September 30, 1982 - 82/176

Statement by Mr. Joyce on Barbados
Executive Board Meeting 82/131
October 1, 1982

At the time of the last Article IV consultations with Barbados in December, 1981, it was clear that Barbados was encountering serious economic difficulties. Merchandise exports were off, tourist earnings were falling short of expectations and while domestic activity had been well sustained in 1981, this was largely attributable to a continued construction boom and the effects of overly expansionary fiscal and credit policies. The growing fiscal deficit and the increases in foreign borrowing which accompanied the deterioration in the balance of payments were clearly not sustainable.

These difficulties could be attributed in part to the slowdown in the world economy which was responsible in large measure for the reduction in the country's export earnings. But it was also clear that the fiscal and monetary policies pursued up to mid-1981 were no longer appropriate and that Barbados needed to adjust quickly to the new circumstances in which it then found itself. A number of important steps were taken by the Government in the summer and fall of 1981 to bring government expenditures under better control, to increase government revenues and to restrain the growth of domestic credit and foreign borrowing. Nonetheless, the Executive Board was of the view that these measures might not be sufficient. They urged the Government of Barbados to take additional steps with the view to achieving greater stability and further improvement in the fiscal and monetary situation and in the balance of payments.

My authorities readily accepted that the policies being pursued in early 1981/82 needed to be changed and that the steps already taken in that direction had to be reinforced. However, it was clear to them that the adjustment process would take time and that one could anticipate further increases in the fiscal deficit and indeed some additional worsening of the balance of payments before the new measures would take hold. They anticipated that some assistance from the Fund would likely be required to underpin the adjustment process. However, they determined, in view of the urgency of the situation, to introduce the additional measures as quickly as possible. This was done in the April 1982 budget.

The cornerstone of the new stabilization programme is a planned reduction in the overall fiscal deficit from 6.6 per cent of GDP in FY 1981/82 to 3.5 per cent in FY 1982/83 and 1.8 per cent in FY 1983/84. In pursuit of these targets, the 1982/83 budget introduced additional taxes estimated to be equivalent to 1.5 per cent of GDP plus an additional levy to fund pensions equivalent to a further 1.5 per cent of GDP. These measures, coming on top of the increased taxes and levies introduced in the summer and fall of 1981, in themselves constitute a major fiscal effort. In addition, the budget also provided for further curbs on the growth of current outlays and on capital spending. Finally, the authorities negotiated a two-year wage settlement which limits wage increases in the public service to 14 per cent for the two-year period covering FY 1982/83 and FY 1983/84. This settlement is particularly significant. Not only does it limit the increase in government expenditures as such, but it establishes a pattern since public sector wage settlements are normally used as the benchmark in private sector wage negotiations.

The stabilization program also involves a major tightening of credit policies. Reserve requirements of the commercial banks were increased in late 1981 and the banks were instructed to reduce their outstanding consumer credit by 10 per cent by March 1982. A number of steps were also taken to bring domestic interest rates more into line with international interest rate levels including substantial raises in the central bank's general rediscount rate and sharp increases in treasury bill rates. New instruments have been created to encourage greater savings in the private sector and minimum savings deposit rates have been increased. These measures have already led to a slow-down in the growth of credit to the private sector.

The full effects of the stabilization programme will take time to work their way through the system. It will be some months, at a minimum, before Barbados can achieve a satisfactory level of economic performance. Some recovery in real output can be expected in 1983. This is premised on a moderate improvement in agricultural production and some pickup in the growth of receipts from tourism. In addition, it is hoped that the rate of inflation, as measured by consumer prices, can be brought down to 9.7 per cent for 1982 as a whole and to 8.5 per cent for 1983. The current account deficit in the balance of payments is projected to fall from a high of 10 per cent of GDP in CY 1982 to 7.2 per cent in 1983 and to 3 per cent of GDP in 1984 as major capital projects now under construction are completed. The improvement in the overall balance of payments will occur somewhat faster. Finally, as pointed out above, the anticipated increase in government revenues, together with cutbacks in capital expenditures, should permit a sharp reduction in the overall fiscal deficit.

The Government of Barbados, in support of this programme, is requesting a stand-by arrangement in the amount of SDR 31.875 million covering a 20 month period, i.e. to the end of the 1983/84 fiscal year in Barbados. In addition, the Government is requesting a drawing under the Compensatory Financing Facility of SDR 12.6 million.

The proposed stand-by would set limits on the expansion of net domestic assets of the monetary authorities for the 12 months ending March 30, 1983. The ceiling for the year ending March, 1984, would be negotiated early next year. In addition, Barbados has agreed to limit the expansion of bank credit to the non-financial public sector to BDS dollars 35 million for the 12 months ending March 30, 1983. Finally, limits have been agreed on authorization of new public and public-guaranteed foreign indebtedness.

The request for a CFF drawing is based on an estimated shortfall in aggregate earnings from merchandise exports and from travel in the 12 months ended June, 1982. The amount of the estimated shortfall is almost equally attributable to the reduction in earnings on merchandise account and to the shortfall in tourist receipts. The shortfall in merchandise exports reflects almost wholly reduced earnings on sugar and molasses. The emergence of the shortfall was due to factors beyond the control of my authorities and, in their view, meets all the criteria of the Compensatory Financing Facility.

I would like to express the thanks of the Government of Barbados to the Fund mission for their help and assistance in developing the adjustment programme and working out both the proposed stand-by arrangement and the requested drawing under the Compensatory Financing Facility.

My authorities believe that the adjustment programme, together with the assistance provided by the Fund, will enable them to successfully carry through the stabilization programme, restore the economic health of the economy, and permit continued pursuit of medium-term development objectives once the international economic environment improves. My authorities believe the policies set forth in the programme are adequate to achieve the above objectives but they have indicated they are prepared to consult with the Fund if, at any time, it appears that further measures may be necessary.