Address by the
Hon. Michael B. Halkitis
Minister of State for Finance
to the Bahamas Chamber of Commerce
Wednesday, 13th[h] February, 2013

INTRODUCTION

I am pleased to have been invited to join you today to share with you my perspective on the current economic situation and the outlook going forward.

Of course, the state of our public finances is inextricably linked to prospects for the health and vigour of our economy and I will therefore also share with you the broad outlines of the Government's strategy for returning the public finances to a more desirable and sustainable position. I firmly believe that doing so is critical to creating an environment within which the private sector can more readily flourish.

As you may be aware, the Government will be presenting a Mid-Year Budget update to Parliament in the very near future. That document will set out the fiscal consolidation plan that we will be pursuing both in the near term and through the medium term.

In a nutshell, it is simply imperative, for the sake of the health of the economy and the welfare of our citizens, that we arrest the rising trend in the burden of Government debt and get it back to significantly lower levels relative to the size of the economy.

I will begin with a brief overview of recent economic developments and prospects going forward. I will then turn to a review of the Government's fiscal position and the fiscal policy framework that it intends to pursue over the next several years.

ECONOMIC DEVELOPMENTS AND OUTLOOK

The Bahamian economy has continued to recover modestly though steadily from the global economic and financial crisis. The prime sources of this renewed growth have been the Tourism and Construction sectors of the economy.

Tourism has benefited from a rebound in air arrivals which were up by over 6% in the first eleven months of 2012, building on growth of almost 5% the previous year.

In Construction, developments are underpinned by ongoing foreign investment projects in the tourism sector, such as Baha Mar and Albany in New Providence, and several smaller developments on the Family Islands. These will contribute to an expansion of our tourism productive capacity which, in turn, should serve to bolster the potential growth of the aggregate economy. The public sector's capital works programmes have also provided significant impetus. In contrast, domestic private sector construction activity has been subdued.

Looking ahead, growth in domestic economic activity is projected to be sustained in 2013, with the International Monetary Fund projecting real growth of 2.7%. This sustained expansion stems from continued global growth, particularly in the United States. This should spur further gains in the high value-added group segment of the tourist market.

Ongoing large-scale foreign investment developments, and to a lesser extent public sector programmes, are expected to sustain the growth in construction sector activity.

However, until the recovery broadens to absorb the excess capacity in our economy, unemployment levels are expected to remain challenging. On that score, I would note that the Department of Statistics published its latest semi-annual labour force survey last week, for the November 2012 period. On the whole, the data reveal a generally encouraging picture on the employment and unemployment fronts, with the national unemployment rate falling to 14% from 14.7% in May 2012. That is also down almost 2 full points from the peak of 15.9% in November 2011.

However, labour force developments in Grand Bahama and for our youth were somewhat less encouraging. The rate of unemployment in Grand Bahama rose over the six-month period from 17.3% to 18% while the youth rate of unemployment rose slightly to 30.7%. These are areas of clear, ongoing public policy concern and the Government will need to redouble its efforts to ensure that the fruits of the economic recovery are shared more equally across our islands and the various age groups in society.

It will therefore be critical that the economy achieve appreciably higher rates of growth over time in order to generate sufficient new job opportunities to get us to much lower rates of unemployment. The Government's growth agenda is targeted precisely at engendering the stronger growth of the Bahamian economy that is so vitally important.

Very briefly, the broad thrust of the Government's growth strategy includes diversifying the key tourism and financial services industries, as well as the overall economy, partly through the promotion of innovation in high value-added products.

We also seek to foster linkages between sectors and to identify and remove impediments to growth, particularly in the business environment.

In addition, the Government attaches a high priority to identifying, promoting and supporting new foreign direct investment projects.

As small and medium size enterprises are the real engines of growth and job creation, the Government is developing a new policy framework that will enhance the creation and expansion of small and medium size enterprises and the employment opportunities that they generate.

We are also striving to enhance the business environment through a variety of initiatives that will improve the business–Government interface. These range from the adoption of a modern e-Government platform for a number of Government programmes and services, to reform programmes to make key Government agencies more customer-friendly and their services more easily accessible. Efforts have been focused in the areas of Customs, Business Licence, Real Property Tax and overall tax administration. Equally so we will begin to focus on how e-Government can be used to improve the efficency and effectiveness of the internal operations of the Government, which also has implications for how effectively we respond to the private sector's needs.

FISCAL DEVELOPMENTS AND OUTLOOK

As I mentioned earlier, restoring the public finances to a healthier and sustainable position for the long term is also a key component of our strategy for enhanced growth and job creation. That will enhance confidence in The Bahamas as a prime location for investment and will support financial market conditions that are propitious to more a buoyant expansion of the private sector.

International observers of the Bahamian scene have noted the critical need for a medium term fiscal consolidation plan. In its December announcement of a downgrade in our credit rating as well as a negative outlook, Moody's noted our high and rising levels of debt and a weakening of our debt sustainability metrics.

