

CREDIT SUPPLY, MONETARY POLICY AND STRUCTURAL ADJUSTMENT IN GHANA

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1. Introduction

One of the principal objectives of the structural adjustment programmes (SAPs) implemented in sub-Saharan Africa (SSA) and elsewhere in the developing world is an expansion of the private sector in production and trade. To facilitate this, the private sector requires an increased supply of financial resources with which to purchase fixed and working capital. The international financial institutions supporting SAPs regard an expansion in the availability of finance to the private sector as one of the primary mechanisms for stimulating private investment (IMF, 1987).

Given the low level of development of domestic financial markets and constraints on access to foreign capital, the private sector in most SSA countries relies mainly on domestic bank credit to accommodate its requirements for outside financing (ie finance not generated from retained profits or by the owners of firms).

The necessary expansion of bank credit to the private sector may however be constrained for a variety of reasons including the inelasticity of supply of financial savings, monetary policy, the financial weaknesses of the domestic banks and informational problems relating in particular to the perceived credit worthiness of prospective borrowers.

This paper explores these issues by examining developments in credit markets in Ghana. Ghana has implemented a wide ranging SAP, known as the Economic Recovery Programme (ERP), since 1983. Despite the recovery of output growth has taken place in Ghana during the ERP, private investment levels have remained depressed (Aryeetey, 1994). Constraints facing prospective investors in credit markets may have contributed to the weak investment response to adjustment in Ghana.

The organisation of this paper is as follows. Theoretical arguments relevant to an understanding of how credit markets might be affected by SAPs are discussed in section 2. Section 3 provides a short review of pertinent developments in domestic credit markets in Ghana in the two decades prior to the introduction of the ERP. Section 4 outlines the main monetary and financial policies implemented during the ERP and the objectives associated with these policies. Trends in bank credit to the private sector during the ERP and the impact of monetary policies on credit supply are assessed in section 5, while section 6 discusses the consequences of credit constraints for private investment. Some of the policy implications arising from the analysis are noted in the conclusion.

1. The views expressed here are solely those of the author. The author thanks Sammuell Gayi and Augustine Fritz Gockel for their comments.

2. Credit Demand and Supply During Adjustment: A Review of Theoretical Issues

This section focuses on three issues: how will structural adjustment affect credit demand? How can credit supply to the private sector be raised? And what are the potential obstacles to an expansion of credit supply?

SAPs aim to provide incentives for the private sector to both expand output and to reorientate production towards tradeable goods, particularly exports. A successful response by the private sector to these incentives is likely to substantially raise credit demand in both real and nominal terms for a number of reasons.

First, the reorientation of production will entail a rise in gross investment expenditures, even if the overall level of the capital stock remains roughly stable, because much of the capital stock is industry specific for technological reasons.

Second, because a large proportion of investment goods (and material inputs) are tradeable, their purchase price expressed in terms of domestic currency will rise as a result of exchange rate devaluation, which is a central policy component of most SAPs.

Third, an expansion of tradeable/export production may entail the emergence of new firms, rather than simply a reallocation of production by already existing firms. The former will not have the liquidity accumulated from past profits with which to finance investment expenditures and will thus require funds from outside sources.

The finance necessary to facilitate an expansion of private sector investment and production could be obtained from three possible sources. The reduction of fiscal deficits may reduce the public sector's recourse to domestic credit and therefore reduce financial "crowding out" of the private sector. Second, a commitment to adjustment on the part of the government may increase access to external sources of finance to the public and/or private sectors. Third, financial liberalisation, a key component of which is usually increased real interest rates, may stimulate the growth of financial savings by boosting private savings rates, reducing capital flight or by channelling savings held in the form of low productivity non financial assets into financial intermediaries (Fry, 1988).

Several potential objections to the efficacy of financial liberalisation as an instrument of financial resource mobilisation have been raised in the literature. The response of overall savings to increases in real interest rates is both theoretically and empirically ambiguous (Giovannini, 1983; Nissanke, 1991), while Taylor (1983) argues that an increase in funds channelled through formal sector intermediaries is likely to be at the expense of informal (curb) market intermediation rather of unproductive investments.

Even if adjustment policies succeed in expanding the supply the supply of financial savings, the domestic banking system may experience difficulties in channelling these

funds to prospective private sector borrowers, in part because of the effects of some of the important policy components of SAPs. In particular the supply of bank credit may be constrained by monetary policies, by the adverse effects of raising interest rates and other adjustment related policies on the default risk of lending, and by the financial and operational weaknesses of domestic banks.

The need to restore and maintain macroeconomic stability is likely to entail a counter inflationary monetary policy. Unless substantial reductions in public borrowing from the domestic banking system can be attained, restraints on bank lending to the private sector will be necessary in order to control the growth of monetary aggregates. In addition efforts by the monetary authorities to rebuild foreign reserve holdings will intensify pressure on private borrowing.

The rise in real interest rates may prove problematic for both credit demand and supply. Risk adjusted rates of return to capital may not be sufficiently high to permit a general expansion of borrowing at higher real interest rates (Roe, 1982; Beckerman, 1988). Even if loan demand is maintained, the banks may be reluctant to increase credit supply in response to higher lending rates in case this induces a rise in loan default rates. Because of adverse incentive and selection problems which arise as a result of informational asymmetries in financial markets, interest rates may be positively correlated with loan default probabilities and as a consequence banks may operate a regime of non price rationing of credit even in a liberalised financial market (Jaffee and Stiglitz, 1990).²

Finally the ability of the banks to accommodate an expansion of credit demand from the private sector may be impeded by the financial difficulties facing the banks themselves. Many of the banks in SSA have experienced severe financial distress as a consequence of high loan default rates. Their capital base is weak and some are technically insolvent, while staff have only limited experience and expertise in extending loans according to commercial criteria (Harvey, 1993; World Bank, 1989: 70-77).

