

Makereve Institute of Social Research

EDRP. 101.

Corrigendum

Insert "Central" before Bank of Kenya Act in heading.

P.3. line 17. insert line omitted: "by the President;
in the case of Kenya" after appointed.

P.4. line 7. insert English at end of line.

P.5. line 13. Delete all after "These requirements are
set out in the following table" to end of page and
insert table below:

MINIMUM ALLOCATION

TO RESERVE

	If Reserve Fund is Less Than:	Proportion of Ner Profits to be transferred to Reserve Fund:
KENYA	100% of authorised capital	25%
TANZANIA	100% of authorised capital	25%
	300% of authorised capital	12½%
UGANDA	50% of paid-up capital	100%
	100% of paid-up capital	25%
	200% of paid-up capital	12½%

W.T.N.
24/10/66.

Comparative Analysis of Central Bank Acts.

Bank of Tanzania Act, 1965
Bank of Kenya Act, 1966
Bank of Uganda Act, 1966

In making this comparative analysis I shall concentrate on those matters in which the three banks differ; there are of course numbers of matters on which the legislation is identical or virtually identical. Thus, all the East African banks are to be sole banks of issue, taking over assets and liabilities from the Currency Board, and they are all to have the same legal status, namely, that of a body corporate, with perpetual succession and a common seal which may sue or be sued in its corporate name.

The first matter in which there are subtle differences is the statement of the objects of the banks. It is not suggested that the operations of the bank will be very significantly different because of differences in fine shades of meaning in the objects stated in the legislation. In general, central bank legislation differs very considerably in this characteristic, ranging from Acts which specify no general objectives at all, such as that of the Bank of Rhodesia and the Act which established its predecessor bank, the Bank of Rhodesia and Nyasaland, neither of which specify any general objective at all. At the other extreme, the Monetary Law Act of Ceylon specifies fairly comprehensive objectives as follows:

- (a) the stabilisation of domestic monetary values;
- (b) the preservation of the par value of the Ceylon rupee and the free use of the rupee for current international transactions;
- (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 the productive resources of Ceylon.

Moreover it goes on to set out in two long sections the matters to be taken into consideration and action to be taken in connection with domestic monetary stabilisation and international monetary stabilisation respectively. Of the two extremes, saying nothing is probably better than cluttering up the central bank with preconceived notions of how it shall perform its functions. The East African Acts confine themselves to fairly succinct statements of the basic objectives, which are contained within sections of the Acts in the case of Kenya and Tanzania, but in the preamble to the Act in the case of Uganda.

Section 4 of Kenya's Act reads:

"The principle objects of the Bank shall be to regulate the issue of notes and coins, to assist in the development and maintenance of a sound monetary, credit and banking system in Kenya conducive to the orderly balanced economic development of the country, and the external stability of the currency, and to serve as banker and financial adviser to the Government".

Tanzania's Act, Section 5(2) reads:

"Within the context of the economic policy of the Government the activities of the Bank shall be directed to the promotion of credit and exchange conditions conducive to the rapid growth of the national economy of Tanzania, due regard being had to the desirability of fostering monetary stability".

The preamble to the Bank of Uganda Act reads as follows:

"An Act to establish the Bank of Uganda which shall issue legal tender currency and maintain external reserves in order to safeguard the international value of that currency, promote stability and a sound financial structure conducive to a balanced and sustained rate of growth of the economy and other purposes connected therewith".

There is probably general agreement about the threefold objective of monetary policy, that is to say, internal stability, external balance and a high rate of growth. The real trouble arises where these are not consistent in the policy that they require. The wording in which these objectives are expressed is not very important, but the relative weight that is given to them may be significant. There can be no doubt about the emphasis in the preamble of the Bank of Uganda Act: the stress is clearly upon safeguarding the international value of the currency and promoting stability and a sound financial structure. The words chosen in connection with the rate of growth are such as to minimise any possible conflict between this and the primary objectives.

The Central Bank of Kenya (or the Banki Quu ya Kenya) is modest, in that its objective is only to assist in the development and maintenance of a sound system, conducive to the orderly and balanced development of the country and the external stability of the currency. Here it is an orderly and balanced development to which the financial system is to be conducive.

The Bank of Tanzania is first of all firmly put in its place viz-a-viz government because its objectives are defined 'within the context of the economic policy of the government'. Of course; this must be so for any central bank, and there is probably nothing very sinister

in saying it, or in leaving it out. But it is perhaps suggestive that the Bank of Tanzania is to be directed 'to the promotion of credit and exchange conditions conducive to rapid growth'. There then follows the qualification to this, 'due regard being had to the desirability of fostering monetary stability'. What this means depends upon how much regard is thought to be due to monetary stability but we can deduce from the ordering of these objectives something which is not surprising, namely that Tanzania is in a hurry. This does not constitute a bad mark from the confidence point of view, as many people might suppose, because an African government which is not in a hurry may not be very stable.

