Pre-Budget Report

in advance of fiscal year

2023-2024

GOVERNMENT OF BERMUDA

Ministry of Finance

Government of Bermuda 2023/24 Pre-Budget Report

Chapter 1 – Introduction

What Is a Pre-budget Report?

A pre-budget report (PBR) is a policy statement issued by the Government prior to the release of its budget that defines the priorities for the next 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 take action to address the problems the island faces, and it is important 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 objective of the PBR is to increase public awareness of the Government's fiscal and budget policy objectives and to establish a benchmark for evaluating the conduct of fiscal and budget policy.

The PBR also serves to educate the public and encourage debate about how effectively the budget strategy copes with current economic and social priorities. The PBR is intended to provide an opportunity for 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 facing the Government.

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 stability throughout society 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 have a positive impact on future generations.

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

Chapter 2 – Economic Review

Global Economy

According to the IMF's October 2022 World Economic Outlook (WEO), the global economy is experiencing a number of challenges and, for many, 2023 will feel like a recession. Global growth is projected to remain unchanged at 3.2% in 2022 and to decline to 2.7% in 2023, with the 2022 forecast 0.2% lower than the July 2022 WEO. This is the weakest growth profile since 2001, with the exception of the global financial crisis and the recent COVID-19 pandemic.

The main challenges faced by the global economy include Russia's invasion of Ukraine, a cost-of-living crisis caused by persistent and broadening inflation pressures, the lingering effects of the COVID-19 pandemic, and the economic slowdown in China.

Russia's war in Ukraine continues to negatively affect the region and the entire world.

The war has displaced millions, led to the substantial loss of human life, and severely damaged Ukraine's infrastructure. Reduced exports from Russia, especially gas, have also damaged the fossil fuel trade, with the flow of Russian pipeline gas to Europe reduced to approximately 20% of its level in 2021.

The war is also having severe economic ramifications in Europe, with greater energy prices, weaker consumer confidence, and slower momentum in manufacturing resulting from persistent supply chain disruptions and rising input costs. In addition, it is also having a detrimental impact on global food prices. Despite the recent agreement on Black Sea grain exports, global food prices remain elevated, but they are expected to decrease.

Since 2021, inflation has grown more quickly and persistently than expected. In 2022, inflation in advanced economies reached its highest rate since 1982. Although inflation affects the majority of economies, its impact is most severe on lower-income groups in developing countries. In such countries, up to half of household consumption expenditure is on food, meaning that price increases can have a stark impact on human health and living standards.

In the US, inflation reached one of its highest levels in approximately 40 years, with prices in August 8.3% higher year over year. The euro area witnessed price increases of 10% in September, while the UK experienced annual inflation of 9.9%. Emerging markets and developing countries fared little better and are estimated to have seen inflation of 10.1% in the second quarter of 2022. To prevent inflation from becoming entrenched, central banks, including the Federal Reserve, the European Central Bank, and the Bank of England, have rapidly increased interest rates.

In addition to the war in Ukraine and high levels of inflation, the pandemic continues to dampen economic activity. This has especially been the case in China, where a second-quarter contraction contributed to slower global economic activity and temporary lockdowns in Shanghai and elsewhere due to COVID-19 outbreaks have weakened local demand. Growth in China has been downgraded to 3.2% in 2022, the lowest level in over four decades excluding the initial COVID-19 crisis in 2020. Along with lockdowns due to COVID-19, the Chinese economy has been declining due to a rapidly weakening property sector, which represents approximately 20% of its economic activity.

The continued impact of COVID-19 also threatens economic recovery in sub-Saharan Africa, where vaccination rates are a fraction of those in other regions, which has been partially blamed for lagging GDP results in that region.

US Economy

Based on information provided by the OECD Economic Outlook November 2022, surging levels of inflation and tighter financial conditions will continue to slow spending across the US economy.

With the notable deceleration in domestic production, labour demand and wage growth will weaken. The continued tightening of monetary policy will provide a headwind to short-term growth and government spending has now returned to more normal levels with the reduction of pandemic support.

Further reduction in the dependence on fossil fuels continues to be a priority given global energy shortages and the aim of reaching net zero emissions by 2050. Personal consumption expenditures have continued to increase but at a more modest pace since the start of 2022. Investment has weakened, especially in the housing market. Nominal wages have risen, leading to stronger growth in unit labour costs, which has contributed to broadening inflationary pressures.

The direct impact of Russia's war in Ukraine has been less pronounced than in many other countries as US exports of natural gas and wheat have risen in response to shortages in global markets. However, mainly due to the war, domestic food and gasoline prices remain elevated compared with pre-pandemic levels. The Federal Open Market Committee is now rapidly tightening monetary policy in response to the surge in inflation and the federal funds rate has been lifted by 3.75% since March 2022.

Market interest rates have risen sharply at all maturities, reflecting both policy decisions and the expectation of further monetary tightening ahead.

Real GDP in the US is anticipated to grow by 1.8% in 2022, 0.5% in 2023, and 1.0% in 2024. With the anticipated dampened economic growth over the next three years in the US, any positive impact on Bermuda's economy will also be diminished. As Bermuda's largest trading partner and source of the overwhelming majority of visitors to the island, the US's economic performance will have an impact on the pace of Bermuda's economic recovery.

