

PRIVATIZATION ISSUES: CONSIDERATIONS
FOR THE BAHAMAS

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by

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Introduction

The primary objectives of this paper are to review the main issues in the privatization debate and in so doing establish a framework for The Bahamas Government's possible action regarding public corporations' activities in light of their recent performance. In order to provide a proper context for these discussions, Section I gives a brief overview of the rationale behind the emergence of public sector entities, and the recent motivations guiding the shift in policy emphasis towards greater private sector involvement. Section II goes on to provide a summary of the main arguments in the privatization debate, against the backdrop of the available evidence on developing countries' experiences. The main conclusion here is that while privatization is an attractive reform mechanism, it is difficult to implement, and that the best means of promoting efficiency gains firstly requires the enhancement of competitive conditions with the type of ownership being a secondary consideration.

In Section III we provide background information on the various public corporations in The Bahamas, highlighting their operating and regulatory environments. The paper deals more narrowly with the non-financial public corporations, all of which have separate legal identities and which are likely to be the focus of more immediate reforms and privatization activities.

Section IV presents an analysis of the macroeconomic impact and performance of public corporations for the years 1975 through

1989. Here, the size and other important characteristics of these entities are examined against the trends in output, together with a disaggregation of the corporations' financial position. It is intended that this section be widened to include an empirical study on the impact of these entities on economic growth. In concluding, Section V discusses the various issues which the authorities must consider in framing a successful approach to privatization.

Section I. Origins and Ideology

In many developing countries, public corporations account for a significant share of economic activity. The majority of these institutions initially emerged as inherited enterprises from colonial times and their subsequent enlargement can be explained by a blend of economic, financial and political ideologies as relates to development. Brown¹ noted that in the Caribbean experience, the growth in public sector activity reflected the government's greater responsibility for development in the aftermath of political independence. While some entities were inherited, the creation of new entities became the favoured means of achieving governments' social and economic policies.

The rapid expansion of public enterprises during the 1950s and 1960s reflected the dominant view that state intervention was required to redress perceived failures of private markets to efficiently allocate resources. Government intervention was adopted as the principal means of development for developing countries in the post-war period, and such thinking was actively promoted by prominent economists and international agencies such as the World Bank whose programmes supported the strengthening of public sector activities.

Among the more pragmatic reasons for the interventionist view were the absence of private sector initiative and the inability of the private sector to undertake the scale of investment required. The creation of parastatal institutions was expected to deliver substantial social benefits such as the distribution of goods at a reasonable price and the promotion of a desirable distribution of income and consumption. As domestic circumstances dictated, these institutions soon came to serve as a conduit for employment objectives of the government. Equally pervasive was the argument that to develop, governments needed to hold and lead from the commanding heights of the economy, and so many sought to control strategic natural resources and activities.

As a result of the sizeable investments made by governments in infrastructure, there was a marked acceleration in developing countries' economic growth rates since World War II, together with large-scale job creation and income distribution. But this

perception has changed in the last thirty years as the experience with the public sector performance has generally been highly disappointing. Public corporations are no longer viewed as making a positive contribution to development and there is growing acceptance that they can be a major source of macroeconomic instability. According to R.P. Short's² findings, public enterprises' deficits have become extremely large creating demands on government budgets, bank credit and foreign borrowing. His computations indicate that public enterprises accounted for approximately three-fourths of the central government's deficit for a sample of 34 developing countries examined, as losses of public enterprises' were covered by means of direct budgetary transfers and other means of government support. Furthermore, the overall deficit averaged 5.5% of GDP during the mid-70s and bank credit grew by 46% per annum compared with 27% for other users.

Faced with a deterioration in economic conditions following the oil shocks in the 1970s and the subsequent fiscal pressures, governments began to reevaluate their involvement in these entities. This initial motivation was propelled by an ideological shift against government intervention in the economy in favour of the private sector. Privatization has therefore become a popular concept, but it is far from being a new dogma as for centuries countries have encouraged the private sector. Ironically, the same objectives which underscored nationalization efforts are now driving the privatization cycle.

Gaining prominence in the U.K. under the Thatcher administration, the privatization process was extended to developing countries and recently in Eastern Europe as IMF/World Bank stabilization programmes began to address the scope of public sector activities. Since the early 1980s the World Bank has supported privatization programmes in some 30 countries. According to a study undertaken, over two dozen nations sold industrial assets worth \$25 billion in 1989 and 1990, and an additional \$200 billion in public assets is likely to be privatized over the course of the 1990s.³ Further a review of selected developing country experiences indicates that privatization has played a significant role in the economic transformation of Chile and Mexico, but has been less successful in Brazil, Bolivia, Colombia and Argentina. In the Caribbean, the outcome has again been mixed, although Jamaica's experience is regarded as an instructive paradigm. On the other hand, countries such as Ghana, Senegal, Zambia and Turkey which have entrenched privatization programmes, are all experiencing implementation difficulties and delays.

