

# Shaping Our Future

## 2007/08 Address to the Legislative Assembly

Delivered by the Honourable Financial Secretary Kenneth Jefferson, JP, to the Legislative Assembly 27<sup>th</sup> April 2007.

### Contents

Part 1: Introduction.....	2
Part 2: The Economic Outlook .....	3
Part 3: An Overview of Financial Statement Forecasts.....	4
Part:4 Executive Assets and Equity Investments .....	6
Part 5: Revenue Measures.....	7
Part 6: Borrowings .....	8
Part 7: Compliance with Principles of Responsible Financial Management and Strategic Policy Statement .....	10
Part 8: Conclusion .....	11

## **Part 1: Introduction**

Madam Speaker, on behalf of the Government of the Cayman Islands, I rise to present the Budget for the 2007/8 financial year that encompasses the 12-month period from 1st July 2007 to 30th June 2008. This year is referred to throughout this Address as 2007/8.

Each year, governments throughout the world undertake and complete the important exercise of the preparation of national budgets. The purpose of a national budget is twofold: 1) it sets out the fiscal discipline that a government will adhere to during the year; and 2) its content indicates the direction in which a government intends to take a country.

Accordingly, this Budget Address contains both elements: fiscal discipline and the direction that the government intends to take the Islands. This Budget Address is entitled “Shaping our Future”.

Whilst the Islands’ economy has been robust in recent years, we cannot afford to rest on our past successes. The devastation caused by Hurricane Ivan in 2004 forced us to realise the fragility of our prosperity. The Government therefore recognises that when the Islands’ economy is strong it must take the necessary steps to shape the future of the Cayman Islands to ensure that the successes continue.

Shaping our future entails knowing the factors that impact the successes we have enjoyed for years and taking steps to enhance those factors. Shaping our future well will result in, amongst other things, a well educated population; the Islands being able to offer good health care to everyone; a strong economy that affords a high standard of living; fiscal interventions by Government that are sustainable; low levels of crime; and a preserved environment.

The 2007/8 Budget strives to enhance the well-being of today’s generation and, it presents a sustainable and affordable platform for building successes in the years to come.

## Part 2: The Economic Outlook

Shaping our future must take into account the present economic conditions and, those conditions that are forecast for the future. In its August 2006 report, Moody's Investors Service raised the ratings for the Cayman Islands to Aaa and Aa3 which are equivalent to exceptional and high-grade ratings. The ratings are based on the Islands' macroeconomic performance; political and social developments; the state of Government's finances and its debt position; and the Islands' vulnerability to external shocks. These exceptional and high-grade ratings place the Cayman Islands on par with the UK, the USA and Canada. These ratings in the 2006 Moody's report provide an independent verification not only of the Government's ability and willingness to meet its debt obligations but they also indicate that the Islands' macroeconomic fundamentals are solid. The Government therefore asserts that the Islands' macroeconomic fundamentals provide evidence that present conditions are conducive to future successes.

During the 2007/8 financial year, the Cayman Islands' economy is expected to remain robust due to the continued recovery of the tourism sector, the near completion of reconstruction efforts and the continued expansion of the financial services sector. In respect of the 2007/8 financial year:

- real GDP growth is expected to be 3.5%;
- inflation is forecast to be 3.5%; and
- unemployment is expected to be 3.6%.

The comparable rates that are forecast in respect of the current financial year, 2006/7, are as follows:

- real GDP growth is expected to be 4.2%;
- inflation is forecast to be 2.2%; and
- unemployment is expected to be 3.1%.

The forecasts that I have just outlined are applicable to a 1st July to 30th June period. Since many entities have a financial year that ends on 31st December coupled with the fact that until a few years ago Government also maintained a financial year which ended on 31st December, members of the general public, private and public sector entities may be able to better-relate to information presented on a calendar year basis. In respect of the year to 31st December 2007, the economy is expected to grow by 3.8%; inflation is forecast to be 3.6% and unemployment, 3.5%.

The Government therefore reiterates the point made earlier that the Islands' macroeconomic fundamentals provide evidence that present conditions are conducive to future successes and, this positive outlook is supported by the results forecast for such macroeconomic fundamentals.

### **Part 3: An Overview of Financial Statement Forecasts**

Madam Speaker, I said at the outset of this Address that a fundamental purpose of a national budget is to set out the fiscal discipline that a government will follow during the course of a year.

The fiscal discipline that Government will follow is provided by the forecast financial statements which are contained in Part C of the Annual Plan and Estimates document that was Laid on the Table of the Legislative Assembly earlier. In particular, the fiscal discipline that Government will follow in the 2007/8 financial year is given by the level of its planned expenditure for that year. It must however be recognised that revenues also impact fiscal discipline – since Government's spending is a function of its revenues.

