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Feature Articles

A perspective on...

The Proposed Labour Bill
&
The IMF's Annual Report

Social Virtues and Prosperity
by Francis Fukuyama

A reprint of ...

The Caribbean Tiger:
A Development Strategy
for the Bahamas

The Institute for Economic Freedom is an independent non-political non-profit 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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Introduction

This issue includes two long articles that appeared in *The Tribune* in early April under the byline "*An economist's perspective*".

Page 2. The Proposed Labour Bill.

This article appeared after publication of ten shorter Letters to the Editor that began in September 1997. The article restates the major points made previously, makes specific proposals for a new Bill and comments on government policy.

Page 10. The IMF's Annual Report.

The Executive Board of the International Monetary Fund on March 13, 1998 gave an annual report to the government on the economic and financial welfare of the Bahamas. A synopsis of this Report was released by the Minister of Finance on April 6, 1998. The Institute provides a perspective that is relevant to the upcoming 1998/99 Budget.

Page 16. Social Virtues and Prosperity by Francis Fukuyama.

This is a series of quotations from Mr. Fukuyama's book, *Trust: The Social Virtues and the Creation of Prosperity*, plus editorial notes.

Page 19. The Caribbean Tiger: A Development Strategy for the Bahamas.

By popular demand this study, published in February 1995, is reprinted in an abridged version. The data included in the text is unchanged from the original.

The Proposed Labour Bill

A bit of theory.

Classical economists like to apply theory to life...and two of their favorite theories are that people act in their own self-interest and that they act rationally. The "classicists" are given a hard time about such theories since people seem to act so irrationally in this world...and people differ so much within and between cultures. Self-interest and rationality seem at best to be heroic assumptions.

The surprise of all surprises is that these classical theories are valid. If the price of wheat goes up relative to the price of corn, farmers shift their output from corn to wheat. They do this whether they live in China, France, India, or Iran. The data prove this...theory predicts behavior...the theory is valid.

This approach can be used with the proposed Minimum Labour Standards Bill.

Let's start with the minimum wage.

People tend to be paid what they are worth. It is in the self interest of the employer to pay a wage that attracts an employee to work but which does not exceed the value of the work he produces.

If government mandates an even higher wage, as maybe the case with a minimum wage, then the worker is not employed and the employer seeks an alternative. The worker with inadequate skills

is particularly vulnerable since he is denied the opportunity to learn higher skills and to learn about other opportunities.

A minimum wage discriminates against the unskilled.

And then there is vacation and severance pay.

The proposed Labour Bill will apply to every private sector employee in the country...even if the enterprise has only one employee, if the employment contract is unwritten or if the term is as short as one week.

The Bill entitles every employee after 15 years of employment 60 weeks vacation per year or cash in lieu of vacation and 60 weeks of severance pay. If an employer needs the work of such a long-term employee, by law he will be paying him or her over two times his base wage for 40 hours of work. In addition, because of the way the severance entitlements are calculated, the employer will now have a financial incentive to hire full-time employees for 8-1/2 months and then fire them and to hire half-time employees for 17 1/2 months and then fire them.

For the employer the proposed Labour Bill raises significantly the cost of the experienced long-term worker relative to the cost of the less-experienced short-term worker.

For the worker it increases his risk of unemployment when the financial requirements of a family are highest.

The Bill also raises business costs and risks.

The expressed purpose of the Bill is government regulation of the workplace. It will saddle all business, large and small, with two new bureaucratic "empires" dedicated to regulation...including formal reporting requirements and quasi legal processes.

Employment law and litigation consume scarce management time and capital. This is particularly critical for small businesses in the start-up phase of operations. Manifesto II states that "a majority of the new jobs required to make the Bahamas a fully employed society will come from small business enterprises."

The Bill increases the magnitude of the employer's risk since it enhances "Grievance Lotto", the new industrial relations game. It's where a grieved worker with the support of a bright lawyer seeks a punitive damage award from the Industrial Tribunal. The good news...the good news for the worker/player...is that the more affluent the employer is, the bigger the potential award.

Ironically because the Bill raises employment costs and risks, it creates an even bigger incentive to hire foreigners.

Is this another case of business "whining"?

No! It is not...because...the data validating it is simply overwhelming.

- In the Bahamas right now there is no minimum wage for private companies ...in the United States and Great Britain there is. In the Bahamas all major gas stations offer full service...there's always a young adult there to serve. In the U. S. and the U. K. there is self-service.
- In the United States between 1938 and 1950 the minimum wage, contained in the Fair Labor Standards Act of 1938, was ineffective because it remained unchanged when all wages and prices were rising. Thomas Sowell points out that "as of that time, teenage unemployment was not appreciably higher than that of older workers, and black and white teenagers also had very similar unemployment rates."

