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Address by
Mr. Cleviston Haynes
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Barbados' Economic Recovery: Adjustment, Adaptation and the Way Forward

I welcome this opportunity to address this distinguished gathering of executives of corporate Barbados. Ever since I assumed the post of Governor, both your current and immediate past Presidents have sought to have me join you for one of your monthly meetings, secure in the knowledge that there is no such thing as a free lunch. The price of my attendance has always been that I use the occasion to share with you the Bank's perspective on the performance of and prospects for the Barbados economy. Let me assure you that the delay in accepting your kind invitation was not due to the price but to the fact that, until now, we were unable to align our schedules.

At the outset, let me indicate the Bank's desire to foster a closer working relationship with the Chamber which, in its long history dating back almost two centuries, has witnessed several troughs and peaks of the business cycle in Barbados and elsewhere. During tough times this experience has imbued your membership with the type of resilience that is now needed as we face critical economic challenges as a country. The Bank is a much younger institution but over its life, it has shown and continues to demonstrate its ability to adapt and rise to the challenge.

I believe that both of our organisations have a common interest in seeing the Barbados economy prosper and that our mutual interests can be pursued through enhanced collaboration in a spirit of cooperation and partnership. In this regard, there is an opportunity to strengthen the links between the private and public sector through regular exchanges of information on economic developments and emerging trends. As you are aware, the Bank provides the public with regular analysis and economic forecasts and we are firmly of the view that good forecasting and policy analysis requires timely and good quality data.

I look forward, therefore, to concluding an information sharing agreement with the Chamber that will create the framework for our respective institutions to provide each other with relevant economic data, while maintaining appropriate levels of confidentiality for firm level data. This should enable the Bank to meet its domestic and international obligations while allowing the private sector to benefit from timely access to economic data for planning.

The theme of my remarks today is **Barbados Economic Recovery, Adjustment, Adaptation and the Way Forward.** This is appropriate as we are fewer than two months into a programme with the IMF and there have been several encouraging signs within recent months. My presentation is divided into four parts. Firstly, I will place in context the need for the recovery programme that we are undertaking. Secondly, I will highlight some lessons that can be gleaned from our recent experiences. Thirdly, I will discuss key aspects of the adjustment programme, before examining how the private sector can contribute to the overall recovery.

Context for Recovery

The state of the domestic economy has been widely discussed in recent months because of its prolonged under-performance that ultimately resulted in the decision of the new administration to pursue a deep fiscal adjustment, comprehensive debt restructuring and structural reforms with the support of the International Monetary Fund. These measures are intended to correct fiscal imbalances, secure meaningful and gradual debt reduction, reduce financing needs and restore macroeconomic stability.

Understanding the policy approach adopted by Government requires an appreciation of the context. The Barbados economy was slow to recover from the global financial crisis of 2008 and encountered multiple policy challenges. In particular, a fiscal crisis emerged that spilled over into an environment of a sustained low level of economic activity as delays in project and policy implementation contributed to a weakening of the investment environment. The international reserves declined and this raised concerns about the viability of the exchange rate peg. Public sector indebtedness, as measured by the debt to GDP ratio, rose sharply. Credit rating agencies, concerned about the ability of Barbados to service its debt, lowered the national credit rating well below investment grade, resulting in reduced access of Government to financing from both the domestic and foreign capital markets and increased debt servicing costs.

Government recognised the need for fiscal consolidation to address the challenges but the adjustment effort became protracted as policy initiatives fell short of their targets. Sequential reforms were made to the personal income tax and property taxes, new taxes were introduced and the value added tax was reformed and the rate increased to stabilise revenue as Government attempted to compensate for a substantial loss in revenue from foreign sources, principally from the international business sector. Expenditure restraint through some reduction in public sector employment and cuts in long-standing entitlement programmes were stymied by rising interest costs and transfers to state-owned enterprises. However, potential growth enhancing capital expenditure absorbed much of the expenditure adjustment. Some state-owned enterprises cushioned the impact on growth through their own capital works programmes but since these enterprises often lacked the financial capacity to service the ensuing debt, Central Government was subsequently forced to absorb the cost of these expenditures.

The fiscal deficit declined from its double digit peak but the persistence of deficits caused the debt to continue to rise, leading to a continuous deterioration in the sovereign credit rating and diminished access to funding. The ensuing cash flow difficulties encumbered Government's ability to make payments on a timely basis, resulting in an accumulation of public sector arrears to the private sector and the NIS.

Lessons from Past Crises

As we reflect on how we reached a situation that now requires a major policy adjustment, it is important for us to draw insights from this experience that might preclude a recurrence. In this regard, I want to touch on three inter-related lessons from past crises that remain relevant now as well as a new observation that has implications for how we adapt policy in the future.

