

**IDB COUNTRY STRATEGY  
WITH  
THE COMMONWEALTH OF THE BAHAMAS  
2013–2017**

This document was prepared by Astrid Wynter (Country Office Representative), Emmanuel Abuelafia and Michael Nelson (CCB/CCB), and Sharon Miller, Cherran O'Brien and Natalie Bethel (all of CCB/CBH). Inputs were received from David Ochoa (FMP/CGY), Lila Mallory (FMP/CJA), Claudia Stevenson (IFD/CTI), Jaiwattie Anganu (CMF/CJA), Gerardo Reyes-Tagle and Gustavo Garcia (both of IFD/FMM), Sophia Whyte-Givens (FMM/CJA), Jorge Von Horoch, Arnaldo Posadas, and Mariano Lafuente (both of IFD/ICS), Mariel Fiat Ortiz (ICS/CJA), Fernando de Olloqui and Luana Garcia Marques Ozemela (IFD/CMF), Sylvia Larrea and Christiaan Gischler (both of INE/ENE), Cassandra Rogers (RND/CBA), Gerard Alleng and Sara Valero Freitag (both of INE/CCS), Maria Victoria Fazio (SCL/LMK), Carlos Herran (SCL/EDU), and Nick Blumenthal (VPP/VPP). Maria Jordan (CCB/CCB) was in charge of editorial and document production.

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## ELECTRONIC LINKS TO BACKGROUND INFORMATION

[Bahamas Growth Diagnostic \(\*Confidential\*\)](#)  
[Consultation with Civil Society](#)  
[Portfolio Report](#)  
[Fiscal Note](#)  
[Public Sector Management Note](#)  
[Citizen Security and Justice Note](#)  
[Energy Note](#)  
[Private and Financial Sector Development Note](#)  
[Disaster Risk Management/Coastal Risk Management Note](#)  
[Climate Change Note](#)  
[Labor Market Note](#)  
[Fiduciary Technical Note](#)

## ABBREVIATIONS

BAIC	Bahamas Agricultural Investment Corporation
BDB	Bahamas Development Bank
CC	Climate Change
CDB	Caribbean Development Bank
ConSOC	Civil Society Consulting Group
CPD	Country Program Document
CPE	Country Program Evaluation
CS	Country Strategy
DOS	Department of Statistics
DRM	Disaster Risk Management
EA	Executing Agency
EU	European Union
EVF	Enterprise Venture Fund
FDI	Foreign Direct Investment
FY	Fiscal Year
GCI	General Capital Increase
GDP	Gross Domestic Product
GEF	Global Environment Facility
GoBH	Government of The Bahamas
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
LAC	Latin America and Caribbean
MIF	Multilateral Investment Fund
MNS	Ministry of National Security
MOE	Ministry of Education
MoF	Ministry of Finance
MSME	Micro, Small and Medium Enterprise
NSG	Non-Sovereign Guarantee
OAG	Office of the Auditor General
PAHO	Pan American Health Organization
PBL	Policy Based Loan
PEU	Project Executing Unit
PMR	Project Monitoring Report
RE	Renewable Energy
SCF	Structured and Corporate Finance
SG	Sovereign Guarantee
SME	Small and Medium Enterprises
SSN	Social Safety Net
TC	Technical Cooperation
UNDP	United Nations Development Program

## Executive Summary

Country Context:	<p>The Bahamas achieved a relatively high per capita income of US\$23,000. However, beginning in 2008, economic growth faltered. Per capita incomes are still 8.2% below 2007 levels and growth rates remain subdued. The elevated figure also masks significant income inequality. The global economic crisis exposed structural weaknesses that inhibit economic growth and increase vulnerability. With 350,000 inhabitants, the internal market of this archipelagic nation is small, the production base is narrow and it relies almost totally on one trading partner. The prolonged downturn is also manifesting itself in historically high levels of crime and violence. Moreover, The Bahamas is particularly vulnerable to natural disasters and to the impact of climate change. The global economic downturn has resulted in higher fiscal deficits and rising debt. Fiscal action can stabilize the debt build up, but growth is required to reverse falling income. Growth means going beyond traditional products and markets so diversification is essential.</p>
The IDB in The Bahamas:	<p>The current Country Strategy (2010-2014) supports GoBH efforts to enhance growth by improving infrastructure and supporting SME development. The current Government, which took office in May 2012, requested a new Country Strategy prior to the expiration of the current one to reflect the current development priorities and align more with the 5-year political cycle.</p>
Priority Sectors 2013-2017:	<p>The proposed Country Strategy 2013-2017 would support transformative initiatives of GoBH to ensure macroeconomic sustainability; ensure social stability and employment; and increase resilience to the negative impacts of climate change. CS priority areas include: (1) Public Finances and Management; (2) Citizen Security and Justice; (3) Energy; (4) Private Sector Development; and (5) Coastal Risk Management and Climate Change Adaptation. Interventions in these sectors will contribute significantly to stemming the erosion of per capita incomes by protecting public investment space and promoting growth.</p>
Bank Financing:	<p>The GoBH has decided to rely on domestic markets to satisfy the bulk of its financing needs (\$1.2 billion) during the strategy period. Therefore, GoBH will utilize Bank financing of up to US\$150 million for tightly focused transformative interventions that have high government priority and require specialized technical support. GOBH has decided to primarily use the investment loan modality, but may also opt for policy-based financing as deemed appropriate. Average annual approvals and disbursements will be significantly lower than levels observed in the current CS. Nevertheless, net flows are expected to remain positive.</p>
CS Implementation:	<p>Intensified efforts to strengthen local execution capacity and country systems will be made to improve the pace of portfolio execution and enable the use of such systems in Bank-financed operations.</p>
Donor Coordination:	<p>The IDB is the largest multilateral development institution in The Bahamas. The Bank's on-going operations include initiatives that are also supported by other agencies, including the CDB, PAHO and IMF. The process of coordination takes place mainly on a case by case basis.</p>
Risks:	<p>The vulnerability to external shocks (oil and food prices) and natural disasters could create economic and social pressures that compromise adherence to the pace of fiscal reform. The strong institutional and technical support to the agencies driving the reform agenda will mitigate that risk. In addition, the main reform decisions are expected to be taken up front and the enabling legislation is relatively difficult to reverse.</p>

**THE BAHAMAS COUNTRY STRATEGY MATRIX**

<b>Country Development Goals</b>	<b>IDB Priority Sector</b>	<b>IDB Strategic Objectives</b>	<b>Expected Results of the Strategy</b>	<b>Indicators</b>	<b>Baseline Values<sup>1</sup></b>
To launch an extensive review of the Bahamian tax system with a view to proposing alternative means of taxation that address the problems of the current system while providing the Government with a stable, buoyant and adequate source of revenue to meet its governance obligations to the Bahamian people.  Place greater emphasis on	<b>1. Public Finances and Management</b>	1.1 To ensure fiscal sustainability.	A transparent and streamlined framework for tax administration.	% Tax Revenue to GDP (MOF).	16% (2011).
			Improvements in the allocative efficiency of expenditure.	% Current Expenditure to GDP (MOF).	19.5% (2011).
				Subsidies & Transfers to Public Corporations as a % of GDP (MOF).	2.9% (2011).
		1.2 To strengthen planning and delivery capacity.	Improved quality of the country's investment program.	Percentage of new investment projects that have undergone the revised appraisal process. <sup>2</sup>	0% (2012).
			Improved public sector management.	Management for Development Results: Pillars on Strategic Planning (IDB MfDR). <sup>3</sup>	0.2 (2009).

<sup>1</sup> Unless otherwise indicated, the baseline indicators were derived from the diagnostic studies, and sector notes, referred to in the electronic links, portfolio review documents and the Medium-Term Socio-Economic Framework (MTF). Progress on baselines will be monitored by the Bank and will be measured at least once (at end of Country Strategy period); frequency of interim measurements will be determined during programming process.

<sup>2</sup> Appraisal process comprises verification of project alignment with national development priorities, and technical, financial and socio-economic feasibility, among others. The appraisal process would apply to all investment projects subject to a decision by the National Economic Council, led by the Prime Minister. This includes purely public sector projects (managed by the Ministry of Finance) as well as private sector investments subject to the assessment of The Bahamas Investment Authority. The instrument through which all investment projects would be required to go through such appraisal process would be a policy document approved by Cabinet.

<sup>3</sup> This composite index (0 to 5.0 scale) from the IDB's Management for Development Results Methodology measures the government's progress on Strategic Planning by applying a standardized questionnaire covering aspects such as: (i) the existence of long-term and medium term plans and the legal and institutional framework for planning; (ii) the consistency of the government's agenda by checking the existence of performance indicators and targets for the administration's term in office; (iii) the articulation of the plan in the government's budget; (iv) medium and short-term monitoring and coordination of the plan; and (v) the involvement of the legislature, the private sector and civil society in the preparation and monitoring of the plan. For a more detailed explanation of the methodology see: IDB (2011), *Managing for development results: Progress and challenges in Latin America and the Caribbean*, IDB, Washington, DC or visit: <http://www.iadb.org/en/topics/prodev/prodev-evaluation-tool,2018.html>

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planning beyond the 5-year political cycle. Improved institutional capacity for planning and investment assessment will ensure better economic performance and contribute to the sustainability of public finances.				Management for Development Results: Pillar for Monitoring and Evaluation (IDB MfDR). <sup>4</sup>	0.8 (2009).
To reduce violence and crime and build a safer Bahamas.	<b><u>2. Citizen Security and Justice</u></b>	2.1 To assist the implementation of targeted social interventions and as well as urban planning and development	Reduction in levels of crime. <sup>5</sup>	# of homicides per/100,000 persons (Royal Bahamas Police Force and Planning Statistics).	28 (2010).
To improve the social environment in The Bahamas conducive to competitiveness and greater standards of living.			Increase in the number of youth enrolled in programs that foster social cohesion	# of youth enrolled in programs that foster social cohesion such as the URP initiative (MNS).	0 (2012).
		2.2 To strengthen public sector institutional capacity to respond to crime.	Strengthened strategic planning capabilities of the criminal justice sector.	% of crime prevention projects that are designed and implemented following the Strategic Crime Prevention Plan <sup>6</sup> (MNS).	0 (2013).
			Improved perception of security, safety and order.	Percent of firms identifying crime, theft, and disorder as a major constraint. (WB Enterprise Survey).	19.5 (2010).

<sup>4</sup> This composite index (0 to 5.0 scale) from the IDB’s Management for Development Results Methodology measures the government’s progress on Monitoring and Evaluation by applying a standardized questionnaire covering aspects such as: (i) the legal and institutional framework for monitoring and evaluation of government performance; (ii) the scope of monitoring and evaluation activities and the use and dissemination level of this information; (iii) the quality of the statistical data systems; and (iv) actions arising from non-fulfillment of objectives. For a more detailed explanation of the methodology see: IDB (2011), *Managing for development results: Progress and challenges in Latin America and the Caribbean*, IDB, Washington, DC or visit: <http://www.iadb.org/en/topics/prodev/prodev-evaluation-tool.2018.html>

<sup>5</sup> Crime in The Bahamas is classified into two categories: 1) crimes against persons, which include murder, attempted murder, manslaughter, rape, attempted rape, unlawful sexual intercourse, armed robbery, robbery and attempted robbery; and 2) crimes against property, which include burglary, house break-in, shop break-in, stealing, stealing from a vehicle, stolen vehicles.

<sup>6</sup> Strategic Crime Prevention Plan includes short-term, intermediate and long term objectives, action steps, performance indicators, benchmarks and an implementation plan.

