Pre-Budget Report

IN ADVANCE OF FISCAL YEAR

2019 - 2020

GOVERNMENT OF BERMUDA
Ministry of Finance

Chapter 1
Purpose of the 2019/20 Pre-budget Report

What Is a Pre-budget Report?

A Pre-budget Report (PBR) is a policy statement issued by the Government prior to the release of the budget. It defines the priorities for the next budget in a medium-term framework covering external developments and internal strategies. The PBR should clearly state the Government's economic and fiscal policy challenges and its objectives and intentions in the medium term.

Like most small states and territories, Bermuda's economy is highly vulnerable to external events, underlining the need for financial and fiscal prudence. This vulnerability is compounded by Bermuda's continuing budget deficits and high level of Government debt, which now stands at $2.46 billion.

The Government has to take a number of actions to address the problems the island faces, and it is important that stakeholders and citizens understand these vulnerabilities, have the opportunity to give their views, and are aware of the factors driving the Government's fiscal policy decisions. The Government should be accountable for developing strategies to cope with both domestic and international turbulence, and the strategies adopted should be transparent and open to criticism and comment. The Government should also be accountable for their execution.

To ensure this, the Government re-introduced a PBR as part of the preparation process for the 2018/19 budget and is continuing this process for the 2019/20 budget. The only other PBR was prepared in December 2011, under the former Progressive Labour Party administration, as part of the preparation process for the 2012/13 budget. The reintroduction of a PBR reflects this Government's decision to participate in the Open Budget Initiative (OBI).

> *Greater transparency and public participation in the budget process [are] more likely to yield spending priorities that serve the best interests of society as a whole… The regular release of information can provoke public debate and encourage accountability. And budget information is important not just for accountability to the public but also for internal management purposes.*
>
> *Holding the government fiscally accountable requires the production and dissemination of budget information from the formulation stage, through approval, execution, and evaluation (or oversight). Yet around the world today,*

citizens and legislatures frequently lack at least some basic information about government decisions and actions at every stage of the budget process.[1]

Purpose of the Pre-budget Report

The objective of the PBR is to increase public awareness of a government's fiscal and budget policy objectives, and to establish a benchmark for evaluating the conduct of fiscal and budget policy.

The PBR also serves to **educate** the public and encourage debate on the budget strategy and how effectively it copes with current economic and social priorities. The PBR is intended to provide an opportunity for stakeholders such as business and social groups to understand and comment on options for the next budget. This can give stakeholders confidence that the administration's budget policies are grounded in longer-term fiscal and budget strategies.

From the government's perspective, the scope for public misunderstanding of the (eventually chosen) budget strategy is reduced due to a greater public appreciation of the nature of the trade-offs facing the government.

Pre-budget submissions by such groups that respond to the PBR can also **alert** the government to unforeseen pitfalls and alternative policy options and improve the quality of the budget. They may even pre-empt embarrassing policy back-flips after the budget has been handed down, when previously invisible problems come to the fore.

The PBR will also improve the budget preparation process for the **line ministries** in the current budget year as well as in forward years, by imparting a clearer knowledge of the government's strategies.

Finally, a PBR increases the **accountability** of present and future governments for effective fiscal policy management. This is at two levels:

- The government can be held accountable for the extent to which the fiscal strategy it proposes in the PBR conforms to the principles of sound fiscal management.
- The government can be held accountable at the end of the fiscal year for the extent to which the realised fiscal outcome conforms to the strategy it proposed for that year in the PBR.

[1] Harika Masud and Jason M. Lakin, "What the Open Budget Survey 2010 Tells Us about the Global State of Transparency", Yale Journal of International Economics, Winter 2011, p. 65.

- The reintroduction of a PBR is a sign of this Government's commitment to transparent government in Bermuda, which was one of the key planks included in the Government's 2017 Election Platform.

Principles of Good Fiscal Policy

Fiscal policy should be directed to ensuring that prosperity reaches all segments of Bermuda's society while having a sustainable medium-term framework. To date, Bermuda's economy has not worked for all Bermudians, and this Government was elected to ensure prosperity reaches all. To meet these objectives, this Government's fiscal strategy will be framed in accordance with the following principles of sound fiscal management.

- Prudently manage financial risks faced by the Government, to include maintaining general government debt and contingent liabilities at prudent levels.
- Ensure that fiscal policy contributes to the achievement of adequate national saving and, as appropriate, to dampening cyclical fluctuations in economic activity, taking account of the economic risks facing the nation and their impact on the Government's fiscal position.
- Pursue spending and taxing policies that are consistent with a reasonable degree of stability and predictability in the level of the tax burden, while promoting fairness and equity in both spending and taxes.
- Maintain the integrity of the tax system.
- Ensure that policy decisions have regard to their financial effects on future generations.

The last few years have highlighted the conflicting goals policymakers face with regard to fiscal policy: more fiscal stimulus or fiscal austerity. The fiscal tightening pressure has sparked a debate between policymakers. Some governments have embraced austerity in a bid to quickly cut the deficit, while others continue to push for more spending. The way to think about the fiscal split is two-fold.

First, the classical concern: when deficits are high and people are worried about an unsustainable surge in debt, deficit reduction may have a strong positive confidence-building effect that offsets the negative shock to the economy. The counter to that is the Keynesian view: when there is a large output gap and demand remains weak, deficit reduction may weaken demand even more.

The Government takes the position that while risks exist, it is critical that we invest in creating a more diversified economy, which will create stronger economic growth for the island, as our ability to reduce our debt depends on being able to grow our economy and create more jobs in Bermuda. A stronger and more diversified economy will assist in our mission to increase employment across all sections of the Bermuda economy and create jobs and opportunities in not only existing industries, but also new sectors that will drive stronger economic growth in the future.

However, it is important to note that while diversification is a major priority, the Government will always put stability first, taking no risks with the island's sterling reputation or the sustainability of the public finances.

Risks Facing the Bermuda Economy

In their recent report, the Fiscal Responsibility Panel (FRP) highlighted a number of risks to Bermuda's economy. These risks, among others, underscore the need for financial and fiscal prudence, and the Government has considered these risks when framing the 2019/20 budget.

Some of the threats noted by the FRP are as follows:

- *Risks from global initiatives in financial regulation.* The Caribbean Financial Action Task Force's (CFATF) assessment of Bermuda's Anti-Money Laundering (AML) and Counter-Terrorism Financing (CTF) measures is now underway. While there are some reasons for optimism about a positive outcome, this is not yet certain.
- *Reputational risks.* Bermuda rightly prides itself as a well-regulated place to do business with a respected regulatory and legal system. This has been key to Bermuda's success in attracting international business. Many have stressed to us the potential risks to this reputation if something were to go wrong with any of the new businesses attracted by Bermuda's new FinTech strategy. Regulating these businesses effectively must be a high priority.
- *Potential EU action to blacklist Bermuda as a "non-co-operative" tax jurisdiction under the EU Code of Conduct initiative*. The FRP said last year it is important to recognise the political motivation of those in the EU who object to Bermuda's facilitation of corporate vehicles with no substantial business on the island and the absence of a corporation tax, and who wish to include Bermuda on any blacklist of "non-co-operative" jurisdictions. There have been intensive discussions with the EU on this issue over the last year, focusing on how to

prevent companies with no substantial business on the island from benefitting from Bermuda's tax regime. The outcome has been new legislation in Bermuda, and all comparable jurisdictions, requiring companies that benefit from the tax regime to have a substantial presence on the island, including in terms of employment.

- *It will also be important to maintain Solvency II equivalence for insurance regulation.* The European Commission will shortly be reviewing Solvency II requirements. Bermuda needs to continue to develop its strategy to engage with the EU post-Brexit and the decision to establish a representative office in Brussels was timely.
- *US tax reform.* The tax reform legislation eventually passed by Congress does not appear to have had any significant negative impacts on Bermuda's insurance and reinsurance industry; this risk has therefore diminished significantly. Nevertheless, we will need to ensure that we maintain our comparative advantage as a place to do business and keep a close eye on developments in Washington.
- *The general rise in populism and economic nationalism in advanced economies*. This risk has materialised, leading to significant tensions between the US and other countries, especially China; fortunately, Bermuda has, as yet, not been adversely affected in any direct sense. However, if trade tensions continue to rise, there will be an increasing risk of spillover into measures that would have a more direct impact on Bermuda, which benefits hugely from globalisation in general and international capital mobility in particular.
- *Impact of global warming and climate change.* With global warming, extreme weather events are becoming more frequent. Bermuda had a narrow escape this year from the full force of Tropical Storm Florence. Over the long term, however, Bermuda is at risk from a major weather event. While Bermuda has coped well in the past, the FRP believe we need to clarify the potential impacts of climate change. Climate change will also have wider impacts on Bermuda's insurance and reinsurance businesses, in the short term leading to significant payouts, but in the longer term possibly leading to higher insurance rates and increased business.
- *Brexit.* Bermuda is not part of the EU, and is responsible for its own trade policy. The vast majority of Bermuda's trade in goods is with the US, and most tourists are from North America. The direct impact of Brexit on Bermuda is therefore small. Even the knock-on effects of a disruptive "No Deal" Brexit would be unlikely to have a material direct impact on the Bermudian economy, although it

might lead to further strains in global financial markets, which could in turn impact Bermuda. However, to the extent that the UK acts to defend Bermuda's interests in the EU, particularly in relation to financial services regulation and tax policy, Bermuda may find it more difficult to make its case in Brussels.

