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INFORMATION

April 20, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Bahamas - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with the Bahamas. It is proposed to bring this subject to the agenda for discussion on Friday, May 13, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Hernández-Catá, ext. 74143.

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INTERNATIONAL MONETARY FUND

BAHAMAS

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the 1983  
Article IV Consultation with the Bahamas

Approved by E. Wiesner and W.A. Beveridge

April 19, 1983

A fund mission held the 1983 Article IV consultation discussions with representatives of the Bahamas in the period February 1-16, 1983; the Bahamas accepted the obligations of Article VIII, Sections 2, 3, and 4 in December 1973. The Bahamian representatives were led by Mr. Arthur D. Hanna, Deputy Prime Minister and Minister of Finance, and Mr. William C. Allen, Governor of the Central Bank of the Bahamas. They also included senior officials from the Ministries of Finance, Labor and Home Affairs, Tourism, Agriculture and Fisheries, Works and Utilities, and Education and Culture; the Central Bank of the Bahamas; the Department of Statistics; and the National Insurance Board. The staff met with officials of the public corporations and with representatives of the labor unions and of the financial and business community. Mr. Robert Joyce, Executive Director for the Bahamas, participated in the final round of policy discussions. The Fund mission consisted of Ernesto Hernandez-Cata (Head), Yusuke Horiguchi, Lloyd R. Kenward and Fredesvinda G. Pham (all WHD), and Valerie Rowles (Secretary-WHD).

I. Recent Economic Developments

Following a decline in 1981, overall economic activity appears to have risen moderately in 1982. Activity in the tourist sector had dropped sharply in 1981 owing to the weakness of demand in the United States and other industrial countries and to the adverse effects on competitiveness of the appreciation of the U.S. and Bahamian dollars since mid-1980. Tourist activity is estimated to have shown a modest increase in 1982 (in spite of continued unfavorable conditions abroad), apparently in reflection of the aggressive marketing strategy pursued by the Bahamas. The rate of growth of construction has been coming down from the very high rates recorded in 1979-80, but commercial construction was well sustained in 1981-82 by work on two large projects by the publicly owned Hotel Corporation. Activity in the relatively small, export-oriented, manufacturing sector picked up in 1982 from the depressed level of the previous year, but there are indications that agricultural output declined rather sharply.

The rate of price increase has moderated considerably since the spring of 1981, broadly in line with the slowing of inflation in the United States. The 12-month rate of increase in consumer prices, which reached more than 13 per cent in May 1981, was down to 4-1/2 per cent in December 1982. Recently, there has also been a deceleration in wage settlements although the rate of increase in wages in most sectors remains well above the current rate of price inflation. The wage contract signed in the hotel industry in May 1982 called for an average annual increase in total compensation of just under 8 per cent for the period 1982-84, down from about 12 per cent during the preceding three-year period. It may be noted that the rate of increase of hourly earnings in the U.S. hotel sector came down from a yearly average of about 10 per cent from 1978 to 1981 to less than 4 per cent in 1982. The salaries of government employees increased by 7 per cent and 9 per cent in 1980 and 1981, respectively; no general salary increase was granted in 1982 although there was a substantial increase in earnings stemming from annual salary increments and bonuses. A general salary adjustment averaging a little less than 7 per cent has been proposed for 1983.

With regard to the balance of payments, there was a substantial improvement in the current account in 1982, but at the same time there was a large decline in long-term capital inflows; net official international reserves registered a small increase. The current account shifted from surpluses of B\$25-35 million a year in 1976-77 to deficits of B\$30-40 million in 1979-80. The deficit widened to B\$80 million in 1981, owing largely to a decline in the value of merchandise exports and to a sharp drop in the growth of tourist receipts. In 1982 the current account deficit is estimated to have narrowed to B\$20 million (about 1-1/2 per cent of the staff's estimate of GDP). The drop in the deficit resulted largely from a substantial improvement in the trade balance; there was a strong rebound of exports from the depressed levels of 1981 <sup>1/</sup> and a small decline in the value of imports reflecting a fall in the volume and price of imported oil.

