



COMMONWEALTH OF THE BAHAMAS

**2018/19
BUDGET COMMUNICATION**

**IMPLEMENTING THE GOVERNMENT'S POLICY AGENDA
AND
SECURING CORE FISCAL OBJECTIVES**

Presented to the Honourable House of Assembly

By

**The Hon. K. Peter Turnquest, M.P.
Deputy Prime Minister and Minister of Finance**

on

Wednesday, 30th May 2018

2018/19 BUDGET COMMUNICATION

Mr. Speaker,

It is my honour to present the 2018/19 Budget Communication.

I. INTRODUCTION

Mr. Speaker,

This is a landmark Budget. Indeed, it is arguably the most transformative Budget in the history of our nation. It is a Budget about finally putting an end to past practices of fiscal mismanagement and, instead, adopting an approach to the management of the fiscal affairs of the nation in the manner that they should be managed, that is, in a responsible, transparent and accountable way. To those ends, this Budget:

- First, ends the past practice of artificially under-budgeting for known commitments and properly accounts for Government expenditure such that it truly reflects the costs of current commitments and thereby prevents the buildup of significant expenditure arrears;
- Second, fully provides for the clearing up of the mountain of arrears and unbudgeted commitments left behind by previous governments that currently total some \$360 million;
- Third, provides through proposed Fiscal Responsibility legislation, a legally-binding framework for responsible fiscal management as well as effective parliamentary and public scrutiny of the fiscal performance of the Government; and

- Fourth, establishes a sound and credible fiscal plan for the 2018/19 fiscal period and beyond that:
 - addresses the fiscal pressures that we confront and provides for the implementation of the Government's socio-economic growth agenda in a fiscally responsible way;
 - secures the achievement of the proposed legally mandated annual deficit reduction objectives; and
 - sets the course toward the legislated, longer term goal of reducing the burden of Government debt to no more than 50 per cent of GDP.

In our first Budget last year, I stated that Bahamians had given our Government a decisive mandate to bring about

the much-needed transformation of both public financial management and our economy in order to secure a better life and future for all Bahamians. Our citizens desperately need and desire strong and decisive leadership that is fully transparent and accountable to the people; that exercises prudent management of their tax dollars; and that encourages and facilitates a growing economy that supports new job growth and a higher standard of living. The Bahamian people gave us an overwhelming mandate to fulfill their aspirations in these areas and we owe it to them to deliver nothing less. The transformational socio-economic growth agenda that we presented in the 2017 Manifesto and the Speech from the Throne speaks directly to those core national objectives and delineates the specific action plans that we will implement in their pursuit. That is

the plan of action that we promised. That is the plan of action that we are pursuing.

In this Budget, at the one-year mark of our mandate, I will speak frankly to:

- what our Government said it would do at this time last year and what has so far been achieved;
- what further actions we are implementing in core priority areas in the new Budget year; and
- our fiscal action plan to address the pressures that we face and to ensure that we meet the mandated fiscal objectives of the proposed Fiscal Responsibility law.

Mr. Speaker,

Bahamians have long heard, and indeed have come to be skeptical about, the words “strong leadership”, “responsibility”, “transparency” and “accountability” that

have been bandied about in recent years as empty slogans and without follow-through, to the point that they have effectively become devoid of meaning. Our predecessors perfected the art with flowery rhetoric, exaggerated adornment and unrealistic optimism and promises. It is little wonder that, in the end, their approach to governance was doomed to failure and their administration to rebuke and rejection.

The previous administration talked a good game but then perennially proceeded to play by its own rules, which meant that there was no responsibility for its actions and no accountability to Bahamian citizens.

Our Government will not play by that rulebook.

Bahamians want to know, indeed they deserve to know, the truth in respect of the state of, and prospects for, the national economy and the public finances, as well as

what their Government plans to do about the challenges that we as a society confront.

Mr. Speaker,

That is precisely what this vitally important annual document is all about. It is the vehicle through which Government informs the people about what it has accomplished during the last year and what it has planned for the coming year. It is on the basis of the information and data contained herein that our citizens are in a position to render judgment on their Government's performance in delivering good governance, sound financial management and the concrete economic and social advancement of our nation.

Mr. Speaker,

Our Government fervently believes in adhering to the true meaning and import of the words "strong

leadership”, “responsibility”, “transparency” and “accountability” and in this Budget we will “tell it like it is”. Quite bluntly, the economic, social and fiscal challenges that we confront are difficult and daunting. I will not dwell at length yet again on the economic and fiscal damage that was inflicted on our nation during the previous administration’s five-year mandate. The consequences are plain enough and painful enough for all to see. I will reiterate, though, that our task has been made all the more difficult by the extent of that damage.

I spoke to this matter in the last Budget Communication, in plain language and in unvarnished terms. If we are to achieve the fundamental objectives of our transformational agenda and bring palpable improvements to the lives of Bahamians, it is critically important that we return the public finances to a more sustainable state, with

sharply lower deficits, eventual balanced budgets and a reduced burden of Government debt. We simply cannot continue the irresponsible practice of piling one yearly deficit on another and further deepening the debt hole of the nation. The unrelenting and damaging deficit and debt spiral must be arrested. Otherwise interest payments will absorb ever-increasing shares of our revenue dollars, thereby further constraining our ability to fund the much-needed programmes, services and public infrastructure that our citizens expect from their Government. Going forward, we must articulate and commit to a fiscal framework that caps the size of government to manageable limits to avoid an unchecked growth in Government spending that could over time undermine the economic viability of the country.

I was, therefore, unequivocal in last year's Budget Communication that we would be judicious and fiscally

prudent in the implementation of our ambitious growth agenda, doing so in a manner that will ensure that the annual deficit is steadily reduced and eliminated, thereby gradually returning the burden of debt to lower and more desirable levels. Accordingly, the five-year policy platform of our Government is being implemented in a phased and reasoned way, within the budgetary limitations that we face.

I will now turn to a brief discussion of what the Government has achieved to date during its first full fiscal year in office and our action plans for the coming year and beyond.

II. Implementing the Government's Policy Agenda

i. Promoting Fiscal Responsibility

Our Government made a commitment to the Bahamian people that we would enshrine fiscal discipline as

a core element of our transformative growth agenda. Putting the nation's fiscal house in order is a clear prerequisite to a more buoyant private sector and stronger job growth as well as securing sustainable improvements in the standard of living of our citizens. Perennial Government deficits and an ever-ballooning burden of Government debt pose a direct threat to a better life today and to prospects for future generations.

Reflecting the importance that we attach to our commitment in this area, we announced in our very first Budget that we would proceed with the elaboration of Fiscal Responsibility legislation and binding fiscal rules. .

The draft bill is presently out for public consultation and feedback. The purpose of this legislation will be to:

- Establish in law the principles and procedures of responsible fiscal management;

- guide the formulation and implementation of fiscal policy objectives;
- guide the annual budget within a medium-term fiscal framework; and
- facilitate effective parliamentary and public scrutiny and oversight of fiscal performance.

The provisions of the proposed law are structured around the general principles of responsible fiscal management, namely: accountability, responsibility, stability, transparency, inter-generational fairness and inclusive growth.

The specific fiscal responsibility principles incorporated in the law relate to:

- achieving and maintaining a sustainable fiscal balance;
- achieving and maintaining prudent levels of public debt; and
- prudently managing fiscal risks.

The specific fiscal objectives that have been established to operationalize the core fiscal responsibility principles are set out in the first Schedule of the Bill, namely:

- the long term debt objective is to reduce debt to no more than 50 per cent of GDP;
- the fiscal balance is to be reduced to no more than 0.5 per cent of GDP from FY 2020/21 onwards;

- to allow for a transition to the latter objective, the fiscal balance shall not exceed 1.8 per cent of GDP in 2018/19 and 1.0 per cent of GDP in FY2019/20; and
- following the attainment of the 0.5 per cent of GDP objective for the fiscal balance, the growth of recurrent expenditure shall not exceed the long term rate of growth of nominal GDP.

The Bill provides for mechanisms to enforce its binding fiscal commitments. To that end, an independent Fiscal Responsibility Council is to be established with responsibility for assessing the Government's compliance with the general principles, fiscal responsibility principles and fiscal objectives, and to advise on fiscal and budgetary matters of the Government.