The latest IMF Article IV consultation exercise was concluded in November and the staff report was presented to the IMF Executive Board on February 4th of this year. Besides expressing support for the Government's growth strategy, one of the overriding conclusions of the IMF exercise is that the key priority must be to strengthen the public finances, as delayed fiscal consolidation could pose risks to long-term debt and external sustainability. The Government was encouraged to implement a medium-term plan to strengthen revenues and improve tax administration, rationalize public expenditure and put public enterprises on a sound financial footing.

The Government fully appreciates the need for fiscal action. The 2012/13 Budget Communication, presented to Parliament a mere three weeks after the election, noted the gravity of the fiscal situation with sizeable, ongoing capital expenditures, contracts entered into just before the election and large carry-over expenditures form 2011/12. We stated at the time that we were firmly committed to the return of the fiscal accounts to a more desirable and sustainable position.

While we acknowledged that the time available to us had been too short to develop a full-fledged plan to address this unsustainable fiscal position, we did announce a number of immediate reform measures in the areas of revenue administration. While securing additional revenues for the Government, these measures are also targeted to improving service to taxpayers, thereby improving the environment for private sector expansion.

I would like to share with you the details of what specifically has been achieved in these areas since the time of the Budget Communication.

For one, we announced that we were proceeding with plans to establish a Central Revenue Agency (CRA). There are currently more than 30 departments and agencies collecting a variety of taxes and fees for the Government. The present system of administration results in poorly developed functions such as registration, arrears management, and audit. Compliance with the law for major taxes and fees is often weak. Significant revenue leakage is occurring and compliance and enforcement results are minimal, partly due to the absence of an Agency with the legal authority to enforce the law and apply penalties for non-compliance.

The mission of the CRA will be to ensure compliance with tax legislation by providing efficient and effective services and by conducting appropriate enforcement activity. The establishment of a CRA will address the critical structural deficiencies of the present tax system, will improve collections and will introduce a much-needed client service orientation where services are provided to taxpayers that allow them to understand and easily access the information they require to comply with the law and which promptly addresses their concerns.

The new CRA will have collection responsibilities for all taxes and fees not closely tied to the direct program activities of another department. Where the taxes and fees are intrinsic to the activities of the particular department, that department will remain responsible for collection. As such, the CRA will be responsible for Stamp Tax, Real Property Tax, Business Licences and taxes, Hotel Occupancy Tax, Casino Tax, and other Bank and Trust Company fees. With this revenue administration reform, fully 90 per cent of all taxes, fees and service charges will be collected by either Customs or the new CRA.

At this time, I can report that the CRA has indeed been established and that an initial locale for its operations has been secured. The first sections of the CRA are slated to relocate to this new accommodation in the very near future.

As well, we announced that were moving ahead with the reform and modernization of the Real Property Tax system with the assistance of an international expert. As has been amply documented, the real property tax (RPT) system suffers from many critical structural defects and, as a result, revenues generated by the system fall significantly short of the amounts that should rightfully be collected. Specific reforms have been developed which could readily double property tax revenues over the next five years.

The very first step in the reform process has been the identification of the major gaps in RPT performance relative to desirable norms. There are grave deficiencies in the property tax coverage ratio, the billing ratio and the collection ratio. Specifically, for the 2011 tax year, it is estimated that nearly one third of the properties that should be assessed are not covered or registered in the RPT database. That amounts to about 35,000 properties being outside the system.

We are also narrowing in on how to remedy billing deficiencies. Of the 88,000 properties that are on the tax register, almost 22,000 benefit from the owner occupied exemption. We also have reason to believe that almost half of the non-exempt properties are not getting their bills for various reasons, including inaccurate billing addresses. It means that the Government is collecting only about half of what it should be getting from real property taxes.

There are also significant challenges with valuation ratios as assessments do not track changes in market values as closely might be desirable. In the view of experts within the Ministry, under a well funtioning system, we can allow up to 10 years to lapse between assessments. And so when valuation adjustments occur many property owners experience a sticker-price shock.

In remedying these problems, the Government will most likely have to modernize the property tax legislation. We will have to adopt modern approaches that rely on intelligence gathered from satellite imagery and GPS technology. We will also have to embrace Computer Assisted Mass Appraisal (CAMA) systems that are currently in use in almost every country.

These reforms will have to be comprehensive. Through their implementation over the next several years, the RPT system will become considerably improved in respect of both customer service and revenue collections.

The Government has also initiated a major transformation of the Customs Department, with the assistance of the Inter-American Development Bank, which is focused on strengthening both Customs management and Customs operations. The overriding objective of this exercise is to improve the facilitation of trade while strengthening the ability of Customs to collect revenue and protect the borders.

On the management side, efforts are being deployed to modernize the Customs institutional framework, the enhancement of its management capacity and the professionalism of its human capital.

