

PRE-BUDGET REPORT

in advance of fiscal year

2024-2025



GOVERNMENT OF BERMUDA

Ministry of Finance

Chapter 1 – Introduction

What Is a Pre-budget Report?

A pre-budget report (PBR) is a policy statement issued by the Government that defines its priorities and approach in advance of the full budget in a medium-term framework covering external developments and internal strategies. A PBR is intended to clearly state the Government's economic and fiscal policy challenges and its objectives and intentions in the medium term.

Like most small states and territories, Bermuda's economy is vulnerable to external events, underlining the need for financial and fiscal prudence. This vulnerability is compounded by Bermuda's continuing budget deficits and government net debt, standing at \$3.1 billion.

The Government must continue to address the problems the island faces, and it is essential that stakeholders and citizens understand these challenges, have the opportunity to give their views, and are aware of the factors driving the Government's fiscal policy decisions. The Government should also be accountable for developing strategies to cope with both domestic and international turbulence, and the strategies contemplated should be transparent and open to feedback.

Purpose of the Pre-budget Report

The PBR aims to increase public awareness of the Government's fiscal and budget policy objectives and establish a benchmark for evaluating fiscal policy.

The PBR also educates the public and encourages debate about how effectively the budget strategy copes with current economic and social priorities. The PBR is intended to allow stakeholders, such as business and social groups, to understand and comment on options for the next budget. This gives stakeholders confidence that the administration's budget policies are grounded in longer-term fiscal and budget strategies.

From the Government's perspective, the scope for public misunderstanding of the eventual budget strategy is reduced due to a greater appreciation of the challenges it faces.

Pre-budget submissions by groups who respond to the PBR can also alert the Government to unforeseen pitfalls and alternative policy options and improve the quality of the budget. They may even prevent embarrassing policy U-turns after the budget has been handed down when previously invisible problems come to the fore.

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

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

The Principles of Good Fiscal Policy

Good fiscal policy is intended to accelerate economic growth while ensuring all Bermudians have an opportunity to benefit and prosper from it. The policies should promote and maintain societal stability in both the short- and medium-term.

To meet these objectives, the Government's fiscal strategy will be framed in accordance with the following principles of sound fiscal management:

- Prudent management of the financial risks faced by the Government.
- Ensure fiscal policies contribute to enhancing the Government's fiscal position.
- Pursue fiscal policies consistent with a reasonable degree of stability and predictability.
- Maintain the integrity of the tax system.
- Ensure policy decisions are constructive and positively impact future generations.

The Government maintains that the uncertainty of these times should not deter efforts to promote and invest in the diversification of Bermuda's economy. The Government's prudent economic management has provided an avenue for GDP growth on which the Government will continue to capitalise. These growth opportunities will further improve Bermuda's ability to reduce the deficit and increase employment across all sections of the local economy. In addition, it will create jobs and opportunities not only in existing industries but also in new sectors that will drive stronger economic growth.

Chapter 2 – Economic Review

Global Economy

According to the IMF's October 2023 World Economic Outlook (WEO), after suffering setbacks from the Russia-Ukraine war, cost-of-living crises, and the COVID-19 pandemic, the global economy is on a path of recovery. The recovery, however, is slower than expected and uneven with global divergences forming. Global growth is projected to decrease from 3.5% in 2022 to 3.0% in 2023 and 2.9% in 2024, a 0.1 percentage point decline in 2024's forecast from the IMF's July 2023 WEO.

Headline inflation is projected to fall from 9.2% in 2022 to 5.9% in 2023 and 4.8% in 2024, while core inflation, excluding food and energy, is also projected to fall to 4.5% in 2024. In 2023, advanced economies have been experiencing disinflation with inflation projected to fall by 2.7 percentage points. On the other hand, emerging markets and developing countries are expected to have a slower trajectory to pre-pandemic levels with inflation projected to decline by 1.3 percentage points. These inflation levels are believed to be achievable under a "soft landing" scenario where a sharp fall in economic activity doesn't occur as inflation falls.

Global economic divergences however are expected to continue. Among advanced economies, the United States' economic activity is growing, driven by investment and consumption, whereas the economic activity in the Eurozone is falling. In contrast, most emerging markets' economic activities are growing, with the exception of China, which is currently dealing with the effects of its real estate crisis and lower investor confidence. These global divergences are fuelled by varying degrees of monetary policy, the occurrence of last year's commodity price shock and the slow recovery of the services economy, among other factors.

The implementation of tighter monetary policy continues to put moderate downward pressure on inflation levels. However, uncertainty about the strength and speed of monetary policy transmission and how uneven it is across countries arises. According to the OECD Economic Outlook September 2023, Central Banks are likely to hold policy rates higher for longer due to new indications of an upward drift in inflation expectations and persistent cost pressures. This might reveal financial weaknesses in the financial institutions' balance sheets, resulting in the re-evaluation of liquidity, duration, and credit risks. In addition, previous interest rate rises and tighter credit conditions could lead to slowed consumption, unemployment, and bankruptcy increases. The IMF's October 2023 WEO reports that there has been a rise in firm bankruptcies in the U.S. and Eurozone, albeit from historically low levels. These tighter credit conditions hinder investment, housing markets, and economic activity with a large impact in countries with greater percentages of adjustable-rate mortgages and households that are less able or willing to use their savings. Furthermore, countries are at different stages in their monetary policy process. Developed economies, except for Japan, are still tightening whereas emerging markets, e.g., Chile and Brazil, have started the easing stage.

The occurrence of last year's commodity price shock affected inflation and economic activity across many countries. Due to the Russia-Ukraine war, the rise in energy prices and the subsequent fall in activity was more severe in economies largely reliant on Russian energy imports. Compared to the U.S., where core inflation pressures are driven by a tight labour market, some of the IMF's recent research on the Eurozone indicates that the pass-through from increased energy prices was a major factor in increasing core inflation. Additionally, the OECD Economic Outlook September 2023 reports that the war has the potential to put pressure on the costs of corn, edible oils, wheat, and fertilisers due to the Black Sea Grain Initiative ending.