As an additional enforcement mechanism, the law provides that, whenever the Government does not comply with the requirements of the fiscal objectives, it shall be required to prepare and implement an adjustment plan. Such a plan will need to be tabled in Parliament and forwarded to the Fiscal Responsibility Council, as well as published on an official website of the Government. The plan will clearly specify the measures that will be taken to return to compliance with the requirements for the legally mandated fiscal objectives.

The stringent fiscal requirements of this legislation are groundbreaking in the affairs of our nation but are necessary to ensure that no Government, including our own, ever repeats the disastrous fiscal experience of the previous administration.

Notwithstanding the fact that the Fiscal Responsibility Bill has not yet been enacted, we have crafted this budget consistent with the key principles and articulated targets as guidepost, underscoring our commitment to the achievement of fiscal discipline and proper governance.

ii. Measures to Redress the Public Finances

In light of the magnitude of the primary fiscal imbalance that we faced upon coming to office, we have, as I mentioned earlier, adopted a judicious and balanced approach to fiscal consolidation that comprises actions to both restrain expenditure and enhance revenues.

Expenditure Restraint

On the expenditure front, we are pursuing an in-depth and extensive review of all Government programmes and services. It is simply well past time for such a review to ensure that the administration and delivery of Government programmes and services are up to the best international standards of the 21st century. Archaic and manual practices and procedures must be replaced in order to better serve the population at appreciably lower cost. As such, beyond contributing to deficit reduction, that review also seeks to:

- enhance value for money;
- improve services to make them more effective and efficient; and
- identify savings and reallocations to accommodate our core policy priorities.

As an immediate cost saving measure, all Ministries and Departments were mandated during this fiscal period to implement a 10 per cent reduction in respect of their discretionary expenditures. As a result, the Government wage bill and purchases of goods and services this fiscal year are projected to be down by \$120 million, or 10.3 per cent, from the amounts budgeted. For its part, the in-depth review of expenditure is expected to make a significant and permanent contribution to deficit reduction going forward.

***Government Digital Transformation
to Strengthen Competitiveness***

The Government has been in discussions with the IDB on a project that we refer to as the "Digital Bahamas Initiative".

The main objective of this project is to foster the country's competitiveness by reducing the costs of

conducting business with the Government. This general objective will be accomplished by achieving the following specific objectives: (i) streamlining government procedures and making them available online to reduce the cost of government bureaucracy; (ii) increasing the use of ICTs in the public sector; and (iii) increasing transparency of Government activities and strengthening auditing and control mechanisms. The three principal components of the project will focus on:

- Simplifying and digitizing government procedures;
- Strengthening institutional capacity for a digital government; and
- Enhancing transparency and integrity in government.

As for results, the project is expected to lead to:

- a reduction in the time and cost of Government procedures;
- an increase in the data shared and used across Government offices for policy design and Government management;
- an improvement in the quality and quantity of Government information published, and its use by citizens; and
- the establishment of a single national identity number and identity card – presumptively using the current NIB ID number – that will allow for ease in transacting business in the public and private spheres of the country.

We expect to finalize the details of this new project early in the new fiscal year. The net result of this will be a

reduction in processes and paperwork and the means to conduct government business more efficiently. Simply put, as the private sector and the rest of the world is doing, we will make use of technology to deliver public services cheaper, faster and better.

The government will also provide support to the Central Bank's current move toward a digital form of Bahamian currency, as well as support to the efforts of the Central Bank and the commercial banking sector to move toward a cashless society. Our ambition is no less than to make the Bahamas a regional leader and then a world leader in the utilization of digital technology for the benefits of its citizens. In so doing, we shall catapult the Bahamas ahead of many of its contemporaries and create opportunities and efficiencies for all Bahamians.

Transformation of the State Owned Enterprises

In addition, the Government is striving to transform its State Owned Enterprises (or SOEs) into self-sufficient entities. As was laid out in the Budget Communication last year, funding in the amount of \$429 million was provided for 25 SOEs in the 2017/18 fiscal year, representing an increase of \$79 million from the previous fiscal year. In light of the critical priority being attached to fiscal consolidation, such a drain on the public finances must clearly be rationalized.

To that end, the Government has directed each SOE to begin looking at a move toward a cost-recovery operating model, which might include a mix of revenue enhancement initiatives, as well as measures to reduce expenditures in-line with industry benchmarks. The SOEs are now formulating articulated strategies that we expect will take them to this optimized point within 3 to 5 years.

As a supplement to this exercise and to provide guidance, the Government is currently pursuing the engagement of a consulting firm to provide an analysis of selected SOEs and Authorities and to create a roadmap with respect to best options for those SOEs and Authorities becoming self-sustaining entities. Specifically, the work will entail the creation of a detailed strategic approach to cost rationalization and cost recovery for select SOEs consistent with global best practices for similar agencies in similar jurisdictions. As well, the contract will call for the development of the modalities to permit suitable Government in-house professionals to be able to undertake similar strategic reviews of the remaining SOEs and the requisite training and support of the identified professionals.

***Enhanced Accountability and Transparency
at the Ministry of Finance***

We are, as well, pursuing measures to strengthen the accountability and transparency of the Ministry of Finance, including the recent creation of two new senior positions within the Ministry in the form of a Deputy Financial Secretary with responsibility for strengthening the operational capacity of the Ministry and a Deputy Financial Secretary in charge of economic and fiscal policy matters. The latter position is under recruitment and expected to be filled shortly. The Ministry will also undertake an internal restructuring and will recruit additional Bahamian professionals so as to ensure that the agency is equipped to provide its optimal level of fiscal, economic and budgetary management and support.

The Ministry of Finance is also pursuing the implementation and successful completion of the \$33 million IDB-financed Public Financial Management and

Performance Monitoring Reform project that had been floundering up until last year and producing meager tangible results.

The objective of this exercise is to enhance the capacity of the Ministry to produce high quality information for evidence-based policymaking, as well as improve the ability to better allocate and track public funds. In this regard, the Ministry will also work to strengthen its analytical capacity in the area of fiscal policy development and implementation.

As well, the Ministry is moving to the adoption of new budgeting and accounting software and standards and the introduction of accrual accounting and the systems that support it. Also in development is the implementation of a new, modern Chart of Accounts that is fully compatible with international standards. As an initial step to avoid the

buildup of future arrears, the Government is enabling accrual accounting with the planned introduction of International Public Sector Accounting Standards (or IPSAS) for government bookkeeping and reporting that will provide increased visibility into outstanding cash requirements and facilitate cash planning. Here again, we are committed to bringing the Bahamian government up to modern and international standards.

Revenue Enhancement

The Ministry of Finance has also been mandated to renew its emphasis on enhanced revenue collection. To that end, the Revenue Enhancement Unit, another example of an initiative simply floundering under the previous administration, is being recast to ensure that revenue is properly and fully collected across the major tax segments . To facilitate these efforts, an amendment is being proposed

to the Financial Administration and Audit Act to provide the authority to the Ministry of Finance to form an inter-departmental unit that will be assigned the task of revenue enhancement across the major areas of taxation.

In addition, the Ministry's revenue policy structure will be reorganized in such a way that officers will be assigned responsibility for the monitoring and analysis of a specific major area of revenue, on the basis of which recommendations are to be formulated for remedial measures that will ensure that revenue objectives are met.

We will also re-energize the reform and modernization exercises that have been launched in respect of the major tax areas, such as Customs and Real Property Tax. A full management audit of Customs procedures and processes will be undertaken to determine the extent to which they deviate from international best practice and the

best way forward to close the gaps that are identified. The reformed procedures that result are expected to lead to both better service to the private sector and citizens as well as enhanced revenue collection.

The Real Property Tax system has long been acknowledged to be antiquated and inadequate to its mandate and mission. The desirable reforms identified in recent years must be reassessed and, where appropriate, re-initiated and pursued with purpose and determination. We will do so as a matter of priority and ensure that the necessary resources are dedicated to this important challenge. Developing a modern and equitable system of property taxation will better serve our citizens and secure the revenues that are anticipated from the system. Previous estimates suggest that a properly functioning system could readily yield significant improvements in revenues.

While the efforts to strengthen the Customs Department and the Real Property Tax administration will take some time to come to fruition, we realize that given the state of the nation's finances, we cannot wait an indeterminate time to see results. Accordingly, this budget targets upwards of \$80 million in increased customs, excise and real property tax revenues in 2018/19, over the anticipated run rate so as to ensure that the revamped revenue collection unit – and the revenue agencies individually – are mandated to improve their collection of the taxes that are on the books presently. Further, they will have to demonstrate to my satisfaction – and that of the Bahamian people – that their efforts are producing tangible benefits in bringing in uncollected and under-collected taxes.

