The Bahamas Fiscal Responsibility Bill 2018: Some Observations and Practical Guidance for Implementation Effectiveness

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Abstract

This Policy Brief examines The Bahamas' Fiscal Responsibility Bill 2018, juxtaposing it against some standard principles that typically guide the formation of a fiscal responsibility framework. Key findings are that The Bahamas' proposed framework as outlined in the bill are clear, sound, and accord with the typical objectives of a standard fiscal responsibility framework. The embedded fiscal rules appear to be well designed and meet the key requirement test because they will be enshrined in law with an independent oversight fiscal council to monitor and report on compliance and administrative sanctions in cases of breach. Importantly, The Bahamas' proposed framework strikes a good balance between credibility and flexibility, with built-in escape clauses and mechanisms that support fiscal countercyclicality. Three key lessons are distilled from the experiences of Jamaica and Grenada (the two other independent CARICOM countries with fiscal responsibility laws) that might be useful for The Bahamas: (i) strong public financial management systems are integral for the smooth implementation of the legislation; (ii) public consultations are not only important prior to the design of the framework, but they are also important during its implementation; and (iii) it is important to embed contingency provisions in the framework given The Bahamas' inherent vulnerability to natural hazards.

JEL Codes: E62, H60

Key Words: Fiscal Responsibility Framework, The Bahamas

1 Introduction

The Bahamas Government has taken the bold step to legislate a rules-based framework for fiscal responsibility. When The Bahamas' Fiscal Responsibility Legislation (FRL) comes into force on July 1, 2018, it will be the third independent CARICOM member country (after Jamaica and Grenada) to have such a law. Indeed, The Bahamas' fiscal performance in recent years has drawn attention to the need to entrench fiscal discipline, enhance budget credibility and promote countercyclical fiscal policy. The proposed FRL is aimed at achieving those.

This Policy Brief offers some observations on The Bahamas' Fiscal Responsibility Bill (FRB) 2018. It juxtaposes the proposed provisions of the FRB 2018 against some standard principles that typically guide the formation of a FRL, which, as discussed in Wright, Grenade and Scott-Joseph (2017) are: (i) clarity of objectives, (ii) design parameters, (iii) implementation modalities, and (iv) institutional arrangements.

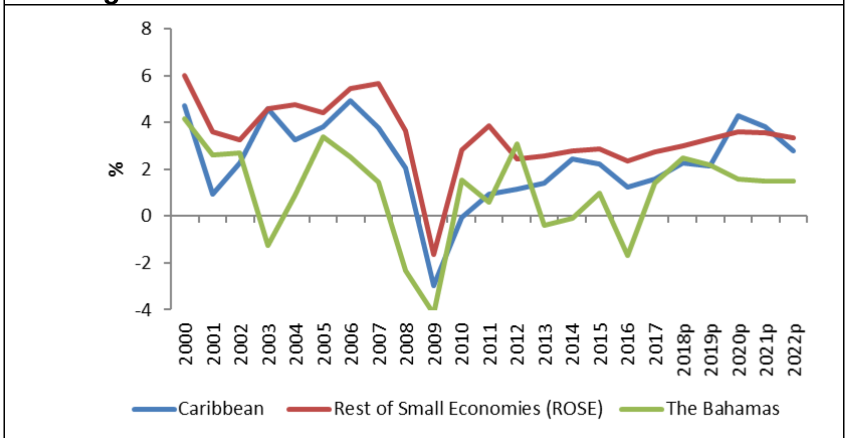
This Policy Brief also offers practical guidance for implementation effectiveness based on salient lessons that have emerged from Jamaica and Grenada, where the FRLs have been in force since 2012 and 2016 respectively. The Brief is organised as follows. Section 2 summarizes The Bahamas' macro-fiscal context, while Section 3 critically examines The Bahamas' FRB 2018 through the lens of the four guiding principles. Section 4 distils lessons from Jamaica and Grenada that might be useful for The Bahamas, and Section 5 concludes.

2 The Bahamas' Macro-Fiscal Context

The Bahamas is an archipelagic nation with economic dependence on the principal sectors of tourism and financial services.[1] From the period of the global financial crisis, growth has been stagnant at roughly 0.3 percent but still below regional comparators. Growth is projected to improve by 2.5 percent in 2018 and 2.2 percent in 2019 after a steady performance in 2017. The medium-term average growth rate projected by the IMF is approximately 1.9 percent. The growth strategy of the government involves the provision of incentives and tax concessions to encourage large, private tourism-related capital projects, enabling a faster growth recovery over the medium term.

[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.

