

## Julian W Francis: The Bahamas economy - critical strategic issues

Remarks by Mr Julian W Francis, Governor of the Central Bank of The Bahamas, at the 13th Annual Bahamas Business Outlook, Nassau, 20 January 2004.

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An attempt to form a view on the short-to-medium term Business Outlook must necessarily seek to identify the principal challenges facing us and assess our readiness to confront them.

What then are the challenges?

These are not new; for years there has been general agreement on the list; what is changing is how the Bahamas economy is being shaped and affected over time by these challenges, especially in those areas where we have not been able to implement appropriate policy to address and cope with these external forces.

The Bahamas has generally been able to hold its own and to perform well in the two major economic components of its economy: tourism and financial services. This ability to compete in these two industries can be explained largely by the related comparative advantage held by our country, vis-à-vis those who in fact **can** compete against us in those industries, given mainly geographic considerations. But, it is the result, also, of a long-standing significant openness in the broad policies governing the operation of those activities in this environment; there is virtually no restriction on investments by credible and acceptable parties in either sector - with the exception of the domestic retail banking sector where, for a long time, some level of restriction on entry has applied.

With respect to the labor policy applicable to these two major sectors, it has generally facilitated the management and technical - including infrastructural development - needs of these sectors and, I believe, would be considered by those operating in the sectors as reasonably flexible.

- The Bahamas government has consistently sought to provide necessary fiscal and administrative support to these sectors; the Hotel Encouragement Act, for example, and the incentives which it provides, has been critically important in attracting many hotel projects to the Bahamas. In financial services, we need consider only the recent establishment of a Government ministry to focus on issues related to that sector to have clear evidence of Government's commitment to support this industry.

The policy of openness, and determination to be competitive in these two industries, its no doubt the result of the realization that despite the comparative advantage enjoyed in each instance, because these are global industries which cannot be easily controlled by individual countries acting alone, and this is especially true of the smaller countries such as The Bahamas, one has to play by the rules of the broader global environment or not play at all. Indeed this is the reality which has been lost, recently, on many who still pine for the old days of financial services; they do not fully understand, or agree, that The Bahamas, alone, cannot cause this industry to behave as we might wish.

A most interesting, even intriguing, paradox is that while the Bahamas has thrived and built its successful economy largely through the embrace of these two global industries, which have demanded and have largely received exemption from a more closed, inward-looking investment policy generally, a large segment of our economy has not been spared the reflex of protectionism and administrative control, which in many instances probably should have been left behind when we closed the doors on the decade of the sixties. To fully reinforce this point, let me ask you to consider for only a second what the respective size and economic contribution of our tourism and financial services sectors would be, had these been restricted to a Bahamian-only- policy.

It is probably not an exaggeration to assume that they would be considerably smaller, far more costly in their operation, and would consequently speak for only a fraction of the contribution the actual industries make to our economy.

I think its important to point-out, that I do not wish to suggest an inherent inefficiency in domestic business, although this is often the experience, but rather to point to: (a) the resource availability advantage of a non-restrictive policy, and (b) the fact that in an open economic environment, domestic resources are, like those from abroad, forced to be efficient, competitive participants, or they will dissipate, not benefiting from the protection of public policy. The domestic economy, and whatever

opportunity there may be for the economy to develop, will benefit from the significantly higher levels of resources available and competitive efficiencies.

Some of the principal areas of administrative economic control include:

- **The Exchange Control Policy;**
- **The Investment Policy**, which restricts entry by non-Bahamians into certain areas of the economy;
- **The Public sector official virtual monopoly over provisions of electrically and telecommunications services;**
- **The monopoly over provisions of legal services**, held by the Bahamas Bar Association; and
- **The Immigration Policy**, which appears to be premised on the principle that work permits should be available only for positions which cannot be filled by Bahamians.

While I don't propose to examine each of these in great detail, I feel a few comments could be useful:

**Exchange Controls:** the need for these is, of course, rooted in the country's decision, almost forty years ago, to adopt its own currency at values which have always been fixed and not permitted to float on the currency markets. Had the decision been taken at the beginning or early on to adopt the U.S. Dollar (for example) as the currency, or to allow the B. Dollar to float, exchange controls would not have been necessary.

I would argue that we are too far down the path of having pursued the fixed exchange rate arrangement to make a sudden complete reversal. It is therefore, in my view, necessary to pursue the measured liberalization path which has been followed for more than ten years now, the ultimate objective being complete removal of controls in the future. I have said on a number of occasions before, and sincerely believe, that The Bahamas will at some point during the next ten or so years decide to become a member of a larger currency arrangement.

