FOR AGENDA

SM/84/176

CONTAINS CONFIDENTIAL
INFORMATION

July 18, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Barbados - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Barbados. A draft decision appears on page 19.

It is proposed to bring this subject to the agenda for discussion on Friday, August 10, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Kimaro (ext. (5)7161).

Att: (1)

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INTERNATIONAL MONETARY FUND

BARBADOS

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives
for the 1984 Article IV Consultation with Barbados

Approved by E. Wiesner and W.A. Beveridge

July 17, 1984

I. Introduction

The 1984 Article IV consultation discussions with Barbados were held in Bridgetown during the period April 30-May 18, 1984. The representatives of Barbados included the Prime Minister, who is also Minister of Finance, the Governor of the Central Bank, and senior government officials. The staff team comprised Messrs. Kimaro (Head-WHD), Lin (RES), Zavoico (TRE) and Zeas (WHD), Miss Lituma (STAT), and Miss Rowles (Secretary-WHD). Mr. R. Joyce, Executive Director for Barbados, participated in the policy discussions.

The last Article IV consultation discussions with Barbados were held in early 1983 in conjuntion with a review of progress under the 20-month stand-by arrangement that had been approved by the Executive Board on October 1, 1982; the relevant documents (EBS/83/109, 5/26/83, and SM/83/82, 5/19/83) were discussed by the Executive Board on June 13, 1983. The staff conducted a second review under the stand-by arrangement in October 1983 and issued a report (EBS/84/4, 1/6/84) for the information of Executive Directors. All purchases available under the arrangement (SDR 31.875 million, or 125 percent of the old quota) were made on schedule.

The Chairman's Summing Up of the Board's discussion on the last Article IV consultation with Barbados stressed the importance of restraining wages and of raising public sector savings through curbs on the growth of current expenditure. It also emphasized the need for a policy of flexible interest rates to enhance private capital inflows and domestic savings and for an exchange rate policy that would safeguard international competitiveness. As described below, there has been further deterioration on a number of these fronts and the staff suggests a number of corrective actions.

II. Background to the Discussions

For many years Barbados has stressed the role of private investment in promoting diversified export-led economic growth. Social stability and outward-looking policies provided strong inducement for investment in tourism and manufacturing, both of which expanded and superseded the sugar sector as main sources of employment and foreign exchange earnings. In the 20-year period through 1983, gross domestic capital formation averaged about 25 percent of GDP, the trend growth of real per capita GDP was 2 percent a year, and domestic savings increased to the equivalent of nearly 80 percent of gross investment in the past five years. This savings performance facilitated a broadening of private local ownership in the major productive sectors. In recent years the Government has extended its participation in productive ventures in the tourism, energy and transportation sectors as well as in some regional enterprises.

Despite the progress made in economic diversification, Barbados' economic performance in recent years has been adversely affected by the world recession, poor weather conditions, and economic problems in the region. Real GDP declined by a cumulative 7 percent in 1981 and 1982 owing to poor sugar crops and the impact on exports and tourism of the world recession (Table 1). In 1983 real GDP stagnated as sugar production fell further and the value-added of the tourist sector in real terms declined. Moreover, manufacturing production (garments, furniture, and chemicals) for the Caribbean Community (CARICOM) customs union market was adversely affected by economic problems in the region. However, output in certain other sectors increased in 1983; production of foodstuffs rose considerably, the fish catch nearly doubled, output of crude oil grew by nearly one half to 380,000 barrels (one third of domestic requirements), and production of electronic components for export to the United States more than doubled. In reflection of the recent weakness in overall economic performance, the rate of unemployment, which had declined to less than 11 percent in 1981, increased to about 15 percent in 1983.

Despite the weakening economic performance, aggregate expenditure continued to increase in 1981, bolstered by expansionary fiscal and credit policies and relatively large increases in wages. In FY 1981/82 (April-March) the deficit of the general government in relation to GDP rose by nearly 3 percentage points to about 6 1/2 percent. Moreover, in 1981 domestic credit increased by about 30 percent (in terms of the banking system's private sector liabilities at the beginning of period), and the rise in consumer prices remained around 14 1/2 percent. As imports expanded more rapidly than earnings from exports and tourism, the deficit in the current account of the balance of payments (including transfers) widened from the equivalent of about 4 1/2 percent of GDP in 1980 to over 10 percent in 1981. This development, coupled with substantial short-term capital outflows prompted by large differentials between foreign and domestic interest rates, put pressure on official international reserves, which the authorities sought to support through recourse to foreign borrowing on commercial terms.

Table 1. Barbados: Selected Indicators

	Annual Average 1976-80	1980	1981	1982	Prel. 1983	Est. 1984 1/
	(Percentage change)					
Nominal GDP	15.5	28.3	10.9	4.4	6.0	10.3
Real GDP	5.1	4.8	-2.6	-4.3	--	2.2
Tourism 2/	13.8	7.1	-11.3	-24.5	-8.8	5.0
Sugar production (tonnage)	8.9	15.3	-28.6	-8.6	-3.1	17.4
Manufactured production (real value-added)	12.9	1.9	-3.6	0.4	-0.1	0.8
Consumer prices	9.7	14.5	14.6	10.3	5.3	6.5
Wages	12.4	18.8	12.7	10.6	6.1	10.8
Unemployment rate (in percent)3/	14.0	12.7	10.8	13.8	15.0	14.8
	(In percent of GDP)					
Balance of payments current account deficit	-5.0	-4.6	-10.2	-3.9	-4.1	-2.6
External public debt 4/	11.3	12.2	21.2	25.2	29.8	29.5
Debt service ratio 5/	4.0	5.4	5.2	6.8	6.5	10.2
	1976/77-1980/81	1980/81	1981/82	1982/83	Prel. 1983/84	Budget 1984/85
Overall deficit of general government 6/	-3.6	-3.6	-6.4	-2.6	-1.2	-1.6

Sources: Central Bank of Barbados; and Fund staff estimates.

1/ Reflecting present policy stance; in particular, estimates for the external current account and the overall deficit of the general government incorporate the impact of a recent decision to cut back total budgeted expenditure for FY 1984/85 by the equivalent of 2 percentage points of GDP.
2/ Total number of tourist days.
3/ Quarterly averages; unemployed persons comprise those actively seeking work within a three-month period prior to the date of interview.
4/ Includes Central Bank debt.
5/ As a percent of receipts from merchandise exports and tourism.
6/ Comprises the Central Government and the Social Security System (NIF).

