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**IDB COUNTRY STRATEGY**

**WITH**

**BARBADOS**

**(2009-2013)**

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## LINKS TO SECTOR NOTES AND OTHER BACKGROUND INFORMATION

Macroeconomic Risks	<a href="#">Macroeconomic Risks</a>
Integrated Coastal Zone Management	<a href="#">Sector Note Integrated Coastal Zone Management</a>
Water and Sanitation	<a href="#">Sector Note on Water and Sanitation</a>
Energy	<a href="#">Energy Sector Note</a>
Education	<a href="#">Sector Note on Education</a>

## ABBREVIATIONS

BWA	Barbados Water Authority
CDB	Caribbean Development Bank
CSAG	Civil Society Advisory Group
DLP	Democratic Labour Party
EE	Energy efficiency
EIB	European Investment Bank
EU	European Union
GDP	Gross domestic product
ICT	Information and communications technology
IDB	Inter-American Development Bank
IIC	Inter-American Investment Corporation
KCP	Knowledge and capacity-building product
MIF	Multilateral Investment Fund
NSG	Non-sovereign guaranteed
PEFA	Public expenditure and financial accountability
PRODEV	Management for Results Program
RE	Renewable energy
SCF	Structured and Corporate Finance (Department)
SME	Small and medium-sized enterprise
TC	Technical cooperation
TVET	Technical and vocational training
UNDP	United Nations Development Program
UK	United Kingdom
US	United States
VAT	Value added tax

## EXECUTIVE SUMMARY

Despite significant economic and social progress in recent decades, Barbados exhibits a series of vulnerabilities that could threaten hard-won gains. Burgeoning fiscal and external imbalances preclude a major fiscal stimulus to soften the impact of the current global financial crisis on the island's economy, while existing weaknesses in the local business climate are increasingly exposed by the loss of trade preferences abroad and growing market liberalization at home; high energy costs exacerbate these problems. Scarce (and poorly managed) water supplies and coastal erosion pose a threat to the island's crucial tourism industry, and climate change is likely to further increase these vulnerabilities. Gaps in education—particularly in school-to-work transition and technical and vocational training—have led to unmet needs in the labor market and added to youth unemployment.

The IDB Country Strategy with Barbados (2009-2013) (the “Strategy”) will support the Government of Barbados in addressing these vulnerabilities, both through the existing portfolio—which focuses on public sector modernization and includes programs to address the country's fiscal challenge—and support in four priority areas: coastal zone management and climate change adaptation; water and sanitation; energy; and education. Specifically, the Strategy will contribute to the achievement of four country development goals: (i) building resilience to coastal risks, natural disasters and climate change; (ii) more efficient water supply and resource management; (iii) reduced oil import bill, promotion of clean energy and more efficient use of energy; and (iv) improved quality and relevance of the education system. All four areas are aligned with the Bank's corporate priorities, are critical for the competitiveness of the Barbadian economy and will be the focus of country programming in both sovereign-guaranteed and non-sovereign-guaranteed lending.

The expected results of the Strategy include, among others: (i) improved public sector capacity to understand and manage coastal risk factors such as erosion, flooding, reef degradation and natural disasters; (ii) a more efficient and financially viable Barbados Water Authority (BWA); (iii) a new institutional and policy framework for promoting energy efficiency and renewable energy; and (iv) higher student academic performance in core subjects, and improved delivery of technical and vocational training programs. The expected results will be tracked through the results matrix.

IDB sovereign-guaranteed (SG) lending to Barbados over the five-year strategy period is estimated at US\$200 million. Depending on the mix between investment and policy-based lending, projected disbursements for the period 2009-2013 could reach a total of US\$245.8 million, and net loan flows (disbursements minus repayment of principal) could reach US\$156.3 million. Net cash flows from the Bank to Barbados (net loan flows minus loan interest payments) are expected to be positive in all years, totaling US\$116 million over the period. Non-sovereign lending volumes are uncertain and will result from origination efforts undertaken in the strategic priority areas, while grant funding is estimated at around US\$5 million over the strategy period. The IDB will continue to work closely with other development agencies active in Barbados, some of which have expressed an interest in providing additional financing for investment needs in the strategic areas supported by the Bank.

The most important risks to achieving the Strategy's expected results are macroeconomic and fiscal risks resulting from a possible worsening of the external imbalance and failure to reign in the fiscal deficit; attendant sociopolitical risks that could weaken the social partnership, and slow implementation of the actions foreseen in the strategic priority areas, particularly those of a policy nature. Although the Bank cannot mitigate these risks, it can be responsive in adjusting the Strategy (if necessary) to a new country context.

## COUNTRY STRATEGY RESULTS MATRIX

Country Development Goals	IDB Strategic Objectives	Expected Results of the Strategy	Indicators and Baseline Values (2009) <sup>1</sup>
1. Build Resilience to Coastal Risks, Natural Disasters and Climate Change	1.1 Improve information for the management of coastal risks and climate change adaptation	<ul style="list-style-type: none"> <li>Improved understanding of risk factors such as erosion, flooding, reef degradation, natural disasters and sea level rise</li> </ul>	<ul style="list-style-type: none"> <li>Costal Zone Management Unit (CZMU) has no modeling capabilities to assess risk factors (i.e. climate change and sediment transport) = 0 model in place at CZMU.</li> </ul>
	1.2 Strengthen regulatory and institutional framework	<ul style="list-style-type: none"> <li>Regulatory/institutional framework in place for effective management of coastal zone, disaster risk and climate change adaptation</li> </ul>	<ul style="list-style-type: none"> <li>The draft National Coastal Zone Management (CZM) Plan needs to be upgraded to include disaster risk management and climate change adaptation before approval = 0 CZM Plan</li> </ul>
	1.3 Protect and restore priority coastal ecosystems and infrastructure	<ul style="list-style-type: none"> <li>Shoreline stabilization infrastructure expanded</li> </ul>	<ul style="list-style-type: none"> <li>Stabilized beaches with infrastructure and other stabilization measures= 2 km stabilized out of 8 Km</li> </ul>
<ul style="list-style-type: none"> <li>Essential ecosystems services (e.g., shoreline stability, sand and sediment production) maintained</li> </ul>		<ul style="list-style-type: none"> <li>Total extent of fringing reefs that are seriously deteriorated = 80%</li> </ul>	
2. More Efficient Water Supply and Resource Management	2.1 Improve BWA's financial and operational conditions	<ul style="list-style-type: none"> <li>Improved operational efficiency and financial viability of BWA</li> </ul>	<ul style="list-style-type: none"> <li>Gross Profit Margin ((Total Operating Revenue – Cost of good sold)/Total Operating Revenue) = 5.5%</li> <li>EBITDA Margin (Earnings before interest, tax, depreciation and amortization /Total Operating Revenue) = -17.3%</li> <li>Accounts receivable/ Total Operating Revenue = 22.4%</li> </ul>
		<ul style="list-style-type: none"> <li>Reduced unaccounted-for-water (UFW)</li> </ul>	<ul style="list-style-type: none"> <li>UFW (1 – vol. water billed/vol. of water produced) = 54%</li> </ul>
	2.2 Support design of wastewater treatment action plan	<ul style="list-style-type: none"> <li>BWA has technical/financial plans in place to start major investments in wastewater treatment</li> </ul>	<ul style="list-style-type: none"> <li>No plans are in place = 0 plans.</li> </ul>
3. Lower Oil Imports, Promotion of Clean Energy and More	3.1 Strengthen institutional and policy framework for promoting EE and RE	<ul style="list-style-type: none"> <li>Strategic framework in place, including measurable targets for EE and RE</li> </ul>	<ul style="list-style-type: none"> <li>There is no policy framework in place to promote sustainable energy = 0 policy framework</li> <li>No mechanisms for independent and small power producers to sell electricity to the grid = 0 such producers sell to the grid</li> </ul>

<sup>1</sup> The baseline indicators were derived from the Sector Notes, analysis conducted for portfolio and pipeline development, and discussions with the Government. Progress on baselines will be measured at least once (at end of strategy period); frequency of interim measurements will be determined during programming process.

Country Development Goals	IDB Strategic Objectives	Expected Results of the Strategy	Indicators and Baseline Values (2009) <sup>1</sup>
Efficient Energy Use	(including data collection)	<ul style="list-style-type: none"> <li>Strengthened sector capacity for planning and implementation of energy policy</li> </ul>	<ul style="list-style-type: none"> <li>Capacity-building plan in place to promote sustainable energy = No plan available.</li> </ul>
	3.2 Expansion of programs to support EE and RE	<ul style="list-style-type: none"> <li>Expanded demand-driven funding for EE and RE initiatives</li> </ul>	<ul style="list-style-type: none"> <li>Government has no funding mechanism to promote EE and RE = 0 funding available</li> </ul>
		<ul style="list-style-type: none"> <li>Financial and environmental benefits of EE and RE generated</li> </ul>	<ul style="list-style-type: none"> <li>Financial benefits of EE and RE (e.g. energy savings from lower oil import dependence, or new RE/EE applications) = baseline to be calculated by end of year 2009</li> <li>CO2 reduction from greater EE/RE = baseline to be calculated by end of year 2009</li> </ul>
		<ul style="list-style-type: none"> <li>Feasibility of major RE projects determined</li> </ul>	<ul style="list-style-type: none"> <li>Limited/Incomplete feasibility studies conducted to date and zero RE projects implemented successfully</li> </ul>
4. Improved Quality and Relevance of Education	4.1 Enhance sector-wide strategic planning, data collection capacity	<ul style="list-style-type: none"> <li>Strengthened sector-wide strategic planning and data collection capacity</li> </ul>	<ul style="list-style-type: none"> <li>No current strategic plan for education sector = 0 plan</li> <li>Software for Educational Management Information System (EMIS) installed and training provided for its use in 71 of 95 primary and secondary schools. Only 35 schools are using it.</li> </ul>
	4.2 Strengthen TVET and the school-to-work transition	<ul style="list-style-type: none"> <li>Improved relevance and delivery of TVET programs</li> </ul>	<ul style="list-style-type: none"> <li>Ministry of Labour does not conduct regular industry/ employer surveys and hence information needed to match labor market needs and training programs is not available</li> <li>Program Advisory Committees (which include private sector) do not meet regularly and have limited accountability</li> <li>TVET faculty has limited opportunity for professional development = baseline to be developed in 2010</li> </ul>
		<ul style="list-style-type: none"> <li>Secondary school leavers are better prepared to enter work through the integration of life-skills training</li> </ul>	<ul style="list-style-type: none"> <li>According to NISE employer survey (2007), 36% of employers are not satisfied with skill levels of high school graduates when entering work (writing, math, behavior, ability to work in teams, computer and listening skills)</li> </ul>
	4.3 Improve the quality of primary and secondary education	<ul style="list-style-type: none"> <li>Improved student academic performance in core subjects</li> </ul>	<ul style="list-style-type: none"> <li>Pass rates are 60% in English and 50% in Maths in 2008 in the Caribbean Secondary Education Certificate (CSEC) administered by the Caribbean Examination Council (CXC)</li> </ul>

