The 49TH Annual Monetary Studies Conference

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"Conference Theme: Repositioning Small States for New Global Realities: Prospects and Challenges"

32nd Adlith Brown Memorial Lecture, delivered by Carla Barnett PhD CBE

[Salutations]

Good evening ladies and gentlemen.

This event is a signature honour for me. To be asked to deliver the keynote lecture at the conference where I cut my teeth on undertaking and presenting research as a fresh, young graduate of the University of the West Indies is honour enough. But to speak in honour of Adlith Brown, an extremely capable and articulate woman whom I and my colleagues looked up to as an example; who took it on herself to mentor the fresh young economists who prepared papers for the Annual Monetary Studies Conference; and whom I had the pleasure to know, but not for long enough, makes it that much more special. This is indeed a signature honour to present this lecture, following a long line of luminaries that came before me to pay her respect every year since 1984.

When I participated in my first Monetary Studies Conference, the Central Bank of Belize was just transitioning from a Monetary Authority with all the excitement of institution building, including capacity development among staff, such as the young economists in a fledgling Research Department. So it was with much trepidation that I and my colleagues set about undertaking research and preparing papers for the annual Monetary Studies Conference. We were nervous as we presented the findings of that research to be critiqued by experienced economists, university professors, central bankers, and other much more highly trained and experienced economists than we were. But we had Adlith running things. She made sure we crossed our T's and dotted our I's. And she organized the conference so that the newbies were able to get excellent and supportive critique from the more experienced colleagues to guide us in revising our papers and hopefully get them published.

This was all part of the plan and the process for building economic research capacity in the then young Central Banks of the Region and for building the knowledge base required to understand and provide good policy guidance for the economies and the financial systems of our countries. The critique around the conference table was tough but it was constructive. The disagreements were loud but good natured and the camaraderie was real.

The Regional Programme of Monetary Studies which was guided so carefully and effectively by Adlith Brown in the early days has grown up and matured through all the ups and downs. Since leaving the Central Bank of Belize, a long time ago, I have not been a participant in the annual conference, but I have noted with some satisfaction its evolution into the CCMF which continues to carry the research programme forward.

If this is really the 49th Annual Monetary Studies Conference, then next year the Central Banks of the Region and the University of the West Indies will have good reason to celebrate - It will be the 50th year. Congratulations are in order. I suspect that, at this meeting, the planning will be in high gear for a banner year next year.

Global Transitions

The theme for this year's conference is extremely timely as 'Money Studies" enters its 50th year: "Repositioning small states for new global realities: Prospects and Challenges". Indeed, we appear to be in a period of great transitions and uncertainties not unlike great transitions of periods passed, such as the industrial revolution.

The heights of the industrial revolution of the 19th century yielded great economic growth and transformation across the globe. Powered by the steam engine, machine tools, trains and big ships, everything grew.

The size and productivity of the production unit grew exponentially and firms grew into great corporations. Global trade exploded as large firms sought markets across the globe. Capital markets exploded to provide the newly wealthy with opportunities to invest and become even wealthier. Towards the end of this period we also began to see the transformation of war machinery with the production of military equipment of larger scale and scope.

As all this growth was happening, we also saw the growth in inequality both within countries and between countries. Great urban poverty arose. There was unfettered pollution of the environment and exploitation of labour – including child labour.

By the time we got to the turn of the 19th into the 20th century, the new production systems, fed by unorganized and cheap labour, felt the backlash in the rise of labour unions and the beginnings of government intervention through regulation of industry. Out of this turmoil, two major political ideologies ended up at opposite and opposing ends of a bi-polar world. The two world wars of the first half of the 20th century emerged and we ended that tumultuous transitionary period with the establishment of multilateralism as the preferred approach to prevent another descent into “world” war. Multilateralism became one of the guiding principles to keep an unstable mass of international relationships in some kind of balance.

It is true that these great transformations that I have reduced to a few little paragraphs were much more complex than I am making them out to be. But it is also true that in the grand scheme of millennia of evolution, these all happened in the blink of an eye.

