PRIVATIZATION IN THE BAHAMAS

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The subject of privatizing state-owned enterprises, called public corporations in The Bahamas, sprang into prominence with the election of Margaret Thatcher as prime minister of Britain in 1979. Privatization became a household word with the rapid sell-off of banks and state-owned firms in several Latin American countries during the 1980s (including the virtual privatization of Chile's state-run pension system), and especially following the collapse of the iron curtain in 1989 throughout Central and Eastern Europe. Privatization has taken a variety of forms, ranging from vouchers, to a combination of vouchers in conjunction with selling a controlling stake to strategic investors, to private placements.

Privatization is justified on several grounds. One is to eliminate the endless flow of taxpayer subsidies required to keep state-owned firms in business, thereby relieving pressure on state budgets. Another is to eliminate political patronage and gross inefficiency that characterize the operations of many state-owned firms. A third is to reduce public sector employment and the political clout exercised by public sector unions over wage increases and government economic policy. A fourth is to link pay increases with increases in productivity.

State-owned firms in The Bahamas fit the paradigm of privatization. Several major problems afflict the public corporations, which can be treated as an arm of the public services. First, the public sector is grossly overstaffed. Many young Bahamians relish a position in the public corporations, which carries status, a relatively high salary, and virtual civil service protection.

Second, the government and the various public corporations and agencies have given excessive pay increases over the past decade. Both the World Bank and Inter-American Development Bank specifically caution against public sector pay increases because they tend to have a demonstration effect on other sectors of the economy.

Third, it is desirable to shift the ownership and management of public corporations to private enterprise ownership and management. Good progress has been made in privatizing state-owned hotels. But this progress must be extended to other public enterprises, which would transform large numbers of public sector employees into private sector employees. This is especially so for the Bahamas Telecommunications Corporation, Batelco, since the retention and future development of banking and financial services require constant improvement of telecommunications services. Public corporations with monopoly status have little incentive to improve quality or reduce prices and often lack access to funds to pay for modernization. Complaints about the low quality and high cost of telecommunications services provided by Batelco are widespread.

The portfolio of the Bahamas Development Bank has a number of questionable assets. Bahamasair may be the most overstaffed airline in the world. The high and rising overhead charges incurred by the National Insurance Board would be intolerable in any privately-managed pension fund.

A Statistical Portrait of State-Owned Enterprises in The Bahamas

At the end of 1996, the total contingent liabilities of the government, consisting of that portion of the borrowing of the public corporations guaranteed by the government, stood at about $308 million dollars. The three main borrowers were the Bahamas Electricity Corporation (BEC), $132 million; the Bahamas Mortgage Corporation, $115 million; and Bahamasair, $36 million. (When the $308 million in government-guaranteed debt of the public corporations is added to the direct national debt of $1.24 billion, the total national debt comes to $1.54 billion, estimated at about 40% of GDP.)

At the end of 1996, the total debt of the public corporations amounted to $389 million, of which just over half, about $213 million, consisted of foreign currency debt. The external debt of the public corporations takes the form of government guaranteed loans. 61% of the external debt is that of BEC. The total debt of the public corporations has come off its high of $474 million in 1992.

A consensus exists within The Bahamas that the public corporations are inefficient, overstaffed, and routinely suffer from political interference primarily for purposes of employment. As part of my work with the Securities Market Task Force, I reviewed in 1995 what were then the most recent official published reports of the public corporations and interviewed several of their administrators. I also met with high volume purchasers of the services of the public corporations. What follows is the status of the public corporations as of mid-1995. Some of these results may have become dated by recent developments, but the main trends still apply.

I recommend that every educated resident of The Bahamas take the time and effort to study the annual reports and financial statements of the public corporations and public agencies.

I will focus my remarks on the big three: the Bahamas Electric Corporation (BEC), the Bahamas Telecommunications Corporation (BTC), and the National Insurance Board (NIB). The appendix to this talk includes information on the Bahamas Agricultural and Industrial Corporation (BAIC), the Bahamas Mortgage Corporation (BMC), the Bahamas Development Bank (BDB), and the Water and Sewerage Corporation (WSC).

