Balance of payments adjustment in Barbados

1. INTRODUCTION

In September 1991, Barbados implemented a structural adjustment programme aided by the international monetary fund (IMF). The government of Barbados invited the IMF to provide balance of payments support to the country’s depleted foreign reserves which had reached a low BBD 38.9 million. That diminution of the foreign reserves resulted from several factors; namely, fiscal over expansion that caused the central government’s fiscal deficit to rise to 7.5% of GDP in 1990; a bunching of external debt repayments; and poor performances of all the main foreign exchange sectors, particularly tourism, sugar, and manufacturing. The problems generated by the reduction in the country’s foreign reserves were exacerbated by the negative impact of the gulf war in Iraq which not only led to a decline in travel and tourism but also to an increase in the oil price and hence inflation, which

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surged to an average of 6% in 1990 and 1991 both of which stood above the annual average rate of 3% for the Barbadian economy.

The severity of the problems faced in 1991 was such that the government came under tremendous pressure from the IMF to devalue the local currency. That pressure was resisted through the implementation of tight fiscal and monetary reforms which resulted in among other things an 8% cut in public sector wages and the retrenchment of more than 3,000 government employees.

It therefore came as no surprise when Arthur (2005) proposed several measures aimed at curtailing imports of consumer goods, as well as improving revenue generation that can, in turn, be injected into boosting the country's productive capacity and, by extension, export potential. These measures clearly reflect the government's response to what it perceived as potentially serious Balance of Payments (BOP) adjustment problems facing the economy. If not remedied, severe BOP problems could have serious consequences for macroeconomic stability within the Barbadian economy as evident in 1991.

Clearly, given the decision of the government to intervene to resolve potential BOP challenges for the economy, several key questions arise. First, was there cause for concern? Second, what factors accounted for the BOP problems? Third, what were the proposed remedies? Fourth, what economic and historical experiences provided the foundations for those BOP problems? Fifth, is there any theoretical justification for Arthur's (2005) intervention? Sixth, can the proposed remedies help relieve some of the pressures on the BOP? The search for answers to these key questions forms the basic motivation for our paper. We believe that answers to these questions could contribute to the policy debate pertaining to the role of the government or market in resolving balance of payments problems in small, open economies like Barbados. In this light, the objective of our paper is to provide an economic analysis of the problem and its potential solutions based upon available data.

1 By Arthur (2005) is meant Owen S. Arthur who was the Prime Minister and Minister of Finance in Barbados from 1994-2008. As Prime Minister, he was Head of the Government. Therefore, all references to Arthur (2005) throughout the paper are synonymous to the Government of Barbados.
To achieve our objective and provide answers to the six questions of interest, the rest of the paper is structured as follows. The answer to the first question is discussed in section 2. This section presents a summary of the contextual framework within which Arthur (2005) proposed measures to tackle the potential BOP problems facing the country. The answer to the second and third questions are addressed in section 3, which documents and analyses the main factors identified as the cause of the BOP problems and policies proposed by the Arthur (2005) to alleviate them. Section 4, which addresses the fourth question, summarises the economic and historical experiences of Barbados that have led to the evolution of the pattern of trade observed and BOP challenges. The fifth question is taken up in section 5, which highlights some of the main theoretical arguments for and against government’s intervention to resolve BOP problems, and the policies necessary to affect BOP equilibrium. This section also assesses these theoretical policy views within the context of the Barbados case. The final section contains some concluding remarks and provides an answer to the sixth question.

2. THE CONTEXTUAL FRAMEWORK

At present, the major challenges facing Barbados with respect to its balance of payments position relate directly to the country’s external trade balance and international reserves position.

According to the Central Bank of Barbados Balance of Payments of Barbados 2006, during 2005, the visible trade balance deteriorated by BBD 229.2 million (11.8%) to BBD 2,171.1 million. In that same period, visible trade payments amounted to BBD 2,928.2 million, compared to BBD 2,528.1 million one year earlier, representing the largest outflow within the last decade. This expansion has been reflected in the burgeoning of merchandise imports, specifically in consumer and intermediate goods imports. As illustrated in Figure 1, merchandise imports continuing on an increasingly upward trend since 1992, amounted to nearly 50% of gross domestic product (GDP) by the end of 2005. Consequently, the current account deficit expanded to an estimated 12.3% of GDP, up from 12.0% in 2004 (see Figure 2).

