CENTRAL BANK OF BARBADOS

(Research Department)

THE CONFLICT BETWEEN GROWTH STABILISATION AND DEVELOPMENT ROLES OF FISCAL POLICY IN BARBADOS, 1964-76

By

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The Conflict between growth, stabilisation and development roles of fiscal policy in Barbados 1964 - 1976

Fiscal policy is concerned with establishing budgetary conditions which will achieve stated policy goals. This paper examines the impact of budgetary movements on the economy. It examines factors which constrain fiscal policy, feed-back effects from the rest of the economy which influence fiscal outlook and structural and external factors which modify fiscal effectiveness. The paper analyses changes in fiscal stance in the context of the cyclical position of the economy and discusses the trade-offs between development, growth and stabilisation as fiscal policy adjusts to the economic environment as perceived. The paper extracts a description of fiscal policy from discretionary and automatic fiscal movements through an examination of tax measures, expenditure patterns, changes in target variables and where they corroborate these, policy statements related to the role of the public sector.

The lack of adequate data on G.N.P. and employment imposed a severe handicap on the analysis and seriously undermined the confidence with which some conclusions might have been drawn. However, despite the use of estimates and the presence of some gaps in the data, conclusions tend to be affected only in quantitative terms. Within the period 1964-1976 * distinct structural changes in public sector budgeting became evident. The period starts with a mild recession of 1964 when G.D.P. fell in real terms, through a period of moderate growth, into a second period of recession in 1974 and 1975 - a recession deeper and different

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* The fiscal year runs from April to March while G.D.P. data are calculated on a calendar year basis. The periods do not therefore correspond exactly.

Reference to a particular year in this context means the fiscal year, eg. "in 1964" means in the fiscal year 1964/65 and 1964-75 means in the fiscal year 1964/65 through 1975/76.

in character from that of 1964.

The Scope of Fiscal Policy

Traditional decision-making powers enable Government to alter the general level and direction of economic activity indirectly by influencing variables such as disposable incomes, business confidence credit availability, interest rate behaviour etc. or more directly by itself spending on selected sectors. Because of the small share of the public sector in G.D.P., in 1964 Government was equipped better to influence the economic environment by playing primarily a developmental role, thus influencing economic growth indirectly. However, during the period reviewed, the share of the public sector in total product doubled, from 9.9% in 1964 to 19.9% in 1975. Government's contribution to G.D.P. grew faster than overall G.D.P. in every year since 1964.* As distinct from its role as decision-maker, Government also increasingly influenced the level of activity in the economy by virtue of its own aggregate size. This broadened the potential role of fiscal policy. Expansions and contractions in the public sector therefore had increasingly greater repercussions for the rest of the economy. This enhanced the role of fiscal policy as a potential stabilisation tool. However, while this gave added effectiveness to fiscal policy it also increased the size of offsetting movements on the budget itself and on the private sector.

As an employer, the capacity of the public sector to influence economic activity rose rapidly. In 1974, when Governments' share in total product was 18%, it controlled 26.4% of the work force. For every change in expenditure there

*(See Table 1.)

Gross Domestic Product of the Government Sector

Table 1

($ Million)