Bahamas Electricity Corporation (BEC)

As of mid-1995, the most recent statement for BEC was the "1993 Annual Report and Financial Statements." In addition to detailed financial comparisons for 1992 and 1993, the report includes a ten-year statistical summary encompassing generation capacity, maximum system demand, units generated and sold, revenue, number of consumers and employees, and a balance sheet summary.

Over the ten years encompassing 1984-1993, most performance indicators rose about 80%: installed generation capacity, units generated, and units sold. However, revenue from sales of electricity only increased by 55% (in current, not inflation-adjusted, dollars). The number of consumers rose from 39,025 to 63,408, and the number of employees increased from 659 to 1,057.

Fixed assets (less depreciation) grew from $93.6 million to $263.4 million, well in excess of revenue growth. This expansion was financed by a more than fivefold rise in external debt, from $30.1 million to $166.4 million and a more than quadrupling of reserves from $26.7 million to $112.1 million.

Net profit was $10.48 million in 1993, nearly double the average of the preceding four years.

The most alarming part of the financial statement is accounts receivable. Accounts receivable for private customers increased from $16.5 million in 1992 to just under $20 million in 1993. But accounts receivable from government corporations and departments grew from $26.5 million to $31.1 million, year over year. Total receivables stood at $51.1 million. The statement reports that "Management is currently negotiating formal arrangements for the repayment of these long-term receivables from the various Government Corporations." In this case, as in many others, government ministries, departments, and corporations do not promptly pay their bills to each other. This situation is analogous to the inter-enterprise debt situation that burdens the economies of the former socialist countries of Central and East Europe.

BEC plans major investment outlays in the next few years, which will require substantial additional borrowing. Much of this new borrowing would not be necessary if the government paid its outstanding bills.

It is widely repeated within the international and domestic business community that the price of electricity is too high, even taking into account the need to import fuel and the small and scattered size of BEC's operations.

Bahamas Telecommunications Corporation (Batelco)

The most frequently voiced criticisms of all the public corporations were directed at Batelco. Critics charge Batelco with high cost, poor quality, deficient service, and serving too much as a welfare program for its employees. No individual with whom I spoke (the number exceeds 100) uttered positive remarks. Indeed, members of the financial services sector uniformly expressed concern that The Bahamas risks losing business to other offshore financial centers unless Batelco service and price competitiveness improve dramatically.

As of 1995, the most recent financial statement for Batelco was for the year ended December 1993. The balance sheet shows $133.2 million in net assets and liabilities. The most revealing figure appears under "current assets": $67.9 million in accounts receivable and prepayments. This exceeds by $17 million the sum of $50.5 million in accounts payable and accrued liabilities. The net assets consist of $100 million in Bahamas Government ordinary stock (public debt) and $31 million in statutory reserve (along with $2.2 million in deferred income).

Operating revenues of $130.7 million in 1993, an increase of $10.4 million over 1992, were generated by $29.3 million in local service, $93.8 million in toll service, and $7.6 million in other charges. The toll service receipts accounted for $7.3 million of the increased operating revenues in 1993. The most serious complaint directed at Batelco is the high cost of long distance service, and to protect that revenue source the Parliament has outlawed call-back services.

Operating expenses consisted of $59.1 million for plant, $34.4 million for administrative charges, $19.6 million for depreciation, and $6.3 million for personnel and training.

Operating profit in 1993 was $10.9 million, compared with a loss of $983,000 in 1992. The change was attributable to a rise in operating revenues, largely toll services, with no increase in operating expenses.

Of accounts receivable, $7.1 million was due from government corporations and agencies, an improvement over the higher figure of $14.4 million in 1992. However, total customer accounts outstanding rose from $44.8 million to just under $51 million.

Of the $50.5 million in accounts payable and accrued liabilities, some $19.9 million is the employee pension fund deficit (which explains the less than enthusiastic employee support for privatization), $9.9 million in security deposits (it's not Batelco's money), and $16.7 million in trade payables. Batelco, like BEC and other public entities, needs to do a better a job of collecting its bills.

