BERMUDA FISCAL RESPONSIBILITY PANEL

2020 Annual Assessment

Jonathan Portes (Chair)
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List of Acronyms

BHB: Bermuda Hospitals Board

BMA: Bermuda Monetary Authority

CARTAC: IMF's Caribbean Regional Technical Assistance Center

CPF: Contributory Pension Fund

CPI: Consumer Price Index

GDP: Gross Domestic Product

IMF: International Monetary Fund

OECD: Organisation for Economic Cooperation and Development

PCR: Polymerase chain reaction

PSSF: Public Service Superannuation Fund

Quango: quasi-autonomous non-governmental organization

SUB: Supplemental Unemployment Benefit

TRC: Tax Reform Commission

WHO: World Health Organisation

Executive Summary

This is the Panel's sixth annual report. Although it was prepared under very different circumstances from previous years, we have had productive discussions with Ministers, officials and many others on the Island and we are grateful for their advice, but all the judgements and recommendations are our own independent conclusions.

The COVID-19 crisis required that the Government take immediate actions to protect the population and mitigate the economic consequences for businesses and livelihoods. Bermuda's response has, by global standards, been exemplary. It has successfully addressed the health crisis, in turn allowing the economy to reopen, while protecting the population. But the fiscal and debt impacts have been considerable. Measures must now be taken to preserve the gains that have been made, to shore up the public finances, and to build confidence in the Government's fiscal plans and resilience for the future. While difficult decisions will have to be taken, the crisis offers an opportunity to reconsider important aspects of the public finances, society, and the economy.

Our previous reports have highlighted what Bermuda's leaders have long recognised as serious concerns affecting Bermuda's fiscal and economic position. These include a population that is shrinking and ageing, with fewer workers and far more elderly, many with chronic and debilitating health problems; reliance on a highly competitive and sought after international business sector for much of its tax revenue and economic output; a social insurance system that continues to accumulate significant unfunded liabilities which add to Bermuda's potential public debt; a tax system that heavily burdens its working population relative to those receiving income from other sources, such as rent, interest and dividends; and its island economy increasingly at risk from the multiple hazards of climate change.

We paint a stark picture of Bermuda's fiscal challenges, but one that is shared and recognised by the Government itself. In mid-November, the Minister of Finance characterised the deficit as "not only unsustainable but economically and financially imprudent." He underscored the risks, and that dealing with the deficit "will require some sacrifice from all sectors of [the Bermudian] community." In the next two years, even under a more optimistic scenario, Bermuda's fiscal path will be very narrow, with its financial scope limited both by the size of the debt maturing in 2023-24 and the speed with which its financial cushion in the Sinking Fund will be drawn down by fiscal deficits, with nothing left for contingencies.

Our recommendations cover those that require attention now and the much-needed, structural reforms that address long-term fiscal challenges (as we have recommended in previous reports). They should be viewed as a comprehensive package:

Fiscal targets: Our estimates imply that there is a fiscal gap of at least $50 million if the budget is to be balanced by 2023-24. We recommend that the Government aim to at least restore revenues to the pre-COVID-19 (i.e. 2019-20) level of $1,110 million by 2022-23, with a further significant increase in 2023-24 to meet the balanced budget target. Beyond budget balance in 2023-24, the Government should target a budget surplus of $50 million per annum, to be achieved in fiscal year 2026-27 and continued thereafter to pay down the debt.

Fiscal strategy and tax reform: The Tax Reform Commission (TRC) should be given a clear, time-limited mandate to provide a report to the Government by June 2021, to allow measures to be implemented in 2022-23. The objective of such measures should be to achieve the medium-term revenue targets described above, broaden the tax base and move toward a more progressive tax structure on personal income that taxes earnings from assets as well as labour We suggest, over the next two to three years, the introduction of

i) a tax on dividend and interest receipts;

ii) an annual rental tax on owners of large properties and multiple units (thus exempting all but high earners);

iii) an increase in taxes on sugar and other unhealthy products; and a carbon tax.

The TRC should also examine the case for, over the medium to longer term, the introduction of a corporate income tax at a modest rate, as is the case in some other small island jurisdictions such as Jersey and Guernsey.

Public expenditure: the Government will need to impose a tight budgetary regime in 2021-22; an across the board cut in most major spending Departments and agencies is both justified and necessary. Over the medium term, more fundamental reforms are required.

Healthcare: While Bermuda's healthcare system has responded well to the crisis, it has long been clear that its financing is both unsustainable and inequitable. We endorse the Government's programme of reforms. These will require greater progressivity in burden sharing. Risks are high, and sustained policy action over the next two years is required.

Pensions: The foundations of Bermuda's social insurance system have been undermined by demographic developments and a lack of policy resolve, now accentuated by measures taken to address the COVID-19 crisis. The Government should as planned restore contributions for the Public Service Superannuation Fund (PSSF) and the Contributory Pension Fund (CPF). Fundamental reforms, including increases in retirement age, and income-related contributions to the CPF, will also be necessary.

Immigration: COVID-19 presents a potential opportunity. Bermuda should be an attractive place to live and work. But to take advantage of these opportunities to grow the workforce and the economy, radical reforms to the immigration system are needed. Bermuda needs to make it easier, not just for people to come to work, but to stay and contribute to the Island on an ongoing basis, and, eventually, to settle permanently, with appropriate rights, responsibilities, and security for their families and children.

Climate Change: We would encourage the Government to carry out an assessment of the physical, economic and fiscal risks that climate change might pose to the Island, and where necessary invest further in measures to improve its resilience. Furthermore, responsibility for assessing such risks should be vested in a designated government agency, with clear lines of accountability.

Economic growth and diversification: Economic growth and diversification will be important to increase the tax base and decrease reliance on only a few sectors. Bermuda has an opportunity to build on its internationally respected financial regulatory framework and successful international business sector, and the focus on fintech is broadly appropriate. Measures to boost domestic investment, including the establishment of a National Digital Bank, are also welcome. However, there are potential risks attached to such initiatives, and appropriate governance and regulation will be essential.

We have aimed to set out a far-reaching and comprehensive package of measures. But these proposals originate not merely from us, but from a wide variety of Bermudian stakeholders, in Government, Opposition, business and civil society. Many have been discussed and debated over a period of years. The aftermath of the COVID-19 crisis makes them more necessary than ever, and the Government's strong showing in the recent election provides it with an unprecedented window of opportunity to act.

A. Introduction

1. This is the Panel's sixth annual report. Our role, as set out in our letters of appointment, is "to provide Bermuda's Parliament, Minister of Finance and Financial Policy Council with an annual published assessment of the territory's fiscal strategy, focusing on progress in meeting the territory's medium term objectives for public spending, taxation, borrowing and debt reduction." In making our assessment we are asked to "review the impact of the most recent Bermuda Government Budget; the credibility of macro and fiscal assumptions underlying Government projections; and the risks that could affect progress in meeting the territory's fiscal goals…[offering]…advice where needed on ways to refine these goals, and on adjustments to fiscal strategy and tax and spending policies needed to achieve them."

2. The pandemic, and associated changes in working practices in both Bermuda and our home countries, meant that we, on the advice of the Ministry of Finance, decided not to travel to Bermuda this year. Our meetings have therefore been conducted remotely. We have nevertheless had a full schedule of meetings and helpful discussions with Ministers and their officials, and as ever are particularly grateful to Anthony Manders, Deborah Harris and the other staff of the Ministry of Finance for their support. We would also like to thank the many others on the island who have offered us information and advice (a complete list is in Annex A) and Carol Martin for organising our video conferencing. However, the report's judgements and recommendations reflect our own independent views.

3. Section B summarises our key findings and recommendations from last year; section C sets out economic and fiscal developments in Bermuda prior to the COVID-19 crisis; and section D sets out the Government's initial response to the crisis in the first three months. Section E describes developments since the economy reopened in July. Looking forward, section F reviews relevant external developments and reassesses the uncertainties and risks facing the Island. Section G discusses the implications for the public finances, and section H sets out immediate and longer-term recommendations. Finally, Section I summarises our conclusions and sets out our key recommendations.

