

# A Key to Success: Responsible Financial Management

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Delivered by the Honourable Financial Secretary Kenneth Jefferson, JP, to the Legislative Assembly at the Budget Meeting Friday, 28th April 2006.

## Contents

Part 1: Introduction.....	2
Part 2: The Economic Outlook .....	3
An Overview of Financial Statement Forecasts .....	4
Executive Assets.....	6
Equity Investments .....	7
Part 3: Proposed New Revenue Measures .....	8
Stamp Duty on Land Transfers.....	9
Immigration Fees .....	10
Local Companies Control Licences.....	10
Postal Rates.....	10
Building Permit and Infrastructure Fund Fees.....	10
General Registry Fees .....	11
Tax Undertaking Certificates.....	11
Other Financial Services Fees.....	12
Practising and Operational Licence Fees .....	12
Other Fee Increases .....	12
Borrowings.....	13
Compliance with Strategic Policy Statement and Principles of Responsible Financial Management....	14
Part 4: Conclusion .....	16

## Part 1: Introduction

Madam Speaker, on behalf of the Government of the Cayman Islands, I rise to present the Budget for the 2006/7 financial year that encompasses the 12-month period from 1st July 2006 to 30th June 2007.

The Government of the Cayman Islands is determined to succeed in its efforts to achieve the 11 broad outcome goals specified in the 2006/7 Strategic Policy Statement, or SPS for short, which was approved by the Legislative Assembly on 30th November 2005.

On a national level, when success is achieved, it is evident in many facets. Success is achieved by a government when, among other things, it:

- educates its population well;
- provides its citizens with a good health-care system and proper health-care facilities;
- creates the conditions under which its economy can flourish – thereby providing an opportunity for its citizens to enjoy a good standard of living;
- protects its citizens from crime; and
- preserves the environment.

Madam Speaker, these five outcomes are included in the SPS.

With limited resources at its disposal, in order to achieve success, Government must be responsible in the use of those resources. Fiscal responsibility by Government is therefore key to achieving success. I have therefore themed my Budget Address for Government's financial year that will end on 30th June 2007: "A Key to Success: Responsible Financial Management".

The Honourable Leader of Government Business in his contribution will detail the key policy actions that the Government will pursue in the 2006/7 financial year to achieve Government's 11 broad outcome goals set-out in its SPS.

The 2006/7 Budget is based on responsible financial management.

It is a Budget that will allow the Government to achieve its goals.

It is a Budget that builds a solid foundation for the future of the Cayman Islands.

## **Part 2: The Economic Outlook**

Madam Speaker, the Government recognises that success in the economy is the outcome of making sound decisions that are informed by reliable data. In order to assist in its decision-making processes, private sector entities therefore expect Government to provide forecast macroeconomic data as to the likely performance of the economy in the coming year.

The 2006/7 economic outlook for the Cayman Islands is bright and the economy is expected to experience strong growth in all sectors.

Current macroeconomic forecasts indicate that the Cayman Islands' economy will grow by 3.6% during the 2006/7 financial year. Inflation is forecast to be 3% and unemployment 3.8%. The variance between these forecasts and those stated in the Strategic Policy Statement for 2006/7 is negligible. 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, they will be better able to relate to information presented on a calendar year basis. Therefore, for the year to 31st December 2006: the economy is expected to grow by 4.2%; inflation is forecast to be 3% and unemployment 3.9%.

## An Overview of Financial Statement Forecasts

Madam Speaker, let me now turn to the financial statement forecasts that are included in the Annual Plan and Estimates. I will focus on the Core Government figures.

The financial statements in the Annual Plan and Estimates start at page 298.

The key measure of Government's performance is the difference between its Operating Revenues and Operating Expenses. A surplus exists if Operating Revenues exceed Operating Expenses.

The financial statements indicate a forecast surplus of \$32.5 million for the 2006/7 year. This surplus is forecast even after budgeting \$2.0 million of Extraordinary Expenditure to provide Hurricane Ivan relief assistance.

The surplus is calculated by subtracting total Operating Expenses of \$395.0 million, \$12.6 million of Interest and financing expenses and \$2.0 million of Extraordinary Items from the forecast Operating Revenue of \$442.1 million.