Turning to the actual constitutions of the banks, they all have in common, management by a Board, which in the cases of Kenya and Uganda comprises a Governor, Deputy Governor and a number of directors; Tanzania differing only in having a Director General in place of Deputy Governor. In all cases the Governor and Deputy Governor (Director General) are appointed for four years, and eligible for reappointment; in the case of Uganda for five years and eligible for reappointment; in the case of Tanzania no term is specified in the legislation. Uganda specifies that the Governor and Deputy Governor shall be persons of recognised financial and banking experience, but the Tanzanian and Kenyan Acts are silent on this point. The Kenya Bank is to have four directors, the Tanzanian Bank five directors, and the Uganda Bank between five and seven directors. In no case is any qualification for directors laid down in the legislation though there are the usual disqualification of persons of un-sound mind, bankrupts, and felons. Practice regarding qualifications differs considerably among the central banks of English - speaking Africa: the Bank of Rhodesia, not only specifies that the directors shall be engaged in financial commercial, industrial or agricultural pursuits, but allocates a number of directors to each of these fields; the Banks of Nyasaland and Malawi both require that the directors shall be of recognised standing and experience in business professional or academic fields; the most nebulous requirement is that of Zambia which requires that they shall be 'persons of recognised standing'. The fact that the East African banks have not thought fit to commit themselves even to this qualification is probably not a significant indication of contrary intentions.

The most important distinction which must be made in respect of the composition of the Board, and indeed the constitution of the Banks, is the fact that both Kenya and Tanzania legislate for the Permanent Secretary to the Treasury to be a full voting member of their respective Boards. Uganda, on the other hand, has maintained what might be described as the British tradition of excluding government from the deliberations and decisions of the Board; only in Ghana among speaking African countries is there a government representative on the Board, but this is quite common elsewhere. The advantage is that it maintains close contact between the Ministry of Finance and the central bank, and that the Ministry of Finance is aware of the problems with which the central bank is trying to deal, and is able, in this context, to present the government's financial policy to the Board. On the other hand, there is considerable strength in the argument that government representation confuses a vital issue by involving the government on both sides of the counter. Ultimately the government view must, of course, prevail; but the Board is likely to assess the requirements of the monetary situation much more clearly and objectively if one of its major borrowing customers is not one of its members. That the government's policy must ultimately be paramount is clearly recognised in the Uganda legislation: Section 45 of the Act, (Minister's powers of Direction) reads as follows:

The Minister may, after consultation with the Governor, give directions of a general nature relating to the financial and economic policy of the Bank, and the Bank shall be bound to comply.

This makes the relationship clear-cut and unambiguous; the Board is autonomous in its deliberations and decisions, but these decisions are ultimately subject to direction from the government.

The government's ultimate authority is secured in the case of Kenya via the right of the Treasury representative (shared with the Governor) to suspend a vote and refer the matter to the Minister, whose decision is binding. In the case of Tanzania the Governor or Treasury representative may require a decision of the Board to be postponed for seven days, and although there is no explicit provision for reference in such case to the Minister, it is clear that such reference would be made on any questions of conflict, and that the outcome would be the same as

that specified in the Kenya Act.

Turning to the provisions for the capital of the banks, one is tempted to make the cynical comment that these appear to have been determined by a competitive auction with the object of establishing confidence. Thus, Tanzania started off by specifying a capital of £1 million, Kenya followed with £1.3 millions, and Uganda resoundingly capped these two bids by specifying a capital of £2 millions. The ratio of these figures to the volume of total commercial bank deposits, respectively, is as follows: Tanzania 2.2 percent; Kenya 1.8 percent, Uganda 5.7 percent. The provisions regarding the accumulation of reserves differ considerably in the percentage of profit to be put to reserve as the reserve grows relative to capital. These requirements are set out in the following table, which also shows the way in which the combined capital and reserves of the Banks will accumulate after five years, after ten years and the final position, on the assumption that only the specified minimum provision is made for reserves. The table assumes a constant profit equal to that earned by the Currency Board in 1964/65, shared between the three Central Banks on the basis of the currency distribution as estimated by the Board in the 1965 Report.

