A Common-Sense Budget Addressing The Needs Of Today And The Future

2005/06 Address to the Legislative Assembly

Delivered by the Honourable Financial Secretary Kenneth Jefferson, JP, to the Legislative Assembly 10th October 2005.

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Part 1: Introduction

Madam Speaker, it is my privilege to present the Budget for the 2005/6 financial year that covers the 12-month period from 1st July 2005 to 30th June 2006, on behalf of the Government. In keeping with the practice in recent years, after I have concluded my Address, it is anticipated that the Honourable Leader of Government Business will be the first Member to give his contribution to the debate on the Appropriation Bill.

Madam Speaker, the 2005/6 Budget is a common-sense budget that reflects a careful and deliberate plan of action established by the Government.

It is a budget that allocates resources to the Government's highest priority outcomes.

It is a budget that addresses the needs of today while also preparing for the needs of the future.

It is a budget that recognises the differing circumstances of the three Islands, and allocates resources accordingly.

It is a budget that supports the economy - particularly the key sectors of financial services and tourism that drive the economy.

Madam Speaker, it is a budget that is fiscally responsible; it complies with both the Government's fiscal strategy and the Principles of Responsible Financial Management set out in the Public Management and Finance Law.

Part 2: Overview of the Key Budget Policies

Madam Speaker, the Budget provides for approximately $367.3 million of operating expenditure in 2005/6, and a further $80.6 million of investing or capital expenditure.

These expenditures have been allocated to fund outputs, transfer payments, executive assets and other policy actions designed to achieve the Government's 11 broad outcome goals. Those outcomes were set out in the 2005/6 Strategic Policy Statement agreed by this Legislative Assembly in August 2005.

Madam Speaker, the Honourable Leader of Government Business will comment in detail about the outcome goals and the policy actions being funded when he makes his contribution. However, for the benefit of Honourable Members I would like to provide an overview of the key policy drivers of the Budget.

I do this, Madam Speaker, because the annual Budget is much more than an annual financial statement. It is the Government's plan of action for a financial year.

The public can perhaps relate more easily to Government's policies, its actions and its planned services that the Budget provides funding for, more than it can to the financial statement component of annual Budget documentation. The policies and actions of Government along with the services it will provide are given in the Annual Plan and Estimates for the 2005/6 financial year that was Tabled earlier.

Madam Speaker, the Annual Plan and Estimates contain a wide range of policy actions. Many of these are in respect of annually recurring outputs and actions by Government. However, the Budget provides some additional resources to deal with particular challenges facing the country at this time that were not in existence in previous years.

In particular, approximately $36.5 million has been allocated to support the ongoing hurricane recovery effort. This is a very significant amount as it equates to approximately 8.5% of total government revenue forecast for 2005/6. This is expenditure that was not required before Hurricane Ivan and is a reflection of the degree of re-prioritisation of government expenditure that has occurred as part of this financial year's budget process.

Some of the specific actions to be funded from this amount include further assistance to residents to rebuild and furnish their homes, further debris removal, the reconstruction of roads and seawalls, the reconstruction of civic centres and other public buildings, repairs to community sports facilities, and improvements to emergency management outputs.

Another area of priority in this budget is the funding of agencies involved in fighting crime. An additional $4.75 million has been provided for Police outputs, together with $3.9 million for new police equipment.

The third notable feature of the budget is the amount of funds allocated to strengthen families and the community. The cost of policy actions relating to this outcome is $96.1 million. Operating and Capital expenditure planned on education during the year is $94.5 million. Planned expenditure on strengthening families and the community and on education, totals $190.6 million. This is a significant level of expenditure on these two outcome goals of Government.

However, Madam Speaker, as I indicated in my opening remarks, this Budget is concerned with more than just the challenges of today. It is also focused on positioning the country for the future. Three sets of budget initiatives are notable in this context.

The first is in relation to education infrastructure. The budget provides for an equity injection of $19.9 million into the Ministry of Education, Training, Employment, Youth, Sports and Culture. Of this $19.9 million, $14.9 million is to begin the construction of the three new high schools, a new primary school, and other school facilities on both Grand Cayman and Cayman Brac.

The second is road infrastructure. The budget allocates $9.6 million for road related projects. Of this amount, $5.4 million is to fund the further development of major arterial roads.

The third relates to health services. The budget makes provision for a $12 million equity injection into the Health Services Authority. This is part of a larger programme of activity to put the Health Services Authority on a stable financial and clinical footing for the future. It therefore reflects the Government's commitment to improving the health of the nation and it recognises the importance of health services to the quality of living in these Islands.

