2023

BERMUDA FISCAL RESPONSIBILITY PANEL

ANNUAL ASSESSMENT

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Bermuda Fiscal Responsibility Panel
Annual Assessment 2023

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List of Acronyms

BELCO: Bermuda Electric Light Company
BMA: Bermuda Monetary Authority
CIT: Corporate Income Tax
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
GDP: Gross Domestic Product
GMT: Global Minimum Tax
GloBE: G20/Inclusive Framework Global Minimum Tax
IMF: International Monetary Fund
IPCC: InterGovernmental Panel on Climate Change
MNE: Multinational Enterprise
OECD: Organisation for Economic Cooperation and Development
PSSF: Public Service Superannuation Fund
QRTC: Qualified Refundable Tax Credit
TRC: Tax Reform Commission
UN: United Nations

Executive Summary

This is the Panel's ninth annual report. We visited the Island from 19 to 24 November 2023, 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 economy has strengthened over the past year, driven by international business. We expect the Government to remain within its fiscal guardrails, for the ratios of gross and net debt and debt service to GDP, for the forecast period and the Government's plans are consistent with its objectives of a balanced budget in 2024-25 and a surplus of $50 million in 2026-27; it will be important to credibility for the government to deliver on these commitments in the face of any adverse shocks or new spending pressures.

However, over the medium to long term, Bermuda faces a number of serious risks to its economic and fiscal position: international economic and political developments; the adverse impacts of climate changes; an ageing population, adding to large spending pressures, explicit and implicit, from the pension and health systems; and the risk that changes to international tax rules might result in an exodus of companies from Bermuda - an existential threat to an economy still very dependent on international business.

But the last of these is also an opportunity; the introduction of a corporate income tax for companies in scope of the Global Minimum Tax, if structured appropriately and implemented efficiently, could lead to a substantial increase in Bermuda's tax revenues, helping to address some of these issues. So far, the Government has risen to this challenge, engaging closely with business and proceeding expeditiously but carefully. The hardest part, however, is still to come. It is vital that the Government put in place a framework that ensures that any additional revenues are allocated in a way that retains international business, maximises the long-term benefits to the people of Bermuda and mitigates the very serious risks we have identified.

We therefore make a number of specific recommendations:

- Bermuda should make an early and binding commitment to use a substantial proportion of the net revenues from introducing a CIT for companies coming within the scope of the Global Minimum Tax to reduce Bermuda's net debt, eventually converting it to a net asset position.

- Some revenues should be held in a "stabilisation fund"; this would help insure against the risk of having to borrow at high interest rates on the open market if volatility was such that revenues fell below base budget needs in any year.

- A mechanism should be established to ensure that decisions on the allocation of the CIT revenues are taken transparently on the basis of independent expert advice and scrutiny, and do not jeopardise macroeconomic stability.

- We recommend that the above recommendations are enshrined in legislation on a fiscal framework.

We also make recommendation as to the objectives and structure of Qualified Refundable Tax Credits, and to the approach of the Tax Reform Commission (TRC) in recommending changes to the current tax system to modernise it and make it more progressive, including the introduction of a personal income tax at a low rate.

Beyond tax, we make a number of further recommendations, relating in particular to diversification (both geographic and sectoral), planning for and mitigating the impact of climate change, and immigration and housing, where both policy changes and improvements to government processes are required.

Introduction

1. This is the Panel's ninth annual report. Our remit, shown in the Box below, is set out by the Minister of Finance in our letters of appointment; it reflects the Government's fiscal targets as reiterated in the 2023 Budget. In addition, following the recommendation in our 2021 report, the Government has targeted a surplus of $50 million in 2026-27; we also report on progress towards that goal.

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:

1. Progress towards the Bermuda Government achieving a balanced budget by fiscal year 2024-25.
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%.
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.
4. Advise 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 between November 19 and November 24, 2023. 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. We have decided to take a somewhat different approach to the structure of our report this year, although our formal remit remains unchanged. Our view is that while Bermuda has many assets, it faces several serious risks, combined with a unique opportunity to address them. Any analysis of the fiscal issues that we are required to address must include an analysis of those risks, how their crystallisation would affect fiscal performance, and set out an approach that addresses them for the long term. We have therefore structured our report accordingly. As in the past, we set out our key findings and recommendations from last year (section A) and give an update on economic and fiscal developments since then, including the 2023 Budget (section B), and developments relating to the Global Minimum Tax (GMT) (section C). We then present our formal assessment of the Government's compliance to date with the fiscal guardrails (section D).

4. After that, however, we focus our report on the key risks, which are discussed in Section E. These include the global economic and geopolitical environment; the lack of diversification of the Bermudian economy; changes to the tax regime; climate change; and the economic and fiscal implications of demographic trends for Bermuda's economy and its health and pension systems. Section F provides fiscal scenarios illustrating the effect of the crystallisation of some of these risks. In Section G we bring this together with a set of recommendations. We recommend using the opportunity presented by the GMT to "future-proof" Bermuda against the risks it faces.

A. Key findings of the 2022 Report

5. Our 2022 report noted the impact of the rise in inflation and interest rates in the US and globally, and the consequent risks to Bermuda, given elevated debt levels. We welcomed the commitment not only to a balanced budget in 2024-25 but, in line with our earlier recommendation, a surplus of $50 million in 2026-27. We confirmed that we expected the Government to remain within its fiscal guardrails, for the ratios of gross and net debt to GDP, for the forecast period. Overall, our assessment was that the overall fiscal strategy set out in 2022 was more coherent and credible than that of previous Budgets.

6. However, we also noted that the 2022 Budget projections had already been significantly revised by the time of our report, and that further policy action would likely be required to deliver the surplus target in 2026-27. Our key fiscal recommendation was therefore that that the Government continue to plan for an annual budget surplus of at least $50 million for 2026-27 and subsequent years. In our view this required further structural increases in revenues, and we 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 also discussed the potential impact of, and responses to, the proposed Global Minimum Tax.

7. We also made several further, broader recommendations:

i) The Government should address legal and regulatory barriers that inhibit the banking sector from providing greater access to credit for Bermuda residents and businesses.

ii) Increased resilience against the impacts of climate change should be incorporated into all Government strategies.

iii) Concrete actions to increase immigration and the labour force were essential.

iv) The Government should move to implement without further delay reforms designed to make the pension and health systems more sustainable, including increasing retirement ages.

v) The Government should curtail guarantees for commercial businesses, which pose a substantial fiscal risk.

vi) We concluded by noting that the Government was addressing many of the most serious problems facing the country, including issues raised in our previous report, and had set out an ambitious and challenging agenda: what was required was implementation and delivery.

B. Bermuda's current economic and fiscal position

Economic Developments

8. Bermuda's economic growth rate appears to have increased. Following 2021's sharp recovery from the pandemic, with Gross Domestic Product (GDP) growth of 5.1%, growth is thought to have been in the region of 3-4% in 2022[1], regaining its pre-pandemic level, even as US and global economic growth slowed significantly. International business remained buoyant. In the first quarter of 2023, economic activity was up 3.6% on a year earlier, driven by household expenditure and exports of goods and services; air visitor arrivals and their spending roughly doubled. However, Gross Fixed Capital Formation, especially that related to construction, declined, likely in part as a result of the shortfall in Government capital expenditure compared to the budget, as did Government consumption. Business registrations increased.

[1] The publication of some economic statistics has been delayed by the recent cyber-attack on Government systems.

9. Despite a handful of well publicised projects that appear to be stalled or delayed, the Government has made some encouraging progress in its attempts to diversify the economy, albeit from a low base. Perhaps most notable is the development of the sub-sea communications sector and, related to that, attracting satellite earth stations as part of the national space strategy. A major investment in an intercontinental cable running through Bermuda, with associated jobs and infrastructure on the island, was announced by Google in September. Other promising Blue Economy initiatives which build on Bermuda's natural advantages are contained in the Bermuda Ocean Prosperity Plan which is currently completing consultation.