Beginning in 1950, however, Congress raised the minimum and drastically extended its coverage. "Over the next three decades, teenage unemployment rose relative to the unemployment of older workers and black teenage unemployment rose far above white teenage unemployment. By the 1970s, black teenage unemployment had risen to several times what it had been in 1950. At no time during the three decades after 1950, not even in the most prosperous years, was black teenage unemployment as low as it had been in 1949—a recession year."

- A major study on labour market regulation and unemployment by James Gwartney will be released in the next two weeks. It compares Germany, Italy and Spain...countries with greater government regulated and centrally planned labour markets...with the United States and Japan...two countries with less regulated and planned labour markets. The unemployment rate is substantially higher in the former than in the latter. The United Kingdom prior to 1980 experienced the high unemployment rates typical of Germany, Italy and Spain today and with de-regulation after 1980 has a significantly lower level.
- Since 1980 governments around the world have been moving away from government ownership and regulation of their economies. The cases are greatly different and the results stunning.

Chile 40 years ago started with a national socialism so complete that it was called "the fatherland of the state." Chile then experienced communism, a military dictatorship with a plan that freed the economy and finally political freedom with astounding growth in investment, labour productivity and gross domestic product per person and a reduction in the fiscal deficits.

New Zealand, in contrast, became one of the most highly

regulated countries in the free world under a parliamentary democracy. Under a Labour Party in 1984 it began a series of reforms that dramatically reduced government regulation and management with results that have equaled Chile's.

Economic freedom has been defined, measured and included in an Economic Freedom Index. This has been done for more than 100 countries going back to 1975; and... there is a positive correlation between economic freedom and economic growth. A high or an increasing level of economic freedom produces high or increasing economic growth. When examined in this system the Bahamas shows a declining Freedom rating and very recently economic stagnation. This work is impressive and is available to you through the Institute for Economic Freedom.

The bottom line is simply this.

The proposed Labour Bill is a bad piece of legislation. The compassionate and concerned politician...in his desire to produce justice and equity in the work place...and to get re-elected...will, in fact, create...

- Structural long term unemployment for the unskilled,
- Employment insecurity for the skilled and
- Economic stagnation.

The Bill appears to benefit the worker...but...in reality it will do more harm than good. The Bill should be replaced with one that seeks to accomplish less...but ironically one that in doing less will accomplish more...especially when it is combined with other government initiatives.

What kind of bill will the Minister of Labour deliver to Parliament? Will he stress political appearances or economic reality?

The Minister of Labour should...

prepare a new labour bill that does the following:

- 1 It should restate the common law on "dismissal with just cause." Statute law tends to take precedence over common law and the common law is being obscured by the 1996 Act and by the proposed Bill. Dismissal needs clarification not obfuscation.
- 2 It should require every employer to provide each employee with a written list of the terms of employment that must be accepted by the employee.
- 3 It should provide no government mandated minimum standards and no restrictions on bargaining, individual or collective. With this the government accepts its inability to frame a single labor contract...and that is what the Labour Bill is...a single contract for all employees in all industries; and with this the government accepts the ability of the market to do a valued economic function more effectively.
- 4 It should eliminate the ability of the Arbitration Tribunal to award punitive damages. The purpose of this is to end "Grievance Lotto" which is necessary to promote a more civil society.
- 5 It should make any changes that will assure that the dispute settlement process...conciliation, arbitration and litigation before the Tribunal...is certain, fair and low cost. The greater financial resources of the employer should not allow a miscarriage of justice.
- 6 It should delete entirely the occupational health and safety provisions from the Bill. These should only be framed for

discussion after a written analysis of need has been circulated to all concerned.

But...what can a government do to improve the lot of the people?

Fortunately, there is an answer. Important ideas have been developed by two Nobel Prize winning economists, Theodore Schultz and Gary Becker, and by Francis Fukuyama. According to them the most important investments that a country can make are not in business regulation and government planning...not even in machinery, bricks, mortar and computer software. The most important are those made in Human and Social Capital.

From their extensive work on developed and less developed countries one can conclude that the Bahamas will not achieve prosperity and sustained economic growth unless it recognizes its needs.

- The country needs an Education Revolution because such a large portion of its population leaves school unprepared for productive work. The revolution should not end until every young male leaves school with certain minimums...like the ability to add, subtract, multiply, divide and read engineering drawings...until every gifted student leaves with a mathematics competency that includes calculus. People tend to be paid what they are worth and the country needs to be committed to an Education Revolution that raises the worth of everyone. Gary Becker in advising Brazil stated that such investments were necessary to maintain the very fabric of their society.
- The country needs a Legal Revolution...it needs a commitment to civility and the rule of law. This means dealing with the increasing threat to personal safety posed by violent crime. But in addition, there is the perception that justice for

the white collar thief is at best uncertain. The country cannot prosper when such uncertainty prevails...and...the government can do something about it.