The Bahamas has not been untouched by these recent developments as questions are being raised about the economic efficiency of public sector activities in the provision of goods and services. The announcement of privatization as an agenda priority of the recently appointed Economic Advisory Council in mid-1991 was predicated upon concerns for the increasing fiscal burden of the public corporations, the weakness in the framework of accountability

accountability, the rapid accumulation of debt, and the difficulty of political considerations influencing economic judgement in the management of these parastatals. It is within such a context that the Government has stated its intent to reform the public corporations and investigate the possibilities for shifting publicly managed activities to the private sector.

Section II: Privatization Issues and Experiences

Privatization, which is defined as a greater role for the private sector and embraces the more general concept of introducing market forces into the economy, has generally taken the form of sale of state assets and management through contracts and leases. As mentioned earlier, privatization has become a key component in the design of structural adjustment programmes in many developing countries. The most cogent justification lies in its potential reduction of budgetary deficits. Proponents have also argued that less governmental intervention would impact favourably on productive and allocative efficiency. Yet another explanation is the view that privatization is a means of stimulating the growth of domestic capital markets and broadening ownership base. It is not surprising, therefore, that many governments are exploring the possibility of achieving these benefits. On the other hand, opponents of privatization have underscored various negative

implications such as the likelihood of increased unemployment and financial instability.

While it is perhaps too early to make any definitive statements on the success or failure of privatization as an economic policy tool, one emerging impression is that the effectiveness of privatization as a policy instrument is neither absolute nor unconditional. An overall assessment of developing countries' privatization experiences against the various objectives it sets out to accomplish, suggests that while privatization is no more a panacea for public sector ills than is public sector intervention, under appropriate conditions it could contribute to improvements in economic performance. A brief discussion on experiences in developing countries follows.

Budgetary Impact

To date, the outcome with respect to budgetary gains is mixed with the proceeds from privatization having had very little impact on the reduction of fiscal deficits. In the case of Chile, efforts involving 197 companies between 1974 and 1978, realized proceeds of US\$585 million, approximately 4.5% of GDP. However, it is believed that many of these assets were undervalued by approximately 40%, hence the suggestion that the difference between the sale price and book value be used as a more appropriate measure of the budgetary gains. The Jamaican experience reported that the

proceeds from the sale of public enterprises amounted to a modest 1% of annual GDP, with minimal impact on the state deficit. Among the mitigating factors contributing to this reduced impact are the lack of commitment to privatization; inability of governments to affect the necessary pre-privatization reforms the underpricing of assets to attract buyers, and inadequate policy frameworks.

Efficiency Impact

The argument that privatization will improve efficiency is core to the current debate. The literature on privatization underscores the difficulties in trying to measure the impact of privatization on allocative efficiency. For example in Chile's case it is difficult to determine whether efficiency was due to privatization or to greater concentration across industries. Hemming and Mansoor⁴ posited that allocative efficiency is a function of market structure rather than the ownership characteristics of assets. If this is the case, then privatization by itself will not change the nature of the market in which these entities operate, nor the factors which shape pricing decisions. The empirical evidence so far seems to suggest that privatization needs to be accompanied by other reform measures such as financial liberalization to promote efficient markets. Further, productive efficiency gains could be realized owing to reduced political interference and overstaffing; greater accountability and

motivation due to shifts in property rights and increased competition in capital markets. It is widely agreed that such a blend of measures has contributed to improvements in efficiency in countries such as Jamaica, Chile and Mexico.

Strengthening of Capital Markets

Privatization has been promoted as a means of encouraging economic democracy, particularly in those countries where capital markets are thin. However, there is no incontrovertible evidence to suggest that privatization efforts have enhanced the development of capital markets. To the contrary, the experience has been that in most countries limited private sector absorptive capacity has resulted in the majority of privatization programmes being executed through outright sale of assets involving selected local interests. As a result, the extent to which gains could be achieved through broader participation of the domestic market are limited. The Chilean experience is most illustrative of such an outcome as the Government eventually had to intervene in previous assets sales which ended up in the hands of a few conglomerates. The evidence therefore, suggests that parallel to privatization efforts, authorities would need to undertake measures not only to deepen capital markets through appropriate regulatory reforms, but also to encourage greater savings.

Section III: Overview of Non-Financial Public Corporations
in The Bahamas

Not unlike many other developing countries, most public corporations in The Bahamas had their genesis in colonial administrations, and over time, were expanded as the authorities responded to various domestic and external impulses.

