

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**IDB COUNTRY STRATEGY  
WITH  
BARBADOS**

**November 2005**

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## ABBREVIATION

AFS	Audited Financial Statements
BCI	Business Climate Initiative
BLP	Barbados Labour Party
BOP	Balance of Payment
BWA	Barbados Water Authority
CDB	Caribbean Development Bank
CDERA	Caribbean Disaster Emergency Response Agency
CDM	Comprehensive Disaster Management
CEA	Country Environment Assessment
CFP	Country Financing Parameters
CRNM	Caribbean Regional Negotiating Machinery
CROSQ	Caricom Regional Organization for Standards and Quality
CS	Country Strategy
CSME	Caricom Single Market and Economy
DLP	Democratic Labour Party
EDF	European Development Fund
EIA	Environmental Impact Assessment
EU	European Union
FSO	Fund for Special Operation
GDP	Gross Domestic Product
GOBA	Government of Barbados
HDI	Human Development Index
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
MDG	Millennium Development Goals
MIF	Multilateral Investment Fund
NISE	National Initiative for Service Excellence
NLF	New Lending Framework
NSP	National Strategic Plan
OC	Ordinary Capital
OVE	Office of Evaluation and Oversight
PCMIS	Project Cycle Management Information System
PEIF	Public Expenditure Investment Fund
PEUs	Project Execution Units
PPP	Public Private Partnership
PRI	Private Sector Development
PROPEF	Project Preparation and Execution Facility
PSDS	Private Sector Development Strategy
PSIP	Public Sector Investment Program
REER	Real Effective Exchange Rate
ROS/DAU	Disbursement and External Audit Office
RULC	Real Unit Labor Cost
SWAp	Sector Wide Approach
TII	Tourism Intelligence International
UNDP	United Nations Development Program
VAT	Value Added Tax
WEF	World Economic Forum

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## EXECUTIVE SUMMARY

**Development challenges.** Barbados is confronting major new challenges in maintaining international competitiveness in the face of global liberalization and preference erosion, while it continues to face the problems typical of small, open, island economies – vulnerability to international economic shocks and natural disasters, an undiversified production structure, and high infrastructure costs relative to population and tax base. Institutional weaknesses in both the public and private sector compound these problems. In the current environment of globalization and greater regional integration, the urgency to improve competitiveness is increasing.

The country has experienced moderate economic growth since 2003, recovering from a sharp downturn in 2001-2002. Its macroeconomic conditions are generally stable, but a deteriorating balance-of-payments trend and high debt ratio are causes of concern. Government and government-guaranteed debt is expected to remain virtually unchanged at the current level of around 87% over the next 3 years. Despite fiscal improvement in the last two years, the need to reduce the debt burden makes fiscal and debt management a critical focus of economic policy.

In the medium term, Barbados needs to make a transition from its traditional ways of management and doing business to approaches that will provide higher performance in a more competitive, information and technology-driven international environment. Consequently, this Country Strategy (CS) proposes that the main theme of Bank activity in Barbados over the period 2005-2008 should be to help lay the groundwork for a more competitive economy, better able to sustain economic growth and withstand the occurrence of international shocks.

The economy has shifted toward increased dependence on services while the merchandise sectors are showing declining competitiveness and export performance. The tourism industry is the clear engine of growth in Barbados today, providing the backbone around which the economy as a whole is organized. Although studies have shown that Barbados is an industry leader in terms of tourists' and tour operators' assessments of its product, Barbados will need to maintain and even improve the quality of its tourism product, contain costs, rejuvenate attractions and pursue new high value-added niches if it is to preserve its competitiveness as a tourist destination in the future.

The SME sector is a potential source of increased employment opportunities, but its growth is limited by inadequate access to credit and business development services, the lack of entrepreneurial training, and a lack of SME awareness of the opportunities and hurdles presented by changes in the international economic environment. Moreover, market access and taxation and customs are identified as problem areas, and transport infrastructure has emerged as a major obstacle to a favorable business climate due to high traffic congestion.

Growth in Barbados' trade with CARICOM has outstripped its total trade growth since the establishment of the Community in 1973, and the region represents a key market for

Barbadian products and services in the future. The establishment of a CARICOM Single Market and Economy (CSME) will add urgency to efforts to restructure the Barbados economy for greater efficiency and competitiveness to meet the challenges of increasing regional competition and the free movement of labor.

Although Barbados has attained high standards in education, major gaps persist with respect to skills and productivity relative to the needs of the productive sectors. The institutional framework for the labor market is relatively sound, but needs updating to increase flexibility and in light of the technological changes that are transforming the way the international marketplace functions.

There are significant signs that the international competitiveness of Barbados has weakened in ways that could undermine future sustained growth over the medium to long term. Labor productivity indicators show decline in recent years and the investment-GDP ratio has fallen from 25% in 1980 to just over 15% in 2002.

In light of these challenges, the government's development strategy for the next five years sets high priority on making the transition to a more competitive economy and recognizes the role of public sector reform in this process.

**Impact of previous strategy and lessons learned.** The Bank is Barbados' most important multilateral development partner. Bank financing accounted for 17% of total capital expenditures and 64% of total project financing from foreign sources over the period 2001-2004. However, the Bank's contribution to Barbados' development extends beyond the direct impact of the lending portfolio. The quality of the technical assistance that the Bank facilitates makes a high value-added contribution in Barbados, although it is difficult to quantify. Bank operations and non-financial products such as studies and policy dialogue have informed policy initiatives by the Government that directly address key constraints to the country's development and contribute to future investments, whether or not the Bank finances them.

A detailed analysis of development impact makes clear that the previous CS was overly ambitious and could not accomplish many of its objectives. Nevertheless, the Bank did play a key role in certain sectors, through technical support provided by previous projects and during project design. The Bank's contribution appears to be strongest in the sectors where support was provided over a long period of time, spanning several Country Strategies – in education, the environment and, to a lesser extent, economic management capacity. This implies the need for a long-term commitment to address specific development challenges, building on the understanding of the country context and relationships with the government in existing programmatic areas.

A number of initiatives from the previous CS were cancelled, postponed or suffered major delays in execution, indicating that project development and implementation problems are major obstacles limiting development effectiveness. As a result, the new CS will give significant attention to addressing the root causes of these delays. The focus of the CS and operations will be narrower. To improve execution, projects should be of moderate size and anticipated duration, and have relatively narrow and well-defined

objectives or utilize a phased approach. The Bank needs to be more cautious in its approach to projects that may be affected by policy issues and if required, provide support to address such issues before launching new investment projects. Slow project execution has affected not only the Bank's portfolio, but also the programs of other development agencies, and it is acknowledged as a problem by the GOBA itself. One objective of the institutional strengthening proposed by this CS is improvement in project execution.

**Country strategy objectives.** This CS presents a renewed framework for Bank activity in Barbados, in light of the country's strategic development objectives and prevailing domestic and international economic prospects. The CS provides continuity with the previous CS in terms of its development objectives, emphasizing competitiveness and the promotion of private sector-led growth. However, it proposes a less ambitious operational program and the use of new instruments to address institutional, policy and technical issues.

The overall goal of Bank support in Barbados for 2005-2008 is to strengthen competitiveness as a basis for sustained growth and improved well-being of the population. The specific objective of the CS is to raise the capacity of Barbados and its businesses to compete in a changing international economic environment. Strengthening competitiveness in this context means improving economic efficiency and productivity, resulting in higher profitability, production and performance in domestic and foreign markets.

The CS is geared to address public sector institutional weaknesses, including support for the government's efforts to strengthen program management and implementation, improve tax administration, and reform policies and management in key sectors and institutions. In addition, the CS calls for the Bank to continue to monitor and reinforce implementation of prudent macroeconomic policies through ongoing country dialogue, focusing on improving the fiscal balance and containing debt.

The CS also focuses on strengthening competitiveness through improvements in human and physical capital and capacity building that directly impact private sector environment and performance. It will address key areas identified by the studies that were carried out in preparation for this CS, including: labor market reform and improvement of private sector management practices in line with international practice; SME and entrepreneurship development; strengthening service orientation; expanding market access; enhancing human resource development; neighborhood upgrading and transport improvement. Most of these areas will be addressed with technical assistance and institutional strengthening facilities.

**Operational program.** This CS proposes an operational program of 9 operations totaling \$65.7 million. The emphasis is on small projects and non-financial cooperation, given fiscal constraints and the appropriateness of such operations for needed institutional strengthening and capacity building. The highlight of the indicative operational program is a competitiveness program loan, for which the Bank will explore the use of flexible modalities provided under the new lending framework to provide access to resources for feasibility studies, action plans, training, policy and institutional reform, capacity

building and related investments. The operational program also includes 1 investment loan, 2 reimbursable TCs and 5 sector facilities for institutional strengthening.

**Private sector operations.** The CS's focus on improving the environment for private sector led growth implies a significant role for the private sector instruments of the Bank. However, at present, the Inter-American Investment Corporation (IIC) and Private Sector Department (PRI) have no operations in execution or in the pipeline in Barbados. The Multilateral Investment Fund (MIF) has one project in execution and one in the pipeline. In Barbados, the context of the tripartite agreement of business, labor and government makes it crucial to build consensus among the three partners to improve the investment climate and pave the way for a greater role for the Bank's private sector group. Bank efforts to raise the involvement of its private sector arms and more specifically define their roles are being supported by the ongoing preparation of the Private Sector Development Strategy (PSDS) and associated business plan as well as the BCI Action Plan. In addition, the government is seeking to make a better use of public resources through public-private partnerships for financing the construction of infrastructure and provision of services; the Bank will support GOBA's efforts to strengthen its ability to manage and monitor relationships with the private sector in order to obtain the greatest benefits at the lowest cost.

**Risks.** The main strategy implementation risks are: (i) continued implementation weakness; (ii) international shocks that can have major economic impact (e.g., rising energy costs); and (iii) hurricane disasters that could damage the tourist industry and cause destabilizing, unanticipated fiscal expenditure. The measures proposed by this CS will help achieve the institutional strengthening, economic diversification and growth that are necessary to lessen these risks. Regional operations and non-financial products in the areas of energy and disaster management will help Barbados cope with these risks as well.

**Issues for dialogue.** Issues for dialogue include macroeconomic conditions, policy options for reducing the adverse impact of rising oil prices on the balance of payments and investment, and the alternatives for improving program execution provided by the Bank's new procurement policy and new lending instruments and the PRODEV.