- The country needs to deal with the breakdown of the family. Admittedly in this regard the role of government is limited while the roles of individuals, families and their voluntary associations...churches, civic clubs, etc...are far more important. Government cannot legislate a strong and stable family structure and durable social institutions...not as it can create a central bank or an army. But it needs to be conscious of the problem and refrain from policies that exacerbate it.

These very brief comments on education, justice and the family indicate that classical economics does not postulate a “do-nothing” government. Rather it clearly identifies the “right policies” for a government that is concerned with the economic welfare of its citizens.

Francis Fukuyama in his book *Trust* concludes that a “thriving society depends on a people’s habits, customs, and ethics.”

James McBride, the black author of the best selling book, *The Color of Water*, described his parents’ model for raising 12 children as “hard work, no nonsense, a quest for excellence, a distrust of authority figures, and a deep belief in God and education.”

These words are worth remembering.

The above is a speech by Ralph Massey that was given to the Bankers Institute of the Bahamas on March 26, 1998 and was printed by *The Tribune* on April 2, 1998, pages 9 - 10 and by *The Punch* on April 17, 1998, page 25.

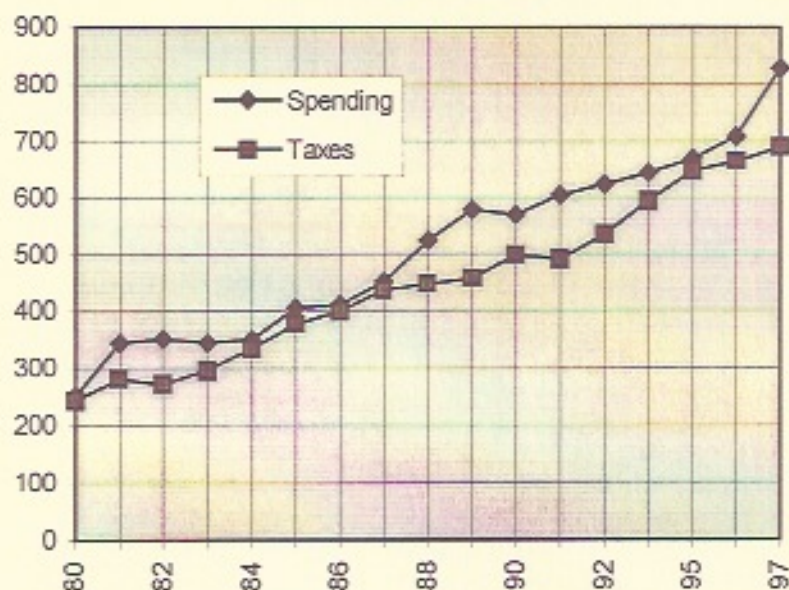
An economist's perspective

The IMF's Annual Report

On April 2, 1998 Minister of Finance William Allen tabled the Annual Report of the International Monetary Fund that "encouraged the Bahamas to restore a tight fiscal stance". What can one make of this talk about "prudent fiscal policies"?

The saga of spend and tax.

Government
Spending & Taxes



One can begin by looking at spending and taxing in perspective. *Manifesto I* asserted that the level of taxation in the Summer of 1992 was "more than sufficient to meet the needs of the country."

What happened after 1992 is a different story. The FNM never lived within the 1992 tax levels. That would have required an immediate pruning of some spending and/or the sale of assets to provide the funds for the needed repair of the country. Perhaps that target was unreasonable or a pre-election over-statement.

But as is very clear the record of "spend and tax" has not changed from the PLP to the FNM administration in 1992. Between 1990 and 1996/97, for instance, both spending and taxing grew at 5.1% per annum. The surprising result of this is that the deficit grew from \$72 million to \$140 million...it doubled.

The implications of "business as usual" are alarming:

- Interest payments are growing at roughly 9% per year and in the future are likely to always exceed capital expenditures. This interest is a deferred tax; and unless the debt is retired, future generations will be taxed forever for the inability of its "heroes" to live within their means.
- The government's share of the economy has grown and is at a level that inhibits rapid economic growth.

**Total Government Expenditures
as a Percent of
Gross Domestic Product**

	1980	1992	1996/97
Per Cent	17.2%	20.4	23.2-23.6%

The government's share of the economy is moving in the wrong direction and is too high to promote rapid economic growth. The government share of GDP in Great Britain during the Industrial Revolution and the United States during the 19th Century...when both became leading economic powers...was around 10%. In Hong Kong government spending as a share of GDP ranged from 13% to 19% as the GDP in constant dollars per person moved from a level below Mexico to one above the United States in 35 years. For policy purposes the Hong Kong government considered a 20% share as a "never to exceed" limit.

- The continued growth in Bahamian dollar debt and the failure of the foreign exchange reserves to grow at least proportionately have increased the vulnerability to international currency risks...to an Asian style financial meltdown. This risk was described by Alvin Rabushka in May 1997 in a series of lectures in Nassau.