The absence of an annual report makes it difficult to itemize growth of revenues, employees, return on equity, etc.

The National Insurance Board

It is important to discuss the National Insurance Board, because it is an integral part of any discussion involving public agencies. The Board's liabilities consist of payments to Bahamians as a result of sickness, invalidity, maternity, retirement, death, industrial injury, medical care, and general social assistance. At the end of 1991, the Board's assets consisted of government debt (about 47%), loans to the Bahamas Mortgage Corporation (about 16%), long-term loans to quasi-government corporations (to promote infrastructure, about 9%), government treasury bills (classified as current assets, about 10%), and cash. The Board holds one form or another of public debt as the bulk of its assets. At the end of 1996, the Board held about $520 million in government debt in all forms. The Board is not free to make investment decisions based on what its director and members determine to constitute sound risk-adjusted, rate-of-return decisions.

The Board operates increasingly as a pay-as-you-go system, in which current benefits are paid, in part, from current income, and only partly from returns on investment. The level of investment income does not provide sufficient funds to pay current benefits and administrative expenses. Therefore, a portion of new contributions must be used to pay current benefits. Given the young average age of the Bahamian population, the Board will develop higher unfunded future liabilities unless (1) the level of investment income rises, which means greater internal freedom over investment decisions, (2) benefits are reduced, or (3) the tax rate and cap of payroll contributions are increased.

It should be noted that the government plans to increase the National Insurance Board ceiling on insurable wage and benefit payments. It also plans to introduce, financed by an additional payroll tax, a contributory, fully-funded Unemployment Insurance Program and a national contributory, fully-funded Catastrophic Health Insurance Plan

As noted, the Board invests disproportionately in long-term and short-term government debt, rather than equity investments or other investments in The Bahamas and overseas that increase at a higher long-run annual average. Domestic government debt is never a desirable asset, since it is denominated in soft Bahamian dollars and is guaranteed only by the government's power to tax. In many countries, government debt finances current consumption rather than investment. It rarely is invested in infrastructure or projects that produce a real economic return. The Board is a principal holder of government debt, and servicing that debt is the largest component of the annual budget and the largest drain on tax revenues.

Evidence of inefficiency in the management of the Board is indicated by a rise in administrative overhead from 25% of investment income in 1981 to 35% of investment income in 1991, an excessive ratio driven by bloated administrative expenses. Overall, administrative expenses have risen from 7.9% of total Board expenditure in 1981 to 13.1% in 1991; of this, staff salaries and allowances account for a rise from 5.6% to 9% of total expenditure. The National Insurance Board has increasingly become a fund run for the benefit of its staff, not for the recipients of benefits.

In early 1995, the Board employed 512 full-time persons. Of these, only 8 were in non-union management positions.

The lack of diversification in assets reflects government policy. The Board cannot purchase overseas assets without government approval, because of foreign reserves considerations. Nor does the Board have much opportunity for equity investments within the Bahamian economy so long as the large public corporations remain in the hands of the government.

The National Insurance Board is both a near- and long-term issue that must be addressed. First and foremost, its assets are government debt. It uses payroll taxes (the source of its contributions) to purchase more debt. The assets of the Board are not the equivalent of collateralized assets in the standard sense of security for bank loans; rather, they represent government liabilities, backed by the power to tax. In the future, the Board must be run more efficiently, earn higher returns, serve its beneficiaries (not its staff), and not be used a vehicle to finance government debt apart from well defined infrastructure investments or other capital outlays that earn a return including the cost of capital.

Summary

BEC and Batelco constitute genuine targets for privatization, and their shares would be important listings in any future Bahamas stock exchange. The Bahamas Agricultural and Investment Corporatioon, the Water and Sewerage Corporation, the Bahamas Mortgage Corporation, and the Bahamas Development Bank require serious overhaul or transformation before they become attractive opportunities for private investors. Bahamasair is years away from potential privatization. With luck, the Hotel Corporation of the Bahamas will close its doors in the near future. The National Insurance Board is not, as indicated, a commercial enterprise as such, but nonetheless deserves serious analysis lest the long-term pension arrangements lead to higher future taxes or reduced retirement benefits. Its continued accumulation of government debt also poses a growing threat to the country's credit structure and financial system.

