

STRUCTURAL ADJUSTMENT IN BARBADOS 1970-1984

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by

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The economy of Barbados survived the disequilibria of the 1970s and early 1980s to wind up, at the end of 1984, with useful gains in national output and income. Inflation had been reduced to levels comparable with those of leading industrial countries. The balance of payments was about balanced, although foreign exchange liquidity was somewhat diminished by the suspension of regional payments arrangements under which Barbados was owed substantial amounts. However, no headway had been made against unemployment; levels were higher than they were a decade earlier.

The leading indicators of economic performance were all highly volatile over the 1970 to 1984 period; episodes of great economic difficulty were interspersed with years of expansion and relative calm. Three crisis periods can be identified. The first, associated with the first oil crisis, occurred in 1973 and 1974. The balance of payments went into deficit in 1973, output contracted in 1974, and the country faced a sharp increase in prices which rose almost 40% in 1974. The balance of payments recovered briefly in 1974 and 1975, while output was on the increase from 1975. Inflation was brought back to single digits by 1976.

The second period of difficulty was the 1976 balance of payments crisis. The balance of payments deteriorated abruptly, but otherwise the economy seemed in reasonably good health. The balance of payments recovered in 1977 and the next three years were a period of relatively stable expansion. Output rose, inflation was low up until 1979, and there were balance of payments surpluses.

The third crisis period lasted from 1981 to 1984. The second oil shock generated high inflation in 1980 and was followed by economic contraction between 1981 and 1983, together with record balance of payments deficits in 1981 and 1982. The high inflation persisted through 1981. The employment gains registered between 1978 and 1981 were completely reversed between 1982 and 1984. Inflation was brought under control in 1982 and output recovered a little in 1984. The balance of payments was in surplus in 1983 and just balanced in 1984. However, unemployment was still on the increase.

The economic resurgence after the first oil crisis owed more to exogenous factors than to domestic policies. Three adjustment policies were implemented at that time. Interest rates were adjusted to maintain the confidence in the domestic currency, just around the time of the introduction of the Barbados dollar. No other monetary policies could be put in place since the Central Bank was not yet operational

in 1973. There were some selected trade controls but they were not sufficiently general to depress total imports. Existing exchange controls were not effective. They did not apply to transactions in Sterling and London was the principal financial contact for the local banking system.

There was some borrowing on the Eurodollar market, possible because Barbados at the time had extremely low debt service ratios. However, there was major contraction in real imports because of a fall in real output. Depressed foreign demand in the tourism sector reduced real output, as a result, real imports fell in 1974 and 1975, helping to contain the balance of payments deficit and laying a foundation for a turn around in external payments. The revival of output and the balance of payments in 1974 and 1975 resulted from windfall sugar receipts followed by renewed expansion in tourism as the growth in the major industrial countries began to pick up.

The balance of payments crisis of 1976 was largely precipitated by fiscal extravagance. Increases in current expenditure ate up the entire current account surplus and raised the overall deficit to the point where it accounted for 7% of GDP, up from 2% the year before. Credit to Government from the banking system rose to record levels. A drop in the price of sugar aggravated the external payments outcome. In an attempt

to rectify the situation, credit limits were imposed beginning in 1977 and they were followed by strong fiscal contraction from 1978 onwards.

The recession of 1981 to 1983 was the most prolonged and troublesome. Fiscal and monetary measures were brought to bear along with external borrowing to a greater extent than had ever been the case before. Fiscal policy got off on the wrong footing with high expenditures for the election year in 1981. They undoubtedly helped to sustain the growth in imports, which took place in spite of the decline in real output. However, Government reigned in expenditure immediately afterwards and additional taxes improved the fiscal deficit to GDP ratio from over 8% to 5% in 1982. Nineteen hundred and eighty-three was also a year of fiscal prudence, although 1984 was more expansionary.

Restrictive monetary measures were brought to bear to buttress the fiscal correction. Selective credit limits were imposed on the main spending sectors and penal general discount rates were stipulated. However, there were special provisions for discounts for producers. Interest rates were raised in line with the uptrend in international rates.