The Budget.

The arithmetic of the government's position is quite simple. In 1996/97 it had income of \$687 million and it spent \$827 million producing a record \$140 million deficit.

Now it is reasonable to expect income to grow at perhaps 3% per year. This means that in 1998/99 tax revenues would reach \$729 million. To balance the budget the Government would have to reduce spending by \$100 million. To avoid an Asian meltdown...a highly desirable policy objective...the Bahamas should reduce total spending to pre-1996/97 levels.

But that is only the first step in what should be a clearly stated longer term strategy. All proceeds from its privatization programs should be used to retire the existing government debt and a "never to exceed" cap should be put on total spending. Such a

long-term strategy should be clearly proposed in the 1998/99 Budget.

The four points.

In preparing the Budget there are four areas that need special comment:

1. Privatization.

Clearly the government needs to undertake the painful task of focusing expenditures on those activities that enhance prosperity. To do so it needs to free itself from those businesses where it does poorly. It should liquidate its ownership of Bahamasair, Batelco, Bahamas Electricity, Water and Sewerage and the Post Office...a daunting yet necessary task. It must do it if the government wants to —

- a) reduce the cost of government;
- b) provide the funds to invest in public safety, the justice system and human capital; and
- c) establish a level of taxation that will encourage economic growth. These are desirable goals that go beyond the budget year.

2. Education & Human Capital.

For Adam Smith in the 18th century and Theodore Schultz and Gary Becker, two Nobel Prize winners in economics in the 20th century, the critical investment is the one in humans. Human Capital is “the acquired abilities of people—their education, work experience, skills, and health...not space, cropland, energy, or other physical properties of the earth...”

The government should concentrate on the education system. A good idea, for instance, is one described by Gary Becker.

"It's well recognized that the bottom quarter of...high school students aren't well prepared for employment. An extensive training and employment programme designed for high school dropouts could greatly improve their economic prospects." It could be a three year programme. Incentives could be a key feature of the plan: a voucher system to allow the student to go to the state-licensed public or private school that accepts him and a stipend paid for achievement in the school portion of the programme.

Such specialized work/study programmes are costly...but successful programmes of this type can lessen the social divides of race and class and be more beneficial than a Law School, for instance.

3. Trust & Social Capital.

The government should promote trust rather than distrust. Trust is a critical factor in the knowledge, habits and ethics that determine how people associate with each other. Francis Fukuyama calls this "social capital." The Government depletes Social Capital with a Labour Bill that promotes the "we and them" ethic. It should promote the rule of law and should invest in a legal system where justice is certain, swift, fair and equal.

A high level of trust and social capital are conducive to economic growth. "Low trust" societies...ones that accept a low level of honesty, for instance...have a restricted capacity to create efficient organizations. In such societies business generally does not grow beyond the capital and managerial limits of a family and inevitably involve higher costs of operation. Such firms then have difficulty competing with foreign firms that do not have this handicap.

4. Private Enterprise & the Marketplace.

The major theme of the 1992 FNM campaign was "Deliverance" from "government" initiative, welfare and dependency. Yet the government continues to increase its role as the initiator and controller of the economic life. This can be seen in measures as price controls and the proposed Minimum Labour Standards Bill, government insurance of bank deposits and regulation of health services.

For the rest of the world, the discovery of private enterprise and the marketplace as the most efficient way to organize economic life has been the main policy event of the past 20 years. In the Bahamas a fundamental distrust of them remains imbedded in law and politics. The Bahamas needs to create free market opportunities for private initiative and diminish the debilitating influence of government on business.

A strategy embracing these four points is difficult for politicians and voters to accept. It needs committed leaders and an informed electorate to be successful...it is challenging.

The above article was printed in *The Tribune*, April 8, 1998, pages 2 - 3.

Social Virtues and Prosperity

by

Francis Fukuyama

Trust.

"Perhaps the most crucial area of modern life in which culture exercises a direct influence on domestic well-being and international order is the economy...economic activity represents a crucial part of social life and is knit together by a wide variety of norms, rules, moral obligations, and other habits that together shape the society...

a nation's well-being, as well as its ability to compete, is conditioned by a single, pervasive cultural characteristic: the level of trust inherent in the society.

Social capital.

"Social capital is a capability that arises from the prevalence of trust in a society or in certain parts of it. It can be embodied in the smallest and most basic social group, the family, as well as the largest of all groups, the nation, and in all the other groups in between. Social capital differs from other forms of human capital insofar as it is usually created and transmitted through cultural mechanisms like religion, tradition, or historical habit...

Source: Francis Fukuyama, *Trust: The Social Virtues and the Creation of Prosperity*, Simon & Schuster, New York, 1995, pages 5 - 6 & 26 - 28.

