

Bermuda Budget Release 2004

Key Budget Areas

- Social Impact
- The Effects on Individuals
- Economic Performance
- Business
- Tourism

“Budgeting reflects the ability to think ahead..... We have to think about spending responsibly – our values, those things we hold dear and want to be reflected as to who we are.”

The Hon. Paula A. Cox, J.P., M.P., delivered her first budget statement which commenced with “As the first female Finance Minister for the Government of Bermuda, I have an awesome task.” She noted Government’s main economic and social policy objectives of building and maintaining a strong economic and financial foundation with education, housing, healthcare and public safety as the main issues, continuing on the path of prudent stewardship of the public purse that was so ably mapped by her father, the late Hon. C. Eugene Cox CBE, J.P., M.P.

We note that in order to achieve these goals we have again seen growth in Government expenditure by 5.6% with a 1% growth in the number of Government employees; an 8% growth since 2002. Cost of Government salaries and benefits are increasing 6.4% while inflation is currently at 3%.

The Revenue projections are \$693.9m, a 6.7% increase on the 2003/04 original estimate, while Expenditure projections are \$660.2m, a 5.6% increase; resulting in a \$33.7m current account surplus. The Government intends to borrow \$82.7m which together with the \$32.1m unspent appropriations from 2003/04 will provide the \$114.8m for capital expenditure. Capital commitments for projects in progress or due to commence in future fiscal periods are not included in these borrowings.

Overall, the budget is reflective of a prudent outlook on Bermuda’s economy for the coming year, while continuing the social fabric initiatives of the Government. We commend the minister for her recognition of the importance of the balance in the objective of Government needs and the economic reality for the tax payer. She noted “there is a symbiotic relationship between twin pillars of our economy” as she presented the budget estimates.

Economic Performance

It would not be possible to understand Bermuda's economic performance in 2003 without considering the significant impact of Hurricane Fabian. Revenues for 2003/2004 were buoyant, with the original estimates of revenue of \$650.1m revised upward by 2.5% to \$666.4m. This performance, however, would likely have been stronger had it not been for the effects of Fabian. This had a particular impact on tourism and related tax revenues. Major items contributing to the buoyancy were increases in payroll tax (\$23m), cruise passenger tax (\$1.5m), customs duty (\$1.1m) and land tax (\$1m). This buoyancy was partially offset by decreases in stamp duty (\$4.5m), airport departure tax (\$1m) and hotel occupancy tax (\$1m) and transport receipts (\$1.1m).

Current account original expenditure estimates (excluding debt servicing costs and sinking fund contributions) increased by 3.2% to \$632.1m from \$612.4m. This increase was attributed to unanticipated costs of Hurricane Fabian (\$10m) and an extraordinary transfer of \$3.5m to the Bermuda Monetary Authority. Together with a decrease in estimates of capital expenditures of \$10m, this resulted in an overall decrease in the projected deficit of \$7.9m from the original estimate of \$78.1m to \$70.2m. The projected growth in GDP in 2004 is 2.0% to 2.5%, somewhat behind forecast growth is the US economy of between 4% and 5%, but consistent with the United Kingdom, Canada and Western Europe which were less favourable but suggested modest growth.

The 2004/2005 budget estimates an increase in revenues of 4.1% to \$693.9m (2003/2004 revised - \$666.4m). This increase exceeds the growth of 2.7% (\$16.8m) in current account expenditures to \$648.9m (2003/2004 revised - \$632.1m), excluding debt servicing costs and sinking fund contributions. Capital expenditure increases of 23.0% to \$114.9m (2003/2004 revised - \$93.4m) result in a projected budgeted deficit of \$81.2m (2003/2004 revised deficit - \$70.2m). Government will increase borrowing significantly for 2004/2005 fiscal period with an increase in debts and guarantees of \$84.4m to bring total borrowings from the revised estimate of \$140.2m to \$224.6m.

Once again, international business was the largest single contributor to the economy, contributing \$480m to 2002 GDP (the latest figures available), representing an increase of 1.9%. This is equivalent to 15.6% of total GDP. The real estate and education sectors showed the most significant monetary growth year on year, increasing by \$15.5m (3.7%) and \$11.7m (6.3%) respectively. All figures are at constant market prices.

The number of registered companies grew by 1.4% to a total of 13,509 at the end of 2003 compared to 13,318 at the end of 2002.

The tourism sector declined, with the signs of recovery shown in 2002 and early 2003 negated by effects of Hurricane Fabian. Visitor arrivals showed a slight decrease of 0.3% from the comparative period in 2002, however in the first three quarters of the year (before the full impact of Hurricane Fabian) arrivals had shown growth of 2.2%. Visitor expenditures for the first three quarters of 2003 decreased by 7.5% against the same period in the prior year, with a sharp decrease in the third quarter. The number of

bednights sold also decreased by 12.3%. Employment in the hotel and restaurant sectors continued to fall by 3.7%.

