



COMMONWEALTH OF THE BAHAMAS

**2003 /04
BUDGET COMMUNICATION**

Presented to the Honourable House of Assembly

By

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Minister of Finance

on

Wednesday, 28th May, 2003

2003/04 BUDGET COMMUNICATION

I have the honour to present the 2003/04 Budget Communication.

Introduction

The presentation of the Budget Communication is usually a matter of considerable interest to the public, and I am sure that this year is no different.

Everyone wants the Budget Communication to provide a realistic assessment of the economic situation which is likely to emerge during the course of the next year, because jobs and incomes and prosperity hinge on these economic developments. In this Communication I hope that I can convey a cautious, but realistic and confident assessment that the global economy, and with it the Bahamian economy, is commencing a steadily strengthening recovery. In this regard, the April 2003, *World Economic Outlook*, the authoritative publication issued by the International Monetary Fund projects real economic growth for the Bahamian economy of 2.9% in 2003 and 4.5% in 2004. While in many respects the *World*

***Economic Outlook* emphasizes the risks affecting the global economy, the relatively upbeat growth rates projected for the Bahamian economy are reassuring. What is even more reassuring is the announcement by Kerzner International that work will shortly start on the \$600 million Phase III Development on Paradise Island. The project alone, involving the anticipated creation of 2000 new permanent jobs for Bahamians, is a tremendous confidence boost to the Bahamian economy, and further confirms that the outlook for the Bahamian economy is indeed very bright moving into 2004 and later years.**

The re-opening of Club Med in San Salvador and the recent announcement of a \$130 million project for Abaco are also confidence boosters for the Bahamian economy. In the coming weeks and months it is expected that similar anchor projects will be announced for the Exuma Cays, South Eleuthera, Rum Cay, Cat Island, Grand Bahama and other Islands.

Some members of the public, and special interest groups, look to the Budget in anticipation of new announcements such as concessions and special payments. To many of those persons

and interest groups I would suggest that this is a time for caution but as recovery strengthens, our growing economy should provide the financial resources to implement, with increasing vigour, the policies in *Our Plan*. However, to the elderly, the vulnerable, the handicapped, the underprivileged, and the lower income groups, I want to say that, despite the necessity for fiscal restraint, in this Budget we are making significant concessions which we hope are a start in helping you better cope. As our economy improves and our revenues increase, we will add to these concessions.

Finally, I am sure that this Honourable House, and the people of The Bahamas generally are waiting apprehensively for the taxation measures which are usually announced in the Budget. To all of these people, I am glad to announce that, while the 2003/04 Budget contains revenue enhancement measures, it does not contain any major taxation increases and only very modest increases in a small number of fees.

Speaking more broadly, the importance of the Budget Communication derives from the fact that it is the annual vehicle for setting out the economic, financial and social

programme of the Government for the next year, and placing this programme in the context of the Government's medium-term strategy. I wish to emphasise most strongly that the programme and the strategy are informed by the Government's philosophy in relation to good governance. The expression 'good governance' has many dimensions. Probably the most important dimension of good governance would be the ability of government to provide a prosperous, secure and safe way of life for all of its people. The global phenomenon of the rise of terrorism and violent crime and the vicissitudes of the international economy, preclude any country - regardless of size - from being able to guarantee good governance in that sense. This means that the dimension of good governance which a government can address comprises at least the following elements:-

First, explaining to the public the critical political, economic and social issues which must be addressed to protect the national interest and their personal interests,

Second, explaining to the public the policy options available and the implications of these various options, and

Third, listening carefully as the public articulate their views as to the most acceptable options.

It is only when this entire process is completed that appropriate and sensible decisions can be taken which have the fullest understanding and support of the Bahamian public.

After one short year in office it is clear that this Government is pursuing this dimension of good governance. The complexity and magnitude of the issues facing The Bahamas - which arise from the integration of The Bahamas into the global economy and the uncertain global environment - require Government to explain, to consult, to listen, and then decide. This is my Government's approach and I am very proud that this is the approach which we are following. This consultative and participatory approach is the essence of democracy. It means that we will not rush to judgement or to decision based on the crucial issues facing the Bahamian nation. Instead we will move forward carefully and deliberately and take decisions

based on the best possible information and following the widest consultations.

To give a very specific example of our approach, I wish to advise this Honourable House that we have the Report of the Prison Reform Commission. We have studied that Report and we will commence implementation of the Report in 2003/04.

Similarly, we have the report of the expert group on Clifton Cay. We have studied that report and will be implementing its recommendations in 2003/04.

The Labor and Employment Law Review Commission has reported and that Report is currently being reviewed.

My Government has also received an Interim Report from the National Health Insurance Commission and look forward to their final report and recommendations in the ensuing budget period.

As I have said, my Government is concerned to inform and consult widely on all major issues so as to reach the broadest consensus and understanding before moving forward. In moving forward, I would wish to ensure that all of our decisions

attract the fullest support of the Bahamian public so as to minimize the necessity for corrective actions.

My Government's approach is, I believe, precisely what is needed at this time in our nation's history and is very much in the mainstream of participatory democracy as practiced in many advanced countries.

The Macroeconomic Fundamentals

In accord with the usual two-year consultative cycle, the IMF Article IV Consultation Mission visited The Bahamas in April, 2003. Following the precedents set by the publication of the Reports of the 1999 and 2001 Article IV Consultation Missions, the Report of the recent Mission will be published later this year following discussion by the IMF Executive Board.

The recent Mission met with my Cabinet to give us a preliminary review of its findings. One of the most important comments by the IMF Mission was that The Bahamas has a long track record of prudent macroeconomic and financial stability. Our economy has been severely buffeted from time to time by external shocks, but unlike most other independent countries

in this Region excluding the North American giants, The Bahamas has never had to seek financial assistance from the multilateral financial organizations such as the IMF. Great credit is due to successive Governments of The Bahamas and to the people of The Bahamas for that track record. At the same time, the Bahamian people have recognized that this track record involved, and continues to involve, considerable self-discipline, awareness of economic and fiscal realities, and great patience in pursuing growth-oriented policies so that improvements in public services can be soundly and sustainably financed. Of course, there have been circumstances in some periods when maintaining the record was extremely difficult. For example, the early years of the 1990's when the Gulf Crisis and War occurred. More recently, during the sharp deterioration in the external environment in 2001/2002.

This track record is sufficiently impressive, and the prospects for the Bahamian economy sufficiently strong that bankers have recommended that The Bahamas should float another US \$ Bond Issue in New York in the coming months.

This is a matter which I will discuss later in this Communication.

In this Budget Communication I will be setting out the measures which are necessary to maintain this proud record. Above all else, maintaining this record requires keeping the objective of fiscal balance firmly in view.

International Economic Developments

Turning to these developments, we are all acutely aware that the strong expansion in the global economy came to an end in the year 2000. Initially, there were the corrections in global stock markets, which particularly affected high-tech stocks. These corrections were further exacerbated by concerns about corporate governance, particularly in the US, which further dampened expectations of early return to rapid economic growth. Political factors then intervened to further exacerbate matters. There were the awful terrorism events of September, 2001, and the heightened geopolitical uncertainties primarily in the Middle East which certainly dampened

expectations of an early return to the confidence and optimism of the 1990's.

No economy has escaped the difficulties in the global economy in recent years. For example, economies as different as the United Kingdom and Barbados have experienced these difficulties; thus, the Governor of the Bank of England in a major address recently stated:-

“... It has made life pretty difficult, too, I have to say for those of us involved in macro-economic management.”

and the Rt. Hon. Prime Minister of Barbados in his October 2002 Financial Statement to Parliament said:-

“...Since I last had the honour to present the economic and financial policies of the Government of Barbados ..., our nation had to endure more than an ordinary measure of economic difficulty.”

The IMF, in its April, 2003, issue of the *World Economic Outlook*, suggests that there will be subnormal growth in 2003, and that will lead to a tepid recovery with normal growth only resuming during the first half of 2004. Indeed it is worth stating the comments of the IMF's Economic Counsellor and

Director of Research at the Press Conference explaining the projections in the issue. He stated as follows:-

“It is possible things could turn around more quickly, if war jitters have indeed been single-handedly forestalling the recovery, if oil prices turn out to be significantly lower than our baseline, and if global productivity growth turns out to be even more robust than we project. But, in our view, it is not just the war – a number of other risks weigh on the outlook. These risks include the unwinding of the equity price bubble in some regions, financial imbalances around the globe including the patently unsustainable constellation of current accounts, structural weakness in Japan and Europe, continuing security concerns that put sand in the wheels of globalization, as well as a variety of sundry further risks including fragilities in emerging markets and SARS.”

A period of sustained global deflation would be most unwelcome because, on the basis of historical experience, it would result in rising personal and corporate debt burdens and bankruptcies, and in rising unemployment and other social

costs. As a Governor of the US Federal Reserve Board stated in a recent speech:-

“Sustained deflation can be highly destructive to a modern economy and should be strongly resisted. Fortunately for the foreseeable future, the chances of serious deflation in the United States appear remote indeed, in large part because of our economy’s underlying strengths but also because of the determination of the Federal Reserve and other US policymakers to act preemptively against deflationary pressures.”

Even more recently again, the Chairman of the US Federal Reserve made similar cautious remarks.

My purpose in setting out these external and expert views at some length is to present to this Honourable House the background against which the 2003/04 Budget has to be prepared. Every other democracy is moving forward with great care and deliberation in economic and fiscal matters because of the continuing global uncertainties and insecurities. We must follow suit. This is a time for cautious optimism but not for alarm. This cautious optimism is certainly reflected in the

recently announced investment projects and those currently in the pipeline.

What my Government proposes to do in this Budget is to move forward, I repeat move forward, in implementing its programme as set out in *Our Plan* with deliberation and caution so the economy and the public finances can cope with any further major and unexpected external shocks.

As I have stated, the Report of the 2003 IMF Article IV Consultation Mission will be published after the Executive Board considers it probably about July, 2003. I am sure that this Report will be generally supportive of the Government's caution in macroeconomic matters. I also have no doubt that the Report will recommend significant changes in many aspects of our economic and fiscal arrangements for implementation in the medium-term. Consistent with this Government's consultative approach in all major matters, these recommendations will be implemented as appropriate over a reasonable time-scale and after consultation with the Bahamian public. Furthermore, in our approach we will take the greatest care to ensure that implementation does not diminish the

attractiveness of the Bahamian economy for productive inward investment.