"The social capital needed to create [communities with shared ethical values] cannot be acquired, as in the case of other forms of human capital, through a rational investment decision. That is, an individual can decide to 'invest' in conventional human capital like a college education, or training to become a machinist or computer programmer, simply by going to the appropriate school.

Acquisition of social capital, by contrast, requires [living] to the moral norms of a community and...the acquisition of virtues like loyalty, honesty, and dependability.

The cost of distrust.

"The group, moreover, has to adopt common norms as a whole before trust can become generalized among its members. In other words, social capital cannot be acquired simply by individuals acting on their own...

"Social capital has major consequences for the nature of the industrial economy that society will be able to create. If people who have to work together in an enterprise trust one another because they are all operating according to a common set of ethical norms, doing business costs less. Such a society will be better able to innovate organizationally, since the high degree of trust will permit a wide variety of social relationships to emerge...

"By contrast, people who do not trust one another will end up cooperating only under a system of formal rules and regulations, which have to be negotiated, agreed to, litigated, and enforced, sometimes by coercive means. This legal apparatus, serving as a substitute for trust, entails what economists call 'transaction costs.'

Widespread distrust in a society, in other words, imposes a kind of tax on all forms of economic activity, a tax that

high-trust societies do not have to pay.”

Editor's notes.

These comments on trust and social capital by Francis Fukuyama are contained in his 476 page study, *Trust: The Social Virtues and the Creation of Prosperity*.

The author contends that --

- The demise of the Communist and Socialist systems with their emphasis on social engineering has been followed by the universal acceptance of liberal political and economic institutions that “depend on a healthy and dynamic civil society for their vitality.”
- The important truths about “the nature of money and markets[,the substance of neo classical economics,]...are correct about eighty percent of the time. However, there is a missing twenty percent of human behavior...that cannot be understood apart from the customs, morals, and habits of the society in which it occurs. In short, it cannot be divorced from culture.”

These conclusions are based on his interpretation of the historical development of China, Taiwan, Italy, France, Korea, Japan, the United Kingdom, Germany and the United States. He examines the three broad paths to sociability: family and kinship; voluntary associations outside kinship such as schools, clubs and professional organizations; and the state. He then relates these paths to a range of business organizations and the social factors determining their success or failure and the effect of this on the economy as a whole.

A reprint

The Caribbean Tiger: A Development Strategy for the Bahamas

Over the past 25 years the Bahamian government has grown continuously in absolute size and has "socialized" the economy. It has reached the same crisis point as many other countries; namely, it has exhausted its financial options and the economy has become increasingly non-competitive. Unwilling to cut expenditures, the government has raised taxes and fees sharply; many of these have reached the point where they produce diminishing revenue. More alarming, tourism and the financial sector became marginal in world markets.

The Progressive Liberal Party and then the Free National Movement began new initiatives. It is the contention of this policy statement that the FNM must pursue an entirely new overall policy. Alone neither changes in the present duty structure nor the creation of a new sales tax will solve the crisis.

The country needs to concentrate on those policies that will convert the Bahamas into the "economic tiger" of the Caribbean. This entails a gigantic change from the liberal/socialist policies and programs of the past 25 years.

- **Reduce and Refocus.** The country cannot avoid the need to reduce the total size of government; greater taxation and borrowing are no longer viable options. It should sell its interests not only in the hotels but also in Bahamasair, commercial banking, utilities and post office. Private enterprise can manage these activities more efficiently and the

public interest can be protected. The country must refocus its efforts on public safety and justice, public works and quality education tailored to the nation's needs.

- **Venture Capital & Private Enterprise.** It must create a climate that is favorable to private capital and foster a public confidence in the free enterprise system. It is widely perceived that the Bahamas has a business climate that is hostile to both local and foreign private enterprise. If it wants greater private enterprise job creation, it must end public attacks on the investment community and major changes should be made in every government entity that deals with local and foreign investors.
- **Labor Productivity.** The government needs to provide leadership in improving labor productivity. This means that it should continue its program to raise the quality of the education system. It also requires a clear public indication by the government of its commitment to improved labor productivity in both the government and private sectors.

The Caribbean Tiger policy confronts reality, directly and honestly. The illusion that the Bahamas was moving from "a third world to a first world status" has been shattered. It was shattered by recession, new challenges, labor problems and failed government policies.

The world of the future will not be easier. In fact, the government is proposing that the Bahamas be an active member in a more competitive hemisphere. At the same time legislation is being presented to Parliament that creates more government regulation and control. Clarity and consistency in policy are essential for long term economic success.

The country desperately needs a strategy for the move into the next century. The right policy is the Caribbean Tiger strategy.

Unfortunately, it contains no public relations gimmick that may be sold easily to voters; and acceptance may come only after much thought and the passage of time. Nevertheless, it is essential in this instance for the FNM to take "The Road Less Traveled".

The FNM's break from the past?