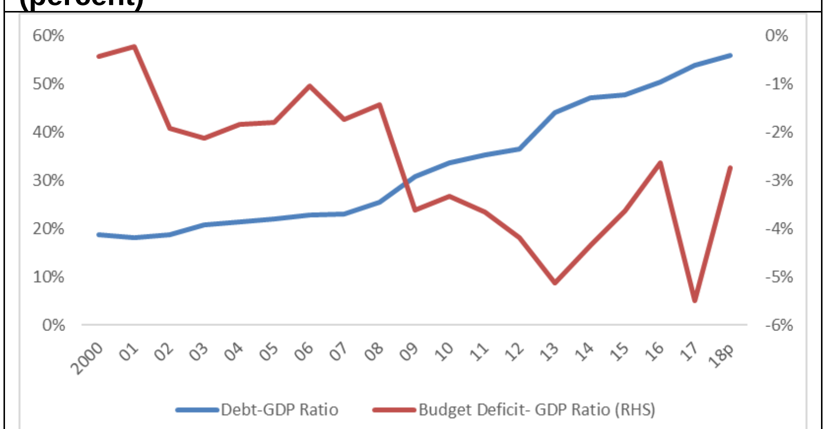
Figure 1: Real Growth Rates



Source: International Monetary Fund, World Economic Outlook (April 2018); and Department of Statistics

Central government debt as a percentage of gross domestic product (GDP) rose from just above 25 percent in FY2007/08 to approximately 55 percent in FY2017/18, and fiscal space tightened as government deficit levels moved from 1 percent in 2008 to roughly 2.7 percent by FY2017/18. The excessive staffing and operational inefficiencies of state-owned enterprises (SOEs) placed an excessive burden on government transfers, amounting to over 5.8 percent (vs 4.1 percent in FY07) of overall GDP or roughly 28 percent of overall government expenditure by FY2017/18. In addition, post-hurricane rebuilding and cleanup activities after several Category 5 storms impacted revenue collections and spending levels.

Figure 2: Central Government Debt and Budget Deficit (percent)



Source: International Monetary Fund, *World Economic Outlook* (April 2018); Department of Statistics and Central Bank of the The Bahamas.

The declining fiscal space has impacted the country's sovereign ratings over the past fiscal year. Moody's Investor Services confirmed The Bahamas' Baa3 credit rating after initiating a review for downgrade. The optimistic prospects of a change in fiscal culture and strong liquidity[2] levels within the financial sector were the main drivers of the confirmation of the sovereign ratings. S&P Global

[2] Commercial banks remain liquid, with levels at roughly twice international regulatory standards.

Ratings affirmed The Bahamas' 'BB+/B' long- and short-term sovereign credit ratings, a rating level below investment grade. The outlook remains stable. The stable outlook reflects an expectation that robust political institutions will anchor fiscal consolidation and higher, albeit low, economic growth over the next one-to-two years.

3 Guiding Principles for Fiscal Responsibility Legislations

Guiding Principle # 1: Clarity of Objectives

The primary objective of a Fiscal Responsibility Framework (FRF) that is enshrined in law is to promote sustainable growth, while at the same time controlling deficits, limiting debt accumulation, and improving fiscal transparency and accountability. Two other proximate goals are to secure long-term fiscal responsibility and sustainability and support short-term macroeconomic stabilisation (Anderson and Minarik, 2006).

The four objectives of The Bahamas' proposed FRF are to: "(i) establish the principles and procedures of responsible fiscal management; (ii) guide the formulation and implementation of fiscal objectives; (iii) guide the annual budget within a medium-term fiscal framework; and (iv) facilitate effective parliamentary and public scrutiny of the fiscal performance of the Government" (FRB 2018: 5). The specific fiscal responsibility objectives are: "(a) achieving and maintaining a sustainable fiscal balance; (b) achieving and maintaining prudent levels of public debt; and (c) prudently managing fiscal risks" (FRB 2018: 8).

The stated objectives of The Bahamas' proposed FRF are sound, unambiguous, and accord with the typical objectives of a standard FRF. The objectives are geared toward embedding medium-to-long-term fiscal sustainability through judicious fiscal management and a solid framework to promote and entrench good fiscal governance. Strengthening fiscal responsibility, enhancing fiscal transparency and accountability, and promoting fiscal and debt sustainability are also explicit objectives for Jamaica and Grenada (Financial Management and Audit Act, 2012, Jamaica and Fiscal Responsibility Legislation No. 29 of 2015, Grenada).

