



THE ECONOMIC LETTER



It's Worth the Effort to Save our Dollar Peg

The Barbados economy is dynamic and internationally competitive, led by a private sector that demonstrates remarkable enterprise and innovation, from our largest and most successful firms to youth entrepreneurs of outstanding promise. But our public sector is living beyond its means, and its low productivity is a drag on investment. Reduced Government spending and forceful measures for public sector reform are the key to arresting foreign reserves losses and securing the exchange rate anchor.

The competitiveness of tourism, Barbados' main source of foreign exchange and our principal engine of growth, is attested to by no less an authority than the World Economic Forum, the organisers of the world-famous Davos Forum. In their 2017 *Travel and Tourism Report* Barbados retained its Number One position among Caribbean destinations, and in the last three years the country has regained its share of the regional tourist market. The country's growth is also being driven by a remarkable surge of local enterprise and innovation, right through the spectrum, from our largest conglomerates to youthful entrepreneurs in a surprising range of activities.

Looking a little further down the road, we see possibilities of even faster growth. Barbadians have leveraged the island's early lead in solar power to place our country at the forefront of the switch from oil to renewable sources of power. This will create an entirely new energy sector, in the installation, adaptation and maintenance of the facilities to produce and distribute renewable power. The skills we develop could be marketed to the entire Caribbean, and beyond.

The longer term prospects of Barbados' international business and financial sector (IBFS) are good, even though the sector is currently experiencing challenges. Barbados is a highly regarded IBFS centre, operating on the basis of tax and investment treaties negotiated with the countries with whom we seek to do business, and we have been at pains to ensure that our regulatory processes are kept on par with international practices established by the IMF, World Bank, the Basel Committee on Banking Supervision and other international authorities. Within this framework, Barbados offers international firms an attractive business proposition: they may improve their profitability by locating activities in Barbados to take advantage of lower costs, compared to large international centres such as London or New York. This competitive advantage means that there will always be firms seeking to invest here, regardless of the concerns about international tax fairness.

However, Barbados' promising growth potential will not be fully realised, and may very well be lost, unless there is a turnaround in the performance of the public sector. Government's responsibilities are to provide public services such as security, education and health services; to align incentives to support entrepreneurship, tourism, IBFS services, renewable energy and dynamic, successful enterprises; and to provide these services efficiently, at tolerable tax rates, and with prudent borrowing. Remedial action is needed in all these aspects, if we are to realise the country's unquestionable potential for growth.

With respect to the provision of public services: Barbados' record on crime prevention, our education and health services, and our transport and communication systems are all of good quality. They are among the reasons why tourists wish to visit, and they play an important part in attracting foreign



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investment. However, the levels of efficiency and productivity in the delivery of public services are not up to par with what visitors and investors have reason to expect, and what our competitors offer. These deficiencies are documented by international reports, and are the everyday experience of Barbadians and visitors alike. Two decades after the Government openly committed to public sector reform, public sector performance is at its lowest ebb.

With respect to the incentives for the leading growth sectors: the intentions of the incentive structures are generally well aligned, but once again the implementation falls short of what is required. Too often there is inconsistency, incompatibility and lack of coordination between various arms of the public service, resulting in long administrative delays and, frequently, loss of potential investment.

Nonetheless, the most pressing economic challenge Barbados faces today relates to the excess of public sector spending over tax revenues, and the unsustainable level of borrowing from the Central Bank. The Bank lends Barbados dollars, but that money is ultimately spent mostly on items that are sourced abroad, in whole or in part. These additional imports add to the demand for foreign exchange, which the Central Bank has guaranteed to supply whenever there is a shortage in the market. Heavy borrowing by Government over the past two years has now depressed Central Bank foreign reserves below the equivalent of 12 weeks of imports, and triggered widespread apprehension about the exchange rate anchor.

In order to restore confidence and secure the peg, decisive action is needed to reduce Government's ongoing expenditure to the amount of tax revenues. The sale of state owned assets may buy a little time, but a reduction in the numbers employed in public services is inevitable, since the present wages bill cannot be managed without further borrowing from Central Bank.

Government is well advised to seek the assistance of the International Monetary Fund, without delay. The Fund can assist in designing the reform process to increase efficiency through the employment of higher levels of skill and the appropriate use of new technology, with no permanent diminution in the quality of public services. An essential element of the reform would be adequate separation packages for all those public servants whose services are no longer needed, so that they may make a smooth transition to the next phase of their lives.

We know from our own experience, and the experiences of our Caribbean neighbours, that short term sacrifices of Government spending are richly rewarding in the long run, in terms of the quality of life of all members of society. Early in 2015, Dr Peter Blair Henry, the second Distinguished Visiting Fellow at the Central Bank of Barbados, compared the performances of Jamaica and Barbados since 1960, and drew the conclusion that Barbadian policy makers' foresight in taking the long view had made the decisive difference that lifted Barbadian living standards well above those of Jamaica. This year's Distinguished Visitor, Dr Patrick Honohan, drawing on the recent experience of Ireland, recommended that an early approach be made for IMF assistance, whenever a country can benefit from such assistance.

There is every reason to be optimistic about the future growth of the economy, increases in employment and improvement in the living standards of Barbadians, both in the near term and further



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ahead. Our tourism is competitive, we have a rising entrepreneurial culture, we have taken important first steps in renewable energy, and our international business centre is based on a solid foundation. However, in order to realise this potential we must deal urgently with the challenges of the public sector, because the relentless pressure of Central Bank funding erodes confidence in the exchange rate anchor. Our own experience, and best international advice, suggest the implementation of a decisive programme of asset sales and Government expenditure reduction, and that IMF assistance be sought for a programme of structural adjustment, focussed on the reform of the public sector.

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