Fiscal Year	Total G.D.P.		% Change		G.D.P. of Gov't.		% Change of Gov't G.D.P.		Government's share in in G.D.P. (%)
	Nominal	Real	Nominal	Real	Nominal	Real	Nominal	Real	
1963	151.4	159.3	-	-	15.0	15.8	9.9	-	9.0
1964	147.3	153.3	- 2.7	-3.8	16.5	17.2	11.2	8.9	11.2
1965	153.9	156.6	4.5	2.2	17.6	17.9	11.4	4.1	11.4
1966	169.6	166.7	10.2	6.5	21.5	21.1	12.7	17.9	12.7
1967	189.2	180.0	11.5	8.0	25.8	24.5	13.6	14.9	13.6
1968	216.7	193.4	14.5	7.4	30.0	26.8	13.8	9.4	13.8
1969	235.3	196.7	8.6	1.7	35.3	27.6	15.0	3.0	15.0
1970	289.9	226.5	23.2	15.2	42.7	33.0	14.7	19.3	14.7
1971	325.1	231.6	12.1	2.3	47.3	33.8	14.6	2.4	14.5
1972	356.7	230.4	9.7	-2.8	54.9	35.5	15.4	5.0	15.3
1973	426.0E	232.2	19.4	0.8	72.0	39.3	16.9	10.7	16.9
1974	528.6E	218.3	23.9	-6.0	95.0	39.2	17.9	-0.3	18.0
1975	(607.0)E	204.5	15.0	-6.3	(121.0)	40.8	(19.9)	4.1	19.0

Source: Government Statistical Office, I.M.F. Staff Estimates
G.D.P. data were adjusted to 1965 prices.

was therefore a greater than proportionate change in Gov ment employment. This increased the public sector's ability to alter the level of employment in the economy directly and broadened the scope of fiscal policy. Data show that when Government G.D.P. rose by only marginal amounts total product itself rose less so, or even declined, showing that the Government sector was growing faster than total national product (See Table 1).

The major focus of the public sector can be judged also by the level and composition of expenditure. An examination of expenditure patterns disclosed changes in the long-run growth objectives of the public sector. In the period 1964 - 1968, emphasis was placed largely on social and economic infrastructural development. If the proportion of spending on capital projects is used as a rough indicator of investment outlays it is noted that 1965/66 was the year of highest capital spending. In that year capital spending represented 24.1% of total spending.[1]

The high level of capital spending on social services in the middle sixties contributed partly to the institutionalisation of a high recurrent costs in the budget and led to escalating expenditure on some sectors in later years. Education and health services all increased their share of total spending while spending on social and community services rose markedly, largely as a result of rigidities relating to personnel and services built into the budget.

[1] The major portion of this spending went to finance road works, water health and housing facilities.

The second phase of public budgeting within the period reviewed was the setting up and streamlining of decentralised public institutions many of which were development oriented.[2] These institutions strongly affected the budget during the years 1970 - 1973* when they absorbed almost half of capital spending. Despite this emphasis, outlays of an 'economic' nature[3] rose only slightly and the ratio of capital spending to total spending declined during the period 1964 - 1974 reviving slightly in the two years 1974 - 1976. The rate of capital spending remained low because of a limited absorptive capacity for capital funds. At this stage in public budgeting, ex-ante decisions on the aggregate size of the deficit as a conscious method of influencing the business cycle were not yet evident.

By 1976 the proportion of spending on economic services had dropped markedly from the higher levels attained in the sixties. Moreover, total expenditure also slowed in the second five-year period to an average annual rate of 18.2% compared with 34.7% in the previous five years. The slowdown in the rate of growth of expenditure was a direct response to sluggish revenues and was a fiscal reaction which stemmed from Government's expressed goal of balanced budgeting.

2 Such institutions include the Industrial Development Corporation, the Agricultural Development Corporation, the Barbados Marketing Corporation and the National Housing Corporation.

3 This category includes areas such as agriculture, transportation, trade, industrial estates, etc.

* Consolidated data on statutory boards were available only for this period.

The impact of the public sector on the economy can be judged not only by the use of manpower and the pattern of spending but also by impositions of taxation. The developmental role of Government, of which the industrialisation programme was a part, had strong repercussions not only for expenditures but, because of the tax measures employed, also for revenues. These included protective measures such as tax holidays, high duties on imported goods for which substitutes were available on the domestic market and low duty on raw materials.[4] These policy measures, though implemented mostly in the period 1965 - 1968 had repercussions for the structure of the budget and for the elasticity of direct and indirect taxes. They resulted in a trade-off between present revenues and future economic development, since most of the allowances implied reductions in tax receipts from corporate profits and a slowdown in the rate of growth of customs receipts.

