



Guernsey Financial
Services Commission

Island economies – Productivity and Prosperity

The economic imperative

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Overview on Island Economies (IEs)

- Analysing small economies surrounded by sea
- Looking at economic prosperity and also economic survival
- Economic objectives are the same in IEs as large economies
 - maximising economic growth or GDP per head
- There are positives and negatives in being an Island economy

Overview on Island Economies (continued)

- Big positive factors are potential benefits from ability to draft own laws, set taxes and react quickly giving flexibility and nimbleness
- Offset by constraining negative factors

Characteristics of Island Economies

- Resource constraints
 - limited natural resources: land, commodities, energy
 - limited manpower resources: finite labour force and expertise
- Externalities
 - vulnerable to economic conditions elsewhere; you can't insulate yourself from the rest of the world economy

Characteristics of Island Economies (continued)

- vulnerable to economic policies and laws elsewhere (UK and EU especially)
- and still subject to global regulations

Identify your competitive advantage

- Natural overlap with William Mason's presentation
- “Our competitive advantages require constant nurturing and development if they are not to be lost”
- Competitive advantage is a relative concept: sometimes comparative advantage
- Not a fixed endowment – it can be eroded

Identify your competitive advantage (continued)

- Usually time limited as competitors seek to imitate
- Guernsey ‘invented’ PCCs but others copied the idea
 - but we “borrowed” the captive insurer concept from Bermuda

Experience of Financial Services Business (FSB) based economies

- FSB approach chosen by many IEs – to achieve high value added per head of finite workforce
 - incentive of an easy source of potential tax revenues
- On the face of it – FSB approach looks attractive/easy and straight forward
 - in fact it is a constant hard slog
- Reality is you have to deal with the downsides

Experience of Financial Services Business (FSB) based economies (continued)

- The classic downsides are:
 - international community keeps moving the regulatory ‘goal posts’
 - have to endure constant criticism of the integrity of FSBs
 - IEs quickly acquire negative labels
- IEs need to be constantly alert to such accusations and deal with them effectively by deploying the facts to set the record straight

Reputation Sensitive Life

- Only effective response: build a robust AML and FC infrastructure
- Economically that impacts the business model
 - skews the cost/income ratio by necessarily increasing the proportion of non-revenue generating staff

Economic Strategy: Diversification

- With such constant challenges to the FSB sector most IEs naturally strive for diversification
 - to reduce concentration risk
 - mitigate the impact of external shocks
- Distinguish two aspects of diversification
 - (i) Diversification across the whole economy
 - (ii) Diversification within the FSB sector

Economic Strategy: Diversification (continued)

- In aspect (i) most IEs choose tourism but also horticulture
 - problem with tourism is its seasonality and its weak multiplier effects – as in cruise ship example
- Aspect (ii) – diversification within finance sector – is already a feature of the Guernsey economy
 - complementarity of the different components

Caveat on Standing Still

- Before dealing with innovation there is a caveat in the wake of the 2008 crisis which flags the danger of complacency
- In our chosen sub sectors of wealth management and private banking there is an ongoing challenge
- Must demonstrate value added and value for money: if you can't justify the fees the business will evaporate

Caveat on Standing Still (continued)

- clients and investors will reasonably ask: what am I paying for? With historically low interest rates and slow economic recovery it is much more challenging
- Response must be – smarter, better educated wealth managers/advisers – who understand and can interpret complex markets for clients

Economic Strategy: Innovation

- My view: not a solution in itself – a subset of diversification
- Our experience – very little is wholly new – just more efficient ways of doing what has been done in past
- Message – FSBs will have to embrace smart applications or get left behind by competitors

Economic Strategy: Innovation (continued)

- Exciting future – crowdfunding and Peer to Peer (P2P) Lending have been enabled by new technology
- Still evolving – no one single model has emerged clearly above the rest so future direction not obvious
 - P2P could go full circle

Cautionary Lessons from the Past

- Returning to the point that ‘competitive advantage’ can evaporate or be lost
- Common sense message for IEs – do not get too committed to one line of business or one specific market that you could be left stranded
- For firms – stronger if diversify lines of business
- Review the experience of some IEs

Wrap-up and Way Forward for IEs

- To stay competitive and survive
 - keep a mix of FSBs/financial products
 - keep open the supply of expertise
 - smart people doing higher value added jobs
 - Do not price yourselves out of your market
 - Embrace innovative applications
 - Maintain top notch infrastructure