AN APPRAISAL OF THE IMPACT OF RECENT CHANGES IN INTEREST RATES IN GUYANA

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INTRODUCTION

Attempts to effect structural economic changes through appropriate investment policies have been at the core of the focus of policymakers in many L.D.C.'s in the 1960's and 1970's. A requirement was seen to be sufficiently low interest rates to encourage (or at least to accommodate) investment activity. Little emphasis was placed on the need to increase domestic financial savings. The dominant framework within which economic policies were analysed therefore emphasised an inverse relationship between interest rates and investment.

The expected high rates of economic growth did not materialize. Perhaps it was the attempts to remove some of the distortions which developed during the pre-independence era and improve the standard of living of the greater part of the population, in the shortest possible time, that led to many inappropriate and bad investments, inefficiency and waste and the growth of large government budget deficits. Combined with high energy prices and large increases in the price of capital goods; their high degree of exposure to fluctuations in economic activity in the developed countries and the implications of this for inflation, the terms of trade etc., many of these economies, in a short while, began to experience severe balance of payments crises and high inflation rates.

A solution to the balance of payments problem is now seen as an economic necessity. The state of the economy in the next few years will be determined by how the balance of payments situation unfolds over the immediate period. This view has been emphasised and probably forced upon many L.D.C.'s by the I.M.F. Although there has been much discussion in the I.M.F. recently on the need for more medium-term (supply side) policies to stimulate output and exports, the major area of emphasis is still short-term adjustment policies.

The dominant framework employed assumes that the root of these problems lies in the inability of the economies to sustain the high levels of total spending which now obtain. As such all policies must aim at either reducing spending and/or increasing the availability of domestic financial resources. It is within this framework that policies such as devaluation, the removal of subsidies, credit restrictions and higher interest rates have to be seen.

On one hand, higher interest rates are expected to lead to an increase in domestic financial savings at the expense of consumption, private capital outflows and non-financial savings. On the other hand, it is seen as an effective rationing device for the limited resources available, in the process, forcing economic units to become more productive.

The point that is emphasised here is that if a high level of investment is considered desirable then attempts must be made to release

as much domestic resources as is possible, for this purpose. Failure to accomplish this would lead to a greater demand for foreign resources (which implies a balance of current account deficit) and all that implies. Further if the rate of return on investment is not high enough to justify higher interest rates, if there is need to encourage infant industries etc., other more direct and effective means should be found for to do so. The general level and spectrum of interest should not be tailored as to subsidise investment activity.

The framework which is now being proposed by many economists is one which emphasises a positive relationship between interest rates and savings, the balance of payments investment and economic growth. This approach has been employed, willingly or not, by many developing countries including Guyana. And it is this that we shall attempt to appraise with respect to the experiences of Guyana over the last few years.

For purposes of convenience the paper is divided into three parts. In Part I we outline the theoretical arguments for higher or positive interest rates in developing countries. Here we concentrate on the relationship between interest rates and savings mobilization; investment activity and, financial intermediation. In Part II we examine developments in the financial system especially since 1978 with a view towards assessing the strength of the relationships discussed in the previous part. In the final part an attempt is made to rationalize these developments and to highlight other contributory factors. We also suggest a possible approach to the determination of the interest rate structure in Guyana.

PART I

HIGHER INTEREST RATES SAVINGS, INVESTMENT AND FINANCIAL INTERMEDIATION

Over the past decade or so the majority of the non-oil producing developing countries have been experiencing, what now seems to be, almost unmanageable balance of payments and inflation problems and low (sometimes even negative) rates of economic growth. Given that their international reserves positions have already been severely eroded, such a situation cannot be tolerated for very much longer. Economists and policymakers are now becoming increasingly aware of the need for appropriate stabilization policies to solve these problems and in the process, create an atmosphere which is conducive to investment. Further, as bilateral and concessionary sources of aid continue to diminish and with commercial loans becoming relatively more expensive and scarce, many developing countries are being forced to turn to the International Monetary Fund for assistance. The framework being used by the Fund emphasises such policies. They are seen as providing the preconditions in the form of a healthier balance of payments position and a manageable goverments budget deficit, for the 'take-off' into self sustained growth.

This approach stresses the need for higher rates of return or 'positive' interest rates on financial assets - i.e. rates that are higher than the expected rate of inflation in the economy. This is expected to rejuvenate the financial system where this has been repressed and encourage the development of new financial institutions, increase the flow of financial saving and assist in the efficient allocation of such funds among borrowers. These higher rates are also expected to contribute to a reduction in the heavy outflow of capital which now takes place in many L.D.C's and indeed, encourage inflows of foreign capital, restrain the rate of inflation and allow a freeing up of the severe foreign exchange restrictions.

The negative and 'unrealistic' interest rate structures which presently characterize many L.D.C s it is argued, frequently lead to the stifling of savings and investment and to the misallocation or underutilization of resources. However, they are still maintained because of one or a combination of the following reasons. These include -

(a) The belief that low interest rates are necessary to encourage investment and stimulate growth.

(b) The feeling that savers in many L.D.C s are not sensitive to changes in interest rates. Saving is considered to be a residual.

(c) It is felt that intervention in the financial markets is necessary to improve the allocation of resources through the redirection of credit to certain priority areas. This frequently takes the form of controls over lending and borrowing rates.

(d) The prevalence of strong vested interests to maintain a low interest rate structure - including the temptation to subsidize Government borrowing.

These have not proven to be convincing enough to justify these low rates, thus the gradual change in attitude towards higher rates. In what follows, we outline the case for higher or positive interest rates and then try to examine the relevance of such an approach to the Guyana economy. Of course, the question of how positive should the level of interest rates be is still being seriously debated by economists.

INTEREST RATES AND FINANCIAL SAVINGS

The amount of money that a person is willing and able to save is dependent on a number of factors. These include, wealth, expectations, income and the rate of return. There is now general agreement among economists that for analytical purposes, the latter two are the most important in L.D.Cs. We can conveniently express this in the following way:

$S = f(Y, i)$ where

S = financial saving

Y = disposable income

i = the rate of interest

This equation represents a consolidation of two broad views on the determinants of savings, which attracted much attention at some time or the other; namely the classical and neoclassical schools which stress the importance of the rate of return on savings and those of Keynes and other modern economists, such as Friedman, who stress the importance of income.