**STRATEGY MATRIX — BANK COUNTRY STRATEGY WITH BARBADOS, 2005-2008**

**STRATEGIC OBJECTIVE: To Raise the Capacity of Barbados and its Businesses to Compete in a Changing International Economic Environment**

Country's strategy	IDB's strategy	Actions of other agencies	IDB actions		Performance Indicators
			Ongoing	Proposed	
Maintain an environment of macroeconomic stability	Support maintenance of stable macroeconomic conditions  Support measures to improve efficiency and effectiveness of govt. revenue services	<b>IMF</b> --periodic Article IV monitoring  <b>CARTAC</b> technical assistance	Country dialogue  Preparation of Customs Excise and VAT Modernization Project	Strengthen GOBA capacity to implement PPP options  Support additional measures to strengthen revenue services, including possible merger of government revenue agencies	Maintain <b>IMF baseline scenario for fiscal deficit and debt</b> : <ul style="list-style-type: none"> <li>▪ <i>Deficit/GDP</i>: baseline (2005 est.)= 6.9%; targets – 2006= 4.6%; 207= 3.3%; 2008= 3.2%</li> <li><i>Debt/GDP</i><sup>*</sup>: baseline (2005 est.) = 88%; targets—2006= 88%; 2007= 87%; 2008= 86.8%</li> </ul>
Improve the international competitiveness of Barbadian products and support the diversification and growth of business activity	Support institutional and policy reform and other initiatives to strengthen the environment for investment, international trade and local business growth		Support for the National Productivity Council  Strengthening Business Facilitation Services (CAIPO)  PSDS and BCI Action Plans  CS competitiveness and labor market diagnostics  Customs, Excise and VAT project in preparation	Support development, consensus building, execution of activities to strengthen competitiveness  Support adoption of labor market reforms to improve flexibility and adaptability to technological and economic changes  Support efforts to strengthen entrepreneurship and SMEs  Support strengthening of standards and laboratory facilities  Support strengthening of business and country-wide service orientation	Adoption of consensus-based <b>national strategy and action plan for competitiveness</b> with timetable, budget and benchmarks by end 2006  <b>Growth of annual export earnings</b> : <ul style="list-style-type: none"> <li>▪ Baseline (Avg. 1994-2003): Barbados= 4.0%</li> <li>▪ Target (Avg. 2005-08): 6%</li> </ul>
Strengthen the physical and human capital needed for private sector growth	Support improvement in transport, neighborhood and environmental infrastructure  Support human capital strengthening through housing, education and training	<b>CDB</b> - Education Sector Enhancement Program; Secondary Education Project; Urban Rehabilitation Program  <b>EU</b> – Support to Barbados Language Center; Health Sector SWAp	Projects in Execution: <ul style="list-style-type: none"> <li>▪ Bridgetown Roads</li> <li>▪ Solid Waste Management</li> <li>▪ Coastal Infrastructure</li> <li>▪ Education Sector Enhancement</li> </ul> Preparation of Housing and Neighborhood Upgrading Program	Support the development of a transport system master plan  Prepare TC project to support strengthening and rationalization of tertiary and vocational training	<b>Approval by cabinet of Transport Master Plan</b> with timetable, budget and performance benchmarks by end 2008 Ratio of gross capital formation to GDP rises from 15% to 20% by 2008.  New environmentally sound <b>solid waste facility fully operational</b> by end 2007  <b>Improved educational achievement</b> as measured by percentage of students scoring less than 30% on BSSEE: <sup>**</sup> <ul style="list-style-type: none"> <li>▪ Baseline: 1997= 25%<sup>1</sup></li> <li>▪ Target: 2008= 12.5%</li> </ul>

\* In this context, debt = total government debt plus government-guaranteed debt

\*\* Barbados Secondary Schools Entrance Examination

<sup>1</sup> This is the most recent figure available. A more up-to-date baseline will be discussed with the GOBA during the dialogue mission.

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			Ongoing	Proposed	
Improve the efficiency and effectiveness of public sector institutions and services	Support improvements in results-based management, accountability and efficiency	CARTAC	<p>Procurement seminars</p> <p>Finalization of TC for Strengthening Barbados Water Authority and related regulations and institutions</p>	<p>Prepare and approve procurement modernization project</p> <p>Use PRODEV resources to support development and implementation of Development Effectiveness Action Plan, including results-based management</p> <p>Provide additional support for strengthening water management, if required</p>	<p><b>Reduced average length of time for contract preparation and award:</b> Baseline will be established by end 2006; reduction in time of 20% by end 2008</p> <p><b>Results-based management systems being used</b> in 1 Ministry by end 2006 and in 3 Ministries by end 2008</p>
Support public and private sector management by improving the timely availability and dissemination of statistics	Support capacity building and functioning of national statistical services		Data collection on education as part of EDUCTECH project	<p>Prepare and approve TC project or sector facility to support modernization of statistical services</p> <p>Support establishment of WEF competitiveness ranking for BA and improve government/ stakeholders' ability to monitor and benchmark competitiveness</p>	<p>By end 2008 <b>statistics on labor, households, and competitiveness have been collected and published</b></p> <ul style="list-style-type: none"> <li>▪ Household surveys designed by July, 2007; first publication by end 2008</li> <li>▪ By end 2006 WEF <b>competitiveness ranking</b> baseline established ; by end 2008 BA ranking improved by 2 places over 2006 ranking</li> </ul>
Finance public sector investments with lower fiscal impact through use of Public-Private Partnerships (PPPs)	Provide assistance to strengthen GOBA capacity to apply PPP options most effectively			Support training and technical assistance to strengthen GOBA capacity to use PPPs to improve financing conditions and quality of infrastructure/ public services	Implementation of at least one <b>PPP agreement with reduced fiscal and debt impact</b> by end 2008***

\*\*\* Requires development of system to evaluate fiscal and debt impact and establishment of baseline based on past agreements. To allow measurement of this indicator in 2008, the system must be in place by end 2007.

## I. INTRODUCTION

### A. Background

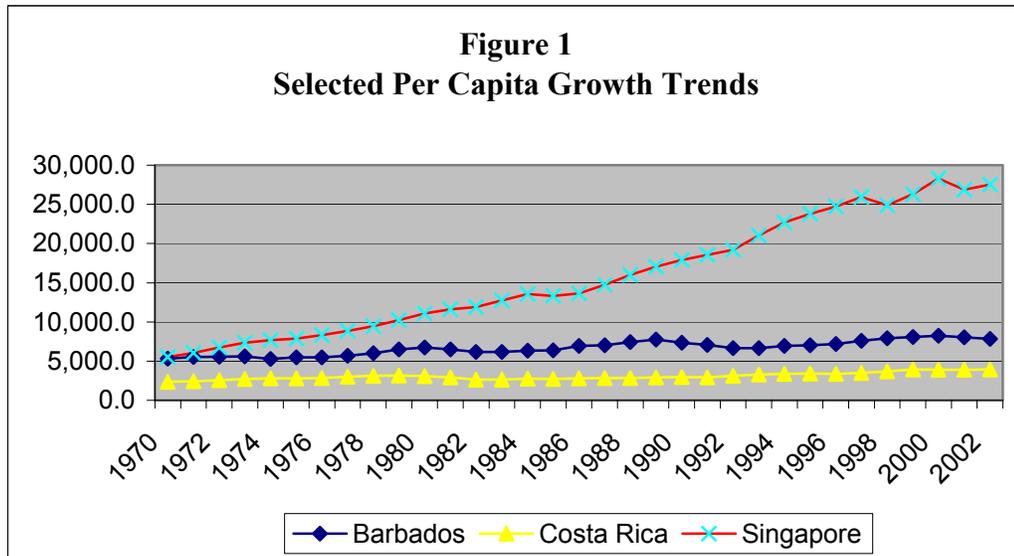
- 1.1 This Country Strategy (CS) document presents a renewed framework for Bank activity in Barbados, in light of the country's strategic development objectives and prevailing domestic and international conditions. The last Barbados CS was approved in 1999, aiming to maintain support for a competitive export-led development path for the country, and for strengthening of the social and economic infrastructure underpinnings of sustainable economic growth. Since 1998, the Bank has continued to contribute to Barbados' development process, by means of its lending programs, technical cooperation and non-financial assistance, all of which conformed to the strategy. However, project preparation and execution have been subject to major delays, warranting the application of particular attention to this matter in the new CS.
- 1.2 As a small, middle-income country, Barbados presents unique challenges for determining strategy formulation and the role of the Bank in the country. The country's middle-income status and access to financial markets suggest that it will rely less on Inter-American Development Bank (IDB) financing for investment projects, while technical cooperation is still important to build institutional capacity. Smaller countries like Barbados cannot take advantage of economies of scale in project preparation and execution as larger countries can. In addition, the resulting small contracts can lead to procurement problems, as major contractors are not as interested in bidding on them. Therefore, the formulation of the CS poses the challenges of how the Bank can stay relevant in Barbados, what adaptations in procedures and instruments are necessary to minimize the costs of doing business and how to shape approaches so as to maximize development effectiveness.
- 1.3 The CS preparation has been informed by a process of analytical studies and dialogue with major stakeholders in the country, including two workshops to discuss the study findings, with other donor participation. A high degree of consistency was observed between the Government of Barbados (GOBA) and the Bank with respect to the diagnosis of challenges and priorities, in the course of the workshops and consultations.

### B. Economic Context

- 1.4 **Growth with stability.** Barbados has achieved a per capita income level of US\$10,000 (US\$15,000 in PPP terms), placing it in the middle-income category. As such, Barbados has made a transition from a crisis-ridden economy in the early twentieth century, at the mercy of fluctuations in the dominant sugar industry and exhibiting high unemployment, inadequate social conditions and poor infrastructure, to a modern developing economy, partly through diversification

into services, especially tourism and financial and business services (Downes 2001).

- 1.5 As Figure 1 shows, Barbados has reached its present state of development through a process of slow but steady growth (averaging about 2% annually) over a period of decades. While there has been some volatility, there have been no sharp reversals. The slow but steady growth trend reflects partly an approach to economic management that emphasizes the need to maintain a critical balance between growth and stability.



- 1.6 Despite the progress Barbados has made, its small size gives it limited resources, and it remains vulnerable to economic and natural shocks that can undermine growth and stability. The competitiveness of the country needs to be strengthened in order to consolidate the gains so far achieved and assure its citizens of continuing improvement in living standards.
- 1.7 **Recent macroeconomic trends.** After averaging 3% growth annually from 1993 to 2000, the economy experienced a sharp downturn in 2001, attributable to a threatened slowdown in the international economy that was aggravated by the effects of the September 11 terrorist attack in the United States. This downturn persisted into 2002 with a cumulative Gross Domestic Product (GDP) reduction of 3.5% over the two years. In response, the government followed a counter-cyclical policy that resulted in a widening of the overall fiscal deficit (including off-budget expenditure) to 11.6% of GDP and a debt/GDP ratio (including government and government-guaranteed debt) that grew from 74% in 2000 to 86% in 2004.

1.8 Since 2003, the Barbados economy has experienced a recovery with GDP growth of 2.0% and 4.4% in 2003 and 2004 respectively, boosted by 6.7% annual growth in the tourism industry. Inflation has remained below 2% annually and the fiscal deficit has narrowed. According to IMF estimates, the central government deficit has contracted from 5.6% of GDP in 2002/2003 to 2.7% in 2004/2005, close to the targeted 2.5% of GDP. Meanwhile, off-budget spending contracted from 6.0% of GDP in 2002/2003 to 0.7% in 2004/2005. However, the widening balance-of-payments (BoP) current account deficit, which reached 11% of GDP in 2004, and the high debt/GDP ratio remain areas of weakness.

INDICATOR	UNIT	2000	2001	2002	2003	2004	2005 <sup>e</sup>
Real GDP	% change	2.3	-2.6	0.5	2.0	4.4	3.1
Inflation	%	2.4	2.8	0.2	1.65	1.4	3.2
Unemployment	%	9.2	9.9	10.7	10.1	9.8	10.0
Fiscal balance: Central Government*	% of GDP	-1.9	-4.2	-5.6	-2.4	-2.7	-3.4
Fiscal balance: including off budget spending*	% of GDP	-1.3	-4.7	-11.6	-5.4	-3.5	-4.5
BOP Current account balance	% of GDP	-5.7	-3.7	-7.5	-6.9	-10.5	-10.4
Central Gov. debt	% of GDP	64.1	73.6	78.4	75.3	74.5	74.7
External national debt	% of GDP	22.6	29.2	27.1	27.2	27.3	26.4
Government and government guaranteed debt	% of GDP	74.1	82.9	86.9	85.0	86.1	88.0
Net international reserves	months of G&S imports	3.7	5.7	5.8	5.8	3.8	2.9

