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Can the Sir Stafford Sands Model of the Bahamian Economy, Survive Today's Global Economy?

Prepared by: A. Gabriella Fraser
Research Department
The Central Bank of The Bahamas

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Abstract

This paper looks at vulnerability, as it pertains to The Bahamian economy, particularly given that economy's high concentration of service based industries. Suggesting a framework for income volatility, it discusses ways in which the Bahamian model might be strengthened, towards greater viability within the global context.

The views expressed are solely those of the author.

Introduction

"There are many disadvantages that derive from small size, which are magnified by the fact that many island states are not only small, but are themselves made up of a number of small islands. Those disadvantages include a narrow range of resources, which forces undue specialisation; excessive dependence on international trade and hence vulnerability to global developments …" [Programme of Action for the Sustainable Development of Small Island Developing States, 1994]

Against the backdrop of a more liberalised and rules-based global economy, vulnerability as it pertains to the integration of developing nations into the international community has emerged as a grave reality, particularly for small island states. Many youthful in political independence, for these countries, today's challenge of development is for an economic independence based not only on sustainable development but also on their economies' prospects for prosperity.

The Bahamas is one of such small island states and moreover, it is a small island nation that itself is comprised of many islands. Given the events of the past 24-months in particular, from the activities of industrialised countries towards a more globalised regulatory infrastructure of offshore financial services, to terrorists attacks on the United States, that sent shock-waves throughout the world. Vulnerability, before an issue discussed mainly among academics and at the policy-making level, increasingly is a major concern to the ordinary citizen.

Building on literature that has dealt with the concept of the measurement of a country's macroeconomic vulnerability, this paper will discuss the idea of its impact. It will discuss specifically the example of the Bahamian economy, particularly as it relates to that economy's concentration on service-oriented industries. In the first section, it will assess the state of the Bahamian economy today and in the second, briefly review the measurement issue. The third section develops the idea of a "Sir Stafford Sands" model

and the forth discusses its vulnerabilities. The final section examines how the Bahamian model might be strengthened.

Section 1

The Bahamian Economy Today

Following recessionary years in 1991 and 1992, The Bahamas emerged out of the 1990s having enjoyed years of stable and robust economic growth. In 2000, The Bahamian economy is estimated to have grown by 5.0%, having expanded by almost 6.0% in 1999, both rates besting the 5-year 1996-2000 average of 4.3%. Per capita income at $16,131 vis-à-vis continuous contractions in unemployment, which was projected at a rate less than 7.0% a year ago, suggested participation in the economy's growth by increasing numbers of Bahamians. The Government's consolidation of its fiscal initiatives produced steadily declining deficit balances, the results of which were further reflected by reductions in corresponding debt statistics.

Table 1: General Macroeconomic Indicators for The Bahamas

	1996	1997	1998	1999	2000	Average
Real GDP Growth Rate	4.2%	3.3%	3.0%	5.9%	5.0%	4.1%*
Per Capita Income (current prices)	13,130	13,640	14,267	15,325	16,131	14,499
Inflation Rate (avg. change in RPI)	1.4%	0.5%	1.3%	1.3%	1.6%	1.2%
Unemployment Rate	11.5%	9.8%	7.8%	7.5%	6.8%	9.2%
Fiscal Balance (as % of GDP)	-1.7%	-3.5%	-1.9%	-1.1%	-0.2%	-1.7%
BoP Current Balance (as % of GDP)	7.2%	16.9%	23.8%	8.9%	8.9%	13.1%
Debt Service Ratio	5.4%	5.2%	3.8%	3.1%	2.7%	4.0%
Total Debt/GDP	43.9%	46.0%	44.8%	43.2%	39.9%	43.6%

Source: The International Monetary Fund and The Central Bank of the Bahamas. Note that whereas all other averages are arithmetic values, average real GDP growth rate is estimated by geometric mean.

In June 2001, The Bahamas was removed from the prominent 'blacklist', which in 2000 had identified countries considered a threat to the stability of the international financial system. These countries and territories, were labelled "non-cooperative" by the Financial Action Task Force (FATF) on Money Laundering, in respect of the FATF's attempts to "foster truly global implementation of international anti-money laundering standards" [FATF, 2000]. And, were further regarded by the Organisation of Economic Cooperation and Development (OECD) as "harmful tax havens", and thus the purveyors of unfair competition in global financial markets. Moreover, the Financial Stability Forum (FSF) had rated The Bahamas as among the worst in the world, as it pertained to the financial system's legal infrastructure and bank supervisory practices. The Bahamas responded with the enactment of a package of legislation aimed at strengthening both its supervisory and anti-money laundering regime. The costs of their compliance relate not only to the actual resources expended in order to meet the stated requirements, but also to the question as to whether or not competitiveness may have also been lost in the adjustment, which continues.

Today, following a series of debilitating shocks, the outlook beyond 2001, seems even less favourable and more uncertain, than in the corresponding period a decade ago.

- On September 4th, a massive fire in downtown Nassau destroyed 1½ blocks of Bay Street, the city's major traffic artery, damaging at least one other. In the destruction, the country lost its Straw Market, a premier tourist attraction and large income earner for over 500 craft businesses and the Ministry of Tourism's headquarter building.

- In the immediate period following the September 11th terrorist attack on the United States, tourist arrivals to The Bahamas (as was the case with other such destinations in the region) plummeted, bringing the industry practically to a screeching halt, as the impact on hotel occupancy and thus employment rates in that sector was immediate.

- October 7th marked the beginning of a possible 'world war' as coalition forces joined in a fight against global terrorism, further exacerbating people's reluctance to travel, particularly given the concerns of US citizens (who comprise more than 80% of the total number of visitors to The Bahamas), as to their safety in countries outside of the US.

