

EMPLOYMENT PAPERS

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**Structural adjustment and
fiscal policy:
A case study for Barbados**

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Preface

This paper is the outcome of a case study on Barbados which the Employment Strategies Branch undertook as part of a wider collaborative effort with the Interdepartmental Project on Structural Adjustment on the design of appropriate fiscal policies in support of structural adjustment.

The paper discusses the context in which Barbados undertook several adjustment programmes and describes their consequences for employment and subsequent growth. It highlights the consensual approach which the government, employers and trade unions in Barbados have recently developed and makes some suggestions for future policies. In this especially in the area of fiscal policies as this in the Barbadian context is a relatively more important policy instrument than exchange rate and monetary policies.

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This paper is the latest output to result from the collaboration between its authors which began with a series of written exchanges over the appropriate design of fiscal policy in support of structural adjustment. In particular, we have been concerned by the lack of consensus as to how revenue might best be raised in such circumstances, other than through general taxation and, specifically, a VAT. A 'think piece' on these questions has now been circulated as Occasional Paper # 8 of the ILO's Interdepartmental Project on Structural Adjustment. As a follow-up to this effort, an empirical test of some arguments presented in that paper was thought to be appropriate. The case-study of Barbados which is presented here has been developed accordingly.

The present paper is based on the findings of a brief mission to Barbados which took place in the fall of 1993. This would not have been possible had the authors not been able to build on considerable help from several sources. In the first instance, Professor Bishnu Persaud, Professor of Caribbean Sustainable Development, University of the West Indies, was instrumental in arranging that the mission might work in close collaboration with Dr. de Lisle Worrell at the Central Bank, Barbados. In turn Dr. Worrell provided not only generous facilities in support of our work but also a considerable intellectual contribution which has significantly influenced this report. This began with his supervision of a series of five briefing notes which were prepared for the mission on a range of subjects by Simon Best, C. Forde, Faye Fraser and Kirk Odle (for details see the bibliography).

We are much indebted to the authors of these reports. Their work provided a valuable benchmark for our further enquiries and an identification of some key issues that need to be resolved. Beyond this, Dr. Worrell helped our mission and stimulated its work in many ways, not least through his leadership of several stimulating discussions of the issues raised by structural adjustment in Barbados and his perceptive sets of comments upon an earlier draft.

We were furthermore assisted by the advice of a great number of civil servants in the various ministries, by the Director of the Barbadian Employers Confederation and the General Secretary of the Barbados Workers' Union, by the local representative of the IMF, by representatives of various non-governmental organisations and by colleagues from the University of the West Indies.

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1. The Growing Crisis, 1980-1990

1.1 Living standards in Barbados

Barbados is a small Caribbean island with a resident population enumerated in the 1980 Census of 249,000. Since then the population has grown slowly, at about 1 per cent per annum, which is to be explained mainly by low rates of fertility. Average age may have increased by about 18 months during the 1980's, while life expectation is estimated as having increased by three years. As a result of these changes, the proportions of the population aged 65 and over, and those 0 to 14, have both been declining, with a corresponding increase in the fraction who are of working age, 15 to 64. One consequence is that the population of working age increased by 6 per cent over the period from 1980 to 1989. Another is that the dependency ratio (defined to exclude the unemployed) has fallen significantly in Barbados.

The gains in life expectation are the result of decreases in age-specific death rates, beginning with infant mortality, which has followed a definite, if somewhat erratic, downward trend, some part of which must be due, no doubt, to an increasing supply of medical practitioners. Over the period of the 1980's the number of practising doctors increased almost 40 per cent while the increase in the supply of nurses was somewhat greater, mainly as a result of a large increase from 1985 to 1986.

Primary school enrolment and, hence, literacy are virtually universal in Barbados while enrolment at the secondary level is about 80 per cent. With the numbers in each population cohort remaining more or less constant as a result of demographic trends while the supply of teachers has been buoyant, the overall result has been that staff/student ratios have improved significantly. At the primary level the number of teachers has grown by 36 per cent over the decade while the number of students has remained more or less constant. Hence the number of students per teacher has fallen from 24 to 18. Similarly, at the secondary level, where there has been no comparable increase in the number of teachers, the corresponding drop has been from 23 to 20. These trends provide considerable opportunities for improvements in the quality of schooling and this may be a part of the explanation as to why the ratio of private to public school attendance has fallen over the decade.

At the tertiary level of education there has been substantial growth over the decade. Enrolments at the Community College have increased by some 35 per cent (and may now have peaked) while enrolment at the Barbados campus of the University of the West Indies grew at twice that rate and continues to do so.

The improvements recorded in the health and education sectors are reinforced by the trends in housing which are reported in Table 1. Most families continue to live in individual houses, with the number of rooms per person having increased over the decade from 1.1 to 1.3. The use of traditional construction materials has declined, while the provision of potable water and sanitary facilities, in particular, have both improved.

The trend in private consumption (as distinct from government consumption expenditure) over the 1980's is difficult to assess, although it can be noted that all indicators point to relatively high levels of consumption growth in the late 1980's compared to the 1980's and to some falling-off in the early 1990's. Statistically, there are two ways to investigate these trends. One is to work with the figures for personal consumption as recorded in the national income accounts, while the other is to rely on real wage and employment data. Both approaches have their difficulties. In the case of the national accounts data, the main problem is to make an adjustment for the tourist expenditures which are otherwise included in the total. We have attempted to do this and then deflated the

resulting figure by the retail price index. Expressed per person, the conclusion reached is that real personal consumption fell by 14 per cent in the period 1981-85 and then rose by 20 per cent from 1985 to 1990. However, this result should be treated with caution since there is some suggestion that tourist expenditures have increasingly been underestimated over time. A somewhat different picture emerges from the real wage data which suggest more or less steady growth at less than one per cent per annum throughout the decade. Employment, however, fell in the early period and rose later with the increase in tourist expenditures. This, then, may have allowed personal consumption to rise.

Social safety nets maintain in Barbados at two levels. Informally, there are extensive family and community networks which, for most individuals, provide a significant adjunct to the formal provisions of the National Assistance board. In addition, some services in kind are provided by the Welfare Department, including school lunches, and there is an ageing stock of public housing which remains available. As a result Barbados does not have a poverty problem comparable to that in, say, Jamaica.

The National Insurance Board operates two main social security schemes, one demographic, the other contra-cyclical. The demographic scheme provides a non-contributory old age pension for those who are 65 or older at a rate of B\$63 per week and without a means test.

Table 1: Some housing statistics

	1980	1990
No. of dwellings	67,138	75,211
Persons per dwelling	3.7	3.4
Average number of rooms	4.2	4.3
: separate houses (%)	90.7	90.3
Dwelling over 20 years old (%)	51.2	48.6
Owner occupied (%)	73.3	76.1
Main construction in wood (%)	58.4	39.9
Main construction in concrete (%)	21.7	33.9
Water into dwelling (%)	60.4	82.5
WC septic tank (%)	43.6	65.2
Electricity (%)	85.3	92.6

Source: Caricom (1980/81) for 1980; provisional unpublished results of the 1990 Census.

This is additional to a contributory scheme which requires a working record over ten years in order to qualify. The nominal rate of benefit has been fixed for some years. In 1986 slightly over half of all pensioners were receiving non-contributory pensions and, on average, the pensions they received were worth about three-quarters of the value of contributory pensions. It can be noted that non-contributory pensions are financed directly out of current contributions of workers and employers and not by a consolidated fund.

The second important safety net is the provision of unemployment benefits. Payments are made at a declining rate for six months to those who have previously been in employment for at least one year in total and also for at least 20 weeks during the last nine months. There is no provision for any form of cash payment to those who have exhausted their

unemployment benefits. Similarly, there is no means of making payments to those who are not members of the insurance scheme. At the end of 1992 there were some 83,000 members of the scheme, of whom 1,300 were self-employed. These numbers can be compared with an estimated total workforce of 97,000 according to the Household Employment Survey and an enumeration of 9,000 persons as being self-employed in the 1990 Census. Unemployment benefits per recipient now average about B\$196 per week, which is three times the level of the non-contributory pension.

1.2 Exports

In 1980 exports of goods and services from Barbados were 1,214 (in millions of Barbados dollars) which represents 73 per cent of GDP for that same year. (See Table 2). Accordingly, the economy is small and open. By 1990, the figure for exports had grown to 1,689 (having been 1,724 in 1989) which implies an increase in value over the decade of 39 per cent. Over this same period, the value of GDP doubled.

Within the aggregate figure for exports, by far the most important contribution both to the level and its trend comes from the service sector and, in particular, that component of services which is attributed to travel. This component stood at 507 in 1980 and had grown to 1,005 by 1990 i.e. to almost double the 1980 figure. One implication is that tourism accounts more or less completely for all the growth in foreign exchange earnings over the decade and is now more important than all other export categories combined. A second implication is that the value of manufacturing exports remained static.

Barbados has great natural beauty and a climate which is ideal for the development of a tourist industry. Equally, the international market for tourism is highly competitive and Barbados has become a high wage economy in comparison with many of its competitors. This may explain in part, at least, why capacity in the industry, which grew rapidly in the 1970's, has remained static since 1980 and now shows some signs of declining. The number of beds available was 13,400 in 1980, grew to a maximum of 14,400 by 1982, and thereafter declined to 13,767 in 1990 and 11,674 in 1991. It is not known to what extent this decline can be explained by the conversion of some hotels to time-share apartments. What is known is that the latter have been increasing in number.

