

DeLisle Worrell: Economic research as a practical guide to policy

Opening remarks by Dr DeLisle Worrell, Governor of the Central Bank of Barbados, at the Central Bank of Barbados' 33rd Annual Review Seminar, Bridgetown, 23 July 2013.

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I am, as many of you will know, an accidental central banker. If Sir Courtney Blackman had not actively sought me out at UWI Mona to establish the research dept of the new Barbados central bank in 1972, I would have pursued my career as an academic, as was always my intention. However, I quickly discovered that the central bank can be the most rewarding career for an economist, because at the central bank you can bridge the gap between academics and policy making that affects the lives and welfare of real people. Practicality has been the hallmark of all my economic research, and my motivation continues to be the desire to better understand why people undertake commercial transactions, so that policy makers may guide us towards transactions that uplift the community, and away from actions that are self-defeating. This bias towards research that captures deep economic insights, and is practical, intuitive and that may be applied to the issues of the day, is manifest in much of the research you will find published on the Central Bank of Barbados website. Let me cite you a few recent examples. In April this year, as you should know, Central Bank introduced a new policy to provide guidance to financial markets on interest rates. That policy was informed by research published under the title "A framework for interest rate policy in Barbados", which you may consult on the website. The research established that US T-bill rates and the volume of excess funds in banks are the most important factors affecting local rates. In 2011 the Bank made a change in policy pertaining to the foreign exchange market, which was informed by the publication "An analysis of Central Bank intervention in the Barbadian foreign exchange market."

In 2011 the Bank published "An analysis of the tourism sector in Barbados", in which we measured Barbados' competitiveness in the US, UK and Canada in terms of market share. The study investigated how market share has been affected by "shocks" which have impacted Caribbean and world tourism, and the factors affecting the utilization of existing tourist capacity as well as factors affecting hotel construction and investment in other tourism and ancillary services and infrastructure.

"A note on tourism expenditure", also published that year, broke down Barbados' tourism performance in the UK by country, showing how Barbados fared in the wealthiest regions, compared with those less affluent.

That year the Bank also published an analysis of the impact of fiscal policy on the demand and supply of foreign exchange, reaching the conclusion that fiscal outcomes in Barbados have been sustainable ever since the mid-1990s. The Caribbean Centre for Money and Finance has just launched a regional study of fiscal sustainability, which will adopt the approach used for Barbados in this study, in assessing fiscal policies throughout the region.

In the paper "International Business and Financial Services Centres in the Caribbean," published in June 2011, the authors showed that the international business and financial services (IBFS) industry in the Caribbean, though miniscule as a proportion of global financial markets, is the principal avenue for diversifying foreign exchange earnings for many Caribbean countries. In the smaller countries it is a major contributor to Gross Domestic Product (GDP), government revenues and employment.

In March 2011 Central Bank published "An analysis of Barbadian student enrollment at UWI Cave Hill, and the cost to the Barbadian government", showing that cost savings of \$25,000–\$44,000 per student could be realised by providing strong incentives for students to complete standard university entry requirements at the Barbados Community College, instead of doing a preliminary year at UWI.

“A review of the VAT system in Barbados”, a paper published last December, will be the subject of a panel discussion in this seminar. The study found that the proportion of indirect taxes in total revenue remained unchanged after the introduction of the VAT in the mid-1990s; the yield of the VAT relative to the rate of tax was no higher than for the consumption tax in the period prior to its introduction; the costs of administering the VAT and customs duties were about the same, relative to their yields, before and after the introduction of the VAT; and the consumption taxes that preceded the VAT were more buoyant in response to changes in income.

Also published last December was a paper entitled “Import Substitution: how practical is it in Barbados”, which concluded that apart from energy there are not many items that can be replaced by locally-produced products due to issues of market size and price competitiveness. The examples I have given are all typical of the research I find most rewarding. As economists we all need to do research of a more technical and academic kind, but it should always be in search of insights that we can incorporate into practical guidance for policy. Our academic research needs to be in depth and grounded in Caribbean realities. That requires deep understanding of the theory, careful observation of Caribbean experience and economic behaviour, and painstaking analysis of the data. You also need to read widely on the topic, and set aside time for thoughtful reflection, as you proceed with the research. The reward will be genuine insight and useful contributions to our understanding of how our economies work. If I have a criticism of much of economic research in the Caribbean nowadays, it is that it is too derivative, an unthinking application of imported theories and methodologies to Caribbean data, often accompanied by econometric pyrotechnics which anyone with mathematical training can very easily see through. At the end of the day this kind of research leaves the policy maker with little guidance, and the general public puzzled and apprehensive.

There is a need, in Barbados, in the Caribbean, and indeed in the wider world, for economics that people can understand. The economy is no more than a convenient way of thinking about all the commercial transactions that take place in the national space in the course of a day or a month or a year. The varying nature of these transactions, and the relationship between them, are mind-bendingly complex, and the economic theories we offer in explanation are pitifully oversimplistic by comparison. Good economics consists of essaying a theory that seems to fit the circumstance under investigation, observing the outcome, making adjustments, and repeating. It is a process that of necessity involves the people who are doing the transactions that produce the observed result. If they are mystified about what you’re doing and why, chances are you

will not get the expected result. That is why it is always most effective to end with economics that people can understand, whatever your theoretical starting point. Here at Central Bank we do academic research to deepen our understanding of economic processes, but it is always with a view to coming up with better policies and prescriptions, whether it is with respect to taxation, fiscal policy, tourism development strategy, import substitution or the many other burning issues that we must address from time to time.