The forecast financial statements show the financial position of both Core Government and the Entire Public Sector – the latter includes Statutory Authorities and Government Companies. I will, however, only focus on the Core Government estimates.

The key measure of the Government's performance is the magnitude of its Net Surplus. Net Surplus is calculated by subtracting total Operating and Financing Expenses from total Operating Revenue.

The financial statements indicate a forecast Net Surplus of \$17.5 million for the 2007/8 year. The Net Surplus is arrived at by subtracting forecast total Operating Expenses of \$469.2 million along with \$12.4 million of financing expenses from the forecast total Operating Revenue of \$499.1 million. The Strategic Policy Statement, or SPS, for the 2007/8 financial year that was Laid on the Table of the Legislative Assembly in December 2006, indicated that the targeted level of Net Surplus was \$19.6 million. The difference between the targeted and forecast Net Surplus is insignificant.

The forecast total Operating Revenue of \$499.1 million is a modest 8.6% more than the \$459.7 million which was presented in the 2007/8 SPS.

Honourable Members will recall that the 2006/7 Budget contained \$23.3 million of new revenue measures which were necessary to generate additional income to help fund the Government's planned capital projects and expanded services over the 2006/7 financial year. The Government recognises that revenue measures impact the cost of living; accordingly new revenue measures have not been pursued in the 2007/8 financial year. The forecast total Operating Revenue of \$499.1 million, therefore, does not include any new revenue measures.

The combined \$481.6 million that consists of forecast total Operating Expenses of \$469.2 million and forecast financing expenses of \$12.4 million, is 4.8% more than the \$459.7 million which was presented in the 2007/8 SPS. The variance is due primarily to the approval of the cost of living adjustment which was awarded to Civil Servants effective July 2006. This cost of living adjustment was approved after the SPS was presented to the Legislative Assembly in December 2006.

The forecast Balance Sheet shows that as at 30th June 2008, Total Assets will be valued at \$990.0 million while Total Liabilities are projected at \$504.7 million. The Government's Net Worth, which is the difference between Total Assets and Total Liabilities, is therefore forecasted to be \$485.3 million.

The Cash Flow Statement indicates that during the 2007/8 year, \$143.1 million will be spent on purchasing and developing Executive Assets and \$16.6 million will be invested in Statutory Authorities and Government Companies.

Additional comments pertaining to fiscal discipline are provided in an upcoming section of this Address that is entitled "Compliance with Principles of Responsible Financial Management and Strategic Policy Statement".

## Part:4 Executive Assets and Equity Investments

Madam Speaker, one of the most immediately apparent ways to identify the direction in which a government intends to take a country, is to consider its capital expenditure and investment programme. Government's annual budget indicates capital expenditures and investments under two headings: Executive Assets and Equity Investments.

The 2007/8 Budget seeks appropriations for the following capital expenditures and investments that the Government expects to undertake during the year:

- \$35.5 million is planned to be spent on three high schools and a new George Town Primary School;
- \$18.0 million is to be spent on the new Government Office Accommodation Project;
- \$14.4 million is sought in respect of the purchase of various entity assets by the Portfolio of Internal and External Affairs – of which \$1.7 million is sought to enable the construction of a headquarters facility for the Hazard Management Cayman Islands;
- \$13.3 million to the Health Services Authority – to enable the Authority to purchase medical equipment and cover a portion of its operating losses;
- \$5.2 million is to be spent on the acquisition of entity assets by the Ministry of Communications, Works and Infrastructure;
- \$4.0 million to extend the Linford Pierson Highway to Walkers Road;
- \$3.8 million is planned to be expended on sports stadia and fields;
- \$3.0 million is to be spent on a new Summary Court building;
- \$3.0 million in respect of miscellaneous road surface upgrades on Grand Cayman;
- \$3.0 million is planned to be spent on a new Civic Centre in Bodden Town – which will serve as a Category 'A' hurricane shelter;
- \$3.0 million is sought in respect of payments to be made for lands used in the construction of public roads;
- \$2.0 million in respect of a new Emergency Facility in Bodden Town;
- \$2.0 million is to be spent on the East/West arterial road on Grand Cayman;
- \$1.1 million in respect of a traffic-calming project;
- \$1.0 million is planned to be spent on the construction of a secure remand facility for juveniles;
- \$0.7 million in respect of various road projects for Cayman Brac & Little Cayman;
- \$0.5 million is sought to enable the Cayman Islands National Insurance Company to purchase an upgrade to its computer system;
- \$0.5 million is planned as an investment in the Maritime Authority of the Cayman Islands;
- \$0.5 million is sought for the National Housing and Community Development Trust;
- \$0.5 million is to be spent on various capital works to be undertaken by the University College of the Cayman Islands;
- \$0.5 million is sought in respect of planned purchases of paving and transport equipment for the National Roads Authority;
- \$0.4 million is sought for the Tourism Attractions Board;

- \$0.3 million is sought to permit the Sister Islands Affordable Housing Corporation to help fund the construction of four additional homes on Cayman Brac; and
- \$0.2 million to assist the National Gallery of the Cayman Islands in its reconstruction efforts.