CAPITAL AND RESERVES

Total Capital Plus Reserves (Minimum)

£ M	On Establishment	After 5 years	After 10 years	Finally	Minimum % of Profit to Reserves
Kenya Annual Profit £1.2m	1.3	2.8	2.8	2.8	R < £1.3: 100%
Tanzania Annual Profit £1.3m	1.0	2.35	3.1	4.0	R < £1m: 25% R < £3m: 12½%
Uganda Annual Profit £1.1m	2.0	4.15	4.9	6.0	R < £1m: 100% R < £2m: 25% R < £4: 12½%

- Assumptions
- (i) That no more provision for Reserves is made than is specified in the acts.
 - (ii) That profits of the three banks together average out at the profit earned by the Currency Board in 1964/5.
 - (iii) That profits accrue to the Banks in proportion to estimated currency distribution.

We turn now to a consideration of the provisions for the unit of currency and its value. All three countries retain the shilling (with a small s in each case) as the unit of currency. Only Kenya differentiates it as a Kenya shilling. All are divided into one hundred cents, and similar provisions are made for the legal tender status of the currency.

No doubt, in spite of the fact that the law lays down that the unit of account in Uganda and Tanzania shall be the shilling, this will eventually become, in common practice, the Uganda and Tanzania shillings. It is questionable, however, whether the failure to specify the national differentiation of the shilling might not lead to considerable legal difficulties in connection with obligations expressed simply in shillings. In fact, however, large sums, including government accounts, official statistics and Central Bank Report, will continue, as at present, to be expressed in pounds. Only Kenya recognised this in its legislation by including a clause reading "twenty shillings shall equal one Kenya pound". Thus Kenya seems to have covered the matter fully, providing for the distinctive character of the Kenya shilling and providing also for the fact that for large sums the unit of account is the pound, although the Kenya shilling is the unit of currency.

It seems a pity that Kenya, explicitly by its reference to the pound, and Uganda and Tanzania implicitly, by the fact that the pound will continue to be used as a unit of account, have not grasped the opportunity for a complete conversion to the decimal system. This was done very simply by Sierra Leone in 1963, when the Central Bank and independent monetary system was established. The new unit of account and currency is the Leone, which is equal to one hundred cents, the par value of which is 1.24414 grains of gold, eleven twelfths fine, which is equal to ten shillings sterling at the present par value. Sierra Leone has thus provided itself with a unit of account which is sufficiently large to enable it to be used conveniently for the expression of sums running into tens of millions of pounds, and which is much more convenient even for small transactions. The same method was employed when the Rand replaced the pound in the Republic of South Africa. The strong desire for each country to maintain the continuity of the name of the unit of account has prevented the same

rational solution in East Africa. Had each country invented a new name for its unit of account, and each made this unit divisible into ten shillings, all the advantages of the decimal system could have been obtained with the minimum departure from continuity, since the shillings would then have continued as at present, but there would have been a national differentiation of the unit of account which would have prevented any legal confusions resulting from the lack of such differentiation. In all three cases the Acts provide that the par value of the unit of currency shall be determined in accordance with international agreements. In Kenya and Tanzania the par value is to be determined by the President on the advice of the Bank, and in Uganda by the Minister on the recommendation of the Board. All three Acts specify that the deviations from the par value of the currency shall not exceed one per cent, this being the margin laid down by the International Monetary Fund of which all the countries are members. In this connection it is interesting to note that Uganda is the only case in which the Act actually specifies that the national currencies shall be convertible. This is secured in the Bank of Uganda Act by Section 20 (Obligation in respect of Currency) which reads as follows:

- Subject to the provisions of any enactment relating to exchange control and of this section, the Bank,
- a. shall on demand buy and sell the shilling against sterling;
 - b. may buy and sell the shilling against gold or other currencies eligible for inclusion in the reserve of external assets specified in Par.B of Subsection 1 of Section 24 of this Act.

It is the obligation under (a), that the Bank 'shall on demand buy and sell the shilling against sterling', which differentiates the Bank of Uganda Act from the other two Acts. Since both Kenya and Tanzania have stated their intention of maintaining the convertibility of their currencies, and since any departure from convertibility would be by some stipulation in an enactment relating to exchange control to which this obligation is subject in the Uganda Act, the absence of such an obligation is probably not significant. A similar obligation appears in the central bank legislation of Malawi and Zambia, but not in that of the Bank of Rhodesia and Nyasaland, now defunct, nor in that of the other successor bank - the Reserve Bank of Rhodesia. In fact Malawi and Zambia

are the only two of the English-speaking African countries which have legislated explicitly for conversion into sterling.

It is possible that the second Subsection of Section 20 in the Bank of Uganda Act may confuse others, as it did the present writer, at first reading; it reads:

"For the purpose of paragraph (a) of the preceding subsection,
(a) the rates of exchange quoted by the Bank for spot transactions shall not differ by more than one per centum from the parity of the shilling with the parity of sterling declared by the International Monetary Fund".