2. Although most of the literature on imperfect information in financial markets was written in the context of the industrialised countries, there are a priori grounds to argue that it may actually have much greater relevance for DCs where informational problems and macroeconomic uncertainty are often much more acute. Informational problems in DCs are exacerbated because firms tend to be smaller, most firms are private rather than public limited companies, and accountancy and auditing standards are low. The undiversified structure of production, the vulnerability of agriculture to environmental conditions and economic instability increase the risks of lending for financial intermediaries.

3. Developments in Credit Markets in Ghana: 1969-83

This section outlines the major developments in credit markets in Ghana during the two decades preceding the ERP, beginning with a brief description of the institutional structure of the financial system. This is followed by an examination of the effects of government controls over, and interaction with, the financial system in the 1970s and early 1980s, highlighting some of the important trends in monetary and financial aggregates.

The financial system in Ghana is dominated by commercial banks. The three largest banks were established during the colonial period and are referred to as primary banks. Several smaller banks, including specialised development finance institutions, were established since independence and are referred to as secondary banks. Public ownership has played a major role in the banking system and by mid 1970s all of the major financial institutions were either wholly or partly publicly owned.

Financial market development outside the banking system was very limited and until the late 1980s the main non bank financial institutions operating in the formal financial sector were the insurance companies. Few primary securities, other than bonds and bills issued by the public sector, were traded on domestic markets. A significant informal financial sector provided services for the large sections of the population denied access to the formal banking system.³

The banking system expanded during the 1960s and early 1970s in terms of the real value of financial assets/liabilities and of the number and diversity of banking institutions. This growth was also reflected to some extent in an increased supply of loans to the private sector. During the 1970s and early 1980s, however, the financial markets were subject to severe financial repression, as a consequence of which banking system began to shrink both in real terms and in relation to the size of the economy, while in addition the private sector was crowded out of credit markets. The main features of the financial repression were high rates of inflation, caused principally by domestic credit creation to finance large fiscal deficits, controlled interest rates which led to negative real returns on financial assets, and controls over the asset portfolios of banks and other financial institutions, which channelled the bulk of loanable funds to the public sector.

3. A detailed description of the institutional structure and operation of the financial system can be found in Aryeetey, Asante, Kyei and Gockel (1990).

Table 1: Financial and Monetary Indicators 1961-90

Year	Broad Money (%of GDP)	Deposits (%of GDP)	Credit to Private Sector (%of GDP)	Credit to Private Sector (%of NDC)	Real Lending Rates %	Real Deposit Rates %
1961-62	20.0	11.5	5.2	58.3	7.5	-0.1
1963-65	24.7	14.9	7.2	39.2	5.0	-2.1
1966-68	22.9	15.3	4.9	27.5	2.8	1.2
1969-71	19.8	12.9	10.0	35.2	0.8	-0.3
1972-74	22.6	15.1	7.0	25.8	-7.9	-8.2
1975-77	28.4	18.3	5.6	16.5	-20.8	-32.8
1978-80	23.3	14.4	2.8	10.7	-23.8	-29.7
1981-83	18.6	11.5	1.7	8.6	-29.7	-35.8
1984-86	15.0	9.1	3.0	14.0	-9.1	5.5
1987-88	17.2	11.0	3.2	14.3	-5.9	-13.6
1989-90	15.2	10.3	5.3	35.9	-2.7	-6.8

NDC = Net Domestic Credit

Sources: Broad Money and Deposits from Bank of Ghana (Annual Reports and Quarterly Economic Bulletins), Quarterly Digest of Statistics. Credit to Private Sector = Claims on Private Sector from Deposit Money Banks; IFS. NDC; International Financial Statistics (IFS), IMF. Real Lending Rates = Nominal interest rate on loans secured by government securities (prime lending rate) deflated by annual change in the GDP deflator; Interest rate data from Leith (1974: 91), Quarterly Digest of Statistics and World Bank (1984: 152). Real Deposit Rates = Nominal interest rate on fixed deposits deflated by consumer price inflation; Interest rate data from Bank of Ghana.

The shrinking of the banking system is illustrated by the financial asset/GDP ratios displayed in table 1. Broad money as a percentage of GDP reached a peak of 28.4% in 1975-77 but then declined to 15% in 1984-86. Deposit mobilisation was discouraged by a combination of negative real deposit rates, falling real incomes, and the damage to public confidence in holding financial assets caused by the currency appropriations in 1979 and 1982 and by the investigation and seizure of bank accounts (ISSER, 1992: 49 - 52).

