



Government Finance Reforms in a Modern Bahamas

Nov, 2013

November, 2013

Ministry of Finance

1

Outline

- **Why reforms of government finances are important**
- **The case for VAT**
- **Understanding how reforms would growth employment, cost of living and poverty impact analysis**
- **Some concluding comments**

November, 2013

Ministry of Finance

2

First some good news

- The economy is slowly improving
- Growth and employment should strengthen further over the next three to five years
 - The US and other major economies are expected continue to improve
 - Flow of foreign investment in hotel sector is strengthening
- The Bahamas will continue to experience average inflation or cost of living increases that are close to the levels in the US

November, 2013

Ministry of Finance

3

Concerns about government finances

- Current state of government finances adds considerable uncertainty about the future
- Raises concern in the minds of foreign investors, about whether the economic and social environment will be stable enough to justify maintaining, expanding or establishing operations in the Bahamas

November, 2013

Ministry of Finance

4

Concerns about government finances

- Bahamian businesses are at risk:
 - Less second round benefits from foreign investments
 - More heightened competition with government for bank credit and other local funding

November, 2013

Ministry of Finance

5

Why reforms are needed...

Staying in control of our destiny

November, 2013

Ministry of Finance

6

The modern realities for The Bahamas

- Our tax system is unfair and unbalanced
- The tax system needs to be broader and better linked to the growing sectors of economy
- Tax compliance needs to be strengthened to introduce fairness and equity
- The quantity and quality of government services provided needs to measure up more to the expectations of a populace of high average incomes

November, 2013

Ministry of Finance

7

The modern realities for The Bahamas

- The Bahamas must participate in international trade agreements or be left further behind
- Trade agreements allow The Bahamas to :
 - Preserve and enhance both local and international opportunities for Bahamian professionals
 - Preserve and enhance policies that advance other local Bahamian business interests
 - Have more say in preserving the rules which govern foreign investments
- To participate in these arrangements, Government reliance on customs duties must decrease

November, 2013

Ministry of Finance

8

Realities facing the government

- Public debt continues to rise, because government spends more than it collects in revenue

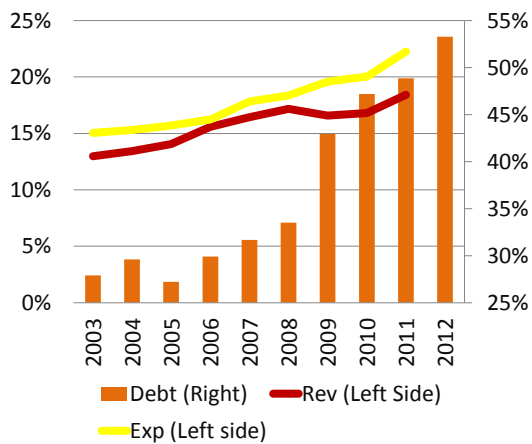
November, 2013

Ministry of Finance

9

Bahamas Govt. Finances and Debt (% of GDP)

Debt continues to rise because revenues have fallen behind expenditures



Ministry of Finance

November, 2013

10

Realities facing the government

- Public debt continues to rise, because government spends more than it collects in revenue
- Interest payments on the debt are increasing, taking resources away from useful public programs

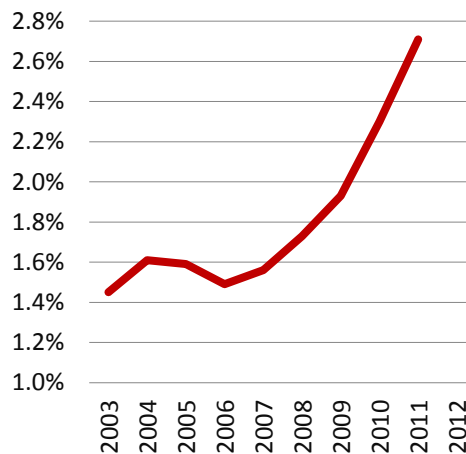
November, 2013

Ministry of Finance

11

Bahamas Govt. Interest Payment Burden (% of GDP)

Rising debt shifts more resources to interest payments. Budgeted at \$229 million in FY2013/14



November, 2013

Ministry of Finance

12

Realities facing the government

- Public debt continues to rise, because government spends more than it collects in revenue
- Interest payments on the debt are increasing, taking resources away from useful public programs
- The increase in the debt must be halted, to free up funds for roads, parks, education, health services and the like...