Overall, Operating Revenue is forecast to be approximately 16.3% higher than the 2005/6 forecast, while total Operating Expenses are forecasted to increase to \$395.0 million, from \$366.7 million. New revenue measures of \$23.3 million account for 38% of the increase over the revenue forecast for 2005/6. This increase of \$23.3 million of new revenue measures affects the following income classifications: domestic levies – \$12.0 million; property levies – \$7.2 million; and sale of goods and services – \$4.1 million.

Total Operating Expenditure shows an increase of 8% over the 2005/6 forecast. The cost of personnel, supplies and consumables accounts for approximately 72% of total Operating Expenses. During 2006/7, this cost is expected to increase by 9% when compared to the 2005/6 forecast. This 9% movement is consistent with the latest award of a 4.8% cost of living increase paid to Civil Servants and, the general increase in price levels.

Included in the total Operating Expenses figure of \$395.0 million is the net loss of Statutory Authorities and Government Companies. This net loss is forecast to be \$0.8 million, a significant reduction from the \$4.2 million estimated for the 2005/6 financial year. Such an improvement is a reflection of the Government's commitment to ensuring that, in aggregate, the public authority sector achieves a break-even position at the earliest possible time.

Madam Speaker, in addition to the figures I have already mentioned, the operating forecasts include \$2.0 million of Extraordinary Expenditures. This item relates to Hurricane Ivan, and consists of housing and relief assistance to the needy. It was not expected that Hurricane Ivan-related expenses would have continued into 2006/7. Nonetheless, Government must be responsive to the needs of the Islands. It is anticipated that 2006/7 will be the last year for Hurricane Ivan-related expenses to appear in Government's annual budget.

The 2006/7 Strategic Policy Statement sets a surplus of \$24.5 million as a target. The financial statements in the Annual Plan and Estimates indicate that the forecast surplus for the 2006/7 financial year is \$32.5 million: it therefore exceeds the target set in the Strategic Policy Statement.

The Cash Flow Statement indicates \$115.1 million will be used for the purchase or development of Executive Assets and \$14.3 million for investments into Statutory Authorities and Government Companies is forecast to occur during the 2006/7 year.

## Executive Assets

The Executive Assets included in the Budget are significant, not just in terms of their monetary value of \$115.1 million but also in terms of the impact they will have on the quality of life of residents.

Many of the Executive Assets included in the 2006/7 Budget are multi-year projects. It is therefore expected that they will appear in future budgets.

Provision has been made for \$48.6 million of new and improved education facilities. Such a significant level of expenditure is consistent with Government's third broad outcome goal of Improving Education and Training in the Cayman Islands.

The main education related Executive Assets to be undertaken during the 2006/7 financial year are:

- the construction of new high schools in Frank Sound and West Bay;
- the construction of a new high school on the existing John Gray High School site;
- the construction of a new George Town Primary School;
- the construction of new school halls at Cayman Brac High School and East End Primary School;
- the conversion of George Hicks High School into four smaller schools; and
- the expansion and improvement of public library facilities.

Government intends to start the construction of two office accommodation buildings during the 2006/7 financial year. A provision of \$11.9 million has been included in the budget for this purpose.

The 2006/7 budget also seeks the following appropriations for other Government facilities:

- \$4.0 million for the new disaster-tolerant National Archive building;
- \$2.5 million for MRCU offices and the aircraft hangar;
- \$2.0 million for the start of a new summary court building;
- \$1.7 million for the purchase of land and construction of an Emergency Services Centre in Bodden Town, which will include a new Fire Station;
- \$1.0 million to fund the construction of the new multi-purpose Civic Centre/Emergency Shelter in Bodden Town;
- \$1.25 million for the development of the Jimmy Powell Cricket Oval in West Bay;
- \$1.0 million for the new Cayman Brac Sports Centre; and
- \$0.25 million for a boxing gym at the Truman Bodden Sports Complex.

Road development projects continue to be an important part of the Government's capital development programme with a total of \$12.9 million being allocated for the continued development of the Islands' road network.