The years 1980 and 1981 were boom years for the tourist industry with some 370 thousand stop-over visitors in 1980 generating a hotel room occupancy ratio of 69 per cent. This rate had fallen to 48 per cent by 1982, since when it recovered slowly to 64 per cent by 1989, only to be set back once again by international recession and growing competition. (See Ministry of Finance and Economic Affairs, 1993, Table 19 for details.) The branch of the industry which caters for cruise ship passengers has proved to be more resilient. Their arrivals had declined from a peak of 156,000 persons per annum to 99,000 by 1984. However, encouraged by improved terminal facilities and extended opportunities for (duty free) shopping, the number of arrivals had grown from the 1984 low point to 363,000 in 1990. Moreover, this growth has continued through 1991 and 1992.

Table 2: Gross Final Demand and Supply, 1980 - 1990
(B\$m at current prices)

Year	Exports	Domestic Final Demand				Total Demand = Total Supply	Sources of supply	
		Private Consumption	Government Consumption	Investment	Total		Imports	GDP at market prices
1980	1214	1081	258	424	1764	2977	1247	1731
1981	1138	1235	312	525	2082	3219	1315	1905
1982	1270	1263	329	451	2043	3313	1323	1990
1983	1490	1321	346	421	2089	3578	1466	2123
1984	1656	1432	388	374	2242	3850	1547	2303
1985	1633	1392	456	372	2225	3858	1448	2410
1986	1496	1692	469	424	2585	4081	1435	2646
1987	1340	1934	498	467	2898	4238	1325	2914
1988	1510	2004	537	543	3085	4594	1495	3099
1989	1724	2158	614	656	3428	5152	1725	3427
1990	1689	2189	694	648	3531	5220	1780	3440

Source: Ministry of Finance and Economic Affairs (1993) Table 23.

Note: The 1980 figure for GDP is a revision of the published figure.

Undoubtedly the tourism industry in Barbados faces problems in the future. Some of these are environmental, since tourism has caused severe damage to the coral reef on the west coast, while the cruise ships also extract their toll, not least by dumping waste at sea. Moreover, the industry makes substantial demands on domestic supplies of potable water and sewerage which are increasingly difficult to meet. It remains to be seen how far either the industry or government will go in promoting collective action which responds to these problems and in encouraging investment in new capacity, either directly or indirectly through the restoration of ecological and historical attractions.

Tourism apart, the export performance of Barbados has been very mixed, with little or no growth overall as previously noted. However, within this aggregate picture, there have been some interesting trends and three industries in particular merits some specific comment, viz. sugar, electrical components and the international business and financial services sector. All three have been discussed previously and at some length in World Bank (1991) to which reference can be made for further details.

The year 1980 was a good one for sugar which, traditionally, has been the most important industry in Barbados, and for its associated products, molasses and rum. Their export value in 1980 reached B\$120 but fell in the following year to B\$66, which is a figure more typical of the subsequent performance up to 1990 (see Table 3), which was itself a good year, with export values reaching B\$82.

Throughout this period from 1980 to 1990 the sugar industry has been taking advantage of favourable quotas in EEC and USA markets. Thus, the World Bank (1991, p. 22) notes that the EEC subsidy alone may have been worth as much as US\$20 million per year over the period 1980 to 1986. However, as the Bank also notes, in order to take advantage of these quotas, Barbados has had to subsidize cane production to provide an incentive for farmers and has, in consequence, locked resources into an activity which under present circumstances no longer has a comparative advantage, even after an appropriate allowance is made for the overvaluation of the domestic currency. Thus, while the quotas have resulted

in a transfer of international resources to Barbados, this has been achieved at the cost of a domestic distortion (although recently a plan is in place to increase production of rum and special sugars, through reorganization and restructuring of the industry).

Table 3 : Various indicators of export performance 1980 - 1990

Year	Number of Hotel beds (^{'000s})	Hotel room occupancy rate (%)	Tourist Stopovers (^{'000s})	Arrivals Cruise passengers (^{'000s})	Exports Electronic components (iv)	(\$m) Sugar molasses and rum (vi)
	(i)	(ii)	(iii)	(iv)	(iv)	(vi)
1980	13.4	69	370	156	43	120
1981	14.1	58	353	136	76	66
1982	14.4	49	304	111	120	76
1983	14.3	52	328	103	300	51
1984	14.3	57	368	99	334	73
1985	14.0	41	359	112	302	72
1986	13.9	48	370	145	239	71
1987	13.8	58	422	229	52	78
1988	13.7	64	451	291	45	79
1989	13.7	64	461	337	42	60
1990	13.8	58	432	363	32	82

Source: Ministry of Finance and Economic Affairs (1993) Table 19 for columns (i) to (iv), Table for columns (v) and (vi).

The history of the electrical components industry in Barbados has yet to be fully told. In 1980 exports stood at some B\$43 million and had shrunk to B\$32 million by 1990. In between, however, they had soared to B\$300 million in 1983 and peaked in 1984 at B\$334 million. Their subsequent decline can be traced directly to the pull-out of two foreign-owned companies for reasons which have never been documented authoritatively. Pending such a clarification it seems that a combination of reasons might account for the decisions made, including changes in the global strategy of parent companies whose subsidiaries were, at one time, located in Barbados, but now have been established in the United States and Ireland.

The International Business and Financial Services sector is a comparatively new industry in Barbados which promises to contribute substantially to developments in the future. Since this sector does not sell its output on the domestic market, all sales are exports and contribute as such to foreign exchange earnings. Unfortunately, no direct estimate of this contribution is available. But, whatever the precise figure may be, it is presumably a part of the item 'Other services (net)' which appears in the Balance of Payments. As can be seen from Table 3, this latter figure has grown rapidly from B\$6 million in 1987 to B\$71 million in 1990 reflecting, perhaps, the growth of the number of companies in the sector, which increased from 449 in 1986 to 1,238 in 1989. Other evidence of this growth is the contribution of 'Finance, Insurance and Business Services' to GDP, which was B\$163 million in 1980 and had grown steadily to B\$433 million by 1990.

The attractions of Barbados for the international business and services sector are clear: the climate, social stability and sound infrastructure all underpin the advantages provided by a well-educated labour force, good global communications and fiscal incentives. The main attraction for Barbados is the creation of jobs for the local workforce and a contribution to the exchequer which may or may not make this industry a net contributor to public finances. What is less ambiguous is that the growth of this sector and the importance of tourism go a long way towards explaining the emerging characterization of Barbados as a predominantly service economy.

1.3 Domestic absorption

While exports increased in value by 42 per cent from 1980 to 1990 the comparable increase in the domestic absorption of goods and services (consumption plus investment) was 94 per cent. By this criterion, growth in Barbados has not been export led.

Private consumption expenditure almost doubled over the period 1980 to 1990, as can be seen from Table 2. However, accordingly to the Cost of Living Index, retail prices increased by 74 per cent over this same period while the population grew by 4 per cent. Consequently, the real per capita increase in private consumption over the decade was only 10 per cent i.e. about one per cent per annum.

Public consumption expenditure grew somewhat more rapidly and was in fact the lead sector in the growth of aggregate demand. From a level of B\$258 million in 1980, public consumption had reached B\$614 million by 1990, an increase of 138 per cent (which reduces to about 31 per cent in real per capita terms).

Investment, which is the third component of domestic absorption, grew least - from B\$424 million in 1980 to B\$656 million in 1990 - an increase of 55 per cent. Throughout the 1970's Barbados was successful in attracting an impressive flow of private investment from abroad but has been less successful since.

Within the aggregate figures for fixed investment construction of housing accounts for about half and other building activity for much of the remainder. As a result, investment in plant, machinery and vehicles, which was only B\$116 million in 1980 i.e. 7 per cent of domestic absorption, rose to 10 per cent in 1981 and had fallen away to less than 6 per cent by 1990.

1.4 The supply response

Some details of the supply response to the growth of effective demand as measured by the sum of exports and domestic absorption have been shown previously in Table 2. They show that imports of goods and services grew from B\$1,247 million in 1980 to B\$1,725 million in 1990 while GDP grew from B\$1,731 million to B\$3,427. The implication is that imports, by value, decreased as a fraction of GDP from 72 to 50 per cent, which is a quite remarkable contraction. It is explained in part by the fact that import prices grew more slowly than the GDP deflator - by 13 per cent according to a World Bank figure as compared with an inflation of 81 per cent according to the national accounts and in part by the contraction of the electronics assembly industry. For the rest it suggests that the supply response to the growth in effective demand came mainly from the domestic economy, more especially from the service sectors, since goods production fell, and with an increased utilization of existing capacity being an important feature. Total employment increased very little, from 100,000 jobs in 1980 to 105,000 in 1990. This is consistent with the finding reported in World Bank (1991) that technical progress has been low, with most productivity increases having been achieved through the reallocation of labour between sectors. One consequence of that has been for unemployment to remain more or less constant as a fraction of the labour force at a level which is variously estimated at about 15 per cent or more.

