July 2003
IMF Country Report No. 03/220

The Bahamas: 2003 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **April 11, 2003,** with the officials of The Bahamas on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 17, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its July 2, 2003 discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

THE BAHAMAS

Staff Report for the 2003 Article IV Consultation

Prepared by Staff Representatives for the 2003 Consultation with The Bahamas

Approved by Ana María Jul and Liam P. Ebrill

June 17, 2003

- **Discussions.** Discussions for the 2003 Article IV consultation were held in Nassau from March 30 to April 11. The mission met with Prime Minister Christie and his cabinet, Governor Francis, other senior government officials, and representatives from labor unions and the business and financial sector.
- **Political context.** The present administration, elected in May 2002, enjoys a large majority in Parliament, but is still defining its policy agenda, including in the fiscal and structural areas.
- **Main issues.** Discussions focused on the appropriate path of fiscal and structural adjustment in the context of a slow recovery, large public financing needs, and increasing competition from neighboring tourism destinations. The authorities aimed at fiscal and monetary restraint to protect international reserves and avoid an excessive debt buildup, and gradual, selective structural reforms to preserve competitiveness. They have expressed their intention to reduce the fiscal deficit to stabilize the debt-to-GDP ratio, but the staff estimates that the measures included in the FY2003/04 budget are insufficient to meet this objective.
- **Fund relations.** The Bahamas is on a 24-month consultation cycle, and the last Article IV consultation was concluded by the Executive Board on August 1, 2001. The Bahamas has accepted the obligations of Article VIII, Sections 2, 3 and 4 of the Articles of Agreement, and maintains an exchange system free of restrictions on payments and transfers for current international transactions.
- **Staff.** The staff team comprised Martine Guerguil (head), Mario Dehesa, Gabriel Lopetegui and Tania Reif (all WHD). Mark Kruger (OED) attended key meetings.

Contents Page

EXECUTIVE SUMMARY

Background

After five years of strong growth, activity contracted in 2001 and remained subdued in 2002 and early 2003 under the impact of the global economic slowdown and lingering terrorism-related security concerns. With the downturn, the central government deficit reversed its declining trend of the previous five years and widened to 3.4 percent of GDP in FY 2001/02. The new government (elected in May 2002) aimed at a gradual reduction of the deficit while supporting the recovery through selective tax exemptions. However, the deficit is estimated to have remained unchanged in the current fiscal year, with public debt rising to 36 percent of GDP at end 2002.

The tightening of monetary policy (through the imposition of a bank-by-bank credit freeze) halted the decline in reserves. Available indicators suggest that, so far, the banking system has weathered the slowdown well. The government is still in the process of shaping its structural policy agenda, and progress in this area has been limited.

Staff expects economic activity to pick up gradually in 2003 and 2004 and, on the basis of measures included in the budget, the fiscal deficit to narrow to 2.8 percent of GDP in FY2003/04. The outlook is vulnerable to significant downside risks related, in the near term, to slower U.S. growth and continuing security concerns and, over the medium term, to a gradual erosion in external competitiveness because of relatively high labor and utilities costs.

Policy discussions

The authorities agreed with staff that fiscal restraint was necessary to stabilize the debt-to-GDP ratio. To this end, they were considering a combination of wage containment and tax measures. Staff recommended additional fiscal adjustment over the medium term (including through tax reform) to regain margins for countercyclical policies. Although the authorities have expressed their commitment to contain the deficit at 2.2 percent of GDP, staff estimates that the measures included in the budget (presented to Parliament after the return of the mission) imply a weaker revenue effort that would result in a gradual increase in the debt burden.

Monetary policy must remain tight to protect reserves. Staff recommended a move to indirect instruments of liquidity management (to increase efficiency) and higher international reserves (to lower vulnerability). The gradual liberalization of exchange controls envisaged by the authorities should be supported by enhanced prudential requirements and a strengthening of the fiscal and foreign reserve positions.

Financial regulations have continued to improve, including through efforts to strengthen anti-money laundering legislation.

The authorities were aware of potential risks to external competitiveness, but preferred building up political consensus before introducing structural changes, including tax and trade reforms.

Data improvement should be a priority. The authorities are aware that severe statistical deficiencies, including the lack of national accounts, continue to hamper surveillance and policy formulation, and they have requested technical assistance to address these issues.

I. BACKGROUND

A. Medium-Term Perspective

1. **The Bahamas is a small open economy with a population of about 300,000.** Tourism, originating predominantly from the United States, accounts for 54 percent of GDP and employs 20 percent of the work force. The second largest sector is financial services, with one of the largest offshore centers in the Caribbean (managing about US$280 billion in foreign assets) and a contribution to GDP of 15 percent. Per capita GDP is estimated at US$16,000, among the highest in the region. Democratic institutions are strong, and social indicators compare favorably with the averages for Latin America and the Caribbean.

2. **The Bahamas has a long track record of prudent macroeconomic management and financial stability.** The Bahamian dollar has been pegged to the U.S. dollar at par since 1973. Inflation has remained low, slightly below inflation in the United States. There are statutory limits to central bank financing of the government, and fiscal deficits have been moderate (an average of 2.2 percent of GDP over the 1990s). With no income tax, the relatively low tax burden is heavily dependent on customs tariffs (which account for 65 percent of tax revenues). Public debt, at an average of 32 percent of GDP over the decade, has remained moderate.

3. **Despite the fixed exchange rate, barriers to international capital mobility create scope for an independent monetary policy.** The central bank relies on direct instruments and moral suasion to control liquidity. Interest rates changes have had a secondary role, and the use of open market operations has been limited. All capital transactions are subject to prior approval by the central bank.[1] In addition, portfolio and real estate investment abroad are settled at a premium over the official exchange rate.[2]

4. **In the second half of the 1990s, large foreign direct investment flows into the tourism, financial and real estate sectors raised growth to an annual rate of 4–5 percent (from 0.6 percent in 1990–95).** Macroeconomic management focused on fiscal consolidation, and the central government deficit was virtually eliminated. The authorities also introduced far reaching reforms to enhance financial regulation and supervision in response to international concerns over risks of money laundering and fraud in the offshore financial sector.

5. **Fund policy advice has concentrated on the need to maintain a prudent monetary and fiscal stance, and to introduce structural reforms to preserve growth and**

---

[1] Central bank approval is also required for large current international transactions, but it is granted liberally.

[2] For portfolio and real estate investment abroad, residents must go through the investment currency market, where foreign exchange is purchased at a rate of B$1.25 per dollar and sold back (when investment funds are repatriated) at a rate of B$1.20 per dollar.

competitiveness, including tax reform (to rationalize the tax system and reduce its dependence on import duties) and privatization (to reduce inefficiencies in the provision of utilities services). The need to improve the statistical base has also been flagged repeatedly. Over recent years, the authorities' main policy objectives have been the preservation of macroeconomic stability and the strengthening of financial regulations. Progress in other structural areas has been much more modest. Moreover, severe statistical deficiencies persist, including the lack of official national accounts.

B. Recent Developments

6. **The economy entered into recession in 2001**—output fell by 2 percent, largely reflecting the adverse impact on tourism and investment of the global economic slowdown and the terrorist attacks of September 2001. Growth was subdued in 2002 and early 2003, as lingering security concerns exacerbated the dampening in U.S. demand, and a modest rebound in tourist arrivals was more than accounted for by the less profitable cruise segment (Figure 1). Inflation has stayed low, and the Bahamian dollar has been broadly stable in real effective terms, although it appreciated by 11 percent vis-à-vis regional competitors over 2001–02 (Figure 2).

The Bahamas: Selected Economic Indicators
(In percent of GDP, unless otherwise indicated)

	2000	2001	2002
Real GDP growth (in percent)	4.9	-2.0	0.7
Fiscal deficit (fiscal year ending June 30)	-0.8	-0.4	-3.4
Government debt	30.8	32.6	35.7
Credit growth (in percent)	14.7	7.8	4.3
External current account balance	-8.4	-6.4	-6.3
Foreign direct investment	9.5	3.3	5.8
Net international reserves (in US$million)	342	312	373

Sources: Central Bank of The Bahamas; Ministry of Finance; and Fund staff estimates.

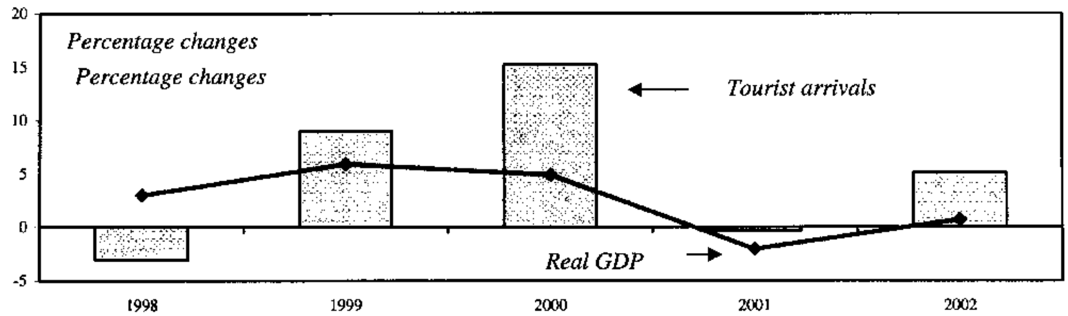
7. **With the economic downturn, the fiscal position deteriorated markedly.** The central government deficit widened to 3.4 percent of GDP in FY 2001/02[3] because of lower revenue from tourism and import taxes. Civil service wages increased following the schedule agreed in the 1999 wage contract.[4] The deficit was financed mainly through domestic

[3] The fiscal year begins July 1.

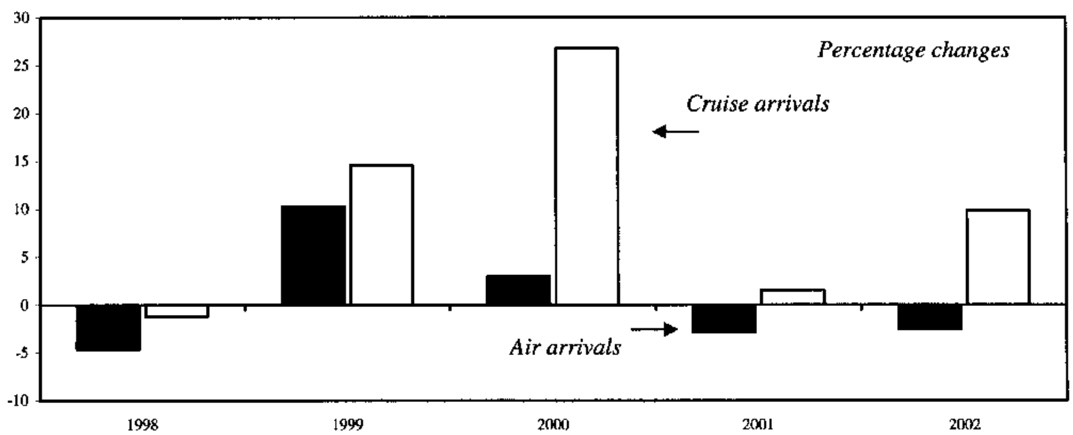
[4] The five-year wage agreement included a substantial adjustment in July 1999, and further increases to be implemented in a phased manner over 2001–04. The public wage bill rose by 0.8 percent of GDP between FY 1998/99 and FY 2001/02.

Figure 1. The Bahamas: Developments in the Real Sector

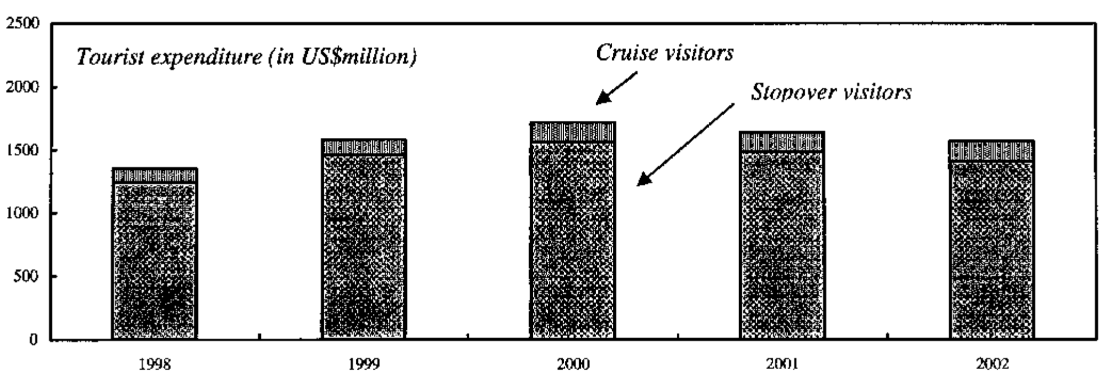
Growth has remained subdued. Tourist arrivals are picking up...



...but the recovery is due to the rebound in cruise arrivals.. .

