Guernsey Financial Services Commission

Industry Seminar – 17 November 2015

Productivity and Prosperity for the Bailiwick

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Why is the Commission Talking about Productivity and Prosperity?

After a little more than two years of fairly radical reform at the Commission, designed to control our cost base and make us more effective and competitive, we thought it might be helpful to use some of our time at this event to reflect upon what it takes to keep Guernsey competitive as a domicile for high value work in an increasingly competitive global market. My colleagues, tomorrow, will provide updates on specific sectors – the progress made and the challenges which remain for Guernsey with our focus today being on an overview of what we think, as a Bailiwick, we need to consider if we are to preserve and enhance international competitiveness.

We are also conscious that this is an opportune time for reflection on how we, together, keep Guernsey competitive, five months ahead of the next elections to the States, with many of our current and prospective States members, carefully reflecting on what policy priorities they should put to their electorates in their manifestos. Lest any of you think that this is a strange subject for a financial services regulator to adopt (as opposed to, say, focusing at length on the weaknesses in controls on outsourcing, an important issue on which the Director of Enforcement will touch this afternoon), the fact is that we regulate the main wealth creating sector of Guernsey's economy. Under our approach to risk based supervision we spend a large amount of time analysing the competitiveness of the business models of key firms in different sectors and we have a strong interest in the success of the sector.

Furthermore via the Commerce and Employment Department's 21st Century Regulator policy letter, due to be debated shortly, the States may wish us to have new objectives which include actions

- "To maintain and support the efficiency, competitiveness, and transparency of financial markets located in the Bailiwick;
- To reduce, and support the reduction of, prudential risk in the financial services sector and the maintenance of financial stability in the Bailiwick; whilst having regard to
- The economic importance of financial services to the Guernsey economy and the need for its status as a competitive high quality international financial centre to be preserved."

Why We Should Reflect?

New technologies have reduced barriers to trade and commerce across the world. The internet, on-line universities, TED and the ubiquitous webinars have also lowered the barriers to technology transfer between nations. At the same time, a large number of economically literate countries with highly developed engineering skills have sought to develop to achieve or to surpass the living standards which those in Western Europe and North America have been accustomed. This degree of interactivity, together with the level of international competition which exists now that so many countries no longer find their economic policies weighed down by 19th Century Marxist dogma, means that any Western nation, and especially the smaller ones which cannot fall back upon a large and semi-captive domestic market, has to work harder to earn its crust of bread. In Guernsey, we have had more than three decades of plenty. Whilst the 2008 crash marked a blip in the fortunes of the island, it did not cause the economic chaos which afflicted many other developed economies. We cannot, however, think that the fact that we are Guernsey allows us to carry on being amongst top ten jurisdictions in the world in terms of GDP per capita'[1]. Rather we need to collectively consider what we have that is good and what we have that is not so good and work, as only small countries can, to ensure that we leave a competitive economy in which our children, or in some cases grandchildren, can work. As the World Economic Forum puts it, "A country's competitiveness is widely accepted as the key driver for sustaining prosperity and raising the wellbeing of its citizens. Enhancing competitiveness is a long term process that requires improvement across many areas as well as a long-lasting commitment from relevant stakeholders to mobilise resources, time and effort."

What Makes Economies Competitive

The World Economic Forum's well established analysis of country competitiveness[2] is based upon twelve pillars:-

1. Institutions – the legal and administrative framework within which individuals, firms and governments interact to generate wealth;
2. Infrastructure – an important factor in determining the location of economic activity and the kinds of activities or sectors that can develop within a country;
3. Macroeconomic environment ;
4. Health and Primary Education;
5. Higher Education and Training;
6. Goods market efficiency;
7. Labour market efficiency;
8. Financial market development – with appropriate regulation to protect investors and other actors in the economy at large;
9. Technological readiness – This is about the agility with which an economy adopts existing technologies to enhance the productivity of its industries, with specific emphasis on its capacity to fully leverage information and communication technologies – C&E has clearly been doing a lot of work in this area in recent years;
10. Market size – whilst Guernsey doesn't do so well here, we can take heart from the WEF observation that, "In the era of globalisation, international markets have become a substitute for domestic markets, especially for small countries";
11. Business Sophistication;

[1] Commission Analysis based on 2014 World Bank and other data.