10. Although demographic trends mean that the population of working age is shrinking, as discussed below, the labour force participation rate has increased, as has the employment rate. Employment in the November 2022 Labour Force Survey was close to its pre-pandemic level, having fallen significantly in the intervening years. Unemployment at 3.1% was lower than before the pandemic, the rate for Bermudians having fallen from 4.4 to 3.5%. The separate employer based employment statistics show an increase in the number of filled jobs in 2022 of about 600 (about 2%).

11. In the short term, this better growth performance likely reflects the strength of the international business sector and, arguably, some boost to activity from the measures contained in the Government's Economic Recovery Plan, as noted above. But it is too early to know whether it represents a sustainable improvement in the trend medium-term growth rate or is simply a cyclical recovery from the ravages of the pandemic and, before that, the global financial crisis.

12. Inflation pressure, meanwhile, remains relatively modest compared to the higher rates seen in the US and elsewhere, continuing the pattern of the last few years. In 2022, consumer price inflation in Bermuda averaged 4.0%, compared with 8.0% in the US and 11.6% in the UK. Consumer prices in June this year were 2.7% higher than a year earlier, inflation having peaked at 5.1% in September 2022. In part, Bermuda's lower inflation rate is likely to reflect Government measures to influence the price of essential items and restrict the extent to which energy and fuel prices were passed through to households, as well as the higher weight of housing rental in the consumption basket and the long lag before rises in the market rate for new rentals impacts existing tenants.[2]

Fiscal Developments

[2] It remains the case, of course, that the cost of living in Bermuda is high relative to most advanced economies. This is driven primarily by structural factors, in particular the fact that most food and manufactured goods must be imported, usually from the US; it is notable, for example, that consumer prices in Hawaii are considerably higher than in California.

13. Stronger economic growth has fed through to Government receipts. Total Government revenue in the 2022/23 fiscal year is currently estimated to have been $1.113 billion, which is higher than the original budget estimate of $1.078 billion and a little above that anticipated at the time of our last report. Stronger revenue was primarily due to higher than expected payroll tax receipts, land tax, foreign currency purchase tax, and immigration receipts. It was achieved despite payroll tax cuts for workers making less than $96,000, $13 million in duty relief to freeze the price of gasoline, the elimination of duty on essential foods and goods, $18 million that was not received from the aircraft registry due to the war in Ukraine and the ending of the Travel Authorisation Fees.

14. Current spending appears to have been kept in check and is estimated to have been $950 million in 2022/23, only slightly above the original budget estimate of $945 million despite significant unplanned expenses, including: $15 million for the Covid-19 pandemic; a $15 million special grant (the first of two) to cover shortfalls in hospital revenue resulting from the pandemic; additional funds for firefighters at the airport; and cost of living economic relief measures such as the payroll tax rebate, relief funds for public school students, and the increase in food benefits for those on Financial Assistance.

15. Capital account spending is estimated to have been $68 million, $5 million below the 2022/23 budget's original estimate of $73 million, nearly $8 million shy of the previous year's investment, and well short of the $85 million anticipated at the time of our last report. Expenditures included additional funding for stabilising the Tynes Bay Waste to Energy Facility and $4.3 million in additional grant funding to Bermuda Housing Corporation. The substantial underspend was attributed to 'the availability of resources and supply chain challenges'.

16. Interest and guarantee management costs are estimated at $141 million, $11million above the 2022/23 original estimate of $130 million. This increase was accounted for by guarantee management fees of $6.4 million and expenses related to the Government's debt refinancing transaction in August 2022.

17. Overall, the 2022/23 budget deficit is now estimated at $47 million, which is $23 million (33%) below the original estimate of $70 million and lower than the $72m forecast at the time of our last report. Net debt at the end of March was $68 million lower than the original estimate of $3.19 billion, at $3.12 billion. These improvements are welcome and reflect generally sound budget management—though underspending on capital expenditure and maintenance required to sustain and improve the Island's infrastructure will have to be made up in future years.

18. The 2023/24 Budget aimed to build on this performance, although the ambition appears somewhat less challenging from the revised starting point. Revenue is budgeted at $1.156 billion, $42 million (or about 3.8%) more than the previous year's outturn, with current account

expenditure up 2.4% at $973 million, leading to a $183 million primary current account surplus. After planned capital expenditure of $95 million – a very substantial increase on this year's outturn - and $130 million of debt service and guarantee management costs, the overall budget deficit is projected to be little changed from the previous year at $43.5 million.

19. Discretionary measures taken in the budget to supplement revenues included changes to make payroll taxes more progressive and shift the burden from employers to employees, in line with our earlier recommendations; increases in tourism-related revenues; and increases in certain fees. Meanwhile, departmental budgets were maintained at last year's enhanced levels, with a 1% allowance for payroll growth, although this still likely implies a continuing fall in real wages in the public sector, which is unlikely to be sustainable indefinitely. Other discretionary spending included increased child daycare allowances for parents, transitional living for young care-leavers, the reintroduction of public health scholarships and air-quality monitoring for those affected by BELCO emissions, while expanding social protections for families via the Financial Assistance programme.

20. Capital spending plans include further investment in the Tynes Bay Waste-to-Energy facility, additional affordable housing units, 40 additional electric buses and related infrastructure, new primary schools, a community health clinic, and upgrading Government IT systems, as well as maintenance, refurbishment and refits, including road surfacing and refits to fast ferries, some of which might more properly be included in the current budget.

21. The latest available in-year data for 2023/24 suggest that revenues are broadly as planned in the Budget. However, there has, again, been significant slippage in capital spending, with an anticipated underspend of $11 million. This is more than offset by a further $16 million grant to the Bermuda Hospital Board to make up the balance of the COVID related shortfall and relieve pressure on the hospital's finances. In addition, it is estimated a further $5 million will be required to cover costs relating to the cyberattack on the Government's IT systems in September. Overall, with some further savings relative to plans from current spending, the projected deficit is little changed from that budgeted.

22. Although there will be little deficit reduction in 2023-24, largely due to the increase in capital spending, the plan remains for a balanced budget in 2024/25 and for continued progress towards the targeted surplus of $50 million in 2026/27. This assumes current spending growth will be kept to 1% a year from next year, while revenues grow by 4.5, 3.0 and 3.0% respectively in the next three years. This assumes broadly unchanged tax policy, and revenues growing broadly in line with nominal GDP, boosted in the first year by the ending of the tax relief for new hires; any decision to further extend this (partially or in full) would reduce revenues.

MEDIUM TERM EXPENDITURE FRAMEWORK (MTEF)

	UNAUDITED ACTUALS 2022/23 $000	BUDGET ESTIMATE 2023/24 $000	PROJECTED FORECAST 2023/24 $000	BUDGET ESTIMATE 2024/25 $000	BUDGET ESTIMATE 2025/26 $000	BUDGET ESTIMATE 2026/27 $000
Revenue and Expenditure Estimates						
Revenue	1,112,978	1,155,525	1,155,525	1,207,524	1,243,749	1,281,062
Current Account Expenditure(excl.debt service)	918,592	972,632	968,127	982,358	992,182	1,002,104
Economic Relief/Additional Expenditures	1,500					
BHB Subsidy Grant	15,000		16,373			
COVID-19 Contingency	15,204	0	0	0	0	0
Current Account Balance(excl.debt service)	162,682	182,893	171,025	225,165	251,567	278,958
Interest on Debt/Guarantee Mgmt.	141,439	130,400	130,400	127,525	127,525	127,525
Surplus (Deficit) Available for Capital Expenditure	21,243	52,493	40,625	97,640	124,042	151,433
Capital Expenditure	68,180	96,007	85,000	95,000	95,000	95,000
Budget Surplus (Deficit)	**(46,937)**	**(43,514)**	**(44,375)**	**2,640**	**29,042**	**56,433**
Gross Debt	3,343,892	3,293,862		3,291,252	3,262,210	3,205,776
Debt Repayments*	(140,000)	(50,000)				
*No Repayments and/or Refinancing due until January, 2027						
BUDGET ASSUMPTIONS:						
Revenue - Growth, Tax Reform and Rate Increases		7.2%		$52M (4.7%)	$36M (3.0%)	$38M (3.0%)
Expenditure Increases		2.9%		$10M (1.0%)	$10M (1.0%)	$10M (1.0%)

