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Feature Articles

Creating the
Correct Environment for
Private Investment

by Gregory H. Bethel

Restructuring the
Bahamian Economy
for the 21st Century

by Alvin Rabushka

The **Institute for Economic Freedom** is an independent non-political non-profit Bahamian institute that promotes economic growth, employment and entrepreneurial activity. It believes that this can best be achieved with a free market economy and a decent society...one that embraces the rule of law, the right of private property, the free exchange of property and services and the individual virtues of self-control, commitment and good will.

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Vol. 2/No. 2. The Bahamas, Freedom and Growth and The Hong Kong Story

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INTRODUCTION

As it has over the past five years Earnst & Young, the accounting firm, sponsored a one-day seminar in January on the Business Outlook for The Bahamas. Particularly noteworthy this year was the candor of the speakers and the clarity of the dialogue during the ensuing question and answer periods.

The Institute selected two of the many fine speeches for for inclusion in this issue. The first is by Mr. Gregory H. Bethel, the Managing Director of Credit Suisse Bahamas, and the second is by Dr. Alvin Rabushka, a Senior Fellow at the Hoover Institution, Stanford University. Dr. Rabushka was the author of "The Hong Kong Story" that was published in the second issue of *The Review* in 1996.

It is our hope that the ideas expressed by the authors will receive the attention that they deserve by all the participants in the 1997 election.

Creating the Correct Environment

For Private Investment

by

Gregory H. Bethel

The Challenge - 3,000 new private industry jobs each year.

In The Bahamas, our challenge is to create jobs for 3,000 persons each year through economic growth within the framework of a fiercely competitive global economy. We must understand that the countries with whom we compete have the same mission...job creation and economic growth. We must also understand that private investment by private individuals, partnerships and companies is the creator of jobs and economic growth. Our politicians and bureaucrats should of course stay far away from operating businesses but they have a crucial role to play in that they are the principal creators of the correct environment for private investment.

With this in mind, we need to -

Create and sustain an environment which would cause Bahamians to invest more of their own resources in job-creating enterprises and attract "quality" non-Bahamians to invest their resources in our country rather than in their own countries or in one of our competitors.

I need not remind you that -

Excessive taxation, government red tape and excessive regulation as well as high labour and other operating expenses drive investors overseas. We must be sensitive to this fact and take advantage of these situations that plague North America

and Western Europe. Indeed, we need to ensure they do not become a plague in The Bahamas.

*How we got here - the
1950's and 1960's.*

In fact, I'm sure you all know the story of how the Banking and Financial Services providers came to The Bahamas in the 1950's and

1960's as inflation, excessive taxes, cumbersome regulations, high labour and other operating expenses in Western Europe and North America caused many multinational companies and other sophisticated investors to look for a "friendlier" environment in which to conduct their business.

We were smart, felt their pain, and created an investor-friendly environment of non-taxation and banking confidentiality to go along with our sand, sea, sunshine, casinos, great food, friendly people and other tropical delights.

*The 1970's and the Dark
Age of the 1980's.*

Unfortunately, some dishonest fund promoters, money launderers, inside traders and other non-desirables took

advantage of this friendly environment in the 1970's and 1980's, created some problems for us, and we suffered a major setback in the late 1980's.

*The good news of the
1990's.*

Nowadays, however, the news is good. Although we are no longer a major booking centre for the deposit and lending business, the

offshore financial services industry is dominated by institutions or firms offering services either directly or indirectly to the worlds' wealthy, commonly referred to as High Net Worth Individuals. These services include:

- Private banking that includes asset management, investment advice and custody or administration of financial wealth

- . Estate planning and trust services that are aimed at asset protection and the orderly distribution of wealth to one's heirs or friends or charities
- . The administration and management of mutual funds and pension funds
- . Accounting and legal services

From my vantage point, the industry is experiencing growth and business is good. The dark age of the 1980's hopefully is behind us.

