



**CAYMAN ISLANDS  
GOVERNMENT**

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# **2013/2014 BUDGET ADDRESS**

## **ECONOMIC GROWTH THROUGH FISCAL PRUDENCE**

**PRESENTED BY: HONOURABLE MARCO ARCHER  
MINISTER FOR FINANCE AND ECONOMIC DEVELOPMENT**

**7<sup>TH</sup> OCTOBER 2013**

Madam Speaker, it is with considerable optimism that I present the first Budget of the newly elected Government, and my first as Minister of Finance and Economic Development. Although these are trying times, I am optimistic for the people of the Cayman Islands. A people who have experienced the impact of a weak economy for far too long; a people who have suffered with unemployment, rising cost of living, and rising crime; a people who almost lost confidence in the very institution of government and its purpose.

But, we are not a people who succumb to circumstance; we are resilient, we persevere, and always strive to rise above our challenges. And, Madam Speaker, our ability to transform the challenges of today, into opportunities for tomorrow, will be largely dependent on a fiscally prudent government.

This budget and the amounts set out in the Appropriation (July 2013 to June 2014) Bill, 2013 allocates resources to meet these challenges; and is aimed at getting the economic fundamentals right, with accountability, transparency, and prudence being the new *modus operandi* throughout all of government.

As we seek to grow our country's economy, we acknowledge the constraints in our expenditure plans, while wholeheartedly embracing the need to be fiscally prudent. As such, I have entitled my Budget Address, "**Economic Growth through Fiscal Prudence.**"

It is important to understand the context of my theme. A government's fiscal policy during difficult times is considered prudent when it is geared toward enhancing revenue mainly through economic growth, while targeting reductions in expenditures to lower the overall fiscal deficit, reign in public debt, and avoid increasing interest payments.

The public sector, therefore, should not accumulate debt at a faster rate than the growth of the domestic economy. Prudent fiscal management also involves generating operating surpluses to support capital expenditures, and accumulating cash reserves to lessen the effects of an economic slowdown. Madam Speaker, it is upon this foundation of fiscal prudence that this Budget is built.

If we learn anything from history, perhaps we should heed the famous Roman statesman, Marcus Cicero, whose timely wisdom came 55 years before the birth of Christ. I quote:

***"The budget should be balanced, the treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance to foreign lands should be curtailed lest Rome become bankrupt. People must again learn to work, instead of living on public assistance."***

Cicero's words ring true today as it did in his time. His influence eventually led Rome towards a balanced budget, reduced public debt and lowered unemployment. Rome then went on to have almost 400 years of prosperity. The lesson I am trying to convey is that our hard times will end and we should strive for an end that is sooner, rather than later.

Madam Speaker, the fiscal policy of the Cayman Islands Government over the medium-term adheres to the definition of fiscal prudence. Revenues and expenditures are planned in such a manner that instead of increasing public sector debt, such debt will be declining. Our fiscal policy targets a modest revenue increase that is non-inflationary, and at a rate that is below projected economic growth, so as not to stifle our fragile economic recovery. This will be accompanied by a decline in total government spending without compromising necessary social investments.

Consequently, total debt of the Cayman Islands Government as a percentage of GDP is forecast to decline from 25.6 % in Fiscal Year 2012/13 to 23.2 % in the current fiscal year, and further to 17.1 % by the end of Fiscal Year 2016/17.

Some may be questioning whether fiscal prudence can indeed lead to economic growth. Normally one associates fiscal prudence with contractionary policy measures. However, this is not always the case. Fiscal prudence can lead to economic growth by reducing the private sector's tax burden, leaving businesses with important capital to expand their operations and create additional jobs.