- *Effects of an ageing population, declining workforce, underfunded public sector pension funds and escalating health-care costs.* This remains a certainty, not just a risk, which will result in serious medium and longer-term pressures on public spending and challenges to growth. It will also make it more difficult to deal with a large debt overhang. The recent census throws these issues into sharp relief, suggesting a sharp rise in the old-age dependency ratio in the near future. Concern about this is a further factor that could ultimately trigger a loss of market confidence. While demographic trends are, by their nature, slow-moving and may not be immediately visible to the public, this is perhaps the single most serious long-term issue Bermuda faces and one that now needs to be addressed with some urgency.

Chapter 2
Economic and Fiscal Performance

Global Economy Experiencing Steady Expansion – Bermuda's Outlook is Improving

According to the latest World Economic Outlook (WEO) released by the IMF in October, the expansion of global growth has been ongoing since the middle of 2016 and is projected to persist into 2019. Global growth is expected to be 3.7% for 2018 and 2019, which are both 0.2 percentage points lower than the April 2018 WEO forecast. Momentum remains strong in the US due to increased fiscal stimulus, however future growth prospects have been dampened due to reported trade measures such as imposed tariffs on $200 billion of US imports from China. Similarly, growth expectations for the eurozone and the UK have also been diminished. The lower forecast in the eurozone is due in large part to softer exports, weaker industrial production and uncertainty over governments' policies. The reduced expectations in the UK are partly due to negative anticipated outcomes of Brexit.

The US economic data has remained robust. Since the USA is Bermuda's largest trading partner and the source of the overwhelming majority of tourists, its economy's performance to date is good news.

Buoyed by the growth in the US economy and the hosting of the America's Cup, Bermuda's economy rebounded in 2017 after experiencing a contraction of 0.1% the previous year. In 2017, the Bermuda economy grew by 2.5% based on constant market prices (real GDP). This result exceeded the Ministry of Finance's expectations of an increase in GDP of 0.75%–1.25%. The largest value increases in real terms were recorded in the hotels and restaurants and real estate and renting activities sectors. In contrast, the financial intermediation sector recorded the largest decline in value.

In 2017, Bermuda recorded its second year of economic growth in the last three years after declining for six years between 2009 and 2014. Despite some positives in our economic performance, there is still an urgency to invest in long-term policies that will diversify the Bermuda economy and create sustained economic growth that reaches all areas of society in Bermuda.

Bermuda’s Economy in 2018 and Future Outlook

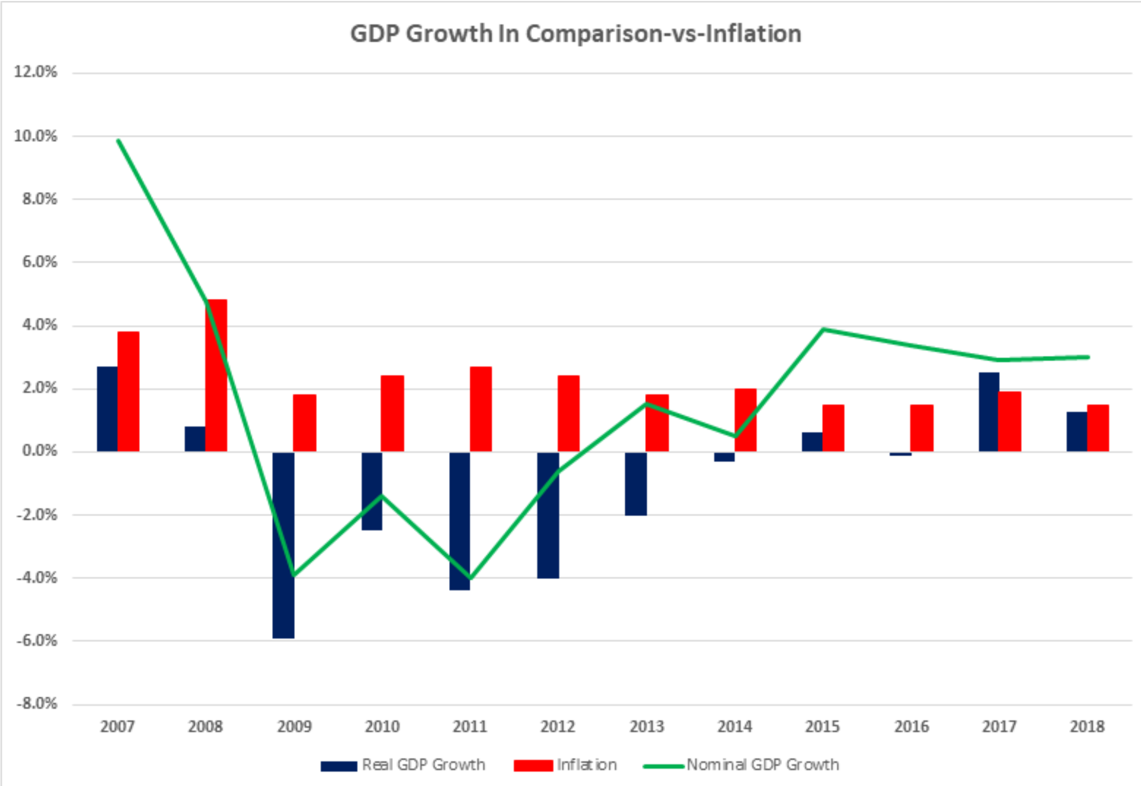
Summary Economic Indicators: Mid-year Economic Review 2018

***Comparative data over the first half of 2018, except when otherwise indicated.**

- The Department of Statistics’ GDP data for the first quarter of 2018 shows that the economy declined by 0.4% in real terms, in contrast to the second quarter of 2018 where GDP increased by 0.8%.
- The year to date (August) average Consumer Price Index remained relatively low at 1.6%, with the 12-month average rate at 1.7%. The primary drivers of inflation during the last 12 months were increased costs in health insurance premiums of 4.1% in April, increases in the average costs of premium fuel and boat repair and maintenance and increases in the education, recreation, entertainment and reading sector.
- Imports decreased by 13.1% over the first two quarters of the year to register at $525 million. This was mainly due to the return to more normal levels following the large increases related to the America’s Cup. The largest decrease was seen in the importation of finished equipment, which saw a decline of 25.7%. Other categories that contributed significantly to the decline in the level of imports were food, beverages and tobacco.
- On the tourism front, air arrivals to November 2018 grew by 4.7%, and the number of cruise passengers increased by 14.2% over the same time period. Total visitor arrivals were up 10.6% versus a year ago.
- Total visitor spending in the first two quarters rose by $2.7 million or 1.3%, settling at $213.1 million.
- There were 12,156 international companies and partnerships registered in Bermuda as of September 2018, representing a 1.1% decrease compared to the 2017 total of 12,295.
- Total value of new construction projects started in the first six months of this year fell by 89.5% from $564.5 million to $59.4 million. This decrease was due to the airport redevelopment and St. Regis projects, which both started in the second quarter of 2017 with a total value of over $500 million.
- The estimated value of construction work put in place was $93.6 million, an increase of 54.2%. The majority of the growth can be attributed to work performed on the airport redevelopment project.

- Based on preliminary estimates from the Office of the Tax Commissioner, employment income for the first three quarters of 2018 increased by $8.3 million to $2.6 billion, a modest increase of 0.3%.
- The total number of persons contributing to Social Insurance as at September 2018 was 33,877. This is 74 more than were contributing in September 2017.
- Total retail sales for the first nine months of 2018 decreased by 2.5% or $21.5 million to register at $854.4 million.
- Bermuda's Balance of Payments over the first quarter of 2018 recorded a surplus on the current account of $343 million, which was $2 million more than the corresponding surplus in 2017. The increase in the current account surplus was due in part to positive movement in the services account, where there was growth of $17 million in both the transportation and financial services.
- Based on figures released by the Bermuda Monetary Authority, Bermuda's money supply declined by 1.0%, or $36 million, year over year at the end of the third quarter of 2018. The decrease in the money supply was partially due to a reduction in deposit liabilities.
- The Banking sector's total assets declined by 7.0% or $1.5 billion at the end of September 2018. The majority of the reduction was driven by a decrease in interbank deposits.
- Loans & Advances fell by 2.5% or $90 million over the first three quarters of 2018, while customer deposits also contracted by 8.2% or $1.5 billion for the same time period.

Recent economic data is somewhat mixed, but overall shows moderate growth at best. Some sectors of the economy have exhibited positive outcomes while other sectors have shown softness. There are positive signs in the tourism and construction sectors and the low level of inflation is beneficial to the economy, since it helps to keep a check on the price of goods and also encourages people to spend and businesses to invest. These positive aspects of the economy are offset by reductions in retail sales, imports, and higher commercial and retail interest rates being charged by local financial institutions. The Government has made a concerted effort to stimulate foreign investment in the Bermuda economy through targeted investment strategies and diversification of business development initiatives. This should translate into higher employment numbers, providing moderate economic growth in most sectors. Considering all of the above factors, the Ministry expects the island's economic growth, in 2018, to expand moderately.



Credit Ratings

The Government currently holds long-term foreign currency credit ratings of “A+” (positive outlook) from Standard and Poor’s (S&P) and “A2” (stable outlook) from Moody’s Investor Services (Moody’s). In 2018, the Government continued to maintain its investment grade credit ratings at a time when a number of other countries were downgraded. Also of positive note is that on April 29, 2018, S&P revised its outlook on Bermuda from stable to positive. This is the first outlook upgrade in Bermuda’s financial rating by a leading credit rating agency since 2010. In making the announcement, S&P, in their overview, stated that Bermuda’s credit story is improving thanks to a return to positive economic growth. The agency added that they view the prudent fiscal policy by the new Progressive Labour Party Government as positive. The positive outlook reflects S&P’s expectations that, in the next 12 to 24 months, real GDP growth will remain moderately positive, fiscal deficits will continue to narrow approaching balance, and Bermuda’s net general government creditor position will improve modestly.