This does not mean that the present exchange rate viz-a-viz sterling is built into the Act; it simply specifies the one per cent margin in terms of the 'cross rate' on sterling parity, thus fixing a rate at which Uganda shillings shall be converted into sterling independently of the direct exchange rate between sterling and the Uganda shilling which may be established by their relative par values at any particular time. Thus, if sterling were to be devalued, the rate at which the Bank of Uganda would be bound by this section to deal in sterling, is the rate implied by the new parity of sterling declared to the International Monetary Fund, unless, of course, the Minister, on the recommendation of the Board, determines a new parity for the value of the Ugandan shilling, which he is empowered to do by statutory instrument at any time.

We turn now to the limits which are imposed by the legislation on the ability of the central banks to create credit. As a direct comparison is somewhat complicated it will be convenient to divide the provisions in the legislation into three sections: (a) short term advances to Government; (b) holdings of government securities; and (c) the aggregate amount of loans outstanding in favour of government.

(a) Short term advances.

The provision for short term advances to government is similar in the Tanzanian and Ugandan Acts; such advances are not to exceed twenty per cent of recurrent revenue in the case of Tanzania, and are limited to three hundred days; in the case of Uganda short term advances are limited to fifteen per cent of recurrent revenue, and must not remain outstanding for more than three months after the end of the financial year in which they are contracted. Not only do the Acts, in both cases, ensure the

short term nature of these advances but the purpose of them is explicitly stipulated in both Acts. In the case of Uganda the wording is 'advances in respect of temporary deficiencies of recurrent revenue'; in the case of Tanzania the wording, which contains a curious linguistic inaccuracy, is as follows: 'The Bank may make direct advances to the Government for the purpose of offsetting fluctuations between receipts from the budget revenue and payments of the Government'. There cannot, of course, be fluctuations "between" revenue and payments, but it is clear that the intention is to provide for offsetting unsynchronised fluctuations in revenue and payments. The Uganda Act provides for this more succinctly by referring to 'deficiencies in recurrent revenue' which will presumably be interpreted as deficiencies relative to recurrent expenditure. It is however a nice point whether the Bank could resist requests for advances in respect of non-recurrent payments for which recurrent revenue was "temporarily" deficient. Be that as it may, the limits are in both cases clearly stated and unambiguously confined to short term purposes by the stipulated time limits.

The Kenya Act permits direct advances to government but puts the limit to government borrowing on the aggregate of such direct advances plus total government securities held. This provision therefore falls to be considered under Section c.

(b) Government security holdings.

Here it is necessary to make a distinction between the limits which are set to securities in terms of maximum life to maturity, and the limits which are set to the total holding of government securities including long term securities. Kenya specifies that the total holding of securities with more than twelve months to run shall not exceed £3 million. Uganda allows the Bank only to buy securities of the Government maturing within twenty-five years and specifies a limit on securities having more than twenty-four months to run equal to thirty per cent of the demand liabilities of the Bank. At the outset the demand liabilities of the Bank will be equal to currency outstanding plus such deposits as the government and the commercial banks transfer to the new bank. The figure represented by this limitation is not at present capable of precise calculation, but it will probably not exceed £6m when the Bank is established. In contrast with Kenya, where the limit is

an absolute one, the limit in the case of Uganda will increase with the increase in the Bank's demand liabilities. Tanzania prescribes an overall limit of an amount equal to twenty-five per cent of average ordinary revenue and further prescribes that no more than an amount equal to ten per cent of annual ordinary revenues shall be in securities which mature later than twelve months from the date of acquisition by the Bank. Calculating, as specified in the Act, on the basis of revenue during the three preceding financial years, the current limit would be about £7.5 million and £3 million respectively.

(c) Limit on aggregate lending to governments.

The Kenya Act provides that the total of direct advances, plus the total of government securities purchased by the Bank, plus government securities held as collateral for loans, shall not exceed a fixed amount of £12 million. It is specified that the securities taken over from the Currency Board are not to count for the purpose of implementing this limit. The limitation therefore applies to all future credit creation in favour of government together with government securities held against loans, for example to the banks. Being an absolute limit expressed in money terms it will certainly require amendment eventually. Tanzania, as we have already seen, provides for a limitation on short term advances, of an amount equal to twenty per cent of average ordinary revenue. In addition it prescribes a limit equal to twenty five per cent of average ordinary revenue for total securities held at any one time by the Bank including both those purchased by the Bank and those held as collateral security for loans given by the Bank. Calculating as specified in the Act on the basis of average ordinary revenue during the three financial years immediately preceding the year in which the calculation is made, the combined limit would, currently, be £12 million approximately. When we turn to Uganda it is somewhat surprising to find that the Act prescribes no overall limit to the amount of lending to the Government. The only two limitations specified in the Act are those with which we have already dealt, namely, the fifteen per cent of recurrent ordinary revenue on short term advances, and the limit equal to thirty per cent of demand liabilities on securities exceeding twenty four months to maturity. It would seem, therefore, that there is no limit prescribed to the amount of securities with less than twenty four months to run which the Bank may hold. This

