EBS/82/153
Supplement 1

CONFIDENTIAL

October 4, 1982

To: Members of the Executive Board

From: The Acting Secretary

Subject: Barbados - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Barbados agreed at Executive Board Meeting 82/121, October 1, 1982.

Att: (1)

Stand-by Arrangement--Barbados

Attached hereto is a letter dated August 23, 1982 from the Prime Minister and Minister of Finance of Barbados and the Governor of the Central Bank of Barbados requesting a stand-by arrangement and setting forth:

(a) the objectives and policies that the authorities of Barbados intend to pursue for the period of this stand-by arrangement;

(b) the policies and measures that the authorities of Barbados intend to pursue for the first period of this stand-by arrangement until April 29, 1983; and

(c) understandings of Barbados with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Barbados will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from October 1, 1982 to May 31, 1984, Barbados will have the right to make purchases from the Fund in an amount equivalent to SDR 31.875 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Until May 31, 1983 purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 16,275,000, provided that purchases shall not exceed the equivalent of SDR 9,562,500 until January 30, 1983, and the equivalent of SDR 12,375,000 until April 30, 1983.

(b) The right of Barbados to make purchases during the remaining period of this stand-by arrangement shall be subject to such phasing as shall be determined.

(c) None of the limits in (a) or (b) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Barbados' currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources and with borrowed resources in the ratio of 2 to 1 until purchases under this arrangement reach the equivalent of SDR 9,562,500, then from ordinary and borrowed resources in the ratio

of 1 to 1.2, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Barbados will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Barbados' currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota:

(a) during any period before April 30, 1983 in which the data at the end of the preceding period indicate that

(i) the limit on net domestic assets of the monetary authorities described in paragraph 8 of the attached letter, or

(ii) the limit on banking system's credit to the nonfinancial public sector described in paragraph 9 of the attached letter, or

(iii) the limit on authorizations of new public and publicly guaranteed foreign indebtedness described in paragraph 10 of the attached letter;

are not observed, or

(b) during any period after April 29, 1983 in which understandings have not been reached on exchange rate policy and on the limits in (a)(i), (ii), and (iii) above for the remaining period of the arrangement as contemplated by paragraph 11 of the attached letter, or after such understandings have been reached, while they are not being observed;

(c) during the entire period of this stand-by arrangement, if Barbados

(i) imposes restrictions on payments and transfers for current international transactions, or

(ii) introduces new or modifies existing multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Barbados is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Barbados and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Barbados' right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Barbados. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Barbados and understandings have been reached regarding the circumstances in which such pruchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Barbados, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Barbados will consult the Fund on the timing of purchases involving borrowed resources.

8. Barbados shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Barbados shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Barbados' balance of payments and reserve position improves.

(b) Any reductions in Barbados' currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arrangement Barbados shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to or of representatives of Barbados to the Fund. Barbados shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Barbados in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 13 of the attached letter Barbados will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Barbados has outstanding purchases in the upper credit tranches, Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Barbados' balance of payments policies.

Bridgetown, Barbados
August 23, 1982

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosière:

1. During 1981 and the first half of 1982 Barbados has been adversely affected by the recession in the industrial countries. Domestic factors, which led to a substantial reduction in agricultural output and oil production, exacerbated the difficulties in 1981. Real GDP contracted by 2.7 per cent last year and is projected to decline by a further 2.2 per cent in 1982; this compares with an average real growth rate of 5 per cent a year for the previous five years. The decline in output has been concentrated almost entirely in the major export sectors (sugar, tourism, and manufacturing) whose strong performance had been the driving force behind the expansion of the economy in recent years. Domestically oriented sectors, particularly construction and distribution, still remained generally buoyant. The unemployment rate fell to an all-time low of less than 10 per cent in 1981 while the rate of inflation averaged close to 15 per cent, up from 13 per cent a year in the previous two years. More recently, however, domestic activity has weakened; unemployment has begun to rise again, while the annual rate of increase in prices averaged less than 11 per cent in the first five months of 1982.

2. Domestic demand was sustained by expansionary fiscal policies last year. Measures taken in FY 1981/82 to reduce direct taxes were not matched by compensating changes in indirect taxes. Current revenue of the Central Government and National Insurance Fund rose by 9 per cent to BDS$508 million; by contrast, current expenditure rose by 17 per cent to BDS$459 million, reducing the current account surplus sharply. Despite curbs on capital spending introduced last September, capital outlays rose from BDS$140 million in FY 1980/81 to BDS$175 million in FY 1981/82. The overall deficit of the Central Government and National Insurance Fund increased from BDS$63 million (3.8 per cent of GDP) to BDS$124 million (6.6 per cent of GDP) in the same period.

3. With the slowdown in exports and tourism and the continued strength of domestic demand, the current account deficit of the balance of payments widened from US$7 million, or 1 per cent of GDP, in 1980 to US$83 million (8 per cent of GDP) in 1981. To accommodate this larger current account deficit, while still achieving a moderate increase in gross official reserves, the Government contracted a US$30 million Eurodollar loan and the Central Bank borrowed a further US$45 million on

commercial terms. Consequently, Barbados' total outstanding external public and public guaranteed debt (including debts of the Central Bank) rose from US$105 million at the end of 1980 to US$203 million at the end of 1981, amounting to 22 per cent of GDP in the latter year. Debt servicing rose to US$23 million, representing a relatively moderate 5.6 per cent of exports of goods and tourist services. The current account deficit is expected to increase further to US$103 million (10 per cent of GDP) in 1982. The increase, however, represents the impact of two large projects for which long-term financing has already been arranged.