C. Tax developments

23. During 2023, since our last report, there have been major developments in relation to tax, both globally and in Bermuda. Globally, it now seems clear that the G20/Inclusive Framework Global Minimum Tax, the "GloBE", will be implemented by a very substantial proportion of multinational enterprise (MNE) headquarters' jurisdictions, as well as many other countries. An EU Directive ensures that all EU countries will do so; the UK, Korea, New Zealand, and many others—advanced, emerging and developing economies-- have developed or enacted legislation; and the ramifications of the US's own unique international minimum tax and its interaction with the GloBE have been addressed in the OECD led rules development process. This will result in all major MNEs, with annual group turnover in excess of 750 million Euro, paying corporate income tax somewhere in the world at an effective tax rate of no less than 15%[3].

24. The Government formed an International Tax Working Group early this year, comprised of private and public sector experts in the area, including representatives of international business. Its charge is to examine how Bermuda can appropriately implement the global

[3] Subject to a variety of technical rules and exceptions, as discussed in previous reports, and with a somewhat different effective rate for US parented MNEs under the US GILTI tax.

agreement. The Working Group reported in July, and in August, pursuant to its recommendations, the Government put forward a first Public Consultation Document on the introduction of a corporate income tax (CIT) in Bermuda for those MNEs falling within the scope of the GloBE. This recommended that Bermuda adopt a CIT that would mirror the requirements of the GloBE, using as a base the modified accounting group income used in the GloBE and applying only to groups falling within the quantitative scope of the GloBE rules. The new CIT would therefore be intended as a "covered tax" within the meaning of those rules, with the rate set at a level intended to mitigate the potential that a "top up" tax under the GloBE rules would have to be paid to any other jurisdictions on profits earned in Bermuda. On October 5, a second, more detailed, consultation document was released. That draft proposed a CIT rate of 15%. For in scope entities, tax assurance certificates will be superseded, though the draft seems to imply that new assurances could continue to be issued in some form after the enactment of the new CIT. The draft also recognises that additional resources will be needed to manage and administer this new tax. A third document, with full draft legislation, was released for comment on November 15 with another two-week consultation period. This draft states that in 2024 qualified refundable tax credits (QRTCs) will be designed and adopted under the new CIT; this will impact both the revenues flowing from the CIT and the impact on Bermuda's competitiveness, and we discuss this below.

25. A CIT along the lines proposed could be expected to generate very considerable revenues, relative to current Bermudian tax revenues, as we noted last year in our report, and as third-party estimates have also noted. The Government is presently working on refining estimates. However, the legislation will not take effect prior to tax years beginning on or after January 1, 2025, so even in the best case, revenues would not materialise before companies' fiscal 2025 year, and therefore would be unlikely to be of significant benefit to Government finances until the 2026-27 fiscal year and beyond. Further, as the consultation document recognises, CIT revenues will very likely be subject to much greater volatility than existing sources of Government revenue, which rely most heavily upon the taxation of labour via the payroll tax and of consumption in the form of trade taxes and customs duties.

26. In September, the Government announced that a new Tax Reform Commission would be formed, with a remit to review the "existing system of domestic taxation to ensure it is in line with the requirements of the Global Minimum Tax while also examining what other changes to… local taxes are needed to ensure that Bermuda's economy remains competitive." In announcing this, the Premier also stated that "Government's policy aim is not to use these new global minimum tax revenues to significantly increase overall Government revenue. This change in global taxation should allow for the reduction of existing taxes that, by their very nature, increase the cost of living and the cost of doing business. For example, additional revenues will likely allow for the reduction or possible elimination of some existing Government taxes and customs duties." The TRC was empaneled in November with representatives from both

political parties, trade unions and the private sector. The full TRC terms of reference are yet to be formalised. We discuss the implications for the TRC and set out our own recommendations below.

D. Panel Assessment

27. In our 2022 Report, we welcomed the Government's detailed response to our major recommendations on the path of future spending, debt and deficits, and its adoption of our recommendation that it target a budget surplus of at least $50 million in 2026/27 and set out illustrative revenue and expenditure projections for 2025/2026 and 2026/27 that met that goal, so that we would finally begin to see a meaningful decline in Bermuda's net debt.

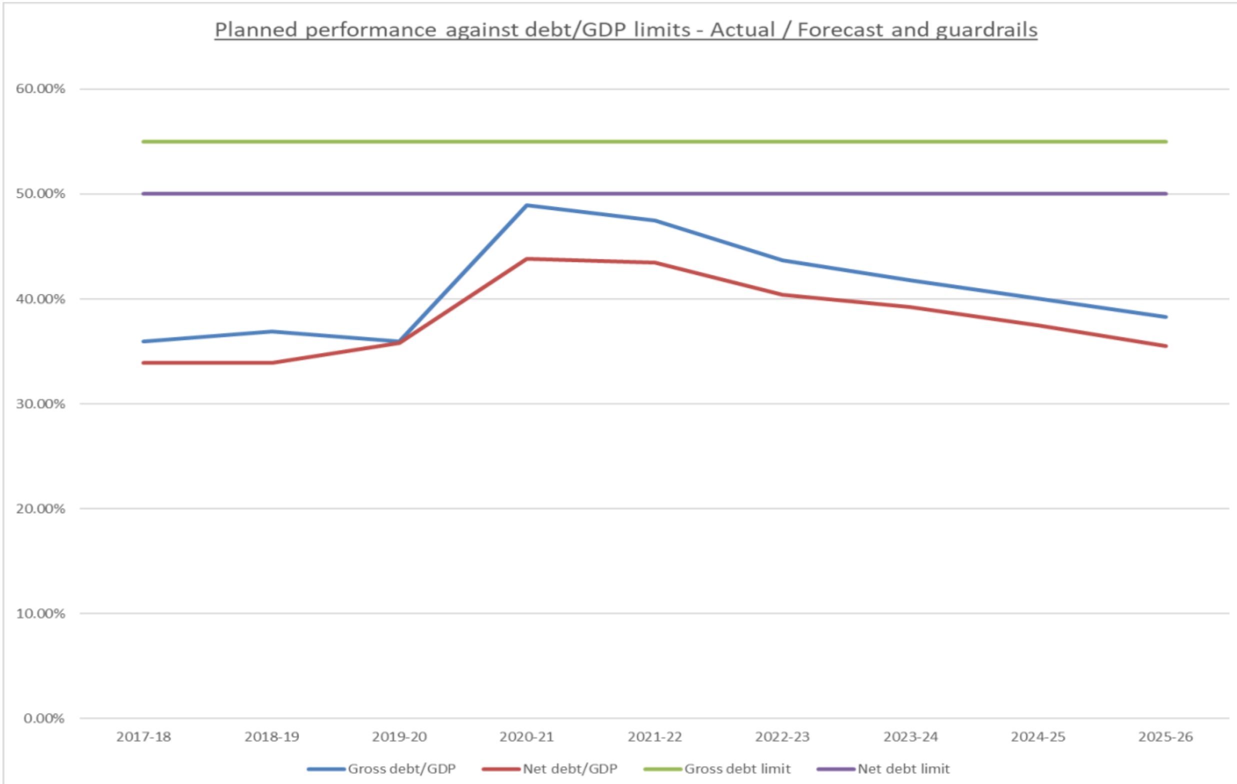
28. The 2023 Budget maintains this approach. While - as we anticipated then - both revenue and expenditure projections are somewhat higher than in the 2022 Budget, the broad path towards a balanced budget and then a surplus have not changed significantly. In particular, the Budget assumes that revenue growth remains reasonably buoyant, driven by wider economic growth and the withdrawal of some reliefs, while spending growth, after some relaxation this year, is held at 1% per year in 2024/25 and beyond. In recent years, revenue growth has generally exceeded projections, giving the government some flexibility to meet in-year pressures for increased spending.

