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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/45-2

10:55 a.m., June 3, 2019

2. The Bahamas—2019 Article IV Consultation

Documents: SM/19/109 and Correction 1; and Correction 2; and Supplement 1; SM/19/110, and Correction 1

Staff: Bornhorst, WHD; Gemayel, SPR

Length: 26 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	**Alternate Executive Directors**
	K. Obiora (AE)
	K. Carvalho da Silveira (AF), Temporary
	E. Rojas Ulo (AG), Temporary
N. Ray (AP)	
	P. Fachada (BR)
	Y. Zhao (CC), Temporary
	J. Suazo (CE), Temporary
L. Levonian (CO)	
	S. Benk (EC)
	A. Castets (FF)
	K. Merk (GR)
	M. Siriwardana (IN)
	M. Psalidopoulos (IT)
	Y. Saito (JA)
	M. Saadaoui (MD), Temporary
	M. Merhi (MI), Temporary
	R. Doornbosch (NE)
	J. Sigurgeirsson (NO)
	L. Palei (RU)
	W. Al Hafedh (SA), Temporary
	P. Trabinski (SZ)
	A. Clark (UK), Temporary
	D. Crane (US), Temporary

H. Al-Atrash, Acting Secretary
O. Vongthieres, Summing Up Officer
B. Zhao, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Finance Department: R. Bhattacharya. Legal Department: F. Fernando, D. McDonnell. Monetary and Capital Markets Department: C. Cohen, J. Morsink, H. Oura, C. Ribas Visconti. Strategy, Policy, and Review Department: E. Gemayel. Western Hemisphere Department: F. Bornhorst, S. Cevik, A. Husain, A. Oshima, U. Ramakrishnan, T. Zhu. Senior Advisors to Executive Directors: D. Hart (CO), J.Weil (CO), C. Williams (CO). Advisors to Executive Directors: M. Albert (FF), P. Di Lorenzo (IT), I. Fragin (GR),

J. Hanson (NE), B. Jappah (AE), G. Kim (AP), P. Mooney (CO), E. Ondo Bile (AF), R. Pandit (ST), I. Skrivere (NO), M. Sylvester (CO).

2. THE BAHAMAS—2019 ARTICLE IV CONSULTATION

Ms. Levonian, Ms. McKiernan and Ms. Vasishtha submitted the following statement:

Our Bahamian authorities highly appreciate the constructive engagements and policy dialogue with the Fund. They welcome the comprehensive assessment of the country's economic situation and financial system done by the Article IV and FSAP teams and broadly concur with the insightful recommendations.

Recent Performance and Economic Outlook

The Bahamian economy continues to recover, with real GDP growing by 1.6 percent in 2018, up from 0.1 percent in 2017. Growth is being driven by buoyant tourism and construction activity underpinned by foreign investment projects, against a backdrop of sound macroeconomic policies, progress on fiscal reforms, and continued expansion of the US economy. Growth is projected to edge up further, reaching 1.8 percent in 2019, before tapering off to the potential rate of growth of about 1.5 percent over the medium term.

While our authorities broadly agree with the medium-term outlook and risks, they expect somewhat stronger growth in 2019 and over the medium term, driven mainly by continued high tourism growth and new FDI projects. Recent progress towards a multi-layered natural disaster resilience strategy will strengthen economic resilience. The Central Bank of the Bahamas (CBoB) expects an additional boost to growth from a gradual expansion in bank lending and diminishing pace of credit contraction.

Inflation increased from 1.6 percent in 2017 to 2.2 percent in 2018, on an annual average basis, due mainly to the increase in the VAT rate from 7.5 to 12 percent in July 2018. Inflation is projected to decline to 1.6 percent in 2019 as the temporary effect of the VAT rate increase fades.

The unemployment rate remains high (10.7 percent in November 2018), especially among the youth, despite positive jobs growth. Meanwhile, the authorities' initiatives to create jobs through support of small businesses and entrepreneurs are beginning to bear fruit as evidenced by the 11.9 percent growth in self-employed in November 2018. Nevertheless, our authorities acknowledge that efforts need to be enhanced to enable employment creation to keep pace with labor force growth. They expect

employment conditions to improve gradually, driven by private sector investment initiatives and tourism sector growth.

Ensuring Fiscal Sustainability

Our reform-oriented Bahamian authorities recognize the importance of responsible fiscal policy to maintain macroeconomic stability and policy credibility. They have adopted a comprehensive set of reforms to set the tone for sound fiscal management strategies.

The Fiscal Responsibility Law (FRL), enacted in October 2018, improves fiscal transparency by anchoring and guiding fiscal policy towards pre-determined targets, which are consistent with previous staff advice. Our authorities remain committed to achieving these targets and legislating public financial management (PFM) reforms to strengthen governance and accountability. In February 2019, Moody's Investor Service changed the outlook for the country's credit rating from negative to stable, while affirming the overall rating at Baa3 in recognition of the authorities' efforts to strengthen the fiscal framework, including enhanced reporting of fiscal accounts.

The budget deficit narrowed to 3.4 percent of GDP in FY2017/18 from 5.5 percent in the previous year, as capital expenditure levels normalized post hurricane reconstruction and current expenditure was tightened. The FY2018/19 budget presented an ambitious and balanced approach to fiscal consolidation comprising actions to restrain expenditures and boost revenues, broadly consistent with staff recommendations. The plan involves eliminating the deficit from its current level of 3.4 percent and keeping the debt-to-GDP ratio under 50 percent. The budget included a series of tax increases as important measures to achieve the deficit target of 1.8 percent of GDP this fiscal year.

However, based on fiscal developments in the first half of the fiscal year, revenue performance appears to be weaker than expected, owing partly to grace periods granted for the implementation of revenue measures, tax exemptions, and legal disputes. Notwithstanding this potential revenue shortfall, the authorities are confident that tight expenditure control will enable them to achieve the budget target for the fiscal year.

Strengthening both tax administration and revenue avenues remain a priority for the government. The soon-to-be-established Revenue Enhancement Unit will identify and address deficiencies in revenue collection

efforts. At the same time, our authorities also recognize the importance of expenditure reforms in fiscal consolidation. The various ongoing reviews, including of investment incentives, State Owned Enterprises (SOE) governance, and the pension system will help guide expenditure rationalization over the medium term.

The Ministry of Finance has also undertaken several public financial legislative initiatives to strengthen the fiscal landscape and secure alignment with international best practices. The Public Financial Management Bill (PFM), which is being drafted with assistance from the IMF's Caribbean Technical Assistance Centre (CARTAC), is expected to develop a more comprehensive legal framework to strengthen the oversight, management and control of public funds. Work has also continued to advance the Public Debt Management Bill and Public Procurement Bills. This work will include the creation of a Public Debt Management Office and a Public Debt Management Unit to, among other things, ensure policy coordination in the preparation of an annual debt management strategy.

Strengthening Resilience to Natural Disasters

Our authorities are taking a proactive, multi-pronged approach to strengthen their natural disaster risk management strategy. The government has secured a US$100 million contingent credit line with the Inter-American Development Bank (IDB) and re-subscribed to disaster insurance through the Caribbean Catastrophe Risk Insurance Facility (CCRIF). In addition, the government is drafting legislation to set up a Disaster Relief Fund to respond to lower impact, but higher frequency, events. The fund, which will be set up using seed money from extinguished dormant accounts in the banking system, demonstrates our authorities' commitment to strengthen resilience and mitigate risks to fiscal sustainability from natural disasters. Our authorities are also taking important initiatives to invest in resilient infrastructure and existing building code, in line with previous staff recommendations.

Financial Sector Stability Assessment (FSSA)

The Bahamas is committed to implementing the reforms needed to strengthen the resilience of the financial sector, which is crucial for achieving robust, sustainable growth. Our authorities welcome the comprehensive FSSA report and the overall assessment that the Bahamian financial system does not currently face significant threats to financial stability. They also welcome the positive assessment of the resilience of both the onshore and offshore sectors to various shocks, and the limited spillovers between the two sectors. They are

pleased with the IMF's acknowledgment of the significant progress made in strengthening the financial sector regulatory infrastructure. They broadly agree with the insightful recommendations and are committed to addressing the identified challenges, while acknowledging that timely and effective implementation of these comprehensive recommendations will require significant resources and appropriate sequencing.

Our authorities recognize the need for decisive and timely resolution of non-performing loans (NPLs), which were at 9.1 percent in 2018, down from a peak of 15.4 percent in 2013. The CBoB remains engaged with financial institutions to put in place practices to reduce NPLs, including through sales or disposal of collateral held against foreclosed loans; restructuring where feasible; and enlarged provisioning and write-off regime for doubtful loans. Given weaknesses in residential mortgage portfolios, the authorities agree on the need to develop a local real estate index to improve NPL valuations. The implementation of the planned consumer credit bureau will also enable better assessments of borrowers' creditworthiness.

The Bahamas has made good progress on implementing the 2013 FSAP recommendations, especially in strengthening financial system oversight. Several initiatives have strengthened the overall supervisory and regulatory framework of banks. The CBoB and the Ministry of Finance have introduced or updated several legislations and regulations on AML/CFT and issued guidance or consultation proposals for Basel II/III regulatory reforms. Likewise, the CBoB has enhanced its risk-based supervision regime on AML in offsite surveillance as well as onsite examinations. Significant progress has also been made in addressing technical compliance deficiencies which led to recent upgrades by the CFATF.

Our authorities have also committed to continued improvements in transparency and enhanced monitoring of the offshore sector, particularly given the changes to the bank licensing regime. With regard to strengthening governance of public financial institutions, the draft Corporate Governance Bill will subject all SOEs, including public banks, to rules limiting political interference.

On a financial crisis management framework, recovery plans of all domestic systemically important banks (DSIBs) will be submitted by end 2019, in line with the amendments to the Bank and Trust Companies Regulations. In addition, the Financial Crisis Management Committee (FCMC), which is an extension of the Group of Financial Services Regulators

(GFSR), will play a leading role in ensuring that the amendments are operationalized.

The central bank remains cognizant of the challenges posed by the persistently high levels of liquidity in the banking system and has employed near-term measures to absorb some of this excess. Measures include the continued sell-off of the CBoB's portfolio of government securities, resulting in a decline from 6.1 percent of GDP in 2016 to 4.2 percent by end-2018.

Financial Inclusion

Our authorities have made progress on financial inclusion initiatives while acknowledging that more could be accomplished. The CBoB recently established regulations to license non-banks to provide electronic money services to the public. On ease of access, simplified customer due diligence requirements were introduced in 2018. Further, as part of the Get Money Smart program, the CBoB is working with commercial banks on a financial literacy campaign on cyber security to improve public comfort with digital financial products.

The central bank is planning to pilot a digital currency as a means of enhancing financial inclusion and closing infrastructural gaps in the domestic payments system. The pilot will focus on the challenges posed by gaps in access to services in remote communities. It will also incorporate best international practices about AML/CFT risks, as well as safeguards against other possible risks. The pilot will be used to gather information on how best to address technological challenges and address changes in payment system usage.

External Sector and Competitiveness

Our Bahamian authorities are very mindful of the need to continue structural reforms to boost competitiveness and the economy's long-term growth potential. Efforts are ongoing to address long-standing structural issues, lower cost of doing business, and boost private sector investment. On enhancing the ease of doing business, the authorities have reformed the Business License tax regime, with emphasis on fees, processing platforms and times, and structure. They are also undertaking measures to lower costs of transacting with the government: the parliament approved a US$30 million loan from the IDB earlier this year, for the Government Digital Transformation to Strengthen Competitiveness Program (DTP).