1.5 Employment and unemployment

Employment trends

Population growth has been very moderate in Barbados with the result that the growth of the labour force has been limited, with net migration playing an insignificant role and labour force participation rates not having changed by much, although there has been some increase in the labour force participation rate of women.

Table 4. Employment, labour force participation rates in selected years 1980-1991

	1980	1982	1984	1986	1988	1990	1991
Total Labour force (000's)	112	112	111	118	123	125	120
Employment	100	97	93	96	101	106	96
Labour force participation final quarter							
Total	65	64	63	66	69	67	64
Male	76	75	74	74	77	76	73
Female	55	55	53	59	62	60	56
Unemployment rate							
Total	11.4	13.3	18.3	19.0	18.6	14.7	20.0
Male	8.6	10.6	15.8	13.7	13.2	10.5	16.7
Female	14.8	16.5	21.3	24.6	24.5	19.3	23.8

Source: Central Bank of Barbados (1993) and earlier years.

These data show that, over the last decade, the Barbados' labour force has, in fact, increased by about 10 per cent. Meanwhile, total employment has remained more or less stagnant at around 100,000 so that the relatively small increase in the labour force has translated into a significant increase in unemployment from 11 to 20% according to the data in Table 4. The impression to be obtained from these data is, therefore, of a rather static situation where labour supply is growing gradually but steadily outstripping labour demand. However, within this aggregate picture, there have been some significant changes in the educational level of the labour force in employment across sectors. Similarly, the composition of unemployment has changed. Barbados has had for many years one of the highest primary and secondary school enrolment rates in the Caribbean with new entrants to the labour market steadily raising the average level of education. Thus, the proportion of employed workers with only primary education has dropped from 47 per cent to 28 per cent over the decade, while the proportion with higher or technical education has more than doubled from less than 5% to more than 10%. Moreover, a typical unemployed person today is just as likely as an employed person to have completed their secondary education.

As regards the sectoral composition of the employed, one observes declining shares in both agriculture and manufacturing, as well as in construction and transportation where the variation around the trend is much larger, which is not surprising since these sectors are more sensitive to cyclical changes (See Table 6). One result is that the pattern of employment illustrates an increasing dependence on services and related activities, both private and public.

**Table 5: Education profiles of employed and unemployed workers
(percentages of totals)**

Highest level obtained	1981	1986	1990	1991	1992
Primary					
Employed	47	43	30	28	28
Unemployed	36	28	23	24	25
Secondary					
Employed	47	52	62	63	62
Unemployed	63	67	75	72	73
Tertiary					
Employed	4	5	8	9	10
Unemployed	1	2	1	3	3

Source: Central Bank of Barbados (1993) and earlier years.

Note: Numbers do not add up due to rounding and the exclusion of certain categories.

As a check on whether the observed decline in employment in industry and agriculture resulted from technical change, i.e. shifts of the production function or from a decline in overall production (caused either by a decline in demand or by supply problems) employment elasticities with respect to physical output have been calculated (see Table 7) for these two sectors. The result in agriculture is that declining employment is strongly correlated ($r^2 = 0.85$) with sugar production, and has an employment elasticity of 0.7. In contrast, manufacturing output and employment are seemingly unrelated ($r^2 = 0.05$) which is the statistical consequence of an oscillating trend in the index of manufacturing combined with a declining trend for employment. The estimated elasticity for this sector is 0.22. What these elasticities tell us is that employment in agriculture would be likely to benefit from an increase in production, but an increase in industrial activity will not automatically result in significant employment creation. The data confirm that choice of industry and the choice of

Table 6: Employment by sector ('000s)

	1980	1982	1984	1986	1988	1990	1992
Agriculture	9.3	8.4	8.5	8.1	6.5	5.7	5.7
Manufacturing	15.0	13.8	12.5	11.3	11.6	11.2	10.2
Electricity, gas & water	0.8	1.6	2.0	2.2	1.8	1.4	1.6
Construction	8.1	7.6	6.9	9.1	9.5	8.6	6.9
Commerce & tourism	21.0	21.8	19.9	20.3	24.3	27.3	26.2
Transport	5.9	4.9	5.1	4.4	3.8	5.7	5.2
Finance	3.1	3.7	3.3	3.3	3.4	3.8	3.7
Services	36.9	35.5	35.2	37.4	39.9	42.8	38.4
Total employment	100.1	97.3	93.1	95.8	100.7	106.4	96.9

Source : Central Bank of Barbados (1993) and earlier years

technology are important factors in determining the growth of labour absorption in manufacturing. Given relatively high wages and the fixed parity of the Barbados dollar vis à vis the US dollar, it is unlikely that labour intensive techniques of production can attract domestic or foreign investors. Therefore, future employment in manufacturing has to come from expanded production in knowledge intensive and skill intensive activities, i.e. in sectors which are inherently human capital intensive.

Table 7: Various indicators of real output

	1980	1982	1984	1986	1988	1990	1991
Index of Manufacturing output (1982 = 100)	111.8	100.0	103.2	103.4	103.9	111.0	105.8
Sugar production (tonnes)	137	89	100	111	80	69	66
Agricultural output per hectare	8.5	5.8	7.0	8.0	7.0	6.6	6.4
Hectares under cultivation	16.1	15.3	14.3	13.9	11.5	10.5	10.

Source : Central Bank of Barbados (1993) and earlier years

Is unemployment structural or frictional?

The main source for unemployment figures in Barbados is provided by a series of labour force and employment surveys. These suggest that unemployment has been rising steadily to a level of about 15% and has increased to levels beyond 20 per cent in the 1990s as a consequence of economic recession and structural adjustment. However, such a high level of unemployment is hard to reconcile with casual empiricism. It seems more likely that some part of those declaring themselves as looking for work are actually working, albeit in some form of informal employment and for wages which might fall below their aspiration level. Unfortunately, few hard data exist on this subject, although some evidence is provided by the National Insurance Scheme.

The majority of workers in Barbados are covered by the National Insurance Scheme operated by the National Insurance Corporation. Participation at the end of the 1980s stood at 83,000 out of a total labour force of 120,000 i.e at about 70, per cent which implies that some 30 per cent of the labour force is not employed or is working in informal occupations outside the scheme. Comparing these figures with the results obtained in the official series of labour force surveys suggests that part of this group who are not participating in the National Insurance Scheme do not declare themselves as looking for work in response to the survey enquiries while another group declares itself as looking for work because of wanting to change job even though they are employed. These possibilities are enumerated in Table 8. What the labour force survey picks up is both the insured unemployed (b) plus some part of categories (c) and (d).

Table 8: The coverage of labour force statistics

Total Labour Force			
Officially insured	Unemployed		Not insured
Working		Not employed	Working
(a)	(b)	(c)	(d)

Insured persons can claim unemployment benefit for a period of up to six months (180 days). However, the figures on actual claims suggest that only a minority of the claims within any one year are for 140 days or more (less than 10 per cent) and, secondly, that although the number of claims has increased between 1988 and 1992, the number of benefit days claimed on average remained of the order of 35-45 days per year. This would seem to suggest that the unemployment which is covered by the National Insurance Fund statistics is mostly frictional unemployment. However, it should be noted in this connection that the data provided by the fund are arranged by calendar year so that any days claimed in more than one year would show up as two short periods rather than one long one. This, plus the termination of coverage after 180 days, will bias downwards the average number of days claimed relative to the level of unemployment.

These limitations notwithstanding, an appreciation of the level of (frictional) unemployment can be derived from the insurance statistics following a series of calculations as set out in Table 9. These suggest an upward trend for frictional unemployment since 1988, which is in contrast with the survey statistics which report a dip in unemployment in the late 1980s and a large increase in the early nineties. It may be appropriate to conclude, therefore, that the early 1990s are characterized not only by higher structural unemployment but by higher frictional unemployment as well, suggesting somewhat lower capacity utilization in the economy in recent years.

Table 9: Indicators of frictional unemployment

	Average # of claims paid per month (i)	Average per # of days claimed (ii)	Equivalent # of persons full time (i) x (ii) = (iii) 12	Number of persons insured (iv)	Frictional unemployment (%) (iii)/(iv) = (v)	Unemployment according to survey (vi)
1988	520	54	2340	96625	2.4	18.6
1989	771	50	3212	90528	3.5	..
1990	1012	54	4554	90576	5.0	14.7
1991	1381	35	4028	95435	4.2	20.0
1992	1639	42	5736	89132	6.5	..

Source: Central Bank of Barbados (1993) and National Insurance Company.

1.6 Trade policy and the exchange rate

Ever since July, 1975 Barbados has maintained a fixed exchange rate against the US dollar of B\$2 to US\$1. Meanwhile, wages and other domestic costs have risen relative to the corresponding costs of international competitors so that the real effective exchange rate has appreciated by about 10 per cent over the decade according to IMF calculations. This may be an important factor in explaining the loss of market share for Barbados in the tourism sector. However, the trend is not monotonic. The appreciation which now maintains relative

to 1980 is the result of a relatively rapid appreciation of 33 per cent from 1980 to 1985 followed by a more or less steady depreciation since then of about 4 per cent per annum.