The main road projects that will be undertaken in 2006/7 are the continuation of the Esterley Tibbetts Highway and the start of the new East/West Arterial Highway connecting the Savannah-Newlands area to Prospect.

## Equity Investments

Madam Speaker, one key component of the Government's medium term fiscal strategy is to seek improvement in the financial performance of Statutory Authorities and Government Companies.

While some success has been realised in this area over the past year, the Government recognises that there is a need for further investment in some of these agencies to ensure that they are adequately capitalised in order to fulfil their missions.

For the 2006/7 financial year, the Government will make the following investments into Statutory Authorities and Government Companies:

- A total of \$9.1 million into the Health Services Authority of which \$2.6 million is to enable the purchase of new medical equipment and \$6.5 million to cover its anticipated operating losses;
- \$3.0 million into the Cayman Islands National Insurance Company to replenish its capital base;
- \$0.8 million will be invested in the Tourism Attractions Board to allow for various improvements to Pedro St. James National Historic Site and Queen Elizabeth II Botanic Park. In addition, a portion of this investment is to allow the Tourism Attractions Board to assume responsibility for the Caribbean Development Bank loan obtained by the Government several years ago to fund the development of the Pedro St. James site;
- \$0.5 million will be injected into the Maritime Authority of the Cayman Islands as part of a three-year plan to capitalise the Authority to enable it to fulfil its business plans and objectives;
- \$0.2 million will be invested in the Children and Youth Services Foundation;
- \$0.3 million into the Sister Islands Affordable Housing Corporation to help fund the construction of homes on Cayman Brac;
- \$0.4 million will be invested in the National Housing and Community Development Trust.

The \$130.0 million of investing activities will be funded from three sources: 1) the introduction of revenue measures; 2) borrowings; and 3) the use of existing cash balances.

### **Part 3: Proposed New Revenue Measures**

Madam Speaker, the sole purpose of the proposed new revenue measures is to assist in the funding of the important and necessary capital expenditure programme required in the Islands.

The 2006/7 Budget contains approximately \$23.3 million in new revenue measures to be implemented during the 2006/7 financial year.

When the Government presented the SPS to the Legislative Assembly last November, that Statement revealed that Government would need to implement new revenue measures in order to generate additional income to help fund new capital projects and new or expanded services.

At that time it was forecast that Government would have to raise \$25 million by new revenue measures in the 2006/7 year. However, the forecasts for the existing revenue sources have been better than expected – thereby reducing, albeit slightly, the need for the entire \$25 million in new measures in 2006/7.

In deciding what the new measures would be, the Government had the difficult task of identifying measures that would minimise the impact on the average citizen while at the same time not acting as a deterrent or impediment to the corporate sector.

The Government conducted wide consultation with many private sector associations. Many of the revenue measures being put forward by the Government were recommended by those associations.

The principal new revenue measures included in the Budget are as follows:

## Stamp Duty on Land Transfers

The current regime of a 5% rate charged on all land transfers was implemented in an effort to stimulate the economy after the September 11th, 2001 terrorist attacks in America.

This uniform rate is to be replaced with a tiered-rate structure.

Honourable Members will recall that certain parcels of property along the West Bay Road corridor and certain parts of George Town previously attracted a stamp duty rate of 9%. The Government intends to increase the present rate of 5% in those areas to 7½%. Elsewhere in the Islands the current rate of 5% will be increased to 6%.

The Government has decided to seek the introduction of a special rate of 4% stamp duty in respect of property bought by Caymanians. However, this special rate of 4% for Caymanians will not apply to those particular parcels of land along the West Bay Road corridor and certain parts of George Town that previously attracted a 9% rate. Caymanians purchasing property in those areas will be required to pay a 7½% stamp duty rate.

In addition to the special 4% rate for Caymanians, further concessions are to be offered to Caymanians acquiring property for the first time – as previously announced by Government. The regime that will operate in respect of Caymanians acquiring property for the first time is as follows:

- The present limit of \$35,000 for the purchase of undeveloped land will be increased to \$50,000 and the applicable rate of duty on such transactions will be zero percent;
- If the land that is acquired has a value in excess of \$50,000 but does not exceed \$75,000, the applicable rate of duty will be 2%;
- If the land purchased exceeds \$75,000, a Caymanian acquiring such property for the first time will pay a 4% duty rate;
- The present limit of \$150,000 applicable to the purchase of property that includes a residential building shall be increased to \$200,000. The relevant rate of duty on such transactions will be zero percent;
- If the value of the property purchased exceeds \$200,000 but does not exceed \$300,000 the applicable rate of duty will be 2%; and
- If the value of the property purchased exceeds \$300,000 the applicable rate of duty is 4%.

