



COMMONWEALTH OF THE BAHAMAS

2007/2008

MID-YEAR BUDGET STATEMENT

ON THE SIX MONTHS ENDING 31ST DECEMBER, 2007

Presented to the Honourable House of Assembly

by

The Rt. Hon. Hubert A. Ingraham, M.P.

Minister of Finance

on

Monday, 25th February, 2008

INTRODUCTION

I have the honour to present to this Honourable House the first Mid-Year Budget Statement in accordance with my undertaking to this Honourable House and to the Bahamian people in the 2007/2008 Budget Communication. As I indicated at that time, this statement sets out the economic background of the fiscal year to date, the fiscal performance of the first six months in the current fiscal year and any proposed additions to expenditure for approval.

PURPOSE AND IMPLICATIONS OF MID- YEAR BUDGET STATEMENT

Ministerial accountability to Parliament

The introduction of this Mid-Year Budget Statement into the Budgetary process of Government represents the establishment of a level of transparency and accountability

which is, without doubt, a noteworthy enhancement in the process of governance.

Up to this point, the budgetary process as involved in the annual Budget Communication and supporting documents primarily concerned itself with a consideration of the economic context of the fiscal period, the articulation of the Government's expenditure plans and programmes for the fiscal year, and with the issues relative to the raising of necessary revenue and finances for the Budget. The performance review which takes place during that process is not the primary focus and is therefore overshadowed by the attention given to the plans for the up-coming year. In short, one might say that little attention is paid to the performance of the Government in the current year because the main focus is on the next year.

The Mid-Year Budget Statement on the other hand, is concerned primarily with how the current fiscal budget is

actually performing in relation to the plans and projections put forward as the Government's goals and objectives in the Budget Communication. It is specifically an opportunity for Ministers to report to Parliament and the Bahamian people on the progress they are making on the programmes established for their portfolios in the current fiscal year, to determine its adequacy and to make the case for any additional expenditure which may be required. The documentation being circulated with this Statement contains the necessary information for this reporting process. The documentation shows the progress of expenditure on Recurrent and Capital Expenditure and on Recurrent Revenues. The information is therefore, being laid before this Honourable House to enable it to query all aspects of the management of the public finances, and to question Ministers thereon.

Thus, this opportunity is specifically structured for Parliamentary review of the performance of the Budget

midway during the fiscal period. This Mid-Year Budget Statement therefore adds an important element of accountability to the Budget process in which the Government is obliged to review the progress of its performance in relation to its stated objectives mid-way in the fiscal year. My Government is honoured to have had the opportunity of introducing this new landmark in strengthening our parliamentary process and making government more accountable to the people.

Accountability of senior Government officials

I would also like to emphasise that the preparation of the data on government expenditure and revenue for the Mid-Year Statement has placed considerable responsibility on the Accounting Officers and Principal Receivers of Revenue throughout the Public Service, and on the senior financial managers in the Public Corporations. In the case of the Public Service, these persons are the highest ranking officials and are usually Permanent Secretaries

and Directors of Departments, and are appointed as Accounting Officers and Principal Receivers of Revenue under the Financial Administration and Audit Act. The Mid-Year Budget Statement imposes a heightened awareness on these senior managers in the Public Service and on the senior managers in the Corporations of the importance of strict financial management and controls. They must analyse and monitor their agencies' budgets closely and brief their Ministers accordingly. In this way, it strengthens financial discipline and awareness. Consequently, the initiation of the Mid-Year Statement can be regarded as a major step in public sector reform and development. It drives home the message to persons at the highest levels, Ministers and senior managers in the Public Sector, that they are clearly expected to manage the people's money with the greatest care and responsibility, and that they are accountable to Parliament and the Bahamian people.

The 2007 IMF Article IV Mission, which published its Report in January, 2008, has this to say about the Mid-Year Statement:-

The Government's intention ... to introduce a midyear budget review (sic) is commendable, promoting transparency and greater accountability in fiscal management.