According to Summers (1996), a current account deficit in excess
of 5% of GDP should warrant some degree of concern. As Figure 2 shows, with the marginal exception of 2001, Barbados' current account deficit has persistently exceeded this threshold from 1999-2005, a period of seven years. Summers maintained that such a scenario is even more critical if the deficit is particularly financed in a way that leads to rapid reversals. This position gained greater prominence after empirical studies on the Asian crisis concluded that countries that were hit hard were those with large deficit/GDP ratios throughout the 1990s (Corseti, Pesenti and Roubini, 1999; Radelet and Sachs, 2000).

As a result of this strong import growth, primarily driven by demand in the non-traded sectors, high international energy prices,
and the moderate decline in tourism (the country's main foreign exchange earning industry), severe pressure has been placed on the Net International Reserves (NIR) of the monetary authorities. As such, the modest rise of BBD 48.7 million in the NIR in 2005 is primarily the proceeds of an international bond issue (BBD 245.2 million) during the fourth quarter. This performance is a reversal from the BBD 312.9 million contraction in the previous year (see Table 1). Moreover, as illustrated in Table 1, the NIR without this foreign borrowing would actually register a decline of BBD 156.8 million. Other significant increases in the NIR, such as in 1995, 1999, 2000 and 2001, have also been supported by high amounts of foreign borrowing.

### TABLE 1. NET INTERNATIONAL RESERVES

<table>
<thead>
<tr>
<th>Years</th>
<th>Changes in Net International Reserves (- increase/ +decrease)</th>
<th>Bonds and Notes</th>
<th>Changes in Net International Reserves without Foreign borrowing (- increase/ +decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>-82.8</td>
<td>80.8</td>
<td>-2.0</td>
</tr>
<tr>
<td>1996</td>
<td>-173.2</td>
<td>-8.0</td>
<td>-181.2</td>
</tr>
<tr>
<td>1997</td>
<td>-36.1</td>
<td>-48.0</td>
<td>-84.1</td>
</tr>
<tr>
<td>1998</td>
<td>11.0</td>
<td>-48.2</td>
<td>-37.2</td>
</tr>
<tr>
<td>1999</td>
<td>-73.9</td>
<td>90.0</td>
<td>16.1</td>
</tr>
<tr>
<td>2000</td>
<td>-356.0</td>
<td>200.0</td>
<td>-156.0</td>
</tr>
<tr>
<td>2001</td>
<td>-445.4</td>
<td>300.0</td>
<td>-145.4</td>
</tr>
<tr>
<td>2002</td>
<td>47.7</td>
<td>-20.0</td>
<td>27.7</td>
</tr>
<tr>
<td>2003</td>
<td>-136.9</td>
<td>-20.0</td>
<td>-156.9</td>
</tr>
<tr>
<td>2004</td>
<td>312.9</td>
<td>-24.9</td>
<td>288.0</td>
</tr>
<tr>
<td>2005</td>
<td>-48.7</td>
<td>205.5</td>
<td>156.8</td>
</tr>
</tbody>
</table>

**SOURCE:** Central Bank of Barbados *Balance of Payments of Barbados 2006.*

The Central Bank of Barbados *Annual Report 2006* also notes that although Barbados registered a surplus on the capital and financial account (BBD 671.7 million) in 2006, approximately BBD 88.5 million above the balance recorded in 2005, this was insufficient to offset the external current account deficit. Thus, as in 2005, the balance of payments was buttressed by significant foreign borrowing (BBD 135.9 million), and there was a BBD 37.6 million reduction in the NIR. Taken together, this evidence clearly points to the unstable nature of Barbados' NIR position.
Hence, the main thrust of the Government of Barbados' economic policy was to address certain structural trends in the country's external trade and its international reserves position, both of which were sufficiently worrisome to warrant the attention of the Government. It is within this context that Arthur (2005) proposed several solutions to the current balance of payments challenges facing the economy. The next section outlines the sources of Barbados' external account woes and the proposed remedies.

3. THE FACTORS AND THE PROPOSED REMEDIES

3.1 Factors Responsible for the Balance of Payments Problems

According to Arthur (2005), Barbados' current BOP problems can be linked to several factors. However, the three that will be highlighted and analysed in this paper are: the huge and rapidly growing import bill; the inheritance of a weak export structure that relied too heavily on preferential access of agricultural commodities to the European Market; and macroeconomic factors, particularly easy access to credit.