The Bahamas has committed to WTO accession by 2020, which brings forward key reform priorities, including improving access to credit for the private sector, lowering energy costs, and addressing skill mismatches in the labor market. Progress on advancing energy sector reforms included restructuring of the state-owned Bahamas Power and Light (BPL) and upgrading the electricity transmission and distribution networks.

Finally, our authorities strongly agree with the need for raising human capital through educational and vocational reforms to lower youth unemployment and address skill mismatches, and are adopting a comprehensive approach to education reform over five years.

Mr. Trabinski and Mr. Makhammadiev submitted the following statement:

We thank staff for well-written reports and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their informative buff statement. The Bahamian authorities are making progress on several fronts, with significant improvements in the fiscal area and enhanced compliance with AML/CFT standards. We take note that the expanding tourism sector will sustain growth in the near term, but urge the authorities to expeditiously tackle structural impediments to support economic performance over the medium term. We broadly share staff's appraisal and offer the following comments for emphasis.

We welcome the enactment of the Fiscal Responsibility Law and encourage the authorities to ensure its effective implementation, as well as to implement other public financial management acts. In this regard, adhering to the specified fiscal rules, operationalizing the fiscal council and building adequate implementation capacity at the Ministry of Finance and other relevant agencies will be important steps. We concur with staff that to boost the credibility of the new policy framework, fiscal consolidation should be effected through reducing low-priority recurrent expenditures rather than the much-needed capital spending. Furthermore, we take good note of measures that have been taken to mitigate costs of potential natural disasters, and we encourage the authorities to keep building financial and structural resilience.

The authorities need to maintain a sound monetary policy framework. To this end, the credibility of the exchange rate system should be further strengthened by building up foreign exchange reserves to the adequate level. We also recommend to proceed with caution on issuing a central bank digital currency (CBDC). While the introduction of a CBDC would be an innovative approach to promote financial inclusion in the country's wide area, we share

staff's concerns that the digital currency could have negative effects on financial stability and would likely heighten AML/CFT risks.

The banking system is healthy overall, but vulnerabilities stemming from problem assets call for immediate action. We urge the authorities to follow staff's recommendations to operationalize the consumer credit bureau and develop real estate price indices. This would help overcome information asymmetry in the credit market, improve the valuation of NPLs and strengthen macro-financial monitoring. We also welcome the authorities' commitment to strengthen the AML/CFT framework and their readiness to comply with tax transparency standards. Nonetheless, the authorities need to carefully monitor risks arising from the new licensing regime for financial institutions, which allows them to operate both in the international and domestic financial sectors of the Bahamas.

Addressing structural bottlenecks is key to boost competitiveness and growth. The authorities should embrace measures to lower the costs of doing business by streamlining administrative processes, reducing customs duty rates, enhancing access to finance and improving the power supply. To reduce skills mismatches in the labor market and youth unemployment, a swift expansion of vocational training and apprenticeship programs is warranted.

Mr. Saito and Mr. Naruse submitted the following statement:

We thank staff for their informative reports and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their insightful statement. We commend that growth has returned after years of stagnation, supported by tourism and construction. We also welcome that the growth momentum is expected to sustain in 2019, driven by new FDI-financed tourism projects and airport upgrades. In addition, we are pleased to see that the new Fiscal Responsibility Law (FRL) was enacted and that important steps have been taken to increase resilience against natural disasters. However, the country faces multiple challenges, including rising public debt, subdued credit growth, and low competitiveness. Therefore, we believe that the authorities need to implement the fiscal responsibility framework, strengthen the financial sector, and boost long-term growth. As we broadly concur with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

We encourage the authorities to effectively implement the new FRL and adopt measures to deliver on the fiscal targets to ensure debt

sustainability. We are encouraged by the staff's commitment to achieving the FRL targets. In this regard, we take note of the authorities' view that tight expenditure control will enable them to achieve the budget target. As staff recommend, we encourage the authorities to limit new hiring to essential staff, rein in low-priority current spending, and reprioritize capital expenditure. Over the medium term, we support the staff's recommendation to contain expenditure growth by further rationalizing the wage bill, advancing the pension reform, and accelerating SOEs reforms.

Financial Sector Policy

While it is welcoming that the banking sector remains sound, we encourage the authorities to implement measures for spurring credit to growth sectors. In this regard, we note the staff's analysis that a large structural liquidity surplus exists as banks maintain conservative lending practices. Could staff elaborate more on the reason why banks maintain conservative lending practices? We welcome the 2019 FSAP finding that the banking sector enjoys healthy profits and maintains high capital and liquidity ratios. However, we note with concern that private sector credit remains weak, hampered by non-performing loans and lack of information about potential borrowers. Given that the domestic residential real estate market accounts for ¾ of NPLs, we agree with the staff's view that a real estate price index and the collection of loan-level data would assist in market monitoring. Also, we encourage the authorities to swiftly establish the credit bureau to help make credit markets more efficient. In addition, we welcome the authorities' commitment to continued improvements in transparency and enhanced monitoring of the offshore sector. Furthermore, we support the authorities' efforts to enhance the implementation and effectiveness of the AML/CFT framework. Lastly, we agree with the importance of strengthening the governance of public financial institutions.

Monetary Policy

We support the staff's view that strengthening the central bank's governance and independence, in line with international best practices, would enhance its operational effectiveness. In this regard, we welcome the authorities' intention to submit the amendment to the central bank law, which aims to strengthen the central bank's governance, operations, and independence, to parliament in 2019. In addition, we agree with the staff's view that the accommodative stance is appropriate because the output and credit gaps are negative and core inflation is contained. Moreover, given a large structural liquidity surplus, we concur with the staff's call for reducing

the central bank's holdings of government debt. Lastly, we note that the central bank will pilot a central bank digital currency to boost financial inclusion. Could staff explain how staff engage with the authorities on Project Sand Dollar? Do staff provide any technical assistance?

Structural Reform

We agree with the need to advance structural reforms to strengthen competitiveness and ensure inclusive growth. We encourage the authorities to advance energy sector reforms for addressing high energy costs and ensuring reliable and affordable electricity. In addition, we note with concern that unemployment remains high, especially among the youth. In this respect, we agree with the staff's call for reducing skills mismatches and boosting human capital accumulation. Lastly, we agree with the importance of fostering the competitiveness of the economy by reducing the costs of conducting business with the government. Could staff elaborate more on the possible measures to reduce the costs of conducting business with the government?

Mr. Obiora and Mr. Jappah submitted the following statement:

We thank staff for the comprehensive reports and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their helpful buff Statement.

Our thoughts are broadly in line with staff analysis and assessment on the Bahamian economy. Following years of stagnation, the economy has returned to steady growth, reflecting a rise in tourism and steadfast implementation of reforms. While the outlook is positive, on the back of projected improvements in tourism receipts and new development projects, growth prospects remain subject to significant downside risks emanating from weak growth in some advanced economies and large emerging markets, additional pressures from the offshore sector, recurrence of natural disasters, and deceleration of reform momentum. Against this background, the authorities should direct policy efforts towards sustained fiscal consolidation, mitigating financial sector vulnerabilities, acceleration of structural reforms, and strengthening resilience to natural disasters.

To attain the medium-term deficit and debt targets, the authorities need to continue on the path of fiscal consolidation. In this connection, we are comforted by the reassuring messages in the buff Statement by Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha, and welcome the enactment of the Financial Responsibility Law (FRL), which provides an anchor for debt and deficit management. We urge the authorities to operationalize this law through

the full constitution of the Fiscal Council. While recognizing improvements reflected in the February 2019 Moody's Investor Service rating action, we reiterate staff's call that the authorities speed up the enactment of enabling legislations, including the public financial management, public procurement, and debt management laws, to strengthen the broader fiscal framework. We would welcome any updates staff may have on progress in enacting these pieces of legislations. We would also welcome elaboration on the overall trend of revenue collection since the expiration of the grace period offered by the authorities on new tax measures.

While we commend the authorities for insisting on ample buffers, persisting and significant vulnerabilities in the financial sector remain a concern. We are encouraged by the authorities' renewed efforts to strengthen the resilience of the sector by improving regulatory and transparency standards, including implementing the 2013 FSAP recommendations. However, given the vulnerabilities described in the staff report, further actions are required to safeguard the sector's stability. To this end, we urge the authorities to enhance regulatory oversight of credit underwriting and methodically resolve the issue of NPLs mostly emanating for the domestic residential real estate market and credit unions. The authorities also need to build on earlier progress and address implementation deficiencies in the AML/CFT regime, including transparency and risk-based oversight. It is also vital that the new legal and legislative mechanisms that address standard setters' transparency concerns are vigorously and urgently pursued.

We welcome efforts at structural reforms aimed at improving competitiveness and raising medium term growth prospects. We applaud the authorities' efforts on energy sector reforms, the DTP competitiveness project, as well as the legislation of the Integrity Commission Bill. To entrench these reforms, it will be critical that the authorities continue their emphasis on reducing labor market inefficiencies, and boosting human capital, particularly as articulated in the five-year education plan geared towards enhancing vocational and apprenticeship programs.

The authorities' measures to strengthen resilience to natural disaster are commendable. In line with context provided by the lucid buff Statement, we are particularly delighted with the creation of a natural disaster fund, contingency financing arrangements with a regional bank, insurance cover, as well as the strengthening of physical infrastructure, under the multi-layered natural resilience strategy, which should help mitigate the impact of natural disaster on the country. We encourage the authorities to work with development partners to continue efforts to further enhance the disaster-coordination mechanism through a comprehensive resilience strategy.

We wish the authorities every success in their endeavors.

Mr. Ray, Mr. Benk, Mr. Kim and Mr. Reininger submitted the following joint statement:

We thank staff for their comprehensive report on The Bahamas, and Ms. Levonian, Ms. McKiernan and Ms. Vasishtha for their informative buff statement. The Bahamian economy has regained momentum following the opening of the Baha Mar resort, and the authorities have embarked on a comprehensive reform path, particularly in the fiscal sector. As a small and open economy, The Bahamas is strongly exposed to changes in its trading partners' economic growth, and its offshore sector faces heightened scrutiny with respect to AML/CFT risks and tax transparency. Moreover, the Bahamian islands are feeling the impact of climate change, with more frequent and larger natural disasters. We agree with the thrust of the staff's appraisal and add the following comments for emphasis.

Acknowledging that current growth is above par, potential growth should be further improved. A three-pillar disaster resilience strategy, including a natural disaster fund, may contribute to increase The Bahamas' potential growth in terms of attracting foreign direct investment. We agree with staff's recommendation that high energy costs, bottlenecks in access to private credit, and skill mismatches in the labor market should be addressed as a priority to unlock the economy's potential. We note the authorities' plans to start a pilot project for the "Sand dollar", a central bank digital currency (CBDC). While we acknowledge the CBDC's potential to enhance financial inclusion and help modernize the payment system in the archipelago, we also see related technological and cyber-security challenges. In this vein, the authorities and staff should continue the constructive dialogue in order to contain possible risks.