The second notable feature of developments in the banking system during the 1970s was the steep fall in borrowing by the private sector. The stock of outstanding credit to the private sector from the primary banks reached a peak of 10% of GDP in 1969-71 but then fell steadily to only 1.7% of GDP in 1981-83 (table 1). The decline in private borrowing was probably not quite as steep if credit extended from the secondary banks is taken into account, although it was still very low in relation to the magnitude of the economy by early 1980s. Credit to the private sector from all of the banks amounted to an average of 3.0% of GDP during 1981-83 (World Bank, 1986:98).⁴

4. A breakdown of the secondary banks' loans between private and public sector borrowers is not available before 1980.

The decline in private sector borrowing was due to a combination of interrelated developments. First, the shrinkage of the banking system detailed above reduced the real volume of financial resources available for intermediation. Second, the private sector was crowded out of domestic credit markets by public sector borrowing. This rose rapidly during the 1970s and led to the imposition of very high reserve ratios on the banks in an attempt to mitigate its inflationary consequences.⁵ Third, there was almost certainly a decline in bankable loan demand (ie in loan demand from borrowers regarded as creditworthy by the banks) as a result of the severe difficulties afflicting the economy during the 1970s and of the severe restrictions on access to foreign exchange.

The consequence of these developments in financial markets was that the private sector had very limited access to credit from the banks (or any formal sector intermediaries) when Ghana embarked on its ERP in 1983.

4. Financial Policy Reforms During the ERP

Financial markets in Ghana have been directly affected by several of the policy reforms implemented under the ERP. These reforms included stabilisation measures, the implementation of most of which began during the first phase of the ERP (1983-86), and liberalisation measures which were introduced more gradually, mainly during the second phase (after 1986).

The stabilisation measures affected financial markets through three major channels. First there was a progressive reduction in public sector borrowing from the domestic banking system. Net flows of domestic borrowing by the public sector fell from 9.6% of GDP in 1982 to 3.3% in 1986 while from 1987 net flows were negative (Islam and Wetzel, 1991: 54). The public sector was able to reduce its domestic borrowing because of both the cut in fiscal deficits and the greater availability of external capital and development assistance.

Second, the Bank of Ghana adopted targets for the expansion of various credit and monetary aggregates in order to control inflation.⁶ Bank specific ceilings on lending to the non government sector (excluding cocoa financing) were imposed as a component of the restrictions on the growth of the banking system's net domestic assets and were consistent

5. The required reserve ratio (cash plus other liquid assets) for the primary banks rose from 40% of deposit liabilities in 1975 to 88% in 1978 and 1979, while that for secondary banks was increased from 46% in 1977 to 70% in 1978 and 1979.

6. Consumer price inflation was very high at the start of the ERP as a result of monetary expansion and of supply side shortages. It fell sharply from 123% per annum in 1983 to 40% in 1984 and averaged 28% between 1984 and 1990.

with the credit ceilings specified in the IMF standby agreements.⁷ These ceilings were "global" in nature; ie they were applied to aggregate non government credit rather than to specific sectors. They were abolished in 1992 as part of the move towards a more market oriented approach to monetary control. In addition to the global ceilings, the Bank of Ghana also set sectoral credit ceilings on the banks designed to encourage lending to priority sectors such as exports, agriculture and manufacturing. The sectoral ceilings were removed in 1987, with the exception of a requirement that 20% of each bank's loan portfolio should be allocated to agriculture, which operated until 1990.

The third major policy change affecting financial markets entailed increases in interest rates. The Bank of Ghana raised controlled nominal interest rates with the aim of achieving positive real rates as part of the strategy to stimulate domestic savings (Bank of Ghana, 1985).

The second phase of the ERP entailed a gradual liberalisation of controls over financial markets, the implementation of a bank restructuring programme and the diversification of financial markets through the establishment of new institutions. The main objective of these reforms was to increase the efficiency of financial intermediation, in particular by moving from direct controls to market based monetary policy instruments and by improving the institutional framework of the financial system.⁸

Interest rate controls were liberalised in 1987-88, allowing banks to determine their own and leading rates. The Bank of Ghana introduced regular securities auctions to facilitate the use of open market operations for monetary control purposes.

A financial sector restructuring programme (FINSAP) was begun in 1989 in order to strengthen the finances and improve the management of the banks, many of which were suffering from severe financial distress as a result of the accumulation of large volumes of non performing loans (World Bank, 1986:73). New management and boards of directors were appointed to the financially distressed banks and their operating procedures were improved to reduce costs and strengthen loan collection. The banks were recapitalised and non performing assets were removed from their portfolios to be replaced with Bank of Ghana bonds. The total of non performing assets, including off balance sheet items,

7. The Bank of Ghana imposed ceilings on both the primary and secondary banks, aggregating these ceilings to derive the totals displayed in table 3. The IMF standby agreement specified ceilings only for the primary banks (World Bank, 1986: 33-35). Thus the ceiling are a subset of the Bank of Ghana ceilings. The non government credit aggregates to which the ceilings were applied included credit to both the private sector and state owned enterprises (SOE) s. As the private sector accounted for the bulk of non government credit (83% at the end of 1983) it was inevitable that the major impact of the ceilings would be on this sector.

8. A chronology of the reforms in the financial sector during 1986-91 is set out in Kapur et al (1991:48).

replaced by bonds amounted to 62 billion cedis in 1991, of which 32 billion cedis were in the form of loans. Non performing loans accounted for over 40% of the stock of outstanding credit to the SOEs and private sector in 1989 (Kapur et al, 1991: 60-61).

Several new financial institutions were established during the late 1980s and early 1990s, although their share of financial markets is very small. These include a stock exchange, two merchant banks, a new commercial bank, two discount houses, a home finance (mortgage) company and a leasing company. The Banking Act was revised in 1989 to enhance prudential requirements while the bank supervisory capacities of the Bank of Ghana were strengthened.