Net inflows of private capital fell from more than B\$100 million in 1981 to about B\$35 million in 1982. There was a sharp decline in long-term borrowing abroad by private companies from the unusually high levels registered in 1981 in connection with the financing of several large projects. There was also a significant reduction in the value of property purchases by nonresidents; this reduction may have been related to administrative delays in authorizing purchases under the Government's land policy. The outflow on net errors and omissions declined from B\$72 million in 1981 to B\$49 million in 1982, perhaps reflecting the narrowing of interest rate differentials between U.S. and Bahamian dollar assets. Net external borrowing by the public sector (mainly to

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<sup>1/</sup> To some extent, the decline in exports in 1981, as well as the pickup in 1982, reflected temporary factors. Also, as explained in Chapter IV of the recent economic developments paper, the estimating method currently in use may have exaggerated movements in merchandise exports in the past two years.

finance investments by the Hotel Corporation) amounted to BS47 million in 1982--a small reduction from 1981, but still very large by historical standards.

Following an increase of B\$8 million during 1981, official international reserves rose by B\$13 million during 1982 to a year-end level of B\$113 million. International reserves rose during the first half of 1982, and by June they were nearly B\$50 million higher than in June of 1981. Since mid-1982, however, the reserve position has tended to weaken and at the end of March 1983 reserves were a little below the level registered a year earlier.

The foreign currency debt of the public sector (which includes direct external borrowing as well as foreign loans channelled through commercial banks in the Bahamas) rose by less than B\$10 million from 1975 to 1980. However, in the last two years it went up by almost B\$130 million, and by the end of 1982 it stood at B\$229 million (approximately 16 per cent of GDP). A large part of the increase in the foreign currency debt in 1981-82 reflected drawings by the Government on the B\$150 million Eurodollar loan negotiated in 1980-81 to finance the investment program of the Hotel Corporation. The undisbursed portion of the loan (some B\$20 million) will be drawn this year, and repayment of principal is scheduled to begin in 1985.

## II. Economic Policies and Prospects

### 1. Short-term economic prospects

The outlook for 1983 is for a moderate pickup in the growth of tourism and economic activity together with continued abatement of cost and price pressures. The growth of tourist expenditure in real terms is likely to increase in 1983 as a result of the projected recovery of the U.S. economy and the intensification of promotion efforts by the Ministry of Tourism. Activity in other sectors of the economy would benefit from the improved performance of tourism and from the reduced cost of external borrowing. Moreover, commercial construction will be sustained by work on the final phase of the Hotel Corporation's hotel-casino complex and a fairly large increase in fixed investment by the other public corporations seems to be in prospect. Government spending on goods and services probably will rise a little in real terms.

The current account of the balance of payments is likely to show a modest deficit in 1983, probably of the same order of magnitude as the one registered last year. Travel receipts are expected to rise substantially and the value of oil imports would fall owing to a decline in prices. However, merchandise exports are likely to be relatively sluggish (following the unusually rapid increase registered in 1982), and non-oil imports are expected to pick up with the rise in economic activity and tourism.

## 2. The public finances

Following an improvement from 1978 to 1980, the fiscal position weakened substantially in the period 1981-82; the overall balance of the public sector shifted from a surplus of B\$10 million in 1980 to deficits of B\$38 million in 1981 and B\$65 million in 1982 (some 4-1/2 per cent of GDP in 1982). Public sector savings, which had been rising steadily for several years, fell markedly from 1980 to 1982; this decline was associated with a sharp drop in the growth of government revenue that reflected the relatively poor performance of tourism and economic activity in general. Investment by the public sector has been growing very rapidly for a number of years, although there was a considerable slowdown in 1982.