The primary reason for all this good news, optimism and growth is found in the deliberate actions taken by the government...with the support and assistance of the private sector...to create the correct environment for private investments. These actions were as follows:

1. The efforts of The Bahamas Government and the financial community jointly working together to promote The Bahamas and to attract and nurture business from abroad whilst at the same time making The Bahamas an easier and more investor-friendly place to transact business.
2. We continue to develop superior legislation to support financial activities and the protection of an individual's private interests which discourages criminal activity. We are the first financial offshore jurisdiction to criminalise money-laundering.
3. Adequate telecommunications are in place to facilitate access to major markets, financial and business centers including telex, direct dial telephone, the SWIFT interbank system, telefax links and the major courier services.

Presently, a major fibre optic cable connection is being installed between The Bahamas and Florida in a joint venture undertaking by BaTelCo and AT&T. I'll have more to say about BaTelCo later on in my presentation.

4. The continued absence of taxes and exchange controls for non-residents which facilitates freedom in the transfer of assets to and from The Bahamas.
5. An improving economic environment due to the influx of foreign investment with a stable currency, adequate reserves and a fiscal policy objective of balanced budgets.
6. Banking secrecy that ensures privacy and confidentiality provided assets are not derived from actions or activities that are illegal in both The Bahamas and the home country of the client.
7. Availability of land for development and good and improving infrastructure, accommodations and ultramodern office space.
8. An abundance of investment incentive programs and tax concessions for the benefit of businesses and individuals administered by The Bahamas Investment Authority, The Office of the Prime Minister, The Ministry of Finance, The Central Bank and other government agencies.

When considering the correct environment for investment I cannot overemphasize that a targeted, consistent and well structured marketing effort is important. As far as past marketing efforts are concerned, we will reap benefits from various promotional efforts in Europe, South America and Canada. The Europeans are somewhat uncertain and timid about the regulations in the European Community (EU) and are seeking comfort by investing offshore on the other side of the Atlantic Ocean. Financial institutions operating in Luxembourg or even Guernsey or Jersey may need to look elsewhere for a "more friendly" environment to operate, particularly a jurisdiction offering banking secrecy, no taxes and monetary certainties but far away from the EU. The South Americans look for sophistication and sound institutions without the yoke of excessive regulation and government bureaucracy. The Asians with Canadian citizenship look for a "refuge" for their non-Canadian earnings until they figure out what

China will do with Hong Kong and Taiwan. Imagine the investments to be generated once the Financial Services Promotion Board and Investment Ambassador begin to "do their thing."

*The key ingredients to
create the correct
environment for private
investment.*

As for the future, the sky is the limit if we give Bahamian and non-Bahamian investors what they expect in support of their confidence level. There are a number of key ingredients which

must be in place to create the correct environment for private investment. I challenge any government and the people who elect them to put them all in place and then watch unemployment and poverty disappear. The ingredients are as follows:

- . political and economic stability with evidence of a continuing maturity
- . a democracy and a market-driven economy...investors say "yes" to market forces and "no" to government intervention
- . balanced budgets and low inflation
- . few (if any) currency restrictions and a friendly, fast and efficient central bank with expertise in place
- . continuing and well planned improvements in infrastructure
- . continuing and well planned improvement in public and private education which produces a well equipped pool of labour for investors to draw from
- . family planning and sensible birth rates...supported by traditional family values...which give the investor an indication of the future crime rate and quality of life in the society
- . a multi-cultural and tolerant society...without continual

negative references to the blacks vs. the whites or foreigners vs. locals

- . a national willingness to forego non-essential luxury items
- . a free capital market and stock exchange
- . reasonably priced and efficient utilities
- . an absence of corruption
- . ease of access with state of the art airports and sea ports

Do this and we will have investor confidence and the correct environment for private investment and there will be hope for 3,000 additional jobs each year and there will be quality economic growth by the year 2000 and beyond.

Things are looking up, but we better be careful and do not take things for granted like we did in the 1980's.

Six further steps needed to preserve jobs and protect gains.

We need to take steps to preserve our gains and to further protect the jobs which were not lost, but could have been lost in the last three years. Here are some ideas I

have or have borrowed from others:

1. Every financial institution must ensure that their compliance and audit departments employ quality staff who have excellent qualifications, good experience and international exposure. As business grows, so do the risks. We must preserve our image abroad and at all costs avoid the tragedy of the 1980's where slackness, corruption and greed cost us dearly.
2. Likewise, the quantity of Information Technology (IT) specialists in The Bahamas will be vital to our growth. In the future, the industry will rely more on computers and

communications and less on people. Do we see this coming? Are we preparing ourselves? With mergers and mega-mergers coming there will be fewer banks, and centralized back office operations. IT will be the engine to drive this vehicle of downsizing forward. The Bahamas must be able to facilitate the growing demand for information and communication technology equipment software and services. Look out BaTelCo. There will be increasing telecommunications traffic. There will be increased demand for mobile telephone facilities to accommodate business. There will be a demand for lines to facilitate the sale of services via the INTERNET.

