Inflation and Economic Development : Some Lessons from the Tanzanian Experience

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I

Tanzania launched its First Five Year Plan (FFYP) for Economic and Social Development (1) in 1964. The Plan rejected monetary disequilibria (e.g. inflationary and deficit financing) of any sort since that was likely to do more harm than good (2), and stressed the importance of a healthy balance of payments position that was not based on trade and exchange restrictions (3). The Second Five-Year Plan (SFYP), which was launched in 1969, also called for internal monetary stability and external balance. It intended to pursue a « cautious policy of monetary expansion » (5) but stressed, unlike the FFYP, the « active use of parastatal financial institutions as a source of public development finance » (6).

Available evidence, as is for instance shown in Table I, indicates that in general the financial record was in line with expectations during the FFYP although consumer prices indicate some upward pressure. The first half of the SFYP, however, witnessed generalised inflationary pressure as the general price level increased at over 3 % p.a. during 1969-71 and Bank of Tanzania lost over 25 % of its 1969 foreign exchange reserves over 1970-71. The period after was one of accelerating price inflation. The foreign reserve level, however, improved considerably over 1971-73, but then dropped precipitously in the crisis year 1974.

In this paper we shall attempt to identify the major forces that led to the failure to achieve the financial stability objective during the SFYP. We shall show that some of the problems are related to the structure of the economy and are therefore generalisable for African countries at a similar stage of development.

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TABLE I

Some Indicators of Inflation, 1964-74*

	1964-68	1968-71	1971-73	1974
1) The General Price Level (1966 = 100)	0.3	3.7[a]	8.9	16.4
2) Retail Price Index (1969 = 100)	3.7[b]	3.8[a]	9.7	30.7
3) Food Price Index (1969 = 100)	2.6[b]	4.3[a]	11.6	31.2
4) Change in Bank of Tanzania Foreign Reserves (Shs Mn)	(+)353.8[c]	(—)123.7	(+)602.3	(—)785.4

*Price changes are in average annual percentages.
[a]Refers to 1969-71.
[b]Refers to the period 1965-68.
[c]Refers to the period June 1966 to December 1968.
Source : Computed from Government Economic Surveys and Bank of Tanzania Economic and Operations Reports.

II

Inflationary developments in underdeveloped economies have for quite some time in the economic development literature been associated with problems of capital formation (7). Characterised by low levels of per capita income on which aggregate saving-income ratios depend, the less developed countries are unable to generate voluntary savings to meet desired levels of national investments. It is argued therefore that inflation « occurs because economic development requires a level of capital formation that is difficult for most underdeveloped countries to finance by ordinary means » (8). The « savings gap » can be bridged by inflationary finance : an indirect tax on money which can reduce real consumption and release resources for investment. This view implies that inflation is fundamentally a monetary phenomenon which can ideally be maintained at some (optimum) rate.

This explanation, however, is unsatisfactory on two main grounds. First of all, the identification of the « savings gap » as a binding constraint at early stages of development serves to conceal the multidimensional character of the development problem (9). Secondly, but more importantly, monetary praxis in developing economics has increasingly shown that inflation is far from being a purely monetary phenomenon. This is the main point of the « structuralist » writing on the

Latin American experience (10). The question which is posed is whether inflation in underdeveloped economies could necessarily be avoided by financial policies which just allow a given economy to maintain its target rate of growth. The answer to the question is: not necessarily. This is mainly because the financial view of the problem (which stresses capital formation issues and the like) overemphasizes the aggregate demand side and overlooks aggregate supply which is probably as important given the structure of underdeveloped economies. Indeed the general tendency to categorise monetary problems in these countries as originating either from attempts to reach the requisite levels of capital formation or from the limitations of underdeveloped economic structures, is an oversimplification if presented as two competing hypotheses. This is because the categorisation tends to obscure the nature of monetary disturbances given that capital formation problems (as expressed for instance through deficit financing) and limitations of economic structure (reflected mainly in the inconsistencies between production and demand at an economy's target rate of growth) are ever present in underdeveloped but developing economies. Furthermore, the relevant variables (those which may be called monetary and those labelled non-monetary) tend to interact in the inflationary process. For these reasons, the analysis of monetary problems of underdeveloped countries need to incorporate monetary as well as non-monetary variables if a better understanding of the issues is to be gained.

A general consideration of sustained inflationary developments in developing countries seem to point out four major areas in which economic performance may be very influential to the inflation process. The areas (for a given country) are: monetary and financial policies; the foreign trade sector; the process of industrialisation and urbanisation, and the supply of capital; and the agricultural and other potentially bottleneck sectors (11). A detailed consideration (12) of the structure of the Tanzanian economy and experience, however, seems to suggest the following areas as having been significant during the period in question: firstly, although the relatively high rate of monetary expansion which characterised the economy during the early years of establishing a national financial system was not inflationary, the later increase in the money-income ratio seems to have been inflationary. Secondly, the agricultural sector as a food supplier and medium-term determinant of national capacity to import lagged behind all sectors except mining during 1968-72 and exerted considerable inflationary strain on consumer prices and the balance of payments. Thirdly, capacity to import did rather poorly given the economy's target rate of growth, partly due to the problems of the country's agriculture but also due to problems arising from the inherited colonial division of labour. Fourthly, and related to the third observation, was the importance of imported inflation arising mainly from the fact that the country lacks basic industries and is therefore economically inflexible.

We shall examine these issues in that order, taking a broader interpretation of inflationary pressures which refers to price inflation as well as to balance of payments disequilibria.

III

A convenient starting point to the analysis of medium to long-term national monetary problems is to accept the obvious that no sustained inflation can be observed without a permissive monetary and financial policy. Some sort of monetary analysis, therefore, showing the broad sources and uses of finance in an economy may provide interesting clues. The framework used for this discussion (13) defines « money creation » to be based on three sources : internal credit expansion, external credit, and liquidity financing which results from a decrease in the proportion of money to income financed (a declining money-income ratio and rising velocity). A decrease in the proportion of money to income will release extra liquidity which could be used to finance a larger volume of transactions or to accomodate other changes in the demand for money. Total monetary creation according to this same framework, must be « absorbed » by real output growth, price level increase, and the balance of payments deficit (14).

Application of these definitions to Tanzanian data leads to a number of observations both on the sources and uses of funds. On the sources side, the data show that external credit monetisation was important throughout the period 1966-73 (since the founding of the Central Bank towards the end of the SFYP) reflecting external loans and grants to Government and parastatal organisations. Internal credit creation became increasingly important for the period as a whole so that if the year 1972 is excluded, this sources rises from a mere 6 per cent of total internal and external credit monetisation during the period 1967-69 to the high proportion of 53 % during 1970-1973. This reverses the order of importance on the sources side during the two sub-periods.