In relation to the first factor, there has been a continued surge in import demand. At the end of 2005, retained imports amounted to BBD 2,911.0 million, a growth of 11.3% (BBD 294.8 million). This increase was mainly due to a 16.4% increase in consumer goods imports, particularly in food and beverages and motor car imports; growth in these areas was 14.1% and 17.8% in 2003 and 2004 respectively.

Additionally, the price of oil had more than doubled, moving from USD 30 per barrel to the unprecedented level of USD 70 per barrel.

Other factors include the significant reduction in revenue generation from offshore financial services transactions and international business; the consolidation of all of Barbados' indirect taxes into one Value Added Tax; trade liberalisation efforts under the auspices of the World Trade Organisation; the implementation of the CARICOM Common External Tariff (CET); the Organisation for Economic Cooperation and Development harmful tax competition initiative that not only put the international business and financial sector's development on pause, but threatened the very survival of the sector; and China joining the World Trade Organisation and its subsequent production of most of the world's textiles.
barrel by the end of 2005. These high oil prices are unlikely to dissipate in the short or medium term and it is reasonable to assume that prices will continue to rise for some time into the future. In December 2007, crude oil prices rose to an all time high of USD 100 per barrel, putting pressure on the already high and rising import bill. The potential for severe natural disaster like hurricanes, earthquake or tsunami, compounds the risk and uncertainty for the Barbadian economy. Recognising this, the Barbados government sought to devise and implement strategies which would minimise the effect of these high oil prices.

These strategies include intensification of efforts to maximise the production of crude oil and natural gas, diversification of the energy mix to make natural gas and other non-liquid fuels more dominant in the economy, introduction and maintenance of a comprehensive set of energy conservation and efficiency measures aimed at maximising the efficient use of energy, and ensuring that renewable energy plays a progressively more significant role in the economy.

With reference to the second factor, it has been argued in the literature that the price concessions and guaranteed access for many African, Caribbean and Pacific (ACP) States’ exports to the European Union (EU) have encouraged many ACP states to remain heavily dependent on a few traditional primary products that are hardly competitive in the global market place. As such, it is believed that trade preferences, such as the LOME Convention, have contributed to inefficiency in production in some developing countries, including CARICOM. These countries have long depended on these trade preferences within the international trading arena for the promotion of their export trade and economic growth. The view is that such preferences merely serve to provide a safety net for inefficient and non-innovative exporters, who could not otherwise survive in the open international export market. Consequently, this prolonged dependence has caused these economies to remain fragile and vulnerable to external economic shocks. In sum, the benefits enjoyed under the LOME

CARICOM countries are Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago.
Convention and other trading arrangements with the United States and Canada, have inhibited the development of local producers and thus the ability of a number of these countries to attain self-sustained economic growth and development.

As a result, one major cause for concern among ACP countries is the fact that traditional benefits, enjoyed under the regime of preferential treatment, are gradually being eroded. The original preferential margins in Europe have already been reduced by the gradual reductions in the *most favoured nation* (MFN) tariffs, over the years. Furthermore, the future of the protocols that for many years have guaranteed export of Caribbean sugar, bananas and rum to Europe are in jeopardy. This certainly affects the Barbados sugar industry, which has experienced severe competition on the international arena in recent times.*

It is no surprise, therefore, that Barbados’ real economic activity in recent years has been led by robust growth in the non-traded sectors. Consequently, 2005 marked the second consecutive year in which traded sector growth was outpaced by that of the non-traded sectors. The weak performance of the traded sectors, which declined by 1%, was almost entirely due to a fall-off in cruise ship activity and in some of the major long-stay tourism markets. On the other hand, in the non-traded sectors, there was a broad based expansion of 5.8%, driven mainly by the growth in construction activity, as was the case in 2004. This relative expansion in the non-traded sectors is likely to result in increased pressure on the external account deficit and lead to a contraction of net international reserves. As a result, the rise in retained imports, which underpins the growth in non-traded activity, has outpaced any net earnings from services, particularly tourism, and domestic merchandise exports.