It is important to stress that the details just mentioned pertaining to property being acquired by Caymanians for the first time, do not apply to those areas along the West Bay Road corridor and certain parts of George Town that will attract a stamp duty rate of 7½%.

It is expected that these changes in the rates of Stamp Duty will generate a net additional revenue of \$6 million during the 2006/7 financial year.

## **Immigration Fees**

Madam Speaker, the Government intends change the fee levels for various categories of work permits. Such changes are expected to generate an additional \$5.1 million during the year. Of this \$5.1 million, \$2.7 million is to be generated by increasing the fees for work permits in the Professional and Managerial category from \$4,070 to \$6,000. A further \$1.0 million is expected to be derived from increasing the fees in the Construction Skilled category from \$1,210 to \$1,500. It should be noted that these fees were last increased in 1998. Increases in other categories of work permits will account for an additional \$1.4 million in revenue. Work permit fees for employees in the General Domestic, Manual and Unskilled category will remain unchanged at \$150.

A \$75 processing fee will be introduced for all Trade and Business Licence applications and renewals. This is expected to produce a further \$0.6 million of revenue during 2006/7.

## **Local Companies Control Licences**

The fees for Local Companies Control Licences have not been changed since 1972. The Government intends to increase these fees from \$200 to \$2,500 thereby achieving an additional \$0.4 million of revenue.

## **Postal Rates**

Postal rates for local mail were last adjusted in 2001 and the Government proposes to increase the current rate from 15 cents to 25 cents.

International Postal rates were last adjusted in 1991. It is proposed that International Group 'A' mail rate increase from its present level of 30 cents to 75 cents; International Group 'B' mail rate will increase from 40 cents to 80 cents and, Group 'C' mail rate will increase from 60 cents to \$1. Additionally, postal rates for unaddressed mail, commonly known as flyers, will increase from 7 cents to 15 cents.

These proposed changes reflect the cost of providing such services to the public. In totality, these adjustments to postal rates are expected to produce \$0.9 million in additional revenue during 2006/7.

## **Building Permit and Infrastructure Fund Fees**

Madam Speaker, Building Permit and Infrastructure Fund Fees like the Stamp Duty rates were reduced as part of an economic stimulus package following the September 11th terrorist attacks in America. It is proposed that the existing rates be returned to their pre-September 11th 2001 levels. These changes are expected to generate an extra \$2.2 million during the 2006/7 financial year.

## **General Registry Fees**

The new revenue measure package in respect of fees collected by General Registry calls for a range of fee increases for various services provided by that Department. These increases are expected to yield an additional \$4.2 million.

The most significant change relating to fees collected by General Registry pertains to the issuance of Certificates in respect of companies listed on the Companies Registry. The fee for obtaining a Certificate of Good Standing will increase from \$41 to \$82. This is expected to produce extra revenue of \$2.6 million in 2006/7.

It is important to emphasise that most of these changes were recommended by private sector associations.

Fees for the provision of copies of documents kept on file with the Companies Registry will also increase from \$41 to \$82 and this is expected to generate \$0.7 million of additional revenue. Annual fees for Exempted Trusts will be increased from \$100 to \$500 and this is expected to yield a further \$0.3 million during the 2006/7 financial year.

Various Certification and Document fees in respect of partnerships will be increased from \$50 to \$82. Such a proposed change is expected to produce \$0.3 million of additional revenue in 2006/7.

Changes to several other fees relating to services provided by the General Registry for Patent and Trade Mark Registrations, matters arising from the Public Recorder Law and the Births, Deaths and Marriages Registry are expected to provide an extra \$0.2 million in revenue.