Madam Speaker, fiscal prudence contributes to macroeconomic stability, primarily in three ways:

**First**, by stemming the growth of government expenditure, a prudent fiscal policy can minimize excessive demand in the economy and reduce inflationary pressures. In this way, households and private businesses alike can benefit from the low inflation, encouraging consumption and investments and ultimately, employment growth;

**Second**, the government's debt-reduction plan over the medium-term is helpful to local investors that depend on the global financial market. It is a general principle that the private sector's cost of borrowing from global financial markets will be lower, once the credit rating of the government of the jurisdiction they are operating in is high. Our debt-reduction plan ensures that the currently high credit rating that the Cayman Islands Government enjoys (Aa3) will remain. This is particularly crucial in these times of turbulent global financial markets which tend to increase the cost of borrowing due to higher risk premiums; and

**Finally**, Madam Speaker, fiscal prudence can also lead to long-term economic growth provided social investments are prioritized in the spending program. It is generally accepted that long-term economic growth depends heavily on investments in the education sector and other necessary capital investments to maximize the productivity of the work force. Therefore, a larger share of these items in the government's budget, notwithstanding the budget's overall reduction in the medium-term, will ensure a positive impact of our fiscal policy on long-term economic growth.

Though we are facing a number of sizeable challenges, this administration will not only reign in spending, but we will also become more rational in the way we approach public spending. Our current fiscal position implores us to make tough but thoughtful decisions. We must live within our means, and question every dollar the Government spends whether that is within a core government department or in one of our Statutory Authorities or Government Companies.

In the Progressives 2013 Manifesto, Members of the People's Progressive Movement laid out a vision of a prosperous future for our Islands in recognition of the great potential we hold. Today, along with the independent MLA's, our government remains committed to that vision. This Budget is the declaration of our intent to begin fulfilling the promises we made to the nation by putting us on a path to fiscal sustainability.

Together, we must carefully assess our strengths and weaknesses, and focus on the strategies that will help us achieve our goals. These strategies must include:

1. **Restoring trust and confidence** in the government, by working more efficiently, promoting transparency, and reducing the overall cost of operating government. In particular, emphasis will be placed on building partnerships within core government and with the Statutory Authorities and Government Owned Companies, so that each unit is not working in isolation; making key investments in our people and our future, by continuing to provide the best opportunities for education locally and overseas, including appropriate training and vocational initiatives;
2. **Upholding fundamental human rights**, as it relates to reducing crime and ensuring a fair and efficient judicial system for all; and
3. **Encouraging and supporting appropriate investment** which will put us on a path to economic stability.

Madam Speaker, given our present fiscal position, certain levels of services and initiatives have had to be decreased or delayed in order to fulfil our long/short-term commitments. And although we have rejected general across the board cuts that threaten our priorities in education, employment, and the provision of basic social services for the neediest persons in our society, nonetheless, we pride ourselves in **practicing practical prudence**, and we have ensured that the 2013/14 Budget allocates the necessary resources to keep pace with the growing demands for healthcare, education and social services, while protecting our borders and exploring opportunities for business prosperity.

We also recognize that we cannot do this alone and will work together – our Cabinet and the other members of this honourable house - to make the necessary decisions and implement the systems and processes to make our plan work.

## 2012/2013 FISCAL POSITION

Madam Speaker, I would now like to review with you the Government's unaudited fiscal performance for the previous fiscal year which ended on 30 June 2013.

The Entire Public Sector recorded a net Operating Surplus of \$63.3 million. The Government's Net Assets were \$1.3 billion. The Cash Balance was \$117.06 million and core government debt stood at \$575.9 million.

These results formed the basis from which the analysis and work necessary for the preparation of the 2013/14 Budget would begin.

## 2013 - 2017 MEDIUM TERM FISCAL STRATEGY

Madam Speaker, earlier I demonstrated in very straightforward terms, how fiscal prudence leads to economic growth.

I will now demonstrate how the Government's Budget for the 2013/14 financial year, is grounded in fiscal prudence.

Madam Speaker, the very essence of Government's fiscal prudence in the preparation of the 2013/14 Budget can be clearly illustrated by reference to the "Medium Term Fiscal Strategy 2013-2017" which was finalised and sent to the Foreign & Commonwealth Office (the "FCO") of the Government of the United Kingdom, on 15<sup>th</sup> August 2013. On 22 August 2013, Minister Simmonds, the FCO's Minister for Africa, the Overseas Territories, Caribbean and International Energy, conveyed his agreement to the Medium Term Fiscal Strategy. Approval was granted without the need to travel to London to participate in a defence of the Strategy. This clearly illustrates that there is an improved relationship between the United Kingdom and the Cayman Islands Government.

