



REPLY TO THE BUDGET *2019/20*

Delivered by

Senator Nick Kempe
Shadow Minister of Finance

1 March 2019



One Bermuda Alliance

INTRO

Mr. Speaker, the One Bermuda Alliance believes that cultivating attitudes of acceptance and tolerance, recognising that Bermuda's strength resides in its plurality and building on our status as a part of the global economy are the keys to economic growth. Furthermore, we believe that improving standards in education as well as providing mechanisms to anchor job creators to Bermuda together with facilitating resident savings to be deployed in the local economy are fundamental to ensuring that growth is inclusive and sustainable.

CONTEXT AND CHALLENGES

Bermuda faces a number of systemic economic challenges, many of which every Finance Minister has had to grapple with for the last 15 years:

- external impacts,
- our accumulated debt and the related repayment costs,
- ongoing annual deficits (Government overspending),
- an antiquated immigration system,
- the rising cost of healthcare,
- an ageing population,
- shifting hostile global compliance standards, and
- a narrow economic tax base.

This Government and those before it have a somewhat limited toolkit with which to tackle these challenges. Those tools consist primarily of taxation, management of Government spending as well as legislation and policy.

EXTERNAL CONTEXT

Bermuda's economy is one of the most open in the world. As such, we are widely exposed to external shocks. Bermuda's longstanding comparative tax advantage with the United States was affected when the US lowered its corporate tax rate for tax years beginning from January 1st, 2018. Our relatively high cost of living was never enough to off-set the comparative tax advantage for businesses operating from our shores. Whilst the combined federal and state US corporate tax rate dropping from 40 to 24.9 percent has not noticeably impacted our re-insurance and insurance business, it becomes even more important that we focus on reducing the cost of living as well as maintaining the integrity of our other jurisdictional advantages as a business center.

Trade wars and the recent raising of tariffs for many goods imported via the U.S. will have a knock-on effect for the cost of goods in Bermuda. The United States is our largest and closest trading partner so it will be very difficult to change our buying patterns enough to avoid the increased cost of physical imports.

EU Substance requirements has a yet to be determined effect on our economy. There are clear and obvious negative effects for many businesses that currently are based in Bermuda and for the companies that service them. The reports that have been done to date conclude that the legislation's effects will be both significant and negative for our economy. Whilst there is some hope that some positive employment effects will come of this legislation, it is paramount that Government prepares to confront the upcoming fiscal year with an abundance of caution.

DEBT

Mr. Speaker, the public debt will continue to erode the prosperity of Bermudians for at least another generation. There has been a narrative pushed by the Government to attribute the debt to the OBA's short time in Government that attempts to deflect from the real causes of the debt predicament we find ourselves in today. We do a disservice to the people of Bermuda by not engaging this topic with intellectual honesty.

Those who cannot remember the past are doomed to repeat it.

How we got here: The 7 years of plenty (2001/02 - 2007/08)

During each of the 7 years of plenty, Bermuda was in an ideal situation benefitting from increasing GDP and Government revenue. Despite this excellent economic context, the Government's operational (current account) spending outgrew the yearly increases in revenue.

The real damage was done due to uncontrolled capital expenditure and an addiction to borrowing to pay for this appalling fiscal management. The OBA believes that Government should be prudent and save when the economy is growing. Competing with the private sector, especially for construction projects, only drives up costs and overheats the economy. Prudent management of surpluses (that should have happened when Government revenues had sustained growth) allows for those savings to be deployed back into the private sector during recessions to stimulate the economy and avoid going deep into debt.

The PLP did the exact opposite of best practice. Capital expenditures grew along with the yearly deficits as did the incessant borrowing and related interest costs on the debt. From 2001/02 to 2007/08, Government revenues grew each year by 6.8% on average, however the public debt grew by 116%, from \$128M to \$277M.

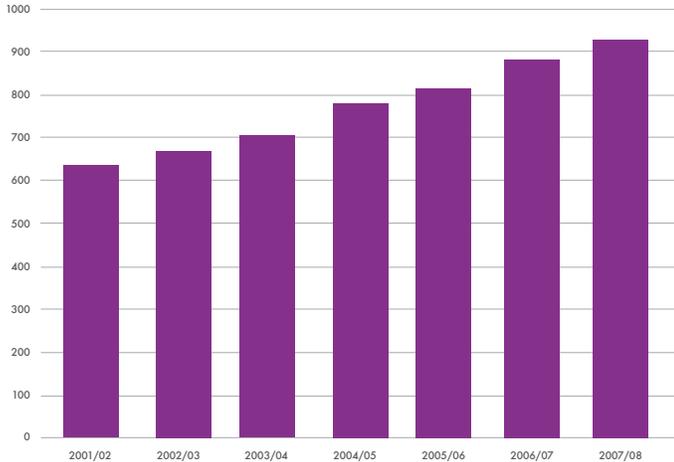
This reckless management of the people's money was a recipe for disaster waiting to happen.

7 YEARS OF PLENTY

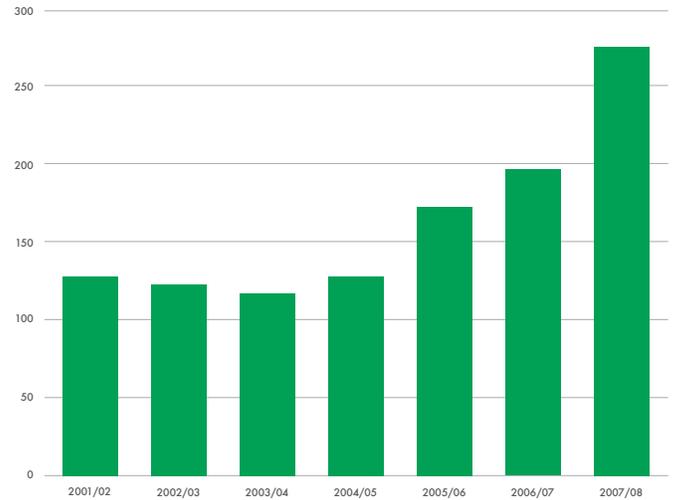
WHAT WOULD YOU THINK IF YOUR COUSIN

GOT A RAISE EVERY YEAR...

AND STILL WENT DEEP INTO DEBT?



REVENUE IN MILLIONS



DEBT IN MILLIONS

The mismanagement in times of plenty made it extremely difficult to protect Bermudians when, from 2008, the global economy went into recession coupled with continued Bermuda-specific mismanagement. The PLP had created a Government machine built on overspending so it didn't take much for the excesses during times of plenty to be felt.

How we got here: The 7 years of famine (2008/09 – 2014/15)

Seven years of plenty were followed by seven years of famine. Despite moderate Government revenue growth in 2008/09, the out of control spending outpaced even growth that year causing an operational deficit (current account shortfall) of \$14M. The full deficit was \$241M that year, but we'll explore why later.

There was no rainy day fund as there hadn't been a surplus since 2003 and it was impossible to slam the brakes on Government spending without casting hundreds of people into the streets. Desperate for revenue, in 2010, the PLP hit the business community with a 15% increase in payroll tax without any consultation. This surprise increase to the cost of business in Bermuda was a breach of trust between the Government and IB and accelerated the on-shoring of back office functions. In fact, in the two years following this move, 1,550 work permit workers left our shores and another 1,250 locals lost their jobs.

Despite a misguided belief by the PLP Government of the time that "Bermuda was another world" - immune to the effects of a sustained debt addiction - when the global economy entered into recession our home grown problems caused us to suffer more and for longer than our economic neighbours.

Mr. Speaker, 2009/10 was a particularly bad year as the public debt doubled in one single year from \$335M to \$666M!