## I. COUNTRY CONTEXT

- 1.1 Barbados's story is one of economic success accompanied by significant social advancement: the country has consistently ranked third in the Americas (after Canada and the United States (US)) on the United Nations Development Program (UNDP) Human Development Index. The shifting structure of the economy has been responsible for such development gains: Barbados has successfully moved away from a heavy reliance on the sugar industry towards a broader economy based on tourism, offshore finance and informatics. Even within these industries, Barbados has moved into higher value-added niches (e.g. upper-end tourism) with significant local employment. The country's relatively advanced level of institutional development has greatly facilitated this structural shift. In addition to well-entrenched parliamentary practices and a high degree of political and social stability, a social partnership of government, private sector and unions, established in the early 1990s, facilitates consensus-building on national policies and has allowed Barbados to surmount critical economic challenges in the past.
- 1.2 Despite these strengths, Barbados exhibits a series of vulnerabilities that could threaten hard-won gains. Although the economy performed relatively well in the wake of the 2001-2002 recession, with average gross domestic product (GDP) growth of 3.5% over the subsequent five years, the economic rebound was accompanied by a significant deterioration in the fiscal position. Between 2001 and 2008, the non-financial public sector deficit averaged 4.6% of GDP (7.9% if the substantial social security surplus is excluded) while the public debt rose from 74% of GDP to an estimated 96%. Bank analysis indicates that, in the absence of a sharp fiscal adjustment, the projected level of the primary balance is well below that necessary to stabilize the debt/GDP ratio (see Annex I). Moreover, although two-thirds of the public debt is denominated in local currency (reducing direct vulnerability to currency depreciation and sudden stops in capital flows), the debt/GDP ratio is highly vulnerable to growth and interest rate shocks. In addition to this fragile fiscal situation, the external position has also worsened significantly, with the current account deficit averaging 8.7% of GDP over the last seven years. Although this gap has been accompanied by large inflows of foreign direct investment, international reserve coverage of imports and of short-term external liabilities has still declined steadily.<sup>2</sup>
- 1.3 Burgeoning fiscal and external imbalances have left Barbados highly exposed to the current international financial crisis (see Annex II). They preclude the ideal response of a major fiscal stimulus, and potentially increase the adjustment that the economy will have to undergo in order to maintain exchange rate stability. Effective adjustment is moreover

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<sup>2</sup> This macroeconomic context has several implications for the strategy. First, the authorities are committed to a sharp fiscal adjustment and reigning in of fiscal spending and are thus well aware of the need for more efficient public sector spending and improved targeting. Second, they have shown interest in a larger financing envelope from the IDB, including policy based lending, as (a) the cost of accessing private sector sources of funding has risen and (b) an increased share of longer term multilateral debt in their liabilities will allow for inflows of foreign currency to assist reserve management in a fixed exchange rate regime and for a better management of their liquidity position. The macroeconomic risks to the strategy are outlined in Section VI.

constrained by weaknesses in the local business climate; these weaknesses are increasingly exposed by the loss of trade preferences in Barbados's main export markets and declining protection in the home market as a result of recently signed trade agreements. High energy costs are an additional drain on competitiveness and a huge burden on the country's import bill, putting further pressure on external accounts. Meanwhile, scarce (and poorly managed) water supplies and coastal erosion pose a threat to growth in the island's crucial tourism industry, and climate change is likely to further increase these vulnerabilities. Gaps in education—particularly in school-to-work transition and technical and vocational training—have led to unmet needs in the labor market, while adding to youth unemployment.

- 1.4 During the new strategy period (2009-2013), the IDB will support the Government of Barbados in addressing these vulnerabilities, both through the existing portfolio—which focuses on public sector modernization and includes programs to address the country's fiscal challenge—and new support in four priority areas: coastal zone management and climate change adaptation; water and sanitation; energy; and education.

## **II. THE IDB IN BARBADOS**

- 2.1 Flows of official finance to Barbados are limited, at just 30% of total external borrowing (which, in turn, is also relatively low—see §1.2). As a result, although the IDB accounts for almost half of official finance, the impact of Bank funding on the overall budget has been limited: from 2005-2008, IDB disbursements were just 0.2% of GDP, 0.6% of total government spending and 7% of capital spending. The Bank is nevertheless valued by the government as a source of technical assistance, providing both sector knowledge (through its knowledge and capacity-building products, KCPs) and project management support (as part of loan execution). The IDB has not, to date, financed any non-sovereign guaranteed (NSG) operations in Barbados, other than technical cooperation (TC) programs funded by the Multilateral Investment Fund (MIF).
- 2.2 The Bank's current portfolio in Barbados covers four main areas: coastal infrastructure, education, housing and public sector modernization (Annex III). In 2009, approval is expected for two further loans envisaged under the previous country strategy (2005-2008).<sup>3</sup> Slow approval and execution of the portfolio, owing to problems on both the Bank's and the borrower's side, has been a major issue in the past, and largely explains the Bank's negative net flows to Barbados in the last six years. However, the strengthening of the Bank's Country Office, new Bank processes and renewed government efforts to solve execution bottlenecks helped improve program delivery in 2008, and provide a good basis for stronger execution performance in the future (Annex III provides experiences and lessons learned in the implementation of the previous country program.)

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<sup>3</sup> The first, Agricultural Health and Food Safety, aims to ensure high quality standards in both local and imported food products (the quality of imports is crucial both for general health purposes and for the tourism industry specifically). The second, the Competitiveness Program, aims to support key business climate reforms; improve transportation, logistics and trade facilitation; and strengthen the private sector through firm-level interventions and the promotion of business cooperation.

### III. PRIORITY SECTORS FOR BANK SUPPORT, 2009-2013

- 3.1 The four sectors identified for support under the new strategy—coastal zone management and climate change adaptation, water and sanitation, energy, and education— reflect the priorities of both the Government of Barbados and the Bank.<sup>4</sup> Their importance was moreover ratified in Bank consultations with its Civil Society Advisory Group (CSAG) in Barbados, which represents 16 non-governmental organizations in the country.
- 3.2 All four sectors are closely linked to the vulnerabilities outlined in Section I, and are critical for the competitiveness of the Barbadian economy. Targeted support in these sectors will therefore help the government address some of the country’s most important development challenges. Given the Bank’s relatively limited role in the country, the aim was to identify a small number of sectors in which it could contribute greatest value-added, rather than spreading its support over many areas with limited results. In coastal zone management and education, the Bank has already provided substantial assistance under previous strategies with Barbados, and has built a solid working relationship with relevant government authorities. The continuation of this relationship provides a valuable opportunity to build upon Bank experience and lessons learned and thus to enhance the effectiveness of future interventions. Water and energy are important strategic initiatives for the Bank, in which a rich variety of experience from other member countries can be brought to bear in Barbados. (For a more detailed analysis of the sectors and the rationale behind agreed areas of support, see the *Sector Notes* prepared for this strategy).

#### A. Coastal Zone Management and Climate Change Adaptation

- 3.3 Barbados’s tourism industry is highly dependent on the quality of the country’s beaches. However, its coastline is highly vulnerable to erosion as a result of dense coastal development in sensitive areas and coral reef degradation. Climate change compounds this threat by putting the country increasingly at risk from extreme weather. Shoreline erosion rates on the west coast (a key area for high-end tourism) are estimated at 15 meters each 100 years. In relation to disaster risk, projections show that 70% of west coast hotels would suffer serious damage in the event of a “100 year flood” (a flood elevation that has a 1% chance of occurring in any given year).
- 3.4 In light of the government’s overall sector goal of building resilience to coastal risks, natural disasters and climate change, Bank support in this area will focus on: (a) strengthening the institutional framework for integrated coastal zone management, including addressing the legal and decision-making obstacles for allowing an effective coordination across the different sectors that influence the health of the coastal zone (e.g.,

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<sup>4</sup> There is currently no national development plan in place in Barbados (the previous administration’s National Strategic Plan for 2006-2025 is no longer in force). The development priorities of the Democratic Labour Party administration that came to power in 2008 are set out in the DLP electoral manifesto “Pathways to Progress”. The manifesto emphasizes the need to ensure that economic development in Barbados remains balanced and socially inclusive. It does not, however, purport to be a comprehensive government strategy. The government is now in the process of defining policy priorities at the level of each sector, some with IDB support and reflected in this strategy.

water and sanitation, construction, agriculture); (b) improving the mechanisms for assessing and managing coastal risks (e.g. data collection, cost recovery from private sector beneficiaries of shoreline protection programs); (c) improving disaster risk prevention and risk transfer (complementing preparedness and response activities); and (d) supporting a program of shoreline stabilization and marine zoning/demarcation.<sup>5</sup> No NSG operations are planned in this sector.<sup>6</sup>

- 3.5 The risk to achieving the strategy's expected results in this sector is a delay in implementing institutional and policy reforms supported by (a)-(c) above, which would limit the Coastal Zone Management Unit's capacity to implement large-scale coastal infrastructure investments in a timely and cost-effective manner and to ensure their long-term viability. This would require the Bank to scale back the investment program, providing less finance than expected during the strategy period. Beyond sector-specific risks, delays in improving disaster risk management could exacerbate the impact of a natural disaster, the occurrence of which is a risk to the entire Strategy (Section VI).

