but rather on the expansion of trade between the Sierra Leone Colony and the United Kingdom. With the assumption of responsibility for economic development at independence, there was not any corresponding change in the operations of the financial institutions. The first serious attempt to reorganize the financial system came in 1964, with the establishment of a central bank, which was largely ineffective because it was modelled on the Bank of England but having to operate in an entirely different environment. Thus, the central bank did little either directly or indirectly to influence the borrowing and lending activities of financial intermediaries with the result that all the financial institutions in the organized as well as the unorganized sectors have maintained almost the same investment pattern as prevailed during the colonial era.

The problem of adapting the institutions to meet the requirements of economic development applies not only to the older institutions but also to the new institutions which have recently been proposed and established. The result of this lack of adaptation of the financial system is that resources from institutional sources have not been available to agriculture and small-scale industries to finance their needed expansion. Apart from the problem of availability of credit, ancillary services and promotional activities are required if credit to the agricultural and small-scale industries sectors are to be used effectively. This necessitates the involvement of the central bank by encouraging existing institutions to provide these services or else by promoting the establishment of more appropriate institutions.

Given the severe constraint of the Balance of payments on Sierra Leone's economic development, we demonstrate, by use of the Polak Model the relationship between economic development and monetary flows and suggest a more appropriate role for the central bank.

As the study shows the existence of a potential supply of domestic financial resources, the recommendations are aimed at mobilizing these resources. The policies proposed include the introduction of suitably attractive financial assets to encourage the holding of financial assets as opposed to real assets or deposits with the commercial banks, the desirability of reducing the volume of capital outflows through the extension of the present limited exchange controls, and the substitution of some existing foreign financial assets for local securities. These proposals involve the creation of two new financial institutions, together with changed priorities in the credit policies of existing financial institutions, including the provision of ancillary services for the productive investment of potential resources.

INTRODUCTION.

Objective of the Study

The study deals with the nature and operations of financial institutions in Sierra Leone during the period 1960 - 1970.

Sierra Leone's development strategy has relied heavily on external sources for its financing. As evidence of this excessive reliance on external sources of finance, the Ten Year Development Plan 1961/62 - 1971/72 expected up to 75% of the total cost of the development programme to be met from external sources. The plan had to be abandoned largely because the anticipated external financial resources were not available.

But even if the volume of external capital that were available to the country was considered adequate in previous years, such finance is no longer adequate for present development needs. On the other hand, these external flows are not now available on their previous scale. For example, official flows in the form of aid and grants have declined substantially and most of these flows now take the form of loans, the repayment obligations on which are already causing serious problems for the budget as these repayments are now 20% of total revenue. In the case of foreign private investments, these have taken place mainly in the mining sector and such investments outside the mining sector have been on the decline. While medium and long term funds from these external sources have not shown any rapid growth, outflows in the form of remittances from previous investments, debt servicing commitments, external expenditure by the government and private remittances have increased sharply with the result that the net inflows have been relatively small. In these circumstances, the country cannot depend too much on external sources for the financing of its development programme.

To achieve the objective of rapid economic development, increasing reliance should be placed on domestic sources.

However, because of rapid increases in the recurrent budget and sluggish growth in revenue, the recurrent budget has generated only small surpluses for the financing of the development expenditure. At the same time, transfers from public sector enterprises have not been significant as a number of public corporations have incurred losses in recent years. Hence, increasing emphasis on domestic sources for development capital presupposes reliance on voluntary domestic financial resources.[1] This in practice involves institutionalisation of domestic savings.

1. Financial institutions can mobilize voluntary savings by offering their own financial assets in exchange for primary securities. They are able to do this because firstly, the financial assets they offer have a wide range of maturity as well as convenience and in consequence are easily acceptable. An added attraction of financial assets is that they are well known and are easily divisible. Further, financial institutions pay interest to savers for their savings, the interest paid depending on the type of financial assets preferred by the saver. By the payment of interest and the provision of an attractive and convenient form of holding savings, these institutions may increase the rate and volume of savings. But the extent to which these institutions can mobilize domestic savings depends on how accessable they are to the public.

Equally important as the mobilization of additional resources by financial institutions is the efficient allocation of the available resources.[2] The experiences of a number of underdeveloped countries have shown that the volume of investment does not necessarily guarantee development. Rather, development requires that financial resources flow into areas and sectors considered of strategic importance for the development of the economy. In effect, therefore, the process of institutionalization and productive investment of domestic savings calls for an organized financial institutional structure that is consistent with the socio-political and economic framework of the country.[3]

2. In the absence of financial institutions, all economic units have to rely on their own resources and those they can borrow from their friends and close relatives. As pointed out by Gurley and Shaw, in this type of situation each economic unit will have to maintain a balanced budget, that is, each will invest its own savings and there are no outlets for excess savings. Usually however, those who are willing and ready to take risks and undertake investments do not have the necessary finance while those who have the funds are either too frightened to undertake risks or not patient enough to wait for long periods before they reap the rewards of their efforts, or do not possess the ability to be entrepreneurs. In these circumstances, if each economic unit has to invest its own savings there is likely to be less savings and inefficient investment because of differences in ability, values and attitude towards risks and uncertainty. Putting at the disposal of entrepreneurs funds available to them, financial institutions make possible the financing of a larger volume of investment.
John G. Gurley and Edward E.S. Shaw, "Financial Institutions and Interrelationships", The Journal of Finance, Vol. 11 (May, 1956), pp. 260-263
Gurley and Shaw, Money in a Theory of Finance (New York: The Brookings Institution, 1960), Chaps. II and III.

3. Solis argues that the banking system is an instrument which can be used by the monetary authority to modify the allocation of loanable funds and resources to the various sectors and thus influence the demand for factors of production, goods and services.
L. Solis, "The Financial System in the Economic Development of Mexico," Weltwirschaftliches Archiv, Vol. 101, No. 1 (September 1968), pp. 36-48.

Our primary concern is thus to assess the extent to which the monetary and financial system has contributed to the availability and use of development finance. We have therefore attempted to answer three basic questions. These are: (a) The extent to which the financial structure has been successful in mobilizing domestic financial resources and the extent to which the system makes possible the continuous mobilization of domestic financial resources; (b) The extent to which domestic savings mobilized by financial institutions have been used for productive investment; and (c) The extent to which the financial system as a whole meets the needs of government's development strategy especially in ensuring that resources from institutional sources flow into areas and sectors considered of importance for economic development. Also, our analysis of the role of the monetary and financial system in the context of economic development includes a discussion on monetary management because of the link between money, income and the balance of payments brought about by the open and underdeveloped nature of the economy.

Method of Analysis

To answer the first two of our basic questions, we have analysed the sources and uses of funds of each financial institution. This analysis also enables us to comment on the extent to which the pattern of resource utilization by the financial institutions has been different from that which obtained under the colonial monetary system. It also enables us to give some indication of the size of the gaps in the credit structure.

To answer the third question, that is, the extent to which the flow of financial resources has been consistent with the development strategy, first requires an identification of the development objective and once this has been done the flow of financial resources is examined in the light of these objectives.

In his 1968/69 Budget Speech the Minister of Finance specified the direction of economic development as follows: "Our most abundant resources are land and manpower and it is my feeling voiced earlier and shared by my colleagues that we must look to the growth of agricultural production as our main hope for economic development."[4] From this and other pronouncements by the government, the development strategy is aimed at achieving the following objectives: Self-sufficiency in the production of foodstuffs, especially staple foods; increase in the volume and value of agricultural exports and diversification of output; promotion of processing of agricultural produce, and lastly the development of local industries based on agricultural production.

These were also the objectives of the previous government as can be seen from the following quotations from that government's development plan: "Until the development of secondary industries have made rapid advance agriculture like other extractive occupations must continue to play a significant role in making the economy viable both externally and internally ....".[5] "The springboard for industrialization will be sought in the processing of agricultural and other primary products ......".[6] "In the encouragement of foreign investment preference will be given to those industries which are based on the use and fabrication of local materials or the use of domestic substitutes for imported materials ......".[7]

This emphasis on agricultural development can be justified on several grounds. The agricultural sector is the largest single contributor to GDP accounting for an average of 33% during the 1960's.

4. Budget Speech for the 1968/69 Financial Year, (Freetown: Government Printer, 1968), p. 3.

5. David Carney, Ten Year Plan for Economic and Social Development 1961/62 - 1971/72 (Freetown: Government Printer, 1963), p. 24.

6. Ibid., p. 24.

7. Ibid., p. 59.

Productivity of agriculture is, however, low and this is borne out by the fact that 75% of the economically active population is engaged directly or indirectly in agriculture. One consequence of low productivity has been large importation of foodstuffs due to shortfalls in local production. A second consequence of low agricultural productivity is that income per worker in this sector is very low. Whereas the per capita income for the country as a whole averaged Le 94.4 for the period 1963/64 to 1969/70, the average for the agricultural sector for the same period was Le 77.

With increased agricultural productivity it should be possible to achieve self sufficiency in foodstuffs that can be produced in the country. To take one example, a 10% increase in rice production would result in a saving of Le 3 million on rice importation. Numerous studies have indicated that Sierra Leone can increase rice production, and the Chinese demonstration team has shown that three crops are possible within one year. And with West Africa being a large importer of rice there are export prospects for this commodity.

In a country like Sierra Leone industrialization must be for the domestic market as severe competition in the world market makes the outlet for industrial products abroad difficult. However, the size of the domestic market is quite small in view of the very low incomes. Hence, a programme of industrialization for the local market can succeed only with increased agricultural productivity which ensures that the mass of the people have a steadily rising purchasing power.

Migration to the towns, a problem in most underdeveloped countries, is the direct result of the absence of profitable employment prospects in the rural areas. A study by Levi found that "migrants predominantly come from the rural areas where there is high population pressure on the land and no alternative labour intensive method of production to land."[8]

8. J.R.S. Levi, "Labour Migration and Unemployment", Economic Review of the Bank of Sierra Leone, Vols. 4 & 5 (June, 1970), p. 10.

He concluded his study as follows: "Would it be going too far to suggest that government should concentrate on injecting resources into areas so as to raise labour productivity and carry out an extensive programme to teach people how to ensure fertility .....?"[9] If his finding is accepted policy measures aimed at improving the productivity of the farmer should reduce migration to the towns.

Capital is usually very scarce in underdeveloped countries and Sierra Leone is no exception. The development of the agricultural sector economizes in the use of capital since it has been shown that rapid and significant returns in agriculture are possible with relatively small amount of capital. This is important, because the bulk of the labour force in this sector is unskilled but is at the same time ready and willing to adopt new methods given the necessary incentive.

To summarize, the government's development strategy, which places the emphasis on agricultural development, is justified as increased agricultural productivity leading to less expenditure on food imports will conserve foreign exchange; secondly, because the size of the market limits severely the extent of industrialization for the home market; thirdly, because it is a labour surplus country; and finally, because there is plenty of fertile land available.

9. Ibid., p. 5. He found close association between labour productivity and migration as can be seen from the following: "In Chart I registered urban unemployment in Sierra Leone is plotted against time, the least squares trend line drawn and the deviation from trend obtained as shown. These deviations from trend are plotted on a graph against rice production (as a measure of rural real incomes), in Chart II, for the six years shown against each point, these being the only years for which data are available. The graph demonstrates a surprisingly strong relationship $r = -0.972$ which is significantly different from zero at the 1% level and almost at the 0.1% level; the 95% confidence interval is -0.731 to -0.997. It suggests that unless urban real wages remain fairly constant, which I am sure they did not, migration and consequent unemployment are not very sensitive to them. That unemployment on the other hand is very sensitive to the current level of earnings may be shown by looking at the bumper 1961 harvest; this was apparently only about 10% higher than average and yet registered unemployment fell by 30%." p.5.
He then went on to show the relationship between rice production and migration.

To achieve a break-through in agriculture however, modern methods of production must ultimately reach the mass of small producers, in addition to the development of plantations. These developments require an adequate flow of resources especially for the essential inputs and for credit facilities. The financial structure will be making a contribution to development of the country, if there exists within the system institutions ready to provide the special assistance agriculture and small scale businessmen need.

The Importance of Monetary Management

An objective of financial development is to encourage savers to hold their savings in liabilities of financial institutions and to ensure the efficient utilization of these savings. Consequently, a fundamental requirement is "the establishment of a unified, efficient inexpensive medium of exchange 'money' capable of elastic changes under the control of 'wise' monetary authorities".[10] In underdeveloped countries such as Sierra Leone there is a high correlation between money (currency in circulation plus demand deposits), income and the balance of payments. The relationship is the direct consequence of the openness of the economy.

Because of this close relationship between money, income and the balance of payments and since an efficient monetary system is essential for the mobilization and utilization of savings, it is necessary that income determination, monetary development and the balance of payments developments be analysed in an integrated model. After a careful examination of various models we consider the Polak Model to be the most appropriate for the Sierra Leone economy.[11] This model gives an

10. Hugh T. Patrick, "Financial Development and Economic Growth in Underdeveloped Countries," Economic Development and Cultural Change, Vol. 14, No. 2 (January, 1966), p. 185.

11. An outline of the Polak Model and its application to the Sierra Leone economy is given in Appendix I.

insight into the relationships. Its significance for the study is that it enables us to show the effects of credit creation on the balance of payments and hence the extent to which development can be financed by borrowings from the banking system.

One of the main conclusions of the Polak Model is that an increase in domestic credit will cause a gradual decline in the foreign exchange reserves of the country to the full extent of the additional credit. Since additional credit results in a depletion of the foreign exchange reserves, monetary management becomes important to ensure that utilization of credit increases the productive capacity of the economy to justify the loss of external reserves; and also, because of the consequences of reserve loss for short period stability, monetary management becomes important to bring about some co-ordination between the desire for long term development and the need for short period stability.

In summary, the study postulates that the development of the monetary and financial system will result in more domestic financial resources being available for development of the Sierra Leone economy. In our examination of this proposition, two main themes emerge. The first, which is centred around our discussion of the sources and uses of funds, is the need to increase the flow of financial resources to activities and sectors consistent with the country's development objective. The second is that the scope for traditional monetary policy is very limited and that emphasis must be placed on the level and flow of external reserves.

Chapter Summary

We begin with an anlysis of the colonial monetary system, of which the monetary and financial system of Sierra Leone was a part until 1963, in order to emphasize those features which ensured its success during the colonial period, and to point out the inadequacies of that system once independence was achieved. This discussion enables us to suggest required reforms in the light of the emphasis on rapid economic development, which became the objective of economic policy after independence.

The detailed examination of the monetary and financial system of Sierra Leone begins in Chapter II with a discussion of the Bank of Sierra Leone. The discussion in this chapter is concentrated on the sources and uses of resources available to the Bank; the Bank's contribution to economic development; and limitations on the effectiveness of the Bank. In our discussion of the Bank's contribution to economic development we examine the enabling provisions of the Bank's Act as well as look at what the Bank has done in practice.

Chapter III examines sources and uses of funds available to the commercial banks. Regression analysis is employed to explain trends in total deposits during the 1960's as well each category of deposits. On the allocation of funds, we examine the composition of loans and their utilization by sectors. We also discuss the contribution of the commercial banks to economic development.

Chapter IV looks at sources and uses of funds of the Post Office Savings bank. Regression analysis is used to explain the continuous loss of deposits at the savings bank during the period of the study.

Other financial institutions are discussed together under Non-Bank Financial Institutions in Chapter V. Here also, the concern is with the sources and uses of funds. Also included in this chapter are institutions which have recently been established, that is, those established after 1970 as well as those now being considered by the government.

Chapter VI examines sources and uses of funds available to the unorganized sector. The discussion in the chapter is centred around the volume of borrowing and lending, the rate of interest payable and the sources of savings.

In Chapter VII we examine the general issues which emerge from our aforementioned analysis of the sources and uses of funds available to financial institutions in the organized and unorganized sectors. The issues raised in this chapter include: The size of the financial sector and its relative importance in providing development capital; the possibilities of converting liquid savings into longer term investment; the possibility of reducing the level of external assets held by the Bank of Sierra Leone; mobilization of domestic resources through the introduction of exchange control; the utilization of resources made available to the government through the sale of government securities.

In Chapter VIII we present a theoretical discussion of the factors influencing the money supply as well as examine the behaviour of the Sierra Leone money supply. With the aid of the Polak Model outlined in Appendix I we show the significance of monetary management for the Sierra Leone economy. We also suggest the direction of monetary management in the light of the observed behaviour of the money supply.

In Chapter IX we suggest proposals for reform which we believe would increase the efficiency of the monetary and financial system and enable the system to mobilize domestic resources for economic development and ensure their utilization for productive investment.

Since the monetary and financial system can best be understood within the economy of which it is a part, we discuss the structural features of the Sierra Leone economy in Appendix I. We demonstrate the implications of the structural features for the financial system by discussing recent developments in the economy using the Polak Model already referred to. The relevance of this model to the Sierra Leone economy is also explained in this appendix.

Appendix II attempts to quantify the extent of unsatisfied demand for credit in the agricultural and small-scale industries sectors. The emphasis on these sectors lies in their importance for the development of the economy. Based on the results of a pilot survey undertaken in 1968, we derive some order of magnitude of the demand for agricultural credit. The agricultural credit gap is obtained as the difference between the estimated demand for agricultural credit and the existing sources of supply. In the case of the industrial sector we do not attempt to refute the argument (confirmed by a number of studies) that effective demand for credit by small-scale industries in underdeveloped countries is low. Instead, we suggest explanations for the low effective demand for capital amongst small-scale industries in Sierra Leone and argue that this demand would be higher if credit facilities are supported by ancillary services.

Our findings support the contention that, given appropriate policies, more domestic financial resources can be mobilized. Their productive utilization, however, requires fundamental changes in the operational policies of existing institutions as well as the establishment of more specialized institutions.

CHAPTER I

THE MONETARY AND FINANCIAL SYSTEM PRIOR TO 1963

Beginning in 1963, a number of financial institutions commenced operations, starting with the establishment of the Bank of Sierra Leone in 1963. At the same time, the role of older institutions were re-defined. In view of the government's emphasis on rapid economic development, we have assumed that the primary objective of reforming the monetary and financial system is to enable it to contribute to the availability of domestic financial resources for development.

Given that reform of the monetary and financial system has been undertaken against the background of economic development, we attempt to suggest the direction in which reform should have proceeded with this objective in view. For this it is necessary to examine the essential features and workings of the colonial monetary system of which the monetary and financial system of Sierra Leone was a part. Such an analysis enables us to emphasize those aspects of the colonial arrangement that are inconsistent with the need for making domestic capital available for economic development.

The chapter is organized into the following sections:

(a) The main features of the colonial monetary system;

(b) The structure of the economy and the workings of the colonial monetary system;

(c) The significance of political independence;

(d) The direction of monetary and financial reform.

(a) The Main Features of the Colonial Monetary System

It is important to understand the distinguishing features of the colonial monetary system which made it quite adequate for the needs of the colonial period. Such an analysis should also enable us to indicate those aspects of the system that are inconsistent with the requirements of economic development.

The colonial monetary system comprised (a) A currency board which was the issuing authority; (b) commercial banks and other financial institutions which were all branches of British Institutions; (c) the absence of deficit financing; (d) special grants from the United Kingdom Treasury; and (e) reliance on the London money and capital markets by both the government and the financial institutions.[1]

We now examine each of these in turn beginning with the currency board arrangement.

1. For a discussion of the Colonial Monetary System see: Ida Greaves, Colonial Monetary Conditions (London: Her Majesty's Stationery Office, 1953).

(i) The West African Currency Board (WACB).[2]

Between November, 1912 and July, 1963 the responsibility for the issuing of currency in Sierra Leone rested with the West African Currency Board. The responsibility of the WACB was defined as follows:

2. The West African Currency Board was established in November 1912 by an Executive Order of the British Secretary of States for the Colonies following the recommendations of the Emmot Committee appointed in 1911 "to enquire into matters affecting the currency of the British West African Colonies and Protectorates". It was intended to serve three main purposes; first, the initiation of a West African issue of currency; second, the assurance of convertibility of local currency into sterling at a known rate of exchange and third, the provision of revenue to the governments through sharing in the profits of issue. The WACB which served Sierra Leone, Ghana, The Gambia, and Nigeria operated from London and was appointed by the Secretary of State for the Colonies. The currency situation which led to the establishment of the WACB was quite precarious. To illustrate, Sierra Leone had the following currencies in circulation: First was commodity currency, mainly iron bars and tobacco. Second was the currency issued by the Sierra Leone Company, the macuta, which was the provincial currency coined by Portugal for Angola. The third category was the British Silver introduced after the transfer of political responsibility from the Sierra Leone Company to the Colonial Office. In the fourth category were the dubloon of Spain and Mexico, the 20 franc piece, the gold coins of the United States (The Eagle) the dollar of Spain and Mexico, the 5 franc piece of Belgium, Italy and Sweden. For a more detailed discussion on the West African Currency Board see:
W.T. Newlyn and D.C. Rowan, Money and Banking in British Colonial Africa (Oxford: The Clarendon Press, 1954), Chap. II;
C.V. Brown, The Nigerian Banking System (London: George Allen and Unwin, 1966), pp 51 - 53;
J.B. Loynes, The West African Currency Board. (London: At the Grosvenor Press, 1962);
R.A. Sowelem, Towards Financial Independence in a Developing Country (London: George Allen & Unwin, 1967), pp 24 - 29; 212 - 235.

"To provide for and to control the supply of currency to the British West African Colonies and Protectorates, to ensure that the currency is maintained in satisfactory conditions, and generally to watch over the interest of the Dependencies in question so far as currency is concerned".[3] In practice, this general obligation of the WACB meant in the words of Greaves, "It is the function of a Currency Authority to satisfy the demand for local currency not to regulate it; controlling the supply of currency in a colony is entirely a technical matter of providing for local requirements while guarding against losses from theft and forgery; it means deciding what types and denominations of currency are to circulate and issuing them on demand, not exercising discretionary authority over the total amount that is available."[4]

Under the provisions of the WACB local currency could only come into circulation with the surrender of an equivalent amount in sterling. At the same time, the WACB is obliged to redeem local currency against sterling. These regulations under which the WACB operated ensured that the value of the WACB currency was always stable with respect to sterling.

A departure from the 100 per cent sterling backing was made in 1957 and 1958 when the WACB acquired Le 4 million of Sierra Leone Government securities. The introduction of this fiduciary element did not change the basis on which the WACB operated as the one-for-one marginal relationship between WACB currency and sterling was not affected.

3. Newlyn and Rowan, op. cit., p.46.

4. Greaves, op. cit., p.12.

(ii) The Commercial Banks and Other Financial Institutions

Apart from being branches of large British commercial banks, the commercial banks in Sierra Leone, like the currency in circulation, were integrated within the banking system of the United Kingdom through interlocking directorships and through the use of the London money and capital markets. Sierra Leone, like other colonies, did not have a money market or outlets for discounting facilities and the temporary employment of surplus funds. Another feature of these banks was that they were supra-national, that is, they operated in several areas throughout the world with the result that their operations in Sierra Leone represented only a tiny fraction of their total world wide business. One implication of this was that funds moved freely from one area to another. As the commercial banks were part of the British banking system they operated "on essentially the same principles as branches located inside the same frontiers as their head offices".[5]

The results of these characteristics were firstly, that credit policies were determined in London and control over the branches was excercised from London. Secondly, because they looked at their banking operations as a whole, they did not hold foreign reserves specifically against their operations in any one country, Sierra Leone in this case. This being the case, their credit policies had no direct relationship to the amount of reserves which they lost or gained on account of a particular country but was determined by their liquidity position in general. Thirdly, because of the integration of the banking system of the colonies with the London money and capital markets and because of the absence of local investment outlets for their surplus funds, the assets of the commercial banks consisted

5. Ibid., p.27.

mainly of investments in London. Apart from the commercial banks, other financial institutions also invested most of their resources in the London money and capital markets. The Post Office Savings bank, for instance, was required by law to invest its resources in securities of the British and Commonwealth Governments and other colonial governments but not in securities issued by the Sierra Leone Government. Pensions, provident and superannuation funds were all invested in London. The same was true of investments of insurance companies.

(iii) The Absence of Deficit Financing

Three important features of colonial government finance were first, the absence of deficit financing; second, the dependence on the London money and capital markets; and third, colonial governments received special grants from the British Treasury.

Because London was both the monetary head-quarters of the country and also the country's capital market, Sierra Leone as well as other colonial governments held balances in London in addition to the loans and grants they obtained.

When colonial governments made use of the borrowing facilities of the London capital market, they enjoyed a privileged position which was made possible by various acts of the British Parliament, the most important being the Colonial Loans Act of 1899 and the Colonial Stock Act of 1900.

Between 1900 and 1938 Sierra Leone floated a total of six stocks in the London market at rates varying between 3% and 4½% and in each case these stocks were guaranteed by the British Government. The total value of these stocks was Le 4 million and maturity ranged between twenty and twenty five years. The London capital market was used again between 1943 and 1958 to raise Le 12 million. The average redemption was twenty years but this time the rate of interest ranged between $5\frac{1}{2}\%$ and $5\frac{1}{8}\%$. In addition, there were two United Kingdom Exchequer loans amounting to Le 3 million and interest at $5\frac{5}{8}\%$ and $6\frac{1}{2}\%$ respectively.

In addition to such borrowings the government received periodic grants from the United Kingdom Treasury.[6] These grants were quite substantial and started about 1800 with a grant of Le 14,000. During most of the period 1839 and 1864 grants in aid exceeded 80% of the total expenditure of the country.[7] Between 1865 and 1895 however, grants averaged 45%. There was a sharp rise thereafter and in 1900 these grants were 97% of total expenditure. Grants during the period 1900 to 1961/62 were as follows:

(Le 000)

1900 to 1945	1945/6 to 1958/59	1959/60	1960/61	1961/62
n.a.	9,062	1,890	2,398	5,474

Source: Ministry of Overseas Development. Aid to Developing Countries (London: H.M.S.O., 1963) Cmnd 2147, Appendix A, pp. 42 - 43.

6. N.A. Cox-George, Finance and Development in West Africa: The Sierra Leone Experience (London: Dennis Dobson, 1961), pp. 156 - 158. Also United Africa Company, Statistical and Economic Review, No. 20 (September, 1957), p.18.
For Colonial Development and Welfare Grants up to 1957 see United Africa Company, Ibid., p.18.

7. Cox-George, op. cit., pp. 156 - 158.

Although as a percentage of total expenditure these grants have declined in importance to less than 10% of total expenditure by 1961/62 they were quite large in absolute terms.

(iv) Observations on the Colonial Monetary System

This monetary and financial arrangement was quite consistent with the economic situation of the country. Sierra Leone, like all other colonies was closely related to the United Kingdom. Virtually all her exports went to the United Kingdom and likewise most of her imports originated from Britain and she depended on Britain for a number of services including shipping and insurance and was the principal source of investment capital. Because trade was the link between the colonies and the United Kingdom, commercial banks in all colonies including Sierra Leone concentrated their credit on the financing of the export/import trade between Britain and the colonies and invested in the London money market surplus funds which could not profitably be invested in the country. In fact, the banks were established primarily for the financing of the export/import trade.

Again, like other colonies, Sierra Leone was not regarded as a separate or foreign country but rather "more properly as the place where Britain considered it convenient to produce primary produce and the production of mineral products."[8] In effect "these colonies were extensions of the United Kingdom."[9] Consequently, the trade between the United Kingdom and Sierra Leone (and for that matter all other colonies) was not external trade in the sense of trade between two

8. J.S. Mill, Principles of Political Economy, quoted by Greaves, op. cit., p. 2.

9. Ibid.,

foreign countries but "resembles the traffic between town and country and is amenable to the principles of home trade."[10] This is supported by the fact that the colonies never had a trade policy of their own and have always been included in the balance of payments of the United Kingdom. Policies introduced to correct adverse balance of payments of the United Kingdom had to be implemented by the colonies. But on the other hand, grants in aid both covered any current account deficits and were a substantial source of development capital.

(b) <u>The Structure of the Economy and the Workings of the Colonial Monetary System</u>

Not only was the colonial monetary arrangements consistent with the objectives of colonial policy they also met the requirements of an open and financially dependent economy.

The conclusions to be drawn from our discussion of the structural features of the Sierra Leone economy in Appendix I are the following: The economy is dependent on foreign trade. The foreign trade sector is the generator of incomes. The consequence of dependence on the foreign trade sector as the main source of income is that this sector also determines the level of employment, output, demand and prices. In addition, the country is dependent on a narrow range of primary products, namely, diamonds, palm kernels, cocoa and coffee. While diamond exports account for about 60% of total export receipts, receipts from palm kernels account for about 50% of agricultural exports and about 10% of total exports. Another consequence of the dependence on foreign trade is that it not only determines the level of individuals' incomes but also dictates the level of government revenue. Also the amount of

10. *Ibid.*, pp. 2 - 3

deposits the commercial banks are able to mobilize depends on income which, in this case, means export incomes and since economic activities are centred around the export/import trade, the volume of commercial banks' loans and advances is influenced by the demand for credit from that sector.

Secondly, our discussion reveals that most of the increases in the investments financed from domestic sources occurred between 1968 and 1969 so that during the pre-independence period, investments were largely financed from external sources. All the mining companies were entirely owned by large foreign international companies. In the case of agricultural produce, these were in the hands of peasant farmers. But the marketing of the crops was undertaken by the trading companies, mainly foreign owned, and they provided the credit that was required for financing the trade.

Thirdly, as the banking system during the colonial period was relatively underdeveloped and investment largely originated from external sources, those who saved in the economy either invested those savings themselves or found others who needed finance and they did so without the assistance of financial institutions. There was no separation of the saving activity from investment activity. In such a situation intentions about savings and investment are related with the result that the divergence between ex-ante-savings and investment is reduced.

Fourthly, in addition to this economic dependence, the country was also financially dependent. The commercial banks as well as other financial institutions were all branches of foreign institutions and the absence of a local money and capital market meant that those with surplus funds sought investment outlets outside the economy and depended on external sources for short term accommodation.

Given these structural features let us now examine how changes in the money supply could come about in order to illustrate the workings of the monetary arrangement. An autonomous rise in exports resulting in a balance of trade surplus leads to increased domestic incomes. Those who have acquired the additional incomes would either spend it on local goods and services or deposit it with a commercial bank. To spend the export proceeds on goods and services the recipients would surrender their foreign earnings to the West African Currency Board in exchange for local currency. So that if the increased incomes were spent, the currency component of the money supply increased. If on the other hand the additional incomes were deposited with the commercial banks, their deposit liabilities would increase but at the same time their external assets would also rise. The money supply would rise if, as a result of their higher liquidity, the commercial banks decided to expand their loans and advances. This was however not automatic since the volume of loans that the banks could extend depended on demand, the availability of securities that were acceptable to the commercial banks and the existence of customers that satisfied the banks' conception of creditworthiness.

As the commercial banks were primarily established to finance the export/import trade, the demand for credit came from the foreign trade sector. Assuming then that there were borrowers who satisfied the banks' condition for a loan, the money supply increased further as a result of an expansion in the volume of lending by the commercial banks.

In the case of capital inflows to finance investment, foreign assets were surrendered to the WACB to meet the local cost of the investment. As in the previous case, some of the incomes made possible by the investment increased the deposits at commercial banks with the possibility of a further rise in the money supply.

In the case of an excess of imports over exports or capital outflows, the currency in circulation contracted. But because the commercial banks could determine what was or was not a creditworthy risk, and because their loans in any one country were not affected by the level of reserves in respect of that country, the commercial banks could influence the money supply independently of this adverse balance of payments. Suppose in this situation the commercial banks decided to increase their lending in Sierra Leone because, in their view, acceptable investment opportunities existed. In such a case, the volume of lending would have increased and not have contracted with the adverse balance of payments. Of course, in the absence of exogenous disturbances, balance will be restored by a contraction of the money supply caused by the leakage into imports and the public's demand for cash. That this type of commercial bank response was possible could be seen from the following quotation from Newlyn and Rowan:

> In 1951, however, the statistics show a huge increase in bank lending combined with a singularly large contraction in sterling assets. The magnitude of this inverse movement of the two variables is quite extraordinary and requires explanation. For the banks to increase their local earning assets by 60 per cent over a year in which their sterling balances fell 40 per cent is a remarkable indication of the importance and the volatility of bank lending in determining the local monetary situation.[11]

Newlyn and Rowan then went on to suggest that the fact that the banks "could behave in this way and thus give great elasticity to bank credit, is due to the supra-territorial nature of the banking structure. The banking system of Southern Rhodesia is not self-contained, and Southern Rhodesia forms but a small part of the banking territory of the banks operating there."[12]

11. Newlyn and Rowan, op. cit., pp. 171 - 172.

12. Ibid., p. 173.

In contrast, however, the normal behaviour of commercial banks in West Africa, especially up to the 1950's was passive. Referring to the sources of changes in the money supply in Nigeria between 1943 and 1951, Newlyn and Rowan observed as follows: "....makes it abundantly plain that the influence of bank credit creation was small and accounted for less than 8 per cent of the change in the total money supply over the period." [13] The passive response has been the normal reaction of commercial banks in Sierra Leone. The commercial banks did not have cause to increase their lending because trading firms met all their own credit requirements for financing the export/import trade. The commercial banks were thus merely "a custodian of cash and not a local provider of short-term capital." [14] Given this passive response, commercial banks' lending declined with an adverse balance of payments.

We can now summarize the factors which could affect the money supply during the colonial period as (a) changes in the external assets of the WACB and the commercial banks; (b) changes in the level of savings and time deposits; and (c) changes in the volume of lending by the commercial banks. Each of these sources of change originated from the external determinants of income.

But in practice, the financing of exports, imports or investment required the expansion of the currency circulation in advance of the sale overseas of the produce. This is because export crops had to be purchased from peasant farmers, who, because of their small incomes could not afford to wait until the produce were exported. The sterling required to increase the supply of local currency was provided by the

13. Ibid., p. 163

14. H.A. Shannon, "The Modern Colonial Sterling Exchange Standard," International Monetary Fund Staff Papers, Vol. 2 (April, 1952), p. 323.

trading firms. In the case of imports, the foreign firms also provided their own finance or obtained the required credit from their own banks abroad. The decision to invest was taken by foreign firms and this decision depended on the world demand for the products. As long as the demand for the produce existed they were always able to obtain the required investment capital from international sources. Once the decision to invest had been taken, the foreign firms made available the sterling assets which was necessary to meet the local cost of the investment.

For each of these activities, exports, imports and investment, the trading firms made available the necessary sterling assets without which the local currency could not increase. The volume of resources which these firms had to make available depended on import and export prices which were determined in the world markets. Hence the amount of resources they could provide depended on world market conditions. Here we need to emphasize the part played by the trading firms in the workings of the system as they ensured its flexibility. Hence, the colonial monetary system worked well because the trading firms and the commercial banks were ready to provide the sterling assets which were necessary for the increase of the money circulation in advance of the sale of exports produce in world markets.

Now, the level of domestic incomes was externally determined, that is, changes in exports, domestic investment and government expenditure were due to factors outside the control of the economy. Similarly, employment, output and prices were also determined externally. At the same time, these external determinants of incomes were also the factors that explained changes in the money supply. In any economy, changes in the value of external transactions will affect domestic incomes and the money supply. But the major difference between an open economy and an economy in which external transactions are relatively unimportant as a determinant of income is that in the latter case, it is possible to neutralize the effects of external transactions and in consequence these external transactions need not affect the money supply. In the former case however, that is, in an open economy, external transactions are the primary determinants of incomes and the money supply.

The colonial monetary arrangements, by eliminating discretionary control, in essence, enabled the monetary system to respond automatically to the external determinants of income, thereby avoiding fluctuations in the value of the domestic currency. But suppose that the monetary arrangement did not reflect the external determinants of income. We consider the effects of an autonomous increase in bank lending and investment which are not matched by export earnings or capital inflows. Given the propensity to import, a large fraction of the net additions to income will flow out of the economy. Since the head office is not likely to maintain an overdrawn position indefinitely, the consequent loss of foreign assets by the banks may lead to contraction in lending. In the case of autonomous investment, a large part of expenditure flows out as a direct expenditure on equipments. This is in addition to what is lost as a result of the high marginal propensity to import. In this case also, the result is a loss of foreign assets. Unless foreign assets are already very large, autonomous bank lending and investment may lead to a balance of payments problem. To the extent that the convertibility of local currency to foreign currencies was essential for foreign trade and capital inflows on which the country relied for its income, the colonial monetary system was consistent with the structural features of the economy and the limited objectives of colonial economic policy.

(c) The Significance of Political Independence

But colonial economic policy was quite inadequate after political independence was achieved in 1961. In pursuit of achieving a high rate of economic development, the strategy entailed diversification of the economy with less emphasis on foreign trade than had previously been the case under the colonial arrangement. In effect, therefore, a structural transformation to ensure continuous development of the economy was what political independence envisaged.

Against this background of the desire for fundamental changes in the economic structure, a monetary and financial system which is outward oriented is largely inappropriate. Nor can the monetary and financial system be uninterested in the country's desire for economic development. For while it is possible to discuss particular industries in isolation of the economy in which it is situated, the monetary and financial system must be seen within the economy of which it is a part.

With the emphasis on rapid economic development after independence, the monetary and financial system has to be an instrument of economic development. This is essential because the commitment to rapid development requires a substantial amount of capital. This capital can come from internal sources or originate from abroad. But there are several reasons why the emphasis must be on mobilizing domestic resources. There is already a large demand for investment funds throughout the world from other underdeveloped countries as well as the more developed countries. It should be noted also that investment funds do not necessarily flow to areas of high priority for development but rather to those countries in which the returns, in the form of profits, are greatest. Hence, investment funds are flowing increasingly to relatively rich countries such as Australia and South Africa. Given the large demand for investment funds, the possibilities are that capital for investment may not be available to small countries such as Sierra Leone on favourable terms.[16] Then, there is also the fact that capital inflows in the form of grants and aids have shown a marked decline since 1963/64.[17]

16. Already in 1951 Sir Cecil Trevor had observed that: In present conditions, the demand on the London Market is particularly heavy and it is in the interest of all concerned that other means of raising capital should be explored as far as possible before resorting to London. To this end, it is particularly desirable that colonial governments should be encouraged to raise as much as possible of their loan requirements locally.
Sir Cecil Trevor, Report on Banking in the Gold Coast and on the Question of Setting up a National Bank (Accra: Government Printer, 1951), para 176 .

17. The decline in grants from the United Kingdom can be seen from the following figures:

BRITISH AID TO SIERRA LEONE

(Le 000)

1962/63		1963/64		1964/65		1965/66	
Grants	Loans	Grants	Loans	Grants	Loans	Grants	Loans
2,152	2,286	1,000	4,120	-	1,660	-	1,840

1966/67		1967/68	
Grants	Loans	Grants	Loans
214	2,838	-	766

Source: Ministry of Overseas Development, British Aid: Statistics of Official Economic Aid to Developing Countries (London: H.M.S.O. June, 1967), Table 19.
British Aid: Statistics of Official Economic Aid to Developing Countries (London: H.M.S.O.) June, 1969.

As regards foreign private investment, inflows are not on their previous scale but at the same time remittances from earlier investment continue. Other outflows include remittances by foreign personnel who have come to assist in the development process either as technicians, businessmen or advisers; investment abroad; and up to 1964 paid passages for holidays abroad for senior civil servants.

These inflows now take the form of loans. We show in Appendix I that debt repayment was about 20% of total revenue in 1969/70. For these reasons the country will have to look increasingly to domestic sources for its development capital. And it should be the responsibility of the monetary and financial institutions, in this changed situation caused by political independence, to mobilize domestic resources for development. At the same time, the lending policies and loan utilization pattern must reflect the changed direction of economic policy.

There are other reasons why the simple colonial device is no longer suitable today. We have emphasized the fact that the colonial monetary arrangements worked well because the trading firms and the commercial banks were willing and able to surrender the sterling backing that was necessary for any increase in the currency circulation. It was relatively easy for the trading firms and the commercial banks to do this because the financing of the export/import trade resulted in their earning foreign exchange. One of the consequences of independence is that the trading firms have been excluded by law from the marketing of agricultural produce. In addition, we argue in Chapter III that trading firms no longer bring in their own finance but rely on commercial banks. Retaining the colonial monetary arrangements in these circumstances would result in marketing difficulties.

Quite apart from the problem of short run elasticity there is the problem of long term expansion in the money supply. As the economy grows, incomes and the volume of transactions also lead to a rising demand for money. Unless this increased demand for money is met there will be a deflationary drag in the economy.

We have noted that the currency board arrangement together with the trading firms and commercial banks ensure that there will be sufficient elasticity but only in so far as the foreign trade sector is concerned. The problem however, arises where the expansion is in the domestic sector, as for example, an increase in the production for local consumption. The local entrepreneur does not have access to commercial banks' funds either because he does not meet the banks' lending conditions or because he does not have the conventional securities that are acceptable to the banks. The commercial firms are equally not interested as the activity is not connected with the export/import trade nor will it lead to their earning foreign exchange. The result is that the expansion cannot be financed. Given the desire for rapid economic development it is essential to diffuse credit to all sectors of the economy if the desired development is to be achieved.

A scarcity can arise in another way. We begin with an equilibrium situation in the government budget. We next assume that there is a shortfall of revenue over expenditure. This difficulty can be dealt with by deficit financing. But it should be recalled that the colonial monetary arrangement did not permit such financing. Assuming also that the government does not have large cash balances which can be run-down, then only the commercial banks can provide the necessary accommodating finance.[18]

18. There is no reason for optimism that the commercial banks will be ready to provide finance for activities other than those connected with the export/import trade. Newlyn and Rowan observed as follows: "Expatriate banking in Nigeria began in 1894. Fifty five years later, in 1949, bank advances were, on average, some 5 per cent of the money supply. This is hardly a record which encourages a belief in the secular elasticity of expatriate deposit banking." * We show in Chapter III that there was a considerable expansion in loans and advances in Sierra Leone during the 1960's, so that it can be argued that these banks are no longer 'conservative' in their lending policies. This is not the case, however, for we point out in that chapter that the reason for the expansion was due to the change in the method of financing the export/import trade. The banks' loans and advances have gone mainly to the large expatriate firms with only a small fraction of the total available to Sierra Leonean enterprises. In relation to Sierra Leonean enterprises, therefore, the above quoted statement is still relevant.
* Newlyn and Rowan, <u>op. cit</u>., p. 196.

In the absence of the necessary accommodating finance, economic activities would have to be reduced as the government attempts to balance revenue and expenditure. Such a reduction in economic activity may however influence the commercial banks to reduce their volume of loans and advances with further contraction in the level of economic activity. Even if commercial banks are willing to provide the necessary accommodating finance, the point which must be borne in mind is that development in these circumstances will depend on the goodwill of foreign institutions whose policies are dictated from their head offices overseas.

Next, in 1957 when Ghana decided to withdraw from the colonial monetary arrangement, the then Ghanian Minister of Finance described the system as the "financial hallmark of colonialism." The withdrawal of Nigeria too coincided with the attainment of independence. Hence, on political grounds, Sierra Leone could not have retained the system for very long. It should be noted that Ghana and Nigeria accounted for 70 per cent of the WACB currency in circulation in West Africa. Their withdrawal meant a considerable reduction in the activities of the WACB. Thus, the WACB's continued existence was doubtful after 1961 when Sierra Leone became an independent state.

Finally, several authors have argued that by ensuring automatic adjustments the colonial monetary arrangements avoided balance of payments problems. [19] However, economic development in Sierra Leone involves importation on a large scale of capital equipment and technical services which are required for development and which are not available locally. Also, improvements in the standard of living and the demonstration effect imply increased importation of a wide range of consumer goods. There are therefore not likely to be any balance of payments difficulties as long as economic activities are kept very low. But when action is taken to improve the productive capacity of the economy, balance of payments difficulties tend to emerge.

In summary, political independence with its emphasis on rapid economic development requires a monetary and financial system to adjust itself to this objective. A monetary and financial arrangement which precludes deficit financing and which involves the holding of excessive external reserves would impose a severe constraint on development.

19. Hazelwood argues as follows:
The special feature introduced by the colonial monetary system is that a colony 'cannot have a balance of payments problem as that term is now commonly understood'.. This is ensured in two ways. First, by prohibiting 'deficit finance', the colonial monetary arrangements prevent the maintenance of local incomes and expenditure on imports when external earnings have fallen. Secondly, the '100 per cent reserve system' looks after dissaving (including the withdrawal of liquid capital by expatriate enterprises) when internal incomes fall.... The '100 per cent reserve currency prevents balance of payments difficulties because there is always sterling available to meet expenditure from hoards.

A. Hazelwood, "The Economics of Colonial Monetary Arrangements," _Social and Economic Studies_, Vol. 3, no. 4 (December, 1954), p 298.
Greaves remarks "...if a colony is unable to meet its external obligations it is because of lack of money - of income in internal currency - not because of the lack of foreign exchange."
Greaves, _op. cit._, p. 88.

(d) Direction of Monetary and Financial Reform

Since the main criticisms of the currency arrangement was the automatic link which the system was supposed to create between the money supply and the balance of payments, those who have advocated reform of the system have hoped that one of the consequences of the reform would be to create an institution that would be capable of taking discretionary action with the objective of stabilizing domestic money incomes, output and employment.[20] Given a foreign trade sector representing about 30% of GNP, output and incomes were to a large extent dependent on external factors. At the same time, a large part of investment expenditure was accounted for by the government sector whose decisions were not necessarily influenced by purely economic considerations. But even in the case of private investment, domestic interest rates were not particularly important in influencing investment decisions as most of these were financed by capital inflows. Further, the high import leakages substantially reduced the margin of discretion which the authorities have in setting the level of internal demand. So that it was the structural features of the economy and not the currency board regulations that limit the scope for completely independent action by the monetary authorities.

But the fundamental problem facing the country is the vicious circle of under-employment, low incomes and low savings. The basic requirement in this underdeveloped setting is the development of the monetary and financial system to make possible the mobilization and efficient utilization of domestic financial resources in order to increase the relative importance of domestically financed investment. Such a

20. Thus the Ceylonese Monetary Law charged the central bank of that country with the following: " ... 'by regulating the supply, availability cost and character of credit' so as to secure, as far as possible the following objectives: (a) the stabilization of domestic monetary values, (b) the preservation of the par value of the Ceylon rupee, (c) the promotion and maintenance of a high level of production, employment, and real income in Ceylon, and (d) the encouragement and promotion of the full development of productive resources of Ceylon".
R.S. Sayers (ed.), Banking in the British Commonwealth (Oxford: At the Clarendon Press, 1952), p. 418.

development, by reducing the relative importance of external pressure, also increases the ability of the monetary authority to influence domestic incomes and employment. Hence, monetary and financial reform must give prominence to the developmental aspects of policy.

However, when the development of the monetary and financial institutions is placed within the context of rapid economic development of the country, the exchange rate of the currency becomes an inescapable issue. This is because with a fixed exchange rate, a conflict develops between the objective of accelerating internal investment and maintaining external balance. In theory, this balance of payments "trap" arises as follows. We begin with a situation in which exports and imports are equal and with a given level of income. It is now decided to increase investment substantially. Such an investment programme presupposes increases in imports as most of the capital goods required for development are not available locally. Also, the rise in the level of investment raises the initial level of income, some of which may be spent on imported consumer goods. And even if we assume that the investment may lead to an expansion in exports, this is possible only after a time-lag. Hence, the outcome is a deficit in the balance of trade with the extent of the trade gap depending on the proportion of direct expenditure on imports, the propensity to import, and the elasticity of supply of the export sector. If we rule out large scale capital inflows then there is an inevitable conflict between rapid development and the balance of payments.

There are two possible approaches in dealing with this balance of payments constraint. The first approach involves the adoption of a flexible exchange-rate policy. Such a policy allows automatic adjustments in relative prices. In the second approach in which a fixed exchange-rate is maintained external balance is restored by the adoption of certain deflationary policies while the imbalance has to be financed by means of the country's international reserves.

The main advantages of a fixed exchange-rate policy is it ensures stability. A fixed exchange-rate also implies that certain specific guidelines are to be followed by the monetary authority, with the responsibility of management of the system vested in the monetary authority rather than with the politicians.

The floating alternative, it has been argued, eliminates the likely conflict between rapid development and external balance as it ensures the preservation of external equilibrium. With the absence of external disequilibrium, the authorities are in a position to pursue autonomous domestic policies which are consistent with the development objective. However, the success of such a policy presupposes that "all other things remaining equal". In practice there may be a number of constraints. These obstacles include the price elasticities of imports and exports, existing international agreements on the marketing of produce, existing trading links and the relative size of the country. It should be noted that currencies of small countries such as Sierra Leone derive their usefulness because they are convertible at a fixed rate of exchange to a major currency, sterling in this case. Consequently, assuming it is decided to adopt a flexible exchange rate policy, the question which arises is should the "Leone" be free to fluctuate against all currencies or ought it to be pegged to a major currency such as sterling or other currency grouping while floating with respect to other currencies?[21]

21. On this issue Mundell's suggestions concerning "Optimum Currency Areas" become interesting. His proposal is to establish currency areas comprising several countries. As between different such areas, exchange rates could be freely variable; within each area, exchange rates should be fixed and payments adjustments would be assured because of his assumption of closer economic integration and co-operation.
Robert A. Mundell, International Economics (New York: The Macmillan Company Ltd., 1968), Chap. 12. See also
R.I. McKinnon, "Optimum Currency Areas", American Economic Review, Vol. 53 (1963), pp. 717 - 724.

Indeed, the increased foreign exchange costs of servicing external borrowings with a depreciated currency will be an additional burden on development expenditure. Also, one of the advantages of floating is that the consequent depreciation of its value stimulates the export of commodities which were previously uncompetitive. But most of Sierra Leone's exports are mineral and primary produce and the country, during the period of our study, did not experience difficulties in selling its products at prevailing prices. In addition, the manufacturing sector is small. Hence, the stimulus to exports which results from floating the currency is of little practical significance.

At the same time, the higher import prices need not lead to any substantial import substitution because of the absence of entrepreneurs, the nature of the commodities being imported, and the small size of the Sierra Leone market. (See Chapter II). As exports need not show any significant expansion while imports cost more, the value of the currency is likely to depreciate further to restore external balance. This continuous depreciation of the value of the currency and the resulting impact on domestic prices may force the government to intervene in the foreign exchange market. Hence, the existence of constraints make the return to fixed exchange-rate policy inevitable.

A fixed exchange-rate policy is assumed in this thesis because the rate of exchange of the "Leone" has not been a serious obstacle to development. This is because the trade gap was not very large during the 1960's, and those years were characterized by gains in the country's international reserves.

The basic problem, as already indicated, is how to mobilize domestic resources and once acquired how to use these resources productively. In this context, reverse flows have been a serious handicap as the absence of restrictions have facilitated such outflows. The extent of such reverse flows is examined in Chapter VIII and in that chapter we emphasize that the necessity for exchange control lies in its ability to prevent the outflow of domestic financial resources which can be used for financing development.

It will be contended in this thesis that financial institutions have not been successful in improving the relative importance of domestically financed investment partly because resources mobilized have been mainly liquid, in the form of money and near money liabilities of the banking system; and also, because most of the resources which flowed to these institutions were invested outside the economy. This has been the inevitable outcome in view of the fact that the underlying constraints, namely, the openess of the economy and the supra-national character of the financial institutions, were not adequately dealt with, with the result that the central bank which was the instrument of monetary and financial reform, was not suitably equipped to deal with the problems of financial development. Because sufficient thought was not given to the fundamental problems of the economy when these institutions were being planned, the institutions established have been largely ineffective.

We recognize that an efficient monetary and financial system by itself cannot ensure development. Nevertheless, such a system is an indispensable instrument of economic development. As Hazelwood put it:

> ..... inadequate or inappropriate monetary arrangements may make it difficult for a country to take full advantage of its economic potentialities. Endowing it with 'advanced' monetary institutions will not transform a 'backward' country into an 'advanced' one, but changes in its monetary system may oil the wheels of economic progress.[22]

The starting point of our analysis of the Sierra Leone monetary and financial system is with the Bank of Sierra Leone, the central bank.

22. Hazelwood, op. cit., p. 291.

CHAPTER II

THE BANK OF SIERRA LEONE: SOURCES AND USES OF FUNDS

This chapter argues that the central bank which replaced the West Afican Currency Board operates largely like the currency board, primarily because the Bank functions like the conventional central bank of the Bank of England tpye. It is equipped mainly with orthodox instruments such as "open market operations" and "bank Rate" although it has to operate in an underdeveloped and financially dependent environment. The net effect of the limited legal authority is that the Bank has been unable to improve the flow of financial resources to the important agricultural and small-scale industries sectors. But quite apart from the constraints imposed on the Bank by its legislation, there are those which are due to the nature of the economy and the attitude of the Bank's management; and these have made it difficult for the Bank to take a broader view of its role in an underdeveloped environment.

The chapter is divided into the following sections: The establishment of the Bank of Sierra Leone and its organization; sources of funds; uses of funds; and limitations on the effectiveness of the Bank of Sierra Leone.

(a) Establishment of the Bank of Sierra Leone and its Organization

The most important institutional change in the evolution of the monetary and financial system has been the replacement of the West African Currency Board by the Bank of Sierra Leone, the central bank, in 1963.

We have observed in the previous chapter that by 1962 reform of the monetary and financial system was inevitable. With the approach of independence, the Governments of Sierra Leone and the Gambia, the other members of the West African Currency Board, invited Mr. J.B. Loynes of the Bank of England " ..... to examine the present currency system and to recommend how the system could be developed to meet the economic and political needs of the two territories both common and individual."[1] Mr. Loynes in his report which was published in 1961 considered three possibilities. These were: Continuation of the WACB arrangement but with headquarters transferred from London to Freetown; a joint Sierra Leone/Gambia Currency Board; and a Central Bank. He did not consider any of these alternatives suitable for Sierra Leone.[2]

1. Introductory letter to His Excellency the Governor of Sierra Leone in J.B. Loynes, Report on the Future of the Currencies of Sierra Leone and the Gambia (Freetown: Government Printer, 1961).

2. Like Fisher, Sir Cecil Trevor, Paton and others, he argued that the 'right conditions' did not exist for the establishment of a central bank. The right conditions for the functioning of a central bank were defined by Sir Cecil Trevor as follows: " ..... it is essential that all the flexible instruments necessary to an advanced economy should be available in the form of a Government Securities Market, a Bill Market, a Stock Exchange, banking and insurance systems." Sir Cecil Trevor, Report on Banking in the Gold Coast and on the Question of Setting up a National Bank (Accra: Government Printer, 1951), para 100. Also, see footnote 28 for other references.

The institution he considered appropriate to the country's needs was to be known as a 'Monetary Institute'. This new institution should be concerned, in the early stages, only with the issue and redemption of currency; but he hoped that in time, the institution would perform all the usual functions of a central bank. In a sense therefore, the new institution proposed by Mr. Loynes was a currency board with a new name.

Although the Sierra Leone Government accepted the Loynes Report it did not establish the Monetary Institute recommended. The first indication that the Sierra Leone Government intended to establish a central bank rather than a Monetary Institute was given by the Minister of Finance in his 1962/63 Budget Speech.[3]

During that financial year Mr. H.S. Hall of the Bank of England was invited to undertake the preliminary arrangements for the establishment of a central bank including the drafting of the necessary legislation. The Bank of Sierra Leone Act became law on the 27th March, 1963 and the Bank was opened for business on the 4th August, 1964.

The responsibility of the Bank is defined as follows: "To issue legal tender currency in Sierra Leone and to maintain external reserves in order to safeguard the international value of the currency; to act as banker and financial adviser to the government and to promote

3. He said, "No independent country can regard itself as truely independent until it has its own national currency....the time is not too distant when Sierra Leone too will have its own central bank." <u>Budget Speech</u> delivered by the Minister of Finance in the Sierra Leone House of Representatives on 21st March, 1963. (Freetown: Government Printer, 1963), p.5.

monetary stability and a sound financial structure."[4]

The management of the Bank is by a Board of Directors consisting of a Governor, a Deputy Governor and three other Directors. The Governor and his Deputy who must be persons with "recognized financial experience"[5] are appointed by the President and hold office for five years. The other directors are appointed by the Prime Minister for a period of three years.[6] Following British tradition, government officials are excluded from the deliberations and decisions of the Board of Directors.[7]

The Bank is organized into three main departments; the General Manager's, the Secretary's and Research Departments. The Internal Audit which is a small section works directly with the Governors. The General Manager's Department is the largest department and deals mainly with the issue and redemption of currency, banking, the management of government debt and bank examination. The Secretary's Department deals with administration while the Research Department

4. In contrast the Bank of Ghana Act, 1963, defined the responsibility of the Bank as "to regulate and direct the credit and banking system in accordance with the economic policy of the government; to propose to the government measures which are likely to have a favourable effect on the balance of payments, movement of prices, the state of public finance and the general development of the national economy and monetary stability; to do all such things as are incidental or conducive to the efficient performance of its functions under this or any other enactment." The Bank of Ghana Act, (1963) p.5. The Bank of Jamaica is required "to influence the volume and conditions of supply of credit so as to promote the fullest expansion in production, trade and employment consistent with the maintenance of monetary stability in Jamaica and the external value of the currency, and to foster the development of money and capital markets in Jamaica." W.F. Crick, Commonwealth Banking Systems (Oxford: The Clarendon Press, 1965), pp.41-42.

5. Bank of Sierra Leone Act, 1963. Section 10 (i).

6. Unlike the Governor and his Deputy, the other directors need not have financial experience and can be selected from those with experience in "business, professional or academic matters." *Ibid.*, Section 11 (i)

7. The Bank of Sierra Leone Act states that "No person shall be appointed or shall remain Governor, Deputy Governor or a Director of the Bank who is: (a) a member of the House of Representatives, (b) a Director, salaried official or shareholder of any commercial bank which carries on business in Sierra Leone, (c) an officer of the public sector. *Ibid.*, Section 12.

collects, analyses and interpretes information relating to all aspects of the economy but especially to money and banking. This enables the Bank to fulfil its obligation as financial adviser to the government.

(b) <u>Sources of Funds</u>

From Table 2.I which shows the Balance Sheet of the Bank of Sierra Leone for the period 1964 - 1970, the main sources of funds available to the Bank are currency issued and deposits. In addition, the Bank operates a Call Money Fund for short term surplus funds. The management of this fund also adds to the Bank's resources.

(i) The Issuing of Currency

As we have seen, prior to 1963 currency in circulation had to be backed 100% by sterling assets. Consequently, the maximum rate of issue of currency depended on the rate of acquisition of sterling assets. The 1963 Bank of Sierra Leone Act, however, introduced two changes, these were a provision to enable the Bank to hold assets other than sterling and a reduction in the amount of external cover for the currency from 100% to 60%. The significance of the change is that the issue of currency was facilitated by the greater ease of acquiring local assets as backing for the issue. But although these regulations set the limit for the amount of currency that can be issued, the actual issue depends upon the method of financing public expenditure and the demand for currency by the general public.

TABLE 2.I STATEMENT OF ASSETS AND LIABILITIES OF THE BANK OF SIERRA LEONE :

LIABILITIES (Le. 000)

End of Period	Sierra Leone Currency Issued	Deposits: Government	Deposits: Commercial Banks	Deposits: Others	Total	Capital	General Reserve	Allocation of S.D.R's	Other Liabilities	Total Liabilities
1964 September	8,752	631	174	15	820			--	641	10,213
December	11,268	1,539	223	218	1,980			--	594	13,842
1965 March	13,373	1,687	217	195	2,099			--	4,196	19,668
June	14,570	841	220	398	1,459				4,230	20,259
September	14,252	674	221	266	1,161			--	3,761	19,174
December	15,273	782	222	283	1,097			--	4,084	20,454
1966 March	16,834	696	875	294	1,570	700	101	--	3,118	22,323
June	16,651	1,342	217	262	1,690	700	101	--	3,565	22,707
September	15,469	592	216	230	827	700	101	--	3,467	20,564
December	16,116	510	220	46	776	700	101	--	3,039	20,732
1967 March	16,984	642	1,356	103	2,101	700	193	--	2,379	22,357
June	16,158	551	220	80	851	700	193	--	2,655	20,557
September	15,446	722	217	258	1,197	700	193	--	3,018	20,554
December	15,627	1,287	221	214	1,722	700	193	--	3,217	21,459
1968 March	17,772	1,052	571	221	1,844	700	268	--	3,972	24,556
June	20,340	1,196	224	236	1,657	700	268	--	4,683	27,647
September	19,706	1,408	233	58	1,689	1,500	268	--	5,197	28,360
December	19,679	1,687	217	3,204	5,108	1,500	268	--	6,263	32,818
1969 March	22,634	3,808	223	2,014	6,045	1,500	415	--	5,178	35,772
June	23,555	3,619	223	2,664	6,506	1,500	415	--	5,544	37,520
September	22,208	3,626	219	4,181	8,026	1,500	415	--	6,018	38,167
December	22,058	3,634	215	3,127	6,976	1,500	415	--	7,340	38,289
1970 March	21,147	2,749	220	3,212	6,181	1,500	415	2,100	6,976	39,626
June	21,838	1,742	218	4,590	6,550	1,500	415	2,100	6,781	39,491
September	19,464	1,267	255	5,968	7,490	1,500	415	2,100	7,590	38,866
December	20,162	1,885	329	4,950	7,167	1,500	415	2,100	7,562	39,213

ASSETS

End of Period	External: Balances with banks Abroad	External: Foreign Government Securities	External: W.A.C.B. Notes and Coins	External: Holdings of SDR's	Total	Government Securities	Rediscounts and Advances	Fixed Assets	Other* Assets	Total Assets
1964 September	1,195	3,790	4,297	--	9,282			931		10,213
December	1,646	6,780	4,096	--	12,522			1,320		13,842
1965 March	1,031	7,928	4,074	--	13,033	9	1,510	5,116		19,668
June	1,148	10,462	552	--	12,162	3,508	616	4,003		20,259
September	1,013	10,258	54	--	11,325	3,766	400	3,683		19,174
December	1,104	11,083	28	--	12,215	3,829	799	3,611		20,454
1966 March	977	10,765	8	--	11,750	5,277	1,445	754	3,097	22,323
June	2,185	9,574	2	--	11,761	5,484	1,610	769	3,083	22,707
September	810	9,869	3	--	10,682	4,930	910	831	3,211	20,564
December	836	11,243	--	--	12,079	3,543	1,580	837	2,693	20,732
1967 March	1,225	11,720	--	--	12,945	4,451	1,830	840	2,291	22,357
June	636	10,690	--	--	11,326	4,051	1,890	865	2,425	20,557
September	1,296	9,681	--	--	10,977	4,172	1,882	870	2,653	20,554
December	577	11,440	--	--	12,017	4,385	1,401	800	2,856	21,459
1968 March	1,766	12,199	--	--	13,965	4,247	1,590	848	3,906	24,556
June	1,664	14,957	--	--	16,622	5,123	520	913	4,470	27,647
September	1,391	16,380	--	--	17,771	3,129	1,030	1,779	4,651	28,360
December	1,907	20,994	--	--	22,901	2,412	150	1,566	5,789	32,818
1969 March	8,120	17,957	--	--	26,077	2,542	351	1,657	5,145	35,772
June	14,137	14,599	--	--	28,736	1,854	3	1,744	5,183	37,520
September	15,544	13,634	--	--	29,178	1,658	44	1,783	5,504	38,167
December	21,067	8,417	--	--	29,484	1,282	1	1,573	5,949	38,289
1970 March	22,875	7,427	--	408	30,710	675	1	1,661	6,579	39,626
June	21,397	6,352	--	401	28,150	1,418	1,571	1,706	6,646	39,491
September	21,514	4,539	--	401	26,454	865	2,891	1,758	6,898	38,866
December	16,448	7,796	--	401	24,645	2,009	4,264	1,794	6,511	39,213

*'Other Assets' for the period 1964-1965 are included in Fixed Assets

Source: Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March, 1972), Table 1.

The relationship between currency issued, currency in circulation, deposits and the money supply is shown in Table 2.II. Between 1960 and 1970, currency in circulation, that is, currency issued less currency held by the commercial banks, went up by 73 per cent, rising from Le 11 million in 1960 to Le 19 million by 1970. During the period there was a slight change in the proportion of currency held by the commercial banks in relation to currency issued. The proportion of currency held by the commercial banks dropped from a high of 13.3 per cent in 1963 to 5.1 per cent by 1970. If we divided the period into two parts, that is, 1960-1964 and 1965-1970, currency held by the commercial banks averaged 11.2 per cent and 9.2 per cent respectively. A probable explanation for the decline in the amount of currency held by the commercial banks is the facilities for clearing operations provided by the Bank of Sierra Leone since 1964. The clearing facilities offered by the Bank have resulted in banks settling their accounts through the manipulation of their deposits with the Bank instead of by cash payments which was the usual practice before this facility became available.

Currency in circulation as a ratio of the money supply averaged 65 per cent for the period 1960 - 1970. Currency in circulation as a ratio of GNP decreased slightly although at the end of 1969/70 the percentage was the same as it had been in 1963/64. The ratio of currency in circulation to total deposits gives some indication of the non-bank's public preference for currency as against deposits. Currency as a ratio of total deposits has declined slightly. The small shift from currency to savings and time deposits may be due to the growth of branches of commercial banks. We show in Chapter III that the number of banking offices increased from 3 in 1950 to 28 by the end of 1970.

TABLE 2.II CURRENCY AND ASSOCIATED RATIOS, 1960-1970

	Currency Issued (Le 000)	Cash in Banks (Le 000)	Cash in Banks/ Currency Issued (ratio)	Currency in circulation (Le 000)	Currency in circulation/ Total Deposits (ratio)	Currency in circulation/ Demand Deposits (ratio)	Currency in circulation/ Money supply (ratio)	Currency in circulation/ GNP (ratio)
1960	12,068	1,168	.107	10,900	1.205	1.884	.653	n.a.
1961	13,924	1,284	.102	12,640	1.174	1.867	.651	n.a.
1962	14,414	1,334	.102	13,080	1.044	1.664	.623	n.a.
1963	14,632	1,712	.133	12,920	1.014	1.781	.639	.660
1964	15,023	1,599	.119	13,424	0.880	1.611	.630	.610
1965	15,502	1,315	.093	14,187	0.937	1.951	.656	.610
1966	16,116	1,641	.113	14,475	0.866	1.862	.660	.600
1967	15,627	1,263	.088	14,364	0.822	1.716	.659	.570
1968	19,679	1,826	.102	17,853	0.830	1.796	.673	.630
1969	22,057	1,839	.091	20,218	0.788	1.733	.665	.660
1970	20,162	1,305	.051	18,941	0.773	1,876	.668	n.a.

Sources: Economic Review of the Bank of Sierra Leone, Vol. 5, No. 4 (March 1971), Tables 5, 7, and 33.
For 1960 figures see same publication Vol. 3, No. 1 (June, 1968), Table 8.

In those areas in which banking offices exist the public's relative preference for deposits can be explained in terms of the yield and convenience of deposits. But because large areas of the country are still without banking offices and due to low incomes, the growth in bank branches has not had any significant impact on currency in circulation with the result that currency still accounts for two-thirds of the money supply. The ratio of currency in circulation to demand deposits as indicator of the habit of using cheques confirms that currency is more widely used than demand deposits.

Let us now examine the factors which explain the large currency component of the money supply. The main explanatory variable is the level of income. We point out in Appendix I that per capita income has been very low throughout the 1960's and averaged Le 94 for the period 1963/64 - 1969/70. Because incomes are so low virtually all of it is required for basic necessities. Hence, while looking at the opportunity cost of holding currency, account must also be taken of the level of income.[8] Once this is done, the only choice available to a large number of people is between currency on the one hand and goods and services on the other. Another explanatory variable is the method of financing the marketing of diamonds. We point out in Appendix I that diamonds account for about 60% of Sierra Leone's export receipts. In an effort to reduce the scale of smuggling, the Sierra Leone Government in 1956 established the Government Diamond Office whose responsibility is to purchase diamonds mined under the Alluvial Diamond Mining Scheme.[9] But because of the ease with which

8. A regression analysis with currency as the dependent variable and real national income per capita as the independent variable gives the following result:

(Log Function)

$$6.097 + 1.83Y^{*} \qquad R^2 = 0.966 \qquad D\text{-}W = 1.6207$$

9. H.L. van der Laan, The Sierra Leone Diamonds: An Economic Study Covering the years 1952 - 1961 (London: Oxford University Press, 1965) Chaps. 1 and 10.

diamonds can be mined, most of the local miners do not have a licence. The illicit miner naturally insists on cash transactions; but even licensed dealers also insist on cash transactions as they themselves obtain some of their diamonds from illicit miners. Consequently, transactions through the Government Diamond Office is entirely in cash to encourage the flow of diamonds mined in the country through official channels. Thus, with the expansion of diamond output the volume of currency should also increase.

Also, the marketing of agricultural produce is entirely in cash. We show in Appendix II that agricultural holdings are quite small and that output per farmer as well as agricultural incomes are also low. His meagre income prevents him from selling directly to agents of the Sierra Leone Produce Marketing Board (SLPMB) who may be several miles away from his farm. Consequently, he disposes of his produce at the place of production to traders and others who in turn sell these produce to agents of the SLPMB.

In addition, Table AP.II shows that the agricultural sector's share of GNP increased slightly relative to those of the other sectors. The growth of agricultural output is partly reflected in agricultural exports which rose from Le 5 million in 1967 to over Le 18 million by 1970. Since the agricultural sector is not adequately served by banks, an increase in its share relative to the other sectors, or higher incomes for farmers, would increase currency relative to deposits. But the fact that agricultural incomes are very low may also explain why transactions in the agricultural sector are largely in cash.

Another contributory factor is the growth of retail trade, especially petty trading. This is closely related to income levels.

As incomes are very low people can only purchase a few items as and when needed. To take one example, an individual will buy two sticks of cigarettes instead of a packet of ten because this is what he can afford. Or he may buy four lumps of sugar instead of one pound worth. In Appendix I we point out that of the economically active population of 938,000, 382,000 were self-employed and of these 53,000 are petty traders. These figures give some indication of the relative importance of retail trade.

In summary, the low level of income together with the marketing arrangement for diamonds mined by local miners as well as the marketing arrangements for agricultural produce have accounted for the expansion in currency in circulation and hence the large currency component of the money supply.[10]

(ii) Deposits

Deposits are the second source of resources available to the Bank of Sierra Leone. The depositors of the Bank are the government, the commercial banks and government corporations. In 1964 and 1965

10. Cagan, in his analysis of the behaviour of the currency component of the money supply in the United States, suggests three main explanatory variables: The expected net rate of interest on savings and time deposits; the expected real income; and the personal income tax as a percentage of personal income. Macesich applies the Cagan analysis to the behaviour of currency in Canada and largely supports Cagan's thesis. But Khazzoom who deals mainly with under-developed countries disagrees with the emphasis that Cagan and Macesich place on interest on deposits and on the income tax. For him the behaviour of currency reflects the effects of institutional and other factors. So that other factors such as the growth of banking, urbanization, monetization, income distribution and inflation (most of which are discussed by Cagan but which are not considered important in the United States situation) are the variable Khazzoom lays emphasis on. Our findings on the behaviour of currency in circulation in Sierra Leone lend support to Khazzoom's main conclusion. Philip R. Cagan, "The Demand for Currency Relative to the Total Money Supply," Journal of Political Economy, Vol. 66 (August, 1958), pp.301-28. George Macesich, "Demand for Currency and Taxation in Canada," Southern Economic Journal, Vol. 39 (July, 1962), pp. 33-38. Joseph D. Khazzoom, The Currency Ratio in Developing Countries (New York: Frederick A. Praeger, Inc., 1966), pp. 22 - 24.

government deposits averaged Le 1.0 million approximately. In 1966 and 1967 however, the average was only Le 0.8 million. Since 1968, government deposits have exceeded Le 1.0 million. Deposits were particularly high in 1969 averaging Le 3.7 million. These higher levels of government deposits since 1969 are due to favourable world prices for cocoa and palm kernels which prevailed in 1968 and 1969. The government's deposits benefited when the higher incomes were spent through indirect taxes. Another contributory factor has been the economies in government spending introduced with the Stabilization Programme of November, 1966 (discussed in Appendix I).