Bermuda Economy

After implementing several public health measures that caused severe disruptions to the economy in 2020 in an effort to combat the spread of COVID-19, the Government sought to keep Bermuda open for business in 2021. As a result, Bermuda's economy grew by 5.4% based on constant market prices (real GDP) after declining by 6.8% in 2020.

The largest increases in value added in absolute terms were recorded for international business activity, accommodation and food services activity, and professional, scientific and technical activities. These positive results were partially offset by reductions in the value added for public administration and construction and quarrying.

In 2022, the Government has sought to build on the positive results witnessed in 2021 by continuing to implement Bermuda's Economic Recovery Plan, which has yielded economic benefits. Based on figures released by the Department of Statistics, GDP grew by 1.4% in real terms over the first two quarters of 2022. This growth was primarily driven by increased household final consumption expenditure. The increase was reflected in higher expenditure for accommodation services, air transport, and personal care services, along with increased spending on clothing, fuel, and household supplies.

Summary of Bermuda Economic Indicators

- The year-to-date (August) average consumer price index was 3.6% and the twelve-month average rate was 3.2%. The primary causes 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 year in the food sector.
- Total retail sales to August 2022 grew by 3.0% ($23.0 million) to register at $795.0 million. Apparel stores exhibited the largest growth in sales followed by service stations and building material stores. In the majority of categories with increased sales, retailers reported increased spending by residents with the easing of COVID-19 restrictions. This led to greater sales along the majority of product lines for businesses.
- The total value of new construction projects started for the first six months of this year increased by 16.7%, from $77.4 million to $90.3 million.
- The estimated value of construction work put in place in the first two quarters of 2022 was $52.1 million, a decrease of 31.5%. The majority of the activity in this sector can be attributed to the $16 million of work performed on hotels and guest houses.
- Based on preliminary estimates from the Office of the Tax Commissioner, employment income for the first six months of 2022 grew by $187.7 million to $2.021 billion, an increase of 10.2% compared to the first six months of 2021.
- Imports increased by 22.0% over the first two quarters of the year to register at $578 million. The majority of the increase can be attributed to a $46.4 million (172.8%) uptick in the imports of fuels. The other categories that contributed significantly to the growth in the level of imports were finished equipment and machinery.
- Air arrivals during the first three quarters of 2022 grew by 102.3%, increasing from 55,864 in 2021 to 113,020 in 2022. After experiencing only 2,710 cruise passengers over the first nine months of 2021, this year's figures totalled 302,777, a drastic improvement as the industry rebounds after the COVID-19 pandemic. Total visitor arrivals grew from 59,887 to 419,899, an increase of 360,012 visitors versus a year ago.

- Total air visitor spending in the first three quarters of 2022 grew from approximately $93.4 million in 2021 to approximately $211.2 million in 2022, an increase of 126.1%.

- There were 12,405 international companies and partnerships registered in Bermuda as of September 30, 2022, representing a 1.7% increase compared to the 2021 total of 12,200.

- 643 new international companies and partnerships were registered in Bermuda during the first three quarters of 2022, representing a 6.4% decrease when compared to the 687 new companies registered in 2021.

- Bermuda's balance of payments for the first two quarters of 2022 recorded a surplus on the current account of $567 million, which was $46 million (7.5%) less than the corresponding surplus in 2021. The greatest contribution to the current account surplus was in the primary income account, which increased by $83 million in 2022. Within the primary income account, employee compensation and investment income grew by $45 million and $28 million, respectively.

- Based on figures released by the Bermuda Monetary Authority, Bermuda's money supply grew by 1.8% ($74 million) year over year at the end of the second quarter of 2022.

- The banking sector's total assets declined by 3.6% ($1 billion) at the end of June 2022. The year-over-year decrease was driven by a reduction in interbank deposits of $0.8 billion (15.7%) and investments of $0.1 billion (0.8%).

- Loans and advances decreased by 1.2% ($1.0 billion) when compared to June 2021, while customer deposits fell by 3.2% ($0.8 billion) for the same time period.

The economic data presented above indicate that Bermuda's economy is continuing to grow in 2022 after rebounding strongly in 2021. In 2022, many of the sectors that experienced a vast improvement in 2021 continue to show positive results.

Additional Bermuda Economic Information

In the external sector of the economy, the international business sector, and in particular the (re)insurance sector, remained resilient during the pandemic. The Bermuda (re)insurance market adapted well to COVID-19-related restrictions and was able to continue to service policyholders in a near-seamless manner. In addition, the international business sector remains strong in 2022, evidenced by the fact that the number of international businesses registered has increased by 1.7% over the first three quarters of the year. It is anticipated that this sector will continue to be the main driver of our economy for the foreseeable future. During the same time period, air and cruise arrivals, along with visitor spending, all increased considerably.

Turning to the domestic sector, employment income for the first six months of 2022 grew by 10.2%. With more disposable income, consumers have been able to purchase more goods, leading to retail sales growing by 3.0% over the first eight months of the year. Greater retail sales resulted in businesses needing to import more inventory which contributed to a 22.0% increase in imports. Another positive economic result that benefits retail sales and imports is the 16.7% increase in the total value of new construction projects started for the first six months of 2022.