Along with these measures to restrict spending, Government borrowed on international financial markets

and from the IMF via a stand-by and an export compensatory arrangement.

Signs of recovery, albeit laggard and halting, began to appear only in 1984. The recovery was based on a revival of demand for tourism, and on the expansion of assembly type manufacturing for the North American market. Prices and supply conditions continue to bedevil the sugar industry, while manufacturing is slowed by the inability and slowness to identify and exploit potential new markets.

#### Structural Changes and Barbados' Economic Performance

Since 1970 there have been no major changes in the structure of exports which might have increased the resilience of the balance of payments. The concentration of exports - measured by the percentage of exports of goods and services accounted for by three largest items - remained stable, after having fallen significantly during the 1960s (with the development of tourism). With substantial growth during the 1970s export manufacturing effectively replaced the flagging sugar industry as a source of foreign exchange. The relative importance of tradable goods in total output also remained roughly at the same level. Structural change had taken place in the 1960s with the relative decline in sugar production and a relative gain in importance for the non-traded sector. No further changes have been observed since then.

The burden of the increase in the price of oil seems to have fallen mainly on consumer goods imports. Fuels absorbed proportionately more of import expenditure after

1973 at the expense of imports of consumer goods. However, this cannot be attributed to any deliberate policy on the part of the authorities. Later in the 1970s intermediate goods began to gain in importance, also at the expense of imports of consumer goods. By this time, fiscal restraint had been imposed along with monetary curbs and they may have helped to dampen the imports of consumer goods. The growth in intermediate goods was associated with the growing importance of assembly-type manufactures for the United States market. An increasing proportion of investment appears to have taken the form of imports of capital goods from about 1977 onwards. Again this seems not to have been the result of any deliberate policy.

There is a notable trend for increases in the savings ratio from 1977 onwards. The growing current account surplus of Government contributed to national savings from 1978 onwards (except for 1984). However, that will only partly account for the savings phenomenon, which needs to be explored further.

Apart from fiscal stringency no official policy seems to have contributed much to structural change. The regime of industrial protection which had been enforced throughout the period has been examined for its effects on the growth of investment, with no positive results. The evidence is collected and discussed in Codrington et al, 'Private Foreign Investment in Barbados', Central Bank of

Barbados (mimeo), January 1985. Interest rates appear to have little effect on either supply or demand, judging from results of econometric tests (See Boamah et al, 'An Econometric Model for Short-term Forecasting in Barbados', Central Bank of Barbados (mimeo), December 1984). There have been no exchange rate changes or other deliberate attempts to alter relative prices.

#### An Interpretation of the Barbados Experience

It seems that adjustment policies, by and large, can help to manage expenditure within the resources provided by the levels of output. This is essential in order to maintain stable balance of payments, modest inflation and so encourage investment. Failure to adjust expenditure leads to flight of capital, loss of confidence, contraction in output and a running-down of the capital stock. But economic policies are not nearly so useful in stimulating production and allocating resources (with the exception of fiscal policy). We have seen how fiscal policy can be used to generate savings as well as to promote economic adjustment. However, price incentives for resource allocation, protection - for example - have had a much less noticeable effect.

This is not really surprising if one examines the tradable sectors. The sugar industry is in the throes of

technical change which has had a depressing effect on yields. Partly this is a consequence of economic development; low productivity, labour-intensive cultivation methods are no longer possible if workers are to command a wage which ensures them an average basket of goods compatible with common standards of living. Sugar was also affected at the beginning of the 1970s by adverse terms of trade compared with real estate. This is a universal problem to which zoning seems the only answer. In the manufacturing sector there seems to be infinite demand for what Barbados can produce to sell in the markets of the United States. The problem is identifying the markets for which our products can qualify and targetting production in those areas. Although tourism is a service which is sensitive to prices Barbados' tourism can only be sold on the basis of product differentiation. There will always be many countries which can effectively undersell the Barbados tourism product precisely because their countries are much poorer.

In the non-tradable sectors and in the economy generally prices adjust relatively quickly while quantities adjust slowly or not at all. This is a reflection of the prevailing oligopolies in the distribution sector and in banking, financial and other professional services. In the public utilities there are natural monopolies which derive from the small size of the country. This leaves room for competition mainly in

personal services and in the many sources of irregular unemployment. With such little scope for facile price movement, there is no reason to expect global price policies to have predictable effects.