Guiding Principle # 2: Design Parameters

There are some broad criteria that should guide the design of an FRF, and especially the fiscal rules and targets that are embedded. These include simplicity, credibility, flexibility, and the fiscal and economic idiosyncrasies of countries. Different countries choose different targets, and the choice of anchor is adopted typically to provide adequate guidance to annual budgets, with a view to ensuring medium-term fiscal and debt sustainability. Economic considerations, such as achieving a long-term investment objective, also inform the choice of debt anchor and targets. In the case of The Bahamas, guided by debt sustainability considerations, its proposed FRF includes a **debt target** (to reduce debt from 57 percent of GDP in FY2016/17 to a debt level of no more than 50 percent of GDP[3]) and **two fiscal rules; an overall balance rule** (a fiscal balance that does not exceed a deficit of 0.5 percent of GDP from FY2020/21 onward) **and an expenditure rule** (the rate of growth of nominal current expenditure no more than the estimated long-term nominal growth in GDP, once the overall balance rule is met).

The Bahamas' proposed FRF passes the simplicity test because the fiscal variables being constrained (public debt, overall balance, and current expenditure) are clearly defined,

[3] "Government shall state the financial year by which this long-term debt objective is intended to be achieved in the fiscal strategy report" (FRB 2018: 16).

uncomplicated, and difficult to manipulate. The medium-term debt anchor is supported by two clear operational rules, which are designed to put public debt on a firm downward trajectory toward its sustainable target.

The FRF meets the key requirement test because the fiscal rules and targets will be enshrined in law with an independent oversight fiscal council to monitor and report on compliance. Strict enforcement of the FRF provisions will, over time, bolster the credibility of The Bahamas' rules-based framework.

The proposed FRF also passes the flexibility test. There is built-in flexibility with the inclusion of the compliance margin, which shall not exceed 0.5 percent of GDP for the fiscal balance rule. Escape clauses are also included to allow for a moratorium of the fiscal targets and objectives in exceptional circumstances (external shocks resulting in a significant economic downturn, national security considerations, or natural disasters). These features provide a good balance between credibility and flexibility because they support the deployment of countercyclical fiscal policies when appropriate.

The Bahamas' fiscal rules and targets, though calibrated to suit the economic and fiscal idiosyncrasies of the country, are similar to those of Jamaica and Grenada. In all three cases, there is a medium-term debt anchor that is complemented by operational fiscal rules to guide the conduct of fiscal policy, with the express objective of reducing public debt to its target. In the case of Jamaica, there is a fiscal balance rule and a wage bill rule (expenditure sub-component rule). In the case of Grenada, there are four rules (primary balance, primary expenditure, wage bill, and contingent liabilities related to public private partnerships). Table 1 summarizes the main features of the FRFs of The Bahamas, Jamaica, and Grenada.

Guiding Principle # 3: Implementation Modalities

The integrity of a FRF is enhanced with clear implementation arrangements and reporting requirements. The Bahamas' proposed FRF outlines clear and concrete timelines for implementation. Reporting dates to Parliament, as well as the contents of all reports will be enshrined in the law. The integrity of a FRF and a government's commitment to its legislated fiscal rules and targets are also likely to be enhanced when there is high degree of certainty that noncompliance would be sanctioned. Based on a survey of relevant literature, Wright et al. (2017) found that typically, sanctions are either financial (e.g., fees and fines) or administrative (e.g., submission of a corrective plan to Parliament). In the case of The Bahamas, in the event of a breach of the fiscal responsibility objectives, Section 15 of the FRB 2018 makes provision for the Minister to appear before the Public Accounts Committee of Parliament to explain the cause of the breach and present a credible fiscal adjustment plan. This de facto administrative sanction is not an explicit provision in the FRLs of Jamaica and Grenada; its inclusion in The Bahamas' FRB 2018 is most welcomed.

Guiding Principle # 4: Institutional Arrangements

From a review of relevant literature, there is consensus that FRFs must be supported by strong institutional arrangements. Independent fiscal councils, or "fiscal watchdogs" as they are commonly referred to, are crucial institutional pillars that support rules-based fiscal frameworks. Independent fiscal agencies typically perform some or all the following functions: provide objective analysis of current fiscal developments; assess medium and long-term fiscal sustainability; monitor and report on compliance with fiscal rules and other official fiscal objectives; produce independent forecasts and projections of budgetary and wider macroeconomic variables—

provide direct inputs into the budget process; and assess the appropriateness of the fiscal policy stance. Notwithstanding the important mandate of independent fiscal agencies, it is important to note that they have no role (direct and/or indirect) in setting fiscal policy targets (Calmfors and Wren-Lewis, 2011). Though useful, where their capacity is limited to produce alternative fiscal forecasts or where they lack the resources to communicate to the public, their usefulness can be limited. This notwithstanding, Wyplosz (2011) contended that after fiscal rules, a fiscal council is the second most important solution for promoting fiscal discipline and sustainable public finances. The Bahamas' FRB 2018 makes provision for an independent fiscal responsibility council. The council's mandate will be to assess compliance with the general principles, fiscal responsibility principles and fiscal objectives, provide advice on fiscal and budgetary matters of the Government, and report to Parliament.