Sustainable growth will depend on continued fiscal consolidation. We commend the authorities for enacting the new Fiscal Responsibility Law (FRL) and for their commitment to achieve the FRL targets and legislate public financial management reforms. We agree with staff's view that investment in implementation capacity and tax administration capacity as well as expenditure control and a comprehensive review of tax expenditures would help fiscal consolidation. In this vein, we welcome the ongoing reviews of investment incentives, SOE governance and the pension system and that the draft Corporate Governance Bill will subject all SOEs, including public banks, to rules limiting political interference. With custom duties currently amounting to about 5 percent of GDP, or one-third of total tax revenues, the

authorities will need to address to the fiscal impact of their planned WTO membership by 2020. What is the expected revenue decline in the initial years of WTO membership and has this been accounted for when setting the FRL target for the fiscal balance in FY 2020/21 (–0.5 percent of GDP)? Against this backdrop, we encourage the authorities to embark on a comprehensive tax reform, including income taxation and market-value-based property taxation, and to put in place the prerequisites such as a comprehensive property registry. Do staff assess The Bahamas' institutional capacity as sufficient to fulfill the comprehensive tax-related recommendations all at once? We note that staff advise the fiscal reform and consolidation be balanced with priority measures for more inclusive growth and wonder what specific measures staff would suggest.

Banks should be encouraged to lend, and further progress is needed to resolve NPLs. We note that banks maintain conservative lending practices and pension funds and insurance companies hold liquid assets as reflected by excess liquidity. We concur with staff that the central bank could use this as an opportunity to continue selling down its holdings of government debt securities. We welcome the authorities' broad agreement with the FSSA recommendations and would like to highlight the importance of completing legislative reforms to strengthen recovery and resolution powers of the central bank, enhancing the supervision of credit underwriting, collecting loan-level data and developing a real estate price index.

Reform efforts towards a transparent and well-regulated offshore sector should continue. We commend the authorities for their objective of a competitive tax jurisdiction that is fully compliant with AML/CFT standards and international tax transparency requirements. We appreciate the recent progress such as the enactment of the Beneficial Ownership Law and the issuance of the Codes of Practice for designated non-financial business and professions (DNFBPs), both recognized by the FATF. We welcome the authorities' commitment to continue the implementation and effectiveness of the AML/CFT framework and their agreement with the FSSA recommendation to step-up risk-based supervision of financial institutions and DNFBPs, also by committing significant resources. Concerning tax transparency, we acknowledge that the OECD's Global Forum found The Bahamas largely compliant with international standards and note that the EU listed The Bahamas as having a cooperative tax jurisdiction, subject to successful delivery of their commitments. In this vein, we welcome the set of laws to establish a new legal and fiscal framework for the offshore sector to remove preferential treatment of non-resident companies and achieve a level

playing field between resident and non-resident companies. At the same time, we concur with staff that potential spillovers require careful monitoring.

Improving data availability is an investment for better informed policy making. We welcome the authorities' efforts to improve the availability and quality of data and strongly encourage them to provide the required resources.

Mr. Doornbosch, Mr. Psalidopoulos, Mr. Di Lorenzo and Mr. Hanson submitted the following joint statement:

We thank staff for their well written set of reports and Mses. Levonian, McKiernan and Vasishtha for their insightful buff statement. We welcome the authorities' efforts to maintain fiscal sustainability, strengthen resilience to natural disasters and address AML/CFT deficiencies. We broadly share staff's assessment and would like to make the following comments for emphasis.

We welcome the enactment of the Fiscal Responsibility Law. The new fiscal rule, with a debt-anchor and two operational rules for the overall deficit and expenditure growth, will help put debt on a downward trajectory. The well-defined escape clauses allow for stabilization in case of shocks, including natural disasters. Independent oversight by the fiscal council will enhance transparency and bolster the credibility of the framework. We note that the DSA forecasts a higher debt level in 2024 than the fiscal rule and we encourage the authorities to take the additional fiscal efforts necessary to meet the targets of the Fiscal Responsibility Law. Mses. Levonian, McKiernan and Vasishtha mention many welcome fiscal initiatives in their buff statement, including ongoing expenditure reviews, the establishment of a Revenue Enhancement Unit and the preparation of a Public Financial Management Bill. To reduce reliance on central bank financing, a prompt establishment of a Public Debt Management Office is warranted, and needs to be complemented by the approval of the law aimed at strengthening the central bank's governance and independence. We note that the buff statement doesn't mention tax policy reform, while staff advises a comprehensive approach to reform of the tax system to increase its efficiency and enhance its progressivity, including through the introduction of taxes on income, capital gains and inheritance. We would be interested to hear more about the discussions with the authorities on this topic. Staff's comments are welcome.

We welcome the authorities' disaster risk management strategy. Staff's discussion on the topic based on the three-pillar strategy discussed last month in the Board meeting on Building Resilience in Developing Countries Vulnerable to Large Natural Disasters is insightful. We also welcome the

tailored natural disaster scenario in the DSA. We support the efforts of the authorities to strengthen financial resilience through the establishment of a natural disaster fund, a contingent credit line with the Inter-American Development Bank and disaster insurance through the Caribbean Catastrophe Risk Insurance Facility, as well as their efforts to improve infrastructures' resilience.

We agree with staff that the introduction of Central Bank Digital Currency (CBDC) can deliver benefits but is subject to risks. The authorities should be vigilant about risks related to financial stability, cybersecurity and AML/CFT, and the extent to which other options can be instrumental in attaining the same goals. We welcome the discussion of benefits and consequences of CBDC in Annex VII but note that the discussion is rather abstract and would have benefitted from more practical guidance.

AML/CFT supervision should be strengthened further. We agree with staff that the authorities should continue to implement measures as agreed with the FATF to address the identified AML/CFT deficiencies, including through risk-based supervision. We welcome the authorities' efforts to strengthen the AML/CFT framework and move towards compliance with tax transparency standards.

Mr. Fachada and Ms. Mohammed submitted the following statement:

We thank staff for the reports and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their statement. After several years of stagnation, economic growth has returned to Bahamas, buoyed by tourism and foreign investment projects. Nevertheless, the economy remains challenged by elevated public debt and current account deficit, high non-performing loans in the banking sector and structural impediments. Accordingly, fiscal consolidation, enhanced financial supervision and regulation, and improved business climate and competitiveness are necessary to put Bahamas on a more sustainable path.

Effective implementation of the Fiscal Responsibility Law (FRL) would bolster fiscal consolidation and public debt sustainability. We welcome the authorities' commitment to meeting the FRL targets, but greater efforts are needed on both the expenditure and revenue sides. Strengthening the tax administration and reviewing the existing tax exemptions and incentives can provide the much-needed boost to revenue. Containing expenditure by rationalizing wage bills, advancing the pension reform, and accelerating state-owned enterprises (SOEs) reforms are important elements in ensuring

fiscal consolidation. These measures should be complemented with greater control and a stronger public financial management framework.

Although the authorities have made substantial improvement in strengthening the financial sector's supervisory and regulatory framework, further progress is needed. We support the recommendation for swift implementation of the credit bureau and an asset registry to assist with improved efficiency in credit markets. Also, given the changes to the bank licensing regime, we concur with staff that careful monitoring of the offshore sector is warranted. Enhancement of AML/CFT framework and the modification of legal and fiscal framework in the offshore sector would be a step in the right direction to ensure compliance with international tax transparency requirements. Moreover, the authorities are encouraged to continue to implement the Financial Action Task Force (FATF) recommendations, including to mitigate possible correspondent banking relationship pressures.

Implementation of structural reform is paramount to improving the business climate and boosting competitiveness to unlock potential growth. We take note that the World Bank's ease of doing business indicator highlights onerous administrative processes, high costs of trading across borders, poor access to credit and lack of reliable and affordable electricity. Addressing these constraints to growth and investment would entail swift policy action to reduce the high energy costs, bottlenecks in access to credit and skills mismatches in the labor market, among other structural factors.

Finally, we commend the authorities for the progress they have made in building ex-ante resilience to natural disasters. The establishment of a natural disaster fund as part of a multilayered financial resilience strategy is welcomed. We acknowledge the authorities' efforts in upgrading the physical resilience, strengthen natural infrastructure and improve coastal flood control measures.

Mr. Villar and Mrs. Del Cid-Bonilla submitted the following statement:

We thank staff for the comprehensive set of reports and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their informative buff statement. The Bahamian economy expanded to 1.6 percent in 2018, after a long period of stagnation, supported by a rebound in tourism and foreign investment projects in the construction sector. The authorities have made impressive progress in fiscal consolidation and other relevant reforms, including the strengthening of the country's National Disaster Risk Management Strategy. The short-term

outlook is positive with some downside risks; however, important challenges remain to increase growth potential and ensure its sustainability over the medium term. We broadly share staff's appraisal and will only emphasize a few topics.

Fiscal consolidation

We commend the authorities for the adoption of the Fiscal Responsibility Law (FRL) enacted in October 2018 and we encourage an effective implementation. The FRL improves fiscal transparency and provides an important medium-term framework to guide fiscal policy. Reforms in public financial management, public procurement and debt management are also essential to support fiscal consolidation. We welcome the authorities' commitment to adopt these laws and the progress in the corresponding drafting with support from Fund's TA. Staff stressed the importance of expenditure restraint to achieve the 2018/19 budget deficit target. Given the previous difficulties in implement current expenditure cuts how does staff envisage implementation of this recommendation?

Additional fiscal effort to meet the FRL targets over the medium term is needed. Staff's recommendations in this regard include rationalizing the wage bill, advancing the pension reform and accelerating SOEs reforms. Can staff update on the progress and feasibility of implementing these reforms? On strengthening tax administration capacity, Ms. Levonian, Ms. McKiernan and Ms. Vasishtha indicate in their buff statement that the authorities will soon establish a "Revenue Enhancement Unit" to identify and address deficiencies in revenue collection. Could staff provide more details on the structure and governance planned by the authorities for this unit?

Financial stability

We welcome the authorities progress in strengthening the financial system and the efforts since the 2013 FSAP to strengthen its oversight. The recent FSSA found the financial system resilient to current threats and overall effective banking supervision, while stressing the need to continue strengthening risk-based supervision. This said, some risks remain, especially associated to domestic assets quality. In this regard, further progress in supervision of credit underwriting and timely resolution of NPLs in some banks and credit unions are warranted. Given that residential mortgage-related loans account for ¾ of NPLs, staff recommends the development of a real state prices index to understand better the dynamics of the domestic residential real state market. Since the development of this type of indicator is

generally costly and time consuming, we wonder if TA is being considered for this purpose and what the expected timing for its implementation may be.

A concrete reform plan for the Bank of Bahamas (BOB) and the strengthening of governance of state-controlled financial institutions are vital. Staff highlights the need to undertake a strategic review of BOB and to complete the planned reforms to enhance recovery and resolution powers, as well as to improve governance and transparency of any public asset management company. Can staff update on the status of both? governance arrangements for state-controlled financial institutions should be strengthened to ensure operational independence and support effective supervision. Can staff comment on the Corporate Governance Bill that is being drafted? Are privatization plans being considered over the medium term?

Monetary policy

The recent reduction of CBOB's holdings of government debt from 6.1 percent of GDP in 2016 to 4.2 percent in 2018 is a step in the right direction. Going forward, we share staff's view on the urgency to strengthen the central bank's governance and independence to enhance its operational effectiveness. In this regard, we welcome the authorities' intentions to send the initiative to parliament this year.

Medium-term growth prospects

Significant structural bottlenecks limit Bahamas competitiveness and its capacity to increase growth potential over the medium term. Modernization of electricity generation and distribution is a key reform. We understand that the authorities are planning the restructuring of the state-owned Bahamas Power and Light (BPL) and upgrading of the electricity transmission and distribution networks. Can staff provide more granular information about the strategy envisaged? Does this contemplate reforms to the regulatory framework whose robustness is essential?

With these remarks we wish the Bahamian authorities the best in their future endeavors.