Deposits of commercial banks have been about Le 0.2 million and only on four occasions was this sum exceeded to any appreciable extent. The level of commercial banks' deposits was agreed upon with the Bank of Sierra Leone who has undertaken to transfer to the Call Money Fund all sums in excess of the agreed minimum. Deposits of commercial banks at the Bank do not earn interest.

Other deposits have not been particularly significant, ranging between Le 50,000 and Le 0.4 million during most of the period 1964 to 1968. Only on a few occasions did these deposits exceed Le 0.3 million. Since December, 1968, however, these deposits have increased considerably. At the end of December, 1968, 'Other Deposits' were Le 3.2 million, a rise of Le 2.9 million on the previous month. This new level of deposits was maintained in 1968 and 1969, averaging Le 3.0 million and Le 4.7 million respectively. 'Other Deposits' were particularly high in 1970, rising to Le 6.3 million in August, 1970.

This big increase in 'Other Deposits' since December, 1968, has been due to Bank's treatment of the Call Money Fund. Before 1968 Call Money was not included on the balance sheet. On the recommendation of the External Auditors Call Money has been included in 'Other Deposits' since December 1968. The Call Money Fund is discussed below.

The result of growth in government and other deposits is that total deposits at the Bank rose rapidly, rising from Le 0.8 million in September, 1964, to Le 7.2 million by December, 1970. The highest level of deposits, Le 8.8 million, was attained in August, 1969. Because of the growth in deposits, the share of deposits in the total liabilities of the Bank also went up, rising from an average of about 6% between September, 1965 and September, 1968, to an average of 17% since the end of 1968. In 1969 deposits averaged 18% of the Bank's total liabilities though in September, 1969, deposits were 21% of total liabilities. By December 1970 however, deposits accounted for 18% of total liabilities.

(iii) The Call Money Fund

Through the Call Money Fund which is operated by the Bank, resources also flow to the Bank. This fund was established in 1964 and the objective has been to provide short term investment outlets for surplus funds, that is, those ranging from one day to seven days. The main participants are the commercial banks, the corporations and the Sierra Leone Produce Marketing Board.

The total amount received by the Fund at the end of November 1964, the first month of operation of the Fund, amounted to Le 3 million, while withdrawals amounted to Le 1.5 million, leaving an operational balance of Le 1.5 million. Since 1964 payments into the Fund have grown rapidly. Payments in 1965 and 1966 averaged Le 5.5 million and Le 4.9 million respectively; while withdrawals were Le 5.4 million and Le 4.8 million per month in 1965 and 1966 respectively. The highest monthly payment was in May, 1965, with a total of Le 10.8 million. Withdrawals then amounted to Le 9.8 million. Because these are very short investments the rate of interest is only 2½%. The Bank is able to pay this rate because the funds received are invested in Sierra Leone and British Treasury bills.

The investment of Call Money Fund in Sierra Leone Government Treasury bills were as follows:

	(Le 000)
1964	725
1965	300
1966	2,645
1967	1,100
1968	15
1969	Nil
1970	Nil

Source: <u>Economic Review of the Bank of Sierra Leone</u>, Vol. 5, No. 1 (June, 1970). Table 4, and
<u>Quarterly Statistical Review of the Bank of Sierra Leone</u> No. 5 (June, 1966). Table 3.

Call Money Fund invested in British Treasury Bills were as follows:

	(Le 000)
1964	300
1965	500
1966	1,010
1967	1,257

Source: From information made available by the Bank of Sierra Leone.

By providing this outlet for investment the participants have been able to earn income on funds which would otherwise have been idle or remitted abroad.

(iv) Capital and other Miscellaneous Liabilities

Section 7 (i) of the Bank of Sierra Leone Act 1963 defined the authorized capital of the Bank as Le 1.5 million to be subscribed by the Sierra Leone Government. Up to June, 1968 only Le 0.7 million was paid-up. Since September, 1968, the authorised capital has been fully paid.

The reserves of the Bank have been built up by transfers from net profit. The legislation of the Bank requires that one quarter of net profit should be transferred to 'reserves' until the reserve fund exceeds the paid-up capital and thereafter, the percentage should be reduced to one-eigth. At the end of 1970 the Bank's reserve fund was 28 per cent of paid-up capital compared with 14 per cent in 1966.

Allocation of Special Drawing Rights (SDR) appear as a liability of the Bank in 1970. These SDR's were allocated to the Sierra Leone Government, and therefore, they appear as liabilities of the central bank because the Bank is the custodian of the country's international reserves.

The remaining liabilities of the Bank are largely liabilities abroad on documentary credits and guarantees.

(c) Uses of Funds

From Table 2.I the main uses into which the Bank's resources have been put are holdings of foreign assets and advances to the government.

(i) The Holding of Foreign Assets

Foreign assets of the Bank have grown significantly since 1964. At the end of September, 1964, one month after the Bank was opened for business, external assets amounted to Le 9.3 million and by the end of 1965 these assets totalled Le 12 million. These assets continued to rise after 1967, reaching Le 29.5 million at the end of December, 1969. The Bank's external assets in 1970 included newly introduced IMF's Special Drawing Rights which amounted to Le 0.4 million.

The holding of foreign assets is a legal requirement. Section 27 of the Bank of Sierra Leone Act 1963 required the Bank to hold external assets equivalent to 50 per cent of the Bank's demand liabilities.[12] The only difference between this provision of the Bank of Sierra Leone Act and the arrangement under the WACB is that whereas the former stipulates a reserve/currency ratio of 60% the latter required a 100% reserve/currency ratio. This involves a once and for all fiduciary element of 40%. In addition, any new issue of currency henceforth requires only a 60% external reserves cover.

The previous provision requiring the Bank to hold foreign assets against the stock of money was probably unavoidable during the colonial period when convertibility then meant the conversion of local currency into a foreign currency and when such convertibility was essential for a colony wishing to attract foreign private investment. Under the present regulations of the International Monetary Fund, convertibility now means the absence of exchange and payments restrictions on Current Account.[13]

Also, convertibility of the local currency into a foreign currency is not necessary nowadays for the attraction of foreign capital because of various government guarantee arrangements. In these circumstances, the new regulation requiring the Bank to hold external assets against its currency in circulation would appear unnecessary. This does not mean that the country does not require foreign reserves. In fact, as long as the country continues to trade with other countries some

12. The linking of reserves to demand liabilities recognizes the claim to convertibility of both components of the money stock. It should be noted that demand liabilities of the central bank include the Bank's deposit liabilities as well as currency issued, while its deposit liabilities include commercial banks' deposits. In addition, the Bank's obligation with respect to reserves is defined as 60% of currency issued.

13. International Monetary Fund Statistics published by the International Monetary Fund.

amount of foreign reserves will always be required for international settlements. But the interesting feature of the reserve requirement is that that amount which is specified as the minimal cannot legally be used for the purpose of financing deficits in the balance of payments. And yet, it is precisely for such emergencies that reserves are held.

A more logical development would have been the creation of a wholly token currency managed by the Bank and the requirement that the Bank hold the country's external reserves.[14] In such a case, the Bank decides on the size of the reserves it considers adequate for foreign exchange transactions.

However, there are some advantages in having an external backing for the domestic money supply. It should be recalled that the WACB had been in operation in Sierra Leone between 1912 and 1963 and the replacement of its currency demanded considerable caution if confidence was to be maintained. Furthermore, the stipulation of an external reserve enables the central bank to resist an excessive demand for credit expansion (especially from the government).

The 1970 Bank of Sierra Leone (Amendment) Act defined the obligation of the Bank with respect to the holding of external reserves as follows:

> The Bank shall at all times use its best endeavours to maintain the value of reserve specified in Section 27, together with special drawing rights constituting assets of the account authorised by Section 4 of the International Financial Organisations Act 1962, at an aggregate amount of not less than the value of three months' imports as recorded and averaged for the last three preceding years.[15]

14. This is the situation in a number of countries, e.g., Ceylon, Philippines, Israel, Australia, New Zealand and Canada.

15. Bank of Sierra Leone (Amendment) Act, Section 28 (i).

The ratio of external assets of the Bank of Sierra Leone to the country's imports for the years between 1964 to 1970 is shown in Table 2.III.

TABLE 2.III. RATIO OF EXTERNAL ASSETS OF THE BANK OF SIERRA LEONE TO IMPORTS: 1964-1970.

End of Month		Ratio
1964	December	0.192
1965	"	0.196
1966	"	0.192
1967	"	0.203
1968	"	0.303
1969	"	0.317
1970	"	0.301

Source: As in Table 2.I

According to Section 28 (i) reserves are defined to include Special Drawing Rights allocated by the International Monetary Fund. Since the Bank manages most of the Sinking Funds of the government and at the same time the Bank is banker to the Sierra Leone Produce Marketing Board, it can be argued that the reserves held by the Bank should be interpreted as the reserves of the country. With this assumption we can then interpret the Bank's responsibility with respect to currency and reserves as follows: As regards the issue of currency, the sole right of issue is vested in the Bank which determines the amount of currency to be issued. The holding of reserves is a separate function.[16]

16. The fact that the Bank has no discretion in determining the level of foreign reserves is not a serious weakness. This is because Sierra Leone's major exports are mineral products whose export receipts do not fluctuate as violently as do receipts from agricultural produce. Thus, having a fixed ratio of reserves to imports is not a severe limitation.

The significance of Section 28 (i) of the 1970 Act is that it has removed the link between the money stock and the holding of external assets. In so doing, it has eliminated the apparent conflict which results from the maintenance of a legal requirement and the need for flexibility which we have pointed out has been one of the main criticisms of the colonial monetary system.

We have examined in Chapter VII the possibility and practicability of using external assets held by the Bank for financing economic development by substituting, some at least, of these assets by government securities.

(ii) Advances to the Government

The next main use of the Bank's resources has taken the form of purchases of government stocks and Treasury bills, and Ways and Means advances to the government. The maximum amount of stocks and Treasury bills that the Bank can hold as well as total Ways and Means advances that can be made available to the government are fixed by the Bank of Sierra Leone Act and the Treasury Bills Act.

The legal limit on the Bank's holdings of government stocks is defined as 20% of the Bank's demand liabilities. The maximum amount of Treasury bills that the Bank can hold was defined by the 1964 Treasury Bills Act as 20% of estimated recurrent revenue. This limit was raised by the Treasury Bills (Amendment) Act 1971 to 30%. Ways and Means advances to the government is limited to 5% of estimated recurrent revenue. Under the 1963 Bank of Sierra Leone Act, all such advances should be re-paid within the financial year. Under the Bank of Sierra Leone (Amendment) Act 1970, however, the Bank can grant further Ways and Means Advances to the extent to which the outstanding amount is less than the maximum permissible limit of 5% of estimated revenue.

Section 34, subsection 1 (a), of the Bank of Sierra Leone (Amendment) Act 1970 allows the Bank to grant advances to the government for the settlement of subscriptions and other payments to international financial organisations. The Bank has provided loans to the government under this section for the repayment of the International Monetary Fund Credit and for the payment of the gold portion of the recent increase in the IMF Quota. Table 2.IV shows the Bank's holdings of the government securities and Ways and Means Advances.

TABLE 2.IV BANK OF SIERRA LEONE'S HOLDINGS OF GOVERNMENT SECURITIES AND ADVANCES TO GOVERNMENT

(Le 000)

	Government Securities	Rediscounts & Advances	Total*
1964	Nil	Nil	Nil (-)
1965	3,829	799	4,628 (17)
1966	3,543	1,580	5,123 (24)
1967	4,385	1,401	5,786 (27)
1968	2,412	150	2,562 (8)
1969	1,282	1	1,283 (3)
1970	2,009	4,254	6,263 (16)

* Figures in parentheses show the total of Government Securities and Rediscounts and Advances as a percentage of total assets of the Bank.

Source: Table 2.I

Government securities comprise the Bank's holdings of government stocks and Treasury bills. The main feature of the table is that the Bank's assistance to the government was quite large during the period 1965 - 1967, the years of serious financial crisis which culminated in the Stabilization Programme of November, 1966.

Holdings of Treasury bills

Up to 1967 the Bank held large amounts of outstanding Treasury bills as can be seen from Table 2.V. However, the share of the Bank has been overstated because part of its holdings include investment of the Call Money Fund operated by the Bank. Excluding the latter, the holdings of the central bank (as shown in the last column of Table 2.V.) are not unduly large.

TABLE 2.V. BANK OF SIERRA LEONE'S HOLDINGS OF OUTSTANDING TREASURY BILLS 1964 - 1970

	Outstanding Treasury Bills (Le 000)	Treasury Bills Held by Bank of Sierra Leone (Le 000)	Bank of Sierra Leone's Holdings as % of outstanding Treasury Bills (%)	Call Money Fund invested in Treasury Bills (Le 000)	Treasury Bills Held by Bank of Sierra Leone (net of Call Money Fund invested in Treasury Bills (Le 000)	Bank of Sierra Leone's Holdings (net of Call Money Fund invested in Treasury Bills as % of outstanding Treasury Bills) (%)
1964	1,300	734.4	56.5	725	9.4	0.7
1965	3,800	1,237.6	33.1	300	937.6	25.0
1966	6,150	2,785	45.3	2,645	140.1	2.3
1967	8,200	2,685	32.7	1,100	1,585.3	19.0
1968	8,260	172	2.1	15	157.1	1.9
1969	7,932	0.8	0.1	0	0.8	0.1
1970	10,200	679.8	6.6	0	679.8	6.6

Sources: Economic Review of the Bank of Sierra Leone, Vol. 5, No. 1 (June, 1970), Table 3 and No. 4 (March, 1971), Table 20.

(iii) Fixed Assets and Other Assets

Fixed Assets include the Bank's buildings as well as equipment. Between 1964 and 1968 the Bank of Sierra Leone had only one office, that is, its main office in Freetown. A second office in Kenema, was opened for business in August, 1970. The construction and equipment of this second office as well as the completion of work on the main building largely explain the sharp rise in fixed assets after 1968. The other assets include mainly 'contra' items.

In summary, from the assets/liabilities of the Bank of Sierra Leone shown in Table 2.I, the Bank's resources went up by Le 25.4 million between 1964 and 1970, rising from Le 13.8 million in 1964 to Le 39.2 million by the end of 1970. The increase in assets/liabilities were particularly large in the years 1967-8 and 1968-9 when the gains were Le 11.4 million and Le 5.5 million respectively. As a result of the considerable expansion of the Bank's assets/liabilities, the Bank has since 1968 emerged as the largest financial institution. However, a large part of these resources as was previously discussed have been held in the form of external cover for the currency as was required by the Bank of Sierra Leone Act 1963 until its amendment in 1970.

(d) Limitations on the Effectiveness of the Bank of Sierra Leone

(i) The Direction of Credit

To be able to influence the direction of credit, the central bank needs to be equipped with appropriate legal authority. Let us now examine the legal powers that were at the disposal of the Bank during the period 1964 - 1970.

The powers conferred on the Bank are contained in the Banking Act 1964 and the Banking Act of February, 1970. The legal authority available to the Bank under the Banking Act 1964 are the following: Section 12 prohibits loans (a) to any person in excess of 25 per cent of the published reserves of the banks; (b) against the security of its own shares; (c) unsecured credit facilities of an aggregate amount in excess of Le 1,000 to its directors, companies or partnerships in which the bank or its directors have shares; (d) unsecured loans to its employees must not exceed a year's salary.

Section 20 required the commercial banks to maintain a minimum liquidity ratio of 15 per cent of their total deposits. Section 31 authorizes the Bank to fix general ceilings for bank credit of all types or of a specified category at the prevailing or higher rates.[17]

Several factors affect the effectiveness of the Bank's power to control the commercial banks. The nature of their operations limits the effectiveness of the legal provisions. In this regard, Section 12 except for clause (d) is of limited usefulness in view of the fact that the commercial banks, as we show in Chapter III, are supra-national with all their directors and shareholders outside the country. Also, the importance of Section 20 is reduced because British commercial banks have been accustomed to holding about 30 per cent of their assets in fairly liquid form. Hence, the requirement that these banks should

17. These rather general powers may be contrasted with the situation in some other developing countries. For example, the Central Bank of Nigeria Amendment Act 1968 has the following provisions with respect to directing the flow of credit from commercial banks: (a) powers to vary the composition of special liquid assets to be held by commercial banks; (b) power to call for special deposits; (c) power to prescribe minimum ratios of total credit which each commercial bank should grant to indigenous persons (In April, 1972 the Central Bank of Nigeria instructed foreign commercial banks to reserve 35 per cent of their credit for Nigerians); (d) provision to require that commercial banks' loans exceeding such amounts as the central bank may decide be subject to approval from the central bank; (e) power to issue allocate and re-purchase securities from non-bank financial institutions. Annual Report of the Central Bank of Nigeria (1968). Also, Central Bank of Nigeria (Amendment) Act, 1968.

Credit controls have been used in some countries to direct the flow of credit. Commenting on the success achieved by this instrument in the Philippines, Castro observed "In one year, 1957, with the enforcement of a priority listing for credit, loans granted to industry rose by 73.1 per cent, which was surpassed only by the percentage rise in public utility loans where the base was smaller." A.A. Castro, "Central Banking in the Philippines", in Gethyn Davies (ed.), Central Banking in South East Asia (Hong Kong: The University Press, 1960), p. 180.

maintain a liquidity ratio of 15 per cent was of limited significance. With the exception of 1964 and 1965 commercial banks' liquid assets/deposits ratio has always exceeded 30 per cent. Another limitation on the effectiveness of the liquidity requirement is the fact that up to 1967 the required assets could include British Treasury bills which are not subjected to control by the central bank.

The liquidity ratio was progressively increased from 15 per cent to 30 per cent between November, 1966 and February, 1967, as one of the measures adopted to implement the Stand-By Agreement which became effective in November, 1966.[18] Liquid assets were then defined to exclude British Treasury bills. However, the liquidity ratio was not very effective as an instrument of controlling credit during the period 1964 - 1970 as the banks brought in funds from their head offices.

To strengthen the powers of the central bank, the Bank of Sierra Leone (Amendment) Act 1970 and the Banking Act 1970 were passed, the most important provisions being contained in Sections 29 and 37 of the Bank of Sierra Leone (Amendment) Act and Sections 16 and 21 of the Banking Act. Under Section 29 1(e), the Bank can purchase and rediscount inland bills of exchange which have been "....issued for the purpose of financing economic activities related to agriculture, forestry, fishing or mining and maturing within 15 months." Taken together with Section 21 sub-section 3(e), of the Banking Act, it is now possible to direct the flow of credit to specific sectors. That sub-section includes inland bills of exchange which are eligible for rediscounting at the Bank as one of the forms in which liquid assets could be held. The amount of such bills that the commercial banks can hold are subject to regulation by the Bank. Thus, by specifying that half of the required liquid assets could be held in the form of

18. See Appendix I.

inland bills, the flow of loans could therefore be diverted. Although this provision looks promising, the handicap is that there are no inland bills of exchange of any form in Sierra Leone. Until such bills are created the provision is of no practical importance.

Under Section 37 of the Bank of Sierra Leone (Amendment) Act 1970, the Bank can prescribe the minimum reserve ratio and may specify different reserve ratios for different classes of deposits. Section 16 of the Banking Act on the other hand authorizes the Bank to examine the books of each commercial bank at least once a year ".....in order to determine that the requirements of law have been complied with in the administration of its affairs." These two provisions are likely to be successful in limiting the flow of credit to certain areas but there is nothing positive in them to ensure that credit will be made to flow to the areas in which they are needed most for the development of the economy.

The general conclusion on the powers of the Bank to control and direct the flow of resources from the commercial banks is that during the period 1964 - 1970 the enabling provisions of the Banking Act 1964 were of limited practical usefulness. At the same time, however, the provisions of the Banking Act 1970 and the Bank of Sierra Leone (Amendment) Act 1970 are likely to succeed in prohibiting loans for certain purposes, but that there is nothing positive in these enactments to influence the flow of credit directly.

(ii) Contribution to Economic Development

Given that the financial structure is underdeveloped the central bank must not only be concerned with the direction of financial flows but it must also be concerned with changing the structure, partly to mobilize more domestic resources and partly to fill the credit gaps. We now examine the enabling provisions of the Bank of Sierra Leone Act as well as the Bank's performance in this field.

Section 31 sub-section 1 (i) of the Bank of Sierra Leone Act 1963 authorizes the Bank to contribute to the share capital of institutions established for "....the purpose of facilitating the financing of economic development." Under sub-section 1 (j) of the same section the Bank can grant advances for "....fixed periods not exceeding three months against publicly issued Treasury bills of the Government and maturing within ninety-three days." These sections are retained in the Amendment Act of 1970 (Section 29). But in addition, the new Act requires the Bank to establish and maintain a Development Credit Fund (Section 40). This fund is to be established by grants from the government and by transfers from the Bank's net profit. The fund is to be used for making loans and advances to co-operative banks and other financial institutions established with the Bank's participation and to facilitate the purchase, holding or sale of debentures, bonds and other debt obligations having a maturity of eight years and issued by co-operative banks or financial institutions established with the Bank's assistance.

During the period of our study the Bank made use of Section 31 sub-section 1(i) by providing part of the capital for the National Development Bank, the Benthworth Finance Company, and the National Agricultural Development Authority. To the extent that these institutions facilitate economic development, the Bank as a share-holder would have contributed indirectly to economic development. The performances of these non-bank financial institutions are examined in Chapter V.

In practice, the effectiveness of the enabling provisions of the 1970 amendments is limited for the following reasons: The provision of Section 40 and Section 29, sub-section 1 (i) merely enables the Bank to give financial assistance through institutions. Only the Co-operative Development Bank is concerned with agricultural credit so that the Bank's assistance would have to be channelled through this institution. The problem however is that this institution has only recently been established without the Bank's assistance or encouragement. Thus the Bank would need to wait until the Co-operative Bank had established itself before its resources can go to it. This need not have been the case if the Co-operative Bank was established with the assistance of the Bank. The National Development Bank and the Benthworth Finance Company which the Bank helped to establish do not deal with the problem of agriculture. Of equal importance is the fact that the resources that the Bank can put at the disposal of financial insitutions out of the Development Credit Fund depends on the resources that are available to the Bank. For example, the Bank has, from its own resources, provided loans to the government for the repayment of the International Monetary Fund Stand-by Credit and for the payment of the gold portion of the recent increase in the International Monetary Fund Quota. Also, we have noted that holdings of Treasury bills by the Bank has been raised to 30% of estimated revenue as compared with 20% previously. Developments such as these are likely to affect the amount of resources that may be available for other purposes. Also, it will be recalled that the government is the other contributor to the Development Credit Fund. The amount that the government can make available to the Fund depends on the budgetary performance.[19] We show in Appendix I that the current budget has not generated a large enough surplus for the development budget. Thus, the amount that can be made available through the budget is not likely to be large.

19. In recent years, there have been serious budgetary difficulties. In his 1971/72 Budget Speech, the Minister of Finance gave the anticipated budgetary performance for the financial year as follows: "after taking into account the likely yield of the new tax measures, current revenues are estimated to amount to Le 51.72 million in 1971/72, whilst expenditure is estimated at Le 50.62 million which includes public debt charges of Le 10.25 million." The expected budget surplus therefore was very small compared with a realised surplus of Le 3.6 million in 1970/71. Against this small surplus the estimated development expenditure was Le 10.1 million. (<u>Budget Speech</u> for the 1971/72 Financial Year delivered in the Sierra Leone House of Representatives on 28th June, 1971. (Freetown: Government Printer), 1971, p. 14).

Another restriction on the effectiveness of the Bank is contained in the proviso to Section 29, sub-section 1 (i). This states that " .... the total value of any such holdings of shares shall not at any time exceed twenty per cent of the paid-up capital and General Reserve of the Bank." The paid-up capital and general reserve fund of the Bank at the end of 1970 was Le 2.8 million. Twenty per cent of this amount is approximately Le 0.6 million.[20] Part of this amount is already committed to the National Development Bank, the Benthworth Finance Company, the proposed National Agricultural Development Authority, and the proposed National Commercial Bank - thus leaving very little to be employed to finance other productive investment.

The Bank of Sierra Leone's major contribution to the economic development of the country has been in the field of research and to some extent in the training of personnel. The research aspects of the Bank's activities assumes importance because the Central Statistical Office began operations only comparatively recently and, aside from the University, the Research Department of the Bank is the only other institution which undertakes a continuous programme of studies into various aspects of the Sierra Leone economy. The statistics assembled by the Bank as well as the results of investigations are primarily made available to the government, but some of these are also made available to the public through the Bank's publications. In addition, the Bank has commissioned special studies by experts both

20. This provision limiting the share participation of the Bank to 20% is rather restrictive when compared to other countries. For example, the participation of the Central Bank of Nigeria can amount to 10 times the aggregate of its paid-up capital and general reserve. And in the case of the Central Bank of Sudan there are no limitations whatsoever; see Bank of Sudan Act 1962 (Section 57A).

from within and outside the country. Four studies of particular importance include the Moinuddin Study on agricultural credit;[21] the study of the Glasgow University team which examined aspects of the Bank's research activities;[22] the Killick study on the Balance of Payments of the Mining Sector;[23] and the Cox-George study on Entrepreneurship.[24] The first three of these studies were by foreign experts while the fourth is from the University of Sierra Leone.

To improve the technical efficiency of its staff and those of other financial institutions, the Bank has since 1968 organized a course of training which prepares participants for the United Kingdom Institute of Bankers Diploma Examinations.[25] In addition, at the end of 1970 six members of the staff of the Research Department were pursuing higher degree courses in American and British Universities.

21. This study is discussed in Chapter VI and Appendix II.

22. The Glasgow University team consisted of Dr. C.V. Brown, Mrs. E. Thorne and Mr. J.T. Hughes. They visited the Bank in the summers of 1965 and 1966. See C.V. Brown, Measures for Increasing Credit to Sierra Leonean Enterprise (Freetown, August, 1965) A Report prepared for the Bank of Sierra Leone.

23. See Tony Killick and R.W. During, "The Balance of Payments Effects of Sierra Leone's Mining Sector," Economic Review of the Bank of Sierra Leone, Vol. 12, No. 2 (September, 1967); idem, "A Statistical Approach to the Balance of Payments of a Low Income Country," Journal of Development Studies, Vol. 5, No. 4 (July, 1968), pp. 274 - 278.

24. Professor Cox-George was chairman of a 'working party' appointed by the Governor of the Bank of Sierra Leone to report on 'Capital Availability and Sierra Leonean Entrepreneurship' See N.A. Cox-George, (Chairman), Report of the Working Party on Capital Availability and Sierra Leonean Entrepreneurship (Freetown: Bank of Sierra Leone, 1972). A report prepared for the Bank of Sierra Leone.

25. Participants must be on the staff of a financial institution and they must be sponsored by their employers. The Bank of Sierra Leone provides the accommodation but the cost of running the course is shared with the commercial banks.

(iii) Limitations Imposed by the Nature of the Economy

Quite apart from the legal restrictions imposed on the Bank, limitations imposed by the nature of the economy affect the ability of the Bank to maintain at one and the same time the internal and external value of the money as required by the Bank's Act.

The internal and external value of money are to a very large extent outside the control of the Bank. For example, changes in the internal value of the currency are likely to arise from four main sources: increases in the prices of commodities; increases in export receipts resulting in higher incomes for those connected with the export industries; capital inflow in the form of foreign private investment and official loans and grants; investment exceeding savings with the difference being financed by the central bank. First we consider the relationship between money and prices.

As discussed in Appendix I foreign trade accounts for about 30% of GNP. The implication of this is that prices in Sierra Leone are affected to a considerable extent by prices abroad. In the case of staple foodstuffs, external prices also play an important role, since the main staple food, rice, is imported on a large scale. In the case of locally manufactured goods not only is the volume of such products small, but also their import content is quite large due in part to the fact that machinery and raw materials required are imported. In addition, these industries have tended to equate the prices of their products with the prices of imported commodities they substitute. Thus most domestic price changes will originate from outside the economy.

As regards capital inflows, the foreign private investor hands over to the Bank foreign exchange and receives local money from the Bank. Here the Bank is obliged to make local money available for the foreign assets it receives. With respect to exports, exporters generally surrender their export proceeds in exchange for local money.

The internal value of money is affected when this money is utilized. Here, then, the Bank plays a purely passive role. Only where the Bank provides credit to finance additional domestic expenditure can it exert some influence. But even here, the central bank in an under-developed country may not have an entirely free hand. If the government is determined to obtain additional credit from the central bank, it can do so by merely altering the central bank's legislation and a number of governments have been known to do this.

Externally, the purchasing power of the currency depends partly upon the relationship of exports to imports prices, that is, the barter terms of trade. The external value tends to fall if import prices rise faster than export prices. This is because a larger quantity of exports is now exchanged for the same quantity of imports. Sierra Leone is a small producer both in relation to the total world output of primary produce and mineral products so that the country is not in a position to influence the price she received for her exports. Besides, the quantity of the main agricultural produce that can be exported is subject to international quotas so that output in excess of the agreed quota would have to be sold at reduced prices. In the case of diamonds, which account for about 60% of total export receipts, we show in Appendix I that its marketing is rigidly controlled by an international monopsonist to prevent frequent price fluctuations. Hence, additional production which is likely to result in lowering of prices may be stockpiled rather than sold. Thus, although the price elasticity of exports supply is low, significant expansion in output at a changed price is not likely with the present composition of exports and under the present marketing arrangements.

In the case of imports, the country depends on external sources not only for capital equipments and raw materials but also for a wide range of manufactured goods as well as foodstuffs. But Sierra Leone is a small importer in relation to total world exports and in relation to the exports of countries such as the United States, the United Kingdom and Japan. At the same time, local industries and agriculture are not likely to offer substitute goods whenever import prices increase because of the absence of the other co-operating factors such as entrepreneurs and capital. Besides, the nature of the commodities exported and the size of the market limit the extent to which commodities now exported could be processed for the domestic market. For example, only a tiny fraction of diamond output can be sold locally. The country's requirements for steel in relation to the cost of establishing a steel mill and keeping it fully operational is such that exports of iron ore will continue. Given the climatic conditions, only small quantities of cocoa and coffee would be consumed locally. In this situation, Sierra Leone's demand elasticity for imports is not only very low, but also, changes in the prices of imports are not likely to lead to significant substitution of local production. And although the central bank can give advice on exchange rate policy its recommendation would take into account the price elasticities of imports and exports. We can therefore conclude that the Bank's influence on the value of money in Sierra Leone is very limited indeed.

(iv) Limitations on Policy Instruments Available to the Bank

The nature of the economy also limits the scope for the use of the traditional instruments of monetary policy such as the 'bank rate' and 'open market operations'.[26]

An effective Bank Rate policy among other things presupposes that the central bank is a lender of last resort to the banking system; that there exists a wide variety of securities with varying yield and maturities; the existence of a diversified money and capital market well integrated and highly sensitive to interest changes at the centre.

26. These tools are given to the Bank in Sections 31 and 33.

These conditions ensure that as the central bank is the ultimate source of liquidity to the system stimuli from the central bank have some effect on the entire system. However, the Bank of Sierra Leone is, in practice, not a lender of last resort to the banking system because the commercial banks, being branches of large foreign banks, have relied on their head offices for additional liquidity in time of need. Similarly, the other financial institutions look to their head offices rather than to the central bank. In the second place, there exist two distinct sectors with virtually no links between them. In the organized sector are the commercial banks and a few financial institutions and these deal almost exclusively with the government, commercial firms and those individuals who can provide the types of securities that are acceptable to the lending institutions. The characteristic feature of this sector is that the rate of interest is comparatively low. The rest of the economy consists of the unorganized sector. Here, however, there is no one market but many small markets; this sector is characterized by very high rates of interest. Because rates here are very high marginal changes in the Bank of Sierra Leone rate is not likely to have much significance on lending rates or the availability of finance in the sector.

Changes in the rates in the organized sector over which the central bank may be assumed to have some control is questionable also. Investment is largely by foreign companies which are branches of international companies. The investment decisions of such companies are not influenced by local interest rates. For example, as long as the world market prospects for diamonds or iron ore are favourable the funds for investment in these mines would be raised in the international financial centres. In the case of the export/import trade which has received an average of 65% of commercial bank's resources during 1964 - 1970, the rate of interest on which such finance is obtained is to a large extent influenced by rates outside the economy, especially in the London money market. We pointed out in Chapter II that the link between the London money and capital market and the banking system was an important feature of the colonial monetary system. This link has not been broken because the head offices of the overseas banks are the lenders of last resort to Sierra Leone banks. In effect, therefore, the rates charged by the banking system are not local rates.

But even if the central bank decides to change the local interest rates, problems are likely to arise. This is because, although it is doubtful how much extra burden this would involve, one has to bear in mind the inefficiencies that are likely in raising the extra taxes to service the debt and the redistributive effects as holders of government securities are likely to be those who are already well-off.

Finally, there does not exist a wide variety of financial assets in Sierra Leone. At the same time, we have noted the fact that incomes are very low. Hence, most people hold their savings in the form of currency or to a lesser extent in deposits with commercial banks. This is in contrast to the situation in a developed economy in which, in addition to currency and deposits, people can invest in a wide range of financial assets.

(v) Limitations Imposed by the Attitude of Management

However, while recognizing the limitations imposed by the Bank's legislation and the structure of the economy the attitude of management is equally important. Given that the legislation was restrictive, moral suasion could have been used to achieve the desired pattern of loan distribution. Also, the legislation could have been interpreted less rigidly. The attitude of the management of the East African Currency Board illustrates this point. As we have seen, the legislation of the various currency boards do not allow any loans to commercial banks.

The function of a currency board is to issue and redeem currency. The East African Currency Board, however, used its own initiative to allocate a part of its fiduciary issue to commercial banks for the financing of the purchase of produce from local farmers.[27] We are therefore suggesting that if the bank of Sierra Leone had a certain pattern of loan distribution which it wanted implemented, the restrictive nature of the law need not have been an obstacle. It can however be argued that the Bank could not have been more zealous for the following reasons: There was no operative development plan throughout the 1960's. Therefore directing financial resources to the government may not have resulted in any significant increase in productive investment. It is quite likely that if the central bank had been too enthusiastic about development capital in the absence of a planned utilization of these funds, the Bank may have accelerated the external pressures on the economy. Also, in the early years of the Bank's existence virtually all the senior officers of the Bank were on secondment from the Bank of England. It should be remembered that in country after country Bank of England officials have argued that a central bank has no place in an underdeveloped country because the "right" conditions do not exist.[28]

27. M. Gaskin, "Monetary Flexibility in Dependent Economies," East African Economic Review, New Series, Vol. 1, No. 2 (June, 1965), p. 100. W.T. Newlyn, "An African Monetary Perspective," in Essays in Money and Banking in Honour of R.S. Sayers, edited by G.R. Whittlesey and J.S.G. Wilson (Oxford: At the Clarendon Press, 1968), pp 151 - 166.

28. J.L. Fisher disposed of the question of a central bank in Nigeria in these words: "The financial environment hardly exists at present for a central bank other than semi-automatically as a bank of issue." J.L. Fisher, Report on the Desirability and Practicability of Establishing a Central Bank in Nigeria for Promoting Economic Development of the Country (Lagos: Government Printer, 1953), p.18.

G.D. Paton also rejected the idea of a central bank for the Gold Coast and Nigeria. G.D. Paton, Report on Banking in the Gold Coast (Accra: Government Printer, 1948); idem, Report on Banking in Nigeria (Lagos: Government Printer, 1948).
See also, J.O. Olakanpo, Central Banking in the Commonwealth (Calcutta: Bookland Private Ltd., 1965); and T. Balogh, "A Note on the Monetary Controversy of Malaya," The Malayan Economic Review, Vol. 4. No. 2 (October, 1959), pp. 116 - 121.

Loynes, as pointed out earlier in this chapter, saw no need for the creation of a fully-fledged central bank in Sierra Leone. He concluded that "....the country's banking system, reinforced by the London connections, already provides an adequate and efficient service to the government and public."[29] His main reason for recommending the establishment of a Monetary Institute in Sierra Leone was due to his reasoning that "....any national monetary system should keep in-tact the features of the old system which help trade and investment and preserve public trust."[30] In the eyes of these officials there was nothing wrong with the currency board arrangement and, in any case, a central bank had no place in a country such as Sierra Leone. This may largely explain the type of legislation the Bank of Sierra Leone adopted, the interpretation given to that legislation and the general attitude of the Bank's management.

(e) <u>Conclusion</u>

Although the Bank of Sierra Leone has made more financial resources available to the government and has assisted in providing basic information, the general conclusion, nevertheless, is that during the period under review, the Bank operated rather like the West African Currency Board. This is partly because in its desire for caution the government established a central bank with limited functions without sufficiently taking into account the nature of the economy within which the central bank was to operate. Consequently the functions assigned to the Bank were inappropriate to the requirements of the economy. Nor was the attitude of the Bank's management sufficiently flexible to allow for the needed experimentation.

In Chapter VIII we discuss proposals for improving the effectiveness of the Bank within the context of economic development.

29. Loynes, <u>op.cit.</u>, pp. 4 - 5

30. <u>Ibid</u>., p.2.

CHAPTER III

COMMERCIAL BANKS: SOURCES AND USES OF FUNDS

Under the colonial monetary system, the commercial banks made loans and advances primarily to the large firms in the foreign trade sector because it was for the financing of the export/import trade that these banks were established.

Our analysis of the sources and uses of funds shows that there has been a very large growth in total deposits made possible by better branch coverage, advertisement and the rise in incomes. The expansion in loans and advances together with extensive borrowings from head offices would, a priori, suggest that there has been a fundamental change in the lending philosophy of the commercial banks. Our analysis shows that there has been no significant change with the result that their resources continue to flow to the foreign trade sector. The agricultural and small scale industries sectors whose development we have argued will raise the rate of growth of the economy still continue to look for their credit needs outside the organised banking system.

The major change has been that whereas under the colonial monetary system any surplus funds of the commercial banks sought investment outlets in the London money and capital markets, these banks now show an overdrawn position with their head offices. Secondly, through their purchases of government securities, they now place substantial financial resources at the disposal of the government and such investments have been at the expense of loans to the private sector.

This chapter is divided into five sections as follows: An introductory section; sources of funds; uses of funds; the availability of development capital; and the proposed National Commercial Bank.

(a) Introduction

There are three commercial banks in Sierra Leone. These are the Standard Bank of West Africa Ltd. (formerly the Bank of British West Africa Ltd., 1894 - 1957; the Bank of West Africa Ltd., 1957 - 1971), Barclays Bank, D.C. & O., and Intra Bank (S.L.) Ltd.

The Standard Bank of West Africa Ltd. was incorporated in Liverpool and its objective was to take over the banking business of Messrs. Elder Dempster Lines and Company. By the end of 1894 the bank had three branches, which were located in Lagos, Accra and Freetown. Since then the bank has established branches throughout West Africa, especially in territories formerly controlled by Britain, and by the end of 1970 operated 12 branches in Sierra Leone. This bank is jointly owned by Lloyds Bank Ltd., The Westminster Bank Ltd., The National Provincial Bank Ltd., and the Standard Bank of South Africa Ltd.[1] At the same time the bank is interlocked by common directors with Midlands Bank Ltd., Coutts and Company Ltd., and the Yorkshire Penny Bank Ltd.,.

1. The need for the services of a bank was first felt by merchants who considered it inconvenient to transport large stocks of money from place to place. It was as a result of representations by them to their principals in London that the African Banking Corporation was persuaded to open a branch in Lagos in 1892. When this office was closed a year later, it was a shipowner, Sir Alfred Jones, who persuaded Elder Dempster and Company to acquire and run the branch that was abandoned by the African Banking Corporation. This new bank not only dealt with the shipowners but also kept the accounts of the colonial government and controlled the flow of British coins into the Lagos colony. In 1893 the government stipulated two conditions for its continued patronage of the bank. These were that the bank should operate independently of the shipping business and should be registered as a joint stock bank. To meet these conditions the British banks listed above founded the Bank of West Africa on the 31st May, 1894, with Sir Alfred Jones as Chairman. It was this bank that opened a branch in Sierra Leone in 1898, its primary purpose being to facilitate trade. This point must be emphasized because it largely explains why the finance of foreign trade has been and continues to be their main business.

Barclays Bank D.C. & O. Ltd. originated from the Colonial Bank which was established by Royal Charter in 1836 to undertake banking business in the West Indies. The first office of the bank in Sierra Leone was opened in 1916. The Colonial Bank merged with the Anglo Egyptian Bank Ltd. and the National Bank of South Africa Ltd. and this affiliate became Barclays Bank D.C. & O, a subsidiary of Barclays Bank Ltd., one of the big 'five' in the United Kingdom. In 1925, the year of its incorporation, Barclays Bank D.C. & O. had the same chairman and deputy chairman as Barclays Bank Ltd. (London). Other directors of the bank came from the Bank of Australia, the Eastern Bank, the Bank of New South Wales, and the Seson Banking Company. Unlike the Standard Bank of West Africa Ltd., whose activities are concentrated in Africa, Barclays Bank D.C. & O's activities are more world wide. Of the 1,600 branches in 1969, 13 were in Sierra Leone. Thus, Barclays Bank D.C. & O. and the Standard Bank of West Africa between them operate 23 of the 28 commercial banking offices in Sierra Leone.

The third bank, Intra Bank (S.L.) Ltd., a Lebanese owned bank, commenced operation in Sierra Leone in 1964 and at the end of 1970 had four branches. This bank is a branch of the Intra Bank group with head offices in Beirut, Lebanon.

The main consequence of these external connections are: In the first place, the banking operations in Sierra Leone form only a very small part of the banks' total banking business. Secondly, the head offices of these banks as well as the directors and shareholders are outside Sierra Leone. Thirdly, it is at the head offices that general policies are formulated. The situation is likely to change in the future as a result of two recent legislations in Sierra Leone; these are the Banking Act, 1970, and the Banking (Amendment) Act, 1971.

The significance of the Banking Act 1970 and the Banking (Amendment) Act 1971 is to reduce the dependence of the banks from external influences.

First, Section 10 (a) of the Banking Act 1970 requires every bank to maintain assets in Sierra Leone equivalent to 85 per cent of their liabilities in the country. The effect is to reduce the flow of resources from Freetown to their head offices. The other sub-sections of Section 10 authorize the Bank of Sierra Leone to determine the forms in which these assets are to be held. Second, Section 6 (b) on minimum paid-up capital states that banks whose head offices are outside the country should, in lieu of paid-up capital, deposit with the Bank of Sierra Leone Le 0.8 million out of their own resources transferred from abroad.

In the case of the Banking (Amendment) Act, 1971, the important provision in terms of making the banks more self-contained is Section 8 (c). This section enables a bank whose head office is outside Sierra Leone to transfer its assets and liabilities to a bank incorporated within Sierra Leone. Both Standard Bank of West Africa and Barclays Bank D.C. & O. have made use of this provision and have transferred their assets and liabilities in the country respectively to Standard Bank (Sierra Leone) Ltd., and Barclays Bank (Sierra Leone) Ltd.

But as we shall see later in this chapter, these provisions are not likely to result in any significant inflow of resources as already throughout the 1960's the banks have brought in funds from their head offices, with the result that their assets in the country are greater than the 85 per cent required by the 1970 Banking Act.

As can be seen from Table 3.I there were only three bank branches in 1950. Ten years later, that is, at the end of 1960, there were twenty banking offices and at the end of 1970 the number had increased to twenty eight. The distribution of these offices by provinces is as follows:

Western Area	10
Eastern Province	8
Southern Province	6
Northern Province	4

The increase in the number of banking offices especially since 1960 partly contributed to the growth in deposits observed during the period as they were established in towns which previously had only offices of the Post Office Savings Bank. With a population of approximately 2.5 million and a total of 28 banking offices this gives about 90,000 persons to a banking office.

The towns which have banking offices include the main commercial centres. Some important areas are, however, still without banking offices. For example, Kabala in the north is an important cattle centre and has a population of over 5,000. The area around Pujehun is an important piassava and rutile region. Baoma, Yarmandu, Jaiama Town, Kailahun, each with a population of 5,000 have no commercial banking facilities. One feature of these areas is that activities are concentrated in the three or four months of the harvest season.

TABLE 3.I COMMERCIAL BANK BRANCHES

Towns	Standard No.	Standard Year established	Barclays No.	Barclays Year established	Intra No.	Intra Year established	Total
Blama			1 (Agency)	1959			1
Bo	1	1949	1	1957	1	1964	3
Bonthe	1	1956					1
Clock Tower			1	1964			1
Cline Town	1	1957	1	1958			2
Fourah Bay College	1	1958					1
Freetown	2	1898 1968	1	1917	1	1963	4
Kenema	1	1961	1	1955			2
Koidu	1	1958	1	1959	1	1966	3
Lunsar			1	1959			1
Magburaka			1 (Agency)	1959			1
Makemi			1	1956			1
Moyamba			1	1966			1
Pendembu	1	1956					1
Port Loko	1	1958					1
Segbwema	1	1956					1
Wellington	1	1963	1	1963			2
Yengema			1	1964			1
	12		13		3		28

Source: From Information available to the Bank of Sierra Leone.

(b) Sources of Funds

From Table 3.II, which shows the consolidated balance sheet of the commercial banks, it can be seen that the main sources of funds available to the banks are deposits and borrowings from head offices.

(i) Deposits

Commercial banks accept three classes of deposits - savings, time and demand. The minimum deposit acceptable for a savings account at a bank is Le 10 while the minimum for a time deposit is Le 100. Demand deposits, as the name implies, can be drawn upon on demand (by means of a cheque) while time deposits require a period of notice ranging from three months to a year. Withdrawals from a savings account can take place at any time as long as the operating balance is over Le 10. But as a result of frequent withdrawals, the banks now charge 20 cents for every withdrawal in excess of four during a calendar month.

Total deposits rose from Le 9 million in 1960 to Le 24.4 million by the end of 1970, an increase of Le 15.4 million over half of which occurred during 1967 - 1969. All three categories of deposits increased, but the growth was particularly rapid in savings and time deposits. While time deposits rose from Le 0.4 million in 1960 to Le 3.5 million by 1970, savings deposits went up by Le 7.9 million between the two years. Demand deposits on the other hand gained Le 4.3 million during the period under review.

The growth in savings and time deposits relative to demand deposits may reflect the lack of convenience of using cheques in the settlement of debts. The inefficiency of chequing services has been cited as one of the general characteristics of the monetary system of underdeveloped countries. Thus Khazzoom observes "...it is almost universally true, that, except for a limited range, checking deposits cannot be used in underdeveloped countries to pay for transactions before they are converted into currency." [2] He goes on to argue that ".... the choice facing the

2. Khazzoom, op. cit., p. 111.

TABLE 3.II AGGREGATED STATEMENT OF ASSETS AND LIABILITIES OF COMMERCIAL BANKS

LIABILITIES

End of Period	DEPOSITS				Balance Due to		Bills Payable	Other Liabilities and Capital	Total Liabilities
	Total	Demand	Savings	Time	Banks in Sierra Leone	Head Office and Branches Abroad			
1960	9,044	5,784	2,910	350	172	590	--	1,178	10,986
1961	10,764	6,770	3,442	552	62	1,300	--	2,104	14,230
1962	12,524	6,860	4,018	1,646	142	1,612	--	1,472	15,750
1963	12,740	7,256	4,746	738	182	5,810	--	2,012	20,744
1964	15,255	8,330	6,027	898	22	7,021	5	3,776	26,079
1965	15,132	7,272	6,609	1,251	141	5,702	44	4,697	25,716
1966	16,714	7,772	7,118	1,824	90	5,921	42	4,977	27,744
1967	17,466	8,368	6,697	2,401	11	5,171	56	5,196	27,900
1968	21,520	9,940	8,598	2,982	13	4,312	83	10,701	36,629
1969	25,670	11,664	10,269	3,737	31	2,433	70	8,054	36,258
1970	24,395	10,051	10,824	3,520	135	1,609	129	11,043	37,303

ASSETS

End of Period	Cash in Hand	Balance with		Money at Call in Sierra Leone	Treasure Bills and other Bills Discounted and Payable:		Loans and Advances	Other Assets including Premises	Total Assets
		Banks in Sierra Leone	Head Office and Branches Abroad		in Sierra Leone	outside Sierra Leone			
1960	1,168	164	1,164	--	--	--	5,460	3,030	10,986
1961	1,284	44	892	--	--	--	7,022	4,988	14,230
1962	1,334	144	796	--	--	--	9,984	3,492	15,750
1963	1,712	148	8	--	16	--	13,978	4,882	20,744
1964	1,599	653	66	960	1,126	1,603	14,870	5,202	26,079
1965	1,315	921	189	1,660	1,204	42	14,548	5,837	25,716
1966	1,641	285	226	2,830	2,093	10	15,250	5,409	27,744
1967	1,263	825	181	1,490	3,187	27	15,214	5,713	27,900
1968	1,826	1,186	976	1,165	6,473	41	15,698	9,264	36,629
1969	1,839	1,655	417	2,295	5,965	3	16,178	7,906	36,258
1970	1,305	1,144	70	1,715	6,000	--	18,743	8,276	37,303

Sources: Quarterly Statistical Review of the Bank of Sierra Leone, No. 5 (June 1966) Table 8, and Economic Review of the Bank of Sierra Leone, Vol. 5, No. 4 (March 1961), Table 7.

individual in underdeveloped countries is not between currency and demand deposits, as much as between currency and savings and time deposits."[3] Further evidence that demand deposits are not widely used in the settlement of debt in Sierra Leone can be obtained from the turnover rate of demand deposits shown in Table 3.III.

TABLE 3.III TURNOVER RATE OF DEMAND DEPOSITS IN SIERRA LEONE 1965 - 1970.

Year	Debits to demand deposits (Le million)	Average demand deposits (Le million)	Turnover rate (Deposit velocity of circulation ratio)
1965	25.95	8.02	3.16
1966	25.45	6.96	3.66
1967	26.57	7.55	3.52
1968	32.91	8.93	3.69
1969	43.11	10.43	4.13
1970	45.35	11.02	3.96

Source: Economic Review of the Bank of Sierra Leone, Vol. 5, No. 4 (March, 1971), from Table 8.

The turnover rate of demand deposits is a measure of the extent of use of demand deposits during year. If the velocity is high this indicates the growing use of cheques and the ease of acquiring non-monetary assets. A low velocity on the other hand would suggest that securities other than monetary and near money assets are not easily available. Sierra Leone's velocity of demand deposits has not only been low but it has not changed much during the 1960's. In contrast to a velocity of about 4 for the country in 1970, the East African Currency Board Area

3. *Ibid.*, p.80.

had a velocity of about 10 in 1963.[4]

Up to September, 1966, deposits at commercial banks were classified into 'Government' and 'Others'. Since December, 1966, deposits of the government and public corporations have been shown separately and these averaged 3.4% and 6.9% respectively during 1966 to 1970. A detailed breakdown of the ownership of deposits at commercial banks (aside from the deposits of government and public corporations) is not available. However, this writer in August, 1970, obtained from the commercial banks the following breakdown of their deposits liabilities (average for June, 1969 and June, 1970):

Government 2.4%; Public Corporations 7.7%; Commercial Firms 12%; Financial Institutions 0.2%; Individuals 69.3%; and Others 8.4%.

We have used these percentages except for those of government and public corporations for which the more reliable information available at the Bank of Sierra Leone are adopted. With this adjustment the percentages now become:

Government 3.4%; Public Corporations 6.9%; Commercial Firms 12%; Financial Institutions 0.2%; Individuals 69.3%; and Others 8.2%.[5]

These ratios were applied to total deposits (as given in Table 3.II) and the results obtained are shown in Table 3.IV.

The most important feature of the table is that individuals have accounted for about two-thirds of the deposits mobilized by the commercial banks during the 1960's.

4. H.L. Engberg, "Commercial Banking in East Africa," in Applied Economics of Africa, Vol. 2, Macro-economics, edited by H. Whetham and Jean I. Currie (Cambridge: The University Press, 1967), pp. 55.

5. For the period 1960-1965 the breakdown is estimated on the following assumptions based on discussions with the commercial banks: (a) Individuals equal to all savings deposits plus 50% of demand deposits (average for the period 1960-1965); (b) Government equals the sum of the percentages of Government and Public Corporations at commercial banks: and (c) Others equal time deposits

Table 3.IV Ownership of Deposits at Commercial Banks, 1960-1970 (Le 000)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Government)							568	594	732	873	829
Public Corporations)	2,892	3,385	3,930	3,628	4,165	3,636	1,153	1,205	1,485	1,771	1,684
Commercial Firms)							2,006	2,096	2,582	3,081	2,927
Individuals	5,802	6,827	6,948	8,374	10,192	10,245	11,583	12,104	14,913	17,789	16,906
Financial Institutions)							33	35	43	51	49
)	350	552	1,646	738	898	1,251					
Others)							1,371	1,432	1,765	2,105	2,000
TOTALS	9,044	10,764	12,524	12,740	15,255	15,132	16,714	17,466	21,520	25,670	24,395

Source: These are our own estimates calculated from Table 3.II, for assumptions made in deriving the figures see the discussion in the text on page 83 (including footnote 5).

(ii) Borrowings from Head Office

In addition to local deposits, commercial banks being branches of foreign international banks have access to funds from their head offices. They have made use of this facility to a considerable extent as such borrowings have ranged between Le 0.5 million and Le 7 million during the 1960's. Borrowings from head offices were particularly large during the years 1963 - 1966 when such borrowings averaged 24% of total liabilities. By the end of 1970, however, head office borrowings accounted for only about 4% of total liabilities.

(iii) Other Liabilities Including Capital

The 1964 Banking Act defined the paid-up capital of each foreign commercial bank operating in the country as Le 0.4 million. This amount (as we have seen) was raised to Le 0.8 million by the 1970 Act.

As regards reserves, another item in this category of liabilities, the banks are required to transfer 50% of their net profits to reserves until the reserve fund is equivalent to one half of their paid-up capital. Once this level is attained the transfers from net profits can be reduced to 25%.

Liabilities on documentary credit and liabilities on guarantees make up the rest of the banks' liabilities. These arise in connection with the financing of the export/import trade.

(d) <u>Factors Explaining the Expansion of Deposits</u>

The level of deposits at commercial banks depends on the one hand, on supply factors which emanate from the operations of the banking system while on the other it depends on demand factors which reside in the willingness of the public to hold bank deposits in competition with other types of assets.

The relevant factors on the supply side include the liquidity requirement which the commercial banks are obliged to observe; the acquisition or loss of foreign assets; and the lending policies of the banks, which is greatly influenced by their views on what is or is not a good credit risk. On the demand side, the most important factors are the relative preference of individuals for borrowing from commercial banks, prices and the rate of interest. We now examine these variables in turn omitting the non-quantitative variables.

In the case of the liquidity ratio, the higher the ratio that is imposed on the banks, the lower, all other things being equal, will be the level of deposits. Thus, the level of deposits will be lower if the liquid assets/deposits ratio is 40% than if the ratio is 15%. Liquid assets consists of cash, balances with the central bank and other banks in Sierra Leone, Money at Call with the central bank, and holdings of Treasury bills and short term government stocks. Cash holdings of the banks did not change much during the period under study. This is also true of deposits with the central bank. Most of the changes that have occurred in the behaviour of liquid assets occurred in Money at Call and the banks' holdings of government securities.

To the extent that the public prefers to borrow from the commercial banks and those who seek commercial banks' loans meet the required conditions, the volume of deposits will also increase. On the other hand, if the public prefers borrowing from non-bank financial institutions, then the commercial banks are likely to make fewer loans and the volume of deposits will in consequence be smaller. Our conclusion in Chapter V is that the non-bank financial institutions have invested most of their resources in government securities and in financial assets which originate from outside the economy. It can therefore be assumed that the public would prefer to borrow from commercial banks.

In the case of external reserves, a loss of reserves implies that this is the source from which the loan expansion is being financed. For example, there may be profitable investment opportunities but the level of deposits mobilized may be insufficient to take advantage of the opportunities. In such a case, the banks get the required funds by reducing the level of their external assets or they borrow from their Head offices. Our analysis has shown that the commercial banks have borrowed substantially from their head offices resulting in an over-drawn external position.

The price level is another variable which is likely to affect the level of total deposits. Rapid price rises may increase the need to borrow because they reduce the value of disposable personal income; and for the same reason reduce the amount of deposits that flow to the banks. Between 1960 and 1970 the consumer price index rose from 96 in December, 1960 to 140.9 by the end of 1970. This represents an annual increase of 4 percentage points. But as we show in Appendix I there has been only marginal increases in wages during the 1960's.

The rate of interest affects the level of total deposits through its effects on willingness to borrow and to the extent that it influences saving decisions. During the 1960's the prime rate, that is, the rate payable by the banks' first class customers, ranged between 6½% and 8½%. The rate of interest payable by other customers ranged between 12% and 14%. In contrast, rates of interest in the unorganized sector exceeded 100%. Because the rate of interest in the organized banking system is lower (other things being equal) people would prefer to borrow from the commercial bank. Hence, the prevailing low rate of interest should have a positive effect on the level of deposits. The effect of the rate of interest on savings is examined below.

We now show statistically which of the variable discussed explain the expansion in total deposits during the 1960's. We assume that the relationship between the variables selected and the dependent variable is linear; and take first difference to eliminate any trend that may exist between the variables.[6] The following are the definitions of the variables shown in the table:

- t is one quarter
- TD_t Total deposits at commercial banks at time t at constant prices
- LP_t Loans and advances by commercial banks to the private sector at time t at constant prices
- RR_t Required reserves defined as 30% of total deposits at time t at constant prices
- ER_t Reserves over and above 30% of total deposits at time t at constant prices
- HB_t Head Office borrowing at constant prices t at time t.

Deflator - we have not used the National Income deflator as our analyses are based on quarterly figures. The deflator used is arrived at as follows: The consumer price index for Freetown with 1961 = 100 is converted into a series with June 1964 = 1.

Assumptions - conforming to the usual least squares assumptions.

Our best results are given in Table 3.V.

6. The variables were tested under the following functional forms: (a) Linear and (b) Double Log. The main difference between the log and non-log functions is that in the case of the former, the co-efficients are the elasticities of the variables with respect to the dependent variable. In the case of the latter, the co-efficients represent the marginal product of the dependent variable with respect to the independent variable. Let us illustrate the difference with the following examples:

$$\Delta TD_t = a_1 + a_2 \Delta LP_t = a_3 \Delta HB_t + a_4 \Delta ER_t = a_5 \Delta RR_t + e_{4t} \quad ..(1)$$

$$\Delta LogTD_t = a_1 + a_2 \Delta logLP_t + a_3 \Delta logHB_t + a_4 \Delta logER_t + a_5 \Delta logRR_t + e_{5t} \quad .(2)$$

The form of equation (1) implies that the change in Total Deposits at commercial banks has a constant marginal product with respect to each of the explanatory variables. The same equation in log form, that is, equation (2) means that the change in total deposits has a constant elasticity with respect to each of the explanatory variables.

TABLE 3.V REGRESSION RESULTS: TOTAL DEPOSITS (First Difference)

Dependent Variable	Constant	Coefficients of Explanatory Variables					R^2	Durbin-Watson Statistic	DF
		AD	RR	ER	LP	HB			
TD_t	253.2677	0.2322 (2.2300)**					0.2263	1.9068	17
TD_t	10.4204		1.3210 (4.4121)**				0.4282	1.5611	26
TD_t	-36.1316		1.4564 (5.1889)**	0.2296 (1.6081)*	0.2214 (1.8171)*		0.5616	1.6045	26
TD_t	-45.74077		1.3219 (4.9088)**	0.4070 (2.5939)**	0.3602 (2.7517)**	-0.2078 (-2.1387)**	0.6343	1.8254	23

Notes: Figures in parentheses are the T-ratios
*Significant at the 5% significance level
**Significant at the 1% significance level
DF are degrees of freedom.

There is no serious problem of multicollinearity because, firstly, the partial correlation coefficients as shown in the correlation matrix do not show any high correlation between the independent variables; secondly, the coefficients do not change significantly with the introduction of additional variables; thirdly, an examination of the standard errors of the regression coefficients shows that they are not very large (this note applies to all our regression results).

Source: Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March, 1972), Table 5.

The level of savings and time deposits could be explained by disposable personal income, yield on these deposits and the net alternative yields on other assets. We show in Appendix I that GNP grew at an annual average rate of 3% in real terms during the years 1963/64 to 1969/70. We would therefore expect some of this increased income to be saved. The explanatory variables on the income side are foreign trade, the level of government expenditure, prices, monetization and the rate of interest. We now examine these variables in turn.

Virtually all economic activities are centred around the foreign trade sector. Consequently, significant changes in the value of exports and imports can affect peoples income. Between 1960 and 1970 domestic exports went up by approximately Le 3 million annually. Except for 1962 and 1967 when there were substantial declines, this growth continued throughout the 1960's. With a continuous rise in the value of exports, one would expect that some of the increased incomes would be saved. But from the point of view of savings and time deposits we consider the activities of the Sierra Leone Produce Marketing Board (SLPMB) and the Government Diamond Office (GDO) of particular importance. This is because purchases of the SLPMB and the GDO accrue to individuals directly as incomes. Exports proceeds on the other hand need not accrue directly as income because some may be retained abroad by the mining companies.

The level of government expenditure affects incomes and hence the level of savings and time deposits at commercial banks because a large part of government expenditure is on wages and salaries.

Price movements influence the level of savings and time deposits as some people are likely to save less since rising prices reduces the value of disposable income. At the same time, others saving for a specific purpose may save more in order to be able to purchase the required articles at current prices.

Monetization of the economy, that is, the reduction of subsistence activities should increase the level of savings and time deposits, as some of the income, being in the form of money, are likely to be diverted to commercial banks. As suggested by Engberg,[8] we consider total debits an approximate indicator of the extent of monetization. The monetization index thus derived is obtained by dividing total debits by GDP. The resulting index with 1965 = 100 worked out as follows:

	Monetization Index (%)
1965	100.0
1966	96.3
1967	95.7
1968	106.4
1969	129.7

Source: Calculated from Data in Table 7 of the Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March, 1972).

The decline in the index in 1966/67 and 1967/68 was due mainly to the general lull in economic activities that followed the financial crisis of that period. With economic recovery in 1968 - 1970, the index has shown a sharp rise. However, the period of observation is short so that one cannot come to any definite conclusion about the effect of monetization on savings and time deposits.

The rate of interest on savings and time deposits might be expected to affect the level of savings and time deposits. It could be argued that those people who save for a specific purpose would tend to save less if the rate of interest rises significantly. Others may be induced to save more to take advantage of the higher interest rate. However, during the 1960's there was only one change in the rate of interest payable on savings deposits. This change occurred in November, 1967, and was one of the policy measures introduced by the Stabilization Programme

8. "As the aggregate volume of payments made through the banks depends on the total number of transactions and purchases of all kinds and on the methods of effecting payments, total debits may be used as an approximate index of the degree to which the money economy has been diffused in a developing country."
Engberg, op. cit., p. 59.

of 1967 discussed in Appendix I. This change raised the rate of interest on savings deposits to 4% from 3% previously. In the case of time deposits, there were two changes in the rates. The first occurred in November, 1965, when the rates on 3 - 6 months, 6 - 12 months, and over 12 months, which were respectively $2\frac{1}{2}\%$, 3% and $3\frac{1}{2}\%$, went up by $\frac{1}{2}\%$ in each case. The second upward movement in the rates took place in November, 1967. This time however, there was a 1% rise in each of the three categories. As the rate of interest did not change very much during the 1960's it would be difficult to come to any definite conclusion about the effect of the rate of interest on the amount of net savings.

On the choices available to the individual, he may decide to hold his savings in cash, in the form of Treasury bills and government stocks, in an account with a commercial bank, and in the form of claims on non-bank financial institutions. What he actually does with his savings will depend on its amount, his expectation about his future commitments, the yield from each of the available assets, and his own psychological attitude about particular institutions. For example, he may distrust a government financial institution because he believes that his savings may not be safe with such an institution. Alternatively, he may decide not to hold government securities because he believes the government will not redeem the securities when due. The fact of low income, however, restricts the choices open to him. The minimum investment in Treasury bills and government securities is Le 500. Hence, investments in Treasury bills and government stocks by individuals accounted for only about 2% of outstanding government securities at the end of 1970. Also, people do not have access to non-bank financial institutions because the minimum investments are quite large relative to their income. In addition, we show in Chapter V that most of the non-bank financial institutions were only recently established and with the exception of one or two institutions, they do not mobilize deposits from the public. Thus, people would either hold their savings in cash or in savings and time deposits at commercial banks.

We now show statistically which of the variables discussed above explain the expansion in savings and time deposits during the period under review.

The following are the definitions of the variables shown in the tables:

QM	Savings plus time deposits at commercial banks at time t at constant prices
AD	Purchases of agricultural produce plus purchases of diamonds at time t at constant prices
G	Government total expenditure at time t at constant prices
$\frac{dP}{dt}$	The rate of change of prices calculated from the Freetown consumer price index. We have used this index because it is the only one available.

Our best results are given in Table 3.VI.

Following Snyder[9] we assume that demand deposits adjust to currency in circulation; we also assume a one period lag. Our results are as shown in Table 3.VII.

We also tested the hypothesis that demand deposits are functions of the cash base. The cash base is defined as the banks' cash holdings plus their deposits with the central bank. That is:

$$D_t = a_1 + a_2 C_t + e_t$$

This equation yields an R^2 of only 0.129 and a Durbin-Watson statistic of 0.54. The log formulation produced similar results.

(e) Uses of Funds

Commercial banks utilize the resources available to them for their lending operations and their holdings of liquid assets.

9. Wayne W. Snyder, "Money in a Developing Economy", Review of Economics and Statistics, Vol. 46, No. 4 (1968), p. 415.

TABLE 3.VI. REGRESSION RESULTS: SAVINGS AND TIME DEPOSITS (First Difference)

Dependent Variable	Constant	Coefficients of Explanatory Variables AD	EG	$\frac{d_P}{d_t}$	R	R^2	Durbin Watson Statistic	DF
			Log Functions					
Log QM	0.0143	0.1626 (4.6523)**		-0.8779 (-4.2006)**		0.6075	1.6974	16
Log QM	0.0110	0.1624 (4.5178)**		-0.8507 (-3.7679)**	0.0581 (0.3495)	0.6107	1.6599	15
Log QM	0.0113	0.1630 (4.5015)**	0.0089 (0.2067)	-0.8781 (-4.1321)**		0.6086	1.6960	15

Notes: Figures in parentheses are the T-ratios.

DF are degrees of Freedom.

* Significant at the 5% significance level

**Significant at the 1% significance level.

Here we have made use of the log specification not necessarily because it gives a better fit to the data, but to give some uniformity to the interpretation of the coefficients as the independent variables are measured in different units.

Source: Calculated from quarterly data in the Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March 1972), Tables 5 and 29, and Quarterly Statistical Review of the Bank of Sierra Leone, No. 5 (June, 1966), Table 8.

Figures for purchases of agricultural produce are from the Sierra Leone Produce Marketing Board.

TABLE 3.VII REGRESSION RESULTS : DEMAND DEPOSITS

Dependent Variable	Constant	Coefficients of Explanatory Variables		R^2	Durbin-Watson Statistic	DF
		Z	Z, (lagged one period)			
D_d	447.43	0.5393 (9.3758)**		0.7717	0.7890	26
D_d	948.08		0.5185 (7.5430)**	0.6947	1.1273	26

Notes: Figures in parentheses are the T ratios.

**Significant at the 1% Significance Level

DF are degrees of Freedom

Source: Calculated from quarterly data in the Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March 1972), Table 5, and Quarterly Statistical Review of the Bank of Sierra Leone, No. 5 (June, 1966), Table 8.

(i) Loans and advances

Between 1960 and 1970 loans increased almost four-fold, rising from Le 5.5 million in 1960 to Le 19 million by 1970. Most of the increases took place between 1960 and 1963 and between 1969 and 1970 when loans went up by Le 6.5 million and Le 3 million respectively.

This rapid expansion in the volume of loans and advances to the private sector suggests that there have been major changes in the lending policies of the commercial banks since foreign banks operating in under-developed countries have usually been accused of conservative lending policies.[10] In our view no significant change in policy has ocurred. What in fact has happened is that there has been a major change in the method of financing the export/import trade.

Up to the late 1950's the large commercial firms were very important sources of credit.[11] Table 3.VIII shows the extent of such credit by one commercial firm in Nigeria and Ghana. This company also maintained branches in other parts of British West Africa. No detailed figures are available for Sierra Leone but the figures illustrate the magnitude of credit which was provided by commercial firms. As can be seen from the table, credit took the form of advances to produce buyers during the crop season. In addition, the company disposed of its merchandise through African traders who were allowed to make payment for these goods after they had been sold. The company estimated the total value of such credit in August 1948 at £ 1.4 million.[12] The magnitude of these credits led Newlyn and Rowan to make the following observations:

10. J. Mars, "The Monetary and Banking System and the Loan Market of Nigeria" in Mining, Commerce and Finance in Nigeria, edited by M. Perham (London: Faber & Faber Ltd. 1947). pp 207 - 208,
H.A. de. S. Gunasekera, From Dependent Currency to Central Banking in Ceylon (London: G. Bell & Sons Ltd., 1962), pp 200 - 205,
Newlyn and Rowan, op. cit., Chap. 4,
R.A. Sowelem, Towards Financial Independence in a Developing Economy (London: George Allen & Unwin Ltd., 1967), pp. 191 - 194.

11. United African Company, Statistical and Economic Review, No. 4. (September, 1949), pp. 51 - 56.

12. Ibid., p.55.

This figure (that is, the sum of net advances to produce-buyers and advances to retailers) exceeded the total advances by the two British banks in Nigeria and the Gold Coast. The above figures which are unfortunately not available for later years, show that the United Africa Company is a more important lender than the two British banks together. Moreover, these figures relate to the period when buying activity is small and it is possible that in December advances to produce buyers are as high as £2 million.[13]

TABLE 3.VIII OPERATIONS OF THE UNITED AFRICA COMPANY IN RESPECT OF PURCHASES OF PRODUCE IN THE 1947/8 BUYING SEASON.

	Total value of produce purchased on behalf of Marketing Boards by United Africa Group	Proportion of purchase financed by money advances to middlemen	Average duration of advances	Estimated interval between purchase by company and payment by Boards	Average period for which company must use its own funds
	(£ 000)	(%)	(Days)	(Days)	(Days)
COCOA					
Nigeria	1,643	85	21	104	122
Gold Coast	6,334	100	10	23	33
GROUNDNUTS					
Nigeria	3,219	76	14	266	276
PALM OIL					
Nigeria	3,320	15	21	113	116
PALM KERNELS					
Nigeria	3,943	28	28	104	111

Source: United Africa Company, Statistical and Economic Review, No. 4 (September, 1949), p. 52.

These financial arrangements were in respect of one company, the United Africa Company, which had branches throughout West Africa. But the possibilities are that other expatriate companies which were also

13. Newlyn and Rowan op. cit., pp. 138 and 139.

produce buyers and dealers in merchandise also provided credit to African traders who were their middlemen in which case the total volume of credit from the commercial firms was quite considerable.