B. Key findings of the 2019 Report

4. Our 2019 report described 2019 as a year of missed opportunity, not just because of further delay in meeting the target for budget balance, but because of the continuing failure to strengthen Bermuda's fiscal position along the lines proposed by the Tax Reform Commission (TRC) and this Panel. We saw tax reform as critical, both to bring down Bermuda's debt level and to reduce its excessive reliance on payroll-based taxes. However, the Government made significant progress in setting out a clear agenda for the reform of the financing of healthcare and was exploring measures to address the underfunded public pension system. It also recognised the need for major reforms to the immigration system.

5. We proposed a challenging agenda, requiring action both in the short term, in particular major reforms to the tax system and tax increases, and over the medium to long term, addressing spending pressures in the health sector and from the government's pension and health insurance liabilities for its employees and retirees (and its potential contingent liability in relation to the Contributory Pension Fund (CPF)). We also recommended that the Government set out a clear fiscal strategy and associated targets for the next few years, including targeting a surplus of at least $50 million and a timescale for meeting the existing debt/revenue target of 80%. Given the relatively benign domestic and international economic environment, we argued that the case for immediate action was strong. The longer the delay in addressing the large debt overhang, the more serious the underlying issues would become, and the more vulnerable Bermuda would be to unanticipated shocks.

6. While the pandemic has led to huge changes in the economic environment, both in Bermuda and globally, many of these recommendations remain relevant. We did not, of course, forecast the pandemic; we have, however, consistently warned of the vulnerability of Bermuda's finances to an external shock. And our recommendations for long-term reforms to the tax, immigration and health systems remain equally, if not more, pressing in the new circumstances which Bermuda faces, as we discuss below.

C. Developments prior to the COVID-19 crisis

7. Despite recording a primary current budget surplus, the overall deficit of $42.2m in the 2019-20 fiscal year was significantly worse than the Budget plans for a $7.4 million surplus, as revenues fell slightly short and some extra expenditures were incurred, in particular extraordinary expenditures of $19.0 million related to Morgan's Point, an additional grant to the Bermuda Hospital Board (BHB), and some early COVID-19 expenses.

8. More worryingly, the 2020 Budget, published just before the implications of the COVID-19 pandemic became clear, proposed no significant changes to tax or spending, with modest revenue growth largely offset by adjustments to the payroll tax, and little change in overall spending. A $19.8 million deficit was projected for 2020-21. While there were some welcome elements in the Budget, especially measures to promote economic diversification and growth, there was no substantive response to our recommendations, either for a clear overall fiscal strategy and targets, or for specific tax measures.

9. In other areas, however, the Government acted on some of the Panel's recommendations. In March, as part of Immigration Reform and with bipartisan support, amendments to the Bermuda Immigration and Protection Act 1956 addressed the issue of persons born to Bermudians overseas, who were ineligible for Bermuda Status, and the plight of Mixed Status Families where some members had Bermuda Status or Permanent Residency and some did not.

10. Gross Domestic Product (GDP) grew by just 0.5% in real, inflation adjusted, terms in 2019, following a 0.4% fallback in the previous year following the America's Cup; the Government estimated that underlying growth was 1-2%. In the first quarter of 2020, GDP was 2.8% below that of a year earlier, as the pandemic started to bite. Inflation remained low.

11. Although there were encouraging signs that employment was expanding in the year to August 2019, with a 1½% increase in total jobs, including a 6% growth in hotel jobs, this was in part due to growth in public sector employment; there was a 5% increase in jobs in public administration over the year while employment in Education, Health & Social Work grew by 3%. Meanwhile the median gross annual income of employees rose 1½% in nominal terms. The unemployment rate had fallen to 3.8% in November 2019, 4.4% for Bermudians, significantly lower than a few years ago, but youth (16-24 years) unemployment remained high at 18.1%.

12. Bermuda therefore began the COVID-19 crisis with a budget deficit, a large debt overhang, and slow growth. As we noted in the 2019 report:

> "*Bermuda, as a small open economy competing in a global marketplace, remains highly vulnerable to external events. These external risks—not merely financial but also broader economic, geopolitical, and environmental—have not yet materialised, but have increased over the last year, and are unlikely to diminish in the medium term. Given the fiscal position, and the limited progress of the Government in acting on our previous recommendations, we are concerned that Bermuda will have little fiscal or macroeconomic policy space to address any crystallisation of these risks.*"

D. The immediate policy response to COVID-19 and its associated economic impacts

13. Bermuda responded rapidly and effectively to the emerging COVID-19 crisis, commencing preparations when the risk first became known in January, starting social distancing on 12 March and imposing self-quarantine on all arrivals from 17 March, the day before the first positive, imported, cases were recorded on the Island. Incoming passenger flights and arrivals by sea were stopped on 20 March and, from 4 April, following a series of progressively more stringent measures, a state of emergency was imposed with residents required to 'shelter in place,' effectively locking down society and the economy for all but essential activities. Schools were shut.

14. Together with extensive testing (both PCR and antibody), rapid results, and the successful implementation of the test, track, trace and isolate protocol advocated by the World Health Organisation, community transmission was avoided, and the pandemic was successfully contained. By end-May there had been 140 confirmed cases of COVID-19 in Bermuda (about 200 per 100,000) and 9 deaths (about 14 per 100,000), significantly lower than the rates in the USA, UK, or much of Europe.

15. The success of these measures allowed the gradual lifting of restrictions after just 4 weeks of 'shelter in place.' On 21 May Bermuda moved to the second phase of easing the lockdown, including restricted opening of retail, personal services and the outdoor spaces of bars and restaurants, with rules in place on physical distancing and masks. Phase Three, from 11 June, reopened, subject to safety guidelines and restrictions on numbers: gyms, pools, places of worship, cinemas, museums, private schools, childcare and summer camps. It allowed indoor dining at restaurants and no longer mandated, but still recommended, working from home. A week later, Phase 3B saw the reopening of additional personal services and spas. On 1 July, the state of emergency ended and Phase Four heralded the 'new normal' with bars and nightclubs opening and the commencement of commercial flights, with electronic travel authorisation and strict testing and quarantine measures in place for incoming and returning passengers.

16. The initial economic impact of the crisis was severe and sharp, occurring towards the beginning of the Bermuda tourist season. The tourism sector virtually shut down. Total visitor arrivals in the first half of the year were down by 91% on a year earlier. Hotels, restaurants, bars, and retail establishments bore the brunt as total air visitor spending in the first six months of the year fell by 82% from a year earlier. Total on island retail sales for the first six months of 2020 were 7.5% down on the year before. Imports fell by more than 10%. From these sectors, impacts radiated out to other areas of the economy partially dependent on tourism, including construction and real estate, with adverse effects on employment and incomes. Based on preliminary estimates from the Office of the Tax Commissioner, employment income for the first 6 months of 2020 fell by 7.7% compared to a year earlier. Overall, the Government estimates that GDP fell by approximately 15% in the first half of 2020.

17. As elsewhere, the Government's immediate response was to introduce emergency measures to mitigate the economic impact of the restrictions on individuals and businesses. It introduced a 12-week (ultimately 18-week after two extensions), unemployment benefit of 60% of gross earnings up to a maximum $500 a week for those residents and work permit holders unable to leave the Island and not eligible for financial assistance. Over 10,000 individuals—close to one in three of the workforce – received the benefit at a cost of $58 million. Of these, about 2,700 were work permit holders.

18. To further support struggling households, the National Pension Scheme [Occupational Pensions] Act 1998 was amended to permit a person under the age of 65 who participates in a private defined contribution pension plan or local retirement product, to voluntarily withdraw up to $12,000 from 1 June 2020 to 30 June 2021, and a person who has reached the age of 65 to withdraw up to 25% of their pension account balances. The Act was further amended to allow a suspension of employee and employer pension contributions from 1 July 2020 to 30 June 2021 while a voluntary suspension of Social Insurance Contributions for employees and employers was also introduced over the same period.

19. Other support to business included payroll tax relief for bars and restaurants and deferred customs duty for importers. In April, the Bermuda Economic Development Corporation launched the $24 million 'COVID-19 Business Aid Loan and Grant Fund' for small and medium sized enterprises, supported by $12 million of additional Government funding. By October, the programme, which is to run until end-2020, or until funds run out, had assisted 114 (largely small) businesses with just under $2.5 million in loans and grants.

Informal Advice of the Panel

20. In June 2020, at the request of the Minister of Finance, we provided urgent advice on the challenges faced by Bermuda as a result of the COVID-19 crisis, and the implications for Bermuda's economic and fiscal policies. We argued that while Bermuda had responded well to the immediate challenges, its fiscal position was seriously threatened. Even on an optimistic scenario, the trajectory of the borrowing requirement needed to finance the deficits did not appear sustainable.