Benefits of Privatization

Privatization is an effective way to reduce the level of public employment. Employees in private firms instantly become private sector employees, and must perform their jobs in accordance with business considerations of efficiency.

Everyone recognizes the poor quality of telecommunications services. Privatization of Batelco and the Bahamas Electricity Corporation affords the country the opportunity to accomplish several objectives at one time: (1) improve their efficiency, (2) reduce the size of the public sector, (3) build broad popular support for peoples' capitalism, (4) provide investment opportunities for public and private pension funds, and (5) provide local investment opportunities for a Bahamas stock exchange.

Privatization can be accomplished through several different mechanisms—vouchers, a combination of vouchers and sale of a controlling stake to a strategic investor, a private placement. Time does not permit me to review the pros and cons of these different approaches. Privatization has been the subject of much study, controversy, and criticism. But there is no doubt that public ownership is a greater failure in every respect. Try to imagine the economy of The Bahamas today if the government was still running the hotels, instead of several key private enterpreneurs who have rebuilt tourism in the country.

Whichever method may be selected, and the method may vary among the different public corporations and agencies, *it is important that the proceeds of privatization be solely allocated to retire national debt.* Any foreign currency proceeds of privatization should go to enlarge the Central Bank's foreign reserves.

Privatization would help establish a culture of equity ownership, allow Bahamians to participate in the economic future of these newly privatized enterprises, and facilitate local capital market development.

APPENDIX

The Bahamas Agricultural and Industrial Corporation (BAIC). As of 1995, BAIC had a small staff of 25 persons, a budget of $2 million, and a mission of promoting small business development throughout the country. BAIC was established by an Act of Parliament in 1981 and opened for business in 1982. BAIC has largely relied on "walk-in" business, rather than actively seeking to solicit proposals for business assistance. Its primary shortcomings are the lack of professional staff with the skills to assess applications for business assistance, and overstaffing with clerical assistants. The general view is that BAIC has not been very successful in its mission.

Bahamas Mortgage Corporation (BMC). As of 1995, the most recent available report was for 1992-1993, which was also the tenth anniversary of the BMC. As of June 30, 1993, BMC had issued 3,458 loans in an aggregate amount of $138.8 million. For the year in question, about two-thirds of the loans were granted in New Providence, with the remaining third in the Family Islands.

As of June 30, 1993, the BMC had sold $113 million in bonds to finance its mortgage lending and construction financing activities, primarily to the National Insurance Board, the Central Bank, and the Clearing Banks and Insurance Companies. These are risk-free assets because the Bahamas Government has guaranteed all of them, up to a maximum authorized level of $120 million.

The report does not indicate the health of BMC's loan portfolio, except that the corporation provides an ongoing program of loan forbearance and counselling to assist persons who face difficulty in meeting loan repayments. During 1992-1993, BMC reduced all mortgage interest rates by 0.75%.

Bahamas Development Bank (BDB). The "Bahamas Development Bank Annual Report 1993" summarizes 16 years of providing financial and technical assistance to Bahamian entrepreneurs in the areas of agriculture, fishing, marine and land transportation, tourism, manufacturing, service enterprises, and other commercial operations. During its existence, BDB approved $57.3 million in loans, of which $17.5 million was in the service sector. Total assets in 1993 amounted to $29.3 million, with share capital of $16 million. Financial resources are largely supplied by the Central Bank ($6.2 million), the Caribbean

Development Bank ($3.9 million), the National Insurance Board ($7.4 million), and the European Development Fund ($0.7 million).