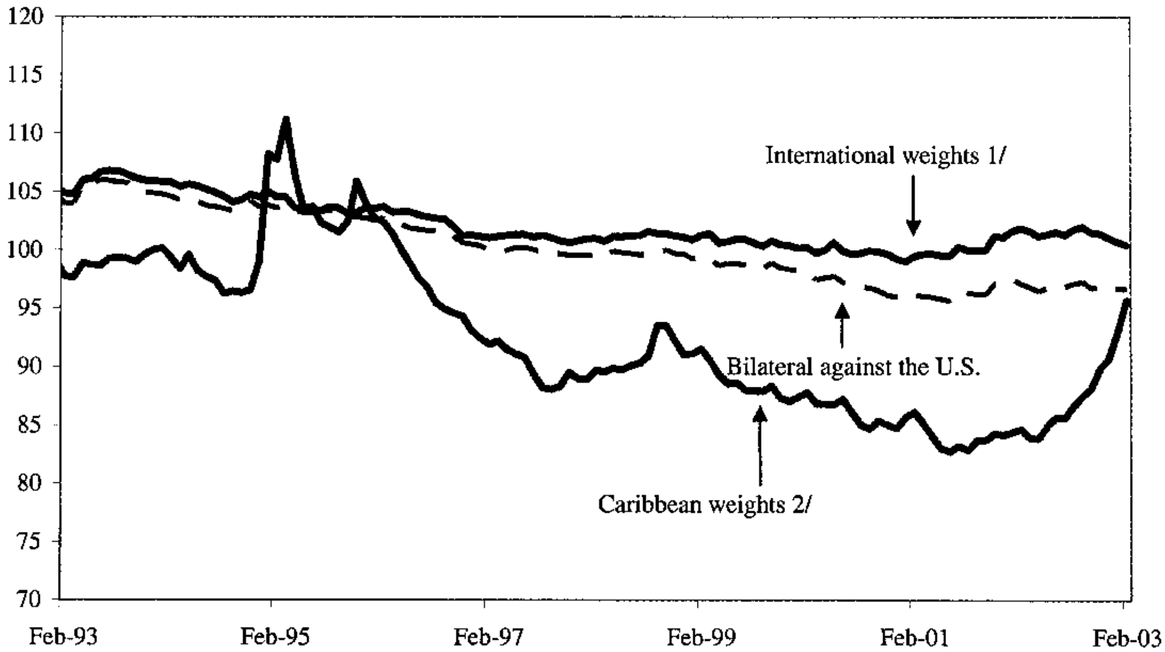


..and cruise visitors contribute much less than stopover visitors to total tourism receipts.



Source: Central Bank of the Bahamas; Caribbean Tourism Organization; and Fund staff estimates.

Figure 2. The Bahamas: Real Effective Exchange Rates
(1990 = 100)



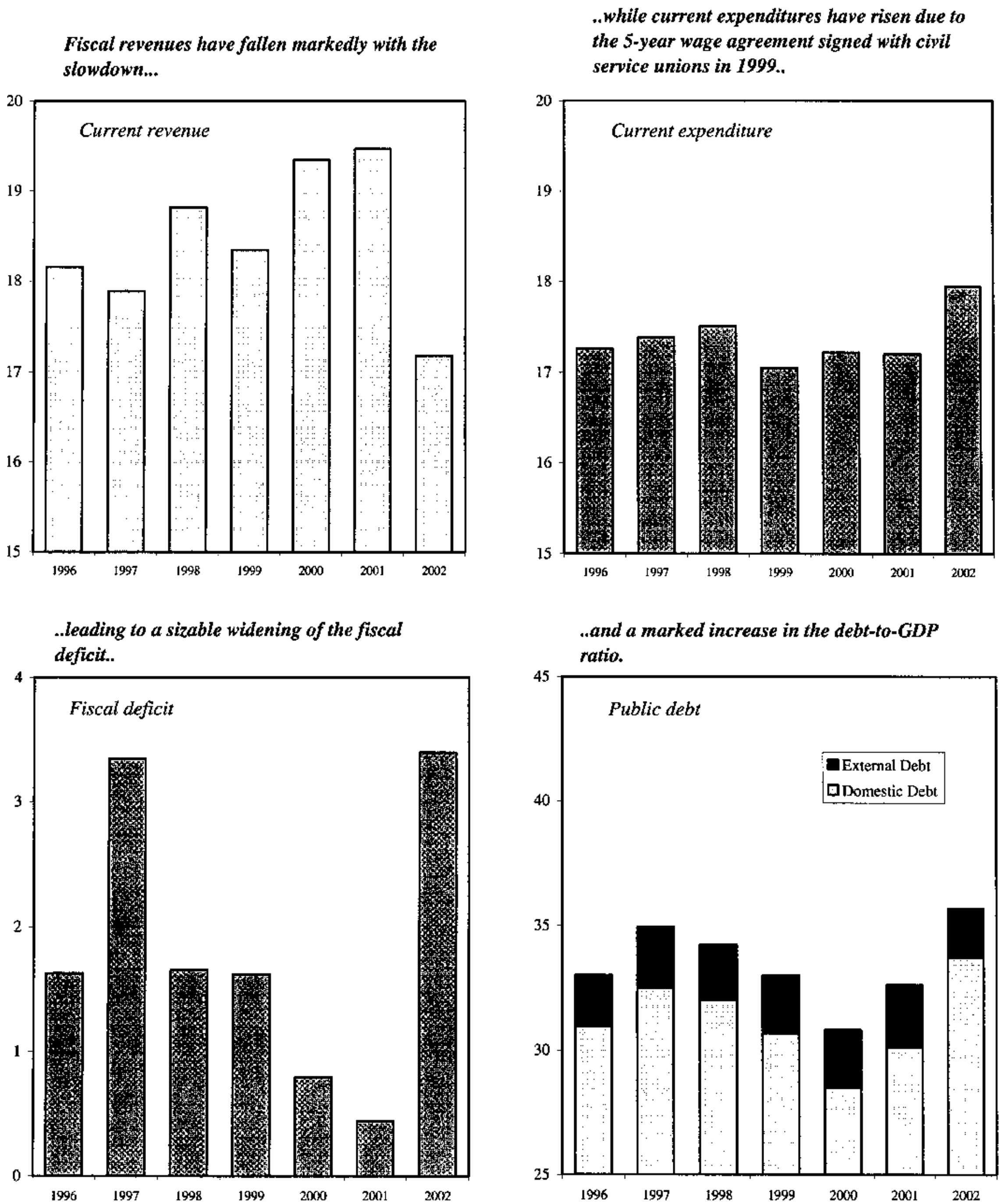
Source: Fund staff estimates.
1/ Weighted by country of origin of tourists.
2/ Weighted by size of main competitors in the Caribbean tourism market.

borrowing, including an increase in central bank credit to close to its statutory limits (Figure 3).

8. **The performance of public corporations was little changed.** The consolidated result of the nonfinancial enterprises shifted to virtual balance in 2002, mainly because of delays in investment spending. It is projected to shift back to a small deficit in 2003. Three of the enterprises (Bahamasair, the Water and Sewerage Corporation, and the Broadcasting Corporation) continued to require government transfers (0.7 percent of GDP).

9. **The surplus of the National Insurance Board (NIB), the state pension institution, increased slightly in 2002, to 1.1 percent of GDP.** The improved performance resulted from a reduction in administrative costs and strengthened collection of contributions.

Figure 3. The Bahamas: Fiscal Developments
(in percent of GDP) 1/

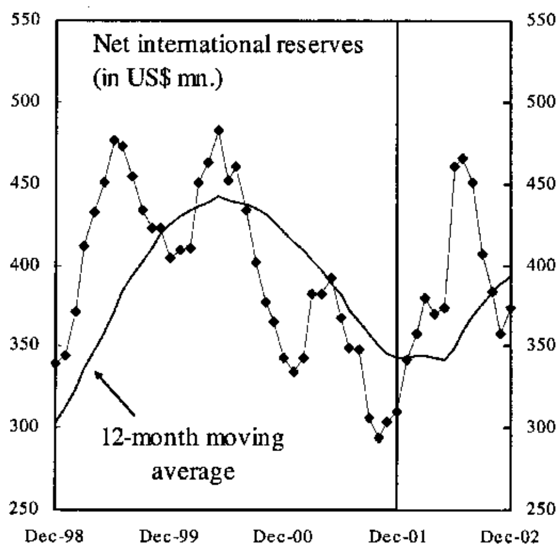


Sources: The Central Bank of The Bahamas; and Fund staff estimates.
1/ Central government only. Corresponds to fiscal years ending June 30.

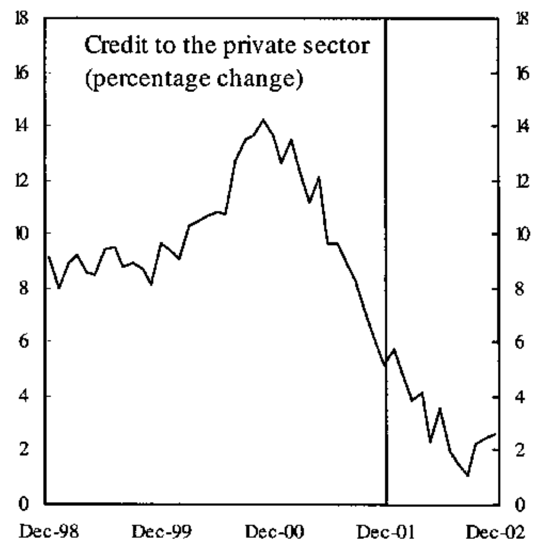
10. **Monetary policy was tightened in September 2001 to halt a decline in foreign reserves** (Figure 4). A bank-by-bank ceiling was imposed on outstanding domestic currency credit plus loan commitments, which allowed moderate credit growth in 2002 (4 percent, down from 8 percent in 2001). Deposit and lending interest rates remained fairly stable throughout the period. As the effect of the credit freeze gradually took hold, reserves recovered from a low of US$300 million in October 2001 to US$370 million by end 2002 (2½ months of merchandise imports).

Figure 4. The Bahamas: Monetary Developments

International reserves recovered...



..as monetary policy was tightened..



Source: Central Bank of The Bahamas.

11. **Available indicators suggest that so far, the domestic banking system has weathered the slowdown well.** The share of nonperforming loans has remained low (at 4.4 percent of total loans), profits have remained high (an average of 2.7 percent of assets), and capitalization indicators healthy.

12. **The external current account deficit narrowed to 6¼ percent of GDP in 2002** (from 8½ percent in 2000), as the drop in exports and tourism receipts was more than offset by a sharp reduction in imports.[5] With unsettled global financial markets and uncertain

[5] About 40 percent of merchandise exports correspond to re-exports through a large transshipment terminal opened in 1998. It is estimated that imports account for about 70 percent of tourism spending.

prospects, FDI flows slowed to 3 percent of GDP in 2001 (they had averaged 12 percent of GDP over 1997–2000), but rebounded to 6 percent in 2002.

13. **A new government was elected by a landslide in May 2002 with an agenda to revitalize the economy and employment, and expand social spending.** The new authorities were intent on broadening consultations with the public to inform policy decisions. To this end, a number of commissions were established to issue recommendations on certain issues, including key structural reforms initiated by the previous administration, such as financial regulation and trade reforms, and participation in multilateral trade arrangements.[6]

14. **The budget for FY 2002/03 aimed at a gradual reduction in the fiscal deficit while addressing the priorities of the new government.** A number of tax exemptions schemes were established to encourage investment and support economic activity, particularly in the construction sector. Real property taxes were lowered, and projects were set up to improve roads, ports and airport facilities. Budget allocations for education and health were also increased. However, revenue shortfalls forced the authorities to introduce an emergency spending containment program in November 2002, followed by measures to strengthen tax collections and reduce evasion.[7]

15. **These measures were insufficient to reduce the fiscal deficit in FY 2002/03.** It is projected at 3.4 percent of GDP, the same level as in the previous fiscal year, above the 2.9 percent envisaged in the budget. The deficit has been partly financed by a U.S. dollar loan intermediated by local banks. Central government debt rose to 36 percent of GDP at end- 2002, with foreign-currency debt accounting for 13 percent of the total.

Central Government Operations
FY 2002/03; in percent of GDP

	Budget	*Prel. Outturn*
Revenue	18.7	17.1
Current spending	18.6	17.8
Capital spending	3.0	2.7
Overall deficit	**-2.9**	**-3.4**

Source: Ministry of Finance.

[6] The Bahamas holds observer status at the WTO. It is a member of the Caribbean Community, and in negotiations for the Free Trade Agreement of the Americas. It rates five on the Fund's index of trade restrictiveness (ten being the most restrictive), mainly on account of its high tariffs. The Bahamas' average tariff rate is among the highest in the world, and almost doubles that of neighboring Caribbean countries. There are 17 tariff rates, ranging from zero to 210 per-cent, for an average tariff of 30.8 percent. About two thirds of imports are taxed at the 35 percent rate. Seven percent of imports (mostly food items) are exempt, while higher rates (45 to 75 percent) apply to motor vehicle imports.

[7] Government entities were required to reduce current expenditure by 5 percent. Government vacancies were frozen, and capital outlays postponed. On the revenue side, the passenger tax was included in the cost of air tickets collected by airline companies to reduce evasion.

