HOW CAN SMALL COUNTRIES GET ALONG IN A BIG WORLD?

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Thank you for the invitation to speak at this conference. I will speak to how The Bahamas is managing its interactions with the sometimes helpful and often intrusive international groups who seek to impose their version of an optimal order on the world. My comments are informed by the last year and a half in The Bahamas, and the previous 15 working for the Australian Prudential Regulation Authority, or APRA.

Humanity has organised itself into about 200 national jurisdictions. It is obviously the case that cooperation between these countries generates enormous benefits. It is I trust equally obvious that this cooperation and the benefits therefrom are greatly enhanced by international adoption of standards and codes of practice.

But, and this is a big "but", these standards and codes are generally developed by big countries, and imposed on small countries. Furthermore, participation is not optional for small countries aspiring to better than North Korean standards of living.

Today I will touch on four international interveners: the IMF, the Financial Action Task Force, the European Union, and the OECD. The IMF and the FATF are particularly on our mind at the moment, as The Bahamas is simultaneously engaged in an FSAP and in getting ourselves off a FATF blacklist.

The IMF is perhaps the most straightforward case. It encourages, and in some cases forces, small countries to follow the western consensus on sensible economic management. In normal times this proceeds via surveillance and engagement, particularly the Article IV and FSAP processes. For countries not in serious financial difficulty, the IMF is a sometimes annoying but almost always useful consultant, and a consultant made more valuable because for all practical purposes, it can't be fired. Furthermore, my experience has been that countries would generally be wise to follow, or at the least very carefully consider, advice received from the IMF. My unvarying experience over many years is that, however unpalatable a particular piece of advice, it is expertly constructed and honestly provided.

When it comes to countries who are no longer in a position to pay their international bills, the IMF looms considerably larger on the horizon. For several decades the IMF has offered adjustment programs to a great many countries, but the bargain can be harsh. That is: the IMF will lend an insolvent country the funds necessary to avoid disaster, but at the price of the country following the IMF's policy prescriptions. This advice is generally to cut public sector spending, clean up the banking system, strengthen tax collections, and suppress corruption. Following this advice is by definition politically and socially painful: the country in question got in trouble in the first place because it wouldn't adopt sound policies without the IMF's coercion.

The best strategy for small countries dealing with the IMF is therefore to follow their advice, or have a very good reason for not doing so, during good times. This greatly reduces the odds that a small country will be forced to follow much harsher but possibly unavoidable advice during times of financial difficulty.

None of this is to say that the IMF is correct all the time, and they wouldn't claim any such perfection. But the IMF is expert, honest, and disinterested; can we really ask for more than that?

Moving on to the FATF, and our relevant regional body the CFATF, we face a somewhat different proposition. The FATF was founded in the early 1990s explicitly to combat Latin American transnational drug dealing. Their mission was expanded over time, to the point where anti-terrorist work is claimed to be the number one goal, along with anti-proliferation, and using financial controls to combat any sort of crime anywhere in the world. The focus on trans-national money movement has also reduced, and the FATF nowadays is perfectly happy to inject itself into the internal affairs of every country in the world.

What is good about this arrangement? In fact, quite a lot. The FATF and its regional bodies provide a well-developed framework for any jurisdiction to improve its financial system's resistance to financial crime. The mutual evaluation process provides the necessary discipline to take the framework seriously. In The Bahamas, particularly in the 1980s and 1990s, we had more than enough of a lesson on the catastrophic effects of illegal drugs and drug money. Since major reforms commenced in 2000, we have striven, with considerable success, to create a society more resistant to dirty money. Does any sane country or sane people want to become or live in a narco-state, or a terrorist haven? Certainly neither The Bahamas nor TCI fall into any such category.

Although the FATF's intentions are good, their execution is from a small state viewpoint unattractive. The FATF has defined 40 technical compliance measures and 11 effectiveness measures for AML/CFT. From our perspective, these measures suffer from three drawbacks:

a) There is no empirical backing that the 51 measures in aggregate predict any nation's incidence of money laundering. We routinely see large money laundering incidents associated with countries who rank highly on these measures, and vice versa.
b) The 51 measures and current assessment processes are in our view over-weighted towards terrorism and proliferation. In countries where drug money remains the main issue, and there is no history of terrorism or support for proliferation, the FATF assessments can downgrade the whole country based upon non-punishment of a non-existent risk.
c) The measures are punishment-based rather than prevention-based. The important quantitative indicators include the number of suspicious transaction reports filed, the

> number of AML convictions, and the asset seizure track record. This means that countries with a great deal of money laundering activity, such as the United States and the United Kingdom, score very well on the FATF indicators, because they catch many crooks every year. But they catch so many money launderers because they have a lot of money laundering. Wouldn't it be better to run a country in a manner calculated to produce few money laundering convictions, because there is very little money laundering?