3. We must invest more in training our people abroad and at home. We need to upgrade the skills of staff to insure service excellence in our banks, trust companies, hotels, businesses and the public sector especially government offices which serve investors...both Bahamian and non-Bahamian. Training should include:
 - . Apprenticeship programs involving 11th/12th grade students and College of the Bahamas students
 - . Exposure to PC's and the INTERNET in every primary school
 - . Language courses...especially Spanish, Portuguese and German
 - . Selling skills and marketing techniques
 - . International exposure for our lawyers and key government officials
 - . Trainee exchanges with the approval of work permits for expatriates to train in The Bahamas while a Bahamian colleague trains abroad
4. We need to support our officials at the Ministry of Education as

they seek to improve our education system. There have been improvements and more are on the way. There must be the planned periodic consultations between the business leaders who already have Strategic Medium Term Plans and our educators who should be influenced by these plans and the government in its role as facilitator.

5. Crime and the safety of clients, investors and colleagues from abroad is a major concern. On the subject of crime, I hope each of us present in this room is actively involved in some program or effort through a church, social club or a political party which seek to positively mentor and guide our young people. It is not enough to complain about the problem. You must be a part of the solution.
6. We need to give our regulators at The Central Bank, the Securities Board and the Registrar General's Office more private sector and international exposure. They must be effective and skilled guardians and watchdogs of the offshore and onshore financial services industry. Again, image preservation is of vital importance.

Ladies and gentlemen, I've said enough. What we have to do is clear.

It's now up to FNM's and PLP's, black, white, red and brown Bahamians to avoid the temptation to focus on short-term self interests and to commit to the long term national interest of *Creating The Correct Environment for Private Investments.*

Restructuring the
Bahamian Economy
for the 21st Century

by

Alvin Rabushka

Since January 1995, I have enjoyed the opportunity to serve as an economic adviser to the Securities Market Task Force, which consists of an exceptional group of professionals chaired by Larry Gibson, that shares a common vision of a successful international and domestic securities exchange in The Bahamas. During the course of my research, I have met with more than a hundred distinguished Bahamians from all walks of economic, political, and social life, many of whom are in attendance at today's seminar. I want to take this moment to thank all those Bahamians who took the time to share with me their insights, experience, and knowledge about the Bahamian economy. My views on the problems and prospects of the Bahamian economy as it approaches the 21st century rest, in part, on the education they provided me.

The Bahamas must adapt to the realities of the global market place.

The Bahamian economy is dependent on two sectors, tourism and financial services, both of which earn their living in foreign currencies. Although The Bahamas

is an independent country, its people depend for their livelihood on the sale of services to foreigners. The proceeds of foreign currency earnings provide the means to import goods and services not produced in The Bahamas. This is the fundamental economic reality of the islands.

In both sectors, 1996 was a very good year and 1997 promises to be even better. Nonetheless, The Bahamas remains overly dependent on two sectors. If either turns down in a significant way, the current prosperity and future prospects of The Bahamas will be put at risk.

Restructuring the Bahamian economy for the 21st century means finding new sources of income and employment. This objective has always been a goal of Bahamian policy, but has yet to be realized. The technological progress affecting 21st century economic life means that the government and the people of The Bahamas must adapt to the realities of the global market place. Like it or not, The Bahamas will have to take all necessary steps to insure that the islands remain a user-friendly place to tourists and businessmen alike. The islands face tough competition from other tourist destinations and offshore centers, which means that The Bahamas will have to work hard just to stay even. Staying even and getting ahead require exploring some fundamental changes in economic policy, which is the subject of my talk.

The Historical Legacy

I want to focus on two important institutions of the Bahamian economy, the public finances and the monetary system, and the interaction between them. To understand the current situation, it is necessary to set the historical backdrop.