- Finally on November 5th, Hurricane Michelle, the third major system to hit The Bahamas in ten years (Floyd in 1999 and Andrew in 1992), in her aftermath left considerable property and infrastructure damage to Andros and New Providence islands. Following winds in excess of 100 mph and torrential rains that caused extensive flooding, the damage to these islands, together home to more than 80% of the country's population --- New Providence being the island on which the country's capital city, Nassau is located --- was significant

The overall impact of these events was summarised by the country's Prime Minister as follows:

- Fewer stopover visitors, reduced hotel occupancy and power room revenues
- Deterioration in employment, business profits and incomes in hotel and related sectors
- Reduction in discretionary spending by Bahamian consumers
- A significant slide in government revenues
- A demand for significant increased expenditure on tourism promotion in order to counteract the negative forces affecting tourism
- A need to spend more on security measures
- A need to spend additional funds to effect repairs and to lend assistance to individuals following the damage caused by Hurricane Michelle

In all, tourism is the major employer in The Bahamas, employing not only persons directly in the hotel sector but also in the many spin-off industries and sectors that it feeds into, including: retail and wholesale trade, construction, light manufacturing, cottage industry, restaurants and entertainment, maintenance and repair services, agriculture, fishing and various other food services; and has significantly influenced employment in various professional services, which provide particularly significant levels of high-end employment. Moreover, the tourism industry accounts for the largest share of the Government's revenue.

As a consequence, the Government has been compelled to take a stance of fiscal austerity.

Section 2

The Vulnerability of Small Island Developing States

On the basis mainly of economic exposure; remoteness and insularity; and proneness to natural disasters, recent studies, with emphasis on the world's small states, have devised the concept of an index by which a country's macroeconomic vulnerability might be assessed. Looking specifically at work done by the University of Malta [Briguglio, 1995] and the Commonwealth Secretariat [2000], economic exposure is determined generally on the basis of the economy's trade and financial linkages with the rest of the world; remoteness and insularity is a factor of particular significance to small island developing states (SIDS); while the final component is essentially intended to incorporate economies' susceptibility to environmental hazards and disasters.

The Commonwealth Vulnerability Index (as estimated by the Commonwealth Secretariat) is comprised of two major components: risk as measured by income volatility and resilience, as determined on the basis of a weighted measure of GDP using principal components analysis. From a 111-country sample, a statistical determination for income volatility was estimated as follows:

$$Incvol_i = \beta_0 + \beta_1 Vuln_i. D_i + \beta_2 Exdep_i + \beta_3 Div_i + \varepsilon_i \qquad (1)$$

Where Incvol = Income volatility as measured by the standard deviation of country annual growth rates (1980-1992), VulnD = susceptibility to natural disasters as measured by the proportion of the population that is affected, Exdep = Export dependence as measured by average exports of goods and non-factor services to GDP, Div = Merchandise export diversification (1995) as determined by the UN Conference on Trade and Development and ε_i is the residual term.

Selected results follow, with lowest rankings indicating the most vulnerable, most risky, least resilient and lowest real per capita GDP respectively:

Notably, the Secretariat's index illustrates that income alone is not likely to determine a country's capacity to withstand and potentially recover from various shocks. In particular, the Bahamian economy, though ranked as the highest per capita income country in the 111-member group, on the basis of greater risk associated with its projected income volatility (only 3 other countries were estimated more risky, Vanuatu, Antigua & Barbuda, and Tonga), is included in the lowest quartile; illustrative perhaps of the general risk-return principle that suggests that higher returns are possible primarily in the context of high risk.

Table 2: The Commonwealth Secretariat's Vulnerability Index for Select Countries

	Commonwealth Vulnerability Index	Risk	Resilience	Real per Capita GDP (1995)
Dominica	6	11	7	76
Antigua & Barbuda	8	2	19	86
Grenada	11	13	12	61
St Kitts & Nevis	13	26	6	104
Guyana	17	16	23	45
St. Lucia	18	19	21	74
Belize	22	22	22	82
Suriname	24	76	15	70
The Bahamas	**26**	**4**	**49**	**111**
Barbados	37	37	36	106
Haiti	51	96	39	23
Jamaica	53	30	57	91
Honduras	57	45	54	105
Trinidad & Tobago	62	50	63	102
Panama	71	72	70	93
Paraguay	72	46	74	67
Costa Rica	75	62	75	91
El Salvador	79	98	76	52
Dominican Republic	82	83	79	71
Guatemala	85	99	82	68
Chile	96	68	95	103
Peru	97	97	94	66
Argentina	107	109	107	99
Mexico	109	111	108	98
Brazil	111	110	110	88

Source: Atkins, Mazzi and Easter, A Commonwealth Vulnerability Index for Developing Countries – The Position of Small States, Commonwealth Secretariat Economic Paper 40, 2000

Section 3

The Sir Stafford Sands Model

Historical Overview

"The two and a half decades after 1945 were a period of unparalleled, almost uninterrupted expansion and success. Soaring tourist and investment figures and a corresponding rise in government revenue were accompanied by huge improvements in living standards, education and political sophistication." [Craton, 1986] Economic expansion in The Bahamas in the post World War II era was attributed to an unprecedented promotional advertising campaign, which positioned The Bahamas as a year-round tourist destination. Primarily the spot for wealthy 'winter' travellers, the aggressive promotion of Bahamian "Summer Vacations" introduced a new class of visitor to The Bahamas, and kept resort doors open year-round.

Hailed as the architect of the modern-day Bahamian economy, this campaign was engineered by the late Sir Stafford Sands, Chairman of the Development Board since 1949. In that position, Sir Stafford essentially transformed The Bahamas "from a quality to a mass tourist resort" [Thompson, 1979]. In a single year (1950-1951), tourist arrivals increased by 47% and the rise in the industry in the ensuing years has been described as startling. The industry's sharp and rapid expansion led to substantial increases in public revenue alongside a surge in investments. With attractive tax and customs duty concessions, under the Hotels Encouragement Act, 1949, a construction boom was financed by continuous and large inflows of capital, that were also particularly motivated by the income-tax-free environment. Lucrative resort developments took off, including Lyford Cay in 1955 and Paradise Island in 1959. By the mid-1960s, there were over 40 hotels and residential clubs --- 32 of which had been constructed since 1949 --- moreover,

there were 43 airfields throughout The Bahamas, and Nassau alone accounted for air traffic of up to 65 flights daily.