The fact that many economic indicators have increased year over year is positive news on the economic front. However, while many of these indicators have increased compared to 2021, it should be noted that some of them, such as imports, construction, and tourist arrivals and spending, are below the 2019 figures. This indicates that the economy is moving in the right direction, but some sectors have not yet fully recovered to pre-pandemic levels.

Based on the economic data available, the Ministry of Finance expects GDP in 2022 to grow in the range of 2.5% to 4.5%; this growth prediction will see Bermuda's GDP fully recover its pre-pandemic size by the end of 2022.

Since the COVID-19 disruptions, the Bermuda Government has sought to balance the health and social aspects of the pandemic with the economic realities that face our island home. This has been and will continue to be done through the implementation of timely and targeted measures geared to increasing direct foreign investment in the economy, stimulating domestic spending, and maintaining employment.

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 their May 10, 2022 rating report for Bermuda, 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 their report that they “view Bermuda’s policymaking as largely effective, predictable, and proactive, and its political institutions as stable. We believe the territory can and is willing to implement reforms to ensure the long-term sustainability of public finances.”

In addition, S&P have also stated that they expect the next several years to continue to benefit from the growth in the international financial sector and a pickup in tourism and that this growth will lead to reduced deficits and less borrowing.

Moody’s

On June 21, 2022, Moody’s released their annual rating of Bermuda. As a result of this review, Moody’s affirmed Bermuda’s A2 issuer and senior unsecured bond ratings, along with a stable outlook. This rating affirmation, which confirms that there is no change in rating since the 2021 report, once again indicates that Bermuda’s bonds are seen to be of good quality with a low credit or default risk.

In the 2022 annual credit analysis, it was noted that the key drivers of the ratings affirmation were Bermuda’s positive track record of fiscal consolidation, which will support debt stabilisation, a vibrant international business sector, and a rebound in tourism. The stable outlook reflects Moody’s expectations that fiscal consolidation efforts will stabilise debt around current levels, supported by moderate growth due to the rebound in tourism activity and strong growth in the international business sector.

KBRA

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

KBRA indicated that the decision to affirm Bermuda's positive rating and outlook is rooted in their expectation that Bermuda will be largely resilient to moves towards global corporate tax reform and Brexit. Other considerations include the country's high wealth level and strong institutions, including a high-quality regulatory environment, Bermuda being recognized for its world-class (re)insurance and alternative capital sectors, such as Insurance Linked Securities (ILS), and Bermuda's large current account and international investment surpluses, along with sizeable net external assets, particularly in the financial sector.

The public should accept the outcomes of these reports as independent and objective endorsements of the Government's fiscal and economic policies, which are aimed at strengthening the economy as the country rebounds from the COVID-19 pandemic.

Public Debt

At the end of September 2022, total net government debt outstanding was $3.1 billion, which is $400 million beneath the present statutory debt ceiling of $3.5 billion. The Ministry of Finance regards this level of debt as a serious challenge and, therefore, has made balancing the budget a priority.

A recent focus of the Government was on the refinancing of almost $1 billion in debt due to mature within two years, given the changing interest rate environment. In July and August of 2022, the Government successfully issued a combined total of $890 million in senior notes due in 2032. These latest transactions have allowed the Government to fully refinance all of its near-term external debt, with more than four years until the next maturity in January 2027 – a positive action taken in light of the expected continued challenging interest rate environment.

With our recent debt refinancing, the annual debt service cost as of December 2022 will be $129.5 million, $2.3 million (1.8%) more than the previous year. This underlines the urgent need to balance the budget to begin reducing Bermuda's debt.

Further, as a result of continued prudent management of the country's finances and progress made on Bermuda's Economic Recovery Plan, the Government has not had to utilise the country's sinking fund to the extent originally projected. This provides the Government with the option to repay the $50 million in Bermuda dollar debt outstanding next year without having to refinance this debt and, therefore, allows for a reduction in outstanding debt.

As the Government commits to moving the country beyond the pandemic, it is equally important to remain committed to the objective of halting the increase in our net debt and working to reduce it. This is in order to attain target ratios for debt to revenue and debt service to government revenue of less than 80% and 10%, respectively. It is necessary to note that it will not be possible to achieve these goals without a diversified and growing economy, which will not only produce balanced economic growth but will also benefit 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 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 2021/22

For the fiscal year ending in March 2022, total revenue is projected to be $1.086 billion, $87 million (9%) above the original estimate of $999 million. This increase is primarily driven by a $23.9 million (12%) increase in customs duties, $16.2 million (73%) increase in stamp duty, $10.6 million (106%) increase in civil aviation, $9.7 million (230%) increase in revenue from travel authorisation, and a $12.4 million increase in payroll tax.

Current account expenditures are now projected to be $945 million, $42 million above the 2021/22 original estimate of $903 million. It should be noted that COVID-19 expenditures are projected to total $36.9 million, $21.9 million more than original estimates, which includes $20 million for the minimum revenue guarantee to Skyport and $10 million for unemployment benefits.