## **Tax Undertaking Certificates**

Tax Undertaking Certificates are often sought by Exempted Companies, Exempted Limited Partnerships and Exempted Trusts. Such certificates provide an undertaking by the Government that the requesting entities shall not be impacted by the remote possibility of future taxation being introduced in the Cayman Islands.

The certificates are valid for a maximum of 30 or 50 years. The fee for such undertaking certificates is currently \$150; this will increase to \$500 and will yield approximately \$2.1 million in additional revenue during the 2006/7 financial year. This revenue measure was recommended by private sector associations.

## Other Financial Services Fees

The new revenue measures also incorporate increases to: Captive Insurance Licences; external Insurer Licences; Restricted and Unrestricted Trust licence application fees and the Annual Licence Fee for Restricted Trusts. These fee increases are expected to generate additional revenue of \$0.4 million during the 2006/7 financial year.

## Practising and Operational Licence Fees

At present, law and accounting firms pay \$1,500 per lawyer or accountant. It is proposed that this fee be increased to \$2,000. This measure is expected to yield additional revenue of \$0.2 million.

Madam Speaker, a new schedule of fees is also proposed for Operational Licences for Law and Accounting firms. The new schedule takes into account the number of lawyers and accountants employed in their respective firms. It is proposed that the maximum licence fee be increased to \$400,000 for firms that have fifty one or more accountants or lawyers. The maximum licence fee, at present, is \$300,000. This measure is expected to produce additional revenue of \$0.3 million during the financial year 2006/7.

## Other Fee Increases

In addition to the increases that I have just outlined, the new revenue measure package also includes increased fees for Apostilles. The fee for Apostilles was last adjusted in 2001 and the Government proposes to increase this from \$50 to \$100, thereby achieving \$0.3 million of additional revenue. Increases to the fee charged at present for obtaining certificates for naturalisation and proof of nationality are expected to generate \$0.3 million of additional revenue during 2006/7.

Madam Speaker, it is important that I emphasize the following points in respect of the proposed new revenue measures:

- The revenue measures do not take effect until 1st July 2006 – the start of the upcoming financial year;
- In many instances whilst the legislative changes required to effect such revenue measures will be in place by 1st July 2006, many of the enhanced revenue sources will crystallise on 1st January 2007;
- A detailed schedule of the proposed revenue measures is on hand and will be made available to Honourable Members;
- The sole purpose of the revenue measures is to assist the Government in carrying out the important and necessary Capital Expenditure programme required in the Islands; and
- Many of the significant proposed revenue measures were recommended by private sector associations.

## Borrowings

The financial statements in the Annual Plan and Estimates indicate that the Government will seek an appropriation to borrow up to \$94.0 million in the 2006/7 financial year to assist in the financing of significant capital expenditures that I detailed earlier. Honourable Members will recall that the Strategic Policy Statement for the 2006/7 financial year envisaged a borrowing of \$89.0 million.

It would be hasty and unjustified to criticise the anticipated borrowing of an additional \$5.0 million over and above the borrowing of \$89.0 million shown in that Statement. Government has an appropriation to borrow \$63.0 million in the financial year that will end on 30th June 2006. To date, only \$24.0 million has been drawn down of the \$63.0 million borrowing ability.

The \$24.0 million was drawn down in November 2005 and Government does not anticipate the need to borrow any further amount in the year to 30th June 2006. The unused borrowing ability is therefore expected to be \$39.0 million in respect of the 2005/6 financial year. Since the \$63.0 million appropriation for 2005/6 was intended to assist in the financing of the capital expenditures during that year, coupled with the fact that a significant portion of those expenditures will not occur until the upcoming financial year, it is only fair and reasonable that the Government seeks to borrow, in 2006/7, a portion of the unused loan appropriation of \$39.0 million that is likely to exist at 30th June 2006. Government is only seeking to utilise \$5.0 million in the 2006/7 year of that \$39.0 million unused appropriation.

In listening to this Address, one might ask if there is a \$32.5 million surplus, why is there a need for \$23.3 million in new revenue measures?

First of all, the revenue measures form part of the projected \$32.5 million surplus. Therefore, if the \$23.3 million of revenue measures were excluded, the surplus would not be \$32.5 million. The \$32.5 million surplus and the \$23.3 million revenue measures package cannot be separated.