[2] *The Global Competitiveness Report 2013-14* (WEF)

12. Innovation – which can emerge from technological and non-technological knowledge with non-technological innovations being closely related to the know-how, skills and working conditions that are embedded in organisations;

The WEF tracks indicators for each of those pillars to develop a global competitiveness ranking. The WEF also charts five different stages of development with Guernsey most definitely being in the most advanced stage. The trouble with being at the most advanced stage is that, "As countries move into the innovation drive stage (the most advanced), wages will have risen by so much that they are able to sustain those higher wages and the associated standard of living only if their businesses are able to compete with new and unique products.[3]"

I'd rather be practical we can perhaps learn something through looking at the factors which make WEF's two most competitive countries, competitive. These are Switzerland and Singapore - countries with whom, I'm happy to say, Guernsey has a lot in common.

If we turn to Switzerland first, the WEF highlights the following features of Switzerland as being key to its ongoing track record of delivering a very high standard of living to its citizens:-

1. Effective and transparent public institutions with a political system which ensures cohesive and inclusive leadership across political boundaries which enables the country to implement a long term economic agenda.[4]
2. The strong culture among stakeholders in government, business and civil society of working together.[5]
3. The population voting on major decisions directly.
4. An independent judiciary, a strong rule of law and a highly accountable public sector;
5. The successful implementation of a debt brake a decade ago which helped create a stable macroeconomic environment;
6. A top notch labour market that is both flexible and efficient;
7. An educational system which is outstanding in producing a highly skilled labour force that continues to receive important on-the-job training; and
8. An excellent innovation ecosystem.

With regard to Singapore, WEF observes that its key features are:-

1. The world's most efficient goods market and labour market;
2. One of the world's best institutional frameworks; and
3. A strong focus on education.

It is worth pausing, making use of other analytical sources, to unpack the reasons for these countries success stories, especially given the undoubted commonality between Switzerland and Guernsey with regard to finance and Singapore and Guernsey with regard to their status as small island economies.

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[3] p. 12 *The Global Competitiveness Report 2013-14* (WEF)
[4] p. 13 *Ibid*
[5] p. 13 *Ibid*

Singapore has, for a start, a prime minister who openly espouses the slightly Darwinist perspective that, "to survive you have to be exceptional." His predecessors, surrounded by two imposing large states, have also espoused that view and acted on it for the last fifty years. Additional key features of the success story that is modern Singapore include:-

1. Having had one ruling party since independence, albeit with elections. This has allowed a great continuity of policy. Senior politicians and officials are paid at levels equivalent to senior company executives so that talented people have an incentive to run the country and take care of the whole rather than being compelled, for the sake of their children and spouses, to confine themselves to private sector roles.

2. A cultural dislike of corruption.

3. An effective commercial legal system.

4. An attractive geographical location on one of the world's major trade routes which has made it a natural hub for shipping, an imperial advantage which an independent Singapore has capitalised on.

5. Good housing for all citizens through its Central Provident Fund – this housing commitment comprises the lion's share of the Singaporean welfare state with the corollary of very little support for people who won't work - rather different from the Western welfare model.

6. Low flat taxes, being comfortable with inequality and the philosophy that a rising tide will raise all boats – Measured by its Gini coefficient, Singapore is among the world's most unequal countries but it doesn't have much poverty.

7. A mind-set of growth to survive with not just careful land use management but also a well-managed land reclamation programme which has seen it grow by 85 square miles since independence with plans to grow by a further 21 square miles by 2030[6].

8. A tightly managed but open immigration policy although it is noteworthy that its openness is not without its critics when it comes to issuing work permits to less skilled labourers. Nevertheless, Singapore has been ready to grow its population which has doubled in the last 30 years[7].

9. An aggressive attitude to infrastructure investments.[8]

10. Economic diversification with large scale manufacturing and shipping industries rather than the perhaps reliance on services some might imagine.

11. National champions in some sectors such as retail banking whilst being hugely open to multinationals.

12. And finally, a very high savings rate – nearly 50% of GDP.

Turning to a fascinating Credit Suisse Research Institute publication on the success of small countries[9], we find the welcome conclusion that small countries can often do much better than

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[6] p. 5 Special Report on Singapore by the Economist 18th July 2015.

[7] p. 5 Ibid

[8] p. 637 Michael Porter, *The Competitive Advantage of Nations*

[9] Published July 2014

larger countries, we find much in its analysis of the causes of this which support the approach taken by Singapore and Switzerland to being competitive. The Credit Suisse study notes that:-

1. “Education is a key determinant of human capability. ... The correlation between secondary school education attainment and GDP per capita is particularly strong.”