To arrest the financial deterioration, the authorities initiated adjustment measures in late 1981 which in the following year were consolidated into a stabilization program supported by use of Fund resources. The program provided for a tightening of demand policies, including a reduction in the fiscal deficit and in the rate of domestic credit expansion. The program also envisaged restraint in wages, caution in external borrowing on commercial terms, and increased flexibility in the management of domestic interest rates. Implementation of the program led to an improvement of the internal and external financial situation. Substantial revenue measures resulted in an average annual growth of about 14 percent in general government revenue in FY 1982/83 and FY 1983/84, and the revenue-GDP ratio, which had declined from over 28 percent in FY 1979/80 to 26 1/2 percent in FY 1981/82, increased to about 31 percent in FY 1983/84. Meanwhile, the authorities curbed the growth of both current and capital expenditure, thereby facilitating an expansion in budgetary savings and a reduction of the overall fiscal deficit to 2.6 percent of GDP in FY 1982/83 and 1.2 percent in FY 1983/84 (Table 2).

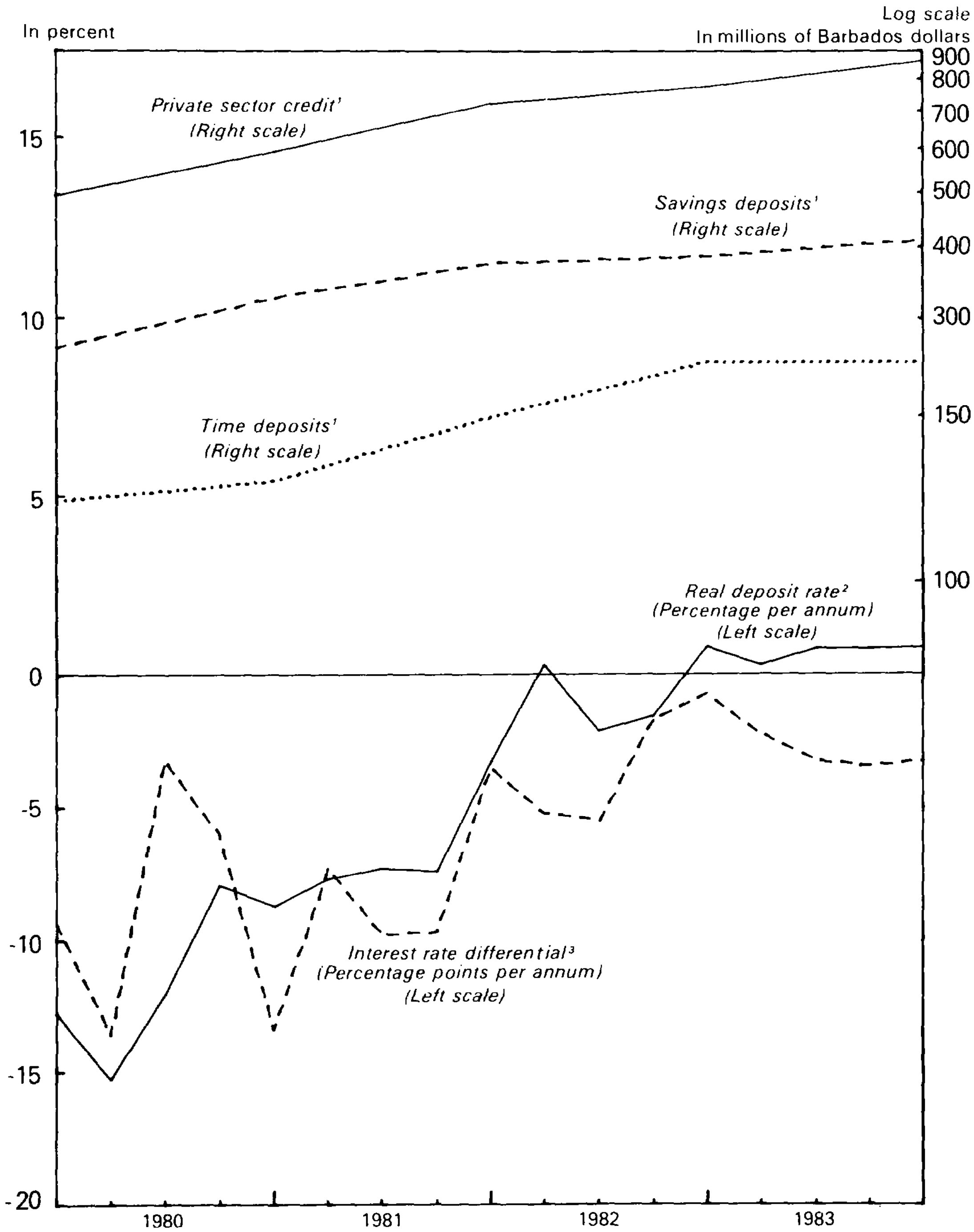
The banking system's net domestic assets rose by about 7 percent in 1982, broadly in line with the growth in liabilities to the private sector (Table 3). In 1982 the differential in favor of interest rates abroad was also sharply reduced (Chart 1). The relatively tight monetary policy maintained throughout 1982 was relaxed somewhat in 1983 when the banking system's net domestic assets expanded by about 11 percent; the Central Bank's net domestic assets rose by over 17 percent, largely because of the construction of its own office building which was partly financed by a medium-term foreign loan. Credit to the private sector grew by over 10 percent, partly to finance a rebuilding of inventories as well as increased imports of consumer durables prompted by a liberalization of automobile imports. Commercial banks financed part of their domestic credit operations through foreign borrowing, as credits financed with externally acquired resources was exempted from interest rate ceilings. The banking system's liabilities to the private sector increased by less than 4 1/2 percent in 1983, or well below the growth of nominal GDP, probably because of renewed short-term capital outflows induced by the renewed widening of interest rate differentials in favor of assets denominated in foreign currencies.

During the program period in 1982-83, wage increases moderated and domestic inflation abated. The rise in consumer prices decelerated to nearly 10 1/2 percent in 1982 and 5 1/2 percent in 1983, aided in part by the trend of import prices. Moreover, the external current account deficit declined to the equivalent of 4 percent of GDP in 1982 from more than 10 percent in the preceding year as imports fell by 5 percent and domestic exports (notably electronic components) increased by 25 percent

CHART 1

BARBADOS

SELECTED MONETARY VARIABLES



Source: Central Bank of Barbados.

[1] By the Banking System.

[2] Difference between the nominal interest rate on 90-day deposits at the end of the period and the increase in the consumer price index during the previous twelve months.

[3] On 90 day deposits in favour of the United States (i.e. Barbados rate minus U.S. rate).