However, with the hosting of the International Cricket Council (ICC) Cricket World Cup (CWC) 2007, the strength of the pound sterling and an expected recovery in cruise tourism, faster growth

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*The age of economic preferences effectively came to an end, in 2005, with the decision of the European Union to cut the guaranteed price for sugar provided to the ACP countries by 36% over a four-year period. As such, the current guaranteed price of EUR 523.7 per tonne is scheduled to decrease to EUR 335 by the 2008/2009 crop. Based on its quota to the EU of 31,097 tonnes (white sugar equivalent), Barbados stands to lose more than BBD 30 million over the four year period.*
in tourism is expected in the future. According to the Central Bank of Barbados Annual Report 2006, tourism output is conservatively projected to grow by 6% in 2007 and should result in a higher overall growth rate for the traded sectors, thus easing the pressure on the balance of payments. In addition, a significant portion of the capital and financial inflows, which were used to finance productive projects including the redevelopment of Kensington Oval into a multipurpose world-class facility, the refurbishment of hotels (for example, Hilton Barbados and Accra Beach Hotel), and the improvement of road infrastructure, is expected to expand the country's earning capacity over time.

Regarding the third factor, Arthur (2005) has inferred that the external problems facing the Barbadian economy can also be traced to certain macroeconomic forces affecting the country. He lamented the fact that Barbadians are spending too much in relation to the country's earning capacity simply because they have easy access credit. Therefore, each time there is a surge in credit creation in excess of the growth in liquid assets in the financial system, that major addition to spending power puts additional pressure on the country's international reserves.

As noted in the Central Bank of Barbados Annual Report 2005, the robust growth in imports was reflected by the surge of non-financial private sector credit relative to the rate of growth in deposits. During this period, commercial bank credit to the non-financial private sector grew by BBD 687.2 million (23.3%) compared to a growth of only 11.2% growth in domestic deposits during the year, marking the largest annual growth in credit since the Central Bank was established in 1972. The situation was exacerbated by a reduction in import duties from 45% on average during the 1980s to 20% at present. This reduction in duties not only lowered the cost of extra-regional imports into Barbados, but also increased the competitive position of imports.

Overall, the country continues to witness an unsustainable demand for imports. In 2005 alone, Barbados' imports increased by almost BBD 300 million, a growth of 11%. Arthur (2005) concluded that a series of measures would have to be instituted to control the growth of credit in the economy, because it is credit, above all else, that is causing the growth in Barbados' imports.

To summarise, therefore, what Barbados faces is the twin problem of surging imports and weak export performance. Thus, the
performance of the tourism sector in generating a tremendous amount of foreign exchange is insufficient to compensate for the growing demand of imported consumer goods and the inadequate performance of other traded sectors of the Barbadian economy. As a result, to counteract these difficulties, Arthur (2005) proposed several measures aimed at curtailting imports of consumer goods as well as improving revenue generation that can, in turn, be injected into boosting the country’s productive capacity and, by extension, export potential. These measures are outlined in the subsequent sub-section.

3.2 Proposed Remedies

Based on Arthur’s (2005) perception of the major factors responsible for the country’s balance of payments difficulties, documented and analysed in section 3.1, he proposed several measures aimed at resolving the external imbalance, especially on the current account, so that the economy can return to a sustainable external position. First, the Central Bank of Barbados was given the mandate to tighten credit by increasing interest rates, as well as by varying the reserve requirements of commercial banks. This was to ensure that credit became more expensive and harder to attain, and to restrain the extent to which credit creation undermined Barbados’ capacity to pay its way in the world. Indeed, the objective of this proposal was to put a line on credit creation for both public and private purposes if the economy was to restore external balance. However, Arthur (2005) urged the need for more credit to be directed towards expansion in agriculture and tourism, as well as other productive purposes rather than to the distributive sector and for personal use to purchase imports.

Second, emphasis was placed on measures geared at creating new capacity and bringing new incentives to stimulate desirable change with respect to exports. Towards this end, Arthur (2005) proposed the creation of a dedicated Export Promotion and Marketing Fund to assist in boosting exports. The fund will be capitalised largely from taxes on imports. This initiative was justified on the grounds that Barbadians are consuming BBD 2.8 billion worth of imported goods, and the fact that the rate of consumption is increasing at BBD 0.5 billion a year. The proposed
revenue-generating measure was a 3% excise tax on extra-regional imports\(^5\) of consumption goods for 18 months. This tax was subsequently raised to 6%. Goods needed for investment inputs, companies operating under incentives, and the hotel industry were all exempted from this tax. The anticipated effect of this measure was that the high rate of importation of foreign goods would be curbed and there would be greater sales of domestically produced goods. Hopefully, the net result of this measure would be the enhancement of domestic production capacity to expand Barbados' exports, and the building of distribution relationships with Barbadians and the domestic economy.