November, 2013

Ministry of Finance

13

How did we get here?

- Deficits have gotten larger and since 2007
- Borrowings helped to soften the blow of recession

November, 2013

Ministry of Finance

14

Can we afford not to act?

November, 2013

Ministry of Finance

15

The cost of doing nothing

- Debt would continue to rise
- Less capacity to borrow for emergencies
 - More difficult to recover from hurricanes and other disasters
 - At greater risk for more severe belt tightening if there is economic shutdown in foreign economies on which we depend for tourists
- Credit downgrade and eventual loss of access to credit markets

November, 2013

Ministry of Finance

16

The cost of doing nothing

- Government would have to introduce much larger tax increase
- Large increases in prices for subsidized public services
- Larger reductions in spending would be needed, including possible reductions in public sector employment and salaries
- Difficulty maintaining the value of the Bahamian dollar

November, 2013

Ministry of Finance

17

A comprehensive approach to addressing the challenges

November, 2013

Ministry of Finance

18

The comprehensive approach

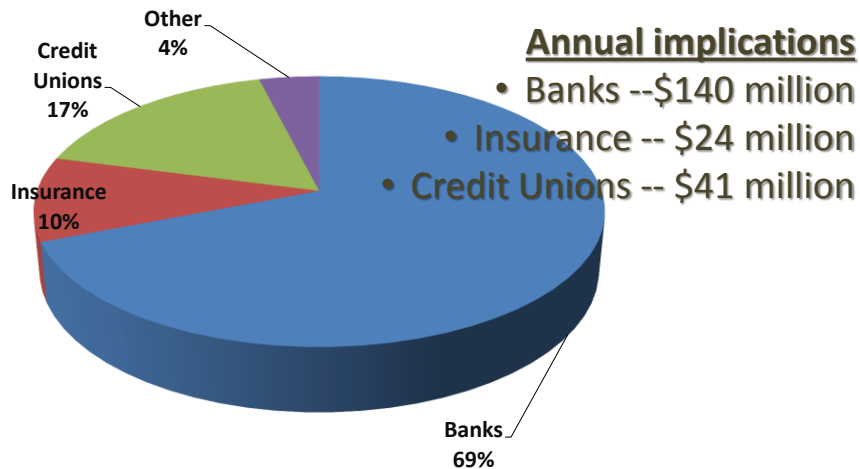
- The entire public sector must become more efficient:
 - Contain and reduce costs inside government and within public corporations
 - Do it gradually to avoid unsettling effects on private sector

November, 2013

Ministry of Finance

19

Government monthly salaried persons deductions average \$20 million



November, 2013

Ministry of Finance

20

The comprehensive approach

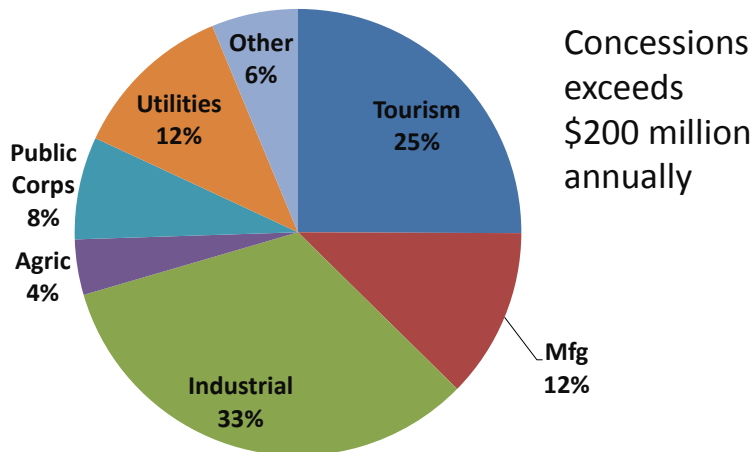
- The entire public sector must become more efficient:
 - Contain and reduce costs inside government and within public corporations
 - Do it gradually to avoid unsettling effects on private sector
- Make the system of tax concessions less generous, but in a fashion which does not jeopardize existing

November, 2013

Ministry of Finance

21

Is it straight forward to rollback tax concessions?



