

ECONOMIC GROWTH IN A SMALL DEVELOPING COUNTRY: THE CASE OF BARBADOS

by

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1 Introduction

- Research on economic growth in small countries concludes:
 - I. Small size does not per se inhibit the growth performance of a country (i.e., cross-country studies with small and large countries) - relationship between country size and economic growth not statistically significant.
 - II. For small countries, the key factors which **positively** affect economic growth are:
 - exports
 - capital inflows
 - investment in physical and human capital
 - III. Too much intervention in the economy by the government can retard the growth process

- Purpose of this study is to identify the factors which have affected the growth process in Barbados over the period 1960-2000

● Features of Barbados:

- ➔ small, developing country - population of 267,400 in 1999
- ➔ highest ranked country in the LAC region with respect to the UNDP HDI
- ➔ real GDP in 1960 was Bds \$316.1m (US \$158.1m) and in 1999 it was Bds \$954m (US \$477m)
- ➔ average annual growth rate: 2.9 percent (1960-1999)
- ➔ real GDP per capita in 1960 was Bds \$1356.25 (US \$678.13), while in 1999, it was Bds \$3567.69 (US \$1783.85)
- ➔ population growth rate: 0.35 percent per annum
- ➔ general upward trend in real GDP with three periods of major decline: 1973-75, 1982-84 and 1990-93 - due to external shocks (oil price increases, recession)

2 Overview of Economic Growth Theory

Time path of real GDP (or real GDP per capita) influenced by:

- ➔ **long-term** (i.e., trend) and **short-term** (i.e., irregular)

→ **economic and non-economic** factors

Issue: What are the factors underlying the data-generating process with respect to real GDP and real GDP per capita?

Factors identified in the literature on economic growth theory

→ savings

→ physical capital accumulation

→ international trade

→ growth of knowledge and ideas

→ nature of private-public relations

→ institutions (property rights, economic freedom)

→ technical change

→ product innovation and R and D

→ human capital formation

→ financial development

→ inflation

Barro (1998) notes that over 140 possible determinants have been identified in the empirical literature.

- Research on Economic Growth in a Small Economy has focused on:
 - international trade (i.e., exports)
 - human capital development
 - physical capital investment (via foreign direct investment - FDI)
- Research Question: To what extent have these variables influenced the economic growth process in a small developing country such as Barbados

3 Analytical History of the Growth Process: 1960-2000

3.1 Historical Background

- Introduction of sugar cane cultivation in 1640s
- Sugar industry dominated economic activities until late 1950s (white indentured labour then black slave labour)
- Main export - UK under preferential arrangements (Barbados - a classic case of an 'export-propelled monocultural economy')

- ❑ Emigration and remittances important between 1900 and 1965
- ❑ Post-World War II changes in the political institutions resulted from riots associated with the Great Depression 1929-32
- ❑ View held: political and institutional change was the means to attain economic change (1946-1960)
- ❑ In 1950s and 1960s, a number of initiatives introduced:
 - development planning
 - establishment of development institutions
 - granting of fiscal incentives
- ❑ Focus on private sector-led development (domestic and especially foreign). The government saw its role as providing the institutional, physical and policy frameworks.
- ❑ development policy objectives:
 - diversification (promotion of manufacturing and tourism)
 - employment creation
 - provision of social services

- human resources development
- poverty alleviation

3.2 Growth and Structural Changes

☐ Over 1960-99 period, growth rate in real GDP was 2.9%

- 1960-70: relatively high growth rate (6.8%)
- 1970-80: slow down in growth (2.5%)

Sub-period picture shows significant decline: 1970-75
and good recovery: 1975-80

- 1980-1990: further slow-down in growth (0.9%);
decline in 1980-85, recovery 1985-90
- 1990-2000: slight improvement, with decline in 1990-95
and recovery in 1995-2000

☐ Role of external events in influencing growth path

☐ Structural change - decline of contribution of agriculture to
real GDP (especially sugar)

- growth of tourism since 1960s
- constancy for manufacturing
- high degree of foreign-ownership in manufacturing and
tourism compared with sugar industry

- transition from an agricultural-based economy (i.e., sugar production) to services-based economy