An important force off-setting internal credit creation was the relatively high rate of expansion in time and savings deposits of commercial banks. These deposits were about 39 per cent of money supply in 1968 and rose to over 50 per cent in 1973.

Liquidity financing as defined above and recorded on the sources side, was actually « absorbing » funds through the persistently rising money - income ratio. Such liquidity increase neutralised about 38 per cent of total internal and external monetisation over the period 1967-69 but the figure dropped to about 33 per cent during 1970-73.

On the uses side, income growth « absorbed » quite a high proportion of over 56 per cent of the total monetisation (internal and external) in the period 1967-69, but then declined in the subsequent period to only 29 per cent. Accordingly a greater proportion of monetary expansion must have ended up financing price increases, additions to liquidity, and/or balance of payments deficits. Price increase which had absorbed only 7 per cent of total credit monetisation during 1967-69 greatly increased its importance to absorb about 33 % of the total in the period 1970-73. Balance of payments deficits were much less important during 1967-69 but their role was enhanced in the subse-

quent period. This conclusion is consistent with changes in foreign exchange reserves as indicated in Table I.

From the preceeding analysis, it is clear that the main force behind monetary expansion during the SFYP was internal credit creation. It is important, therefore, to look more closely at the nature of credit expansion during the period and indicate possible consequences on the price level and the balance of payments.

A general impression of the forces behind domestic credit expansion can be gained by looking at gross bank lending as presented in Table 2.

TABLE 2

Total Bank Lending, 1966-1973* (Shs Mn)
Central Government

	Bank of Tanzania	Commercial Banks	Total	Non-Government Lending
1966	72.5	98.0	170.5	806.9
1968	64.9	80.1	145.0	819.8
1969	75.6	168.3	243.9	964.1
1970	291.3	164.7	456.0	1141.3
1971	572.4	247.4	753.8	1365.4
1972	506.4	424.9	997.3	1397.6
1973	484.9	558.6	1043.5	1566.9

*The figures are given in quarterly averages.
Source : Bank of Tanzania, *Economic and Operations Report* (various years).

As can be seen from the table, the year 1969 was the beginning of continued rapid increases in bank borrowing both by the Government and non-government sectors. While non-government borrowing expanded by about 13 per cent p.a. between 1969 and 1973, Government borrowing increased much faster at 43 per cent p.a. thus accounting for close to 60 per cent of total bank credit increase during the period.

Table 3 which shows the sources of Government development funds during the two Five-Year Plan periods, indicates strongly that the major force leading to fast expansion in Government bank borrowing was the desire to increase development finance; for the recurrent budget registered surpluses throughout the period. The table shows that Government borrowing from the banking system remained

TABLE 3

Sources of Government Development Finance, 1964-65 - 1973-74 (Shs Mn)

	1964-65	67-68	68-69	1970-71	71-72	72-73	73-74
Total Expenditure* Financed by	203.8	344.1	461.0	829.0	739.0	763.2	1442.0
(a) Surplus on Recurrent Budget	40.0	64.5	83.8	51.7	78.0	133.2	238.0
(b) Non-Bank Borrowing	15.3	138.1	68.2	143.3	86.0	164.0	196.0
(c) Borrowing from Banking System	30.0	47.3	162.0	314.0	203.0	116.0	521.0
(d) Other Internal Sources	40.0	10.2	24.0	50.0	21.0	25.0	6.0
(e) External Loans and Grants	78.5	84.0	123.0	270.0	351.0	325.0	481.0

* Excludes expenditure on the Tanzania - Zambia Railway.

Sources : 1964-65 - 1967-68 figures were estimated by using scattered information from Bank of Tanzania Reports, Government Economic Surveys for various years, annual Budget Speeches (by Minister for Finance), and East African Currency Board Reports. The post- 1967-68 data were taken from Economic Surveys and Annual Plans for various years.

quite small both in absolute and relative terms, during the first three years of the FFYP, but thereafter expanded rapidly for the fiscal years 1968-69 to 1970-71. The following two years saw a decrease in borrowing over the two previous years as the Finance and Credit Plan went into operation to guide the economy's short-term macromonetary policies. For the two Plan periods compared, however, borrowing from the banking system during the SFYP increased by about five times (in nominal terms) of the amounts borrowed during the FFYP.

There are a number of reasons to explain this relatively rapid expansion since the last two years of the FFYP. First of all, the establishment of an institutionally independent national financial system that started with the founding of the Central Bank in 1966 meant that the inhibitions of the colonial Currency Board could be overcome. This process was reinforced by the socialisation measures following the Arusha Declaration (15). Consequently the SFYP assigned a greater role, than the FFYP had done, to the banking system as a source of financing development expenditure. Secondly, the rate of increase in this type of expenditure was constrained by the manpower bottle-

neck (limited capacity to identify analyse and implement projects) during the early years of FFYP, but this bottleneck was gradually easing.

As for credit expansion to sectors other than Central Government, it is important to note that the bulk of non-agricultural credit was being channelled to parastatal organisations which, as public institutions, enjoyed relatively easy access to bank credit (16). Credit increase during 1972 and 1973, however, grew by only 2.4 and 12.1 per cent respectively, principally due to the Finance and Credit Plan policies.

In order to characterise the nature of Government borrowing for purposes of development financing, let us examine some features of the SFYP's sources and uses of investment funds. First, the Plan envisaged a transfer of shs. 620 millions from the recurrent to the development budget over the Plan period, under the assumption that recurrent expenditure would be restrained. It turned out, however, that while tax and other revenues rose at a commendable rate of about 17 per cent p.a., recurrent expenditure rose at nearly the same rate (16 per cent annually) with the consequence that only about 50 per cent of the planned budgetary surpluses had been so contributed during the first four years of the Plan. One can therefore conclude that one important force behind Government credit expansion must have been the failure on the part of the recurrent budget to generate budgetary surpluses as planned. Also, since tax effort had been considerably increased, it is fair to say that part of the problem was the too-rapid expansion in the recurrent expenditure (17). Most importantly for the analysis of inflationary developments, it is worth recognising that this kind of deficit financing was unplanned and was therefore not accompanied by appropriate compensatory policies.

Another important item indicating the nature of the resources gap during the SFYP is the planned transfer from Central Government to Parastatals. The sum so envisaged was shs. 650 millions. Over the Plan period, however, about twice that amount was actually transferred implying that bank borrowing had to be relied upon to finance the gap unless other sources were able to make up for the difference. It turned out that borrowing from banks had to be increasingly resorted to although non-bank financial intermediaries remained the next important source of internal funds throughout the period. The large gap between the actual and planned transfers seems to be due to the facts that parastatal investment requirements were very likely underestimated and that the parastatals as a whole did not practise adequate financial control (18). But to these reasons should be added the consideration of organisational changes in the parastatal system (19). The conclusion from this second observation on the nature of Government borrowing is the same as the previous one: deficit financing did not take place on any planned basis but developed as a result of unanticipated developments in the parastatal system.