In the former case, interest is seen as the reward which has to be offered to induce an abstention from present consumption and a financial ization of savings. If potential savers are to be encouraged to invest in financial assets, then the rate of return on such assets has to be competitive with other forms of holding savings - either by reducing the rate of inflation (a difficult task in small open economies in the initial period of the stabilisation programme), or by raising the rate of return on financial assets. The simple law of supply suggests that the greater the rate of return, the greater will be the incentive to save and citeris paribus, the greater the level of saving. This suggests, therefore, that

if a higher rate is offered to savers, savings will increase. This in turn assumes that savers are conscious of the real return on their savings and will respond to changes in this rate.

Empirically, it has been very difficult to establish the precise relationship between changes in the rates of interest and the response of total saving. Since there are other variables which have to be considered in the equation where financial intermediation and the 'banking habit' have not very much developed as is the case in many L.D.Cs, this problem is further compounded.

This brings us to the second school of thought whose thesis is that saving is mainly a function of income. There are several versions of this theory, ranging from Keynes who argued that saving is a function of disposable income, Milton Friedman's 'permanent income' hypothesis and Modighiani's 'life cycle income' hypothesis to Duesenberry's relative income hypothesis. In spite of this, economists generally agree that when real incomes are rising, and the economy is progressing, the scope for increasing the level of financial saving is increased. And once the rate of inflation is not excessively high or the expectations of the level of the future rate do not operate as a disincentive, then such potential can be tapped through appropriate monetary incentives.

In other words, in addition to realistic interest rates, income is considered to be an important determinant of saving. There must be the scope for increasing saving if increased interest rates will have any positive effects on the accumulation of financial resources.

The analysis of positive interest rates and savings mobilization must not however, over-shadow considerations of the impact on investment and of the investment opportunities available. This is of crucial importance as all other financial assets are claims on or ultimately motivated by the desire to finance such capital - and as such this should play a significant role when the level and structure of interest rates are being determined.

INTEREST RATES AND INVESTMENT

It is the contention of many economists that a low or negative lending rate (equivalent to a rate below the theoretical equilibrium level) leads to credit rationing and the exclusion of many borrowers whose loans cost more to administer and who are higher credit risks, but who at the same time, are very productive.

A higher lending rate together with a greater spread between official lending and borrowing rates for the credit institution, is expected to encourage increased lending to marginal groups, probably at the expense of those offering a lower rate. Generally, therefore, the supply curve for a particular type of credit will be rising with respect to

the rate of return available to lending institutions. This implies that there is a rate high enough to induce a lender to increase his supply of a particular type of credit, provided that the loan applicants' agreement to pay a higher rate raises the expected value of the return on such lending sufficiently.

Further, it is argued that cheap credit in the form of low interest rates subsidize inefficiency and hardly serve as an encouragement for producers to improve their methods of production. Higher interest rates will present entrepreneurs with the choice of either improving their productivity and production or be forced out of business.

There are many who hold the view that lending rates should be kept low enough so as not to discourage investment in favour of the holding of money balances. Such an argument does not take into account the need to increase the availability of domestic financing resources (which can then be invested) through an increase in the public's willingness to hold such balances (and the implications for the balance of payments). If there is need to subsidise investors or to encourage the development of infant industries, interest rates should not be used for this purpose since this may very well prove to be counterproductive. Other more direct and appropriate methods are available and can be used effectively.

In addition, with the present underdeveloped state of financial intermediation in many developing countries, much of the finance for investment especially in the non-exporting sector has to be generated from within businesses. This constrains investment in new and more efficient techniques of production - which need relatively large sums for their introduction. Higher interest rates, are expected to lead to an improvement in the process of financial intermediation, facilitating a greater flow of finance into new investments and new techniques, thus improving the overall rate of return.

Here, we have raised the important issue of the utilization of funds generated by increased financial intermediation. It is generally assumed that the asset management policies of financial intermediaries have, built into them, an allocative mechanism which leads to the optimum allocation of resources. This suggests that such resources are channelled to those who would use them most efficiently. And, if these are socially most productive then such intermediation would lead to an improvement in the economic well-being of the country. However, in addition to the rate of return, lending institutions take into account such factors as credit worthiness of the entrepreneur, knowledge of certain activities and the cost of administering loans. In addition, market imperfections and credit policies can lead to a situation where prices do not reflect social value and thus a given profit rate may not measure social productivity. As a result the allocation of resources by the financial system may not always be in the best interest of a particular country.

The above analysis suggests that high interest rate policies could yield only partial results in this direction. They may lead to an increase in the mobilization of savings but would not necessarily ensure their optimum use. This is not an argument for curtailing financial intermediation. It is to emphasise that these policies must be supplemented by other measures directed at ensuring that the rate of profit moves to approximate social productivity.

INTEREST RATES AND FINANCIAL INTERMEDIATION

The benefits of increased financial intermediation in the growth process are now well recognised in many L.D.Cs. The experiences of the developed countries have proven to be very instructive in this case. During the early stages of their development there arose an increasing dichotomy between the decisions to save and invest - in the sense that those who were investors were not necessarily the savers also. This resulted in increased financial intermediation and the provision of various types of financial assets in response to the needs of the surplus units. These intermediaries in turn, were able to provide an increased supply of funds to capital starved entrepreneurs, allowing them to break out of the system of self-financing or borrowing at high rates from money lenders.

The contention is that there is need for such a process in developing countries where the range of financial institutions, in terms of their activities, and their special distribution is limited. It is important, however, that financial institutions are induced to increase their intermediation. A requirement is a rate of return which is sufficient to cover the cost of mobilizing resources and of disbursing such resources. If rates are not allowed to float freely, then there is need to ensure that the structure of the rates is such as to encourage such a development. We note the theory of the firm which suggests that financial intermediation will continue until their marginal cost of attracting funds is equal to their marginal revenue derived from the use of such resources. Attempts to reduce the spreads available to them down to the minimum in order to hold lending rates down may lead to a contraction in their activities.

It is clear that from what we have said so far that where interest rates are legislated, the determination of the level of such rates and the relationship among them is an important and technical task. Care has to be taken to ensure that there are no serious conflicts among the rates, that deposit and lending rates are at levels that are conducive to savings mobilization and investment activity and that priority sectors receive adequate finance. This is not a simple task in any economy, given the diversity of the agents which impact on the economic environment. In many countries this is achieved after a long and painful process of trial and error. And, of course, these rates have to be constantly monitored to take into account the changing domestic and international situations. This suggests that an interest rate policy has to be dynamic and a once-for-all solution should never be sought after since there are none available.

Rather, constant review of short-run situations is necessary for effective management of the economy.

We now examine developments in the deposit mobilisation and asset portfolios of financial institutions in Guyana. Here emphasis will be placed on the banking system, since we believe that a proper understanding of such developments gives a good insight into developments in other financial institutions and in the economy as a whole.

