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Development Challenges in Barbados

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Abstract

This policy brief presents a summary of the development challenges facing the country.

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Development Challenges in Barbados

Medium-Term Economic and Social Trends

Barbados has witnessed only modest growth in recent years. Since the 2008 financial crisis, the country's real growth rate has been slow, averaging just 0.6 percent annually. While higher in recent years, real GDP growth slowed again by the end of 2017, reaching 1 percent, compared to 1.8 percent growth over the same period in 2016. The outcome reflects tighter fiscal policy, weaker tourism performance during the second half of the year, and the delayed implementation of tourism-related investment projects. Long-stay arrivals rose by 4.4 percent to reach 652,500 visitors at the end of 2017, but the average length of stay of visitors declined by 5.6 percent. The growth in arrivals came from the United States (11.2 percent) and Canadian markets (7.7 percent), counteracting a 1.2 percent fall in arrivals from the United Kingdom, partially reflecting the uncertainty surrounding Brexit.

The government's fiscal position has been improving but remains a concern. Fiscal consolidation to date has reduced the financing gap, but it has yet to stabilize the increasing trend in public debt. The fiscal deficit narrowed to 5.7 percent of GDP for FY2016/17, from 9.4 percent at the end of FY2015/16. The fiscal deficit fell by 33 percent, to US$199.8 million, after the first nine months of FY2017/18 (April–December). This outcome was bolstered by a 12 percent increase in total revenues, led primarily by higher collections in excise taxes, in the value-added tax (VAT) and from the National Social Responsibility Levy (NSRL).[1] On the expenditure side, current expenditures grew to US$1,112.2 million, 2.6 percent more than a similar period in FY2016/17. However, growth-enhancing capital expenditure fell by 29 percent. Gross central government debt stood at an estimated 145.9 percent of GDP (inclusive of National Insurance Scheme holdings) at the end of December 2017.

International reserves fell to 6.6 weeks of imports (US$205 million) at the end of December 2017, compared to 10.5 weeks a year earlier (see Figure 1). This fall was mostly due to external debt servicing obligations and weaker private sector capital flows. At the same time, the effects of a pick-up in global oil prices and higher indirect taxes supported an increase in inflation rates, which reached 4 percent at the end of October 2017.

Barbados has relatively high living standards. The Human Development Index (UNDP, 2016) places the country in the high human development category, with a rank of 54 among 188. Life expectancy and mean years of schooling stood at 75.8 years and 10.5 years, respectively, in 2015. In addition, there is high investment in education and health, with government expenditures accounting for around 6 percent of GDP and 4 percent of GDP, respectively, over the last five years. This is comparable to many OECD states' levels of spending. However, the latest Barbados Survey of Living

[1] The NSRL, which was introduced on September 1, 2016, is a tax imposed on goods imported into Barbados and on domestically manufactured goods at a rate of 10 percent.

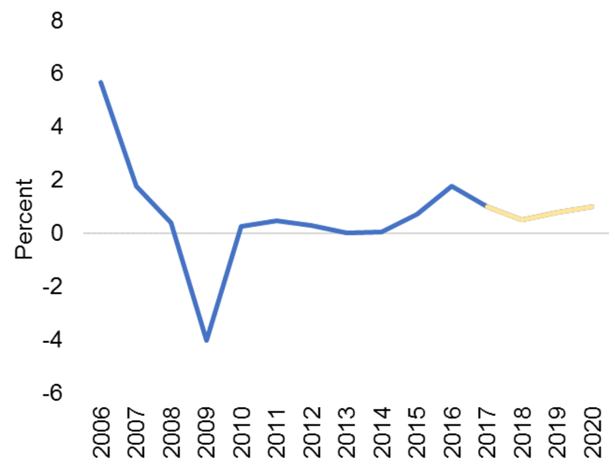
Conditions (BSLC) 2016-2017 shows that overall household poverty levels in Barbados rose from 15.1 percent in 2010 to 17.2 percent in 2016, despite falls in extreme poverty levels. Individual poverty rates stood at 25.7 percent in 2016. At the same time, unemployment rates remain elevated, reaching 10.2 percent at the end of September 2017.

Medium-Term Economic and Social Outlook

Elections are due in the first half of 2018. The current Parliament of Barbados was dissolved on March 6, 2018 with elections constitutionally due within the following 90 days.

The Central Bank of Barbados and the IMF forecast economic growth in 2018 ranging between 0.5 and 1 percent, and growth in the medium term is projected to be under 2 percent annually. The government is counting on strong tourism and construction sector performance to offset the dampening effects of weaker internal demand expected from the imposition of additional fiscal consolidation measures. At the same time, this outcome could be impacted by the continued delay and slow execution in tourism-related projects. Inflation is projected to continue increasing and to reach around 5 percent by the end of 2018, partially due to the increase in the NSRL and expected higher international oil prices. While budget measures have led to an improvement in the fiscal deficit, further efforts are needed to reduce government debt going forward.

