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October 25, 2010

**Statement by Mr. Lee, Mr. Di Maio, and Mr. B.Pereira on The Bahamas
(Preliminary)
Executive Board Meeting
October 27, 2010**

We thank staff for the well-focused report and the additional context provided by Messrs. Hockin and Rolle in their statement.

The Bahamas has been adversely affected by the global crisis since the first quarter of 2008 through the decline in tourism and foreign direct investment. With increased unemployment, and contraction in domestic activity, real GDP contracted by 4.6 percent in 2009 and there is significant uncertainty on the growth outlook for 2010. Against this background, we agree broadly with the staff's assessment and recommendations, and we limit our comments to fiscal adjustment and structural policies to lift growth and manage vulnerability.

A strong and sustained fiscal consolidation is required to stabilize and then reduce the debt-to-GDP ratio. We are therefore encouraged by the authorities' implementation of the fiscal measures in FY2010/11 budget which include improvements in tax administration and collection, strict expenditure controls, including wages, lower transfers to public enterprises, and a reform of fiscal incentives. However, given the risk of projected revenue shortfall endangering the fiscal targets, we agree with staff that earlier identification of contingent fiscal measures to ensure their timely and effective implementation are key to fiscal and debt sustainability. We also caution the authorities against over-optimism on the possible outcome of the fiscal measures.

We welcome the authorities' openness to the adoption of a Value Added Tax (VAT) in the future and note staff's cross-country evidence suggesting that successful implementation of VAT could yield additional revenue of about 2-3 percent of GDP. We acknowledge the benefits associated with a successful implementation of VAT and encourage the authorities to also understand the downside risks of the introduction of VAT such as a one-off inflation hike and the possibility of reduced revenue in the short term due to transitional and administrative challenges. We also encourage the authorities to consider the full range of other revenue-raising options that would provide stable income at a low cost to growth and with positive benefits for equity, including more comprehensive property taxation. To

minimize the risks, *we encourage staff to ensure that regional experiences from other small island states are considered and shared with the authorities to ensure VAT challenges are appropriately addressed.*

We are encouraged by the authorities taking gradual steps towards the adoption of a more detailed medium-term macroeconomic and budget framework and consider this step crucial for developing an effective medium-term fiscal policy aimed at putting public debt as a share of GDP on a declining path, and towards allowing for the creation of fiscal space to help manage future external shocks. Consistent with the capacity and capability in the Bahamas, we encourage the Fund and other providers of technical assistance (TA) to provide strong support.

Although the applied minimum reserve target exceeds the minimum target stipulated by law, the authorities are willing to consider a reserve-adequacy indicator with staff input in its development. We therefore encourage staff to work collaboratively with the authorities to design and develop an adequate level of foreign reserve relevant to The Bahamas' context and to adequately cope with its external vulnerability in the future.

We support staff's call to strengthen the financial sector regulation and supervision. We consider the authorities' actions critical in ensuring that the risk of the increased nonperformance loan (NPL) is contained and financial sector stability is maintained.

The Bahamas is heavily reliant on tourism and financial services, and relatively vulnerable to external shocks. In this context, we agree with staff that the focus on enhancing economic growth should focus on private sector led growth, with a particular emphasis on fiscal consolidation, would be beneficial for the economy. *However, given the need for well-focused growth strategies, we would welcome further elaboration from staff on the prioritization and sequencing of these medium-term growth measures to ensure their effectiveness and efficiency.*

On another issue, on timely and quality economic data, like staff, we encourage the authorities to make use of TA provided by the Fund to strengthen its government finance statistics and national accounts, to improve its economic surveillance and policy formulation capacity and capability.

With these comments we wish the authorities all the best in their endeavors.