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October 25, 2010

**Statement by Mr. Fachada and Ms. Florestal on The Bahamas  
(Preliminary)  
Executive Board Meeting  
October 27, 2010**

1. We thank staff for a concise overview of the macroeconomic challenges that the Bahamas faces as it struggles to recover from the global crisis. We also thank Mr. Hockin and Mr. Rolle for their helpful buff statement. The repercussions of the country's tight link to the US economy are effectively illustrated in the staff's report and key policy issues going forward are well identified, namely: (i) fiscal and debt sustainability including the transparent subsidization of public enterprises; (ii) the regulation and supervision of the non-bank financial sector; and (iii) boosting growth. On the latter, the outlook is intimately linked not only to the recovery path of the US economy but also on the authorities' success in diversifying the tourism product and client base as well in encouraging investors to move forward with some of the large projects tabled before the crisis.

**On fiscal sustainability**

2. The authorities adopted difficult and unpopular fiscal measures at the beginning of the 2010/2011 budget cycle despite the tough economic times and the upcoming 2012 elections. Their efforts and determination have successfully staved off any further downgrading by a credit rating agency. Nonetheless, we concur with staff that the expected yield from the measures outlined in the budget communication is rather optimistic. Firstly, because the fiscal package includes both increases of several taxes as well as reductions of some others in order to rationalize the tax system and eliminate trade distortions making it hard to anticipate a highly positive net effect in the short term. Secondly, because the tax increases may depress further the economy.

3. According to staff's estimates, to bring the public debt-to-GDP ratio back to the level of 40 percent of GDP by 2015/16, a primary surplus of 1.4 percent on average – the equivalent of an effort of 2.3 percent of GDP per year over the next 6 years – is needed. Considering that the primary fiscal balance has only been positive once (in 2005/06) during

the past decade, achieving this debt-to-GDP ratio in the foreseeable horizon seems rather difficult and possibly unrealistic.

4. The report suggests that, in light of cross-country evidence, the adoption of a VAT could yield additional revenues of about 2-3 percent of GDP. However, it remains unclear how a VAT in the Bahamas would offset the high dependence on indirect taxes (chiefly trade taxes) as well as what are the respective roles of rigidity in the tax system and administrative efficiency in the relatively low level of tax collection.

5. The Bahamas Electricity Company (BEC) and other public enterprises in difficulty represent a significant drain on budget resources and improvements in their financial situation and management is crucial for a successful fiscal consolidation. In paragraph 9, the potential inflationary impact of planned increases in electricity tariffs is pointed out. It should be recalled that a partial cost recovery effort was launched this past August through the levying of a fuel surcharge to recuperate from customers a 10 percent customs duty and stamp tax on fuel imports for which the company had benefited an exemption for two years. This measure had to be repealed because of lack of advance notice. It is unclear to us if the planned tariff increases will be in addition to this surcharge or if they fit within a comprehensive reform agenda to improve the BEC's financial situation and whether these adjustments would allow the company to fully recover costs.

### **On international reserves**

6. The significant increase in international reserves in 2009 came with a financial cost given that it was partially accomplished with the help of a US\$ 300 million, 20-year international bond issue. We agree that strengthening international reserves in the Bahamas is paramount to mitigate the effects of large external shocks, support the currency peg and provide room for counter-cyclical policies, if necessary. We also welcome the Government's intention to develop, with Fund staff's input, a reserve-adequacy indicator suitable for the Bahamas. However, we note that the Lipschitz *et al.* threshold methodology suggested by staff leads to very ambitious reserve targets as actual gross international reserves only represent about half of the required floor. We would encourage the exploration of alternative methodologies and the adoption of one that leads to a realistic target and that is compatible with the characteristics of the Bahamian economy.

### **On the financial sector**

7. The Bahamas' financial sector has withstood the crisis well and staff notes that it is recovering faster than its other Caribbean neighbors. The Authorities need to be commended for the signing in such a short time span of 18 Tax-Information Exchange Agreements (TIEAs), well over the minimum that was required by the OECD to be removed from the grey list. Given that these TIEAs cover most of the economies with which the Bahamas does

business and that these arrangements carry administrative and financial costs, we wonder if there are substantial marginal benefits to justify the signing of additional TIEAs, as staff refers in paragraph 25. In the same vein, it would be opportune to examine how the financial sector in the Bahamas is coping with the United States' revised Qualified Intermediary (QI) program.