In 1960 (June 8th) the House of Assembly, in an act to preserve the status of The Bahamas as a tax-free jurisdiction, the House adopted the following resolution: "Resolved that it is the unanimous opinion of this House that it is not in the best interest of the Colony to impose and tax on the income or capital gains of any person, company or corporation."

The expansion in the Bahamian economy supported major infrastructure development projects, financed essential public services, particularly the development of hospital facilities and housing projects; and of course created opportunities for financial intermediation. Whereas there was only a single commercial bank in The Bahamas in 1946, "by 1967 there were no less than 70 banks and trust companies" [Craton, 1986], which were governed by strict secrecy policies, a major attraction to the foreign investor.

In 1964, with the introduction of self-government to The Bahamas, The Board of Development became the Ministry of Tourism. Portfolios for the Ministries of Tourism and Finance were combined, and Sir Stafford, House representative for City District, New Providence since 1937, assumed the ministerial responsibilities for them both, laying before the House The Banks and Trust Companies Regulations Act, 1965, the legislation that would regulate the industry for many years to follow. Given the country's policy focus in those years, one could estimate a conceptual model of the Bahamian economy as follows:

$$\text{Economic Prosperity} = f(\text{tourism, financial services})$$

Whereby tourism and financial services became the main pillars of the Bahamian economy. But, as the economy experienced rapid growth during the period of the 1950s and 1960s, its demand for imports also accelerated.

The Model

Often referred to as a two-sector[1] economy, it has been widely criticised, for its limited diversification, particularly given the heavy reliance on a single industry as its primary source of foreign exchange vis-à-vis a consumption base that is predominantly reliant on foreign imports.

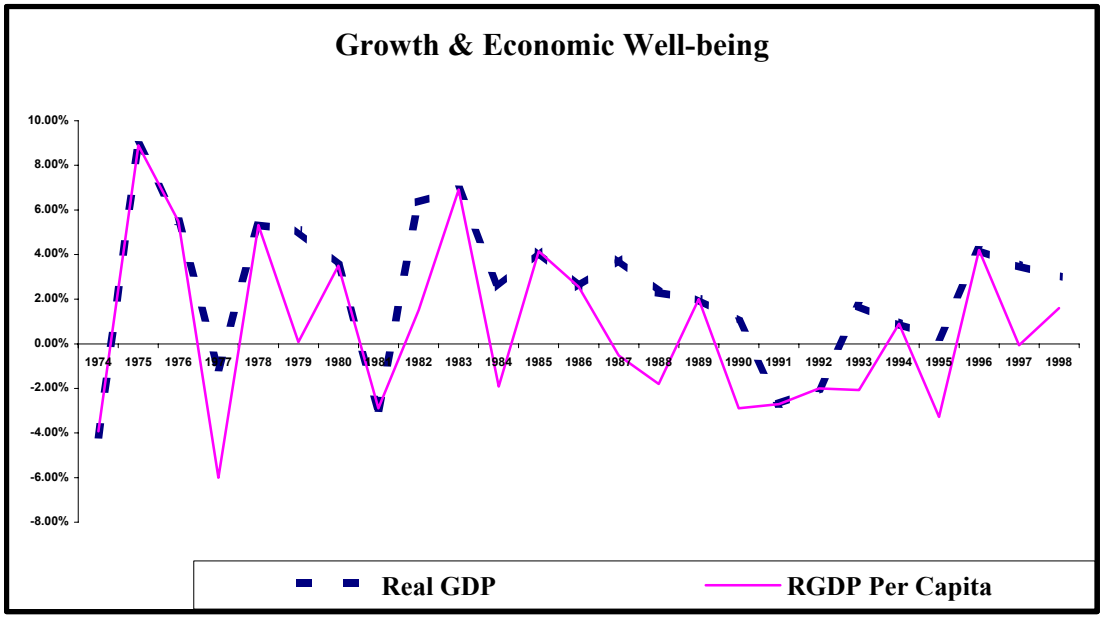
Though Sir Stafford Sands' policy initiatives were aimed precisely at consolidating these two Bahamian niches in the global economy, in steering most of the economy's available resources to the production of these sectors, concomitantly, a major dependency was created on external sources for the supply of basic commodities, other consumables and tools and other resources necessary for capital development. To illustrate the significance of this relationship, in 2000, while direct travel services generated $1.8 billion in export earnings, the economy spent $1.9 billion on the purchase of merchandise imports. Moreover, within the context of The Bahamas' fixed exchange rate regime, the broader picture also suggests an underlying monetary cycle whereby, when money is multiplied through the issuance of domestic credit, a significant proportion ends up leaving the country via the foreign exchange market.

The credit crisis of the late nineteen eighties was perhaps the most pronounced example of how this cycle when disturbed, could have seriously adverse repercussions. At the time, and over a short period, the rate of increase in both consumption and investment spending had grown appreciably, to the degree where credit growth had considerably outpaced deposit growth, placing increased pressure on the country's foreign currency reserves. The consequent rate of increase in foreign exchange purchases compelled the central bank to institute immediate restrictive measures in order to curb some of this pressure, as by then international reserves had already contracted considerably. The bank is in fact limited by statute to maintain the country's stock of external reserves no lower

[1] Tourism and Financial Services

than the stated minimum[2], deemed necessary for the reasonable function of national affairs. Invariably, it could be suggested that in the Bahamian model, the state of foreign reserves is in fact the economy's ultimate monetary target.

Chart 1: Real Economic Growth in The Bahamas (1974-1998)



Source: The Department of Statistics, The Central Bank of The Bahamas and The International Monetary Fund.