Source: IMF ; e: estimated; \* Fiscal year basis

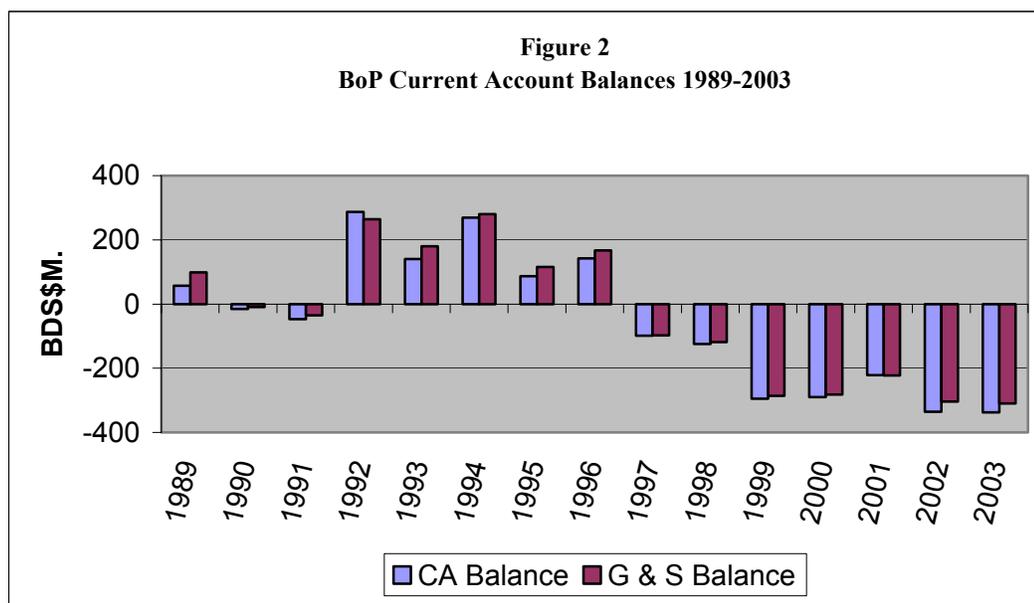
1.9 **Debt and fiscal management.** Despite fiscal improvement in the last two years, the need to reduce the debt burden makes fiscal and debt management a critical focus of economic policy in Barbados. The overall fiscal deficit (including extra-budgetary spending) narrowed to 3.5% of GDP in 2004 after reaching 11.6% in 2002 as a result of countercyclical spending. However, the deficit needs to be narrowed further and the primary balance increased if the debt burden is to be reduced. The Government has committed to a gradual reduction of the debt/GDP ratio to the Maastricht target of 60%, aiming to take advantage of the favorable international economic conditions at this time.<sup>2</sup> However, current projections show central government debt declining from 74.5% of GDP in 2004 to 72.2% of GDP by 2008 while government and government-guaranteed debt remains virtually unchanged at around 87%. Consequently, particular emphasis has to be placed on spending reduction and institutional improvements that would help to eliminate the deficit of the public enterprises and reduce transfers. The GOBA is also proposing a shift toward more debt retirement out of future divestments.

<sup>2</sup> Ministry of Finance and Economic Affairs, Economic and Financial Statements of the MFEA, 2003 and 2004.

## II. KEY DEVELOPMENT CHALLENGES

### A. The Competitiveness Challenge

- 2.1 The most fundamental challenge confronting Barbados at this time is the need to raise its level of competitiveness relative to that of its main trading partners. According to the Bank's Competitiveness Strategy, competitiveness at the country level is defined as, "the quality of the economic and institutional environment for the sustainable development of private productive activity and the increase in productivity." The competitiveness of firms depends on country-level competitiveness as well as specific product markets and the firms' internal characteristics. In accordance with the Bank's definition, Barbados' competitiveness has already been showing symptoms of decline in recent years, especially in manufacturing and agriculture.
- 2.2 The clearest overall indication of the weakened competitiveness of Barbadian products is the drop in the country's BoP current account balance –from a comfortable surplus in the early 1990s to a widening deficit in more recent years (Figure 2). Barbados' merchandise exports, which grew by only 1.4% per year over the last decade compared to 6% worldwide.



- 2.3 **Merchandise exports.** In general, studies have found that Barbados does not have a competitive merchandise export sector (Thomas 2005, Jessen and Vignoles 2004, Hertford 2005). For example, an analysis that divided the top 30 Barbadian exports into 4 categories of performance, i.e., champions, underachievers, achievers in adversity and declining sectors, found the largest number of products

to be underachievers, followed by achievers in adversity (Jessen and Vignoles 2004).<sup>3</sup>

- 2.4 **Sugar industry.** The contraction of the sugar industry has played a major role in declining merchandise export earnings, as sugar earnings declined from BDS\$106 million in 1980 to BDS\$41 million in 2003. Sugar exports fell from 184,000 tons in 1967 to 34,600 tons in 2003 and total production declined from 204,000 to 36,000 tons. Barbados is a high cost producer (prices are an estimated 55% of production costs) and the opportunity costs of the land used are high, so that the industry is sustained with the help of a government subsidy. The future of the industry is questionable, especially in light of an expected 39% cut in the preferential prices obtained on the European Market. Sugar production for fuel grade ethanol may be an option, as studies show it becoming profitable at oil prices above US\$30 per barrel (Hertford 2005). The present movement of prices above US\$60 per barrel raises the viability of this option.
- 2.5 **Tourism.** The tourism industry has emerged as the clear engine of growth, providing the backbone around which the economy as a whole is organized. The value added contribution of tourism is estimated at 15-20% of total GDP, but estimates based on the Tourism Satellite Accounts methodology indicate that tourism and travel account –directly and indirectly– for US\$1.3 billion, i.e., over 50% of GDP and about 58% of total employment in Barbados (Tourism Intelligence International 2005). In addition, an 80% correlation has been found between tourist arrivals and real GDP growth in Barbados (ECLAC 2003).
- 2.6 With the recovery from the effects of September 11, 2001, the growth in arrivals has averaged 7% over the last two years, and Tourism Intelligence International (TII) projects they will grow by 4.4% annually from 2004 to 2010. Nevertheless, Barbados has to maintain the quality of its tourism product, controlling cost factors, rejuvenating its attractions and strategically pursuing high value added niches. TII found that Barbados is an industry leader in terms of tourists' and tour operators' assessments of its product, with over 90% of visitors surveyed reporting they would definitely or probably return to the island. However, one area in which Barbados ranked poorly relative to competitors was "value for money," underlining the need to improve service delivery and cost competitiveness. TII also found that although sun, sand and sea will remain the main attractions, new niches including health and wellness present profitable prospects for Barbados. It is also important for Barbados to explore non-traditional markets in Latin America, Europe and Asia.<sup>4</sup>

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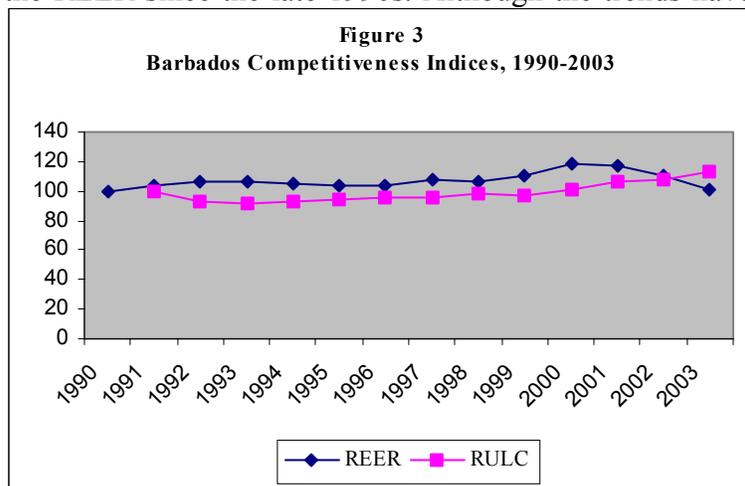
<sup>3</sup> Competitiveness of the products is categorized by comparison of the rate of growth of their export shares and world trade growth. Champions are products showing rising export shares in growing international markets, underachievers are products with declining export shares in growing markets, achievers in adversity are products with rising shares in contracting markets and declining sectors are products with declining export performance in contracting markets.

<sup>4</sup> 40% of Barbados visitors come from the UK and nearly 25% come from the USA.

2.7 **Declining investment rate.** Another sign of weakness is a downward trend in the investment-GDP ratio. This ratio fell from 25% in 1980 to just over 15% in 2002. Over that period, the Barbados ratio has averaged a higher percentage than Latin America and the Caribbean as a whole, but lower than the high-growth economies of Asia.

2.8 **Declining productivity and rising prices of exports.** Although data on productivity are limited, available indicators also suggest that productivity has failed to keep pace with wages. In addition, prices for Barbadian products have risen relative to those of trading partners. This is illustrated with reference to movements in the real unit labor cost (RULC), which shows the relationship between worker compensation and worker productivity over time, and the real effective exchange rate (REER), which reflects movements in the relative price levels of a country and its trading partners. An increase in the REER represents an appreciation in prices (and therefore declining competitiveness) relative to those of other countries and an increase in the RULC indicates declining labor productivity. As Figure 3 shows, there has been deterioration in the RULC since the early 1990s and in the REER since the late 1990s. Although the trends have not been sharp, they have been sustained.<sup>5</sup>

The fixed exchange rate parity of the Barbadian Dollar with the US Dollar limits the use of this lever of price competition, and therefore both quality and productivity are the key drivers needed for expanding Barbados' exports.



2.9 **Continued vulnerability.** Barbados continues to face some critical challenges typical of small, open, island economies. In particular, it faces vulnerabilities to international economic shocks and natural disasters, which are heightened by its undiversified production structure, and high infrastructural costs relative to population and tax base.<sup>6</sup> Barbados also needs to adjust to an increasingly liberalized trade environment and tighter conditions with respect to the availability of capital resources, resulting from likely increases in interest rates and declining availability of development assistance. These areas of vulnerability

<sup>5</sup> It should be noted that the REER of Barbados has been affected favorably by recent movements of the exchange rate of the US Dollar relative to the Euro and other major currencies. Estimates of the REER and RULC are obtained from Thomas (2005).

<sup>6</sup> *Towards a Barbados National Strategic Plan, 2001-2010.*

can severely undermine economic progress and stability in the future, and they raise the urgency of achieving a more competitive economy.

- 2.10 One vulnerability of immediate relevance is the country's dependence on imported petroleum products. The current round of rising oil prices raises the urgency of finding renewable alternative energy sources. Barbados produces a small amount of oil but its main source of energy is imported petroleum products, which in 2003 represented 12% of total import expenditure. Increased petroleum prices will affect Barbados by widening the current account deficit, given the lack of an automatic pass-through mechanism from international prices to consumer prices to curb consumer demand.
- 2.11 In the circumstances, Barbados needs to adopt both short-term and long-term strategies to address the problem of rising energy costs. In the short run, the emphasis would be on implementing measures to curb petroleum consumption in response to rising prices. In the long run, it is necessary to look for alternative and renewable sources of energy. The issue of energy costs and its implications has been added to the agenda of the annual national consultation between the social partners which will take place later this year.

## **B. Competitiveness Factors**

- 2.12 Many factors lie behind the competitiveness challenge in Barbados. These include high utility costs (e.g., telecommunications and electricity costs), inadequate transportation infrastructure, difficulties of small firms in accessing finance, public and private sector management weaknesses, labor market rigidities, the low integration of Information and Communication Technology (ICT) into firm activity and inadequate availability and use of statistical information by both public and private sectors. At the same time, Barbados has many advantages on which it can build a stronger competitive position in the world economy, particularly its high levels of social development and stable government, institutions and economy. The challenge for Barbados is to identify and reinforce its strengths and implement remedies for its weaknesses so that its competitiveness and standard of living can be improved.
- 2.13 **Political stability and governance.** Politically and socially, stability and the reign of strong democratic traditions are hallmarks of Barbadian society. Barbados gained independence in 1966 under a parliamentary system of government, dominated by two main parties, the Democratic Labour Party (DLP) and the Barbados Labour Party (BLP), which have alternated the holding of government office.<sup>7</sup> The current government has been in office since 1994 and holds 23 of the 30 seats in Parliament. Stable governance and political conditions contribute to competitiveness by providing a basis for stable economic expectations and avoiding some costs imposed by political disturbances.

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<sup>7</sup> Each party has held office two times since Independence: 1961-76, DLP; 1976-86, BLP; 1986-94, DLP; 1994-present, BLP. At the present time, the government is held by the BLP which is in its third consecutive term, since being elected in 1994. The BLP holds 23 of the 30 seats.