Overall, there has been a marginal decline of 0.4% in the number of jobs in Bermuda. Although there was continued strong growth in employment in international business (5.3%) and public sector and real estate sector (2%) there were sharp decreases in the hospitality sector, principally as a result of the effects of Hurricane Fabian on capacity. 2002 showed modest increase in total number of jobs of 0.5%

Inflation for 2003 averaged 3.2%, slightly higher than that experienced in the G7 countries. The forecast for 2004 is for this to moderate and track in a range centered around 3.0%, although this estimate is based on an expectation of a lack of sharp increases in university and private education costs and a cautiously optimistic outlook for oil prices. This is marginally higher than the consensus forecasts for the G7 countries of between 1.5% and 2.6%.

The Effect on Individuals

Payroll Taxes

- Standard rate to be increased to 13.5% from 12.75%
- Employee portion to remain unchanged at 4.75%
- Payroll tax cap to be increased to \$235,000 from \$225,000

Property

- Land Tax rates to be reviewed following a revaluation of Annual Rental Values with effect from July 1, 2004 not expected to vary individual bills significantly.

Pensions

- Pension benefits to be raised by 9% with effect from August 2004.
- Contribution rates to increase by 4.25% from August 2004.

Household

- Duty on cigarettes increased to 15.5 cents from 13 cents per cigarette adding \$5 to the existing retail price of carton of cigarettes
- Duty on steel doors and windows to be reduced from 22.5% to 10%
- Bus and ferry fares to increase by 10% with effect from 1st April
- Private vehicle license fees to be increased by an average of 5% with effect from 1st April
- Cell phone annual license fees increased from \$3 to \$5 per month
- At the Bermuda International Airport, the allowance of \$100 for persons entering or returning to Bermuda with goods purchased overseas will remain in place but Government will remove the condition of having to have been outside Bermuda for 72 hours.

Focus on Tourism

The budget recognises the vital importance of the tourism industry and the symbiotic relationship between the twin pillars of our economy – tourism and international business.

In addition to the continuation of the trend of declining tourist numbers, the major challenge to tourism in 2003/04 was the devastation wrought by Hurricane Fabian. This led to decreased revenues from passenger and hotel taxes and temporarily reduced Bermuda's bed capacity by 20% or 1,200 beds. As a result there was a rise in short-term structural unemployment in the sector.

In order to provide assistance in the rebuilding process, legislation has been brought forward to extend the Hotels (Temporary Customs Duty Relief) Act 1991 by a further 5 year period. In addition, Hotel Occupancy Tax and Passenger Taxes will remain unchanged in 2004/05. The hospitality industry has been excluded from the increase in payroll tax.

The Ministry of Tourism's allocation of current programme expenditure comprises \$35.7 million of the total \$43.3 million expenditure allocated to the Ministry of Tourism, Telecommunications and E-Commerce in the 2004/05 budget. The budgeted decrease in expenditure of \$223k on the prior year reflects the transfer of sport/community events to the Ministry of Community Affairs and Sport.

Impact on Business

The Government's focus in 2004/2005 is to stabilize, rejuvenate and encourage business activity in all economic sectors. Results from the Annual Employment Survey indicate a marginal decline in overall employment levels of 0.4% in 2003, reflecting a loss of 135 jobs across the economy. Employment levels in the international business sector rose by 5.3% or 189 positions. The public sector and real estate sector employment levels rose by 2%, the wholesale and motor-vehicle sector posted an increase of 1.8%, and the construction sector was virtually unchanged from the previous year. During 2003, the number of international companies registered in Bermuda increased by 191.

The outlook for 2004 in the United States appears brighter than in recent years. As a key trading partner, this should have a positive effect on the Bermuda economy. The economic fundamentals are stable and the outlook is for steady improvement in 2004.

To meet the objective laid out by government for 2004/05, the Government is proposing the following:

- Increase of Payroll Tax to 13.5% from its existing rate of 12.75%. This increase will apply to all business with annual payrolls in excess of \$200,000. The employee portion will remain 4.75% in 2004/05.
- Payroll Tax salary cap of \$225,000 will be increased to \$235,000.
- No tax increase in other payroll tax categories which include farmers and fishermen, hotels, guest houses and restaurants.
- Government is in the process of finalizing the valuation of Annual Rental Values, which are expected to increase 25 to 30%. Tax rates are expected to be adjusted to minimize the impact to taxpayers.
- Government fees and services will increase by 5% on average.
- Cellular telephone license fees increased to \$60 annually.
- Duty reduction from 22.25% to 10% for steel doors, windows and their frames.