The FNM in 1992 published its Manifesto outlining the policies and objectives that it would carry out if elected. Like all political documents of this type it contained something of interest to every sector of the electorate. It contained, however, statements that differed significantly from its predecessor, the PLP. The FNM declared its intention to provide every citizen "the opportunity to be all that he or she wants to be, assured of upward mobility in an open society fuelled by a market-driven economy."

In the 1994/95 budget the Minister of Finance listed what the government would do to carry the country in this new direction:

- Release entrepreneurial skills,
- Encourage honest endeavor and enterprise,
- Create a more highly skilled and educated work force, and
- Provide incentives for investment in specific areas.

This was a clear break from liberal/socialist orthodoxy. The individual would have the initiative and means to provide for his own needs, not the government. For the FNM "Deliverance" was from government initiative, welfare and dependency. Also it was from a party that appeared to focus on its own financial gain as shown in the proceedings of the Commission of Inquiry.

The Manifesto '92 also stated the FNM conviction that the current level of taxation was "more than sufficient to meet the

needs of the country." The budget also sought to eradicate deprivation and distribute prosperity more equitably. It used these goals to justify the planned tax increases.

Financial trends.

In recent times and without exception the government has increased spending year after year. Please note the attached graph and the compounded annual growth of the economy, government expenditures and revenues shown below (in per cent per annum):

	From 1980 to 1992 -----	From 1992 to 1994/95 ----- Budget
Total Expenditures.....	7.4%	6.2 %
Total Revenues.....	5.8%	7.2%
Gross Domestic Product	6.4%	Nil

During the PLP years spending grew faster than revenues and the deficit was consistently financed with ever increasing debt. On taking office the FNM continued to increase spending, funding it with significantly increased taxes and further growth in indebtedness. The economy peaked in 1990, declined in 1991, 92 and 93 and appears to have recovered somewhat in 1994.

The economic consequences of these trends are as follows:

- Interest Payments increased at an annual compound rate of 9.5% from 1980 to the present fiscal year. They grew from 50% of non-current spending, principally capital expenditures, to 115%.

- From 1980 to 1990 government expenditures grew at the same rate as the economy as a whole, but grew much faster after 1990.
- The recession and limits on borrowing forced the FNM to increase tax revenues. Tax revenues dropped from \$534.2 million in 1992 to \$524.6 million in 1993, down 2%, but are planned to rise 16.9% in fiscal 1994.

The recession and its resultant impact on government funding was in large part due to world developments. Its impact was, however, clearly exacerbated by the loss of Bahamian competitiveness in tourism and international banking. The travails of tourism are well documented. The rapid expansion of cruise ship vacations, other new tourist destinations, the high cost of Bahamian operations and the poor quality of its product adversely affected tourist earnings.

In international financial markets the Bahamas steadily lost ground to new off-shore financial centers. This was most clearly evident after the U. S. invasion of Panama when the migration of business was exclusively to the Cayman and the British Virgin Islands. Only the modernization of Bahamian laws and financial services in the latter years of the Pindling administration arrested the deterioration.

These two international businesses are fiercely competitive. The Bahamas became an increasingly marginal player but important beginnings of a recovery have been laid in both industries.

A bit of theory.

In this country as in all countries seeking the benefits of a free market economy, there is a policy conflict between economic reality and political needs.

Should free markets determine how resources are divided?

The proponents of free market economies note that every day there are far too many transactions occurring for anyone even to describe. The individual, for instance, on any given day may decide to consume or alternately to save (delay consumption) and invest. The latter transaction fits M. Scott Peck's concept of "discipline" as described in *The Road Less Traveled: A New Psychology of Love, Traditional Values and Spiritual Growth*. The proponents observe that in this and in all other transactions each party generally ends up better off, a win-win result. Even critics marvel at how free markets work.

To the critics, such markets appear impersonal and generally produce results that are deemed unequal and unjust.

Should the government take resources from some and give these resources to others?

To the liberal/socialist such programs are compassionate.

To the critics such programs do not deal with the loss of the private property rights of the involuntary giver. Nor do they speak to the long term and often subtle adverse effects on the program beneficiaries, the diminution of individual responsibility and discipline. To the critic such programs are public plunder and thievery, acts that help politicians get re-elected.

This conflict is not new; in this century it is rooted in the depressions in Great Britain that began in 1925 and in the U.S. in 1929. Both were epic events that generated profound and lasting debates over causes and remedies.

The English economist John Maynard Keynes and *The General Theory of Employment, Interest and Money* produced the "solution". He observed a link between aggregate demand and overall employment and the existence of unutilized manpower and productive capacity. He provided an economic rationale for

governments to transfer money to consumers and, if necessary, to borrow the needed funds without levying new taxes. All this was done for the greater good of the country.

Keynes admitted that inflating demand in this way to increase production was a short run solution. And, in fact, such short term measures could produce serious adverse effects in the long run. When pressed on this, his reply was that "Since in the long run we are all dead, government policy should be guided...by short-term considerations."