Structural Reform of the Tax System

Mr. Speaker,

It is undeniable that our current system of taxation must be reformed and modernized in order to ease the compliance burden on citizens and the private sector as well as generate the revenues that are rightfully due to Government. As has been demonstrated with the introduction of the Value Added Tax, it is possible to implement international best practices and modern processes and procedures based on state of the art technologies such that tax administration is client friendly, efficient and effective. As I have said, we are striving to do just that for all of the major taxes.

However, having said that, it is also evident that our very structure of taxation itself is antiquated and inadequate to the needs of modern governance in the 21st century. A tax system with traditionally heavy reliance on Customs duties and, more recently Excise duties, that apply solely to goods

is clearly deficient in a world in which services have come to dominate goods in terms of relative economic importance. Indeed it is estimated that services account for fully 78 per cent of Gross Domestic Product. This distortionary situation was rectified to some extent with the introduction of the broad-based VAT in 2015 but it is still the case that Customs and Excise duties account for upwards of 30 per cent of total Recurrent Revenue.

With planned accession to the World Trade Organization, there will be a requirement to implement significant reductions in Customs duties in this country in return for membership in a group that will secure access to foreign markets and the protections afforded by a structured, rules-based system of trade, which is vitally important to a small trading nation such as ours.

But outside of the WTO requirements, it is the view of the Government that adjusting the relative burden of taxation from goods and toward a more equitable balance of goods and services is critical to reduce the distortions in our economy which have disadvantaged those involved in the trade of goods – as well as our poorer citizens who tend to spend a disproportionately higher share of their incomes on goods over services.

The Business License regime in our country, with a fee structure based on turnover, has long been cause for concern within the business community and with policymakers. The system is generally seen as inefficient, inequitable and distortionary. Previous recommendations for a radical reform and even complete elimination of the fee structure, as currently configured, have inevitably

floundered in the face of fiscal pressures to maintain revenue levels.

In total, our tax system generates revenues that are projected to amount to some 16.1 per cent of GDP in 2017/18. That ratio stands in stark contrast to an average ratio in the mid 20 per cent range in the Caribbean region. As well, it has been estimated that our system as structured produces far less revenue than potentially could be raised given the economic structure of the country. In its latest Article IV Staff Report, the IMF went so far as to suggest that, with the recently revised national accounts—revealing an economy much larger than previously thought—there exists significant scope to accelerate the pace of tax reform.

In light of the evolving pressures outlined above, our Government is of the view that it would be desirable and

appropriate to look at a further restructuring of our system of taxation away from narrow-based and distortionary taxes. Accordingly, we have commissioned Deloitte to undertake a detailed assessment of the appropriateness of, and options for, alternative forms of Business Tax in The Bahamas, the revenues from which could, as an option, serve to replace the fees now collected in respect of Business License. At this stage, this is simply exploratory work geared to obtain an empirically based assessment of tax options and to canvass the views of a full range of Bahamian stakeholders. This study is just underway and I emphasize that no policy commitment has been made to the introduction of any alternate form of tax at this juncture.

As well, it needs to be borne in mind, at least for the purposes of prudent fiscal planning, that the introduction of such a new tax instrument would require an appropriate

development and implementation period that would extend beyond the time horizon of this Budget.

Debt Management Legislation

As well, we are proceeding with the preparation of new Debt Management legislation that is also targeted for tabling in the period ahead.

To that end, the Central Bank has approached the Commonwealth Secretariat to provide technical assistance for drafting appropriate legislation to modernize our public debt management infrastructure. Work to date suggests the establishment of a new framework, consistent with international best practices, that is designed to support a properly functioning debt management regime. That framework would include, for further consideration and possible implementation:

- the establishment of a Public Debt Management Unit responsible for debt management activities;
- the establishment of a Public Debt Management Advisory Committee to guide the Government's borrowing policies and debt management operations;
- the establishment of a public debt management strategy, in line with the Government's fiscal policy and Budget framework, with which all borrowing and other debt management activities would need to comply;
- the establishment of mandatory requirements for reporting to Parliament by the Minister of Finance, including on the performance of debt management relative to the strategy as well as on all guarantees issued by the Government; and

➤the provision for external audit requirements of all debt management activities.

As an additional measure to manage debt more responsibly, the Government has established a sinking fund to accommodate the repayment of the recent \$750 million international bond issue and will contribute some \$39 million to that fund in the 2018/19 fiscal year.

iii. Bolstering Growth and Job Creation

Mr. Speaker, it virtually goes without saying that, with the level of unemployment in this country and the annual rate of increase of our labour force, it is critically important that we succeed in boosting the rate of growth of our economy. We have been steadfast in our commitment to that goal as it will bring significant benefits not only in terms

of new and expanding job opportunities but also in respect of contributing to our plan for fiscal consolidation.

Improving the Ease of Doing Business

That brings me to the matter of the ease of doing business in this country. All will know that we have not fared favourably in the annual country rankings of the ease of doing business developed by the World Bank. Indeed in the latest 2018 rankings, which are based on data as of mid-2017, we placed 119th out of 190 countries, with our worst showing in respect of registering property where we actually placed 167th, followed by trading across borders with a 157th ranking.

Improving the ease of doing business in this country is, therefore, a core component of our strategy to bolster Bahamian entrepreneurship, investment and economic

growth. In our Manifesto, we were explicit that we would progress public sector reform to create an efficient public service committed to improving the ease of doing business with the Government. And, shortly after coming to office, we followed through on that commitment with the establishment of a private sector led Committee to develop recommendations for improvements in the ease of doing business in this country.

As a key element of that initiative, the Ministry of Finance formed a cross-agency committee to examine how to make the business license application process faster, easier and more efficient. The committee consisted of representatives from Finance and the major government agencies responsible for issuing approvals required to open a business, that is, the Department of Physical Planning, the Ministry of Works, the

Department of Environmental Health Services and the Royal Bahamas Police Force.

The ultimate goal of the Committee was to streamline the entire business license process to allow much faster approval times through greater use of digital platforms that will support integration of systems between agencies for complete online service.

Our focus has been on making the system faster, easier and better. To that end, we are making the Business License system:

- Faster by shortening the time required to secure both new and renewed licenses;
- Easier, stress-free and more citizen centered by fostering greater inter-agency cooperation to facilitate the acquisition of licenses; and

➤ Better through improved service delivery via a single point of contact.

Upon completion in early 2019, the new system will also include the complete integration of systems between agencies and complete online services, including the submission of applications and the reservation of business names through the Office of the Registrar General.

We are also reviewing the recommendations of the Ease of Doing Committee in respect of other areas of concern. In response, we are making administrative changes to procedures as well as introducing, as appropriate, proposed amendments to legislation to address those concerns. .

I will present highlights of the legislative amendments that are being proposed in response to the

recommendations of the Ease of Doing Business Committee shortly. The full set of proposed legislative amendments is being tabled today.

Commercial Enterprises Act

We have also introduced the Commercial Enterprises Act to promote the establishment of new business undertakings or services, with an investment of at least \$250,000, in a number of specified areas of activity, including leading edge sectors such as nanotechnology and bioinformatics and analytics. The Act also provides for the prescription of any Island or part thereof to be a specified commercial enterprise zone for the purpose of rationalizing infrastructure investment, efficient land use or the encouragement of clusters of commercial development. Incentives may also be prescribed in respect of such

specified commercial enterprise zones. In addition, the Act liberalizes the granting of work permits to any enterprise that seeks to establish itself in our country and requires permits for its management team and key personnel.

Promoting the Development of MSMEs

The Government is firmly dedicated to the growth and expansion of micro and small and medium sized enterprises (or MSMEs) in The Bahamas. It is widely acknowledged that these enterprises comprise the so-called backbone of the private sector and are responsible for generating the bulk of new job opportunities.

