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**ECONOMIC SURVEY OF THE CARIBBEAN  
2003-2004**

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At the time this report was in its final formatting phase, the economies of Grenada and Jamaica were significantly affected by Hurricane Ivan. As a result, the GDP growth projections for 2004 for both countries correspond to the expected growth rates in the absence of a natural disaster.

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## Executive summary

This survey examines the macroeconomic performance of Caribbean countries for 2003 and what the data availability allows for 2004. The analysis in this publication refers, as in past years, to Caribbean Community (CARICOM) economies and also, for the first time, to the majority of the Non-Independent Caribbean Countries (NICCs) that are members of the Caribbean Development and Cooperation Committee (CDCC).<sup>1</sup>

The survey shows that Caribbean economies have, in general, exhibited a process of economic recovery. In 2003, Caribbean countries improved their performance registering on average 2.8% GDP growth compared with the 1.0% recorded in 2002. There are nonetheless significant disparities in GDP growth among countries. At the lower end of the spectrum, Guyana and the British Virgin Islands registered economic downturns (-0.6% and -1.9%). At the higher end, Antigua and Barbuda and Suriname doubled their growth rates in 2003 in comparison with the previous year. However, the overall growth divergence narrowed.

The 2003 recovery was fuelled mainly by the services sector, and more specifically by tourism. To a lesser extent, it reflected the contribution to aggregate growth of primary sector activities. The tourism sector's performance in 2003 is a direct expression of the pick up of the global travel industry following the events of 11 September 2001. Primary sector activities benefited in great part from the increase in the international prices of oil and non-oil commodities.

Caribbean countries experienced improvement in their fiscal accounts largely through restraint in government expenditure. Five countries (Belize, The Bahamas, Guyana, the Netherlands Antilles and Saint Lucia) proved to be the exception to this trend. Despite fiscal consolidation efforts, the disparity among Caribbean countries remains extremely high for a region whose ultimate goal is monetary and economic union. At one extreme Trinidad and Tobago exhibits a fiscal surplus equivalent to 1.4% of GDP. At the other extreme, Belize, Guyana, and the member States of the Organisation of Eastern Caribbean States (OECS) have fiscal deficits reaching levels which are of the order of 10% of GDP or greater.

In spite of the efforts aimed at fiscal consolidation the public debt remains one of the main constraints to the economic development of Caribbean countries. From 1997 to 2003 the average public debt-to-GDP ratio increased from 62% to 85% ranking the Caribbean as one the most indebted regions of the world. When decomposed in terms of its internal and external component, the former represents 34% of GDP of the total while the latter has reached 54% of GDP. In addition, sustainability computations show that for most countries the current indebtedness levels are unsustainable. A long-term solution must involve efforts aimed at fiscal consolidation as well as the development of export promotion strategies at the national and regional levels.

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<sup>1</sup> Caribbean countries analyzed in this survey include: Anguilla, Aruba, Antigua and Barbuda, Barbados, The Bahamas, The British Virgin Islands, Dominica, Jamaica, Grenada, Guyana, Montserrat, The Netherlands Antilles, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago and the United States Virgin Islands. The extent to which countries are included in the different computations and indicators presented in the paper depends solely on data availability.

On the external front, the current account deficit for the Caribbean, as a whole, narrowed in particular as a result of the performance of commodity-oriented economies which benefited from increases in the international prices of commodities. In contrast, service-oriented economies suffered, for the most part, a deterioration in their external accounts

The conduct of monetary policy varied according to the type of exchange rate regime in place. In fixed exchange rate regime economies, the monetary authorities acted passively. In the case of managed exchange rate regimes, the monetary authorities employed a series of tools to guide the behaviour of prices and the exchange rate.

For 2004, the Caribbean region is expected to experience continued increase in its rate of GDP growth mainly as a result of the improvement in growth prospects for commodity-oriented economies. Service-oriented economies are projected to maintain for the most part their current growth levels as visitor arrivals and tourist expenditure continue to recover from the effects of the events of 11 September. The main challenge that governments will confront in 2004 is how to maintain the current growth trajectory while at the same time offsetting the effects of the increase of international oil prices on government expenditure, import growth and inflation.

The survey is divided into four sections. The first presents a regional economic overview which briefly compares the performance of Caribbean countries relative to that of Latin America and then focuses on the particularities of macroeconomic performance for 2003 for the Caribbean region in the aggregate. The section also includes a preliminary projection for 2004.

Since tourism provided the impetus for the recovery of 2003, the second section analyses the nature of the recovery and the strategies being pursued to increase tourism's contribution to economic growth. Given the recent attention placed on the state of indebtedness of Caribbean economies as an obstacle to long-run growth, this section also examines the question of public debt.

The third section, and by far the most comprehensive, describes the macroeconomic evolution of CARICOM and the NICCs (Aruba, Netherlands Antilles, British Virgin Islands and the United States Virgin Islands) for 2003, with some preliminary estimates for 2004. For institutional reasons the analysis of two of the NICCs, Anguilla and Montserrat, is presented with that of the OECS. Where data availability permits, a table with the main macroeconomic indicators is included in the analysis of each country.

The final section is a statistical annex. It consists of a series of statistical tables, mainly for CARICOM economies, that include the distribution of GDP by sector of economic activity (in levels and rates of growth); real sector indicators; the fiscal accounts of the central government; a monetary survey; the balance of payments according to the methodology of the 5th Manual of the International Monetary Fund (IMF); and external sector indicators. This last set includes the external debt, exports (usually classified by traditional and non traditional); imports (usually classified by economic category) and, when relevant, tourism indicators.

## **I. REGIONAL OVERVIEW**

## 1. Caribbean performance within the context of Latin America and the Caribbean

Over the last decade the rate of growth of GDP in the Caribbean surpassed that of Latin America and exhibited a lower degree of volatility (see Figure 1 below).

For the period 1992-2003 the rate of growth for Latin America and the Caribbean averaged 2.4% and 2.7%, respectively. The volatility of GDP growth, measured by the ratio of its standard deviation to the mean, averaged 0.8% and 0.5% for both regions. This growth pattern has become more pronounced in the last five years. From 1998 to 2003, GDP growth in the Caribbean has been systematically above that of Latin America.<sup>2</sup>

The lack of correlation between the growth trajectories of Latin America and the Caribbean<sup>3</sup> underscores the fact that economic performance has responded to different and perhaps independent factors.

For one thing, Caribbean economies have not been subject to the type of sharp macroeconomic crisis that affected a series of Latin American economies.<sup>4</sup> These crises brought about by the interplay of external and internal factors are largely responsible for the pronounced troughs of the Latin American GDP series.

For the Caribbean the largest trough is the one recorded following the September 11th events. This was caused purely by an external shock and did not respond in any way to the internal dynamics of the economies in question. In the same way the period of stable growth expansion (1994-1998) and acceleration (1998-2000) favourably reflected external conditions and in particular the unprecedented performance of the United States economy from 1992 to 2000 (see Figure 1).

At the country level, Dominica recorded in 2002 (-5.0%) the largest contraction. The case of Dominica responded to a fiscal crisis leading to the implementation to a three year IMF Poverty Reduction and Growth Facility Programme based mainly on fiscal consolidation. Other OECS states (St. Kitts and Nevis, St. Vincent and the Grenadines, Grenada, St. Lucia and Antigua and Barbuda) have also undertaken adjustment programmes under the umbrella of the Structural Adjustment Technical Assistance Programme.

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<sup>2</sup> Per capita GDP figures tell a similar story. During 1992-2003, the average GDP per capita growth for Latin American countries was less than 1% (0.8%). This highlights a progressive impoverishment of the region or, more to the point, a significant slowdown in productivity. Contrarily, per capita GDP growth averaged 1.9% for the Caribbean.

<sup>3</sup> The simple correlation coefficient yielded a value of -0.00035.

<sup>4</sup> These include Cuba (-13.8% and -16.0% GDP growth in 1992 and 1993), Haiti (-13.8% and -8.2% GDP growth in 1992 and 1994), Mexico (-6.1% in 1995), Ecuador and Venezuela (-5.7% and -5.5% in 1999), Argentina, Uruguay and Venezuela (-10.8%, -12.0% and -9.0% in 2002 and -9.3% in 2003 for Venezuela).

**[FIGURE 1]**

The performance of the Caribbean also highlights the positive results of the structural adjustment programmes of the larger economies (Barbados, Trinidad and Tobago and Guyana) implemented at the beginning of the 1990s. Barbados registered positive rates of growth above 2% for most of the 1990s. Guyana recorded some of the highest growth rates in the region averaging 8% between 1992 and 1997 before settling to a lower growth plateau in the latter part of the decade. Finally, Trinidad and Tobago, benefiting also from the impulse of the energy sector, witnessed rates of growth above 3% consistently since 1994 with the exception of 1996 and 2002.

Experience in the region also points to a conscious policy aimed at the expansion of aggregate demand which helped to boost overall regional economic growth. St. Kitts and Nevis and Grenada are cases in point. The most illustrative case is, however, that of Belize whose rates of economic growth as a result of rising government's capital expenditures averaged 8.6% in the said period.

## **2. The Caribbean real sector performance in 2003**

In 2003 Caribbean countries improved their performance, registering on average 2.4% GDP growth which compares favourably with the listless 0.75% of the previous year. However, this figure masks the significant disparities in GDP growth observed among countries: whereas Guyana and the British Virgin Islands registered economic downturns, contracting by 0.6% and 1.9%, respectively, Antigua and Barbuda and Suriname doubled their growth rates in 2003 in comparison with the previous year. Nevertheless despite these disparities, overall growth divergence in the region narrowed. In fact, one of the smallest degrees of divergence among Caribbean economies in the past two decades was recorded in 2003 (see Tables 1 and 2).<sup>5</sup>

When classified in terms of their external market orientation, commodity-oriented economies exhibited the highest level of economic growth, standing on average at 3.1%, compared to 2.4% in 2002. For their part, service-oriented economies clearly exhibited the greatest acceleration in economic growth (up from 0.3% in 2002 to 2.8% in 2003) and were thus the driving force to the increase in average growth for the region.<sup>6</sup>

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<sup>5</sup> The concept of Convergence (divergence) used here is known in the literature as Convergence gamma and is computed as the ratio of the standard deviation to the mean for cross-sectional data.

<sup>6</sup> 'Commodity-oriented economies' and 'service-oriented economies' are analytical categories denoting opposite poles which delimit the types of productive structures found in the Caribbean region. As such, some economies are closer to the commodity category while others are akin to the service category. In some cases an economy may fall under both categories or may shift over time from the one category to the other. For the purposes of this document, Guyana, Jamaica Suriname and Trinidad and Tobago are commodity-oriented economies. Barbados, The Bahamas, Jamaica, the NICCs and the OECS are considered service-oriented economies.