TABLE 1

A SUMMARY OF INTEREST RATES IN GUYANA (Per Annum)

(1968 - 1981)

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
BANK RATE	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	8.50	10.50	12.50	12.50	14.00
DEPOSIT RATES															
Commercial Banks															
Savings	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	6.50	8.50	10.50	10.50	11.50
3 months time	4.00	4.75	4.75	4.75	4.00	4.00	4.00	4.00	4.00	4.00	7.00	9.00	11.00	11.00	12.00
6 months time	4.50	5.50	5.50	5.50	4.50	4.50	4.50	4.50	4.50	4.50	7.50	9.50	11.50	11.50	12.50
12 months time	5.00	6.50	6.50	6.50	5.50	5.50	5.50	5.50	5.50	5.50	8.50	10.50	12.50	12.50	13.00
New Building Society															
Deposits					5.00	5.00	5.00	5.00	5.00	5.00	6.00	7.00	8.00	8.00	8.00
Five Dollar Shares					6.00	6.00	6.00	6.00	6.00	6.00	7.00	8.50	10.50	10.50	12.50
Save and Prosper Shares					7.00	7.00	7.00	6.50	6.50	6.50	8.00	9.00	11.00	11.00	12.50
Government Securities															
Treasury Bills	6.01	6.12	6.09	5.88	5.88	5.88	5.88	5.88	5.88	5.88	7.80	9.72	11.62	11.62	12.75
Debentures	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	11.00	11.00	11.00	14.50
LENDING RATES															
Commercial Banks															
Prime	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50	9.50	11.50	13.50	13.50	15.00
Average	8.00	8.20	8.80	8.90	9.10	8.90	8.90	8.90	8.90	8.90	10.50	12.75	13.88	13.94	
Mortgage Loans															
New Building Society					8.00	8.00	8.00	8.00	8.00	8.00	8.00	10.00	10.00	12.00	14.00
Insurance Cos. & Agencies										8.5-10.0	8.5-11.00	8.50-11.00	8.50-12.50	8.50-12.50	10.00
Mortgage Finance Bank															
Guyana Mortgage Finance Co.				8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50
Guyana Housing & Dev. Co.				9.50	9.50	9.50	9.50	9.50	9.50	9.50	9.50	9.50	9.50	9.50	
Trust Companies						8.5-9.5	8.5-9.5	8.5-	9.5-10.0	9.5-10.0	9.50-10.50	11.0-12.0	12.00	12.00	14.0
OTHER RATES															
Gaibank										9.0-10.0	9.00-10.50	10.50-12.0	12.00	12.00	12.0

SOURCE: Bank of Guyana.

PART II

FINANCIAL DEVELOPMENTS IN GUYANA

SAVINGS

The first major change in official interest rates in Guyana took place in June 1978. After that there were other changes in May 1979, in July 1980 and in June 1982. In each case, except the latter the Bank Rate was increased by 2 percentage points. In June 1982 this rate was increased by 1.5 percentage points. Other official rates were then increased. These changes are shown in Table 1.

Prior to 1978, the monetary authorities followed a policy of low and stable interest rates. Various explanations have been advanced for this attitude to the use of interest rates in developing countries. We noted a few in the last section. With respect to Guyana one gets the impression that an active interest rate policy was not seen as being of much importance by the policymakers. The preoccupation was with growth rather than direct short-run stabilization policies, thus the large capital programmes etc.

The change in 1978 and the two subsequent changes seem to have been partly a result of I.M.F.'s insistence, after Guyana was forced to turn to this institution for balance of payments support. I.M.F.'s conditionality, circumscribed within a framework of adjustment and increased liberalization of the economy, almost always suggest policies for reducing inflation and balance of payments deficits - among which are devaluation, the removal of subsidies, control of public sector borrowing and increased interest rates. Good intentioned as they might be, these policies do not always work in favour of the domestic economy, and indeed have sometimes been counter productive. Have the changes in interest rates produced the desired effects discussed in Part I and are further changes advisable in our context? In what follows we discuss the former and in the next section we attempt to deal with the latter.

As Table 1 shows, after each increase in the Bank Rate, other interest rates were simultaneously adjusted upwards. The deposit rates of the commercial banks were first increased by 3 percentage points in 1978, by 2 percentage points each in 1979 and 1980 and by 1 percentage point in 1982 except for the rate on twelve months fixed deposit which was raised by only 0.5 percentage point at that time. Thus, since 1978, the annual rate on small savings deposits moved from 3.5% to 11.5%; three months time from 4% to 12% and six months and twelve months time from 4.5% and 5.5% respectively to 12.5% and 13.0%. In effect, between 1978 and 1982, the deposit rates offered by commercial banks moved upwards by 8 percentage points, or more than twice the pre-1978 level in the case of

saving and one and half to two times that level in the case of time deposits.

Notwithstanding these increases, the real deposit rates continued to be negative in the light of inflation rates of about 16% and over, which have been prevailing since 1977.

The response of total saving in the banking system has not been very significant. Total deposits rose by 11.5% in 1978, 15.2% in 1979, 23% in 1980, 18.3% in 1981 and by 15.9% in the first nine months of 1982. As we can see from Table 2(a) these increases were not very much different from those of previous periods, say between 1970 and 1975. If we attempt to deflate nominal deposits by some appropriate measure of the rate of inflation we would be better able to see the real growth in deposits during this period. Unfortunately, the only such measure available to us is the Urban Consumer Price Index - which suffers from a number of shortcomings. However, deflating by this measure would still give us some useful insights into these developments. This is done in Table 2(b). The results show that the highest rate of increase in real deposits - this is also the case for nominal deposits - were achieved during periods when the economy was relatively buoyant as in 1974-1975 period, for instance. Also in 1978, 1979 and 1981, there were actually decreases in real financial savings in the banking system.

Further analysis of the rate of change of interest bearing deposits (time and savings) will not lead to results which are significantly different from the above. Although the volume of saving deposits rose by some 117.5% between December 1977 and September 1982 (a fifty-sever month period), the increase in the same period prior to December 1977 was as much as 139.9%.

The response in the volume of commercial banks' time deposits has been more significant. There were increases of such magnitudes as 24% in 1979 31.8% in 1980 and 19.6% in 1981 leading to an increase of 173.8% in the period December 1977 to September 1982. However, in years such as 1971 and 1972 there were much larger increases than those of 1979 and 1980 Further, when we note that a significant proportion (46.3%) of the 31.8% increase in 1980 was a result of the increase in time deposits of other financial institutions, such as pension funds, the association between interest rate changes and changes in saving in Guyana becomes weaker. The other financial institutions' holdings of treasury bills (which now earns 12.75%) fell by 35.1% between May 1979 (when interest rates were changed for the second time) and December 1979 and by about 40% during 1980 - indicating that there was some substitution of higher yielding time-deposits for treasury bills.

