

Barbados: Staff Report for the 1999 Article IV Consultation

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BARBADOS

Staff Report for the 1999 Article IV Consultation

Prepared by the Staff Representatives for the
1999 Consultation with Barbados

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October 6, 1999

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EXECUTIVE SUMMARY

- **Economic performance continued strong in 1998 and early 1999.** Real GDP grew by 4.8 percent in 1998 and is projected to grow by 3 percent in 1999. Unemployment has continued to fall and inflation has remained low, while the strong expansion of domestic demand has led to a widening of the small external current account deficit.
- **In view of Barbados' vulnerability to exogenous shocks because of an undiversified economic base, the authorities are seeking to increase the official international reserves.** Unemployment is still high and the authorities face the medium-term challenge of maintaining adequate output and employment growth, while dealing with an aging population in the context of a welfare system that provides for free public education and health, as well as public pensions.
- **In the context of the currency peg, domestic absorption would need to be kept in check in order to contain the external current account deficit and reduce pressures on official international reserves.** The authorities already took steps to slow domestic demand by delaying certain capital projects in 1998 and increasing the reserve requirement on bank deposits in mid-1999, but additional measures to slow the rapid expansion of credit to the private sector may be necessary.
- **Keeping the fiscal deficit near balance** by way of firm control on both public sector hiring and wage restraint, also will be essential, including by spreading over several years planned payments to compensate for the 1991 wage reduction.
- **To strengthen the financial system's health,** the authorities are looking into tightening certain prudential requirements and improving the regulation and supervision of credit unions and insurance companies and offshore financial services. The minimum deposit rate introduces rigidity in interest rate determination, but the authorities consider it useful in encouraging financial savings in Barbados.
- **The latest incomes policy arrangement among the government, labor and business, should help protect external competitiveness and facilitate output and employment growth.** Careful attention should be paid to ensuring that wage adjustments reflect inflation and productivity changes. Current severance payments arrangements, the unemployment insurance scheme and other social contributions are burdensome, hinder labor mobility, and should be reformed.
- The authorities have drawn up a comprehensive **medium-term public sector investment program**, which includes major projects and policy reforms in the areas of transportation infrastructure, education, and environmental protection. **Structural reforms** also should cover the pension and health systems, utility regulation, privatization, tax rationalization, and trade liberalization.

I. INTRODUCTION

1. The 1999 Article IV consultation discussions with Barbados were conducted in Bridgetown in early August 1999. The mission met with the Prime Minister (who is also Minister of Finance and Economic Affairs), the Governor of the Central Bank of Barbados (CBB), senior government and CBB officials, and business and labor union representatives.¹
2. In concluding the last Article IV consultation on January 30, 1998, Executive Directors commended the authorities for their pursuit of restrained fiscal and incomes policies, the successful introduction of the value-added tax (VAT), and the adoption of new financial legislation. Noting the relatively high costs prevailing in the export sector, the still high unemployment, and the recent weakening of the fiscal position, Directors stressed the need for continued fiscal and wage restraint to help preserve the exchange rate peg, while enhancing external competitiveness by promoting labor market flexibility and accelerating structural reforms.²
3. **The Barbados Labour Party (BLP), which has been in office since 1994, won a landslide victory in the January 1999 general elections.** During the campaign, the Prime Minister highlighted the need for continuity in economic policy; however, he also promised to reverse an 8 percent cut in public servants' wage payments that took place in 1991.
4. Barbados publishes monthly and quarterly data on a wide range of areas. However, data on the national accounts, the nonbank financial institutions, the public enterprises, and the external accounts have weaknesses with respect to consistency and timeliness, which may affect the assessment of economic developments and policy formulation.

II. BACKGROUND AND RECENT DEVELOPMENTS

5. Following a major adjustment effort in support of the exchange rate parity, which had come under pressure in the context of a balance of payments crisis in the early 1990s, **Barbados has been experiencing steady economic growth since 1993 founded on prudent economic management and generally favorable external conditions.** Economic

¹ The mission consisted of Mr. Guzmán (Head), Ms. Bjornland, and Messrs. Hilaire and Medeiros (all WHD). The mission was assisted in its work by Mr. Michael Tharkur, the economist for Barbados at the Inter-American Development Bank. Mr. Askari-Rankouhi (Advisor to the Executive Director) participated in the closing discussions.

² Barbados has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system free of restrictions on payments and transfers for current international transactions. Fund relations is summarized in Appendix I.

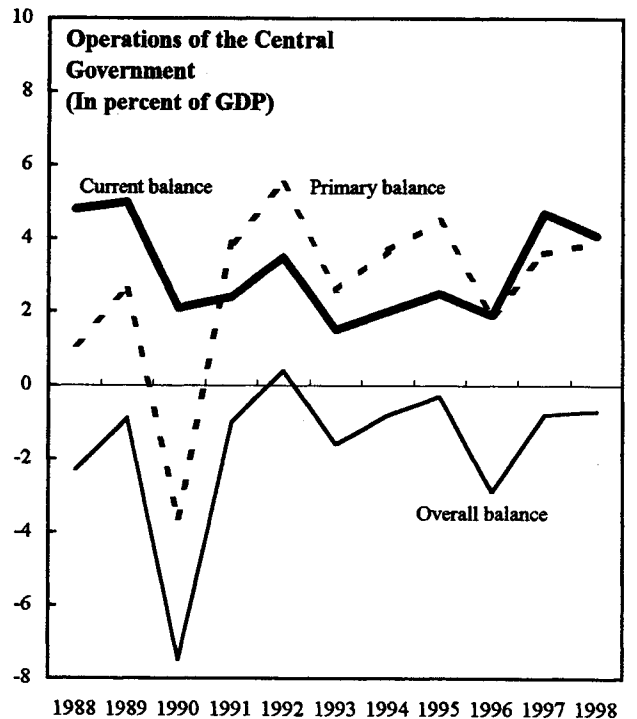
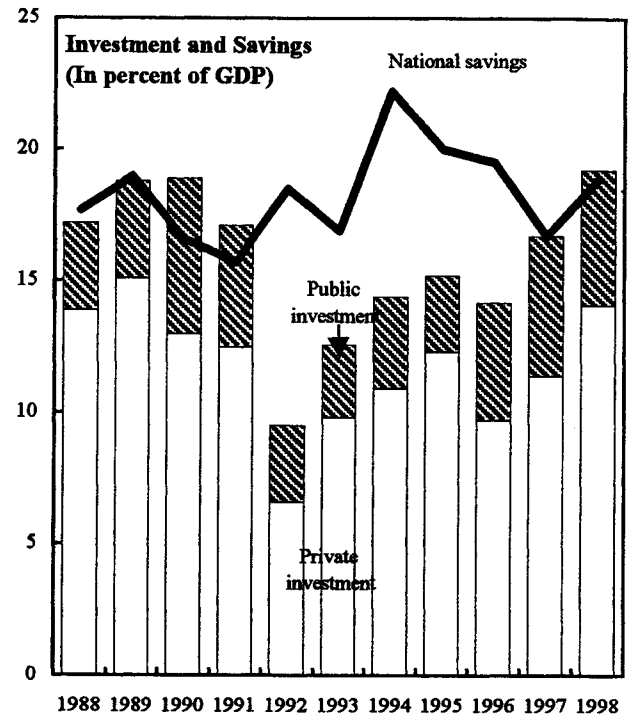
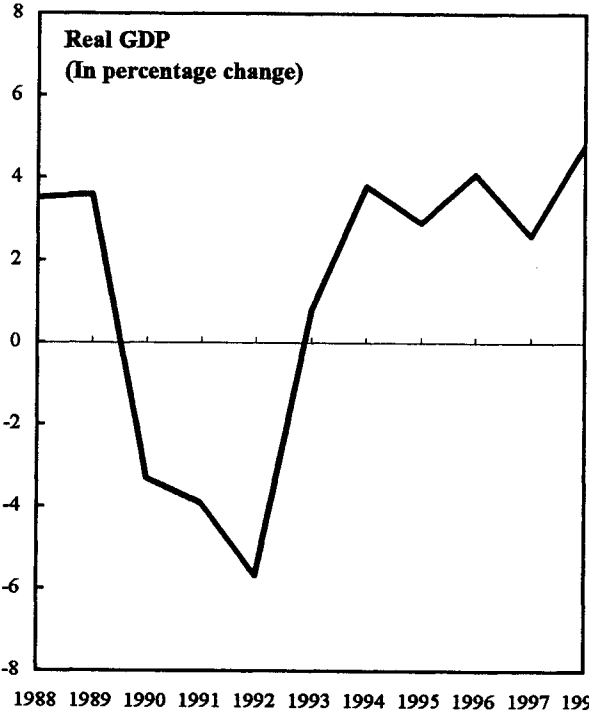
policy has been based on the authorities' commitment to fiscal and wage restraint, consistent with the maintenance of the long-standing exchange rate parity with the U.S. dollar. The country relies heavily on tourism, high-cost sugar exports to protected markets and, in recent years, offshore business services.

6. **In 1998, real GDP growth picked up to 4.8 percent (Figure 1), while 12-month consumer price inflation fell below 2 percent by year-end (Table 1).** Tourism performed very well as long-stay arrivals rose by about 8½ percent. The sugar crop declined by 26 percent because of a severe drought. Manufacturing output grew by 3½ percent, while construction activity grew by 15 percent bolstered by the expansion and refurbishment of hotels and tourist facilities. Offshore business services also expanded strongly as the number of registered offshore companies increased by 16 percent.³ The unemployment rate declined from 12.2 percent at end-1997 to 11.8 percent at end-1998.

7. Despite a 6 percent increase in tourism receipts, **the external current account** moved from balance in 1997 to a US\$9 million (½ percent of GDP) deficit in 1998 as sugar exports contracted (Table 2). Net capital inflows did not fully cover the current account deficit, in part due to the postponement of government's planned external commercial borrowing because of unsettled international financial market conditions. Consequently, **gross international reserves** declined to the equivalent of about two and a half months of imports of goods and services. Short-term public debt was equivalent to about a quarter of official gross international reserves and external public debt was equivalent to less than 15 percent of GDP. Barbados' **real effective exchange rate** remained basically unchanged during 1998 and through June 1999 (Figure 2).