During the 7 years of famine, Government revenues decreased on average by 1% and expenditure grew on average by 1%. The effect of debt repayment started to be felt as public services started to get crowded out in order to pay back the indulgences during the times of plenty.

During the 7 years of famine our debt grew by 512%, or six-fold, from \$335M to \$2.050B.

The preceding examples are highlighted not just to cast blame, albeit well deserved, but so as to frame the realities of that time as the debt created from the mismanagement of projects and operational overspending under the last PLP administration continues to haunt us to this day.

How we got here: THE OBA EFFECT

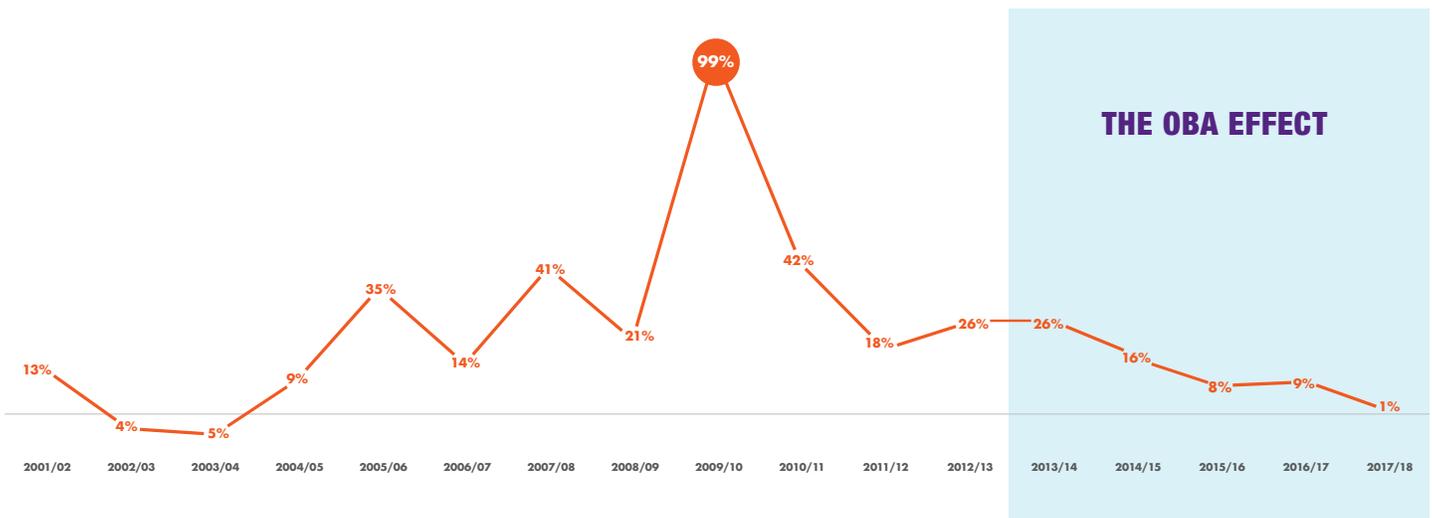
The OBA was elected in late December 2012, right before the close of the 2012/13 fiscal year in March. Unfortunately, one cannot stop a moving train wreck in its tracks and there was little to be done about the 2013/14 budget already well in motion. Minister Richards looked “under the hood” as promised. A plan consisting of economic stimulus to create jobs and disciplined reduction was followed by a determined effort to reduce the deficit.



Of course, money had to be borrowed as there was a massive inherited deficit while the stimulus programme took effect and Government spending was reduced gradually in an effort avoid mass redundancies of civil servants. The OBA determined the debt ceiling required to clean up the mess and set it at \$2.5B. The OBA inherited a machine running an operational deficit of \$101M and an overall deficit of \$299M in 2012/13. The OBA handed over a Government running an operational surplus of \$166M and an overall deficit of only \$8M (if you don't include the Sinking Fund contribution) in 2017/18.

For those Honourable members wishing to make political points with the debt, it is worth noting that during the last five fiscal years of PLP Government (2008/09 to 2012/13), the debt grew by 320% from \$335M to \$1.408B. From the start of the times of plenty in 2001/02 until the year of the election in 2012/13, the debt had grown by 1,045% or eleven times over!

UNCONTROLLED DEBT MANAGEMENT VERSUS OBA GLIDE PATH



DEBT INCREASE IN % FROM 2002-2018

The OBA returned the Government to current account surpluses after only 2 years at the helm by successfully bringing the Government overspending machine under control. This was the first time that the Government achieved a current account surplus in over 8 years. The OBA were on target to deliver a balanced budget and cap the growth of debt in fiscal year 2018/19, i.e. this past fiscal year.

DEBT SERVICE

The problem with the public debt, Mr. Speaker, is not just its effect on crowding out public services and driving up taxes, but the fact that the negative effects are not widely enough understood. The numbers at times seem so large that they are unfathomable.

The interest on our national debt now \$117M for 2019/20!

If debt had not been racked up unnecessarily during years of tragic mismanagement, we would now be able to spend almost double what we presently spend on education, for example. Or we could have paid for the hospital AND the airport in cash without needing to go to foreign investors. In 2019/20, the \$117M per year in interest on debt alone makes it one of our biggest ministries along with national security (\$135M), education (\$137M) and health (\$190M plus \$51M for Financial Assistance). The debt is very real and without aggressively paying off the debt the yearly interest will continue to take money that should be spent on education and seniors.

DEBT MANAGEMENT

Just as bundling and refinancing personal debts, credit cards and mortgages can save money and reduce size of payments, so can careful management of the public debt. Minister Richards was the first Bermuda Finance Minister to successfully tender existing loan notes to lower the overall yearly interest cost. Imitation being the sincerest form of flattery, the PLP Minister of Finance has repeated this wise precedent. Whilst there are limits to this strategy of debt management, it will have to remain for the foreseeable future nonetheless as our debt is here to stay for many years to come.

DEFICIT

Like any household, when the Government spends more than it earns, it needs to make up the difference either by drawing down on savings or by racking up debt. Government has had no savings for a very long time. The amount that the Government overspends each year is called the deficit. A balanced budget is when the Government does not spend more than it earns (and a surplus is when there is money left over after balancing).

The Government earns revenue through taxation. Once you subtract the operational spending, you get the Current Account Balance which we spoke about earlier. After that you must take into account the interest on debt and the sinking fund contribution which is a forced savings of 2.5% of outstanding debt to assist at the time debts are due. The only other consideration is capital expenditure for the year. After all four of these expense lines are subtracted, the Government accounts will be either in a deficit, balanced or surplus position.