Figure 1. Real GDP Growth, 2006-2020



Sources: Central Bank of Barbados and IMF (2017).

Risk Factors

A number of risk factors can affect Barbados' medium-term outlook. These include the government's high debt levels, low levels of international reserves, the threat of higher international oil prices and limited access to new financing. Moreover, the uncertainty surrounding Brexit may bring challenges to growth prospects and could have implications for demand for goods and tourism, as the UK is one of the country's key trading partners. At the same time, the incidence of natural disasters, servicing of foreign debt and higher-than-expected US and domestic interest rates remain a cause for concern for medium-term economic prospects.

Development Challenges

Fiscal consolidation could have a negative impact on the real economy. The Barbados Sustainable Recovery Plan 2018[2] presents the government's plan, which includes an ambitious and necessary set of reforms to increase revenue collection and curb expenditures. However, the increase in taxes is starting to become a burden on taxpayers and businesses, particularly those outside the tourism industry, given this sector's extensive tax exemptions. The reforms are also expected to have negative externalities on the import and consumption of goods and services. Transfers and salaries and wages are expected to be the main focus of expenditure-side reforms. Transfers have gradually declined from 13.7 percent of GDP in FY2013/14 to 12.6 percent of GDP in FY2016/17, and the public sector wage bill has also fallen since FY2012/13, partly as a result of the layoff of 3,000 public workers in 2014.

Social outcomes and the stock of capital could worsen with the proposed fiscal reforms, and expenditure reduction could affect social sectors, mostly through a modification of subsidies and transfers, and should be protected. The University of the West Indies (UWI) and Queen Elizabeth Hospital (QEH), which are the main beneficiaries of these transfers, will be particularly vulnerable to expenditure cuts. The country's stock of capital is also likely to be adversely affected by the reforms. Although Barbados has an overall good level and quality of infrastructure, lower investment levels and insufficient operation and maintenance spending will weaken the current stock of capital. This can be particularly damaging for the tourism industry, which relies heavily on high-quality infrastructure. Other key sectors for growth, which can potentially be affected by inadequate levels of infrastructure, are energy, transport and connectivity and water and sanitation.

Structural challenges, which hinder economic growth, remain. Firstly, the economy presents low levels of diversification and a high dependence on imports, which make it vulnerable to fluctuations in tourism along with financial and oil markets. Barbados relies heavily on the tourism and financial services sectors, which comprised 33.9 percent of GDP in 2017 without accounting for tourism's indirect weight on other economic sectors. Historically, the country has also presented a negative trade balance, depending heavily on the import of goods, particularly food and oil. Secondly, the economy presents shortfalls in its level of competitiveness, which can negatively impact the financial and tourism sectors. Barbados ranked 72nd of 138 in the Global Competitiveness Index (GCI) 2016–2017 (World Economic Forum, 2016). Barbados' small market size, rigid labor laws, fiscal imbalances and high trade tariffs were identified as key structural constraints to its competitiveness. Finally, the business climate is weak. Barbados ranked 132nd of 190 in the *Doing Business 2018*

[2] This Plan is a framework for Barbados National Economic and Social Development Restructuring and Enhancement Program and was prepared by the Ministry of Finance and Economic Affairs in collaboration with the Social Partnership.

report (World Bank, 2018), faring worst on indicators for registering property, enforcing contracts and protecting minority investors. An inadequate labor supply, inefficient red tape and the high tax burden are perceived as key constraints to private sector operations.

It is thus important for the Government to foster measures which will support the country's competitiveness and private sector development going forward. Setting and committing to a structural reform program that tackles consecutive fiscal imbalances and boosts investor confidence could be a key short-term measure. Further structural challenges could be met by i) revisiting trade tariffs and the burden of taxation, particularly outside the tourism industry; ii) promoting diversification in energy sources to reduce dependency on oil imports, for example, by investing in renewable energy sources; iii) fostering labor market flexibility and a workforce skills supply that meets labor market demands; and iv) reducing excessive red tape by reviewing SOEs, reforming legal processes and reducing time and cost of public processes, which could improve the ease of doing business.

Conclusion

The country faces several challenges to its overall medium-term outlook. High fiscal deficits and debt levels, as well as low reserves, are key challenges to growth, particularly given the pegged exchange rate. Amid this challenging macroeconomic environment, however, political and social stability and cohesion remain the country's major strengths. Barbados scores well on perception-based surveys on governance and institutions and has low levels of crime and corruption. Barbadians also present some of the highest educational attainment and healthcare indicators in the Caribbean region. To date, Barbados has an overall good stock of capital and good coverage levels of Communication Technology (ICT)—almost 80 percent of individuals report using the Internet. However, these indicators are likely to be negatively affected by the fiscal adjustment program. Further structural reforms are also key to unlocking economic growth potential, particularly by fostering greater competitiveness and private sector development.

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