While the consequence of maintaining a fixed nominal exchange rate throughout the 1980's may have included an adverse effect on comparative advantage and export market shares, this same policy may equally well have served to attract foreign investment to Barbados, which earned an enviable reputation for sound macro-economic management following the successful stabilization policy which was introduced early in the decade in response to a real output decline that was triggered by the 1979 oil-price shock. However, it can also be argued that high real wages and rigidities in the labour market have served to offset this advantage, if only in parts of the tourist sector, which, although investment has picked up in 1994, has as yet to experience a revival of the significant influx of private foreign investment which characterized the 1970's.

With the exchange rate policy as its starting point, the trade policies which have been followed in Barbados reflect a variety of alternative objectives resulting in a wide dispersion of effective protection rates for different products. This has taken the form of differential tariff rates, stamp duties and quantitative restrictions through licensing and other means, the aggregate effect of which has been to create a substantial bias against exports. This has, in turn, led foreign investors in export sectors to seek various exemptions and/or fiscal incentives. The view taken in World Bank (1991) is that these concessions have not been sufficient to overcome the anti-export bias of the trade regime as a whole.

The combined effect of these movements in 'other capital' and the current account deficit define the long term public sector borrowing from abroad that would be required to maintain constant reserves (subject to official financing by the IMF and other monetary authorities). In practice, this required level of borrowing was realized from 1984 to 1988. But in 1989 the reserves started to fall, and they fell again, and yet more sharply, in 1990.

Table 10: The balance of payments current account deficit and its financing, 1980 - 1990 (\$ m at current prices)

Year	Exports of goods & services	Imports of Goods	Visible trade deficit	Travel credits	Travel debits	Other services (net credit)	Trans- fers (net credit)	Current a/c deficits (b)	Public long term borrow- ing	Other capital (net receipts)	Decrease in Reserves
	(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)	(x)	(xi)
1980	364	1051	687	507	38	34	43	141	54	41	47
1981	327	1152	825	528	44	56	36	249	99	73	77
1982	419	1108	689	510	53	102	47	84	24	75	-14
1983	547	1249	702	510	43	92	42	101	58	57	-13
1984	683	1325	642	575	46	106	29	-22	12	-36	2
1985	604	1223	619	625	47	110	11	-81	57	-50	-89
1986	491	1211	720	656	58	67	23	32	107	-69	-6
1987	264	1072	807	766	73	6	13	107	154	-6	-41
1988	291	1206	915	926	75	33	35	-5	87	-19	-72
1989	196	1400	1104	1063	90	14	12	5	28	-95	72
1990	303	1406	1147	1005	95	71	86	75	23	-51	102

Source: Ministry of Finance and Economic Affairs (1993), Table 18 (with revisions)

Notes: (a) (iii) = (ii) - (i)

(b) (viii) = (iii) - (iv) + (v) - (vi) - (vii)

The net result of the policies adopted has been to maintain a degree of external equilibrium throughout the decade. As shown in Table 10, the current account deficit which marked the early years from 1980 to 1983 was turned into a surplus in 1984, and again in 1985, in part as a result of successful stabilization policies in the earlier years. The surplus was then cancelled out by losses in 1986 and 1987, followed by two years of approximate balance in 1988 and 1989, with a significant current account deficit re-emerging in 1990.

Table 10 shows the corresponding trends on the capital account, with separate details for long term public sector borrowing and other capital movements. It is apparent that the latter contributed significantly to the financing of the current account deficit in the period 1980 to 1983. But the series goes seriously into deficit in the mid-1980's and again for 1989 and 1990.

1.7 Fiscal policy and internal balance

Total government revenue increased from B\$441 million in FY 1980/1 to B\$950 million in FY 1990/1, an increase of 115 per cent over ten years, which exceeds the 99 per cent increase in GDP at current factor cost over the same period. Some details of this increase in revenue raising are shown in Table 11.

Perhaps the most striking feature of Table 11 is the lack of buoyancy of direct taxes on income, profit and property. This is a direct result of concessions and an increasing reliance on (i) indirect taxes on goods on services and (ii) stamp duties, which are predominantly customs duties. Thus personal income and profits taxes, which accounted for almost 40 per cent of total revenue in 1980/81, were reduced in importance to 26 per cent by 1990/91.

Similarly, the importance of import duties proper declined over the period and had to be supplemented by a growing reliance on stamp duties and payroll levies. Hence imports generated about 25 per cent of revenues throughout the period, and the declining contribution of income taxes had to be compensated by a steady increase in importance, from 13 to 22 per cent, of consumption taxes, and from 1 to 10 per cent of levies. The overall consequence of these changes has been that government revenues became increasingly reliant on indirect taxes which contributed accordingly not only to increases in the cost of living, which then tended to increase wages, but also to the indirect costs of employing labour. Hence the pattern of resource mobilization through the 1980's tended to aggravate the characterization of Barbados as having high labour costs.

While central government revenues were rising over the decade from 1980/81 to 1990/91, expenditures were also rising, by 224 per cent in fact. Tables 12 and 13 set out some details of this expansion. Given that there was already a fiscal deficit in 1980/81, the implication is that the deficit has not been eliminated over the decade. Rather, it has persisted at around 20 to 25 per cent of total revenues.

Table 12 shows the shift over the decade in the main components of central government expenditure. These indicate that the largest increase has been in interest charges, which have grown steadily as a result of the need to borrow in order to finance the fiscal deficit previously referred to. It is also to be noted that wages and salaries are the only other item to have risen faster than government revenue so that capital expenditures especially have been subject to some compression.

Table 11: Central Government Revenue and the Fiscal Deficit 1980/81 to 1990/91 (\$m at current prices)

Fiscal year	Taxes on income and profits (i)	Levies (ii)	Taxes on property (iii)	Taxes on goods and services (iv)	Import duties (v)	Stamp duties (vi)	Non-tax revenue (vii)	Total revenue (a) (viii)	Fiscal deficit (ix)	Total expenditure (b) (x)
1980/81	162	3	22	106	90	5	54	441	93	534
1981/82	177	-3	28	119	90	6	54	469	154	623
1982/83	194	23	26	125	75	18	35	496	94	590
1883/84	195	26	28	138	90	26	39	541	73	614
1984/85	189	30	28	159	84	47	36	572	122	694
1985/86	204	30	35	167	97	75	37	644	123	772
1986/87	161	44	43	190	116	86	33	670	122	792
1987/88	136	70	36	221	116	106	42	727	212	939
1988/89	228	75	48	266	120	83	64	882	90	972
1989/90	247	86	49	304	126	105	72	988	66	1054
1990/91	250	91	46	286	118	101	58	950	248	1197

Source: Central Bank of Barbados (1992), tables G1 and 3.

Table 12: Central Government Expenditure

Year	Wages	Goods & services	Interest	Current transfers	Total current expenditure	Investment	Other capital expenditure	Total capital expenditure	Total expenditure
1980/81	173	52	31	139	395	91	48	139	534
1981/82	184	60	52	154	450	114	59	173	623
1982/83	203	54	71	148	477	60	53	113	590
1983/84	207	59	63	158	487	66	61	127	614
1984/85	243	63	65	174	560	84	50	134	694
1985/86	267	70	70	220	626	99	47	146	772
1986/87	291	68	81	187	627	121	44	165	792
1987/88	337	84	100	227	748	117	75	191	939
1988/89	374	101	121	236	781	112	80	192	972
1989/90	424	114	132	256	852	145	58	203	1054
1990/91	354	94	164	288	957	182	52	240	1197

Table 13 provides an alternative perspective on the increase in Government expenditure. Within what is otherwise quite a uniform picture, it is noteworthy that defence expenditures were low in 1980/81 and have grown least over the decade. In contrast, educational

expenditures have been high by international standards (8.4 per cent of GDP in 1990/91) and the growth of capital expenditures in the education sector is particularly notable. Overall, central government expenditure in 1990/91 was equal to 31 per cent of the GDP.

While government revenue increased over the decade of the 1980's, as previously noted, the even faster growth of spending has meant that government has been in deficit every year since independence, back in 1966, with a borrowing requirement throughout the 1980's that was never far below 20 per cent of total expenditure for most of the period (see Table 11). Inevitably, then, the national debt has grown and with it the costs of debt servicing. At some point, a fiscal crisis became inevitable as these trends persisted.

Table 13: Central Government expenditure 1980/81 and 1990/91 by function

	1980/81			1990/91		
	Current	Capital	Total	Current	Capital	Total
General Public Service	61.6	17.7	79.3	146.9	37.7	184.6
Defence	8.4	12.0	20.4	25.6	3.0	28.6
Education	92.9	19.0	111.9	221.4	63.6	285.0
Health	61.7	25.0	86.7	141.0	24.8	165.8
Social Services including Housing	65.8	15.5	81.3	148.6	35.1	183.7
Roads and Transport	47.4	20.3	67.7	78.9	44.4	123.3
Other Economic (Agriculture, water, trade, industry and tourism)	26.7	29.4	56.0	62.7	31.5	94.2
Charges of debt	30.5	-	30.5	132.3	-	132.2
Total	395.0	138.8	533.8	957.3	240.1	1197.4

1.8 Debt

The persistent fiscal deficit throughout the 1980's has created a need for central government to borrow and has resulted in accelerating growth of the national debt as recorded in Table 14.

Borrowing has taken place both internally and from abroad in roughly equal amounts over the period of the 1980's. However, much of the international borrowing was on relative short terms so that the servicing of external debt has been the greater problem throughout the decade.