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February 1985

RATIO OF VALUE ADDED IN TRADABLE GOODS TO TOTAL GDP

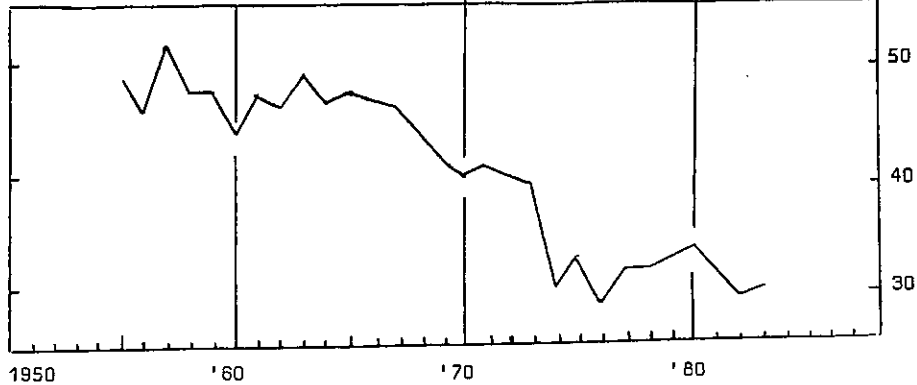


CHART 2 IMPORT SHARES

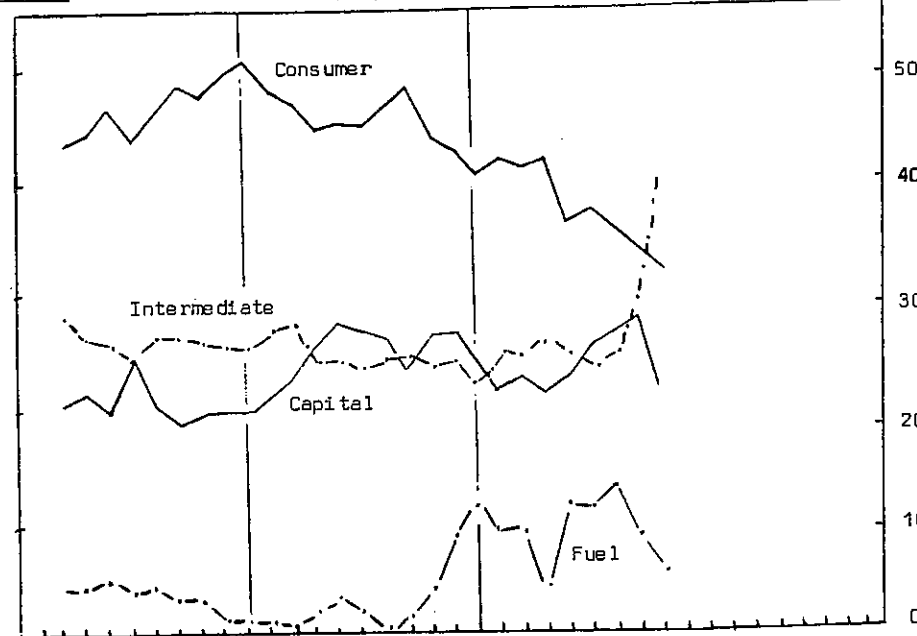


CHART 3 RATIO OF IMPORTS OF RAW MATERIALS & INTERMEDIATE GOODS TO GDP

