



2008/9 Budget Address

‘Maintaining Fiscal Prudence in Challenging Economic Times’

By

HON KENNETH JEFFERSON
Financial Secretary

**Presented at the
Legislative Assembly
Wednesday, 30th April 2008**

Introduction

Madam Speaker, on behalf of the Government of the Cayman Islands, I rise to present the Budget for the 2008/9 financial year that encompasses the 12-month period from the 1st July 2008 to 30th June 2009. This year is referred to throughout this Address as 2008/9.

The 2008/9 Budget is the fifth budget being presented under the accrual system of accounting and in accordance with the Public Management and Finance Law (2005 Revision), (the "PMFL"). I am pleased to report that, as in the four previous Budgets under this system, the 2008/9 Budget is fully compliant with all the principles of responsible financial management as set out in the PMFL.

It features the milestone accomplishment of a 90-day executive expenditure cash reserve at the end of the 2008/9 financial year. This means that at 30th June 2009, the Government is expected to have a level of cash that will be sufficient to pay for a quarter of a year of Government's expenditure and, it is legally required to maintain such a minimum level of cash at the end of each financial year subsequent to 2008/9.

Madam Speaker, these accomplishments are significant given the considerable global economic challenges that exist currently and which will undoubtedly continue to impact the Cayman Islands. The accomplishments were only possible by making some difficult decisions in the preparation of the 2008/9 Budget. It is with this difficult economic setting in mind that I have entitled my address, "Maintaining Fiscal Prudence in Challenging Economic Times".

The Global Economic Outlook

The world is undergoing tremendous economic change and experiencing a high degree of economic uncertainty. Developed countries are finding it difficult to maintain positive economic growth amid significant changes in the world's financial markets, the seemingly ever increasing price of oil, rising commodity prices, increasing food prices and ever increasing competition from developing economies.

In its April 2008 World Economic Outlook, the International Monetary Fund emphasized that significant changes in the global economic outlook have occurred since the second half of 2007. Lower growth rates in 2008 and 2009 are now forecasted for the United States of America (the "US"), resulting mainly from its profound housing market crisis.

Difficulties in financial markets are not restricted to the US; they have spread to other advanced economies and have affected global growth prospects. At the same time, a general increase in commodity prices is expected to push inflationary pressures worldwide.

The US real Gross Domestic Product (GDP) growth forecast for the 2008 calendar year has been downscaled to 0.5% from 1.9% as of September 2007. Notwithstanding the reduction in rates by the US Federal Reserve Board and the implementation of the US Federal Government's economic stimulus package, a quick recovery is not expected. Thus, US real GDP growth in calendar year 2009 is forecast to remain at a low rate of 0.6%. Due to the large share of the US and other advanced countries in the world's economy, the forecasted growth of global output for 2008 has been reduced to 3.7% compared to 5.2% as of September 2007; and for 2009, at 3.8% compared to 4.8% as of September 2007.

Sharp increases in commodity prices including those of oil and grain are expected to cause increases in consumer price indices globally and will undoubtedly impact the Cayman Islands. The inflation rates for the US and other advanced economies are forecasted at 3.0% and 2.6%, respectively, in 2008, and at 2.0% in 2009.

The Cayman Islands' Economic Forecasts

In view of the changes in the economic prospects for the world's major economies which are key markets for the Cayman Islands, the forecasts of real GDP growth for the Cayman Islands have been lowered to 1.7% for the 2008 calendar year and 1.4% in 2009. It may be noted that while these growth rates are lower when compared to those in 2005, 2006 and 2007, they are slightly higher when compared to the economic performance between 2000 and 2003 when GDP growth occurred at an estimated average rate of 1.3%.

The key assumptions for the forecasts in 2008 and 2009 are that the financial services sector will remain resilient and that the high-end stay-over tourism market will remain relatively buoyant. Given the GDP growth expectations, unemployment¹ rates in the Cayman Islands are forecast at 4.1% in 2008 and 4.5% in 2009.

For the Cayman Islands, the forecast inflation rates are 3.1% in 2008, and 3.0% in 2009. The actual inflation rate in 2007 was 3.2%.

Fundamentals of the Cayman Islands' Economy

Madam Speaker, the fundamentals of the Cayman Islands economy remain strong. The Cayman Islands has maintained its "Aa3" credit rating from Moody's Investors Service. This standard provides potential investors in the Cayman Islands with the confidence that our economy is sound and is being managed prudently.

The Financial Services Sector—Performance and Outlook

The Cayman Islands continues to be recognized as one of the world's leading offshore financial centres. Our financial services industry experienced steady growth over the past year and this trend is expected to continue into the next financial year.

