

MONETARY POLICY IN DEVELOPING COUNTRIES

*Edited by
Sheila Page*



London and New York

CONTENTS

| | |
|---------------------------|-----|
| <i>Figures and tables</i> | ix |
| <i>Acknowledgements</i> | xii |

Part I The nature of monetary policy and the financial sector

| | |
|---|----|
| 1 THE NEW DEMAND FOR MONETARY DEVELOPMENT | 3 |
| <i>Sheila Page</i> | |
| <i>The new interest in monetary policy</i> | 6 |
| <i>What monetisation can do for developing countries</i> | 8 |
| <i>Why developing countries are different</i> | 9 |
| 2 THE INSTITUTIONAL FRAMEWORK | 11 |
| <i>Tony Addison and Lionel Demery</i> | |
| <i>Monetisation</i> | 11 |
| <i>Informal and formal money institutions and markets</i> | 12 |
| <i>The banking system</i> | 13 |
| <i>The market for securities</i> | 14 |
| <i>Measuring money</i> | 14 |
| 3 AN ANALYTICAL FRAMEWORK | 17 |
| <i>Tony Addison and Lionel Demery</i> | |
| <i>The sources of money creation</i> | 17 |
| <i>A money-multiplier model</i> | 18 |
| <i>The demand for money</i> | 21 |
| <i>Issues concerning causality</i> | 22 |
| 4 A FRAMEWORK FOR POLICY ANALYSIS | 25 |
| <i>Tony Addison, Lionel Demery and Sheila Page</i> | |
| <i>Targets for monetary control</i> | 25 |
| <i>Methods of monetary control</i> | 26 |
| <i>Policy questions</i> | 35 |

CONTENTS

Part II Country studies

| | | |
|---|--|-----|
| 5 | KENYA, 1967-88 | 39 |
| | <i>Tony Killick and F.M. Mwegu</i> | |
| | <i>Introduction</i> | 39 |
| | <i>The economic setting</i> | 39 |
| | <i>Research findings</i> | 47 |
| | <i>Policy conclusions</i> | 72 |
| 6 | GHANA, 1957-88 | 79 |
| | <i>Nii Kwaku Sowa</i> | |
| | <i>Introduction</i> | 79 |
| | <i>The state of the economy</i> | 80 |
| | <i>The structure and operations of the financial system</i> | 85 |
| | <i>Model of the money market</i> | 93 |
| | <i>Monetary policy implementation, 1957-88</i> | 101 |
| | <i>Conclusions</i> | 104 |
| 7 | CÔTE D'IVOIRE, 1973-88 | 107 |
| | <i>Christopher E. Lane</i> | |
| | <i>Introduction</i> | 107 |
| | <i>The state of the economy</i> | 107 |
| | <i>The structure and operations of the financial system</i> | 109 |
| | <i>Instruments of monetary policy</i> | 115 |
| | <i>Problems of monetary control</i> | 122 |
| | <i>Real economy effects of monetary policy</i> | 126 |
| | <i>Evaluating membership of the UMOA</i> | 128 |
| | <i>Conclusions</i> | 133 |
| 8 | INDONESIA, 1974-90 | 137 |
| | <i>Christopher E. Lane, David C. Cole and Betty F. Slade</i> | |
| | <i>Introduction</i> | 137 |
| | <i>The financial system</i> | 138 |
| | <i>Monetary policy implementation 1974-82</i> | 141 |
| | <i>Monetary policy implementation 1983-90</i> | 147 |
| | <i>Demand for money</i> | 155 |
| | <i>Conclusions</i> | 160 |
| 9 | BANGLADESH, 1973-85 | 165 |
| | <i>Ashok Parikh</i> | |
| | <i>Introduction</i> | 165 |
| | <i>State of the economy</i> | 165 |
| | <i>The process of monetisation</i> | 169 |
| | <i>Monetary policy instruments and control</i> | 170 |
| | <i>Problems of monetary policy implementation</i> | 173 |

