

2010/2011 Budget Communication by Prime Minister the Rt. Hon. Hubert Ingraham:

THE PRIME MINISTER: Mr. Speaker, this is the 33rd Budget Exercise in which I will have participated in this Parliament as an MP; the 14th as the Prime Minister and the 6th as Minister of Finance.

Such extensive experience in this country's fiscal affairs has enabled me to observe the many ebbs and flows of economic life in The Bahamas and the attempts by successive Ministers of Finance to grapple with them. I have learned many profound lessons and made a number of keen observations, none more so than these:

- Leaders must fully assess the reality of the circumstances in which they find themselves and act accordingly;
- The economic circumstances in which a country finds itself cannot be ignored when planning for the future;
- Every crisis presents an opportunity for us to be better than we are; and
- The leader who runs from today's difficult decisions only defers and doubles them for future generations.

It has also been my observation that nothing lasts forever, neither good times nor bad times. These harsh economic times which we face are coming to an end but ever so modestly.

The Budget being presented to Parliament seeks to put us in the best position to maximize the gains from the emerging modest recovery through sacrifice, service and reform.

These lessons and observations underlie this watershed 2010/11 Budget Communication. Embodied in my Communication today is my full recognition that it is my solemn duty and earnest commitment, as Prime Minister and Minister of Finance, to so provide for the use of the public funds that the essentials are accounted for, priorities are attended to and the future is not put at unnecessary risk.

This is a Budget that contains the most significant structural fiscal action of any Budget in recent years, with the overriding objective of enhancing the nation's economic prospects by putting its fiscal house in order on a sustained basis.

I want to stress that the fiscal targets and budget strategy that will so engage us now have relevance and meaning because they are essential to the economic welfare of our people. Failure to act would jeopardize our solid reputation as an attractive destination for foreign investment, would subject us to much higher borrowing costs and would dampen prospects for stronger growth and higher standards of living. We cannot and we will not fail.

Accordingly, this Budget begins to aggressively redress public finances now, by containing the growth of Government debt this coming year and beginning to move the debt-to-GDP ratio back to more prudent and desirable levels over the medium term. We are fully aware that it will now take some time to do this, given the extraordinary measures that we had to take in the crisis. This Budget sets explicit debt targets for the two succeeding years beyond 2010/11, clearly indicating reductions in the debt-to-GDP ratio over that period.

Abraham Lincoln once said: “You cannot escape the responsibility of tomorrow by evading it today”.

This Budget acknowledges that truth.

When the economic crisis hit, like other governments around the world, we were required to execute an economic and fiscal strategy that was appropriate for Bahamians and the Bahamian economy. We did! As a result, we are emerging out of that crisis with an economy nurtured by our extraordinary efforts though badly bruised; a financial system that is sound; and a society with a greatly enhanced social safety net.

Our necessary efforts in the crisis did not come without a price. Our fiscal state is not what we would want it to be. However, we knew what it would take to get us through the crisis and we know what it will take to advance our circumstances beyond it. This Budget is the beginning of the latter effort.

A MEDIUM-TERM FISCAL STRATEGY FOR THE TIMES

The time for concerted fiscal action is now. It is projected that the Government debt will stand at 47.3 per cent of GDP at the end of this fiscal year. That represents an increase of almost 11 percentage points from its level in mid-2008, when the crisis hit its apex.

The undesirable ramifications of continuing such a debt build-up are evident. With higher debt, we must devote a larger and increasing share of every revenue dollar to interest payments. In 2009/10, almost 15 cents of every dollar of revenue will be siphoned off to pay interest on the debt, up sharply from under 10 cents before the crisis. Those are precious revenues that cannot be put to productive use in providing valuable services to our citizens.

The fundamental problem confronting Government is that the fiscal structure of 2009/10, brought on by the crisis, is unsustainable. The fact is that the extraordinary level of deficit spending that we and other nations have had to undertake in the face of a most extraordinary crisis can only continue to our peril. With the economy on the rebound, we must now reduce the level of deficit spending.