Part 3: The Financial Forecasts

Madam Speaker, I would now like to turn to the financial forecasts.

Basis Preparation

In accordance with the requirements of the Public Management and Finance Law, the Annual Plan and Estimates tabled in this Honourable House today include a detailed set of financial forecasts for the 2005/6 financial year in the form of a full set of accrual-based financial statements. Those forecasts are provided in Part C of the Annual Plan and Estimates.

The forecast financial statements provide a comprehensive range of financial information about the Government's forecast financial performance for the year. Within the financial statements as a whole, I would like to draw Honourable Members' attention to three components.

The first is the forecast Operating Statement. This reports the budgeted revenues and expenses, measured on an accruals basis, and the resulting net surplus or deficit. The net surplus or deficit is the key measure of the Government's operating performance.

The second key statement is the forecast Balance Sheet. This reports the assets and liabilities Government is budgeting to own, or in the case of liabilities, owe, at the end of 2005/6. The resulting Net Worth figure, being total assets less total liabilities, is the key measure of the Government's financial position.

The third key statement is the forecast statement of cash flows. This reports the operating, investing, and financing cash flows the Government is budgeting for 2005/6. This statement provides information about changes in cash balances which result from Government's recurring operating activities, its capital expenditures and its borrowing plans. The resulting net increase or decrease in cash and cash equivalents that arise from the movement in these three areas is the key measure of the change in the Government's cash position.

The financial statements have been prepared using the accrual basis of accounting. As this is only the second year that the Budget has been compiled on this basis, I would like to remind Honourable Members of the key features of accrual accounting.

Firstly, under accrual accounting, recurring operating transactions are distinct from capital transactions. Separate statements are prepared for recurring operating transactions and capital activities. These activities are recorded in the three statements I have just outlined - the Operating Statement, Balance Sheet and Statement of Cash Flows.

Secondly, under accrual accounting, operating revenue is recognised in the Operating Statement when it is due, not when the cash is collected. Revenue due but not collected is recorded as debtors in the Balance Sheet.

Operating expenses, on the other hand are recognised in the Operating Statement when the expense is incurred. This is usually the point at which the expenditure is committed to, rather than when the cash payments are made by, Government. Expenses payable but not yet paid are recorded in the Balance Sheet as creditors.

Thirdly, non-cash expenses are also recognised in the Operating Statement. The major non-cash expense is depreciation. This reflects the use - or wearing out - of assets. Any write-off or reduction in the value of assets is also recorded as an accrual expense.

In accordance with the requirements of the Public Management and Finance Law, the forecast financial statements provide two sets of figures: one for the Core Government Sector; and one for the Entire Public Sector.

The Core Government comprises the Legislative Assembly, Cabinet, Ministries and Portfolios, the Judicial Administration, the Audit Office and the Office of the Complaints Commissioner. It also includes the operating surpluses and deficits of Statutory Authorities and Government Companies as a single line in the Operating Statement entitled, in this year's financial statements, "Net Loss of Public Authorities". Similarly, the Net Worth of Statutory Authorities and Government Companies is recognised in a single line in the Balance Sheet entitled "Net Worth of Public Authorities".

The Entire Public Sector includes the same information as the Core Government. However, in the column of the financial statements that provides details of the Entire Public Sector, the revenues, expenses, assets and liabilities of Public Authorities are reported on a line-by-line basis by aggregating these items with the revenues, expenses, assets and liabilities of the Core Government.

The key measures of Government's financial performance and position - the overall operating activity and Net Worth - are the same for both the Core Government and the Entire Public Sector.

Madam Speaker, it is also important to state that while the financial statements shown in the Annual Plan and Estimates provide information on the activities of Statutory Authorities and Government Companies, the Appropriation Bill does not seek to obtain amounts that would fund the entire operations of Statutory Authorities and Government Companies. The Appropriation Bill seeks to obtain funding for Core Government's operations - some of which involves making equity investments in Statutory Authorities and purchasing outputs from Government Companies.

Overview of Forecasts

Madam Speaker, the financial forecasts that I have just outlined fully comply with both the Government's fiscal strategy outlined in the Strategic Policy Statement for 2005/6, and the Principles of Responsible Financial Management contained in Section 14 of the Public Management and Finance Law.

The Government's fiscal strategy has three elements: fiscal responsibility; addressing the Islands' infrastructure needs; and economic management considerations.

In relation to fiscal responsibility, one of the Government's 11 outcome goals is sound fiscal management. The Government recognises that this is the bedrock upon which investor confidence in these Islands is built. It is also critical to the Government's ability to obtain the financing necessary to repair, maintain and further develop the Islands' infrastructure.