16. **In September 2002, the central bank relaxed exchange controls to increase market flexibility and broaden savings opportunities.** Certain outward investments (including investment in foreign stocks by company-based retirement funds) are now allowed at the official exchange rate without paying the premium. The limits on international current transactions which can be intermediated directly by banks, without recourse to the central bank, were also increased.[8]

17. **The government is still in the process of shaping its structural policy agenda, and progress in this area has been limited.** The privatization of the telecommunications company The Bahamas Telecommunications Company (BTC, formerly BATELCO) is expected to be concluded before year-end, after several delays. Labor legislation became less flexible in 2000–01 with a reduction in the legal work week and the establishment of a minimum wage, but the lack of employment data makes it difficult to assess the impact of these changes on labor markets.

C. Outlook and Risks

18. **Economic activity is expected to pick up gradually.** Output growth would rebound modestly in 2003, to 0.9 percent, and further to 2½ percent in 2004, following the projected recovery in U.S. demand. Tourist bookings for the first months of 2003—the most active part of the year—held up in spite of Iraq-related security concerns, and further increases in arrivals, including higher-spending air arrivals, are expected for the year as a whole. Investment is also projected to rebound with a number of hotel expansions and new resorts. With the recovery, the external current account deficit would widen to 7.7 percent of GDP, mostly financed with direct investment.

The Bahamas: Near-Term Outlook
(In percent of GDP, unless otherwise indicated)

	2003	2004	2005
Real GDP growth, in percent	0.9	2.5	3.0
Fiscal deficit (fiscal year ending June 30)	-3.4	-2.8	-2.6
Government debt	38.1	39.0	39.6
External current account balance	-7.7	-7.9	-7.7
Foreign direct investment	6.7	6.9	7.1
Net international reserves (in US$million)	424	412	425

Source: Fund staff estimates.

[8] These limits vary according the type of transactions. The limit for personal travel expenses and gifts was raised from US$1,000 to US$10,000, and from US$3,000 to US$25,000 for port expenses and professional fees.

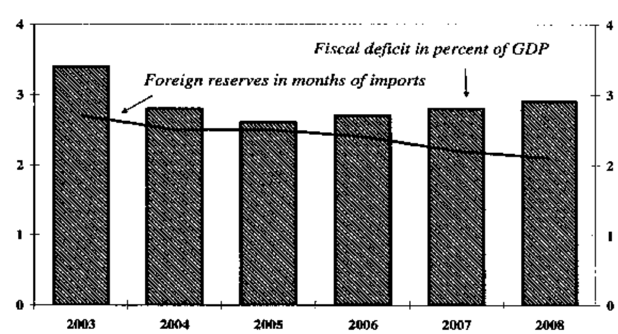
19. **On the basis of the measures included in the budget, staff projects a reduction in the fiscal deficit to 2.8 percent of GDP for FY 2003/04.** This would result in an increase in the debt-to-GDP ratio to 39 percent of GDP by end 2004, and limit the increase in reserves (they would remain below three months of imports). The deficit would be financed in part with the placement of international sovereign bonds.

20. **Because of the economy's high dependency on U.S. tourist arrivals, near term growth prospects are vulnerable to a slower than expected U.S. recovery and renewed terrorism-related security concerns.** The financial sector seems able to withstand the impact of an extended slowdown relatively well, thanks to its high capitalization, the low weight of non performing assets, and extensive firewalls between domestic and offshore activities. However, in an adverse scenario where U.S. growth does not firm up until 2004, the fiscal deficit would widen to 3.8 percent of GDP in the absence of additional fiscal measures, pushing up the debt-to-GDP ratio and raising pressures on reserves.

21. **Over the medium term, labor rigidities and inefficiencies in the utilities sector risk undermining competitiveness in the context of a fixed exchange rate.** Labor and utilities costs are high compared to competing tourism destinations (Box 1). High prices for telecommunications may also be hindering the diversification of offshore financial services. In addition, the fast growth in tourism demand has put pressure on the infrastructure, particularly transportation facilities and the provision of water services.

22. **Medium-term projections point to a gradual erosion in external competitiveness.** Output growth is estimated at 3 percent per year, consistent with a progressive loss of market share in the dynamic tourism sector. Tourism receipts are expected to pick up in coming years as a string of investment projects come on stream.[9] However, they would still fall short of the projected growth in U.S. tourism demand, because of increasing competition from neighboring Caribbean destinations.[10]

Figure 5. The Bahamas: Medium-Term Fiscal Outlook



23. **Under current policies, the fiscal deficit would rise to 3 percent of GDP over the medium term, maintaining pressures on reserves (Figure 5).** The deficit would narrow slightly to 2.6 percent of GDP in FY 2004/05, largely because of the rebound in growth and the lagged effects from the strengthening of tax

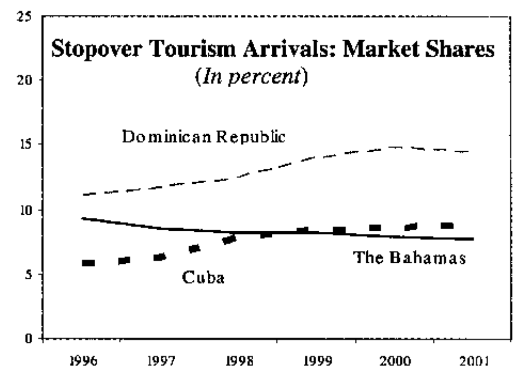
[9] Also, starting in 2006 the Tax Information Exchange Agreement with the United States will exempt from U.S. taxes spending for conventions held in The Bahamas.

[10] Over recent years, U.S. demand for foreign tourism services has grown about twice as fast as GDP. Were this trend to continue, U.S. demand for foreign tourism services would grow by 7 percent annually in 2004–08.

Box 1. Competitiveness in the Tourism Sector

The tourism sector has been the engine of growth. It represents more than 50 percent of GDP and fuels the economy directly, from the revenue earned through tourist expenditure, and indirectly through increased domestic demand by foreign direct investment in the sector.

A number of indicators suggest that The Bahamas may be losing market share relative to other Caribbean destinations. Although the lack of comprehensive and up-to-date data hampers the assessment, The Bahamas' share of installed rooms, stopover arrivals and tourist expenditure has decreased since 1995, mainly in favor of new competitors such as Cuba, Mexico (Cancun) and the Dominican Republic. The Bahamas has increased its presence in the cruise market, but this segment is less profitable because cruise visitors tend to spend much less than stopover visitors.



Relatively high wage and utility costs combined with large red tape costs of doing business are likely important factors behind the shrinking market share. A private sector study estimates that operating costs are 20 and 185 percent higher, respectively, in The Bahamas compared to similar hotels in the Caribbean and North America, while gross operating profits are between one half and one third lower.

- High operating costs are partly a consequence of the low flexibility of wage contracts. Salary increases are rarely linked to productivity, and are often pre-arranged in multi-year wage agreements, leaving little room for adjustments to unexpected shocks.
- Utility costs are estimated to be 30 percent higher than in competitor countries, partly because of difficult geographic characteristics, but also because of the inefficiency of public companies.
- Red-tape costs have been identified as investors' number one complaint in a January 2003 study by The Bahamas Chamber of Commerce.

Over the past two years, the appreciation of the Bahamian currency in real effective terms against the main Caribbean competitors may have further eroded The Bahamas' competitive position. As noted, the Bahamas dollar appreciated by 11 percent in real effective terms against its main regional competitors over 2001–02, erasing most of the gains of the previous five years. With a fixed exchange rate, preserving the country's competitive position relies heavily on prudent fiscal management and flexibility in labor and other factor markets, magnifying the benefits of structural reforms.

administration in the previous fiscal year. It would then widen gradually to 3 percent of GDP as the increase in tax revenue is more than offset by higher spending in wages and infrastructure maintenance, and a growing interest bill. Foreign investment flows to the tourism and financial sectors would be barely enough to finance the external current account deficit. Foreign reserves would remain around US$425 million, with the ratio of reserves to imports declining to about two months of imports by 2008.

24. **Continued debt accumulation increases the vulnerability of the economy to adverse domestic or external shocks.** Under the baseline scenario, the debt burden grows slowly but steadily to over 42 percent of GDP by 2008 (11 percentage points above its 2000 level). The ratio of foreign-currency debt doubles to 9 percent of GDP. Stress tests show that a slowdown in economic activity would trigger negative debt dynamics in the absence of fiscal adjustment, with the debt-to-GDP ratio rising to 47 percent, and the external debt ratio to 14 percent. The fiscal deficit needs to be lowered to about 2 percent of GDP to stabilize the debt-to-GDP ratio at around 38 percent and ensure debt sustainability (Box 2).

II. Policy Discussions

25. **Policy discussions focused on the appropriate path of fiscal adjustment in the context of a slow economic recovery, large public financing needs, and increasing challenges to maintaining external competitiveness.** The authorities agreed with staff that the uncertain outlook called for fiscal restraint in the near term. Staff recommended additional fiscal adjustment over the medium term to regain margins for countercyclical policies, and greater emphasis on structural reforms to preserve competitiveness. The authorities argued that it would be difficult to proceed with structural changes, including tax reforms, in the absence of greater political consensus. In the event, staff estimates that the measures included in the draft budget (presented to Parliament after the return of the mission) would not reduce the deficit enough to stabilize the debt-to-GDP ratio in the near and medium term.

A. Fiscal Policy

26. **At the time of the discussions, the authorities were considering a reduction in the fiscal deficit to about 2 percent of GDP in FY 2003/04.** Staff supported this objective, but emphasized the need for further fiscal adjustment in following years. Although the authorities saw benefits in further fiscal consolidation, they were non-committal on measures or a time span to achieve this objective.

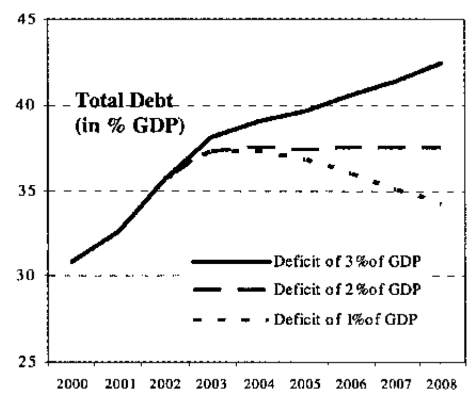
27. **The authorities expressed their intention to focus first on expenditure control to contain the deficit.** They plan to seek the postponement of the wage increase scheduled for FY 2003/04 in the context of the 1999 wage agreement, and to exert significant restraint in

Box 2. Public Debt Sustainability Analysis

Background

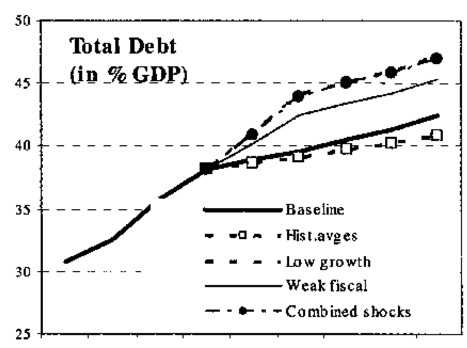
Total central government debt has increased significantly since 2001, reflecting a weakening of the fiscal accounts. The debt-to-GDP ratio, at 36 percent at end 2002, was 6 percentage points higher than its end-2000 level. However, the impact on terms of vulnerability was reduced by the low share of external or short-term obligations in the debt stock. The bulk of the debt (72 percent) corresponds to long-term domestic paper with an average maturity of 10 years. Although the share of foreign-currency debt increased markedly in 2002 as the government financed the fiscal deficit with a U.S. dollar loan intermediated by local banks, it remains small (13 percent of total government debt, 4½ percent of GDP). There is virtually no short-term external debt. The main holders of public securities are the NIB (34 percent of total public debt), banks (29 percent) and the central bank (10 percent).

Medium-term outlook



Staff estimates that the measures included in the FY 2003/04 budget would only reduce the deficit to 2.8 percent of GDP, which is insufficient to stabilize the debt-to-GDP ratio in the near or medium term. In the absence of additional measures, the debt burden would grow slowly but steadily to reach 42 percent of GDP in 2008. The ratio of foreign-currency debt to GDP would double over 2003–08 to 9 percent (21 percent of total government debt), as the authorities tap international markets to take advantage of longer maturities and avoid crowding out domestic financial transactions. Policy actions aimed at lowering the fiscal deficit to about 2 percent of GDP would stabilize the debt-to-GDP ratio and avoid adverse debt dynamics. Further deficit reduction (to 1 percent of GDP) is required to bring the debt-to-GDP ratio gradually back to its pre-slowdown level, and restore the scope for countercyclical fiscal policy.

Sensitivity analysis



Continued debt accumulation increases markedly the vulnerability of the Bahamian economy and would threaten fiscal sustainability in the face of adverse shocks. Stress tests (following the methodology approved by the Executive Board) show that a growth slowdown would push the debt ratio up sharply, by 9 percentage points, to 47 percent of GDP. External debt rises most in a scenario of low tourism receipts. Other adverse shocks lead to smaller, but still sizeable debt growth (6 percentage points on average).