29. Overall, then, these assumptions, while optimistic, may not be unreasonable given this year's relatively good performance on maintaining control of current spending, assuming no significant shocks. Indeed, leaving aside the large increase in capital expenditure this year – which will not in any event materialise as planned - they are largely consistent with our projections last year. They do, however, rely on continued economic growth combined with spending restraint and, crucially, as we discuss below, are very vulnerable to shocks. In addition, the control of spending has been achieved partly by delaying routine maintenance to infrastructure assets, which is not viable in the long term, and including repairs and maintenance as capital rather than current expenditure. Previous years have seen spending growing consistently faster than planned, largely offset by faster revenue growth compared to forecast. It cannot be assumed that the latter will continue with the current tax system. Hitting the balanced budget target will require a sustained focus on containing day-to-day running costs.

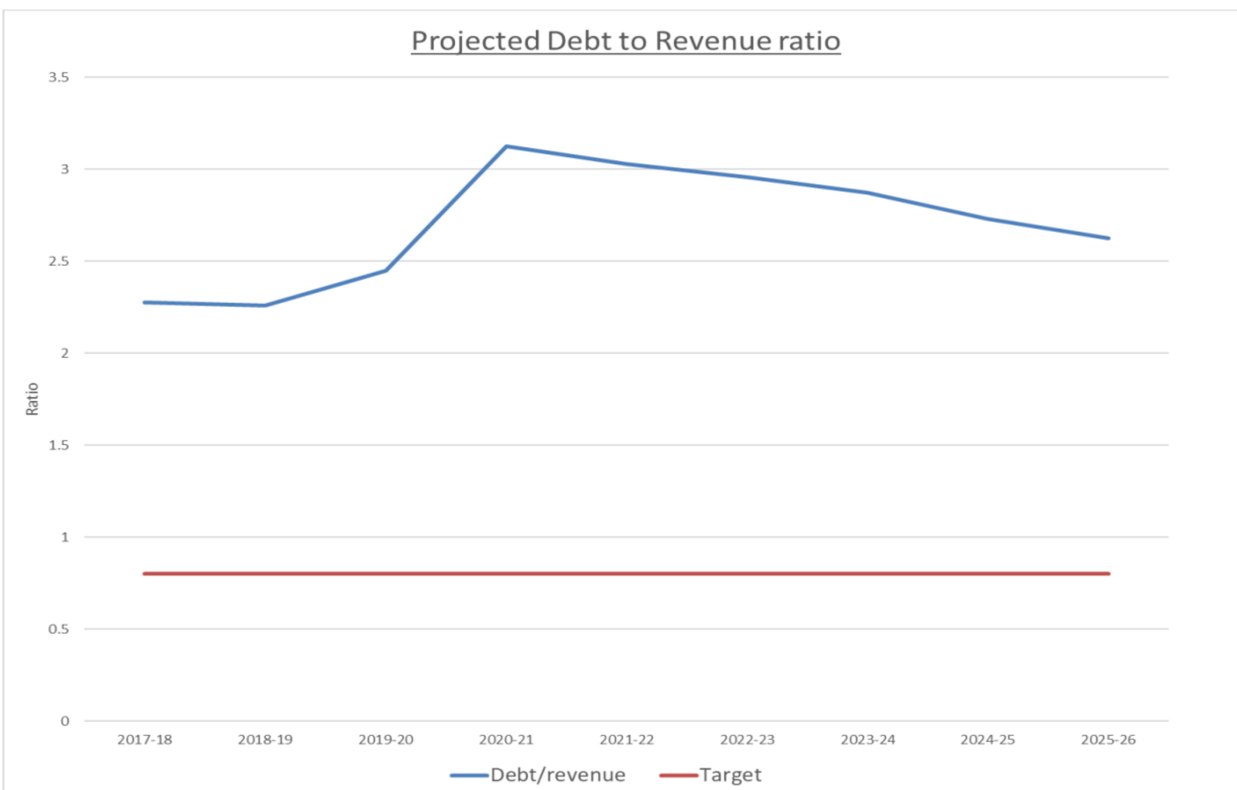
30. Meanwhile, the Government's debt position has not changed materially since our last report; after successive refinancings, discussed in detail in previous reports, no refinancing is required until 2027 (the local issue of $50 million due at the end of 2023 will be repaid from the Sinking Fund).

Bermuda Government Debt				
Issue Type	Currency	Maturity	Coupon	Principal Outstanding ($ Millions)
Local Issue	BMD	12/16/2023	4.750%	50.00
114A / Reg S	USD	1/25/2027	3.717%	604.60
114A / Reg S	USD	1/11/2029	4.750%	449.30
114A / Reg S	USD	8/20/2030	2.375%	675.00
114A / Reg S	USD	7/15/2032	5.000%	890.00
114A / Reg S	USD	8/20/2050	3.375%	675.00
Total Debt				**3,343.90**

31. Overall, then, as shown in the chart and Box below, our assessment is that the Government's plans remain consistent with its fiscal guardrails. However, there remains limited room for further slippage, and, absent policy action, there are significant downside risks, both in relation to the objective of budget balance next year and to the 2026/27 target. 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. While reducing, this remains at about 270%, in sharp contrast to the Government's objective of 80%. The debt service to revenue ratio, while falling closer to the target of 10%, currently stands at 12% and may rise again as debt is refinanced at likely higher interest rates. We discuss the implication of this analysis below.



Planned performance against debt/GDP limits - Actual / Forecast and guardrails
60.00%
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
2017-18
2018-19
2019-20
2020-21
2021-22
2022-23
2023-24
2024-25
2025-26
Gross debt/GDP
Net debt/GDP
Gross debt limit
Net debt limit



Projected Debt to Revenue ratio
3.5
3
2.5
2
1.5
1
0.5
0
Ratio
2017-18
2018-19
2019-20
2020-21
2021-22
2022-23
2023-24
2024-25
2025-26
Debt/revenue
Target

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 maintains the path towards achieving a balanced budget by year 2024-25 and a surplus of $50 million in 2026-27, relying on tight controls on spending and increased revenues resulting primarily from economic growth. The target is appropriate and achievable, but further action on tax reform to enhance revenues 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 2022) is approximately $7.5 billion, implying limits of approximately $4.15 billion, $3.75 billion, and $225 million, for gross debt, net debt and debt service respectively, in the current year.

With net debt peaking at about $3.15 billion, while gross debt remains at $3.35 billion, and debt service costs of approximately $130 million, while GDP should continue 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 forecast to fall below 250% of over the forecast period, which is welcome but still much too high. The debt service ratio is about 12% and falling, but may rise again when debt has to be refinanced, likely at higher interest rates in 2027. 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. Risks and Vulnerabilities

32. Given the relative stability in the near-term fiscal trajectory after the pandemic-driven volatility of recent years, the extensive analysis set out in our previous reports, and considerable uncertainty in a fast-changing world, we felt this was an opportune time to step back and analyse some of the key issues and risks facing the Island. These are considerable and include: Bermuda's exposure to international economic and political developments, particularly in the United States; the lack of sectoral as well as geographical diversification of Bermuda's economy,

including the impact on Bermuda of international initiatives on corporate income tax; climate change; and Bermuda's own demographic challenges.