Evidence of the strength of this industry can be found in a number of areas. For the 12-month period ended 31st March 2008 the General Registry recorded a 5% growth in total company registrations.

Exempt companies grew by 9%. This is an important benchmark because exempt companies represent approximately 80% of the revenue generated by the General Registry.

The Cayman Islands Monetary Authority recorded a 14.7% increase in the number of registered mutual funds for the year ended 31st March 2008. This sector continues to perform well and all indications are that growth will carry on into the coming financial year.

The Cayman Islands remain a choice jurisdiction with over 40 of the world's top 50 banks licensed here.

¹ A person is said to be unemployed when they are actively seeking work but is unable to find it.

The Cayman Islands Stock Exchange recorded a 43% increase in its total listings for the 2007 calendar year which includes a 19% increase in fund listings and more than doubled the number of debt securities listed. Market capitalisation increased 51% from US\$111.5 billion to US\$168 billion.

The Tourism Industry—Performance and Outlook

Madam Speaker, over the past three years, the tourism industry has been stable and made a significant contribution to the economic development of the Cayman Islands. Since 2005, when the recovery from Hurricane Ivan began, tourist air arrivals have significantly grown year over year. In 2006, air arrivals grew by 59.3%; in 2007 by a further 9.1% and for the first quarter of 2008 we have had a 9% increase in air arrivals when compared to this period last year.

This recovery can be attributed to a joint public and private sector initiative to drive economic recovery and product improvement. The Government has continued to build effective distribution channels, protected or grown all important airlift to the destination, and led a strategic shift in the target market which has better positioned the destination to survive the ups and downs of the world economy.

The Government has recently led a strategic plan to help the entire industry prepare for, and mitigate, the expected negative impacts of the global economic downturn. While a softening of the recent growth trends are expected later this year, we remain optimistic that given investments in marketing coupled with the strong British Pound and Euro, the Cayman Islands will rebound with a strong winter 2009.

While the United States remains by far the largest market for the Cayman Islands representing some 80% of all visitor arrivals, both Canada and Europe are demonstrating impressive growth with each posting gains in excess of 16% at year-end 2007. In the first quarter of 2008, these secondary markets continue to perform well, with Canada showing an increase of over 23% and Europe showing an increase of 10%, compared to this period last year.

The Impact of the Global Economy on the Cayman Islands

Madam Speaker, the effect of the global economic downturn on the Cayman Islands, is not all doom and gloom. In recent months, the interest rates charged by local banks for loans and mortgages have fallen dramatically following reductions in the US prime lending rate, giving some real relief on personal and business cash flows.

I wish to remind everyone that the Government already has in place certain tariffs that seek to minimise the extent of any increase in the cost of living. Currently, import duties are not charged on staple food products such as chicken, fish, rice, beans, flour, bread, cereals, milk, cream, butter, cheese, sugar and salt—in addition to a number of other food products which are charged reduced import duties of 10% to 15%.

The decision to keep these food products at reduced or duty-free rates is important: it endeavours to ensure that all members of our society continue to have access, at affordable-as-possible prices, to that most basic necessity, food.

In December 2007, Government announced that it had entered into an agreement with Caribbean Utilities Company, to provide an import duty rebate on the fuel the Company consumes in generating electricity: the Company, in turn, has and will continue to pass this rebate on to residential consumers—resulting in reduced electricity bills. The annual financial impact of this deliberate decision of Government to alleviate a portion of the high cost of electricity to residential consumers is approximately \$6 million. In 2008/9, Government's forecast revenue from import duties on diesel has therefore been amended to take account of this decision.

The Appropriations

Madam Speaker, I will now turn to the specific Appropriations listed in The Bill that is now before this Honourable House. Details of these Appropriations are shown in the Annual Plan and Estimates (AP&E) Document which accompanies the Appropriation Bill.

This Bill provides for Appropriations across eight different categories in respect of the planned activities of the 13 Ministries, Portfolios and other Government entities. These Appropriations will allow the Government to incur expenditures, make investments and undertake borrowings during the 2008/9 year to achieve its Broad Outcome Goals.

Output Groups

Output Group Appropriations total \$419.6 million, of which some \$87.2 million is for outputs to be delivered by Statutory Authorities and Government Companies and \$13.9 million is for outputs to be delivered by Non-Governmental Organisations.

Transfer Payments

Appropriations for Transfer Payments total \$22.4 million and will allow for the continuance of important financial assistance to those most needy in our society.