It is a fact that even now our debt to GDP ratio remains among the lowest in the region, indeed, in the Americas; yet, it is not our desire or aim to take comfort in this fact.

I cannot place enough emphasis on the vital need to set early and realistic objectives for debt reduction.

In this context, I would cite from the recent Fiscal Monitor of the IMF Fiscal Affairs Division: “If governments fail to signal a credible commitment to reduce debt ratios, the resulting increase in interest rates (and decline in growth rates) could increase the required effort markedly.

This underscores the importance of early actions to demonstrate a commitment to lower debt ratios.”

The fundamental objectives of the medium-term fiscal strategy of the 2010/11 Budget are as follows:

- Contain the debt-to-GDP ratio immediately; and
- Reduce over the medium-term the debt ratio to 40 per cent, as promptly as possible and as economic conditions permit. Having made it clear what our central aim is in this 2010/2011 Budget Communication, I now wish to turn to the environment in which we must pursue that aim.

THE GLOBAL ECONOMY

As The Bahamas is a small open economy, it goes without saying that our future economic prospects and, in turn, fiscal developments will be closely linked to the fortunes of the world economy and especially those of the U.S. Accordingly, before discussing the domestic economy and our fiscal projections, I will review briefly international economic developments and prospects.

The global recovery has advanced more quickly and strongly than had been expected last year, largely on the basis of the extraordinary fiscal, monetary and financial support that governments have provided around the globe.

In its latest World Economic Outlook published last month, the IMF is now projecting the world economy to grow by 4¼ percent in both 2010 and 2011. That is up significantly from the contraction of 0.6 per cent in 2009.

However the recovery in the major advanced economies is likely to remain sluggish and modest by historical standards, with downside risks still prominent. As policy stimulus is gradually withdrawn, the strength of the rebound in private sector demand remains open to question as balance sheets must be restored and financial markets remain vulnerable.

Also weighing on economic prospects will be the need for governments to improve their fiscal positions and achieve lower levels of public debt. Sovereign risk is another important factor impinging on global economic prospects.

Some of the countries with especially challenging fiscal positions have seen sharp increases in their risk premiums and market concerns about possible defaults could result in a widespread debt crisis. That could depress output growth widely around the globe.

The IMF expects the U.S. economy to rebound sharply in 2010, posting stimulus-fed real growth of over 3 per cent, after a contraction of 2.4 per cent last year. Growth in 2011 is forecast at a more modest 2.6 per cent on the basis of still subdued private demand and continuing sluggishness in employment growth.

The Euro area, the U.K. and Japan are expected to post relatively modest growth in 2010, of under 2 per cent, following relatively sharp declines in activity in 2009. The developing Asian economies are forecast to continue growing strongly, with China and India registering real growth rates of 10 per cent and 8.8 per cent, respectively, with similar growth again in 2011.

THE BAHAMIAN ECONOMY

As for the domestic economy, preliminary estimates indicate that it contracted by 4.3 per cent in 2009, following a decline of 1.7 per cent in 2008, and modest growth of 1.9 per cent in 2007. With the economic downturn, the annual unemployment rate rose by 5.5 percentage points to 14.2 per cent in 2009.

Output in the tourism sector shrank in 2009. Hotel sector indicators showed a 20.6 per cent fall in overall room revenues, reflecting a 4.7 percentage point decline in the average occupancy rate and an 8.3 per cent decrease in the average daily room rate.

Total arrivals rose by 5.7 per cent to 4.6 million but this reflected a 13.1 per cent increase in sea arrivals as air arrivals fell by 10.1 per cent. Preliminary data for New Providence hotels indicate an upturn in the first quarter of 2010. Room revenues rose by some 6.7 per cent, reflecting a 3.2 percentage point increase in the occupancy rate to 67.2 per cent and a 2.2 per cent gain in average daily room rates.