The international environment

33. Amid geopolitical conflict and macroeconomic policy tightening, the world economy, still recovering from the COVID pandemic, slowed in 2023 and the IMF expects global growth to remain below that of recent decades into the medium term. Although recession appears at this juncture to have been avoided, risks remain, particularly of financial instability and a sharp repricing of risk leading to wider borrowing margins and a stronger US dollar, war in Ukraine and the Middle East raising commodity prices, and entrenched inflation requiring stronger policy action.

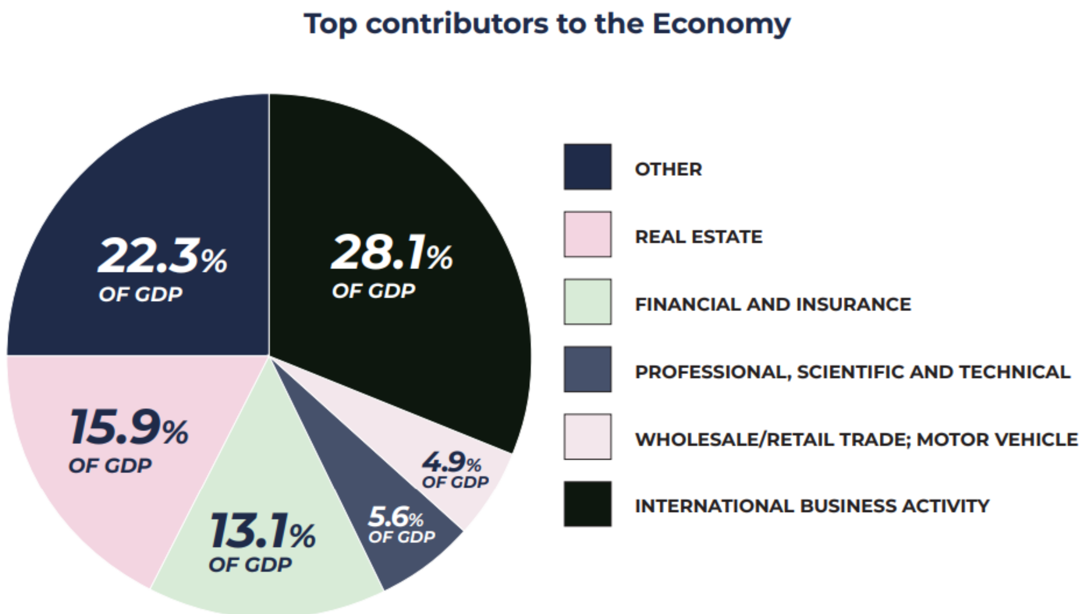
34. Most relevant for Bermuda, however, is the performance of the US. Bermuda is highly dependent on its economic linkages with the US across almost all dimensions. With the Bermudian currency pegged to the US dollar, US monetary policy and capital market developments directly impact Bermudian monetary conditions; the US is by far the largest market for tourism; the Bermudian international business sector is closely linked to US (and European) markets; and the US is by far the largest source of imports of both goods and services, including food, health, education, transport and travel. Moreover, as Bermuda borrows in US dollars, US Treasury yields directly affect the cost of Government borrowing.

35. The US economy has staged a reasonably strong recovery since the pandemic, and inflation is now falling back, although some analysts predict a mild recession next year. Of greater concern is the impact of higher US interest rates: both short-term policy rates and longer-term Treasury yields have risen sharply. This has an immediate impact on the cost of borrowing to Bermudian households and businesses. By contrast, Bermuda's Government borrowing costs have been insulated by the various refinancings which allowed the locking-in of relatively low long-term interest rates. But this will not last for ever – if Bermuda had to refinance its entire debt today, it would have to pay at least an extra 2 percentage points, at a cost of at least $60 million per year. With a significant amount of debt coming due as early as 2027, this represents a substantial medium-term risk.

36. More broadly, the risk of political instability in the US has risen once again. By its nature, it is difficult to assess, let alone quantify, any potential impacts on Bermuda. Nevertheless, for the foreseeable future, Bermuda cannot blithely assume continued political and economic stability in the US, or safe and easy access to its goods and services.

A poorly diversified economy

37. Perhaps even more worrying than Bermuda's dependence on the US is the lack of diversification of the domestic economy. Bermuda remains largely reliant upon international business, real estate, and domestic finance and insurance, which together contribute over half of GDP, and, to a lesser extent, tourism, and wholesale and retail trades, which are major employers. Accommodation and food services is among the fastest growing sectors of the economy. This means that major shocks to these sectors will – as was seen during the pandemic with tourism – have a correspondingly large impact on overall economic activity and employment, and hence on the Government's fiscal accounts.



[Source: Economic Development Strategy Bermuda, 2023-27 https://www.gov.bm/sites/default/files/Economic%20Development%20Strategy%202023-2027.PDF

38. International business directly accounts for over a quarter of total economic output and indirectly contributes substantially more, including to the professional services, real estate, hospitality and travel sectors. It is directly responsible for 15% of filled jobs, the largest single employing sector. Fortunately, the impacts of the pandemic were largely temporary, and the international business sector remained resilient throughout, but this may not be the case in future. Any long-lasting structural changes – whether driven by artificial intelligence, regulatory developments, international or domestic taxation changes, or anything else – that adversely

impacted Bermuda's international business sector could undermine the country's current economic model.

39. As was detailed in both of our last two reports, the G20/Inclusive Framework Global Minimum Tax will have a major impact on multinational businesses headquartered, or doing business through subsidiaries or branches, in Bermuda. This will to a great extent vitiate the benefits those enterprises realise under current circumstances from the absence of a corporate income tax (CIT) in Bermuda—and, correspondingly, will limit or erase the benefits from Bermuda's tax assurance certificate program, under the Exempted Undertakings Tax Protection Act of 1966, which in essence promises that no CIT will be applied to the holders before 2035.

40. The Government has a good record of engagement and consultation with international business, and this is reflected in the design of its new CIT in response to the GloBE, which to date has commanded wide support. International business in Bermuda also benefits from the jurisdiction being a well-regulated international hub of knowledge and expertise for insurance and reinsurance. Nevertheless, the authorities must remain attentive to the concerns of international business to ensure that Bermuda remains an attractive and cost-effective place to live, work and do business. The role an appropriately designed QRTC scheme could play is discussed further under recommendations below.

41. In recent years, the Government has focused much attention on "digital assets", as part of a strategy to diversify and promote innovation in the financial services sector. Bermuda has proceeded carefully here and has developed a reputation for serious regulation of the sector, beginning with the adoption of the Digital Assets Law in 2018. However, in the wake of the collapse of FTX, US regulation is likely to tighten further in respect of some activities, and even relatively responsible jurisdictions like Bermuda will need to be careful not to be tarnished by association,

Climate change

42. The Panel has been discussing the risk posed to Bermuda from climate change for some time. Of particular concern to Bermuda would be rising sea levels and flooding, increased or intensified tropical storm activity, freshwater shortage, and changing weather, including reduction or loss of the Gulf Stream. New scientific reports and a series of extreme weather events have served to highlight the issue further this year. The sixth synthesis report from the InterGovernmental Panel on Climate Change (IPCC) in March concluded that global surface temperature between 2011 and 2020 was already 1.1 degrees Celsius higher than the 1850 to 1900 pre-industrial average. More recent evidence suggests warming has now reached 1.2 degrees, against the ceiling of 1.5 degrees sought by the Paris Agreement. Mean global sea level rise is accelerating, reaching 3.7mm a year between 2006 and 2018 according to the IPCC.

Ocean warming and acidification have adversely affected fisheries and shellfish aquaculture production in some regions.

