Press Information Notice (PIN) No. 98/10
FOR IMMEDIATE RELEASE
February 25, 1998

International Monetary Fund
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Barbados

The IMF Executive Board on January 30, 1998 concluded the 1997 Article IV consultation[1] with Barbados.

Background

Barbados' economic performance has improved considerably in recent years due to good economic management and a more favorable external environment. Subsequent to a recession in 1990–92 and a slow recovery in 1993, **real GDP** growth averaged 3.5 percent a year during 1994–95. Growth accelerated to 5 percent in 1996, based on a recovery in sugar output from a drought in 1995 and a strong expansion in tourism, commerce, and construction. The performance of these sectors remained relatively strong in 1997, when real GDP is estimated by the Central Bank of Barbados (CBB) to have increased by 4.3 percent.

Inflation was low during 1994–96 (an average of 1.7 percent). However, prices rose by 7 percent in January 1997 with the introduction of a value-added tax (VAT); the largest increase was recorded in the prices of domestically produced food products, which previously were not subject to consumption taxes. Subsequent to the zero-rating of a basket of food items, prices declined in October 1997, and for 1997 as a whole prices increased by 3.6 percent. Barbados' real effective exchange rate, as measured by relative consumer prices, depreciated by 5 percent during 1994–96, but is estimated to have appreciated by 5 percent in 1997 reflecting in part the

[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.

appreciation of the U.S. dollar, to which the Barbados dollar is pegged.

There has been considerable wage restraint in recent years and stable industrial relations, facilitated by two successive prices and incomes protocols among the government, employers, and labor unions. The **unemployment rate** has declined substantially; it fell from 25 percent at the end of 1992 to 12.2 percent at the end of 1997; real wages are estimated to have declined by 7.5 percent in 1992 and to have remained about constant during 1993–96.

Reflecting a considerable strengthening of public sector saving and a decline in public investment (both relative to the late 1980s and 1990), the underlying **fiscal position** (excluding nonrecurrent operations) was in surplus during FYs 1991/92–1995/96 (April–March); during this period, small deficits in the central government were more than offset by the surpluses of the National Insurance Scheme. In FY 1996/97, however, the fiscal position shifted from a surplus of 2 percent of GDP in FY 1995/96 into a deficit of 0.8 percent of GDP as a substantial increase in central government investment was accompanied by a decline in central government saving. The underlying fiscal position is projected to revert to a small surplus (0.8 percent of GDP) in FY 1997/98.

The introduction of the **VAT** in January 1997 represented the culmination of the process of tax reform initiated in 1992 to streamline and improve the efficiency of the tax system. The VAT is broad based and has a rate of 15 percent, except for hotel accommodations that have a rate of 7.5 percent. To alleviate the impact of higher food prices on the poor, in early 1997 the government increased the minimum pension and cash grants to welfare recipients, and, more recently, zero-rated a number of basic food items effective October 1997. The government has proposed a regime of price controls on a number of zero-rated food items but these have not been implemented so far.

The main objective of **monetary policy** is to preserve the long standing exchange parity with the U.S. dollar. The net domestic assets of the CBB have declined steadily in recent years, as the public sector shifted from net debtor to the CBB to net creditor. The overall credit expansion by the banking system has been restrained.

During the 12 months ended June 1997, commercial banks were very liquid due to a rapid growth of broad money (associated with a strong balance of payments performance) and sluggish private demand for credit. During July–September 1997, the CBB conducted open market sales of treasury bills and withdrew government deposits from commercial banks. This policy, together with a recovery in credit to the private sector, led to a significant reduction in commercial banks' excess reserves. Also, the treasury bill rate which had declined steadily since June 1996 to 2.6 percent in June 1997, began to increase reaching 4.8 percent in December 1997. Bank lending rates remained virtually unchanged during this period notwithstanding the fact that the CBB lowered the minimum deposit rate from 5 percent to 4 percent in May 1997.

The **external current account** is estimated to have been in surplus in recent years. The surplus is estimated to have declined in 1997; imports grew rapidly as businesses rebuilt the inventories that were depleted prior to the introduction of the VAT. By December 1997 net international reserves of the monetary authorities were US$271 million or 130 percent of base money compared with US$170 million or 100 percent of base money at end-1995.

In the last few years there have been structural reforms in the financial system (the closure and restructuring of two state banks), and in the tax and trade areas, and divestment of two partially state-owned enterprises. More recently, new financial legislation became effective in July 1997, strengthening prudential supervision along the lines of the Basle Accord, improving standards on capital adequacy, loan loss provisioning, liquid assets ratios, and limiting concentration of ownership and credit to related parties. In agreement with other members of the Caribbean Common Market, import duties were lowered in April 1997 to a range of 5–25 percent from 5–30 percent, and the special import surcharges that replaced several nontariff barriers in early 1994 are being phased out, albeit a slower pace than initially envisaged.

Executive Board Assessment

Executive Directors commended the authorities for the maintenance of restrained fiscal and incomes policies, which had contributed in recent years to price stability, economic growth, a sharp reduction in unemployment, and the strengthening of the external position. They welcomed the progress made by the authorities in improving the efficiency of the tax system through the successful introduction of the VAT. They also welcomed the adoption of new financial legislation that reinforced the regulatory and supervisory power of the central bank over commercial banks.