The period that we are going through now, is comparable in several ways to the era attending the industrial revolution. Production processes continue to be transformed, this time by the technological revolution, resulting in increased productivity.

Transportation and communication infrastructure and the development of innovative delivery channels are facilitating the expansion of trade at a phenomenal rate, especially trade in services. The production of military equipment, and the profitability of military enterprise, continue to grow.

Huge pockets of wealth are being created at the same time poverty is intensifying, indicating growing inequality.

And the wealthy continue to look for places to invest their money within and, now also, outside of the traditional capital markets, including offshore and trust options available for a long time in parts of Europe, and more recently in various countries and territories in the Caribbean and even states in the great United States.

The concerns about pollution have grown as scientific research has confirmed the long-term impact of environmentally unsustainable production practices, particularly in manufacturing and agriculture. The concern now, though, is not only about the impact of, for example, the effect of polluted air on the populations living near to factories. It is the long-term effect of these factories – be they in Europe, Asia or North America – on the social, economic and environmental sustainability of territories and communities far away in the Pacific and the Caribbean and elsewhere.

So, there are some basic similarities between the industrial revolution and this current technological revolution in terms of the growth in productivity, trade and wealth. This world **has** seen these kinds of transitions and transformations that we are experiencing before. But the complexity of the current transition and transformation appear more intense and the effect of failure to adequately address the consequences appears to present existential threats particularly to small states.

What is particularly worrisome, at this time, is the open threat to multilateralism as the way to find consensus on possible solutions to these existential threats. What appear to be impulsive actions by the USA, for example, to withdraw support for certain multilateral processes and institutions, lead inevitably to questions regarding the efficacy of these institutions in achieving their stated objectives on behalf of all. This is unfortunate, particularly for small states because multilateralism provides the opportunity to band together to advocate their position and to make alliances with larger states on issues that are mutually beneficial.

Challenges of Small Size

It is in this broad context that I want to talk about two specific challenges/ threats small states face at this time.

For those of us old enough to remember, the small states agenda first gained legitimacy with a decision of the Commonwealth Heads of Government Meeting in 1997 – a full 20 years ago – to lead an effort essentially to convince the Washington institutions that the special circumstances of small states deserved focused attention.

> "*Heads of Government requested that a Task Force be established by the Commonwealth and the World Bank in order to encourage the multilateral agencies to review their treatment of small states in recognition of the vulnerability of these countries. In keeping with the wishes of Commonwealth leaders, the Secretary-General arranged a five-member, high-level mission to visit key international organisations to discuss the concerns of small states."* [1]

Three years later, the World Bank took on the responsibility for arranging an annual discussion at the Small States Forum at the Fund/Bank Annual Meetings. This year, after much research, meetings, formal and informal discussions, a Road Map for Action[2] has been tabled to guide future work on the Small States Agenda. There is hope that this will have some positive impact on defining and implementing solutions which make it more possible for small states to sustainably and effectively address those development challenges which are unique to this group of countries because of their small size.

[1] Commonwealth Secretariat/World Bank Joint Task Force on Small States Report.
[2] ***Small States, A Roadmap for World Bank Group Engagement***, World Bank Group, May 2017, tabled at the Spring Meetings and further discussed at the Small States Forum at the Annual Meetings.

These challenges are well known[3]. They include, but are not limited to:

- The per capita cost of public investment in both physical infrastructure and social services is extremely high because of low population;
- Fiscal revenue sources are limited;
- Labour market constraints limit private sector investment;
- Communication and transportation services tend to be inconvenient, limited and costly;
- Difficulty in maintaining operationally smooth and uninterrupted international banking relationships - indeed the growing marginalization from the international financial market - seems near insurmountable at this time; and
- Vulnerability associated with climate change – more frequent and more destructive natural disasters, sea level rise, etc. – which results in frequent and large fiscal shocks.

It is these two last-mentioned challenges that I want to focus on for the remainder of this presentation.