43. On current trends, global warming and its climate impacts are set to get considerably worse. The IPCC notes that 'Global Greenhouse Gas emissions in 2030 implied by Nationally Determined Contributions as of October 2021, prior to COP26, make it likely that warming will exceed 1.5 degrees this century and make it harder to limit warming below 2 degrees. Without policy strengthening, global warming of 3.2 degrees by 2100 is projected with medium confidence. Moreover, the availability of climate finance falls short of that required to limit warming to 1.5 degrees across all regions. Further global mean sea level rise and ocean acidification is virtually certain, while ocean deoxygenation is expected with high confidence. Current 1-in-100 year extreme sea level events are expected to occur annually in more than half of all tidal gauge locations by 2100. Intensification of tropical cyclones and/or extra-tropical storms is expected with medium confidence. Recent research by the British Antarctic Survey suggests that the west Antarctic ice sheet is now unstable with accelerated melt pushing up sea levels this century all but inevitable[4].

44. Although the IPCC held with medium confidence that the Atlantic Meridional Overturning Circulation (AMOC), or Gulf Stream, 'will not collapse abruptly before 2100', recently published research[5] from Denmark adds to concern that AMOC may be weakening and becoming unstable. The authors model a collapse in the Gulf Stream occurring as early as in the next few years.

45. A recent detailed two part study by the Bermuda Institute of Ocean Sciences (BIOS)[6] reported that mean sea levels in Bermuda had risen by 0.25 metres between 1900 and 2020 and were projected, with high confidence, to rise a further 0.24 to 0.26 metres by 2050 and by 0.5 to 0.7 metres by 2100, with a risk that greater glacial ice melt could lead to higher levels still. Hurricane intensity and frequency has increased which, together with rising sea levels and oceanographic warm eddies, increase the risk of coastal flooding even in good weather. There was some evidence of increased rainfall and higher wind speeds. These changes would put a small number of, predominantly higher value, properties in coastal areas less than 1 metre above sea level at dramatically increased risk over the next 50 years, while an increasing risk and intensity of storms, increasing rainfall extremes and warm eddies raise the flooding risk for many. The cost of hurricane damage will increase. Weather becoming windier and rainier, together with shrinking beaches as sea levels rise, probable loss of coral reefs, increased

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[4] Naughten, K.A., Holland, P.R. & De Ryft, J. Unavoidable future increase in West Antarctic ice-shelf melting over the twenty-first century. *Nat. Clim. Chang.*(2023). https://doi.org/10.1038/s41558-023-01818-x

[5]Ditlevsen, P., Ditlevsen, S. Warning of a forthcoming collapse of the Atlantic meridional overturning circulation. *Nature Communications* **14**, 4254 (2023). https://doi.org/10.1038/s41467-023-39810-w

[6] Guishard, M, Bermuda Institute of Ocean Sciences, Climate Change and Bermuda (2022 and 2023)

transatlantic flight times and travel disruption could impact traditional tourism. An increased incidence of salinity in fresh groundwater will reduce water quality and affect agriculture. Risks from flooding to several important Bermudian assets were identified, including the World Heritage site at St George's which will be subject to regular flooding at high tide within the next 30 years, the airport, large parts of which are projected to be flooded annually by 2050, and up to four care facilities situated in low lying coastal areas. The report further identified risks from Bermuda's extreme reliance on US agriculture and ports, which will themselves be adversely impacted by climate change.

Demography, pensions and health

46. Since its inception in 2015, the Panel has identified the ageing and shrinking of Bermuda's working age population as a serious threat to Bermuda's long-term economic future and fiscal sustainability. Fewer people in work means lower GDP and lower tax revenues, while an increased proportion of people over working age or otherwise out of the labour force means lower GDP per capita as well as higher spending on pensions and health. Last year, the Government published a position paper entitled "Addressing the Challenge of an Ageing Population in Bermuda", assessing and detailing the potentially disastrous implications of demographic change; it calculated 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 set an ambitious target of achieving that over 5 years.

47. One year on, the scale of this issue was illuminated by the 2022 Labour Force Survey; Bermuda has just over 20,000 residents aged between 45 and 64, compared to only 15,000 between the ages of 25 and 44. The direct result of natural population changes is that about 1,000 people leave the workforce every year, while only 500 join – a net reduction of 1% each and every year for the foreseeable future.

Selected Characteristics of the Population 16 Years and Over	Total	Sex Male	Female
Relationship to Household Reference Person			
Total	54,463	25,947	28,516
Household Reference Person	29,313	13,520	15,793
Husband / wife	11,018	5,467	5,551
Child	7,791	3,956	3,835
Grandchild	462	293	169
Father / mother	1,507	456	1,051
Grandparent	55	0	55
Parent-in-law	120	87	33
Son -/ daughter-in-law	239	191	48
Brother / sister	636	338	299
Other relative	526	199	327
Live-in partner	1,540	725	815
Other non-relative	1,257	716	540
Age Groups			
Total	54,463	25,947	28,516
16 - 24	5,640	2,861	2,780
25 - 34	6,207	2,956	3,251
35 - 44	8,732	4,257	4,475
45 - 54	9,512	4,791	4,721
55 - 64	10,693	5,166	5,527
65+	13,678	5,916	7,762

Source: Bermuda Labour Force Survey, November 2022

48. But this is not the only consequence of demographic trends. The combination of population ageing, a high cost of living and a relatively unhealthy population helps make Bermuda's healthcare costs per capita among the highest in the world. Pressure on healthcare provision will only increase. This in turn means continued pressure on Government finances.

49. Similarly, an ageing population undermines the future solvency of the Government pension funds; the Contributory Pension Fund (CPF) and the Public Sector Superannuation Fund (PSSF). On the latter, a package of measures is under discussion to increase contribution rates and raise retirement ages, which should help put the PSSF on a more secure footing. However, by 2026, the CPF will be paying over $100 million a year more in benefits than it will be receiving in contributions, and on central assumptions it will be exhausted by the mid-2040s.

50. The causes and implications of these inter-related demographic issues have been repeatedly examined in detail in our previous reports, and we will not repeat those analyses here. Rather, below we draw attention to the risks to long-run fiscal sustainability that arise.

F. Fiscal implications

51. Were some or all of the risks described above to materialise – for example, the loss of tourism and/or international business, some of the more adverse climate change scenarios with material impact on Bermuda, economic and political instability in the US disrupting trade, or a failure to deal with population ageing — there would be a considerable fiscal impact. The nature of some of the risks is such that it is difficult or impossible to quantify the effect in fiscal terms, but they would potentially be extremely large. Recent reforms mean that the payroll tax is now much more progressive, meaning that international business accounts for a very large share of total revenue.

52. However, it is possible, in broad terms, to examine the impact of a failure to adequately address the implications of the demographic time bomb. There are two relevant perspectives here. First, what is the effective, or underlying, debt of the Bermudan Government that might ultimately have to be financed by Bermuda's taxpayers, directly or indirectly? There is no single answer to this, but one obvious calculation is to add the current actuarial deficits of the CPF and PSSF, as well as the debt of the BHB, to the official debt.

Existing net debt	$3.2 billion
CPF	$800 million
PSSF	$1,000 million[7]
Bermuda Hospital Board	$267million[8]
Other miscellaneous guarantees	$200 million approx[9]

53. It is worth noting that Moody's, for example, describes Bermuda's current official debt ratio of about 45% as "in line with the median for its A-rated peers of 49%" – but the above calculation yields a total figure for "underlying" Government debt, including Government-guaranteed debt and unfunded liabilities, but excluding contingent liabilities, of well over $5 billion, or between 4 and 5 times annual revenues. This is in no sense an official measure of debt, and as noted action is being taken to address the actuarial deficit of the PSSF, but it nonetheless gives a sense of the scale of the potential future fiscal pressures.