5. The Effects of Financial Policies on Private Sector Credit During the ERP

The effects of the ERP on the cost and quantity of bank credit extended to the private sector are examined in this section. We begin by presenting the relevant statistical data and then proceed to discuss the effects of monetary and financial policies on the evolution of private sector borrowing during the ERP. The questions we aim to address are:

- i) Has the ERP led to an improvement in the supply of credit in real terms to the private sector?
- ii) What were the most important constraints on the expansion of private sector bank borrowing during the ERP?
- iii) How have increased interest rates affected borrowing?
- iv) Were credit markets characterised by excess demand during the ERP? Were firms unable to undertake potentially viable investment projects because they were denied sufficient credit by the banks?

The analysis is complicated for a number of reasons. There are difficulties in determining causation because trends in financial aggregates are influenced by multiple variables while some of the potentially important influences such as collateral requirements and lending risk are unobservable.

As noted in section 3, the financial system in Ghana was, and still is, dominated by the banks. Even after the emergence of several new financial institutions, the banks accounted for 77% of the financial system's total assets, other than those held by the Bank of Ghana, in 1992 (World Bank, 1994: 49). There is very little non bank formal sector finance available to most private sector firms, which are therefore heavily dependent upon bank credit as source of funds for working capital and investment expenditures.⁹

9. The major non bank financial institutions are the Stock Exchange, established in 1989, and Social Security and

Although we are primarily concerned with the effects of the ERP on the asset side of the banks' balance sheets it is worth noting developments in their principal liabilities, deposits, as these provide the resources for lending to the private sector and other borrowers. As a percentage of GDP, bank deposits displayed at best a very modest recovery during the ERP, rising from 7.8% in 1983 to 11.1% in 1989 before falling back to 9.6% in the following year (Bank of Ghana, 1989/90). The ERP has not brought about any substantial degree of financial deepening.

Table 2 sets out data on the stock of credit extended to the private sector from the primary and secondary banks. The data indicate that credit markets did not respond vigorously to adjustment.¹⁰ Credit markets were very depressed in the early 1980s because of both financial repression and low credit demand due to the protracted economic crisis, as noted in section 3 above. After 1983 credit markets displayed more buoyancy, but the volume of credit extended by the banks to the private sector remained very low in relation to the size of the economy, averaging 5.3% of GDP during 1984-90.¹¹ This reflected both the "shallowness" of financial intermediation and the small share of credit to the private sector in the total assets of the commercial banks: the latter amounted to only 20% in 1990 (World Bank, 1991: 107). Moreover because a substantial proportion of the stock of credit was accounted for by the accumulation of non performing loans, the flow of new credit extended annually to borrowers must have been very small.¹²

National Insurance Trust (SSNIT). The former provides opportunities for a few large firms to raise funds (16 firms were listed in 1990). Until 1990 SSNIT funds were invested only in government debt.

Some firms have been able to access foreign sources of loans, especially suppliers' credits, to finance equipment expenditures. However, because of the rapid nominal depreciation of the exchange rate, foreign borrowing has entailed very high costs (and risks) for firms which serviced their loans from income generated in the domestic market.

10. Because of changes in the composition of the monetary aggregates it is not possible to construct a consistent series of private credit data covering both the 1970s and the 1980s. The credit figures in table 2 consist of total claims on the private sector by the primary and secondary banks combined. Prior to 1980 the secondary banks' lending was not disaggregated into public and private sectors.

The first tranche of private sector non performing loans was removed from the asset portfolios of the banks in 1990, but this is not reflected in the credit data for 1990 in table 2 in order to maintain consistency with the preceding years.

11. As a percentage of GDP, bank credit to the private sector was much higher in most other SSA countries than in Ghana. The unweighted average for 7 CFA zone countries during the 1980s was 26%, while the unweighted average for 11 non CFA zone countries was 12% (data from International Financial Statistics Yearbook).

12. It is also likely that a proportion of the annual increases in the stock of credit which occurred during the ERP was due to the capitalisation of unpaid interest on non performing loans.

Table 2: Credit to the Private Sector 1980-90 (Cedi Millions)

Year	Credit (Current Prices)	Credit as % of GDP	Credit Constant 1980 Prices (A)	Credit Constant 1980 Prices (B)
1980	1675	3.9	1675	1675
1981	2271	3.1	1295	1522
1982	2337	2.7	1040	1364
1983	5171	2.8	1032	1304
1984	11086	4.1	1635	1187
1985	19799	5.8	2421	1499
1986	36460	7.1	3146	1766
1987	46946	6.3	2910	1740
1988	58183	5.5	2703	1553
1989	61140	4.3	2214	1327
1990	80218	3.9	2073	1424

Credit = claims on the private sector by the commercial banks (including the secondary banks).

Credit in constant 1980 prices: A = nominal credit deflated by the GDP deflator; B = nominal credit deflated by the GFCF deflator.

Sources: Bank of Ghana (1986, 1987). World Bank (1986: 98). World Bank (1991: 107). Quarterly Digest of Statistics (various issues)

Columns 4 and 5 of table 2 provide estimates of the nominal stock of private sector credit deflated by the GDP and GFCF deflators respectively, ie they are indicators of real credit. Between 1982 and 1990 the former almost doubled but the latter rose by only 4.5%. Hence in relation to the purchase cost of capital goods, the private sector experienced only a marginal increase in credit during the ERP. Both indicators of real credit expanded between 1982 and 1986 but then declined in the following four years. The decline occurred because the growth in nominal credit slowed markedly after 1986 (from an average of 89% per annum during 1983-86 to 22% during 1987-90) but this was matched by proportionate falls in the growth rates of capital goods and output prices.

