Bermuda Fiscal Responsibility Panel
Annual Assessment

2022

Jonathan Portes (Chair), Marian Bell and Victoria Perry | November 24, 2022

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List of Acronyms

BELCO: Bermuda Electric Light Company

BEPS: Base Erosion and Profit Shifting

BHB: Bermuda Hospitals Board

BHP: Bermuda Health Plan

BMA: Bermuda Monetary Authority

COP: Conference of the Parties of the UN Framework Convention on Climate Change

CPF: Contributory Pension Fund

CPI: Consumer Price Index

ERP: Economic Recovery Plan

FAR: Fuel Adjustment Rate

GDP: Gross Domestic Product

GEHI: Government Employees' Health Insurance

IF: Inclusive Framework

IMF: International Monetary Fund

IPCC: Intergovernmental Panel on Climate Change

MNE: Multinational Enterprise

NDC: Nationally Determined Contribution

OECD: Organisation for Economic Cooperation and Development

PMO: Project Management Office

PRC: Permanent Residency Certificate

PSSF: Public Service Superannuation Fund

RA: Regulatory Authority

TRC: Tax Reform Commission

UHC: Universal Health Coverage

UN: United Nations

Executive Summary

This is the Panel's eighth annual report. We visited the Island from 20 to 25 November, and we have had productive discussions with Ministers, officials and many others. We are grateful for their contributions, but all the judgements and recommendations are our own.

Bermuda's post-pandemic recovery continues, driven by international business and a gradual recovery in tourism. But the sharp rise in inflation and interest rates in the US and globally has inevitably impacted the Bermudian economy. The long-term increase in debt—now well over $3 billion, nearly three times annual revenues—remains a serious concern.

We expect the Government to remain within its fiscal guardrails, for the ratios of gross and net debt to GDP, for the forecast period. The 2022-23 plans announced in the 2022 Budget in February provide for revenues and spending higher than previously planned. Beyond 2022-23, the higher revenue forecast assumed some increase resulting from both tax reform and continued revenue buoyancy; the increase in the spending plan reflected a more realistic vision than that in the 2021 Budget—the extremely tight restrictions of which in our view were unlikely to be realised. And the overall fiscal strategy set out in 2022 was more coherent and credible than that of previous Budgets, in particular the adoption, in line with our recommendation, of a target for a budget surplus of $50 million in 2026-27. These were all very welcome developments.

Yet, the 2022 Budget projections themselves are no longer realistic, as spending plans and revenue estimates for this year are both now significantly higher than projected at the time of the Budget. Furthermore, the Budget assumed that spending would grow by only 1.5 percent per annum in future years, but in the Panel's view this was, and remains, extremely unlikely. Rather, based on spending pressures and recent experience, the Panel's own "likely scenario" is for spending to grow 1 percent more slowly than revenues. This would result in the budget not being balanced until 2025-26 and a budget surplus of about $25 million in 2026-27, well short of the $50 million target. Even this assumes that tax reform, long delayed, does finally deliver some structural increase in revenue. And even under this relatively optimistic scenario, the debt to revenue ratio would remain close to 300%, in sharp contrast to the government's long-term objective of 80%.

This leads to several recommendations:

- The Panel reiterates **its recommendation that the government plan for an annual budget surplus of at least $50 million for 2026-27 and subsequent years.** This is the absolute minimum needed to make appreciable inroads into Bermuda's large external debt burden. Current policies, which assume implausibly low spending increases, and largely rely on revenue buoyancy to produce revenue increases, are in our view unlikely to deliver this; further structural increases in revenues are required.
- Second, we note that previous commitments to increase revenues from tax reform have not materialised; indeed, recent changes and commitments to further tax concessions have put downward pressure on future revenues. Since its inception the Panel has recommended fundamental reforms aimed at broadening the tax base, increasing the progressivity of the tax system, and increasing revenues, including taxing individual capital income. We understand that the Government intends to consult on a number of these issues in the Pre-Budget Report, including revisiting some of the earlier recommendations from the Tax Reform Commission. **We welcome this and recommend again that the Government commits, in the next Budget, to legislating and implementing a set of reforms along the lines set out above.**

- Third, **it is important that the Government endeavours to avoid in year fiscal policy changes in normal circumstances**.

As noted in last year's report—and now even more critical, in light of global tax reform developments—the Government should liaise closely with the international business sector regarding the potential impact of and responses to the proposed Global Minimum Tax. In this regard, we are very encouraged that the Government intends to constitute an advisory group comprised of the key stakeholders to pursue this particularly complex issue. As the Premier recognised both last year and this year, this global change can have important implications for potential revenues, as well as for the behavioural responses of the international business sector in Bermuda.

Broader long-term issues

Economic growth, competition and diversification are important. In particular, the banking sector should provide greater access for Bermuda residents and businesses. Barriers to growth include lack of a shared credit scoring system, lack of a requirement for routine provision of business financial statements, lack of clear legal procedures for handling company failures outside the financial sector, and the absence of competition law. These are legal and regulatory framework issues—as opposed to "digital" issues—and as such their solutions can be addressed by Government now.

Bermuda is at high risk from climate change. The current serious and welcome focus on improving the resilience of the island to rising sea levels and extreme weather events must be sustained. Mitigation of Bermuda's quite tiny emissions is not of great importance either for Bermuda or for the world in general—though increasing Bermuda's reliance on renewable energy would have a positive environmental and economic impact. The Climate Task Force should be adequately resourced and supported, and recommendations for increased climate resilience should be incorporated into all Government strategies.

The current serious and welcome focus on improving the resilience of the island to rising sea levels and extreme weather events must be sustained.

As the Panel has emphasised before, the single most critical problem facing Bermuda in the medium to longer term is that of the size and composition of its population. Addressing this problem is a question of increasing immigration and the labour force—there is no other solution. The Panel endorses the analysis and recommendations contained in the recent September report from the Ministry of Economy and Labor. While the changes introduced in January 2022 were very welcome, and clearly a step in the right direction, change in this regard must go further, expanding the ability of workers to achieve permanent residency and to move to Bermuda as a home, as well as encouraging educated and skilled Bermudians to return. This is crucial for economic growth, for the future of the health and pension systems needed to support ageing Bermudians, and for the generation of tax revenues to support longer term efforts for the public welfare .

The Bermuda government is faced with huge contingent liabilities in several areas, a problem which has been well recognised but must be addressed now.

- Pension liabilities are well understood, and have been analysed and assessed at length. The Government should move to implement without further delay reforms designed to make the system more sustainable, including increasing retirement ages.
- Similarly, government provided health benefits are planned to be reformed along the lines of the Bermuda Health Plan to provide affordable universal health coverage better, and more efficiently, than that now available. Again, the Government now needs to move from plans to implementation.
- Finally, guarantees for commercial businesses pose a substantial risk—as has been seen in the recent call of the Morgan's Point guarantee—and should be significantly curtailed. Guarantees virtually never should be issued to back commercial projects—including those included in the Economic Recovery Plan.

The Government is addressing many of the most serious problems facing the country, including issues raised in our previous report. The overall fiscal strategy set out in the 2022 Budget is more coherent and credible than that in prior budgets, but further action is required to deliver it. The fallout from the pandemic is largely behind now, though new global problems—inflation, fuel prices, and worsening climate change—now face the country. The Government has responded with an ambitious and challenging agenda: the Economic Recovery Plan, the Bermuda Health Plan, the Climate Task Force, an agenda to reform the pension system, and the recent Ministry of Economy and Labor report on demographic pressures. What is now required is implementation and delivery.

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A. Introduction

1. This is the Panel's eighth annual report. Our remit, shown in Box 1 below, is set out by the Minister of Finance in our letters of appointment; it has been revised to incorporate the Government's latest fiscal targets as set out in the 2022 Budget.

Role of the Panel

The Panel is established to provide Bermuda's Parliament, Minister of Finance and the Financial Policy Council with an annual published assessment of the territory's fiscal strategy, focusing on progress in meeting the territory's medium term objectives for public spending, taxation, borrowing and debt reduction.

In its reports the Panel will therefore review:

Progress towards the Bermuda Government achieving a balanced budget by fiscal year 2024-25 ***[Note: the 2022 Budget revised this target from 2023-24 to 2024-25 and added a target of a $50 million surplus in 2026-27.]***

Compliance with the fiscal guardrails that Government has established – ratio of gross debt to GDP not to exceed 55%; ratio of net debt to GDP not to exceed 50%; and debt service to GDP not to exceed 3%.

Prospects for further progress towards meeting the longer-term aims of reducing debt and debt service to less than 80% and 10% of revenues, and for implementing the rule that net borrowing can only be considered to finance capital spending.

In making its assessment, the Panel will review the impact of the most recent Bermuda Government annual budget; the credibility of macro and fiscal assumptions underlying Government projections; and the risks that could affect progress in meeting the territory's fiscal goals.

The Panel may offer advice where needed on ways to refine these goals, and on adjustments to fiscal strategy and tax and spending policies needed to achieve them. If there are dissident views within the Panel, these will be included in its report.

2. The Panel is comprised of Jonathan Portes (Chair), Marian Bell, and Victoria Perry. We greatly value the face-to-face interaction with Bermuda's key stakeholders, inside and outside government, that we gain from our annual visits, and we were therefore pleased that we were again able to visit Bermuda this year, between November 20 and November 25. We had a full schedule of meetings and helpful discussions with Ministers and their officials, and thank particularly Cheryl Lister, Deborah Harris, Carol Martin and the other staff of the Ministry of Finance for their support. We would also like to thank the many others on the Island who have offered us information and advice (a complete list of our meetings is in Annex A). However, the report's judgements and recommendations reflect our own independent views. Our report is, as with all our reports to date, unanimous.