In 1974 - 1976, concern for the drain on foreign reserves and for the widening balance of payments deficit took priority, and short-term stabilisation policies tended to override long-term growth objectives. New tax measures were introduced which affected corporate profits and consumer spending.[5] This period marked a shift in the fiscal policy stance of the 1960's and early 1970's which was explicitly aimed to "frame a tax policy designed to stimulate economic growth" through an easy policy on corporate taxes. Changes in corporate taxation temporarily reduced funds available for re-investment thus contracting the rate of

[4] The measures included: Investment allowances, concessions to international business companies, allowance of tax deduction for interest changes, the loss in duty on imports.

[5] e.g. Phasing of company taxes
Imposition of sales tax

Table 2

Government Revenue and Expenditure

Real and Nominal Values

($ Million)

Date	Current Revenue		% Change		Total Expenditure		% Change	
Fiscal Year	Nominal	Real	Nominal	Real	Nominal	Real	Nominal	Real
1964	37.2	38.5	14.5	12.6	38.2	39.6		
1965	38.7	39.2	4.0	1.8	43.2	43.7	24.1	10.4
1966	42.8	41.7	10.6	6.4	52.8	51.5	21.0	17.4
1967	47.8	44.4	11.7	6.5	54.7	50.8	14.8	-1.4
1968	61.0	53.4	27.6	20.3	58.7	48.3	15.0	-4.9
1969	73.9	60.8	21.1	13.9	78.9	64.9	13.9	34.4
1970	87.9	67.9	18.9	11.7	98.8	76.3	15.2	17.6
1971	103.2	73.2	17.4	7.8	111.7	79.2	19.6	3.8
1972	108.2	68.7	4.8	-6.1	120.1	76.2	17.9	-3.8
1973	125.1	63.2	15.6	-8.1	171.7	86.8	17.9	13.9
1974	159.2	61.0	27.3	-3.5	195.5	74.9	19.2	-13.7
1975	198.3	65.3	24.6	7.0	228.0	75.1	21.2	0.3

Source: Accountant General; Ministry of Finance growth in the tax base. In the context of the position of the economy in the business cycle, both measures tended to a pro-cyclical movement with possibilities for reducing private sector activity but with distinct anti-inflationary implications.

Discretionary versus automatic tools

Because of the structure of the tax system and the decline in real product, revenues did not reap the benefits normally associated with inflation-induced fiscal drag. Indeed discretionary measures were mainly responsible for the constant average annual rate of increase in revenue of 18%, and for their high buoyancy (Table 3). Seventy percent of the increase in revenue in 1975/76 derived from new tax measures.

During the period 1966 - 1976 the five-year average rate of increase in expenditure slipped marginally from 16.0% to 15.6%. In real terms both revenues and expenditures declined. Real revenues fell from an annual five-year average rate of growth of 11.8% to 0.6%, while expenditure fell from 7.8% to a negative growth rate of 2.4% in the second half of the review period. This decline in revenues was a direct consequence of declining real G.D.P. associated with the slowdown in economic activity and increase in price inflation (See Table 2).

The country's tax effort rose from 21.7% in 1964/1965 to 26.6% in 1969/70 even though this was a period of tax cuts and tax incentives.* Total

* See Table 4.

