

Development Challenges in The Bahamas

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Abstract

This policy brief presents a summary of the development challenges facing the country.

Key Words: Regional Integration, Economic Growth, Productivity and Growth, Economic Integration, Investment, and Global Trade

JEL Codes: H30, F15, F31, F32, F34, Q32



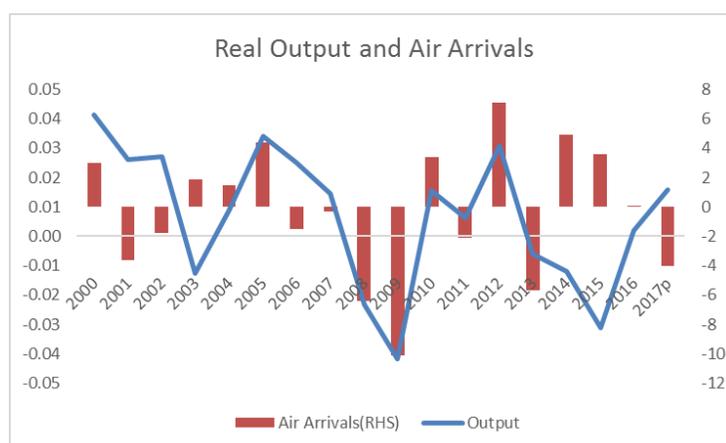
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Medium-Term Economic and Social Trends

The economy of The Bahamas, an archipelagic nation with over 700 islands and cays, depends on the principal sectors of tourism and financial services.¹ Since the global financial crisis, the nation has continued to experience low growth rates and mounting levels of debt. The average rate of real growth has been approximately 0.50 percent since 2008, as subdued contributions from the tourism and financial sectors, along with low levels of total factor productivity, were identified as the main reasons for the decline (Figure 1). The country has been losing market share by an estimated 0.5 percent in the Caribbean region in terms of international tourist arrivals since 2006, while stricter international regulatory standards have led to increases in operational costs within the financial sector, the economy's next major engine of growth, impacting long-standing correspondent banking relationships and the long-term performance of the offshore subsector.

Figure 1. Real Output and Air Arrivals



Source: Central Bank of The Bahamas.

Central government debt as a percentage of gross domestic product (GDP) rose from just above 30 percent in FY2006/2007 to approximately 60 percent in FY2016/2017, and fiscal space

¹ According to the World Travel and Tourism Council, The Bahamas was the 10th most tourism-dependent economy in the world in 2015. Tourism accounts directly and indirectly for 43.6 percent of GDP, 51.6 percent of total employment, and 61.5 percent of total exports.



tightened as primary deficit levels moved from 1 percent in 2006 to roughly 2.6 percent by FY2016/2017. The excessive staffing and operational inefficiencies of state-owned enterprises (SOEs) placed an excessive burden on government transfers, amounting to some 7 percent of overall GDP or roughly 30 percent of overall government expenditure. In addition, post-hurricane rebuilding and cleanup activities after several Category 5 storms impacted revenue collections and spending levels. External competitiveness has declined due to the appreciation of the U.S. dollar, with which The Bahamas maintains a peg. Foreign direct investment (FDI) has declined as well, even as liquidity and external reserves levels have been boosted by proceeds from the Government's recent bond issue.

Medium-Term Economic and Social Outlook

Pursuing a pro-growth path for the medium term will be a challenge, especially in an environment of declining fiscal space and lower levels of external competitiveness. Growth in The Bahamas for 2017 is estimated to be moderately positive (1.6 percent), with further improvement to 2.5 percent expected in 2018. The opening of the Baha Mar mega resort, and construction activity related to the over US\$4.2 billion project, other foreign direct investments (FDIs), rebuilding activities following Hurricanes Matthew and Irma, and continued robust economic returns in the United States are all expected to boost growth in the near to medium term.

The government has embarked on efforts to rationalize public expenditure through a 10-percent reduction in government spending (amounting to approximately 2 percent of GDP) in FY2017/18 and improved tax collection efforts. The first five months of 2017/18 have shown a decline in the deficit, driven by higher levels of collection and the stabilization of expenditure after recent spending on hurricane rebuilding. The planned introduction of fiscal responsibility legislation expected by the second quarter of 2018, in addition to current cost-cutting measures, raises hopes that currently high levels of budget deficit and debt burden will be gradually reduced, bringing greater credibility to the level of fiscal governance throughout the country.