International Trade Developments

In this context I would like to refer to the issues of the application of The Bahamas for membership in the World Trade Organisation, WTO, the ongoing discussions on the proposed Free Trade Area of The Americas, FTAA, and the position regarding the Caribbean Single Market and Economy, CSME. I have established a special commission under the co-chairmanship of the Deputy Governor of the Central Bank and the President of the Chamber of Commerce to consider the implications of these developments for the Bahamian economy. I look forward to the report of the Commission.

While I do not wish to anticipate the recommendations of the Commission, there are a number of specific points which I would like to emphasise in relation to this matter.

Firstly, this Government will consider carefully, before entering any trade agreement - and I include membership of the WTO.

Secondly, in entering into any trade agreement - or any other agreement affecting the vital interests of The Bahamas - my Government will be seeking clear and concrete reciprocal advantages for The Bahamas to, at a very minimum, offset any additional costs which the Bahamian economy will have to bear.

Thirdly, if entering into any trade agreement involves restructuring in any way our revenue system, as some advise we may have to do in due course, we will be seeking an extensive transitional period before any such restructuring has to take place.

Finally, I believe that the Bahamian economy and people are very well equipped by tradition and historical experience to take full advantage of opportunities which global and hemispheric developments may present. In that regard, we in Government will be doing everything possible to ensure that our economy and our people are competitive and equipped to exploit the opportunities which we are assured will arise.

Let me conclude on this point by stating that we in The Bahamas fully appreciate the importance of being part of the

mainstream in regional, hemispheric and global economic partnerships. My Government believes that we Bahamians can do this and still protect our vital national interests.

Relations with International Financial Organizations

Since entering office in May, 2002, I have had the opportunity of meeting with representatives of the two major international financial institutions of most importance to The Bahamas namely, the International Monetary Fund, IMF, and the Inter-American Development Bank, IDB. These institutions have willingly responded to our requests for technical assistance on a range of important issues. In the case of the IMF, in the last few years the IMF has provided valuable technical assistance in relation to enhancing the regulatory competitiveness of the financial services sector, strengthening and rationalising revenue administration, and on the production of timely and comprehensive economic statistics. My Government recognizes the importance of ensuring that the

key elements of recommendations arising from this technical assistance are implemented quickly.

In the case of the IDB, the Bank also provides valuable technical assistance. For example, the Bank recently conducted a seminar for senior officials to improve the quality of project planning and implementation. On a broader front, the Government and the Bank are in process of finalizing a country programme for implementation over the medium-term.

I am aware from discussions with the officials of the Inter-American Development Bank and various ministries in The Bahamas, that the Bank is an invaluable source of technical advice as well as being an important source of funding on reasonable terms. It seems to me that we as a nation will be looking increasingly to the Bank for technical assistance and financing as we move to deal with critical long-term issues. These are issues such as coastal erosion, environmental protection and solid and sanitary waste management. They are issues of critical importance because we must deal effectively and in good time with these issues in order to safeguard the

environment which is of such importance to our primary industry, tourism, as well as protecting our own habitat.

Steps to Strengthen Good Governance

We are currently in consultation with the Inter-American Development on a programme to cover the initial 5 years of this Government's period in office. One of the components of that programme will be projects and studies to assist in public sector reform and modernization. When I speak of public sector reform and modernisation I am not speaking negatively about the performance of the public sector. We have a public sector of high quality and the production of this Budget is testament to the dedication of many persons in the Public Service in the Ministry of Finance and of the other Ministries and Departments which provide input into the budget process.

However, the goal must surely be to strive for excellence throughout the Public Service and the Public Sector, a goal which is attainable provided the effort and organization is forthcoming. In the highly globalised and competitive world of this Century, an efficient and high performance economy

requires excellence from both its public and private sectors. In view of this consideration, it is vital that Government decisions are based on excellent systems throughout the Public Sector which generate comprehensive, timely and accurate economic and social statistics; provide comprehensive analyses of options; generate soundly based recommendations; and most importantly, ensure that the decisions are implemented in the manner intended. Unless decisions are based and implemented in this way, there is the great danger of overlooking vital considerations or of reaching unsound judgements or, indeed, of failing to implement the decisions taken in the manner determined. The intensification of globalization in the last decade means that the scope for correcting erroneous decisions and judgements is more and more restricted. Therefore, it is vital to put in place the whole range of systems which will facilitate proper decision-making. I have already referred to the important seminar conducted by the IDB for senior officials on project planning and implementation. This seminar was invaluable in disseminating knowledge and information on better ways of planning projects and programmes.

The whole range of strategies , information systems, and motivational steps, to which I refer means reconstructing the management approach and systems of the Public Sector. For brevity, I refer to this as Public Sector Modernisation.

You will appreciate from the remarks which I have made in other places and on other occasions that what I mean is the development of a new mindset throughout the Public Service and the Corporations and agencies of Government. The goal of the Public Sector must be excellent performance. It must mean that the rights and entitlements and needs of the taxpayer and the customer are primary; that these rights and entitlements are fully understood and ascertainable; that the officials in these various offices are motivated, trained and equipped to respond as quickly and as positively as possible to the public's reasonable demands; that recommendations to the policy level are based on the comprehensive information and analytical systems which I have earlier mentioned; and that the officials are accountable for their performance. The technical assistance of the IMF and IDB to which I have referred provides valuable advice which, when implemented expeditiously, strengthens

good governance. In relation to our own endeavors, already the Minister with responsibility for the Public Service is implementing new strategies within the Public Service. However, the issue of modernization extends to all entities – not just Ministries and Departments - which are mandated to provide services to the public. To encompass the overall issue of Public Sector Modernisation, I am establishing a special commission on Public Sector Reform and Modernisation to recommend specific proposals within a short period of months on proceeding with reform.

Another important issue of good governance is the strengthening of internal financial controls in all government agencies. Effective controls provide assurance to the public that ministries, departments and other government agencies are using public funds in accordance with law and approved policies, and are using the funds as efficiently and effectively as possible. The Auditor General is, of course, the constitutional office which reports to this Honourable House on these matters, but it is equally important for the executive – the Government – to have in place mechanisms for reviewing

its own procedures and controls. The Auditor General can then determine if the government's management and accounting systems are operating to acceptable standards, and that there is value for money in any expenditure incurred. Consequently, I am providing an additional amount in the Auditor General's Estimates for the implementation of an enhanced audit programme. I am certain that this expenditure will pay off in terms of ensuring that there is better value for the taxpayer's money.

Another issue which is of major importance in the medium-term to long-term is the safeguarding of the financial basis of the National Insurance Board. The recent report by the independent actuary on the Board's financial position highlighted certain critical issues. One of the most important of these issues is the necessity to gradually increase contributions as soon as possible to enable the Board to maintain its financial equilibrium. This is a critical issue which my Government will be addressing during its period in office.

The Performance of the Bahamian Economy in 2002/03

At this juncture, I would like to provide a brief review of the performance of the Bahamian economy.

The performance of the Bahamian economy strengthened during 2002 as compared to 2001. This is evident from the following factors.

First, tourism recovered from most of the setback experienced in 2001.

Second, the recent downtrend in foreign investments appears to have bottomed out, with net Foreign Direct Investment (FDI) inflows increasing moderately.

Third, the construction sector, which until very recently relied heavily on foreign investment projects, continued to derive steady support from domestic investments, financed by increased mortgage lending from local financial institutions.

Fourth, there is evidence of continuing improvement as has been heralded in the recent announcements of resort investments and expansion.

Tourism

Prior to September 11 2001, tourism was already experiencing significantly slowed growth, as a result of the weakening pace of the US economy. In the immediate aftermath of the terrorist attacks, industry output contracted sharply; the hotel sector was forced to absorb a sizeable discount on average room rates, and simultaneously face a sharp contraction in room occupancy rates. The industry, however, began an immediate pricing recovery, that was for the most part concluded by the end of the 2002 summer season.

Preliminary estimates suggest a 2.3% increase in tourism earnings, to \$1.7 billion during 2002, from \$1.6 billion in 2001, which was a decline of 4.8% over 2000.

In support of this upturn, total visitor arrivals increased by 5.2% to a record 4.2 million in 2002, following a 0.5% contraction in 2001. The increase in cruise visitors arose

from an 8.9% increase in sea arrivals to a record 3 million passengers in 2002. In the context of less marked weakness in stopover activity, the decline in air arrivals tapered to 1.8%, for a total of 1.4 million visitors — a decline which is considerably less than the 2001 decline of 3.6%.

Looking at how the major Bahamas destinations performed last year, the industry's expenditure growth was due to the ability of New Providence hotel properties to recoup some room pricing discounts. In addition, there was increased sales on the expanded hotel room inventory in Grand Bahama and there was an inroad into cruise activity in the Family Islands.

Although we are confident about the various positive factors favouring the outlook for the industry, our optimism is cautioned by concerns about SARS, and heightened vigilance over global terrorism. No doubt, over time as the war on terrorism lessens the threats and consumers become less wary of travel, our tourism industry will benefit. In any event, the proximity of The Bahamas to the US should operate in our favour. With regard to stopover tourism, it is also vital that

the global airline industry returns quickly to a healthy financial position. Thus, in the absence of any new global catastrophies and natural disasters, we can look forward to a significant increase in both stopover and cruise ship visitors.

In order to strengthen our tourism sector, the 2003/04 Capital Development Budget contains a number of projects for that purpose. Thus, it is intended to carryout important repair and maintenance works at Prince George Dock, and effect considerable improvements to facilities at Nassau International Airport, and the airports in Exuma and Marsh Harbour, among others. I will be explaining later in this Communication the new revenue source to provide much of the funding for these improvements.

Construction

Construction activities continue to make an important contribution to employment and output. Comprehensive data on building activity are only available for the first six months of 2002. Therefore, it is not possible to do more than outline developments based on estimates. These suggest a stable

overall output trend, balanced between increased investments in new projects and the conclusion of works carried over from 2001.

The Kerzner International and other major tourism related and other foreign investment projects are expected to infuse renewed momentum into construction during 2003 and well into 2004. In addition, second homes demand by non-Bahamians in New Providence, Grand Bahama and the Family Islands is expected to strengthen over the next few months, aided by diminishing uncertainty in the global economic outlook.