- 2.14 **Institutionalized consensus building.** An important factor behind Barbados' social and economic stability is the maintenance of a social contract involving Government, Labour and Private Sector, which provides a platform for building social consensus on major economic issues. The social contract has proven to be a useful tool in Barbados for the institutionalization of social dialogue and consensus building on economic policy and strategy (Downes and Nurse 2004, Fashoyin 2004). The Partners have signed 5 protocols since 1993 all of which have included the promotion of performance-based payment schemes and improved industrial relations among their goals. However, while the protocols have contributed to economic stabilization, they have not had satisfactory results with respect to the main labor market objectives. This matter continues to receive the attention of the social partners and will be the subject of a national consultation to be held in October 2005. The social contract can be an important asset for building consensus around reforms needed to improve the country's competitiveness.
- 2.15 **Investment framework.** On the whole, investors judge the policy and legal framework and the framework for foreign direct investment to be good. In addition, Barbados ranks highly –worldwide and among the Caribbean countries– on the Kauffman scale indicators of government effectiveness, accountability, regulatory quality, control of corruption and the rule of law.<sup>8</sup> However, market access (due largely to the regulatory framework and lack of consistent application of standards), access to land (understandable given the limited geographical size) and taxation and customs have been identified in investor surveys as areas for improvement.
- 2.16 **Labor market.** The institutional framework for the labor market is relatively sound, reflecting the evolution of policy and engagement of the major social partners. However, it needs to be reviewed and updated to increase flexibility in light of technological changes that are transforming the way the international marketplace functions. The need for reforms in favor of productivity-based payment schemes has already been recognized under the social contract.
- 2.17 **Social development.** Barbados has made a high investment in social development, contributing to economic performance through human resource development and social stability. Ever since the 1940s, successive governments have placed high emphasis on social development and have built up a strong legislative and institutional framework to plan and implement social policy. As shown in **Annex I**, this emphasis has resulted in Barbados having already achieved most of the Millennium Development Goals (MDG). A second general indication is the fact that the Human Development Index (HDI) ranking of Barbados for 2002 is 11 points higher than its *per capita* ranking in the world, underlining the high contribution of social development considerations to its HDI ranking.

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<sup>8</sup> Kauffman, Kay and Mastruzzi, Governance Matters III: Government Indicators for 1996-2002. World Bank.

- 2.18 Significant indicators of social development include a 100% literacy rate, life expectancy at birth of 77 years (in 2000) and an extensive social protection network which includes a social security system, public and private pension schemes and an unemployment insurance scheme established in 1982. In addition, absolute poverty measured 13.9% of the population in 1997 and the Gini coefficient declined from 0.48 in 1979 to 0.39 in 1997, indicating a significant improvement in equity. There has also been a strong tradition of social institution building and reform, culminating in the establishment of the Ministry of Social Transformation to help streamline the functions of the multiplicity of public agencies providing social services.
- 2.19 Despite the social progress achieved, Barbados faces a number of major challenges in this sector.<sup>9</sup> In the context of a high debt burden and fiscal concerns, efforts have to be made to contain the growth of social spending. This situation is aggravated by stagnant population growth and a demographic transition that has resulted in a doubling of the proportion of the elderly in the population since the early 1990s and an associated rising dependency ratio. Housing also represents a significant challenge as a supply deficit persists while there is concern about rising disparities in housing conditions between rich and poor, and increasing social distress associated with this trend.
- 2.20 Although Barbados has attained high standards in education, major gaps persist with respect to labor skills and productivity. Despite an overall surplus of labor, with unemployment standing at 9%, there are critical shortages of labor in specific professional areas. This suggests that the vocational training and tertiary education institutions are not properly aligned with the needs of the business sector. Accreditation of skilled labor is also an area that warrants attention to facilitate labor mobility. Finally, Barbados needs to focus attention on service quality if it is to remain competitive.
- 2.21 **Infrastructure.** Barbados is considered to have good infrastructure, but transport infrastructure has emerged as a major obstacle to a favorable business climate due to high traffic congestion. Slippage in the maintenance of infrastructure is also undermining performance. The government has announced construction plans to ease the congestion anticipated during the World Cup Cricket. However, the problem calls for a comprehensive long-term response that may take land use into consideration.
- 2.22 **Institutional weaknesses in the public sector.** The public sector plays a major role in Barbados, especially in the provision of social services and as a catalyst in relation to leading economic sectors. However, it is characterized by weaknesses and inefficiencies that impede achievement of developmental objectives. Among the problems which have been observed are over-centralization of decision-making and dependence on rigid regulations. The management and functioning of the public sector have failed to keep pace with the growing size

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<sup>9</sup> Thomas 2002.

and complexity of the economy. Compressed wage and salary scales are resulting in higher turnover of high-level professional staff in some disciplines. These conditions are contributing to log jams, loss of productivity, difficulties in meeting project execution targets and, ultimately, expanded costs of operation. More efficient public sector management and functioning will contribute to improved competitiveness and national economic performance by providing a more favorable climate for business activity and improved fiscal performance.

- 2.23 **Private sector management capabilities.** Competitiveness depends not only on the social, institutional and regulatory framework in which firms operate, but also on internal factors, namely management practices. Barbados suffers from weak entrepreneurship and management traditions. Small and micro enterprises in particular, although a fertile breeding ground for firms with growth potential, often have a limited entrepreneurial orientation as regards risk-taking, and lack financial and management skills and an understanding of the opportunities and hurdles presented by changes in the international economic environment. In the context of the need to diversify the Barbadian economy, create employment and boost exports, SME development, which can be supported by training, improved access to finance and business development services, emerges as a strategic priority.

### C. **The Regional Dimension**<sup>10</sup>

- 2.24 As a founding member of the 15-member Caribbean Community and Common Market (CARICOM), Barbados is playing a leading role in efforts to deepen regional integration through the establishment of a CARICOM Single Market and Economy (CSME). The CSME embodies steps to liberalize the movement of goods, services, persons and capital and the right of establishment within the Caribbean Community. This amounts to an enlargement of the market for goods and services and the economic space for resource allocation and investment. In addition, through regional cooperation, Barbados will be able to take part with a louder voice in negotiations in international arenas such as the World Trade Organization (WTO) and EU/ACP.
- 2.25 Growth in Barbados' trade with CARICOM has outstripped its total trade growth since the establishment of the Community in 1973. By 2003 imports from CARICOM countries (BDS\$546 million) had risen from 13% to 23% of total imports, while Barbados exports to CARICOM (BDS\$29 million) had risen from 28% to 39% of total exports. It can be seen that CARICOM has had a positive impact in stimulating Barbados' exports even though the trade deficit has expanded.
- 2.26 Deepening CARICOM integration will help Barbados overcome resource and market size limitations and exploit its existing advantages. The proposed lifting of

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<sup>10</sup> For a succinct presentation of what CSME means to Barbados, Williams 2005, a presentation of the Governor of the Central Bank of Barbados to the Barbados Employers' Confederation.

restrictions on cross-border investment in services and rules of establishment under the CSME will facilitate greater investment in Barbados and allow Barbadian financial, tourism management and other service companies to build on their strengths, investing within the region and acquiring experience to compete in a wider global context. Greater competition will encourage stronger firms to grow and weed out the less efficient. The free movement of labor will help restrain the growth of wage costs in Barbados and access to lower cost resources and products in other countries will help to moderate prices.

- 2.27 These changes may cause short-term dislocations for firms and workers. Financially, some fear that the elimination of capital controls could lead to capital outflows and threaten the fixed exchange rate regime and that capital account liberalization could result in a loss of independence of monetary policy as interest rates are influenced by interest-rate differentials across the region. While there is an awareness of these risks, it is expected that the outcome will be favorable in the long run.<sup>11</sup>

#### **D. National Development Priorities**

- 2.28 Barbados has set high priority on making the transition to a more competitive economy, and the government has declared itself to be permanently in a reform mode.<sup>12</sup> Consequently, there is consistency between Bank strategy and GOBA priority in identifying competitiveness as a leading priority for development efforts over the medium term.<sup>13</sup>
- 2.29 The main issues driving short to medium-term priorities are: (i) the BoP deterioration and associated international reserve loss, and the consequent need to raise competitiveness; (ii) the extensive changes in international economic conditions following the WTO changes and impending changes in trade relations with the EU; (iii) the need to achieve full readiness to implement the CSME; and (iv) the need to prepare to take advantage of the showcase opportunities of hosting the final of the World Cup Cricket in 2007.
- 2.30 On the basis of these considerations, the Government is proposing a package of measures, supported by spending allocations, to strengthen service orientation and performance, foster tourism growth and international business and financial services, reduce taxes and modernize tax administration and strengthen export promotion. In the social sector, the Government is committed to enhanced support for youth programs and assistance in the integration of persons with disabilities.

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<sup>11</sup> The Bank will support Barbados' regional integration objectives as part of its contribution to trade and competitiveness improvements outlined in this CS and as part of the Bank's Regional Programming Paper currently under preparation.

<sup>12</sup> *Economic and Financial Policies of the Government of Barbados* presented by the Minister of Finance, p. 10 and the *National Strategic Plan of Barbados, 2005-2010* (NSP).

<sup>13</sup> The National Strategic Plan of Barbados, 2005-2010 gives a comprehensive outline of the strategic objectives of the government, which are on the whole consistent with the diagnostic assessment of the Bank. However, the National Strategic Plan identifies multiple objectives, without assigning priority or linking them specifically to the government's budgetary plans.

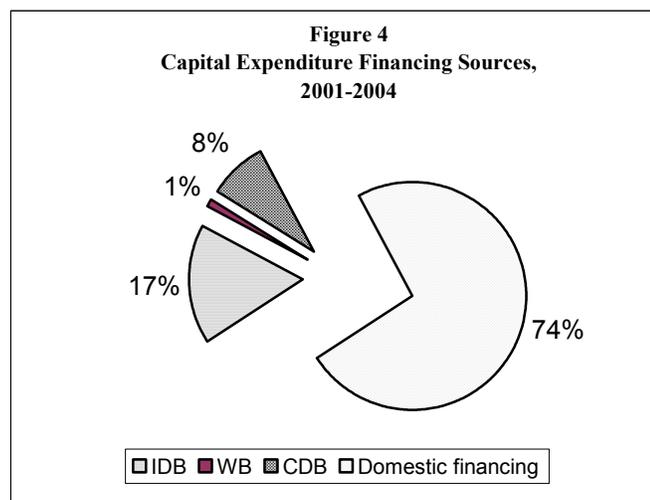
The Government has also announced a commitment to spend more than B\$100 million, equivalent to 40% of central Government projected capital spending in 2005/06, on infrastructure for the hosting of the World Cup Cricket in 2007.

- 2.31 The GOBA has set an indicative medium-term growth target of 3%. Given a population growth rate that is close to zero, this translates into real per capita growth of nearly 3%. This low growth target reflects the GOBA emphasis on maintaining balance between economic growth and stability, and concern about the need to exercise some demand restraint in face of the widening BoP deficit.

### III. ASSESSMENT OF PAST STRATEGY AND PORTFOLIO ISSUES

#### A. Development Impact

- 3.1 The Bank is Barbados' most important multilateral development partner, as shown in Figure 4. Bank financing accounted for 17% of total capital expenditures and 64% of total project financing from foreign sources over the period 2001-2004. But the Bank's contribution to Barbados' development extends beyond the direct impact of the lending portfolio. The quality of the technical assistance that the Bank facilitates makes a high value-added contribution in Barbados, although it is difficult to quantify. Bank operations and non-financial products such as studies and policy dialogue have informed policy initiatives by the Government that directly address key constraints to the country's development and contribute to future investments, whether or not the Bank finances them.<sup>14</sup>



- 3.2 **Strategic objectives of the previous Country Strategy.** The Bank's strategic objectives for the period 1998-2001 (extended to 2004) were to support a competitive export-led development path for the country, and strengthen the social and economic infrastructure underpinnings of sustainable economic growth. More specifically, the CS focused on: (i) strengthening human resource development to enhance comparative advantage; (ii) enhancing the environmental infrastructure and natural resource management; (iii) strengthening the

<sup>14</sup> For example, IDB-supported studies have provided the basis for projects later financed by the CDB and the government itself.