3.3 Explaining Growth Performance: A Literature Review

- Descriptive studies - qualitative
- Quantitative studies - growth accounting
 - time series regression analysis
- Results of empirical studies:
 - ➔ Growth Accounting: human capital - 48%
physical capital -31%
residual -20%
(total productivity)
 - ➔ Regression Analysis: financial development (+)
physical capital (+)
human capital (+)
exports (+)
government distortionary
policies (-)
interest rate (-)

3.4 Explaining Growth Performance: Further Analysis

- Investment in human capital (education/training):
 - ➔ growth in size and relative contribution of government expenditure in education (5.2% for current, 6.4% for capital over the period)
 - ➔ increase in enrolment in schools/tertiary levels. High enrolment rates due to compulsory nature of schooling
 - ➔ growth in tertiary enrolment and gradual decline in primary level (i.e., falling fertility)
 - ➔ large public sector education system, small private sector
 - ➔ increase in labour force with secondary education and higher
 - ➔ growth in female participation rate
 - ➔ improvement in health as evidenced by high expenditure
 - ➔ focus on social investment in the country
- Investment in Physical Capital
 - ➔ increase in personal financial savings (4.2% in real terms over period 1973-2000)

- government savings on current account
- relative constant 'real' gross investment
- erratic FDI pattern

☐ Exports sector

- fall in sugar exports
- rise in price of sugar
- light manufacturing in selected industry by FDI
- increase in export of sugar
- growth in tourism (arrivals, expenditure)

☐ Macroeconomic management

- relatively low inflation rates (episodes of high inflation 1969-75 and 1979-82. Externally induced. Fixed exchange rate with main trading partner (UK then USA).
- some appreciation of real exchange rate 1976-89 - loss of competitiveness
- fiscal incentives to promote private sector development
- growth in fiscal deficit but generally relatively low rates of fiscal deficit to GDP
- shifts in tax policy - direct to indirect 1984-87

use of levies

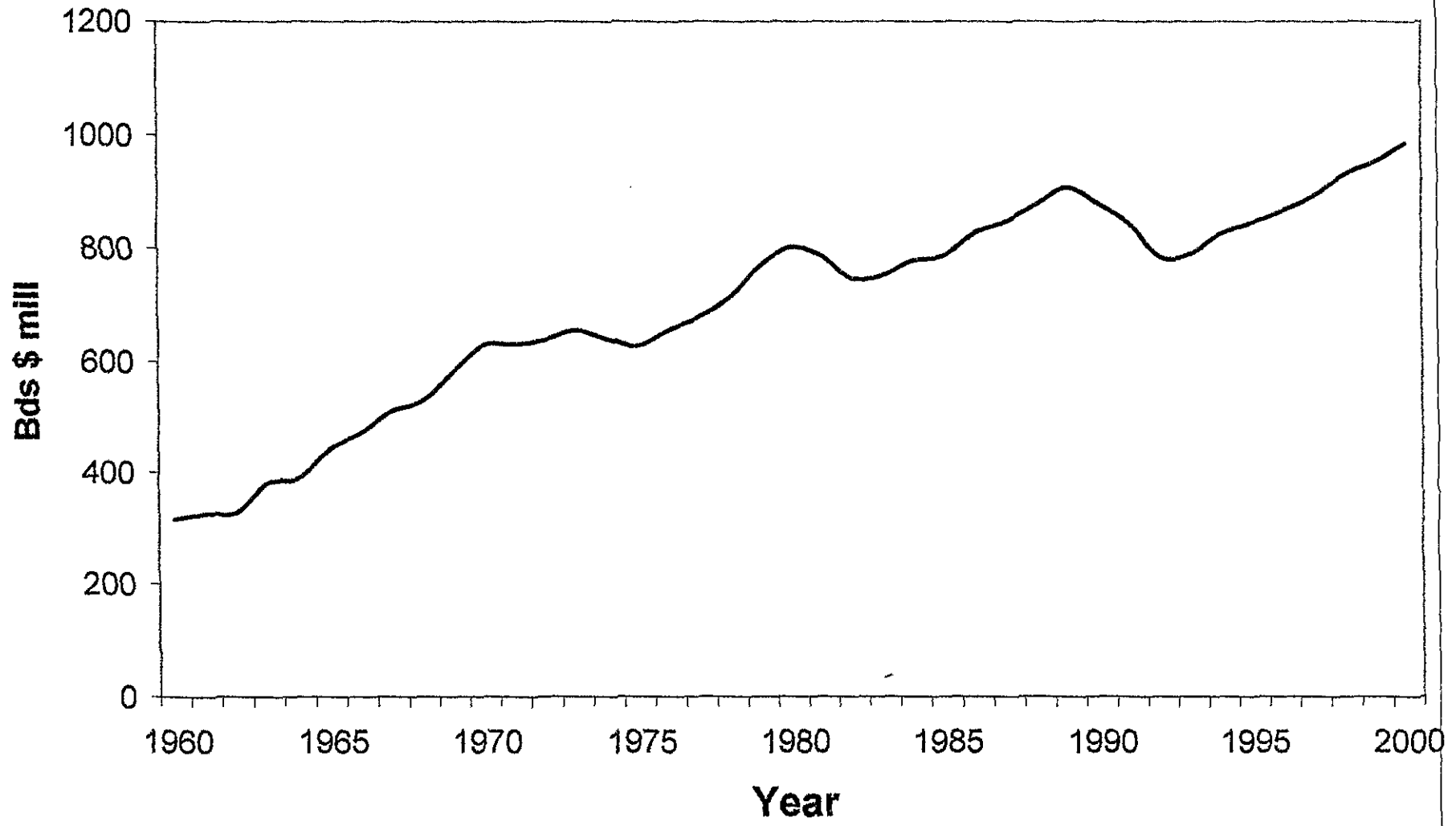
tax reform - removal of levies and
introduction of VAT