First is the oft-repeated dictum that the sustainability of the pegged exchange rate requires an unwavering commitment to fiscal discipline. It should not be lost on anyone that each of Barbados' approaches to the IMF has been preceded by a significant weakening of fiscal discipline. There is an unquestioned tenet that the fixed exchange rate must be supported by adequate buffers of foreign reserves as a means of fostering confidence. Reserves may experience short-term declines, but over the long-term, it is important to preserve such buffers. Where imbalances between the demand and supply for foreign exchange arise, it is fiscal policy that has proven most effective in achieving macroeconomic stabilisation. By extension, relaxing fiscal prudence over a protracted period can undermine reserve buffers. What experience has taught us is that the ensuing adjustment will often need to be swift and deep to restore macroeconomic stability.

Secondly, Central Bank lending to the Central Government is not a substitute for fiscal prudence. As in 1991, accommodative monetary policy, through Central Bank lending, was a significant feature of the economic landscape on this occasion. While the Bank's support for Government was initially intended to be temporary, ostensibly to prevent a disorderly adjustment, while Government re-ordered its economic priorities, the persistence of the deficits and the retreat of domestic players from the local capital market placed added pressure on the Bank to accommodate Government. Initially, overall weak demand for private sector credit masked the negative impact of this response on the balance of payments, but, in hindsight, some persons have concluded that over the long-term the policy helped to delay the faster adjustment that was needed.

Thirdly, when the economic circumstances warrant, macroeconomic adjustment must be implemented and executed in a timely manner to reduce the severity of the fallout. Early action can preserve adequate fiscal and reserve buffers to enable the economy to absorb economic shocks. Delays in implementation, on the other hand, can facilitate a worsening of the situation and result in the need for tougher corrective measures.

What is New?

In 1991, the near depletion of the foreign reserves accelerated the approach to the International Monetary Fund. In the most recent crisis, there was a strong reserve buffer at the outset of the crisis that, together with initial on-going access to capital markets, dampened the adjustment effort even though there was downward pressure on reserves. Of significance, is that in 1991, Barbados was not integrated into the international capital markets and was not subject to the scrutiny of the rating agencies. The monitoring and frequent downgrades by these agencies underscored the need for greater fiscal discipline. Whether or not we agree with the assessments of the agencies, there can be no doubt as to their potential to alter perceptions about the sustainability of economic policy. From a policy perspective, we ignore them at our own peril.

Macroeconomic Adjustment and Economic Recovery

The economic situation as outlined earlier was clearly unsustainable and required strong credible corrective action. As we all know, just as effective medicine often seems unpalatable, so too can adjustment measures be unpopular.

To reverse the weak macroeconomic trends, Barbados is currently in the early phase of the execution of a home-grown economic recovery and transformation programme, the Barbados Economic Recovery and Transformation Plan (affectionately called BERT), which is supported by a four-year Extended Fund Facility arrangement with the International Monetary Fund. The framework set out under the programme is comprehensive and relevant, involving a mix of fiscal adjustment measures, reforms of the state-owned enterprises sector and other structural economic reforms intended to create a platform for sustainable long-term growth and promote foreign reserves accumulation, while restoring fiscal and debt sustainability over the medium term.

The anchors of the programme are by now well-known. First a primary surplus of 6% of GDP beginning F2019/20, based on improved revenue collection and expenditure reforms, particularly related to state-owned enterprises, represents a critical element of Government's effort to achieve sustainability. New tax measures have come on stream since June and the full year effect will be realised in FY 2019/20 as will the full scope of the expenditure containment measures.

Secondly, Government has committed to reducing the debt to GDP ratio to 60% by 2033. In this regard, a core element of the plan is the debt restructuring programme, which began with the recently concluded domestic debt exchange and which, it is hoped, will involve the external commercial debt in the not too distant future. The programme will reduce interest costs in the short term, eliminate financing constraints, facilitate payment of arrears and put the debt on a downward trajectory.

The implementation of these strategies has begun to yield encouraging results. Additional concessional loan financing totalling US$175 million from other multilateral development institutions, the Inter-American Development Bank and the Caribbean Development Bank, has been made available to Government. The receipt of these funds will significantly boost the external sector position, with the stock of gross international reserves now expected to exceed $1 billion by year-end or close to three months of import cover.

Government's cash flow position has improved significantly. Current year tax refunds are being paid, the NIS is now receiving its monthly transfers and the Government's overdraft account is being used infrequently.

Already, Standard and Poor's has upgraded Barbados' credit rating on local currency debt from selective default to B/B-. This represents an important first step towards rebuilding the international profile of Barbados and regaining the position of investment grade.

These are all positive signs which should raise confidence and help to stimulate growth enhancing investments. However more heavy lifting is required. Achieving long-term fiscal sustainability and strengthening growth prospects require effective implementation of structural reforms. In this regard, the Programme contains several structural benchmarks, including initiatives to strengthen tax policy and administration, upgrade public financial management and to reform the operational framework for State-owned enterprises. In addition, enhancements to the growth and business environment are planned to address the perennial weaknesses in the business environment that could potentially constrain the generation of greater foreign and local direct investment.

Let me highlight three of the critical elements of the reforms. First Government has committed to undertake a comprehensive review of the tax system. This pledge has gained new impetus in the wake of last week's announcement of the plan to converge the corporate tax rates for international and domestic companies. This decision is likely to simplify the tax framework and it will have implications for the wider tax system, including the overhaul in the structure of personal income taxes and transactions based taxes.