Buoyancy of Selected Taxes

Table 3

(Ratios)

Item	Fiscal Year											
	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Tax Revenue	..	0.5	1.1	1.1	2.0	2.3	1.0	1.0	0.8	0.7	1.1	1.3
Personal Income Taxes	..	0.3	2.1	–	–	-0.2	1.2	1.9	-0.6	0.5	1.3	1.4
Company Taxes	..	2.6	0.6	–	–	2.3	0.7	0.9	-0.9	1.9	4.1	0.6
Consumption Tax	..	7.4	0.6	–	5.5	2.6	1.7	0.9	1.4	-0.2	2.8	0.3
Land Tax	..	–	–	–	–	–	–	–	–	–	0.4	1.2
Import duties	..	1.0	0.7	1.1	0.8	2.9	0.6	0.5	1.3	1.1	0.2	0.4
Non-Tax Revenue	..	3.4	0.8	0.7	1.5	3.8	0.0	2.0	1.5	1.3	1.2	3.2
Total Revenue	..	0.9	1.0	1.0	1.9	2.5	0.8	1.4	0.5	0.8	1.1	1.6

Data: Accountant General and Ministry of Finance tax effort remained virtually unchanged in the post 19[illegible]0 period and new tax measures were even necessary to maintain tax effort at the existing level. These measures modified the rate of decline of revenue in real terms, and helped to maintain tax effort at a relatively high level. In a study of tax effort in several developing countries* in the period 1969 - 1971 the highest tax effort recorded was 31.3%. Caribbean countries showed fairly high tax efforts, Guyana 23.4%, Jamaica 19.4% and Trinidad and Tobago 17.7%. Barbados was not included in the survey, but the proximate tax effort for Barbados was calculated at 26.5%. This compares with the tax effort in developed countries of over 40%.

High base to income elasticities of some taxes (in the context of falling real G.D.P.) and low tax to base elasticities of others resulted in a low rate of automatic increases in Government revenues. Revenues from categories with high elasticities could not compensate for the low overall elasticities. Revenue movements stemming from the automatic element of taxation in many categories were therefore small or negative. The major tax category carrying a high tax to base elasticity was personal income taxes.

Government derives 85% of its revenue from taxes and the remaining 15% from non-tax revenues. Personal income taxes are the single largest revenue earner, and revenues from this source grew at an annual average rate of 14.2% per annum, particularly in the period 1974 - 1976. The contribution of personal income taxes to total revenue rose from 17.7% in 1964-65 to 22.4% in 1975-76. At the same time, the ratio of personal income taxes to G.D.P. rose

* R.J. Chellah et al "Tax Effort in Developing Countries" - I.M.F. Staff Papers - Vol.XXII No.1 March 1975

Table 4

Tax Effort - Taxes as % of G.D.P.

	Fiscal Year											
	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Total Taxes	21.7	21.2	21.3	21.5	24.2	26.6	26.5	26.5	25.9	24.8	25.4	26.5
Taxes on income and profit	8.6	7.8	8.1	8.6	11.2	10.3	11.4	12.0	10.8	10.9	13.1	13.6
Personal income taxes	4.5	4.4	3.3		6.6	5.9	6.2	6.7	5.8	6.6	7.0	7.3
Company Taxes	4.1	3.4	3.3		3.7	4.4	4.1	4.1	3.7	3.3	5.2	5.0
Taxes on Goods & Services												
Customs duties	7.5	7.4	7.3	7.3	7.1	8.1	7.5	7.1	7.3	7.4	5.6	5.1
Excise tax	1.8	1.6	1.9	1.8	1.8	1.7	1.4	1.6	1.1	0.9	0.7	0.7
Consumption tax	0.8	1.0	0.9	0.8	1.2	1.4	1.6	1.6	1.6	1.3	1.8	1.6

Source Data: Accountant General, Ministry of Finance from 4.4% in 1964-65 to 7.3 % in 1975-76. Data on income earnings are not available for the period prior to 1972. Since there were no tax exemptions or discretionary changes relating to income taxes between 1972 and 1975 the buoyancy of the tax was close to the level of built in flexibility. The latt.. average of 1.2 was largely due to the progressivity of the tax base.* The elasticity of tax to base was ( ). The declining proportion of non-taxable returns also illustrates the progressivity of the tax as it responded to higher incomes. This ratio fell from 28.9% in 1972-73 to 16.9% in 1974-75 and indicates that a larger proportion of the work force was falling into the tax net.