Service-oriented economies have mostly recovered from the pandemic and the Russia-Ukraine conflict. Compared to heavy manufacturing economies, like Germany and China, service-oriented economies such as Spain and France have profited from a robust demand for services over the past year. The increased demand for labour-intensive services has however led to tighter labour markets and persistently higher service inflation. The current contractionary monetary environment has however begun to weaken activity in the services sector and further added to the persistent slowdown occurring in the manufacturing sector. This suggests a possible dampening in services inflation, labour markets, and activity going into 2024.

With the global economy moderating after its aggressive start to 2023, risks remain tilted to the downside. Key concerns surrounding the effectiveness of monetary policy and the persistence of inflation continue. The adverse effects of higher interest rates could prove stronger than expected, while greater inflation persistence would require additional policy tightening that might expose financial vulnerabilities and slow overall global demand and growth.

U.S. Economy

The U.S. economy has shown great resilience to the continuous increases in interest rates with growth in consumer spending fuelled by excess savings accumulated during the pandemic. However, excess savings are depleting, real disposable income growth is flat, and household debt is increasing which could impact the sustainability of this consumption driven growth. Given the uncertainty of sustainable consumption and tighter monetary policy, OECD predicts real GDP growth to fall from 2.2% in 2023 to 1.3% in 2024.

Since 2022, interest rate increases in most developed countries have played a significant role in global growth. Borrowing rates for individuals and businesses have risen, financial and credit conditions have tightened, and asset price growth has slowed or turned negative. The U.S. Federal Funds rate is currently above 5%, its highest level since 2005. The U.S.'s high interest rates have led to increases in loan and credit card delinquency rates and corporate insolvencies which were seen in the bank failures that occurred in March 2023. Even though the Federal Reserve has now for five consecutive months (August to December 2023) held its rate steady, the previous increases will have lingering effects when existing mortgage loan rates are changed and corporate loans are rolled over.

Housing prices initially fell with a reduction in the volumes of loans and transactions for housing purchases. However, more recent monthly data shows some indication of stabilisation as prices have

started to increase moderately. This reversal in prices is driven by structural characteristics such as a shortage of available homes for sale.

Inflation in the U.S. is trending downwards. Headline inflation is projected to fall from 6.3% in 2022 to 3.8% in 2023 and 2.6% in 2024, while core inflation is projected to decrease from 5% in 2022 to 4.2% in 2023 and 2.7% in 2024. The inflation rate is anticipated to fall to its 2% target rate without major disruptions in the labour markets. The unemployment rate has risen marginally due to the easing of wage pressures that occurred this year. The IMF Economic Outlook October 2023 reports that unemployment is projected to increase moderately, from 3.6% to 3.9% in 2025.

The U.S. economic performance and monetary policy stance will continue to have spillover effects on the Bermudian economy, primarily through imported inflation and tourism, among other channels.

Bermuda Economy

Bermuda's economy, in spite of several global disruptions and shocks since COVID-19 has continued to show positive signs of recovery and growth. Key economic indicators such as employment, international business, tourism, construction, and exports are all showing signs of positive growth. Inflation has continued on a downward trend since peaking in the third quarter of 2022, employment income continues to grow, and the tourism sector has continued on its positive trajectory since the initial shock from the pandemic.

In 2023, the Government has sought to build on the GDP growth witnessed in 2021 and 2022 by continuing to execute its Economic Development Strategy, which has yielded economic benefits. For the first quarter of 2023, GDP growth was primarily driven by a 1.1% increase in household final consumption which includes higher expenditure for air travel, new and used motor vehicles, vehicle maintenance and repair services, and personal care services.

It is also worth noting that government expenditure declined by 3.2% due primarily to a reduction in expenditure on professional services, salaries, and equipment.

Based on figures released by the Department of Statistics, Real GDP was estimated to have grown 3.0% in 2022 and 3.6% for the first quarter of 2023.

Summary of Bermuda Economic Indicators

Inflation at the end of June stood at 2.7% compared to 4.7% in the previous year, with a twelve-month average rate of 4.1%. The primary drivers of inflation during the last twelve months were increased costs of overseas hotels and airfares in the transportation and foreign travel sector and increases in the average costs of various food items throughout the food sector.

Total retail sales year-to-date June grew by 2.4% (\$13.8 million) to register at \$595.7 million. Motor vehicle stores exhibited the highest growth in sales, followed by food and apparel stores.

The total value of new construction projects started for the first quarter of this year increased by 101.3%, from \$36.7 million to \$73.8 million.

The estimated value of construction work put in place in the first quarter of 2023 was \$24.7 million, a decrease of 19.7%. This was primarily driven by a decrease of work put in place in the industrial and plant category. This decline was tapered by an increase in work put in place related to offices, shops, and warehouses.

Based on preliminary estimates from the Office of the Tax Commissioner, employment income for the first quarter months of 2023 grew by \$86.7 million to \$1.164 billion, an increase of 7.9% compared to the same period of 2022.

Imports increased by 0.5% over the first three months of the year to register at \$279 million. The majority of the increase can be attributed to a \$15.4 million (22.1%) uptick in the imports of finished equipment. On the other hand, imports of fuels for the first quarter of this year decreased by \$24 million (51%) when compared to 2022.

Leisure air arrivals during the first three quarters of 2023 grew by 25.3%, increasing from 79,745 in 2022 to 99,907 in 2023. Cruise arrivals increased by 33.9%, increasing from 302,777 in 2022 to 405,310 in 2023. Total visitor arrivals grew from 382,522 to 505,217, an increase of 122,695 visitors (32.1%) versus a year ago.

Total air visitor spending in the first three quarters of 2023 grew from approximately \$211.2 million in 2022 to approximately \$271.7 million in 2023, an increase of 28.7%. Total cruise visitor spending grew from approximately \$78.2 million in 2022 to approximately \$121.9 million in 2023, an increase of 56%.