3. The report is structured as follows. Section B summarises our key findings and recommendations from last year; section C sets out economic developments, both international and domestic, since our last report; section D examines fiscal developments; section E sets out our judgement of the Government's progress towards meeting the fiscal rules and targets set out above; and section F focuses in detail on international corporate taxation issues. Looking forward, section G discusses broader issues, opportunities and risks. Finally, Section H summarises our conclusions and key recommendations.

B. Key findings of the 2021 Report

4. At the time of our 2021 Report, Bermuda's economy was recovering from the worst effects of the pandemic, but recovery was very far from complete. Meanwhile, inflation was beginning to squeeze household incomes. And, as a direct result of the pandemic, but also the calling of the Carolina Bay guarantee, net debt had risen to more than $3 billion, up more than a billion since the Panel began its work in 2015. We therefore welcomed the Government's renewed commitment to balance the budget by 2023-24 and noted that forecasts implied that the government would remain within its new fiscal guardrails, for the ratios of gross and net debt to GDP, for the forecast period. However the debt to revenue ratio, the most important indicator of Bermuda's fiscal sustainability, remained at over 300%, far above the target of 80%.

5. We also noted significant risks to the fiscal outlook, both domestically and internationally generated. We reaffirmed our long-standing concerns that Bermuda remained dependent on international capital markets to refinance its debt, and was therefore very vulnerable to a rise in global long-term interest rates—a risk that had increased in the uncertain economic environment after the pandemic.

6. We therefore argued that, over the medium term, the Government needed to boost revenues to reduce debt from its very elevated post-pandemic level and to manage the considerable contingent liabilities. More broadly, Bermuda's most fundamental challenge remained demographic; a shrinking workforce and an ageing population inevitably undermines the sustainability of the public pension and health systems. Both systems require reform, but a growing working population would make a major contribution.

7. Our recommendations therefore covered both fiscal issues and the broader structural reforms needed to put the public finances on a more sustainable long-term path. We recommended that at the next Budget the Government commit to a further set of specific time-bound objectives for revenue and budget balance after 2023-24. Consistent with our previous reports, we recommended the Government target a budget surplus of $50 million per annum, to be achieved by fiscal year 2026-27 and continued thereafter, to pay down the debt and to demonstrate real progress towards meeting the debt-revenue target.

8. We also recommended that the Government's response to any agreement on a global corporate minimum tax should aim to ensure that a significant share of any increased total taxes falling on its international businesses accrues to Bermuda rather than elsewhere; and that the reconstituted Tax Reform Commission (TRC) should be charged with developing a medium term tax strategy to increase tax revenues by moving toward a more progressive tax structure that taxes earnings from capital, including interest, dividend and rental income, as well as labour, and broadens the tax base while disincentivising behaviour that is damaging to health or the environment.

9. Beyond tax policy, our key recommendations included the following:

i) We cautioned that the government should limit the provision of government guarantees, as these impose potentially large future fiscal costs.

ii) We welcomed the ambitious proposals to boost growth set out in the Economic Recovery Plan (ERP), and emphasised the need to focus on delivery of the key elements of the plan.

iii) We noted the need to ensure that digital initiatives would in no way jeopardise Bermuda's hard-won reputation as a well-regulated global financial centre.

iv) We reaffirmed our long-standing view that further action should be taken to expand the working population through a flexible and responsive immigration policy.

v) We welcomed the government's commitment to pension reform, which in our view should include increased contributions and higher retirement ages to address the large actuarial deficits in the current plans.

vi) We noted the Island's vulnerability to climate change, and recommended that policy focus on increasing the Island's resilience to the impacts of climate change.

C. Economic developments

10. Overall, the world economy grew rapidly in 2021 as it bounced back from the worst effects of the COVID-19 pandemic. However, as economies reopened, inflationary pressures began to emerge in late 2021, reflecting the continuing impact of the pandemic on supply chains and the extraordinarily loose macroeconomic policy run by most advanced economies. Energy prices rose sharply. These pressures were severely exacerbated by the Russian invasion of Ukraine in February 2022. That, and the response to it, led to a reduction in supply and a sharp rise in the price of oil and gas, and of several important foodstuffs.

11. In response to rising inflation, central banks have raised interest rates and begun shrinking their balance sheets. The result has been a sharp rise in both short-term policy rates and long-term interest rates: the benchmark US 10 year Treasury bond yield traded well above 4% in October before falling back to 3.7% at the time of writing—more than double the 1.5% seen at the time our last report was written in late November 2021. Moreover, there is some evidence that the significant and widespread pick-up in inflation has dislodged inflation expectations and undermined central bank credibility, which had been a key foundation of low and stable inflation in the preceding decades. The longer elevated inflation rates continue, the greater the risk that short term interest rates will have to remain higher for longer for credibility to be restored.

12. In conjunction with the global recovery, Bermuda's economic recovery continued. Real, inflation adjusted, Gross Domestic Product (GDP) rose 5.4% in 2021 to stand 1.8% below its 2019, pre-pandemic, level. In current prices, the output of the Bermuda economy in 2021 was $7.3 billion. Although the recovery was fairly broad based, international business, Bermuda's largest sector accounting for 28% of the economy, was by far the biggest contributor to growth in 2021, up 8.4%– its fastest growth since 2007 –with reinsurance, portfolio management and insurance brokerage growing most rapidly. Growth continued, albeit more slowly, into the first half of this year when GDP was 1.4% higher than a

year previously. While the total number of jobs in Bermuda fell 3.4% in 2021[1], International Business added 172 jobs, growing its workforce by 4.1%. Many of the additional international finance jobs were senior managerial positions at director and chief executive officer level, which bodes well for further expansion of the sector.

13. Tourism and business travel has also staged a partial recovery, but remains weak. This partly reflects the ongoing closure of the Fairmont Southampton, the Island's largest hotel and conference centre, which will not reopen before 2024 at the earliest, and a reduction in air capacity to Bermuda, including the loss of direct flights from Boston in the winter months. Although air visitor numbers have been growing strongly and have exceeded budget forecasts, providing a useful income stream, arrivals in the first three quarters of this year were about 56 % of pre-pandemic levels. However, air visitors are reportedly staying longer and spending considerably more per person than in 2019. Cruise ship passenger numbers have returned to about 70 % of pre-pandemic levels, but per passenger spending has risen only very slightly. Several cruise ships cancelled Bermuda stopovers in the autumn, as testing and travel authorisation remained more onerous than in other jurisdictions. However in mid-November the Travel Authorisations was discontinued and all other COVID public health emergency measures are to be lifted by the end of November 2022.

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[1] Survey reference week (August 29 to September 4, 2021).

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14. After adjusting for inflation, the volume of local retail sales in Bermuda was 1.1% lower in July 2022 than a year earlier, and 6.7% lower than before the pandemic in July 2019, continuing the flat to declining trend of on-island retail spending seen in recent years. However the current value of overseas declarations[2] continued to grow, up by 1.2% in the year to July to stand 21.0% above the pre-pandemic level three years earlier.

15. The external account has continued to be strong. As all but the goods account improved over the year, the surplus on the current account of the balance of payments widened to $334m in the first quarter. The largest contributor to the improvement was the primary income account and particularly a net increase in receipts from non-residents, with employee compensation especially strong. Meanwhile Bermuda's net international investment position improved further to $6.1 billion in the first quarter.

16. Domestically generated inflation as measured by the GDP deflator was 3.9% in the second quarter, and consumer price inflation has risen significantly. August's 4.7% inflation rate equaled that of June, a 14 year high[3]. Food, up 9.5% year-on-year, and Transport and Foreign Travel, up 9.1%, were the largest contributors to the annual inflation rate in August, the latter boosted by the cost of overseas hotel stays and a 14.3% rise in airfares. Also experiencing an above average annual increase, but forming a lower proportion of household spending, was Fuel and Power, up 15.2% in the year.

17. All commercially generated electric power in Bermuda is generated using fuel oil and diesel, imported from the US by ship. US export prices for relevant fuels, year on year July 2021 to July 2022 increased by nearly 50 percent; overall fuel costs to BELCO jumped from $70 per barrel in January, to $130 per barrel by March, reflecting world prices in the wake of the Russian invasion of Ukraine, but prices have fallen back in recent months. Fuel cost increases are passed directly to households through the Fuel Adjustment Rate (FAR) which was increased in July by 6.5 percent, meaning household energy prices, already high by international standards, rose still more. However, the falling oil prices in recent months allowed the FAR to be reduced in October by just over 16 percent, to $0.16874/kWh from the July FAR of $0.2012/kWh. As of this month, Bermuda ranks fourth in the world in price per Kwh, at just over $0.40. BELCO earlier this year requested an increase in the "retail tariff/usage" portion of its prices by 16 percent; however, the Bermuda Regulatory Authority granted only a 7.6 percent increase. Thus for the moment at least some pressure on energy consumers has been mitigated.

18. Given Bermuda's reliance on imported goods and energy, and the currency peg to the dollar, it was inevitable that a sharp rise in US inflation would increase inflationary pressures on the Island, although inflation has not risen as far or as fast as in many advanced economies, in part because of government action to reduce the pass-through of fuel and energy prices. Similarly, rises in US interest rates have direct implications for borrowing costs for Bermudian businesses and homeowners, although the local retail banks have been able to limit the extent of pass-through to borrowers. Bermuda therefore faces similar economic risks to many other advanced economies, with rising inflation and higher interest rates reducing consumer and business confidence, real incomes, and consumer demand. Bermuda is likely to face a prolonged period during which the unfavourable external economic environment has a direct impact.