Table 2. Barbados: Consolidated Accounts of the Central Government and the National Insurance Fund (NIF)

	1980/81	1981/82	1982/83	Prel. 1983/84	Proj. 1984/85 1/
	(In millions of Barbados dollars)				
Total revenue 2/	468.2	510.6	601.4	662.5	731.8
Of which: income, profits, and payroll levies	164.0	171.4	213.3	216.7	227.0
Consumption taxes	108.2	121.0	127.9	149.6	171.6
Import and stamp duties	94.8	95.0	92.2	115.5	138.5
NIF net of transfers	41.1	57.9	103.0	117.1	129.4
Total expenditure and net lending	531.0	634.0	652.7	688.4	770.0
Current expenditure	392.0	459.4	510.1	542.2	615.1
Wages and salaries	171.7	183.7	196.6	201.2	...
Transfers	132.5	145.1	128.8	146.7	...
Interest	29.9	52.4	71.1	62.7	65.7
Goods and services	38.6	41.9	47.3	53.8	...
NIF	19.3	31.1	64.8	76.1	91.1
Current surplus	74.0	49.6	89.5	117.1	114.7
Capital expenditure and net lending	139.0	174.6	142.6	146.2	154.9
Overall deficit	-62.8	-123.4	-51.3	-26.1	-38.2
Foreign financing	78.0	91.1	51.9	30.2	26.7
Drawings	89.6	104.3	66.5	64.6	49.7
Amortization	-10.9	-13.2	-14.6	-34.4	-23.0
Domestic financing	-15.2	32.3	-0.6	-4.1	11.5
Banking system	8.7	51.9	-5.5	-0.7	...
Other	-23.9	-19.6	4.9	-3.4	...
	(As percent of GDP)				
Current revenue	26.9	26.5	29.9	31.1	31.1
Current expenditure	22.7	23.9	25.5	25.5	26.3
Current surplus	4.3	2.6	4.5	5.5	4.9
Capital expenditure and net lending	8.0	9.1	7.1	6.9	6.6
Overall deficit	-3.6	-6.4	-2.6	-1.2	-1.6
Foreign financing	4.5	4.7	2.6	1.4	1.1
Domestic financing	-0.9	1.7	--	-0.2	0.5
Of which: banking system	(0.5)	(2.7)	(-0.2)	(--)	(...)

Sources: Ministry of Finance and Planning; and Fund staff projections.

1/ The figures differ from those in the originally announced budget because they reflect the intended cutback in expenditure and minor revisions on the revenue estimates.
2/ Includes capital receipts averaging about BDS$2 million per year.

Table 3. Barbados: Selected Monetary Indicators

	1980	1981	1982	1983	March 31 1983	March 31 1984
I. Summary Operations of the Banking System						
(Changes in percent) 1/						
Net foreign assets	5.9	-11.0	0.4	1.1	-7.0	-1.2
Net domestic assets	13.3	29.7	7.0	10.9	21.3	13.5
Credit to general government	(-1.3)	(7.1)	(2.1)	(-1.5)	(7.0)	(-0.7)
Private sector	(16.1)	(18.3)	(6.1)	(10.1)	(15.8)	(10.9)
Liabilities to the private sector	17.3	13.9	7.4	4.4	12.3	4.9
II. Interest Rates (end of period)						
Discount rate	7.0	22.0	20.0	16.0	20.0	16.0
Commercial banks' maximum weighted lending rate	10.0	15.0	13.0	11.5	13.0	11.5
Savings deposit rate	5.1	8.0	6.0	5.3	6.0	5.3
Time deposits (90 days)	5.3	9.0	8.0	6.5	7.5	6.5
III. Reserve Requirements (end of period)						
(As percent of deposit liabilities)						
Required reserves	20.0	25.0	27.0	27.0	27.0	27.0
Cash	8.0	8.0	8.0	8.0	8.0	8.0
Government securities	12.0	17.0	19.0	19.0	19.0	19.0
Excess reserves	8.1	3.2	5.1	2.0	2.4	3.8
Cash	0.5	0.3	1.1	0.7	--	0.1
Government securities	7.6	2.9	4.0	1.3	2.4	3.7

Sources: Central Bank of Barbados.

1/ In relation to liabilities to the private sector at the beginning of the period; figures in the last two columns refer to year ending March 31.

(Table 4).1/ As a result, the overall balance of payments deficit declined substantially in 1982, notwithstanding a sharp drop in net capital inflows. In 1983 the external current account deficit remained largely unchanged in terms of GDP even though merchandise exports rose by about 30 percent on the strength of further growth of electronic components. This lack of improvement in the current account in 1983 was mainly attributable to stagnation in tourist earnings, and to a strong expansion in imports of project-related capital goods and, to a lesser extent, of consumer goods. In 1983 there was a sharp increase in drawings on government and government-guaranteed external loans and in other capital inflows related to the construction of the Arawak cement plant, and the overall balance of payments registered a small surplus.

At end-1983 gross official international reserves amounted to about US$128 million (about 2 1/2 months of that year's retained imports). However, these reserves included US$60 million of illiquid claims against the suspended Caribbean Multilateral Clearing Facility (CMCF) to which Guyana is the principal debtor, and US$6 million in overdue claims against Jamaica.

Barbados' government and government-guaranteed external debt increased by about 9 percentage points of GDP to 22 percent during 1981. In the following two-year period, under the stand-by program, the external debt rose by approximately 4 percentage points of GDP annually, reaching about US$317 million (30 percent of GDP) at the end of 1983. The buildup of external debt in 1981 was mainly in the form of medium-term commercial borrowing. In 1982 and 1983, taken together, about 40 percent of the accumulation in debt represented purchases from the Fund, and the rest consisted largely of borrowing to finance a number of development projects now virtually completed. Debt service payments increased from the equivalent of less than 5 percent of export and tourism receipts in the 1979-80 period to 6 1/2 percent in 1983.

Since mid-1975 the Barbados dollar has been pegged to the U.S. dollar at a rate of BDS$2 per U.S. dollar. During the five-year period through 1983, the exchange value of the Barbados dollar, adjusted for relative consumer price movements, increased by approximately 20 percent against the currencies of countries which account for most of Barbados' tourism and merchandise trade (Chart 2). Meanwhile, unit labor costs in Barbados in relation to those of the manufacturing sector in the United States rose by nearly 25 percent.

1/ Since about 1982 the official estimates of tourism receipts used in compiling the balance of payments do not fully reflect large discounts offered on hotel rates. It is also probable that net contribution to the external current account of the rapidly expanding subsector of electronic assembly may be overstated. Because of these statistical weaknesses, which stem largely from the methods used to derive the data, there is a need for caution in interpreting developments in the current account of the balance of payments.