Interest/guarantee management costs are projected to be $130.8 million, $3 million more than originally budgeted, with most of this increase related to ongoing costs for the failed Morgan's Point project guaranteed by the previous OBA Government. Capital account expenditures are projected to be $75.9 million, $16.9 million less than originally budgeted.

Based on these figures, the 2021/22 budget deficit is now expected to be $66 million, $58.7 million (53%) below the 2021/22 original estimate of $124.7 million. This represents a $118.1 million reduction compared to the previous fiscal year. This deficit reduction demonstrates that despite continued payments to Skyport and incurred costs as a result of the Morgan's Point project, the Government remains on track to move towards a balanced budget.

2022/23 Mid-year Fiscal Performance

Following the Government's mid-year assessment, total revenue is revised to be $1.1 billion, approximately $30 million above initial estimates. This increase is primarily due to the continued economic recovery, with better-than-expected increases in tourism-related revenues, payroll tax, and stamp duty. The increase in revenue has more than offset the $17.8 million loss in revenue from the aircraft register as a result of the Russia/Ukraine war.

Total current account expenditures are now projected to be $956.8 million, $11.7 million above the 2022/23 original estimate of $945.1 million. The projected increase is primarily due to the Government's relief package and other additional spending announced as a result of the previous year's performance being better than expected.

Interest/guarantee management costs are projected to be $138.3 million, $10.5 million more than originally budgeted, primarily as a result of one-time costs associated with the recent Government debt refinancing. It is also recognised that as a result of the recent debt refinancing transactions the annual debt service costs as of December 2022 will be $2.3 million (1.8%) more than the previous year.

Capital account expenditures are projected to be $85.0 million, $12.0 million more than the $73.0 million originally budgeted. The projected increase is a result of the approved $7 million to fund critical refurbishments to the Tynes Bay Waste-to-Energy Facility to ensure its continued operation and the additional $4.1 million to assist the Bermuda Housing Corporation to prepare renovations to a number of units, which will be used to provide additional affordable housing for Bermudians.

The revised budget deficit for 2022/23 is now projected to be $72 million, $2 million (2.9%) more than the original estimate of $70 million. This projection is despite the economic relief package, reductions in duty, significant additional investments in affordable housing and infrastructure, and one-time expenses due to the successful debt refinancing.

When combining the revised deficit for this fiscal year and the expected deficit from last fiscal year, the Government's net debt is in a much stronger position than forecasted during February's budget presentation.

The March 31, 2022 net debt level was $66 million lower than previously forecast in the 2022/23 Budget Statement. In addition, as of March 31, 2023, net debt is now forecasted to be $115 million lower than originally estimated in the 2022/23 Budget Statement.

	2022/23 Original Estimate	2022/23 Revised Estimate	September 2021/22	September 2022/23
	$000	**$000**	**$000**	**$000**
Revenue				
Custom Duties	228,218	228,218	114,312	114,068
Payroll Tax	453,657	470,641	251,653	262,199
International Companies	63,840	63,840	1,289	3,563
Foreign Currency Purchase Tax	24,275	27,847	12,089	13,923
Land Tax	80,000	82,000	36,443	26,617
Hotel Occupancy Tax	6,400	6,014	1,325	2,815
Vehicle Licences & Registration	29,250	29,240	13,266	12,763
Passenger Tax	12,854	18,700	36	13,923
Stamp Duty	27,200	32,261	16,589	14,790
Civil Aviation Receipts	17,800	-	8,368	-
Financial Services Tax	13,501	14,557	7,141	7,207
Telecommunications Receipts	16,757	17,045	8,702	8,459
Immigration Receipts	13,758	15,345	7,291	8,465
All Other Receipts	90,292	102,424	24,986	63,670
Total	**1,077,802**	**1,108,132**	**503,490**	**552,462**
Expenditure				
Current Account Expenditure	947,065	948,227	435,444	458,841
Unemployment/Supplemental Benefit	-	746	9,223	621
COVID-19 Expenditure	-	7,868	12,077	6,249
Capital Account Expenditure	72,987	84,987	25,584	25,979
Interest On Debt	127,750	138,290	64,451	79,041
Total	**1,147,802**	**1,180,118**	**546,779**	**570,731**
Surplus / -Deficit	**-70,000**	**-71,986**	**-43,289**	**-18,269**

Chapter 4 – Vision for Tax Reform

The Fiscal Responsibility Panel, in its 2021 report, stated that the Government should plan for an annual budget surplus of at least $50 million for the fiscal year 2026/27. However, it is their view that it is highly unlikely that the Government will achieve this under the current tax structure. As a result, the panel recommends that the Government considers fundamental reforms aimed at broadening the tax base, increasing the progressivity of the tax system, and increasing revenues, including taxing individual capital income.

The Government supports the notion that fundamental tax reform is required in order to meet our fiscal targets, ensure continued economic growth, and address the increasing cost of living. The tax burden in Bermuda needs to be more fairly shared 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 in 2018, 2020, and 2022. The aim of these reductions was to 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 our payroll tax reductions, this year that worker now pays only $720, a reduction of $1,560, and receives a cumulative tax saving of just under $5,000 since 2017.