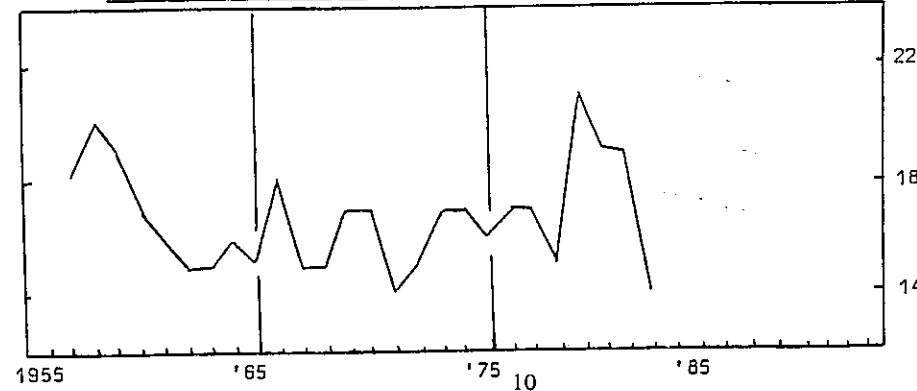


CHART 4

RATIO OF CAPITAL GOODS IMPORTS TO CAPITAL FORMATION

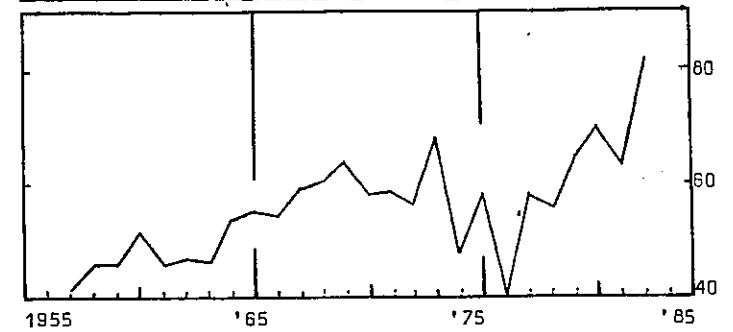


CHART 5

RATIO OF CONSUMPTION TO GDP

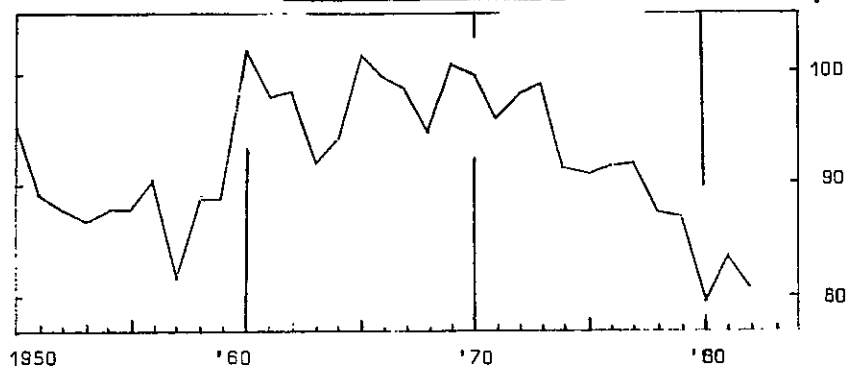


CHART 6

RATIO OF SAVINGS TO GDP

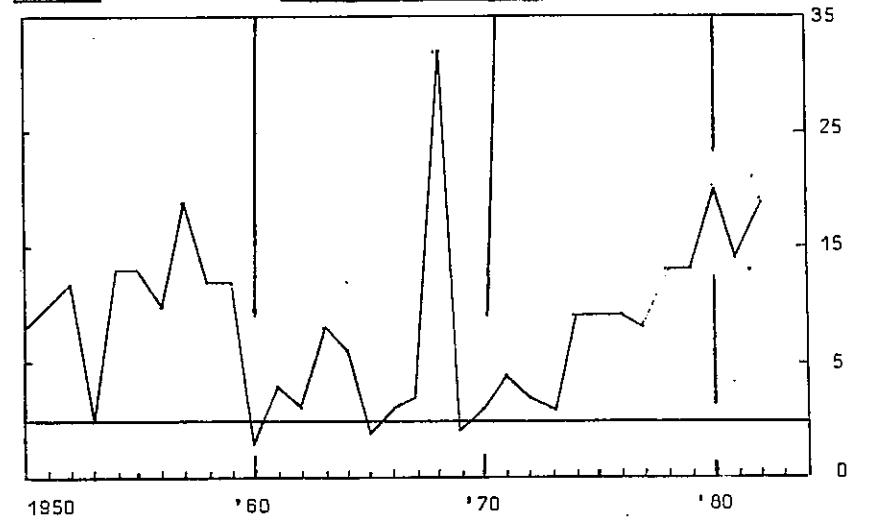


CHART 7