Table 4. Barbados: Balance of Payments

(In millions U.S. dollars)

	1980	1981	1982	Prel. 1983	Est. 1984 1/
Current account	-39.9	-97.7	-38.6	-43.1	-30.4
Trade balance	-368.3	-408.4	-341.8	-348.6	-352.9
Exports, f.o.b. 2/	167.9	175.2	211.9	276.4	306.9
Of which: domestic exports	150.1	150.3	187.4	259.5	290.4
Sugar	57.8	31.7	35.5	26.8	33.1
Electronic components	24.3	38.6	60.9	133.2	159.8
Other	68.0	80.0	91.0	99.5	97.5
Imports, c.i.f. 3/	536.2	583.6	553.7	625.0	659.8
Of which: retained imports	457.3	508.1	480.5	556.6	589.3
Tourist receipts (net)	234.5	241.9	228.6	232.5	242.0
Interest on public external debt	-6.7	-12.5	-18.1	-21.4	-25.7
Other services (net)	79.1	63.2	69.4	74.4	83.2
Unrequited transfers (net)	21.5	18.1	23.3	20.0	23.0
Capital account (net)	66.4	127.8	30.9	95.6	65.0
Official capital (including exceptional financing) 4/	27.8	47.9	11.4	38.2	9.0
Other long-term	4.8	34.9	14.9	60.3	48.5
Government guaranteed (including Central Bank)	(4.2)	(4.0)	(1.9)	(26.2)	(21.5)
Commercial banks	(-3.7)	(2.0)	(2.5)	(12.7)	(--)
Other	(4.3)	(28.9)	(10.5)	(21.4)	(27.0)
Short-term capital (including valuation adjustment)	31.5	43.0	4.6	1.3	7.5
Errors and omissions	-6.6	-54.9	2.0	-46.8	-45.0
SDR allocation	2.3	2.0	--	--	--
Overall balance	19.9	-24.8	-5.7	5.7	-10.4
Change in net official reserves (increase -)	-19.9	24.8	5.7	-5.7	10.4
	(In percent GDP)				
Memorandum items					
Current account	4.6	10.2	3.9	4.1	2.6
External public debt	12.7	21.9	25.3	29.8	29.5
	(In percent)				
Change in the terms of trade	-1.9	7.3	0.7	-0.2	1.2
	(In millions of U.S. dollars; end of year)				
Gross official international reserves	80.0	103.4	125.7	128.2	117.8
Of which: liquid reserves	(60.4)	(66.5)	(52.7)	(43.4)	(33.0)
External public debt	109.9	203.4	252.0	317.0	345.5

Sources: Central Bank of Barbados; and Fund staff estimates.

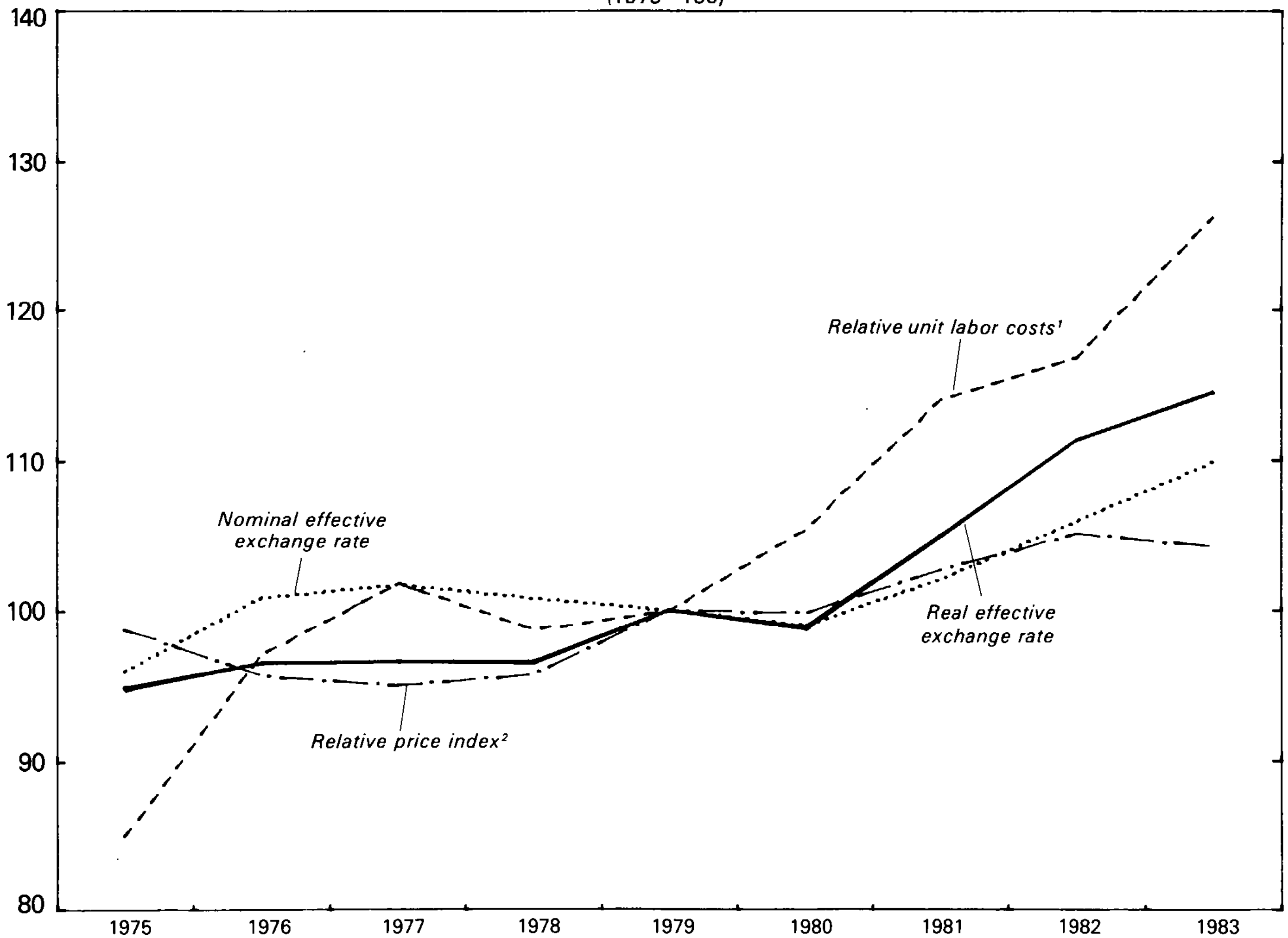
1/ Reflecting present policy stance.
2/ Includes domestic exports and re-exports other than bunkers.
3/ Includes retained imports of bunkers and other re-exports.
4/ Including budgetary borrowing to support the balance of payments of US$18 million and US$30 million in 1980 and 1981, respectively.

CHART 2

BARBADOS

INDICES OF COMPETITIVENESS

(1979 = 100)



[1]Barbados unit labor costs divided by U.S. unit labor costs in maufacturing.
[2]Barbados consumer prices divided by weighted consumer prices of the trading partners.

Import quotas on passenger and small commercial vehicles were eliminated in early 1983. Moreover, differential fees on purchases of foreign exchange, which had constituted a multiple currency practice, were eliminated at the end of May 1983. The exchange system is presently free of restrictions on payments and transfers for current international transactions.

III. Review of the program for FY 1983/84

The consultation discussions provided an occasion to review performance under the recently completed stand-by arrangement. The implementation of the financial program for FY 1983/84 was satisfactory, and all performance criteria through end-March 1984 were observed (Table 5). The decline in the overall deficit of the general government exceeded the program target because of a better-than-expected revenue performance. This, together with continued wage restraint, played a role in the abatement of domestic inflation. Because of the various factors cited above, the external current account deficit as a percent of GDP remained largely unchanged in 1983, but well below the program target which had been set in anticipation of weaker export growth. Owing to the substantial increase in capital inflows, the balance of payments nonetheless registered a small overall surplus in 1983, instead of a deficit foreseen under the program.