The contribution of customs duties or total revenues declined from 29.6 % in 1964/65 to 15.7% in 1975/76. Though this is the second most important source of revenue, the buoyancy of the tax is low. Receipts fell sharply following the rise in customs duties on the imposition of the Common External Tariff in 1973. Because of the strong relationship between base and income (average elasticity is 0.7/) receipts actually fell during the 1974-76 recession (See Table 5). The built-in flexibility of the tax tended to be less than the buoyancy indicating the importance of discretionary allowances.[6] Since the economic recession and the increase in customs duties which resulted from the CET occured simultaneously, reductions in customs receipts could have been a consequence either of the recession or of increased tax rates. However, a partitioning of elasticity for those two years reveals a slightly higher tax to base elasticity than base to income suggesting that imports reacted more

6 Imports of raw materials for some industrial sectors are given preferential tax treatment.

* C.Y. Mansfield: "Elasticity and Buoyancy of a tax system" - I.M.F. Staff Papers Volume XIX No. 2 July 1972.

sharply to income than did customs duties to imports. Lagging income was therefore largely responsible for the decline in customs duties. However, a lower tax to base elasticity in this period than previously suggests a change in the pattern of imports to lower dutiable items.

Data are not available on the business profits which form the tax base of company taxes.[7] The contribution of company taxes to total revenue fell from 16.7% in 1964-65 to 15.3% in 1975-76. The relative contribution of company tax receipts to Government revenue fell in the pre-1970 period largely because of tax incentives and concessions to entrepreneurs designed to stimulate business investment. In the period following the granting of these allowances receipts from company taxes recovered slightly, rising from 13.3% of current revenue to 15.3% in 1975-76, still 1.3% below the level in 1964/65.

Up to 1973/74, collections from company taxes, increased only marginally every year. In 1974 - 75, collections were phased into a partial PAYE basis. This seriously affected the cash-flow position of companies, since company taxes doubled within two years. To the extent that this represented future tax payments, the final burden was lessened, but the effect on investment in that year and in the following year may have been adverse.

7
Profits of reporting companies are taxes at 40% after deductions for exemptions and concessions.

*
In addition to phasing, dividends became taxable before payment with effect from 1975.

From this examination of the revenue performance of three major tax categories, inelasticities in the base of some taxes suggests that structural factors contributed to the decline in the automatic element of revenues; but that a more important explanation was the lack of growth in real G.D.P. The resulting size of the overseas deficit constrained the growth and development objectives of the public sector and its revenue raising needs may have accentuated the business cycle.

Measuring Budget Impact

In the period reviewed, Government's overall deficit rose from $1.0 million in 1964-65 to $33.0 million in 1975-76. This does not, however, imply that fiscal policy was continuously expansionary, as can be verified by applying a measure of budget impact.[8] By this method fiscal policy was persistently contractionary during the period 1964-70 and except for a brief interval in 1971 and 1972-74, remained contractionary up to 1975-76. (See Table 6). Fiscal policy in the pre-1970 period tended to be mostly pro-cyclical, becoming passively anti-cyclical with an unchanged fiscal stance when exports rose above trend in 1966-67 and 1968-69. In the 4-year period 1969 through 1972, when exports were at a low ebb, an expansionary stance was called for. Government responded by breaking the trend towards contractionary fiscal policy and became actively anti-cyclical. In 1970-71 and 1973-74 this expansionary fiscal stance was effected largely as a result of increased tax allowances and increased wages and salaries. In the period 1974-76 Government's fiscal policy

[8] This method was applied by Cheetal Chand, in an unpublished paper, to Malaysia. It is based on the idea of cyclical neutrality and is adapted for countries whose G.N.P. fluctuates in sympathy with export earnings and whose economy is mainly propelled by export earnings. It is based on the assumption that Government spending should take up the shortfalls in export earnings.

