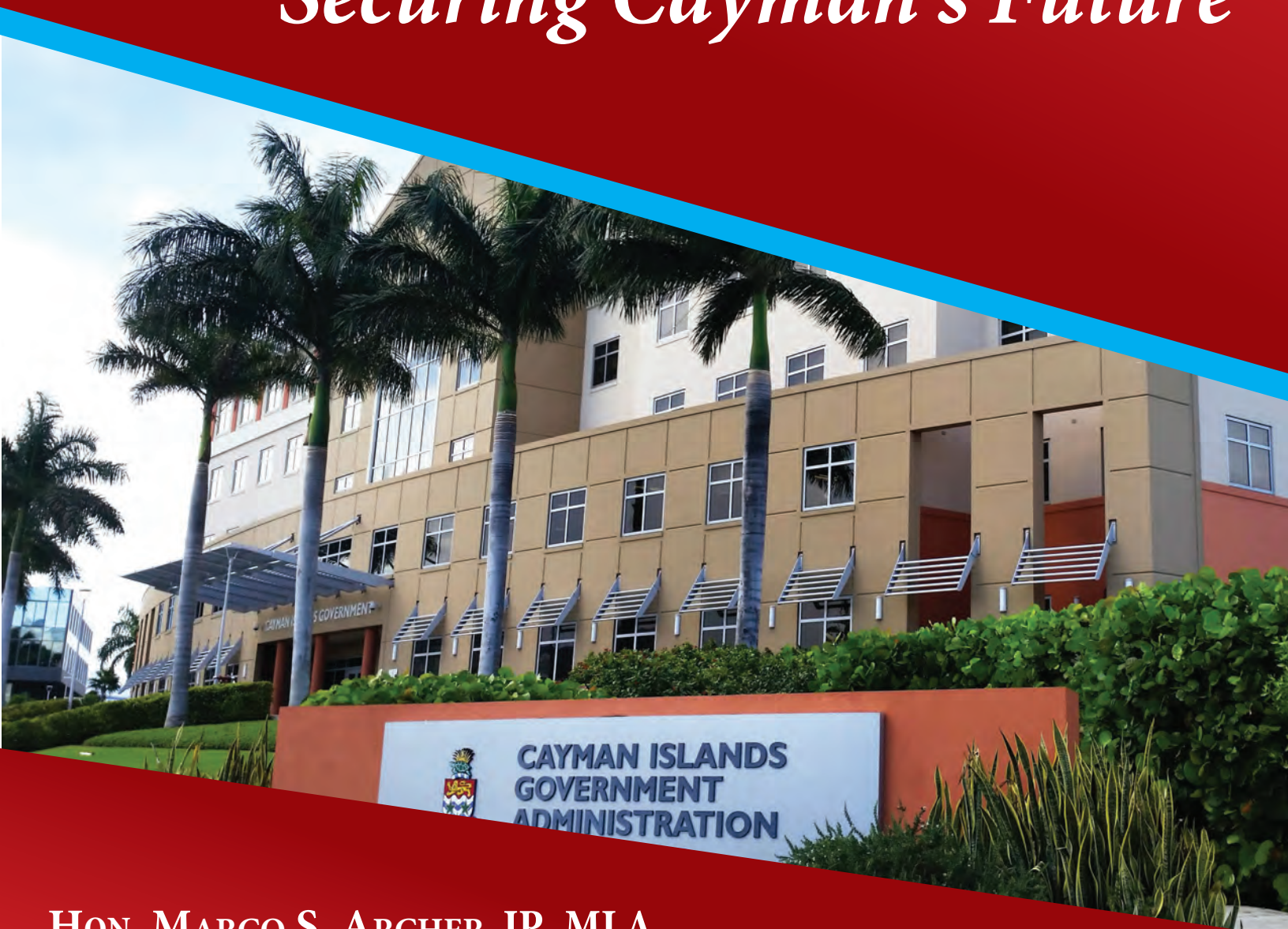




CAYMAN ISLANDS  
GOVERNMENT

*Budget Address 2016/2017*

# *Securing Cayman's Future*



**HON. MARCO S. ARCHER, JP, MLA**

**MINISTER FOR FINANCE AND ECONOMIC DEVELOPMENT**

*30 May, 2016*

# **Securing Cayman's Future**

## **Introduction**

Madam Speaker, I thank God for the privilege to rise today to speak to The Appropriation (July 2016 to December 2017) Bill, 2016 and for the success that He has bestowed upon us.

