



T H E   R E V I E W  
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## Important Issues

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and the  
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The Fourth Hammer  
Blow



The Institute has made several important changes that are evident in this issue. The first appears on the cover. "The Institute for Economic Freedom" has become "The Nassau Institute"...a name that the Directors believe is more fitting for their broadened objectives.

The second is the appointment of Dr. Gilbert HMO Morris as Managing Director. Dr. Gilbert, a Bahamian, has had impressive educational and professional careers and he adds greatly to the skills and capabilities of the Institute.

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# Highlights from this issue

## **Financial Legislation.**

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These supra-national initiatives – if they are successful – will mean that a handful of nations will have developed an official means of policing nations around the world...Despite its “sovereign nation” rhetoric, the objective of the UN Ad Hoc Committee of Experts is to abolish Offshore Financial Centres and to end all tax competition.

The desire of a nation to be taken seriously is directly proportional to the strength of its national vision and the basis of its sovereign law and legal tradition. And this above all points to the fact that a failure of this vision and this sovereignty are the surest signs we know of imminent national decline.

## **The IMF Verdict.**

The International Monetary Fund in its 1999 and 2001 Consultations observed that hotel operating costs in the Bahamas were “among the highest in the region and there was a need to remain competitive”; and, referring to the five labour bills circulated in 2000, it warned against increasing labour costs

## **Labour Legislation.**

The labour legislation proposed by Government creates a “vicious cycle” of higher direct labour costs, more spending on government bureaucracies, a costly diversion of managerial resources, higher prices, less employment, an institutional resistance to change and finally an alarming capital flight. These are the unintended consequences of such legislation.

## **The Minimum Wage.**

The economic “Law of Supply and Demand” as applied in this case states that if a government mandates an increase in wages paid by

private enterprise, then the number of workers employed declines... The Bahamian Government, in effect, recognizes this... namely, that its minimum wage will increase unemployment. And so it gives blanket exclusions from the minimum to the employees of small businesses, students in summer employment, students working and studying and gas station attendants and under certain conditions the physically impaired.



# The Loss of Sovereignty and the Offshore Financial Business

by

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The imposition of radical financial legislation in the Bahamas late last year evidences that the Government is losing control of the country to a growing number of competing supranational agencies acting in violation of international law and the concept of national sovereignty. Their objective is to eliminate Offshore Financial Centres (OFCs) and to end international tax competition. This has already drastically altered the country's financial service framework and has caused international business to move to other countries.

The developed countries of the world through these agencies have and are acting in their national interest, as they should. The governments of the OFCs must act likewise in their own national interest. The situation for the Bahamas is not likely to improve in the absence of imaginative and forceful action.

This article will discuss what has happened and what can be done.

## ***What's at stake?***

The potential economic fallout from these developments could be very serious. For instance, the economies of the Bahamas and Cayman Islands have two main pillars, tourism and the financial industry that includes banking, insurance and mutual funds. The value of deposits held in banks in the Bahamas and Cayman Islands in 1997 totaled over \$ 915 billion. As of 1997, there are over 1000 banks including 49 of the world's top 50 banks. Together The Bahamas and Cayman Islands together would be rated the fourth largest international banking

operation in the world and the fourth largest financial centre in the world after London, Tokyo and New York. Such an astounding position cannot simply be replaced by tourism, and the prestige itself is profoundly irreplaceable.

### ***The why and who.***

Why did the financial crisis occur in the first place? The fact is that the populations of the developed countries are aging at the same time that birthrates are declining. This creates significant fiscal problems for welfare states with ever growing government benefits pressing against available tax revenues. To escape high taxes, individuals and corporations in these countries become "tax refugees" moving their assets to lower tax jurisdictions. In the case of the Bahamas the money laundering associated with the illegal international drug trade is a related and complicating problem.