In an extended essay on the evolution of debt since independence, Anyadike-Danes (1993) has identified the Commercial Banks and the National Insurance Fund as the main domestic purchasers of Government Debt, with the former being obliged to hold increasing amounts as the required ratio of securities to deposit was progressively raised over the years until it reached 22 per cent in 1986. Thereafter, Government had to place increasing reliance on borrowing from overseas, in which context a new development was to introduce

yen placements in 1985 and again in 1986. The subsequent appreciation of the yen against the dollar has made this a very expensive form of borrowing.

Inexorably, as the debt increased, so did the problems of servicing old debt and raising new money to meet the continuing deficit, to the point that, in 1990, government was having to place new borrowing at an annual rate which had grown to 10 per cent of the domestic product. This proved to be too much for the international markets so that, in the fourth quarter of 1990, there was no real alternative to reaching an accommodation with the IMF in order to abate the drain on reserves and to provide an alternative to borrowing from the Central Bank.

Table 14: The Government borrowing requirement and Growth of Debt, 1980-1990 (\$m at current prices)

Year	Amortisation of internal debt	Amortisation of external debt	Sinking fund	Sub-total	Fiscal deficit	New borrowing requirement	Internal Debt	External Debt	Total Debt
	(i)	(ii)	(iii)	(iv)	(v)	(iv)	(v)	(vi)	(vii)
1980	6	13	3	22	90	111	329	164	493
1981	5	13	4	22	155	176	427	259	686
1982	6	15	4	25	120	145	475	287	762
1983	8	18	4	30	74	104	516	347	864
1984	9	23	4	35	120	155	590	365	956
1985	4	29	4	37	126	168	652	444	1096
1986	16	40	4	60	122	182	713	554	1267
1987	11	46	7	64	218	283	754	707	1461
1988	28	40	6	74	124	198	822	790	1612
1989	15	125	6	146	66	212	878	817	1695
1990	14	69	8	91	248	339	1021	836	1857

Source : Central Bank of Barbados (1992), Tables G 9 & 11

Note: (a) (i) + (ii) + (iii) = (iv)

(b) (iv) + (v) = (vi)

From a purely arithmetic perspective there was a fiscal crisis in 1990/91 because expenditure rose by B\$144 million compared to the previous year, and revenue was down by B\$38 million. This resulted in the highest fiscal deficit on record for any year of some B\$248 million. But it can also be noted that three years previously the deficit had reached B\$220 million without any serious repercussions. On that occasion foreign financing had been available to cover over half the deficit (B\$116 million) while the Central Bank had funded B\$47 million, much of which was passed on as long-term debentures to various domestic banks and trust companies. What had now changed was the fact that debt charges had increased by B\$28 million between 1986/87 and 1988/89 while servicing requirements had grown appreciably more. In 1990/91 it proved difficult to increase either domestic or foreign long-term financing: the former rose by only B\$34 million. Hence government was obliged to arrange a substantial loan (B\$95 million) from the IMF and the bulk of the outstanding financing had to be achieved on a short-term basis through the sale of treasury bills, of which the Central Bank's holding rose from zero to B\$89 million during the year. The problem then was to have these taken up by the financial sector so that the Central Bank

could cover any future periods of liquidity and expectations of devaluation could be quashed. This was finally achieved in 1992, by which time there were acute fears of devaluation which required a substantial discount to stabilize currency holdings and hence an increase in the discount rate to nearly 14 per cent. The cost of turning over a stock of treasury bills worth some B\$500 million for around 18 months at an interest rate premium of around 6 per cent over previous and later rates was some B\$45 million, i.e., about 1.5 per cent of GDP. That, then, was the cost, not of the deficit itself (there was no similar cost in 1987/88) but of losing control over domestic financing and retaining a fixed exchange rate.

1.9 Stabilization

The budget statement in April, 1991 introduced a stabilization tax of 1.5 per cent on all incomes, increased employers' severance fund contributions (and also increased the consumption tax to compensate for a lower CET). In May, 1991 a cut of 7 per cent in public expenditure was ordered which was to apply across the board to the 1991/92 estimates. Supplementary estimates were approved in September 1991. These accepted that "One key causal factor in the disequilibrium in the economy has been the acceleration of public expenditure, driven by substantial increases in allocations for wages and salaries". These supplementary estimates required additional expenditure cuts of B\$114 million. Hence the initial estimates of some B\$1,263 million were reduced to approximately B\$1,050 million, and additional revenue of B\$62 million was raised. The latter came from an increase in the stabilization tax (to 4 per cent on incomes over 15,000) while the expenditure reduction was to be achieved by a temporary 8 per cent cut in public sector wages and salaries, which would yield B\$33 million and cuts of B\$41 million in capital expenditure, B\$35 million on current transfers, and a small amount of B\$4 million on purchases of goods and services. This clearly put the main burden of expenditure cuts on the capital account. In addition 2,000 casual workers were laid off, predominantly in the Public Works Department.

Table 15 shows some details of where the cuts were made in the capital budget. Broadly, economic services and housing, etc. were cut by two-thirds, education and health by nearly one half, and general public services hardly at all. Normally, the public sector housing programme would expect to complete some 100-200 units annually. Indeed, up to 400 units were being completed annually in the late 1980's, but this number had been allowed to fall away to only 36 units completed in the first three quarters of 1992. Similarly, recent levels of capital expenditure on roads have been well below those which maintained through the 1980's. Presumably, this is a state of affairs which could continue for a few years yet. But, sooner or later, capital expenditures will need to be reinstated. Achieving greater efficiency in capital programmes may be possible and it is noteworthy that road maintenance, for example, is being subcontracted to the private sector. But, in general, it must be recognized that the sacrifice of the public investment programme can only be a short-term solution.

As a further contribution to stabilization, government divested its shares in the Barbados Telephone Company to realize some US\$49 million equivalent in foreign exchange which was then used to meet government's most immediate debt servicing obligations.

To some extent the impact of the domestic credit squeeze on imports was ameliorated by an extended use of trade credits. But it seems likely, none the less, that a significant compression of imports was achieved and that this contributed significantly to a surplus on the Balance of Payments in 1992 (despite a continuing weak performance by the tourist sector) and an improvement in reserves. Similarly, the reduction in public expenditure

contributed to a reduction in the fiscal deficit as well as a decline in real output which was otherwise attributable to the generally weak export demand.

By these means a degree of stabilization was achieved quite quickly so that, during the second half of 1992, the government was able to relax the credit squeeze. The discount rate and mortgage rate were reduced and so was the stipulated securities ratio. To this extent, the immediate crisis was soon abated. However, it left in its wake an aggravated problem of unemployment which is reckoned by some authorities to be well beyond 20 per cent and an overhang of debt, particularly foreign debt, which will be a continuing drain on national resources for many years to come. This, then, is the background against which Barbados has committed itself to a programme of structural adjustment.

Table 15. Barbados capital expenditure, 1989/90 and 1992/93 (as a percentage of GDP)

	1989/90	1992/93
Total: of which	5.9	3.0
Education	1.0	0.5
Health	0.5	0.2
General public services	1.3	1.2
Housing and community services	1.0	0.3
Economic services: of which	2.1	0.7
Agriculture	0.4	0.2
Roads, etc.	1.5	0.5
Trade, industry	0.3	0.1

Source : Economic and financial statistics

2. The Structural Adjustment Strategy

2.1 Introduction

The first step in responding to the 1991 crisis has been one of stabilization: to stop the depletion of foreign exchange reserves by reducing the flow of imports to levels which can be sustained by foreign exchange earnings and long term capital flows. This has been achieved by a package of measures which reduced both the fiscal deficit and the supply of credit to the private sector. Accordingly, Barbados can now turn to the longer-term task of restructuring the economy, which is to be realized via the promotion of private sector activity, with the role of government being to provide a support function and to create appropriate incentives.

Within this general framework there are some particular features of the situation in Barbados which colour the form which the various elements of the structural adjustment are likely to assume. Foremost among these is the identification of particular economic activities as ones in which the island of Barbados has or can develop a comparative advantage over

time. The quality end of international tourism is seen to be one of these. Others include international business and information services. The first depends critically on the sustainable development of the natural environment, the second on maintaining the development of the stock of human capital and, therefore, on the supply of education services in particular. Both are difficult. And, meanwhile, there is the substantial legacy of unemployment which it will be difficult to reduce.

It is against this background that Barbados achieved, in August 1993, what so many other countries would have wished to achieve when confronted with the need for structural adjustment, namely a protocol on prices and incomes which has been agreed on a tripartite basis between government, employers and employees through their respective representatives. The protocol recognizes that there has been a gradual erosion of international competitiveness over the years and that this must be restored. Moreover, the costs of devaluation in terms of long-term reputation are seen as being greater than any potential short-term benefits, so that maintenance of the exchange rate is agreed as a cornerstone of policy. The strategy must therefore be to encourage growth through investment and productivity gains and hence, hopefully to create more jobs in the future. To this end, wage restraint linked to productivity gains and improvements in efficiency are seen as being the appropriate way forward. Accordingly, the protocol endorses a freeze of basic wages, salaries and benefits for two years while allowing productivity bonuses to be paid and for profit sharing.