What was the impact of the rapid monetary expansion during the period in question ? As indicated earlier, the economy was increasing its liquidity (the amount of money per unit of income financed) during most of this period and was therefore reducing the inflationary

impact of the monetary increase. This, to be sure, is important in itself since under such conditions it becomes possible to use deficit finance or some other type of bank credit creation to accelerate capital formation without generating inflation. The room for absorbing monetary expansion in this way, however, seems to be limited (note in our case monetary absorption through this factor decreased from 38 per cent during 1967-69 to 33 per cent over 1970-73) because structural factors leading to increased demand for money are likely to change only gradually. There exists the possibility therefore that after a certain period the price level and the money-income ratio could start moving together as the rise in that ratio increasingly reflects the holding of unplanned money balances. Under these circumstances one should expect a positive impact of monetary expansion on the price level. This is what seems to have happened in Tanzania as can be seen from Table I. The same table shows also that the expansion « spilled over » into the balance of payments ; the Bank of Tanzania lost over 25 per cent of its 1969 foreign exchange reserves over 1970-71.

Detailed statistical analysis (20) along the same lines suggests a few more interesting points : firstly the relationship between changes in money supply and the price level turns out to be significant for the period as a whole (1966-73), although with rather low overall significance. Secondly, the relationship between changes in food prices and money supply shows the highest statistical significance implying that money supply changes will move most closely with the prices of wage goods of which food is the most typical (the proportion of food expenditure to total private consumption having been over 50 per cent), and shows further that the expansionary impact will be immediate. Thirdly, an attempt to relate these variables in terms of the rates of change rather than the changes themselves, revealed very weak (insignificant) results suggesting therefore that the rate of inflation is not explained by the rate of monetary expansion. This conclusion still holds with available quarterly (rather than annual) data.

The failure of the rate of monetary expansion to explain the rate of inflation carries a few implications. First of all, one could argue that the sub-periods 1967-69 and 1970-73 were rather dissimilar in terms of the importance of the various factors « absorbing » money as suggested earlier , and that the expected weak money-price relationship during 1967-69 is being reflected in the overall weak results. Secondly, the period 1967-73 could be regarded as too short and therefore incapable of revealing long-term systematic tendencies. There is of course the fact that the available data in our countries have a number of obvious limitations. These important observations imply that the capital formation view of inflationary problems outlined earlier cannot be rejected on technical grounds. What is clear, however, that alternative variables (besides strictly monetary ones) and approaches must be considered if a better undestanding of inflation during the period in question is to be gained. In particular, the « structuralist hypothesis » alluded to earlier suggests possible areas of inquiry.

IV

One such possible area is agricultural production whose performance we said was unsatisfactory. In particular, food supply did not expand sufficiently fast to meet increasing demand that was arising from such factors as population increase, per capita income growth, rapid urbanisation and general income expansion, income redistribution, shifts in preferences etc. Demand growth is of course checked by price increases but the degree of response (price elasticity) is rather low in low-income economies. At the same time the degree of response with respect to income changes (income elasticity) is relatively high for such economies. Thus given an initial equlibrium in two food markets, a change in the relative price of food resulting from increased demand will, everything remaining equal, be greater in a lower-income than in higher-income economy. Further, the inflationary impact of inadequate food supply is strengthened by the high proportion of this item in aggregate private consumer expenditure which in Tanzania averaged over 50 per cent (21) over the period 1967-72.

It should be noted that an increase in the relative price of food needs not lead to a generalised increase in consumer prices if non-food prices are sufficiently flexible downwards. But it should be clear that during the development process, price declines in an underdeveloped economy's major sectors are unlikely (22).

For purposes of determining whether supply was adequate to maintain a stable relative price of food a relationship defining annual increase in demand to depend mainly on income per capita growth, the rate of population growth, and the rate of change in the relative price of food, was used (23). This relationship indicated that in order to keep relative food prices stable, production in Tanzania should have grown at around 4 per cent p.a. (24). Available production indices (25), however, indicate that food output during most of the SFYP period grew by only around 2,5 per cent p.a., although growth was satisfactory during the FFYP period. Indeed, given the importance of the food item in aggregate consumption, one could even conclude from this evidence and from experiences in other developing countries that one of the important factors explaining Tanzania's general price stability during the FFYP was a satisfactory food production.

The outcome of the production shortfall during the SFYP was an accelerating food price increase which was on the average the highest of all the indicators of price inflation over the period 1969-1973/74. Even this inflation rate was not sufficient to restore equilibrium in the market since price controls were strengthened and shortages became part of economic life during the latter half of the Plan period. The general poor performance of the agricultural sector was particularly worsened by the severe drought of 1973-74 when the country had to spend nearly 40 per cent of its merchandise export proceeds to import food.

Increases in food prices during most of the SFYP period were the main force behind the general increase in consumer prices. During

1969-71 for instance, the structure of the Retail Price Index (for Dar es Salaam minimum wage workers, 1963 = 100) moved as is shown in Table 4. For the sub-period 1971-73 the same structure of change persisted: the Retail Price Index (on 1963 base) increased by 9.7 per cent p.a. with the corresponding food index rising by an annual average of 11.6 per cent; this implies that the food index rose at about 10.2 per cent p.a. and non-food prices at only 5.6 per cent, given the indicated weights used for constructing the index.

TABLE 4

The Structure of the Retail Price Index, 1969-71 (1963 = 100)*

(Annual Percentage Changes)

(a) Food (77)	6.0
(b) Drink and Tobacco (7)	— 0.9
(c) Fuel and Soap (8)	— 0.8
(d) Clothing (6)	— 0.8
(e) Household Articles (2)	11.8

*Refers to Dar es Salaam minimum wage workers.
Note: The figures in brackets indicate the corresponding weights.
Source: Computed from Bank of Tanzania, Economic and Operations Report (June 1975).

Besides price effects, shortfalls in production claimed an increasing share of export proceeds to purchase food imports; the proportion rose from below 10 per cent in 1969 to nearly 16 per cent in 1972. This is the general trend for Africa as a whole (26).

