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Publisher's Note

The *Economic Review* is published three times a year in June, September and December, by the Central Bank of Barbados. It is prepared by the Bank's Research Department and contains articles of research undertaken at the Bank. In addition, we welcome contributions of a non-technical and empirical nature on economic and policy issues in the Caribbean. Book reviews and surveys are also welcome. All submitted papers are reviewed by the Editorial Committee* and external referees.

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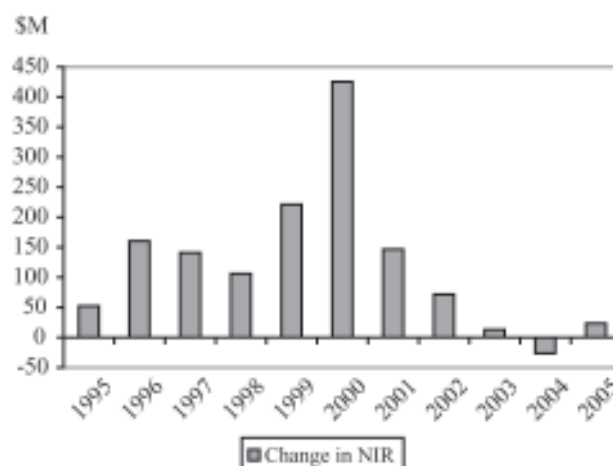


Overview

The Barbadian economy expanded by 3.0% during the first half of 2005, some 2.0 percentage points below the rate of growth for the comparable period of 2004. In contrast to the previous two years, this year's performance was driven primarily by the non-traded sectors, since a decline in tourism value-added adversely affected the traded sectors. The lower travel receipts, combined with continued strong import growth fuelled by the expansion in the non-traded sectors, led to a deficit on the external current account. Nonetheless, the net international reserves (NIR) of the monetary authorities rose during the period under review, as a result of the transfer of foreign receipts from the commercial banking system to the Central Bank and the solid performance of the capital and financial account. Credit to the non-financial private sector increased for the seventh consecutive quarter in order to finance the high consumer import demand, contributing to a contraction in commercial bank liquidity during the first half of the year. Despite this, the overall fiscal deficit was financed from domestic sources.

Real output of the traded sectors declined marginally (0.5%) during the first six months of 2005. This was significantly lower than the 6.7% growth recorded last year and primarily reflected the downturn in tourism activity and the continued poor performance of the non-sugar agriculture and fishing industries. The non-traded sectors, on the other

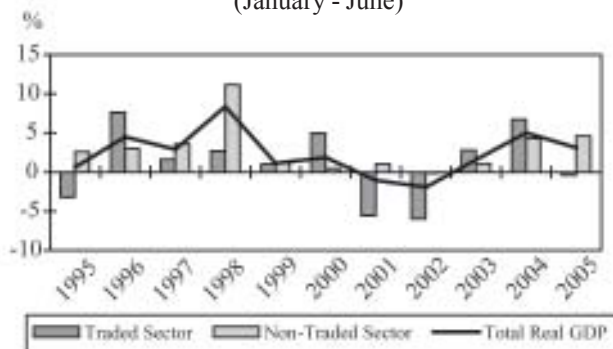
Change in Net International Reserves
(January - June)



hand, expanded by more than 4.0% for the second year in a row due to broad-based expansion in the component sub-sectors, especially construction. Nevertheless, the traded sector provided the largest number of net new jobs during the first six months of the year, resulting in a reduction in the unemployment rate at the end of June 2005 when compared to the same period of 2004. The hike in international oil prices fed into domestic prices thus contributing to a higher inflation rate at the end of June 2005.

With imports of consumer and intermediate goods burgeoning and earnings from tourism weakening during the first six months of 2005, the external current account recorded its second largest deficit in fifteen years. However, the poor performance of the current account was offset by an improvement on the capital and financial account, stemming from higher private sector inflows coupled with lower public sector outflows. As a result, the NIR rose by \$23.6 million, keeping the import reserve cover at 23.8 weeks. However, without the loan receipts that were received during the period under review, the NIR would have been slightly below the level recorded at the end of June 2004.

Real GDP Growth Rate
(January - June)



The growth in tax revenue moderated considerably during the first six months of this year as a result of reduced revenue from international trade taxes, the downward revision of the income tax rate and increased personal allowances at the beginning of 2005. Combined with higher expenditure on wages and salaries as well as goods and services, this produced an overall fiscal deficit of \$15.4 million for the first half of 2005 in contrast to a surplus of \$30.8 million for the corresponding period of last year.

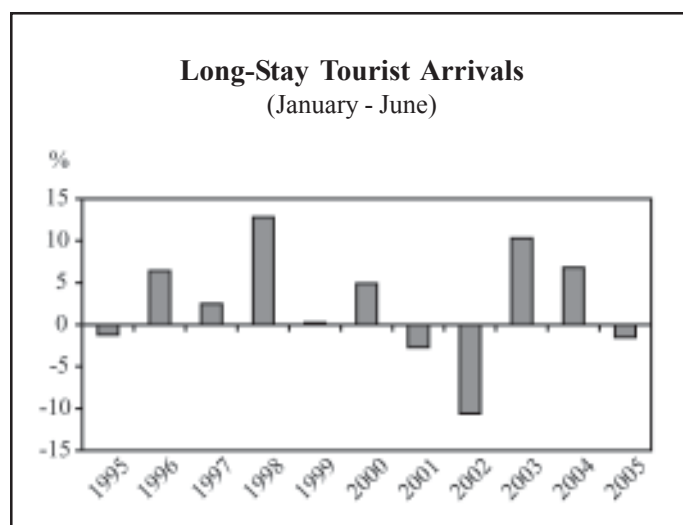
The liquid asset ratio fell by 1.4 percentage points to 12.4% at the end of June 2005 compared to the same period of 2004, reflecting continued growth in commercial bank lending to finance strong consumer import demand. In an attempt to, *inter alia*, reduce import demand which had been fuelled by relatively low interest rates, the Central Bank tightened its monetary policy stance during the second quarter of 2005 by raising the minimum deposit rate twice during the period.

Production, Prices and Employment

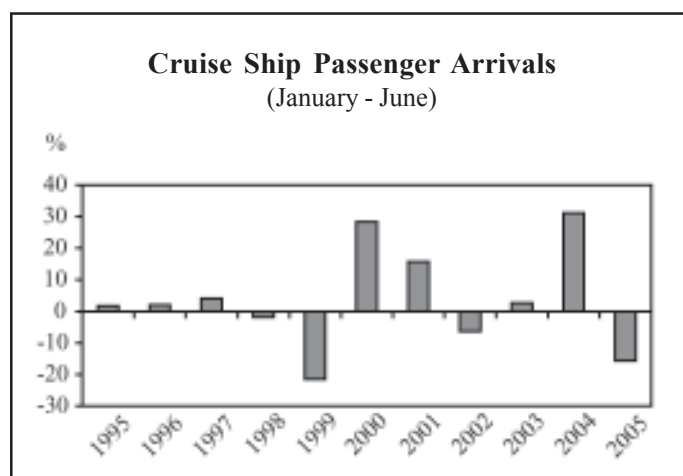
Tourism

After decreasing by 2.2% during the first quarter of 2005, real value-added in the tourism sector fell by a further 5.7% in the second quarter. As a result, the decline for the first half of the year was estimated at 3.6% compared to a 14.6% increase for the same period of 2004. (Last year's exceptional growth rate was mainly the result of Barbados hosting the third cricket test match between England and the West Indies in April and a booming cruise industry. However, these factors were not repeated in 2005 and the decline in tourism output may reflect a return to trend.)

During the January – June period of 2005, total long-stay arrivals decreased by 1.5%, after a 6.8% increase over the corresponding period of 2004. Visitors from two of the three main source markets – Canada and the UK – which



account for over 50% of total arrivals, declined, with the number of Canadian tourists registering the largest fall-off (12.0%) reflecting the reduction in airlift capacity. Visitor arrivals out of the UK fell by 6.7% and, together with the decline in visitors from Continental Europe (2.2%), overall European arrivals were down by 6.1% this year. Of the three main source markets, only the American market improved during the first six months of 2005, up by 2.1%, compared to 3.1% in the corresponding period of 2004. A 16.1% increase in arrivals from Trinidad and Tobago boosted total arrivals from CARICOM countries as total visitors

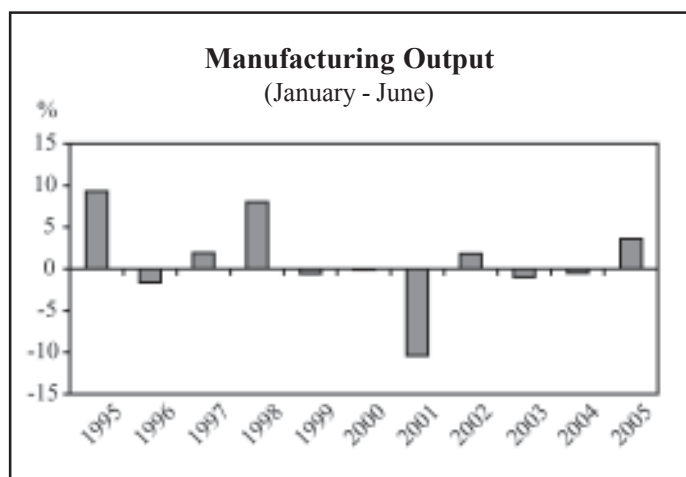


from the region increased by 9.0%, while arrivals from all other countries grew by 14.9%.

The cruise industry did not fare well during the first six months of 2005 relative to the same period of 2004, partially because of competition from the “homeland” ports along the Northeastern and Southern coasts of the United States. Additionally, the sector has been hampered by high fuel costs, slow capacity growth and operational difficulties at the hub in Puerto Rico where the majority of cruise ships visiting Barbados originate. Consequently, during the first six months of the year there was a 15.6% fall-off in cruise passengers, in contrast to a 31.1% increase in the comparable period of the previous year.

Manufacturing

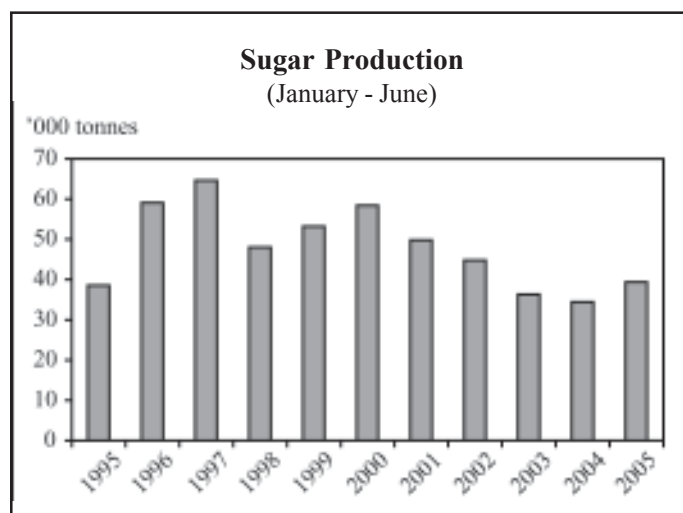
After decreasing by 0.5% during the first half of 2004, real manufacturing value-added rose by 3.1% during the comparable period of 2005, which is above the general trend for the last four years. The strength of the performances of beverages and tobacco and chemicals, combined with the marginal improvement in the miscellaneous manufacturing category, the largest category within the manufacturing sector, was sufficient to lead to an overall positive outturn during the January – June period of this year. Real value-added of beverages and tobacco was up by 19.7% on account of increased rum production, while



the output of chemicals and the other manufacturing category expanded by 10.2% and 1.3%, respectively. Production of electrical components, on the other hand, was significantly below last years' level, falling by 23.0%.

Agriculture and Fishing

During the first six months of 2005, output of the sugar industry grew by 14.5% or 4,992 tonnes above last year's total production to reach 39,350 tonnes, in contrast to a fall of 5.4% in the same period of 2004. This is the first year since 2000 that sugar output increased and primarily reflected favourable weather conditions during the planting season. Barbados is, therefore, expected to reach its quota



of 35,000 tonnes, unlike the previous year when production fell short by around 642 tonnes. Real output of non-sugar agriculture and fishing, on the other hand, declined by 3.6% during the first half of 2005, compared to a decrease of 3.1% in the January-June period of 2004. Fish catches contracted by an estimated 10.5%, after a 21.8% slump last year, while milk production was reduced for the fourth consecutive half-year (5.2%). With regard to chicken, production increased moderately on top of the 17.7% and 5.2% increases recorded in 2004 and 2003, respectively.

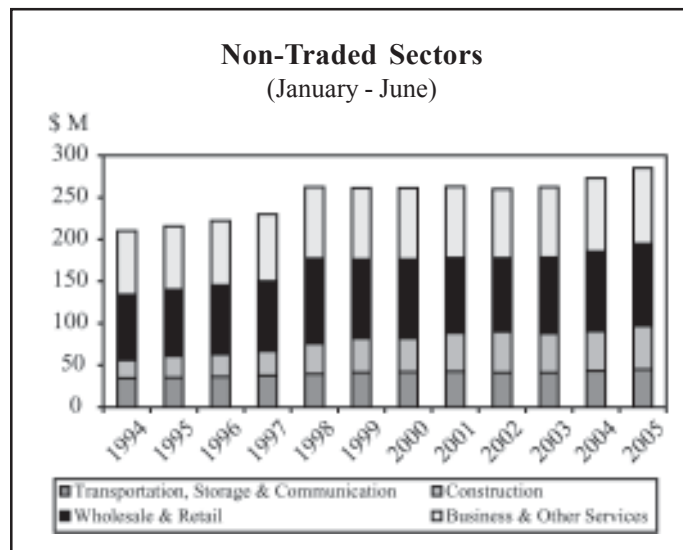
International Business and Financial Services

During the first half of 2005, some 218 new licenses were issued to international business and financial entities, compared to 173 in the similar period of 2004. The majority were for International Business Companies (IBCs), which accounted for 189 of the new licences, 53 more than last year. Barbados also welcomed 22 new Societies with Restricted Liability (SRLs), down from 29 in 2004; five new Exempt Insurance Companies, compared to six in 2004; and two new Exempt Insurance Management Companies, unlike 2004 when there were no new entrants to this market. No new offshore banks were licensed and one offshore bank was closed during the period under review.

Non-Traded Sectors

The non-traded sectors outperformed the traded sectors for the first time since 2001 and provided the main impetus for the growth of the Barbadian economy. Similar to 2001, the construction sector led the expansion of the non-traded sectors, with output increasing by 9.6% during the first half of 2005, after a marginal rise of 0.8% in the same period of 2004. Activity on major projects in preparation for the 2007 Cricket World Cup, heightened commercial real estate development and an upsurge in residential housing development as a result of low mortgage rates stimulated growth in this sector. As evidence of the upswing in construction activity, domestic consumption of cement climbed by 8.5% during the first five months of 2005, while imports of construction materials this year were almost 50% more than for the January-April period of 2004. The burgeoning construction activity spurred growth in the mining and quarrying as well as the electricity, gas and water industries, which expanded at rates of 4.2% and 7.4%, respectively.

Transportation, storage and communications grew by 4.2% during the January-June period of 2005, compared to an expansion of 5.7% in the corresponding period of 2004, as this industry benefited from the growth in real economic activity. Output of the wholesale and retail and business

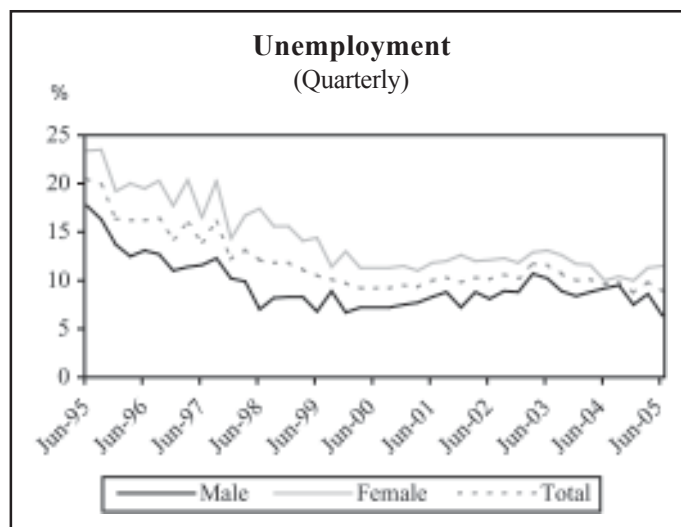
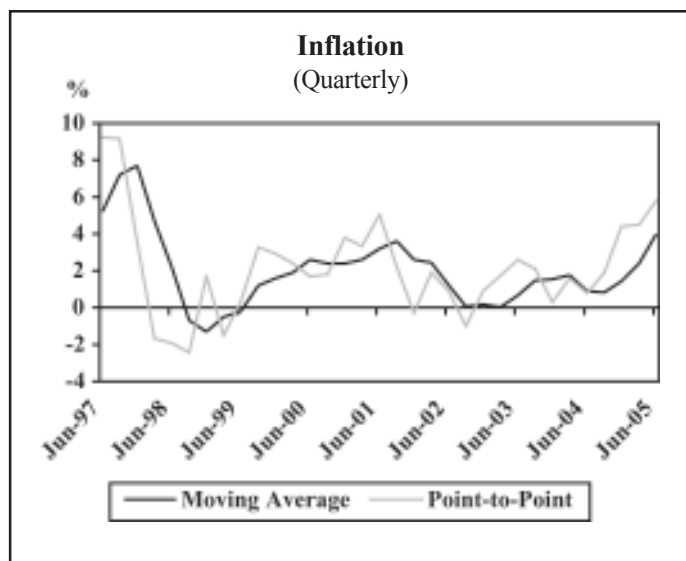


and other services industries during the first half of 2005 were also higher, expanding by 2.5% and 3.1%, respectively.