To support the protocol, it has been agreed that any price increases which might be necessary should be justified by increases in material costs; that a working party on indexation and the measurement of productivity in the public sector should be created within the framework of a National Productivity Board; and that the income tax structure should recognize the aims and objectives of the protocol and be designed to support them.

The degree of social consensus which is represented by the protocol constitutes a major achievement for all parties. It provides both a foundation for specific policies and a challenge to which these policies should respond.

The policies which are now being developed and, in some cases, have already been initiated, fall into four main categories:

- reform of direct and indirect taxation;
- trade reform;
- reform of the public sector; and
- sectoral reforms affecting *inter alia*:
 - international business;
 - tourism;
 - the financial sector; and
 - agriculture.

Each of these areas of reform is reviewed in this chapter. It is the hope of their promoters that, as a package, they will encourage the economy to resume growth over the medium term, bringing unemployed down to below 20 per cent while raising reserves of foreign exchange to a level which would provide three months coverage of imports. To achieve all this it is going to be necessary to maintain tight controls on public expenditure and to find ways of increasing labour productivity so as to increase the competitiveness of domestically produced goods and services both internationally and in domestic markets.

2.2 Reform of direct and indirect taxation

A comprehensive reform of direct taxation was agreed back in July 1992 and the

process of implementation is already well underway. It was thought to be desirable for a variety of reasons. The direct tax system which previously maintained was the result of piece-meal changes over time, many of which were introduced in response to sectoral interests. The system had lost transparency as a result. It was also distortionary and, therefore, unfair, not least on account of various concessions which tended to favour the rich and specific interests, such as unlimited mortgage interest deductions. In other respects the system was highly progressive, thereby encouraging pressures to concede preferences and attempt evasion. All these factors tended to increase the administrative complexities of the system.

The objective of the reform is to simplify the tax structure and to broaden the tax base without losing revenue. The first of these objectives depends on the elimination of some particular exemptions and the replacement of the existing tax schedules with a basic rate of 25 per cent and a standard rate of 40 per cent. The integration of PAYE and the National Insurance scheme then leads to a 40 per cent flat rate of taxation. The second is being achieved by extending the coverage of direct taxes to include a withholding tax of 12.5 per cent on interest and a final tax of 12.5 per cent on dividends (to be paid at source) which will otherwise be exempt. In due course, all levies except the training levy are to be eliminated, dependent spouse and child allowances are to be introduced, and tax brackets are to be indexed. The general corporate tax rate has been increased to 40 per cent but various export incentives have been retained. The general rate on property (other than owner-occupied housing) has been set at 0.95 per cent with a discount of 50 per cent for agriculture. For owner-occupiers a rate of 0.35 per cent will apply on the first B\$100 thousand of value, with the general rate being applied thereafter.

It is anticipated that the overall impact of these measures will be to increase incentives for both individuals and companies and to reduce administrative costs. It is also expected that the system will be fairer. However, it is evident that dividends will remain privileged as a form of income as, apparently, will capital gains.

Not unlike the previous system of direct taxation, there are at present a multiplicity of indirect taxes in Barbados, the overall impact of which is certainly distortionary. These taxes include import duties, consumption taxes, stamp duties, hotel and restaurant sales taxes, taxes on overseas telephone calls, travel tickets, bank assets, public entertainment, and surcharges on rental property. Many of these are now to be eliminated as a result of the decision to introduce a value added tax in 1994,

The main disadvantage of the present system has been its impact on costs in general and the cascading effect on the cost of exports in particular, resulting in a significant anti-export bias. Accordingly, it is expected that the main advantages of the shift to VAT will derive from the elimination of this bias.

Details of the new VAT remain to be finalized and there are a number of issues outstanding, starting with the setting of a standard rate (around 15 per cent) the exemption level of turnover (perhaps B\$100,000) and the rate of turnover tax, if any, to apply to businesses which are exempt (perhaps 5 per cent). The possibility of zero-rating food remains to be addressed. At present there is a 20 per cent stamp duty on food imports from outside CARICOM and a consumption tax on some imports from within CARICOM. Similarly, there is a case to be examined for applying a lower rate to agricultural products in general.

2.3 Trade reform

Trade policies and the indirect tax system are inextricably interlinked. It is essential, accordingly, that their reform should be harmonized.

From the perspective of trade reform, the introduction of VAT goes a long way to providing exporters with a sound incentive framework if exports are zero rated. Not least, the effect is to remove the domestic indirect tax component from costs (an incentive which some existing export manufacturers enjoy) and so allow the would-be exporter to buy raw materials and sell their product at border prices. However, this same set of policies will equally have the effect of removing the protection which manufacturers supplying the local market had previously enjoyed. Barbados is no exception to the general rule that countries which seek to promote import substitution finish up with an elaborate system of effective protection which depends on licensing, import quotas and price controls, reinforced by some specific embargoes, as well as the standard superstructure of import and stamp duties.

Barbados has now decided to eliminate these distortions with a phased programme of surcharges to provide temporary protection for those manufacturers who need time to reduce their costs in order to improve their chances of competing effectively in the more competitive environment which will maintain in the future as a result of reductions in the current rates of effective protection and the removal of licensing requirements for most imports. A strategic concern for this aspect of adjustment will be to move towards a reduction of the Common External Tariff rates, eventually to rates in the range of 5 to 20 per cent, although this is not likely to be achieved for several years. A more immediate objective is to bring the maximum rate down to 35 per cent.

2.4 Reform of the public sector

There are two important aspects of the reforms in the public sector which are now underway in Barbados. One concerns the determination of those activities which government, as opposed to the private sector, should undertake. The other is to look at the efficiency which characterizes the performance of the public sector in all its aspects.

The debate over what things the government should be doing has not as yet been taken very far. To-date it has centred around the divestiture of public enterprises and has as yet to move very far into areas such as contracting out and the role of NGOs. However, divestiture has got off to a racing start with the ready sale of the government's stake in the Barbados Telephone Company to Cable and Wireless last December. This simple transaction was promoted by the immediate need to raise foreign exchange to meet debt servicing obligations as previously noted. It is inevitable that subsequent divestitures have generally become more difficult and will increasingly be so. The government is apparently well advanced in identifying potential opportunities for privatization, rehabilitation or closure. The more difficult part will be to find buyers or to close down those operations which cannot be justified commercially or on social grounds.

The fact that Government employs some 20 per cent of the labour force in Barbados means that it must play its full part in securing the efficiency gains which are needed as a basis for restoring comparative advantages and restructuring the economy. According to some observers, there is ample scope for cutting the cost of public administration while, at the same time, improving its efficiency. Such thinking is reinforced by the redefinition of government's role as being less ambiguously supportive of the private sector. At some point this has to mean that reducing the role of government is to be a part of structural adjustment. However, just how this might come about is not entirely clear. What is clear, however, is that there will be little or no scope for a real increase in public expenditure for some time to come (unless exports do unexpectedly well) and a corresponding need to improve the management of public expenditure through tighter budgetary controls which are reinforced by quantified performance criteria and value-for-money audits. Accordingly, a Public Expenditure Management Programme is central to governments' plans for improved

governance and hence for efficiency gains to offset the consequences of the compression of public expenditure which must be achieved in the years to come. To the extent that government revenue is geared to imports in Barbados, it follows that the task of reducing the fiscal deficit must depend disproportionately on reductions in public expenditure which must therefore decrease as a fraction of the GDP.

It remains essentially for the future for government to decide on the extent to which cuts will be made in public expenditure and in what areas. An early illustration, which may be indicative, is provided by the human resource development programme which has recently been worked out with the IDB and World Bank in the form of loan agreements. This project aims to increase the supply of skilled workers by strengthening facilities for technical and vocational training and to strengthen basic education also, again through training and teaching resources, and to improve the employment services. But there is also a downside to this package. The student teacher ratio in primary education is to rise from its present level of 19 to 1 to a new norm of 25 to 1, which is significantly beyond the level of 23 to 1 that was previously binding on Government as a condition of a previous World Bank loan. Inevitably, fewer teachers and fewer schools will be required. Therefore, the project will provide for modification/expansion of some schools to allow others to be closed, and for enhanced school management capabilities at all levels to plan and implement the implied retrenchments and rationalization. Similarly, the capacity to design, evaluate and eventually to implement new proposals for cost recovery at all levels of education is to be developed. Charges for school meals, rental of textbooks and for instruction are all possibilities which are under review.

The seriousness of the present situation in Barbados is implicit in the acknowledged risks of this human resource development project. One such risk is that fiscal stringency may prevent government from delivering the counterpart funds which it is committed to provide by the loan agreement. Another is the opposition to the programme which is anticipated from interested parties among whom, it must be reckoned, parents and teachers will be prominent.

2.5 Sectoral reforms

The various reforms of taxation and trade policy which have previously been discussed, reinforced by the public sector reforms, define an environment in which it is anticipated that the private sector will find sufficient incentives. However, there are some additional and sector specific policies which can add substantially to the encouragement of the private enterprise sector. Among the reforms being discussed, and some which are underway, particular mention can be made of those reforms which effect tourism, sugar, the Barbados National Bank and the international services sector.

First, in relation to tourism, there are two main strands to the adjustment policies which, it is hoped, will encourage this sector to play the leading role in lifting Barbados out of its present difficulties. They concern marketing and performance respectively.