There is also the major consideration that over the past decade or so, international correspondent banks have become gun-shy about maintaining relationships with respondent banks. For small island states, de-risking is not so much about banking, but the risk of loss of access to the international payments system, which in turn is loss of access to the imports we need to maintain a modern society.

The FATF compliance scores are typically the largest input into correspondent banking risk models. Because the 51 scores do not differentiate between the banking system and the rest of the economy, one can too easily imagine, and in The Bahamas we are currently living, the case where poor scores on relatively trivial matters such as used car dealers and jewelry stores reduce international acceptance of well-regulated sectors such as banking. This is not the FATF's fault, but it is a direct result of the FATF's mutual evaluation methodology.

So what are small countries to do about the FATF? In summary: do your best to engage proactively, and ensure a substantial devotion of resources to the CFATF mutual evaluation process.

From the 1990s, the world's large countries decided that they would no longer tolerate the world's small countries facilitating financial crime, first crime associated with drug money, and latterly crime associated with any source, with a focus on terrorism. This trampled on our sovereignty, but for some of the reasons mentioned previously was not a bad thing for most small countries. Unfettered international movement of drug money helps no country, including financial intermediaries.

In the past decade or so, the world's large countries decided that they would no longer tolerate the facilitation of tax avoidance by small countries. First we had FATCA, then CRS. Strikingly, what we do not have is the US held to these standards, so America has become the last great haven for non-American tax avoiding money.

As part of this effort, we have also seen a movement to ban privacy in global financial dealings, at the same time there have been large movements to increase personal privacy as a human right. The upshot of all this has yet to be worked out.

In the case of the IMF and the FATF, what we have experienced is a combination of helpful consulting and technical assistance, with sometimes painful and unhelpful imposition. In the tax avoidance and privacy spheres, particularly as operated by the EU and the OECD, we are experiencing the imposition without the help.

The Europeans and the American's have conscripted the world's small states in their desire to remove loopholes and hiding places for corporate and personal money they consider taxable in their jurisdictions. Part of this conscription has been demands for data on individual financial services clients, whatever the local confidentiality laws. Increasingly, and particularly from the EU and OECD, we are seeing demands that small states make their local tax regime less attractive to foreign companies and investors.

What is the basis for these EU demands? In summary, they are big and powerful, and willing to exercise this power to force their will on us. So what is our strategy? Faced with overwhelming economic force, we comply where we must, and optimise where we can.

To take some recent examples, the EU and OECD are demanding economic substance, more disclosure of ultimate beneficial ownership, and reduction in tax subsidies for some forms of investment. The Bahamian Government has responded by commencing legislation that is benchmarked against global best practice, to achieve compliance with the EU and OECD demands.

We also have the recent example of the OECD issuing a quasi-blacklist of countries maintaining, to the OECD, questionable citizenship by investment and residency by investment schemes. Among the list of problems with this action:

- There was insufficient consultation before the OECD issued the list;
- There was evidently no distinguishing between citizenship and residency schemes, which can have quite different effects; and
- All or nearly all OECD countries maintain similar schemes, but not by coincidence, none of these schemes made the OECD list.

It is hard to see this action as anything other than an attempt to hobble non-OECD competition for OECD member investment schemes. It is very much a case of the OECD seeing the mote in small county eyes, and not seeing the beam in their own member's orbs.

The Bahamian approach to this list has been to ignore it to the degree reasonably possible.

Similarly, there is a growing international movement towards publicly disclosing the ultimate ownership of, in essence, every asset in the world. This could have unwelcome consequences. If this policy succeeds, the world's kidnappers, stalkers, and thieves, including cyber-thieves, will have been given a public roadmap to assist their efforts.

The Bahamian position here, expressed in CRS and elsewhere, is that we are willing to disclose beneficial ownership to relevant law enforcement and tax authorities, but we consider that public disclosure would be highly unhelpful.

There is the further consideration that Delaware corporate registry arrangements, and U.S. trust company arrangements in many states, will continue to allow anonymous ownership of assets. The UK has been highly proactive in this space, but we understand that considerable undisclosed assets, often speaking Russian, can be found in Mayfair and similar neighbourhoods. In this sense, the global push for full asset disclosure becomes in essence a job creation scheme for the American and British funds management, banking, and trust industries.

In the short term, The Bahamas, TCI, and other small states must comply with rules imposed on us by large states. We can agree that this is unfair, colonialist, and inconsiderate, but the reality remains that we must comply or starve.

In the longer term, small states need to get better at sorting out what is useful from these impositions, from what is not. Those aspects that are useful should be implemented, despite any resentment at the way they are imposed, because they are good for our societies. Those aspects that are not useful, and at times actively harmful, can only be resisted if the small states become better at collective action. But that is a conversation for another day.

I congratulate the financial services industry in the Turks and Caicos Islands for its successes to date, and wish you every success in the future. Thank you for your attention.

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