In FY 1983/84 progress also was made in other areas. The observance of the limitation on external debt authorization, coupled with the repayment by the Central Bank of some of its commercial foreign debt, contributed to an overall improvement in the external debt profile. Moreover, the financial position of the nonfinancial public enterprises (NPEs) improved, resulting in a reduction of budgetary transfers to these entities. Budgetary transfers to the Transport Board, however, exceeded the originally envisaged level because of delays in implementing measures that would have improved collection of fares. Furthermore, wide differentials between foreign and domestic interest rates emerged in the latter part of the program period and contributed to short-term capital outflows.

IV. Economic Prospects and Policy Discussions

1. Economic prospects

In 1984 real GDP is expected to expand by 2 percent, reflecting a modest recovery in most sectors, except for the regionally-oriented manufacturing industries. Unemployment is projected to fall slightly, and consumer prices are likely to increase by about 6 1/2 percent, or somewhat higher than the rise in import prices, because of some intensification of price pressures following relatively large wage increases.

Table 5. Barbados: Performance Under the Stand-By

	Dec. 1982	1983 March	1983 June	1983 Sept.	1983 Dec.	Mar. 1984
A. Quantitative Performance Criteria (End of Period)						
(In millions of Barbados dollars)						
Net domestic assets 1/						
Limit	111	97	69	83	74	85
Actual	48	53	29	56	43	34
Banking system credit to the nonfinancial public sector						
Limit	180	151	154	168	182	156
Actual	159	136	140	147	147	122
(In millions of U.S. dollars)						
External debt authorization 2/						
Limit	35.0	35.0	45.5	45.5	45.5	45.5
Actual	20.5	20.5	20.5	20.5	24.7	24.7

B. Selected Indicators

	1982/83 Program	1982/83 Actual 3/	1983/84 Program	1983/84 Prel. 3/
(In percent of GDP)				
Fiscal performance (General government)				
Revenue	29.0	29.9	30.0	31.1
Total expenditure	32.6	32.6	32.4	32.4
Current savings	2.5	4.5	3.8	5.5
Overall deficit	-3.5	-2.6	-2.3	-1.2
(Changes in percent) 4/				
Money and credit				
Domestic credit	10.0	7.0	13.4	10.9
Public sector	4.3	2.1	4.6	-1.5
Private sector	10.1	6.1	10.5	10.1
Liabilities to the private sector	11.2	7.4	9.1	4.4

	1982 Program	1982 Actual	1983 Program	1983 Prel.
Balance of payments				
Domestic exports 5/	10.1	24.7	8.5	38.5
Retained imports 5/	3.5	-5.4	3.3	15.8
Tourist receipts 5/	-4.0	-3.5	4.8	0.2
Current account (as percent of GDP)	-10.0	-3.9	-8.2	-4.1
Overall balance (in millions of US$)	-32.5	-5.7	-10.0	5.7
Other indicators				
Real GDP 5/	-2.2	-4.1	0.1	--
Consumer prices 5/	9.7	10.3	8.8	5.3
External public debt (as percent of GDP)	25.3	25.2	30.3	29.8
Debt service ratio 6/	7.6	6.8	8.4	6.5

1/ Defined as currency issue and the counterpart of any new issue of SDRs less net international reserves.
2/ Authorizations (cumulative) of government and government-guaranteed debt with maturities of one to ten years.
3/ Because of recent official revisions, the GDP figures used in deriving the various ratios in these columns are slightly different from those used in drawing up the programs.
4/ In relation to liabilities to the private sector at the beginning of the period.
5/ Annual percent increase.
6/ Amortization and interest as a percent of merchandise exports and tourism receipts.

Regarding prospects in specific sectors, production of foodstuffs, fishing and electronic components are expected to continue to increase, but the growth of output in the rest of the export sector is likely to be modest. Owing mainly to favorable weather, sugar production in the 1984 crop season just ended increased by 17 percent to slightly more than 100,000 metric tons, but it was still below the break-even level of 135,000 tons. In 1984, as in the preceding two years, the sugar industry will need considerable financial support owing to the relatively low level of output, rising labor costs, and the appreciation of the Barbados dollar against the ECU, in which guaranteed prices for sugar exports to the European Community are quoted. In the tourist sector, the total number of tourist days is projected to increase by about 5 percent in 1984; the recovery in arrivals from countries whose currencies have depreciated against the Barbados dollar will probably remain weak and occupancy rates are expected to remain low, with adverse effects on the hotel industry's financial situation. Output of the regionally-based manufacturing industries is expected to decline further as the economic problems of major trading partners in CARICOM are likely to persist.

The originally announced budget for FY 1984/85 provides for increases of 19 percent and 11 1/2 percent of total expenditure and revenue of the general government, respectively, and an overall deficit equivalent to about 3 1/2 percent of GDP. The rise in expenditure reflects mainly public sector wage awards averaging 12 percent this fiscal year; increases of 21 percent in noncontributory pensions; and a boost in capital expenditure, partly to provide jobs. The increase in revenue will derive mostly from the expansion of the tax base. Discretionary revenue measures include numerous concessions on personal taxation aimed at "inflation-proofing" previous tax allowances and at promoting personal savings, and on corporate taxation to alleviate financial problems induced by the recession. The most important revenue-generating measure is an increase from 3 percent to 5 percent in the stamp duty on imports, which was deemed appropriate in view of the relative cheapening of imports resulting from the recent effective appreciation of the Barbados dollar. Tax rates on cigarettes and alcohol consumption, betting and entertainment, and property transfer also were increased.

The recent wage award in the public sector provides, in addition to the increase of 12 percent in FY 1984/85, for a further upward adjustment of 5 percent in FY 1985/86. Thus far, two-year wage settlements in the private sector have been broadly in line with those awarded by the Government.

The balance of payments estimates for 1984 shown in Tables 1 and 4 reflect the above-described growth prospects for exports and the impact of recent remedial measures which are outlined in the following section. Earnings from merchandise exports and tourism are projected to increase by about 14 percent. Imports are expected to rise only by about 5 1/2 percent, with a decline in project-related capital goods partly offsetting a strong expansion in consumer goods imports induced by the increase in wages. The external current account deficit is projected to fall to about 2 1/2 percent of GDP. Capital inflows are expected to decline considerably, however, owing to the completion of major investment projects and reduced foreign borrowing by the commercial banks; as a result, the overall balance of payments is expected to revert to a deficit.

2. Policy discussions

At the expiration of the program for FY 1983/84, Barbados' external financial situation remained fragile. Liquid official international reserves at end-March 1984 were equivalent to only about one month of estimated imports. Accordingly, there remained a need to strengthen the external current account position further in order to increase the international reserves while avoiding an excessive buildup of external debt.