The Colonial Legacy - First, the public finances. All British colonies, including The Bahamas, were subject to the colonial regulations, which included a section on the conduct of the public Finances. The underlying principle of the regulations was that colonies should never subject the United Kingdom Treasury to any charges: self-support was the guiding principle. The Colonial Office had to approve the annual budget estimates, and could disallow proposed items of expenditure (though it rarely did so). In short, colonies were expected to balance their budgets.

When The Bahamas proclaimed its independence in 1973, the country was virtually free from public debt.

Second, the monetary system. Currency boards were the monetary arrangement of choice in most British colonies, and the Bahamas was no exception. A currency board is a monetary system that maintains a fixed exchange rate and full convertibility between domestic notes and coins and some reserve currency. A currency board achieves its purpose by holding 100 percent external reserves against the domestic note issue.

A currency board does not have discretionary control over the domestic money supply. Under the currency board monetary system, surpluses or deficits in the balance of payments, in the current and capital accounts, translate into increases or decreases in the domestic money supply. This arrangement is similar to the classical gold standard, balance-of-payments monetary system.

It is important to understand what a currency board cannot do.

It cannot create inflation because it does not control the ultimate reserves of the monetary system. It may transmit inflation from the reserve country, but cannot create inflation because it cannot independently increase its monetary base.

A currency board cannot finance spending by the domestic government or domestic state enterprises because it is not allowed to lend to them. A typical currency board is not a lender of last resort. It does not lend to commercial banks or to other enterprises to help them avoid bankruptcy.

*The Independence Legacy -
a Central Bank and the
freedom to incur fiscal
deficits.*

Ambassador Timothy Baswell Donaldson, who served during the transition from the Board of Commissioners of Currency prior to 1968, to the Bahamas Monetary Authority and in 1968, to the

Central Bank of the Bahamas in 1974 can fill you in on the specific

details of the former Bahamian currency board. The important points, for the purpose of my discussion, is that the newly-established Central Bank of The Bahamas was empowered to buy government debt and also serve as lender of last resort to the commercial banks, which effectively enables them to buy government debt without risk.

During the currency board era, no control was placed on foreign exchange transactions inside the sterling block, until the United Kingdom disbanded the block when it floated sterling in July 1972. After that date, sterling also became a foreign currency in The Bahamas. At that moment, the Bahamas Monetary Authority and then its successor, the Central Bank, assumed responsibility for exchange control between the Bahamian dollar and foreign currencies.

The newly independent Bahamas could have reestablished a currency board monetary system, using U.S. dollars as its reserve currency. It did not. Instead, the government established a Central Bank. This act, which was common to almost all newly-independent nations, set The Bahamas in a new fiscal direction.

The advent of internal self-rule and the establishment of the Central Bank in place of the former currency board eliminated the balanced-budget requirement embedded in the colonial regulations and permitted the Bahamian government to sell public debt to the Central Bank. The government also sold public debt to the commercial banks, which is indirectly guaranteed by the Central Bank. Later, the National Insurance Board was established. Financed by a payroll tax, it, too, bought government debt, which today constitutes almost all of its assets (although these assets are government liabilities collateralized only by the power to tax).

To summarize, independence brought fundamental institutional change to the conduct of government business: The Bahamian Government was now free to spend beyond its means, and make up the difference through public borrowing.

To be fair, the newly-independent Bahamas faced a backlog of unmet social needs, ranging from, education to housing, health care, and

infrastructure. It would have been politically difficult, if not impossible, to ask Bahamians to wait a generation for an expansion in these public programs.

The Current Situation

The Post Independence Legacy - massive B\$ debt and exchange controls.

Let me now turn to the present day. The future development of The Bahamas is threatened with two realities that have unfolded since 1973.

The first is the accumulation of a massive public debt that continues to rise year in and year out.

The second, related to the first, is the existence of an exchange control regime that puts The Bahamas at a competitive disadvantage with such rivals as Bermuda, the Cayman Islands, the Channel Islands, Cyprus, and others. The existence of exchange control, which will remain in place for some time as I will explain shortly, may be an impediment to the full development potential of the soon to be established Bahamas Stock Exchange, which constitutes an important addition to the islands' offshore sector.