At present the prime players in the coterie of supranational organizations are The Organization for Economic Cooperation and Development (OECD) on tax matters, its Financial Action Task Force (FATF) on money laundering and the United States Internal Revenue Service (IRS) and its Qualified Intermediary (QI) program. Each of these groups issued "Blacklists" in an effort to name and shame the OFCs for their banking regulations or financial instruments such as International Business Companies (IBCs) and to induce change.

### ***The illegality of it all.***

**The OECD.** The initiatives of the OECD on Tax Harmonization are to be found in its *Memorandum of Understanding* which aims to equalize tax levels around the world, thus eliminating tax advantages in each region, particularly the OFCs. The problem is it is illegal at international law according to *Assembly General Resolution 2131* of 1965 that limits intervention in the domestic affairs of other nations.

In addition, the Memorandum calls for the "spontaneous" exchange of information between OFCs to aid governments in their investigations on tax matters. It provides that any nation that makes a public declaration followed by a letter to the OECD will be considered party to the Memorandum.

There are several things wrong at this point:

- First, this sounds much like a treaty when, in fact, the OECD has no capacity in law to form treaties since it is not a nation.
- Secondly, there is no basis in law for the instant provision of private financial information. The protection of the individual from intrusions is the basis of the western democratic state model, and the first principle of the legitimacy of democratic government. As such, no supra-national body can – in law – demand an action that is a direct assault on the sovereign character of a state.

The Group of Seven Countries (G-7) established the FATF at its 1989 Summit in Paris. Its basic document is the 40 Recommendations that bear much resemblance to the OECD's Memorandum. However, they concern money laundering and are ostensibly directed against international financial crimes. The Recommendations appear to be in breach of international law as in the case of the OECD.

The regulations forced by the OECD, FATF, IRS on the OFCs have effectively redefined under duress the legislative personality of the nations against whom they are directed. Under the Vienna Convention on Treaties (1969) a treaty is void if its conclusion has been procured by the threat or use of force in violation of the principles of international law embodied in the Charter of the United Nations.

For instance, in December 2000 the Bahamas enacted eleven separate bills to conform to the demands of the OECD and FATF. This was done even after the OECD's own *Offshore Center Working Group* concluded that Off-shore Centers cause no significant interferences to international financial stability.

**Not only are the FATF's impositions breaches of the sovereign character of the nations where they have procured enactments, Attorney Maurice O. Ginton contends that such enactments may be considered in themselves as acts of treason.**

**Internal Revenue Service.** The IRS occupies an interesting position in this controversy insofar as the U.S. benefits from net capital inflows produced by capital flight from abroad end up invested in U.S. markets. This capital flow finances the persistent trade deficit of the U.S.

However, since the US has a tax system that taxes the worldwide income of its citizens, the IRS is always interested to learn the identities



of investors offshore. This allows them to tax US citizens investing from foreign countries such as the Bahamas. It is for this reason that IBCs and a variety of trust facilities have been under attack because of the secrecy or confidentiality rules in the laws of the Bahamas, Switzerland, Hong Kong, and even within the U.S. in states with "offshore" financial centers such as Delaware, Nevada, Alaska and Colorado.

The mechanism employed by the IRS is its Qualified Intermediary Program (QI). This program is also illegal on every ground of international law, U.S. constitutional law and certainly the laws of the Bahamas.

- First, it offends the principle of comity between nations, it is in breach of UN Resolution 2131, and it is an agency-to-state treaty having no basis in law.
- Second, it violates US constitutional law, having usurped Congressional Authority, and it violates rules of administrative law by failing to have regard for alternative arguments from the parties affected by its regulations.
- Furthermore, it is an outright breach of a common law rule of international law and a law jealously guarded by the fifty states in America that provides that no state shall be obliged to enforce the financial laws of any other state.
- Lastly, the QI regulations of the IRS are a devastating breach of Bahamian constitutional law, as it is in conflict with Article 2 Rule on Sovereignty. It alters unilaterally the common law principle of lawyer-client privilege, founded on the principle of the "right to an attorney" which itself is founded on the concept "innocent until proven guilty."