RATIO OF SAVINGS TO CAPITAL FORMATION

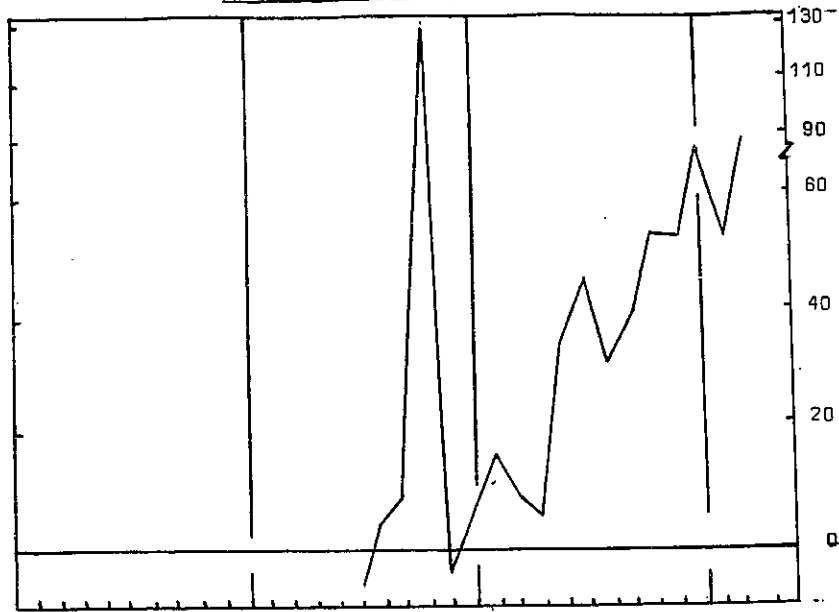


CHART 8

RATIO OF CAPITAL FORMATION TO CHANGES IN GDP

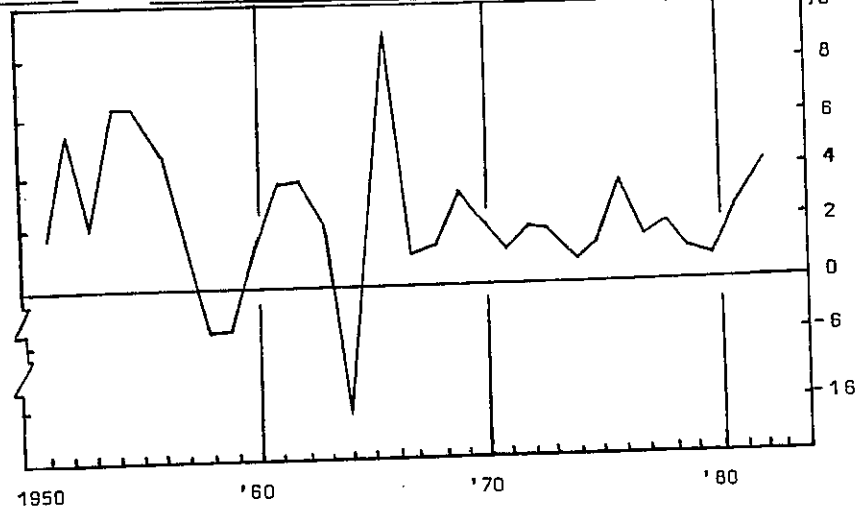


CHART 9

RATIO OF CHANGE IN CLAIMS TO GDP

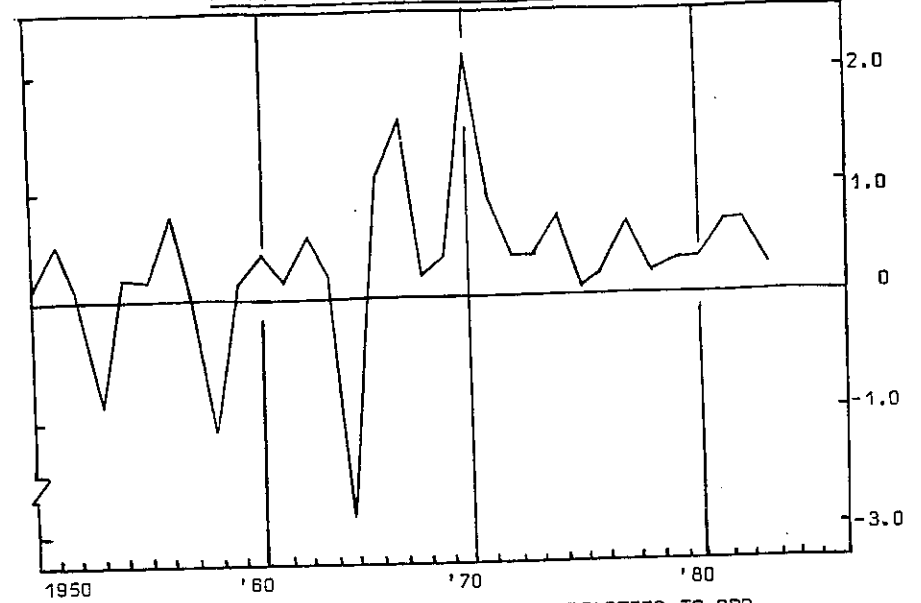


CHART 10

CHANGES IN MONETARY LIABILITIES TO GDP