Retail merchants and farmers have requested relief from Customs Duty. Government does not feel that this is prudent at this time, but will continue discussions with these groups to understand their requirements and the scope of relief they seek to arrive at a solution.

Social Agenda

Within this budget, Government has focused on a robust domestic social agenda to improve the overall quality of life for the people of Bermuda. The key developments were in healthcare, culture and education.

Healthcare

- Ministry of Health and Family Services – budget increased by \$6.5m. Areas of development include: increased funding for the provision of therapy services for students in the new special school; grant awarded to the National Drug Commission for the establishment of a women's treatment facility; development of a public-private partnership with Fordham University to initiate study on "Ageing in Bermuda."
- Duty on cigarettes raised from 13 cents to 15.5 cents/per cigarette in conjunction with an aim for long-term reductions in healthcare costs.

Culture

- \$15.7m budget for Ministry of Community Affairs and Sport of which \$308,000 focused on special interest programmes and signature sporting events. Additional grant for funding community programmes, including "Grass Roots Programme."

- Additional funding allocated for the research and development of plans for a School for the Performing Arts, establishment of a Financial Services Academy and a grant to the Bermuda Sloop Foundation.
- \$60,000 allocated to pilot "Ashay Rites of Passage" – a cultural education programme for students.
- Renewed focus on aquatic programmes in public schools through the Bermuda Sloop Foundation.
- Additional funding to be determined for the Bermuda National Gallery and Family Learning Centre.
- \$204,000 provided for continued education opportunities through Teen Services.

Education

- \$13.9m granted to Bermuda College to assist with the administration and delivery of academic and technical diploma and degree programmes for the community.
- Continued focus on the provision and delivery of programmes to improve the knowledge base of students and delivery instruction.

- \$292,000 provided for a mathematics literacy project aimed at preschool, primary and middle levels.
- New funding of \$220,000 to expand the character education programme, to promote "good citizens" within the student community.
- Allocation for staff development and teachers maintained at \$456,000.
- \$693,000 approved funding for Summer Employment Programme to assist about 250 secondary and university level students to be employed in various Government Departments.

Other Social Programmes

- Planned investment of \$115m in educational plant and equipment, St. George's Residential Care Facility for seniors, refurbishment of ferry docks and public landings, the new Hamilton Police Station and Magistrates court among other key projects.
- \$600,000 new funding for 5 additional police and civilian support staff for Bermuda Police Services Financial Investigations Unit. Additional funding provided to increase police force to maintain safety in the community.

Economic Figures

“...the good news is that we weathered the storm. The even better news is that notwithstanding the ravages of Hurricane Fabian, the economic outlook for 2004 is promising.”

The economic figures in this table have been adjusted to reflect actual figures for the prior years. Percent changes relate to original estimate. Please note that the Government now uses current market prices for GDP calculations.

The following highlights significant components of the 2004/2005 budget:			
	04/05 estimate	03/04 revised	Change
Revenues	693.9	666.4	4.1%
Current account expenditures (excluding debt and sinking fund)	648.9	632.1	2.7%
Capital expenditures	114.9	93.4	23.0%
Deficit	81.2	70.2	15.7%
Debts and guarantees	224.6	140.2	60.2%
The economic figures in the table below have been adjusted to to reflect actual figures figures for the prior years.			
	2002	2003	2004
Population	62,000	62,000	62,059
GDP (at constant market prices (1996), \$b)	3.136	3.214	3.286
GDP per capita (\$)	50,581	51,839	52,955
% change	2.0%	2.5%	2.0 - 2.5%
	02/03	03/04	04/05
Current account (\$m)			
Revenue	671.1	666.4	693.9
Expenditure (excluding debt and sinking fund)	559.2	632.1	648.9
Balance	111.9	34.3	45.0
Current account expenditure per capita (\$)	9,019	10,195	10,456
% change	4.8%	13.0%	2.6%
Capital expenditure (\$m)	70.8	93.4	114.9
Capital expenditure per capita (\$)	1,142	1,506	1,851

* estimate value

% changes relate to revised estimate/actual as appropriate

This briefing is intended as a general guide to the Budget 2004. It is not intended to be comprehensive and should not be used as a basis for decisions. For that purpose advice should be obtained which takes into account all the client's circumstances.

Every effort has been made to ensure the accuracy of the information contained herein. In view of its purpose the reader will appreciate that we, the Bermuda firm, are unable to accept liability for any errors or omissions which may arise.

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