The result of these impositions is that the Bahamas and sundry OFCs have become the administrative territories of G-7 powers. If this persists, it must be taken as a sign that sovereignty, in so far as it has been characterized in the history of the rise of Western Capitalist Juris-Culture, is at an end.

*The UN and the future.*



Of real concern for the future is the role of the UN that may become the dominant agency of financial regulation.

The Social and Economic Council of the United Nations in 1967 founded what is today its Ad Hoc Group of Experts. The group is composed of 25 members, experts and tax administrators from 15 developing and 10 developed countries. As it evolved it was given various tasks such as guidelines for tax treaties, proposals for international cooperation to combat tax evasion and avoidance and international cooperation to reduce incompatibilities between tax systems

The UN like the International Monetary Fund has criticized the workings of the OECD/FATF, arguing in the spirit of national sovereignty in an apparent defense of members of the UN General Assembly against the intrusions by external agencies that have no jurisdiction in law. The Ad Hoc Group of Experts recognized the need for legal legitimacy in all state-to-state and agency-to-state relations in the international arena.

However, such rhetoric by the UN may take little solace to the OFCs since they appear to be public relations "spin". The intent of the Ad Hoc Group of Experts is apparent –

- It states "the inability to obtain information from tax haven countries and tax information not available within its jurisdiction impedes the efforts of many tax administrations to deal effectively with the cases of tax avoidance and tax evasion".

- It has opted for a series of bi-lateral treaties which link the developing world with the developed world; with the former giving up its tax information, whilst the latter developed countries offer assistance to developing countries to enable them to carry out exchanges of information procedures to control harmful tax competition. This is apparently taken to be a fair exchange. All of the features of bilateralism except that mutuality and reciprocity are noticeable by their absence. In point of fact, the bi-lateral approach to this treaty development immediately prejudices the less powerful party.

Despite its "sovereign nation" rhetoric, the objective of the UN Ad Hoc Committee of Experts is to abolish Offshore Financial Centres and to end all tax competition.

However, the UN recognizes it has no sanction powers and thus it lacks the enforcement mechanism to carry out any threats. The proposed solution is made up of four elements:

1. **Use the sanctioning powers of the Security Council.** The Swiss Government for several years has conducted a dialogue, now called the *Interlaken Process*, with interested parties to develop a policy of "targeted financial sanctions". This is a variation on comprehensive economic embargoes that the UN has used in international diplomacy. Targeted financial sanctions would exert pressure directly on the targeted country's decision-makers by localizing and freezing their assets in the world financial markets. Such action would affect, for instance, debt servicing, exit clauses and asset management. As necessary these could be supplemented with arms embargoes, visa and travel restrictions, etc.
2. **Monitor the movement of funds and track the identity of their owners.** Despite the intrinsic complexity of the world financial system, the globalization of financial flows, the reliance on computer-driven electronic transfer mechanisms and new computer software offer an opportunity to accomplish this.
3. **Collect individual and corporate data using the intrusive "Know Your Customer" rules.** It is believed that this data can be usefully integrated into usable databases.
4. **Obtain a mandate to begin the program.**

These supra-national initiatives – if they are successful – will mean that a handful of nations will have developed an official means of policing nations around the world. It will mean that the lazy approach to national development will hurt nations that have used their time unwisely. Plainly we can determine now that the UN's "friendly" rhetoric and its Ad Hoc Committee are in fact hostile to the very basis upon which economic life is built in the Bahamas.

### *Policy recommendations.*

1. The Bahamas should join a "Group" seeking a summary judgment in the U. S. Courts against the Qualified Intermediary Rules of the Internal Revenue Service. The action is on behalf of members of the U. S. Senate and Congress and a member of the Swiss Parliament and



hopefully will be joined by Caribbean countries and the bankers associations. The Group is headed by Dr. Gilbert Morris, Anton Kellor of the Swiss Investor Protection Association and Dan Mitchell of the Heritage Foundation. Apparently, Paul O'Neill, the Secretary of Treasury, is tentative in his support of the QI program and would change direction if he had a pre-text. A successful court action challenging the legal basis of the program would be that pre-text.