Prices and Employment

The 12-month moving average rate of inflation at the end of June 2005 was 3.9%, in comparison to one year prior when inflation was 0.9%. The increase in prices was mostly felt in the food categories (6.6%). However, higher prices were also applied to items such as transportation (4.5%), medical and personal care (2.0%), housing (3.7%), education, recreation and miscellaneous items (1.9%) and clothing and footwear (1.0%). On the other hand, the prices of household operations and supplies fell by 0.5%.

The average unemployment rate decreased from 9.6% at the end of the second quarter of 2004 to 8.9% at June 30, 2005, as the number of employed persons grew by roughly 1,000 persons. Most of these jobs were created in the tourism, government, construction and quarrying industries with losses in transportation and communication, manufacturing, finance, insurance and business services and other agriculture industries. The rate of unemployment for males fell by 2.8 percentage points to reach 6.4% while the rate of unemployment for females rose by 1.5 percentage points to 11.5%.



Financial Sector

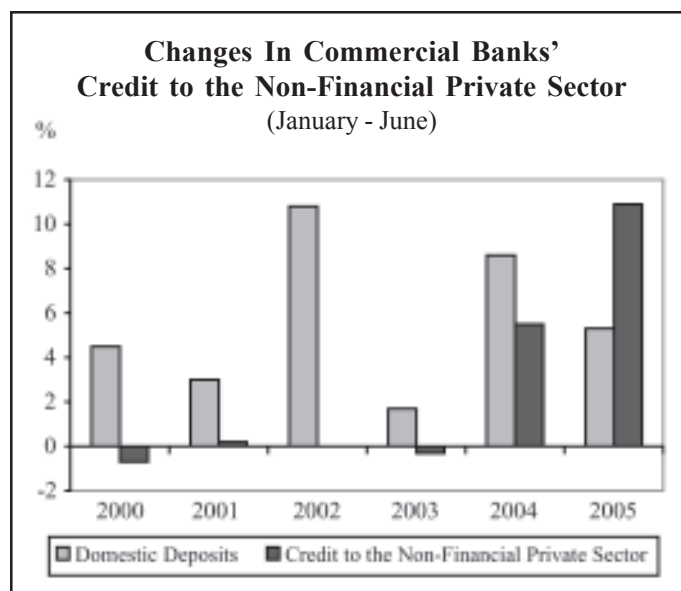
Deposits

During the first six months of 2005, total domestic deposits in the banking system increased by 4.2%, following growth of 11.0% in the same period of 2004. The expansion in deposits during the period was fuelled mainly by higher deposits of private individuals, which grew by 4.2% (\$124.7 million), and statutory bodies, up by 30.7% (\$45.2 million). The deposits of statutory bodies were boosted in part by proceeds of a \$150 million bond issue by the Barbados Water Authority. Deposits of financial institutions also rose during the period (5.0% or \$40.2 million), albeit at a rate of approximately one-third of that reported in 2004. The two remaining major deposit categories – government and business firms – were up by \$39.9 million and \$14.5 million, respectively. Although benefitting from a \$22.0 million increase in the account of tourism entities, business firms' deposits rose by only 1.5% compared to the 17.1% rise in the corresponding period in 2004.

Credit

Lending by commercial banks has been steadily increasing since the fourth quarter of 2003 and remained

robust during the first six months of 2005. Credit to the non-financial private sector picked up by 10.9% (\$333.5 million), versus 5.5% (\$143.7 million) for the comparable period of 2004, with most of the increase in credit going to private individuals and the distribution sector. Partly driven by a \$67.5 million spurt in mortgages for private dwellings, personal lending grew by \$156.5 million during the first six months of this year, compared to \$45.8 million in the same period one year earlier. The gain in momentum in mortgage



Summary Accounts of the Banking System
(\$Million)

	2003				2004				2005 ^p	
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun
Net International Reserves	1,940.3	1,929.3	2,053.1	2,087.1	2,169.1	2,244.4	1,880.8	1,746.7	1,752.3	1,659.3
Monetary Authorities	1,358.3	1,379.2	1,513.0	1,503.3	1,539.3	1,478.2	1,292.4	1,190.5	1,227.9	1,214.2
Commercial Banks	582.0	550.1	540.1	583.8	629.8	766.2	588.5	556.2	524.4	445.2
Net Domestic Assets	1,944.6	1,973.9	1,976.0	2,086.8	2,231.4	2,386.2	2,781.5	3,137.6	3,150.0	3,370.2
Credit to Public Sector	350.3	332.2	322.7	480.8	294.1	367.4	759.3	642.3	508.4	528.7
Central Government (net)	641.7	680.4	654.7	722.7	659.7	707.2	821.6	867.1	734.1	784.3
Rest of Public Sector	(291.5)	(348.2)	(335.0)	(241.9)	(365.6)	(339.8)	(62.2)	(224.8)	(225.7)	(255.7)
Credit to Rest of Financial System	143.6	144.3	145.5	155.6	161.2	160.9	221.0	234.9	260.5	298.4
Liabilities to Other Financial Institutions	378.4	372.6	362.6	390.1	403.2	416.0	489.2	394.4	453.3	475.4
Credit to Non-Financial Private Sector	2,592.6	2,590.7	2,564.4	2,622.6	2,702.0	2,766.4	2,798.6	3,061.8	3,185.8	3,395.3
Liabilities to the Non-Financial Private Sector	3,884.8	3,903.1	4,029.1	4,173.9	4,400.5	4,630.6	4,662.3	4,884.2	4,902.3	5,029.5
Currency in Circulation	329.3	341.4	339.0	329.0	342.3	345.9	368.0	398.7	392.0	403.0
Demand Deposits	1,053.6	1,009.6	1,121.4	1,200.3	1,273.1	1,432.1	1,399.2	1,537.0	1,548.0	1,576.5
Time Deposits	347.7	341.1	333.4	313.2	374.6	362.7	396.3	381.8	343.8	352.4
Savings Deposits	2,154.2	2,211.0	2,235.3	2,331.5	2,410.5	2,490.0	2,498.8	2,566.7	2,618.5	2,697.6
MEMO:										
Domestic Deposits	4,430.0	4,505.1	4,751.7	4,917.1	5,278.1	5,457.7	5,258.6	5,532.3	5,638.8	5,763.0
Liquid Foreign Assets	1,356.9	1,382.2	1,518.7	1,504.9	1,533.0	1,480.4	1,298.1	1,193.4	1,233.5	1,219.0
Loans & Advances	2,810.9	2,801.0	2,793.1	2,867.0	2,950.0	2,974.3	3,081.9	3,346.1	3,429.7	3,630.2

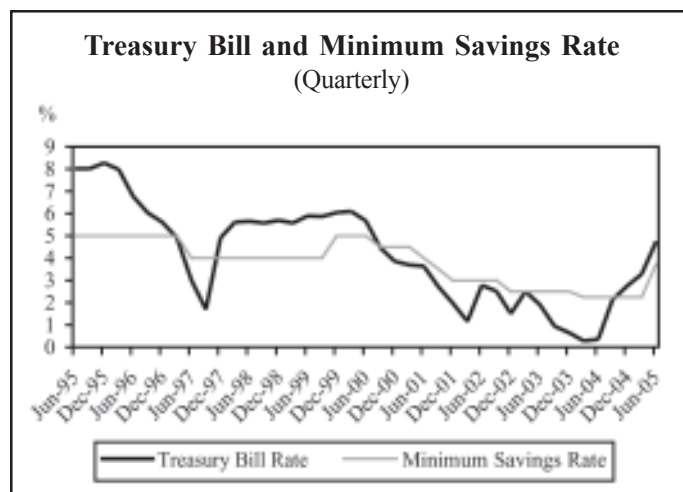
Source: The Central Bank of Barbados
P: Provisional

lending was the result of low mortgage rates and the intense promotion by financial institutions and represents the largest expansion in private mortgages since 1999. Similarly, credit to the distribution sector advanced by \$75.0 million to reach \$396.7 million at the end of June 2005. The spike in credit to the distribution sector partially reflects lending to a local company to finance a takeover. Significant increases in credit were also recorded for tourism (\$55.7 million), professional services (\$32.1 million), construction (\$17.7 million) and manufacturing (\$10.0 million) entities.

Liquidity and Interest Rates

Liquidity – as measured by the liquid asset ratio¹ – fell by 1.4 percentage points to reach 12.4% at the end of June 2005. Liquidity has been contracting since the second half of 2004 as evidenced by ratios of 17.3%, 16.3% and 13.9% at the end of the second, third and fourth quarters of 2004, in that order, and 13.8% at the end of March 2005. As the commercial banks sought to finance expanding credit demand, they reduced their holdings of treasury bills and excess cash, which declined by \$109.7 million and \$22.3 million, respectively. Consequently, the average discount rate of three-month treasury bills moved from 2.76% at the end of 2004 to 4.75% at the end of June 2005.

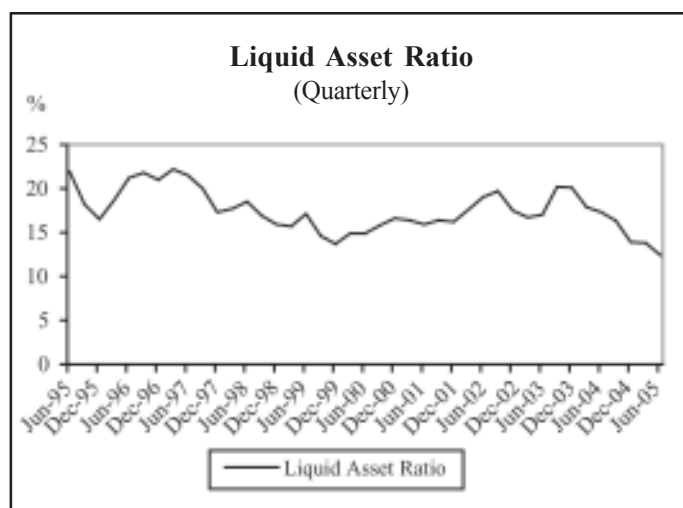
During the second quarter of 2005, the Central Bank increased the minimum deposit rate on two separate occasions; it was raised by half of a percentage point on April 1 and by a full percentage point at the beginning of June. The minimum deposit rate, therefore, now stands at 3.75% as opposed to the rate of 2.25% that the Central Bank had maintained since March 2004. This change in monetary policy is an effort to curb consumer spending and discourage capital outflows, thereby protecting the balance of payments. Although still too early to ascertain whether these measures had the intended effect on consumer spending and consumer imports, they halted the downward



movement of interest rates, as the weighted average lending rate moved from 9.83% in December last year to 10.4% at the end of June 2005.

Government Securities

The total value of treasury bills outstanding at the end of June 2005 was \$641.7 million, down by \$4.2 million when compared to the figure at the end of 2004, with \$531.5 million being allotted to commercial banks and trust companies. The amount of savings bonds outstanding at the end of June 2005 was \$109.7 million compared to \$114.9 million at the end of December 2004, as the government



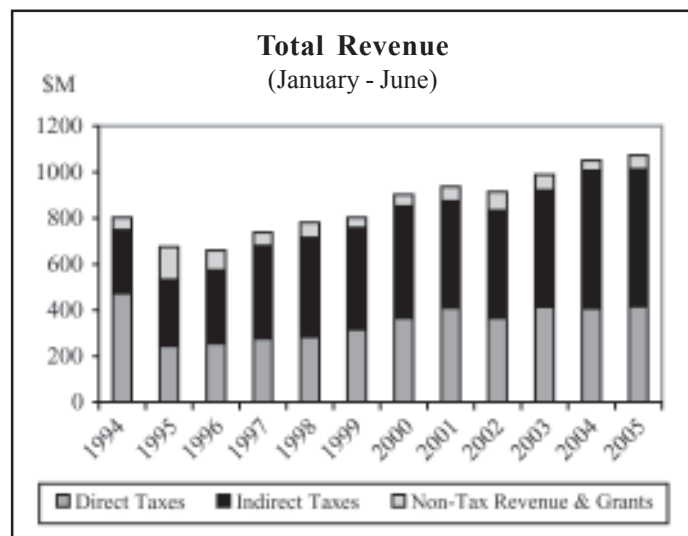
¹The liquid asset ratio is calculated as commercial banks' cash, deposits at the Central Bank and Treasury Bills divided by total assets.

rolled over maturing bonds by issuing a new series on June 1, 2005. Conversely, government debentures outstanding rose by roughly \$262.8 million at the end of June 2005 relative to the end of 2004. As has been the trend in recent times, the National Insurance Scheme accounted for nearly half of the debentures outstanding, holding \$1.1 billion at the end of June 2005.

Public Sector

Revenue

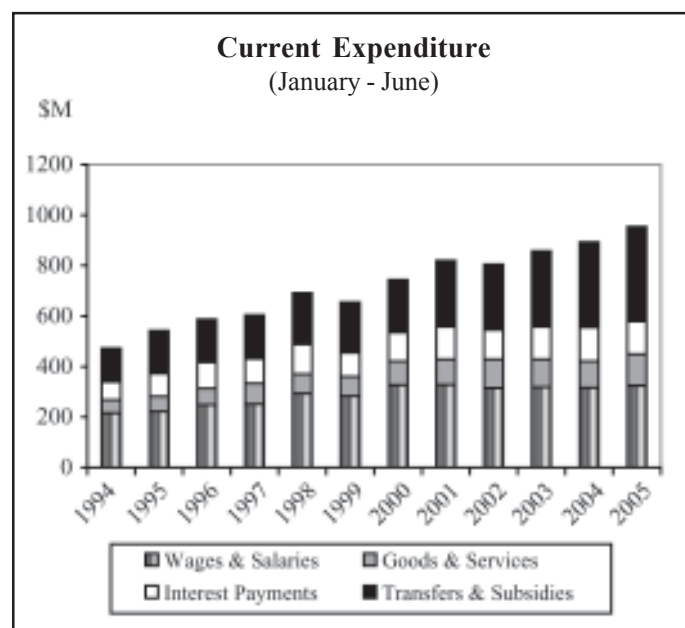
During the first half of 2005, total revenue grew by approximately 2.0% to \$1,072.2 million, on account of increases in non-tax revenue, corporate tax receipts and VAT and other indirect tax collections, which edged out declines in personal and excise taxes and import duties. Despite the reduction of the corporate tax rate, corporate taxes registered a significant turnaround from last year's performance. Higher profitability – especially of International Business Corporations – and the end of the tax holiday of some exempt insurance companies drove a 28.2% (\$43.9 million) expansion during the first half of this year, in contrast to a 3.7% (\$6.0 million) contraction in the corresponding period of 2004. Concurrent with the cut in the income tax rate and the increase in personal allowances, personal taxes collected were \$28.7 million, or 15.1%, below that of the comparable period of 2004.



In contrast to 2004, excise tax collections of \$98.1 million were \$9.0 million less during the first half of the year, as a result of the slowdown in motorcar imports and an offsetting transaction between Government and a public sector enterprise. The growth in VAT collections decelerated to 2.6% during the January-June period of 2005 compared to the similar period of 2004 when the rate of expansion was 11.5%. Import duties were virtually unchanged from last year, moving from \$101.0 million in the first half of 2004 to \$100.3 million during the same period of 2005, while other indirect tax receipts were down by roughly \$2.0 million (3.0%). Non-tax revenue increased by 45.2% to reach \$52.7 million for the first six months of 2005.

Expenditure

Total expenditure during the first half of 2005 rose by 7.0% to reach \$1,091.3 million, as higher spending on wages and salaries and goods and services as well as increased transfers and subsidies surpassed lower interest payments. This figure is significantly above the average of \$865.2 million for the last ten years and, moreover, it represents the largest rate of growth recorded during the first half of the year since 2001 when total government spending grew by 11.7%.



Following a 0.7% decline in the January-June period of 2004, expenditure on wages and salaries grew by 2.5% during the first six months of 2005 on account of the 3% expansion in the wage rate implemented during the fiscal year 2004-2005 and increased employment. Spending on goods and services was also up by 18.7%, in contrast to a reduction of 3.8% in the corresponding period of 2004. Transfers and subsidies climbed by 11.1% during the January-June period of 2005 - compared to 12.5% in the similar period of last year - mainly due to supplemental payments made to the Transport Board, the Barbados Tourism Authority and the University of the West Indies. Interest payments were down by 3.4%, unchanged from the corresponding period of 2004 as the sharp decline in payments to external lenders outweighed the expansion in domestic debt payments. On-budget capital expenditure rose by 9.5% during the review period, following a reduction of 25.4% in the same period of 2004 when several public sector projects were completed and capital outflows to the

Queen Elizabeth Hospital were reclassified as transfers and subsidies.

Financing

During the first half of 2005, Government continued to rely on domestic sources for financing, as the estimated overall fiscal deficit this year was \$19.7 million, a turnaround from the surplus of \$31.5 million during the corresponding period of 2004. As has been the trend in recent years, the National Insurance Scheme provided a significant portion of the financing, increasing their holdings of government paper by \$125.6 million. Additionally, Government was a net depositor at the Central Bank during the January – June period for the second year running, with net balances falling from \$72.9 million in 2004 to \$20.6 million this year. During the first six months of 2005, amortisation payments of \$40.2 million surpassed project fund inflows of \$9.3 million, resulting in net foreign outflows of \$30.9 million.