of course would include Treasury Bills, which in the United Kingdom, in spite of the fact that they were originally intended to offset deficiencies of revenue and to be instruments for temporary borrowing, now constitute a substantial part of the permanent national debt of the United Kingdom. It is true that in Uganda's case the liquidity of the securities over which no limit is specified would ensure that the Bank technically had the whip hand in that it could run them off within a comparatively short period of time, assuming that the maturity was evenly distributed. Nevertheless it does mean that in respect of this form of borrowing there is no absolute limit to which the Government can be referred by the Bank except that relating to the minimum external reserve which in Uganda's case is expressed in terms of the Bank's liabilities. It is perhaps worth pointing out that the same prima facie gap occurs in the legislation relating to the Central Banks of Sierra Leone and Zambia, and the now defunct Bank of Rhodesia and Nyasaland. Indeed, in the case of the latter bank, no restriction on lending to government is specified at all, and in the case of Zambia there is no limit except with regard to short term advances, although it is only allowed to purchase government securities which mature within twenty five years. In all other cases of central banks in English-speaking Africa there is an overall limit on the amount of central bank lending to the government. (Summary in Appendix One).

We examine next the powers of control that these banks have been given over financial institutions which are in all cases pretty comprehensive. In respect of minimum cash reserves all three Acts allow the Central Bank to specify the minimum balances which must be held with the Central Bank by the commercial banks and allow them to differentiate with respect to different kinds of liabilities. In all three cases the maximum balances which can be required is set at twenty per cent of the total liabilities of the commercial banks; Kenya and Tanzania specify thirty days notice for a change in such requirements, but Uganda states that the period of grace shall be specified by the Bank. In all cases it is specified that the regulations shall be uniform for all banks.

None of the Acts explicitly empowers the Central Banks to prescribe liquidity ratios, which is surprising, considering that it is only by such a control that a central bank can prevent a banking system based upon an external money market from frustrating attempts to control bank expansion

via a cash ration. This was soon discovered by the Bank of Rhodesia and Nyasaland which had to amend its legislation to introduce compulsory minimum liquidity ratios which could be prescribed and varied from time to time by the Bank. The neglect to provide this weapon specifically presumably means, assuming that it is not proposed to close access to London entirely by exchange control, that the present fully loaned up position of the commercial banks is assumed by the authorities to guarantee a closed position.

With regard to control of interest rates, Kenya and Tanzania restrict themselves to specific provisions in respect of interest on deposits only. Thus, the Kenya Act prescribes that the Bank may determine maximum rates paid by specified banks on deposits, while the Tanzania Act prescribed that maximum, or minimum rates on deposits may be prescribed by the Bank. Uganda's explicit provisions in this matter are more comprehensive, in that the Bank is empowered to prescribe maximum or minimum rates of interest on deposits or other liabilities and on credit extended in any form.

So much for the specific powers set out in the Act. These are in each case supplemented by very wide general powers which it will be best to quote verbatim. The relevant provisions in the Kenya Act are contained in Sections 40 and 41, which are as follows:

40. (1) The Bank may issue instructions specifying in respect of any loans, advances or investments made by specified banks -
- (a) the purposes for which they may or may not be granted,
 - (b) the maximum maturities or, in the case of loans and advances, the type and minimum amount of security which shall be required, and in the case of letters of credit, the minimum amount of margin deposit; or
 - (c) the limits for any particular categories of loans, advances or investments or for their total amount outstanding.

Section 41 reads as follows:

41. (1) The Bank may issue instructions designed to control the volume, terms and conditions of credit, including instalment facilities, in the form of loans, advances or investments, extended by specified financial institutions.

In both cases the second subsection provides for the gazetting of the instructions and for their uniform application. It is very difficult to imagine that a central bank would ever wish to do anything which does not come within the very wide terms of these powers.

The Bank of Tanzania Act gives the Bank controls which are specified in Sections 49 and 50 as follows:-

- 49 (1) The Bank may, when it considers such action necessary, issue orders to control the volume, terms and conditions of credit extended by banks and, in the transaction of their business in Tanzania, the Bank shall comply with such orders.
- 50 (1) The Bank may, when it considers such action necessary, issue orders to control the volume, terms and conditions of credit (including instalment credit) extended through loans, advances or investments by specified financial institutions and, in the transaction of their business in Tanzania, such institutions shall comply with such orders.