The mandate of BDB is to create jobs through lending. During the 10 years 1984-1993, BDB estimates it created more than 2,100 jobs. (The annual report does not indicate how many of these jobs remain intact.) BDB's net losses over this period (annual net income minus annual net loss) amount to about $3.2 million, of which $2 million is attributable to 1992-1993. Indeed, in the segmented entitled "Chairman's Report," it was reported that the board of directors and management recognized the need to tackle non-performing loans (without indicating their scope and size) and, therefore, established an "arrears unit." No new lines of credit were extended to the bank in 1993. (The government-guaranteed share of BDB's loans amounts to about $5.4 million.)

In 1993, 45% of loan approvals was allocated to the service sector. Only 2.2% went to manufacturing. Disbursements to manufacturing over the history of BDB were $3.2 million out of a total of $24.8 million.

The accumulated deficit at the end of 1993 amounted to $3.8 million, an increase of $1.2 million over the prior year.

The Hotel Corporation of The Bahamas (HCB). Great progress has been made in privatizing government-owned hotels, and for good reason. The audited financial statement for the year ended December 1993 disclosed a net loss of $33.5 million for the year, with liabilities exceeding assets of $50.2 million. Accrued interest to the Bahamas Government at year's end amounted to $40.8 million, a sum that was never going to be repaid by HCB. The balance sheet shows an accumulated deficit of $114.7 million.

Water & Sewerage Corporation. As of 1995, the most recent published annual report was for the year ended December 1991 (issued December 1993), and the most recent audited financial statements were for the year ended December 1992. The 1991 report tells a bleak story.

! WSC incurred significant losses. The net loss for New Providence was $3.86 million and the net loss for the Family Islands was $3.43 million. (The government subsidy to the provision of operations in the Family

Islands was $2.7 million.)

! Total water production decreased from 8 million gallons per day in 1990 to 7.4 million gallons per day in 1991.

! Approximately 47% of average water production is from supplies in New Providence, 37% is imported from North Andros, and 16% is purchased from non-WSC sources.

! Water produced from WSC well fields in New Providence is high in salinity and hardness and must be blended with North Andros water brought in by barges to meet minimum consumption standards, but is still well below international standards.

! Of a total of 2.7 billion imperial gallons produced in 1991, 1.3 billion was sold, while 49% of all produced water was unaccounted for (not sold). During the 15 years, 1977-1991, the fraction of unaccounted for water has ranged from a low of 37% in 1979 to a high of 52% in 1990.

! There were 521 leak repairs made on water mains and 5,378 on service lines. Valves and hydrant repairs and replacement totalled 41. (The entire water distribution infrastructure is in serious need of repair and overhaul, with estimated costs of correction in the tens of millions of dollars.)

! Current assets to current liabilities decreased from 1.01 in 1977 to 0.52 in 1991. The debt to equity ratio, or total liabilities to tangible net worth, increased from 0.47 in 1977 to 1.26 in 1991.

! The average age of receivable (days) increased from the low-to mid-hundreds in the 1980s to surpass one year in 1990.

The balance sheet of WSC at the end of 1991 revealed net current liabilities of $9.6 million, and long-term debt of $26.5 million. The assets consist largely of $49.3 million in equity contributions by the Bahamas Government, reduced by $11 million accumulated deficit.

The audited statement for 1992 revealed an increase in the Bahamas

Government equity contribution of $6 million, largely to cover a rise in net current liabilities and an expansion in fixed assets. Accounts receivable amounted to $9.3 million, but this number was reduced from a much higher sum by about $9 million in allowance for doubtful accounts. Of the receivables for water and sewerage services in New Providence, about $2.5 million is attributable to government ministries, departments, and other public corporations, a rise of about $1 million over 1991.

The provision of low quality water by WSC has resulted in the growing use of privately-owned reverse osmosis systems. Sun Resorts International, the single largest consumer of WSC's supply, has installed its own reverse osmosis plant. Despite its own plant coming on line in 1995, Sun agreed to buy 750,000 gallons a day during 1995, which amounts to about one-fifth of recorded WSC sales a year. Sun plans to reduce, and ultimately eliminate, its purchases in future years, which will have an adverse impact on WSC's cash flow.