**Table 1**  
**Indicators of size and development for Caribbean States**  
**2003**

Caribbean states	Area in Thousands of Km <sup>2</sup>	Population Thousands of inhabitants 2003	GDP per capita US dollars 2003	Poverty Percentage of population below the poverty line	Unemployment rate 2003	Inflation 2003	Fiscal balance as percentage of GDP 2003	Current account as percentage of GDP 2003	Public debt as percentage of GDP 2003
The Bahamas	14	312	16691	....	10.8	3.0	....	-8.17	45.0
Barbados	0.43	272	9651	14	11.1	1.6	-2.5	-8.0	71.1
Belize	23	290	3646	....	12.9	2.6	-10.9	-18.3	88.9
Guyana	216	762	911	35	....	4.9	-34.7	-11.0	172.0
Jamaica	11	2 600	2962	19	13.1	14.1	-5.9	-12.4	142.0
Suriname	164	439	2470	....	....	26.0	0.2	-14.0	37.0
Trinidad and Tobago	0.44	1 300	7836	21	10.6	3.0	2.7	9.6	28.0
OECS	2.81	578	4338	....	....	1.8	-9.0	-19.0	109.0
Anguilla	0.1	12	7840	....	....	6.9	2.	-34.7	17.2
Antigua and Barbuda	0.44	74	8369	12	....	....	-9.0	-12.7	151.7
Dominica	0.75	72	3023	33	....	3.0	-5.0	-13.2	127.0
Grenada	0.34	102	3353	32	....	1.1	-10	-34.5	110.1
Montserrat	0.1	4	7569	....	....	1.2	-28	-17.4	16.3
St. Kitts and Nevis	0.27	50	6510	31	....	3.1	-9	-23.7	162.0
St. Lucia	0.62	167	3658	19	....	0.4	-9	-15.4	66.5
St. Vincent and the Grenadines	0.39	112	2819	33	....	2.7	-2.4	-18.2	76.7
Aruba	1.0	91	22000	....	6.9	3.7	1.0	-7.0	41.0
British Virgin Islands	0.1	21	10000	....	....	0.4	-0.7	....	....
Netherlands Antilles	0.8	219	11400	....	....	1.9	-5.0	0.2	90.0
United States Virgin Islands	0.3	108	12500	....	8.5	....	....	....	....

... denotes not available.  
Source: ECLAC, based on official statistics.

<b>Table 2</b>					
<b>GDP growth</b>					
<b>1980-2004</b>					
	<b>1981-1990</b>	<b>1991-2001</b>	<b>2002</b>	<b>2003a/</b>	<b>2004b/</b>
Anguilla	....	3.8	-3.1	3.0	....
Aruba c/	....	3.2	-2.6	1.4	....
Antigua and Barbuda	6.1	3.4	2.1	5.8	5.0
The Bahamas	...	1.8	2.3	0.2	....
Barbados	1.1	0.9	-0.5	2.2	3.0
Belize	4.5	4.9	4.4	4.4	4.0-5.0
British Virgin Islands	....	....	....	-1.9	....
Dominica	4.4	2.4	-5.1	1.0	1.0
Grenada	3.5	3.5	-0.4	5.7	3.0
Guyana	-2.9	4.7	1.1	-0.6	2.5
Jamaica	2.2	0.7	1.1	2.1	2.3
Montserrat	...	-8.5	4.9	1.2	....
Netherlands Antillesd/	....	-1.3	0.4	1.4	0.9
St. Kitts and Nevis	5.8	4.1	-0.3	0.6	2.0
St. Lucia	6.8	1.4	0.4	3.7	2.5
St. Vincent and the Grenadines	6.5	3.0	1.7	3.6	2.4
Suriname	0.5	1.0	3.0	5.6	6.0
Trinidad and Tobago	-2.6	2.7	2.7	4.1	6.0-7.0
<b>Average</b>	<b>3.0</b>	<b>2.0</b>	<b>0.7</b>	<b>2.4</b>	<b>3.5</b>
Service-oriented economies	4.0	1.5	0.3	2.7	2.4
Commodity-oriented economies	0.3	2.8	2.5	3.1	4.6
Divergence	1.1	1.6	2.8	0.7	1.9

Note: a/ estimated; b/projected. c/ 1995-2001; d/1997-2001.  
 ... denotes not available.  
 Source: On the basis of official information

## **2.1 The tourism sector**

The 2003 recovery was essentially a service sector driven recovery. Specifically, it was led by the recovery in tourism and was only, to a lesser extent, the reflection of the contribution to aggregate growth of commodity-oriented economies. The tourism sector's performance in 2003 is a direct expression of the pick-up of the global travel industry following the events of 11 September and is reflected in the expansion in airlifts and cruise ship calls and improved marketing strategies to recover market share losses.<sup>7</sup>

The extent to which tourism performance affects the rate of growth of Caribbean economies' GDP depends partly on size considerations. It is also a reflection of the close sectoral linkages between tourism and other economic sectors in some of the service-oriented economies

<sup>7</sup> For example, data for the OECS indicate that the number of cruise ship calls recovered from -21% in 2002 to 3.5% in 2003 (and 7% if St Vincent and the Grenadines is excluded from the group).

(Antigua and Barbuda, The Bahamas, Barbados and the Non-Independent Caribbean Countries (NICCs)). Among these, Barbados provides the most illustrative example of this linkage. The simple correlation coefficient between the rate of growth of GDP and that of tourist arrivals (used as a proxy for tourist expenditure) yields a value of 0.85 (see Figure 2).

Other service-oriented economies (Dominica, Saint Lucia and Grenada) do not demonstrate a similar linkage. The scatter diagram in Figure 3 shows the relationship between the average rate of growth of tourist arrivals (stopovers) and that of GDP for the period 1990-2003. Economies, such as Barbados and The Bahamas, are close to the 45° line which maps a one-to-one correspondence between GDP growth and that of tourist arrivals. Others are clearly situated below the 45° line. For them the rate of growth of GDP is less than proportional to that of tourist arrivals.

In a similar vein, the use of limited available data on tourist expenditure and simple econometric analysis demonstrates that for the economies situated below the 45° line, a 10% growth in visitor expenditure generates only a 0.2% growth in GDP. The empirical evidence presented indicates that maintaining the growth momentum will require additional efforts and strategies for further developing and diversifying the tourism sector.

Interestingly, in 2003 tourism was also a significant contributor to the rate of growth of some of the commodity-oriented economies, such as Belize, or economies with a strong primary sector such as Jamaica. In the case of Belize, the contribution of total visitor arrivals is largely explained by cruise ship arrivals (98% for the same period). Nonetheless, stopover arrivals and tourist expenditure expanded significantly in relation to the previous year (1% and 11% in 2002 and 2003). The significant expansion of tourism in Belize is due to the fact that the country has been able to offer one of the most diversified tourism products in the Caribbean and Central American regions. The Belizean tourist product includes the traditional beach and sun tourism and the advantages of the second largest barrier reef in the world as well the heritage of the Mayan culture. Belize is also the least deforested Central American Isthmus country which is endowed with a rich and varied fauna. In the case of Jamaica, the tourism sector recorded the highest growth of any of the sectors.<sup>8</sup>

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<sup>8</sup> Section II of this report investigates in greater detail the developments in tourism in the region and in member States during 2003, pointing to challenges that the sector faces as well as to potential strategies that are being pursued.

**[FIGURES 2 AND 3]**

**(FIGURE 3)**

## **2.2. *Primary sector activities***

Following tourism, activities associated with the primary sector constituted the second largest contributor to overall growth. In the case of Belize, primary activities grew by 36% in real terms. For Jamaica, the contribution of agriculture and mining to GDP growth is estimated at 16.4% and 12.5%, respectively, (18% for the miscellaneous services category which includes hotels and restaurants). In addition, both sectors recorded the largest rates of growth for 2003 (5.7% and 4.8%) after that of tourism. In the case of Trinidad and Tobago, the energy sector witnessed an expansion of 11% which dwarfed the 1.8% growth in the non-energy sector. Overall, only Guyana provided the exception to this general trend in that it recorded declines in most of its primary sector activities (by 9% for sugar and mining and by 2% for other agriculture). This was due to structural and technical problems.

Primary sector activities benefited partly from the increase in the international prices of oil and non-oil commodities, including alumina and bauxite, and sugar and bananas. The international prices of alumina expanded 10%, responding to the rise in external demand driven by China. Those of sugar and bananas rose by 8.7% and 4.1%, respectively. For their part, crude oil prices rose by 20% relative to 2002.

The behaviour of the primary sector was not only due to favourable commodity prices, but was also reflected in the increase in productive capacity in some of these economies. Trinidad and Tobago expanded the production of natural gas due to the commissioning of the Train III liquefied natural gas facility (LNG). Plans have also been undertaken to expand sea drilling activities. The performance of the primary sector in Jamaica reflected as well increased capacity utilization in the alumina sector.

## **3. *Fiscal and external performance***

### **3.1. *Fiscal performance***

The increase in the overall level of economic activity was accompanied by conscious efforts to contain and reduce fiscal imbalances. This policy was in general terms in line with that of most Latin American countries. On average, the aggregate fiscal deficit for the region narrowed from 8.9% to 6.7% (see Figure 4), largely due to a reduction in public expenditure.

However, five countries (Belize, The Bahamas, Guyana, the Netherlands Antilles and Saint Lucia) proved to be the exception to this trend. In both Belize and the Bahamas, the fiscal outcome responded to the increase in interest rate payments to service the external debt. In the particular case of Belize, interest payments on the public debt rose 76% and represented 22% of current expenditure for 2003. In fact, Belize is particularly noteworthy as the fiscal deficit expanded threefold, from 3.7% of GDP in 2002 to 10.8% of GDP in 2003.

**[ FIGURE 4 ]**

For the member States of the OECS, Jamaica, Suriname, Aruba and the British Virgin Islands fiscal policy was carried out through expenditure restraint. Fiscal performance in Barbados and Trinidad and Tobago benefited from the pick-up in economic activity and, in the case of Trinidad and Tobago, from the increase in the international price of oil. Fiscal reforms were implemented in Barbados, Jamaica and Suriname (see Box 1). In the case of the British Virgin Islands, the contraction in capital expenditure (-43%) was the main vehicle used to achieve fiscal consolidation.