Mr. Sigurgeirsson and Ms. Skrivere submitted the following statement:

We thank staff for the comprehensive Article IV and FSSA reports and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their helpful buff statement. We broadly concur with staff's assessment and offer the following

comments on fiscal policy, AML/CFT issues, climate change resilience, and data issues for emphasis.

We welcome the authorities' progress and achievements towards improving the fiscal situation, nevertheless efforts must continue to reach the targets set out in the new Fiscal Responsibility Law (FRL). The consolidation measures implemented so far to contain the budget deficit are encouraging, and we welcome the recent measures to improve fiscal transparency and accountability, particularly the new FRL. However, the public debt level remains high, and we encourage the authorities to continue their efforts and implement decisive measures to restrain and reprioritize spending to place public debt on a clear downward trajectory.

While the authorities have continued to upgrade their AML/CFT legislative framework, further efforts will be needed to enhance the effectiveness and operationalization of these measures. We note that progress has been made and the country has been re-rated on a number of recommendations. Nevertheless, the Bahamas remains on the FATF list of jurisdictions with strategic deficiencies, and we share staff's recommendations to focus on the effective implementation of the AML/CFT framework. A concerted effort in addressing ML/FT concerns is especially important in view of the size and importance of the offshore sector. On a related matter, we urge the authorities to carefully assess the risks, particularly financial integrity risks, related to the central bank digital currency project. We look forward to an assessment and the authorities' key takeaways after the pilot exercise has been concluded.

As the Bahamas is vulnerable to natural disasters and climate change, the authorities' proactive strategy to strengthen resilience appears warranted. We note that a comprehensive disaster resilience strategy is recommended by staff (para 19). Could staff elaborate what practical steps, or changes to existing government strategies are needed?

We share staff's views on the importance of the availability and quality of data, and we encourage the authorities to improve their data accessibility and dissemination practices.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the detailed reports and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their informative buff statement. Growth in The Bahamas is firming up, driven by tourism and construction,

and is projected to converge to the potential rate over the medium-term. However, the higher reliance on offshore financial services and tourism has made the economy vulnerable to various external and internal shocks. We commend the authorities for their commitment to macroeconomic stability to achieve sustainable and inclusive growth. Going forward, continuous refinement of the policy mix and reforms to remove structural impediments are essential to effectively deal with The Bahama's development challenges. We broadly agree with staff's assessment and wish to make following remarks for emphasis.

Continued efforts in strengthening fiscal consolidation are important to address rising debt levels, maintain macroeconomic stability, and ensure policy credibility. In this regard, we welcome the bold step of legislating a rules-based framework through the Fiscal Responsibility Law (FRL) to entrench fiscal discipline, transparency, and accountability, which will need effective implementation. Further measures through more comprehensive tax reforms to enhance progressivity of the tax system amidst global tax trends and prospective accession to WTO, while reviewing tax expenditures, and further strengthening of tax administration are imperative to increase revenue. As The Bahamas doesn't levy taxes on income, staff's comments are welcome on the use of income tax to increase government revenue and improve income distribution in the medium-term. Further reining in current spending, particularly through reviews in SOE governance and the pension system, while helping vulnerable households, and prioritizing capital spending, will also help reduce the budget deficit. The timely enactment of public financial management, public procurement and public debt management laws will help further strengthening of this process. We would have expected more information on the performance of SOEs in the report. Could staff comment?

We concur with staff on the current accommodative monetary policy, given negative output and credit gaps, and contained core inflation. The deepening of domestic debt markets is important to reduce excess liquidity and improve monetary transmission. The gradual reduction of the central bank's government debt holdings will also support this. Given the importance of improving governance and operational independence of the CBOB, we urge immediate adoption of the planned amendments to CBOB law. The authorities' plans to introduce a central bank digital currency seem to be driven by the need to address issues related to financial inclusion. While noting its potential benefits. we would welcome staff's comments on their recommendation of deploying proven technologies to increase financial inclusion in contract to the proposed digital "sand dollar" project, given the

financial stability, data privacy, sovereign and cyber security risks associated with the latter.

The banking system remains sound, with well-capitalized, liquid, and profitable banks. The 2019 FSAP report has identified the resilience of both the onshore and offshore sectors to various shocks, and we positively note the authorities' broad agreement for its recommendations. In particular, further progress in supervision of credit underwriting, timely resolution of NPLs and strengthening of recovery and resolution powers of the central bank have been identified as key measures to ensure resilience against adverse shocks, which need closer attention. The contraction in credit to the private sector amidst ample liquidity is a matter for concern. We note the importance of a real estate price index and the collection of loan-level data to facilitate the future implementation of LTV or DTI based lending standards, including in the residential mortgage market. Given the heightened international scrutiny of the offshore sector, the authorities are encouraged to continue their efforts to further strengthen the effectiveness of the country's AML/CFT regime and address any related technical compliance deficiencies in line with FATF and CFATF recommendations.

Continued structural reforms are imperative to increase long-term growth potential, address the declining competitiveness due to currency appreciation, and tackle the still-high unemployment. Addressing the areas in the World Bank's ease of doing business index (DBI), including onerous administrative processes, high costs of trading across borders, poor access to credit, and lack of reliable and affordable electricity, need to give priority in enhancing private sector participation and attracting new FDI. Decisively addressing the other impediments, including skills mismatches and structural problems within the labor market, is also important.

Finally, we emphasize the need for continuous vigilance on natural disasters in The Bahamas, along with other small island countries. We commend the authorities for their proactive measures towards a multi-layered natural disaster resilience strategy to improve financial as well as physical ex ante preparedness to natural disasters. The ongoing work to set up a Disaster Relief Fund to respond to such events is also encouraging.

With these remarks, we wish The Bahamian authorities all success in their future endeavors.

Mr. Lopetegui and Mr. Rojas Ulo submitted the following statement:

We thank staff for a clear and candid report and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their helpful buff statement.

The Bahamas' economy is showing signs of recovery and is addressing key issues through the implementation of structural reforms that will support growth and strengthen resilience. After a period of stagnation, economic growth has returned led by the tourism sector and construction activity. Looking forward, economic growth is projected to increase slightly to 1.8 percent in 2019 from 1.6 percent in 2018 and stabilize at 1.5 percent over the medium term due to domestic bottlenecks and a narrow economic base. Unfortunately, unemployment is projected to remain high. We support the authorities' efforts in the implementation and deepening of structural reforms to enhance competitiveness and promote resilient and diversified growth.

The fiscal consolidation process to ensure sustainability should be continued with additional efforts to implement the Fiscal Responsibility Law (FRL). The new FRL enhances transparency and introduces numerical rules to ensure moderate fiscal deficits and spending growth, with a debt anchor of 50 percent of GDP. The fiscal deficit will decline gradually in line with the targets established in the transition period of the FRL. We encourage the authorities to consolidate gains in fiscal governance and enact expeditiously the Public Financial Management, Public Procurement, and Public Debt Management Laws. In addition, reforming public pensions and healthcare is essential to balance debt-sustainability with inclusiveness priorities. We support staff's recommendation for a comprehensive approach to reform the tax system to increase efficiency and enhance progressivity.

The monetary/exchange-rate framework has been successful in containing inflation, but monetary policy transmission should be further strengthened. The inflation rate has increased slightly from 1.8 percent in 2017 to 2.0 percent in 2018 and is projected to remain at low levels in the medium term. Structural liquidity surplus propelled by the Central Bank of the Bahamas' (CBOB) holdings of government debt and reduced lending may create pressures on both the FX market and inflation, and this excess liquidity should be sterilized and reduced. Institutional progress for developing a compressive public management strategy to reduce the government's reliance on the CBOB are welcome. We support staff's recommendations to strengthen the current monetary framework and modernize its institutional structure to boost the credibility of the FX regime.

Banking sector soundness indicators remain stable but further efforts are needed to strengthen supervision against adverse shocks. The 2019 FSAP revealed that financial soundness indicators on profitability, liquidity, and capital buffers remain favorable. Non-performing loans (NPLs) declined to 9.1 percent in 2018 but are still high and should be improved. In addition, in 2018 credit to the private sector contracted and the credit-to-GDP ratio fell to 47.3 percent. The authorities should continue monitoring the banking sector and strengthen supervision of credit and resolution on NPLs. We are inclined to support staff`s recommendations on the authorities' need to implement an action plan to strengthen the public Bank of the Bahamas (BOB) and more systematic monitoring of corresponding banking relationship pressures.

We encourage the authorities to continue efforts to improve the effectiveness of the AML/CFT framework. The Financial Action Task Force (FATF) identified the Bahamas' economy as a country with strategic deficiencies. The authorities should continue with the implementation of actions to heighten scrutiny of the offshore sector by strengthening the AML/CFT framework and modifying the legal and fiscal framework to reduce reputational risk and safeguard its contribution to the economy. We support staff's recommendations on enhancing the effectiveness of the AML/CFT framework in accordance with the FATF and developing a medium-term strategy for the offshore sector.

We support the implementation of structural reforms to increase resilience, improve competitiveness, and facilitate structural transformation. The Bahamas' economy is a small and open economy with a narrow production and export base, highly vulnerable to climate change and natural disasters. The disaster resilience strategy should be strengthened by better enforcing building codes, improving coastal management, upgrading physical resilience, and well-defined sectoral and territorial responsibilities. We concur with staff's conclusions to enhance sustained growth and competitiveness requires the implementation of a reform program that tackles structural bottlenecks to prepare economy for the planned accession to the World Trade Organization in 2020.

With these comments, we wish the Bahamas and its people success in their future endeavors.

Mr. Castets and Ms. Albert submitted the following statement:

We thank staff for their useful set of papers, as well as Ms. Levonian, Ms. McKiernan and Ms. Vasishtha for their helpful buff statement. We

welcome the growth recovery in Bahamas and commend the efforts made by the authorities to improve the fiscal position and develop a resilience strategy to natural disasters. However, improving the debt trajectory, pursuing efforts to enhance the AML/CFT framework and transparency standards, remain significant challenges to tackle, as well as boosting the low potential growth. We broadly agree with the thrust of staff's appraisal and would like to add the following comments for emphasis:

Fiscal consolidation

We commend the efforts made by the authorities to strengthen fiscal resilience. We encourage them to pursue in that direction to bring debt down from 63 percent of GDP towards 50 percent of GDP with a greater focus on tax revenues mobilization. In that regard, we commend the enactment of the FRL and fiscal consolidation measures. However, we agree with staff's recommendation to quickly enact the PFM. The Bahamas is a high-income economy, and on the revenue side, we note that tax revenues are below the regional average. The increase of VAT is a positive step, but more can be done to reduce tax exemptions and increase progressivity. We consider that a comprehensive review of the tax regime is needed to improve the fiscal situation and welcome the soon-to-be-established Revenue Enhancement Unit. Other levies than VAT and business licenses should be mobilized, and property taxation could for example play a greater role. Moreover, we note that accession to the WTO by 2020 will reduce significantly the tax revenues as custom duties currently represent one-third of total tax revenues. Does staff incorporate the impact of WTO accession in its projections of tax revenues? We note from the report p.17 that "the authorities noted that there are no plans to change the tax system at this time", could staff elaborate on the authorities' position and the articulation with its recommendations? Regarding expenditures, we fully share staff's opinion to carefully balance the composition of spending to achieve inclusive growth and invest in the implementation of the natural disaster resilience strategy. Finally, we thank staff for their very deep and useful DSA analysis which integrates a natural disaster scenario and the preparation measures recently adopted by the authorities, which shows that debt would still increase to 63 percent of GDP by FY 2023/2024, the use of buffers offsetting the negative impact on growth.