CONTENTS

| | |
|---|-----|
| <i>Impact of agricultural and industrial policy on demand for credit</i> | 178 |
| <i>Appendix: Econometric models of Bangladesh monetary sector</i> | 180 |
| 10 CHINA, 1949–88 | 185 |
| <i>Anita Santorum</i> | |
| <i>Introduction</i> | 185 |
| <i>Financial institutions</i> | 187 |
| <i>Money supply and demand</i> | 206 |
| <i>Aggregate and sectoral effects of the central bank's monetary policy</i> | 211 |
| <i>Conclusion</i> | 220 |
| <i>Appendix</i> | 222 |

Part III Special studies

| | |
|---|-----|
| 11 THE INFORMAL FINANCIAL SECTOR: HOW DOES IT OPERATE AND WHO ARE THE CUSTOMERS? | 227 |
| <i>J. J. Thomas</i> | |
| <i>Introduction</i> | 227 |
| <i>Formal financial institutions and the rural traditional and urban informal sectors</i> | 228 |
| <i>Informal financial institutions</i> | 234 |
| <i>The informal financial sector and monetary policy</i> | 245 |
| <i>Conclusions</i> | 247 |
| 12 EXCHANGE RATES AND THE EFFECTIVENESS OF MONETARY POLICY | 251 |
| <i>Christopher E. Lane</i> | |
| <i>Nominal anchors and real targets</i> | 251 |
| <i>Changes in exchange-rate arrangements</i> | 254 |
| <i>The 'nominal anchor' in the Franc Zone</i> | 257 |
| <i>Raising the anchor: currency floats in the 1980s</i> | 262 |
| <i>Real targets: a feasible policy objective in developing countries?</i> | 270 |
| <i>The conditions for using exchange-rate policy</i> | 273 |

Part IV Monetary policy and the financial sector

| | |
|--|-----|
| 13 THE USE OF MONETARY POLICY | 279 |
| <i>John Healey and Sheila Page</i> | |
| <i>Monetary policy?</i> | 280 |
| <i>How effective has monetary policy been in achieving stabilisation objectives?</i> | 286 |
| <i>Monetary policy with external shocks</i> | 288 |

CONTENTS

| | | |
|----|---|-----|
| 14 | THE FINANCIAL SECTOR | 297 |
| | <i>Sheila Page and John Healey</i> | |
| | <i>Monetary instruments and their effectiveness</i> | 297 |
| | <i>Constraints on the effective implementation of monetary policy in developing countries</i> | 304 |
| | <i>Developing the financial sector</i> | 311 |
| 15 | THE RELATIONSHIP BETWEEN FORMAL AND INFORMAL FINANCE | 319 |
| | <i>Sheila Page</i> | |
| 16 | MONETARY POLICY AND DEVELOPMENT | 325 |
| | <i>Sheila Page</i> | |
| | <i>Notes</i> | 329 |
| | <i>References</i> | 339 |
| | <i>Index</i> | 359 |

FIGURES AND TABLES

FIGURES

Ghana

| | |
|---|----|
| 6.1 Indicators of financial depth 1960–88 | 86 |
|---|----|

Côte-d'Ivoire

| | |
|---|-----|
| 7.1 Indicators of financial development | 110 |
| 7.2 Real deposit rate 1963–88 | 121 |
| 7.3 Côte-d'Ivoire real and nominal effective exchange rates | 130 |

China

| | |
|---|-----|
| 10.1 China's banking system after 1984 | 193 |
| 10.2 P–S index and monetary growth, 1955–83 | 212 |
| 10.3 Rural value added and credit, 1977–86 | 219 |

Exchange rates

| | |
|---|-----|
| 12.1 Franc Zone real effective exchange rates | 258 |
| 12.2 Inflation differential Côte-d'Ivoire and France | 260 |
| 12.3 Côte d'Ivoire relative prices – real exchange rate | 261 |

TABLES

Analysis

| | |
|------------------------------------|----|
| 4.1 Techniques of monetary control | 25 |
|------------------------------------|----|