In Jamaica, fiscal reforms implemented in the months of April and May included widening the tax base of the general consumption tax as well as increases in the rate applied on the use of telephone services and duty rates on selected imports. In Suriname fiscal reforms were introduced between December 2002 and January 2003. A series of tax measures were introduced to address the existing fiscal imbalance and the negative effect of the implementation of the third and fourth phase of CARICOM's Common External Tariff starting in January 2003.

<b>Box 1</b>		
<b>Fiscal reforms in the Caribbean</b>		
<b>2002-2004</b>		
<b>Jamaica</b>		
<u>Tax measure</u>	<u>Date of implementation</u>	<u>Revenue effect in terms of GDP</u>
4.0% cess on imports	May 1 – 31, 2003	0.8
2.0% custom user fee	June 1, 2003	
Increased Stamp Duty on imports by in-bond merchant	May 1, 2003	0.0
Widening of the General Consumption Tax base	June 1, 2003	
Increase in assets tax rates	June 1, 2003	2.1
Adjustments to the aggregate duty structure on selected motor vehicles	May 1, 2003 June 1, 2003	0.0
Adjustment to the age limit on imported vehicles		
Removal of income tax credit on bonuses share issues	June 1, 2003	0.0
Change in the duty concession policy		0.1
Increase in Special Consumption Tax (SCT) on alcoholic beverages	April 22, 2003 April 24, 2003	0.1 0.1
		3.4
<b>Barbados</b>		
Reduction in the basic and marginal tax rates. The basic tax rate will be reduced from 25% to 22.5% in 2003 and to 20% in 2004. The marginal tax rate will be reduced from its present level of 40% to 37.5% in 2005 and to 35% in 2006		
Increase in the tax-free threshold from BD\$ 15,000 to BD\$ 17,500 in 2004 and to BD\$ 25,000 in 2007.		
Reduction in the corporation tax from its present level 40% to 25% in 2007		
<b>Suriname</b>		
The measures effective in 2003 included an increase in the threshold of the wealth tax, and the introduction of a threshold in the rental value tax and a casino tax consisting in the payment of a fixed amount per tables and machines. These also comprised changes to the threshold income brackets and increases in the tax rates of the income tax and of the sales tax rate (effective in December 2002). The latter rose from 5% to 8% for services and from 7% to 10% for goods.		
<u>Source:</u> Planning Institute of Jamaica. Economic and Social Survey of Jamaica (2003); Jamaica Memorandum on the Budget 2004/2005. Ministry of Finance of Jamaica (15April 2004) and on the basis of official sources.		

Nevertheless, despite the recent fiscal consolidation efforts, disparity among Caribbean countries remains extremely high for a region whose ultimate goal is monetary and economic union as dictated by the legal texts of the Caribbean Single Market and Economy (CSME).<sup>9</sup> At one extreme Trinidad and Tobago exhibits a fiscal surplus equivalent to 1.4% of GDP. At the other extreme, Belize, Guyana, and the member States of the OECS have fiscal deficits reaching levels which are near or higher than 10% of GDP (see Figure 4).

Analysis of the aggregate fiscal stance and the tax to GDP ratio as a percentage of GDP shows that Caribbean economies have in the aggregate exhibited fiscal disequilibria (see Figure 5).<sup>10</sup> Fiscal policy began an expansionary stance from 1995 that lasted until 2002. This trend however turned in 2003, as the fiscal stance decreased mainly as a result of a decline in government expenditure. On the other hand, the tax to GDP ratio witnessed a slight increase of half a percentage point (25.4% and 26.0% in 2002 and 2003, respectively) showing a weak response of the tax system to economic growth.<sup>11</sup> This implies mainly that the attainment of fiscal balance can in effect in effect only be brought about through a policy of government expenditure restraint.

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<sup>9</sup> The cross-sectional coefficient of variation rose from -0.99 in 2002 to -1.09 in 2003, indicating that the country deviation of the budget deficit from its mean is higher than the mean itself.

<sup>10</sup> The fiscal stance is defined as government expenditure divided by the tax ratio (tax revenue over GDP). The fiscal stance is neutral when tax revenue covers government expenditure; accordingly, the fiscal stance is equal to GDP. The fiscal stance is said to be expansionary (restrictive) when government expenditure exceeds (falls short of) revenue; accordingly the fiscal stance is greater (less than) than GDP. The deviation between the fiscal stance and GDP as a percentage of GDP provides an indication of the extent to which fiscal policy deviates from a neutral stance.

<sup>11</sup> The correlation coefficient between both for the 1990 is statistically insignificant and indeed close to value of zero.

**[FIGURE 5]**

### 3.2. *The external sector*

On the external front, the region reduced its current account imbalance. In 2003 the average current account deficit for the Caribbean declined from 11.9% to 10.7% of GDP (see Figure 6). This behaviour reflected mainly the good performance of commodity-oriented economies and thus the positive effect of the improvement in external demand and the rise in commodity prices.

Trinidad and Tobago is a noteworthy case as it recorded the best balance on its current account in a decade (8% of surplus on the current account). Jamaica also experienced the first increase in three years in the nominal value of its exports.

The evolution of commodity exports is reflected in the movement of the export performance ratio (see Figure 6).<sup>12</sup> The ratio is below GDP for the period 1993-2003 indicating a disequilibrium in the balance of trade. Its slightly increasing slope for the year 2003 shows an improvement of export performance at the aggregate level.

In contrast with commodity-oriented economies, service-oriented economies suffered for the most part a deterioration in their external accounts (-12.4% and -13.15% of GDP in 2002 and 2003). Even though, in general, the services account saw its surplus increase, this positive result was insufficient to offset the negative results on the balance of trade and the income accounts.

An important fact to note is the substantial expansion of remittances. The most significant case is that of Jamaica, where remittance flows reached 15% of GDP surpassing the levels registered in other regions and countries prone to unilateral transfer flows such as Central America or the Dominican Republic.

The capital account exhibited a mixed behaviour for all countries involved. In some cases, such as in Trinidad and Tobago and Belize, it witnessed an outflow while in others, such as The Bahamas and Barbados, it registered significant inflows.

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<sup>12</sup> In the case of merchandise trade this indicator equals the ratio of exports to the average propensity of import (i.e. the ratio of imports to GDP). When exports are equal to imports, the export performance ratio is equal to GDP. When exports are greater (less) than imports, the export performance ratio is greater (smaller) than GDP.

**[INSERT FIGURE 6]**

Nonetheless in most cases the outcome responded exclusively to a conscious policy decision on the part of the authorities rather than on external factors. The exception is the OECS whose balance on the financial and capital account, was determined by foreign direct investment flows in infrastructure.

Trinidad and Tobago's continuing financial expansion and its debt operations repayments resulted in a deficit in the capital and financial accounts. Inflows in the case of Belize responded to the decision of the authorities to purchase on a temporary basis the equities of the Belize Telecommunications Company. In Barbados the Government sold a State-owned bank to foreign concerns. Finally The Bahamas received the proceeds from floating a bond on the international market to re-finance its external debt.

#### 4. The monetary policy stance

The conduct of monetary policy varied according to the exchange rate regime (see Box 2 below). In fixed exchange rate regime economies, with the exceptions of Aruba and the Netherlands Antilles, the monetary authority largely played a passive role adapting to the prevailing economic conditions. The monetary stance sought in this way to sustain the recovery of economic activity.

<b>Box 2</b>			
<b>Hard and soft pegs in the selected Caribbean countries</b>			
<b>1970 – 2003</b>			
<b>Countries</b>	<b>Time period</b>	<b>Soft Pegs</b>	<b>Hard pegs</b>
OECS	1976-2003		United States dollar
Bahamas			United States dollar
Barbados	1966-July 1975		Sterling
	1975 – 2003		United States dollar
Belize	1976-2003		United States Dollar
Guyana	1970-1975		Sterling
	1975-1984		United States dollar
	1984	United States dollar	
Jamaica	1971		United States dollar
	1984	United States dollar	
Trinidad and Tobago	1975-1993		United States dollar
	1993-2003	United States dollar	

Source: On the basis of official information.

As such those economies (with hard pegs) that recorded capital inflows (Bahamas, Barbados) also registered increasing levels of liquidity.

In the case of the OECS, with a currency union and a particular case of a fixed exchange rate regime, the money supply is demand driven and the Eastern Caribbean Central Bank (ECCB) maintained, as in the past, a neutral policy stance.

On the other hand, Aruba and the Netherlands Antilles imposed quantitative limits (a credit ceiling in the former and an increase in the reserve requirement in the latter) to reign in the growth of domestic credit.

In the case of managed exchange rate regimes (or soft pegs), such as Trinidad and Tobago and Jamaica, the monetary authorities employed a series of tools to guide the behaviour of prices and the exchange rate. The exception to the rule was Guyana. In view of the impending economic contraction and price contraction, the Central Bank of Guyana allowed the financial system to accumulate liquidity.

The Central Bank of Trinidad and Tobago used the reverse repurchase agreement rate to steer monetary policy backed by open market operations and interventions in the foreign exchange market. The monetary authority guided by market conditions applied a restrictive monetary policy in the first semester which it relaxed in the second half of the year.

In the case of Jamaica the authorities were forced to intervene following an official announcement at the end of 2002 that the government would not meet its fiscal target for the fiscal year 2002/2003 which triggered a sharp currency depreciation. The Bank of Jamaica used several instruments to stop the decline in the exchange rate and the consequent unwarranted price increases (see Box 4 below). These included the more orthodox open market operations and the consequent interest rates hikes as well as the use of foreign exchange reserves to prop up the currency. Intervention also comprised more heterodox tools such as the imposition of a 'Special Deposit' for national financial institutions, prescribed liabilities at the Bank of Jamaica and moral suasion. The latter came through an announcement of the Prime Minister stating that the government was committed to backing the currency.

The Jamaican case is of particular interest because it yields important insights into the issue of currency crisis in smaller economies giving way to an alternative explanation based on institutional arrangements and in particular on the relationship between the government and the Central Bank.

The thrust of the argument is that in smaller economies debt operations are unavoidable. As result, monetary policy cannot be independent of fiscal policy. When the debt burden is significant and the debt is denominated mostly in national currency, the Central Bank can arguably lower the term structure of the rates of interest to lessen the burden of the government debt. In a flexible exchange rate regime the nominal exchange rate has to fall in line with that of the interest rate. At a point in time if a government does not comply with its stated budget deficit target as occurred at the end of 2002, economic agents will expect a sharper fall in the interest rate and a greater depreciation of the exchange rate. In an attempt to avoid capital losses, economic agents switch from assets denominated in national currency to assets denominated in foreign currency. The stage for a currency crisis is thus set.