As regards the domestic segment of construction, the Central Bank's survey revealed that outstanding residential mortgages at banks, insurance companies and the Bahamas Mortgage Corporation rose by \$154.7 million (12.9%) to \$1,355 million in 2002, supported by an average lending rate of 8.9%, the lowest rate in the last 20 years. By March of this year, the outstanding amounts increased further to \$1,379.1 million, implying a continuation of this trend.

Balance of Payments

The balance of payments statistics summarize trade and investment transactions between The Bahamas and the rest of the world. From these accounts, summary observations can be made about trends in the importation of goods and corresponding inferences about import duty collections by the Government. The accounts also underscore the level of foreign exchange usage by the domestic economy and the economy's ability to sustain them. They also give indications of net foreign investment and capital flows.

The Bahamas has always been a net importer of goods. The resultant merchandise trade deficit, however, decreased by 6.8% to \$1.04 billion in 2002. Although our import bill rose during the year, national expenditures on goods imports were moderately reduced, given less upward demand pressure from both private sector credit expansion and large scale construction projects. Tourism inflows provided the largest offset to the trade deficit, and along with other transactions resulted in a decrease in the more encompassing current

account deficit to \$357.2 million, from a revised \$388.1 million in 2002.

There is also a direct link between the level of imports flowing into The Bahamas and foreign direct investments. During 2002, net private foreign investment improved to \$316.7 million from a low point of \$164.7 million in 2001. Net direct capital inflows rose to an estimated \$144million from \$62.9 million in 2001, and net loan funding on foreign investments increased to an estimated \$116.7 million from \$63.6 million in 2001. External demand for real estate in The Bahamas also firmed, with net foreign property sales increasing to \$56 million in 2002 from \$38.2 million in 2001.

As I mentioned earlier, the announcement by Kerzner International of the commencement of the next phase of the development is a tremendous boost to the Bahamian economy. It will result in enhanced capital inflows which will fuel domestic expenditure, and hence revenues, as well as providing additional employment. Moreover, the investment by Kerzner International is likely to lead to other capital inflows as other

hotel and resort interests appreciate the enhanced attractiveness of The Bahamas as an investment location.

The Bahamas continues to experience very moderate to mild inflation, corresponding to similar trends in international prices and in particular, those in the United States. The average domestic inflation rate for 2002, as measured by the change in the Retail Price Index, was stable at 2%.

During calendar year 2002, Government debt rose by \$202.4 million to \$1,805.2 million primarily to complete the financing of the \$125 million facility contracted by the previous administration. This compared to a level of \$1,603.6 million during 2001 before the \$125million facility was drawn down. There were also increased contingent liabilities, which is the Government Guaranteed debt of the public corporations and the amounts under the Education Loan Guarantee Scheme. These rose by \$43.0 million or 12.9% to \$401.8 million in 2002, as compared to a reduction of \$5.8 million to \$358.8 million in 2001.

As regards the total foreign currency debt of the public sector, inclusive of the Government and the public corporations, increases were recorded in both the outstanding amounts and the debt servicing burden during 2002. The public sector's total foreign currency debt increased by \$120.8 million or by 31.8% to \$500.6 million in 2002. About 60% of this increase was the result of the net financing undertaken by the Government during June and July last year, with the public corporations' net borrowing representing the balance.

By regional and international standards however, the foreign currency debt burden remains low. Debt servicing, comprising principal amortization and interest payments, averaged 4.1% of The Bahamas' export of goods and services during 2002. Although this was higher than ratios experienced in each of the last four years, which ranged between 2.6% and 3.1% of exports, it was below the 5.5% ratio estimated in 1996 and 1997, on lower outstanding debt of \$392 and \$360 million, respectively. In other words, the increase in foreign currency debt is still in line with the recent years cumulative growth in output in foreign exchange earning activities. Once the

economy picks up, as is expected, this servicing burden should again retreat below the 4% level.

In relation to foreign debt, this Honourable House will recall the US \$125million loan, to which I have already made reference, which was arranged in late 2001 by the previous administration mainly from international banks with presence in The Bahamas. The purpose of the loan was to ease the adverse economic and fiscal pressures arising in the aftermath of the 11 September, 2001, terrorism events in the US. The loan was very helpful in that regard. However, the repayment period of the loan is only 5 years which is a short repayment period and that would involve a considerable budgetary burden in the next 5 years. Moreover, long-term US \$ interest rates are at low levels at present. Consequently, my Government has been advised that long-term financing could be obtainable as a US\$ Bond Issue which would be on excellent terms, with a long maturity structure and a coupon related to a small margin over long-dated US Treasuries. Therefore, my Government is exploring the raising of a US\$ Bond Issue for \$200million to pay off the \$125million and to provide US \$75million to

finance the 2003/04 Capital Budget. This would result in significant savings on interest payments and spread out the maturity structure of our Debt consistent with the nature of that Debt.

Trends in Money and Credit

Monetary policy, as conducted by the Central Bank, has been instrumental in ensuring the stability of the economy, during a period in which we have been so enveloped by adverse external developments. After the events of September 11, 2001, the Central Bank imposed restrictions, limiting any further increase in domestic banks' Bahamian dollar credit beyond those amounts outstanding or already committed at the beginning of September 2001. In the economic slowdown that was evident prior to September 2001, the Central Bank had already urged banks to be more rigorous in assessing the credit worthiness of borrowers to prevent any undue deterioration in the quality of banks' assets.

The tight credit policy stance maintained by the Central Bank and buoyant liquidity conditions assisted by proceeds from the Government's foreign currency borrowing, produced

moderately lower average interest rates in the economy during 2002. Commercial banks' weighted average deposit rate fell to 4.11% from 4.24% in 2001, and average lending rate to 11.33% from 11.47% in the previous year, including a reduction in the average consumer loan rate to 13.07% versus 13.41% and the softening in average residential mortgage rates, to 8.90% from 8.95% in 2001.

The country's external reserves increased by \$60.8 million or 19.5% to \$373.2 million at end-2002, after respective declines of 15.2% and 8.8% in 2000 and 2001. During the first four months of 2003, external reserves experienced a strong seasonal improvement of \$86.7 million to \$459.9 million, exceeding the \$58.0 million increase to \$370.4 million in the same period last year. The important difference however, is that the supporting growth came from the rebound in net private sector tourism-related inflows, which more than outstripped outflows associated with a net repayment of public sector foreign currency debt. In terms of import coverage, the April 2003 reserves were equivalent to 3.7 months of non-oil

merchandise imports, as compared to 2.8 months of coverage on the April 2002 balances.

Financial Services

Contribution to economy

Despite the upheavals of the past two years, financial services continue to represent the second largest sector of the Bahamian economy, with contribution to GDP estimated at 15%. The sector provides some of the highest paying jobs, and growth opportunities for a number of associated sectors including the legal and accounting professions.

Preliminary results of the 2002 Central Bank survey, indicate that the banking sector's total expenditures in the local economy dipped below \$400 million, from a level approaching \$430 million in 2001. This is probably a temporary development largely reflecting some moderation in capital expenditures on renovations and the construction of new office premises. While this has to be interpreted in the context of the significant capital investments which banks made in the last three years, it also reflects important

structural changes underway, as the international financial sector adjusts to the new regime in place.

Although banks' operating expenses were approximately stable overall, total employment fell by an estimated 63 positions to 4,523, with the number of Bahamian persons employed reduced by 73 to 4,227, owing to some rationalization measures taken in a number of domestic retail operations and the winding up of an important offshore licensee.

The resulting separation packages helped to boost salary payments and therefore influenced the more stable trend in operating expenses. The continued reduction in the number of bank licensees, which for the most part did not have physical operations in The Bahamas has not had a significant impact on the employment of Bahamian persons and on local expenditure by the financial services sector, other than reducing the licence fees collected by the Government.

Programme to enhance competitiveness

Our efforts to enhance the competitiveness of the financial services sector focused on a number of important areas during 2002, including:-

First, the establishment of the Financial Services Consultative Forum, which has primary responsibility to make recommendations on those products and services which will enhance the competitiveness of The Bahamas in the international business arena.

Second, measures aimed at streamlining and simplifying compliance procedures and eliminating overlap and duplication of effort by the regulatory authorities; this approach strengthens compliance procedures while eliminating unnecessary costs on the institutions subject to regulation. These measures will be implemented in the near term after necessary consultations have been completed and the necessary adjustments to the regulatory framework have been completed.

Third, an intensified focus on the development of the domestic capital markets.

Fourth, the pursuit of initiatives to modernize the domestic payments system, and

Fifth, the implementation of the on-line integrated Registered Agent System in the Registrar General's Department that allows for on-line incorporation of International Business Companies, IBCs., and filing of relevant documents.

Coordination and Cooperation of Regulators

Honourable Members will be aware of the progress that has been made to strengthen cooperation and the coordination of activities among the various Bahamian supervisory agencies. Along these lines, a Memorandum of Understanding was signed in October 2002, between the Central Bank, the Registrar of Insurance Companies, the Bahamas Compliance Commission, the Securities Commission, and the Inspector of Financial and Corporate Service Providers. Within the framework of the MOU, joint on-site examinations have already begun of licensees supervised by more than one agency. The benefit of such an arrangement is that, from the regulators perspective, it

reduces total supervisory costs, and for those financial institutions that answer to multiple supervisory agencies, also cause compliance costs to be lower and minimize duplication of efforts.

The Government of The Bahamas believes that additional progress can be made in fine tuning the financial sector regulatory regime, being mindful however, that whatever is done, this regime has to remain credible in the eyes of the international community and in conformity with international standards. At the same time we must maintain a balance between costs of regulations, as they affect our international competitiveness, and benefits derived otherwise from them. From our experience so far, we have seen that the consultative approach to the development of financial sector regulations is a key element in meeting these objectives, and it is a practice to which this Government will continue to adhere.

As a significant participant in the provision of international business and financial services, The Bahamas has given greater priority to information exchange and cooperation

with foreign authorities as part of the global effort to stem the illicit use of financial services for money laundering and other forms of criminality. This responsibility is discharged in a manner that preserves confidentiality for legitimate business activities.

Domestic Payments System Modernisation

As an increasing volume of business transactions occur through electronic means, it becomes important that our domestic payments system accommodates these transactions in the most efficient means. Currently, local cheque processing and payments settlements are carried out manually among domestic banks. In an economy where the volume of non-cash transactions has increased significantly in the last decade, more efficient clearing mechanisms are needed to ensure that the payments system reinforces as opposed to encumbers domestic commerce.

