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SIDS, Vulnerabilities in Size: The Bahamian Economy

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Abstract:

This paper discusses the structural characteristics of small island developing state economies that make them especially vulnerable to external shocks. In addition to outlining the features common to most states in this group of nations, peculiarities specific to the Bahamas are also discussed. The paper explains how the consequences of these weaknesses are heightened during periods of slowed and negative growth.

Key words:

Small island developing states (SIDS), structural weaknesses, vulnerabilities, economic resilience, external shocks

The Bahamas is one of fifty-two countries and territories around the world, classified by the United Nations as a Small Island Developing State (SIDS). These SIDS, including The Bahamas, share certain economic and environmental vulnerabilities that heighten economies' exposure to harmful external shocks. In this brief the core common characteristics are identified, and the vulnerabilities most critical to The Bahamas' current situation and its ongoing development are highlighted.

Realities of Being Small: Small State Vulnerabilities

Broadly, there are four characteristics that render small islands states particularly vulnerable to external forces. Each one of these characteristics gives way to a range of issues.

1. LIMITED RESOURCE BASE
   Limited resource bases generally result in either of the following:
   a. Dependence on a narrow economic/productive base.
   b. Compels specialisation – the economy becomes a single commodity exporter. Ostensibly the economic equivalent of the notion of 'putting all of one's eggs in one basket', albeit a situation dictated by the prevailing circumstances.
2. HIGH DEPENDENCE ON EXPORT EARNINGS
   Given their limited resource base, SIDS are generally very high importers. They are often very high importers of food and oil in particular, import commodities essential to the basic well-being and functioning of small island countries. Exports and export earnings, are therefore critical to the small island state, which must amass the foreign exchange necessary to satisfy the economy's import needs. As a consequence, SIDS are highly dependent on international trade and therefore particularly susceptible to adverse developments that affect global trade. In the case of food and oil, fluctuating world prices becomes a major factor.
3. SMALL DOMESTIC MARKET
   By virtue of their smallness, advantages typically associated with economies of scale are simply not available to the small island state, significantly limiting productive capacities and heightening the costs of development. Specifically, consequences most often include:
   - Limited export volumes.
   - High per unit production costs.
   - High per capita costs for public administration and infrastructure development.
   - High dependence on imported technologies.
   - Limited domestic competition. Relegating markets to frameworks that are predominantly oligopolistic and monopolistic.
   - Limited human resource base and therefore limited capacity to meet needs for specialised skills and expertise necessary for effective development; development most relevant to the needs and prospects for the economy.
4. HIGH SUSCEPTIBILITY TO CLIMATE CHANGE, NATURAL AND ENVIRONMENTAL DISASTERS
   Climate change and sea level rise pose significant risk to the sustainable development of SIDS. Experts further reveal that long term effects threaten the viability and even existence of some SIDS. Moreover, small island states tend to suffer disproportionately high economic, social and environmental consequences due to natural disasters.

Vulnerability Issues for The Bahamas

The Bahamas shares many of these vulnerabilities inherent in its structural identity, with a few added elements characteristic of the Bahamian situation. The Bahamas is heavily dependent on tourism, the economy's dominant sector. Financial services to a lesser though still significant extent is the second most important economic activity. No other sector has consistently contributed more than 5% of the nation's

GDP. Moreover, there are additional issues of note that deepen the impact of the country's substantive dependence on the tourism industry.

The sector is predominantly foreign owned, and non-Bahamian owners and investors are permitted to freely repatriate profits. This is a critical concern particularly given the poor spill-over into local markets due to the tourism sector's weak linkages with the domestic sector. For example, development of the agriculture and fisheries industry, that is strategically aligned with tourism prospects and development would have significant mutual benefit for both industries as well as wider national impact as far as driving down the volume of the nation's food imports. There is no such strategic alignment. Agricultural and fisheries development has not kept pace with the economy's growth and expanding demands, neither in volume, quality, nor value-added services. In terms of the sector's contribution to the country's GDP it has become less significant in recent years. On average, agriculture accounts for less than one percent of GDP, and fisheries, just over one percent. The local construction sector is impacted particularly when there are new investments. Most of the country's foreign direct investments are tourism based, and these investments do provide spill over for the local construction industry.