PLP Has Reduced the Tax Burden on Workers in Bermuda					
Salary	**Reduction in Taxes in 2018**	**Reduction in Taxes in 2020**	**Reduction in Taxes in 2022**	**Total Annual Reduction 2017–2022**	**Cumulative Tax Savings in 2018, 19, 20, 21, and 22**
$36,000	-$270	-$720	-$180	**-$1,170**	**-$3,690**
$48,000	-$360	-$960	-$240	**-$1,560**	**-$4,920**
$60,000	-$270	-$720	-$180	**-$1,170**	**-$3,690**
$72,000	-$180	-$480	-$120	**-$780**	**-$2,460**
$84,000	-$90	-$240	-$60	**-$390**	**-$1,230**
$96,000	$0	$0	$0	**$0**	**$0**
	First PLP payroll tax reduction for workers	In 2020, further reductions were made saving families even more	Further reduction this year that is in addition to savings made in previous years	This is the difference in annual payroll tax between the OBA (2017) and PLP (2022)	This is the total amount of tax savings for a worker over the last five 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.

Work Ongoing

In October 2021, the international community agreed to a landmark deal that included a proposed global minimum effective corporate tax rate of 15% for large multinational enterprises. To date, the specifics regarding the "implementation administrative measures" have not been published, so it is currently difficult to predict the impact that this new global tax system will have on Bermuda's economy, how the tax will be implemented, and what the implementation timeline will be. In spite of the uncertainty, the Government is taking the necessary actions to ensure we are best prepared when final guidance is published.

During this fiscal year, it was envisioned to reconstitute the Tax Reform Commission to assist with the preparation for the proposed global minimum tax agreement and the implementation of a more progressive taxation system. However, this was deemed impractical due to concerns expressed by stakeholders around the ability of the Tax Reform Commission to adequately address matters concerning the significant changes in international tax. In response, the Ministry of Finance has formed an international tax working group that will look at the proposed global minimum tax agreement and other international tax matters.

Future Tax Reform Priorities

Tax Reform Commission

It is still envisioned that a new Tax Reform Commission will be appointed under the Tax Reform Commission Act. The commission would be tasked with developing a medium-term domestic tax strategy to increase tax revenues by moving towards a more progressive tax structure and broadening the tax base in line with the recommendations from the Fiscal Responsibility Panel, which stated, *"The reconstituted Tax Reform Commission should be charged with developing a medium term tax strategy to increase tax revenues by moving toward a more progressive tax structure that taxes earnings from capital, including interest, dividend and rental income, as well as labour, and broadens the tax base while disincentivising behaviour that is damaging to health or the environment."*

Social Insurance

In the upcoming fiscal year, and as promised in the Throne Speech, the Government will look to change Bermuda's social insurance system from a fixed-rate contribution to one based on a percentage of income.

The historic and unfair system that sees a CEO making $500,000 a year pay the same amount in contributions as a worker making $50,000 a year cannot and will not continue. This change will increase the take-home pay of low-income workers while ensuring that our pension fund is sustainable for future generations.

Social insurance contributions based on a percentage of income would not be a concept unique to Bermuda. It has been implemented in many other countries around the world, including the US, Canada, and the United Kingdom, which changed from a flat rate to a percentage of income 45 years ago. It is the right and proper thing to do.

Elimination of Payroll Tax for Low-Wage Workers

In its 2020 election platform, the Government pledged to eliminate payroll taxes for those persons making under $48,000 a year. The Government intends to keep this pledge as it is vital to ensure that low-wage workers, who spend more of their income on essentials such as food and energy, and who are hardest hit by global inflation, increase their take-home pay.

Tax Collection and Accounts Receivables

Tax collection and accounts receivables continue to be a challenge; however, the Government is committed to prioritising a further review of existing policies and making a more concerted effort towards collection.

At the end of the current fiscal year, accounts receivables are projected to increase by 5%, which is unsustainable and cannot continue. As the Government considers tax reform, the Ministry of Finance will also invest in the infrastructure within the Office of the Tax Commissioner to provide the resources and support needed to collect outstanding taxes more effectively.

Chapter 5 – Framing the 2023/2024 Budget

As the Government approaches the formulation of the 2023/24 budget, the following key factors will impact the framing and composition of that budget:

- The Government's 2020 General Election Campaign Platform and the 2022 Speech From the Throne
  - 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
  - Adjustments in taxes must be structured in a way that supports Bermuda's post-pandemic economic recovery, which is being powered by international business expansion. Bermuda continues to compete with other jurisdictions and any tax changes must be viewed with a global lens.
- Continued fiscal consolidation to reduce deficits on the path towards a balanced budget in the fiscal year 2024/25
  - The Government has committed to a balanced budget in the fiscal year 2024/2025 and the 2023/24 budget must make progress in that area.
  - This will be especially difficult as the Government must replace the combined $40 million of lost revenue from the ending of the Travel Authorization Fee and the revenue lost from the Bermuda Civil Aviation Authority due to sanctions that were imposed against Russia.
- Continued investment and support for the initiatives within Bermuda's Economic Recovery Plan
  - Long-term economic growth is vital, and successfully executing Bermuda's Economic Recovery Plan is necessary to ensure such growth for the economy. Investments today that result in economic growth will increase tax revenue in future years and support debt reduction.
- 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 2022 Fiscal Responsibility Panel report
  - The Fiscal Responsibility Panel plays an important role in fiscal policy-making in Bermuda. It represents the only independent assessment of the Government's

fiscal plans and makes recommendations to ensure that the Government of Bermuda is progressing towards meeting established fiscal targets.
- Feedback from the Pre-budget Report in advance of the fiscal year 2023/24
    - 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 2023/24 budget.

