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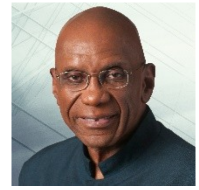

Illustration: Marc Hollingsworth, Media Solutions International

Why Devaluation Harms Caribbean Economies

During the decade that I worked at the International Monetary Fund in Washington DC, my colleagues from European countries would often remark that holidays in Antigua, Barbados and St Kitts were more expensive than for Cuba, the Dominican Republic and Jamaica. They attributed the cost difference to the fact that the currencies of the latter countries had been devalued in terms of the US dollar, and they inferred that the more expensive destinations could attract more tourists, and accelerate the rate of growth of their economies, by devaluing their currencies. The fallacy of this argument is exposed in my new book, *Development and Stabilization in Small Open Economies*, which will be published by Routledge in London and New York early in the New Year. What follows is the paragraph with which the book opens.

> The banner headline in the Barbados *Sunday Sun* newspaper of October 28, 2012 read "IMF Clash", under juxtaposed photos of Christine Lagarde, then Managing Director of the International Monetary Fund, and myself, Governor of the Central Bank of Barbados. The article reported on a leaked transcript of a meeting in Tokyo, Japan two Sundays earlier, between the Managing Director and Caribbean delegates to the annual meetings of the IMF and World Bank, which had concluded in the Japanese capital that week.
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> The transcript "showed a vigorous debate between Worrell and Lagarde, a former French minister of finance, over the merits of devaluation, and how economic growth could be achieved", according to the article. Lagarde's experience would have been that when the value of the euro falls relative to the dollar, travel to France becomes more affordable, resulting in a surge of visitors to that country.

In contrast, everyone in the Caribbean knows that airfares to the region, hotel rates, restaurant menus, taxi fares, access fees to tourist attractions, souvenirs, spa treatments, hair braiding and all services targetted at the tourist business, are priced in US dollars.

When the value of the Trinidad and Tobago currency fell from 4.25 to the dollar to 6.00 in 1993, the taxi fare from Piarco International Airport to downtown Port-of-Spain increased from 95 in local currency to 132, but it remained unchanged in US dollars at US$22. The prices at which small economies sell to the international market are set, usually in US dollars, and are unaffected by changes in the value of the local currency.

What determines the number of tourists spending holidays in Caribbean countries is the amount of accommodation, and the country's reputation for offering value for money. In forecasting economic growth the factors that should be taken into consideration are the productivity of the workforce and other factors of production, and the amount of investment in new capacity.

Changes in the value of local currency, with respect to the US dollar or other currency, have no effect on the volume of tourism or exports of minerals, manufactured goods or agricultural products. Exchange rate changes therefore have no impact on the growth of national income, which depends on the supply of foreign currency.

Devaluation of the local currency is known to be a major source of inflation in the Caribbean, driving up the cost of living when the prices of imports are stable, and aggravating imported inflation in the current climate of international price acceleration. In economies that are as dependent on imports as those of the Caribbean, the devaluation-induced loss of purchasing power and the increased cost of producing exports and providing tourist services are a considerable drag on real income and output.

Further information on *Development and Stabilization in Small Open Economies* may be found at this link, where you may also find information on the date of issue, availability and pricing.

My Economic Letters may be found under "Commentary" at DeLisleWorrell.com.