Critically, not only is the sector predominantly foreign owned, this foreign ownership is dominated by a single property and thus a single investment group. Similar to the broader domestic market, the country's largest industry is also defined by traits of oligopolistic and monopolistic organisation. In 2013, the Atlantis Resort was estimated to have accounted for 65% of all hotel room revenue earnings in The Bahamas, and a 75% share of the room revenue generated by New Providence and Paradise Island hotel properties[1]. The scale of vulnerability is amplified, with an economy singly dependent on one industry, tourism; an industry largely owned by a single provider; an industry and an economy, singly dependent on one market, the US. The economy's vulnerability is deepened, as its dependencies narrow, even at the industry level, underscoring the need for diversification within the economy's core sector. The tourism industry ostensibly is defined and identified by its hotel sector.

Foreign ownership of the sector also suggests an overall stay experience for property guests that is ultimately defined by that ownership, which in most cases is an international hotel chain. The notion therefore of creating an authentically Bahamian experience competes against the chain's own branding identity. The extent that these competing factors might tend more on the authenticity of the experience, impacts the industry's spill over into the local economy. A local economy that could fill the gaps necessary for a distinctly Bahamian experience. The financial services sector is also dualistic in nature, comprising a competitive offshore sector versus a small domestic sector.

More than its dependence on a single industry, The Bahamas is also heavily dependent on a single market, the United States. From 2000 – 2013, an average of 82.8% of stopover visitors to The Bahamas came from the US, compared to just 6.6% from Canada, the second highest market over the same period. As a consequence, any downturn in the US' economy has an immediate and direct impact on tourism arrivals and visitor expenditure. By its nature, leisure travel, the principal driver for the country's foreign exchange earnings, has high income-elasticity, as a non-essential expense. In contrast to the more inelastic essential national spending that it funds. This kind of dependence on a single economy, along with the domestic market's inability to offset tourism losses, deepens the impact of a slowed US economy on Bahamian economic performance.

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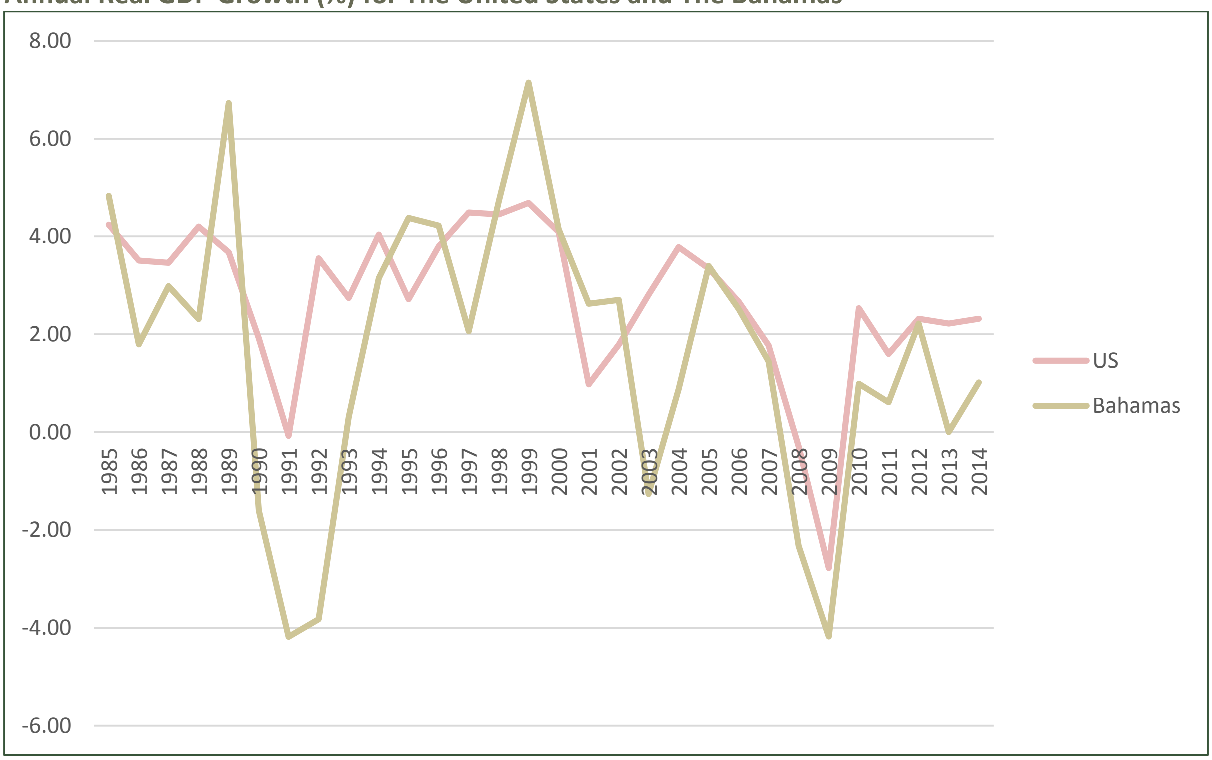
[1] 2014, Johnson, David, former Director General of Bahamas Tourism and current CEO of the Tourism Development Corporation.