The construction sector remained lackluster in 2009, as several large-scale foreign investment projects were either scaled-back or stalled. Activity in domestic real estate investments remained weak. Total mortgage disbursements for new construction and building repairs fell by 16.4 per cent.

The dominant residential component contracted by 16.3 per cent while commercial disbursements decreased by 17.5 per cent. Mortgage commitments—a forward looking indicator of economic activity—narrowed in number by 14.4 per cent and in value by 18.7 per cent. Preliminary data for the twelve months to January 2010 suggest sustained moderation in inflation, as average price gains slackened by 2.9 percentage points to 1.8 per cent, as compared to a rate of 4.7 per cent a year ago.

Foreign direct investment inflows fell by 22.1 per cent to \$653.6 million, on account of reduced equity investments and land purchases. Nevertheless external reserves grew by \$253.0 million to \$815.9 million at end-2009, equivalent to an improved estimated 20.7 weeks of non-oil merchandise imports, in comparison to 13.1 weeks in 2008.

During 2009, liquidity remained relatively buoyant, supported by the slowdown in private sector demand and increased public sector foreign currency loan inflows which sustained growth in external reserves. The contraction of the domestic economy in 2009 was somewhat more pronounced than the 3.9 per cent decline projected at the time of last year's Budget and, as might be expected, that has had direct implications for our fiscal performance.

We have reason to expect a less marked decline this year of 0.5 per cent and a more positive result of 2.0 per cent next year. This is consistent with the views of the IMF.

This cautious optimism is based on the following:

- Improved tourism performance this year over last year and better performance next year, as employment in the advanced economies, particularly the U.S., firms up in line with expectations;

- The spending of nearly half a billion dollars in Grand Bahama due to the continuing renovations and expansion at BORCO and the commencement of renovations and expansion at Stat Oil, the former Burma Oil;
- The \$400 million redevelopment of the Lynden Pindling International Airport is continuing at a fast pace and is on schedule; Bahamians make up 76 per cent of the work force on the project and of the \$80 million that has been spent to date, \$30 million has been awarded to local contractors;
- Two new Government Administration complexes are under construction in Grand Bahama and in Abaco;
- The completion of the magistrates' court complex on Nassau and Meeting Streets;
- Development of the new Port at Arawak Cay has commenced;
- It now appears that a number of the stalled tourism related developments may re-start during the new fiscal period including a \$100 million expenditure by Kerzner International; and
- The continuing aggressive public sector capital spending planned for this fiscal year.

These projects along with a modest general improvement anticipated in the overall economy in the medium term will put us in a more favourable economic position than we have seen in recent times. This notwithstanding, it is necessary to note that the gains will be modest and conditions in the global economy remain fragile, warranting caution as we move forward.

FISCAL PERFORMANCE 2009/10

Recurrent Revenue is being severely and adversely affected by the ongoing weakness in economic activity. It is now estimated that it will come in at \$1,295 million in 2009/10, or 17.5 per cent of GDP. This is \$94 million short of what was forecast.

Recurrent Expenditure in 2009/10 is estimated at \$1,554 million, up slightly from the \$1,530 million allocated in the 2009/10 Budget. The bulk of that increase resulted from funds used by the Government for its six-month Employment Programme announced at the end of 2009.

Financial constraints will not permit a continuation of this programme. Allowing for Capital Expenditure and Debt Redemption, the GFS deficit in 2009/10 is now estimated at \$425 million, some \$139 million more than projected in the 2009/10 Budget. Relative to the size of the economy, the GFS deficit will stand at 5.7 per cent of GDP, up from the estimated level of 3.9 per cent. The Government debt will be about \$3,510 million at the end of 2009/10, or 47.3 per cent of GDP.

FISCAL POLICY 2010/11 AND BEYOND

The current environment requires a fiscal policy that calls for expenditure restraint as well as enhanced revenue measures in order to put the public debt on the proper downward trajectory.

