Ewart S Williams: The global financial crisis – institutional management and regional opportunities

Remarks by Mr Ewart S Williams, Governor of the Central Bank of Trinidad & Tobago, at the Caribbean Law Institute Inaugural Symposium on Current Developments in Caribbean Community Law, Port-of-Spain, 10 November 2009.

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The global credit and financial crisis has been the subject of much debate and analysis and not unexpectedly, several factors have been identified as the main culprits.

Analysts have pointed to: the sub-prime mortgage debacle; over-expansive monetary policies leading to a property and share-price bubbles in many developed countries; the proliferation of complex investment instruments based on high levels of leverage; the failure of large banks and financial institutions to measure and manage risks and lax financial regulation and supervision, which failed to require banks to hold adequate levels of capital, and failed to detect serious liquidity exposures in wholesale funding markets.

As you know, at first the crisis was considered a payment for the sins of developed countries; it was half expected that the large emerging markets would have been affected but it was felt that developing countries would have gone unscathed because of their limited integration in the international financial system.

Of course, it is now history that the international financial crisis morphed into a global recession which has spared almost no one, certainly not us here in the Caribbean. The international recession also coincided with the **collapse of two regional financial institutions** – the Stanford Bank and the CL Financial conglomerate.

These financial setbacks have created serious hardships for the large numbers of depositors and policy-holders of these institutions, though they have not had systemic implications for the regional financial system.

The latest data from the IMF projects negative growth for all of the thirteen Caricom countries with the exception, perhaps of Guyana, Suriname and Dominica. As a consequence, most, if not all the Caricom countries are facing double-digit unemployment levels.

The transmission mechanism from the global recession to the region has involved two main channels viz: the sharp decline in tourism and workers' remittances and the slump in commodity prices. A few countries have been further affected by the decline in direct foreign investment and the unavailability or higher costs of external borrowing.

The global financial crisis has affected the tourism-dependent regional economies firstly through the drop in tourist arrivals ranging from around 10 per cent for the Bahamas, Barbuda and Antigua and Barbados to around 20 per cent for St. Vincent and the Grenadines, and St. Kitts and Nevis. Jamaica is reported to have had a reduction of only about 3 per cent.

The fall in workers' remittances faced by the region as a whole has been estimated at between 15 to 20 per cent. This is very significant since, in some cases, like Jamaica, remittances are estimated to account for between 50 and 60 percent of current foreign exchange receipts.

The impact of the global recession has also been transmitted through the decline in commodity prices. Jamaica, Suriname and Guyana have had to face a decline of about one-half in aluminum prices, while Trinidad and Tobago saw oil prices plunge from US$147 per barrel to US$40 per barrel and gas prices from US$8 per mmbtu to under US$3 per mmbtu.

In the case of Trinidad and Tobago, concerns about the sharp economic downturn and rising unemployment, after close to a decade of buoyant economic conditions, have created significant uncertainties and put a damper on private consumption and investment spending. Fortunately the Government was able to provide some fiscal stimulus to compensate for the decline in private expenditures and this has helped to contain the reduction in output and employment.

Unfortunately, most of the other countries in the region do not have the fiscal space (or have limited fiscal space) because, in the first case, they were running fiscal deficits even before the crisis and secondly because of their high debt burdens, averaging about 90 per cent of GDP and for some countries running well in excess of 100 per cent of GDP.

Accordingly many in the region have decided to seek financial assistance from the IMF and from other multilateral institutions.

And there is no hope of relief soon …

The latest indicators suggest that **economic growth in the US and in most advanced economies has resumed** though the consensus is that the recovery would be sluggish and even more importantly that **employment conditions in these countries could get worse before they start to improve**.

That is not very good news for the regional economies that depend heavily on tourism and workers' remittances. (Reports about advanced bookings for most Caribbean destinations also paint a pretty dismal picture for the tourism sector in 2010). The likelihood therefore is for continued economic decline or stagnation in the tourism-dependent economies in 2010.

A word about the Clico, British American and BAICO collapse. While, as I have said before, it has not had systemic consequences, it is likely to be a rather costly failure. The Trinidad and Tobago government has approved a sum of TT$5 billion to meet the statutory deficit of Clico. The Trinidad and Tobago, as well as, the Barbados governments has also contributed to meeting the statutory deficits of the BAICO subsidiaries in the OECS. All this notwithstanding, when the dust settles there could be some losses to pensioners and policyholders, and additional burdens on the already stretched budgets of regional governments.