There were 12,263 international companies and partnerships registered in Bermuda as of the end of the first quarter representing a 0.4% decrease compared to the 2022 total of 12,307.

189 new international companies and partnerships were registered in Bermuda during the first quarter of 2023, representing a 16.4% decrease when compared to the 226 new companies registered in 2022.

Bermuda's balance of payments for the first quarter of 2023 recorded a surplus on the current account of \$309 million, which was \$45 million (12.7%) less than the corresponding surplus in 2022. The greatest contribution to the current account surplus was the primary income account, which was \$564 million. Within the primary income account, employee compensation, the primary driver, grew by \$43 million whereas investment income decreased by \$93 million.

Based on figures released by the Bermuda Monetary Authority, Bermuda's money supply declined by 2.6% (\$108 million) year-over-year at the end of the second quarter of 2023.

The banking sector's total assets declined by 10.5% (\$2.8 billion) at the end of June 2023. The year-over-year decrease was driven by a reduction in interbank deposits of \$1.9 billion (44.2%) and investments of

\$1.3 billion (9.9%). These were partly offset by increases in loans and advances and in other assets over the same period.

Loans and advances increased by 3.5% (\$0.3 billion) when compared to June 2022, while customer deposits fell by 2.8% (\$0.6 billion) for the same time period.

The economic indicators presented above indicate Bermuda's economy's continued path of recovery in 2023 with positive growth across most sectors. Bermuda's future economic growth will be fuelled by developments in the international business, tourism, and real estate sectors.

Additional Bermuda Economic Information

In the external sector of the economy, the international business sector, and in particular the (re)insurance sector, continue to drive positive economic growth. Despite the marginal decline of 0.4% in the number of international businesses registered at the end of the first quarter of 2023, the sector's overall employment income continued to increase. In the first quarter of 2023, the international business sector employment income grew by 10% and accounted for 47% of total employment income.

The tourism sector continues to recover with total visitor arrivals at the end of the third quarter equivalent to 84% of 2019 levels, 505,217 vs 605,003. With regard to leisure air arrivals during the same period, arrivals were equivalent to 63% of 2019 levels (99,907 vs 157,977), further demonstrating the significance of the Fairmont Southampton hotel being closed, having represented approx. 25% of the island's total room capacity. Cruise arrivals also showed improvement, now equivalent to 91% of 2019 levels (405,310 vs 447,026). Leisure air arrivals, although slow to recover to pre-pandemic levels, are supported with a faster recovery in nominal visitor spending. Total expenditure by leisure air visitors was estimated to be at 79% of 2019 levels (\$195 million vs \$249 million) with average expenditure at 124% of 2019 levels (\$1,955 vs \$1,574), exceeding pre-pandemic average spend.

Turning to the domestic sector, employment income for the first quarter of 2023 grew by 7.9%. With more disposable income, consumers have been able to purchase more goods, leading to retail sales growing by 2.8% over the same period. Greater retail sales resulted in businesses needing to import more inventory, contributing to a 0.5% increase in overall imports with an underlying 29% increase in clothing imports and 15% increase in food, beverage, and tobacco-related imports in the first quarter. Retail sales growth, supported by the gradual decline in inflation, is expected to continue to remain positive.

The fact that many economic indicators have increased year-over-year and continue to show positive signs of recovery is great news. However, while many of these indicators have increased for the first quarter of 2023 compared to 2022, focus must be placed on ensuring that the economy continues on this path. Global spillovers from tighter monetary policy in advanced economies, slowing in global demand, the real estate crisis in China, and the current geopolitical climate are some of the primary downside risks to Bermuda's economic growth in the short- and medium-term.

Based on Bermuda's most recent economic indicators and the global environment, the Ministry of Finance expects real GDP in 2023 to grow in the range of 2.5% to 3.0%.

The Bermuda Government's continued implementation of timely and targeted measures geared to increasing direct foreign investment in the economy, stimulating domestic spending, and maintaining employment will continue to drive economic growth and dampen the impact of internal and external risks.

Credit Ratings

The Government currently holds long-term foreign currency credit ratings of “A+” (stable outlook) from Standard and Poor’s (S&P), “A2” (stable outlook) from Moody’s Investor Services (Moody’s), and “A+” (stable outlook) from Kroll Bond Rating Agency (KBRA).

S&P

In its May 9, 2023 rating report, S&P reaffirmed Bermuda's A+ long-term sovereign credit and senior unsecured debt ratings, as well as its A-1 short-term rating and its AA+ transfer and convertibility assessment as stable.

S&P highlighted in its report that they “expect the local economy to remain healthy, supporting government finances, limiting the need to increase gross debt, and supporting the territory’s external position (including current account surpluses).

In addition, S&P also stated that despite the economic recovery it expects a fiscal deficit to be in line with the government’s budget of 1% of GDP this year. S&P went on to say they assume that a combination of GDP growth, recovering revenues, and a commitment to fiscal consolidation will lead to decreasing fiscal deficits and stabilise the Government's net debt burden.

Moody’s

In December 2023, Moody’s released its annual rating of Bermuda, affirming the country’s A2 issuer and senior unsecured bond ratings, along with a stable outlook. This affirmation confirms Bermuda has maintained its rating since 2017 and, once again, indicates Bermuda’s bonds are seen to be of good quality with a low credit or default risk.

In the 2023 annual credit analysis, it was noted that the key drivers of the ratings affirmation were Bermuda’s very high per capita income, strong offshore financial with a high-quality regulator, and also recognises Bermuda is on track to achieve a balanced budget by 2024. The stable outlook reflects Moody’s assessment of policymakers’ continued commitment to a prudent fiscal stance, which will help stabilise Bermuda’s debt burden in the next two to three years following the economic shock of the pandemic.

KBRA

KBRA, in its October 7, 2022 ratings assessment, affirmed Bermuda's long-term rating at A+ with a stable outlook, while the short-term rating was affirmed at K1+.