In 2010/11, we are holding Recurrent Expenditure to \$1,554 million. That is unchanged from the amount expended in 2009/10. In real terms, Recurrent Expenditure will decline by some 1.9 per cent in 2010/11, or by roughly \$30 million. Beyond next year, our operational target is to further reduce Recurrent Expenditure relative to GDP.

While Recurrent Revenues can be expected to benefit somewhat from the modest economic growth that is projected, there can be no doubt that significantly higher levels of revenue are required. Our near term objective is to get the ratio of Recurrent Revenue to GDP up to 19.7 per cent in 2010/11, or \$1,492 million, and then, at a minimum, to increase it to 20 per cent of GDP in the years beyond 2010/11. To that end, ongoing efforts to enhance revenue administration and collections will be redoubled and further strengthened.

And, to further secure the anticipated and critical increase in revenues, the Government is implementing a number of new measures that are expected to contribute additional revenue.

In order to attain our overriding debt targets, it will also be necessary to exercise restraint in respect of Capital Expenditure in the years to come. In line with commitments and the need to provide ongoing support to the economy, these expenditures will rise modestly in 2010/11, to 3.5 per cent of GDP. However, beyond the next fiscal year, it is our intention to hold Capital Expenditure to 3 per cent of GDP.

The expenditure restraint and revenue enhancement measures will result in a significant reduction in the GFS deficit in 2010/11, to a level of \$227 million as compared to \$425 million in 2009/10. That will also represent a significant reduction in the deficit relative to the size of the economy, from 5.7 per cent last year to 3.0 per cent in 2010/11.

Government debt at the end of June 2011 is projected to stand at 49.2 per cent of GDP, up from 47.3 per cent a year earlier.

The near term and medium-term implications of our fiscal action plan are presented in the multi-year fiscal projections that are included in the Annex to this Communication. Importantly, it will be seen in these projections that, through our fiscal action plan, we fully expect to meet our short-term target of first slowing the growth rate of our debt to GDP ratio and then setting it on a downward trajectory. The debt-to-GDP ratio is projected to fall to 48.7 per cent by 2012/13.

RECURRENT EXPENDITURE

In light of the key fiscal priorities of this Budget, overall allocations to Government Ministries, Departments and Agencies in 2010/11 are being reduced by 2.6 per cent from their level in 2009/10. Despite this, all should have funding sufficient to meet their core mandate to the public. Priority spending will continue to be given to Education, Health and National Security.

In order to secure the attainment of our fiscal objectives, the Government is also implementing a number of targeted expenditure reductions, namely:

- The salary of the Prime Minister is being reduced by 10 per cent and those of Parliamentarians, in both the House of Assembly and the Senate, are being reduced by 5 per cent;
- The duty allowances of the Prime Minister and Ministers are being reduced by 50 per cent;
- For the Prime Minister, the combination of these two measures amounts to a 16 per cent reduction in take-home pay;

- For Ministers and the Speaker, the combination of these measures amounts to a 7.3 per cent reduction in take-home pay;
- For the Leader of the Opposition and Members of the House, these measures represent a 5 per cent cut in pay;
- The responsibility allowance of the Secretary to Cabinet, Financial Secretary, Permanent Secretaries and other senior Public Officials will be reduced by 50 per cent;
- Increments for Public Officers will not be paid in 2010/11;
- Public service promotions are being frozen, except in special cases;
- Public service employment is being frozen, except in extenuating circumstances, such as essential services;
- The positions of those public officers retiring in 2010/11 will not be filled, except in the Department of Education;
- The provision for overtime is being reduced from \$10.4 million to \$1.5 million;
- Insurance premiums for vehicles, vessels and aircraft are being placed under the purview of the Ministry of Finance to allow for the negotiation of a more favourable price for insurance;
- The level of payment for medical and life insurance premiums paid by Government on behalf of public officials is unsustainable and the schemes will be reviewed;
- Contributions and grants to charitable organizations and institutions are being reduced by 10 to 25 per cent;
- Subsidies to private schools are being reduced by 20 per cent; and
- Mail boat subsidies are being reduced by 10 per cent.