The inclusion of an independent fiscal council in The Bahamas' FRF will help to promote fiscal transparency and accountability, and as such, augurs well for the credibility of the framework. An independent fiscal oversight body is also a feature of Grenada's FRL. Grenada's Fiscal Responsibility Oversight Committee (FROC) has already produced two reports on the government's compliance with its fiscal rules and targets, and in this regard, the FROC is helping to promote a new culture of fiscal transparency and accountability. On May 10, 2018, the Finance Minister of Jamaica announced that the Cabinet had approved the establishment of an independent fiscal council as part of measures to strengthen Jamaica's FRF. The Minister of Finance further indicated that the government had procured the services of experienced international experts to help develop the council's design (Jamaica Information Service, 2018). At the time of writing (May/June 2018), the council was not yet established.

Table 1: Fiscal Responsibility Framework: The Bahamas, Jamaica and Grenada

	The Bahamas	Jamaica	Grenada
Fiscal Target (Debt anchor)	**Public Debt:** No more than 50 percent of GDP	**Public Debt:** 60 percent of GDP or less by fiscal year 2025/26	**Public Debt:** 55 percent of GDP
Fiscal Rule(s)	**Overall Balance:** Deficit of no more than 0.5 percent of GDP from fiscal year 2020/21 onward ***Transition:*** *Deficits of no more than 1.8 percent of GDP and 1 percent of GDP in fiscal years 2018/19 and 2019/20, respectively.* **Expenditure:** Rate of growth in nominal current expenditure no more than the rate of growth in nominal GDP *(Applicable only after attainment of deficit target in 2020/21)*	**Overall Balance**: To attain a fiscal balance by fiscal year 2018 **Expenditure**: I. Annual wage bill of the Government not to exceed 9 percent of GDP	**Primary Balance:** Not less than 3.5 percent of GDP until debt target is reached **Expenditure**: II. Annual growth in primary expenditure[4] not to exceed 2 percent in real terms III. Annual wage bill of the Government not to exceed 9 percent of GDP **Public-Private Partnerships:** Contingent liabilities related to PPPs not to exceed 5 percent of GDP
Escape Clauses	**Yes:** ✓ Severe economic downturn ✓ National security considerations ✓ Natural disasters	**Yes:** ✓ National security considerations ✓ Natural emergencies	**Yes:** ✓ Economic recession ✓ Financial crisis ✓ Natural disasters, public health epidemics, war
Legislated Fiscal Council	**Yes.** Fiscal Responsibility Council (five members)	**Forthcoming[5]**	**Yes.** Fiscal Responsibility Oversight Committee (five members)
Sanctions for Breach of Fiscal Objectives	**Yes.** (Administrative)	**No**	**No**
Legislation Introduced within the Context of an IMF Program	**No**	**Yes**	**Yes**

Sources: *Fiscal Responsibility Act, No. 29 of 2015 - Grenada*
Fiscal Responsibility Bill, 2018 – The Bahamas
International Monetary Fund (March 2017) – Fiscal Rules at a Glance

[4] Total expenditure less interest payments.
[5] On May 10, 2018, the Minister of Finance announced that the Cabinet had approved the establishment of an independent fiscal council as part of measures to strengthen Jamaica's FRF; however, at the time of writing (May/June 2018), the council was not yet established.

4 Lessons from Jamaica and Grenada

Fiscal rules and FRFs more broadly are not perfect and they certainly are not panaceas. Indeed, "they cannot guarantee fiscal sustainability, but they have become a popular mechanism by which to anchor fiscal policy, infuse fiscal discipline, and promote credibility" (Wright et al., 2017: 3). Since coming into force in 2012, Jamaica's Financial Administration and Audit Act was amended in 2014 and 2016. Grenada's Fiscal Responsibility Legislation No. 29 of 2015, which came into force in 2016, has been amended once. The point being made is that FRFs evolve over time given changing economic, social, and political contexts. Strengthening fiscal responsibility, enhancing fiscal transparency and accountability, and promoting fiscal and debt sustainability are also explicit objectives of the respective FRFs of Jamaica and Grenada. Fiscal and debt sustainability objectives underpin the respective debt anchors and targets that have been adopted in both countries as described in Table 1.