The magnitude of the United Africa Company figures suggest that the funds were raised outside West Africa. We have seen that the total amount involved in financing produce buying was £18.5 million (Le 39 million). The company also reported that at the end of 1948 it had to find £13 million (Le 26 million) worth of stocks of general merchandise in, and in transit to, Nigeria and the Gold Coast, and in London and Manchester. And to meet its daily requirements for cash the company had to hold large sums in West Africa. At the end of August 1948 total cash holdings of the company were £6.9 million (Le 13.8 million). Thus, through these trading firms, a large number of small traders had access to credit which they would not otherwise have had.

This arrangement changed in the late 1950's. First the trading firms ceased to be agents of the Sierra Leone Produce Marketing Board (by law) and their place was taken over by co-operatives and indigeneous traders.[14] Secondly, most expatriate firms moved out of retailing into wholesale trading. Thirdly, the rising wave of African nationalism during the late 1950's probably made foreign firms sceptical about the future, thus employing in their business as little of their own funds as possible and relying rather more on commercial banks' funds. Finally, as in the 1940's and 1950's loans still went predominantly to finance the import/export trade.[15]

14. Annual Reports of the Sierra Leone Produce Marketing Board - various issues.

15. It may be argued that there must have been some change in banks' policy - if only insofar as they were willing to make these substantial loans to foreign firms. The point here is that the banks have always been willing to finance these firms. In the earlier years, however, these firms used most of their own funds and hence their need for bank finance was less. The surplus resources which the banks could not deploy locally were invested overseas. As the commercial firms rely more on bank finance and less on their own funds the situation reversed. The change, if any, is that the banks are now bringing in the funds instead of the commercial firms.

An examination of the main recipients of commercial banks' loans further supports our proposition that there has been no fundamental change in the lending policies of the banks and what has happened is that foreign commercial firms now rely more on the bank finance instead of bringing in most of their own resources. Using 1966 as an example, there was an average of 1765 customers per quarter and loans averaged Le 15.9 million. Of this amount, 188 customers received Le 14.1 million. That is, 11% of total customers received 89% of the available loans. This group was made up as follows: Those receiving loans of over Le 20,000 numbered 108, and 80 received loans ranging between Le 10,000 and Le 20,000. From our knowledge of business in Sierra Leone it is most unlikely that more than a few Sierra Leoneans are in either of these groups. At the other end of the scale, about 65% of total customers received loans ranging from Le 1 to Le 1,000. The total amount received by this group of customers was Le 0.29 million or 2% of total loans. As Table 3.IX shows this has been the pattern of distribution during the 1960's.

TABLE 3.IX ANALYSIS OF LOANS AND ADVANCES: AVERAGE NUMBER OF CUSTOMERS AND TOTAL LOANS IN EACH CATEGORY

	Up to Le 100	Le 101-200	Le 201-1,000	Le 1,001-2,000	Le 2,001-10,000	Le 10,001-20,000	(number) Over Le 20,000
	Number of Customers in Each Category						
1964	528	199	414	220	235	82	106
1965	616	212	424	179	244	80	104
1966	511	164	448	192	262	80	108
1967	499	124	461	155	265	66	102
1968	561	133	402	160	230	63	100
1969	625	165	507	202	272	69	106
1970	753	229	516	226	353	94	107
	Total Loans in Each Category (Le 000)						
1964	18	22	198	547	1,225	1,065	11,390
1965	27	27	191	254	992	979	11,350
1966	18	24	245	282	1,198	1,459	12,659
1967	13	19	249	221	1,269	934	11,939
1968	15	22	254	245	1,074	898	12,555
1969	19	25	270	297	1,255	981	13,281
1970	26	49	327	523	1,964	2,849	12,364

Source: Economic Review of the Bank of Sierra Leone. Vol. 1, No. 5 (December, 1970), Table 12.

Table 3.X which classifies commercial banks' loans by economic sectors reveals that throughout the 1960's general commerce has been the main recipient of commercial banks' funds. This sector which includes the financing of imports, wholesale and retail trade, has accounted for an average of 65% of total loans during the period under review.

The mining sector which, as we have seen, accounts for 80% of total export receipts does not rely for its finance on the commercial banks. The mining companies themselves provide most of their financial requirements. This is the result of the nature of the industry which requires medium and long term investment.

The manufacturing sector received an average of 7% during the 1960's. The manufacturing sector is in many ways similar to wholesale and retail trades as most manufacturing has consisted largely of putting together what has already been manufactured outside the economy. Adding manufacturing loans to those for general commerce would increase the share of 'general commerce' to about 72% of total loans.

The agricultural sector received a mere 6% of total loans on average. The average of 10% for the period 1967 to December, 1969, is rather misleading. This sudden upsurge in the percentage of loans to the agricultural sector in 1967 and which continued until early 1970 was due to the special loan to the Sierra Leone Produce Marketing Board which is discussed in Appendix I.

TABLE 3.X SECTORAL DISTRIBUTION OF LOANS AND ADVANCES: PERCENTAGE OF TOTAL LOANS.

	1964	1965	1966	1967	1968	1969	1970
Government	1.6	1.0	5.5	-	-	-	-
Local Authority	0.2	0.1	-	-	-	-	-
Financial Institutions	2.3	-	-	-	0.1	0.1	0.7
Public Utility	-	0.1	-	-	-	-	-
Agriculture	2.0	7.1	0.8	11.9	11.3	6.8	0.7
Mining	-	2.2	3.8	0.9	1.1	2.6	1.8
Manufacturing	5.0	6.4	8.4	7.9	6.9	7.2	9.3
Building & Construction	6.7	14.5	14.8	8.3	9.3	8.7	3.3
General Commerce	72.4	61.8	44.5	63.2	66.4	69.5	74.7
Miscellaneous	9.8	6.8	22.2	7.8	4.9	5.1	9.5
TOTALS	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Calculated from data in Table 10 of Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March, 1972).

Under an agreement with the government, the commercial banks make funds available to the Registrar of Co-operative Societies for financing agriculture. The total amount provided by the commercial banks under this agreement amounted to Le 0.8 million (exclusive of interest) of which Le 0.5 million were still outstanding at the end of December, 1970. The extent to which loans under the Registrar of Co-operatives Loans Scheme have been successful in improving agricultural productivity is examined in Appendix II. What is clear is that even with the special contributions to the Registrar of Co-operatives the flow of credit to the agricultural sector has remained very small.

Building and construction received about 9.5% of all loans in the 1960's. Loans to this sector have been relatively high in 1965 and 1966. With independence and the appearance of new industries there has been an increase in demand for offices, factory buildings and more sophisticated dwelling houses, mainly for the large influx of expatriate personnel. This higher demand for new structures continued throughout the 1960's. We should point out that the Building and Construction sector also contains large foreign construction firms.

Most requests for loans and advances in the Miscellaneous category are from salaried employees for the purchase of cars, property and consumer durables in general.

With the establishment of the Bank of Sierra Leone, short term financial requirements of the government and government corporations are now met by Ways and Means Advances from the Bank of Sierra Leone and by the issue of Treasury bills. Hence loans to the government have been negligible. The banks however provided substantial assistance to the government during the financial crisis of 1966 at which time the government had used up all the facilities available to it from the Bank of Sierra Leone.

(iii) Liquid Assets

If commercial banks can dispose of their securities quickly without capital loss, if all customers honour their obligations on time, and if loans can be called in quickly, then there need be no problems about illiquidity. However, commercial banks are concerned about liquidity because of the existence of uncertainties.

In general, commercial banks encounter uncertainties from the following sources: The number of customers who might default; the percentage of customers who may not request renewal of loans; possible fluctuations in their deposit liabilities; changes in the market value of their securities; and adverse clearings.[16]

To be able to meet unexpected demands on their resources the banks should be able to convert part of their assets into cash quickly without incurring a capital loss. This in turn depends on the length of life of the securities they hold. Where the life of the assets is three months, the risk of loss in rediscounting such assets is relatively small. On the other hand, the capital loss on an asset with maturity exceeding three months will be higher especially if it is rediscounted at a higher rate than that at which it was acquired.

The first line of liquidity protection required to meet an unexpected demand is to hold cash and/or balances with other banks, including balances with the central bank. Cash and deposit balances are completely free of risk of capital loss. However, cash and deposit balances do not earn interest, so that the holding of these assets reduces their earning potential. Hence, to maximize their earnings the banks seek to minimize their holdings of cash reserves. The desire to maximize their income results in the banks holding assets other than cash. These other assets in Sierra Leone which are relatively liquid and yet earn interest include Money at Call with the Bank of Sierra Leone, Treasury bills, short-term government stocks, inland bills of exchange and promisory notes.

16. Basil J. Moore, An Introduction to the Theory of Finance: Asset-holder Behaviour Under Uncertainty (New York: The Free Press, 1968), pp 156 - 68,
Stephen M. Goldfeld, Commercial Bank Behaviour and Economic Activity (Amsterdam: North Holland Publishing Co., 1966), pp. 12 - 54.
Edward J. Kane and Burton Malkiel, "Portfolio Allocation, Deposit Variability, and the Availability Doctrine," Quarterly Journal of Economics (February, 1965), pp. 113 - 34. and
Richard C. Porter, "A Model of Bank Portfolio Selection," in James Tobin and Donald Hester, Financial Markets and Economic Activity (New York: John Wiley & Sons, Inc., 1967), pp. 69 - 71.

Of these assets, Money at Call and Treasury bills possess maximum shiftability as the former is managed by the central bank while Treasury bills can be rediscounted at any time at the central bank.

But as the commercial banks are expected to maintain a liquidity ratio equivalent to 30% of their total deposits, it can be argued that most of the banks' holdings of Treasury bills are not available to meet unexpected demands in respect of adverse clearings or for satisfying new loan requirements. Only the excess above the required liquidity stipulation is available for this purpose. However, Money at Call, by its nature, is suitable for emergencies. These funds are held on a day-to-day basis, and hence, although the rate of interest is only 2½% while that on Treasury bills is 5½% they are convenient interest earning assets which enable them to meet sudden demands without having to rediscount their holdings of Treasury bills or having to borrow from their head office.

Table 3.XI shows the banks' holdings of liquid assets for the period 1964 to 1970.

TABLE 3.XI COMPOSITION OF LIQUID ASSETS OF COMMERCIAL BANKS 1964 - 1970 (Le million)

Liquid Assets	1964	1965	1966	1967	1968	1969	1970
Cash	1.6(44)	1.3(31)	1.6(25)	1.3(25)	1.8(19)	1.8(16)	1.3(13)
Bank Balances	0.6(18)	0.9(21)	0.3(5)	0.8(13)	1.2(12)	1.6(15)	1.1(11)
Money at Call	1.0(27)	1.7(39)	2.8(44)	1.5(23)	1.2(12)	2.3(20)	1.7(16)
Treasury bills (and other government securities)	0.4(11)	0.4(9)	1.7(26)	2.9(45)	5.2(57)	5.3(49)	6.2(60)
TOTAL LIQUID ASSETS	3.6(100)	4.3(100)	6.4(100)	6.5(100)	9.4(100)	11.0(100)	10.3(100)

Notes: Figures in parentheses are percentage of total liquid assets.

Source: <u>Economic Review of the Bank of Sierra Leone</u>, Vol. 5, No. 4 (March, 1971), Tables 7 & 20.

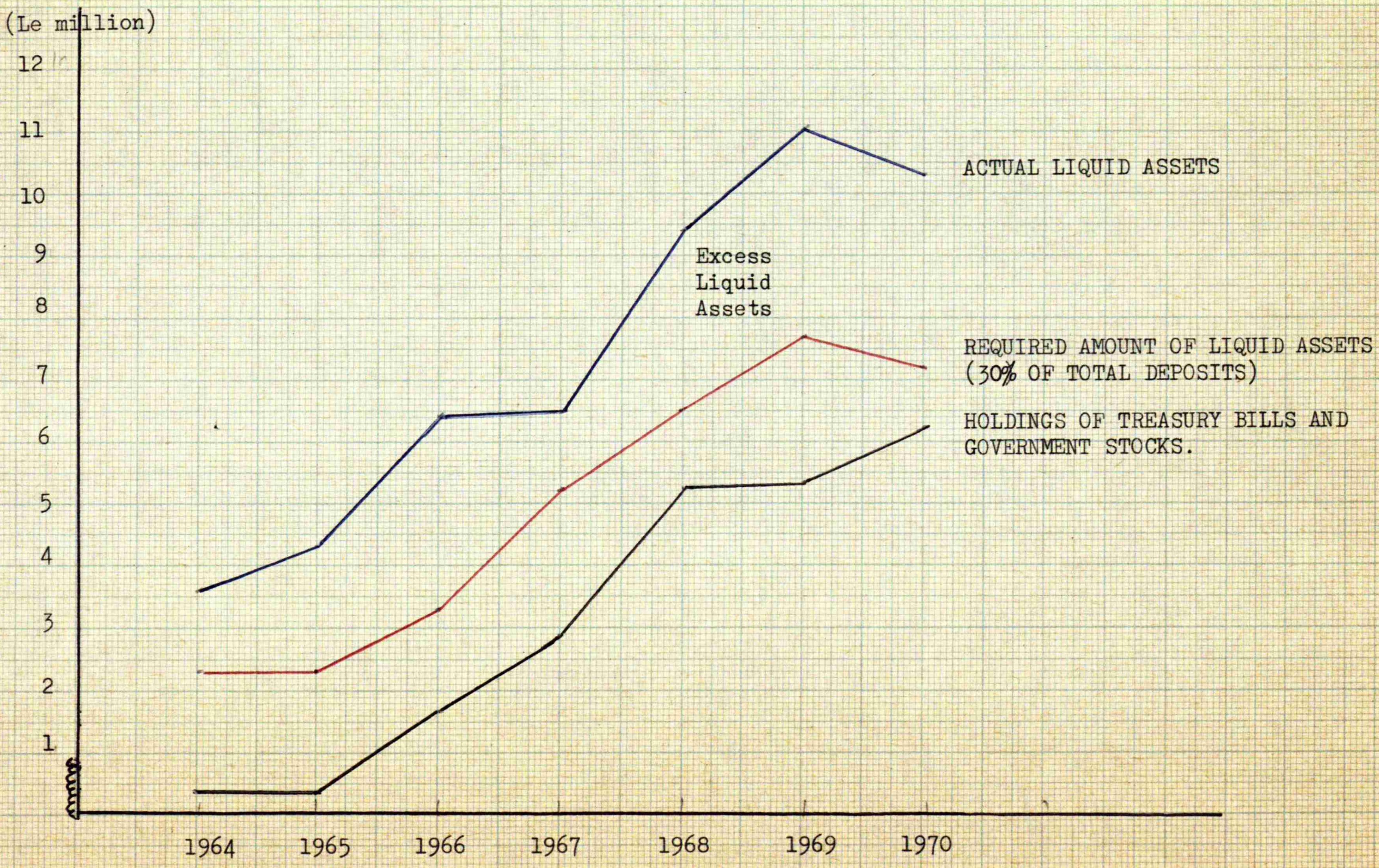
At the end of December, 1964, commercial banks held Treasury bills to the value of Le 0.4 million. Their holdings of Treasury bills remained at this level throughout 1965. In 1966, their holdings increased to Le 1.7 million. By 1968 their investment in Treasury bills totalled Le 5.2 million. Purchases of Treasury bills declined slightly in 1969 and 1970 but this decline was offset by acquisitions of other short-term government securities.[17]

The commercial banks' increased holdings of Treasury bills resulted from the official raising of the liquidity ratio requirement from 15% in October, 1966, to 30% by March, 1967. The liquidity ratio requirements compel commercial banks to maintain the equivalent of 30% of their deposit liabilities in liquid assets within Sierra Leone. Since Treasury bills are by far the most profitable of these assets, commercial banks purchased increasing amounts of Treasury bills to comply with the liquidity stipulation.

This is however not the entire explanation, since with the exception of 1964 and 1965 the banks have held more than 30% of their deposit liabilities in liquid form. Chart 3.I shows liquid assets of commercial banks during the years 1964 - 1970. It indicates that during this period the banks held a large amount of excess liquidity. What was significant about the new liquidity regulation was the condition that the liquid assets had to be payable within Sierra Leone. But even without this stipulation commercial banks would probably have invested in Treasury bills because of the attractiveness of this form of investment. To illustrate, the rate of return on Treasury bills ranged between 5% and 6% during the years 1967 and 1970. On the other hand, the rate of return on commercial banks' loans ranged between 8½% (the prime rate) and 12% to 14% to other customers. However, the return on

17. In 1969, the commercial banks purchased government stocks to the value of Le 0.9 million. These were included in liquid assets because they were suitable for rediscounting at the central bank and by the end of 1969 had less than nine months to maturity.

CHART 3.1 LIQUID ASSETS OF COMMERCIAL BANKS, 1964-1970



Sources: Tables 3.1 and 3.VIII

Treasury bills investment is tax-free and with practically no risks involved. The higher rate of return on other investments by the commercial banks are subject to tax at the usual rate of 45% and, in addition, there is some element of risk. Thus, when the higher rates of return are discounted for risk and tax obligation they are not much higher than the lower rate of return on Treasury bills. It is therefore probable that the attractiveness of this form of investment was also a contributory factor explaining the growth in Treasury bills investment by the commercial banks.

The Banking Act permits commercial banks to include in their official liquid assets inland bills of exchange and promisory notes that are eligible for rediscounting at the Bank of Sierra Leone. The Bank of Sierra Leone has informed the commercial banks that such bills held for liquidity purposes should not exceed 2% of their total deposits. In fact, however, no suitable inland bills existed which could be rediscounted at the Bank of Sierra Leone.

Liquid assets accounted for 24% of total deposits at the end of 1964. Since then, liquid assets rose continuously and were 44% by 1968. At the end of 1970 liquid assets represented 43% of total deposits.

(iii) Other Assets Including Premises

The main items in this category are the banks' buildings and equipment. The growth in 'other assets' is due partly to the increase in the number of branches of commercial banks. We have seen that the number of banking offices increased from 3 in the 1950's to 28 by the end of 1970. The noticeable rise in 'other assets' since 1967 is largely explained by revaluation of the banks assets which mainly affected the Freetown premises.

The other items in "other assets" are 'contra' items, that is, assets on documentary credit and guarantees.

(c) <u>The Commercial Banks and the Availability of Development Capital</u>

During the period 1960 - 1970 the commercial banks accounted for an average of 45% of the assets of all financial institutions (see Table 7.I). The assets of these banks rose from Le 11 million in 1960 to Le 37 million by the end of 1970. These figures suggest that the commercial banks have been active in mobilizing domestic financial resources. The banks have been able to achieve this result because of their better branch coverage compared with the 1950's, their increased advertising on the radio, in cinemas, and through publicity posters, and they have benefited from higher incomes due partly to the growth of GNP during the period and to the Africanization of the Civil Service.

These increased resources available to the banks have, however, not resulted in any significant change in the lending policies of the banks. Although their total loans went up by Le 14 million between 1960 and 1970, they continue to flow largely to 'general commerce' which is devoted mainly to financing the export/import trade. However, since 1964 loans to the private sector have been declining in relation to total deposits. In 1960 loans were 60% of total deposits but by 1963 the loans/deposits ratio had risen to 110%. Since then, the loans/deposits ratio declined continuously and was 68% at the end of 1970. At the same time finance to the government in the form of holdings of government stocks and Treasury bills has risen considerably, increasing from Le 0.4 million in 1964 to Le 6.2 million by the end of 1970. So that the increased investments in government securities have been at the expense of loans to the private sector. Although it could be argued that the change in the liquidity requirement which took place in 1967 is an explanatory factor, it has been shown that the banks have always held excess liquid assets and that part of the explanation must be that it is more profitable to invest in government securities than to expand loans.

The banks continued preference for the foreign trade sector may have been influenced by their desire for liquidity, but we do not think that this factor has been the dominating influence. As Williamson has observed, "....the broad conclusion that may be drawn is that commercial banks can rely on a proportion of their funds as being of a stable nature and therefore capable, without endangering the liquidity of the banks, of being lent for somewhat longer periods than the customary short term commercial advance."[18] We would therefore suggest that the following factors have been important. The banks were originally established to finance the export/import trade. This is an area with which they are familiar. This sector has been dominated by large foreign firms, most of which have their parent companies in the same country of origin as the banks. Thus, the risk of loss in financing such firms is likely to be less than in financing an unfamiliar institution. Also, the foreign trade sector is able to provide the type of securities that are acceptable to the banks as firms in this sector have been accustomed to these securities in their countries of origin. And besides, a firm in this sector is able to obtain a loan on the strength of its parent company. Further, moving into the agricultural sector, for example, would involve having to deal with a large number of small farmers, whereas at present they deal with a few large firms. This is not only likely to increase administrative costs, but also the possibility of default is greater. Because the foreign trade sector is well known and less risky there has not been any pressing need to move outside this sector into unfamiliar fields where the degree

18. G.I. Williamson, The Role and Practice of Commercial Banks and Other Institutions in Financing Development. Fiftieth Anniversary Commemoration Lectures (Cairo: National Bank of Egypt, 1965), p. 10. For similar views, see R. Maimberg, "About the Theory and Practice of the Participation of Deposit Banks in the Financing of Capital Projects (with reference to conditions governing England and India)," Indian Economic Journal, Vol. 16, Nos. 4/5 (April/June, 1969), pp 496 - 506.

of loss will be greater. Furthermore, investment in government securities is highly profitable. What we are in fact suggesting is that there have been no compelling reasons for the commercial banks to look for investment outlets outside their traditional areas.

There is sufficient evidence, however, to suggest that the commercial banks may be ready to change their policies. We have noted earlier that the banks have provided overdraft facilities for the Registrar of Co-operative Societies Loan Scheme.[19] In addition, the commercial banks are shareholders in the National Development Bank discussed in Chapter V. Also, the commercial banks nominated respresentatives to the working party appointed by the Governor of the Bank of Sierra Leone to examine the problems of entrepreneurial development in Sierra Leone. Finally, we show in Appendix I that one of the commercial banks made a substantial loan to the Sierra Leone Produce Marketing Board during the period of financial crisis. These developments indicate that the commercial banks are adaptable. But it is apparent that the initiative must come from the central bank. Appropriate incentives would have to be offered to the banks and, in particular, the problem of securities for loans and poor repayment records would have to be given serious attention.

Through moral suasion and appropriate credit control the Bank of Sierra Leone could achieve a more desirable distribution of commercial banks' funds. The powers available to the Bank of Sierra Leone should include direct regulation of loans in addition to its present indirect instruments. The central bank should, for example, be able to place a ceiling on all loans for 'general commerce' or 'miscellaneous' loans. Alternatively, the central bank should be able to specify the percentage of total loans that can flow to each sector. In view of the problem of

19. The poor repayment records of loans under this scheme would justify the commercial banks' lack of enthusiasm in extending a large number of small loans. This is further discussed in Appendix II.

securities, it may be necessary for the Bank to guarantee such loans. To avoid the securities problem, the Bank's instruction to the commercial banks can be that where suitable customers are not available, loans reserved for a specific sector are to be made available to an institution such as the National Development Bank. Also, the reserve requirement can be used for the purpose of directing credit to preferred sectors. At present, reserve requirement is defined in relation to deposits, and thus the volume of lending is controlled indirectly through variations in the reserve/deposits ratio. The reserve ratio could be related to loans, in which case control over the banks' lending can be effected through variations in the deposit requirement for each category of loans. On the other hand, the central bank can direct the flow of credit through the form in which the liquidity requirement is specified. Assuming that the liquidity requirement is 30% of total deposits, as at present, then by defining liquid assets to include inland bills of exchange (as argued in the previous chapter) and specifying that, say 50% of the required liquid assets must be held in this form, the central bank would influence the flow of funds to specific sectors. To do this, however, these inland bills of exchange must first be brought into circulation. But if the central bank has direct powers to control the volume of lending, then this change in the operation of the reserve requirement may not be necessary.

The amendments which are necessary to the Bank of Sierra Leone Act are discussed in Chapter IX. But it needs to be stressed here, that through selective credit control the central bank could correct the present bias in the lending policies of the commercial banks and thereby enable them to contribute to the availability of financial resources for development.

(e) The Proposed National Commercial Bank

In 1963, the government declared its intention to establish a National Commercial Bank as follows:

> We cannot assume that foreign banks operating in our country will always be ready and willing to sponsor the development of banking in areas and along the lines that we might want. Such a vital component in the framework of economic development should not rest entirely in the hands of overseas concerns. The government, has, therefore, decided to establish a State Commercial Bank for the expansion of industrial, commercial, agricultural and other enterprises by the means of short term loans, or the purchase of shares on reasonable terms that the public could bear.[20]

Although the government even acquired a centrally situated site for the offices of the new bank, the policy was not implemented. The main reason for the non-implementation of the proposal was that some members of the government were convinced that the new institution might be misused by politicians. The idea of a National Commercial Bank was revived by the Bank of Sierra Leone in 1968. During his visit to Pakistan, the Secretary of the Bank of Sierra Leone discussed the idea of a joint venture between one of the leading Pakistani banks and the Sierra Leone Government and which would gradually be transferred to local ownership over a period of years.[21] This idea was discussed with the National Bank of Pakistan Ltd., the United Bank Ltd., and the Habib Bank Ltd., and as the banks were enthusiastic about the proposal, the Secretary informed the Governors of the Bank of Sierra Leone on his return from Pakistan.

The general principles appeared attractive to the Bank of Sierra Leone since the foreign participation would provide capable management and thus remove the fear of political interference. Secondly, the foreign participation would provide some of the funds necessary for financing the venture.

20. Minister of Finance, Budget Speech, delivered at the Sierra Leone House of Representatives on Wednesday, 25th March, 1965 (Freetown: Government Printer, 1965), pp. 6-7.

21. Memorandum to the Governors prepared by the Secretary, Bank of Sierra Leone, 5th August, 1968.

Three Pakistani banks were consequently invited to send study teams to Sierra Leone to investigate the scope and possibilities of the new commercial bank. Two of these, the Habib Bank Ltd. and the National Bank of Pakistan Ltd. submitted proposals. The proposals of the National Bank of Pakistan with some amendments were submitted to the Sierra Leone Government as the basis of the joint venture. The main points of the proposals are the following:

The share capital of the new bank will be Le 400,000. The Sierra Leone Government will have 60% of the share capital and the National Bank of Pakistan will have 40%. The technical management of the bank will be provided by the National Bank of Pakistan for a period of 10 years which may be extended or shortened by mutual agreement.

During the whole period of the agreement responsibility for the administration and management of the affairs of the bank will rest with the National Bank within the framework of the overall policy laid down from time to time by the Board of Directors.

Directors will be appointed by the shareholders in proportion to their participation in the share capital. The Government of Sierra Leone will appoint the Chairman from amongst the Directors. The National Bank will be able to repatriate its share capital and profits.

The bank will be the sole agent of the Bank of Sierra Leone.

Government and semi government bodies will be encouraged to use the services of the new bank.

The National Bank will train local personnel.

The National Bank will receive a management fee of 25% of the net profits.

Observations on the proposed commercial bank

The whole necessity for a new commercial bank is to provide services not now provided by the existing commercial banks and, in particular, to provide for investments other than in the export/import sector and to Africans who cannot, under existing policies of foreign banks, receive credit. The existing commercial banks argue that firstly, the African, on the whole, does not have securities that are acceptable to commercial banks and secondly, they contend, that the repayment records of the African borrower are particularly unsatisfactory. Thirdly, Africans, on the whole, do not present economically and financially viable projects.

Assuming that the arguments of the existing banks are correct, then, unless these impediments are removed, the volume of lending to Sierra Leoneans will not rise. Unfortunately, none of the proposals has concentrated on how to remove the present risks inherent in lending to a large number of small borrowers or dealt with what needs to be done about making local securities more readily acceptable as collateral for lending. Because, unless the impedements are removed, merely establishing what appears to be a local bank is not likely to change the situation.

Secondly, if the whole objective of the new bank is to deal with the problems of lending to Sierra Leoneans then the Board of Directors should be able to influence the Managing Director in this direction. But with a management contract which will give him a wide discretion over policy the prime objective may not be realized. This is quite likely if the bank from the onset gets the deposits of government and semi-government bodies, but is unable to say how these funds are to be deployed in the interest of Sierra Leoneans.

Thirdly, none of the proposals has defined the sphere of operations of the new bank. This is of extreme importance because the Co-operative Development Bank will be concerned with financing agriculture and processing of agricultural produce as well as the mobilization of deposits in the rural areas where there are no banking services at present. This, therefore, leaves the new commercial bank with no specific area of operation.

One possibility is that the new bank should finance Sierra Leoneans connected with the import/export trade. This will not be desirable from the point of view of development since the emphasis, so far as development is concerned, should be on production. Besides, the existing commercial banks are providing import/export finance efficiently and on a large scale. Thus, there does not seem to be a need for another institution to provide exactly the same service.

Also, to make an impact on the banking scene, the new commercial bank must be used as an instrument of expansion of the banking habit. This would imply that the new commercial bank must have branches throughout the country or have mobile banks which will visit various parts of the country weekly or fortnightly or as often as the situation demanded. The fact is, however, that the offices of the new bank will be concentrated in the main towns, at least in the initial stages.

In summary, the National Commercial Bank, as presently conceived, cannot deal with the problem of agricultural credit nor can it increase the volume of lending to Sierra Leoneans or extend the banking habit. More likely, it may duplicate an existing service. We have suggested an alternative arrangement for the proposed commercial bank in Chapter IX.

(d) <u>Conclusion</u>

We have shown that the commercial banks have been successful in mobilizing domestic financial resources and have supplemented their resources with borrowings from their head offices.

There has however, not been any fundamental change in the loan distribution pattern as loans continue to flow to the large commercial firms in the foreign trade sector. But we also point out that there is evidence to suggest that the commercial banks can change their lending policies if the central bank deals adequately with the problem of securities for loans and with the problem of bad debts.

At the same time, we contend that the central bank needs to be equipped with instruments to enable it to influence the conditions, volume and flow of loans.

Finally, we argue that the proposed National Commercial Bank as presently conceived will not make significant contributions, either to the problem of credit to Sierra Leoneans or to the problem of agricultural credit in general.

CHAPTER IV

POST OFFICE SAVINGS BANK: SOURCES AND USES OF FUNDS

Next to the central bank and the commercial banks, the Post Office Savings bank (POSB) is the third largest financial institution in the country and was established with the objective of providing a "ready means for the deposit of savings and so to encourage thrift." Unlike all other financial institutions which have maintained branches only in the principal towns, the POSB has branches throughout the country. But whereas other financial institutions gained deposits during the period of our study, the POSB lost deposits throughout. Amongst the probable explanations for the continuous loss of deposits we tested the hypothesis that the decline may have been due to a switch from the POSB to the commercial banks.

The Chapter is divided into the following sections: Sources of funds; statistical analysis of factors explaining trends in deposits; and uses of funds.

(a) Sources of Funds

The first Post Office Savings bank offices were opened in Freetown and Bonthe on the 1st December, 1896. Seven more offices of the savings bank were opened between 1901 and the outbreak of the first world war. No office was established between 1914 and 1922 but between 1922 and the outbreak of the second world war twenty one offices were opened to the public. Since 1949 a further fourteen offices have been established, the most recent being that at Lungi which was opened on the 1st January, 1961. At the end of 1970 there were forty four offices of the savings bank throughout the country. The geographical distribution of these offices is given in Table 4.I.

TABLE 4.I POST OFFICE SAVINGS BANK: OFFICES BY PROVINCES

	No. of Post Office Savings Bank Branches	No. of Depositors on 30.6.68	Per Cent of Depositors %	Total Amount Credited on 30.6.68 Le 000	Per Cent of Total Amount %
Eastern Province	10	6,004	7.4	271.5	10.5
Northern Province	13	6,139	7.6	194.0	7.5
Southern Province	13	10,181	12.5	349.1	13.5
Western Area	8	58,799	72.5	1,771.4	68.5
TOTALS	44	81,123	100.0	2,586.0	100.0

Source: Post Office Savings Bank, Annual Report, 1968/69 (Unpublished)

The total number of depositors grew steadily from 1896 and was 36,000 in 1946. Ten years later depositors numbered 63,000 and were 70,931 at the beginning of our period. The rise in the number of depositors continued throughout the 1960's and totalled 81,123 at the end of our period.

The minimum deposit acceptable at the savings bank is 10 cents compared with Le 10 by the commercial banks. In consequence, the savings bank has a large number of very small accounts with the result that growth in the number of depositors need not mean spectacular increases in deposits. In other words, significant gains in the number of depositors may produce only marginal increases in total deposits.

A feature of the Post Office Savings bank is that deposits and withdrawals can take place at any office of the savings bank throughout the country. Thus a depositor with a Pass Book issued in Bo can make a deposit into his account while he is at, say, Freetown. Consequently, figures appearing for deposits under Freetown, for example, may not necessarily mean that those deposits were actually lodged at that office but may include credits from other offices. To illustrate, total deposits for the Freetown office for June 1969, was Le 35,059 but the deposits actually collected in Freetown were Le 31,091. The difference of Le 3,960 was credited from other offices.

From Table 4.II, four offices of the Post Office Savings Bank in Freetown accounted for a very large proportion of total deposits as well as the total number of depositors. The main Freetown office alone accounted for over 60% of the total cumulative deposits at the end of June, 1968. About 68% of the number of depositors at the end of June, 1968, held accounts in this office. The table shows that eleven offices of the Post Office Savings bank in seven towns explain about 82% of the cumulative deposits and about 79% of the total number of depositors. The considerable size of the Freetown office in relation to the other offices explains why the Western Area is so prominent in Table 4.I.

TABLE 4.II DEPOSITS IN SEVEN TOWNS WITH POPULATION OF OVER 10,000 INHABITANTS

	No. of Post Office Savings Bank Branches	No. of Depositors on 30.6.68	Percentage of Depositors	Total Amount Credited on 30.6.68 Le 000	Percentage of Total Amount
Bo	2	3,685	4.5	116.4	4.5
Freetown	4	55,487	68.4	1,717.1	66.4
Kenema	1	1,343	1.7	129.3	5.0
Magburaka	1	1,060	1.3	25.9	1.0
Makeni	1	1,151	1.4	24.9	1.0
Moyamba	1	1,150	1.4	51.7	2.0
Port Loko	1	970	0.1	50.6	2.0
TOTALS	11	64,846	78.8	2,115.9	81.9

Source: Post Office Savings Bank, Annual Report, 1968/69. (Unpublished)

The trend in deposits can be seen from Table 4.III and Chart 4.I. The trend throughout the 1960's has been downwards. The only exception was in 1964 especially between June and December of that year when deposits increased substantially. Deposits dropped from a monthly average of Le 77,264 in 1960 to Le 47,405 by 1969 while the annual average fell from Le 927,162 in 1960 to Le 568,865 by 1969.

With withdrawals exceeding deposits, the cumulative deposits at the Post Office Savings bank has declined from Le 3.1 million in December 1960 to Le 2.4 million by December, 1970. In contrast deposits for earlier years show significant increases. For example, deposits at the Post Office Savings bank totalled Le 2 million in 1946; by 1956 they amounted to Le 3.1 million and were Le 3.2 million by 1959.[1]

1. For figures relating to the period 1940-1946, see N.A. Cox-George, Finance and Development: The Sierra Leone Experience (London: Dennis Dobson, 1961), p. 233. For figures relating to the period 1945-1960, see Loynes, op. cit., p. 29.

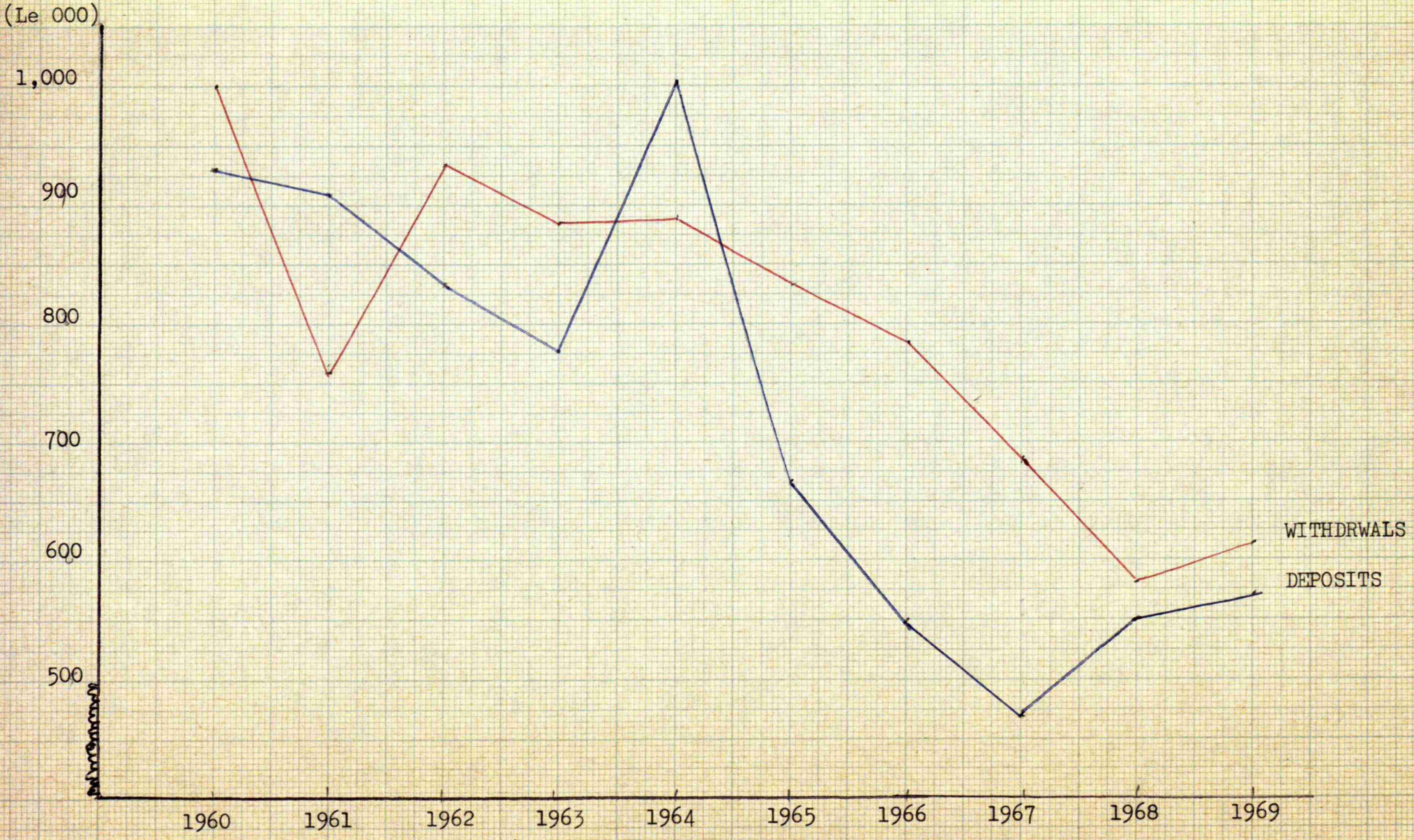
TABLE 4.III POST OFFICE SAVINGS BANK, DEPOSITS: MONTHLY, 1960-1969

(Le 000)

	January	February	March	April	May	June	July	August	September	October	November	December	Total
1960	64	74	92	72	76	73	101	83	56	90	79	68	928
1961	60	73	84	79	86	81	95	74	70	71	62	75	910
1962	75	58	88	62	74	68	77	73	64	70	55	72	836
1963	61	61	77	53	79	55	87	58	57	64	45	75	772
1964	58	62	75	61	73	88	105	96	112	116	96	135	1,077
1965	44	46	64	54	63	65	58	61	61	49	43	50	668
1966	41	42	50	47	54	51	44	48	43	49	39	41	549
1967	43	38	41	40	41	39	33	37	35	31	47	44	469
1968	48	43	40	36	56	37	57	51	53	42	47	40	550
1969	46	43	46	43	47	54	53	42	48	55	44	48	569

Source: Compiled from unpublished data at the Post Office Savings Bank

CHART 4.I DEPOSITS AND WITHDRAWALS AT THE POST OFFICE SAVINGS BANK, 1960-1969



Sources: Tables 4.III and 4.IV

The general downward trend which has characterized Post Office savings in the 1960's is largely the result of higher levels of withdrawals in relation to deposits and a drop in the number of transactions. Withdrawals during the period under review are shown in Table 4.IV.

At the end of 1960 total withdrawals were just over Le 1 million and although throughout the 1960's withdrawals did not exceed this level they however remained high. There was a 26% decline between 1960 and 1961 but withdrawals went up again in 1962 by 23%. Only in 1968 was the total amount withdrawn less than Le 580,000. In all other years withdrawals exceeded Le 600,000 and in five out of the ten years exceeded Le 800,000. Whereas the range of withdrawals up to 1965 was between Le 750,000 and Le 1.1 million, since 1965 the range has narrowed to between Le 570,000 and Le 800,000.

This high level of withdrawals has been a feature of all the main offices of the savings bank. However, withdrawals were particularly noticeable at the Freetown office. Throughout the 1960's withdrawals were more than deposits at the Freetown office. In 1962, 1963 and 1964 withdrawals exceeded Le 700,000 and only in 1968 was the total amount withdrawn less than Le 500,000.

Because withdrawals exceeded deposits throughout the 1960's net deposits were negative. Chart 4.II shows net deposits during the period 1960 - 1969.

The possible explanations for the high level of withdrawals and in consequence the downward trend in deposits are:

(a) The level of economic activities - the financial collapse of the Sierra Leone Produce Marketing Board and the financial difficulties of the government during the financial years 1965/66 and 1966/67 necessitated some austerity measures, the effects of which were to reduce the level of economic activity with consequences for the level of income and the volume of savings.

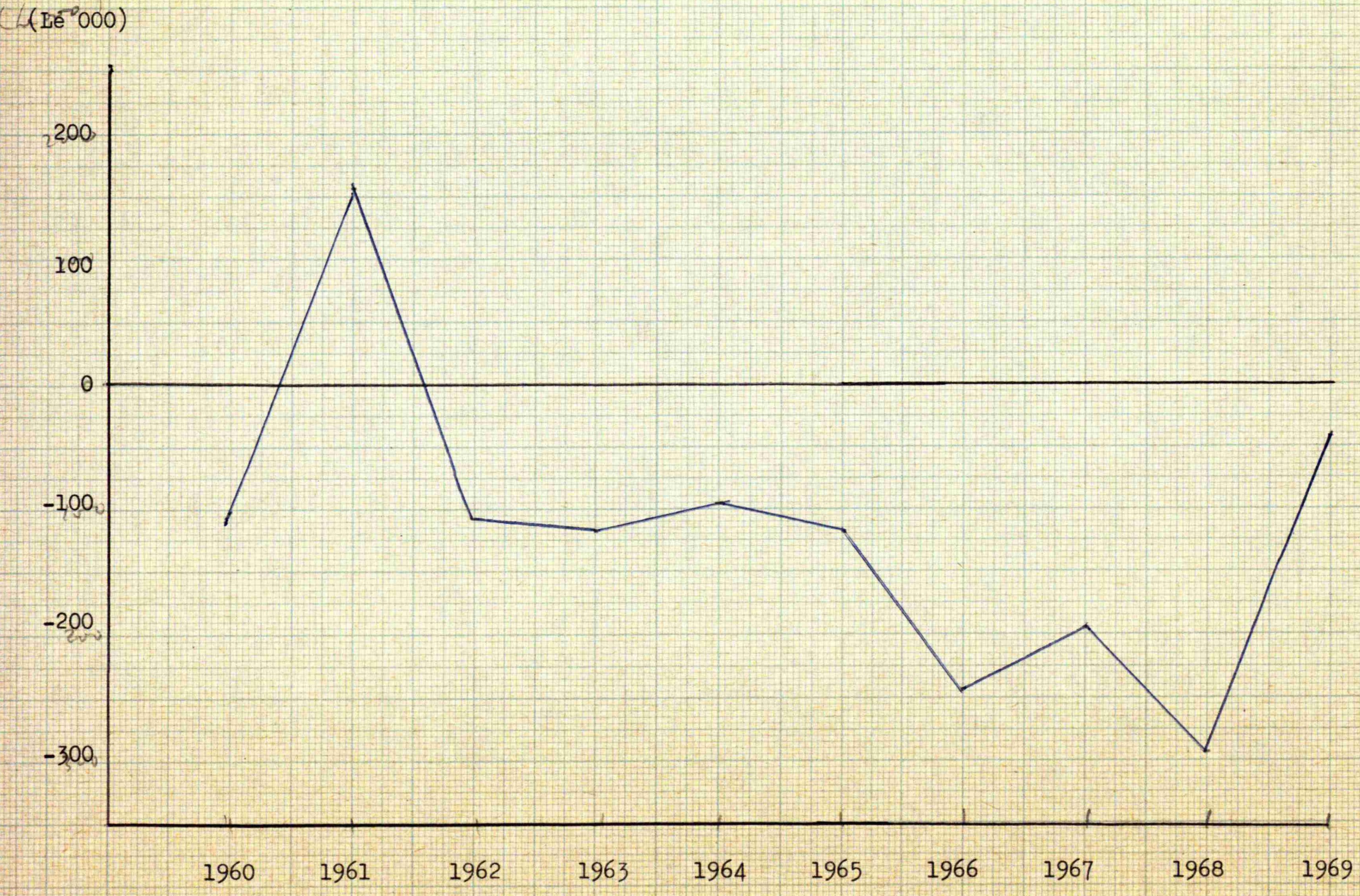
TABLE 4.IV POST OFFICE SAVINGS BANK, WITHDRAWALS: MONTHLY, 1960-1969

(Le 000)

	January	February	March	April	May	June	July	August	September	October	November	December	Total
1960	97	73	77	83	95	98	82	86	72	103	83	80	1,029
1961	38	30	33	60	73	61	74	84	81	79	70	77	760
1962	94	70	67	83	75	82	73	77	77	73	85	81	937
1963	80	76	62	73	76	84	66	77	78	63	66	90	891
1964	84	80	68	62	75	68	88	71	77	68	61	72	894
1965	74	64	67	71	70	62	64	77	67	58	82	76	832
1966	72	58	90	56	51	58	72	77	55	58	58	81	786
1967	67	62	48	60	60	53	58	57	63	53	52	52	685
1968	45	55	40	51	50	37	52	49	57	48	44	51	579
1969	46	60	44	40	43	43	49	55	60	50	60	65	615

Source: Compiled from unpublished data at the Post Office Savings Bank

CHART 4.II NET DEPOSITS AT THE POST OFFICE SAVINGS BANK, 1960-1969



Sources: Tables 4.III and 4.IV.

(b) investment in Sierra Leone Treasury bills,

(c) the cost of living,

(d) the rate of interest,

(e) shift to the commercial banks, and

(f) State Lottery sales.

Each of these possibilities is examined below.

The Financial Crisis of the years 1965/66 and 1966/67:- We have argued in Appendix I that during the period 1965/66 to 1967/68 both the central government and the Sierra Leone Produce Marketing Board were in financial difficulties. For most depositors the financial difficulties resulting in the government being unable to pay salaries in time meant that their deposits in the Post Office Savings bank, a government institution, were no longer safe. This lack of confidence explained at least some of the withdrawals between 1965 and 1967. Lack of confidence was particularly important, as can be seen from the following figures:

	1964/65	1965/66	1966/67	1967/68	1968/69
Saving and Time Deposits at Commercial Banks	100	114.5	129.0	131.9	168.1
Post Office Savings	100	96.9	87.5	81.3	81.3

Source: Central Statistics Office, Sierra Leone's National Accounts (Freetown: Government Printer, June, 1970), from Table 1.

The fall in economic activity, following the introduction of the Stabilization Programme, resulted in higher levels of unemployment (as a number of projects had to be abandoned) and lower incomes for a number of people. The lower level of income was the result of the indirect taxes, introduced to raise the level of government revenue. Some of the commodities on which people with low incomes spend their incomes and which were affected by the budgetary measures include: beer, cigarettes, matches, umbrellas, postal charges, school fees, transport fares, and clothing. Table 4.V gives some indication of the price changes that occurred after the budgetary changes. While the entire price changes shown on Table 4.V may not necessarily be due to the budget, there is no doubt that the new taxes contributed to price changes.

TABLE 4.V SELECTED PRICE CHANGES IN 1967

Commodities	Ist Quarter 1967	3rd Quarter 1967
Fresh fish	Le 5.24c	Le 7.09c
Ladies' Umbrellas (each)	1.87c	2.08c
Umbrellas (black cotton)	1.40c	1.80c
Men's khaki shorts (locally made)	43.33c	76.67c
Men's cotton shirts (each)	1.42c	1.50c
Air Letter (U.K.) (each)	7.00c	9.50c
Transport fare - Congo/Cline Town (1 adult ride)	7.00c	8.00c
School fees, Class 1 (per term)	44.00c	64.00c

Source: Bank of Sierra Leone, <u>Annual Report</u> 1967, from Table 9.

In these circumstances, withdrawals were unavoidable.

The decline in economic activities was worsened by the difficulties of the SLPMB. The Board's financial collapse meant that those with deposits had to make withdrawals in order to meet normal expenditure. At the same time, agricultural exports were lower as farmers did not consider it worth their while to take produce to the Board, which could not pay cash for such produce. The combined effect was a lower level of deposits.

Shift to the Commercial Banks - We have argued, and our tables show, that the decline in savings through the Post Office Savings bank was a feature of the 1960's. Thus, the economic and financial difficulties of the government and the Sierra Leone Produce Marketing Board which covered the period 1966 to the early part of 1968 could not have accounted for all the decline.

Another possible explanation is that a shift has taken place from savings bank to the commercial banks. This is likely for the following reasons: In the first place, the Post Office Savings bank is within the Ministry of Transport and Communication and is administered by civil servants. It does not operate on strictly commercial principles. Secondly, withdrawals are governed by strict rules. For example, withdrawals in excess of Le 4 require a week's notice and only one withdrawal is allowed in any one week. More than four withdrawals per month are possible but this is only with the approval of the head office in Freetown. The important fact is that most of the users of the Post Office Savings bank are people with very small incomes and these would hardly afford to wait too long when unexpected demands on their savings arise. In other words, the Post Office Savings bank cannot guarantee that depositors will have access to their savings as and when the necessity arises. It may happen that the depositor needs to make more than four withdrawals, only to find that this is not possible, or that several days must elapse. Thirdly, the Post Office Savings bank does not provide overdraft facilities. This may be an added attraction in favour of the commercial banks. Finally, as such banks are private institutions they are preferred to a government institution because depositors have the mistaken notion that once their savings are known to the government, such savings are likely to be taxed.

From Table 4.VI which shows the trend in deposits in towns with no commercial banking offices, it can be argued that no shift has occurred

TABLE 4.VI NET DEPOSITS IN TOWNS WITH NO COMMERCIAL BANKING OFFICE, 1960 - 1969

(Leones)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Batkanu	-46	-4	-8	14	40	327	12	105	-6	83
Bauya	-606	619	-380	-450	791	273	-603	-653	620	-7
Blama	1,313	-1,439	-173	454	-107	-773	92	-851	1,034	752
Bonthe	-11,204	-2,232	-35	-8,302	-7,469	56	-674	-2,796	--	--
Daru	2,679	3,528	410	2,066	455	45	1,224	-8,028	247	342
Hangha	455	-5,005	-1,659	4,559	2,117	-1,345	226	-1,574	-656	-168
Hastings	1,038	2,505	1,927	3,061	3,062	1,360	1,078	1,009	1,233	1,040
Kabala	385	2,448	2,030	-1,769	2,362	-3,723	514	1,119	3,642	1,790
Kailahum	-713	730	1,507	3,268	-1,767	712	1,667	-104	1,278	1,255
Kambia	5,211	3,978	5,022	4,811	4,647	1,064	2,010	561	5,323	3,021
Kamakiwie	164	1,320	595	709	1,189	789	770	599	361	--
Kissy	1,960	3,553	4,837	3,740	4,018	1,465	2,173	1,206	1,538	2,952
Lunsar	-799	-180	665	551	-1,477	-468	16	237	1,255	845
Lungi	--	1,023	1,792	2,299	791	1,441	1,334	-691	467	1,108
Mange	126	-148	--	13	85	36	58	74	--	--
Mano	2,726	3,805	598	-795	961	-73	-4,411	--	2,236	1,191
Mathru	2,539	296	558	1,618	1,509	1,208	602	-626	30	-282
Njala	6,849	1,074	663	1,055	652	1,063	817	1,267	1,826	1,802
Pujehum	-2,058	-16	-7,316	3,320	2,957	1,076	-537	-1,582	-85	2,472
Rokupr	1,281	928	-21	954	472	1,702	97	701	895	2,399
Rotifunk	-493	1,620	55	3,674	461	908	-122	-930	867	1,034
Sembehun	-1,138	-1,437	4,027	910	-814	-2,315	-2,942	-952	433	1,001
Segbwema	881	2,449	-3,302	-11	-1,030	-2,151	-819	-1,500	-2,113	-1,114
Sulima	-449	--	--	--	--	--	--	--	--	--
Sumbuya	434	816	1,379	738	11	-79	348	-831	362	1,480
Songo	1,847	998	440	944	1,096	785	760	766	1,263	2,466
Yonibana	1,000	2,108	-424	750	1,838	1,830	-165	-322	351	352
Waterloo	1,978	2,985	3,357	1,833	4,370	2,608	3,236	-168	3,365	7,970

Source: Compiled from data at the Post Office Savings Bank.

since the trend in twenty one of these offices of the Post Office Savings bank has also been downwards. However one cannot reject this possibility on the basis of Table 4.VI, because, in the first place, the offices in question account for less than 10% of the total savings through the Post Office Savings bank. Secondly, most of these towns are on the rail route. With the decline in rail traffic culminating in the decision to phase out the railway, trade and other activities made possible by the railway declined also. Hence, the loss of deposits in some of these towns may be due to the shift in centres of economic activities caused by the change from rail to road traffic. Thus, the possibility of a shift does exist.

Investment in Sierra Leone Treasury bills

We do not think that this possibility is particularly significant since the minimum investment in Treasury bills is Le 500. The range of monthly deposits in each of the 44 offices of the POSB is shown in Table 4.VII.

TABLE 4.VII RANGE OF MONTHLY DEPOSITS IN EACH OF THE 44 OFFICES OF THE POST OFFICE SAVINGS BANK.

Range	June 1969	June 1967	June 1965	June 1960
Le 20,000 and over	1	1	1	1
5,000 - 10,000	-	-	-	-
3,000 - 5,000	1	-	1	-
2,000 - 3,000	-	-	-	-
1,000 - 2,000	2	2	1	2
500 - 1,000	5	2	5	6
300 - 500	7	5	8	7
Below Le 300	28	34	28	28

Source: Compiled from data available at the Post Office Savings Bank.

This table refers to deposits collected for the months specified in the table. Thus, if we take June, 1967, only in five out of the forty-four offices did deposits exceed Le 500. During the 1960's there was an average of eight offices in which monthly deposits exceeded Le 500. In addition, deposits per individual account are quite small with the result that the average level of deposits at each office is well below Le 500. The average level of deposits in the main offices of the POSB are: Kenema Le 109; Port Loko Le 58; Moyamba Le 56; Bo Le 36; and Freetown Le 35. The conclusion is that not much is likely from this source.

The Cost of Living

The possibility here is that prices grow faster than income with the result that not only is saving not possible but in addition, expenditure has to be sustained by some withdrawals. The evidence suggests that during the 1960's prices grew faster than income. The tax measures introduced during the period of financial crisis, together with increased cost of imports, have resulted in a 44 percentage point rise in the consumer price index between 1960 and 1970. The price index, which is based on expenditure of the small income earners, rose from 96 (1961 = 100) in 1960 to 140 by December, 1970. During this period there has been only marginal increases in wages (see Appendix I). In addition, there has not been any significant increases in the producer prices of the main agricultural produce, palm kernels and cocoa. For example, in 1960 the producer price per ton of palm kernels was Le 63. It rose to Le 74 in 1967 but by 1970 was Le 78. In the case of cocoa the producer price per ton was Le 374 in 1960. It fell to Le 275 by 1967 and was Le 372 by 1970.[2]

2. R.G. Saylor, The Economy of Sierra Leone (Durham N.C.: Duke University Press, 1967), p. 114.; and Bank of Sierra Leone, Annual Reports, 1968-1970.

Thus, whereas the price index shows substantial increase, the rise in the level of income has not been too noticeable, especially in the period 1965 - 1967.[3] The net result should be smaller savings.

At the same time, the level of consumption expenditure rose substantially during the 1960's as can be seen from the following figures:

	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69
Real Consumption Expenditure (Le million)*	173.0	191.4	195.9	206.7	212.0	221.9

* At constant 1963/64 prices arrived at by applying the national income price deflator to the current-price data.

Source: Central Statistics Office, Sierra Leone's National Accounts (Freetown: Government Printer, June, 1970), Table 30.

This rise in the level of expenditure also explains some of the decline in savings.

Investment by farmers - Since farmers and small scale operators do not have access to commercial banks' funds it could well be that these people run down their deposits in order to invest in their farms or businesses.[4] However, from the figures given in our discussion on 'Investment in Sierra Leone Government Treasury Bills' it is clear that funds from this source could not have financed any significant investment in agriculture.

State Lottery Sales[5] - State Lottery sales are also likely to affect

3. Per capita income with 1964/65 = 100, were as follows: 1965/66 104; 1966/67 106; 1967/68 109; 1968/69 120.

4. S.H. Moinuddin, "Sources of Agricultural Credit in Sierra Leone", Economic Review, Vol. 4, No. 1 (June 1969), pp. 11, 12 and 21.

5. The State Lottery Ltd., was incorporated under the companies Ordinance as a company limited by guarantee on the 10th December, 1962. The principle objectives of the company are defined by the Memorandum of Association as: "(a) The carrying on of a national lottery by selling tickets at a price fixed by the Board of Directors at such intervals as the Board shall think fit and; (b) To contribute its profits to the Consolidated Revenue Fund for transfer to the Development Fund to be expended only on hospitals and schools in Sierra Leone." The payments so far made are 1963/64 Le 157,044, 1964/65 Le 39,657, 1965/66 Le 13,167, 1966/67 Le 5,233, 1967/68 Le 2,000, 1968/69 Le 9,549.

the level of Post Office savings because of the following: The price per ticket is 40 cents for 'Ordinary' draws and 60 cents for the 'Anniversary' draw. It is therefore likely that those making small savings may decide to purchase a state lottery ticket instead of making a deposit. Secondly, state lottery tickets can be purchased from the Post Office, and the Post Office has accounted for an average of 7% of all sales. The possibility is that some of those who are likely to make small savings are encouraged to purchase state lottery tickets. Thirdly, an average of 55% of state lottery tickets have been sold in Freetown and it should be noted that 66% of all deposits at the Post Office Savings bank are in Freetown and the fact that loss of deposits from the Freetown offices have been particularly large during the period.

State Lottery sales during the period 1963 - 1969 were:

TABLE 4.VIII STATE LOTTERY SALES, 1963 - 1969 (Leones)

	Sales	
1963	378,965	
1964	326,396	
1965	228,536	
1966	185,423	
1967	114,254	
1968	125,479	
1969	88,789	(Jan - June only)

Source: Sierra Leone State Lottery Ltd., *Annual Reports*, 1963/64 - 1968/69.

From Table 4.VIII however, State Lottery Sales declined by Le 299,000 between 1963 and June, 1969. That is, the State Lottery lost sales during the same period as the decline in deposits at the POSB. Hence, while for the reasons suggested we would have expected state lottery sales to be an explanatory variable for the decline in POSB deposits, the decline in state lottery sales would suggest that this variable is not a contributory factor. POSB deposits were found to be positively correlated with state lottery sales when one would have expected a negative correlation. The possitive correlation must have resulted from the fact that both variables moved in the same direction during the 1960's.

(b) Factors Explaining Trends in Post Office Savings - A Statistical Analysis

Of all the possible explanations for the continuous decline in the level of POSB deposits we consider two factors very important. These factors are: the level of savings plus time deposits at commercial banks and the rate of change of prices. We also think that non-quantitative factors such as uncertainty and especially the financial difficulties of the government and the SLPMB are equally important. We do not however introduce these factors into our model. Our model is:

Post Office Savings Deposits = F (Savings plus Time Deposits at Commercial Banks, Rate of Change of Prices)

The relationship between these variables and the level of Post Office savings deposits were tested under the following functional forms: (a) Linear; (b) Double log. It was considered more appropriate to take first difference to eliminate any trend that may exist between the variables. The equations are as follows:

$$SP_t = a_1 + a_2\, QM_t + a_3 \frac{dP}{dt} + e_{1t}$$

$$\text{Log } SP_t = b_1 + b_2 \text{ Log } QM_t + b_3 \text{ Log } \frac{dP}{dt} + e_{2t}$$

where:

SP — The level of Post Office Savings bank deposits at constant prices at time t.

QM — The level of savings and time deposits at commercial banks at time t (at constant prices).

$\frac{dP}{dt}$ — The rate of change of consumer prices calculated from the Freetown consumer price index as the bulk of Post Office savings deposits are in Freetown and its vicinity.

Deflator - The deflator used is arrived at as follows: The consumer price index for Freetown with 1960 = 100 is converted into a series with June 1964 equal to 1.

Assumptions: Conforming to the usual least squares assumptions.

Our best results are given in Table 4.IX.

TABLE 4.IX REGRESSION RESULTS: POST OFFICE SAVINGS DEPOSITS (FIRST DIFFERENCE)

Dependent variable	Constant	Co-efficients of Explanatory Variables Log_{QM}	$\text{Log}_{\frac{dP}{dt}}$	R^2	Durbin Watson Statistic	DF
Log SP_t	-0.1125	0.1953 (1.7431)*		0.1213	2.4105	22
Log SP_t	-0.8279		-014149 (-5.2504)**	0.5561	1.0428	22
Log SP_t	-0.9627	0.1188 (1.52026)	-0.3920 (-5.0042)	0.5992	1.3056	22

Notes: Figures in parentheses are the T-ratios

* Significant at the 5% significance level

** Significant at the 1% significance level

DF are degrees of freedom

We have used the log specification here not necessarily because it gives a better fit to the data but to give some uniformity to the interpretation of the co-efficients as the independent variables are measured in different units.

Source: Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March, 1972) Tables 9 and 32.

This result suggests that the rate of change of price has been an important explanatory variable. Although variable QM is significant at the 5% significance level and explains about 12% of the R^2 we cannot conclude that there has been a shift from the Post Office Savings bank to the commercial banks because of the positive sign. These results do not support the hypothesis that a shift to the commercial banks is a factor explaining the decline in Post Office savings during the 1960's.

The results suggest that non-quantitative factors should explain some of the loss in deposits which the Post Office Savings bank has experienced during the 1960's.

It could be argued that raising the rate of interest substantially may increase the rate of saving through the Post Office Savings bank. But while this may be generally true in view of the continuous rise in consumer price index, the volume of savings through this institution may not change much if the cause of the decline is lack of confidence in a government institution.

(c) <u>Uses of Post Office Savings Bank Funds</u>

The Post Office Savings Bank Ordinance restricted investment of deposits mobilized by the POSB to British and other securities of the Commonwealth and Colonial Governments. Thus there was no local investment while this legislation was in operation. Table 4.X on the balance sheet of the Post Office Savings bank shows that the resources of the POSB were in the main invested abroad up to 1965.

The major change in the investment policy of the POSB took place in 1965 when the earlier restrictions on local investment were abolished by the repeal of the Post Office Savings Bank Ordinance. Beginning in 1966, a number of securities were realized and the proceeds invested in Sierra Leone Government securities. Since 1966, therefore, the POSB funds have been deployed locally, mainly by the government.

(d) <u>Conclusion</u>

This Chapter has shown that the POSB lost deposits during the 1960's. To improve the efficiency of the savings bank we argue in Chapter IX that the savings bank should be the nucleus of the proposed National Commercial Bank discussed in the previous chapter.

TABLE 4.X BALANCE SHEET OF THE POST OFFICE SAVINGS BANK, 1959/60 - 1968/69[1]

(Le 000)

	Liabilities			Assets						
	Balance due depositors	Other liabilities	Total liabilities	Investment at market value	Local[2] investment	Capital account deficit	Cash with Accountant General	Cash and Money at Call	Other assets	Total Assets
1959/60	3,140	10	3,150	2,872	--	255	23	--	--	3,150
1960/61	3,179	10	3,189	2,673	--	265	251	--	--	3,189
1961/62	3,295	11	3,306	2,679	--	225	402	--	--	3,306
1962/63	3,279	17	3,296	2,777	--	121	386	--	12	3,296
1963/64	3,235	11	3,246	2,567	--	12	635	--	32	3,246
1964/65	3,199	92	3,291	2,485	--	--	801	--	5	3,291
1965/66	3,000	266	3,266	356	2,996	--	-120	34	--	3,266
1966/67	2,706	248	2,954	328	2,911	--	-320	35	--	2,954
1967/68	2,586	335	2,921	312	2,836	--	-456	31	198	2,921
1968/69	2,574	498	3,072	297	3,181	--	-439	24	--	3,072

Notes: 1. 1959/60 - 1963/64 Financial year ending 31st March, 1964/65 - 1968/69 Financial year ending 30th June.

2. Local investments comprise government securities and loans to the government - Le 0.4 million made in 1965/66.

Source: Post Office Savings Bank, Annual Reports 1959/60 - 1968/69.

CHAPTER V

NON-BANK FINANCIAL INSTITUTIONS: SOURCES AND USES OF FUNDS

The non-bank financial institutions differ from banks in that the liabilities of the banks act as media of exchange while those of non-bank financial institutions do not. These non-bank institutions, however, make an important contribution to economic development. They are able to supply loanable funds to deficit units by using their own resources and by mobilizing additional resources directly from the public. When these resources that are available to non-bank institutions are used to finance productive investment, these institutions assist the development process. However, they will not be contributing to economic development if the funds that are available to them are utilized to build up their cash reserves or invested outside the economy. Thus it is not enough for non-bank financial institutions to mobilize previously idle balances. What these institutions do with the resources is also important.

Aside from the Post Office Savings bank which was discussed in the previous chapter, the non-bank financial institutions examined in this chapter include the insurance companies, the National Development Bank, thrift and credit societies, pensions and other trust funds, the Benthworth Finance Company, the recently established National Insurance Company and the National Co-operative Development Bank, and the currently proposed National Agricultural Development Authority.

(a) Insurance Companies

(i) Sources of Funds

Insurance business in Sierra Leone is carried on by fifteen foreign insurance companies from the following countries.

United Kingdom	10
United States	3
India	1
Trinidad	1

The various classes of insurance business undertaken by the fifteen insurance companies are shown in Table 5.I.

TABLE 5.I CLASSES OF INSURANCE BUSINESS

Type of Company	Number of Companies	Number of Companies Transacting Non-Life Business				Number of Companies transacting Life Business
		Fire	Motor	Marine Cargo & Transportation	Others	
Domestic	-	-	-	-	-	-
Foreign controlled subsidiaries	2	-	-	-	-	2
Agencies branches of foreign companies	13	9	10	9	10	4
TOTAL:	15	9	10	9	10	6

Source: Unpublished data available from the Ministry of Finance.

Of the life companies, only three deal exclusively with life insurance. Out of the ten companies transacting motor insurance business, only one deals exclusively in motor insurance. Thus, four companies are specialized while the others provide various types of insurance business. One company which specializes in underwriting began operations in 1970.

Each of the insurance companies is a branch of a foreign company and up to the end of 1970 these local branches had not published balance sheets in respect of their operations in Sierra Leone. The only available information relates to premiums collected. We have therefore used this information as an indication of the resources available to insurance companies in Sierra Leone. The premiums generated during 1960 - 1970 are as follows:

TABLE 5.II PREMIUMS COLLECTED, 1960 - 1970 (Le 000)

Non-Life Premiums	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Fire						165	197	193	203	246	
Marine						58	65	87	63	76	
Motor						542	744	926	842	1,011	
Miscellaneous						177	190	244	254	305	
TOTAL NON-LIFE PREMIUMS	434	504	555	670	765	942	1,196	1,450	1,364	1,638	1,916
LIFE PREMIUMS	100	110	120	140	165	173	347	354	368	1,236	1,446
TOTAL PREMIUMS (Life plus Non-Life)	534	614	675	810	930	1,115	1,543	1,804	1,732	2,874	3,362

Source: For the years 1965-1969, the unpublished data are available at the Ministry of Finance. Information for the years 1960-1964 are our own estimates made with the help of the Insurance Officer at the Ministry of Finance. It was assumed that the average rate of growth of fire insurance premiums which was 10% for the years 1965-1969 held for the period 1960-1964. On this assumption we obtained Le 82,000 as the estimated premiums for 1960. In the case of motor insurance we applied the percentage rate of growth of new vehicles registered which was 61% between 1960 and 1964. On this basis, motor insurance premiums in 1960 amounted to Le 213,000. In the case of life insurance it was assumed that premiums would not have exceeded Le 100,000. Marine insurance was estimated at Le 40,000 while miscellaneous insurance was thought to be about Le 100,000. Hence we arrived at a gross premium for 1960 of Le 534,000.

For 1970, it is assumed that gross premiums were 17% higher than the 1969 figure. This percentage is the average for the years 1965 - 1968 (1969 was considered a 'freak' year for life premiums hence the exclusion of this year in deriving the average).

Claims against insurance companies vary greatly depending on the class of insurance. During the years 1965 - 1969, for which this information is available, claims as a percentage of premiums collected averaged 52% for fire, 82% for marine, 50% for motor and 64% for miscellaneous.

(ii) Uses of Funds

In deciding whether to invest their surplus funds locally or overseas, the insurance company may be influenced by a number of factors. One factor is the need and desirability to spread risks; this consideration may lead to the flow of resources to the head office for the pooling of contingency funds and re-insurance. Another factor is the availability of local investment outlets; if there are no suitable outlets locally, then funds will flow overseas. In addition, the existence of legislation regulating the activities of the insurance companies is also an important consideration. In the absence of such a legislation it is possible that local investment outlets may exist but funds may continue to flow abroad out of habit or because of higher profit expectation. These factors would tend to result in a large proportion of non-life premiums flowing abroad in view of the high proportion of claims. In the case of life insurance which is relatively new in Sierra Leone, claims are likely to be lower and therefore life funds are more suitable for longer term investments. Consequently, such funds need not flow out of the economy.

Insurance companies in Sierra Leone have invested within the country only since 1966. Their investments were confined to government securities as shown below.

(Le 000)

	1966	1967	1968	1969	1970
Sierra Leone Treasury Bills	75	145	178	198	225
Government Stocks	50	50	50	50	50
Total	125	195	228	248	275

These local investments accounted for barely 10% of the premiums received.

(b) The National Development Bank Limited

(i) Sources of Funds

The National Development Bank Ltd. (NDB) was incorporated on the 9th March, 1968 as a public limited company. Its authorized capital is Le 1 million, of which Le 0.7 million had been paid up by the end of 1970. There are two categories of shareholders: "A" shareholders consist of Sierra Leonean subscribers, international and regional agencies such as the African Development Bank Ltd., and "B" shareholders are foreigners. Both classes of shareholders, however, have the same rights and privileges.[1]

In addition to its paid-up capital, the Sierra Leone Government provided a long term interest-free loan of Le 1 million over the years 1968 - 1970. Also, over-subscribed "B" shares were retained by the NDB as a short-term loan pending the issue of additional "A" shares. Added to these, NDB can borrow up to three times the sum of its issued capital and reserves (including the Le 1 million interest-free loan from the government). The total resources available to the NDB during the years 1968 - 1970 were: (le)

	1968	1969	1970
Paid-up Capital			
"A" Shareholders	288,106	349,446	349,986
"B" Shareholders	287,881	349,121	349,121
Reserves	5,300	27,821	102,919
Interest-free Loan from the Sierra Leone Government	674,655	699,655	1,000,000
Loans	126,440	65,200	65,200

Source: National Development Bank Ltd., *Annual Reports*, 1968 - 1970.