FIGURES AND TABLES

Kenya

| | |
|--|----|
| 5.1 Macroeconomic indicators for Kenya, 1969–88 | 40 |
| 5.2 Indicators of financial deepening, selected years | 45 |
| 5.3 Relationships between domestic credit and the balance of payments, 1973–88 | 50 |
| 5.4 Short-run money demand functions in Kenya, 1973:3–1988:4 | 55 |
| 5.5 Predictability and bias in Kenyan budgeting | 62 |
| 5.6 OLS estimates of private credit functions | 65 |

Ghana

| | |
|--|-----|
| 6.1 Basic indicators of real economic performance | 80 |
| 6.2 Structure of production and consumption in Ghana | 81 |
| 6.3 Indicators of fiscal performance, 1965–88 | 83 |
| 6.4 Distribution of bank deposits and branches, 1988 | 88 |
| 6.5 Changes in money supply and sources of changes | 95 |
| 6.6 Money supply equations (2SLS estimation) | 97 |
| 6.7 Money demand equations (2SLS estimation) | 100 |
| 6.8 Key financial rates and ratios (1960–88) | 102 |

Côte d'Ivoire

| | |
|--|-----|
| 7.1 Economic growth in Côte d'Ivoire | 108 |
| 7.2 Major financial system assets, 1987 | 111 |
| 7.3 Credit and refinancing | 115 |
| 7.4 Central bank refinancing – ceilings and results | 116 |
| 7.5 Sectoral credit – objectives and outcomes | 120 |
| 7.6 Changes in counterparts to monetary base | 124 |
| 7.7 GDP growth – Côte d'Ivoire and other African countries | 128 |
| 7.8 Côte d'Ivoire: trade shares | 131 |

Indonesia

| | |
|--|-----|
| 8.1 Banking system: number of banks and banking offices | 139 |
| 8.2 Monetary policy targets, 1974/5–1982/3 | 142 |
| 8.3 Comparing the oil price shocks: changes in economic indicators | 144 |
| 8.4 Comparing the oil price shocks: credit and government operations | 146 |

Bangladesh

| | |
|------------------------------------|-----|
| 9.1 Bangladesh economic indicators | 166 |
| 9.2 Percentage change in prices | 167 |

FIGURES AND TABLES

| | |
|--|-----|
| 9.3 Percentage change in money and bank credit | 167 |
| 9.4 Indicators of monetisation | 169 |
| 9.5 Bangladesh securities: stocks outstanding | 171 |
| 9.6 Interest rates | 172 |
| 9.7 Foreign trade | 177 |
| 9.8 Total advances of Bangladesh Krishi and Shilpa banks | 180 |

China

| | |
|--|-----|
| 10.1 Net saving as percentage of national income | 191 |
| 10.2 Real rates of interest, nominal spread between interest rate on loans and savings deposits, and inflation | 196 |
| 10.3 Households' savings deposits | 201 |
| 10.4 Number of savings offices in urban and rural areas | 202 |
| 10.5 Treasury bonds and government deficit | 205 |
| 10.6 Price equation, 1958–83 | 215 |
| 10.7 Monetary growth and economic performance | 218 |
| 10.8 Agricultural credit and sales of agricultural inputs | 219 |

Informal sector

| | |
|--|-----|
| 11.1 Some indications of the size of the informal financial sector | 246 |
|--|-----|

Exchange rates

| | |
|---|-----|
| 12.1 Monetary instruments and exchange-rate regimes | 252 |
| 12.2 Effectiveness of monetary policy in the Franc Zone: central bank refinancing targets | 259 |
| 12.3 1980s floating regimes: exchange rates and monetary growth | 263 |
| 12.4 Floating exchange-rate regimes: economic background | 264 |
| 12.5 Monetary policy effectiveness and economic structure in developing countries | 274 |

Financial sector

| | |
|--|-----|
| 14.1 Demand for money: summary results | 310 |
|--|-----|