Accordingly, the Government is fully committed to the Principles of Responsible Financial Management; these Principles are intended to ensure that Government remains fiscally responsible and prudent. Compliance with the Principles is therefore the first, and perhaps most important, element of the Government's fiscal strategy. It is, and will continue to be, a key driver of the Government's financial decision-making.

The second element of the Government's fiscal strategy is the generation of the cash flows necessary to finance priority infrastructure needs. The Government's approach to achieve this is five-fold.

The first is to keep a tight rein on operating expenditure.

Controlling operating expenditure generates operating surpluses to finance the new needs. Such control requires active prioritisation of expenditure demands and this has been a key feature of the 2005/6 budget process. A rigorous and detailed expenditure review and expenditure-cutting exercise was conducted by Cabinet when establishing the targets for each member of Cabinet set out in the Strategic Policy Statement.

As a general rule, the allocations to each Minister and Official Member of Cabinet for 2005/6 were approximately equal to what was received in 2004/5. The exception to this was in relation to specific, identified new initiatives essential to the achievement of the Government's outcome priorities. These included new outputs relating to fighting crime from the Royal Cayman Islands Police, the Portfolio of Legal Affairs and Judicial Administration. They also included additional expenditures relating to the recovery and restoration of the Islands after Hurricane Ivan.

The second financing strategy is ensuring that Public Authorities are financially sustainable.

This strategy involves working with Statutory Authorities and Government Companies - particularly the large-loss making ones such as Cayman Airways Ltd and the Health Services Authority - to develop financially stable business operations. The ultimate goal in this regard is to achieve an overall break-even position for the public authority sector.

As I have already outlined, significant progress has been made in achieving this goal as part of this budget.

The third financing strategy involves identifying new external sources of finances. No new external finance sources have been included in the 2005/6 budget but work to explore such options is underway and will be incorporated in future years' budgets.

The fourth financing strategy is to undertake new borrowing, but with two important caveats. First, borrowing must be within the limits established by the Principles of Responsible Financial Management and secondly, the timing of capital expenditure will be managed so as minimise borrowing levels.

As previously stated, the forecasts have been prepared on a basis that complies with these caveats. While $63 million of new borrowing is planned, after taking into account the repayment of existing borrowing, net public debt is forecast to increase by only $46.9 million in 2005/6. This level of borrowing is well within the limits of the Principles of Responsible Financial Management established by the Public Management and Finance Law. In addition, the use of existing cash balances ensures that borrowing levels are minimised.

The final financing strategy is to increase revenue; the medium term targets established in the Strategic Policy Statement made provision for this, especially in the 2006/7 and 2007/8 financial years.

However, as the Honourable Leader of Government Business outlined when he Tabled the Strategic Policy Statement in August 2005, new revenue measures will be used only to fund new or additional public services. New revenue measures will not be introduced to fund increases in costs relating to existing services. These will be funded by natural revenue growth or expenditure reprioritisation, as has been the case with this budget.

The 2005/6 budget forecasts include provision for only one new revenue measure - an increase in mutual funds fees that I outlined earlier - and as indicated, this will be used to ensure that the Cayman Islands Monetary Authority can support the current growth levels being experienced in the mutual funds sector.

Madam Speaker, the third element of the Government's fiscal strategy relates to economic management. The Government recognises that if not properly thought out, new revenue measures can be damaging to the economy. Accordingly, in determining the level of operating revenues, operating expenses, and capital expenditures, it will consider the economic impact these levels will have. The Government used this approach when considering the new revenue measure for 2005/6 that I just outlined.

Madam Speaker, another benchmark for assessing the financial forecasts included in the Annual Plan and Estimates is the extent of their compliance with the aggregate financial targets established in the Strategic Policy Statement approved by this Honourable House in August. I shall refer to the Strategic Policy Statement hereafter as the SPS.

I am pleased to report that the budget forecasts fully comply with those parameters, Madam Speaker. The key operating measure - the "surplus before Extraordinary Items" - is $2.4 million better than the SPS target figure.

In relation to Balance Sheet activities, the forecast balance of borrowings at the 30th June 2006 year-end is $26.5 million less than the SPS target figure. This reflects a higher opening cash position than was stated when the SPS targets were established, thereby reducing the borrowing requirement.