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[2] Goods declared, whether for personal or business use, by returning residents via the airport, imports via couriers, imports via the Bermuda Post Office and the value of non-commercial imports by households via sea.

[3] The correction of inaccuracy in compiling the Fuel and Power component of the Consumer Price Index led to a discontinuity in the series between June and July 2022.

19. While work continues on the Economic Recovery Plan, the government does not expect it to be making a significant positive contribution to GDP growth until 2023, when it was forecast to raise GDP by 1.3-1.5% per year. Responsibility for implementing the Plan has been transferred to the Ministry of Economy and Labour, and the Panel is encouraged that the Project Management Office (PMO) commenced work in June. The 31 wide-ranging initiatives have been prioritised with emphasis on the rehabilitation of Tyne's Bay infrastructure, the development of Uptown Northeast Hamilton, the development of the casino industry and the development of vertical farming, in addition to expanding the workforce. However, it is reported that the partner in the vertical farming initiative has encountered financial difficulties, which will slow progress.

D. Fiscal developments

20. In our 2021 report, we noted that the COVID-19 crisis had left a permanent scar on the Government's fiscal position; and that, while the Government's plans were consistent with the objective of eliminating the deficit by 2023–24, there were significant risks, both domestic and international, and limited room for slippage. We criticised slow progress on tax reform, and were sceptical that in practice the Government would be able to deliver the very tight expenditure limits proposed in the 2021 Budget. We repeated our warnings that Bermuda remained at the mercy of the credit rating agencies and financial markets, themselves driven by uncertain global events.

21. Since then, a number of these risks, both domestic and international, have materialised. On the positive side, the fiscal outturns for 2020–21 and 2021–22 showed a material improvement on the projections included in the 2021 Budget and in our last report. Following on from a better than expected $184 million deficit in 2020–21, the deficit for the 2021–22 fiscal year is estimated, as of September, to have been $81 million, a $44 million improvement on the $124.7 million originally budgeted.

22. This reflected faster than forecast growth in both revenues and spending. Revenues for 2021–22 were, at $1.07 billion, 7% above the original estimate, primarily due to Customs Duty, Stamp Duty, Passenger Tax, Civil Aviation Receipts, Payroll Tax and Travel Authorisation Fees performing better than expected.

23. However, as we warned, the Government's tight current spending targets have indeed proved undeliverable. Covid-related expenditures of about $37 million, including $20 million for the Skyport minimum revenue guarantee, are estimated to have exceeded budget by $22 million, and with an overspend of about $20 million on other current spending meant that total current spending was $42 million in excess of the original estimate. In addition, the cost of debt interest payments and guarantees was $5 million above that originally estimated, largely reflecting further unforeseen costs of the Morgan's Bay guarantee. This was somewhat offset by capital expenditure falling a projected $17 million below budget.

24. In the Budget, the government substantially adjusted plans for 2022–23, to provide for faster growth in both revenue and spending, and a slower pace of deficit reduction. The 2021 Budget projected that spending in 2022–23 would be $896 million. But, as the Premier observed in the 2022 Budget speech, this would have required substantial cuts to public services and large numbers of redundancies. The 2022 Budget provided for spending of $945 million, fully $50 million (or more than 5%) higher than previously planned, and revenues of $1.078 billion, about 3% higher than planned. The overall deficit for 2022–23 was therefore at the time of the Budget forecast at $70 million, well in excess of the $41 million deficit previously anticipated for the year.

25. The government extended several temporary COVID related emergency measures in the Budget, including Supplementary Unemployment Benefit (SUB), initially until 31 August but subsequently extended again until November 2022, hospitality payroll tax concessions, and voluntary pension withdrawal, and provided additional cost of living support in the form of reduced payroll tax for persons earning less than $96,000, a 10% reduction in vehicle licensing fees, and land tax relief for charities and registered care homes. Fuel prices at the pump were frozen from February to insulate the economy from the impact of the war in Ukraine.

26. Taken together, the net effect of these substantial changes to planned revenues and expenditures was to push the target date for achieving a balanced budget back by a year, to 2024–25, with surpluses budgeted thereafter. However, in line with our recommendation, a $50 million surplus was planned for 2026–27 and subsequent years. The Budget plans anticipated that this would be achieved by revenue increases of 4% and 5% in the next two fiscal years and 3% thereafter, offsetting expenditure increases of 0.5% next year and 1.5% per annum thereafter.

27. However, the Budget is already out of date. In July, the government, as foreshadowed in the Budget, chose to recycle half of the then expected improvement in the 2021–22 deficit relative to the original forecast into a $15 million economic relief package. This comprised a number of measures designed to help working families with the rising cost of living. Most important is a payroll tax rebate for low earners: those earning less than $60,000 annually received a $250 rebate and those earning between $60,000 and $96,000 a $100 rebate. In addition, a payment of $150 per pupil was made in September to all parents and guardians of students in public schools to assist with school expenses for the new academic year; LED lightbulbs were acquired for free distribution to households; the Department of Financial Assistance food allowance budget was increased by 15%; duty relief on the importation of vehicle fuel was extended to ensure the ongoing freeze in fuel prices at the pump; and the duty on staple goods was reduced and measures put in place to ensure savings are passed on to consumers.

28. Following stronger than expected revenues continuing into the first quarter of fiscal 2022–23, implying an additional $30 million for the year as a whole, some further expenditure increases were announced in September, including spending on affordable housing and bringing forward expenditure on the Tynes Bay Waste to Energy facility. The forecast budget deficit was little changed, compared to the Budget, at $72 million.

29. In a further debt refinancing exercise in July 2022, the Government sold $500 million of 5% ten-year notes, the proceeds of which will be used to pay off a $140 million 5.73% note due in December and a $354 million 4.138% note due in January 2023, meaning that the government would not have to return to financial markets until early 2024. However, in contrast to previous refinancings, interest rates on new borrowing were similar to those on the outstanding notes, rather than considerably lower, and the refinancing meant that Bermuda would pay an additional $2.3 million per annum in interest, while not materially changing the overall net debt figure.

30. Subsequently, in August ,the government took the opportunity of favourable market conditions and a reduced spread over US Treasuries, reflecting a positive assessment by credit rating agencies, to extend the refinancing. An additional $390 million of 5% Senior Notes due in 2032 were issued at a premium placement yield of 4.54%, sufficient to redeem the approximately $400 million of outstanding notes due in 2024. Combined with the initial issuance, gross debt will decline by about $6 million as a result of the summer refinancings. In conjunction with taking $50 million from the Sinking Fund to repay domestic debt maturing in 2023, it is not expected that Bermuda should have to return to the financial markets before a January 2027 note is due for redemption.

Government Debt

Pro Forma as of 4 December 2022*

Issue Type	Currency	Maturity	Coupon	Principal Outstanding ($ millions)
Local Issue	BMD	16/12/2023	4.750%	50.0
144A/Reg S	USD	25/01/2027	3.717%	604.6
144A/Reg S	USD	01/11/2029	4.750%	449.3
144A/Reg S	USD	20/08/2030	2.375%	675.0
144A/Reg S	USD	15/07/2032	5.000%	890.0
144A/Reg S	USD	20/08/2050	3.375%	675.0
Total				**3,343.9**

**$140 million non-redeemable private placement notes due 12/4/2022*

E. Panel Assessment

31. The 2022 Budget includes a detailed response to our major recommendations on the path of future spending, debt and deficits. Despite a delay in achieving budget balance, the Government responded positively to our recommendation that it target a budget surplus of $50 million in 2026-27, and set out illustrative revenue and expenditure projections for 2025-2026 and 2026-27 that meet that goal, so that we would finally begin to see a meaningful decline in Bermuda's net debt. We also note that the 2022 Budget Statement contains more detail on revenue and expenditure forecasts and the evolution of Government debt than previous statements; in particular, the inclusion of (albeit broad-brush) revenue and expenditure projections up to 2026-27, two years further out than previous statements. This additional transparency is welcome.

32. We welcome the evident seriousness with which the Government has addressed the issues raised in our report. The commitment to substantive tax reform responds to one of our key fiscal recommendations. However, the fiscal projections set out in the Budget are no longer realistic, since both the spending and revenue estimates for the current year are already significantly higher than planned at the time of the Budget. They therefore do not form a useful basis for assessing whether the Government is on track to meet its fiscal targets.

33. We have therefore made our own assessment, taking account of the latest available information supplied by the Government. In assessing the fiscal position, one approach would be to assume that the "baseline scenario" for Government plans is the percentage revenue and spending increases set out in the Budget, which assume revenue will grow faster than nominal GDP in the short term as a result of tax reform, and very tight control of spending. The Budget provided for revenue growth of 4% in 2023-24 and 5% in the subsequent year, and 3% thereafter, which was to be delivered by a combination of economic growth and tax reform. However, given this year's higher outturn, this would now imply an increase of only 1% in 2023-24 from that baseline, compared to the current forecast outturn for 2022-23. We therefore assume that revenues grow in line with the Budget projections, but from this year's higher base. We see this as the minimum plausible objective.

34. Under this scenario, there would only be a relatively small deficit in 2023-24, and by 2026-27 the surplus would reach $86 million, well in excess of the target of $50 million, and a welcome step toward bringing down the debt to revenue ratio more rapidly. We describe this as the "policy scenario", since it is consistent with the revenue and spending growth projections incorporated in the Budget.