Central to our thrust in this area is the strategy to promote the development of MSMEs that is founded on seven key policy pillars to guide specific policy prescriptions for these enterprises, These seven key policy pillars are the following:

- Improving the enabling environment for MSMEs by facilitating their interactions with public and regulatory entities, e.g. easing the obtaining of licenses and certificates as well as the use of digital platforms to fulfill tax and regulatory requirements;
- Increasing direct financing to MSMEs through the commitment of \$25 million over five years for such measures as micro loans, small business loans, grants and guarantee facilities through the commercial banking sector;
- Enhancing MSME business development support through the establishment of the Small Business Development Centre;
- Providing specific support for entrepreneurship and MSME development within marginalized groups, with

specific funding and support set aside for youth, and for poor or otherwise underserved communities;

- Fostering a culture of entrepreneurship and innovation with support for curricula-based programmes such as Junior Achievement and for new financial literacy and entrepreneurial programmes within the school system;
- Strengthening corporate governance and minimizing outside political interference within MSME enabling agencies; and
- Promoting greater linkages between our MSMEs and other domestic and international sectors of our economy so that small businesses have more opportunities to sell their goods and services inside the country and out.

On the matter of the new Small Business Development Centre, I would add that this is an initiative spearheaded by the Government, the University of The Bahamas and The Bahamas Chamber of Commerce and Employers' Confederation with support from the Organization of American States. The Centre will provide a resource for all Bahamians to receive advisory and technical support when seeking to open a business or expand their operations. The Centre will also steer entrepreneurs to available funding opportunities through government or private means and assist business owners in navigating through the regulatory and tax registration requirements for a new business.

I am pleased to advise that the Government and the stakeholders of the Small Business Development Centre have recently appointed the Centre's Executive Director.

We expect that the Centre will begin operations shortly. We shall have much more to say about this in the coming weeks.

Beyond the streamlining of the Business Licence process, we also announced a waiver of Business Licence fees for small businesses with turnover under \$100,000 that will take effect with the next filing period.

***Economic Diversification
through the Digital and Blue Economies***

The Government has a stated objective of pursuing the further diversification of our economy as a means of supporting more buoyant and resilient economic growth. To that end, we have secured a non-reimbursable grant from the Inter-American Development Bank in the amount of \$500,000 to finance a three-year technical cooperation project with a particular focus on the Digital Economy and the Blue Economy.

With the objective of promoting Bahamian firms to incorporate digital technologies into their business strategy and create new innovative technology-based business models, the Government aims to develop a sector strategy that involves both public and private stakeholders. To that end, we contemplate the need to improve the existing ICT infrastructure and legal and institutional framework in order to promote investment in the digital sector, as well as to use digital solutions to improve productivity in all economic sectors.

The "Blue Economy" concept was first used during the 2012 United Nations Conference on Sustainable Development and is an evolving concept that recognizes the need to maximize the enormous economic potential presented by the ocean, while preserving it. In this regard,

the Blue Economy can be broadly defined to include economic activity that directly or indirectly uses the sea as an input. The concept of the Blue Economy includes the simultaneous promotion of economic growth, environmental sustainability, social inclusion and strengthening of oceans ecosystems. For small island states such as The Bahamas, although traditional industries and sectors - fisheries, maritime transport and coastal tourism - represent a large portion of economic activity, articulating a strategy around our blue economy also enables identification and diversification into many other new and emerging ocean-based activities and sectors, including marine aquaculture, seabed mining, maritime safety and surveillance, marine biotechnology, marine security offshore wind energy, ocean renewable energy and deep-sea oil and gas production.

The project will proceed in three major phases. In the first phase, the project will undertake a diagnostic for each one of the industries, with the objective of validating the initial activities that have been identified, prioritizing one or more actionable and discrete actions to support with a focus on early implementation, the economic impact and the possibility of scaling up. Expected results include a recommendation of the activities for each sector, with a detailed, time bound action plan for each one of the activities, discussed and agreed with relevant stakeholders

In phase two, efforts will be dedicated to promote stakeholder ownership and commitment; to establish a structure for driving the implementation of the roadmap; and to initiate immediate actions (“low hanging fruits”) utilizing

available resources.

In phase three, activities will center on communication campaigns to promote the findings from the studies, and awareness campaigns between the public and private stakeholders that will support the creation of networks and communities with the stakeholders. In addition, a monitoring and evaluation system with indicators regarding the sectors performance will be developed.

Within the Bahamas' Blue Economy, there has been considerable public dialogue for years on the question of the extent to which the country is maximizing its potential financial and economic yield from its fisheries stock, its salt mines, and its deposits of aragonite. This diagnostic study will examine these and other Blue Economy opportunities empirically and dispassionately; the study and attendant

consultations with stakeholders and the general public will guide public policy so as to ensure that we as a country take full advantage of the promises of our Blue Economy in a way that is sustainable and maximizes the shared welfare of all Bahamian citizens.

Mr. Speaker,

As I have just explained, we began implementing our comprehensive and proactive economic action plan from the very first day that we took office last year and we will proceed with its further implementation in the coming Budget year. Ministers will elaborate on the specific plans in their respective areas of responsibility during the upcoming Budget debate.

I will, however, stress yet again that our plans and actions will be guided by the overriding need for

vigilant adherence to strict fiscal discipline. Whatever we do and, however we do it, will be faithful to the binding requirement that we meet the mandated fiscal balance objectives in the new Fiscal Responsibility legislation. As such, requests for funding allocations for new initiatives have been scrutinized and prioritized meticulously.

I will, therefore, now turn to a discussion of the current fiscal position as portrayed by the projected fiscal outturn for the 2017/18 fiscal year. I will then review the specific revenue measures that are being proposed in this Budget to:

- follow up on our Government's commitments to Bahamians;
- provide further tax relief to consumers and businesses;

- advance environmental and energy-efficiency objectives;
- generate additional revenue for Government; and
- enhance administration and compliance in respect of our major taxes.

I will then present an assessment of fiscal prospects for the 2018/19 fiscal year and the next two fiscal years. That will bring me to a discussion of how those prospects square with the mandated objectives for the fiscal balance that we must absolutely meet over the next three years.

To set the context for that discussion, I will begin with a brief review of the global economic environment and the state of, and prospects for, the Bahamian economy.

III. THE GLOBAL ECONOMY

Mr. Speaker,

As compared to the global outlook that was presented in the Budget Communication last year, prospects for the world economy have now been revised upwards appreciably, at least over the next two to three years. Beyond that, the impact of structural factors on the rate of potential growth is still expected to dominate the global economic landscape.

Based on the latest World Economic Outlook published by the International Monetary Fund (IMF) in April, the global economic outlook is the most buoyant that it has been since the start of the decade. This is spurred by expansionary fiscal policies in the United States, supportive world financial conditions and an ongoing upswing in global investment and trade.

The expansion of the world economy in 2017, at 3.8 per cent, was the strongest since 2011 and that pace is forecast to be maintained in both 2018 and 2019, at 3.9 per cent each year.

However, the longer term outlook beginning in 2020 and beyond is projected to be somewhat more challenging for policymakers. At that point, the advanced economies are forecast to return to potential growth rates that are significantly lower than those that prevailed before the onset of the global financial crisis of 2008-09. Ageing populations and meager productivity improvements are expected to be the main drivers of this slowdown. In the U.S., growth over the medium term will be dampened below potential by the projected reversal of the expansionary impact of the recent fiscal policy changes.

In addition, the IMF is of the view that the balance of risks to the economic outlook tends to the downside over the medium term, due to a number of significant concerns. These range from a potential sharp tightening of financial conditions as the advanced economies approach potential output levels to growing trade tensions and the attendant threat of protectionist policies on the part of the major global trading countries.

Prospects for the U.S. economy through 2019 have clearly been buoyed by the expansionary tax reform measures of December 2017. Particularly significant are the lower corporate income tax rates as well as the temporary allowance of full expensing of investment. Also important is the higher level of government spending flowing from the budget agreement of February 2018. The IMF estimates that, by 2020, the level of real GDP in that country will be

some 1.2 per cent higher than it otherwise would have been in the absence of the announced tax policy changes. On an annual basis, U.S. growth is now projected at 2.9 per cent this year and 2.7 per cent in 2019. These rates reflect significant upward revisions of 0.6 per cent and 0.8 per cent, respectively, from the forecast of last October.

The sobering element of this new projection is that U.S. growth over the medium term is now expected to be weaker than previously forecast, due to the increased fiscal deficits in the wake of current expansionary policies and the temporary nature of some of the recently announced tax policy changes.

Both the Euro area and Japan are forecast to expand at above trend growth rates in the near term on the basis of accommodating policy stances, improved external demand conditions and buoyant domestic demand. Growth

projections for all major Euro economies have been revised upwards with the aggregate outlook up one-half of a percentage point to a rate of 2.4 per cent in 2018, followed by an upward revision of 0.3 of a point to 2 per cent in 2019.