The use of historical data gives rise to more modest increases in debt ratios than in the baseline, reflecting the existence of virtual primary balance and low interest rates in the recent past. Because of the absence of reliable GDP and debt data, all these ratios may underestimate the debt-to-GDP ratios.

granting merit increases. Containing the public wage bill is also important to limit parallel pressures in the private sector that could have adverse effects on competitiveness.

28. **Staff argued that transfers to inefficient public enterprises should be reduced to make space for needed improvements in tourism infrastructure.** The authorities saw little scope for strengthening the financial position of the public corporations in the immediate future. They thought that subsidies to the national airline company were justified on national and strategic grounds.[11] Major structural problems at the Water and Sewerage Corporation (including widespread leakages through the water pipes) are being addressed with support from the IADB, but it is not likely that they will be resolved soon.

29. **The authorities aim at raising tax revenue through improvements in tax administration.** Given the large prevailing levels of tax evasion, staff strongly supported these efforts, but warned that they require time and determined political support to bear fruits.[12] A comprehensive review of existing and prospective tax exemptions to assess their effective net benefits and reduce evasion is warranted.[13] The authorities were receptive to the argument, but were eager to maintain investment incentives at a level comparable to those offered by regional competitors.

30. **The authorities said that they were considering additional tax measures to reduce the fiscal deficit to about 2 percent of GDP.** The staff recommended focusing on taxes with the least distortionary effects. Property taxation could be strengthened through the reassessment of property values. There is also scope to raise certain licensing fees while simplifying their overall structure and to increase specific excise taxes (including on liquors and motor fuels).

31. **Staff estimates that the draft budget will result in a deficit equivalent to 2.8 percent of GDP, larger than the 2.2 percent projected by the authorities.[14]** Spending restraint, including modest wage growth, would keep the ratio of public expenditure to GDP broadly stable. However, only two revenue measures were included in the budget: stricter penalties for non compliance with certain taxes, and higher fees for a number of government

[11] To ensure regular air service to the smaller islands, and to reduce the dependency of the local tourism industry on foreign air carriers.

[12] Evasion is estimated at about 50 percent for property taxes and business licensing fees, and penalties for noncompliance are either minimal or not enforced. Evasion of customs duties is also widespread.

[13] Most investments are exempted from property taxes and customs duties on imports.

[14] This discrepancy is explained by a different estimate of the yield of tax administration measures (0.3 percent of GDP), and the reclassification of the sale of government shares in two companies (0.3 percent of GDP) from revenue to financing.

services. With these measures, and the slow economic recovery, the primary position will remain in deficit. In a later communication with staff, the authorities have expressed their commitment to contain the deficit at 2.2 percent of GDP, and their readiness to take additional revenue measures, if needed, to reach that objective. They expect the rebound in the global economy to strengthen tax collections, and found it premature to implement stronger adjustment measures at this time.

32. **Staff had argued that over the medium term, the authorities should aim at bringing the debt-to-GDP ratio back to the 32–34 percent range registered before the slowdown.** Reducing the deficit to about 1 percent of GDP over a period of three years would lower the debt ratio to 34 percent of GDP by 2008. The lower debt burden would allow the authorities to undertake countercyclical policies to mitigate the impact of adverse shocks. This is important because the small size of the Bahamian economy, and its high dependency on U.S. tourism demand, makes it highly vulnerable to unexpected shocks.

33. **Tax reform is necessary to ensure fiscal sustainability.** The reliance on a complex system of customs and tourism duties increases the vulnerability of tax revenue to cyclical fluctuations, and facilitates tax evasion. Staff recommended shifting to a broad-based value-added tax or sales tax, in line with FAD recommendations. The authorities were concerned that a tax reform would provide avenues for increasing the already high levels of tax evasion, because of administrative shortcomings and widespread public resistance to new taxes. The authorities thus favored a less ambitious approach focusing on improving customs administration through enhanced valuation and auditing techniques and staff training.[15] They were also considering the establishment of a tax commission to sensitize public opinion on the need to raise revenue before committing to the reform itself.

B. Monetary and Exchange Rate Policies

34. **The authorities indicated their intention to maintain the freeze on credit in domestic currency to protect reserves.** The staff concurred with the need for continued credit restraint, but recommended a gradual move to indirect instruments to manage liquidity. Continuing quantitative controls distort credit allocation, stifle bank competition and foster financial disintermediation. The authorities noted that a low credit demand elasticity makes direct controls a more reliable and effective instrument than interest rates to control credit expansion. Regarding disintermediation, nonbank credit activity has remained small, but the central bank stands ready to take remedial regulatory actions should negative developments unfold in this area.

35. **The exchange rate peg continues to serve the country well.** The small size of the economy and its strong commercial ties with the United States argue for maintaining the peg

---

[15] A FAD technical assistance mission visited The Bahamas in March 2003 to advise on ways to strengthen customs administration.

to the U.S. dollar. Inflation has remained low, contributing to the stability of the currency in real effective terms.

36. **Staff pointed out that the level of international reserves remains relatively low.** Although short-term external debt is very small, and controls on capital transactions reduce the risk of sudden capital flight, the narrow basis of growth increases the vulnerability of the economy in the face of external shocks. Staff recommended that the reserves be increased, at a minimum, to three months of imports, or 100 percent of the monetary base.[16] The authorities, however, felt comfortable with the present level of reserves and saw no pressing need to increase it.

37. **The authorities expressed their intention to gradually dismantle restrictions on capital transactions, although in a prudent manner.** Staff pointed out that the liberalization of the capital account could support the deepening of domestic capital markets and increase competition in the domestic financial sector. However, it agreed with the authorities on the need to proceed cautiously, and advised them to ensure that adequate prudential regulations were first in place to contain the potentially adverse impact of large and volatile short-term capital flows. A higher level of reserves, a more flexible monetary framework, and a stronger fiscal position would also be recommendable before dismantling capital restrictions.

C. Financial Sector Policies

38. **The authorities have continued to strengthen the supervisory framework** (Box 3). The central bank issued new licensing guidelines and started the transformation of prudential norms into transparent regulations. Cooperation with foreign regulators has been intensified, and the scope for on-site examinations broadened. Efforts are ongoing to harmonize the activities of the five regulatory agencies to eliminate potential overlaps. Staff welcomed these steps, and encouraged the authorities to continue addressing remaining weaknesses, following the recommendations of the Module 2 assessment report now being finalized. It advised the authorities to further develop the framework for exchanging information with foreign regulators, and recommended ensuring that regulatory agencies have access to the resources they need for an efficient and independent undertaking of their duties.

39. **A comprehensive bill is now being drafted to enhance the anti-money laundering/combating the financing of terrorism regime.** The authorities expect to submit it to Parliament in the second half of 2003, after consultation with domestic regulators and

---

[16] On average, in 2000–01 reserve holdings in the Caribbean economies were equivalent to four to five months of merchandise imports.

Box 3. Recent Developments in Financial Regulation

The development of The Bahamas' international financial sector has been stimulated by a combination of economic and political stability, low taxation, and a largely deregulated environment. The central bank estimates that the financial sector accounts for 15 percent of GDP, with half of this contribution generated by banks, and the rest by insurance companies, mutual funds and providers of ancillary services. The offshore financial center, one of the largest in the Caribbean, comprises 276 banks and trust companies managing US$280 billion in assets (U.S. banks hold 10 percent of active licenses and 70 percent of assets). The much smaller domestic financial sector (9 banks and 16 trust companies) is more closely linked to domestic activity (it accounts for 70 percent of sectoral employment and 60 percent of local spending). Strict regulations and foreign exchange controls constrain transactions between offshore and domestic banks.

In late 2000, The Bahamas launched a comprehensive legislative effort to strengthen financial regulation and supervision practices, following the concerns raised by the Financial Action Task Force (FATF) and the Financial Stability Forum (FSF) over risks of money laundering and fraud in the offshore financial center. Under the lead of the central bank, the regulatory and supervisory framework has been continuously improved over the past two years. A Module II financial sector assessment was conducted by a MFD mission in late 2002. The conclusions—now being discussed with the authorities—are expected to guide future policy actions.

Key reforms have been introduced to bring the regulatory system closer to international standards and further improvements are under way.

- Licensing requirements have been tightened, and new physical presence requirements have been established with a view to eliminate "shell" banks by June 2004. Since end 2000, over 100 banking licenses have been revoked or terminated.
- *Ad hoc* prudential norms, applied at the time of licensing, are being transformed into transparent regulations and guidelines.
- The range of supervisory intervention tools available to the central bank has been extended. The frequency and scope of on-site supervision activities have been expanded to assess risk management and corporate governance practices.
- Regulations on customer identification and the reporting of suspicious transactions were strengthened, and cooperation with foreign regulators in the fight against money laundering has increased. Banks have been verifying the identity of customers, international business companies no longer issue bearer shares, and a Financial Intelligence Unit was created to monitor and investigate suspicious transactions reports.

So far, regulatory tightening appears to have had only a modest impact on the volume of business of offshore and domestic financial institutions. In particular, the closing of "shell" banks (that do not have meaningful physical presence in The Bahamas) does not seem to have affected employment or assets in a noticeable way. Both the authorities and industry participants are of the view that upgraded regulations will benefit the jurisdiction over the medium term by enhancing reputation and transparency.

The Bahamas: Selected Indicators of the Financial Sector

	1997	*2000*	*2002*
Licensed banks	418	410	301
Employment */	3,942	4,460	4,586
Assets managed (in US$billion)	243	272	279
Local spending (in percent of GDP) */			
Banks and trusts	7.0	7.4	7.7
Of which: offshore banks	2.3	3.0	3.1

Sources: CBB, BIS, and Fund staff estimates.
*/ Latest data corresponds to 2001.

the public in general.[17] The authorities agreed that quick progress on this initiative was important.

40. **Greater reliance on market forces in determining interest rates on government paper would enhance transparency and foster capital market deepening.** The interest rates at which public bonds are offered in primary placements are now determined by the central bank. In general, private sector demand for this paper has exceeded supply. An interest-based auction system would better reflect the cost of public debt, while providing benchmarks for the placement of private securities. The authorities were concerned that limited competition in the domestic banking sector would give the two largest banks excessive influence over the level of interest rates, and possibly increase unduly public borrowing costs.

D. Public Debt Management Policies

41. **The authorities are considering placing sovereign bonds in international markets for US$200 million (3.8 percent of GDP) to refinance their foreign-currency bank debt and fund part of next fiscal year's deficit.** Foreign-currency obligations represent only 13 percent of government debt (4½ percent of GDP) and The Bahamas, with an investment-grade credit rating, could access foreign financing at relatively long maturities and low interest rates.

42. **The mission recommended that the government use this option prudently.** External financing should not be used to delay necessary fiscal adjustment, particularly in view of the high degree of uncertainties in the outlook. However, in a context of gradual fiscal consolidation, foreign borrowing could help in reducing the stock of domestic debt, particularly government debt with the central bank (now at 3.2 percent of GDP), and support an increase in reserves. Similarly, proceeds from the privatization of BTC should be used to redeem government debt to the central bank.

43. **Staff recommended the development of a formal public debt management framework covering both government and government-guaranteed obligations.** It would better inform the authorities about the size and schedule of direct and contingent liabilities, and alternative sources of financing. The liabilities of the NIB represent fiscal contingent liabilities and as such should be integrated into this framework. Although the NIB is now in surplus, staff advised the authorities to formulate promptly appropriate pension reform measures, to protect its financial situation over the medium term (Box 4).

---

[17] The new law is expected to adhere to the provisions of relevant international conventions, including the 1999 Convention for the Suppression of Financing of Terrorism and the U.N. Security Council Resolution 1373.

Box 4. Long-Term Challenges Facing the National Insurance Board

The National Insurance Board (NIB) is a partially funded defined benefits pension plan. Set up in 1974 following the British social insurance model, it provides relatively generous benefits. Pensions equal to a maximum of 60 percent of wages are paid to contributors aged 65 or older. The contribution rate is set at 8.8 percent, with a ceiling of $400 per week (2.6 times the minimum wage) on insurable earnings.

The NIB ran a surplus of 1.1 percent of GDP in 2002. Benefits reserves, at $1.2 billion, represent more than 9 times total annual expenditure, or 23½ percent of GDP.

However, the low contribution rate and high administrative costs put increasing pressure on the NIB's financial results. Since the early 1990s, the NIB's overall surplus is fully derived from investment income, as total expenditure exceeds total contributions. The present value of assets and contributions has fallen well below the present value of benefits due to past and present contributors.

Demographic trends are expected to worsen the situation further. In the next twenty years, the ratio of contributors to pensioners will decrease from 10 to 4. In a pessimistic scenario developed by the authorities, with no change in policies, the NIB would incur its first cash flow deficit in 2014, and its reserves would be depleted by 2025.

The challenges faced by the NIB are similar to those faced by other Caribbean countries. The contribution rate is within the 6–11 percent regional range, and requirements for benefits, including the retirement age and minimum enrollment period, are also comparable. Benefit reserves across the region stand at around 20 to 30 percent of GDP, with the ratio of reserve to annual expenditure in the 9–20 range.