21. If Bermuda lost access to financial markets and could not borrow to finance ongoing spending, the Government would have to implement very large emergency spending reductions, which in turn would further exacerbate the economic damage already sustained. Our recommendations were specifically directed at minimising the risk of such an eventuality.

22. We urged the Government to access the international capital markets as soon as possible to borrow the maximum amount realistically practicable for the longest maturity available. The objective was not just to finance the Government's immediate borrowing requirements—essential as that would be—but to repay borrowing to domestic banks, provide funds to meet future large debt repayments, and to build up a significant contingency reserve. We also noted that for this strategy to be viable, international financial markets would need to be confident in Bermuda's ability to repay its debts. That in turn would require a credible short-to-medium term fiscal strategy, including significant new revenue-raising measures; firm commitments on tax reform; and a credible set of fiscal targets. We also set out other short-term priorities: measures to restart tourism in a safe and sustainable way, support for the domestic financial sector and international business, and reforms to the immigration system to make Bermuda an attractive place to live and work.

E. Developments since reopening the economy

23. Since July, Bermuda has kept the pandemic under control while reopening the economy and schools. As of 25 November, Bermuda had 26 active COVID-19 cases and no one in hospital with the disease. There have been no deaths from the virus since May. Most recent cases have been imported, including by returning residents, mainly from the US and UK. As the rest of the world has entered second, or even third, waves of the pandemic, the rate of imported cases has risen. The Government and society at large will need continued vigilance to prevent a resurgence of the virus and local or community transmission, which could necessitate another lockdown. A recent unexplained outbreak in a workplace underscores this and has led the WHO to class Bermuda as having 'clusters' rather than 'sporadic' cases.

24. As the economy has reopened, domestic economic activity has picked up somewhat. The International Business sector remained strong through the pandemic and maintained employment levels. As a result, it is possible that the current account of the balance of payments remained in surplus despite the fall in tourism. Having fallen sharply, the volume of local retail sales has recovered in recent months and is now higher than a year ago. However, tourism and associated industries are still severely impacted. Despite the opening up of air passenger routes in July, international passenger arrivals to Bermuda in October were a little over a third of airline seat capacity, itself nearly two thirds below capacity a year ago. Cruise ship traffic has not restarted and is likely to be depressed well into the next year.

25. The lack of timely data makes it hard to assess the current state of the labour market. With the reopening of the economy including shops, hotels and restaurants, it seems that many of the 10,000 workers who received unemployment benefit during the state of emergency have now returned to work. Among those who have not, many non-Bermudians who lost their jobs may have left the Island, which could open up future job opportunities for residents, although it may also be a drag on recovery in the medium term. But the labour market is still characterised by a spate of recent redundancies, reduced hours and wages, and job insecurity; hotel closures, including for renovation, have weakened the demand for labour. Consumer Price Index (CPI) inflation averaged a little below ½% per annum in the first half of the year and fell to -1.4% in July. Overall, the Government expects that, assuming no major setback to the recovery from a resurgence of the virus, the economy will shrink by 8.5% over the year as a whole.

26. Further support measures include an extension of the payroll tax break for restaurants and bars, a new 50% payroll tax break for taxi drivers and the creation of Supplemental Unemployment Benefit (SUB) to provide assistance to Bermudians in need of ongoing financial support and health insurance following the expiration, after 18 weeks, of their eligibility for the COVID-19 Emergency Unemployment Fund. SUB will run until the end of March 2021. As of November, 94 applications had been approved (with a further 141 unemployed people on the main Financial Assistance program), suggesting that Bermudian unemployment has been sharply reduced from the peak, although the relatively restrictive conditions applying to SUB and Financial Assistance mean that there may be some unemployed people not receiving any financial support.

27. The Department of Workforce Development has launched a Re-employment Strategy facilitating training and development opportunities for Bermudians to reskill, upskill, and become equipped to replace work permit holders in specific occupations including landscaping, restaurants, cleaning as well as in the hotel industry. A moratorium until 30 April 2021 on specific work permit categories—Closed Category Jobs—has been extended to cover more occupations to ensure available job opportunities are reserved for Bermudians. In September, a comprehensive Financial Assistance Reform Strategy was announced with an emphasis on training, education and employment support, and enhancing incentives to work. Financial incentives, in the form of payroll tax relief, for international businesses to grow their Bermuda workforce have been enacted.

28. To help offset the impact on the public finances of the cost of these and other support measures, in August the Government agreed to further cost saving measures with a number of public sector unions, cutting wages and salaries by 10% and removing overtime premia for a year. To mitigate the impact on take home pay for employees, contributions to social insurance and the Public Service Superannuation Fund (PSSF) were suspended.

29. To provide a stimulus to the economy, paused capital projects were restarted in August, some aspects of the Government's long-term capital plan brought forward and several new capital projects, such as investments in renewable energy on government buildings that will reduce the Government's energy costs, have been launched. This is expected to increase capital spending by $8 million, compared to the original budget of $85 million.

30. A snap general election at the beginning of October saw the governing Progressive Labour Party win by thirty seats to One Bermuda Alliance's six. This gave the ruling party another five-year term and a strong mandate to deliver an ambitious programme of rebuilding the economy for Bermudians, healthcare and education reform, immigration reform, renewable energy, broadening the tax base, balancing the budget and improved government efficiency.

F. External developments and risks

31. The pandemic has fundamentally altered the external environment facing Bermuda. The IMF projects that the world economy will shrink by 4.4% in 2020, and then recover by 5.2% in 2021 taking output slightly above that of 2019—two lost years of global growth, with limited catchup thereafter. The medium-term projections also assume that many countries' economies will experience scarring from the depth of the recession and the need for structural change, including adjustment costs and productivity impacts for surviving firms as they upgrade workplace safety, deal with firm bankruptcies, cope with costly resource reallocation across sectors, and address discouraged workers exiting the workforce. The scarring is expected to compound forces that dragged productivity growth lower across many economies in the years leading up to the pandemic.

32. Even this may be optimistic: it assumes that social distancing continues but fades over time as vaccine coverage expands and therapies improve. The recent resurgence of the virus in most of Europe, combined with its continued high prevalence in the US, means that significant downside risks remain, particularly to the fiscal outlook. The IMF notes that the fiscal consequences of the pandemic, direct and indirect, will be a large increase in sovereign debt, which will need to be financed from a smaller tax base.

33. This has several implications for Bermuda's economic and fiscal outlook:

- The international business sector is highly interconnected with other major financial sectors and is therefore not immune to global economic and financial market developments. So far it appears to have been relatively resilient to the immediate crisis, but the impact of a prolonged global recession and low interest rates may be more severe.

- The speed and extent of recovery in Bermuda's tourism sector will depend on both the course of the pandemic in the US (which will influence both the ability and willingness of US tourists to travel and whether it is safe for Bermuda to allow large numbers of tourists) and on broader economic and social developments. If the pandemic and its aftereffects lead to a permanent fall in international travel and tourism, this will require significant adjustment.

- The most direct immediate impact of the crisis on financial markets has been the further fall in US and global interest rates. US 10-year Treasury yields are below 1%, while real (inflation-adjusted) yields are negative. In the short term, this is good news for relatively credit-worthy borrowers, like Bermuda, and has enabled the Government to both refinance a large proportion of its debt and prefund the deficit for the next 2 years at attractive rates.

- However, there is considerable uncertainty about the future path of interest rates; while many economists (and the IMF) expect interest rates to remain low for an extended period, reflecting subdued economic activity globally, others warn that pent-up demand and supply constraints could lead to a surprisingly large rise in inflation, pushing up rates. Any economic strategy should be robust to a scenario in which interest rates rise, at least for borrowers subject to credit risk (i.e., all those except large, advanced sovereigns borrowing in their own currency).

34. While the pandemic and the associated uncertainties overshadow other risks, that does not mean they should be ignored. Climate change continues to be a major and growing threat, with 2020 seeing several extreme weather events. Physically, Bermuda is vulnerable to hurricanes, storm surges and rising sea level, given its geographical position and low-lying land. However, the insurance and reinsurance sector 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. The Bermuda Monetary Authority (BMA) and the UK's Prudential Regulatory Authority (PRA) conducted a joint stress test of insurers in 2019, supplementing this with an additional exercise focusing on COVID-19-related losses in 2020. The conclusions, published in June 2020, were encouraging, finding that insurers were resilient to a wide range of adverse scenarios.