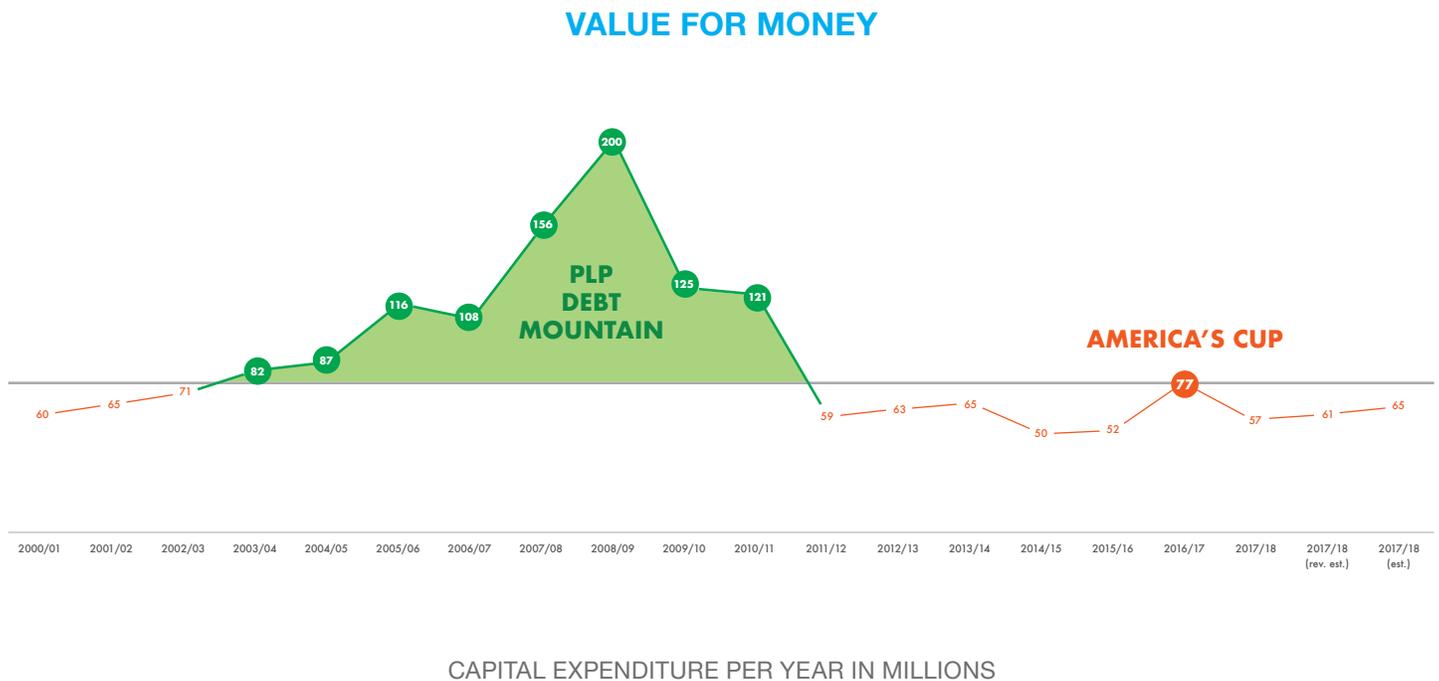
DEFICIT: PLP LEGACY

Mr. Speaker, remember the example of 2008/09, when the Government first presented a current account deficit of \$14M, but a final deficit of \$241? Let's take a look at the last 20 years of capital expenditure (CapEx) in 5 years blocks to understand more:

- 2000/01 to 2004/05: avg CapEx per year \$69M
- **2005/06 to 2009/10: avg CapEx per year \$141M**
- 2010/11 to 2014/15: avg CapEx per year \$72M
- 2015/16 to 2019/20 (est): avg CapEx per year \$62M

As we take a closer look at the numbers, it is clear that the additional \$73M per year on average in capital expenditure between 2006 and 2010 when compared to the other periods drove the deficits that played a significant part in creating the debt problems that continue to harm Bermudians to this day. At the end of 2004/05, our yearly Government deficit was \$37M and our public debt was \$128M.

By the end of 2009/10, our debt had grown 5 fold in as many years to \$666M and the Government was now overspending by \$194M each year!



Much noise was made about the amount of money invested to support one of the OBA's signature stimulus programmes, the America's Cup. It is clear to see from historical spending that the OBA provided incredible value for tax payer money. This investment created jobs, stimulated the economy and improved the prosperity of Mr. and Mrs. Bermuda.

The 2006 - 2010 period truly marks the height of irresponsible Governance and the lowest point of trust in the PLP's ability to manage the public purse. Multiple Auditor General Special Reports were published in response to mismanaged money during that period – Heritage Wharf, Berkeley, BLDC, Port Royal, Global Hue, etc. and \$890M of audited accounts were unaccounted for.

After the 2012 election, the OBA set into action its stimulus plan for the economy and then tackled the Government spending problem. Between 2014/15 and 2017/18, Bermuda's economy as a whole experienced GDP growth for the first time in 6 years, Government revenues grew by 4% on average, whilst Government spending was reduced by 2% each year. Part of the Government's revenue growth was due to increased economic activity and part was due to new taxes.

DEFICIT: OBA RESULTS

Mr. Speaker, the OBA believes that Government has a social contract with the taxpayers and will not tax Bermudians without both a plan to grow the economy and a commitment to reduce Government spending at the same time. The OBA was on target deliver a balanced budget in fiscal year 2018/19. This plan was reiterated as an election promise by Minister Richards and the OBA was on track to deliver. Premier Burt repeated the promise and committed to a balanced budget by 2019, however we have now seen that mark missed for two consecutive years if Sinking Fund contributions are considered.

IMMIGRATION POLICY

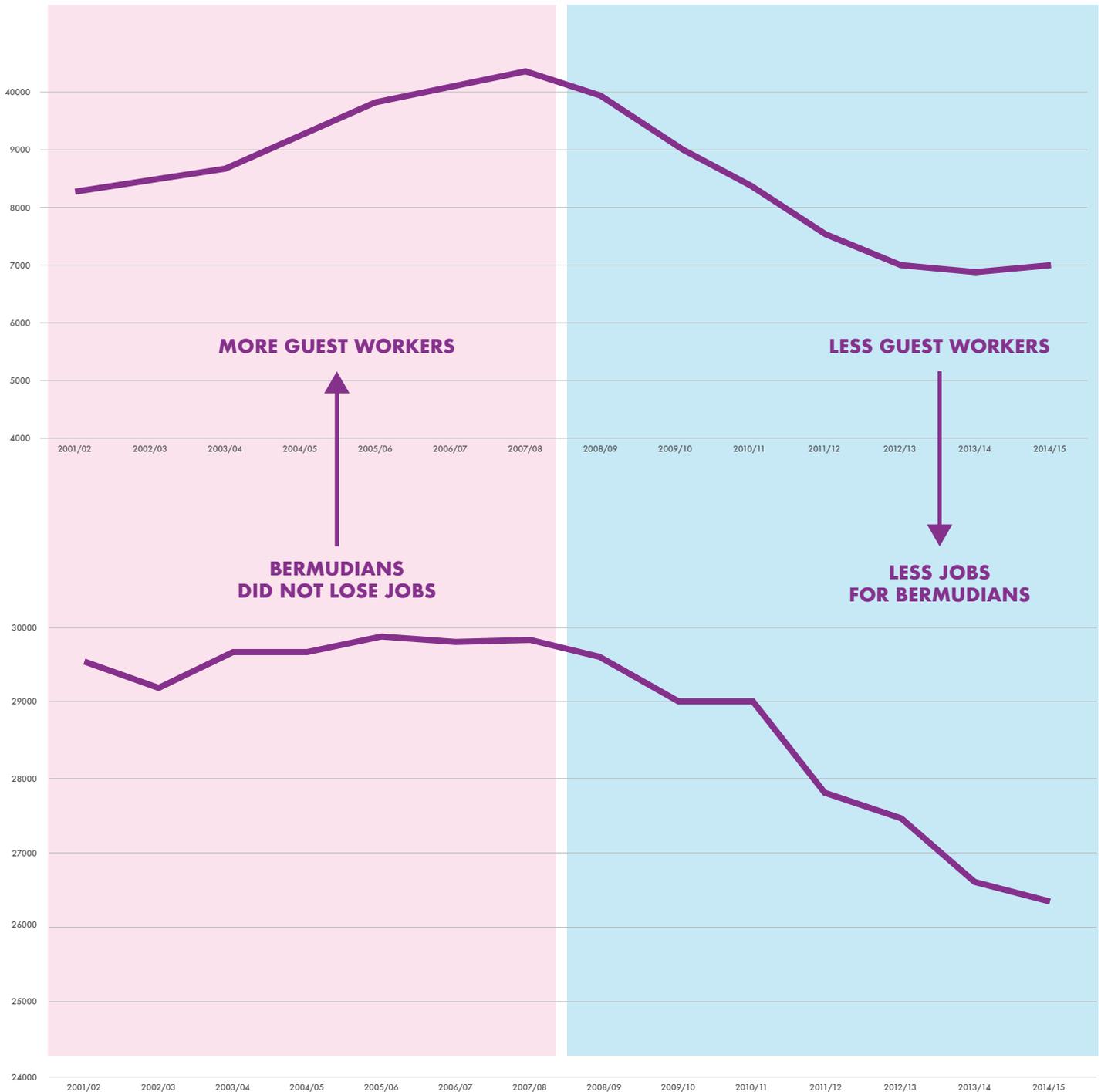
Bermuda has been managing its immigration policy since 1956 with a tool built on the premise that we need to keep people out. In fact, the piece of legislation is called the Immigration and Protection Act.

