Report Of The 40th Annual Conference Of The British Islands And Mediterranean Region Of The Commonwealth Parliamentary Association Guernsey 15th-18th June 2009

Delegates: **Richard Willmott**
William Walden

Secretary: **Sarah Kelly**

The topic of this year's conference was the international economic downturn, its impacts and the responsibilities of parliamentarians. The main goals of the conference were to focus on the responsibilities of parliamentarians, share expertise in financial regulation, governance and investment to consider a joint and effective global response to the crisis.

The conference was opened by Sir Fabian Malbon, the Lieutenant-Governor who welcomed all delegates, 65, including observers from Canada, India and the Caribbean. Sir Geoffrey Rowland, the Bailiff, gave a talk on the evolution of Guernsey's constitution and it's constitutional relationship with the United Kingdom and the European Union.

To help us understand the full extent and causes of the crisis, we were treated to some very interesting and enlightening speeches from some eminent members of the political, business and financial world.

The keynote speech was delivered by the Rt Hon. John Redwood, MP. He gave a general overview of the credit crunch. The main reasons for the crisis were, in his view, the Monetary Policy Committees poor conduct of the monetary policy: the independence of the Bank of England, the boom and bust culture, the expansion of banks and shadow banks with the knowledge of the regulators.

This led to a vicious cycle: weakened banks with quantities of bad mortgage and corporate debt, plunging output and incomes so that as people lose jobs they default on their mortgages and therefore the banks have no income to cover their large debts.

The UK and US Governments were slow to deal with the problem and when they did, it was more crisis management than any long term solution. For example, putting more share capital into the banks gives the banks no incentive to fix the problem themselves. They delay making the painful decisions and necessary adjustments themselves. They continue to work in the same way but with Government money. It would be more helpful if Governments told banks to cut their costs and reduce their risks.

He further suggested that the world economy needs rebalancing. China, Japan and Germany are saving and exporting too much. They need to be encouraged to spend their money on imports to redress the balance.

Finally, he suggested that regulatory regimes need to be more flexible: tighter regulation when the money policy is too easy, relaxed regulation when it is tight. The Government should ensure fit and proper people run the regulatory institutions.

He likened the crisis to a drinks party. You could attend a drinks party and drink good wine, and quite a lot of it, with very little after effect. However, if you attend a drinks party and drink bad wine to excess, the hangover the next morning is far worse. Equate this to good debt and bad debt.

In conclusion, he suggested that you cannot solve the problem of over-borrowing by borrowing more. You cannot solve the problem of too many bad debts by transferring them to the Government. Governments should avoid saddling tax payers with too much bad, doubtful and expensive debt. Spending and borrowing more in the public sector is not necessarily reflationary, it may cut private activity by depressing confidence and taking private money away as tax revenue and savings.

The next speaker was Pofessor Robert Van Order, former chief economist with Freddie Mac and lecturer at the University of Aberdeen and George Washington University. He examined the causes of the mortgage crisis in the US as well as the origins and characteristics of the shadow banking system. This system operated without much regulation and produced some of the toxic assets which caused the banks to fail. This system was allowed to grow and exist outside the normal regulatory framework.

The origin of the credit crunch in the US was a bubble in the house prices beginning around 2003. This led to excessive production of new houses and this led to a bust beginning in 2006. This in turn led to a default in mortgage payments – especially in the sub-prime mortgage sector. This affects the willingness of banks to lend money to those involved in the mortgage markets.

Interestingly, as far as the US is concerned, the defaults occurred mostly in the 'sand states', eg, California, Arizona, Nevada and Florida. The sub-prime mortgage market was larger in these states. The Government were encouraging low income lending and therefore increasing the sub-prime mortgage market. The institutions themselves were borrowing to sustain this market and therefore when the bubble burst it was unclear which institution had what debt. This could be seen as a regulatory failure to stop this 'credit default swap' system.

Tom Burns, Senior Lecturer in Law at the University of Aberdeen outlined the shadow banking system and its effect on this current crisis. He believes an important contributory factor in this crisis has been the complexity and opacity of the shadow banking system.

This is essentially a private law system that was left to its own devices and therefore began to under price its credit risk. It was privately regulated and was in such a poor condition that it could not withstand a liquidity crisis.

Shadow banking is effectively converting cash flows from underlying assets or debts into a smooth repayment stream thus enabling the owner of the assets or debts to raise asset-backed finance through a loan or an issue of debt securities which is limited recourse in nature to the credit of the assets or debts, rather than that of the owner as a whole. Some of the main players in this system are the investment banks, hedge funds and money market funds.