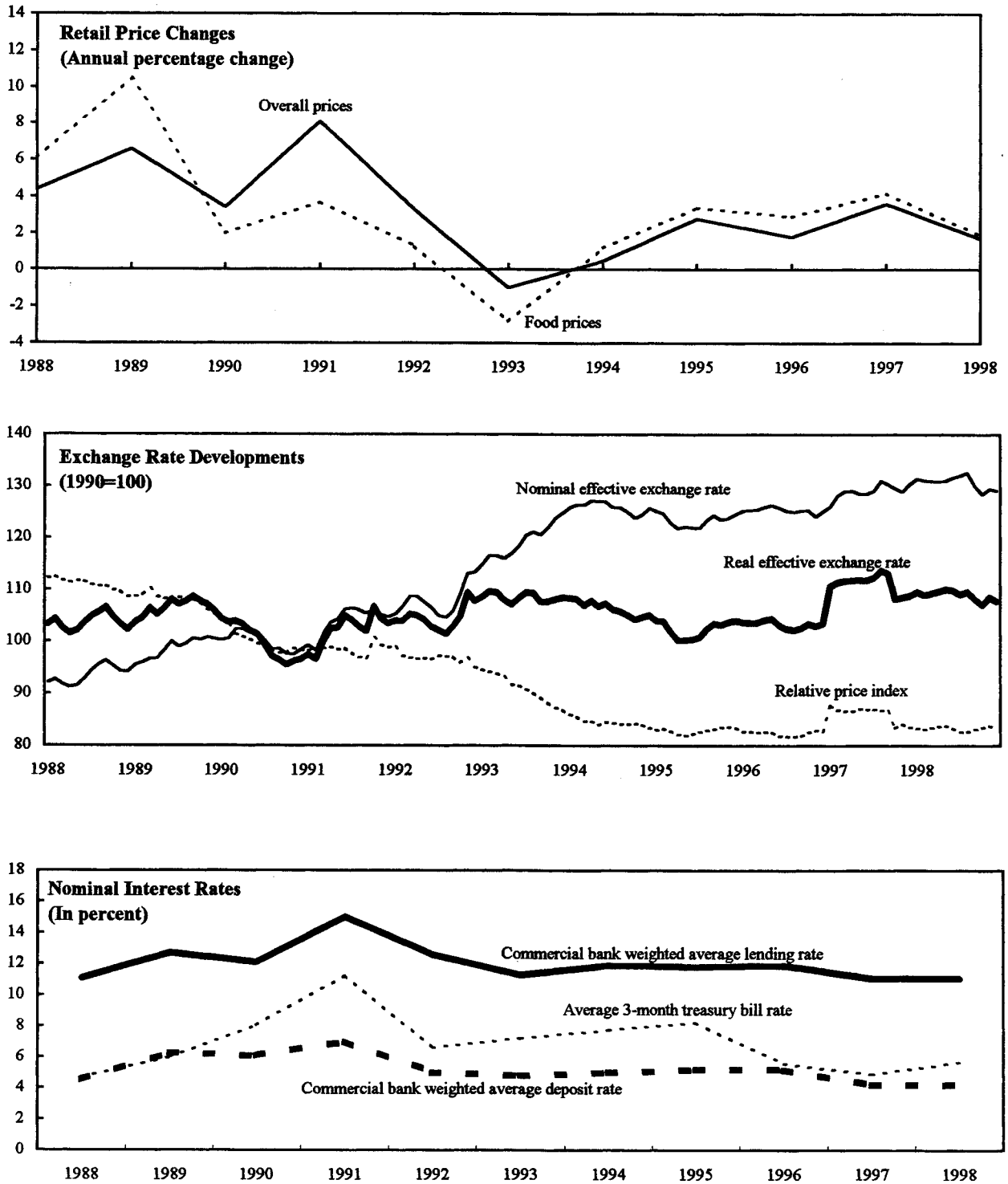
³ Most of the companies are international business companies and foreign sales companies. There are also about 360 companies dealing with insurance business and 44 offshore banks.

Figure 1. Barbados: Selected Economic Indicators, 1988-98



Sources: Ministry of Finance; Barbados Statistical Services; and Central Bank of Barbados.

Figure 2. Barbados: Selected Price and Financial Indicators, 1988-98



Sources: Central Bank of Barbados; and IMF Information Notice System.

8. **The nonfinancial public sector balance** is estimated to have shifted from a small deficit in FY 1997/98 to a small surplus in FY 1998/99 (fiscal years begin in April) (Table 3). The central government deficit remained at about $\frac{3}{4}$ percent of GDP in FY 1998/99 as higher current spending was broadly offset by a reduction in capital spending (Table 4). The rise in current spending partly reflected the introduction in September 1998 of government-subsidized mortgage facilities and other incentives to encourage home ownership, and increases in pensions. Reflecting administrative improvements, tax collection was buoyant despite a narrowing of the VAT base in October 1997⁴ and a lowering of others taxes announced in September 1998.⁵ In relation to GDP, the combined deficit of the public enterprises declined reflecting lower capital spending, while the surplus of the National Insurance Scheme (NIS) remained unchanged. The public debt/GDP ratio fell to 43 percent.

9. **During 1998, monetary aggregates and credit expanded strongly.** Broad money grew by 11½ percent, with the share of U.S. dollar denominated deposits in total deposits rising slightly to 13 percent (Tables 5 and 6). Bank net credit to the public sector declined slightly during 1998, while bank credit to the private sector rose sharply. As banks' liquidity tightened, treasury bill rates rose steadily from a low of 1½ percent in mid-1997 to 5.9 percent in May 1999, but commercial bank interest rates on loans and deposits remained largely unchanged.⁶ The financial condition of commercial banks improved in 1998 partly reflecting the recapitalization in earlier years and ongoing restructuring of the state-owned Barbados National Bank (BNB), which accounts for 17 percent of total bank assets. At end-1998, commercial banks' capital represented 11½ percent of total risk weighted assets (similar to a year earlier), while substandard loans had declined to 6¼ percent of total loans (8.7 percent at end-1997).

10. **The authorities continued to implement a prudent incomes policy in 1998.** In May 1998 representatives of the government, business, and labor signed a third social pact covering 1998–2000, which maintains productivity-based wage increases (Box 1). Recent wage settlements in the private sector have been on the order of 2 to 5 percent per annum, while public sector wages rose by 6¼ percent in FY 1997/98 and 3 percent in FY 1998/99. Industrial relations have been generally harmonious.

⁴ The VAT was introduced in January 1997 to replace 11 other indirect taxes. The standard VAT rate is 15 percent, but hotel accommodation bears a lower rate of 7½ percent. To relieve the effect on the cost of living for the poor, the government zero-rated a basket of 35 basic food items in October 1997.

⁵ Namely, a lowering of taxes for small businesses; enhanced tax incentives for manufacturers and small hoteliers; and an increase in tax allowances for low income earners.

⁶ The CBB sets minimum savings and time deposit rates but not lending rates.

Box 1: Barbados: Labor Market Issues

Legal framework

Four pieces of legislation provide a legal framework for labor relations in Barbados: (i) the National Insurance and Social Security Act of 1966 instituted the National Insurance Scheme, which insures against unemployment, sickness, employment injury, maternity, and other events; (ii) the Severance Pay Act of 1971, which establishes that all workers are entitled to severance pay after two years of employment, if their job is discontinued for any reason other than voluntary termination or justified dismissal; (iii) the Shops Act of 1989 (revised in June 1997), which establishes a minimum wage for attendants at retail stores; and (iv) a law guaranteeing a four-week paid vacation for all employees.

The protocols

Since the early 1990s, labor market relations in Barbados have been conducted under the framework of successive economy-wide arrangements or "protocols" among representatives of the government, labor, and business. These protocols were born out of the severe economic problems in 1990-91, with the realization that a restrained incomes policy was necessary in order to maintain the fixed exchange rate parity.

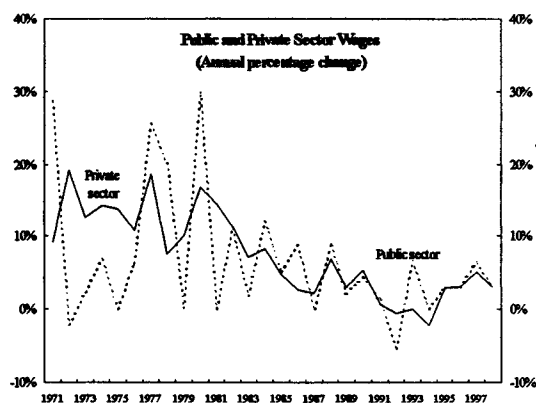
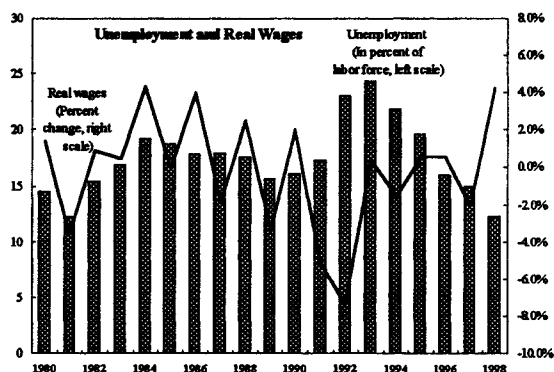
I. The first protocol for the Implementation of a Prices and Incomes Policy covered the period 1993 to 1995 and made provision for an economy wide wage freeze.

II. The second protocol (1995 to 1997) provided for a period of wage restraint in line with productivity changes.

III. The third protocol (1998-2000) maintained productivity guidelines for wage increases, and also emphasized issues of job security and training.

Private and public wages

Unionized labor accounts for 60 percent of the labor force. The government accounts for 20 percent of total employment and its wage settlements have a direct influence on private sector wages. Government wages are set in two-year contracts with the first year settlement generally being larger than the second: this accounts for the jagged pattern of public sector wages in the lower figure. Private sector wage contracts are generally longer and more staggered, resulting in a wage pattern that is close to the cycle of public sector wage changes but is much smoother.



Areas of concern

Although the unemployment rate has declined from 24 to 11 percent in early 1999 and labor market flexibility has improved, some areas of concern remain:

- The definition of work practices included in labor contracts still imparts a degree of rigidity to the workplace, precluding the optimal allocation of workers across tasks by employers.
- A direct link between wage increases and productivity has been established in only some sectors.
- The severance payments scheme needs to be reformed to improve coordination with unemployment compensation and retirement benefits.

11. **Progress continued on structural reforms with support from the Inter-American Development Bank (IDB).**⁷ In the last few years, there have been reforms in the financial system (including the closure of the state-owned Barbados Development Bank (BDB) and the restructuring of the BNB) and in the tax and trade areas, some restructuring of the financially troubled private sugar industry,⁸ and divestment of two partially state-owned enterprises. Also, new financial legislation became effective in July 1997 to strengthen prudential regulation and supervision of banks and deposit-taking nonbank financial institutions along the lines of the Basle Accord.⁹ In agreement with other members of the Caribbean Community (CARICOM), import duties were lowered in April 1998 from 5–25 percent to the agreed final range of 5–20 percent and the special import surcharges that replaced several nontariff barriers in early 1994 were reduced. Anti-money laundering legislation was passed in December 1998.

12. **In the first half of 1999, real GDP** is estimated to have grown by 2¾ percent (compared with a year earlier), while **the unemployment rate** fell to 10½ percent in June 1999. **Domestic demand** expanded strongly as the development of tourism facilities and private consumption responded to a 17 percent increase in **credit to the private sector** in the year ending June 1999. Also, there was an increase in government employment in the run-up to the general elections in early 1999, which had a negative effect on the public finances. **The external current account deficit** is widening: the U.S. dollar value of merchandise imports grew by 7 percent in the first half of 1999 (relative to the same period a year earlier), while tourism receipts declined slightly partly reflecting the closing of the two largest hotels for refurbishment and the redirection of some cruise ships to other destinations. **Official gross international reserves**, nevertheless, rose sharply during the first half of the year (to over three months of imports of goods and services) in large measure because of government borrowing in the regional capital market in April 1999.¹⁰ **Inflation** was down to 0.4 percent during the year ending June 1999.

⁷ The IDB is Barbados' major external creditor and, in its lending operations with the country, takes into consideration the Fund staff assessment of Barbados' policies through the Article IV consultations. See Appendix II.

⁸ The government's involvement in the sugar industry intensified in 1993 when it arranged the restructuring of the industry's large debt to a state bank.

⁹ A summary description of the legislation and the new regulations was included in Box 2 of the Staff Report for the 1997 Article IV consultation (SM/97/294).

¹⁰ The government placed a US\$75 million bond in the Caribbean capital market and gross reserves rose to US\$386 million by June 1999. Amortization payments of international bonds would total US\$53 million in FY 1998/99–FY 1999/2000.