The overall financial position of the Government moved from a surplus of B\$5 million in 1980 to a small deficit in 1981 and to a deficit of about B\$22 million in 1982.<sup>1/</sup> The current surplus of the Government (which had been rising rapidly for a number of years) declined somewhat in 1981 and fell by a sizable amount in 1982. As had been the case in the previous year, the growth of tax revenue in 1982 was affected adversely by the weakness of economic activity. Moreover, the growth in nontax revenue (which had been boosted in 1980-81 by increases in fees collected from offshore industrial companies) dropped sharply in 1982. Current expenditures increased much faster than revenues last year. However, the rate of increase in current spending declined from 1981 to 1982; the rise in wages and salaries slowed down, and there was a reduction in the level of expenditure on other goods and services as a result of government efforts to control such outlays. The rate of increase in spending on capital formation came down in 1982, following rapid increases in previous years.

The overall deficit of the nonfinancial public corporations widened substantially from 1980 to 1982, mostly because of a large increase in capital expenditure. After rising sharply in 1981, investment by the Electricity Corporation declined in 1982, but this decline was more than offset by a large rise in capital outlays by the Hotel Corporation. The current surplus of the corporations fell in both 1981 and 1982; in recent years, the revenues of certain corporations have been affected adversely by stagnant or declining sales and by delays in the implementation of price adjustments. However, late last year the Government authorized the Bahamas Electricity Corporation and the Water and Sewerage Corporation to increase their rates; this should lead to a significant improvement in the operating results of these enterprises and thus to a reduction in their reliance on government transfers and subsidies.

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<sup>1/</sup> These estimates exclude government loans and advances to the public corporations, particularly the large foreign borrowing that was channelled through the government accounts to the Hotel Corporation in 1981-82. Including loans and advances, the government deficit moved from B\$2 million in 1980 to B\$56 million in 1981 and to B\$64 million in 1982.

According to the budget for 1983, the current surplus of the Government would rise to BS24 million this year from BS20 million in 1982. Revenue would increase by nearly 7-1/2 per cent in 1983 compared with a rise of 4 per cent in 1982; the acceleration would result largely from measures announced by the Government in December 1982. These measures included increases in customs duties on gasoline, diesel fuel, and certain consumer goods; an increase in the fees payable by bank and trust companies in the Bahamas; a rise in the departure tax for tourists; and a rise in motor vehicle licenses and fees. The yield of these measures is projected at about BS8 million in 1983, or some 2-1/2 per cent of total government revenue.

The budget envisages a reduction in the growth of current expenditure (to 6-1/2 per cent in 1983, compared with 11-1/2 per cent in 1982 and 16-1/2 per cent in 1981). Although a general salary increase of BS10 million has been proposed for 1983, the rate of increase in total wages and salaries would decline (from 8-1/2 per cent in 1982 to 7-1/2 per cent this year) as a result of efforts to restrict employment growth, overtime pay, and annual salary increments. Spending on other goods and services would pick up in 1983, but interest payments would rise at a more moderate pace (owing partly to declines in foreign interest rates) and transfers and subsidies would decline. On the basis of the budget, capital expenditure would rise from BS41 million in 1982 to BS57 million in 1983. The overall government deficit (excluding loans and advances to the public corporations) would be BS33 million in 1983, an increase of BS11 million from 1982.

The staff's estimate of the fiscal outcome for 1983 suggested that the overall government deficit will be smaller than has been budgeted. On the basis of the outlook for U.S. interest rates, interest payments on the Government's foreign currency debt would reach BS17 million in 1983, or about BS6 million less than the amount budgeted. With respect to capital formation, there has been a tendency in the past for government investment to fall short of budgeted levels. On the basis of the expenditure plans of the various ministries, it appeared that actual expenditure on capital account might be of the order of BS42 million (or some BS15 million less than the amount contemplated in the budget). After adjusting the budget numbers for the factors just referred to, the staff estimated that the overall deficit of the Government in 1983 would be of the order of BS12 million. In addition, BS23 million would be required to amortize the government debt, and it is estimated that in 1983 the Hotel Corporation would need as much as BS58 million in government loans in connection with the final stage of its investment program. Thus, the gross financing requirement of the Government would amount to BS93 million in 1983. By way of comparison, the gross financing requirement in 1982 had been BS87 million; however, it had been largely covered by drawings from foreign currency loans that had previously been arranged.