Public Debt Concern

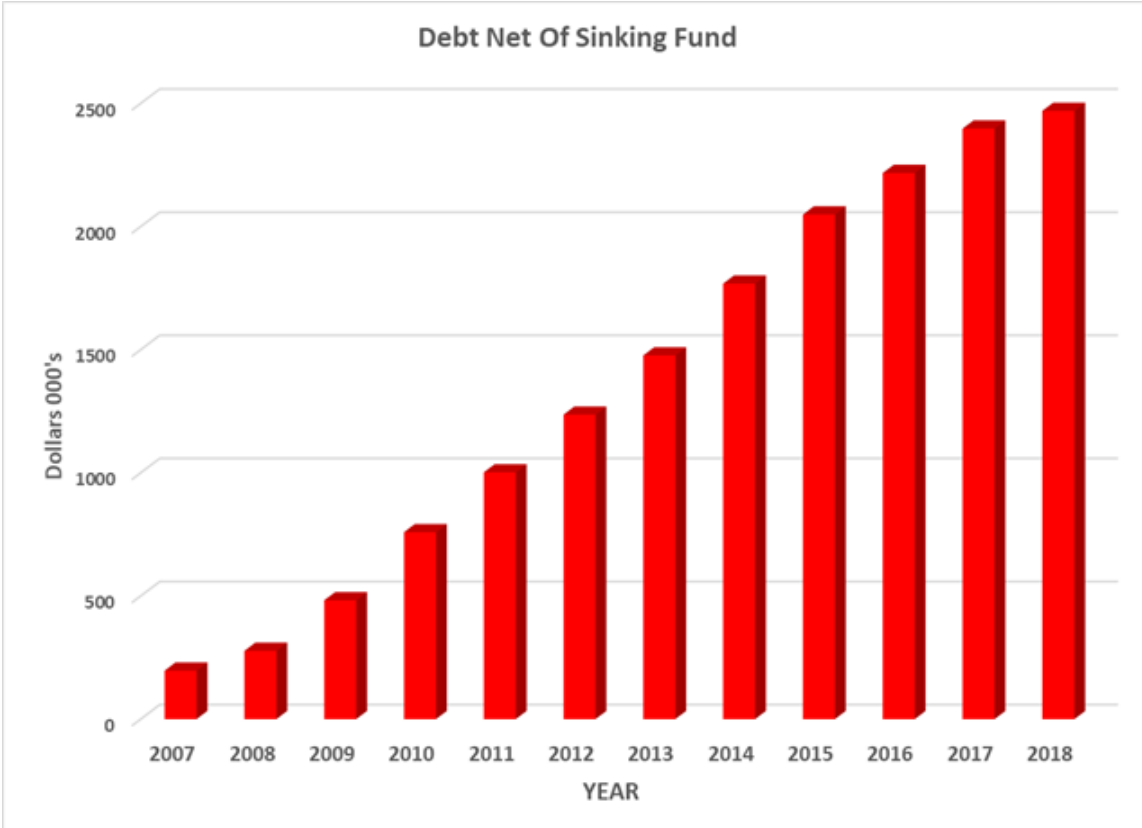
Current global and local economic conditions are improving, but there is still pressure on public finances. Since 2008, the level of national debt has increased sharply and the Government regards persistent growth in debt as a serious challenge. Since 2009, Bermuda has added $1.98 billion to the national debt. At the end of this fiscal year, total net Government debt outstanding will rise to approximately $2.465 billion, which is only $35 million below the current statutory debt ceiling of $2.5 billion.

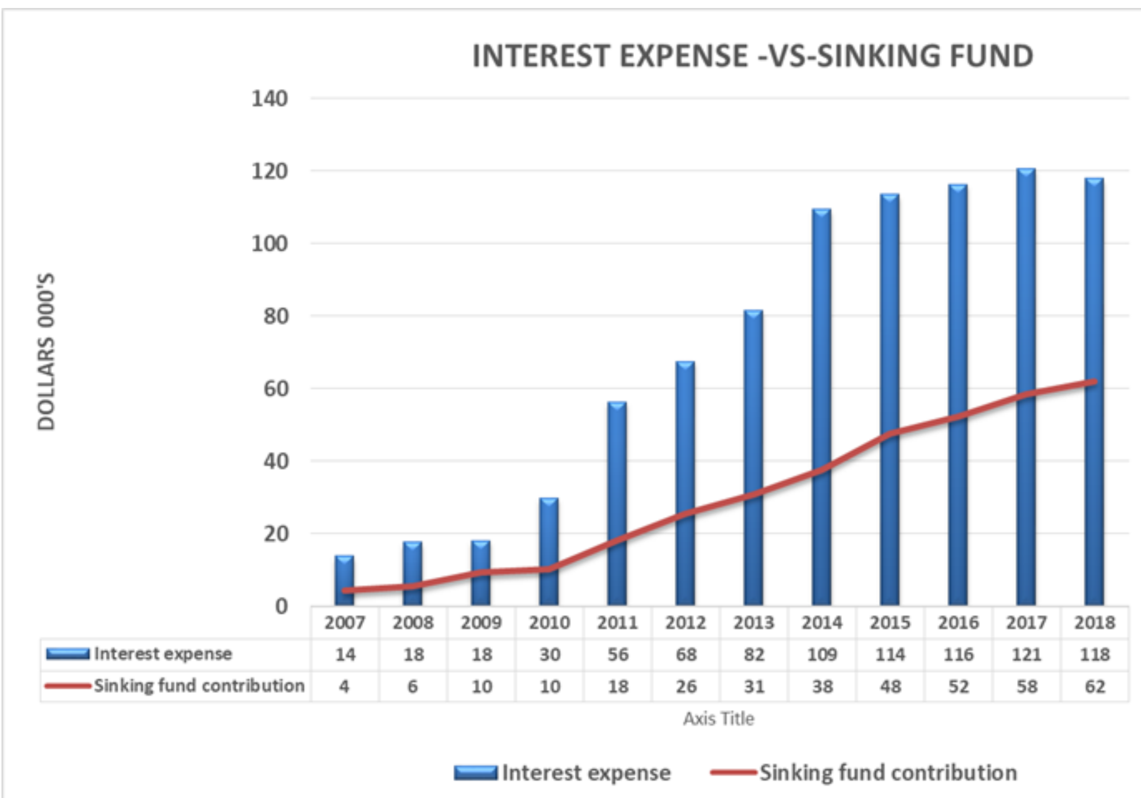
Like most small states and territories, Bermuda's economy is highly vulnerable to external events; the following vulnerabilities are common to many small states and territories including Bermuda:

- A high degree of openness means they are heavily exposed to external shocks in global markets.
- Their narrow resource base and small domestic markets prevent small economies from diversifying into a wide range of activities, making them more vulnerable to terms of trade shocks. When one dominant activity declines, it has an impact throughout the economy, which is the case in Bermuda, where the insurance sector is dominant.
- Government revenues are also volatile.
- Most are vulnerable to natural disasters.
- Capital markets tend to see small states as more risky than larger countries.

The above vulnerabilities underline the need to maintain lower debt levels than larger jurisdictions, but they also point to the urgent need to diversify Bermuda's economy. The annual debt service cost (interest only) is currently $124 million, claiming 11.4 cents of every dollar the government takes in. Some similar jurisdictions facing similar circumstances have been forced by external events to take action to reduce deficits and set out formal rules for limiting deficits and debt.

The Government remains committed to the targets of halting the rise in our net debt by fiscal year 2019/20 and thereafter working to reduce net debt, so as to achieve target ratios for debt and debt service to Government revenues of less than 80% and 10%, respectively. However, it is important to note that it will not be possible to meet those targets without a growing and diversified economy that not only creates balanced economic growth but also benefits all Bermuda residents.


Debt Net Of Sinking Fund
Dollars 000's
2500
2000
1500
1000
500
0
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
YEAR


INTEREST EXPENSE -VS-SINKING FUND
DOLLARS 000'S
140
120
100
80
60
40
20
0

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Interest expense	14	18	18	30	56	68	82	109	114	116	121	118
Sinking fund contribution	4	6	10	10	18	26	31	38	48	52	58	62

Axis Title
Interest expense
Sinking fund contribution

2017/18 Actual Fiscal Review

The total revenue raised by the Consolidated Fund for fiscal year 2017/18, excluding extraordinary revenue of $6.6 million from deferred insurance proceeds taken into income, was approximately $1.063 billion, representing an increase of $74.8 million (7.6%) from fiscal year 2016/17's total recurring revenue of $988 million. This exceeded original budget estimates by approximately $20.4 million (2.0%). The most significant generators of revenues for fiscal year 2017/18 were payroll taxes, accounting for $456.7 million or 42.7% of total revenue (2016/17 – $401.8 million or 39.0%) and customs duty, accounting for $223.0 million or 20.9% (2016/176 – $211.1 million or 20%).

Current expenses for fiscal year 2017/18 were $1.130 billion (2016/17 – $1.2776 billion). The three largest components of current expenses were employee costs, grants and contributions, and interest on debt. Total employee costs were $518.5 million or 45.9% (2016/17 – $525.7 million or 42.9 %) of total expenses. Included in this amount is $65.7 million (2016/17 – $75.9 million) of non-cash retirement benefit expenses. Grants and contributions were $285.3 million or 25.2% (2016/17 – $293.2 million or 23.99%) and interest on debt was $117.9 million or 10.4% (2016/17 – $120.6 million or 9.81%). Total current expenditure (including debt service) on a modified cash basis (on the same basis that is shown in the Budget Book) was $1.073 billion (2016/17 – $1.093 billion), which was $48.9 million less (2016/17 – $30.8 million less) than adjusted budget estimates.