While The Bahamas' proximity to the United States is without a doubt a competitive advantage for tourism – the availability of affordable direct flights is unmatched by any other CARICOM destination – the ease and accessibility of travel between the US' south eastern coast and The Bahamas, also makes it an ideal trading partner. As a consequence, the US is also the country's main trading partner. Such single market reliance, heightens vulnerabilities already associated with a high dependency on international trade.

From 2000 – 2013 an average of 91.7% of all non-oil imports came from the United States, including as much as 94.5% in 2009. On the export side, an average of 70.0% of all non-oil Bahamian exports over the same period, was US bound, including 76.8% in 2013, the highest ratio over the period. This heavy reliance on the US economy is evident in comparative real GDP annual growth estimates, with Bahamas growth trends matching the pattern of US growth. The impact of the country's reliance on the US in terms of tourism and trade is particularly notable in downturn years. In those years, the Bahamian economy declines more deeply than the US, given the wide ranging impacts of these key activities on the overall economy. The recovery is often also slower for The Bahamas, as the rebound typically comes from a deeper and sometimes more pronounced downturn.

Annual Real GDP Growth (%) for The United States and The Bahamas



These structural elements that weaken the economy's resilience to shocks underlie the protracted impact that the 2008 – 2009 global economic crisis has had on the Bahamian economy.

Also shaping part of the economy's structural vulnerabilities is the fact that energy in The Bahamas is exclusively oil based, creating high dependence on the import of oil and oil products. Like other SIDS, The Bahamas is a price-taker. Its volume of trade with the world is too insignificant in international terms to influence high and fluctuating world prices, exposing the economy to the impulses of global oil markets. This places the economy in a situation of low energy security, against a backdrop of the economy's increasing electricity demands and critical capacity issues in meeting those demands.

Through to the end of 2014, tourism and trade were also the principal sources for tax revenue. Given the various dependencies inherent in the Bahamas model, there is significant unpredictability attached to tourism along with the generally high elasticity of imports. On average, taxes on international trade and transactions account for more than half of total tax revenue, while travel and tourism taxes[2] account for under 15% of the total intake. Slowed or negative growth in tourism and trade therefore has an immediate and considerable impact in fiscal terms, constraining tax income significantly. Depending on the extent of inflexibility in expenditure demands, growing deficits result. Broadening of the tax base becomes a necessity to buoy the revenue side. Beginning January 1, 2015, a value-added tax (VAT) on domestic consumption was implemented (7.5%).