13. **The authorities have taken steps to slow the expansion of domestic demand, including delaying the implementation of certain public investment projects since the latter part of 1998, a 1 percentage point increase in the reserve requirement on bank deposits to 6 percent and an increase in the central bank discount rate from 9 percent to 10 percent in May 1999.¹¹ However, a further boost to domestic demand is likely to come from the impending payment of public sector wage increases retroactive to April 1999.¹²**

III. POLICY DISCUSSIONS

14. **The authorities' economic objectives are to keep inflation low and sustain the growth of output and employment based on service exports, while reducing vulnerabilities as the economy continues to open up and preparing for the aging of the population in the long term. Accordingly, their strategy is to maintain the finances of the nonfinancial public sector near balance in support of the exchange rate peg by taking steps to protect public saving, while carrying out a public sector investment program (PSIP) focused on economic and social infrastructure and environmental protection. The strategy also calls for tightening credit policy by increasing public sector deposits at the central bank to help build the official international reserve cushion and implementing structural reforms covering education, health, the public pension system, the regulation and supervision of utility monopolies and the nonbank financial sector, trade and corporate taxes, and privatization.**

15. **The authorities' strategy appears appropriate in the context of Barbados' ongoing successful transition from an economy based on agricultural exports to preferential markets to one based on service exports, in which it has comparative advantage. Indeed, the prospects for the tourism sector appear good: economic conditions in the main tourism markets remain strong and Barbados is well positioned to continue to sell high-end tourism services. Also, it is likely to continue to have access to substantial long-term external financing for its investment needs in the form of loans from the Inter-American Development Bank (IDB) and the Caribbean Development Bank (CDB), as well as private foreign direct investment.**

16. **Notwithstanding the favorable medium-term prospects, the economy's vulnerability to exogenous shocks is a source of concern (Table 6). Although inflation is expected to remain under control, the strong growth of absorption is expected to lead to a widening of the**

¹¹ The additional requirement for banks to hold 20 percent of their deposits in government securities was maintained, as well as the 4 percent floor on saving and time deposit rates.

¹² Wage negotiations currently underway cover FY 1999/2000–FY 2000/01. The negotiations include payments to compensate public workers for the pay reduction that took place in 1991.

external current account deficit to 2–2½ percent of GDP in 1999, from near balance in 1998. Such a deficit level is not worrisome per se—particularly because it is expected to be financed by long-term capital flows—but its further widening could make Barbados dependent on reversible short-term capital flows and increase the risk to the economy, for instance, from a prolonged tourism slowdown. Thus, the authorities remain committed to public expenditure and wage restraint, and stand ready to take further steps to tighten domestic credit conditions in order to slow the expansion of domestic demand and protect official international reserves.

A. Fiscal Policy

17. Largely reflecting an expected sizable jump in the central government wage bill, the finances of the nonfinancial public sector are projected to shift from a surplus of ¼ percent of GDP in FY 1998/99 to a deficit exceeding ½ percent of GDP in FY 1999/2000. In this context, the mission advised that public sector hiring be frozen immediately, and that payments to compensate for the 1991 public sector wage cut be paid over four years starting in FY 2000/01 so that overall public sector wage increases remain in line with inflation and productivity growth. Also, the authorities were cautioned against undertaking nonpriority capital outlays and introducing measures in the short run that could undermine tax collections (such as, widening ad hoc, sectoral tax incentives or reducing the corporate tax rate). Instead, it was important to take steps to strengthen tax administration further. The authorities noted that new hiring already has been restricted and stressed their continued commitment to implementing a prudent wage policy. In this respect, their intention was to spread the compensation for the 1991 wage reduction over several years, although the final formula would depend on the outcome of the negotiations with labor unions. They stressed that such payments would be subject to income taxes and social security contributions. Also, they indicated their intention to take steps to improve the administration of the property transfer tax, which is being evaded.

18. The authorities intend to keep the overall fiscal deficit near balance in the medium term, consistent with a decline of the public debt/GDP ratio and balance of payments viability. At the same time, they would seek to make room for capital spending and for higher recurrent outlays on maintenance of the physical capital stock and for the expansion of critical services as the economy develops and the population ages. The authorities agreed with the mission that achieving these objectives calls for: (1) the implementation of a cautious wage policy and restraint in public sector hiring; (2) steps to hold down the growth of central government spending through cost recovery measures in the delivery of key public services,¹³ while

¹³ In particular, attention should be paid to bus fares; water and sewage fees; airport and seaport charges; rents charged by the housing authority and the Barbados Industrial Development Corporation; and fees for tertiary education and for the delivery of health services to the nonpoor. Government transfers to the nonfinancial public enterprises and covering free tertiary education were equivalent to 3 percent of GDP in FY 1998/99. Spending on free health services amounted to 3.8 percent of GDP in FY 1997/98.

maintaining full subsidies in the delivery of these services only for the poorest; (3) a comprehensive reform of the current public pay-as-you-go pension system to secure its long-term solvency and its continued contribution to national saving; and (4) steps to strengthen tax administration.¹⁴ The authorities will be seeking financial and technical assistance from the IDB and the World Bank for the design and implementation of reforms and investment projects in these areas.

19. With the aim of reducing production costs and improving competitiveness and the investment environment, in late August 1999 the authorities announced several measures that on balance are expected to weaken the public finances by ½ percent of GDP on an annual basis. These include: (1) the creation of a Commission on Competitiveness to reduce red tape and bureaucratic impediments to investment in Barbados; (2) reductions in taxes on energy products and in seaport rates as part of a program to bring energy and port costs in line with other Caribbean countries; (3) new fiscal incentives for tourism, fishing, and agriculture; (4) replacement of import licenses on a few manufactured items (processed food, detergent, and cotton shirts) by tariffs from April 2000; and (5) measures to improve the collection of property transfer and land taxes.

B. Exchange Rate and Credit Policies

20. The authorities are committed to the maintenance of the exchange rate peg to the U.S. dollar which, together with the implementation of prudent fiscal, credit and incomes policies, has been essential for promoting low inflation and confidence. To help secure the peg, they intend to build the cushion of official international reserve assets, while keeping the external public debt/GDP ratio low and continuing to refrain from undertaking short-term external borrowing. External competitiveness is not a problem at present as the outlook for tourism is positive and private investment in the export sectors is strengthening; unemployment is declining in the context of a manageable external current account deficit that is largely financed by long-term capital inflows (including sizable direct foreign investment); and the real effective exchange rate has remained broadly stable. Nevertheless, the authorities intend to implement a PSIP and structural reforms (discussed below) aimed at strengthening competitiveness and securing the continued export growth in the medium term.

21. Additional actions to tighten domestic credit conditions may be needed to help slow the fast expansion of domestic demand. The authorities felt that the credit tightening measures implemented in May have had limited impact. To tighten credit conditions further, the authorities have begun to move government deposits out of the commercial banks and into the central bank. Also, they are ready to take additional credit tightening measures (such as,

¹⁴ Such as, institutional and technological changes to help focus administration efforts on the large taxpayers and to facilitate the cross-checking of tax returns and payments to the different tax collection agencies.

placing government debt instruments in the domestic market, with the proceeds sterilized in the central bank) if necessary to ensure that credit expansion slows satisfactorily.¹⁵

22. CBB officials highlighted the progress that has been made in improving the efficiency of financial intermediation and the health of the financial system in recent years. Of particular importance has been the closing of the BDB, the capitalization and restructuring of the BNB (whose profitability has been restored in preparation for its privatization next year), and the strengthening of the regulation and supervision of the commercial banks and other deposit taking financial institutions (merchant banks, trust and finance companies) in the context of the Financial Institutions Act, which became operational in July 1997. The authorities now are looking into revising legislation covering offshore financial services to ensure that CBB jurisdiction is consistent with the Core Principles of Banking Supervision; adjusting prudential requirements to increase disincentives to high risk bank loans (e.g., credit card lending); strengthening the regulation and supervision of credit unions and insurance companies; and setting up a securities commission to regulate the commercial paper market, in line with international standards and practices. Although the authorities acknowledged that the minimum deposit rate (which is currently binding on certain deposits) introduces rigidity in interest rate determination, they considered it useful in encouraging financial savings in Barbados.

C. Incomes Policy and Labor Market Issues

23. The authorities, as well as representatives of the labor unions and employers, indicated their strong support for the latest incomes policy arrangement which, if properly implemented, should help protect external competitiveness and maintain strong output and employment growth. In this context, the tripartite National Productivity Council, which is charged with developing and disseminating productivity measurements, should be strengthened as careful attention needs to be paid to productivity changes as a guideline in making wage adjustments at the enterprise level. Technical assistance from the IDB or the World Bank in this area would be highly desirable.

24. Severance pay arrangements, the unemployment insurance scheme and other social contributions are burdensome and adversely affect private investment, external competitiveness, and employment growth. For instance, the duplication of benefits across the unemployment and severance payments schemes lead to high labor costs for employers, while the lack of portability of the latter contributes to labor market rigidity.¹⁶ Also, in the private

¹⁵ Open market operations have been rarely used actively in Barbados. In 1997, the central bank sterilized some of the excess liquidity through open market sales of treasury bills.

¹⁶ To qualify for unemployment insurance, a worker who has lost his job or has had earnings reduced by more than 50 percent (i) must have been insured for at least one year; (ii) must have made at least 20 weekly contributions within the last 3 consecutive quarters of

(continued...)

sector total social contributions constitute 17¾ percent of the wage, of which 9¾ percentage points are paid by the employer. Thus, it would be desirable to consolidate the unemployment and severance systems and avoid increases in social contribution rates (which are being considered as part of a pension system reform).

D. Structural Issues

25. **The authorities aim to sustain public investment and bolster private investment in the medium term.** The PSIP includes projects largely in the areas of transportation infrastructure (the expansion and improvement of roads, the airport, and the port), human capital (primary and secondary education and health), and environmental protection (sewerage and solid waste management and coastal conservation) (Box 2). The authorities acknowledged the importance of accelerating the implementation of these projects (which involve administrative changes in the corresponding ministries and public enterprises, as well as policy reforms, which are supported by the IDB and the CDB), while refraining from implementing nonpriority projects that do not carry associated external financing and could be undertaken by the private sector. Also the authorities, with IDB assistance, are planning to restructure the regulatory framework covering public utility monopolies (e.g., in telecommunications, electricity, and potable water) and encourage private investment and the expansion of service delivery, while lowering domestic production costs. To promote investment in tourism and offshore services, the authorities are planning to rationalize a number of uncoordinated, ad hoc tax incentives, and reduce the corporate income tax rate as fiscal and macroeconomic conditions allow.

26. **Further privatizations of public entities are planned** to help improve economic efficiency and bolster investment. The authorities intend to divest the state-owned insurance company by the end of this year and the BNB in the first half of next year. Six other entities (including the airport and the Bridgetown port) would be privatized in the medium term. The proceeds from privatization would be used to help attract private investment in commercially viable joint ventures in tourism and for tourism infrastructure. To improve the terms of privatization, divestment of these entities should be opened to international competition.

employment; and (iii) must be actively seeking work. Unemployment insurance is based on 60 percent of weekly earnings and benefits are limited to 26 weeks. Workers are entitled to severance pay if dismissed without cause, or laid off after 2 years of employment. The benefits are 2½ weeks of pay for each year of service up to 10 years, rising to 3½ weeks of pay between 20 years and 33 years of service. Pay is determined by the wages at the time the employment is terminated.