With empty homes, stores and offices across the island, what exactly are we protecting ourselves from in 2019?

Up until 2007/08, Bermuda's working population grew almost every year according to the annual employment briefs. That year, Bermuda's workforce was at its largest ever coinciding with BOTH the most work permit holders and locals (Bermudians, Spouses of Bermudians and PRC Holders) ever employed and Bermuda was at its wealthiest. By the end of the seven years of famine, 3,377 work permit holders left our shores. Some would attempt to convince you that therefore Bermudians would reap the benefits and fill those jobs. **The reality is that another 3,517 locals lost their jobs too.** The total number of jobs in Bermuda declined by 6,894.

That's almost 7,000 fewer people earning money to spend in stores, take taxis, etc. Consider the fact that when guest workers stop working, they also leave the island. That's 3,377 less people paying rent in Bermudian-owned rental apartments.

GUEST WORKERS DO NOT TAKE BERMUDIAN JOBS



The narrative that guest workers take Bermudian jobs is also false when the economy is growing. During the seven years of plenty from 2001-2008, work-permit holders increased under the PLP by 2,446. **The increase in guest workers did not displace locals whose numbers actually increased by 325.** For those that want the breakdown by race, the highest number of guest workers employed in Bermuda was in 2008, which coincided with the highest level of employment for black people, and presumably for black Bermudians, however that level of detail is not available in the Employment Briefs.

The positive effect of guest workers is the inconvenient truth of our times in some quarters and the longer this issue is politicized and decision makers stick their heads in the sand, the longer Bermudians will struggle to find prosperity in our own land.

An excellent anecdotal example of how work permits create employment for locals comes from the Premier in a recent Motion to Adjourn. The Premier laid out the example of an unnamed entity that if it were to create a company in Bermuda it would consist of 14 work permit holders and 6 Bermudians. In that specific case there are over 2 work permits required for every 1 Bermudian job created.

In a jurisdiction as small as Bermuda with such a large percentage of the economy built around International Business, immigration policy and its relation to resident population is an important lever that Governments have to directly stimulate the economy.

Jobs for Bermudians was, and remains, the priority of OBA economic policy. In order to achieve this, job and wealth creators should be welcomed to our shores so that talented Bermudians presently overseas have a working economy to which they can return. Making Bermuda an attractive place to do business is a combination of jurisdictional reputation, resident know-how, cost of living and immigration policy. Mr Speaker, we believe that a growing economy is the best way to ensure a job for every Bermudian and a welcoming immigration policy is a precursor to achieve that growth. Furthermore, after guest workers have shown their commitment to Bermuda, clear pathways to status should exist to allow resident job creators and their children the security to commit financially long-term to their and our mutual success.

Bermudians have a choice.

**Do you want jobs and prosperity? More money in your pocket?
Or do you want more taxes and a higher cost of living?**

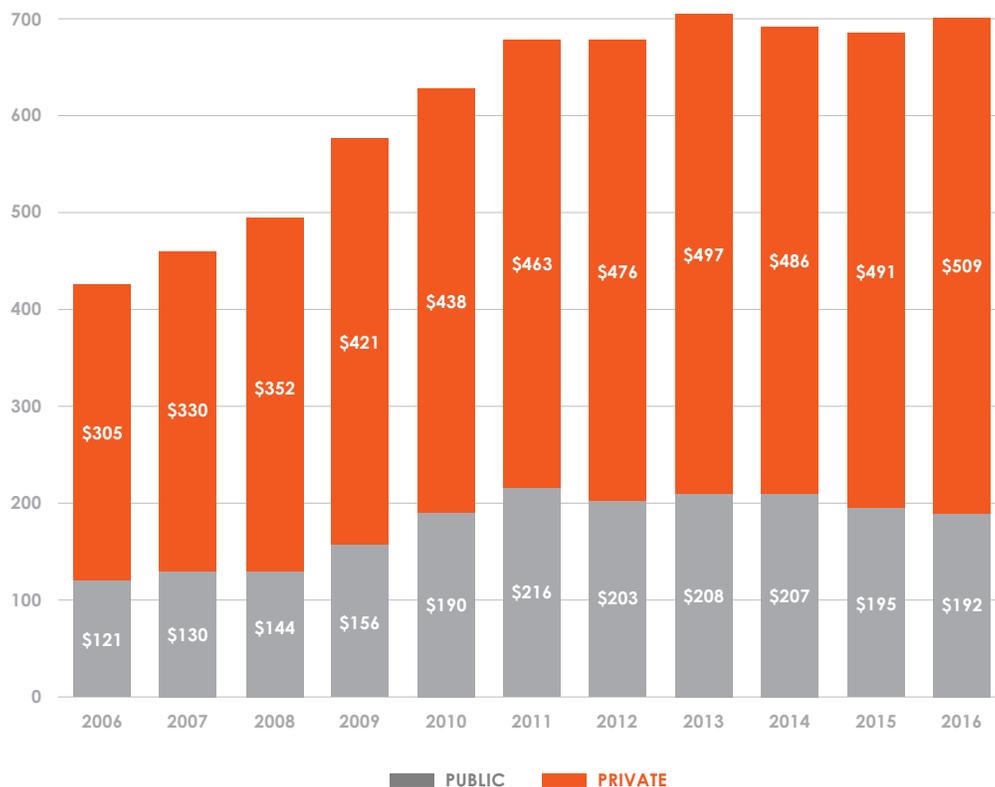
HEALTH CARE COSTS

When we talk about cost of living in Bermuda the two main components of non-discretionary spending are now rent and healthcare according to Government's Consumer Price Index. However in 2004, healthcare spending lagged well behind food.

In fact from 2004-2012, the total spend on healthcare for Bermuda rose 80%.

There is major resistance by the current administration to address the root cause of unchecked provider costs and overuse of certain services.

TOTAL HEALTH CARE SPENDING IN BERMUDA



PUBLIC AND PRIVATE HEALTH FINANCING IN MILLIONS. SOURCE: BHEC

In February 2018 the BHeC said: *“Our healthcare system is at a breaking point. We cannot continue with the status quo and we must make bold moves to change this course.”* And added, *“Our population is ageing which means there are less working people to fund the health system. If we do not make impactful changes soon, the younger generations will be paying for our inaction in the future”.*

This month, the head of Bermuda's Healthcare Watchdog organization was unceremoniously dismissed in a move reminiscent of the 2007 office raid and arrest of financial watchdog, Auditor General.

PATI requests have now reaffirmed the fact the cost containment policies implemented under the OBA were not politically targeted as the PLP have alleged. The fact remains that the efforts to contain the areas of most egregious overuse were undermined by a PLP cabinet insistent on reimbursing previously reduced diagnostic imaging fees without evidence of necessity. Spending of taxpayer monies must always be subject to taxpayer scrutiny.