## **B. Water and Sanitation**

- 3.6 Barbados ranks among the top 15 countries in the world in terms of water scarcity. Such scarcity constrains further development of the tourism industry and is expected to be aggravated by climate change, as rising sea levels lead to increased saltwater intrusion into groundwater supplies, exacerbating existing problems related to the availability and quality of drinking water.<sup>7</sup> Inadequate sewage treatment (only 8% of water produced is collected as wastewater and treated) adversely affects the country's beaches (its prime tourist attraction) by lowering water quality and causing coral degradation (which further exposes the coastline to erosion). The government's ability to deal with these issues is constrained by the fragile financial situation of the Barbados Water Authority (BWA), resulting from both depressed revenues (a history of low tariffs, high rates of unaccounted-for-water) and high costs (soaring energy bills, increased reliance on the output of a costly desalination plant). BWA's operational efficiency is moreover diminished by inadequate staffing and obsolete commercial and management information systems.
- 3.7 In line with the government's overall sector goal of more efficient water supply and resource management, Bank interventions in this sector will focus on: (a) improving BWA's operational efficiency and financial sustainability (through e.g. establishment of improved operational procedures and mechanisms for revenue generation and reduction of commercial losses); (b) in parallel and complementary to (a), supporting BWA's

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<sup>5</sup> As to sequencing, the Bank would initially support components (a)-(c), accompanied by some investments in (d). Further investments could be financed in a subsequent phase.

<sup>6</sup> As regards climate change adaptation, areas that have been identified as amenable to MIF support include: (i) improving the abilities of small businesses, particularly those linked to the tourism sector, to better understand and anticipate the threats associated with climate change, (ii) helping local financial institutions to develop environmental risk management and risk financing strategies and products, and (iii) supporting local private sector associations to help raise enterprise awareness.

<sup>7</sup> Although 97% of the population receives piped drinking water directly to their homes, this achievement comes at a high cost. Current abstraction levels from some wells exceed sustainable levels, resulting in growing salinity of some groundwater sources. This, combined with of pollution on other aquifers, raises the cost of potable water production.

infrastructure program for reducing production costs and physical losses; and (c) preparation of a comprehensive wastewater treatment action plan (comprising, among others, options for wastewater reuse, feasibility studies for a new treatment facility, and tariff-setting mechanisms) and a financing plan for priority investments in wastewater treatment. To the extent that these issues can be satisfactorily addressed, the Bank could provide financing for some of these investments. NSG financing for BWA will depend on the company achieving an acceptable level of creditworthiness and governance standards as a result of the measures contemplated in (a) above.

- 3.8 The risks in this sector are: (a) delays on the policy/institutional front, as a result of which BWA would not be sufficiently strengthened for its revenues to cover its operating and investment costs or to justify Bank financing of such investments; and (b) delays in implementing the infrastructure program, causing continued physical losses and placing limits on BWA's capacity to achieve financial viability. While these delays would not influence the scope of IDB financing in the short term, they could constrain continued support in the future.

### **C. Energy**

- 3.9 Barbados depends on imports for most of its energy needs and is thus highly vulnerable to the volatile international energy market. This heightens the country's macroeconomic vulnerability and the costs to government of maintaining price stability through fiscal stabilization mechanisms; high energy costs also adversely affect business performance in the country.<sup>8</sup> With few possibilities of expanding its own limited production of fossil fuels<sup>9</sup>, the most effective alternative to balance demand and supply is to: (a) curtail demand growth via greater energy efficiency (EE), and (b) expand production from renewable energy (RE) sources. Neither of these two areas (EE and RE) has an established policy/regulatory framework for the promotion of public or private investments, nor the corresponding institutional capacities required under such a framework. There is also a need to optimize the use of fossil fuels, mainly natural gas, as a measure of energy conservation.

- 3.10 The government's goal is to reduce the oil import bill, promote clean energy and use energy more efficiently. In light of this goal, the Bank will focus initially on supporting the government in defining a more precise sector strategy. Once this is accomplished, Bank interventions will include supporting: (a) the drafting of a sector policy framework that promotes energy efficiency savings and renewable energy production (e.g. public and/or private EE programs, mechanisms to expand RE supply such as power purchase agreements to facilitate the sale of power by independent power producers to the grid, and waste-to-energy projects); (b) capacity building for the effective planning and implementation of EE and RE programs (including data gathering and analysis); (c) pilot

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<sup>8</sup> The cost of energy is high in Barbados because of both (i) the high cost of oil relative to other energy sources (hydro, coal) and (ii) the added high cost of transporting energy to the island.

<sup>9</sup> Barbados has some fossil fuel reserves, but production of both oil and gas is declining steadily. There is some prospect of the discovery of new reserves (licensing for offshore exploration is underway), yet the country must plan for a worst case scenario while trying to mitigate the impact of existing levels of import dependence.

programs for EE and RE and expansion of demand-driven financial support for such initiatives; and (d) preparation of pre-feasibility studies for investments and an assessment of options for natural gas transmission and distribution, with the aim of rationalizing the existing network. NSG support would focus on the EE and RE areas, leveraging the Bank's SG interventions under (c) and (d).<sup>10</sup> IDB's Structured and Corporate Finance Department (SCF) has recently been working with sponsors interested in developing RE and EE projects, and expects to see some activity in this area in the short to medium term.

- 3.11 The risks in this sector are: (a) waning interest of government, consumers and investors in EE and RE initiatives if energy costs from traditional sources drop; and/or (b) an institutional and policy framework (established by the government) that is not attractive enough to boost public and private sector investments in EE and RE. In either case, possibilities of future Bank investments in this area would be curtailed.

#### **D. Education**

- 3.12 The sector diagnostic indicates that: (a) in spite of great improvements in expanding access to all levels of education, quality concerns persist<sup>11</sup>; (b) there is a weak link between educational programs and the needs of the labor market (gaps include limited abilities among school graduates in technical subjects, and poor workforce ethic resulting from inadequate "life skills" tuition); and (c) the education system cannot deal effectively with youth at risk. Sector policy is not yet fully defined: national consultations aimed at developing a White Paper for the sector (to be published in 2010) are currently underway.

- 3.13 In light of the government's overall goal of increasing the quality of education and its relevance to the country's development needs, Bank interventions in the sector will therefore comprise: (a) enhancing sector planning and data collection capacity (including support for the preparation of the White Paper and the corresponding strategic plan for the sector); (b) under the assumption that the sector strategy will emphasize stronger links between the education system and the labor market: strengthening school-to-work transition and technical and vocational training (TVET) (e.g. modernization of TVET centers, strengthening of TVET programs that improve workforce ethic and target youth at risk); and (c) improving the quality of primary and secondary education (e.g. teacher training, curricular development, upgrading of school infrastructure). The sequencing of financial support for possible investments contemplated in (b)-(c) above will depend on the priorities outlined in the sector strategy and the corresponding sector policy framework. No NSG lending is expected in the education sector in the short term.<sup>12</sup>

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<sup>10</sup> For example, investments in manufacturing of components/equipment for the RE sector; bio-energy, wind and biomass projects; and support for capital-intensive sectors and the tourism sector that integrate EE measures. IIC has already launched a technical assistance program that focuses on promoting EE and clean technologies with SMEs.

<sup>11</sup> Some indicators include weak national assessment results in core subjects and many school leavers who do not meet the basic prerequisites for admission to post-secondary/tertiary institutions.

<sup>12</sup> Beyond the four priority sectors of the Strategy, other areas for NSG intervention may include tourism and financial/capital market development, building on current Bank activities in these areas (MIF/IIC technical assistance and the Competitiveness Program that will improve the business environment for private sector investment and financing). Additionally, the Government has plans for drafting an industrial policy to enable NSG interventions in other sectors such as light manufacturing and agri-business.

- 3.14 The main risks are: (a) insufficient coordination between the Ministries of Education and Labour (responsible for TVET), without which the desired link between the mainstream education sector and TVET programs will remain tenuous; and (b) possibly as a consequence thereof, that the new sector strategy does not place sufficient emphasis on this link. This would require the Bank to reduce the scope and/or funding of its interventions in the education sector, focusing exclusively on traditional primary/secondary education support.