TABLE 2(a)

COMMERCIAL BANKS DEPOSITS

1965-1981

G$Mn.

	Total Deposits	% Change	Time Deposits	% Change	Savings Deposits	% Change	Demand Deposits	% Change
1965	79.0		11.5		45.6		21.9	
1966	83.0	5.1	12.8	11.3	50.5	10.8	19.7	-10.1
1967	93.5	12.7	16.3	27.3	56.3	11.5	20.9	6.1
1968	104.8	12.1	20.5	25.8	62.4	10.8	21.9	4.8
1969	117.7	12.3	29.7	44.9	63.9	2.4	24.1	10.1
1970	127.5	8.3	38.0	28.0	67.1	5.0	22.4	-7.1
1971	151.4	18.8	50.2	32.1	74.5	11.0	26.7	19.2
1972	182.6	20.7	70.7	40.2	80.8	8.5	31.5	18.0
1973	217.8	19.2	81.0	15.1	100.6	24.5	36.2	14.9
1974	251.8	15.6	79.1	-2.3	114.7	14.0	58.0	60.2
1975	352.1	39.8	99.7	26.0	154.4	34.6	98.0	68.9
1976	377.3	7.2	109.0	9.3	172.2	11.5	96.1	-1.9
1977	445.9	18.2	129.7	19.0	204.0	18.5	112.2	16.8
1978	497.1	11.5	141.6	9.2	241.4	18.3	114.1	1.7
1979	572.6	15.2	175.6	24.0	274.0	13.5	123.0	7.8
1980	704.0	23.0	231.5	31.8	319.1	16.5	153.4	24.7
1981	832.9	18.3	276.9	19.6	397.3	24.5	158.6	3.4
1982 (Sept.)	965.6	15.9	355.1	28.2	443.7	11.7	166.8	5.2

SOURCE: BANK OF GUYANA.

With respect to demand deposits, between 1973 and 1977, the proportion of total deposits held in this form increased gradually from 16.6% to 25.1%. However after the change in deposit rates, this began to decline and was 17.3% by September 1982. A factor which might have had an impact in this case also is the contraction of economic activity and the implications for businesses holdings of current accounts. If we analyze savings in non-bank financial institutions such as the New Building Society, we would also find that the level of saving has hardly responded to the changes in interest rates which took place. This we do very briefly below.

In the case of the New Building Society, each change in the Bank Rate was accompanied by changes in the rates offered depositors - although by smaller magnitudes. In 1978, the rates on five-dollar shares and deposits were allowed to rise by one percentage point while that on save and prosper shares went up by 1.5 percentage points. In 1979, 1980 and 1982 there were further increases as shown in Table 1. Thus, after the latter change, the rates on five-dollar shares, save and prosper and deposits stood at 12.5%, 12.5% and 8% respectively, representing increases of 6.5, 6.0 and 3 percentage points compared with 8 percentage points on those offered by the commercial banks. It seems an attempt was made to increase the attractiveness of saving in this institution in 1982 when the rate on five dollar shares was increased by 2.0 percentage points compared with a 1.0 percentage point rise in the deposit rates of the commercial banks. It is yet too early to assess the impact of this move. The general indicators however suggest that much should not be expected in this respect.

The rate of accumulation of savings in this institution did not even approximate the rate achieved in previous years. Between 1977 and 1981, the increase was 75% compared with over 120% in the four year period prior to 1977. The relatively high yielding five dollar shares continued to be the major contributor.

As we have seen, the changes in deposit rates between 1978 and 1982 did not have any significant impact on total financial saving. This suggests that other factors, exerting a greater influence than interest rates, were present. It is very tempting to argue that the changes were not large enough to introduce "the positiveness" in interest rates in Guyana; that the public was insensitive to such small changes, and that what is needed is a large increase - to provide a shock effect. As we shall see later, even this will not provide the desired benefits necessary to compensate for the costs involved in such an approach. There must be present, the scope for increasing savings in the first instance. There is a point beyond which it is not possible to further squeeze consumption and it seems to be the case that in Guyana, we have reached this point. At the same time in our present economic situation even higher deposit rates will not induce an increase in private foreign capital inflows although it may induce residents to hold more of their funds inside of Guyana rather than transfer them outside through the unofficial channels.

TABLE 2(b)

COMMERCIAL BANKS TOTAL DEPOSITS DEFLATED BY

URBAN CONSUMER PRICE INDEX

G$Mn.

	Total Deposits	U.C.P.I.	Total Deposits at 1970 prices	% Change
1970	127.5	100.0	127.5	
1971	151.4	101.0	149.9	17.6
1972	182.6	106.0	172.2	14.9
1973	217.8	114.0	191.0	10.9
1974	251.8	140.7	179.0	-6.3
1975	352.1	145.3	242.3	35.4
1976	377.3	162.0	232.9	-3.9
1977	445.9	176.4	252.8	8.5
1978	497.1	213.1	233.3	-7.7
1979	572.6	254.5	225.0	-3.6
1980	704.0	264.0	266.6	18.5
1981	832.9	322.7	258.1	-3.2

SOURCE: BANK OF GUYANA.

It is clear, however, that these increases in deposit rates have led to a change in the form in which savings are being held - in favour of relatively high yielding time deposits in the banking system. If we begin in 1972, we note that as a proportion of total deposits there was a gradual increase of both saving and demand deposits and a consequent decrease in time deposits (See Table 2c). This situation continued up to 1978. After the changes in interest rates, as a percentage of total deposits, time deposits moved from 28.5% to 36.7% by September 1982, while saving deposits fell slightly from 48.6% to 46.0% and demand deposits decreased from 22.9% to 17.3%. Further, as we have indicated there was a gradual decline in the rate of accumulation of savings in other deposit taking institutions such as the New Building Society - most likely in favour of the commercial banks which have been paying higher rates.