54. An alternative perspective is to consider the likely budget pressures on current spending and tax revenues that will arise over the medium term as a result of the trends above, on a

[7] As noted above, this will be very substantially reduced if proposed measures to address the actuarial deficit are implemented.
[8] The value of the guarantee of the BHB's debt is shown in the Government's accounts as approximately $800 million, but this also includes future interest payments
[9] Where these are guarantees for commercial projects, they are contingent liabilities, which will not necessarily, but may, have to be financed by taxpayers.

"business as usual" basis". Consider the likely impacts not over the very long-term but merely over the next ten years:

- As noted above, all of Bermuda's existing debt will need to be refinanced; at current interest rates, this would add up to $60 million annually in interest payments alone.

- At present, the gap between current contributions and expenditures in the CPF is covered from the liquidation of assets, and hence is neither financed by contributors nor directly by Government. But by the early 2030s, the gap between contributions and expenditures in the CPF will be $150 million every year. While the fund is projected to have enough assets to cover benefit payments until the 2040s, it is highly unlikely to be either sensible or politically sustainable to allow the Fund to be steadily depleted over this period.

- Historical experience suggests health expenditures are unlikely to grow by less than 5% per annum, leading to budget pressures of up to $100 million a year on top of the current $200 million in direct Government financing.

- The shrinkage in Bermuda's working age population of 1% per year, other things being equal, will likely translate to a commensurate reduction in growth and hence tax revenues of about $10 million a year *every* year – so cumulating to about $100 million a year over a decade.

55. Overall, what this means is that on a "business as usual" basis, there are likely – on a relatively conservative estimate - to be additional budget pressures over the next decade of somewhere in the region of $300 million a year, more than a quarter of revenues and nearly a third of current spending on public services. While some of these pressures are implicitly already included in Government forecasts and our analysis, most are not, certainly in the years beyond 2026/27.

56. It is important to note that this is not a forecast or a prediction – it is an illustrative calculation of the impact of "business as usual". In practice, however, the large deficits implied here will not materialise, because well before that point is reached Bermuda will be unable to finance its debt. The choice then is simply whether Bermuda will take decisive actions to address these pressures in advance of that point, or whether it will be obliged to do so by financial markets. This is not a counsel of despair in any sense, but it is a "burning platform": Bermuda cannot afford to wait a decade.

G. Recommendations

Fiscal Policy

57. Bermuda now has a significant primary surplus. It has done well over the past few years to maintain a credible path towards a balanced budget, despite a number of adverse shocks, most obviously the pandemic. Spending has generally been kept under control, and steady revenue growth has therefore largely fed through into deficit reduction. A nimble and professional approach to debt management has also enabled Bermuda both to control debt interest payments and reduce its exposure to refinancing risks. All this has significantly mitigated the risks of a major fiscal crisis in the short-term.

58. As set out above, the Government's plans are consistent with the fiscal guardrails, the achievement of a balanced budget in 2024/25 and a surplus of $50 million in 2026/27: plans which we think remain appropriate, subject to our recommendations below on any additional revenues from the CIT which may materialise over this period. Delivering these plans will require continued tight control of current spending; the Government should be prepared to implement further measures to reduce spending or enhance revenues if it appears that the targets are in jeopardy. Balancing the budget in 2024-25 is an important symbol of the government's commitment to fiscal responsibility, and any failure to do so would have negative implications for its future credibility.

59. The short run therefore looks reasonably secure. However, looking forward to the medium and longer run, and despite the above progress, policy-makers have consistently ducked structural reforms along the lines repeatedly recommended by this Panel. While sensible measures to address the long-term pressures from health and pensions have been developed, implementation has been repeatedly delayed. The direction of travel on immigration policy is welcome, but will take time and sustained focus to deliver concrete results.

60. Meanwhile, the combination of the – fortunately temporary – sharp rise in the deficit during the pandemic, and the calling of Government guarantees, means that net debt is now considerably higher than projected in the pre-pandemic period.

61. As discussed above, the medium to long-term risks now facing Bermuda are formidable – and potentially disastrous from a fiscal perspective. As the IMF recently put it:

> "Fiscal buffers have eroded in many countries, with elevated debt levels, rising funding costs, slowing growth, and an increasing mismatch between the growing demands on the state and available fiscal resources. This leaves many countries more vulnerable to crises and demands a renewed focus on managing fiscal risks." IMF World Economic Report, October 2023

62. But there is now an opportunity to address this. The combination of the introduction of a CIT and relative economic stability means Bermuda has a chance to put things on a better footing now, for the long term. The Government's objective that the CIT should not result in an increase in the cost of living or doing business in Bermuda is understandable – but needs to be matched by a clear commitment to use a substantial proportion of any extra revenues to reduce Bermuda's debt, to build up fiscal buffers against the pressures and risks described above, and to save for and invest in future generations.

63. From the perspective of fiscal policy and long-term fiscal sustainability, the increase in tax revenues resulting from the CIT is not dissimilar to the windfalls seen in oil and gas producing countries, or indeed to Ireland's recent experience with large, unexpected and volatile corporate tax revenues. While there are huge potential benefits, there are also at least three serious risks:

- Revenues resulting from such sources should not be assumed to be permanent; just as oil and gas will eventually run out, there is a risk that, whether because of domestic or international developments, a significant proportion of international business may over time leave Bermuda.

- Such revenues are likely to be volatile. Just like oil prices, the profits of international business in Bermuda are highly variable, much more so than payrolls. Replacing tax on one with the other risks significant revenue shortfalls in "bad" years. This fact was recognised in the latest consultation document, which proposes to permit only 80 percent of tax to be offset in any year by loss carry forwards. However, though this is a good idea, it is fairly limited fix to the volatility issue.

- Recycling revenues into domestic tax cuts or Government spending increases – and hence into domestic demand – poses serious macroeconomic risks. In particular, given the nature of Bermuda's economy and supply constraints, there is a serious risk that it would simply result in boosting prices throughout the economy, including consumer goods and real estate. This would not only raise the cost of living, negating the real impacts of tax cuts, but could make some domestic businesses less competitive (a form of "Dutch disease") further impeding economic diversification.

64. For all these reasons, the IMF strongly recommends that oil and gas producers, for example, should budget on the basis of non-oil revenues as far as possible, and save a large proportion of oil revenues in a sinking or sovereign wealth fund.

65. A direct analogy with Bermuda's current position is Ireland. Like Bermuda, Ireland was badly hit by the global financial crisis, and experienced a fiscal crisis as a result, necessitating severe austerity. However, Ireland has experienced rapid growth in corporation tax revenues, further accelerated in recent years by the direction of travel in the international tax and regulatory environment. The Irish Government, mindful of the experience of the crisis, and aware of the potential volatility and uncertainty of CIT revenues, has begun to establish mechanisms to ensure that these very large increases in CIT revenues are used wisely. These include the establishment of a "Reserve Fund" and constraints on short-term spending increases or tax cuts. The Irish Fiscal Council – an independent advisory body with a similar remit to this Panel – recommended the following:

> "1) to avoid using concentrated and unpredictable increases in corporation tax receipts as a basis for increasing permanent spending and 2) to redirect these to the Reserve Fund or towards debt reduction"[10]

66. We agree. Our most important and urgent recommendation, directed both at the Government and the TRC in its deliberations, is therefore that Bermuda should make an early and binding commitment to use a substantial proportion of net revenues from the CIT to reduce Bermuda's net debt, eventually converting it to a net asset position. This proportion might vary from year to year, reflecting the likely volatility of CIT revenues, but should be consistent with a clear objective for substantially reducing and, ideally, eliminating Bermuda's net debt over the medium-term, perhaps 10 years after CIT revenues first materialise. An objective of eliminating net debt in 10 years would require an annual surplus of about $350 million, or about 5% of Bermuda's annual GDP.