Total capital account cash expenditure was $56.6 million, which was $10.8 million lower than the original budget estimates.

Total capital and current account cash expenditure for 2017/18 was $1.129 billion, which was $47.5 million or 4.1% lower than the original budget estimate of $1.177 billion.

The financial statements of the Consolidated Fund are prepared on the accrual basis of accounting and the all-inclusive results from government operations (both current and capital) for the year ending March 31, 2018 was a deficit of $85.4 million. The modified cash all-inclusive results from government operations (on the same basis that is shown in the Budget Book) was a deficit of $66.5 million. This compares with a deficit of $134.7 million that was originally budgeted. Therefore, the actual overall deficit was down by $68.2 million or 50.6% when compared with the original estimate.

Cash and cash equivalents at the end of fiscal year 2017/18 totalled $20.2 million, which was $75.5 million lower than the balance at the end of 2016/17.

The March 31, 2018 total accounts receivable net of provision for doubtful accounts increased by 14.6% to $179.7 million, compared with $156.8 million at March 31, 2017. The most significant contribution to the accounts receivable balance before provision was $254.6 million from the Office of the Tax Commissioner (OTC), representing an approximate $26.8 million increase in accounts receivable from March 31, 2017 ($227.8 million). The increase in the gross taxes receivable was offset by an increase in the respective allowance for doubtful accounts balance of $3.5 million to $94.1 million in fiscal year 2017/18 from $90.6 million in fiscal year 2016/17. The net accounts receivable balance was 16.8% of revenue for the year (2017 – 15.20%). A significant portion of the gross receivable at March 31, 2018 (57.1 %) represents payroll tax, which was due and payable on April 15, 2018. During the month of April 2018, the Government collected approximately $120.6 million in payroll taxes (April 2017 – $112.0 million). The 2018 allowance for bad debts was $130.5 million, representing a $2 million, or 1.5%, increase from March 31, 2017. The balance of OTC receivables that were over 90 days was $34.5 million as at March 31, 2018.

The closing Net Book Value of Tangible Capital Assets for the year was relatively consistent at $692.8 million (2017 – $698.1 million), a decrease of $5.2 million or 0.75% on the year.

Net Public Debt, which excludes guarantees and is net of the Government Borrowing Sinking Fund, increased by $21.4 million (2016/17 – $179.6 million) during fiscal year 2017/18, standing at $2.419 billion (2017 – $2.397 billion) at the end of the year. This represents a 0.9% increase from 2017. Items of note are as follows:

- On December 14, 2017 the Government entered into a $135 million loan facility with Butterfield Bank (“BNTB”). At March 31, 2018, $85 million of this facility had been drawn on.
- The 2018 Sinking Fund balance was $150.2 million (2017 – $86.6 million). At the close of the year, the available borrowing limit was $81.2 million (2017 – $102.7 million).

Eight-Month Fiscal Performance to November 2018

The headline numbers for the 2018/19 National Budget were: a revenue target of $1.09 billion; current expenditure of $1.12 billion, including debt service; capital expenditure of $62.2 million; and a projected deficit of $89.7 million.

Total revenues for the eight months ending November 2018 are $733.7 million or $29.8 million (4.06%) above November 2017. This is due to higher collection in payroll tax, land tax, international company fees, and stamp duty, offset by lower collections in customs duty and all other receipts.

In general, total revenues are tracking slightly below budget estimates, however the strength in payroll tax receipts increases the chances of meeting the total revenue target of $1.09 billion for the current fiscal year.

Customs duties are currently tracking 3.0% below budget estimates and approximately $2.9 million below receipts that were recorded up to the same period in 2017. This is reasonable, given that: 1) the 2017 America's Cup event resulted in extraordinary increases in customs duty receipts; and 2) the delay in implementing the Sugar Tax, until October 1, 2018, had an impact on customs duty collections. Payroll taxes are tracking 0.34% above budget estimates and are $13 million higher than 2017 receipts.

Current expenditures, excluding debt service, for the period ending November 2018 are $7.0 million higher than in November 2017. Government current account spending to date is higher during this fiscal year, when compared with the same period last year, mainly due to higher salaries and wages as a result of the pay award given to public officers in 2017/18 which was not fully recorded until December 2018, and also higher professional services cost. This was offset partially by decreases in other expenses, grants and contributions and material and supplies.

Overall, current expenditures, excluding debt service, are presently tracking 0.48% or $4.5 million above budget estimates. The $623.9 million spent in the first eight months of 2018/19 represents approximately 67.15% of the total current account budget of $929.1 million.

Capital expenditures for the period ending November 2018 are slightly lower than in November 2017, registering at $34.3 million, which is 56% of the total 2018/19 capital budget allocation of $62.2 million.

Interest expenses are the same as in November 2017 but are expected to decrease going forward (more below). Meanwhile, the Sinking Fund Contribution is $1.4 million higher than in 2017 due to higher debt levels.

Total expenditures for the reporting period were $783.7 million, which was $7.8 million higher than in 2017.

Excluding debt service, the Government recorded a $109.7 million current account surplus for the first eight months of the year. The total deficit was $50.0 million, compared with a deficit of $71.9 million in 2017/18.

As at November 30, 2018, gross debt stood at $2.68 billion. Net of the Sinking Fund, debt is $2.466 billion.

On November 15, 2018, the Government executed an international bond transaction for a total of $620 million. The purpose of this transaction was to: 1) pay off an 18-month $135 million loan facility agreement with Butterfield Bank Limited; 2) finance a portion of the 2018/19 deficit; and 3) refinance more expensive government bonds. As a result of the transaction, the Government has lowered the average rate of interest it pays on the total amount of bonds outstanding from approximately 4.63% to 4.591% and has reduced its interest expenses by about $1 million per year.

The total Government debt stock following this transaction is as follows:

Senior Notes Due 2019 – US$ 100,000,000
Issue Date: May 21, 2009
Interest: 7.38% payable semi-annually
May 21 and November 21
Notes Due: May 21, 2019

Senior Notes Due 2019 – US$ 80,000,000
Issue Date: November 10, 2009
Interest: 5.93% payable semi-annually
November 10 and May 10
Notes Due: November 10, 2019

Senior Notes Due 2022 – US$ 140,000,000
Issue Date: December 4, 2007
Interest: 5.73% payable semi-annually
June 4 and December 4
Notes Due: December 4, 2022

Senior Notes Due 2023 – US$ 475,000,000
Issue Date: July 3, 2012
Interest: 4.138% payable semi-annually
January 3 and July 3
Notes Due: January 3, 2023

Senior Notes Due 2023 – BMD$ 50,000,000
Issue Date: December 16, 2013
Interest: 4.75% payable semi-annually
June 16 and December 16
Notes Due: December 16, 2023

Senior Notes Due 2024 – US$ 550,000,000
Issue Date: August 6, 2013
Interest: 4.854% payable semi-annually
February 6 and August 6
Notes Due: February 6, 2024

Senior Notes Due 2027 – US$ 665,000,000
Issue Date: October 19, 2016
Interest: 3.717% payable semi-annually
January 25 and July 25
Notes Due: January 25, 2027

Senior Notes Due 2029 – US$ 620,000,000
Issue Date: November 15, 2018
Interest: 4.75% payable semi-annually
February 15 and August 15
Notes Due: February 15, 2029