**THE BAHAMAS COUNTRY STRATEGY MATRIX**

<b>Country Development Goals</b>	<b>IDB Priority Sector</b>	<b>IDB Strategic Objectives</b>	<b>Expected Results of the Strategy</b>	<b>Indicators</b>	<b>Baseline Values<sup>1</sup></b>
To have a well-managed, efficient, and profitable energy sector.	<b><u>3. Energy</u></b>	3.1 To increase the use of energy efficiency and conservation measures.	Increased use of EE and energy conservation (EC) including installation of Solar Water Heaters.	Average Annual % of Energy Savings from EE and EC measures (MOE).	0 (2013).
		3.2 To diversify The Bahamas' energy matrix by tapping renewable energy resources.	Increased contribution of renewable energy sources such as Photovoltaics.	RE contribution to energy grid in MW (MOE).	0 (2013).
		3.3 To increase access to financing to Energy Efficiency (EE) and Renewable Energy (RE) .	Increased level of financing to support EE and RE projects business and residential sectors.	US\$ amount in EE or RE loans to business and residential sectors.	0 (2013).
To remove impediments to business so that Government facilitates the growth of business.	<b><u>4. Private Sector Development</u></b>	4.1 To establish a policy framework to promote Public Private Partnerships.	Enhanced capacity for coordination between public and private sectors.	# of PPP investment projects approved by Bahamas Investment Authority (MOF).	0 (2013).
		4.2 To rationalize Government regulations that hinder business registration, operation, and dispute resolution.	Improved Business Climate, Innovation and Access to Finance (by MSMEs) in The Bahamas.	# of Procedures to Start a Business (WB Doing Business Report).	7(2013).
				# of days to register a property (WB Doing Business).	122 (2013).
		4.3 To reform the financial sector to increase access to financing for domestic firms and individuals.		% of SMEs with credit (WB Doing Business).	11.5% (2013).
				Getting credit ranking (WB Doing Business).	83 (2013).
4.4 To improve alignment between the labor supply and the needs of employers and preparing individuals for self-employment.	Increased integration of private sector needs to training programs (either in the curriculum and/or through on the job training) and job placement services.	# of individuals (all, men, women, youth) benefited from programs to promote higher labor market productivity (DOS).	0 (2013).		



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To safeguard and protect The Bahamas for future generations including preservation of the environment.	<b><u>5. Coastal Risk Management &amp; Climate Change Adaptation</u></b>	5.1 To build resilience to coastal hazards including those associated with climate change through enhanced conservation and management of the coastal zone.	Improved capacity for coastal risk management (risk assessment, prevention and mitigation, financial risk management and disaster preparedness and response).	IDB Risk Management Index (RMI) <sup>7</sup> .	29.76 (2010).
	<b><u>Use of Fiduciary Country Systems</u></b>	5.1 To increase use of external control in sovereign loan portfolio.	Increased use of the validated public financial management subsystems.	% of portfolio (number of loans) with sovereign guarantee using external control subsystem.	25% (2013).

<sup>7</sup> The Risk Management Index, one of the IDB Indicators of Disaster Risk and Risk Management, measures country performance in risk management in terms of the four public policy areas of disaster risk management viz. risk identification, risk reduction (prevention and mitigation), disaster management (preparedness and response); and governance and financial protection. It ranges from 0 to 100.

## I. COUNTRY CONTEXT

- 1.1 The Bahamas achieved a relatively high per capita income of US\$23,000. However, beginning in 2008, economic growth faltered. Per capita incomes are still 8.2% below 2007 levels and growth rates remain subdued. The elevated figure also masks significant income inequality. The exogenous shock of sudden and prolonged economic downturn in its main trading partner, the United States, exposed structural weaknesses that inhibit the country's economic growth and compromise its resilience to such shocks. Labor productivity is decreasing,<sup>8</sup> unemployment is high,<sup>9</sup> poverty is increasing;<sup>10</sup> and crime and violence have escalated.<sup>11</sup> Reversing these trends is also made difficult by some of the inherent characteristics of this archipelagic nation. The internal market is small,<sup>12</sup> and the production base is narrow – tourism and financial services account for 70% of output and 90% of tourists are from a single country (the U.S., which also accounts for 90% of imports and 70% of exports). Moreover, The Bahamas is particularly vulnerable to natural disasters and to the impact of climate change.<sup>13</sup> The small population is distributed throughout 28 inhabited islands stretching over 233,000 square kilometers of ocean with substantial differences in their population density and economic activity.<sup>14</sup> This reality places fixed demands on the budget to provide the same level of public services to all citizens. The Bahamas also faces challenges from informal immigration.<sup>15</sup>
- 1.2 Growth in new product areas and access to new markets will require leadership by the private sector and facilitation by the public sector. Domestic players will need to be complemented by external investors. The Bahamas has shown it can attract substantial Foreign Direct Investment to its traditional sectors, and there is political will to implement the required reforms to increase competitiveness,<sup>16</sup> encourage new activities and engage with new trading partners. As shown in the Growth Diagnostic, there are structural obstacles to growth. The fiscal situation needs consolidation;<sup>17</sup> the tax system is opaque and introduces several distortions to economic activity;<sup>18</sup> energy supply is unreliable and expensive;<sup>19</sup> there is a skills mismatch in the labor market;<sup>20</sup> crime is

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<sup>8</sup> Labor productivity, measured as output per worker relative to US values, decreased from 0.7 to 0.64 between 2000 and 2007. Total factor productivity, on the other hand, decreased from 0.75 to 0.65 when compared with the evolution of US productivity.

<sup>9</sup> Overall unemployment reached 14.7% in 2012; among youth, however, the unemployment rate climbed from 15% in 2001 to 34% in 2011.

<sup>10</sup> The Labor Force Survey data indicated an 83 percent growth in the number of households living below USD\$5,000 between 2007 and 2011. The Gini coefficient for The Bahamas was estimated at 0.57 in 2005. No more recent data are available.

<sup>11</sup> According to the Royal Bahamas Police Force, national crime statistics document a consistent increase in violent crimes since 2005, with a brief turn-around in 2009 and 2010, and escalating to a new record in 2011 of 432/100,000.

<sup>12</sup> The population of The Bahamas is just over 350,000.

<sup>13</sup> The Bahamas lies in the direct path of Atlantic hurricanes and tropical storms and on average is affected by a hurricane once every three years.

<sup>14</sup> Around 90% of all economic activity is generated in a single island: New Providence which is also the location of the capital city, Nassau.

<sup>15</sup> The Government estimates that undocumented immigrants represent over 10% of the population.

<sup>16</sup> The term competitiveness herein refers to the measure of a country's advantage or disadvantage in selling its products or services in international markets.

<sup>17</sup> Falling tax revenues as a percent of GDP over the past 3 years and the rigidity of public expenditure led to a deterioration of the fiscal position. Additionally, there is concern over the fast rising debt levels, which reached 50% of GDP in 2011.

<sup>18</sup> The fiscal system relies heavily on trade and tourism taxes, as there are neither direct taxes nor value added taxes. In an attempt to avoid some of the negative effects of trade taxes on investment and economic activity, the Government introduced several special tax schemes. However public information about the requirements and beneficiaries of the tax exceptions, as well as on the cost of these measures is unknown and their impact can sometimes be uneven.

<sup>19</sup> The cost of energy is approximately US\$ 0.40 per kWh - one of the highest in Latin America and the Caribbean. The country also has a very low level of energy security (energy import bill amounts to 11% of GDP), exposing The Bahamas to fluctuations in international oil prices.

<sup>20</sup> According to the 2012 Enterprise Survey, most employers complain that it is increasingly difficult to find skilled labor because there is a mismatch in the level of education and required skills necessary to meet labor market needs.

compromising economic activity;<sup>21</sup> certain public infrastructure is deficient, and bureaucratic inefficiencies hinder economic diversification.<sup>22</sup>

- 1.3 In May 2012, the Progressive Liberal Party (PLP) won a landslide victory in the elections.<sup>23</sup> Among the new administration's stated objectives are to reduce crime and to build a stronger economy that generates jobs, deepens and broadens Bahamian ownership and produces a higher standard of living for all. The Government's medium-term development vision is detailed in the Charter for Governance: "Vision 2030 – Charting a Course of Change in The Bahamas." The Charter identifies the issues that are contributing to the decline in the country's economic performance and the well-being of the population (rapidly rising debt burden, high crime, high unemployment, poor skills in the labor market, excessive energy costs, concentration of productive activities in too few sectors, among others), and outlines actions to address them. The proposed new IDB Country Strategy, which was requested by the new Government prior to the expiration of the current CS, is entirely consistent with the vision for the country articulated in the Charter.

## II. IDB IN THE BAHAMAS

- 2.1 The current Country Strategy for 2010-2014 supports GoBH efforts to enhance productivity and growth by improving infrastructure and supporting SME development. The previous administration placed a heavy emphasis on using the Bank's expertise and financing to support key infrastructure investments<sup>24</sup> in order to stimulate economic activity, while it anticipated use of its own resources to address social sector and other burgeoning structural issues such as fiscal sustainability. As such, the selected CS priority areas were: energy, water and sanitation, transport and SME development.
- 2.2 After the national elections in May 2012, the new administration and the Bank promptly engaged in discussions on the strategic partnership. The Bank's Growth Diagnostic also assisted in orienting these discussions. This dialogue resulted in a Government request for a new Country Strategy with The Bahamas, prior to the expiration of the current CS, to realign the role of the Bank as a development partner in the country.<sup>25</sup> <sup>26</sup> Upon review, the Bank agreed to initiate preparation of a new CS based on: (i) the merits of alignment of the new CS with the new Government's strategic objectives and period in office;<sup>27</sup> and (ii) consistency with the Bank's Country Strategy guidelines.

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<sup>21</sup> Approximately 1.6% of the annual sales of the firms are devoted to security services, a proportion much higher than the benchmark countries as well as other countries in LAC.

<sup>22</sup> Road infrastructure is still deficient in some areas despite significant improvements. Efficient and reliable inter-island transport is a necessity for economic development in an archipelagic country. The air transport sector is in the process of a significant reform; however, challenges related to the sustainability of inter-island services remain. The supply of water is heavily subsidized and experiences high technical and commercial losses.

<sup>23</sup> The current majority for the Progressive Liberal Party in Parliament is 30 seats, the opposition Free National Movement has 8 seats.

<sup>24</sup> In particular, the selected sectors and lines of intervention targeted areas in which the country was unable to obtain commercial financing, such as supporting the Water and Sanitation Company (WSC) as well as the Bahamas Electricity Company to achieve financial and operational sustainability.

<sup>25</sup> Although the IDB is the main multilateral creditor, accounting for around 98% of the total multilateral debt, its contribution to the national budget, as stated above, has been primarily concentrated in infrastructure. Therefore, the realigned role of the Bank seeks to adjust the focus of engagement to specific sectors which will position the economy for sustainable private sector-led growth, and in which the Bank displays a comparative advantage.

<sup>26</sup> It is also notable that three of the four priority areas under the current approved 2010-2014 Country Strategy with The Bahamas have matured from approval of operations to implementation – as the initially envisaged financial envelope of US\$195 million had already been used in full. These priority areas are Transport, Water and SME Development. Furthermore, it is expected that as a result of Bank-financed interventions the GoBH will be financially and institutionally capable of carrying on work in these sectors.

<sup>27</sup> The political cycle in The Bahamas is generally five years. The next national elections are constitutionally due in May 2017.