Enhancing accountability and transparency

Finally, in setting the general context of the importance of the Mid-Year Budget Statement I would like to pay tribute to the commendable work of the Central Bank of The Bahamas in producing its monthly and quarterly publications. These bring together important commentaries on the economy, and provide excellent data on a wide range of economic indicators. The annual Budget documentation, the documentation for this Mid-Year Statement, the publications of the Central Bank and the statistics prepared by the Department of Statistics provide

a wealth of material on the Bahamian economy which enables Parliament, the Bahamian investors and international institutions and investors to closely follow developments in the Bahamian economy. My Government intends to ensure that if there are any deficiencies or shortcomings in the information available, these deficiencies or shortcomings will be speedily addressed. This is a further dimension to our commitment to transparency and accountability.

THE ECONOMIC CONTEXT

The Global Economic Outlook

Fears of a U.S. recession, and a general deterioration in credit and severe strains in financial markets are definitely moderating the outlook for global economic growth in 2008. The International Monetary Fund projects solid growth for the year, but sees the overall balance of risks to the global growth outlook as being on the

downside. Projections for global growth for 2008 have been reduced from 4.8 percent to 4.1 percent.

The projections for growth in the advanced economies have been reduced significantly. In the United States projected growth has been lowered to 1.5 percent for 2008, down from the 2.2 percent in 2007.

For other major economic regions, such as the Euro Area and Japan, growth prospects have been similarly dampened.

What began as a test of credit markets related to the sub-prime sector has clearly extended well beyond this sector to bring pressure on the balance sheets of major financial institutions. This has put severe strain on credit markets and is perceived by some as threatening a deeper economic down-turn in the United States and elsewhere.

At the same time, it has to be stated that there is no universal consensus on the likelihood and possible severity of a deeper recession in the United States and its global

consequences. A Conference at the end of January, 2008, hosted by the Brookings Institution and the International Monetary Fund did not produce consensus on these issues. Indeed there were positive views as well as negative views. In this context I would mention the major, indeed almost unprecedented, reduction in interest rates by the Federal Reserve and the economic stimulus package recently approved by the US Congress.

Domestic Economic Developments

As regards the Bahamian economy, it is important to bear in mind that as recently as January, 2008, when the Report of the 2007 Article IV Mission was published, the growth projections for the Bahamian economy for 2007 was 5.6% in nominal terms or 3.1% in real terms, and for 2008 it was 6.5% in nominal terms or 4.0% in real terms. Thus, even as late as January of this year, the IMF seemed to believe that the Bahamian economy could grow by 6.5% in nominal terms or 4.0% in real terms in 2008.

Admittedly, the Report referred to the possible impact of a major downturn in the US economy but it also referred to the growth momentum of the Bahamian economy based on the implementation of major investment projects in 2008.

I should also mention in this context the Standard & Poor's report on the Bahamian economy. That report noted the downturn in tourism arrivals in the first 9 months of 2007, bearing in mind that tourism contributes 60% of GDP, suggested a shrinking in the construction sector which accounts for 10% of GDP, and also suggested that the financial services sector, which accounts for 20% of GDP, could be adversely affected by the global crisis in the financial markets.

While, we note with concern the views of Standard & Poor's, framed as they are in the general context of a US and global downturn which is not yet certain, we are not yet persuaded to downgrade the growth rate, in view of the fact that it was not a particularly dynamic rate in the first

instance. As regards the individual sectors, we believe that tourism performance is below expectation, and we are going to address this issue decisively by allocating additional funds for tourism promotion. However, we also believe that the construction sector will perform more strongly than the report suggests.

In view of its importance to the economy, I want to make more detailed comments on the tourism sector. Its performance remained subdued in 2007 with both air and sea arrivals trending lower. The weakening in this sector which became evident in 2006 grew more pronounced in 2007.

It appears that the greatest slippage occurred in Grand Bahama and in the Family Islands. In New Providence the slippage of 1.8 percent was less severe. The problem with quantifying the issues is that reliable, accurate, comprehensive and timely tourism data are not available, and as soon as they are they will be published. We do not

wish to repeat the experience of the recent past where inaccurate and patchy numbers were prematurely issued. We cannot have a rational discussion on this matter – of paramount public concern – or, indeed, on any other such matter, without good data.

Even if we do not have the quality data we would like for decision-making, we realize that there is a serious concern with the performance of the tourism sector in 2007 and so far in 2008. That is why we are implementing a major expenditure initiative in that sector. Indeed, our tourism sector needs urgent attention to review its competitiveness, its attractiveness and its capacity. This review is in progress and as an initial impetus to the sector we are providing an additional \$12million for tourism promotion in the Supplementary Recurrent Appropriation Bill.