Government Financing

(January - June)
(\$Million)

	2000	2001	2002	2003	2004	2005 ^p
Domestic Financing	(213.6)	49.2	89.8	37.5	(3.4)	50.6
Central Bank	(352.5)	(46.2)	105.8	38.3	(72.9)	(20.6)
Commercial Banks	40.3	23.1	61.0	(9.3)	79.4	9.5
National Insurance Scheme	71.6	22.4	33.6	25.2	20.0	125.6
Private Non-Bank	41.6	33.1	(22.0)	8.4	48.6	115.5
Divestment	0.0	52.2	0.0	0.0	0.0	0.0
Other Public Sector	(3.4)	(14.5)	0.0	0.0	(1.5)	0.0
Other	(11.0)	21.0	(88.6)	(25.2)	(78.8)	(179.4)
Foreign Financing (net)	201.4	8.3	2.4	1.6	(28.2)	(30.9)
Capital Markets	200.0	0.0	0.0	0.0	0.0	0.0
Project Funds	21.9	29.7	21.1	37.2	16.0	9.3
Policy Loans	0.0	0.0	0.0	0.0	0.0	0.0
Amortisation	(20.7)	(21.4)	(18.7)	(35.6)	(44.2)	(40.2)
Divestment	0.0	0.0	0.0	0.0	0.0	0.0
Total Financing	(12.0)	57.5	92.2	39.8	(31.5)	19.7

Sources: The Central Bank of Barbados and Accountant General

P: Provisional

Government Operations

(January – June)

(\$Million)

	2000	2001	2002	2003	2004 ^R	2005 ^P
Total Current Revenue	902.3	937.1	914.3	987.8	1,051.0	1,072.2
Tax Revenue	851.9	873.2	833.9	921.7	1,006.2	1,012.0
<i>Direct Taxes</i>	365.0	409.4	365.5	414.3	407.3	414.7
Personal	174.1	182.2	186.0	202.2	189.9	161.1
Corporate	136.1	157.1	122.9	161.7	155.7	199.6
Levies	6.1	10.9	8.7	4.7	0.0	3.4
Property	32.5	37.9	29.4	26.9	32.2	34.6
Other	16.2	21.3	18.5	18.8	29.5	16.0
<i>Indirect Taxes</i>	486.9	463.8	468.4	507.5	598.9	597.3
Consumption	0.5	0.0	(0.0)	0.0	0.0	0.0
Stamp	7.1	7.5	5.6	6.7	8.3	10.1
VAT	260.3	257.5	263.0	282.9	315.5	323.8
Excises	86.9	82.7	59.4	69.1	107.1	98.1
Import Duties	69.4	57.5	79.3	77.3	101.0	100.3
Hotel & Restaurant	0.2	0.0	0.0	0.0	0.0	0.0
Other	62.6	58.5	61.1	71.5	67.0	65.0
Non Tax Revenue & Grants	50.4	63.9	80.4	66.1	44.8	60.1
Current Expenditure	743.2	819.6	803.9	857.9	893.3	953.9
Wages & Salaries	327.8	329.1	314.3	318.5	316.2	324.2
Goods & Services	92.8	99.8	114.0	109.6	105.4	125.1
Interest Payments	115.1	128.7	116.9	130.0	134.4	129.8
External	36.1	53.3	60.0	49.8	78.5	43.2
Domestic	79.0	75.4	56.9	80.2	55.9	86.6
Transfers & Subsidies	207.5	262.1	258.9	299.7	337.2	374.8
Current A/C Balance	159.2	117.5	110.3	130.0	157.7	118.3
Capital Expenditure	146.2	164.2	204.6	169.0	124.4	134.9
Net Lending	0.9	10.9	(2.0)	0.2	1.7	3.2
Total Expenditure & Net Lending	890.3	994.7	1,006.5	1,027.0	1,019.4	1,091.9
Overall Balance	12.1	(57.5)	(92.3)	(39.2)	31.6	(19.7)

Source: The Central Bank of Barbados

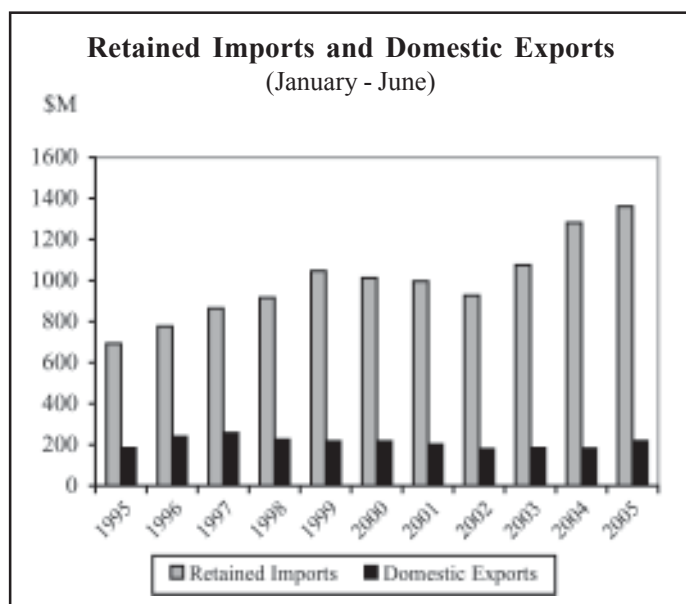
P: Provisional

R: Revised

Foreign Trade and Payments

Current Account

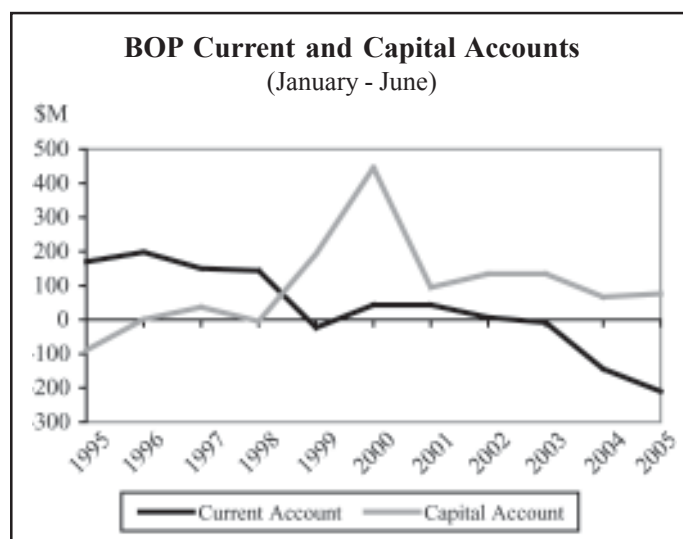
Declining travel credits and further growth in retained imports resulted in continued weakness of the external current account during the first six months of 2005. The external current account deficit was estimated at \$188.6 million, an improvement of just \$4.6 million when compared to the corresponding period of 2004. Owing to the slowdown in the tourism sector, travel credits were down by \$6.8 million (0.8%) during the first six months of 2005, a complete reversal of the situation in the same period of last year when they were up by \$20.7 million (2.3%).



After expanding by 9.2% in the first three months of 2005, growth in retained imports is estimated to have moderated in the second quarter. The overall growth rate for the first half of 2005, therefore, continued to be fairly high at 4.0% – though slower than the 19.1% surge in the comparable period of the prior year – and drove the persistent weakness of the external current account. Growth in imports of intermediate goods was faster during the first

four months of 2005, expanding by 14.8% or about twice the rate registered during the corresponding period of the previous year. The main driver of this increase was construction materials, up by 47.1% compared to 8.3% in 2004, which offset slowdowns in the rate of growth of fuel imports (from 11.4% in 2004 to 7.6% in 2005) and other miscellaneous intermediate goods imports (from 14.0% in 2004 to 2.6% in 2005).

The rate of growth of consumer goods imports, on the other hand, receded during the first four months of 2005, to an estimated 10.9% as opposed to 19.1% in the same period of 2004, because the fall-off in imports of durable goods partially offset the strengthening of non-durable goods imports. Durable goods imports grew by a mere 1.6% in 2005, after increasing by 25.3% last year, owing to a 1.3% decrease in motorcar imports. The value of non-durable goods imported rose by 3.2 percentage points this year to reach 15.0%, as imports of food and beverages continued to dominate this category. In contrast, imports of capital goods declined by 17.8%, following a rise of 47.1% in the corresponding period of 2004, mainly as a result of a contraction in imports of machinery. The hike in imports of machinery in 2004 was due to a local utility company bringing in a major piece of equipment.



For the second year in a row, domestic exports increased during the first half of the year, growing by an estimated 28.0% compared to 14.0% in the similar period of 2004, on account of improved performances in most export categories. Sugar exports during the first six months of 2005 were up by an estimated 10.6%, after a decline of

3.2% in the corresponding period of 2004. Chemicals, rum and electrical components, building on last year's increases, grew by a further 39.4%, 26.6% and 17.6% respectively, during the first four months of 2005. The improvement in chemical exports was the result of a local company obtaining a large contract to produce insecticide while higher rum

Balance of Payments

(January – June)

(\$Million)

	2000	2001	2002	2003	2004 ^R	2005 ^P
Current Account Balance	43.5	43.5	14.4	(8.4)	(193.2)	(188.6)
Merchandise Trade	(659.2)	(664.2)	(626.8)	(749.7)	(937.9)	(946.8)
Total Exports (BOP Basis)	243.4	244.7	210.9	231.9	234.3	234.6
<i>Domestic Exports</i>	217.3	200.9	180.1	184.7	182.7	214.2
Sugar	52.2	44.0	37.7	41.0	39.7	43.9
Elec. Comp.	18.9	19.8	13.7	12.5	14.7	14.2
Chemicals	26.2	21.5	20.9	20.4	20.1	25.4
Food/Bev	43.3	44.5	44.8	41.1	40.3	51.6
All Other	76.7	71.1	63.0	69.7	67.8	79.1
Total Imports (BOP Basis)	968.5	969.6	889.5	1,036.9	1,229.4	1,248.9
<i>Retained Imports</i>	1,012.2	997.3	926.5	1,075.1	1,280.8	1,331.5
Consumer Goods	408.2	403.2	388.2	412.8	495.2	549.2
Capital Goods	238.4	217.8	198.5	240.4	314.1	246.4
Intermediate Goods	362.0	372.8	336.5	418.5	465.8	530.3
Miscellaneous Goods	3.6	3.5	3.4	3.4	5.6	5.6
Services (Net)	710.8	712.5	666.3	775.3	797.1	805.8
Travel Credits	835.8	847.9	772.2	889.5	910.2	903.4
Other	(90.3)	(82.6)	(92.6)	(103.2)	(135.9)	150.9
Investment Income (net)	(81.4)	(95.8)	(27.1)	(114.7)	(129.2)	(131.5)
Transfers (net)	73.3	91.0	74.6	80.7	76.8	83.8
Capital and Financial Account	436.0	95.6	204.4	167.7	70.8	72.5
Long Term	371.0	120.7	133.4	166.6	53.9	134.5
Public Sector	220.1	1.7	(25.0)	(4.5)	(79.5)	(42.4)
Private Sector	150.9	119.0	(158.4)	171.1	133.4	177.0
Other	42.6	(21.6)	(5.2)	(88.8)	151.4	(67.4)
Short Term	22.5	(3.5)	76.2	89.9	168.3	5.4
Errors & Omissions	(23.8)	5.3	(146.5)	58.9	279.8	28.7
Balance for Official Financing	455.7	144.3	72.3	218.2	157.3	(87.4)
Official Financing (net)	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	0.0	0.0	0.0
Other Financial Institutions	0.0	0.0	0.0	0.0	0.0	0.0
Reserve movements (CBB basis)						
(-Increase/+Decrease)	(455.7)	(144.3)	(72.3)	(218.2)	(157.3)	87.4
Change in NIR (IMF basis)						
(-Increase/+Decrease)	(425.5)	(146.5)	(71.5)	(13.0)	25.1	(23.6)

Source: The Central Bank of Barbados

P: Provisional

R: Revised

exports were due to a local distillery expanding their capacity. The other manufacturing category, which accounts for a large percentage of domestic exports, registered a complete turnaround from last year's outturn, surging by 19.8% over the first four months of the year, following a 16.8% contraction in the comparable period of 2004. Another strong export category was miscellaneous commodities which, despite a drop in fuel exports, almost doubled during the January – April period, after declining by 20.8% in the corresponding period of last year. Additionally, a reversal was registered in the other food and beverages category, which exported 42.5% more than in the previous year.

Capital and Financial Account

The external capital and financial account registered its seventh consecutive first half surplus (\$72.5 million), which represented an increase of \$1.7 million over the surplus reported in 2004. This outcome was mainly the product of estimated net long-term inflows of \$134.5 million, of which private long-term capital inflows were up by \$43.6 million to total \$177.0 million, resulting from the construction of new real estate projects for non-residents. The public long-term capital account also showed signs of improvement, as outflows for the January - June period fell from \$79.5 million in 2004 to \$42.5 million in 2005. Miscellaneous outflows amounted to \$67.4 million during the first half of this year compared to outflows of \$151.4 million in 2004, while lower short-term inflows were also recorded in the capital account.

Regional Economic Developments

Overview

In general, regional economies reported improved performances during the first six months of 2005, relative to the comparable period of 2004. Nevertheless, some countries continued to struggle after the havoc caused by last year's active hurricane season that affected vulnerable

sectors such as agriculture and tourism. Weak tourism receipts and agricultural exports, coupled with increased imports, led to the worsening of the external current account situation in many countries. The fiscal positions of several countries were also adversely affected by rebuilding efforts, with only Trinidad and Tobago and Guyana recording a fiscal surplus for the first half of 2005. For the most part, interest rates in the region fell during the first six months of 2005 and liquidity remained high as some monetary authorities implemented policy changes during the period under review. The inflation rate in Trinidad and Tobago was above last year's rate and price increases in Jamaica continued to trend above the regional average. Exchange rates were relatively stable among the three floating exchange rate regimes in the region.

Tourism

Preliminary estimates indicate that the regional tourism sectors had mixed results during the first quarter of 2005, with increased long-stay arrivals in some of the main tourist markets being tempered by a general decline in cruise passenger arrivals. The growth rate of stopovers to Jamaica reached 8.0% during the first three months of the year. This outturn is the result of spring break activities, local celebrations and international meetings that were held during the period. Furthermore, the Jamaican tourism sector benefited from the perceived increased price competitiveness of the Jamaican tourism product – compared to other international destinations – that resulted from the depreciation of the US dollar vis-à-vis the Euro and the Pound Sterling during the quarter. Preliminary information for the first quarter of 2005 suggests that total stopover arrivals to the member states of the Organisation of Eastern Caribbean States (OECS) rose. Additionally, higher tourist arrivals were also reported for Belize, Bermuda, Martinique and Suriname, as these markets grew by 4.9%, 7.5%, 8.7% and 24.2%, respectively.

In contrast to the rest of the region, the Bahamas and the Cayman Islands are still feeling the effects of the September 2004 hurricanes as the havoc wreaked contributed to the weaker performances of these tourism sectors. Lower capacity in Grand Bahama led to a 4.2% reduction in stop-over tourist arrivals to the Bahamas during the first quarter of 2005, in contrast to a surge of 13.3% in the comparable period of 2004, while in the Cayman Islands, long-stay tourist arrivals plummeted by 56.2% during the January – March period of 2005.

Cruise passenger arrivals for many of the regional destinations fell during the quarter, the main exceptions being Belize, Grenada and Jamaica. As with long-stay tourist arrivals, the Bahamian cruise sector was hampered by capacity constraints and arrivals fell by 2.4% during the first quarter of the year. Despite the reduction, however, the Bahamas led the region in the number of cruise passenger arrivals during the period under review. Relatively poor performances were also recorded in the member states of the OECS (with the exception of Grenada) and the Cayman Islands. In contrast to the general regional trend, Belize welcomed 15.4% more cruise passengers during the first quarter of the year. Changes to shipping schedules to Jamaica caused cruise ships to arrive later in the year when compared to 2004. Cruise passenger arrivals to this island therefore declined by 2.3% and 0.1% during January and February and surged by 16.7% in March, an overall increase for the quarter of 1.5%. Surprisingly, despite the havoc caused by Hurricane Ivan in Grenada, cruise passenger arrivals to this territory were up by 18.7% for the first three months of the year.

Agriculture

Output of the Jamaican agriculture, forestry and fishing sector declined by 23.8% during the first three months of 2005, approximately twice the rate of contraction reported during the corresponding period of 2004. The agriculture sub-sector, in particular, suffered from the residual effects of the 2004 hurricane season as well as the drought

conditions and associated bush fires that plagued the country. The reduction in hectares of domestic crops reaped was compounded by mechanical problems and industrial disputes to result in a 36.5% decrease in sugar cane harvested, leading to a 34.3% drop in sugar yields. Coffee production also underperformed in 2005, on account of a fall in the amount of cherry coffee delivered to the processing plants as well as the delay in the settlement of claims arising from the 2004 hurricanes. Only livestock output increased this year (up by 7.6%), driven by a 12.3% rise in poultry production. Agricultural output of the OECS also declined this year, primarily as a result of the damage inflicted by Hurricane Ivan.

Minerals

During the first quarter of 2005, the Jamaican mining industry improved by 0.9% due to expansions in crude bauxite production as well as alumina output. The performance of the bauxite industry reflected a rebound from the infrastructural damage that caused low production levels during the last quarter of 2004 and was above output levels reported during the same period of 2004, while further improvement in alumina production was hampered by maintenance and technical problems.