All of the utility operations are publicly owned and operate under separate legal frameworks (See Chart I). The Bahamas Electricity Corporation (B.E.C), which is the successor to the colonial infrastructure, the Electricity Department, has made considerable investments over the years to extend its generation capacity and distribution system. At present it is undertaking an expansion project valued at \$149.0 million. Regarded as one of the most profitable public corporations, the Bahamas Telecommunications Corporation (BATELCO) has carried out a comprehensive programme of expanding its network of operations into the various Family Islands and has maintained state of the arts technology. Both the Broadcasting Corporation, which is responsible for radio and television activities and the Bahamas Water and Sewerage Corporation have also made considerable investments over the years.

While public corporations in The Bahamas, by and large, operate in the traditional sectors, an exception has been the government's involvement in the hotel industry. The Hotel Corporation, which serves as a vehicle for Government's acquisition and construction

**REGULATORY FRAMEWORK
OF NONFINANCIAL PUBLIC CORPORATIONS IN THE BAHAMAS**

| PUBLIC CORPORATION | ACT OF PARLIAMENT | DATE OF ESTABLISHMENT | MAIN PROVISION | MINISTER RESPONSIBLE | ISSUE BONDS | COMPETITION |
|---|--|-----------------------|--|----------------------|---|-------------|
| 1. Bahamas Electricity Corporation (B.E.C.) | Electricity Act | May 1958 | Establishment of the corporation to supply energy for any person requiring a supply of energy. | Consumer Affairs | Shares/Stock Act of Parliament | NO |
| 2. Bahamas Telecommunications Corporation (BaTelCo) | Bahamas Telecommunications Corporation Act | June 1968 | Establishment of a Bahamas Telecommunications Corporation for maintenance/development of telecommunications stations established in The Bahamas. | Consumer Affairs | Yes subject to Minister's approval | NO |
| 3. Water and Sewerage Corporation | Water & Sewerage Corporation Act | July 1978 | Establishment of corporation to control/ensure the optimum development and use of the water resources of The Bahamas. | Consumer Affairs | Debentures subject to Minister's approval | NO |
| 4. Hotel Corporation of the Bahamas | Hotel Corporation of the Bahamas Act | October 1974 | Establishment of the Hotel Corporation, the purposes of which shall be the extension and improvement of the hotel as resort industry in The Bahamas. | Finance | Debentures subject to Minister's approval | YES |
| 5. Bahamasair Holdings Ltd. | No | February 1973 | Incorporated under the Companies Act | National Security | (Shares) Wholly owned by Government | YES |
| 6. Broadcasting Corporation of The Bahamas | Broadcasting Act | May 1958 | The establishment of a corporation to carry on—with the exclusive right—a broadcasting and television service in The Bahamas as a means of information, education and entertainment. | Consumer Affairs | Debentures subject to Minister's approval | NO |

of hotels, currently owns 11 properties in New Providence and the Family Islands, and is vested with the Government's interest in the casinos. The original motivation is explained by government's desire to preempt the closure of several hotels and consequently loss of jobs in the mid-70s owing to a weakness in economic activity. After a period of direct administration, all of the operating hotels are now managed by international companies under some contractual arrangement.

Bahamasair, the national air carrier, is the only public corporation which was not established by an Act of Parliament. As a publicly owned company it operates under private law with the government as sole owner. Although not the subject of this study, other public corporations include the National Insurance Board, which administers the government's social security programmes; the Bahamas Agricultural and Industrial Corporation, which has the authority to, inter alia, acquire property, engage in joint ventures with the private sector, and encourage the growth of local entrepreneurship; the Bahamas Development Bank, and the Bahamas Mortgage Corporation, which administers the housing scheme. While the Post Office, the Port Department and the Civil Aviation Department are normally treated as public enterprises, their operations are integrated with those of the central government for budgetary purposes.

Ministerial influence is strong in the operations of these public corporations as organizational structures allow for the

appointment of a governing board which is chaired by a designated Minister. Other members of the Board usually consist of a Ministry of Finance representative along with appointees by the designated Minister. At the operational level, the General Manager is appointed by the Board with the concurrence of the Minister, and is responsible for the daily administration of the corporations' affairs and the provision of technical advice and guidance in matters of policy.

With the exception of Bahamasair and the Hotel Corporation, all public corporations function with exclusive rights as codified in the legal provisions of the various Acts, thereby eliminating any competition. In principle, these operations tend to fall within the category of natural monopolies, where efficiency considerations require the existence of a single producer. The commercial activities of the utility operations, with the exception of BATELCO, are subject to government intervention in the pricing of their products. The Ministry of Consumer Affairs, under which these fall, is also the regulatory body.

Apart from direct funding from the government, public corporations are empowered to obtain financing via the banking system and can borrow from abroad. Section 17 of the Financial Administration and Audit Act provides for public corporations to obtain government guarantees and advances once approval is granted by Parliament. All borrowing--including the issuance of bonds--is subject to the relevant Minister's approval, along with the consent

of the Minister of Finance.