35. Our previous reports have discussed the Caribbean Financial Action Task Force anti-money laundering and anti-terrorism "mutual evaluation." This report was published in January 2020. It concluded that since the last report in 2008, the framework has undergone significant changes which has strengthened the overall regime. This largely positive report reflects very extensive efforts on the part of the Government and the private sector, and significantly decreases risks on this front.

36. Bermuda's status with respect to the EU's blacklist of non-cooperative tax jurisdictions, has also been resolved for the moment, following Bermuda's implementation of measures (primarily relating to economic substance for collective investment funds). Bermuda is now fully compliant and has been moved to the "white list." Progress has also been made with respect to OECD standards on corporate taxes, the Base Erosion and Profit Sharing Pillar 2, as Bermuda joins the OECD Multilateral Competent Authority agreement to automatically exchange tax information.

37. However, further pressure on this front is inevitable, principally from countries heavily reliant on corporate tax revenues seeking to limit potentially harmful or distortionary tax competition, to ensure that taxation reflects economic presence, to harmonise tax bases, and/or to set minimum rates. This raises concerns about the potential impact on Bermuda's attractiveness as a base for international corporates. In short, while Bermuda has responded flexibly and appropriately to a variety of international regulatory pressures and issues over previous years, such pressures will not diminish, particularly in respect of taxation, and may well intensify, as other governments seek to rebuild their public finances.

G. Fiscal and Debt Prospects

38. The COVID-19 crisis had an immediate impact on the Government's fiscal position. In our 2019 report, we set out three possible scenarios for the evolution of debt and deficits. Under the base case, the debt to revenue ratio was on a gradually declining track. We forecast very slow progress indeed on debt reduction and noted that Bermuda would remain vulnerable for the foreseeable future to any economic shock, domestic or global, that had a significant impact on economic activity and/or tax revenues.

39. We also modelled a "recession" scenario, under which tax revenue fell by 2% a year in cash terms in 2020-21 and 2021-22, after which growth would resume at its estimated trend rate; we also assumed a significant, but plausible, further increase in the effective interest rate payable on Bermuda Government debt, to 7%. Under this scenario, the budget deficit reappeared in 2020-21, and remained a permanent fixture. We noted that it was highly likely that this scenario would at some point lead to a complete loss of market access to financing (a "sudden stop"); in such an event, emergency fiscal measures – that is, tax increases and/or spending cuts – would be necessary.

40. The COVID-19 crisis represents a far larger and more immediate shock. The Government's current projections are that, compared to the forecasts set out in the 2020-21 Budget (or the base case presented in our 2019 report), revenues will fall by nearly $210 million this fiscal year, while COVID-19-related spending (primarily on unemployment benefits, support to businesses, and obligations under the revenue guarantee provided to the airport operator) will amount to about $125 million.

41. In the absence of any action to mitigate these impacts, the borrowing requirement in the current year would have exceeded $360 million, approximately 40% of revenue. As noted above, the Government has taken a variety of emergency measures to reduce spending in this fiscal year, estimated to save approximately $73 million, reducing the borrowing requirement in the current year to about $294 million—still over 30% of forecast revenues. Put another way, the measures taken so far, while significant, account for only a fifth of this year's fiscal shortfall.

42. In August, the Government of Bermuda raised $1.35 billion in the international capital markets at historically low rates. Two new Senior Notes were issued, split evenly into a 10-year maturity at a record low coupon of 2.375%, at 170 basis points, the smallest spread over 10-year US Treasuries ever achieved by Bermuda, and Bermuda's first ever 30-year note at 3.375%, 195 basis points over Treasuries. Concurrent tender offers refinanced $500 million while $331 million of short-term credit facilities with local banks was repaid. The Government's refinancing effort was supported by this Panel and the Financial Policy Council.

43. The new borrowing, together with the refinancing of current debt at now lower market rates, had a number of impacts—it reduced annual interest payments on existing debt by around $10 million, increased overall interest payments by about $3.1 million per year, increased outstanding principal, and generated a cash surplus which was deposited in the Sinking Fund to finance this year's deficit and that of subsequent years. The Government's debt position as of September 2020 is summarised in the table below.

Government Debt				
	MATURITY	**RATE**	**20 AUGUST**	**INTEREST**
140M SENIOR NOTES (multiple purchasers)	04/12/2022	5.730%	140,000,000	8,022,000.000
144Reg/S Bond	03/01/2023	4.138%	353,905,000	14,644,588.900
Local Bond	16/12/2023	4.750%	50,000,000	2,375,000.000
144Reg/S Bond	06/02/2024	4.854%	402,203,000	19,522,933.620
144Reg/S Bond	25/01/2027	3.717%	604,624,000	22,473,874.080
144Reg/S Bond	15/02/2029	4.750%	449,268,000	21,340,230.000
New 10-Year	20/08/2030	2.375%	675,000,000	16,031,250.000
New 10-Year	20/08/2050	2.375%	675,000,000	22,781,250.000
Total			**3,350,000,000**	**127,191,127**
				3.80%
Sinking Fund			**409,785,005**	
Net Debt			**2,940,214,995**	

44. In its published platform, the Progressive Labour Party committed to an objective for budget balance in three fiscal years, which we take to refer to 2023-24. However, it has not yet set out spending and revenue projections consistent with this: we assume these will be published in the 2021-22 Budget.

45. Fiscal planning and forecasting are extraordinarily difficult in current circumstances. Nevertheless, to fulfil our remit, it is necessary to produce plausible scenarios for Bermuda's future fiscal prospects. In order to construct a baseline scenario, we make a number of stylised assumptions:

- tourism-related revenues in the fiscal year 2021-22 return to 50% of normal (i.e. 2019-20), and stabilise at 75% of their originally forecast 2020-21 level in 2022-23 and thereafter, reflecting the likely reluctance of many potential tourists, even after the end of the pandemic, to venture on international flights or cruise ships;

- other revenues return to 95% of normal (i.e. their 2019-20 levels) in 2021-22, and to their 2019-20 level in 2022-23 and rise by 3% per year thereafter. This assumes that international business activity is essentially unaffected by the pandemic, and there are only limited spillovers from the reduction of tourism to the rest of the economy;
- once current emergency spending measures and spending cuts expire in the first few months of 2021-22, we assume that spending returns to its previous path; we also assume an additional $25m for COVID-19-related contingency spending (for example, vaccine procurement) in 2021-22;
- capital spending falls relative to the current level of $90 million, but, reflecting the Government's ambitions in this area, remains above the pre-pandemic level; and
- interest payments on Government debt remain stable until 2023-24, reflecting the prefinancing of the deficit for almost all of this period, but after that we assume the average interest rate on the debt stock rises gradually to 5.5%.

46. Under this scenario, which assumes some permanent damage to the tourism sector, but a full recovery in the rest of the economy, the deficit (and resulting borrowing requirement) falls sharply, but remains at a very elevated level, about $157 million, in 2021-22. Net debt reaches about $3.1 billion this year, and $3.25 billion, despite spending restraint, by the following year. This is before taking account of Government guarantees and contingent liabilities— which, as we have seen both in the case of Morgan's Point and the airport, can quickly become significant charges on the Government budget.

47. In 2022-23 the deficit falls sharply, as we assume a return to near normality. However, absent policy action, deficits continue indefinitely and begin to grow again, exceeding $50 million in 2023-24, as the debt is refinanced at higher interest rates. The debt-revenue ratio, currently at 340%, remains above the pre-pandemic level for the foreseeable future. This is in very sharp contrast to the target, set out in the original 2015 remit to the Panel, of 80%.

48. Under this scenario, the Government's cumulative borrowing requirement (ignoring short-term credit facilities) over the second half of 2020-21 and the subsequent two financial years would be about $350 million. Given the current balance in the Sinking Fund, this of itself would not require additional borrowing from the markets.

49. However, the Government will need to refinance a large amount of maturing debt, in particular the $354 million bond maturing in January 2023, at a time when the Sinking Fund will nearly been exhausted.[1] This means that, within two years, Bermuda will be at the mercy of the credit rating agencies and financial markets, themselves driven by unpredictable global events. The possibility of a ratings downgrade—driven either by external or domestic events—would hang over the country for the foreseeable future.