My Government has chosen to take a balanced view of the likely growth prospects of the Bahamian economy in

2008. The current outlook for strong capital inflows into productive projects already underway may not be seriously affected by global or U.S. developments in 2008 and 2009. This could give rise to what we consider would be a certain element of ‘decoupling’ between the performance of the US and Bahamian economies in 2008. By this I mean that while normally the health of our tourism sector, and therefore our economy, is heavily connected to prevailing conditions in North America, in 2008 matters might be a little different. This is because even if there is a more severe recession in the US in 2008, the capital inflows and the momentum of some of the major investment projects in The Bahamas will partially compensate.

Turning to other economic indicators, despite the surge in crude oil prices during the year, inflation remained relatively low at 2.5 percent, up from the 1.8 percent of the previous year.

The ease in credit growth, particularly in the latter half of the year, permitted liquidity conditions to remain relatively buoyant as the banking system's excess reserves expanded by \$105.5 million to \$241.7 million, compared to a contraction of \$59.2 million the previous year. Excess liquid assets also improved by \$145.4 million to \$154.8 million, compared to a contraction of \$103.0 million in the previous year.

The credit-inspired pressure on external reserves in the previous two years, was substantially reduced in the second half of 2007 and the loss of external reserves of \$45 million was substantially below the losses in each of the previous two years. For instance, in 2005 the External Reserves fell by \$89million, and in 2006, they fell by \$79million.

The most recent economic data suggest that construction activity moderated during 2007 in both residential and commercial investments. It is expected

that the activity in this sector may be stronger in 2008 as construction on some large scale foreign investment projects is scheduled to commence.

Preliminary estimates, indicate that unemployment in The Bahamas rose by 0.3 percentage points to 7.9% in 2007. This rise in unemployment reflected the fact that the number of persons added to the labour force in 2007 was 5,850 while the number of persons employed in the same period was 4,985. The reduction in the level of unemployment and the raising of living standards are, of course, the ultimate objectives of government economic policy. Therefore, we must encourage the training, educating and equipping of as many Bahamians as possible in order for them to take advantage of the gainful opportunities opening up and available in the economy. To this end, we must have in place the right structures for education, training, placement and entrepreneurial development. The appropriate Ministers will, no doubt,

wish to address these issues in the debate on this Mid-Year Budget Statement and the related Supplementary Appropriations Bills.

2007/08 BUDGET PERFORMANCE

It will be recalled that in the 2007/08 Budget Communication my Government committed to a GFS Deficit of 1.8% of Gross Domestic Product. The GFS Deficit is total government expenditure excluding debt redemption minus revenues excluding borrowings. It provides a measure of the impact of the budgetary situation on the level of Government borrowing. The Government's fiscal commitment is the systematic reduction and ultimate elimination of the GFS Deficit, in order to bring the debt to GDP ratio to between 30 percent and 35 percent of Gross Domestic Product, from its 2007/08 level of 37.3%. We recognize this as an essential requirement in preserving the competitiveness and economic viability of our country and therefore critical in

the urgent task of continuously improving the economic welfare of the Bahamian people.

My Government's commitment to eliminating the deficit and bringing the level of Government Debt to within the range 30% to 35% of GDP are not theoretical undertakings. They are very real issues for the people of The Bahamas. A country with a high level of Government Debt has to levy high levels of taxation to service the debt and thus, all else being equal, reduces take-home pay, and depresses economic expansion which hurts both public and private sectors welfare. A country with a high level of government debt has very little room to manoeuvre if the economic environment deteriorates and revenues fall. This is because the government has either to reduce expenditure on vital services or raise additional taxation because borrowing is not available. My Government's strategy is to steer The Bahamas towards a situation where there is no risk to our economy from having a high level of

Government debt arising from a sequence of major fiscal deficits. My Government has given great weight to these issues and we are convinced that the Bahamian public, international institutions and investors in our economy will endorse our strategy. We have progressed far along this road but we have further to travel.

