THE BANKING SYSTEM AND THE STATE OF THE GUYANESE ECONOMY

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INTRODUCTION:

Despite some controversy over their role in specific cases, it seems generally accepted that banks have been closely associated with the development of many of today's industrialised and "newly-industrialised" countries. With respect to the developing countries, the issue is not whether banks are vital to the development process. Discussion has, however, focussed on the organization and functioning of both the monetary authority and the banks to cater to the needs of development. This paper attempts to make a contribution to these discussions by examining the current role of Banks in Guyana. The conclusion is that while the contribution to the country's efforts at development has been substantial, the Banking System remains vulnerable to the criticism that much remains to be done if it is to realize its full potential in the development process.

The Role Of Commercial Banks:

In developing economies, perhaps the best indicator of the pivotal role of the Banking System is the extent to which recourse has to be made to the I.M.F. under standby and higher credit tranches. For in almost all such arrangements, targets, or ceilings are set on the expansion of credit to the public sector, and in a few cases, to the private sector. Such targets are set not necessarily because the I.M.F. adheres rigidly to a "monetary approach" to stabilization but because it is the Banking System that often finances the large public sector deficits that result in inflationary conditions and balance of payments problems. The implication for the role of Banks is that while they are an indispensable source of both current and capital funds to the public sector, the financing of excessive deficits often leads to a slowing down or a reversal of growth and development.

In Guyana the most visible means by which the Banks influence the economy is through their financing of the public sector. In so doing, the Banks may be said to have assisted in the process of reducing the "savings constraint" to growth.

The Central Bank's data show that in July 1982, almost 85 percent of private sector time and savings deposits were on-lent to the public sector. In addition to financing the deficits of the public sector, funds channeled through the Banking System have been used to provide additional resources to the two development banks.[1]

Unfortunately, the incurring of large deficits (13 percent of G.D.P. in 1981) largely financed by the Banking System has led to the inflationary conditions and pressure on the balance of payments which, in turn, have led to recourse to the I.M.F. Thus, with respect to the Banks' role in the financial intermediation process, while these institutions have channeled

(1) Involved in agricultural and industrial development, and housing.

funds from savers to the leading sector of the economy, excessive recourse to these funds by the public sector seems to have contributed to the present state of the economy.

Foreign Exchange:

Quite apart from the shortage of domestic savings, the lack of foreign exchange is for some countries an even greater constraint to growth. A possible contribution of Banks, and, in particular, foreign Banks, is, therefore, the extent to which they are able to facilitate foreign exchange flows into a country. In Guyana, the Banks have made significant contributions in this area. BIS data show that as at the end of June 1982 reporting banks' assets (loans) outstanding to Guyana totalled US$118 million while liabilities (deposits) totalled US$56 million to yield net loans outstanding of US$62 million. World Bank data [1] show that as at the end of 1979, financial market creditors (principally banks) had loans outstanding (including undisbursed) to Guyana of US$118 million, or 17 percent of total outstanding debt. Of these amounts, three of the five foreign banks operating in Guyana, the Royal Bank of Canada, Chase Manhattan Bank, and Barclays Bank International, are largely responsible for arranging these loans and hold the major proportion as part of their offshore loan portfolio.

The World Bank data underestimates the role of the Banks to the extent that it includes only identifiable government-guaranteed loans to the public sector with maturities of one year and over. While the value of foreign currency loans outstanding to the private sector is generally considered small, short-term credits to the public sector enterprises are not likely to have been insignificant.

(1) World Bank Annual Report 1981 - p. 135. No later published data are available.

In addition to direct lending, foreign banks have helped to alleviate the foreign exchange scarcity problem by, from time to time, running up high overdraft levels with their head offices and branches abroad. Such balances totalled US$2.6 million in July 1981, US$0.65 million in December, and US$5 million in January 1982 (US$4 million, net)

Criticisms Of Banks:

Perhaps the major criticism of the Banks in Guyana relates to their role in financing public sector enterprises. The financing of public sector operations and deficits by the banking system in both developed and developing countries has been a feature for some time now. This type of financing is not necessarily ruinous for an economy and in several instances has contributed in no small measure to economic growth and welfare. However, it is likely to be damaging under the following conditions:-

(1) Where loans are extended to official enterprises with no track record of operational efficiency.

(2) Where increasing amounts of credit are made available to corporations when even the most rudimentary form of financial analysis indicates that repayment is unlikely to be forthcoming in the near future out of earnings.

(3) Where credit is extended in the absence of financial reports and plans indicating the current and estimated future position of the enterprise.