There are plans afoot for a new company to take over the liabilities of BAICO. However, it is estimated that this would require around US$400 million.

As you may be aware, the international crisis has again raised concerns about the **adequacy of the international financial infrastructure**, and whether it is sensitive to the needs of emerging market and developing countries. In fact, over the past few months, there has been more progress on an international reform agenda than had occurred in the past five years. Some of the achievements have been:

- Restructuring the main body that sets the international financial agenda, to provide for broader representation of the fast-growing emerging market economies. Thus, the G7 has given way to the G20 in which are represented China, India, Brazil, Argentina and South Africa. This is certainly an improvement in voice and representation, **though as I would come back to later, there is a question as to whether it has gone far enough**.
- Reform of the IMF has gathered new momentum. This reform has included so far, an **increase in resources available for** lending to emerging market and developing countries; **greater access to IMF resources by countries needing support**; a modest relaxation of IMF conditionality and **a new SDR allocation (which is in fact a one-time gift of foreign exchange and which has been very helpful for countries in balance of payments)**. Unfortunately, the SDR allocations are based

on quotas so the benefit does not go to those most in need e.g. Dominica got US$11 million and T&T – US$426 million.

- Mindful that the international financial crisis emanated from the developed countries, **there is now a very active discussion on how regulation could be reformed to avoid another major financial crisis**. This discussion has raised issues about the risks of having institutions that are "too big to fall", the salary incentive structure in the banking industry and the need for a counter-cyclical approach to financial regulation.
- Unfortunately, as part of the reform agenda the OECD has begun a new assault **on "off-shore" financial centres**. If this is successful it could have widespread negative effects on several regional economies.

At the last IMF/World Bank Meeting in Turkey, the Caribbean made **a strong pitch for changes in the operating framework of the multilateral financial** institutions. This framework puts per capita income as the defining parameter for the assistance from the IFI's. On that basis, the Caribbean, where per capita income is high by developing-country standards, is not eligible for special concessionary assistance. The essence of the Caribbean case is that **notwithstanding our high per capita incomes**, the Caribbean faces specific vulnerabilities arriving from:

(i) Small size;

(ii) Susceptibility to natural disasters and the impact of climate change; and

(iii) The very high public debt ratio.

The World Bank indicated that it would consider the Caribbean's case.

So, **what are the lessons that this crisis holds for the region?**

If there is any lesson that the last few months should forcefully bring to us, it should be that, in this new global environment, **deeper regional integration is absolutely critical** for the survival of all the Caribbean economies. It is clearly a case of "**we swim together or we sink together** – admittedly some faster than others".

For years, we have talked closer integration. However, the journey towards the CSME has been slow indeed. This would seem to be the time to accelerate our efforts.

We need to seriously consider and expedite several things:

- **One**, to bring regional production structures into better alignment.
- **Two**, the region needs to develop a policy agenda to improve its resilience in future crises.
- **Three**, we need to quickly upgrade and harmonize regulatory and supervisory systems and put in place mechanisms for regional regulatory coordination.
- **Four,** as the EU has shown, the creation of a more cohesive regional economic (and political) bloc will strengthen our capacity to bargain collectively with international financial institutions like the IMF, World Bank and WTO and the OECD.

And finally, Clico…

There are many lessons to be drawn from the Clico crisis and there must be, given the size of Clico and its vast reach. There are in the first instance:

- questions about the failure of regulation legitimate questions … If Clico was too big to fail, it should have been subject to more up to date legislation;

- questions of the role of the auditors in all this … Clico has always been given a clean bill of health by the auditors. Unqualified audit reports: even AM Best rated Clico BBB in 2007, a slight downgrade from its previous A-rating; and
- there are questions about market discipline ... if you were being offered these high rates of interest something must have been wrong;

I prefer, however, to focus on the governance issues because, without doubt, the failure of Clico was a failure of Governance … it was absence of controls from the Board of Directors.

Clico shows what damage could occur when **prudence is clouded by unbridled ambition**.

Clico shows what can happen in the virtual absence of a risk management framework and the absence of internal controls.

Clico shows that we need to rethink corporate governance … not only in Trinidad and Tobago but in the region as a whole.

Conferences like this could help enormously.

Thank you.