Although debt could create a problem for future taxpayers, he claimed that this really was not a problem at all. He dismissed debt repayment and service with the phrase, "we owe it to ourselves."

It is easy to see why these ideas were embraced. Without the need to balance the budget governments could more readily pursue their liberal/socialist ideals. Governments dismissed free markets as the most efficient mechanism to organize production and award entrepreneurship, capital and labor. Business cartels and trade unions were accepted and encouraged. The immediate income effect on wages in union jobs was more important than the adverse impact on product prices and overall employment. Governments avoided the pressing need for freer markets and more flexible cost structures.

What Keynes did not see is that—

- Governments would not exercise discipline in spending. His system called for more spending at certain phases of the business cycle and less at others, creating surpluses or deficits as appropriate. In the Bahamas, as in most other countries, spending just continuously expands.
- Income transfers designed to deal with short term personal needs ended up creating social structures, values and behav-

ior that were destructive to both a healthy society and the economy.

- Government support of powerful trade unions increased both industrial strife and labor costs while reducing productivity.

The results of Keynesianism were inflation, skyrocketing debt and/or economic decline. The decline was either absolute, as in some countries in Africa and Latin America, or relative, as in Great Britain and the United States.

It took a long time to recognize it, but the economic policies of Keynes failed wherever seriously implemented; and his critics, principally Frederick Hayek and Milton Friedman, were right.

The eminent economist Walter Williams dealt with these issues with Bahamian audiences in April 1994. He discussed the observed wealth of some nations and the poverty of others. He concluded that people are poor for one of three reasons:

- They do not have the knowledge and skills to produce those things or services that are valued by others. This implies a lack of education, on-the-job training or ability to migrate.
- They can produce such things or services but are prevented from doing so. Minimum wage laws, union hiring practices, licensing and discrimination prevent them from getting a job, or from getting on the bottom rung of the job ladder. Thus one is not able to benefit fully from one's labor.
- They can choose to be poor. It is regrettable that government social benefits or taxes can make this choice the attractive alternative.

Walter Williams concluded that the Bahamas should--

- Promote private property rights,
- Provide for high quality education, and
- Allow and encourage the labor market to function freely.

The Caribbean Tiger Strategy.

Governments and electorates consciously and subconsciously choose the type of country they ultimately get. This is most often the result of many decisions over a long period of time. Today do the Bahamian government and the electorate want to tread water in a pack of mediocre performers? Or do they want a country that is a dynamic force of growth and opportunity for its citizens and the economic tiger of the Caribbean?

The goals stated in Manifesto '92 held out that hope for the future. But the achievement of that hope will require no less than the transformation of Bahamian society, government and the electorate, and not more of the same old politics. This will require a bold program that abandons the liberal/socialist orthodoxy of the past. It will need leaders who share the vision and have the determination to implement it. Of greatest importance is the political courage to provide leadership for programs that will bring short term uncertainty and hardship for some just as it creates new opportunities for others.

The government cannot continue to do what it has done in past, take ever increasing amounts of money from its taxpayers to secure an ever expanding unproductive government share of the economy. This is basically immoral. Furthermore, it produces and perpetuates mediocrity.

To become the "economic tiger" of the Caribbean the Bahamian Government must --

- Reduce the total size of government and concentrate government expenditures in those areas where it has the greatest chance of being productive.
- Do what it does best.

Public safety. Crime has become the society's number one problem that demands the country's best efforts. A comprehensive program can be crafted with professionals agreeing on many aspects. For instance, the construction of a maximum security prison on a family island is necessary to separate the hardened criminal from lesser offenders held at Fox Hill. This would be a big and important step.

Public Works. Since August 1992 the Ministry of Public Works has made very substantial improvements that have gone far to eliminate the trashy look on New Providence. This trashy look clearly identified the Bahamas as a mismanaged third world country. Its elimination is essential to a reviving tourist industry; and it is also critical to the sense of pride and identity of every Bahamian.

Furthermore, investments in infrastructure can be highly productive. But the government should seek to avoid "white elephant" investments by making its investments in roads, airports, ports, waste disposal facilities and parks complementary to private sector investments. Good examples of the potential are San Salvador where Club Med has created a new viable mini-economy and Abaco where the long overdue north-south highway should enhance materially both agricultural and tourist development.

Education. The Asian tigers, South Korea, Japan, etc., are societies that value teachers and learning. These countries produce far more graduates with much higher linguistic, numerical and mechanical skills than is the case in North

America and the Caribbean. The business community finds the average Bahamian graduate lacking in this regard. The aim must be the raising of performance levels of both teachers and students. This may entail an increased employment of foreign teachers in the short and intermediate term.

- The government should liquidate its interests in Bahamasair, the Hotel Corporation, Batelco, Bahamas Electricity, Water and Sewerage and the Post Office.