I am pleased to announce to this Honourable House that the Central Bank, and local clearing banks, have commenced plans to introduce an automated clearing house system, ACH,

and a real time gross settlement system, RTGS. The ACH would facilitate small value transactions with a significantly reduced time delay in the clearing of these payments in comparison to the current system used by banks, and a RTGS would permit real time instantaneous processing of large-value transactions.

This modernization initiative is now in its second phase, being overseen by a newly created National Payments Council, comprising the heads of the local clearing banks. As their objective, the Council and the Central Bank are working towards having the real time gross settlement system operational by the first quarter of 2004, and having the automated clearinghouse system functioning shortly thereafter.

Domestic Capital Markets

As regards recent trends in the domestic capital markets, Mr. Speaker, in view of general weakness in the economy, activity was diminished during 2002. In particular, there was a marked decline in trading volume on The Bahamas

International Securities Exchange, BISX, combined with a continued falloff in equity prices. The voluntary de-listing of one company reduced the total number of publicly listed companies trading on the Exchange to 16. The volume of shares traded on BISX decreased by 23% to 3.02 million in 2002, corresponding to a 38% decline in the total value of shares traded to \$14.6 million from \$23.5 million in 2001.

The further development of domestic capital markets will introduce more efficiency and competitiveness to the local financial system, and facilitate increased savings and investments by our own nationals in this economy. BISX has encountered financial difficulties. The final report is expected soon from the select Committee headed by the Governor of the Central Bank, that was appointed in November 2002, to advise my Ministry on the best approach to moving forward on this matter.

The privatization of Government corporations and the subsequent listing and trading of any shares widely held by the public can only serve to accelerate the pace of capital markets development in The Bahamas. In particular, any increased

volume of trading of local securities is likely to lead to more efficient valuations of such securities thereby encouraging more Bahamians to invest in such instruments. These are issues which the Government and the regulatory authorities have under continuing consideration.

Capital Account Liberalisation

Successive governments of The Bahamas have moved cautiously and deliberately in liberalizing the capital account of the Balance-of-Payments. Recent remarks by an IMF team which has studied the effects of liberalizing capital flows in developing countries highlight some of the issues.

For instance, one of the IMF officials stated:-

“...it is hard to argue that capital account liberalization has not often been accompanied by increased vulnerability to crises. Unfortunately, there is no magic policy prescription for alleviating the risks associated with financial globalization. It is always critical to implement sound fiscal, monetary, and

exchange rate policies and to create an environment that could attract more stable capital flows.”

Surely those who advocate further capital account liberalization have to prove beyond a reasonable doubt that such a move would provide additional employment for Bahamians or would enhance the living standards of Bahamians. I do not believe that at this time of considerable global uncertainties such a course can be justified. Indeed, the thrust of the IMF views which I have mentioned is that liberalization would lead to greater volatility. It is, of course, a matter which the Government will keep under continuing attention and as ongoing circumstances warrant or permit, we will move forward with additional careful liberalization measures. International experience is that the form of capital inflows which we have encouraged and continue to encourage – entitled ‘direct foreign investment’ – are much more stable and less volatile in turbulent times.

Government's Medium-Term Social and Economic Strategy

The Government's medium-term strategy is to pursue sound macroeconomic and fiscal policies thereby enhancing the competitiveness of the Bahamian economy and the attractiveness of the economy for domestic and international investment. Economic stability and the resulting investment generate increased job opportunities and incomes for Bahamians, and the stronger revenue base provides the resources for expanding essential public services. We are building on the 6 pillars of tourism, financial services, e-commerce, international services, manufacturing industry, and agriculture, and fisheries. You will note that I have departed from the usual classification of regarding only tourism, financial services and e-commerce as “*the*” pillars of the economy. I believe that while always acknowledging the overwhelming importance of these three sectors, we must never underestimate the value which we can obtain from encouraging the development of manufacturing industry,

agriculture and fisheries, and other international services. Each of the 6 pillars is being addressed by a range of encouragement policies which will be refined and intensified as we move forward. By growing the economy we will create more employment, we will disperse this growth geographically so that all of the inhabited Family Islands participate and benefit, we will enhance living standards throughout The Bahamas, and the growing economy will generate the revenues to permit the development of essential public services. It is intended that to the extent possible a major touristic development in each Island will form the basis for further diversification.

Without question, the uncertain global environment inhibits growth and development of every economy, that of The Bahamas included. Consequently, we must be careful and patient in our expectations as long as this uncertainty continues. But we firmly believe that our prudence and patience will pay off in the sustainable development of our economy.

Fiscal Performance 2002/03

The global environment is completely overshadowing fiscal performance in 2002/03. Recurrent Revenue is likely to be \$60million less than in 2000/01 - the year before the terrible events of September, 11, 2001. While Recurrent Revenue has fallen, Recurrent Expenditure has moved inexorably upward and will be some \$85million more than in 2000/01. There are, of course, sound reasons for the upward movement in Recurrent Expenditure, on services such as debt servicing, education, health, and security. Nevertheless, the result is a projected GFS Deficit of 3.3% of GDP, following a GFD Deficit of almost similar magnitude in 2001/02. The GFS Deficit is the Deficit when one takes total government expenditure, excluding Debt Redemption, and offsets Recurrent Revenue. The Deficit is a measure of the addition to Government Debt arising from the Budget.

We have seen a considerable gap open up in 2001/02 and 2002/03 between Recurrent Revenue and Recurrent Expenditure. In 2002/03, this gap arises because of the

reduction of \$60million in Recurrent Revenue and the increase of \$85million in Recurrent Expenditure. A gap of this magnitude is clearly unsustainable. There is ample evidence from our own Hemisphere as to the disastrous consequences which follow if a country fails or refuses to exercise fiscal discipline. We Bahamians are a practical people and we do not need much convincing to realize that any household which consistently spends more than it earned must be facing disaster. Of course, there can be differing views on the balance of the correction - for example, should we cut expenditure by a greater amount than we increase revenue and how should we contain expenditure and increase revenue. There are no easy answers which will satisfy everyone. However, constructive argument must focus on the central issue. No-one of a serious frame of mind should propose additional expenditures without specifying how such expenditure is to be financed, and no-one should criticize particular revenue measures without specifying an alternative source of finance.

Therefore, in 2003/04 we will commence on the programme of measures to contain the deficit and gradually

eliminate it over a reasonable period of years. As I will explain, we intend to embark on this course of fiscal correction by tackling both the revenue and expenditure sides of the Budget.

Fiscal Programme 2003/04

The 2003/04 Budget represents the first step in implementing a sustainable fiscal policy taking account of the less promising global environment which developed in 2000 and 2001. We can do little to change that environment but we can behave sensibly and respond positively to the new challenges and opportunities. And that is what we intend to do.

In 2003/04, my Government will aim to achieve a GFS Deficit of not more than 2.2% of GDP, as compared with the outturns of 3.2% in 2001/02 and 3.3% projected for 2002/03. You will note from what I have said that the Government Deficits in these 3 years, 2001/02, 2002/03 and 2003/04, add some 10% points to Government Debt bringing it very close to the 40% level. My Government has reviewed every item of expenditure and every item of revenue to see if we could do more to reduce the Deficit in 2003/04 while still proceeding

with our programme. We reluctantly concluded that containing the Deficit to 2.2% of GDP is the maximum feasible in one year. In this regard, we are bearing in mind that the Kerzner International project and other capital projects will enhance revenue performance in due course.

We intend to achieve this first step in reducing the Deficit by a combination of expenditure containment and, in parallel with fostering growth in the economy, through revenue enhancement measures.

It is essential that we demonstrate to the international community that we are very serious in our intention to bring the fiscal situation under firm control. The Bahamas has an A3 Rating from Moodys, and we should not jeopardize that rating in any way. Indeed, that Rating is invaluable in that it confirms that the Bahamian economy is fundamentally sound, and that The Bahamas is an attractive environment for international investment. It is no accident that Kerzner International are putting in place a volume of investment which is larger and more diverse than any investment taking place in any other Commonwealth Caribbean country. Moreover, we are using the

A3 Rating directly to raise \$200million in US\$ Bond Issue in New York. This is a matter which I will explain later in this Communication.

In the case of expenditure, we will be able to proceed in 2003/04 by allocating fully to all essential services - health, security, infrastructure, education, and general government services. The feature of our approach to public expenditure is to place greater emphasis on better management of resources and in imposing fees where possible to recover costs. In view of the weakness in the revenue side of the Budget over the last few years, there is no possibility of providing significantly greater resources to every essential service if revenue resources do not increase more rapidly. Therefore, we must first concentrate on better management of existing resources, while growing the economy, improving revenue administration and enforcement, and levying fees where appropriate to recover costs. As the enforcement measures yield results and the economy generates more revenues, there will be scope to streamline revenue policies, and to lessen the tax burden.

Main Features of Recurrent Expenditure 2003/04

Until the global economy clearly moves into full speed, and with it the Bahamian economy, our resources are limited. Therefore, we must very clearly prioritise and manage most prudently the valuable resources which are available. I will state our priorities. They are as follows:-

First, creating additional high-quality sustainable employment as rapidly as possible, and safeguarding existing employment income levels. We want to see these new employment opportunities dispersed equitably throughout the whole of The Bahamas. Employment creation is the best social policy of all, because good quality employment enables people to live with dignity and independence, it reduces crime and other consequences of deprivation, and it creates a caring society with strong democratic roots.

Second, closely linked with the first priority, is the emphasis on education, training and skills acquisition especially for our young people. An educated and highly

skilled labour force is far more likely to lead a productive and secure life and attract international and local investment, than one which is not. Moreover, a highly educated labour force provides an attractive basis for the development of e-business. We must adopt a holistic approach to dealing with our young people so as to guide them away from dangers, enable them to live productive meaningful lives and contribute and take pride in the society of which they are a vital part. This means dealing with the whole range of social issues which need to be addressed: living conditions, family income, education and training opportunities, recreational opportunities, encouragement and advice from role models, and a safety net to ensure that if a young person stumbles, they do not fall into the way of serious crime and alienation.

The Government will institute a national training programme in partnership with developers in various locations to ensure that Bahamians are trained to become the major component of the labour force on the projects during the construction as well as the permanent phase.