Unfortunately, and with a few outstanding exceptions, much of bank lending to official enterprises is characterized by one or more of the above with the banks dispensing with the loan criteria which they apply often quite rigorously, to the private sector borrowers and satisfying themselves with guarantees issued by the Government. The result is that while prudent banking practice suggests that a guarantee should be the basis for granting a loan only in the last resort, current practice in Guyana appears to indicate that in the case of loans to public sector enterprises, guarantees are the sole reason for the granting of credit.

Several reasons have been advanced by the banks for this behaviour. Firstly, one often hears that it is government's policy that banks direct most of their loanable funds to the public sector. This argument is largely accurate but also largely based on convenience. It is accurate to the extent that while in 1976 the Central Bank issued guidelines to commercial banks requesting that credit extended to the public and private sectors should exceed 1975 levels by no more than 5 and 7 percent respectively, by 1977 quantitative guidelines were being issued only on private sector credit, and by 1981, the limits placed on credit to the public sector clearly implied that the Central Bank envisaged higher levels of lending to that sector. In addition, policy statements and actions by the government have emphasized, since 1974/75, the leading role of the public sector. The argument is convenient to the extent that many banks, in a situation where largely because of the scarcity of foreign exchange, private sector activity is said to be sluggish, are happy to lend large sums under government guarantee to public corporations at rates which are often higher than prime. However, it is fair to say that many banks appear to have reached their prudential limits on credit to certain public sector enterprises and are much more hesitant about extending further loans.

In conclusion, the banks cannot escape some measure of criticism for extending credit to public sector enterprises above the level which normal banking criteria might have considered prudent. To the extent that there was real or perceived pressure from the government on the banks to extend credit beyond prudent levels in order to keep companies afloat, this suggests:-

(1) the absence of a sufficient appreciation of the crucial role of monetary policy in a small, open economy.

(2) inappropriate criteria for the extension of credit, and inadequate supervision of the use of credit, by state-owned corporations.

(3) some deficiencies in financial management of the corporations.

It is the banks behaviour, in addition to these factors which have contributed to the current malaise in which the Guyanese economy finds itself.

Lending Cirteria:

In both the domestic and international arenas, banking is becoming a riskier business. The rapidly increasing risks in international banking are well-known and attract much media attention, as a result, the growing complexity of domestic banking might have tended to be overlooked. However, the ever-increasing number of corporate bankruptcies and the more spectacular failures in the U.S. banking system all underline the fact that domestic loan write-offs have been much higher than those on international lending for almost all of the major OECD banks. The response to greater risk and complexity has been that bankers have been seeking to improve the quality of their loan portfolios.

Given the depressed state of the Guyanese economy, one might assume that corporate borrowers in particular, might be facing difficulties in servicing their bank loans. Foreign exchange shortages and rising rates of interest are likely to have exacerbated these difficulties. While loan loss provision data are unavailable for the foreign-owned banks, the Guyana National Co-operative Bank's 1981 Annual Report shows such provisions almost doubling to reach \$2.25 million. Pulling at this rather tenuous strand, one might be tempted to conclude that the lending environment in Guyana is also becoming increasingly complex, (if one assumes a uniform quality of credit appraisal across the banking system). However, since, as we have noted above, lending to public sector enterprises comprise some 80 percent of the banks' loan portfolio (52 percent for G.N.C.B.), the notion of increased complexity needs to be treated with some caution. In this context, the rigid adherence by certain banks to very strict lending criteria applied to the private sector appears to have some elements of contradiction. In some cases, banks have been said to require a 100 percent cash guarantee before a loan is finally approved. In another case, a request by a professional within the banking system for a loan of \$600 was refused because of the lack of such a guarantee. What is worrying about this apparent over-reliance on collateral and guarantees is that it implies that bankers are unprepared to expose themselves even minimum levels of risk-taking. As a result, however promising are the financial prospects for new entrants into private sector business activity, finance from the banks, is unlikely to be forthcoming in the absence of iron-clad guarantees. To the extent that this practice is widespread, banks are unlikely to make a significant contribution to growth and development.

The Role Of the Central Bank:

The Bank of Guyana Act directs the Bank to "... be guided in all its actions by the objectives of fostering monetary stability and promoting credit and exchange conditions conducive to the growth of the economy of Guyana".[1]

The rapid expansion of the money supply since 1975, the phenomenal expansion of credit to the public sector in conjunction with falling rates of real G.D.P. growth, rapidly rising prices and depreciated exchange rate (in both the official and parallel markets) all point to the conclusion that the Bank has not achieved much success in the pursuit of its objectives. Even when bolstered by the support of an I.M.F. Extended Fund Facility, it has proved impossible to control credit to the public sector. This state of affairs has arisen not necessarily because the Bank has been inefficient, but perhaps, more importantly, since the economy has come under the influence of central planning and the predominance of government. These latter factors appear to have led to the relative neglect of money, the banking system, and the role of monetary policy, and the concentration of attention on the so-called 'real' variables such as capital investment and output. However, both experience and available research work [2] should, by now, have demonstrated that it is exactly such neglect of money and monetary policies that have resulted in the failure of several L.D.C.s to achieve the environment of stability on which sustained growth and development so much depend. This concern and appreciation of the role of the banking system are not confined to capitalist-oriented or I.M.F. dominated economies - note the following items:-