Financial sector

We commend the authorities for their efforts to improve the AML/CFT framework and enhance tax transparency standards, as pressure on the offshore sector is identified as a high risk in the RAM. As the financial

sector amounts to 21 times the GDP as of 2018, we encourage the authorities to comply with these standards and to implement the new framework for the international sector. We also support the reform of the BOB and efforts to strengthen governance of state-controlled institutions. We note the plan to pilot the “Sand dollar”, digital version of the Bahamas dollar, and see the monitoring of risks related to financial stability as important. We also look forward to the results of this initiative in terms of financial inclusion. Could staff elaborate on the best way in its view to tackle the issue of weak credit growth?

We note the absence of progress on the implementation of past policy advices regarding the improvement of the data collection but see the recent subscription to the e-GDDS as a positive first step. We consider this issue as a priority to identify risks and especially the development of a real estate index, as the domestic real estate market represents ¾ of NPLs which are high at 9.1 percent in 2018, and this index could bring also more visibility for an increase in property tax rate.

Monetary policy

We encourage the authorities to strengthen the central bank independence and improve the monetary policy transmission by deepening domestic debt and interbank market, and reducing the CBOB’s holding of the government debt. An increase of reserves, just below the 3-month benchmark, would be useful preventive measure to absorb a potential external shock and to underpin the credibility of the peg. It will also help to reduce external risks in a context of large current account deficit. We note that the external sector position is assessed as weaker than suggested by fundamentals and desirable policies.

Structural reforms

We applaud the authorities’ efforts to enhance resilience against natural disasters and encourage them to implement significant measures to boost the low potential growth. We strongly welcome the steps taken towards a comprehensive disaster risk financing strategy as natural disasters exposure is a macro-critical issue for The Bahamas. Does staff consider a CCPA in the future for The Bahamas?

As potential growth remains low at 1.5 percent of GDP, we consider measures to boost competitiveness and education as essential. In particular, reducing the costs of trading and the administrative process, as well as the

implementation of the energy sector reform and the reduction of skills mismatch should contribute to improve productivity and increase human capital.

Ms. Mahasandana and Ms. Pandit submitted the following statement:

We thank staff for a well-written report and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their informative buff statement. After a prolonged period of stagnation, the Bahamas's economy appears on track of rebounding, with tourism and FDI in construction supporting growth to reach 1.6 percent in 2018, while, inflation remains contained. However, high young unemployment remains a critical challenge to the economy. Furthermore, high dependency on tourism sector, public debt burden, and vulnerability to natural disasters and climate change effects present structural difficulties to sustain a faster pace of economic expansion. We commend the government's advanced reforms efforts in tackling fiscal and structural challenges and commitment to promote transparency and accountability. We broadly agree with the thrust of staff's appraisal and would like to raise the following comments for emphasis.

Continuing the fiscal consolidation effort is warranted to ensure debt sustainability. As public debt continues to increase, fiscal consolidation is crucial to build the fiscal buffer and ensure that public debt remains on a sustainable path. We commend the authorities' efforts to establish the Fiscal Responsibility Law (FRL) and other PFM initiatives to support the fiscal consolidation process and facilitate the gradual convergence towards the debt anchor. We positively note that authorities remain committed to tight expenditure control and are currently undertaking the reviews of investment incentives, SOE governance and the pension system to facilitate expenditure rationalization over the medium term. Furthermore, authorities' efforts to establish a fiscal council and the adoption of an arrears clearance strategy are welcome steps. For the medium term, we see merit in staff's recommendation for a comprehensive approach to reform the tax system to enhance efficiency and improve progressivity.

Broad structural reforms are essential to address structural bottlenecks and enhance the competitiveness. The economy faces long standing structural impediments including cumbersome administrative processes, poor credit access, high trading costs as well as insufficient power supply, as reflected in the World Bank Ease of Doing Business Index. In this vein, addressing these bottlenecks are vital to enhance competitiveness and promote growth. As such we join staff in encouraging authorities to address the impediments by advancing energy sector reform, promoting digitalization in the government to

lower transaction costs and improving the quality of education and vocational program to ease labor market bottlenecks. Similarly, we encourage the authorities to build a comprehensive disaster resilience strategy to mitigate the adverse impact of natural disasters and climate change. It is also essential that the authorities further strengthen their compliance with the AML/CFT and offshore tax transparency standards.

We commend authorities' continuing efforts to promote a sound and well-capitalized banking system. Nevertheless, staff observed that credit growth has been constrained by NPLs and lack of information on potential clients. While the NPL level has declined significantly, we agree with staff on the need to enhance supervision of credit underwriting and NPL resolution, improve macro-financial monitoring tools such as a real estate price index, and the operationalization of a credit bureau. To contain disruptions to the system from the loss of correspondent banking relationships (CBR), staff has rightfully noted that a more systematic monitoring of CBR pressures is essential along with a strong AML/CFT and tax transparency frameworks. We also encourage authorities to strengthen risk-based supervision and commend the on-going initiatives to issue the guidance or consultation proposals for Basel II/III regulatory reforms, as noted in the buff. We note the authorities' plan to issue a central bank digital currency (CBDC) to foster financial inclusion. However, we agree with staff that there is a need to better understand the risk to financial stability and explore adopting robust technologies such as mobile phone applications to boost financial inclusion. Moreover, the introduction a CBCD could also require a broad financial literacy program to be successful.

Central bank independence is vital for credible and strong financial system. Establishing an independent central bank is essential for the policy credibility and operational effectiveness. In this regard, we welcome the authorities' intention to submit the relevant amended central bank law to parliament in 2019. This would be helpful to strengthen monetary as well as financial stability.

With these comments, we wish Bahamas and its people success in their future endeavors.

Mr. Raghani, Mr. Sylla and Mr. Carvalho da Silveira submitted the following statement:

We thank staff for the informative set of papers and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their insightful buff statement.

We commend the authorities for the solid macroeconomic policies and progress made in addressing fiscal and external vulnerabilities which supported the resumption of growth in 2018 after a period of economic sluggishness. Real GDP reached 1.6 percent supported by a surge in tourism and construction while inflation remained moderate. Although employment conditions are gradually improving, the rate of joblessness is still high at 10 percent. The external position remains weaker than implied by fundamentals and medium-term desirable policies as the current account deficit continued to deteriorate to 16.4 percent of GDP. In addition to reform fatigue, risks stemming from tightening of global financial conditions, slower growth in key trading partners and climate change could affect the country growth prospects. Against this backdrop, we encourage the authorities to steadfastly implement their reform agenda aimed at building resilience, enhancing transparency in the financial sector and safeguarding the fiscal adjustment to put public debt on a downward path. We concur with the trust of staff appraisal and will limit our comments to the following points.

Swift implementation of the Fiscal Responsibility Law (FRL) and Public Financial Management legislation remains critical to support medium-term fiscal consolidation plans and converge toward the debt anchor. We welcome the commitment to the FRL's targets and efforts made to reduce the deficit to 3.4 percent of GDP in FY2017/18. Nonetheless, for the FY2018/19, we agree with staff that further expenditure-controlling measures such as limiting hiring and non-priority spending, are required in light of the foreseen revenue underperformance. Moreover, to reduce the debt over the medium-term, focus should be geared towards containing wages and reforming the pension system as well as state-owned enterprises, while being mindful of spending needs necessary for supporting inclusive growth and dealing with natural disasters. In this vein, consideration should also be given to reviewing the current tax system, as recommend by staff. Likewise, given that the enacted FRL also provides guidance for the PFM reforms, we encourage the authorities to ratify the remaining reforms in order to improve transparency and accountability. That said, could staff comment on the status of the fiscal council?

Efforts to build resilience to climate-related disasters should continue. We take good note of the steps taken by the Bahamas authorities to improve resilience through the natural disaster fund, the Inter-American Development Bank credit line as well as disaster insurance. In light of the increasing frequency of these disasters, we encourage the authorities to continue these efforts while also paying due attention to physical resilience.

The financial sector is healthy and well-capitalized. However, implementing the 2019 FSAP recommendation to address remaining risks is imperative to safeguard financial stability. In this respect, we concur that strengthening banking supervision and resolution of Non-Performing Loans (NPLs), coupled with improving systemic risk-based oversight and enhancing financial crisis management function of the central bank should remain the focus. On the latter, the legislative reform plan for the Bank of the Bahamas must be pursued to prevent the reappearance of bailouts, as emphasized by staff. With regards to Money Laundering and Financing of Terrorism (ML/FT), we note the deficiencies identified by the Financial Action Task Force (FATF) and the significant resource employed by the authorities to improve the AML/CFT legal and supervisory framework. Looking ahead, we encourage the authorities to continue to focus on compliance and effective implementation in line with the FATF action plan. The authorities' commitment to ensure that the country upholds its adherence to international tax transparency standards is well appreciated.

Adoption of Fintech to support financial inclusion is noteworthy, but continued vigilance is warranted. We welcome the authorities plan to issue a central bank digital currency in the pursuit of making financial services accessible at affordable costs to all individuals and businesses. In addition, we are pleased to note that the project also strives to combat money laundering and illicit flows by reducing cash transaction. Looking ahead, it would be important that regulation strikes a sensible balance between creating a supportive space for innovation and maintaining a robust regulatory framework. Could staff comment on the overall regulatory framework crypto currencies and or digital assets in the Bahamas?

We concur that tackling existing structural bottlenecks will be essential to enhance competitiveness and foster higher and inclusive growth. We praise the Bahamas' commitment to make rapid progress with its WTO accession process. The participation affirms the importance of a rules-based global trading system to the stability and growth of the world economy. In this connection, priority should be given to reforms aimed at reducing energy costs, lowering cost of doing business with the government as well as addressing skills mismatches.

Finally, we encourage the authorities to continue their efforts to improve the quality and dissemination of economic data.

With these remarks, we wish the authorities of the Bahamas every success in their future endeavors.

Mr. Sun and Ms. Zhao submitted the following statement:

We thank staff for the well-written reports and Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for their informative buff statement. Thanks to recent reforms, economic growth is firming up. Nevertheless, elevated external risks will likely put pressure on growth prospects. Therefore, policies should focus on implementing the fiscal responsibility framework, strengthening regulation of the offshore sector, and improving competitiveness. We broadly share staff's assessment and would limit ourselves to the following points for emphasis.

Effective implementation of the Fiscal Responsibility Law (FRL) and continued Public Financial Management (PFM) reforms are key to fiscal consolidation. We welcome the enactment of the FRL and the authorities' commitment to keeping up the pace of the fiscal adjustment in line with the FRL's target. To help secure fiscal sustainability and strengthen governance, we see the need to enact expeditiously the remaining PFM reforms. We note staff's proposal of introducing an income tax in the medium term, while the authorities have no plan to change the tax system at this time. Could staff explain the reasons behind this divergence between the authorities and staff?

Strengthened monetary and financial stability can better support economic growth. The central bank's holding of government bonds should be reduced to strengthen the credibility of the exchange rate peg and improve monetary policy transmission. We encourage the authorities to further enhance banking supervision of credit risks, strengthen the banking resolution framework and improve governance of asset management companies. Potential spillovers to the domestic financial system from the unification of the banking license regimes require careful monitoring. We welcome the authorities' progress in implementing the FSAP recommendations and encourage them to address the remaining AML/CFT concerns in light of the potential risks posed by the issuance of the e-currency.