Third, we are increasingly an urban society with all of the associated ills. We must deal with urban renewal and ills such as poor or inadequate housing. Again, poor living conditions are too often associated with being breeding grounds for crime and disruption. In this matter I am particularly conscious of the vulnerability of some of our young people.

Fourth, we must deal with crime and its root causes, and this requires implementing prison reform and urban renewal so that recidivism is diminished. Once again, I am deeply concerned that we do the right things to protect and guide our young people.

The National Urban Renewal Commission which has been expanded from the Farm Road Project will be a major part of the Government's drive to provide help and hope to the less fortunate persons in our Bahamas. This programme will move systematically throughout the over-the-hill area and eventually throughout the economically depressed areas of the Family Islands. As this work proceeds, needs will be identified in terms of employment, health,

education, social and environmental and to the extent possible, will be rectified. This urban renewal programme coupled with the implementation of the report of the Prison Reform Commission, represents a major thrust of the Government's fight against crime as the major causes of crime will be addressed and minimized.

Five, we must protect our society against illegal immigration so that the culture of The Bahamas is not fundamentally altered to the detriment of the nation. We must be humane and compassionate in this issue but we cannot compromise and allow our homeland to become the homeland of others without our consent. And illegal immigration, by definition, does not have our consent. We will work as constructively as we can within our means to reduce and eliminate the cause which give rise to illegal immigration but we cannot tolerate illegal immigration because in doing so we are effectively conceding our society, our culture, our way of life and our very homeland to others whom we have not invited. Therefore, my Government is developing a major Defence Force

installation in Inagua. This installation will not only be a base for Defence Force and other personnel for air and surface surveillance, but will also include a detention centre to hold illegal immigrants temporarily before their repatriation to their own homeland. The installation's detention centre will be used to detain illegal immigrants before they can enter into and disperse throughout our main population centres. This will not only be a cost effective way of dealing with this problem - which is threatening to overwhelm The Bahamas - but it will also provide much needed employment in support services to the people of Inagua and the southern islands.

Six, we must protect our environment and our heritage.

Experience elsewhere demonstrates that environmental degradation can quickly arise if a country is not vigilant.

Apart from the damage to ourselves and successive generations of Bahamians, as a country dependent on tourism we have no room for manoeuvre. Consequently, I am creating a vehicle to acquire Clifton Cay to protect it for Bahamians and the generations to come. The

acquisition is expected to be corrected to the shortest possible period of time. I am proposing to establish the *Clifton Cay National Park Authority* which will operate along the lines of *The Bridge Authority*. The *Clifton Cay National Park Authority* will issue bonds - similar to *Bridge Bonds* - and the proceeds of the issue will be used to acquire Clifton Cay. This purchase and acquisition will be made in the shortest possible time. Since the *Clifton Cay National Park Authority* will not have revenues, unlike the Bridge Authority, the annual payments on servicing the bonds will be met by the Consolidated Fund under an appropriate Head. In this way, the costs of acquisition of Clifton Cay will be spread over a long period of years - a reasonable approach bearing in mind that the benefits will also continue in perpetuity. The Authority will also have the capability of accepting donations from the many good corporate and wealthy persons who would like to make a contribution to the development of Clifton Cay National Park. Rest assured that the conservation of

Clifton will involve the widest possible consultation with the public.

Seven, we must avoid adding further taxation on those who now comply with their existing obligations but we must deal strictly with tax evasion and tax fraud. We simply must deal with those who do not pay their just share of taxes in our society. Only if we collect in fullest measure the revenues which are already on the statute book can we afford the programmes which I have mentioned and also avoid imposing additional taxation on The Bahamian people. In this Budget there are no new or additional taxes but we will be putting in place hard-hitting measures to ensure full compliance with existing taxes.

Expenditure provisions are made in the 2003/04 Estimates of Expenditure to deal with all of these matters. Some provisions are across several Ministries and Departments which are coordinating their efforts in pursuit of the priorities which I have mentioned.

The final point which I wish to make is that with the greatest reluctance the Government has determined that the Public Service general pay award due on 1 July, 2003, is simply not feasible at this time without raising taxation. Raising taxation to pay for this award would be difficult because it would mean asking Bahamians who suffered and made sacrifices during the last few difficult years to pay higher taxation for a pay increase for those in the Public Service who were exempted from such sacrifice. The Government made this decision with great reluctance because we appreciate the dedication and sense of duty of so many in the Public Service.

I sincerely believe that the workers in the Public Service will appreciate the need for forbearance on this matter. If, as I believe, the revenue situation improves during 2003/04, it should be possible to revisit this decision with a view to making a payment or part payment no later than December, 2003.

I will summarise for this Honourable House the main expenditure provisions in this Budget. In considering these provisions I would ask Members, and the Bahamian public, to

bear certain points in mind, because they influenced the Government in framing the various expenditure provisions.

The provisions generally are framed on the basis that given the relatively tepid global recovery, it is better to include affordable provisions which are certain to be financed, than to include ambitious provisions which run the risk of being curtailed once the financial year begins. Related to this point is the point that the Government will keep these expenditure provisions, and revenue provisions, under continuing review, so that if scope develops to increase the provisions, then Government will act accordingly.

The third point which I would like to make is that many of the Government's high priority policies cut across several Ministries and agencies, so it is necessary to take these linkages into account in evaluating progress being made on the priorities.

Finally, very large sums of money are being placed at the disposal of the various agencies of Government in this Budget. Simply throwing more money at problems would not necessarily be the better solution to accelerating progress:

indeed, the careful and prudent management of the limited resources which we have is, by far, the more prudent approach. In view of the fact that increasing taxation would only cause hardship, it is clear that better management of expenditure is the key to success in implementing *Our Plan*.

Turning to the details of the various provisions in the Budget, overall Recurrent Expenditure is \$1,062million. This is an increase of \$27million or 2.6% over the provisions made in 2002/03. However, because of the necessity for expenditure restraint in 2002/03, the projected outturn in that year is likely to be about \$20million less than Budget. Thus, the increase in 2003/04 is about \$47million or 4.6% over projected outturn for 2002/03.

In 2003/04, \$189million is required for interest and redemption of Government debt. This provision is 18% of Recurrent Expenditure in 2003/04. This is an increase of \$15million over 2002/03 even though interest rates remain low. It is evident that control over fiscal deficits and borrowing are crucial if The Bahamas wants to avoid spending a rising proportion of its revenues on debt service. The way to

controlling deficits and borrowing is to contain expenditure and collect revenues.

\$191million is being spent on education and training including almost \$20million in Government expenditure for the College of The Bahamas in addition to the fees collected by the College which the College retains. A disappointing aspect of the education budget is that defaults under the Education Loan Programme seem to be a problem. The Minister of Education will be putting in place mechanisms to ensure that defaults do not become a charge on the Consolidated Fund. It is vital to recoup the loans made under this scheme so as to enable the scheme to go forward properly funded. The scale of expenditure on education underlines my Government's determination to place the highest priority on providing every Bahamian child and young person with the means to progress and to live a productive life.

Almost \$161million is being spent on the health services plus the fees retained by the Public Hospitals Authority. This underlines the priority to ensure that all Bahamians have access to health care.

Almost \$131million is being provided for Security including almost \$84million for the Police, and \$29million for the Defence Force. \$14.2million is being provided for Prisons, and I have already mentioned the priority which my Government is giving to prison reform.

Over \$79million is being allocated to Foreign Affairs and the Public Service, most of which, of course, is for rents and pensions.

Despite fiscal constraints, over \$73million is being allocated to the Ministry of Tourism and the Gaming Board to focus on promoting The Bahamas in this crucial period.

\$45million is being allocated to the Ministry of Finance and its crucial accounting, revenue raising, and statistics departments. In this regard, almost \$20million is being allocated to Customs which is the department responsible for raising over two-thirds of our revenues.

Over \$36million is being allocated to Transport. As I have mentioned, international air transport is a critical area, and considerable capital resources will be spent on making improvements to our major airports in the period ahead. It is

intended that user fees will be implemented which will amortise the expenditures involved.

Over \$32million is being allocated to Agriculture, Fisheries, and Local Government for services which mean so much in the Family Islands.

Over \$26million is being allocated to Social Services. This amount is, of course, only a small component of overall expenditure on dealing with poverty and deprivation. One must look across all expenditures to see the full expenditures which my Government is undertaking to deal with this difficult issue.

\$22million is being allocated to Works for maintaining public buildings and other works.

\$16million is being allocated to Labour and Immigration. An issue of the highest importance, illegal immigration, is of course one of the critical issues dealt with.

\$13million is being allocated for justice related Heads.

Over \$9million is being allocated for Youth, Sports and Culture. Again this sum should be viewed in relation to the other provisions across the board – principally in education which assist in the development of our young people.

Almost \$8million is being allocated to the Office of the Attorney General which has a very heavy work programme.

Over \$5million is being allocated to the Ministry of Financial Services and Investments. This is a crucial area of my Government's programme.

Almost \$4million is allocated for the Ministry of Trade and Industry. The Ministry is playing a critical role in coordinating the discussions on the free trade issue.

Over \$2million is being allocated to the Department of Lands and Surveys.

Almost \$2million is being allocated to the Office of the Auditor General to enable that Office to undertake a more extended audit programme to ensure that public monies are spent properly and efficiently.

Over \$2million is being provided for Housing and National Insurance. Again, this amount is only the tip of the iceberg because substantial recurrent and capital sums are spread across a number of Heads to deal with the urban renewal programme and the housing programme and related matters.

Other provisions are for the Governor General and staff, the Senate, House of Assembly, the Office of the Prime Minister, the Office of the Deputy Prime Minister, the Cabinet Office, the Bahamas Information Service, Government Printing, and the Public Utilities Commission.

Almost every Head of Expenditure includes provision for Personal Emoluments for members of the Public Service. I wish to take this occasion once again to pay tribute to their commitment and dedication to duty, and again request them to be patient and understanding in regard to the temporary deferment - of the pay award originally due on 1 July, 2003.

Main Features of Capital Expenditure 2003/04

As regards Capital Expenditure, the provision for 2003/04 is \$145million. All of the major Capital Heads are being properly provided for, and individual Ministers will explain the situation in relation to the services for which they are responsible.

There is one specific area of expenditure which merits special attention.