With regard to its public finances the Bahamas can pride itself on being a "low-tax" country. Nonetheless, the public finances have undergone steady deterioration during the past two decades in two respects.

The relative size of the public sector, that is, all expenditures financed from public funds, has increased from less than 15 percent of the gross domestic product (GDP) to just over 20 percent of GDP.

In addition, the public debt of the country has steadily increased. The balanced-budget norm inherited from the colonial era eroded in marked fashion in the 1980's, as the

government incurred deficits on recurrent expenditure in 1983, 1984, 1985, 1988, 1990, and every year during the 1990's. When capital outlays, which are a more important source of recent public debt, are added in, the deficits take on an even larger dimension.

During the 1980's, which enjoyed three surplus years, total deficits on recurrent expenditure amounted to \$185 million. The total deficit for 1991, including capital outlays, was about \$114 million; in 1992, \$80 million; in 1993, about \$87 million. The changeover in the fiscal year witnessed a deficit of \$49 million in 1993/94, \$23.5 million in 1994/95, an estimated \$84.2 million in 1995/96, and an estimated \$99.1 million for 1996/97. By the middle of 1996, total national debt amounted to \$1.2 billion, with additional contingent liabilities for the public corporations of \$316 million, for a total national debt of \$1.52 billion. This represents about 40 percent of the GDP.

The consequence of rising debt is an increase in debt servicing, standing at an estimated \$89 million in the 1996/97 budget, or almost one-eighth of government spending. Along with wages and salaries of \$353 million, these two items eat up 58 percent of the budget.

A few words on the composition of public revenues are in order. The Bahamas is disproportionately dependent on one source of revenue, namely, import duties. Other important sources of revenue include stamp taxes, departure fees, property taxes, selective services, and motor vehicle taxes. Fines, forfeits, and administrative fees supply the majority of non-tax revenue. Income from public corporations is negligible, which means that these public enterprises are not being run on a commercial basis.

The Monetary System and Exchange Control

I now want to shift to the topics of the current monetary system and the sensitive subject of exchange control. The Bahamas is an Article VIII member of the International Monetary Fund, which requires that no restrictions be placed on current account transactions, unless the balance of payments is in jeopardy. Exchange control, however,

applies to capital account transactions (e.g., loans, equity investments, and inward and outward direct foreign investment).

The public welfare rests on the country's ability to produce US\$ earnings.

The Bahamas issues its own independent currency, the Bahamian dollar, which is set at parity with the U.S. dollar. The Central bank maintains parity by a

combination of external reserves in the form of U.S. dollars and a system of exchange control. External reserves average at least two months worth of imports. One benefit of an independent currency is that The Bahamas earns seigniorage on its note issue because it receives interest on its foreign currency holdings.

But a crucial point must be kept in mind. The issue of local currency does not mask the reality that the economy of the islands effectively rests on U.S. dollar earnings from tourism and financial services. To put this in technical language, high-powered base money in the Bahamas is not Bahamian notes and coins in circulation, but is U.S. dollar reserves of the Central Bank. Any marked decline in U.S. dollar earnings in the islands would generate a decline in the Bahamian standard of living in that Bahamians would not have as many U.S. dollars with which to pay import bills. In practical terms, a decline in U.S. dollar reserves prompts the Central Bank to advise the commercial banks to tighten credit.

The Bahamas does not have a typical central bank because discretion in monetary policy is restricted by the Bank's determination to maintain a fixed rate of exchange at parity with the U.S. dollar. The Central Bank must maintain a sufficient level of foreign reserves to meet foreign dollar liabilities on current account transactions. So long as reserves are adequate, this objective can be met in the conduct of normal business. However, any diminution in foreign reserves reduces the ability of those holding Bahamian dollars to acquire foreign currency to pay overseas bills, thereby shrinking the demand for Bahamian dollars and domestic economic activity conducted in Bahamian currency.

The entire structure of B\$ financial instruments rests on a narrow US\$ base that is also essential to pay import bills.

A description of the money supply and the composition of domestic credit is required to fully understand why the Central Bank maintains exchange control on capital account transactions.