Barbados has in recent years enjoyed particular success in attracting tourists from mainland Europe, and one element of marketing strategy will be to exploit this success which derives in part, perhaps, from the growing use of English as the European Community language. More generally, it is thought that a pro-active marketing strategy will reap useful returns. The replacement of the Barbados Board of Tourism by a new Tourism Authority has taken effect in that respect. In giving focus to the new strategy there is much which government could do to improve the infrastructure supporting tourism and to assist in the development of special segments of the tourism market, such as eco- and heritage tourism, honeymoons and conventions.

As to performance, it must be said that an increasing number of hotels in Barbados are in need of refurbishment, so that new proposals for making credit available on attractive

terms to finance such efforts is likely to prove popular. However, it is also likely that the future success of the industry will depend on providing better value for money, i.e. by improved productivity through better management and skill training, but also through better motivation of staff. Accordingly, profit sharing schemes are to be encouraged as part of a two-edged approach to raising standards in this critical sector.

Turning now to sugar, it is evident that both acreage and output have been declining for twenty years and the main priority for the future must be to stop this decline and retrench what remains of this erstwhile staple activity around a guaranteed preferential EC quota. In doing so it should be recognized that archaic management, exacerbated by access to easy credit at the Barbados National Bank, are perhaps more to blame than the restrictive practices of labour in bringing the industry to its present bankrupt state. But whatever the truth of that may be, the bottom line is that the costs of producing sugar in Barbados are approaching twice what they should or could be (36 cents per pound as opposed to 20 or less) given known technologies.

The proposed remedy for this situation is the establishment of two new agencies, an Agricultural Credit Trust (the Trust) and an Agricultural Management Company (the Company). The Company will be wholly owned by the Trust, which will take over the non-performing agricultural debt and, in particular, the sugar industry loan portfolio of the National Bank, which will be purchased by government in exchange for securities. The Trust will then endeavour to service its liability by rationalizing the assets which it will acquire under this scheme. One important component in doing so will be the creation of the Company, which will be charged with the management of the sugar plantations and factories as a consolidated entity. It is envisaged that, in the first instance, day to day management responsibilities will be contracted out to a foreign management company and that, in the longer term, the Company will be privatized. Meanwhile, it is recognized that some subsidization will be called for, perhaps over a five year period. The intent is that any such subsidy should be made explicit in the budget, and should be conceded only if it can be justified on cost-benefit grounds.

In other respects, the role of the Trust will be to promote improved productivity in agriculture at three levels: in improved technology for existing crops; crop diversification; and changes in land use. None of this will be easy in Barbados, in part because the fragility of the soils makes change a risky business, calling for superior husbandry skills, and in part because the main alternative uses of land which have emerged to date have been simply to abandon it, potentially for use as informal rubbish dumps, or otherwise to develop land for housing or commercial use, which can be highly profitable, depending on location. These same profits will now provide the main source of revenue from which the Trust is expected to pay off its debt.

The Barbados National Bank holds 14 per cent of public deposits in the banking system. Yet its assets are extremely weak and loans to the agricultural sector are only a part of the story. In the commercial sector, almost half the portfolio represents loans to public enterprises which have been guaranteed by government. The vast majority of these enterprises are now insolvent or defunct. Hence some forty percent of the non-agricultural portfolio of the Bank cannot be recovered and must therefore be written off.

Finally, there are various ways in which the government can extend the welcome which it has already shown to the international business services sector, mainly through specific tax concessions and legal facilities. However, to the extent that the benefits of developing this sector are restricted to those of an increase in demand for domestic skills which are already fully employed, it is not clear how beneficial this activity might emerge as being from a cost-benefit point of view. Much will depend on the extent to which these international activities

contribute to the domestic supply of foreign exchange. And on that there is at present a paucity of information.

2.6 An overview of the proposals

A central theme which runs through the various proposals which have been made to date is the need for Barbados to develop its comparative advantages in international markets, not only by developing new products but also by improving its competitiveness in the production of goods and services for which it has an established position. It is accordingly of some interest to review the various proposals (based upon the various government documents made available to the authors) from this particular point of view.

First, with respect to fiscal policy, it is evident that the maintenance of a low fiscal deficit over the medium term will help to ensure that money creation is avoided, which is an important consideration in eliminating any excess demand for domestic goods and services. This in turn makes an important contribution to improving competitiveness by holding down prices and costs, such as the renting of office and factory space. It also means that sectors such as distribution and construction which might be stimulated by credit expansion will not be competing so strongly with exporting sectors for managerial and other high quality skills.

To help maintain a low fiscal deficit, the Government has undertaken to review all areas of public expenditure and to prepare a medium-term expenditure strategy. This will ensure that future budgets will not lead to increased deficits, despite the projected reduction in real taxation levels over the next few years. The intention is that Government will streamline operations and prioritize expenditure categories. As a part of this effort it is intended that Government will develop a medium-term investment programme in which projects will be included only if their benefits to the development of human resources, infrastructure and the environment outweigh their costs. At the same time, all public enterprises will be reviewed with a view to privatization where possible, restructuring where necessary or closure where they are no longer needed.

The temporary wage freeze for the public and private sectors announced by the Prime Minister in his 1993/94 Financial Statement improves competitiveness by ensuring that one important element in domestic prices remains unchanged while international prices rise. Government has set the example with a two year wage freeze for the public service and has provided guidance for the private sector through an incomes policy statement. Greater flexibility and improved incentive structures are being encouraged in the labour market. Many private sector companies have introduced productivity-enhancing schemes using the services of international management consultants. The National Productivity Board will now be reformed to better assist social partners by providing guidelines for wage contracts that link pay and productivity. In addition, measures are being taken to reduce the costs of job switching. Severance payments have been made less burdensome to companies and further changes are being considered. These will facilitate the replacement of low productivity jobs by high productivity jobs in other firms or sectors.

Tax reform will increase the profitability of firms and hence contribute to holding down costs and investment incentives by reducing payroll costs through the elimination of special levies and stabilization taxes. All indirect taxes on inputs for exports and tourism will be removed through the introduction of a value added tax. Special incentives for investment in housing for higher income earners have already been eliminated to discourage excessive investment in domestic real estate in preference to investment in traded activities.

Trade reform will help to improve the competitiveness of exports and services by lowering the cost of import-competing goods. The removal of licensing requirements for all non competitive and most competitive imports is an important element of the trade reform.

Reduction in protection for import substituting manufacturing is to be accompanied by intensified programmes for export promotion and financing so that manufacturing firms may improve productivity and quality relative to internationally competitive standards.

The Government of Barbados has always crafted policy in accordance with the philosophy of a market driven economy. Major examples include the shift towards consumer based taxation in the later 1970's and the 1986 tax reform package. However, interventions in response to sectoral interests have introduced significant distortions over the years as we have noted earlier. Structural reforms are now designed to remove these distortions, to reduce the extent of Government intervention, to improve the collaboration between Government and the private sector and to improve the incentive framework.

With the private sector in the vanguard of growth generation over the medium-term, the Government intends to reduce the scope of its economic activities and the burden of unnecessary regulations. Moreover, the public sector borrowing requirement will be reduced as a result of the closures or sale of public enterprises which have previously made losses. One result of this should be to make funds more readily available to the private sector.

Institutional arrangements for co-operation between the private sector and Government are being renovated and strengthened. The Economic Consultative Council has been revived with periodic meetings to consider major elements of the structural reform. The Council is chaired by the Prime Minister and includes the economic ministries, the Central Bank, private sector organizations and trade unions. A Foreign Exchange Committee comprising representatives from all sectors has been set up with a mandate to monitor and improve the performance of the foreign exchange earning sectors. It has established task forces to address specific issues and monitors their progress through monthly meetings. One task force in particular will provide the private sector with a possibility of pinpointing administrative hurdles and bureaucratic impediments to entrepreneurship. The promotional agencies for manufacturing, international business services, information services and tourism are being reformed. New institutions have been set up to provide financing and technical expertise for the rehabilitation of private agriculture. And the Central Bank will embark upon a thorough review of existing exchange regulations to eliminate obsolete regulations and facilitate current transactions. While safeguarding the level of reserves, the aim will be to gradually remove all remaining foreign exchange restrictions on the current account.

As a package, the contention is that these reforms can be expected to secure a significant improvement in the competitiveness of domestic producers of goods and services over the medium term and hence an adjustment of the structure of the economy in ways which will restore its viability and recreate a growth potential. Thus, it can be anticipated that private sector restructuring in Barbados will result in the replacement of low productivity, low quality operations with more skill-intensive activity.

The main worry must be that this restructuring will release significant numbers of low skilled workers at the same time that shortages for specific skills, especially in the area of information services, are likely to maintain. Labour market rigidities, especially the high level of severance payments, have already meant that many firms which previously retained an excessive payroll could no longer sustain this overhead as the recession continued. Accordingly, there is now a major problem of unemployment to be addressed as a part of structural adjustment. The ultimate objective of the structural adjustment programme must be to provide viable and sustainable employment opportunities for Barbadians. And, meanwhile, Government will need to re-evaluate and streamline the social services if it is to maintain a social safety net that is financially viable in the long-term and to target the provision of services to those in need of protection.