The Medium Term Fiscal Strategy was developed in order to bring the financial operations of the Government in full compliance with the parameters set out in the Framework for Fiscal Responsibility (the "FFR") under the sixth schedule of the Public Management and Finance (Amendment) Law, 2012.

The FFR sets out four guiding policy principles:

1. Effective **medium-term planning**, to ensure that the full impact of fiscal decisions is understood;
2. Putting **value for money** considerations at the heart of the decision-making process;
3. Effective **management of risk**; and
4. Delivering improved **accountability** in all public sector operations.

This Government is committed to using these sound principles to guide our policy development.

The FFR also specifies the financial targets with which the Cayman Islands Government is expected to achieve full compliance by the end of the 2015/16 financial year. These targets are:

1. **Net Debt** of the entire public sector should be no greater than 80% of Operating Revenues;
2. **Debt Service** – that is, the annual payments related to all public sector borrowing commitments should be no greater than 10% of core government's operating revenues; and
3. **Liquid Assets**, or the cash balances at the lowest point during the year should be no less than 25% of annual operating expenditures.

Madam Speaker, these targets are extremely aggressive but if we manage the country's finances in such a way that we are able to achieve compliance with them we will ensure that the Cayman Islands will have the resources to continue progressing its development without unnecessarily burdening future generations.

The Medium Term Fiscal Plan gives us a path to FFR compliance and formed the frame within which the 2013/14 Budget would be prepared. I am happy to report that we have met these targets and have a budget which puts us firmly on the path towards FFR compliance and fiscal sustainability.

Under the agreed Medium Term Fiscal Strategy, Operating Expenses are forecast to decline by 2% annually from now until 2014/15, and then ease to a 1% increase through 2016/17.

Operating revenue is forecast to increase moderately at an annual growth rate of 2% between 2013/14 to 2015/16, and then 4% growth in 2016/17. This rate of growth is in line with the GDP forecasts which show a 2.3% growth in 2013/14; 2.5% growth in 2014/15 and 2.3% in 2015/16.

Madam Speaker, a country's revenue burden is said to be declining if the growth of revenue collection is slower than economic growth, such that the ratio of revenue to GDP falls over time. This ratio for the Cayman Islands will be declining from 23.9 % in Fiscal Year 2012/13 to 22.4 % in Fiscal Year 2016/17. This clearly demonstrates our commitment to reducing the tax burden which is expected to positively impact the economy by making more resources available for private sector investment and employment opportunities.

Revenue generation in Cayman is directly linked to our general economic performance and our fiscal strategy does not seek to make any structural changes to this model by introducing any new or increased tax burden on the society.

Instead, we are focusing our efforts on revenue management by:

1. encouraging economic growth through private sector investment - as the economy grows so does Government revenue; and
2. improving the collection of revenues from existing measures by identifying and closing loopholes; and implementing clear policies limiting the grant of waivers and concessions from various Government fees such as import duty and stamp duties. These policies are currently being finalised and will be published before the end of October.

Over the medium term, Cayman's economy will benefit from large scale projects from both the public and private sector, such as: the redevelopment of the Owen Roberts International Airport Terminal; the construction of a modern cruise ship berthing facility; the development of the new Kimpton Hotel on Seven Mile Beach; redevelopment of the former Hyatt Beach Suites Hotel; the development of a new hotel near the Cayman Health City Hospital; and the development of a new hotel in Beach Bay, Bodden Town.

These capital projects when combined with the expected strong growth in the financial services sector and strong tourism arrivals point to a very robust economic outlook.

Consequently, the Medium Term Fiscal Plan calls for no new borrowings by the Government over the forecast period, instead the Government will be focused on paying down its debt and where possible restructuring its debt portfolio to cut interest costs and remove potential uncertainties around the repayment of bullet bonds.

Madam Speaker, I will now turn to some of the economic forecasts underpinning the Medium Term Fiscal Plan. In Fiscal Year 2013/14, barring any major spikes in international oil prices, inflation is estimated at 1.6 %. Inflation is expected to increase marginally to 2.3% in Fiscal Year 2014/15 and to 2.5% in Fiscal Year 2015/16 as gradual economic recovery in the rest of the world exerts upward pressure on food and fuel prices.