- environment for private sector development; and (iv) strengthening economic management capacity and administration of justice.
- 3.3 **Outcomes.** The 1998-2002 CS made important contributions to improve development outcomes in the education and environment/natural resources sectors, and smaller contributions toward strengthening private sector development and improving economic management. However, the quantitative measurement of these contributions has proven to be difficult, and as a careful qualitative assessment shows, they have been much less significant than expected at the time of the CS's approval.
- 3.4 For each of its specific objectives, the CS identified indicators against which development impact could be assessed. Many of the indicators were defined in terms of project outputs rather than as development outcomes, and they generally do not include quantitative baselines, targets and timetables. Nevertheless, they do provide some guidance for assessing development effectiveness in qualitative terms.
- 3.5 As can be seen from Table 2 below, the Bank's support from the beginning of the CS period until mid-2005 had some positive impact on 8 of the 15 strategic challenges identified in the CS, contributing to education, water management, beach protection, transportation, pension reform and public sector investment objectives. In 3 of these 8 cases, the Bank played only a limited catalytic role by supporting early studies and providing technical support from staff in the development of projects that were later financed by others or canceled. In 7 areas, Bank support has not yet materialized, due to delays in project approval or implementation, but future efforts are expected to yield results.
- 3.6 The analysis of its development impact makes clear that the 1998-2002 CS was overly ambitious and could not accomplish most of its objectives, even by 2005, implying that the Bank and Barbados **should be more realistic and more modest in setting objectives and targets for the new CS.** However, the analysis also shows that the Bank played a key role in certain sectors, through technical support provided by previous projects and during project design. In addition, the results show that the Bank's contribution appears to be strongest in the sectors where support has been provided over a long period of time, spanning several Country Strategies –in education, the environment and to a lesser extent economic management capacity.<sup>15</sup> This implies the **need for a long-term commitment to address specific development challenges** and the need to build on the understanding of the country context and relationships with the government in existing programmatic areas. Finally, the large number of initiatives that were cancelled or delayed (sometimes over more than one strategy period) shows that **project development and implementation problems are one of the main obstacles limiting development effectiveness.** As a result, the new CS must give significant attention to addressing the root causes of these delays.

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<sup>15</sup> Country Program Evaluation by OVE for a comprehensive review from 1990 to 2004.

<b>Table 2</b>		
<b>Barbados Country Strategy 1999-2002 (extended to 2005)</b>		
<b>Development Impact: Challenges, Indicators and Results</b>		
<b>Development Challenge (1999 Strategy)</b>	<b>Indicator of Development Impact (1999 Strategy)</b>	<b>Results as of 6/30/2005</b>
<b>I. Strengthen human resource development</b>		
Strategic human resource development to enhance comparative advantage	<ul style="list-style-type: none"> <li>▪ Increased skill levels in line with needs of private sector</li> <li>▪ Reduced unemployment and improvement in labor productivity</li> <li>▪ Increased employment in higher skilled jobs and faster growth of informatics sector</li> </ul>	<b>Partial – Positive</b> <ul style="list-style-type: none"> <li>▪ Major IDB project for education sector in execution but implementation is slow</li> <li>▪ Improvement in intermediate educational outcomes such as curriculum development, teacher training and partial integration of information technology in education</li> <li>▪ Unemployment reduced, but not due to IDB support</li> </ul>
Improve the living conditions of low-income earners through access to better housing	<ul style="list-style-type: none"> <li>▪ Measurable improvement in the housing stock</li> <li>▪ Improvement in the efficiency of delivery of low income housing</li> <li>▪ Improvements in community infrastructure</li> </ul>	<b>None so far</b> <ul style="list-style-type: none"> <li>▪ Loan currently under preparation</li> </ul>
Improve health condition of the population and thereby improve productivity	<ul style="list-style-type: none"> <li>▪ Improvement in cost-effectiveness of health care, a larger share of private sector in service delivery, measurable reduction in incidence of diseases, and improvement in health indicators</li> </ul>	<b>None so far</b> <ul style="list-style-type: none"> <li>▪ Planned IDB loan dropped from pipeline; TC project identified in earlier strategy now in execution</li> </ul>
<b>II. Enhance environmental infrastructure and natural resource management</b>		
Reduce environmental deterioration resulting from inadequate solid waste disposal system	<ul style="list-style-type: none"> <li>▪ Improvement in island-wide solid waste collection disposal system</li> <li>▪ Improvement in quality of environment</li> </ul>	<b>None so far</b> <ul style="list-style-type: none"> <li>▪ Bank-supported project not yet in execution</li> </ul>
Improve the adequacy, cost efficiency and management of potable water supply	<ul style="list-style-type: none"> <li>▪ Improvements in sector policies and management, including financial operations of BWA</li> <li>▪ Improvement in adequacy of potable water supply during year and significant reduction in system losses</li> </ul>	<b>Partial – Positive</b> <ul style="list-style-type: none"> <li>▪ Dialogue with GOBA on BWA influencing water management policy, but management component of one project not fully implemented and TC project in pipeline still awaiting GOBA green light</li> </ul>
Management of liquid waste disposal and coastal pollution	<ul style="list-style-type: none"> <li>▪ Improved water quality on West Coast</li> <li>▪ Reduced contamination of underground aquifers</li> <li>▪ Improved quality of tourism product on West Coast</li> </ul>	<b>None so far</b> <ul style="list-style-type: none"> <li>▪ West Coast project postponed until 2009</li> <li>▪ South Coast project (from earlier strategy) completed, with positive results for water quality, environment and tourism product</li> </ul>
Beach protection and coastal management	<ul style="list-style-type: none"> <li>▪ Reduction in losses of beaches from natural hazards, environmental deterioration, and uncoordinated physical developments</li> </ul>	<b>Partial – Positive</b> <ul style="list-style-type: none"> <li>▪ Bank-funded projects resulted in some beach protection and improved capacity for coastal resource management</li> </ul>
<b>III. Strengthen the environment for private sector development</b>		
Inadequate seaport complex	<ul style="list-style-type: none"> <li>▪ Achievement of agreed improvements in operational targets by BPA</li> <li>▪ Reduce traffic congestion of the harbor</li> <li>▪ Higher cruise ship passenger arrivals</li> <li>▪ Increase spending per passenger</li> </ul>	<b>Limited</b> <ul style="list-style-type: none"> <li>▪ Planned IDB loan dropped from pipeline</li> <li>▪ Multisector Pre-investment Program and Japan Fund TC supported studies/consultancies for BPA long-term planning and implementation of works.</li> </ul>
Traffic congestion in Bridgetown	<ul style="list-style-type: none"> <li>▪ Operational bypass roads and measurable time reduction in traffic flow through Bridgetown</li> </ul>	<b>Partial - Positive</b> <ul style="list-style-type: none"> <li>▪ Bypass roads upgraded</li> <li>▪ Current data insufficient to draw conclusions on traffic flow and time reduction as traffic volume has increased; PCR will review this result</li> </ul>

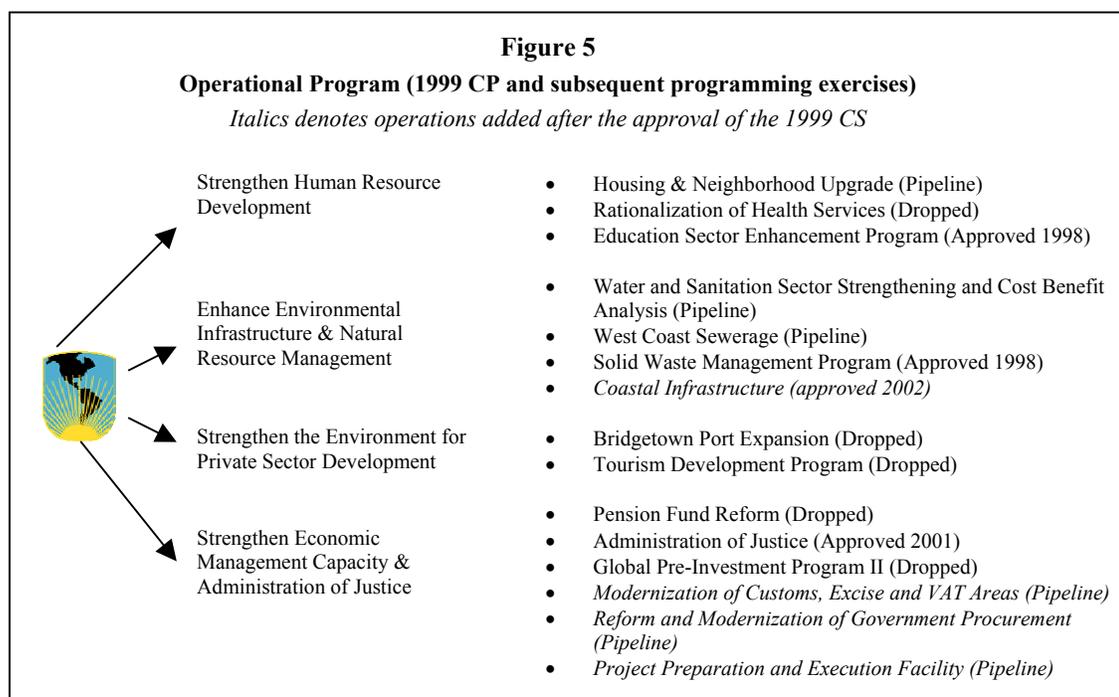
<b>Development Challenge (1999 Strategy)</b>	<b>Indicator of Development Impact (1999 Strategy)</b>	<b>Results as of 6/30/2005</b>
Economic diversification through small/micro enterprise development and strengthening of non-bank financial supervision/regulation	<ul style="list-style-type: none"> <li>▪ Increase in viable small business activities and membership of small business association</li> <li>▪ Reduction of unemployment/under employment</li> <li>▪ Improved performance and management of credit unions</li> <li>▪ Increase in private investment/GDP</li> </ul>	<p><b>None so far</b></p> <ul style="list-style-type: none"> <li>▪ Bank support limited to credit union project, currently under preparation</li> </ul>
Preserve competitiveness through sustained improvements in productivity	<ul style="list-style-type: none"> <li>▪ More active role of National Productivity Council providing advice on improving productivity and input to the wage bargaining process</li> </ul>	<p><b>None so far</b></p> <ul style="list-style-type: none"> <li>▪ Bank support to National Productivity Council provided through MIF project, but project executing slowly</li> </ul>
Diversify tourism sector and improve export earnings and competitiveness	<ul style="list-style-type: none"> <li>▪ Completion of agreed physical infrastructure and financially viable operation of new products developed</li> <li>▪ Increased management efficiency and coordination with private sector</li> <li>▪ Higher value-added of tourism sector</li> </ul>	<p><b>Limited</b></p> <ul style="list-style-type: none"> <li>▪ Planned IDB loan dropped from pipeline, but studies funded by Multisector Preinvestment Program served as basis for CDB Urban Rehabilitation/tourism project</li> <li>▪ Tourism sector expanded, but not due to IDB support</li> </ul>
<b>IV. Strengthen economic management capacity and administration of justice</b>		
Strategic economic planning and improved project PSIP management	<ul style="list-style-type: none"> <li>▪ A fully staffed operational project executing units in key line ministries</li> <li>▪ Improved capacity in Solicitor General's Department to deal effectively with legal aspects of project development</li> <li>▪ Structured research unit in MFEA with analytic tools and regular economic intelligence reporting mechanisms; operational mechanism in PIU to integrate PSIP into fiscal planning and generate regular reports on fiscal sustainability of changes in PSIP</li> </ul>	<p><b>Partial - Positive</b></p> <ul style="list-style-type: none"> <li>▪ Targets partially met, but not due to IDB support envisioned during the strategy period</li> <li>▪ Planned IDB loan dropped from pipeline, but delayed effects of Multisector Preinvestment Program contributed to some improvements in project cycle management</li> <li>▪ GOBA recently moved on its own to multiyear budgets and integration of PSIP within fiscal policy</li> </ul>
Reduce the social and economic burden of the pension system given aging population trend	<ul style="list-style-type: none"> <li>▪ Reduced fiscal cost of pension burden in line with targets to be determined</li> <li>▪ Actuarial reviews of the NIS confirming soundness of the scheme</li> </ul>	<p><b>Limited</b></p> <ul style="list-style-type: none"> <li>▪ Planned IDB loan dropped from pipeline</li> <li>▪ Studies financed by C&amp;D Action Plan supported identification reforms</li> </ul>
Rising youth crimes, inadequate penal reform system and low prison standards	<ul style="list-style-type: none"> <li>▪ Reduction in juvenile crime and improved internationally acceptable penal rehabilitation systems</li> </ul>	<p><b>None so far</b></p> <ul style="list-style-type: none"> <li>▪ Bank support approved, but implementation at initial stage only</li> </ul>

## **B. Portfolio Issues**

3.7 **Overview.** As Figure 5 indicates, projects were approved in 3 out of the 4 areas of the operational program proposed under the 1999 CS. Nevertheless, the active portfolio (including operations in execution previous to 1999), covers operations in all four areas of that CS. The share of current operations supporting human resources is 60%, environmental infrastructure and natural resources 21%, private sector development 13% and economic management and justice 6%. This compares with a projected full pipeline scenario of 47% for human resources, 30% for environmental infrastructure and natural resources, 12% for private sector development and 12% for economic management and justice.<sup>16</sup>

<sup>16</sup> These percentages are based on the full pipeline scenario proposed in the Strategy, including the 2 operations that were approved in 1998.

