Sir K Dwight Venner: Evolution of global governance and its critical offshoot corporate governance

Opening remarks by Sir K Dwight Venner, Governor of the Eastern Caribbean Central Bank, at the 2nd Meeting of the Caribbean Corporate Governance Forum, St Kitts, 8 March 2005.

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Mr Chairman

We meet at a time of unprecedented change in the international system with the advent of the New Millennium. Prior to this, however, the seeds of change leading to the very dynamic, fluid and volatile state of the international economy and political system were being laid by several critical events. These events laid the basis for the evolution of Global Governance and its critical offshoot Corporate Governance, which is the reason why we are gathered here today.

An understanding of the history of the evolution of the international system is vital to an understanding of the Corporate Governance movement if one can term it that. The phenomena of globalisation which underpins this seemingly new aspect of our lives is not in fact new, but has been occurring with major interruptions since the 19th century. Certainly between 1860 and 1913 there was a considerable flow of trade and capital between the established states and their colonial empires. This was interrupted by the World War I and the interwar period. The trade disputes and struggles for resources led to World War II, following which there was an unprecedented period of stability and growth during the 1950s and 1960s. This came to an end in the late 1960s and certainly by 1971.

During this period the map of the world changed considerably as did the geopolitics of the international system. A large number of countries, parts of former colonial empires, became independent and took their place in the community of nations. At the same time, however, the world became divided along ideological lines, the East-West divide which ushered in the Cold War era. Competition between East and West took the form of differences in political and economic systems, communism versus liberal democracy, and the command versus the market economy.

One could describe the post World War II environment as one of ideological competition revolving around politics, finance and trade. This system began to unravel in a remarkable way with the destabilisation of the market system as the inflation generated by the Vietnam War in the United States, and the dollar surplus in Europe, caused the demise of the Bretton Woods system of fixed exchange rates, which had guided the international financial system in the post war period. This, one can argue, led to the first oil crisis and further destabilisation.

The world in very quick time moved from a comfort zone of fixed exchange rates and a low and stable price for oil to a new era of floating exchange rates, and an unprecedented high price and volatility of one of the most critical commodities in international trade. Further, fundamental change came in 1989 with the demise of communism and the unraveling of the Soviet Union, the other super power.

The results of these separate events, when put together, represented a fundamental change in the architecture of the international political and economic system on the approach of the New Millennium. A number of seminal books have been written on this new phenomena and they are worthy of note at this point. They are –

- *The End of History and the Last Man* by Francis Fukuyama;
- *The Clash of Civilisations and the Remaking of World Order* by Samuel Huntington;
- *The Borderless World* by Kenichi Ohmae.

All of these books in direct and indirect ways speak to the issue of Global Governance in a world which had apparently lost its original moorings and needed new paradigms on which to base its relationships. These relationships involved those between states as well as between firms. The books raised various questions. For example, *will differences in civilizations like Western Civilisation versus Islam be a governing principle in the conduct of international political and economic affairs?* The current situation revolving around the issue of terrorism may suggest this, although the jury is still very much out on the matter.

The ascendancy of liberal democracy has been certainly confirmed as in theory there are certainly more states which have reasonably fair electoral practices. However, the deeper underpinnings of liberal democracy such as an independent judiciary, freedom of the press, and well-regulated markets are yet to appear in many countries.

The borderless world is real in so far as the movement of finance, capital and the increasing flow of goods is concerned, but we are yet to see the demise of the nation state as predicted by Ohmae as a corollary to the borderless world. What is clear is that there has been a consolidation of states into one world in terms of inclusiveness through such international institutions as the United Nations, the Bretton Woods institutions, the IMF and World Bank, and the World Trade Organisation representing respectively politics, finance and trade.

The demise of communism and the command system of resource allocation has left the market system in sole command as the arbiter of economic decision making. All countries, including the former Soviet Union are moving to, or have established, market-type economies. The debate over whether the state or the market is the more appropriate means of allocating resources has, in a sense, been decisively won by the market.

The overriding question which now has to be posed is: *who governs the market?* This question must be answered both globally and nationally for the simple reason that all states are not equal and within countries all sections of society are not equal. There are, and can be, consequences if there is market failure on a global scale like the Great Depression, or a systemic global financial crisis as was the fear during the Asian crisis or before that with the default of Mexico in 1982 and the subsequent debt crisis in Latin America.

The international economic system is so interdependent and the flow of capital so huge and so potentially volatile that safety nets and governance systems must be put in place to prevent an economic and financial melt down. This would have spill-over effects on the system of liberal democracy, as in a response to such crises, governments may be tempted to assume authoritarian power. It could provoke ethnic strife within and between countries as scarce resources may be commanded by those who have political, military and economic power.

Where does this place Corporate Governance in the context of a rapidly changing and volatile environment?

Firstly, there are serious contradictions in the architecture of the international system. There is an increasing cross border flow of goods, services, capital and even labour. There are international conventions which states subscribe to, but there is no political architecture which can effectively regulate, police and redress the major issues which follow in the wake of these massive cross border flows.

Secondly, and because of the first, there has been a perceptible shift in power from nation states represented by their ministries of finance, tax authorities and central banks to the participants in international and national financial and equity markets, namely, pension funds, trust funds, hedge funds, large financial conglomerates and bond holders. Bond holders, for example, have been able to hold up sovereign debt restructurings and pension funds have been able to unseat Boards of Directors and Management.