Other Executive Expenses

Other Executive Expenses total \$28.5 million and will be used to fund items such as: payments to the Public Service Pensions Board to reduce the Government's Past Service Liability in respect of the Civil Service pensions scheme; personal emoluments to the Executive branch of Government; and contributions to various international organisations including CARICOM, the Caribbean Development Bank and United Nations' agencies.

Equity Investments

Equity Investments into Ministries, Portfolios, Statutory Authorities and Government Companies total \$118.1 million and will be used to fund the following major items:

- Ministry of Education, Training, Employment, Youth, Sports and Culture—**\$68 million**— for the construction of three new high schools on Grand Cayman, development of a new George Town Primary School, repairs and upgrades to existing schools, completion of the George Town Public Library, upgraded information technology equipment and software and the purchase of land for a new Cayman Brac High School;
- Portfolio of Internal and External Affairs—**\$15 million** — for the development of a Bodden Town Emergency Response Facility, development of a marine base and purchase of vessels and equipment for the Royal Cayman Islands Police Service, prison building renovations, purchase of vehicles and equipment for the Fire Service, development of a National Emergency Operations Centre;
- Ministry of Communications, Works and Infrastructure—**\$6.8 million**—for the construction of a new vehicle licensing headquarters, purchase of vehicles and heavy equipment, upgrades to the Airport Post Office, equipment and materials for a recycling programme;

- Ministry of District Administration, Planning, Agriculture and Housing—**\$3 million**—for the development of a new aircraft hangar for MRCU and the purchase of vehicles, equipment and other assets for the Ministry;
- Health Services Authority—**\$8.2 million**—for the purchase of new medical equipment and to cover the Authority’s expected Operating Losses;
- Cayman Turtle Farm (1983) Limited—**\$8.1 million**—for bond repayments and expected Operating Losses;
- Tourism Attractions Board—**\$1.9 million**—for the repayment of its Caribbean Development Bank loan;
- Cayman Islands National Insurance Company—**\$1.5 million**—to maintain the company’s compliance with the minimum capitalisation requirements of its insurance licence.

Executive Assets

Executive Asset Appropriations total \$46.3 million and will be used to fund the following:

- construction of the new Government Administration Building—**\$19.5 million**;
- continued improvements to the Islands’ road network—\$8.8 million;
- construction of upgraded sports facilities on Grand Cayman and Cayman Brac—**\$2.6 million**;
- construction of new or upgraded Senior Citizen Homes in North Side and East End—**\$2 million**;
- construction of a new Summary Courts Building—**\$2 million**;
- development of a new Bodden Town Civic Centre—**\$1.9 million**;
- improvements to landfills on all three Islands—**\$1.2 million**;
- development of a Juvenile Secure Remand Facility—**\$1 million**;
- construction of a dedicated mental health facility—**\$1 million**;

- development of a new Farmers' Market—**\$0.85 million**; and
- acquisition of additional land for the Barkers National Park—**\$0.8 million**.

Madam Speaker, the significant level of capital expenditures that will occur as a result of the Equity Investments and Executive Assets, will provide a tremendous boost to our local economy.

Loans Made

Appropriations for Loans to be made by the Government total \$1.3 million. This is a relatively small amount and represents Loans Made to the following categories of persons: persons in need of urgent overseas medical care; Government employees in respect of loans to acquire property and loans to farmers.

Borrowings

Appropriations for Borrowings total \$154 million and will be used to fund the Government's planned capital investment programme.

Madam Speaker, it is very important that I point out that the level of borrowing proposed for 2008/9 is exactly the same as that set out in the Strategic Policy Statement (SPS) for 2008/9. The SPS provided the foundation for the detailed 2008/9 Budget that has been Tabled earlier and it was approved by the Legislative Assembly on 30th November 2007. Hence, the Legislative Assembly has approved the level of borrowing set out in the 2008/9 Budget.

Recently, there has been much public commentary on the level of borrowing and debt incurred by Central Government. Whilst it is legitimate for such discussion to occur, it must be done in a factual manner. Such commentary frequently states that Central Government's borrowing in the course of a year and/or its debt is \$700 million.

Note 27, on page 311 in the Annual Plan and Estimates document for 2008/9 clearly indicates that the Central Government's debt level expected at 30th June 2009— assuming that the full current year's proposed borrowing of \$154 million is drawn-down—is \$412.7 million. Commentary that Central Government's debt and/or its borrowing in the course of a year is \$700 million, is therefore inaccurate.

Nonetheless, it is proper that members of the public focus on Central Government and the wider public sector debt. The Government, equally, keeps a focus on borrowing and debt levels.

Financing Expenses

The Appropriations for Financing Expenses total \$13.4 million and represent the interest expense on the full balance of Government borrowings.