With regards to financial reporting and accountability, public corporations are required to prepare for presentation before Parliament, a statement of accounts along with a copy of any reports made by auditors on the statement, or on the accounts.

Another important facet of public corporations' operations in The Bahamas is the existence of rather strong labour unions. Over the years, they have been able to obtain sizeable wage settlements and benefit packages for members. This is certain to be a constraining variable in the formula for privatization.

Section IV: Macroeconomic Performance of the Non-Financial Public Corporations

The quantitative importance of public corporations in The Bahamas has been underpinned by their large shares in aggregate output and investment. Reflecting their high capital intensity, public corporations accounted for an average 26% of gross fixed capital formation between 1975 and 1979, and a proportion in GDP of less than 6% (See Table I). Since then, the average share of public corporations in capital formation climbed to roughly 66% in the 80s, sharply above the average estimated share in GDP of 13.4%. This prominence is further highlighted by their shares in employment. From constituting 3.3% of the employed labour force

TABLE 1
PUBLIC CORPORATIONS' DEFICIT / GDP RATIOS

| Year | Public Corp. Share of Gross Capital Formation | Public Corporation Financial Deficit as % of GDP | Government Deficit as % of GDP | Budgetary Burden of Public Corp. as % of GDP |
|------|---|--|--------------------------------|--|
| 1980 | 58.6 | 1.9 | 2.0 | 0.7 |
| 1981 | 69.7 | 4.5 | 5.6 | 3.9 |
| 1982 | 71.9 | 4.8 | 6.1 | 3.0 |
| 1983 | 70.8 | 3.0 | 7.0 | 3.6 |
| 1984 | 68.1 | 0.5 | 2.6 | 1.2 |
| 1985 | 63.6 | 0.3 | 4.1 | 0.4 |
| 1986 | 62.1 | 0.4 | 2.3 | 0.1 |
| 1987 | 65.9 | 2.5 | 3.2 | 0.2 |
| 1988 | 65.7 | 3.0 | 5.6 | 0.4 |
| 1989 | 72.1 | 1.8 | 8.5 | 0.2 |
| 1990 | n/a | 3.1 | 4.4 | 1.1 |

SOURCE: Department of Statistics
Central Bank of The Bahamas

Aggregated Operations of the
Nonfinancial Public Corporations
B\$ Millions

| | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|----------------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 68.2 | 74.4 | 83.4 | 110.8 | 129.4 | 164.5 | 170.0 | 178.9 | 205.7 | 251.6 | 263.3 | 280.1 | 295.7 | 297.4 |
| Current Expenditure | 61.7 | 70.2 | 80.4 | 96.6 | 111.3 | 138.8 | 152.0 | 167.5 | 172.3 | 188.5 | 213.8 | 216.5 | 263.0 | 286.0 |
| Current Balance | 6.5 | 4.2 | 3.0 | 14.2 | 18.1 | 25.7 | 18.0 | 11.4 | 33.4 | 63.1 | 49.4 | 63.6 | 32.7 | 11.4 |
| Capital Expenditure | 6.3 | 14.5 | 14.5 | 14.1 | 38.5 | 50.1 | 84.9 | 82.9 | 76.7 | 55.2 | 54.2 | 71.6 | 91.0 | 86.0 |
| Overall Balance | 0.2 | -10.3 | -11.5 | 0.1 | -20.4 | -24.4 | -66.9 | -71.5 | -43.3 | 7.9 | -4.7 | -8.0 | -58.3 | -74.6 |
| Financing (net) | -0.2 | 10.3 | 11.5 | -0.1 | 20.4 | 24.4 | 66.9 | 71.5 | 43.3 | -7.9 | 4.7 | 8.0 | 58.3 | 74.6 |
| Govt transfers & loans | 8.9 | 7.5 | 13.5 | 8.7 | 18.2 | 12.0 | 58.6 | 46.7 | 54.9 | 10.4 | 9.2 | 8.0 | 6.6 | 10.5 |
| NIB loans | -- | -- | -- | -- | -- | -- | -- | 0.0 | 5.7 | 11.8 | 14.5 | 20.2 | 24.4 | 27.1 |
| Domestic financial system | -2.1 | -1.5 | -4.9 | -4.7 | -10.1 | 3.5 | -4.4 | 24.4 | -9.9 | -23.1 | -4.4 | -3.0 | 27.5 | 15.2 |
| Bahamian dollar borrowing | -2.1 | -1.5 | -4.9 | -4.7 | -10.1 | 3.5 | -1.7 | 21.7 | -15.0 | 0.9 | -11.0 | 4.0 | 20.6 | 13.5 |
| Deposits (- inc.) | -- | -- | -- | -- | -- | -- | -2.7 | 2.7 | 5.1 | -24.0 | 6.6 | -7.0 | 6.9 | 1.7 |
| Foreign currency borrowing | -7.1 | 0.4 | 10.9 | -2.9 | 12.6 | 16.8 | 14.7 | 8.5 | -8.5 | -14.1 | -11.2 | -0.3 | 1.3 | -7.9 |
| Residual | 0.1 | 3.9 | -8.0 | -1.2 | -0.3 | -7.9 | 12.7 | -8.1 | 1.1 | 7.1 | -3.4 | -16.9 | -1.5 | 29.7 |