In this Mid-Year Budget Statement, we remain committed to the limit of 1.8% for the GFS Deficit in the 2007/08 Budget Communication and we are not departing from it. In this Statement we are making adjustments to Recurrent and Capital Expenditures but, crucially, we are remaining within the total limits already approved for these Expenditures. Furthermore, we are not making any adjustments to Revenue. Therefore, there will be no increases in taxes and there will be no new taxes. I will elaborate on these points as we progress.

The documentation being circulated with this Mid-Year Budget Statement shows the progress for the first 6

months of the 2007/08 fiscal year, that is for the period July to December 2007, of Recurrent and Capital Expenditure and Recurrent Revenue. The purpose of the data is to enable this Honourable House to assess the progress being made through the 2007/08 Budget across the whole field of government expenditure and revenue.

The totals for expenditure and revenue for the six-month period must be viewed with some caution for the reason that there is no legal reason under the financial legislation to effect a cut-off to delineate the first six months from the second half of the fiscal period, whereas it is a constitutional requirement, reflected in the financial legislation, that books must be closed at the end-year. As a consequence in both revenue and expenditure there can be seasonal and other factors that significantly affect the apparent performance in the first 6 months of the fiscal year. Allowance must be made for these factors in analyzing the data.

On the basis of the data for the first 6 months of the 2007/08 fiscal year, that is for the period July to December, 2007, expenditure was some \$75million less than forecast whereas revenue was only \$53million less than forecast. Thus, there is a surplus of revenue over expenditure emerging of \$22million.

Recurrent Expenditure

As I said, on present trends it seems clear that overall actual Recurrent Expenditure will be substantially below the level provided for in the Approved 2007/08 Estimates. Thus, the data circulated with this Statement show Recurrent Expenditure being some \$75million below forecast for the first 6 months, that is for the period July to December, 2007. Not all of the underspending in recurrent expenditure of \$75million arising in the first half of 2007/08 will result in realized savings at the end of the fiscal year. In the six month cycles, some under-expenditure could easily arise from even brief

administrative delays in expenditure implementation. There is, however, an element of underspending which traditionally carries through to year-end and in the circumstances represents savings sufficient to at least offset the proposed supplementary recurrent expenditure of \$23 million. As a result, the additional Recurrent Expenditures provided for in this Mid-Year Budget Statement amounting to \$23million can be accommodated without involving reductions in Recurrent Expenditure on essential government services and without any increase whatsoever in overall expenditure. Indeed, bearing in mind that the Approved 2007/08 Estimates represent the limit of authorized expenditure, administrative action can be taken to contain expenditure. In view of my earlier comments on the enhanced emphasis being placed on careful and prudent management of the Government's finances by Ministers and the senior management in the Public Service and the Public Corporations, I see the

process of control being exercised more diligently and more responsibly than heretofore.

Additional Recurrent Expenditure is being allocated to the following Heads and is set out in the accompanying Supplementary Appropriation Bill.

Head 67: Ministry of Tourism and Aviation:

An additional \$12million for enhanced tourism promotion.

Head 63: Public Hospitals Authority: \$2million is being advanced to the Authority for the item Other Contractual Services to address increased expenditure on cancer treatment and dialysis services and an additional \$1.6million is being advanced for the item Supplies and Materials, mainly the increased costs of medical drugs.

Head 5 Department of Public Service:

An additional \$2million outstanding gratuities for the estates of deceased public officers. Some of the claims have been outstanding for many years. This amount plus

the amount already available in the current budget allocation will meet these claims which will be settled this fiscal year.

Head 31: Royal Bahamas Police Force: An additional \$2million for essential items such as *Transportation and Subsistence*, and for other current items.

Head 7: Office of the Attorney General and Minister of Legal Affairs, and Head 25: Magistrate's Courts

An additional \$150,000 for Head 7, and \$30,000 for Head 25, to meet the items *Transportation of persons within The Bahamas, Subsistence for Travellers within The Bahamas* and \$50,000 for *Operation of Facilities and Other Service Contracts*.

Head 45: Department of Housing: An additional \$800,000 to reimburse the Corporation Sole Account for salaries advanced to contract workers engaged in the Department of Housing.

Head 65: Department of Environmental Health

Services: An additional \$250,000 for the item Gasoline and an additional \$614,384 for the item Operations of Facilities or Other Service Contracts to meet commitments.

Ministers will deal with any queries in relation to the additional appropriations or the reduced appropriations.