Another payment that was agreed without any assessment in Court was the recent compensation for victims of the unfortunate pepper spraying incident. The payment was also made prior to the finalization of the Parliamentary Joint Select Committee's findings and was subject to a Non-Disclosure Agreement. Lack of transparency evaporates trust.

DEMOGRAPHICS

We as Bermudians are not replacing ourselves. Like many western economies, the baby boomer generation is retiring or close to doing so. From 2010 to 2016 the old age dependency ratio increased from 19 to 25, at the same time as the youth dependency ratio decreased slightly from 23 to 22. The census projections show that we are at the tipping point now and that in 2026 we are on target for the old age dependency ratio to soar to 40! Including young age dependency (under 15 years old), the total dependency ratio is set to move from 47 in 2016 to 61 in 2026.

That means that for every 100 working age individuals there will be 61 non-working age individuals. That is an increase of 30% in a 10-year span. The working population in Bermuda fell by nearly a thousand people between 2016 and 2018 according to the most recent Labour Force Surveys. The dependency ratio can only be covered by increased taxes, increased premiums or aggressive regulation of the largest abusers on the cost side. The burden on Mr. and Mrs. Bermuda and the private sector needs to be considered in the stark light of demographic truths and not political rhetoric. This again speaks to the dire need for immigration reform. This trend, as it stands, is simply unsustainable.

SHIFTING GLOBAL COMPLIANCE

There are many acronyms associated with the heightened global compliance structure: FATCA, BEPS, AML-ATF, KYC, etc. and they all bring an increased cost to businesses looking to operate and bank in the global economy. The newest layer is EU Substance requirements with an OECD global standard around the corner. The largest players on the global market are looking outward to the offshore world with much more vigour than they are internally to try and address tax compliance and collection challenges in their own jurisdictions. The hypocrisy of EU Substance Requirements is obvious as it is only outward looking and fails to apply the same standard to Ireland, Luxembourg, Malta, etc.

This latest salvo will fundamentally affect the ability for certain companies to maintain their presence in Bermuda in their present forms. The thrust of this legislation is for companies to prove “adequacy” or, in layman’s terms, to put “boots on the ground” in Bermuda. There are some that believe that a silver lining may come from EU Substance in the way of increased presence of certain companies here. Whether that will outweigh the negative effects from exiting businesses is still to be seen. It is of note that the recent EU Economic Incentive Programme was simply a rehashing of existing policies and OBA stimulus legislation. Until we have more certainty around the impact of EU Substance requirements, this existential threat must be matched by increased caution in Government revenue projections and a greater resolve to control Government spending.

NARROW ECONOMIC BASE

Almost two-thirds of Government’s revenue in 2018/19 was budgeted to come from payroll tax (\$454m) and customs duty (\$235m). Both of these taxes are inextricably linked to our working population. When fewer people are working in Bermuda, each worker will bear a larger portion of the burden if Government does nothing to reduce spending to match the smaller worker base. There has been no attempt to resize Government to the declining population – or increase the population to match the size of Government - during the two PLP budgets since the election.

GOVERNANCE TOOLS

TAXES AND COST OF GOVERNMENT

Taxing the population sensitively and spending that money efficiently are two equally important parts of the social contract that any Government has with its people.

In sports, the art of the feint is highly prized. A footballer feints like he is going left then suddenly turns right, or feints that he is going to run then suddenly stops. Such tactics are designed to fool the opponent by enticing him to expect a certain outcome, only to discover, often too late, that a different outcome is on the cards. This tactic is great in sports, but a questionable one in finance because you sow doubt into the minds of business people.

The Government has gone out of its way to make Bermuda think that it was going to deliver very unpleasant medicine. First there was the Tax Reform Commission which was directed to find \$150M in increased taxes. Then there was the Pre-Budget Report that proposed \$50M in increased taxes. The prospect of this policy was frightening as everyone predicted it would implode what little vitality existed in the Bermuda economy. These feints were entirely unnecessary as the budget gap that the OBA left was relatively modest and could be closed with a very modest increase in revenues combined with further reductions in government spending.

This Government campaigned on bold tax reform, not increased taxes. What is to become of the Tax Reform Commission Report? Will we see it resurface in the next budget?

This Budget was full of sleight of hand to hide the lack of results or actual reforms for a better and fairer Bermuda, such as:

- **Residential Rent Tax. Despite the outcry against the rental tax, Government is putting up land tax instead, which is worse. At least the rental tax had a carve out for people living in their own home. Also, the lowest ARV's had their land tax reduced to 0.0%. This may sound good if you are struggling to get by in the smallest of dwellings in Bermuda, until you realise that the new \$300 flat fee is actually going to cost you more.**

- “Economic Plan” and “National Health Plan” are superficial and almost aspirational. This is no “how” detailed and the results speak for themselves. The emperor has no clothes.
- Public Sector Reform and streamlining the operations of Government was promised, but there is no reduction in operational spend budgeted over the next three years.

- **The largest single increase of any cost line is the travel account at 12%.**

- From the Budget Statement: “it is not prudent to raise an additional \$50.0 million in revenue at this time”. What was missing from that statement is that \$39 million in revenue is being raised anyway through increased taxation.

- Increased business registrations were announced, but net numbers were not shared and revenues from IB company fees were budgeted to be lower than last year.
- Legislated sinking fund contributions have been replaced with a vague “up to 75%” of Budget Surplus. No matter how you cut it, that contribution will be far less than the approximately \$65M per annum mandated by the Government Loans Act. Even with sinking fund contributions, without reducing Government spending, growing the economy or imposing further tax increases, the Sinking Fund will be woefully underfunded when it is time to retire the \$615M worth of notes due in 2022/23. What is the plan to retire these notes?

• Payroll tax concessions were given to employers in International Business and only the largest select retailers, there was nothing for the rest of Bermudian business in other industries or for the smaller players in the retail sector.

- Again this year, the Finance Minister attempts to distance the PLP from the debt it created in 2012/13 by mislabelling that year’s debt as “OBA Government” in the Budget Statement. This detail highlights a Party mindset more focused on deflection than actually taking responsibility for the financial mess Bermuda is in.

• Sugar tax is increasing from 50% to 75% and will apply to more items. There was no mention of subsidies for healthy products so this measure will have a disproportionate impact on those who cannot afford healthy foods.

- Foreign Currency Purchase Tax. This increase disproportionately hits Bermudians too. Basically, everyone earning Bermuda dollars lost purchasing power compared to those in IB that earn in US dollars. Also, everything imported from now costs that much more so this tax will drive up the cost of living for everyone.
- Commercial land tax is going up which is yet another attack on a struggling Bermuda business market.
- Government is going to be charging back taxpayers who pay by credit card. Unfortunately, credit card agreements prohibit businesses from doing the same thing to their customers so this is just another way that taxpayers get squeezed in the middle. More taxes on one side and Government chargebacks on the other.

• The Financial Service Tax is increasing so premiums on your car and bike insurance will go up too. The taxes will be passed on like any other cost of business, so for the Government to say that the fee would be the obligation of the insurer is either naïveté or they simply don’t want people to see the line item on their bill showing that it is indeed Government causing them to pay more. More sleight of hand.

- Ministry Headquarters have large increases in the budget allocation. Are the Ministers leading by example?

It is reckless for Government to forgo the sinking fund contribution of \$67M in order to claim a sense of achievement of a \$7M surplus. Revised estimates show last year's budget projections are already on track to be missed by \$13M which gives little confidence that this narrow target can be hit. There is no justification to celebrate a projected surplus before it is achieved given past performance. Removing the savings discipline of future Sinking Fund contributions will leave us ill prepared to retire future debt.