- growth in tax-GDP ratio (17.9% 1960 to 36.8% in 1999)
- some periods of BOP deficit (linked to fiscal deficit problems)
- use of commercial policies constrained

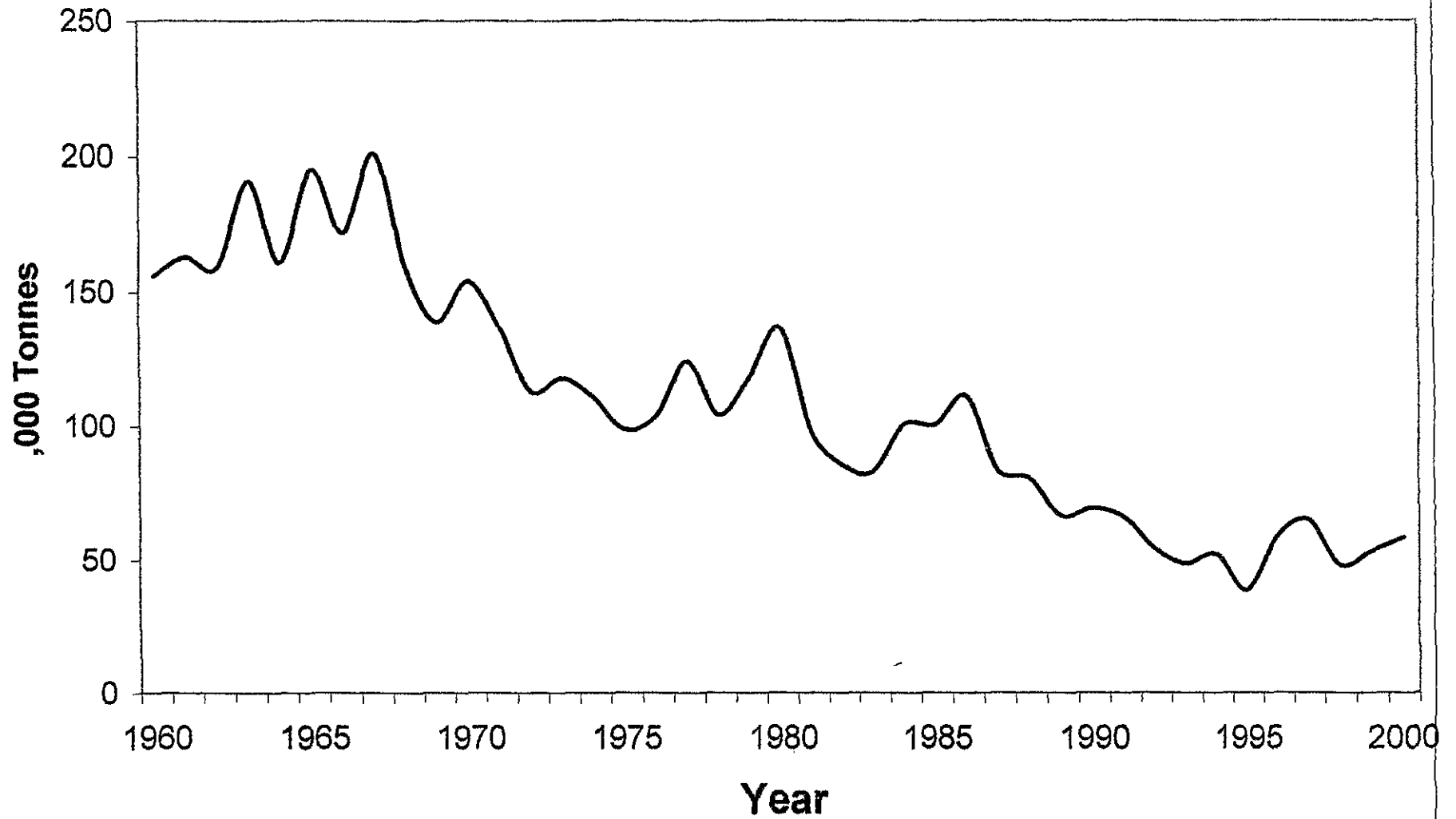
□ Institutional Environment

- stable democratic state
- liberal democratic philosophy
- good governance
- high credit rating - financial/economic and civil liberties