This has in a sense provided a counterbalance to the pressures within the market system, particularly stock valuations for consistency, improving performance to impress markets and investors. This has led to serious abuses and corporate malfeasance as in the celebrated cases of **Enron, Worldcom, Parmacat** and others. The tensions in the market system spring from competition not only within, but also between countries with variants in the kind of market capitalism they practice. One author, Bruno Amable has identified five types of market capitalism, each characterized by specific institutional forms, and particular institutional complementarities:

1. The Market based Model;
2. The Social Democratic Model;
3. The Continental European Model;
4. The Mediterranean Model;
5. The Asian Model.

These models which we will not describe in detail, are characterized by a greater or lesser degree of state involvement, the particular role of financial and labour markets and the presence or absence of welfare state arrangements. The fact of the matter is that market failure and/or corporate malfeasance can create havoc with economic, political and social arrangements and stability. Regulation by the state, social welfare or social protection mechanisms, and the self regulation of private sector entities are critical for **stability, growth and development.**

The rights of shareholders, the rights of participants in pension funds, and the rights of ordinary citizens to enjoy the economic benefits of being part of a community are intrinsically enshrined in the social contract between state and citizen and to the extent that they become threatened, become enshrined in the laws of the country. This certainly is the case in the nation state where the concept of public goods and public policy represent the necessity to protect citizens' rights en bloc and not a particular section of the society.

Since the world is now so interdependent and contagion both in the economic and financial spheres is no longer a theoretical construct, but a highly possible event, there is an understanding that there are such things as international public goods and that corporate governance therefore extends beyond national borders. The most obvious area which reflects this is the financial arena and international standards and codes have started and proliferated from this arena into other related areas.

The successive financial crises in different regimes of the world over the last two decades have manifestly illustrated the impact of the volatility of the financial system on both economic and political events. A special G22 Working Group on Transparency and Accountability was established in the late 1990s to review and report on this matter. They concluded that *"inadequate transparency by international organizations, national and governmental units, and private sector entities was a contributing force to the serious financial disturbances that have plagued the global economy".* They concluded that markets cannot function efficiently and that they will continue to be highly vulnerable to instability, in the absence of adequate, reliable and timely information from all quarters.

A number of standard setting bodies dealing with a number of financial sector related areas have been established to address the situation. The IMF has produced for example, the Code of Good Practices on Transparency in Monetary and Financial Policies and there have been standards and codes in Accounting, Auditing, Banking Regulation and Supervision, Bankruptcy, Insurance Regulation, Payment System and Securities Market Regulation, and of course, **Corporate Governance.**

The OECD has taken the lead responsibility for Corporate Governance and has issued the OECD Principles of Corporate Governance in 2004 after extensive international consultation. The Principles, as stated in the preamble, are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance.

In the Caribbean we have some definite advantages as we embark on the development of our corporate governance systems in the region. The most important of course, is a sound foundation of liberal democracy which has flourished since the attainment of universal adult suffrage in the 1950s and 60s. We have had a system and series of free and fair elections in which the losers were not shot or exiled, and had the right to challenge the results in our courts. We have had an outstanding system of justice certainly in comparison with many countries in the first, second and third worlds.

We have also had the rights of religion, free association and freedom of the press. These rights and institutions are the bedrocks on which good corporate governance is built. It has been a principle among our firms that their accounts and performance should be publicly audited and because of the importance of foreign investment the standards of OECD countries have been accepted as the norm.

We do have some grounds to cover in this new dispensation when the Standards of Transparency and Accountability have been raised considerably in response to the international environment. The flow of foreign investment needed to facilitate sustainable growth and development over a time period, long enough to treat successfully with our unemployment and poverty issues, will be dependent on our practice of good corporate governance both in the public and private sectors.

In the public sector, good public finance and debt management policies will be vital in creating the environment for development. The regulatory activities of the state in passing and enforcing legislation to support good corporate governance will also be important. However, the example set by the government in publishing statistics and having their financial statements pass through the constitutional process of parliamentary scrutiny of the public accounts committee after examination by the Auditor General, is absolutely vital to the integrity of the corporate governance process in our region.

The regional private sector in order to develop and be internationally competitive has no other option than to accept these practices. Their commitment to good corporate practices and corporate citizenship is critical not only for their own growth and development but for that of the region as well.

There is, in our societies because of our history, a great suspicion of the motives of businesses and businessmen. The Anancy image is quite alive and well in our societies. In addition, the ethnic images of our business classes pose some ambiguity, as, since they are essentially family oriented, there is no public disclosure. The suspicion of the Tax Departments also encourages an attitude on non-disclosure. The public and private sectors have to work in tandem to realize an atmosphere of trust.

Professions such as Law and Accounting have to play a critical role in bringing our business communities into the new paradigm of transparency and disclosure.

The market economy, we can conclude, works best when it is properly regulated and the dissemination of information is supportive of choices which lead to improved resource allocation. All institutions, both in the public and private sectors must strive to ensure that, both nationally and regionally, we set and maintain standards of corporate governance which lead to the sustainable growth and development of our region and our people.