Structural reforms are essential to lift medium-term growth potentials. In light of the authorities' strong commitment to a fixed exchange rate regime, structural reforms—in addition to credible fiscal consolidation—are indispensable to raise competitiveness and reduce the current account deficit. We see value in taking prompt actions in advancing energy sector reforms, lowering cost of conducting business with the government, and improving the quality of education to boost human capital accumulation.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Ronicle and Mr. Clark submitted the following statement:

We thank Staff for the informative papers and Ms. Levonian, Ms. McKiernan and Ms. Vasishtha for their comprehensive buff statement. We share Staff's assessment on the outlook for the economy of The Bahamas; while growth has returned and resilience to climate and economic shocks has risen, low competitiveness and a lack of diversification are likely to hinder future growth.

We agree that the risks to the medium-term outlook are heightened. This includes both on the external side, in terms of the slowing external demand and tighter financial conditions and ongoing climate and weather-related risks, but also domestically where delayed implementation of economic reforms and fiscal consolidation could undermine macroeconomic stability.

On fiscal policy we welcome the enactment of the new Fiscal Responsibility Law (FRL), which will improve fiscal transparency and guide fiscal policy to pre-determined targets, the commitment to enact public financial management (PFM) reforms and the narrowing of the fiscal deficit. This will strengthen overall governance and accountability, and in conjunction with adherence to the budget deficit target will help convergence towards the debt anchor target. However, we note public debt continues to increase and therefore encourage expenditure restraint, building tax collection capacity and a comprehensive review of tax policies.

We strongly welcome the authorities' efforts to put in place a more robust disaster risk finance strategy, based on a multi-layered financial resilience strategy, including a Natural Disaster Fund, Contingent Credit Lines and Disaster Insurance, which we regard as consistent with best practice in this area. We support the recommendations that this financial resilience strategy should be accompanied by a more comprehensive disaster resilience strategy, covering physical infrastructure and post-disaster resilience plans.

On the financial sector, we welcome the good progress on implementing the 2013 FSAP recommendations, especially in strengthening financial system oversight, and we note the overall assessment that the financial sector is sound and resilient to current stability threats. We strongly welcome the authorities taking steps to address the Financial Action Task Force identifying The Bahamas as having strategic AML/CFT deficiencies,

and recognize that progress has been made in addressing technical compliance deficiencies.

However, as outlined in detail in the Financial System Stability Assessment and in the Staff Report, despite progress in the strengthening of regulatory and transparency standards and action on the Financial Action Task Force assessment, there remain significant reputational risks from the lack of progress on AML/CFT reforms. Authorities should focus on swift resolution of non-performing loans, undertake a strategic review of the Bank of Bahamas, undertake closer monitoring of Correspondent Banking Relationships (CBR) pressures and develop a medium-term strategy for the international sector, especially on tax transparency and preventing harmful tax practices.

Finally, whilst growth has returned and projected to increase with new FDI and as reforms are being implemented, we note that growth is expected to slow to a modest 1.5 percent. We agree that addressing long-standing structural issues is a necessary priority, since these continue to reduce competitiveness and constrain private investment. Focus areas should be those highlighted by the Doing Business Index, specifically lowering the administrative costs by reducing onerous processes, reducing the costs of cross-border trading and reducing energy costs.

The Acting Chair (Mr. Zhang) made the following statement:

The growth of The Bahamas resumed after years of stagnation, and the outlook is on the positive side. This reflects the government's efforts, particularly on the side of the prudent policies and structural reforms. But looking ahead, the risks remain considerable. As most gray statements pointed out, there is a need to continue the reform, which has covered a wide range of areas, for example, fiscal consolidation, financial sector stability, and the improved business environment. All of these are quite crucial and necessary.

Another important aspect is that the country is vulnerable to natural disasters and climate change. The authorities also are quite aware of that. Significant steps have already been taken. Directors have encouraged the authorities to continue this effort.

The staff representative from the Western Hemisphere Department (Mr. Bornhorst), in response to questions and comments from Executive Directors, made the following statement:[1]

> Before answering questions of general interest, I would like to inform Directors about the draft budget for the 2019-2020 fiscal year that was tabled to parliament on May 29, and the staff's views on it. The draft budget is in line with the consolidation that is envisaged under the fiscal responsibility law. The budget targets an overall deficit of 1 percent of GDP for next fiscal year, as is established in the transition path toward the targets of the fiscal responsibility law. The budget does not include any major policy announcements. To achieve the fiscal target, the authorities will focus on revenue enhancement measures, including addressing leakages in customs and revamping the framework for the property taxand also on rationalizing expenditure. Results from the ongoing review of the wage bill have identified instances of overbudgeting. The budget announces efforts to review and, ultimately, reduce subsidies to state-owned enterprises (SOEs).
>
> Smaller but also important policy initiatives in this budget include the reduction of some import duties, a review of tax and other investment incentives, as well as enhancements to education and training programs, and more investments in renewable energy. The budget statement further stresses the importance of moving ahead with enacting the public financial management agenda, an item that was reflected in many of the gray statements we received.
>
> To summarize, the draft budget does not change the thrust of the staff appraisal and is in line with the discussions that we had during the consultation.
>
> The staff welcomes the continuing commitment to the fiscal responsibility law targets and the budget's policy focus on priorities that were identified during the discussions.
>
> That being said, the staff continues to project that the fiscal balance target will be missed by about half a percent of GDP this fiscal year and next fiscal year. We do note, however, a convergence in the revenue projections. We maintain the view that a tight control of current expenditure will be necessary to deliver on the full target while safeguarding capital expenditure.

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[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

Now I would like to turn to a topic that was raised by several Directors about the discussion with the authorities about tax policy.

In line with the advice that was given in previous consultations, the staff proposes a comprehensive review of tax policy, with a view of increasing progressivity, including through the taxation of income, which The Bahamas currently does not have.

The staff found that there is no consensus in The Bahamas on the merits of moving away from the indirect tax only model, which The Bahamas has had for many decades. The staff heard both sides of the arguments in the discussions with the authorities and found that the business community but also the society at large seems to be undecided about the merits of direct taxes on income. In the discussions, many highlighted the simplicity of the current system and argued that introducing income taxation would require not only a significant upgrade to the tax administration capacity but also a broader education campaign of both taxpayers and businesses.

The authorities agreed that income taxation could have merits from the viewpoint of reducing income inequalities, but they also noted that the value-added tax rate had been increased significantly as recently as last year. Therefore, the authorities did not see a need for additional taxes to follow through with their fiscal consolidation plan and, therefore, stressed that this was not the time to introduce new taxes.

Within the existing tax system, the taxation of real estate property provides room to add progressivity. The staff supports the authorities' plans to upgrade the real property register and move toward a consistent and market-based valuation of real property and has argued in the staff report for an increase in the tax rate or the tax structure.

A change in the tax regime toward income taxation would also impact the international financial sector, given the removal of preferential treatment of non-resident entities. While there are concerns that income taxation could reduce the attractiveness of The Bahamas as a competitive tax jurisdiction, some in the country have also argued that this could lead to a preferable outcome, with fewer non-resident firms but a more substantial economic presence. The staff does not have sufficient information to form a view on this interesting aspect of tax policy reform.

Against this background, in the report, the staff has recommended a comprehensive review of the tax system to inform the policy debate. We

welcome that the authorities have since reached out to the Caribbean Regional Technical Assistance Center (CARTAC) and the Fiscal Affairs Department (FAD) for a possible technical collaboration on this matter, and we look forward to engaging with them on this.

Mr. Obiora made the following statement:

I thank the staff for the well-written report and the underlying analysis, especially in the Financial Sector Assessment Program (FSAP) report. I would also like to thank Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha for the contents and the insights they provided in their buff statement.

In our gray statement, we commended the authorities for the enactment of the fiscal responsibility law. We believe that this law is a critical pivot upon which the medium-term debt and deficit targets for The Bahamas will be met. But we do believe that, to strengthen the broader fiscal framework, it is important that the authorities treat with urgency the passage of associated enabling laws, including the public financial management law and the debt sustainability law.

We also believe that the staff responded to our question on revenue collection targets, but we are was still concerned that, in their answer, they suggested that there would be a shortfall in the collection of VAT for the fiscal year 2018-2019. This shortfall is not significant. It is about 1.2 percentage points of GDP. I wonder if they could provide any insights as to plans the authorities may have to cover this shortfall.

The last comment we have is on the innovative and forward-looking plans that the authorities have with disaster management. In light of all that we have been discussing in the Board on climate change, we believe that the plan is very good. We wonder if it provides a template that the staff could use to provide advice to other countries that are prone to climate change and natural disasters. In the buff statement, Ms. Levonian goes into good detail as to the implementation of plans for disaster-resilient infrastructure. We find it very useful, and we believe it is something that staff can build on for advice to countries that have the same issues.

Ms. Crane made the following statement:

We welcome the recovery in growth and progress on fiscal reform and financial resilience, and encourage continued structural reforms to improve competitiveness and private sector-led growth.

We agree with much of what was in the gray statements but would like to underscore a few points for emphasis.

We commend the authorities for the enactment of the fiscal responsibility law and look forward to its strong implementation. We welcome the staff's discussion of revenue reforms that can help underpin medium-term sustainability, remove distortions, and reduce income inequality. We appreciate the staff's description of the fiscal responsibility law framework and other public financial management initiatives that will guide fiscal policy in the medium term. We are pleased to see references in Ms. Levonian's buff statement to the authorities' intent in this regard.

We welcome further measures to strengthen central bank governance, address unemployment and domestic bottlenecks, continue to build reserves, and improve statistical data. Given that The Bahamas lags behind peers in many Doing Business indicators, tackling structural bottlenecks is especially needed to prepare the economy for the planned accession to the World Trade Organization (WTO) in 2020.

On the financial sector, we urge the authorities to further strengthen the supervision of credit underwriting and resolve NPLs in a timely manner, as well as address its Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) deficiencies, as agreed with the Financial Action Task Force (FATF) and as mentioned in many other gray statements.

Regarding the piloting of a central bank digital currency aimed at financial inclusion, we would echo the staff and other chairs about the need for caution around potential risks. We encourage the authorities to focus on measures like establishing a credit bureau and asset registrar to reduce costs and increase access to financial services, as recommended by the staff.

We agree with the staff that a comprehensive disaster-resilient strategy would help the Bahamas unify all aspects of resilience and preparedness for natural disasters. We welcome the authorities' recent steps to begin establishing a savings fund, put in place a contingent credit line with the Inter-American Development Bank (IDB), and re-enter the Caribbean

Catastrophe Risk Insurance Facility (CCRIF) insurance pool with coverage better tailored to country needs. We appreciate in the staff report the discussion of how that was going about.

With that, we wish the authorities well.

The staff representative from the Western Hemisphere Department (Mr. Bornhorst), in response to further questions and comments from Executive Directors, made the following additional statement:

The revenue collection on VAT for the current budget is below the budgeted amount. The shortfall is, in large part, due to origin of growth projections ever since the budget was approved.

We do note, however, that the expenditure has been contained through the third quarter of the fiscal year, we see a below historic execution pattern. with that, we come to the projection that the fiscal outcome will be 2.3 percent of GDP for this year.

Ms. Levonian made the following concluding statement:

On behalf of our Bahamian authorities, let me first recognize our mission chiefs for Article IV consultation and the FSAP, Messrs. Bornhorst and Cohen, and their teams for the excellent work. Our authorities continue to value the close engagement and open communications during their policy discussions with the Fund. I also want to thank Directors for their thoughtful comments and suggestions, which I will be sure to convey to our authorities.