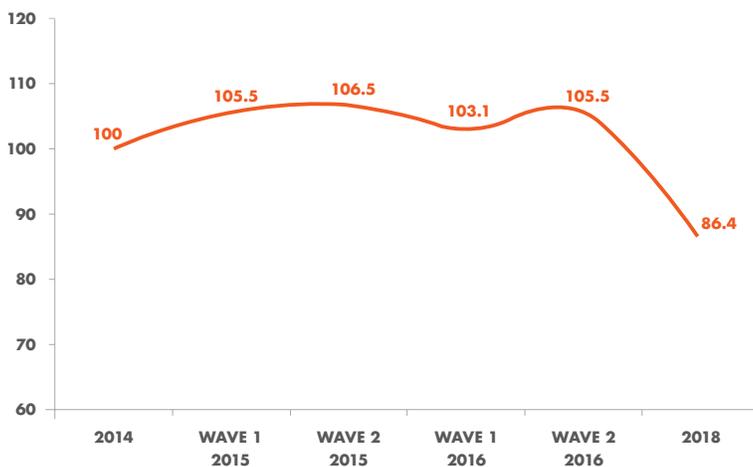
It is curious that this Government sees fit to increase taxation revenue by \$39M and yet do nothing to reduce its own expenses! The Budget statement is quick to chastise the OBA for increasing taxes, but fails to note that the OBA handed over a Government spending only \$908M on a glide path of reduced spending - a trend that this Government immediately reversed. The OBA's second year in Government showed results, whilst the PLP's second year will be characterised for slippage. Slippage on revenue projections. Slippage on spending targets. Slippage on balanced budget promises.

In fact Mr. Speaker, if you remove the Sinking Fund contribution from the 2017/18 actuals at the end of the OBA's term, there was only a deficit of \$8M which the PLP regressed in its first budget in 2018/19. Despite the SAGE Report providing a blue print for efficiency and savings, additionally the taxpayer was paying for a Minister responsible for Government Reform for over a year. On top of that, an Efficiency Committee chaired by the Junior Minister of Finance spent 15 months working on a report that was submitted in September 2018. Where are the savings? Why aren't they being passed onto Mr. and Mrs. Bermuda?

The private sector is reeling as evidenced by low levels of business confidence, months of retail sale declines and decreases in household final consumption and yet taxes are going up again this year, with up to \$150m in additional tax burden being considered over the next two years.

DECLINING CONFIDENCE IN THE PLP'S ECONOMY

FALLING BUSINESS CONFIDENCE



SOURCE: 2018 BERMUDA BUSINESS CONFIDENCE INDEX

FALLING RETAIL SALES

MARCH 2018	-5.1%
APRIL 2018	-7.6%
MAY 2018	-3.8%
JUNE 2018	-9.6%
JULY 2018	-4.4%
AUGUST 2018	-3.5%
SEPTEMBER 2018	-6.2%

ANNUAL % CHANGE IN RETAIL SALES VOLUME

The Premier must start to lead by example. When Premier Burt unveiled his first Cabinet, he stated that his Cabinet was smaller than the previous OBA one and added that “fiscal responsibility must start at the top”. The inference, of course, was that his Cabinet was going to cost the taxpayer less than the outgoing administration’s Cabinet. This proved to be a false premise as every single member of Premier Burt’s first Cabinet was on full-time Minister salaries increasing the total Cabinet cost by \$150,000. The very next year the Premier misled the public again by inferring that savings were to be had because he had reduced the number of Ministries from 11 to 10. However, the number of Ministers actually increased to 12, including a Minister without Portfolio, costing an additional quarter million per year. While the number of Ministries may have decreased, we have not heard of any corresponding reduction of civil servants or Government spend either. The Premier’s own personal entourage increased at the same time he dropped the Portfolio of Finance.

Whilst the entire PLP Cabinet is claiming full-time Ministerial Salaries many of those that have actually filed Register of Interest forms note that they are being paid from other jobs. This is inconsistent with the leadership of a Government that is missing spending targets, forgoing sinking fund contributions to balance the budget, inconveniencing the public with austerity measures such as once weekly trash collection and raising taxes on every day Bermudians. Why isn’t the PLP reducing its spending instead of squeezing more and more out of Mr. and Mrs. Bermuda. It would appear that doing less with more has replaced the old campaign promise of doing more with less.

STIMULUS

Mr. Speaker, the OBA worked quickly in Government to identify achievable short-term sources of economic stimulus and direct foreign investment as putting Bermudians to work was our number one priority. The America’s Cup, the Airport Project and the various hotels created jobs, many of which thankfully continue to this day. The BTA has created a new life to tourism and the growth also continues to this day. Imagine how much worse our economy would be 18 months into this PLP Government if the economy was missing those jobs as well. Construction jobs, taxi fares, hotel and restaurant jobs as well as many others. Government’s own statistics office confirms this. The economy still needs diversification to mitigate external shocks, but short-term private sector construction and tourism related growth provides much needed runway while Bermuda aggressively searches for new pillars. Imagine how much worse it will be when the Airport and the hotels finish construction if the PLP still has not found their own stimulus programmes.

In a town hall meeting on the Pre-Budget Report, the Finance Minister lamented, “I cannot predict that an America’s Cup will happen next year so in the meantime I have to work with the hand that I was dealt”. This comment both acknowledges that the Cup had a positive influence on Bermuda’s economy as well as recognizes that his Cabinet colleagues have not been successful in identifying or successfully securing a new source of stimulus.

INFRASTRUCTURE FUND

In May of last year, the Bermuda Infrastructure Fund was unveiled with the Premier stating, “The fund is important for Bermuda on two fronts: it supports the modernisation of Bermuda’s ageing infrastructure and will provide jobs for Bermudians in the months and years to come.” There is no mention of the Fund in the Budget Statement. The OBA would appreciate an update on what projects have been completed to date, how many jobs those projects have created and how much has been paid in fees by the Government for the management of the fund to date.

TOURISM

The America’s Cup, the Airport, and new hotels all mean jobs. Growth in tourism means jobs. New jobs. Jobs for Bermudians and jobs relocated here from overseas.

Our tourism industry is still ripe for more growth potential, especially as relates to hotel development. Overseas direct investment still needs to be focused on. There are more sites that could be developed and the OBA projects will end soon. Whilst the BTA is primarily a destination marketing entity, Government is needed to find and close deals with hotel developers. We are pleased to hear that the Government has heeded our calls for an Event Authority which should have happened in the immediate aftermath of the America’s Cup. A Bermuda Yacht Agency for supporting super yachts is another legacy stimulus from the America’s Cup that could have been embraced had this Government not been so focused on dismantling OBA successes.

If it weren’t for the PLP’s toxicity towards the America’s Cup, Bermuda could now be benefitting from the presence of a Sail GP team and a circuit stop.

INCREASED WORKING POPULATION

Economically, an increased residential working population contributes to alleviating every single one of the systemic issues addressed at the beginning of this Budget Reply:

- **Debt, debt service and deficit. More working people in Bermuda means greater payroll tax collection and more local consumption which increases customs duty. A greater residential population creates a multiplier effect on our two biggest buckets of tax.**
- **Health care costs. Guest workers are generally younger and healthier than our average resident. Increasing the number of guest workers massively improves the sustainability of our health care system.**
- **Ageing population. Increasing working age population with all else staying the same directly reduces our maintenance ratio. Total health care costs and ageing population are closely intertwined.**
- **Global compliance requirements. Many companies are going to have to do more to justify presence in Bermuda under new tax regimes. We are competing with other jurisdictions on this front and must present a welcoming attitude.**
- **Narrow economy. More working age people on island decreases the tax load per person.**

Whilst it would be nice to think that all that growth can happen from returning Bermudians that went overseas during the 7 years of famine, recent history does not support that happening without also increasing the number of guest workers.