3.8 From 1998 to 2004, a total of 4 loans and 3 technical cooperation projects were approved, for a total of US \$123.8 million in loans and US\$632,080 in technical cooperation. A total of US \$80.1 million was disbursed from 1998 to 2004. As of June 30, 2005, Barbados' portfolio of five active loans amounted to US\$142.3 million. Of this amount, US\$44.1 million has been disbursed, reflecting a 31% cumulative disbursement rate. The portfolio also includes one non-reimbursable technical cooperation project in the health sector for the amount of approximately US\$1.3 million and one MIF operation for US\$417,000. The performance of the portfolio is reviewed in section III. C. below.



3.9 **Net flows.** Approvals and cash flows reported in Table 3 below show high levels of volatility since 1998, as well as a tendency toward reduction of the size of the Barbados program. Annual Bank loan approvals have varied widely during the CS period, with no approvals in 4 out of 7 years. Approvals averaged US\$17.7 million per year, but if the US\$85 million EDUTECH loan (approved in 1998) is excluded, approvals averaged only US\$5.5 million per year. Disbursements have declined since 2001 when the last tranche of a sector loan approved under the previous CS was released, while repayments are increasing. As a result of the low level of disbursements in 2004, net loan flow turned negative for the first time since 1999 and net cash outflow from Barbados amounted to US\$13.3 million. Preliminary estimates for 2006 indicate that net cash outflow will rise to over US\$30 million. As approvals and disbursements are not expected to rise significantly, the Bank is likely to remain a net negative lender for the duration of the new CS period, which will make its technical contributions even more important than in the past.

Table 3 Cash Flow Summary								
	1998	1999	2000	2001	2002	2003	2004	2005 <sup>1/</sup>
Loan approvals	98.0	0.0	0.0	8.7	17.0	0.0	0.0	38.0
Repayments	7.5	8.1	7.3	7.3	8.1	11.0	13.8	12.1
Disbursements	17.9	5.8	10.4	24.2	15.8	16.0	7.9	7.5
Net loan flow	10.4	-2.3	3.1	16.9	7.7	5.0	-5.9	-4.6
Interest and charges	8.2	9.7	10.0	8.7	7.2	8.2	7.4	9.4
Net cash flow	2.2	-12.0	-6.9	8.2	0.5	-3.2	-13.3	-14.0
<b>Debt outstanding</b>	<b>143.9</b>	<b>141.6</b>	<b>127.0</b>	<b>143.9</b>	<b>151.6</b>	<b>156.6</b>	<b>150.7</b>	<b>146.1</b>

1/ Provisional

- 3.10 **Portfolio performance.** As noted above, a major weakness exhibited by the Bank's portfolio in Barbados is **slow project execution**. The implementation of three of the five projects currently in the portfolio is rated as unsatisfactory, and the general pace of execution is slow for all projects. In 2004, the average execution period for investment loans was 8.2 years, compared to 5.7 years Bank-wide. This slowness has contributed to problems in achieving development objectives for two of the projects in the current portfolio as well as others that were completed during the strategy period. However, three of the five projects in Barbados are currently classified as likely to achieve their development objectives, although over a longer period of time than originally anticipated.
- 3.11 Even though government budget constraints mean that planned counterpart funding is tight, in practice GOBA has often had to increase its counterpart for Bank-financed projects because the slow execution of projects results in rising costs which must then be covered by the government. For example, changes in design and construction methods and the failure of the main contractor for the recently completed South Coast Sewerage Project raised the cost of this project to approximately US\$137 million, double the original cost estimate. The cost of the Bridgetown Roads Program increased by 55% due to delays in its initial phases. Today, with the South Coast Sewerage Project completed, GOBA is financing an average of 44% of the cost of the portfolio projects.
- 3.12 **Centralized decision-making process.** Most decisions related to project development and execution are made at the highest levels of government, slowing decision-making. In its recent strategy documents, the government recognizes that in this respect, management processes have failed to keep up with the growth in size and sophistication complexity of the economy and the proliferation of management challenges. Slow decision-making can also be due to difficult policy dilemmas that may remain unresolved inside the government for significant periods of time. An example of a project so affected is the solid waste project

currently in the portfolio, which was approved 6 years ago and still has not met the conditions for eligibility.

- 3.13 **Complex project design and scope resulting in costly technical problems and re-adjustments.** This is illustrated by the experience of the South Coast Water and Sewerage Project. The firm originally selected to build the project infrastructure withdrew in 1997 when its technology proved inappropriate for the soil conditions in Barbados, and a new firm had to be selected. The water treatment plant component advanced faster than other components, making additional maintenance necessary and adding to cost overruns. The actual construction of the wastewater treatment plant and ocean outfall did not have a major negative impact on local residents, but the other related works disrupted business and residential activity, diminished commercial revenue, aggravated traffic congestion, and produced dust and other construction disturbances.
- 3.14 **Lengthy and cumbersome procurement process.** The procurement process can take as long as two years to complete. A central authority takes decisions relating to tenders and contracting and every contract signed by any Ministry must first be reviewed by the Office of the Solicitor General. To avoid delays, many government agencies sign so-called “letters of intent” with consultants until the definitive contracts are ready, but enforcement of these informal letters is problematic, and they are not sufficient for Bank disbursement requirements. In addition, staff of the Project Executing Units (PEUs) and Ministries is often relatively inexperienced and uninformed about the procurement procedures of the Bank and their own government.
- 3.15 **Staffing issues affecting project executing units.** PEUs are usually constituted within relevant ministries where staff may have competing responsibilities and there is a high turnover of staff that moves on to other jobs once they have been trained.

### C. **Lessons Learned and Implications for the Strategy**<sup>17</sup>

- 3.17 One of the main implications of this analysis is that the Bank and Barbados cannot continue to do business in the same manner that has characterized the relationship over the past seven years, and even before. The Bank needs to move toward an approach that facilitates the government’s own efforts to improve its effectiveness and efficiency. The Bank also needs to play a more strategic role in the future, facilitating technical expertise and helping GOBA to leverage resources from the private sector. **Manageable project design and execution.** The past experience shows that future operations should be well focused. To improve execution, projects should be of moderate size and anticipated duration, and have relatively narrow and well-defined objectives. In the case of projects addressing larger problems, such as the Housing and Neighborhood Upgrading

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<sup>17</sup> The OVE evaluation of the Barbados program is under preparation. OVE and the CS team discussed the draft OVE evaluation and this section reflects agreement on the relevant issues relating to Bank experience in Barbados.

Program, a phased approach is recommended. More careful attention needs to be paid to staffing issues within PEUs such as training, full-time assignment of staff to projects and remuneration. The Project Preparation and Execution Facility (PROPEF), which has already been approved, should help to partially alleviate the problem of persistent turnover and shortage of key staff in executing agencies by providing support for consultants and staff training at project start-up and during key moments in execution.

- 3.18 **Addressing policy issues.** The Office of Evaluation and Oversight (OVE) evaluation indicates that the Bank may have encouraged the GOBA to sign loan agreements before it was close to meeting conditions prior. A number of projects have been stalled by policy decisions. This implies that the Bank needs to be more cautious in its approach to projects that may be affected by policy issues. The Bank can provide support to address difficult policy issues before launching new investment projects by using reimbursable technical cooperation, pilot activities within other loans and non-financial products.
- 3.19 **Simplifying procurement.** Procurement constitutes a significant bottleneck to the execution of projects financed not only by the Bank, but by other international development institutions as well. The new CS will support reform and streamlining of procurement with a project already in the pipeline and non-financial products such as training for government officials. It will lay the groundwork for moving toward greater reliance on the government's systems, as the European Union is currently doing. In addition, the CS aims to develop better ways to respond to GOBA's need for technical assistance, developing new methodologies or instruments, if required.

#### IV. OTHER DONOR ACTIVITY

- 4.1 A number of international and bilateral agencies maintain a presence in Barbados, but their activities are focused on the smaller Eastern Caribbean states. In addition to the IDB, the Caribbean Development Bank (CDB) and the EU are the major development agencies providing support to Barbados at this time. By virtue of the size of its portfolio and its strategic dialogue with the country, the IDB is the country's most important international development partner. The European Investment Bank has one outstanding loan to the country and the People's Republic of China has recently begun to provide concessional financing. Given the experience with donor harmonization on support for the CRNM, based in Barbados, and a number of recent developments in the EU and CDB programs, the prospects for donor coordination, cooperation and harmonization in Barbados are good.
- 4.2 The IDB maintains a close relationship with the CDB, both on regional and national issues. Coordination with the CDB on Barbados is focused on the education sector, where the IDB and CDB are co-financing a major education program, EDUTECH. The CDB is also providing assistance to improve several

- tourism sites in Barbados, through its Urban Rehabilitation Program. The Bank will coordinate with the CDB on the preparation of the country financing parameters for Barbados, and the two institutions could consider a common Sector-Wide Approach (SWAp) to education in the future, probably during the next CS period (2009-2012).
- 4.3 The CDB has initiated preparation of a CS paper for Barbados scheduled for Board consideration in December of this year. Following agreement between the CDB and IDB to collaborate with respect to programming and other activities, CDB staff participated in the review of the analytical work carried out in preparation for this CS, and have indicated willingness to further coordinate efforts with IDB as they proceed with their strategy preparation.
- 4.4 The EU, the major grant-making institution contributing to Barbados' public sector investment program, is concentrating its assistance in the health sector under the current European Development Fund (EDF) allocation, and has targeted education and tourism under previous EDFs. The EU is the first donor to attempt a SWAp in Barbados, with a recently approved €10 million grant for the health sector and a €300,000 TC to assist with implementation and performance monitoring. Building on studies of governance, procurement and financial management by the EU, the project will utilize the country's own systems for project financial management and procurement. However, the project is a modified SWAp, in that the agreed areas of expenditure to be financed are limited and do not include significant recurrent costs. A process of consultation and development of a health sector strategy with the government and a broad range of stakeholders at the local level preceded the development of the facility and is considered by the EU to be the key to the executability of the program. This experience will be of interest to the Bank as it looks to apply flexible lending arrangements under the NLF.
- 4.5 Both the EU and the CDB note the presence of a well-qualified civil service force, the country's stable and reliable legal framework and institutions, and the government's dedication to socio-economic growth as advantages in their relations with Barbados. However, both the CDB and EU programs have experienced delays in project execution, and cite the lengthy procurement processes and the need to limit project dimensioning for easier management as areas for improvement. Both institutions are also committed to increased coordination in strategy definition. In such an environment, the Bank CS should explore ways of laying the groundwork for closer harmonization through greater reliance on the country's systems. All three major donors, including the Bank, can provide technical support to achieve this goal.