We can also note here that even institutions like the New Building Society and the Insurance Companies increased their deposits with commercial banks - at the expense of their holdings of such assets as treasury bills. These developments lend support to Coats and Khatkhate who claim that:-

> "In most studies the impact of interest rates has been found to be negligible (Miksell and Zinser (1972) Williamson (1968), Houthakker (1965), Khatkhate (1972) ... For all the hazards involved in empirical investigation, however, it has succeeded in demonstrating unambiguously that interest rates have a predictable and much more definitive impact in the form in which savings are held."[1)]

A change in the form in which savings are held may be desirable in an economy such as ours. Longer term liabilities can then be matched with longer-term assets (which are considered to be more 'developmental' than shorter-term assets). However, as the theory suggests, our major concern is with the impact on total savings (and therefore on total spending) since this is where the major benefits of a higher interest policy are said to lie. The relevant question is: why were such benefits not realized? And, further, what measures, if any have to be taken? These questions we tackle in the next part of this paper. But before we do that, we trace the developments in the investment of resources by the financial system, again in an attempt to determine whether there was any noticeable impact of the changes in interest rates.

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1) Coats W.L. and Khatkhate D.R. - Money and Monetary Policy in L.D.C.s: Survey of Issues and Evidence: May 29, 1979.

TABLE 2(c)

COMMERCIAL BANKS' DEPOSITS

(as a percentage of Total Deposits)

	Demand	Time	Savings
1970	17.6	29.8	52.6
1971	17.6	33.2	49.2
1972	17.2	38.5	44.3
1973	16.6	37.2	46.2
1974	23.0	31.4	45.6
1975	27.8	28.3	43.9
1976	25.5	28.9	45.6
1977	25.2	29.1	45.7
1978	23.0	28.5	48.5
1979	21.5	30.6	47.9
1980	21.8	32.9	45.3
1981	19.0	33.3	47.7
1982 (Sept.)	17.3	36.7	46.0

SOURCE: BANK OF GUYANA

UTILIZATION OF RESOURCES

When the Bank Rate was increased in 1978, the lending rates of the commercial banks and other lending agencies were also increased. With respect to the commercial banks, the Central Bank issued the following instructions:

> "Your bank's prime lending rate will be increased to 9.5 per cent per annum."
>
> "Your bank will be expected to contain increases in other lending rates to within 2% of their current levels."2)

Thus, while deposit rates went up by 3 percentage points, lending rates were permitted to rise by only 2 percentage points above their June 1978 levels. In 1979, and 1980, similar instructions were given to the commercial banks. In these instances, however, both the deposit rates and lending rates were increased by 2 percentage points. In 1982 a slightly different approach was taken. In this case deposit rates were increased by about 1.0 percentage point whereas lending rates were permitted to rise by 1.5 percentage points, thus increasing the spread available to the commercial banks. As we shall see later on, this seems to have been an attempt to remove some of the disincentive and anomalies which were introduced into the interest rate structure after 1978. Once again it is yet too early to quantify the impact on financial intermediation and on the willingness of the commercial banks to lend to the non-traditional customers. Although this is a step in the right direction much should not be expected from it in the short-run. There are other more important factors operating presently against such developments - the foreign exchange and balance of payments crises, for example and also such measures need time to induce changes in the attitudes of lenders.

These changes in lending rates led to an increase in the prime lending rate of 7.5 percentage points between 1977 and 1982. At the same time, the rate on saving deposits was increased by 8 percentage points while that on twelve months time deposits went up by 7.5 percentage points.

The banks generally followed these instructions. However certain fees were either increased or introduced - e.g. committment fee, application fee - to assist in covering the increasing costs which are involved in lending to the private sector. Precise figures as to the size of such fees are not available. These, however, do not seem to be very substantial to compensate for the reduction in the spreads that the banks are allowed.

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2) Central Bank's Circulars to Commercial Banks

TABLE 3

LOANS OUTSTANDING OF SELECTED NON-BANK FINANCIAL INSTITUTIONS

G$Mn.

	1973	1974	1975	1976	1977	1978	1979	1980	1981
1. New Building Society	14.9	18.4	21.7	27.1	35.5	44.4	49.6	54.6	58.6
% Change	26.3	23.5	17.9	24.9	31.0	25.1	11.7	10.0	7.3
2. Mortgage Finance Bank	-	2.2	9.8	15.6	20.1	21.8	24.4	27.0	30.5*
% Change	-	-	-	59.2	28.8	8.4	11.9	10.6	13.0
3. Domestic Ins. Cos.	-	-	34.7	37.9	44.5	46.2	50.7	52.1	61.8*
% Change	-	-	-	9.2	17.4	3.8	9.7	2.8	18.6
4. G.H.D.C. & G.M.F.C.	17.2	19.8	19.7	19.6	18.3	17.1	15.2	13.5	11.5
% Change	17.0	15.1	-0.5	-0.5	-6.6	-6.6	-16.9	-11.2	-14.8
5. Trust Companies	-	3.5	5.8	7.3	9.6	12.2	17.0	20.0	35.2
% Change	-	-	65.7	25.8	31.5	27.1	39.3	17.6	76.0
6. G.A.I.D.C.B.	1.8	7.6	11.4	14.8	20.9	21.2	36.9	48.0	56.6
% Change	-	-	50.0	29.8	41.2	1.4	74.0	33.3	17.9

SOURCE: BANK OF GUYANA

*Provisional

In Section 1 the need for a higher return to lenders, especially in a high risk environment was emphasised. These recent developments in our interest rate structure, may be considered to be insufficient by proponents of the high interest rate theory. As such, they may argue that the full impact of the higher interest rate policy could not have been achieved and the changes in June 1982 would not give rise to the benefits anticipated. In the rest of this section, we examine developments in lending and investment in Guyana.

Over the past decade or so, the public sector, through nationalizations coupled with the closing and/or scaling down of many private businesses, has increased its domination over economic activities in this country. A reflection of this is its increased absorption of resources mobilized by the banking system, through their purchases of treasury bills and by direct loans and advances. In June 1982 this amounted to over 90% of the deposits of commercial banks, compared with 45.7% in 1974.

Although the banks are permitted to charge over 17% for loans to the private sector, they chose to invest much of their resources in treasury bills - which now earn 12.75%. By September 1982, 34.0% of their total deposits were so invested, compared with 11.4% in 1970.

Loans and advances to the public corporations - mostly at the prime rate alone accounted for 63.0% of their deposits in June 1982 compared with 25.6% in 1978. The major corporations - GUYMINE, GUYSUCO, Guyana Rice Board and Guyana Electricity Corporation - accounted for over 85% of this amount.

As we indicated above, the private sector's absorption of resources mobilized by the banking system declined from 60% of total deposits in 1970 to 30.0% in June 1982. In fact, since 1978 - when it reached its lowest point of 23.4% - the commercial banks' lending to the private sector increased by almost over 100%. This somewhat exciting development was a result of a tripling of loans and advances to the private sector by the Guyana National Co-operative Bank. This led to an increase in its share of such lending from 38% in 1978 to 66% in June 1982. The other banks hardly increased such lending.