On the basis of the economic outlook for 1984, present wage policies, and the budget originally announced for FY 1984/85, Barbados' external position in 1984 would have deteriorated substantially. The discussions therefore focused on policies that would bolster the external position in the period immediately ahead. The authorities agreed that it would be appropriate to build up official reserves by the equivalent of about two weeks of imports and that the ratio of government and government-guaranteed debt to GDP should be stabilized at around the level prevailing at the end of 1983; this would require an effort virtually to eliminate the external current account deficit. They recognized that attainment of these objectives would call for substantial measures to strengthen the current account balance.

Regarding the strategy for promoting the adjustment that is required, the staff underlined the need for a multi-faceted effort embracing the curtailment of budgetary expenditure, a tighter credit policy, and an increased flexibility in interest rates. In addition, the recent appreciation of the real effective exchange rate and the relatively weak performance of the main export sectors, including tourism, suggested a need for an adjustment in the exchange rate. The staff took the position that a program encompassing all these measures would promote the needed improvement in the external position without a further increase in the already high level of taxation, or a drastic cutback in budgetary expenditure at a time when unemployment was relatively high. The mission stressed that any exchange rate adjustment would, of course, need to be supported by restraint in wages in order to ensure an improvement in external competitiveness, and a strengthening of financial profitability in tourism and other traditional export industries. The staff also expressed the view that improved export performance, including a reorientation of the regionally-based industries toward less protected third markets, offered the best avenue for accelerating Barbados' economic growth, and for reducing unemployment from the present relatively high level.

In responding to the general strategy outlined by the mission, the authorities said that the magnitude of the required adjustment would depend upon whether a solution to Barbados' outstanding claims against the CMCF can be found soon. Furthermore, the authorities felt that the adjustment problems could be dealt with adequately through tighter demand management policies and through policies aimed at strengthening the performance of the export sectors other than through the exchange rate. They were confident that the adjustment strategy they were envisaging would obviate the need for exchange rate adjustment, which might, among other things, provoke a price-wage spiral.

a. Fiscal policies

The authorities indicated that both current and capital expenditure of the general government would be scaled down from the originally budgeted level in roughly equal amounts totaling the equivalent of about 2 percentage points of GDP. This would result in an overall fiscal deficit equivalent to about 1 1/2 percent of GDP in FY 1984/85, slightly above the deficit of the previous fiscal year. The curtailment of current outlays would derive partly from savings on wages and salaries owing to the suppression of a system under which substitute teachers are hired during the vacations of permanent teachers. The reduction of capital expenditures would fall mostly on new projects without foreign financing.

The staff pointed out that the indicated cutback in expenditure did not appear sufficient to secure a fiscal improvement consistent with the targeted external position. The authorities said that they would review the capital expenditure program in order to identify scope for extra expenditure savings, particularly from the domestically financed projects. They also stated that they would be monitoring developments in the balance of payments situation and that, if needed, they would consider additional revenue measures, including a further increase of the stamp duty on imports to raise revenue by the equivalent of about 1/2 percent of GDP on a full year basis.

The staff noted that despite recent progress in reducing current budgetary transfers to the NPEs, total transfers remained at more than 2 percent of GDP. The mission also inquired about the possible budgetary impact of two new large ventures, a US$60 million tourist complex and a US$120 million cement plant which was encountering initial marketing problems.

The authorities pointed out that in recent years total transfers to the NPEs remained substantially below the level of earlier years because of pricing and other measures taken to ensure the commercial viability of the NPEs. They were also confident that such transfers would continue to decline because the acquisition of new buses and improved fare collection would strengthen the performance of the Transport Board. In addition, various programs which were being implemented would increasingly shift responsibility for providing housing to the private sector. They also noted that the management contract of the foreign firm running the tourist complex absolved the Government of responsibility for operating losses and that, except for a modest additional equity contribution in 1984, the cement plant was expected to stand commercially on its own.

b. Monetary policies

Regarding credit developments, the authorities explained that in 1983 monetary policy had been formulated against the prospect of economic recovery which was not fully realized, partly because of the tightening of import restrictions by Trinidad and Tobago toward the end of the year. They agreed that under the present circumstances there was a need for tighter credit policy which they would pursue through selective credit controls. Moreover, they did not expect further foreign borrowing by the commercial banks to support lending operations in Barbados in 1984. The staff observed that while selective controls could secure a deceleration in credit expansion, they could easily be circumvented and, in any event, they would introduce further distortions in the credit market. For these reasons, the staff suggested that the needed tightening of credit expansion should be supported by an increase in the cash reserve requirement, a tight overall rediscount policy and increased flexibility in interest rates.

The Central Bank fixes minimum interest rates on savings and time deposits, maximum average lending rates of commercial banks, maximum rates for residential and commercial mortgages, and a variety of preferential rediscount rates. In 1983 and early 1984, continued wide differentials between foreign and domestic deposit rates have contributed to substantial capital outflows. To avoid distortions in the financial system and to reduce incentives for capital outflows, the mission urged the removal of interest rate ceilings or, as a minimum, an increase in the commercial banks' fixed average lending rate to a level which would allow domestic deposit rates to be competitive with foreign rates. The authorities stated that they had been reviewing the interest rate structure and that some upward adjustment in officially controlled interest rates was being considered.

Following the mission's return, the authorities increased, effective July 1, 1984, the ceiling on the average lending rate of the commercial banks by 1/2 percentage point to 12 percent; this adjustment would still not make domestic interest rates competitive with foreign rates. The authorities also raised the maximum interest rate for residential as well as commercial mortgages by about 2 percentage points to 13 percent. Moreover, a decision was taken to freeze credit for distribution and personal needs at the level outstanding as of end-March 1984.

c. External policies

Regarding economic policies for the export sector, the authorities explained that their objective was to raise sugar production to a break-even level. The pursuit of this objective has entailed substantial investment in mechanization and efforts directed at improving crop husbandry and raising yields. They noted that financial support to the sugar industry dates back only a few years and has been smaller (in relation to production costs) than that extended by many sugar-producing countries in the region and elsewhere. They also expected that such support would diminish with rising output.

Concerning tourism, the authorities noted that the recent poor showing of arrivals, especially from Canada and the European countries, which together account for about 40 percent of Barbados' tourists, occurred despite large discounts which had been extended on hotel rates. They thought therefore that the unsatisfactory performance of arrivals was not because of uncompetitive prices, but rather that it pointed to a need to rethink the growth strategy for the tourist sector. In this regard, they felt that Barbados' tourism industry should be geared increasingly toward higher income tourists and, to this end, suitable strategies would be developed.

With regard to manufacturing exports, the authorities agreed that regionally-based industries should be reoriented toward third markets. They explained that this was being promoted through the provision of supporting institutional and financial facilities and through efforts that would enable Barbados to exploit the opportunities afforded under the U.S. Caribbean Basin Initiative. The authorities felt that the strong performance of electronic exports was a sign of the competitiveness of manufactures in nonregional markets.