In summary, the foregoing discussion and evidence show that the country's inflationary problems were to a significant extent related to poor performance in food production growth during the SFYP period. The food price index rose faster than the available aggregate price indices and increased food imports worsened the already strained foreign exchange position. As we stated earlier, food prices at Tanzania's per capita income are particularly sensitive to monetary expansion; this implies that whatever may be the country's price and incomes policy, a stagnating food supply is bound to push up wages as economic growth requires both an adequate monetary expansion as well as the maintenance of a minimum level of incentives. Minimum wage increases since 1970 seem to have been partly based on food prices. These tendencies as the most recent evidence shows could easily lead to self perpetuating demand pressures if supply does not grow significantly.

The part of our original hypothesis which stated that the agricultural sector did poorly as a food supplier, and that given the forces of demand shortfalls in food production were likely to exert inflatio-

nary pressures, is therefore not contradicted by the evidence adduced here. The evidence however, shows that the problem became important mainly during the SFYP.

V

The analysis of monetary problems from a development point of view indicates as we stated at the beginning of this paper that inflationary pressures could also arise from an unsatisfactory agricultural export performance which in many less developed countries (LDC's) is the medium and/or long term determinant of national import capacity. Let us therefore turn to examining the country's import capacity and the associated monetary problems.

Insufficient capacity to import becomes a potential bottleneck once a reasonably high target rate of growth is fixed for an economy. This is because planned investment effectuation in Tanzanian-type economies depends strongly on imports of intermediate and capital goods which these economies may not be able to finance (for various reasons indicated below) without excessive reductions in consumer goods imports. Policy reaction to insufficient capacity to import has usually been the application of a combinaison of directly restrictive measures e.g. import controls, and indirect ones e.g. devaluation, each of which, however, could generate inflationary pressures.

The first point to note about import capacity is the fact that world demand for primary product exports (excluding oil) has increased rather sluggishly during the past two decades. Further, this sluggish demand is a long term structural problem as explained by the late R. Nurkse many years ago (27). Nurkse argued that these structural problems were some of the reasons which led to the decline in the share of LDC's in world exports from about 32 per cent in 1928 to 24 per cent in 1957 ; during which period the corresponding import shares rose from 27 to over 30 per cent (in both cases excluding oil producers). Some of Nurkse's arguments have been supported by empirical evidence. J.M. Finger for example, has shown that the ratio of raw materials to total U.S. manufacturing output was on the whole declining between 1948-63 to which period the study was restricted (28). Another study by Houthakker and Magee (29) has shown the low demand elasticities for LDC's exports (much less than unity) in contrast to those for industrial countries (greater than or near unity) and the corresponding import demand elasticities (greater than unity for LDC's). They observe in this study that LDC's « face quite low income elasticities of demand for their exports, presumably as a result of excessive emphasis on such unpromising products as coffee ». They argue, as one would expect that « a country with a higher income elasticity of demand for its imports than the foreign income elasticity for its exports will experience more rapid import growth than export growth, a deterioration in its trade balance and eventual pressure on the exchange rate... even relatively slow domestic income growth may be insufficient to cure payments imbalances if the relative income

elasticities are sufficiently adverse ». A further piece of empirical evidence is by B. Cohen (30) who shows that on the 1952-54 base, non-primary product imports into Canada, United States and W. Europe grew by nearly 13 per cent p.a. by 1962-64 compared to primary products which grew annually by only over 3 per cent. Imports of cotton and coffee, for instance, declined during this period. When one examines the record for the rest of the 1960's and the early seventies (in both cases excluding oil exports), the long term record does not seem to be much changed: available evidence for East Africa, for instance, seems consistent with Nurkse's views (31).

Prof. D. Seers has summarised the connection between the export problem and the inflationary process in LDC's (32). This is easily seen by initially assuming a trade balance and ignoring international capital flows for a given country, in which case dynamic equilibrium can only be preserved if exports and imports grow at the same rate. Since, however, imports normally grow faster than GDP, the above condition implies that in dynamic equilibrium the rate of growth of exports must be greater than that of GDP. Further, the rate of growth of GDP may have to reach a certain minimum value if economic performance is to be socially acceptable; in that case a dynamic condition for social and economic equilibrium becomes one of requiring export growth to exceed the rate of growth of the socially acceptable level of GDP. The immediate question which then arises is what happens if the above condition is not satisfied ?

Firstly, accumulated foreign reserves may be used to finance the required consumer and producer goods imports. But as can be easily imagined, this can help only for a limited period. The assumption of no capital inflow made above could, however, be relaxed so that we speak of a country's enhanced import capacity (through the capital inflows) to match the requisite level of imports. Reliance on foreign capital, however, is well known for its basic limitations.

Secondly, the economy may reduce the proportion of imported manufactures through devaluation and/or import controls. On the side of imports, devaluation is likely to raise prices not only of imported goods but also of domestic substitutes. For most underdeveloped countries the devaluation impact on prices will not be significantly abated by substitution of domestic output for imports as the structure of production is not generally consistent with that of domestic demand. For this reason, repetitive devaluation will lead to persistent upward price pressure.

Import controls which also tend to be inflationary are a widespread feature in LDC's. Quite often import controls are instituted to defend the economy in the face of inadequate growth in foreign exchange reserves and they are therefore not based on any particular view of an economy's desired transformation. This is especially true in the short run when the export problem as structurally rooted in the present international division of labour is inadequately understood by policy makers. The tendency is therefore to « close off » the economy and create shortages of what might be reasonably described as dispensable imports, and of other imports which are actually desira-

ble for smooth and efficient running of a modern economy. Shortages accompanied by very likely increases in money incomes lead to inflationary pressures.

Thirdly, acceptable rates of growth can be propped up beyond those permitted by export growth through import-substituting industrialisation which has itself been pointed out as a potential cause of inflation in LDC's. A deeper consideration of this issue, however, suggests that it may be insignificant for most African countries including Tanzania (33).

How has Tanzania's capacity to import faired during the period 1966-73 (the period of our concern for which consistent data are available) ? Let us start by noting that a country's total capacity to import is defined as the total foreign exchange receipts from exports, from the inflow of capital, and from services and other items — which the country can spend in a given period without having to rely on compensatory (mainly short-term) movements of capital (34). This total can be measured in current prices or in terms of purchasing power. For purposes of policy, however, it is important to show that sub-total which a country can spend without adding to national external liabilities i.e. to exclude long and medium-term loans. This subtotal has at times been termed the current import capacity (35).

Tanzania's real current capacity to import (36) declined in 1967 and then rose by about 4 per cent p.a. during 1968-70, but only to surpass the 1966 level by a mere 2 per cent. Thereafter it was marked by annual declines. A number of factors explain these trends : first of all, deteriorating terms of trade reduced the purchasing power of exports by over shs. 360 millions a year on the average between 1966-70 and by a higher average of over shs. 540 millions a year between 1971-73 when import prices rose much faster than export prices.