The detailed allocations by Ministry, Department and Agency are set out in the accompanying documentation. Clearly, if we are to achieve our overriding fiscal objectives, all will need to manage public resources judiciously and prudently within the very stringent limits that have been established.

CAPITAL EXPENDITURE

With the very difficult fiscal situation, we are increasing the provision for Capital Expenditure in 2010/11 only modestly to accommodate commitments. We are setting it at \$265 million, as compared to \$255 million in 2009/10. This highlights my Government's continued commitment to modernizing and expanding the nation's infrastructure as a means of also supporting the economy at this time.

REVENUE MEASURES

Again this year, the Government is introducing a number of revenue measures to further rationalize rates and to continue the simplification of the tariff structure as follows:

- the rate on computer networking equipment is being reduced from 45 per cent to 10 per cent;
- the rate on LED light bulbs is being reduced from 45 per cent to "Free" to align it with the rate on compact fluorescent bulbs;
- the rate on sheet rock board is being reduced from 25 per cent to 10 per cent to align it with the rate on cement board;

- the rate on tankless water heaters is being reduced from 45 per cent to 10 per cent to promote energy efficiency;
- the rate on aircraft parts is being reduced from 10 per cent to “Free”;
- Item 8 of the Tariff Act is being amended to make clear that its provisions apply to small businesses with a turnover of \$250,000 or less per year.

A two-year holiday from the payment of business licence fees is being provided to petty, very small and small businesses as defined in the Business Licence Act.

The current system for determining motor vehicle fees is inordinately complex and cumbersome, as it contains 19 separate vehicle and rate categories. In order to simplify this system and facilitate administration, a new fee structure is being introduced that contains only three separate vehicle classes, based on the weight of the vehicle.

The annual fees are also being increased to better reflect the impact of vehicles on the Nation’s roadways and to cover the cost of street lighting, for which the Government will in future make payments to BEC. To further simplify the taxation of vehicles and to promote the use of more fuel-efficient vehicles, it is proposed to reduce the number of excise tax rates on cars and trucks to two: a rate of 65 per cent on passenger vehicles with an engine of 2000 c.c. or less and a rate of 85 per cent for all other passenger vehicles and trucks.

Vehicles with engines of 2000 c.c. or less include the Hyundai Accent and Tucson, the Kia Sportage and Rio, the Honda Civic and Fit, Nissan Sentra, Pontiac Vibe, the Toyota Corolla and Matrix and the VW Golf.

The current requirement for a permit to import chicken is being eliminated.

It is proposed to reduce the differential in taxation between domestic and imported beers. Accordingly, the Spirits and Beer Manufacture Act will be amended to provide for the rate of tax on domestic production to be increased from \$4 to \$6 per gallon.

The increase in the tax rate will be phased in on beer produced in the Port Area that is shipped to other parts of The Bahamas. It is being increased to \$4 per gallon and eventually will be brought to the same level as other locally produced beer.

The phase-in of tax on Port Area beer reflects the fact that other beer manufacturers in The Bahamas have benefited from concessions for extended periods of time following their start-up.

A number of tax rates and administrative arrangements are being modified to produce the additional revenues that are required to achieve the planned and required increase in the revenue yield of the tax system:

- The various rates of stamp tax on realty transactions are being increased by two percentage points. This will not impact the continuation of exempting first time homeowners from the payment of Stamp Tax on a dwelling home or property for the construction of a dwelling home valued up to \$500,000;
- Stamp tax on bank transactions is being increased by 15 cents with effect from 1st July 2010;

- The air and sea departure taxes are being increased by \$5 effective on July 1, and the increase for cruise ship passengers is effective on October 1;
- The hotel room tax is being increased to 10 per cent of the room rate effective July 1;
- The annual fees payable by retail banks are being increased by 50 per cent to provide for their more equitable taxation.