As mentioned in our buff statement, our authorities largely share the staff's views on the main policy challenges and recommendations. They welcome the Financial System Stability Assessment (FSSA) report's conclusions about the overall soundness of the financial system and the recognition of the significant progress made in strengthening financial regulation and supervision. With that, I would like to highlight a few points.

First, regarding the deficiencies in the fiscal framework, authorities have taken measures to strengthen the institutional arrangements that guide fiscal policy while simultaneously increasing transparency. A significant milestone is the fiscal responsibility law, which was enacted last year. The government is also committed to adopting international reporting standards for the fiscal accounts. For example, they recently subscribed to the Enhanced General Data Dissemination System (e-GDDS), and started to publish

quarterly budgetary performance reports and their first ever annual fiscal strategy report.

In addition, strengthening tax administration, along with expenditure reforms, remains a priority for the administration. The Bahamas has also adopted several measures to improve its ability to respond to climate-related shocks and to mitigate risks to fiscal sustainability for such events. Taken altogether, these efforts will strengthen the fiscal policy framework, increase accountability, and improve public financial management, which will enhance the government's ability to respond to shocks.

Second, we note the views expressed by some Directors around the risks associated with a central bank digital currency and would like to briefly reiterate a few points on this issue.

Project Sand Dollar is one of many initiatives being undertaken toward the digitization and modernization of the Bahamian payment system. The central bank views the pilot digital currency as a means to enhance financial inclusion across the archipelago, close gaps in the domestic payments system, and alleviate vulnerabilities from de-risking. They view the digital currency as being important for many family islands which have seen commercial banks downsize and pull out of their communities, leaving them without banking services.

At the macro level, financial institutions still lack sufficient profit incentives to accelerate their adoption of fintech solutions. At the same time, risk considerations are front and center in the minds of our authorities, and they will ensure that the framework includes safeguards against money laundering and terrorist financing and other risks.

Third, our authorities are aware that they must address longstanding structural impediments to unlock growth potential in the medium term. Our buff statement and the staff report highlight some of the planned policies in this regard, but the result will take time to materialize.

Finally, our authorities are committed to implementing the reforms needed to strengthen financial sector resilience.

In closing, our authorities recognize there is more work to be done and remain determined to press ahead with the needed reforms.

The Acting Chair (Mr. Zhang) noted that The Bahamas is an Article VIII member and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the strengthening economic activity and the prospect of continued growth, underpinned by prudent policies and comprehensive structural reforms. At the same time, Directors noted the still high unemployment rate, rising public debt, and risks associated with external imbalances. They underscored the need to rebuild policy buffers, safeguard financial stability, and further enhance resilience to natural disasters.

Directors welcomed the decisive steps to consolidate the fiscal position and the authorities' commitment to fiscal sustainability and macro-financial stability. They particularly welcomed the enactment of the Fiscal Responsibility Law, noting that its effective implementation would bolster policy credibility and ensure durable gains from fiscal consolidation. Directors encouraged steps to further strengthen public financial management systems, tighten expenditure control, and operationalize the fiscal council as planned. They also saw value in a comprehensive review of the tax regime to enhance its efficiency and progressivity, including by reducing distortions and other preferential treatment.

Directors stressed the importance of advancing structural reforms to boost competitiveness and unlock the economy's potential for high and inclusive growth. In view of the planned accession to the WTO, they recommended prioritizing reforms that tackle high energy costs, improve access to credit, and address skill mismatches in the labor market. Lowering the cost of doing business would help attract needed foreign direct investment.

Directors noted that significant progress has been made in implementing the 2013 FSAP recommendations, and that the overall banking system remains resilient. They encouraged further efforts to revive credit growth, resolve nonperforming loans, and strengthen supervision of credit underwriting. To this end, they supported developing a real estate price index and operationalizing the credit bureau. Directors welcomed ongoing efforts to strengthen the central bank's recovery and resolution powers, as well as its governance and independence. They highlighted the need to complete the legislative reform of the banking resolution framework, improve governance of public asset management companies and state-controlled financial institutions, and address remaining deficiencies in the AML/CFT framework.

Directors looked forward to the swift implementation of the new framework for the international sector aimed at enhancing its transparency and monitoring. They encouraged the authorities to remain vigilant against potential spillovers into the domestic financial system from the unification of banking license regimes. Directors also welcomed the authorities' initiatives to advance financial inclusion while emphasizing the need to proceed with caution on the issuance of a central bank digital currency, mindful of possible risks to financial stability.

Directors welcomed the recent subscription to the enhanced General Data Dissemination System. They looked forward to further progress in improving the availability and quality of economic data.

It is expected that the next Article IV consultation with The Bahamas will be held on the standard 12-month cycle.

APPROVAL: April 20, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Policy and reforms

1. ***We would also welcome elaboration on the overall trend of revenue collection since the expiration of the grace period offered by the authorities on new tax measures.***

- The impact of the 2018 VAT increase on government revenue is lagged. This is due to the quarterly collection schedule itself, and, in large part, to the fact that the government honored prior bookings in the tourism sector that were made at the lower rate. Data for January-March 2019 (Q3 FY2018/19) show an acceleration of VAT revenue collection by 9 percent over the previous quarter. For the entire FY 2018/19, staff expects VAT collections to reach 7.6 percent of GDP, against 8.4 percent of GDP in the budget.

2. ***What is the expected revenue decline in the initial years of WTO membership and has this been accounted for when setting the FRL target for the fiscal balance in FY 2020/21 (–0.5 percent of GDP)?***

3. ***Does staff incorporate the impact of WTO accession in its projections of tax revenues?***

- The decline in international trade revenue from WTO accession will depend on the terms of the accession agreement, in particular the agreed tariff reductions and implementation schedule. These parameters are subject to ongoing negotiations and uncertainty. Staff projections incorporate a decline in revenue of B$60 million (about ½ percent of GDP) per year by FY2021/22. This is a working assumption and does not, in any way, anticipate a specific outcome of the accession negotiation. In the most recent budget documentation, the authorities have estimated the impact to be in the same order of magnitude (B$50 million).

- The Fiscal Responsibility Law defines targets for the fiscal balance that allow convergence to the debt anchor over the medium term. As such, the FRL does not specify underlying policies, which are determined in annual budgets. As the WTO accession agreement takes shape, additional compensating revenue and /or expenditure measures may become necessary.

4. ***Given the previous difficulties in implement current expenditure cuts how does staff envisage implementation of this recommendation?***

- Staff welcomes the efforts of the Ministry of Finance to improve top-down budgeting practices and the stepped-up dialogue with line ministries to narrow down budgetary forecasts. This will allow early identification of expenditure pressure points and saving opportunities. The Ministry is also strengthening expenditure control to prevent accumulation of new payment arrears from unfunded expenditure commitments.

5. ***Staff's recommendations in this regard include rationalizing the wage bill, advancing the pension reform and accelerating SOEs reforms. Can staff update on the progress and feasibility of implementing these reforms?***

6. ***We would have expected more information on the performance of SOEs in the report. Could staff comment?***

- Staff notes the progress in reducing the **wage bill** as share of GDP, from 5.8 percent in FY2016/17 to 5.6 percent in FY2018/19. This is the result of attrition, and a hiring freeze, but also of tighter expenditure control. In addition, an ongoing review of the wage bill has identified sizeable savings.

- **Pension reform** encompasses the reform of civil servants' retirement plan as well as the pension system (and related benefits) for private sector employees. Both systems require reform to ensure long-term sustainability (See IMF Country Report 16/224). The authorities are considering reform options for the private sector pension system, but it is not clear if a reform will be pursued in the current Parliament. Staff is considering engaging further with the authorities on this topic for next year's Article IV consultation.

- The Ministry of Finance is pursuing a strategy to ensure cost-recovery and self-sufficiency for all **SOEs**. As a starting point, they have started a formal review to identify cost-cutting measures for the government and to improve their transparency. Regarding performance, untimely annual financial statements limit the availability of above the line information; SOE debt, however, has decreased by about 1 percent of GDP from FY2015/16 to 13 percent of GDP in FY 2017/18.

7. ***We note that staff advise the fiscal reform and consolidation be balanced with priority measures for more inclusive growth and wonder what specific measures staff would suggest.***

- Staff hopes that a new household survey will soon be conducted to provide critical information necessary to develop an inclusive growth agenda. Staff is considering engaging with the authorities on this topic for next year's Article IV consultation.

- Staff's recommendation to add progressivity to the tax system is motivated by high income inequality (see below), which is detrimental to inclusive growth.

8. ***As The Bahamas doesn't levy taxes on income, staff's comments are welcome on the use of income tax to increase government revenue and improve income distribution in the medium-term.***

- The Bahamas would benefit from additional revenue mobilization, but staff does not see the main purpose of introducing income taxation in tapping new sources of revenue. Instead, income taxes could function as a policy tool for achieving a more equal post-tax income distribution over the medium term. Income taxation would also allow reducing distortions in the business sector that arise from the current system of indirect taxation in combination with business license fees levied on turnover, with no regard to company profitability.

- Staff is cognizant that this requires a well-planned, comprehensive approach that has implications for the Bahamian international financial sector, as it must also comply with international tax transparency standards.

9. ***We note that the buff statement doesn't mention tax policy reform, while staff advises a comprehensive approach to reform of the tax system to increase its efficiency and enhance its progressivity, including through the introduction of taxes on income, capital gains and inheritance. We would be interested to hear more about the discussions with the authorities on this topic. Staff's comments are welcome.***

10. ***We note staff's proposal of introducing an income tax in the medium term, while the authorities have no plan to change the tax system at this time. Could staff explain the reasons behind this divergence between the authorities and staff?***

11. ***We note from the report p.17 that "the authorities noted that there are no plans to change the tax system at this time", could staff elaborate on the authorities' position and the articulation with its recommendations?***

- These questions will be addressed orally.

12. ***Could staff provide more details on the structure and governance planned by the authorities for the "Revenue Enhancement Unit"?***

- The Revenue Enhancement Unit is an inter-departmental unit under the Ministry of Finance. The unit's main objective will be to identify weaknesses and deficiencies in current revenue collection efforts to ensure all levied taxes are properly and fully

collected across all of the major revenue agencies. The establishment of this unit has been delayed; current plans aim for it to become operative in July 2019. Staff understands that the unit will be supervised by the Financial Secretary or the head of the Inland Revenue Department.

13. ***Do staff assess The Bahamas' institutional capacity as sufficient to fulfill the comprehensive tax-related recommendations all at once?***

- In response to international pressure the authorities have already approved legislation to meet international tax transparency standards. Efforts to complete the legislation, in particular the new Business License Fee Act, are ongoing. Implementation will have implications for domestic businesses and the financial sector. Negotiations over the accession to the WTO, a review of tax incentives, and the strengthening of the tax administration place an additional burden on already stretched staff and institutions.

- New taxation initiatives (e.g., a comprehensive review of the tax system) will add demands on limited institutional capacity. Staff has therefore advocated a medium-term approach for the tax review and is engaging with the authorities to provide support through additional CD, including through CARTAC.

14. ***That said, could staff comment on the status of the fiscal council?***

- The Fiscal Responsibility Act requires the establishment of the fiscal council by July 1, 2019. The authorities have identified nominees for the council's five members with legal, business, economic, accounting and financial backgrounds, in consultation with the Bahamas Bar Association, the Bahamas Chamber of Commerce and Employers Confederation, the University of The Bahamas, the Bahamas Institute of Chartered Accountants, and the Chartered Financial Analyst Society of The Bahamas. The Governor-General is expected to appoint these nominees in time for the council to be operational by July 1.