Economic prospects for both China and India remain largely unchanged, though still relatively buoyant with growth rates exceeding 6.4 per cent and 7.4 per cent in 2018 and 2019, respectively.

In a nutshell, the relatively bullish outlook for the world economy, and especially the U.S., in the near term presents both opportunities and challenges for The Bahamas. While the global environment will clearly support the ongoing recovery and expansion of our economy, it will be incumbent on us to capitalize on these near term developments and prospects to meaningfully address the fiscal problems that we confront. That will be critical to

permit us to create the fiscal buffers and headroom that will be necessary when external conditions turn somewhat less favourable, as is projected by the IMF over the medium to longer term. It will also be vitally important that we proactively implement our transformative plan to remove the structural impediments to more buoyant growth, strengthen the productivity, competitiveness and resilience of our domestic economy and position it to better adapt to the evolving international environment, including pending accession to the World Trade Organization.

IV. THE BAHAMIAN ECONOMY

I now turn to recent domestic economic developments and prospects for the future.

The Department of Statistics recently released its estimates of Gross Domestic Product for 2017, as well as revisions for the previous four years. The rate of real

economic growth last year is estimated to have been 1.4 per cent, as had been projected at the time of the last Budget. In addition, the historical revisions suggest that the size of our economy in current dollar terms was some \$577 million larger in 2016 than had been estimated last year, a development that is reflected in the GDP estimate for 2017 at just over \$12 billion. These revisions, of course, affect the fiscal ratios, for the weight of both the Deficit and the Debt relative to GDP, that are presented in this Communication and in the supporting documentation. As such, they are especially relevant in the context of the Government's fiscal policy planning in relation to the achievement of the fiscal targets set out in the imminent Fiscal Responsibility Bill.

The relatively modest rebound in real economic growth in 2017 was driven primarily by buoyant activity in the construction sector as a result of completion work on the

Baha Mar resort and other foreign investment projects, as well as hurricane-related reconstruction activity. However, other private sector construction work remained relatively subdued as the commercial banks maintained prudent lending policies. Reflecting this, total mortgage disbursements for new construction and repairs shrank by 3.4 per cent in 2017, on the heels of a 6.7 per cent contraction on 2016.

The performance of the tourism sector was muted in 2017, reflecting severe weather-related travel disruptions, the hurricane-related reduction in hotel capacity in Grand Bahama and enhanced competition from competitor destinations. Following growth of 2.5 per cent in 2016, total visitor arrivals contracted by 2.1 per cent last year on the basis of reductions in both air and sea arrivals, by 4 per cent and 1.5 per cent, respectively. The persistent

and long-standing relatively flat performance of the air and stay-over segment of the tourism market is particularly troubling as that is the portion that makes the most significant contribution to the growth of value-added in the tourism industry. The lackluster performance of this market last year was reflected, for instance, in the performance of the large hotel properties in New Providence and Paradise Island where the average occupancy rate declined by 10 per cent to 60.7 per cent. However, despite this development, total room revenue was largely unchanged on the basis of increased room inventory.

In contrast, there are now indications that the performance of the tourism sector rebounded somewhat more buoyantly in the first quarter of 2018 and that this improvement will be sustained.

The labour market posted improved performance in 2017, in line with the emerging rebound in economic growth. The key driving factors in this improvement were the phased opening of the Baha Mar resort, hurricane-related construction activity and a number of international cultural events. The Department of Statistics reports that, between November 2016 and November 2017, total employment increased by 11,345 to a total of 203,730. This growth in employment surpassed the 4.1 per cent expansion in the labour force during this period, the latter reflecting both the entry of new graduates into the labour market and a 2,000 decrease in the number of discouraged workers. As a result, the national rate of unemployment in November last year stood at 10.1 per cent, fully 1.5 percentage points lower than the rate a year earlier.

Improvements in the labour market were also broad-based across the country. The unemployment rate in New Providence fell by 2.3 percentage points to 10.6 per cent. It declined by 1.3 points to 12.1 per cent in Grand Bahamas and by 0.5 points to 8.6 per cent in Abaco over the 12-month period.

The rate of retail price inflation rose to 1.5 per cent in 2017 after having declined by 0.4 per cent the year before, largely reflecting the impact of increased international oil prices. The dominant component of the price index, comprising housing, water, gas, electricity and other fuels, posted a cost increase of 3.7 per cent during the year as compared to a 1.1 per cent decline in 2016. In contrast, the average cost of food and non-alcoholic beverages continued to decline in 2017, though by a more modest 0.1 per cent on the heels of a 0.9 per cent contraction

the prior year. With higher world oil prices, the average price of gasoline and diesel rose by 8.9 per cent and 10.6 per cent, respectively, following declines in the area of 10 per cent in 2016.

Developments on the monetary and credit fronts remained positive in the last year, with the banking sector's credit quality indicators improving significantly and the domestic banks maintaining strong capital levels. Private sector loan arrears fell by over 12 per cent in 2017 and by a further 2.5 per cent in the first quarter of this year. Arrears in the non-performing segment declined by over 22 per cent last year and by an additional 0.1 per cent in the first quarter of this year.

Interest rates were generally lower in 2017, led by commercial mortgages with a reduction of over 1 full percentage point to an average of 6.83 per cent. Residential

and consumer loan rates both posted declines, of almost one-half a point, to 5.76 per cent and 13.61 per cent, respectively.

With the Government's foreign borrowing activities, both bank liquidity and external reserves expanded during the year. The latter increased by a notable \$513 million to \$1.4 billion at the end of 2017. That amounted to some 23 weeks of total merchandise imports, which is almost double the international benchmark. Reserves rose by a further \$189 million in the first quarter of this year to a level of just under \$1.6 billion, largely reflecting improvement in the performance of the tourism sector.

As for the Balance of Payments, the current account deficit grew by some \$750 million in 2017, to a level of \$1.9 billion. This reflected a deterioration in the merchandise trade deficit of roughly one quarter of a billion

dollars to \$2.4 billion, with non-oil imports expanding by \$160 million, largely in respect of capital equipment for foreign investment projects and for hurricane-related construction work. The surplus on the services account fell by \$120 million to a level of just under \$1 billion.

The external borrowing activities of the Government impacted the capital and financial account of the Balance of Payments last year, with the surplus rising by over \$1 billion, to just over \$1.6 billion. Net private loan inflows also grew by \$211 million to \$722 million. Net direct investment inflows totaled \$74 million.

As for economic growth prospects, expectations are for continued strengthening of the momentum underway, with further gains by the tourism sector on the basis of sustained expansion in the U.S. and other key source markets. Various foreign investment projects are expected to

continue to buoy the domestic construction sector. As well, the full opening of Baha Mar should add to the more buoyant growth impetus. We can thus anticipate yet further improvements in labour market conditions in the period ahead.

On the basis of these evolving trends, we expect the rate of economic growth, in real terms, to increase from the 1.4 per cent of 2017 to some 2.5 per cent this year and 2.2 per cent in 2019.

V. FISCAL PERFORMANCE IN 2017/18

I now turn to fiscal performance in the 2017/18 fiscal year.

At the time of the last Budget Communication, a GFS deficit of \$323 million was projected for the 2017/18 fiscal year. As I had mentioned at the time, since the Budget was being presented a mere three weeks after the election,

the fiscal projections in the Budget largely reflected preparatory work that had gone on prior to our coming to office.

In light of that fact, I explicitly stated that, since our Government was firmly committed to the achievement of our deficit and debt reduction objectives, we would implement in-year fiscal adjustments, as needed, to secure a lower deficit in 2018/19 than was being projected in the Communication. And, indeed, the Government did announce in July an across-the-board 10 per cent reduction in primary, or discretionary, recurrent expenditure relative to the sums that had been budgeted. Interest payments and debt redemption, of course, reflect fixed commitments of the Government.

On the basis of this in-year expenditure restraint measure, and our ongoing fiscal vigilance, we have

succeeded, based on the projected fiscal results for the 2017/18 fiscal year, in reducing expenditure on the wage bill and purchases of goods and services by some \$120 million, or 10.3 per cent, from the amounts budgeted for these items. As subventions to the State-Owned Enterprises represent an important portion of primary recurrent expenditure, at roughly one-quarter of the total, it is clear that reductions in this area are also warranted and necessary to the achievement of our fiscal goals. However, as I outlined earlier, any such reductions are dependent on those enterprises implementing much-needed transformation and modernization exercises that realistically can only be achieved over time. The senior management teams of these entities have been directed to do so.