Within the report, KBRA stated Bermuda's ratings reflect its commitment to fiscal restraint and consolidation (even if slightly delayed), the ongoing recovery of tourism, and KBRA's expectations for durability in its status as a financial hub.

KBRA also included that it expects Bermuda to be largely resilient to moves towards global corporate tax reform, although risks exist as in their opinion Bermuda's innovativeness positions it to be a hub in emerging financial industries.

These three reports are independent and objective endorsements of the Government's fiscal and economic policies, which are aimed at growing Bermuda's economy, increasing the working population, investing in infrastructure, tackling long-term liabilities, and balancing Bermuda's budget.

Public Debt

As of September 2023, total net government debt outstanding was \$3.1 billion, which is \$400 million beneath the present statutory debt ceiling of \$3.5 billion. This level of debt is a difficult challenge, however, by consistently outperforming budget projections and reducing our deficits the Government has positioned itself to begin the path of reducing Bermuda's gross debt with a \$50 million repayment from the Sinking Fund expected to be made in December 2023.

In July and August of 2022, the Government successfully issued a combined total of \$890 million in senior notes due in 2032. With this transaction the Government successfully refinanced all of its near-term external debt. The next next debt maturity will be in January 2027.

The annual debt service cost as of December 2023 will be \$129.9 million, which is 11.2% of the total expected Revenue, however, with the mentioned \$50 million debt repayment the Government's annual interest expense is expected to decline by approx. \$2.4 million in the next fiscal year.

The Government recognises that in order to attain the target ratios for debt to revenue and debt service to government revenue of less than 80% and 10% respectively, it must put in place policies and initiatives that promote growth and diversification within Bermuda's economy that also benefits all Bermuda residents.

Similar to many small countries and territories, Bermuda's economy is highly susceptible to external events which can have a serious effect on the island's debt. The following vulnerabilities are common to many small islands, including Bermuda:

- A high level of openness means they are heavily exposed to shocks in global markets.
- A narrow resource base and small domestic market prevent small economies from diversifying to a vast assortment of activities, making them more susceptible in terms of trade shocks.
- When one prevailing activity declines, it has a major impact on the economy. In Bermuda, the insurance sector continues to be dominant.
- Government revenues are volatile.

- A high degree of susceptibility to natural disasters.
- Capital markets tend to view small countries as riskier than larger ones.

These vulnerabilities further emphasise the need to maintain lower debt levels than larger countries and also point to the urgent requirement to diversify Bermuda's economy.

Chapter 3 – Government Fiscal Performance

Fiscal Performance 2022/23

For the fiscal year ending in March 2023, total revenue is expected to be \$1.113 billion, \$35.2 million (3%) above the original estimate of \$1.078 billion. This increase was primarily driven by a \$26.8 million (6%) increase in Payroll Tax, \$6.1 million (508%) increase in investment income, \$5.9 million (15%) increase in FCPT, and a \$5.8 million (7%) increase in Land Tax.

The Government is encouraged to see that in spite of not receiving \$30.1 million of budgeted revenue due to the impact of the Russia/Ukraine war on the aircraft register, forgone Customs Duty to freeze fuel prices, and forgone Customs Duty as a result of eliminating Duty on essential goods, the Government still managed to exceed revenue targets.

Current Account Expenditure is expected to be \$950.3 million, \$5.2 million above the 2022/23 original estimate of \$945.1 million. It should also be noted that the primary factors for the increase are \$15.2 million of unbudgeted COVID-19 expenditures due to the prolonged impact of the pandemic, a \$15 million grant provided to the Bermuda Hospitals Board to support the hospital, and additional funding for firefighters at the airport to ensure we meet the necessary requirements to keep the airport open. With over \$30 million dollars of unbudgeted expenses, it is a testament to sound the sound fiscal discipline and management of the Government that 85% of this unexpected expenditure was able to be found within existing budgets.

Interest/guarantee management costs are projected to be \$141.4 million, \$13.7 million more than originally budgeted, with most of this increase related to one-time costs for the 2022 Government debt refinancing and continued fees for Morgan's Point.

Capital Account Expenditures are projected to be \$68.2 million, \$4.8 million less than originally budgeted, primarily a result of delays with the refurbishment of Tynes Bay Waste-To-Energy facility.

Based on these figures, the 2022/23 budget deficit is now expected to be \$46.9 million, \$23.1 million (33%) below the 2022/23 original estimate of \$70.0 million and \$30.4 million below the 2022/23 revised estimate of \$77.4 million. The projected deficit also represents a \$13.1 million reduction compared to the previous fiscal year. This demonstrates that despite the socioeconomic challenges the Government remains on track to move towards a balanced budget.

2023/24 Mid-year Fiscal Performance

Following the Government's mid-year assessment, Total Revenue remains projected to be \$1.155 billion, which is on track with the original budgeted figure. The Total Revenue figure represents continued economic recovery, evidenced by expected increases in tourism-related revenues, Payroll Tax, and Land Tax.

Total Current Account Expenditure is revised to be \$984.5 million, \$11.9 million above the original estimate of \$972.6 million. The projected increase is primarily due to a further \$16.4 million grant to the Bermuda Hospitals Board in support of the hospital.

Interest/Guarantee Management costs are projected to be \$130.4 million, which is on track with the original budgeted figure as there are no unbudgeted or one-time associated costs this fiscal year.

Capital Account Expenditures are projected to be \$85.0 million, \$11.0 less than the original estimate of 96.0 million. These expenditures include additional funding for stabilising the Tynes Bay Waste to Energy Facility and \$4.3 million in additional grant funding to Bermuda Housing Corporation to bring more affordable housing online. This anticipated underspend in capital account expenditures is mainly due to the availability of construction resources and supply chain challenges.

