Remarks by The Governor of the Eastern Caribbean Central Bank
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CORPORATE GOVERNANCE, THE BANKING SYSTEM AND DEVELOPMENT

The Eastern Caribbean Currency Union is now at a cross roads in its development as the economies of the member states seek to effect an economic transition in order to improve their prospects for growth and development.

The transition involves moving from economies and economic conditions based on preferential treatment for export agricultural commodities, weak and narrow markets for capital and labour, ineffective taxation systems, inappropriate expenditure programming and private sectors which are not regionally or internationally competitive, to new dynamic and flexible economic systems based on the use of high technology, innovative management systems and an outward global approach.

The facts of modern economic life are fairly clear to us by now in a general way, even if the details are not particularly self-evident. There will be an increasingly interdependent international economic system with the flows of capital, labour, commodities and services across national borders increasing at an exponential rate. Another fact which brings us face to face with reality, is that the nations which are stronger, both militarily and economically will exert a disproportionate influence on economic progress.

In the Caribbean, we have already begun to feel the effects of these conditions as the rules of the game change and new circumstances force changes on the international system, and in turn on our countries. The most obvious case for us is the impact on the banana industry of the new rules under the WTO. The banana farmers of the Currency Union were caught in the middle of a trade dispute between the European Union and the United States, which has resulted in the dramatic decline of the banana industry. The farmers and the industry can be described as innocent bystanders, and casualties in a dispute which essentially had nothing to do with them. The outcome is all the more ironic when the scale of the subsidies to agriculture in both Europe and the United States is known. The ability of resources in the banana industry to shift seamlessly is constrained by the size of the producing countries and the inability to find suitable alternative crops which have access to large markets.

Another example for us, of the difficulties of participating in the global economy is the case of offshore banking, where, once again, a shift in the rules and the comparative advantage we had, has occurred. The offshore sector enjoyed a comparative advantage when it was based on lax regulation and secrecy. Several financial crises and the threat of terrorism have changed these conditions, and another potential industry has suffered what could be a fatal blow.

These illustrations should lead us to take another view of the world as a whole, and our own domestic circumstances if we are to survive in this new environment. The international environment, as we have pointed out, is fraught with uncertainty and therefore we need to refine our information sources in areas directly and indirectly related to us in order to mitigate the risk involved in participating in the global economy.

On the domestic front, more choices are open to us and we have to consciously decide how we can or will manipulate the things we have under our direct control in order to achieve our desired objectives. One of our first decisions will have to be, what is the geographic and political domain of our operations in the context of individual islands, the Currency Union, CARICOM, the Americas, and the world? The extent to which we conceive our own domestic situation to be sustainable without undue influence from each level of operation is the extent to which we will surrender our decision-making powers to that particular level.

In a practical sense, we have the ultimate in legal and constitutional sovereignty at the level of each individual state. Working outwards, we move to the OECS/ECCU in which the countries have a very close relationship (including a common currency) to CARICOM which is a looser arrangement, to the FTAA, and finally the WTO. Our power to affect events at the WTO and FTAA levels is extremely limited. At the CARICOM level it depends on whether the numerical and bargaining strength of the OECS is utilized. At the OECS level it is our ability to coordinate our common interests in response to third parties. . This leaves us in the OECS with the dilemma as to how we coordinate national and OECS policies in a way that allows us to fulfill our responsibilities to our citizens by providing them with a satisfying economic, social and political life.

This gives us a contextual background for our approach to development, which, in the broadest sense, will emanate from corporate governance and money and capital market development. The three parties to this arrangement will be:

1. Public sector
2. The financial sector
3. The non-financial private sector.

It is how we coordinate and leverage the activities of these three parties that will determine our success in the years ahead.

Corporate governance is now a major issue in the international community, following the Asian financial crisis of 1997 and the more recent corporate scandals of Enron and WorldCom. The state, the financial sector, and the private sector, are dynamically involved in the process of corporate governance through related, but sometimes different channels. The state has the responsibility of passing laws and establishing regulatory authorities. The financial sector has to carry out due diligence on the private sector and increasingly on the state as it makes lending decisions. The private sector has to have its own bylaws and respect shareholder and stakeholder rights in producing outputs for consumption and distribution.

Corporate Governance has to do with the influence and impact of institutions and rules, and has been defined by Shleifer and Vishny as follows:
"Corporate governance mechanisms are economic and legal institutions that can be altered through political processes." There are other variants on this theme which emphasize that "Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment."

In the case of corporations, one definition asserts that, "Corporate governance is the system by which companies are directed and controlled. Another states that a corporate governance system is the complex set of constraints that shape the ex post bargaining over quasi rents generated by the firm.