The first is the increased marginalization and growing exclusion from normal operations of the international financial markets, referring, of course, to the uncertainty of correspondent banking relations between small states and the rest of the world. This is an immediate challenge that requires effective solutions in the near term.

The second is the matter of climate change and the broad impact it will have on the economy and society with increasing intensity through the medium to long term.

I focus on these because of all the challenges small states face. These are the most critical in the near term and in the long term; and these are the challenges that small states have very little, if any, control over.

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[3] ***A Big Question on Small States, Finance and Development***, September 2013, Vol. 50, No. 3, Sarwat Jahan and Ke Wang.

Marginalization from the International Financial Markets

For years we have been discussing the impact of de-risking through the termination of correspondent banking relations within the international financial system. There are two very useful studies of the de-risking phenomena that were published last year. The Commonwealth Secretariat completed the report: ***Disconnecting from Global Finance: The Impact of AML/CFT Regulations in Commonwealth Developing Countries.*** The Caribbean Policy Research Institute and the University of the West Indies published ***The Correspondent Banking Problem Impact of De-Banking Practices on Caribbean Economies.*** Both are excellent pieces of work and both reflect ongoing research headed in the same direction.

There is agreement that,

> *In general, there are three main reasons for the surge in de-banking practices: (i) a fear of reputational loss, (ii) rising compliance costs and (iii) rising fines and penalties for breaches. Correspondent banks fear the impact on their reputations if they are found to be (or even suspected of being) willingly or unintentionally aiding the financing of criminal organisations.*[4]

This de-banking as a result of de-risking, has accelerated as regulatory agencies consistently increase and expand requirements and standards which are intended to prevent the laundering of the proceeds of crime and stop the flow of funds for terrorist activities through the international financial system. The requirements that are being instituted by different agencies are not necessarily mutually consistent or well-coordinated. They reflect the specific concerns and requirements of the FATF/CFATF, US Treasury Department, the Office of Controller of Currency, the OECD, and specific countries with special requirements.

The loss of correspondence banking relationships that began to creep up on some countries several years ago has reached critical levels with banks continually on the search for new correspondents as existing correspondents increasingly exit small

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[4] The Correspondent Banking Problem Impact of de-banking practices on Caribbean Economies, Caribbean Policy Research Institute, R154 / February 2016

states. Quite a bit of research has been underway in our region and in Washington and London, and there is the promise of even more analysis of the nature and scope of the problem.

And before any thought arises that it is otherwise, I have to emphasize that small states, particularly in this instance Caribbean small states, agree that this is a global issue; and understand, accept, believe that in the global financial system, weakness in any part weakens the whole.

Because we are committed to continue to work to address the weaknesses within our financial systems, significant resources have been allocated by regional central banks, regional governments and international institutions to strengthen the financial systems; and that the per capita costs of doing this are much higher in our countries, which is an inherent consequence of our smallness.

Countries of the region for years have been on a continuous cycle of revision of legal frameworks and strengthening of financial regulations. Supervisory structures and processes have been re-organised and focused on know your customer [KYC] and anti-money laundering [AML] systems. Issues ranging from international tax cooperation, to AML, to countering the financing of terrorism, to national risk assessments and constant scaling up of KYC training find their way into legal reform processes on a regular basis.

So, what is happening? We know that de-risking has caused significantly higher costs for even the simplest of transactions, reflecting the costs associated with compliance with evolving regulations and the complexities involved in completing the most basic transaction. Where legitimate transactions become impossible, the loss of correspondence banking relations appears to be driving transactions underground. Businesses which cannot get access to foreign exchange to meet payments for imports of goods and services from the formal banking sector will and do resort to informal markets.

On the export side, the loss of access to the international banking system may cause, or may already be causing, exporters of goods and services to keep as much of their foreign exchange earnings abroad as possible, in order to be able to ensure ready access to foreign exchange when they need it for inputs. This will have the effect of starving our economies – all small open economies - of foreign currency.