The second section in each case provides for the gazetting of the instructions, for their uniform application, and specifies that the institutions concerned shall not be required to take any step to reduce any existing credit prematurely. The legal interpretation, if it should ever come to that, of the word 'prematurely' is an interesting speculation. The obvious interpretation is 'prior to maturity', but it is very doubtful whether that is what the drafters of the clause had in mind. If it were thus interpreted it would simply mean a prohibition on new loans. However, it cannot be denied that the powers given to the Bank are comprehensive and it is questionable whether, with such general provision included in the legislation, it is necessary to specify any of the other particular controls which the Bank may employ.

The general powers given to the Bank of Uganda are specified in Section 32 of the Act.

- 2 (1) The Bank may, by statutory instrument, prescribe,
- (a) the maximum amounts of investments, loans, advances and bills and promissory notes discounted whether applied in total or to any specified class or classes of such investments, loans, advances and bills and promissory notes discounted which each banking institution may have outstanding during such period as may be specified by the Bank;
 - (b) the purpose for which loans and advances may be granted and the class of business underlying investments and bills and promissory notes discounted;
 - (c) the maximum period of loans and advances and the type and minimum amount of security which shall be required; and the maximum tenor of bills and promissory notes discounted;
 - (d) the maximum or minimum rates of interest and other charges which in the transaction of their business banking institutions may pay on any type of deposit or other liability and impose on credit extended in any form.

It is difficult to think of anything that a central bank would want to do by way of controlling banking institutions which is not included in this list, but the powers are not specified in the general terms which confer potential omnipotence upon the Banks of Tanzania and Kenya. One respect in which the powers given to the Bank of Uganda do seem to be defective is that they refer only to banking institutions. The definition of banking institutions given in Section 50, (interpretations) of the bill is that this term 'includes the Uganda Commercial Bank and a bank licenced under the Banking Ordinance, 1955'. This presumably means 'any bank licenced under the Banking Ordinance 1955', and it seems a little patronising to point out that the term includes the Uganda Commercial Bank but presumably it is not so licenced. However, it is clear that the term does not include non-bank financial intermediaries which are likely to be of increasing importance in the future development of the financial system.

Finally, we have to consider one of the most important provisions made in the legislation, that relating to the external reserves of each central bank. We will first consider the specification of the composition of the foreign exchange reserve.

In the case of the Bank of Tanzania the foreign exchange reserve must consist of any or all of the following:

- (a) gold;
- (b) convertible foreign exchange in the form of -
 - (i) demand or time deposits with foreign central banks, or with the banks' agents or correspondents abroad;
 - (ii) documents and instruments customarily used for the making of payments or transfers in international transactions;
 - (iii) notes or coins;
- (c) securities of, or guaranteed by, foreign governments or international financial organisations or institutions.

The form of the convertible foreign exchange, and the kinds of securities which may be held are to be determined by the Bank from time to time.

The requirements for the Bank of Kenya are identical, except that, under the third general category (c) it is specified that the securities shall be 'convertible and marketable'. The requirement that the securities held by central banks should be those of foreign governments whose currency is convertible is a normal requirement and it is surprising that

it is not specified in the Tanzanian Act. The requirement that the securities shall be marketable is not a usual provision in central bank legislation, but it seems to be an eminently sensible one. It is not much use holding securities expressed in a convertible currency if it is impossible, at any reasonable price to convert such securities into the convertible currency.

The stipulation in the case of the Bank of Uganda is similar to that of Tanzania, except that the composition of the reserve is specified in more detail, and in respect of all foreign financial assets there is a clear specification that they must be of a country whose currency is sterling or is freely convertible into gold or sterling. It is further provided that securities should not exceed forty per cent of the total reserve, and that three quarters of these securities shall mature in periods not exceeding five years. Uganda therefore specifically provides, as does Kenya, for convertibility of the securities held in the foreign exchange reserve, and also specifies a measure of liquidity for such securities, but in a balance of payments crisis liquidity based upon a maturity under five years is not the same thing as marketability. However, this point is mainly of academic interest in view of the substantial minimum of foreign exchange reserve which must be held, for if some part of the foreign exchange can never be used by virtue of the minimum requirement, then neither the marketability nor the liquidity of this element is of much concern.