Table 6

Budget Impact
$ Million

Item	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
	Fiscal Year											
Exports	60.3	64.3	70.0	71.5	80.2	74.2	79.1	80.2	84.5	103.4	172.4	217.0
GNP	147.3	153.9	169.6	189.2	216.7	235.3	289.9	325.1	356.7 E	426.0 E	528.0 E	607.[illegible] F
General Deficit	-1.0	-4.5	-10.0	-6.9	2.3	-5.0	-10.9	-8.5	-11.9	-46.7	-36.3	-33.0
Trend Revenue	44.7	46.7	51.4	57.4	65.7	71.3	87.9	98.6	108.2	129.2	160.1	184.1
Trend Expenditure	17.6	32.7	47.8	62.9	78.0	93.1	108.2	123.3	138.4	153.5	168.6	183.7
Cyclically neutral balance ( ) surplus	(27.1)	(14.0)	(3.6)	-5.5	-12.3	-21.8	-20.3	-24.7	-30.2	-24.3	-8.5	(0.4
Overall balance as % of GDP-deficit	0.7	2.9	5.9	3.7	(1.1)	2.1	3.8	2.6	3.3	11.0	6.9	5.4
Cyclically neutral balance as % of GDP	(26.3)	(13.3)	(3.1)	1.6	3.1	5.0	3.8	4.2	4.6	3.1	0.9	-
Clyclical effect of Budget	27.5	16.2	9.0	2.1	-4.2	-7.2	-	-1.6	-1.3	8.9	6.0	5.4
Changes in fiscal stance	-	-11.3	-7.3	-6.9	-6.3	-3.0	7.2	-1.6	0.3	10.2	-2.9	-1.4
Need for fiscal policy expansionary (+) contractionary (-)		+	-	+	-	+	+	+	+	-	-	-
Qualitative assessment of the budget			✓		✓		✓		✓		✓	✓

Source: Ministry of Finance, Accountant General, Government Statistical Service responded more positively to the recession than to that of 1964. Though in both cases its policy was contractionary, it was less so in the recession of 1974 and 1975 than in that ten years earlier. The data indicate that the contractionary fiscal policy of 1974-1976 was in tune with export trends and with the position of the economy in the business cycle. However, this conclusion must be qualified, since the assumption that export receipts have their full multiplier effect throughout the economy did not hold in this period. In 1975, the imposition of a levy on sugar receipts appropriated a large portion of sugar receipts to Government,* thus transferring from the private sector to Government the means for shaping a fiscal policy consistent with the business cycle. This raises the question: is Government structured to increase economic growth and productivity directly?

The more flexible areas of spending are personal emoluments and capital formation. Both however, tend to be areas in which expansion is simpler than contraction, so stabilisation possibilities are one-sided. Even so, Government budget is not structured to increase capital formation at the same rate as it spends on wages, since efforts to increase capital formation rapidly encounter problems of capital absorption. Government is thus limited in its growth objective by its structure. If the slow rate of growth of G.D.P. is a cyclical phenomenon then Government can take up the slack in economic activity with little repercussion, but if it represents a secular trend then an anti-cyclical fiscal policy can lead to increasing budget deficits and balance of payments difficulties.

* Receipts from sugar export more than doubled in 1975 because of high sugar prices.

In addition, the position of the economy is not all-important, but the degree of inflation existing, for example, can also limit the extent to which fiscal policy can deal with recessionary situations. The trade-off may not be between stabilisation and growth or stabilisation and development but between recession and inflation.

Fiscal Policy in Inflation

The response of fiscal policy to the rate of inflation has important consequences not only for the business cycle but for private demand and for future changes in the general price level. In an inflationary situation, increased taxes on goods and services can dampen private sector demand. However, in December 1974 when a 5% tax was imposed on retail sales the economy was experiencing a period of low resource utilisation and weak demand pressure and therefore the inflationary consequences were mild.