Notwithstanding, over the years The Bahamas has benefited considerably from these luxury industries, which have given way to large-scale real property investments and to a great extent provide most the country's high-end salaried jobs. Overall, the economy has enjoyed high levels of income and employment, both of which have grown at generally favourable rates. And undeniably The Bahamas does maintain a distinct comparative advantage: its proximity to the United States and ease of travel between the two countries on the one hand, and given its geographical make-up as an archipelago of islands, it has the capacity to offer a variety of travel experiences to the visitor.

[2] "The value of the said reserve shall not at any time be less than fifty per centum of the value of the aggregate of the notes and coins in circulation and the demand liabilities of the Bank". The Central Bank of The Bahamas Act, 2000, Part V, Section 18, subsection (2).

The defining issue however is two-fold: foreign exchange is earned primarily on the basis of non-essential spending by persons and entities non-resident to The Bahamas. A function of persons' disposable income, travel is among the items that are the first to be either cut out indefinitely or reduced, during times of uncertainty. Whereas these earnings are used to finance essential goods and services, which for the most part, the domestic market is unable to provide. Moreover, a significant proportion of the foreign spending is employed for purposes of providing inputs for the tourism sector, which actually requires the support of a large import base.

Simply, an external shock if severe enough could cut off major international currency inflows almost instantaneously, while consumption spending --- permanent in the sense that people spend according to specific patterns, that tend to moderate only over time --- would be likely to take a much longer time to adjust, triggering a critical macroeconomic imbalance, which could persist indefinitely. By the very nature of a shock, it being outside the control of the effected economy, the consequent impact then on that economy, would depend primarily on either one or both of at least two things, its macroeconomic structure and/or policy.

Section 4

Just how vulnerable is The Bahamas?

In an attempt to construct an empirical model of the Bahamian economy, the objective was two-pronged: first to attempt in some way, to add statistical content to the conceptual model noted above, then secondly, following the example of the Commonwealth Secretariat and previous other studies, to illustrate a measure for income volatility within the context of vulnerabilities considered inherent in the Bahamian example. Recognisably, the limitations in this exercise, due primarily to sample size, particularly within a time series scenario, and generally the availability of data, tend to restrict the results to discussion purposes only. Notwithstanding, after substantial testing, the conceptual model was redeveloped to suggest that income volatility as represented by fluctuations in real per capita income, might be determined by the following specification. A linear relationship is assumed, and logarithms are used as a determination for elasticities:

$$Log\ (PCINX) = \alpha_0 + \alpha_1\ Log\ XDiv + \alpha_2\ Log\ Mdp + \alpha_3\ Log\ VXPGDP + \alpha_4\ Log\ PCINX(-1) + \varepsilon \qquad (2)$$

Where PCINX = Real per capita income (expressed as an index), XDiv = Export Diversification, MDP = Import Dependence, VXPGDP = ratio of visitor expenditure to GDP and ε a stochastic error term. Export diversification is measured as the absolute difference between the share of Bahamian service exports to its total exports, and a world average of the same value, larger numbers therefore indicating a lesser degree of diversification. The estimated world ratio was based on the weighted average share of

service exports to total exports for a selected 12-member[3] country group, where weights were assessed according to each country's share of GDP in the groups total.

Import dependence was measured as the ratio of import tax revenue to government consumption expenditure. This measure was chosen as an illustration of the significance of customs duties to the provision of necessary public services, particularly given today's global tendency towards freer trade among nations. Alternatively the ratio of imports to GDP yielded similar results. Conversely, the share of tourist expenditures to overall production is included as an indicator of the degree of significance of the country's dependence on its most major export. For a time series sample from 1977 to 1998 the exercise included 22 observations, and generated the following relationship:

$$\textit{Log (PCINX)} = -1.19 - 0.32\ \textit{Log XDiv} + 0.15\ \textit{Log Mdp} + 0.23\ \textit{Log VXPGDP} + 0.35\ \textit{Log PCINX(-1)} + \varepsilon \quad (3)$$

Statistical results are noted in the table below:

Table 3: A Statistical Estimate for Bahamian Income Volatility

Dependent Variable: LOG(PCINX)
Method: Least Squares

Sample(adjusted): 1977 1998
Included observations: 22 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.188319	0.327202	-3.631761	0.0021
LOG(XDIV)	-0.320325	0.089760	-3.568676	0.0024
LOG(MDP)	0.149771	0.083020	1.804035	0.0890
LOG(VXPGDP)	0.227706	0.067440	3.376437	0.0036
LOG(PCINX(-1))	0.351697	0.126702	2.775789	0.0129
R-squared	0.860252	Mean dependent var		-0.044269
Adjusted R-squared	0.827370	S.D. dependent var		0.049532
S.E. of regression	0.020580	Akaike info criterion		-4.732269
Sum squared resid	0.007200	Schwarz criterion		-4.484305
Log likelihood	57.05496	F-statistic		26.16188
Durbin-Watson stat	2.110459	Prob(F-statistic)		0.000000

[3] Barbados, Brazil, Canada, Chile, the Dominican Republic, Jamaica, Malaysia, Singapore, Trinidad &

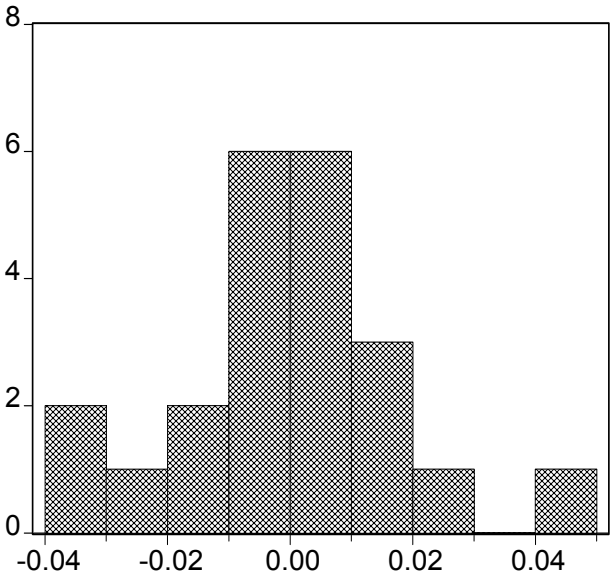
The negative coefficient of the export diversification variable indicates an inverse relationship, suggesting that an increasing concentration of service exports would tend to influence an adverse impact on per capita economic production. That as this concentration, relative to the rest of the world increases, the economy would tend toward increased vulnerability, given the heightened responsiveness to external shocks, implied by the model. Whereas a similar relationship with import dependency might be expected, the direct relationship here is perhaps indicative of on the one hand: the significance of government revenue generated from import related transactions in improving the well being of persons through the provision of public services. And on the other, as results using the alternative measure imports-to-GDP were similar, it is perhaps reflective of the importance of the contribution of external goods and services, in facilitating production in the economy.