#### IV. BANK FINANCING UNDER THE STRATEGY

- 4.1 **Sovereign-guaranteed lending.** The government and the Bank's country team estimate total sovereign-guaranteed lending at US\$ 200 million under the 2009-2013 strategy period, based on the government's financing needs. This is greater than total lending under the previous two strategies (US\$126 million in 1999-2004 and US\$49.4 million in 2005-2008). However, three factors favor more financing under this strategy. First, infrastructure investment needs in the water and coastal zone management sectors are substantial (the last strategy focused heavily on institutional strengthening and less on infrastructure). Second, in addition to investment lending, the authorities have expressed interest in receiving financial support for policy reforms (such support was absent in the previous two strategies) in the area of energy. Third, recent progress in resolving execution bottlenecks provides potential for improved portfolio performance with larger lending volumes in the future.
- 4.2 Based on total SG lending of US\$200 million and certain assumptions regarding the country program that will be associated with the strategy, Bank net loan flows to Barbados would reach US\$156.3 million over the strategy period.<sup>13</sup> This level of Bank lending would add around 18% to the external debt, and 5% to the central government's total stock of public debt as of end-2008. However, the impact with respect to the debt/GDP ratio may be negligible depending on the level of GDP growth experienced over the five-year period and the extent to which new borrowing is associated with retirement of existing debt. In addition, the government has confirmed plans for a significant adjustment to its fiscal position, with a view to steadily reducing the overall debt burden.<sup>14</sup> Under the assumption that such debt reduction materializes, Bank lending should thus be seen as supporting a modest rebalancing of government borrowing away from the local market in favor of external financing—both to support the country's balance of payments position and to relieve pressure on the domestic credit markets.<sup>15</sup>

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<sup>13</sup> Depending on the mix between investment and policy-based lending, projected disbursements for the period 2009-2013 could reach a total of US\$245.8 million. Subtracting repayments of principal, this would result in net loan flows of US\$156.3 million. Net cash flows from the Bank to Barbados (net loan flows minus loan interest payments) are expected to be positive in all years, totaling US\$116 million over the period.

<sup>14</sup> As announced in the 2009 budget, the government aims to generate a central government primary surplus of at least 5.9% of GDP from 2011 onwards—representing a fiscal adjustment of almost 5% of GDP—with a view to reducing the central government debt/GDP ratio from 83% in 2008 to 70% by 2018).

<sup>15</sup> The speed with which the government can achieve its debt reduction targets will influence the composition of the country program with respect to loan modalities.

- 4.3 **Non-sovereign guaranteed lending.** As indicated, demand for NSG operations is uncertain, but some such lending is expected in the coming years.
- 4.4 **Grant-funding and KCs.** The country team will seek to tap the Bank's strategic initiative funds and other grant finance to support analytical work and the preparation of new operations in the selected priority areas, as well as further work related to the public sector modernization portfolio. MIF will continue to focus on assistance for small and medium-sized enterprises (SMEs), entrepreneurship and information and communications technology (ICT), complementing the activities of the Competitiveness Program. Total grant funding over the strategy period is estimated at around US\$5 million, almost double the funding provided in the previous strategy period (US\$2.6 million).

## V. STRATEGY IMPLEMENTATION

- 5.1 **Lessons from the previous strategy.** Of the nine loan operations envisaged under the previous strategy (2005-2008), only five were approved during the strategy period; three of them in the final year. Late approvals and very slow portfolio execution during most of the strategy period meant that the Bank and the Government had little chance of achieving the expected results of the strategy, and despite a strong recovery in disbursements in 2008, Bank net cash flows to Barbados<sup>16</sup> remain negative. Simpler and more risk-based project design, more agile government decision-making, faster and more efficient procurement processes, and active Bank involvement throughout the project cycle will be necessary to improve execution performance (for more detail, see Annex III).
- 5.2 **Use of national systems.** The Bank presently uses project execution units for all projects, and all operational supervisions are conducted ex-ante. Furthermore, all projects are audited by external audit firms. Over the past 10 years, however, the government has moved to modernize and strengthen its fiduciary systems, prompting the Bank to begin a review of its own practices in this area with the aim of moving to ex-post review and the use of country systems in Bank-financed projects. The Bank has already initiated project-specific risk assessments to determine readiness for moving to ex-post review of procurement processes and disbursement requests in individual operations. A review of country systems will be conducted within the first two years of the strategy period.<sup>17</sup>
- 5.3 With respect to *financial management systems*, a recent EU-sponsored Public Expenditure and Financial Accountability (PEFA) assessment concluded that public financial management is generally sound and conducive to the basic principles of fairness, transparency and checks, and accountability.<sup>18</sup> Weak internal controls within many

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<sup>16</sup> Net cash flows are Bank disbursements minus borrower's repayment of principal, interest and other loan charges.

<sup>17</sup> The review will determine the readiness of country systems in relation to the execution of Bank-financed projects; help identify information gaps; and suggest priority areas for strengthening that could be addressed with Bank support.

<sup>18</sup> The government passed legislation in 2007 to move to an accrual basis of accounting and to strengthen the role of the Auditor General by granting the office greater independence and authority; Annual Reports of the Auditor General are now published on its website.

government departments are nonetheless highlighted as an area of concern in both the Accountant General's Report for Financial Year 2007-2008 and the PEFA. Addressing these weaknesses is important in order to move towards the full use of country systems in this area. The implications for the lending and TC/KCP program associated with the Strategy are (a) that it needs to take account of possible technical assistance needs to support these reforms; and (b) that execution performance is likely to improve once country systems are used in Bank-financed projects, since this would lower transaction costs for both the Bank and the Government.

- 5.4 As regards *procurement systems*, a recent procurement assessment undertaken by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD-DAC) identified a number of weaknesses in Barbados's public procurement system, including several important gaps in the institutional and documentation frameworks, and lengthy approval processes for contracts. Under a Bank-financed procurement program approved in 2008, however, Barbados is in the process of updating and improving its procurement systems. Reforms to both the legal and institutional framework for procurement, and improved operational procedures, will facilitate use of country systems in this area.
- 5.5 *Planning, monitoring and evaluation systems* in Barbados all need strengthening. Limitations in this area are compounded by weaknesses in *data collection and analysis*. To help the government address these issues, (a) the Bank approved a PRODEV operation in 2007 to support results-based management in the public sector and a loan in 2008 aimed at strengthening the legal and institutional framework for the production of statistics; and (b) in those sectors receiving Bank support under this strategy, emphasis will be placed on developing comprehensive planning, monitoring and evaluation systems, as well as on strengthening data generation capacity.
- 5.6 **Coordination with development partners.** Most development agencies in Barbados have programs centered on the wider Caribbean region, rather than on the country itself. There has thus been little need to establish formal coordination mechanisms for Barbados-specific activities. The Bank has a strong relationship with the Caribbean Development Bank (CDB), centered mostly on the regional program, but also on the co-financing of Barbados's Education Sector Enhancement Program. For the purposes of this strategy, the Bank has consulted with the CDB and two other agencies active in Barbados - the European Commission and the European Investment Bank (EIB). Both the CDB and the EIB have expressed an interest in providing additional financing for investment needs in the strategic areas supported by the Bank, and opportunities for co-financing and parallel financing are being explored (Annex IV describes the main activities of the various development partners in Barbados).

## VI. RISK ASSESSMENT

- 6.1 **Macroeconomic and fiscal risks.** The global economic crisis has hit Barbados hard. Future growth rates, the government's fiscal position and hence the trajectory of the country's debt are highly contingent on developments in the North American and United Kingdom (UK) markets, since growth, the health of financial systems and consumer confidence in these markets are important drivers for Barbados's tourism and financial services industries. Under the best of circumstances, the authorities will probably have to dedicate significant time and effort to managing the impact on the Barbadian economy, while a scarcity of counterpart funding could slow program delivery. If the latter were to occur, the Bank could move to 100% financing of operations, requiring a larger financing envelope, and/or a reduction in the scope of the strategy. Full (100%) financing is permitted under the Country Financing Parameters agreed in 2006 (CP-3053-2), which remain relevant to country circumstances.
- 6.2 The main macroeconomic risk that Barbados faces is that of a continued deterioration of its fiscal position and higher debt/GDP ratios, associated with prolonged economic contraction. Under such a scenario, and to preserve the country's important social gains, the financing envelope may be further increased (subject to debt-sustainability parameters) and/or the country programming associated with the strategy may be adjusted towards supporting further structural reforms. In *Estimation of Possible Additional Bank Financing in Response to [Macroeconomic Risks](#)*, the Country Team considers the downside risk of a continued 3% GDP contraction in 2010 instead of zero growth projected by the IMF, and proposes that, in response, the Bank make US\$20 million in additional financing available to the country. The Government's fiscal adjustment plans for 2011 and beyond would be sufficient to absorb this additional funding while still achieving the required debt ratio reduction.
- 6.3 **Socio-political risk.** If the current economic downturn is particularly acute and prolonged, there is also a risk that rising social tension will weaken the Social Partnership. This would make it more difficult to build consensus, and could slow progress on critical reform initiatives (e.g., in areas affecting employment), requiring the Bank to review and possibly restructure interventions linked to policy reform, and/or change the sequencing of those interventions.
- 6.4 **Disaster risk.** Barbados is less vulnerable to natural disasters than most of its Caribbean neighbors, yet the risk is present and is heightened by the impact of climate change. A major natural disaster could have a devastating economic and social impact, and would require the Bank to redirect most of its funding towards emergency response and reconstruction. To prepare for such a scenario, and as part of its support for coastal zone management, the Bank will finance a country-risk evaluation for Barbados, which will identify the geographic areas and sectors most at risk from natural disasters. It will also support the creation of a system for the assessment and management of disaster and climate change risk in Barbados.

## ANNEX I

DEBT SUSTAINABILITY: AN ASSESSMENT<sup>1</sup>

## I. PUBLIC DEBT INDICATORS

- 1.1 Barbados faces a huge challenge with respect to its public debt (see Table 1). Total public sector debt has risen steadily over the last two decades, reaching 96% of GDP in 2008. Domestic debt has grown faster than external debt and now amounts to almost 75% of total public sector debt.