2.3 As of June 2013, the IDB's sovereign-guaranteed portfolio had an average age of 1.2 years and had grown from 2 loans totaling US\$113 million in 2010 to 8 loans totaling US\$333 million. Private sector support has been through four MIF operations, totaling US\$0.85 million and IIC technical assistance to SMEs through the FINPYME Diagnostics. The TC portfolio is robust, with total approvals of US\$4.7 million. Most of the loan portfolio is in infrastructure (89%) that is critical to the tourism industry. Trade accounts for 5% of the portfolio, while education and social protection amount to 4% and 2% respectively. Performance indicators have improved over the past three years, mainly due to better execution in the road transport subsector and the new projects in the water and air transport sectors approved in 2011 and 2012. Actual disbursements have nearly doubled since the commencement of the Strategy period in 2010 and with an execution rate of just above 50%.<sup>28</sup> With the increase in lending, net cash flows have remained positive throughout the CS period with sharp improvements in 2011 and 2012 (127% and 132% respectively) over the 2010 period, and with a similar outlook for 2013.

### III. BANK STRATEGIC ORIENTATION FOR 2013-2017

- 3.1 Given the negative impact of the international economic crisis on economic growth, productivity and social cohesion in The Bahamas, the strategic intent of this CS is to support GoBH efforts to ensure macroeconomic sustainability, social stability and employment; and to increase resilience to the negative impacts of natural disasters and climate change. The Bank intends to: (i) support the implementation of fiscal and debt sustainability reforms in public sector finances and management; (ii) foster social cohesion, with an emphasis on preventing crime and violence and strengthening the criminal justice system; (iii) modernize the electricity subsector and diversify the energy matrix; (iv) facilitate diversification of both the economy and its trading partners by enhancing areas of comparative advantage and removing constraints to private sector activity; and (v) build resilience to natural disasters through improved coastal zone management, incorporating disaster risk reduction and climate change adaptation measures in development planning, control and monitoring. The Bank support will focus on the following priority areas: (1) Public Finances and Management; (2) Citizen Security and Justice; (3) Energy; (4) Private Sector Development; and (5) Coastal Risk Management and Climate Change Adaptation.<sup>29</sup> Interventions in these areas will contribute to stemming the erosion of per capita incomes by protecting public investment space and promoting growth. Efforts will be made to generate non-sovereign guaranteed (NSG) lending that is closely aligned to the development and diversification of the private sector, as well as direct financing in alternative energy and energy efficiency. This will take place in addition to seeking opportunistic interventions in sectors where IDB participation provides financial and non-financial additionality.<sup>30</sup>
- 3.2 The Government's debt management strategy limits the size of the Bank's financial support during the strategy period. The Government envisages mobilizing funds from the domestic market to satisfy at least fifty percent of the estimated \$1.2 billion financing needs during the CS period, as well as accessing the international financial market and reengaging with other multilateral development partners. The CS priority areas were selected based on their potential transformative impact on the country and on these being areas in which the Bank possesses comparative advantages including specialized expertise. Selection of priority areas took into consideration the extensive analytical work

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<sup>28</sup> Actual disbursements increased from US\$32.8 million in 2010 to US\$61.9 million at the close of 2012. Of the approved amount, approximately 54% has been disbursed – also mainly due to better execution in the road transport subsector.

<sup>29</sup> Energy, as well as Business Climate and the Financial Sector within the Private Sector Development priority area will be supported primarily through technical assistance.

<sup>30</sup> Particularly with SMEs and microfinance institutions and in the tourism and services sectors. In addition, the private sector windows will seek to support the private sector with technical assistance projects, including work on expanding market access for local producers (e.g. agriculture and crafts).

carried out by the Bank, the considerable Bank-financed investments already made in infrastructure, and the results of the last Country Program Evaluation (CPE).<sup>31</sup> The proposed areas have also been validated with the Civil Society Consultative Group (ConSoC) and are fully aligned with the priorities of GoBH as outlined in the Charter for Governance: “Vision 2030 – Charting a Course of Change in The Bahamas.” They also reflect Bank priorities outlined in the Ninth General Capital Increase (GCI-9) (AB-2764).<sup>32</sup>

## **A. Public Finances and Management**

- 3.3 The fiscal situation in The Bahamas has deteriorated relatively quickly due to a sustained level of expenditure in the face of reduced revenue streams. The revenue base is very narrow as it relies heavily on trade and tourism taxes, and there are neither income nor value added taxes. In addition, to reduce the negative effects of trade taxes on investment, the Government has introduced several ad hoc tax schemes based on waivers and incentives. As a result, the tax system lacks transparency and distorts the economy. The tax regime requires reform to rationalize the incentive programs and prepare for full membership in the World Trade Organization (WTO), which will require lower trade barriers. The relatively low tax burden is also attributable to the extremely weak institutional capacity of the customs and tax administrations. Tax administration capacity is weak, particularly for inland revenues. Part of this weakness is due to the current tax structure. The Customs Department collects taxes on international trade and excises, while the administration of the inland or domestic revenues is dispersed across some 30 other ministries, departments and agencies. There is also room for improvement in the real estate tax.<sup>33</sup>
- 3.4 On the expenditure side, the main challenges are: (i) the lack of a consolidated and publicly consulted long term economic development strategy which tends to cause decision-making to be ad hoc and subject to political influences rather than efficiency criteria, leading to inefficiencies and inconsistencies; (ii) the absence of an appropriate institutional arrangement and a clear methodology to assess and prioritize public investment projects, reduces the effectiveness and transparency of public expenditure; (iii) the operation of the State Owned Enterprises (especially electricity) represents a drain on public finances, not only due to cash transfers from the central government but also due to the contingent liabilities generated by these enterprises,<sup>34</sup> and (iv) the commitment to provide comparable level of services to all citizens regardless of where in the archipelago they may reside. The GoBH and the Bank are working together through different operations to address the challenges identified above.<sup>35</sup>
- 3.5 On the revenue side, the GoBH stressed its commitment to improve the fiscal performance of the country in the medium term and it has embarked on several reforms to improve public finances. The Cabinet already approved the “White Paper on Tax Reform” that encompasses a road map for the introduction of a value-added tax by mid-2014. Also, the GoBH is moving forward with a plan to

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<sup>31</sup> The last Country Program Evaluation covered the period 2001-2008. Please see Annex III.

<sup>32</sup> In general terms, approvals during the CS period will contribute to the goal of “supporting development in small and vulnerable countries”. Additionally, Social Protection, Citizen Security and Private Sector Development may contribute to poverty reduction and equity enhancement.

<sup>33</sup> Estimates show potential increase in property tax collection of up to 100% over a five year period thanks to updates in fiscal valuation and enhanced efforts in tax collection.

<sup>34</sup> Contingent liabilities reached 14% of GDP by mid-2012.

<sup>35</sup> The WSC Support Program (2624/OC-BH) has the objective to improve the performance of the Water and Sewerage Corporation in The Bahamas. PRODEV’s Management for Results Technical Assistance (ATN/OC-12185-BH) is supporting Government in its efforts to improve procurement, financial management, information data systems and monitoring and evaluation. As part of the “Conditions for a Sustainable Fiscal Policy in The Bahamas” (ATN/JF-13061-BH), the Bank is supporting the strengthening of the Tax Administration Department, the assessment of public expenditure in the Family Islands, improvement in data collection, assessment of the fiscal risks of the country and the development of a medium term debt strategy.

obtain full membership in the WTO. This implies reductions in trade tariffs. Government is also considering reforms to rationalize incentives to private investment and social activities, remove distortions, strengthen tax administration, improve equity and identify additional sources of revenue to preserve fiscal sustainability.

- 3.6 Based on ongoing analytical work and the Government's strong commitment to fiscal sustainability, the Bank's interventions for the CS period will focus investment lending and technical assistance on: (i) ensuring fiscal sustainability - on the revenue side, the IDB will support implementation of the reform of the tax regime to improve revenue generation, increase equity and compliance; on the expenditure side, the IDB will support improvements in the effectiveness and efficiency of public expenditure as well as governance through reforms in public sector management;<sup>36</sup> and (ii) strengthening the country's planning and delivery capacity - including creating institutional capacity to prioritize public investments, monitor performance; and control expenditure. The outcome will be enhanced macroeconomic stability and strategic direction of scarce public resources.
- 3.7 The risks in the overall priority area are that: (i) the reforms envisaged will take time to have a significant impact on fiscal sustainability, while key stakeholders are eager to see improvements in the fiscal accounts;<sup>37</sup> (ii) the institutional reforms require the buy-in of key stakeholders; and (iii) delays in the implementation of the reform agenda could limit the usefulness of the investment operations. The introduction of the multi-year development plan, together with the strengthening of the planning and delivery capacities of the Government and the implementation of the tax reform measures should provide enough evidence of a credible and sustainable fiscal scenario. Moreover, the timing of approval of the Bank-financed operations will be contingent on the advancement of the reform process.

## **B. Citizen Security and Justice**

- 3.8 Despite strong levels of political participation and a stable democracy, The Bahamas has not escaped the regional trend of increasing crime<sup>38</sup> and violence that is threatening the prospects for further development in the Caribbean. Indeed, recent data documents a 49% increase (from 8,157 to 12,147) in crimes committed against persons<sup>39</sup> and property<sup>40</sup> during the period 2005 to 2011. These elevated levels are raising concern at the local and international levels,<sup>41</sup> and have direct effects on human welfare in the short run, and longer run effects on social cohesion and economic growth – particularly with respect to tourism. Bahamian firms also register high costs of doing business as they are forced to divert resources from productive uses to cover security costs as well as direct losses due to crime.<sup>42</sup> Notable contributing factors to the crime and violence situation in The

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<sup>36</sup> This includes strengthening the statistical capacity of the Department of Statistics (DOS) under the framework of the National Statistical System.

<sup>37</sup> See December 2012 Moody's report on The Bahamas.

<sup>38</sup> Crime in The Bahamas is classified into two categories: 1) crimes against persons, which include murder, attempted murder, manslaughter, rape, attempted rape, unlawful sexual intercourse, armed robbery, robbery and attempted robbery; and 2) crimes against property, which include burglary, house break-in, shop break-in, stealing, stealing from a vehicle, stolen vehicles.

<sup>39</sup> According to the Royal Bahamas Police Force & Planning Unit, statistics document a steady increase in crime against persons since 2005, with brief abatement in 2009 and 2010, to record levels in 2011 of 532/100,000 inhabitants. The number of reported homicides and rapes experienced a 35% and 37% increase between 2010 and 2011, with nearly all victims being Bahamian.

<sup>40</sup> Police statistical data on burglary, house break-ins, and shop break-ins show increases from 2010 to 2011: housebreak-ins went up by 3% for a total of 3,237; stealing from vehicles increased by 47%; and stolen vehicles increased by 7%.

<sup>41</sup> The Bahamas' 2010 murder rate of 28/100,000 was one of the highest in the region; compared to Barbados (11.30), Guyana (18.50), Jamaica (52.10), and Trinidad and Tobago (35.20). According to the World Health Organization, rates above 10 per 100,000 constitute an epidemic and rates above 30 per 100,000 inhabitants constitute an armed conflict.

<sup>42</sup> According to The World Bank Enterprise Surveys, businesses operating in Bahamas are significantly constrained by the level of crime and violence. Indeed, 19.5% of surveyed firms identified crime, theft and disorder as major constraints to doing business (compared to 1.2% in Barbados, 34.2% in Suriname, 34.2% in Trinidad and Tobago, 46.1% in Jamaica and 35% in Guyana).

Bahamas are: (i) the geographic location of the Bahamian archipelago as a transit point for the drug trade between South America and the United States; (ii) the relatively small criminal justice system which is often overwhelmed in terms of police, courts and prisons,<sup>43</sup> and unable to prosecute criminals within a reasonable time;<sup>44</sup> and (iii) a lack of information combined with insufficient coordination to tackle citizen security issues – including prevalence of youth in these events<sup>45</sup> – in a comprehensive manner.