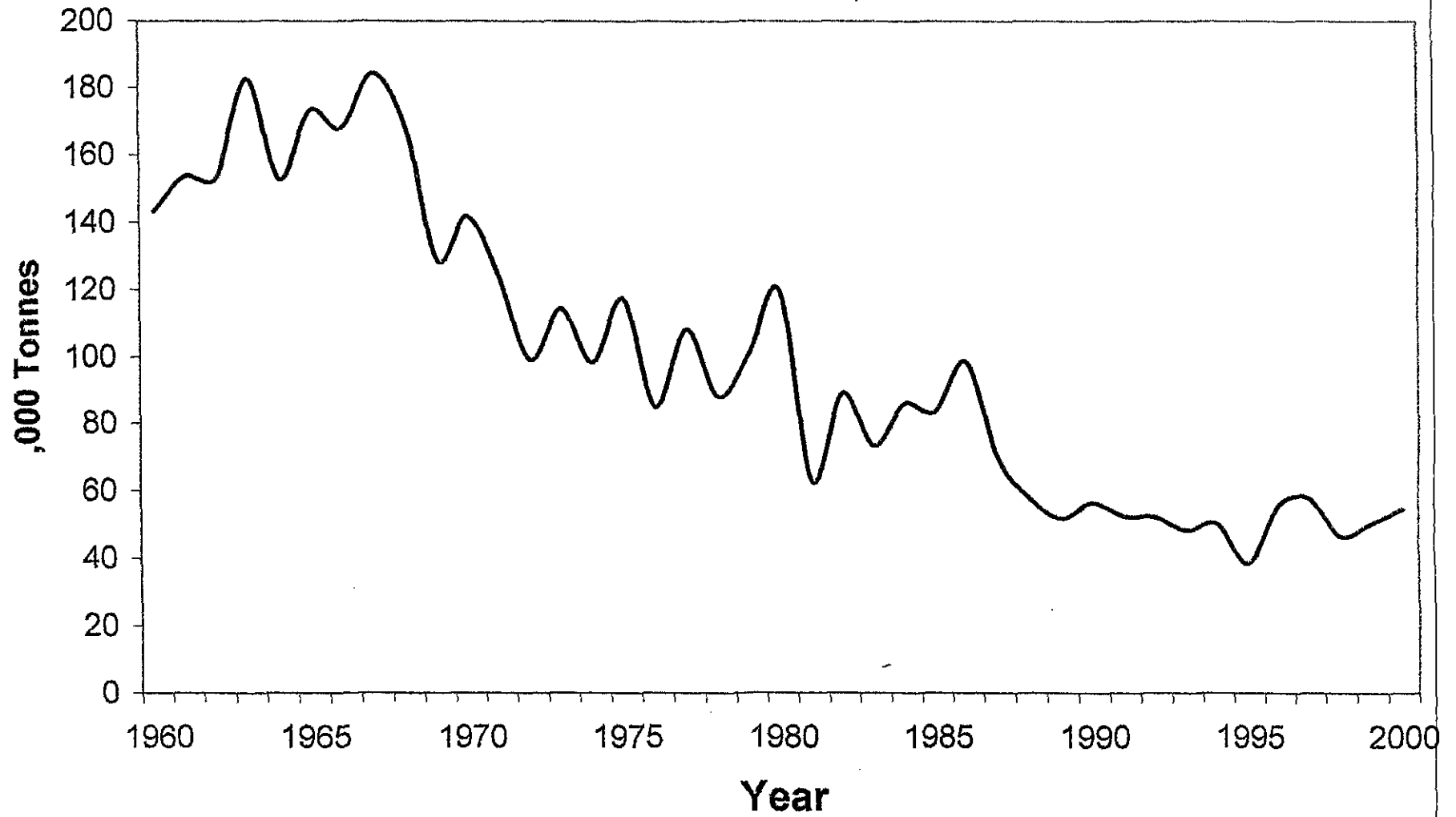
Real GDP at Factor Costs