Government's Forecast Financial Statements

Madam Speaker, I will now turn to the forecast financial statements which underpin the 2008/9 Budget. These statements are also shown in the AP&E document which accompanies the Appropriation Bill.

The Operating Results

The Net Operating Surplus is the key measure of the Government's operating performance. In order to comply with the PMFL, Government is required to achieve a surplus.

The 2008/9 Budget forecasts a Net Operating Surplus of \$13.5 million. This surplus is an important component of the Government's overall fiscal strategy: operating surpluses assist the country in achieving cash balance levels that comply with the PMFL and, such surpluses also help to fund capital expenditures.

The fact that the Government is forecasting a Net Operating Surplus in the face of global economic difficulties is not an accident nor was it achieved easily. Over the past few weeks Ministries and Portfolios were required to re-examine their 2008/9 Budgets in order to identify expenses which could be eliminated without creating disruption to the provision of services to the public. Each year, Ministries and Portfolios—which can be collectively described as agencies—are given expenditure allocations that they are expected to abide by as closely as possible. This is done in the SPS that is formulated in respect of each financial year.

The SPS is presented to the Legislative Assembly by 1st December each year—in respect of Government's financial year that will start on 1st July in the following calendar year.

In many instances, the 2008/9 expenditure re-examination exercise resulted in agencies reducing their Budgets below their SPS allocations.

Madam Speaker, I must congratulate Honourable Ministers and Members of Cabinet along with their Chief Officers and their finance teams for undertaking this important task of intense budget scrutiny and also for re-prioritising their plans for the year ahead in order for the Government to have a forecast operating surplus for 2008/9.

Revenue Projections for 2008/9

There will not be any new revenue measures introduced in the 2008/9 financial year. This honours an earlier commitment given to the country by the Government and it reflects a deliberate action of the Government not to increase the financial obligations of businesses and individuals during 2008/9.

In the 2008/9 financial year, the Government is forecast to earn approximately \$528 million in operating revenue. This is approximately \$11 million less than was forecast in the 2008/9 SPS. This downward revenue projection is the direct result of the current economic environment we find ourselves operating in, and it also reflects lower economic growth forecasts. The revenue forecasts represent a slight gain of \$4.9 million over the estimated revenues for the current 2007/8 financial year.

Over the past four financial years the Government of the Cayman Islands has experienced significant growth in its revenues and while overall net growth in revenues is forecast for the 2008/9 financial year, this growth is not expected to be as strong as in previous years.

The reduction in the forecasts of Other Import Duties and Charges primarily reflects the view that the decline in the outlook of the US economy would impact the Cayman Islands, resulting in lower imports. This is supported by the Economics and Statistics Office's import statistics, which suggest that the value of total imports in 2007 is significantly lower than in 2006.

The lowering of the forecasts for Cruise Ship Departure Taxes and the Environmental Protection Fund Fee is directly linked to lower forecasts for cruise arrivals in 2007/8 and 2008/9.

While there will not be any new revenue measures in 2008/9, Government's revenue-collecting agencies will be stepping up their efforts to collect all revenue which is due to Government. In this regard, all businesses and individuals are asked to be prompt with their payments to Government. Delayed payments negatively impact cash flow and can lead to higher expenses for debt collection.

Forecast Operating Expenses

The 2008/9 Operating Expenses are forecast to be \$501.3 million. This amount represents some \$28.2 million more than was forecast in the SPS and a \$12 million increase over the expected 2007/8 outturn.

On the surface, these increased operating expenses may seem to present cause for concern, however, one has to consider the economic environment in which we operate and the fact that these higher-than-expected operating costs are being driven by a number of external factors which are impacting the cost of doing business worldwide such as the rising cost of healthcare, fuel, electricity, and general upward inflationary pressures on most areas of expenditure.

The costs associated with the provision of safe, high quality healthcare have continued to increase in the Cayman Islands; this is consistent with global trends.

The Government, through the Cayman Islands National Insurance Company (CINICO) provides health insurance to civil servants and their dependants; civil service pensioners; employees of some statutory authorities and Government companies; as well as the elderly, veterans and seamen, health-impaired and low income members of our community.

CINICO has seen a significant increase in the cost of providing overseas medical care. In addition, there has been an increase in fees being charged by the Health Services Authority, the primary health care provider for persons insured by CINICO. These facts have resulted in CINICO increasing the premiums it charges Government for civil servants and pensioners by 44% and 32% respectively, resulting in a net increase of \$14 million in expense to the Government for the 2008/9 financial year.

This \$14 million increase accounts for approximately 50% of the increase in operating expenses between the level in the SPS and the 2008/9 Budget.