As far as natural disasters and the small island state, the 2004 landfall of Hurricanes Frances and Jeanne effectively illustrate how severe natural disasters can be for small islands. Although the hurricanes affected the whole Bahamas, the impact was especially destructive in the northern Bahamas, in particular for Grand Bahama. Both occurred in September of 2004, Jeanne following Frances by scarcely three weeks. In the case of Grand Bahama, striking an already weakened and vulnerable island. Grand Bahama had yet to regroup, repair and recover from damages suffered by the pounding of Frances. Frances' movement was slow, and the storm's expanse large, impacting the island for a comparably long period of time. Jeanne's passage soon after at category three hurricane force strength, worsened an already desperate state.

In Eight Mile Rock, Grand Bahama's largest community, more than 75% of homes suffered serious structural damage. The eastern end of the island was cut off due to flooding and damages related to storm surges, and Freeport's international airport was also severely flooded. At one point all of Grand Bahama was left without electricity. In total 2,300 downed poles were reported, accounting for the bulk of the estimated $8 million in losses. More than 18,700 Grand Bahama Power company customers were reportedly without services for more than six weeks. Access to water was also limited, with the utility suffering an estimated $2.7 million in damages.[3]

With the island contending with extensive physical damages, economic activity in Grand Bahama suffered tremendously. Restoration and repair was an involved process. The year after Frances and Jeanne, tourist arrivals to Grand Bahama fell by 10.7% including a 20.6% drop in air arrivals and a 5.1% skid in arrivals by sea. Air arrivals, comprising the stop over visitor statistic, continued a steady decline in every subsequent year, except for a brief uptick in 2012. Job losses piled up, escalating unemployment to double digits the following year (11.0%), compared to a decade low of 6.4% in 2002.

Like other SIDS, The Bahamas has the four characteristics most broadly associated with the country group: a limited resource base, high dependence on export earnings, small domestic market and high susceptibility to climate change, natural and environmental disasters. In summary, the vulnerabilities extend farther to include the following additional characteristics:

- *Narrow Economic Base:* The economy is heavily reliant on a single industry, tourism.
- *Weak linkages of main industry to domestic market:* The country's main industry is largely foreign owned, and has weak linkages to domestic markets.
- *Narrow ownership base of the main industry:* ownership of the country's principal industry to date has rested predominantly with a single foreign investment entity.

[22] Travel and tourism taxes include, departure taxes, gaming and hotel occupancy taxes.
[3] 2004 (December) ECLAC, Impact Hurricanes Frances and Jeanne.

- *The Bahamas is a net importer:* Tourism, its dominant industry is the economy's principal source for foreign exchange earnings.
- *Heavily dependent on a single economy:* Bahamas tourism and trade are predominantly dependent on the health and stability of the US economy.
- *Limited tax base:* The country's tax base is narrow and up to December 2014, also predominantly dependent on tourism and trade, exacerbating governments' capacity to fund essential public services in downturn years.

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Author's Profile

An Economist by profession, Ms. Fraser is a proven researcher and analyst. The founding Principal of the Vivian Group, her career achievements cross key sectors of the Bahamian economy, including, Higher Education, Tourism, Financial Services and the Electronic Communications Sector, in core responsibility areas of administration, policy and regulation. At The College of The Bahamas she was the Associate Vice President with responsibility for External Affairs and a part time faculty member in the School of Business; at the Ministry of Tourism and Aviation she was the Director for Onshore Communications; while at The Central Bank of The Bahamas, she held various positions including Economist and Assistant Manager of the Bank's Research Department; at the Utilities Regulation and Competition Authority she was the Corporate and Consumer Relations Manager.

Trained by the International Monetary Fund (IMF), The World Bank, The Bank of England, The Commonwealth Secretariat, The Centre for Latin American Monetary Studies (CEMLA) and the University of Florida's Public Utility Research Center, she holds a Master of Arts degree in Economic Development and Policy Analysis from the University of Nottingham (UK), a Bachelor of Science degree in Economics and Finance from Barry University (USA), and an Associate of Arts degree in Pure and Applied Mathematics from The College of The Bahamas. Ms. Fraser has a postgraduate Diploma in Financial Economics from the University of London and a certificate from the London School of Economics and Political Science for studies in Unemployment, Inequality and the Welfare State and Economic Perspectives on Society. She is currently completing a Doctorate in Business Administration degree (DBA) with the University of Bath (UK).

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