External reserves of the Bahamas fluctuate around the \$200 million level. On this base, the country's banks have built a domestic credit structure amounting to almost \$2.6 billion as of June 1996. The ratio of M3, the most comprehensive measure of money supply, to foreign reserves is about 13:1, which is a reasonable multiplier of money supply to base money in countries with sophisticated credit structures. (In Russia, for example, the ratio just barely exceeds 2:1.)

Domestic credit consists of loans to the government, commercial bank credit, and credit granted by other local financial institutions. In June 1996, net domestic credit to the government stood at \$394 million. Of this the Central Bank provided \$98 million; commercial banks and other financial institutions, \$296 million; domestic credit to public corporations, \$86 million. Domestic credit to the private sector came to about \$2.1 billion.

The government's share, including public corporations, of domestic credit is about 18.5 percent. But this figure grossly understates the exposure of the country's credit structure to the burden of public debt. The national debt of the government consists of \$1.2 billion in direct charges and another \$316 million in contingent liabilities. The overwhelming bulk of these liabilities, all but some \$60 million, is denominated in Bahamian dollars.

The keystone of The Bahamas monetary base, some US\$200 million or so in foreign reserves, must support a total domestic money supply of about B\$2.6 billion, and also support total direct national debt of \$1.2 billion, of which only \$478 million appears in the June 1996 money supply statistics. In the absence of exchange control, any rush to convert domestic financial assets into U.S. dollars would quickly exhaust foreign reserves, unless the commercial banks raised interest

rates sharply (which would contract the economy), or undertook massive borrowing abroad from their home offices, which would be hard to justify under conditions of capital flight. For example, private pension funds in The Bahamas, which hold Bahamian-dollar denominated assets at over \$400 million, by themselves could exhaust all foreign reserves if they shifted, say, half of their portfolios from bank deposits and local equities to foreign equities and bonds. The National Insurance Board holds over \$400 million in government securities; any meaningful diversification abroad would quickly use up the reserves. Insurance companies, too, could drain the reserves by converting a portion of their several hundred million dollars of Bahamian assets into foreign assets. Market capitalization of local equities has grown to exceed \$600 million, and this money is effectively locked up in Bahamian dollars.

To repeat, the entire structure of Bahamian dollar instruments and the ultimate value of real domestic assets, rest on a precariously small foundation of U.S. dollar reserves, which are essential to pay import bills. The reserves are too small to both pay import bills and accommodate more than a modest conversion of Bahamian assets into foreign currency. This condition explains the need for capital account exchange control.

To summarize at this point, without getting into an analysis of the merits of what budget deficits were used to finance during the past fifteen years, the conversion of the Bahamas currency board into a central bank was a major contributing factor to the government's accumulation of public debt and the practice of annual deficits on a consolidated budget basis.

The Public Finances in Conflict With the Monetary System (Or, the Government Versus the Central Bank)

The government's revenue system is in conflict with its foreign exchange system.

A key problem with the revenue structure is that any decline in imports puts enormous pressure on the public finances. But there is

another reason why heavy dependence on imports is undesirable as the most important source of tax revenue and why the tax system of The Bahamas needs rethinking.

The country's revenue system is in conflict with its system of exchange control. Rising imports generate higher revenues, which are required to meet public expenditures. But rising imports also drain foreign currency. The Central Bank maintains a watchful eye on the level of foreign reserves to insure the US\$1 = B\$1 exchange rate. Thus, the possibility of higher revenues from import duties conflicts with the Central Bank's exchange-rate policy of maintaining parity. If reserves decline too far, decisions must be taken to slow imports (e.g., raise domestic interest rates). The Central Bank issued such a warning in autumn 1995 when foreign reserves declined to worrisome levels.

Thus, maintaining parity between the Bahamian and U.S. dollars may compel a reduction in imports, which consequently reduces the chief source of state revenue. There is no corresponding mechanism to compel a reduction in state expenditure. In fact, there may be pressure to increase expenditure, because falling import duties reflect a slowdown in economic activity. This is a Catch-22 situation, ending in a larger public debt.

The tension between increasing state revenues through higher imports (to balance the state budget) and protecting the parity of the Bahamian dollar by maintaining adequate reserves is manageable, and has been successfully managed over time. Nonetheless, this unique combination of import duties and exchange control acts as a brake on the free flow of goods, services, and investment capital.