The staff inquired into the means for covering the Government's financing requirement in 1983. The Bahamian authorities said that they were contemplating a BS35 million issue of long-term government securities to be subscribed by the National Insurance Board and by private financial institutions. Bahamian officials also indicated that some BS25 million would be available in the form of drawings from existing foreign currency credits but they added that they were not inclined to resort to new external borrowing this year. The mission noted that, in view of the tight liquidity position of the commercial banks and of the need to protect the international reserve position of the Central Bank, it would be difficult to satisfy the remaining financing requirement of BS33 million from the domestic banking system.

The Bahamian authorities recognized that action was needed to reduce the Government's financing requirement to manageable levels. They said that, as a result of ongoing efforts to improve tax collection (particularly in the area of real estate taxes), government revenue might increase considerably faster than was envisaged in the budget, and that the growth of current expenditure would continue to be restrained. They added that, if these measures proved to be insufficient, the Government would hold capital expenditures not only below budgeted levels, but even below the level projected by the staff. If necessary, the Government was prepared to restrict investment to a few high priority projects that would not exceed BS35 million.

Concerning the financial outlook in the longer term, the staff discussed with the Bahamian authorities a set of projections for the five-year period extending through 1987, by which time the Government would have begun repayments on the BS150 million loan related to the Hotel Corporation's investment program. On the assumption that there would be no further external borrowing by the Government, the domestic financing requirements of the public sector in 1986-87 would be very large by historical standards. Moreover, the external environment might turn out to be less favorable than had been assumed by the staff, in which case the prospective financing problem could become quite serious. On the basis of these projections, the staff suggested that a tightening of the fiscal position would be necessary over the medium term. The Bahamian representatives answered that, for the time being, the Government had gone as far as it could in the direction of increasing taxes. The objective of restructuring the revenue base of the Bahamas would be pursued, but this would be a lengthy process. Over the medium term, they added, fiscal tightening would have to emphasize expenditure restraint and increased revenue from existing taxes.

### 3. Monetary developments and policies

In the period from 1980 to mid-1982 the Bahamian banking system was influenced by the emergence of a large differential between U.S. and Bahamian dollar interest rates. The rate of growth of the commercial banks' deposit liabilities declined markedly and local residents substituted borrowing in domestic currency for loans denominated in U.S. dollars (which are channelled from abroad through commercial banks in the

Bahamas). These developments were reflected in a tightening of the Bahamian dollar liquidity position of the commercial banks, and these banks borrowed heavily from the Central Bank in order to meet their reserve requirements. In January 1982 the monetary authorities increased the discount rate from 9 to 10 per cent and introduced a surcharge of 1-2 percentage points for frequent or large borrowers. The growth of commercial banks' deposit liabilities picked up during 1982, but the liquidity position of the banking system remained tight, owing in part to a large increase in the demand for Bahamian dollar credit by the nonfinancial public corporations. Commercial bank borrowing from the Central Bank subsided after the measures of January 1982 but rose again toward the end of the year.

In the discussion of monetary and credit policy for 1983, it was noted that official international reserves were equivalent to a little more than two months' imports. Central Bank officials acknowledged that the reserve position was barely adequate given the Government's objective of maintaining a fixed exchange rate between the Bahamian and U.S. dollars, and that it would be prudent to increase the level of reserves. The staff noted that, in view of this objective, there would be little or no room to expand Central Bank credit to the public sector and that reserve provision to the commercial banks would have to be restrained.

As a result of the decline in U.S. interest rates since mid-1982, yield differentials have been moving in favor of assets denominated in Bahamian dollars. In particular, the commercial banks' prime rate on Bahamian dollar loans, which was not adjusted in 1982, is now somewhat above comparable U.S. dollar rates. Notwithstanding these changes in relative interest rates, foreign currency lending by commercial banks to the private sector declined during 1982. An increase in such lending appeared to be desirable as it would encourage commercial banks to raise funds abroad, thus alleviating the pressure on the financial system. Central Bank officials said that they had not discouraged commercial banks from borrowing abroad, but that there had been some reluctance on the part of the private sector to borrow U.S. dollars because of uncertainty concerning the future course of U.S. interest rates, and also because of a perception of exchange risk. The staff indicated that, in these circumstances, it might be desirable to allow a widening of the differential between Bahamian and U.S. dollar rates. It would seem that the best way to achieve the appropriate differential would be to allow interest rates on Bahamian dollar assets to be determined by market conditions.