15. ***We reiterate staff's call that the authorities speed up the enactment of enabling legislations, including the public financial management, public procurement, and debt management laws, to strengthen the broader fiscal framework. We would welcome any updates staff may have on progress in enacting these pieces of legislations.***

- Authorities intend to send the following three pieces of legislation to Parliament by end-2019.

- The Public Financial Management Bill is expected to be ready for public consultation in the next few months. It includes clarification of the roles and responsibilities of

finance officers, reporting requirements, accountability expectations for government agencies, expanded budget disclosure requirements, the oversight of SOEs, and specific criminal penalties for those that breech the public trust and who cannot account for their actions in the management of public funds. CARTAC has advised on its drafting.

- The Public Procurement Bill will ensure that the awarding and management of all contracts, vendors' accounts and logistical arrangements for products and services in the country will be conducted in a transparent and fiscally responsible manner. The Bill also provides the legislative framework for electronic government procurement. CARTAC has advised on its drafting.

- The Public Debt Management Bill will provide a governance framework for Government debt activities and mandate that an annual Debt Management Strategy Report be produced and presented to Parliament at the time of the Annual Budget exercise. The draft is currently being finalized to ensure consistency with the other pieces of legislation, including the FRL.

Financial Sector

16. ***Could staff elaborate more on the reason why banks maintain conservative lending practices?***

17. ***Could staff elaborate on the best way in its view to tackle the issue of weak credit growth?***

- Banks have faced declining investment portfolios and persistently high NPLs since the global financial crisis. Although capital is high, the large stock of problem assets creates uncertainties for many banks. Conservative lending reflects a combination of factors such as limited commercial lending opportunities due to the weak economy, strained borrowers' debt-servicing capacity, and a relatively flat real-estate market. The latter has the potential for illiquidity and low NPL recoveries under new negative economic shocks. In commercial lending, the absence of a credit bureau and of strong businesses book-keeping make assessment of new borrowers' creditworthiness challenging. The few businesses with the track record and scale for substantial borrowing already have access to credit. In consumer lending, the absence of a credit bureau has led banks to focus primarily on borrowers with regular paychecks from which payroll deductions of loan payments can be made.

- Weak aggregate credit growth reflects a business climate with limited investment opportunities, poor information on borrower creditworthiness, and a focus by banks on consumer credit, where little sustainable growth is available. Improving the

business climate through structural reforms and SME initiatives would increase the pool of potential applicants. Financial inclusion initiatives that help businesses document a track record of cash flows will also facilitate access to credit.

- Operationalization of the credit bureau will serve as an important tool to expand both consumer and business credit, by enhancing assessments of borrower creditworthiness. A real estate price index will help to improve loan valuations and potentially recovery values on NPLs, thereby stimulating lending. In addition, addressing the current stock of problem loans would free-up balance sheet space in bank books.

18. ***Staff highlights the need to undertake a strategic review of BOB and to complete the planned reforms to enhance recovery and resolution powers, as well as to improve governance and transparency of any public asset management company. Can staff update on the status of both?***

- The legislative agenda regarding recovery and resolution is underway and the authorities expect to enact it this year. This legislation is now expected to include language improving the governance and transparency of public asset management companies, taking on recommendations from the FSAP team. A strategic review of Bank of The Bahamas is being actively contemplated by the authorities but there is no timeline in place for action.

19. ***Governance arrangements for state-controlled financial institutions should be strengthened to ensure operational independence and support effective supervision. Can staff comment on the Corporate Governance Bill that is being drafted? Are privatization plans being considered over the medium term?***

- The Corporate Governance Bill will strengthen independence, transparency, and accountability for the boards of all publicly listed companies, and hence should strengthen the governance arrangements for the Bank of The Bahamas. However, there is further need for explicit improvements to the governance of state-controlled financial institutions, where there are broader issues regarding appropriate institutional objectives and governance of the use of funds.

- Staff does not have any information on privatization plans for the Bank of The Bahamas. A comprehensive restructuring plan should be prepared as a basis for any such discussions.

Central Bank Digital Currency

20. ***While noting its potential benefits. we would welcome staff's comments on their recommendation of deploying proven technologies to increase financial inclusion in contrast to the proposed digital "sand dollar" project, given the financial stability, data privacy, sovereign and cyber security risks associated with the latter.***

- Guided by the Bali Fintech Agenda and Staff Discussion Notes on the subject, staff noted that new financial technologies can help bridge gaps in the financial landscape, but that the issuance of a central bank digital currency also may pose risks to financial stability, cybersecurity, and in the AML/CFT sphere. Accordingly, staff emphasized that the central bank digital currency pilot should be compatible with, and complementary to, the existing financial infrastructure and include safeguards against these risks. The authorities noted that lack of economies of scale (a small population size) and geographical fragmentation throughout the archipelago have discouraged private banks and service providers from investing in payment systems, and that they hope that a central bank digital currency can boost financial inclusion. Based on other countries' experiences staff encouraged the authorities to also explore the benefits that proven technologies can yield to achieve financial inclusion, such as mobile phone applications, and enabling greater access to automated teller machines (ATMs).

21. ***Could staff comment on the overall regulatory framework crypto currencies and or digital assets in the Bahamas?***

- The Digital Assets and Registered Exchanges (DARE) Bill is currently in the public consultation process. The bill provides for the regulation of the issuance and sale of digital tokens, and for the regulation of the conduct of those issuing digital tokens and those providing intermediary services related to the issuance of digital tokens.

- Staff considers it a positive development that the authorities are upgrading the regulatory framework for digital assets. However, it would be premature for staff to reach a conclusion on whether the draft is fully in line with the current standard, including because of still ongoing discussions about the implementation of the new standard for virtual assets at international level.

- Regarding financial integrity aspects of the draft legislation, the standard on AML/CFT for virtual assets is still being developed by the Financial Action Task Force. It would therefore be premature to provide a definitive view regarding the Bill's level of compliance with the new standard. Staff nevertheless welcomes the fact that the Bill calls for the registration and AML/CFT supervision of digital asset businesses, and notes that the Bill calls for the transposition, to the digital asset

sector, of current AML/CFT laws and regulations, which, as highlighted in the FSAP, require improvements to be fully in line with the FATF standard. Finally, staff also notes that the Bill, if passed, would need to be accompanied by implementing regulations that clarify the authorities' expectations with respect to the effective implementation of the regulatory framework.

Structural Reforms

22. ***Could staff elaborate more on the possible measures to reduce the costs of conducting business with the government?***

- The IDB financed project *Government Digital Transformation to Strengthen Competitiveness Program (DPT)* provides the framework for fostering competitiveness, with emphasis on reducing the costs of conducting business with the government. This objective is expected to be achieved through (i) streamlining government procedures and making them available online to reduce the cost of government bureaucracy; (ii) increasing the use of information and communications technology in the public sector; and (iii) increasing transparency of government activities and strengthening auditing and control mechanisms.

- Specific measures are underway to make it easier to start a business, stay in business, and to conduct personal business with the government. An inter-agency working group, including representatives from various Ministries and Departments, has been set up with the objective of recommending measures to significantly improve The Bahamas' ranking in the World Bank's *Ease of Doing Business* index. The processes for renewing a business license and for getting a construction permit has been considerably streamlined, making them easier and quicker.

23. ***We understand that the authorities are planning the restructuring of the state-owned Bahamas Power and Light (BPL) and upgrading of the electricity transmission and distribution networks. Can staff provide more granular information about the strategy envisaged? Does this contemplate reforms to the regulatory framework whose robustness is essential?***

- The government is aiming to cut electricity costs by at least 40-50 percent over the medium term by implementing a three-pronged strategy to reduce costs (i) Shifting power generation from diesel fuel to heavy fuel oil, and subsequently to cheaper Liquified Natural Gas (LNG) on the main island, (ii) increasing reliance on solar energy in the Family Islands, and (iii) reducing the cost of borrowing of the BPL through a debt-refinancing operation. An international oil company has been awarded a contract to build a regassification plant and the LNG power plant, which are expected to be completed by 2021. A solar car park has recently been completed.

BPL has identified inefficiencies, including in operations, electricity production, distribution, and tariff collection. To improve the reliability of the electricity grid BPL has completed an audit and is upgrading the transmissions and distribution network.

- At present there are no plans to reform the regulatory framework. However, staff has recommended strengthening regulatory oversight of both BPL and private sector operators, and adopting measures (including amending the regulatory framework as needed) to promote energy efficiency and attract FDI in renewable energy.

- **Resilience to natural disasters**

24. ***As the Bahamas is vulnerable to natural disasters and climate change, the authorities' proactive strategy to strengthen resilience appears warranted. We note that a comprehensive disaster resilience strategy is recommended by staff (para 19). Could staff elaborate what practical steps, or changes to existing government strategies are needed?***

- A comprehensive disaster resilience strategy comprises measures to build financial, structural, and post-disaster resilience. The Bahamian authorities are taking steps to strengthen all three pillars. Staff has focused the dialogue on strengthening *financial resilience*, where the authorities are implementing a multilayered disaster risk financing strategy with support from the IDB. Development partners have identified areas where *structural resilience* could be strengthened, including enforcement of building codes and strengthening coastal protection. Staff sees merit in an integrated approach that would also encompass a review and strengthening of *post-disaster resilience,* including to maintain essential public and social services in the event of a disaster. Developing a full Disaster Resilience Strategy, as discussed in the recent Board paper "Building Resilience in Countries Vulnerable to Large Natural Disasters", would require a dedicated, multi-agency approach.

25. ***Does staff consider a CCPA in the future for The Bahamas?***

- While a Climate Change Policy Assessment (CCPA) would be a useful exercise for The Bahamas, the tool is still in its pilot phase. No decision has been taken regarding its future delivery modalities, resource allocation, priorities for delivery across the membership, and cooperation with development partners. Staff will stay engaged with the authorities and support them in the best way possible based on their needs.

Fund Engagement

26. ***Could staff explain how staff engage with the authorities on Project Sand Dollar? Do staff provide any technical assistance?***

- The Project Sand Dollar is currently in the design phase, which limits the information made available to staff. Staff had technical and high-level discussions with the authorities on general aspects surrounding the issuance of central bank digital currency and provided information reflecting the Bali Fintech Agenda and the Staff Discussion Note on the subject. Staff prepared a summary note on this issue for the authorities (Annex VII). Staff also encouraged the authorities to dialogue with other central banks in the region that are considering issuing a CBDC.

- Staff has not provided technical assistance in this matter. Fund Capacity Development would likely focus on helping authorities to think through the consequences of CBDC on financial stability, payment system security, monetary policy transmission, and financial integrity.

- Staff will continue to engage with the Bahamian authorities on this matter as the pilot project moves forward and conceptual and technical issues surrounding CBDC are better understood.

27. ***Staff recommends the development of a real estate prices index to understand better the dynamics of the domestic residential real estate market. Since the development of this type of indicator is generally costly and time consuming, we wonder if TA is being considered for this purpose and what the expected timing for its implementation may be.***

- During the FSAP the authorities already had preliminary discussions with STA regarding TA on this topic, and we understand there have been some further discussions on potential data sources to underpin an index. STA is of the view that there may be scope to compile some basic indicators in the short term, but a more comprehensive index would likely require the development of better administrative data on property transfers which would might require inter-agency collaboration over the longer term. Some further follow-up discussion with the authorities is required before a decision on TA can be made.