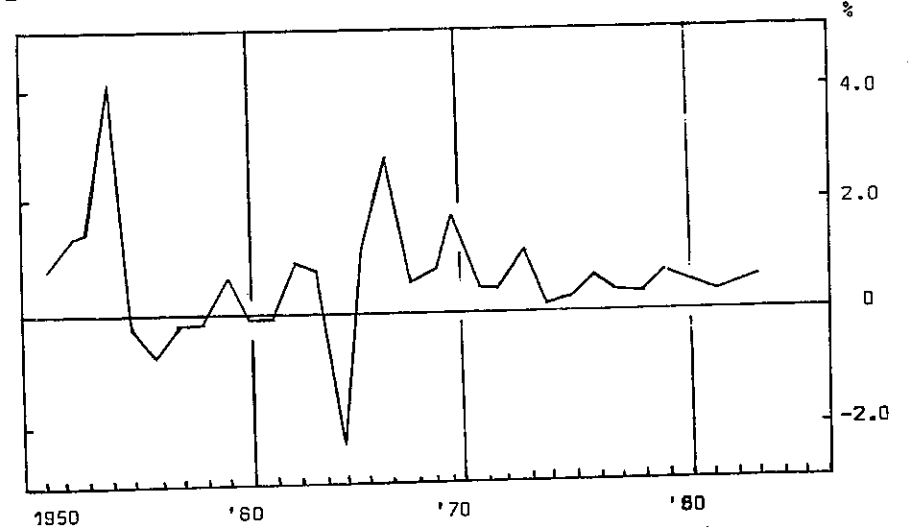


CHART 11

EXPORT CONCENTRATION

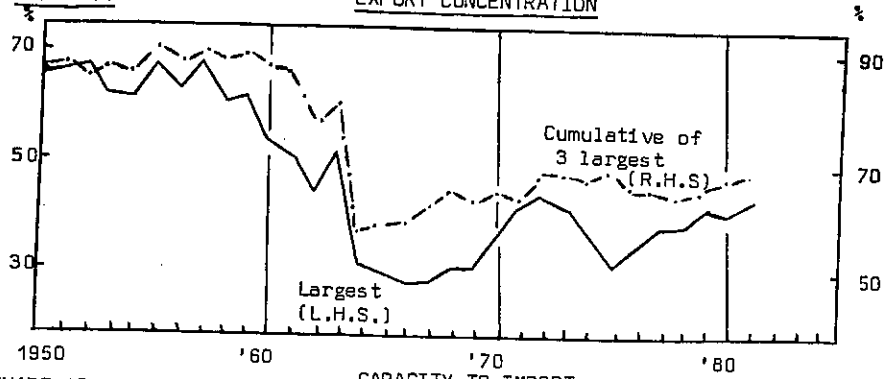
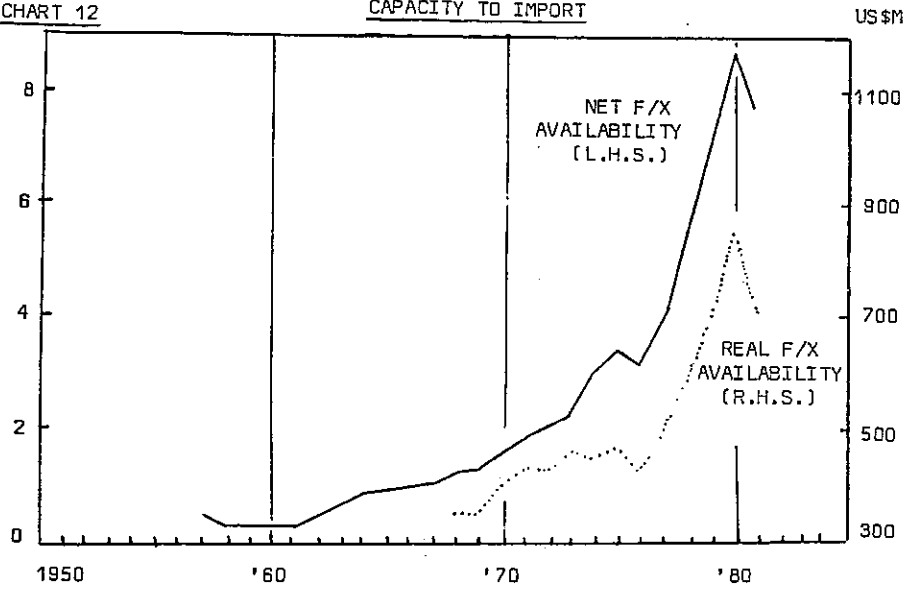
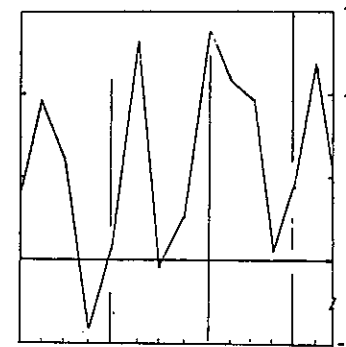


CHART 12

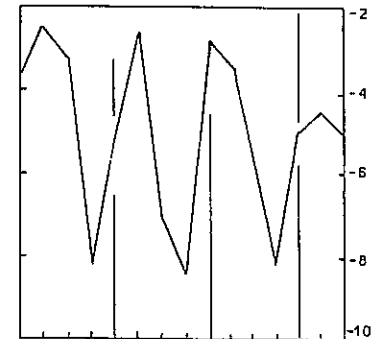
CAPACITY TO IMPORT



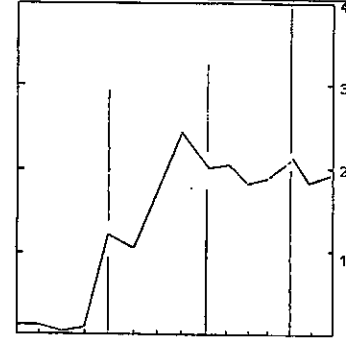
GOVERNMENT SURPLUS/DEFICIT ON CURRENT ACCOUNT AS % OF GOKF\*



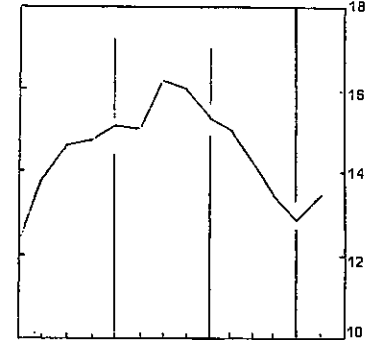
RATIO OF FISCAL DEFICIT TO GDP



CREDIT TO GOV'T BY BANKING SYSTEM AS % OF TOTAL CREDIT OF THE BANKING SYSTEM



RATIO OF GOV'T SERVICES TO TOTAL GDP



\*GOKF - Gross Domestic Capital Formation