The 2016/17 Budget is my fourth Budget as Minister for Finance and Economic Development and represents yet another steady step in our progress toward long term fiscal stability, economic growth and ensuring a sound financial future for our Islands.

Madam Speaker when I presented this Administration's first Budget on 7<sup>th</sup> October 2013 my Budget Address was entitled "Economic Growth through Fiscal Prudence" and I put forward the sound reasoning that if the Government would practice fiscal prudence, economic growth would follow due to investors' and business entities' having increased confidence in the Cayman Islands.

Over the past three fiscal years this Government has worked to do just that, improving the state of public sector finances, restoring investor confidence, lowering the cost of doing business, lowering the cost of living in certain circumstances, and bringing back national pride and optimism for our people.

This was not easy and we had to make some hard decisions along the way regarding certain services or planned capital investments.

The hard decisions were necessary. It was only a few years ago that the country was experiencing:

- increasing operating expenditure and deficit budgets;
- rising national debt from borrowings;
- falling cash reserves; and
- non-compliance with the Principles of Responsible Financial Management set out in the Public Management and Finance Law (the "PMFL").

It was these conditions that led the United Kingdom to step in and prescribe by law the Framework for Fiscal Responsibility or the FFR. The FFR set extremely stringent financial rules for the Government to follow, however, we have now achieved full compliance.

Upon taking office in May 2013, this Administration embraced the challenges imposed by the FFR and immediately tackled them head-on by establishing a Medium Term Fiscal Strategy which set out our key fiscal policies.

These fiscal policies have guided our approach to financial management, yielding strong positive results, placing the Cayman Islands in an enviable financial position we are now experiencing:

- Continuous economic growth;
- Operating Surpluses by controlling expenditure;
- Rising Cash Reserves;
- Declining Debt Balances;
- Declining Debt-to-GDP ratio;
- Declining Expenditure-to-GDP ratio;
- Declining Revenue-to-GDP ratio (Tax Burden)

The 2016/17 Budget continues these efforts and calls for no new borrowings and no new tax measures while delivering enhanced public services and advancing the development of key infrastructure projects.

### **Fiscal Achievements During the 3-Year Period: 2013/14 to 2015/16**

Madam Speaker, over the last three years this Government has made significant progress to improve the financial affairs of the Cayman Islands. This achievement is due to the combined efforts of many - the Cabinet, public sector managers and employees, private sector partners, and the wider public.

#### **Medium Term Fiscal Strategy ("MTFS")**

The foundation for the Government's fiscal achievements was articulated in the **Medium Term Fiscal Strategy** (MTFS), which was finalised on 15<sup>th</sup> August 2013. The MTFS covers the 4-year period ending 30<sup>th</sup> June 2017. The UK Government's Foreign & Commonwealth Office ("FCO"), conveyed its agreement to the MTFS on 22<sup>nd</sup> August 2013 and, it was Tabled in the Legislative Assembly on 21<sup>st</sup> November 2013.

The strategies detailed in the MTFS included:

- stabilizing revenues;
- lowering expenditures;
- lowering financing costs;
- reducing Public Sector Debt;
- improving Cash balances;
- lowering the cost of operations for small businesses;
- redeveloping Owen Roberts International Airport; and
- developing a modern cruise-berthing facility.

Over the past three years, Government's Operating revenues have grown steadily with economic growth at an average annual rate of 3.7%, surpassing the targets set out in the MTFS.