The government should get out of those businesses that have absorbed so much of its resources in the past. The management of these companies should be completely separated from political considerations and the sale of the entire government interest in them is likely to achieve this end.

A bit of entrepreneurial reality.

Critical to the Caribbean Tiger strategy is the roll of the private sector, particularly the process of saving, investing and taking entrepreneurial risks.

The Bahamas is perceived as having a business environment that is hostile to the investor, Bahamian and foreign. The barriers encountered by the prospective investor, Bahamian and foreign, include too much bureaucracy and inefficiency; too many political agendas, personal considerations and favors; too few written regulations and too little enforcement of those regulations that do exist. Business licensing has been described as "Dickensian in its setting". The perception is that government hostility exists for all who have not struck the "right deal". In economic terms a deal is a private tax that reduces the yield to the investor.

It is very difficult to dramatize just what the investor has faced and just how much the economy has lost. One example is the experience of a charter flight service and air craft maintenance

center at Marsh Harbor, Abaco. The owner is a U.S. and U.K. qualified commercial pilot, mechanic and aircraft inspector who is quite possibly the best aircraft mechanic in the country.

In April 1984 he applied for a lease of crown land at the Marsh Harbor Airport for the construction of a hangar. This is necessary for an aircraft maintenance center to meet the requirements under both Bahamian and U.S. regulations for providing "certified" repairs on commercial aircraft. Under the PLP and the FNM, Bahamian civil aviation approved only one such center, Bahamasair.

For ten years the lease application languished in the Ministry of Public Works, the Department of Lands and Surveys and Civil Aviation. For ten years the company serviced its customers in a rough clearing, in the open air, without public utilities, without a paved taxi-way to its "service area" and from two Ro-Ro cargo trailers. In the end the FAA ruled that repairs made by the company on its own commercial aircraft were not acceptable because they were not done in a certified center. Therefore, the operator's charter aircraft could no longer land in the U.S.

A short term solution to the aircraft servicing problem came 22 months after the FNM came to power and then only after a front page article in a major newspaper. As of the date of this publication the FNM government still has not completed the lease transaction.

In this case the operator, civil aviation, Abaco and the Bahamian economy were diminished by this ten year bureaucratic delay. Yet politicians in both parties find it useful to criticize the commercial banks, the "Bay Street Boys" and the "White Knights" for not investing in new ventures.

It is safe to assume, however, that entrepreneurs, both Bahamian and foreign, will invest if free to do so. What is clear is that in a

hostile environment they will not or will do so on a reduced scale. Facing such hostility the typical capitalist/entrepreneur, unlike the Abaco entrepreneur described above, simply votes with his feet; he takes his capital and his bright idea and goes elsewhere; or he leaves his funds on deposit in a commercial bank. One can cite situation after situation where this has happened. Unfortunately for the Bahamas no one has constructed an index or list of investments not made because of political and bureaucratic intimidation. One only perceives a need for more jobs and investment.

If a Caribbean 'Tiger' strategy is to succeed -

- The government must create a climate that is supportive of risk taking and cease and desist from public attacks on potential investors, including the "Bay Street Boys" and "White Knights".
- This program most certainly will require organizational and personnel changes at every government entity that investors encounter.

Labor productivity and unions.

How a labor market works is very critical in a country like the Bahamas. In this case one industry, tourism, produces about half of both the gross domestic product and total government revenues.

Unfortunately for the hotelier, the government and all Bahamians, the international market for vacation services is very competitive and periodically seems to produce entirely new competitive threats. The cruise ship is a floating hotel with a casino. Cuba is a re-emerging tourist destination. The past and possible future impact of these are known to all who are interested. They give national importance to hotel operating costs and service quality.

In this industry a militant union has dominated hotel operations.

Often this has not been to the benefit of the industry, the country or the government.

Furthermore, it is reported that unionized restaurants have up to 50% more employees than non-unionized.

What is clear is that the price of labor has been high, service quality poor and productivity low. In order to be competitive with tourist destinations in lower wage countries the Bahamas must raise productivity to levels higher than the regional average. This is a problem of national importance.

The government should do the following:

- Allocate a large part of its effort in education at producing quality candidates for entry level as well as lower and middle management positions in tourism. The objective must be the attainment of world class standards.
- Take specific actions signaling a government determination to bring about increased labor productivity. This must be done by the government in public corporations, in the civil service and in any mediation or arbitration of labor disputes in the private sector.

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“a nation’s well-being, as well as its ability to compete, is conditioned by a single, pervasive cultural characteristic: the level of trust inherent in the society...

“Acquisition of social capital...requires [living] to the moral norms of a community and...the acquisition of virtues like loyalty, honesty, and dependability...

“Widespread distrust in a society...imposes a kind of tax on all forms of economic activity, a tax that high-trust societies do not have to pay.”

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