The regulators did not pick up on this market because there were 'out of sight'. They used off-shore tax havens and finance centres and they were sophisticated market

participants who could look after themselves. However, there is now a call for more transparency and regulation in this market place.

The conference then examined the impact on the current crisis on the developing world in a speeches provided by Dr Dirk Willem te Velde of the Overseas Development Institute (ODI) and Hon.Speaker Delroy Chuck, MP, Speaker of the House of Representatives in Jamaica. The ODI has been monitoring the effect of the global financial crisis on the developing countries. Many developing countries have found that foreign direct investment has decreased or suspended altogether.

Developing countries also experience trade value issues. The less developed countries are more competitive in their exports, selling cheaper garments, and this puts the better developed countries in a higher niche and hence more vulnerable.

This produces job losses, eg, Cambodia has already lost 51,000 garment jobs (around 15% of garment workers). This in turn produces more poverty. The developed world is then asked for more aid and a cycle emerges.

Delroy Chuck gave an account of the Jamaican experience in the light of this concept and how the reliance on one export, bananas, has proved a challenge in this climate.

Dealing with the Government response to the crisis, Professor Patrick Minford, former adviser to Margaret Thatcher, outlined current frameworks for financial and political cooperation and the capacity to mitigate the effects of the present recession. Different countries have adopted different methods of dealing with the crisis, even though it has a similar global effect. In his view, Europe failed to co-ordinate a response quickly enough. It acted only after individual members has acted.

Again, regulation, or lack of it, was the key to the problem. Regulations were in place but they were largely ignored by the regulators and the various governments.

Having listened to the political view, we were given the business perspective by Jon Moulton, CEO and Founder of Alchemy Partners, the private equity firm. He said that the trigger of the current climate was quite simple. In good economies there arose a new wall of structured debt instruments providing cheap debt in great volume. People got very rich finding assets to take advantage of this financing. When the good assets ran out, people acquired worse and worse assets at higher and higher prices. The integrity of this system declined, the complexity increased and this caused a boom. Eventually, the poor assets could not generate enough income to pay the interest. This caused the bust.

He suggested that a lot more debt will be generated. The UK government has been borrowing more than its income for most of the last 50 years. This means government debt is rising faster than ever before. The interest payments alone may kill any growth. The current UK solutions are: higher taxes – cause recession; less spending – cause recession; inflation – cause chaos.

Mr Michael Fallon, MP, Vice-Chair of the Treasury Select Committee of the House of Commons, spoke of the cross party approach to tackling the problems facing the UK government. All of the advice produced by his committee was agreed unanimously by all committee members, regardless of them being in government or opposition. He said

this was an unusual situation and showed the extent of the problem and how everyone wished to see a solution as soon as possible.

Conclusion

As usual, the delegates at the conference attended workshops to discuss these topics further and give their own experiences. Following those discussions, reports were made back to conference and the following conclusions were reached.

The conference recognised the need for Commonwealth Legislatures to determine principles and priorities to hold their respective executives to account on the challenges of determining new rules for financial frameworks. The Parliamentarians at the conference wish to invite their Executives to:

- Base future policy decisions at correcting and avoiding the root causes of the crisis – such as the lack of financial regulation in key areas;
- Act appropriately by refraining from undermining the need for competition with protectionism;
- Re-establish inter-bank lending and investor confidence with assistance to public and private sector banks to purge balance sheets and improve corporate management strategies;
- Reduce public spending whilst recognising the need to sustain public investment in infrastructure, including promotion of local tourism and green technology;
- Increase the amount of international development aid, monitor its effectiveness and maintain strong commitments to the Millennium Development Goals;
- Establish new programmes of social assistance for the weakest members of society;
- Urge the G20 to take into account the needs of small nations;
- Recognise the need to provide financial education to both investors and consumers with the aim of restoring confidence in government action and the financial industry;
- Consider a framework for the Commonwealth to monitor the impact of the crisis in developing and partner countries;
- Encourage the Commonwealth to use its significant international influence to facilitate finance and development strategies for developing and partner countries.

Overall, the Conference was very interesting and gave an insight into the current global financial situation from different angles. From the public and private sectors, from developed and developing countries. From Alderney's perspective, it made us realise that we are not immune due to our location or our size. We must ourselves, and urge Guernsey, to follow the guidance given by the conference to ensure that the effect on Alderney is kept to a minimum.

We thank our Guernsey colleagues for hosting this event and for providing some very high calibre speakers.