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Marc Hollingsworth, Media Support International

Foreign Earnings Benefit the Economy Through Imports

The foreign currency Caribbean countries earn from tourism and exports provides the fuel which keeps our economies running. We use this foreign exchange to buy oil, vehicles, machinery and a variety of materials, supplies and consumer goods. The income earned by people who work in tourism and export industries, or who supply products and services to these industries, circulates within the economy, creating incomes that are a multiple of foreign earnings. The imports bought with foreign earnings support government services, construction, wholesale and retail activity, as well as all other nontradable activities in the economy.

The GDP, which measures the total size of the economy, is much larger than the total of foreign currency available because of the multiplier effects of foreign currency inflows. However, the GDP depends entirely on the availability of foreign currency. If the amount of foreign currency available falls, the country cannot afford the previous levels of imports; some products disappear from shops and supermarkets and some domestic economic activity is lost. Also, in order to increase GDP, we need to earn more foreign exchange because a rising level of GDP will increase the demand for imports.

Note that virtually all the foreign currency that is earned or borrowed each year goes back out of the country. If anything remains of foreign currency supply after import needs are fully satisfied, the surplus is either placed in accounts with banks abroad or surrendered to the Central Bank, to be placed on the foreign reserve account held with the Federal Reserve Bank of New York.

A little foreign currency may remain in the domestic economy in the form of cash and foreign currency deposits held mainly as a hedge against inflation and for fear of possible devaluation of the domestic currency. Hoarding of foreign currency brings no benefit to the local economy; any attempt to put these funds to use will trigger a demand for imports, directly or indirectly. Whatever purpose for which the hoarded funds are used, the providers of the products or services purchased will eventually have to use the foreign exchange to purchase the imports they need to continue their operations.

When all is said and done, foreign currency earned or borrowed always has to leave the country to provide a benefit, in terms of an imported good or service.

It is also the case that all the foreign currency the country can absorb will come into the country, whether hotels or exporting companies are locally or foreign owned and whether the tourist services and exports are paid for at home or abroad.

This seems counter-intuitive; if a tourist prepays for a packaged holiday in Barbados, surely less foreign exchange comes to Barbados than for a holiday paid for in the traditional way. But is that really so, if we compare like with like?

For a given quality of accommodation, a competitive hotel will receive average revenue within the price range for that quality and it will use this revenue to meet normal operating expenses, irrespective of where the money is paid. Taxi drivers, restaurant operators and all ancillary service providers are also paid at the prevailing market rates, irrespective of the locus of payment. All payments for goods and services provided in the host economy are made locally. They represent foreign currency inflows, they have domestic multiplier effects, and the foreign currency they earn is available to the banking system to pay for imports.

It is more difficult to generalize about the benefits to the local economy from the profits of export industries and tourism. What is clear is that the widespread assumption that profits are always a loss to the economy has to be questioned. If, as in Guyana, exports are generating super-profits, the rational investor decision is to reinvest heavily in expansion of export capacity. A decision to deploy surpluses elsewhere rather than reinvest may be a sign of declining productivity and competitiveness in the export business, whether the investor is local or foreign. Maintaining international competitiveness will attract continuing foreign currency inflows for investment, whether or not ownership is local.

In sum, the economy benefits, not from the inflow of foreign currency, but from the influx of imports which are purchased for domestic use with the proceeds of foreign earnings and foreign investment. Payments may be made domestically or they may be made abroad; what matters is the total amount, because that is what determines the amount of imports the country can afford.

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