<b>Box 4</b>			
<b>Use of monetary policy instruments in Jamaica</b>			
<b>January to May</b>			
<b>2003</b>			
<b>Measure</b>	<b>Date of introduction</b>	<b>Nominal rate of exchange with the US dollar</b>	
		<b>Date</b>	<b>Value</b>
Special Deposit for institutions to hold 5.0% of their Jamaican dollar prescribed liabilities at the Bank of Jamaica	January 10	2/12/02;	49.95
		10/02/03	51.13
Issuance of a 120 Reverse Repurchase instrument at 30%.	February 10 (remover February 14)	10/02/03	53.19
Increase in interest rates on open market instruments from 180 to 365 days.	March 19	19/03/03	54.80
Increase in interest rates on open market instruments from 30 to 365 days.	March 26	26/03/03	55.40
Reduction of interest rates on some open market instruments	April 25	25/04/03	56.84
Communication by the Prime Minister backing the currency	May 18	16/05/03	67.77
		16/06/03	59.03

Source: On the basis of official information.

This type of interaction between the government and the Central Bank, or between fiscal and monetary policy, which is examined in the debt section of this survey, is also visible in other economies. Barbados is a case in point. The excess liquidity in the financial system was used to purchase government debt paper lowering its yield and with it the government's debt burden.

## **5. CARICOM's international trade negotiations**

As part of the process of integration in the international economy, CARICOM countries launched in April 2004 the Economic Partnership Agreement (EPA) Negotiations with the European Union. These agreements are meant to "build upon and strengthen the regional integration process and complement and support national strategies, policies of adjustment and structural transformation [...and...] should reflect differences among Caribbean economies in levels of development and size."<sup>13</sup>

Within the Free Trade Area of the Americas (FTAA) negotiations, CARICOM economies completed the national trade-related capacity building strategies which formed the basis for roundtable discussions with potential donors. The strategies seek to enhance the

<sup>13</sup> Trade Negotiations Insights. From Doha to Cotonou. Vol.3.No3. May 2004.

capacity of countries in trade negotiations, in the implementation of trade agreements and in adjusting their economies to the greater levels of openness and trade integration. The first such meeting took place in Washington. In 2003, FTAA negotiators also recognized that countries may 'assume different levels of commitments within a framework of common and balanced set of rights and obligations'. In 2004 the FTAA negotiations are stalled partly due to countries' inability to develop the new framework.

In 2003 CARICOM countries also signed a free trade agreement with Costa Rica. This strategy marks continuity in CARICOM's international insertion which was guided initially by preferential trading arrangements with its major trading partners and subsequently supported by bilateral free trade agreements with non-traditional partners. CARICOM signed free bilateral free trade agreements with Venezuela (1993), Colombia (1995), Cuba (2001) and more recently the Dominican Republic (2001).

While it is too early to identify to what extent CARICOM economies will benefit from the trade agreement with Costa Rica, the available data show that Caribbean economies accounted in 2003 for 2.7% of Costa Rica's exports. Of this market share, CARICOM economies represent only 38% (Jamaica (24%), Trinidad and Tobago (9%), Barbados (3%) and The Bahamas (2%)) or 1% of Costa Rica's total exports. On the other hand, Costa Rica has registered a consistent trade surplus with Jamaica, its largest trading partner in the English-speaking Caribbean, and has balanced its trade with Trinidad and Tobago, which prior to 2003 was in favour of Trinidad and Tobago.

## **6. Economic prospects for 2004**

For 2004 the Caribbean region is expected to increase its rate of GDP growth with respect to 2003 mainly as a result of the improvement in growth prospects for commodity-oriented economies. Trinidad and Tobago (6%-7% in 2004) will benefit from the continuing dynamism of the energy sector propelled by increases in capacity, improvements in productivity and favourable international conditions. Guyana (2.5%) is expecting a turnaround from the negative rate of growth of 2003 driven by improvements in most economic sector with the exception of mining and quarrying. The country also expects an increased inflow of foreign direct investment. Jamaica's economic performance (2.3%) will respond to the increase in investment in the productive capacity of its alumina operations. Finally, Suriname's economy (6%) is projected to reap the benefits of the expansion of capacity in the bauxite industry as well as the restructuring of the banana sector.

Service-oriented economies are projected to maintain for the most part their current growth levels as visitor arrivals and tourist expenditure continue to recover from the effects of the September 11th events. The relationship will be most evident in the case of Barbados as the economy is expected to raise its current rate of growth by one percentage point in 2004. In the case of The Bahamas this will be enhanced by greater investment in infrastructure. For its part, the OECS expects to benefit from a rebound of the construction subsector as well as from banana production.

The increase in the overall level of economic activity will translate into higher import demand which in the majority of the cases (the exception being Trinidad and Tobago) will be affected by the rise in the international price of oil. However, the overall impact on the current account of the balance of payments will depend on the extent to which the export performance of goods and services can offset the rise in imports. It is expected that most economies will maintain their current external deficit position at current levels. Trinidad and Tobago is once again the exception to the norm and is poised to record a surplus on its balance of payments current account.

On the fiscal side countries will, partly due to their high levels of indebtedness, continue to pursue their fiscal consolidation efforts. The fiscal imbalance is projected to be within the vicinity of 8% of GDP. Given the low tax buoyancy of Caribbean economies, any improvement on the revenue side will have to come from tax reform or improvements in administrative efficiency. Government expenditure for its part will be confined to wage bill expenses and interest payments. In some countries (Guyana, Jamaica and Suriname) the increase in the minimum wage will contribute to the rise of current expenditures. In others (Barbados and Jamaica) the financial system will help to attenuate the burden of debt servicing.

Monetary policy would do well to let the economic recovery settle in. However it will face a significant challenge in trying to maintain their target rates of economic growth while at the same time controlling an inflation rate which, in the absence for any countervailing measure, will be fuelled by the increase in international oil prices.

## **II. ANALYSIS OF SELECTED TOPICS**

## **Tourism performance in the Caribbean**

### **1. The importance of tourism<sup>14</sup>**

The Caribbean is considered to be the most tourism-intensive region in the world, with an overall contribution of travel and tourism to output and employment in 2003 of 14%.<sup>15</sup> Whilst this contribution was lower than in 2000, when the rates for output and employment were 17% and 15%, the rate of growth of the sector's contribution in 2003 was higher (3% and 4% respectively) than in 2000 (1% and 0.7%, respectively).

The importance of tourism for individual Caribbean countries has determined the categorisation of the region as tourism intensive. In the OECS subregion, Antigua and Barbuda and the British Virgin Islands are the countries most dependent on tourism with a contribution of tourism to the economy representing 74% and 95%, respectively, in 2003. In the case of Antigua and Barbuda, this contribution was significantly less than in 2000 when it was 84% of output. The Bahamas, Barbados and Saint Lucia are the other countries in the region where travel and tourism make a significantly high contribution to output as well as to employment (see Table 3).

The dependence of Caribbean countries on tourism was brought into sharp relief after the terrorist attacks of September 2001. Overall contribution to output fell by more than one percentage point in 2002. However, the decline did not begin after 2001 but was evident before that when tourism contribution to both output and employment began to decline.

Given the importance of tourism for the region, this chapter investigates in detail the developments that have affected this sector in 2003. In particular, it points out that cruise stopovers have increased more than proportionately relative to stopover tourism, and analyses whether this is a trend that will ultimately prove to be beneficial to the region.

### **2. The 2003 tourism recovery**

#### ***2.1 The regional perspective***

The year 2003 stands out as it marked a significant recovery in tourism's contribution to the Caribbean region. The industry's output real growth was 3.6% compared with a decline of 7.1% in 2002. Its contribution to employment growth in the industry increased by 6.3% compared with a fall of 3.7% in 2002. The most significant growth of output was recorded for Saint Lucia (17.9%) and Jamaica (16.4%). These countries also recorded the most significant growth in employment (17.8% and 15.6%, respectively). The country with the most significant decline in output growth (-9.2%) and employment (-7.1%) was Dominica.

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<sup>14</sup> Most of the analysis is limited to CARICOM economies. Cuba, Puerto Rico, Mexico and the Dominican Republic are referred to as the Hispanic Caribbean.

<sup>15</sup> See World Travel & Tourism Council (WTTC) 2004. *The Caribbean: The Impact of Travel & Tourism on Jobs and the Economy*.

**[INSERT FIGURE 7]**

Inflows of visitors and tourists numbered 10.8 million in 2003, the highest figure recorded to date, exceeding the 2000 figure by 8.2%. However, the growth in the categories of arrivals varied. Tourist arrivals grew by 3.4% whereas cruise ship arrivals recorded a significant growth of 12.1%, resulting in 4.4 million tourists and 6.5 million visitors, respectively<sup>16</sup> (see Figure 7).

The Bahamas and Jamaica and, to a lesser extent, Barbados dominate stopover tourism in the region, accounting for 34.4%, 30.8% and 12.1%, respectively, of all stopover arrivals in 2003. Other CARICOM countries accounted for less than 10% each of total arrivals. Whereas stopover tourism was on a declining trend prior to the September 2001 attacks, that component of tourist arrivals has now returned to its pre-2001 level and seems set to continue on an increasing trend

	Output				Employment			
	2000	2001	2002	2003	2000	2001	2002	2003
<b>Hispanic and non-Hispanic Caribbean</b>	16.6	15.8	14.2	13.9	14.9	14.2	13.6	14
Antigua & Barbuda	83.9	77.6	74.4	74.3	95	94.8	89.4	89.2
Bahamas	54.9	54.5	50	52	69.8	68.5	61.9	64.6
Barbados	44.9	42.8	47.5	47.8	50.5	47.8	52.6	52.9
Belize	23.9	23.2	23.1	21.8	23.5	22.7	22.7	21.3
British Virgin Islands	95.2	95.2	95.2	95.2	94.4	95	95	95
Cuba	13.3	12.7	12.1	12.5	11.5	10.9	10.4	10.7
Dominica	24.2	24.5	23.5	22.3	22.1	22.3	21.3	20.2
Dom.Rep.	22.7	21.4	21.5	21.9	19.7	18.5	18.6	19
Grenada	27.8	25.4	25.9	25.9	25.9	24	24.3	24.2
Guyana	10.3	9.7	8.6	8.4	12.5	11.7	10.4	10.2
Jamaica	32.1	31.5	29.7	32.4	28.3	27.7	26.2	28.7
Puerto Rico	6.4	6.4	5.2	5	7.1	7.2	5.6	5.5
St.Kitts/Nevis	28	28.8	26.3	26.4	28.5	29.3	26.6	26.5
St. Lucia	44.8	41.8	42.5	47.9	45.1	41.6	42.2	47.7
St.Vincent/Grenadines	31.5	32	31.8	31.4	28.2	28.7	28.4	27.9
Trinidad & Tobago	11.5	10.7	10.5	10.4	11.1	10.5	10.1	10

Source: Based on data in WTTC 2004 Report

Cruise tourism is an important tourism component in the Caribbean, which attracts approximately half of all cruise passengers worldwide. Within CARICOM, cruise visitor arrivals now account for about 60% of all tourism arrivals, up from 51% in 1997. The significant increase (12.1%) in cruise ship visitors in 2003 marked the recovery from weak performance in 2002 and stagnation in 2001 (2.3% and 0.3%, respectively). Bahamas, Barbados, Belize and

<sup>16</sup> Tourists are defined as visitors that spend at least 24 hours in the country. Cruise ship passengers are classified as visitors as they spend less than a day in the country that the ship visits.