Risks Facing the Bermuda Economy

In their 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 has taken them into account when framing the 2023/24 budget.

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

- ***Global Tax Initiative Risk***: Bermuda faces a pressing challenge: international developments on corporate taxation potentially pose a threat to Bermuda's business model.

  There are two pillars associated with this tax. Pillar One would have little if any impact on Bermuda. However, Pillar Two could, in theory, have a significant impact on Bermuda's business model.

  Pillar Two is intended to create an agreed "global minimum effective tax" at a rate of 15%, with the aim of ensuring that all MNE (multinational enterprises or otherwise referring to companies with multinational clients) profits are taxed somewhere by some country at that effective rate (on a jurisdictional basis). The idea is to eliminate the incentives for MNEs to shift taxable profits to countries with no or low corporate income tax, which includes Bermuda.

  Low-tax jurisdictions are the segment projected to lose tax base and revenues from this minimum tax approach. While Bermuda has long imposed no regular corporate income tax on either domestic or international businesses, approximately 7% of projected 2021/22 revenues are derived from fees imposed on the international business sector.

  Of more importance is the question of whether this change in the global architecture will cause the current international business and finance sector in Bermuda to shrink or, at the very least, reduce or eliminate potential growth – with an accompanying loss of employment not only in the sector but also in all of the supporting services and spillovers to the local economy. On the fiscal side, it is estimated that approximately half of all payroll tax revenues derive directly or indirectly from the international business sector.

- ***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 and 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.

- ***Impact of Global Warming and Climate Change***: Given its geographical position and low-lying land, Bermuda is particularly vulnerable to climate change, the movement of the Gulf Stream, hurricanes, storm surges, and rising sea levels.

  In addition, while rising ocean temperatures and acidification will affect its coral reefs, biodiversity, fishing and tourism, the IPCC has found that due to past and future greenhouse gas emissions, many climate changes are now irreversible. It is now virtually certain that the global mean sea level, which increased by 0.20 metres between 1901 and 2018, will continue to rise over the rest of the 21st century due to further deep ocean warming and ice sheet melt.

  Relative sea level rise contributes to increases in the frequency and severity of coastal flooding in low-lying areas and to coastal erosion. In Bermuda, a rise in sea level and ocean change will create the risk of ocean swell and storm surges that could inundate key infrastructure and heritage sites (e.g., the airport and St George's) on a regular basis. Occurrences of coastal inundation that at present are deemed to be extreme events will be within the normal daily tidal range in as little as 20 years.

- ***Insurance Industry Risk****:* Bermuda's insurance and reinsurance sector is exposed to climate risk but appears sufficiently well capitalised to deal with increasing extreme weather and natural catastrophe events, benefiting from increased investment returns, higher premiums, and increased insurance penetration. While this could change in the event of a series of adverse events, Bermuda's financial regulators are closely monitoring these risks.

- ***Risk of Rising Global Interest Rates****:* Given the scale of Bermuda's debt, and the fact that the Federal Funds Rate has been increased by 3.75% since March 2022, the possibility of a large, sustained rise in global interest rates remains one of the most serious risks facing Bermuda.

- ***Inflationary Risk:*** Macroeconomic policy stimulus and the release of pent-up demand, combined with supply bottlenecks, has led inflation to rise markedly in some countries, including in the US.

  The extent of the monetary policy response to rising inflation will depend on whether it is viewed as a temporary shock or whether rising inflation expectations and wage demands lead to a more entrenched increase. Rising prices will affect Bermuda, which is heavily reliant on imported final and intermediate goods and commodities.

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 the Government wishes to solicit feedback on. Prior to finalising the 2023/24 budget, the Government will engage with the public and with other stakeholders to receive feedback on the policy considerations outlined below.

Payroll Tax Changes

The Government continues to consider prudent measures regarding its payroll tax structure that will lessen the financial pressures experienced by a majority of Bermudians and Bermudian businesses alike. The objective is to make the payroll tax system more progressive, reducing the tax burden on low and middle-income workers and small to medium-sized businesses.

To achieve this aim, the Government proposes the following for consultation:

Employee Payroll Taxes

- Eliminating payroll tax for the first $48,000 of labour income for all employees. This proposed change will remove 30% of the workforce from being liable for payroll tax while providing relief to these workers who are most affected by reduced purchasing power due to the high global inflation.
- To compensate for lost revenue, the next three tax bands will need to be adjusted upwards, and the proposed rates are provided in Table 1, below.
- The result of these proposed rates will see all persons making under $105,000 annually paying less in payroll tax compared to the prior year (Table 2).
- These proposed changes are estimated to result in $19.6 million in additional revenue for the treasury.