- 3.9 In response to this priority, GoBH has advanced a number of initiatives including: (i) targeted social interventions as well as urban planning and development;<sup>46</sup> (ii) revitalization of the Heads of National Law Enforcement Agencies (HONLEA),<sup>47</sup> which aims to ensure sustained collaboration and information exchange between the law enforcement agencies and to strengthen intelligence capacity to counter local and international crime; and (iii) initiatives to enhance the functioning of the criminal justice system such as restructuring the police force, reintroducing the Swift Justice Initiative (SJI),<sup>48</sup> introducing a restorative justice system, and improving correctional services. Notwithstanding these efforts, there is still an urgent need for a crosscutting, inter-sectoral crime and violence strategy emphasizing prevention, and combining the strengthening of key sector institutions and targeting different risk factors affecting community life in a coordinated way, using evidence-based interventions.
- 3.10 Given the Bank’s leadership and experience within the sector throughout the Caribbean region, Bank-financed interventions will aim to stem the rise of crime and violence and increase safety and security for Bahamian citizens and visitors to the country. Specific lines of intervention will include investment lending and technical assistance to: (i) support the implementation of interventions that address the most modifiable risk factors, and promote community mobilization and local social development interventions in high crime, disadvantaged, low-income urban neighborhoods;<sup>49</sup> and (ii) strengthen public sector institutional capacity to respond to crime, including support to data generation functions, the formulation of a national crime prevention strategy,<sup>50</sup> support to reform

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<sup>43</sup> The Bahamas has some of the highest prisoner to population ratios in the world which challenges the effectiveness of the rehabilitation process.

<sup>44</sup> In 2009, 68% of the total prisoner population in The Bahamas was awaiting trial. Furthermore, in 2010, the number of prisoners in The Bahamas, 382/100,000 habitants, was the highest in the region (Barbados, Guyana, Jamaica and Trinidad and Tobago registered rates of 369, 286, 193 and 274 per 100,000 respectively during that year).

<sup>45</sup> According to recent statistics from the Royal Bahamas Police Force & Planning Unit, 33% of homicide victims in 2012 were persons between 18 and 25 years of age.

<sup>46</sup> One of these initiatives includes the Urban Renewal Program, which works in coordination with civil society and communities in addressing social ills that are affecting the society at large, in particular inner city communities. This government program seeks to enfranchise community members and engage them in development planning as a way towards a significant reduction in crime. The URP also seeks to engage young people who face challenges in their live, providing alternatives to idleness and risky behavior.

<sup>47</sup> HONLEA is formed by the Commissioner of the Royal Police Force; the Commodore of the Royal Defense Force; the Comptroller of the Customs Department; the Director of the Immigration Department; and the Superintendent of Her Majesty’s Prison.

<sup>48</sup> The “Swift Justice” Initiative (SJI) aims to ensure trials for major crime categories are conducted within 18 months of detention and to reduce the number of persons released on bail for serious crimes. The SJI is implemented under the Office of the Attorney General.

<sup>49</sup> Specific actions could include: (i) attention to youth at risk through mentoring, vocational skills and social skills training (self-regulation, anger management, and decision-making) and remedial education; (ii) job-training for youth at risk; (iii) provision of life skills training for youth at risk which provide them necessary skills to take advantage of education and employment opportunities and increase their participation in their communities; (iv) prevention of child maltreatment through the improvement of parenting skills; (iii) prevention of violence in schools involving neighboring community agencies, civil society groups, community leaders, parents and residents as well as government actors; (iv) training in community organizing and resident engagement advocacy to promote community governance; and (v) situational crime prevention (such as the creation of safe community spaces, community gardens, exterior lighting, among others). The MIF may also explore projects concentrating on labor force training for youth.

<sup>50</sup> Bank assistance may be provided to relevant institutions to further strengthen the government’s capacity in generating useful information as well as policy formulation, analysis and evaluation. It could include training in qualitative research to support information derived from quantitative surveys so as to deepen analyses and better explain changes in quantitative measures.

efforts of the police force,<sup>51</sup> a swifter and more efficient judicial system,<sup>52</sup> an effective restorative justice system,<sup>53</sup> and correctional services that facilitate rehabilitation.<sup>54</sup>

- 3.11 A major challenge is the difficulty of coordinating multiple public entities involved in these interventions. The lessons learned from the Bank's experience throughout the Caribbean region, as well as high-level interest in addressing crime and violence in the country will aid in mitigating this risk. The provision of technical assistance for data generation and development of a coordinated crime and violence strategy will also play a key role in mitigating both design and execution risks.

### C. Energy

- 3.12 Inefficiencies in the energy sector represent a major challenge to economic development in The Bahamas particularly with regard to public expenditure, mounting contingent liabilities and impaired competitiveness. There is low energy security as the country mostly relies on imported petroleum for electricity generation.<sup>55</sup> Electricity is expensive<sup>56</sup> yet unreliable,<sup>57</sup> which means that the country is vulnerable to spikes in international oil prices. The Bahamas Electricity Corporation (BEC) – the main provider of electricity and a state owned company<sup>58</sup> – is constrained financially due to the high cost of inputs, technical and non-technical losses, and the challenge to provide services to several islands without the possibility of charging a tariff<sup>59</sup> according to the corresponding production costs. Bank-financed studies reveal that low cost energy efficiency (EE) and conservation measures that could save the equivalent of 27% of present demand from the tourism and residential sectors are yet to be implemented.<sup>60</sup> Finally, renewable energy (RE) technologies such as solar water heaters (SWH) and photovoltaic (PV) systems also remain untapped, but present attractive opportunities for diversification of the energy matrix given their favorable generation costs.<sup>61</sup> However, implementation of EE and RE will not only depend on the removal of legal barriers, but also on the promotion of programs to enhance awareness, to create incentives for private sector participation and to overcome the financial and technical constraints faced by the EE and RE markets.<sup>62</sup>

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<sup>51</sup> Among other actions this could include training (criminal investigation, data analysis, patrolling and prosecution); assistance in addressing management-related areas such as human resources, communications and the media, complaints and discipline and performance management; development of effective support services, including information technology, communications; and improvement in community-police relation etc.

<sup>52</sup> These efforts would emphasize information management systems, performance indicators, problem diagnosis, increased accountability and better attention and service to citizens.

<sup>53</sup> Key features include promoting the conditions for an effective restorative justice system such as design of rules of procedure; appropriate standards of judicial performance; definition of offences that should be subject to restorative justice processes; implementation of a training program for judicial officers; marketing strategies to disseminate the benefits of this method.

<sup>54</sup> Activities such as design of treatment options for drug dependence, strengthening of prison management, improvement of prison conditions, and exploration of alternative sentencing options for non-violent inmates.

<sup>55</sup> Oil imports amounted to 11% of GDP in 2011 and electricity generation is 100% based on hydrocarbons.

<sup>56</sup> The average cost of energy is approximately US40 cents per kWh – one of the highest in Latin America and the Caribbean.

<sup>57</sup> Two indicators on the reliability of services are the number of power outages (2.2 per month for The Bahamas, which compares to 0.5 in Trinidad and Tobago and 0.6 in Panama) and the ownership of power generators (60% of the firms surveyed by the Enterprise Survey own a power generator, in comparison with 20% in Trinidad and Tobago and 13% in Panama).

<sup>58</sup> BEC covers the island of New Providence and the Family Islands providing electricity services to 96,000 customers (85% of all consumers in The Bahamas). On the Grand Bahama Island, electricity supply is under the authority of the Grand Bahama Port Authority (GBPA). The Hawksbill Creek Agreement was signed in 1955 and gave GBPA the responsibility for the provision, management and administration of all infrastructure including the sole right to construct and operate utilities.

<sup>59</sup> Ministry of Public Works and Urban Development assumes a number of roles and functions with respect to the electricity sector by acting as policy-maker and regulator at the same time, including tariff-setting.

<sup>60</sup> Strengthening the Energy Sector in the Bahamas (BH-T1012).

<sup>61</sup> Promoting Sustainable Energy in the Bahamas (BH-T1016).

<sup>62</sup> According to the IDB's study, despite the large number of financial institutions (banks & trusts) licensed to operate in The Bahamas only four financial institutions offer products that could potentially be used to finance EE or RE projects. Among the main reasons for the low supply of credit include: (a) the small size of individual investments; (b) the low prospects on returns in the EE and RE market; and (c) high perception of risks by local financial institutions.



- 3.13 The Bank, leveraging its extensive technical assistance,<sup>63</sup> will deepen its engagement in the sector by providing additional resources to create an adequate regulatory and legal environment to: (i) increase the use of energy efficiency and conservation measures in the public and private sectors; (ii) diversify The Bahamas' energy matrix by tapping renewable energy resources (particularly PV) including direct financing to private sector renewable energy and energy efficiency projects while offering technical assistance to companies and firms; and (iii) provide support to the structuring of adequate financing mechanisms (e.g. SPVs - Special Purpose Vehicle Funds<sup>64</sup>) that take into account local conditions, reducing perception of risks by local financial institutions and engaging them in financing EE and RE to the business and residential sectors. The NSG windows will also seek out opportunities to offer technical assistance and direct financing to firms for private sector renewable energy and energy efficiency projects. GoBH expressed its intention to utilize other sources of financing to improve the quality and reliability of the BEC via corporate governance, management, and upgrading of its facilities in generation, transmission and distribution.
- 3.14 The risks of the proposed strategy in this sector are: (i) GoBH inability to effect management, corporate governance and operations reforms of the BEC could diminish the impact of IDB financed interventions in the energy sector, particularly given that BEC will continue to be the main provider of electricity during the period; (ii) discouraging stakeholder interest in the diversification of the energy matrix if fossil fuel prices drop significantly; (iii) lack of GoBH support in promoting the necessary adjustments to the institutional and regulatory framework to support EE and RE; and (iv) an institutional and policy framework that provides insufficient incentives to promote public-private sector investments in RE and EE. These risks are mitigated by several Bank-financed technical assistance and grant funding operations implemented since 2010, which provide clear recommendations for action in the sector. These studies include an assessment and recommendations for BEC's financial and operational sustainability that will inform GoBH efforts, an assessment of EE and RE potential, alternatives for BEC's expansion plan, integration of EE and RE into the energy matrix, and improvements to the regulatory framework.

#### **D. Private Sector Development**

- 3.15 Private sector-led growth in The Bahamas emanates primarily from two traditional sources (tourism and financial services), with high concentration of trading activity taking place between New Providence and the United States. This productive structure of a narrow economic base, openness, high energy dependence and relatively high transport costs is not atypical of small-island developing states given that lack of scale rules out many alternative production opportunities.<sup>65</sup> However, the dynamism of the Bahamian private sector to adapt to new developments in the country and benefit from favorable economic opportunities, both within and outside of traditional growth sectors, is hampered by key constraints in the business climate, labor market productivity, and financial sector.
- 3.16 Business Climate. Certain elements of The Bahamas' business climate pose difficulties for businesses according to the World Bank's 2013 Doing Business Report, which lowered the country's overall ease of doing business ranking from 71<sup>st</sup> to 77<sup>th</sup> place out of 185 countries surveyed.<sup>66</sup> The most pressing concerns lie in the areas of property registration and administration, firm registration

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<sup>63</sup> (i) Strengthening the Energy Sector in the Bahamas (BH-T1012); (ii) Promoting Sustainable Energy in the Bahamas (BH-T1016); (iii) Implementing sustainable energy projects in The Bahamas (BH-X1001); and (iv) Promotion of Energy Efficient Residential Lighting (BH-X1002).