When the cash flow statement in the financial statements contained in the Annual Plan and Estimates is compared to the cash flow target figures shown in the SPS, differences will emerge. Those differences reflect the fact that the operating activity and Balance Sheet positions in the Annual Plan and Estimates have changed from those contained in the SPS that was considered by the Legislative Assembly in August 2005. Those changes simply reflect more accurate and up-to-date information since August. The forecast closing cash balance for 2005/6, of $71.3 million, is only $5.2 million less than the SPS target figure.

However, the forecast $71.3 million level of cash balances at 30th June 2006, equivalent to 76 days of expenditures, is significantly in excess of the 45-days cash balances level set by the Principles of Responsible Financial Management for the 2005/6 year.

Madam Speaker, perhaps most importantly of all, the financial forecasts also fully comply with the Principles of Responsible Financial Management set out in the Public Management and Finance Law.

The operating surplus before Extraordinary Items is positive as required by those Principles. Core Government's Net Worth is also positive - as required by the Principles.

The Debt Service ratio, which measures the debt-servicing burden of the Government, is forecast to be 6.8% of Core Government revenue; well below the 10% required by the Principles.

The Net Debt ratio, which is a measure of the sustainability of the total amount of public debt, is forecast to be 64.4% of Core Government's revenue, again well below the 80% required by the Principles.

Finally, cash reserves are forecast to be at a level equal to 76 days of executive expenditure. This is in excess of the 45 days required by the Law for 2005/6, the 60 days required for 2006/7 and the 75 days required by 2007/8.

Compliance with Strategic Policy Statement and Principles of Responsible Financial Management

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Part4: Timing of the Budget

Madam Speaker, before I conclude I would like to take a moment to explain the timing of this Budget Address.

As Honourable Members are aware, the Annual Plan and Estimates document is normally prepared and presented to the Legislative Assembly in April each year. This allows the Appropriation Bill to be enacted before a new financial year begins on 1st July each year.

However, Hurricane Ivan and the delayed General Election have resulted in a later than usual budget process for the 2005/6 financial year. The Strategic Policy Statement for 2005/6 presented to the Legislative Assembly in early August 2005, was much later than usual.

This, in turn, has resulted in a much later than normal finalisation of the Budget for the current financial year: the 2005/6 full-year budget is now being presented to the Legislative Assembly - approximately three months after the current financial year began on 1st July 2005. Honourable Members are reminded that during the period from 1st July 2005 to the end of October 2005, Government is duly authorised to incur expenditures by virtue of the "Pre-Appropriation" Motion approved by the Legislative Assembly in June 2005.

The Annual Plan and Estimates and other budget documents for 2005/6 cover the full 12-month period from 1st July 2005 to 30th June 2006. They therefore supersede the documents provided to the Legislative Assembly at the time of the Pre-Appropriation Motion. If enacted into Law, the 2005/6 Appropriation Bill will subsume the interim appropriation authority provided by the Pre-Appropriation Motion.

The timing of the 2005/6 budget process is a one-year aberration. The timing for the 2006/7 budget cycle will revert to that prescribed by the Public Management and Finance Law; the 2006/7 Strategic Policy Statement will be presented to the Legislative Assembly for its consideration no later than 1st December 2005, and the 2006/7 Budget will be presented to the House no later than 1st May 2006.Part

5: Conclusion

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

I also wish to thank you, Madam Speaker, for your persistent enquiries as to progress being made on the finalisation of the Budget documentation.

Madam Speaker, it is a little over one year since Hurricane Ivan ravaged our Islands. These Islands have made tremendous progress in the restoration effort over that time. However, there is still much to do.

The Annual Plan and Estimates, Tabled earlier, acknowledges and recognises that there is still much to do. It allocates substantial resources to outputs, transfer payments, capital projects and other actions related to Government's stated number one priority outcome - dealing with the aftermath of, and lessons from, Hurricane Ivan.

However, Madam Speaker, as important as it is to restore the Cayman Islands after the storm, it is also important that we look forward to the future. It is important that we prepare for the challenges and opportunities of the future. The 2005/6 Budget does this too, Madam Speaker. It provides funding to develop the economic and social infrastructure of these Islands; particularly noteworthy are new high schools and new arterial roads.

At the same time, Madam Speaker, the Budget maintains funding levels for the vast array of Government's other annually recurring services.

It is also important to note that it does all of this in a fiscally responsible way - a way that will support the ongoing development of our economy.

Madam Speaker, this 2005/6 Appropriation Bill is based on a common-sense Budget that complies with the Principles of Responsible Financial Management, addresses the Islands' needs of today, and prepares for its needs of the future.

Madam Speaker, I commend The Appropriation (July 2005 to June 2006) Bill, 2005 to Honourable Members and accordingly ask that they support the Bill.

Thank you, Madam Speaker.