Devaluation of the Bahamian dollar would not improve circumstances and would, in fact, make matters worse. It would erode the value of domestic assets, generate a sharp rise in domestic prices as imports became more expensive, and send a signal to the world that the government was not prepared to get its fiscal house in order.

We might note, at this point, the disappointing performance of the

officially recorded Bahamian economy in recent years. Between 1986 and the current fiscal year, total growth amounted to just over 13 percent—the two recession years of 1991-1992 wiped out much of the economy's performance during the twelve years in question. Indeed, population growth of about 2 percent a year means that per capita income actually fell over this period. (By way of historical comparison, it is estimated that per capita income rose at an annual rate of 6 percent during the 1960's.)

Where Does The Bahamas Go From Here to the 21st Century?

The Bahamas has been digging itself into a hole of public debt from which it should climb out. No problem of this magnitude, which has taken two decades to create, can be corrected overnight. Nor is it necessary to correct the problem overnight. What is required, however, is a clear statement of policy and the political determination to embark on a course that will position The Bahamas to participate fully in the global economy of the 21st century.

Balance the budget.

The first obvious step is to get to a balanced budget as quickly as possible. The government must not spend more than it takes in. The benefits of a balanced budget are several. It tells the rest of the world and the local business community that the government is serious about its fiscal responsibilities. It means that the burden of the national debt in terms of interest outlays will gradually decline over time as economic growth transforms the public debt into a steadily smaller share of the GDP. It also means that resources now drained from private hands will be available to individuals and enterprises for investment in the economy, rather than being used to finance public consumption.

Privatize the government corporations and pay down the public debt with the proceeds.

A collateral step is to use the proceeds of partial or complete privatization of the public corporations, in particular, the electricity and telecommunications enterprises, to pay down public

debt. In fact, I would recommend that the Parliament enact legislation stipulating this use of any funds realized from their sale. The immediate benefit would be a reduction in interest outlays. Any reduction in debt servicing costs gives room for tax reform and reduction, and frees up funds for infrastructure and other critical public requirements. The global marketplace, on line in cyberspace, would immediately notice this improvement in the public balance sheet of The Bahamas.

Rethink the tax system.

A third step is to rethink the revenue structure of The Bahamas to reduce, where possible, the innate conflict between reliance on import duties and the Central Bank's policy of maintaining parity with the U.S. dollar. There have been commissions in past years which have examined the very sensitive issue of tax reform in the "tax haven" of The Bahamas. I do not want to make any specific tax reform recommendations today, other than to suggest that a public dialogue begin on this critical subject.

Take steps to increase the foreign exchange reserves.

A fourth area of policy is for the Central bank, in conjunction with the government, to draw up ideas to increase the foreign currency reserves on which the credit structure of The Bahamas now hinges. If reserves could be doubled, say, to \$400 million, it would give the Central Bank much greater latitude in moving to a more relaxed regime of exchange control on the capital account, with an ultimate goal of possible elimination. This would help The Bahamas in its rivalry with such competitors as Bermuda and the Cayman Islands.

Attract foreign investment.

To that end, making The Bahamas attractive for inward direct foreign investment should become a top priority of the government. The Bahamas has done a good job in securing better ownership and management of its major hotels. The government has also met with success in attracting a large investment in Grand Bahama.

Foster entirely new off-shore industries.

A final recommendation is to aggressively pursue diversification, especially in the offshore sector. The Bahamas can

learn from other offshore centers that have gone beyond financial services to develop such activities as architecture, management consulting, construction, research and development, high-tech data processing, health care delivery, and manufacturing, to name a few. Much of the required infrastructure is already in place in Freeport. Success in this effort may involve confronting some taboos in Bahamian politics, but the 21st century is just three years away and time is fleeting.

Conclusion

I want to conclude on an upbeat note. I don't want to leave this audience and the Bahamian people with any sense of despair. Rather, I believe that -

a few key changes in economic policy can lay a foundation of renewed growth and optimism.

If The Bahamas can double its rate of economic growth, from an annual average of 2 to 4 percent - which I believe is possible -

its people will gradually come to enjoy a living standard closer to that in the United States and Western Europe. At a higher growth rate, there will be more and better jobs for the graduating classes of young Bahamians..

Thank you for your kind attention.