[1] We understand the Government has the facility to refinance the notes maturing in December 2022 on the same terms that were achieved in August.

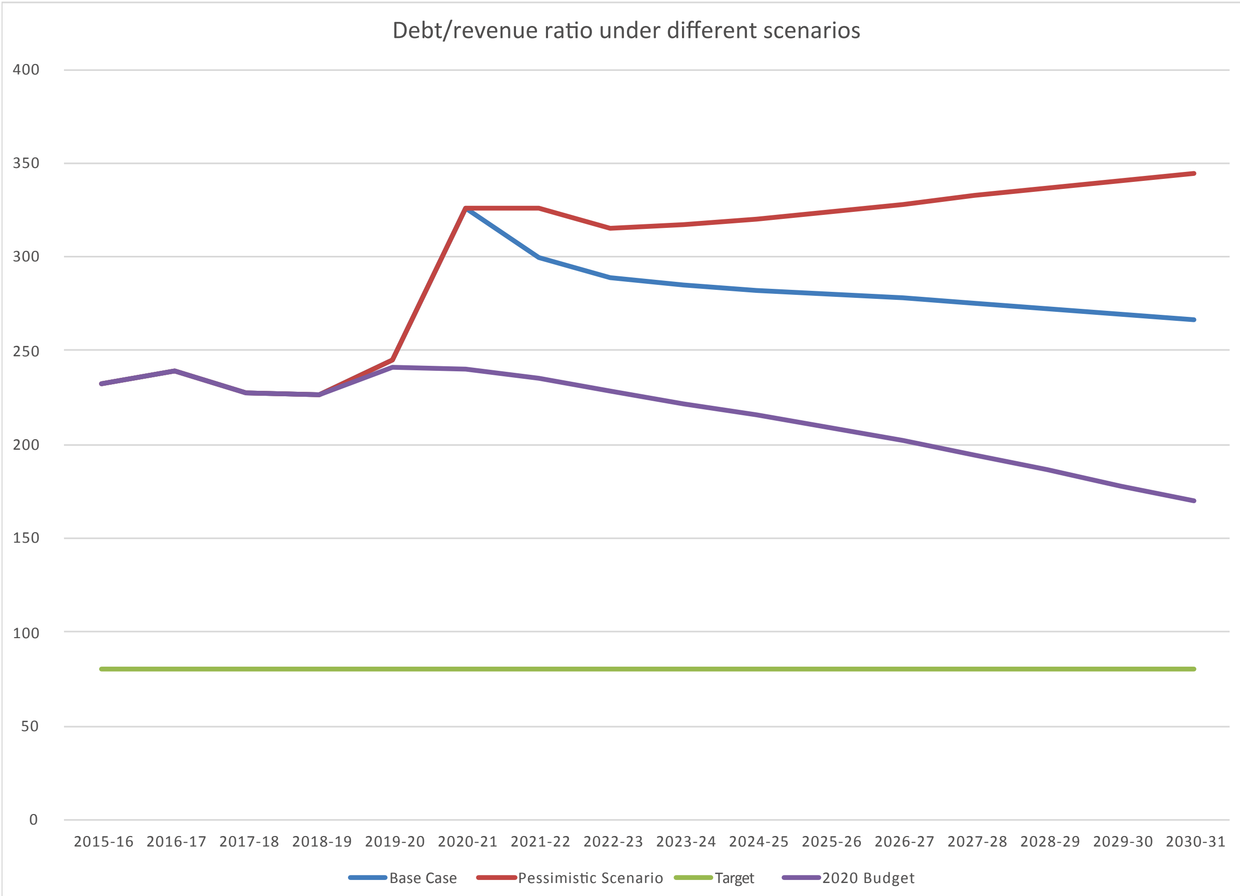
50. As problematic as this scenario might appear, we regard it as a sensible base case. It assumes that tourism will recover, albeit not fully, while international business returns to "normal", and that there are limited spillovers to the rest of the economy from the reduction in tourism. That requires that efforts to suppress the pandemic are broadly successful, not just in Bermuda but in the US and elsewhere, over the first half of next year at the latest; that there is little or no permanent damage to the global economy; and that there are not large permanent shifts in demand, driven either by government regulation or by changes in household behaviour, that might drive a deeper reduction in tourism (for example, widespread aversion to cruise ship-based holidays). And we assume no other major exogenous shock.

51. If any or all of these further risks materialise—and they are largely outside Bermuda's control—the outcome could be significantly worse. We therefore also model an adverse, but unfortunately far from inconceivable, scenario. This incorporates similar assumptions on spending and interest payments, but more pessimistic assumptions on economic activity and revenues, including a large permanent hit to tourism, and smaller but still significant long-term damage to the rest of the economy. Specifically, we assume:

- tourism-related revenues in the fiscal year 2021-22 return to 25% of normal and stabilise at 50% of their 2019-20 level thereafter; and
- other key revenues, including customs duties, return to 90% of normal in 2021-22, and stabilise at 95% of normal thereafter.

52. Under this scenario, the debt and debt to revenue ratio are clearly on an unsustainable path. The deficit remains at very elevated levels – $220 million in 2021-22 and $100 million in 2022-23, and then begins to rise again, as interest payments on the very large debt stock increase. The debt to revenue ratio follows a similar course.

53. Since the debt would be on a clearly unsustainable trajectory, it would be inevitable that Bermuda's credit rating would at some point be downgraded and interest rates on new debt would be higher, probably by a substantial amount. In practice, the Government would be forced to impose very large emergency tax increases and spending cuts, perhaps accompanied by capital flight and a consequent foreign exchange crisis. This scenario is clearly unacceptable.



54. As the chart shows, the pandemic has led to a sharp increase in the debt/revenue ratio; and, even in the base case, it will remain much higher than forecast in the 2020 Budget for the foreseeable future. In other words, even in the base, case scenario with unchanged policies, Bermuda is gambling that international financial markets remain willing to lend freely at low interest rates; in a pessimistic scenario, it is heading for a fiscal cliff. Given the uncertainties, it is obviously not possible to attach specific probabilities to these scenarios. And even if recovery in the short term is stronger than we or the Government currently assume, this does not significantly alter the medium-term picture, in particular the need to refinance a large amount of debt by early 2023 at the latest. Our view therefore is that a failure to take early action involves an unacceptable level of risk.

55. Our recommendations, set out in the following section, are framed accordingly.

H. The Way Forward

Fiscal strategy and tax measures

56. In its election manifesto, the Government made a number of pledges, including a commitment to budget balance by fiscal year 2023-24, a reduction of payroll taxes on low-income earners, broadening the tax base to increase revenue, and a request for a reconstituted Tax Reform Commission (TRC) to re-examine possible tax reforms. The manifesto also pledged to increase spending, both on infrastructure projects and public services. Delivering on these promises while achieving the balanced budget target, necessary to put debt on a sustainable trajectory, will be very challenging, even without the additional uncertainties of the pandemic and the continuing demands that management of the COVID-19 crisis has placed on the health ministry.

57. As noted above, our estimates imply that there is a fiscal gap of at least $50 million if the budget is to be balanced by 2023-24. Beyond this, reducing Bermuda's debt is likely to require revenues commensurate with its income level and that of most of its regional comparators.[2] We therefore recommend that the Government aim to at least restore revenues to the pre-COVID-19 (i.e. 2019-20) level of $1,110 million by 2022-23, with a further significant increase in 2023-24 to meet the balanced budget target.

58. Beyond budget balance in 2023-24, the Government should target a budget surplus of $50 million per annum, as we recommended in 2019, to be achieved over the subsequent three years, i.e. by fiscal year 2026-27, and continued thereafter. Such a surplus would allow a reduction in the debt to revenue ratio by at least 5 percentage points per year in each year thereafter. Targeting such a surplus would set a clear overall framework within which the Ministry of Finance could operate, while giving the Panel a benchmark against which to assess progress.

59. These fiscal targets would balance the need for the Government to support the economy in the short term, as it recovers from COVID-19, and provide the increased tax revenues required to move towards fiscal sustainability over the longer term. In order both to prevent hardship and to support overall demand, the Government should consider unemployment benefits and other forms of time-limited business support to deal with the specific burdens of the pandemic.