The revised budget deficit for 2023/24 is \$44.4 million, \$0.9 million more than the original budgeted figure of \$43.5 million. This projected deficit is relatively on track with the original estimates despite unbudgeted costs associated with the cyber attack on the Government, the funding boost for the hospital, and a negotiated increase in salaries and wages for many public officers.

The balance of the Sinking Fund as of September 2023 was \$199.2 million. The Government aims to maintain a balance of \$100 million in the Fund and therefore, after funding the projected deficit for this fiscal year, making the \$50 million debt repayment, and with a balanced budget projected going forward, the Government expects to achieve its objective.

2023/24 Budget Performance	2023/24 Original Estimate	2023/24 Revised Estimate	September 2023/24 (6 months)	September 2022/23 (6 months)	Difference b/w YTD for FY 22/23 & 23/24
	\$0	\$0	\$0	\$0	\$0
Revenue					
Custom Duties	227,264	227,264	121,429	114,068	7,361
Payroll Tax	512,500	512,500	280,017	262,199	17,818
International Companies	71,639	71,639	4,137	3,563	574
Foreign Currency Purchase Tax	30,800	30,800	14,981	13,923	1,058
Land Tax	87,195	87,195	37,325	26,617	10,708
Hotel Occupancy Tax	6,496	6,496	3,427	2,815	612
Vehicle Licences & Registration	30,000	30,000	12,393	12,763	-370
Passenger Tax	27,305	27,305	15,874	13,501	2,373
Transport Infrastructure Tax	11,805	11,805	7,407	4,447	2,960
Stamp Duty	32,254	32,254	9,992	14,790	-4,798
Financial Services Tax	14,539	14,539	6,837	7,207	-370
Telecommunications Receipts	17,098	17,098	8,549	8,459	90
Immigration Receipts	19,766	19,766	8,004	8,465	-461
All Other Receipts	66,864	66,864	31,716	59,645	-27,929
Total	1,155,525	1,155,525	562,088	552,462	9,626
Expenditure					
Current Account Expenditure	972,632	972,632	473,557	458,841	14,716
Unemployment/Supplemental Benefit	-	-	0	621	-621
COVID-19 Expenditure	-	-	0	6,249	-6,249
Capital Account Expenditure	96,007	96,007	34,419	25,979	8,440
Interest On Debt	130,400	130,400	66,209	79,041	-12,832
Total	1,199,039	1,199,039	574,185	570,731	3,454
Surplus / -Deficit	-43,514	-43,514	-12,097	-18,269	6,172

Chapter 4 – Vision for Tax Reform

The Fiscal Responsibility Panel, in its 2022 report, reiterated its recommendation for the Government to plan for an annual budget surplus of at least \$50 million for the fiscal year 2026/27. The Panel further emphasised its view that to achieve this the Government must undertake fundamental tax reforms aimed at broadening the tax base, increasing the progressivity of the tax system, and increasing revenues.

The Government supports the notion regarding fundamental tax reform and believes the tax burden in Bermuda needs to be more fairly distributed amongst all portions of the economy and shifted away from working people.

Work Done to Date

Since 2017, the Government has taken the following action to reform taxes in Bermuda:

Reducing the Tax Burden on Workers

Since returning to office in 2017, the PLP Government has reduced payroll taxes for workers four times. The aim of these reductions was to primarily increase the take-home pay of many hardworking Bermudians and help mitigate against Bermuda’s cost of living.

Prior to the PLP returning to government, a worker earning \$48,000 a year was required to pay \$2,280 in payroll taxes. With the Government’s payroll tax reductions, this year that worker now pays only \$240, a reduction of \$2,040, and receives a cumulative tax saving of just under \$7,000 since 2017.

The PLP Government Has Reduced the Tax Burden on Workers in Bermuda						
Salary	Reduction in Taxes				Total Annual Reduction 2017–2023	Cumulative Tax Savings from 2017-2023
	2018	2020	2022	2023		
\$36,000	-\$270	-\$720	-\$180	-\$360	-\$1,530	-\$5,220
\$48,000	-\$360	-\$960	-\$240	-\$480	-\$2,040	-\$6,960
\$60,000	-\$270	-\$720	-\$180	-\$450	-\$1,620	-\$5,310
\$72,000	-\$180	-\$480	-\$120	-\$420	-\$1,200	-\$3,660
\$84,000	-\$90	-\$240	-\$60	-\$390	-\$780	-\$2,010
\$96,000	\$0	\$0	\$0	-\$360	-\$360	-\$360
	First PLP payroll tax reduction for workers	Further payroll tax reduction	Further payroll tax reduction	Further payroll tax reduction	This is the difference in annual payroll tax between the OBA (2017) and PLP (2023)	This is the total amount of payroll tax savings for a worker over the last 6 years

Implementing the Tax Reform Commission Recommendations

Since receiving the Tax Reform Commission's 2018 Report, the Government has implemented a number of its recommendations, including:

- Increase in land tax: In 2019, the Government instituted a new land tax structure, which saw increases across the board.
- Adjustments to FCPT: In 2019, the Government increased the foreign currency purchase tax from 1% to 1.25%.
- Increase in immigration fees: In 2020, the Government implemented a general 5% increase in immigration fees.
- Reduction in Customs Duty on staple food items and children's clothing

Corporate Income Tax

The OECD in collaboration with the G20 negotiated an international tax agreement, commonly known as the Global Minimum Tax, which ultimately resulted in the Base Erosion and Profit Shifting (BEPS) Pillar Two Model Rules. These rules aim to impose a minimum effective tax rate in each jurisdiction of 15% on the corporate profits of multinational enterprises with more than €750 million in total global revenues.

In response, the Government formed an International Tax Working Group, in January 2023, consisting of specialists in international tax matters and representatives of various bodies to examine the best way to implement the new Global Minimum Tax in Bermuda and provide recommendations on these matters.

The International Tax Working Group completed the first phase of its work in July 2023 and submitted its recommendations to the Government. Having assessed the recommendations, the Government began its consultation period by issuing a consultation paper on the proposed new corporate income tax regime that will only apply to Bermuda businesses that meet the identified criteria. The Government has completed the third and final consultation period and has introduced the Corporate Income Tax Act 2023 into the Bermuda Legislature, with the proposed corporate income tax set to be effective in 2025.