<sup>64</sup> EE/RE financing programs can be successfully implemented in The Bahamas through the establishment and use of second or first-tier funds.

<sup>65</sup> Study on the vulnerability and resilience of Caribbean Small Island Developing States (UN ECLAC, 2011). No data was specifically available for The Bahamas. However, diversification of trading partners was identified as a key component to the reduction of economic volatility among Caribbean Small Island States similar to The Bahamas.

<sup>66</sup> The Bahamas ranks 13<sup>th</sup> in the Latin America and Caribbean region in the World Bank Doing Business 2013 Report.

and licensing, and enforcing contracts.<sup>67</sup> Registering property is an opaque and costly process in which several public agencies, sometimes with duplicate responsibilities, must give clearance before activities can be completed. Notwithstanding land registration, security of land tenure is not always assured.<sup>68</sup> Business registration, and by extension, local entrepreneurship, may also be hampered by legislation<sup>69</sup> that requires certifications from at least 4 agencies in a process that requires 4-12 months. Licensing is further complicated by the fact that there are numerous provisions under different Acts whereby licenses are obtained from different offices, with different fees, depending on the type of business activity. Enforcing a contract requires 49 procedures, takes 427 days and court costs represent 28.9% of the value of the claim. These areas of the business climate have the impact of deterring private investment from taking place and limiting the scope for use of collateral for access to finance.

3.17 Labor Market and Productivity. Two main issues within The Bahamas' current labor market are persistent unemployment<sup>70</sup> and a skills supply mismatch with private sector demand. This labor market scenario reflects the interaction and evolution of economic, human capital, and institutional factors. First, despite small but positive GDP growth in 2010 and 2011,<sup>71</sup> double digit unemployment still persists (14.7% in 2012), reinforcing the fact that there are other factors associated with the employment situation.<sup>72</sup> According to the 2010 Enterprise Survey, employers of all business sizes cited skills shortages<sup>73</sup> as the main obstacle to running a business in The Bahamas. The 2012 IDB-financed Wage and Productivity survey also revealed that the persistence of these skills gaps can be attributed in large part to inefficiencies in the design, provision and evaluation of skills-training programs.<sup>74</sup> Among others, the constraints of these training programs include: (i) lack of a defined space for the private sector in the curriculum design of courses, in the quality control phase, and in the definition of the demanded skills and competences of the country;<sup>75</sup> (ii) the lengthy procedure for updating training curricula of existing programs creates disincentives to new developments in the curricula;<sup>76</sup> (iii) no autonomous national accrediting agency nor evaluation system of training programs; and (iv) lack of statistics on students/trainees, total enrollment, graduation status, etc.

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<sup>67</sup> The Bahamas received a ranking of 179<sup>th</sup> for registering property, 82<sup>nd</sup> for business registration, and 123<sup>rd</sup> for enforcing contracts.

<sup>68</sup> Land tenure security in the country is reduced by: (i) overlapping claims and rights to land as a result of property disputes and the lack of a parcel based cadastral map; (ii) uncertainty regarding ownership of land resulting from outdated real property rights system and information in the registry; and (iii) a complex conveyance system for property registration and transfers, especially unclear with regards to the decision making process for the registration of Crown Lands, which amount to approximately 70% of all land—regarding the latter, while standard administrative procedures are in place, allocation, administration and pricing are done on a largely ad-hoc basis.

<sup>69</sup> Business registration is largely governed by the Business License Act and the Companies Act.

<sup>70</sup> Unemployment spells in Bahamas are high: 52% of the unemployed have been jobless for more than 12 months.

<sup>71</sup> Recovery in GDP was registered at 1% growth in 2010 and 2% in 2011 according to IMF estimates.

<sup>72</sup> In fact, even in 2004 and 2005, during periods of high FDI, the unemployment rate in The Bahamas was 10.2%. This is due in part to poor learning outcomes and lacking skillsets of students leaving the education system. The Bank is currently financing a loan in execution in the education sector, INSPIRE Program (BH-L1003), which among other objectives, seeks to strengthen institutional capacity within the Ministry of Education, and to enhance the policy and regulatory framework for the sector.

<sup>73</sup> The main skills that employers seek among the labor force are: numeracy and literacy, soft skills (responsibility, team work, and communication), IT skills and specific skills.

<sup>74</sup> In The Bahamas, the major public training institutions are the College of The Bahamas (COB), the Bahamas Technical & Vocational Institute (BTVI) and the University of the West Indies (UWI). Private training providers include established local institutions such as Success Training College, The Bahamas Baptist Community College (BACC) and Atlantic College, as well as local branches of foreign colleges and universities (including Nova Southeastern University and Sojourner Douglas College).

<sup>75</sup> The International Labor Organization (ILO), under the Decent Work Program launched in 2008 for The Bahamas has sponsored the participation of the private sector in a tripartite dialogue denominated TRIFOR between the government, the workers unions and the employers (the social partners). However, the private sector has not yet been integrated in the design and quality control of training programs.

<sup>76</sup> All registered training providers first need prior approval from the Ministry of Education if they want to introduce a new programme/course or make (major) modifications to existing programmes.

- 3.18 Financial Sector. The financial sector is characterized by its dualistic nature, consisting of a small domestic sector<sup>77</sup> alongside a competitive off-shore sector that contributes to 15-20% of GDP. Within the domestic sector, there are government, quasi-government and private banks and financial institutions. Although banks have considerable short-term liquidity,<sup>78</sup> the domestic private sector – particularly Small and Medium-sized Enterprises (SMEs) that account for an estimated 90% of registered businesses in the country – encounter significant difficulty in gaining both access to credit and business development services.<sup>79</sup> The Central Bank has created the Bahamas Credit Bureau Project to help address credit information asymmetries and reduce risk to lenders.<sup>80</sup> However, provision of financial and non-financial services, and overall support to SMEs, appear insufficient and ineffective.<sup>81</sup> The public institutions have not been sustainable, with needed yearly government subventions, accumulated deficits and inability to lend because of under capitalization.<sup>82</sup> This is due mainly to a lack of overarching policy and coordination between the many institutions,<sup>83</sup> and to the target market not being clearly identified.
- 3.19 The Bank proposes to support interventions that directly increase or facilitate diversification of both the economy and its trading partners. IDB interventions in this area will include technical assistance to: (i) establish a policy framework to promote Public Private Partnerships,<sup>84</sup> particularly with regard to development of skills in the labor market; (ii) rationalize Government regulations that hinder property registration and administration, business registration, licensing and operation, and dispute resolution; and (iii) reform the financial sector to increase access to financing for domestic firms (particularly MSME's) and individuals. Lending in this area will aim to improve alignment between the labor supply and the needs of employers and prepare individuals for self-employment. Training initiatives will be reoriented to reflect the needs of the private sector. The Bank's private sector windows will seek to finance private sector projects in which the IDB provides high levels of financial and non-financial additionality, particularly with SMEs and microfinance institutions and in the tourism and services sectors. In addition, they will seek to support the private sector with technical assistance projects, including work on expanding market access for local producers (e.g. agriculture and crafts).
- 3.20 Potential risks that can delay implementation and achievement of sector goals are: (i) discouraging stakeholder interest to pursue broader-based growth initiatives as the tourism industry rebounds; (ii) inadequate framework for productive participation and partnership among the private sector, public sector and training institutions to design effective skills development strategies and identify joint economic priorities; and (iii) persistence of information gaps that prevent evidence-based policy-making. These risks will be mitigated by: (a) high-level Government commitment to unlock private

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<sup>77</sup> The domestic sector consists mainly of banks and trust companies, which account for the largest share of the financial services industry in terms of employment, total outlays and scale of operations.

<sup>78</sup> However, it should be noted that the effects of the economic slowdown have continued to take a toll on the quality of bank portfolio's and their profitability, reflected in declines in interest revenue and heightened loan loss provisions.

<sup>79</sup> A 2006 Bank-financed study (Road Map for Improving Business Climate for SME's) revealed that less than 50 percent of the SMEs surveyed had access to commercial bank loans and very few made use of training and business development services.

<sup>80</sup> In support of enhancing access to credit for SME's the MIF project "Supporting Micro Financial Services Through Technology" (ATN/ME-13709-BH) is the first project in The Bahamas to focus on the development of a non-collateral based risk methodology related to extending financial services to the underserved population in the Bahamas.

<sup>81</sup> Public interventions aimed at supporting domestic business include the Bahamas Development Bank (BDB), the Bahamas Agricultural and Industrial Corporation (BAIC) and the Entrepreneurial Venture Fund (EVF).

<sup>82</sup> As a reflection of this, for example, as of 2007 the Government had provided US\$26.6 million in subsidies to the BDB and guaranteed US\$50 million in loans. As of 2005 the Government has provided US\$14.5 million in subsidies to the BAIC.

<sup>83</sup> The Government is currently promoting legislation that would establish an SME Development Agency, the basis for effectively providing financial and non-financial services to SMEs, however more direction and action in this area would support the dynamism of the sector.

<sup>84</sup> NSG windows will monitor developments and actively pursue opportunities to finance PPP projects once the framework is in place.

sector growth that will ease the public sector fiscal burden mentioned above; (b) ensuring that both the government and the legislators agree to including the private sector in the design of training programs under the new skills development framework; and (c) provision of technical assistance to the Department of Statistics (DOS) in order to produce frequent and reliable data.<sup>85</sup>

## **E. Coastal Risk Management and Climate Change Adaptation**

- 3.21 The Bahamas lies in the direct path of Atlantic hurricanes and tropical storms and is on average affected by a hurricane or tropical storm once every three years. During the last thirty years, the top ten hurricanes and tropical storms resulted in more than US\$2.65 billion in economic damage.<sup>86</sup> Three of its islands (Andros, Abaco and Grand Bahama) are ranked within the top 10 of all cities, islands and countries affected by tropical storms in the North Atlantic Basin.<sup>87</sup> Furthermore, climate change (CC) exacerbates disaster risk by increasing the frequency and intensity of recurrent and catastrophic events. With 80% of The Bahamas' land mass within 1.5 meters of mean sea level, its low lying topography, and the small size of the islands, the territory is essentially coastal. Sea level rise scenarios of 1 meter and 5 meters will effectively inundate 11% and 60% of the total land mass of the country respectively.<sup>88</sup> However, a 2010 Bank-financed study<sup>89</sup> of The Bahamas showed inter alia that: (i) deficiencies exist in integrated coastal zone management (ICZM): the country lacks an appropriate legal, regulatory and institutional framework for ICZM that adequately incorporates disaster risk management (DRM) and climate change considerations into planning and development at national and sub-national levels;<sup>90</sup> (ii) the country's constrained financial capacity to recover from a catastrophic climatic event despite access to post-disaster recovery and reconstruction financial resources;<sup>91</sup> (iii) limited information on coastal vulnerability, which is also not linked to a national risk information system that could be used for evaluation, updating, monitoring of coastal processes and associated risks; and (iv) insufficient consideration is given to natural hazard and climate risk in land use and urban planning.
- 3.22 To build resilience to coastal hazards including those associated with the slow onset of climate change impacts, Bank support will be channeled through a combination of investment lending and technical assistance to: (i) strengthen the policy, legal, regulatory framework and institutional capacity for ICZM to address current and future vulnerabilities including an ICZM plan and financial strategy for managing coastal risk; (ii) increase the scope of and access to coastal risk information and risk assessment methodologies, and tools for use in development planning and decision making; and (iii) promote the design and construction of climate and other hazard resilient coastal infrastructure with a view to reducing vulnerability and controlling erosion, flooding and other hazard impacts.
- 3.23 The low level of public awareness and mobilization in creating resilience to DRM and CC is a risk to the success of the proposed program that will be addressed through technical assistance to expand

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<sup>85</sup> Lack of human and financial resources and limited succession planning are challenges faced by the Department of Statistics. Additionally, the Statistics Act does not allow data to be published on a micro level, even for research purposes (without a Memorandum of Understanding). However, this Act is under review by Government.