2018/19 BUDGET PERFORMANCE FOR THE MONTH ENDING 30TH NOVEMBER, 2018

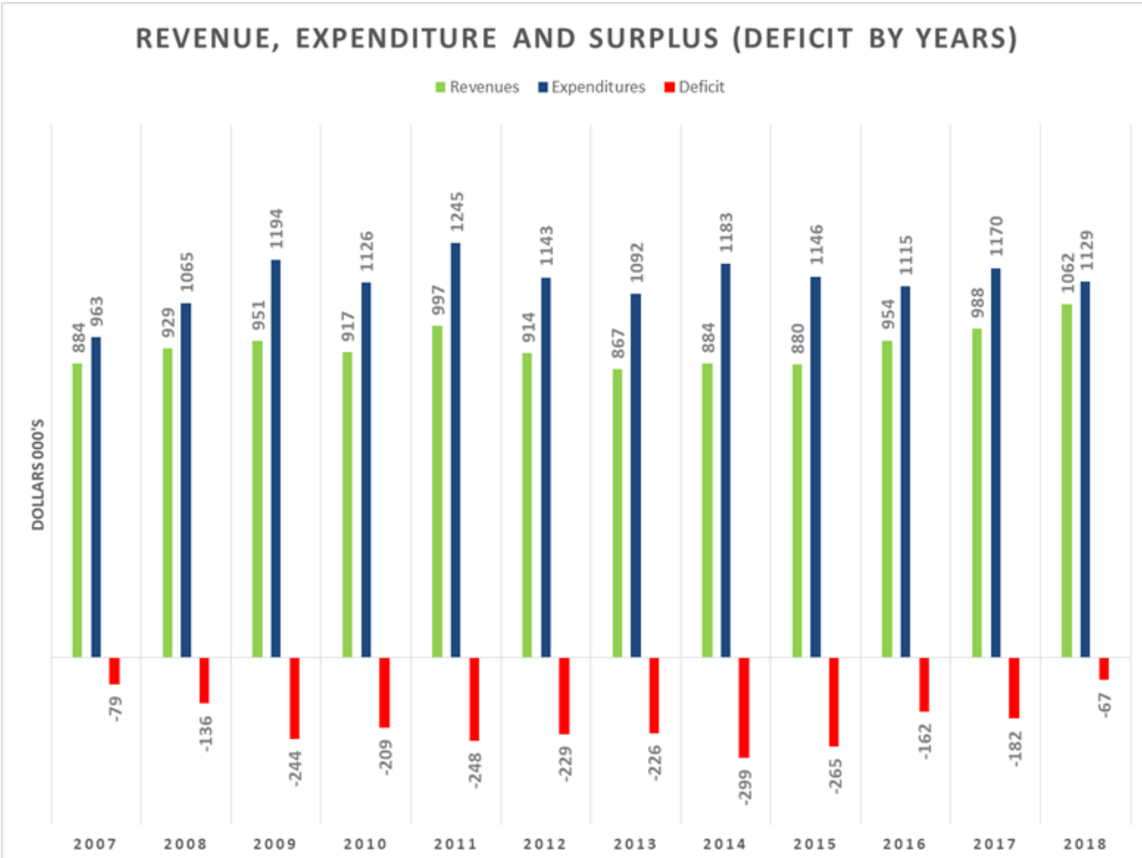
REVENUE

	2018/19 ORIGINAL ESTIMATE $000	NOV 2018/19 $000	NOV 2017/18 $000
CUSTOMS DUTIES	235,000	155,516	158,476
PAYROLL TAX	454,000	345,777	332,788
INTERNATIONAL COMPANIES	64,461	9,012	4,516
FOREIGN CURRENCY PURCHASE TAX	22,000	15,677	15,710
LAND TAX	78,330	41,713	33,827
HOTEL OCCUPANCY TAX	11,000	9,012	8,662
VEHICLE LICENCES & REGISTRATION	30,449	19,229	18,117
PASSENGER TAX	25,000	24,317	22,688
STAMP DUTY	23,000	21,130	18,519
CIVIL AVIATION RECEIPTS	19,850	13,233	12,000
FINANCIAL SERVICES TAX*	8,900	6,872	5,283
TELECOMMUNICATION RECEIPTS	17,950	11,530	10,313
IMMIGRATION RECEIPTS	16,500	10,844	10,550
ALL OTHER RECEIPTS	83,421	49,792	52,429
TOTAL	1,089,861	733,654	703,878

** indicates new tax/fee in 2017/18*

EXPENDITURE

	2018/19 ORIGINAL ESTIMATE $000	NOV 2018/19 $000	NOV 2017/18 $000
Current Account Expenditure	929,134	623,901	616,877
Capital Account Expenditure	62,209	34,286	34,863
Interest on Debt	124,000	82,667	82,667
Sinking Fund Contribution	64,223	42,815	41,390
TOTAL	1,179,566	783,669	775,797
DEFICIT		(50,015)	(71,919)


REVENUE, EXPENDITURE AND SURPLUS (DEFICIT BY YEARS)
Revenues
Expenditures
Deficit
DOLLARS 000'S
884
963
-79
929
1065
-136
951
1194
-244
917
1126
-209
997
1245
-248
914
1143
-229
867
1092
-226
884
1183
-299
880
1146
-265
954
1115
-162
988
1170
-182
1062
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-67
2007
2008
2009
2010
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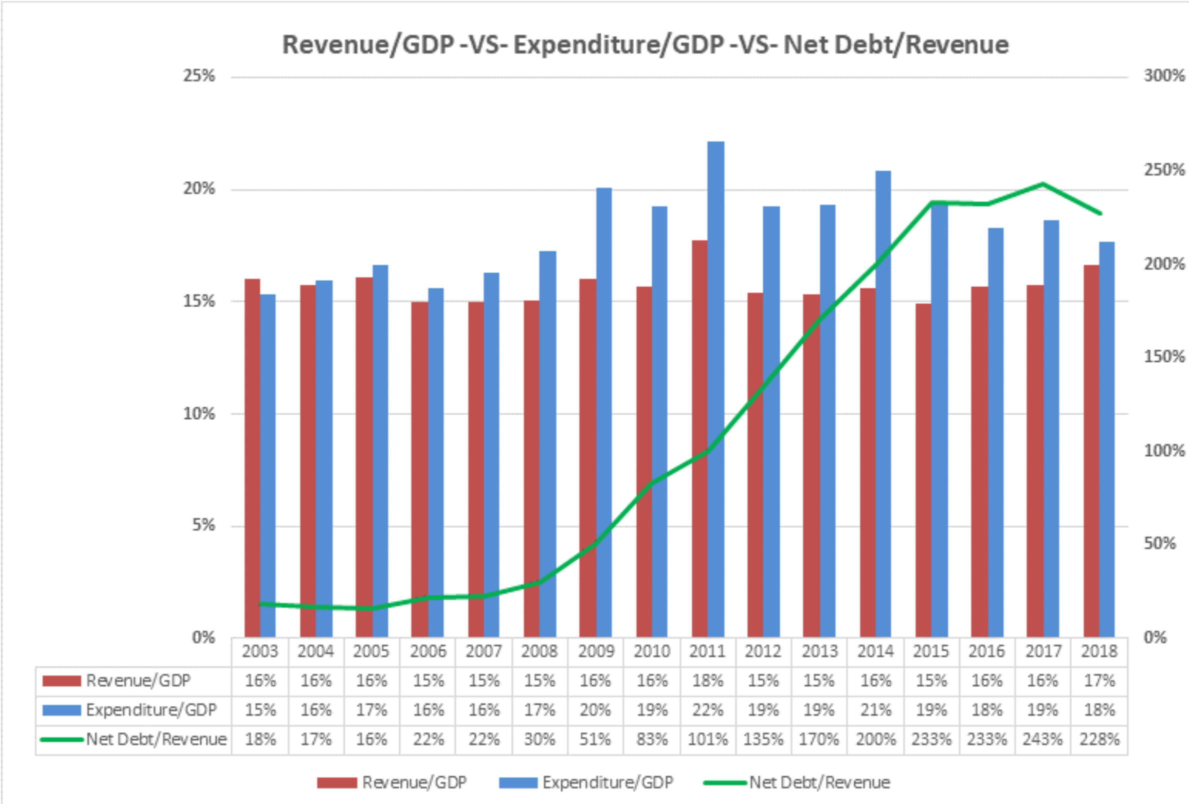
2018



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue/GDP	16%	16%	16%	15%	15%	15%	16%	16%	18%	15%	15%	16%	15%	16%	16%	17%
Expenditure/GDP	15%	16%	17%	16%	16%	17%	20%	19%	22%	19%	19%	21%	19%	18%	19%	18%
Net Debt/Revenue	18%	17%	16%	22%	22%	30%	51%	83%	101%	135%	170%	200%	233%	233%	243%	228%

Chapter 3
The Government's Fiscal Strategy for 2019/20

"In order for Bermuda to succeed, we need to return our economy to a path of balanced growth that creates jobs, provides rising income and assists our budget challenges. It is our belief that a better environment must be created in which Bermudian businesses can thrive, opportunities for Bermudians can be created, and in which capable, qualified Bermudians can earn opportunities to work, train and succeed at every level."

– Progressive Labour Party 2017 Election Platform

"Mr. Speaker, this budget will lay the economic foundation needed to change the economic status quo that has failed so many. It will see us invest in Bermudians, bring fairness to our tax system, scrap outdated policies from the last century which are a barrier to true empowerment, and place Bermuda on a path toward ***economic growth****,* ***economic diversification****, and* ***economic security*** *for all Bermudians."*

– 2018–2019 Budget Statement in Support of the Revenue and Expenditure

Government Policies

Our promise to the people of Bermuda was – and is – to harness the power of Bermuda's economy to produce a fairer, more just society in which economic growth is the engine of success for more of our citizens. We have started that work through the following measures.

Since becoming the ruling party in 2017, the PLP has pursued a multi-pronged strategy to expand the Bermuda economy by focusing on policies designed to create employment opportunities for Bermudians and promote entrepreneurship. To achieve these goals, the Government has begun implementing initiatives to: (i) stimulate domestic and foreign expenditure in the economy through further economic liberalisation, targeted investment strategies and diversification of business development initiatives; (ii) continue supporting successful industries, while adhering to fiscally responsible policies through a balanced, long-term growth agenda; and (iii) promote economic equality through socially targeted investment strategies.