The lack of a more vigorous and sustained recovery of private credit during the ERP could have been the result of either weak loan demand or of constraints on the supply side. The latter appears a more plausible explanation, as it is likely that the growth of the economy since 1983 combined with the liberalisation of trade and the steep rises in import costs would have given a strong boost to loan demand from the private sector. This is supported by surveys of firms in which shortages of credit have been frequently cited by the respondents as the most important constraint on investment.¹³ The commercial bankers also reported

13. A World Bank survey of firms in 1989 reported that credit was a major or moderate problem for 89% of firms

strong loan demand, especially from manufacturing firms, (IMF, 1989B: 19-20).

The contention that access to credit was constrained on the supply side, rather than lack of demand, is borne out by the close correlation between actual bank lending and the credit ceilings imposed by the Bank of Ghana after 1983 (table 3). During 1980-83 the stock of credit extended to the non government sector varied widely from the levels allowable under the ceilings specified by the Bank of Ghana. In 1980 and 1981 credit fell short of the ceilings by 22% and 34% respectively, while it exceeded the ceiling by 33% in 1983. During the following four years the banks maintained their lending within 4.3% of the maximum allowed by the Bank of Ghana, and only in 1986 did credit fail, by a small margin, to reach the ceiling. The credit ceilings therefore appear to have been a binding constraint on bank lending during the first part of the ERP; had they not been we could have expected to see, either a shortfall between the stock of credit and the ceiling (if loan demand had been insufficient), or credit exceeding the ceiling by a larger margin (if the ceilings had been ignored by the banks). Because the latter would have jeopardised continuing support for the ERP from the IMF, the Bank of Ghana would have exerted considerable pressure on the commercial banks to remain within the allowable lending limits. Banks which exceeded their credit ceiling were liable to incur penalties from the Bank of Ghana.¹⁴

Although data pertaining to the credit ceilings are not available after 1987, there is evidence to suggest that they remained a constraint on bank lending. In 1988 several banks began extending credit in the form of off balance sheet acceptances to evade the ceilings until prevented from doing so by a Bank of Ghana directive in March 1989. Commercial bankers reported to an IMF mission in 1989 that the ceilings prevented them from accommodation strong demand for credit from credit worthy customers, as a consequence of which they continued to hold substantial levels of excess reserves (IMF, 1989B: 17-20 & 88-90). In February 1989 six banks were temporarily barred from the foreign exchange auction for exceeding their credit ceilings (Sowa, 1991: 29). Moreover there was a progressive tightening of the credit ceilings between 1986 and 1989 which

surveyed (World Bank, 1991: 38-45), while the African Regional Programme for Enterprise Development survey of manufacturing firms found that lack of access to credit was regarded by firms as the most severe constraint on expansion (Baah-Nuakoh and Teal, 1993). Credit was the most important operating problem for small enterprises in a 1989 survey reported by Steel and Webster (1992).

14. Penalties were not enforced for minor infringements of the ceilings but were in more serious cases. Penalties included fines and the barring of the banks from the foreign exchange auction (IMF, 1989B, 88-90).

Table 3: Commercial Banks' Credit to the Non Government Sector, Credit Ceilings and Excess Reserves Cedi Millions (current price)

Year	Credit	Credit Ceiling	Deviation of Credit from Ceiling (%)	Excess Reserves
1980	2068	2637	-21.6	779
1981	2803	4224	-33.6	1347
1982	2996	2945	1.7	1861
1983	6231	4701	32.5	3029
1984	11996	11506	4.3	2614
1985	22177	21348	3.9	3587
1986	39906	40348	-1.1	12845
1987	52485	51086	2.7	9613
1988	66227	na	na	10578
1989	79016	na	na	10380
1990	76344	na	na	33057

na = not available

Credit is total outstanding credit to the non government sector (excluding cocoa marketing) from primary and secondary banks. Reserves include cash and other liquid assets. The data are end of year figures. The 1990 figure for outstanding credit reflects the removal of non performing loans.

Sources: Bank of Ghana (1986, 1987), World Bank (1986).

reduced the permitted allowable annual nominal expansion of bank credit.¹⁵

This tightening of the ceilings was most likely cause of the marked slowdown of nominal private credit growth after 1986 and the consequent decline in real credit noted above.

The apparent severity of the constraints on private borrowing raises the question of why credit policy was so restrictive given that one of the main objectives of the ERP was stimulate the private sector and that the improvement in public finances should have released resources for use by private borrowers. The need to maintain tight credit ceilings arose because money supply growth, and hence inflation, remained high: broad money growth averaged 42.3% per annum during 1984-90. Two different explanations of the excessive money supply growth have been advanced. Younger (1992) emphasises the impact of large inflows of foreign aid (combined with the government's concern to prevent

15. The ceiling on non government credit shown in table 3 increased by 89% in 1986 but only 27% in 1987. While the 1988 and 1989 ceilings are unavailable, an indication of their growth is provided in the 1989 IMF staff report on Ghana (IMF, 1989A), which shows programmed increases in "credit to the rest of the economy" (an aggregate very similar to the bank credit to the non government sector shown in table 3) of 24% and 22% in 1988 and 1989 respectively.

an appreciation of the real exchange rate) on the monetary base, while Bhatt (1993) attributes the money supply growth to the losses arising from the revaluation, due to exchange rate depreciation, of the banking system's external liabilities. The problems arising from monetary growth were compounded by the lack of financial deepening during the ERP. Had the rise in deposit rates been more successful in boosting holdings of monetary assets (and therefore lowering the velocity of circulation) a larger increase in private borrowing would have been compatible with inflation targets.