A number of reforms should be implemented to address these long term challenges.

- An increase in the contribution rate is an essential requirement to achieve sustainability. The average contribution rate required to fully cover expenditure over the next 60 years is 15½ percent, almost double the current one. The rate could be raised gradually over seven years, starting in 2004.
- The ceiling on insurable wages should also be increased to better reflect labor market trends.
- Requirements for benefits should be tightened, raising the minimum contribution period from three to ten years. The number of years over which wages are averaged for calculating pensions should also be raised to ensure that pension amounts more closely reflect career earnings.
- Administrative expenses—equal to 19 percent of contribution income—could be reduced significantly through substantial staff retrenchment.

Another key reform would be to allow the NIB to invest part of its resources abroad. The size of the NIB relative to the Bahamian economy, and the restriction on investing overseas, makes it difficult to find suitable investments. Almost one third of the NIB portfolio is now held in relatively low-yielding short-term bank deposits, a share that is not consistent with the long-term nature of NIB liabilities.

E. Growth and Competitiveness

44. **Discussions focused on measures to preserve competitiveness, particularly in the areas of utilities and infrastructure.** The authorities' and staff views differed about the potential payoffs of structural reforms in these areas, and the priority they deserved in their policy agenda.

45. **The authorities preferred a gradual, selective approach to structural policy reform, including trade reform.** They stressed the importance of gaining public support before introducing structural changes. Although recognizing that The Bahamas is a relatively high cost tourism destination, the authorities did not believe that the risk of losing market share was very high. They thought that the proximity to the United States and a focus on high-income demand largely protected The Bahamas from regional competition.

46. **However, the authorities were concerned about a perceived slowdown in employment growth.** To address that issue, they were promoting the inclusion in labor contracts of clauses linking wage increases to productivity, to ensure that they are more closely in line with economic performance. They were committed to maintaining a favorable business climate and were taking steps to streamline administrative procedures for approval of new investments. Projects to upgrade transportation infrastructure were also under study.

47. **Staff welcomed these steps but recommended a more ambitious approach to reforms to raise potential output growth.** It praised the authorities' progress toward the privatization of BTC, and encouraged them to prepare for further sales of public companies, underscoring that it would help competitiveness by lowering utility costs. There may also be scope for granting concessions to private operators in critical areas such as airports and ports, with a view to alleviating the demand on scarce public funds and improving efficiency. Close attention needs to be paid to a continued upgrading of the relevant regulatory frameworks to ensure that services are competitively and fairly priced.

48. **Staff also encouraged the authorities to proceed with trade reform and participation in multilateral trade arrangements.** The authorities view tariffs as a key revenue source rather than an instrument of protection, and a further rationalization of the tariff structure is conditional upon the implementation of a tax reform. The mission argued that the current trade regime is a source of distortions and that there is scope to reduce tariffs and their dispersion, as well as streamlining widespread tariff exemptions.

F. Statistical Issues

49. **The Bahamas participates in the General Data Dissemination System but statistical data and practices remain weak**. In particular, series for the national accounts and labor statistics are lacking. Public enterprise data is available with long delays and under variable formats. Real sector indicators are only available with long delays and coverage is very limited. Gaps and inconsistencies in key economic data constitute a serious impediment to the assessment of vulnerabilities and the formulation of appropriate policies to address them.

50. **Staff urged the authorities to take immediate steps to prepare and publish reliable official national accounts series,** and request further technical assistance as needed. Staff also recommended the preparation of a broader set of short-term economic indicators to guide policy decisions and enhance the short-term monitoring of the economy. The authorities ascribed part of the statistical problems to a general reluctance of the public to provide information, but expressed their intention to act promptly to redress the situation, including through public campaigns and technical assistance.

III. Staff Appraisal

51. **The Bahamas has a long track record of prudent macroeconomic management.** A dynamic tourism sector, financial stability, and solid institutions have underpinned the country's economic success. These strengths have allowed The Bahamas to withstand adverse shocks relatively well. In particular, the moderate level of public debt (36 percent of GDP at end 2002), sound monetary conditions, and a reputation for cautious monetary management, have allowed the government to delay fiscal adjustment without compromising macroeconomic stability after the 2001 downturn.

52. **The economy is expected to strengthen gradually in 2003 and 2004, but remains vulnerable to a prolonged U.S. slowdown and growing competition from other tourist destinations.** The scope for policy maneuver has narrowed because of the weakening in the fiscal position and the decline in reserves. Economic policy should focus on raising international reserves and regaining room for fiscal maneuver as a shield against unforeseen contingencies. Structural reforms should also be pursued to heighten resilience and improve competitiveness over the medium term.

53. **The first priority is to consolidate the fiscal position.** The measures included in the FY2003/04 budget would reduce the fiscal deficit to 2.8 percent of GDP, which would be insufficient to stabilize the public debt-to-GDP ratio and, in the face of unexpected shocks, could threaten fiscal sustainability. It is important to preserve The Bahamas' record of sound fiscal management and regain margin for countercyclical policy response. To this end, the recent decline in the tax ratio needs to be reversed. Additional spending restraint, particularly with respect to transfers to inefficient public enterprises, is also recommended. Moreover, staff urges the authorities to promptly identify contingency measures to ensure that they meet the FY 2003/04 budget targets.

54. **Tax reform is required to ensure fiscal sustainability over the medium term.** Shifting to a broad-based value-added tax or sales tax would strengthen the tax base, eliminate distortions, and reduce the vulnerability of the fiscal accounts to future cyclical downturns. The authorities should move aggressively and without delay to garner political support for such reform so as to be able to proceed with implementation.

55. **The exchange rate peg to the U.S. dollar remains appropriate, but should be supported by a higher level of reserves.** The low level of international reserves increases

the economy's vulnerability to external shocks. Fiscal adjustment would facilitate the increase in net reserves by allowing a reduction in government debt with the central bank.

56. **Credit restraint remains appropriate until the fiscal and international reserve positions have strengthened.** However, staff recommends a gradual move toward a more flexible and market-oriented framework for liquidity and credit management. The prudent, gradual relaxation of foreign exchange controls could help deepen the domestic credit market and foster competition in the banking sector if accompanied by adequate prudential regulations, higher foreign reserves, flexible money management, and a stronger fiscal position.

57. **The authorities should use external financing prudently while still aiming at reducing the debt-to-GDP ratio.** A formal public debt management framework integrating government and government-guaranteed obligations (including those of public corporations) would help guide decisions on the appropriate balance between domestic and external debt.

58. **The authorities should be commended for their continuing efforts to improve financial supervision and regulation**, including ongoing efforts to promptly introduce legislation prohibiting the financing of terrorism, in accordance with relevant international standards. They should continue to develop their framework for cooperation with regulatory agencies in other countries.

59. **Further progress in the implementation of structural reforms would help lower costs and preserve competitiveness.** Progress has been slow since the last consultation, continuing to constrain long-term growth prospects. Steps to increase the flexibility of wage arrangements, and to finalize the privatization of the telecommunications company, are welcome. There is scope to further private sector participation and efficiency in the utilities and infrastructure sectors to reduce costs.

60. **Policy formulation and monitoring continue to be hampered by severe gaps and inconsistencies in economic data, and urgent improvements are needed in some key areas.** Staff urges the authorities to move resolutely to improve the quality, coverage and timeliness of economic data.

61. It is recommended that the next Article IV consultation be held on the regular 24-month cycle.

Table 1. The Bahamas: Selected Economic Indicators

	1998	1999	2000	2001	Prel. 2002	Proj. 2003
(Annual percentage changes; unless otherwise indicated)						
Real sector						
Real GDP 1/	3.0	5.9	4.9	-2.0	0.7	0.9
Nominal GDP 1/	6.3	9.1	7.6	-0.1	2.9	2.6
Consumer price index (annual average)	1.3	1.3	1.6	2.0	2.0	1.7
Unemployment rate (in percent)	7.8	7.5	...	...	...	...
Total visitor arrivals	-3.1	9.0	15.2	-0.4	5.1	4.0
Of which						
Air arrivals	-4.7	10.3	3.0	-2.9	-2.5	2.0
Cruise arrivals	-1.2	14.5	26.8	1.6	9.8	4.9
Central government finances 2/						
Current revenue	11.3	5.1	14.2	4.3	-10.5	2.2
Current expenditure	6.6	4.9	9.4	3.5	5.8	1.7
Capital expenditure and net lending	-18.3	4.9	8.7	-4.0	-1.6	4.7
Financial sector						
Net domestic assets 3/	11.4	11.1	8.6	8.2	7.1	-0.4
Credit to the nonfinancial public sector 3/	1.6	0.2	-3.1	2.2	2.8	-1.8
Credit to the private sector 3/	12.0	11.6	15.4	8.8	5.0	2.1
Liabilities to the private sector	15.2	10.1	7.5	3.6	3.5	3.1
Base money	20.5	20.5	-3.4	12.9	10.8	0.4
Average bank deposit rate (in percent)	5.6	4.5	4.0	4.2	4.2	...
Average bank lending rate (in percent)	12.3	11.8	11.7	11.5	11.4	...
External sector						
Exports of goods and services	3.1	20.4	23.8	-6.0	-1.8	3.3
Of which						
Travel receipts (net)	-5.8	15.9	19.5	-4.4	-4.5	4.3
Imports of goods and services	13.8	0.2	14.1	-9.6	-2.3	5.3
Effective exchange rate (end of period; depreciation -)						
Nominal	0.5	0.7	1.3	0.6	1.1	...
Real	0.3	-0.7	-1.1	1.9	0.1	...
(In percent of GDP; unless otherwise indicated)						
Central government 2/						
Current balance	1.3	1.3	2.1	2.3	-0.8	-0.7
Overall balance	-1.7	-1.6	-0.8	-0.4	-3.4	-3.4
External sector						
Current account balance	-23.8	-8.9	-8.4	-6.4	-6.3	-7.7
Overall balance (increase -)	-2.8	-1.4	1.2	0.6	-1.2	-1.0
External public debt (end of period)	3.3	3.0	2.8	3.3	4.6	6.0
Memorandum items:						
Net international reserves						
(end of period; millions of U.S. dollars)	338.8	404.0	342.6	312.4	373.2	423.6
In percent of base money	109.2	108.2	94.9	76.7	82.7	93.5
In months of merchandise imports	2.3	2.7	1.9	2.1	2.5	2.7
External debt-service ratio 4/	3.3	2.9	2.3	2.7	2.5	3.9
Total central government debt	34.2	33.1	30.8	32.6	35.7	38.1
GDP (in millions of Bahamian dollars) 1/	4,190	4,573	4,920	4,917	5,058	5,187
Nominal GDP per capita (in U.S. dollars) 1/	14,314	15,354	16,238	15,956	16,140	16,276

Sources: Central Bank of The Bahamas; Ministry of Finance; and Fund staff estimates and projections.

1/ Estimated by the staff on the basis of partial indicators.
2/ Corresponds to the fiscal year ending June 30.
3/ In relation to liabilities to the private sector at the beginning of the year.
4/ In percent of exports of goods and nonfactor services.

Table 2. The Bahamas: Operations of the Central Government 1/

	FY 97/98	FY 98/99	FY 99/00	FY 00/01	FY 01/02	Projections FY 02/03	Projections FY 03/04
	(In percent of GDP)						
Current revenue	**18.8**	**18.3**	**19.3**	**19.5**	**17.2**	**17.1**	**17.7**
Tax revenue	16.8	16.6	17.7	17.4	15.5	15.8	16.4
Taxes on international trade	11.2	10.5	11.7	11.0	9.9	9.9	10.0
Tourism taxes	1.6	1.6	1.7	1.7	1.7	1.8	1.9
Miscelaneous taxes	4.0	4.6	4.2	4.1	3.9	4.0	4.4
Other	0.1	0.0	0.1	0.6	0.0	0.0	0.0
Nontax revenue	2.0	1.7	1.6	2.0	1.7	1.3	1.3
Total expenditure	**20.5**	**20.0**	**20.1**	**19.9**	**20.6**	**20.5**	**20.5**
Current expenditure	**17.5**	**17.0**	**17.2**	**17.2**	**17.9**	**17.8**	**17.8**
Wages and salaries 2/	9.4	8.8	9.3	9.1	9.5	9.7	9.5
Goods and services 2/	3.8	4.0	4.0	4.3	4.6	4.2	4.2
Interest payments 2/	2.3	2.3	2.0	1.8	2.0	2.0	2.3
Subsidies and transfers 2/	2.0	2.0	1.9	1.9	1.8	1.9	1.8
Current balance	**1.3**	**1.3**	**2.1**	**2.3**	**-0.8**	**-0.7**	**-0.2**
Capital expenditure	**3.0**	**2.9**	**2.9**	**2.7**	**2.6**	**2.7**	**2.6**
Capital formation	2.0	2.0	2.1	1.7	2.0	1.8	1.7
Capital transfers and net lending	1.0	0.9	0.8	1.0	0.6	0.8	0.9
Overall balance	**-1.7**	**-1.6**	**-0.8**	**-0.4**	**-3.4**	**-3.4**	**-2.8**
Financing	**1.7**	**1.6**	**0.8**	**0.4**	**3.4**	**3.4**	**2.8**
Foreign financing	-0.5	0.2	0.4	-0.1	-0.3	0.1	4.1
Domestic financing	2.2	1.4	0.4	0.5	3.7	3.3	-1.3
Memorandum item:							
Primary balance	0.7	0.6	1.2	1.4	-1.4	-1.3	-0.5

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Corresponds to the fiscal year ending June 30.