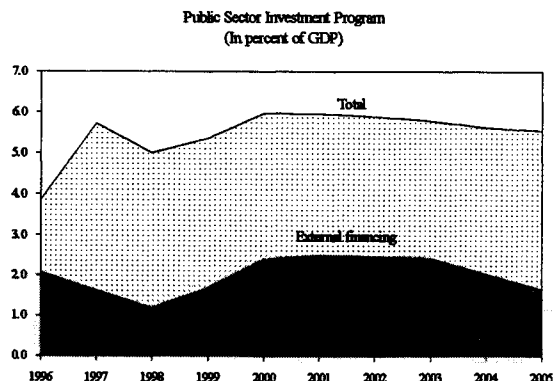
Box 2: Barbados: Public Sector Investment Program

Pace of public sector investment

From a low of 2 percent of GDP in the early 1990s, the public sector investment program (PSIP) has steadily recovered to reach over 5 percent of GDP in fiscal years 1997/98 and 1998/99. In late 1998, the Government slowed down its overall investment spending to reduce the pressures on an overheating economy.

Medium-term priorities

During the past four years, the government has concentrated on investments in solid waste and sewerage disposal systems, coastal conservation, highway expansion, airport rehabilitation, and primary school infrastructure. The medium term PSIP is aimed at improving human resources, the economic infrastructure and the environment to support economic growth based on the export of services, mainly tourism. Some of the main projects are:



- **Edutech 2000** is a comprehensive education sector enhancement program launched in 1998 and estimated to cost US\$180 million, with financing mainly by the Inter-American Development Bank (IDB) (US\$85 million) and the Caribbean Development Bank (CDB) (US\$30 million). The project, to be implemented over seven years, supports reforms of curricula and teacher training and seeks to improve teaching infrastructure, including by equipping all primary and secondary schools with state of the art computer equipment. It also would reform the Ministry of Education to deal with a more technology based education service.
- **Expansion of the Bridgetown port** is intended to facilitate higher value added from cruise ship tourism and to ease congestion in the harbor. It is estimated to cost US\$36 million, with financing mainly from the IDB, and implemented over three years beginning in 2000.
- **Rehabilitation of the Grantley Adams International Airport** is already underway and is intended to sustain higher rates of air arrivals and increased cargo. The total project cost is US\$82 million, to be financed in part by the CDB and European Investment Bank (EIB) over four years.
- **Improvements to the road infrastructure** are continuing, including the introduction of new bypass roads to improve traffic management programs in the capital, Bridgetown. The projects would cost about US\$27 million, of which US\$18 million would be provided by the IDB.
- **Projects to improve the water supply** involve reform in the Barbados Water Authority, programs to replace mains (to curb extensive distribution losses) and new development of underground water resources to complement a privately-run desalination plant that will be in operation by late 1999.
- **The south coast sewerage project** is ongoing and involves comprehensive collection systems to relieve the pressure of underground sewerage contamination and near-shore pollution. The IDB would provide US\$50 million of this US\$80 million project.
- **A west coast sewerage project**, which is likely to be supported by the IDB, is in an advanced stage of preparation and is intended to improve coastal water quality along the West Coast, while reducing contamination of underground aquifers.
- **A Coastal Conservation Program** is being drawn up to address the issues of beach erosion, water quality, and conservation of coastal flora and fauna.

27. **The authorities are planning a comprehensive pension system reform.** The latest actuarial report on the operations of the NIS forecast a decline in income from contributions relative to pension outlays and the depletion of its reserves by 2022. Steps taken thus far to deal with this situation are insufficient¹⁷ and the authorities are contemplating a more comprehensive reform, including restructuring the current pay-as-you-go system, introducing mandatory “defined contribution” pensions and voluntary funded private accounts, and institutional strengthening of the NIS and the Office of Insurance Supervision.

28. **The authorities intend to continue opening the economy** in the context of initiatives for liberalizing intra-Caribbean trade and capital movements¹⁸ and in preparation for a more open hemispheric trading environment early in the next century. The authorities intend to remove remaining import surcharges on a wide range of imported manufactured goods by April 2000, and replace the remaining few nontariff barriers to imports from outside CARICOM, largely covering some agricultural products and processed food, with tariffs consistent with Barbados’ WTO commitments.

E. Other Issues

29. **Barbados ranks very high in terms of social and economic indicators.** The 1998 Human Development Report of the United Nations Development Program (UNDP) puts Barbados in first place in the Caribbean region and 24th in the world based on the UNDP’s Index of Human Development. The coverage of primary and secondary education services and preventive and curative health services is very high. However, a 1997 IDB study estimated that, despite a fairly extensive social safety net that mitigates the effect of high unemployment, 13 percent of the population was living in poverty. It is expected that continued strong output and employment growth should help reduce poverty. Moreover, to improve the efficiency and targeting of the social safety net, a new ministry has been formed with a view to consolidating, streamlining and more closely integrating the operations of entities responsible for social safety net services.

30. The authorities agreed to participate as a pilot case for implementation of the Fund’s General Data Dissemination System (GDDS). To this end, they cooperated with the Fund in the preparation of the metadata, which includes plans for improving data quality. The authorities are working to improve the quality and timeliness of national account statistics, but further efforts are needed to improve the quality and timeliness of balance of payments and

¹⁷ In September 1998, the government adjusted some of the contribution rates and outlined plans to transfer the cost of noncontributory benefits to the treasury on a phased basis over a number of years.

¹⁸ All capital outflows and certain capital inflows require approval.

financial statistics. A work program (including the need for technical assistance) should be developed as part of these efforts.

31. The authorities' efforts to deal with **the year 2000 computer problem** have included several public education programs. Available information suggest high levels of readiness to deal with this issue in the energy, banking, telecommunications, air and maritime transportation, health care, and government sectors. Contingency plans are in place in the above sectors and have been tested in the energy, telecommunications, air transport, and some government sectors.

F. Medium-Term Outlook

32. The staff developed an illustrative medium-term scenario based on the assumed implementation of the authorities' economic strategy, as set out above (Table 7). In the scenario, the driving force of the economy would continue to be tourism and other export services, with real GDP growth expected to average 3 percent a year and inflation 2 percent, and the unemployment rate is expected to fall to around 8 percent by 2004.

33. National saving would increase moderately during 2000–04 to make room for a somewhat higher domestic investment to GDP ratio, while containing the external current account deficit. The strengthening of national saving would reflect prudent public sector wage adjustments and strict control on public sector hiring, efficiency improvements and the introduction of cost recovery in public services, a comprehensive reform of the public pension system, and productivity gains ensuing from tax and trade changes, the privatization of public entities, and an improved regulation of private monopolies.

34. The ratio of the external current account deficit to GDP would be expected to decline to 2 percent in the medium term. Exports of goods and services would expand strongly as a result of enhanced competitiveness arising from tax reductions and structural reforms, while import growth would be in line with nominal GDP. Capital inflows, largely long-term borrowing and foreign direct investment, would be sufficient to cover the external current account deficit and increase official international reserves to around four months of imports of goods and services. Gross external public debt would rise from 16 percent of GDP in 1999 to 18 percent of GDP in 2004; however, the external public debt net of international reserve assets would fall sharply.

35. If financial and incomes policies remain prudent and priority investments and structural reforms are implemented, slower export growth or less private capital inflows would lead to somewhat lower investment and output growth, while the balance of payments would remain viable. In contrast, if there is a weakening of the public finances, a relaxation of incomes policy, delays in implementing PSIP projects and a failure to implement structural reforms, investment and the growth of exports, output and employment would be significantly less than in the above scenario; and the external current account deficit would be higher and long-term

capital inflows and official international reserves lower, thereby substantially increasing economic vulnerabilities.

IV. STAFF APPRAISAL

36. Barbados' recent strong economic performance reflects the stabilization policies and structural reforms that have been implemented since the early 1990s, as well as a generally favorable external economic environment. Nonetheless, unemployment is still high and Barbados remains vulnerable to exogenous shocks because of an undiversified economic base. It also faces the medium-term challenge of maintaining adequate output and employment growth, while dealing with an aging population in the context of a welfare system that provides for free public education and health, as well as public pensions.

37. The authorities are to be commended for their continued commitment to macroeconomic and structural policies aimed at keeping inflation low, promoting national saving and investment, boosting external competitiveness in the context of the exchange rate peg, sustaining strong output and employment growth, and reducing the economy's vulnerability. These policies comprise a high level of public savings in support of public investment, a prudent credit policy that provides for building official international reserves, and key structural reforms.

38. In the short term, keeping the fiscal deficit near balance will temper the expansion of domestic demand, contain the expected widening of the external current account deficit and reduce pressures on official international reserves. An essential element is the exercise of strict restraint on the wage bill through firm control on both public sector hiring and wage increases. Wage adjustment should be in line with projected inflation and productivity growth; this would necessarily entail spreading payments to compensate for the 1991 wage reduction over several years. It also would be important to apply strict priorities on capital spending and to refrain from taking further steps that undermine tax collection, while acting to strengthen tax administration.

39. In the medium term, maintaining the public finances broadly in balance would be required in order to lower the public debt to GDP ratio and to allow continued strong private investment, while securing balance of payments viability. To do so, while keeping an appropriate level of public investment spending and expanding the delivery of essential services (health, education, social security, environmental protection, and infrastructure maintenance), it will be necessary not only to continue implementing a cautious wage policy and restraining public hiring, but also to raise the efficiency and introduce cost recovery in the delivery of public services and to undertake a comprehensive reform of the public pension system. The authorities are seeking financial and technical support from the official international community for their efforts in these areas.

40. The rapid expansion of bank credit to the private sector has been contributing to the strong growth of domestic demand. In this context, the staff fully supports the actions recently

taken by the authorities to tighten domestic credit conditions and boost official international reserves, and encourages them to develop market based instruments of monetary control. They should also act quickly to strengthen the frameworks of financial regulation and supervision, particularly covering the nonbanks and offshore financial services, in line with international best practices to reduce risks to the financial system and protect the interests of depositors. Satisfactory progress in the area of prudential regulation and supervision and the removal of the floor on deposit interest rates would facilitate foreign capital inflows, reduce borrowing costs, and strengthen private investment.

41. In recent years, wage restraint has been essential to maintaining export competitiveness and the strong growth of output and employment. A commendable spirit of cooperation between the labor unions, employer associations, and the government has permitted agreements on a series of income protocols, which have been vital to securing wage restraint and stable labor relations. The continuation of such cooperation would be of great importance for satisfactorily implementing the current incomes protocol and securing its renewal. Moreover, the authorities should take steps to strengthen the institutional framework for measuring productivity changes, which guide wage adjustments under the protocol. Steps also are needed to promote labor market flexibility and contain nonwage labor costs, including through a consolidation of the unemployment insurance and severance schemes and through avoidance of increases in social contribution rates.

42. The exchange rate peg to the U.S. dollar, supported by the implementation of prudent fiscal, credit and incomes policies, has been essential for keeping inflation low and upholding confidence. In this context, and in view of the authorities' commitment to the peg and their demonstrated willingness to implement policies to defend it, its maintenance is appropriate. Nevertheless, the authorities should implement policies to increase the official international reserve cushion to increase the peg's resilience in the context of the economy's vulnerability to exogenous shocks. At the same time, they should continue their efforts to implement trade and tax changes and structural reforms to bolster external competitiveness and secure the growth of service exports in the medium term.

43. Barbados' future growth prospects will be enhanced by sustaining the pace of public investment in key areas, as well by pursuing reforms to improve the functioning of markets and bolster private investment and productivity. Particularly relevant in these respects are the projects that entail significant policy reforms, cost recovery and efficiency gains in the areas of education, health, environmental protection, and infrastructure. Also encouraging is the planned restructuring of the regulatory framework covering utilities, which is needed to secure private investment for service expansion and to lower domestic production costs. Also, the authorities should redouble efforts to privatize state-owned entities and to design and implement a comprehensive social security reform that secures the funding of pensions as the population ages and fosters an appropriate level of national saving well into the next century. A rationalization of tax incentives (rather than the use of inefficient, ad hoc fiscal incentives) and reduction of corporate tax rates once fiscal and macroeconomic conditions allow, also should help maintain private saving and investment strong.

