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Economic Adjustment in Barbados: Examples from Successful Countries

It goes without saying that your best advice for success in any endeavour comes from those that have achieved success in a similar venture. This month's column draws lessons on successful economic adjustment from four countries which were among the hardest hit by the 2008 economic crisis, countries which took decisive measures in response, and today can boast of restored growth and unimpaired standards of living. Our exemplars are all countries that have maintained very high human development throughout the adjustment period. **Ireland** is Number 8 in the Human Development Index, reflecting the high purchasing power of average incomes, and very good health and educational outcomes. **Iceland**, our second example, is at Number 9. Our third selection, **Cyprus**, is at Number 33, and **Latvia**, the fourth example, is at Number 44. **Barbados** is at Number 54, so the chosen examples are all worthy of emulation.

The four exemplars are, like Barbados, small open economies that are highly integrated into international financial markets, with foreign banks and financial institutions, and financial links to major centres like London and New York. However, their exchange rate arrangements vary: Ireland and Cyprus are members of the euro area; Latvia elected to maintain a fixed peg to the euro; and Iceland allowed its currency to depreciate. What was common to all four countries was a deep cut in government expenditure on items other than infrastructure, and they all secured financial support from the IMF.

Dr Patrick Honohan, who was Governor of the Central Bank of Ireland at the time of their crisis, visited with us as this year's Distinguished Visiting Fellow at the Central Bank of Barbados. While here he advised that, based on Irish experience, a major cut in government expenditure, and securing timely financial support from the IMF, were the keys to successful adjustment. The Government of Ireland cut its consumption expenditure by as much as 7.1 percent in 2010, restricting GDP growth to only 0.4 percent. However, growth speeded up in 2011, and by 2016 the growth rate was estimated at 4.6 percent. In their "Concluding Statement" after a visit to Ireland in March 2017, a team from the IMF stated "After a period of sacrifice, economic recovery is well underway."

The collapse of Icelandic banks which had extended their operations globally is one of the best known episodes of the 2007/8 financial crisis. In an interview posted at *IMF.org*, the Governor of Iceland's Central Bank, Mar Gudmundsson, noted that the Icelandic Government initiated crisis management measures in advance of an approach to the IMF in 2008 for US$2.1 billion of support to assist with the meltdown of the currency. Government's consumption expenditure was cut each year from 2009 to 2012, for a total reduction of 13 percent. The economy contracted by a cumulative 10 percent in 2009 and 2010. The sacrifice was worth it: growth resumed in 2011, and in March this year the IMF reported a remarkable growth rate in 2016 of 7.2 percent. The krone appreciated by as much as 20 percent, and the fiscal deficit was cut to half a percentage point of GDP in 2015. Iceland repaid all its obligations to the IMF ahead of schedule in October 2015.

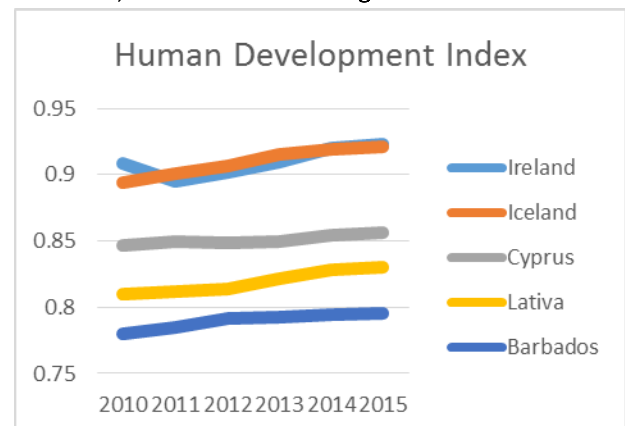
The economic and financial crisis in Cyprus was another event that captured global headlines, largely because of the country's financial links to Greece. Recession in Cyprus began in 2012, around the time of the crisis talks to address the threatened default on Greek debt. However, whereas Greece's problems

are ongoing, in March last year the *IMF Survey* headline read "Cyprus turns economy around, successfully exits IMF programme". Once again, a large cut in Government consumption expenditure, amounting to 15 percent over the 2012-2014 period, was the defining feature of the adjustment programme.

The story of Latvia's adjustment follows a similar pattern: a reduction of 8 percent in government consumption expenditure in 2010 caused a recession that year, but growth resumed the very next year, and the economy has expanded every year since. The fiscal deficit was reduced from 8.5 percent of GDP in 2010 to 1.3 percent in 2015.

What do we learn from these episodes?

The countries chosen are all of a similar size to Barbados and its Caribbean neighbours, with populations ranging from less than 300,000 to about 5 million. They are all ahead of Barbados in terms of their standard of living and quality of life, and are therefore legitimate role models for us. The adjustment problem faced by each country was of a far greater magnitude than what Barbados needs to deal with today. In every case the centrepiece of adjustment was a major cut in the costs of running the government, ranging from 7 percent in Ireland to 15 percent in Iceland. That led to a slowdown in growth and, in some cases, severe contraction for a year or more, but robust income growth was restored in the medium term, in every instance. More importantly, the Human Development Index improved in Iceland and Latvia throughout the period, even during the adjustment years. The economies contracted temporarily, but standards of living and quality of life were unaffected. In the cases of Ireland and Cyprus there was a dip in the HDI, but only for a single year. This is evidence in support of the adage that short term pain can yield long term gain.



It is also important to note that these adjustment programmes were all supported by IMF financing agreements, giving the lie to the myth that the IMF is committed to currency devaluation in every situation, and that IMF assistance always comes at a cost in terms of social wellbeing.

The lesson for Barbados is clear, and it confirms what we already know, based on our own experience in 1991. The treatment for what ails our economy is a reduction in the costs of operation of government and state enterprises, supported by financial assistance from the IMF and other international and regional financial institutions. That may hurt the economy somewhat in the near term, but it will reset the external balance, restore confidence, reverse the sentiment at credit rating agencies, and uncover the strong underlying competitiveness of our tourism, international business, rum and other selected manufactures, and renewable energy service providers.