These rising revenues over this period are the result of economic growth that was spurred in large part by the specific policy decisions of this Administration to:

- not introduce new revenue measures that would increase the tax burden; and
- reduce taxes in those areas that would yield the greatest impact by encouraging economic growth while also reducing the cost of doing business and the cost of living where possible for residents.

The specific policy measures that we introduced are as follows:

- reduced import duty on diesel fuel used by CUC to generate electricity;
- reduced import duty for licensed traders;
- reduced import duty on building materials;
- reduced Trade and Business Licence Fees for Small Business licensees;
- the continuation of current stamp duty and import duty concessions for the Sister Islands; and
- following the amendment of the Customs Tariff Law on 5 April 2012 that removed the duty exempt status for schools, this Administration in February 2014, took a reasoned approach to waiving import duty for all private schools for all items to be used directly in the classroom in order to keep the cost of education from rising.

Madam Speaker, when the Government decided to remove the requirement for Government agencies to pay import duty as part of cost reduction measures, Government schools also benefitted from not paying import duties.

To ensure that education remains affordable for all, as part of the aforementioned exercise, this Administration also amended the law to make all school supplies duty-free for private citizens and businesses alike.

Madam Speaker, I am pleased to say that the Board of Directors of at least one private school, for a number of reasons related to reduced operating cost of doing business, have announced that they will not be increasing school fees for the school year starting September 2016.



### Lower Expenditures

In terms of Expenditure, this Administration took decisive actions very early to reduce operating expenditure where possible and to strictly control any growth in expenses to ensure that the Government would not have to cut jobs even though this was alluded to by Hon. Minister Simmons at the FCO in June 2013. During the 2013/14 and 2014/15 financial years expenditure was kept well below the 2012/13 expenditure levels. In 2013/14 operating expenditure was some \$18.4 million less than the 2012/13 year and between 2013/14 and 2014/15 expenditure fell by a further \$15.2 million.

These reductions were achieved by strengthening the overall governance and management of the finance function across the public sector. Significant emphasis was placed on compliance with procurement policies and strict adherence to best practice.

A significant contributing element to the decrease in operating expenditures has been the cost-control measure of requiring any requested increase to head-count in the Civil Service, to be subject to scrutiny by a "Moratorium Committee", which is headed by the Honourable Deputy Governor.

The Portfolio of the Civil Service has confirmed that over the past three years there has been a clear decrease in the size of the Civil Service: at 30 June 2013 there were 3,601 civil servants, this dropped to 3,571 at 30 June 2014 and further to 3,484 at 30 June 2015.

### Lower Financing Costs

Financing costs have decreased steadily over the 2013/14 to 2015/16 period, as the Core Government debt balance has been declining at an average rate of 4.3 % or CI\$23.5 million year-on-year since July 2013. This reflects the following important factors:

- Government has not undertaken any borrowing over the 3 -year period;
- Government eliminated its revolving overdraft facility in July 2014. The Cayman Islands has been using an overdraft facility for at least the past 20 years;
- Debt principal has been reduced by Government's repayment of debt; and
- Government's renegotiation of the interest rates with respect to several of its loans has secured lower interest rates, and reduced the amount of interest payable each year.

It is expected that Government will save \$6.2 million in financing expense over a 10-year period from these actions.

### Capital Investments

Government has also restricted the level of capital investment funding to surplus cash generated from operating activities whilst remaining cognizant that there is a delicate balance to be struck between the containment of capital investment spending and the need for adequate investment in a growing economy such as ours.

### Reducing Public Sector Debt

Our aggressive debt management strategy of no new borrowings, accelerated payments and debt restructuring has yielded a \$116.4 million reduction in Entire Public Sector debt over the past three financial years from \$709.8 million at 30 June 2013 to a forecast balance of \$593.4 million at 30 June 2016. Madam Speaker, this figure is inclusive of the debt balances for both core government and the SAGC's.

A country's debt-to-GDP ratio is a measure of the size of its debt compared to its economic output or the size of its economy. It is an excellent indicator of the overall health of an economy and its resilience to periods of economic slowdown. Generally, the higher a country's debt the less able it is to spend in order to stimulate the economy, respond to natural catastrophes or external shocks, or invest in improved services to its people.