Jamaica captured more than the overall increase in visitors in 2003, accounting for a combined 86% of the total market.

## ***2.2 The recovery of tourism in selected countries***

As stated in the first section of this report, the recovery in tourism was widespread. It affected not only as expected service-oriented economies, but also commodity-oriented economies (i.e. Belize) or economies with a strong primary sector, such as Jamaica, which felt the positive impact in the growth of tourism. This subsection highlights the recovery in Bahamas (a service-oriented economy), Belize (a commodity-oriented economy) and Jamaica (an economy with a strong primary sector).

### **2.2.1. The Bahamas**

The Bahamas is one of the main tourist destinations in the Caribbean, attracting approximately 1.5 million stopover visitors and 3 million cruise visitors in 2003. What differentiates the Bahamas from other traditional holiday destinations is the fact that the Bahamas has generally been a destination for the more affluent segments of society. This is reflected in a relatively high average daily room rate of approximately \$192.64 (at March 2004), with average daily rates ranging from \$230 for Nassau and \$180 for the Out Islands, to \$100 for Grand Bahamas. It is also reflected in the demographic profile of stopover tourists. Approximately 11% had household incomes between \$40,000 and \$59,999 and approximately 65% had pre-tax household incomes of \$60,000 a year or more. Moreover, 40% had household incomes of \$100,000 a year or more. This profile facilitates relatively high spending, with 61% of stopover tourists spending \$1,000-\$4,000 on their visit and 15% spending more than \$4,000 (all staying 4-7 nights). Analysis of overall expenditure shows that approximately 13% of expenditure is expenditure in casinos. This is a significant item of expenditure, which is almost twice as much as expenditure on shopping (7%).

However, whereas growth in cruise tourism has consistently outperformed the average rate of the region since 1997, stopover tourism has been on a downward trend. Nevertheless, the Kerzner International Group plans to invest \$1 billion in order to increase the number of rooms and suites, from 1,200 to 1,500, in their Atlantis Resort on Paradise Island, a complex that boasts a high occupancy rate in excess of 80% and has an average daily room rate (ADR) of close to \$300. The Bahamian authorities have recognized the need to attract more stopover visitors, which results in significantly higher spill overs to the Bahamian economy. The creation of a 'Tourist Welcome Centre' is therefore planned at the cruise docking facilities, the underlying idea being that advertising the Bahamas in detail may entice cruise visitors to return. However, analysis of data points to a small proportion (less than 4%) of cruise visitors actually returning as stopover tourists.

### **2.2.2. Belize**

Belize has seen a dramatic expansion in tourism, especially in cruise visits: whilst stopover tourism has increased by 35% since 1997 to 197,746 stopovers, cruise visitors have

exploded from a mere 2,680 in 1997 to 488,917 in 2003. This increase has posed some challenges for the country, which has been traditionally agriculture based.

The surge in cruise tourism seems to have caught the government by surprise, as the country does not have a proper cruise ship terminal. Visitors have to be ferried by water taxis from the cruise ships to the 'Tourism Village' in Belize City. However, the government has improved upon its Tourism Village complex by completing a fourth terminal for 50–60 new shops. It has also introduced a water taxi service from the 'Tourism Village' to two of the popular cays, providing tourists with opportunities to enjoy water sports and the beaches. Moreover, at the end of 2003 a joint business venture between the Port Authority and Carnival Corporation was announced, to develop a new cruise terminal facility. This facility would include the construction of a pier to accommodate two cruise ships.

The surge in tourism is a recent phenomenon for Belize. Although the country has a large number of ancient Mayan sites, the majority are not potential destinations for cruise ship visitors as a combination of poor roads and distance from the coast renders a journey too long for a one-day visit. The government is however planning to upgrade the northern highway in 2004 and has put effort into enhancing its archaeological sites. An expansion of the runway at its international airport in Belize City is also planned in order to facilitate an increase in air arrivals.

### 2.2.3 Jamaica

Jamaica like the Bahamas is one of the main tourist destinations in the region attracting about 2.5 million stopover tourists and cruise visitors. In 2003 tourism performance increased significantly, in particular cruise tourism, which benefited from the arrival of 14 new cruise ships. The average length of stay of stopover tourists (10.2 nights) remained the same with the bulk of stopover tourists originating from the United States (72%). However, visitor expenditure increased by over 9%.

Government policy towards the sector is pursued within the context of the Tourism Master Plan prepared by the Ministry of Industry and Tourism in 2003. Incentives were approved to stimulate investment in establishing and upgrading tourist attractions, namely tax-free importation of goods for a period of five years and exemption from corporate taxes also for five years.

Government response to the volatility of cruise tourism was the signing in February 2004 of a Facility Fee Agreement between the Port Authority of Jamaica and the cruise company Carnival Corporation. Under the agreement the cruise company will bring a half million cruise passengers to Jamaica every year over the period 2004-2008 resulting in a total of 2.5 million visitors during the period. Carnival Corporation will pay a fixed fee (per passenger) each year resulting in revenue of at least US\$17.7 million over the contract period.<sup>17</sup> This facility will help to stabilise cruise tourism in addition to the security measures that were instituted at Jamaica's piers in January 2003. The latter no doubt contributed to the significant increase in cruise visitors in 2003.

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<sup>17</sup> See Planning Institute of Jamaica, Economic and Social Survey Jamaica 2003

In a follow up to this agreement, government announced in June 2004 that another agreement would be signed between the Port Authority and Royal Caribbean Cruises, which will guarantee a minimum of two million cruise passengers over five years and earnings of not less than US\$16 million. Cruise arrivals are to be further boosted by the confirmation from Pullmantur of Spain that its cruise ship line (Holiday Dreams) booked 156 calls to Jamaica's second city, Montego Bay, over a three-year period beginning in November 2004. Average passenger load of the ship is estimated at 850. With these guarantees Jamaica would have secured about US\$35 million in revenue from cruise arrivals over the next five years, which would enable the Port Authority to finance its development projects.

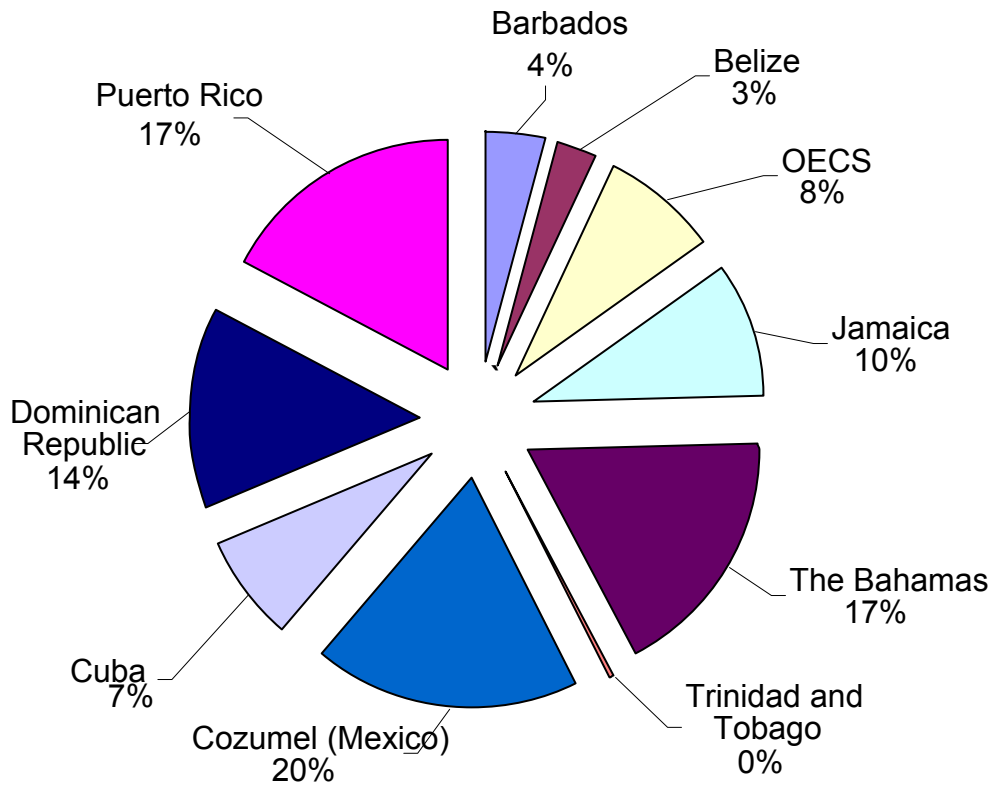
Tourism organizations have redefined and expanded their efforts in promoting the development of tourism on the island. The Tourism Product Development Company (TPDCo) has refocused its role towards the development of the tourism product. It inspects and monitors standards in the industry and organizes training programmes in the upgrading of skills. The Jamaica Tourist Board (JTB) expanded its marketing strategy through promotion campaigns and the launching of a web site. The Port Authority of Jamaica (PAJ) also expanded its marketing of Jamaica as a cruise destination through, among other things, familiarisation tours for executives of cruise ships.

Although Jamaica has taken steps to cope with the volatile cruise tourism category it is still unclear to what extent benefits can exceed the costs of catering to cruise ship arrivals. Although most governments in the region still seem to think that a significant proportion of cruise visitors will return as stopover tourists it is difficult to prove or disprove this view given data inadequacy. Nevertheless, it may be more a case of a sort of demonstration effect whereby stopover tourists are encouraged by the fact of increased cruise ship arrivals.

### **3. Challenges and strategies for the tourism industry in the Caribbean**

Despite the positive developments in tourism, especially the resurgence in the growth of tourist arrivals, Caribbean countries face a number of challenges regarding the sector. One of these is the competition from the Hispanic Caribbean. Cuba, Dominica Republic and Puerto Rico have the largest tourism market shares, totalling 58% in 2003 (Figure 8). In 2002 the Hispanic Caribbean had about twice the share of stopover arrivals (69%) as the other Caribbean countries in the aggregate (31%). In 2003, this gap increased in favour of the former (70%) as stopover tourist arrivals grew almost 3 times as fast for the Hispanic Caribbean (9.5%) as for the rest of the Caribbean (3.4%).