60. The TRC should be reconvened as soon as practicable with a clear, time-limited mandate to propose measures that would raise Bermuda's tax ratio to a level commensurate with comparator countries, achieve the medium-term revenue targets described above, broaden the tax base and move toward a more progressive tax structure on personal income that taxes earnings from capital as well as labour. It should be mandated to provide a report to the Government by June 2021, to allow measures to be implemented in 2022-23. Given the amount of existing work on these issues, this should be feasible.

61. In particular, based on the previous TRC report and earlier CARTAC recommendations, we suggest the early announcement, and introduction as soon as practicable, but certainly over the next two to three years, of:

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[2] Bermuda's tax to GDP ratio, at under 17 per cent, remains significantly below those of many other Caribbean economies: Bahamas 19.0; Barbados 27.5 – 29.1 (2018/19 estimate); Dominica 23.3; Grenada 21.4; St Kitts and Nevis 19.5; St Lucia 20.5; and St Vincent and the Grenadines 25.7.

i) a tax on dividend and interest receipts;

ii) an annual rental tax on owners of large properties and multiple units (thus exempting all but high earners);

iii) an increase in taxes on sugar and other unhealthy products; and

iv) a carbon tax.

62. The Office of the Tax Commissioner has made significant progress over recent years in improving the efficiency and timeliness of tax collection but, as we have repeatedly emphasised, the Government needs to ensure it is appropriately resourced to continue this task as well as to implement any tax changes that might be proposed. Tax arrears remain substantial ($85 million in 2018), as noted in the most recent Auditor General's Report, and are likely to have grown considerably during the pandemic.

63. Over the medium-term, we support a move to a more comprehensive progressive tax on all forms of personal income. While we are sympathetic to the idea of a reduction in payroll taxes on low-income earners, the fiscal arithmetic set out above means there is no scope for tax cuts now. These must form part of a broader reform of the tax system aimed at a sustainable increase in tax revenues overall and the proper taxation of income from capital assets alongside labour income.

64. Bermuda will need to ensure it maintains a strong position in its international negotiations on tax harmonisation issues. This might mean that it could prove necessary, in the future, to increase revenues from multinational companies registered in Bermuda, whether by increasing registration fees or, over the medium to longer term, the introduction of a corporate income tax at a modest rate, as is the case in some other small island jurisdictions such as Jersey and Guernsey, and we recommend that the TRC also examine the merits of such an approach.

Fiscal targets and fiscal rules

65. We recommend that the Government put in place a fiscal framework with clear rules to ensure fiscal sustainability over the longer term. This would reflect international and regional best practice. As recommended in our 2019 report, this framework should include specific and time-bound fiscal targets. Our recommendations above imply a rising budget surplus in the three years following 2023-24, and a $50 million per annum surplus thereafter so as to reduce both the debt and the crucial debt/revenue ratio.

66. Beyond this, it has become increasingly common among neighbouring countries to introduce a medium-term fiscal framework that also includes binding fiscal rules (see Box). The Government may wish to consider such mechanisms, which could enhance transparency, add to fiscal discipline, and provide for more effective targeting of fiscal policy through the adoption of fiscal anchors and fiscal rules, while maintaining flexibility in the event of unanticipated shocks.

Box: Recent innovations in Budgetary Policy in the Caribbean

Over the last decade, several small states in the Caribbean—notably, the Bahamas, Grenada, Barbados, St. Kitts and Nevis—have or are in the process of forcefully addressing the challenge of reducing unsustainably high debt to GDP ratios. The key elements have included framing their budgets to achieve fiscal anchors within a formal transparent medium-term fiscal framework, passing Fiscal Responsibility Legislation, and adopting fiscal rules that give teeth to these targets. Some have also begun to build up savings funds to foster resilience in the face of the risk of climate-related natural disasters.

The Bahamas framework under its Fiscal Responsibility Law (FRL) establishes three specific fiscal rules to be achieved over a transition: **(i)** a ceiling on the overall budget deficit (set as a share of GDP); **(ii)** a ceiling on the annual current expenditure growth rate set at the long-term nominal GDP growth rate **(iii)** and a ceiling on government debt as a share of GDP, to be achieved at a target date. A compliance margin of ½ percent of GDP is set. A fiscal council was also established to help enhance transparency and bolster the credibility of the rule-based policy framework.

Other countries, such as Grenada, under its Fiscal Responsibility Legislation, focused their expenditure rule on primary spending of the central government and specific parastatal entities, in line with estimated potential output growth, allowing the actual primary budget to be cyclically adjusted. They also introduced a "stock correction mechanism" to require adjustment measures if public debt exceeds the targeted level during three fiscal years. Also, important, the rule-based framework includes escape clauses that suspend the rule-based framework with well-defined triggers to provide policy flexibility to address rare events, such as natural disasters or public health epidemics.

Source: International Monetary Fund, *The Bahamas, 2019 Article IV Consultation and Staff Report* (IMF Country Report No 19/198 (July 2019); International Monetary Fund, *Grenada, Second Review under the Extended Credit Facility* (July 2015).

Expenditure policy

67. The COVID-19 crisis, with its adverse effects on government revenues, forced the Government to implement a number of measures to reduce expenditure. To continue to contain costs, particularly given the prevailing uncertainties on how quickly the economy will rebound to its pre-COVID-19 level, and limit increases in the tax burden on the private sector, the Government will need to impose a tight budgetary regime in 2021-22. In current circumstances, an across the board cut in most major spending Departments and agencies, while crude, is both justified and necessary. The key exception would be the Ministry of Health, given the additional manpower, supply and vaccine costs required for the containment of the pandemic.

68. Over the medium term, more fundamental reforms are required. While there have been various previous government initiatives (the Sage Commission Report, the Efficiency Committee's agenda for action, and recent zero-based budgeting efforts), this has not yet translated into significant savings. Recently, the Government has sought to shift from a functional to a service-centric budget. Current policies of attrition now need to be paired with a new Sage Commission, one that can propose ways to deliver public services within a tightened budget. This should include revisiting the role and cost of the many Quangos in the public sector and, where appropriate, buyout packages for redundant public sector workers.

69. The Government's recent election manifesto calls for investments that can make the Government's provision of services more efficient. Many small states in the Caribbean have also revisited their public investment appraisal processes to ensure an adequate rate of return on capital expenditures. This is advisable and could include assessment of whether the existing and proposed capital infrastructure is resilient to the potential impact of climate change, a rising sea level, and natural disaster shocks.

Addressing the crisis in the healthcare system

70. Bermuda's health care costs are among the highest in the world and its rapidly ageing population has a high incidence of chronic illness. A significant part of the population lacks insurance, and the health system has been struggling to finance the cost of those requiring long-term care services. Last year, the Government presented a vision of policy reform that sought to move towards a unitary health insurance financing system, while preserving the quality and effectiveness of medical care, increasing efficiency, reducing duplication, and minimising costs. Some initial steps at implementation were taken. Our 2019 report examined these proposals in depth and broadly endorsed them. They built on international experience gained among the more successful advanced and emerging market countries in providing cost-effective health care in the context of an ageing population.

71. The COVID-19 crisis makes the need for reform far more urgent. The BHB has faced mounting costs in its response to the crisis. Looking forward, its capacity to finance its debt will need to be carefully managed, given the Government's contingent liability for the debt. With increasing unemployment, many workers were no longer insured and have had to rely on the emergency unemployment benefits or financial assistance to help cover their insurance—coverage which expires in March 2021.

72. The Minister of Health has recently announced that the Bermuda Health Plan will be implemented over the next year. The pandemic has exacerbated the challenges faced by the Ministry but it is apparent that the Government is working closely with its external consultants to fully elaborate its proposals, clarify a timetable for its phased and full implementation over the next several years, and pass the legislative measures required for action. Reforms will be necessary to shore-up the financing of the system and these will most likely require greater progressivity in burden sharing, both among taxpayers and the elderly. Risks, both financial and related to the implementation of the reforms, are high. We share the view of the Government that this can no longer be viewed as a long-term challenge, but one that requires sustained policy action over the next two years.

Rebuilding the financial sustainability of the public pension system

73. The foundations of Bermuda's social insurance system have been undermined by long-standing demographic developments and lack of policy resolve. Recent pre-COVID-19 reports by the Government's actuaries clearly indicated what reforms would be needed to reduce the size of the unfunded liabilities, all of which constitute significant potential contingent liabilities which could add to the burden of the Government's mounting debt. The political economy of pension and social insurance reform has become even more challenging in view of the COVID-19 emergency decision to forego Government employee and employer contributions for pensions and social insurance. Also, the decision to allow private sector employees to withdraw some of their pension savings under the private sector pension system underscores the importance of the financial position of the CPF as a first-pillar source of private sector retirement income.