Basic remittances from abroad have become extremely difficult to complete, so ordinary people have to find innovative ways to ensure that they can send money home.

Consider this, all the indicators that de-risking is resulting in the expansion of the informal sector suggests that one consequence may actually be an increase in the very risks that we are trying to mitigate. I remember making this point at the Fund/Bank Annual Meetings last year and having persons respond with understanding and voicing that this was not a desirable outcome. Clearly there is a need to give serious thought to the distinct possibility of such a perverse policy result.

Additionally, there still is a need to review carefully the impact of de-risking on our domestic economies because of the real possibility of expansion of the informal sector. We have to be concerned not only about informality in the foreign exchange market; but also about revenue sources being hidden in the informal market; and also of illegal sources of foreign exchange mixing with legal sources in the informal market.

Consider as well that one of the key desired outcomes of stronger financial sector supervision is financial sector stability; but de-risking and the exit of correspondent banks, by leading to expansion in the informal sector may contribute to the increased likelihood of macro-economic instability and undermining of growth efforts.

These are matters that require further study including, for the young quants attending this conference, modeling of the possible impacts on our economies. We have to know what we are dealing with if we want to properly protect the development gains that have been made in the Region. If we want to be able to achieve sustainable growth and if we want to mitigate the risk of economic dislocations that lead so easily to increasing unemployment and poverty, then we have to broaden our research ourselves, and bring these findings to the table to inform policy decisions not only at home, but around the table internationally where the big decisions are made.

As I said before, small developing states, particularly in this instance Caribbean small states, are at one with developed countries in understanding the absolute need to prevent the banking system from being used to facilitate terrorism and laundering the proceeds of crime. It is a global issue; the international financial system is interconnected. We are committed to continue to work to address the weaknesses within our financial systems **because we agree that in the global financial system, weakness in any part weakens the whole**. That is why it is so important to ensure that in the business of de-risking we do not become the even weaker link in the international system through the expansion of informal markets.

Small States and Climate Change

Let's turn to Climate Change. Imagine you are a small state, and you manage to get all your ducks in a row. You have good fiscal and debt management, exports of goods and services are growing at a clip, and investments in education and health are paying off with improved social indicators. Then a category 5 hurricane hits, as it did Dominica just a month ago, and damages or destroys much of your social and economic infrastructure – roads, utilities, housing, ports, schools, hospitals – and destroys all of your potential agricultural exports in the field. And then the following year, before you have recovered, or indeed, as with Barbuda, if in the same year when you are still trying to clean up after one hurricane, another hurricane hits. What do you do? Think about it, what do you do?

The reality is that, with climate change, more storms and more intense storms appear to be the new normal. Although the advice is to plan for this eventuality by, among other things, building up fiscal buffers and implementing climate change adaptation policies and disaster risk reduction plans including catastrophic risk insurance – the reality is that with already limited fiscal space, it is difficult to do all these things while addressing poverty, security, health and everything else all at the same time. Our countries are institutionalizing national emergency management – preparation, response, recovery and rebuilding. Some of us are ahead of the game. We share experiences and expertise and we help each other in the post storm response as best we can. But can we ever do all that is necessary and required to properly prepare and respond?

The IMF, in its recent paper, ***Small States' Resilience to Natural Disasters and Climate Change – Role for the IMF***, in addition to noting that "*the annual cost of disasters for small countries is more than four times that for larger countries*", goes on to say that "*Greater exposure to disasters has important macroeconomic effects on small states, resulting in lower investment, lower GDP per capita, higher poverty, and a more volatile revenue base*". Moreover, "*Climate change is projected to affect small states disproportionately, partly by exacerbating natural disasters and partly through more gradual effects such as rising sea level. Small states will thus face much larger economic costs from climate change than larger peers.*"[5]

I want to suggest to you tonight that the reality is, and will be, much more than disproportionality in the distribution of the economic costs of climate change. It would appear that the economic transformations that are implied by climate change could go well beyond anything the world has seen before. The industrial revolution and the technological revolution will have nothing on what is in the pipeline for the world and especially for small states because of climate change.

