DeLisle Worrell: Challenges facing Caribbean economists

Opening remarks by Dr DeLisle Worrell, Governor of the Central Bank of Barbados, at the Annual Monetary Conference, Bridgetown, 15 November 2011.

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The Annual Monetary Studies Conference (AMSC) is now well established. It is the leading conference of Caribbean economists and economists working on the Caribbean. The quality of research and presentation at this conference is uniformly high, and the meeting offers the best opportunity Caribbean economists have for networking. The *Journal of Banking Finance and Economics in Emerging Economies*, the journal of the Caribbean Centre for money and Finance, offers swift publication of the best papers from this conference. So we can say that AMSC is no longer aspirational but a fixture of the Caribbean economic landscape.

The conference is now challenged to push to the next level. There are 2 aspects of the challenge facing Caribbean economists that I would like to see this conference tackle: the need for new ways of conceptualising our economies, and the need to do research that points the way more clearly for policy makers and the public.

Why do we need new concepts? The conventional analysis gives counter intuitive answers to many of the questions that are of ongoing interest:

Conventional economics says that flexible exchange rates are better, but the countries with fixed exchange rates are more prosperous;

Conventional economics teaches that it is good policy for the Central Bank to speak out publicly against bad fiscal policy, but in truth public disagreement destroys the credibility of both parties;

Conventional economics recommends that to reduce inflation you should raise interest rates, even though higher interest drives up costs;

Conventional economics suggests that stock exchanges are a good way to fund investment, even though new issues to fund capital formation have become a rarity.

At the moment our research looks pretty much like any other. We used to argue that Caribbean circumstances were different, that small open economies (SOEs) were different, and that resource rich and resource poor countries were different. Nowadays we use the same models, the same specifications, similar data and the same tests. If you use these methods and you get the same result for Barbados, with an economy the size of a small county in an obscure US state, as you get for the entire US, shouldn't you be sceptical?

The truth is that economies are so diverse in so many ways that the notion of universal theory is problematic. The simplifications which are the essence of modelling will make sense only if they mirror the essential features of each economy. We need to build models that capture the essence of our economies, and that surely cannot be a mirror of the US.

Technology is changing today's world at an ever more furious pace. Does it still make sense – if it ever did – to think of economic transactions in equilibrium terms? Largely because of technological change, and the changes in societies that have resulted, the world of today is very different from societies of even 30 years ago. Are models grounded in principles dating back more than a century still relevant?

The failure to be sufficiently specific may explain why we offer so little practical guidance to policy makers. Here are some of the issues about which central bankers have to make decisions.

How do we assess regional financial stability in the Caribbean? What financial soundness indicators (FSIs)are appropriate and useful for this integrated financial region? What early warning systems do we need for a region where cross border risks have been the most troublesome in recent times?

The market behaviour of Caribbean exchange rates in an era of consolidated treasury management is proving somewhat of a conundrum. The changing cash management strategies of conglomerate firms, foreign investors and multinational banks are resulting in fundamental changes to the way our foreign exchange markets work. We need research into these markets.

We need alternative approaches to interest rate determination and more realistic models of interest rate effects. We have tested the interest sensitivity of loans every which way, and one thing is clear: small changes, of the orders of magnitude common in industrial countries, have little effect.

We need better indicators of fiscal sustainability on the open economy. We keep talking about debt sustainability when we should be discussing fiscal sustainability. And we need to distinguish the problematic from the unsustainable, if our advice is to be taken seriously.

We need to test the limits to countercyclical policy in small open economies. The models we borrow from less open economies fail to take account of the early onset of the foreign exchange constraint in our economies.

The Annual Monetary Studies Conference is well established and productive, a gathering we all look forward to. The papers are interesting enough, in a conventional sort of way. But now we need to take the extra steps to make this a truly exciting meeting, a place to try out new concepts, new models, and different ways of thinking about our problems. And we need to be a bit more down to earth, to speak more directly to policy makers. That means we have to ask more relevant questions in our research. We may continue to use the most sophisticated tools that are appropriate to the circumstances, but we must be able to give a compelling intuitive explanation of results and recommendations.

I wish us all an enjoyable and productive conference.