

**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.