The staff noted, nevertheless, that the medium-term prospects for expansion in foreign exchange earnings in the absence of a shift in policy orientation did not appear to be favorable. Sugar production had been characterized by a secular decline in output, yields, and acreage; cyclical recovery of tourism had been unusually weak; and regionally-based manufacturing exports were expected to decline in 1984 and to continue to face weak export demand over the ensuing years. These circumstances warranted a re-examination of the role that the exchange rate policy could play in alleviating the problems being experienced and in encouraging investment. The mission was also of the view that a reorientation into third markets of many industries now benefiting from relatively high effective protection under the CARICOM common external tariff might not be possible in the absence of an improvement in the competitive position of Barbados' producers.

The authorities felt that, given the extreme openness of their small island economy and the high import-intensity of activities in the export sector, an exchange rate adjustment would trigger a price-wage spiral and result in only a modest improvement in financial performance of establishments in the export sector. Moreover, they felt that, as in the past, the stability of the exchange rate would foster firm expectations regarding rates of return on private investment and contribute toward a high rate of capital formation in the economy.

On the basis of the debt outstanding at end-1983, and assuming a further buildup of external indebtedness consistent with the target of maintaining the debt-GDP ratio constant at the 1983 level, total debt service payments are projected to reach a peak equivalent to about 13 percent of receipts from merchandise exports and tourism in 1987; this will exceed the authorities' indicative ceiling of 10 percent for the debt service burden (Table 6). The staff pointed out that these ratios may be substantially biased downward because of possible overestimation of tourist receipts and of the relatively small contribution to value-added of the recent expansion in exports of electronic components. Moreover, the staff cautioned that failure to secure the targeted improvement in the external position could result in unsustainable growth of external debt, especially in view of Barbados' heavy dependence on essential imports and of the importance of maintaining a liberal system of trade and payments. The staff also stressed the need for restraint in external commercial borrowing by the public and private sectors, including the commercial banks.

V. Staff Appraisal

Barbados' economy entered a recessionary period in 1981 from which it is staging a slow recovery because of problems in tourism and other export sectors. After declining by a cumulative 7 percent in 1981-82 and stagnating in 1983, real GDP is expected to rise by about 2 percent in 1984. Meanwhile, the unemployment rate increased from about 11 percent in 1981 to 15 percent in 1983 and is not likely to decline significantly this year.

A deterioration in the internal and external financial situation during the initial phase of the recession in 1981 prompted the adoption of a financial stabilization program supported by the Fund. The program was implemented as planned and the financial situation strengthened in 1982 and 1983. The overall fiscal deficit of the general government declined substantially, wage increases slowed down, domestic inflation abated, and the external current account deficit declined from the equivalent of over 10 percent of GDP in 1981 to about 4 percent in 1982. The external current account did not improve further in 1983 because of a stagnation in tourist earnings and a relatively large expansion in project-related capital imports.

At the termination of the stabilization program, at end-March 1984, liquid official international reserves were equivalent to about four weeks of imports, which is low for Barbados' open economy. Subsequent wage settlements, together with the budget for FY 1984/85 which was announced in April 1984, would have strained the external

Table 6. Barbados: External Public Debt

	1981	1982	Rev. 1983	Staff Projections 1984	1985	1986	1987	1988
			(In millions of U.S. dollars)					
Total outstanding (end of period)	203.4	252.0	317.0	345.5	376.6	410.5	447.5	487.7
Debt service	21.3	29.9	33.2	56.6	55.2	78.8	93.4	93.6
Amortization	8.7	12.4	12.7	28.0	24.8	44.7	56.1	53.6
Interest	12.6	17.5	20.5	28.6	30.4	34.1	37.3	40.0
			(In percent)					
Total outstanding debt/GDP ratio	21.2	25.2	29.8	29.5	29.5	29.5	29.5	29.5
Debt service ratio 1/	5.2	6.8	6.5	10.2	9.2	12.0	13.1	12.1
Debt service ratio 2/	3.9	4.5	5.4	7.3	8.4	11.3	12.6	11.7

Source: Ministry of Finance and Planning.

1/ Ratio of Debt Service to Domestic Exports and Tourism.
2/ Excluding Central Bank debt.

financial position. To limit the adverse effects, the authorities have rolled back planned budgetary expenditure by the equivalent of 2 percentage points of GDP, which should permit a reduction of the overall fiscal deficit for FY 1984/85 to the equivalent of nearly 1 1/2 percent of GDP, or slightly above the deficit of the previous year. The authorities also intend to reinforce their efforts in the fiscal field with a selective tightening of credit for distribution and personal needs, together with a small upward adjustment in the commercial banks' maximum average lending rate.

The staff fully supports the authorities' efforts to contain the budget deficit. Moreover, the staff agrees with the authorities that a tightening in credit policy is essential to protect the external position. However, the staff is of the view that greater reliance in this regard should be placed on the cash reserve requirement, a tight overall rediscount policy, and a flexible management of interest rates, rather than on selective credit controls. Also, the staff would urge removal of interest rate ceilings in order to enhance the efficiency of the financial system and dampen incentives for capital outflows. As a minimum, a further increase in the maximum average lending rate for commercial banks is needed in order to make the yields on domestic assets competitive with those on foreign assets.

Even with the recent remedial measures, the balance of payments is expected to move into a deficit in 1984. Accordingly, to improve the reserve position while avoiding an excessive buildup of external debt, the staff is of the view that additional adjustment measures should be adopted promptly.

An adjustment strategy based exclusively on demand management and interest rate policies is unlikely to address adequately the problems of unemployment and of the export sector. Indeed, such a strategy risks having to resort to unduly deflationary policies that could accentuate the problem of unemployment. The Barbados dollar has appreciated considerably against the currencies of the major trading partners, thereby contributing to financial problems and weak growth in most export industries. Recent wage settlements in the public and the private sectors have been large in relation to the increase in productivity, and in the absence of offsetting measures, will erode further Barbados' international competitiveness. In the staff's view, there is a need to review wage setting procedures to avoid in the future, and to the extent possible reverse, the large real increases of recent years. Moreover, consideration should be given to supplementing policies of demand restraint by an adjustment in the exchange rate. Without such an adjustment, the burden that would fall on budgetary expenditure restraint in order to achieve the necessary strengthening of the external position would be very large; in the circumstances, further revenue measures might also be required, which would be undesirable in view of the already high tax burden.

It is recommended that the next Article IV consultation with Barbados be held on the standard 12-month cycle.

VI. Proposed Decision

1984 Article IV Consultation

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Barbados, in light of the 1984 Article IV consultation with Barbados conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Barbados' exchange system is free of restrictions on payments and transfers for current international transactions.