2. The Institute’s research also appears to show that successful small countries are rather less fractionalised than less successful countries. In connection with these points it notes that - surprisingly - successful small countries spend less per head on education than developed large countries, possibly because such large countries have to take into account the diversity of languages and cultures which often exist in larger countries. It is, of course, worth challenging any unthinking association of homogeneity with economic success. Singapore is not, for example, particularly homogenous in ethnic terms with large Indian and Western populations living alongside the majority Chinese community which is, itself, sub-divided through different linguistic traditions. It does, however, have a unified educational ethos reinforced by compulsory military service helping to build a sense of shared endeavour and it is this, rather than any inappropriate focus on ethnicity, which is worth taking into account when considering what it takes to be a successful small jurisdiction.

3. Institutions and intangible factors like the rule of law matter more for economic development than democracy itself because decent institutions encourage trust, investment in human capital and help to lower the frictions of doing business.

4. Excellence in intangible infrastructure is a small country speciality.

The Credit Suisse Research Institute argues that the secret source of being a successful small country is, “a sense of strategic planning and an awareness of the impact that outside forces (markets, trade, immigration) can have on a small state as well as the institutional ability to implement policy in these fields.”

The good news coming from the study, for a small state such as Guernsey is that, in a world of free trade, being small does not matter. It debunks a number of myths about there being economies of scales in large countries, observing that the diseconomies associated with transport, transactions and heterogeneity help explain why smaller countries tend to exhibit higher GDP growth and higher Human Development Index rankings. It also, as well as using up to date correlations to undertake its analysis, looks back in history at the richest countries between the 12th to 15th Centuries and concludes that the key to growth and wealth creation for Venice, Genoa, Amsterdam and Hamburg was free trade, larger cities and small governments. It concludes by observing that, in the present day, tax rates for individuals tend to be 5% higher in large countries.

So how do we measure up?

As many of you will have noted as I’ve been talking, Guernsey is fortunate in sharing a number of the factors that make Singapore and Switzerland so prosperous. The good news is that we score well on a number of these factors:-

1. We have a **flexible and efficient internal labour market** although one of the Commission’s economists complains that the rate of unemployment is too low for it to work properly. Whilst I appreciate the economic theory around natural rates of unemployment which underlies his concern, I think in practise it’s pretty flexible in

terms of allocating talent and indicating to you when you need to import talent because the skills you need are simply not available locally;

2. We share a **cultural dislike of corruption** with other successful small economies such as Singapore;

3. Whilst St Peter Port isn't exactly Singapore harbour, like Singapore we share an **attractive geographical location.**

4. We have **low flat taxes** and appear culturally comfortable with the income inequality which goes with that, perhaps because it is a key factor which drives growth and thereby delivers the relative prosperity of the median Guernseyman and woman.

5. Compared with the vast majority of countries, we have a sense of shared endeavour. The island is certainly not de facto segmented on sectarian or ethnic grounds as is too often the case in many large countries.

6. Like Singapore, we have a **relatively well housed population** with relatively low numbers on the waiting list for social housing. This is undoubtedly due to some considerable extent to the modest birth rate and lack of inheritance tax on dwellings but the level of indebtedness required to buy into the housing market if you have not inherited is eye watering for many.

7. There would appear to be a strong **working together culture** among stakeholders, business and civil society. The widespread joined up working which took place following the publication of the European Union tax list was a shining example of that and I hope that some of you might consider that the Commission is now, alongside you and government, a partner in the quest to do the right things to ensure the future long term prosperity of Guernsey.

8. We are not, unlike Singapore, a **one party state** but then neither is Switzerland. We do, however, have a non-party state which facilitates co-operation without artificial party divides standing in the way of productive partnerships although, conversely, we have a collection of States members elected with often different and sometimes contradictory manifesto commitments. In one sense we are quite far away from the Singaporean model of having had one democratically elected ruling party for the last fifty years but in another sense we are quite close in practise in that we tend to have a States comprised of individuals who collectively think of themselves as representing Guernsey rather than narrow sectional interests – our system is therefore a vast improvement on many countries and one which offers both continuity and stability. This in turn feeds into whether we have **effective public institutions pursing long term policy**. We are certainly not beyond reproach and we should always strive for improvement but aside from minor disagreements about road layouts in the capital, there is a good deal of long term economic policy which moves within relatively modest parameters from States to States thereby providing some reassurance to the business community and investors in terms of stability.

9. Parts of our intangible infrastructure are good. Guernsey has a culture where the **rule of law** based on our highly respected Anglo-Norman legal tradition is well embedded, attracting many foreign investors who wish to make sure that they put their money somewhere which is a safe long term destination. Here we must not be complacent as perpetual upgrading is required – hence the Commission-led revision of laws project

this year and further work on replacing the NRFSB legislation is necessary – something which we hope to take forward next year in conjunction with you and the States. We also need to be careful that costs are contained so that those providing legal services are cost competitive with other comparable jurisdictions.