Secondly, long and medium term debt servicing grew considerably over the years ; rising from an average of 2.5 per cent of the purchasing power of exports for the period 1966-1969 to nearly 10 per cent for 1970-73.

Poor export performance is the third but most important reason accounting for the basic trend in the current capacity to import. The negative terms of trade effects during 1966-70 mainly affected the levels of rather than the changes in the purchasing power of exports (except for 1967). Since 1971, however, the terms of trade changes became increasingly important. During the period 1967-71, the export index slowly rising leading to a moderate worsening of the terms of trade. The negative terms of trade effects were not counteracted by quantum increases so that the purchasing power of exports remained below the 1966 level ; having grown by only 1.5 per cent p.a. Despite the general export price increase in 1972, the purchasing power of exports did not exceed the 1968 mark because of the sharp deterioration in the terms of trade. In 1973, the quantum index declined, and without significant improvements in the terms of trade, the export purchasing power declined further.

Total capacity to import did well between 1968-71 growing at over 15 per cent p.a. but depending heavily on foreign medium and

long-term loans, since current import capacity grew by only less than 2 per cent p.a. during the same period. The total capacity declined in 1972 and 1973 as the capital inflows levelled off while the import price index rose quite sharply. We should probably stress the importance of distinguishing between current and total import capacity since the latter includes medium and long term debts which are usually incurred for financing specific development projects. It is the specificity of such external finance which tends to give the increments in foreign exchange resources beyond the current capacity a « rigid » character. In other words, demand management policies have much less power over resources other than current import capacity. For this reason, Tanzania managed to carry out most of the planned projects in the SFYP but with inflationary pressures arising partly from the unsatisfactory growth in the current capacity to import.

Policy makers reacted to the trends we have described. Following the recovery from the export downswing of 1967 the country's capacity to import almost recovered its previous level in 1968, with the comfortable foreign reserve position then enjoyed by the newly established Central Bank ready to assist in meeting import demand. Indeed in 1969 the Bank Governor was confidently stressing the opportunity cost of holding excessive foreign exchange reserves and warning of the economic dangers of the reliance by domestic enterprises on foreign supplier's credit, and of other forms of foreign capital (37). In 1968, however, the balance of payments registered sizeable deficits on both the trade and current accounts which grew in subsequent years with the exception of 1969. Fortunately when these deficits were increasing, total import capacity was also rising fast during 1968-71, but current import capacity was changing very slowly. The country was therefore relying on foreign capital which, as we mentioned, tends to be rather rigidly tied to a specific pattern of expenditure.

The SFYP authors seem to have sensed this vulnerable situation and fixed consumer goods imports at a constant figure beginning with 1969. Despite these restrictions and the growing total capacity to import, however, the Bank of Tanzania heavily lost reserves in the following year, and to a lesser extent continued to do so in 1971. If we take the broader definition of inflation i.e. to mean price as well as balance of payments pressures, as stated earlier, then we can interpret the above developments which began 1968-69 and revealed themselves much more conspicuously in 1970-71 to mean excessive aggregate demand for imports given the poor export record.

Our general discussion in the proceeding pages indicated that a number of options other than use of foreign reserves and control of imports are possible when a less developed country is faced with the kind of situation outlined above. Most important among these, we mentioned devaluation and import-replacing industrialisation. A further examination of these issues, however, indicates that for the case of Tanzania these latter two were not important reactions to the events being discussed although developments in 1974-75 indicated that these options could be important in the future. For the period under discussion, the main reaction to the deteriorating foreign

exchange position which, as we stressed, resulted from a near stagnation in the current import capacity that was accompanied by a relatively high import demand, was the extension and strengthening of foreign exchange and import controls.

These controls, established much more decisively in 1971, almost immediately created general shortage of consumer goods imports which is believed to have been exploited by the uncertain commercial racial minorities following the state take-over of wholesale trade business in 1970 and rented houses in 1971. The pressure was partly reflected in the relatively high increase of nearly 5 per cent in the Middle-grade Civil Servants Cost of Living Index (Dar es Salaam) during 1971, compared to the less than 2 per cent annual increase between 1967-70. Although a number of other forces were already at work pushing up prices, the fact of import shortages was recognised as important and was one of the causes calling for the strengthening of price controls. The general pressure on prices arising from import shortages is actually difficult to gauge quantitatively but it seems to have spread to a number of non-consumer goods as the administration of these controls became firmly established. The establishment of the Price Commission in 1973 seems to have helped reduce the importance of the shortage factor on prices particularly with respect to consumer goods.

In conclusion, the unsatisfactory performance of Tanzania's current capacity to import arising from the virtual stagnancy of the export quantum and the deteriorating terms of trade accompanied by rapid credit expansion since 1968 led to foreign exchange losses, import controls, and rising consumer prices. Without a strong export base, however, import controls to curb foreign oriented demand are a very weak subtitute; for as the more recent evidence has shown these controls cannot be expected to release the extra foreign currency necessary to finance the country's rising import bill. Indeed as the resources under the effective control of the authorities diminish, the poor performance of the current import capacity could lead to a decline in the rate of growth (38) unless external finance becomes available. Even if such finances were available, our preceeding discussion suggests that with an unsatisfactory current import capacity, inflationary pressures could not be avoided because of the specificity associated with external funds.

VI

Rising import prices were not, however, simply a result of domestic excess demand; they were exogenously influenced also by inflation conditions abroad (39) which in an open and dependent economy may significantly determine movements in the price level and the balance of payments (under a fixed exchange rate).

Price rises abroad may be transmitted into an open economy through macro-economic and/or micro-economic channels (40). Star-

ting from some initial position, an increase in the price level abroad will make the non-inflating country (call it B) a relatively more attractive source of goods and services for buyers both at home and abroad. If country's B economy is resilient, this will lead to a rise in exports and a fall in imports leading to a favourable trade balance and, everything remaining equal, to an increase in foreign reserves. This increase in foreign reserves will be accompanied by a rising price level due to the domestic excess demand pressure.

The micro-economic channel provides the link between developments in the rest of the world factor markets and the domestic cost of production. Factor prices e.g. wages may be pushed up by demonstration effects from neighbouring countries' union or public policy actions for example. If on the other hand, a given country is highly dependent on imported inputs e.g. imported capital and intermediate goods, then inflation abroad will have a « cost-push » effect on the price level.