Source : Audited accounts of the corporations.

in 1979, their share climbed to 3.9% in 1986 and to 4.0% in 1989. Between 1980 and 1989, employment at these corporations grew at an average annual rate of some 7.6%, with the actual number of employed more than doubled at 4,474 persons. By comparison, the entire public sector accounted for 21.0% of total employed persons, with a modest rise to 22.0% in 1989.

The overall deficit or financing requirements of the public corporations, which has been identified as the main summary indicator of their macroeconomic impact, is here defined as the difference between current plus capital expenditures and revenue. Table 2 presents aggregated operations of the nonfinancial public corporations for the years 1975 - 1988. Except for modest surpluses in three of the review years, the overall balance of the public corporations was in substantial deficit accounted for by both a reduction in internal cash generation and higher capital outlays. Between 1979 and 1983, the deficit was 3.4% of GDP, tapering off to 1.6 % in the five years to 1980. A significantly improved operating surplus and reduced capital expenditures underpinned the shift in the overall balance to a surplus of \$7.9 million in 1984.

The overall trend conceals the disparity in performance among the corporations included in the review. As shown in Table 3, Bahamas Telecommunications Corporation is considered to be the most financially profitable entity along with the Bahamas Electricity Corporation. On the other hand, Bahamasair has experienced

TABLE 3
PUBLIC CORPORATIONS' DEFICIT / GDP RATIOS

| Year | Public Corp. Share of Gross Capital Formation | Public Corporation Financial Deficit as % of GDP | Government Deficit as % of GDP | Budgetary Burden of Public Corp. as % of GDP |
|------|---|--|--------------------------------|--|
| 1980 | 58.6 | 1.9 | 2.0 | 0.7 |
| 1981 | 69.7 | 4.5 | 5.6 | 3.9 |
| 1982 | 71.9 | 4.8 | 6.1 | 3.0 |
| 1983 | 70.8 | 3.0 | 7.0 | 3.6 |
| 1984 | 68.1 | 0.5 | 2.6 | 1.2 |
| 1985 | 63.6 | 0.3 | 4.1 | 0.4 |
| 1986 | 62.1 | 0.4 | 2.3 | 0.1 |
| 1987 | 65.9 | 2.5 | 3.2 | 0.2 |
| 1988 | 65.7 | 3.0 | 5.6 | 0.4 |
| 1989 | 72.1 | 1.8 | 8.5 | 0.2 |
| 1990 | n/a | 3.1 | 4.4 | 1.1 |

SOURCE: Department of Statistics
Central Bank of The Bahamas

considerable difficulty in achieving operating surpluses and despite efforts to improve efficiency, continues to require substantial subsidization from the government. Further, the Broadcasting Corporation's financial position is hampered by its very narrow revenue base.

Public corporations have mainly utilized four sources of finance over the years, namely, internal resources, government, the banking system and foreign borrowing. In recent years, there has also been substantial recourse to the surpluses of the National Insurance Board. An examination of the current or operating balances indicates that between 1975 and 1983, approximately 54% of public corporations' investment requirements were self-financed with the proportion falling to 15.3% in 1988.

Financing From Government

Table 4 shows the various indicators of the fiscal burden of public corporations. The net transfer of resources from the Government to public corporations has accounted for a substantial proportion of financing resources, reaching a high of 71.3% in the three years to 1981. By definition, the fiscal burden takes into consideration government transfers, subsidies, loans and equity contribution less public corporations' dividends and debt service payments to government.