Inflation

In general, inflationary pressures in the region – as measured by the 12-month moving average – eased during the first three months of 2005, with the exception of Trinidad and Tobago. Despite a marginal reduction in the rate of inflation, the average increase in prices in Jamaica continued to be significantly above the regional average, as the 12-month moving average inflation rate for this territory declined marginally by 8 basis points to 12.8% at the end of March 2005. In Guyana, the inflation rate was virtually unchanged when compared to the 5.4% recorded in the corresponding period of 2004, while inflation in the Bahamas fell to less than 1.0% during the first three months of 2005. In contrast, prices in Trinidad and Tobago picked up as the inflation rate

moved from 3.7% at the end of March 2004 to 4.6% at the end of March 2005, while higher oil prices and the recent depreciation of the US dollar against other major currencies was behind the moderately higher prices in the OECS.

Interest Rates

Interest rates in the region trended downward during the first quarter of 2005. The Central Bank of the Bahamas lowered the discount rate by 50 basis points to 5.25% as well as the prime rate from 6.00% to 5.50% in February of this year. Consequently, the weighted average loan rate declined from 11.57% at the end of the first quarter of 2004 to 10.64% at the end of the same period of 2005, while the weighted average deposit rate was 58 basis points below the rate at the end of March 2004. As evidence of the high level of liquidity in the Bahamian market, the average discount rate on 90-day Treasury bills fell from 0.94% at the end of March 2004 to 0.18% at the end of the same month of this year.

The Central Bank of Trinidad and Tobago increased its 'repo rate' by 25 basis points to 5.25% in March in an effort to combat rising inflation and narrow the spread between Trinidadian and foreign interest rates. Nevertheless, the ordinary savings and prime lending rates both declined during the first three months of 2005. In Jamaica, the savings and weighted average loan rates fell by around 2 percentage points, while the 90-day Treasury bill rate declined from 15.23% to 13.21% at the end of March 2004 and 2005, respectively. Similar to the rest of the region, most interest rates in Guyana declined during the review period.

Exchange Rates

Exchange rates in the region remained relatively stable with the Guyanese dollar experiencing the largest fluctuation this year, depreciating by 0.1% against the US dollar at the end of April 2005 to reach G\$200.00. The Trinidadian and Jamaican dollars remained stable at the end of June and April, at TT\$6.30 and J\$61.65 respectively.

Public Sector Operations

Regional governments had mixed results in their efforts to control the fiscal accounts during the first quarter of 2005. Central government operations in Trinidad and Tobago generated a surplus of US\$388.1 million during the January – March period of 2005. This represents a significant turnaround from the deficit of US\$122.3 million registered during the comparable period of 2004 and was the result of higher than anticipated collections from both the energy and non-energy sectors. The fiscal outturn of the government of Guyana also improved on last year's first quarter surplus of US\$11.9 million, registering a surplus of US\$14.3 for the similar period of 2005. Lower revenue growth, coupled with higher government spending, led to an overall fiscal deficit in the Bahamas of US\$33.2 million compared to US\$24.2 million during the corresponding period of 2004. The Bahamian fiscal deficit was financed primarily from domestic sources: mainly issues of Government Treasury bills and advances from the Central Bank. The fiscal accounts of Jamaica worsened during the first three months of 2005, registering a surplus of US\$421.7 million – roughly US\$794.8 million below last year's figure – as a result of higher than budgeted government spending.

Foreign Sector Developments

The external position of the region appears to have deteriorated during the first quarter of 2005 as all economies for which information was available posted a larger current account deficit relative to 2004. The widening of the external account of the Bahamas from US\$12.9 million in 2004 to US\$76.2 million was blamed on an elevated oil bill (due solely to higher prices) coupled with a decrease in net tourism receipts. The capital and financial account, on the other hand, registered a surplus of US\$128.5 million, almost triple that reported in 2004. The external current account balance of Jamaica also declined slightly this year, falling from a deficit of US\$0.7 million during the January – March period of 2004 to a deficit of US\$0.9 million as a result of the

combined effects of decreased export revenue and higher spending, particularly imports of manufactured goods. The value of imports into Guyana increased by 6.9% during the first quarter of 2005 relative to 2004 to reach US\$168.4 million, while exports fell by 9.5% to US\$107.6 million during the review period.

International Economic Developments

Overview

The international economy recorded another strong performance despite higher oil prices. However, the growth rate slowed during the first half of 2005 when compared to the similar periods of 2003 and 2004 and industrial production and global trade were somewhat dampened. Economic expansion in the US and China continued unabated while the Euro area and Japan showed moderate signs of recovery. The inflation picture was also relatively stable, despite higher oil prices, and interest rates continued to be low across the world.

Industrial Economies

Following a 3.8% increase in real GDP in the first quarter, the United States economy expanded by a further 3.4% during the second quarter of this year, although this represented a deceleration from the 4.8% recorded for the comparable period of 2004. The main factor behind the second quarter slowdown was a reduction in private inventory investment, although the full impact of this downturn was partially offset by higher levels of exports. Nevertheless, personal consumption expenditure, equipment and software expenditure, residential fixed investment and government spending increased while imports declined during the period. Real exports of goods and services rose by 12.6% during the second quarter of this year while the growth of real imports of goods and services fell by 2.0%. With continued strong growth, the unemployment rate continued its downward trend, reaching 5.0% at the end of June 2005.

Preliminary estimates suggest that the Canadian economy grew by 2.6% in the second quarter of 2005 compared to the same period of 2004, owing to a steady increase in domestic demand. At the same time, the year-on-year rate of core inflation at the end of the quarter was only 1.6% and the rate of inflation at the end of the second half of 2005 is expected to have increased to 2.1% from 1.4% in 2004. Generally, the Canadian economy is not facing any meaningful inflation pressures over the short-term. The unemployment rate fell from 7.3% in 2004 to 6.7% this year – matching the historical low.

In the Euro area second quarter GDP rose by a provisional 0.3% compared to the first quarter of 2005, and was up 1.2% year-on-year, in line with expectations. Real economic activity in Germany, Italy and the Netherlands all came in above forecasts. In Germany, growth was flat in the second quarter; meanwhile, Italy came out of recession in the second quarter, as its GDP grew 0.7% from the first quarter, much higher than the consensus estimate of a 0.3% increase. Over the period, the central bank was slightly more upbeat about the prospects for growth but expressed concern about strong money and credit growth as well as rising house prices.

The expansion of the UK economy is expected to have slowed during the second quarter of 2005, as Britain's economy showed its weakest performance for 12 years during the second quarter and continues to grow below trend. This is the result of reduced consumer spending, slower growth in house prices and a contraction in manufacturing, which partially offset strong growth in business services and finance. The pattern of employment growth evolved in line with the performance of the economy and eased over the review period. However, inflationary pressures increased from 2.7% over the first half of 2004 to 3.1% for the corresponding period of 2005.

The Japanese economy continued to recover at a moderate pace during the first six months of 2005, led by improved corporate profits and higher business investment.

However, the growth in the level of exports weakened throughout the months of January to April and was flat during May and June, while industrial production levelled off during the first half of the year. Although the growth in imports remained flat throughout the first six months of the year, the sharp rise in crude oil prices combined with weak exports led to a reduced surplus in the trade balance. Concurrent with the economic recovery, the unemployment rate fell by 0.4 of a percentage point to 4.2% at the end of June 2005, and wages increased moderately in the final month of the review period.

Emerging Market Economies

According to preliminary estimates, the Chinese economy grew by 9.5% during the first half of 2005, with broad-based growth recorded in all major sectors. In spite of increased output, however, exports fell by 3.0% and, with a double-digit drop in imports, the trade deficit was 15.9% lower than in 2004. Even with a rapid acceleration of consumption demand, the rate of inflation slowed to 2.3% at the end of June, compared to 3.6% in 2004.

The economy of Brazil is estimated to have grown by 2.9% during the first three months of 2005; this growth rate represents a continuation of the deceleration experienced in recent quarters. Concurrently, 1 million new jobs were created during the first half of the year, contributing to the reduction of the unemployment rate to 10.2% at the end of June 2005. Exports in June reached a record high, propelling the current account surplus to US\$12.5 billion, as a result of robust growth across most export categories; confirming the success of the export diversification process that has been under way for two years.

Industrial production in Argentina expanded by 7.1% during the first six months of 2005 on account of strong

growth in the textiles, metal-mechanics and construction industries. Consequently, inflationary pressures have accelerated as a result of rising demand, supply constraints and growing wage pressures, causing consumer prices to increase by 4.5% during the first four months of 2005. With regard to monetary policy initiatives, the Central Bank of Argentina tightened its policy stance during the review period, increasing its policy rates on three separate occasions to bring the repo rate to 3.75%.

Commodity Prices

The upward spiral of oil prices continued to be the dominant story in the commodities markets during the first half of 2005, reaching above US\$60.00 per barrel during the review period. In addition to demand pressures as many developed countries gear up for the winter season, supply constraints in Norway, Nigeria, Iraq and Venezuela have contributed to persistent market uncertainty about the current very low production capacity. Although OPEC promised to increase production, there were concerns that most OPEC member countries already produce at full capacity, especially in light of the failure to replace declining wells in Indonesia and Venezuela and insurgent attacks in Iraq. Furthermore, slower growth of oil production in non-OPEC countries has placed additional pressure on oil prices.

In general, non-fuel commodity prices have increased during the first six months of 2005 relative to 2004, as indicated by the 7.2% rise in the non-fuel commodities index. The pick-up in prices has been attributed to reduced inventories within the metals markets as well as bad weather in key food producing regions. With regard to the two main export crops of the region however – sugar and bananas – prices have fallen in light of recent decisions made at the World Trade Organisation.

Commodity Prices

Commodities	Jun-2004	Dec-2004	Jun-2005	% Change on Jun-04	% Change on Dec-04
Total (Index of Market Prices)	147.58	155.55	195.49	32.5	25.7
Non-Fuel (Index of Market Prices)	98.94	97.57	106.02	7.2	8.7
Food (Index of Market Prices)	103.72	94.14	97.98	(5.5)	4.1
Sugar (US cents / lb)	30.31	31.98	30.18	(0.4)	(5.6)
Bananas (US \$ / 40lb)	596.43	497.24	500.06	(16.2)	0.6
Rice (US \$ / metric ton)	244.23	278.43	287.05	17.5	3.1
Wheat (US \$ / bushel)	154.74	153.87	141.93	(8.3)	(7.8)
Soybeans (US \$ / metric ton)	320.69	198.62	254.74	(20.6)	28.3
Metals (Index of Market Prices)	106.82	117.28	195.49	83.0	66.7
Aluminium	1,682.04	1,852.92	1,731.94	3.0	(6.5)
Iron Ore (US \$ / metric ton)	37.90	37.90	65.00	71.5	71.5
Copper (US ¢ / lb)	2,689.05	3,139.79	3,529.73	31.3	12.4
Silver (US ¢ / oz.)	5.77	6.82	7.05	22.2	3.4
Gold (US \$ / oz.)	392.4	442.1	430.7	9.8	(2.6)
Petroleum (US \$ / barrel)	35.54	39.09	53.89	51.6	37.9

Sources: IMF Commodity Prices and Bloomberg



Caribbean Stock Markets: Summary of Second Quarter 2005

Barbados Stock Exchange (BSE)

At the end of the second quarter of 2005, the Barbados Stock Exchange (B.S.E) recorded a 46.5% decline in trading volume for all market segments, compared to the previous quarter. The majority of this decline was recorded for the regular market; nevertheless, the Local Index recorded a quarterly increase of 2.01%, to end at 3,942.70 points. Similarly, the Cross-list Index rose by 2.63% for the second quarter, closing at 2,230.34 points for the period. There was no activity on the junior market for the second quarter, as Sunbeach Communications Inc. remains suspended from trading and Fortress Caribbean Property Fund has graduated to the regular market, effective April 01, 2005.

As of April 01, 2005, the B.S.E issued a Composite Index, along with its Market Capitalisation, on the performance of all of the companies listed on the Exchange. Since being compiled in April 2005, the Composite Index recorded an increase of 2.06%, with a rise in market capitalisation of only 0.53%. Local market capitalisation showed a modest quarterly decrease of 0.36% to close at \$10,590.10 million as at June 30, 2005. The capitalisation of cross-listed securities rose by 4.62%, to end above the level of the local market, at \$10,754.69 million.

Also with effect from the beginning of April 2005, the Exchange instituted one-cent increments in share pricing. For the second quarter, thirteen companies advanced, eight declined and one remained unchanged, while three securities did not trade. During the period, ANSA McAL (Barbados) Ltd. had the greatest share price increase of 102%, followed by Trinidad Cement Ltd. and Cave Shepherd & Co. Ltd., with expansion of 54% and 34%, respectively.

Trading activity on the B.S.E over the quarter was also affected by the May delisting of the shares of A.S. Brydens and Sons (B'dos) (A.S.B.) Limited. This followed

the successful take-over bid of A.S.B by McEneaney Alstons (B'dos) Limited, which resulted in the latter acquiring all of the shares of A.S.B.

Barbados Farms Ltd. was the top traded security in the regular market for the second quarter of 2005, accounting for 24% of the total volume of shares traded for the period. It was followed by Sagicor Financial Corporation and the Barbados National Bank, which accounted for 19% of the volume traded. Barbados National Bank also recorded the highest value in securities traded of 23% of the total value of shares traded for the second quarter. Sagicor Financial Corporation and RBTT Financial Holdings Ltd. recorded the second and third highest values traded of 17% and 15% of total value traded, respectively.

For the quarter ending June 30, 2005, the Odd-Lot Market recorded a 36.4% decline in share volume compared to the previous quarter, with Sagicor Financial Corp. recording the greatest volume (53%) and value (47%) of shares traded in this market.

Barbados Mutual Funds

During the second quarter of 2005, Fortress Caribbean Growth Fund and Roybar Investment Corporation recorded the highest increases in net asset value of 7.63%

Mutual Fund Performance

Mutual Fund	Jun. 30, 2005 NAV (Bds\$)	Mar. 31, 2005 NAV (Bds\$)
Roybar Investment Corp.	16.10	15.67
Fortress Caribbean Growth Fund	3.81	3.54
Fortress High Interest Fund	1.21	1.20
BNB Income Fund	1.28	1.26
BNB Capital Growth Fund	1.51	1.53
BNB Gift Trust Fund	1.04	1.03
BNB Prop. & Unlisted Sec. Investment Fund	1.63	1.60
CLICO Balanced Fund Inc.	1.28	1.29
Sagicor Global Balanced Fund	2.05	2.05
Sagicor Select Growth Fund	1.02	1.05
Sagicor Preferred Income Fund	1.04	1.02

Source: Securities Exchange of Barbados

and 2.74%, respectively. These performances were mainly attributed to the improved performances of locally held equities. Most other mutual funds in the market registered an average expansion in net asset value of approximately 0.3%.

Jamaica Stock Exchange (JSE)

During the April to June period of 2005, trading volume on the JSE rose by 58.5%, with an associated increase in share value of 21.3%, to approximately \$6.0 billion. Over the period fifteen companies advanced, seventeen declined and seven remained unchanged. The major companies advancing were Trinidad Cement Limited registering the best performance of a 42.7% rise in share price, Kingston Wharves (23.6%) and Gleaner Company (23.2%). In spite of registering an expansion of 6.5% for the first month in the quarter, the JSE Index declined overall

for the second quarter, moving from 111,931.17 at the beginning of the period, to end at 110,637.77 (down 1.17%) for June 30, 2005.

Trinidad and Tobago Stock Exchange (TTSE)

In the second quarter of 2005, the TTSE Index grew by 3.3% to close at 1479.9779 points. The total volume of shares traded declined by 21.7% for the period, in spite of an initial increase in activity earlier in the period. RBTT Financial Holdings shares dominated trading for the months of April and June, while Neal and Massy Holdings, as well as the National Commercial Bank Jamaica significantly contributed to volumes traded during the latter part of the quarter. Overall for the period, seventeen companies advanced, fourteen declined and three remained unchanged. The major advancers were National Enterprises Limited with 36.2%, Caribbean Communications Network Ltd. (34.3%) and L. J. Williams (31.8%).

Top Ten Performing Companies*

Barbados	%	Jamaica	%	Trinidad	%
ANSAMcAL (Barbados) Ltd.	101.7	Trinidad Cement Ltd.	42.7	National Enterprises Ltd.	36.2
Trinidad Cement Ltd.	53.6	Kingston Wharves Ltd.	23.6	Caribbean Communications Network Ltd.	34.3
C&W BARBADOS	25.0	Gleaner Company	23.2	LJ. Williams Ltd.	31.8
Grace, Kennedy & Co. Ltd.	22.2	FirstCaribbean International Bank Jamaica	20.6	ANSA Merchant Bank Ltd.	21.9
Neal & Massy	20.1	Desnoes & Geddes Ltd.	15.9	Prestige Holdings Ltd.	21.2
Barbados National Bank Inc.	13.2	Montego Freeport Ltd.	11.7	BWIA West Indies Airways Ltd.	20.0
Barbados Farms	12.6	Carreras Group Limited	8.6	Angostura Holdings Ltd.	19.4
Sagicor Financial Corporation	5.3	Radio Jamaica Ltd.	8.3	Neal & Massy Holdings Ltd.	10.6
Light & Power Holdings	4.2	Guardian Holdings	4.9	Dehrings Bunting & Golding Ltd.	8.9
Banks Holdings	2.9	Courts (Jamaica)	4.8	Scotiabank Trinidad and Tobago Ltd.	6.3

Source: Barbados, Jamaica and Trinidad and Tobago Stock Exchanges

* Based on share price appreciation during the second quarter of 2005

Interest Rates

United States of America

At the June 30th policy meeting, the Fed raised the Fed Funds rate on short-term interest rates by 25 basis points to 3.25%, the fourth such expansion of one-quarter of a percentage point for the year. These increases have been based on positive economic data, with inflation being the biggest threat. Unlike last year, when various uncertainties about the economy restricted investors and businesses, the US economy appears to be on firmer ground in 2005, although inflation could escalate, especially if oil prices break out of their current price range. Meanwhile, markets expect that the Fed will continue to increase interest rates until the benchmark rate reaches an estimated 4% by the end of this year.