#### 4. External policies and issues

The Bahamas maintains very close financial and commercial ties with the United States, and U.S. tourists account for more than three quarters of all foreign visitors to the Bahamas. In view of the importance of the economic relations between the two countries, the Bahamian authorities consider that it is appropriate and useful to maintain the

parity between the Bahamian dollar and the U.S. dollar. Of course, this objective implies that the underlying cost-price situation of the Bahamas should not deteriorate relative to that of the United States. As was indicated earlier, consumer price inflation in the Bahamas has been declining in line with developments in the United States. The rate of increase in wages in certain important sectors is still higher in the Bahamas than in the United States. However, recent multi-year labor contracts--many of which were heavily front-loaded--suggest that there will be a significant moderation of wages in the period ahead.

The external debt of the public sector has increased sharply in the past two years in connection with the investment programs of certain public enterprises (particularly the Hotel and Electricity Corporations). In the discussion of the public external debt situation over the medium term, it was noted that the ratio of debt service to exports of goods and services in 1982 was less than 5 per cent and that, on the basis of existing commitments, this ratio was unlikely to rise much over the next four to five years. However, because of the high import content of tourism in the Bahamas, the debt service ratio may not be a very meaningful indicator of the adequacy of the external debt position. Other measures provide a different reading of the debt situation; for example, the ratio of government and government-guaranteed foreign currency debt to GDP may have risen from about 8 per cent in 1980 to 16 per cent at the end of 1982. The staff indicated that further substantial increases in the external debt to finance government deficits would only postpone the necessary fiscal adjustment, might generate uncertainty concerning future policies and have adverse effects on the credit standing of the Bahamas.

Foreign banks and trust companies (including offshore financial institutions) have continued to make a significant contribution to the Bahamian economy, particularly in the areas of government revenue and employment creation.<sup>1/</sup> Following several years of very rapid expansion, the Eurocurrency operations of offshore banks in the Bahamas declined significantly during the course of 1982, largely as a result of the establishment since December 1981 of International Banking Facilities in New York and other financial centers in the United States. This decline has not affected the fees paid to the Government by offshore financial institutions in the Bahamas and has had virtually no impact on domestic employment.

##### 5. Development policies and issues

Tourism is by far the most important industry of the Bahamas (it accounts for approximately one third of GDP) and the expansion of tourism continues to be a major element of the country's development strategy. The Ministry of Tourism is presently involved in a large expansion of its promotional activities; its budget has been increased from

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<sup>1/</sup> The role of foreign financial institutions in the economy is discussed in Appendix I of the recent economic developments paper.

BS21 million in 1982 to BS29 million in 1983. The additional funds will be used to finance new marketing initiatives designed to develop untapped markets (particularly in Canada and in the United States) and increase the number of charter flights. The Government is also involved in the tourist industry through the operations of the Hotel Corporation which presently owns properties containing about 1,100 rooms (9 per cent of the industry's total capacity). The capacity of the Corporation will increase substantially in 1983 with the completion of its BS150 million investment program. A 250-room property in Grand Bahama is scheduled to reopen by mid-1983, and work on the 730-room hotel-casino complex in New Providence is expected to be completed by the end of the year.

For some time the Government has pursued an agricultural development strategy aimed at diversifying the economy, increasing local food supplies and creating employment opportunities in the outer islands. The Government has indicated that in 1983 it will intensify its efforts to expand agro-industrial activity by encouraging several large investment projects that are expected to involve foreign private investment and will be located in the outer islands. Over the past five years, the government-owned Bahamas Development Bank has contributed to the financing of development projects, particularly in the areas of fishing and marine transportation. The resources of the Bahamas Development Bank will be augmented in 1983 with a BS3 million line of credit from the Caribbean Development Bank; in addition, a BS3-1/2 million contribution from the National Insurance Board is expected over the next five years.