Between 1977 and 1985, the net fiscal burden of public

: 4
BUDGETARY BURDEN
(B\$ Millions)

| | <u>1975-1980</u> | <u>1981-1983</u> | <u>1984</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> | <u>1988</u> | <u>1989</u> | <u>1990</u> | <u>1991*</u> |
|--|------------------|------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| (i) Loans, Equity, Transfers | 68.8 | 160.2 | 22.0 | 9.2 | 8.0 | 6.6 | 10.5 | 6.3 | 26.9 | 27.6 |
| (ii) Loan Repayments | 11.5 | 0.6 | 0.5 | 1.2 | 4.8 | 0.6 | 0.6 | 1.2 | - | 3.2 |
| (iii) Dividends Payments | 1.5 | 3.0 | 2.0 | 1.0 | 1.5 | 1.4 | 1.1 | 1.9 | 1.0 | 0.3 |
| (iv) Net Transfers (i-ii-iii) | 55.8 | 156.6 | 19.5 | 7.0 | 1.7 | 4.6 | 8.8 | 3.2 | 25.9 | 24.1 |
| (v) Government's Budget Deficit () | (219.5) | (277.0) | (40.9) | (76.5) | (47.6) | (74.9) | (136.8) | (183.1) | (100.7) | (60.6) |
| (vi) Net Transfers as percentage (%)/ Government budget deficit | 25.4 | 56.5 | 47.7 | 9.2 | 3.6 | 6.1 | 6.4 | 1.7 | 25.7 | 39.8 |

* As at September, 1991

SOURCE: Treasury Statistical Printouts
Central Bank of The Bahamas

corporation accounted for an average 40.0% of Government budget deficit. Though improving to an average of 8.3% in the five years to 1989, the ratio strengthened to some 25.7% in 1990 and is expected to account for an even higher proportion in 1991 owing to the present operating posture of the public sector corporations.

While it is difficult to isolate the components of the fiscal deficit which adjusted to accommodate these burdens, it is very likely that these burdens are passed on to a substantial extent, and can be viewed as an explanation of high and rising government deficits.

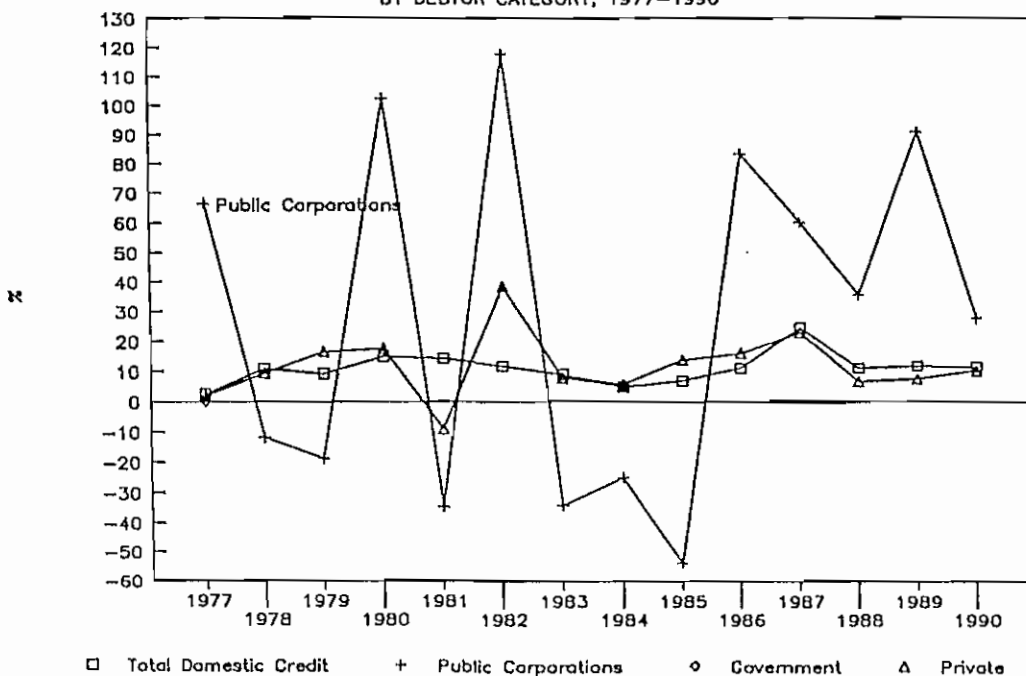
Banking System

Financing from the banking system is important given the implications for money supply growth, credit expansion and consequential external reserve loss. An examination of credit trends as depicted in Table 5, reveals that credit to public corporations has risen markedly in recent years, increasing much faster than that to other sectors of the economy. Aside from two exceptional years of credit growth in 1980 and 1982, there was a consistent net flow of resources to banks. In the five year period ending 1990, credit to this group grew at a staggering average rate of 52% annually, almost three times the average growth rate for central government and the private sector. Consequently, the public corporations' share in total domestic credit virtually