Canada

After two 25-basis-point hikes in September and October of last year, the Bank of Canada (BOC) has kept the overnight rate unchanged, at 2.50% for the year. It is predicted, however, that the BOC will soon resume raising the target rate for overnight lending. These predictions have been made against the backdrop of a first-quarter GDP growth, which came in slightly weaker than expected, and softer second quarter growth than forecasted. The new round of rate hikes is expected to commence during the third quarter. The increase is expected to be a 25 basis points hike, to 2.75%. Unless there is a dramatic improvement in GDP growth and tightened capacity, the market predicts that the BOC will raise rates by a small, quarter-percentage-point step on each occasion, finishing the year at 3.25%.

United Kingdom

As widely expected, during the second quarter UK interest rates were held at 4.75%. The repo rate - the rate of interest at which the Bank of England (BOE) lends to commercial banks - has remained at 4.75% since August

2004, when policymakers last increased rates, aimed at helping to cool consumer spending driven by Britain's surging housing market. It is possible that the Monetary Policy Committee could soften its stance as early as the third quarter of 2005. Consumer price inflation hit 2% - the Treasury's target - in June and the BOE will be wary of pushing it any higher and containing consumer debt, as it does not want to undo its efforts at controlling the UK housing market (the key driver of the recent surge in consumer spending). The widely expected 25bps cut is expected to be a catalyst for growth and will provide an essential boost to consumer and business confidence, as the UK economy has grown below trend for four successive quarters - its worst performance in more than a decade.

Europe

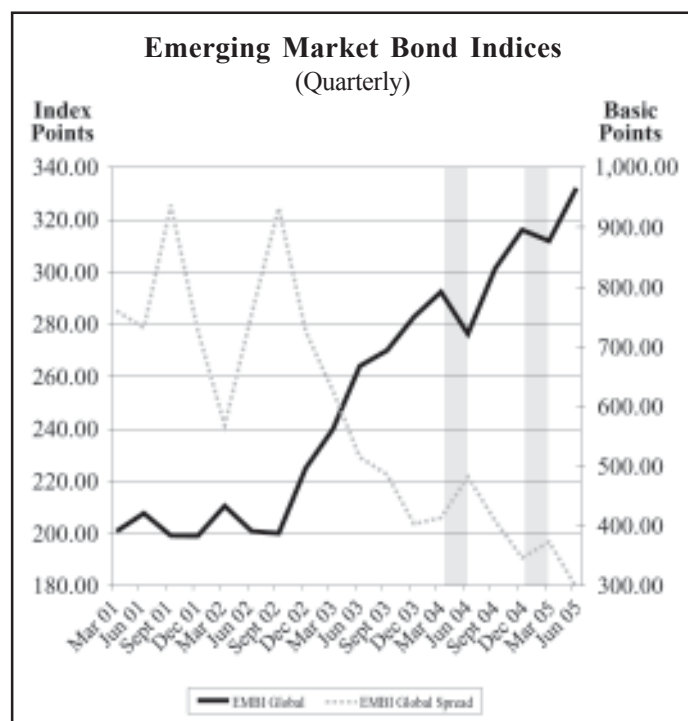
The growth outcome in the second quarter prevented the European Central Bank from becoming excessively concerned about the expansion in the euro area money supply. While reiterating that interest rates in the area remain "appropriate" at 2.0% since June 2003, it also cautioned that inflation must be closely monitored. The lowest credit costs in six decades have pumped more money into the \$9.3 trillion economy than needed for inflation-free growth and fuelled double-digit house price increases in countries such as France and Spain.

Emerging Markets

Bond Markets

Despite US interest rate tightening, yields at the long end of the curve in mature markets actually fell during the quarter and the resulting search for yield drove spreads on emerging market bonds lower. In addition, strong country fundamentals and active debt management by issuers contributed to stable demand for emerging market assets, especially among institutional investors, and a broadening of the investor base. Emerging markets therefore continued to enjoy favourable financing conditions during the quarter,

with gross issuance advancing at a steady pace, allowing them to complete a considerable portion of their financing needs for 2005 and in some cases to engage in pre-financing for 2006.



Equity Markets

Stocks were generally higher in Latin American markets, although the Argentine Merval and Brazilian Bovespa both posted declines. The Merval's dip came as investors reacted to the Argentine government's latest move to deter speculative investment in local capital markets via capital controls, after the restructuring of bonds led to significant investment inflows and a strengthening Peso. The Bovespa's downturn reflected negative investor sentiment in the face of Wall Street losses and a political scandal involving corruption allegations in June. On the other hand, most other regional exchanges performed well, led by the Mexican Bolsa, which trended upward in the quarter on expectations of strong corporate profits.

Emerging Market Equity Indices (Quarterly)

Country/Region	Index	Mar-05	Jun-05	% Ch
Argentina	Merval	1,291.22	1,232.86	-4.5
Brazil	Bovespa	26,610.65	25,051.21	-5.9
Chile	IPSA	1,961.69	2,056.84	4.9
Mexico	IPC	12,676.90	13,486.13	6.4
Venezuela	Caracas	28,977.07	21,595.64	-25.5
Latin America		1,510.47	1,617.01	7.1
China	Shanghai	1,181.24	1,080.94	-8.5
Hong Kong	Hang Seng	13,516.88	14,201.06	5.1
India	Mumbai	6,492.82	7,193.85	10.8
Indonesia	Jakarta	1,080.17	1,122.38	3.9
Malaysia	Kuala Lumpur	871.35	888.32	1.9
Philippines	PSE	1,954.69	1,924.23	-1.6
Singapore	Straits Times	2,141.43	2,212.66	3.3
South Korea	Seoul	965.68	1,008.16	4.4
Thailand	SET	681.49	675.50	-0.9
Taiwan	Weighted	6,005.88	6,241.94	3.9
Asia		236.38	243.02	2.8

Source: Bloomberg

Emerging Market Currencies (Quarterly)

Country/Region	Currency	Mar-05	Jun-05	% Ch
Argentina	Peso	2.92	2.89	1.1
Brazil	Real	2.68	2.33	12.9
Chile	Peso	586.10	577.75	1.4
Mexico	Peso	11.17	10.75	3.8
Venezuela	Bolivar	2,147.30	2,144.60	0.1
India	Rupee	43.75	43.49	0.6
Indonesia	Rupiah	9,465.00	9,760.00	-3.1
Singapore	Dollar	1.65	1.69	-2.1
South Korea	Won	1015.45	1034.5	-1.9
Thailand	Baht	39.12	41.33	-5.6
Taiwan	Dollar	31.53	31.62	-0.3

Source: Bloomberg

For the most part, Asian stocks turned in strong performances during the quarter. India's Sensitive Index stood out, recording a double-digit increase to close on a record high, amid upbeat earnings expectations and liquidity-

boosting foreign funds inflows. China's Shanghai Index continued to lag its regional counterparts due to the ongoing oversupply of share offerings on the market.

Currency Markets

In the main, Asian currencies were down against the dollar on expectations of even higher interest rates in the United States and high oil prices. Conversely, most of

the major Latin currencies appreciated against the US dollar during the quarter, led by the Brazilian real, which closed at a new 13-quarter peak. The real's rise came as currency markets shrugged off the political woes rocking equity markets, as well as news that the country's Treasury would be buying dollars on the market to pay its external debt, and focused instead on strong dollar inflows from exports.



Charting Our Course in CSME: PART I¹

On Thursday May 5, 2005, the Central Bank of Barbados hosted a public seminar at the Sherbourne Conference Centre under the theme “Charting our Course in the CSME”. The seminar brought together a variety of distinguished local and regional speakers, including Government ministers, trade negotiators, business executives, academics, trade specialists and financial consultants to discuss this important topic.

The welcome remarks were given by Dr. Marion Williams, Governor of the Central Bank of Barbados. According to Dr. Williams, the purpose of the seminar was to sensitise the public to the opportunities and challenges of the Caribbean Single Market and Economy (CSME), in order to facilitate an understanding of how it will affect businesses, people’s livelihoods and the general development of Barbados. The Governor explained that a single market and economy should reduce the vulnerability of regional economies, reduce prices of goods and improve the standard of living of the region in the long run. She also asserted that because of the CSME, Caribbean countries should be better able to handle external threats. In her address, Dr. Williams outlined a number of important concerns, the principal one being the issue of competitiveness in the global market. In this regard, she noted that the CSME is necessary if Caribbean countries are to survive and encouraged member states to aim for extra-regional as well as intra-regional competitiveness, especially in those areas where the latter serves as an important steppingstone.

In his keynote address, the Honourable Kerrie Simmons, Minister of State in the Ministry of Foreign Affairs, welcomed the Central Bank’s decision to host a seminar on the CSME, which he saw as a timely one, given the scheduled launch of the CSME by the end of 2005. In order

to facilitate the progression to a single economy, the Minister noted that one of the key issues that would need to be addressed was the removal of restrictions on capital flows, since the region is seeking to attract higher levels of investment. In addition, he emphasised that there should be greater efforts aimed at helping those member states that need development assistance to overcome the current imbalances that exist within the region. Therefore, he encouraged all member states to approach the bargaining table and to support the creation of a Regional Development Fund. Mr. Simmons also stressed the importance of the private sector to the success of the CSME. For the CSME to move the region beyond the present situation, where regional producers compete among themselves instead of pooling resources to compete against extra-regional players, he felt that it would require deepening regional capital markets and establishing new institutions, for example, a regional competition commission.

Session I: Trade and Competitiveness

The first speaker of this session was Mr. Ramesh Chaitoo, Services Specialist with the Caribbean Regional Negotiating Machinery. In Mr. Chaitoo’s introduction, he posed the question: “What can the CSME do to enhance the Caribbean’s competitiveness?” Noting that services exports for the region have risen since 1993, whereas goods exports have plummeted, he identified a need to develop new service industries so as to attract new investment in services, diversify the region’s services portfolio and expand on many of the existing services, which are relatively underdeveloped.

Chaitoo suggested that the advent of the CSME would greatly facilitate moves in this regard by providing greater opportunities for competition among firms and professionals, improving the quality of service provided and reducing the cost of service to customers. However, he also identified a number of characteristics of firms in the Caribbean, as well as external factors, that could pose

¹This update summarizes the contributions of the presenters and discussants featured in the morning session of the Conference. The afternoon session will be addressed in the December edition of the Economic Review.

challenges to firms attempting to capitalise on the opportunities presented by the CSME. Among the factors he highlighted as being internal to regional firms were: their small size, limited capital base, limited access to finance and market resources and low brand recognition beyond their domestic market. The external factors Chaitoo referred to included the high cost of financing (high interest rates on loans and large spreads between lending and deposit rates) and infrastructural services (telecommunications, electricity, business services) and limited incentives for services.

In concluding, he re-emphasised that infrastructure is very expensive in the region, for example, broadband access, and that the telecommunications sector, a key aspect of firms' operations today, must therefore open up to ensure affordable Internet access.

The next speaker, Dr. Patrick Antoine, Ambassador of Grenada to the WTO, defined competitiveness as the ability of a firm or industry to generate higher rates of profits in the production and trade of goods relative to other firms. He identified the following key factors in firm competitiveness: product characteristics, investment, human capital, enterprise, factor endowments, factor supplies and scale economies. In light of these realities, Dr. Antoine suggested that the region's economies could not afford to lock themselves into their domestic markets; they must go global. In his opinion, the CSME is an important steppingstone in this process, with the free movement of labour, as well as the possibilities for creating a wider pool of formally trained workers and strong social partnerships. In closing, he highlighted processed products as a possible growth area with high technology content.

Discussant, Professor Andrew Downes, noted that Barbados was losing its competitiveness at the aggregate level and listed a number of factors that could help to improve competitiveness in Barbados:

- Practical leadership and management team.
- Adoption of strategic planning.
- Achievement and maintenance of high international standards of quality goods and services.

- Adoption of technology and international standards.
- Establishment of strategic alliances.
- Market surveillance.
- Enhanced human resource development.
- Good customer relationships.
- Good financial management.

Dr. Lawson Nurse of the Barbados Private Sector Trade Team, the other discussant for the session, reiterated the points of the two presenters. While he deemed the cost of doing business in Barbados to be high compared to other countries, he asserted that product quality was more important than price for competitiveness.

In the ensuing discussion, participants spoke of difficulty in accessing funds and high legal costs. The problem posed in quantifying the value of intellectual property in order to get credit was also raised by a participant.

These comments and questions provoked varying responses from the panellists:

- Dr. Antoine pointed out that the Treaty of Chaguaramas does allow for the free movement of artistes within the region, but also acknowledged that a number of difficulties still exist in the operationalisation.
- Professor Downes mentioned that a survey of the cultural industries in Barbados was being conducted, which would form the basis of future policy measures.
- Dr. Nurse agreed that the arts are important and he explained that CARICOM had given the go-ahead for negotiations in the area of cultural services. He also informed participants that the Private Sector Trade Team would be going around to individual companies in the sector to get an idea of their concerns in order to feed these concerns into the negotiating process.
- Mr. Chaitoo acknowledged that artistes were not properly represented and that they faced many difficulties in selling their products/services within the region, although this was an area that has great

potential for growth. He also agreed that legal costs were definitely too high in Barbados and that this problem should be addressed.

Session II: Panel Discussion - Issues on the Ground

First, Dr. Denny Lewis-Bynoe of the Central Bank of Barbados sought to answer the question, “Why CSME?” In doing so, she posited that the CSME advanced the region’s status in a global economy as, with the advent of CSME, the region should profit from increased trade, enhanced bargaining power, economies of scale and also reduced economic vulnerability through diversification. Dr. Lewis-Bynoe then posed the following questions: Can the CSME be an effective vehicle for transforming economies? How will these benefits be distributed? How are we going to adjust to free trade? How is CSME unfolding as opposed to how we would like it to unfold?

Dr. Stephen MacAndrew of CARICOM’s Barbados-based CSME Unit made a number of important points, but the most striking remark came when he explained that even though the CSME gives Caribbean nationals the opportunity to migrate and work elsewhere in the region, most people are still applying for work permits and, surprisingly, governments are still issuing them. This brought to the audience’s attention the fact that the majority of people in the region are not fully aware of the workings of the CSME and that conferences such as the one held by the Central Bank of Barbados are definitely required.

Mr. Joseph Goddard, representing Goddard’s Enterprises, a Barbadian firm with considerable experience in market expansion through overseas investment, was able to provide a practical, ground-level perspective on the issues surrounding intra-regional investment. Firstly, he identified a number of fundamentals that any company needs to have in place before investing abroad. These included: a profitable home base; a well developed management structure and accounting system; adequate backup management skills, for example sick leave and vacation; the ability to handle external

shocks when carrying out investment; and, a network of good strategic links.

He went on to list some of the problems his firm has faced investing in the region such as operational difficulties, obtaining work permits for technical staff and inadequate air transportation services and telecommunications. Goddard also advised prospective investors to always work with a good legal representative and accounting firm. He warned that it was better to use a local bank familiar with one’s history and cash flows. In conclusion, he singled out the movement of graduates across the region as one of the greatest benefits of the CSME for intra-regional investment, although he noted that relocating people is costly.

Members of the audience provided some important insights into what they saw as being the issues on the ground in implementing the CSME. For example, a well-known Barbadian journalist raised a concern that when reporters travel within the region their equipment is sometimes seized at the airport. She suggested that although there are policies in place for regional integration, they are not filtering down.

Dr. Lewis-Bynoe felt that the points raised by the audience proved that there are issues on the ground that need to be addressed, because while policymakers are broadly tackling the issues, it is apparent that some are not at the forefront. Dr. MacAndrew opined that the problem at the airport is that immigration officials are not adequately trained. He also agreed that there were other problems at the lower levels that must be addressed.

Luncheon Presentation

Dr. Winston Andersen, General Counsel for the CARICOM Secretariat started with the premise that since the CSME was based on the rule of law, it is essential to assess parties’ compliance with the rules. Firstly, he outlined the legal architecture of the CSME including its basic constitutional documents (the original and revised Treaties of Chaguaramas), the legislative acts of Community Organs,

and supplementary inter-governmental agreements such as the CARICOM Double Taxation Agreement. He then went on to provide a brief status report on legislative compliance within CARICOM, noting that the community has made remarkable progress in this regard. For example, most territories have enacted the Revised Treaty of Chaguaramas and recognised the CCJ, while the programme to remove restrictions on services, establishment and the movement of labour and capital is generally on track and the removal of restrictions on goods is virtually complete. However, in

concluding, Dr. Andersen cautioned that despite the progress made generally, there still remained a compliance deficit and challenges such as Member States' unwillingness to relinquish their sovereignty, as well as resource limitations. To meet these challenges and close this deficit, he advocated the creation of a CARICOM Commission to make the decision-making process more efficient. He also spoke to the roles of the CCJ and the Secretary General, respectively, in ensuring compliance.