Madam Speaker, the Government is clearly demonstrating that it sees a future in which education, law and order, adequate health care services for everyone, new and upgraded road infrastructure, secure and suitable accommodation for the delivery of public services and the provision of sporting facilities, are important and, it is taking action to make these a reality.

## **Part 5: Revenue Measures**

As I stated earlier, Madam Speaker, the Government does not propose any new revenue measures for 2007/8. Therefore, the forecast level of expenditures, both Operating and Capital, will be funded by existing cash balances, existing sources of revenues and borrowings

## Part 6: Borrowings

The level of borrowing that Government includes in its annual budget attracts significant scrutiny. Principally this is because legislators, past and present, seek to minimise borrowings. The present Government also adheres to this philosophy. This position is obvious when we examine the borrowing that has occurred in the current financial year. Government has the ability to borrow \$94 million in the current financial year that will end on 30th June 2007. In the 10-month period from 1st July 2006 to 27th April 2007, only \$10 million of that amount has actually been borrowed.

Whilst Government's Operating Revenues are greater than Operating and Financing Expenses for 2007/8, the resulting \$17.5 million Net Surplus is only able to partially fund the necessary capital expenditures and investments that are required to propel the Islands forward. It must therefore be accepted that borrowing is a necessary and legitimate financing mechanism.

The financial statements in the Annual Plan and Estimates indicate that the Government will seek an appropriation to borrow up to \$129.8 million in the 2007/8 year to assist in the funding of the capital expenditures and investments that I outlined earlier. The \$129.8 million in borrowings for 2007/8 exceed the target amount stated in the SPS by \$8.3 million. It is important that I explain why this single-year variation is not a cause for concern.

The SPS for 2007/8 that was Tabled in the Legislative Assembly in December 2006 envisaged that borrowings for 2006/7 would be \$48 million and for 2007/8, the amount would be \$121.5 million. The combined borrowings envisaged in the SPS for the two years, is therefore \$169.5 million. The Government has, to today's date, only drawn-down \$10 million in the current financial year. It is forecast that the maximum amount of additional borrowings in the two-month period to June 2007, is \$17 million. Thus the forecast maximum amount of borrowing during the year to 30th June 2007 is \$27 million – out of a possible \$94 million that has been appropriated for the current year. When the maximum borrowings of \$27 million for the 2006/7 year are combined with the \$129.8 million of borrowings for the 2007/8 year, the resulting \$156.8 million should be compared to the \$169.5 million in borrowings envisaged by the SPS over the two years, 2006/7 and 2007/8. The Government is therefore forecasting that borrowings in 2006/7 and 2007/8 will actually be \$12.7 million less than envisaged in the SPS.

When this two-year perspective is adopted, it is clear that the philosophy of borrowing minimisation mentioned earlier continues in the 2007/8 Budget.

I take this opportunity to provide information on the level of central Government Public Debt. Central Government Public Debt has two components: 1) funds borrowed by Government for use on its own capital expenditures; and 2) funds borrowed by Government but on-lent to Statutory Authorities – this latter component being known in past years as Self-Financing Loans.

At 30th June 2005, central Government Public Debt was \$164.5 million. During the year to 30th June 2006, borrowings of \$24 million were made by Government whilst repayment of debt-principal was \$14.7 million. The outstanding balance on central Government Public Debt was \$173.8 million at 30th June 2006. In the 10-month period from 1st July 2006 to today, borrowings of \$10 million have been

made by Government whilst \$13.6 million of debt-principal repayment has occurred. Therefore as at 27th April 2007, today, central Government Public Debt stands at \$170.2 million.

As shown in the Annual Plan and Estimates for 2007/8, the Balance Sheet therein indicates that as at 30th June 2008, the balance of the Government's outstanding debt is forecast to be \$295.7 million which is 3% below the \$305.8 million that was stated in the 2007/8 SPS.

Borrowings are typically scrutinised with two considerations in mind: 1) what the borrowed funds will be used for; and 2) whether the borrowings are affordable. I have stated that the 2007/8 borrowings will be used to fund necessary capital expenditures and investments that will propel the Islands forward. Borrowings will not be made to pay for Operating Expenses – those are adequately covered by Operating Revenues. I will now turn to the affordability of forecast borrowings for 2007/8.