Visitor expenditure as expected, exhibited a strong positive relationship with economic growth, and by the very nature of travel demand being a function of disposable income, presumably a more elastic response in periods of economic downturn is likely to be the case. Combined, these three variables suggest that global economic shocks are potentially a major source of income variability in the Bahamian context, with export diversification, or the lack thereof, exhibiting the strongest influence.

A residual analyses of the specification indicated the following:

Tobago, the United Kingdom, the United States and Venezuela.

Chart 2: Histogram - Normality Test



Series: Residuals	
Sample 1977 1998	
Observations 22	
Mean	-3.93E-16
Median	0.001228
Maximum	0.047971
Minimum	-0.031435
Std. Dev.	0.018517
Skewness	0.318429
Kurtosis	3.628253
Jarque-Bera	0.733600
Probability	0.692948

Table 4: Correlogram of Residuals

Sample: 1977 1998
Included observations: 22

Autocorrelation	Partial Correlation		AC	PAC	Q-Stat	Prob
. *| . |	. *| . |	1	-0.139	-0.139	0.4826	0.487
. |* . |	. |* . |	2	0.149	0.133	1.0722	0.585
. *| . |	. *| . |	3	-0.162	-0.130	1.8014	0.615
***| . |	***| . |	4	-0.356	-0.431	5.5172	0.238
. *| . |	.**| . |	5	-0.162	-0.292	6.3353	0.275
.**| . |	***| . |	6	-0.257	-0.356	8.5099	0.203
. |* . |	. *| . |	7	0.186	-0.071	9.7329	0.204
. |**. |	. |* . |	8	0.198	0.074	11.216	0.190
. |**. |	. | . |	9	0.217	0.026	13.135	0.157
. | . |	.**| . |	10	0.031	-0.249	13.176	0.214
. |**. |	. |* . |	11	0.200	0.193	15.102	0.178
***| . |	.**| . |	12	-0.398	-0.252	23.475	0.024

Before arriving at the specified model noted above (2) a series of testing was done, in am attempt to incorporate as many variables deemed relevant to The Bahamian example as

possible, including: Btx – Expenditure by Banks and Trust Companies in The Bahamas, including both its operational and capital investment spending. Generally, financial services account for up to 15% of the Bahamas' GDP, this measure though over a 28-year average (1973-2000) explained less than half of that industry's contribution. As a result the proxy used, perhaps too narrow an indicator, as far as the overall contribution of financial services generally, was not significant.

In an attempt to account for a determination of environmental influences on the economy, a dummy variable for the occurrence of hurricanes was included. Over the sample period, although the Bahamas experienced five hurricanes[4] this variable was found to be statistically insignificant. One of the reasons why such a variable though would be particularly important to small island economies such as The Bahamas, is that given the smallness of these countries, on a per capita basis, the actual system tends to effect larger proportions of the population and by the same token major segments of the economies, than would be the case for geographically larger, less densely populated countries, and more diversely structured economies. During the sample period though, the worst damage due to hurricanes for The Bahamas was concentrated on islands other than New Providence, which is home to the vast majority of the population and all of the major public and private services. As a result, recovery from those shocks was fair.

In all, the underpinning argument of vulnerability then, is the importance of foreign currency inflows to the Bahamas. On the question of export diversification and dependence, can The Bahamas effectively diversify its foreign exchange earnings? On the question of import dependence, can The Bahamas sustain itself sufficiently to fill any gaps in consumption that might be brought on by significant contractions in the stock foreign reserves? Diversification raises two issues, diversification opportunities within existing sectors, and diversification into or of, other sectors. Import dependency raises questions not only of the capacities of local production outside of service industries, but also speaks to issues regarding consumer behaviour, and thus permanent income theories. The question then speaks to the effective management of the current account of the

[4] David – 1979, Kate – 1985, Andrew – 1992, Lilly - 1996 and Floyd - 1996

balance of payments, which of course is indicative of the economy's savings-investment gap.

Table 5: The Current Account Balance as a % of GDP

1974	-8.9%	**1988**	-5.2%
1975	5.4%	**1989**	-3.1%
1976	6.0%	**1990**	-5.6%
1977	9.0%	**1991**	-5.8%
1978	-13.8%	**1992**	-3.6%
1979	-31.2%	**1993**	1.5%
1980	-1.0%	**1994**	-1.2%
1981	-4.9%	**1995**	-4.2%
1982	-3.7%	**1996**	-7.2%
1983	-2.0%	**1997**	-16.9%
1984	-2.5%	**1998**	-23.8%
1985	-1.9%	**1999**	-8.9%
1986	-1.1%	**2000**	-8.9%
1987	-7.6%		

Negative indicates a current account deficit

Source: The Central Bank of The Bahamas

Section 5

Strengthening the Bahamian Model

Tourism directly and indirectly accounts for roughly two-thirds of all gross domestic production in The Bahamas, while the financial services industry is estimated to comprise a 15% share. Agriculture, fisheries, mining and manufacturing combined, on average represent less than 9% of total output. When an economy earns $1.8 billion of foreign exchange from travel services alone, vis-à-vis expenditure of $1.9 billion on merchandise imports, to what extent can that economy on the one hand develop other areas that might generate significant levels of foreign exchange? Or on the other, reduce its economy's demand for merchandise imports?