1. The main shareholders of the NDB include: The African Development Bank Ltd., The Bank of Sierra Leone, Bank fur Gemeinwirtschaft Aktiegellschaft of West Germany, Templesman and Sons of New York, Sierra Leone Selection Trust Ltd., Degremont, the Forest Industries Corporation, commercial banks and two leading commercial firms.

(ii) Uses of Funds

The objective of the NDB is defined as follows: "To carry on the business of assisting enterprises engaged in industry, commerce, agriculture and the exploitation of natural resources in Sierra Leone with a view to contributing to the economic development of Sierra Leone."[2] The NDB's financial participation is limited to a minimum of Le 7,500 and a maximum of Le 150,000; it cannot underwrite more than 25% of the share of any enterprise and its loan equity in a project cannot exceed 50% of the total investment.[3]

Of the total number of 60 applications during 1968 - 1970, 14 were for agriculture, 29 were for manufacturing, 6 were for fishing and 11 were for services. Of these, the NDB approved 14 by the end of 1970. The NDB's commitments in respect of these projects are given in Table 5.III.

2. National Development Bank, Memorandum and Articles of Association, Freetown, 1968. p. 1.
The securities acceptable to the NDB include:
(a) First legal mortage of fixed assets which must relate to the project being financed;
(b) Floating charges on other assets;
(c) Guarantee given by reputable banks or parent companies;
(d) Pledge of government securities and marketable securities;
(e) Standing order for regular payment of principal and interest.
National Development Bank, Objectives and Functions, Freetown. (1968) p. 5.

3. Prior to 1971 the maximum was Le 60,000 and it was raised in order to allow the NDB to participate in bigger ventures. National Development Bank, Annual Report, 1971, p. 6.

TABLE 5.III SCHEDULE OF INVESTMENT OF THE NATIONAL DEVELOPMENT BANK LIMITED AT 31st DECEMBER, 1970

No.	Title of Investment	Amount Sanctioned			Portfolio at 31st December, 1970		
		Ordinary Shares	Preference Shares	Loans	Ordinary Shares	Preference Shares	Loans
1.	Salt Manufacturing Company (S.L.) Limited	15,000	--	40,000	15,000	--	40,000
2.	Atlantic Printers Limited	5,250	9,000	15,000	5,250	9,000	15,000
3.	Afro Fishing Industries Limited	15,000	--	30,000	--	--	--
4.	United Paper Company Limited	8,000	--	12,000	8,000	--	12,000
5.	Bentworth Finance (S.L.) Ltd.	60,000	--	--	60,000	--	--
6.	Adenor's Metal Works Limited	--	--	10,000	--	--	10,000
7.	Morgan Pharmacies Limited	10,000	--	--	10,000	--	--
8.	Sierra Industrial Vestments Company Limited	--	50,000	--	--	50,000	--
9.	Sierra Leone Galvanised Industries Limited	35,000	35,000	--	--	--	--
10.	Morgan Garage - Kenema	--	--	8,000	--	--	8,000
11.	Cape Sierra Hotel Limited	--	--	60,000	--	--	--
12.	Bo Motors Limited	--	--	25,000	--	--	--
13.	Surena Garage	--	--	10,000	--	--	--
14.	Brewo Motors Limited	--	420	--	--	420	--
		148,250	94,420	210,000			

Source: National Development Bank Ltd., Annual Report 1970, p.18.

In addition to the investments shown in the last three columns of Table 5.III, other assets of the NDB include:

	1968	1969	1970 (Le)
Government Stocks (at cost)	604,000	619,000	654,000
Treasury Bills	334,155	285,441	267,284
Fixed Deposits	414,229	557,348	693,678
	1,352,384	1,461,789	1,614,962

Source: National Development Bank Ltd., Annual Reports, 1968 - 1970.

These assets accounted for about 93% of the total assets of the National Development Bank (shown in Table 5.IV), and thus only a very small proportion has so far been made available for the purpose for which the NDB was established.

TABLE 5.IV BALANCE SHEET OF THE NATIONAL DEVELOPMENT BANK LTD. 1968 - 1970 (Le 000)

	LIABILITIES				ASSETS			
	Share Capital	Loan Capital	Reserves	Total Liabilities	Fixed Assets	Investments	Current Assets less Current Liabilities	Total Assets
1968	576	801	11	1,388	16	604	768	1,388
1969	698	765	56	1,519	15	619	885	1,519
1970	699	1,065	103	1,867	8	869	990	1,867

Source: National Development Bank Ltd., Annual Reports, (1968 - 1970).

Even allowing for the difficulties of getting started this pattern of resource utilization is not the type one would have expected from an institution which is concerned with economic development.

The main explanation for this is the lack of viable projects. The problem of the availability of economically and technically viable projects is not peculiar to Sierra Leone. The shortage of projects qualifying for bank finance has been found to be the most serious problem in other countries. With respect to Nigeria, for example, Schatz concludes that " .... the real deficiency is not a shortage of capital funds. The main weakness in the policy of promoting development by making capital available to indigenous business, lies in the scarcity of potentially profitable undertakings."[4] Other studies in various parts of Africa have supported this view.[5] Because of the absence of viable projects, and given the size of the Sierra Leone market, one would expect the NDB to undertake promotional activities without which it would continue to have difficulty in securing business. The Working Party on 'Capital Availability and Sierra Leonean Entrepreneurship' observes that although the NDB is doing some feasibility studies, " ... its department on Project Evaluation is as yet ill - or inadequately equipped; and this together with the mounting pressures on it is seriously

4. Sayre P. Schatz, "Government Lending to African Business: Inept Incentive," Journal of Modern African Studies, Vol. 6, No. 4 (1968), p. 520.

5. "The lack of commercially viable projects turns out to be the fundamental problem in country after country, which has tried to promote development by providing capital to indigenous businessmen. This has been the case in Uganda, where more than one investigation has found more capital available to help the industrial entrepreneurs than can at present be efficiently used and that the difficulty lies in finding worthwhile schemes to finance."
Ibid., p. 521.
"The Industrial Development Bank of Sudan could find in its first year only three small projects which it could support with loans."
Ibid., p. 521.
"Even more than capital the African needs enterprise or management."
N.A. Cox-George, Report on African Participation in the Commerce of Sierra Leone (Freetown: Government Printer, 1960), p. 40.

affecting its elasticity and there is the danger that it will soon degenerate into an inflexible and inefficient bureaucracy if it is not improved."[6] Because of this deficiency, the Working Party recommends either the enlargement of the NDB or the establishment of a new institutions.[7]

In our view, the responsibility for pre-investment studies as well as promotional activities should be entrusted to the NDB. This is not expecting too much from an essentially private development bank as the following quotation shows:

> Most development bankers that I interviewed concur with Dr. Gutierrez that the promotional function of a private development bank is vital. Skilled project implementors must be encouraged, and, in their absence, institutions such as private development banks must be willing to intercede by taking the steps necessary to create sound projects and encourage entrepreneurs to enter them.[8]

In its 1971 Annual Report, the NDB says "There is certainly no dearth of projects for development if proper feasibility studies are carried out."[9] What appears to be the limiting factor is having the

6. N.A. Cox-George (Chairman), Report of the Working Party on Capital Availability and Sierra Leonean Entrepreneurship, op. cit., p.24.

7. The Working Party recommends that the new institution undertakes the following functions:
"(a) To identify economically viable projects and offer financial and technical assistance for their realisation;
(b) to evaluate the economic viability and technical feasibility of projects presented to it and to discourage the promotion of unworthy projects;
(c) to explore the possibilities of new avenues for investments and to assist in the evaluation and reorganization of existing small businesses the owners of which may not be in a position to perform such tasks themselves."

8. Philip Perera, Development Finance (New York: Frederick A Praeger Publishers, 1968), p. 230.

9. National Development Bank, Annual Report, 1971, p. 7.

qualified personnel. "As the staff in the management and professional levels improve in strength we should be able to undertake more promotional work."[10] Because the availability of viable projects is fundamental for the bank's success we have argued in Chapter IX that the government should make the services of experts available to the NDB out of public funds. We have also argued in that chapter that the responsibilities of the NDB should be enlarged to include pre-investment and feasibility studies, promotional activities, and the provision of certain ancillary services which are important for the successful development of enterprises.

(c) Co-operative Thrift and Credit Societies

(i) Sources of Funds

The main source of funds are the deposits of their members. Membership of individual societies varies greatly ranging from a few members to several hundreds with a total membership of 33,475 in 1969/70. Table 5.V shows that membership increased by 19,589 between 1961/62 and 1969/70, though during 1964/65 and 1968/69 there was a temporary decline in membership. Although these societies are widely dispersed throughout the country, they tend to be concentrated in Bo, Moyamba, and Kenema. The minimum deposit payable per member is 50 cents but members usually deposit more than this minimum. From Table 5.V., it can be seen that deposits of members rose from slightly less than Le 0.2 million in 1961/62 to about Le 0.8 million by 1969/70. Adding reserves to their deposits their total resources amounted to Le 0.9 million in 1969/70.

In addition to their own resources the thrift and credit societies can obtain additional funds from the Registrar of Co-operative Societies' Loan Fund established in 1950. The fund is made up of overdraft facilities from two commercial banks. However, thrift and credit societies rely mostly on their own resources with the result that only 54 such societies out of a total of 647 in 1969 borrowed from the

10. Ibid.,

TABLE 5.V THRIFT AND CREDIT SOCIETIES - MEMBERSHIP, DEPOSITS AND LOANS, 1961/1962 - 1969/1970

		1961/62	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70
Number of Societies		269	362	419	489	591	617	652	647	na.
Membership of Societies		13,886	17,248	22,116	21,694	27,843	28,983	30,454	29,353	33,475
Deposits/Savings & Stores	Le 000	150	209	291	357	478	485	688	729	781
Reserves	"	11	15	23	33	50	51	75	76	119
Marketing/Turnover	"	8	9	n.a.	2	8	1	2	99	n.a.
R.C.S. Loans Issued	"	n.a.	23	36	51	145	140	32	29	--
Member Loans Issued	"	171	219	321	398	150	145	818	497	436
Total Loans Repaid	"	120	144	221	283	99	94	418	425	410
Total Loans Outstanding	"	163	238	338	453	196	191	814	810	836

Source: Unpublished data available at the Co-operative Department.

Registrar of Co-operative Societies' Loan Fund.

(ii) Uses of Funds

In general, co-operative thrift and credit societies provide three categories of loans; those repayable within twelve months, those payable after one year but within three years, and those repayable after three years but within six years. Loans repayable within a year are mainly consumption loans, especially during the 'hungry season', but in addition some of these loans have been used to improve production, especially for the purchase of seeds. Loans repayable within three years have been mainly for buildings, including renovation, and for rice hullers. Those recoverable within six years have been advanced for the purchase of lorries and iron safes.

At the end of 1969/70 financial year the societies had about 10,000 individual loans totalling Le 0.8 million. These loans are mainly character loans and in consequence repayment and recovery have been reasonably good. The repayment of loans by 54 societies from the Registrar of Co-operative Societies' Loan Fund has however not been completely satisfactory. Of the total sum of Le 83,062 made available to these societies, Le 47,583 was outstanding at the end of June, 1969 and of this Le 2,439 was due for repayment in 1969. Thus at the end of June, 1969 overdue debt was Le 45,144.

Co-operative thrift and credit societies should be able to mobilize savings in the rural areas because of their location and the spirit of co-operation which is the basis of these societies. Incomes in these areas are not only low but also flow at irregular intervals, and this type of income pattern is conducive to co-operative-type institutions. Also, thrift and credit societies are within easy reach of people in the areas. In spite of these advantages there has been no spectacular rise in the volume of small savings mobilized by these institutions. Because of the limited resources available to these societies they have not been able to meet all the needs of their members. This in turn has affected the societies' ability to mobilize additional savings. Members of co-operatives, not being able to obtain financial assistance from their societies, have had to find other sources with a consequent retardation in the expansion of the resources of the societies. Non-members, on the other hand, are not attracted to the societies because they are aware that financial assistance cannot be guaranteed in time of need. Also, as the resources available to these societies are quite small, they have concentrated in building up their reserves with the result that so far they have not paid any interest on their deposits. Furthermore, the co-operatives have incurred additional expenses by accepting responsibility to process applications, disburse and enforce loan repayments (for loans from the Registrar of Co-operative Societies' Loan Fund).[11] To meet these costs a rate of interest higher than the rate of borrowed funds is charged but, in addition, members contribute in the form of levies.[12] The main disadvantage is that such levies make marketing through the co-operatives more expensive and the result is that farmers use channels other than the co-operatives for the marketing of their produce.

11. These additional costs include the cost of assessment, the keeping of records in connection with loan repayment, the cost of marketing arrangements, and the cost of default.

12. It could be argued that the levies made are not as high as the charges of money lenders and traders (see Chapter VI). But the important difference is that most charges of money lenders and traders are concealed either in the prices of provision or other goods credited or in the price the trader pays for the farmer's crops. With the co-operatives it is a direct charge which is explicitly shown.

(d) Pensions, Provident and Superannuation Funds

(i) Sources of Funds

In general there are two categories of provident funds now in operation in Sierra Leone. In the first category both the employee and the employer contribute an equal amount, while in the second the employer's contribution is more than the employee's. An example of the first group is the Road Transport Corporation.[13] Here the employee's contribution is 5% of his assessable earnings, subject to a maximum of Le 60 per month. The Corporation contributes an equal percentage. For assessable earnings below Le 22 per month, the contributions are as follows:

TABLE 5.VI PROVIDENT FUND CONTRIBUTIONS FOR EARNINGS BELOW Le 22: SIERRA LEONE ROAD TRANSPORT CORPORATION.

Monthly Pay	Total Contribution	Employer's (Corporation) Share	Employee's Share
Le 22	Le 2.20	Le 1.10	Le 1.10
21	2.10	1.30	0.80
20	2.00	1.50	0.50
19	1.90	1.70	0.20
18	1.80	1.80	-
Below Le 18	10%	10%	

Source: Unpublished data available at the Sierra Leone Road Transport Corporation.

The right to benefit is subject to the accomplishment of a qualifying period of sixty contributions paid on a monthly basis.

13. The Corporation came into being in 1965 taking over the functions of the former Road Transport Department.

The Sierra Leone Selection Trust Ltd., is an example of the second group. Here, the company's contribution is 10% and the employee's contribution is 7½%. In this case, only senior members of the staff can participate, and these numbered 250 at the end of 1969. Should a member resign or leave the services of the company, he is entitled to a refund of all his contributions plus interest at 3%. The number of years service with the company determines the percentage of the company's contributions payable to an employee.

Table 5.VII shows the value of all the pensions and provident funds for the years 1960 to 1970.[14]

14. This information refers to large companies only. However, the small companies and institutions about which we have no information are not likely to account for more than 3% to 5% of the totals given in the table. This estimate is based on our knowledge of the sizes of firms in the country.

TABLE 5.VII PENSIONS, PROVIDENT, PUBLIC AND PRIVATE TRUST FUNDS, 1960 - 1970

	1960	1961	1962	1963	1964	1965	1966	1968	1968	1969	1970
Mining Companies						650	670	695	719	754	790
Commercial Firms						448	519	519	553	591	620
Public Corporations						206	257	257	319	339	360
Government Employees						99	61	39	35	30	31
Others						40	40	42	60	71	73
TOTAL	823	892	1,080	1,200	1,371	1,443	1,547	1,552	1,686	1,785	1,874

Source: For the years 1965-1970, information compiled from data available at the Bank of Sierra Leone. Figures for the years 1960-1964 are our own estimates. The estimates were arrived at as follows: Between 1965 and 1970 these funds grew at an average rate of 5% per a num. During this period the paid labour force was enlarged by about 3,000 workers. During the years 1960-1964, the addition to the labour force was 10,000. We therefore assume that the rate of growth of these funds was higher than that achieved during 1965-1970. We do not attribute any of the increases to higher wages as there has been no salary revision since 1957. As not all workers participated in these funds, we assume that the rate of increase between 1960 and 1964 was 60%. The rate of increase between 1964 and 1965 was assumed to be 5% (the average for the years 1965-1970). On the assumption of a 60% increase between 1960 and 1964 we obtained Le 548,000 as the rise between the two dates. In allocating this amount to the years 1961, 1962, 1963 and 1964, we used the rate of growth of the paid labour force, which were respectively 4%, 11%, 7% and 10%, as weights.

(ii) Uses of Funds

Public and private, pensions, provident and trust funds have, in the main been invested overseas. Their investment in Sierra Leone have been confined to government securities. These investments are given in Table 5.VIII.

TABLE 5.VIII INVESTMENTS OF PENSIONS, PROVIDENT, PUBLIC AND PRIVATE TRUST FUNDS IN SIERRA LEONE GOVERNMENT SECURITIES (Le 000)

	Pension Funds Investment in Sierra Leone Government Securities	Provident Funds Investment in Sierra Leone Government Securities	Public and Private Trust Investment in Sierra Leone Government Securities
1964	18(1.4)*	3(0.02)*	3(0.02)*
1965	114(1.4)	38(0.5)	5(0.05)
1966	162(1.3)	95(0.7)	12(0.09)
1967	293(1.9)	180(1.1)	17(0.01)
1968	387(2.2)	237(1.3)	21(0.01)
1969	517(3.0)	298(1.7)	42(0.20)
1970	597(3.0)	256(1.2)	30(0.10)

* Figures in parentheses are percentage of outstanding government securities.

Source: Calculated from Tables 16 & 17 in the Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4, (March, 1972).

The investments of pensions, provident and other trust funds overseas, especially before 1964, have been due to the virtual absence of local investment outlets. It should be noted that Sierra Leone Government Securities became available to the public only since 1964. However, an important consideration for the continuing overseas investment of these funds after 1964 is the yield. The rate of interest on Sierra Leone Treasury bills is currently 5½%, while the rate of interest on Sierra Leone

Government Stocks is 6½%. In contrast, investment in the London money and capital markets earned more than 8½%.[15]

(e) <u>Benthworth Finance Company (Sierra Leone) Ltd.</u>

(i) Sources of Funds

Benthworth Finance Company (Sierra Leone) Ltd., was incorporated in Freetown on the 23rd February, 1970 and began operations on the 1st August, 1970.[16] The resources available to the company are as follows: The paid-up capital which amounted to Le 300,000 is held by the Sierra Leone Government, Le 30,000; the Bank of Sierra Leone, Le 30,000; the National Development Bank Ltd., Le 60,000; Barclays Bank Overseas Development Corporation, Le 60,000; Royal Exchange Assurance, Le 30,000; and Hambros Bank Ltd., Le 90,000. In addition, the company enjoys overdraft facilities of up to Le 800,000 from a local bank, and the National Development Bank Ltd., has undertaken to keep Le 150,000 in a fixed deposit account with the company. Benthworth can also borrow from both local and external sources to the equivalent of six times the sum of its paid-up capital and reserves.

(ii) Uses of Funds

The company undertakes the following categories of business: A car loan scheme for Members of Parliament, civil servants, employees of public corporations and government employed school teachers. The loan

15. Some of the securities held by the Board of Trustees of the Sierra Leone Produce Marketing Board Provident Fund in 1969 were:

7½% National Savings Certificate;
7½% British Savings Bond;
8½% Treasury Stock 1980/82.

See Sierra Leone Produce Marketing Board Provident Fund, <u>Annual Statement of Accounts</u>, (Freetown, 1969).

16. The company is administered by a board of directors consisting of six members, which is responsible for general policy; the day-to-day operations are the responsibility of the general manager. In addition, the company has entered into an agreement with Hambros Management Corporation Ltd., for advisory services for which the company pays a service fee of 2% of the turnover with a minimum fee of Le 9,000 per annum.

is repayable within four years and carries interest at $8\frac{1}{2}\%$. Another category of business consists of commercial hire purchase transactions for motor vehicles, plant, machinery and equipment. Unlike the first group which requires no down-payment, here a deposit ranging from $33\frac{1}{3}\%$ to 45% of the cost price is required. In the case of commercial hire purchase, the hirer buys the vehicle from the dealer and signs a hire purchase agreement with the dealer. This agreement is then forwarded to Benthworth for acceptance. The terms and conditions for a commercial hire purchase are the following:

	Deposits	Charges	Repayment Period
Private Cars	$33\frac{1}{3}\%$	12.0%	18 months
Taxis	40%	13.2%	7 months
Mini Buses	40%	13.2%	12 months
Light Commercial Vehicles	35%	13.2%	10 months
Heavy Commercial Vehicles	$33\frac{1}{3}\%$	13.2%	12 months

A third category of business is comprehensive insurance of private cars purchased under the car loan scheme. The insurance loan is repayable within 12 months and carries interest at $8\frac{1}{2}\%$. Finally, the company also does block discounting.

At the end of April 1971, total advances by the company amounted to Le 820,889, involving 517 hire purchase agreements. Of these, 47% were for private cars, 25% were for taxis, 23% were for commercial vehicles, and the remainder was for block discounting and insurance.

Table 5.IX on the balance sheet of the company shows that Benthworth has incurred losses during the first few months of its operation, the losses amounting to Le 65,612 by the end of April, 1971. The reason for this is that the company did not attract the volume of business

TABLE 5.IX BALANCE SHEET OF BENTHWORTH FINANCE (SIERRA LEONE) LTD., SEPTEMBER 1970 - APRIL 1971

	September 1970	November 1970	January 1971	February 1971	March 1971	April 1971
Fixed Assets	13,328	13,304	14,386	14,137	13,651	13,340
Current Assets	321,958	459,622	632,428	737,824	796,640	817,203
Total Assets	335,286	472,926	646,814	751,961	810,291	830,543
Current Liabilities	46,006	159,207	325,590	424,936	471,741	483,932
Net Assets	289,280	313,719	321,224	327,025	338,550	346,611
Issued Capital	300,000	300,000	300,000	300,000	300,000	300,000
Profit and Loss Account (Loss)	53,155	60,548	75,601	80,987	66,991	65,612
Deferred Income	42,280	74,267	96,825	108,012	105,541	112,223
	289,280	313,719	321,224	327,025	338,550	346,611

Source: Unpublished data available at Benthworth Finance (Sierra Leone) Limited.

anticipated. It was estimated that turnover during the first year of operation would amount to about Le 2.0 million, with gross charges totalling Le 381,756 and an estimated profit of Le 20,158. The volume of business transacted from its incorporation in February, 1970 to the end of February, 1971 was as follows:

	(Le 000)	
	Advances	Gross Charges
Government and other loan schemes	304	97
Insurance	30	3
Commercial vehicles	282	32
Block Discounting	261	10
	877	142

Source: Unpublished data available from the Benthworth Finance Company (S.L.) Ltd.

From these figures it can be seen that the volume of business transacted was less than half of what was forecast. It was hoped that the company would handle all the car purchases of the government and semi-government bodies as well as public corporations and various educational institutions. However, this did not materialize, probably because of the company's charges. The Government had previously charged 5% under its car purchase scheme and some public corporations charged as low as 3%. Consequently, the staff associations of public corporations in particular have not been willing to pay the new charges. Also, the traditional motor dealers, such as United Africa Company Ltd. who, in the main, did not have hire purchase arrangements of their own, have lost their command over the distribution of cars since about 1965, and most of the new car distributors, to improve sales, offer customers hire purchase arrangements which they finance partly from their own resources but mainly from commercial bank loans.

Official encouragement in the form of Sierra Leone Government and Bank of Sierra Leone participation in the company can be justified on the ground of preventing foreign domination in the financial field but cannot be justified on the ground of economic development since the company has merely duplicated a service that had already been available. On the other hand, the contribution to economic development will be quite significant if the emphasis is on financing the purchase of equipment for productive purposes, such as agriculture.

We have pointed out that the government's development strategy aims at improving the productivity of the agricultural sector and we point out in Appendix II that a contributory factor to the present low agricultural productivity is the primitive nature of some of the implements used. In these circumstances, an institution providing equipment loans will be making an important contribution to agricultural development. This is because a small agricultural producer who has learnt about the achievement of a piece of equipment may not be able to ascertain whether it is suitable for West African conditions but a large institution should be able to do so. Also, ordering an equipment at long distances can cause serious problems for a small producer; but these are difficulties which an institution like Benthworth with its external connections should be able to avoid. A large institution will also be able to store spare parts. Further, an institution specializing in equipment loans is likely to have technical staff to demonstrate the right use of equipments. This may not be so crucial in a situation in which technical education, at all levels, is of a high standard. However, where technical education is not generally available, showing people the correct use of machinery improves the efficiency and life of the equipment. Also, securities for loans presents a serious constraint in the agricultural areas. In these areas, land is all that a farmer can offer and under Native Law, although he has the use of the land, he does not own the land. Equipment loans, in such a situation, may to a large extent deal with the problem of securities as the equipment becomes the collateral for the loan. In addition, since the emphasis is on increased productivity, equipment loans are not only likely to achieve this result but also, ensure that the loans are used for the purposes for which they are intended.

An equipment loan scheme is already in existence in Sierra Leone. This is the Sierra Leone Revolving Loan Scheme of the Mines Department. The scheme was established in 1960 by a free grant of Le 100,000 from American Aid Funds released to British Territories in Africa.[17] The purpose of the scheme is to assist alluvial diamond miners with the purchase of equipments aimed at improving productivity. Under this scheme, the Mines Department uses part of the grant to purchase mining equipments such as pumps, pump spares, screening for washing diamond gravel. Miners in turn obtained these equipments from the Mines Department. In the case of small items, the customer pays the full cost of the equipment. In the case of other items, a deposit equivalent to 50% of the total cost is required. The balance is repayable within six months. The Mines Department does not stock heavy machinery. This is ordered when the customer deposits 50% of the cost. Freight and insurance are added to the remaining balance and this constitutes the loan which must be repaid within twelve months. A hire purchase agreement is executed before the delivery of the equipment. The rate of interest charged is 1% above the British Bank Rate. Under the agreement all equipments are to be repossessed if the repayments are not made on the due dates. During the life time of the agreement, the customer is obliged to make the machinery available for inspection by the Mines Department.

17. Briefly, the objectives of the scheme are:
(a) To improve the efficiency of mining and washing of diamonds mined under the Alluvial Diamond Mining Scheme by using efficient equipment;
(b) To make this equipment available to the ordinary miner who normally would not be able to pay full cost;
(c) To reduce the prices of this equipment by eliminating commercial firms and private traders.

Sales under the scheme were as follows:

	(Le 000)
1960 - 1963	202
1964	35
1965	50
1966	65
1967	75
1968	73
1969	163
1970	60

Apart from providing the machinery, the Mines Department also maintains "Area Superintendents" who hold occasional exhibitions to demonstrate the correct use and maintenance of equipments.[13]

To contribute to economic development of the country, Benthworth would need to investigate this type of activity.

(f) <u>The National Insurance Company</u>

The Sierra Leone Government in March, 1969 appointed a National Committee on Insurance to examine the possibilities of establishing a National Insurance Company and the introduction of a comprehensive legislation for the control of insurance business in Sierra Leone.[19]

18. Part of the total fund under the scheme is managed by Crown Agents. At the end of 1969 investments managed by Crown Agents totalled Le 100,944. In addition, the Chief Inspector of Mines is required to remit to Crown Agents all surplus funds held locally for investment.

19. The terms of reference of the committee were: (a) to study the situation in Sierra Leone with respect to all types of insurance; (b) to make proposals to the Government for the control and operation of insurance companies in Sierra Leone; (c) to make recommendations to the Government on the establishment, structure and operations of a National Insurance Company; and (d) to submit a report on (a) to (c) to the Minister of Finance. The chairman of this committee was Mr. S. L. Bangura, Governor of the Bank of Sierra Leone.

The committee was assisted by two experts provided by the Government of Pakistan and they reported on the feasibility of setting up a National Insurance Company and matters relating to the drafting of insurance legislation. Mr. Najmul Hasan who reported on the feasibility of establishing a National Insurance Company concluded that such an institution would be economically viable.[20] He believed that the National Insurance Company will be able to secure business from the following sources during the first year of its operation:

(a) 75% of public sector motor insurance business and 50% of public sector fire, marine and miscellaneous insurance business;

(b) 20% of private sector motor insurance business and 10% of private sector fire, marine, and miscellaneous business.

Applying these percentages to the 1968 premiums collected, he obtained an estimated premium income for the new company of Le 314,864. This premium income was expected to increase by 10% per annum. Commission was estimated at 15%, claims at 57%, and expenses at 16%. On these calculations, he expected profits to range between 10% and 40%. The estimated profits rose to between 20% and 70% when claims were 48% of total premiums. The estimated profits would be higher still if more premiums were collected or if the claims were reduced. In the case of life insurance, he estimated that 70% of the premiums arose from Sierra Leonean lives. He expected that with industrialization and the growth of a middle class there would be a rising demand for life insurance. A second source of life insurance business which he suggested was from superannuation funds and other insured schemes especially those in which

20. Najmul Hasan, Report on the Feasibility of Setting up a National Insurance Company or Corporation, submitted to the Minister of Finance on the 27th May, 1970. (unpublished). Mr. Hasan is the Manager of the Pakistan Insurance Corporation.

the Government is involved. Here, he expected that the contributions of the employers and employees to be paid directly to the insurance company which would then assume responsibility for paying pensions to the employees when they retire.

The insurance legislation prepared by Mr. Khalfe[21] and which was enacted in July, 1971, has two important provisions. First, each insurance company should have a paid-up capital of Le 50,000 or Le 100,000 for both life and motor insurance and Le 200,000 for other classes of insurance, whether done singly or not. Second, all life funds should be invested within Sierra Leone while companies transacting non-life business are required to invest 40% of their gross premiums in local assets.

Hasan's calculations for the success of the National Insurance Company is based on patronage from statutory corporations, the companies in which the Government has invested and supported. This approach is realistic, since trade and commerce are mainly foreign enterprises and are not likely to be enthusiastic about a new local company. As most private cars are owned by Sierra Leoneans and since all cars must be insured, an appeal to patriotism should attract some of this business from foreign firms to the new company. At the same time, the demand for cars is likely to rise with rising standard of living. With a well planned and executed advertising campaign, the National Insurance Company should become a viable undertaking. But it must be pointed out that success cannot be taken for granted as much would depend on efficient management and the vigour and success of the advertising campaign. The appearance of a local company is likely to increase the mobilization of domestic resources through competition for new business. But even if the volume of savings does not rise, the transfer of funds to a local

21. A.M. Khalfe, Report on Matters Relating to the Drafting of an Insurance Legislation (Freetown, May 1970). This report has not been published. Mr. Khalfe was Controller of Insurance, Government of Pakistan.

institution would ensure that most of the resources are invested locally. The same results would be achieved by Khalfe's proposal requiring that the entire life funds plus 40% of non-life premiums be invested locally.

A major problem which required consideration concerns the local assets into which insurance funds can be invested. In the case of non-life business which requires fairly liquid investment for easy realization to meet unexpected claims, Treasury bills are available and these can be rediscounted at any time at the Bank of Sierra Leone. There may be a problem about yield as Treasury bills fetch only 5½%. In the case of life funds which are more suitable to medium and long term investment, these funds can be invested in Sierra Leone Government Stocks. Even if it is argued that such stocks are not now available, these funds can be invested in Treasury bills pending the introduction of new stocks. To deal with any liquidity emergencies that might arise, there should be some provision in the Bank of Sierra Leone Act which will make it possible for an insurance company unable to sell government stocks to be assisted by the Bank.

Another outlet for insurance funds is investment in office and residential buildings which have very high demand at present. There is however, at present an obstacle because the Non-Citizens (Interest in Land) Act of 1966 forbids foreigners from acquiring any freehold in land, and unless this Act is amended this type of investment is not possible for the foreign owned insurance companies.

A third outlet for local investment is the purchase of shares of joint stock companies. But virtually all the large companies operating in the country are branches of large international concerns, and consequently their shares are not quoted locally but in their countries of origin. Also, there is no local stock market. And up to the end of December, 1970, only four companies have been publically issued. Hence, the number of companies in whose equity the insurance companies can participate is quite small. In addition, because there is no stock market there may be difficulties in disposing of stocks when such sales become necessary.

In summary, the new legislation ensures some protection for policy holders. Also, by making available most of the funds mobilized within the country for local investment, these insurance companies would increase the availability of development finance. But it would seem that much more attention would have to be given to the question of local outlets for investment, as our analysis has shown that these outlets are few and those that exist have severe limitations.

(g) The National Co-operative Development Bank

The National Co-operative Development Bank was established in July 1971.[22] In common with other co-operative-type banks, it was not registered under the Banking Act but was registered as a co-operative society, under the Co-operative Societies Act. Any registered co-operative society can subscribe to the shares of the NCDB. The minimum amount of shares that can be purchased by a society is Le 2 per member and the maximum is limited to 20% of the total shares. Similarly, the liabilities of any society to the NCDB are also limited, the ceiling being twenty times the value of the paid-up capital of the society.

22. The main objectives of the NCDB are: (a) To operate as the apex financial society of the co-operative movement; (b) to provide a central source of credit for the movement; (c) to mobilize rural savings and accept deposits, savings and other funds from non-members and provide mobile banking services in the rural areas; (d) to provide advice to societies and individuals on the proper use of credit; and (e) to provide a central body for the channelling of finance to the co-operative movement from sources external to the movement.

It was anticipated that the following resources would be available to the NCDB: (i) Probable paid-up capital, Le 50,000, based on the minimum contribution of Le 2 per member; (ii) cash balance from the Government, Le 40,000; (iii) recovery of loans under the Registrar of Co-operative Societies' Loan Fund, Le 200,000;[23] (iv) reserve funds of co-operative societies, Le 50,000; and (v) surplus funds of societies which were likely to be deposited with the NCDB, Le 100,000. The NCDB also expected to borrow up to Le 2 million in the early stages through the issue of debentures and co-operative savings bonds.

The contribution of the NCDB to the provision of agricultural credit is likely to be limited. To begin with, this bank will be used mainly by the co-operative societies which at present cover less than 6% of total farmers. Assuming that all the resources anticipated are available to the bank, this will give the NCDB total resources of Le 0.4 million. If we assume that half of this amount is used for lending, then this is a definite improvement on what is currently available to the co-operative societies. But it is doubtful whether these resources will in fact be forthcoming. The recovery of loans under the Registrar of Co-operative Societies' Loan Fund may not be successful because we argue in Appendix II that recipients have been unable to repay their debts as the loans had been used for purposes which have not been connected with increasing the productive capacity of the farmer. On the other hand, they do not now qualify for further assistance because previous debts have not been repaid. Thus, the most that can be expected is repayment in small amounts over a period, on the assumption that action is taken to recover these outstanding loans. In the case of the Government's contribution, this may not be forthcoming because, the Government as

23. The total loans outstanding under the Fund is Le 400,000 and it was estimated that half of this outstanding amount could be recovered.

guarantor of the overdraft facilities under the Registrar of Co-operative Societies' Loan Fund will have to make good payments which are now overdue to the commercial banks. Next, we have shown that budgetary difficulties have begun to re-appear.[24] Also, the Government is already committed to providing part of the capital of the National Agricultural Development Authority to be established with the assistance of the International Development Association. On the whole therefore, the amount of resources that may be available to the NCDB may be much less than what is anticipated. This being the case, the scope of the bank's activities will be severely restricted.

(h) <u>The National Agricultural Development Authority</u>

The Government has declared its intention to establish an institution to be called 'National Agricultural Development Authority' to deal with some of the problems of agricultural development. The proposed institution is not strictly a financial institution but an institution which will be concerned primarily with the implementation of a programme of agricultural development in the South-Eastern region of the country. We have included it for discussion because it was selected as an alternative to the Agricultural Development Bank recommended by Moinuddin.[25]

24. These budgetary difficulties were referred to in Chapter II.

25. This alternative was recommended by the International Development Association and was a condition for the IDA providing 76% of the total cost of an agricultural development programme to be undertaken in the South-Eastern region of the country. The agricultural development programme which NADA is to implement consists of the following:

Firstly, (a) completing the establishment of a 2,000 acre oil palm plantation by planting 710 acres, and constructing a palm oil mill to service the estate and associated small-holder plantations; (b) clearing and bringing into rice production up to 13,500 acres of inland swamps; (c) planting up to 3,750 acres of cocoa; (d) planting up to 2,235 acres of oil palm; (e) constructing up to 40 small rice mills; (f) planting the first 4,500 acres of a 10,000 acres timber plantation.

Secondly, providing small-holders with credit for labour, pesticides, fertilizers and improved yield planting materials to farmers who would be involved in the scheme.

Thirdly, training project farmers in efficient rice, cocoa and oil palm production.

The National Agricultural Development Authority will be established with an authorized share capital of Le 6 million. Of this amount Le 3.4 million would be subscribed in the course of carrying out the project. The Sierra Leone Government is expected to subscribe Le 3.15 million. This amount includes Le 0.2 million, the estimated value of oil palm estate assets already developed. The Bank of Sierra Leone and the Sierra Leone Produce Marketing Board are expected to subscribe Le 150,000 and Le 100,000 respectively.

On formation, NADA would call up Le 140,000 from the Sierra Leone Government and Le 40,000 each from the Bank of Sierra Leone and the Sierra Leone Produce Marketing Board. The remaining Government equity would be called up as the Government automatically passed on the IDA credit to NADA. The remaining contributions of the Bank of Sierra Leone and the Sierra Leone Produce Marketing Board would be called up as and when required.

The most attractive feature of the NADA is that it will be combining the granting of credit with supervision of that credit. The drawback of NADA however, is that the institution is concerned with the implementation of a particular project and will not be concerned with the problem of agricultural credit in general.

(i) <u>The Non-Bank Financial Institutions and the Availability of Development Capital</u>

Our discussion of the individual institutions has shown that their assets/liabilities increased throughout the 1960's, rising from Le 1.6 million in 1960 to Le 10.3 million by 1970 (see Table 5.X). However, not all institutions have been successful in mobilizing domestic savings. We have pointed out that the thrift and credit societies should be able to mobilize rural savings because they are geared to that kind of activity. But we have observed that the deposits mobilized were not particularly large, especially in relation to the growth in membership of these societies. On the other hand, institutions such as the Benthworth Finance Company and the National Agricultural Development Authority do not solicit deposits from the public whereas the National Co-operative Development Bank had not begun operations by the end of the period covered by our study. The National Development Bank has mobilized some domestic financial resources by encouraging public participation in the share capital of companies.[26] Resources have also been mobilized through life insurance. Although the total value of life insurance premiums of about Le 1.5 million in 1970 is small, the premiums collected more than doubled between 1966 and 1970.

As pointed out in the introductory section of this chapter the importance of these non-bank financial institutions does not lie entirely in their ability to mobilize domestic financial resources, but more important is the use that is made of the resources available to them. Given the importance of achieving rapid economic development, the basic problems with which these institutions should have been concerned with are how to increase the flow of financial resources to the agricultural and small-scale industries sectors and how to ensure that the available credit is utilized to improve the productive capacity of the farmer and small-scale businessman. This therefore involves not only the provision of finance but also the availability of ancillary services for the effective utilization of credit. The consequence of neglect of these basic issues has resulted in the establishment of inappropriate institutions. We have brought together in Table 5.X the uses of resources available to non-bank financial institutions.

26. The National Development Bank was the first institution whose shares were made available to the Sierra Leone public. That issue was over-subscribed to the extent of Le 126,447, or 44% of the shares available to Sierra Leoneans. In 1969, the NDB acquired 25% of the shares of Brewo Motors Ltd. When these shares were offered to the public they were over-subscribed by about 20%. Brewo Motors Ltd. made a further issue of 10,000 shares to Sierra Leoneans in 1970.

TABLE 5.X USES OF RESOURCES AVAILABLE TO NON-BANK FINANCIAL INSTUTIONS

(Le 000)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Investment in Government Securities	-	-	-	-	24	208	396	686	1,811	2,009	2,083
Shares in local companies	-	-	-	-	-	-	-	-	-	-	-
Other investments in Sierra Leone[1]	103	223	298	445	616	453	451	1,082	1,851	2,002	2,768
Overseas Investments[2]	1,358	1,497	1,745	1,999	2,265	2,400	2,705	2,671	2,545	3,553	4,170
Other Assets	152	279	382	456	573	1,014	967	381	808	950	1,233
TOTAL ASSETS	1,613	1,999	2,425	2,900	3,478	4,075	4,519	4,820	7,015	8,514	10,254

Notes: 1. Include investments by Sierra Leone Investments Limited, loans under the Revolving Loans Scheme and Co-operative Thrift and Credit Societies loans outstanding.

2. Include assets of Insurance Companies and those of Pensions, Provident and other trust funds less local investments.

Sources: Tables 5.II., 5.V., 5.VI., 5.XII and 7.I.

The holding of government securities by non-bank financial institutions averaged 14% of their total assets during the years 1964 - 1970. It should be noted that most of the increases between 1968 - 1970 were accounted for by the National Development Bank which began operations in 1968. Also, the large increase in 'Other Local Investments' has been due mainly to the National Development Bank. But the significant feature of the table is that overseas investment averaged more than 50%.

This is not the pattern of allocation that one would have expected in a situation where the primary concern is for long-term development capital. We have argued that the Benthworth Finance Company could make more long term capital available for agriculture and small-scale industries if the emphasis had been on providing equipment loans. We have also contended that the problem of financial flows to the agricultural sector remains because of the limited financial resources that are likely to be available to the National Co-operative Development Bank, while the National Agricultural Development Authority is confined to a limited geographical region.

In Chapter IX we take the view that the establishment of an Agricultural and Co-operative Development Bank could deal more adequately with the problem of agricultural credit while a commercial bank, with emphasis on 'mixed banking', should be able to assist industries which are too small for consideration by the National Development Bank. Although the National Development Bank provides financial assistance to a number of firms, we argue in that chapter that more can be done if the functions of the NDB are enlarged to include (a) mobilization of domestic financial resources through the regular issue of various types of financial assets; (b) emphasis on pre-investment and feasibility studies as well as promotional activities; and (c) the provision of ancillary services which may be essential for the success of enterprises.

CHAPTER VI

THE UNORGANIZED SECTOR

Our analysis of the sources and uses of funds available to financial institutions in Chapters II to V has revealed that only a very small fraction of the resources of these institutions flows to the agricultural and small-scale industries sectors. This chapter argues that the credit requirements of farmers and small-scale businessmen have been provided by the unorganized sector.

The emphasis of this chapter is on the volume of borrowing and the sources of funds, the rate of interest, and the extent to which the unorganized sector can be integrated with the organized banking system.

(a) <u>The Volume of Borrowing and Lending</u>

We include in the unorganized sector all the non-institutional sources of capital and credit. As in the case of the institutional sources, our concern is with the sources and uses of funds. Information on the size of the sector is quite scanty and we have therefore used indirect indicators to give some order of magnitude of the volume of business in this sector. One such indicator is the "Income Expenditure Surveys", carried out during the period 1966 to 1968. Only two of the survey reports have been published. These are those relating to the Western Area and the Southern Province. For the purpose of presentation of the survey results, the Western Area was divided into three groups: Freetown proper; other urban areas; and rural areas. The size of the sample was 3,071 households made up as follows: Freetown 2,106; urban areas 760; rural areas 205. For the income and expenditure information, however, only one tenth of this sample was used. In the case of the Southern Province, the sample size was 1,265 households in 1,188 dwelling units. This was made up as follows: Bo 597; Moyamba 172; Pujehun 82; Bonthe 94; Mano 90; Baoma/Jerihun 75; Gbangbatoke/Mokanji 155. For the income and expenditure survey, 400 households were interviewed.

Broadly it could be argued that the demand for the services of financial institutions tend to arise from the urban areas, while the rural areas tend to rely on the unorganized sector. However, the income and expenditure pattern suggest that a large section of the urban areas make use of the services of institutions in the unorganized sector.

From Table 6.1, where we combine the results of the two surveys, it can be seen that in all the areas more than 60% earn less than Le 40.00 per month. Average incomes in the various areas were

<u>Western Area</u>:

All Western Province	Le 44.37
Freetown	46.57
Urban Areas	44.85
Rural Areas	23.13

Southern Province:

All Southern Province	Le 40.90
Mining Areas	40.15

TABLE 6.I INCOME RANGES IN THE URBAN AND RURAL AREAS

(Per Cent)

Income Range	Western Province Urban Areas	Freetown	Southern Province Urban Areas	Western Province Rural Areas
No income reported	6.0	10.9	16.5	7.9
Less than Le 10	9.9	4.6	7.0	26.0
Le 10.00 - Le 19.99	18.9	12.9	14.8	23.9
Le 20.00 - Le 29.99	22.2	21.2	17.5	15.6
Le 30.00 - Le 39.99	13.2	15.5	18.0	11.5
Less than Le 40.00	70.2	65.1	73.8	84.9
Le 40.00 - Le 59.99	12.8	15.1	13.6	5.7
Le 60.00 - Le 79.99	6.2	7.6	6.9	1.6
Le 80.00 - Le 99.99	4.3	3.4	4.0	1.1
Le 40.00 - Le 99.99	23.3	26.1	24.5	8.4
Le 100.00 - Le 199.99	4.5	6.8	1.7	4.9
Le 200.00 and over	2.0	1.9	-	1.8
Le 100.00 and over	6.5	8.7	1.7	6.7
TOTAL	100.0	100.0	100.0	100.0

Sources: Central Statistics Office, Household Survey of the Western Area (November, 1966 - January, 1968) Final Report, (Freetown: Government Printer, July, 1968) and Household Survey of the Southern Province, Urban Areas (March 1968 - December, 1969) Final Report (Freetown: Government Printer, May, 1971).

Average monthly expenditures in these areas are shown in Table 6.II.

TABLE 6.II EXPENDITURES IN THE URBAN AREAS OF THE PROVINCES

(Leones)

Expenditure	Western Area Urban Areas	Freetown	Southern Province Urban Areas	Western Province Rural Areas
Food & Beverages	25.66	26.73	16.49	19.18
Alcoholic Drinks	1.26	1.21	1.40	0.79
Tobacco & Kolnuts	1.48	1.68	0.89	0.82
Transportation	2.43	2.24	3.07	0.48
Fuel & Light	2.52	2.66	2.32	1.11
Medical Care	1.40	1.57	2.95	0.64
Clothing & Shoes	4.23	5.06	10.30	1.09
Housing	6.99	7.85	3.91	1.75
Miscellaneous	4.64	5.62	7.70	0.54
TOTAL	50.61	54.62	49.03	26.40

Source: As in Table 6.I

Since average expenditures exceed Le 40.00, one would expect borrowing on a fairly large scale. Given the size of their incomes, however, most of those who need to borrow are likely to use the unorganized institutions. In the rural areas on the other hand, more than 90% earn less than Le 40, but even though average income is as low as Le 23.13 more than 60% earn less than this amount. This also gives some indication of possible reliance on institutions in the unorganized sector to meet borrowing needs.

Our next indication of the extent of lending and borrowing is from surveys which were recently undertaken to find out borrowing habits and sources of credit for farmers, retailers of staple food and individuals.

Two surveys are important in this regard. These are the Moinuddin Survey of October and November 1968, and the Agricultural Survey of 1971. The Moinuddin Survey was carried out in the villages and townships of Bonthe, Kambia, Makeni, Mambolo, Port Loko and Kenema.[1] The farm-holders selected for the survey were largely those who had previously been interviewed in connection with the Agricultural Statistical Survey of 1965/66. The main findings of the survey were as follows:

Approximately 20% of the farmers interviewed did not borrow whereas the remaining 80% borrowed from the following sources:

	Percentage of Total Farmers	Percentage from Each Source
Relatives & Friends	50	45
African Traders	19	19
Non-Africa Traders	3	2
Co-operatives	8	11
Africa Farmers	19	10
Agricultural Credit Scheme	1	13
TOTAL	100	100

Source: S.H. Moinuddin, "Sources of Agricultural Credit in Sierra Leone," Economic Review of the Bank of Sierra Leone, Vol. 4, No. 1 (June, 1969), pp. 3 - 8.

1. Mr. Moinuddin, an Agricultural Credit Expert, was seconded to the Bank of Sierra Leone from Pakistan under the Central Banking Service of the International Monetary Fund.

The purposes for which loans were borrowed were as follows:

	Percentage of Total Number of Borrowers	Percentage of Total Amount Borrowed
Seeds and Fertilizers	8	3
Labour	15	11
'Hungry Season'	43	33
Social and Religious Purposes	14	10
Ploughing Fees	2	2
Litigation	6	7
Maintenance of Plantation Construction and Repairs to Homestead	4	8
Plantation Crops	4	21
Others	4	5
TOTAL	100	100

The main conclusion that can be drawn from the Moinuddin Survey is that borrowings are largely from 'relatives and friends' and from 'traders', and that less than 50% of the loans received were used for agricultural purposes.

The Agricultural Survey of 1971 was carried out during the period January to April, 1971. This survey gives some indication of the extent of borrowing and the sources and uses of the funds borrowed. For the purpose of the survey, 1,575 farmers were selected from 12,558 farmers in 105 enumeration areas throughout the country. Unlike the Moinuddin Survey which was restricted to certain areas of the country, the 1971 survey included all the twelve districts as well as the Western Area. The survey revealed that about 30% of the farmers surveyed did not borrow at all. The total amount borrowed by the remaining farmers amounted to

Le 30,099, of which Le 24,861 were borrowed in cash and Le 5,218 were in kind.[2] The details of these borrowings are shown in Table 6.III.

The purposes for which the loans were borrowed were as follows:

Farming (Seeds, Fertilizers, Labour, etc.)	42%
Businesses Other than Farming	23%
Domestic Purposes	35%

It should be noted that the loans classified as 'domestic' are personal in respect of the 'Hungry Season'. The conclusion that can be drawn from this survey is that it largely supports the broad conclusions of the Moinuddin Survey, which are that most farmers need to borrow, that most of the loans come from "relatives and friends" and "traders", and more than half of the loans are used for purposes other than farming.

2. The survey revealed that the duration of the loans was for short periods. Thus, although the survey sought information on indebtedness for the period 1966 to 1971, it was found that 95% of the debts were contracted in 1970 and was repayable as follows:

Less than three months	8%
Three months but less than six months	24%
Six months but less than one year	59%
More than one year	9%

TABLE 6.III NUMBER OF FARMERS REPORTING LOANS AND AMOUNT BORROWED (IN CASH AND KIND)* AND THE REPAYMENT OF THESE LOANS (IN CASH AND KIND) BY TYPE OF LENDER

Type of Lender	Number of Farmers Reporting Loan (Number)	%	Amount Borrowed in Cash (Le)	%	Amount Borrowed in Kind (Le)	%	Repayment Cash (Le)	%	Kind (Le)	%
Paramount Chief	22	2	746	3	8		393	1.7	102	0.6
Relatives/Friends	689	68	15,016	60	3,105	60	13,136	58	13,300	81
Banks	6	1	1,028	4	84	2	495	2	231	1
African Traders	187	18	2,639	11	1,466	28	3,362	15	2,312	14
Non-African Traders	30	3	1,022	4	506	9	1,278	6	516	3
Co-operatives	39	4	3,185	13	30	0.6	3,102	14	18	
Agriculture Department	5	1	40	-	-	-	35		-	
Any other organization	31	3	1,139	4	19		745	3	23	
	1,009		24,815		5,218		22,546		16,502	

*The results of the 1971 Agricultural Survey have not been published. The details were processed at my request and I hereby acknowledge the assistance of the Director of Statistics in providing this information.

Some indication of the magnitude of credit extended to retailers of staple food is contained in a survey carried out by Njala University College in 1968. The findings of that survey are summarized in Table 6.IV.

TABLE 6.IV PERCENTAGE OF RETAILERS OF STAPLE FOOD WHO EXTENDED SOME CREDIT

Staple Food Commodity Handled	Percentage Extending Credit	Number of Weeks Credit was Extended		
		Less than One	One or Two	Three or Four
Shelled Groundnuts	20	-	-	20
Rice	48	13	6	29
Cassava	60	60	-	-
Foofoo	72	25	22	25
Pounded Groundnuts	80	50	10	20
Palm Oil	84	10	26	48
All Staples	69	25	15	29

Source: R.J. Mutti and D.N. Atere-Roberts, Marketing Staple Crops in Sierra Leone (Washington D.C.: U.S. AID., 1968), Table 6.

The table shows the percentage of retailers of staple food who extended credit and the duration of this credit. In this case, however, only 10% of the total retailers interviewed received a part of their purchases on credit.

From the surveys quoted above, the principal sources of credit in the unorganized sector are "relatives and friends" and "traders". At first sight it would seem rather surprising that the money-lender does not play any significant role in the credit structure of the unorganized market. However, the money-lender is in fact concealed in both groups. The reason for this is that the law requires money-lenders to obtain a licence before commencing their business. The main provisions of the

Money-Lenders' Act of 1941, under which everyone operating as a money-lender must register, are the following: The money-lender is required to take out annually a licence in respect of every address at which he carries on his business. Obtaining the licence is not particularly easy. He must first obtain a Certificate from the Moneylenders' Licencing Board, the Chairman of which is the Police Magistrate of the area in which he intends to set up his business. But before his application he is required to give notice of his intention by registered letter to both the magistrate and the Commissioner of Police; and at the hearing of his application, the Commissioner of Police can be present and object to the application being granted. Next, he goes to the local authority with his certificate and obtains the licence. In the case of Freetown, for example, he presents the certificate to the Town Clerk and obtains the licence on the payment of the sum of Le 30 per annum or Le 16 half yearly. He cannot, however, obtain the licence from the Town Clerk's Office without the Certificate from the Magistrate. Further, the Law requires that the money-lender should within seven days of signing the contract for a loan deliver a certified copy of the contract to the borrower. Such a contract must contain the date on which the loan was made; the amount of the principal and the rate of interest. The rates of interest which the law allows are as follows:

(a) Where the loan is secured by a first charge on any real or personal property, or by indemnity or personal guarantee, the rate should be 15% (simple interest) for the first Le 1,000 or part thereof and 12½% for all sums in excess of this amount;

(b) Where the loan is secured by a second charge the rate of interest should be 17½% for the first Le 1,000 and 15% for all other amounts;

(c) Where the loan is unsecured the rate of interest is 48% (simple interest) per annum;

(d) Where no rate of interest is stated and repayments are in equal instalments the following formula should be used to calculate the rate of interest:

$$\frac{100 \times I \times 24}{(N - 1) \times P \times L}$$

where I is total interest payment

P principal

L number of calendar months in the intervals between instalments

N number of instalments

In addition the money-lender is required to keep a securely bounded book in which he should enter particulars of loans including the rate of interest on such loans. This provision is important as any proceedings under the Act require a detailed statement of account.

However, not many money-lenders are registered. In the Freetown area for example, registration was less than 10 throughout the 1960's. Given the main provisions of the Money-lenders' Ordinance it is not difficult to see why money-lenders do not register. In the first place they do not register in order to avoid the payment of the annual fee, which is currently Le 30, and the payment of taxes. Secondly, because most money-lenders deal with persons well-known to them they consider it unnecessary to have detailed records and consider the paper work involved costly, particularly so as this extra work on their part does not necessarily guarantee additional business. Another probable reason is the fact that the protection which the law offers is not particularly important as transactions are invariably between people who are well-known to each other. But perhaps of considerable importance is the fact that under Native Law and Custom all debts are recoverable whether or not there is a written agreement. As long as the debt is acknowledged, the Native Courts enforce judgement irrespective of whether or not the complainant has a licence to operate as a money-lender. Since most borrowers do not seek - indeed may avoid - the protection of the law, the rates of interest fixed by the Ordinance do not bear any relationship to what actually happens in practice.

Generally there are three groups of money-lenders. In the first group are traders. These combine their retail trading with money-lending. In this case the loan may be in kind as well as in cash, and repayment may also be in kind or cash. In the second group are those who acquired the resources for their business while at commercial firms or in the civil service. These begin business as money-lenders on their retirement. We found that those who have registered in Freetown and in the other cities are in this group. In the third group are individuals who are not full-time money-lenders but combine money lending with other activities. They operate on a very small scale and use their past savings or income from present employment or business. This type of money-lender is common amongst the lower-paid workers. However, the money-lender need not be a single person. Three or four people could agree to pool their resources to start such a business. In one case known to us, four people established a fund which was used as the basis of the business. To obtain a loan from this fund, the applicant must be recommended by one of the participants and the participant making the recommendation must be ready to guarantee repayment.

Those who use the money-lender can also be classified into three broad categories: The lower-paid workers use the money-lenders, especially at the beginning of each school year for books, uniforms, and in some cases for part of the school fees. They also use the money-lender for social commitments such as funerals and marriages. This group of people includes junior clerks, messengers, and daily wage workers. Farmers who are also in the low-income group use the money-lender during the "hungry season" and in some cases for equipments required for their farms, such as seeds. Those in the middle and upper income groups use the money-lender in special circumstances such as litigation, medical care or when a sudden misfortune occurs as, for example, an unexpected death.

(b) The Rate of Interest

On average, the rate of interest charged varies between 20% and 25% per month. In Freetown, the rate of interest is fairly uniform, being payment of 50 cents for each Le 2 borrowed per month, that is 25% per month. In a few cases the rate charged is 40 cents on Le 2 per month. Where the borrower is unable to repay both principal and interest he is allowed to repay the interest only, leaving the principal outstanding. On an annual basis, the rate of interest is 300% per annum. Another indication of the rate of interest payable in the rural sector is given in the Moinuddin study as follows:[3]

3. Other estimates of the rates of interest in the unorganized sector are as follows: "In the rainy season there is no limit, it may reach 200 per cent even in some cases it may be as high as 400 per cent per year. For example, in the planting period one bushel of rice may be advanced to the farmer for sowing in August on condition that he returns double this amount after harvesting in October".
M.A. Soliman, Report on Agricultural Credit in Sierra Leone (Freetown: United Nations Office, July, 1969). Mr. Soliman, an Agricultural Credit Expert of the Food and Agricultural Organization of the United Nations, prepared this report at the request of the Ministry of Agriculture and Natural Resources.

".... There is always a condition attached that produce should be sold to that trader, and this is usually upon such disadvantageous terms as to amount in effect to an interest of 100 per cent per annum or even more. Individual men or groups of men also frequently make loans; and in such cases the loans are usually for a month or little more, and the interest is 25 per cent on the transactions."
N.A. Cox-George, Report on African Participation in the Commerce of Sierra Leone, op. cit., p. 27.

	Percentage of Total Amount Borrowed
Relatives and Friends	
Interest Free	29
5% - 75% p.a.	38
100% p.a. and over	33
African Traders	
Interest Free	13
13% - 70% p.a.	8
100% p.a. and over	77
African Farmers	
Interest Free	4
12% - 50% p.a.	10
100% p.a. and over	86
Non-African Traders	
100% p.a. and over	100

Source: S.H. Moinuddin, Agricultural Credit in Sierra Leone, (Freetown: Bank of Sierra Leone, January, 1969), pp. 68 - 69. (Unpublished report prepared for the Bank of Sierra Leone).

He revealed that in the case of borrowings from traders and farmers, a condition for loans was that the crops were to be sold to the lender at prices about 50% - 60% below the prevailing prices.

These rates are no doubt very high in comparison with rates charged in the organized sector or with those laid down by the Money-lender's Ordinance. To explain these high rates requires an examination of the conditions in the unorganized market for loanable funds. The underlying factors in this market are the virtual monopoly of those who provide the loans and the high risks involved in lending in this sector, which is due to the nature of the sector.

Lenders in the rural areas are in a monopolistic position because of the controls which they are able to exert on borrowers. Effective control over the farmer has taken a number of forms. To begin with, the farmer is aware that no other source of credit is available to him. The importance of this is that he realizes that unless he meets his obligations to his creditors there would be no one willing to help him in case of real emergency. Hence, the farmer always makes sure that the creditor has first claims on his produce at harvest. Being in the same locality as the farmer, the lender knows the scale of operation of the farmer, the type of crops he produces and his financial position. He also knows when crops are harvested and therefore the moment when to claim produce. This knowledge enables him to approve or reject a loan request on the day it is made, or at most within a few days. Next, the lender, as already indicated, is invariably a trader or a merchant with stocks of almost everything the farmer is likely to need, including seeds, provisions and implements. This explains why many loans are in kind. Because of this, it is possible to conceal the rate of interest in the price of the provisions or seeds. Also, control is effected through the marketing arrangements.

He cannot provide his own warehouse nor does he have the means of transporting his produce from his farm to the nearest agent of the Sierra Leone Produce Marketing Board who may be miles away. Because he is poor he requires immediate payment. Consequently, at harvest, he has to dispose of his produce. Since the buyer is the interpreter of the rules of the Marketing Board, what the farmer receives depends on the grading of the buyer and if he is already indebted to the buyer he has no alternative but to accept his decision. Finally, control is effected indirectly. A lender may deliberately leave balances uncollected only to request payment at an awkward moment when he knows the farmer would not be able to repay. But by agreeing to postpone payment to a later date the farmer feels the lender has done him a good turn which he must not forget in future.

The other factors which help to explain the high interest rates include the following: Those who use the unorganized sector do so because the securities they can offer for the loans are not acceptable anywhere else. Besides, banks are not likely to provide loans for consumption and for social obligations on the scale on which these are required by farmers. However, such loans are vital to the farmer. For example, loans are required to meet social obligations such as funerals and marriages as well as to tide people over the "hungry season".[4]

Then there is the administrative cumbersomeness which borrowers in the modern sector cannot avoid. Forms must be filled, detailed explanations are required and in a number of cases investigations have to be made. All of these are time-consuming but are necessary from the lender's point of view to ensure that the money loaned is repayed at due dates. Most of these are avoided in the unorganized market. Transactions are invariably verbal with the lender relying on his personal knowledge of the borrower and on customs and traditions of his locality. Thus, the rates in the unorganized sector are high because risks are greater due to the fact that there may be no collateral and such securities that exist are not acceptable elsewhere and because of the nature of the operations which rely heavily on personal knowledge, customs and moral obligations.[5]

4. In Appendix II we have discussed the farmer's method of production, marketing arrangements, the social set-up and other factors which affect his productivity and his income. It is the economic and social conditions under which he operates that make it necessary for him to borrow on the scale he does.

5. On rates of interest in the unorganized sector of underdeveloped economies, see the following:
Anthony Bottomley, "Monopoly Profits as a Determinant of Interest Rates in Underdeveloped Rural Areas", Oxford Economic Papers, Vol. 16, No. 3 (November, 1964), pp. 431 - 439. Also by the same Author "The Cost of Administering Private Loans in Underdeveloped Rural Areas", Oxford Economic Papers, Vol. 15, No. 2 (July, 1963), pp. 154 - 163; and "The Premium for Risk as a Determinant of Interest Rates in Underdeveloped Rural Areas", Quarterly Journal of Economics, Vol. 77, No. 4 (November, 1963), pp. 637 - 647;
Millard Long, "Interest Rates and the Structure of Agricultural Credit Markets", Oxford Economic Papers, Vol. 20, No. 2 (July, 1968), pp. 275-287.
Albert Levenson, "Interest Rates and Cost Differentials in Bank Lending to Small and Large Businesses", Review of Economics and Statistics, Vol. 44 No. 2 (1962), pp. 190 - 197.

Although the high rates of interest reflect supply and demand conditions we must nevertheless point out that the existing high rates tend to inhibit improvements in agricultural productivity. This is the case because a large part of total lending is for purposes which do not directly improve the farmer's capacity to earn more income. He has to borrow on this scale for non-productive purposes as the returns on his farm are not large enough to sustain him and his family until the next harvest. Next, the fact that he is constantly in debt implies that he cannot accumulate cash savings. In addition, the relatively high rate of interest that obtains in the unorganized sector increases significantly his cost of production.[6]

(c) Personal Savings

Those businessmen who do not use the money-lenders because of high interest rates and who at the same time cannot obtain funds from financial institutions in the organized sector have to rely on their own savings. The Njala University College study, already referred to, found that wholesalers in villages and towns operated mainly on their own funds. That study observes ".....nearly all bulkers in villages, towns and cities reported that the major source of funds for their operations came from their own savings."[7] Also, we have pointed out that only 10% of

6. The repayment record has been good, especially because of the control which the lender has over the borrower. If necessary, he also puts pressure on the relatives and friends of the borrower. In some cases he may even threaten to report non-repayment to the borrower's employers. This is very effective since most employees would not wish their bosses to know about such transactions. In our investigations during the summer of 1970 we were informed of two employees of a certain bank who lost their jobs because the bank was notified that they had not honoured their debts to a lender. Furthermore, the money-lender can threaten to resort to the "Juju-man" or "Witch-Doctor" whom it is generally believed has the power of ill or good luck as well as life or death.

7. Mutti and Atere Roberts, op. cit., p. 65.

all retailers of staple foodstuffs obtain credit of some sort, so that 90% of these retailers too rely on their own savings. One means by which such savings can be accumulated is through an institution known locally as "osusu".

The "osusu" is a system of rotating credit in which a lump sum composed of fixed contributions by a number of people is distributed as a whole to each member of the group in turn. Thus, if there are seven members and if the monthly contribution is Le 2 from each participant, then each receives Le 14 in rotation. The "osusu" is automatically dissolved when the last participant receives payment. It may start all over again if the participants so agree. The number of participants varies widely, but where the contributions are monthly the number does not exceed twelve. There are no formalities to be observed. The participants simply come together and agree among themselves to contribute a stated sum regularly. Sometimes an elder may be in charge but in a large number of cases the agreement between the participants is that the organization rotates as well. That is, the member whose turn it is to receive the fund collects the contributions from the other participants. The order of rotation is decided by the participants before the first payment or where there is an organizer he decides the order of rotation. Defaults are virtually nil, since the participants are invariably well-known to each other and in most cases may be close friends or associates.

Apart from using such savings for business purposes, people also participate in "osusu" for other reasons, notably for anticipated consumption expenditure and for anticipated social expenditure. For example, someone who wants a radiogram or a refrigerator and who does not have the initial deposit may participate in an "osusu" in order to acquire the initial deposit. Again, someone may participate in an "osusu" in order to accumulate funds which may be required to celebrate the wedding of a relative. "Osusu" could also be a source of insurance for unexpected expenditure, such as sudden illness or death or floods. In such a case, the person distressed persuades other members to allow him to receive the fund out of turn.

While most "osusu" are very small there are a few large ones. Contributions in the large group exceed Le 10. The largest known to us was organized by the senior staff of a large company. Here the contribution was Le 60 per month. Most of the members used the savings accumulated to purchase durable consumer goods and two used theirs together with other resources to purchase land. The smallest known to us was organized amongst the market women in one of the large markets in Freetown. Here the contribution was 10 cents payable on each market day, that is, Tuesday, Thursday and Saturday. Through this institution, the habit of thrift is encouraged even amongst people with very low incomes.

But from the point of view of economic development it is not the thrift aspect that is important (as the amounts involved may be quite small). The "osusu" encourages the use of money in the rural areas and hence facilitates the monetization of the economy. From the point of view of economic development the "osusu" can be looked upon as a transitional stage in the process of acquainting people to financial assets.

(d) The Unorganized Sector and the Availability of Development Capital

A rough indication of the volume of business handled by the sector can be obtained from the Agricultural Survey of 1971 and the Moinuddin Pilot Survey of 1968. The unorganized sector covers, it is generally believed, about two-thirds of the population (including parts of the urban areas); given a population of 2.5 million in 1970, over 1.5 million are considered to be in the unorganized sector.[8] On the basis

8. There are no reliable data on this, but the above-mentioned order of magnitude conforms to the generally held view.

of the volume of borrowing revealed by the 1971 Agricultural Survey, we estimate total borrowings at about Le 6.5 million. The Moinuddin Pilot Survey estimated farmers' borrowing requirements for the 1968/69 planting season to be Le 5.5 million.[9] Allowing for borrowing by non-farmers, which his survey did not take account of, a figure of about Le 6.5 million would be the likely order of magnitude.

This volume of credit is quite small in relation to the total assets of all financial institutions, or even the volume of lending by the commercial banks, and yet the organized sector cannot meet these requirements. Hence, the unorganized sector becomes significant.

In order to improve the lot of the farmers their dependence on institutional sources of credit must be increased. The problem therefore is how to increase the flow of financial resources to borrowers who now depend entirely on the unorganized sector. A solution to the problem may be achieved through integration of the organized with the unorganized sector.

(i) Integration with the Organized Sector

It may be possible to arrive at a real integration of the two sectors if a new institution specializing in the requirements of the rural areas is established. In view of our observation in Appendix II, such an institution should combine the provision of credit with marketing and the provision of ancillary services so as to ensure that credit made available increases the productive capacity of the recipients. If such a result is achieved, then it should be possible for small producers to reduce their dependence on loans and they may probably be able to increase their own savings. An institution which is likely to achieve this result is discussed in Chapter IX. To the extent that such an

9. The Moinuddin Pilot Survey is discussed in Appendix II.

institution attains the desired objective, the relative importance of the money-lenders and traders as sources of agricultural credit is likely to be reduced.

Integration of the unorganized with the organized sector may also be achieved through the rate of interest policy. As we have seen, the rate of interest charged in the unorganized sector is several times higher than that prevailing in the modern banking sector. The reason we have suggested for the high rates is that such rates reflected supply and demand conditions. But as explained in Chapter II, lending rates in the organized sector do not entirely depend upon factors within the economy. We have pointed out that the commercial banks which are the main financial institutions have borrowed extensively from their Head Offices. Thus, their lending rates would have to take into account rates prevailing in London where these offices are situated. Also, investments are largely financed by inflows of foreign capital and therefore are influenced by external interest rates. In addition, we have seen that resources flow out of the economy in search of investment outlets. Because of these external influences, rates of interest prevailing in the organized sector reflect conditions outside the economy. Suppose that interest rates on savings deposits were raised to give a positive rate in real terms, for example, raised to 10%. The probable result of such a rise would be to reduce the flow of financial resources to the unorganized sector and to channel more resources through financial institutions. Farmers benefit when some of the additional resources flow to the new institutions established to deal with the problem of agricultural credit. The interest rate policy of the central bank in this regard is discussed in Chapter IX.

A fundamental requirement for the integration of the two sectors is the registration of all dealers in the unorganized sector. There must also be a constant flow of resources between the sectors.

To facilitate such registration, it may be necessary to eliminate all the charges now payable under the Money-lenders Ordinance. Also, the Native Court Act would have to be amended to require the production of a registration certificate as a condition for examining suits involving debts. A third possibility in order to encourage registration is through publicity campaigns aimed at emphasizing the possible advantages of registration. Also, the procedure for registration must be simpler than those contained in the Money-lenders' Ordinance. Assuming that it is possible to have most of them registered, the central bank would be able to have some insight into their operations and it should then be possible to regulate their activities.

The question of communication between the two sectors poses a problem, namely, what are the appropriate institutions in the organized sector through which the money-lenders could be brought into the organized sector? The problem becomes relatively easier, if a specialized institution is established to deal with the problem of agricultural credit. In such an event, the number of money-lenders would be smaller. If we assume that the remaining money-lenders would not be concerned with agricultural credit, then the most appropriate channel of communication between the money-lenders and the organized sector should be the re-organized National Commercial bank discussed in Chapter IX. We argue in that chapter that the new bank should undertake mixed banking and deal with businesses which are too small for the National Development bank. A department of that bank could deal with the money-lenders. In which case, the legislation requiring registration should stipulate registration with the National Commercial bank and regulation of their activities could then be achieved through that bank. Also, any loan requirements of money-lenders could be provided by that institution.