This increase was directed mainly to the services and household sectors which absorbed 63.0% and the manufacturing sector which accounted for 31.0% of the increases between 1978 and June 1982. The agricultural sector received a meagre 5.7% of the amount.

The lower rate of return offered to the commercial banks might have been a contributory factor to such developments. However, we feel that there were more powerful factors and that even if the spreads were increased, lending to the private sector would not have been very much greater. This is based on the thesis that the level of investment is

determined by the demand for and supply of investment funds. We shall try to show that additional factors operating on both the supply and demand sides as the serious shortage of imported inputs - were major contributors - significant enough to nullify the impact of any increased spreads.

Before we do that, we should take a brief look at developments in the non-bank financial institutions.

Unlike the commercial banks, there is much concern in these institutions over what they consider to be the 'low' rates of interest they are allowed to charge on loans, compared with the increasingly high costs involved in mobilizing funds and in lending to the private sector. It is true that the spreads that they are allowed have not increased by very much. The New Building Society, for example, was required to pay an increase of 6.5 percentage points on five dollar shares and was allowed a 6.0 percentage point increase in mortgage rates in the period under consideration. Requests by the Guyana Housing and Development Company and the Guyana Mortgage Finance Company for increased rates were turned down by the Ministry of Finance. As a result, their official mortgage rates have not been changed since 1971. The domestic insurance companies and the foreign insurance agencies were allowed, a small increase in the rates they charge on loans. And the Guyana Co-operative Agricultural and Industrial Development Bank has always complained that the 'subsidized' rates they are required to charge is one of the reasons for their poor performance, given that they are required to operate in a very risky environment.

An examination of the balance sheets of these institutions indicates a relative reduction in their activities over the years. This can be seen from Table 3. The rate of increase of lending of the New Building Society fell from between the 20%-30% range up to 1978 to 11.7%, 10% and 7.3% in 1979, 1980 and 1981 respectively. We note that their time deposits with the commercial banks continued to increase since 1977 from nothing to G$8 million by September, 1982. Why should they lend to the private sector when they can earn just as much on safe, time deposits with the commercial banks? A similar trend can be observed for the domestic insurance companies, who, since 1978 have been holding much of their increased resources in foreign assets and in bank deposits. Figures of their present holdings of foreign assets are not available as yet. When we examined the other institutions, a similar trend was observed.

These institutions claim that the meagre spreads and the distorted structure of interest rates were contributory factors. These affected their willingness to supply funds to prospective borrowers. As we shall see, there were also other factors affecting the demand for such funds (a result of a contraction in economic activity over the period) which had a depressing effect on their activities.

Our analysis suggests that the possible impact of the changes in the level and structure of our interest rates was not fully considered when such changes were made. Rather than encouraging increased financial intermediation, they served to dampen the willingness of financial institutions to expand their activities. As a result, the domestic commercial bank has had to undertake the additional burden of proving certain (relatively expensive) services, as the foreign commercial banks withdrew from such areas. The latter now operate in a safe area - collecting deposits from the public and transferring these to treasury bills and Government guaranteed loans and in the process receiving a good return. Should they not be encouraged to become more deeply involved in the development process? They have expertise, experience, resources and the organisation to support their activities. Of course there will be costs attached but that is at the centre of the development problem, that is, being able to weigh the costs and the benefits that would flow from any proposed policy measure.

PART III

IMPLICATIONS AND POSSIBLE APPROACHES

The analysis in the last section shows that the changes in interest rates did not lead to any significant change in the mobilisation of financial savings in Guyana. This is very much unlike the situation in countries such as Korea, Taiwan and Indonesia, frequently cited by economists as success stories in the application of high interest rate policies. This should not be surprising. As we noted earlier, the level of financial savings is a function, not only of interest rates, but also of other factors such as incomes, expectations, wealth, etc. A higher interest rate is an incentive to increase savings. However, before this increased incentive is transformed into actual savings, there must be present, the scope for increasing savings.

In Korea, between 1964 and 1970 (interest rates were substantially increased in 1965) per capita incomes rose by about 300% whereas prices went up by about 96%, giving rise to a substantial rise in real incomes. In addition, given the virtual absence of private financial savings before the change in deposit rates, this meant that there was much scope for increasing savings. As McKinnon pointed out:-

> "the flow of private savings increased from virtually nothing to about 8% of G.N.P. by 1969."1)

In Indonesia between 1968-1971 a similar situation was present. Real per capita income was rising and the state of the economy was improving when the new rates were implemented. In addition, other measures were utilized to lend support to the higher deposit rates offered. Some were:-

(a) payment of deposits to depositors was publicly guaranteed by the Government.

(b) the Government agreed not to ask depositors any questions about the source of their funds.

(c) interest earned on deposits were tax-free.

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1) McKinnon, R. (ed) - Money and Finance in Economic Growth and Development. Essays in honour of E.S. Shaw. Marcel Dekker. N.Y. 1976. Chapter 4.

(d) the Central Bank subsidized the Commercial Banks (amounting to about one-third of interest payments) for part of the interest they paid on six and twelve months deposits — to subsidise the lending rate.

It may be useful to note here that there is still much debate on relationship between financial flows and real flows and, moreso, on whether financial saving is an active or passive agent in economic growth or whether it is the rate of growth that determines the growth in saving. Our view is that an increase in the accumulation of real saving in the financial system is a favourable development for the balance of payments and if such resources are invested wisely, this can lead to a positive impact on growth. At the same time, as an economy is growing and income is being generated and financial intermediaries are becoming more active and widespread, there would be an increase in the willingness and ability of economic units to increase their savings.

The situation in Guyana, however, has been very much different. Since 1976 - consumer prices have risen by over 75% whereas per capita income has not risen by more than 30% - giving rise to a continuing decline in real incomes. Further, when interest rates were changed in 1978, the savings of private households in the banking system were already high - about 35% of G.N.P. So where could the additional savings have come from?

The extremely poor performance of the public sector has been a major contributor to the depressed economic activity and falling real incomes. Where is the savings to come from, if the public sector utilizes over 80% of the resources thus mobilized and, in turn, generates negative savings? Surely there must come a time when it will be virtually impossible to increase even nominal savings any further - irrespective of the level of deposit rates.