Export Dependence and Diversification

Diversification within the Tourism Sector

Back in 1949 it was a new promotional advertising strategy that transformed the Bahamas from a strictly winter haven to a year-round tourist resort. The promotional objective today, should be to broaden the base of tourism, to create a destination of broad international appeal. As it stands, over 80% of visitors to The Bahamas originate from the United States, in the year 2000 81.9%. 8.0% came from Europe, 5.7% from Canada and the remaining 4.4% from various other countries. Moreover, US tourists tend to come mainly from the Florida market, and various East Coast cities. Persons that travel from longer distances, tend to stay longer (from 1996-2000 visitors from the US stayed an average of 5.7 days, whereas tourists from Canada and Europe stayed 9.2 and 10.3 days respectively) and on average tend to represent higher income groups. But by broadening the base, somewhat of a buffer to external shocks is created. Since economies are not likely to be affected in the same ways to global events, differentiated responses would be expected.

Broadening the base of tourism means transforming The Bahamas into a more international destination, one of the requirements will be a multi-lingual population. In the year 2000 Puerto Rico accounted for a 19.0% share of stopover arrivals in the Caribbean, the Dominican Republic, 15.6% and The Bahamas amassed the third highest share of 9.3%. So, despite the many English-speaking destinations in the Caribbean, visitors flocked in significantly greater numbers to countries of a more Spanish origin, indicative of the opportunities that a second language potentially can provide for the economy.

Potentially, another opportunity exists in the positioning of cruise travel, particularly as persons begin to reconsider air travel. In 2000, preliminary estimates show cruise and day visitors increasing by 26.0% versus only a 1.2% increase in the number of stopover arrivals. But the average cruise passenger spent only $55.70 per day versus $162.70 by the stopover tourist. The challenge then is to create avenues through which the day passenger might be enticed to spend more on. This is an opportunity for diversification of the tourism product through the value-added by other more creative services, particularly in areas of entertainment, food and culture, it is an opportunity to exploit things considered uniquely Bahamian. In addition, initiatives should be explored, whereby the owners of such services take on a greater share of the burden of promotions. As it stands, promotional advertising is limited to resort promotion, most of which represent chains that can be found in a number of countries around the world. Promotional spending should be directed at the marketing of services and events that can be experienced only in The Bahamas.

Though Sir Stafford Sands' main objective was to create a mass tourist industry, opportunities exist for niche markets within the industry, particularly as it relates to sport fishing, bird watching and other such eco-tourism activities that tend to be the choice mainly of more wealthy travellers.

Diversification outside of Tourism

Though the land mass of the Bahama Islands is indeed small, its ocean area is vast, covering over 100,000 square miles of sea. Over the 1995-1999 period, fisheries production on average made up 54.8% of total non-oil merchandise exports, and grew at an average annual rate of 5.5%. Arguably, fisheries is an area of economic activity in The Bahamas that is under-exploited, and has the potential for much larger foreign exchange earnings.

There are two key factors that relate to the diversification question: "The Bahamas does not have abundant labour resources … and by virtue of high labour costs in The Bahamas, feasible new industries would have to provide a commensurate level of high-value added" [BEA, 2001]. The implication being that diversification should follow a path of knowledge and skills-based activity. The question really then is one of human capital development.

In The Bahamas, 4.0% of its labour force is employed in agriculture and fisheries ventures, 5.2% in industrial and manufacturing sectors and 90.8% in service industries. In building tourism and financial services industries, The Bahamas also built professional and support services transferable across skills- knowledge- and information-based sectors. What it needs now though is a plan for greater consolidation of its human resources. For instance, as it stands there is an estimated 24% gross enrolment in tertiary education, in the medium- to long-term the objective should be to substantially increase that number --- alongside a strategy for exploitation of a larger base of such intellectual industries.

Import Dependence

An analysis of imports by commodity grouping indicates that over the 1995-1999 period, on average 62.8% of imports represented the purchase of capital equipment, 12.2% on oil consumption and 16.1% on the importation of food and live animals. Whereas expenditure on machinery and equipment by their very nature represent future

production, and thus can be argued as necessary spending, we may wish to ask the question as to how we might curb spending in the two categories noted in Table 6: oil and food. Both essentially energy products, can we reduce importation of these products without significant sacrifices in consumption.

Table 6: Imports by Commodity Group, as a % of total Merchandise Imports

	Oil (local Consumption)	Food and Live animals	Machinery, Trans. Equip Other manu goods
1995	13.6%	18.1%	61.1%
1996	15.3%	17.6%	59.2%
1997	12.4%	15.0%	62.8%
1998	9.8%	15.0%	67.5%
1999	9.9%	14.8%	63.4%
Average	12.2%	16.1%	62.8%

Looking specifically at the hotel sector, a considerable proportion of their operational budgets are spent on utility services, in particular electricity and electrical services, which are generated using oil and oil based products. There is one resort though, Ti Amo, located on Andros island that is fully operated by solar power. Given the obvious advantage of an essentially year-round tropical climate, the question then is to what extent are we truly taking advantage of our environmental opportunities, and whether or not the example of this single resort represents a feasible direction for the industry.

Further on the theme of solar energy, one company in The Bahamas, claiming to be the "next wave in personal transportation" has in fact made a small success of electric auto production, with their "Island Neighbourhood Vehicle". No larger than golf carts and utilised mainly by delivery type business services and as the name suggests, for neighbourhood commutes. Should the economy be looking towards developing such automobiles in greater numbers, for longer 'normal' commutes, instead of imports that

require much of the oil and petroleum based products that the economy consumes? particularly for a small island like New Providence, Bahamas where the number of private vehicles exceeds 100,000.