Table 1

Income Bands	Previous Rates	Proposed Rates
$0 – $48,000	1.50%	0%
$48,000 – $96,000	9%	10%
$96,000 – $235,000	9%	11.50%
$235,000 – $900,000	9.50%	13%

Table 2

Impact of Proposed FY 2023/2024 Employee Payroll Tax Changes			
Income	**Taxation**	**Effective Tax Rate**	**Change From Prev Year**
$36,000	$ -	0.00%	-$540
$42,000	$ -	0.00%	-$720
$48,000	$ -	0.00%	-$720
$54,000	$600	1.11%	-$660
$60,000	$1,200	2.00%	-$600
$66,000	$1,800	2.73%	-$540
$72,000	$2,400	3.33%	-$480
$78,000	$3,000	3.85%	-$420
$84,000	$3,600	4.29%	-$360
$90,000	$4,200	4.67%	-$300
$96,000	$4,800	5.00%	-$240
$102,000	$5,490	5.38%	-$90
$108,000	$6,180	5.72%	$60

Business Payroll Taxes

- Reduction of payroll taxes for small and medium-sized businesses (payrolls under $1 million), hotels, restaurants, and retailers, as detailed in Table 3, below.
- Elimination of the payroll tax for farmers, fishermen, educational, sport and science institutions, and small businesses with an annual payroll of less than $200,000.
- Increase in exempted company payroll tax from 10.25% to 10.75%.
- These proposed changes are estimated to be revenue neutral to the treasury.

Table 3

Employer Payroll Tax Categories	Previous Rates	Proposed Rates
Annual payroll < $200,000	1.75%	0.00%
$200,000 ≤ Annual payroll ≤ $350,000	3.50%	2.50%
$350,000 ≤ Annual payroll ≤ $500,000	6.50%	5.50%
$500,000 < Annual payroll ≤ $1,000,000	9.00%	7.50%
Annual payroll > $1,000,000	10.25%	10.25%
Exempt undertakings	10.25%	10.75%
Gov., gov. boards, parish councils, & Bda College	0.00%	0.00%
Farm, fish & educ, sport, and scientific inst.	1.75%	0.00%
Charities, schools, religious & cultural orgs	0.00%	0.00%
Economic Empowerment Zone	0.00%	0.00%
BHB, Corp of Hamilton and St Georges	3.50%	3.50%
Qualifying retail	7.00%	6.00%
Hotels & restaurants w/annual payroll ≥ $200,000	6.00%	5.00%

Other Payroll Tax Measures

- The payroll tax cap of $900,000 has not been increased since 2017, and the Government is considering increasing it to $1,000,000. Though representations were made to the Government to eliminate the payroll tax cap given its regressive nature, the Ministry of Finance considers the revenue gained from the elimination of the cap would be offset by reductions in highly paid executives resident in Bermuda. The proposed increase in the payroll tax cap is estimated to yield $1.75 million in additional revenue for the treasury.
- Citizens of the United States and others who are required to pay US income taxes on their global income suffer a form of double taxation if the amount of employee payroll tax paid in Bermuda is not able to be deducted from the US tax liability. With the changes to the Payroll Taxes Act in 2017, which specifically make employees responsible for such taxes, this may create the conditions for US taxpayers to deduct Bermuda employee payroll taxes paid from their US tax liability. The Government of Bermuda's Washington DC Office is seeking official confirmation of the eligibility of Bermuda's payroll tax for the Foreign Tax Credit.

End of Payroll Tax Concessions

The COVID-19 pandemic saw the Government introduce a number of temporary payroll tax concessions. These concessions were necessary to provide short-term support; however, if in place for extended periods of time, they can cause distortions in the economy and reduce an economy's efficiency and productivity. It is important for businesses to not build these concessions into their business models and to make the necessary adjustments to thrive in an evolving economy. Additionally, as these concessions were issued across industries and sectors, some companies received the subsidy despite not being in need; therefore, the Government is proposing to end all pandemic-related payroll tax concessions.

Tax Reform Commission Recommendations

In 2018, the Tax Reform Commission was assembled to examine Bermuda's tax system and recommend appropriate changes. The items below are recommendations included within its report that have yet to be implemented and are being shared for consultation and feedback from the public:

- A flat withholding tax on services outsourced by local companies to foreign service providers. Such services are a direct substitute for services that could be, and in many cases are, provided locally.
- A flat withholding tax on interest and/or dividend income that is attributable to local companies.
- Introduce seven new fee bands into the existing company fee structure with the aim of aligning company fees with a company's assessed capital. This will provide a more progressive fee structure.

Description of Tax	Intent of Measure	Impact	Revenue Projection (2020/21)
Withholding Tax - Managed Services	Flat tax based on overseas services provided locally	Companies	$27.5 million
Withholding Tax - Interest/dividend	Flat tax on the value of dividends/interest	Recipient	$2.5 million
International Company Fees	Align fees with a company's assessed capital by increasing the number of bands	Companies	$25.5 million

Full explanations of the above tax proposals can be found on the Bermuda Government Portal: https://www.gov.bm/sites/default/files/Tax-Reform-Commission-Report-Final-2018-11-19.pdf

Other Revenue Considerations

In addition to the revenue measures being considered above, the Government is requesting feedback on additional revenue considerations:

- To increase revenue to the treasury and offset the elimination of duty for essential goods, the Government has been asked to consider increasing duty on luxury items that are imported into Bermuda.