Third, Arthur (2005) noted that an aspect of Barbados' over consumption, and an area in which the country's import bill had been growing too fast, was the importation of motor vehicles. In this regard, he proposed a change in the excise tax on motor vehicles. For cars with engines' capacity of 1,800cc or a chargeable value of BBD 45,000 or less, there was no change in the excise tax. However, cars carrying engines with a capacity greater than 1800cc, and which cost more than BBD 45,000, would witness an increase in the excise tax from 93% to 120%. Lorries that were 5 tonnes in weight or over would now pay an excise tax of 10% of their value. Finally, the environmental levy on used cars would move from BBD 150 per car to BBD 2,000 per car.

Indeed, Arthur (2005) pointed out that the revenues from the excise tax on extra-regional imports on consumer goods, the excise tax on motor vehicles over 1800cc and a chargeable value of BBD 45,000, the new excise tax on lorries five-tonnes and over, and the environmental levy on used cars, were not going into the general revenue but were to be used for specific purposes. Specifically, these funds would be credited to the Export Promotion and Marketing Fund to be administered by the Enterprise Growth Fund. A portion of the funds were also to be used to assist the private sector in improving their export production capacity.

Thus far, we have analysed three of the major factors identified as critical in understanding the balance of payments challenges confronting Barbados. We have also documented the policy

\(^5\) By extra-regional is meant imports originating from all countries except those in CARICOM.
measures proposed by Arthur (2005) to combat those challenges. In the next section, we address the economic and historical experiences of Barbados' development thrust, which underpin the balance of payments challenges the country faces.

4. THE ECONOMIC AND HISTORICAL EXPERIENCES OF BARBADOS

The huge surge in imports and the weak export performance witnessed in Barbados over the past decade are reflective of the types of historical relationships the country has forged over a long period of time with Europe and North America, as well as the shift in development strategies that occurred since the 1950s.

The economic performance of the Barbadian economy has and continues to be strongly influenced by the historical (and indeed colonial) relationship that exists with Europe, particularly the United Kingdom. Based on this colonial relationship, Barbados invested a huge amount of resources in its sugar industry, which benefits from preferential access to the European market and a subsidised price in excess of world market price. In addition, the performance of the country's tourism industry is greatly enhanced from large number of visitors from Europe on an annual basis.

Furthermore, the benefits derived from this relationship include stability in the prices of exports to Europe, favourable terms of trade, and continued access to preferential arrangements. Since most of these benefits accrue mainly to traditional agricultural staples such as bananas, sugar, and rice, little efforts were made to diversify the country's agricultural exports in particular and exports in general. Thus, the economy evolved with a rather narrow export base, which is now proving insufficient to offset the huge increases in imports, despite the strong performance of tourism.

To expand the range of economic activities in the country, Barbados implemented development strategies that involved some degree of industrialisation. Elements of those strategies were

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6 See Blackman (1991) for a more detailed discussion of issues relevant to these relationships in Barbados and the wider Caribbean context.
consistent with the views expressed by Lewis (1950, 1954) — views that reflected some degree of dissatisfaction with the vast deterioration in the economic and social conditions of Caribbean countries and the manner in which the colonial authorities handled their developments. Lewis' strategy advocated the insertion of foreign enterprise and capital into the domestic economy to take advantage of cheap labour in the traditional agricultural sector and to manufacture for metropolitan markets. Specifically, Lewis prescribed export-based industrialisation for economic development, invitation to foreign capitalists to invest in the domestic economy, and granting tax and other incentives to encourage overseas investment in the country. Presently, these policies are being pursued in Barbados with some degree of success.

During the 1960s and 1970s, Lewis' ideas fell under severe scrutiny, mostly from the Plantation School. Contrary to Lewis' model of industrialisation through attracting foreign direct investment and promoting exports, the plantation model is one of internally propelled growth and development. In terms of policy prescriptions, the plantation economy model proposes that production be reorganised around the domestic economy, with the local sectors becoming the target for investment and long-term capital accumulation. A policy of import substitution industrialisation (ISI) was favoured. This paradigm dominated development policy in Barbados during the 1960s and 1970s as well as the early 1980s. This ISI strategy resulted in the establishment of inefficient local industries protected by high import duties and tariffs.