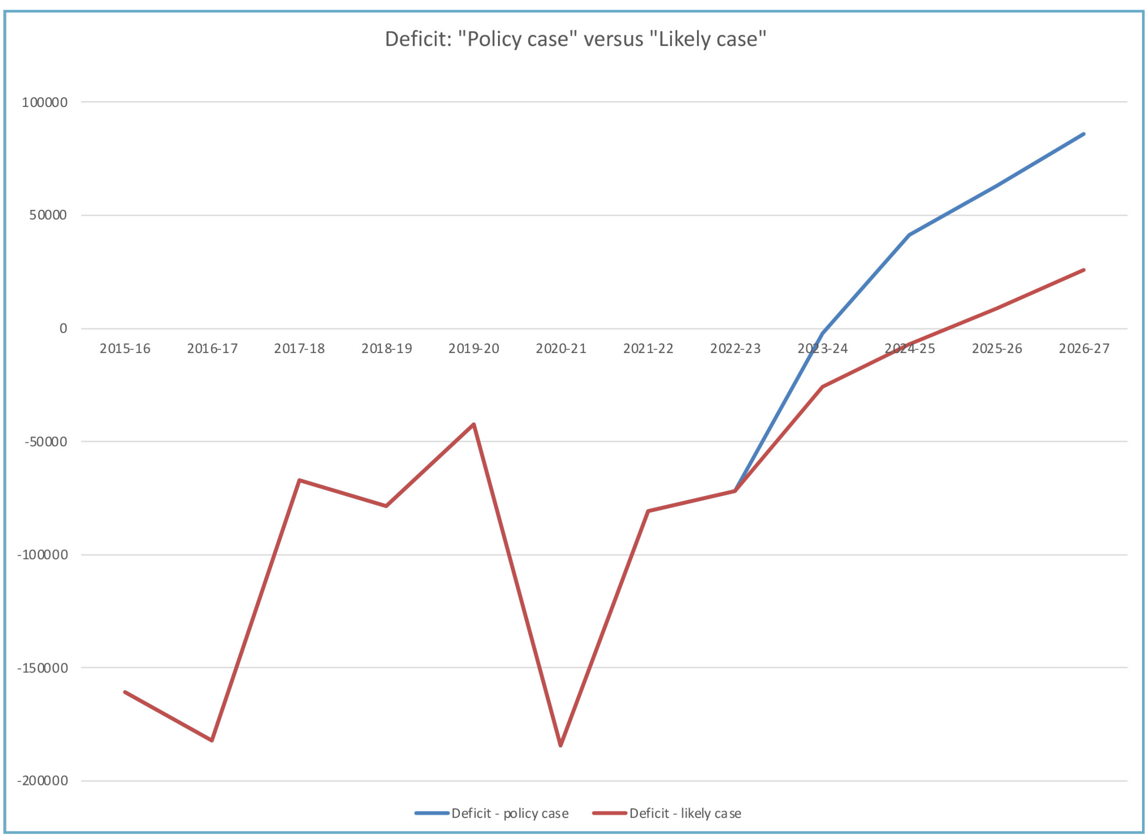
35. But it also seems completely unrealistic, particular as regards spending. The Budget assumed that current spending only grows by 0.5% in 2023-24 and 1.5% a year thereafter. But spending (excluding spending directly related to covid) has risen by about 5% per year over the last 2 years. There will be further upward pressure on spending in both the short term, as a consequence of political pressure for the government to provide additional support for households to deal with the cost of living crisis, and over the medium to long term. Moreover, the July and September packages suggest that government will in practice increase discretionary spending if and when revenues increase. Our assumption, therefore, is that future spending will in practice run well ahead of Budget projections, and our assessment of the overall fiscal position needs to take account of that.

36. In previous reports we have argued for a review of public services and a focus on improving processing and administrative efficiency in the provision of government services. It remains the case that there is scope for further reform. But Bermuda's spending is not out of line with that of similar British Overseas Territories and Crown Dependencies which provide a similar range of services.

37. In keeping with the Premier's statement in the original 2022-23 Budget Speech, regarding legitimate demands for salary increases in the public sector—negotiations around which are ongoing—current projections include the assumption of some increase for this year. However, it appears that the final outturn for spending in 2021-22 may be just a bit below that included in the latest published figures, which would reduce the baseline very slightly.

38. We therefore construct a "likely scenario" under which spending grows 1% slower than revenues over the forecast horizon. Under this scenario, the government would not move into surplus until 2025-26, and the surplus in 2026-27 would be about $25 million, well below the $50 million target. The two alternative scenarios are shown in the table on page 13.

Fiscal Year	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Current revenue	998280	1072884	1108132	1152457	1210080	1246383	1283774
Current spending - Planned	855533	907554	945065	949790.3	964037.2	978497.7	993175.2
Current spending - Likely	855533	907554	945065	973417	1012354	1032601	1053253
Covid related and extra spending	126143	36948	11738	-	-	-	-
Interest	145110	132810	138290	129750	129750	129750	129750
Capex	55647	76300	84987	75000	75000	75000	75000
Overall balance - "Policy Case"	-184153	-80728	-71948	-2083.045	41292.96	63134.81	85848.82
Overall balance - "Likely Case"	-184153	-80728	-71948	-25709.67	-7023.484	9031.848	25771.31



39. Meanwhile, both scenarios assume the government does indeed meet targets for future revenue growth, which rely at least in part on tax reform. However, so far, the government has not yet delivered any significant structural reform to the tax system, preferring to rely on economic growth to deliver revenue growth. The Budget commitment to reconstitute the Tax Reform Commission has not been fulfilled. Over the last eighteen months, during the recovery from the pandemic and with higher inflation, revenues have indeed outperformed forecasts, meaning that the government has been able to make some modest tax cuts and spending increases without increasing the deficit compared to projections. This strategy, while it avoids some of the need to make hard choices on both tax reform and spending reductions, was perhaps understandable in the recovery period, but is extremely risky going forward, and represents a downside risk even to our "likely" scenario. If revenues grew by only 3% per year, there would still be a budget deficit in 2026-27.

40. We are therefore particularly concerned at the degree of reliance on revenue buoyancy, resulting from economic growth and inflation, rather than policy change. Indeed, in some respects, recent changes have both complicated the system and reduced future revenues. As noted, steps have been already taken to extend the existing covid-related payroll tax relief for the hotel and restaurant industry, on both employers and employees, although this is currently set to expire in March. New concessions to the extent of more than $120 million over the next decade have been granted to the Fairmont Southampton project alone—essentially eliminating all the major taxes to which that enterprise would be subject: hotel taxes, employer payroll taxes, and customs duties on construction and refits. However, the taxes forgiven under these concessions will be paid directly to service the loan guaranteed by the government for the project.

41. The Budget speech also pledged to introduce amendments to the Tourism Investment Act more generally to extend the duration of concessions for hotel developers, citing the policies of comparable neighbouring jurisdictions. While it is common for tourist-dependent destinations to offer various forms of preferential treatment to hotel developers, as in the case with most tax incentives, it is extremely difficult to demonstrate, through economic data and analysis, that there are net economic or fiscal benefits for the countries utilising them[4]. But such measures do have a direct negative impact on government revenues, which may or may not be offset by indirect impacts from growth in employment, visitor numbers and tourist spending. It is important therefore that these decisions are based on rigorous analysis and evaluation, and with at least some degree of transparency .

42. Meanwhile, previous commitments to increase revenues from tax reform have not materialised, nor has the Tax Reform Commission been reconstituted. This lack of fundamental reform is very disappointing; we have repeatedly recommended (since our inception in 2015) fundamental reforms aimed at broadening the tax base and increasing revenues; but while successive governments have broadly accepted and endorsed these recommendations, very little progress has been made; the basic structure of taxation in Bermuda remains much the same. For payroll tax, recent changes have resulted in some additional progressivity—albeit by reducing revenue at the lower end. Nonetheless, the vast majority of the tax burden borne directly by individuals continues to fall only on labour income, with no taxation of income from capital. We understand that the Government intends to note for consultation a number of these issues in the Pre-Budget Report, including revisiting some of the earlier recommendations from the previous Tax Reform Commission.