67. It would be consistent with reducing net debt to hold at least some additional revenues in a "stabilisation fund"; this would help insure against the risk of having to borrow at high interest rates on the open market if volatility was such that revenues fell below base budget needs in any year, or if Bermuda were hit by an adverse economic shock. Beyond eliminating net debt, and accumulating liquid assets in a stabilisation fund, in time Bermuda should use excess revenues to build fiscal reserves in the form of a sovereign wealth fund.

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68. We would also recommend the establishment of a mechanism to ensure that decisions on the allocation of the CIT revenues are taken transparently, on the basis of independent expert advice and scrutiny and do not jeopardise macroeconomic stability. For example, one possibility might be to allocate some of the residual revenues towards addressing the large unfunded deficits in Bermuda's principal pension schemes; this would also address issues of intergenerational

[10] https://www.fiscalcouncil.ie/wp-content/uploads/2022/11/Box-D-Irelands-Reserve-Fund-is-restored-but-needs-some-rethinking-Fiscal-Assessment-Report-November-2022.pdf

equity. This would require further discussion and analysis, and ideally would reflect a broad political and social consensus of Bermudian society.

69. At this stage, given the uncertainty about the amount, timing and volatility of additional revenues, the Government does need not commit to quantitative allocation rules --for example, the precise formula by which normal and excess revenues should be defined. However, it is not too soon – indeed, in our view it is essential -- to set expectations among households and businesses and to set out a clear commitment to a robust institutional framework. We recommend that the TRC frame its recommendations accordingly and that the Government commits in principle to legislate in line with the recommendations above. Specifically, we recommend legislation that provides for:

- a fiscal rule setting out the strategic approach governing the allocation of proceeds from the CIT, and enshrining a commitment to reducing net debt and building net assets.

- the establishment of a "stabilisation fund" on the lines set out above, to ensure that the government has a buffer of relatively liquid assets to manage volatility in revenues.

- the establishment of an independent body with a remit to make recommendations (at least on an annual basis) on the allocation of proceeds as between debt repayments, the stabilisation fund, and the other possible long term future-oriented uses set out above. Such a body should have expertise on macroeconomic, fiscal and debt management policy and reflect the views of Bermudian civil society.

Tax Design

70. Very important to the success of the CIT will be the design, and the purposes and scale, of the QRTCs. They have the potential to serve two purposes: first, to allow affected companies to reduce their tax bills (and perhaps to smooth them over time), reducing the potential financial disincentive to remain domiciled in Bermuda; and to improve Bermuda's economic and social infrastructure, broadly defined, which could also improve Bermuda's attractiveness. Obvious areas where QRTCs could potentially be beneficial include housing, skills development and training, and infrastructure – all areas where Bermuda has underinvested in the past and areas where improvements would be of benefit to international businesses and their employees.

71. The Government therefore intends to focus the next stage of its work on the CIT on this issue, drawing on technical expertise to ensure that the QRTCs are in line with the requirements for qualification under the GloBE rules, to consider how their introduction will affect projected revenues, and in particular to develop the incentive goals of the QRTCs in affecting the behavior of in-scope entities.

72. The TRC is also charged with recommending changes to the current tax system in the light of the potential impact of the CIT. In our view, the TRC in making its recommendations, should prioritise the following:

i) The Panel has long recommended a move from the payroll tax, especially the employer element, to an individual income tax that would also tax income from capital. This would both make the system more progressive and could help reduce the cost of labour, especially for international business, thus boosting employment. The additional revenues from a CIT might mean that such an income tax could be introduced at relatively low levels by international standards, easing the transition and improving Bermuda's competitiveness.

ii) Such a tax would need to be designed carefully to ensure that it maintained – and if possible enhanced – Bermuda's attractiveness to those moving to the Island on either a permanent or a temporary basis. It may be advisable to adopt some form of remittance-based tax for those residing for only a few years—but these decisions should come within the remit of the TRC.

iii) Ideally, reductions in import tariffs would be combined with a move towards a broad based consumption tax that would cover domestically consumed services as well as goods. Again, the increased revenues from the CIT mean that this could be set at a relatively low level to maintain competitiveness, reduce costs for international business, and ease the transition. Such a tax would be applicable to hospitality services, and thus would need to be coordinated with existing tourism taxes.

73. While these appear to be major changes in the tax system, this is the critical moment to examine such structural improvements. In addition to the macroeconomic arguments set out above, it would be a major missed opportunity if the Government did not use the additional revenues potentially flowing from the CIT to reform and restructure the tax system to give Bermuda -for the first time in its history - a modern and competitive tax system, one which helps to create fairness across the residents of the country, while also helping to make the economic environment and costs of doing business here attractive for international business.

Broader long-term issues

74. In addition to the above recommendations aimed at improving the Government finances and enhancing fiscal resilience and sustainability, it is our strong belief that Bermuda should also continue to seek to mitigate the other risks outlined in section E above. Not only will this

enhance resilience and wellbeing, but it will reduce the potential adverse impact on the fiscal position should risks crystallise. Economic growth, competition and diversification, geographical as well as sectoral, are important, as is addressing the rising dependency ratio and the consequent problems for the health and pensions systems.

75. Our recommendations in these respects differ little from those of our previous reports, but for the sake of completeness we summarise them again here:

(i) Bermuda should continue to concentrate on leveraging its traditional expertise in the insurance sector with fintech, and in particular should avoid a focus on cryptocurrencies. Recent years have seen some encouraging diversification, and accompanying expansion, of the sector beyond pure property and casualty and there is the potential to do more, building on Bermuda's strengths in the fields of insurance linked securities and climate risk finance.

(ii) Beyond insurance and finance, Bermuda needs to continue to diversify. Rather than 'picking winners' Bermuda should continue to ensure it has the legislative and governance frameworks in place to take advantage of its natural advantages, including its strategic ocean location.

(iii) On geographic diversification, a number of initiatives are under way. The Government intends to consult on full membership of CARICOM, which could lead to closer economic integration. Further, in late August Bermuda received UK approval to appoint a representative to the GCC countries for the purpose of furthering economic ties in the region. There has been an expansion of direct flights to Canada. All these are welcome steps, and we would encourage further moves to increase geographical diversification.

(iv) The Government should address legal and regulatory barriers that inhibit the banking sector from providing greater access to credit for Bermuda residents and businesses; the mortgage programme for low income households appears to be progressing well, but more could be done in terms of financial inclusion and SME finance.

(v) 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. The Climate Task Force should be adequately resourced and supported, and recommendations for increased climate resilience should be incorporated into all Government strategies, policies and regulations.

(vi) On immigration and the expansion of the workforce, the Panel endorses the analysis and recommendations contained in last year's report on the ageing of Bermuda's population from the Ministry of Economy and Labor, and the commitments to make it easier for long-term residents to achieve permanent status, as well as to attract Bermudians to return from abroad. This will require both further policy development and improvements to the speed and efficiency of the system. This is of particular importance to the International Business sector, but it is also essential to the growth of other, more domestically focused businesses like tourism, retail and hospitality.

(vii) Expanding the working age population will, however, require supporting policies. In particular, to accommodate the scale of workforce (and hence population) expansion that is envisaged as needed, Bermuda will need to expand housing supply considerably faster than in the recent past; again, this will require both policy change (and, as noted above, QRTCs might help here) and a speedier and more efficient planning process.

(viii) the PSSF reforms currently under discussion should be implemented as soon as possible, and the Government should aim to progress similar changes to the CPF, including increasing retirement ages. Similarly, it should implement planned health care reforms along the lines of the Bermuda Health Plan to provide affordable universal health coverage better, and more efficiently, than that now available

(ix) Guarantees for commercial businesses pose a substantial risk and should be significantly curtailed. Guarantees virtually never should be issued to back commercial projects.

(x) Policymaking would benefit from more timely economic statistics. Resources could be freed up by reducing the frequency of the monthly retail sales publication which, in recent years, has tended to confirm the secular trend toward online shopping.