Risk Factors

In addition to the short to medium-term fiscal risks outlined above, pension liabilities may pose a serious long-term challenge. Liabilities for government pensions, covering public entities and social security commitments, are now estimated at nearly 160 percent of GDP, and some estimates indicate those commitments underfunded. Further increases are expected as the retired Bahamian population is expected to reach 41.6 per 100 workers by 2060, dramatically above the current ratio of 1:10 and somewhat more than the United States level of 36.8 per 100 workers. Low elevation throughout The Bahamas, along with weak environmental planning, make the economy susceptible to disaster risk and climate change. Hurricanes Joaquin, Matthew and Irma impacted the archipelago in the past three years, with estimated rebuilding costs of almost US\$750 million. Disaster risks and climatic change events present significant challenges to the preservation of human life and maintaining and improving economic activity while achieving fiscal and debt targets. In a tourism-based country, climate adaptation measures will reduce the



vulnerability of tourism support systems such as water management, transportation, food supply, and energy, while also preserving natural attractions that are critical for the tourism industry.

Development Challenges

The Bahamian economy is constrained from achieving higher and more inclusive growth levels by low total factor productivity (TFP). With falling productivity growth, characterized by declining contributions from both labor and capital over the past decade, the country has seen economic growth below its regional neighbors. Without the development of a strong policy and regulatory environment protecting investors, particularly in regard to promoting entrepreneurship and international investment, TFP growth will continue to be curtailed. While investments in the Baha Mar Casino Project noted above and the recently announced US\$5.5 billion Oban Refinery deal in Grand Bahama are expected to lift productivity levels in the near and medium term, the Government of The Bahamas' (GoBH) growth-inducing efforts continue to face challenges in an environment of tightening fiscal space and weakened external competitiveness.

The Bahamas has a high ranking on the Human Development Index (HDI). The Bahamas' HDI value (0.778) measures above the regional average for Latin America and the Caribbean (0.75) and within the high human development category at 50th out of 188 countries and territories (UNDP, 2016). However, low growth rates over the past decade are contributing to troubling trends in social indicators. Poverty rates are lower than regional comparators, but trends are increasing for the measured period (2001-2013) from 9.3 to 12.8 percent.² Moreover, there are regional and demographic disparities, with poverty rates in the southern-most Family Islands at 17.2 percent, almost 5 percent above the national average. For young adults and children, estimates are roughly 6 percent above the archipelago's average (18.4 percent), and female-headed households show a higher poverty rate than male-headed households (9.7 percent and 7.9 percent, respectively).

The archipelagic profile of the nation, with uneven population, social and economic distribution across vast areas, has contributed to inequalities in delivery of and access to education and health care. This has affected the labor market through young workers' level of educational achievement, as well as the quality of the education they receive. For the past half-decade, unemployment levels have remained between 14 and 16 percent, with youth levels at almost twice the national rate, measured as high as 30 percent over the same period. According to the Labor Force Survey, female unemployment was higher than that for males in 2016 (14.5 percent and 11 percent, respectively). The overall unemployment rate declined to 9.9 percent in May 2017 from 11.6 percent in November 2016, with employment boosted by construction of Baha Mar and reconstruction activities after the hurricanes. The Baha Mar project has created almost 3,500 additional jobs, with 1,500 more expected by the completion of the project's third and final stage (Rosewood Resort Hotel) in the second quarter of 2018. Rising poverty and jobless rates, on the other, have contributed to an increase in the crime rate, including a doubling of the murder rate

² Data provided by the 2013 Household Expenditure Survey (Government of The Bahamas, 2016).



over the past decade.³ These conditions have in turn resulted in rising security costs for firms,⁴ along with weakened sales and lower perceptions of safety, especially in the most populated areas.

Conclusion

The Bahamas faces important challenges. Economic growth has remained subdued since the 2008 world economic crisis. A strong dependence on tourism and on specific tourism markets, vulnerability to weather related shocks and being a small country, spread over dozens of islands, all constrain economic growth. At the same time, the debt-to-GDP ratio has been increasing, bringing fiscal challenges and a need to adjust in the short to medium term. The authorities have recognized the need to adjust and reform, including through measures to increase tax revenues and reduce expenditures. Other strengths of the country include proximity to the United States, a strong brand in international tourism and a long history of political stability.

³ For more information, see Sutton (2016).

⁴ Some firms report losses of up to 5 percent of total GDP.



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