TABLE 3
TRENDS IN DOMESTIC CREDIT BY SECTOR

| Year | Total Domestic Credit | | Public Corporations | | Government | | Private | |
|------|-----------------------|---------|---------------------|---------|-------------|---------|-------------|---------|
| | Growth Rate | % Share | Growth Rate | % Share | Growth Rate | % Share | Growth Rate | % Share |
| 1977 | 2.5 | 100.0 | 66.2 | 3.4 | (5.0) | 21.9 | 1.8 | 74.7 |
| 1978 | 10.8 | 100.0 | (11.8) | 5.5 | 22.6 | 20.3 | 9.3 | 74.2 |
| 1979 | 9.1 | 100.0 | (18.9) | 4.4 | (10.0) | 22.4 | 16.5 | 73.2 |
| 1980 | 15.0 | 100.0 | 102.3 | 3.2 | (10.3) | 18.5 | 17.4 | 78.2 |
| 1981 | 14.2 | 100.0 | (34.6) | 5.7 | 162.3 | 14.4 | (9.1) | (79.9) |
| 1982 | 11.7 | 100.0 | 117.6 | 3.3 | (50.2) | 33.2 | 38.5 | 63.6 |
| 1983 | 8.9 | 100.0 | (34.3) | 6.4 | 32.9 | 14.8 | 7.9 | 78.8 |
| 1984 | 5.0 | 100.0 | (25.2) | 3.8 | 8.1 | 18.0 | 5.7 | 78.1 |
| 1985 | 6.9 | 100.0 | (53.8) | 2.7 | (13.4) | 18.6 | 13.8 | 78.7 |
| 1986 | 11.1 | 100.0 | 83.5 | 1.2 | (22.2) | 15.0 | 16.0 | 83.8 |
| 1987 | 24.5 | 100.0 | 60.2 | 2.0 | 30.8 | 10.5 | 22.9 | 87.5 |
| 1988 | 11.1 | 100.0 | 35.8 | 2.5 | 39.5 | 11.1 | 6.7 | 86.4 |
| 1989 | 11.7 | 100.0 | 91.1 | 3.1 | 18.9 | 13.9 | 7.5 | 83.0 |
| 1990 | 11.4 | 100.0 | 27.9 | 5.3 | 12.9 | 14.8 | 10.1 | 79.9 |

GROWTH RATES IN DOMESTIC CREDIT
BY DEBTOR CATEGORY, 1977-1990



SOURCE: Central Bank of The Bahamas

doubled to 5.3% from 2.7% in 1985.

A similar growth pattern is observed for both the Bahamian dollar and foreign currency components of credit, although the latter expanded at a faster pace. After declining to \$8.1 million in 1984, foreign currency credit to public corporations advanced at an average annual rate of 41.8% to \$71.9 million at end-1990. The corollary to these increased foreign currency liabilities can be seen in the upturn in the domestic banks' net foreign liability position--much of which is explained by public sector activities over the years.

External Borrowings

Like internal foreign currency borrowings, the increase in external indebtedness of public corporations was primarily for the purchase of imported capital equipment and therefore had little immediate impact on the overall balance of payments or domestic liquidity conditions. What is crucial from a long run perspective, however, is the consequential increase in the debt burden and the need to meet debt servicing requirements from future foreign exchange earnings. Between 1979 and 1982, the stock of public corporations' external indebtedness grew at an average annual rate of 4.0% to peak at \$59.9 million in 1982 (See Table 6). Thereafter, it declined to \$17.9 million in 1988 but since, there has been an almost four-fold increase in external debt. Most of this

TABLE 6
Foreign Currency Indebtedness of Public Corporations
(1979-1990)

| | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> | <u>1988</u> | <u>1989</u> | <u>1990</u> |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Total F/C Debt | 40.8 | 57.6 | 72.3 | 80.8 | 72.3 | 58.2 | 47.0 | 47.3 | 48.6 | 40.7 | 88.2 | 126.9 |
| External | 21.5 | 31.3 | 58.2 | 59.9 | 53.6 | 50.0 | 43.9 | 36.9 | 27.8 | 17.9 | 44.8 | 68.1 |
| Internal F/C | 19.3 | 26.3 | 14.1 | 20.9 | 18.7 | 8.2 | 3.1 | 10.4 | 20.8 | 22.8 | 43.4 | 58.8 |
| Drawings | 16.9 | 21.6 | 44.7 | 15.9 | 1.8 | 5.7 | 2.9 | 10.9 | 12.8 | 6.3 | 58.4 | 46.1 |
| Debt Service | 7.0 | 8.2 | 35.4 | 14.6 | 16.3 | 26.2 | 17.8 | 14.7 | 15.0 | 17.2 | 15.2 | 14.5 |
| Principal | 4.3 | 4.8 | 30.0 | 7.4 | 10.3 | 19.8 | 14.1 | 10.6 | 11.5 | 14.2 | 11.0 | 7.4 |
| Interest | 2.7 | 3.4 | 5.4 | 7.2 | 6.0 | 6.4 | 3.7 | 4.1 | 3.5 | 3.0 | 4.2 | 7.1 |
| Total f/c debt by creditor type | | | | | | | | | | | | |
| Multilateral | 6.1 | 11.4 | 14.3 | 18.4 | 19.1 | 17.5 | 14.8 | 14.4 | 12.6 | 12.1 | 24.2 | 45.6 |
| Commercial Banks | 17.0 | 32.1 | 20.0 | 25.8 | 22.5 | 10.9 | 4.9 | 11.5 | 20.7 | 22.8 | 61.0 | 79.7 |
| Other | 17.7 | 14.1 | 38.0 | 36.1 | 30.2 | 29.3 | 26.8 | 21.4 | 15.3 | 5.8 | 3.0 | 1.6 |
| Contingent liabilities (% of total) | 97.1% | 96.9% | 98.2% | 98.0% | 95.3% | 85.6% | 82.1% | 64.1% | 44.7% | 40.3% | 44.9% | 45.9% |