November, 2013

Ministry of Finance

22

The comprehensive approach

- The entire public sector must become more efficient:
 - Contain and reduce costs inside government and within public corporations
- Make the system of concession less generous
- Improve revenue performance
 - Adopt new broad base measures to share tax burden more equitably
 - Do more to collect existing taxes: customs revenue, property taxes, business licence, tobacco (excise stamp)

November, 2013

Ministry of Finance

23

The Government's strategy reduce debt: the \$500 million correction

By 2017:

- Grow annual revenue by at least \$500 million relative to the current level of collections
 - VAT must provide at least \$200M
 - Other direct measures and reforms to give at least \$200M
 - Economic growth provides remainder
- Maintain tight control on spending. Reduce the size of government relative to the economy

November, 2013

Ministry of Finance

24

Does The Bahamas have a spending problem?

November, 2013

Ministry of Finance

26

Does the Bahamas have a spending problem?

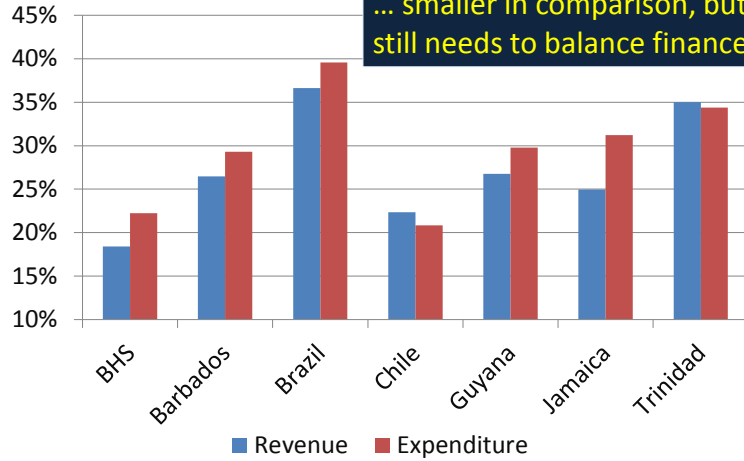
- The level of both expenditures and taxation are lower than in regional countries
- Debt levels and the share of government resources spend on interest payments are lower in comparison
- However The Bahamas could find itself in the same burdensome circumstances as some of its neighbours

November, 2013

Ministry of Finance

27

Government Revenue and Expenditure (% of GDP, in 2011)

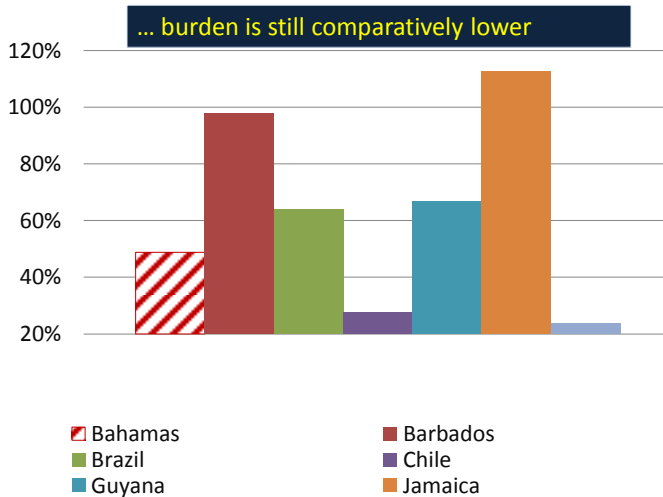


November, 2013

Ministry of Finance

28

Government Debt 2011

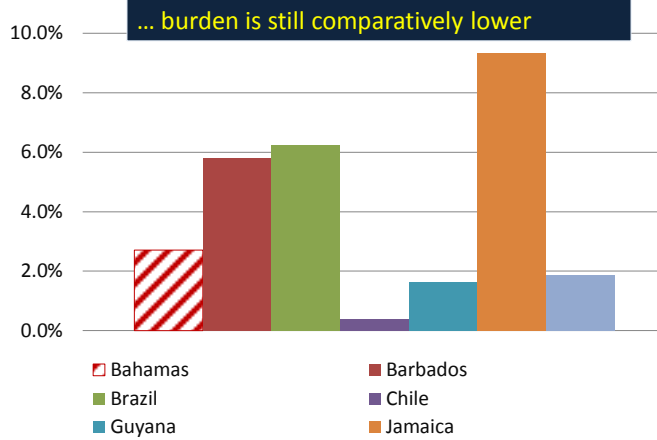


November, 2013

Ministry of Finance

29

Interest Payments in 2011 (% of GDP)



November, 2013

Ministry of Finance

30

Why VAT?