<sup>86</sup> EM-DAT: The OFDA/CRED International Disaster Database [www.em-dat.net](http://www.em-dat.net) - Université Catholique de Louvain - Brussels - Belgium.

<sup>87</sup> Hurricane City: [www.hurricanecity.com/rank](http://www.hurricanecity.com/rank)

<sup>88</sup> Dasgupta et al, 2007. The Impact of Sea Level Rise on Developing Countries: A Comparative Analysis. World Bank Policy Research Working Paper 4136, February 2007.

<sup>89</sup> Indicators of Disaster Risk and Risk Management for the Bahamas, 2010.

<sup>90</sup> Various pieces of legislation assign responsibility for the management of coastal resources to a number of agencies, including NEMA, Ministry of Works and the BEST. As a result, various sectors and national and local agencies (Family Islands) have responsibility for the management of coastal areas, primarily through land planning ordinances. A dedicated unit for ICZM does not exist.

<sup>91</sup> Such as The Bahamas' Disaster Relief and Recovery Fund and the Caribbean Catastrophe Risk Insurance Facility.

public awareness campaigns and engage local governments and communities in coordinated mitigation events. There is also limited human and institutional capacity to mainstream and implement climate change programs into the development process, which will also be addressed through technical assistance to strengthen public sector institutional capacity.

#### **F. Other Areas for Future Dialogue 2013-2017**

- 3.24 In addition to the priority areas identified above, the Bank will support diagnostic and analytical activities in the following dialogue areas: (a) Education: The provision of quality education services: (i) via strengthening capacity at the secondary education level to improve transition from school to work, including potential areas for PPPs, and (ii) for special needs children and youth throughout all levels of the educational system also with an emphasis on the transition from school to work; (b) Food Security: The country depends almost entirely on imports for food. An analysis will be undertaken of the options for increasing the production and consumption of local food; (c) Transport: An analysis of (i) the potential impacts and opportunities that the completion of the Panama Canal will have for The Bahamas, and (ii) how inter-island mobility could be made more efficient across the 28 inhabited islands; (iii) enhancing trade links with the rest of the Caribbean and Latin America; and (d) Informal Immigration: There are significant pockets of poverty that are often associated with the phenomenon of informal immigration. The profiles and needs of such areas will be assessed.

### **IV. BANK FINANCING UNDER THE STRATEGY**

- 4.1 The proposed financial envelope is fully consistent with The Bahamas Medium-Term Fiscal Consolidation Framework, which prioritizes use of domestic and external commercial financing to cover most of the financing needs of about US\$1.2 billion during the CS period. In particular, the GoBH has determined that it will mobilize financing from the domestic market to satisfy at least 50% of the financing gap. The proposed envelope of US\$ 150 million, which responds to an expressed GOBH request, will place a heavy emphasis on investments, but may also opt for policy-based support as deemed appropriate. The CS will focus solely in areas: (i) where Bank support would have a transformative impact; and (ii) in which the Bank possesses comparative advantages including specialized expertise. Average annual approvals are expected to be US\$30 million, compared to the annual average of US\$ 73 million for 2010-2012. Yearly disbursements are expected to average US\$ 34 million, compared to an average of US\$ 53 million under the current CS. Net flows are expected to be positive provided that new loans enter the portfolio in 2014.<sup>92</sup> The current outstanding debt to the IDB accounts for 5% of total debt and 25% of external debt. The IDB's exposure is expected to maintain its level as a percentage of total debt but to decrease as a percentage of external debt. Additionally, consistent with historical levels, total grant funding for technical assistance and investment grants over the CS period is estimated at US\$6 million.

### **V. STRATEGY IMPLEMENTATION**

#### **A. Efforts to Strengthen Execution**

- 5.1 Historically, The Bahamas' portfolio has encountered significant difficulties throughout the project management cycle as highlighted in the past OVE evaluation 2001-2008, which jeopardized the achievement of strategic objectives. Since 2011, in order to enhance the efficiency of project preparation, execution, and supervision, several initiatives have been put in place to address these challenges: (i) IDB engagement in strategic planning meetings with the MOF at least once per

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<sup>92</sup> The available loan balance under the existing portfolio amounted to \$154.9 million in June 2013.

quarter; (ii) strategic and programming discussions with Government at the highest levels (Prime Minister, Cabinet, Line Ministries); (iii) carefully designed and executed analytical work which includes dialogue with the sectors' stakeholders and eventual implementers; (iv) provision of on-site assistance by the IDB country office (COF) operations staff to new and/or inexperienced project execution units to orient them in executing, monitoring and controlling projects to international standards using best practices; and (v) deepened economic sector work to the extent that the medium-term strategic dialogue with GoBH and selection of priority areas have been guided by the Growth Diagnostic developed by the IDB economics team. Throughout the CS period, the Bank will build on existing efforts to promote better execution of IDB financed programs in The Bahamas. Emphasis on equipping executing agencies with tools to carry out more effective project management will continue. Accordingly, an annual training plan for executing agencies borne out of an assessment conducted in collaboration with the Ministry of Finance will be implemented as new projects are approved.

## **B. Country Systems**

- 5.2 In line with efforts to improve execution during this CS period, and consistent with the Bank's strategy for expanded use of country systems, the IDB is currently relying on the following financial management subsystems in Bahamas: Budget, Treasury and External Control. The Bank and the GOBH are currently in the design of a program to manage public sector finances. The Bank is supporting the GOBH in strengthening the External Control subsystem, and will work closely with the GOBH on a mutually agreed plan to strengthen the Office of the Auditor General (OAG). The mutual goal is to have the OAG become eligible to perform the audit of upcoming Bank financed operations. Support could be provided to the AOG in updating the Audit Manual, improving the standardized procedures of the internal audit, developing a training plan based on the Strategic needs as well as improvement in knowledge sharing and functions between the Public Accounts Committee and the OAG.
- 5.3 The Bank is currently supporting the GOBH through MIF's grant facility ICT4GP in assisting an effort to increase transparency of Government-to-Business activities by supporting the creation of a centralized Suppliers' Registry particularly oriented to increase participation of MSMEs. In addition, the Bank approved a technical assistance grant under the PRODEV geared at introducing Management for Results into the administration of public resources. One of its components will finance the establishment of the role and functions of the Public Procurement Department included in the Procurement Legislation Roadmap.

Use of Country systems <sup>93</sup>	Baseline 2013	Estimated Use 2017	Foreseen actions
<b>Financial Management</b>			
Budget	100	100	None
Treasury	100	100	None
Accounting and Reporting <sup>94</sup>	13	13	None
Internal Audit	13	13	None
External Control	25	50	Support the AG in strengthening audit office, particularly in standardized procedures, manuals, training and the improving its coordination with the Public Accounts Committee.
<b>Procurement</b>			
National Informative System	0%	0%	N/A
Shopping	0%	0%	N/A
Contracting of Individual Consultants	0%	0%	N/A
NCB partial	0%	0%	N/A
NCB advanced	0%	0%	N/A

5.4 **Monitoring and Evaluation:** At present, The Bahamas does not have a formal system of monitoring and evaluation of public sector investment programs. Usually, budget allocation to capital projects is based on prior year spending and the priority accorded the investment. Through recent initiatives by the Ministry of Investments (MOI) in the Office of the Prime Minister to establish a more sustainable approach to planning, Government has recognized and demonstrated the need for more robust systems for monitoring public resources. With IDB support under the currently executing PRODEV as well as the creation of the MOI strategic planning office, Government will have an opportunity to build up country systems for project management and strategic planning with appropriate mechanisms for continuous monitoring and evaluation.

5.5 **Statistics:** Responsibility for the collection, dissemination, storage and the retrieval of statistical information of the Country resides with the Department of Statistics (DOS) which adheres to international standards in carrying out these functions. Generally, the Bank uses the country data systems although The Bahamas still has data gaps. Recognizing the need to strengthen national data systems, in recent years the Bank has worked with DOS in conducting a labor market wage and productivity survey, the first of its kind in the region. Further Bank support to DOS will be given during the design and analysis of the Household Expenditure Survey which is being conducted with the support of the IDB-financed Social Safety Net Reform Program.

### C. Coordination with Other Development Partners

5.6 The IDB is the most active of multilateral institutions in The Bahamas. Others include the European Union and the Caribbean Development Bank (CDB), which is currently in discussions with GoBH on a new Country Assistance Strategy with the country (medium-strategic engagement). Neither of these institutions has a local office. However, improved coordination with the CDB is anticipated as a result of its reengagement with the country. PAHO and IICA both have offices in Nassau and the IDB exchanges information with them and have achieved significant coordination, such as joint support for the production of food stuffs locally for domestic consumption; IDB is collaborating with

<sup>93</sup> % of the Bank's active portfolio of loans which is managed through national systems.

<sup>94</sup> These subsystems (Accounting and reporting and Internal Control) are not using the country systems. However, there is a PBL that represents 13% of the projects financed by the Bank.

PAHO on an initiative to improve living conditions in shanty towns in New Providence. The Bank is also coordinating closely with the International Monetary Fund (IMF) particularly in the public finances and management area.

## VI. RISK ASSESSMENT

- 6.1 **Macroeconomic Risk:**<sup>95</sup> The country faces several macroeconomic risks in the medium term and the timely implementation of the policy reforms is key to maintain macroeconomic stability. The debt stock might reach unsustainable levels if the medium term fiscal consolidation plan is not implemented in a timely fashion. The Bank is working closely with the GoBH and IMF in supporting the implementation of the required reforms. The country's fragility is increased by its high dependence on a single trading partner and two economic sectors.. A deceleration of economic activity in the US would reduce visitors to the islands, which would have a negative impact on tourism activity, employment and fiscal figures. Furthermore, increasing international regulation jeopardizes further growth in the financial sector. This CS will support the country in diversifying both its production base and trading partners. External imbalances have been financed by FDI, which put the country in a more fragile situation due to sudden stops in capital inflows. Moreover, the CS envisages helping the country to improve the efficiency of energy use as well as to diversify the energy matrix, reducing oil imports and improving its external balance.
- 6.2 **Disaster Risk and Climate Risk:** Bank-financed studies suggest that The Bahamas has low disaster resilience and has constrained financial capacity to recover from major climate-related events, which could jeopardize the attainment of the CS expected results. During the CS period, the Bank will continue to provide assistance to strengthen the institutional and regulatory framework for comprehensive DRM and CC adaptation and to improve natural risk hazard and climate change information and management.<sup>96</sup>
- 6.3 **Implementation Risk:** The delivery of the CS could be compromised should the Bank's financial support be constrained by weak advances towards macroeconomic stabilization which could impede the implementation of the reforms envisaged. To ensure adequate execution rates, efforts will be made to enhance oversight of project executing units.

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<sup>95</sup> As mandated in the framework of the agreement of the Ninth General Increase in Resources of the Inter-American Development Bank, annual macroeconomic sustainability assessments are being done for the borrowing member countries.

<sup>96</sup> Should an extreme climatic event take place during the CS period, it is understood that GOBH priorities may shift and require a re-direction of resources from the existing portfolio to attend to immediate reconstruction efforts.



