MEMORANDUM

From: Financial Secretary – Ministry of Finance and Corporate Governance

To: Hon. Prime Minister and Minister of Finance and Corporate Governance

Date: March 5, 2018

RE: **Potential Revenue Impact of Measures**

Further to your request, please find below the Ministry's perspective on the following measures:

1. Reducing gasoline and diesel prices by $2.00 per gallon
2. Reducing the Corporation Tax from 25% to 12.5%
3. Revenue Impact of Reducing Food Prices
4. Creation of New Duty Free Zones
5. Fiscal Impact of Measures

Impact of $2.00 reduction in Gasoline and Diesel Prices

In February 2018, the US Energy Information Administration reported the average price per barrel for Brent Crude Oil at US$54.00. It is also estimated that the price per barrel will increase in 2018 to US$62.00. In 2017, the Government generated $78 million in gross consumption tax revenue for gasoline and diesel. A $2.00 reduction in gasoline and diesel prices, assuming the average cost of the product remains unchanged (i.e. $6.27 per gallon for gasoline and $5.19 per gallon for diesel) then the impact would be a over $40 million reduction in gross consumption tax revenue for the year. Given the expected increase in the cost of crude oil in 2018, the revenue impact of a $2.00 change in price at the pump will likely be significantly above $40 million.

Reduction of Corporate Income Tax from 25% to 12.5%

Corporation Tax yielded $67 million in 2017 and is projected to generate about $70 million in 2018. Whether the reduction in the corporation tax is immediate or gradual, the impact will be a reduction in revenue from the corporation tax. Government's revenue could be reduced by as much as $35 million if there are no compensating revenue measures to off-set the reduction in the revenue yield from corporation tax.

Revenue Impact of Reducing Food Prices

This would likely involve adjusting the basket of essential goods, thereby increasing the number of items that are ABST zero rated. It may also involve adjusting the Import Duty and Revenue Recovery Charge on certain food items. An adjustment in rates on any items will lead to a reduction in revenue. Depending on the adjustment to the list of zero rated items contained in Schedule 2 of the ABST Regulations (as amended), the estimated revenue impact could be between $10 million and $15 million. The revenue loss could increase to as much as $20 million if there are adjustments to the Import Duty or the Revenue Recovery Charge.

While a decrease in taxes on food items should result in a reduction in the cost of the items, assuming no increase in the landed cost of the items, the overall impact of these adjustments on the general cost of living will depend on whether retailers pass on the savings from reduced taxes. The Prices and Consumer Affairs Department and the price control mechanism would need to be strengthened – before the adjustment in tax rates – to ensure the intended reduction in the cost of living is achieved.

Creation of New Duty Free Zones

As advised by the Comptroller of Customs, there are already duty free arrangements in place at Jolly Harbour, Nelson's Dockyard, and Falmouth Harbour for the yachting industry. Any items purchased by visitors on yachts are free of duties and taxes. Also, Redcliffe Quay is already a duty free area. If the duty free arrangements in the Jolly Harbour, Nelson's Dockyard, and Falmouth Harbour areas are to be extended beyond yachting visitors, then the same arrangement that is established for Heritage Quay and Redcliffe Quay can be implemented. This means visitors would enjoy duty free concessions while locals will have to pay the duty paid price on purchases. The impact on revenue will depend on how effective the current arrangements for the yachting industry are monitored to ensure only eligible purchases are free of duties and taxes. If additional shops are established in the areas and the number of visitors increases, then the Government could generate additional revenue through Unincorporated Business Tax (UBT) or Corporation Tax (depending on the nature of the businesses). This would also apply to Barbuda. However, for Barbuda, there would first need to be significant investment in creating a cargo and cruise port; developing additional tourism plant and products; and enhancing other economic opportunities if a duty free zone is to be viable.

Fiscal Implications of Proposed Measures

In Budget 2018, the projected fiscal deficit is $85.5 million and amortization amounts to $362.9 million. The Government's financing requirement or funding gap is therefore $448.4 million for 2018. Any measure that leads to a reduction in Government revenue, without any corresponding reduction in Government expenditure, will lead to a widening of the fiscal deficit. A widening of the fiscal deficit will increase the funding gap and can lead to increased public sector debt (either through additional borrowing or arrears accumulation).

Kindly advise if any further information or clarification is required.

Whitfield Harris
Financial Secretary