2/ In FY 1999/2000 the government established the Public Hospitals Authority (PHA) as an autonomous entity. For comparability of treatment with the previous years,the staff reclassified central government trasfers to the PHA as wages and purchases ofgoods and services.

Table 3. The Bahamas: Operations of Public Corporations 1/

(In percent of GDP)

	1998	1999	2000	2001	Prel. 2002	Proj. 2003
I. Operations of the Nonfinancial Public Corporations 1/						
Total revenue	**13.0**	**13.2**	**13.3**	**13.0**	**13.4**	**13.5**
Current revenue	12.0	12.3	12.5	12.7	13.0	13.2
Of wchih: Operating revenue	11.8	12.2	12.5	12.5	12.8	13.0
Capital revenue	0.9	0.9	0.8	0.3	0.3	0.3
Total expenditure	**14.7**	**16.0**	**13.6**	**13.8**	**13.4**	**13.9**
Current expenditure	11.2	13.1	11.6	11.8	11.8	11.8
Of which: Operating expenditure	10.0	10.3	11.0	11.2	11.3	11.2
Interest payments	0.8	0.8	0.4	0.5	0.3	0.4
Capital expenditure	**3.5**	**2.9**	**2.1**	**2.0**	**1.6**	**2.1**
Operating balance	**1.8**	**1.9**	**1.5**	**1.3**	**1.5**	**1.8**
Current account balance	**0.8**	**-0.8**	**0.9**	**0.9**	**1.2**	**1.4**
Overall balance	**-1.3**	**-2.1**	**-0.7**	**-0.5**	**0.1**	**-0.4**
Total financing	**1.3**	**2.1**	**0.7**	**0.5**	**-0.1**	**0.4**
External	0.4	0.0	-0.2	-0.6	-0.3	0.0
Domestic	0.9	2.1	0.9	1.1	0.3	0.4
II. Operations of the National Insurance Board						
Revenue	**3.6**	**3.6**	**3.6**	**3.8**	**3.8**	**4.0**
Contributions	2.0	2.3	2.3	2.4	2.4	2.5
Investment income	1.4	1.3	1.2	1.3	1.3	1.3
Transfers from central government	0.1	0.1	0.1	0.1	0.1	0.1
Expenditure	**2.3**	**2.5**	**2.6**	**2.9**	**2.6**	**2.7**
Current	2.1	2.3	2.3	2.5	2.5	2.6
Wages and salaries	0.3	0.3	0.3	0.3	0.2	0.2
Benefit payments	1.6	1.8	1.8	1.9	2.1	2.1
Goods and services	0.2	0.2	0.2	0.3	0.2	0.2
Capital	0.2	0.2	0.4	0.4	0.1	0.1
Operating balance	**-0.1**	**0.0**	**0.1**	**-0.1**	**-0.1**	**-0.1**
Current account balance	**1.5**	**1.4**	**1.4**	**1.3**	**1.2**	**1.4**
Overall balance	**1.3**	**1.1**	**1.0**	**0.9**	**1.1**	**1.2**

Sources: Ministry of Finance; Public Corporations; National Insurance Board; and Fund staff estimates and projections.

1/ The Bahamas Telecommunications Company, Bahamas Electricity, Water and Sewerage, Bahamasair, and Broadcasting Corporation.

Table 4. The Bahamas: Summary Accounts of the Central Bank and the Financial System

	1998	1999	2000	2001	Prel. 2002	Proj. 2003
	(In millions of Bahamian dollars, end of period)					
Central bank						
Net international reserves	338.7	404.0	342.6	312.4	373.2	423.6
Net domestic assets	-28.5	-30.5	18.3	94.9	78.3	29.6
Nonfinancial public sector	53.1	51.2	114.3	185.1	164.5	123.3
Central Government	59.3	69.8	120.8	187.5	173.0	131.8
Other	-81.6	-81.7	-96.1	-90.2	-86.2	-93.7
Reserve money	310.2	373.5	360.8	407.3	451.5	453.2
Currency held by the private sector	125.6	148.4	151.4	153.5	154.8	159.1
Liabilities with financial institutions	184.6	225.1	209.4	253.8	296.7	294.1
Financial system						
Net foreign assets	-23.9	-50.8	-84.1	-234.5	-357.3	-234.1
Of which						
Commercial banks and OFIs	-362.6	-454.8	-426.7	-546.9	-730.5	-657.7
Net domestic assets	2,759.5	3,064.0	3,322.1	3,588.0	3,827.7	3,813.4
Credit to the nonfinancial public sector	429.8	434.6	340.0	411.6	505.1	441.1
Central Government	452.6	495.5	508.5	626.0	651.4	567.9
Credit to the private sector	2,836.6	3,155.2	3,618.6	3,902.1	4,069.6	4,142.8
Other	-506.9	-525.8	-636.5	-725.7	-747.0	-770.5
Liabilities to the private sector	2,735.6	3,013.2	3,238.0	3,353.5	3,470.4	3,579.2
Money	573.9	715.0	760.6	747.9	777.2	798.8
Currency held by the private sector	125.6	148.4	151.4	153.5	154.8	159.1
Demand deposits	448.3	566.6	609.2	594.4	622.4	639.7
Quasi-money	2,161.7	2,298.2	2,477.4	2,605.6	2,693.2	2,780.4
	(Annual percentage change in terms of liabilities to the private sector at the beginning of the period)					
Net foreign assets	3.8	-1.0	-1.1	-4.6	-3.7	3.5
Net domestic assets	11.4	11.1	8.6	8.2	7.1	-0.4
Credit to the Public sector	1.6	0.2	-3.1	2.2	2.8	-1.8
Credit to the Private sector	12.0	11.6	15.4	8.8	5.0	2.1
Liabilities to the private sector	15.2	10.1	7.5	3.6	3.5	3.1
Money	3.8	5.2	1.5	-0.4	0.9	0.6
Quasi-money	11.4	5.0	5.9	4.0	2.6	2.5
	(Annual percentage changes)					
Net domestic assets	10.9	11.0	8.4	8.0	6.7	-0.4
Credit to the nonfinancial public sector	9.7	1.1	-21.8	21.1	22.7	-12.7
Credit to the private sector	11.2	11.2	14.7	7.8	4.3	1.8
Liabilities to the private sector	15.2	10.1	7.5	3.6	3.5	3.1
Money	18.4	24.6	6.4	-1.7	3.9	2.8
Quasi-money	14.3	6.3	7.8	5.2	3.4	3.2
	(In percent of GDP)					
Credit to the private sector	67.7	69.0	73.5	79.4	80.5	79.9
Money	13.7	15.6	15.5	15.2	15.4	15.4
Liabilities to the private sector	65.3	65.9	65.8	68.2	68.6	69.0
Memorandum items:						
Net international reserves, in months of imports	2.3	2.7	1.9	2.1	2.5	2.7
Net international reserves, in percent of monetary base	109.2	108.2	94.9	76.7	82.7	93.5
Central bank credit to the public sector in percent of monetary base	17.1	13.7	31.7	45.4	36.4	27.2

Sources: Central Bank of The Bahamas; and Fund staff estimates.

Table 5. The Bahamas: Indicators of External and Financial Vulnerability

	1998	1999	2000	2001	Prel. 2002
Financial indicators					
Broad money (12-month percentage change)	15.2	10.1	7.5	3.6	3.5
Private sector credit (12-month percentage change)	11.2	11.2	14.7	7.8	4.3
Three-month treasury-bill rate (end of period)	3.5	1.5	0.9	3.0	2.3
Domestic public debt (in percent of GDP, end of period)	36.3	35.2	32.5	34.4	39.3
External indicators					
Exports of goods and services (12-month percentage change)	3.1	20.4	23.8	-6.0	-1.8
Imports of goods and services (12-month percentage change)	13.8	0.2	14.1	-9.6	-2.3
Current account balance (in percent of GDP)	-23.8	-8.9	-8.4	-6.4	-6.3
Capital account balance (in percent of GDP) 1/	26.6	10.4	7.1	5.8	7.5
Net international reserves (end of period, millions of US$)	339	404	343	312	373
In months of merchandise imports	2.3	2.7	1.9	2.0	2.5
In percent of base money	109.3	108.2	94.9	76.7	82.7
In percent of broad money	12.4	13.4	10.6	9.2	10.6
Commercial banks, net foreign assets (end of period, millions of US$)	-363	-455	-426	-547	-728
External public debt (in percent of GDP)	8.3	8.0	7.5	7.1	6.1
External debt service (in percent of exports of goods and services)	3.3	2.9	2.3	2.7	2.5
Central Government External debt service (in percent of government revenue)	3.9	4.4	2.6	2.6	8.8
REER appreciation (+) (end of period)	0.3	-0.7	-1.1	1.9	0.1
Banking sector risk indicators					
Total assets, percent of GDP	93.9	96.4	97.3	103.6	111.6
Assets in foreign currency, percent of total assets	11.2	11.1	10.8	11.0	13.0
Foreign currency deposits, percent of total deposits	2.2	1.7	2.5	2.6	2.5
Deposits maturing within 3 months, percent of total deposits	38.9	34.1	32.9	33.9	28.9
Net worth to risk-weighted assets ratio, percent	20.0	17.5	18.8	18.5	22.9
Nonperforming loans to total loans ratio, percent	6.2	5.1	5.1	4.8	4.4
Provisions to total loans ratio, percent	2.5	2.2	2.6	2.4	2.0
Provisions to nonperforming loans ratio, percent	41.0	43.1	51.5	49.8	44.8
Pre-tax net revenue, percent of net worth 2/	35.8	27.5	34.3	29.3	23.9
Pre-tax net revenue, percent of total assets 2/	2.9	2.5	3.5	3.3	2.7
Administrative expenses, percent of total assets	3.6	3.7	3.6	3.5	3.1
Liquid assets to deposits ratio, percent	20.1	21.2	17.2	18.1	18.8
Lending interest rate, percent	12.3	11.8	11.7	11.5	11.3
Deposit interest rate, percent	5.6	4.5	4.0	4.2	4.1
Average interest rate spread, percent	6.8	7.4	7.8	7.2	7.2

Sources: Central Bank of The Bahamas; and Fund staff estimates and projections.

1/ Includes errors and omissions.

2/ Data for 2002 reflects the year-to-date position to September, annualized.

Table 6. The Bahamas: Balance of Payments

	1998	1999	2000	2001	Prel. 2002	Proj. 2003
	(In millions of U.S. dollars)					
Current account balance	**-995.6**	**-409.0**	**-410.9**	**-312.9**	**-318.9**	**-399.7**
Trade balance	**-1,373.9**	**-1,249.3**	**-1,310.4**	**-1,110.8**	**-1,035.4**	**-1,120.8**
Exports	362.9	523.2	805.3	765.5	740.4	764.8
Imports	1,736.8	1,772.5	2,115.7	1,876.3	1,775.8	1,885.6
Service balance	**543.0**	**799.2**	**1,016.4**	**945.2**	**886.9**	**912.1**
Travel (net)	1,098.3	1,272.6	1,521.1	1,453.6	1,388.5	1,447.8
Construction services	-145.8	-100.9	-102.9	-33.0	-55.2	-67.7
Other services (net)	-409.5	-372.5	-401.8	-475.4	-446.4	-468.1
Income (net)	**-199.1**	**-199.1**	**-199.1**	**-199.1**	**-199.1**	**-199.1**
Of which: interests and dividends	-164.6	-88.7	-121.8	-142.3	-163.0	-184.3
Current transfers	**34.4**	**170.8**	**56.0**	**41.8**	**42.4**	**44.4**
Capital account balance	**859.9**	**583.5**	**421.5**	**242.3**	**440.3**	**450.1**
Capital transfers	-11.7	-13.6	-16.4	-20.3	-24.5	-25.1
Long-term public sector	-5.3	-5.0	-2.7	-22.1	-35.6	200.0
Disbursements	35.7	42.2	27.3	25.7	17.3	221.8
Amortization	-41.0	-47.2	-30.0	-47.8	-52.9	-21.8
Financial system	29.9	91.8	-28.0	120.4	205.4	-70.1
Direct investment	847.0	510.3	468.6	164.3	295.0	345.3
Net errors and omisions	**255.0**	**-109.3**	**-72.0**	**40.4**	**-60.6**	**0.0**
Change in net international reserves (increase -)	**-119.3**	**-65.2**	**61.5**	**30.2**	**-60.8**	**-50.4**
	(In percent of GDP)					
Current account balance	**-23.8**	**-8.9**	**-8.4**	**-6.4**	**-6.3**	**-7.7**
Trade balance	**-32.8**	**-27.3**	**-26.6**	**-22.6**	**-20.5**	**-21.6**
Exports	8.7	11.4	16.4	15.6	14.6	14.7
Imports	41.5	38.8	43.0	38.2	35.1	36.4
Service (net)	**13.0**	**17.5**	**20.7**	**19.2**	**17.5**	**17.6**
Of which: travel receipts	32.3	34.6	36.9	35.6	33.1	33.6
Income (net)	**-4.8**	**-2.8**	**-3.5**	**-3.8**	**-4.2**	**-4.5**
Current transfers	**0.8**	**3.7**	**1.1**	**0.9**	**0.8**	**0.9**
Capital account balance	**26.6**	**10.4**	**7.1**	**5.8**	**7.5**	**8.7**
Capital transfers	-0.3	-0.3	-0.3	-0.4	-0.5	-0.5
Long-term public sector	-0.1	-0.1	-0.1	-0.4	-0.7	3.9
Financial system	0.7	2.0	-0.6	2.4	4.1	-1.4
Direct investment	20.2	11.2	9.5	3.3	5.8	6.7
Net errors and omissions	**6.1**	**-2.4**	**-1.5**	**0.8**	**-1.2**	**0.0**
Change in net international reserves (increase -)	**-2.8**	**-1.4**	**1.2**	**0.6**	**-1.2**	**-1.0**
Net international reserves						
(end of period; millions of US$)	338.8	404.0	342.6	312.4	373.2	423.6
In percent of base money	109.3	108.2	94.9	76.7	82.7	93.5
In months of merchanise imports	2.3	2.7	1.9	2.0	2.5	2.7

Sources: Central Bank, Department of Statistics; and Fund staff estimates.