Faced with macroeconomic problems in the 1980s and spurred on by the International Monetary Fund (IMF) and the World Bank, Barbados, like other Caribbean countries, abandoned its inward-looking strategy of industrialisation in favour of

7 For some of the criticisms levied against Lewis and an in-depth exposition on the Plantation School, see Beckford (1972), Best (1968), and Thomas (1968).

8 Some of the economic problems of the 1980s included reductions in gross per capita investment, deterioration in physical and human capital, rising levels of malnutrition, rising levels of debt, sharp contraction in private capital inflows, an increase in net outflows of capital, weak economic structures, and inappropriate economic policies (Wilson, 1992). The 1970s oil crises significantly aggravated these economic problems. For a detailed discussion of the oil crises see Lee et al. (1990), Fleay (2000) and Odell (2001).
an outward-oriented development strategy. This strategy promoted exportation of processed products, semi-manufacturers, light manufacturing, and non-traditional agricultural commodities (rather than continue to focus on the export of a few major unprocessed primary products). The basic argument supporting this view was that openness to foreign competition and capital and elimination of export biases would engender structural change in accordance with the dictates of comparative advantage. In essence, import substitution industrialisation was replaced by an outward-oriented development strategy (Thorpe, 1997; Weeks, 1995).

As the outward-oriented paradigm gained favour with the United States Agency for International Development (USAID) and the World Bank, access to development funds became increasingly dependent on adopting policies consistent with this approach. During the period 1978-1988, the Organisation for Economic Cooperation and Development (OECD, 1992) documented the huge amount of resources in the form of official/overseas development assistance (ODA) to Barbados and other Caribbean countries from various bilateral and multilateral donors including the US, Canada, the United Nations Development Programme (UNDP), and the Inter-American Development Bank (IADB). Net ODA disbursements to the Caribbean from all sources, at 1987 prices and exchange rates, totalled BBD 572 million in 1978 and BBD 509 million in 1988 (OECD, 1992, p. 98-99). Agriculture benefited tremendously.

Thus, Barbados, like many other Caribbean countries, had little choice but to move in the direction of outward-oriented policies, despite continued scepticism regarding the efficacy of such policies. The acceptance of these liberal policies by institutions such as the IMF and World Bank resulted in the outward-oriented development strategy being identified as the Washington Consensus, which opposes import protection.

The US efforts towards boosting agricultural export expansion from the Caribbean was strongly supported by the passage of the Caribbean Basin Economic Recovery Act (CBERA) in 1983 and its successor, the Caribbean Basin Trade Partnership Act (CBTPA). The CBTPA expanded duty-free access to the US market granted under the original CBERA and provided near NAFTA parity to eligible beneficiaries.

Williamson (1993) is credited with the creation of the concept known as the
Based on the adoption of these liberal policies in Barbados, import duties and tariffs have been lowered, contributing significantly to the increases in imports documented and analysed earlier. However, the country's export base remains narrow with most foreign exchange earnings generated by tourism and sugar. With a narrow export base, the economy is unable to fully exploit available opportunities in the global market. Hence, it is becoming increasingly difficult to maintain BOP stability.

5. THEORETICAL PERSPECTIVES

In this section of the paper, we address the question of whether there is in fact any theoretical justification for the government's intervention to resolve any potential difficulties for the country's balance of payments. Our discussion draws heavily on an excellent presentation by Ruccio (1991). According to Ruccio (1991), there are essentially three strategies open to a government to alleviate balance of payments problems. These strategies can be classified as the neoclassical or market-oriented approach, the structuralist theory, and a third paradigm that draws wisdom from both the neoclassical and structuralist schools of thoughts.

The neoclassical approach is based on the belief that balance of payments problems arise principally from existing deficiencies that deny the external market its ability to achieve equilibrium. These deficiencies include, inter alia, the presence of an overvalued exchange rate and restrictions on the movement of foreign exchange, particularly out of the local economy. When the government deems it necessary to intervene in the functioning of the economy, that action creates distortions which not only results in the failure of the market to achieve desired equilibrium, but also transmits unseemly warning signs to individual economic participants. The absence of these distortions will guarantee that the economy will not move toward a state of macroeconomic disequilibrium. In any eventually, should macroeconomic disequilibrium occur, adjustments in individual reactions will restore market stability. If the market mechanism is designed to function in such an efficient manner, why would it be possible for the balance of Washington Consensus.
payments to record a deficit? This situation can arise if the economy is impacted by an internal or external shock such as a hurricane or unexpected rise in world oil prices. In any event, individuals will respond, the market will eventually adjust, the disparity will wane, and the economy will return to macroeconomic equilibrium.