In the context of underdeveloped economies, however, the macro-economic channel is not a satisfactory explanation of the external inflation link because of the assumption which underlies that explanation. The assumption is that the non-inflating economy will respond to changing relative prices in such a way that it will satisfy a greater portion of its aggregate demand domestically (thus reducing imports) and expand its exports. The result of this should be a favourable trade balance. While it may be argued that an economy's capacity to adjust to relative price changes can only be a matter of degree, one has to concede the fact that for an average developing country such relative price changes may not be effective in increasing demand for primary product exports and in reducing producer and durable consumer imports. Ruling out extreme inflation rates, one could probably expect some reduction in consumer goods imports but not so for the case of producer goods which in these economies are crucial to the attainment of planned growth rates. Thus although we agree with the broad conclusions predicted by the macro-economic channel, we have to conclude that it may not be an important one for understanding the imported inflation problem in LDC's.

The cost link on the other hand is a more important one given the problem of factor substitution in domestic production. And given the high dependence of investments effectuation on imports, imported inflation may have the effect of pushing costs and very likely the price level, the impact on the latter depending on the weight of imported inputs in total costs. If as is usually the case, the attainment of the economy's target rate of growth requires increased imported inputs, the effects of external inflation are likely to be increases in the price level through costs, and a decrease in foreign reserves if a fixed exchange rate is maintained. Thus contrary to the conclusions derived from the experience of the industrial economies, the tendency in the LDC's may be the depletion rather than the accumulation of reserves. The shortage of reserves may generate further inflationary pressures as we indicated earlier.

As would be expected Tanzania is heavily dependent on imports for its investment needs and, despite the import - substitution efforts, it still depends on imported manufactured goods for a significant portion of consumption requirements (41). Given this pattern of demand and the country's structure of production, it is easily predictable that inflation in the import-supplying economies was likely to increase costs and therefore the price level, at the same time affecting the country's foreign reserve position negatively. Besides the cost/price and reserve effects, imported inflation tends to be deflationary through reduction of export purchasing power and therefore of domestic real disposable income. As a consequence of the above effect, credit expansion may have to be greater than usual if the deflationary tendencies are to be resisted (42).

The effect of import prices on domestic prices has been demonstrated to be statistically significant even for more developed, more flexible open economies (43) ; we would therefore expect economies like Tanzania to exhibit a greater impact. This is what was confirmed by a more detailed (44) statistical analysis : imported inflation emerged as one of the more important variables determining the rate of domestic inflation ; a factor which price controls and/or normal growth rates in productivity may not be able to reverse.

VII

The analysis in sections IV to VI has indicated, with due regard to number of technical limitations not treated here, that there is a significant relationship between movements in price and balance of payments on the one hand and the structure of the economy on the other. There remains one very important qualification to be made : the factors identified in the stated sections together with deficit financing and monetary expansion analysed in section III, were not equally important throughout the period in question. Different factors assumed differing importance at different times ; a fact which must be brought out in the analysis if a near-satisfactory explanation of inflation during this period is to emerge. Such an exercice, however, would very likely require a separate paper (45). We can therefore, in the space available, only summarise our findings along these lines so as to add this necessary dimension to the picture.

If one begins with the FFYP, one notices as indicated in Table I, that most of the period (i.e. 1964-68) was marked by a general financial stability. This is predictable given the factors we have identified in this paper and those that are related to them : public capital expenditure increased quite rapidly but was not associated with fast expansion in bank credit ; food production and other consumer goods were increasing although there was some moderate excess demand pressure ; exports were slightly higher than imports for the period as a whole and there was an accumulation of foreign exchange reserves ; import costs (as mesured by the import price index) were stable and wage increases had a small impact on the general price level. Consumer prices were, however, further affected by a stronger cost-

push wage effect and by indirect taxes. It is particularly important to note that it is non-food prices which increased fastest and « pulled » the retail price index beyond the food price increase.

The economy began the next sub-period with a comfortable foreign reserve position and considerable industrial capacity which had been established during the first sub-period.

In contrast to the market stability in the general price level during the 1964-68 sub-period, the period 1968-71 witnessed generalised inflationary pressures as the general price level increased at over 3 per cent p.a. during 1969-71 and the Bank of Tanzania lost reserves over 1970-71. Consumer prices on the whole, however, did not accelerate as the Retail Price Index for minimum wage workers (Dar es Salaam) increased at only 3.8 per cent p.a. compared to the 3.7 per cent previously. The structure of change in the consumer prices, however, was changing as shown in Table 4. The main forces at work during this sub-period can be summarised as follows : an internally generated monetary expansion (with for instance Government development expenditure increasing by 34 per cent p.a. during 1968-69-71, and bank lending to Government by over three times during 1969-71 ; and total bank credit and money supply increasing by 30 and 18 per cent p.a. respectively over 1968-71) was proceeding in the absence of an adequate current capacity to import and a reasonably growing agricultural sector. Foreign exchange reserves accumulated during the previous period were depleted and food prices « pulled up » consumer prices. The increase in monetary demand exerted pressure on the general price level as the money-income ratio which increased by around 7 per cent in 1969 and by over 15 per cent on 1971 seems to have partly reflected the holding of undesired cash balances. Import costs during this period were reasonably stable as the import price index rose at only slightly over 2 per cent p.a.

The inflationary pressures of 1968-71 were extended to the 1971-73 sub-period, and the general price level increase accelerated at an annual rate of nearly 9 per cent compared to less than 4 per cent during the previous period. The foreign reserve level, however, improved considerably for a number of reasons some of which are: a considerable restraint on public development expenditure (Government reduced and then held its development expenditure nearly constant for the two years 1971-72 and 72-73 while the parastatals increased capital formation at only around 3 per cent p.a.) ; the decline of about 11 per cent in the quantum of imports ; the « raw materials boom » of 1972-73 ; and the increased scrutiny on foreign exchange use. Although one should expect the expansionary policies of the 1968-71 sub-period to exert a lagged effect on the price level during 1971-73, a closer analysis of the major forces at work during the latter period suggests that the most important factor was imported cost-inflation. Also, the real problems of the economy which were noted for the period 1968-71 remained : poor performance in food production (except for 1972) and in the quantum increase in exports (which increased by less than 1.5 per cent p.a. during 1966-71 and remained below any of the levels during 1966-68 in 1973).

VIII

In the preceeding pages we have attempted to demonstrate the importance of including aggregate supply issues in the interpretation of monetary problems of the underdeveloped countries. Demand-based interpretations which emphasize capital formation problems tend to conceal the structural constraints within which progressive financial policies have to operate and therefore fail to reveal the limitations of such policies as instruments of general economic policy. Indeed given the situation as outlined in this paper we find ourselves in agreement with the observation that

> *while a good or a bad financial policy affects the economy, it is the economy that determines finance. Without a well-based economy it is impossible to solve financial difficulties, and without a growing economy it is impossible to attain financial sufficiency. Financial difficulties can be overcome only by down-to-earth and effective economic development. To neglect economic development and the opening up of sources of finance and instead to hope for the solution of financial difficulties by curtailing indispensable expenditures, is a conservative notion which cannot solve any problems* (46).