Madam Speaker, economic growth in the past fiscal year also had a positive impact on labour supply and employment. The total labour force expanded, with employment growing by 2.5%. The improvement was particularly strong in 2012, in a number of sectors such as: hotels and restaurants; construction; manufacturing; mining and quarrying; and administrative and support services. However, the unemployment rate remained at 6.1 % in the 2012/13 Fiscal Year as not all new entrants to the labour force found employment.

In the 2013/14 Fiscal Year, the unemployment rate is projected to decline to 5.9 %. In the succeeding years, the unemployment rate is expected to be lower than 5.9 % as the envisioned projects and other local services with strong linkages to these projects generate greater employment opportunities. Sustained improvement of the tourism and financial services sectors is also expected to absorb new entrants to the labour force.

## **2013/2014 FISCAL OUTLOOK**

Turning now to the details of the 2013/2014 Budget. Operating Revenues are forecast to be \$644.6 million; Operating Expenditures are forecast to be \$517.9 million; and Financing Expenses are forecast at \$31.4 million. This results in a core government net operating surplus of \$95.3 million. After factoring in the forecast net operating surplus of the Statutory Authorities and Government Owned Companies of \$5.0 million the Entire Public Sector is forecast to record a net surplus of \$100.3 million. Capital Investments are forecast to be \$51.9 million.

Core Government debt is forecast to be \$548.8 million at 30 June 2014 based on no new long term borrowings and principal debt repayments of \$26.3 million during 2013/14.

Cash Balances are forecast to increase during the year by \$44.9 million growing to \$161.9 million at 30 June 2014. Of this amount \$59.9 million will be in the operating bank account and \$102 million in the various reserve funds such as the General Reserve Fund, the Environmental Protection Fund, the Infrastructure Development Fund, etc.

However, even though we find ourselves in a surplus position, with today's fiscal challenges comes the opportunity for Government to demonstrate greater wisdom in spending the people's money. This Government is committed to doing just that and together with the civil service we will strive to deliver solid financial performance during our tenure.

The Government's revenue outlook is stable, and is not dependent on any unproven measures. This year will see the implementation of only one new tax measure, 'Licensing and Registration of Hedge Funds Directors.' This measure was originally announced last year by the previous administration but was delayed in order to allow for proper consultation with the financial industry.

When examining and agreeing the operating expenditure limits set out in this budget the government was challenged to balance the needs and demands of the society with resource limitations. As you are aware Madam Speaker, the demands on Government's expenditures are driven by a number of factors, this year, the primary drivers of expenditure are:

1. Necessary education and training initiatives;
2. Unemployment related issues;
3. Rising Health Care costs;
4. Rising Crime rates;
5. continued reliance on Government's social assistance programs; and
6. New constitutional requirements.

With every household and business in Cayman being forced to scrutinise their expenditures, as a responsible government, we too, have looked at our operating expenditures, to ensure that our citizens are getting the best value for their tax dollars.

The operating expenditures of the Government are impacted not only by the operations of the core government (Ministries and Portfolios) but also by the operations of the various Statutory Authorities and Government Owned Companies (the "SAGCs").

These SAGCs are an integral part of the Cayman Islands Government because they exist through delegated authority to carry out certain functions and to minimize liability risks. But as a result of their existence they are in a position to have first call on the revenue they collect. Therefore any effort to improve the financial performance of the Cayman Islands Government must include the SAGCs.

Last financial year the Government spent approximately \$110.8 million on outputs from the SAGCs. For 2013/14 this has been reduced to \$100.7 million by implementing a number of innovative measures.

On 14th August the Ministry of Finance held a meeting with the larger SAGCs to discuss matters related to annual budgets, how to achieve greater collaboration between SAGCs and improving financial performance. During that meeting it was discovered that while some SAGCs collect most of their revenue in US\$ but expenditure is in CI\$ there were others that collected the bulk of their revenue in CI\$ but purchased large quantities of US\$ from the local banks for their overseas expenditure. Consequently, it was agreed that they would collaborate whereby those with excess US\$ cash would sell to those in need at a fair exchange rate.