Stabilization policies

4. The Government of Barbados considers that the development strategies and objectives which are set out in the country's Development Plan are still sound and relevant. These include the commitment to the working of a mixed economy, and the pursuit of a broadly based export-led growth. The Government recognizes, however, that in the current unfavourable international environment short-term priority has to be accorded to the implementation of a stabilization programme which is designed to reverse the deterioration in the balance of payments and in the state of public finances. In support of this programme, the Government of Barbados is requesting a stand-by arrangement with the Fund in the amount of SDR 31.875 million. At the same time, the Government is also requesting a purchase under the Decision on Compensatory Financing of Export Fluctuations.

5. Various elements of the stabilization programme have already been put in place by measures taken in September 1981, and in the budget of 1982/83. These include:

(i) measures intended to reduce the size of the fiscal deficit to less than 2 per cent of GDP by FY 1983/84; these include (a) a cut in capital expenditure in both nominal and real terms and the decision to support only ongoing projects or those financed by international development agencies; (b) strict control of the growth of current expenditure by the streamlining of public services; (c) strong public sector support for wage restraint; (d) measures to raise additional revenues which have included imposition of transport and health levies last September; a package of tax measures expected to yield the equivalent of 1.5 per cent of GDP, introduced with the 1982/83 budget; introduction (also in April 1982) of a payroll levy, yielding the equivalent of a further 1.5 per cent of GDP; and tariff changes in the major public enterprises;

(ii) restrictive credit policies, particularly on consumer credit;

(iii) moves to narrow the differential between domestic and international interest rates in order to reduce outflows of capital.

6. As a result of these measures, the deficit of the Central Government and National Insurance Fund for FY 1982/83 is now projected at BDS$72 million, or 3.5 per cent of GDP (down from 6.6 per cent in FY 1981/82). The deficit would be financed to the extent of BDS$35 million (net) with medium- and long-term loans already contracted from foreign bilateral and multilateral lending agencies, to the extent of BDS$2 million from the domestic nonfinancial sector and to the extent of BDS$35 million from the domestic banking system, which is provided for in the monetary programme described in paragraph 8.

7. Given the overriding need for Barbados to remain internationally competitive, the Government considers that wage restraint is critical to the success of the stabilization effort and to minimizing the rise in unemployment. The wage negotiation in the public sector is particularly significant, therefore, not only for its impact on the fiscal deficit but also because the level of wage settlements in the public sector is normally used as the benchmark against which settlements in other sectors are set. With this in mind, the Government has announced a new two-year wage settlement for the public service amounting to about 7 per cent a year on average.

8. Credit policies will aim at limiting the Central Bank's loss of net foreign exchange reserves to US$21 million from March 31, 1982 through September 30, 1982, to US$30 million from March 31, 1982 through December 31, 1982, and to US$25 million over the twelve months through March 31, 1983. In line with this aim and given the projected increase in currency issue, the net domestic assets of the Central Bank, defined as the difference between the currency issue plus the counterpart of any new SDR allocations, and its net international reserves, which stood at BDS$43 million at the end of June 1982, and is estimated at BDS$77 million at the end of September 1982; will not exceed BDS$111 million through the end of December 1982; and BDS$97 million through the end of March 1983. Assuming no change in the net foreign asset position of the commercial banks, the programmed Central Bank credit expansion is believed consistent with a total bank credit expansion of about 17 per cent over the twelve months through March 1983 and with an increase of about 10 per cent in credit to the private sector. These credit policies have been reinforced by increases in commercial bank liquidity requirements, selective credit controls, and restrictions on consumer installment lending. Furthermore, interest rates have now risen to levels comparable with those in international markets, and it is hoped that this will arrest the unidentified outflows on the balance of payments.

9. In line with the fiscal and credit programmes described above, the net credit of the banking system to the nonfinancial public sector, which stood at BDS$116 million at the end of March 1982, and is estimated at BDS$146 million at the end of September 1982; will not exceed BDS$180 million through the end of December 1982; and BDS$151 million through the end of March 1983.

10. In order to moderate the growth in external debt, authorizations for external debt of the public sector, defined as consisting of the Central Government, the public enterprises, and the private sector with government guarantee with maturities of at least one year and up to and including ten years, will not exceed US$35 million during the programme period. This ceiling may be revised in the context of the review described in paragraph 11 for the remaining period of the arrangement.

11. The Government of Barbados will review with the Fund the progress made in implementing its financial programme and will reach understandings with the Fund by April 30, 1983 to cover the period of the stand-by arrangement starting on April 1, 1983, which coincides with the Government's fiscal year 1983/84.

12. Barbados maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. There are fees on certain purchases of foreign exchange, for nonbalance of payments reasons, which give rise to a multiple currency practice for which the Fund has granted approval until December 31, 1982. It is planned to eliminate this multiple currency practice no later than in the next budget.

13. The Government believes that the policies set forth in this letter are adequate to achieve the objectives of its programme, but will take any further measures that may become appropriate for this purpose. Barbados will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund on such consultation.

Sincerely yours,

/s/
J.M.G. Adams
Prime Minister and
Minister of Finance and Planning

/s/
Courtney Blackman
Governor
Central Bank of Barbados