10. Whilst I very much doubt we have a **savings rate** similar to the nearly 50% of GDP which Singapore records, we certainly have a savings culture with banks indicating that Guernseymen and women dislike debt and pay down their mortgages far faster than their brethren in the UK.

11. A tightly managed but open **immigration policy** – this is always going to be a very tricky issue and it is certainly one on which the current States has done a lot of work. We do, however, appear to have had a successful track record of running a relatively open immigration system which has served the interests of the indigenous population quite well. We have avoided the extremes of the political spectrum and have sought a cautious middle ground - open to high earning immigrants with the right specialist skills to help us upgrade our economic performance.

12. An excellent **innovation ecosystem** – I think we have created a lot of innovative things in Guernsey over the years, image rights, PCCs, ICCs, perfecting if not inventing captive insurance and within the financial services sector over the last year there have been a lot of innovation initiatives to work out where we should aim for and what are the strengths on which we should endeavour to build. The Commission has been happy to be an integral part of those deliberations, making constructive suggestions based on our unique perspectives into the financial services industry. Thus, whilst I cannot speak for Guernsey business beyond the financial services industry, I think we have sufficient mass here in our main economic sector to innovate effectively. That is not to say that we cannot strive to improve but the legal flexibility which we have here, legal flexibility which is considerably greater on almost all business matters than that enjoyed by individual member states of the European Union gives us, if not a unique, certainly an unusual competitive advantage within the European context. It is one which we need to continue to work to develop. The Fiduciary and Innovations Director will say more about this tomorrow whilst the General Counsel will, later on this afternoon, explain how we are using the Revision of Laws project to help us create the flexibility to cope with future changes in global financial services standards.

That being the easy bit – and I'm sure you didn't all come here today expecting a series of talks focusing on how wonderful Guernsey is (after all we aren't either the Tourist Office or even Guernsey Finance) – I think we also need to look critically at areas where our collective approach is perhaps somewhat different to the most economically competitive and prosperous small economies:-

1. Unlike the Swiss we don't have a **plebiscite-based democracy** here although the size of the electorate relative to the States means that we tend to be closer to our elected representatives than would be possible in most countries. Given that neither Singapore nor Hong Kong have anything approaching a plebiscite based democracy, we should perhaps not be overly worried about this difference with Switzerland as the Credit Swiss regression analysis shows the rule of law to be far more important than democratic credentials in driving economic growth.

2. We have a lot of outstanding teachers and some **education**al establishments which are outstanding at turning out highly skilled school leavers. Many firms are also good at providing continuing on the job training. But this is certainly an area where we might question whether the whole of Guernsey has the focus on academic attainment, of pushing every pupil to achieve the very best that he or she could achieve in the same way that Singapore, Finland or Switzerland do and then, of course, we have a notable gap in terms of an academically focused tertiary sector institution.

Many people from Guernsey have found well paid posts in the financial services sector over the past decades with secondary school levels of educational attainment, bringing their parents work ethic from the horticultural industry with them. The world is, however, becoming much more complex and competitive. The definitions of what "well educated" looks like are changing on a global basis with the standards required for entry into many highly productive sectors increasingly requiring a first degree from a top flight higher education institution, if not a post graduate qualification.

Many firms are automating or outsourcing to lower cost jurisdictions the work which was previously done by white collar workers with modest education backgrounds. We need to do all that we can to ensure that our children and their teachers understand that those jobs are simply not going to exist on Guernsey as we move further into the 21st Century and they need to work really hard, make some difficult choices in terms of living off island to go through the higher education process and return with the skills which allow them to compete with those who have gone through the English and Irish educational systems which are both increasingly prizing and producing the academic excellence which forms such a helpful foundation for young people who will be required to cope with a huge amount of change in their working lives, given the rate of evolution of technology and job roles.

3. There is a further angle to this, if you decide that you wish to maintain the sense of shared purpose of the island and the balanced approach to immigration which Credit Suisse suggest is helpful for economic success in small countries, we surely want to ensure that our children are equipped to work effectively alongside the highly skilled high earning immigrants we allow to enter Guernsey as respected peers able to partner with them from a position of educational equality. At the Commission, alongside some other employers, we now have a well-developed graduate programme but I wonder whether we are collectively doing enough to make sure that everyone on Guernsey has the academic and entrepreneurial skills they need to succeed as they seek to join the workforce and create value in our sophisticated economy.