This is the provision which is being made for the construction of the major permanent base in Inagua, including the construction of a detention centre, to deal with illegal immigration as well as with smuggling. I have already referred to this matter.

The biggest single provision is for Works where \$53million is being allocated. This provision will be spent on infrastructure in New Providence, and the Family Islands, including airports, roads and docks to conform with major investment developments. As I have mentioned, it is envisaged that user fees will be implemented to offset the major expenditures involved on airports throughout The Bahamas as well as some at least of the new revenue from air traffic control.

Over \$20million will be spent on educational facilities, including almost \$2million for the College of The Bahamas.

\$12million will be spent on capital works by the the Ministry of Health, the Public Hospitals Authority and the Department of Environmental Health.

The security services will receive almost \$9million for equipment and other capital expenditures.

Almost \$2million is allocated for housing, but this, of course, is only a fraction of the total amount for urban re-development and housing which is spread over many expenditure heads. In addition to the allocation of \$2million there is the housing finance provided by the Bahamas Mortgage Corporation.

Other important provisions include \$10million for Bahamasair, \$8million for the Water & Sewerage Corporation, and \$4million for the Broadcasting Corporation of The Bahamas. The Head entitled “Sundry Capital Expenditure” also includes \$0.5million for the IDB package for Haiti, which will facilitate the reactivation of the suspended international aid programme.

Main Features of Recurrent Revenue 2003/04

The Recurrent Revenue Estimates for 2003/04 amount to \$1005million as compared with the projected outturn of \$910million in 2002/03.

This is an increase of \$95million. We believe that \$30million will come from increased revenue yield through buoyancy as the capital investment projects announced come on stream and the economy strengthens. A further \$30million will come from improved administration because we are serious in our intentions to deal with tax fraud and cheating. An additional \$15million will come from the sale of shares in Cable Bahamas and the Bank of The Bahamas to the National Insurance Board to facilitate the Board in diversifying its investments. A further \$15million will arise from increasing the whole range of fees for government services, excluding the Business Licence Fee. These fees for services have remained unchanged for many years in some instances, and it is only reasonable to increase them to compensate for cost increases in providing the services.

The final component of the revenue increase is the most important in many ways in that it is a new revenue source which we are opening up which will not have any impact on Bahamians or tourists or others doing business within The Bahamas. This component arises from the fees which will be

collected from the introduction of a Flight Information Region, FIR, and Air Traffic Control System for The Bahamas. At present these Fees are collected by the US authorities because they provide air traffic control over most of the area of The Bahamas. We intend that air traffic control will become a responsibility of the Department of Civil Aviation and as a consequence, the fees will revert to the Treasury.

We are in consultation with Canadian consultants over the putting in place of the necessary facilities. In addition to annual fees which could amount to \$40million to \$50million in the medium-term, the assumption of responsibility for air traffic control would result in the provision of some 120 high quality job opportunities for Bahamians. In the 2003/04 Budget we are making a provision of \$5million as the estimated net revenue arising from the new arrangements during the course of 2003/04.

This new source of revenue provides the Bahamian people with fresh opportunities provided that we can be sensible with determining the pace of expansion of expenditure on essential services and on projects in *Our Plan*. By this statement I mean

that this new source of revenue, taken in conjunction with expenditure moderation, with revenue buoyancy as the economy expands, and with very much firmer revenue enforcement measures to counter fraud and evasion, presents us with the possibility of eliminating the GFS Deficit within a reasonable period of years without the necessity for more revenue measures which would impact on the Bahamian people. If this opportunity is not taken, it will be necessary to impose additional revenue measures in the very near future or to run the risks associated with the accumulation of GFS Deficits and a high level of Government Debt..

I am also amending the Fourth Schedule to the Customs Management Act to broaden the relief which the elderly, the handicapped and the chronically ill can derive from the relief already in the Act. In addition I am adding the socially disadvantaged as a category of person who can benefit from the relief. As a safeguard, the Minister of Finance will provide the relief in every instance only on the recommendation of the Ministry of Social Services. I expect the overall cost to the Consolidated Fund to be modest but the actual scale of the

relief to every person and household in need of the relief will, I hope, be such as to assure them that our society truly cares for them.

Borrowing and National Debt

In 2003/03, Government Debt was about 36.5% of GDP. The projected GFS Deficit for 2003/04 will raise this by 2.2 % to 38.7 % of GDP. This figure of 38.7% is an important indicator because based on worldwide experience, the IMF in various publications warns that a ratio of Government Debt to GDP greater than 40% runs increasing risks of releasing debt dynamics especially if there are major adverse external developments. Therefore, in the case of The Bahamas we must take care to ensure that we do not cross this 40% threshold.

The Bahamas was able to adjust to the crises in 1991 and 2001 precisely because our ratio of Government Debt to GDP was well below 40%. Consequently, it is very much in the national interest to eliminate the annual GFS Deficits as quickly as possible and return the ratio of Government Debt to GDP to well below 40%. The new source of revenue provides us with such an opportunity.

It will be noted that the Budget data do not include any proceeds from the privatization of BTC, formerly Batelco. Work is proceeding urgently on this matter and Cabinet will soon be in position to make final decisions. In view of the uncertainties and the necessary bargaining nature of the transactions between Government and the various entities interested in acquiring BTC, it would not be appropriate to make a provision for the sales proceeds in the Budget. Doing so would be premature disclosure of the Government's bargaining position.

Conclusion

The 2003/04 Budget reflects:-

Firstly, the continuing commitment of the Government of The Bahamas to sound macroeconomic and fiscal management in a world of great uncertainties. Macroeconomic stability protects the lower income and middle income groups against the ravages of inflation and savage economic adjustment. The Bahamian people, and foreign investors, know from experience elsewhere, and appreciate that sound macroeconomic and fiscal

fundamentals are indispensable to safeguarding social harmony, incomes and employment and are, without any question whatever, the key to future development.

Secondly, my Government is deeply committed to improving the welfare of the Bahamian people, and we will move forward deliberately and carefully to implement the appropriate policies to achieve this purpose. The expenditure provisions in the 2003/04 Budget amount to over \$1.2 billion or roughly 20% of GDP. Clearly it is vital that every responsible person meet their just share of the costs of financing these essential services. Constructive and concerned discussion of these expenditure provisions must focus on the issues which I mentioned earlier. These issues concern how best to obtain value for money, how best to allocate the scarce resources, and how best to raise the revenues to finance the expenditures.

Third, the 2003/04 Budget reflects the commitment of this Government to the creation of sustainable employment in good quality employment suitable for our young people, our commitment to education and skills training, the commitment of Government to its urban renewal programme and to proper and adequate housing for all our people, and our policy of ensuring that all of the Family Islands have the facilities and adequate infrastructure which they need.

Fourth, it reflects our policy as a Government to listen carefully to the expectations of our people and to respond sensitively. We know that while the Bahamian people are supportive of the expansion of essential public services, levying substantial additional taxation at this juncture would not be the right course. Indeed, if the fiscal situation had permitted, the Government would have wished to reduce taxation to assist those families coping with their financial responsibilities.

I have no doubt that voices will be raised stating that we should be doing more in various areas and sectors. Indeed we would - if we could. The revenue constraint in the uncertain global environment is the constraint. As that constraint loosens, which could occur over the coming months, we will have more resources to devote to the programmes and projects we promised in *Our Plan*.

As I have said repeatedly, it is pointless and futile to criticize this Budget on the basis that more should be done for some area of public expenditure. Unless one can show how the additional resources will be obtained to meet the costs involved, that approach is futile. I know that the Bahamian public will not wish to hear talk about what should be - rather than the reality of what is now affordable.

The resources which are being expended in this Budget are of enormous dimension in the context of the Bahamian economy. The combined Recurrent and Capital Budgets represent 22.5% of GDP. The Public Corporations will also expend considerable additional resources on their investment programmes.

The sheer scale of these expenditures places great responsibilities on Ministers and others concerned with expenditure. Each Minister during his or her Budget Contribution will set out the policies and management practices which the Government is implementing to maximize the benefits from the provision for which he or she is responsible. I am sure that the people of The Bahamas, in considering this Budget, will be satisfied that my Government is doing everything possible to protect the economy, to protect the more vulnerable in our society, to provide essential public services with maximum efficiency, and to levy the necessary revenue in the most efficient and equitable manner.

The Anglo-Irish poet W.B. Yeats once said:-

“I doubt if any nation can become prosperous unless it has national faith; and one very important part of national faith, is faith in its resources, both in the richness of its soil and the richness of its intellect. ”

I believe that no-one in this Honourable House will have any doubts about the people of The Bahamas having faith in

themselves and in their country. And I believe that the people of The Bahamas have placed great trust in this Government, and they will know from this Budget that this trust is something which my Government cherishes.

Table I. Growth of the Bahamian Economy 1995 - 2004

	1995	1996	1997	1998	1999	2000	2001	2002*	2003*	2004*
GDP(Current Prices) (\$Millions)	3500	3750	3940	4190	4575	4880	4950	5050	5260	5470
Growth-Current Prices(%)	2.2	7.1	5.3	6.3	9.1	6.7	1.5	2.0	4.1	4.0
Growth-Constant Prices(%)	0.3	4.2	3.3	3.0	5.9	5.0	-0.5	0.1	2.9	2.5
Prices (%)	2.1	1.4	0.5	1.3 (a)	1.3 (a)	1.6	2.0	1.9	1.2	1.5

Source: IMF World Economic Outlook ,April 2003

*Subject to confirmation in Staff Report of 2003 IMF Article IV Consultation Mission

(a) GDP deflator is higher in those years.