Table 7. The Bahamas: Public Debt

	1998	1999	2000	2001	Prel. 2002	Proj. 2003
	(In percent of GDP)					
Central government						
External debt	2.2	2.3	2.3	2.5	2.0	5.8
Internal debt	32.0	30.7	28.5	30.1	33.7	32.3
Of which : in foreign currency	1.1	0.6	0.4	0.8	2.6	0.2
Total central government debt	34.2	33.1	30.8	32.6	35.7	38.1
Of which : in foreign currency	3.3	3.0	2.8	3.3	4.6	6.0
Public corporations						
External debt	6.1	5.7	5.2	4.6	4.2	4.1
Internal debt	4.3	4.4	4.0	4.3	5.6	5.8
Of which : in foreign currency	0.2	0.1	0.1	0.1	1.4	1.3
Total public corporations debt	10.4	10.2	9.1	8.9	9.8	9.9
Of which : in foreign currency	6.3	5.9	5.2	4.7	5.6	5.4
Total public sector						
External debt	8.3	8.0	7.5	7.1	6.1	9.8
Internal debt	36.3	35.2	32.5	34.4	39.3	38.1
Of which : in foreign currency	1.3	0.8	0.5	0.9	4.0	1.5
Total public sector debt	44.6	43.2	40.0	41.5	45.4	48.0
Of which : in foreign currency	9.6	8.8	8.0	7.9	10.1	11.4

Sources: Central Bank of The Bahamas; and Fund staff estimates.

Table 8 The Bahamas: Summary Medium-Term Macro Flows

	2000	2001	Prel. 2002	Projections 2003	2004	2005	2006	2007	2008
	(Annual percentage change)								
National income									
GDP at constant prices	4.9	-2.0	0.7	0.9	2.5	3.0	3.0	3.0	3.0
Tourism									
Total Visitor arrivals	15.2	-0.4	5.1	4.0	3.5	4.0	4.0	4.0	4.0
Balance of payments									
Exports of goods and services	23.8	-6.0	-1.8	3.3	4.4	5.1	5.1	5.1	5.2
Of which									
Travel receipts (net)	19.5	-4.4	-4.5	4.3	4.3	5.1	5.1	5.1	5.1
Imports of goods and services	14.1	-9.6	-2.3	5.3	5.2	4.9	5.2	5.6	5.5
	(In percent of GDP)								
Balance of payments									
Current account	**-8.4**	**-6.4**	**-6.3**	**-7.7**	**-7.9**	**-7.7**	**-7.8**	**-8.0**	**-8.1**
Capital account	**7.1**	**5.8**	**7.5**	**8.7**	**7.7**	**7.9**	**7.8**	**7.9**	**8.2**
Public sector (net) 1/	-0.4	-0.9	-1.2	3.4	0.3	0.4	0.4	0.7	0.9
Private sector (net) 2/	7.5	6.6	8.7	5.3	7.3	7.6	7.3	7.3	7.3
Direct investment	9.5	3.3	5.8	6.7	6.9	7.1	6.9	6.8	6.7
Other private sector 3/	-2.0	3.3	2.9	-1.4	0.4	0.4	0.4	0.4	0.5
Change in net international reserves (increase -)	**1.2**	**0.6**	**-1.2**	**-1.0**	**0.2**	**-0.2**	**0.0**	**0.0**	**0.0**
Central government 4/									
Current revenue	19.3	19.5	17.2	17.1	17.7	18.1	18.2	18.1	18.1
Current expenditure	17.2	17.2	17.9	17.8	17.8	18.1	18.3	18.3	18.4
Current account balance	2.1	2.3	-0.8	-0.7	-0.2	0.0	-0.1	-0.2	-0.3
Capital expenditure	2.9	2.7	2.6	2.7	2.6	2.6	2.6	2.6	2.6
Overall balance	-0.8	-0.4	-3.4	-3.4	-2.8	-2.6	-2.7	-2.8	-2.9
Memorandum items (eop):									
Total central government debt (in percent of GDP)	30.8	32.6	35.7	38.1	39.0	39.6	40.6	41.5	42.5
Of which									
External central government debt (in percent of GDP) 5/	2.8	3.2	4.5	5.9	6.5	7.1	7.4	7.8	8.3
External debt service 6/	2.3	2.7	2.5	3.9	4.1	4.3	4.3	4.4	4.6
Net international reserves									
(millions of U.S. dollars)	342.6	312.4	373.2	423.6	411.8	425.3	425.8	423.5	425.0
(In months of merchandise imports)	1.9	2.0	2.5	2.7	2.5	2.5	2.4	2.2	2.1

Source: Fund staff projections.

1/ Includes capital transfers.

2/ Includes errors and omissions.

3/ Includes financial sector.

4/ Refers to fiscal years ending June 30.

5/ Includes foreign currency debt with domestic banks.

6/ In percent of exports of goods and nonfactor services. Includes interest and amortization.

Table 9. The Bahamas: Public Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	2000	2001	2002	Projections 2003	2004	2005	2006	2007	2008
I. Central Government Debt 1/									
Baseline medium-term projections									
Central government debt 1/	**30.8**	**32.6**	**35.7**	**38.1**	**39.0**	**39.6**	**40.6**	**41.5**	**42.5**
Gross financing needs 2/									
In millions of U.S. dollars	33.4	175.3	281.6	342.3	204.2	225.9	253.1	291.4	288.9
In percent of GDP	0.7	3.6	5.6	6.6	3.7	3.9	4.2	4.6	4.4
Stress tests									
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2004-08				38.1	38.6	39.1	39.7	40.2	40.8
2. Real interest rate is at historical average plus two standard deviations in 2004 and 2005				38.1	40.0	41.6	42.6	43.4	44.5
3. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005				38.1	41.0	44.1	45.1	46.1	47.2
4. Primary balance is at historical average minus two standard deviations in 2004 and 2005				38.1	40.2	42.4	43.4	44.3	45.4
5. Combination of 2–4 using one standard deviation shocks				38.1	40.9	43.9	45.0	45.9	47.0
6. One time 30 percent real depreciation in 2004				38.1	41.5	42.2	43.2	44.1	45.1
7. 10 percent of GDP increase in debt stock in 2004				38.1	49.0	49.8	50.9	51.9	53.1
II. Foreign Currency Debt 3/									
Baseline medium-term projections									
Foreign currency debt 3/	**2.8**	**3.3**	**4.6**	**6.0**	**6.5**	**7.1**	**7.5**	**7.8**	**8.3**
Gross financing needs 4/									
In millions of U.S. dollars	426.7	328.8	384.5	524.7	429.3	455.2	480.1	558.3	568.9
In percent of GDP	8.7	6.7	7.6	10.1	7.9	8.0	8.0	8.8	8.6
Stress tests									
1. Real growth, nominal interest rate, current account, and non-debt inflows are at historical average in 2004-08				6.0	6.7	7.9	8.7	9.2	9.6
2. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005				6.0	6.9	7.8	8.2	8.5	9.1
3. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005				6.0	6.8	7.8	8.2	8.5	9.1
4. Change in U.S. dollar GDP deflator is at historical average minus two standard deviations in 2004 and 2005				6.0	6.6	7.2	7.6	7.9	8.4
5. Travel receipts are at historical average minus two standard deviations in 2004 and 2005				6.0	9.1	12.3	12.9	13.4	14.0
6. Combination of 2-5 using one standard deviation shocks				6.0	9.1	12.9	13.4	13.9	14.6
7. One time 30 percent nominal depreciation in 2004				6.0	9.1	9.8	10.2	10.6	11.2

Sources: Central Bank of The Bahamas; Ministry of Finance; and Fund staff estimates and projections.

1/ Gross debt of the central government. Data on the compostion and terms of the debt of public corporations is incomplete and could not be included into this exercise.

2/ Central government deficit plus amortization of medium- and long-term debt.

3/ Central government foreign currency debt. Includes external debt plus domestic debt denominated in foreign currency.

4/ Includes external current account plus amortization on medium- and long-term debt.

The Bahamas—Fund Relations
(As of April 30, 2003)

I. **Membership Status:**
Joined: August 21, 1973
Status: Article VIII

II. General Resources Account:	SDR Million	Percent of Quota
Quota	130.30	100.00
Fund holdings of currency	124.06	95.21
Reserve position in Fund	6.24	4.79

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	10.23	100.00
Holdings	0.12	1.19

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Obligations to the Fund** (SDR million; based on present holdings of SDRs):

	Overdue	Projections				
	3/31/03	2003	2004	2005	2006	2007
Charges/interest	0.0	0.13	0.18	0.18	0.18	0.18
Total	**0.0**	**0.13**	**0.18**	**0.18**	**0.18**	**0.18**

VII. **Exchange Rate Arrangement and Exchange System:**

The Bahamian dollar is pegged to the U.S. dollar at B$1 per US$1. The official buying and selling rates are B$1.0025 (buying) and B$1.0040 (selling) per U.S. dollar. In addition, the central bank buys and sells investment currency at premium bid and offer rates of 20 percent and 25 percent, respectively.

The Bahamas has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

VIII. **Article IV Consultation:**

The Bahamas is on a 24-month consultation cycle. The last Article IV consultation discussions took place in April 2001, and the staff report (SM/01/230) was considered by the Executive Board on August 1, 2001.

IX. **Technical Assistance:**

Department	**Dates**	**Purpose**
CARTAC	March 2003	Insurance supervision.
FAD	March 2003	Modernization of customs.
CARTAC	January 2003	Consolidated financial sector supervision.
STA	December 2002	Institutional arrangements for compiling national accounts statistics.
CARTAC	November/December 2002	Workshop on national accounts compilation.
MAE	October/December 2002	Assessment of the supervision and regulation of the Financial sector.
FAD	August/September 2002	Tax reform to reduce reliance on import duties and strengthen revenues.
CARTAC	December 2001	Public expenditure management.
TGS	June 2001	Improve systems used to manage economic time series.
MAE	January 2001	Brief visit to review new supervisory and regulatory framework.

The Bahamas: Relations with the Inter-American Development Bank
(In millions of U.S. dollars)

A. Active Loans as of January 31, 2003

Purpose	Approval Date	Amount	Amount Disbursed
Primary and Secondary Education			
Improvement	12/14/1994	21.0	19.2
Family Islands Potable Water	7/29/1998	14.0	10.2
Solid Waste Management	2/17/1999	23.5	11.4
Health Sector Strengthening	5/23/2000	0.8	0.8
Infrastructure Rehabilitation	9/13/2000	21.0	7.7
New Providence Transport Program	5/30/2001	46.2	10.9
		126.5	**60.2**

B. Net Flow of Convertible Currencies

	1998	1999	2000	2001	2002	Proj. 2003
Loan disbursements	34.6	12.9	20.8	21.1	13.8	17.5
Repayments	8.0	10.0	11.2	9.7	11.6	14.1
Net loan flow	**26.6**	**2.9**	**9.6**	**11.4**	**2.2**	**3.4**
Interest and charges	11.6	13.0	12.8	13.1	12.4	14.6
Net cash flow	**15.0**	**-10.1**	**-3.2**	**-1.7**	**-10.2**	**-11.2**

C. Recent Country Strategy

The IDB's strategy has been to focus on: (i) supporting private sector development; (ii) mitigating vulnerability to external shocks; (iii) promoting social development and equity enhancement; (iv) integrating the Family Islands; and (v) improving environmental management and natural resource conservation. In the social area, the Bank has recently assisted the Bahamian authorities in the design, execution, and analysis of a household survey on poverty and living standards.