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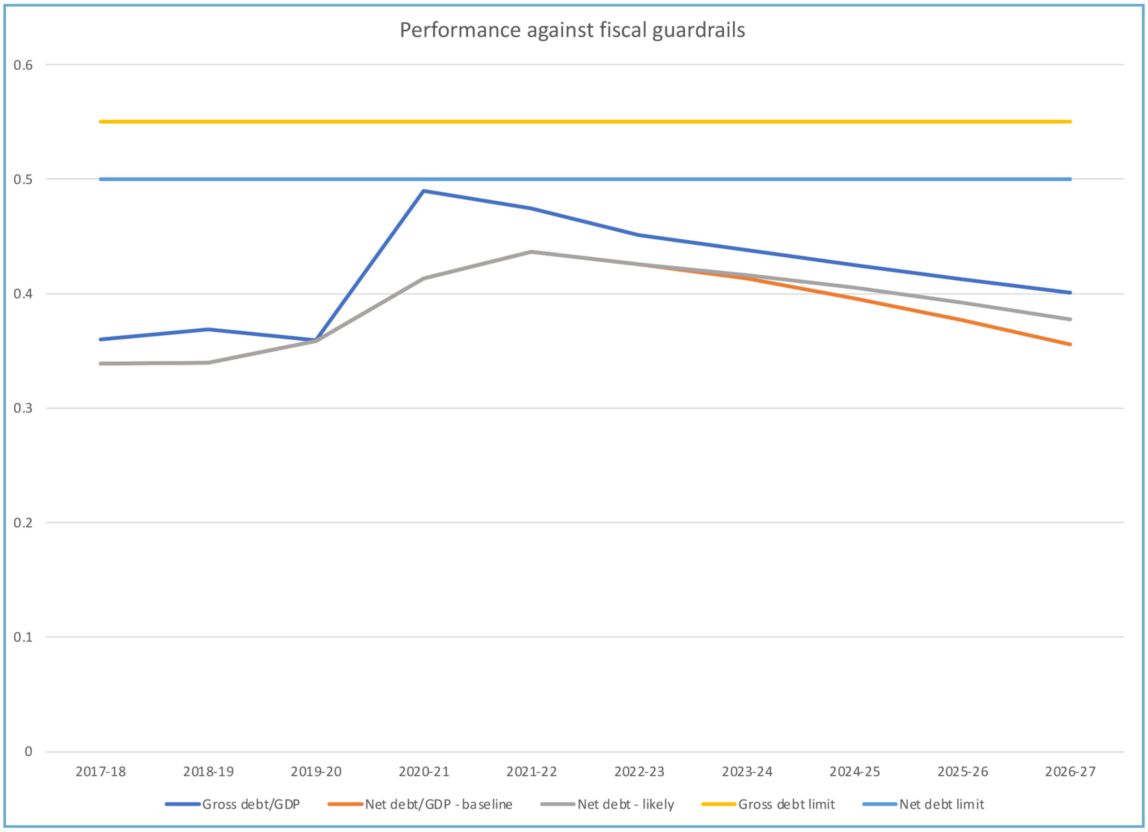
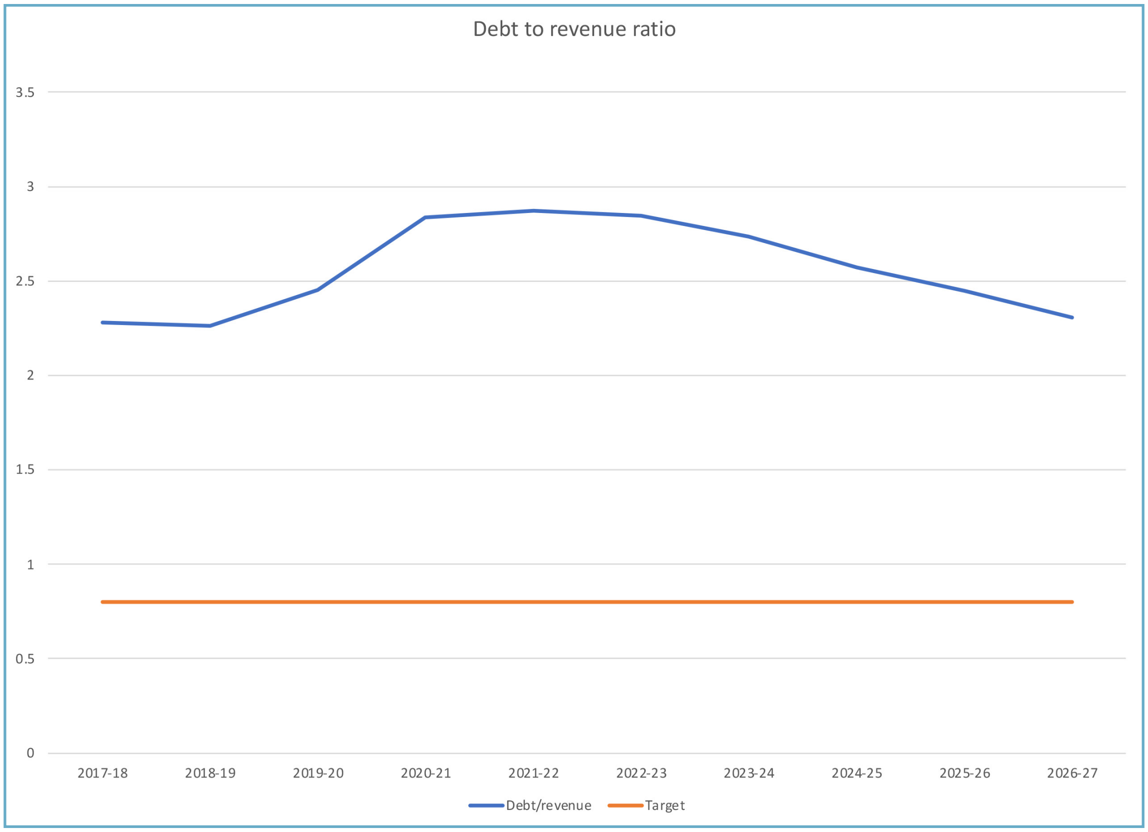
[4] See for example, "Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment," A Report of the G20 Development Working Group, IMF 2015, available on IMF website.

43. Overall, then, as shown in the chart and Box below, our assessment is that the Government's plans remain consistent with its fiscal guardrails, even under our "likely scenario", but there remains limited room for further slippage, and, absent policy action, there are significant downside risks on the revenue side. We also note that, as we have previously emphasised, while debt/GDP ratios in Bermuda do not look particularly elevated by international standards, lower limits are more appropriate for jurisdictions like Bermuda which do not borrow in their own currency and where significant sections of the economy are lightly taxed and highly mobile. More relevant is the debt to revenue ratio, which we regard as the key indicator from the point of view of fiscal sustainability. This would remain close to 300%, in sharp contrast to the government's long-term objective of 80%, while the debt service to revenue ratio reduces slowly from its current level of about 13% towards the target of 10%.

44. While we welcome the government's continued commitment to fiscal prudence and to a fiscal envelope consistent with stabilising and then reducing the debt, we remain extremely concerned by the lack of a clear strategy for a structural boost to tax revenues, particularly given the likelihood of further increases in spending above the projections. The revenue to GDP ratio, low not only by international standards but relative to comparable jurisdictions, does not rise meaningfully over the forecast period, remaining close to 15%. As we noted last year, the pandemic has increased Bermuda's net debt by more than $400 million, the debt to GDP ratio by more than 5 percentage points, and the already too high debt to revenue ratio by about 40 percentage points.





45. Moreover, unfortunately, the headline debt numbers understate the magnitude of the long-term liabilities. As we have repeatedly highlighted, the large actuarial deficits of Bermuda's public pension funds are ultimately a call on the taxpayer; and the expanded use of government guarantees in recent years also poses a significant fiscal risk. Both are discussed in more detail below.

46. The size of Bermuda's explicit and implicit debt is particularly a concern given the global economic environment. Over the past few years, the Panel has repeatedly warned of the risk to Bermuda's finances from external events, in particular a rise in US and global long-term interest rates. Fortunately for Bermuda, until 2021 these risks did not materialise – indeed long-term interest rates fell – meaning that Bermuda was not only able to finance its growing debt, but refinance large amounts at relatively advantageous rates.

47. The debt refinancings this year are very welcome. But, as noted above, long-term interest rates have now risen substantially and could rise further; there is no scope for complacency about Bermuda's ability to continue to finance its debt at relatively attractive interest rates. A strategy that relies on economic growth to boost revenues and reduce debt may be viable, at least for a time, while interest rates are very low; it is very unlikely to be so in an environment of rising rates, which will over time result in higher interest costs, in turn aggravating the fiscal position. Bermuda needs to act to increase revenues on a structural basis.

Compliance with the Government's fiscal rules: The Panel's Assessment

1. Progress towards the Bermuda Government achieving a balanced budget by fiscal year 2024/25 and a surplus of $50 million in 2026–27.

   The Budget sets out a path towards achieving a balanced budget by a revised target of fiscal year 2024-25 and a surplus of $50 million in 2026–27, relying on tight controls on spending and increased revenues from recovery and tax reform. The target is appropriate, but has already been overtaken by developments since the Budget. Urgent action on tax reform remains essential, particularly given that further unplanned increases in spending are likely.

2. Compliance with the fiscal guardrails that Government has established—ratio of gross debt to GDP not to exceed 55%; ratio of net debt to GDP not to exceed 50%; and debt service to GDP not to exceed 3%.

   Bermuda's current level of GDP (in 2021) is $ 7.3 billion, implying limits of approximately $3.85 billion, $3.65 billion, and $220 million, for gross debt, net debt and debt service respectively, in the current year.

   With net debt peaking at just below $3.2 billion, gross debt remaining at $3.35 billion, and debt service costs of approximately $130 million, and assuming that GDP continues to grow at 3-5% in nominal terms in 2022 and beyond, we expect all the guardrails to be observed throughout the forecast period.

3. Prospects for further progress towards meeting the longer-term aims of reducing debt and debt service to less than 80% and 10% of revenues, and for implementing the rule that net borrowing can only be considered to finance capital spending.

   Net debt is currently just under 3 times revenues, and this ratio will only fall slowly over the forecast period; the debt service ratio is about 13%. We remain of the view that it is essential to raise the revenue/GDP ratio so as to reduce these ratios substantially over time.

E. The international income tax landscape

48. At the time last year's Panel report was drafted, Government and international business in Bermuda were pondering the potential impact of the G20/Inclusive Framework blueprints for global corporate international income tax reform. At that time, Government intended to reconstitute the Tax Reform Commission to address these issues for Bermuda.

49. In a separate cross border taxation issue, and on a positive note, Bermuda has recently been removed from the EU "grey list" of jurisdictions deemed not fully cooperative in the global push to enhance transparency and international cooperation in reporting on offshore incomes. In the international transparency area, including under the purview of the Global Forum on Transparency and Exchange of Information, Bermuda is not presently at risk thanks to positive actions taken by Government over the past several years.