2. Beyond this the Bahamas should develop a legal and diplomatic base to defend its sovereignty. Within the U. S. Government this would mean promoting close ties with the conservatives of the Black Congressional Caucus and within the UN promoting the Offshore Financial Centre Bloc. This is taking place in other Caribbean countries.

3. Promote within the Bahamas the rule of law, vigorous law enforcement and an efficient judiciary system. A dogged pursuit of its international legal rights cannot be sustained without an analogous effort within the country. An unquestioned national legal integrity is essential.

4. Make a clear distinction between tax evasion and tax avoidance. Tax evasion is a criminal offence whereas tax avoidance is not. Avoidance is a structuring of one's financial affairs so as to pay the lowest possible tax. However, if that loophole was illegal and if a government felt that it was an offence and sent a subpoena, the subpoena would be taken to court. If the crime cited in the subpoena was not listed as a crime in the relative country, then it should not be treated as such.

If nothing at all, the events of the past year should teach us a lesson:

National vision is not a mythical, but a concrete thing. The absence of it usually forebodes an essential corruption of social and political life by reducing all political initiatives to mere stop-gap measures.

Sovereignty itself is not mythical, and it too is concrete. A failure to defend it is the first step down the ladder into international oblivion and inconsequence.

The desire of a nation to be taken seriously is directly proportional to the strength of its national vision and the basis of its sovereign



law and legal tradition. And this above all points to the fact that a failure of this vision and this sovereignty are the surest signs we know of imminent national decline.

August 27, 2001

## The IMF Verdict on the Labour Bills

by *Ralph J. Massey*

Every two years the International Monetary Fund reviews the Bahamian economy and the policies of the Bahamian Government. It releases its analysis in the form of a Consultation. However, the only information included in the public release is that which both parties agree to release; whereas all of the IMF's views are made available to other international organizations. The language is diplomatic and non-confrontational and one must compare reports for important clues.

### *What the IMF did say.*

These comments relate to the Employment Act alone.

**Background.** The 1999 Consultation made no comment on pending labour legislation; the 2001 report describes the five labour bills.

**Staff Appraisal.** The 1999 report stated that hotel operating costs were among the highest in the region and there was a need to remain competitive" and to increase "flexibility in labor arrangements."

The 2001 Appraisal has two paragraphs that make several points –

1. The Government expected that the Bills "would lead to some increase in labor costs, but thought that the impact would be small". The IMF could not verify this.
2. It recommended that the work week reduction should be introduced gradually in the construction and retail industries.

3. It stressed the need to maintain flexibility with regards to part-time and temporary workers and reduce rigidities in collective agreements in the tourism sector.

**Executive Board Assessment.** The 1999 report contains a single phrase noting the importance of "measures to tackle rigidities in labor arrangements."

The 2001 Assessment notes the need to maintain the competitiveness of tourism and the need to evaluate the "impact of labor costs of the proposed reduction in the workweek." It repeated its concerns about flexibility with regard to part-time and temporary employment and the rigidities in collective agreements.

The diplomatic language of the IMF cannot mask the clear warning signs. Fortunately, the Bahamas Employers Confederation 18-months ago developed the analytical tool to identify the cost impact. Selective sampling then and a new survey document the significant cost impact.

### ***What the IMF did not say.***

The published Consultation, however, does not indicate that the IMF put the pending legislation into a policy perspective.

The IMF chose not to recognize that

1. The Bills are a significant increase in government control and
2. Government regulated, centrally planned labour markets have been thoroughly tried and tested in Western Europe and have failed.

Countries with such regimes have had substantially higher rates of unemployment than countries with freer labour markets. This has been well documented and reported in the Bahamian press by the Institute.