All three countries specify a minimum foreign exchange reserve, but in rather different terms. Both the Tanzania and Kenya Acts stipulate that the Bank must 'use its best endeavours to maintain a reserve of external assets at an aggregate amount of not less than the value of four months imports'. Uganda however, imposes a rigid legal minimum, in the following terms: 'The value of the reserve of external assets specified in the preceding subsection shall not be less than an amount equivalent to forty per centum of the total demand liabilities of the Bank'. A clause added after the Bill was printed provides for the possibility that during the period of conversion the external assets taken over from the Currency Board may be less than the required proportion of liabilities. Converting these requirements into pounds, with the reservations that have previously been made about the imprecision of forecasting the actual level

of the Bank of Uganda's demand liabilities the results are as follows:

	<u>£ Million</u>		<u>Number of months imports</u>
Kenya	30.0	=	4
Tanzania	17.0	=	4
Uganda	9.0	=	2

The whole concept of a minimum foreign exchange reserve is a very complicated one. In the first place it is arguable whether it is desirable in principle; in the second place it is arguable in what terms it should be set; and in the third place the appropriate level for such a stipulated reserve is very difficult to determine. It should be stressed that the last question is a quite separate one from the question of the size of reserve at which a central bank should normally aim.

The form of the specification of the minimum reserve requirement in the Tanzanian and Kenyan Acts is clearly intended to get over the basic disadvantage which is inherent in the stipulation of a minimum external reserve. That is the fact that, as soon as a minimum is stipulated, the specified amount of foreign exchange becomes immobilised for ever. Requiring a central bank to use its best endeavours to maintain a reserve of not less than a specified amount is quite a strong injunction in countries where the practice of informed public criticism is highly developed and it has the advantage that, in an emergency, which can be shown to be of short duration, the use of part of the stipulated reserve is possible and desirable. In opposition to this argument it is claimed that a provision requiring a minimum of foreign exchange to be held as an ultimate reserve is conducive to confidence in the currency. If this is so, then the confidence generated is either irrational or based upon the assumption that if the worst comes to the worst the requirement will be suspended. But in matters of foreign exchange, particularly in the minds of speculators, rationality is not the thing that matters: if, in the opinion of financiers, the strength of a currency depends on the Governor of the Central Bank burning yellow candles wearing a pink toga at midnight preceeding each meeting of the Board, then at midnight, wearing a pink toga, yellow candles, he must burn. A more rational argument for the legal minimum which is exemplified in the Uganda legislation is that it constitutes an unanswerable check to any pressures which may be brought to

bear upon the Bank to increase credit beyond the point at which the reserve has been reduced to, or near to, the minimum point. This argument relates also to the second of the questions raised above in respect of the terms in which minimum external exchange requirements should be expressed. By relating the minimum reserve requirement directly to the liabilities of the Central Bank, any increase in credit after the point at which foreign reserves have fallen to the minimum point is actually illegal. The Central Bank cannot at that point expand its liabilities without breaking the law. This would apply even if it could be argued that the whole of the extra credit created would be confined within the economy and lead to no deterioration in the external balance, because the expansion of credit would, in itself, lower the ratio of foreign exchange to liabilities below that specified, by virtue of the necessary increase in the Bank's liabilities.

In this connection it may be pertinent to recall that the legal limit placed upon the Bank of England in respect of its note issue by the Bank Charter Act of 1844 had to be suspended on three occasions during the nineteenth century, and the Governor of the Bank of England had to be indemnified by a subsequent Act of Parliament for having broken the law. Such a procedure can be obviated by stipulating that in cases of emergency and with the concurrence of the legislature the minimum provision can be suspended. The trouble is that the implementation of any such provision would be likely to undermine confidence in the currency, and thus exacerbate the balance of payments position that it was designed to correct. From this point of view the Tanzanian and Kenyan provision is to be preferred. Moreover if the provision is to be made as loose as this, then there is much to be said for specifying the reserve requirement in terms of imports rather than in terms of an item in the balance sheet.

In order to make comparisons, the main parameters imposed on the monetary system by the central bank legislation are set out in Appendix two in respect of the three East African countries together with those of the remaining English-speaking African countries and the twenty-one countries

covered by Dr. Hans Aufricht's standard collection.¹ These parameters are taken to be the specification of the limit on the central bank's capacity to create credit, and the specification of the minimum foreign exchange reserve.

It is interesting to note that the Old Lady of Threadneedle Street operating in an international monetary centre in a very 'open' economy is bound by no minimum reserve requirement at all; indeed, the entire liabilities of the Bank of England are now backed only by Government securities and the foreign exchange reserves of the system are separately accounted for by the Exchange Equalisation Account. The only legal constraint which has operated on the Bank of England's capacity for credit creation during most of its history is the limitation of the fiduciary note issue, under the Currency and Bank Notes Act, which, however provides that the Treasury may direct alterations on the representation of the Bank. In fact this has become a formality for the simple reason that the limitation is on currency and it is unthinkable the Bank should be placed in a position in which it would have to default on its liabilities to pay out Bank of England notes in exchange for deposits held by the commercial banks, to be effective the limit should be on total liabilities.