Madam Speaker, I am pleased to say that thus far this arrangement could potentially save one entity US\$350k in foreign exchange costs and enable another to receive an additional US\$100k in foreign exchange revenue; a combined benefit of US\$450k during this fiscal year. Madam Speaker, today I am speaking of hundreds of thousands of dollars between two entities during this 2013/14 Fiscal Year, but, across all SAGCs, this will amount to millions of dollars within a few years. As is often the case a dollar saved is a dollar earned.

Madam Speaker, coming out of that August 14th meeting, it was also agreed that the Cayman Islands Airports Authority (CIAA) would no longer charge rent to the Customs Department and the Immigration Department. Instead the CIAA would receive revenue directly from other coercive fees diverted from core government.

The net effect of this decision is zero but the overall benefit is that it allows core government to reduce its operational expenditure and avoid the need for increased tax revenue, thus reducing the pressure to add to the cost of living and doing business.

Along the same lines the Government will take a policy decision to exempt core government agencies and SAGCs from paying import duty. While this measure means that the Government will appear to earn less revenue it also means lower operating expenditures for both the SAGCs and core government.

Another area of partnership between the SAGCs and the core government is in the area of cash management. Based on their business cycles and the underlying cash flows there are times when SAGCs have surplus cash on hand lying idle while the core government is running an overdraft. By partnering with the SAGCs to have them place their surplus cash on deposit with the Treasury Department, the Government is forecast to save approximately \$89,000 in interest expense by 31 January 2014.

Madam Speaker, the four initiatives launched with our SAGCs that I just spoke of: collaboration on foreign exchange transactions; the removal of rental charges on core government departments by SAGCs; the removal of customs import duty; and improved cash management - all lead to a reduction of operating cost for the Cayman Islands Government. And by reducing operating cost, we will in effect reduce the need for new and inflationary revenue measures over time.

A number of other measures have been initiated within the public sector to determine where expenditure can be further reduced, these initiatives include:

- The continuation of the Budget Delivery Committee;
- Rent savings: where possible various agencies are moving into vacant spaces in the new Government Administration Building in lieu of private rental accommodations;
- A voluntary separation programme which gives certain employees the opportunity to voluntarily leave the civil service; thereby driving down personnel costs over the medium to long term;
- Providing more efficient social programmes; and
- Limiting outputs purchased from SAGCs while driving improved financial operating results in these entities.

I would like to re-emphasize that major cuts to essential programs and services were not considered. Depriving our society of fundamental support will likely cost these Islands much more in the future in terms of economic development and social issues. Nonetheless the 2013/14 Budget incorporates necessary, targeted and sensible reductions to Government expenditure.

Madam Speaker, the 2013/14 forecast for core government Operating Expenses of \$517.9 million represents a \$6.8 million reduction from the 2012/13 levels. The major components of the operating expenses reflected in the Appropriation Bill now before this Honourable House are:

- **Personnel Costs** - forecast to be \$237.6 million, this includes a provision of \$11.4 million to be paid into the Public Service Pensions Fund towards the Government's past service liability for civil service pensions benefits;
- **Supplies and Consumables** are forecast to be \$90.9 million. This represents an increase of \$3.4 million over 2012/13 but is driven primarily by having to account for a full year of operating costs of the new Clifton Hunter High School and additional classrooms at primary schools as well as costs associated with the upgrade to the Government's financial management information system (IRIS);
- **Outputs from Statutory Authorities and Government Companies** are forecast to be \$100.7 million this is a reduction of \$10.1 million from 2012/13 and is primarily the result of the initiatives I spoke of earlier along with the reassignment of \$5.5 million in coercive revenues to the Cayman Islands Monetary Authority and \$4.5 million to the Health Services Authority which has allowed the Government to reduce its output funding to these Authorities by the same amount;
- **Outputs from Non-Governmental Output Suppliers** are forecast to be \$25.2 million. The appropriations within this category of expense fund a wide variety of programmes provided by agencies external to the Government. The major items in this category are: \$14 million to fund overseas medical care for indigents and uninsured persons; \$2.5 million to provide Legal Aid services to qualified persons; \$1.6 million to provide rental housing accommodations to persons in need; \$1.5 million in funding to the Cayman Islands Private Schools Association; and \$1.4 million to fund the NCVO Pines Retirement Home to provide residential care to indigent, elderly and disabled persons.
- **Transfer Payments** are forecast to be \$33.2 million. While this is a \$1.5 million increase over the 2012/13 Budget, the appropriations within this category provide funding for many important programmes including: \$13.6 million for local and overseas scholarships; \$7.8 million for poor relief payments to the most vulnerable persons in our community; and \$6.7 million in benefit payments to our most needy seamen and veterans.