Even if we assume that there was scope for increasing financial savings, financial institutions must be encouraged to attract such savings. This incentive has not been very strong since 1978. Given the decrease in the spread that took place, the increased riskiness of lending to the private sector and the relatively low return on the next best avenue for investment, Treasury Bills (earning 12.75% per annum, compared with between 11.5% and 13.0% that they have to pay for deposits) it is not surprising that most of the commercial banks scaled down the scope of their operations. With the relative decrease in financial intermediation, the mobilization potential of the financial system was consequently reduced. And we know that increased financial intermediation (geographically and otherwise) does have an impact on financial savings, especially in underdeveloped economies, where such facilities are limited.

In addition, even if one suspects that there are large cash hoards lying in the hands of the private sector, as is frequently claimed, adequate support measures were not implemented to induce a smooth transfer of such funds into the organised financial sector. Surely, an interest rate policy will not be enough given, say, our steep tax structure and deteriorating economic situation.

Further, given the stringent foreign exchange controls now in existence and the deteriorating state of the economy, it is difficult to foresee any substantial reduction in the outflow of funds - which takes place by various means - or increase in the flow of foreign capital - even if this were considered desirable and hence encouraged. In fact, it has been found that one of the preconditions for such developments is an improvement in the economic health of a country, coupled with an improvement in its balance of payments situation.

Therefore, if we cannot significantly increase domestic financial resources or attract 'desirable' foreign savings, other means have to be found to stimulate the economy. Of utmost importance is the efficient utilization of what is already available. The point is that the increased mobilisation and investment of savings are only two of the factors which determine the shape of the balance of payments and the rate of economic growth. Where such funds are channeled and and how efficiently they are utilized are also very important.

Less easily measurable qualitative factors such as the efficiency of its manpower resources, soundness of projects, the efficiency and flexibility of its economic system and supply bottlenecks are all significant factors in this context. The concern should be first with increasing the productivity of existing resources by attempting to remove or reduce the intensity of such bottlenecks rather than with increasing the availability of resources.

Analysis of the contributory factors to the present risky lending environment points to several factors among which are inappropriate pricing policies, poor marketing arrangements, etc. However, the most important has been the severe shortage of foreign inputs - such as raw materials and spare parts - experienced by producers. This has led to two separate but related developments. Faced with such problems, many producers have scaled down (or shelved plans to expand) the size of their businesses - thus reducing their demand for credit from the financial system. Secondly, shortages of such inputs have caused many borrowers to close operations for long periods, operate at losses or permanently close their business and thus default on their loan repayments. The experiences of the Guyana Co-operative Agricultural and Industrial Development Bank reflect well, the nature and intensity of this problem.

Thus, together with a decrease in the demand for loans, lending agencies themselves have become increasingly reluctant to lend to private businesses - together leading to a contraction in the share of credit to this sector. It is therefore not surprising that the share of credit to private agriculture - an area that has much potential - is so low. This contraction of credit is a good thing for the shape of the balance of payments in the short run if it is sterilized in the banking system. Where it is used to finance the huge losses of the public sector the problem is further compounded.

An assumption of the approach which we outlined in Section I is that the shortage of capital was a major problem in L.D.C.'s and that higher interest rates and increased spreads were necessary in any attempts to solve this problem. As we have seen production has become an increasingly risky business in Guyana - and it is this that has to be affected. Given our present attitude to foreign capital, a higher interest rate policy cannot produce the desired results. Indeed, it might further intensify the problem by increasing the operating costs of many enterprises. Nor would an increased spread lead to increased lending to the private sector - even if this were desired and encouraged.

This was the point made by every foreign commercial bank operating in Guyana, at interviews conducted with them in October 1981. It emphasises that the demand for capital and the willingness of financial intermediaries to supply such capital at the required rate and the desired direction, should not be ignored. It also demonstrates that an economy which is heavily dependent on foreign inputs, must be capable of transforming domestic financial resources into foreign exchange.

This leads us directly into the need for a healthy balance of payments and foreign reserves position -- which in turn is expected to be the end product of a successful stabilization program. Once we continue to tolerate a situation where over 80% of the economy suffer from severe inefficiencies and waste, we will never be able to achieve this goal.

And, we have seen that an increase in the costs of bank lending to the public sector is certainly not enough to force the kinds of changes which are necessary. Although the commercial banks do assess the viability of projects undertaken by these businesses, Government guarantees of such loans remove the risks involved. Many enterprise suffer from serious shortages of foreign inputs, limited managerial and other skills, inefficiency and waste, which result in severe losses. This warrants a thorough review of their operations, of the economic and social usefulness of Government's support and of possible alternatives. Perhaps these enterprises should be forced to prove their viability before additional finance is provided.

Higher interest rates did not produce the kind of developments which were anticipated. There are deep-seated problems and conflicts which lie in the heart of our development strategy, which first have to be resolved. This requires a careful assessment of how the economy has functioned over the past decade and the prospects for stabilization and development, in the near future.

In the meantime, however, there is need to take another look at the structure of interest rates, with a view towards removing some of the distortions which arose since 1978 and which are still present.

RATIONALIZATION OF INTEREST RATES

In any attempt to rationalize the structure of interest rates in an economy, a major consideration should be to encourage increased financial intermediation. Financial institutions must be induced to improve their financial technology in order to maximise the accumulation of financial resources and distribute such savings among the most productive economic units. This in turn requires the assurance of an adequate return on their funds.

On one side, the rates offered to potential savers should be so structured as to provide a wide range of ways of holding financial savings - attempting as far as is possible, to satisfy the needs of the different types of savers. On the other side, the lending rates should not operate as a disincentive to key investors while trying to accomodate the broad spectrum of investments which are needed in a developing country. And since the process of financial intermediation is about the efficient transfer of resources from surplus to deficit units, the two sets of rates should be so related that they do not discourage increased activity by financial institutions.

Our concern therefore, is with the relationship among the various rates and the impact on financial intermediation in Guyana. We begin with an examination of the deposit and lending rates of the banking system. This approach will provide a useful framework within which other rates can then be examined.

Over the years, as the state of the economy deteriorated and as the public sector became increasingly dominant, the avenues into which the commercial banks channeled their resources became narrower. With the exception of the Guyana National Co-operative Bank, there is now little lending to the private sector - except to the more reputable customers. From the standpoint of the commercial banks, this is not the most desirable asset portfolio, since it produces a lower rate of return. This has caused the foreign commercial banks to curtail their activities in certain areas; with the domestic bank adopting an accommodating attitude and expanding its activities in those very areas.

The banks receive 12.75% on treasury bills and the prime rate on loans and advances to the public corporations (which are Government guaranteed). At the same time, they are required to pay 11.5% on saving deposits and 13.0% on twelve months time deposits. Since the foreign banks are very liquid and all marginal funds are invested in treasury bills, it is clear that they would not encourage twelve months deposits. In June 1982 the following circular was sent to the Banks:

> "All Commercial Banks will be expected to accept both 6 months and twelve months fixed deposits at the rates stated."