Secondly, this additional revenue is needed to partially fund the ongoing Capital Expenditure programme, providing for new schools, roads, new government office accommodations, sporting facilities, assets and facilities for enhanced policing, and other much needed Executive Assets.

Thirdly, Madam Speaker, upon completion of these facilities such as the schools, the projected 11% increase in Operating Expenses explains the need for additional revenue.

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

On a technical level there are two bases on which the 2006/7 Budget can be assessed: whether it complies with the Principles of Responsible Financial Management and whether it is consistent with the 2006/7 Strategic Policy Statement.

Madam Speaker, the financial forecasts fully comply with the Principles of Responsible Financial Management contained in Section 14 of the Public Management and Finance Law and are consistent with the Government's fiscal strategy outlined in the 2006/7 SPS.

The first Principle of Responsible Financial Management requires Government's revenues to exceed its operating expenses. The financial statements indicate a surplus of \$32.5 million and therefore there is full compliance with this Principle.

The second Principle requires that Government's Assets exceed its Liabilities. The financial statements indicate a forecast Net Worth of \$493.2 million at 30th June 2007 and there is compliance with the second Principle.

The third Principle requires that the Government's interest and other debt servicing expenses plus principal repayments of its borrowings, should not exceed 10% of its revenues. The Government's forecast debt servicing ratio for 2006/7 is 7.1% which complies with this Principle.

The fourth Principle requires that the existing balance of Government's borrowing, plus a risk-weighted portion of public authorities' debt that has been guaranteed by Government, less the Government's cash balances, should not exceed 80% of Government's revenue. This is referred to as the Net Debt Ratio. The forecast Net Debt Ratio for 2006/7 is 60%, which complies with this Principle.

The fifth Principle requires that Government's cash reserves should be maintained at a level equivalent to 60 days of expenditure in 2006/7. It is forecast that Government's cash reserves at 30th June 2007 will be equivalent to 62 days of expenditure. There is compliance with this Principle.

Madam Speaker, in November 2005, the Legislative Assembly granted approval for the 2006/7 Strategic Policy Statement to be the foundation for the 2006/7 Budget. It is therefore important to comment on the extent of compliance achieved in relation to that Statement.

The Strategic Policy Statement sets a figure of \$24.5 million as the target for the 2006/7 surplus. The financial statements indicate that this target has been exceeded since the forecast surplus is \$32.5 million.

Table 3 in Part A of the Annual Plan and Estimates compares the SPS targets with forecasted performance for the 2006/7 financial year. This Table is found on page 281 in the Annual Plan and Estimates.

Madam Speaker, Honourable Members will notice from this Table that there is a negligible difference between the level of Cash Reserves targeted in the Strategic Policy Statement and the 2006/7 forecasted financial statements.

The level of Cash Reserves at 30th June 2007 is forecasted to be \$71.0 million. This is \$0.6 million less than the \$71.6 million target set in the 2006/7 SPS. The \$71.0 million is equivalent to 62 days of expenditure and is below the 71 days targeted in the 2006/7 Strategic Policy Statement. This is due to partially funding planned capital expenditures using Cash Reserves which help to reduce Government's borrowing requirement, its interest expense and future debt repayment obligations.

Madam Speaker, the financial forecasts fully comply with the Principles of Responsible Financial Management contained in Section 14 of the Public Management and Finance Law and are consistent with the Government's fiscal strategy outlined in the 2006/7 SPS.

## **Part 4: Conclusion**

Madam Speaker, the 2006/7 Budget complies with the Principles of Responsible Financial Management as required by the Public Management and Finance Law and is consistent with the Strategic Policy Statement which was approved in the Legislative Assembly on 30th November 2005.

This Budget will enable the Government to achieve its goals and build a solid foundation for the future of the Cayman Islands.

Madam Speaker, 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 the Director of the Budget Unit, Mr Michael Nixon for spearheading the production of the 2006/7 Budget.

Madam Speaker, I commend The Appropriation (July 2006 to June 2007) Bill, 2006 to Honourable Members and accordingly ask that they support the Bill.

Thank you, Madam Speaker.