The Bahamas: Indicators of Social Development

	The Bahamas (Most Recent Estimates)	The Bahamas (15-20 Years Ago)	Latin America and Caribbean (Most Recent Estimates)
Demographic			
Population (millions)	0.3	0.2	515.7
Density (population per square kilometer)	21.8	20.6	25.0
Population annual growth rate (percent)	1.5	2.5	1.8
Of which			
Urban	2.0	...	2.6
Crude birth rate (per thousand population)	18.0	23.7	22.0
Crude death rate (per thousand population)	5.3	5.8	6.0
Fertility rate (births per women)	2.2	...	2.6
Labor force			
Economically active population (millions)	0.2	0.1	324.9
Agriculture (percent of labor force)	3.5	5.9	19.0
Industry (percent of labor force)	15.2	17.2	24.0
Health			
Infant mortality (per thousand live births)	18.0	25.9	30.0
Mortality rate under five years of age (per thousand live births)	22.0	35.0	38.0
Life expectancy at birth (years)	69.0	68.1	70.0
Physicians per 1,000 inhabitants	2.3	0.9	1.6
Hospital beds per 1,000 inhabitants	2.5	2.3	2.2
Immunized under 12-months (percent of group)			
Measles	93.0	...	91.0
DPT	86.0	40.0	92.0
Access to safe water (percent of population)	96.0	...	85.0
Urban	98.0	...	93.0
Rural	86.0	...	62.0
Nutrition			
Food production			
(index 1989-91 = 100)	145.5	90.9	101.0
Daily calorie supply (calories per person)	2,546.0	...	2,726.0
Daily protein supply (grams per person)	80.7	...	68.0
Education			
Gross enrollment ratios (percent of school age group) 1/			
Primary	97.9	98.5	130.0
Secondary	88.9	88.1	75.0
Pupil/teacher ratio (pupils per teacher)			
Primary	22.0	...	28.0
Secondary	16.0	...	26.0
Illiteracy rate (percent of population over 15 years)	4.6	6.6	12.0
Newspaper circulation (per thousand of population)	100.0	157.0	71.0
Women			
Gross enrollment ratio (percent of school age group) 1/			
Primary	104.4	101.3	99.0
Secondary	91.6	...	...
Illiteracy rate (percent of population over 15 years)	3.7	6.1	6.0
Life expectancy (years)	77.2	72.2	74.0
Labor force (percent of total)	47.3	43.4	34.8

Sources: World Bank Social Indicators of Development 2003; IDB Social Indicators; and Statistics Office of The Bahamas.

1/ Includes over and underage students.

The Bahamas: Statistical Issues

The Bahamas suffers from significant weaknesses in the timeliness, coverage, quality and frequency of economic data. The central bank produces annual and quarterly reports covering macro economic developments, but several series have long lags and are frequently revised. The Department of Statistics (DOS) is responsible for generating output statistics but many series have been discontinued or are not available (most notably, the national accounts). The DOS faces numerous operational challenges including the unavailability of technical staffing and lack of financial support for some critical statistical initiatives. In addition, institutional arrangements could be improved to facilitate the production and dissemination of data on a timely basis.

The Bahamas began participation in the General Data Dissemination System (GDDS) in 2003. Its metadata were posted to the Fund's Dissemination Standards Bulletin Board on February 14, 2003.

National accounts

National accounts estimates for the period beyond 1995 are not available. The most recent release was in December 1997, for revised national accounts data covering GDP by type of economic activity and expenditure category at current and constant 1991 prices, as well as national income for 1989–1995. The estimation process has been hampered by weaknesses in the source data and poor methodological practices. The primary source of data for national accounts statistics is the annual survey of establishments. However, the survey response rate is low and coverage of economic activities through administrative data sources is inadequate.

For the period 1996–2002, the staff has generated rough estimates of GDP at current and constant prices based on indicators of activity, sectoral weights and estimated deflators. The authorities publish information on sector activity such as construction, fisheries, and employment with a significant lag. Supplemental information includes data on tourism activity (number of visitors, tourist expenditure and hotel occupancy rates). Statistics on the labor market, including data on income and wages, are not generally available, with the exception of data on labor force and employment up to 1998 published in *IFS*.

Government finance

Monthly data is reported by the central bank for publication in IFS through December 2002. The data covers major aggregates on budgetary operations of the central government (excluding social security); it is updated on a quarterly basis. Annual data covering the central government through 2001 are published in the 2002 *GFS Yearbook.* Data on public enterprises is available only with long lags and under variable formats.

Money and banking

Monetary and banking data is adequate in terms of availability and quality. Nevertheless, the authorities could improve the quality of banking data by including prudential indicators (weighted capital-to-assets ratios, share of non performing loans in total loans, provisions to past due loans, earnings to net worth ratios) and indicators of the banking structure (number of banks and nonbank institutions, market shares in deposits and assets).

External sector

Quarterly balance of payment statistics are reported to the Fund on a relatively timely basis. The latest data published in the May 2003 issue of IFS are for the second quarter of 2002.

The Bahamas: Core Statistical Indicators
(As of June 2, 2003)

	Exchange Rate	International Reserves	Reserves/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	Fixed rate since 1970	5/16/03	5/16/03	5/16/03	5/16/03	4/03	3/03	12/02	12/02	3/03	1995	12/02
Date Received		6/2/03	6/2/03	6/2/03	6/2/03	5/03	5/03	5/03	5/03	5/03	1997	3/03
Frequency of Data		W	W	W	W	M	M	Q	Q	Q	A	Q
Frequency of Reporting		M	M	M	M	M	M	Q	Q	Q	A	Q
Source of Update		Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Dept. of Statistics	Central Bank
Mode of Reporting		M	M	M	M	M	M	M	M	M	M	M
Confidentiality		U	U	U	U	U	U	U	U	U	U	U
Frequency of Publication		M	M	M	M	M	M	Q	Q	Q	A	Q

Frequency of Data/Reporting/Publication: M=Monthly; Q=Quarterly; A=Annually.
Mode of Reporting: M=Email/facsimile.
Confidentiality: U=Unrestricted use.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 03/87
EMBARGOED
NOT FOR NEWSWIRE TRANSMISSION
UNTIL 10:30 AM WASHINGTON TIME (1430 GMT)
July 23, 2003

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with The Bahamas

On July 2, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with The Bahamas.[1]

Background

The Bahamas, a small open economy that is highly dependent on tourism, has a long track record of prudent macroeconomic management and financial stability. In the second half of the 1990s, large foreign investment flows raised growth to 4–5 percent. Policies focused on fiscal consolidation (the deficit was virtually eliminated) and the strengthening of financial regulation and supervision to address risks of money laundering and fraud in the offshore financial sector.

Growth turned negative in 2001 and remained subdued in 2002 and early 2003 under the impact of the global economic slowdown and lingering terrorism-related security concerns. With the downturn, the central government deficit widened markedly, to 3.4 percent of GDP in FY 2001/02. The new government (elected in May 2002) aimed at a gradual reduction of the deficit while supporting the recovery through selective tax exemptions. However, the deficit is estimated to have remained at 3.4 percent of GDP, with public debt rising to 36 percent of GDP at end 2002.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The tightening of monetary policy (through the imposition of a bank-by-bank credit freeze) halted the decline in reserves. Available indicators suggest that, so far, the banking system has weathered the slowdown well. The government is still in the process of shaping its structural policy agenda, and progress in this area has been limited.

Economic activity is expected to pick up gradually in 2003 and 2004 with the resumption of strong capital inflows, but the fiscal deficit would narrow only modestly, to 2.8 percent of GDP, contributing to further debt accumulation. For 2003-2004, the government debt-to-GDP ratio would still be below 40 percent. However, the debt path is vulnerable to significant downside risks related, in the near term, to slower U.S. growth and continuing security concerns and, over the medium term, to a gradual erosion in external competitiveness because of relatively high labor and utilities costs.

Executive Board Assessment

Directors commended The Bahamas' long track record of prudent macroeconomic management that led to an extended period of relative prosperity. Inflation is low, the public debt is moderate, the banking system is sound, and the country's credit rating is good. However, Directors noted that since 2001 economic growth has slowed, and the fiscal position has weakened, under the impact of the global economic slowdown and the lingering security concerns. While the economy is expected to strengthen gradually in 2003 and 2004, it remains vulnerable to developments in the United States and to growing competition from other tourist destinations and offshore financial centers.

Directors cautioned that the scope for policy maneuver has narrowed because of the weakening of the fiscal position. They recommended that economic policy focus on raising international reserves, regaining room for fiscal maneuver, and diversifying the economic base to maintain confidence and reduce economic vulnerabilities. They emphasized the importance of structural reforms to improve competitiveness over the medium term.

Directors stressed the need to consolidate the fiscal position in order to reduce the debt-to-GDP ratio and ensure fiscal sustainability, although there was support for allowing the full play of automatic stabilizers in view of the sluggish economic growth. In this regard, they supported the steps taken to contain the wage bill and recommended additional spending restraint, particularly with respect to transfers to inefficient public enterprises. Directors also encouraged action to reverse the recent decline in the tax ratio. They called for tax reform to broaden the tax base and eliminate distortions in the tax system. Improvements in revenue administration should be given high priority.

Directors considered that the fixed exchange rate peg to the U.S. dollar has served The Bahamas well, and welcomed the strong commitment of the authorities to the peg. However, noting the real effective appreciation of the currency over the last two years, they stressed that maintenance of the peg would require sound fiscal, wage, and structural policies to protect external competitiveness.

Directors recommended a gradual move toward a more flexible and market-oriented framework for liquidity and credit management. In the short term, credit restraint will be necessary until the fiscal and international reserve positions have strengthened. For the medium term, Directors thought that a prudent, gradual relaxation of foreign exchange controls could help deepen the domestic credit market and foster competition in the banking sector. These changes would need to be accompanied by adequate prudential regulations, higher foreign reserves, flexible liquidity management, and a stronger fiscal position.

Directors advised prudent use of external financing, given the need to reduce the debt-to-GDP ratio. A formal public debt management framework integrating government and government-guaranteed obligations, including those of public corporations, would help guide decisions on the appropriate balance between domestic and external debt.

Directors commended the continuing efforts to improve financial supervision and regulation, including the introduction of legislation to bring the regimes for combating money laundering and terrorism financing into compliance with relevant international standards. They recommended continued development of the framework for cooperation with regulatory agencies in other countries.

Directors emphasized that further progress with structural reform would help lower costs and preserve external competitiveness. They welcomed efforts to garner political support for reform, and encouraged vigorous implementation. They emphasized labor market reform to reduce labor costs, including the linking of wage increases to productivity increases. They commended the progress toward privatization of the telecommunications company, but noted that there is scope for increased private sector participation and efficiency in the utilities and infrastructure sectors. Directors also stressed the need to reduce trade restrictions, including the very high tariff rates, and to simplify the complex tariff structure. They encouraged greater regional integration and closer links to the World Trade Organization.

Directors welcomed The Bahamas' participation in the General Data Dissemination System and encouraged action to remove the significant gaps and inconsistencies that currently exist in the economic data. They supported the authorities' request for technical assistance to address these issues.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2003 Article IV Consultation with the Bahamas is also available.

The Bahamas: Selected Economic Indicators

	1998	1999	2000	2001	Prel. 2002
(Annual percentage changes; unless otherwise indicated)					
Real sector					
Real GDP 1/	3.0	5.9	4.9	-2.0	0.7
Total visitor arrivals	-3.1	9.0	15.2	-0.4	5.1
Of which					
Air arrivals	-4.7	10.3	3.0	-2.9	-2.5
Cruise arrivals	-1.2	14.5	26.8	1.6	9.8
Consumer price index (annual average)	1.3	1.3	1.6	2.0	2.0
Financial sector					
Broad money 2/	15.2	10.1	7.5	3.6	3.5
Credit to the private sector 2/	11.2	11.2	14.7	7.8	4.3
(In percent of GDP at market prices)					
Central government finances					
Central government overall balance 3/	-1.7	-1.6	-0.8	-0.4	-3.4
Central government savings 3/	1.3	1.3	2.1	2.3	-0.8
Central government debt 2/	34.2	33.1	30.8	32.6	35.7
(In millions of U.S. dollars; unless otherwise indicated)					
External sector					
Current account balance	-995.6	-409.0	-410.9	-312.9	-318.9
Overall balance	-119.3	-65.2	61.5	30.2	-60.8
Net international reserves 2/	338.8	404.0	342.6	312.4	373.2
(In percent of base money)	109.3	108.2	94.9	76.7	82.7
External debt of central government (in percent of GDP) 2/	2.2	2.3	2.3	2.5	2.0
Real effective exchange rate appreciation 2/	0.3	-0.7	-1.1	1.9	0.1

Sources: The Central Bank of The Bahamas; Ministry of Finance; and IMF staff estimates.

1/ Estimated by IMF staff on the basis of partial indicators.
2/ End of period.
3/ Corresponds to the fiscal year ending June 30.