Stimulating Investment in the Economy through Further Liberalisation, Targeted Investment Strategies and Diversification of Business Development Initiatives

- *Focusing on Keeping Bermudian Investments in Bermuda and Increasing Foreign Direct Investment.* The Bermuda Monetary Authority (the BMA) indicated that over the last 10 years, $3 billion earned in Bermuda has been reinvested in foreign economies. In an effort to incentivise the retention of these funds in Bermuda, the Government has recently focused on stimulating local investment while adapting to the realities of a global and technology-driven economic landscape. The Bermuda Business Development Agency (the BDA) has carried out strategic overseas business development meetings to increase the total number of international companies establishing operations in or doing business from Bermuda, while simultaneously implementing proactive, targeted marketing and business development strategies locally to stimulate job retention and growth in the international business and professional services sectors. Additionally, the Government announced in the 2018/19 Budget Statement that we will welcome global law firms to Bermuda. The presence of international law firms will generally benefit the economy and employment prospects of Bermudians as well as enhance the national brand. Once curtailed by broadened risk mitigation strategies in the wake of the global financial crisis, the banking sector presents another area of growth potential.
- *Establishment of a New Banking Licence Designed to Provide Financial Technology (FinTech) Companies with Access to Traditional Banking and Growth Opportunities*. The Ministry of Finance has consulted with the BMA to coordinate policy measures and initiatives designed to expand the number of banks operating in Bermuda servicing growth markets such as FinTech, in particular those companies involved in initial coin offerings (ICOs), digital assets and virtual currencies. In July 2018, the Minister of Finance introduced the Banks and Deposit Companies Amendment Act 2018 (the Restricted Banks Act), which extends the existing bank licensing framework under the Banks and Deposit Companies Act 1999 to establish a new banking licence that will encourage banks to service the needs of the FinTech sector. The Restricted Banks Act aims to ensure that FinTech companies are granted access to the traditional banking sector while addressing Bermuda-based banks' reluctance to enter the ICO, digital assets and virtual currency markets based on an ongoing need for risk management. In October 2018, the Government awarded its first ICO certification under its new regulatory regime to a US-based FinTech company, strengthening its reputation as a highly desirable regulatory jurisdiction.
- *Curtailing Financial Regulation that Hinders Economic Growth Opportunities for International Businesses.* Bermuda has long been a jurisdiction of choice for international businesses. The Government has a history of adopting legislation to make Bermuda more attractive to entrepreneurs, developers and companies seeking to establish residence in Bermuda, including a current plan to relax the Companies Act's protectionist business ownership and control requirements, known as the 60/40 Rule. To this end, the Government is working to adopt a

more flexible approach to applications by local companies that seek exemption from the 60/40 Rule.

- *Focusing on Long-Term Economic and Social Health through the Government's "Bermuda First" Advisory Group.* On October 26, 2017, the Premier announced the "Bermuda First" advisory group, a commission born from the PLP's platform for its first 100 days in office and consisting of local and international business and community leaders working to develop a long-term economic and social plan for Bermuda. The main objective of the advisory group is to identify opportunities for economic expansion through new and emerging industries and technologies, and assist the Government in developing a balanced long-term economic growth strategy. The group has been provided with an operating budget to conduct research and prepare policy recommendations.
- The Government intends to take forward the work of the **Bi-partisan Committee on Immigration Reform** to ensure that the rights of Bermudians are advanced and protected, while recognising the need to grow the economy with balanced work permit and residential policies. This bi-partisan committee is building on the principles outlined in the October 2017 report from the Immigration Working Group.
- A new **Bermuda Infrastructure Fund** has been established that is intended to channel private sector investment into Bermuda's infrastructure assets. The Government has agreed to underwrite the management fee. Possible projects range from energy and sewage to commercial and residential property.

Framing the 2019/20 Budget

As mentioned in the risk section included in this report, the country is facing a number of risks to our economy. Of all the risks highlighted, the potential EU action to blacklist Bermuda as a "non-co-operative" tax jurisdiction under the EU Code of Conduct is perhaps the most significant risk to Bermuda's international business sector and to Bermuda's economy in recent memory. To manage this risk, the Government has implemented reforms and on December 17, 2018, the Economic Substance Act 2018 was passed by Parliament. The purpose of this legislation and accompanying legislation is to ensure that Bermuda remains off any EU list of non-compliant jurisdictions and will continue to thrive as an international business centre.

This was only the first phase in managing this risk and there is still much work to do to ensure our economic security. The Government will continue to work with our industry stakeholders to obtain the best outcome for the country. There is no doubt that this event has inserted a level of uncertainty in our budget preparation, especially in the forecasting of our revenues.

Other key factors which have impacted upon the framing and composition of the 2018/19 budget include economic considerations, taxation sensitivities, continuing deficits and high debt levels, the debt ceiling and the implementation of the Government's fiscal strategy to halt the rise of our debt by 2019/20.

Taxation sensitivities relate to the perception by taxpayers of the weight of the existing tax burden and their willingness to absorb further tax rate increases. The 2018/19 budget presented by the Government featured a $47.5 million (4.6%) increase in revenues. There is still an immediate need for additional revenue and the Ministry proposes to increase annual revenues by $50 million in 2019/20 as laid out in the 2018/19 budget. The Government established a Tax Reform Commission (TRC) to review our tax system and present recommendations to the Minister with their report received in November 2018. The Ministry is currently evaluating all recommendations and considering which recommendations can be included in the 2019/20 budget.

Controlling public sector expenditure remains a focus of the Government. While there has been some success in cutting costs, it has become increasingly difficult to implement further reductions under the current Government structure and the across-the-board expenditure cuts in previous budgets.

The Government's 2017 Election Platform called for increased Government efficiency in order to control Government expenditure, rather than across-the-board cuts. To this end, the Government established an Efficiency Committee (EC) to review the functioning of all government departments and recommend improvements in the efficiency of operations. The EC presented its report to the Minister in September 2018 and has highlighted how savings and greater effectiveness can be obtained by the government in the areas of financial assistance, purchasing of materials, inventory management, and handling of staff vacancies. Looking forward, the EC also emphasised the importance of developing a detailed overall strategic plan to guide spending priorities of the government over the medium to long term as critical.

The Government has already implemented some of the recommendations of the EC and is carefully considering and quantifying others in advance of the 2019/20 budget cycle.

The Government has already taken a different approach to improving efficiency by moving resources to priority areas and looking for ways to improve efficiency across government, in particular by seeking to develop effective and linked-up IT systems.

In order to meet the objectives of providing targeted investments to grow and diversify Bermuda's economy, educate our children, provide health care and security for our citizens and assistance to the less fortunate among us, the Government proposes to set the total current account appropriation, less debt service, at approximately $929 million. This amount is equal to the budgeted expenditure that was approved for the current 2018/19 fiscal year. **(Total current expenditure will remain unchanged.)**

The Government remains committed to balancing the budget. However, if unrealistic targets are established and not met, this undermines the credibility of the Government pertaining to public commitments on cost control. Actual comparable current account expenditure for the last five years is as follows:

Fiscal Year	2013	2014	2015	2016	2017	2018
Current Expenditure (in BD$ millions)	998.8	970.9	935.1	902.2	914.3	892.9*
Percentage change		(2.8)%	(3.7)%	(3.5)%	1.3%	(2.3)%

** Includes one-off $25 million reduction in Bermuda Hospital Board Subsidy and the Government's pay award to public officers, which cost the Government approximately $9 million.*

It is also critical that we maintain and strengthen our infrastructure and stimulate economic activity, therefore the Government plans to set capital expenditure at a prudent level of $60–$65 million.

The Government's intention is to target a total deficit in 2019/20 of $30–$40 million. As this deficit is less than the contribution to the Sinking Fund (estimated at $67 million), net debt will begin to decrease in 2019/20. This is an important milestone and will be the first time since 2004 that net debt will be reduced. The Government's fiscal projections for the 2019/20 budget were laid out in the 2018/19 budget and are as follows:

	ESTIMATE 2018/19 $000	ESTIMATE 2019/20 $000
Revenue and Expenditure Estimates		
Revenue	1,089,861	1,139,967
Current Account Expenditure (excl. debt & s/fund)	(929,134)	(929,134)
Current Account Balance (excl. debt & s/fund)	160,727	210,833
Interest on Debt	(124,000)	115,000
	36,727	95,833
Sinking Fund Contribution	(64,223)	(67,000)
Surplus (Deficit) Available for Capital Expenditure	(27,496)	28,833
Capital Expenditure	(62,209)	(60,000)
Budget Surplus (Deficit)	(89,705)	(31,167)

Policy Options Under Consideration for 2019/20 Budget

The following are **considerations** for inclusion in next year's budget. One of the main objectives of a pre-budget statement is to provide a document that elicits discussion from stakeholders. Prior to finalising the budget, the Government will hold public forums and meetings with stakeholders and discuss the ideas outlined below.

In the 2017 Throne Speech, this Government committed to creating a Tax Reform Commission. As a result, the TRC was formed under the Tax Reform Commission Act 2017. The purpose of the TRC was to conduct a review of Bermuda's system of taxation and revenue collection and make recommendations on tax reform to Parliament.

More specifically, the TRC was given the following mandate by the Minister of Finance:

- Examine Bermuda's tax system and determine any measures that may be taken to best enable a system of taxation and revenue collection that is equitable, effective, efficient, competitive and transparent.
- Increase public sector revenue yield from 17% of GDP to a minimum of 20%–22% of GDP.
- Prepare and submit a report and recommendations in accordance with section 7 of the Tax Reform Act.

A seven-member team was assembled in order for the TRC to be able to carry out its duties and their report was published on November 17, 2018.

The TRC determined that if the proposed tax policy recommendations, which include suggestions for both tax increases and tax cuts, are implemented, an additional yield of approximately $147 million could be generated over the next 2–3-year period, increasing government revenue to approximately $1.26 billion (20% of GDP) by 2020, compared with 17% of GDP in 2017.

