

**A RISK MANAGEMENT APPROACH TO  
CLIMATE CHANGE  
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**Topic: *How Caribbean Businesses Manage Risk***

This conference comes some seven years and two hundred and twenty two days after the Global Conference on the Sustainable Development of Small Island Developing States held here in Barbados from 26<sup>th</sup> April to 6<sup>th</sup> May 1994. The Summit was billed as a programme of action for Small Island States and was seen as the first test of the global partnership by which rich and poor countries agreed to work together for sustainable development.

It is indeed instructive that **The *Declaration of Barbados***, the final communiqué of the Conference, made reference to a number of characteristics which are distinctively applicable to the Caribbean region.

- (1) *“Small island developing states are particularly vulnerable to natural as well as environmental disasters and have a limited capacity to respond to and recover from such disasters.”*
- (2) *“While small island developing states are among those who contribute least to global climate change and sea level rise, they are among those that would suffer most from the adverse effects of such phenomena and could in some cases become uninhabitable. Therefore, they are among those particularly vulnerable states that need assistance under the United Nations Framework Convention on Climate Change, including adaptation measures and mitigation efforts.”*

The ordinary dictionary meaning of risk dwells on a chance or possibility of danger, loss, injury or other adverse consequences, whereas from a business and banking perspective, risk means exposure to uncertainty of outcome with the possibility of experiencing loss. As individuals, corporate citizens or nation States, we are encompassed by risk. No business enterprise can attain success without engaging in risk and the business of banking is generally characterised by the manner in which it supports and responds to the financial risks of its environment. In some instances, banks fall victims to their own risk exposure with dire economic consequences. One calls to mind the 1987 Merrill Lynch lost of US \$377 Million

while trading mortgage – back securities; also the 1989 Midland Bank lost, reportedly in the region of US \$174 Million, resulting from a wrong guesstimate on interest rate movements stands out like a beacon of caution.

In 1992 Barclays Bank made provisions of US \$3.8 Billion for bad and doubtful debts and in the process created history by recording the bank's first operating loss. The year 1995 witnessed the virtual collapse of the prestigious Barings Bank with losses of US \$1.3 Billion on a speculative proprietary position; one year later, in the interest of economic stability, a number of Japan's major banking institutions wrote off US \$54.7 Billion of bad debts which were accumulated in the halcyon days of the Japanese economy. These are just a few examples which serve to illustrate that risk management is more a victim of hindsight than a victor of foresight.

In the Caribbean, challenges of globalisation and trade liberalisation will accelerate the process of economic integration. With a combined population in the vicinity of 6.5 million, the Caribbean region, because of their relative openness and concentration on a small range of products, is characterised as being particularly vulnerable to external changes in terms of trade (e.g. the WTO ruling on

preferential prices by European Union for bananas) and occasional natural disasters.

The effects of unpredictable natural disasters carry a contingent risk which can possibly be compensated by external insurance but one has to consider that this form of hedging merely transfers the risk to another entity i.e. the insurance company. However, no amount of insurance can fully compensate for the loss of human lives and the economic damage that can result from natural disasters.

Furthermore the frequency of disasters in the region, have impacted negatively on insurance itself with an increase both in insurance premiums and in deductibles. A Year 2000 report, *Developments and Challenges in the Caribbean Region* by the International Monetary Fund (IMF) chronicles some recent major disasters with an indication of their impact: -

- In Jamaica, Hurricane Gilbert (1988) left over 200,000 homeless and damaged over 95% of all health sector facilities. Total losses exceeded 65 percent of annual GDP.
- Hurricane Hugo (1989) resulted in damages to Montserrat in excess of 200 percent of GDP.

- Flooding and landslides associated with tropical storm Debbie (1994) caused damages corresponding to 18 percent of GDP in St. Lucia.
- Hurricanes Luis and Marilyn (1995) affected a number of countries in the region. Losses totalled 65 percent of GDP in Antigua. These storms also destroyed nearly the entire banana crop in Dominica and a substantial portion of it in St. Lucia.
- Hurricane Georges (1998) destroyed 85 percent of the housing stock and 50 percent of the sugar harvest in St. Kitts and Nevis, as well as causing extensive damage to health, education, and tourism facilities; it damaged 15 percent of the livestock sector in Antigua and Barbuda.
- Hurricane Lenny (1999) put 65 percent of the island of Barbuda under water and destroyed 95 percent of its agricultural crops; it led to the closure of the major hotel and employer in Nevis, and severely damaged urban areas in St. Kitts.
- Losses from individual landslides have been smaller, but their collective impact has been substantial. Volcanoes have caused extensive damage to agricultural areas in several countries, including St. Vincent and the Grenadines, Martinique, and Montserrat.

The foregoing experiences provide empirical evidence that besides the fundamental criteria of risk assessment, i.e. market risk, credit risk, liquidity risk, operational risk, business risk and legal risk, we in the Caribbean must also factor in the risk of climate change both in project analysis as well as national economic strategy.

The IMF report goes on to state that natural disasters have had particularly damaging effects on the agricultural and tourism sectors in the Caribbean region through the destruction of crops and infrastructure (commercial and residential buildings). In light of this, Caribbean countries have developed some regional initiatives in the areas of prevention and coordination of disaster management, and with World Bank assistance, are providing schemes for improving risk-sharing for catastrophe losses involving market arrangements to handle disaster risks for public and private sector assets and infrastructure.

The management of risk associated with climate change is far from being of a regional dimension – it is world-wide. At an unprecedented special session of the United Nations General Assembly in October 1999 representatives of small states laid claim for greater efforts to combat climate change, rising seas and globalisation. The UN assembly was reminded that while the 1992 Earth Summit

in Rio put the plight of small island States on the international agenda, the ‘action plan’ agreed at the 1994 Barbados Earth Summit has not been implemented.

Besides the impact of natural disasters such as hurricanes, torrential rains, earthquakes, volcanic eruptions and land slides, the smallest states are about to lose trade concessions that have sustained their largely agricultural economies. For example WTO rulings to cut preferences especially in the European Unions’ relation with former African Caribbean and Pacific colonies.

With economies that are based largely on agriculture and tourism, the Caribbean is particularly vulnerable to climate change and therefore, as a buffer against external shocks, would have to harness itself on enhancing external competitiveness and promote diversification of exports. Furthermore, specific design and building codes have been tabled to upgrade construction that will weather the storm of natural disasters, especially hurricanes and floods. In terms of financial propriety, the region as a whole has to insulate itself against the rapid development of both formal and informal non-bank institutions, as any major loss in financial confidence can have more lasting and devastating effects than hurricanes themselves. In the midst of these varying complexities, managing risk in the Caribbean is by no means a comforting charge.

In fact, the 1994 Summit while acknowledging the present and potential plight of small States was deliberate in including in its **Barbados Declaration** a message of restraint. An article in the Declaration stated “ *Small island developing states are limited in size, have vulnerable economies and are dependent both upon narrow resource bases and on international trade, without the means of influencing the terms of that trade*”.

These concerns are probably best encapsulated in the remarks of Ambassador Penelope Wensley of Australia who chaired the negotiations of the 1994 Barbados conference. Ambassador Wensley stated, “**The Barbados Agreement** *underscores the commitment of the international community to the small islands. Absence of immediate financing should not detract from what has been achieved. This Conference has put small islands – their concerns and interests – on the global map.*” I hope that this demure presentation has done a similar thing for the Caribbean region.