This type of legislation creates a "vicious cycle" of higher direct labour costs, more spending on government bureaucracies, a costly diversion of managerial resources, higher prices, less employment, an institutional resistance to change and finally an alarming capital flight. These are the unintended consequences of such legislation.

In the case of Germany, Chancellor Gerhard Schroeder just intervened in the Volkswagen labour dispute in an attempt to change existing

labour rules in order to create 5,000 jobs. Ultimately, such centralized regulation and planning helped create the economic pressures that ended on this Government's doorstep with the OECD demand that the Bahamas should end its unfair tax competition. The labour bills will substantially raise labour costs and start the "vicious cycle" here.

The futility of the Government's effort is evidenced in the difficulty in framing the legislation that is "compatible" to all. The effort started more than three and one half years ago as a single bill that then blossomed into five bills that were to be presented as an integrated package. Now only three of those bills are to be presented...not as a package but serially.

The first, The Employment Act, is a *de facto* single labour contract applicable to all Bahamian workers both union and non-union. The economy is small but very diverse; and at present, an estimated 18,000 workers of a total labor force of 167,000 or 10.8% are under union contracts. Without getting into the incredible details the three and one half year exercise demonstrates that a "one size fits all" contract will do exactly what the IMF warns against and what has failed in Western Europe.

### ***Conclusions.***

It is folly to take such legislative action especially at a time when the country is in a recession.

It is folly to take such momentous legislative action without an economic impact statement of any kind.

The Institute believes the Bills should be withdrawn from consideration and the Government should go to work on legislation that is in tune with the demands of a small nation in the highly competitive world of the 21<sup>st</sup> century. This will be the subject of another Letter to the Editor.



# The Minimum Wages Act 2001

by Ralph J. Massey

On Monday of this week the Employment Act 2001 was passed apparently without discussion in Parliament and the Rt. Hon. Hubert Ingraham will table two more bills. These are intended to produce new protections and secure as yet unrealized economic gains for those who allegedly were denied their fair share in the FNM engineered prosperity of the past six years.

The Bills are controversial because the consequences of such legislation are often the opposite of the stated objectives. The Minimum Wages Act 2001 is a good example.

## *Supply and demand.*

Minimum wage legislation is popular with politicians seeking voter support ...especially during election years. Yet in the United States it has been an economic illusion for the intended beneficiaries. In all probability the proposed Minimum Wages Act 2001 is no exception.

The economic "Law of Supply and Demand" as applied in this case states that if a government mandates an increase in wages paid by private enterprise, then the number of workers employed declines.

The effect of minimum wage legislation has been studied and re-studied in the United States in no small part due to the availability of relevant employment data going back decades. For instance, a study dated June 1998 showed that the 1990-91 increase in the minimum wage reduced employment from three percent to eleven percent for teen-agers and poorly educated adults. And following the 1996-97 increase the employment rates of teen-agers and poorly educated adults were still below the levels registered nine years earlier.

The Bahamian Government, in effect, recognizes this... namely, that its minimum wage will increase unemployment. And so it gives blanket exclusions from the minimum to the employees of small businesses, students in summer employment, students working and

studying and gas station attendants and under certain conditions the physically impaired.

**It does not address the problem of poorly educated adults.** For instance, Government mandated wage increases are likely to accelerate the introduction of computer technologies. The employment of poorly educated adults is put in jeopardy by the legislation.

### ***Wages councils.***

However, the Bill not only proposes a basic minimum wage but creates a complicated bureaucratic device...wages councils...that can set unique minimum wages for any industry or part of an industry. The International Monetary Fund in its August 2001 Consultation recommended that this provision be ruled out. Wages Councils will submerge business in a process directly analogous to Grievance Lotto...the politically popular labour grievance game played out today before the Industrial Tribunal.

Why would a Government in the same document recognize the adverse impact of minimum wage legislation and at the same time provide the mechanism for creating many minimums?