The Bahamian authorities felt that progress in promoting industrial ventures had been slow and a specific ministry had been created to stimulate development in this area. Efforts would continue to be directed to the encouragement of industrial activities that would rely relatively heavily on locally available resources. In addition, the Government has announced the establishment in 1983 of a free-trade zone that is expected to provide a framework for new export oriented, labor intensive industries. The recently established Bahamas Agricultural and Industrial Corporation is expected to play a central role in the development of the free-trade zone and will receive financial assistance from the World Bank. The Bahamian authorities also drew attention to their continued efforts to attract foreign companies in other areas of the economy. In December 1982, the Government introduced an External Insurance Bill which is intended to encourage the location of insurance businesses in the Bahamas. Moreover, there was a significant increase in the number of foreign ships registered in the Bahamas following the passage of new legislation in April 1982.

### III. Staff Appraisal

For the past two and a half years the Bahamian economy has been affected by unfavorable conditions abroad, including the slow growth of incomes in the United States and other industrial countries. Following a sharp decline in 1981, activity in the tourist sector increased a

little in 1982 and total output appears to have risen moderately. The outlook for 1983 is for a further pickup in the growth of tourism and economic activity in general, owing largely to the expected recovery of the U.S. economy. Inflation has declined substantially during the past two years in reflection of the slowdown in import prices; last year there was also a deceleration in wage settlements, although in certain sectors wages increased more rapidly in the Bahamas than in the United States. The outlook for 1983 is for some further moderation in the rise of prices and wages. With regard to the balance of payments, there was a substantial narrowing of the current account deficit in 1982, which was accompanied by a sizable reduction in private long-term capital inflows. The current account is not likely to change much in 1983, but the net inflow of public sector capital is expected to decline substantially. The international reserve position of the Central Bank improved during the first half of 1982 but it has weakened since then; at the end of March 1983 international reserves were a little below the level registered a year earlier.

In view of the objective of the Bahamian authorities to maintain the parity between the Bahamian and the U.S. dollars--an objective that is endorsed by the staff--it would be desirable to strengthen the international reserve position of the Central Bank. Furthermore, the foreign currency debt of the public sector (which had been fairly stable for several years through 1980) has risen from 8 per cent to 16 per cent of GDP in the past two years, and further substantial increases in the debt would not be appropriate at this time. These considerations suggest that policies should be aimed at improving the fiscal performance.

In late 1982, the Government acted to increase certain taxes and fees and to raise the prices charged by some public corporations. Furthermore, the Government has taken steps to improve revenue collection and restrain the growth in current spending. As a result of these measures and of the projected recovery of the economy, there should be a significant rise in government savings in 1983. Moreover, the authorities have indicated that they were prepared to hold down government investment this year well below budgeted levels. Nevertheless, the staff envisages that the gross financing requirement of the Government in 1983 will be very large, mainly because the Hotel Corporation will need considerable financial assistance from the Government in order to complete its investment program. It should be recalled that the major element of this program is the construction of a large hotel-casino complex, and that delays in the completion of this project would have adverse effects on the financial position of the public sector in 1984.

In the view of the staff, the financing available may not be sufficient to cover the estimated government requirements for 1983. At the same time, the financial system of the Bahamas is not in a position to absorb a very large volume of government debt without causing an unduly large squeeze in the availability of credit to the private sector or endangering the international reserve position of the Central Bank. In these circumstances, the staff believes that the Government's efforts

to increase tax collection and to curb current expenditure should be intensified. In particular, it would seem that efforts should be made to hold down the rate of increase in government salaries; this would contribute to an improvement in the fiscal position and also would have a favorable influence on wage settlements in other sectors of the economy.

Looking beyond 1983, the financial position of the Government is expected to improve temporarily; government lending to the public corporations is likely to decline substantially in 1984 as the current investment programs of several corporations are completed. However, the fiscal position is expected to come under pressure again by 1986-87, when payments to amortize the public sector's foreign currency debt will amount to about BS45 million a year. To a large extent these payments would reflect amortizations on the BS150 million loan negotiated by the Government in 1980-81 to finance the investment program of the Hotel Corporation, and it seems that the cash flow of the Corporation will not be sufficient to cover the cost of servicing the debt by 1986-87. This prospect would seem to call for a significant tightening of the fiscal position over the next several years.