Education and training systems in Barbados are essentially traditional in their approach. The school system turns out technically qualified persons, who are said to be lacking in motivation and work ethic according to some employers. Advanced training and recruitment for high positions typically takes place within establishments so that there are few training programmes open to dismissed workers as a result of factory closures. In the context of the new adjustment measures and high levels of unemployment, this traditional system is evidently in need of some overhaul and Government is much aware of this. Programmes to alleviate the employment transition problems through retraining under supervision of the National Training Board have, therefore, been recommended alongside a strengthening of the National Employment Board in order to arrive at a more open system of recruitment. Given the informal sector activities which have sprung up recently, it is evidently incorrect to say that there is a general lack of enterprise culture in Barbados. It is probably correct, however, to suggest that better access to finance and less regulation will help to develop this enterprise culture and so encourage small enterprises to flourish providing increase employment opportunities. However, as we indicated earlier, little research has been done in this area and it is therefore difficult to estimate the potential for of future employment growth in this sector.

If current proposals to improve the labour market are implemented they will undoubtedly help to reduce the problems of transitional unemployment and create more employment opportunities in the small-scale sector. However, improving the functioning of the labour market alone will not be sufficient to reduce unemployment as such. This requires a resumption of growth in the mainstream of economic activity in order to increase labour demand in the formal sector and hence to increase demand for the products of the informal small-scale sector which will then encourage this sector to employ more workers.

There is undoubtedly scope for increased capacity utilization in the export sectors. In agriculture, for example, there is considerable scope for a reorganization of the sugar industry, whereby production and acreage can be augmented, leading to an increased labour demand. Secondly, in the tourist industry, there is ample scope for hotel bed occupancy rates to be increased if demand can be stimulated and this too will lead to increased employment. However, the prospects for increasing employment via the number of cruise ship visitors is more problematic since the expansion of this sector is contingent on investment as indicated earlier.

According to the World Bank (1991), 75 per cent of output from the manufacturing sector caters for the local market. However, the employment elasticity for manufacturing is likely to remain low since, despite the social contract, real wages will probably remain high and therefore encourage the adoption of labour saving techniques by manufacturing enterprises. Hence, if growth does pick up, manufacturing employment will probably increase somewhat, but large increases in employment cannot be expected if high value added export markets are to be developed. In general, it seems that new employment opportunities will be mainly for the more highly skilled workers.

Services, and especially government services, provide the lion's share of employment in Barbados. Not much expansion in government employment is to be expected in the years to come because of the various measures for public sector restructuring. Indeed, a decline is likely. Offsetting this, however, business services can expand rather quickly and employment opportunities will most likely increase in this sector. However, even a vigorous growth of employment opportunities in this sector will make only a small dent in the total unemployment problem simply because this sector is not as yet very large.

It follows from these arguments that unemployment is likely to persist as structural adjustment proceeds. It is thus of utmost importance that the Government and its social

partners should ensure that social security and other safety nets remain in place to ameliorate the social costs which structural adjustment will otherwise entail.

2.7 Some thoughts in conclusion

Barbados made an excellent start to the process of structural adjustment in establishing a tripartite protocol as a foundation for future policy. This has admitted the possibility of maintaining a fixed exchange rate and served accordingly to reinforce the potential attractions of Barbados to investors from overseas. However, there is as yet a long way to go and much to be achieved if the economy is to recover. As we have seen, the immediate foreign exchange crisis in 1992 was, in effect, paid for by selling off the international telephone company. And the necessary cuts in public expenditure were achieved largely by cutting back on investments, such as housing and road maintenance. A large part of the adjustment process remains for the future, therefore. It is in that spirit that the issues set out below may be of some value in supporting the central policies which have already been identified.

Improving the national accounts

It is in times of crisis that information on the way in which the economy is working becomes most important. As the centre piece of information on the real (i.e. non-financial) economy, the national income accounts are crucial in this regard. And, in Barbados, they suggest some cause for concern. Of the main aggregates with the national accounts, the household consumption figure is not based on direct (survey) information and may, therefore, have drifted away from reality over time. Our difficulty in reconciling the available data on consumption and wage trends has been noted earlier and it may be that a direct monitoring of any future changes in living standards via a continuing household survey would be appropriate at this time. It would then be an obvious next step to build such survey information into the national accounting estimates. Import statistics are another area for concern. The substantial compression achieved over the decade of the 1980's has been noted previously. As an addition to it the further compression which was apparently achieved in the process of stabilisation is quite remarkable, to a point at which it is only prudent to ask if the figures might not be reliable. It is important to review the underlying methodology, therefore, as part of a general effort to improve the estimation of GDP, which is, after all, the base against which the new value added tax, which is to be a central feature of the proposed fiscal reforms, is to be levied. Indeed, the introduction of VAT, which necessarily involves the setting up and maintaining of a register of establishments, provides an excellent opportunity to promote the construction of national accounts from an establishment-based enquiry. There is no tradition in Barbados of going beyond the figures for GDP to attempt an estimate of the national income. The main difficulty is to develop suitable statistical monitors for offshore activity, especially in the financial sector. It will be important to try and fill this gap if issues, such as the fiscal impact of this off-shore activity, are to be assessed.

Consultative processes

While the national accounts provide one sort of information another, which is just as important, is the information to be obtained via a process of consultation on different aspects of the structural adjustment process. Two areas in particular would seem to be important, one of which can be accommodated within the tripartite dialogue provided for by the established protocol. This first area concerns the process of transition from the present trade regime to the more open, competitive structure which is envisaged for the future. The transition must necessarily involve dismantling the superstructure of protection of various

forms - tariffs, quotas, etc. This could well result in serious dislocations of production and employment if the whole process is not sequenced and tempered in relation to the specific issues which arise in relation to specific commodities. Active dialogue with manufacturers and the trade unions is the evident first step to getting this right.

A second and somewhat different agenda for dialogue concerns the identification of those areas of public expenditure where cuts can be made with the least harmful effects on vulnerable individuals and families. Non-government organizations often female dominated and trade unions are much better informed on these questions of social priorities and have become increasingly articulate on the implications of structural adjustment in recent years. They should be listened to, because the impact of cuts falls largely on their constituency.

Public utility pricing

Cuts in expenditures are unavoidable as a part of the effort to control the fiscal deficit. But they can be kept to a minimum by raising revenue from new sources when this is otherwise appropriate. In Barbados there is a *prima facie* case for raising revenue via a thorough review of public utility pricing policies. As matters currently stand public utility pricing policies are out of date in some key areas and there is potential, accordingly, for raising considerable sums of money by developing a new set of pro-active policies which can rest firmly in their own economic logic. Water, sewerage and telephone charges are all suitable candidates for review.

Local telephone calls are free in Barbados with the result that the number of lines which can be served by any one local exchange is only about two thirds of the number that one would expect from international norms. This is grossly inefficient. While recognising that networking on the telephone is a part of the Barbados way of life, it remains arguable none-the-less, that this is one part of their way of life that people would be prepared to let go if they were faced with the genuine alternatives, which may turn out to be cut backs in hospital services, or in education, or both. The introduction of charges for local telephone calls has the potential for raising a significant contribution to total revenue in a progressive way, at the same time as improving the efficiency of resource allocation.

Similarly, water and sewerage charges based on marginal social costs are appropriate on grounds of efficiency, yet it is only now, and in association with improvement schemes, that realistic charges are being introduced. Barbados has a finite supply of sweet water which is being depleted. Something needs to be done about this on grounds of sustainability, and especially if the tourist industry is to grow while retaining its quality differential relative to other resorts. The case for discouraging waste by charging whatever it takes to re-establish sustainability is a strong one. Since there are various possibilities for protecting the poor through split tariff schedules or other means, the counter argument in terms of equity cannot be invoked in this case. The present generation in Barbados is mortgaging the future for its children by depleting the sweet water reserves. A time of fiscal stringency may define an opportune moment for doing something about this.

Protecting the environment

Sewerage raises similar concerns to those associated with potable water. Being a relatively compact island, Barbados has traditionally pumped effluent into the sea, to the point that the environment is being seriously effected. The damage to the coral reef off the west coast is probably irreparable, and this fact already tarnishes the attraction for tourists of some traditional centres. Again, there is a very strong case for Barbados to charge for the externalities generated by sewerage to the point at which people in general, and the tourist industry in particular, has an incentive to see something done about it in terms of improved

treatment plant and the release of effluent at greater distances from the shore, which is an aspect of this matter which concerns cruise traffic just as much as the hotel sector.

It is argued that the international tourist industry is highly competitive, so that Barbados cannot afford to have higher standards for sewerage disposal than other islands in the Caribbean. That argument rings a little hollow, however, given the claim to be a quality resort. Moreover, it seems likely that as the Caribbean in general becomes increasingly polluted, tourists will become increasingly sensitive to this issue. Improved methods of sewerage disposal may then become a key element in the strategy for retaining a market share.

Another respect in which the attractions of Barbados as a tourist destination could usefully be enhanced would be to rehabilitate some of the significant historical sites and museums on the island. While the sugar industry is now greatly reduced in Barbados, its history endures and could usefully be exploited, along with the island's natural history, as a part of the package of policies which can help to secure the future for the tourist industry.

The success or failure of structural adjustment in Barbados will depend on the island's ability to remain an attractive place for foreigners to visit, to invest in and to work. The need, then, is to fine-tune a generally sound macro strategy to this specific area of comparative advantage.

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