44. The national accounts, balance of payments and financial data provided to the Fund for conducting surveillance have certain weaknesses with respect to their quality and timeliness, some of which are being addressed. The authorities should develop and implement a comprehensive action plan to improve the quality and timeliness of economic and financial statistics in order to provide a better basis for economic policy formulation. The GDDS is an appropriate framework for this effort.

45. The authorities' intention to release the Article IV staff report under the pilot project is welcome. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Barbados: Selected Economic and Financial Indicators

	1996	1997	Prel. 1998	Projections	
				1999	2000
(Annual percentage changes; unless otherwise specified)					
National income and prices					
Real GDP	4.1	2.6	4.8	2.9	3.7
GDP deflator	3.1	4.1	3.8	2.9	2.0
Tourist arrivals	1.1	5.6	8.5	1.0	3.0
Consumer prices (12-month increase)	1.8	3.6	1.7	0.5	2.5
Unemployment rate (in percent of the labor force) 1/	14.3	12.2	11.8	...	...
External sector					
Exports	16.9	0.7	-7.9	0.0	3.7
Tourism receipts	3.5	6.3	6.0	1.1	4.4
Imports	7.9	19.5	1.8	6.1	5.3
Real effective exchange rate (depreciation -) 2/	-0.6	5.2	-1.0	...	...
Central government 3/					
Revenue	5.3	18.8	7.4	4.4	4.7
Expenditure	14.5	11.0	7.0	7.5	5.6
Money and credit					
Net domestic assets 4/	4.6	6.1	15.0	6.2	1.8
<i>Of which:</i>					
Public sector credit	1.5	-2.1	-0.5	-2.2	-2.7
Private sector credit	3.1	12.9	11.9	9.6	4.6
Money and quasi-money	11.1	7.1	11.5	10.0	5.8
Velocity (GDP relative to M2)	1.8	1.8	1.8	1.7	1.7
(In percent of GDP at market prices)					
Public sector 3/					
Public sector underlying balance (deficit -)	-0.8	-0.2	0.2	-0.6	-0.3
Central government overall balance	-2.9	-0.8	-0.7	-1.7	-1.9
National Insurance Scheme	2.4	2.5	2.4	2.0	2.3
Public enterprises	-0.3	-1.9	-1.5	-0.9	-0.7
Central government underlying current balance (deficit -)	1.9	4.6	4.1	3.3	3.2
Savings and investment					
Gross domestic investment	14.3	16.7	19.2	19.3	19.3
Public investment	4.5	5.3	5.1	6.4	6.6
Private investment	9.7	11.4	14.1	12.9	12.7
Gross national saving	19.5	16.7	18.8	17.2	16.9
Public saving	6.6	6.6	6.8	5.8	6.3
Private saving	12.9	10.1	12.0	11.4	10.6
External current account (deficit -)	5.2	0.0	-0.4	-2.1	-2.4
Public external debt 5/	18.5	16.2	14.4	15.3	16.5
(In percent of exports of goods and services)					
Debt service on external public debt	9.8	7.8	4.9	6.7	4.4
(In millions of U.S. dollars)					
Overall balance of payments (deficit -)	87.3	18.1	-5.5	39.1	60.4
Gross international reserves of the monetary authorities (months of imports of goods and services)	2.6	2.6	2.4	2.6	2.9

Sources: Barbadian authorities; and Fund staff estimates.

1/ End of period.

2/ Information Notice System; end of period.

3/ Fiscal year (April-March).

4/ In relation to liabilities of the banking system to the private sector at the beginning of the period.

5/ Refers to central government and government guaranteed debt.

Table 2. Barbados: Summary Balance of Payments and External Debt

	1996	1997	Prel. 1998	Projections	
				1999	2000
I. Balance of Payments					
(In millions of U.S. dollars)					
Current account	104.4	0.0	-8.8	-53.8	-63.4
Merchandise trade balance	-456.1	-599.0	-637.7	-692.9	-733.4
Exports	286.8	288.8	265.9	265.5	275.4
<i>Of which:</i>					
Domestic exports	214.3	210.5	190.5	189.4	196.3
Sugar and molasses	36.0	35.9	28.6	26.2	26.6
Other	178.3	174.6	161.8	163.3	169.7
Imports	742.9	887.7	903.6	958.5	1,008.8
Services (net)	573.1	602.6	650.3	661.2	685.5
<i>Of which:</i>					
Travel (credit)	692.6	723.2	766.3	774.5	808.9
Investment income (net)	-52.2	-51.0	-70.2	-76.3	-72.7
<i>Of which:</i>					
Interest on public debt	-31.7	-29.7	-27.4	-36.5	-38.4
Current transfers (net)	39.8	47.4	48.8	54.3	57.2
Capital account	-17.3	18.1	3.3	92.9	123.8
Long-term capital	20.0	4.8	33.2	137.1	123.8
Public sector	-5.8	-35.5	-33.4	59.1	45.3
Loans and investment	-5.8	-35.5	-33.4	59.1	45.3
Central government	4.0	-27.2	-31.4	59.0	26.8
Government guaranteed	-2.0	-0.6	-1.0	1.1	19.3
Central bank	-7.8	-7.8	-1.0	-1.0	-0.8
Private sector	25.9	40.3	66.6	78.0	78.5
Direct investment	45.5	38.3	28.0	63.1	44.7
Commercial banks	2.6	22.8	28.0	2.3	3.6
Other	-22.2	-20.8	10.7	12.6	30.3
Short-term capital	69.4	19.0	6.7	-10.6	0.0
Public sector	-0.8	-0.6	0.0	0.0	0.0
Commercial banks	78.8	3.0	6.7	-10.6	0.0
Other private	-8.7	16.7	0.0	0.0	0.0
Other capital 1/	-106.6	-5.7	-36.6	-33.6	0.0
Overall balance (deficit -)	87.3	18.1	-5.5	39.1	60.4
(In percent of GDP)					
Current account	5.2	0.0	-0.4	-2.2	-2.4

Table 2. Barbados: Summary Balance of Payments and External Debt

	1996	1997	Prel. 1998	Projections	
				1999	2000
II. External Debt					
(In millions of U.S. dollars)					
Public and publicly guaranteed					
Total outstanding (end of year)	393.1	341.5	352.8	411.6	457.1
Central government	370.5	336.4	323.2	382.0	413.8
Government guaranteed	3.0	2.4	27.8	28.8	43.3
Central bank	19.6	2.8	1.8	0.8	0.0
Debt service	122.4	101.2	65.9	90.4	62.0
Amortization	90.7	71.5	38.5	53.9	23.6
Interest payments	31.7	29.7	27.4	36.5	38.4
Private nonguaranteed debt					
Total outstanding (end of year)	75.5	72.3	66.7	79.3	109.5
Debt service	48.6	52.2	13.5	8.1	9.2
Amortization	44.8	44.8	9.3	2.4	1.8
Interest payments	3.8	7.4	4.2	5.7	7.4
(In percent of GDP)					
Total debt outstanding	23.8	20.0	17.4	18.3	20.1
Public and publicly guaranteed debt 2/	18.5	16.2	14.4	15.3	16.5
Net public debt 3/	9.6	4.6	3.2	3.8	3.7
(In percent of exports and tourism receipts)					
Debt service					
On total debt outstanding	17.5	15.2	7.7	9.5	6.6
On public and publicly guaranteed debt 2/	6.8	6.8	6.3	8.6	5.6

Sources: Ministry of Finance; Central Bank of Barbados; Barbados Statistical Service; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Includes central government and government guaranteed debt.

3/ Defined as public debt minus net international reserves.

Table 3. Barbados: Summary Operations of the Public Sector 1/

(In percent of GDP at market prices)

	1995/96	1996/97	1997/98	Prel.	Projections	
				1998/99	1999/00	2000/01
Public sector saving 2/	5.3	4.8	6.2	5.3	5.8	6.3
Central government	2.6	2.0	4.7	4.3	3.5	3.5
National Insurance Scheme	2.3	2.4	2.5	2.4	2.0	2.3
Public enterprises	0.4	0.4	-1.0	-1.4	0.3	0.5
Public sector capital expenditure and net lending	3.2	5.6	6.4	5.1	6.4	6.6
Central government	2.9	4.9	5.5	5.0	5.2	5.4
National Insurance Scheme	0.0	0.0	0.0	0.0	0.0	0.0
Public enterprises	0.3	0.7	0.9	0.1	1.2	1.2
Underlying public sector balance 3/	2.1	-0.8	-0.2	0.2	-0.6	-0.3
Central government	-0.3	-2.9	-0.8	-0.7	-1.7	-1.9
National Insurance Scheme	2.3	2.4	2.5	2.4	2.0	2.3
Public enterprises	0.1	-0.3	-1.9	-1.5	-0.9	-0.7

Sources: Ministry of Finance; National Insurance Scheme; and Fund staff estimates.

1/ Fiscal year (April-March).

2/ Includes capital revenue.

3/ Excludes nonrecurrent operations.

Table 4. Barbados: Summary Operations of the Central Government 1/

	1995/96	1996/97	1997/98	Prel. 1998/99	Projections	
					1999/00	2000/01
(In millions of Barbados dollars)						
Total revenue and grants	1,155.9	1,217.6	1,446.1	1,553.2	1,621.0	1,704.3
Current revenue	1,153.1	1,215.2	1,443.7	1,542.2	1,610.4	1,694.3
Tax revenue	1,082.3	1,130.6	1,381.3	1,447.5	1,553.8	16,113.5
Taxes on income and profits	364.2	385.3	419.3	449.3	479.2	505.3
Levies	13.6	20.6	26.2	27.6	28.8	30.4
Taxes on property	70.0	75.8	72.4	85.6	89.4	94.3
Taxes on goods and services	450.5	488.5	723.2	735.2	774.8	814.8
Import duties	93.2	91.4	127.7	136.7	147.9	154.3
Stamp duties	90.8	69.0	12.5	13.1	13.7	14.4
Nontax revenue	70.8	84.6	62.4	94.7	76.6	80.8
Capital revenue and grants	2.8	2.4	2.4	11.0	10.6	10.0
Total expenditure and net lending	1,166.9	1,336.5	1,484.3	1,587.6	1,706.9	1,805.9
Current expenditure	1,055.4	1,137.2	1,236.7	1,344.6	1,444.7	1,519.5
Wages and salaries	412.3	448.9	478.1	494.8	570.1	581.1
National insurance contribution	27.0	28.6	29.7	31.8	38.8	39.5
Goods and services	114.7	122.4	138.3	164.9	170.7	185.1
Interest	187.8	196.7	198.3	221.3	243.6	256.1
Domestic	135.4	149.6	159.3	170.0	174.6	186.2
Foreign	52.4	47.1	39.0	51.3	69.0	69.9
Transfers	313.6	340.6	392.3	431.8	421.5	457.7
Capital expenditure and net lending	111.5	199.3	247.6	243.0	262.2	286.4
Underlying surplus/deficit (-)	-11.0	-118.9	-38.2	-34.4	-85.9	-101.6
Extraordinary transactions 2/	-0.8	-41.4	0.0	0.0	0.0	0.0
Overall surplus/deficit (-)	-11.8	-160.3	-38.2	-34.4	-85.9	-101.6
Current surplus/deficit (-)	97.7	78.0	207.0	197.6	165.7	174.7
Primary surplus/deficit (-)	176.8	77.8	160.1	186.9	157.7	154.5
(In percent of GDP at current market prices)						
Total revenue and grants	29.7	29.8	32.1	32.2	32.2	32.1
Current revenue	29.6	29.7	32.1	32.0	32.0	31.9
Tax revenue	27.8	27.7	30.7	30.0	30.4	30.4
Nontax revenue	1.8	2.1	1.4	2.0	1.5	1.5
Capital revenue and grants	0.1	0.1	0.1	0.2	0.2	0.2
Total expenditure and net lending	30.0	32.7	33.0	32.9	33.9	34.0
Current expenditure	27.1	27.8	27.5	27.9	28.7	28.6
Wages and salaries 3/	11.3	11.7	11.3	10.9	12.1	11.7
Goods and services	2.9	3.0	3.1	3.4	3.4	3.5
Interest	4.8	4.8	4.4	4.6	4.8	4.8
Transfers	8.1	8.3	8.7	9.0	8.4	8.6
Capital expenditure and net lending	2.9	4.9	5.5	5.0	5.2	5.4
Underlying surplus/deficit (-)	-0.3	-2.9	-0.8	-0.7	-1.7	-1.9
Extraordinary transactions 1/	0.0	-1.0	0.0	0.0	0.0	0.0
Overall surplus/deficit (-)	-0.3	-3.9	-0.8	-0.7	-1.7	-1.9
Current surplus/deficit (-)	2.5	1.9	4.6	4.1	3.3	3.3
Primary surplus or deficit	4.5	1.9	3.6	3.9	3.1	2.9