50. More focal for this report, developments of relevance to Bermuda in respect of the G20/Inclusive Framework proposals for reforms to the international corporate taxation architecture have occurred since last year's Panel report was written. These are explored in this section.

***Pillar One:** Reallocation of Some Profits of Very Large Multinational Enterprises to Market Jurisdictions*

51. The Panel's report last year described Pillar One of the proposals, and noted that it appeared that the insurance industry would be excluded from the scope of the proposed reform, as constituting part of the regulated financial services sector. Further detail on this point was promulgated in May 2022, in an OECD public consultation document addressing the regulated financial services exclusion of Part A. That document describes the intended handling of that exclusion from the Pillar One Amount A model rules, still currently being drafted. It does treat the insurance industry—including reinsurance—as part of this excluded sector, but adds that it should be noted that, "…this does not reflect the final or consensus views of the [IF] [in] that some members hold the view that reinsurance…ought not to be excluded….". However, even if reinsurance were not to be excluded from the scope of Pillar One, Pillar One would be likely to have less—and not necessarily a negative—impact on Bermuda than Pillar Two, and because any imminent international implementation of Pillar One appears somewhat dubious, this report again this year will not address Pillar One further.

The Panel's report last year described Pillar One of the proposals, and noted that it appeared that the insurance industry would be excluded from the scope of the proposed reform, as constituting part of the regulated financial services sector.

Pillar Two: *The proposed Global Effective Minimum Tax*

52. The prospects for implementation of the most salient of the global tax reform proposals for Bermuda, the so-called global minimum effective tax under Pillar Two, are also not entirely resolved at this point, although they are far more likely than those for Pillar One, with a significant number of major jurisdictions already moving to design or introduce necessary legislation, and the EU still working to reach unanimous agreement by year-end on a Directive to implement these rules.

53. Bermuda has no corporate income tax. Yet it is not in the same position as some Caribbean countries and jurisdictions which may host numerous constituent entities of multinational enterprises (MNEs) in scope for Pillar Two, but in which little or no business activity takes place. Rather, Bermuda constitutes one of the world's major global insurance and reinsurance hubs. Further, and of relevance for Pillar Two, some of the major international businesses, especially in the reinsurance sector, are actually headquartered in Bermuda. That is, in the terminology of Pillar Two, the "ultimate parent entity" is Bermuda resident. Others, though, are subsidiary entities owned by foreign parents. And in both cases, the major constituent entities of Bermuda headquartered companies, or the foreign ultimate parents, may be resident in any of many—especially high income—countries: notably the United States and the United Kingdom, but also including Japan, France and other jurisdictions. The implications of Pillar Two can differ across those in-scope entities: those headquartered in Bermuda; and those whose ultimate parent entities are resident elsewhere.

54. The most dramatic change in the global minimum tax proposals since our last report was drafted occurred in late December 2021, when the so-called "rule order" of countries with the right to impose a top up tax under the minimum tax was, effectively, changed in the release by the OECD of model rules for implementing Pillar Two. The goal of the global effective minimum tax is to ensure that any in scope MNE pays at least 15 percent tax, somewhere, on the "excess profits" generated by its constituent entities in each country (on a jurisdiction-by-jurisdiction basis) in which it does business. To the extent that the effective tax in any jurisdiction fell short, a "top up" tax would be imposed. The "somewhere", until the December model rules were released, was to be in the first instance the ultimate parent jurisdiction—that is, on a residence basis under the traditional corporate tax architecture. This rule is now called the IRR. For major MNEs headquartered in Bermuda—largely in the reinsurance industry—the IRR remains most relevant.

55. A secondary, back up, rule, now called the UTPR—and not planned to come into effect until a year after the IRR rule—would reallocate any unclaimed top up tax amount across all other jurisdictions included in the covered MNE group, should the ultimate parent jurisdiction, or a subsidiary parent jurisdiction further down the corporate structure, not adopt the global minimum tax through its domestic legislation. Only through the UTPR would strictly "source" jurisdictions have derived any direct revenue benefit from the global minimum tax prior to the introduction of the QDMTT proposal at the end of 2021.

56. The change in the model rules of December would, instead, in effect allocate in the first instance the top up amount to the domestic jurisdiction of any subsidiary entity doing business there—should that jurisdiction choose to take advantage of this opportunity—thus coming ahead of the claim of the parent jurisdiction to impose the top up tax. It does this by anticipating the adoption of a "qualified domestic minimum top up tax" (QDMTT) at the discretion of that country. Such a tax, in order to qualify to seize all of the top up amount, would have to be structured following the rules of the global minimum tax. If done, the amount of top up tax on locally generated excess profits would accrue to the local jurisdiction rather than to the parent jurisdiction under the IIR.

57. For Bermuda, the underlying question remains as it did last year, however. If either its headquartered MNEs, or MNE subsidiaries located in Bermuda, will be subject to top up taxes somewhere in the world, even in the absence of corporate tax in Bermuda, can Bermuda capture some or all of that newly imposed tax difference for itself, and how? In regard to Bermuda based in-scope headquartered MNEs, if Bermuda does not adopt the IIR of Pillar Two itself, nor adopt a QDMTT, top up tax will end up being owed elsewhere in jurisdictions that do adopt Pillar Two—either through a subsidiary entity under an intermediate IIR, through the QDMTT elsewhere, or failing that, under the UTPR in other jurisdictions. Bermuda itself has, as referenced last year, a tax stabilisation agreement with international business that corporate income taxes will not be imposed before 2035. But that domestic agreement cannot prevent any top up tax amount generated in regard to Bermuda companies from being imposed in other jurisdictions as a result of the adoption of the global minimum tax elsewhere, and therefore will not benefit international business to that extent regardless of Bermuda's actions.

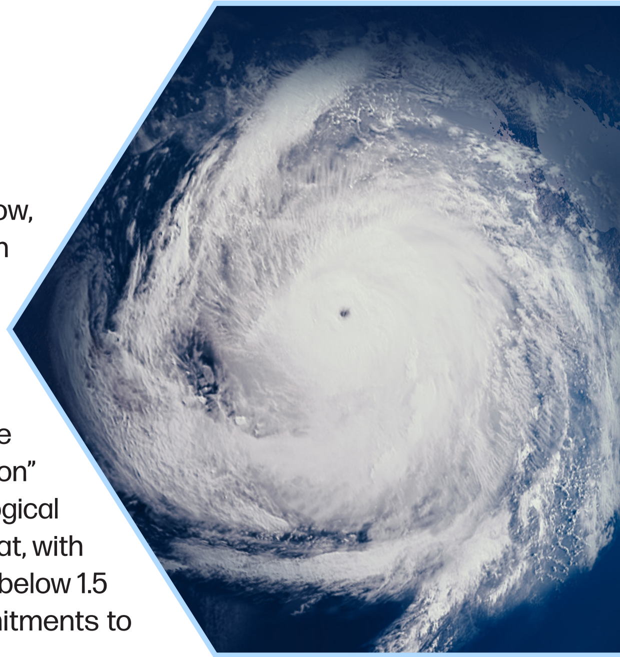
58. More important though is the question of how if at all an increase (elsewhere) in tax on profits that previously had incurred low or no tax as a result of Bermuda's tax regime would affect the attractiveness in the longer run of Bermuda as a place to do business. This is the so-called behavioural response issue which researchers and analysts are attempting to model. This could—and likely will - differ across business sectors. Most notably, Bermuda is one of the most important global centres of the (re)insurance industry—which after decades has given companies an important reason to remain in Bermuda aside from its low tax regime. While some profits may simply be shifted through the jurisdiction, others are actually generated in Bermuda. Again, that will be specific to the sector and company.

59. Recent work by researchers at the EU Tax Observatory attempts to model on a country by country basis the likely impact of the Pillar Two rules, using the country by country financial reports mandated under action item 13 of the original BEPS project. Their overall global results for total tax increase under Pillar Two are roughly in line with those of the OECD and the IMF, although arrived at with different methodology. The researchers also make an attempt - somewhat more speculatively—to adjust those results on a country by country basis for possible behavioural responses by the MNEs affected. Against that background, their results for Bermuda are, in relation to Bermuda's economy, very large indeed even after they account for behavioural changes. If this proved to be remotely close to the potential reality, it is even more important that the government pursue this matter, in conjunction with its business stakeholders.

60. Therefore, it is very encouraging that government appears to be doing so. In a press conference on October 13, the Premier noted that the government was highly focused on the international tax issues at present, and in that context has been reaching out to stakeholders in the international business community and their advisors; and a formal advisory panel on these international tax issues now being constituted. Further, on October 9, Kroll Bond Rating Agency (KBRA) released its latest report on Bermuda, in which—presumably after some background investigation—it indicated that its affirmation of Bermuda's overall positive outlook took account of the potential risks from international tax reform, but that Bermuda has been resilient to this, with "the risk expected to be manageable."

G. Other issues, opportunities and risks

Energy and climate change



61. The year following the COP26 climate conference in Glasgow, at which world leaders pledged to keep global warming within 1.5 degrees of pre-industrial levels, has seen an escalation of extreme weather events globally. The recent 2022 United in Science report by the United Nations and global science partners[5] warned that, even if fully implemented, the mitigation pledges were grossly inadequate to stay within the 1.5 degree ceiling and that we are entering “uncharted territory of destruction” as multiple tipping points are reached. Indeed, a World Meteorological Organisation report for COP27 in Egypt in November stated that, with greenhouse gases in the atmosphere at record levels, staying below 1.5 degrees is “barely within reach”. COP27 led to no new commitments to reduce emissions or to phase out fossil fuel exploitation.