The planned **capital investments** of \$51.9 million is intended to fund some \$27.3 million in core government assets such as roads, land, building improvements, vehicles and equipment. A sum of \$24.6 million will be invested in SAGCs primarily to fund the debt service obligations of these entities.

In terms of compliance with the Principles of Responsible Financial Management set out in the Public Management and Finance Law and the Framework For Fiscal Responsibility the 2013/14 Budget forecasts the following levels of compliance with the principles:

1. **Net Operating Position: Should be Positive:** – for 2013/14 this has been achieved with a \$100.3 million operating surplus forecast;
2. **Net Worth: Should be positive:** for 2013/14 Net Worth is forecast at \$1.36 billion;
3. **Debt Service: Should be no more than 10% of core Government Revenue:** – For 2013/14 this is forecast to be 12.2%;

4. **Net Debt: Should be no more than 80% of Core Government Revenue:-** for 2013/14 Net Debt is forecast to be 72.4%;
5. **Cash Reserves: Should be no less than 90 days of estimated executive expenses:**  
For 2013/14 this is forecast to be 6.5 days. While this may seem low to some it is important to point out that as per the FFR, this ratio is calculated at the point in the year when the core government's cash balances are at their lowest. Based on the forecast profile of cash inflows and outflows this is expected to occur at 31 December 2013 when the unrestricted cash balances are expected to be \$9.8 million. Therefore, taking the cash balances at 31 December allows for a more robust measure of cash reserves.

Having said this, I am making it clear that although our fiscal resources are limited, we are making investments where possible, while maintaining effective levels of support for our people.

## **CONCLUSION**

In closing, I would like to re-state my optimism for our country and by working together we can achieve a prosperous future.

While there remains a lot to be done over the next four years, we have taken the initial steps of identifying our vision of what we wish to accomplish and establishing the resource framework within which to operate. With the right attitude, we can convert our challenges into opportunities.

Madam Speaker, we cannot allow our people to fall behind. As legislators, we all have a responsibility to act prudently and make decisions which address the needs and concerns today while setting a firm foundation for the future.

This Budget affords us the opportunity to reshape Government. We are changing how we do business; we can no longer proceed with "business as usual." We must learn to do more with less.

During the campaign trail, we made many promises, which we intend to keep. However, with our fiscal constraints, we have to make prudent choices. We have to prioritize some projects while deferring others. We have to adjust to our current realities.

However, with this Budget, this Government has taken a major step forward to a brighter future for these islands - one in which the country will have the financial resources to weather future economic storms should they arise and a future that is filled with endless opportunities for personal growth, economic growth and the well-being for our people.

The people of the Cayman Islands have a long and proud history of being creative, resilient, industrious, caring and hardworking and we must now seek to draw on these values and characteristics which have served us well through the ages to now move the country forward in a new age.

Madam Speaker, this Budget is responsible; balanced; facilitates economic growth and clearly sets the country on a fiscally responsible path.

Finally, the preparation of the Government's Budget is an enormous undertaking and this year would not have been possible without the hard work and commitment of many and I wish to thank the Honourable Premier; Cabinet Ministers; Official Members; Councillors; Chief Officers and their staff. Also, I especially wish to thank the Financial Secretary, Mr. Kenneth Jefferson and the team within the Ministry of Finance, including Chief Officer Mrs. Sonia McLaughlin; Senior Assistant Financial Secretary Mr. Michael Nixon; Deputy Accountant General Mr. Ronnie Dunn and the staff of the Budget and Management Unit.

It has been both an honour and a privilege to present this Budget today. I now humbly commend the **Appropriation (July 2013 to June 2014) Bill, 2013** to this Honourable House and ask all Members for their support of the Bill.