Table 1: Selected Fiscal and Debt Indicators

	2006	2007	2008	2009
Real GDP growth (%)	3.3	3.3	0.7	-3.5
Public sector fiscal balance (% of GDP)	-3.7	-5	-4	-5.1
CG revenue and grants (% of GDP)	34.2	34.9	35.3	35.1
Interest payments (% of GDP)	5	4.9	5.2	5.1
Primary balance (% of GDP)	0	-1.4	-0.1	-1.4
Total public sector debt (% of GDP)	92.8	94.6	95.7	96.7
External debt (% of GDP)	27.6	24.2	26	25.6
Domestic debt (% of GDP)	65.2	70.4	69.7	71.1
External interest payments/XGS (%)	3.0	2.4	3.7	3.2
External interest payments/GDP (%)	1.9	1.5	2.3	1.9
Total interest payments/CG revenue (%)	14.6	14.0	14.7	14.5

XGS: exports of goods and services. CG: Central Government

Source: IMF Article IV Report, 2008 and IDB estimates. Shaded columns are projections. The table reflects growth and fiscal projections announced in the government's 2009 Budget Statement.

- 1.2 Given the slow growth of external debt, it is not surprising that the external debt indicators show relative stability: external debt has ranged from 24-28% of GDP over the last few years. The external debt service ratio is thus within a manageable range. Interest payments on external debt have ranged from 1.5 to 2.3% of total exports of goods and services over the same period.
- 1.3 The present situation, however, raises serious concerns about debt sustainability. The main source of concern is the relationship between debt service and the primary fiscal balance. The primary balance is a key variable with regard to debt sustainability because it indicates how well fiscal management is doing in terms of generating resources to service debt. It is therefore a matter of major concern that the primary balance is less than interest payments on the total public sector debt. Interest payments averaged 5% of GDP in 2006-08 compared to an average primary balance of -0.5% of GDP. It is inevitable that the total debt stock will continue to rise as long as interest payments exceed the primary balance.

<sup>1</sup> Prepared by Desmond Thomas (CCB/CCB) on the basis of the debt sustainability analysis carried out by C.E. Castro (2008).

- 1.4 It is also important to note that the country's overall fiscal deficit has been relatively high over the last few years. Current estimates for 2006-09 show the fiscal deficit averaging 4% of GDP. The high fiscal deficits are an aggravating factor contributing to the difficult debt situation.
- 1.5 The current international economic crisis is adding to the challenges of fiscal and debt management in Barbados. Barbados is one of the Caribbean countries hardest hit by the crisis because of its high dependence on the tourism industry. The IMF's April World Economic Outlook (WEO) estimates forecast a 3.5% contraction in Barbados's GDP in 2009. The Barbados Government's announcement of a 2.8% annual contraction as of the first quarter of 2009 is also indicative of a severe adverse impact. In the circumstances, there will be strong pressure on the Government to pursue a countercyclical fiscal expansion, but the high debt ratio is a major constraint on such action.
- 1.6 The Government of Barbados projects that total public debt will reach 102% of GDP by the end of 2009. The Government has announced a strategy to generate primary surpluses of at least 5.9% of GDP from 2011 onwards with a view to reducing the central government debt/GDP ratio estimated to be 83% at the end of 2008 to just below 70% by the end of 2018.

## **II. DEBT SUSTAINABILITY GOALS**

- 2.1 As has already been observed, debt sustainability requires that debt service and the primary fiscal balance are in a manageable relationship to each other. The primary balance indicates the availability of fiscal resources to service debt. But it is not enough that the primary surplus that is generated is adequate for debt service payment. It is also important that debt service is maintained at a reasonable level in order to keep the resources that are diverted from traditional public sector development goals to a minimum. Moreover, given the heightened vulnerabilities that Barbados faces as a small country overwhelmingly dependent on one export industry, debt service needs to be maintained at a reasonable level to leave adequate room for policy responses to shocks when they occur.
- 2.2 Two factors affecting the size of the debt service are the debt stock and interest rates. Debt management is therefore concerned with (i) trying to contain the growth of the debt stock and (ii) negotiating favorable terms. In this regard, debt management has to take into account the possibility of interest rate shocks.
- 2.3 In light of these considerations, efforts to achieve debt sustainability in Barbados must focus on reducing the public sector debt stock from its current level of 96% of GDP. The Government's goal is to raise its primary surplus and thereby reduce the debt/GDP ratio to 70% by 2018.

## **III. DEBT SUSTAINABILITY ANALYSIS: THREE APPROACHES**

- 3.1 Castro (2008) presents three approaches to debt sustainability analysis (DSA) for Barbados, namely, a standard approach, a “sudden-stop” approach and a probabilistic approach, or fan charts (FC) approach. These approaches essentially try to estimate the path of the debt/GDP ratio under different scenarios and on that basis estimate the primary surplus needed to keep the debt ratio from escalating.
- 3.2 The **standard approach** is a basic model which depends on only two parameters, the GDP growth rate and the interest rate, to estimate future interest payments on public debt. This determines the primary surplus that the government has to generate, in the context of a growing economy, in order to service its debt and thereby keep the debt/GDP ratio from growing.
- 3.3 The “**sudden-stop**” model incorporates a larger range of variables, including:
  - a. Non-tradable goods demand elasticity
  - b. Current account deficit (CAD)/GDP
  - c. CAD/tradable goods absorption (calculated as CAD/imports of goods and services)
  - d. Required percentage change in the real exchange rate for the external equilibrium after a sudden stop
  - e. domestic debt denominated in foreign currency
  - f. GDP percentage of tradable goods (exports of goods and services/GDP), and
  - g. average real interest rate.
- 3.4 This approach shows the impact of specific shocks on debt service and therefore on the required primary surplus for debt sustainability. Typical shocks considered include an abrupt drop in foreign direct investment (FDI), a rise in the interest rate or drop in GDP growth. Castro (2008) observes that the applicability of this approach to Barbados is limited by two factors: the high ratio of exports to GDP and the low level of dollarization of the Barbados debt given the fact that nearly 75% of the debt is domestic. For this reason this note will focus on the findings of the other two approaches.
- 3.5 The **fan chart approach** uses probabilistic rather than deterministic methods to generate forecasts of the debt/GDP ratio. It expands on the basic model by explicitly recognizing the composition of debt in terms of domestic and external debt, the respective interest rates and the role of exchange rate change (which is 0 in the case of Barbados).

#### IV. CONCLUSIONS

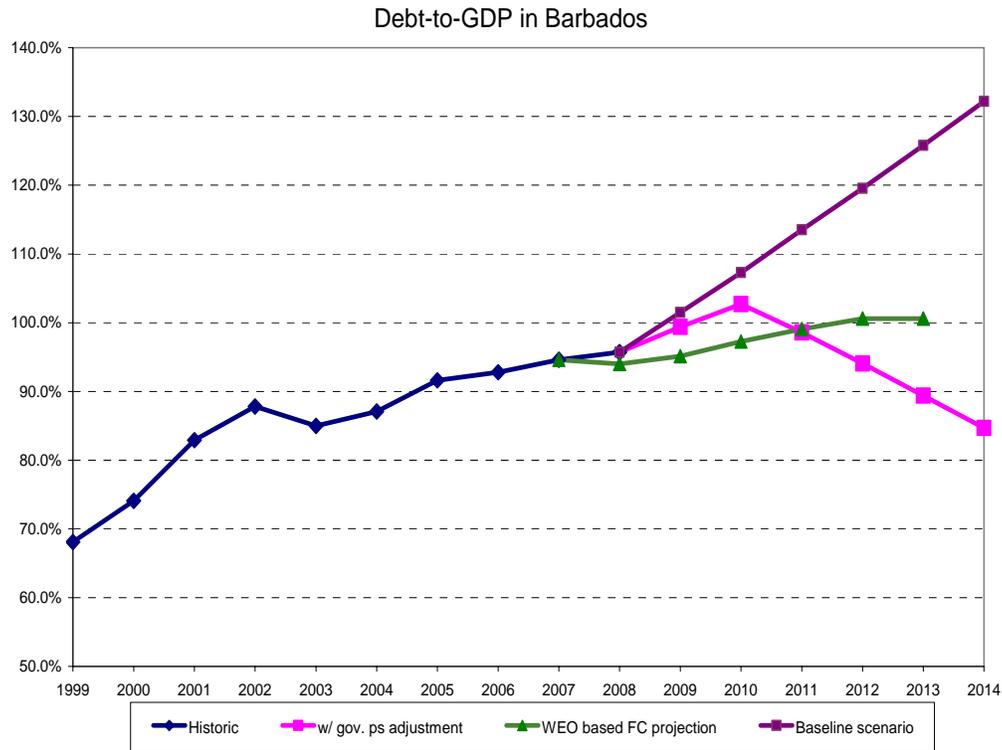
- 4.1 All three DSA models underscore the need for a greater fiscal effort in order to maintain debt sustainability. The **standard model** generates estimates of the primary surplus required depending on assumptions about interest rates and growth. We may, for example, assume that a real average interest rate of 3% holds for the medium to long-term. With respect to the GDP growth rate, one possible assumption is to adopt the long-run historical average growth rate of the last three decades, which is 1.2%. On that basis, the primary surplus required to sustain the debt/GDP ratio at its current level is 1.67% of GDP. With a projected primary balance of -1.4% of GDP in 2009, this would imply an upward adjustment of 3.07 percentage points in the primary surplus (see Table 2).
- 4.2 However, this would be a conservative basis for estimating the relevant growth rate. It may be more reasonable to assume that when the global economy recovers, Barbados would return to its recent growth path of about 3% annually. In that case, the required primary surplus indicated by the model is 0.01% of GDP, representing an upward adjustment of 1.41 percentage points from the current level.