It is important to note that, at present, the Government's annual operating budget is funded by payroll taxes, duties, and various other taxes and fees. While the current system has historically proven to be a relatively effective and predictable means of funding Government's Current Account Expenditure, it does not meet the requirements to be treated as Covered Taxes under the guidelines of the mentioned Rules. Accordingly, a multinational enterprise with a presence in Bermuda could effectively be exposed to double taxation in the jurisdiction.

The Government seeks to mitigate the exposure for double taxation by introducing legislation that ensures the Bermuda corporate income tax qualifies as a Covered Tax, leverages certain key scoping and definitional elements of the mentioned Rules, and includes design features intended to support key Government policy initiatives. (e.g. maintaining the competitiveness and reputation for quality of Bermuda, reduction in cost of living and doing business, job creation, increasing the residential population, and other initiatives intended to stimulate the broader Bermuda economy)

While recognizing we are still in the consultation phase, it is being considered that the Bermuda taxable income (loss) would be determined from a financial statement prepared under an acceptable accounting standard. In addition, further analysis should be completed to determine whether other accounting standards meet the requirements of those that are acceptable as a starting point in the determination of taxable income.

The taxes paid under the proposed Bermuda corporate income tax regime would be those which would be payable to other jurisdictions under the global minimum tax framework. Any new corporate income tax adopted would also include certain tax credits which support Bermuda's economic goals and maintains Bermuda's global attractiveness. In addition, the recently empanelled Tax Reform Commission will examine the possibility of restructuring the island's existing tax regimes as a means of lowering the cost of living and doing business in Bermuda.

The Government believes this proposed tax regime is supportive of Bermuda's status as a leading international financial centre. Bermuda plans to continue to invest in key policy initiatives, including reduction in the cost of living, job creation, and other programs to stimulate the economy and enhance its attractiveness to MNEs.

The Government's approach is to use tax reform to bolster policy initiatives that will enhance Bermuda's economic growth prospects. The Government continues to guide Bermuda to sustainable economic growth and development. It is vital that Government economic policy attracts and retains business in Bermuda, boosts foreign investment, increases employment opportunities while expanding the workforce, and builds the local economy to its fullest potential.

Work Ongoing

In October 2023, the Government empanelled a new Tax Reform Commission 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 existing taxes/fees are needed to ensure Bermuda's economy remains competitive.

The Chairman of the new commission is Mr. Darren Johnston and the rest of the commission consists of highly qualified and diverse individuals representing a range of industries throughout Bermuda. The members of the commission are as follows

- Darren Johnston - former CEO of Price Waterhouse Cooper Limited – Caribbean Region and is currently the Chief Operating Officer of Orbis Investments, and a Director of Orbis Holdings Limited and other subsidiaries
- Mr. Albert Benchimol – the International Business Representative, who is the Former President and CEO of AXIS Capital Ltd. and currently serves as a Strategic Advisor
- Mr. Brian Holdipp JP – the Progressive Labour Party Representative and who is currently Corporate & Finance Counsel at Mello Jones & Martin
- Mr. Douglas DeCouto JP – the One Bermuda Alliance Representative and who currently serves as OBA Shadow Finance Minister

- Mr. Chris Furbert – the Bermuda Trade Union Congress Representative, who is currently President of the Bermuda Industrial Union
- Mr. Jonathan Howes representing the Bermuda Chamber of Commerce, who is the Chief Executive Officer of Bermuda Press Ltd.

The Tax Reform Commission is expected to begin reviewing the domestic tax framework in light of the proposed Corporate Income Tax in November 2023 with the aim of delivering its recommendations by mid-2024.

Tax Collection and Accounts Receivable

The Government targeted to recover \$7.5 million of past due taxes during this fiscal year and as of November 2023 has collected in excess \$15.7 million in past due taxes, far exceeding the full-year budget target.

This is as a result of the Office of the Tax Commissioner (OTC) implementing a new debt management system, which has proven to be effective, and is currently developing a performance management component to the system which will provide the OTC additional abilities to assess its effectiveness.

Also, as mentioned within the 2023/24 Budget Statement, the OTC has begun initial meetings with the Department of Public Prosecutions which is prepared to begin prosecutions for non-filers that have been deemed to have the ability to pay.

Chapter 5 – Framing the 2024/2025 Budget

As the Government approaches the formulation of the 2024/25 budget, the following key factors will impact its framing and composition:

- The Government’s 2020 General Election Campaign Platform and subsequent Throne Speeches
 - The Government was elected to carry out its mandate. Appropriate fiscal policies are a vital tool in ensuring the agenda is executed with the required investment to support policies that earned voter support at the ballot box.
- Economic considerations
 - Global economic uncertainty must factor into fiscal policy setting. Increased global inflation, increasing global interest rates, and the risk of a global economic downturn must all be considered when setting the Government's short-term fiscal policy.
- Taxation sensitivities
 - Any adjustment in taxes must be structured in a way that supports Bermuda's economic recovery. Bermuda continues to compete with other jurisdictions and therefore the Government must view any tax changes with a global lens.
- Continued fiscal consolidation to reduce deficits on the path towards a balanced budget
 - The Government has committed to a balanced budget in the fiscal year 2024/2025.
 - The Government must continue to focus on fiscally prudent policies that will help foster economic growth, increase revenue, and improve government efficiencies.
- Continuation of zero-based budgeting and associated tools
 - Often governments continue programmes from year to year without regard to whether those services still produce value for the public. Over the last two years, as part of the Public Sector Reform Initiative, public service value assessments have taken place throughout all government ministries to ensure the most effective delivery of public services to Bermuda residents. It is anticipated that further work will be done in this regard in the 2023/24 fiscal year to realise additional spending efficiencies.
- Recommendations from the 2023 Fiscal Responsibility Panel report
 - The Fiscal Responsibility Panel plays an important role in fiscal policymaking in Bermuda. It represents the only independent assessment of the Government's fiscal plans and makes recommendations to ensure the Government of Bermuda is progressing towards meeting established fiscal targets.
- Feedback from the Pre-budget Report in advance of the fiscal year 2024/25
 - The Pre-budget Report is a consultation document to elicit feedback from residents and businesses that will be affected by changes to the Government budget. This consultative process is considered essential to ensure that any planned initiatives have adequate public consultation prior to the unveiling of the 2024/25 budget.