Another area of Operating Expense which has seen a significant increase since the SPS forecasts are the net operating losses of the Statutory Authorities and Government Companies, commonly referred to as SAGCs. When the 2008/9 SPS was approved by the Legislative Assembly in November 2007, these agencies were collectively forecast to record an Operating Deficit of \$1.6 million in the 2008/9 financial year. However, for the 2008/9 Budget this forecast deficit has been increased by approximately \$10 million to \$11.6 million.

This significantly-worsened operating position in the SAGC sector is being driven by a combination of the global economic factors described earlier as well as particular challenges facing some agencies.

The most notable loss-making SAGCs are: the Health Services Authority with a projected net loss of \$7.6 million; Cayman Turtle Farm (1983) Limited with a projected net loss of \$6.9 million and Cayman Airways Limited with a projected net loss of \$2.7 million. The Government takes this matter very seriously and is working closely with all loss-making SAGCs to implement changes in these organisations which will improve their operating position.

The Forecast Cash Flow Statement

Madam Speaker, the forecast Cash Flow Statement indicates that \$145 million will be used for the purchase or development of new assets and a further \$21.6 million will be used to fund Equity Investments into SAGCs.

The Cash Flow Statement indicates that net cash outflows for investing activities are expected to be \$165.4 million for the 2008/9 financial year. This represents a \$33.9 million reduction over the SPS forecasts and reflects Government's commitment to keep its capital investment programme to levels that will enable compliance with the PMFL.

Cash Reserves at 30th June 2009 are expected to be \$118.5 million. This is a \$7 million increase over the forecasted 30th June 2008 expected cash balance of \$111.5 million. The expected Cash Reserves level of \$118.5 million at 30th June 2009 complies with the minimum 90-day expenditure coverage required for the PMFL for the 2008/9 financial year.

Compliance with the PMFL

Madam Speaker, the PMFL is very specific in terms of how it defines the fiscal guidelines within which the Government must operate its financial affairs.

The Principles of Responsible Financial Management are set out in Section 14 of the PMFL and I will now explain how this 2008/9 Budget complies with these Principles.

The first principle relates to the operating results of the Government and requires that Core Government's Revenue less Core Government Expenses be positive. This has been fully satisfied with a forecast operating surplus of \$13.5 million.

The second principle requires that Government maintains a positive Net Worth. Full compliance has been met as the Government's Net Worth is forecast to be \$532.6 million at 30th June 2009.

The third principle relates to the maximum allowable Debt Service costs and requires that these costs be no more than 10% of Core Government Revenue. This ratio is ultra prudent, and holds the Government to a very strict limit. It is the international norm for this type of ratio to be calculated using only the principal repayments; however, the PMFL goes a step further by including interest payments in the calculation, making the ratio more onerous to comply with. For 2008/9, the Government is forecasting its Debt Service Ratio to be 7.9%—which is below the 10% limit.

The fourth principle also relates to borrowing but it sets the limit for the total amount of Net Debt that can be carried by the Government to be no more than 80% of Core Government Revenue.

The Net Debt is calculated as being the outstanding balance of Core Government Debt **plus** the outstanding balance of self-financing loans **plus** the weighted outstanding balance of SAGCs' debt guaranteed by the Government, **less** core government liquid assets.

For 2008/9 the Government is forecasting its Net Debt Ratio to be 73% of Core Government Revenue—which is below the maximum of 80%.

The fifth principle requires that Government maintains cash reserves that are no less than 90 days of estimated executive expenses at 30th June 2009. The 2008/9 Budget complies with this requirement with cash reserves forecast at 91 days.

Conclusion

Madam Speaker, the preparation of the 2008/9 Budget has been challenging but it has also been rewarding. In the face of global economic uncertainty the Government has had to make changes to planned budgetary interventions for the 2008/9 financial year.

It has been rewarding because despite global economic difficulties, the Government has produced a Budget which is grounded in sound fiscal management and is in full compliance with the Public Management and Finance Law. The 2008/9 Budget is a budget that will enable the Government to achieve its stated national priorities.

The 2008/9 Budget will allow for the construction of some key physical infrastructure that will, among other things, improve the overall efficiency of the delivery of Government services; significantly improve the educational system for our children; foster economic development and growth; and create a firm footing for the next generation of Caymanians to create the next chapter of the Cayman success story.

The requests made in the 2008/9 Budget are encompassed within the Bill that is now before the Legislative Assembly.

I, therefore, commend The Appropriation (July 2008 to June 2009) Bill, 2008 to this Honourable Legislative Assembly and seek members' support.

Thank you, Madam Speaker.