Some years ago, in casual conversation with a scientist, I mentioned that my mango tree had a particularly short bearing season last year and, all of a sudden, I was having mangos from the same tree much too early "this year". His immediate response was, "that's climate change". I thought at first it was a joke. But it was not. I got a good lesson in the changes that climate scientists were already seeing in agricultural production and in fisheries.

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[5] ***Small States' Resilience to Natural Disasters and Climate Change – Role for the IMF,*** International Monetary Fund 2017***.***

Everything I have read on the topic so far points to major transformation of our economies because of climate change. Climate scientists already know this. Some economists are beginning to get interested in modeling the economic impact of what the science is projecting. The fact that at this conference there is a panel on climate change and its impact on development is excellent. The fact that there is at least one economist here attempting to model climate variability and link the results to the future of agriculture is even better. We need that and much more.

What are some of the likely transformational effects of climate change on small states that require economic analysis? I have been told that it is easier to list what will not change: nothing.

Climate change is already bringing increased fiscal burden to small states through fiscal provisions for disaster preparedness. There is the need to undertake more frequent response, clean up and recovery after extreme weather events.

Dominica and Barbuda and the BVI and our other sister countries and territories in the East Caribbean are still in the response phase after the storms of 4 to 6 weeks ago. That is ensuring that citizens whose homes were damaged or destroyed have shelter, food, water, medicines where necessary and clothes to wear - just the basic necessities for life. That is one set of costs.

Then there is the clean-up, the removal of the debris that storms leave behind – pieces of houses, trees, utility poles, debris from landslides, the bits and pieces of forests that the rivers bring down to the coast. That is another set of costs.

Then there is the restoration of basic services: electricity and water, in particular and the clean-up of government offices and schools and health buildings that were not destroyed in preparation for restoration of those services. That is another set of costs.

Then there are the losses to revenue from disruptions of trade and commerce. This, at the same time that revenue is required to meet the national emergency.

Then there is the damage and loss to the private sector who, even where insured, may require emergency support in order to be able to return to production, employment and exports as quickly as possible.

These are the immediate challenges; and those of you who have worked on any response and recovery effort after a hurricane know how it feels. Our countries have been dealing with this, and more recently with the establishment of National Emergency Management Organisations, the planning and execution has improved, and quite significantly in some countries.

What climate change is causing, though, is having to do it more frequently and the additional fiscal burden that implies.

This burden will increase further because of the increased cost of economic infrastructure, as road designs, for example, build in provisions for higher ground water levels and greater water flows as a result of increased rain events. Cost of maintenance will also increase. This is the nature of climate change adaptation and mitigation and the additional fiscal burden that climate adapted infrastructure implies.

At the productive sector level, the projected increase in average temperature, as well as the variability in temperature, will likely cause significant negative effects on agriculture as we know it because of changes in growing season and fruiting seasons. Changing rainfall patterns will have implications for the continued suitability of current crops.

Warming oceans can result in fish and other sea creatures migrating away from our waters to maintain their body temperature. So all those lovely groupers and snappers that we have been protecting through our various fisheries management programmes throughout our region may well migrate north as water temperature rises.

Environmental assets – coral reefs, forest flora and fauna – will also be affected. In Belize, for example, we boast of having the longest living barrier reef in the world. It is a spectacular World Heritage Site. Sea level rise and increased ocean temperature clearly present grave threats to its long-term sustainability as a living reef.

The Government of Belize recently took the unprecedented step of tabling legislation to implement a moratorium on oil exploration to protect the reef from the possibility of oil spills. But even if we do nothing else in or around the Belize Barrier Reef so as to protect it, the reef can and will still be affected negatively by rising water temperatures – a phenomenon that is totally outside of the control of anyone in Belize.