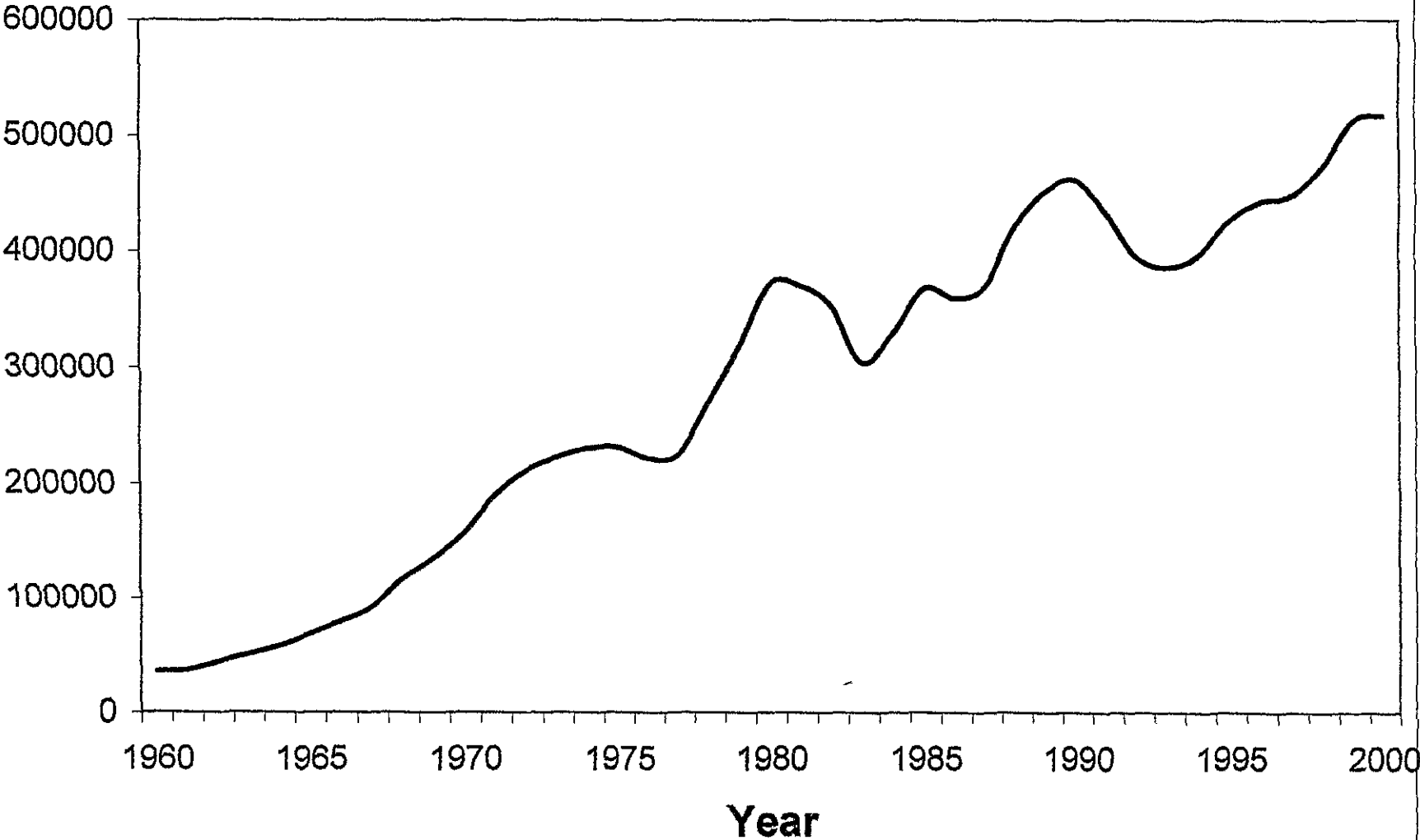
Sugar Production



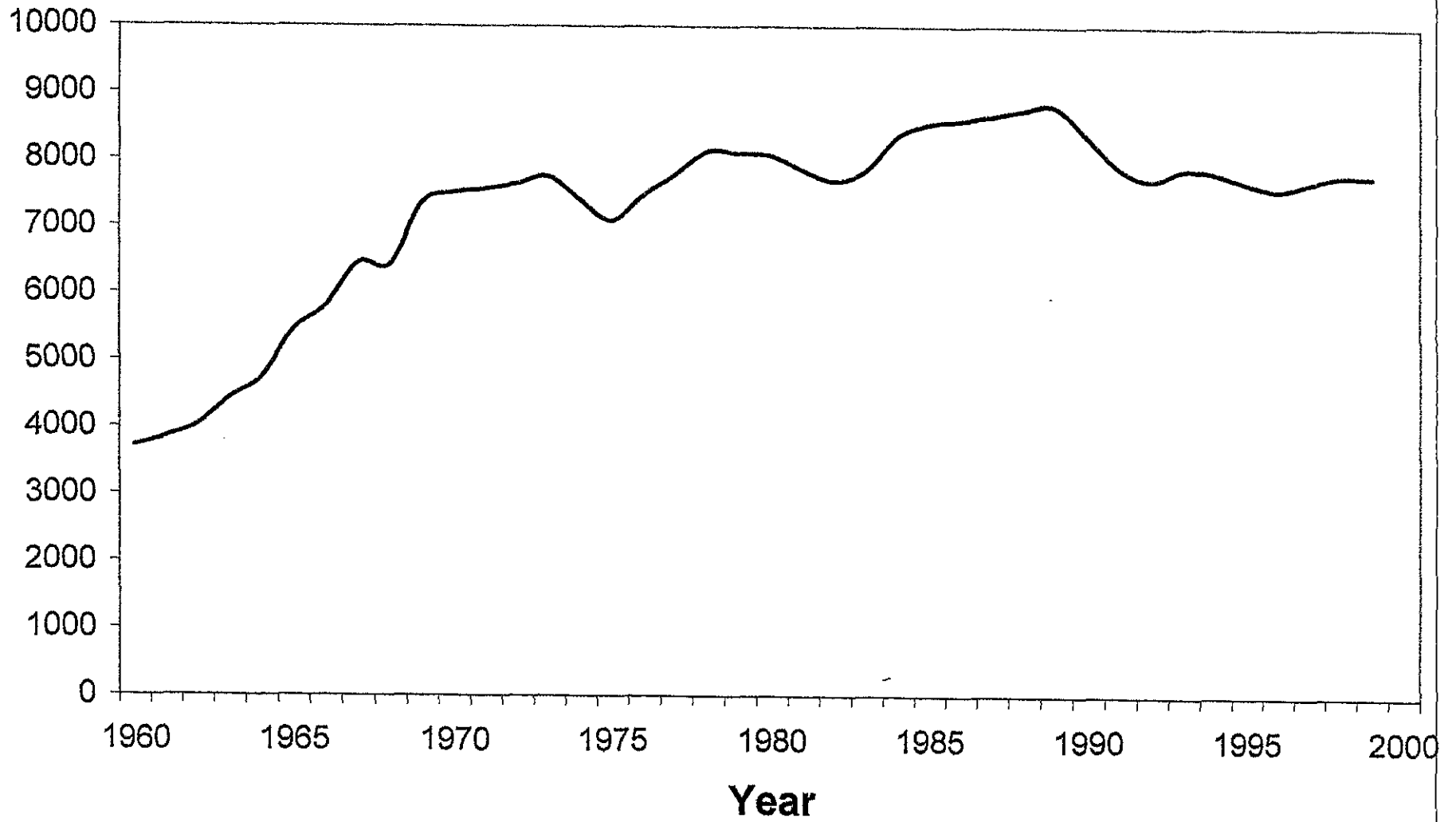
Sugar Exported



Tourism Arrivals



Labour Productivity



Inflation Rate (%)