Economic Development Strategy

Earlier this year the Ministry of Economy and Labour conducted a detailed review of current economic development initiatives, an in-depth analysis of Bermuda's industries and growth opportunities, and a review of other plans and strategies of relevance. The Ministry considered feedback from stakeholders and subsequently produced, in collaboration with the newly formed Bermuda Economic Development Advisory Board, the Economic Development Strategy that guides the work of organisations involved in economic development activities in Bermuda.

The new strategy builds on the work of the 2021 economic recovery plan. The 31 ERP policy initiatives are advancing well, with over 80% of them on track, some of which have already demonstrated positive results, such as:

- The legislative framework to establish Bermuda's Subsea Communications Sector
- Mortgage Guarantee Programme with the Bermuda Commercial Bank to assist with homeownership
- The BEDC COVID-19 Support Programme has successfully deployed \$6.1 million in loans, grants, and guarantees to small and medium sized businesses
- The Economic Investment Certificate has exceeded expectations, with associated investments totalling over \$440 million
- Extension of the Temporary Residency Certificate (digital nomads)
- Establishment of Bermuda's first statutory minimum wage of \$16.40
- Increasing the public stock of affordable housing
- Online Single Market Economy (SME) Marketplace

The Economic Development Strategy sets out a roadmap which provides a clear path to guide Bermuda to sustainable economic growth and development. The Strategy seeks to build an economy that creates greater opportunities for the people of Bermuda, supports entrepreneurship and small businesses, supports farmers and fisherman, and embraces new technologies and opportunities for diversification.

The Five Strategic Priorities of the Economic Development Strategy are:

- Local and international business expansion
- Business attraction and investment promotion
- Entrepreneurship and small business development
- Continued execution of the ERP
- Investing in people

The strategy focuses on collaboration and partnerships with relevant industries to maximise efficient and sustainable development. The Economic Development Advisory Board has been focused on ensuring key performance indicators are assigned to action strategic initiatives and that resources are allocated to ensure the effective execution of the action items set out in the plan.

Risks Facing the Bermuda Economy

In its 2022 report, the Fiscal Responsibility Panel highlighted a number of risks to Bermuda's economy. These risks, among others, underscore the need for financial and fiscal prudence, and the Government will take them into account when framing the 2024/25 budget.

Some of the threats noted by the Fiscal Responsibility Panel since 2021 are summarised as follows:

- **Energy and Climate Change:** Of particular concern to Bermuda is rising sea levels from melting ice caps, with a recent study based on satellite imagery warning of minimum sea level rises of 27 centimetres from Greenland alone. Together with the possibility of increasingly intensive 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.

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 seagrass carbon sinks, and insurance capabilities.

- **Immigration and the Labour Force:** Bermuda must focus on growing its working-age population to support economic growth and boost tax revenues in the short-term, address the challenges of an ageing population, and improve the solvency and sustainability of public pension funds and healthcare over the long-term.

The Government has recognised the scale of this challenge, and 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". The paper assesses and details the potentially disastrous implications of demographic change and proposes that government policy should explicitly aim to counter these. 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 five years. As the paper recognises, such an increase is entirely unfeasible unless there is a significant change in net long-term work-related migration.

- **Growth and diversification:** Economic growth in Bermuda has averaged 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 the Government as a whole, as well as the pension and health systems.

The Government should remain alert to further opportunities to grow the economy, enhance the welfare of its citizens, and boost tax revenues. 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 the government to be proactive in this area.

The underdeveloped nature of Bermuda's capital markets and Bermudians' access to banks is also concerning, 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.

Attempts to develop digital finance in Bermuda should be mindful of financial and reputational risk to Bermuda's hard won standing as a well-regulated financial centre. These concerns have been reinforced by recent developments in the cryptocurrency sector.

- **Pensions, health, and other contingent liabilities:** The Government 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 Service Superannuation Fund (PSSF). In response, the Government has consulted with various stakeholders with the primary aim of ensuring the long-term sustainability of these schemes.

With regard to the PSSF, recommendations have been shared with unions covered by the Fund which have received broad support as the Government works towards a final agreement. The recommendations put forth will ensure the PSSF is sustainable into the future.

The Government also continues to advance the consultation regarding changes that will make the CPF sustainable, and will provide an update following the current round of consultation.

Policy Options Under Consideration

The following are considerations for inclusion in next year's budget. One of the main objectives of a Pre-Budget Report is to provide a document that elicits discussion from stakeholders. The Government sought policy proposals for consideration from the following bodies:

- Association of Bermuda Insurers and Reinsurers
- Association of Bermuda International Companies
- Bermuda Chamber of Commerce
- Bermuda Hotel Association
- Bermuda International Long-Term Insurers and Reinsurers
- Bermuda Trade Union Congress

The policy options below contain proposals from the Government and submissions received that Ministry of Finance wishes to solicit feedback. The ministry will engage with the public and other stakeholders regarding these proposals prior to finalising the 2024/25 budget.

It is important to note the proposals below are suggestions for consultation, and none of the proposals are final.

Revenue Increasing Considerations

The Government is not planning any major changes to its existing tax system for this upcoming fiscal year, however, the following items are under consideration.