As far as food production, what are the opportunities that exist for expansion of production, at the very least for the local market? Though agriculture is largely criticised as an infeasible export industry, are sufficient efforts being made towards achieving subsistence production? It can be argued that the industry is one that has hardly evolved overtime. Lacking the kinds of broad-based capital and technological advances that continue to transform the industry world-wide, many of the older and ageing practitioners operate largely subsidised ventures under methodologies and systems long considered antiquated, for the sale of goods mainly to the government operated produce exchange. Only in very small numbers, have farmers emerged with market viable enterprises. In the absence of a clear policy as to the development of this industry, it lacks a concentrated effort towards the creation of a human resource base that includes agriculture among skills-based industries. Though it seems that in the Bahamas generally, that the industry is not highly regarded, it is by far an industry that has more to offer, beyond its present degree of exploitation.

Offshore Financial Services

With the introduction of a legislative package that includes “nine pieces legislation that address three major issues: (i) customer identification, reporting of suspicious transactions, and transparency (ii) financial supervisions practices and (iii) international cooperation” [IMF, 2001]. And institutional changes including the establishment of a Financial Intelligence Unit and revisions to the powers and duties of the Central Bank of The Bahamas, the financial services sector is in the midst of a major transformation, the overall impact of which are too early to effectively assess.

Conclusion

The strengthening of the Bahamian model is no doubt a medium to long-term affair. Today, as the economy copes with the effects of most recent events, and the uncertainty of the future, it is clear that the basis of the economy's resilience in the short-term, is largely a behavioural one. Depending on how households have managed their savings in the past, and on the opportunities for consumption smoothing that policy-makers are able to initiate.

The challenge perhaps is not the mere concentration on services, but that the model itself did not seem to evolve fast enough to keep pace with the changing times, nor has it fully exploited opportunities that the human infrastructure developed in support of existing industries, can provide. The tourism industry is still largely just a hotel industry, and the events of the past 24-months exposed the financial services industry as one that seemingly too did not manage to keep up with the pace of change. Once ranked among the top three offshore centres in the world, by 2000 The Bahamas had already lost some of this prominence. Strengthening the model means continuing the building process of existing industries, which are without question highly suited to The Bahamas and encouraging continued development into broader areas of services, professional health and medical services, accounting, legal, financial and of course technological and information services. One thing that the new economy has certainly taught us, is that intellectual markets can be developed anywhere in the world, as long as the infrastructure needed to develop the human resources not only exists, but is also made a priority.

Appendix 1: Abbreviations

BTX – Total expenditure by banks and trust companies
BTXGDP - Total expenditure by banks and trust companies as a proportion of GDP
Div – Merchandise export diversification
Exdep – Export Dependence as measured by average exports of goods and non-factor services to GDP
GDP – Gross Domestic Product
Incvol – Income Volatility
MDP – Import dependence as expressed by total tax revenue on imports as a percentage of Government's consumption
MDP2 – Import dependence expressed by total imports of goods and services as a percentage of GDP
NGDP – Nominal GDP
NGDPC – Nominal per capita income
PCINX – Real per capita income
Vuln – Vulnerability
VXP – Visitor or tourist expenditure
VXPGDP - Visitor or tourist expenditure as a proportion of GDP
Xdiv – Export Diversification, comparison of Bahamian value to a world value, as measured by service exports as a ratio to total exports

Appendix 2: Select Macroeconomic Indicators (unless otherwise indicated, all values expressed as indices, where base year = 1990)

	PCINX	VXP	VXPGDP	BTX	BTXGDP	NGDP	NGDPC	MDP *(ratio)*	MDP2 *(ratio)*
1973	82.7	22.8	86.1	19.3	73.0	26.5	36.2	0.795	na
1974	79.5	24.8	86.3	20.0	69.6	28.7	39.3	0.779	0.859
1975	86.5	24.0	69.6	21.1	61.2	34.4	47.1	0.676	0.629
1976	91.3	27.8	73.3	26.5	69.8	37.9	51.9	0.657	0.608
1977	85.8	31.1	80.4	29.6	76.5	38.7	50.3	0.727	0.606
1978	90.4	37.4	86.4	29.8	68.8	43.2	56.2	0.747	0.761
1979	90.4	42.4	85.5	36.5	73.7	49.6	61.4	0.810	0.934
1980	93.6	45.0	96.0	43.2	92.3	46.9	58.0	0.814	0.810
1981	90.9	48.3	89.8	49.7	92.5	53.7	66.5	0.718	0.746
1982	92.3	49.4	91.3	51.6	95.3	54.1	64.0	0.721	0.734
1983	98.6	58.2	105.9	63.3	115.2	54.9	64.9	0.736	0.765
1984	96.8	60.5	105.1	70.4	122.3	57.6	65.1	0.722	0.773
1985	100.8	75.2	112.4	72.6	108.5	66.9	75.6	0.819	0.760
1986	103.3	83.4	111.2	85.0	113.3	75.0	84.8	0.787	0.702
1987	102.8	86.5	105.2	85.7	104.2	82.2	89.1	0.808	0.716
1988	101.0	86.8	105.5	88.8	107.9	82.3	85.6	0.758	0.689
1989	103.0	98.4	102.5	92.3	96.3	95.9	99.8	0.740	0.633
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	0.724	0.663
1991	97.3	89.6	90.8	100.8	102.2	98.6	98.6	0.659	0.623
1992	95.4	93.4	93.0	106.9	106.4	100.5	100.5	0.639	0.596
1993	93.4	97.9	94.4	112.0	108.0	103.7	99.9	0.624	0.537
1994	94.2	100.2	92.4	120.6	111.1	108.5	104.4	0.720	0.543
1995	91.1	101.6	90.9	125.5	112.2	111.8	103.8	0.695	0.575
1996	95.0	105.5	88.4	146.7	122.9	119.4	110.9	0.665	0.596
1997	94.9	106.9	85.0	157.9	125.6	125.7	112.7	0.663	0.687
1998	96.4	102.2	76.5	156.1	116.8	133.7	118.2	0.635	0.736
1999	100.7	119.5	81.9	183.9	126.0	145.9	127.3	0.724	0.681
2000	103.3	137.0	87.3	210.4	134.0	157.0	133.8	0.790	0.666