Moody's Investors Service, in a 2 February 2016 article entitled: "**Caribbean sovereigns face a silent debt crisis**" stated:

"The Caribbean region has become one of the most indebted in the world as a slow and steady build-up of debt has left the region's economies vulnerable to external shocks and the heightened risk of sovereign defaults...it happened gradually over many years. Currently, 12 of the 20 Caribbean economies for which data is available have government debt-to-GDP ratios of over 60% and four have debt-to-GDP ratios in excess of 100%."

Madam Speaker, I am happy to report, that the Cayman Islands is not in this category, and our Debt-to-GDP ratio has improved over the past three years, from 22% in 2012/13 to 18% in 2015/16 for the Core Government and from 27.2% in 2012/13 to 21.2% in 2015/16 for the Entire Public Sector. We are on track to see further improvement in these ratios in 2016/17.

### Improving Cash Balances

The expected results of growing revenues with economic growth, reducing operating and financing expenses and containing capital investments is improved cash/bank account balances held by the Government.

Government's significantly improved bank account balances led to its decision in July 2014 to cancel the revolving overdraft facility, thereby reducing financing expenses.

Furthermore, Government's improved bank account balances led to the UK Government's FCO acknowledging, in an 18 February 2016 letter, that Government had satisfied the key Cash Reserves Ratio, which is specified in the FFR.

It is clear from the preceding information that Government's fiscal achievements in the three years 2013/14 to 2015/16, have been impressive and undoubtedly demonstrate our commitment to stabilize the country's finances and **Securing Cayman's Future**.

### **Improved Financial Management**

Madam Speaker, in addition to the specific fiscal achievements that I just spoke to, this Administration has strengthened the overall financial management within the Government, placing significant importance and emphasis on improved internal business processes, adherence to PMFL and compliance with the International Public Sector Accounting Standards (IPSAS).

During the past three years, significant progress has been made to improve the quality and timeliness of the financial statements being produced by public sector entities and audited by the Office of the Auditor General.

Audited financial statements are necessary to allow for the Cabinet, Legislators, Public Service Managers, and the general public to make informed financial decisions and assess performance.

Last November, I provided this Honourable House with an update on the status of the production of annual accounts and the relevant audits for Government entities. I think that it is appropriate now, to remind Honourable Members of the issues and our actions to improve the overall quality of the financial statements being produced.

In my November 2015 update I noted the vast improvement which was reported by the Auditor General in his reports dated 25 September 2015. These reports noted that Core Government along with Statutory Authorities and Government Companies have made significant strides over the last few years towards improving the quality of financial statements.

It was also noted that the 2013/14 financial year would likely be the first time that no Ministry, Portfolio, Statutory Authority or Government Company would receive an adverse opinion or a disclaimer of opinion. Of the thirty-seven audits completed for the year ended 30 June 2014 all of them received either an Unqualified or Qualified opinion – remarkably, the majority of these were unqualified, the best possible audit opinion an entity can receive.

Additionally, for the financial year ended 30 June 2015, thirty audits were completed and eighty percent of those completed received an unqualified opinion with the remainder being qualified opinions.

The last element of financial reporting is the Entire Public Sector consolidated financial statements which are prepared by the Ministry of Finance. This involves taking all of the financial statements of the Government's 42 Public Sector Entities and consolidating them.

I noted previously that while the financial statements for the year ended 30 June 2014 received an adverse opinion, this was also the first audit opinion that had been issued on the EPS since the Law was introduced in 2004. While this is not the desired opinion, it did show the vast improvement where we are now able to have an audit conducted versus the disclaimer of opinion issued in previous years.

Madam Speaker, you will recall that I previously identified five issues which lead to the adverse opinion for the Entire Public Sector accounts which are as follows:

1. Material Omissions;
2. Property Plant and Equipment, Valuation and Completeness;
3. Erroneous Opening and Closing Balances;
4. Revenue and Related Receivables Completeness; and
5. Consolidation Integrity Issues.