The main implication of such a step would be the loss of the Government's ability to borrow from the Central Bank. The most important theoretical benefit to the economy of the eventual removal of exchange controls is the removal on restrictions to the movement of capital.

I believe that The Bahamas would be a considerable **beneficiary** of such a development when it eventually is possible, but wish to emphasize that it would probably not be possible in the very short term.

**Investments:** National security, environmental, and reputational concerns dictate that there should be some level of approval with respect to proposed investments into the economy. However, I am not certain that the strict reservation of certain activities for Bahamians can be maintained if our economy is to achieve the level of competitiveness needed in the current and developing environment. The policy requires review in the context of what is happening around us.

**Public Utilities:** unless we move quickly to commercialize the benefit of the diminishing monopoly, we will completely lose the stock of value developed in the national telephone company over the years. As in the tourism and financial services industries, and numerous others, telecommunications has become one of those industries which is driven by global forces. In the same way that communist China found that they could not control it, and particularly its internet applications, The Bahamas needs to embrace international telecommunications industry fully, and allow business and the community generally to realize the tremendous benefits it provides. I realize that there is an understanding of this reality at the policy-making level, but as in other domains we do have to appreciate that developments will not wait for us.

Equally, in the provisions of electric power to our economy, particularly in the more developed centers of The Bahamas, we should not be driven by protectionism, but should seek to offer to the Bahamas economy the very latest and most developed technology by way of commercial arrangements which allow our consumers to enjoy terms as similar as possible to those available anywhere else.

Those who would have us believe that this has anything to do with our birthright or national pride are wrong! The best long term interest of Bahamians in a globalized environment is served by policies which embrace all opportunities available to us, and which force us to be challenged by the highest standards practiced anywhere.

**Legal Services:** there is, I think, an increasing realization that the maintenance of a strict legal monopoly in favour of members of the Bahamas Bar, certainly as it affects the delivery of international financial services, is highly counter-productive. The best that one can say for this anachronism is that it fails to appreciate to what extent legal services have become synonymous with this industry; some feel that like some of our labour union leaders, legal practitioners who refuse to contemplate any compromise in this regard are simply pursuing naked self interest. If the policy-makers refuse to take on the Bar in a meaningful way on this issue, this is a matter which should be put to the Bahamian people to decide. It is simply too important to the future of a potentially more vibrant and dynamic financial services industry to leave it as it currently stands.

**Immigration:** There is a view that there needs to be a separation of border protection from immigration issues related to the development of those business sectors which The Bahamas most favour if our economy is to compete globally. While, as I suggested earlier, Tourism and Financial Services have probably not been significantly disadvantaged in this regard, especially during the last ten to fifteen years or so, there is room for considerable reform in this area, to provide the flexibility and efficiency which business should enjoy. The Bahamas needs to overcome the underlying unwillingness to accept the meaningful and equal participation in our economy by persons from elsewhere. This, I admit, will probably change more quickly, when more Bahamians, themselves, venture to invest and pursue business beyond our borders. Again, though, if we have to wait for this type of "organic" acceptance to occur before we can reform the way our economy works, we risk missing-out on the positioning phase of this new global economic order. We should consider most carefully if we are to take such a risk.

With regard to labor issues more generally, our country is clearly faced with a crisis of unreasonableness in the expectations which labor has been made to understand it should have vis-à-vis what the economy can and should, given competitive realities, afford to labor.

This, I think, is one of the largest issues challenging the orderly development of the Bahamians economy.

The time, I think, has come for tow things in particular to happen:

- (1) There needs to be careful reflections on the operation of labor unions, to ensue the they do not continue to capriciously hold the economy at ransom; and,
- (2) The institutionalization of a meaningful forum for dialogue between labor, industry and government, as employer, needs to be pursued, to -
  - a) develop a better appreciation by labor of its appropriate place in the economy, and
  - b) provide for a long-term stable framework within which orderly negotiation and determination of labor contracts, and other issues of importance between these groupings, could be pursued.

I would argue that the influence of labor leaders - as distinct from the union membership - is currently far in excess of what it should be given what they represent in the entire process. One can wonder whether they have not been allowed to direct the administration of labor far too much in their individual interest.

Is The Bahamas ready for these types of reform? Certainly not for the most part.

There is a pervasive Bahamian desire to resist change and to assume that our country can continue to enjoy the fruits of our traditional good fortune without any particular effort on our part.

Of course this is a badly mistaken view which in any event does not seem to recognize that we ourselves demand an ever increasing improved standard and quality of life.

Unless we are willing to embrace these types of reforms in the way we pursue development, the improvements which we have known for three half decades of development will become increasingly difficult to realize.

A development vision for The Bahamas over the next decade must be based on the principle of openness.