**Table 2: Required Primary Surplus for Different Interest and Growth Rates**

Total Public Sector Required Primary Surplus (% GDP)						
		Long-Term GDP growth rate				
		-0.5%	1.0%	1.2%	2.0%	3.0%
Average real interest rate	1.0%	1.46%	0.01%	-0.22%	-0.92%	-1.84%
	2.0%	2.42%	0.96%	0.73%	0.01%	-0.91%
	3.0%	3.38%	1.91%	<b>1.67%</b>	0.95%	0.01%
	4.0%	4.34%	2.86%	2.62%	1.89%	0.94%
	5.0%	5.30%	3.80%	3.57%	2.83%	1.87%
	6.0%	6.27%	4.75%	4.51%	3.77%	2.80%
	7.0%	7.23%	5.70%	5.46%	4.71%	3.73%

- 4.3 The **fan chart model** also emphasizes the need for serious action to ensure debt sustainability. The chart below illustrates three paths depending on different scenarios. The baseline scenario (what will happen without any policy intervention) incorporates currently available information about recent fiscal and GDP developments. The WEO-based fan chart projection indicates the path of the debt ratio generated by the probabilistic model. It is based on WEO historical data prior to the onset of the international crisis. The relevant line in the chart depicts the mid-point of a fan of possible lines generated by a probability distribution. The third line shows the path of the debt ratio assuming the implementation of the Government's plan to raise the primary surplus to 5.9% of GDP from 2011 onwards. It can be seen that this action would result in a marked trend toward the goal of a 70% debt ratio by 2018.

Chart 1: Debt Ratio Projections: Three Scenarios



4.4 It is evident that increased fiscal effort is required over the next few years to ensure a sustainable path of the debt/GDP ratio. In that regard, it is worth noting that the theoretical models used here have focused on estimating the required primary surplus for ensuring that the debt ratio does not grow. However, there is wide recognition that the current debt ratio is too high and debt management needs to be aimed at reducing it over the long run to provide the policy space for responding to inevitable shocks. Therefore, the required primary balance should include a margin for amortization which will not only reduce the debt ratio but will also lead to a reduction in the required primary surplus over the medium to long term. Indeed, this is reflected in the debt path generated in the case of the Government’s planned fiscal adjustment. With GDP growing, these adjustments would be consistent with a level of continued borrowing for development.

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## **ANNEX II**

### **IMPLICATIONS OF THE INTERNATIONAL ECONOMIC CRISIS<sup>1</sup>**

#### **A. Scope of the International Economic Crisis**

- 1.1 The world economy is experiencing a crisis of catastrophic proportions, already being compared to the Great Depression of the 1930s. It is evident that, although the crisis was triggered in the financial markets of the US, it is now global and not limited to financial sectors. The April WEO update forecasted a 1.3% contraction in world output in 2009, reflecting the deepest global recession since World War II. The main characteristics of the crisis include a sharp drop in real estate value in the US and elsewhere, plummeting stock prices resulting in loss of stock market capitalization of more than 50% over the last year, falling commodity prices (including that of oil), rising interest rate spreads facing emerging markets, and increased exchange rate volatility. The crisis emerged initially as a financial crisis but is now having strong adverse impact in the real economy.

#### **B. Impact of the Crisis in Barbados**

- 1.2 Barbados does not appear to have suffered any direct contagion from the financial crisis in the US and other countries. There are six banks operating in Barbados, all predominantly foreign-owned, and they continue to be operating soundly. The absence of contagion is attributable to the fact that the banks are all owned by non-US banks, mainly Canadian, and bank supervision and practices are appropriate. The non-bank financial sector also appears to be free of contagion from the US financial market.
- 1.3 However, the international economic crisis is having a severe adverse impact in the real sectors of the Barbados economy. Barbados is a small open, export-driven economy, with tourism as its leading industry. Tourism accounts for one half of total exports, and is estimated to account directly and indirectly (through its links to other major sectors such as distribution and construction) for about 39% of GDP and 44% of employment. The main markets for the Barbados tourist industry are Europe (mainly the UK), the Caribbean, the US and Canada.
- 1.4 With income, employment and wealth contracting dramatically in these countries, the Barbadian economy will inevitably be affected. According to the April 2009 World Economic Outlook update, Barbados is expected to suffer a 3.5% GDP contraction in 2009, after growth of only 0.7% in 2008. This projected contraction is the second highest in the CARICOM region, and a leading contributor is declining tourism performance. Official figures released in the Government's budget presentation show that in 2008, real value-added from the tourist industry declined by 1.7% after growing by 3.1% in 2007. First quarter tourist arrivals in 2009 showed a 6.2% decline compared with the same period in 2008.

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<sup>1</sup> This note was prepared by Desmond Thomas (CCB/CCB).

- 1.5 Another industry that is being affected (indirectly) is off-shore banking, which is an important industry in Barbados. It is possible to trace threats to the future of off-shore banking indirectly to the effects of the international crisis. Apart from the direct impact of recession in the industrialized countries on this activity, the crisis is fueling political pressures in the US and elsewhere to place obstacles in the way of companies using tax “havens” abroad. Even if Barbados’s well-regulated industry escapes the latter pressures, the recession itself will likely lead to declining income, rising unemployment and falling government revenues.
- 1.6 There are indications that one indirect effect of the crisis is to weaken FDI inflows. This can have major implications with respect to macroeconomic stability. Given the existence of sizable external current account deficits, Barbados relies on a steady capital inflow to finance imports. In recent years there has been a trend of narrowing current account deficits which had risen as high as 13% of GDP in 2005. However, they were still high at 8% of GDP in 2008.

### **C. Barbados’s Government Response**

- 1.7 The options for counter-cyclical spending to boost economic activity and employment are severely limited given fiscal conditions in Barbados. With the total public debt standing at 96% of GDP, the room for expansionary fiscal policy is limited. With FDI contracting also, there is an increased need for external borrowing to maintain external stability. At the same time, revenue growth has been restricted by reduced economic activity affecting off-shore banking and other areas.
- 1.8 The Government is responding with a package of fiscal measures announced in the budget. The measures, while reflecting the Government’s development approaches, are also aimed at boosting economic activity in specified areas (e.g., road building, reduced VAT on building materials and locally produced arts and craft). This is to be balanced by increased charges in other areas (e.g., water rates). The Government has also announced its intention to reduce the debt/GDP ratio of the central government to 70% by 2018 and to this end has proposed to raise the primary balance to at least 5.9% of GDP from 2011 onwards.
- 1.9 The Bank’s strategy will provide support to the Government’s efforts to promote economic activity and maintain macroeconomic stability. The Bank remains ready to provide financial support in the priority areas identified in the Country Strategy and to accelerate disbursements, mindful of the need to avoid an escalation of the country’s debt/GDP ratio. The Bank will also use its non-financial products to support research and dialogue on the appropriate approaches for sustainable recovery and growth.

## ANNEX III<sup>1</sup>

### PAST STRATEGY, PORTFOLIO AND LESSONS LEARNED

- 1.1 Flows of official finance to Barbados are limited, at just 30% of total external borrowing (which, in turn, is also relatively low given that two thirds of the country's public debt is domestic). As a result, although the IDB accounts for almost half of official finance and ranks alongside the Caribbean Development Bank (CDB) as Barbados's most important multilateral development partner, the impact of Bank funding on the country's overall budget has been limited. From 2005-2008, IDB disbursements equaled just 0.2% of GDP, 0.6% of total government spending and 7% of capital spending [Central Bank, 2009].
  - 1.2 Despite this low level of funding, however, the IDB is an important source of technical assistance for the government, providing both sector knowledge through KCPs and project management support as part of loan execution.
- A. Implementation of the 2005-2008 Country Strategy**
- 1.3 Within its overall theme of **competitiveness**, the previous strategy had two main areas of focus: **private sector development** and **public sector modernization**. Approval of nine loan operations was anticipated, with a total estimated value of \$65.7 million.
  - 1.4 Seven of these operations moved forward. But only two were approved between 2005 and 2007, and it was only in 2008 that the lending program effectively got underway, with three further approvals bringing total financing during the strategy period to \$49.4 million. That year also saw progress on two other loans envisaged in the strategy, both scheduled for approval in 2009 (Competitiveness and Agricultural Health, where a PROPEF is now underway). If these are included, total financing under the previous strategy reaches \$68.4 million.
  - 1.5 From 2005-2008, the Bank moreover approved seven grant projects for Barbados, for a total of \$2.6 million: one PRODEV operation focusing on management for results, four MIFs supporting private sector development, and two TCs in the area of trade facilitation. Barbados also benefited from assistance under the IDB's Business Climate Initiative for diagnostic work related to the preparation of the Competitiveness loan, and from several regional MIFs and TCs.<sup>2</sup>
  - 1.6 Given the focus of the strategy results matrix on pipeline results rather than the portfolio, **late approval of the operational program meant that the Bank had little chance of contributing to expected country results within the strategy period**, though the desired impact is likely to be seen in the medium term.

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<sup>1</sup> Prepared by the CCB/CBA Country Team.

<sup>2</sup> From 2005-2008, the Bank approved almost 40 regional grant operations for the Caribbean, totaling US\$16.5 million. Over half of these directly support the goals of the 2005-2008 strategy with Barbados.

