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Welcome Remarks
Dr. DeLisle Worrell, Governor, Central Bank of Barbados
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Competing in the Global Market of Research

The Central Bank of Barbados can be proud of its research achievements over the forty plus years of its existence. We have a rich trove of economic data and analysis that we have accumulated over those years, most of which is available for download from the internet, from our own website among others. Thanks to this research we understand better how our economy works, and how the economy has evolved over time. Understanding the economy is the key to the formulation of good economic policy, and for public involvement in the execution of the economic strategy.

This is a vitally important activity, because our economy does not behave in the same way as the US or UK economies, or the economy of any large country whose currency is widely used around the globe. Our economic policies do not work well if they are modelled on those of large industrialised countries, countries that provided the context for the development of the economic models and policies that comprise the conventional policy suite reflected in the reports of the IMF, World Bank and other international institutions.

We are by no means alone among developing and emerging market economies in recognising that the conventional policy dictate does not improve the condition of our economies. However, we are among the very few that have an alternative diagnosis and prescription for curing our economic ailments. The key to our diagnosis is the explicit recognition that size matters for economic adjustment and growth.

Small countries do not have the possibilities that large countries have of producing at home to substitute for imported goods to any meaningful extent, nor can they diversify their exports beyond a narrow compass. The reason is obvious to anyone who lives in a very small country: with limited resources and skills the country must of necessity concentrate on getting production of a limited range of products and services up to international standards of competitiveness. Precisely because they are small producers in a global market, only those products and services that are competitive internationally will survive. Except for purely domestic production such as construction and personal care, anything that is not internationally competitive will be driven from the market, either through formal channels, or - if prohibitive barriers to international trade are erected - via informal markets.

The reality of a limited range of production of anything that can be traded, in comparison with the very wide range of consumption items, production inputs and capital goods that a modern economy needs, defines what we describe in economic terms as a "hard" foreign exchange constraint. In practical terms it means that you cannot grow the economy if you do not have an additional source of foreign exchange, and you will not secure additional foreign exchange by lowering your selling price - for example by devaluation. It means that a central tenet of the conventional wisdom, which recommends a combination of fiscal expansion and an exchange rate depreciation, will not result in growth of output. (Remember that we are talking about small producers selling on a global market, where they can sell everything they can produce at the ruling price.) Instead, devaluation causes imported inflation, and depresses real income and output.

Note that this analysis does not depend on the country's level of development, or the sophistication of its financial markets. It is as valid for Malta, Iceland and Bermuda as it is for Barbados and Trinidad and Tobago. Whenever international institutions admit to evidence that conventional policies are not working, they typically seek the cause in the development of the country's financial system. Their argument is that underdevelopment of the financial system is the reason that monetary and exchange policies have little traction. But financial underdevelopment is the wrong suspect; the fault lies with small size. Since small size is not "curable", foreign-exchange-constrained economies must find an alternative policy mix which works around these constraints.

Barbados' economic policy explicitly recognises the foreign exchange constraint. In this we are unique. This country's adjustment programme since 2013 offers a textbook demonstration of an effective framework for managing the foreign exchange-constrained economy in the face of adverse circumstances. Because foreign exchange is crucial, economic policy makers check the balance of inflows and outflows every day, so that any pressure on foreign exchange may be detected immediately. In May of 2013 we noticed a persistent decline in foreign exchange reserves, and we understood that total spending in the economy would have to be cut, to reduce the demand for imports in line with the available foreign inflows. The tool used to adjust spending was fiscal tightening. The first budget adjustment, in August 2013, proved insufficient; the reserves continued to fall. But the December measures did the trick, by bringing the fiscal deficit down from 12 percent to under 7 percent, and the country's foreign reserves have since reverted to the normal pattern seen in the years prior to 2013.

Barbados also has lessons to teach the world about how to grow the foreign exchange-constrained economy. Such economies depend on foreign exchange for their growth, so the growth strategy must focus on increasing the productivity of the merchandise exports and services in which the country has a demonstrated competitive advantage, enhancing the product and moving up the value chain, and investment in value added products. Barbados has comparative advantages in tourism and related services, international business and financial services, and branded export products such as rum, and it has a potential comparative advantage in green energy. Overall, the economy can grow only as fast as the growth of foreign exchange to finance the additional imports needed by the growing economy.

A third lesson has to do with the sustainability of fiscal policy. Government services do not produce any foreign exchange, and the expenditures associated with them create a demand for imports. The financing of Government deficits may also add to expenditure and the demand for imports. If Government's expansion creates a demand for imports that is larger than the foreign currency inflows available, and that situation is allowed to persist, the fiscal stance becomes unsustainable. That is the situation the fiscal contraction of 2013 managed to avert. Conversely, the fiscal stance may be sustained if it puts no pressure on the level of foreign exchange, even though fiscal adjustment may be desirable on other grounds.

A fourth lesson is the limitations of monetary policy in the foreign exchange-constrained economy. In modern economies the central bank cannot actively manage financial flows across its borders, even if all flows are transacted within the formal financial sector. This is true whatever the nature of the country's exchange rate arrangements, and irrespective of the rigour of stipulations and reporting requirements of the central bank. The central bank's role is reduced to creating the right incentives to avoid speculative or precautionary financial outflows. The surest way to do this is to maintain a domestic interest rate policy which follows the US Treasury bill rate, with allowance for a small risk premium, which will vary from country to country.

All of these lessons about the management of the foreign exchange-constrained economy are drawn from economic analysis which is available through the Central Bank of Barbados website, and in research papers I have worked on with many in the audience today. I want to suggest that this theme of the foreign exchange-constrained economy offers the Central Bank of Barbados one way of branding our research, to give us a competitive edge in the global market for research. I am grateful to Professor Mamingi, who is the one who spotted the potential for making our research output distinctive in this way.

Over many years the Central Bank of Barbados has made its name as an institution that is oriented towards research and analysis. The internet and electronic media have offered us the opportunity to get our message to a global audience. However, because there are so many millions who are also clamouring for an internet audience, the Central

Bank has to offer a product that is of interest, and differs from the others. The many ways in which foreign exchange availability constrains our economy, and economies of similar size, constitutes a research agenda that no other central bank appears to be addressing. It is a niche that we at CBB have begun to fill, with working papers on monetary policy, the integration of monetary and fiscal policy, the structure of the small open economy, and several others; with the publication of our fiscal stability book by the Caribbean Centre for Money and Finance, we are leading the Caribbean in the direction of analysis that recognises the FX constraint. There is great potential here for us to make this our distinct contribution to the international debate on the diversity of economic policy and the implication for policy implementation.

Our Bank's Annual Review Seminar is now an established part of the Caribbean economic landscape, and a marketplace that many of us look forward to each year. It is an opportunity for an enlightening interchange of ideas, and a chance to our interns and many of the region's young economists to gain their spurs. As we go forward, we should seize opportunities to develop insights that will enrich the global economic debate, because the problems we face are not unique to the Caribbean. The focus on the foreign exchange constraint to small economies like our own is a vitally important insight. There a scores of counties worldwide who can benefit from our analysis of the implications of this constraint. We must continue to explore the effects of the constraint in our research, and we should use the ARS and other avenues of dissemination to the maximum, to get this message out.

DeLisle Worrell
July 27, 2015