Capital Expenditure during the 2017/18 fiscal year was also subjected to restraint and is expected to come

in at \$153 million, down from the budgeted \$230 million. However, during the year, a detailed review by the Ministry of Finance, the Central Bank and advisors determined that a modification of the accounting treatment of payments to RESOLVE was necessary. These payments related to the payout on the initial \$100 million in promissory notes issued by the previous government to the Bank of The Bahamas to transfer non-performing loans. By treating the toxic loans as receivables, they were considered investment assets and, as such, the payments were not considered an expenditure item. Based on RESOLVE's own conservative estimates for recoverability, it now would be more appropriate to treat only 20 per cent of the loans as assets. As such, \$80 million of the full payment of \$100 million has been reclassified as a capital expenditure. Consequently, the outturn for Capital

Expenditure in 2017/18, at \$233 million, is largely in line with the Budget projection.

For its part, Recurrent Revenue in the current fiscal year continued to perform less buoyantly than had been projected at the time of the Budget Communication and this despite the economy posting a real rate of growth of 1.4 per cent in 2017, exactly as had been projected last May. At a projected \$2,020 million, Recurrent Revenue is expected to be some \$130 million below forecast. Given the rebound in real growth, such lackluster performance of revenue is definitely a matter of pressing concern and speaks to the mandate given to the Ministry of Finance and its Revenue Enhancement Unit to address the areas of revenue under-performance so as to exceed the status quo run rate in the upcoming fiscal year.

The bottom line is that the yield of our revenue system, at 16.1 per cent of GDP in 2017/18, is well below the revenue yields found elsewhere in the region, where yields average in the area of 25 per cent of GDP, and certainly is inadequate to the needs of a modern government.

In reviewing the fiscal outturn for 2017/18, it is also incumbent on me to clarify the figure for debt redemption. This clarification is necessary due to the persistent campaign of misinformation, perpetrated in part by some in this Honorable House who certainly know better, but refuse to do better. They and other pundits – finding no real fault in this government’s progress in addressing the fiscal maladies it met in place – have sought willfully to misrepresent the government’s fiscal activities and financial position for self-serving political gain.

One will note a large increase in debt redemption this fiscal year to a level of over \$1 billion as compared to the Budget estimate of \$433 million. That level of redemption reflects the Government's decision to effect a sizeable rollover of bridging facilities into longer term debt through the proceeds of the \$750 million international bond issue in late 2017. Such repayment of debt appears as part of Recurrent Expenditure, which explains the large increase in that component of the fiscal accounts. Given that debt repayment is, however, deducted in the calculation of the GFS deficit, we have appropriately modified our presentation of Recurrent Expenditure to exclude debt repayment.

It is important to point out, Mr. Speaker, that this administration – in terms of its application of GFS deficit recording and reporting at the summary level – is applying

the very same internationally accepted methodology and protocols as the former administration. I say no more on this at this juncture.

On the basis of these fiscal developments, the GFS deficit outturn in 2017/18 is projected at \$310 million, a net improvement of \$13 million over the Budget forecast of \$323 million.

Relative to the size of the economy, the fiscal outturn in 2017/18 represents a significant improvement relative to the fiscal performance in 2016/17, the last year of the previous administration's term in office. The GFS Deficit in 2017/18 is projected at 2.5 per cent of GDP, down by over one-half from the 5.5 per cent of GDP in 2016/17. In dollar terms, this means that the efforts of the current Government reduced the deficit by some \$351 million year-on-year.

On the basis of this fiscal improvement and the growth in the size of the economy, the ratio of debt-to-GDP is projected at 57.2 per cent at the end of the 2017/18 fiscal year.

VI. REVENUE MEASURES IN THIS BUDGET

Mr. Speaker,

For the fiscal year 2018/2019 the government is faced with stark and urgent fiscal realities that will require substantial enhanced revenues and the accompanying upward adjustments in certain taxes and fees. I will address the substantial elements of these increases in detail later in this presentation.

Given this need to enhance revenue, it is even more incumbent upon the Government to do what it can to protect the vulnerable, as well to as implement key policy

priorities and reshape the economy for sustained success. The government is undertaking a number of very targeted tax measures to provide tangible benefits to key segments of Bahamian society and economy.

I shall turn my attention to this presently. The details of these various measures are set out in an Annex to the Budget Document.

Commitments to Bahamians and Tax Relief Measures

As for measures that that we are implementing to meet our commitments to Bahamians and provide tax relief to individuals and businesses:

- effective August 1, we are eliminating VAT on all breadbasket items, with the exception of sugar, as sugar will – for health reasons – be removed from the list of breadbasket items. This would mean the elimination of VAT on the following items:

- Butter
- Cooking Oil
- Mayonnaise
- Grits
- Cheese
- Corned Beef
- Evaporated Milk
- Margarine
- Rice
- Flour
- Bread
- Tomato Paste
- Baby Cereal
- Baby Formula
- Soup
- Broths
- Baby Food
- Powdered Detergents
- Condensed Milk
- Soaps
- Fresh Milk
- Mustard

- We are eliminating VAT on medicines;
- We are eliminating VAT on residential property insurance;
- We are waiving VAT on residential electricity bills at or under \$100 and water bills at or under \$50; for clarity, this is not for the first \$100 or \$50 in a person's bills, but it is targeted at those bills which come in at or under the stated amounts. For electricity customers, this would impact over 30,000 BPL households alone. For water customers, this would impact some 43,000 Water & Sewerage customers. This waiver will be applicable to all licensed utilities in the country.
- we are increasing the Customs personal travel exemption from \$300 to \$500 per person;

- we are providing for the VAT zero-rating of fund-raising activities held by charitable organizations;
- we are implementing various concessions in respect of Real Property Tax, Customs duties, Excise duties, Business License fees and Stamp Tax in favour of designated Economic Empowerment Zones, beginning with the “over-the-hill” community;
- we are providing for the waiver of duty on clothing and shoe imports upon application by importers and retailers of same. This will be extended to any merchant, large or small, who has a business license for the sale of clothes or shoes. We are at the same time putting in place procedures to ensure that the savings are passed on to consumers. This will be a benefit to all Bahamians, but particularly to those who

do not have the means to travel abroad to shop for their clothes like others are sometimes able to do;

- we are providing duty-free entry for goods for use in the commercial printing industry, as well as for processing and garment manufacturing equipment without the need to apply for specific concessions as before;
- we are extending for one year both the City of Nassau Revitalization Act and the Family Island Development Encouragement Act;
- we are extending for 5 years the first-time homeowners Stamp tax exemption;
- we are extending for 2 years the duty exemption on materials used for the renovation, repair and upgrade of dilapidated buildings;

- we are eliminating duties on a number of food products, including: whole salmon; frozen fish fillets; bread spreads; potato products; tofu; and prepared and preserved tomatoes;
- we are eliminating duties on solar kits upon application to the Ministry of Finance. Presently solar panels are duty free, and this new allowance will mean that vendors or individuals who are bringing in full solar kits can have all related elements brought in duty free.
- we are reducing duties on floor tiles and fabric softener;
- we are extending the 0.75 per cent Business License fee rate, currently applicable to hotels with turnover over \$400 million, to all hotels with 10 rooms or more

so that smaller Bahamian owned hotels can take advantage of the concession that was offered to the larger foreign owned properties;

- we are extending the duty exemption to church buses 8 years old or less from the current limitation that limits the concession to buses that are 3 years old or less;
- we are providing an exemption from Business License fees for all schools that are registered with the Ministry of Education; and
- we are eliminating the duty on airplanes and helicopters in an effort to build an Airplane Registry Industry within the country.

Advancing Environmental and Energy-efficiency Objectives

The government maintains as a policy priority the need to embrace technologies that reduce the national need for the import and use of fossil fuels and those which maximize renewable energies. In addition to the reduction in duties related to import of solar energy components, this Government is undertaking the following:

- we are reducing the excise duty on electric and hybrid vehicles valued at \$50,000 and under down to 10 per cent;
- we are reducing the excise duty on electric motorcycles down to 10 per cent;
- we are reducing the excise duty on new smaller vehicles up to 1500cc in engine size down to 25 per cent; for clarity this applies to new vehicles only.