(ii) The Relative Importance of the Unorganized Sector

The integration of the organized sector with the unorganized sector should not imply destruction of the unorganized sector. This is because the uniqueness of the unorganized institutions make it questionable whether a reduction in its size or its complete destruction is desirable. To illustrate, through the "osusu" system, the habit of thrift is encouraged even amongst people with very low incomes. The question which should be raised is whether the integration of the two sectors would lead to a net increase in domestic savings. In other words, will those people who previously used the "ususu" as an incentive to save necessarily use the commercial banks? The possibilities are that savings through the banks need not rise. In the first place, people use the institutions in the unorganized sector for a variety of reasons. Some do so because of the informal nature of the transactions. Also, most of the people in the rural areas are not literate in English, hence there is the problem of filling forms. There is the problem too of giving answers to questions which may be considered an unnecessary probing into their private affairs. In addition, there is the mistaken belief that by using institutional sources their savings are likely to be known by the government who may then tax such savings. Such people are not likely to be attracted to financial institutions. In the absence of institutions in the unorganized sector, such people are likely to spend all their incomes.

Furthermore, transactions in the unorganized sector involve a large number of individuals with very small amounts. For the financial institutions, the cost of administration may be too large in relation to the income to be earned. The informal arrangement of money-lenders, as contended earlier avoid such costs. Another aspect of the cost problem is the fact that institutions in the unorganized sector are within easy reach. A commercial bank, for example, will be located in specific areas as the cost of establishing a large number of small branches throughout the rural areas may be considerable. The fact that formal institutions may be some distance away from savers implies that some savings will be missed completely as people may not consider it worth their while to cover the distance just to make a deposit.

Also, the opportunity to borrow is itself an important incentive to production in the rural areas. In those regions, incomes are low and at the same time one needs to recall the importance attached to social obligations and the close association between social and productive activities in rural areas. Hence, as already indicated a large part of the borrowings in the sector are for purposes which are not directly connected with increased productivity. And the fact that people are able to borrow to meet social commitments encourages production since borrowers would have to increase their output in order to honour their debts. But financial institutions in the organized sector make relatively few loans for social purposes so that with the elimination of the unorganized institutions an important incentive to production may be lost.

Undoubtedly, the volume of savings mobilized in the unorganized sector have been small and have been used mainly for consumption. However, it must be borne in mind that these institutions in the unorganized sector emerged in response to the social and economic circumstances of the localities and were not established with the view of aiding the development of the country. Even so, they make two significant contributions to development. In the first place, institutions in the unorganized sector have a comparative advantage in administering small loans and this is in addition to the fact that these institutions are the only sources of credit for most people in the rural areas. Secondly, the habit of thrift which they encourage is an indispensable step in the process of introducing people to financial assets. This is because once people have been accustomed to making small savings they are likely to be attracted to financial assets when their incomes increase.

But granted that these institutions were not originally intended as instruments of economic development the question which arises is how to get these institutions to make a contribution to the development process. The problem in fact amounts to how to influence the activities of these unorganized institutions? The problem is complicated by the fact that like most mutual institutions, institutions in the unorganized sector have no clearly defined aims, they have grown without any specifically defined objectives. There is a further difficulty of regulating the interests of depositors and borrowers bearing in mind that they may be one and the same individuals.

The desired results can however be achieved through the establishment of the specialized institution referred to earlier. This institution, apart from providing credit will also make available ancillary services which will ensure the productive utilization of credit. Allocation of resources is improved as the ancillary services ensure that the available credit is used productively. And through increased productivity made possible by the supervised credit, farmers and others may be able to save more. For those people in the rural areas who may not have access to this specialized institution we suggest in Chapter IX incentives which may be appropriate to attract their savings.

(e) Conclusion

We have argued that the unorganized sector is the only source of credit available to most farmers and small-scale businesses. The money-lenders and traders who provide such credit should not however be blamed for the prevailing high rates of interest as the rates charged merely reflect supply and demand conditions in the unorganized sector. And it would seem that money-lenders and traders will continue to be important in this sector until such time as alternative sources of credit are made available. Similarly, the flow of resources to the unorganized sector would continue until other equally attractive ways of holding savings become available. With the 4% earnings on savings deposits at commercial banks and the Post Office Savings bank, and given the annual 4.3 percentage point increase in the consumer price index between 1960 and 1970, resources flow to the unorganized sector where high interest rates compensates for inflation.

While the prevailing high rates may be justified in terms of conditions prevailing in the sector, nevertheless the credit structure impedes improvements in the productive capacity of the farmers. But any new scheme aimed at reducing the size of the unorganized sector would need to recognize that there are very few equally attractive ways of holding savings; that, apart from production credit, some consumption credit may be equally important; that the rates of interest payable on deposits in financial institutions are low and have been negative in real terms; and finally, it must incorporate some of the features which have accounted for the good repayment record in the sector.

CHAPTER VII

THE PROVISION OF DEVELOPMENT CAPITAL

In this chapter we examine the general issues which have arisen from our discussion of the sources and uses of funds in the previous chapters. First, we bring together in a consolidated form information on the sources and uses of funds. This aggregated information enables us to give some order of magnitude of the size of the financial sector for the eleven year period for which this information could be obtained. Next, as our main conclusion on the sources of funds is that savings are held in essentially liquid form, we examine the possibility of using at least some of these liquid resources for long term investment. Since about 30% of the resources available to financial institutions are held in the form of foreign assets by the Bank of Sierra Leone, we examine the possibility of substituting some of these external assets for local assets. Other financial institutions have also invested a substantial part of their resources outside the economy. In addition, capital flows out of the economy through remittances by commercial firms, individuals, and the government. We therefore examine the extent to which domestic financial resources can be mobilized through exchange control, through the imposition of controls on imports, and other devices such as surrender of export earnings and agreement with foreign firms on the re-investment of profits.

Because about 14% of the resources of financial institutions have been made available to the government in the form of holdings of government securities, we examine the extent to which these resources have financed any co-ordinated programme of development.

(a) The Size of the Financial Sector

Until comparatively recently, financial institutions have been largely regarded as a consequence of development, that is, these institutions emerge in response to the demand for their services. From this standpoint, the study of the development process of financial institutions is of little practical value since their non-development only reflects lack of development in the rest of the economy. However, several studies have shown that financial institutions can be both "demand following" and "supply leading".[1] By demonstrating that financial institutions can be influenced directly, the study of these institutions with a view of improving their efficiency is important for economic development.

One of the main contributions of financial institutions in the development process is in increasing the capital stock.[2] This, as

1. Bennett, for example, argues that finance for innovation may not be forthcoming because of imperfections within the economy. In such a case it is necessary to divert funds to those entrepreneurs who can use such funds for the financing of economic development. But in addition, the system can be manipulated in the direction required. Thus, if financial institutions do not allocate their funds "properly" their allocation decisions can be influenced directly. The attractiveness of their securities can be improved by influencing the rate of interest and the flow of funds between institutions encouraged.
Robert L. Bennett, The Financial Sector and Economic Development: The Mexican Case (Baltimore: The John Hopkins Press, 1965), Chap. I. See also Rondo Cameron (ed.), Banking in the Early Stages of Industralization (Oxford: The University Press, 1967), Chap. VIII;
John G. Gurley and Edward S. Shaw, "Financial Structure and Economic Development," Economic Development and Cultural Change, Vol. 15, No. 3 (April, 1967), pp. 257 - 268;
Solis, op. cit., pp. 36 - 48 and
Patrick, op. cit., pp. 174 - 189.

2. Patrick observes that "A considerable portion of tangible wealth in underdeveloped countries is held in forms unproductive of sustained growth" and argues that a "re-allocation of as much as 10% of this wealth to more productive forms would be equivalent to 20% or 30% of GNP and would raise the level of output by about 10%."
Ibid., p. 179.

we argued in the Introductory Chapter, involves the institutionalization of savings. The mobilization of domestic savings by financial institutions in turn implies a reduction of subsistence activities, that is, monetization of the economy, getting people to hold financial as opposed to other assets, and providing facilities for the continuous mobilization of domestic savings.

(i) Growth of the Financial Sector

Table 7.I gives assets of all financial institutions for the years 1960 - 1970. This table shows that assets of financial institutions at the end of 1970 were about four times what they were in 1960. Although the annual rate of growth of assets averaged 13% (current prices), the rise was particularly high in 1960 - 61 and 1967 - 68 when the increases were 20% and 39% respectively. The table also reveals that three institutions - namely, the Bank of Sierra Leone, the commercial banks and the Post Office Savings bank accounted for about 90% of the total assets of all financial institutions. But most of the observed growth in assets have been due to increases in the assets of the Bank of Sierra Leone and the commercial banks. To illustrate, the gains in assets between 1967 and 1968 were the result of a 53% and a 31% rise in the assets of the Bank of Sierra Leone and the commercial banks respectively.

Following Goldsmith,[3] we use as indicator of the size of the financial sector the ratio of the assets of financial institutions to Gross National Product.[4] This ratio varied between 20% and 29% during

3. R.W. Goldsmith, Financial Structure and Development (New Haven: Yale University Press, 1969). Goldsmith's method of analysis consisted of identification of factors which describe the financial sector and the expression of these in a number of equations. The Financial Interrelation Ratio (FIR) and its equivalent in flow dimension, the Aggregate New Issue Ratio (ANIR) describe the financial sector. The financial interrelation ratio is the broadest measure of the relative size of the financial system and is defined as the value of all financial assets divided by the value of all tangible assets. ANIR measures the issues of financial institutions.

4. GNP figures for Sierra Leone are available only for the years 1963/64 to 1969/70. For our calculations, 1963/64 = 1963.

TABLE 7.I TOTAL ASSETS/LIABILITIES OF FINANCIAL INSTITUTIONS, 1960-1970

(Le 000)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Bank of Sierra Leone[1]	12,068	13,924	14,414	14,632	15,023	20,454	20,732	21,459	32,818	38,239	39,213
Commercial Banks	10,986	14,230	15,750	20,744	26,079	25,716	27,744	27,900	36,629	36,258	37,303
Post Office Savings Bank	3,189	3,306	3,296	3,246	3,291	3,266	2,954	2,922	3,072	2,980	2,891
Insurance Companies	534	614	675	810	930	1,115	1,543	1,804	1,732	2,874	3,361
National Development Bank	—	—	—	—	—	—	—	—	1,388	1,519	1,867
Co-operative Thrift and Credit Societies	264	402	569	707	897	1,078	981	1,002	1,737	1,856	1,986
Pensions, Provident, Superannuation Funds	823	892	1,080	1,200	1,371	1,443	1,547	1,552	1,686	1,785	1,874
Sierra Leone Investment Ltd.[2]	—	—	—	73	161	294	289	289	289	289	289
Sierra Leone Revolving Loan Scheme	—	100	111	121	131	145	159	173	183	191	201
Benthworth Finance Co. Ltd.	—	—	—	—	—	—	—	—	—	—	646
TOTAL	27,864	33,468	35,895	41,533	47,888	53,511	55,949	57,101	79,534	85,991	89,631

Notes: 1. As the West African Currency Board did not publish balance sheets for individual countries, we do not have assets/liabilities information for the years 1960-1964. Figures for these years are the Bank's estimates of currency issued in Sierra Leone. We pointed out in Chapter I that the responsibility of the WACB was to issue and redeem currency. Hence, currency issued were its principal liabilities; capital and reserves (the other items on the liabilities side of the balance sheet) were quite small and therefore not likely to affect the total significantly.

2. Sierra Leone Investment Ltd. has not issued a balance sheet beyond 1966. However, the company still exists and one of its investments has been successful. In the absence of subsequent balance sheets we have assumed that the assets shown in the 1966 balance sheet held for the years 1967-1970.

Sources: Chapters II - V.

the years 1963/64 and 1969/70. This result suggests that Goldsmith's finding, with respect to the underdeveloped countries he studied, is also true of Sierra Leone. He observes "....The absolute value of the ratio of financial institutions' assets to national product in less developed countries in 1963 is still below the ratio observed in developed countries in 1880".[5] The ratio of about 30% achieved by Sierra Leone in 1969/70 is lower than that which Goldsmith found for all countries, except Nigeria in 1963.[6]

Whereas the assets of non-bank financial institutions went up by a mere 0.6% between 1963/64 and 1969/70, those of the banks rose by 8%, indicating the relative growth of the banks in the financial structure.

(ii) Sources of Aggregate Funds

Table 7.II gives details of the sources of funds discussed in Chapters II - V. From this table it can be seen that the main sources of funds are deposits and currency issued by the central bank.

The household sector, defined to include individuals, non-corporate businesses, private institutions such as Fourah Bay College and charitable institutions, accounted for about 78% of the deposits mobilized by financial institutions. The deposits of the government sector (the central government and public corporations) accounted for only 10% of total deposits. Deposits of the corporate sector were also small averaging about 12%. If we assume that institutions would hold as little currency as possible and are not likely to account for more than 10% of currency in circulation, then about 80% of currency issued by the central bank is held by the household sector. Thus, the general conclusion on the sources of funds is that they were obtained largely through increased holdings of money by the household sector.

5. Goldsmith, op. cit., p. 390.

6. Ibid., p. 209.

TABLE 7.II SOURCES OF FUNDS AVAILABLE TO FINANCIAL INSTITUTIONS, 1960 - 1970

(Le000)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
DEPOSITS											
Bankers					223	222	220	221	217	215	329
Government	932	1,109	1,290	1,312	2,195	1,443	1,078	1,881	2,419	4,507	2,717
Public Corporations					915	908	1,153	1,205	1,485	1,771	1,684
Commercial firms	1,610	1,916	2,229	2,268	2,716	2,693	2,006	2,096	2,582	3,081	2,927
Individuals[1]	9,036	10,197	11,461	11,585	13,124	12,968	14,396	14,704	17,483	20,213	19,356
Pensions, Provident and Life Insurance	915	993	1,190	1,329	1,524	1,616	1,849	1,905	2,054	3,021	3,332
Co-operative Thrift and Credit Societies	95	130	161	224	314	390	528	536	763	805	900
Others	606	721	839	854	1,240	1,297	1,450	1,681	5,439	5,854	7,693
TOTAL DEPOSITS	13,194	15,066	17,170	17,572	22,251	21,537	22,680	24,229	32,442	39,467	38,938
LOANS RECEIVED											
External[2]	590	1,300	1,612	5,810	7,021	5,702	5,921	5,171	4,312	2,433	1,609
Government (including Government guaranteed)			60	60	71	60	68	68	743	768	1,068
Others	172	62	142	182	22	141	90	11	13	31	40
SALE OF FINANCIAL LIABILITIES[3]			700	700	700	700	700	700	1,402	1,464	1,464
GRANTS[4]	100	100	100	100	100	100	100	100	100	100	100
CURRENCY ISSUED	12,068	13,924	14,414	14,632	15,023	15,273	16,116	15,627	19,679	22,058	20,162
ALLOCATION OF S.D.R's	—	—	—	—	—	—	—	—	—	—	2,100
OTHER LIABILITIES INCLUDING CAPITAL AND RESERVES	1,740	3,016	1,697	2,477	2,700	9,998	10,272	11,195	20,847	19,670	24,150
TOTAL	27,864	33,468	35,895	41,533	47,888	53,511	55,949	57,101	79,534	85,991	89,631

SOURCES AND NOTES:

Unless otherwise indicated below the sources are: Chapters II-V and Appendix II.

1. Individuals' deposits are the sum of deposits at commercial banks and those of the Post Office Savings Bank. The Post Office Savings Bank figures used here are the December figures and not the Balance Sheet figures given in Table 4.VI. The December figures are from Table 9 of Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March, 1972).

2. Borrowings from the head offices of commercial banks.

3. Shares of the National Development Bank Ltd. and shares of the Revolving Loans Scheme of the Mines Department.

4. Revolving Loans Scheme of the Mines Department.

Table 7.II also shows that the deposits of individuals grew at an average annual rate of 9% during the years 1960 - 1970, and allowing for price increases the rate of growth in real terms averaged 5%. Growth of these deposits was particularly rapid between 1963 - 64, 1967 - 68 and 1968 - 69 when the increase was 14%, 18% and 18% respectively. Increase in income during the period would explain only a small proportion of the observed growth in savings since per capita real income increased by less than 1% per annum. The main explanation for the rise has been the activities of financial institutions. We have shown in the previous chapters that during the period of study, financial institutions, especially the commercial banks, improved their branch coverage as well as embarked on advertising campaigns which emphasized the advantages of savings with financial institutions. Also, through the publicity campaigns of the National Development Bank people have become aware of the advantages of holding their savings in the form of shares.[7]

We point out in Appendix I that outside the mining sector, domestic capital formation has been mainly in residential and non-residential buildings. In these circumstances, although the rise in assets of financial institutions indicate success in channelling resources through financial institutions, there is still considerable scope for further mobilization.

7. Some other studies have shown that financial institutions can increase the rate of saving. See, for example, Economic Commission For Asia and the Far East, "Measures for Mobilizing Domestic Savings and Productive Investment", Bulletin of the Economic Commission for Asia and the Far East, Vol. 13, No. 3 (December, 1962), pp. 1 - 25. This study found a positive association between the rate of total household saving and the structure of this saving which is measured by the ratio of saving in financial assets to the ratio of saving in tangible assets. To show the relationship between the structure of household saving to its rate, a scatter diagram measuring this relationship was used. This diagram showed a cluster of the observations around a positively sloped straight line trend, the implication being that countries with a high rate of saving tend to have high ratios of financial/tangible assets in saving and vice versa. It was suggested that this relationship held within individual countries, implying that in years when the rate of household saving increased, the ratio of saving in financial/tangible assets rose also.

(iii) Uses of Aggregate Funds

An important contribution of financial institutions in the development process is their influence on the allocation of resources. Generally, the existence of financial institutions should improve the allocation of resources for the following reasons. There are a number of projects which by their nature are too large and involve considerable financial resources which a single individual or group of individuals may not be able to finance. Through these institutions, the necessary funds are made available for such projects. Also financial institutions are able to appraise alternative forms of investment to ensure that the most profitable ventures are financed. In addition, they diversify their investment in order to reduce risks. Finally, because of differences in ability, attitude towards risks and uncertainty, not all individuals can be successful entrepreneurs. Hence, if each economic unit invested its own savings there is likely to be inefficiency in the allocation of resources.

In order to give some indication of the extent to which financial institutions in Sierra Leone have contributed to improving the allocation of domestic financial resources, we summarize in Table 7.III the allocation of resources available by these institutions. From this table it can be seen that the main uses are: The holding of foreign securities, loans and advances for financing of the export/import trade, and investment in government securities.

Foreign securities held by the Bank of Sierra Leone account for about 30% of the assets of all financial institutions. Adding foreign assets held by other financial institutions to those of the Bank of Sierra Leone, the percentage of foreign assets to total financial assets averaged about 37% though in some years, the percentage of foreign assets to total assets approached 50%.

TABLE 7.III USES OF FUNDS AVAILABLE TO FINANCIAL INSTITUTIONS 1960 - 1970 (Le 000)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
MONEY AT CALL					960	1,660	2,830	1,490	1,165	2,295	1.715
CASH IN HAND, BALANCES WITH BANKS IN SIERRA LEONE AND HEAD OFFICE	2,496	2,220	2,274	1,868	2,318	2,425	2,152	2,269	3,988	3,911	2,519
LOANS AND ADVANCES (Private Sector)											
Agriculture	54	76			288	1,036	117	1,810	1,780	1,083	125
Mining					1	320	579	143	177	415	345
Manufacturing					747	933	1,282	1,201	1,090	1,158	1,739
Building/Construction					1,002	2,108	2,254	1,265	1,450	1,403	613
General Commerce	5,406	6,946	9,984	13,978	10,767	8,991	6,787	9,615	10,420	11,170	14,006
Miscellaneous Loans (from Commercial banks)					1,856	989	3,389	1,166	772	812	1,915
Co-operative Loans	103	163	238	338	453	196	191	814	810	836	860
LOANS AND ADVANCES (Government)											
Rediscounts and Advances (Central Bank)						799	1,580	1,400	150	1	4,254
Claims on Public Corporations	-	-	-	-	-	-	778	1,862	1,773	996	50
Other Loans	-	60	60	107	163	257	260	268	273	281	286
PURCHASES OF FINANCIAL ASSETS											
Government Securities					1,158	8,216	10,604	11,449	13,126	11,050	12,582
Foreign Securities and foreign balances of the Bank of Sierra Leone	10,900	9,927	11,369	11,591	13,607	15,184	13,730	13,247	22,901	29,484	24,645
Other foreign securities	4,031	4,176	4,522	4,565	4,750	2,756	3,033	2,983	2,842	3,833	4,367
SHARES IN COMPANIES (in Sierra Leone)	-	-	-	-	-	-	-	-	702	764	764
Other Assets including fixed assets	4,874	9,900	7,448	9,085	9,818	7,641	6,383	6,119	16,115	1[illegible],499	18,746
TOTAL	27,864	33,468	35,895	41,533	47,888	53,511	55,949	57,101	79,534	85,991	89,631

NOTES:

1. Money at Call - See Chapter II.
2. Cash in Hand, etc. - see Chapters III & V. Also included are the cash balances of the Post Office Savings Bank.
3. Loans and Advances to the Private Sector - see Chapter III.
4. For Co-operative loans - see Table 6.IV.
5. Other loans — Investments by Sierra Leone Investments Ltd. and loans under the Sierra Leone Revolving Loan Scheme.
6. Government Securities refers to Treasury Bills and Government Stocks.
7. Foreign Assets and Balances of the Bank of Sierra Leone - see Chapter II.
8. Other Foreign Assets - Investments by the Post Office Savings Bank, Pensions, Provident and Superannuation Funds, Insurance Companies.
9. Shares in Companies - see Chapter V.

SOURCES: Chapters II - V.

Loans and advances have, in the main, financed the export/import trade. We have shown in Chapter III that 11% of all customers in the category Le 10,000 and over, received 85% of the total loans available from commercial banks which have provided most of the loans to the private sector. The recipients of these loans are foreign firms as only a few Sierra Leonean enterprises are likely to require financial assistance on such a scale. Loans and advances for productive purposes (that is, all loans to the private sector excluding miscellaneous loans) averaged 24% of total financial assets. Assuming that loans in the miscellaneous category, loans from the co-operative thrift and credit societies, and "other loans" have gone entirely to Sierra Leoneans, then loans to nationals averaged less than 10% of the total loans from financial institutions. Loans to the agricultural sector on the other hand accounted for less than 5% of the total.

The holdings of government securities by financial institutions increased substantially between 1965 and 1970. If we add Ways and Means advances and loans to government to the holdings of government securities, then the government sector accounted for an average of about 17% of the resources of financial institutions during 1964 - 1970. There is nothing fundamentally wrong in directing resources to the government especially as the government plays a major role in the economy. What is important is that the resources made available in this way must have a reasonable prospect of enhancing the productive capacity of the economy.[8]

8. Ahmad, for example, has shown that the increase in the rate of government investment in Ghana during the years 1960 - 1965 was accompanied by declining rate of growth of the economy because of the preponderance of less productive investment.
N. Ahmad, Deficit Financing, Inflation and Capital Formation: The Ghanian Experience, 1960 - 1965 (Munchen: Weltform Verlag, 1970), pp. 111 - 118.

(b) Possibility of Converting Liquid Resources into Long-term and Other Securities

There is evidence of demand for securities with long maturities. An indication of this is the fact that shares which have been made available to the public have been over-subscribed.[9] In addition to the shares of the National Development Bank and those of Brewo Motors which have been over-subscribed, West Africa reported as follows: "Applications for shares in Barclays Bank (Sierra Leone) Ltd. far exceeded the number available. 80,000 shares were offered but applications were received for almost 150,000".[10]

Additional evidence of demand for long term securities can be obtained from the following figures which give the holdings of government securities by private institutions and individuals:

	Holdings of Government Securities by Private Institutions and Individuals* (Le 000)
1964	2
1965	147 (3.6)
1966	175 (1.3)
1967	251 (1.6)
1968	451 (2.6)
1969	785 (4.6)
1970	965 (4.5)

* Figures in parentheses refer to percentages of outstanding government securities

Sources: Unpublished data from the Bank of Sierra Leone.

9. Over-subscription may not necessarily indicate excess demand and can be the result of the pricing policy adopted. It may also reflect the fact that investors expect rates of interest to fall in the near future; but in a country like Sierra Leone this may not be an important factor since the number of speculative investors is extremely small. People have become aware of the advantages of holding their savings in the form of shares because of the publicity campaign organized by the National Development Bank. Hence over-subscription shows some increase in popularity in this form of investment.

10. Overseas Newspapers Agencies, West Africa (London), 23rd June, 1972, p. 808.

From these figures it can be seen that between 1964 and 1970 private institutions and individuals have increased their holdings of government securities from virtually nil in 1964 to almost Le 1 million by 1970. The share of individuals is quite significant, accounting for an average of 54% between 1966 and 1970.

Further evidence of peoples' willingness to hold non-cash assets can be obtained by observing the behaviour of currency and savings and time deposits. As savings and time deposits are more likely to serve the store of value function of money than currency, the ratio of currency to savings and time deposits gives some indication of asset preference. In 1960, the ratio of currency to savings and time deposits was 3.34, but by 1970 this ratio had declined to only 1.32. The ratio continually declined throughout the 1960's.

	Ratio of Currency in Circulation to Savings and Time Deposits (Ratios)
1960	3.343
1961	3.165
1962	2.804
1963	2.356
1964	1.938
1965	1.805
1966	1.619
1967	1.579
1968	1.542
1969	1.444
1970	1.315

Purchases of Treasury bills in recent years also show the public's increasing preference for holding financial assets. Treasury bills issues have been over-subscribed throughout most of 1969 and 1970 with the over-subscription in all cases exceeding Le 0.5 million and in a number of instances exceeding Le 1 million. Table 7.IV shows the extent of over-subscription for Treasury bills.

TABLE 7.IV TREASURY BILLS ISSUED AND APPLIED FOR: MONTHLY 1969 - 1970 (Le 000)

Issue			Amount Applied For	Amount Offered	Amount Over Subscribed
29-30.5.69	due	28.8.69	2,240	1,700	541
3.7.69	"	2.10.69	4,191	3,232	959
31.7.69	"	30.10.69	4,100	3,000	1,101
28.8.69	"	27.11.69	3,625	1,700	1,926
2.10.69	"	1.1.70	5,937	3,232	2,706
30.10.69	"	29.1.70	5,025	3,000	2,025
27.11.69	"	26.2.70	3,276	1,700	1,576
1-2.1.70	"	2.4.60	4,487	3,232	1,255
29.1.70	"	30.4.70	3,579	3,000	579
26.2.70	"	28.5.70	2,544	1,700	844
2.4.70	"	2.7.70	4,485	3,232	1,253
30.4.70	"	30.7.70	3,319	3,000	1,319
28.5.70	"	27.8.70	3,414	1,700	1,714
2.7.70	"	1.10.70	3,711	3,232	470
27.8.70	"	29.1.71	3,317	2,700	617

Source: Unpublished data from the Bank of Sierra Leone.

Given the legal limit for outstanding Treasury bills of 20% of estimated revenue, outstanding Treasury bills for 1970/71 could have been Le 9.1 million. But the total of Treasury bills outstanding at the end of April 1970 was Le 7.9 million, allowing an additional Le 1.2 million to be issued. However, when the May issue was made, excess demand amoumted to Le 1.7 million. Thus, even if supply was extended to the statutory limit, there would still have been excess demand.

We can therefore conclude that if sufficiently attractive securities are made available to the public it may be possible to mobilize resources through financial mediation. The different kinds of new securities as well as the institutions for introducing them are discussed in Chapter IX.

(c) Reducing the Level of Reserves Held by the Central Bank

Relating the Bank of Sierra Leone's external assets to its demand liabilities, it can be remarked that the Bank's holdings of foreign assets have been very large averaging 86% during the period 1964 - 1970. There is therefore a strong case, a priori, for a reduction in the level of reserves held by the Bank. Before arriving at such a conclusion, however, it is necessary to consider the country's total external reserves as the external assets of the Bank of Sierra Leone are only a part of the country's external reserves.

Table 7.V shows Sierra Leone's external assets during the period 1960 - 1970. From the table it can be seen that the external assets of institutions other than the Bank of Sierra Leone are relatively small; besides these assets are held for specific purposes. Sinking Fund investments are for the liquidation of certain external loans and the investment of pensions funds due to non-residents. The commercial banks are indebted to their head offices; hence the negative balance shown for these institutions. Appropriated funds are those which are administered by the government, especially pensions and superannuation funds, while other funds of the government showed a negative balance at the end of 1970. Assets of other official institutions, which include the Post Office Savings bank and the Sierra Leone Produce Marketing Board which were Le 9.8 million in 1960 were only Le 1.7 million at the end of 1970 due to a substantial decline in 1965 when assets of the Sierra Leone Produce Marketing Board were substituted for government securities. Because of the relatively small size of external assets held by these institutions and also as these assets are held for specific purposes, the external

TABLE 7.V SIERRA LEONE'S EXTERNAL ASSETS, 1960 - 1970

(Le 000)

End of Period	CENTRAL BANK				COMMERCIAL BANKS	GOVERNMENT			LIQUID FUNDS OF OTHER OFFICIAL INSTITUTIONS	SINKING FUNDS	TOTAL EXTERNAL ASSETS
	Bank of Sierra Leone	IMF Gold Trenche	Special Drawing Rights	Total		Appropriated Funds	Other Funds	Total			
1960 December	9,695	-	-	9,695	574	n.a.	9,816	9,816	7,088	n.a.	27,173
1961 December	9,927	-	-	9,927	- 408	576	8,368	8,944	8,066	3,496	30,025
1962 December	10,409	960	-	11,369	- 816	207	4,806	5,013	8,424	3,548	27,538
1963 December	10,631	960	-	11,591	-5,707	267	7,050	7,317	8,562	2,979	24,647
1964 December	13,137	960	-	13,607	-5,352	282	4,349	4,631	8,413	2,888	24,187
1965 December	14,224	960	-	15,184	-5,468	280	1,217	1,497	2,244	3,893	17,350
1966 December	13,730	572	-	13,730	-5,685	256	606	861	1,995	4,101	15,003
1967 December	13,247	-	-	13,247	-4,963	234	79	313	1,776	4,363	14,739
1968 December	22,901	-	-	22,901	-3,295	219	1,205	1,424	2,563	5,253	28,846
1969 December	29,484	-	-	29,484	-2,019	258	1,477	1,735	2,311	7,020	38,531
1970 December	24,645	3,665	401	28,711	-1,539	239	- 259	- 20	1,750	2,258	31,160

Source: Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March, 1972) Table 18, and Quarterly Statistical Review of the Bank of Sierra Leone No. 5 (June, 1966) Table 18.

assets of the Bank of Sierra Leone represent the country's international reserves.[11]

The holding of external assets is a burden on a small country such as Sierra Leone since these reserves have to be obtained. They are acquired through export surpluses or through capital imports. As these reserves can be used to increase the productive capacity of the economy or to raise the country's consumption, the cost of holding external reserves can be measured in terms of the income which would have arisen if the resources were invested locally or in terms of the foregone consumption.

The need for holding foreign exchange would be less if the country could adopt effective domestic policies which automatically correct deficits in its international payments. In practice, this means pursuing policies which influence the demand and supply for foreign exchange. However, reduction in government expenditure and greater unemployment which are likely consequences of the government's corrective policy measures may not be politically practicable. Hence the necessity for holding external reserves as a precautionary measure to enable the country to face a payments deficit without having to interrupt its development programme.

But there are other reasons which make it necessary to hold external reserves. Sierra Leone has a very large foreign trade sector, exports and imports being important determinants of the level of economic activity. The exports are heavily concentrated on a few primary commodities, the world prices of which are subject to violent fluctuations. Reserves in these circumstances prevent sudden contractions in imports which would otherwise be necessary. However, an examination of the variations in the level of reserves held by the Bank of Sierra Leone does not reveal any large fluctuations in foreign trade. Besides, the Gold Tranche position

11. The International Monetary Fund defines international reserves as official holdings of gold and convertible foreign exchange, the IMF Gold Tranche, and Special Drawing Rights.

and the Special Drawing Rights have been more than adequate to meet the changes in reserves that have occurred. When reserves are expressed as percentages of imports and exports, the results obtained show that reserves have been increasing relative to imports and exports. A rising trend is also noticeable when reserves are expressed as percentages of GNP. Table 7.VI shows external assets of the Bank of Sierra Leone as percentages of GNP, imports and exports.

TABLE 7.VI BANK OF SIERRA LEONE'S EXTERNAL ASSETS IN RELATION TO GNP, IMPORTS AND EXPORTS

	External Assets as a Percentage of		
	GNP	Imports	Exports
1960	n.a.	26.0	27.2
1961	n.a.	15.2	19.7
1962	n.a.	18.7	34.1
1963	5.9	19.4	22.8
1964	6.2	19.2	22.3
1965	6.5	19.6	26.4
1966	5.7	19.2	25.8
1967	5.2	20.3	29.1
1968	8.1	30.3	30.2
1969	9.6	31.7	33.8
1970	n.a.	30.1	35.0

Source: <u>Economic Review of the Bank of Sierra Leone</u>, Vol. 6, No. 4 (March, 1972), Tables 18, 20 and 33.

Given this rising trend in the level of reserves we can conclude that fluctuations in foreign trade is not a primary reason for holding reserves.

Difficulties in obtaining credit on reasonable terms may be a factor explaining the importance of holding external reserves. It should be noted that the availability of liquid funds for any one country depends on the simultaneous demand by others. In addition, how much credit the country is able to obtain will depend on its capacity to repay the debt. An important consideration in this regard is the present level of debt commitment. Where the debt burden is already very large, it may be difficult to obtain assistance from international organizations and other countries. We show in Appendix I that debt repayment at the end of 1970 represented 21% of government revenue, indicating a severe constraint on further borrowings.

The case for holding external reserves can be examined from an entirely different standpoint. Suppose that external demand for the country's main exports rose substantially but at the same time there are no suitable projects to be financed nor are suitable entrepreneurs available. In such a situation, it may be desirable to accumulate external assets which can then be used to finance development at a later stage. The alternative to building up external assets is to deploy the resources on low priority projects; so that the holding of external assets in this context allows the country time to plan for the effective utilization of the export surplus.

However, the accumulation of external assets depends very much on the instruments in which these assets are invested. It should be noted that at present the investments have taken the form of holdings of securities of the United Kingdom and United States Governments and that such securities carry very low rates of interests. The value of these assets may be eroded as a result of the high rates of inflation in these countries. There is therefore likely to be a decline in the earnings from these investments in real terms with a consequent loss in purchasing power of the initial investment. A dilema thus arises. Should export surpluses be invested in external assets whose value depreciate, or ought these resources to be spent domestically on low priority projects? Most people would opt for spending these resources locally. But even if we assume the non-availability of suitable projects, the export surplus could be used to acquire the services of foreign experts who would examine and prepare such projects. But the absence of suitable projects cannot be an explanation for the holding of external reserves in Sierra Leone since we have argued in the Introductory Chapter that the 1961/62 - 1971/72 Development Plan was abandoned largely because the anticipated external finance was not forthcoming. It would thus seem that the balance of payments constraint is the primary reason for holding external reserves.

In order to come to some conclusion about the desirability of reducing the present level of reserves held by the Bank of Sierra Leone, it is necessary to show that it is excessive and this involves arriving at some notion of what the optimum level is. A method of calculation of the optimum level of reserves has been suggested by Heller.[12] The result of his analysis is that the optimal level of external reserves is given by that amount which minimizes the total cost of adjusting and/or financing an external balance. The formula which gives the optimum amount of external reserves is as follows:

$$R_{opt} = h \cdot \frac{\log (r.m)}{\log 0.5}$$

Where r is the differential between the social rate of return on capital and the return on reserves;

m is the marginal propensity to import;

h is the change in the level of reserves;

π is the probability with which adjusting is used as a means of providing for external balance and it is given as $\pi = r.m$

This formulation links optimal external reserves to imports, the opportunity cost of holding reserves and the stability of the country's international account.

12. H.R. Heller, "Optimal International Reserves", <u>Economic Journal</u>, Vol. 76 (1966), pp. 296 - 311.

Applying this formula to the Sierra Leone data we arrive at the optimum reserves as follows:[13]

h, the yearly change in reserves for the years 1960 - 1970 is Le 1,967

For the expression $\frac{\log (r.m)}{\log 0.5}$ we obtain

$$\frac{\log (0.08 \times 0.32)}{\log 0.5}$$

$$= 5.2884$$

Optimum external reserves is thus

$$\text{Le } 1{,}967 \quad \times \quad 5.2884$$

$$= \underline{\text{Le } 10{,}402} \qquad \text{i.e.} \qquad \underline{\text{Le } 10.4 \text{ million}}$$

This can be compared with the average level of reserves for the period which was Le 16,352. It can be seen therefore that the average level of reserves during the years 1960 - 1970 has been about 1½ times the calculated optimum. Even in 1966/67 when the level of reserves led to a stabilization programme, the reserves held were never less than Le 10 million. Suppose we double the calculated optimum reserves to take account of the fact that the 1960's was a favourable year for the acquisition of external assets. On this basis the level of reserves could be reduced to about Le 20 million from its 1970 level of Le 29 million.

13. h is calculated as the average yearly change for the years 1960 - 1970. There is no correlation between these average yearly changes and a trend variable. When the annual changes were correlated with a trend variable we obtained an R^2 of 0.081. No adjustments were therefore made for trend element.
r measures the opportunity cost of holding reserves as given by the differential between the internal rate of return on capital and the return on liquid international reserves held. We have assumed that the rate of return on investment in Sierra Leone will be 15%. It should be noted that May found average rate of return on investment in the country to be 24% (see section (e)). Because we are assuming investment in agriculture it was felt that 15% would be more realistic. The programme of agricultural development to be implemented by the National Agricultural Development Authority (discussed in Chapter V) provides evidence of the availability of projects to ensure a marginal/average rate of return of 15%. The rate on liquid assets used is the weekly British Treasury bills rate for 1970 as most of the reserves are in London. The average weekly Treasury bills rate used is 6.999% (see Central Statistics Office, Financial Statistics, No. 129 (London: HMSO., January, 1973), Table 20). m the marginal propensity to import, was found to be 0.32 (see Appendix I).

It can be argued that since the largest capital expenditure has been less than Le 9 million, releasing an additional Le 9 million in one year may result in serious external pressures. To take care of this possibility, the reduction in the level of reserves held by the Bank of Sierra Leone can be achieved in two years instead of in a single year. What must be emphasized is the fact that the utilization of the amount available should be carefully planned. It must also be pointed out that this is a once and for all windfall which is not available on a continuing basis. Hence, reducing the level of reserves held by the central bank is not a permanent source of development capital. However, during the period when this amount is made available, such resources, if properly utilized, can make a significant contribution to financing development.

(d) Exchange Control to Limit Capital Outflows

(i) The Case for Exchange Control

The case for exchange control lies in the need for mobilizing domestic resources. A United Nations study observes "..... Shortage of capital and shortage of foreign exchange are two of the most common phenomena of development. It is proper, therefore, that developing countries should scrutinize activities and transactions which result in the withdrawal of resources from the local development effort."[14]

We show in Appendix I that whereas up to 1961/62 foreign assistance was mainly in the form of grants, since then loans have been more important and that the amount of net inflow has been greatly reduced after allowance

14. United Nations, External Financing of Economic Development (New York: United Nations, 1960), p.2.

has been made for interest and amortization payments.[15] Not only has the inflow been small in relation to gross loans but also the following reasons indicate that official flows may not be available on their previous scale. We show in Appendix I that debt repayments now represent about 21% of estimated revenue and about 14% of export receipts. In addition, the extent to which funds can flow from the more developed countries depends upon the economic and political climate of the developed countries. Serious balance of payments difficulties in the United Kingdom for example, greatly limit the volume of resources that can be allowed to flow out of the country. In 1968 the United States declared that her aid policy to Africa would be concentrated on eight countries (Sierra Leone excluded) and on multi-national projects while aid to other countries outside the select group would be limited to fulfilling existing commitments. Such a change in policy might have been influenced by political consideration, especially as a result of changed attitudes

15. Contractor and Suppliers credit are an important fraction of the total debt. About a third of all external loans between 1963 and 1965 were of this nature. Half the external loans in 1966 fell into this category while in 1967 it was 70%. On the burden of Contractor Finance see John V. Simpson "Development Finance: A Comment on Contractor Finance in Sierra Leone", Journal of Development Studies, Vol. 3 (1966) pp. 178 - 186, and on the problem in some other underdeveloped countries in West Africa see A.A. Ayida "Contractor Finance and Supplier Credit in Economic Growth", The Nigerian Journal of Economic and Social Studies, Vol. 7, No. 2 (July, 1965), pp. 5 - 15.
United Nations "The Terms of Financial Flows and the Problem of Debt Servicing", Proceedings of the United Nations Conference on Trade and Development, Document TD/7/SUPP. 3 (New York: United Nations, 1968), pp 28 - 35.
United Nations, "The Outlook for Debt Servicing", Proceedings of the United Nations Conference on Trade and Development, Document TD/7/SUPP.5 (New York: United Nations, 1968), pp 36 - 44 and
Courtenacy Slater, "External Debt and Economic Development: Some Empirical Tests of Macro Economic Approaches", The Southen Economic Journal, Vol. 35, No. 3 (January, 1970), pp. 252 - 262.

towards foreign aid. As changes in attitudes and policies do occur from time to time one cannot be certain that the desired volume of aid required will always be forthcoming. It should be noted that foreign loans and grants are not without conditions. To illustrate, the conditions for British assistance are defined as follows:

> We shall have regard to the economic position of the country concerned. We believe that this rather than the nature of the project or other purpose of the loan, should be the decisive economic criterion for the terms of aid. We shall have regard particularly to the relative poverty of the country, together with its present and prospective balance of payments. We shall also take into account its efforts to mobilize resources for development and to use them effectively and its policy in relation to commercial credit.[16]

There is in addition, the problem of meeting the local costs. Further, there is the possibility that there may not be "an identity of views" on the projects to be financed with the result that the foreign government providing the assistance has to determine development priorities. Also, a large number of underdeveloped countries are now seeking official flows. The combined effect of these factors is to limit the inflow to any one country greatly.

During the Colonial period and up to the early 1960's, almost the entire foreign private investment originated from the United Kingdom. The volume of foreign private investment by United Kingdom companies up to 1962 was estimated at Le 21.7 million.[17] Table 7.VII on the other hand gives British private investment in the country between 1963 and 1967 (the years for which this information is available). This table reveals that whereas in 1963 gross investment by British firms was Le 11.7 million, by 1967 investment was only Le 4.4 million. In 1963 British private investment represented 97.8% of total foreign investment but it was only 47.8% of the total in 1967. This decline in the volume

16. Ministry of Overseas Development, The Workings of the New Ministry (London: Her Majesty's Stationery Office, 1965), Cmnd. 2736, p.99.

17. For a breakdown of this figure, see Board of Trade Journal, 15th November, 1963, p. 1080.

TABLE 7.VII UNITED KINGDOM PRIVATE LONG TERM INVESTMENT IN SIERRA LEONE

(Le 000)

	1963		1964		1965		1966		1967	
Sector	Gross Investment	Depre-ciation	Gross Investment	Depre-ciation	Gross Investment	Depre-ciation	Gross Investment	Depre-ciation	Gross Investment	Depre-ciation
Mining	9.30	2.90	8.62	4.15	4.80	2.75	1.52	3.72	2.49	2.84
Manufacturing	0.06	--	0.02	--	--	--	0.21	--	0.48	0.26
Distribution	2.14	1.44	0.76	0.34	1.38	0.89	0.74	0.74	0.39	0.42
Transport and Communications	0.05	0.02	0.02	0.01	0.04	--	--	--	0.06	0.05
Banking	0.11	0.12	0.08	0.03	0.07	0.13	0.03	0.02	0.98	--
TOTAL	11.66	4.48	9.50	4.53	6.29	3.77	2.50	4.48	4.42	3.57
Percentage of Total Investment	98.8%		74.8%		49.5%		22.9%		47.8%	

Source: Unpublished data from the Bank of Sierra Leone of British private investment is not peculiar to Sierra Leone. The flow of British private investment to developing countries generally has been declining since 1961.[18]

In addition to the declining investment in Sierra Leone is the very rapid growth of depreciation write-offs. In 1963 depreciation was 38% of gross investment but by 1966 depreciation exceeded gross investment and was 179% of gross investment. In 1967 depreciation represented 81% of gross investment. The main point about depreciation write-offs is that they are unrelated to the actual life of the plant and may also reduce the amount of tax revenue. However, the point which we would like to emphasize is that these write-offs represent outflows from earlier investment and thereby have the effect of reducing capital inflows.

The Bank of Sierra Leone's estimates of income, re-invested earnings and administrative expenses to parent companies of British firms are given in Table 7.VIII.

TABLE 7.VIII EARNINGS OF BRITISH PRIVATE INVESTMENT (Le 000)

	1963	1964	1965	1966	1967
Income	6,253	6,040	8,749	9,600	8,410
Re-invested earnings	-12	1,176	688	898	241
Administrative expenses and services charges paid by local branches to their head offices and parent companies	376	477	1,940	1,988	1,568

Source: Bank of Sierra Leone, Economic Trends (Freetown, November/December 1967), pp. 5 - 6.

18. See Overseas Development Institute, British Development Policies (London: HMSO., 1966), Table 8.

In 1967, May estimated earning rates on British investment in Africa at 10.3% for the years 1959 to 1964.[19] For the same period earning rates by British firms in Sierra Leone averaged 23.8%. We thus have relatively high earning rates in Sierra Leone but with declining investment.[20] The decline in British private investment has been partly offset by other foreign investment.

Total foreign private investment in the country during the period 1963 to 1970 are given in Apprndix I and these averaged Le 13.7 million for the years 1963 - 1970. Investment income during the same period however averaged Le 7.1 million. These outflows together with depreciation allowances and other overseas commitments reduce the net inflows considerably.

Other outflows include the withholding of export earnings abroad, investment in foreign securities which we noted was a feature of the investment of non-bank financial institutions. Also to be taken account of are remittances of income and other earnings by expatriates, holidays abroad for which there are no limits on the amount that can be taken out of the country. Government transfers are also important, apart from pensions, scholarships for studying overseas, passages for government officers spending their leave overseas (until 1965), conferences abroad, expenditure on diplomatic missions. The combined effects of these outflows can be ascertained by examining the current account deficit of the balance of payments.

19. R.S. May, "Earnings of United Kingdom and United States Direct Investment in the Less Developed Countries 1959 - 64", Scottish Journal of Political Economy, Vol. 14 (November, 1967), p. 204.

20. In contrast, the following quotation shows that in Nigeria British investment was financed largely by new capital inflow: "(a) Of the twenty six manufacturing companies concerned in this survey, the approximate relative size of various sources of finance as at 1963/64 was new capital 60%, indigenous sources 25%, retained earnings (including profits made in other projects and re-invested) 15%. (b) For 1958-60 and 1962-63 (the only years for which such information is available) retained earnings of United Kingdom companies amounted to only about a third of new investment".
R.S. May, "Direct Private Investment in Nigeria 1953 - 63", Scottish Journal of Political Economy, Vol. 12 (1965), p. 251.

The overall deficits on goods and services in the period 1963 - 1970 for which balance of payments figures are available were:

(Le 000)

1963	1964	1965	1966	1967	1968	1969	1970
-12,505	-15,708	-24,780	-20,574	-21,905	-4,684	-11,980	-14,931

Of which freight and insurance net of other transportation were:

-305	-2,065	-2,437	-2,519	49	64	-1,828	-208

The trade deficits were:

-1,086	-351	-7,545	-6,449	-7,951	-10,662	-5,461	-1,532

Reverse flows thus account for more than half the deficits and have taken the following forms:

Depreciation allowances:

2,032	2,406	2,832	3,746	3,058	3,645	4,697	3,931

Investment Income:

6,455	7,071	8,496	5,387	8,200	8,156	6,635	6,625

Repayment on contractor finance:

1,264	2,171	2,160	2,421	2,751	2,034	1,153	3,106

Management Fees and Agent Fees:

3,279	3,670	3,955	4,071	3,102	4,565	5,110	5,855

Source: Bank of Sierra Leone, Balance of Payments, 1963 - 68 and 1966 - 1970 (Freetown, 1969 and 1971), from Table 1 in each case.

Hence, the relevance of exchange control in the context of the availability of development finance lies in the need to reduce these outflows.

(ii) The Case against Exchange Control

The cost of exchange control can be considerable. This involves the cost of obtaining professional experts as well as local personnel with honesty, integrity and a sense of fair play.[21] These qualities are

21. Experiences of such countries as Ghana, Ceylon, Indonesia, and Pakistan illustrate the importance of an efficient administrative machinery.

not easily available in underdeveloped countries. Another problem of equal importance can be seen from the following quotation: ".... The Department issues an average of 150 circulars every year and the present exchange control manual contains 182 closely printed pages besides about 210 application forms."[22] Under-valuation of exports and Over-valuation of imports are other malpractices which are the direct result of the introduction of controls. Countries which have imposed exchange controls have not succeeded in checking these abuses. Over-valuation of imports and Under-valuation of exports both lead to loss of foreign exchange since the former leads to the country paying more for imports but receives less for exports. In addition, the International Monetary Fund of which Sierra Leone is a member is opposed to controls. However, as a number of countries who are also members of the IMF impose various forms of exchange control restrictions, this cannot be a serious obstacle. Finally, perhaps the most serious argument against exchange control is smuggling. This is particularly the case because diamonds are the main exports. The argument is that because of the nature of diamonds, controls can be avoided by smuggling this commodity.

One suggestion for eliminating administrative abuses and black-marketing is by the auctioning of the available foreign exchange.[23] Under a system of exchange auction, the State through the central bank, buys all the available exchange from exporters. Certificates representing specified amounts of the available exchange are then sold by the central bank at an auction. These certificates entitle purchasers to obtain import licenses and to secure "spot" the amount of foreign exchange stated in the certificate at par plus a remittance tax. For the purpose

22. State Bank of Pakistan, Exchange Control in Pakistan (Karachi: State Bank of Pakistan, 1967), p.1.

23. On "foreign exchange auction", see Alexander Kafka, "The Brazilian Exchange Auction System", Review of Economics and Statistics, Vol. 38 (1956), pp. 308-322, and J. Bhagwati, "Indian Balance of Payments Policy and Exchange Auctions", Oxford Economic Papers, Vol. 14 (1962), pp. 51 - 68.

of the auction all imported commodities are classified according to their relative importance. Those considered important for the maintenance of the level of economic activities go into the first category and so forth. By allowing importers to bid for the available foreign exchange, the system of exchange auction allows market forces to allocate scarce resources. More important however, is the fact that such a system transfers to the government profits previously made by importers.[24]

Extending the present controls to include the sterling area is all that is required and the result of this limited control can be substantial but without some of the disadvantages of more elaborate controls.[25] To begin with, profits and other investment incomes would only be remitted on evidence that the original investment was financed from an external account source. However, the problem of diamond smuggling is serious as controls are likely to increase outflows through unofficial sources. Although diamond smuggling has been a serious problem this has been the result of the price differentials between Kenema and Monrovia. Diamond smuggling need not be intensified with the extension of the present controls to the sterling area. At present, payment for diamonds purchased in Sierra Leone "Shall be made by the purchaser either in United States dollars or in the currency which is legal tender in the country of the purchaser."[26] Thus although the smuggling argument may be serious, the

24. Usually excluded from such auction are the foreign purchases of the government and imports which are regarded as essential.

25. The present Exchange Control was introduced under the Defence (Finance) Regulations of 1940. The object of that legislation was to control the flow of foreign exchange from the Sterling Area. The 1940 regulations were replaced in 1954 by the Sierra Leone Exchange Control Ordinance which was a virtual copy of the British Exchange Control Act of 1947. Under the 1954 Ordinance, no dealing in non-scheduled Territory currencies, securities and gold could take place without the approval of the Minister of Finance. The only change introduced in the Sierra Leone Exchange Control (Amendment) Act, 1965, was the definition of foreign currency as "any currency other than Sierra Leone currency". The controls were as previously limited to transactions involving non-scheduled territories.

26. See The Exchange Control (Diamond Export Payment) Order 1958, Section 2 (b).

present arrangement can minimize the impact. And if the price differentials between Liberia and Sierra Leone can be reduced this too may have significant impact on the scale of smuggling.[27]

(iii) Alternatives to Exchange Control

Alternatively, resources can be conserved for development purposes by the imposition of import duties on all imports which are not considered essential for development. The imposition of duties avoids a number of problems which are connected with exchange control. For example, administrative abuses are eliminated by ensuring that allocation of resources is decided by the price mechanism rather than by the discretion of officials. Another advantage is the contribution to the government revenue. If the commodities and the rate of taxes are carefully selected the government revenue increases. This can be an important factor because of the dependence of government revenues on indirect taxes and the lack of buoyancy of revenue from other sources. The problem here however, is deciding on the rate of duty that will both curb the non-essential demand for foreign exchange and provide additional revenue to the government.

Another alternative is to request all export firms and especially the mining companies to surrender an agreed percentage of their foreign exchange received from export sale. This should ensure that at least a reasonable percentage of foreign exchange originating from the country returns to the economy. There are examples of this requirement already in existence. One example is the British 25% surrender rule on investment in foreign securities. Here British investors are obliged to surrender 25% of the proceeds of investment in foreign securities.

27. Since this section was written, the Sierra Leone Government has extended exchange control to the sterling area. This decision was taken not because of conviction about the desirability of exchange control but because of the decision of the British Government to float the Pound. We have therefore decided to retain this section to emphasize the need to maintain exchange control after a fixed rate of exchange for Sterling has been determined.

Also, it should be possible to negotiate with foreign companies the extent of repatriation of profits and hence the extent to which they are expected to re-invest. This would be desirable because of the various incentives provided for the attraction of foreign private capital. Without some efforts to ensure that at least some of the foreign capital remained within the country for further investment, it is questionable whether incentives to foreign firms are in fact in the interest of economic development. Similarly, there is no reason why external debt cannot be re-negotiated so as to ensure that repayments take into account the expected growth in export earnings, with the possibility of suspending payments altogether when export receipts fall.

In summary, these policy measures are not mutually exclusive but may be complementary to each other. In practice, therefore, a combination of measures may be needed to achieve the desired result rather than any single measure in isolation.

(e) Utilization of Funds made Available to Government Through the Sale of Government Securities

As government stocks are not tied to any specific projects, it is possible for the government to mobilize resources through the floating of stocks without this being reflected in increased investment. We point out in Appendix I that total expenditure rose by about 90% between 1960/61 and 1969/70. During the same period, capital expenditure represented a declining percentage of total expenditure. It can thus be inferred that additional resources made available to the government have been used to expand current expenditure.

The available evidence seems to suggest that this has been the case. Government's capital formation as a percentage of total gross domestic capital formation during the years 1963/64 to 1969/70, for which this information is available, were as follows:

1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70
34.9	30.9	30.5	36.6	17.0	16.6	18.2

These figures indicate that growth in government's total expenditure have been accompanied by a drop in the government's share of gross domestic capital formation.

Government's current and capital expenditure as percentages of GNP are given in Table 7.IX.

TABLE 7.IX GOVERNMENT CURRENT AND CAPITAL EXPENDITURE[28] AS PERCENTAGES OF GNP 1963/4-1969/70

(Percentages)

Current Expenditure	1963/4	1964/5	1965/6	1966/7	1967/8	1968/9	1969/70
Administrative services including defence pensions and gratuities	5.2	5.1	5.9	4.7	4.8	4.4	5.0
Social Services	4.0	4.1	5.3	4.2	4.3	4.1	4.3
Economic Services	5.6	6.2	5.9	3.7	3.6	3.3	4.7
Debt Servicing	0.9	1.0	2.6	0.8	3.5	3.6	3.9
Capital Expenditure	3.5	3.8	3.7	2.6	1.9	1.1	2.0
Total Expenditure	19.2	20.2	23.4	16.0	18.1	16.5	19.9

Source: Bank of Sierra Leone, Annual Report 1971, Tables 14 and 15.

The table reveals that capital expenditure which represented 3.5% of GNP in 1963/64 declined to 1.1% in 1968/69 and was 2.0% by 1969/70.

28. General services comprise the following: General administration, justice, police national defence, pensions and gratuities. Social services' expenditure are those on education and welfare, health, and housing and country planning. Expenditure on economic services are those on agriculture and natural resources, trade and industry, transport and communications and construction.

Even so, capital expenditure on economic services averaged only 38% of total capital expenditure (See Table AP.IX). This pattern of expenditure reflects the general argument that investment in physical and social infrastructure should precede the more directly productive investment, the reasoning being that once the services are provided other investment would follow.[29] No doubt, expenditure on the physical and social infrastructure are of vital importance to economic development. However, in planning investment in such services it is essential that productive investments are not neglected or allowed to lag behind. This is important for the following reasons. Educational expenditure for example, may be justified because it improves efficiency and raises the aspirations of individuals. However, a large number of students qualify each year without any prospects of some employment. Unemployment amongst graduates is already becoming a serious problem in Sierra Leone, consequently, while education is desirable, one needs to take employment prospects into account. Also, a casual visitor to Freetown will observe that road transportation is operated by private enterprise. Public transport has been unable to compete. And to provide the public transport system in the city with an assured income it has been suggested that all forms of private transport should be banned within the city. Also, people with very low incomes have preferred consulting private practitioners to using the relatively cheaper medical service of the government. The main point about these examples is that if incomes increase as a result of a productive investment, the demand for social infrastructure will grow and people may be prepared to pay

29. P.N. Rosenstein-Rodan, "Notes on the Theory of the Big Push", in H.S. Ellis (ed), Economic Development for Latin America (New York: St. Martin's Press, 1961), pp. 60 - 61.

for such services if they have steady employment. On the other hand there is no reason to suppose that the provision of these services by itself will lead to more directly productive investment. Further, if productive investment lagged behind physical and social infrastructure two developments are likely. In the first place, given the high marginal propensity to import, the increased incomes may leak into imports. In the second place there is the problem of meeting the re-current costs of these services.

Thus, while adequate physical and social infrastructure are extremely important for economic development, equal emphasis must also be placed on directly productive investment.

(f) Financial Institutions and the Availability and Use of Development Finance

We argued in the Introductory Chapter that the extent to which the financial system has contributed to the availability and use of development finance would be evaluated with reference to their efforts in mobilizing domestic financial resources, the utilization of these resources for productive investment, and the extent to which they facilitate the government's development strategy.

Our analysis has shown that during the years 1960 - 1970, financial assets have represented a rising percentage of GNP. We have also argued that the financial system made possible the continuous mobilization of domestic savings through advertising campaigns and the extension of the branch coverage. On this evidence it could be argued that financial institutions have contributed to the availability of development finance. We would not entirely agree with such a conclusion for the following reasons. We have shown that domestic savings have been held in liquid form and were therefore not available for long term investment. In addition, a financial assets/GNP ratio of 30% for Sierra Leone in 1969/70 compares unfavourably with a ratio approaching 80% for some other underdeveloped countries (attained in 1963).[30] Furthermore, we have noted that the financial assets/GNP ratio of non-bank financial institutions went up by less than 1% between 1963/64 and 1969/70.

This fact emphasizes the inappropriateness of some of the institutions and the inefficient operation of others, problems which we have high-lighted in earlier chapters. Only the commercial banks have achieved some degree of success in mobilizing domestic savings.

We have shown that 24% of total financial assets have been used by the private sector for productive purposes. Assuming that resources made available to the government have been utilized for productive investment, then resources used for productive purposes would average 35%.[31] The utilization pattern of resources available to financial institutions during the period under review was as follows:

	Average 1960 - 1970
	%
Liquid Resources	7
Productive Investment	35
Other Loans	2
External Assets	37
Other Assets (Including Fixed Assets)	19
	100

Since the financial system needs to hold some amount of liquid resources and external reserves, not all its resources are available for productive investment. Aside from using some of its funds for financing its

30. Goldsmith, op. cit., p. 209.

31. This percentage of productive investment is over-stated because we have argued earlier in this chapter that resources made available to the government have not been used productively. (Resources available to the government averaged 11% for the years 1960 - 1970).

own fixed investment, the above evidence suggests that resources of the financial system have, on the whole, been used productively. However, it should be observed that an outflow of domestic resources which averaged 37% of total assets is quite substantial even allowing for the fact that the country needs to maintain some international reserves. Of the 24% of productive investment by the private sector, about 19% have been for the financing of the export/import trade sector. This sector undoubtedly makes important contributions to development. But it should be recalled that the objective of political independence is to diversify the economic structure to ensure continuous development. This pattern of resource allocation is not likely to facilitate the attainment of this goal. Furthermore, given a development strategy which we have argued aims at transforming the agricultural and small-scale industries sectors, the current pattern of resource allocation is unlikely to enhance the attainment of the stated policy objective as only a small fraction of total financial resources have been available to the priority sectors (see Table 7.III). We argue in Appendix II that the nature of the agricultural and small-scale industries sectors impose constraints on financial institutions of British origin so that only specialized financial institutions are appropriate for these sectors. Unfortunately, no such specialized institutions exist within the financial structure.

In summary, the conclusions which emerge from the analyses in this chapter are two-fold - namely, that although it could be argued that financial institutions have achieved some measure of success in channelling domestic resources through institutions, there is scope for the mobilization of additional savings; and that the present allocation pattern can be improved substantially, in particular, the amount of external assets held by the Bank of Sierra Leone could be reduced by about 30%. The policy implications of these conclusions are examined in Chapter IX.

CHAPTER VIII

THE BEHAVIOUR OF THE MONEY SUPPLY AND ITS SIGNIFICANCE FOR MONETARY MANAGEMENT

This chapter argues that because of the nature of the economy, the central bank should be concerned primarily with the management of external reserves, the mobilization of domestic financial resources so as to increase the relative importance of domestically financed investment, and because of the large import leakage ensure that the available credit be utilized for productive investment.

Section (a) presents a general theoretical discussion of the process of money supply determination. In section (b) we test two hypotheses concerning the behaviour of the Sierra Leone money supply, the objective of which is to indicate the relative importance of the variables influencing the money supply. Since we show that the central bank's ability to influence the money supply is limited, the final section suggests the appropriate direction of monetary management in Sierra Leone.

(a) The Process of Money Supply Determination

The general practice has been to treat the money supply as exogenously determined by the monetary authority.[1] That is,

$$M_{1t} = a + bB_t + e_t$$

Where M_1 is money supply (currency in circulation plus demand deposits);

B_t is the monetary base defined as the monetary liabilities of the central bank;

a is a constant; and

e is the error term.

This formulation states that the money supply is a multiple of the monetary base and since the monetary base is the liabilities of the central bank, the money supply is uniquely determined by the monetary authority. Thus, through variation in its monetary liabilities the central bank can control the supply of money and this is possible because of the fractional reserve nature of the banking system.

This approach, however, does not give any indication of the part played by the commercial banks and the non-bank public in determining the money supply. Since about the 1950's, the trend has been away from this mechanical approach and in the direction of establishing behavioural hypotheses that can be used to predict the response of the money supply to changes in monetary variables. The studies in this field and which

1. J.M. Keynes, General Theory of Employment, Interest and Money (London: MacMillan and Co. Ltd., 1936), p. 230. H.G. Johnson, "Monetary Theory and Keynesian Economics," reprinted in R.W. Clower (ed.), Monetary Theory: Selected Readings (London: Penguin Books, 1969), p. 231. Also by the same author, Macroeconomics and Monetary Theory (London: Gray Mills Publishing Ltd., 1971), Chap. 18.

we considered appropriate for our purpose are those of Brunner-Meltzer[2] and Snyder.[3]

According to Brunner-Meltzer, the money supply is derived as the product of the monetary multiplier (n) and the monetary base.

That is, $M_1 = nB$

Thus to describe and explain the behaviour of the money supply it is necessary to analyse the factors that determine the multiplier process and those factors that influence the monetary base. The monetary multiplier is determined by five ratios. These ratios are, the ratio of currency in circulation to non-bank public demand deposits (k), the ratio of the non-bank public's holding of savings and time deposits to demand deposits (t), the ratio of borrowings by commercial banks to total deposits (b), the ratio of reserves held by commercial banks to total deposits (r), and the ratio of government deposits at commercial banks to demand deposits (g). These ratios describe the behaviour of commercial banks for reserves and borrowing, the public's demand for currency and savings and time deposits.

The monetary base is made up of high-powered money, that is, currency in circulation, currency holdings of the commercial banks, deposits of the commercial banks with the central bank, and government deposits. The demand for high-powered money by the commercial banks and the non-bank

2. Karl Brunner and Allan Meltzer, An Alternative Approach to the Monetary Mechanism (Washington D.C: U.S. Government Printing Office, 1964). Also by the same authors, "Some Further investigations of the Demand and Supply Functions of Money," Journal of Finance, Vol. 19 (May, 1964), pp. 240 - 283, and Allan Meltzer, "The Behaviour of the French Money Supply, 1938 - 1954" Journal of Political Economy, Vol. 67(June, 1959), pp. 275 - 291.

3. Wayne W. Snyder, "Money in a Developing Economy: A Case Study of Pakistan, 1953 - 1961," Review of Economics and Statistics, Vol. 46, No. 2 (May, 1964), pp. 413 - 420.

public must adjust to the supply as determined by the central bank. In an attempt to adjust to the quantity of high-powered money the commercial banks and the non-bank public will shift demand between currency, financial assets and real assets. The process of portfolio adjustment will lead to a change in interest rates and prices of real assets, and to a change in the money supply. And in the case of the monetary base, any increase or decrease in the monetary base must affect one of the competing uses.[4]

The underlying reasoning in the Snyder approach (which is also assumed in the Polak Model) is that since the money supply is a liability of the banking system, a model based on the consolidated balance sheet of the banking system should explain the process by which the money supply is determined. Hence he uses a simplified set of assets and liabilities of the banking system to explain how the money supply is determined. His model includes behavioural functions to explain demand deposits, vault cash, commercial bank lending to the private sector, borrowing from the central bank. Specifications are also given for excess reserves, and currency in circulation. From these specifications he estimates the money supply by a system of simultaneous equations.

In the analysis that follows, the objective is not to estimate the money supply, but rather, to examine the process by which the money supply is determined so as to indicate the influence of the central bank.

4. The analysis of Friedman-Schwartz is similar to that of Brunner-Meltzer. They use an identity in which ex-post rate of change of the money supply (currency in circulation plus total deposits, M_2) is allocated to three main determinants, high-powered money (H), the reserve ratio of commercial banks($\frac{D}{R}$), and the deposits to currency ratio($\frac{D}{C}$). H reflects the behaviour of the monetary authority, $\frac{D}{R}$ gives the reaction of the commercial banks, and $\frac{D}{C}$ the attitude of the public. Like Brunner-Meltzer they argue that the ratios are influenced by a number of factors and reflect the preference for various financial and non-financial assets. Like Brunner-Meltzer, the money supply is determined jointly by the two ratios and the monetary base.
See, Milton Friedman and Anna Schwartz, A Monetary History of the United States, 1867 - 1960 (Princeton: Princeton University Press, 1963) Appendix B.

(b) The Money Supply Process in Sierra Leone

The main factors influencing the money supply in Sierra Leone are the banking system, the budget deficits and the behaviour of the non-bank financial institutions and the balance of payments. The non-bank financial institutions are relatively unimportant as their assets are not widely held and most of these institutions are not of the type that mobilize deposits from the public. The government budget deficits will partly be reflected in the assets/liabilities of the banking system as most of these deficits are financed by credit from the banking system, and partly also in the balance of payments through loss of external reserves. The principal influences on the money supply are thus the banking system and the balance of payments.

The effects of the banking system on the money supply can be obtained from the consolidated balance sheet of the banking system. Such a consolidated balance sheet contains the following variables:[5]

ASSETS		LIABILITIES	
LA	Liquid Assets Cash Treasury Bills Balances with banks in Sierra Leone Money at Call	Z	Currency in Circulation
		QM	Time and Savings Deposits
		D	Demand Deposits
		HB	Head Office Borrowings
FA	Foreign Assets	DG	Government Deposits
LG	Claims on Government		Other Assets (net)
LP	Loans to Private Sector		

5. Note that:

$LA_t = RR_t + ER_t$; where RR are Required reserves, ER are Excess reserves

$RR_t = 0.30\ TD_t$; where TD_t are Total Deposits

$ER_t =$ Reserves above RR_t

$TD_t = D_t + QM_t$

The identity relating to the above is as follows:

$$Z_t + D_t = LP_t + LG_t + FA_t + LA_t - QM_t - HB_t - G_t$$

The effect of the banking system on the money supply is thus obtained by explaining these variables.

The other influence on the money supply is the balance of payments. The effects of the balance of payments will however be reflected in foreign assets of the banking system since we have shown in the previous chapter that the foreign assets of the central bank represent the country's international reserves. Thus by explaining the behaviour of each of the variables in the consolidated balance sheet one should have an insight into the process of money supply determination in the country. The equations which explain each of these variables are as follows:

$$FA_t = a_1 + a_2X_t + a_3CI_t - a_4M_t + e_{1t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (1)$$

$$LG_t = b_1 + b_2EG_t + e_{2t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (2)$$

$$DG_t = \alpha + \beta EG_t + e_{3t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (3)$$

$$D_t = c_1 + c_2Z_t + e_{4t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (4)$$

$$QM_t = d_1 + d_2AD_t + d_3EG_t + d_4R_t + e_{5t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (5)$$

$$Z_t = h_1 + h_2AD_t + h_3EG_t + h_4R_t + h_5\frac{dP}{dt} + e_{6t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (6)$$

$$LP_t = q_1 + q_2QM_t + q_3HB_t + q_4R_t + e_{7t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (7)$$

$$TD_t = p_1 + p_2FT_t + p_3HB_t + p_4ER_t + e_{8t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (8)$$

$$ER_t = g_1 + g_2Q + e_{9t} \quad \ldots\ldots\ldots\ldots\ldots\ldots (9)$$

Equation (1) states that foreign assets (FA) depend on exports, capital inflows (CI), and imports (M). Equations (2) and (3) relate claims on the government (LG) and government deposits with the banking system (DG) to government expenditure (EG). Equation (4) relates demand deposits (D) to currency in circulation (Z). Demand deposits can also be expressed as a function of savings and time deposits. Equation (5) states that savings and time deposits (QM) depend on income and the rate of interest (R). The variables (AD) and (EG) are used as indicators of income (See Chapter III). From Chapter II, currency in circulation (Z) was found to be a function of real income per capita, the rate of interest on alternative assets and other non-quantitative factors such as the importance of petty trading and the method of financing the local purchase of diamonds and agricultural produce. In equation (6), which gives the function for currency in circulation, we have omitted the non-quantitative factors.

In specifying the supply function of loans (LP) in equation (7), two aspects of the nature of banking in Sierra Leone have to be taken into account. The first is creditworthiness which appears to be of over-riding importance. The second is the fact that the collaterals demanded by the banks are not derived from the range and availability of local securities; instead, they reflect the conditions prevailing in the United Kingdom where the head offices of the banks are situated. The implication of these features is that the supply function of loans exists independently of the rate of interest.[6] If demand for loans by potential creditworthy borrowers is greater than local resources, the banks borrow from their head offices (HB). An alternative specification is to make loans and advances a function of foreign trade as most of the loans from the commercial banks finance export/import trade.

Equation (8) states that total deposits (TD) depend on loans and advances to the private sector, borrowings from head offices, and their liquid assets (LA). This specification arises from our discussion of the

6. This observation is supported by the following quotation from Greaves, which as we saw in Chapter III is also relevant to the current situation in Sierra Leone: "Managers everywhere were of the opinion that all local credit requirements which are properly the business of commercial banks are fully met, and they declared that they were both able and willing to increase the volume of loans if suitable opportunities for doing so were offered them."
Greaves, op. cit., p. 47.

factors which determine the level of total deposits in Chapter III. Excess reserves (ER) depend on the volume of deposits mobilized and the extent of head office borrowings in relation to the demand for loans. The demand for loans however, is largely determined by creditworthiness. Where creditworthy customers are not available, resources are held in liquid form, especially in the form of investment in government securities. Excess reserves therefore depend on the availability of creditworthy customers (Q).[7]

The functional specifications of the system of equations reveal that the determinants of the money supply are foreign trade, capital inflows, the level of government expenditure, quasi-money, borrowings from head offices, prices and the rate of interest. As our primary concern is with the role of the central bank in the process of money supply determination we consider it appropriate to test the following hypotheses: (a) That traditional monetary variables play only a minor role in explaining the behaviour of the money supply; and (b) that the crucial explanation for the money supply process should be sought in variables which are not directly influenced by the central bank.