Sources: Ministry of Finance; and Fund staff estimates.

1/ Fiscal year (April-March).

2/ Includes assumption of Barbados Development Bank debt, capitalization of Barbados National Bank, and divestment proceeds.

3/ Includes national insurance contributions.

Table 5. Barbados: Summary Indicators of the Banking System

	1996	1997	Prel. 1998	1999		
				Mar.	Jun.	Dec.
(In millions of Barbados dollars)						
I. Central Bank						
Net international reserves	513.7	548.0	538.8	553.5	759.5	617.0
Net domestic assets	-35.5	-126.7	-52.7	-100.2	-250.2	-40.8
Credit to the public sector	-224.5	-218.4	-214.1	-253.9	-374.6	-176.9
Medium- and long-term foreign liabilities	20.9	5.4	3.4	3.2	2.4	3.2
Monetary base	457.3	415.9	482.7	450.1	506.9	572.9
Liabilities to commercial banks	237.2	176.3	214.5	183.1	251.1	290.0
Currency in circulation	220.1	239.6	268.2	267.0	255.8	283.0
II. Banking System						
Net international reserves	421.2	466.3	417.7	514.6	698.1	517.0
Net domestic assets	1,972.0	2,115.5	2,491.9	2,523.1	2,466.2	2,663.6
Credit to the public sector	399.5	351.2	338.9	362.0	307.0	280.7
Credit to the central government	641.7	673.5	585.7	597.3	518.3	535.0
National Insurance Scheme	-136.2	-208.7	-159.3	-158.3	-175.2	-165.6
Other	-106.0	-113.7	-87.4	-77.0	-36.1	-88.6
Credit to the private sector	1,540.9	1,842.6	2,140.7	2,217.4	2,337.4	2,408.3
Medium- and long-term foreign liabilities	50.6	69.6	128.8	131.6	117.8	128.6
Liabilities to the private sector	2,342.6	2,512.2	2,780.8	2,906.1	3,046.5	3,052.0
Broad money	2,230.7	2,389.3	2,663.2	2,782.0	2,918.2	2,929.7
Narrow money	708.5	753.7	882.6	910.2	942.0	961.9
Quasi-money	1,522.2	1,635.6	1,780.7	1,871.8	1,976.2	1,967.8
Private share capital and surplus	111.9	122.9	117.6	124.1	128.3	122.2
(Annual nominal percentage change)						
I. Central Bank						
Net international reserves	51.4	6.7	-1.7	-11.1	15.7	14.5
Net domestic assets 1/	-23.5	-19.9	17.8	20.3	-8.0	2.5
Credit to the public sector 1/	-35.5	1.3	1.0	9.9	-12.3	7.3
Medium- and long-term foreign liabilities	-43.4	74.2	-36.6	-38.3	-45.8	-5.8
Monetary base	31.1	-9.0	16.1	4.8	16.2	18.7
Liabilities to commercial banks	59.9	-25.7	21.7	-3.3	31.2	35.2
Currency in circulation	9.9	8.9	11.9	11.2	4.5	5.5
II. Banking System						
Net international reserves	37.8	10.7	-10.4	-7.7	25.7	23.8
Net domestic assets 2/	4.6	6.1	15.0	14.8	8.1	6.2
Credit to the public sector 2/	1.5	-2.1	-0.4	3.4	-1.6	-2.2
Credit to the private sector 2/	3.1	12.9	11.9	13.4	14.9	9.6
Medium- and long-term foreign liabilities	-30.0	37.6	85.1	79.8	47.6	-0.2
Liabilities to the private sector	11.1	7.2	10.7	10.9	12.0	9.7
Broad money	11.1	7.1	11.5	11.6	12.3	10.0
Narrow money	21.5	6.4	17.1	11.8	12.0	9.0
Quasi-money	6.9	7.5	8.9	11.5	12.5	10.5
Private share capital and surplus	10.8	9.8	-4.4	-1.9	4.3	4.0

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

1/ In relation to the monetary base at the beginning of the period.

2/ In relation to liabilities to the private sector at the beginning of the period.

Table 6. Barbados: Indicators of External Vulnerability

(In percent of GDP, unless otherwise indicated)

	1996	1997	Prel. 1998	Projections	
				1999	2000
Financial indicators					
Public sector debt 1/	52.6	47.2	42.7	41.7	40.5
Broad money (in percent change, 12-month basis)	11.1	7.1	11.5	10.0	5.8
Private sector credit (in percent change, 12-month basis)	4.4	19.6	16.2	12.5	6.3
3-month T-bill rate 2/	5.6	4.9	5.7	6.0	6.2
3-month T-bill rate (real) 3/	3.7	1.3	4.0	5.5	3.6
External indicators					
Exports of goods and services (in percent change, 12-month basis in U.S. dollars)	7.6	4.4	2.7	1.0	4.2
Imports of goods and services (in percent change, 12-month basis in U.S. dollars)	7.5	14.9	2.0	4.3	5.3
Current account balance	5.2	0.0	-0.4	-2.2	-2.4
Capital and financial account balance	-0.9	0.8	0.1	3.7	4.7
Gross official reserves (in millions of U.S. dollars) 4/	222.6	242.0	236.1	275.2	335.6
Central bank short-term foreign liabilities (in millions of U.S. dollars)	25.5	12.4	6.0	6.0	6.0
Official reserves in months of imports of goods and services 4/	2.6	2.6	2.4	2.6	2.9
Broad money to reserves	5.3	5.1	6.4	5.7	5.0
Total short-term external debt to reserves 4/ 5/	24.1	18.6	23.7	9.7	8.6
Total external debt 6/	18.5	16.2	14.4	15.3	16.5
Total external debt to exports of goods and services (in percent) 6/	31.5	26.2	26.4	30.5	32.5
External interest payments to exports of goods and services (in percent) 7/	2.5	2.3	2.0	2.7	2.7
External amortization payments to exports of goods and services (in percent) 8/	7.3	5.5	2.9	4.0	1.7
Exchange rate (per U.S. dollar, end of period)	2.0	2.0	2.0	...	...
REER appreciation (12-month basis)	-0.6	5.2	-1.0	...	...
Financial market indicators					
Foreign currency debt rating 9/	Ba2	Ba1	Ba1	...	...
Spread of benchmark bonds (basis points, end of period)	...	...	399.2	...	...
Memorandum items:					
Financial risk factors 10/					
Share of foreign deposits in total deposits	16.8	12.1	13.0	13.0	...
Share of foreign currency denominated liabilities in total liabilities	18.0	15.4	16.0	16.0	...

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

1/ Central government debt, net of holdings by statutory bodies and National Insurance Scheme.

2/ Average rate of discount (end of period).

3/ T-bill rate adjusted for actual year-on-year inflation.

4/ Reserves exclude CARICOM facility and regional bilateral balances, which are not usable.

5/ Short-term external debt refers to public sector amortization due in the following year (including to the Fund) and central bank short-term liabilities.

6/ Refers to central government and government guaranteed debt.

7/ Refers to public sector interest.

8/ Refers to public sector amortization.

9/ Moody's.

10/ Refers to data on commercial banks.

Table 7. Barbados: Medium-Term Economic Outlook

	1998	1999	2000	2001	2002	2003	2004
I. Selected Indicators							
(Annual percentage change)							
Real GDP	4.8	2.9	3.7	2.5	2.5	2.8	2.8
Consumer prices (12-month increase)	1.7	0.5	2.5	2.0	2.0	2.0	2.0
Tourist arrivals	8.5	1.0	3.0	3.0	3.0	3.0	3.0
II. Savings-Investment							
(Percent of GDP)							
Gross national saving	18.8	17.2	16.9	17.0	17.5	17.6	17.6
Public	6.8	5.8	6.3	6.6	7.1	6.9	7.0
Private	12.0	11.4	10.6	10.4	10.4	10.7	10.6
Investment	19.2	19.3	19.3	19.2	19.5	19.6	19.6
Public	5.1	6.4	6.6	6.7	6.9	6.4	6.3
Private	14.1	12.9	12.7	12.5	12.6	13.2	13.3
Foreign savings	0.4	2.1	2.4	2.2	2.0	2.0	2.0
III. Public Sector Operations 1/							
(Percent of GDP)							
Public sector savings 2/	5.3	5.8	6.3	6.6	7.1	6.9	7.0
Central government	4.3	3.5	3.5	3.6	3.9	3.5	3.7
National Insurance Scheme	2.4	2.0	2.3	2.4	2.6	2.8	2.7
Public enterprises	-1.4	0.3	0.5	0.6	0.6	0.6	0.6
Capital expenditure	5.1	6.4	6.6	6.7	6.9	6.4	6.3
Central government	5.0	5.2	5.4	5.1	5.3	5.3	5.0
Public enterprises	0.1	1.2	1.2	1.6	1.6	1.1	1.3
Public sector balances	0.2	-0.6	-0.3	-0.1	0.2	0.5	0.7
Central government	-0.7	-1.7	-1.9	-1.5	-1.4	-1.8	-1.3
National Insurance Scheme	2.4	2.0	2.3	2.4	2.6	2.8	2.7
Public enterprises	-1.5	-0.9	-0.7	-1.0	-1.0	-0.5	-0.7
IV. Balance of Payments and External Debt							
(Annual percentage change)							
Exports of goods and services	2.7	1.0	4.2	5.4	5.6	5.6	5.6
Imports of goods and services	2.0	4.3	5.3	5.1	5.2	5.7	5.7
(In months of imports of goods and services)							
Gross official reserves	2.4	2.6	2.9	3.2	3.4	3.7	4.2
(Percent of GDP)							
Public and publicly guaranteed debt							
Gross	15.3	16.5	17.3	17.3	17.6	17.9	18.1
Net of official reserve assets	3.2	3.8	3.7	2.9	2.1	1.1	-0.3

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

1/ Fiscal year (April-March).

2/ Includes capital revenue.