In terms of operations, the focus is on an upgrade of operational procedures, a cutting-edge automated system and the service-oriented technological platform and programmes needed to increase measures of trade facilitation while balancing control and security. As a matter of policy the Ministry of Finance is committed to eliminating all obstacles that discourage the online submission of customs declarations, within the the shortest time possible, and we will ensure that the resources are provided to Customs to accomplish this. These innovations will increase the speed and efficiency of Customs processing, and allow us to deploy our Customs resources more effectively.

Finally, the Government has tabled legislation for the introduction of new excise stamps for all tobacco products. Investigations have found that the Government is losing considerable tax revenues every year through the illegal importation of tobacco products and that excise stamps could assist in securing some $20 million of those leakages.

Beyond the measures to improve revenue administration that are currently underway, the Government has also followed up on the Budget commitment to issue a White Paper on Tax Reform, which it tabled in the House of Assembly this morning.

As is set out in the White Paper, the overarching objectives of the tax reform proposals are threefold, namely:

1. to secure an adequate revenue base in support of modern governance;
2. to establish a tax structure that promotes economic efficiency and stronger economic growth; and
3. to make the tax system more equitable.

Within the proposed package of tax reforms, it is recommended that a VAT be introduced, as of July 1, 2014, at a rate of 15%, consistent with VAT rates generally charged elsewhere. Such a VAT rate, in combination with the other reform proposals, would ensure that Government will have access to adequate revenues streams for the future.

As for Customs duties, it is generally acknowledged that, based on the experience of other acceding countries, pending membership in the World Trade Organization (WTO) will require reductions in Bahamian bound tariff rates. The final determination of those import tariff reductions will be subject to the ongoing WTO access negotiations. However, the excise taxes that are currently imposed on selected products, namely tobacco, petroleum, vehicles and certain luxury items will be unaffected by WTO accession as, by law, they are imposed at the same rate on both domestic production and imports of those products.

It is also proposed to rationalize another area of consumption taxation in The Bahamas with the elimination of business licence tax which essentially amounts to a tax on consumption. From a business perspective, this tax has undesirable features in that no rebate of business licence tax is allowed for exports, thus hindering international competitiveness, and it also results in cascading of taxes whereby tax is being imposed on tax through the production chain.

It is proposed that business licence taxes should nonetheless be retained as a simple, annual registration fee on businesses at a rate of $100 per year. For banks and insurance companies, the current Business Licence tax structure would continue.

For competitiveness reasons, it is also proposed to eliminate the hotel occupancy tax and to subject hotel accommodations to VAT rather than subject them to both taxes. This will allow hotels to claim VAT input credits on their purchases of materials and supplies and will be consistent with the current Hotels Encouragement regime. Hotels will benefit from lower compliance costs and the Government will benefit from administrative economies of scale.

However, again for competitiveness reasons, it is proposed that hotels be subject to a VAT rate equal to the current hotel occupancy tax rate of 10%. Similarly, given the large contribution of hotels to economic activity, it is proposed that food and beverage sales in hotels be subject to VAT at the same rate of 10%.

Given the relatively high rates of excise tax imposed on a number of excisable items, it is proposed that all excise tax rates be reduced by an amount just sufficient to counteract the imposition of a 15% VAT on those products. As a result, the total tax payable on excisable products would remain unchanged.

The Government believes that its programme of tax reform, when fully implemented, will result in considerably greater and more efficient revenue collection, the proceeds of which will better equip the Government to meet the increasingly complex financial needs of our nation. More fundamentally, it will bring into being a new system of taxation that shares the tax burden more fairly and equitably.

Building on these various reforms to both revenue policies and administration, the Government is reviewing the parameters of the comprehensive medium-term fiscal consolidation plan that is to be presented in the Mid-Year Budget Statement.

Beyond revenue reforms, this plan will also involve actions in respect of Recurrent Expenditure and Capital Expenditure, which have over the past few years risen to levels relative to the size of the economy that are unprecedented, at least in recent memory. Such levels of public outlays are clearly unsustainable from a fiscal perspective.

The range of actions in our medium-term fiscal consolidation plan will target both a significant reduction in the relative weight of Recurrent and Capital Expenditures and an appreciable enhancement in the yield of our revenue system. These actions will thus be structured such as to secure our target of eliminating the deficit on the Recurrent Account of the public finances. They will also secure the objective of engineering a reversal in the trend of the debt burden and over time getting it back to a level that is desirable and sustainable.

The various provisions of the Financial Administration and Audit Act will be instrumental as move forward with strengthening expenditure controls and improving public financial management. As well, it is clear that priority will need to be attached to putting our public sector corporations on a sound and sustainable financial basis. That will necessarily entail enhanced oversight of their operations and restructuring plans going forward. Finally, we will assess the long-run liability position of public sector pension plans with a view to securing the longer run financial viability of those plans.

CONCLUSION

In closing, I would merely like to repeat my appreciation to the Chamber for giving me this opportunity to outline the key features of the Government's approach to addressing the critical fiscal challenges before us and what we have been able to accomplish in those areas since the Budget.

As I have explained, we have a plan of action and we will pursue it with determination in the years to come, for the benefit of our economy and Bahamian citizens.