Tourism Maturity and a Ranking of Relative Tourism Potential in the Caribbean

By Peter Whitehall and Roland Craigwell*

Abstract: This paper develops the concept of relative tourism maturity, and proposes an empirical framework that facilitates construction of indices of relative tourism potential. Each destination is given a score with respect to the common characteristics often associated with tourism potential: tourism penetration, tourism density, the trend in rooms, and tourism promotional impact. Alternative indices of relative tourism potential are then developed by averaging the scores and by using the technique of principal components in a cross section of 29 Caribbean destinations. Destinations are then ranked in order of expected potential relative to each other. The index of relative potential suggests that the small high density destinations are relatively more mature. The approach developed in this paper for relative potential provides an alternative focus for tourism researchers seeking to classify tourism economies in the Caribbean as the region's destinations become more mature.

Introduction

The Caribbean is a diverse region where English, Spanish, French, Dutch, and other languages are spoken. Apart from hundreds of sparsely populated islands, and excluding Mexico and Venezuela, the 32 territories of the Caribbean comprise 22 small islands with populations under 500,000 each, and land area under 1,500 square kilometres, six fairly large islands with populations of 1 to 11 million each, 3 mainland territories with small populations and large land areas, that is, Belize, Guyana and Suriname, and finally, the Bahamas which has a tiny population but boasts a land area of 13,864

square kilometres and 700 small islands. The large six, Haiti, the Dominican Republic, Cuba, Puerto Rico, Jamaica and Trinidad and Tobago, account for 80% of the total population of the region estimated at 40 million.

Tourism is vital to the region since it supplies 14.8% of gross domestic product, 18.4% of exports of goods and services and 15.5% of total employment (see World Travel and Tourism Council Report, 2004). However, tourism in the region has struggled to keep pace with the growth in world tourism in the decade of the 1990s. In recent years the gain in arrivals has largely reflected the mounting popularity of the Hispanic Caribbean, while other destinations in the region have witnessed a slowdown in the rate of growth in tourist arrivals.

The tourism lifecycle is considered the process or set of stages through which a destination evolves with maturity being the end result of this evolution (Butler, 1980). An index of relative tourism maturity would therefore allow comparison of destinations which appear to be at different levels of maturity or points along the lifecycle, without necessarily being specific about what stage each destination is at.

However, adequate time series data are not available to facilitate a comprehensive investigation of relative tourism maturity over time. As an alternative this paper examines characteristics likely to indicate the tourism potential of destinations relative to each other at a point in time, referred in this paper as relative tourism potential. The framework developed in this paper is not intended to displace the Tourism Area Life Cycle, which is not readily observed, but to provide a supportive construct which is easier to estimate. In other words, the main objective of this study is to devise measures of tourism potential using the concept of relative maturity. This is critical given the importance of tourism to several destinations in the Caribbean region and the need for countries with limited potential to have a framework which facilitates their consideration of what can be done to improve their prospects and relative position in the region.

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The plan of this paper is as follows: First the tourism lifecycle theory is discussed and a relative tourism potential model is presented. Then the methodology and data used in this paper are described and the results of the empirical estimation are set out. The final section examines the policy implications and makes concluding remarks.

Tourism Lifecycle Maturity and Potential

The tourist area lifecycle concept was developed to explain the growth, stagnation and eventual decline of destinations after evolving through certain phases [Butler (1980), Cohen (1972), Hovinen (1981)]. Butler (1980) outlined a tourism life cycle framework where a destination goes through in sequence, the six key phases of exploration, involvement, development, consolidation, stagnation and, decline and/or rejuvenation as seen in Figure 1. In the exploration phase, attractions for tourists do not exist, the tourism product may be ill-defined and most visitors tend to be drifters and/or explorers. In the next phase, termed involvement, there is a more concerted effort to provide attractions and specific tourism related services. In these first two phases of growth, visitor arrivals are likely to be positive, but often slow at best.

In the development phase, there is significant involvement by tourism officials and businesspersons together with the expansion of tourist attractions. As a result, tourist arrivals tend to grow exponentially. During the consolidation phase the rate of increase in the number of visitors slows and infrastructure deteriorates. Arrivals often peak at this stage. In the stagnation phase, the destination is often seen as unfashionable, and tourism officials find increasing difficulty in maintaining arrivals from key source markets. In the final phase, growth becomes sluggish, and eventually declines or the destination rejuvenates owing to the development of new attractions such as under-utilised natural resources, international sports events or casinos.

Empirical evidence of the life cycle phenomena in island destinations can be found in Oglethorpe (1984) for Malta, Choy (1992) for the Pacific Islands and Wilkinson

(1987), Whitehall (1997) and Moore and Whitehall (2005) for the Caribbean. One of the primary features of the lifecycle model is that as a destination advances along the Butler S-curve, there is increasing difficulty in attracting tourists, despite marketing efforts, because of negative utility from, inter alia, overutilisation of resources (see Greenidge and Whitehall, 2000). This phenomenon of increasing difficulty of attracting tourists describes the concept of tourism maturity.

Hovinen (2002) proposed an additional ‘maturity’ stage – after Butler’s six – that is characterised by multiple tourism products, each with its own life cycle. Likewise, Moore and Whitehall (2005) found that, consistent with the Butler S-shaped curve, there were different tourism life cycles for the leading US and UK tourism source markets of the Caribbean island of Barbados; they were therefore able to identify the specific/life cycle of a source market of a particular destination by using Markov Switching Vector Auto Regression models. The likelihood that a common destination life cycle might not exist suggests significant difficulty in determining the six Butler – type phases of a particular destination, since this requires knowledge of the full tourism lifecycle. However, it should be possible to determine whether a given destination is relatively more mature than another or has more untapped potential than another, based on presumed characteristics of tourism maturity or potential. This leads us to the concept of relative maturity and potential, measurement of which is the principle object of this paper.

Activities, attractions and private sector advertising are clearly vital in drawing tourists to a destination. Unfortunately, however, data on such factors are not readily available for a large enough number of Caribbean destinations. Moreover, tourism maturity is a difficult concept to measure in the absence of time series data. Most studies of tourism potential, however, have tended to be somewhat anecdotal, with little reliance on rigorous techniques. Cothran and Cothran (1998) found that tourism potential in Mexico could be compromised by political and economic volatility, and by social factors, such as crime and

resentment of western influence. Kelly (1998), in her study of Jordan's tourism potential, stressed the importance of limiting factors, such as bureaucratic red tape, micromanagement, substandard facilities, training gaps, unimplemented regulations, erratic policy formulation, and of more subtle issues, such as cultural values, political sensitivities and long held stereotypes.

Yet, the fact that several of these socio-political factors can be addressed might mean that the potential for tourism in such places still does exist, and an important critique of such studies might be that they describe gaps in tourism performance without really addressing the issue of what is tourism potential.

Building a Relative Tourism Potential Model

The general principle involved in building a relative tourism potential model is that tourism demand depends on a combination of income and price factors, on the one hand, and a combination of externality or non-price factors related to tourism maturity characteristics on the other, where the latter factors can lead to shifts in demand over time (Greenidge and Whitehall, 2000).

Characteristics which help to indicate the tourism potential of a destination are derived from fairly common concepts in use in the literature on tourism maturity and lifecycle. These are tourism interaction, carrying capacity, intervention, and promotional impact. An implicit assumption in this paper is that as destinations mature tourism potential eventually declines. The characteristics are subsequently grouped by various means into an index. The index is intended as an indication of relative potential of each destination compared to others rather than as an absolute measure of potential.

Tourism Interaction

A useful indication of tourism interaction is the tourism penetration ratio ideally defined as the number of visitor-days or visitor-nights over population since this measure captures average visitor load. However, due to

data constraints, tourism penetration is specified as arrivals divided by population¹. It is commonly assumed that as the ratio of tourists to the resident population rises beyond some critical point, as yet unobserved, it will become more difficult to attract additional numbers of tourists to a given destination for social, environmental, psychological, political or other reasons related to the likelihood of eventual negative impacts on the resident community. For more on this community-based perspective see Doxey (1975) and D'Amore (1983). In addition, tourism interaction may include certain specific effects on tourists such as crime and reduced customer service. In this regard, some researchers found that tourists are more likely to be victims of crime than residents [see, for example, Chesney-Lind and Lind (1986) and De Albuquerque and McElroy (1999)]. In essence, one should expect a positive relationship between the tourism penetration ratio, maturity and potential. It is noteworthy that McElroy and Albuquerque (1998) calculated an aggregate tourism penetration index comprising penetration, density, per capita visitor spending and rooms per square kilometre. However, the inclusion of both visitor density (arrivals per square kilometre) and rooms per square kilometre may de-emphasize usable information about investment in rooms which is not related to either density or penetration. Secondly, their index is not strictly a penetration index since it covers maturity and demand features.

Although a yardstick is not available, it appears that in virtually all of the small islands the penetration ratio is high indicating significant penetration and perhaps little scope for rapid expansion of tourism (see Tables 1 and 2).

¹ In countries where there is a growing number of permanent tourists – people that have retired to live in the area or people that have chosen to live there because of the tourism amenities and don't have to work - a more comfortable denominator would be working adults. This data is however not available for all countries in this sample. Visitor days are also not available owing to inadequate data on average length of stay.

Tourism Carrying Capacity

A worthwhile indicator of tourism carrying capacity is the tourism density ratio which should be specified as visitor-days or visitor-nights over land area. However, as a result of data limitations, tourism density is defined here as arrivals over land area suitable for tourism. The concept of tourism carrying capacity carries with it an approach to tourism which permits growth within acceptable limits which do not threaten the sustained use of limited resources (Gill and Williams, 2001). It may refer to the maximum number of tourists that can be accommodated within a specified geographic location (O'Reilly, 1986) or it may be a market driven concept related to the capacity to supply quality tourist experiences (Plog, 1991). Another rationale for carrying capacity has to do with the unattractiveness of some island destinations as a retreat when tourists find themselves increasingly encountering persons they are acquainted with from their own hometown as visitor arrivals expand overtime. In summary then, it is expected that there is a positive relation between tourism carrying capacity and potential.

Tourism density could be critical in some small islands and also in congested cities and resorts. The Caribbean region seems to fit this scenario quite well given the preponderance of 11 small relatively high-density states, namely, Curacao, Grenada, St. Lucia, Antigua, US Virgin Islands, Anguilla, Barbados, St. Martin, Aruba, and Bermuda. The relatively low-density countries include the larger territories, that is, Cuba, Belize, Guyana, Dominican Republic, Trinidad and Tobago, Jamaica, The Bahamas, and Puerto Rico (see Tables 1 and 2).

Tourism Intervention

Researchers have stressed the importance of development planning to re-invigorate maturing tourism resorts. In his Isle of Man case study, Cooper (1989) proposed that the tourism lifecycle should be influenced by management decisions to improve the quality of the resort. In essence, tourism planners don't just sit idly by and allow their destinations to deteriorate. They try various options to rejuvenate their destinations as noted by Conlin (1995), Greenidge and Whitehall (2000) and Whitehall (1997). Tourism investment by the private sector could be a useful

gauge of this intervention, and the growth in private sector investment is likely to be slower the more mature the destination, *ceteris paribus*, if investors perceive that the potential rate of return is not relatively attractive. Since data on tourism investment is not available, growth in the number of rooms² is used as a proxy, following the suggestion of Haywood (1986) who recognised that the growth trend in arrivals was a possible method of identifying when a region or destination moved from one stage of the tourism life cycle to another. From Tables 1 and 2, the larger countries seem to have faster rates of growth in rooms over the 5 year period considered.

Tourism Promotional Impact

The life cycle concept assumes that, with the onset of maturity, it becomes increasingly difficult to attract tourists to destinations, after a certain level of size or success is reached. This can result in a lower impact of each dollar of promotional expenditure in relation to visitor expenditure realised. Reduced promotional impact could result from lower visitor spending per head as visitors gradually reduce their length of stay in an increasingly un-attractive destination. It could also be due to discounting of room rates by hoteliers in an attempt to attract larger numbers of visitors, or the accommodation of tourists of relatively lower spending power over time. Hence, there should be a positive relationship between tourism promotion expenditure and potential. Looking at Tables 1 and 2, it is observed that in general, the larger islands have greater promotional impact when measured as a value above the median of 46.9%. However, there are a few small islands with significant promotional impact, for example, Guadeloupe, the Turks and Caicos, and the US Virgin islands. This could reflect efforts to rejuvenate these islands since, as discussed earlier, tourism planners do not just sit back and allow their destination to deteriorate with age, and so on.

² Focussing on the change in the bed base assumes that the market mix is constant, which may not be appropriate in those countries where the market mix has shifted to the cruise industry and/or in cases where there is significant second home, time share and condominium development.

Methodology and Data

Methodology

Two methods are used to calculate a ranking of tourism potential in the Caribbean region. The first is an un-weighted index, computed as the simple average of the rankings of the relevant indicator variables. The second is a weighted index, using weights determined by the procedure of principal components. According to Johnson (1998), principal components analysis discovers the true dimensionality of the space of the data using a mathematical procedure that computes eigenvalues and eigenvectors of the covariance matrix or the correlation matrix. The eigenvalues and eigenvectors give rise to new variables called principal components that (i) are uncorrelated, (ii) the first principal component accounts for much of the variability in the data as possible, and (iii) each succeeding component accounts for as much of the remaining variation as is possible. Denoting eigenvalues and eigenvectors respectively by $\lambda_1 \geq \lambda_2 \geq \dots \geq \lambda_p$ and $a_1, a_2, \dots, a_p$ respectively, the j^{th} principal component score y_j for the experimental unit z is

$$y_{zj} = a_j z_r \quad j = 1, \dots, p \quad (1)$$

Owing to the normalisation of the eigenvectors to unity, the elements in different eigenvectors cannot be compared unless they are scaled by the square root of its corresponding eigenvalue, that is, $c_j = \lambda_j^{-1/2} a_j$. These new vectors have length $\sqrt{\lambda_j}$ instead of 1 and are called component loading vectors (if the covariance matrix is used) and component correlation vectors (if the correlation matrix is utilised). Formally,

$$\begin{aligned} \text{cov}(x_i, y_j) &= c_{ij} \\ \text{cor}(x_i, y_j) &= c_{ij} \end{aligned} \quad (2)$$

which gives the covariance or correlation between the original variables and the principal component.

Data

In this study, the Caribbean includes the Central American territory of Belize and the South American territory

of Guyana which are part of the Caribbean Common Market. Suriname is excluded because of data deficiencies. Some studies of the region also incorporate tourism resorts in Mexico and Venezuela, but these are omitted here due to their vast land area and population relative to the Caribbean Islands.

Data for the 29 Caribbean countries analysed in this study were sourced from the Caribbean Tourism Organisation's *Statistical Report 2000 Edition* and then standardised to ensure commensurability. The tourism penetration ratio defined as arrivals in 2000 divided by population (in millions) is used as a proxy for tourism interaction. Ordinarily, bed nights would be preferred to arrivals as the former is a superior measure of tourism product. However, data on bednights was not available. The tourism density ratio, defined as arrivals in 2000 over land area suitable for tourism, is used as a measure for tourism carrying capacity. For most countries, except Belize and Guyana, it was taken that land available for tourism was the total land area because of their small size and reasonably accessible surface. However, for Guyana and Belize, which have vast inaccessible regions, total land area was scaled down by the proportion of coast line to perimeter using a factor of $\frac{1}{4}$ and $\frac{1}{5}$ respectively to ensure comparability with island destinations. It is noteworthy that this study distinguishes between tourism penetration and tourism density, contrary to some researchers who either do not make the distinction or consider both characteristics as being part of tourism carrying capacity (see Gill and Williams, 2001).

The growth rate of the number of rooms in accommodation over the five year period 1995-2000 was used as a proxy for tourism intervention. Five years is chosen to rule out the possibility of shocks like September 11, distorting characteristics of the tourism industry. Tourism promotional impact is defined as tourism visitor expenditure divided by promotional budgets of the National Tourism Organisation³, where the latter includes spending on

³ Ideally promotional data should include what the private sector spends on airlines, hotels and so on. However, this information was unavailable.

administration, advertising, marketing and research but excludes spending on infrastructure and other services. Estimates of expenditure by the National Tourism Organisations of Cuba and the Dominican Republic are derived from the World Travel and Tourism Council Report of 2004.

The cut-off point for the data is the year 2000 for two reasons: (i) information for the period 2001-2002 may be contaminated owing to the worldwide shock deriving from terrorist attacks of September 11, and (ii) data for 2003 were not yet available for most of the countries in the study. The summary statistics of the data are given in Table 3.

Results

Un-weighted Rankings of Tourism Potential

The 29 Caribbean states are initially ranked on a scale of 1 to 29 based on the scores of the various characteristics of tourism potential. For example, the country with the highest penetration ratio is considered the most mature or having the least potential and ranked number 29 by this characteristic and so on. Similarly, for the density ratio. On the other hand, the country with the highest growth rates for room supply is considered the least mature or having the most potential and ranked number one by this characteristic, and so on. Similarly, for the tourism promotional impact. Summing the rankings from the four tourism potential characteristics for each destination and dividing through by 4 derives an average un-weighted tourism potential ranking (see Table 4).

In general, by most of the characteristics, the larger countries of Haiti, Belize, Cuba, the Dominica Republic, Guyana, Jamaica, Puerto Rico and Trinidad and Tobago are relatively less mature and have relatively more potential. However, a few small islands also appear to be relatively less mature, including Dominica, St. Vincent and The Turks and Caicos Islands. The relatively more mature destinations or those with less potential include the US Virgin Islands, the British Virgin Islands, Aruba, Bermuda, St. Marten and the Cayman Islands.