## ANNEX I: BAHAMAS: SELECTED ECONOMIC INDICATORS

	2007	2008	2009	2010	2011	2012
(Annual percentage changes, unless otherwise indicated)						
<b>Real Sector 1/</b>						
Real GDP	1.4	-2.3	-4.9	0.2	1.6	1.8
Nominal GDP (millions of local currency)	4.4	-0.9	-6.4	0.7	0.2	3.5
Inflation (end of period) - IMF	2.8	4.5	1.3	1.6	4.0	1.5
Inflation (end of period) - Central Bank	2.8	4.6	1.3	1.7	3.2	
<b>External Sector</b>						
Merchandise Exports (B\$ Million)	801.8	955.8	665.8	702.4	833.5	929.3
Merchandise Imports (B\$ Million)	2956.2	3199	2540	2590.6	2965.7	3330.6
Services (net) (B\$ Million)	1019.7	1140.4	1074.4	1312.5	1313.7	1241.3
Of which Travel	1809.7	1848.6	1697.4	1919.2	2007.9	2081.1
Current Account Balance (B\$ Million)	-1314.2	-1164.8	-927.0	-813.1	-1090.6	-1462.5
Current Account (% GDP)	16	14	12	10	13	18
FDI (percent of GDP)	9	10	8	11	8	5
(In percent of GDP, unless otherwise indicated, on a fiscal year basis)						
<b>Central Government</b>						
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/2013 1/
Recurrent Expenditure	17.2	18.8	19.7	21.1	20.6	21.0
Recurrent Revenue	17.4	16.7	16.7	18.7	18.1	17.5
Capital Expenditure	2.8	3.3	3.2	3.4	5.0	4.4
Primary balance	0.1	-2.6	2.8	0.6	-3.3	-4.0
Overall Balance	-1.6	-4.5	-5.2	-2.1	-5.6	-6.5
<b>Debt Indicators</b>						
Central Government Debt	32.3	38.6	43.9	45.7	49.4	54.3
Central Government Debt over Revenues	188.1	233.0	261.1	247.9	256.5	289.7
External Public Debt	3.3	4.8	9.1	9.4	9.4	10.1
External debt service as percent of exports of goods and services 2/	6.6	6.6	25.4	11.5	5.7	8.5

1/ projected

2/ The increase in 2009 reflects repayment of internal forex loan of US\$ 185 million to domestic banks.

## ANNEX II: MACROECONOMIC CONTEXT

The Bahamian economy has been challenged as a result of the fallout from the global recession since end-2008. After experiencing contractions in output at about -1.5% and -5.4% in 2008 and 2009 respectively, the country registered modest growth in 2010 and 2011 (0.9% and 1.6%, respectively). Growth for 2012 is 2.5%. The year 2012 featured high unemployment rates,<sup>97</sup> elevated non-performing loans, weak consumer demand and sluggish private sector credit growth and modest hotel revenues. Growth, which is highly dependent on the US economy, is expected to hover around 2-3% per year in the medium term.

The fiscal system relies heavily on trade and tourism taxes, as there are neither direct taxes nor value added taxes. Formal tax exemptions are large, estimated to be worth about 2% of GDP in FY 11/12. Current expenditures have increased over the past two years to reach 21% of GDP in FY11/12, mostly reflecting higher interest payments. Capital expenditure increases in the last years reflect the increase in transfers to some of the State Owned Enterprises as well as in public investment. Falling tax revenues as a percent of GDP over the past 3 years and the rigidity of public expenditure led to a deterioration of the fiscal position. The preliminary figures for the fiscal year 2011/12 show an expected fiscal deficit that reached up to 5.6%. The GoBH presented in May 2012 the budget proposal for FY 2012/13 where recurrent expenditure will reach US\$ 1821 million (21.5% of GDP) and an expected deficit of 6.5% of GDP for the fiscal year. The Government has embarked on a number of activities to strengthen the fiscal performance of the country, including reforms to tax and customs administration and the improvement of the efficiency and effectiveness of public expenditure.

The Minister of Finance presented to Parliament the mid-year budget review on February 25th, 2013. For FY 2012/13, the Minister of Finance stressed that the Government expects to reach its fiscal target of a deficit of 6.5% to GDP and it is implementing specific activities to adjust to the lower than expected level of revenue, including reducing recurrent expenditure and enhancing tax collection in the short term especially for property tax and customs.

The Government also used the mid-year budget statement to outline the details of the medium term fiscal consolidation plan. Its goal is to stabilize and reduce the stock of debt in the medium term. Specifically, the goals are: a) for recurrent expenditure, to reduce recurrent outlays by 0.5% of GDP each year to reach to 19.1% by FY 2016/17; b) for capital expenditure, the Government targets the execution to 3% of GDP and; c) for revenues, to increase 4% of GDP from FY 2013/14 to FY 2016/17. The Government expects to run fiscal surpluses by FY 2016/17.

**Table 1 Medium-Term Fiscal Consolidation Plan (% of GDP)**

						Projected				
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
<b>Recurrent Expenditure</b>	17.2	18.8	19.7	21.1	20.6	21	20.6	20.1	19.6	19.1
<b>Recurrent Revenue</b>	17.4	16.7	16.7	18.7	18.1	17.5	18.6	19.6	21	21.5
<b>Capital Expenditure</b>	2.8	3.3	3.2	3.4	5	4.4	3.5	3	3	3
<b>Primary balance</b>	0.1	-2.6	2.8	0.6	-3.3	-4	-1.8	0.4	2.7	3.4
<b>Overall Balance</b>	-1.6	-4.5	-5.2	-2.1	-5.6	-6.5	-4.6	-2.4	0	0.8
<b>Debt Stock</b>	32.3	38.6	43.9	45.7	49.4	54.3	56.8	56.8	54.3	51.1

Source: Ministry of Finance – 2012/13 Mid-Year Budget Statement.

<sup>97</sup> Unemployment rate reached 13.7% by 2011. The youth unemployment rate is 27.5%. The expectations are that private sector investment projects would create more employment opportunities. Moreover, the IDB is supporting the country in its effort to improve labor training.

**As of end-September 2012, the debt-to-GDP ratio was around 55% of GDP from levels below 30% in 2008.** There is increasing concern to address the rising debt levels that put at risk the investment grade rating of the sovereign debt.<sup>98</sup> The debt sustainability analysis performed by the Bank shows that the level of debt is expected to remain at sustainable levels in the medium term under alternative scenarios. However, the debt management strategy adopted by the Government could hinder the profile of the debt and increase its burden on the fiscal account. The Government stressed its intentions to focus the financing of its fiscal gap on the domestic market (and some portion on the international market) that will most likely prove to be more expensive and on worse terms than other sources of financing.

**The Bahamas has the lowest inflation rate in the region and it is projected to remain this way during the next couple of years.** Inflation in The Bahamas is highly correlated with US inflation, reflecting the exchange rate peg and the large share of consumer goods imported from mainland United States. However, it tends to be more sensitive to changes in commodity prices, particularly food and oil prices.

**Bahamas' current account deficits continue to be very large, with about two-thirds of the deficits financed through Foreign Direct Investment (FDI).** The country has been running substantial current account deficits, reaching 14% of GDP in 2011. The deficit is mainly financed by Foreign Direct Investment (FDI) that accounts for two-thirds of the deficit (particularly by construction in the tourism sector). The rest of the current account deficit is financed by net private financial inflows which typically are around 3.5% of GDP. Over the medium-to-long term, sustainability of the current account will crucially depend on a pick-up of export-led growth of services, in particular tourism and related services: as in a small open economy, external demand is the key driver of growth.

**The quality of the credit portfolio worsened.** The non-performing loans reached 20% of the outstanding portfolio. Moreover, the average delinquency period increased in the last couple of years. Before the economic crisis, around 35% of delinquent loans were overdue more than 180 days. By September 2012, almost 60% of the non-performing loans were delayed more than 180 days. This situation reflects both the worsening of the portfolio and also the decision of the banks to withhold loans and not to move forward in the foreclosure process in the case of delinquent mortgages.

**Recent assessments of the financial sector are scant, but all seem to suggest that the sector is well-regulated and is constantly reforming.** There are continual efforts and progress in the regulatory regime. The IMF recently finished its review of the financial sector as part of the Financial Sector Assessment Program (FSAP). The main conclusions in the IMF Article IV report, are that there are no short-term threats to the country's financial stability and that the domestic financial sector is resilient and could withstand considerable shocks. Progress has been made in the regulation of the insurance sector and credit unions, where there are efforts to bring them more in line with banking regulation so as to avoid regulatory arbitrage. The Central Bank is working on the crisis management strategy for the financial sector. Moreover, The Bahamas has fully complied with the necessary requirements to exit the OECD "grey list" of offshore financial centers, by signing more than 24 Tax-Information Exchange Agreements (when only 12 were required), and now complies with all requirements necessary to be on the "white list."

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<sup>98</sup> One rating agency, Moody's, downgraded the sovereign debt rating of The Bahamas in December 2013 to Baa1, citing concerns about the low level of growth and high fiscal imbalances.

### ANNEX III: EXTENDED LENDING FRAMEWORK

#### FINANCING SCENARIO

	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	Average 2013-17
Total Approvals	86	0	35	55	30	30	30
Total Disbursement	72	43	30	23	30	38	33
Net Flows	52	22	10	2	10	11	
Debt Stock with IDB	229	251	261	263	273	284	
External debt	744	855	933	1001	1053	1093	
IDB/external	23.5%	22.7%	21.8%	20.8%	20.6%	20.7%	
IDB/total	5.3%	5.3%	5.3%	5.1%	5.0%	5.0%	

**ANNEX IV: Recommendations of the Country Program Evaluation 2001-2008<sup>99</sup>**

<b>Recommendations of the Country Strategy Evaluation (OVE)</b>	<b>Incorporation in the Country Strategy 2013-2017</b>
<p><b>OVE Recommendation 1.</b> If the Bank is to improve its performance in the country, it must pay more attention to the process of policy and planning. The Bank, together with The Bahamas, should define what role it is to have. This could be accomplished by working more deeply with the country to strengthen public sector investment planning and management.</p>	<p>As explained in Section II: IDB in The Bahamas, an integral element of the Country Strategy 2013-2017 is to strengthen public sector management in the Bahamas including strengthening the Government’s capacity to plan, monitor and evaluate investments. As such, Public Finances and Management is a priority area of the CS. (Paragraphs 2.1 – 2.2)</p>
<p><b>OVE Recommendation 2.</b> The new strategy should clearly define its strategic goal and development objectives at the program level, and within a results framework that includes verifiable outcome indicators -- benchmarks, milestones, and targets. The developmental objectives of the Bank's program should be specific, measurable, and attainable.</p>	<p>This CS clearly outlines the overall strategic intent, as well as sector objectives and lines of Bank intervention. The Results Matrix also provides SMART outcome indicators – benchmarks and targets. The CS as well as the supporting sector notes were validated by the Strategic Planning and Development Division for evaluability. (Paragraphs 3.1 – 3.2)</p>

<sup>99</sup> The Government of The Bahamas submitted a request to postpone development of a new Country Program Evaluation (CPE) until the end of the new CS period given that approvals in three of the four priority areas of the previous CS took place between late 2011 and 2012. After consultation with the Office of Evaluation (OVE), it was adjudged that a more comprehensive evaluation could be completed as the programs progress during the implementation phase. Nonetheless, this Country Strategy fully takes into account the lessons learned from the last CPE.