(1) Bank of Guyana Annual Report 1980 p. 101

(2) See, for example, a collection of such research, W. Cline and S. Weintraub (eds): "Economic Stabilization in Developing Countries". Brookings. 1980.

POLAND

According to a report from the Polish news agency P.A.P., the Polish banking system will be reformed to make it more closely resemble that of a market economy. Full implementation of the reform will create conditions for a more effective functioning of the economy.

The agency quoted the President of the National Bank of Poland, Mr. Stanislaw Majewski, as stating that under the new reform enterprises using credits will be checked for credit-worthiness. The Governor was quoted as saying: "We must simply be sure whether enterprises are able to repay the credits they have drawn, that is, whether they are profitable".

According to a Polish document circulated to western bankers in November, Poland's economic planners have urged a greater role for the National Bank of Poland, together with a system of independent banks.

(B.I.S. Review: 12.1.82)

EAST GERMANY

East Germany has greatly strengthened the role of its banking system to achieve greater industrial productivity which continues to lag one-third behind that of West Germany.

Under a new decree state banks have been given sweeping authority to control the country's 157 giant industrial trusts by stipulating the conditions under which they are to receive loans. If a state company fails to meet production targets, including productivity gains, and lags in repaying loans, it can be charged interest up to 12%. This is two points higher than previously.

The state banking system has been given powers to examine the accounts of state concerns and to impose a total ban on loans to companies which do not meet performance standards. The decree states, that in the case of conflicts between state companies and a bank, the bank director's word is final.

(Financial Times: 20.3.82)

Quite apart from the perceived overall neglect of monetary matters, it might be useful to question whether the Bank has been as forceful and influential enough in the performance of its roles as advisor on monetary matters and of supervisor of the banking system as its Barbadian and Jamaican counterparts appear to be.

Conclusion:

With the Guyanese economy in its present depressed state, it is important for the banking system to assess its current operations and functioning against its original objectives, to identify its areas of weakness, and to formulate a programme for reform. For the Central Bank, such a programme should include:

1. A re-affirmation of its role as effective supervisor of the banking system and the achievement of a greater degree of influence over monetary affairs. This enhanced role would incorporate the power of sanction over delinquent members of the banking system and over inefficient users of both domestic and foreign credit. Effective supervision can, of course, not take place unless the Bank has detailed knowledge of the operations of the commercial banks. Such knowledge cannot simply be assumed, it needs to be acquired.

2. Assisting in the general effort at educating both public and policymakers in the disadvantages of large and growing public sector deficits and other important economic issues.

3. Efforts at encouraging commercial banks, by the use of rediscount facilities, special funds, and guarantees, to increase their lending to deserving private sector businesses in the export and manufacturing sectors.

4. Efforts at improving the quality of skills in the banking system.

5. Continuous research into all aspects of the banking system, especially as they relate to possible contributions to development, and into the design and implementation of appropriate monetary policies conducive to stabilization.

SELECTED MONETARY DATA

G$ mn
(END OF PERIOD)

BANK OF GUYANA:	1975	1976	1977	1978	1979	1980	1981	LATEST 1982
FOREIGN ASSETS	255.7	69.5	59.6	148.6	44.7	32.4	20.7	5.9
CLAIMS ON GOVT.	44.4	254.4	346.1	396.2	589.2	828.4	933.6	910.4
G$ mn (END OF PERIOD)								
COMMERCIAL BANKS								
CLAIMS ON GOVT.	146.0	135.8	187.3	213.5	198.7	216.5	249.3	328.6
CLAIMS ON PUBLIC ENTERPRISES	57.5	76.5	118.8	121.9	172.6	229.3	375.7	642.7
CLAIMS ON BUSINESS AND INDIVIDUALS	117.4	120.0	113.0	121.1	162.7	195.8	262.1	284.0
TIME AND SAVINGS DEPOSITS	246.7	272.4	321.0	369.8	429.7	527.3	644.9	731.0
PER CENT OR INDEX NUMBERS (1975 = 100)								
INTEREST AND PRICES								
DISCOUNT RATE (END OF PERIOD)	6.5	6.5	6.5	8.5	10.5	12.5	12.5	14.0

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