Guyana, Jamaica and Trinidad and Tobago entered the tourism business much later than, for example, Antigua, Bermuda and Barbados, partly because of access to significant quantities of mineral deposits of bauxite and oil. Guyana is a virgin territory where the tourism product is growing very slowly but the potential is clear. Belize is a relatively underdeveloped mainland territory with a small population while Haiti has had a long history of political instability.

Weighted Rankings of Tourism Potential

All principal component estimations were done in EVIEWS 5 using both the correlation and covariance matrices. However, underlying results were very similar so only findings with the correlation matrix will be reported. A prerequisite of the principal component analysis is to make sure that the variables are correlated. From Table 5 most of the variables in the correlation matrix appear to be 'significantly' correlated with each other. Furthermore, the result of Barlett's test of sphericity (see Johnson, 1998) implies that the observations form an ellipsoid, indicating the data is appropriate for principal component analysis.

The first step in determining the weighted system is to calculate the principal components from the eigenvalues and eigenvectors of the correlation matrix. As mentioned earlier, the eigenvalues determine the extent to which various components explain the variance in the original (standardised variables). It is customary however to measure the importance of the j^{th} principal component by looking at the ratio of the eigenvalue to the trace of the correlation matrix, that is, $\lambda_j / \text{tr}(P)$. This gives the proportion of the total variability in the original variables that is accounted for by the j^{th} principal component. The results from this procedure indicate that the first principal component 'explains' 72% of the variance of the variables, while the second accounts for 24%, and the third, 4%.

As the interest is in a composite representation of the variables, only the first principal component will be

employed. It is notable that this choice has an eigenvalue of 2.88 and therefore satisfies the Guttman-Kaiser criterion of selecting the principal component with eigenvalues greater than one (see Child, 1970).

The second step towards a weighting system is to calculate the component correlation vectors as defined in Equation (2) above. This process gave relatively high values of the component correlation for the first principal component ranging from 0.33 to 0.58, further reinforcing the choice of the first principal component for constructing the weights.

The final step in the analysis is to determine the component score coefficients, which form the basis of the weights for the composite index. This is done by dividing the component's correlation vectors by the eigenvalue corresponding to the first principal component. Note that since the variables are standardised by their means and standard deviations, some of the resulting component scores would be negative and hence, were adjusted using the formula: *maturity score* = 100[1+(*Component score*)].

The results of the above adjustment are given in Table 4, and they indicate that the 10 destinations with the highest potential in the Caribbean are Haiti, Belize, Cuba, the Dominican Republic, Trinidad and Tobago, the Bahamas, Guyana, Puerto Rico and Jamaica. This group includes the 6 largest territories in the region where tourism density is lowest. The relatively more mature destinations in the region, that is, those with the least potential, are for the most part the small islands with the highest tourism density, that is, Barbados, Cayman Islands, US Virgin Islands, British Virgin Islands, Aruba, Bermuda and St. Martin, with the latter being the most mature destination, that is, having the least potential in the group of 29 countries. These results suggest that the rankings are heavily influenced by the volatility in the tourism density variable (carrying capacity). In fact, a look at the coefficient of variation in Table 3 and Table 6 confirms this. The coefficient of variation is relatively small for tourism interaction (1.11), intervention (0.24) and promotion (0.60) but relatively high for carrying capacity (2.21). This helps

to explain the coefficient of variation of the weighted tourism potential index (2.08). For the Caribbean, it would appear then that the tourism potential index is best understood by creating clusters of territories according to tourism density. This results in a large, low density group, a small, high density group and a small island, low-medium density group.

Policy Implications and Conclusions

In discussing the policy implications of this study it is important to consider what can be done by the countries with the least potential to improve their relative position. This can be facilitated by distinguishing between the characteristics which are largely under the control of policy makers (for example, tourism promotion and tourism intervention) and those which are not (for example, tourism interaction with the resident population and tourism carrying capacity of the available land area).

A review of Tables 1 and 3 indicates that for the seven (7) countries having the lowest potential, all, except the Cayman, had below average tourism intervention (defined as the growth in rooms between 1995-2000). While four of the seven, namely Barbados, Cayman, Aruba and Bermuda, depicted below average tourism promotional impact (specified as visitor expenditure per unit of expenditure by the National Tourism Organisation).

One possible interpretation of these results is that investors are shying away from putting resources into additional room space in destinations considered to have relatively less potential than others in the same region. Tourism planners in these destinations should therefore focus on measures to make tourism investment more attractive and hassle free. Such policy initiatives could include a review of tax incentives, pay for performance schemes, human resource training (such as customer service courses), cleanliness, as well as beautification and safety concerns, where relevant.

In relation to tourism promotion, the results are mixed in the sense that it is not possible to conclude that the destinations

with the least potential have less potential because of difficulties regarding the quantum or efficiency of promotional expenditure by national promotional agencies. However, there could be some merit in countries such as Barbados, Cayman, Aruba and Bermuda re-examining the efficiency and quantum of tourism promotional expenditure with a view to strengthening promotional impact and in consequence, tourism potential. Policies to strengthen promotional impact include a review of market segmentation, targeting and related issues such as availability of air routes, seating capacity and so on.

Tourism density emerges as an important characteristic and, to some extent, a critical constraint to additional tourism potential for many of the small islands of the Caribbean. This may mean that the smaller islands will inevitably be relatively less competitive than their larger neighbours where density is not a constraint. The main policy implication of this result is that aggressive tourism rejuvenation planning is needed in the small high density Caribbean islands in order to delay or counter the negative implications of maturity. This is particularly important in Antigua, Barbados, Bermuda and Aruba which appear to be among the more mature tourism destinations in the

Caribbean with relatively less additional tourism potential. Notably these destinations realised relatively limited growth in room supply and below average promotional impact.

Another result from this study is that it demonstrates how inferences concerning relative tourism potential can be obtained through analysis of characteristics associated with maturity indicators without the need for large volumes of data over the full life cycle of each destination. These measures can be used to inform studies of tourism maturity and demand; nor are they region specific but can be applied to other destinations and regions as well. The most useful feature of the paper is that it provides an alternative focus for researchers who have made little headway in measuring and modelling the elusive tourism lifecycle.

There are also opportunities for future research as to whether the index of tourism potential enhances the popular tourism demand models for individual destinations overtime, or adds to the explanation of tourism demand or destination competitiveness across destinations. It would also be interesting to discover whether the index of tourism potential supports the assumption that it will become increasingly difficult beyond some point to attract tourists to a destination owing to the onset of maturity.

Table 1
Indicators of Tourism Potential for Selected Caribbean Countries

Country	Interaction ¹	Carrying Capacity ²	Intervention ³	Promotion ⁴
Haiti	0.02	5.17	1.00	45.00
Belize	0.78	28.39	1.11	30.26
Cuba	0.16	15.99	1.36	46.69
Dominica Rep.	0.40	49.45	1.60	50.38
Dominica	0.91	97.87	1.51	30.15
Trinidad and Tobago	0.31	69.97	1.46	51.68
Bahamas	5.23	106.86	1.03	33.61
Guyana	0.14	2.08	1.14	118.71
Puerto Rico	0.88	132.34	1.16	25.04
Jamaica	0.51	115.78	1.13	49.41
Montserrat	1.95	101.34	0.37	61.22
Bonaire	3.80	178.02	1.00	20.70
St. Vincent	0.65	175.58	1.49	48.36
St. Kitts	1.81	312.27	1.12	17.97
Grenada	1.27	375.20	1.10	22.95
Curacao	1.38	430.74	1.51	24.24
Turks and Caicos	9.70	282.01	1.89	130.74
St. Lucia	1.73	420.47	1.14	40.00
Antigua	3.30	470.16	0.96	47.91
Martinique	1.35	496.50	1.21	49.07
Anguilla	3.24	481.20	1.12	67.64
Guadeloupe	1.91	517.84	1.03	100.93
Barbados	2.04	1,259.79	1.11	32.14
Cayman	8.66	1,517.31	1.50	20.43
US Virgin Islands	5.59	1,666.45	0.97	97.54
BVI	14.13	1,868.63	1.13	76.57
Aruba	7.65	3,836.30	1.09	46.93
Bermuda	5.24	5,952.11	0.81	11.72
St. Maarten	10.12	12,714.47	0.96	95.02

Source: Authors' Estimates based on data from the Caribbean Tourism Organisation.

Notes:

1. Proxied by tourism penetration defined as tourism arrivals divided by population in millions.
2. Proxied by tourism density defined as tourism arrivals divided by land area in square kilometers.
3. Growth of rooms in tourism accommodation 1995-2000.
4. Visitor expenditure per unit of expenditure by national tourism organisation.

Table 2

Unweighted Ranking By Individual Tourism Potential Characteristics

Country	Rank Interaction	Rank Carrying Capacity	Rank Intervention	Rank Promotion	Average RankUnweighted
Haiti	1	2	24	17	9
Belize	8	4	18	21	10
Cuba	3	3	8	16	4
Dominica Rep.	5	5	2	10	2
Dominica	10	7	4	22	7
Trinidad and Tobago	4	6	7	9	3
Bahamas	22	9	21	19	18
Guyana	2	1	12	2	1
Puerto Rico	9	11	10	23	11
Jamaica	6	10	13	11	6
Montserrat	17	8	29	8	15
Bonaire	21	13	23	26	26
St. Vincent	7	12	6	13	5
St. Kitts	15	15	15	28	20
Grenada	11	16	19	25	19
Curacao	13	18	3	24	13
Turks and Caicos	27	14	1	1	8
St. Lucia	14	17	11	18	14
Antigua	20	19	27	14	24
Martinique	12	21	9	12	12
Anguilla	19	20	16	7	16
Guadeloupe	16	22	22	3	17
Barbados	18	23	17	20	22
Cayman	26	24	5	27	25
US Virgin Islands	24	25	25	4	21
BVI	29	29	14	6	23
Aruba	25	26	20	15	27
Bermuda	23	27	28	29	29
St. Maarten	28	28	26	5	28

Table 3

Descriptive Statistics For Original Variables

	Interaction	Carrying Capacity	Intervention	Promotion
St. Deviation	3.62	2567.83	0.29	31.04
Mean	3.27	1161.39	1.17	51.48
Coef. of Variation	1.11	2.21	0.24	0.60

Table 4
Ranking Using Principal Component Analysis and Simple Averaging

Country	Principal Components Score	Weighted Rank	Unweighted Rank
Haiti	5,988.81	1	9
Belize	6,344.78	2	10
Cuba	7,202.32	3	4
Dominica Rep.	10,650.73	4	2
Dominica	12,526.65	5	7
Trinidad and Tobago	12,594.23	6	3
Bahamas	14,041.65	7	18
Guyana	14,606.20	8	1
Puerto Rico	14,911.94	9	11
Jamaica	16,344.94	10	6
Montserrat	16,520.60	11	15
Bonaire	18,650.01	12	26
St. Vincent	21,555.72	13	5
St. Kitts	30,027.37	14	20
Grenada	36,135.38	15	19
Curacao	41,255.14	16	13
Turks and Caicos	41,670.07	17	8
St. Lucia	42,227.20	18	14
Antigua	47,677.44	19	24
Martinique	50,009.88	20	12
Anguilla	51,039.13	21	16
Guadeloupe	58,156.17	22	17
Barbados	115,434.34	23	22
Cayman	137,372.35	24	25
US Virgin Islands	159,495.75	25	21
BVI	175,566.41	26	23
Aruba	345,240.10	27	27
Bermuda	527,640.10	28	29
St. Maarten	1,135,339.25	29	28

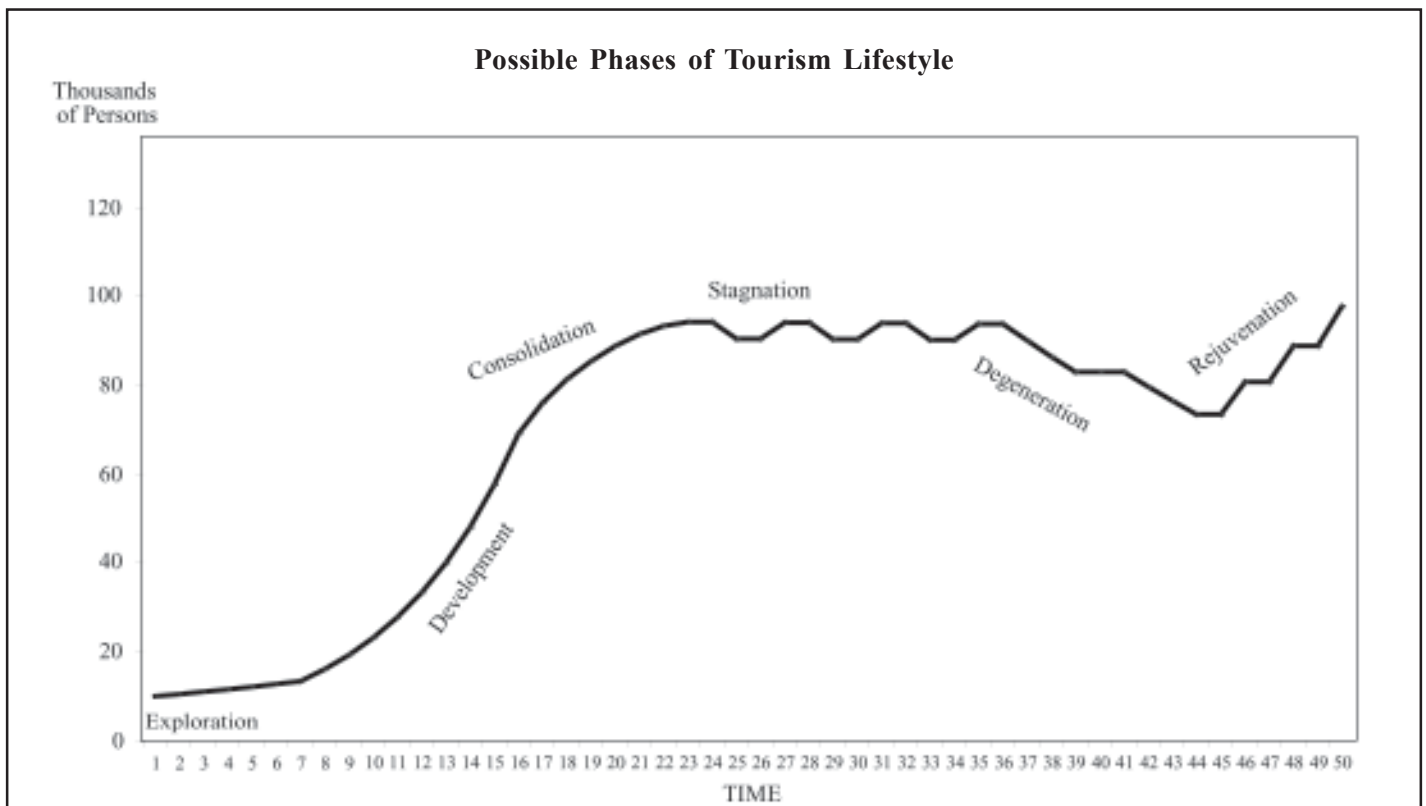
Table 5
Correlation Matrix of Standardized Variables

	Interaction	Carrying Capacity	Intervention	Promotion
Interaction	1.000000	0.060615	-0.691499	-0.775050
Carrying Capacity	-0.060615	1.000000	-0.551130	-0.492254
Intervention	-0.691499	-0.551130	1.000000	0.992416
Promotion	-0.775050	-0.492254	0.992416	1.000000

Table 6
Descriptive Statistics for Tourism Potential Index

Standard Deviation	227,572.00
Arithmetic Mean	109,180.16
Geometric Mean	38,239.88
Coefficient of Variation	2.08

Figure 1



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Helping Countries Develop: The Role of Fiscal Policy
Edited by Sanjeev Gupta et. al. (International Monetary Fund)
A Review by Sunielle Stanford*

Introduction and Overview

The book *Helping Countries Develop: The Role of Fiscal Policy* is an insightful collection of articles that should be of particular interest to students of economics, policy makers or those persons with an understanding and appreciation of development issues affecting developing countries. The work is a 2004 International Monetary Fund (IMF) publication which has been edited by Gupta, Clements and Inchauste. In this volume, the contributing authors shed light on the precise channels through which fiscal policy can foster growth and economic development in low-income economies. Given the current global focus on poverty reduction, the book also highlights the extent to which government expenditure can achieve the Millennium Development Goals (MDGs) and explores the relationship between growth, fiscal policy and poverty.

In the Foreword, Horst Köhler (Former Managing Director of the International Monetary Fund) noted that in the long-run, prudent fiscal policy could impact positively on economic growth and economic development. For example, low and/or sustainable levels of public debt suggest that government has available financial resources to finance poverty reduction schemes, improve the provision of social services and by extension, foster an appropriate climate for economic development. In the short-run, there was less agreement on the appropriate role of fiscal policy. Köhler noted that while some economists cited that fiscal policy should be used to alleviate short-term fluctuations in output and employment, others argued that fiscal policy was an ineffective policy tool in developing countries since these economies are typically plagued with high levels of unsustainable debt. Thus, it was argued in such a situation, government would not have sufficient resources to meet the growth requirements of the economy.