ECONOMIC DEVELOPMENT POLICY

It is the OBA philosophy that Government's job is not to create industries, but rather to create the conditions in which business creators can thrive. That philosophy appears to differ from that of this Government.

The Premier is attempting to directly create new markets in Bermuda, such as FinTech. A "new silicon valley" was promised at Southside followed by backtracking to a hub in town and then more recently something to be explored by the private sector. Herein lies another major difference in approach to business development between the OBA and the PLP. The OBA approaches an opportunity or an obstacle, assesses the challenges, sees what the private sector can do and then what Government can do to assist. The PLP sees the same opportunity or obstacle, promises that Government will do it, then assesses the challenges, determines it cannot actually execute as promised and only then turns to the private sector. We question whether the desire to find validation and credibility has led to many unfounded announcements of success – promises that have not been fulfilled. Bermuda has been subjected to a PLP pattern of overpromising and underdelivering on this front.

Jobs were announced in June 2018, but then backtracked a few months later. A FinTech bank was foreshadowed in an announcement at Davos, but then the timeline "corrected" upon return to Bermuda.. In June 2018, the Premier stated, *"I'm relatively certain that within the next two months you'll begin to see more companies that will sign leases, that will begin hiring, that will begin setting up, and will begin their philanthropic efforts here in Bermuda."*

The number of FinTech MOUs that have been signed promising tens of millions of dollars do not seem to have come to fruition. The hundreds of jobs promised last year have not come to fruition either. How many jobs have actually been created? Surely, the Government must know from payroll tax returns! This is the Government's flagship economic programme. If there actually were any successes they would be promoted far and wide just like the MOUs that never happened. We understand that the FinTech umbrella covers many business models, some more legitimate than others. We hope that the Premier's zealotry does not cause Bermuda to engage with organisations that could bring our jurisdiction's reputation into disrepute. It is clear that banking is a major challenge for the development of FinTech and we wish the Premier the best of luck that front.

WE ALSO LOOK FORWARD TO HEARING PROGRESS REPORTS THIS SESSION ON THE FOLLOWING MOUS:

- **Arbitrade promised: \$1,000,000 donation to the incubator at Park Place, \$45,000 donation to the gang rehabilitation chicken farm, \$25,000 donation to Mirrors, \$25,000 to the Family Center**
- **Shyft promised: \$10,000,000 investment in Bermuda to create new jobs, reskill workers, invest in local businesses, education and infrastructure**
- **Binance promised: 40 jobs (30 of which Bermudian), \$10,000,000 in university sponsorship for Bermudians, \$5,000,000 investment in Bermudian blockchain companies**
- **Medici Ventures promised: 30 jobs in Bermuda**
- **Omega One promised: 20 jobs for Bermudians and 10% of a token sale to be donated to sport and community clubs in Bermuda**

Despite bullish optimism by the Premier, we caution that the employment potential and other benefits of FinTech not be over-hyped to the public.

Mr. Speaker, another industry where we believe it is Government's job to create conditions for success, but not get directly involved in industry creation is bank financing.

The Minister stated, "Government will, in conjunction with private sector banks, pilot a mortgage guarantee programme in return for a reduction in interest rates charged to Bermudians for their mortgages".

Mortgage loans, like all loans, are based on the borrower's ability to repay, as opposed to the quality of the collateral. Local banks have a large book of impaired mortgages. Mortgages get into trouble because of the borrower's inability to maintain the repayment schedule. This plan appears to be an invitation to the banks to lay off their impaired mortgages onto the Government. What administrative resources does the Government have to manage such impaired assets? This plan will only serve to increase the civil service and not have much of an effect on interest rates.

One of the most troubling proposals contained in the Minister's budget statement is, "*Government will create a government backed mortgage lender,*" to provide mortgages to civil servants.

The first question that arises is, "Why does this government seem fit to use the taxes paid by everyone to benefit only the civil service?"

Another question that arises is, "With what?"

The Government itself is a net debtor to the tune of about \$2.5 billion, meaning that it has no real money of its own. Is the Minister's intention to use borrowed money to fund this entity, first with equity capital and then with debt capital to lend to would be borrowers? How can a government that doesn't even have enough money to meet its Sinking Fund obligations even consider such a move?

Perhaps there is another source the Minister has in mind. Is the Minister planning to raid the Public Sector Pension Funds, the Contributory Fund and the Public Service Superannuation Fund, to fund this venture? Both of these funds are underfunded. This would be a major departure from a long held policy of segregating pensioners' funds from Bermuda based risks, and could be the thin edge of the wedge for further local investment adventures with pensioners' money. It should be borne in mind that the public sector pension assets do not belong to the Government - they belong to Bermuda's pensioners - both private and public sectors. Government's role is one of prudent stewardship. Such a use would violate any notion of prudent stewardship.

Also, where would the Government acquire the lending expertise? There certainly is none within the civil service at this time. Clearly, such expertise would have to be poached from the banking sector, thereby increasing the ranks of the civil service. And what would be the lending criteria? Where would the accountability lie? How does the Government discipline a poorly performing civil servant if his termination will result in a non-performing mortgage loan for that Government?

And we are not talking about insignificant numbers either. Providing 2,000 civil servants with \$500,000 mortgages results in a \$1 billion mortgage portfolio.

Lastly on this subject, what will the unleashing of all this credit on the local property market mean to property prices? This proposal is a non-starter if Government cannot answer all of these questions satisfactorily.

GROWTH FOCUSED IMMIGRATION POLICIES

Is immigration Bermuda's Brexit? Brexit has divided a country, divided political parties and is driving business from Britain's shores as economists are predicting a Brexit recession. It is well known that members of this Government are stating in meetings with International Business that they recognise the need for increased immigration. This is in stark contrast to much of their public political messaging. Like Brexit, will immigration split a political party? Unlike in the U.K., will a leader emerge in this government to unite the country around this issue in the name of prosperity?

A recent article in Dowling and Partners' IBNR Weekly had the following assessment of Bermuda, "We agree that Bermuda has a history of reinventing itself, but the current environment brings new challenges as the island has to deal with the bloated government, high levels of debt, high costs of living and no free flow of people (foreigners can't own local businesses, can't buy commercial real estate, can only buy high-end residential properties and have very high hurdles to become a resident)".

The fundamental inhibitors to growth remain the same from the OBA's time in Government. A clear and welcoming immigration policy is needed to ensure that we can attract the global expertise and capital needed to grow our stagnant economy and drastically increase our working population. Furthermore, it is essential that we arrest the exodus of long-term contributors to our economy.

The answers to immigration reform that have been backed by the various working groups are essentially the same as those proposed at the time so we welcome any action on this issue. We fully expect to see Pathways to Status presented repackaged with a different name. It is long overdue.

The Fiscal Responsibility Panel stated in its 2018 Annual Report that, "A precondition for faster growth is to increase the island's workforce. It is the only realistic counter to the island's demographic challenge from a rapidly shrinking and ageing population. Immigrants and returning Bermudians with the right skills will help to create jobs, not displace them".

This is a pivotal moment in Bermuda's history and this issue cannot be avoided any more as it is presently being subjected to a slow death by committee. The Premier purports to be able to pass Immigration Reform because he feels he has the people's trust. The OBA welcomes him to move ahead.

DEBT MANAGEMENT

The OBA recognises the Minister's premise as relates to the Sinking Fund that borrowing to save can cost more due to negative carrying costs (difference between borrowing and saving interest rates). However, given the severity of the debt burden and fact that the margin of the projected surplus exceeds the amount by which the last budget missed its original estimates, we fear the departure from savings discipline coupled with the political temptation to spend away surpluses will hinder our ability to retire future debt. The non-committal objective of dedicating "up to 75%" of budget surpluses to debt re-purchases and/or Sinking Fund Contributions is an entirely underwhelming alternative to existing Sinking Fund solution. For example, what happens to the other 25% of the surplus?