To test the first hypotheses, changes in the money supply were regressed against changes in each of the following monetary variables: excess reserves (1); required reserves (2); the rate of interest (3); and borrowings by the commercial banks (4). The results are shown in Table 8.I.

7. If we assume that Commercial Banks aim at maximising their profits, then they would build up reserves when the rate of interest on other investments are low and to reduce the level of reserves when these rates are high, however, during 1970 for example, when the British Treasury Bills rate averaged 6.99% (the Treasury bills rate in Sierra Leone was 5½%) the banks increased the borrowings through their head offices for use in Sierra Leone. But it should be noted that in that year liquid assets of the banks were 43% of their deposit liabilities, 13% above the legal requirements. It would thus seem that the rate of interest plays a relatively minor role in the determining excess liquidity.

TABLE 8.I REGRESSION RESULTS: MONEY SUPPLY AND OTHER MONETARY VARIABLES, 1964 - 1970

	Excess Reserves ER	Required Reserves RR	Rate of Interest R	Head Office Borrowings HB	R^2	Durbin-Watson Statistic	DF
			(Log Functions)				
1.	0.0022 (0.0697)				0.0003	1.7463	17
2.		0.1370 (1.4283)			0.1071	1.5587	17
3.			0.0995 (0.3992)		0.0093	1.7526	17
4.				-0.0350 (-1.4862)	0.1150	1.6579	17

Notes: Figures in parentheses are the T-ratios

DF are degrees of freedom

Source: Calculated from quarterly data in Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March, 1972), Tables 3 and 5, and Quarterly Statistical Review of the Bank of Sierra Leone, No. 5 (June, 1966), Table 8.

The table reveals that excess reserves and the rate of interest explain less than 1% of the changes in the money supply whereas required reserves explain about 11%. Although borrowings by the commercial banks account for about 16%, such borrowings are from the head offices of these banks and not from the central bank. We can therefore conclude that the traditional monetary variables which can be influenced by the central bank explain about 11% of the observed changes in the money supply.

To test the second hypothesis, we examine the actual behaviour of the money supply during the years 1964 - 1970 for which detailed information could be obtained. The factors which cause changes in the money supply are given in Table 8.II. From the table it can be seen that three factors largely explain changes in the money supply. These are, foreign assets of the banking system, credit to the government, and savings and time deposits.

TABLE 8.II DIRECT DETERMINANTS OF THE MONEY SUPPLY, 1964 - 1970

(Le million)

End of December	DOMESTIC CREDIT				FOREIGN ASSETS			OTHER ASSETS (net)	QUASI-MONEY	MONEY SUPPLY
	Government (net*)		Private Sector	Total	Central Bank	Commercial Banks	Total			
	By the Central Bank	By the Commercial Banks								
1964	2,235	- 399	15,596	17,432	13,607	-5,352	8,255	2,138	6,925	20,900
1965	3,910	- 41	15,352	19,221	15,184	-5,468	9,468	19	7,860	21,096
1966	6,648	1,187	15,643	23,478	13,730	-5,685	8,045	- 663	8,942	21,918
1967	9,143	2,241	15,451	26,835	9,439	-4,963	4,476	- 423	9,098	21,790
1968	3,189	5,454	16,121	24,764	19,110	-3,295	15,815	-2,473	11,580	26,526
1969	105	4,495	16,908	21,508	26,956	-2,019	24,937	-2,048	14,006	30,391
1970	-2,576	5,057	19,350	21,831	28,711	-1,539	27,172	-6,447	14,344	28,212

*Net of government deposits with the central bank and commercial banks as well as Treasury IMF Account.

Source: Adapted from Economic Review of the Bank of Sierra Leone, Vol. 6, No. 4 (March 1972), Table 4a.

Gains in savings and time deposits as well as increases in government deposits have a contractionary effect on the money supply. This is because the acquisition of these deposits involves a shift from currency and demand deposits. Government deposits, for example, rises as a result of the payment of direct and indirect taxes and such payments are made in currency and by cheques. Growth in savings and time deposits, on the other hand, may be the result of the opening up of new accounts. With monetization and the spread of the banking habit people become aware of the advantages of holding their savings in the form of deposits with commercial banks. The higher level of savings and time deposits may also be the result of larger payments into existing accounts.

Increases in credit to the private sector, credit to the government, and foreign assets all result in an expansion of the money supply. A rise in foreign assets increases the money supply because, in return for these assets, the banking system credits the customer's current account with the amount or surrenders currency. In the case of credit to the private sector, the customer's current account is credited with the amount of the loan and the money supply increases because of the rise in demand deposits. Credit to the government leads to an expansion in the money supply when the government spends the funds acquired on goods and services. But both the private sector and the government may use a part of the loans received from the banking system on imported commodities. In such an event, foreign assets decline, with the extent of the fall depending on the marginal propensity to import. The money supply, in this case, contracts as currency and deposits are given up in exchange for the required foreign assets.[8]

Between 1964 and 1967, the level of the government budget deficits was the most important single factor influencing Sierra Leone's money

8. For a general discussion on the direct determinants of the money supply, see L.V. Chandler, The Economics of Money and Banking (New York: Harper & Row, Fourth Edition, 1964), Chap. 11.

supply. To finance the large budget deficits of those years, the government borrowed extensively from the banking system, and such credit to the government went up by about Le 10 million (See Appendix I). The result of these borrowings, however, was a decline in foreign assets of the banking system from Le 8.3 million to Le 4.5 million. Between 1964 and 1965 non-bank foreign assets also dropped by Le 9.1 million, again connected with the financing of the budget deficits.

The years 1968 to 1970 were associated with gains in foreign assets made possible by the favourable trade balance of the period together with capital inflows. Also, economies in government spending resulting from the implementation of the Stabilization Programme led to budget surpluses. As a result, net foreign assets of the banking system rose from Le 4.5 million in 1967 to Le 27 million in 1970. The favourable trade position was also reflected in higher incomes, some of which were absorbed by savings and time deposits. Hence, quasi-money which was Le 9.1 million in 1967 went up to Le 14.3 million by 1970. Although the higher level of savings and time deposits should imply a contraction in the money supply, the faster rate of acquisition of foreign assets prevented such a decline.

In summary, foreign trade and government expenditure, through their effects on foreign assets quasi-money and domestic credit have been the principal factors affecting the money supply.

Explaining the behaviour of the Sierra Leone money supply in terms of the monetary multiplier and the monetary base (the Brunner-Meltzer approach) leads to the same conclusion.[9] This analysis is given in

9. The definition of money supply (M_2) used here is currency in circulation plus total deposits. The use of this wider concept re-enforces the conclusion reached with respect to the more conventional conception of the money supply (M_1). The explanation of the ratios which determine the monetary multiplier are as follows:

a is the ratio of the private sector deposits with the central bank to demand deposits;
b is the ratio of reserves to liquid assets of commercial banks;
c is the ratio of currency in circulation to money supply;
g is the ratio of government deposits with the commercial banks to the banks' demand deposits
r is the ratio of liquid assets to deposit liabilities of commercial banks; and
t is the ratio of savings and time deposits to total deposits.

Table 8.III. From the table it can be seen that the impact of the a, c, g, and t ratios have been relatively insignificant in explaining changes in the monetary multiplier. The r-ratio had a significant impact on the monetary multiplier in 1963 - 64 and in 1965 - 66. The former was due to the fact that the liquidity ratio was first stipulated in 1964, while the later is explained by the higher liquidity requirements which came into operation in November, 1966. With the exception of those two years, the impact of the r-ratio has not been large. But changes in the b-ratio have been significant. We have argued in Chapter III that a switch has taken place in the portfolio preference of the commercial banks. That is, they have increased their holdings of government securities. The b-ratio reflects this change. Undoubtedly, changes in high-powered money have had a greater impact in explaining fluctuations in the money supply than the monetary multiplier. External assets of the central bank and also credit to the government by the central bank have been the principal explanatory variables.

Having shown that the traditional monetary variables explain only a relatively small part of changes in the money supply, we now examine the extent to which the central bank can influence these variables. We have argued in Chapter II that local rates of interest did not determine investments during the 1960's because these investments were financed largely by capital inflows. This being the case, high interest rates need not deter investors. At the same time, exceptionally low local interest rates would not necessarily lead to large increases in the volume of lending. This is because the amount of loans depend, on the one hand, on the right type of securities being available and on the other the business to be financed must be proper business of banks. Thus, merely lowering the rate of interest may not result in increased demand for loans. Moreover, if the local rates of interest are too high, the volume of lending should not change significantly. It was suggested in Chapter III

TABLE 8.III ANALYSIS OF CHANGES IN THE MONEY SUPPLY: THE IMPACT OF THE PRINCIPAL VARIABLES*

(Le million)

	1963-64	1964-65	1965-66	1966-67	1967-68	1968-69	1969-70	1970-71
CHANGES IN M_2 DUE TO CHANGES IN THE MONETARY MULTIPLIER (n_t)	-1.22	-1.32	-0.19	2.62	0.84	-0.62	2.70	1.57
The Impact of the c ratio	0.78	-0.28	0.72	0.23	-0.20	0.80	0.83	0.44
" " " " b "	-0.99	-0.81	0.82	2.35	2.46	-2.30	1.66	0.98
" " " " r "	-2.20	0.07	-2.20	0.49	-1.20	1.88	-0.07	-0.02
" " " " t "	0.07	0.10	0.01	0.01	0.03	0.02	0.04	-0.04
" " " " a "	-0.48	-0.37	0.59	-0.30	0.19	-0.45	0.36	0.24
" " " " g "	-0.25	0.09	---	-0.07	0.05	-0.02	0.08	0.06
Residual	-0.13	-0.12	-0.13	-0.09	-0.49	-0.20	0.55	-0.09
CHANGES IN M_2 DUE TO CHANGES IN HIGH-POWERED MONEY (B_t)	3.39	2.45	2.09	-2.59	6.37	6.92	4.54	3.72
Change in Central Bank's net foreign assets	2.02	1.58	-1.46	-4.29	-9.67	7.85	1.75	0.77
Change in Central Bank's net Credit to Government	-0.81	1.68	2.74	2.49	-5.95	-3.08	-2.69	4.23
Other changes	2.18	-0.81	0.81	-0.79	2.65	2.15	-3.60	-1.28
CHANGES IN MONEY SUPPLY (M_2)	2.17	1.13	1.90	0.03	7.21	6.30	-1.84	5.29

*The model on which these calculations are based is given in the Appendix to this Chapter.

Source: Calculated from data in Economic Review of the Bank of Sierra Leone Vol. 6, No. 4 (March 1972) Tables 4a and 4b.

that commercial firms, for various reasons including the fact that they have been excluded by law from the marketing of produce, do not bring in their own funds to the same extent as they did in the 1940's and 1950's and now rely on bank finance. This being the case, a higher level of local interest rates may not result in a severe drop in the demand for credit from these firms. Another factor which makes the local interest rates a relatively unimportant policy variable is the absence of a capital market. In the rudementary securities market that now exists, the main customers are the central bank, the commercial banks, and public corporations. The commercial banks will purchase government securities irrespective of the rate of interest, to fulfil their liquidity requirements. The central bank and public corporations, being government bodies, could be "persuaded" to buy these securities, while individuals buy them because there are few other outlets for investment funds. Consequently, the conclusion on the rate of interest is that its manipulation by the central bank may not produce the type of effects that are associated with the rate of interest in the economically more developed countries.

With respect to the currency ratio (c), we have noted in Chapter II that purchases of diamonds and agricultural produce are entirely cash transactions. Moreover cheques are not widely used in the settlement of debts, and because of low incomes, most wages and salaries are also received in cash. Hence the central bank is not likely to have much influence on the currency component of the money supply. Regarding government deposits these depend on the government, and as such the central bank cannot control the g-ratio. Nor does the central bank have much influence on borrowings by the commercial banks since borrowings are financed from their own head offices. Although the central bank can prohibit such borrowings this is unlikely as the country requires capital inflows. Only the liquidity ratio (r) is subjected to direct control by the central bank. The impact of this variable accounted for about 11% of the observed changes in the money supply during 1964 - 1970. On the whole, therefore, the central bank's influence on the money supply process is very limited indeed!

In contrast, in an economically advanced country, the monetary authority can influence the monetary multiplier as well as the monetary base. This is so because the central bank of a developed economy is the lender of last resort. Also, there exists in such countries well integrated money and capital markets which are highly sensitive to changes in the rate of interest. Consequently, through its interest rate policy the central bank can influence all the variables in the monetary multiplier. In the case of the monetary base (in the United States) it has been shown by Keran and Babb that it is primarily composed of the Federal Reserve holdings of government securities (adjusted for changes in reserve requirement).[10]

This variable was found to account for 73.5% of the monetary base in 1968 and is directly controllable by the Federal Reserve. But while other items of the monetary base are not directly controllable by the Federal Reserve, the Federal Reserve can influence these variables through variations in its holdings of government securities.[11]

Quite apart from the inability of the Bank of Sierra Leone to control the money supply there are other limitations on the effectiveness of traditional monetary policy in Sierra Leone. To begin with, one of the assumptions of the quantity theory of money is that prices are, in the main, determined within the economy and reflect the marginal cost of

10. See Michael W. Keran and Christopher T. Babb, "An Explanation of Federal Reserve Actions (1933 - 1968)," Federal Reserve Bank of ST. Louis Review (July, 1968), pp. 7 - 18.

11. To determine the indirect effect of the Federal Reserve actions on the non-controllable items, Keran and Babb ran a regression of changes in the controllable sources on changes of the non-controlled sources. They used seasonally adjusted monthly data for the period January, 1953 to December, 1968. Their results are statistically significant at the 5% level and the conclusion is that the Federal Reserve is able to take defensive action to offset the impact of the non-controllable items in the monetary base.
Ibid., p. 12.

production. In this situation, increasing the quantity of money without adding to the volume of goods and services would result in higher prices. Hence the emphasis on controlling the money supply. But we have already argued that prices in Sierra Leone are to a large extent determined by the costs of production in world markets for imports and exports and in consequence it is difficult to influence local prices to any significant extent through domestic policies.

Furthermore, in the traditional Keneysian income determination model, aggregate demand, and hence employment and output, can be stimulated by policy measures aimed at influencing investment on which it depends. In Sierra Leone, however, fluctuations in export receipts is the key variable and they depend on supply and demand conditions in world markets and on international agreements on quotas. In this situation attention has to be directed towards exports and/or the reduction of imports.

Also, because of the openness of the economy, the credit multiplier is quite small. In economically advanced countries the formula for deriving the credit multiplier is[12]

$$\frac{1}{\alpha + \beta} \Delta C$$

Where α is public's cash ratio
β is banks' cash ratio
ΔC is the change in the cash base

This would yield a multiplier of 3 and above for most economically advanced countries and above 5 for countries with a public cash ratio of 10% to 15%. The formula for an open underdeveloped economy like that of Sierra Leone is given as[13]

12. W.T. Newlyn, The Theory of Money (Oxford: At the Clarendon Press, 1971), Second edition, p.22.

13. W.T. Newlyn, Money in an African Context (Nairobi: The University Press, 1967), p. 126.

$$\frac{1}{\alpha + \beta + \left[M_e + \dfrac{m(1 + M_e)}{s + t + m} \right]} \Delta C$$

Where α & β are as defined above

Me	is the direct expenditure on imports
m	is the propensity to import
s	is the propensity to save
t	is the propensity to pay tax

This formulation takes account of the fact that since there are no capital goods industries a large part of any expenditure must be on imports and this is quite apart from the marginal propensity to import out of a given income. We substitute r for β (r is the required liquidity ratio) as this is a legal requirement. Substituting the appropriate values for Sierra Leone we obtain[14]

$$\frac{1}{.65 + .30 + \left[.40 + \dfrac{.32\ (.60)}{.04 + .14 + .32} \right]} \Delta C$$

$$= \quad 0.720 \Delta C$$

14. The estimates of the parameters were obtained as follows: (a) Public's cash ratio - the geometric mean of the ratios of currency in circulation to money supply; (b) liquidity ratio of commercial banks - 30% of total deposits, a legal requirement; (c) propensity to import, see Appendix I; (d) propensity to save - the geometric mean of the ratios of gross savings to disposable income. For savings data see Appendix I; (e) propensity to tax - the geometric mean of the ratios of tax revenue to GNP; (f) we assume that the direct expenditure on imports is 40%. This assumption is based on the findings of investment patterns in the mining sector. See Tony Killick and R.W. During "A Statistical Approach to the Balance of Payments of a Low Income Country," Journal of Development Studies, Vol. 5, No. 4 (July, 1968), pp. 274 - 278.

The credit multiplier is thus less than 1 and it would be smaller still depending on the size of the direct expenditure on imports. The small credit multiplier is due to the high propensity to import together with large direct expenditure on imports. What is important about the credit multiplier is not so much its small value but the fact that the variability of the leakages make prediction difficult. In addition, the implication of a high marginal propensity to import is that any inflationary pressure will be reflected in leakages into imports and consequent loss of external reserves rather than in domestic price increases. These leakages into imports are facilitated by the fact that credit has always been available for the export/import trade. This means that less emphasis should be placed on the problems of inflation as evidenced by price increases and attention should be concentrated on the level and flow of external reserves.

For traditional monetary management to be effective in a country such as Sierra Leone, the monetary authority must control the balance of payments as incomes and the liquidity of the economy are dependent on the balance of payments. As pointed out by Olankanpo,[15] the only controllable item of the balance of payments is imports. To the extent that policy measures are adopted to control imports, it should be possible to affect both the liquidity of the public and the banking system.

An instrument which has been suggested for this purpose is "Advanced Deposits on Imports."[16] Advanced deposits on imports reduce the ability of the public to spend while at the same time they restrict imports.

15. J.O.W. Olankanpo, "Monetary Management in Dependent Economies," Economica (N.S.)., Vol. 28 (1961), pp. 402 - 406.

16. J. Marshall, "Advanced Deposits on Imports," International Monetary Fund Staff Papers, Vol. 6 (1958), pp. 239 - 257, and E.A. Birnbaum and M.A. Qureshi, "Advanced Deposits Requirements for Imports," International Monetary Fund Staff Papers, Vol. 8 (1960), pp. 115 - 125.

The advanced deposits requirement may take a number of forms. The importer may be required to deposit with the central bank the full cost of imports in local currency or in a specified foreign currency. He may also be required to deposit a stated percentage of the total cost of the imports. In order to make the required deposits, the importer may either have to use his own resources or borrow from the banking system or the non-bank public. If the commercial banks and other financial institutions are prohibited from making loans for this purpose, then the importer has to depend on his own resources. He may have to disinvest and, depending on the extent of the disinvestment, incomes and total demand may decline. If the deposits are obtained from the non-bank public, the effect would be the same, the liquidity of the public will be reduced. The liquidity of the commercial banks will also decline if importers meet the deposits requirement from their deposit balances. In effect, the instrument of advanced deposits on imports has the ability of temporarily absorbing liquidity.

Since it has been argued that the commercial banks had excess liquidity during the 1960's, in those circumstances it is essential to prohibit bank loans for meeting the advanced deposits requirement. Another condition which is required for success is that the accumulated deposits must be completely frozen. This implies that if the deposits were originally made to the commercial banks such deposits should be transferred to the central bank or a 100% liquidity requirement imposed against such deposits. It also implies that the government, too, must not be able to expand its expenditure.

Another policy instrument which can be utilized is the manipulation of government deposits. Let us assume that government budgeted for a surplus during the period of export expansion. To stimulate investment during a recession such accumulated deposits can be transferred from the central bank to commercial banks which are ready to finance loans to sectors approved by the central bank. Alternatively, if the government deposits were previously with a commercial bank, such deposits can be transferred from that bank if its credit policy is not considered appropriate. Such manipulation of government deposits presupposes that the deposits are quite large. This has not been the case in Sierra Leone, and therefore the scope for such a policy is limited.

A third policy instrument which can be utilized is "special deposits". During a period of export expansion and when the commercial banks are gaining deposits, the central bank, through special deposits can prevent their increased liquidity being used as a basis for further credit expansion. These instruments if used successfully can increase the effectiveness of counter-cyclical monetary policy.

However, while recognizing the desirability of short-period stability this is relatively less important when compared to the long-run objective of development of the monetary and financial system.

(c) Monetary Management in the Sierra Leone Economy

Having shown that traditional monetary policy with its emphasis on the control of the money supply is inappropriate to the Sierra Leone situation, we now examine what monetary management should involve in such an economy. Here we shall make use of the results obtained by fitting the Polak Model to the Sierra Leone economy (See Appendix I).

One of the conclusions from the model is that an increase in domestic credit will result in a gradual depletion of external reserves to the full extent of the additional credit. We now show the dependence of credit creation on reserves. This amounts to estimating the time it takes for the income generated by the credit creation to be lost through imports (v) and the size of the import drain (m). Polak points out that it is not necessary to obtain the individual values of m and v as their joint value is quite adequate for the analysis. Where no national income figures are available he suggests that mv can be calculated as follows:

$$m.v. = \frac{M}{Y} \times \frac{Y}{M_1}$$

where M_1 is the money supply

M is import

$$\text{thus} \quad m.v. = \frac{M}{M_1}$$

From Table AP.XI m is 0.32 (average 1963 - 1970) and v is 9.4 (average 1963 - 1970).

His tables of sample pairs of mv with m ranging between 0.10 and 0.50.

and v between 2 and 10 show that with v = 9 and for any values of m = 0.20 about 55% of the import effect occurs in the first year. But the actual co-efficient for the first year for Sierra Leone is 0.70. Thus 70% of any credit creation leaks into imports within the first year and the entire credit creation is absorbed into imports in three years.[18]

As domestic credit leaks out of the economy within three years, the central bank has two fundamental responsibilities as regards monetary management. First, it must be able to determine in advance the level of reserve loss that will cause the minimum of external pressures. Second, it must ensure that the available credit is used productively. But the central bank must not only be concerned with the allocation of available credit, it must also assist in the mobilization of additional domestic savings.

(i) The Level of Reserves

We have argued in the previous chapter that the level of reserves was excessive during the 1960's and that it could be reduced. Suppose it was decided to reduce it to Le 20 million. Given the level of international reserves at the end of 1970, which was Le 29.2 million,

18. The following extract from Polak's Table is relevant with respect to the Sierra Leone economy:

CO-EFFICIENTS FOR Q(0), Q (-1), Q(-11) and Q(-III) IN THE DETERMINATION OF M(0)

Velocity v	Import ratio m	Q(0)	Q(-I)	Q(-II)	Q(-III)
9	0.30	0.67	0.30	0.03	0.00
	0.35	0.70	0.28	0.02	0.00

J.J. Polak, and Lorette Boissonneault, "Monetary Analysis of Income and Imports and its Statistical Application," International Monetary Fund Staff Papers, Vol. 8 (1959/60), Table 3, p. 359.

this would mean that about Le 9 million would be available for financing development. But for the reserves to show this decline, domestic credit could rise to Le 11 million (based on our previous calculation of a 73% loss during the first year). This however is only one limiting case since such large excess reserves are not likely to be always available.

Aside from a situation of large excess reserves it is possible to determine the "safe" level of monetary expansion. A suggestion for determining the desirable monetary expansion has been given by Ezekiel.[19] His model takes into account the growth in real income, the proportion of income people are willing to hold in the form of money, inventory expansion, and growth in international reserves.

Substituting appropriate Sierra Leone data in Ezekiel's formula we obtain:

k_{t-1} = 0.10

a = 0.001

b_t = 0.02

e = 0.065

g = 0.01

c = 3.5

Excluding provision for growth in reserves (because reserves have not been a constraint in the case of Sierra Leone) we calculated the permissible

19. The expression for determining the permissible monetary expansion is given as:

$$\frac{k_{t-1}\left(1+a+\frac{a}{b_t}\right) - (e+g)}{c\,(1+b_t)}$$

Where

k is the initial proportion of income held in money;
a is the annual rate of change in k;
b_t is the annual rate of increase in real income;
e is the proportion of foreign reserves in income;
g is the proportion of inventories to income;
c is the incremental capital/output ratio.

Hannan Ezekiel, "Monetary Expansion and Economic Development," International Monetary Fund Staff Papers, Vol. 14 (1967), pp. 82 - 86.

level of monetary expansion as follows:[20]

$$\frac{0.10\left(1 + 0.001 + \frac{0.001}{0.02}\right) - 0.01}{3.5\,(1 + 0.02)}$$

$$= \frac{0.0951}{3.570}$$

$$= \underline{0.026} \qquad \text{that is, about } 3\%$$

The calculation thus reveals that the money supply in 1970 could have expanded by about 3% in contrast to a decline of about 7%.[21]

By calculating the order of magnitude of the level of domestic credit expansion that will cause the minimum external pressure, monetary policy can be geared to more objective criteria.

20. For GNP figures, 1963/64 = 1963.

k_{t-1} - the ratio of money (currency in circulation to demand deposits) to GNP, in 1969;
a - the average of the change in the money/GNP ratio for the years 1963 - 1969;
b_t - calculated from Table 4 in Central Statistics Office, Sierra Leone's National Account (Freetown: Government Printer, June, 1970;
e - the ratio of external reserves to GNP (average for the years 1963 - 1969). See Table 7.V for figures on External Reserves;
g - calculated from Table 5 in Central Statistics Office, Sierra Leone's National Accounts (Freetown: Government Printer, June, 1970);
c - calculated from Table 4 in Central Statistics Office, Sierra Leone's National Accounts (Freetown: Government Printer, June, 1970).

21. An alternative method of arriving at the permissible credit expansion involves the preparation of hypothetical sectoral balance sheets for each of the major sectors of the economy. The impact of each of these sectors on the balance of payments is then assessed, and through appropriate modifications it is possible to arrive at a combination of sectoral expenditures that will produce the minimum pressure on the balance of payments. For the preparation of such balance sheets see Harold M. Knight, "A Monetary Budget," International Monetary Fund Staff Papers, Vol. 7 (1959/60), pp. 210 - 223 and
Graeme S. Dorrance, "A Framework for the Determination of Central Banking Policy," International Monetary Fund Staff Papers, Vol. 17 (1970), pp. 226 - 244.

(ii) Direction of Credit

Having determined the amount of credit that is likely to cause the minimum amount of external disturbance, the central bank's task would then be to distribute the available credit amongst competing sectors. And since 70% of this credit will leak out of the economy within a year, the quality of the investment must be the criterion on which the available credit would have to be distributed.

But suppose that the government insists on a budget deficit which is as large as the available credit. Two consequences must follow from this if external balance is not to be seriously distorted. The first implication is that credit to the private sector must remain at their previous level. Second, since some of the expenditure resulting from the use of the credit may flow to the banks, the central bank would have to ensure that additional deposits are not made the basis of expansion in lending by the commercial banks.

There is also the possibility that the government's budget deficit may exceed the amount of credit that is considered safe. Assuming that the government is unwilling to reduce this deficit, then the central bank, in order to avoid serious external problems, would have to achieve a reduction in credit in the private sector. In this case, not only must there be no secondary expansion resulting from the increase in bank deposits, but also, the previous level of loans has to be reduced to achieve a net contraction to compensate for the larger budget deficit.[22]

Since we hav assumed so far that the available credit goes entirely to the government, a major problem for the central bankconcerns

22. Policy measures which may achieve this result include special deposits and raising the reserve requirements of commercial banks. On reserve requirement, a number of suggestions exist as to how to arrive at the appropriate ratios. See Richard Goode and R.S. Thorn, "Variable Reserve Requirement Against Commercial Bank Deposits," International Monetary Fund Staff Papers, Vol. 7 (1959), pp. 9 - 43; and Dorrance, op. cit., pp.215-245.

the type of investment that the government undertakes. To ensure that investment by the government increases the productive capacity of the economy, the central bank would have to convince the government about the desirability of tying long-term government securities to specific projects. This proposition is in order to ensure that the resources made available to the government are not merely used to increase consumption expenditure. Such a proposal also makes it relatively easier to service the debt. Alternatively, resources acquired by the sale of government stocks can be directed to institutions such as the National Development Bank which is likely to invest such funds productively. The experience during the 1966/67 financial crisis suggests that the government would endeavour to heed the advice of the central bank. During that crisis, the government had to secure the services of the International Monetary Fund which in turn specified a number of conditions for its assistance. The constant reminder of this possibility is likely to persuade the government of the need for a higher proportion of productive investment in its investment programme in the future.

Thus far, we have considered the case of the available credit being absorbed by the government. We now examine the possibility of some of this credit being available for the private sector. In Appendix II we emphasize the desirability of the flow of financial resources to the agricultural and small-scale industries sectors. We also point out in that Appendix that farmers and small-scale businessmen have been unable to obtain their credit requirements from institutional sources and suggest that a specialized institution providing credit and other ancillary services is required to deal with the special problems of the agricultural sector. The central bank's role in this respect is to assist in the establishment of such an institution by participating in its share capital and subsequently to ensure that financial resources flow to this institution once it has been established.

Conclusion

We have seen that the influence of the central bank on the variables affecting the money supply is very small, so that a policy objective which emphasizes the control of the money supply is likely to be of limited practical usefulness.

Given the underdeveloped nature of the economy in general and the financial institutions in particular, monetary management must concentrate on the development of the financial system so as to enable the system to mobilize more domestic financial resources for development. At the same time, the drains through imports and the effects of these on the external reserves require a prior assessment by the central bank of the effects of various levels of expenditure on external reserves. Such an analysis would indicate the extent of possible reserves loss that the economy can withstand. Policy measures can then ensure that the available credit is utilized productively.

In sum, monetary management for the Sierra Leone economy must involve the management of the level and flow of external reserves and the direction of available credit for productive investment.

APPENDIX TO CHAPTER VIII

MODEL FOR THE ANALYSIS OF CHANGES IN THE MONEY SUPPLY (M_2)

This appendix gives the model on which our analysis of changes in the money supply is based. The model is as follows:

$$M_2 = Z_t + D_t \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (1)$$

$$B_t = Z_t + R_t + D_p \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (2)$$

$$Z_t = cM_2 \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (3)$$

$$R_t = bL_t \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (4)$$

$$L_t = r(D_t + D_g - D_p) \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (5)$$

$$D_p = aD_d \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (6)$$

$$D_g = g(D_d - D_p) \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (7)$$

$$D_t = D_d + QM_t \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (8)$$

$$QM_t = tD_t \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (9)$$

Where

M_2 is the money supply;

Z_t is currency in the hands of the public (currency in circulation);

D_t is total deposits of the private sector at the commercial banks;

R_t is the cash reserves of the commercial banks;

D_p is the private sector's deposits with the central bank;

D_g is the deposits of the government with the commercial banks;

L_t is total liquid assets of the commercial banks;

QM_t is savings and time deposits;

D_d is demand deposits

B_t is high-powered money;

and sub-script (t) is the time period.

From the model the monetary multiplier (n_t) becomes:

$$n_t = \frac{1}{c + (1-c)\left[br + (1-t)\left\{a + brg(1-a) - abr\right\}\right]}$$

where

- a is the ratio of the private sector deposits with the central bank to demand deposits;
- b is the ratio of reserves to liquid assets of commercial banks;
- c is the ratio of currency in circulation to money supply;
- g is the ratio of government deposits with the commercial banks to the banks' demand deposits;
- r is the ratio of liquid assets to deposit liabilities of commercial banks;
- and t is the ratio of savings and time deposits to total deposits.

As the money supply is the product of the monetary multiplier and high-powered money we have:

$$M_2 = n_t B_t \qquad (10)$$

The monetary multiplier was derived as follows:

From the model we have

$$D_d = D_t - QM_t = (1-t)D_t \quad \text{from (8) and (9)}$$

$$\text{and } D_t = (1-c)M_2 \quad \text{from (1) and (3)}$$

Also we have $D_g = g(1-a)D_d = g(1-a)(1-t)D_t = g(1-a)(1-t)(1-c)M_2$

and $D_p = a(1-t)D_t = a(1-t)(1-c)M_2$

Hence $L_t = r\left[1 + g(1-a)(1-t) - a(1-t)\right]D_t$

$= r\left[1 + g(1-a)(1-t) - a(1-t)\right](1-c)M_2$

Therefore $R_t = br\left[1 + g(1-a)(1-t) - a(1-t)\right](1-c)M_2$

From the identity $Z_t + R_t + D_p = B_t$ we have

$$cM_2 + br\left[1 + g(1-a)(1-t) - a(1-t)\right](1-c)M_2 + a(1-t)(1-c)M_2 = B_t$$

Therefore

$$M_2 = \frac{B_t}{c + (1-c)\left[br + (1-t)\left\{a + brg\ (1-a) - abr\right\}\right]}$$

On calculating[22]

$$\frac{\partial n_t}{\partial c}, \frac{\partial n_t}{\partial r}, \frac{\partial n_t}{\partial b}, \frac{\partial n_t}{\partial t}, \frac{\partial n_t}{\partial a}, \text{ and } \frac{\partial n_t}{\partial g},$$

we obtain the impact of each of the ratios on n_t.

The results of the calculations are as follows:

Changes in n_t due to change in c $= -B_t n_t^2 \left[1-br - (1-t)\left\{a + brg(1-a) - abr\right\}\right]\Delta c$

Changes in n_t due to change in r

$$= -B_t n_t^2\ b(1-c)\left[1- (1-t)\ \left\{a - g\ (1-a)\right\}\right]\Delta r$$

Changes in n_t due to change in b

$$= -B_t n_t^2\ r(1-c)\ \left[1 - (1-t)\ \left\{a - g(1-a)\right\}\right]\Delta\ b$$

Changes in n_t due to change in t

$$= B_t n_t^2\ (1-c)\ \left[a + brg\ (1-a) - abr\right]\Delta t$$

22. Note on the differentiation:

Let $y_t = f(X_i)$ and let $B_t n_t = \dfrac{B_t}{f(X_i)} = \dfrac{B_t}{Y_t}$

$$\therefore\quad B_t \frac{dn_t}{dX_i} = -B_t \frac{\frac{dY_t}{dX_i}}{Y_t^2} = -n_t^2 B_t \frac{dY_t}{dX_i}$$

Changes in n_t due to change in a

$$= -B_t n_t^2 (1-c)(1-t)\ 1-br\ (1-g)\ \Delta a$$

Changes in n_t due to change in g

$$= -B_t n_t^2\ br(1-t)(1-c)(1-a)\Delta g$$

Changes in the money supply (M_2) due to changes in the monetary multiplier (n_t) $\quad = \quad B_t \Delta n_t$

Changes in the money supply (M_2) due to changes in the monetary base (B_t) $\quad = \quad n_{t-1} \Delta B_t$

Table 8A.I gives the monetary data on which the calculations are based. Table 8A.II shows the ratios obtained for each of the variables in the monetary multiplier.

TABLE 8A.I MONETARY DATA, 1963-1970

(Le million)

		1963	1964	1965	1966	1967	1968	1969	1970
Money Supply	M_2	25.66	27.83	28.96	30.86	30.89	38.10	44.40	42.56
Monetary Base	B_t	14.63	16.56	18.02	19.32	17.70	21.35	25.23	22.65
Currency in Circulation	Z_t	12.92	13.42	14.19	14.48	14.36	17.85	20.22	18.86
Cash Reserves of Commercial Bank	R_t	1.71	2.78	3.20	4.69	2.98	3.21	4.35	3.41
Private Sector Demand Deposits with Commercial Banks	D_p	--	0.36	0.63	0.15	0.36	0.29	0.66	0.38
Deposit Component of the Money Supply	D_t	12.74	14.41	14.77	16.38	16.53	20.25	24.18	23.69
Demand Deposits	D_d	7.26	7.48	6.91	7.44	7.43	8.67	10.17	9.35
Savings and Time Deposits	QM_t	5.48	6.93	7.86	8.94	9.10	11.58	14.01	14.34
Total Liquid Assets of Commercial Banks	L_t	1.88	4.15	4.02	6.54	6.03	9.29	8.80	8.69
Total Deposits with Commercial Banks	$[D_t+D_d-D_p]$	12.74	14.85	14.58	16.74	16.88	20.56	24.26	23.70
Private Sector Demand Deposits with commercial Banks	(D_d-D_p)	7.26	7.12	6.28	7.29	7.07	8.38	9.51	8.97
Government Demand deposits with Commercial Banks	D_g	--	0.80	0.44	0.50	0.71	0.60	0.74	0.39

Source: Adapted from data in <u>Economic Review of the Bank of Sierra Leone</u>, Vol. 6, No. 4 (March 1972), Tables 4a and 5.

TABLE 8A.II MONETARY RATIOS, 1963-1970

		1963	1964	1965	1966	1967	1968	1969	1970
The Ratio of the Private Sector deposits with the Central bank to Demand Deposits $\frac{D_p}{D_d}$	a	—	0.0481	0.0912	0.0202	0.0484	0.0334	0.0649	0.0435
The Ratio of Reserves to Liquid Assets of Commercial Banks $\frac{R_t}{L_t}$	b	0.9096	0.6699	0.7960	0.7171	0.4942	0.3455	0.4943	0.3924
The Ratio of Currency in Circulation to Money Supply $\frac{Z_t}{M_2}$	c	0.5035	0.4822	0.4900	0.4692	0.4649	0.4685	0.4554	0.4431
The Ratio of Government Deposits with the commercial banks to the banks' Demand Deposits $\frac{D_g}{D_d-D_p}$	g	—	0.1124	0.0701	0.0699	0.1004	0.0716	0.0778	0.0435
The Ratio of Liquid Assets to Deposit Liabilities of Commercial Banks $\frac{L_t}{(D_t+D_g-D_p)}$	r	0.1476	0.2795	0.2757	0.3907	0.3572	0.4518	0.3627	0.3667
The Ratio of Savings and Time Deposits to Total Deposits of Commercial Banks $\frac{Q_{1t}}{D_t}$	t	0.4301	0.4809	0.5322	0.5458	0.5505	0.5718	0.5794	0.6053

Source: Calculated from data in Table 8A.I

CHAPTER IX

PROPOSALS FOR THE MOBILIZATION AND EFFICIENT UTILIZATION OF VOLUNTARY DOMESTIC SAVINGS

In the previous chapters we have examined the sources and uses of funds available to financial institutions in Sierra Leone and indicated that although these institutions have succeeded in mobilizing voluntary domestic savings, there is much scope for the mobilization of additional domestic resources. The first section emphasizes the importance of mobilizing voluntary domestic savings. Section (b) examines measures which may result in more domestic savings flowing through financial institutions. In section (c) we discuss institutional reforms which are essential for the efficient utilization of the resources available to financial institutions. The final section considers the extent to which the proposals discussed in the preceding sections may require legislative changes.

(a) <u>The Importance of Domestic Savings</u>

The relative significance of voluntary domestic savings can be seen by examining the other sources of development capital. These sources can broadly be classified into domestic and foreign.

Foreign savings include official loans and grants and foreign private investments. It was shown in Chapter VII that foreign savings were an important source of development capital in the past but that there has been significant reductions in these inflows during the 1960's. Because of the debt re-payment burden, the problem of financing the local costs of loans and grants, and the changing attitude towards foreign aid, it may not be realistic to rely exclusively on foreign loans and grants for development. A slow-down in the rate of foreign private investment was also observed. And as action is taken to give the government more control over the economy (for example, the acquisition of majority interest in foreign enterprises) it may be difficult to attract foreign private capital on the scale required for development. These uncertainties concerning foreign savings therefore suggest that increasing reliance must be placed on domestic sources. These domestic sources include transfers from the budget and transfers from public sector enterprises.[1]

Transfers from public sector enterprises is a possible source of domestic capital for development. Table 9.I gives detailed information on transfers to the government from public corporations and government departments during the years 1960/61 to 1969/70. These transfers increased from Le 1.8 million in 1960/61 to Le 4.2 million by 1962/63. Since 1963/64 transfers to the government declined substantially and were as low as

1. The use of foreign assets may be another source of development capital. It was shown in Chapter VII that the international reserves held by the Bank of Sierra Leone could be reduced by approximately 30%. However, we also argued that this is a once and for all windfall which is not available on a continuing basis. Once this reduction has taken place, development capital cannot be expected from this source until the reserves have again become excessive.

TABLE 9.I TRANSFERS TO GOVERNMENT REVENUE FROM PUBLIC CORPORATIONS AND GOVERNMENT DEPARTMENTS, 1960/61 - 1969/70

(Le 000)

	1960/61	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70
Electricity	1,010	1,192	1,285	1,460	486	150	25	--	6	60
Posts and Telecommunications	425	612	600	895	1,023	1,111	--	--	1,147	1,260
Rice Department	--	140	133	45	221	--	--	--	--	--
Forest Industries	--	524	646	481	676	22	--	--	--	--
Port and Marine	374	--	1,568	250	609	68	--	--	--	164
Bank of Sierra Leone	--	--	--	--	--	228	206	170	331	726
Sierra Leone External Communications	--	--	--	--	--	10	18	--	19	27
Road Transport Corporation	--	--	--	--	--	--	--	--	--	--
Sierra Leone Investments	--	--	--	--	--	--	4	--	--	--
Sierra Leone Airways	--	--	--	--	--	--	3	--	--	--
Dominco Dividend	--	--	--	--	--	--	--	--	--	--
TOTALS	1,809	2,468	4,232	3,131	2,815	1,589	256	170	1,503	2,237

Source: Ministry of Finance, Financial Reports (Annual, 1960/61 to 1967/68)
Figures for 1968/69 and 1969/70 are from Estimates of Revenue and Expenditure.

Le 0.2 million in 1967/68. Even with improvements in 1968/69 and 1969/70, by 1969/70 transfers were only Le 0.4 million higher than what they had been in 1960/61. While these corporations and departments are providing some development finance, on the basis of their performances during the 1960's too much reliance cannot be placed on them, partly because of their own internal capital requirement and partly also because some of the corporations have incurred losses in recent years.

Another possible source of development capital is transfers from the budget. We show in Appendix I that during the period 1960/61 to 1969/70 expenditure grew faster than revenue. The overall budget deficits during the 1960's were as follows:

(Le million)

1960/61	1961/2	1962/3	1963/4	1964/5	1965/6	1966/7	1967/8	1968/9	1969/70
-6,471	-9,044	-5,853	-4,359	-7,371	-11,165	-918	-6,866	+4,428	-4,428

Not only was the period characterized by large budget deficits but, as pointed out in Chapter VII, capital expenditure as a percentage of total expenditure and GNP declined during the 1960's. A relative decline in the government's share of capital formation was also observed. To the extent that it is possible to get government to reduce its current expenditure, it may be possible to increase the proportion available for directly productive investment. However, it may be difficult in practice to achieve such a reduction. Expenditure on overseas missions, for example, can be used to illustrate this problem. Such expenditure was less than Le 0.1 million in 1963 but by 1970, it exceeded Le 3 million due to extension of some embassies and the opening up of additional embassies and consulates. On purely economic grounds, one could question the necessity of a small country having many foreign missions. The same is true of conferences abroad, the size of general administration and especially defence. Yet, it is in such areas that the economic arguments are usually not convincing to the politicians. Hence, the most that can be expected are marginal reductions in current expenditure.

But while it may be difficult to reduce the level of current expenditure, more resources can be made available through raising taxes. During the period 1963/64 to 1969/70 (the years for which GNP figures are available) tax revenue as a percentage of GNP averaged 14%. To increase the tax effort to about 20% of GNP, however, requires considerable improvements in the tax administration and tax collection machinery. In addition, it may be necessary to adopt more vigorous measures to enforce payments. In 1969/70 the following measures were introduced to enforce the payment of taxes: (a) An Income Tax Clearance Act, which requires persons intending to leave the country to obtain a tax clearance certificate; (b) doubling of the staff of the Income Tax Department; and (c) the establishment of tax collection offices in the provinces. In spite of these measures, the Minister of Finance in his 1971/72 Budget Statement estimated uncollected income tax at about 50% of the development expenditure for 1970/71.

Through the PAYE system, taxes of most people are deducted at source. Hence, the uncollected taxes are mostly in respect of businessmen, professionals and politicians. Through more vigorous action, it may be possible to get some of these people to pay their tax liabilities. But at the same time, one must recognize that some may continue to evade their tax responsibilities. Hence, while it can be argued that more development capital can be raised through taxation, the difficulties connected with collecting such taxes should not be overlooked.

Since we have argued that the government budget and public sector enterprises are not likely to generate sufficient resources for economic development attention has to be directed to alternative sources of development capital. The only other alternative source is through the mobilization of voluntary domestic savings. Consequently, the financing of economic development must rely primarily on this source.

(b) Policy Measures for the Mobilization of Voluntary Domestic Savings

Those with savings may decide to hold financial assets, real assets or make loans to those requiring funds especially in the unorganized sector. As economic development is aided by channelling savings through financial institutions, the question which therefore arises is what incentives may be required to increase the flow of domestic savings through these institutions? To devise the most appropriate incentives presupposes knowledge of the motives which influence people to save. These factors include the need for security, the desire for self improvement, anticipated future consumption, financial prudence and the opportunity of increasing earnings.[2]

(i) Incentives to Savers

For most people the primary motive for saving is the security motive, that is, the desire to finance predictable long-term needs. For example, some save so as to make adequate provision for their old age or for sickness. Others may want to acquire their own homes. The security motive for saving is quite important in a country such as Sierra Leone where there are no officially sponsored social security arrangements.

Another motive for saving is what Keynes refers to as "a common instinct to look forward to a gradually improving standard of life."[3] This may be significant in Sierra Leone because the standard of living is very low. The desire for self improvement leads people to save for the education of their children or to enable them to acquire some skills which will improve their earning potential.

For some people, the main reason for saving is to enable them to acquire a durable consumer good. Also, occasions such as marriages,

2. For a general treatment of the factors affecting savings (or the counterpart, consumption) see G. Ackley, Macroeconomic Theory, (New York: The Macmillan Company, 1961) Chaps. 10 - 12.

3. Keynes, op. cit., p. 108.

the birth of a child, intitiation into exclusive societies or the death of an elder are occasions for special ceremonies. People save for such anticipated expenditure.

The motive of financial prudence mainly affects enterprises. Businesses save so as to provide for the future replacement of equipment. They also save to ensure the availability of liquid resources for emergencies. Furthermore, the retained profits of businesses have been one of the main sources of finance for the expansion of enterprises. In the case of small-scale businessmen and farmers, an added reason for saving is the knowledge that they are not likely to secure financial accommodation from financial institutions.

Finally, there are those who save because of the returns on savings. We suggested in Chapter VI that resources flow into the unorganized sector because of the high rates of interest which can be obtained in that sector. People may be induced to save to take advantage of the higher interest rates to be earned in that sector.

From the foregoing discussion it can be deduced that those who can be persuaded to make use of financial institutions are those whose savings currently flow into the unorganized sector and those whose saving decisions are influenced by the security motive or the desire for self improvement. Such savers seek to hold long-term financial assets because such assets ensure the growth of their income and provide a ready conversion into cash in case of emergency. For these people, the rate of interest is an important incentive. For the rate of interest to be a significant inducement for people to hold their savings in the form of financial assets as opposed to physical assets or other forms of holding savings, the interest rate policy cannot ignore the increase in prices in recent years, the rates of interest payable on other financial investment as well as the rates that could be obtained outside the country.

Between 1966 and 1968, the rate of interest on Treasury bills in Sierra Lèone was 6% and since March, 1969, the rate of interest has been 5½%. During the 1960's, time deposits at commercial banks earned interest of 5%, while the rate on savings deposits was 4%. On the other hand, with the British Bank Rate at 7½% during 1969/70, investment in London could fetch at least 8½% whereas the rate of interest on Sierra Leone Government stocks ranged between 5½% and 6½%. Only one stock has been issued at 7%. To encourage the holding of long-term financial assets more attractive rates of interest are required.[4]

One difficulty about ensuring that the rate of interest reflects the scarcity of capital funds is the fact that such a policy would raise the cost of government borrowing. However, because the rate of interest has been low, the holders of government securities have, in the main, been government and semi-government bodies, and the commercial banks. But if the rate of interest is sufficiently attractive, then it should be possible to have wider participation. Therefore, while the cost of borrowing for the government may rise in the short run, the long term effect would be the increased ability of the government to borrow more from the general public.

Incentives to savers may also take the form of bonuses. The bonus might take the form of lottery. Another form of bonus is a scheme which entitles the saver to borrow after saving regularly over a specified period. One such scheme, in operation in Denmark, entitles the saver after saving regularly for twelve months to receive a loan equalling the amount saved, after two years savings, twice the amount saved, and so on.[5] This

4. An example of a successful interest rate policy in mobilizing domestic savings is provided by the experience of South East Asia. See Delano P. Villanueva, "A Survey of Financial System and the Saving-Investment Process in Korea and the Philippines", Finance and Development, Vol. 8, No. 2 (June, 1971), pp. 16-19, and Anand G. Chandvarkar, "Some Aspects of Interest Rates Policies in Less Developed Economies; The Experience of Selected Asian Countries," International Monetary Fund Staff Papers, Vol. 18 (1971), pp. 48-110. One device which has been used to protect the returns from savings against inflation is known as indexing or value linking. Under this policy the interest to be paid on a bond or the nominal value of the bond or both are linked to the cost of living index or any other appropriately designed index. See Sanjaya Lall, "Countering Inflation: The Role of Value Linking," Finance and Development, Vol. 6, No. 2 (June, 1969), pp. 10 - 15.

5. United Nations, Report of the International Seminar on the Mobilization of Personal Savings in Developing Countries (Stockholm, Sweden 2 - 11 August, 1971), p. 30.

would be more appropriate for encouraging the small saver to leave his savings with the financial institution for a longer period than he normally would.

Incentives can take the form of tax concessions. Here, the government indirectly increases the returns on savings by exempting from direct taxation either some groups of savers or certain types of savings. For example, at present, earnings from Treasury bills investment are tax exempt, and this facility could be extended to government stocks.

Specifically, with respect to rural savings, a provision of lending facilities is a crucial element in any major successful mobilization scheme. This is so because, as we have seen, people in the rural areas are generally unable to borrow from the organized financial institutions and therefore they do not see the advantage to them of depositing their surplus savings with these institutions. Also, to the extent that people in rural areas can see direct results from the use of their savings they are likely to increase the volume of savings. This possibility exists because, in most of these areas there has been virtually no significant development over several years. If somehow the savings are linked with a specific project or projects in the rural areas the people in those areas see a positive result and they may be more willing to save through financial institutions.

(ii) Publicity Campaigns

The previous section has been concerned with diverting existing savings through financial institutions, but there is evidence to suggest that the volume of savings can actually be raised. Per capita income, which was Le 83.3 in 1963/64, rose to Le 109.2 in 1969/70 (in current prices). This income, though low, was higher than the per capita income in some other underdeveloped countries.[6] It should be noted that during

6. United Nations, Year Book of National Accounts Statistics 1971 (New York: United Nations, 1973), Vol. III, Table 1b, pp. 8 - 12.

1964/65 and 1968/69 per capita real income increased by about 5% and when such an increase in income occurs one would expect a part to be saved.

Aside from the size of income, its distribution may affect the volume of savings. Sierra Leone's very long history of university education has resulted in a large group of professionals (relative to other underdeveloped countries of similar size). Since professionals and those in the middle income category tend to save more, this income distribution should enhance the country's savings potential.

The form in which savings are held can have a considerable impact on saving habits. In the rural areas, for example, savings are held in the form of physical assets. To the extent that a switch to financial assets is made the amount of savings may be expected to be stimulated since as people become more aware of the advantages of holding financial assets they are likely to attempt to increase their savings. As a United Nations Report observes people " ...... would save more if there were better savings institutions ...... if these institutions were more widespread, and if more persons were employed by governments to organize them, and to urge people to save."[7]

The first step in the process of getting people to save more is to make them aware of the benefits to be derived from saving. This calls for a properly planned publicity campaign, but to be successful such a campaign must be based on an analysis of the motives that prompt people to save and the factors which inhibit holdings of financial assets. The objective of the campaign would be to eliminate the hidden fears and misconceptions which people have, especially about financial institutions. Equally important, the campaign must lay emphasis on the advantages both to the individual saver and the country. An example of this is one of the slogans used sometime ago by the Sierra Leone State Lottery, which amounted

7. United Nations, Measures for the Economic Development of Underdeveloped Countries (New York: United Nations, 1951), p. 36. See also Arthur Lewis, The Theory of Economic Growth (London: George Allen and Unwin Ltd., 1955), p. 229.

to saying: "You have a chance to win Le 1, 000; the proceeds contribute to the building of a hospital." In other words, people must be made to see the positive consequences of increased savings.[8]

Since such campaigns must aim at reaching as large an audience as is possible, the regular market days afford an appropriate opportunity for a savings drive. Broadcasting time could also be allocated for such campaigns. In addition, the usual advertising channels can be made use of, that is, in cinemas, newspapers and outdoor publicity posters.[9]

An experience during the second world war is suggestive in this connection. The Post Office Savings bank organized a savings drive which culminated each year in a "Victory Savings Week". This campaign resulted in a considerable expansion in the level of Post Office Savings bank deposits.[10]

8. In some countries, especially in Latin America, they have attempted to convey the idea that the savings institutions are in fact owned by the people, the objective being to encourage them to patronize such institutions calling them "bancos populares" or "peoples banks".

9. For example, one form which these savings campaigns took was by means of a side film on the activities of the Swaziland Credit and Savings Bank and this was shown at the Agricultural Show of that country.

10. N.A. Cox-George, Finance and Development in West Africa: The Sierra Leone Experience, op.cit., p. 257. "Apart from the general and continuous growth in Post Office Savings bank deposits throughout the war years the result of these campaigns show:

1941	(V. S. W.)	Le 31,600	saved
1942	"	90,480	"
1943	"	84,000	"
1944	"	101,600	"

the average weekly savings pre-war being Le 278 net."

While efforts are concentrated on the mobilization of available resources in the urban and rural areas, special attempts should be made to develop the savings habit amongst the young so that when they become adults or their income increases they will be able to save naturally. In fact, through the young, parents may become convinced about the advantages of saving. Several such savings schemes are already in existence in many parts of the world. Australia for example, observes a "Youth Savings Week" during the last week in October. During that week children are taken to savings banks to deposit their own savings. The savings banks not only use the opportunity to familiarize their visitors with the work of the banks but they also organize several social activities for the children. Sweden has a scheme under which young persons between the ages of 16 and 25 undertake to save 10% of their salary regularly. The amount is deducted on each pay day and paid into a special wage-savings account and no withdrawal, except in cases of extreme emergency, is possible until the participant is 25. Egypt encourages savings amongst school children. In this case, the children deposit an agreed small amount regularly. These are collected by the teachers, and once a month, the officials of the savings banks collect the deposits from each school. However, these and similar schemes may only increase the volume of future savings.

(iii) Instruments and Institutions for the Mobilization of Voluntary Domestic Savings

The main instrument which can be used to mobilize savings for long-term investment is through the issue of government stocks. As the emphasis is on long term finance, maturity of such stocks should vary between five and ten years since it will be extremely difficult to convince people who have not been accustomed to holding such securities to hold stocks with maturities exceeding ten years. One factor which can influence the public's participation in these issues is the ability of the government to service the debt. If the funds mobilized are tied to viable projects such loans will be self-financing and there should be no problems. But if the resources made available to the government through the sale of securities merely increase the government's current expenditures, then there will be difficulties in servicing the debt. It is essential therefore that a larger proportion of resources mobilized through the issue of stocks should be invested productively.

Through the issue of premium bonds it should be possible to attract the savings of the small investor. A 50 cents premium development bond repayable after say, five years, can be issued for the purpose. To encourage participation, it can incorporate the lottery element. This implies that each premium bond becomes eligible for a draw either once or twice a year. In this regard, the progress of the State Lottery suggests that such a scheme could succeed.

Investment funds can also be mobilized through the development of a market for equities. There are three possible approaches. To begin with, the government is a shareholder in a number of manufacturing companies. A start in the development of such a market can be made by government selling its holdings to the public. With such sales to the public, resources become available immediately for economic development. Also, we have noted that some foreign companies have sold some of their shares to the Sierra Leone public. It is quite possible to persuade others to do the same. The difficulty here, however, is that the resources released to the firms may be invested abroad. But with exchange control (discussed in Chapter VII) such funds will be retained in the economy. Resources can also be mobilized by the encouragement of small enterprises to form joint stock companies.

Through the establishment of a national provident fund, additional resources can be raised for development. Such a fund should not only embrace existing pension, provident and superannuation funds discussed in Chapter V but also, extended to include all workers. Let us assume that the scheme embraces all workers in establishments employing six or more workers, that is, all firms, companies, public corporations and institutions now making regular returns to the Labour Division of the Ministry of Lands Mines and Labour. Estimated wages and salaries paid by employing bodies employing twenty persons and over was Le 20 million at the end of 1970. If we assume that employers and employees each contribute 5%, the total contribution will amount to Le 2 million. The suggested 5% contribution is quite realistic since contributions under existing schemes exceed this percentage.

Closely associated with the types of instruments is the institution that will be the most appropriate medium for the mobilization of domestic savings. Three possible alternatives can be considered. The various stocks and bonds can be issued by the Bank of Sierra Leone. If this is done, the amounts mobilized can be paid into the Development Credit Fund discussed in Chapter II. There are several advantages here. In the first place the size of the Fund would no longer be limited by what the Bank is able to make available from its own resources. Secondly, because of the Bank's reputation in the country, its stocks are likely to be preferred to government stocks. Thirdly, there may be no difficulties about rediscounting these stocks at the Bank. Fourthly, this access to additional resources increases the Bank's ability to influence the system directly. The resources mobilized can then be made available to institutions such as the National Development Bank or the Agricultural and Co-operative Development Bank (discussed later in this Chapter). Alternatively an entirely new institution can be established for the purpose. One such institution which may be suitable for Sierra Leone is the Latin American type finance corporations (finançieras). Such a corporation issues several types of securities including participation certificates, finance bonds and these could be purchased by individuals or by institutions. The yield on the instruments issued by these finance corporations are generally higher than the returns offered by commercial banks and mortgage banks.[8] Thirdly, the job of issuing the new medium and long-term securities for development could be assigned to the National Development Bank.

Given the size of the Sierra Leone economy, we do not think that there will be a large enough business for an entirely new institution. We are thus left with the Bank of Sierra Leone and the National Development Bank. The Bank of Sierra Leone's role in the development of the financial system should be to fill the gaps in the system and where necessary providing services which are not available. Since the National Development Bank is already making financial assets available to the public, we believe that it is the most appropriate institution for the purpose.

The primary objective of mobilizing domestic resources is to make them available for productive investment. However Appendix II gives examples of cases in which resources have been wasted due to lapses in management. Hence, to the extent that managerial defficiencies can be remedied, this in itself, is a significant contribution to the efficient utilization of scarce resources. But in view of the low priority given to commercial and technical education (see Appendix I), management training and business advice must be linked with the provision of finance.

Some of the special characteristics of good management may probably be attributed to entrepreneurial talent, however, most of the skills can be acquired through properly organized courses. For example, short courses can be organized to train businessmen in elementary book-keeping as well

8. The new institution can also take the form of an investment trust. An example of a successful investment trust in an underdeveloped country is the National Investment Trust of Pakistan.

as in the general management of an enterprise. Through such courses and their own every day practical experiences, businessmen can acquire some of the skills of management. But there does not exist in Sierra Leone any institution or agency which provides practical down-to-earth training to suit the experiences and needs of small-scale entrepreneurs. A Sierra Leone Institute of Management was established in 1968, with emphasis on middle and top management. Apart from training facilities, there is need also for some advisory services. The following example can illustrate the types of problems which can arise. "A Nigerian manufacturer of rubber soled shoes started business in 1959 with the latest kind of plant and equipment. The market for his product was already good. Government felt sure that a firm of this nature could be successful. However, a crippling hold-up occurred when the factory started operations because the raw material imports were unsatisfactory and the firm suffered from a protracted curtailment of production."[9] Some institution or agency should be able to advise and give assistance when such emergencies arise.

This responsibility for management training and business advice can be assigned either to the Sierra Leone Institute of Management or the National Development Bank, which we have argued, should be entrusted with the responsibility of mobilizing domestic savings. The main difficulty about assigning responsibility for management training to the Sierra Leone Institute of Management is that such an institution may not

9. The following are other examples to illustrate the need for business advice. "One large indigenous firm, for example, found after ten costly months that the engineer they brought from Germany to set up their German equipment was incapable of doing the job and hence they had to find other technical personnel to do the installation." "During one of my visits to a successful Nigerian mattress producer, the shop was completely idle except for a few women combing out coir fibre by hand. The workers were there (and were drawing pay); the demand for the products of the firm was sufficient; the equipment was in good working order. The trouble was the stock of a seemingly insignificant ribbon which was used to bind the seams of the matresses had run out." S.P. Schatz, "Economic Environment and Private Enterprise in West Africa," Economic Bulletin of Ghana (December, 1963), p. 13.

be able to provide courses that are suitable to small-scale enterprises. The experiences of Ghana and Kenya can illustrate the problem.[10] In both these countries, the management training and advisory centres were established with the assistance of the International Labour Office and the United Nations Development Institute in Dakar. These international bodies also provided experts for the management centres. It has been found that the ILO experts in Kenya were not able to adapt the content of their courses, as well as the teaching methods to suit the requirements of small-scale African enterprises. This was also the experience of the Management Development and Productivity Institute of Ghana. Realizing that the courses were too sophisticated for the needs of small-scale enterprises, the Institute in 1971 established a Ghanaian Business Bureau to deal with the special requirements of the small businessman. We are therefore not in favour of assigning responsibility for management training and business advice to the Sierra Leone Institute of Management so as not to repeat the experiences quoted.

The National Development Bank (NDB) appears to be the most appropriate institution for two main reasons. In the first place, the NDB is already in contact with businesses so that it is aware of the types of problems being encountered, the educational background of the businessmen is known to the NDB, hence, the NDB is more likely to provide the type of courses that are relevant to the ability and requirements of small-scale enterprises. Secondly, the NDB is already helping some of its clients to improve their accounting records. What is therefore required is an enlargement of its scope to include all businesses requiring the service. It is not enough for the NDB to deal only with those who applied for its assistance. We believe that the importance

10. John C. de Wilde, Report on the Development of African Private Enterprise (Washington D.C.: IBRD., 1971), Vol. II Chaps. IV, VI, and VIII.

of efficient management is so crucial for the development of small-scale industries that we would expect the NDB to literally "chase" firms with this service.

(c) Proposals for Institutional Reform

(i) A Development Bank With Larger Role

From our observations on the National Development Bank in Chapter V and in the light of our conclusions from the previous section of this chapter, the National Development Bank must undertake the following functions: Its first task is in the field of mobilization of medium and long term savings. It should mobilize savings by issuing securities of varying yield and maturities. To enable the National Development Bank to do this, it should be given the necessary statutory powers. It should also mobilize savings by encouraging the formation of joint stock companies and offering their shares or bonds to the public. To encourage this development, a condition for the NDB's assistance must be that companies or individuals seeking financial assistance from the NDB should be prepared to sell shares to the public. If the NDB succeeds in getting more public participation in the shares of companies it will not only be mobilizing more domestic savings but will at the same time be dealing with one of the problems of small-scale industries.

A third aspect of the NDB's activity in mobilizing resources is that the NDB must be ready to sell investments from its own portfolio thereby increasing the supply of marketable securities and releasing its own funds to new investment. Since the NDB has shareholders from outside the country, it should also endeavour to attract foreign capital into the economy. This can be done by selling its obligations abroad and providing potential investors with details about investment opportunities in the country.

The second major responsibility of the NDB must be the identification of economically and financially viable projects. The NDB has argued that the scarcity of economically viable projects has been a limiting factor inhibiting its activity. This problem is not peculiar to Sierra Leone as we have argued that this has been the conclusion reached by a number of economists who have dealt with the problem. In view of this dearth of viable projects, greater effort will have to be directed towards feasibility and pre-investment studies. The NDB is the best place, at present, in which such investigations can take place from the point of view of its contacts with international bodies and other development banks and its contact with local industries. The amount that may be available for such investigations will be limited and so too are the experts that may be required. This being the case, it will be necessary to concentrate on a specific area of activity. Thus, for example, if the emphasis is on agro-based industries research activities will be concentrated in that area. A change of emphasis could then be made as and when this is considered appropriate.

However, a private development bank cannot be expected to meet the cost of investigating and promoting the development of economically viable projects from its own resources. The costs involved should be borne by the government as a public service in view of the underdeveloped nature of the Sierra Leone economy. Through technical assistance with the various governments or through the World Bank and the International Finance Corporation the government can secure the services of the experts required. This should, however, be regarded as only a temporary solution while steps are taken to get Sierra Leoneans qualified in the techniques of project evaluation.

The main criticism against this arrangement would be the possibility of inefficiency if the same institution investigates and ultimately finances a project. This may be a serious danger for a government sponsored development bank but need not be a problem for an institution such as the NDB. No doubt the NDB too may be subjected to various pressures, political and otherwise as a government institution. The fundamental difference however is that the NDB is also answerable to international bodies such as the African Development Bank and other external shareholders. Hence, in the case of the NDB there is a countervailing force which a government sponsored institution does not have. The effect of this countervailing influence is to reduce the number of politically inspired projects and increase the possibility of decisions being based more on economic and financial realities.[11]

The third responsibility of the NDB should be the provision of ancillary services especially offering facilities for management training and furnishing technical and administrative advice. By keeping in close touch with the borrowers, the NDB can detect difficulties in their early stages. One of the problems we suggested that the businessman faces is that of preparing adequate records. This is an important service which the NDB should be equipped to provide. The NDB should be able to organize short courses in simplified book-keeping for businessmen. There is likely to be a favourable response if potential customers of the NDB become aware that a condition of the NDB's assistance includes conforming to some minimum standards of financial accounting.

Another service which the NDB must be able to provide is technical information. This includes information about market prospects, information on where to get machinery and assistance in obtaining such equipments. This does not mean that the NDB should have several experts in all the possible fields. What needs to be done is to make use of available

11. The assumption is that there will be investors who will be willing to take advantage of the opportunities once more viable projects become available. But this need not happen and in such a case, efforts could be directed towards getting the public interested through the joint stock form of business organization. One experiment which has been tried in Kenya and which can be explored, is to get Syrians, Libanese and Indians out of retail trade into industries. Also, the NDB can publicize available viable projects abroad through the NDB's foreign shareholders.

international institutions, like the International Finance Corporation, the Food and Agricultural Organization and the World Bank as well as other development banks. In effect, our conception of the NDB is an institution which provides the businessman with all the services, including credit, he needs for the success of the enterprise.

Finally, what the NDB is able to do depends on its efforts in mobilizing resources. It is essential therefore that the public must have confidence in the institution. This being the case, the companies whose formation the NDB promotes and those whose shares it guarantees must be efficiently managed. So that the NDB must endeavour to strike a balance between excess caution and over enthusiasm.

(ii) An Agricultural and Co-operative Development Bank

Because of the peculiarities of the agricultural sector, we would recommend the establishment of a separate institution for this sector. We noted in Chapter IV that the government has declared its intention to establish an institution to be known as the National Agricultural Development Authority. This institution combines the provision of credit with ancillary services and marketing. These are, in fact, the features we consider essential in the Sierra Leone situation. The difficulty however, is that this institution will be concerned with a specific project and not with the problem of agricultural credit in general. There is therefore need for an institution in the shape of an agricultural and co-operative development bank. We pointed out in Appendix II that Moinuddin recommended the establishment of such an institution but that his proposals were not implemented, instead the government opted for the Agricultural Development Authority.

Our recommendation for the Agricultural and Co-operative Development Bank is an amendment of the Moinuddin proposal. What Moinuddin envisages is not an institution that only provides credit, but also the institution should be concerned with the general development of the agricultural sector with the agricultural bank becoming the instrument for effecting this development. While we accept the broad principles, we would suggest the following modifications: In the first place, as the Sierra Leone Produce Marketing Board (SLPMB) is responsible for the marketing of agricultural produce, it is therefore not necessary for the bank to be involved in marketing. All that is required is an undertaking by the borrower to sell his produce to the SLPMB and authorizing the SLPMB to deduct the repayment due. Repayments are thus made at source and these deductions collected by the SLPMB then go to the bank. This arrangement implies not only close collaboration between the proposed bank and the SLPMB but also the involvement of the SLPMB in the establishment of the bank. The SLPMB is required, under existing legislation, to look after the welfare of the Sierra Leone farmer and since the objective of the bank is to increase agricultural productivity, the activity of the bank should be of interest to the SLPMB.[12] We would therefore suggest that the SLPMB takes an active part in the establishment of the bank, in which case, it will not be necessary for the bank to have its own warehouses.

Secondly, the agricultural department is currently dealing with extension services. Thus we would expect this department to continue to undertake all extension work. Otherwise, there will be duplication of services and even conflict. But in view of the short-comings associated with civil service procedures, a more appropriate arrangement would be to transfer the extension service staff of the agricultural department to the proposed agricultural bank. This is a more acceptable

12. The Sierra Leone Produce Marketing Board Act defines the responsibility of the SLPMB as follows:
"It shall be the duty of the Board to secure the most favourable arrangements for the purchase, export and marketing of Sierra Leone produce and to assist in the development by all possible means of the agricultural industry of Sierra Leone for the benefit and prosperity of the producers and the areas of production."
Sierra Leone Produce Marketing Board Act, 1949, p. 1.

arrangement since the bank would then be certain that it can provide the technical service to support the loans approved.

Thirdly, instead of the government providing all the share capital we would suggest that this be shared between the SLPMB, the existing Co-operative Bank and the government.[13] In addition, 50% of the net profit of the SLPMB should be paid to the bank as ad hoc grants.

Fourthly, it should be emphasized that a primary condition for loans must be the willingness of groups or societies to guarantee the repayment of the loans; and that the liability of each member of the group is unlimited.[14] This will be fundamental for the success of the bank as there are virtually no securities for loans in the rural areas. Unlimited liability should be an important deterrent against the recommendation of doubtful customers.

13. With the establishment of the Agricultural and Co-operative Development Bank, the present Co-operative Bank will cease operations. We do not consider it appropriate for the new bank to absorb the National Agricultural Development Authority because this institution is dealing with a specific project. But once the project has been implemented there would be a case for absorbing this institution.

14. To begin with, a financial institution may incur considerable costs in administering a large number of small loans. Also, there are no securities in the rural areas that are acceptable to a financial institution. The collective responsibility for loans not only reduces the need for securities but also shifts the responsibility for enforcing payment to the group. The Co-operatives which are the most suitable bodies through which group loans can be made have attracted only a small percentage of Sierra Leone farmers. But progress in increasing agricultural productivity cannot wait until co-operatives have been developed. Something has to be done in the meanwhile. However, while recognizing that there is the need to increase the flow of credit to agriculture one must also take into account the poor repayment records of past schemes and emphasize the need for financial discipline. We may also recall our finding in Chapter VI where it was pointed out that to enforce repayment the money-lenders could exert a number of pressures including the use of the "Juju man" or "witch-doctor". So that, although unlimited liability may appear to be too severe it may enable an individual to be more discreet.

Fifthly, we do not agree with the proposal that government and semi-government bodies should be compelled to patronize the bank. By assuring the bank much business before it even begins operations may merely make the bank complacent.