The Act states that wages must be regulated by tri-partite bodies. Yet, no data or impact statement supports this policy position. The Minimum Wages Act adds to the vicious cycle of higher labour costs, more spending on regulation, more litigation, higher prices, the diversion of scarce entrepreneurial resources, and less employment.

### ***The irony of it all.***

It is ironic that the Bahamian Government is so deeply involved in expanding its regulation of private business when the failures of government management are so apparent.

1. Batelco can't be sold because it never had a proper accounting system;
2. Bahamasair can't survive off the public dole and probably is not saleable at any price;
3. BEC is the perfect monopoly; its service is grossly erratic, prices are very high and major power users are not allowed to generate their own;

4. Water and Sewerage is in deficit because of water leakages and unrecorded consumption, and

5. Recently when it really mattered, the inadequacy of the fire fighting capacity of this Government was clearly evident.

A political elite exhibits a profound intellectual arrogance when it dismisses arguments to the contrary and imposes its vision on a society. What makes it worse is that it does so without a ripple of meaningful protest. For the FNM Government, regulation of private industry is a legacy to be realized.

September 10, 2001

## The Fourth Hammer Blow

The Punch Editorial of September 17th described the three hammer blows to the Bahamian economy –

- 1) The drop in tourist revenues caused by the U.S. recession and the World Trade Center bombing
- 2) The Government's response to the OECD money laundering and unfair tax competition attacks, the "Eleven Bills of Christmas", that badly damaged the financial services sector, and
- 3) The failure to act on the Ministry of Works Straw Market Fire Fighting Report.

However, the Editor failed to mention the Fourth Hammer Blow, The Employment Act that was passed on September 10<sup>th</sup> by Parliament, the two bills that Government intends to table soon and the two waiting in the wings.

The International Monetary Fund in its 1999 and 2001 Consultations observed that hotel operating costs in the Bahamas were "among the highest in the region and there was a need to remain competitive"; and, referring to the five labour bills circulated in 2000, it warned against



increasing labour costs.

The IMF stated that the Government argued that the Bills "would lead to some increase in labor costs, but thought that the impact would be small"; but they, the IMF, could not verify this claim.

To resolve this factual problem the Bahamas Employers Confederation did a business survey on the expected cost increases. In negotiations between the Coalition of Employers and the Government, the latter would not jointly review the BECon Survey results. In addition, the Minister of Labour in his comments to Parliament did not discuss the IMF warning, Government data supporting its statement to the IMF or the BECon survey.

The Minister of Labour did state that the Employment Act had the "support of the business community". This is not correct. At the very beginning of its last conference the Employers clearly stated their strong advice to defer consideration of the bill.

The above suggests that Minister of Labour should comment further and the Punch should revise its list of Hammer Blows.

September 20, 2001

# The Elusive Quest for Growth

"How did some people (about 900million of them) in Western Europe, North America, and parts of the Pacific Rim find prosperity, while 5 billion people live in poor nations? Why do 1.2 billion people live in extreme poverty on less than one dollar per day?

"We have learned once and for all that there are no magical elixirs to bring a happy ending to our quest for growth. Prosperity happens when all the players in the development game have the right incentives.

- It happens when government incentives induce technological adaptation, high-quality investment in machines, and high-quality schooling.
- It happens when donors face incentives that induce them to give aid to countries with good policies where aid will have high payoffs, not to countries with poor policies where aid is wasted.
- It happens when the poor get good opportunities and incentives, which requires government welfare programs that reward rather than penalize earning income.
- It happens when politics is not polarized between antagonistic interest groups, but there is a common consensus to invest in the future.
- Broad and deep development happens when a government that is held accountable for its actions energetically takes up the task of investing in collective goods like health, education and the rule of law." (page 289)

This quote is from a book with the above title published this year by The MIT Press. Mr. William Easterly, the author, is Senior Advisor, Development Research Group, The World Bank.



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