FOOTNOTES

(1) United Republic of Tanzania, *Tanganyika Five Year Plan for Economic and Social Development* (1964-1969) Vol. I, Dar es Salaam : Government Printer, 1964 — hereafter referred to as FFYP.
(2) FFYP, p. 87.
(3) *ibid.*, p. 89.
(4) United Republic of Tanzania, *Second Five-Year Plan for Economic and Social Development*, 1969-1974, Vol. I ; Dar es Salaam, Government Printer, 1969 — hereafter referred to as SFYP.
(5) SFYP, p. 213.
(6) *ibid*, p. 213.
(7) See for instance, E.M. Bernstein and I.G. Patel, « Inflation in Relation to Economic Development » in the *I.M.F. Staff Papers*, Vol. II, November 1952 ; and P. Schatz, « Inflation in Underdeveloped Areas : A Theoretical Analysis » in *The American Economic Review* (September 1957).
(8) P. Schatz, *op. cit.*
(9) See for example the discussion by D.R. Khatkhate, « Analytic Basis of the Working of Monetary Policy in Less Developed Countries » in the *I.M.F. Staff Papers*, Vol. XIX November, 1972 ; and A.O. Hirschman, *The Strategy of Economic Development*, New Haven : Yale University Press, 1958.
(10) See for instance, W. Baer, « The Inflation Controversy in Latin America : A Survey » in *Latin American Research Review*, Vol. II (Spring 1967 ; and R. Thorp, « Inflation and the Financing of Economic Development » in K. Griffin (ed), *Financing Development in Latin America*, London : Macmillan, 1971.
(11) For delineation and further discussion of these areas see for instance R. Kahil, *Inflation and Economic Development in Brazil* 1946-1963, London : Oxford University Press, 1973 ; and my « The Tanzanian Monetary Experience, 1964-1973 ». Unpublished Ph. D. Thesis, Harvard University, June, 1976.
(12) See my « The Tanzanian Monetary Experience... » *op. cit.*

(13) The analytical framework is one developed by the Organisation for European Economic Cooperation. *Statistics of Sources and Uses of Finance*, 1948-1958. Paris : OEEC, 1960.

(14) For definitional problems see OEEC *op. cit.* ; and for problems of practical application to Tanzania see my « The Tanzanian Monetary Experience, 1964-1973 » *op. cit.*, Ch. III.

(15) The Arusha Declaration has been reproduced in a number of publications ; one of them is J.K. Nyerere, *Ujamaa : Essays on Socialism*. Dar es Salaam : Oxford University Press, 1968.

(16) It has been estimated that 40 per cent of total credit from financial institutions (excluding Bank of Tanzania and National Insurance Corporation credit to Government) went to parastatal organisations and that the proportion grow to 71 % in 1972. See W.E. Clark, « Socialist Development and Public Investment in Tanzania, 1964-1973 ». Unpublished Ph. D. Thesis, Harvard University, 1974, p. 279.

(17) Tendencies to over-spending in Government Ministries is also pointed out in J. Loxley, « Financial Planning and Control in Tanzania » in *Towards Socialist Planning*, edited by Uchumi Editorial Board. Dar es Salaam : Tanzania Publishing House, 1972.

(18) J. Loxley, *op. cit.*

(19) Some of these changes led to the establishment of new parastatals ; see for instance C.D. Msuya, « Proliferation of Public Institutions in Tanzania : Its Impact on the Economy ». Dar es Salaam, February 1974, Mimeo.

(20) See D.G. Rwegasira, « Inflation and Monetary Expansion : « The 1966-73 Tanzanian Experience » *Economic Research Bureau Paper* 76.8, University of Dar es Salaam, 1976.

(21) See United Republic of Tanzania, *National Accounts of Tanzania*, 1964-72, Dar es Salaam : Bureau of Statistics, 1974.

(22) For some arguments see A.O. Hirschman, *The Strategy of Economic Development*, *op. cit.*, pp. 158-160 ; J. Olivera, « On Structural Inflation and Latin American Structuralism » in the *Oxford Economic Papers*, Vol. XVI (November 1964) ; H.J. Bruton, *Inflation in a Growing Economy*. University of Bombay Series in Monetary and International Economics, N° 2, 1961, Ch. V.

(23) For details see M. Edel, *Food Supply and Inflation in Latin America*. New York : Frederick Praeger ; and D.G. Rwegasira, « Inflation and the Structure of the Tanzanian Economy : The 1966-73 Evidence » *Economic Research Bureau Paper* 76.9, University of Dar es Salaam, 1976.

(24) This figure is approximately the same as that suggested by the United Nations Economic Commission for Africa ; see its « The Food situation in Africa : Towards an African Food Development Plan » in the *Agricultural Economics Bulletin for Africa* N° 15 (June 1974).

(25) See for instance the U.N. Food and Agriculture Organisation, *Production Yearbook* (relevant years) ; and my « Inflation and the Structure of the Tanzanian Economy... » *op. cit.*, p. 9.

(26) In 1971 for instance, food, beverage and tobacco imports accounted for about 13 per cent of total African imports thus virtually exhausting earnings from exports of domestic manufactures (see E.C.A., *Survey of Economic Conditions in Africa*, 1973 — Part I, New York, 1974).

(27) See R. Nurkse, « Patterns of Trade and Development » contained in his *Equilibrium and Growth in the World Economy*. Cambridge, Mass : Harvard University Press 1961, edited by G. Haberler and R. Stern. Similar discussion is contained in J.F. Rweyemamu, « International Trade and the Developing Countries » in *The Journal of Modern African Studies*, Vol. 7, N° 2 (1969).

(28) J.M. Finger, « Technical Change and the Demand for Materials : A Test of the Nurkse Hypothesis » in the *Journal of Development Studies*, Vol. 10 (April - July, 1974).

(29) H.S. Houthakker and S.P. Magee, « Income and Price Elasticities in World Trade » in the *Review of Economics and Statistics*, Vol. LI (May 1969).

(30) B.I. Cohen, « The Less Developed Countries' Exports of Primary Products » in the *Economic Journal* Vol. 78 (June, 1968).

(31) See D.G. Rwegasira, « Inflation and the Structure of the Tanzanian Economy... » *op. cit.*

(32) D. Seers, « A Theory of Inflation and Growth in Underdeveloped Countries Based on the Experience of Latin America » in the *Oxford Economic Papers* Vol. XIV (June 1962).

(33) See the writer's « The Tanzanian Monetary Experience... » *op. cit.*

(34) See for example, United Nations, Department of Economic and Social Affairs, *Studies in Long-Term Economic Projections for the World Economy*. New York, 1964, p. 54, and *Economic Survey of Latin America*, 1957. New York, 1959, p. 65.