Recommendations of the Country Strategy Evaluation (OVE)	Incorporation in the Country Strategy 2013-2017
<p><b>OVE Recommendation 3.</b> The high cost of project preparation must be addressed. To enhance its efficiency, the Bank should: (i) become more adept at inserting itself into the planning process; (ii) establish clear, time-bound agreements with the country on the scope and dimension of project preparation, data sharing, and inter-agency coordination; (iii) establish an oversight mechanism to jointly manage project preparation and address bottlenecks; (iv) tailor projects to inherent political constraints and viable institutional capacity; (v) address risks from the perspective of the country; and (vi) deepen its understanding of the political economy in which decisions are made and the institutional environment in which they are managed through additional analytical work.</p>	<p>To enhance the efficiency of project preparation in The Bahamas several initiatives have been put in place: (i) IDB engages in strategic planning meetings with the MOF at least once per quarter; (ii) the current CS process has entailed significant and probing discussions with Government at the highest levels (Prime Minister, Cabinet, line Ministries) including discussions of the political economy and the associated risks from the country perspective; (iii) carefully designed and executed analytical work which includes dialogue with the sectors' stakeholders and eventual implementers; (iv) Country Office (COF) operations team members also provide increased on-site assistance to new and/or inexperienced project execution units to orient them in executing, monitoring and controlling projects to international standards using best practices; and (v) economic sector work has deepened and broadened to the extent that the medium-term strategic dialogue with GOBH and selection of priority areas has been guided by the Growth Diagnostics developed by the economics team.</p>
<p><b>OVE Recommendation 4.</b> The slow rate of project execution must also be addressed. The opportunity to learn from the country's past experience as well as from that of the Bank should not be overlooked. Therefore, OVE recommends that the Bank broaden its analytical program to include in-depth research on execution constraints.</p>	<p>The CS team recognizes the significant historical difficulties throughout the project management cycle in The Bahamas as highlighted in the past OVE evaluation which jeopardized the achievement of strategic objectives. These considerations were fully taken into account in the design of the CS and its financing envelope. As highlighted in the previous response, specific measures were set in motion during the previous strategy period (which will continue intensification during the current CS period) to address and eliminate these implementation challenges. For this reason, the section Efforts to Strengthen Execution (Paragraph 5.1) has been included.</p>
<p><b>OVE Recommendation 5.</b> Given the country's high credit rating, strong macroeconomic framework, and low level of corruption, The Bahamas would be a good candidate to use national systems.</p>	<p>Section V. B. Country Systems charts the expected progress during the CS period toward use of national systems. A full diagnostic is also provided in the Fiduciary Technical Note.</p>

<b>Recommendations of the Country Strategy Evaluation (OVE)</b>	<b>Incorporation in the Country Strategy 2013-2017</b>
<p><b>OVE Recommendation 6.</b> Challenges to competitiveness in its driving economic sector, tourism, relate to the capacity of government to expand public services in tandem with demand. Electricity generation, a key input to the hotel industry, remains inadequate... Thus, support for infrastructure, both in New Providence and the Family islands, should continue to be a central focus of the Bank's Country Program.</p> <p>Furthermore, the dramatic rise in the cost of imported fossil fuels, on which The Bahamas' economy is heavily dependent, makes it advisable that the country pursue renewable sources of energy. Thus, there is scope for the Bank to explore realizable goals in this critical area in the future strategy.</p>	<p>As stated in the Energy priority area, the CS recognizes the importance of efficient and quality provision of public services for the competitiveness of the Bahamian economy. As a continuation of these efforts undertaken during the previous strategy period, the CS outlines that the Bank will strategically support the GoBH via technical assistance operations to: (i) modernize the institutional and regulatory framework of the electricity sector; (ii) increase the use of energy efficiency and conservation measures; and (iii) diversify The Bahamas' energy matrix by tapping renewable energy resources (particularly PV); (Paragraphs 3.12 – 3.14).</p> <p>Bank interventions in the Transport and Water sectors under the previous CS have matured from approval of operations to implementation. An evaluation of their achievement of their respective development objectives will take place during the CS period.</p>

<b>Recommendations of the Country Strategy Evaluation (OVE)</b>	<b>Incorporation in the Country Strategy 2013-2017</b>
<p><b>OVE Recommendation 7.</b> OVE recommends that the new strategy: (i) continue to support instruments of social policy and economic participation, particularly in the Family Islands; (ii) specify how the benefits of programming will flow to the poor; (iii) realistically dimension investments to ensure that outcomes are attainable and that resources are not spread too thinly; and (iv) explore the extent to which synergies can be exploited by clustering small, targeted operations around a measurable, shared purpose.</p>	<p>Social Policy and Economic Participation of Family Islands: Private sector development will include a focus on including Family Island businesses and potential entrepreneurs and extending access to finance and business development services to the same. Additionally, efforts in the Public Finances and Management priority area will enhance the efficiency of the public sector to provide better service to all citizens regardless of the island on which they reside. Other on-going Bank initiatives to be implemented during the CS period, such as the Caribbean Hotel Energy Efficiency and Renewable Energy Action Advanced Program, both reduce the cost of doing business in the Family Islands and complement the enhancement of the tourism product.</p> <p>Supporting the growth of SMEs will have an impact on the level of poverty via the effect on unemployment (90% of registered businesses in The Bahamas are SMEs). Also improvements in the skills sets of the labor force and the incorporation of the private sector in the design of training curricula (as well as incentives for the private sector to invest more in training of workers) should have a positive impact on productivity.</p> <p>Realistic dimensioning of projects: This is a necessity given the fiscal situation in the country and the Government and the public’s concern with attaining value for money in the use of public resources. Also, given the limitations re the capacity of the public sector in particular, operations will have to be dimensioned to take this constraint into account.</p> <p>Synergies: Citizen Security &amp; Justice will involve social sector agencies and labor market actors in the interventions for at-risk youth, in addition to the agencies responsible directly for crime prevention and law enforcement and justice administration. For practical purposes there may be more than a single operation, however, the effectiveness of interventions in this area are by nature multi-sectoral and provide an opportunity for synergistic activities. Improving employment prospects and life skills of at-risk youth is assumed to also have an impact on the poorer segments of the population.</p>



Recommendations of the Country Strategy Evaluation (OVE)	Incorporation in the Country Strategy 2013-2017
<p><b>OVE Recommendation 8.</b> The country is vulnerable to natural disasters, particularly hurricanes. While the Bank has been responsive in the past, its task is not finished. There is scope for the Bank to support the efforts of The Bahamas by enhancing the country's analytic capacity to anticipate the impact of climate change on the national economy, to assess the fiscal aspects of mitigation measures, and to evaluate future-looking policy responses. In addition, some of the instruments that the Bank has used to provide relief, lack the flexibility that is needed as a first response. This underscores the imperative for the Bank to analyze its existing tools, with a view to improving the mix and relevance of available instruments and technical assistance.</p>	<p>As highlighted in the Coastal Risk Management and Climate Change Adaptation priority sector, the CS aims to build resilience to coastal hazards including those associated with climate change through enhanced conservation and management of the coastal zone. Specific lines of intervention are outlined in paragraph 3.21 – 3.23.</p>
<p><b>OVE Recommendation 9.</b> OVE recognizes the difficulties faced by the Bank's private sector windows when working in The Bahamas, and urges them to more actively explore opportunities for investment. The new strategy may want to consider building on existing synergies between MIF and IIC in order to lay the groundwork for greater private sector engagement.</p>	<p>As signaled in paragraph 2.3, the MIF has 4 active projects for US\$0.85 million while the IIC has been providing technical assistance to SMEs through the FINPYME <i>Diagnostics</i>. In light of proposed establishment of a PPP policy framework, the NSG windows will monitor developments and actively pursue opportunities to finance PPP projects once the framework is in place (paragraph 3.19). As an innovative modality to address private sector needs, the Bank is piloting implementation of one local private sector consultant to identify and channel leads to all NSG windows.</p>
<p><b>OVE Recommendation 10.</b> It is possible that The Bahamas may seek support from the Bank to finance anti-cyclical measures. The new strategy should therefore take into account the context of the financial crises and government's response when establishing short-term goals and actions.</p>	<p>The CS explicitly takes into consideration the effects of the global financial crisis on The Bahamas. Moreover, the CS benefits from extensive analytical work and dialogue with GOBH in order to address the structural weaknesses of the Bahamian economy, which exacerbate inherent vulnerabilities to exogenous shocks. (Paragraphs 1.1 – 1.3)</p>

## ANNEX V: DEVELOPMENT EFFECTIVENESS MATRIX SUMMARY

### Country Strategy: BAHAMAS 2013-2017

**STRATEGIC ALIGNMENT** This measures two dimensions: (i) the extent to which the objectives of the strategy are consistent with the country's development challenges and with the government's priorities and plans; and (ii) use of a mix of products (financial, knowledge, technical assistance) to attain the objectives, and identification of other cooperation agencies and their areas of action

**Consistency of strategic objectives:** The country strategy (CS) identifies the following areas of work: (1) Public Finances and Management; (2) Citizen Security and Justice; (3) Energy; (4) Private Sector Development; and (5) Coastal Risk Management and Climate Change Adaptation. The CS also identifies the following dialogue areas: (1) Education; (2) Food Security; (3) Transport; (4) Informal Immigration. The CS is aligned with the priorities of GoBH. Priority areas as well as dialogue areas were identified as a result of the dialogue between the Bank and the country.

**Mix of products and participation by other donors:** The strategy proposes to use different Bank instruments such as sovereign-guaranteed operations, NSG operations, and technical-cooperation; it takes into consideration coordination with and interventions by other multilateral donors, such as Pan American Health Organization (PAHO). Improved coordination with the CDB is anticipated as a result of its reengagement with the country.

**EFFECTIVENESS** (This measures whether the country strategy is likely to achieve its intended objectives, through an examination of four dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and build up of country systems; and (iv) the analysis of the lending framework.

Effectiveness dimensions	%
<b>I. Sector diagnostics</b>	<b>%</b>
- Identifies the main problems based on empirical evidence	100
- Identifies the main beneficiaries	100
- Identifies and measures the factors that contribute to the problems identified	100
- Presents the policy framework and a sequence for Bank intervention	100
- The diagnostic corresponds to the objectives presented in the strategy	88
<b>II. Results matrix</b>	<b>%</b>
- The expected outcomes are clearly defined	92
- The indicators are outcome indicators and are SMART	85
- The indicators have baselines	100

All sector notes presented to support the country strategy:

- clearly identify the main sector problems based on empirical evidence.
- identify the potential beneficiaries in each area of intervention.
- identify or measure the factors that contribute to the problems identified.
- identify the policy framework and a sequence for Bank actions.

In 88% of the notes there is consistency between the note and the proposed strategic objectives.

Results matrix: The results matrix includes 7 strategic objectives for Bank action and 13 indicators to measure progress.

- 92% of strategic objectives clearly identify expected outcomes.
- All indicators used are SMART. 85% of indicators are outcome indicators.
- All the indicators have baselines.

**Country Systems:** With regard to fiduciary systems (financial management and procurement) assessments were conducted for all financial management sub-systems and for the procurement information system. The Bank is currently using all financial management subsystems and is not using any procurement subsystem. All financial management sub-systems with the exception of internal audit as well as procurement sub-systems will be strengthened during the country strategy period.

**Lending framework:** The strategy contains an analysis of the country's financing requirements and provides an estimate of the amount required from the Bank. Given the size of the envelope, the CS areas of intervention are very focused.

**RISKS.** This measures three dimensions: (i) identification of factors that actually do or might affect attainment of the proposed objectives; (ii) definition of mitigation measures; and (iii) monitoring mechanisms.

The strategy identifies the risks associated with Bank participation in each of the strategic sectors and identifies mitigation measures. It also discusses more general risks (macroeconomic, disaster and climate and implementation) that will be monitored during the country strategy period.