It could be argued that instead of having a separate institution for agriculture, the new bank could be absorbed by an enlarged National Development Bank, with two departments, one each for agriculture and industry. We do not support such an arrangement. To start with, there is not likely to be any economy in personnel as a result of the merger since the agricultural sector requires virtually different personnel from those required by the industrial sector. Furthermore, we have suggested that the functions of the National Development Bank be enlarged to enable it to provide all types of assistance that may be necessary for the success of an enterprise. As the NDB is still trying to get off the ground it would not seem desirable to overload an unproven institution. Finally, agriculture is too important to be regarded as a mere appendage to industry. This is precisely what is likely to happen if agriculture is added to the functions of the NDB as presently constituted. By having two separate institutions one increases the possibility of each sector developing to its full potential.

(iii) An Alternative Arrangement for the Proposed National Commercial Bank

It seems to us that very little will be gained if the new commercial bank only duplicates the services now being provided by the existing commercial banks.[15] Consequently, the new bank will have to depart from present conceptions of "good" commercial banking. This it will have to do because the new bank should be dealing primarily with people who do not have conventional securities and should be ready to provide medium and long-term loans which are the types of loans Sierra Leonean entreprepeurs require.

Given these conditions, we believe that an alternative arrangement is to make the Post Office Savings bank (POSB) the nucleus of the new commercial bank. The new commercial bank should absorb all the staff and existing branches of the POSB but cease to be a department of the civil service.

It is not even necessary to obtain the services of foreign experts for the re-organization of the POSB. The Bank of Sierra Leone has some qualified and experienced personnel in its operations department who could be seconded to the new bank. However, because of the possibility that the new bank might be looked upon as a department of the Bank of Sierra Leone, foreign experts could be brought in on a contract basis and the duration of their stay limited to a maximum of five years. This may not involve more than three expatriates as the establishment of the Bank

15. It can be argued that the presence of the local bank may provide the existing banks with more competition. We do not think that this will be the likely outcome. The existing banks are well established and have been financing foreign trade for over fifty years. Besides, they have access to outside resources through their external connections. A relatively small local bahk cannot compete effectively with these banks. Even in Nigeria which has a number of indigenous commercial banks some of which are assisted by the State Governments, such indigenous banks have not competed successfully with the well established banks. Commenting on the importance of expatriate banks in the Nigerian Banking System, Brown observes that "The Nigerian banking system is still dominated by the two large British banks, Barclays and B.W.A."* These two banks were found by Newlyn and Rowan to dominate the Nigerian Banking scene in the 1950's.
Finally, what is required in the context of economic development is not so much competition but filling the gaps in the system.

*Brown, op. cit., p. 91.

of Sierra Leone which was much more elaborate and which also involved the introduction of a decimal currency did not involve more than ten expatriates.[16] At the same time, some of the foreign scholarships now available to the country can be used to train more Sierra Leonean bankers if this is absolutely necessary.

The attraction of the POSB is that this institution already has a large number of branches and these are scattered throughout the country. What appears to be lacking at present is initiative and drive which a new arrangement can provide.

The capital of the bank should be provided entirely by the public. Government's contribution could take the form of an interest free loan to the bank and periodic loans, should this become necessary. This suggestion is prompted by the experiences of the Nigerian Indigenous banks. A number of official inquiries have revealed that their lending policies were influenced by political decisions and most of their loans went to enterprises belonging to politicians. This was the case because these banks, with the exception of one, are owned by the regional governments. Commenting on the future success of these indigenous banks Brown observed as follows: "Indigenous banks cannot fulfil a useful role in the economy until they gain the confidence of the Nigerian public. They will not be able to gain this confidence until they can demonstrate that indigenous banking business is run on sound lines, for Nigerians are aware that their savings are secure in expatriate banks."[17] These conditions are also necessary for the success of the new commercial bank.

We observe in Appendix II that loans under the Agricultural and Fisheries Loans Schemes; the Registrar of Co-operative Societies Loans Scheme; the Development of Industries Board have all experienced very

16. A.B. Taylor, "Central Banking in Underdeveloped Countries with Special Reference to West Africa Since 1957". Unpublished Masters Thesis, The University of Newcastle-Upon-Tyne (February, 1968), pp. 114 -117.

17. Brown, <u>op. cit.</u>, pp. 189 - 90.

poor repayment records because the approval of the loans were politically inspired while political influences have also prevented effective action to enforce repayment. But we showed in Chapter IV that while the Post Office Savings bank was losing deposits during the period of financial crisis, the commercial banks were gaining deposits, demonstrating confidence in the foreign institutions. Hence, a pre-requisite for success is that political interference must be reduced to a minimum to ensure public confidence in the new bank. Without such confidence, it may be extremely difficult to mobilize deposits. We believe that if the government is excluded from the share participation in the bank the amount of political influence is likely to be small.

As the bank will be taking over the assets and liabilities of the POSB the government may not have to make any loans available to the bank for some time. For its immediate requirements the bank should take over the cash balances of the POSB which is now held by the Treasury, and in addition, rediscount some of the Treasury bills now held on behalf of the POSB. The subscriptions to the shares of the new bank is another source of funds that is immediately available to the bank. The bank should also take over the operations of the Revolving Loans Scheme of the Mines Department discussed in Chapter IV. For additional investment funds which may be necessary at a later stage, the bank may have to seek the assistance of the National Development Bank as well as depend on deposits that it may be able to mobilize

The success of the new bank would require that loans must go to projects or enterprises that are potentially commercially viable. This is essential for its reputation and in order to maintain the confidence of the public. This being the case, the bank must endeavour to avoid the twin dangers of giving credit to people who are unlikely to repay and those who will not use the credit for the purpose for which it is intended. It will therefore be desirable for the new bank to examine the problems of lending to Sierra Leoneans carefully from the outset, otherwise, there may be disappointment all round.[18]

One suggestion for dealing with this problem and which was proposed in 1965 is for the establishment of a 'Loans Advisory Scheme' aimed at improving the volume of credit available to Sierra Leoneans.[19] To this end it was expected to act as a co-ordinating agency for all sources of credit. In addition, it should collect information and give technical assistance. The type of information to be assembled include information about debtors, so that it should not be possible for a bad debtor of a commercial bank or any other credit agency to obtain credit from another institution, information on the type of projects being frequently undertaken, and information on the most suitable pieces of equipment for various projects.

The problem of securities for loans however remains. New local securities have to be investigated. There are three possibilities to be considered. The first is land and since the new bank would be a local institution it will not be affected by the provisions of the Non-Citizens (Interest in Land) Act. But there is a problem about land ownership outside the Western Area where land is not individually owned. One approach to this problem is to adopt the arrangement used for loans under the Agricultural Loans and Credit Scheme.[20]

18. The experiences of the Development of Industries Board, the Agricultural and Fisheries Loans and Credit Schemes discussed in Appendix II provide ample evidence of the types of problems. The Audit Report on the Development of Industries Board for 1961 cited several cases in which loans became unrecoverable because of worthless securities and also some of the guarantors turned out to be persons without means.

19. C.V. Brown, Measures for Increasing Credit to Sierra Leonean Enterprise, A Report Prepared for the Bank of Sierra Leone (Freetown: August, 1968).

20. Under that scheme land was accepted as a security once the Chief or Tribal Authority confirms that the applicant has a right to the use of the land. In the case of default, the land is allocated by the Tribal Authority to someone else who makes use of it until the loan is repaid.

The introduction of bearer bonds would enable many to borrow for consumption as well as assist in the mobilization of domestic savings. The bank would have to go in for more equipment loans in which case the equipments become the securities for the loans. Finally, consideration should now be given to the introduction of inland bills of exchange specified in Section 29 i (e) of the Bank of Sierra Leone (Amendment) Act of 1970.[21] In this connection, an investigation of the Nigerian and Ghanaian Bill Finance Schemes (which have been in operation for over five years) might indicate the best way of bringing inland bills of exchange into circulation.

It can be argued that there is the probability of the bank becoming illiquid as it may not be relying on the conventional type of securities. This should not happen for the following reasons. If inland bills of exchange come into circulation, by holding such assets which can be discounted at the central bank liquidity is assured. Also, term loans and even consumer loans have assured liquidity because of the borrowers' sale-proceeds or anticipated income. Furthermore, long-term loans are not necessarily illiquid if they are repaid by instalments. Much therefore depends on what the bank does and how carefully loans are processed. Hence our emphasis on equipment loans.

The new commercial bank must move in the direction of mixed banking because of the existence of a credit gap within the economy. Mixed banking implies the provision of long-term finance in addition to the usual short-term loans. In our analysis of loans and advances from commercial banks it was observed that the volume of loans to Sierra

21. "(e) purchase, sell, discount and rediscount inland bills of exchange and promisory notes bearing two or more good signatures, one of which shall be that of a bank, drawn or issued for the purpose of financing economic activities related to agriculture, forestry, fishing or mining, and maturing within fifteen months, exclusive of days of grace from the date of their acquisition by the bank;" Bank of Sierra Leone (Amendment) Act 1970.

Leonean enterprises was small. In the case of the NDB, its minimum investment is Le 7,500 and its total investment in any one project is limited to 50% of the total investment on that project. Hence, the NDB cannot invest in a project whose total investment does not exceed Le 15,000. Yet, the size of the economy is such as to suggest that small-scale businesses will continue to dominate the industrial scene for some time. The new bank should therefore be concerned with assisting all enterprises which are too small for consideration by the NDB.

Since we have advocated that the NDB should provide a number of ancillary services, it will not be necessary for the new bank to provide a wide range of ancillary services but only those which may be specific to small-scale enterprises.

In conclusion, the new commercial bank must follow the example of the 19th century German commercial banks for only then will it be making a contribution to the development of the financial structure.[22]

(b) How Far the Changes Suggested Require Legislation

Following from our discussions in Chapters II and III the Bank of Sierra Leone Act and the Banking Act should be amended to include the following provisions: Firstly, there should be a provision to enable the central bank to call in special deposits as and when this is considered desirable. This should enable the central bank to control the overall volume of credit. Secondly, all loans above a stated amount, say Le 5,000, for example, should require the prior approval of the central bank. At the same time, the terms and conditions of all such loans are to be subjected to the approval of the central bank. Thirdly, there should be a provision

22. Cameron, op. cit., pp. 177-179.

to enable the central bank to place a ceiling on the volume of lending to each sector of the economy as well as to prohibit further lending to a sector or activity which is not considered desirable. But to encourage the flow of bank credit to priority sectors the central bank should be able to specify preferential rates of interest. Fourthly, because of the problem of securities it may be necessary for the central bank to guarantee certain loans which banks may normally be reluctant to approve. Hence, where the central bank decides that loans should be reserved for a sector or an activity, then the central bank should be able to guarantee such loans. Such an enabling provision is therefore necessary. Fifthly, to ensure that the Development Credit Fund will have adequate resources, this fund should be built up by the transfer of 50% of the net profit of the Bank until the fund reaches a stated sum, say Le 1 million and thereafter the percentage can be reduced to what is provided for under the present legislation. Loans from this fund should be for a period of not less than 5 years and not exceeding 10 years. Sixthly, the equity and share participation of the central bank is at present restricted to 20% of the central bank's capital and general reserve fund. This restriction should be omitted. The limitation which is required, in view of our observations on the Benthworth Finance Company, is that in participating in the establishment of any financial institution, the central bank must ensure that existing services are not duplicated. In short, all new financial institutions to be supported by the central bank must complement rather than compete with or substitute existing institutions.

Finally, the present Bank of Sierra Leone Act defines the central bank's relationship with the government, the public and the commercial banks. The central bank's position vis-a-vis the non-bank financial institutions should also be defined. In this regard, the central bank's legislation should require all financial institutions to co-operate with the central bank to provide an integrated financial service for the economy. Consequently, the central bank's approval must be sought before any new non-bank financial institution is established and also, the central bank would have to be consulted and its approval sought before large loans are made.

With respect to the National Development Bank, legislation may be required to make the NDB the institution responsible for the issuing of securities to the public. Thus, any other institution or firm which intends to mobilize resources from the public should do so only through the NDB.

In the case of the Agricultural and Co-operative Development Bank and the National Commercial Bank, legislation will be required to give these institutions first claims on produce raised by loans from the institutions. Also, legislation may be necessary to enforce the principle of unlimited liability for all group loans.

(e) Conclusion

This chapter has suggested changes which may result in the mobilization of more domestic resources and the efficient utilization of these funds. Our underlying argument is that people will save more if they become aware of the opportunities open to them and if they see a distinct advantage in holding financial assets. Given adequate publicity it should be possible to get people to hold government stocks or purchase equities in local businesses.

Our policy suggestions for improving the efficiency of financial institutions have been directed towards making more use of existing institutions and secondly to stress the desirability of providing ancillary services to ensure the productive utilization of available credit.

We have advocated the establishment of an institution in the shape of an Agricultural and Co-operative Development Bank because the problem of agricultural credit and the development of agriculture in general are not adequately handled by existing institutional arrangements.

Finally, we emphasize the need to equip the central bank with appropriate instruments so as to enable it to influence not only the lending policies of the commercial banks, but also, the lending activities of all financial institutions in the country.

CHAPTER X

C O N C L U S I O N S

This study has been concerned with the monetary and financial institutions in Sierra Leone and in particular with the consequent resource allocation in the economy.

We recognize that no amount of modification of the monetary and financial mechanism can, by itself, ensure rapid economic development as, for example, good financial institutions need not make more entrepreneurs available. But a more efficient financial system is likely to increase the volume of financial flows and probably also lead to a higher level of savings and investment. Furthermore, a more efficient financial system should result in a better allocation of financial resources.

Our study postulates that for the monetary and financial system to contribute to economic development, the system must: (a) Mobilize more domestic financial resources, and (b) ensure that available resources are used for productive investment, especially in the agricultural and small-scale industries sectors.

We suggested in Chapter I that the need for the mobilization of domestic financial resources arose from the emphasis on rapid economic development after the attainment of political independence. Given this objective and the fact that the demand for investment funds far exceeds the supply in the world as a whole, the commitment to a programme of rapid economic development implies that increasing reliance must be placed on domestic sources.

Our discussion in Chapters II to V and Chapter VII revealed that the monetary and financial system achieved some degree of success in mobilizing domestic savings. It was however pointed out that the ratio of financial assets to GNP was only 30% as compared with about 80% for some other underdeveloped countries. Besides, our findings show that these savings were mainly held in the form of money and near-money liabilities of the banking system. Chapter VII however argued that there was sufficient evidence to indicate that people could be induced to switch to securities of longer maturities if appropriate financial assets were available to them.

It was shown that of the total resources available to financial institutions, only about 35% could be classified as productive investments of which about 19% have been used for the financing of the export/import trade and 11% have been made available to the government. But it was revealed that resources placed at the disposal of the government largely increased their non-development current expenditure, so that the percentage of productive investment is, in fact, overstated. A substantial proportion of the resources of financial institutions, approximately 37%, consisted of holdings of external assets. We emphasized that even allowing for the fact that the country needed to maintain some foreign reserves, the amount held was excessive and perhaps a third of these assets could be used to finance economic development by their substitution for local securities.

The virtual absence of institutional sources of credit to agriculture and small-scale industries (examined in Appendix II) was seen to arise not because of a lack of demand but was due rather to the nature of operations within these sectors, the absence of securities acceptable to financial institutions, and the prevalent behaviour of the financial institutions - for example, in the past and still today, commercial banks of British origin have not been enthusiastic in financing agriculture. Hence, as was discussed in Chapter VI, the bulk of the credit to agriculture and small-scale industries had to be provided through non-institutional sources.

Attempts by the government to increase the flow of financial resources to agriculture and small-scale industries by establishing special schemes have not been successful because inadequate consideration was given to the problem of lending to a large number of farmers and small-scale enterprises and insufficient provision was made for ancillary services which, in the Sierra Leone situation, are essential for the efficient utilization of resources. In addition, the new institutions which were created - the Bank of Sierra Leone, the National Development Bank, the Benthworth Finance Company, and the Co-operative Development Bank - did not succeed in making their desired impact.

Given the economic situation that existed after independence, a central bank had to be unorthodox in the sense of performing functions which its counterpart in an economically advanced country could entrust to specialized institutions. But we observed in Chapter II that the broad objective of the Bank of Sierra Leone was too narrowly defined with emphasis on the control of the money supply and the banking system. Chapter VIII pointed out, however, that the main determinants of the money supply were outside the direct control of the central bank. In addition, that chapter as well as Chapter III emphasized that the supply function of commercial banks' loans and advances depended largely on the banks' conception of creditworthiness and the availability of conventional securities. It was argued that if the banks were satisfied on these issues, they were willing and able to provide as many loans as were required. Their continuous borrowings from their head offices throughout the 1960's supported this contention. This access to external funds reduced considerably the significance of the liquidity ratio as a controlling instrument. Also, variables such as excess reserves which have considerable influence in the determination of bank lending in the economically developed countries have had relatively little significance in the Sierra Leone context. These factors together with the openness of the economy imply that it was futile to concentrate on the control of the money supply or to be pre-occupied with monetary stability.

The basic requirement of the economy was (and continues to be) the mobilization of domestic financial resources to increase the relative importance of domestic sources of investment and to channel these funds for productive investment. It was in this sense that the central bank had to be unorthodox. The emphasis of the central bank in these circumstances should have been on the appropriate development of the financial system.

The National Development Bank has so far proved inadequate because, given the small size of the Sierra Leone economy and the shortage of entrepreneurs, the NDB should have concentrated on feasibility and pre-investment studies as well as the provision of ancillary services and thereby prepare projects in forms suitable for financing from institutional sources.

The Benthworth Finance Company, established to provide funds for commercial hire-purchase, has concentrated on the financing of commercial vehicles. It was maintained in Chapter IV that this institution could have made a significant contribution to economic development if the emphasis had instead been on the procurement of equipment for productive investment since finance for commercial vehicles was already available.

The Co-operative Development Bank, only recently established, is unlikely to substantially affect the flow of credit to the agricultural sector because anticipated resources may not be very large and furthermore, the co-operative movement as a whole accounts for about 6% of all the farmers in Sierra Leone.

In short, the new institutions have failed to solve the problem of providing sufficient resources to the agricultural and small-scale industries sectors. To ensure that resources flow to these sectors, the central bank will have to deal with the problem of acceptable securities, as argued in Chapters II, III, and IX. Also, the central bank should be ready to make some of its own resources available by its participation in the establishment of specialized institutions and once such institutions became operational to see that resources got to them. However, the greatest contribution which the central bank can make to the development of the economy is with respect to the balance of payments. We have shown that because the import content of consumption, production and investment is very high, any programme of rapid development will be constrained by the availability of external reserves. Realizing that the import leakage is large, the central bank should be able to determine in advance the effects on the reserves of various levels of development expenditure and in consequence advise on the maximum reserve loss that the economy could accommodate. Because of the ultimate leakage into imports of development expenditure the central bank would have to be concerned with the quality of investment. This objective can be achieved if the central bank insists that development funds mobilized through the issue of government stocks be tied to specific projects. Thus, the role of the central bank should involve the management of the level of external reserves and the direction of available resources for productive investment.

In our study we have shown that much more use could be made of available statistical data. In most underdeveloped countries national income data are seldom available over a sufficiently long period of time to be useful for analytical purposes. But these countries do have more reliable information on government expenditure, foreign trade, the operations of marketing boards, and government corporations as well as monetary and banking data. Our regression analysis of savings and time deposits, for example, revealed that the explanatory variables include purchases of agricultural produce, purchases of diamonds and government expenditure. Information on these is available on a regular basis so that one does not need to wait for long periods until national income figures are issued to explain the movements in savings and time deposits. The same applies to currency in circulation.

Our study has provided statistical information which previously was not readily available, as for example, information on the size of the financial sector and the unorganized sector. Also, we have given some order of magnitude for variables such as the credit multiplier and the optimum level of reserves.

From our study it is evident that the financial system can make a valuable contribution to economic development if appropriate measures are taken, given the balance of payments constraint, (a) to mobilize more domestic resources; (b) to deal with the problem of securities for loans and the special problem of lending to a large number of small operators in the agricultural and small-scale industries sectors; and (c) to improve the quality of investment so as to increase the productive capacity of the economy.

We have argued that more domestic resources could be mobilized and have suggested instruments as well as incentives that might be required for that purpose. The switch from money and near-money liabilities to less liquid instruments which this development entails would provide more long-term finance for the development of the economy. From the point of view of the central bank, however, the relative increase in domestic sources of finance improves its ability to manage the economy.

Appendix I

THE STRUCTURE OF THE SIERRA LEONE ECONOMY AND ITS SIGNIFICANCE FOR DEVELOPMENT FINANCE

(a) The Structure of the Economy

Since the financial system must be examined within the context of the economy of which it is a part, this appendix discusses the structural features of the Sierra Leone economy. The analysis is divided into three sections. In the first section we examine the structural features of the economy emphasizing those aspects which we believe affect the mobilization and utilization of savings. In the second section we discuss the Polak model and show its relevance to the Sierra Leone economy. In the final section we apply the model to the Sierra Leone data.

(i) Population and Labour Force

Sierra Leone, a former British Colony in West Africa, became an Independent State on the 27th April, 1961. The country has a total area of 28,000 square miles and is divided for administrative purposes into four provinces, namely: Western Area with a population of 195,023; Northern Province with a population of 897,566; Eastern Province with a population of 545,579 and Southern Province with a population of 542,187.[1]

There are seven towns with population of over 10,000, the largest of these being Freetown, the capital with a population of 128,000. The second largest town Bo, has a population of only 40,000.

It has been estimated that 938,000 of the population of 2.5 million are economically active, thus about 60% of the population are too young or too old to contribute to productivity. Of the total

1. Central Statistics Office, Population Census 1963, (Freetown: Government Printer, 1965) and Central Statistics Office, Sierra Leone's National Accounts, (Freetown: Government Printer, June, 1971), Table 22.

labour force, those receiving wages of some sort are estimated at 102,000 of whom 3,000 are employers. Self-employed are estimated at 382,000 of whom 53,000 are petty traders.

The only available information on the quality of the labour force is contained in a manpower survey undertaken by Robert Brown in 1964.[2] That survey revealed that less than 20% of the workers in establishments employing 6 or more persons could be classified as intermediate or high level manpower. Of those who had skills, 25% were teachers, 33% clerical workers and 15% were expatriates. But though the situation may have changed since then, the following figures suggest that there may be serious gaps especially at the intermediate and supervisory levels: At the end of the 1967/68 school year there were 136,570 pupils in primary schools but only 22,119 in secondary schools and 1,053 in technical and vocational schools.[3]

The level of wages has been fairly stable throughout the 1960's as can be seen from Table AP.I.

TABLE AP.I — DAILY WAGE RATES FOR SELECTED CLASSES OF WORKERS 1960 & 1969

	1960			1969		
Unskilled workers	60 cents	-	70 cents	70 cents	-	90 cents
Semi-skilled	70 "	-	90 "	80 "	-	Le 1.10c
Skilled Drivers	90 "	-	Le 1.50c	Le 1	-	Le 1.60c
Technical Staff Clerical Staff	Le 372	-	Le 1,104	Le 372	-	Le 1,104

Source: Ministry of Lands, Mines and Labour.

2. Robert Brown, Interim Report to the Government of Sierra Leone on the Manpower Situation (London: Department of Technical Co-operation, 1964).

3. Ministry of Education, Annual Report, 1967/68 (Freetown: by the Government Printer, 1969).

There has been no revision of the salaries of civil servants since 1957 when the last revision took place.[4] This has been possible because the government is the largest single employer accounting for an average of 50% of the wage labour force. Per capita income is quite low, Le 83.3 in 1963/64 and although this income went up by an average of about 7% (current prices) between 1963/64 and 1969/70, this income was only Le 109.2 in 1970. But during the period, the consumer price indices for both Freetown and the Mining areas rose by 5% and 3% per annum respectively.[5] Hence, in real terms, the increase in incomes during the 1960's has been very small.

In common with other underdeveloped countries Sierra Leone has a dual economy. The modern sector comprises mining, wholesale and retail trade, banking and finance most of which are owned and operated by foreign companies using modern equipment and techniques in production. The largest activity in this sector is mining whose output is exported. In the subsistence sector, the people produce primarily for their own consumption. At the same time, they also produce some cash crops for sale. Production is largely by peasant farmers by traditional methods which have not undergone significant changes for very long periods. Simple hand tools, and manual labour have been the main implements and fertilizers are hardly used because they are expensive. The estimated farm population is 1.5 million, 1.2 million of whome are over 10 years of age and for 753,000 of these agriculture is the primary or secondary occupation.[6] Since there are only 250,700 agricultural holders, the

4. A Commission under Professor N.A. Cox-George reviewed the salary structure of the Civil Service in 1971. Following the recommendations of this Commission salary increases ranging between 3% and 15% came into effect in September, 1971.

5. The Freetown Index 1961 = 100 which was 99 in 1962 rose to 144 by 1970. In the case of the Mining Area Index this increased from 104 in 1963 to 126 in 1969. Bank of Sierra Leone Economic Review, Vol. 5, No. 4, Tables 36 and 37.

6. Central Statistics Office, Agricultural Statistical Survey, 1965/66 (Freetown: Government Printer, 1967).

bulk of the farm population are family workers. Out of the total agricultural area of 14.5 million acres only about one million acres are now being cultivated; 22,700 acres of these are cultivated by institutional and large farmers and the rest by small farm holders and their families. Of the 250,700 small holders, 164,100 cultivate less than 5 acres each and 48,600 cultivate between 5 and 10 acres each. Thus 212,300 have farms of less than 10 acres each. These farmers are largely illiterate[7] and produce only one crop a year. Mainly because of the nature of farming, productivity is very low and one result of this has been that the country, like other underdeveloped countries, has relied rather heavily on the importation of food.

(ii) Industrial Origin of Gross Domestic Product

Figures on Sierra Leone's Gross Domestic Product (GDP) are available for the period 1963/64 through 1969/70. These figures are shown in Table AP.II. The table shows that GDP at constant 1963/64 prices grew by an average of 2.5% during the period. Growth was particularly high between 1963/4 and 1964/5 when GDP increased by 6.7%. The rate of increase was particularly low between 1966/7 and 1967/8 and between 1967/8 and 1968/9 when the rise was only 0.8% in each case. Between 1965/6 and 1966/7 GDP declined by 0.7%.

The sectoral contribution to the GDP is as follows: The sector comprising agriculture, forestry, hunting and fishing is the largest single sector accounting for an average of 33% of GDP. The table also reveals that the sector increased its share slightly during the period, though at the end of 1969/70 agriculture's percentage contribution was less than it had been in 1963/4. Agricultural commodities produced for exports are: palm kernels, palm oil, Kola nuts, ginger, coffee, benniseed and piassava. Palm kernels are the principal agricultural exports

7. Professor Due thinks that illiteracy in the country may be as high as 80%. John F. Due, Taxation and Economic Development in Tropical Africa (Cambridge, Massachusetts: The M.I.T. Press, 1963), p. 14.

accounting for an average of 50% of total agricultural exports during the period under review. Exports of agricultural produce more than doubled between 1960 and 1970, rising from Le 10 million to Le 20.6 million and with most of the increase occurring between 1968 and 1970.[8]

TABLE AP.II INDUSTRIAL ORIGIN OF GROSS DOMESTIC PRODUCT AT CONSTANT 1963/64 PRICES

(Le million)

	1963/4	1964/5	1965/6	1966/7	1967/8	1968/9	1969/70
Agriculture, hunting forestry and fishing	69.5	70.1	69.4	75.7	77.6	81.8	84.2
Mining and quarrying	36.6	40.9	45.5	39.6	37.4	39.7	42.8
Electricity and water supply	1.1	1.3	1.4	1.6	1.8	2.0	2.3
Manufacturing and handicrafts	12.0	12.8	13.4	14.0	14.1	14.4	15.0
Construction	7.1	7.5	8.4	8.2	8.9	10.8	12.4
Wholesale and retail trade restaurants & hotels	29.0	33.1	34.8	31.3	30.1	35.0	33.2
Transport, storage and communications	14.5	15.9	16.6	17.4	18.4	20.1	21.5
Finance, insurance real estate & others	12.9	13.9	15.3	15.2	15.2	15.8	17.8
Public administration & other services	18.4	19.1	20.2	20.4	21.8	23.8	26.2
GROSS DOMESTIC PRODUCT AT FACTOR COST	201.1	214.6	225.0	223.5	225.3	243.4	255.4

Source: Central Statistics Office: Sierra Leone's National Accounts (Freetown: Government Printer June 1971), Table 8, p.10.

8. The United Nations Conference on Trade and Development estimates that the rate of growth of agricultural produce would be about 5% per annum in the coming years. We do not think the rate of expansion of Sierra Leone exports would exceed this percentage for the following reasons: To begin with agricultural exports are not likely to show any significant growth due to the unfavourable world market prospects for palm kernels and cocoa.
I.G. Stewart & H.W. Ord, African Primary Products and International Trade (Edinburgh: The University Press, 1965), Chap. 8. Earnings of coffee are likely to rise significantly giving the present world price trends. There could also be some increase in the export earnings of piassava which is now no longer controlled by the Sierra Leone Produce Marketing Board. On the whole, however, agricultural exports should not show much rise because of the proportion of palm kernels and cocoa to total agricultural exports. In other words, we do not expect agricultural exports to rise more than the 5% suggested for underdeveloped countries.
Proceedings of the United Nations Conference on Trade and Development, Vol. 4, Problems and Policies of Financing, (New York: United Nations, 1968), Sales No. E. 68.11.D.17 especially Table 2, p.7.

The mining sector with an average of 18% is the second largest sector.[9] The main mining products are diamonds, iron ore, bauxite and rutile. Almost all the diamonds mined in Sierra Leone are exported. Between 1960 and 1970 diamond exports almost doubled, rising from Le 33 million in 1960 to Le 53 million at the end of 1970. Diamond exports represent about 80% of mining exports and 60% of total exports. Exports of iron ore have not shown much expansion during the period under review. The total increases in exports was Le 2 million in the ten year period. Exports of bauxite which were Le 64,000 in 1963 reached Le 1.5 million in 1968 but by 1970 had declined to Le 1.1 million. Exports of rutile which began in 1967 were suspended in 1969 because of technical difficulties.

Manufacturing including handicrafts accounts for an average of 6% of GDP. These industries produce mainly for the domestic market.

9. The mining of diamonds began in 1932 by the Sierra Leone Selection Trust Ltd., a wholly owned subsidiary of Consolidated African Selection Trust. Prior to 1955 the company had exclusive mining rights over all diamonds found anywhere in Sierra Leone. The discovery of diamonds in large quantities in areas outside the immediate interest of the SLST Ltd. led to illicit mining and diamond smuggling on a large scale. One estimate puts the value of smuggling at between Le 8 million and Le 12 million per annum. Largely as a result of the loss to the economy through smuggling the mining agreement with the SLST Ltd. was re-negotiated in 1955, the result of that review being the limitation of the SLST Ltd. lease to 450 square miles. The other areas were made available to Sierra Leonean miners under the Alluvial Diamond Mining Scheme introduced in January 1956. Under this scheme Sierra Leoneans or companies in which Sierra Leoneans have majority interest are permitted to prospect for diamonds on payment of a fee of approximately Le 40. Diamonds mined under the scheme were sold to the Government Diamond Office established as a part of the Alluvial Diamond Mining Scheme. In December 1970, the company's name was changed to the National Diamond Mining Company (S.L.) Ltd. following the acquisition of majority interest by the Sierra Leone Government. The SLST Ltd. now has a 49% interest in the new company and appoints five of the eleven directors. The mining of iron ore began in 1933 by the Sierra Leona Development Company, a subsidiary of William Baird of Glasgow. The mining of bauxite started in 1963 by the Sierra Leone Ore and Metal Company, wholly owned by Alusuisse of Zurich.

Table AP.III shows the output of some of the local industries.[10]

TABLE AP. III — OUTPUT OF SOME MANUFACTURING INDUSTRIES 1966-1969

Commodity	Unit	1966	1967	1968	1969
Tobacco & Cigarettes	'000 lbs	980.3	824.7	803.6	902.6
Beer & Spirits	'000 imp Gal	802.8	757.6	1,155.3	1,380.4
Acetylene	'000 cu. ft.	858.2	915.3	1,045.8	1,014.3
Oxygen	'000 cu. ft.	2,066.2	2,091.6	2,306.8	2,513.7
Carbon Dioxide	'000 lbs	144.1	131.2	149.3	194.4
Plastic Foot wear	'000 pairs	197.7	480.5	729.6	663.7
Cement	'000 tons	11.8	43.4	43.3	no production
Nails	cwt		7,108	12,968	13,484
Umbrellas	doz		7,373	2,262	4,319
Paint	'000 imp Gal		43.8	86.5	95.1
Matches	Gross boxes		15,000	59,600	69,375

Source: Annual Reports of the Bank of Sierra Leone, 1968 and 1969, p. 46 and p. 60 respectively.

10. These industries can be grouped into four categories. In the first group are all government owned industries operated either by public corporations or by a government department. In this group we have the government printing works, the furniture factory operated by the Forest Industries Corporation; rice mills operated by the Rice Corporation; palm oil mills, operated by the Sierra Leone Produce Marketing Board and the Oil Refinery which is managed by an Israeli firm. In the second group are industries with varying degrees of government participation. Here we have a cement factory, alcoholic beverages and the diamond cutting and polishing firm. The third group comprises factories which are entirely owned by foreign private firms. This is the largest group. Commodities produced are beer, cigarettes, canned tunas, tobacco, umbrellas, furniture, soft drinks, oxygen and carbon dioxide, and paint. In the final group are foreign firms with Sierra Leone participation. These produce knitted fabrics, wearing apparel, nails, cardboard cartons, and re-treated tyres.

Construction, transport and communications, electricity and water supply together account for an average of 11% of GDP.[11] The tertiary sector comprising wholesale and retail trade; banking and finance; real estate, personal, business, professional and domestic services; public administration and defence contributes an average of 32% to GDP.

(iii) Capital Formation and its Financing

Table AP IV shows Gross Domestic Capital Formation by type of assets. The Table reveals that 44% of private investment consists of machinery and equipment and that the private sector accounts for an average of 72% of total capital formation during the period under review. As the mining sector is capital intensive and in the private sector, most of the investment by the private sector has been in the mining sector. The next important outlet for investment funds has been in private residential buildings.

11. Transportation is rather difficult. As a result of high operating costs and loss of traffic due to its slowness the railway has incurred large deficits averaging Le 800,000 annually since 1960. This is a major factor explaining the decision taken in 1969 to phase out the railway. The total mileage of motorable roads was estimated at about 6,000 miles in 1970. But most of these roads are unpaved laterite roads and only about 500 miles were paved by the end of 1970. As most of the roads are laterite and as the country is subjected to heavy rainfall, some of these roads can be very bad and this explains why the life of commercial vehicles is estimated at 24 months. Besides, the principle centres of economic activity are not sufficiently linked with the main centres of consumption. For example, Kabala is an important centre for vegetables and cattle-rearing, the road to Kabala however is particularly bad during the rainy season. Electricity is outside the reach of a large number of people especially outside Freetown and besides about 40% of total electricity generated is by the mining companies. While some of the main towns have no problem with water supply, adequate water supply is still a problem in many parts of the country.

TABLE AP. IV GROSS DOMESTIC CAPITAL FORMATION BY TYPE OF PURCHASER AND TYPE OF INVESTMENT 1963/4 - 1969/70

(Le million)

	1963/4	1964/5	1965/6	1966/7	1967/8	1968/9	1969/70
Total Government							
Improvement to land	0.2	1.0	1.3	0.9	0.1	0.2	0.1
Buildings and works	4.9	4.9	5.8	7.9	4.8	4.9	8.3
Machinery and equipment	3.1	3.1	5.1	4.2	1.5	2.5	2.3
Total	8.2	9.0	12.2	13.0	6.4	7.6	10.7
Private Sector							
Buildings and works	8.6	8.6	11.2	8.7	13.9	17.8	17.6
Machinery and equipment	7.8	13.2	15.5	13.1	16.3	16.6	28.0
Total	16.4	22.8	26.7	21.8	30.2	34.4	45.6
Total Fixed Capital Formation							
Improvement to land	0.2	1.0	1.3	0.9	0.1	0.2	0.1
Buildings and works	13.5	14.5	17.0	16.6	18.7	22.7	25.9
Machinery and equipment	10.9	16.3	20.6	17.3	17.8	19.1	30.3
Total	24.6	31.8	38.9	34.8	36.6	42.0	56.3
Increase in Stock	-1.1	-2.7	1.1	0.8	1.1	3.7	2.3
GROSS DOMESTIC CAPITAL FORMATION	23.5	29.2	40.0	35.6	37.7	45.7	58.6

Source: Central Statistics Office, Sierra Leone's National Account (Freetown: Government Printer, June, 1971), Table 12, p.16.

Since domestic savings for the period 1963/64 to 1969/70 averaged 4% of GDP whereas Gross Domestic Capital Formation averaged 13.5% of GDP during the same period, capital inflows have been an important source of financing domestic capital formation. The extent of capital inflow can be seen from Table AP.V.

TABLE AP. V. GROSS CAPITAL INFLOW, 1964-1970
(Short and Long Term)

(Le million)

	1964	1965	1966	1967	1968	1969	1970
Private Sector	13.4	19.2	7.9	11.9	11.8	16.3	15.2
Government	11.6	11.5	7.5	10.5	10.8	9.2	15.8
TOTAL	25.0	30.7	15.4	22.4	22.6	25.5	31.0

Source: Bank of Sierra Leone, Sierra Leone's Balance of Payments 1963-1968 and 1965-1970, from Table 1 in each case.

Net capital inflows were calculated to be:

13.7	11.8	5.7	10.6	11.3	14.3	11.5

Source: R.W. During and Miss M.E. Grant, "The Balance of Payments of Sierra Leone 1963-1967," Economic Review of the Bank of Sierra Leone, Vol. 3, No.1 (June, 1968), pp. 16-23. Information for the years 1968-1970 was obtained through correspondence with Miss Grant.

Domestic savings during the period 1963/64 to 1969/70 are given in Table AP. VI.

TABLE AP. VI DOMESTIC SAVINGS, 1963/64 - 1969/70[12]

(Le million)

	1963/4	1964/5	1965/6	1966/7	1967/8	1968/9	1969/70
Government (Current Surplus)	5.01	3.34	1.73	6.30	7.26	16.84	15.08
Corporations	0.62	0.25	2.12	0.42	1.76	3.40	3.46
Private Sector*	0.27	-4.59	3.25	-0.12	-5.52	5.36	10.96
TOTAL	5.9	-1.0	7.1	6.6	3.5	25.6	29.5

*Calculated as residual

Source: Central Statistics Office, Sierra Leone's National Accounts (Freetown: Government Printer , June, 1970), Tables 24 and 29.

12. Table AP.VI cannot directly be compared with Tables AP.IV and AP.V because of the fact that the former refers to calender year while the latter is financial year. Also, the errors and ommission elements of the balance of payments have to be taken into account.

From Table AP.VI domestic savings have been quite low during most of the 1960's. The level of domestic savings averaged 4% of Gross Domestic Product for the period because of the high levels of savings in 1968/69 and 1969/70. Excluding those two years, domestic savings averaged 2% of GDP.

One consequence of low domestic savings is that consumption has been high. The composition of private consumption expenditure in 1963/64 and 1969/70 is as follows:

TABLE AP. VII COMPOSITION OF PRIVATE CONSUMPTION EXPENDITURE
(Percentage of Total Private Expenditure)
1963/64 and 1969/70

	1963/4	1969/70
Durable Goods	7.4	8.2
Semi-durable Goods	13.4	12.0
Non durable Goods	62.7	60.9
Services	16.3	19.5

Source: Central Statistics Office, Sierra Leone's National Account, (Freetown: Government Printer, June 1971), from Table 16A, p.28.

It should be noted that in 1963/4 and 1969/70 expenditure on two items were:

	1963/4	1969/70
Food beverages and Tobacco	55.0	53.0
Clothing	13.4	12.0

As there are no capital goods industries one would expect that durable and semi-durable goods would be imported. In addition however, imports of consumer goods account for about 50% of total imports with food beverages and tobacco being the largest category accounting for an average of 20% of all imports.

(iv) Foreign Trade and the Balance of Payments

Imports and exports as percentages of GNP are shown in Table AP.VIII.

TABLE AP. VIII IMPORTS AND EXPORTS AS PERCENTAGES OF GNP 1963 - 1969

	Imports %	Exports %	Foreign Trade (Average of imports plus exports)
1963	30.5	29.6	30.0
1964	32.3	31.8	32.1
1965	33.2	27.2	30.2
1966	29.5	24.4	26.9
1967	25.8	20.0	22.9
1968	26.7	28.2	27.4
1969	28.8	29.1	28.9

Source: Economic Review of the Bank of Sierra Leone, Vol. 5, No. 4, (March, 1971) Table 23.

From the above table foreign trade averaged 29% during the period 1963-1969. What gives these figures particular significance is the fact that the GNP figures include some estimate of subsistence activity. Thus excluding subsistence activity foreign trade as a percentage of monetary GNP may approach 50%.

During the period 1963-1969 imports averaged 30% while exports averaged 28%. The trade deficits during the period were:

Trade Deficits 1963 - 1970 (Le million)

1963	1964	1965	1966	1967	1968	1969	1970
-1.1	-0.3	-7.5	-6.4	-8.0	10.7	5.5	-1.5

Source: Bank of Sierra Leone, Sierra Leone's Balance of Payments 1963-68 and 1966-70, from Table 1 in each case.

In addition to these trade deficits the invisible balance for such services as shipping and insurance have been in deficit as these services are supplied by foreign companies. Including the invisibles the overall deficit on goods and services were as follows:

Overall Deficit on Goods and Services 1963 - 1970 (Le million)

1963	1964	1965	1966	1967	1968	1969	1970
-12.5	-15.7	-24.8	-20.6	-21.9	-4.7	-12.0	-14.9

Source: Bank of Sierra Leone, Sierra Leone's Balance of Payments 1963 - 1968 and 1966 - 1970. From Table 1 in each case.

Because of capital inflows however, the overall deficits in the balance of payments during the period were:

Surplus/Deficit on Current and Capital Accounts 1963-1970 (Le million)

1963	1964	1965	1966	1967	1968	1969	1970
-2.9	2.2	-2.7	-6.8	-5.1	11.1	7.2	1.3

Source: Bank of Sierra Leone, Sierra Leone's Balance of Payments 1963 - 1968 and 1966 - 70. From summary table in each case.

The implications of the openness of the economy is that the income multiplier is considerably lower than in an economically advanced country. The income multiplier is usually given as:

$$\Delta Y = \frac{\Delta I}{s + t + m}$$

where ΔY = change in income

ΔI = change in investment

s, t, m, are respectively the propensities to save, to pay taxes and to import.

In this economy however, we have to take account of the fact that capital goods have to be imported. In effect a large percentage of any investment expenditure goes abroad for machinery, equipment, services of certain experts and similar expenditure. When account is taken of this, the income multiplier reduces to:

$$\Delta Y = \frac{(1 - Me)\Delta I}{s + t + m}$$

Where Me is the direct expenditure on imports.

If we assume that direct expenditure on imports ranges between 40% and 50% and given a marginal propensity to import of 33% and propensities to save and tax of 10% then the income multiplier is just over 1. In the case of the Oil Refinery in which the direct expenditure on imports may exceed 60% (since crude oil as well as machinery and equipment are imported) the multiplier may even be less than 1.

(iv) Government Finance

Government revenue which was Le 25.7 million in 1960/61 rose to Le 50.6 million by the end of the 1969/70 financial year. The main sources of revenue have been: taxes on foreign trade; taxes on incomes (personal and companies); taxes on internal transactions (excise, licences and duties). Taxes on foreign trade contribute the largest share, an average of 55%.

The share of taxes on income which was 22% of total taxes in 1961 and rose to 30% in 1963 declined to 17% in 1965 and has still not recovered from this low level. Other taxes which together contributed about 27% in 1961/2 now contribute only 10%. With several public corporations making losses in recent years, contributions from this source have been slight. Of the main sources of revenue, only foreign trade and taxes on internal transactions show some growth but the rate of growth has been modest. Hence total revenue as a percentage of GNP for the period 1963/64 to 1969/70 (the years for which GNP figures are available) are:

1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70
17.5	16.1	18.2	15.7	15.4	18.2	18.5

Source: Economic Review of the Bank of Sierra Leone, Vol. 5, No. 4 (March, 1971) Table 19.

Between 1960/61 and 1969/70 total expenditure rose from Le 32.1 million in 1960 to Le 61 million by 1970, a rise of 91 per cent. Total expenditure as a percentage of GNP for the period 1963/64 to 1969/70 are as follows:

1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70
19.7	19.8	23.0	16.6	18.1	16.6	19.9

Source: Economic Review of the Bank of Sierra Leone, Vol. 5, No. 4 (March, 1971), Table 19.

The functional classification of government's expenditure is given in Table AP. IX. The table shows that "General and Social services" have increased their share of total expenditure. But what is striking from the table is the growth of 'unallocable' expenditure. This item includes debt servicing, which went up from Le 1 million in 1960/61 to Le 12 million by 1969/70. Expenditure on economic services however has fallen from 42 per cent of total expenditure in 1963/64 to less than 25 per cent of the total in 1969/70. Thus, whereas total expenditure has been rising, expenditure on economic services has been declining.

TABLE AP. IX ECONOMIC CLASSIFICATION OF GOVERNMENT EXPENDITURE: AS PERCENTAGE OF TOTAL EXPENDITURE 1963/4 - 1969/70.

Expenditure Categories	1963/4	1964/5	1965/6	1966/7	1967/8	1968/9	1969/70
General Services	18.7	19.0	19.6	20.4	18.1	20.9	21.4
Social Services	22.9	25.1	26.1	29.2	26.4	24.1	24.1
Economic Services	41.7	38.6	30.5	35.3	25.0	25.5	27.3
Unallocable	16.7	17.3	23.8	15.1	30.5	29.5	27.1
			CAPITAL EXPENDITURE		(Percentages)		
Economic Services	53.0	44.5	35.0	54.2	32.9	16.1	30.1
Unallocable Expenditure	30.2	35.9	54.2	23.9	53.7	81.0	64.4
of which sinking fund and loan repayment	(10.6)	(14.7)	(37.1)	(12.7)	(47.2)	(76.4)	(60.5)

Source: Central Statistics Office, Sierra Leone's National Accounts, (Freetown: Government Printer, June, 1971) Table, 30.

Not only has the level of capital expenditure been falling, but also, not all expenditure on economic services are "productive" in the sense of contributing directly to future income. Table AP.IX also examines capital expenditure of the government. The table reveals that with the exception of 1963/4 and 1968/9, capital expenditure on economic services have dropped sharply.

Comparing these figures with those for revenue given earlier, the observation is that the period under review has been characterized by large budget deficits.

In an effort to raise development capital, the government borrowed from external sources including contractor finance. The flow of loans has resulted in a rapid growth of external indebtedness. Between 1960 and 1969/70 the value of debt trebled and amounted to Le 70.4 million by 1970. One implication of this growth is shown in Table AP.X.

TABLE AP. X THE SIGNIFICANCE OF DEBT SERVICING, 1960/61-1969/70

	1960/61	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70	1970
Debt Servicing (Le million)	1.0	1.2	1.3	1.9	2.3	6.1	2.8	8.7	10.2	12.6	
Debt Servicing as per cent of Current Revenue (%)	3.9	4.4	4.5	5.5	6.4	14.4	5.1	17.0	18.0	21.5	
Debt servicing as per cent of Exports (%)	2.0	3.6	2.6	3.1	4.0	11.4	4.4	11.5	11.7	14.4	

Source: Bank of Sierra Leone, Annual Report, 1971, Table 15, p. 83.

In 1960/61 debt servicing was less than 5% of current revenue and was also less than 3% of export receipts. By 1970 debt servicing represented 22% and 14% of current revenue and export earnings respectively.

(vi) Summary

In summary, the objective of the discussion of the structural features is to describe the conditions under which development of the financial system must take place. The selection of the structural features discussed was therefore influenced by this objective. The significance of the large agricultural population is that most of the people depend for their income on export receipts. The size of this income, however, depends on the vagaries of the weather and the prices at which the commodities are sold abroad. Consequently, the total amount of domestic financial resources that can be mobilized for development to a large extent depends on the volatility of export incomes.

As investments are mainly externally financed, dividends and other payments arising from these investments flow out of the economy, so that mobilization of domestic financial resources also depends on the extent to which reverse flows can be reduced. The importance of a high marginal propensity to import is that inflationary pressures will be reflected in loss of external reserves and not necessarily through domestic price increases.

(b) <u>The Polak Model and Its Relevance to the Sierra Leone Economy</u>

It was argued in the Introductory Chapter that an efficient monetary and financial system was essential for the mobilization and productive utilization of savings because of the close relationship between money, income and the balance of payments. Using Sierra Leone's data, we obtain an R^2 of 0.80 between money supply and exports, and between money supply and GDP. GDP is also highly correlated with imports. These results are expected because exports are important determinants of domestic incomes while the correlation between imports and GDP emphasizes the reliance on imports for all capital goods and a wide variety of consumer goods. These relationships require that income determination, monetary developments and the balance of payments be analysed together in an integrated model in order to see the effects of developments in one sector on the other. A model which achieves this objective has been suggested by Polak.[13]

The objective of the model is to study the effect of credit policy on income and the balance of payments. Basically he is interested in questions such as the quantitative implications of say a certain rate of credit creation on real economic variables and the process by which newly created money income gives rise to imports and thus affect the payments position of the country. In his model, the forces which generate income are exports, capital inflows, and net domestic credit creation.

In order for there to be money income there must be a quantity of money circulating in the economy which is related to the income by velocity. He thinks that the ratio of money to income is constant so that income cannot rise without affecting the money supply. If, therefore, a satisfactory explanation can be provided for changes in the quantity of money it would be possible to have a good explanation of income changes by means of a monetary analysis.

Since money is a liability of the banking system, by adding the changes in the assets items in the balance sheet an explanation of changes in the money supply is obtained. From such a consolidated balance sheet of the banking system, a change in the money stock arises from two main sources, external through foreign assets and from domestic influences via domestic credit creation.

Suppose there is an increase in domestic credit and that this loan is used to pay out as income. The level of income rises. Some of this income will be spent on domestic goods and services and some will

13. J.J. Polak, "Monetary Analysis of Income Formation and Payments Problems," International Monetary Fund Staff Papers, Vol. 6 (1957/58), pp. 1 - 50.

be spent on imports. Part of the loan that is spent locally are incomes to those who provide the goods and services. There is a further round of income generation when the recipients also make purchases. This process continues until the resulting incomes add up to some multiple of the original expenditure and the magnitude of this multiple rise is determined by the income multiplier.[14] The money supply also goes up as people require additional stock of money to finance the higher level of transactions. Pölak assumes a constant ratio of money to income so that the extent of the increase in the money stock will be proportional to the new level of income. There is also a secondary expansion resulting from the activities of the commercial banks. He omits this possibility on the assumption that all incomes are spent.

The effect of this credit creation giving rise to higher incomes and expenditure is a continuous depletion of the external reserves. First, there is loss of reserves through the direct expenditure on imports. The second source of reserve loss arises from the fact that some of the domestic expenditures are on imports. The size of the drain here is determined by the propensity to import. The depletion of the reserves ultimately equals the amount of credit created. "There will be a

14. It can be shown that additional income generated by the credit creation will be:

$$\frac{\Delta DC}{m^2 v} (1+m)^{-v(i-2)} (1-(1+m)^{-v})^2$$

This sum of extra incomes tends towards $\frac{\Delta DC}{m}$ as i approaches infinity. Similarly, extra imports will be:

$$\frac{\Delta DC}{mv} (1+m)^{-v(i-2)} (1-(1+m)^{-v})^2$$

This expression tends towards ΔDC as i approaches infinity. Where

ΔDC	is increase in net domestic assets of the banking system;
Y	is income;
m	is the marginal propensity to import;
v	is the velocity of circulation.

See Clive S. Gray, "Credit Creation for Nigeria's Economic Development," <u>The Nigerian Journal of Economic and Social Studies</u>, Vol. 5, No. 3 (November 1963), especially pp. 252 - 255.

continuous loss of reserves which will gradually build up to an annual rate equalling the injection of credit".[15] However, it takes time for the newly created income to be lost through imports. This time lag depends on the time it takes for earnings to be distributed as wages and salaries, the time it takes individuals to respond to their increased incomes, and the time taken by producers to increase production in response to the higher level of demand. This time lag which in fact determines the velocity of circulation of money together with the size of the marginal propensity to import determine how quickly the incomes generated by the credit creation leak into imports.

In the case of exports and net capital inflows, incomes, imports and money will rise as in the previous case but in addition the banking system acquires foreign assets. As the adjustment of imports to income is lagged, the reserves continue to show an increase. But in equilibrium, income, money, and imports will be higher and reserves will have levelled off at the new higher level.

Since imports are the only leaks from the income generating process and imports are also the only drain from the money supply, by calculating the marginal propensity to import and the time it takes for this income to be lost through imports (the velocity of circulation of money) one can determine the level of income and imports.

The model is as follows:

On the assumption that the relationship between money and income is linear and homogenous

$$Y_t = \frac{1}{k} MO_t \qquad \text{.....................} \quad (1)$$

where Y is income
MO is the money supply
k is a constant

15. Polak, op. cit., p. 26.

Defining t as the time required by the total stock of money to circulate once as income, the equation (1) becomes:

$$Y_t = MO_t \quad \text{or} \quad Y_{t+1} = MO_{t+1} \quad \dots\dots\dots\dots\dots\dots \quad (2)$$

Polak splits the stock of money in the period t+1 into the stock of money existing in period t plus the expansion of money at the beginning of the period t+1. Thus:

$$Y_t = MO_{t-1} + \Delta MO_t \quad \dots\dots\dots\dots\dots\dots \quad (3)$$

Substituting equation (2) in equation (3) we have:

$$Y_t = Y_{t-1} + \Delta MO_t \quad \dots\dots\dots\dots\dots\dots \quad (4)$$

This is his basic equation.

Changes in money MO from the balance sheet of the banking system is equal to changes in net foreign assets (FA) plus changes in gross domestic credit (DC) less the change in savings and time deposits (QM):

$$\Delta MO_t = \Delta FA_t + \Delta DC_t - \Delta QM_t \quad \dots\dots\dots\dots\dots\dots \quad (5)$$

Substituting equation (5) in equation (4) gives:

$$Y_t = Y_{t-1} + \Delta FA_t + \Delta DC_t - \Delta QM_t \quad \dots\dots\dots\dots\dots \quad (6)$$

But $\Delta FA_t = X_t + R_t - M_t$ $\quad \dots\dots\dots\dots\dots\dots \quad$ (7)

Therefore:

$$Y_t = Y_{t-1} + X_t + R_t - M_t + \Delta DC_t - \Delta QM_t \quad \dots\dots \quad (8)$$

and showing domestic credit net of savings and time deposits gives:

$$Y_t = Y_{t-1} + X_t + R_t - M_t + \Delta DC_t \quad \dots\dots\dots\dots \quad (9)$$

This equation states that income in this period equals income in the previous period, plus new income due to internal credit creation, plus new income due to exports, less income lost through imports. To complete the system he makes imports a function of income:

$$M_t = mY_t \quad \dots\dots\dots\dots\dots\dots\dots \quad (10)$$

Equation (10) states that import payments in a given period are related to income in the same period. The equation assumes that the marginal and average propensities to import are equal and constant. His solution for Y_t and M_t in terms of the autonomous variables are:

From (9) and (10)

$$Y_t = \frac{1}{(1+m)} Q_t + Y_t \qquad \dots\dots\dots\dots\dots\dots\dots (11)$$

where $Q_t = X_t + R_t + \Delta_{\varepsilon} DC_t$

and

$$M_t = \frac{m}{(1+m)} Q_t + Y_t \qquad \dots\dots\dots\dots\dots\dots\dots (12)$$

The expressions for Y_t and M_t are consequently:

$$Y_t \frac{Q_t}{(1+m)} + \frac{Q_{t-1}}{(1+m)^2} + \frac{Q_{t-2}}{(1+m)^3} \dots \frac{Q_{t-n}}{(1+m)^n} \dots (13)$$

and

$$M_t = \frac{mQ_t}{(1+m)} + \frac{mQ_{t-1}}{(1+m)^2} + \frac{mQ_{t-2}}{(1+m)^3} \dots \frac{mQ_{t-n}}{(1+m)^n} \dots (14)$$

If $m < 0 < 1$; then $\frac{1}{(1+m)} < I$

If n is very large the sum of the series converge to $\frac{1}{m}$ while $\frac{1}{(1+m)}$ becomes zero. We are thus left with:

$$Y_{t_n} = \frac{1}{m} Q_{t_n} \qquad \dots\dots\dots\dots\dots\dots\dots (15)$$

$$M_{t_n} = \Delta DC_{t_n} + X_{t_n} + CI_{t_n} \qquad \dots\dots\dots\dots\dots\dots (16)$$

Imports and income are thus explained in terms of exports, capital inflow and credit creation.

From the model an autonomous and lasting increase in exports will firstly, over time, raise foreign exchange reserves by the accumulated excess of exports over imports; secondly, increase income by the same amount as the increase in the money supply; thirdly, increase imports. The rise in income will level out when the gains in exports have completely leaked out of the system.

In the case of a rise in domestic credit, foreign exchange reserves will decline gradually to the full extent of the additional credit. The second and third effects would be the same as in the previous case.

In the case of capital inflows which are equivalent in their effects to an increase in exports, the effects will be the same as in the case of an increase in exports.

The model just described is relevant to the Sierra Leone economy because the fundamental assumptions of the model correspond with the structural characteristics of the economy. The basic assumptions of the Polak Model concern the velocity of money and the relationship between income and money. His assumption that the velocity of money is constant implies that changes in the income stream will always lead to changes in the quantity of money. The assumption of a constant ratio of money to income means that leakages such as the propensity to save and to pay tax can be ignored.

As we have seen, exports are the base of the income-determination model. We have also pointed out that because of the absence of capital-goods industries account has to be taken of direct expenditures on imports and this is in addition to the high marginal propensity to import. Consequently, the import drain dominates all the other leaks and is the main determinant of the income multiplier. Exports and imports both result in changes in the quantity of money. Exports lead to an increase in the money supply when the export proceeds are spent locally, while in the case of imports, local currency and deposits have to be given up to purchase the foreign exchange with which to pay for the required imports.

Furthermore, we have seen that investment by the mining companies are financed by capital inflows. Small businesses on the other hand rely on retained profits (see Appendix II). And because of the absence of a local money and capital market idle funds that exist are invested in foreign securities. But because investment as a whole depends largely on capital inflows any change in the relationship between savings and investment will be reflected in a corresponding change in the quantity of money.

Also, we have noted that the government has incurred large budget deficits during the period of our study. These deficits as we have seen were financed by borrowings from external sources and from the banking system. These foreign and local borrowings affect the quantity of money through their effects on the external reserves.

Finally, our conclusion on non-bank financial institutions revealed the virtual absence of financial intermediation by these institutions. The importance of intermediation by non-bank financial institutions is that they economized in the use of money thereby allowing a given stock of money to finance a large volume of transaction. The virtual absence of assets of these institutions imply the absence of indirect influences on the money supply.

We can thus conclude that the main determinants of domestic expenditure in Sierra Leone are the same variables which cause changes in the money supply and that variations in the money stock are not the result of alterations in the velocity of circulation but rather are caused by changes in the absolute volume.

(c) The Application of the Polak Model to the Sierra Leone Economy

Having shown that the Polak model is consistent with the structural characteristics of the Sierra Leone economy we now test the applicability of the model. In the application of the model to the Sierra Leone economy, we have followed the procedure adopted by Polak and Biossonneault in their application of the model to the Norwegian economy.[16] The four balance of payments categories derived from Sierra Leone's balance of payments[17] data are given in Table AP.XVI. Table AP. XI shows how we arrive at the series used for the computation of imports and income. Tables AP. XII and AP. XIII show respectively how we obtain figures for "computed imports" and "computed incomes". The purpose of Tables AP. XIV and AP. XV is to demonstrate that the model gives the best estimates of income and imports for the 1960's[18] emphasizing the relevance of the model to the Sierra Leone economy.

16. J.J. Polak, and Lorette Biossonneault, "Monetary Analysis of Income and Imports and Its Statistical Application", op. cit., pp. 349 - 415.

17. See Bank of Sierra Leone, Sierra Leone's Balance of Payments 1963 - 1968 and 1965 - 1970 (summary tables in each case).

18. In the case of income, the predicted values deviate more widely from actuals as can be seen from Table AP. XII but even so, the figures obtained by the Polak model compare favourably with the other indicator of income.

TABLE AP.XI INCOME AND MONETARY DATA

		1963	1964	1965	1966	1967	1968	1969	1970
Y Average for year (GNP)	Le Million	195.7	219.7	231.9	242.6	252.4	282.8	306.0	326.5
Y* Estimated end Year	Le Million	207.7	225.8	237.3	247.5	267.6	294.4	316.3	
MO	Le Million	19.8	20.9	21.1	21.8	26.5	30.4	28.2	
M	Le Million	63.0	71.3	70.3	73.6	70.3	85.5	104.6	111.1
M ÷ Y	Ratio	.322	.325	.303	.303	.279	.302	.342	.340
Y* ÷ MO	%	9.5	9.3	8.9	8.9	9.9	10.3	8.9	
		V Average 1963-1970 9.4, k = 0.106 or 0.11							
ΔY	Le Million		18.1	11.5	10.2	20.1	26.8	21.9	
kΔY			1.99	1.26	1.12	2.21	2.95	2.41	
ΔMO	Le Million	-0.8	1.1	0.3	0.3	-0.1	4.7	3.9	-2.2
V(kΔY-ΔMO)			0.89	0.96	0.82	2.31	-1.75	-1.49	
Marginal Import Equation			0.34Y - 7.9						
M computed on the basis of the Marginal Import Equation	Le Million	58.6	66.8	70.9	74.6	77.9	88.3	96.1	103.1
Minus M_A	Le Million	-4.4	-4.5	0.6	1.0	7.6	2.8	-8.5	-8.0
Q	Le Million	62.2	72.4	70.6	73.9	70.2	90.2	108.5	108.9

Sources: For figures on MO (money supply) see Table 8.III

For Y (income) figures see Central Statistics Office, Sierra Leone's National Accounts (Freetown: Government Printer, 1971), Table 4. (See pages 335 and 336 for Explanatory Notes).

Explanatory Notes to Table AP. XI

Y^* – National income figures do not refer to the same time period as money supply data. To make the figures comparable, he suggests calculating the annual rate of income at or around the end of year. This end-of-year estimates are derived as the average of the preceeding year and those of the following year.

ΔY, change in income is obtained from the estimates of end-of-year income.

The expression $V(k\Delta Y - \Delta MO)$ takes account of changes in velocity. This expression is derived as follows: If the average ratio of income to money is defined as $k = \frac{1}{v}$ and the ratio in any one year as $k_t = \frac{1}{v_t}$,

then it can be shown that

$$\Delta MO_t = k\Delta Y_t + \Delta k_t Y_{t-1} + \Delta' k_t \; \Delta Y_t$$

where $\Delta k_t = k_t - k_{t-1}$

and $\Delta' k_t = k_t - k$

In the above equation the change in money is the result of changes in income, velocity and the product of the two changes. He suggests that the third effect should be attributed to velocity. When this is done the velocity effect is obtained as $V(k\Delta Y - \Delta MO)$. The velocity effects in Tables AP. XII and AP. XIII, is calculated by applying the import and income co-efficients respectively to the velocity figures.

Minus M_A takes into account the possibility of autonomous imports. Thus the import equation now becomes

$$M_t = mY_t + M_{At} \qquad \ldots\ldots\ldots\ldots\ldots\ldots\ldots(10a)$$

Substituting this equation for equation (10), gives an additional additive term, namely, $-M_A$ amongst the factors determining income. Figures for $-M_A$ are obtained by deducting actual import payments (from Table AP. XI) from the product of the average import-income ratio and income. The M_A effect in Tables AP. XII and AP. XIII is calculated by applying the import and income co-efficients respectively to the $-M_A$ figures.

Q is the sum of exports, capital movements, and monetary expansion (see Table AP. XVI).

The import and income co-efficients used in Tables AP. XII and AP.XIII are obtained from the Polak Tables by looking up the appropriate values of (m) and (v).

The expression $\frac{\tilde{M}}{m'}$, in Table AP. XIII is a constant term which Polak suggests should be added to take account of situations in which marginal propensity to import is different from average propensity to import. Adding the constant term $\tilde{M}$ to the import equation (10) we have

$$M_t = m'Y_{tt} + \tilde{M} \quad \dots\dots\dots\dots\dots\dots \quad (10b)$$

and consequently equation (14) becomes

$$M_t = \frac{m'}{1+m'}\left[Q - \tilde{M}\right] + \frac{m'}{(1+m)^2}\left[Q_t - \tilde{M}\right] + \dots\dots + \tilde{M} \dots\dots (14)$$

As the sum of the co-efficients equal 1 the equation becomes

$$M_t = \frac{m'}{1+m'} Q_t + \frac{m'}{(1+m')^2} Q_{t-1} \quad \dots\dots\dots\dots\dots\dots$$

The income equation (13) is thus

$$Y_t = \frac{Q_t}{1+m'} + \frac{Q_{t-1}}{(1+m')^2} \quad \dots\dots\dots\dots \quad \frac{\tilde{M}}{m'} \quad \dots\dots\dots\dots \quad (13a)$$

TABLE AP.XII COMPUTED IMPORTS

	1963	1964	1965	1966	1967	1968	1969	1970
Q	62.2	72.4	70.6	73.9	70.2	90.2	108.5	108.9
0.70	43.54	50.68	49.42	51.73	49.14	63.14	75.95	76.23
0.28		17.42	20.27	19.77	20.69	19.66	25.26	30.38
0.02		(1.20)	1.24	1.45	1.41	1.48	1.40	1.80
Computed Imports		69.2	70.9	73.0	71.2	84.3	102.6	108.4
M	63.0	71.3	70.3	73.6	70.3	85.5	104.6	111.1
Residual			-0.6	0.6	-0.9	1.2	2.0	2.7
Minus M_A	-4.4	-4.5	-0.6	1.0	7.6	2.8	-8.5	-8.0
0.70	-3.08	-3.15	-0.42	0.70	5.32	1.96	-5.95	-5.60
0.28		-1.23	-1.26	-0.17	0.28	2.13	0.78	-2.38
0.02		(0.01)	-0.09	-0.09	-0.00	0.00	0.02	0.06
M_A Effect on Imports		-4.37	-1.77	0.44	5.60	4.09	-5.15	-7.92
V Effect		0.89	0.96	0.82	2.31	-1.75	-1.49	
0.70		0.62	0.67	0.57	1.62	-1.23	-1.04	
0.28			0.25	0.27	0.23	0.65	-0.49	
0.02			0.00	0.01	0.02	0.02	0.05	
V Effect on Imports			0.92	0.85	1.87	-0.56	-1.48	
M_A	4.4	4.5	0.6	-1.0	-7.6	-2.80	8.50	8.00
Computed Residual (M_A Effect plus V Effect plus M_A)			-0.2	6.29	-4.11	-4.59	5.98	
Residual Error (Residual minus Computed Residual)			-0.4	0.31	4.02	5.79	3.98	

Sources: Table AP.XIII, also J. J. Polck and Lorette Boissonneautt, "Monetary Analysis of Income and Imports and its Statistical Application", International Monetary Fund Staff Papers, Vol. 7 (April 1960), Tables 3 and 4 pp. 358-361 and pp. 367-373.

TABLE AP.XIII COMPUTED INCOME

	1963	1964	1965	1966	1967	1968	1969	1970
Q	62.2	72.4	70.6	73.9	70.2	90.2	108.5	108.9
2.01	125.02	145.52	141.91	148.54	141.10	181.30	218.09	218.89
0.78		48.52	56.47	55.07	57.64	54.76	70.36	84.63
0.05		(3.00)	3.11	3.62	3.53	3.70	3.51	4.51
M		23.24	23.24	23.24	23.24	23.24	23.24	23.24
m								
Computed Income Interim Figure		220.28	224.73	230.47	225.51	263.00	315.20	331.27
Y	195.7	219.7	231.9	242.6	252.4	282.8	306.0	326.5
Residual Interim		-0.6	7.2	12.1	26.9	19.8	-9.2	-4.8
Minus M_A	-4.4	-4.5	-0.6	1.0	7.6	2.8	-8.5	-8.0
2.01	-8.84	-9.05	-1.21	2.01	15.28	5.63	-17.09	-16.08
0.78		-3.43	-3.51	-0.47	0.78	5.93	2.18	-6.63
0.05		(0.20)	-0.22	-0.22	0.00	0.00	0.38	0.38
M_A Effect on Income		-12.28	-4.94	1.32	16.06	11.56	-14.53	-22.33
V Effect		0.89	0.96	0.82	2.31	-1.75	-1.49	
2.01		1.79	1.93	1.65	4.64	-3.52	-2.99	
0.78			0.69	0.75	0.64	1.80	-1.37	
0.05			0.03	0.04	0.05	0.04	0.12	
V Effect on Income			2.65	2.44	4.33	-1.68	-4.24	
Computed Residual (M_A Effect plus V Effect)			-2.31	3.76	20.39	9.88	-18.77	
Computed Residual			9.51	8.3	6.5	9.9	-9.6	
Average				4.9				
Computed Income		225.1	229.6	235.4	250.4	267.9	320.1	336.2
(Difference between Actual and Computed Income)		-5.4	2.3	7.2	2.0	14.9	-14.1	

Sources: Table AP.XVI, also J.J. Polck and Lorette Boissonneault, "Monetary Analysis of Income and Imports and its Statistical Application", International Monetary Fund Staff Papers, Vol. 7 (April, 1960) Tables 3 and 4, pp. 358-361 and pp. 367-373.

TABLE AP.XIV ACTUAL AND PREDICTED IMPORTS 1964-1970

(Le million)

	Actual Imports	Imports calculated on the basis of the marginal import equation	Imports calculated on the basis of Polak Model	Imports calculated on the basis of equation (16) $M = \Delta DC + X + CI$
1964	71.3	66.8	69.2	76.2
1965	70.3	70.9	70.9	73.4
1966	73.6	74.6	73.0	71.8
1967	70.3	77.9	71.2	65.9
1968	85.5	88.3	84.3	90.5
1969	104.6	96.1	102.6	104.8
1970	111.1	103.1	108.4	115.7

Sources: Tables AP.V; AP.VI; AP.VIII and AP.XIII.

From the above table, the Polak Model gives the best estimate of imports for the period 1964 - 1970.

TABLE AP.XV ACTUAL AND PREDICTED INCOME 1963/4 - 1969/70

(Le million)

	Actual Income	Income calculated on the basis of equation (15) $Y = \frac{1}{m}(\Delta DC+X+CI)$	Income calculated by the Polak Model
1964	219.7	224.1	223.6
1965	231.9	215.9	228.1
1966	242.6	211.2	233.9
1967	252.4	193.8	228.9
1968	282.8	266.2	266.4
1969	306.0	308.2	318.6
1970	326.5	340.3	337.2

Source: As in Table AP. XIV

Development in the economy during the period 1963 to 1970 are shown in Table AP. XVI on the Balance of Payments:

TABLE AP. XVI THE BALANCE OF PAYMENTS (THE POLAK REPRESENTATION) 1963 - 1970

(Le million)

	1963	1964	1965	1966	1967	1968	1969	1970
EXPORTS	54.7	64.6	59.8	61.8	51.9	81.3	93.7	103.9
Merchandise fob	51.7	63.1	59.4	55.4	49.0	77.2	87.6	84.4
Investment Income (net)	-5.5	-6.5	-8.5	-5.4	-8.2	-8.1	-6.6	-6.6
Other Receipts	8.5	8.0	9.1	8.6	11.1	12.2	12.7	16.1
IMPORTS	63.0	71.3	70.3	73.6	70.3	85.5	104.6	111.1
Merchandise cif	58.2	69.8	73.9	68.3	62.8	73.3	90.4	93.1
Drawings on project loans and use of non bank exchange reserves	-4.4	-8.9	-14.8	-8.8	-5.0	-3.3	-5.0	-4.3
Other payments including net transfers	9.2	10.4	11.2	14.1	12.5	15.5	19.2	22.7
CHANGE IN RESERVES	-2.5	-0.6	-11.6	-2.6	-5.9	11.5	9.2	1.9
CAPITAL MOVEMENT	5.8	6.1	-1.1	9.2	12.5	15.7	20.1	9.1
MONETARY EXPANSION	2.7	1.0	10.9	4.5	3.7	-1.3	-3.3	2.6

Sources: Bank of Sierra Leone, Sierra Leone's Balance of Payments, 1963-1968 and 1965-1970. (summary Table in each case).
Central Statistics Office, Sierra Leone's National Accounts (Freetown: Government Printer, June, 1971), Table 2.