The full suite of recommendations is as follows:

Summary of Tax Policy Recommendations of Tax Reform Commission

Proposed New Taxes

Description of Tax	Intent of Measure	Impact	Revenue Projection 2020/21 ($)	Time Frame
Commercial and Residential Rental Tax	Progressive tax based on Annual Rental Value (ARV)	Property owners	41m	Within 12 months
General Services Tax	Flat tax based on value of local services	Final user	27.5m	Within 24 months
Withholding Tax – Managed Services	Flat tax based on overseas services provided locally	Companies	27.5m	Within 12 months
Withholding Tax – Dividend & Interest	Flat tax on value of dividends/interest	Recipient	2.5m	Within 24 months

Proposed Reforms to Existing Taxes

Description of Tax	Intent of Measure	Impact	Revenue Change by 2020/21	Time Frame
Payroll Tax	Eliminate rate for $48k and under	Employee earnings	($24m)	Within 12 months
	Provide relief by lowering rates	Reduction in payroll cost		
Tax on Owner-Manager Declared Dividend	Dividends for owner-managers in scope of payroll tax	Owner-managers	$15m	Within 12 months
Customs Duty	Reduce cost of staple items and clothing	Final users	($2.1m)	Within 12 months
Excise Tax	Increase excise tax on wine			
Land Tax	Restructure land tax	Property owners	($10.1m)	Within 12 months
Financial Services Banks and Insurers	Generate additional revenue from bank and insurance fees	Financial services firms and customers	$6.1m	Within 12 months
Foreign Currency Purchase Tax	Increase rate to 1.75%	Individuals and companies	$16.5m	Within 12 months
International Company Fees	Align fees with a company's assessed capital by increasing the number of bands	Companies	$25.5m	Within 12 months
Immigration Fees	Generate more revenue	Companies	$3.5m	

- **A “rental income tax”** (actually a property tax, applied as a flat percentage of ARV for properties used primarily for rent as opposed to owner-occupation). This would cover, for example, residential properties whose primary function was for rentals to tourists or international business employees.
- **A new GST of 5%.** This would apply to “non-essential” services, including catering, insurance, vehicle repair, air tickets and so on.
- **A Managed Services Tax of 7.5% on (mostly professional) services purchased from abroad**. This is to be levied as a “withholding tax”.
- **A withholding tax on locally generated dividends and interest**.
- **Substantial increases in the foreign currency purchase tax**.
- **Increases in registration fees for larger foreign companies.**
- **Increases to financial services taxes, including bank and insurance fees.**
- **Reforms to the payroll tax to make it somewhat more progressive, both at the company and the individual level.**
- **Changes to the structure of customs duties, with reductions in duties on food and clothing and increases in alcohol duties.**

As the Ministry of Finance team works to develop the Government’s budget for 2019/20, we have been guided in our consideration of the TRC’s recommendations by the following:

- The solution requires fiscal discipline by our Government where we properly prioritise our needs and our wants.
- We are striving for a balanced approach – we are looking at incremental sources of revenue while at the same time seeking opportunities to make Government more efficient.
- We will seek to understand the impacts of any change in taxes on the broader economy. We accept and understand the axiom that taxpayers do not want to pay any more tax than they have to and their general unwillingness to absorb further tax increases.
- We will focus on better collection and enforcement of taxes that are already on the books.
- We will employ a consultative approach.

Payroll Tax

In 2018/19, the Government made a number of reforms and new concessions to the payroll tax structure. Some of the changes made were as follows:

- provided tax reductions to those earning less than $96,000;
- provided payroll tax concessions for: employers who hired persons with disabilities; new small business entrepreneurs; and taxi operators.

The most significant change to the payroll tax regime provided for in the Payroll Tax Amendment Act 2018 was to address the so-called concept of notional remuneration, which has been a source of concern for many years.

In order to simplify the legislation and ensure that everyone pays their fair share of taxes, the concept of notionals was repealed and, effective April 1, 2018, deemed employees and self-employed persons were made subject to payroll tax on their actual remuneration, which includes dividends or any other form of profit distribution.

In the 2018–2019 Budget Statement, it was also announced that this Government wants local and international companies to create and move jobs to Bermuda. To this end, the Ministry of Finance worked with key business stakeholders to generate incentives for companies to create and locate additional staff in Bermuda by providing payroll tax relief for new positions created in Bermuda.

Economic Substance Incentives Programme

As announced already, in the upcoming budget the Government will extend this relief for exempted companies as part of our Economic Substance Incentives Programme. This programme will provide a two-year employer payroll tax concession for additional jobs created in Bermuda.

The retail industry employs nearly 3,500 Bermudians and the Government is very much aware of the pressure on certain segments of this sector. In an effort to maintain and increase employment levels in this sector, the Government is considering providing some form of targeted payroll tax relief to specified businesses in this sector whose annual payrolls are greater than $1 million.

The TRC has proposed various other payroll tax recommendations, however due to uncertainties in other revenue projections, at this time, Government is not contemplating that any rates will be amended.

Customs Duty

The following are the changes to customs duty currently under consideration by the Government:

- The Speech from the Throne on September 8, 2017 formally introduced the policy for a **Sugar Tax**. The Speech stated: *"…the Government will begin consultation for the introduction of a Sugar Tax on the sale of certain foods and beverages in Bermuda."* In 2018/19, the Sugar Tax was partially implemented. It is proposed to fully implement the Sugar Tax as an increase in the rate of duty on a limited group of items.
- To reduce the cost of certain essential foods and goods, the Ministry of Finance is considering duty relief on certain items.

Financial Service Tax

In the 2017/18 budget, the former Government enacted the Financial Services Tax Act 2017. This act introduced a financial services tax on insurance premiums, excluding health, money transmissions of a money service business and bank assets. In line with the recommendations in the TRC report, it is proposed to increase the financial services fee on banks and insurance premiums to generate additional revenue. The increased fee on insurance premiums will be the obligation of the insurer.

Foreign Currency Purchase Tax (FCPT)

As a revenue-raising measure, it is proposed to increase the FCPT from 1% to between 1.25% and 1.75%.

Land Tax

In the 2018/19 Budget Statement, it was announced that the Government would not introduce a new tax on commercial rents, but rather – as a temporary measure – it will increase land tax rates on commercial properties by 5% to yield an additional $15 million in land taxes. This temporary increase generated additional revenue while the TRC looked at commercial rents and the income earned from commercial properties whose income is not currently subject to taxation. This provision expires on June 30, 2019 and the legislation provides for the rates to revert back to 7%.

It is proposed to increase commercial and tourist properties land tax rates from 7% to 8% and 7.5%, respectively.

It is also proposed to amend the land tax rate structure for residential properties by increasing the taxes for properties with an ARV of under $22,000, noting that property owners with units valued under $22,000 currently pay a maximum land tax of $286 per year compared with the average of $1,116.

The Government is considering implementing a recommendation from the 1999 Report of the Bermuda Tax System to tax vacant land. Taxes on vacant land raise the opportunity cost of holding land for speculative and other purposes and can encourage the land to be converted to its best use.

Commercial and Residential Rents

Some Bermudians have enjoyed the benefits of international business's continued presence in Bermuda and collect commercial and residential rents from their properties across the island. In order to broaden the tax base, the Government is considering taxing commercial and residual rents in line with the recommendation of the TRC report. The tax will be charged on persons who rent out commercial and residential properties for rental income. Initially, it is proposed that the tax will be charged on the ARV of the property and that certain criteria will apply. There may also be exemptions for certain areas such as the Economic Empowering Zones.

Managed Service Tax

In line with the TRC report, the Government is considering levying a tax on professional services provided by non-Bermudian businesses to local and international companies.

Based on government statistics, there are significant financial and other services which are imported. These mainly comprise services which could be rendered by local firms. It is proposed that a withholding tax be applied to these services.

It is more likely than not that these services will continue to be imported for a variety of reasons including: (a) a preference to continue to work with existing service providers; (b) onshore fees still provide cost arbitrage after the tax; or (c) some services are not offered in Bermuda.

These services are a direct substitute for services that could be provided locally and this has resulted in a loss of tax revenue through payroll tax and loss of economic activity.

Tax Collection and Accounts Receivable

Tax collection and accounts receivable have been a considerable problem for the Government for years and it is time to take corrective action.

In the last PBR, we stated: "The Government will ensure that the Office of the Tax Commissioner (OTC) has the resources that it needs to collect taxes that are due. Due to staffing shortages, not all taxes are being collected and adjudicated. The Government has authorised the filling of these long-vacant posts to assist in revenue collection."

As mentioned in the latest Fiscal Responsibility Report, this item has been actioned and has already proven productive in 2018 as previously unpaid stamp duties of almost $3 million have been collected and an additional $4.7 million in uncollected stamp duties have been identified.

We have taken further action to resolve this problem by adding five new temporary additional staff members for a one-year period. These staff members will be working in the operations section, with four in the Debt Management section and one working closely with the Assistant Tax Commissioner–Operations. These additional resources for tax collection and enforcement should pay for themselves many times over with the additional revenue collected during this period.

We can also report that a recent mission by CARTAC proposed a reform and modernisation implementation plan for the OTC, outlining reform priorities with a view to executing such plans in the short, medium, and long term. An important part of the reforms will be the selection and implementation of a commercial off-the-shelf technology solution to support the operations of the tax administration. Work is ongoing on these initiatives.

The Government has also taken additional action by looking at all accounts that are listed as "provision for bad debt". This report is currently being finalised and those accounts that are deemed collectible and do not have payment plans in place will be handed over for the Debt Enforcement Unit in the Attorney General's Chambers to take action.

As mentioned in last year's PBR, the Government is considering implementing a tax amnesty programme. The proposed amnesty would provide eligible taxpayers with a defined timeline to settle the total amount due in return for forgiveness of the late penalties that have been assessed as part of long-outstanding tax bills.

The Government emphasises that the policy options listed above are for discussion purposes and that no decisions on any of the above for the 2019/20 budget have been made. During the month of January, the Government will hold public meetings on the above policy options to encourage public debate and discussion on the priorities for the 2019/20 budget. The Government welcomes feedback on this report, as we look to involve as many as possible in the Open Budgeting Process.