In the editors' overview, Gupta, Clements and Inchauste presented the conceptual background indicating how fiscal policy can affect growth, human and economic development. The editors noted that fiscal policy adjustment in areas of revenue, expenditure and financing policy could also influence long-term economic growth and development. From the point of view of expenditure, fiscal policy could improve or be detrimental to economic growth, owing to government's decisions on investment in human and physical capital. Consequently, the level and composition of government spending in the social sectors (for example, health and education) were key to influencing favourable outcomes in the economy. In relation to government revenue the major concern was whether the existing tax structure of developing countries was enough to finance growth and poverty reduction schemes. However, the empirical evidence on the impact of taxes on growth was inconclusive. Lastly, with regard to financing, the editors noted that the empirical evidence relating to the effect of government spending financed from official development assistance on growth yielded mixed results.

The remainder of the book is divided into five main parts. Part I, *Macroeconomic Policy in Developing Countries*, analyses how fiscal policy affects growth both in the long-run and short-run. The articles in Part II, *Public Spending and the Millennium Development Goals*, are directed at government expenditure policy. The third part, *Revenues and Growth*, focuses specifically on government revenue policy. Part IV on *Fiscal Policy and Aid* examines government spending financed by foreign assistance. Part V concludes with some special topics that also shed light on the relationship between fiscal policy and economic development. In this volume, a wide array of methodologies - inter alia, country case studies, statistical and econometric analysis - were employed to support the authors' arguments.

Macroeconomic Policy in Developing Countries

The articles in this section - which was the largest in the book - addressed three areas: (1) the precise way in

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which fiscal policy instruments can foster economic development in low-income countries; (2) the extent to which government expenditure can achieve the MDGs, and; (3) the interrelationships between growth, fiscal policy and poverty.

In Chapter 2, Gupta, Clements and Baldacci examined the effects of fiscal adjustment (that is, fiscal expansion or fiscal contraction) and expenditure composition on economic growth in low-income countries. The authors considered three aspects of a country's fiscal policy in relation to its impact on growth. These included the fiscal policy stance as measured by the level and changes in the general government budgetary balance, the financing of budgetary deficits, and the composition of government spending.

In the first part of the analysis, correlation results yielded a significant association between deficit reduction, expenditure composition and growth. The above relationship was tested econometrically and the main findings revealed that fiscal consolidations were not detrimental to long-run or short-run growth in low-income countries. In line with economic theory, the results indicated that if a greater proportion of aggregate government spending was allocated to public investment, this would lead to increased levels of growth. More interestingly, the econometric results suggested that fiscal consolidations achieved through cutting certain government payments (such as wages and salaries) spurred higher growth rates in comparison to fiscal adjustments based on revenue increases. Another insightful finding was that domestic financing was more detrimental to growth than external finance because in both the long-run and short-run deficits financed by domestic sources usually led to inflationary pressures.

While the previous study revealed that fiscal consolidation had a positive impact on growth, Baldacci, Clements, Gupta and Mulas-Granados (Chapter 3) noted that an understanding of the factors that contributed to sustainable fiscal consolidation were also important in determining how fiscal adjustment influenced growth in

developing countries. The authors were primarily interested in identifying those factors that indicated the end of a fiscal consolidation period as well as the extent to which improvements in the composition of government expenditure were instrumental in fiscal adjustments lasting more than one year. Macroeconomic stability was instrumental in determining the end of a fiscal consolidation period. The study found that when capital expenditure was protected during fiscal adjustment and government spending on non-wage goods and services increased, the fiscal consolidation period was more sustainable. These results contrasted with findings of developed countries which suggested that total expenditure reduction was a key factor determining sustainable fiscal adjustment.

Equally important in the literature was the precise channel through which fiscal consolidation affected growth in developing countries. The literature noted that for developed countries, increased levels of private investment led to higher growth. But did this 'transmission-channel' hold for developing countries? Chapter 4 by Baldacci, Hillman and Kojo addressed this question. The authors hypothesised that in the case of low-income countries, factor productivity rather than investments was the 'transmission channel' for growth. They based their argument on the structural characteristics peculiar to low-income countries. For example, corrupt governance, which was sometimes evident in low-income countries, reduced the incentives and effectiveness of investments and ultimately lowered growth. In contrast, productive government spending raised total factor productivity and leads to higher levels of output and growth.

Chapters 5 and 6 examined how large and rising debt burdens in developing countries have constrained economic growth as well as human development. Policy makers generally agree that high levels of indebtedness tended to retard economic growth. The theoretical literature surrounding the debt-growth nexus therefore focuses on the debt overhang theory - when a country's expected repayments from its export earnings fall short of the

contractual value of debt. In this debt overhang phenomenon, repayment is linked to economic performance and any improvements in such means creditors will ‘tax away’ resources - that could otherwise be spent in social areas, such as health services and education and other poverty-reduction programmes - at the expense of investment, thus impacting unfavourably on economic growth.

Clements and Bhattacharya utilised a reduced-form growth equation to estimate a debt Laffer curve (a non-linear relationship between debt and growth) and found that when the net present value (NPV) of external debt to GDP passed a threshold of 20-25%, or when the NPV of external debt to exports surpassed the range of 100-105%, additional debt retarded growth. While the stock of debt did not significantly impact on public investment, it was the more critical debt-service ratio which depressed investment. The authors found that a reduction in debt service of about 6% of GDP raised investment by 0.8%-1% of GDP, and this led to a corresponding increase in growth by a marginal 0.2%.

Chapter 6 by Baldacci and Fletcher extended the subject of debt and growth by examining the issue of debt sustainability. Debt sustainability analysis, they argued, was important in determining whether current and/or future fiscal policy was appropriate both in the short-term and long-term. Such an analysis has implications for a country’s broader development objectives, for example, the levels of government expenditure required to achieve certain targets in the MDGs, or other poverty-reduction schemes. According to Baldacci and Fletcher, a nation’s debt is sustainable “if the country can meet its debt-service obligation without recourse to debt relief, debt rescheduling or accumulation of arrears without unduly compromising growth”. A number of indicators which were particularly useful for low-income countries to assess debt sustainability were outlined in the research. These indicators included nominal level of debt as a share of GDP, NPV of debt as a share of GDP, debt to total revenue ratio and ratio of debt service to total revenue. The authors also recommended a number of ways to deal with unsustainable debt, which included increasing foreign grants or lowering government

spending. It was concluded that debt sustainability analysis could only be effective if analysed on a case-by-case basis.

Public Spending and the Millennium Developing Goals

The chapters in Part II focused on the extent to which government expenditure and the composition of spending in the social sectors could improve social outcomes and by extension economic growth. The theoretical argument posited in the literature was that investment in human capital enhanced the productivity of workers, resulting in higher economic growth.

In Chapter 8, Gupta, Verhoeven and Tiongson examined the composition of government outlays in social services (specifically on health and education) in an attempt to determine its impact on key social indicators, namely, mortality rates, educational attainment and infertility rates. The following key questions were raised: 1) what is the impact of public spending on health and education outcomes? 2) does a reallocation of spending among sectors improve socio-economic outcomes of the poor in society? 3) do social indicators for the poor respond differently to public spending than those for the non-poor? In their analysis, the authors focused on intrasectoral distribution defined as the composition of government spending in specific areas. For example, intrasectoral distribution on education refers to the share of resources allocated to primary, secondary and tertiary levels. The findings indicated that higher aggregate expenditure on education and intrasectoral disbursements contributed positively to educational attainment. Similarly, greater investment in health care had a positive influence on health status – with a reduction in infant and child mortality rates. It was therefore concluded that for government expenditure in the social sectors to improve growth prospects and the well-being of people, it was imperative for policy makers to focus more on intrasectoral allocation of resources.

Chapter 9 looked specifically at whether increased government spending in areas of health care would improve

the health of the poor. This study was different from the one conducted in Chapter 8, in that cross-country data based on income distribution was utilized rather than aggregate indicators. Because the poor are more vulnerable to their external environment, variations in health status are not apparent with the use of aggregate data and further do not paint a holistic picture of the quality of life of the poor in society. Hence, there was a need to evaluate the impact of government spending on the poor. As the study employed cross-section data, the authors quite rightly identified that the definition of 'poor' was a relative concept, as it would include different meanings across countries. As a result, the study focused on absolute poverty and used the international poverty line as a benchmark for their analysis. The results from a number of regressions confirmed that the health status of the poor was worse than the non-poor and also that government outlays in health services had a stronger impact on the poor in comparison to the non-poor. For example, the findings indicated that a 1% increase in government health spending targeted to the poor reduced the child mortality rate by half.

The study by Hillman and Jenkner in Chapter 10 assessed advocates' recommendation that user payments – funds used for children's education - should be abolished or disallowed in poor countries and those payments should fall under the aegis of government. Low educational attainment could be explained by a number of demand and supply factors. On the demand side, low school enrolment ratios could be due to low demand for school among the poor. Even in the event that access to school was free, the authors argued, there was an opportunity cost for children of poor parents to attend school. For example, attendance at school meant less available manpower to assist the family. On the supply side, the government could be responsible for low enrolment. This could be occasioned by an inefficient tax structure (that is, ineffective tax administration and tax collection) which would result in a lack of resources for financing education. A number of problems and benefits to user payments were explored. User payments could be beneficial when, for instance, inadequate public resources

were available for education, or education provision from government was of a poor quality because of inadequate monitoring. In addition, parents were less inclined to make user payments if there was poverty, high opportunity costs or low social mobility. Within this context, the decision of whether to abolish or allow user payments should be treated on a case-by-case basis.

Revenues and Growth

The chapters in Part III predominantly focused on the tax structure in developing countries and by extension the link between tax policy and development. In Chapter 12, Keen and Simone pointed out that an efficient tax structure was one which provided government with the resources to finance and implement projects considered beneficial to growth and development. However, due to structural characteristics of developing countries (for example, the presence of a large informal sector) the tax base from which government could actually collect revenue was reduced. Keen and Simone contended that developing countries were faced with the challenge of mobilising taxes necessary for economic growth, without putting undue pressure on the existing tax structure by heavily taxing economic agents in the formal sector. The study in Chapter 12 concentrated on the early 1990s when there was a general shift in the tax system and at the turn of the century. A sample of 47 countries, consisting predominantly of Sub-Saharan Africa and Asia and Pacific countries were classified as low-income countries and lower-middle-income countries. The authors pointed out that in general, for developing countries, about 40% of tax revenue was derived from indirect taxes, with trade taxes, income taxes and social security taxes accounting for 20%, 25% and 17% of tax revenue, respectively. The authors highlighted that the share of property tax revenue was insignificant. An analysis was then made of how revenues from Value Added Tax (VAT), trade tax revenues and corporate tax revenues may be useful in improving the tax structure of developing countries.

The study in Chapter 12 examined whether the introduction of a VAT system delivered the sought after efficiency gains. It was purported in the literature that if the adoption of VAT lowered the marginal social cost of raising tax revenue (this cost encompasses efficiency and distributional effects), then the ratio of total tax revenue to GDP should be greater than those countries without VAT. The findings suggested a positive link between the revenues gained from VAT and the level of income whereas there existed an inverse relationship between revenue gained from VAT and the level of openness of the economy. Openness can be defined as the degree to which residents and non-residents can engage in economic transactions without government imposed costs that are not ordinarily levied on transactions between domestic residents. The authors suggested that the positive relationship indicated that ‘hard-to-tax’ sectors were less important in terms of income earning capacity while the inverse relationship could be attributed to the relative ease in raising trade tax revenue as an alternative source of receipts in open economies. From the latter findings, Keen and Simone concluded that in open economies, adoption of VAT might actually lead to a decline in tax earnings.

With regard to trade taxes, there was a general decline in the application of trade taxes due to a more trade-liberalised environment. The shift away from trade tax revenue must be recovered from elsewhere in the economy and it was recommended that this could be done by a proportionate increase in domestic consumption taxes. An empirical analysis using panel data for 125 countries revealed that countries were unable to recover this trade tax revenue. This suggested that government had an additional responsibility to effectively sequence trade reform to reduce the fall-off in tax earnings and also to strengthen the domestic tax design (in terms of tax administration and tax rate) in order to avoid further declines in tax receipts. Similarly, a decrease in corporate tax incomes raised the issue of alternative revenue sources for developing countries.

The effect of taxation on income distribution was another area analysed in this volume. In Chapter 13, Munoz

and Sang-Wook Cho compared the impact of VAT on income distribution to the former sales tax which VAT replaced. The findings indicated that in Ethiopia, the progressive nature of VAT has had an adverse influence on the poorest 40% of the population. However, this accounted for only 1% of their consumption and further, if the revenues earned from VAT were allocated to poverty reducing activities such as basic education and preventative or primary health care, that 40% of the population would be net beneficiaries.

Fiscal Policy and Aid

Chapters 15 and 16 examined the impact of aggregate official development assistance (ODA) or aid on economic growth. In Chapter 15, Heller and Gupta assessed macroeconomic and microeconomic challenges that government spending financed by large flows of ODA had on the economy. In terms of the macroeconomic challenges, one issue considered was whether aid was used by the recipient economy for spending in domestic markets or to finance imports. If the ODA was spent on imports, there would be no effect on the country’s balance of payments position, since the growth in imports would be financed by the foreign inflows from aid. In contrast, if aid was spent in the domestic market on non-traded goods, then prices in the domestic market would rise. In order to make purchases in the domestic market, the foreign exchange (from the aid inflow) would have to be converted into local currency, thus enlarging the domestic monetary base. With a build up of currency in circulation, the domestic demand for non-traded goods would expand. Coupled with supply constraints on the production of non-traded goods and services in the domestic market, the resulting effect would be higher prices. It was stated that if the country had a fixed exchange rate regime, then the increase of domestic prices relative to import prices would lead to an appreciation of the real exchange rate, which in turn, would make exports more expensive and less competitive in the international market. This could have serious implications for a developing country’s ability to earn foreign exchange from exports.

In terms of microeconomic challenges, ODA can disrupt management capacity of government institutions in developing countries if, for example, the recipient developing country was unable to utilise these additional external resources efficiently. A five part multi-pronged approach was outlined in order to deal with the effective allocation and utilisation of ODA: 1) the criteria under which ODA was distributed should be reconsidered and instead ODA should be channelled towards those countries that would not have macroeconomic problems absorbing aid while still directed to those countries where large parts of the population live in absolute poverty; 2) specific attention should be paid to alleviating institutional bottlenecks that inhibit a low-income country's absorptive capacity of aid flows; 3) developed countries' investments in research and development could lead to technological innovations which would be more easily adopted by poor countries in sectors such as, manufacturing or agriculture; 4) in spite of absorptive challenges facing developing countries, assistance could still be mobilised and accumulated in a trust fund until there were significant improvements in absorptive capacity and; 5) resources could be channelled to finance the removal of barriers that prevented poor countries from accessing markets of developed countries.

Heller and Gupta concluded that for aid to have a beneficial impact on recipient countries, the key players - donor countries, recipient countries and private sector - must be cognisant of the expected allocation challenges arising from external financial flows and must have policies in place to address any such challenges.

The issue of volatility and unpredictability of aid flows was discussed by Buliø and Lane in Chapter 16. The theoretical links between aid and growth were on the basis that aid was a source of additional capital accumulation and could supplement domestic private savings, hence contributing to investment. Nevertheless, this positive impact of aid could be reversed as a result of aid volatility and unpredictability. Buliø and Lane stated that since aid was limited as it depended on the budgets of donor countries, it

was important that aid be managed efficiently. Additionally, they noted that if aid was volatile, then the positive benefits from aid might not materialise and further, the volatility of aid was proportional to aid dependency. This volatility stemmed from the conditions that are attached to aid flows. Conditions attached to aid are referred as 'tied-aid' in the literature. Project aid is an example of 'tied-aid'. Under project-aid, for example, a condition may be that certain goods needed for an investment project in the recipient country must be purchased from the donor country.

Even when low-income countries normally had a good track record of receiving aid flows, it did not necessarily mean that aid flows were predictable. In light of the unpredictable and volatile nature of aid, Buliø and Lane recommended that recipient countries: 1) adopt flexible fiscal policies to adjust to aid inflows; 2) smooth out fluctuations in aid disbursements by depleting international reserves and; 3) rely on domestic non-monetary financing to adjust to the variations in aid flows.

The book ended with two chapters on the fiscal consequences of armed conflict and terrorism, and a comparative analysis between two public expenditure management systems in Africa. In the former, the researchers pointed out that in a regime characterised by conflict, government expenditure needs are exceptionally high while the revenue base tends to be small. In contrast, following the end of that regime, the post-conflict country can experience economic growth, macroeconomic stability, increased tax revenues and a reduction in military spending. The chapter on public expenditure management stressed that fiscal policy on its own would be ineffective unless there were strong institutions (for example, legislative) in the economy and a commitment to enforcing rules.

Conclusion

This publication provided a comprehensive analysis of how fiscal policy - whether through government spending, revenue collection or financing from aid - impacted on

economic development. The authors stressed that not only was the level of government spending important but also the composition of government spending and the effectiveness of the expenditure in targeting the poor in society. With regard to taxation, the studies highlighted the need for tax reform, in terms of tax structure and the potential available revenues that can be earned from the tax system, in order to benefit developing countries. Similarly, for fiscal policy financed from aid inflows to be efficiently allocated, then various macroeconomic and microeconomic challenges must be addressed. Indeed, when prudent fiscal policy is

adopted, combined with efficient institutions, a country is one step closer to achieving the MDGs and a reduction in poverty rates, which help the overall development process.

The work is particularly relevant to the Caribbean as it is specifically targeted at developing countries. As such, it offers policy maker's recommendations and insights into situations that might affect Caribbean economies, such as the issue of the debt-growth nexus and debt sustainability. The policy recommendations largely emphasize demand management and microeconomic policy adjustment policies that are consistent with IMF doctrine.