In order to bring equity between small businesses registered under item 8 of the Tariff Act and larger businesses registered under the Industries Encouragement Act (IEA), duty concessions under the IEA will now be limited to 5 years from the date of approval.

It is also proposed to eliminate the duty concessions offered under the Spirits and Beer Manufacture Act.

Fees under the International Business Companies Act are being increased. In order to eliminate the backlog of documents that have not been stamped, the applicable surcharge will be waived for documents that are presented for stamping on or before October 1, 2010.

Finally, it is proposed to increase the duty on items imported temporarily from 7 per cent to 10 per cent for every three months the items are in the country.

GROWING THE ECONOMY

As it now stands, much of our economic fortunes depend on the pace of recovery of the world economy, in particular the economy of the U.S. It has been a blessing to us, over many decades, that our tourism and financial services sectors cater to international clients from many parts of the world but most especially the U.S.

In many good times, they have enabled us to enjoy the standard of living and level of economic success for which we have been hailed. Of course, on the downside of this, when those economies falter, we experience the negative fall-out, as has been the case over the last year and a half.

While we must necessarily be watchful of the pace of recovery externally, we are mindful that there are steps that we can take to promote our own economic wellbeing as well as optimize the gains from improving external conditions. To this end, you will note in this Budget provisions having been made for the following:

1. An aggressive Foreign Direct Investment promotion thrust, with some \$1 million for this purpose. We expect to mount investment promotion missions, in partnership with the private sector, to key world cities, putting our case to investors to participate in profitable ventures in The Bahamas; and
2. A new Small and Medium Size Business Development Framework to encourage the growth of such businesses, recognizing their contributions to job creation and the sustained development of our economy. This new framework provides for some \$10 million, representing the consolidation of subsidies to BAIC, the Venture Capital Fund, Bahamas Development Bank and an additional \$1 million.

The additional \$1 million will advance the implementation of the new SME support framework and further efforts to explore the development of Bahamian entrepreneurship in

the Boutique Resort Business. It will also assist efforts to create linkages between the tourism sector and local industries. The aim here is to encourage the expansion of Bahamian production and increase foreign earnings retention.

Our economic fortunes will rebound, of that I am confident. Though the wheels of change are now turning only slowly, I am convinced that in time the pace will pick up. It is for us to do what is necessary now to ensure that when it does, we are in the best position to benefit. Our efforts today are geared toward ensuring that we are able to do just that.

CONCLUDING REMARKS

In conclusion, I would like to quote again from President Lincoln. Confronted with a national issue of grave importance, in 1862 he offered these words:

“The dogmas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty and we must rise with the occasion. As our case is new, so we must think anew, and act anew.”

All will most certainly agree that the present for Bahamians and for their Government is stormy indeed, a proverbial maelstrom the likes of which few of us have experienced. We do face grave difficulty. But, for the sake of the current and future generations, we must rise to the occasion and I am proud to proclaim that that is precisely what my Government has done.

Though the recovery may be modest by historical standards, I believe that we can maximize the gains from that recovery through sacrifice, service and social reform.

- Sacrifice will allow us to make adjustments today that will put us in a better position tomorrow.
- Service excellence will allow us to increase our competitive edge and gain accelerated economic benefits therefrom.
- Social Reform will enable us to change our behaviour as a society to improve our quality of life and our attractiveness as a place to visit and in which to conduct business and live.

In this pivotal Budget Communication, we have set out a carefully balanced medium-term strategy, not only to bring order to the nation’s public finances and set them on a sustainable course for the future but also to bring forward much-needed structural reforms that will vastly enhance the domestic business environment.

Ours is a strategy that will promote economic growth and rising standards of living. The ultimate test of all we have done and are doing is how well it improves the quality of life of our people.

I am confident that this strategy will meet that test and garner the support and approval of Bahamians and all those who observe us.