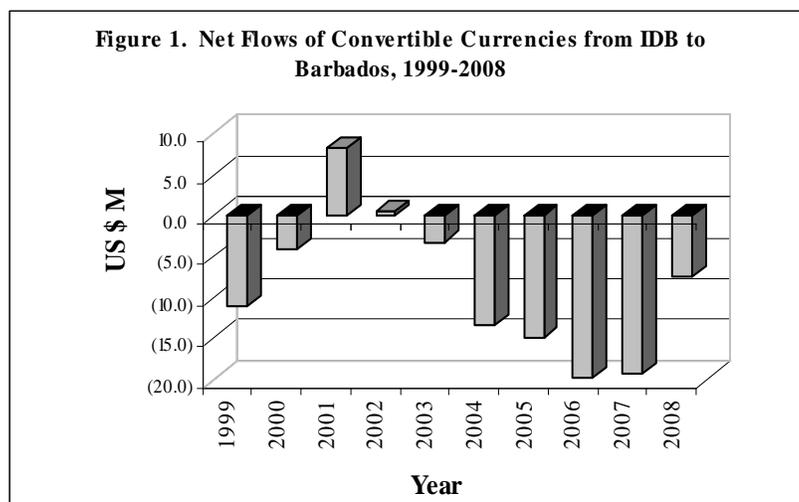
- 1.7 Late approval of the operational program owed to several factors. On the Bank’s side, (i) there were delays in responding to government requests for assistance in some projects; (ii) missions often had scheduling problems; and (iii) preparation and internal approval of project documents took quite long. Prior to the Bank’s internal realignment in 2007-2008, moreover, the Barbados Country Office was thinly staffed and struggled to deliver the close follow-up needed to sustain the momentum of project preparation and dialogue between HQ-based project teams and the government.
- 1.8 On the government’s side, the recurring issue in virtually all projects was the long time it took for counterpart agencies to review project documents submitted by the Bank, including draft loan contracts. Government decision-making processes are protracted because of (i) human resource constraints (public agencies are small and senior-level staffing is limited, thus the temporary absence of even one key officer can substantially slow the work flow); (ii) a tradition of extensive consultation across ministries, requiring even small, sector-specific project proposals to be approved by the full Cabinet; and (iii) centralization of contract approvals in the Solicitor General’s office, which appears to be understaffed considering the amount of legal work flowing through its office.
- 1.9 The slow pace of approvals occurred despite a favourable macroeconomic and political environment in Barbados during most of the strategy period, including three years of stable growth and no major external shocks. In fact, the greatest progress in approvals was made in 2008 – a year in which a new government was elected, and the economy was buffeted by food and energy price shocks and the global financial crisis. A similar pattern was seen in relation to execution of the existing portfolio.

**Table 1: Barbados Portfolio: Status on December 31, 2008**

	Year	US\$M	Disbursed (%)
<b>Loans</b>			
Education Sector Enhancement (1154/OC-BA)	1998	60.03	70.2
Administration of Justice (1332/OC-BA)	2001	8.75	15.9
Coastal Infrastructure Program (1386/OC-BA)	2002	17.00	48.0
Modernization of Customs, Excise, VAT Areas (1684/OC-BA)	2005	4.40	10.6
Housing/Neighborhood Upgrading (PROPEF) (1823/OC-BA)	2006	0.69	16.4
Modernization of the National Standards System (1948/OC-BA)	2007	5.00	5.0
Housing and Neighborhood Upgrading - Phase I (1953/OC-BA)	2008	30.00	5.0
Modernization of the Barbados Statistical Service (2003/OC-BA)	2008	5.00	0.0
Agricultural Health and Food Safety (PROPEF) (2097/OC-BA)	2008	1.09	0.0
Modernization of National Procurement System (2099/OC-BA)	2008	5.00	0.0
<b>Technical Cooperations</b>			
Productivity Improvement in Barbados (ATN/MH-7725-BA)	2001	0.42	85.6
Savings and Loan Cooperatives Sector (ATN/ME-9586-BA)	2005	0.84	31.1
Business Facilitation Services (ATN/CC-9144-BA) (CAN\$)	2005	0.15	25.0
Airport Security (ATN/MT-9722-BA)	2006	0.46	10.0
Mentoring Model Young Entrepreneurs (ATN/ME-10106-BA)	2006	0.49	20.3
Trade Logistics and Facilitation (ATN/CC-10274-BA) (CAN\$)	2007	0.16	89.4
Management for Results – PRODEV (ATN/OC-10569-BA)	2007	0.45	5.0
Information Portal for Entrepreneurs (ATN/ME-11406-BA)	2008	0.11	0.0
<b>TOTAL</b>		<b>140.03</b>	<b>39.3</b>

## B. Portfolio Challenges and Results

- 1.10 At the end of 2008, the IDB portfolio in Barbados comprised eight investment loans, two PROPEFs and eight TCs for a total value of US\$140 million, 39% of which had been disbursed (see Table 1 above). Three large loans approved in previous strategy periods continued to dominate the portfolio during 2005-2008. However, two of them made much progress in 2008 and are expected to close in 2009; a third loan was updated and will disburse fully in 2010.
- 1.11 During the strategy period, **slow disbursements** were the main problem affecting the portfolio, and they were central to poor performance indicators for a number of operations.<sup>3</sup> Between 2005 and 2007, the Bank disbursed only US\$3.1 million a year on average to Barbados, substantially below historic levels of US\$12 million a year in the previous two decades (1985-2004).
- 1.12 Disbursements recovered significantly in 2008 (US\$18.5 million), but were insufficient to reverse the trend of **negative net flows** from the Bank to Barbados since 2003, although they reduced the gap significantly (see chart).



- 1.13 Many of the problems affecting approvals also explain the slow pace of disbursements, but there were additional issues. First, project design was sometimes unwieldy and did not always include adequate risk mitigation plans.<sup>4</sup> Partly because of this, planned timeframes for execution were not realistic. Second, centralized and protracted national procurement processes, including delays in the issuance of goods, works and services contracts,

<sup>3</sup> At December 31, 2008, Barbados had the highest proportion of loans on alert status (28%) in the Bank. Unsatisfactory ratings owed to (i) above average time for approval, (ii) greater than average extensions, and (iii) slow disbursement. Performance is expected to improve with the closing of the three old operations.

<sup>4</sup> E.g., land access/acquisition issues in the coastal infrastructure project; weak coordination among institutions in the justice sector program; or changing government priorities in the housing sector.

substantially slowed execution.<sup>5</sup> The Bank's ex-ante review of all procurement activities (and of its pre-2006 procurement rules in the old operations) further delayed contracting processes, as did the small pool of suitable and available consultants in Barbados. Third, executing agencies and/or steering committees often lacked adequate decision-making power to move execution along speedily.

- 1.14 **Inadequate results frameworks** for the country strategy and several projects have made it difficult to measure the portfolio's impact. The previous strategy's results matrix was overly ambitious (in terms of the expected country results) and, as mentioned, focused only on the pipeline. At the project level, unattainable timeframes, poorly selected or defined indicators, lack of clear interim targets and data constraints affected not only the availability and quality of baseline information but also hampered the capacity to monitor progress and measure operational results.

### **C. Lessons Learned and Recommendations**

- 1.15 Preparation, execution and evaluation of Bank interventions in Barbados, and achievement of results, would be facilitated by:
- a. **Simpler and more risk-based project design, using PROPEFs and other relevant Bank instruments to improve preparation.** Simpler project design (with more focussed interventions, possibly adopting a phased approach to achieving results) and adequate assessment and mitigation of risks could help reduce implementation delays. The PROPEF facility, approved by Barbados in 2006, allows substantial technical work to go ahead prior to approval of a loan, which should help shorten execution time and reduce commitment fees for the government. Greater use of existing grant instruments such as SECCI, Aqua and Infrafunds would serve the same purpose, while also helping the government to bring down the cost of investments. Project teams should make special efforts to adequately assess institutional capacity constraints in executing agencies and to design relevant execution mechanisms that take into account - and seek to mitigate and overcome - those constraints.
  - b. **More agile government decision-making processes.** The government has already begun to address this through delegation of functions to various Cabinet sub-committees; shifting approval of PROPEFs from the full Cabinet to the Ministry of Finance; appointing high-level steering committees in some projects; and, in the absence of immediate plans to de-centralize the contracting process, making efforts to accelerate contract approvals by the SG's office. Adequate staffing of executing units and supporting agencies (including the PIU and SG's office) will be crucial to improving both decision-making and execution, and consultation processes across ministries might be accelerated by giving agencies a specific deadline for providing comments. Longer term, government efforts to implement better management for results (supported by PRODEV) should also help strengthen execution.

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<sup>5</sup> Late issuance of contracts by the SG's office prevented the Bank from reimbursing the government for eligible expenses on a timely basis, raising commitment fees for the government and affecting net flows.

- c. **Faster and more efficient procurement processes.** The Bank-financed procurement reform project for Barbados (approved in 2008) will go some way towards improving national procurement processes in the medium to long term. In the short term, procurement processes can be facilitated by making officers available to each executing unit who are well-trained and experienced in both Bank and national procurement processes. On the Bank's side, recent reform has already led to simpler procedures, and the gradual move to ex-post review will help accelerate contracting processes. Accreditation of COF-based IDB operational staff in procurement matters will eliminate the current delays in sourcing this expertise from headquarters. In the longer term, the Bank's move towards use of country systems should eliminate the need for parallel – Bank and government - processes.
  
- d. **Active Bank support and follow-up throughout the project cycle.** Human resource constraints and elaborate decision-making and consultation procedures on the government's side require sustained and very active follow-up on the Bank's side to ensure effective implementation of the operational program. This, in turn, requires a well-staffed Country Office and close interaction between operational/fiduciary staff and sector teamleaders; in other words, the effective functioning of the Bank's matrix system. Because most teamleaders are based in headquarters or in other country offices, sufficient budget resources must be allocated for them to travel to Barbados when needed, and effective IT systems are required to support frequent consultation by video and audio conference.
  
- e. **Improved results frameworks and monitoring.** The country programming papers associated with the **country strategy** should provide a baseline and indicators for measuring the achievement of program objectives. To facilitate joint monitoring, the indicators should be aligned with data already being collected by the government. To ensure that **project** outcomes can be adequately measured, results frameworks should rely on existing data collection and reporting mechanisms, as well as those that can be developed as part of the project. Results frameworks should define clear, relevant and practical indicators and identify milestones that are linked to the operations plans of the respective project and based on a realistic schedule of activities. Where feasible, annual targets should be set and at a minimum, interim targets established in addition to those at the end of the project. The Bank and the government should periodically carry out a joint review and update of project results framework, indicators, baseline data, assumptions and unit costs.