Even the Sinking Fund contribution of \$65M per year is not enough to drastically reduce the debt, and this up to 75% of surpluses contributes far less. Realistically, without contributing \$100-\$150M per year towards paying off the debt (SF and surplus), Bermuda will continue to have services for Bermudians crowded out by interest payments for generations to come. Without growing the economy to increase Government revenues at the same time that Government spending is reduced through reform and new efficiencies, those yearly debt repayment targets will not be met. Looking to grow Government surpluses entirely with more taxation will only increase the cost of living, reduce Bermuda's competitiveness as a jurisdiction and strangle any hope for local businesses.

RESIDENT LIQUIDITY

Like Immigration, the historical context by which we approach capital is antiquated. The 60/40 rule was created to keep foreign capital out in a time when Bermudian capital controlled all the means of production. Bermudian capital is not what it once was and Bermudians no longer own the banks or telecoms. There is still plenty of wealth being created in Bermuda and the OBA believes that coupled with Pathways to Status and a more aggressive approach to attracting innovators, redefining the 60% ownership rule from "Bermudians" to "residents" would allow all people working here to invest in companies and drive innovation in areas outside of their work permit categories.

Increasing the amount of capital to invest in the local economy would assist entrepreneurs struggling to find financing through the banks. A more liquid local capital market could also invigorate the Bermuda Stock Exchange which is sorely underdeveloped and the trend has been one of a diminishing presence of non-finance companies. We send large amounts of capital overseas by way of repatriated savings of guest workers and pensions of employees in the local economy. We believe that we need to take concrete steps to ensure that more of the savings generated in Bermuda flow through the economy.

There are many people that have been employed and live in Bermuda for over a decade. Their link to Bermuda is strong, however they are forced to keep one eye on the door and accordingly will invest their savings overseas, usually in the form of the purchase of a home. At some point we must allow workers and their children, who have an extended period of employment or residence in Bermuda the ability to fully formalise their relationship with Bermuda through some form of Pathway to Status mechanism. Not only will this help anchor the key value creators who have already passed through various rounds of work permit control to fully commit to Bermuda, but it will also provide the incentive to direct their savings toward investing in Bermuda instead of from whence they came.

PRIVATISATION - MUTUALISATION

The OBA supports the Premier's belief that privatisation of certain Government services would inject "much needed innovation" into the economy. In his first Budget Reply as Junior Finance Minister in 2011, now Premier Burt told the Senate that candidates to privatisation should include public transport, postal services, waste collection, waste treatment, water and recycling. Premier Burt also said that he believes that "governments are not known to be the most efficient organisations". He went on to say that "the new entities will have a stable income stream that will allow them to expand and reinvest, thereby creating additional employment in our economy".

For whatever reason, that support changed to opposition of the idea when Minister Richards sought to move forward "mutualisation". We can only assume that the Premier was opposing the messenger for the sake of opposing instead of engaging with the idea and the process. Now is the time to deliver on ideas that are good for Bermuda. The OBA will not oppose this process just because the Government gets the credit. We believe that there is common ground to be had here and would welcome progress on this much needed shift in delivery of public services.

EDUCATION

Promoting opportunities for Bermudians who want to work in International Business will require a fair immigration system. Of equal or greater importance is that our schools empower our children with the right tools to compete on the global stage.

Ensuring that Education remains a priority focus is paramount.

With a declining youth population, rationalisation of infrastructure will allow more funds to be dedicated towards teacher hiring and development. The Hopkins report focused its findings on quality of teaching, reforming the Ministry and strategic management.

Whilst we recognise the importance of allocating financial support to students through scholarships and grants, the OBA believes that funding continued professional development for teachers is of equal importance.

We believe that consistent and increased accountability as well as removing the mid-term changes in direction caused by political cycles are integral to improving the outcomes. We therefore repeat our support for the transition of the management in education from the convoluted array of Minister, Permanent Secretary, Commissioner, Department and Board that presently oversees our public education system with an Independent Education Authority. Education needs to prepare Bermuda for our current and future economy. Mr. Speaker, how are Bermudians going to benefit from employment with the global players on our shores when only 60% of graduates are earning an internationally recognised credential upon graduation?

BUSINESS DEVELOPMENT

The OBA believes we should continue to support our business development agencies' efforts to create an environment that is attractive to foreign investors that will grow our existing industries or develop new industries that will diversify our economy and mitigate our exposure to external shocks. New hotel development is one such example of the OBA's competence in resolving longstanding problems. FinTech is one such example where a regulatory framework reflective of innovators needs could lead to new industries developing in Bermuda. We see merit in advancing legislation to that end, although it should not be seen as the only path to diversification.

Our business development groups must be allowed to do their job promoting Bermuda as a welcoming jurisdiction that is open for business. Growing our economy should not be myopic in its focus and Ministers should provide oversight but not interfere. Undermining the independence of the Gaming Commission, for example, has effectively killed any hopes of the industry getting banking approval.

NOTIONAL SALARIES

We believe that notional salaries should be assessed and enforced. It is not fair that Owner-Managers pretend that they not work at the company in order to take all their pay as tax-free dividends. The counter to that enforcement, of course, is that after paying payroll tax on notional salaries, dividends for smaller Bermudian-owned businesses should be tax-free just like publicly listed companies and exempt-companies. Not only does the recent dividend tax unfairly affect Bermudian owned companies, but it also runs afoul of the "ring-fencing" criteria used to assess tax havens.

CONCLUSIONS

Mr. Speaker, we are concerned, as are many in the community, that this Government has no plan to grow the economy. Everything the OBA did during its tenure was vehemently opposed. In some cases, due to actual differences in political philosophy, but in most cases simply because the PLP could not accept that it was not in power and refused to be a participant to any Bermuda successes delivered by the OBA.

The PLP has had the benefit of its first year in Government essentially unopposed, an abundant two-thirds majority in Government and yet has achieved very little. The economy is stagnant, buoyed mainly by the airport. Retail sales are sliding. Balanced budget promises have been broken. There has been no progress made on controlling Government spending and taxes have been going up every year with significantly more being considered for the next two years.

The economy is not growing and yet the Ministry of Economic Development has been done away with. The Ministry of Government Reform and the Efficiency Committee have produced a reduction of zero dollars in Government spending and yet the PLP keep asking Bermudians and the private sector to contribute more. The cost of Cabinet and the burden of consultants and advisors only ever grow, and yet there still is no clear direction, just plans to make plans.

This Government, as Opposition, fought tooth and nail against every stimulus initiative of the OBA yet as Government has provided little to nothing of substance now that the shoe is on the other foot. The America's Cup legacy has been squandered entirely due to political hubris. The Airport Project and the St. Regis are no longer framed as the epitome of evil now that it's the PLP that gets to stand at the press conferences and smile.

It is unfortunate that this Government puts the pursuit of power over providing for the people. Gaming has been all but killed due to the injection of political interference clauses and yet the same interference can be seen with the BTA, the BHeC and the Corporations.

The OBA will support beneficial policies for Bermuda and will not let the Party or person that gets it over the line affect that support. Something that is good for Bermuda will take precedence over political kudos. The OBA will also question where needed to ensure that all perspectives are considered and will oppose when legislation is brought forth that we feel is detrimental to Bermuda's best interests.

This is in stark contrast to the manner in which the PLP behaved in response to the job creating stimulus programmes the OBA sought to move forward for Bermuda. Imagine where Bermuda would be if the PLP had put Bermuda first, rather than putting themselves and their partisan politics first.

Thank you, Mr. Speaker.