62. Of particular concern to Bermuda is rising sea levels from melting ice caps, with a recent study[6] based on satellite imagery warning of sea level rises of a minimum 27 centimetres from Greenland alone. Together with a possible increasing intensity of hurricanes, storm surges could threaten more frequent and extensive flooding over wide areas of Bermuda. Also of concern would be changing North Atlantic currents and, in a worst case, loss of the Gulf Stream to Bermuda. Bermuda has been key in setting up and leading the Sargasso Sea Convention which will help to raise awareness of these and other issues internationally.

Together with a possible increasing intensity of hurricanes, storm surges could threaten more frequent and extensive flooding over wide areas of Bermuda.

63. In recent reports the Panel has called for a designated government department to coordinate the island’s response to climate change, ensuring that the response to the considerable risks posed to the island is embedded in all decision making. We are heartened that the Ministry of Home Affairs, under the leadership of the Deputy Premier, has established a Climate Task Force working across government. It will be crucial to ensure that this function is adequately supported and resourced going forward.

64. In the light of the financial constraints facing Bermuda, the focus should be on improving resilience to climate change in terms of reducing Bermuda’s vulnerability to extreme weather events, sustainable development, improving coastal and ocean management, and leveraging the opportunities offered by Bermuda’s ocean location, natural mangrove and sea grass carbon sinks, and insurance capabilities. A study is underway, with support from the UK’s Department of Environment, Food and Rural Affairs, to assess the impact on Bermuda of global warming. This will provide vital information for increasing the island’s resilience. Bermuda’s contribution to global emissions is minuscule and significant expenditure on reducing it further should not of itself be a priority; only where investment is in any

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[5] The UN Environment Programme, the UN Office for Disaster Risk Reduction, the Intergovernmental Panel on Climate Change, the World Climate Research Programme, the Global Carbon Project, the UK Met Office, and the Urban Climate Change Research Network, coordinated by the World Meteorological Organisation on behalf of the UN Secretary General.

[6] Greenland ice sheet climate disequilibrium and committed sea-level rise, Jason E. Box et al, Nature Climate Change, August 2022.

case taking place, or has other significant benefits, should steps be adopted to reduce the country's carbon footprint. One area of importance in this regard is developing sources of renewable energy in line with the ambitious proposals in the Integrated Resource Plan and ERP. By replacing expensive imported fossil fuels and improving energy security, this offers considerable potential economic benefits to the island and should be pursued.

65. Many small states in the Caribbean have revisited their public investment appraisal processes to ensure an adequate rate of return on capital expenditure. This is advisable and should include assessment of whether existing and proposed capital infrastructure is resilient to the potential impact of climate change, a rising sea level, and natural disaster shocks. These additional hurdles should be incorporated in assessing and implementing projects under the Economic Recovery Plan, and the planning system should be used to ensure that new private sector capital expenditure is also climate resilient.

Growth and Diversification

66. Economic growth in Bermuda has disappointed, averaging just 0.4% over the last 5 years. Even in the 5 years to 2019, before the pandemic and when Bermuda was recovering from a protracted downturn following the global financial crisis, growth averaged less than 1% per annum, and the reported level of output is little changed from the boom year of 2008. Over the last decade, the number of jobs in Bermuda has fallen from about 35,400 to 31,300—a decline of about 12%; the number of jobs filled by Bermudians fell by a similar proportion. This in turn translates to lower output and lower tax revenues, undermining the finances of Government as a whole, as well as the pension and health systems.

Economic growth in Bermuda has disappointed, averaging just 0.4% over the last 5 years.

67. Although not all initiatives will come to fruition, the ERP is a welcome attempt to grow and diversify the economy. We would have liked to see greater emphasis on promoting green growth, but a Blue Economy initiative is taking place outside the ERP. The ERP was expected by government to add up to 1½ percentage points per annum to economic activity by 2023 and some of the benefits are believed by government to have been felt already. However, the government should remain alert to further opportunities to grow the economy, enhance the welfare of its citizens and boost tax revenues.

68. One such opportunity might be to develop competition policy, with the dual aims of improving output and lowering prices for consumers. It is unsurprising, given Bermuda's size and location, that many key sectors are dominated by a small number of companies, but that merely emphasises the need for government to be proactive in this area. Recent moves to increase competition in banking via the open banking initiative and encouraging new entrants are a step in this direction, but there are opportunities in other sectors which could be encouraged by developing an appropriate legislative and regulatory architecture. Bermuda currently has no competition law.

69. In previous reports, the Panel has expressed concern about the underdeveloped nature of Bermuda's capital markets and Bermudians' access to bank and, especially, venture capital finance. Impeding access to finance is the absence of a shared credit scoring system, any requirement that businesses provide routine financial statements or accounts, and the lack of clear legal procedures for handling company failures in the non-financial sector. Especially for small businesses, this may hinder their access to capital. While the open banking initiative could improve access to credit information, legislative change in the form of further amendments to the Companies Act might also be required.

70. However, we remain cautious about digital finance. As we have warned previously, attempts to develop digital finance in Bermuda should be mindful of financial and reputational risk to Bermuda's hard won reputation as a well-regulated financial centre. These concerns have been reinforced by recent developments in the cryptocurrency sector.

Immigration and the labour force

71. The Panel has long argued for the need to grow Bermuda's working age population, to support economic growth and boost tax revenues in the short term, and address the challenges of an ageing population and improve the solvency and sustainability of public pension funds and healthcare over the longer term. The Government has recognised the scale of the challenge; in September of this year, the Ministry of Economy and Labour published a position paper entitled "Addressing the Challenge of an Ageing Population in Bermuda", assessing and detailing the potentially disastrous implications of demographic change, and proposing that government policy should explicitly aim to counter this. We fully endorse this view.

72. The paper calculates that bringing Bermuda's old age dependency ratio in line with the OECD average would require an increase in the workforce of about 25%, or 8,400 workers; and sets an ambitious target of achieving that over 5 years. This is hugely ambitious, given that on current trends the workforce will continue to shrink by about 500 per year. As the paper recognises, such an increase is entirely infeasible unless there is a significant step change in net long-term work related migration.

73. We understand that the Government plans to undertake a consultation process, focusing on the specific policies needed to achieve this objective, with a view towards publishing a further policy-focused paper in 2023. In our view, this will require not just incremental changes to Bermuda's highly restrictive migration system, but major structural reforms, including not only the streamlining and expansion of the work permit system, but changes to residence laws. In our last report we welcomed the development that from January 2022 any person who has been ordinarily resident in Bermuda for 20 years or more, non-Bermudian parents of a child with Bermudian Status ordinarily resident in Bermuda for 15 years or more, and children born to 2nd Generation Permanent Resident's Certificate (PRC) holders and who have been ordinarily resident in Bermuda can apply for a PRC. As of June 2022, 125 such applications for PRC had been received, but processing can be slow.

74. But Bermuda could and should go much further. Most advanced economies allow long-term residents to apply for permanent residency—and often citizenship—after 5-10 years; moreover, children of long-term residents are generally eligible for citizenship either at birth or when they become adults. Bermuda needs to make it easier, not just for people to come to work, but to stay, contribute and invest in the Island on an ongoing basis, and, eventually, to settle permanently, with appropriate rights, responsibilities, and security for their families and children. Similarly, more should be done to encourage Bermudians currently resident abroad who wish to return (including with family members) to return, although this alone will not fill more than a relatively small proportion of the gap.

75. Other measures to increase labour force participation will also be required, in particular encouraging people to work longer, reflecting increased life expectancy, and helping those on benefits to return to the workforce.

Pensions, health and other contingent liabilities

76. The government also has significant long-term contingent liabilities which, if crystallised, could imperil future solvency. Chief among these are the government pension funds: the Contributory Pension Fund (CPF) and the Public Sector Superannuation Fund (PSSF). Working with the Ministry of Finance and the Public Funds Investment Committee, the consulting firm McKinsey and Company formulated a set of reforms for public pension funds using three main levers, as identified in the Panel's last report: changes in benefits, contributions and retirement age. The goal should be to ensure the long-term fiscal sustainability of the schemes while incentivising later retirement. This will substantially reduce the economic, fiscal and social risks posed by the current large actuarial deficits. It is disappointing that there appears to have been little progress since our last report; the longer reform is delayed, the larger the costs and risks. Government should move forward on this very quickly.

77. Similarly, on healthcare, current practices are unsustainable. The finances of the Bermuda Hospital Board have been put under severe pressure by the aftermath of the pandemic and by the fall in the labour force, which in turn reduces its revenues from the Mutual Reinsurance Fund fee. Since the Government ultimately stands behind the BHB, and guarantees its debt, this represents a further potential spending pressure; it is implausible that the Government would under any circumstances allow the BHB to cease operations or to default.

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78. Bermuda's healthcare costs per capita among the highest in the world, and the government has devoted considerable effort to devising a broadly sensible set of reforms. The introduction of the Bermuda Health Plan (BHP) is planned to provide affordable Universal, Health Coverage (UHC), covering a wider range of services than the Standard Health Plan it replaces, including preventative measures. It is to be provided by a unified or single insurer, allowing for supplemental private insurance coverage. Our 2019 report examined the principles of the proposals and broadly endorsed them. They build on international experience gained among the more successful advanced and emerging market countries in providing cost-effective health care in the context of an ageing population.

79. Again, the government now needs to move from plans to implementation. For healthcare, this will need to be incremental, to mitigate both financing and implementation risks, but progress on this important issue must not be allowed to stall. The inclusion of UHC within the Economic Recovery Plan is welcome, and we recommend that the PMO and the Ministry of Health set out a clear timeline for the planned changes.