Appendix 3: Determination of Bahamian Export Diversification on a Comparative Basis, of the Concentration of Services in Total Exports, using select Country Examples

	USA	UK	Canada	Barbados	Dominican Republic	Jamaica	Trinidad & Tobago	Brazil
1973	0.1927	0.3039	0.1087	0.6147	0.1392	na	na	na
1974	0.1744	0.2883	0.1083	0.5172	0.1279	na	na	na
1975	0.1789	0.2855	0.1132	0.4714	0.1150	na	0.1685	0.1110
1976	0.1938	0.2848	0.1122	0.5538	0.1514	0.2617	0.1707	0.0927
1977	0.2047	0.2683	0.1045	0.5791	0.1582	0.2274	0.1704	0.0919
1978	0.1997	0.2634	0.1024	0.5803	0.1842	0.2556	0.1686	0.0977
1979	0.1739	0.2633	0.1018	0.6296	0.2346	0.3007	0.1492	0.0882
1980	0.1749	0.2495	0.0993	0.6014	0.2434	0.2939	0.1308	0.0794
1981	0.1945	0.2498	0.1044	0.6473	0.2146	0.3067	0.1330	0.0887
1982	0.2326	0.2420	0.1026	0.5832	0.3276	0.3911	0.1692	0.0823
1983	0.2414	0.2402	0.1040	0.5278	0.3677	0.4406	0.1036	0.0730
1984	0.2443	0.2332	0.0937	0.5068	0.3662	0.4464	0.1092	0.0673
1985	0.2529	0.2369	0.0985	0.5514	0.4417	0.5174	0.1098	0.0753
1986	0.2772	0.2583	0.1159	0.6231	0.4897	0.5611	0.1647	0.0752
1987	0.2807	0.2524	0.1165	0.7565	0.5450	0.5359	0.1289	0.0693
1988	0.2553	0.2482	0.1185	0.7693	0.5325	0.4664	0.1558	0.0632
1989	0.2583	0.2401	0.1239	0.7892	0.5297	0.4599	0.1533	0.0835
1990	0.2736	0.2337	0.1285	0.7491	0.5990	0.4630	0.1435	0.1070
1991	0.2811	0.2315	0.1364	0.7494	0.6455	0.4533	0.1859	0.0950
1992	0.2841	0.2486	0.1333	0.7653	0.7057	0.4972	0.2111	0.1025
1993	0.2863	0.2471	0.1292	0.7859	0.3237	0.5328	0.1907	0.0910
1994	0.2827	0.2434	0.1255	0.8107	0.3412	0.4916	0.1552	0.1001
1995	0.2737	0.2405	0.1190	0.7793	0.3405	0.4731	0.1224	0.1165
1996	0.2795	0.2401	0.1246	0.7638	0.3456	0.4856	0.1638	0.0887
1997	0.2724	0.2508	0.1261	0.7685	0.3465	0.5021	0.1825	0.1012
1998	0.2791	0.2722	0.1315	0.7993	0.3343	0.5254	0.2293	0.1299
1999	0.2826	0.2805	0.1255	0.7965	0.3569	0.5560	na	0.1302
2000	0.2729	0.2642	0.1187	na	0.3601	na	na	0.1455

Appendix 3: (cont'd)

	Chile	Venezuela	Malaysia	Singapore	Weighted Average	Bahamas Average	Xdiv
1973	na	0.1205	na	0.2767	---	---	---
1974	na	0.0280	0.0814	0.2464	---	---	---
1975	0.1349	0.0396	0.0968	0.3059	---	---	---
1976	0.1231	0.0352	0.0699	0.2621	0.1900	0.8207	0.6307
1977	0.1602	0.0496	0.0746	0.2393	0.1958	0.8272	0.6314
1978	0.1635	0.0642	0.0784	0.2360	0.1921	0.8163	0.6242
1979	0.1699	0.0400	0.0666	0.2015	0.1722	0.8093	0.6372
1980	0.2116	0.0347	0.0805	0.2000	0.1710	0.8130	0.6420
1981	0.2340	0.0362	0.1005	0.2541	0.1870	0.8386	0.6516
1982	0.2016	0.0593	0.1157	0.2789	0.2137	0.8002	0.5864
1983	0.1722	0.0683	0.1182	0.2635	0.2192	0.8093	0.5900
1984	0.1539	0.0410	0.1047	0.2034	0.2187	0.7921	0.5735
1985	0.1539	0.0522	0.1125	0.1682	0.2261	0.7988	0.5726
1986	0.1991	0.0872	0.1267	0.1745	0.2481	0.8091	0.5610
1987	0.1646	0.0756	0.1128	0.1661	0.2492	0.8243	0.5751
1988	0.1337	0.0756	0.1018	0.1567	0.2294	0.8247	0.5953
1989	0.1597	0.0664	0.1038	0.1745	0.2327	0.8450	0.6123
1990	0.1809	0.0629	0.1181	0.1898	0.2455	0.8253	0.5798
1991	0.1922	0.0750	0.1148	0.1839	0.2505	0.7992	0.5486
1992	0.1907	0.0846	0.1113	0.1957	0.2552	0.8063	0.5512
1993	0.2145	0.0831	0.1218	0.1928	0.2553	0.8121	0.5568
1994	0.1966	0.0891	0.1407	0.1905	0.2528	0.8378	0.5850
1995	0.1722	0.0805	0.1392	0.2002	0.2465	0.8257	0.5792
1996	0.1920	0.0622	0.1643	0.1921	0.2492	0.8052	0.5560
1997	0.1978	0.0591	0.1686	0.1952	0.2463	0.7800	0.5337
1998	0.2175	0.0767	0.1381	0.1476	0.2555	0.7340	0.4785
1999	0.1953	0.0589	0.1242	0.1719	---	---	---
2000	0.1780	0.0305	na	0.1629	---	---	---

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