The Bahamian authorities recognize that expenditure restraint should play a major role in the strengthening of the public finances over the medium term. However, the extent to which capital formation by the Government can be held down without impairing the development of infrastructure and hence the country's growth prospects appears to be limited. Therefore, it would seem that the fiscal adjustment may require further action on the revenue side. Also, it may be necessary for the Government to reconsider the level of financial assistance to certain public corporations. In this regard the staff believes that the corporations should make every effort to curb increases in wages and other costs and that, in the future, authorizations for price adjustments should be granted without delay.

The current investment plans of the Government and of certain public corporations (particularly the Electricity and Telecommunications Corporations) appear to be consistent with the country's development priorities. As has been mentioned earlier, however, questions remain about the rate of return on the Hotel Corporation's hotel-casino complex. The long-term growth prospects of the Bahamas--as well as the outlook for the public finances--clearly will continue to be affected by the quality of public sector investment. It is therefore important to improve the efficiency of the public administration as regards the selection and the implementation of investment projects.

Government actions affecting the private sector also will influence the performance of the Bahamian economy in the long run. The Government has continued to promote the development of the financial sector and has adopted measures designed to encourage foreign investment in other areas. The Bahamian authorities have indicated that changes in the legislation pertaining to land purchases by nonresidents

will be announced in the near future and the effects of these changes on private investment and the balance of payments could be substantial.

With regard to monetary policy, the balance of payments objectives of the authorities imply that the Central Bank will have little or no room to expand net credit to the public sector in 1983, and that reserve provision to the commercial banks may have to be curtailed. Given the present levels of domestic interest rates, the liquidity position of the banking system is likely to be quite tight and this might reduce the availability of Bahamian dollar credit to the private sector. An increase in foreign currency lending by commercial banks to the private sector (which, as is customary, would be funded from abroad) could alleviate the tightness of credit markets. The monetary authorities have indicated that they would readily grant exchange control approval to requests for such lending. In present circumstances, however, an appreciable expansion in private demand for U.S. dollar loans may require a widening of the differential between Bahamian and U.S. dollar interest rates. In the view of the staff, this would be best achieved by allowing interest rates on Bahamian dollar assets to be determined by market conditions.

Fund Relations with the Bahamas

(Data as of March 31, 1983)

Date of membership: August 21, 1973.

Status: Article VIII.

Quota: SDR 49.5 million.

Fund holdings of Bahamian dollars: SDR 42.85 million or 86.56 per cent of quota.

Exchange rate: The Bahamian dollar is pegged to the U.S. dollar at BS1 per U.S. dollar. The official buying and selling rates are BS1.0025 per U.S. dollar and BS1.004 per U.S. dollar, respectively.

Exchange system: There are no restrictions on the making of payments or transfers for current international transactions. Capital transfers require exchange control approval and outflows of resident-owned capital are restricted.

Gold distribution: 17,117 fine ounces (in four distributions).

Direct distribution of profits from gold sales: US\$3.16 million (July 1, 1976-July 31, 1980).

SDR Department: The Bahamas' holdings of SDRs amounted to SDR 5.75 million or 56.17 per cent of its cumulative allocation of SDR 10.23 million.

Last consultation: The previous consultation discussion with the Bahamas took place in February 1982 and the Staff Report (SM/82/59, 4/1/82) was considered by the Executive Board at EBM/82/60, April 28, 1982.