Directors nonetheless noted a number of economic concerns. In particular, the main export sectors continued to face relatively high costs and intense competition, and unemployment remains high. The fiscal position, although relatively strong, has weakened in the past two years, and the level of the public debt remains relatively high for a small economy that is vulnerable to adverse exogenous shocks. Directors, therefore, stressed the need to consolidate the recent gains and lay the basis for sustained low-inflation growth by continuing to pursue appropriate policies, including, in particular, fiscal consolidation and structural reforms aimed at enhancing the economy's flexibility and competitiveness.

Directors also stressed the need for continued fiscal and wage restraint to help preserve the exchange rate peg, which is a key element of the authorities' economic strategy. They noted that, while the current exchange rate seemed compatible with the maintenance of reasonable levels of economic activity and a strong external position, it would be crucial to enhance external competitiveness by promoting labor market flexibility and moving more rapidly with structural reforms in certain areas.

Pointing to the likely widening of the central government fiscal deficit in the next year, Directors emphasized that public sector savings should be increased to accommodate the required levels of development spending. They cautioned that the current fiscal stance would not permit a reduction in the public debt relative to GDP, and might not lead to a sufficiently strong external position over the medium term. Therefore, they recommended that the authorities aim at achieving a sound fiscal position over the medium term by limiting the central government deficit and by strengthening the finances of the public enterprises.

Directors suggested that, to achieve this fiscal consolidation objective, while maintaining adequate levels of public investment, the authorities should reduce central government current expenditure relative to GDP, including by limiting fiscal support to public and quasi-public enterprises. In this regard, they acknowledged the progress made in the reform of certain public enterprises, but stressed the need to take measures to improve their financial position, including through the setting of appropriate public service rates. They also saw a need to reduce costs in the quasi-public sugar industry and to limit the government's financial involvement in the tourism sector.

In the monetary area, Directors recommended greater use of indirect monetary instruments, the elimination of the interest rate floor on deposits, and the gradual liberalization of the capital account supported by the further strengthening of financial supervision. In this regard, Directors advised the authorities to improve the regulatory framework and supervision of financial institutions that are not supervised by the central bank, as well as to take steps to strengthen the competitiveness of the financial system. In light of the strong growth of private sector credit and the decline in international reserves that took place during the second half of 1997, Directors cautioned that credit conditions should be monitored closely, and they advised the authorities to be prepared to tighten monetary policy if excess demand pressures begin to develop.

Directors remarked that wage restraint and stable labor relations had made an important contribution to economic growth and employment in recent years. They recommended renewal of the income protocol to facilitate the maintenance of stable labor relations and wage restraint. They stressed the need for more flexible work rules and practices, and also encouraged the authorities to review the severance payments regime, with a view to reducing labor costs and enhancing labor flexibility, and integrating it better with the social safety net. Such improvements, together with the authorities' plan to strengthen education and training, should help increase the adaptability of the labor force and address the unemployment problem.

Directors noted that data weaknesses hampered the economic analysis, and urged the authorities to improve the availability and provision of data for surveillance.

Press Information Notices (PINs) are issued, 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.

Barbados: Selected Economic Indicators

	1993	1994	1995	1996	Prel. 1997
	(Annual percentage changes; unless otherwise specified)				
Output and prices					
Real GDP	0.8	4.0	2.9	5.2	4.3
Tourist arrivals	2.7	7.5	3.9	1.1	5.6
Consumer prices (12-month increase) 1/	-1.0	0.5	2.8	1.8	3.6
Unemployment rate (in percent of the labor force) 2/	22.1	21.2	16.4	14.3	12.2
Real effective exchange rate (depreciation -) 3/	0.5	-3.5	-1.3	-0.8	5.0
Money and credit					
Net domestic assets 4/	3.8	1.5	3.1	4.7	5.2
Money and quasi-money	5.1	7.8	4.8	10.5	8.0
	(In percent of GDP at market prices)				
Public sector 5/6/					
Public sector underlying balance (deficit-)	0.6	2.3	2.1	-0.8	0.8
Central government overall balance	-1.6	-0.8	-0.3	-2.9	-1.0
National Insurance Scheme	2.2	2.1	2.3	2.4	2.4
Public enterprises	0.0	1.0	0.1	-0.3	-0.6
Total public debt 7/	79.0	76.7	69.6	66.7	64.3
External public debt 7/	27.1	25.5	22.3	20.6	19.6
Savings and investment					
Gross domestic investment	12.7	13.4	14.1	12.7	15.7
Gross national saving	17.0	21.1	19.0	16.5	18.4
External sector					
External current account	4.3	7.7	4.9	3.8	2.7
Overall balance of payments (in millions of U.S. dollars)	21.1	59.2	40.9	87.2	14.5
Net official international reserves					
(Percentage of base money)	45.2	85.5	97.7	112.3	130.5
(Months of retained imports)	1.6	2.7	2.9	4.0	3.8

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

1/ The increase in 1997 reflects the impact of the introduction of a value-added tax in January 1997.

2/ End of period.

3/ As measured by relative consumer prices. The appreciation in 1997 reflects the domestic price rise related to the introduction of the value-added tax in January 1997 and the appreciation of the U.S. dollar.

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

5/ Fiscal year (April-March).

6/ Excludes nonrecurrent operations.

7/ Includes debt of the central bank, including debt to the IMF.