4. We haven't yet passed a **debt brake law** which the WEF highlighted as being important for giving investors confidence in the Swiss economy. We have an ageing population who are placing increasing demands on the public purse in terms of pension, health and social care costs. In addition, working out effective mechanisms which constrain the growth in the size of state spending is clearly a challenge for us and many other island economies although earlier this year the States agreed to amend government's fiscal framework and place an upper limit on aggregate government income such that it should not exceed 28% of GDP.

5. I don't know whether there may be more scope to both incentivise greater retirement self-sufficiency and to encourage more people to work flexibly for longer so that the economically productive proportion of their life is extended well into their seventies –

so as to make sure that the lifetime balance of work and leisure is equitably spread across the generations whilst helping the public finances remain healthy. This is very common for company directors who perhaps need to do it less from a financial perspective than many others – could we encourage the socially responsible practices of company directors in working for longer to spread to other worker groups?

6. We would, I think, have to search quite hard to find concrete evidence of Guernsey having an **aggressive attitude to land reclamation** and other physical **infrastructure investments** although the States has devoted a lot of energy, alongside the telcos, to investment in upgrading our digital infrastructure over the last few years. That said, the "grow to survive" mind-set of Singapore is not apparent everywhere on our island. Very few people want to feel that they are condemned to live in an ever more crowded space and economic growth will often entail a degree of high quality immigration as, on a small island, you cannot hope to have all the skills you need for everything within the indigenous population. I wonder whether Guernsey might benefit from further land reclamation – both from the perspective of signalling to the outside world that it is a good destination for business-intent upon economic growth and from the practical perspective of creating more land so that a little more immigration does not increase the average population density per square mile. Perhaps we could create a long term plan for land reclamation with clear reclamation targets which could align with targets for new house and office building to indicate that we expect our financial and other sectors to grow. Provided those householders adversely affected were offered fair compensation for any loss of amenity, it has always struck me that there might be a multiple winners from establishing a more Singaporean approach here.

7. We don't have that much **economic diversification** compared with Singapore or Switzerland but it is arguable that it would be very difficult to have great depth and capacity in more than one sector given the size of our working population. Neither do we have the same institutional approach to **national champions** in some areas that Singapore has - though the Commission is delighted to note that we do have significant locally grown businesses alongside many of the big multinational players. This has all contributed to the successful creation of insurance, fiduciary, private banking and fund related clusters which were identified as crucial to national prosperity and advancement more than two decades ago by Professor Porter in his seminal work, "The Competitive Advantage of Nations." We do though need to be wary when businesses which were historically locally owned become - through merger, takeover or expansion – location indifferent. Any jurisdiction needs business leaders who are committed to it as well as to the profitability of their own businesses if the jurisdiction is not to be vulnerable to having its capacity hollowed out in the longer term.

In Summary

I consciously chose today not to dwell on what has happened in any particular sector over the last year and its challenges. I'm fortunate in working with an able team of directors and deputy directors who will speak more about sectoral issues and challenges over the next day and a half. What I have endeavoured to do today is to provide an overview of how we compare with the most highly ranked competitor jurisdictions – countries which have been consistently successful in adapting to make sure that their economies are maximising both their GDP per head and the human development of their population.

I hope I have shown, through my survey of others' analysis of their key success factors, that we match the most competitive countries in a large number of areas and that we still possess many key success factors. That much is reassuring. I have also alluded to areas where we differ from the most competitive small countries. We may be quite comfortable about being different from them but in an ever more competitive global market place, it may be worth considering if our dispersion from their success factors is comfortable. We have no hereditary right to be competitive. The Channel Islands which my grandfather helped liberate 70 years ago were quite poor. There are many poor windswept islands around the world. Guernsey is, thankfully, far from being one of them. If our competitive advantages go, our comparative GDP per head will fall. Our competitive advantages which give rise to our financial stability require constant nurturing and development if they are not to be lost. We need to adapt in a changed business climate.

Ultimately, the Commission is committed to maintaining financial stability, protecting consumers and combatting financial crime. If we are competitive as a jurisdiction, we will be likely to be earning more than we spend making financial stability markedly easier to maintain. If we are competitive, we will continue to deliver world class financial services which will embed consumer protection within them rather than scraping around at the seedy end of the global market. This makes it far easier for us to deliver our consumer protection mandate. Furthermore, if we are competitive there will continue to be high-quality - high-wage jobs in the mainstream economy thus reducing the economic incentives for people to help facilitate financial crime. Thus, from a self-interested point of view, in the same way that at a micro level we much prefer profitable to unprofitable companies, at a macro level the Commission sees Guernsey's competitiveness as key to helping it deliver its mandate and we look forward, over the coming years to working with both government and industry to ensure that our Bailiwick maintains and develops its key success factors, thereby enhancing the wellbeing of its inhabitants.