Amendment to the New Hire Relief

The New Hire Relief has been in place since 2018 with the intent of assessing the relief every 2 years. As a result of the Pandemic the Government decided to allow the relief to roll over in 2020 so the relief period covered 4 years. In 2022 a further 2 years extension was made, however the baseline year remained in 2018 meaning that the relief was in effect for 6 years. The effect of this extension means that any new exempted company started after 2018 has not had any employer payroll tax liability. The amount of remuneration estimated to be untaxed due to this policy is estimated to be \$300 million.

Given the significant amount of payroll not subject to tax, the Government is considering allowing this new hire relief to expire, or is considering adjusting the baseline year to reflect new hires since 2020 or 2022.

Increasing Boat Licensing Fees

To increase revenue to the treasury the Government has been asked to consider increasing the licensing fees for larger boats (35ft or more) which are used recreationally. The submission suggested that vessels with a commercial licence would not be subject to this increase.

Targeted Tax Relief

The Ministry of Finance received a number of submissions related to additional tax relief. The following proposals are being shared for feedback:

- Further reduction of Employer Payroll Tax for the hospitality industry
 - The hospitality industry continues to recover from the Pandemic and it is believed that a further reduction would provide needed relief until tourism figures reach pre-pandemic levels
- Reduction of immigration fees for work permit applications
 - The Government has been asked to consider reducing work permit fees to pre-pandemic levels while it continues to develop and implement its automated system
- Reduction of Land Tax
 - The Government has been asked to consider further reduction of Land Taxes given the cost of living and to provide additional capacity for property owners to develop their property
- Expanding the list of items subject to Customs Duty relief
 - To assist with the rising cost of living, the Government has been asked to consider expanding the list of essential goods that currently incur duty relief. The Cost of Living Commission will also be tasked with identifying additional essential commodities to be added to the Schedule of its Act, thereby reducing Customs Duty that may provide price reductions of those goods to the consumer.

Spending Considerations

The Fiscal Responsibility Panel highlighted in its 2023 report that spending has generally been kept under control, but years of underspending on capital expenditure and maintenance required to sustain and improve the Island's infrastructure will have to be made up in future years. Below are some of the major items that will impact spending considerations in advance of the 2024/25 budget.

Economic Development Strategy

The successful execution of Bermuda's Economic Development Strategy continues to lay the foundation for the Island's economic growth. The Fiscal Responsibility Panel has endorsed the Government's strategy and ensuring sufficient resources are made available is critical for the action items within the strategy to be delivered.

Investments in Technology

In September 2023, the Government of Bermuda was the victim of a highly sophisticated and methodical cyber attack that caused significant disruption to Government IT systems. Prior to this attack, the Government had been engaged in a purposeful process enhancing the security of the Government's IT infrastructure. However, despite these proactive efforts the Government's IT network fell victim to a malicious attack, the scale of which was unprecedented and incomparable to previous cyber attacks.

In the wake of this incident, the teams within IDT have implemented new tools to further strengthen the Government's security posture and the Government will need to significantly increase capital investments in IT infrastructure to reduce the likelihood of similar incidents happening in the future.

Investment in Infrastructure

Years of austerity measures have caused significant underinvestment in Bermuda's infrastructure which has resulted in less than ideal conditions for Bermuda's roads, beaches, and railway trails. The Government will maintain sufficient investment in critical infrastructure to protect the functionality, legacy, and beauty of our island, and depending on revenue projections may increase the planned capital spend from the planned \$95 million for next fiscal year.

Continued Investment In Affordable Housing

The Government will continue to invest in affordable housing to ensure more Bermudians have access to affordable and quality living arrangements. This investment has already proven to release the financial pressure of many hardworking families and the Government is committed to expanding the initiative further.

Ageing Population

The continued ageing of the population poses significant challenges for the Government. Additional investment and or use of government guarantees will be required to construct additional facilities for senior citizens to ensure the most efficient use of public funds. There are many residents in our hospital that could be more efficiently cared for in non-acute facilities, freeing up space in the hospital for additional services that can drive revenue.

Chapter 6 – Conclusion

The Pre-budget Report is a vital tool for the formulation of the annual budget for the Government of Bermuda. The items contained in the previous chapter are submitted for consultative purposes and no final decisions have been made. Previously, the feedback provided has resulted in appropriate adjustments to the Government’s proposals and therefore it is important that there is participation in this phase of the budget development process.

Commitment to Budget Transparency

To meet international best practice for budget transparency, the International Budget Partnership recommends that governments publish eight reports during the budget cycle. The documents and the Government’s commitments are below:

1. **Pre-budget Report:** It is recommended that this document be issued at least one month prior to the Budget Statement to allow adequate time for public feedback.
2. **Budget Statement:** The Government issues budget statements annually. This practice is a matter of custom and will continue.
3. **Citizens’ Budget:** A simplified summary of the budget designed to facilitate discussion. The Government has issued a guide to the budget in the past and will issue this document with the 2024/25 Budget Statement.
4. **Enacted Budget:** The Enacted Budget is the appropriations bill that is passed by the legislature annually, as required by the Bermuda Constitution.
5. **In-year Reports:** The Government currently issues quarterly fiscal performance reports and will continue to do so.
6. **Mid-year Review:** The Government currently issues a Mid-year Review and will continue to do so.
7. **Year-end Report:** The Government issues financial statements once they have been audited, as per the Bermuda Constitution. The Government also provides highlights of the financial statements by way of a Ministerial Statement in the House of Assembly.
8. **Audit Report:** The Auditor General currently issues an Audit Report annually.

As indicated above, it is the aim of the Government to provide all these reports during the coming budget cycle and the 2024/25 fiscal year. In publishing this document and conforming to international standards of budget transparency, this Government reaffirms its commitment to good governance.

Submit Your Feedback

The Government invites and welcomes feedback on this document. In addition to electronic communication, the Government will engage the public and stakeholders in January 2024 to discuss the principles laid out in this document and to solicit public feedback.

If you wish to log your comments/feedback please visit forum.gov.bm or email openbudget@gov.bm. The deadline for submissions is January 17, 2023.