74. As a first step, we believe that the Government should move quickly, in the context of the 2021-22 budget, to restore contributions for the PSSF and the CPF. As the Government well understands, more fundamental measures are needed to address the financial sustainability of the pension system. The Government is actively consulting on alternative policy approaches with external consultants. In previous reports we have argued that increased payroll contributions to the CPF would be desirable, and that contributions based on income (rather than on a flat basis) would be appropriate (as suggested in the 2018 Throne Speech).[3] An increase in the CPF pensionable retirement age would put Bermuda more in line with other comparator countries.

75. Reforms to the PSSF are not likely to require immediate expenditure outlays by the Government or its employees, but as indicated in previous reports, they will require gradual adjustment by Bermuda's citizens as they plan for retirement.[4] In particular, drawing from the experience of other comparator countries, we believe the Government should emphasise reforms that would (i) substantially increase, in a phased manner, the retirement and pensionable age of most public service workers enrolled in the PSSF to age 70 (given the significant increase in longevity of pensioners);[5] (ii) increase the reference wage period to reflect a longer period before retirement; and (iii) reduce the rate of accrual for pension benefits. We would also encourage the Government to review whether its investment portfolio for these funds is achieving an adequate return, given the costs of investment management (possibly deriving benefit from the substantial local expertise of financial sector experts on the Island).

Immigration

76. Immigration has been a contentious political issue in Bermuda, one that has been the subject of intense discussion in the last few years. It is recognised as offering an important counterweight to the negative impact of Bermuda's adverse demographics on its potential growth and wellbeing. COVID-19 presents an opportunity. Thanks to a robust policy response, the Island has not been badly hit by the pandemic, and it can credibly claim that it is well prepared for

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[3] Alternatively, for the next 10 years, the contribution rate could be scheduled to rise more rapidly than benefits.

[4] Such reforms also are needed for the Ministers and Members of the Legislature Pension Fund.

[5] Drawing from a proposal by the Labour Advisory Committee in July 2019 (and tabled by the Premier), the retirement and pensionable age of most public service workers (excepting police officer and fire fighters) should be increased over 10 years from 65 to 70, with the retirement age to be moved to 68 over a five-year period and with actuarial reductions for early retirement prior to age 70. Some protection should be afforded to those workers close to retirement.

future such events (whether a recurrence of COVID-19 or other pandemics). Bermuda should be an attractive place to live and work during the pandemic, as the success of the 'Work from Bermuda One Year Residential Certificate,' has shown, particularly for skilled individuals who can work either remotely in sectors like finance and insurance or more directly in the provision of health care. Beyond that, Bermuda could, potentially, be very attractive post-COVID-19, but that will require Government action across a range of policies – economic stability, fiscal credibility, liberalised immigration laws governing residence and citizenship, and safe but traveller-friendly arrangements for travel.

77. But to take advantage of these opportunities, radical reforms to the immigration system are needed. Many of Bermuda's skilled workers are torn between a desire to continue working in Bermuda and restrictions that imply that they and their dependents may not be able to live and work in Bermuda in the future as citizens. Such a situation ultimately makes Bermuda less attractive both for businesses and people. It also reduces investment in the domestic economy, since many of Bermuda's highest earners (not to mention potential investors interested in starting a business in Bermuda) cannot assume that they are resident for the long term. Now more than ever, this is exceptionally counterproductive, when Bermuda desperately needs private sector investment in the domestic economy.

78. Bermuda needs to make it easier, not just for people to come to work, but to stay and contribute to the Island on an ongoing basis, and, eventually, to settle permanently, with appropriate rights, responsibilities, and security for their families and children. Such changes have been long debated. In a post-COVID-19 world, they are more necessary than ever.

79. Such a policy would help increase investment, boost tax revenues and help address the demographic crisis. There would be other collateral benefits if it reduced reliance on temporary seasonal workers and reduced foreign exchange outflows from workers who do not see Bermuda as their permanent home. With the reform of the health care system, it may also be necessary for Bermuda to expedite the provision of visas for health care workers.

Climate Change

80. Bermuda was threatened by two major hurricanes (Paulette and Epsilon) this year, and the season is not yet over. Fortunately, Bermuda has weathered these storms well, in part reflecting its strong building codes, and in part due to good luck. But the Director of the Bermuda Weather Service, Dr. Mark Guishard, has underscored the increasing risks posed to Bermuda's physical infrastructure and coastline from climate change. As climate change intensifies over the next decade or so major storms will become both more frequent and more severe; 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.

81. In our last report, we proposed that the government carry out an assessment of the economic and financial risks entailed, both in the short to medium term, from the higher probability of major hurricanes and coastal inundations, and in the longer term from the multiple hazards arising from a changed climate.[6] We also noted the ad hoc and fragmented responsibility for climate-related issues. We recommend the establishment of an agency charged with monitoring climate-related environmental indicators, providing risk assessments of threats, and making proposals to mitigate its risks. It could follow the practice of some other Caribbean nations that have moved more aggressively in laying out a climate change adaptation strategy, with identified priorities for achieving physical and financial resilience to climate change risks (see Figure below).[7] At a minimum, such a strategy would involve the financing of critical climate-resilient infrastructure, avoiding capital investment in high risk locations, the establishment of a budget-financed climate resiliency fund, and participation in risk-transferring approaches to cover the potential costs of catastrophic storms.

Figure 4. National Disaster Resilience Strategy
(Three complimentary pillars)

6 The last Government effort to assess climate risks occurred in 2004 with a coastal erosion study commissioned by the Department of Planning. The last major private study on The Impact of Climate Change on Bermuda occurred in 2008 in a report by the Bermuda National Trust.

7 International Monetary Fund, *Building Resilience in Developing Countries Vulnerable to Large Natural Disasters: IMF Policy Paper* (June 2019).

Economic Growth, Diversification and Resilience

82. The Government has long recognised that reliance only on the international business and tourism sectors leaves the country highly vulnerable; the COVID-19 crisis directly threatens the latter. Diversifying the economy, while building on Bermuda's strengths, requires measures aimed at generating an enabling environment that capitalises on potential post-COVID-19 realities, from emerging travel restrictions and work dynamics to redefined geographical, health and social expectations. Meanwhile, higher economic growth will lead to increased tax revenue and a more robust fiscal position.

International Business

83. The international business sector is the largest and growing contributor to the Island's GDP, the main provider of its tax and foreign currency, and the largest private sector employer; in addition, it supports a wealth of technical and ancillary services such as actuarial services, accounting and law. While Bermuda's regulatory regime and competent handling of the pandemic has been well received by the sector, it is essential that the Government is sensitive to the sector's needs going forward. This will include controlling the high cost of doing business in Bermuda, including payroll taxation; maintaining regulatory equivalence with the key markets in the US, EU and UK; and an immigration policy that welcomes key personnel and their families and keeps jobs and income in Bermuda.

Travel and Tourism

84. The tourism sector is an important source of employment, tax revenue and foreign exchange for Bermuda, but it was essentially closed by the successful measures taken to contain the spread of COVID-19 on the Island. As the sector reopened, the Government held a 'Reset, Re-imagine & Renew' Tourism Summit and appointed the Premier as Minister for Tourism. The Bermuda Tourism Authority is developing a new strategic plan. It has tried to strike a balance in terms of promoting tourism and the restrictions needed in terms of testing and quarantine requirements to make Bermuda a relatively attractive destination; the Island cannot afford to jeopardise its success in suppressing the virus. This will become easier as more experience is gained with the use of quick and accurate tests rather than extended quarantine periods, and the likely widespread availability of vaccines in 2021. It would be sensible for Bermuda to coordinate its actions, to the extent possible, with other tourist states, particularly in the Caribbean, to ensure both a standardised approach and avoid a "race to the bottom." This will need constant monitoring, particularly regarding cruise traffic.

Other Growth and Diversification Initiatives

85. The Panel welcomes the creation of the Economic Advisory Council, formed of local business experts, with a mandate to 'make recommendations to the Minister of Finance for a comprehensive (economic recovery) plan to protect jobs and stimulate economic activity over the short, medium and long term', as well as the formation of the Department of Economic Development to coordinate initiatives.