Barbados - Fund Relations
(As of May 31, 1984)

I. Membership Status

(a) Date of membership: December 31, 1970
(b) Status: Article XIV

(A) Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 34.1 million

(b) Total Fund holdings of Barbados currency: SDR 71.64 million or 210.1 percent of quota.

	Millions of SDRs	Percent of Quota
(c) Fund credit	43.59	127.8
Credit tranche	(16.87)	(49.4)
Enlarged access	(15.00)	(43.9)
Compensatory financing	(11.72)	(34.4)
(d) Reserve tranche position	2.15	6.3

III. Current Stand-by and Special Facilities

(a) Current stand-by

(i) Duration: Oct. 1, 1982 to May 31, 1984.
(ii) Amount: SDR 31.875 million.
(iii) Utilization: SDR 31.875 million.
(iv) Undrawn balance: SDR -- million.

(b) Previous stand by arrangements during past 10 years
None.

(c) Special facilities:
Compensatory financing facility

(i) SDR 12.6 million, approved October 1, 1982; overcompensation of SDR 0.9 million repurchased on April 25, 1983.

(ii) SDR 3.5 million, approved January 1, 1977

IV. SDR Department

(a) Net cumulative allocation: SDR 8.04 million.

(b) Holdings: SDR 0.95 million or 11.8 percent of net cumulative allocation.

(c) Current designation plan: None

V. Administered accounts

Gold distribution:	11,125.930 fine ounces
Distribution of profits from gold sales:	US$2.09 million.

VI. Overdue obligations to the Fund None

VII. Exchange rate: Pegged to the U.S. dollar since Mid-1985 at BDS$ 2.00=US$1.00

VIII. Last Article IV Consultation and Stand-by review took place during the period February 15 - March 3, 1983 and April 28 - May 1, 1983, and was discussed by the Executive Board on June 22, 1983 (SM/83/82 of May 19, 1983 and EBS/83/109 of May 26, 1983); a second stand-by review was held during October 21-28, 1983 (EBS/84/4 of January 6, 1984).

IX. Technical Assistance: Review of the accounting system of the National Insurance Fund (October 19-28, 1983).

BARBADOS

Area and population	
Area	166 sq. miles (430 sq. kilometers)
Population (1983)	251.8 thousand
Annual rate of population increase (1979-83)	0.3 percent
Unemployment rate (1983)	15.0 percent
GDP (1983)	SDR 1,008.7 million
	US$1,062.1 million
	BDS$2,124.1 million
GDP per capita (1983)	SDR 3,945.0

	1980	1981	1982	Prel. 1983
Origin of GDP		(percent)		
Agriculture and fishing	10.3	8.7	8.8	9.2
Manufacturing	12.2	11.5	12.1	12.3
Tourism	13.9	13.2	11.9	11.7
Construction	7.0	7.5	6.9	6.8
Government	12.7	13.3	13.5	13.5
Other	44.0	44.6	46.8	46.6
Ratios to GDP				
Exports of goods and nonfactor services	65.0	59.5	60.9	64.4
Imports of goods and nonfactor services	72.4	71.6	66.9	70.3
Current account of the balance of payments	-4.6	-10.2	-3.9	-4.1
Central government revenue	24.7	23.6	24.9	25.7
Central government expenditure	30.0	31.7	30.3	29.4
Central government savings	2.6	0.9	1.5	3.0
Central government overall surplus or deficit (-)	-5.3	-8.1	-5.4	-3.7
External public government and government-guaranteed debt (end of year)	12.7	21.2	25.2	29.8
Gross domestic savings	20.2	18.1	18.3	15.5
Gross investment	24.5	27.4	22.5	19.8
Money and quasi-money (end of year)	40.4	41.5	42.8	42.5
Annual percentage changes in selected economic indicators				
Real GDP per capita	4.6	-2.9	-4.5	-0.5
Real GDP	4.8	-2.6	-4.3	...
GDP at current prices	28.3	10.9	4.4	6.0
Domestic expenditure (at current prices)	28.7	16.2	-1.3	5.9
Investment	(29.3)	(23.7)	(-14.2)	(-6.5)
Consumption	(28.6)	(14.0)	(2.9)	(9.3)
GDP deflator	22.5	15.0	9.2	6.2
Consumer prices (annual averages)	14.5	14.6	10.3	5.3
Central government revenue	24.7	5.8	10.1	9.3
Central government expenditure	33.2	17.1	-0.1	2.8
Money and quasi-money	17.1	14.1	7.6	5.4
Money	(15.1)	(7.7)	(-0.9)	(9.1)
Quasi-money	(18.0)	(12.0)	(11.4)	(4.1)
Net domestic bank assets 2/	13.3	29.7	7.0	10.9
Credit to public sector (net)	(-1.9)	(7.1)	(2.9)	(-2.8)
Credit to private sector	(16.1)	(18.4)	(6.1)	(10.1)
Merchandise exports (f.o.b., in U.S. dollars)	24.5	0.1	24.7	38.5
Merchandise imports (c.i.f., in U.S. dollars)	21.9	11.1	-5.4	15.8
Travel receipts (gross, in U.S. dollars)	22.0	4.1	-3.5	0.2

Central government finances (fiscal year from April 1)	1980	1981	Prel. 1982	Prel. 1983
	(millions of Barbados dollars)			
Revenue	427.8	452.7	498.4	545.0
Expenditure	519.2	608.0	607.2	624.3
Current account surplus or deficit (-)	45.8	17.6	30.8	64.1
Overall surplus or deficit (-)	-91.4	-155.3	-108.8	-78.9
External financing (net)	78.7	91.2	51.9	30.2
Internal financing (net)	12.7	64.1	56.9	48.7
Balance of payments	(millions of U.S. dollars)			
Merchandise exports (f.o.b.)3/	150.1	150.3	187.4	259.5
Merchandise imports (c.i.f.)4/	457.3	508.1	480.5	556.6
Investment income (net)	-8.5	-17.3	-18.6	-21.5
Travel (gross)	253.7	264.1	254.8	255.3
Other services and transfers (net)	22.1	13.3	18.3	20.2
Balance on current and transfer accounts	-39.9	-97.7	-38.6	-43.1
Official capital (net)	27.8	47.9	11.4	38.2
Private capital and errors and omissions (net)5/	29.7	23.0	21.5	10.6
SDR allocations	2.3	2.0	--	--
Change in net official international reserves (increase -)	-19.9	24.8	5.7	-5.7

International reserve position	1980	1981	1982	1983
	(End of period; millions of SDRs)			
Central Bank (gross)	62.3	88.4	113.3	121.5
Central Bank (net)	55.3	39.6	36.7	44.0
Rest of banking system (net)	1.8	-10.3	-4.2	-5.3

1/ Fiscal years from April.
2/ In relation to liabilities to the private sector at beginning of period. Excludes contra-entry of SDR allocations.
3/ Domestic exports, i.e., excludes re-exports.
4/ Retained imports, i.e., excludes imports for re-exports.
5/ Including government guaranteed and Central Bank.