A broader definition sees corporate governance, including the relationship between shareholders, creditors, and corporations; between financial markets, institutions and corporations; and between employees and corporations. It also encompasses the issue of corporate social responsibility including such aspects as the dealings of the firm with respect to culture and the environment.

It can be clearly established by the relationships between the three parties and the scale and scope of corporate governance as defined above, that we are into the realm of economic development with its contending constraints and positive impacts on social and political phenomena.

In our context we need to coordinate the interplay of corporate governance and money and capital market development at both the national and currency union levels. At the governmental level, a clear understanding of this interplay is necessary, but not sufficient for urgent and steady progress.

The state must pass and enforce the necessary laws and regulations to create and establish an environment conducive to growth and development. However, it must also be an example by conforming to its own rules and regulations in its financial management, procurement practices, and impartial delivery of services to the community. The state must have an explicit and aggressive stance against both public, and private sector corruption.

The banking sector at this stage of our development is the body which has, potentially, the greatest possibility of promoting corporate governance and development in our system. The fact of having access to the largest pool of savings in the economy and having to intermediate these to the private sector and the state means being in a position to carry out due diligence to ascertain the risk to depositors.

As corporate entities themselves, banks must have the requisite components of corporate governance in place to carry out the intermediation function effectively.

The role of the board of directors and the management must be carefully defined and performed. The functions of Audit Committees and compensation committees must be explicitly outlined and meticulously adhered to.

In the current environment where bank financing is predominant, banks need to insist, as a condition of making loans, that firms have in place good corporate governance systems and possibly provide assistance and advice in this area. In the case of governments, the banks insistence on good financial practices will also assist in facilitating a process that is now underway.

The Global Corporate Governance Forum is making strenuous efforts to facilitate the observance of good corporate governance on an international scale. In one of their sponsored booklets "Corporate Governance and Development" by Stijn Claessens, five channels through which corporate governance affects growth and development are identified.

The first is the increased access to external financing by firms. This in turn can lead to larger investment, higher growth, and greater employment creation.

The second channel is a lowering of the cost of capital and associated higher firm valuation. This makes more investments attractive to investors, also leading to growth and more employment.

The third channel is better operational performance through better allocation of resources and better management. This creates wealth more generally.

Fourth, good corporate governance can be associated with a reduced risk of financial crises. This is particularly important as financial crises can have large economic and social costs.

Fifth, good corporate governance can mean generally better relationships with all stakeholders. This helps improve social and labour relationships and aspects such as environmental protection.

In the ECCU we are attempting to pull together all the pieces of corporate governance at all levels and to feed them as critical inputs into the development of money and capital markets which we envisage will lead to sustainable growth and development.

On the governmental side, we have, through the World Bank and ECEMP; initiated programmes to upgrade the work of the Auditors General, and to put in place what we refer to as the fiscal machinery. This fiscal machinery deals with the budgeting process starting from the preparation and presentation of government budgets to the implementation, monitoring and evaluation of their outcomes.

Within ministries of finance, critical attention is being paid to fiscal and debt issues through the establishment of policy units. At the central banking level we at the ECCB have undergone a Safeguards Assessment by the IMF to assure us that our internal control systems and legal mandates are being complied with. We have undertaken to place this on the agenda at the level of CARICOM Central Bank Governors and the CEMLA levels.

At the level of the financial sector, we are now undergoing an FSAP to ensure the safety and soundness of the entire financial system. A critical part of this is the corporate governance of financial institutions and their capacity to deal with risk. It also speaks to the powers and capacity of our regulatory and supervisory arrangements.

At the private sector level the SEC and the ECSE have begun to make critical requirements of our private sector as they seek to list on our exchange. The levels of transparency and accountability will have to be considerably ratcheted up if our private sectors are to perform to international standards.

In the ECSE we have a powerful platform that is literally the envy of the entire region. Our experience so far is that for the ECSM, the value of shares has gone up and for the RGSM the price of government debt has gone down.

Good corporate governance in both spheres can accentuate that trend leading to a more efficient allocation of resources in what would then become a virtual circle.

With these results, we could then seek to move beyond our immediate borders to CARICOM on the bases that:

1. Good corporate governance at the three levels makes us attractive to outside investors.

2. We are the de facto regional exchange since we are offering a solution not a location for the long proposed regional stock exchange.

In conclusion, it must be said that despite the current objective conditions, opportunities are presenting themselves for us in the Currency Union. The commercial banks have a critical and fundamental role to play within and between countries. They need to support the concept and practice of good corporate governance at the individual bank level and more importantly they need to form an industry view of their role in facilitating the process of growth and development in the Currency Union.