Historical Economic and Fiscal Information

As of or for fiscal year ended March 31 (except as specified)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
	(dollars in millions, except ratios and GDP per capita)									
Bermuda's economic data										
Nominal GDP	5,938.90	5,855.30	5,620.40	5,585.40	5,670.10	5,699.90	5,927.60	6,127.30	6,269.38	6,394.77
Nominal GDP growth (%)	-3.9%	-1.41%	-4.0%	-0.6%	1.5%	0.5%	3.9%	3.4%	2.9%	2.0%
Population	64,395	64,129	63,193	62,408	61,954	61,777	61,735	61,695	61,695	63,973
Population growth	0.3%	-0.4%	-1.5%	-1.2%	-0.7%	-0.3%	-0.1%	-0.1%	0.0%	0.1%
GDP per capita	90,168	91,305	88,940	89,498	91,521	92,266	96,017	99,316	101,619	99,960
Inflation	1.8%	2.4%	2.7%	2.4%	1.8%	2.0%	1.5%	1.5%	1.9%	1.8%
Real GDP growth (%)	-5.9%	-2.5%	-4.4%	-4.0%	-2.0%	-0.3%	0.6%	-0.1%	2.5%	1.5%
Unemployment	4.5%	7.0%	6.0%	8.0%	7.0%	9.0%	7.0%	6.0%	6.0%	6.0%
Government profit and loss data										
Revenues	950.8	917.3	996.7	914.2	866.6	883.9	880.4	953.6	988.0	1,062.8
Expenditures	1,194.30	1,126.40	1,245.10	1,142.80	1,092.45	1,183.30	1,145.80	1,115.30	1,169.80	1,129.30
Surplus (deficit)	-243.5	-209.1	-248.4	-228.6	-225.9	-299.4	-265.4	-161.7	-181.8	-66.5
Interest expense	18.2	29.9	56.3	67.6	81.6	109.4	113.5	116.3	120.7	117.7
Sinking fund contributior	9.5	10.3	18.3	25.7	30.8	37.6	47.7	52.3	58.4	62.1
Government balance sheet data										
Total debt	562.2	823.4	1,087.5	1,351.0	1,574.0	2,305.0	2,185.0	2,335.0	2,484.0	2,568.9
Sinking Fund balance	79.8	64.5	85.5	114.7	97.1	536.6	135.8	117.3	86.0	150.2
Net debt	482.4	758.9	1,002.0	1,236.3	1,476.9	1,768.4	2,049.2	2,217.7	2,398.0	2,434.0
Guarantees	0.8	210.8	210.8	207.3	278.6	514.4	700.1	698.1	508.1	533.5
Government cash flow data										
Capital expenditures	200.3	125.1	121.0	59.5	63.5	65.4	49.8	43.7	77.6	56.6
Loan proceeds	217.2	261.2	264	264	223	731	-120	150	149	85
Increase in sinking fund	12	-15.3	21	29.2	-17.6	439.5	-400.8	-18.5	-31.3	64.2
Net increase in debt	205.2	276.5	243.1	234.3	240.6	291.5	280.8	168.5	180.3	20.7
Government financial ratio data										
Debt service ratio	2.9%	4.4%	7.5%	10.2%	13.0%	16.6%	18.3%	17.7%	18.1%	16.9%
Net debt/GDP	8.1%	13.0%	17.8%	22.1%	26.0%	31.0%	34.6%	37.4%	39.1%	37.8%
Surplus (Deficit)/GDP	-4.1%	-3.6%	-4.4%	-4.1%	-4.0%	-5.3%	-4.5%	-2.6%	-2.9%	-1.0%

Chapter 4
Unfunded Liabilities

Making our Pension Plans Sustainable

In their recent report, the Fiscal Responsibility Panel noted the following:

Tackling unfunded pension liabilities. Currently, the territory's public sector pension schemes for its employees have an unfunded liability of around $1 billion. Unless tackled, this will be a burden on future budgets. In addition, the Contributory Pension Fund also has very large unfunded liabilities. It is inconceivable that the Government would allow it to fail. Accordingly, *debt reduction needs to be complemented by actions to address these deficits*. Actions that could reduce the need for sharply increased contribution rates include raising the retirement age (which would also mitigate the expected decline in the workforce); and, for public sector employees, basing pensions on the average of salaries over a five-year period and actuarial pension reductions for early retirees.

Owing to the risk that these unfunded liabilities present to the Government, we recognise that it is fiscally prudent for us to adequately fund and to plan for these, albeit long-term, obligations and maintain the funding ratio at an acceptable long-term target level. However, it is important to note that to achieve sustainable solvency, it is not necessary that all accrued benefits be fully funded.

It is important for the public to know that the Government is sensitive to the challenges facing pension plans of this nature and has already taken appropriate steps to preserve the long-term financial viability of the fund. For example, the following actions have been taken over the years in order to improve the sustainability of the Public Service Superannuation Fund (PSSF):

- In 2006–2008, PSSF contribution rates were increased from 5% to 8% and 9.5% for regular members and uniformed officers, respectively. The increase in contributions resulted in an improvement in the cash position of the PSSF.
- In June 2014, the automatic Cost of Living Adjustment (COLA) increases were suspended for pensioners until such time as the sustainability of the PSSF has been improved. The COLA provision added about 23% to the PSSF liabilities and this change improved the sustainability of the fund.

Despite these actions, the PSSF remains underfunded and there are no simple remedies to resolve the underfunded position of the plan. To assist with the review of this pension plan, a Pension and Benefits Working Group (PBWG) was established by the former administration. The purpose of the PBWG was to review all public sector pension plans, and make recommendations to the Minister of Finance and to Cabinet in order to ensure the sustainability of these plans and benefits in a manner that is responsible and fair to both the pensioners and members of the plans and Bermuda taxpayers. Following this review, the PBWG proposed the following changes to the plan:

- Change the final average earnings (FAE) definition from "the salary payable to him immediately preceding the date of his retirement" to an average of his earnings over the five years preceding his date of retirement (or termination).
- Increase the age at which an unreduced pension is payable from 60 to 65 (55 to 60 for special groups).
- Apply actuarial reductions on early retirement prior to age 65 (60).
- Increase contributions.

Finally, this Government has also decided to explore the option of increasing the retirement age on a voluntary basis to 67 and assess the impact that this action would have on the plan.

The Ministry of Finance has engaged the Government's actuary of record to consider the impact that the above-mentioned changes to the plan would have on the long-term sustainability of the fund. This engagement has been completed and is currently being reviewed by the Ministry and the PBWG.

As per this Government's normal custom and practice, the appropriate consultation with the various stakeholders, specifically the public sector unions, will be conducted before any changes are made to the provisions of the plan.

The Contributory Pension Fund is also in an unfunded position and, as for the PSSF, the Government will take the appropriate steps to enhance the benefits paid from the scheme as well as ensure that the fund has the ongoing ability to pay for such benefits.

The Contributory Pension Fund in principle relies on current contributors or workers paying for current pensioners and for the most part is a Pay-As-You-Go financed plan. However, the policy of increasing contribution rates by 2.5% above the rate of pension increases has allowed a significant level of fund to build up and thus the plan is partially funded, which provides further security of benefits.

As at September 30, 2018, the fund had total assets of over $1.9 billion, representing approximately 11.7 times the annual value of benefits paid in the 2017/18 fiscal year; this is a relatively high level of funding.

The 2014 actuarial report of the fund indicated that the viability of the fund in the short to medium term is good, with the fund being positive for the next 25 years. However, recognising the long-term challenges of the fund, the Ministry will continue to closely monitor its performance. The next actuarial report for the CPF is due for the period August 1, 2017 and is currently underway. This report will be tabled in the legislature as soon as it is completed. Following this review, the Ministry will propose changes to the fund to ensure its sustainability in the long term.

Chapter 5
Conclusion

Commitment to Budget Transparency

This PBR represents a step forward in the preparation of budgets and the formulation of budget policy in Bermuda. To meet international best practice for budget transparency, the International Budget Partnership recommends that governments publish eight budget reports during the budget cycle. The documents and the governments' commitments are below:

1. **Pre-budget Report:** This document is the Government's second PBR. It is recommended that this document be issued at least one month prior to the Budget Statement to allow adequate time for public feedback to assist in budget policy formulation.
2. **Budget Statement:** The Government issues budget statements annually. This practice is a matter of custom and will continue.
3. **Citizens' Budget:** A Citizens' Budget is a non-technical presentation that "can take many forms but its distinguishing feature is that it is designed to reach and be understood by as large a segment of the population as possible". A Citizens' Budget is a simplified summary of the budget designed to facilitate discussion. The Government has issued a guide to the budget in the past and will issue this document with the 2019/20 Budget Statement.
4. **Enacted Budget:** The Enacted Budget is the appropriations bill which is passed by the legislature annually, as required by the Bermuda Constitution.
5. **In-year Reports:** The Government currently issues quarterly fiscal performance reports and will continue to do so.
6. **Mid-year Review:** The Government currently issues a Mid-year Review and will continue to do so.
7. **Year-end Report:** The Government does issue financial statements once they have been audited as per the Bermuda Constitution. The Government also provides highlights of the financial statements by way of a ministerial statement in the House of Assembly. The Government commits to developing and releasing a more comprehensive report by way of a Financial Statement Discussion and Analysis document at the same time as its annual financial statements.
8. **Audit Report:** The Auditor General currently issues an Audit Report annually.

It is the aim of the Government to provide all of these reports during the coming budget cycle and 2019/20 fiscal year. In publishing this document and conforming to international standards of budget transparency, this Government reaffirms its commitment to good governance.

Feedback

The Government invites and welcomes feedback on this document. In addition to electronic communication, the Government will hold public meetings in January 2019 to discuss the principles laid out in this document and to solicit public feedback.

Comments can be emailed to: openbudget@gov.bm

GOVERNMENT OF BERMUDA

Ministry of Finance