The following are lessons from the Jamaica and Grenada experiences to date, which might evince useful insights to the Bahamian Authorities as they implement their FRL.

Firstly, it is crucially important that The Bahamas' FRL is supported by strong public financial management (PFM) systems. Ideally, the FRL should be accompanied by, or embedded in PFM legislation. In the case of Jamaica, its fiscal responsibility provisions are part of its comprehensive Financial Administration and Audit Act of 2012, while Grenada's FRL is aligned with its Public Financial Management Act of 2015. Strong PFM systems allow for the conversion of the intent of the FRL (especially the fiscal rules and targets) into the reality of budget policy and implementation. Of the PFM systems, sound accounting and budgeting systems that are consistent across all government ministries are particularly important to ensure timely monitoring of the fiscal responsibility objectives.

Secondly, public consultations are not only important prior to the design of a FRF, but they are also important during the implementation. Constant engagement of key stakeholders, such as the private sector, labour organisations, civil society, Parliamentarians and importantly, public sector employees, is absolutely essential. Public sector employees especially must be familiar with the requirements and provisions of the FRL if its implementation is to be smooth and efficient. Therefore, it would be prudent for the Government of The Bahamas to hold orientation sessions for all members of the Public Service to promote and entrench a new culture of fiscal responsibility, transparency and accountability. It will also be important that orientation sessions be held for the members of the Fiscal Responsibility Council to build their capacity and adequately prepare them to discharge their legislated mandate. In the case of Grenada, the Fiscal Affairs Department of the IMF facilitated orientation workshops for the staff of the Ministry of Finance, as well as the members of the FROC and relevant members of Parliament.

Thirdly, given the inherent vulnerability of The Bahamas to natural hazards, it would be important to embed contingency provisions for natural disasters in the FRL. The IMF, in its Article IV 2018 Report, suggested that The Bahamas should create a natural disaster savings fund with a "target size between 2 to 4 percent of GDP" (IMF 2018: 5). Indeed, explicit governance arrangements for a contingency fund for post-natural disaster rehabilitation would be a welcome addition to the FRB 2018. As The Bahamas' fiscal and economic situation improves over time, it would be prudent for the government to amend the FRL to include an explicit provision for a natural disaster contingency fund. In Grenada for example, its FRL stipulates that 40 percent of the annual receipts from the country's Citizenship by Investment Programme must be set aside for contingency spending, including for natural disasters. Jamaica also has a Natural Disaster Fund.

The Bahamas should seriously consider setting up a contingency fund[6] with legislated governance arrangements as it seeks to enhance its resilience and risk reduction policies.

5 Conclusion

This Policy Brief has examined The Bahamas' FRB 2018, juxtaposing it against some standard principles that typically guide the formation of a FRF. Based on our examination, we conclude that the objectives of The Bahamas' proposed FRF are clear, sound and accord with the typical objectives of a standard rules-based framework. We also find that the proposed FRF, in particular, its embedded fiscal rules, are well designed and meet the key requirement because they will be enshrined in law with an independent oversight fiscal council to monitor and report on compliance and administrative sanctions in cases of breach. Importantly, The Bahamas' proposed FRF strikes a good balance between credibility and flexibility to support the deployment of counter-cyclical fiscal policies when needed. Overall, the proposed FRF is a solid one and, if implemented as stipulated in the FRB 2018, which will become law in July 2018, it will help to entrench fiscal discipline, enhance budget transparency and credibility, and improve fiscal accountability and overall fiscal governance.

Lessons from the implementation of the FRLs in Jamaica and Grenada suggest that The Bahamas' FRF should be accompanied by, or embedded in, comprehensive PFM legislation. The Jamaica and Grenada experiences demonstrate that strong PFM systems are integral for the smooth implementation of FRLs. Another lesson is that public consultations are not only important prior to the design of a FRL, but they also important during its implementation. Therefore, it would be prudent for the Government of The Bahamas to hold orientation sessions for all key stakeholders to promote and entrench a new culture of fiscal responsibility, transparency and accountability. Finally, given the inherent vulnerability of The Bahamas to natural hazards, it would be important to embed contingency provisions for natural disasters in the FRL. Indeed, explicit governance arrangements for a contingency fund for post-natural disaster rehabilitation would be a welcome addition to The Bahamas' FRB 2018 and support fiscal resilience, as well as resilience to environmental shocks.[7]

[6] The GoBH are engaged in efforts in renegotiating CCRIF and setting up a contingent credit facility for natural disasters with IDB.
[7] The Bahamas: Proposal for a loan for the project "Contingent Loan for Natural Disaster Emergencies" PR-4578

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