The table shows continuous loss of external reserves up to 1966 whereas the period 1968 to 1970 has been characterized by gains in reserves. During the period of reserve loss, the extent of such loss was modified by capital inflow. In the period 1968 to 1970, capital inflow contributed to the gains in reserves. Two factors explain the considerable monetary expansion and the consequent loss of reserves which were features of the period up to 1965/66. These were large budget deficits and the financial collapse of the Sierra Leone Produce Marketing Board.

Up to 1962/63, revenue grew faster than expenditure with the result that the current account generated some surpluses which were transferred to the capital budget. In addition, grants and loans were available from the United Kingdom Treasury (this, as we saw in Chapter I is an aspect of the colonial monetary system). In 1961/62 for example, grants from the United Kingdom amounted to Le 5 million. Thus development expenditure was financed mainly from foreign sources but partly also from surpluses transferred from the current budget. In 1963/64 development expenditure rose by approximately 19%. The increase in development expenditure was made possible by two special circumstances. First was the tax revenue paid by the Sierra Leone Selection Trust Ltd., (SLST Ltd.). The tax paid by the SLST Ltd. in that year was in respect of the years 1962/63 and 1963/64. This was the case because, due to differences between the company and the government concerning marketing arrangements, diamonds mined in 1962/63 were not exported in that year. The second feature was the loans and grants referred to. These two features of the 1963/64 financial year which explained the very high level of expenditure in that year but which were not available in 1964/65. To begin with taxes from the SLST Ltd. in 1964/65 reverted to its usual level. But in addition, in 1964/65 the Sierra Leone Development Company Ltd. (SLDC) undertook an extensive expansion programme and was permitted to write off a large part of the new investment against tax liabilities. The direct result of these developments was that tax receipts from companies dropped from almost Le 6 million to just under Le 1 million. Added to this external medium and long term loans were not available on their previous scale. Consequently, the 1964/65 budget showed an overall deficit of Le 3.5 million financed by suppliers' credit.

But in spite of the inherent difficulties, the 1965/66 budget provided for a larger deficit. The current account deficit was Le 4.8 million and the overall deficit was Le 17.9 million financed by suppliers' credit[14] and by the running down of external assets.[15] Against this background of poor budgetary performance the government budgeted for an even larger overall deficit for the 1966/67 financial year, Le 21.0 million as compared with Le 17.9 million in 1965/66.

The financial difficulties of the government was worsened by the financial collapse of the Sierra Leone Produce Marketing Board (SLPMB).[16] Between 1964 and 1966, the SLPMB, against expert advice

14. The impact of suppliers' credit on the budget can be seen from the fact that debt servicing which was only Le 2.3 million in 1964/65 had gone up to Le 12.6 million by 1969/70.

15. In order to provide the financial assistance to the government, the Post Office Savings bank had to realize some of its foreign investment at a loss. Other sources of finance for the deficit included borrowing from the banking system and deferred payments to contractors and local trade and industry. During most of 1965/66 the Bank of Sierra Leone had to provide financial assistance in the form of Ways and Means advances. By mid 1966 external reserves had been substantially reduced and the government was unable to put up the local counterpart funds for foreign financed investment. There was a general lack of confidence with the result that local firms were unable to accept government LPO's. There were difficulties too with the payment of salaries of government employees and teachers.

16. R. Beoku-Betts, Report of a Commission of Inquiry into the Financial Problems of the Sierra Leone Produce Marketing Board (Freetown: Government Printer, 1968), para 30. The report points out that the investments were a financial loss. In its annual report of 1968 the SLPMB had this to say: "Fixed assets acquired in the industralization programme are not considered to have a value until such time as they are complete and in operation. Therefore no values have been placed on these items of plant and machinery in either the Statement of Affairs at 1st July, 1967 or the Balance Sheet at 30th June, 1968". In another section of the same report, the SLPMB points out that the operating loss on the Wellington Mill for the period 1st July to 30th June, 1968 amounted to Le 154,567.

embarked on a programme of investment in industries and plantations.[17] The SLPMB had embarked on this programme of plantations and industrialization on the assumption that overseas sources of finance would be available. The expected overseas finance did not materialize with the result that the SLPMB's liquid funds were completely absorbed by mid 1966. By that date, the Price Maintenance Fund as well as the reserve fund had been virtually used up. The immediate consequence was that the SLPMB was unable to make regular cash payments for produce received and buying agents in turn were not able to pay producers cash for their produce. The SLPMB at this stage started to issue IOU's for produce received. This led to lack of confidence in the SLPMB which is reflected in the volume of business handled by the SLPMB during 1966 and 1967.[18]

17. The SLPMB's plantation programme involved a total of 416,000 acres planted with oil palm trees, bananas, citrus fruits, coconuts, pineapples, rubber, coffee, cocoa, cashew and cotton. Land was acquired for the programme and plantations started in 1965. It was estimated at the commencement of the plantation programme that 60,000 additional jobs for labourers would be created while at the same time increase the SLPMB's profits substantially. Other investments by the SLPMB were as follows: Wellington Palm Kernel Mill Le 1.7 million; Palm Oil Mills (Massanki, Gambia, Hangha, Sahn Malen) Le 0.9 million; Feed Mill (Moyamba) Le 81,483; Instant Coffee Mill (Kenema) Le 017 million; Polythene Bag Machine (Kissy) Le 17,727; Coconut Dehusking Machine (Bo) Le 12,000; Chicken Incubator (Bo)Le 4,000; Fibre Making Machine Le 17,942. (Sierra Leone Produce Marketing Board, Annual Report (1968).

18. The extent of the damage caused by lack of confidence in the SLPMB can be ascertained by examination of the agricultural export figures as the SLPMB has a monopoly for the marketing of virtually all agricultural products. Exports during the period 1964 to 1968 were as follows: Agricultural Exports 1964 - 1968

1964	Le 10,183
1965	9,205
1966	11,694
1967	5,039
1968	18,262

The decline between 1966 and 1967 is not due to a fall in world prices of the commodities in question but rather to smuggling and withholding of produce, the result of lack of confidence in the SLPMB. Annual Report of the Bank of Sierra Leone (1967) p. 22.

To deal with the difficulties, the government obtained the services of the International Monetary Fund on whose recommendation a Stabilization Programme was introduced in November, 1966. In essence, the stabilization programme aimed at reducing the level of expenditure and preventing further depletion of the external reserves. The fiscal policies under the programme aimed at limiting the projected budget deficit to Le 4.1 million. The measures included freezing of all vacancies in the public service; all ministries and departments were instructed to reduce expenditure on fuel, travel and supplies and overall expenditure was to be 10% less than the budgeted provision. Capital expenditure was reduced substantially except in those cases where contractual obligations existed. The Stand-by Programme also provided for increases in taxes to yield additional revenue. In the banking sector, ceilings were placed on net credit expansion by the banking system to the government and the value of government securities to be held by the Bank of Sierra Leone was defined. The liquidity ratio of the commercial banks was to be progressively raised from 15% to 30% by the end of February, 1967. To improve the balance of payments position and the external reserves, government's imports were reduced and at the same time higher import duties on a number of commodities were introduced.[19] For its part, the IMF made available to the government a Stand-By Credit of Le 3.7 million, drawings from which were related to anticipated progress in the implementation of the programme.

19. The following taxes were introduced to increase government revenue; surtaxes of 10% and 15% were levied respectively on companies and personal incomes; a 3% turnover on companies; a special diamond dealers tax; and higher import duties on vehicles and their spares, cinematographic equipment and films, imported cigarettes, fibre board suitcases and knitted fabric. Postal charges on internal and external mails were increased and so were licences for radio and television sets. Subsidies to government corporations were discontinued. Other measures included a strict control on spending of government departments to avoid overspending; a programme to phase out the railway and the reorganization of some government corporations.

The programme was fully implemented in 1967 and by the end of the year the budget deficit had been reduced and the drain on the external reserves halted. In the case of the SLPMB, it was re-organized and its activities limited to marketing. To ensure that only purely economic and commercial consideration would guide the decisions of its Board of Directors, the Governor of the Bank of Sierra Leone, the Economic Adviser and a representative of the Sierra Leone Chamber of Commerce were brought to the Board. At the same time the SLPMB negotiated an external loan of Le 3.9 million with the Head Office of one of the local commercial banks. With this loan the SLPMB was liquid once again and was able to honour outstanding obligations. The devaluation of November, 1967, following the British devaluation, together with higher world prices especially for palm kernels and cocoa enabled the SLPMB to increase the producer prices for produce. These higher prices together with the re-organization of the SLPMB improved confidence in the SLPMB with the result that agricultural exports in 1968 more than trebled.

Encouraged by these developments, a second Stabilization Programme was introduced in 1968. In that programme it was hoped to reduce the deficit further and to eliminate it completely by 1969. To achieve this objective, additional taxes were introduced; external borrowings were restricted and a condition for new loans was that they should have a maturity of at least 11 years. In addition to the ceiling on credit to the government, the Bank of Sierra Leone's rediscount rate was raised by ½% to 6%, the Post Office Savings Bank deposits rate by 1% and the Treasury bills rate by ½%. Finally, borrowings by the government corporations were restricted. This time the Stand-By Credit made available under the programme was Le 1.8 million, which were not utilized because of the favourable balance of payments situation since 1968.

The recovery after 1968 which has the effect of an expansion in exports were thus due to three factors, two of which have already been discussed. The first set of factors are the economies in government spending made possible by the Stabilization Programme, and the second is the restoration of confidence in the Sierra Leone Produce Marketing Board (SLPMB). In addition to the return of confidence, the world prices of palm kernels and cocoa went up and this enabled the SLPMB to pay higher prices for produce. The third factor is the very large increase in diamond exports. Diamond exports which totalled Le 52.8 million in 1970 were only Le 29.4 million in 1967.[20]

To summarize, it has been possible to use the model to provide an explanation of the relationship between credit creation caused by large short-term borrowings by the government (especially in the years 1965/66 and 1966/67) and the resulting substantial loss of external reserves. A greater awareness of the relationships endogenous to the model would probably have improved monetary management during that period.

20. The reasons for the expansion include higher sales to the Government Diamond Office (of diamonds mined under the Alluvial Diamond Mining Scheme) made possible by reduction in smuggling. A second factor was the higher world prices for gems in 1968 and 1969. These increased world prices enabled the Government Diamond Office to pay higher prices to suppliers. Thirdly, the SLST Ltd. increased its output partly in response to a request by the government and partly in order to forestall depletion of its reserves by illicit diggers.

Appendix II

EVIDENCE OF UNSATISFIED DEMAND FOR CREDIT

1. THE AGRICULTURAL SECTOR

(a) Introduction.

Given that rapid increases in agricultural productivity are essential for any programme of economic development, the problem which follows from this is how to achieve this objective. One possibility is through a system of large plantations; alternatively through improvements in efficiency within the present framework of small-scale-labour intensive units; or thirdly, through some combination of both.

In some studies the necessity for developing agriculture is to free labour for industrial development.[1] The implication here is the mechanisation of agriculture. In 1952 the case for plantation agriculture in Africa was given as follows[2]: the rate of growth and fruiting of plantation palms can be observed and the best type of seeds selected for planting; it facilitates orderly planting and harvesting; it makes it possible to apply fertilizers systematically; it makes possible economies in transport and ensures regular supply of fruits; the oil is extracted more efficiently and waste products are utilized.

This approach to agricultural development is not practicable in Sierra Leone. This is because about 65%[3] of the economically active population is engaged directly or indirectly in agriculture and given the fact that the population increases by about 1.5% to 2% per annum, then one would expect a continuous increase in the farm population for some time. At the same time, because of the size of the Sierra Leone market,

1. Gustov. F, Papanek, "Development Problems Relevant to Agricultural Tax Policy" quoted by G.M. Meier in Leading Issues in Development Economics (New York: Oxford University Press, 1964), p.289.

2. The United African Company - Statistical and Economic Review, No. 9 (March, 1952), pp. 3 and 4.

3. Central Statistics Office, Sierra Leone's National Accounts 1963-4 to 1968-9 (Freetown: Government Printer, June, 1970), Table 23.

the industrial sector is not likely in the near future to absorb all the additions to the labour force. In these circumstances any programme which involves replacement of labour on a large scale, apart from being more expensive, may cause serious employment problems. For this reason, increased agricultural productivity in Sierra Leone must be sought through the existing small-scale labour intensive units. A second reason why use must be made of the existing small units is the scarcity of capital which has been emphasized by a number of studies.[4] Most underdeveloped countries do not have all the capital they would like for the simultaneous development of all sectors of their economies. There is therefore need for economy in the use of capital wherever this is possible and it has been shown that such economies are possible in the agricultural sector. Some underdeveloped countries have already achieved spectacular results merely by using high quality seeds, chemical fertilizers and pest control. Besides, there now exists relatively simple and cheap technology which complements labour rather than substitutes labour and which has been shown to result in significant increases in agricultural productivity. The third important factor in favour of development through existing small scale units is to ensure a sustained demand for the products of the industrial sector. Incomes in the agricultural sector are currently very low and such incomes are earned only during certain months of the year because of the seasonal nature of farming. If we rule out manufacturing for the world market for the time being, then demand must come from the agricultural sector. Without this, the manufacturing sector cannot grow. It can be argued that demand can come from the manufacturing sector especially with rising incomes. But one could not rely on this source to any great extent in Sierra Leone because the industrial population is small and incomes are not particularly large.

4. J. Livingstone, "Agriculture Vs. Industry", Journal of Modern African Studies, Vol. 6, No. 3, (October, 1968), pp 329 - 342, and Harry T. Oshima, "A Strategy for Asian Development", Economic Development and Cultural Change, Vol. 10, No. 3 (April, 1962), pp. 294 - 312.

Because of these three factors, we would expect the development strategy for agriculture in Sierra Leone to be largely labour intensive and relying on inputs such as high yielding seeds, chemical fertilizers, pesticides and technologies which complement labour. Our analysis of the demand for credit in the agricultural sector therefore rests on this fundamental contention that the development of the agricultural sector must depend on improving the efficiency of a large number of small-scale farmers and, although some amount of plantation agriculture will be inevitable, this would be the exception rather than the rule.

(b) The Social and Economic Condition of the Farmer

Since our assumption is that development depends on improvement of the efficiency of a large number of small-scale farmers, our starting point of the analysis of the demand for agricultural credit must be with the present condition of small-scale farmers.

The method of production is largely by shifting cultivation with very little use being made of fertilizers. This method involves the following processes.[5] First, the selected site is 'brushed', that is, chopping and lopping off the branches of tall trees and felling the larger ones. The logs are then piled together in many heaps all over the site and are burnt when they are quite dry. To perform this task the implements used are felling axes, pickaxes and cutlasses. The second stage involves

5.K.L. Little, "Land and Labour among the Mendes," Journal of African Affairs, Vol. 47 (March, 1948), pp. 23-31.
Although Little's article was written in 1948 the conditions have not changed much as the following quotation shows:

> Perhaps the best and most succint description of agricultural techniques in Sierra Leone was made by William O. Jones when he attempted to generalize for all tropical Africa: 'Farming methods in tropical Africa, with certain notable exception such as Sudanese Gezira, differ little from those pursued centuries ago, and to Western eyes appear primitive in the extreme. Fields are small irregular patches in the bush or forest, imperfectly cleared before burning because of the lightness of axes and knives that are the standard implements cultivated only by hoes and frequently weeded, and containing a mixture of crops planted in what appears to be completely random disorder'.

Saylor, op. cit., pp. 35 and 36.

ploughing. The implement used here is the hand hoe. Because of this, the ploughing operation merely involves the top soil. Third, is the sowing stage, which involves scattering of seeds over the area ploughed. This is followed by weeding, driving birds away and finally harvesting. For harvesting, bamboo or iron knives are used. The agricultural statistical survey of 1965/66 gives details of agricultural implements in use in the country. A summary of these is given in Table AP. XV11.

These various operations require a large supply of labour and one estimate is that about 100 man-hours are required to brush and eight to ten year old bush and about 200 man hours for ploughing, weeding and harvesting.[6] To obtain the required amount of labour the farmer may receive communal help or pay cash for the services of labour. Usually it is a combination of both except in the very small farms. The farmer is however required to feed all the workers on his farm during the various stages until harvest.[7] At harvest he is expected to reward all those who assisted him. This in fact explains why of the total of 216,526 rice farmers only 20% offered rice for sale. The rest had been consumed both by the farmer and his family and by those who helped with production.

From the farmer's point of view, that is, taking into consideration the resources available to him, shifting cultivation is the only rational alternative open to him. Thus Leach says: "The villagers preference for shifting cultivation is not due to conservatism or stupidity but to perfectly correct assessment of their own economic condition."[8] Making virtually the same point, Saylor contends that although shifting cultivation appears to be costly it is less expensive than the alternative open to farmers which involves the use of fertilizers which are not only expensive

6. K.L. Little, The Mende of Sierra Leone (London: Routledge & Kegan Paul Ltd., 1949), Chap. IV.

7. K.L. Little, "The Mende Farming Household", Sociological Review, Vol. 40 (1949), Sect. iv. pp. 37-56.

8. E.R. Leach, "Some Economic Advantages of Shifting Cultivation", Proceedings of the Ninth Pacific Science Congress, 1959, quoted from Saylor p. 37.

TABLE AP.XVII TOOLS AND IMPLEMENTS USED FOR CULTIVATING LAND BY SIZE OF HOLDING, 1965/1966

	Total All Holders	Percent of Holders Reporting Use of: Hoe	Cutlass	Falling Ax	Pick	Plough	Harrow	Knives	Other
<u>All Holdings</u>	250,700	97.1	90.6	68.1	4.0	1.4	1.1	95.6	1.8
Holdings under 1 acre	32,700	95.7	97.9	66.5	2.7	2.2	0.8	93.3	3.0
1 acre and under 5	131,400	97.0	95.4	67.8	4.7	1.4	1.4	96.4	2.0
5 and under 10	48,600	100.0	99.4	69.0	4.7	0.9	0.7	97.3	0.8
10 and under 15	9,000	96.7	96.7	82.2	1.1	0.4	0.9	95.6	1.1
15 and over	3,300	90.9	93.9	60.6	9.1	1.2	2.5	100.0	1.2
Average not reported	25,800	94.6	91.5	66.0	1.2	2.0	0.6	91.1	1.2

Source: Central Statistics Office.

but are not easily available. By using the trees which were valueless as timber, for nutrients the farmers made a wise economic choice. Thus he concluded that "the traditional system of shifting cultivation permitted a rather sparse population working with few capital goods to achieve a form of ecology balance with its environment".[9] However rational the methods of cultivation are in relation to available resources, any upward shift in income would require a major departure from the traditional methods.

A second factor and perhaps the most important affecting the condition of the farmer is the marketing arrangements. Marketing is undertaken by the Sierra Leone Produce Marketing Board (SLPMB), a statutory body. The SLPMB operates through buying agents in various parts of the country. Naturally, these agents are stationed in the main towns and large villages. The result is that between the farmer and the SLPMB's agents there may be several intermediaries. The consequence of this is that the producer prices announced by the SLPMB are not the prices received by the farmer, since each of the middlemen involved must take some return. Another aspect of the marketing arrangement is the fact that the prices paid by the SLPMB to its buying agents are far less than world prices. Table AP.XVIII shows that in some years the prices fixed by the SLPMB for the two main commodities were as low as 50% of the SLPMB's selling prices. However, even this amount is not what the farmer receives. Taking into account the fact that grades of produce are decided by the traders and others who may buy from farmers, what the farmer actually received may be very small in relation to world prices.

A third important feature of the Sierra Leone agriculture is that it is seasonal, and during the rainy season when food is relatively scarce, the farmer and his family have to depend on previous savings or on crops they have stored. At the same time he cannot supplement his income by working outside the sector since there are virtually no employment outlets elsewhere. But the amount of savings he can make depends on his income

9. Saylor, op. cit., p. 51.

TABLE AP. XVIII

SIERRA LEONE PRODUCE MARKETING BOARD SELLING PRICES AND PRODUCER PRICES FIXED BY THE BOARD

	Prices Received by the SLPMB (Selling Prices) Average F.O.B. Le Per Ton	Producer Prices fixed by the SLPMB (Buying prices) Le Per Ton at Buying Station.
Palm Kernels		
1959	116.00	59.80
1960	106.76	63.20
1961	86.45	63.20
1962	81.84	63.20
1963	87.06	54.20
1964	93.38	56.00
1965	93.38	63.62
1966		63.62
1967	No reports published	53.87
1968		63.21
1969	Details not yet available	65.00
Cocoa		
1959	540.8	372.9
1960	427.6	354.6
1961	333.7	354.6
1962	323.6	298.6
1963	320.0	242.6
1964	371.9	261.3
1965		246.4
1966	No reports published	208.0
1967		211.6
1968		235.2
1969	Details not yet available	274.4

Source: London Office of the Sierra Leone Produce Marketing Board; Annual Reports of the Sierra Leone Produce Marketing Board; Annual Reports of the Bank of Sierra Leone 1966 and 1969.

which is low; and the amount of produce he can store for the 'hungry season' depends on his storage facilities. Where this does not exist, as in most cases, he would have to sell his produce at harvest. To provide his requirements for food and seeds he may have to pledge part of the next season's crops.

Fourthly, customs and traditions are very important in the rural areas. Initiation into traditional societies, marriages, funerals are so important in these areas that some farmers may be prepared to incur very large debts on the security of their farms to fulfil social obligations rather than be looked down upon by others of their community. These customs and traditions are in fact, the main incentive for some of these people. This does not mean that the farmer doe not try to maximise his money profits. What we are in fact suggesting is that the farmer takes into account his social and moral values in trying to maximise his money profits.

(c) The Relative Importance of Agricultural Credit

In the setting we have described consisting of traditional methods of farming, small savings and low returns to the farmer, improvement in agricultural productivity may be possible only with sufficiently attractive incentives to the farmer.[10] This should appear surprising since it is

10. It can be argued that 'hungry season' loans should be discarded because these are merely consumption loans. The point however, is that farmers have only one source of income and that is through the sale of their produce at harvest. They cannot afford warehouses in which to store what may be required for the hungry season as their resources are quite meagre. But more important, without large quantities of food they will not be able to produce at all since most of the operations on the farm are energy consuming. Food in these circumstances is part of the input required for production and without which output would be greatly affected. 'Hungry season' loans especially in the initial stages of development should be treated as production loans and one would expect that with increased productivity farmers would be able to make adequate provision so that this type of loan need not be continued for too long. Also, if the farmer can produce more than one crop a year this would make 'Hungry season' loans unnecessary.

usual to argue that agricultural development in underdeveloped countries needs amongst other things, education, entrepreneurship, good communication and more efficient marketing arrangements. We do not deny that such factors are important and as will be seen later some of these are included in our conception of incentives. What we emphasize is that no matter how efficient the other factors are unless the farmer sees that he can benefit from their utilization the results anticipated may not be realized.

Given the present situation which involves effective control over the farmer's crop by non-institutional sources of credit, the provision of credit through a specialized agency will be an important incentive which is likely to yield significant increases in agricultural productivity. First, the control which non-institutional sources now exert on farmers must be broken since undue debt burdens have been shown to be a major obstacle to agricultural development.[11] Second, a specialized agency for agricultural credit if properly operated will insist that credit flows to those who can use such credit productively. The credit policy of such an institution will indirectly encourage the use of new methods and high yielding seeds, since some of the credit will be specifically for these purposes. Third, to ensure that loans are effectively used such an agency will either establish some close links with existing extension services of the Agricultural and Co-operative Department or may provide its own extension services. Fourth, to ensure that credit requirements are not only met but also that repayments are made when due, such an agency will establish links with marketing institutions such as the Sierra Leone Produce Marketing Board and Co-operative Societies, so that, if need be, repayments are deducted at source, that is, when the produce is sold.

The farmer will respond positively because the use of better inputs will increase his output and hence his income. Also, the conditions for loans from such an agency will be more favourable since the rate of interest is not likely to exceed 20%. In addition, the agency is likely

11. W. Arthur Lewis, "Developing Colonial Agriculture", The Three Banks Review, (March, 1949), pp 3 - 21.

to specify some form of marketing arrangement. This is likely to eliminate at least some of the middlemen and some of the exploitation.[12] The returns to the farmer will be greater still if the Sierra Leone Produce Marketing Board (SLPMB) can modify its pricing policy to give the farmer a larger percentage (say 70%) than at present for his produce. Thus, given proper policy mix, credit can be a sufficient condition for a breakthrough.

It can be argued that instead of providing agricultural credit the same result can be achieved if the farmer received the full world prices (less any expenses for marketing). This may not necessarily be the case. To begin with since nothing has been done to eliminate the middlemen it is not certain that all the higher prices will go to the farmer. Some are likely to be retained by the middlemen. Also, the non-institutional sources from whom he borrows are certain to increase their charges. In addition, the farmers' productivity need not increase as the increased income need not necessarily be spent on better implements. The situation under a system of institutionalized credit should be quite different; (a) the credit will be for some inputs, (b) the hold of money-lenders and others will be weakened, and (c) some of the middlemen are likely to be eliminated.

The farmer benefits by getting more income but the economy also benefits because productivity has increased. There is now sufficient evidence to show that farmers respond positively[13] to economic stimuli

12. The replaced middlemen need not necessarily be unemployed since if productivity increased sufficiently they may be attracted to farming.

13. On this issue, see: Robert M. Stern "The Price Responsiveness of Primary Producers", Review of Economics and Statistics, Vol. 48 (May, 1962), pp 202 - 207;
S. Clayton, Agrarian Development in Peasant Economies (London: Pergamon Press, 1964), Chap. 4;
P.S. Schultz, Economic Crises in World Agriculture (Ann Arbor: The University of Michigan Press, 1965), Chap 2, and
G.L.F. Beckford, "Agricultural Development in Traditional and Peasant Economies - Review Article" Social and Economic Studies, Vol. 15 (1966), pp. 151 - 161.
Saylor, op. cit., pp. 65 - 74.

so that once he knows that by using an improved variety of seed he gets more income, he will certainly continue to use the improved method even though he may not have cause to borrow from the credit agency after the first few loans have been repaid.

Unfortunately, such a specialized agency does not exist. The existing institutional sources are examined below.

(d) Institutional Sources of Agricultural Credit

The institutional sources of credit available to farmers are: the Co-operative societies, the Agricultural Loans and Credit Scheme, the Fisheries Loans and Credit Scheme.

(i) The Co-operative Societies:

At the end of December, 1970 there were 927 Co-operative societies with a total membership of 46,095.[14] Of these 617 are thrift and credit societies, 277 are cocoa, rice and other marketing societies, 29 are central societies and 43 are societies involving various commodities. However, only the marketing societies are directly concerned with agriculture.

The sources of funds available to Co-operative societies are:

Share Capital

Members entrance fees

Members savings and deposits

Reserves of the societies

When these sources have been exhausted, the societies can borrow from the Registrar of Co-operative Societies Loan Fund which was established in 1950 from overdrafts by commercial banks and guaranteed by the government. The overdraft limit at the end of June, 1968 when the facility was suspended was Le 800,000.

14. G.L. Karr and J.S. Bangura, "Co-operatives and the Development of a Credit System for Sierra Leone Agriculture", Bank of Sierra Leone Economic Review, Vol. 3., No. 3 (December, 1968), p. 1.

TABLE A.P.XIX REGISTRAR OF CO-OPERATIVE SOCIETIES - LOANS DISBURSED AND OUTSTANDING AS AT 30th JUNE 1968*

(Leones)

Area	Amount Disbursed	No. of Societies		Loan Outstanding - Termwise			
		Marketing & Others	T & Credit	Short	Medium	Long	TOTAL
Kailahun	56,284	57	1	20,752	2,580	5,831	29,163
Kenema	152,739	68	4	51,388	12,724	19,797	83,909
Magburaka	22,616	6	4	16,925	450	NIL	17,375
Bo	37,829	NIL	22	10,050	8,944	NIL	18,994
Western Area	11,520	3	6	2,543	883	2,794	6,220
Port Loko	108,079	27	8	24,497	31,798	NIL	56,295
Moyamba	16,840	1	6	5,902	1,724	1,446	9,072
Bonthe	253,967	30	3	96,458	50,693	17,197	164,348
Sierra Leone Co-operative Marketing Federation	182,088	-	-	152,777	4,000	NIL	156,777
TOTAL	841,962	192	54	381,292	113,796	47,065	542,153

*Exclusive of Interest

Source: Unpublished data from the Co-operative Department.

The co-operative societies provide short, medium and long term loans. Short term loans are payable within one year and are largely 'hungry season' loans. Medium term loans are provided for the purchase of lorries, lunches, equipment such as coffee and rice hullers, building materials and warehouses. These loans are payable within five years. Prior to 1962, long term loans were provided for plantations and were payable within eight years. Since 1962 such loans have been provided under the Agricultural Loans and Credit Scheme.

Table AP. XIX shows that out of a total of Le 841,942 paid to societies under the Registrar of Co-operatives Loans Fund, Le 542,153 was still outstanding at the end of June, 1968. Of these amounts the share of the marketing societies, which we have pointed out are directly connected with agriculture, was as follows:

TABLE AP. XX — MARKETING SOCIETIES: REGISTRAR OF CO-OPERATIVES LOANS RECEIVED AND OUTSTANDING AS AT THE END OF JUNE, 1968.

	Amount Received Le	Due for recovery Le	Recovered Le	Overdue Le
Short Term	558,801	538,801	186,136	352,665
Medium Term	159,865	142,140	60,785	81,355
Long Term	60,234	50,339	17,409	32,930
	758,900	731,280	264,330	466,950

Source: Registrar of Co-operatives Loan Fund Records, Co-operative Department, Ministerial Buildings, Freetown.

From this it is clear that the marketing societies account for 86% of outstanding loans. Comparing the outstanding loans with the original amount received by the societies, the repayment record has been particularly bad. The picture is worse when we examine the period over which some of these loans have been outstanding. From Table AP. XIX outstanding short term loans were Le 381,292. Of these Le 40,825 has been outstanding for between 5 and 12 years while Le 227,832 has been outstanding for between 2 and 4 years. In the case of the medium term and long term loans 25% and 40% of the overdue loans respectively have been outstanding for over three years. Because of these poor repayment records, the Registrar of Co-operative Loans Scheme was suspended in 1968.

Loans for the mechanical cultivation of rice are provided by the Rice Corporation. To be able to use the services of the Corporation, members must have fields closely grouped and must pay in advance 50% of the fees. The remainder then takes the form of a co-operative loan. The extent of such loans can be seen from the following example: During the 1965/66 financial year, 56 out of the 200 members of the co-operative society at Mabiabunde used the Rice Corporation services. The total area ploughed was 433 acres made up as follows:

Up to 5 acres	28 farmers
5 acres to 10 acres	14 farmers
10 acres to 20 acres	13 farmers
Over 20 acres	1 farmer

This small percentage ofmembers who used the facilities was mainly because the members did not have the necessary down-payment and in other cases the scale of their operation did not make mechanical cultivation profitable.

(ii) The Agricultural Loans and Credit Scheme

The objective of this scheme introduced in 1962 was to increase agricultural productivity by providing long term financial, as well as technical, assistance to those who are likely to make the most use of such credit. In the words of the White Paper introducing the scheme: "Priority will be given to applicants from already established co-operatives or farming associations, local government agricultural institutions, and individuals who on past performance have shown energy and intelligence to apply successfully the advice given to them by the Department of Agriculture."[15]

15. Ministry of Agriculture and Natural Resources, White Paper on Agricultural Development (Freetown: Government Printer, 1961) p. 3.

Prior to this scheme government assistance to agriculture was provided by the Development of Industries Board.[16] It was hoped that with the technical services of the Agricultural Department, the loans repayment record of 53% for agricultural loans granted by the Development of Industries Board would be improved.

To qualify for a loan the applicant must own land. In the case of applicants from the Northern, Eastern and Southern Provinces where land is not individually owned, the applicant is required to obtain a statement from the Paramout Chief confirming that the applicant has a right to the use of the land. The security for the loan is the land on which the project is to be undertaken. Where the applicant is unable to continue the project, the Chiefdom Councils are expected to continue the project by assigning it to someone else. There is a Loans Board for each of the Provinces consisting of:

(a) The Principal Agricultural Officer who is in charge of the loans scheme - he is Chairman of all the Loans Boards,

(b) A representative from each of the District Councils in the Province,

(c) A number representing farming interests equal to 50% and appointed by the Minister of Agriculture and Natural Resources. All recommendations of the Loans Boards are considered by the Chief Agriculturist before the loans are approved. The Chief Agriculturist is authorized to approve loans of up to Le 2,000 while loans exceeding Le 2,000 require the Minister's approval. Between 1961/62

16. The Development of Industries Board was established in 1946 with the objective of providing financial assistance to small industries as well as agriculture. By the end of 1969 the DIB had financed 41 projects of an agricultural nature. The total amount involved including interest was Le 113,538 of which Le 49,135 was still outstanding.

(c) Cont....

and 1966/67 a total of Le 132,524 have been disbursed on 296 projects involving 278 persons. Projects established under the scheme are shown in Table AP.XXI.

TABLE AP. XXI — PROJECTS ESTABLISHED UNDER THE AGRICULTURAL LOANS AND CREDIT SCHEME

	Number approved	Acreage approved	Acreage planted	Completed projects
Oil Palm	134	1,325	775	
Cocoa	52	306	234	
Citrus	45	155	77	
Marketing & Garden	9	4	4	
Plantation Development	5	-	-	
Rubber	3	30	-	
Coffee	4	12	5	
Onion	2	2	2	
Poultry	13			
Cattle raising	5			
Piggery	3			
Rice Mills	14			
Nut cracker	5			
Coffee Huller	2			
	296	1,834	1,097	

Source: Ministry of Agriculture and Natural Resources.

Table AP. XXI can be summarized as follows:

Plantation crops	Le 80,145
Livestock	25,800
Vegetable/Market gardening	2,222
Machinery	18,869
Maintenance of Plantation	488
Processing of Rubber	5,000
	Le 132,524

A plantation loan is roughly utilized as follows:

Total cost	Le 1,200
Land clearance	Le 350 or 29 per cent
Plantation	Le 140 or 12 per cent
Maintenance	Le 360 or 30 per cent
Fertilizers	Le 220 or 18 per cent
Transport	Le 130 or 11 per cent

Source: Consortium for the Development of Agriculture (CODEA), Improvement of Existing Crops and Development of Industrial Plantation (Paris: CODEA., 2 February, 1967), p. 91.

The amount due, repaid and overdue as at the end of December 1969 was as follows:

TABLE AP. XXII AGRICULTURAL LOANS AND CREDIT SCHEME: AMOUNT DUE, REPAID AND OVERDUE

	Amount due Le	Amount Repaid Le	Overdue Le
Plantation crops	4,383	757	3,627
Livestock	24,945	4,470	20,475
Machinery	17,205	6,629	10,575
Vegetable/Marketing gardening	2,280	319	2,461
	49,312	12,175	37,138

Source: Ministry of Agriculture and Natural Resources.

(iii) The Fisheries Loans and Credit Scheme

This Fund was established in 1961. Like the Agricultural Loans and Credit Scheme, the Fisheries Fund was supposed to be a revolving fund. The Fund is administered by the Chief Fisheries Officer of the Ministry of Trade and Industry. As with the Agricultural scheme, the chief fisheries officer approves loans of up to Le 2,000 while the Minister of Trade and

Industry approves loans exceeding Le 2,000. Between 1962 and 1969 a total of Le 85,306 has been disbursed to 114 individuals and 3 thrift and credit societies. The purpose for which the Fisheries Fund has been available are:

(a) The purchase of out-board motors and component parts thereof;

(b) the conversion of canoes to take out-board motors,

(c) the purchase of in-board engines and component parts thereof;

(d) the purchase of improved fishing gear,

(e) the purchase of materials in connection with fishing.

At the end of December, 1969 the total amount due, plus interest, amounted to Le 102,573. Of this amount Le 14,207 was repaid leaving a balance of Le 88,365 outstanding. From these figures it is clear that the fisheries scheme has had the worst repayment record.

(iv) Factors Accounting for the Unsatisfactory Repayment Record

The very unsatisfactory repayment record of the various schemes could be interpreted as evidence of a false demand for credit.[17] We do not agree as a number of factors account for the situation. These factors can broadly be divided into three main categories: those connected with the administration of the schemes, political influences and external factors such as world market conditions.

The Administration of the Scheme - To begin with, the procedure for obtaining loans is rather unwieldy and involves a considerable time lag between the application and the disbursement of the loan with the result that someone in real need would have obtained the amount required from

17. P.S. Schatz, Development Bank Lending in Nigeria (Ibadan: Oxford University Press, (1964). "The idea of a capital shortage in the indigenous private sector of the economy is an illusion created by a large false demand for capital; and that what really exists is not an immediate shortage of capital at all, but an immediate shortage of viable projects; i.e. projects that, all things considered, promise to be sufficiently profitable to attract private investment." p. 89.

some other sources. Briefly, the procedure adopted by the Registrar of Co-operatives for loans under the Registrar of Co-operative Loans Scheme was as follows: Applications are submitted to the Loans Committee of the Co-operative societies. The loans approved by the committee are then vetted by the Co-operative Field Inspector who reduces the size of each loan. The applications then go to the Area Co-operative Officer, who after re-evaluating the applications forwards them with his comments to the Registrar of Co-operatives in Freetown. The Registrar again evaluates the applications before approval. The approved applications then go to the sub-accountant who makes a cheque for the Registrar's signature. The cheque then goes to the Area Officer who encashes and disburses the amount personally or through the field officer. The co-operative society disburses the loan to its members when the sureties have executed a bond which sets out the terms and conditions of the loan.

Secondly, because all applicants know that the amounts applied for will be revised downwards through the various stages of the applications, they apply for far in excess of their needs and in a number of cases are able to get loans far in excess of their requirements. Also, members have been able to get excess loans for another reason. The amount of loans to each member is dependent on his produce turnover and the volume of produce brought to the society's warehouses. Thus a member can borrow up to 80% of his produce turnover if the produce is brought to the society's warehouses. To improve their chances of getting more loans, members have in several cases bought produce from other members and non-members and produced these to the society's warehouses as their own. At harvest they are unable to repay the loan because the yield is far less than their commitments.

Thirdly, according to the regulations, all applicants must state the purpose for which the loan is required, the duration of the loan, and all such applications must be supported by two sureties who should ensure that the loans are used for the purpose stated and from whom the loans should be recovered in cases of default. Also, the regulations require that before a loan is approved the committee and others reviewing the loans must take into account the credit-worthiness and character of the applicant, his earning capacity, his produce turnover, his past repayment discipline and the benefit that will accrue to the borrower. In practice, however, these conditions are not taken into account even at the top level and the reason advanced has been the lack of adequate staff. For example, 38 marketing societies were granted additional loans even though they had not repaid previous loans, and 29 others received medium and long term loans in addition to a number of short term loans. So that societies and members with very poor repayment records received further loans.

Fifthly, it is common knowledge[18] that loans are usually misused if the lending agencies do not have checks to ensure effective utilization. However, there have been cases in which loans for fertilizers, seeds and some implements were disbursed in cash instead of in kind. And because of shortage of staff, the supervision and technical services envisaged under the Agricultural Credit scheme did not materialize.

Finally, no serious attempts were made to recover the overdue loans from defaulters and their sureties. Under the Fisheries scheme it is reported that a number of the recipients could not be traced but at the same time the records do not show attempts made to recover the loans from sureties.

Political influences - This has been an important factor influencing large loans under the Agricultural Credit Scheme and the Fisheries scheme. In these two cases loans exceeding Le 2,000 are the responsibility of Ministers, and a number of such large loans have remained outstanding. The political influence too has affected the loan enforcement as in the cases of some co-operative loans involving committee members and 'big men' of the town, repayment has not been enforced.

18. Karr and Bangura, op. cit., p. 8.

External factors - The most important external factor is falling prices of cocoa and coffee. The considerable fall in the world prices of cocoa and coffee in the late 1950's and early 1960's affected the incomes of farmers and hence their ability to repay their loans.

Secondly, the repayment schedule in some cases was not realistic. For example, loans for lorries, tractors and hullers and iron safes were approved as short term loans and loans for buildings were classified as medium term loans.

Thirdly, the economics of some of the projects were not carefully examined. For example loans made for tractors, lorries and large plantations were approved without examining their economic feasibility. Stores have been built in areas where storage facilities already existed and where those available have not been used. In fact, most of the stores built with Registrar of Co-operative Societies loans have not been used and some of them have had to be rented to meet repayment obligations.

Fourthly, in approving loans for lorries, tractors, hullers and other implements, the basic assumption was that spares and repair facilities would be available. These services, were however, not provided and most of the equipment went without service and in consequence became unproductive.

These factors account for the very unsatisfactory repayment record of the credit schemes operated by government departments. Rather than suggesting lack of demand, the poor repayment records emphasize the need for specialized institutions which will not only provide credit but also educate loan recipients on how to use credit productively.

We must observe that even if the various schemes operated successfully, they are not likely to meet farmers credit needs because the amount involved is less than Le 1 million. If we take the Co-operative societies for example, the impact on agriculture cannot be significant. The co-operative societies, as we have seen, have a total membership of 46,095, only 6% of the Agricultural population. But only about 13,000 of the members of the co-operative societies are farmers. Thus, members of the co-operative societies represent only about 2% of the agricultural population. Even if the co-operatives decided to give all their available resources to farmers, the impact is not likely to be too great. To illustrate, the Balance Sheet of the Co-operative movement at the end of December, 1969, is given in Table AP XXIII.

TABLE AP. XXIII CO-OPERATIVE MOVEMENT BALANCE SHEET ON 30.12.69

Shares and savings	Le 850,000	Fixed Assets	Le 500,000
Reserves	180,000	Members/debtors	1,100,000
Appropriations	315,000	Sundry Debtors	150,000
Creditors	515,000	Liquid Funds	110,000
	Le1,860,000		Le1,860,000

Source: Unpublished data from the Co-operative Department, Ministerial Buildings, Freetown.

From this only Le 110,000 is available for new loans and running expenses. The total number of people involved in the Agricultural credit scheme and the Fisheries scheme is 396 with a total disbursement between 1961 and 1969 of Le 217,830. In the case of the Agricultural scheme 65 applications were pending at the end of 1967. No project has been investigated since 1968 because of shortage of funds. The total number of applications received between 1968 and 1969 was 650.

In sum, we must emphasize that the fact that repayment records have been most unsatisfactory cannot be taken as evidence of false demand for credit in the agricultural sector. If the administrators of the scheme do not ensure that the loan will improve the productive capacity of the recipients, it is inevitable that the repayment records will be poor. But perhaps more important, lapses in administration and the virtual absence of supervisory and extension services, coupled with little or no attempt at recovery of outstanding loans, together account for the unsatisfactory situation.

(e) The Agricultural Credit Gap

We are now in a position to give some indication of the extent of the gap which exists in the provision of agricultural credit through institutional sources.

The supply of institutional credit to the agricultural sector in 1968/9 was as follows:[19]

Sources	Available Credit
Co-operative Credit Scheme including Overdrafts from Commercial Banks	Le 800,000
The Agricultural Credit Scheme	35,000
The Fisheries Credit Scheme	13,000
Total Supply[20]	Le 848,000

We have relied on the Moinuddin Study for estimated demand for agricultural credit in 1968/69. Moinuddin estimated farmers requirements at Le 5.5 million with the following breakdown:

19. The year 1968/69 has been selected as this is the period for which demand figures are available. The figures for the Agricultural Credit Scheme and the Fisheries Scheme are the annual averages while that of the Co-operative Credit Scheme are the overdraft limit for 1968. The figure is used because it is the highest limit ever agreed upon.

20. No account is taken of repayment of previous loans as explained earlier, much attention has not been devoted to the recovery of previous loans with the result that most of these loans have been outstanding for long periods. The repayment of some of these loans is doubtful.

TABLE AP. XXIV FARMERS' CREDIT REQUIREMENTS IN 1968/69.

	Le
Short Term Loans	
Seeds	327,000
Fertilizers	127,000
Labour Charges	2,000,000
'Hungry season' loans	1,547,000
Implements	285,000
Ploughing fees	332,800
Pesticides and insecticides	10,000
	4,528,800
Medium Term Loans	
Bush clearance and levelling of land for swampland rice cultivation	123,056
Spray pumps	83,562
Coffee hullers	35,000
Rice hullers	10,500
Sheep, goat, pig breeding and poultry	25,000
Low lift pumps	30,000
	307,118
Long Term Loans	
Plantation crops, coffee, cocoa	383,000
Citrus and oil palm	191,500
Warehouses	50,000
	624,500
Total Credit Needs	Le 5,460,418

Source: S.H. Moinuddin, Agricultural Credit in Sierra Leone, Report prepared for the Bank of Sierra Leone (January 20th 1968), pp. 71 - 81.

This gives some indication of the extent of demand for credit for the 1968/69 planting season.

Thus, in relation to the institutional sources now providing agricultural credit, the gap is quite large. Relating the estimated gap of Le 5.5 million to the total assets of all financial institutions, however, gives quite the opposite result. The total assets of all financial institutions in 1968 amounted to Le 79.5 million (See Table 7.I). If the assets of the Sierra Leone Produce Marketing Board are added to the assets of all financial institutions we obtain Le 86.6 million. Thus, the estimated gap represents only about 6 per cent of the total assets of all financial institutions. This implies that it should not be difficult for the existing financial institutions to provide the amount of finance that is required for the agricultural sector. This is however, misleading. In the first place, the assets of the National Development Bank are to be excluded because the minimum loan that the NDB can make is Le 7,500 which should not exceed 50% of the share capital of the enterprise. Obviously, this is not intended for small farmers and therefore the resources of the NDB are completely outside their reach. In the second place the total assets of the Bank of Sierra Leone are not available for financing the agricultural sector. This is because the Bank of Sierra Leone Act requires the Bank to hold 50% of its demand liabilities in foreign assets. Given this legal constraint, a large part of the Bank's resources are not available. Also, the Bank of Sierra Leone Act provides that financial assistance from the Bank should be made available through institutions established with the Bank's assistance. We saw in Chapter V that the Bank has participated in the establishment of the NDB, the Benthworth Finance Company, and the Bank has promised assistance to the National Agricultural Authority and the proposed National Commercial Bank. Of these institutions, only NADA deals with agriculture. This institution will be concerned with the implementation of a particular project and therefore its resources will not be available for any other purpose. Thus, even if the Bank of Sierra Leone has resources which can be made available to the agricultural sector, there is a serious problem of how the resources can be channelled to the agricultural sector. If we exclude the assets of the Bank of Sierra Leone and NDB we are left with the assets of the following institutions:

	(Le 000)
Commercial Banks	36,629
The Sierra Leone Produce Marketing Board	7,147

Post Office Savings Bank	2,921
Insurance Companies	1,732
Co-operative Thrift and Credit Societies	805
Pensions Schemes of the government	67
Other Pension Schemes	460
Provident Funds	422

Taking the institutions in turn: Commercial banks of British origin are usually not enthusiastic about dealing with the agricultural sector. We also noted that there are likely to be problems of securities for loans to the agricultural sector since land, the only security that farmers can offer is not acceptable because of the nature of land tenure and the restrictions imposed by the Non-Citizens (Interest in Land) Act. Then there is the problem of lending to a large number of small borrowers. This not only increases the cost of administering loans, but also, there are increased difficulties in enforcing repayments. In addition, there is the risk of natural calamities such as droughts, floods and other disasters, as well as falling world prices, all of which may affect the capacity of the borrower to repay the loan when it became due. These difficulties, as we have seen, partly explain the lack of interest in financing agriculture on the part of the commercial banks and the present high rates on loans in the agricultural sector.

The Sierra Leone Produce Marketing Board has Le 2 million of its assets in government securities, Le 1 million in property and plants, stocks and stores amount to Le 1 million, creditors approximately Le 2 million. Thus, although the assets of the SLPMB are just over Le 7 million, only a small fraction of this can be available for agricultural credit. The resources of the Post Office Savings bank are less than what is required. Besides, virtually all the resources of the POSB are in the government securities. In the case of resources available to pensions, other trusts funds and the life funds of insurance companies, that part which is already invested in government securities is not available for lending to the agricultural sector. For most of these funds, however, the yield is an important consideration and to the extent that the rate of interest payable on agricultural loans are sufficiently attractive resources from this source could be expected to flow to the agricultural sector. Usually however, rates of interest on agricultural securities are not particularly attractive.

Thus, the existing institutions, without a complete reorganization of their investment pattern, and the elimination of the legal and other constraint, are not likely to assist the agricultural sector. However, the provision of agricultural credit involves much more than making loans available. It is now generally agreed that a private financial institution is not well suited for the difficulties connected with lending to the agricultural sector. Also, these risks make financial institutions unable to mobilize sufficient funds for lending to the agricultural sector. Again, as we have already indicated, it will be necessary to link marketing and extension services with the provision of credit to ensure that loans are not only available but that they are used for the purposes for which they were intended and are repaid when due. Thus, what is envisaged is either a new government sponsored institution which will itself provide all three functions, namely, credit marketing and extension services, or alternatively, a new government sponsored institution providing credit only, but working in close co-operation with the SLPMB and the co-operative societies to ensure prompt repayment, and with the agricultural department and Rice Corporation to ensure that credit is used productively.

Moinuddin has recommended the establishment of an institution which will provide all three functions. He recommended the establishment of an Agricultural Bank with the following objective: Firstly, the provision of credit facilities for the development and improvement of agriculture. To this end, the bank should provide short, medium and long term loans. Short term loans should not exceed four months. Medium term loans should be for a period not exceeding five years while long term loans should be repayable within ten years. Secondly, the bank should provide credit for cottage industries allied to agriculture. Loans in this category should be short and medium term. Thirdly, the bank should conduct general banking business. This should enable the bank to mobilize deposits especially in the rural areas where no banking facilities exist at present and at the same time augment the resources of the bank. Fourthly, the bank should assist with the marketing of produce. The objective is to ensure that the farmer gets a reasonable price for his produce. To achieve this objective it is proposed that warehousing and storage facilities be provided. Fifthly, the bank should provide technical assistance to farmers to ensure that the farmer makes effective use of credit made available to him. Finally, the bank should engage in projects aimed at enlarging the acreage under cultivation and the bank must also participate in the manufacture of fertilizers and agricultural implements. The bank should also supply fertilizers and seeds, importing these directly if need be.[21]

What Moinuddin thus envisages is not merely the provision of credit but also the general development of the agricultural sector with the agricultural bank becoming the instrument of this development. We support the general principles of the Moinuddin proposals but we would

21. The sources of funds suggested by Moinuddin are as follows: Share capital should be Le 4 million subscribed by the government. This is to be reduced to 51%. A second source is deposits mobilized by the bank. One suggestion to encourage the flow of deposits is that it should be compulsory for public bodies and quasi government agencies to deposit at least a portion of their funds with the bank. The third source is through the periodic issue of bonds and debentures. Here also he proposes that it should be obligatory for government and semi government institutions to invest in these issues. A fourth source is ad hoc budgetary grants from the government. Finally, the Bank of Sierra Leone is expected to provide soft loans and rediscount inland bills of exchange drawn for the purpose of facilitating agricultural development. H e expects some resources from foreign sources when the bank is well established.

however prefer the establishment of a government sponsored institution which will work in close co-operation with the SLPMB, the Rice Corporation and the Agricultural Department. Our proposals for the type of institution that is required was discussed in Chapter IX.

2. THE INDUSTRIAL SECTOR.

The development of industries in Sierra Leone has been sought through foreign private enterprises and through the development of small-scale indigenous businesses. The availability of credit is not a serious problem to industries financed by foreign private capital since such industries can raise the necessary finance from abroad should the need arise. The extent of foreign private investment was given in Appendix I.

Also, these firms may not encounter difficulties in obtaining credit from domestic financial institutions as there need be no problems about securities or the reputation or financial standing of the firms. Besides, we have shown in Chapter III that commercial banks' funds have gone mainly to large foreign firms. It is therefore in connection with the development of indigenous industries that the availability of credit is relevant. It is with this question that this section is concerned.

(a) <u>The Relative Importance of Industrial Credit</u>

Unlike the agricultural sector in which we have been able to indicate the extent of unsatisfied demand, we have not been able to show directly that there is evidence of unsatisfied demand for industrial credit. In other words, if one tries to find cases in which a successful enterprise has failed because of lack of finance the result of such a search is likely to be negative. On the other hand there exist several examples of cases in which funds have been spent on uneconomic projects. The problem here is due to the fact that an enterprise requires more than finance for its success. We argue however that the availability of credit can be an important factor in the development of indigenous industries. This is because supervised credit can eliminate some, at least, of the problems which at present hinder the development of small-scale industries.

Quite often the single factor approach to the development of small-scale industries has been adopted. In this approach, the most important factor inhibiting the development of indigenous industries is ascertained or assumed and efforts are then directed towards eliminating that problem. Thus, for example, governments of underdeveloped countries have concentrated on schemes for making credit available to small-scale enterprises. In the West African scene, one economist[22] has suggested that the basic problem is the economic environment while another[23] has emphasized entrepreneurship. Our analysis of the problems being encountered by indigenous businessmen, however, indicates that "any single factor approach is likely to be ineffective."[24] In emphasizing the point that too much attention should not be given to a single factor Davenport says: "the development of the modern small-scale factories depends not only on a more adequate capital and credit, but also on managerial training, technical advice, market information, project design, raw material supplies."[25]

22. S.P. Schatz, "Economic Environment and Private Enterprise in West Africa", Economic Bulletin of Ghana (December, 1963), pp 3 - 15. He observed that West African entrepreneurs encounter difficulties in getting equipment ordered, in installing it and keeping it in working order. Also, the life expectancy of equipment is shorter because of the humid climate and the lack of experienced and skilled operators. Other problems over which the businessman has no control include the locking up of large parts of the resources in raw materials to ensure continuous supplies; market size; availability of essential services such as electricity may not be guaranteed.

23. Peter Kilby, Industrialization in an Open Economy: Nigeria 1945 - 1966 (Cambridge: The University Press, 1969), pp. 335 - 342.

24. Eugine Staley, and Richard Morse, Modern Small Industry for Developing Countries (New York: McGraw Hill Book Company, 1965), Quoted from Davenport, op. cit., p.11.

25. Robert W. Davenport, Financing the Small Manufacturer in Developing Countries (New York and London: McGraw-Hill Book Company, 1967) pp. 57 & 58.

Supervised credit, that is, credit combined with the provision of ancillary services, will be fundamental for small-scale industries in Sierra Leone. This is because assisted businesses will be under obligation to implement the advice and suggestions of the lending institutions. They will do so with the knowledge that in cases of emergencies the lending institution will be ready to help. They will also be expected to receive inspectors from the lending institution. In contrast, those enterprises which do not receive any direct financial assistance from the lending institution are under no such obligation. Such enterprises may see no reason why they should abandon a method of production they have been accustomed to for one suggested by a lending institution and about which they are unfamiliar. On the other hand merely providing credit without the other supporting services and without supervision is likely to result in the credit being misused. But the commitment of the enterprise to the lending institution through credit should ensure the continuous development of small industries as such assistance would be conditional on efficient methods of production being utilized, proper accounting procedure adopted and so on. It is in this sense that we consider the availability of credit an important requirement for the successful development of indigenous industries.

(b) Problems of Small-scale Industries' Development:

Like the farmer, the Sierra Leonean businessman encounters a number of problems. First is the problem of entrepreneurship. Two factors have limited the flow of entrepreneurs. To begin with, those who undertake business do so because they could not do anything else or have just retired from the civil service or from a commercial firm. This is the case because, in common with most African countries, Sierra Leoneans have been educated to regard business as an inferior job and to regard the civil service and the professions as the place for the 'best brains'.[26]

26. Rene Dumont, False Start in Africa (London: Andre Deutsch, 1966), especially the introduction by Thomas Balogh.

In addition, jobs in the civil service and the professions ensure a steady flow of income and carry with them several fringe benefits, the most important being furnished houses, for which only a nominal rent is paid, and free medical care. Also, because of the prestige of these jobs, even successful businessmen do not encourage their children to be involved in their enterprise so as to ensure continuity.

The second factor affecting the supply of entrepreneurs is the shortage of technical skills. Manufacturing requires technical skills and this is quite apart from managerial ability. Unfortunately, technical education has not played an important part in the educational structure as we saw in Appendix I.

The attitude of the businessman himself affects his efficiency. Not only does the Sierra Leonean businessman expect quick profits, but also, these profits are invariably not used to expand or modernize the business. These profits are in fact used in conspicuous consumption to demonstrate the extent of his wealth. On the other hand when quick profits are not forthcoming or when a sudden misfortune occurs he is likely to give up the business. He does not keep proper records so that in most cases he cannot assess the profitability of the enterprise. Another aspect of the attitude of the businessman is dishonesty both on the part of partners and employees. This has resulted in most enterprises being a one-man concern. Other factors which have also contributed to the businessman's being individualistic are tribalism and the extended family system.

The central problems of a financial nature for the indigenous businessman are centred on the following. First, indigenous enterprises are under-capitalized. In 1960 Cox-George[27] found that the average size of African enterprises was Le 11,308 and with quite a few of the firms surveyed having capital as low as Le 200. In 1966 Host[28] reported that

27. N.A. Cox-George, Report on African Participation in the Commerce of Sierra Leone, op. cit., p.14.

28. R. Host, Report on Small Industries in Sierra Leone, An Approach to a Comprehensive Programme for Industrial Development in Sierra Leone with Special Reference to Indigenous Small Industry (Freetown: Government Printer, 1965), Chap. 6, para. 6. p. 14.

insufficient capital was one of the major problems facing the indigenous enterprise. This has been the case because of the sources of capital available to it. Initial capital for business has come from (a) past savings including gratuity from previous employment, (b) savings in the form of 'osusu', (c) borrowings from friends and relatives and from (d) commercial banks.

A second source of financial difficulty for the indigenous businessman is that such enterprises invariably have to extend credit to their customers. Non-repayment or delays in making payment can seriously affect the cash flow and since they rely on day-to-day sales for working capital such delays or non-repayment can cause very serious financial problems. In this regard, Marris[29] writing about traders in Kenya observed that about 90 per cent of shopkeepers have had to give credit to retain customers and many lost money in the process. This is also true of Sierra Leone.

Thirdly, there are several problems in connection with obtaining and installing equipment. For example, getting the right type of equipment and getting it in time, particularly now that the frequency of shipping services to Freetown has been reduced, have been serious problems. And so too has been the problem of spares. To take one example, in 1968 and 1969 most of the buses of the Road Transport Corporation were out of service because there were no spares. A new fleet had to be ordered in 1970. If this could happen to a large organization then it is reasonable to expect difficulties for the small operators as well. We saw in the case of the agricultural sector that equipment became unproductive because no spares were available and because there were no repair facilities.

Next, no form of industrial advisory service exists in Sierra Leone. Thus, when difficulties arise the producer has nowhere to turn to and

29. Peter Marris, "Lending Money", Journal of Modern African Studies, Vol. 5, No. 2 (1967), p. 227.

may not have the resources to secure the services of professionals. For example, there may be a sudden drop in demand for his product which he might interpret as a permanent loss and therefore close the business. In this regard, the examples from Schatz which have been referred to in Chapter IX illustrate the problem.[30]

Finally, the size of the Sierra Leone market is very small and the extent of the smallness can be seen from the following comparison:

	Population (Million)	Per Capita GNP (US $)
Sierra Leone	2.4	140
United Kingdom	54.6	1,550
Ghana	7.7	230
Ivory Coast	3.8	210
Argentina	22.3	760
Denmark	4.8	1,740
Sweden	7.7	2,130

Source: International Bank for Reconstruction and Development (IBRD), World Atlas, 1967.

Not only is the market small but it is also highly stratified. Per capita income in the agricultural sector is Le 77 per annum or less than Le 2 per week on average. This group of workers as we have seen constitutes approximately 70% of the economically active population. In the middle stratum is a wide range of workers. These include qualified clerks who earn between Le 8 and Le 10 per week. Artisans and skilled manual workers earn between Le 4 and Le 8 per week, while labourers earn

30. See Chap. IX, p. 286.

between Le 2.50 and Le 4 per week. At the upper level are graduates, politicians, senior civil servants, professionals, diplomats and businessmen. These earn Le 30 per week and over. The total number of people in this group however would not exceed a few hundreds given the educational structure. The implication is that the entrepreneur has to be alert in his assessment of market conditions and he must keep the market under constant review.

To summarize, the indigenous businessman, like his counterpart in other underdeveloped countries, especially in Africa, faces a number of difficulties some of which are the direct result of the nature of the economy while others may be attributed to the businessman himself.

(c) Institutions Providing Financial Assistance to Small-scale Industries:

Unfortunately, it was assumed that finance was the main difficulty facing small-scale enterprises in Sierra Leone and in consequence the programme of assistance to small-scale industries consisted of financial assistance only. During the period under review, three institutions have been established by the government to provide financial assistance to small-scale industries. These are the Development of Industries Board (DIB), Sierra Leone Investment Ltd., (SLIL), and the Sierra Leone Revolving Loan Scheme, (SLRLS). Whereas the DIB was established specifically for small businesses, SLIL was not so restricted. The SLRLS on the other hand is specifically for the mining industry. (See Chapter V).

(i) The Development of Industries Board (DIB).

The DIB was established in 1946 with the enactment of the "Development of Industries (Assistance) Ordinance No. 17" and the first Board of six members was appointed on the 22nd December, 1946 and held its first meeting on the 21st May, 1947. At the first meeting the Board considered 32 applications; 18 were dismissed and 14 referred for further information. By the end of the first year of its operation DIB received a total of 74 applications; 25 of these were rejected, 47 were not considered and only 2 were approved. By the end of 1948 the total applications received by DIB numbered 124 of which 10 were approved.

At the end of the first five years DIB received a total of 328 applications out of which 63 were approved. By the end of 1952, that is, the end of the first five years, DIB's approvals amounted to Le 72,438. Of this amount Le 53,800 were disbursed and arrears totalled Le 10,768. Ten years later, applications received totalled 800, of which 144 were approved.

The resources available to DIB took the form of annual grants from the government. The initial amount made available to the DIB was Le 20,000. Between 1947/8 and 1952/3 the DIB received this amount annually. In 1959/60 and 1960/61 the grant was raised to Le 30,000 but was reduced to Le 20,000 in 1962/63. There were no appropriations between 1953/4 and 1957/8 and since 1963/4. The maximum amount of loans that can be approved in any one year was Le 20,000 up to 1957 and this was raised to Le 30,000 in the period 1959 - 1961.

The loans ranged between Le 100 and Le 5,000 and only in one case was the loan as high as Le 20,000. The loans were largely for the purchase of machinery for small processing industries such as rice hulling, manufacture of soft drinks and concrete block-making. These loans were available only to enterprises which could not raise money from any other source. Table AP XXV shows the breakdown of loans disbursed by DIB as at 30th September, 1965:

TABLE AP. XXV DEVELOPMENT OF INDUSTRIES BOARD LOANS AND REPAYMENT AS AT END OF 1965.

Industrial group	Loan No.	Loan plus interest Le	Arrears No.	Arrears Amount Le	Arrears as per cent of loan & interest %
Manufacturing industries	44	34,574	32	19,034	55.1
Service industries	23	32,530	20	14,368	44.2
Fishing industries	9	7,407	6	2,822	38.1
Arts & Crafts	14	4,763	10	1,115	23.4
Land transportation	6	6,937	4	2,389	34.4
Water transportation	7	10,305	5	1,694	16.4
Agriculture	41	17,012	26	7,715	45.3
TOTALS	144	113,538	103	49,135	53.0

Source: Host Report on Sierra Leone Small Industries (Freetown: Government Printer, 1966), 58.

Most of the loans were disbursed mainly in cash. For example, loans for the erection of buildings to house equipment went directly to the applicants. But where the equipment was imported the amount involved was paid to the importer of the equipment.

The security accepted by the DIB varied widely but could be classified under three broad categories. In the first category is included cases in which the applicant has no security but is sponsored by someone who undertakes to assume responsibility for repayment. The guarantor could be a friend, relative, village headman, or trader. Invariably, however, the capacity of the guarantor to repay the loans was not investigated. In the second category are physical assets both of the applicant and those acquired by the loan.

The duration of the loan varied with the project but usually it was short and medium term. In general, there was no grace period for the repayment of principal. Some loans, however, had grace periods of between 3 and 5 years.

The rate of interest ranged between 2% and 5%. But there was no specific rule as regards the rate of interest. In general loans above Le 2,000 were at 5%, loans between Le 600 and Le 2,000 were at 3% and those below Le 600 were at 2%. The agreement also allowed a grace period for the payment of interest. This ranged between 5 years in the case of large loans to 1 year for the small loans.

Assistance provided by DIB did not take the form of specialized services. Also there were no tariff concessions as has been the case for industries established under the 1960 Development Act.

Total loans plus interest as at 1st April, 1968 (the latest date for which this information is available) amounted to Le 189,572. Repayments on the other hand were Le 52,638 and arrears amounted to Le 128,942. This unsatisfactory repayment record halted the approval of new loans during the period 1954 to 1957 and since 1964. Of the total of 144 loans disbursed 105 were still outstanding on 1st April, 1968.

(ii) Sierra Leone Investments Ltd.

Sierra Leone Investments Ltd., a joint venture between the Sierra Leone Government and the Colonial Development Corporation was established in 1961. Four sevenths of its capital of Le 700,000 was provided by the Colonial Development Corporation and three sevenths by the Sierra Leone Government. In addition to the government's contribution the government advanced the company an interest-free loan of Le 60,000 repayable in five equal annual instalments of Le 12,000 each. The management of SLIL was provided by the Colonial Development Corporation at a contract fee of Le 12,000 per annum.

It was hoped that SLIL would invest in the share capital of enterprises, and underwrite securities, as well as provide loans of various forms. The minimum investment SLIL was authorized to make was Le 20,000 but this was later reduced to Le 6,000. SLIL's total commitment on any one project was limited to 50% of the total cost. But in the case of projects in which the government is a participant SLIL could provide up to 65% of the total cost. Loans from SLIL carried interest at between 8% and 8½% and were for a period of between five and fifteen years.

(iii) Observations on the Assistance Programmes

On the performance of the DIB and SLIL one would conclude that there is no effective demand for credit in the country.[31] But such a conclusion would be incorrect because of the way in which the assistance programmes were conceived, formulated and administered. The DIB and SLIL were established on the assumption that finance was the only obstacle to industrial development. Secondly, the DIB was badly administered due partly to a management which lacked the necessary training and partly also to the fact that the DIB did not have a staff of its own for all the necessary feasibility and pre-investment studies, nor was it possible for the DIB to undertake any follow-up once a loan had been approved.

31. S.P. Schatz, Development Lending in Nigeria (Ibadan: Oxford University Press, 1964), Schatz concluded his study on the Nigerian Development Bank as follows: "The large false demand for capital creates the illusion that there is a shortage of capital. But the records indicate that the true situation is the converse of a capital shortage. Instead of a large number of viable projects vainly seeking capital the situation has been one of capital vainly seeking viable projects.".* He arrived at this conclusion by examining the applications for credit submitted to the Federal Loans Board. He observed that the FLB received a total of 336 applications during the period 1958 - 1962. Of these 290 were not considered economically viable; 46 were considered outside the terms of reference of the FLB; and only 61 were approved. Of those approved, 7 did not have acceptable securities. Thus the effective demand was only 54 out of total applications of 336. He contended that those considered economically viable were as high as 61 because the FLB in its attempt to encourage economic development approved marginal projects and in some cases watered down the securities requirement. But of the 54 projects actually financed by the FLB 11 have proved a failure and 7 others have been experiencing serious difficulties. Thus the number of successful enterprises in relation to the initial number of applications has been quite small.

* p. 97.

In addition, there were political influences which affected both the approval of loans and the enforcement of loan repayments.[32]

Rather than being used as evidence of false demand, their experience should emphasize the need for and the desirability of a more comprehensive approach. Thus Marris[33] writing about African entrepreneurship states that "It is perhaps even more important to create a setting in which Africa businesses are being constantly encouraged through advisory services, training and credit facilities, contract, help in finding markets, and in approaching suppliers."

Some of the difficulties facing the businessman are due to entrepreneurial difficiencies. On the other hand our discussion also reveals that some of the problems are the direct result of the underdeveloped nature of the economy. In most underdeveloped countries it is now recognized that small industries need special assistance without which they are not likely to survive. This assistance, in the words of Basu, involves "...providing elements that may be missing".[34]

The operations of the National Development Bank can be used as one example of direct evidence of effective demand for credit. We noted that during the first four years of its commencing operations, the NDB supported 14 projects, that is, ignoring those which were still in the pipeline. Comparing these approvals with the total number of

32. The following examples illustrate our point. The day-to-day management of the DIB was the responsibility of the Secretary who was of the rank of an Administrative Officer at a salary of Le 1,128 per annum. In contrast, the Secretary of the Hotels and Tourist Board earns Le 5,000 per annum. The reason for the vast difference in salary is the difference in training and experience. Not only is the Secretary of the DIB not trained he does not have the qualified officials for the necessary feasibility studies, pre-investment studies, and post-investment supervision. In addition to these administrative weaknesses is the fact that although the DIB began operations in 1947 it was not until 1957 that the DIB actually defined criteria on which loans were to be granted.

33. Marris, op. cit., p. 229.

34. S.K. Basu, The Theory and Practice of Development Banking (Bombay: Asia Publishing House, 1965), pp. 26 and 27.

applications received the figures are not impressive, as approvals were only about one sixth of total applications received by the NDB. But the number of approvals is significant for two reasons. First, we should recall that the NDB can only assist projects which have been well prepared and are economically and technically sound. Since the shareholders include international financiers as well as banks, and being entirely private and with emphasis on returns on investment, there should be no question of standards of approval being low. In effect the 14 approvals, though small in relation to total applications received, suggest that there is demand. The second point is that if there was an institution responsible for investigation of projects as well as providing other ancillary services, it is probable that the number of projects presented for financial assistance could be higher.

(d) <u>Conclusion</u>

Given the emphasis on agricultural development and the size of the Sierra Leone market, small scale agro-based industries are likely to make a significant impact on the economy.

We argue that the present economic position of the farmer is such that unaided he cannot adopt the new methods and techniques which are required for increased agricultural productivity. In particular, we note the almost complete absence of institutional sources of agricultural credit, point out the implications, and in the light of demand information, give some order of magnitude of the agricultural credit gap.

In the case of the indigenous industries we argue that purely financial assistance cannot ensure success, as other ancillary services such as marketings, getting supplies especially from overseas, keeping proper records and training personnel are equally important. These services are, however, not easily available and the local businessman is not likely to provide them for himself. It is in the wider sense of an overall assistance, that we consider the availability of credit an important condition for the successful development of small scale industries.

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