**Figure 8**  
**Tourism market share of selected Caribbean countries 2003**



Source: Based on data in WTTC 2004 Report

In the cruise tourism market, the situation is reversed with the CARICOM countries having the larger share (61% in 2002). Although cruise ship visitor arrivals grew more significantly for the CARICOM countries in 2003 (13% as against 2% in 2002) than for the Hispanic Caribbean (18% as against 16% in 2002), the former region lost market share to the latter (from 61% to 60% in 2003). This was largely due to significant declines in respect of St. Kitts/Nevis (10%), St. Vincent and the Grenadines (60%) and Trinidad and Tobago (7%). Belize experienced the most significant increase in cruise arrivals in 2003 (80%) whereas Antigua and Barbuda, Dominica and Jamaica recorded increases of the order of 23%, 29% and 31%, respectively. Although the Bahamas had the largest number of cruise visitors in 2003 the increase in visitor arrivals was only 6%.

The second challenge is the volatility of cruise tourism as illustrated above in respect of the performance of the CARICOM countries vis-à-vis the Hispanic Caribbean. This volatility is due to lack of control over the decisions of cruise shipping companies, which can alter their travel routes arbitrarily and particularly in reaction to some unfavourable condition such as tax increase at the port of call. Nevertheless, Caribbean countries continue to rely significantly on

cruise tourism despite the relatively minor contribution of this component to earnings and employment. For example, the ratio of visitor/tourist expenditure ranges from 1:11 for Jamaica to 1:42 for Antigua and Barbuda., that is, for every dollar spent by the (cruise) visitor \$11 are spent by the (stopover) tourist in Jamaica. In addition, total expenditure (visitor plus tourist) as a percentage of GDP has been declining over the years for most Caribbean countries, despite increases in the number of tourists (visitors and stopover tourists combined). Countries with the largest increase in cruise ship visitors such as Belize and Jamaica experienced the most significant decline in their expenditure/GDP ratios (Table 4).

The above relationship suggests that increase in cruise ship visitors relative to stopover tourists is positively correlated with decline in the contribution of tourism expenditure to GDP. This point is strengthened by examining the ratio of cruise visitors to tourists. For example, for every 10 visitors to Jamaica in 1997 there were 17 tourists. The number of tourists declined to 16 in 1999, then to 15 in 2001 and finally to 12 in 2003. In the case of the Bahamas, the number of tourists for every 10 visitors declined progressively over the same period from nine in 1997 to five in 2003. The most startling decline in the ratio is observed in the case of Belize, from 53 tourists for every 10 visitors in 1999 to four tourists for every 10 visitors in 2003.

Cruise ships offer a wide array of services to cruise visitors, providing them with meals, accommodation and on-board shopping. Moreover, passengers are encouraged to spend most of their time and money on the ship. Visitor expenditure on shore is therefore significantly lower than expenditure by stopover tourists. The ports of origin of the cruise ships are the major beneficiaries of cruise tourism as passengers arriving for the cruise frequently overnight there prior to embarking on the cruise.

**Table 4**  
**Tourism expenditure as percentage of GDP**  
**for selected Caribbean countries**

	<b>1987</b>	<b>1990</b>	<b>1993</b>	<b>1996</b>	<b>1999</b>	<b>2003</b>
Antigua & Barbuda	79.6	89.3	71.4	57.1	52.3	38.9
Bahamas	50.2	42.5	42.5	40.1	n.a.	32.2
Barbados	30.3	33.3	37.7	37.2	32.2	25.9
Belize	19.8	27.3	15.5	17.4	18.9	14.7
Dominica	12.3	18.2	17.1	18.4	22.4	19.9
Grenada	35.4	24.0	23.1	24.2	21.6	23.7
Jamaica	19.7	19.5	31.3	22.4	20.6	7.3
St.Kitts/Nevis	52.5	43.1	41.8	32.4	26.3	16.6
St.Lucia	52.1	46.2	52.4	55.8	48.9	40.1
St.Vincent & Grenadines	29.9	34.2	21.7	27.1	28.4	22.0
Based on official data as well as estimates						

The third challenge is increasing revenue from tourism without adversely affecting the growth of the sector. Caribbean governments have been trying to increase their intake from the tourism sector, in particular from cruise tourism since cruise visitors enjoy facilities without having to bear the burden of the cost of those facilities. To date, governments in the region have not been successful in extracting taxes on cruise visitors. Taxes levied on cruise tourism are usually significantly lower than departure taxes levied on outbound flight passengers including stopover tourists. Cruise ship companies have resisted all attempts at increasing taxes on cruise passengers upon disembarkation from cruise ships.

The response to the challenges facing the region in the development of tourism has been varied. Most countries in the region recognise the need to upgrade their tourist facilities to meet the real and potential competition posed by Hispanic destinations. In Barbados and Jamaica, for example, efforts are being made to expand and refurbish international airports as well as tourism plants. Both countries aim to cater to the high end of the tourism market given the difficulty in sustaining price competition. Countries in the region need to differentiate their product if they intend to significantly increase their market share of stopover tourism. A positive development that directly responds to the competition from the Hispanic Caribbean is the relatively recent investment in the region by the Spanish hotel chain, RIU International, which operates two all-inclusive hotels in the Negril area of Jamaica. This development has been enhanced by the increase in airlift from Spain.

All countries have tended to increase support to cruise tourism. For example, Jamaica has been increasing its pier facilities as well its terminals; Barbados is planning to build a new pier which will be able to cater to larger cruise ships; in early 2004 a new pier inclusive of a welcome centre was completed in Grenada; and Belize is to upgrade its facilities to enable the docking of cruise ships since currently visitors have to be transferred by boat to shore which is at a considerable distance. More specific efforts of some countries are highlighted below.

The fiscal constraint of a number of governments in the region limits the extent of support for upgrading and further development of tourism facilities. Increasing fees from tourism operations have been difficult to pursue. Whereas larger facilities are more likely to be able to finance their restructuring, smaller operators may go out of business unless creative ways are found to sustain their contribution. Clustering and sub-contracting are options that should be explored to enhance the development and competitiveness of the tourism product in the region.

The level of capital investment in the tourism sector does not seem to be the determining factor in the growth and contribution of the sector to the national output. The countries with the highest level of capital investment in tourism, namely Antigua and Barbuda, The Bahamas and Barbados, have seen modest growth of between 2% and 5%. Whereas capital investment is critical to the development of the sector countries would have to pursue other strategies to boost competitiveness. CARICOM countries have been losing their competitive edge in tourism in terms of value for money, which contributed to the rise in popularity of the Hispanic Caribbean, namely Cuba, Dominican Republic, Puerto Rico and the Mexican Caribbean area of Cozumel.

One area in which Caribbean countries could enhance their competitiveness is that of sustainable tourism, that is where tourism is developed along with positive environmental practices. Barbados and Jamaica are among the world leaders in sustainable tourism. Forty per cent of the eco-certificates awarded by Green Globe went to the Caribbean. Jamaica has about 22 certified Green Globe properties and is one of five Caribbean countries seeking Blue Flag certification. The Blue Flag programme promotes integrated environmental management.<sup>18</sup> Properties certified as Green Globe or Blue Flag are more likely to increase market share especially in Europe where tourists are more environmentally conscious and therefore want to go to places that are safe in terms of water quality, for example.

The marketing strategy of Caribbean countries needs to be significantly upgraded. Focus has been mainly on the North American market and the European market to a lesser extent. Countries have eschewed promotion in countries such as Japan, China and South Africa, for example. Although resources for tourism promotion are limited, countries could capitalise on the use of the Internet. Increasingly, airline tickets and hotel rooms are being booked online. Caribbean countries have to ensure that the product they offer is presented as favourably as possible to prospective tourists and visitors who are seeking travel destinations via the Internet.

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<sup>18</sup> See “Going ‘green’ means earning more ‘greenbacks’, tourism interests told, Jamaica Observer, July 25, 2004  
[www.jamaicaobserver.com](http://www.jamaicaobserver.com)

## Public debt in the Caribbean - Issues and implications

### 1. The current state of debt in the Caribbean and its potential costs

As stated in the regional overview of this document, most Caribbean economies pursued an expansionary fiscal stance from 1995 until 2002. That is, governments have increased expenditures without altering their tax efforts. As a result, Caribbean countries have accumulated debt over time. (See Table 5).

Country	Total public debt as % of GDP 2003		Internal Debt as a percentage of GDP 2003	External debt as a percentage of GDP 2003
	1997	2003		
Anguilla	10.7	17.2	3.8	13.2
Antigua and Barbuda	107.0	151.7	68.9	83.1
Aruba	39.4	41.5	21.2	20.3
The Bahamas	46.0	45.0	31.5	5.6
Barbados	62.0	71.1	54.9	25.9
Belize	41.0	88.9	13.0	75.8
Dominica	61.0	127.0	39.4	87.6
Grenada	42.0	110.1	30.1	79.9
Guyana	211.0	172.0	....	172.0
Jamaica	103.0	142.0	85.4	56.5
Montserrat	26.0	16.4	2.8	13.2
Netherlands Antilles	64.6	90.2	.....	....
St. Kitts and Nevis	86.0	162.0	75.4	86.6
St. Lucia	36.0	66.1	19.1	46.9
St. Vincent and the Grenadines	48.0	76.7	25.6	51.4
Suriname	24.0	37.0	9.8	27.2
Trinidad and Tobago	52.0	28.0	....	13.8
Average	62.3	84.9	34.4	53.7

Source: on the basis of official data.

On average, the public debt to GDP ratio has increased from 62% to 85% of GDP from 1997 to 2003. When decomposed in terms of its internal and external component, the former represents 34% of GDP of the total while the latter has reached 54% of GDP. In the cases of Aruba, The Bahamas, Barbados and Jamaica the internal debt ratio is greater than the external debt ratio.

Most of the economies (Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, The Netherlands Antilles, St. Kitts and Nevis, Saint Lucia and St. Vincent and the Grenadines) record some of the highest debt to GDP ratios among emerging market economies. More specifically, Antigua and Barbuda, Belize, Dominica, Grenada, Guyana, Jamaica, the Netherlands Antilles and St. Kitts and Nevis rank among the 10 most indebted market emerging economies.<sup>19</sup>

The accumulation of debt per se has important costs. The most obvious one is in terms of foregone resources that could have been put to more productive uses. The case of Jamaica exemplifies this point: functional classification of Jamaica's fiscal expenditures shows that public debt management amounted to 65% of the total which is much higher than the expenditure devoted to productive uses. Indeed, social and community services, which include education and health, account for 16% of the total.