Barbados—Fund Relations
(As of August 31, 1999)

I. Membership Status: Joined December 29, 1970; Article VIII

II. General Resources Account:	SDR Million	Percent of Quota
Quota	67.50	100.0
Fund holdings of currency	62.83	93.1
Reserve tranche position in the Fund	4.68	6.9

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	8.04	100.0
Holdings	0.01	0.2

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements:

	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	2/7/92	5/31/93	23.89	14.67
Stand-By	10/1/82	5/31/84	31.88	31.88

VI. Projected Obligations to the Fund (SDR Million):
(Based on existing use of resources and present holdings of SDRs):

	Overdue 8/31/99	1999	2000	2001	2002	2003
Charges/interest	0.0	0.1	0.3	0.3	0.3	0.3
Total	0.0	0.1	0.3	0.3	0.3	0.3

VII. Exchange Rate Arrangements:

The Barbados dollar has been pegged to the U.S. dollar since mid-1975 at BDS\$2.00=US\$1.00. On July 31, 1995 the official buying and selling rates for the U.S. dollar were BDS\$1.9975 and BDS\$2.0350, respectively, per US\$1.

There are no restrictions on the making of payments and transfers for current international transactions subject to approval under Article VIII. There are exchange controls on invisibles, but bona fide transactions are approved. All capital outflows and certain capital inflows require approval. The authorities accepted the obligations of Article VIII sections 2, 3, and 4 on November 3, 1993.

VIII. Last Article IV Consultation:

The 1997 Article IV consultation discussion was concluded by the Executive Board on January 30, 1998 (EBM/98/10); the documents were (staff report) SM/97/294 and (recent economic developments) SM/98/13. Barbados is on the standard 12-month consultation cycle.

IX. Technical Assistance:

Department	Dates	Purpose
FAD	Nov. 6-17, 1995 Feb. 28-Mar. 12, 1996	Introduction of a value-added tax
MAE	Nov. 1995	Introduction of a deposit insurance scheme
FAD	June 29-July 10, 1992 Oct. 26-Nov.6, 1992	Reform of the indirect tax system
FAD	Feb. 17-28, 1992	Reform of the direct tax system
MAE	Jan. 28-Feb. 6, 1992	Restructuring of the Barbados National Bank
STA	May 15-26, 1989	Review of balance of payments and banking statistics
FAD	Feb. 28, 1989-Feb. 1, 1990	Resident Fiscal Advisor in the Ministry of Finance to provide assistance in budget formulation, structure, and execution

X. Resident Representative:

The resident representative post was closed in January 1995.

Barbados: Relations with the Inter-American Development Bank

I. ACTIVE LOANS TO BARBADOS AS OF JUNE 30, 1999

(In millions of U.S. dollars)

Purpose	Approval Date	Amount	Amount Disbursed	Amount Available
Student Revolving Fund III	Nov. 1989	4.7	4.7	0.0
Primary Education	Nov. 1992	11.6	9.1	2.5
South Coast Sewerage	Nov. 1992	51.2	25.1	26.1
Global Pre-Investment	Dec. 1992	7.0	6.8	0.2
Bridgetown Roads	May. 1993	18.5	1.1	17.4
Tax Administration and Public Expenditure	Aug. 1993	8.1	7.9	0.2
Coastal Conservation I	Dec. 1994	3.6	2.4	1.2
Investment Sector Reform Program	Nov. 1995	35.0	25.2	9.8
Solid Waste Management Program	Oct. 1998	13.0	0.0	13.0
Education Sector Enhancement Program	Dec. 1998	85.0	0.0	85.0
Total		237.7	82.3	155.4

II. NET CASH FLOW OF IDB CONVERTIBLE RESOURCES

(In millions of U.S. dollars)

	1992	1993	1994	1995	1996	1997	1998
Loan approvals	69.8	26.6	3.6	35.0	0.0	0.0	98.0
Repayments	4.7	5.7	6.4	7.4	7.9	7.3	7.5
Disbursements	4.2	3.9	4.8	7.1	29.0	15.1	17.9
Net loan flow	-0.5	-1.8	-1.6	-0.3	21.1	7.8	10.4
Interest and charges	5.8	6.3	6.3	6.7	7.3	7.9	8.2
Debt service	10.5	12.0	12.7	14.1	15.2	15.2	15.7
Debt outstanding	96.0	97.3	100.6	102.0	122.4	130.2	140.6

Barbados—Outstanding Statistical Issues

Barbados cooperated with the Fund in the pilot implementation of the General Data Dissemination System (GDDS). The draft metadata, including plans for improvement of the quality of data, should be updated and finalized soon by the Barbadian authorities.

1. Real sector

Figures for gross domestic product at constant prices are based on 1974 price weights, but the authorities are in the process of updating the weights to 1994.

2. Nonfinancial public sector

Fairly comprehensive and up-to-date data above the line are available for the central government, but there is a lag in the reporting of transfers. As a result of net errors and omissions in the recording of financing transactions, a significant discrepancy exists between the deficit/surplus and financing data. Data on public enterprises are not systematically and promptly reported to the Ministry of Finance.

3. Financial sector

The coverage, quality and timeliness of central bank accounts have improved recently, but important weaknesses remain. More timely reporting by commercial banks and other financial institutions is also required. The Central Bank of Barbados (CBB) classifies loans to nonresidents in domestic currency as credit to the private sector, and domestic currency deposits of nonresidents as part of the broad money stock. The staff recommends that these two items be classified under the net foreign assets of the commercial banks for consistency with the balance of payments methodology. The exclusion of offshore banks' accounts from money and banking statistics is a major weakness of the monetary statistics in Barbados. In addition, the concept of residency applied in monetary statistics is not fully consistent with that of the fifth edition of the *Balance of Payments Manual*. For example, nonnational individuals are recognized as residents only after they have continuously resided in Barbados for at least three years. Also, accounting conventions underlying monetary data compiled by the CBB are in need of improvement. The CBB data are on a cash basis and do not include accrued receivables and payables. Commercial banks' positions are recorded on an accrual basis; however, the accrued interest receivable and payable is classified under other assets or other liabilities respectively rather than under the appropriate category of domestic credit. Marketable securities are recorded at the acquisition cost and revalued to market value only on an annual basis (as of December 31). Short-term zero-coupon securities (treasury bills) are recorded at acquisition cost and are not revalued to market value until redemption at maturity. Positions with the IMF (SDR holdings, Reserve Tranche Position, and SDR Allocation) are valued at the IMF holdings rate rather than at the end-of-period market rate.

4. External sector

Lags in the compilation of merchandise trade data limit the timeliness of estimating the external current account balance. Estimates of the components of the investment account need to be strengthened.

Barbados: Core Statistical Indicators
as of August 31, 1999

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money 1/	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	Fixed rate	08/18/99	08/18/99	08/18/99	08/11/99	06/99	06/99	06/99	Q2/99	Q2/99	Q2/99	05/99
Date Received		08/31/99	08/31/99	08/31/99	08/31/99	08/99	08/99	08/99	08/99	08/99	08/99	08/99
Frequency of Data 2/		W	W	W	W	M	M	M	Q	M	Q	M
Frequency of Reporting 2/		W	W	W	W	M	M	M	Q	M	Q	M
Source of Update 3/		A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting 4/		C	C	C	C	C	C	C	C	C	C	C
Confidentiality 5/		C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication 2/		W	W	W	W	M	M	M	Q	M	Q	M

1/ Preliminary estimate. Actual data provided with a lag of two to three months.

2/ W-weekly, M-monthly, Q-quarterly.

3/ A-direct, reporting by central bank, ministry of finance, or other official agency N-official publication and press release.

4/ C-facsimile.

5/ C-for unrestricted use.



INTERNATIONAL MONETARY FUND

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EXTERNAL
RELATIONS
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Public Information Notice (PIN) No. 99/112
FOR IMMEDIATE RELEASE
December 10, 1999

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Barbados

On November 5, 1999, the Executive Board concluded the Article IV consultation with Barbados.¹

Background

Since the early 1990s, Barbados has been experiencing steady economic growth founded on prudent economic management and generally favorable external conditions. Economic policy has incorporated fiscal and wage restraint, consistent with the maintenance of the long standing exchange parity with the United States dollar. Barbados relies heavily on tourism, high-cost sugar exports to protected markets and, in recent years, offshore business services.

In 1998, real GDP growth picked up, based on strong performances in the tourism and construction sectors, although a drought led to a decline in sugar output. While the pace of growth slowed to 2¾ percent in the first half of 1999 (compared with a year earlier) domestic demand continued to expand vigorously as the development of tourism facilities and private consumption responded to strong growth of credit to the private sector. Inflation was down to 0.4 percent during the year ending June 1999, while the unemployment rate declined further to 10.6 percent.

The nonfinancial public sector balance is estimated to have shifted from a small deficit in FY 1997/98 to a small surplus in FY 1998/99 (fiscal years begin in April). The central government deficit remained at about ¾ percent of GDP in FY 1998/99 as higher current spending was broadly offset by a reduction in capital spending. The rise in current spending

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

partly reflected the introduction in September 1998 of government-subsidized mortgage facilities and other incentives to encourage home ownership, increases in pensions and an increase in government employment. The combined deficit of the public enterprises declined from 1.9 percent of GDP in FY 1997/98 to 1.5 percent of GDP in FY 1998/99, while the surplus of the National Insurance Scheme remained at about 2 percent of GDP.

The external current account moved from balance in 1997 to a deficit in 1998, which widened in early 1999 as private consumption and investment pushed up imports and tourist arrivals slowed. Nonetheless, following a decline in 1998, official gross international reserves rose sharply during the first half of the year (to over three months of imports of goods and services) in large measure because of government borrowing in the regional capital market in April 1999.

The authorities continued to implement a prudent incomes policy and in May 1998 representatives of the government, business and labor signed a third social pact covering 1998–2000, which maintains productivity-based wage increases. Progress continued on structural reforms including some restructuring of the Barbados National Bank and the financially troubled private sugar industry, while import duties were lowered. Anti-money laundering legislation was passed in December 1998.

The authorities' economic objectives are to keep inflation low and sustain the growth of output and employment based on service exports, while reducing vulnerabilities as the economy continues to open up and preparing for the aging of the population in the long term. Accordingly, their strategy is to maintain the finances of the nonfinancial public sector near balance in support of the exchange rate peg by taking steps to increase public saving, while carrying out a public sector investment program focused on economic and social infrastructure and environmental protection. The strategy also calls for tightening credit policy and increasing public sector deposits at the central bank to help build the official international reserves cushion, and implementing structural reforms covering education, health, the public pension system, the regulation and supervision of utility monopolies and the nonbank financial sector, and privatization.

The authorities have recently taken steps to slow the expansion of domestic demand, including delaying the implementation of certain public investment projects since the latter part of 1998, a 1 percentage point increase in the reserve requirement on bank deposits to 6 percent and an increase in the central bank discount rate from 9 percent to 10 percent in May 1999. However a further boost to domestic demand is likely to come from the impending payment of public sector wage increases retroactive to April 1999.

With the aim of reducing production costs and improving competitiveness and the investment environment, in late August 1999 the authorities announced several measures that on balance are expected to weaken the public finances by ½ percent of GDP on an annual basis. These include reductions in energy taxes and seaport rates; new tax and import tariff incentives for the tourism, agriculture and fishing industries; replacement of import licenses on a few

manufactured items by tariffs from April 2000; and measures to improve the collection of property transfer and land taxes.