In addition to the global credit ceilings, the Bank of Ghana also imposed sectoral credit ceilings and reserve requirements on the banks. The sectoral credit ceilings were largely ineffective as large discrepancies were recorded between actual lending to particular sectors and the permitted levels (Bank of Ghana, 1986, 1987; Arieetey, Asante, Kyei and Gockel, 1990: 20-21). The Bank of Ghana took a far more flexible attitude to the enforcement of the sectoral ceilings than it did with the global ceilings.¹⁶ The reserve requirements were not generally a binding constraint on bank lending because the credit ceilings, which target the same aggregate, were more restrictive. As a result the banks held substantial excess reserves (table 3).

The next issue to be addressed is the impact of increased interest rates on loan demand. Table 4 provides indicators of lending rates for the economy in general and for manufacturing industry during 1976-90. Nominal lending rates were increased by the Bank of Ghana from a range of 9%-14% at the end of 1982 to 23.5%-26% in 1987. Lending rates ranged between 20% and 30.25% following interest rate liberalisation in September 1987. The actual interest rates charged to many firms were probably higher than the nominal rates displayed in table 4 by several percentage points if various transactions charges are included. Real lending rates have risen during the ERP but also fluctuated considerably because output price inflation has been erratic. Despite the rise in real interest rates, real lending rates have not appeared to be excessively high during the ERP: the average real rate for borrowing by manufacturers remained negative during 1984-90.

Nevertheless the fact that nominal interest rates have been high, especially since 1987, may have been a significant deterrent to investment. The real rates displayed in table 4 are *ex post*; ie nominal interest rates deflated by the actual rates of output price inflation prevailing contemporaneously. Borrowing decisions must of necessity be based on *ex ante* or expected real rates of interest because when firms contract loans they do not know

16. As the sectoral ceilings did not form part of the performance criteria of the IMF standby agreement, failure to rigorously enforce them did not endanger continued IMF support.

Table 4: Nominal and Real Lending Rates Percent Per Annum 1976-90

Year	Nominal Lending Rates	Real Lending Rates: GDP	Real Lending Rates: Manufacturing
1976	12.5	-12.1	-7.7
1977	12.5	-32.7	-17.6
1978	15.5	-33.4	-25.7
1979	18.5	-15.3	-27.0
1980	18.5	-20.5	-14.5
1981	21.4	-30.8	-24.4
1982	16.9	-8.7	29.4
1983	15.3	-48.3	-55.0
1984	20.0	-11.3	-45.1
1985	23.0	1.9	-34.7
1986	23.0	-13.2	-6.7
1987	30.0	-6.6	10.6
1988	30.1	-2.5	0.2
1989	30.3	1.6	-4.8
1990	30.3	-7.0	1.0

The nominal lending rate is the maximum rate charged on commercial bank secured by stocks - rates refer to averages during the year. The real lending rate for GDP is derived by deflating the nominal lending rate as defined above by the annual change in the GDP deflator. The real lending rate for the manufacturing sector is derived in a similar manner, using the manufacturing value added deflator and the nominal lending rates charged on loans secured by stocks, with the exception of 1984-86 when a specific lending rate for manufacturing was stipulated by the Bank of Ghana.

Sources: Quarterly Digest of Statistics and Bank of Ghana Annual Reports.

the rate of inflation that will prevail during the period for which their loan is contracted. Whereas ex post real rates may appear to have been low because actual inflation rates were high, we do not know what ex ante rates were for potential borrowers. The servicing of loans at interest rates of around 30% or more per annum means that firms must rely on high rates of inflation of the prices of their own products in order to generate sufficient cash flow. The higher nominal interest rates are, the more sensitive is a firm's balance sheet to variations in inflation rates. Given the anti inflationary objectives of economic policy, cautious investors may have been reluctant to rely on high rates of price inflation to secure the viability of their projects. A regime of high nominal interest rates combined with high but variable inflation rates increases the risk of investment for highly geared firms.

The increases in lending rates are therefore likely to have had some adverse effect on loan demand and investment. Nevertheless the correlation between the credit ceilings and the actual stock of credit combined with the survey evidence of credit shortages suggests that the impact of higher lending rates was not sufficient to eliminate excess demand in credit markets at the aggregate level. As such the more important impediment to borrowing

was likely to have been the availability rather than the cost of capital.¹⁷

6. How Important were Credit Constraints for Private Investors?

Although the ERP brought about a marked improvement in the economy with real GDP growth averaging 5% per annum during 1984-90, a reduction in macroeconomic imbalances and the restoration of incentives for exporters, private investment rates remained very depressed. Private investment averaged just over 4% of GDP during 1984-90 and in real terms displayed very little increase from the levels prevailing prior to the ERP (World Bank, 1991). Most of the largest investment projects (mainly in the mining sector) were financed with foreign capital. To what extent therefore can the lack of a more vigorous investment response to the policy reforms of the ERP be attributed to constraints in credit markets and to monetary policy restrictions in particular?