- The high inflation rate was partly responsible for buoyant revenue from personal income taxes but inflation also reduced the real value of personal exemptions and of tax deductions pushing many taxpayers into brackets subject to higher real marginal tax rates, thus reducing real disposable incomes. Inflation could also have resulted in taxable gains on fixed assets and land which were a reflection of inflation rather than real increases in value.

Normally most tax increases in inflationary situations can contribute to inflationary pressures by discouraging capital formation. However, since demand remained dormant in 1975, any decline in capital formation may not have been inflationary. While inflation tended to expand some revenues, recession contracted others but the overriding influence on revenues seemed to stem from the recession. The new tax measures introduced to compensate for overall revenue loss may however, have had consequences for resource allocation and stabilisation. This relates to the question of the extent to which the Government sector can allocate these resources productively.

Efforts in the public sector to control price inflation through price control had only a small impact. In a situation where a large proportion of the inflation was imported fiscal policy was ill-equipped to correct the situation. Government gave priority to controlling inflation through a contractionary budget, but whether this fiscal action was restrictive enough to be anti-inflationary is doubtful. However, in the situation of economic recession a strong contractionary policy might have deepened or prolonged the recession; a tenuous balance therefore needed to be struck.

Though Government's fiscal stance tended to be restrictive, the wages bill of Government climbed sharply in the period 1973-75 by 18.0% per annum. Average income per man rose by 21.0%[9] and prices rose by 24.2%, so that by the productivity rule wages of Government employees did not contribute to the inflation but fell just below the level needed to compensate for the price inflation. More specifically another trade-off seems to exist between high wages and low employment. 32 % of Government spending is allocated to personal emoluments and over the period 1973 to 1975- this rose

[9] This includes annual increments of 5% in wages and salaries.

to 37.8% of total spending. In order to control the wage bill Government cut back employment so that during the period 1973-75 the number of people employed in the Government service declined by 3.0%, while Government wage bill rose by 18%. High wages thus led to proportionately greater reductions in employment.

