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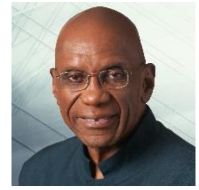

Economic Letter March 2018

Barbados' Foreign Reserves Drain Worsened in 2017

The accelerating loss of foreign reserves in 2017 is evidence of the failure of Government's adjustment policies. Reserves, which fell $246 million in 2016, declined by $274 million in 2017. Since December 2012 the Central Bank has lost over $1 billion of foreign exchange.

The May 2017 Budget was intended to arrest the decline in foreign reserves, which had driven the level below the critical minimum of twelve weeks of imports at December 2016. The main adjustment tool was the NSRL, which was expected to provide $218 million in tax receipts. In fact, between April and December last year the NSRL yielded $97 million.

The NSRL has had an adverse effect on economic growth. In the absence of the tax, the Barbados economy might have achieved another 0.5 percent on top of the one percent growth rate actually attained. That represents a loss of about $50 million of national income.

The foreign exchange fee was introduced in the May Budget to complement the NSRL by slowing the outflow of foreign exchange. However, shortages of foreign exchange persisted, mainly because Government was obliged to repay $137 million of foreign debt. Foreign lenders were unwilling to roll over this debt because of Government's poor credit rating.

The third element of adjustment in the May 2017 Budget was an across-the-board reduction of $82 million in Government expenditure. Actually, total expenditure *increased* by $57 million between April and December. The largest items of expenditure are wages, subsidies to state enterprises and interest on money Government borrowed to fund previous years' deficits.

The Central Bank's foreign reserves continue to be in free fall, with the failure of Government's corrective strategy. The current costs of Government operations exceeded revenues by $288 million between April and December last year, and Central Bank's lending to the public sector increased by $372 million during the year. Unless this gap is closed foreign reserves will be exhausted, and Government will lose control of the exchange rate. The *Barbados Sustainable Recovery Plan 2018* does not address this issue.

All is not yet lost. The first order of business must be to remove the emergency taxes that are strangling private business, and to cut public sector spending to eliminate the current account deficit. In my paper *The Road to Prosperity* I have calculated that an immediate cut of 10 percent in subsidies, and redundancy of 1,500 public workers would suffice. That will halt the foreign reserves slide, and open the way for discussions with the IMF on a programme of financial support for a practical, well-designed strategy for public sector renewal. The full implementation of the 7-point strategy recommended in *The Road to Prosperity* will cure our economy of the twin illnesses of Government overspending and public sector ineptitude, and release the pent-up enterprise of our dynamic private sector. Barbadians must insist that our Government preserve our country's reputation for taking tough short-term measures in the interest of future prosperity.

Note: Data used in this letter are from the Central Bank of Barbados Press Release, Jan 30, 2018.