The evidence discussed in section 5 indicates that private borrowers faced quantitative constraints in credit markets and that the binding, constraint on aggregate credit arose from the credit ceilings. Given the private sector's dependence on bank credit for outside finance, this would almost certainly have curtailed their expenditures, including the purchase of fixed capital. However we do not know the extent to which investment was constrained, ie had lending been less restricted, how much more investment would have taken place? This is a question which raises several issues: the level of excess demand for credit which prevailed during the ERP, the credit worthiness of potential borrowers, the funds available to the commercial banks, the macroeconomic consequences of higher levels of private borrowing and the policy reactions to these consequences.

Although we can only speculate as to the hypothetical consequences of a less restrictive credit policy, it is plausible that the banks would have been reluctant to permit a large expansion of their loan portfolios which would inevitably have involved lending to less creditworthy borrowers. For a number of reasons the commercial banks faced considerable difficulties in accommodating potentially risky borrowers. Until the bank restructuring programme was implemented in 1989-91, their capital base was weak and many banks were carrying large portfolios of non performing loans. Their capacities for

17. This situation may have begun to change. The credit ceilings were removed in 1992 with the Bank of Ghana auctioning securities in order to absorb excess liquidity and thus prevent it being channelled into increased lending. This has involved further rises in lending rates to between 30% and 40% per annum. Several manufacturers told the author in 1993 that they regarded the lending rates that they were then being charged as excessive. With consumer price inflation estimated at around 23% in the first half of 1993 real lending rates were of the order of 7-17% per annum.

evaluating and monitoring risky borrowers were not strong, especially as up to date financial accounts and other relevant information about borrowers were often unavailable. Many of their prospective customers had little experience in preparing adequate loan applications, business plans and other material which would assist the banks to evaluate their credit worthiness.

Assessing the viability of prospective borrowers would have been made more difficult because the policy reforms of the ERP had major distributional consequences, benefitting some firms at the expense of others, and because firms faced greater competition in domestic markets through trade liberalisation. The extent to which banks could compensate for default risks by charging higher rates of interest was limited by interest rates controls until September 1987 (when controls were abolished), and by adverse incentive and selection problems. Potential borrowers often lacked adequate collateral, a problem exacerbated by the failure to revalue their capital assets in line with inflation (World Bank, 1986: 44-48). The real value of non tradeable assets commonly used as collateral (such as property) would also have been eroded by exchange rate devaluation.

7. Conclusion

Since 1983 a major programme of stabilisation and market oriented policy reforms known as the ERP has been implemented in Ghana. The ERP included policy measures to boost financial savings through higher nominal and real interest rates and to reduce public sector crowding out of the private sector in credit markets. Although the efforts to deepen financial markets achieved only modest success there was a substantial reduction in government borrowing from the domestic banking system. Despite this the real volume of bank credit supplied to the private sector recorded only a small rise during the ERP with the stock of private borrowing remaining at very low levels as a percentage of GDP. Shortages of credit are likely to have had an adverse impact on private investment and to have been one of reasons why private investment levels remained depressed during the ERP.

The principal constraint on a more vigorous expansion of private borrowing was the global credit ceilings applied by the Bank of Ghana to the banks as part of its strategy to control inflation. The persistence of moderately high levels of consumer price inflation necessitated maintaining a restrictive credit policy during the ERP. Because of the strong growth in the money supply during the ERP combined with the high velocity of circulation of money, a large share of the burden of controlling inflation fell on private sector borrowers. The impact of monetary policy restrictions on the private sector was exacer-

bated by the large proportion of non performing loans in the portfolios of the banks, the lack of alternative sources of finance for firms other than bank loans and the rise in the cost of capital and intermediate goods as a consequence of exchange rate devaluation.

The experience of Ghana illustrates the difficulties involved in providing adequate finance to support private sector investment while at the same time maintaining macroeconomic stability in the context of very poorly developed financial markets. Although the credit ceilings were the binding constraint on borrowing, the shortages of credit faced by the private sector also reflected more fundamental weaknesses in financial markets in Ghana in addition to the need to maintain a counter inflationary monetary policy. These structural and institutional problems include the very low levels of financial savings and intermediation, the limited development of capital markets and of financial institutions providing venture capital and long term loans, and the financial weaknesses and inefficiencies of the existing banks.

Given that the banks are likely to remain the dominant institutions in financial markets for the foreseeable future, mobilising a much greater volume of bank deposits in real terms is imperative if private sector borrowing is to be expanded without fuelling higher inflation. In addition, although progress has been made under the FINSAP in reforming financial markets, restructuring banks and promoting the growth of new institutions, further strengthening of the financial system in terms of its diversity and efficiency is likely to be crucial to support private sector development.

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Abstract

Structural adjustment programmes in sub-Saharan Africa aim to provide incentives to stimulate an expansion of the private sector in production and trade. If the private sector is to respond positively to these incentives, it is likely to require an increase in the supply of bank credit to finance fixed and working capital expenditures. An expansion of bank credit may however face a number of institutional and policy related constraints. This paper explores these issues by examining the impact of structural adjustment on credit markets in Ghana.

Beginning in 1983, Ghana has implemented a wide ranging SAP which has included reductions in government domestic borrowing, measures to boost financial savings through higher interest rates, and other financial market reforms. Despite these reforms there was only a small increase in real terms, from a very low base, in private sector borrowing from domestic banks during the SAP. Credit shortages were reported by private sector firms to be serious constraint on their expansion, and are likely to have contributed to the very weak response of private investment to the SAP reforms.