86. Measures that have been taken, or are planned, to boost the economy, include facilitating business travel; furthering the economic substance strategy to encourage businesses to have a larger physical presence in Bermuda; favouring local firms in public procurement, including for digitising government services; promoting medical tourism; establishing a cannabis industry; incentivising vertical farming and aquaponics to promote leafy vegetable production; establishing a virtual market for small businesses and a fishing cooperative to purchase larger boats; and the granting of new telecommunications licences (including for a submarine cable). A fast track work permit system is in place for businesses setting up or relocating to Bermuda.

87. Bermuda has an opportunity to build on its internationally respected financial regulatory framework and successful international business sector. This could include facilitating the growth of businesses that flow from the concentration of intellectual capital in Bermuda that originates from the insurance sector. But considerable care needs to be taken given the potential reputational risks. The Government's focus on fintech, if pursued prudently, is broadly appropriate and its proposal to create a Bermudian-owned National Digital Bank mirrors similar proposals recently being considered by other countries; it will, however, be important to ensure that project appraisal and lending is rigorous and independent of government.

88. More broadly, access to finance for start-ups and small and medium sized enterprises is a concern. There seems to be no domestic venture capital market for high risk start-up capital. The absence of any requirement that businesses provide routine financial statements or accounts or clear legal procedures for handling company failures in the non-financial sector may represent a further hindrance to business financing. We welcome the news that the Pension Commission will assist in providing more on-Island investment options, making it easier for workers to voluntarily invest their funds in approved economic development activities in Bermuda. This echoes our 2019 Panel Report recommendation that private sector employees might wish to designate some of their pension savings to be allocated to domestic investments in viable projects. However, this move will need to be accompanied by appropriate controls aimed at ensuring the liquidity and solvency of the funds.

89. As the Panel has noted previously, Bermuda is a small, remote, high-cost island with a domestic skills base that is currently insufficient to support new high-growth industries. The bipartisan commitment to the Education Plan 2022, and vocational training and reskilling is therefore welcome. The Government has the opportunity to leverage the international business sector's skills and resources to help level up and expand the domestic economy, working with Bermuda College to provide education and training, internships and mentoring for Bermudians and small local businesses. This would increase the integration of the international business sector within Bermudian society.

I. Recommendations and Conclusions

90. The COVID-19 crisis required that the Government take immediate actions to protect the population and mitigate the economic consequences for businesses and livelihoods. Bermuda's response has, by global standards, been exemplary. It has successfully addressed the health crisis, in turn allowing the economy to reopen, while protecting the population. But the fiscal and debt impacts have been considerable. Measures must now be taken to preserve the gains that have been made, to shore up the public finances, and to build confidence in the Government's fiscal plans and resilience for the future. While difficult decisions will have to be taken, the crisis offers an opportunity to reconsider important aspects of the public finances, society, and the economy.

91. Our previous reports have highlighted what Bermuda's leaders have long recognised as serious concerns affecting Bermuda's fiscal and economic position. These include a population that is shrinking and ageing, with fewer workers and far more elderly, many with chronic and debilitating health problems; reliance on a highly competitive and sought after international business sector for much of its economic output; a social insurance system that continues to accumulate significant unfunded liabilities which add to Bermuda's potential public debt; a tax system that heavily burdens its working population relative to those with income from assets; and its island economy increasingly at risk from the multiple hazards of climate change.

92. We paint a stark picture of Bermuda's fiscal challenges, but one that is shared and recognized by the Government itself. In mid-November, the Minister of Finance characterised the deficit as "not only unsustainable but economically and financially imprudent." He underscored the risks, and that dealing with the deficit "will require some sacrifice from all sectors of [the Bermudian] community." In the next two years, even under the more optimistic scenarios described above, Bermuda's fiscal path will be very narrow, with its financial scope limited both by the size of the debt maturing in 2023-24 and the speed with which its financial cushion in the Sinking Fund will be drawn down by fiscal deficits, with nothing left for contingencies.

93. Our recommendations cover those that require attention now and the much-needed, structural reforms that address long-term fiscal challenges (as we have recommended in previous reports). They should be viewed as a comprehensive package aimed at the above objectives.

Fiscal targets: Our estimates imply that there is a fiscal gap of at least $50 million if the budget is to be balanced by 2023-24. We recommend that the Government aim to at least restore revenues to the pre-COVID-19 (i.e. 2019-20) level of $1,110 million by 2022-23, with a further significant increase in 2023-24 to meet the balanced budget target. Beyond budget balance in 2023-24, the Government should target a budget surplus of $50 million per annum, to be achieved by fiscal year 2026-27, and continued thereafter.

Fiscal strategy and tax reform: The Tax Reform Commission should be given a clear, time-limited mandate to provide a report to the Government by June 2021, to allow measures to be implemented in 2022-23. The objective of such measures should be to achieve the medium-term revenue targets described above, broaden the tax base and move toward a more progressive tax structure on personal income that taxes earnings from assets as well as labour. We suggest, over the next two to three years, the introduction of

i) a tax on dividend and interest receipts;

ii) an annual rental tax on owners of large properties and multiple units (thus exempting all but high earners);

iii) an increase in taxes on sugar and other unhealthy products; and

iv) a carbon tax.

The TRC should also examine the case for, over the medium to longer term, the introduction of a corporate income tax at a modest rate, as is the case in some other small island jurisdictions such as Jersey and Guernsey.

Public expenditure: the Government will need to impose a tight budgetary regime in 2021-22; an across the board cut in most major spending Departments and agencies is both justified and necessary. Over the medium term, more fundamental reforms are required.

Healthcare: While Bermuda's healthcare system has responded well to the crisis, it has long been clear that its financing is both unsustainable and inequitable. We endorse the Government's programme of reforms. These will require greater progressivity in burden sharing. Risks are high, and sustained policy action over the next two years is required.

Pensions: The foundations of Bermuda's social insurance system have been undermined by long-standing demographic developments and a lack of policy resolve, now accentuated by measures taken to address the COVID-19 crisis. The Government should as planned restore contributions for the PSSF and the CPF. Fundamental reforms, including increases in retirement age and income-related contributions to the CPF, will also be necessary.

Immigration: COVID-19 presents a potential opportunity. Bermuda should be an attractive place to live and work. But to take advantage of these opportunities, radical reforms to the immigration system are needed. Bermuda needs to make it easier, not just for people to come to work, but to stay and contribute to the Island on an ongoing basis, and, eventually, to settle permanently, with appropriate rights, responsibilities, and security for their families and children.

Climate Change: We would encourage the Government to carry out an assessment of the physical, economic and fiscal risks that climate change might pose to the Island, and where necessary invest further in measures to improve its resilience. Furthermore, responsibility for assessing such risks should be vested in a designated government agency, with clear lines of accountability.

Economic growth and diversification: Economic growth and diversification will be important to increase the tax base and decrease reliance on only a few sectors. Bermuda has an opportunity to build on its internationally respected financial regulatory framework and successful international business sector. Measures to boost domestic investment, including the establishment of a National Digital Bank, are also welcome. However, there are potential risks attached to such initiatives and appropriate governance and regulation will be essential.

94. We have aimed to set out a far-reaching and comprehensive package of measures. But these proposals originate not merely from us, but from a wide variety of Bermudian stakeholders, in Government, Opposition, business and civil society. Many have been discussed and debated over a period of years. The aftermath of the COVID-19 crisis make them more necessary than ever and the Government's strong showing in the recent election provides it with an unprecedented window of opportunity to act.

Annex A: List of Meetings Held by the Panel

The Honourable David Burt MP, Premier

The Honourable Curtis Dickinson MP, Minister of Finance

The Honourable Wayne Furbert MP, Minister for the Cabinet Office

The Honourable Kim Wilson MP, Health Minister

The Honourable Cole Simons MP, Leader of the Opposition

Ministry of Finance

Ministry of Health

Office of the Tax Commissioner

Pensions Commission

Bermuda Health Council

Bermuda Business Development Agency

Association of Bermuda Insurers and Reinsurers

Bermuda Bankers Association

Bermuda Hospital Board

Bermuda Monetary Authority

Bermuda Tourism Authority

Bermuda Trade Union Congress

Bermuda Chamber of Commerce

Dr. Mark Guishard, Bermuda Weather Service

Nathan Kowalski (Economic Consultant)

The Fiscal Responsibility Panel