BAHAMASArea and population

|  |   |
|--|---|
| Area   | 5,382 sq. miles (13,939 sq. kilometers) |
| Population (mid-1980)                        | 209,505                                 |
| Annual rate of population increase (1970-80) | 2.1 per cent                            |

Ratios to GDP (1982)1/

|  | (per cent) |
|--|------------|
| Exports of goods and services  | 36         |
| Imports of goods and services  | 87         |
| Government revenue   | 22         |
| Government expenditure   | 26         |
| Public and publicly-guaranteed debt denominated<br>in foreign currency (end of year) | 16         |
| Money and quasi-money (end of year)  | 44         |

Annual changes in selected economic indicators

|  | 1980       | 1981  | 1982 |
|--|------------|-------|------|
|  | (per cent) |       |      |
| Consumer prices (annual average)2/               | 12.1       | 11.1  | 6.1  |
| Government revenue                               | 22.9       | 12.3  | 3.9  |
| Government expenditure                           | 16.3       | 32.5  | 5.6  |
| Money and quasi-money (end of year)              | 14.8       | 9.8   | 14.9 |
| Money  | 1.4        | 6.3   | 9.9  |
| Quasi-money                                      | 20.3       | 11.0  | 16.5 |
| Net domestic financial assets 3/                 | 11.1       | 11.2  | 12.5 |
| Credit to public sector (net)                    | -1.4       | -2.8  | 3.9  |
| Credit to private sector                         | 16.8       | 14.7  | 10.8 |
| Merchandise exports (f.o.b., in U.S.<br>dollars) | 17.6       | -12.1 | 25.8 |
| Merchandise imports (f.o.b., in U.S.<br>dollars) | 23.2       | 1.2   | -0.1 |
| Travel receipts (gross, in U.S. dollars)         | 14.3       | 9.5   | 6.0  |

Government finances

|  | 1980                           | 1981  | 1982  |
|--|--------------------------------|-------|-------|
|  | (millions of Bahamian dollars) |       |       |
| Revenue                                | 261.0                          | 293.1 | 304.6 |
| Expenditure                            | 263.3                          | 349.0 | 368.7 |
| Current account surplus or deficit (-) | 41.4                           | 37.1  | 19.7  |
| Overall surplus or deficit (-)         | 4.6                            | -2.5  | -21.6 |
| Net financing requirement 4/           | 2.3                            | 55.9  | 64.1  |
| Financing in foreign currencies (net)  | -14.4                          | 46.4  | 59.0  |
| Financing in Bahamian dollars (net)    | 16.7                           | 9.0   | 6.5   |

|   |                           |                 |                 |
|---|---------------------------|-----------------|-----------------|
| <u>Balance of payments</u>                          | <u>1980</u>               | <u>1981</u>     | <u>1982</u>     |
| Merchandise exports (f.o.b.)                        | 200.5                     | 176.2           | 221.6           |
| Non-oil merchandise imports (f.o.b.)                | -497.5                    | -510.3          | -519.0          |
| Oil imports   | -128.6                    | -123.4          | -114.1          |
| Travel (net)  | 506.9                     | 541.0           | 565.8           |
| Other services and transfers (net)                  | -114.4                    | -164.7          | -173.5          |
| Balance on current and transfer accounts            | -33.1                     | -81.2           | -19.2           |
| Official capital (net)                              | -7.6                      | 31.1            | 46.4            |
| Private capital (net) <sup>6/</sup>                 | 14.9                      | 125.3           | 35.2            |
| Net errors and omissions                            | 24.3                      | -71.6           | -49.1           |
| Special transactions <sup>7/</sup>                  | 15.5                      | 4.3             | --              |
| Net official international reserves<br>(increase -) | -14.0                     | -7.9            | -13.3           |
| <br><u>International reserve position</u>           | <br><u>1980</u>           | <br><u>1981</u> | <br><u>1982</u> |
|   | <u>(millions of SDRs)</u> |                 |                 |
| Central Bank (gross and net, end of year)           | 72.3                      | 86.1            | 102.9           |

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<sup>1/</sup> Based on an estimated GDP of BS1,413 million in 1982.

<sup>2/</sup> Retail price index in New Providence.

<sup>3/</sup> In relation to money and quasi-money at the beginning of the period.

<sup>4/</sup> Including loans and advances to public corporations.

<sup>5/</sup> Including foreign borrowing channelled through the government accounts to the Hotel Corporation.

<sup>6/</sup> Includes public corporations.

<sup>7/</sup> SDR allocations, IMF gold restitution, and profit from gold sales.