The principal constraint on a more vigorous increase in private sector borrowing was the credit ceilings applied by the Bank of Ghana to the banks as part of its strategy to control inflation. The impact of monetary policy restrictions on private borrowing was exacerbated by the large proportion of non performing loans in the portfolios of banks, the lack alternative sources of finance for firms other than bank loans, and the rise in the cost of capital and intermediate goods as a consequence of exchange rate devaluation. The experience of Ghana illustrates the difficulties involved in providing adequate finance to support private sector investment while at the same time maintaining macroeconomic stability in the context of very poorly developed financial markets.

OFFRE DE CREDIT, POLITIQUE MONÉTAIRE ET LE PROGRAMME D'AJUSTEMENT STRUCTUREL DU GHANA

Résumé

Les programmes d'ajustement en Afrique sub-Saharienne visent à encourager le développement du secteur privé en matière de production et de commerce. Si le secteur privé devait réserver un accueil à ces encouragements, il est probable qu'une augmentation des possibilités de prêt bancaire pour financer les dépenses de fonctionnement serait exigée. Toutefois, l'expansion du crédit bancaire pourrait se heurter à des contraintes d'ordre institutionnel liées aux politiques. Ces questions sont étudiées dans ce document, se fondant sur l'impact de l'ajustement structurel sur les marchés financiers du Ghana.

Au début 1983, le Ghana a mis en oeuvre toute une série de programmes d'ajustement structurel, notamment en ce qui concerne la baisse de l'emprunt public intérieur, les mesures de renforcement de l'épargne à travers des taux d'intérêt plus élevés, et les réformes des marchés financiers. Malgré ces réformes, et durant l'application de ces programmes, il ne s'est produit qu'une petite augmentation en termes réels, partant d'une base très faible, des emprunts effectués par le secteur privé auprès des banques locales. Selon les entreprises du secteur privé, la pénurie de capitaux représente une sérieuse entrave à leur développement et il est probable que cela ait contribué au manque de réaction des investisseurs privés quant aux orientations des programmes d'ajustement structurel.

Les plafonds du crédit imposés par la Banque du Ghana aux banques locales pour contrôler l'inflation a été la principale contrainte à une augmentation plus conséquente des emprunts du secteur privé. L'impact des mesures de restriction monétaire sur les emprunts du secteur privé a été aggravé, pour une large part, par l'insolvabilité des encours de prêts bancaires, le manque d'options financières des entreprises autres que les prêts bancaires, et l'augmentation du coût du capital et des produits semi-finis, conséquence de la dévaluation du taux de change. L'expérience du Ghana montre les difficultés rencontrées dans la fourniture de financements adéquats pour soutenir les investissements du secteur privé et dans le maintien de la stabilité macroéconomique dans le contexte de marchés financiers sous-développés.



Summary

The crucial aspect to focus upon in evaluating Africa's experience in financial sector development is its savings effort, the level and quality of financial intermediation and the efficiency in resource use. On all these scores, the African financial sector has performed very badly. Upon acceding to political independence, African governments decided to remodel their financial infrastructure by the establishment of a diversified set of financial institutions - viz - commercial banks, development banks, savings banks, co-operative banks, housing finance and postal savings banks, etc. Unfortunately, the ensuing benefits have not been commensurate with the enormous costs incurred. A great deal of effort was geared towards the provision of credit rather than the mobilization of resources. The official attitude to resource mobilization has been extremely lax partly due to foreign resource inflows and partly due to the inexpensive rediscounting terms and facilities provided by the central bank.

Commercial bank branches have not yet been sufficiently diffused in the rural hinterland with the result that Africa's resource potential in the rural areas still remains untapped. Development and Co-operative banks have literally become mere retailers of foreign loans and government funds even though many were empowered to mobilize resources in their statutes of establishment. The operations of specialised financial institutions are generally insulated from competition by various legislations, and are even provided with generous subsidies. Instead of undertaking much wider and more demanding tasks, (eg. bringing in financial innovation, developing money and capital markets, broadening the monetized sector of the economy, improving the unorganized segment), central banks

in developing Africa are confined to the narrow contours of a regulator, and are circumventing financial deepening through the provision of generous accommodation to the commercial banks and the government.

Bank credit still remains a financial appendage of certain enclaves: large-scale mineral exporters, highly protected manufacturing, foreign owned undertakings, and the parastatal sector. In contrast, small farmers and indigenous small-scale enterprises remain financially repressed although they possess quite a large share of the deposit resources on which bank credit is based. These repressive influences of the formal banking system are perpetuating the enlargement of the informal sector.

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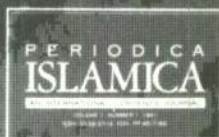
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Summary

Rural women have been one of the most consistently neglected groups in development planning and programming, and, paradoxically, one of the groups with the greatest unrealized potential. Direct access to credit, accompanied by savings, can become a catalyst for change that brings benefits to rural women, as well as to their families and communities. The book will address this issue as follows:

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— Chapter 4 discusses women's demand for credit, its assessment and promotion, with reference to both institutional credit and to savings.

— Chapter 5 provides an overview of institutional strategies for providing financial services to rural women, either separately or together with men, with extensive case illustrations; the variety of operational linkages that are being tried between credit and savings.

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