Notwithstanding the importance of individual actions and the power of the market mechanism, the neoclassical approach promotes several mainstream policy initiatives that are capable of resolving relentless disequilibria on the balance of payments. These policies include stabilising the government's fiscal account, real wage amendments, exchange rate adjustment (either through the implementation of a flexible exchange rate regime, or the devaluation of the local currency if it is deemed to be overvalued), liberalisation of exchange controls, and liberalisation of imports and exports. These measures are necessary to create the right conditions to support individual decision making and to create consistency between government's intervention and the environment required for the market mechanism to function efficiently. Clearly, therefore, within the neoclassical approach, the market mechanism will succeed in restoring balance of payments stability based on the reactions and adjustments made by individuals, not through government's intervention.

Unlike the neoclassical approach, the structuralist theory sees a major role for the government in resolving balance of payments problems. At the heart of the structuralist theory is the idea that the market mechanism is intrinsically flawed and therefore incapable of achieving balance of payments equilibrium independently. Hence, government's intervention is required. Accordingly, the structuralist theory prescribe policies such as greater management of the market mechanism, industrial policies to influence investment decisions at the microeconomic level when faced with uncertainties, and controls over the movements of capital to override potential as well as actual difficulties pertaining to the balance of payments.

The third strategy draws wisdom from both the neoclassical approach and the structuralist theory. This strategy advocates a role for both the market mechanism and the government in restoring balance of payments equilibrium, depending on circumstances. As Ruccio (1991) puts it "This middle position is thus
based on an ever-changing compromise between humanism and structuralism. At times, the tendency to reduce all economic phenomena to human nature is apparent; at other times, given economic and social structures play a significant role."

During the structural adjustment programme in 1991, Barbados refused to let its currency float; hence, its policy prescriptions cannot strictly follow the neoclassical vein. There exists at all levels of Barbados’ society a consensus that maintaining the existing currency anchor with the US is essential to maintaining macroeconomic stability. Indeed, it would be fair to characterise the defence of the exchange rate parity as the central pillar of Barbados’ macroeconomic strategy over the past two decades. While some of the larger economies in the Caribbean region (such as Guyana, Jamaica and Trinidad and Tobago) have opted for various strategies of staged devaluation and managed or dirty floating, Barbados has successfully maintained its fixed exchange rate since 1975, following a short period of devaluation as the currency moved from its peg with the pound sterling to its current US dollar peg. Moreover, given Barbados’ strong import demand, namely its high propensity to import consumer goods, exchange rate depreciation may not be particularly effective.

Based on the discussions in section 3, Barbados’ government policy is more in line with the structuralist’s views. This economy has registered strong economic growth over the past few years with a positive outlook for continued economic expansion. Moreover, it has maintained its parity and has recorded no major economic crisis in the last decade. As a result of the robust growth in imports, which was reflected by the surge in non-financial private sector credit, the Central Bank implemented tight monetary measures such as raising the minimum deposit rate on four occasions (a cumulative expansion of 2.5 percentage points), as well as raising the Bank rate. Liquidity in the banking system was tightened in 2005, as reflected in the reduction of the liquid asset ratio to 9.8% from 14.0% in 2004.

11 As Worrell et al. (1998) argue, during the midst of the 1991 crisis, “the exchange rate anchor was supported by all influential interest groups.” For further insight into macroeconomic policymaking in Barbados and an exposition of what one could term the ‘Bridgetown Consensus’ view concerning the exchange rate anchor, see Blackman (1998).
The implementation of these measures led to some success. As noted in the Central Bank of Barbados *Annual Report 2006*, the tight monetary stance and fiscal initiatives implemented in April 2005 resulted in a small decline in retained imports, in contrast to the sharp increase experienced over the previous three years when import growth averaged 13.5%. There was also a significant expansion in the export of goods and services, particularly in travel credits. The expansion in credit to the non-financial private sector slowed from the historical high of 23.8% (BBD 730 million) in 2005 to 13.2% (BBD 501.1 million) in 2006, when the rate increases took effect. Nonetheless, this increase is still above the rate of 6.3% (BBD 151.6 million) averaged between 1999 and 2004 and represents the second highest level of growth since the establishment of the Central Bank in 1972. Thus, the current tight fiscal and monetary policy environment is recommended is the context of Barbados.