The response of these banks is not clear as yet. It is the first time that they have been given such instructions and it is an attempt to force them to accept such deposits (which they had not been accepting for over three years).

This situation arose in 1978 when the rate on treasury bills moved from 5.88% to 7.80% while the twelve months deposit rate rose from 5.5% to 8.5%. Prior to that, the rate on treasury bills was above that of twelve months deposits - except for a period between 1969 and 1971 - and provided an attraction for the bank to encourage every saver.

Aside from the impact on the form in which savings have been held, this distortion did not seem to have had any significant impact on total savings. Holders of twelve months time deposits in the foreign commercial banks either transferred their funds to three months deposits or moved over to G.N.C.B., who still accept such deposits. As a result, the foreign banks' share of twelve months deposits fell from 67% in 1977 to a meagre 2.1% by the end of 1980 and moved up to a meagre 4.3% by the end of September 1982. On the other hand, their share of three months deposits increased from 80% to 90% over the same period. Further, the narrowing of the spread has even affected saving deposits. The high cost of servicing these accounts has led these banks to put a ceiling (of G$300.00) below which such accounts are not allowed to fall. The G.N.C.B., however continued to service accounts which are as low as G$10.00 and therefore continued to attract such accounts. It is doubtful whether total saving would have been higher if the pre-1978 spreads were maintained.

However, the increased lending activity of G.N.C.B. in areas now avoided by the foreign banks, the relatively high average rate they pay for funds and their higher per unit costs of operations cast a shadow over the commercial soundness of their business. It is a very testing time for the domestic bank. It would call for much ingenuity or assistance for it to extricate itself from this situation.

It is clear that since the change in interest rates in 1978, the foreign commercial banks have reduced their intermediation, while the G.N.C.B. has attempted to fill the gap created. Is this a favourable of unfavourable development? This depends on three things - on an assessment

of the role of these banks in the economy, the role the G.N.C.B. is intended to play and on the ability of the G.N.C.B. to overcome these constraints and become a more dynamic institution.

If we assume that an increase in such intermediation would be useful; that there should be no further increase in the general level of interest rates and that the deposit rates should not be reduced, then the least that can be done is to adjust the present structure of interest rates in such a way as to produce the necessary incentives for increased financial intermediation on the part of the foreign banks. As we pointed eearlier an attempt was made in June 1982. This does not appear to be enough although sufficient time has not yet elapsed to allow one to make a firmer judgement.

The point is that the banks will have to be provided with appropriate outlets to invest their marginal funds, at a rate that is even slightly higher than the highest rate that they now pay for deposits, if they will be induced to accept these deposits and further improve and expand their operations.

This would be similar to a highly successful redeposit scheme which the Central Bank in Taiwan started, after interest rates were changed in 1950. It was expected that the banks would have excess funds which they could not have invested quickly enough and, therefore, a rate slightly above that which they had to pay depositors was offered. The funds accumulated was then made available to financial institutions and other borrowers whenever the need arose. Although in the case of Guyanese this will certainly increase the costs of the Central Bank's operations, the potential benefits may justify its implementation.

A similar approach may be used in fixing the interest rates of other financial institutions. Of course, this requires familiarity with their operations which might necessitate a thorough review of each type of institution. Once this is done, then the relevant actions can be taken to encourage their activities in the desired directions.

Take the Guyana Agricultural and Industrial Bank, for example. Can it continue to operate at such high losses? Are the benefits sufficient to cover such costs? They argue that they should be allowed to charge a higher rate, while the policy-makers feel that they should not and that Government should continue to subsidise their operations. However, one consideration of their financers is the viability of their operations. Institutions such as the Caribbean Development Bank have insisted that they take steps - such as increasing lending rates - in this direction before further funds are made available. How do we resolve this conflict?

Another case is that of the mortgage institutions - New Building Society, the insurance companies, etc. What is their role in the society? Can house-holds afford higher rates on mortgages in our context? Are their claims for an increased rate of return justifiable? What else should be done to stimulate their activity? These are some of the questions which have to be considered when policy measures are designed.

Here, again, it also seems to be the case that the reduction in their activities has been a reflection of a fall in the demand for mortgages - a result of our deteriorating economic situation. That an increased return will stimulate lending is hardly believable. It will certainly put additional burdens on prospective home owners. However, it would be useful to investigate their costs of raising funds in an attempt to ensure that their margin is not further reduced. One would want to believe that when their lending rates were fixed in 1980, such an assessment was done and that the decision was not arbitrarily made.

And lastly, we should also point out that there is need to take a second look at the rate offered on Government long-term securities. With an inflation rate of about 16% per annum over the last five years and expectations of at least similar rates in the years ahead, the three-months treasury bill rate at 12.75%, the rates of commercial banks time deposits of between 12% and 13%, the G.N.C.B. Trust Company three-years deposit rate at 13.5%, it is difficult to grasp the rationale behind such a low rate of return. The economy has everything to gain through a substantial increase in this rate.

Our discussion in this section has shown that there is need for an adjustment in the relationship among the official interest rates in Guyana. The resulting increase in financial intermediation - limited as it might be initially - can provide certain tangible and non-tangible benefits. Of importance also is the potential of a proper system of interest rates to prevent certain negative developments from occurring in the economy and to harness the benefits of progress as the economy moves forward.

CONCLUSION

The increases in official deposit and lending rates in Guyana hardly produced the developments which we discussed in Section 1. This does not mean that this approach is completely inappropriate. It suggests that there are other factors, exerting a greater influence than interest rate changes, which have to be taken into account. Earlier, we pointed to the contraction in real incomes, the serious foreign exchange constraint and inefficiencies in the public sector, among others. Unless immediate steps are taken to increase the efficiency with which the savings generated are used, other supplementary policies will hardly have the right grounds on which to operate.

In this respect the efficient management of Government's budgetary operations is of utmost importance, since this has direct implications for the balance of payments. Higher interest rates will not, and should not be expected to, impact on their level of domestic borrowing or on the efficiency with which such funds are used. It requires firstly a recognition of the consequences of excessive demand for credit from the domestic banking system and a commitment on the part of the policymakers to make the necessary changes to ensure that the demand for financial resources is consistent with the supply of such resources. Of course, this will require that some drastic decisions be taken with respect to a number of enterprises in the public sector.

Unless this approach is taken the traditional adjustment measures that institutions such as the I.M.F. propose will not work and the economy will continue to operate at a very low level.