80. One issue that has become of serious concern in recent years is that of Bermuda's significant contingent liabilities in the form of substantial public sector guarantees (see table). At the time of the last budget these stood at $1.139 billion. While the majority of this relates to the Bermuda Hospitals Board, discussed above, the value of outstanding guarantees for the private sector has grown; and since the Budget, the Government has announced that it intends to provide a guarantee of at least $75 million to developers in relation to the redevelopment of the Fairmont Southampton hotel, and up to $50 million in residential mortgage guarantees.

81. Both of these involve the assumption of significant risk. As we have seen with Morgan Point, guarantees to hotel developers are very risky, particularly when the financing structure is highly leveraged. And while the home mortgage guarantee scheme has been structured to reduce the risk to Government, the Government would still be exposed in the event of a substantial fall in house prices.

	2021/22*
All guarantees as of fiscal year end	
Bermuda Casino Gaming Commission ("BCGC")	2.7
Bermuda Economic Development Corporation ("BEDC")	1.5
Bermuda Hospitals Board ("BHB")	787.7
Bermuda Housing Corporation ("BHC")	29.3
Bermuda Land Development Corporation ("BLDC")	30
Bermuda Tourism Authority ("BTA")	10
Bermudiana Development Company Limited	10
Hotel Bermuda Holdings Ltd ("HBH")	25
InnoFund	2.5
Morgan's Point/Caroline Bay	165
National Sports Centre	3.2
Regulatory Authority ("RA")	0
West End Development Corporation ("WEDCO")	71.8
Total guarantees outstanding	1,138.7
Less Morgan's Point	-165
Net as of fiscal year end	973.7

* As disclosed in the 2022/23 Budget Statement. There have been no material changes to date. However, the Government intends to provide a $75 million guarantee in relation to the redevelopment of the Fairmont Southampton Hotel, and up to $50 million in mortgage guarantees.

82. The Government needs to exercise much greater discipline in the provision of guarantees, and other policies that result in contingent liabilities. Recent experience shows that such liabilities, while initially appearing to be cost-free, and hence consistent with the government's fiscal strategy, can manifest themselves as a call on the budget resulting in large, unplanned increases in expenditure and debt; moreover, they undermine confidence in the Government's overall fiscal strategy. Put bluntly, the Government may not have the fiscal headroom to honour such guarantees, should they crystallise, without causing significant disruption to the provision of public services. The Government should make clear that guarantees will not usually be issued to back commercial projects, including those in the Economic Recovery Plan.

H. Conclusions and Recommendations

Revenues and expenditures.

83. We expect the Government to remain within its fiscal guardrails, for the ratios of gross and net debt to GDP, for the forecast period. Fiscal outturns for 2020–21 and 2021–22 both showed improvement over the projections in the 2021 Budget and in our last report from late 2021, reflecting faster growth than planned in both revenues and expenditures. The 2022–23 plans announced in the 2022 Budget in February also provided for revenues and spending higher than previously planned. Beyond 2022–23, the higher revenue forecast assumed some increase resulting from both tax reform and continued revenue buoyancy; the increase in the spending plan reflected a more realistic vision than that in the 2021 Budget—the extremely tight restrictions of which in our view were unlikely to be realised. And the overall fiscal strategy set out in 2022 was more coherent and credible than that of previous Budgets, in particular the adoption, in line with our recommendation, of a target for a budget surplus of $50 million in 2026–27. These were all very welcome developments.

84. Yet, the 2022 Budget projections themselves are no longer realistic, as spending plans and revenue estimates for this year are both now significantly higher than projected at the time of the Budget. Furthermore, the Budget assumed that spending would grow by only 1.5 percent per annum in future years, but in the Panel's view this was, and remains, extremely unlikely. Rather, based on spending pressures and recent experience, the Panel's own "likely scenario" is for spending to grow 1 percent more slowly than revenues. This would result in the budget not being balanced until 2025-26 and a budget surplus of about $25 million in 2026-27, well short of the $50 million target. Even this assumes that tax reform, long delayed, does finally deliver some structural increase in revenue. And even under this relatively optimistic scenario, the debt to revenue ratio would remain close to 300%, in sharp contrast to the government's long-term objective of 80%.

85. This leads to several recommendations:

- The Panel reiterates **its recommendation that the government plan for an annual budget surplus of at least $50 million for 2026–27 and subsequent years**. This is the absolute minimum needed to make appreciable inroads into Bermuda's large external debt burden. Current policies, which assume implausibly low spending increases, and largely rely on revenue buoyancy to produce revenue increases, are in our view unlikely to deliver this; further structural increases in revenues are required.

- Second, we note that previous commitments to increase revenues from tax reform have not materialised; indeed, recent changes and commitments to further tax concessions have put downward pressure on future revenues. Since its inception the Panel has recommended fundamental reforms aimed at broadening the tax base, increasing the progressivity of the tax system, and increasing revenues, including taxing individual capital income. We understand that the Government intends to consult on a number of these issues in the Pre-Budget Report, including revisiting some of the earlier recommendations from the Tax Reform Commission . We welcome this and recommend again that the Government commits, in the next Budget, to legislating and implementing set of reforms along the lines set out above.

- Third, it is important that the Government endeavours to avoid in year fiscal policy changes in normal circumstances.

86. As noted in last year's report -and now even more critical, in light of global tax reform developments– the Government should liaise closely with the international business sector regarding the potential impact of and responses to the proposed Global Minimum Tax. In this regard, we are very encouraged that the Government intends to constitute an advisory group comprised of the key stakeholders to pursue this particularly complex issue. As the Premier recognised both last year and this year, this global change can have important implications for potential revenues, as well as for the behavioural responses of the international business sector in Bermuda.

Broader long-term issues

87. Economic growth, competition and diversification are important. In particular, the banking sector should provide greater access for Bermuda residents and businesses. Barriers to growth include lack of a shared credit scoring system, lack of a requirement for routine provision of business financial statements, lack of clear legal procedures for handling company failures outside the financial sector, and the absence of competition law. These are legal and regulatory framework issues—as opposed to "digital" issues—and as such their solutions can be addressed by Government now.

88. Bermuda is at high risk from climate change. The current serious and welcome focus on improving the resilience of the island to rising sea levels and extreme weather events must be sustained. Mitigation of Bermuda's quite tiny emissions is not of great importance either for Bermuda or for the world in general—though increasing Bermuda's reliance on renewable energy would have a positive environmental and economic impact. The Climate Task Force should be adequately resourced and supported, and recommendations for increased climate resilience should be incorporated into all Government strategies.

89. As the Panel has emphasised before, the single most critical problem facing Bermuda in the medium to longer term is that of the size and composition of its population. Addressing this problem is a question of increasing immigration and the labour force—there is no other solution. The Panel endorses the analysis and recommendations contained in the recent September report from the Ministry of Economy and Labor. While the changes introduced in January 2022 were very welcome, and clearly a step in the right direction, change in this regard must go further, expanding the ability of workers to achieve permanent residency and to move to Bermuda as a home, as well as encouraging educated and skilled Bermudians to return. This is crucial for economic growth, for the future of the health and pension systems needed to support ageing Bermudians, and for the generation of tax revenues to support longer term efforts for the public welfare .

90. The Bermuda government is faced with huge contingent liabilities in several areas, a problem which has been well recognised but must be addressed now.

- Pension liabilities are well understood, and have been analysed and assessed at length. The Government should move to implement without further delay reforms designed to make the system more sustainable, including increasing retirement ages.
- Similarly, government provided health benefits are planned to be reformed along the lines of the Bermuda Health Plan to provide affordable universal health coverage better, and more efficiently, than that now available. Again, the Government now needs to move from plans to implementation.

- Finally, guarantees for commercial businesses pose a substantial risk—as has been seen in the recent call of the Morgan's Point guarantee—and should be significantly curtailed. Guarantees virtually never should be issued to back commercial projects—including those included in the Economic Recovery Plan.

91. The Government is addressing many of the most serious problems facing the country, including issues raised in our previous report. The overall fiscal strategy set out in the 2022 Budget is more coherent and credible than that in prior budgets, but further action is required to deliver it. The fallout from the pandemic is largely behind now, though new global problems—inflation, fuel prices, and worsening climate change—now face the country. The Government has responded with an ambitious and challenging agenda: the Economic Recovery Plan, the Bermuda Health Plan, the Climate Task Force, an agenda to reform the pension system, and the recent Ministry of Economy and Labor report on demographic pressures. What is now required is implementation and delivery.

The Fiscal Responsibility Panel

Annex A: List of Meetings Held by the Panel

The Honourable David Burt M.P., Premier

The Hon. Walter Roban, JP.MP, Deputy Premier and Minister of Home Affairs

The Honourable Vance Campbell, JP, M.P., Minister for the Cabinet Office and Tourism

The Hon. Kim Wilson, JP. M.P., Minister of Health

The Hon Jason Hayward, JP, M.P., Minister of Economy and Labour

Officials from the above-mentioned Departments

The Honourable Cole Simons M.P, Leader of the Opposition, and other representatives of the Opposition

Mr Barclay Simmons, Chairman of the Pension Funds Investment Committee

Association of Bermuda Insurers and Reinsurers

Bermuda Bankers Association

Bermuda Monetary Authority

Bermuda Tourism Authority

Bermuda Trade Union Congress

Bermuda Chamber of Commerce

Nathan Kowalski, President, Bermuda Chamber of Commerce