The current account deficit for 2006 remained high but improved for the first time since 2001, primarily as a result of the robust growth in domestic merchandise exports, an expansion in travel credits and a contraction in retained imports. Exports of domestic goods rose by 16.8%, representing the third consecutive year of expansion and the second successive year of double digit growth, while the level of retained imports contracted by 1.5% marking the first reduction since 2001. Consumer goods imports also declined, weakening by 12.6%, in contrast to the 16.4% rise in 2005. Consequently, the external account deficit fell from 12.3% of GDP in 2005 to an estimated 8.4% of GDP in 2006. This fall-off, when compared to the annual average expansion of 13.5% during 2003 to 2005, is indicative of the success of the monetary policy measures as well as the cess implemented in 2005. From this evidence, we can therefore argue that the measures announced by Arthur (2005) are economically sound from a structuralist perspective, as a means of solving Barbados balance of payments difficulties.

6. CONCLUSION

Faced with the twin problems of surging imports and weak performances of the export sectors, the government of Barbados felt
obliged to institute measures to alleviate any potentially severe difficulties that can arise in respect of the country's balance of payments. On the basis of that intervention, the government proposed several measures aimed at curtailing imports of consumer goods, as well as improving revenue generation that can, in turn, be injected into boosting the country's productive capacity and, by extension, export potential.

Within this context, we addressed six key questions: Was there cause for concern? What factors accounted for the BOP problems? What were the proposed remedies? What economic and historical experiences provided the foundations for those BOP problems? Is there any theoretical justification for Arthur's (2005) intervention? Can the proposed remedies help relieve some of the pressures on the BOP? In search of answers to these key questions, we provided an economic analysis of the problem and its potential solutions based upon available data.

The first question was addressed in the section on contextual framework. Based on the evidence presented there was indeed sufficient cause for concern to warrant an intervention by the government. The second and third questions were discussed in the section on the factors and the proposed remedies. The fourth question was deliberated in the section on economic and historical experiences. Barbados' reliance on preferential access to the European market, the shift in development strategy from import substitution industrialisation to outward orientation, and the reliance on tourism as the major foreign exchange earner have all contributed significantly to the balance of payments challenges confronting the economy. The fifth question was addressed in the section on theoretical perspectives. Indeed, the government's intervention can be justified within the context of the structuralist paradigm. Of course, neoclassical economists would argue for more market-oriented solutions.

Finally, let us answer the sixth question posed. It is our contention that the proposed remedies may only relieve some of the pressures on the balance of payments in the short term. Barbados' strong import growth is primarily driven by demand in its non-traded sectors, which, as a result of rapid expansion in recent years, is on average about one-third larger than the traded sectors. This leads to continual pressure on the existing external current account deficit and the international reserve position.
Thus, although further tightening of monetary policies to reduce the risks of overheating and to help support the exchange rate peg are recommended, this may only provide a brief reprieve in the short run.

Furthermore, we believe that the success of the measures depends heavily on moral suasion, and the willingness and ability of Barbadians to comply with the policies prescribed. Thus, given the strong demand for imports, especially consumer goods imports, the long-term solution to Barbados' Balance of Payments problems requires a fundamental change in Barbadians' preference relations vis-à-vis demand for domestic versus foreign produced goods and services and channelling of credit more to productive activities as opposed to the purchase of imported consumer items.

In addition, exports of merchandise have remained uncompetitive and dependent on government support and preferential access to foreign markets. Thus, it also requires the development and implementation of a comprehensive export strategy driven by international competitiveness. Finally, with the significant portion of capital and financial inflows used to finance productive projects, such as tourism-related building activities to host CWC 2007 and comprehensive Road Rehabilitation programmes, the country's earning capacity is expected to expand over time. These activities in combination with the strength of the pound sterling and an expected recovery in cruise tourism point to faster growth in tourism in the future, thus easing the pressure on the balance of payments.

REFERENCES

Blackman, Courtney N. (1998), Central Banking in Theory and Practice: A Small States Perspective, Caribbean Centre for Monetary Studies, St Augustine, Trinidad and Tobago.