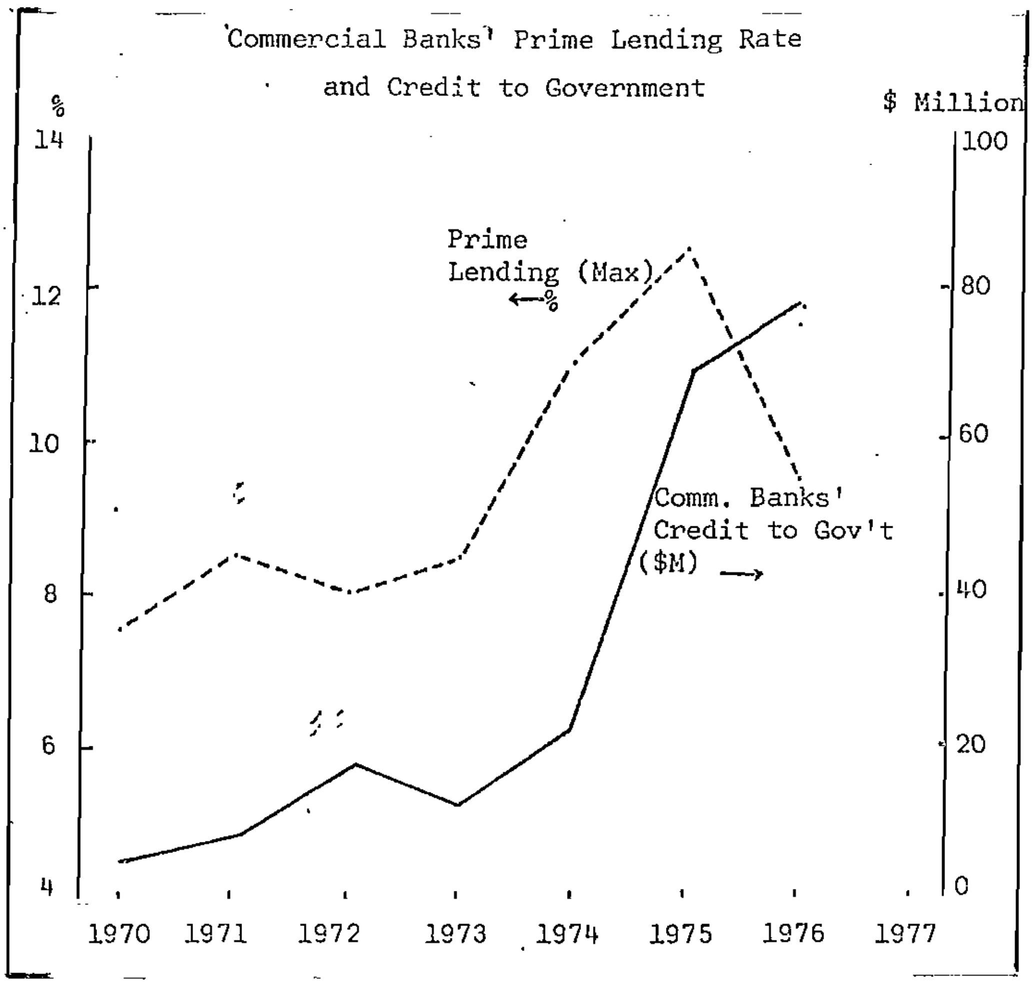
Financing, Credit and Growth

The way in which the deficit is financed also influences growth and development in the economy. During the period reviewed there was a marked shift away from foreign towards domestic borrowing. This necessarily reduced the credit available to other sectors / In the period 1968 to 1972 when the Government deficit first showed signs of widening large portions of credit supplied to Government originated from public financial and non-financial institutions.[10] This undermined available private sector credit only indirectly in so far as deposits were withheld from the banking system. Since the household sector is only a marginal buyer of Government securities, increases in credit to Government had no significant impact on net household wealth.

The effect of credit availability on the private sector was more marked in 1973, when credit to Government influenced the level of loanable funds in the banking system. Normally, if the demand for private sector credit is high or banks are heavily loaned up at a time when Government is selling securities, this could crowd out private spending and possibly bid up the commercial rate of interest. The simultaneous rate of increase in public

[10] The Barbados Savings Bank and National Insurance Board were the major contributors.

Chart A


Commercial Banks' Prime Lending Rate
and Credit to Government
%
$ Million
14
12
10
8
6
4
100
80
60
40
20
0
Prime
Lending (Max)
←%
Comm. Banks'
Credit to Gov't
($M) →
1970
1971
1972
1973
1974
1975
1976
1977

sector credit[11] and interest rates in 1973 and 1974 suggests that there is some correlation. However, at the same time, international interest rates were high, and to the extent that the local money market was less insulated than at present, domestic interest rates may have been bid up (See Chart A). Though the interest rate on short-term securities was lower than commercial rates throughout the post 1973 period; it bore little relationship to commercial rates. The interest rate effect came mainly from the size of credit to Government and not from the size of interest rates on securities. The pressure of financing the Government deficit thus affected key variables relating to the country's growth objectives in 1973.

Finally, the period reviewed tends to fall into three sections. The first, 1964-70, was a period in which there was some development and growth, but in which Government exercised its stabilisation role to only a limited extent. The second, 1970-73, was one of stabilisation, but fluctuating rates of growth, and the third period 1973-75 was a period of recession and a conscious trade-off between growth and stabilisation. Because of data limitations the paper has dealt only with the Central Government budget, but if statutory boards are included, these conclusions may have to be modified. This points to the need for an all-embracing study covering the impact on the economy of the entire public sector.

11 In addition, banks had provided a short-term loan of $20 million to Government but most of these funds were borrowed from foreign banks.