## V. BANK OBJECTIVES, STRATEGY AND AGENDA FOR DIALOGUE

### A. Objectives

- 5.1 The overall goal of Bank support in Barbados for 2005-2008 is to strengthen its competitiveness as a basis for sustained growth and improved well-being of the population. The specific objective of the CS is **to raise the capacity of Barbados and its businesses to compete in a changing international economic environment**. Consequently, this CS will pay attention to supporting economic and social conditions and institutional and policy frameworks that are conducive to increased productivity and performance by Barbadian firms and the economy as a whole. GOBA statements confirm its concurrence in placing high priority on competitiveness.
- 5.2 The emphasis that this CS is placing on competitiveness is justified on the basis of the diagnostic work carried out in preparation for this CS and outlined in Chapters II and III of this document. This work identified Barbados as a small, middle-income country experiencing slow but steady growth and beset by high vulnerability, fiscal and BoP challenges, public sector systems and management that lag behind in relation to the demands of an increasingly complex economy, a private sector environment in need of greater entrepreneurship and support to the development of the service economy.
- 5.3 Moreover, Barbados now faces growing challenges and opportunities from an international economic environment that is becoming increasingly liberalized, information and communication technology-driven, while traditional international preferences are being eroded and competition is becoming more intense regionally as a result of the CSME, and in the important tourist industry. The emphasis on competitiveness is part of a long-term vision for the country, resulting in some continuity between this CS and the previous ones, reflected in the operational program.
- 5.4 Although the CS provides a high degree of **continuity** with the previous CS in terms of its objective and the main program directions, the latter are more narrowly focused. The way the program will be implemented has changed in response to lessons learned during the last CS period. The program proposed by this CS is **transitional** in the sense that the emphasis is on addressing institutional and capacity weaknesses that inhibit the efficient and competitive functioning of the public and private sectors. Consequently, the proposed operational program will concentrate not on investment activity but on technical cooperation and non-financial support. This approach seeks to avoid a repetition of the experience of poor execution of the last CS by concentrating on resolving the institutional and capacity weaknesses and policy issues that underlie that experience, and laying the groundwork for future investment activity. Examples of this include the transport and water sectors where comprehensive infrastructural and institutional activities are contemplated by GOBA.

- 5.5 A further imperative underlying the actions proposed in the CS is to support the government's efforts to improve program management and implementation. This objective is at the heart of the Bank's medium term action plan. As the Bank's experience with project implementation in Barbados and the government's own assessments make clear, this objective has particular relevance. Improvements in this area are key to establishing a new working relationship with Barbados, as they would also support the transition toward the full use of the instruments of the Bank's NLF, which will provide greater flexibility to the government in managing Bank-financed operations.

## **B. Priority Areas**

- 5.6 Stable **macroeconomic conditions** are a basic requirement for conditions favorable to fostering private sector growth. The Bank will continue to monitor and reinforce implementation of prudent policies through ongoing country dialogue, for the achievement at least of the IMF *baseline scenario* identified as a result of the 2005 Article IV consultation. This scenario projects a debt ratio in 2008 that is essentially unchanged at its present level of 87% of GDP and overall public sector fiscal deficit of 3.2% of GDP. This compares with an *active scenario*, which assumes tighter fiscal management and more aggressive debt reduction efforts resulting in a debt ratio of 79% and fiscal deficit of 1% of GDP.
- 5.7 The Bank's diagnostic work indicates that a high priority for Barbados is to strengthen its export orientation and performance, and the environment for private sector-led growth. The CS will therefore support competitiveness through **institutional reforms and capacity building that directly impact private sector environment and performance**. Specific areas indicated by the preceding diagnostic analysis include labor market reform and improvement of private sector management practices that would emphasize performance-based approaches and flexible labor conditions, and bring Barbadian firms more in line with international business practices; SME development and the fostering of entrepreneurship which can boost output and exports and take advantage of the available pool of human resources; and the strengthening of service orientation and promotion of service industries, which is where the comparative advantage of Barbados lies.
- 5.8 The effort to strengthen the environment for private sector-led growth is being supported by preparation of a **private sector development strategy (PSDS)** by the Bank. The development of the PSDS implies a process of analysis and dialogue between the Bank and the private sector and authorities in Barbados, as well as within the Bank between the different parts of the Bank group involved in private sector activities. This process is needed to ensure that there is a better understanding by the Bank of the conditions and attitudes of the private sector and of its complexities. The Strategy will include a plan that identifies and coordinates Bank Group activities, both financial and non-financial, to support the private sector.

- 5.9 The PSDS will build on the diagnostic work done relating to the competitiveness conditions of Barbados in papers prepared as inputs to the country strategy in the areas of competitiveness, the labor market, trade, tourism and agriculture. It will also be based on consultations with private sector, labor and government representatives, taking advantage of the consensus framework provided by the Social Contract among these partners that exists in Barbados. Taking into account the scarcity of data on the private sector in Barbados, the diagnostic aspect of the PSDS will seek to fill the remaining gaps in knowledge with respect to the climate for private sector activities.
- 5.10 The findings of this diagnostic would be discussed by all the different windows of the Bank group to identify key issues and areas in which the Bank group can assist the private sector. Subsequent to these internal discussions, the different windows of the Bank group involved in private sector activities would jointly meet with representatives of the private sector and local authorities in Barbados to identify partnerships and open opportunities for the Bank to assist in a more dynamic development of the private sector. Based upon these discussions, the Bank would prepare the Private Sector Development Strategy. It is expected that this entire process would take about four months, and should be completed in early 2006.
- 5.11 The design of the competitiveness operation identified in the strategy will benefit from and build on the diagnostic and consensus building activities carried out for the PSDS. It is anticipated that this operation will provide support from the IDB, reinforcing investments by the private sector windows.
- 5.12 Strengthening competitiveness will require continuing investments to improve the conditions within which businesses operate. In this regard, there is need for continuing maintenance and improvement in **infrastructure and human capital**. Priority infrastructure areas at this time include the island-wide transport system which is characterized by high congestion, and low-income housing and neighborhood upgrading which would support the competitiveness of the tourist industry by providing attractive locations and combating social distress in run-down areas. The focus of human capital strengthening under this strategy is improvement of post-secondary education aimed at meeting the demands of the productive sectors for skilled labor.
- 5.13 This strategy is also geared to support **public sector institutional strengthening**. Diagnostic assessments indicate that management and decision-making processes, and procedures such as procurement, need to be modernized to keep pace with the demands of the society. Moreover, attention needs to be paid to maximizing efficiency, greater use of cost-recovery and other institutional and policy measures in light of fiscal constraints. There are also human resource issues, reflected in high staff turnover, that affect the ability of the public sector to achieve its objectives in a timely manner. The problem of slow implementation, which plagues development projects and is recognized by the GOBA, is one indication of persistent obstacles to public sector efficiency. The Bank CS will

- respond in this area by supporting capacity building in areas such as procurement modernization and evaluation and application of PPP options, and using PRODEV resources to stimulate public sector results-based management and efficiency.
- 5.14 It must be emphasized that while Bank support to public sector reform is expected to have substantial development impact, the scope for Bank action in this area is narrow and success depends essentially on the GOBA implementing a sufficiently comprehensive program with its own resources. The GOBA recognizes this matter as a priority and has initiated some measures including the establishment of a public sector reform unit and the introduction of pilot measures to move to multi-year budgeting and accrual accounting. Over the years, the public sector has maintained traditional ways of operating and resisted change, and on that basis, it is anticipated that reform will be gradual within the 2005-2008 timeframe.
- 5.15 **Performance indicators.** The strategy proposes a series of 11 indicators to measure progress toward achievement of the overall goal and objective of the program as well as expected intermediate outcomes. Lessons learned from the previous strategy point to the importance of setting realistic targets for the country program. Therefore, the indicators proposed have been carefully chosen to reflect the modest operational pipeline, the availability of data and the feasibility of determining attribution within the limited time frame covered by the Strategy.

### **C. The Operational Program**

- 5.16 As Annex III indicates, the operational program for 2005-2008 consists of 9 operations for a total value of \$65.7 million. The value of this operational program is consistent with the past rate of approvals which averaged US\$17 million per year during 1998-2004, but is considerably smaller than the program proposed in the previous CS. All but one of the proposed loans are in the existing pipeline agreed with the GOBA during the programming mission of January 2005, and 3 were identified during the previous CS. This reflects the continuing relevance of the competitiveness objective.
- 5.17 The proposed operations program includes 1 investment loan, 2 reimbursable TCs, 5 facilities and 1 programmatic or other type of innovative loan. The proposed competitiveness loan will be designed to provide access to resources for feasibility studies, action plans, training, policy and institutional reform, capacity building and related investments for strengthening competitiveness. It will be developed based on a consensus-building process with stakeholders in the country. Some areas where action is already anticipated include support for labor market reform, SME development and the national initiative for service excellence. The PSDS and BCI action plans will further specify activities to be undertaken.
- 5.18 The sole major investment loan, a housing and neighborhood upgrading program, was proposed under the last CS. GOBA has identified this program as a priority to

help the country develop ways to reduce the growing disparity in housing conditions between rich and poor, impact poverty which is closely linked to poor housing conditions, combat the rise of criminal activities and other social distress in run-down areas, and upgrade housing conditions in Bridgetown neighborhoods and other areas frequented by tourists. Consequently, its relevance under this CS relates to its importance in maintaining socioeconomic conditions favorable to social stability and the competitiveness of the tourist industry.

- 5.19 **Bank group private sector involvement.** The CS focus on improving the environment for private sector led growth implies a significant role for the private sector instruments of the Bank. However, at present, the Inter-American Investment Corporation (IIC) and Private Sector Department (PRI) have no operations in execution or in the pipeline in Barbados. The Multilateral Investment Fund (MIF) has one project in execution and one in the pipeline. Bank efforts to raise the involvement of its private sector arms and more specifically define their roles are being supported by the preparation of a Private Sector Development Strategy (PSDS) and the BCI Action Plan currently underway. These documents will define a plan of action for Bank support to private sector development, taking into account the findings of recent studies and consultations with relevant agencies in Barbados.
- 5.20 The need to support SME development underlined in the strategy brings into focus the potential role of the IIC and MIF in Barbados. The **IIC** is having difficulty identifying and closing financing transactions for SMEs in the English-speaking Caribbean in general. According to a recent study, the typical target market for direct IIC financing (companies with total sales of US\$5 million to US\$35 million) is being adequately served by the local banks and Barbadian customers in the target market have a deep sense of loyalty when making banking decisions and feel the IIC's lack of a local presence in the market and inability to offer ancillary services to complement its financing limits its attractiveness as a lender. Consequently, the IIC needs to deliver its financing through a financial intermediary that works with SMEs, including the segment of up to US\$5 million.
- 5.21 The **MIF** has one operation in its pipeline for improving access to financing for SMEs by strengthening the credit unions, but it will participate actively in the PSDS and is expected to provide additional support for SME development and improvements in the business climate during the strategy period. It is also expected that the MIF will continue to support Barbados development as part of its support to regional programs.
- 5.22 With respect to **PRI**, the main opportunities envisaged under this strategy are in the water and transport sectors. It is not anticipated that any operations will be ready for implementation during the 2005-2008 period, but the period will be devoted to development of master plans and addressing relevant institutional and policy issues. PRI would also be ready to consider participation in divestment activities and PPP operations that the GOBA may undertake.