- There are some brands of cigarettes manufactured and sold in Bermuda that are therefore not subject to the import tax on cigarettes of 40 cents per cigarette. This loophole creates a space where special taxes to disincentivise harmful behaviour are not being applied. As these cigarettes are manufactured locally and are not subject to import duty, the Government considered creating a local excise tax. However, the administration of a new local tax would likely be more costly than any revenue to be collected. Instead, the Government is considering requiring local manufacturers of cigarettes and other tobacco products to obtain a licence with an associated fee that will allow for parity of treatment of such products, whether locally manufactured or imported.

Targeted Tax Relief

A significant part of the feedback received by the Ministry of Finance was related to additional tax relief. The following proposals are being shared for feedback:

- Local Dividend Tax Exemption
    - The Government has been asked to consider increasing the ceiling on the payroll tax exemption for local dividends, currently set at $10,000.
- Elimination of Double Taxation for Self-employed Persons.
    - In an effort to avoid double taxation, the Government has been asked to consider removing the requirement for self-employed persons to pay both the employer and employee portion of payroll tax and only be responsible for paying the employee portion.

- Extension of New-Hire Payroll Tax Exemptions
    - The Government has been asked to consider extending the current employer payroll tax concession for new jobs created from one year to two years as a further incentive for the creation of jobs in Bermuda.
- Expansion of Retail and Hospitality Customs Duty Relief to the Personal Care Sector
    - Currently, the retail and hospitality sectors are offered duty relief for capital items purchased when upgrading their establishments. The Government has been asked to consider extending the same relief to personal care providers. The Government would welcome additional feedback as to whether there are other sectors that may benefit from customs duty exemptions for capital upgrades.
- Tax Relief for Persons on Maternity/Paternity Leave
    - The Government has been asked to consider forgiving the employer portion of payroll tax for those on maternity or paternity leave.
- Duty Free for School Uniforms
    - To better assist working families and provide additional relief, the Government has been asked to consider eliminating customs duty on school uniforms.
- Amended Duty Relief Scheme for Small Licensed Tourist Accommodations
    - The Government has been asked to consider introducing a simplified duty relief scheme for the upgrading of smaller licensed tourist facilities such as guest houses.

Spending Considerations

The Fiscal Responsibility Panel highlighted that the spending predictions for future years were likely understated. Accelerating global inflation has exacerbated this challenge highlighted by the FRP, and the Government will exceed the 0.5% current account spending increase that was planned for the fiscal year 2023/24. Below are some of the major items that will impact spending considerations in advance of the 2023/24 budget.

Public Sector Pay Increase

The salaries and wages of public sector workers have not kept up with the increases that have been seen in the private sector. Though the aforementioned proposed tax changes will increase take-home pay for all blue-collar workers, it is no longer feasible to maintain the position of no pay increases during the 2023/24 budget cycle due to rising global inflation. As a result, the Government has adjusted its financial mandate to award public sector workers a pay increase. These increases will need to be reflected in spending plans and offset by revenue increases or cost decreases to meet the Government's budget targets and ensure that the budget is balanced in the 2024/25 fiscal year.

Tourism Investment

To support economic recovery outside of the international business sector, the Government will consider additional investment to support tourism growth. The local tourism industry is a key economic pillar that was severely impacted as a result of the COVID-19 pandemic. Additional investment to support tourism will boost employment as this sector is a major driver of jobs in the economy.

Economic Recovery Plan

The successful execution of Bermuda's Economic Recovery Plan is vital for future economic growth in Bermuda. The Fiscal Responsibility Panel has endorsed the Government's plans but has cautioned against delayed execution. Sufficient resources will need to be made available to ensure that this plan can continue to be delivered.

Investments in Technology

The Government has increased investment in technology over the past few years. However, there are still significant gaps in the Government's technology infrastructure, which could leave the Government exposed to cyberattacks. Upgrading the technology infrastructure is seen as critical to ensuring better efficiency and effectiveness and securing residents' data. Consideration must be given to additional capital expenditure in this area.

Retention and Capacity Building in the Public Service

Successive years of austerity have seen public administration as a percentage of GDP fall to 4.8% in 2021, the lowest level in 15 years. Training and human resource development for public officers will be a key priority to increase the capacity of the public sector so that the Government's objectives can be achieved in as cost-effective and efficient a manner as possible. Additionally, government pay scales are no longer competitive with the private sector, especially for specialised roles like legal, engineering, compliance, and finance, which sees the Government lose its top employees to the private sector. Additional investment will be needed to ensure that specialist roles can be compensated at a level that attracts and retains experienced staff and reduces reliance on external consultants.

Ageing Population

The continued ageing of the population poses significant challenges for the Government. Additional investment 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. Therefore, as previously highlighted, 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 to assist in the formulation of budget policy.
2. **Budget Statement:** The Government issues budget statements annually. This practice is a matter of custom and will continue.
3. **Citizens' Budget:** A Citizens' Budget is a non-technical presentation that "can take many forms but its distinguishing feature is that it is designed to reach and be understood by as large a segment of the population as possible". A Citizens' Budget is 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 2023/24 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 2023/24 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 2023 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 13, 2023.