November, 2013

Ministry of Finance

31

The Case for VAT

- Fits into broader program of reforms
- Broadens tax base
- Increases equity, especially in burden of fiscal adjustment
- Superior to sales taxes in collections and enforcement efficiency

November, 2013

Ministry of Finance

32

The mechanics and concepts.

November, 2013

Ministry of Finance

33

Approach to VAT is one of rebalancing--**Plus**

- A replacement tax (not entirely new revenue)
 - July 1 2014: Lower the average rates of customs duties and excise taxes
 - Impose the VAT on these goods
- Impose VAT on a range of services
 - New revenues from services will offset any reduced customs revenue
- **PLUS....** generate additional net revenue

November, 2013

Ministry of Finance

34

Frequent Comments Questions

- VAT will disadvantage business that cannot claim credits
- The underground economy will flourish
- Individuals will shop abroad to avoid paying VAT at cash register
- A sales tax would be better

November, 2013

Ministry of Finance

40

Frequent Comments Questions

- The culture of tax compliance is weak
- Bahamian business are not accustomed to keeping good records
- VAT increases business uncertainty
- See sponsored video on St. Kitts and Nevis

November, 2013

Ministry of Finance

41

Alternatives....

November, 2013

Ministry of Finance

46

Why Not A Sales Tax?

- The experience is same for end consumer
- Weaker self enforcement mechanism
- No ability to secure any portion of tax before final stages

November, 2013

Ministry of Finance

47

Why not use a lower rate of VAT?

- Fiscal reform is being driven by size of the correction.

November, 2013

Ministry of Finance

48

Why not other taxes: income, corporate

- Reforms would have to be net positive for investments, growth and employment; and occur in equitable fashion across the economic landscape
- Will require reform of incentives frameworks for large FDI, which commonly rule out tax on profits

November, 2013

Ministry of Finance

49

Why not other taxes: income, corporate

- Must fit into broader strategy to build external competitiveness and reduce other costs of doing business (like productivity, and skills deficiency)
- Would require redesign of approach to residential tourism (if equity in personal taxes is achieved)
- Would have to address equity in treatment of international services sector and Freeport licensees

November, 2013

Ministry of Finance

50

What we should expect...

November, 2013

Ministry of Finance

51

Expected Growth

- VAT will encourage private expenditure switching into investments
 - Raises medium and long-range growth potential and reduces structural unemployment
- Over a decade the economy has potential to be at least 10 percent larger than in the absence of reforms.

November, 2013

Ministry of Finance

53

Expected Impact on Inflation

- VAT would have some initial impact on prices which will dissipate quickly
- The fiscal reform package would lead to reduced price pressures
- After 5 years the price level would be comparatively lower overall, than in the absence of reforms.
 - Lower budget deficits reduce the pressures on inflation

November, 2013

Ministry of Finance

54

Social Policies

- The spending on programs which affect the poor, and vulnerable, including old age pensioners will be increased to alleviate the cost of living impacts
- The spending will only have to be increased on a temporary basis
 - These would promote more progressive outcomes over all time frames
- Some services will be exempt, such as
 - Basic bread basket food items
 - Education
 - Health

November, 2013

Ministry of Finance

55

Summing up...

November, 2013

Ministry of Finance

56

Conclusions

- Important to deliver on as broad a fiscal reform as possible
- VAT is an important part of the fiscal reform agenda
- Government is also focused on broader reforms to revenue administration, and public sector expenditure
- Growth, employment and private sector interests will fare better

November, 2013

Ministry of Finance

57

Comments/Questions

taxreform@bahamas.gov.bs



November, 2013

Ministry of Finance

58