- 5.23 PRI is also tracking potential regional projects in which Barbados may be involved, namely: (i) a gas pipeline project running from Trinidad to Guadeloupe via Barbados; and (ii) a submarine fiber optic cable connecting Barbados to the rest of the Eastern Caribbean. In addition, PRI is analyzing potential capital markets transactions involving Caribbean issuers, which may include a tranche to be placed with local investors in Barbados subject to local regulations. PRI is also in the early stages of discussions regarding potential support for a regional fund to be established dedicated to Caribbean investments including in the tourism sector.
- 5.24 **Institutional strengthening.** Two operations already in the pipeline and one new operation will support this objective. As noted earlier, the **modernization of customs, excise and value added tax (VAT)** and **reform of government procurement** are key to improving government efficiency and effectiveness as well as developing a better climate for business. The proposed program for **strengthening the statistical service** will provide much-needed data on the labor force and other social indicators to support private sector decision-making and the monitoring of development effectiveness of the strategy and other government initiatives.

#### **D. Bank Instruments and Facilities**

- 5.25 Past difficulties with project development and execution make it clear that the instruments and processes used to implement the strategy are of fundamental importance to its success. At the same time, the Bank's new Procurement Policy, the NLF, and the new lending instruments that have recently been approved provide a range of new options to effectively support the implementation of the CS and the country program.
- 5.26 **Innovative instruments.** During the 2005-2008 CS period, sector facilities are expected to be the dominant type of instrument used, as they are currently envisaged for five operations in the operational program. Reimbursable technical cooperation will also be an important instrument to provide the kind of technical support that is valued in Barbados, and is currently planned for two operations in the program.
- 5.27 For the planned competitiveness program, the CS proposes to use one of the new lending instruments, such as a performance-driven loan or programmatic policy-based loan, to support the range of technical assistance, investment and policy reforms required for the program to have an impact on the country's and firms' competitiveness. The new instruments provide a better fit for the unique characteristics of Barbados, including: few donors operating in the country with limited leverage on policy issues, the tight fiscal space of the country, the need to better align the Bank's programs with the country's programs and reduce the cost of doing business, and the possibility of moving toward greater use of country systems. These instruments can also reinforce management for results in the government's public sector investment program, as supervision of the loans is

focused on how well the country is progressing towards achieving outcomes, allowing greater flexibility in the mix of inputs used to get there.

- 5.28 Bank preparation of the country financing parameters as well as the action plan for development effectiveness will help the GOBA prepare to take advantage of the new instruments. The Bank is committed to supporting Barbados' initiatives to strengthen its own capacity to measure, monitor and manage for development results. The government has indicated its interest in participating in the PRODEV. During the CS period, the Bank will utilize the PRODEV (Program to Implement the External Pillar of the MTAP for Development Effectiveness) to assist the government in defining and implementing priority actions for improving development effectiveness.
- 5.29 **Public-private partnerships.** The government is seeking to make a better use of public resources through public-private partnerships. In fact, GOBA has already engaged in some of these partnerships with mixed results. For example, the use of take-or-pay contract in the case of water supply has created a large fiscal liability and the build and operate contract for the Hilton Hotel experienced slow execution. In light of these problems and future needs for financing the construction of infrastructure as well as provision of services, the government is keen to improve its ability to manage and monitor relationships with the private sector in order to obtain the greatest benefits at the lowest cost. The Bank will support the government in these efforts.

## **E. Strategy Implementation Risks**

- 5.30 **Implementation weakness.** Given recent execution experience in Barbados, there is concern that preparation and implementation of the proposed CS could be delayed, resulting in failure to achieve its development objectives. Consequently, the CS is proposing a program consisting mainly of smaller operations and the use of innovative instruments. In addition, it is expected that the measures of institutional strengthening and capacity building in the program will improve implementation by streamlining procurement and encouraging results-based management.
- 5.31 An important tool for better management and development decisions is better availability of information, and the pipeline project for the modernization of statistical services in Barbados will contribute to improvement in this area. In the final analysis, the main solution for the weak implementation problem is a strong sense of ownership and shared commitment to the program by the GOBA and the Bank, and continuing dialogue to address problems decisively as they arise. The competitiveness program, which is one of the cornerstones of the CS, will seek to foster such a commitment through a process of consensus-building during its design and utilizing an instrument that allows the Bank to respond more effectively to the country's need for technical assistance and related investments.

- 5.32 **International shocks.** Barbados is highly vulnerable to international shocks because of the high degree of openness of the economy and its high dependence on the tourism industry. Unforeseen events, if they occur, can cause setbacks to the implementation of the Bank's program in Barbados. One event of current concern is the rising cost of energy. In this regard, the Bank stands ready to support activities and strategies aimed at finding sustainable energy solutions as part of its support to competitiveness and trade facilitation. Rising energy costs are imposing similar challenges on most of the other member states of the Bank in the Caribbean Region. Consequently, the Bank will also explore regional approaches within the context of the Regional Programming Paper which is under preparation at this time.
- 5.33 A second concern is the present trend of increasing in international interest rates, which can bring pressure to bear in Barbados by raising the fiscal burden of debt service, quite apart from its adverse effects on investment. This, in turn, can affect the availability of counterpart to execute Bank projects. This is an additional reason for Barbados to pursue fiscal tightness, and the Bank's support to modernization of the Customs and Excise Department will help by strengthening the efficiency of revenue collection.
- 5.34 A third instance to watch is the possible US Dollar appreciation. Barbados has benefited from the recent depreciation of the US Dollar against the Euro because this has helped the competitiveness of its products in European markets. Appreciation of the US Dollar will erode this competitive advantage, raising the urgency of measures, such as those proposed by this CS, to strengthen other areas of competitiveness.
- 5.35 **Natural disasters.** Barbados faces an annual hurricane peril that could adversely affect economic development by damaging tourism assets and reducing tourist arrivals and earnings, causing destruction to the natural environment and necessitating unanticipated fiscal spending that could set back economic stability. In response to this threat, the GOBA needs to strengthen its disaster preparedness and mitigation efforts and pursue adequate insurance measures, both in the formal sense and in terms of a fiscal margin for such a possibility.
- 5.36 Natural disasters have long been a focus of research and programming in the Caribbean. The subject features significantly in the region's leading strategic frameworks, ranging from CARICOM's founding charter in 1973 to the Comprehensive Disaster Management (CDM) framework spearheaded by the Caribbean Disaster Emergency Response Agency (CDERA) in 2001. For its part, Bank support to disaster risk management in the Caribbean is being intensified through on-going revision of its Natural Disaster Policy and the recently approved Action Plan for Improving Disaster Risk Management (2005-2007). Within the framework of the IDB's Regional Policy Dialogue, the Bank is holding a Caribbean Sub-regional meeting of the Natural Disasters Network in Barbados on October 26, 2005.

5.37 Given the common threat to countries of the Caribbean, the regional initiatives of the Bank to support natural disaster preparedness and mitigation are important contributions to meeting the challenges facing Barbados. The IDB and the CDB are joining forces to mainstream disaster risk management and integrate it into fiscal and development policymaking. One of the joint activities in the works for the IDB and CDB is a High Level Forum scheduled to be held in 2006 that will help to align the activities of these institutions in the area of disaster risk management to ensure harmonized and effective interventions in the Region. This Forum would incorporate inputs from the CDB's initiative to integrate natural hazards into Environmental Impact Assessments (EIAs) and the IDB Indicators of Disaster Risk and Risk Management, bringing together member states of both organizations spanning the Caribbean region, including CARICOM countries, the OECS, Haiti, the Dominican Republic and Suriname.

#### **F. Agenda for Dialogue**

5.38 Dialogue between the Bank and the GOBA and other stakeholders will be critical if the history of weak implementation is to be overcome and the development objective is to be achieved. This dialogue is needed to maintain a common understanding of conditions and challenges and to make timely responses to portfolio and pipeline problems. It should involve regular review of performance against specific benchmarks and targets, including those outlined in the matrix to this CS. It is also vitally important to have shared ownership and agreement between the GOBA and the Bank on strategic objectives and direction and to constantly monitor the condition of relations.

5.39 **Macroeconomic stability.** The dialogue should confirm a common understanding between the GOBA and IDB about the macroeconomic conditions and prospects that are key to overall competitiveness goal. The GOBA has committed to a gradual reduction in the debt/GDP ratio but current projections show the debt remaining unchanged over the next five years. In addition, concern is raised by the widened BoP current account deficit and loss of international reserves. The dialogue should examine how well macroeconomic stability is being maintained in relation to scenarios agreed with the IMF, the timeframe for debt reduction, the question of adequate contingencies for possible shocks and how Bank-financed programs would be affected.

5.40 **Project execution problems.** While there is general agreement on the existence of project execution problems, responding to the problems will depend on whether they are caused by policy dilemmas and institutional issues, management and decision-making issues, staffing, inadequate training and experience, design flaws, etc. The dialogue should draw up a specific schedule for consultation to address the problem of slow project execution.

5.41 **New lending framework.** This CS recommends using instruments that give ready access to funding for small, targeted activities aimed specifically at strengthening the private sector business climate and other bases for competitiveness. The

dialogue should explore the range of options provided by the Bank's new procurement policy and the new lending instruments to determine how it may be possible to use a wider variety of instruments in Barbados. In addition, the dialogue should advance the identification of priorities for financing under the PRODEV.

- 5.42 **Rising energy prices.** Rising energy costs will aggravate the BoP difficulties, because imported fuel account for a substantial proportion of import expenditure, and put a brake on economic activity. It is important for Barbados to consider short-term plans to curb fuel consumption and long-term plans to explore renewable domestic energy sources. The dialogue should give consideration to available options and to the possible role of Bank assistance. Recognizing the vulnerability of oil-importing countries the Bank initiated a high-level consultation with its member states at its headquarters in September 2005 as a step towards determining appropriate approaches for responding to the problem.

## MILLENNIUM DEVELOPMENT GOALS

### Progress on Millennium Development Goals Barbados

2. Achieve universal education (net primary enrolment ratio)



3. Promote gender equality (ratio of girls to boys at primary and secondary education)



4. Reduce child mortality (under 5 mortality rate per 1,000)



5. Reduce maternal mortality (rate per 100,000 live births)



6. Combat other diseases (incidence of TB cases detected (per 100,000 people)



7. Ensure environmental sustainability (Access to an improved water source - % of population)



Note: The figure above shows maternal mortality to be falling short of the MDG target but this figure is unreliable given the small population size.



BA-L1004	Reform and Modernization of Government Procurement	2007	5.0
S/N	Strengthening of Standards for Competitiveness	2006	5.0
S/N	Strengthening Agricultural Health System,	2007	3.0
S/N	Institutional Strengthening of the Barbados Statistical Service	2006	3.0
S/N	Restructuring of post-secondary education	2007	0.5
<b>TOTAL</b>			<b>65.7</b>

## **COUNTRY AND SECTOR WORK PROGRAM**

The country and sector work program of the next three years will fund analytical work and feasibility studies aimed at supporting the competitiveness thrust and the examination of GOBA priorities such as, the transportation system to identify action needed to provide a comprehensive improvement and reform options for the Government pension scheme. In addition, the program will try to fulfill the mandates of the Bank, including the PSDS, country environmental assessment (CEA) and the country financing parameters (CFP). The Bank's country and sector work in Barbados will also provide for seminars and workshops for training purposes and to support capacity building with respect to PPPs and other areas of institutional strengthening.

Bank support for non-financial products at the regional level will help address some of the problems that Barbados shares with other Caribbean countries, notably the dependence on imported energy sources and vulnerability to natural disasters. Regional conferences are planned on these subjects and associated regional technical cooperation will help strengthen Barbados disaster mitigation in the tourist sector, its main engine of growth. In addition, a recent proposal calls for creating a fund on a regional basis to deal with petroleum price fluctuations and helping countries explore ways to improve energy use so as to reduce the effects of rising petroleum prices.

The government has indicated interest in participating in the PRODEV (Program to Implement the External Pillar of the MTAP for Development Effectiveness), but the Cabinet is still considering the agreement. The main purpose of the PRODEV will be to assist the government in defining an action plan for improving development effectiveness. Specific applications may include support to GOBA efforts to move to multi-year budgeting, accrual accounting and eventually to output budgeting. The GOBA has already introduced multi-year budgeting and accrual accounting in one ministry on a pilot basis.

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