Executive Board Assessment

Executive Directors commended the authorities for the successful implementation of stabilization policies and structural reforms which have contributed to Barbados's continued strong economic performance, and they also welcomed the impressive improvements in social indicators. Directors noted, however, that Barbados remains vulnerable to exogenous shocks because of its undiversified economic base, and that the country faces the challenge of dealing with an aging population in the context of the generous welfare system.

Directors emphasized that in the short term, the authorities should keep the fiscal deficit near balance to temper the expansion of domestic demand, contain the expected widening of the external current account deficit, and reduce pressures on official international reserves. In this context, restraint on the public sector wage bill is essential. In addition, it would be important to apply priorities on capital spending, and to refrain from taking steps that could undermine tax collection, while acting to strengthen tax administration.

Directors noted that over the medium term, maintaining the public finances broadly in balance would be required in order to lower the public debt-to-GDP ratio, and leave room for continued strong private investment, while securing balance of payments viability. To do so, while keeping an appropriate level of public investment spending, it would be necessary not only to continue implementing a cautious wage policy, but also to raise the efficiency of public services and the social safety net. It would also be important to undertake a comprehensive reform of the public pension system in which the authorities' efforts to facilitate the development of private pensions would be helpful. Noting the rapid expansion of bank credit to the private sector that has contributed to the strong growth of domestic demand, Directors supported the actions recently taken by the authorities to tighten domestic credit conditions.

Directors encouraged the authorities to develop market-based instruments of monetary control. They took note of the progress being made to improve the health of the financial system and to strengthen its supervision and regulation, and encouraged the authorities to continue these efforts in line with international best practice.

Directors noted that the exchange rate peg to the U.S. dollar, supported by appropriate macroeconomic policies, has been effective in keeping inflation low and bolstering confidence. They welcomed the authorities' efforts to increase official international reserves to strengthen the credibility of the peg in the context of the economy's vulnerability to exogenous shocks.

Directors commended the spirit of the cooperation between the labor unions, employer associations, and the Government, as manifested in agreements on a series of income protocols which have been vital to securing wage restraint and stable labor relations. However, pointing to the significant increase in real wages relative to trading partners in the last decade, they underscored the need to maintain external competitiveness, and in this connection they

welcomed the creation of the commission on competitiveness. Directors recommend that steps be taken, also, to promote labor market flexibility. More generally, they considered that trade and tax changes, and structural reforms are needed to fortify external competitiveness, and welcomed the authorities' recognition of, and attention to, these issues.

Directors welcomed the planned restructuring of the regulatory framework covering utilities. They recommended that the authorities redouble their efforts to privatize state-owned entities, rationalize tax incentives, and reduce corporate tax rates, once fiscal and macroeconomic conditions allow.

Directors encouraged the authorities to continue their efforts to improve the quality of national accounts, balance of payments, and public finance data in order to provide a better basis for policy formulation.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. As part of a pilot project, the staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 1999 Article IV consultation with Barbados is also available on the IMF's website (<http://www.imf.org>).

Barbados: Selected Economic Indicators

	1996	1997	1998	Projections	
				1999	2000
(Annual percentage changes)					
Output and prices					
Real GDP	4.1	2.6	4.8	2.9	3.7
Consumer prices (12-month increase)	1.8	3.6	1.7	0.5	2.5
Tourist arrivals	1.1	5.6	8.5	1.0	3.0
Unemployment (percent of labor force)	14.3	12.2	11.8	...	...
Money and credit					
Net domestic assets 1/	4.6	6.1	15.0	6.2	1.8
Public sector credit	1.5	-2.1	-0.5	-2.2	-2.7
Private sector credit	3.1	12.9	11.9	9.6	4.6
Money and quasi-money	11.1	7.1	11.5	10.0	5.8
(In percent of GDP)					
Public sector operations 2/					
Public sector balance	-0.8	-0.2	0.2	-0.6	-0.4
Central government	-2.9	-0.8	-0.7	-1.7	-2.0
National Insurance	2.4	2.5	2.4	2.0	2.3
Public enterprises	-0.3	-1.9	-1.5	-0.9	-0.7
Savings and investment					
Gross domestic investment	14.3	16.7	19.2	19.3	19.3
Gross national saving	19.5	16.7	18.9	17.2	16.9
External sector					
External current account balance	5.2	0.0	-0.4	-2.1	-2.4
Public external debt 3/	18.5	16.2	14.4	15.3	16.5
Gross official reserves (in months of imports) 4/	2.6	2.6	2.4	2.6	2.9

Sources: Barbadian authorities; and IMF staff estimates and projections.

1/ In relation to liabilities of the banking system to the private sector at the beginning of the period.

2/ Fiscal years (April–March).

3/ Refers to central government and government guaranteed debt.

4/ Imports of goods and services in the following year.

**Statement by Thomas A. Bernes, Executive Director
for Barbados
November 5, 1999**

1. My Barbadian authorities would like to convey their appreciation for the useful policy discussions with the staff during the process of the Article IV consultation. They place great importance on their ongoing dialogue with the Fund.

2. My authorities broadly concur with the thrust of the staff's recommendations. They are aware of the difficult challenges that lie ahead with the aging of the population and the inevitable liberalization of the economy, and are ready to meet them head on, as their track record of the 1990s attests. Indeed, the authorities of Barbados are already actively taking steps to address these structural challenges as will be discussed below. And they continue to believe that their strategy of sustainable growth with low inflation, built upon the pillars of a fixed exchange rate, fiscal discipline and a hospitable investment environment will provide the best possible foundation for the needed structural reforms.

Recent Economic Developments and Outlook

3. Barbados has made a successful transition from an agriculture-based economy to an economy fueled by tourism, financial services and small manufacturing, owing in large measure, to the implementation of structural reforms and government's skillful management of the economy. In 1998, the economy recorded its sixth consecutive year of growth, low inflation and declining unemployment. Real GDP growth was estimated at 4.8 percent driven by strong growth in the construction and tourism sectors. Unfavourable weather conditions and a fall in the number of hectares harvested led to a sharp fall in sugar production. As a result, the overall export sector grew only by 1.3 percent.

4. Preliminary data for the first nine months of 1999 indicate a slowdown in the rate of growth of real GDP to approximately 2.5 percent. The economy is projected to expand by 3 percent during the last three months of this year. With population growth of less than 1 percent per annum, Barbados can realize its objective of creating jobs and supporting a higher standard of living for its people by sustaining a growth rate of about 3 percent per year. The unemployment rate has been trending downward, reaching 10.6 percent in June 1999. The inflation rate, as measured by the year-over-year increase in the CPI, was 1.2 percent in September, up from 0.7 percent in the comparable period in 1998. Increases in the prices of food and housing were the main contributors.

5. For the first time since 1991, the external current account showed a small deficit of 0.4 percent in 1998. This was mainly due to an increase in imports, fuelled by rising credits and a strong expansion in the construction sector. Exports were also somewhat weaker due to

the drop in agricultural output. In the first nine months of 1999, the current account deficit widened further. It bears stressing that the widening of the current account deficit is partly attributable to the current high level of investment in the economy and to the reconstruction of two major hotels. This should help to reposition the tourism sector and enhance both the quality and the quantity of the tourist product. A substantial portion of the investment is being financed by long-term private sector capital inflows.

Fiscal Policy

6. The public sector recorded a surplus equivalent to 0.2 percent of GDP in 1998. A 0.7 percent deficit in the central government and a 1.3 percent deficit in public enterprises were more than offset by a 2.1 percent surplus of the National Insurance Scheme. Between January and September of this year, the Government recorded a deficit of \$44.6 million, some \$3.5 million higher than that of the corresponding period last year.

7. In September last year, in early recognition of the warning signals flashed by the rapid growth of credit, measures were instituted to reduce the deficit below the target set at the start of the financial year, including limiting capital expenditures. Indeed, net domestic credit to Government fell from \$682.7 million at the start of 1998 to \$499.1 million at March 1999.

8. One of the areas of discussion with the staff was the restoration of the 1991 public sector wage cut. The staff has recommended the gradual restoration of the cut over a four-year period. The authorities of Barbados understand the merits of this proposal and have discussed such a strategy with the labour unions. In any event, following the public sector wage settlement, the Central Bank of Barbados and the Government are designing instruments to ensure that a significant proportion of the settlement is used to purchase government securities.

9. In its 1999 budget, the Government enunciated measures to strengthen the competitiveness of its productive sectors, thus enhancing its ability to build up its import reserve cover over the medium term.

Monetary and External Policies

10. In addition to the actions taken by the Government, the Central Bank of Barbados has also taken measures to dampen domestic demand pressures. The required cash reserve ratio and the discount rate were both increased by one percentage point in June. To supplement these measures, the Central Bank removed approximately \$20 million of deposits under its management from the banking system and invested them in foreign securities. Monetary policy measures tend to work with some lag, but there is evidence that liquidity in the financial system is tightening and that bank lending will slow in the months ahead. Interest rates are expected to increase slightly and this should help to promote national savings.

11. These monetary policy measures were largely taken in response to extraordinarily rapid growth in credit to the non-financial private sector. Between July 1998 and July 1999, credit to the non-financial private sector increased by over \$332 million, compared to an increase of \$265.5 million in the same period a year earlier, due mainly to a rise in personal disposable income and the rapid growth of activity in the construction sector. Since the measures were introduced, credit creation has slowed somewhat. Nevertheless, the growth of credit to the private sector will be kept under review. And if necessary further protective measures will be enacted.

Structural Reform

12. Barbados has already carried out significant structural reforms which have been important in providing the basis for the sustained non-inflationary growth that has been achieved in recent years. Nevertheless, given the impending changes in its external trading environment and the inevitable changes associated with an aging population, Barbados continues to face imposing structural challenges.

13. In April 1994, Barbados entered an arrangement with the WTO to put in place new international trade arrangements by the year 2004, among which are to be the dismantling of non-tariff barriers to trade and their replacement with bound tariffs which are only to be temporary. In addition, the reconstitution of the Caribbean economy as a single market will entail the removal of all remaining tariff and non-tariff barriers to the movement of goods in the region and will provide for the free movement of capital and people as well. To date, Caribbean Governments have signed seven of the nine protocols required to create the legal framework within which a Single Market and Economy can be formed and function. And there are significant trade negotiations in progress with the Americas and Europe.

14. To facilitate the transition to this new trading environment, the Government of Barbados has announced its intention to create a Commission on Competitiveness. The Commission will act to cut red tape and to ensure that public sector agencies adopt practices conducive to investment. It will also exercise oversight over the implementation of the provisions of the Single Market and Economy as they affect the Barbadian economy, paying special attention to the diffusion of improved information technology through the economy as a factor in inducing improved competitiveness.

15. Before leaving the topic of the change in the external trading environment, my authorities would like to express their support for the announced initiative by the staff to write an economic outlook report for the Caribbean region in the spring. Reports addressing the Caribbean region as a whole will become increasingly necessary as economic integration in the region progresses.

16. The Government's approach to the challenge of providing income support for an aging population is comprised of three elements. One element is putting government finances in a position to sustain its responsibilities. A second element deals with the various instruments made and being made available to encourage voluntary savings and the

regulation of the environment for private pensions. To facilitate the development of private pensions and pension fund managers, modern pension legislation is being put in place. The legislation will come before Parliament in the new year. The third, and perhaps the most critical element at this juncture, is ensuring the future sustainability of the National Insurance Scheme.

Other Issues

17. The authorities will continue to work with the fund to improve the quality of data. As well, during the discussions for the Article IV consultation they requested technical assistance in the areas of fiscal incentives and tax administration, and the regulatory framework for public utilities.

18. My Barbadian authorities strongly support the publication of Article IV reports and have agreed to participate in the pilot project on transparency.