Table I. Growth of the Bahamian Economy 1995 -2004

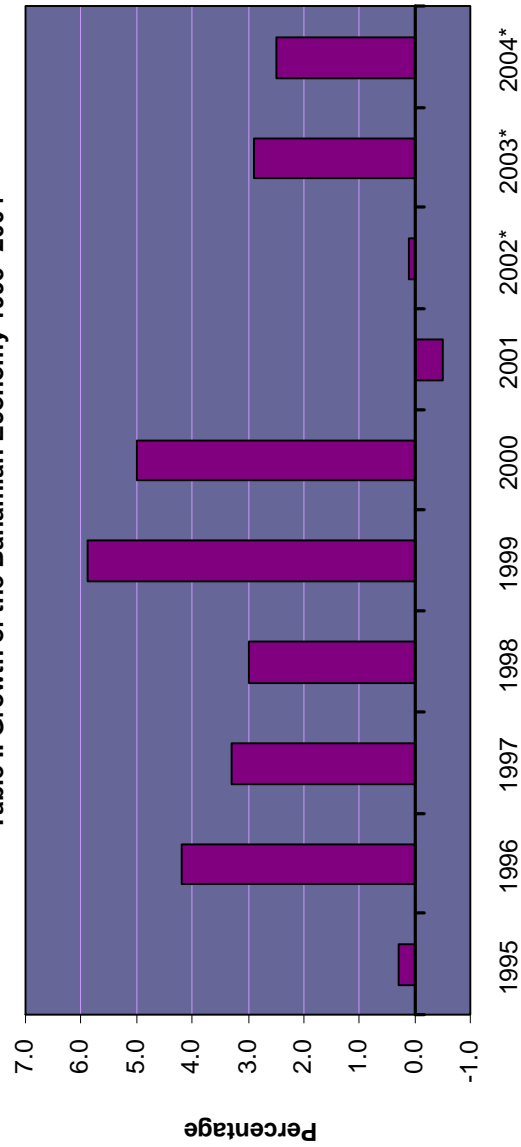


Table II - Budget Performance
\$millions

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03 Budget	2002/03 Projected Outturn	2003/04 Budget
1. Recurrent Expenditure	630	656	704	778	808	837	866	930	986	1035	1015	1062
2. Recurrent Revenue	617	650	672	698	780	822	943	973	875	970	910	1005
3. Recurrent Deficit (1 minus 2)	13	5	32	80	28	15	83	43	-111	-65	-105	-57
4. Capital Expenditure	68	100	92	140	117	124	139	133	138	155	140	145
5. Capital Revenue	1	12	5	3	1	0	0	1	0	3	3	3
6. Capital Deficit (4 minus 5)	67	88	87	137	116	124	139	-132	-138	-152	-137	-142
7. TOTAL DEFICIT (3 plus 6)	80	93	119	217	144	139	56	-89	-249	-217	-242	-199
8. Debt Redemption	69	65	80	84	79	74	41	75	85	70	70	77
9. GFS Deficit (7 minus 8)	11	28	39	137	65	65	15	-14	-164	-147	-172	-122
10. GDP (current prices)	3375	3465	3600	3840	4065	4380	4750	4915	5000	5155	5155	5365
11. GFS Deficit as % of GDP	0.3	0.8	1.1	3.6	1.6	1.5	0.3	-0.3	-3.3	-2.9	-3.3	-2.2

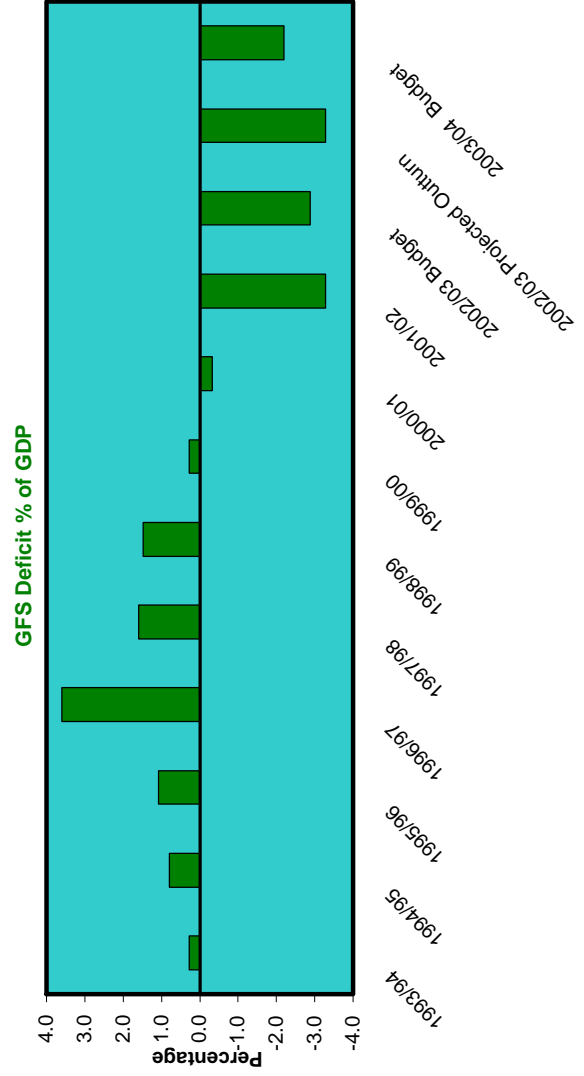
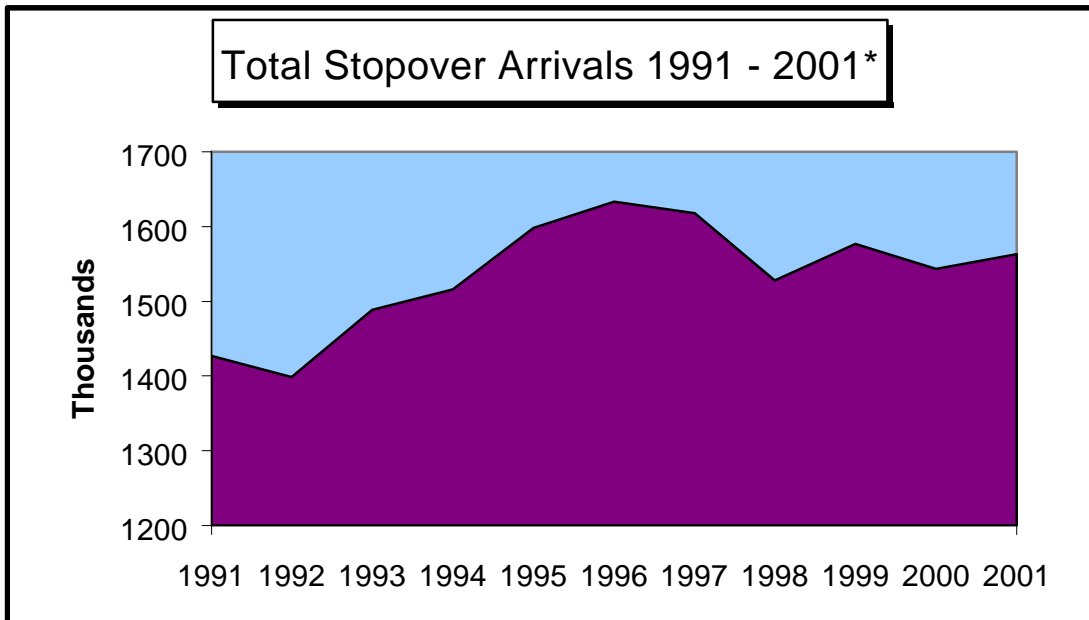
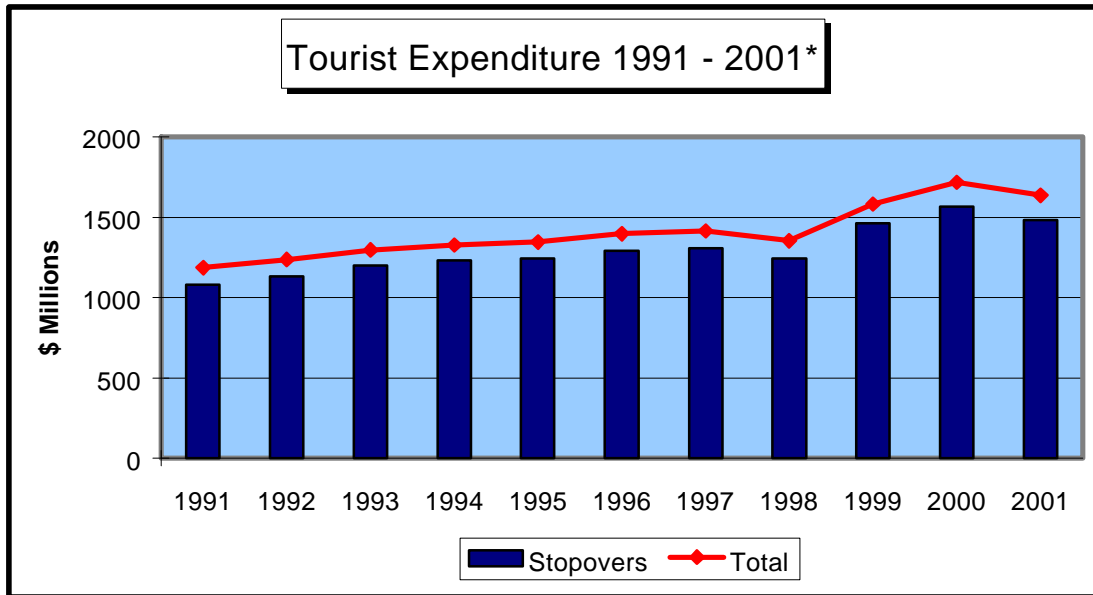
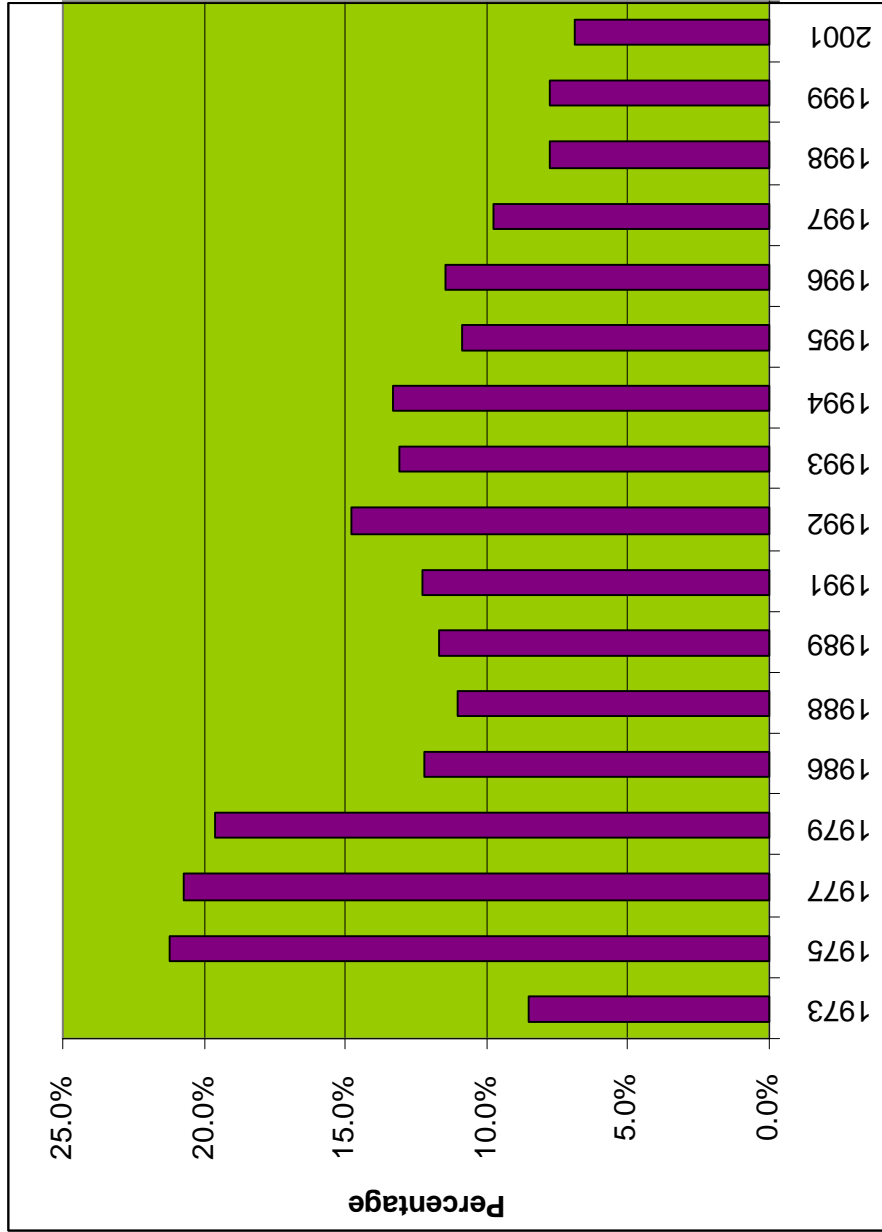