(35) See for example the *Economic Survey of Latin America*, 1957, *op. cit.*

(36) For Statistical qualifications and actual data see the writer's « Inflation and the Structure of the Tanzanian Economy... » *op. cit.*

(37) See E. Mtei, « The State of the Economy and Central Bank Policies » in the Bank of Tanzania, *Economic and Operations Report* (June 1969).

(38) For similar cases see for example, N.H. Leff, « Import Constraints and Development : Causes of the Recent Decline of Brazilian Economic Growth » in the *Review of Economics and Statistics*, Vol. XLIX (November, 1967) ; and P. Hasan, « Inflationary Financing and Economic Development : The Pakistan Experience, 1951-1959 » in the *Yale Economic Essays* Vol. 2 (Fall 1962).

(39) The annual rate of price increase (as measured by GNP deflators) in the industrial countries (members of the IMF) rose from 4.2 per cent p.a. during 1965-70, to 5.4. per cent in 1971, and to over 7 per cent in 1973. See IMP, *Annual Report of the Executive Director for the Fiscal Year Ended April* 30, 1974. Washington D.C., 1974.

(40) For details see, for instance, R. Caves, « Looking at Inflation in the Open Economy » *Discussion Paper* N° 286, Harvard Institute of Economic Research, Harvard University (March 1973) ; S.J. Turnovsky and A. Kapsura, « An Analysis of Imported Inflation in a Short-Run Macro-economic Model » in *The Canadian Journal of Economics* Vol. VII (August 1974) ; and Y. Shinkai, « A Model of Imported Inflation » in the *Journal of Political Economy* Vol. 81 (July - August, 1973).

(41) In 1964, 15.5 per cent of private consumption expenditure was dependent on imports and declined to 12 per cent by 1972. See *National Accounts of Tanzania, op. cit.*, Table 25, p. 34.

(42) For a fuller discussion of the imported inflation effects see for example G. Maynard, « Import Prices and Inflation : the Experience of the United Kingdom, 1950-52 » in the *Oxford Economic Papers*, Vol. 7 (October, 1955).

(43) See J.D. Pitchford, « An Analysis of Price Movements in Australia, 1947-68 » in the *Australian Economic Papers*, Vol. 7 (December 1968) ; R.G. Lipsey and J.M. Parkin, « Income Policy : A Reappraisal » in *Economica*, Vol. 37 (1970) ; and A. Dicks-Mireaux, « The Interrelationship between Cost and Price Changes, 1946-59 : A Study of Inflation in Postwar Britain » in the *Oxford Economic Papers*, Vol. 13 (October 1961.)

(44) See my « Inflation and the Structure of the Tanzanian Economy... » *op. cit.*

(45) For this analysis see my « The Tanzanian Monetary Experience... » *op. cit.* Ch. V.

(46) Mao Tse-Tung, « Economic and Financial Problems » in *Selected Works of Mao Tse-tung*, Pekin : Foreign Languages Press 1965, Vol. III ; quoted in J.G. Gurley « The Formation of Mao's Economic Strategy, 1927-1949 » in *Monthly Review*, Vol. 27, N° 3 (July - August, 1975).

RÉSUMÉ

Dans cet article, l'auteur essaie d'identifier les grandes forces qui ont conduit à l'échec et les tentatives en vue de réaliser la stabilité financière au cours du Deuxième Plan Quinquennal Tanzanien (1969 - 1974). L'auteur montre que certains des problèmes rencontrés sont liés à la structure de l'économie, donc généralisables aux pays africains qui se trouvent à un stade de développement similaire.

Un examen général de l'inflation dans les pays en développement semble indiquer quatre domaines principaux dans lesquels les performances économiques sont susceptibles d'exercer une influence profon-

de sur le processus inflationniste. Ces domaines sont (pour un pays donné) : la politique monétaire et financière ; le secteur du commerce extérieur ; le processus d'industrialisation et d'urbanisation et la fourniture du capital ; et le secteur agricole et d'autres du même genre (impasses potentielles). Cependant, une étude détaillée de l'expérience et de l'économie tanzanienne semble indiquer les domaines suivants comme ayant joué un rôle primordial au cours de la période en question :

Tout d'abord, bien que le taux relativement élevé de l'expansion monétaire qui a caractérisé l'économie au cours des premières années d'existence du système financier national n'ait pas été inflationniste, l'accroissement du rapport monnaie/revenu qui s'en est suivi semble avoir été inflationniste. Deuxièmement, le secteur agricole, en tant que fournisseur de produits alimentaires et déterminant à moyen terme de la capacité nationale d'importation a été de très loin distancé par tous les secteurs, sauf le secteur minier (1968-72) et a exercé une influence inflationniste considérable sur les prix à la consommation et la balance des paiements. Troisièmement, la capacité d'importation a été plutôt faible si l'on tient compte du taux de croissance de l'économie qui était prévu. Ceci est en partie dû aux problèmes particuliers de l'agriculture mais aussi à la division du travail héritée de la colonisation. Quatrièmement et ceci se rapproche de la troisième observation, l'importance de l'inflation importée, due surtout au fait que le pays ne dispose pas des industries de base et n'est donc pas économiquement flexible.

L'auteur examinera ces problèmes dans l'ordre ci-dessus, utilisant une large interprétation des pressions inflationnistes, interprétation qui se refert aussi bien à l'inflation des prix qu'aux déséquilibres de la balance de paiements.

En conclusion, l'auteur a essayé de montrer l'intérêt qu'il y a à inclure tous les problèmes de l'offre des biens dans l'interprétation des problèmes monétaires dans les pays sous-développés. Les interprétations basées sur la demande qui privilégient les problèmes de formation du capital tendent à dissimuler les contraintes structurelles au sein desquelles les politiques financières progressistes doivent opérer et par conséquent, elles ne montrent pas les limites de telles politiques en tant qu'instrument d'une politique économique générale. En fait, étant donné la situation, telle qu'elle est indiquée dans cet article, l'auteur est tout à fait d'accord avec l'observation suivante de Mao Tse-Tung :

« Une politique financière (bonne ou mauvaise) affecte l'économie, mais c'est l'économie qui détermine la finance. Sans base économique solide, il est impossible de résoudre les problèmes financiers et sans croissance économique, il est impossible d'atteindre l'indépendance financière. Les problèmes financiers ne peuvent être résolus que par un développement économique efficace et simple. Négliger le développement économique et l'ouverture des sources de financement et espérer résoudre les problèmes financiers en réduisant les dépenses indispensables, c'est là une politique conservatrice qui ne saurait rien résoudre ».