The emptiness of the regulations prescribing the operations of the Bank of England bring to mind the immortal dialogue between Socrates and an Economist which sprang from the brilliant literary and analytical genius of D.H. Robertson. The passage, which envisages an Economist trying to explain the British monetary system of the late thirties to a visiting Socrates from Mars, runs as follows:²

Socrates: I see that your chief piece of money carries a legend affirming that it is a promise to pay the bearer the sum of one pound. What is this thing a pound, of which payment is thus promised?

Economist: A pound is the British unit of account.

Socrates: So there is, I suppose, some concrete object which embodies more firmly that abstract unit of account than does this paper promise?

Economist: There is no such object, O Socrates.

1. Aufricht, Hans, Central Bank Legislation, T.M.F. Washington 1961.

2. Robertson, D.H. Essays in Monetary Theory. Staples and Staples, Ltd. London 1940.

Socrates: Indeed? Then what your Bank promises is to give me another promise stamped with a different number in case I should regard the number stamped on this promise as in some way ill-omened?

Economist: It would seem, indeed, to be promising something of that kind.

Socrates: So that in order to be in a position to fulfil its promises all the Bank has to do is to keep a store of such promises stamped with all sorts of different numbers?

Economist: By no means, Socrates - that would make its balance-sheet a subject for mockery, and in the eyes of our people there resides in a balance-sheet a certain awe and holiness. The Bank has to keep a store of Government securities.

Socrates: What are Government securities?

Economist: Promises by the Government to pay certain sums of money at certain dates.

Socrates: What are sums of money? Do you mean Bank of England notes?

Economist: I suppose I do.

Socrates: So these promises to pay promises are thought to be in some way solidier and more sacred than the promises themselves?

Economist: They are so thought, as it appears.

Socrates: Do you find that your monetary system works well?

Economist: Pretty well, thank you, Socrates, on the whole.

Socrates: That would be, I suppose, not because of the rather strange rules of which you have told me, but because it is administered by men of ability and wisdom?

Economist: It would seem that that must be the reason, rather than the rules themselves, O Socrates.

APPENDIX ONE

Quantative Limits on Government Loans

	Short Term Advances	Total Securities	Overall Limit.
Kenya	Not Specified	Not Specified	£ 12m.
Tanzania	£ 6m. (20% of Revenue)	£ 7.5m. (25% of Revenue)	£ 13.5
Uganda	£ 4.5m (15% of Revenue)	Not Specified	Not Specified

MATURITY REQUIREMENTS
FOR GOVERNMENT SECURITIES

	Maturity Exceeding:	Maximum Specified:
Kenya	12 Months	£ 3m.
Tanzania	12 Months	£ 3m. (10% of revenue)
Uganda	24 Months	£ 6m. (30% of demand liabilities)

APPENDIX TWO

Legal Limits.

Country	Limit on Government Debt (Excluding temporary)	Minimum External Reserve
Kenya	£ 12m. Ⓢ	4 Months imports. = £ 30m.
Tanzania	25% of Revenue = £ 7.5m.	4 Months imports = £ 17m.
Uganda	N.S.	40% of DL. = £ 9m.
Rhodesian Federation	N.S.	25% of liabilities * to public
Rhodesia	Not exceeding Capital and Reserves + 20% of liabilities to public	25% of Liabilities to public
Malawi	N.S.	50% of DL.
Zambia	N.S.	50% of DL. initially + 25% of increases*
Nigeria	33 $\frac{1}{3}$ % of DL.	40% of DL.
Sierra Leone	20% of DL.	50% of DL.
I. Australia		
	N.S.	N.S.
Canada	N.S.	N.S.
Republic of South Africa	N.S.	25% of liabilities* to public
United Kingdom	N.S.	N.S.
II. Burma		
	N.S.	25% of DL. *
Ceylon	N.S.	N.S.
India	N.S.	R 2,000m. *
Indonesia	N.S.	20% of D.L.
Japan	N.S.	N.S.
Korea	As authorized from time to time by the National Assembly.	N.S.
Pakistan	Not exceeding Capital and Reserves + 3/5 of deposit liabilities.	30% of Notes. *
Philippines	N.S.	N.S.
III. Costa Rica		
	N.S.	N.S.
Cuba	N.S.	25% of D.L.
Dominican Republic	30% of Revenue (40% of Board unanimous)	50% of D.L.
El Salvador	N.S.	25% of D.L.

Guatemala	N.S.	N.S.
Honduras	N.S.	N.S.
Mexico	N.S.	25% of D.L.
Nicaragua	Not exceeding Capital and Reserves	N.S.

- * Provision for suspension.
 ⊕ Includes temporary provision.
 NS. = Not specified
 DL. = Demand Liabilities.

Source

The African information is derived directly from the Acts; the remainder from Aufricht, Hans., Central Bank Legislation. I.M.F. 1961, using his groups.

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