Domestic profit making companies should see this development as an opportunity to use their increased cash-flows to finance new investment from internally generated funds. The adoption of new technologies and investment in employee development should have a better after-tax return that allows firms to be more competitive. I wish also to encourage firms to consider using this windfall to accelerate the thrust towards adoption of alternative energy as a means of reducing Barbados' use and reliance on fossil fuels.

Second, we have an opportunity for much needed reforms of the SOE sector. These include revising the Financial Management and Audit Act to permit improved oversight of SOEs, requiring improved timely financial reporting by SOEs and reviewing the tariff structure of these entities. Reducing transfers to SOEs is an essential element of the fiscal adjustment. However, reforms must be seen not simply as a means of generating financial savings. Instead by enhancing their operational efficiency, SOEs can contribute to improved competitiveness. In addition, timely financial reporting must not be seen simply as a programme requirement but rather as an opportunity to strengthen governance and inadequate accountability. Building on the gains achieved in recent months should create an ingrained habit that will help to inform decision making within the enterprise and by the relevant Ministries.

Third, we have the opportunity to lock in the gains of this fiscal adjustment through the adoption of fiscal rules such as the debt to GDP anchor. The choice of rules and mechanisms for monitoring compliance are yet to be determined, but going that route will help to create a framework for fiscal discipline. Future governments will be expected to adapt their policies in line with the rules during normal times to ensure compliance.

The road to recovery is multi-faceted and cannot be achieved solely through fiscal policy, legislation or rules. For example, we know that strengthening the economic recovery also involves building strong institutional capacity that supports and encourages a good investment climate. Experience has shown that sound political and economic institutions create a solid foundation of economic growth by way of good governance, the maintenance of the rule of law and political stability.

It requires growth-enhancing structural economic reforms that foster an environment for increased export earnings through improved efficiency across the economy. Government has committed to addressing public sector efficiency by removing stifling and inefficient bureaucratic practices. However, to be successful requires the collective and coordinated efforts of all key stakeholders. Indeed, we have to forge our collective efforts over the next four years not only with the common goal of stabilising the Barbados economy, but also preparing our citizens for the recovery and transformation of economic production to the next stage of development, which is the digital transformation and the development of a knowledge-based economy.

Transforming the economy must be predicated on innovative thinking and creative solutions, entrepreneurship, and the improvement in productivity across both the public and private sectors, thereby raising the level of international competitiveness of those goods and services in which we have a relative comparative advantage. Given the structural characteristic of a narrow production base, we are likely to be internationally competitive only in a few economic activities, namely tourism, business, educational and financial services, niche manufacturing, some agro processing and renewable energy production. The transformation of the economic structure has to be premised on building and sustaining that competitive edge, while encouraging greater long-term investment inflows that expand the existing infrastructure to improve our foreign exchange earning capacity.

As Barbados continues on the path to a higher level of development, innovation and business sophistication must play a critical role in the enhancements in productivity and economic growth. The impetus for innovation thrives best where businesses regulations and social norms promote connectivity, creativity, entrepreneurship, collaboration and the adoption of the latest technologies to generate new ideas and to bring new products and business models to the market. The global economy is moving full speed ahead into the fourth industrial revolution, which is driven by technological breakthroughs in areas such as artificial intelligence, robotics, and biotechnology and hence the scope to enhance economic activity in Barbados will depend on the pace and depth of the embrace of technological change.

Therefore, I cannot emphasise too much that the challenge for policy makers and the private sector is to focus on enhancing the competitiveness structures in the context of a global economic environment that is constantly evolving and becoming much more difficult to navigate, especially with the threat of protectionist policies by some countries. In this regard, both the public and private sectors need to continue to leverage and adopt innovative technologies to expand production possibilities. In essence, we simply cannot keep doing things the same way.

We must enhance the quality of the labour force through skills development and must help workers to retool their skills sets, especially in the drive of building a knowledge economy in which the production of goods and services is based on the use of the knowledge-intensive inputs and intellectual capital of the labour force. These inputs reflect the broad 'intangible talents' that may be acquired and honed through experience, training and retraining, learning by doing and research and development.

It is irrefutable that investment is a critical factor for sustaining economic growth, whether in the form of public sector capital expenditure or private foreign direct investment or both. What matters is not just the total amount of investment, but the quality and split between public investment and private investment. At this stage in our development, Government is unable to provide the expansive level of public investment as it did previously, which requires economic growth to be more deeply stimulated by the private investment and activity.

The Way Forward

When one considers the scope of the fiscal adjustment and reforms that Barbados must undertake over the next four years, it is important to reiterate that the economic recovery requires the collective support and commitment of key stakeholders, the Government, private sector and trade unions, and the civil society. The improvement in productivity, innovation and entrepreneurship must underpin this commitment and demonstrate our national resilience. Let us rally together to ensure the Barbados economy is returned to a sound footing over the medium term, by rejuvenating economic growth, building foreign currency reserves, reducing the national debt, and restoring the international credit rating.

Thank you.