- we are reducing the excise duty on rechargeable batteries, other than conventional car batteries, down to 10 per cent; and
- we are increasing the environmental levy on all vehicles from \$200 to \$250.

In respect to vehicles, the express policy intent is to expand and enhance the noteworthy policy objective of the former administration to encourage the import and sale of more fuel efficient cars and trucks. Through this policy that we are today expanding, the country has seen a rise in the import and use of electric and hybrid vehicles and a build up of the support systems for same. This administration wishes to continue to encourage a transition to same. I wish to point out that we are restricting the landed price ceiling to \$50,000 for hybrids and electrical vehicles to avoid persons

bringing in luxury hybrid vehicles at the reduced duty level. Our policy rationale is that if you can afford a luxury vehicle, you can pay the standard vehicle excise duty rate.

We are also making brand new small vehicles much more affordable with the duty rate on those vehicles being set at 25 percent. In addition to the fuel efficiency of smaller vehicles generally speaking – which can reach efficiency levels of some hybrids - these vehicles are much better suited to small islands or congested cities. Further, the lowered duties on these small cars, as well as on electric vehicles and hybrids will allow many ordinary Bahamians once again to be able to afford a brand new car.

Mr. Speaker, in respect to protecting Bahamians from vulnerabilities, perhaps nothing can be so potentially devastating - personally, emotionally and financially – than having to face the prospect of a major injury or illness to

yourself or anyone you care about. Thus, I am also pleased to announce that the Government will – in this upcoming fiscal year - also introduce the first phase of the Catastrophic Care Insurance Plan under NHI during the coming fiscal year, extending real and tangible critical health care coverage to Bahamians throughout the country.

Enhancing Tax Administration and Compliance

For the business community, our legislative reforms are intended to make it easier for them to do business in the Bahamas and to clarify certain key elements within our tax laws that have been the subject of contention between businesses and the tax agencies. Selected examples include the following:

- various provisions of the VAT Act are being amended and/or supplemented to, for instance, streamline the advance ruling process and simplify the auditing

process, clarify the application of zero-rating for international transport and auxiliary services, define the process of trans-shipment, define ancillary educational fees;

- The Business License Regulations are being amended to ease the filing requirements of SMEs with turnover under \$10 million, by giving them the option of submitting either certified or audited financial statements or certified bank statements; businesses with turnover in excess of \$10 million will require fully audited financials.
- the Real Property Tax Act is being amended to clarify the definition of owner-occupied property;
- A wholesale change in the taxation policy for real estate that exempts Real Estate from VAT, replacing

the tax on same with a simpler stamp tax formula: a rate of 2.5 per cent stamp tax on transaction values up to \$100,000 and a rate of 10 per cent above \$100,000.

- The implementation, within the upcoming fiscal year, of a bonded facility arrangement for car dealers, whether big or small to make it easier for all auto retailers to conduct business; and
 - the Business License Act is being amended to require persons importing more than 2 cars per twelve-month period to have a valid Business License as well as to control the unauthorized roadside vending of vehicles.
- To be absolutely clear, the Government wants to continue to encourage all current and future Bahamian entrepreneurs to bring in and sell vehicles if they so

wish. However, we are asking and expecting that if you are in the car import and sales business, that you get a business license and join the sector formally. This protects your prospective customers and permits the Government to have a full accounting of the sector.

VII. FISCAL PROSPECTS IN 2018/19 AND BEYOND

The 2018/19 Fiscal Year

In developing an assessment of fiscal prospects for the 2018/19 fiscal year and beyond, a number of critical factors must be taken into account.

- First, the urgent need to pay off the more than \$360 million in arrears to which I referred earlier and which we plan to clear as follows: \$172 million in 2018/19; \$106 million in 2019/20; \$75 million in 2020/21; and a small balance thereafter. A summary

of these arrears and obligations is in the Annex of the Budget;

- Second, the adoption of proper and factual budgeting for all known commitments across the breadth and scope of Government expenditures, thus ending the past practice of under-budgeting for the sake of displaying unrealistically favourable fiscal outcomes during the budget exercises, but leaving large, unpaid arrears to be paid later. We refer to this as “right budgeting”. This Government will not continue the sham of purposefully under-budgeting known commitments which only leads to another build up of arrears left for others to clean up.;
- as a result, the “right budgeting” approach has led to an increase in allocations of some \$76 million in

2018/19. Examples of some of the more significant such adjustments include having to increase provisions to meet core IT service contract obligations, pensions for public officials, and even the lunch school program all of which were seemingly under-budgeted knowing full well that the allocations would be insufficient.

- Third, some \$48 million in financing for the selected new initiatives, in respect of both Recurrent and Capital Expenditure, that the Government is implementing in the next fiscal year to advance its socio-economic policy agenda, such as:
- \$13.5 million for the Digital Government initiatives in the Ministry of Finance and Ministry of Education;

- \$6 million for the construction of a new school in New Providence;
- \$5 million for Small and Medium Sized Business support;
- \$5 million for the Over-the-Hill initiative;
- \$5 million for LED street lighting;
- \$5 million for a solar demonstration project on one of the Family Islands;
- \$4 million for the recruitment of new college graduates;
- \$2.6 million for BTVI scholarships;
- \$1 million for the PM's cultural grant; and
- 1 million for Freedom of Information; ;

- Fourth, in light of the fact that the Government wage bill has grown by \$226 million, or 40 per cent, between 2011/12 and 2018/19 in an economy that has posted little if any real growth, the necessity of exercising restraint in respect of the overall wage bill and headcount and also the need to focus on enhanced professional skills as the existing professional staff retires;
- Fifth, the establishment and funding of the sinking fund to which I referred earlier;
- Sixth, the vital need to establish a Disaster Relief Fund over the medium term horizon to absorb the fiscal consequences of natural disasters;
- Seventh, the critically important need to boost capital expenditure on critical public infrastructure to

some \$300 million in order to enhance prospects for more buoyant growth of the economy;

- Eighth, the impact of the various revenue measures in this Budget;
- Ninth, the pending requirement to implement important reductions in Customs duties which are critical to the eventual elimination of the distortions in our economy and necessary for the accession to the WTO, which is targeted for December 2019;
- Tenth, the need to engage the Unions and key stakeholders in a discussion of the issue of pension reform, given its potential future fiscal impact; one estimate suggests that accrued Government pension liabilities could exceed \$3.5 billion in the next dozen years; and

- Eleventh, the mandated requirement to meet deficit objectives of 1.8 per cent of GDP in 2018/19, 1.0 per cent in 2019/20 and 0.5 per cent in 2020/21.

With all of these fiscal pressures at play, it is estimated that we would face a significant fiscal gap in 2018/19 and beyond that would need to be eliminated if we are to fully meet the mandated deficit targets.

In assessing options to secure the attainment of the deficit targets, the choices available to us are limited. In developing the Budget framework, we have only approved new funding allocations in respect of Recurrent and Capital Expenditure that are of the highest priority to the Government's policy agenda. Indeed, it will be noted that, close to one-half of the Budget Heads have been allocated

either virtually the same or even smaller amounts for 2018/19 than they were allocated in 2017/18.

Similarly, the tax reductions that we are announcing are selective and in line with our social and policy commitments to Bahamians. The various increases in fees, service charges and taxes that are being implemented have been selected to advance environmental and energy efficiency objectives and/or judiciously enhance revenues.

The bottom line is that we must pay off the massive backlog of arrears, judiciously finance our policy agenda, meet our deficit targets and set the stage for the pending reductions in Customs duties. That is a most daunting fiscal policy challenge indeed that requires decisive, though difficult, policy action.

To address that challenge, we are proposing a three-year fiscal strategy that will allow us to both deal with the

assorted fiscal pressures that we face in 2018/19 and beyond and meet the deficit targets each year. As a core component of that strategy are – as mentioned earlier – a number of enhanced revenue measures in the form of an increase in taxes and fees – and enhanced revenue collection efforts - targeting critically needed new revenue. The incremental revenue gains will permit execution of the government's three-year fiscal plan as follows:

- In year one: we will pay off over \$170 million in old bills and finally budget properly for current known commitments;
- In year two: we will pay off over \$100 million in additional arrears and begin to implement reductions in Customs and excise duties to rebalance the tax burden between the provision of goods and services and reduce the attendant distortionary impacts; and

- In year three: we will substantially complete the payment of arrears and make further significant reductions in Customs and excise duties.