Revenue

In order to monitor performance, forecasts are prepared for each month based as far as possible on the likely pattern of receipts from previous years and other relevant considerations. The forecasts are, therefore, only indicative and not hard and fast.

Revenue forecast for the first six months of fiscal year 2007/08 was \$681million which represents 45.7 percent of revenue forecast for the full year. This 45.7 percent is reasonably reflective of the proportion of revenue which the first 6 months of the year traditionally represents.

Actual revenue for the first six months was \$628.1 or \$52.9 million below forecast.

The principal revenue departure from forecast occurred in stamp tax, which although \$13.3 million higher than in the previous year, was \$ 32.1 million lower than forecast. The remainder was accounted for by Real Property Tax, \$ 8.1 million, Import Duties, \$ 6.7 million, and Gaming Tax, \$ 3.4 millions.

The revenue departure from forecast of \$ 52.9 million was considerably less than recurrent underspending of \$75.3 million in the first half. There is some weakness in revenue performance in the first half of the year, but it is probable that this will be fully offset, inter alia, by improvements expected in the second half from continued enhancement in collections, and from new projects now coming on stream. Taking account of these considerations, at this juncture one can assess that the projected revenue is likely to be fully achieved.

Capital Expenditure

The estimates of Capital Expenditure for the first half are based on planned expenditure or commitments for the period. The underspending of \$22million, the bulk of which occurred in The Ministry of Works and Transport and in other Ministries and Departments represents projects whose initiation or progress has been delayed, or projects unlikely to be proceeded with in this fiscal year, or projects on which reduced expenditure is expected in the current year on the basis of progress to date. Hence the full allocation for these projects would not arise in this fiscal period. This allows for the re-allocation of these funds to other projects. Approval for Supplementary Capital Expenditure of \$39,941,621 is being sought as follows.

Head 21 Sundry Capital Expenditure:

An additional \$11.3million for Bahamasair. The additional expenditure is in respect of payments for

maintenance and capital equipment. The payments will be made directly by the Ministry of Finance after it is satisfied that they are in order.

An additional \$7.4million for the Water and Sewerage Corporation. As in the case of the other loss-making entities, the payments will be made directly by the Ministry of Finance after it is satisfied that the claims are in order.

An additional \$480,000 for the Broadcasting Corporation of The Bahamas to purchase specified capital assets. The purchases will be paid for directly by the Ministry of Finance when it is satisfied that the expenditure is justified and in order.

Head 38 : Ministry of Education, Youth, Sports and Culture:

An additional \$10million for the item New Primary and Secondary Schools to meet outstanding commitments to contractors. And an additional

\$5.76million is being made in respect of the item Repairs – School Facilities in Family Islands and New Providence for the same purposes.

Head 45: Department of Housing: An additional \$5million to restart the Government’s housing programme and upgrading of needed infrastructure.

The Appropriation Amendment Bill includes these provisions.

Ministers will deal with all queries in relation to the increased Capital Appropriations.

It will be noted that \$19million or 48 per cent of the total of \$40million in Supplementary Capital Expenditure represents additional transfers to deficit-generating Public Sector entities. Thus, we are obliged to scale back on other projects to accommodate the demands of these entities. This means that many priority projects may be denied resources because additional funds must be advanced to

the loss-making entities. This is an unsustainable situation which must be addressed.

CONCLUSION

Again and again in this Statement I have emphasized the importance of transparency and accountability. Each Minister and public official must be held accountable for how they spend the financial resources of the Bahamian people and how they collect these resources. I have no problem with accepting this responsibility. As I said in the quotation from Shakespeare at the conclusion of the 2007/08 Budget Communication:

Mine honour is my life; both grow in me;

Take honour from me, and my life is done.

Our beautiful country would be so much richer and fairer if all government servants subscribe to this sentiment.

As this is the first occasion on which the Mid-Year Budget Statement has been presented, and as the

Statement is of great import, I have sought to be exhaustive in setting out the issues involved. As a result the Statement is lengthy but I expect in future years – because the background will be understood – the Statement can be much briefer. I have no doubt, too, that as experience is gained in preparing the data for this Statement in the coming years, the importance of the exercise will be enhanced. I thank the Members of this Honourable House for their patience, and I have the Honour to present the Statement and the associated Bills.

25th February, 2008