Source: Central Bank of The Bahamas Quarterly Reviews,
Quarterly reports of the public corporations and Bahamas Development Bank

accumulation is explained by BEC's electrification expansion project currently underway. An analysis of the external indebtedness by holder indicates that of the \$68.1 million outstanding at end-1990, 67.0% was owed to multilateral institution and the remaining 33.0% to commercial banks.

The total foreign currency debt of public corporations--inclusive of internal foreign currency loans, accounted for approximately 47.4% of the overall public sector foreign currency indebtedness at the end of 1990 as against 43.4% in 1979. Furthermore, the average annual growth rate of public corporation's foreign currency indebtedness in recent years has by far outpaced the rise in central government foreign currency debt.

National Insurance Board

Apart from these sources of financing, public corporations have recently become the beneficiary of finance at subsidized rates from the National Insurance Board (NIB). Between 1983 and 1988, a total of \$103.7 million was obtained from the Board at rates below prime. Underscoring the importance of this funding source, the \$27.1 million borrowed from NIB in 1988 approximated 37% of the public corporation's financing requirements. A major concern arising out of this shifting emphasis is the resultant reduction in the availability of funds for government, and the absence of strict commercial criteria being applied to the granting of these

loans. This feature along with borrowings from multilateral institutions, implies a lower cost of capital to these corporations than to the private sector.

Section V: Domestic Considerations

Against the backdrop of the various privatization experiences in developing countries and the Bahamas Government's resolve to explore privatization options, there is a series of issues which must be considered.

- . programme design and implementation
- . selection of enterprises
- . technical assistance
- . regulatory and legal framework
- . preprivatization reforms
- . political acceptability and dissemination of privatization to the public
- . macroeconomic environment
- . management, employee and trade union opposition

Lack of clarity in approach and decision making have been identified as major constraints in the design of privatization efforts in developing countries. This would include choice of

privatization techniques bearing in mind institutional and infrastructural constraints. Also related to this is the need for the authorities to obtain the technical assistance required to conduct indepth analysis and valuation of the various corporations, and deal with the complexities of legal and financial issues. It is advisable for the Government to create a privatization task-force drawing on resources from both the local private sector as well as foreign experts.

An immediate requirement would be the enactment of appropriate legislation to govern activities related to the issuance and trading of securities. A draft Bill is already under consideration of the authorities. The selection of enterprises will be key to creating a favourable public impression needed to counteract any uncertainty or skepticism concerning this policy tool. It has been suggested that the first candidate be a financially secure enterprise to give credibility to the process. Similarly, there must be political commitment to the process and a programme to create public awareness. Human resource considerations are central to the success of privatization. Uncertainty surrounding loss of employment, creates tension for management and employees which will need to be resolved.

For a natural monopoly such as BEC, it will be important that the government establishes the appropriate regulatory framework to guard against anticompetitive practices and ensure the achievement of social objectives. Barring this the outcome is likely to be the

transfer of an inefficient publicly-owned monopoly to one that is privately owned. This is not without difficulties, however, as the Jamaican authorities, for example, have experienced problems ranging from inappropriate legislation and pricing mechanism to bottlenecks in information flow.

The macroeconomic environment will be a major determinant in the actual sale of public enterprises. Since 1988, we have been experiencing a marked slowdown in economic activity which has correspondingly led to increased fiscal pressures. Conditions such as these have been known to militate or decelerate the pace of privatization and cause the attractiveness of the shares to be undermined. As a consequence, governments have been known to fire sale various assets, thereby reducing the potential fiscal gains.

It may be useful if Government approaches privatization in a broader perspective instead of only divestiture. In a case such as The Broadcasting Corporation, reform may be achieved through the removal of regulation and restrictions to allow private sector entry under some licensing arrangement.

In light of the above considerations, it is clear that the privatization proposition is not a quick fix to relieving the fiscal pressures exerted by public corporations' activities. Some interim measures may be required such as raising prices and reducing labour costs. Further, a more indepth analysis of the corporations' positions is necessary prior to embarking on privatization.

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