## **Part 7: Compliance with Principles of Responsible Financial Management and Strategic Policy Statement**

Madam Speaker, Government is legally obliged to comply with the Principles of Responsible Financial Management (the “Principles”) that are set out in section 14 of the Public Management and Finance Law. The objective of those Principles is to ensure that, over a year, Government’s forecast expenditures, (including the interest cost of borrowing) and its revenues are fiscally disciplined.

The affordability of forecast borrowings for 2007/8 is best judged by an examination of Government’s Debt Service Ratio. This is the third Principle stated in section 14 of the previously-mentioned Law. This Principle requires that Government’s interest and other debt servicing expenses plus principal repayments of its borrowings, do not exceed 10% of its revenues. This is a very conservative definition because it takes into account both interest payments and principal repayments. Government’s forecast Debt Service Ratio for 2007/8 is 6.6%. The forecast level of borrowings for 2007/8 is therefore affordable because there is comfortable compliance with a very conservative 10% limit. The 6.6% Debt Service Ratio is lower than the 7% ratio envisaged in the 2007/8 SPS.

The first Principle requires that the entire public sector’s revenues exceed its expenses. This means that when the revenues and expenses of central Government, all Statutory Authorities and all Government Companies are netted-off, there must be a resulting Surplus. The financial statements for 2007/8 indicate a Net Surplus of \$17.5 million: hence there is compliance with this first Principle. The SPS indicated that the target figure for the 2007/8 Net Surplus was \$19.6 million. The \$2.1 million difference between the forecast Net Surplus for 2007/8 and the SPS target amount is insignificant.

The second Principle requires that Core Government’s assets exceed its liabilities. The financial statements indicate a forecast Net Worth of \$485.3 million at 30th June 2008. There is compliance with this second Principle.

The fourth Principle requires that the existing balance of Government’s borrowing, plus a risk-weighted portion of public agencies’ debt that has been guaranteed by Government, less the Government’s cash balances, should not exceed 80% of central Government’s revenue. This is referred to as the Net Debt Ratio. The forecast Net Debt Ratio for 2007/8 is 61.5%: hence there is compliance with this Principle. When this level is compared to the target ratio of 60% in the 2007/8 SPS, the resulting variance is small.

The fifth Principle requires that Government’s cash balances at 30th June 2008, should, be equivalent to at least 75 days of expenditure in 2007/8. It is forecast that Government’s total cash balances at 30th June 2008 will be equivalent to 75 days of expenditure. Hence there is compliance with this fifth Principle. The Government forecasts that its cash balances will total \$90.3 million at 30th June 2008 – which marginally exceeds the \$90.1 million level set in the SPS.

Madam Speaker, compliance with the Principles is evidence that the 2007/8 Budget is fiscally disciplined and, the fact that it does not differ significantly from the SPS Tabled in this House in December 2006, indicates that it conforms with the 2007/8 SPS.

## Part 8: Conclusion

Madam Speaker, in concluding I must give my sincerest thanks to: all Honourable Ministers and Official Members of Cabinet; all Chief Officers; all Chief Financial Officers and other supporting staff; Statutory Authorities and Government Companies and a special thanks to staff in the Portfolio of Finance, the Budget Unit and the Treasury Department, for producing the Appropriation Bill and its accompanying documentation Tabled earlier.

I would like to make special mention of the sterling efforts of Deputy Financial Secretary, Mrs Sonia McLaughlin and Senior Assistant Financial Secretaries, Mr. Michael Nixon and Mrs. Anne Owens for spearheading the production of the 2007/8 Budget.

I conclude by making reference to my initial remarks – that the purpose of a national budget is twofold: 1) it sets out the fiscal discipline that a government will adhere to during the year; and 2) its content indicates the direction in which a government intends to take a country.

The 2007/8 Budget satisfies those two purposes.

The 2007/8 Budget is fiscally responsible. The salient points are:

- forecast Operating Revenues exceed Operating and Financing Expenses by \$17.5 million;
- core Government's assets exceed its liabilities by \$485.3 million;
- repayment obligations that arise from Government's forecast borrowings are affordable and are less than the 10% upper limit specified for the Debt Service Ratio in the Public Management and Finance Law;
- the forecast level of cash balances, \$90.3 million, at 30th June 2008 is sufficient to meet the legal requirement of 75 days of expenditure-coverage for 2007/8;
- the 2007/8 Budget conforms to the targets set out in the SPS – which the Legislative Assembly resolved to accept as the foundation for the preparation of the 2007/8 Budget.

The content of the 2007/8 Budget indicates that, amongst other things, the Government is clearly demonstrating that it sees a future in which education, law and order, adequate health care services for everyone, new and upgraded road infrastructure, secure and suitable accommodation for the delivery of public services and the provision of sporting facilities, are important. The 2007/8 Budget shows that Government will make these a reality.

Madam Speaker, I commend The Appropriation (July 2007 to June 2008) Bill, 2007 to all Honourable Members and would seek their support.

Thank you.