Revenue-generating Measures

To facilitate this, we are proposing a number of measures that are designed to generate additional revenue to the Government. Specifically, we are increasing:

- the taxation of gaming house activities through the introduction of a sliding scale of rates applied to taxable revenue, namely: up to \$20 million, a rate of 20 per cent; between \$20 million and \$40 million, a rate of 25 per cent; between \$40 million and \$60 million, a rate of 30 per cent; between \$60 million and \$80 million, a rate of 35 per cent; between \$80 million and \$100 million, a rate of 40 per cent; and over \$100 million, a rate of 50 per cent;

- also, the taxation of gaming patrons through a 5 per cent stamp tax to be levied on both deposits made by patrons at the gaming houses and any non-online games/digital sales;
- An increase in the various Immigration fees;
- Introduction of new Port fees;
- the Real Property Tax on foreign-owned vacant land to 2 per cent of value, up from 1.5 percent;
- licensing fees on large commercial vehicles by \$50 for Class B and Class C vehicles; and
- increases to police record fees, fingerprinting fees for casino employees and Labour Certificate fees.

Most substantially Mr. Speaker, the Government is proposing an increase in the rate of Value Added Tax from the current 7.5 percent to 12 percent effective July 1st.

Mr. Speaker,

Our Government fully appreciates the sacrifice that the substantial increases in the VAT rate and other taxes will represent for our citizens. But as I have repeatedly said on record: this Government was elected to do what is right for the welfare of the country and not to do what is politically expedient or politically popular. Facing the situation that we have, we could do as governments have done before – and simply present a misleading budget with under-budgeted allocations and hidden obligations. We could have kicked the can down the road and borrowed some more – delaying the inevitable day of reckoning. By playing this game we

would have only made a bad situation worse. The country's bond rating is at junk status. The reason for that is because others before us failed to act promptly and judiciously. But worse than the junk status, the penalty for inaction is a continued quickening crawl toward a fiscal point of no return. And as we have seen, when countries hit crisis mode, the path to correction is extraordinarily hard and painful.

In the Budget, we could have pretended that this time, we could collect all the uncollected and under-collected taxes in a few weeks and months. But, we recognize that while we must improve our tax yield on existing taxes immediately – which is why we are institutionalizing the Revenue Enhancement Unit – we understand that, to realistically improve our capacity to collect all of our taxes, is a multi-year project given the institutional weaknesses that prevail today. We will

improve in this area. We must. And we will report on our progress regarding same.

That notwithstanding, the firm determination of this Government is that we must fix the situation and do so beginning today. No more kicking the can down the road for someone else to clean up. We are making the tough choices, understanding that the redress of our fiscal situation does require real sacrifice on the part of our citizens; however, by doing so, the country will reverse its spiraling debt situation and set itself up for success in the medium and long term. To ignore the dire fiscal situation before us would be to delay the inevitable adjustment. And the longer we would have delayed, the worse the correction that would be required.

We do not have to look far to see the consequences of governments and countries that waited too long – those

jurisdictions that were forced into painful structural adjustments in order to get the foreign currency necessary to enable them to import the basics and keep their currencies afloat. This government will not wait until it is too late. Instead, we are acting now and we are acting responsibly.

We make the commitment as well that, as the hundreds of millions of old arrears and obligations are finally paid off over the next three years, the Government will then give back to consumers in the form of Customs duty and Excise tax reductions, on the order of \$100 million, to the benefit of Bahamians throughout the country.

With the implementation of this three-year fiscal strategy, the mandated deficit targets will be fully met in 2018/19 and the two following years. The end result will be a balanced budget after three years with some \$100 million

in duty and excise tax reductions, bringing down the cost of imported goods.

As for the fiscal projection for 2018/19, Recurrent Expenditure will amount to \$2,589 million, an increase of \$346 million from the budgeted amount in 2017/18. This increase includes:

- the \$172 million in arrears that will be paid in the coming year;
- the \$76 million increase as a result of the adoption of full and proper budgeting for known commitments across the breadth and scope of Government expenditures;
- some \$19 million for the new Recurrent Expenditure policy initiatives that I previously discussed; and
- \$89 million for additional interest payments.

The level of Capital Expenditure in 2018/19 is set at \$299 million, up \$69 million from \$230 million in 2017/18. Demands for new investments in public infrastructure clearly exceed the amount that is allocated for next year and the Government does want to prioritize such investments as a means of boosting potential economic growth. However the fiscal realities of the day dictate that we scale back the allocations to a level that is fiscally justifiable, at least in the near term.

The outlook for Recurrent Revenue in the coming fiscal year is governed to a large extent by the fiscal impact of both the revenue measures that we are proposing in this Budget as well as the impact of the rise in the rate of VAT. The lesser revenue measures – including adjustments up and down - are estimated to produce a net gain in revenue of some \$100 million while the VAT increase should net new

revenue to the tune of some \$400 million. As a result, after factoring in the growth of the economy and targeted gains from enhanced revenue collections, total Recurrent Revenue in 2018/19 is estimated at a level of \$2,649 million, or 20.1 per cent of GDP. That is an improvement in the revenue yield of 4 full percentage points from the level of 16.1 per cent posted in 2017/18. While still lagging behind regional norms, such a level of the revenue yield is definitely more reasonable in relation to the needs of modern governance.

The GFS Deficit in 2018/19 is therefore projected at \$237 million, some \$73 million lower than in 2017/18. At 1.8 per cent of GDP, the deficit will come in at the target that will be mandated in the fiscal responsibility legislation.

With the decline in the size of the deficit and the ongoing growth of nominal GDP, the debt-to-GDP ratio is

projected to fall to 56.1 per cent in 2018/19, down from 57.2 per cent in 2017/18.

In the outer years of 2019/20 and 2020/21, the growth of primary Recurrent Expenditure is being held to 2.5 per cent per year. As such, this category of discretionary spending will decline from 16.8 per cent of GDP in 2018/19 to 15.4 per cent of GDP in 2020/21.

Capital Expenditure over the forecast horizon is projected to grow by 2.5 per cent per year.

The projection for Recurrent Revenue beyond 2018/19 assumes that the revenue yield of the tax system remains constant at its level of 20.1 per cent of GDP in 2018/19

On the basis of these planning assumptions, the GFS Deficit in 2019/20 is projected at \$85 million, or 0.6 per cent of GDP. In 2020/21, a GFS surplus of some \$10 million is

forecast. As such, we will readily achieve the deficit targets for those two years.

In addition, the debt-to-GDP ratio will decline steadily over the forecast period, to stand at 52.1 per cent at the end of 2020/21.

VIII. CONCLUDING REMARKS

Mr. Speaker,

In conclusion, I want to reemphasize just how significant an event the 2018/19 Budget is in the history of fiscal management in this country. For far too long, our citizens have had to live through, year after year, of blatant fiscal mismanagement, inadequate budgeting, over-spending beyond the fiscal means available, one deficit after another and a burden of Government debt rapidly approaching critical limits.

The era of fiscal irresponsibility has come to an end and, as we promised Bahamians, fiscal discipline will henceforth prevail. With this Budget, we have introduced a legally binding framework that obliges us to adhere to a mandated schedule of continuous deficit reduction and that will prevent any future Government from ever engaging in reckless fiscal management and excessive deficit financing.

Our Government has hit the ground running in developing this Budget within the full constraints of the new Fiscal Responsibility legislation. Quite frankly, with the evolving fiscal pressures that we confront, in respect of both Recurrent and Capital expenditure, the looming downward pressures on Recurrent Revenue, as well as the dire need to clear out the massive arrears left behind by the previous Government, the task this year has been particularly challenging. Very difficult decisions have had to be made in

respect of expenditure allocations with a decisive focus on the areas of highest priority within our policy agenda. Equally difficult decisions have also had to be made in respect of revenue measures. Moving to significantly enhance the revenue yield of our tax system was not done capriciously but rather out of a deep sense of responsibility for righting the ship of state and restoring the fiscal health of the people's Government. This day of fiscal reckoning inevitably had to come and it has fallen to our Government to tackle it with decisiveness and determination. I am proud to assert that we willingly took up the challenge and that, as a result, the 2018/19 Budget stands as a true testament to our resolve and determination.

After all, this is the people's time and they deserve no less than a Government that is firmly and deeply committed to fiscal discipline in the management of the

nations' public finances. To that end, we pray for the guidance of Almighty God as we move ahead to build a better future for all.