The continuous accumulation of debt over time can also trigger unwanted depreciations in the exchange rate and thus increases in inflation and/or balance of payments crises. The standard description is well known.

Starting from an investment/savings balance macroeconomic accounting framework, an increase in the fiscal deficit implies that either external savings must rise or the current account must be in deficit. In the absence of any counteracting fiscal measures on the expenditure or revenue side, financing the deficit increases the government's debt. In the financial systems' balances, government debt (assets) can be matched by greater money creation (a liability). In the absence of restrictions on foreign exchange transactions, and given a favourable interest-rate spread,<sup>20</sup> the increase in liquidity can find an outlet in domestic and/or foreign goods and services and domestic assets. Independently of time and liquidity preferences, the most likely outcome is an increase in prices and/or an initial exchange-rate appreciation. The latter can translate in turn into an increase in imports.

Both these results can widen the current account deficit and erode international reserves. In turn, a decline in international reserves and expectations of a persistent fiscal deficit can lead economic agents to anticipate currency depreciation and to act accordingly. The consequent exchange-rate depreciation feeds back into prices through a cost mechanism and puts further pressure on the current account and international reserves. As mentioned above, the authorities can intervene to defend the local currency using international reserves or interest rate-hikes

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<sup>19</sup> See Sahay R. Stabilization, Debt, and Fiscal Policy in the Caribbean. Preliminary Draft Presented at the International Seminar on Developmental Challenges Facing the Caribbean. Hilton Trinidad & Conference Center. June 11-12, 2004.

<sup>20</sup> As is the case in Caribbean economies.

## 2. The sustainability of public debt

In general, the mainstream criterion to determine whether indeed a given stock of debt can grow, stabilize or decline over time is that of sustainability (See Box 5 below).<sup>21</sup>

The sustainability outlook for Caribbean countries for 2003 is illustrated in Table 6. The table shows the required fiscal surplus to stabilise the debt at its current level (Stability surplus boundary balance), the actual primary balance (the difference between revenue and expenditure excluding interest payments) and the difference between both (i.e., the sustainability gap).

<b>Country</b>	<b>Stability surplus boundary balance</b>	<b>Actual primary balance</b>	<b>Sustainability gap</b>
Anguilla	0.56	-2.11	2.67
Antigua and Barbuda	4.13	-4.84	8.97
Barbados	5.01	-0.12	5.13
Belize	1.68	-6.14	7.82
Dominica	7.66	-2.61	10.28
Grenada	1.33	-4.61	5.93
Guyana	9.63	-9.18	18.81
Jamaica	11.80	12.20	-0.40
St. Kitts and Nevis	12.50	-2.01	14.51
St. Lucia	2.41	-6.91	9.32
St. Vincent and the Grenadines	2.81	0.15	2.67
Suriname	0.92	-3.41	4.34
Trinidad and Tobago	0.12	1.13	-1.00
Average	4.28	-2.19	6.85

Note: Computations were carried out for the countries for which information on all the required variables was readily available.  
Source: On the basis of official information.

<sup>21</sup> There are several approaches to sustainability. Two of the most common approaches found in the literature include the accounting approach and the present value constraint approach. See, Chalk, N. and Hemming R. (2000) "Assessing Fiscal Sustainability in Theory and Practice" IMF Working Paper 00/81. The most common practical methods to compute sustainability in the case of developing economies include: (i) the method of the fiscal deficit-growth gap, (ii) the financial gap method; (iii) the intertemporal budget restriction; (iv) the constant patrimony method; (v) the primary fiscal gap method. The sustainability approach used in this section (see Box 5) is based on Pasinetti (1998) and is developed in ECLAC (2000). The fiscal impact of trade liberalization and commodity price fluctuation: the Case of the Dominican Republic, 1980-1998 (LC/MEX/R.426). The computations presented in this analysis (see Table 6) are preliminary and use averages for the rates of growth and interest rates for the past three years.

**Box 5**  
**Debt Sustainability**

A budget deficit is said to be unsustainable when it leads to uncontrolled increases in the public debt or when interest rates are perceived as being too much of a burden as they are imposed on taxpayers through excessive tax rates or unequal distribution of the burden of the debt. The concept of fiscal sustainability can be examined using an equation that relates four variables: government expenditures, government revenues, rate of growth of real GDP, the real interest rate and the outstanding public debt. More specifically the equation says that the primary budget surplus as percentage of GDP equals the difference between the real interest rate and real GDP growth multiplied by the share of public debt to GDP.

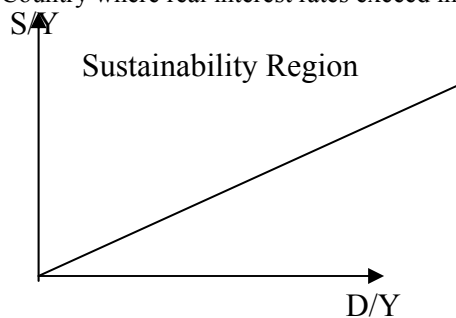
This concept can be expressed formally as follows,

$$(2) S/Y = (r-g)D/Y$$

Where,

S= primary budget surplus  
Y= nominal output  
r = real rate of interest  
D= internal debt  
g= real growth rate of GDP

Equation (2) provides the boundary line between an unsustainable and a sustainable budget surplus or deficit. If,  $S/Y > (r-g)D/Y$  then the surplus or deficit is said to be sustainable. This is illustrated in graph below for a case of a Less Developed Country where real interest rates exceed in general rates of growth of real output.



Notice that the formula considers only internal debt. It would thus at best provide a rough approximation to budget deficit sustainability in less developed countries since external debt often places an important constraint on fiscal accounts. Including external debt in equation (2) and expressing the surplus or deficit boundary line in national currency we obtain,

$$(3) S/Y = (r_i - g) D_i/Y + (r_e + \delta - g) D_e/Y$$

where,

$r_i$  = internal real rate of interest  
 $D_i$  = internal debt  
 $r_e$  = foreign real rate of interest  
 $D_e$  = external debt  
 $\delta$  = exchange rate depreciation

Source: Pasinetti, L. "The myth (or folly) of the 3% deficit/GDP Maastricht 'parameter'." *Cambridge Journal of Economics*, January 1998, 22 (1), 103-116.

In all cases, except in those of Jamaica and Trinidad and Tobago, the actual primary balance exceeds the stability surplus boundary balance. In the case of Trinidad and Tobago this result is explained by the authorities' efforts to reduce the fiscal deficit and by its strong rate of growth in the recent past. In the case of Jamaica the current primary balance which is budgeted to increase to 13.4% of GDP for 2004 was achieved by a contraction in capital expenditures and by the positive effect of the tax measures implemented in the months of May and June of 2003 on tax revenues (25% and 27% of GDP in FYs 2002 and 2003) (see regional overview and Jamaica's country report).

This analysis indicates that the current fiscal stance, in most cases, is not sustainable.<sup>22</sup> In addition, maintaining the debt ratios at their current levels, which as explained earlier are already high by international standards, would require fiscal efforts of the order of at least 4 percentage points of GDP.

### 3. Current debt strategies

There are several available strategies to deal with debt accumulation. The most obvious one is to substantially increase the primary balance, that is, the difference between revenues and expenditures excluding interest payments. This policy alternative responds to an empirical fact. Since the expansion in the fiscal stance began, the public debt to GDP ratio expanded 8.5% per year. More than half of this total (4.5%) is explained by the primary balance while interest rate payments explain 3.3% (or 39% of the accumulation of debt).<sup>23</sup>

However, as the above analysis indicates, the effort required to reach sustainable fiscal positions may jeopardize long-term growth especially if it is achieved by curtailing capital expenditures. Current expenditure restraint can also lead to output and employment losses. More realistic recommendations can include a combination of 'fiscal consolidation, prudent debt management strategies, asset sales/privatisation, reducing vulnerabilities to exogenous shocks and growth-enhancing structural reforms.'<sup>24</sup>

In practice, countries have dealt with the problem of debt accumulation by curtailing government expenditures and through fiscal reform. As seen in the regional overview, most Caribbean countries have adopted a contractionary fiscal stance and a few such as Suriname, Jamaica, and Barbados have opted to implement tax measures in order to limit the size of their fiscal deficit and thus control their future debt path. Other economies such as the OECS and also Jamaica are contemplating the implementation of a more lasting and comprehensive tax reform.

The tax reform proposed by the OECS Tax Reform and Administration Commission envisages a revenue system endowed with the following characteristics; (i) parsimonious; (ii) growth enhancing; (iii) cost minimizing; (iv) broad based; (v) highly compliant; (vi) buoyant; (vii) reliable; and (vi) capable of generating surpluses and a stabilisation fund. Table 7 below shows the target range for revenue for each of the existing taxes bearing in mind that the tax to

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<sup>22</sup> Sustainability analyses using other methods yield a similar conclusion.

<sup>23</sup> See Sahay R. 2004.

<sup>24</sup> Ibid.

GDP ratios should be within a range of 25% to 30%. The tax reform proposal would increase the floor of the tax range from 23.9% to 25.0% of GDP and the ceiling from 29.1% to 30%. The largest proposed increases are expected to be found in personal income, corporate income and property taxes. Declines are forecasted for trade and excise taxes. The transactions tax would maintain its current yield.

The higher tax revenue intake from income and corporate taxes results from the widening of the tax base, the reduction in exemptions and from more efficient implementation of the tax system. The decline in trade taxes responds to the full implementation of the Common External Tariff whereas the rise in property taxes responds to a long-standing proposal of the International Monetary Fund (IMF).

Central to the tax proposal is the introduction of the Value Added Tax which would replace all indirect taxes including consumption and travel taxes. The VAT would have three rates 0%, 10% and 15%. The zero rate applies to basic foods, medications, public transportations, computer hardware and software and exports. The zero rate is meant to make the tax a progressive one. The middle 10% rate applies to tourism-related transactions (hotels, restaurants, yacht cruises, boat cruises). The 15% rate would apply to all other transactions.