Table III. Tourist Expenditure and Arrivals 1991 - 2001



*Source: Central Bank and Ministry of Tourism

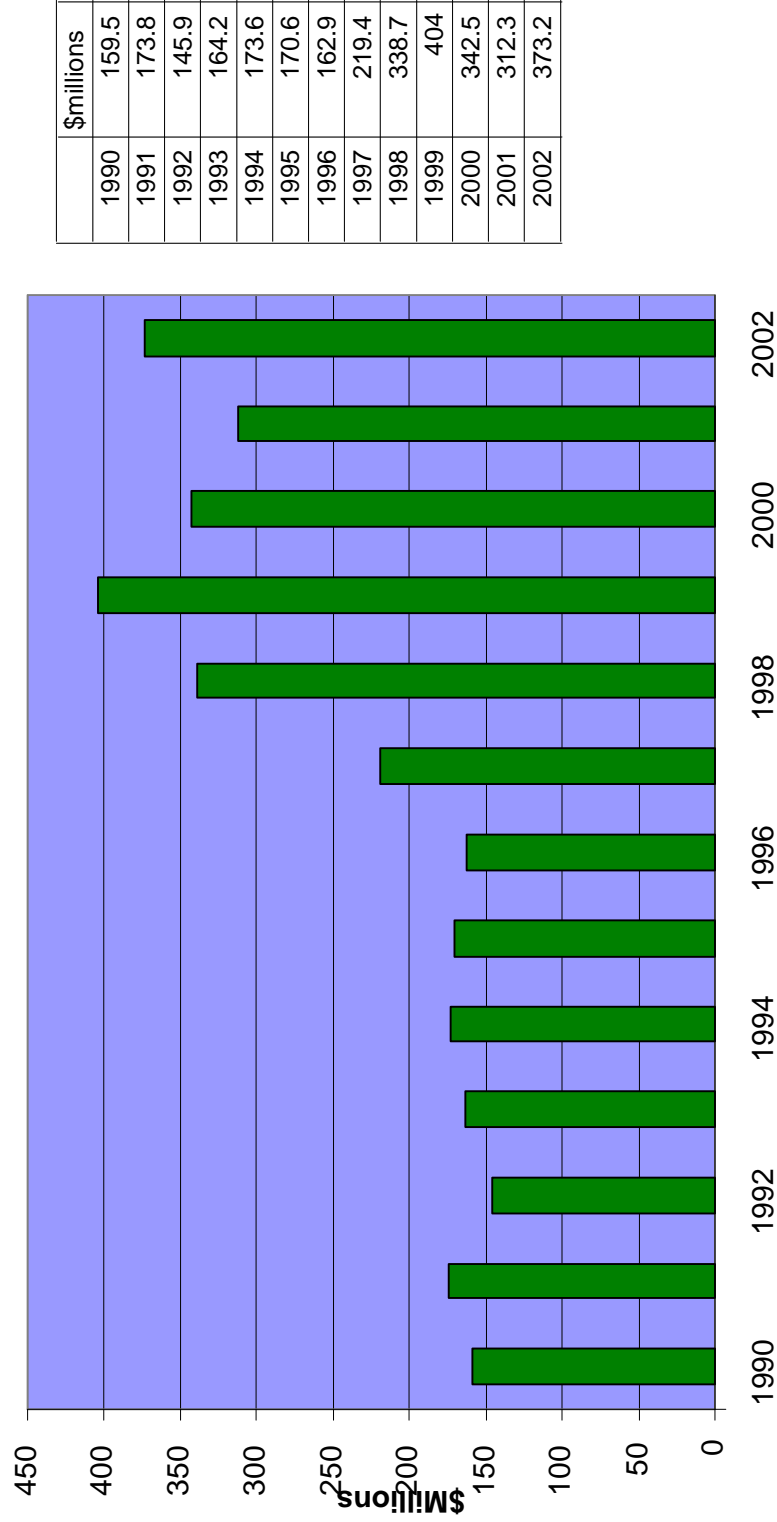
Table IV. Unemployment Rates 1973-2001



Year	%
1973	8.5%
1975	21.2%
1977	20.7%
1979	19.6%
1986	12.2%
1988	11.0%
1989	11.7%
1991	12.3%
1992	14.8%
1993	13.1%
1994	13.3%
1995	10.9%
1996	11.5%
1997	9.8%
1998	7.8%
1999	7.8%
2001	6.9%

Source: Department of Statistics

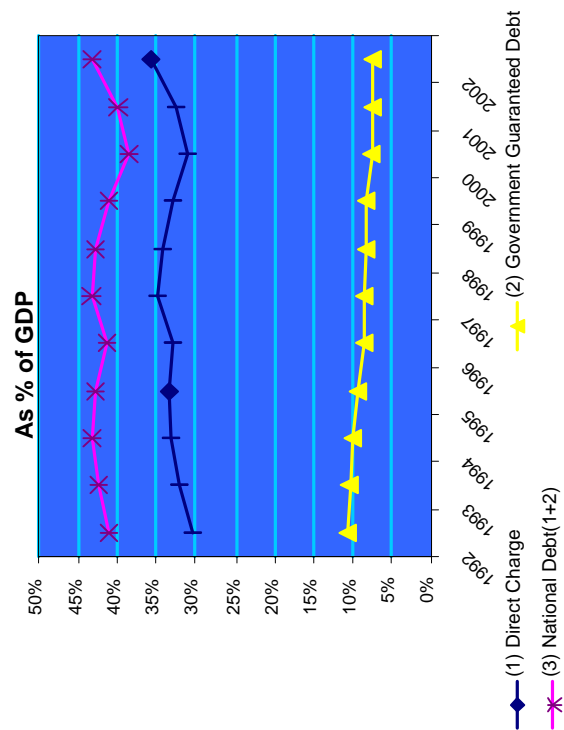
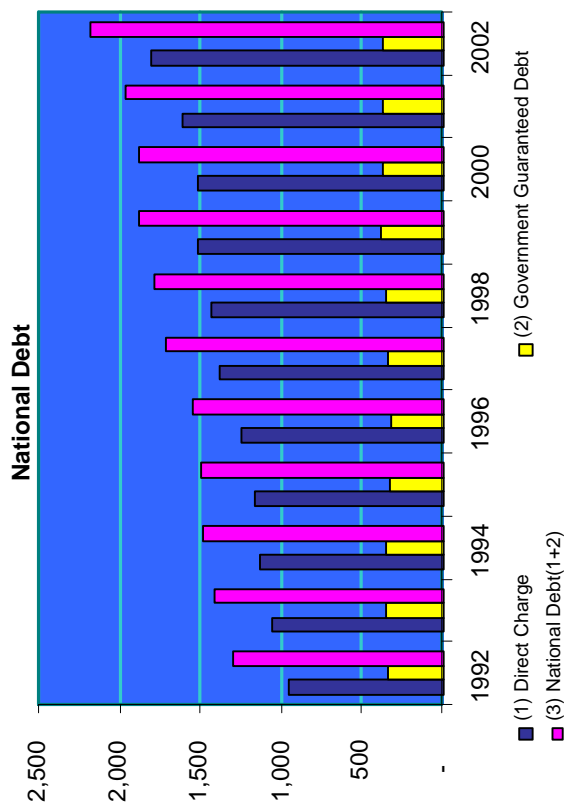
Table V Total External Reserves 1990 - 2002



Source: Central Bank Quarterly Statistical Digest, 2003

Table VI. National Debt

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
\$ millions											
(1) Direct Charge	952	1,065	1,136	1,166	1,235	1,377	1,431	1,509	1,514	1,603	1,805
(2) Government Guaranteed Debt	337	346	343	329	314	332	349	376	370	364	368
(3) National Debt(1+2)	1,289	1,410	1,479	1,495	1,549	1,708	1,783	1,885	1,884	1,967	2,173
GDP(\$millions)	3150	3325	3425	3500	3750	3940	4190	4575	4880	4950	5050
As % of GDP											
(1) Direct Charge	30%	32%	33%	33%	33%	35%	34%	33%	31%	32%	36%
(2) Government Guaranteed Debt	11%	10%	10%	9%	8%	8%	8%	8%	7%	7%	7%
(3) National Debt(1+2)	41%	42%	43%	43%	41%	43%	43%	41%	39%	40%	43%



Source: Central Bank Quarterly Statistical Digest February 2003