## ANNEX IV

## COORDINATION WITH DEVELOPMENT PARTNERS

- 1.1 Flows of official finance to Barbados are limited, and represent only a tiny fraction of total government spending.<sup>1</sup> Multilateral agencies, and more specifically, the IDB and the Caribbean Development Bank (CDB), account for over 90% of all such flows. Although annual contributions have fluctuated considerably, both banks have disbursed similar amounts to Barbados in the last decade, with IDB disbursing an average of US\$10.8 million per year between 1999 and 2008, and CDB disbursing an average US\$9.65 million per year over the last 13 years.<sup>2</sup>
- 1.2 The IDB and the **CDB** have a longstanding and close working relationship. CDB both supports and co-finances the IDB's regional program in the Caribbean and also supports country-specific interventions financed by the IDB, including, in Barbados, the government's large education programme (EDUTECH). In 2007, CDB approved its largest ever loan to Barbados, a \$32.8m loan to support the recapitalization of the regional airline LIAT.
- 1.3 CDB currently has nine active loans to Barbados totaling US\$139.8 million, of which 72.5% has been disbursed. The average age of loans in the portfolio is about 7.4 years. CDB is currently in the process of formulating its own strategy for support to Barbados and hopes to complete it in 2009.

<b>Table 1 – CDB Portfolio in Barbados (1995-2008)</b>			
<b>Project Title</b>	<b>Approval Date</b>	<b>Approved (US\$M)</b>	<b>Disbursed (US\$M)</b>
Secondary Education	1995	11.9	7.9
Expansion of Grantley Adams Intl Airport	1998	22.3	22.3
EDUTECH	1998	31.5	24.9
AIC credit – Caribbean Commercial Bank	2000	1.4	1.4
Hilton Hotel Barbados	2000	7.0	7.0
Urban Rehabilitation Project-Barbados	2000	30.3	15.6
Industrial Credit	2002	15.0	12.6
Harrisons Cave Redevelopment	2006	16.9	9.6
CHBS - Expansion of facilities	2006	3.5	0.0
LIAT recapitalization	2007	32.8	24.1
<b>TOTAL</b>		<b>172.6</b>	<b>125.4</b>

<sup>1</sup> Disbursements from the two main development partners, IDB and CDB, which together account for over 90% of total official finance, rarely exceed 2% of total government spending in any given year, according to estimates based on data from the Central Bank of Barbados and the IMF. No single government agency reports regularly on sources and flows of official finance to Barbados, and the IDB country team found it exceedingly difficult to obtain reliable historical and current data on such flows.

<sup>2</sup> CDB Annual Report, 2008.

- 1.4 Many of the larger projects in the CDB's portfolio facilitate tourism development. They include financing for airport expansion, the construction of the Hilton Hotel, the refurbishment of Barbados's premier tourist attraction, Harrison's Cave, and the aforementioned recapitalization of one of the main regional airlines.
- 1.5 The CDB has expressed interest in supporting some of the priority areas outlined in the IDB Country Strategy with Barbados (2009-2013), and teams from both banks are currently exploring co-financing possibilities in the water sector.
- 1.6 The **European Commission (EC)** has made approximately €29.73 million available to Barbados under its National Indicative Programs of the 6<sup>th</sup>, 7<sup>th</sup>, 8<sup>th</sup> and 9<sup>th</sup> European Development Fund (EDF) (2004 to 2008)<sup>3</sup>. The main development programs undertaken with this funding have been in the health, forensic science, education and hospitality sectors. In addition, an allocation of €9.75 million is available under the 10<sup>th</sup> EDF and will be delivered mainly through budget support. These funds are intended to support skills development for competitive sectors and training of youth at risk.
- 1.7 Barbados also benefits from a €37 million allocation from the EC for its sugar adaptation strategy. These funds are made available over the period 2006-2010 and are administered in the form of budget support aimed at addressing economic, fiscal and structural issues related the abandonment of the Sugar Protocol between ACP countries and the EU.
- 1.8 The IDB and the EC have held preliminary discussions on possible collaboration in the education sector.
- 1.9 The **European Investment Bank (EIB)** partnered with IDB in 1992 for the Barbados South Coast Sewerage Project. As at end 2008, a total of €10 million had been signed in Barbados for the financing of sectors such as water and sewage, airports, electricity and SMEs via the former Barbados Development Bank. Barbados Light and Power Company has been the largest recipient of EIB funding with five operations totaling €65 million. Of particular relevance is the €9.75 million loan signed in 2006 for the financing of a 9.4 MW wind farm.
- 1.10 The EIB has expressed interest in collaborating with the IDB in some of the priority sectors outlined in the country strategy, and discussions to this effect are underway.
- 1.11 Although the **World Bank** graduated Barbados in 1993, special permission was obtained from the WB Board to include Barbados in a regional HIV/AIDS project in 2003. A follow-up national HIV/AIDS project totaling \$35 million was approved in August 2008, to be implemented during 2008-2013. The authorities are currently in discussions with the World Bank on a US\$100-150 million Policy Development Loan (PDL); the sector focus of this PDL is still under discussion.

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<sup>3</sup> Source: Delegation of the European Commission in Barbados.

- 1.12 The **IMF** does not have a lending program with Barbados. Nonetheless, the government benefits from the Fund’s technical expertise through the Article IV consultations and publications and other specific sector assessments.
- 1.13 Several **UN and bilateral agencies** have their regional headquarters in Barbados. Their focus is on regional interventions (with a heavy emphasis, in some cases, on the small eastern Caribbean islands), rather than working with Barbados specifically. To ensure coherence between development partners in keeping with the Paris Declaration on harmonization, the donor agencies active in the region has agreed to work via “Coordination Groups”, under the coordination of the UNDP. Groups have been established in the following areas: disaster management, climate change and environmental management; governance and ICT; macro-economic and public financial management; poverty and social sector development; and trade and the private sector development.
- 1.14 The Canadian International Development Agency (**CIDA**) supports Barbados mainly through regional and hemisphere-wide programs aimed at promoting economic growth and security. Such programs include efforts to enhance the region’s capacity to engage in intra- and extra-regional trade arrangements, strengthen public financial management, build capacity of regional institutions, revitalize the region’s economic and financial infrastructure for private sector development, and increase the resilience of the region when faced with natural disasters.
- 1.15 CIDA is collaborating with the IDB and the UK Department for International Development (DFID) on “Compete Caribbean”, a private sector development initiative that seeks to strengthen the region’s competitiveness, and is also planning new interventions that will build skills for employment.
- 1.16 In the 2008/2009 fiscal year, Barbados received C\$1.86 million in bilateral programming from CIDA. This excludes programming funded through the partnership (Canadian civil society) and multilateral channels, including humanitarian aid and funding to regional development banks such as CDB.
- 1.17 **DFID** does not have any bilateral program with Barbados, but the country is a beneficiary of some of DFID’s regional programming. Barbados hosts DFID’s Caribbean headquarters for regional work on promoting growth (regional integration, low carbon growth, trade facilitation and private sector competitiveness) and reducing the risks of climate change, disasters and crime and violence. DFID is working with IDB and CIDA on developing the “Compete Caribbean” program, and has initiated a Trust Fund with CDB and CARICOM/CARIFORUM to promote regional integration and trade adjustments (particularly in implementing the EU-CARIFORUM Economic Partnership Agreement, EPA).
- 1.18 **USAID’s** Regional Programme is based in Barbados, but most of its work is in the wider Eastern Caribbean. Its current strategy for the region (2005-2009) focuses on two areas (i) controlling the spread of HIV/AIDS and (ii) facilitating an open and competitive trade

environment. The upcoming strategy period (2010-2014) will continue its focus on HIV/AIDS and also work with Youth through workforce development and economic opportunity - entrepreneurship/ microenterprise development. Barbados also benefits from humanitarian assistance in case of natural disasters.

**Table 2: Barbados- Summary - Areas of Donor intervention (2005-2008)**

	EC-EDF	CDB	IBRD	EIB	DFID	CIDA	USAID
Agriculture / Manufacturing / Tourism	X	X		X			
Water & sanitation		X					
Transport / Infrastructure / Telecommunications		X		X			
Energy							
Health	X		X				X
Social Sector (Education, Poverty, Housing, Gender, etc.)	X	X					
Trade / Regional Integration	X				X	X	X
Public Reforms / Economic Mgt / Governance	X				X	X	
Disaster / Natural Hazards management					X	X	X
Competitiveness & Private Sector					X		
Other / Multisector	X	X					

## **ANNEX V**

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## COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX

In August 2008, the Board of Directors approved the Development Effectiveness Framework (GN-2489) to increase the evaluability of all Bank development products. The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the "Good Practice Standards for Country Strategy and Program Evaluation."

The DEM-CS is a yes/no system with a partial score for each of the four evaluation criteria.

	SCORE
<b>I. RELEVANCE</b>	<b>10.00</b>
A. Ownership and Alignment: establishing consistency of CS objectives with government's plans & priorities	10.00
B. Coherence: establishing (i) the definition of programmatic focus in terms of anticipated results and (ii) the integration across Bank instruments/products	10.00
<b>II. EFFECTIVENESS</b>	<b>8.40</b>
A. Strategy Results Framework	10.00
B. Financial Transfers	10.00
C. Build up and use of Country systems	5.20
<b>III. EFFICIENCY</b>	<b>to be determined in Programming document</b>
<b>IV. RISKS</b>	<b>10.00</b>