<b>Table 7</b>			
<b>Tax reform proposals for OECS countries</b>			
<b>Tax</b>	<b>Existing range as % of GDP</b>	<b>Target GDP range as % of GDP</b>	
Personal Income	0.9-4.7	4.0-6.0	
Corporate income	2.7-5.2	4.0-7.0	
Property tax	0.1-1.1	2.0-4.0	
Trade and excise	6.0-14.4	3.0-5.0	
Transactions	9.1-14.5	10.0-14.0	
Total	23.9-29.1	25.0-30.0	
Non tax revenue	2.0-7.5	3.0-5.0	
<b>Net impact measured in current EC\$ of the proposed reform</b>			
<b>Country</b>	<b>Direct taxes</b>	<b>Indirect taxes</b>	<b>Total net impact</b>
Anguilla	....	20.0	20
Antigua and Barbuda	-11.0	34.4	23.4
Dominica	0.0	2.0	2.0
Grenada	0.0	20.0	20.4
Montserrat	0.0	12.2	12.2
St. Kitts and Nevis	-4.3	16.6	12.3
St. Lucia	-7.2	38.8	31.6
St. Vincent and the Grenadines	-8.3	6	-2.3
ECCU	-30.8	151.2	120.2

Source: On the basis of official information.

Overall, the experience with the VAT has been relatively successful in smaller economies Table 8 below shows selected Latin American and Caribbean countries, the date of introduction of the VAT and the computed c-efficiency ratio which is high for most of these economies (i.e., above 50).<sup>25</sup>

Countries with a significant domestic debt stock, such as Barbados and Jamaica, have opted implicitly for using the financial system to ‘liquefy’ the debt. The mechanism is standard: an increase in the demand for government paper decreases its yield. In turn, when the yield declines, eventually the debt service payments also fall. This strategy was adopted in the later part of the 1990’s decade in Barbados and Jamaica when the banking system started to increase and solidify its liquidity position.

<b>Country</b>	<b>Population (millions)</b>	<b>Introduction of VAT</b>	<b>VAT rates</b>	<b>VAT percentage of total tax revenue</b>	<b>VAT percentage of GDP</b>	<b>C-efficiency Ratio</b>
Barbados	0.3	1997	15	32.7	9.5	110.2
Belize	0.2	1996	8			56.2
Costa Rica	3.7	1975	13		4.0	87.4
Dominican Republic	8.5	1983	12	25	4.0 (2001)	44
Jamaica	2.6	1991	15	35.8	8.8	83.5
Nicaragua	4.8	1975	15			34.6
Panama	2.7	1977	5			67.3
Trinidad and Tobago	1.7	1990	15	23.6	4.3	46.8

Sources: On the basis of official data

In the specific case of Barbados the commercial banking system is obliged to hold a certain percentage of its assets in government debt. In addition, in the last few years the commercial banking system has increased significantly its holding of the government debt stock. In 1975, the commercial banking system held 55% of the stock of outstanding treasury bills. In 2003, it held 98% of the outstanding stock. In the commercial banks balance sheets treasury bills and other government assets have gained importance relative to other components. Between 1975 and 2003, the proportion of loans and advances as a percentage of total commercial bank assets declined from 65.5% to 42%. In contrast the proportion of Treasury Bills and other governmental assets increased from 10.2% to 18.2%.

<sup>25</sup> The c-efficiency ratio equals the ratio of VAT revenues to GDP divided by the tax rate. Its value indicates the resulting increase in the VAT-GDP ratio when the tax increases by 1%. In the case of Barbados an increase of 1 percentage point in the tax rate would increase the VAT-GDP ratio by 1.10%.

Table 9 below shows that since the 1990s the internal debt stock of Barbados has increased as a percentage of GDP (from 29% of GDP in 1990 to 50% of GDP in 2003). The Treasury Bill rate increased from 1976 to 1995 and began a steady decline, thereafter. Concomitantly the internal debt service as a percentage of total tax revenue declined from 11.7% in 1995 to 9.6% in 2003. It is noteworthy that this occurred roughly around the time when the fiscal stance began its upward expansion (see Section I, Regional Overview).

This strategy has important limitations as government debt absorbs liquidity that could have been used to expand output and employment. Thus, the commercial banking system prefers to lend to a secure customer such as the government which will not default, rather than to direct its loans into more risky private sector activities. Moreover, this is ultimately a restrictive policy as it implicitly sets a floor to the decline in lending rates.

	<b>Internal debt as % of GDP</b>	<b>External debt as % of GDP</b>	<b>Internal debt as % of total debt</b>	<b>External debt as % of the total</b>	<b>Treasury bills</b>	<b>Internal debt service as % of total current revenue</b>	<b>External debt services As % of total current revenue</b>
1976			78.4	21.6	4.5		
1980			75.1	24.9	6.19		
1985			59.2	40.8	4.58		
1990	29.7	25.0	54.3	45.7	8.06	8.4	6.7
1995	47.1	19.3	70.9	29.1	8.27	11.7	5.1
2000	43.1	20.1	68.2	31.8	3.85	11.2	4.7
2003	50.1	24.7	67.0	33.0	0.64	9.6	6.1

Note: ... not available.  
Source: On the basis of official information.

Other economies, such as Jamaica, have outlined a detailed approach to the management of the debt. Since FY 1998/99 the authorities have adopted a debt management strategy based on the minimization of borrowing costs and have modified this strategy in FY 2003/04 to also include risk management. The main elements of the strategy are twofold and consist mainly in isolating the debt stock from movements in interest rates and exchange rates and in developing a domestic securities market to facilitate the use of market based instruments to trade debt issues. The increase in the share of fixed rate instruments (48% of the outstanding domestic debt in March 2003 and with a target of 60% in FY 2003/04), the restriction and reduction in bonds denominated and indexed to the United States dollar (20% of the domestic debt in March 2003) and the extension in the maturity of the debt are geared to accomplish the first goal. The second goal is to be achieved by continuing with a certain amount of flexibility to place government securities in the domestic market and by anchoring traded securities to benchmark securities with higher liquidity premiums and lower carrying costs. Ultimately the success of the government in

trimming the deficit will depend on growth, stability in the foreign exchange market and the monetary policy strategy.

Also, as in the case of Barbados, monetary policy in Jamaica has facilitated the reduction of the debt burden. Since the middle of the 1990s the Bank of Jamaica adopted a cheap monetary policy with the explicit objective of reducing banks' operating costs and thus the cost of credit to the consumer. But at the same time it has also helped to reduce the government's debt burden. The available data presented in Table 10 illustrates this point. From 2000 to 2002, the internal debt-to-GDP ratio rose from 57% to 82% yet the internal debt service as a percentage of current revenues increased only by six percentage points. In other words, comparatively, the government has been increasing its state of indebtedness at a lower cost due to the decline in the rate of interest.<sup>26</sup>

This policy can lead to unstable exchange rate movements. The currency depreciation episode described in Section I and analysed in more detail in the economic report on Jamaica is a clear illustration. If the monetary authorities adopt a policy of decreasing interest rates to lower the burden of the government debt, a higher than expected deficit will mean a greater than expected decline in interest rates. In turn a greater than expected decline in interest rates will provide the basis to anticipate a larger than expected exchange rate depreciation. Holders of assets denominated in domestic currency will experience a capital loss unless they switch to assets denominated in foreign currency. Certainly holders of foreign currency will experience a capital gain.

In order to avoid capital losses and secure capital gains, agents will switch to foreign currency assets. The concomitant effects of a depreciating exchange rate on prices will force the monetary authority to intervene. Intervention may take the form of foreign exchange market intervention which will translate in a reduction of the monetary authorities stock of foreign reserves. This type of intervention is generally temporary and limited because the loss of reserves can result in a confidence crisis and aggravate the situation.

The alternative is to raise interest rates. However the increase in interest rates can only aggravate the fiscal situation if the bulk of the debt or a significant proportion of it is denominated in domestic currency. Hence the strategy becomes self-defeating and most likely unstable.

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<sup>26</sup> These findings run contrary to the standard belief, such as interest rate parity theorems, that in smaller economies Central Banks cannot affect interest rates.

**Table 10**  
**The behaviour of debt in Jamaica**  
**1992 – 2003**

	<b>Domestic debt to GDP</b>	<b>Treasury Bills</b>	<b>Overall weighted rate of interest</b>	<b>Exchange rate</b>	<b>Internal debt service as a percentage of current revenue</b>
1992	25.97	...	46.04	23.01	...
1993	19.9	...	49.6	25.68	...
1994	31.02	...	45.79	33.35	...
1995	29.29	34.97	48.56	35.54	...
1996	32.73	25.21	37.81	37.02	...
1997	39.28	24.63	31.93	35.59	...
1998	43.87	21.31	30.08	36.68	...
1999	59.77	18.68	24.64	39.33	39.1
2000	56.97	18.32	22.12	43.32	34.5
2001	82.44	15.7	19.46	46.19	40.1
2002	82.2	15.68	18.26	48.73	41.5

Note: ...denotes not available.  
Source: On the basis of official information.

#### **4. Conclusion: The debt and the foreign exchange constraint**

Caribbean countries' debt levels are high by international standards. Sustainability computations show that they are also unsustainable and that the stabilisation of their debt levels would require significant tax and/or expenditure efforts. However, the reduction of their current debt levels may simply not be a feasible policy option as it may result in output and employment losses and jeopardize the process of economic recovery of Caribbean countries.

A long-term solution must obviously involve some type of fiscal consolidation but it should also take into account the constraints facing smaller economies. The fundamental constraint facing these economies is the foreign exchange constraint. In this sense smaller economies are balance-of-payments constrained economies. This means that their actual rate of growth is below that which is warranted by the prevailing internal conditions.

One consequence of this constraint is that smaller economies cannot pursue a fiscal policy that is independent of current external conditions. Indeed, the former must be attuned to the latter. An expansionary fiscal stance will translate sooner or later into a higher import demand and a current account deficit unless export performance, as measured by the export performance ratio (see Regional Overview) improves. As a result, starting from a position where government expenditure equals revenue and in addition imports are equal to exports, an increase in government expenditure means that government is spending more than what it earns (fiscal deficit) and imports surpass exports (external deficit). In other words a fiscal stance in excess of

the export performance ratio will result in a twin deficit situation (fiscal and external deficits) and in the accumulation of debt.

The situation described above is characteristic of most Caribbean economies. This is shown at the aggregate level in Figure 9 where it is seen the fiscal stance is persistently above the export performance ratio in the Caribbean. Debt in Caribbean countries did not increase because governments spent 'too much' per se but rather because they spent 'too much' relative to what the external conditions could tolerate, that is relative to their main constraint. As a result within the logic of this explanation macroeconomic equilibrium means that the fiscal stance should seek to be aligned to the value of the export performance ratio. In other words, export performance is the variable that ultimately sets the limit and scope to fiscal policy. Fiscal policy can work only if the external conditions allow it to work. Thus any attempt at fiscal adjustment, reform or consolidation must also go hand in hand with efforts to develop export promotion strategies and to raise the productivity of imports. Debt reduction strategies must incorporate options to soften the external constraint.

**[INSERT FIGURE 9]**