In all our countries, significant swaths of coastline, including urban areas, are already under threat from sea level rise. Some of our coastline here in Belize, for example, is already below sea level. So, the sea level rise does not have to be large, it just has to be enough to trigger coastal erosion. Whether the response is to adapt or to relocate, the cost will be tremendous.

There is a lot of economic work that is reportedly being done by economists such as Solomon Hsiang[6] and his colleagues on the impact of climate change on productivity, on agricultural production, on human conflict and on a variety of other variables. These studies suggest that, as in all things, there will be winners and there will be losers from climate change. There is a prediction that global GDP can be as much as 23% lower by the end of this century because of climate change[7]. In that equation, colder countries in the north will benefit greatly from, for example, longer planting seasons and countries like ours, already in the hot zone, will lose greatly from a decline in agricultural production. The same outcomes are being predicted for manufacturing. Indeed, the fundamental thesis is that climate change and global warming will lead to even greater inequality between big and small countries, and rich and poor countries.

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[6] On faculty at the Goldman School of Public Policy, University of California, Berkeley

[7] ***Hotter Days Will Drive Global Inequality - Rising temperatures due to climate change will strongly affect economic growth around the world, making some countries richer and some poorer***, by David Rotman, MIT Technology Review, December 20, 2016

The scope for global transformation with negative results is, frankly, just mind boggling. There is, or was, some agreement on the establishment of mechanisms and processes, through the Paris Accord and the operations of the Green Climate Fund, that would make funds available to countries to address the current and impending impact of climate change. The uncomfortable reality, though, is that we already knew the funds to be made available would be inadequate in relation to need. Now, we cannot, at this juncture, even expect that the principle of multilateralism will prevail and that big and small countries will sit around the table and agree to move towards mutually agreed goals.

There are clearly many questions to be asked and answered about climate change and its economic implications for small states like ours. There are many issues requiring research and collaboration between the economists and the scientists. And if I were younger and had more time, this is what I would want to be spending that time on. But I can't. So I am putting it to our young and energetic researchers and scholars: this is where the money is. I mean this, literally. The early research is showing that in the next 50 years we earn or don't earn by climate change. We exist as functional economies or we don't by climate change. We survive as small states or we don't by climate change.

This is not to sensationalize. This is to be rational about the need to study the circumstances of where we are in order to plan for the future. We used to joke about the quote from Keynes that "in the long run we are all dead". But I want to put that quote in its proper context. It is not that we don't have to worry about long term planning. Indeed, the opposite is true, if we don't plan for the long term from now, when the "long term" is upon us, we are all dead.

Conclusions

Ladies and gentlemen, in concluding this presentation, I hope I have sufficiently made the case for intensifying our study of the causes and consequences to the wider economy of the steady marginalization of small states from the international banking system. We stand to lose our hard-fought development gains if the threat of being cut off from international financial markets, does materialize, causing instability, not only in the financial sector, but in the productive sector. As I said earlier, if we want to be able to achieve sustainable growth and if we want to mitigate the risk of economic dislocations that lead so easily to increasing unemployment and poverty, then we have to broaden our research – ourselves – and bring these findings to the table to inform policy decisions not only at home, but around the table internationally where the big decisions are made.

I also hope I have convinced at least some of you that we need to focus much more intensely on the economic impact of climate change. I would like to believe that economists do understand that short term policy decisions have very, very long-term implications. So next year at this conference, let there be a whole day on climate change and the economy. Please put some focus on that work, so that policy advice can adopt the very long term view by properly taking the impact of climate change into account.

As we seek to gain a fuller understanding of what the future may hold for us because of climate change, we will be able to take that knowledge into account to inform good policy today. There is no substitute for well-informed policies that promote growth and stability. There is no getting away from the need to manage our fiscal and debt policies in a sustainable way. And to do that, these policies need to take climate change into account.

Both marginalization from the international banking sector and the inevitability of climate change carry critical implications for small states' ability to chart stable and sustainable futures and that future has already begun.

Thank you, ladies and gentlemen for your attention. It has been my pleasure to address you this evening.

Thank you very much.