These five qualifying issues pose substantial challenges, however, significant action has been taken to address these which I will now explain.

### Material Omissions

This Honourable House will no doubt recall that the issue regarding Material Omissions relates to the requirement to recognize the pension and the post-retirement healthcare liabilities.

Madam Speaker, the Audit Office identified that both post-retirement benefits (pension and healthcare) and the accounting for the Public Service Pensions Board were not fully included in the EPS consolidated financial statements.

The post-retirement healthcare liabilities, of approximately \$1.2 billion, were not included on the face of the primary statements in the 2013/14 EPS consolidated financial statements, but are referenced as disclosures in Notes to the financial statements.

It was a policy decision of the Government to disclose details of the post-retirement healthcare liabilities and expenses in the Notes of the financial statements. This has been the practice since the implementation of accrual accounting under the PMFL in 2004.

Pension obligation liabilities, on the other hand Madam Speaker, have been stated on the face of the Government's Balance Sheet for many years and further details relating thereto are provided in the Notes to the financial statements.

Madam Speaker, you will recall that I noted recently in this Honourable House that the Government is exploring options to reduce the pension and post-retirement healthcare obligations such as: increasing the retirement age of Civil Servants from 60 to 65 years; introducing health insurance premium co-pay for Civil Servants; and reducing the maximum lifetime medical benefits for Civil Servants. It is expected that any such changes will not occur until 2018, allowing sufficient time for discussions.

### Property, Plant and Equipment, Valuation and Completeness

Madam Speaker, I recently reported how IPSAS requires that consistent accounting policies are applied across all entities in the EPS and that not all of Government's assets are reported at their revalued amounts as most Statutory Authorities and Government Companies have yet to complete a revaluation of their fixed assets. I am pleased to announce that we currently have our first Entire Public Sector valuation process under way. This valuation includes both real estate and the entire roads network. This valuation will address the issues raised by the Auditor General and is scheduled to be completed in time to be included in the 2015/16 annual accounts.



### *Erroneous Opening and Closing Balances*

Madam Speaker, you will recall the issue of erroneous opening and closing balances generally related to audits not being completed within the statutory deadline which prevented the EPS Accounts from reflecting any changes which may arise out of those audits.

While it is not for me to speak on behalf of the Office of the Auditor General, I would like to state my support for the proactive step taken by their Office to conduct interim audits during the financial year. These interim audits will allow their office to conduct a significant amount of audit work before the start of the two-month window which is legislated for them to complete their audits. This approach will provide them with the best chance of completing audits within the statutory timeline and, by extension, will give the Ministry of Finance time to include any adjustments into the EPS Accounts.

While this addresses the audits going forward, the Ministry of Finance is still working with a few agencies who have not managed to finalize their audits from prior years. It is anticipated that these will be brought up to date in time to be included in the 2015/16 EPS Accounts.

### *Revenue and Related Receivables Completeness*

Madam Speaker, the Audit Office reported that there is no system in place to ensure that the Government is collecting and reporting all revenues and related receivables. The Ministry of Finance has taken this audit qualification seriously and is in the process of developing a Revenue Management Framework which will include a comprehensive approach to ensure the completeness of revenue.

This Framework will include the following Policies:

- Internal Control;
- Risk Management;
- Revenue Collection;
- Financial Ethics;
- Financial Reporting;
- Revenue Waiver;
- Financial and IT systems;
- Bad Debt; as well as
- Training and continuing education for staff involved in financial management.

With the implementation of this robust and comprehensive framework we are certain that the Auditor General's Office will agree with the accuracy of the revenue collected and recorded.

### Consolidation Integrity Issues

Madam Speaker, you may recall that I mentioned previously the Auditor General's concern that there was no formal reconciliation of inter-agency transactions and balances between Public Sector Entities. In some cases the Ministry of Finance has to make judgments to eliminate entries for some inter-agency transactions. The Auditor General's Office has noted that this approach is not robust enough to ensure that all inter-agency transactions are fully eliminated.

For the 2014/15 financial year, the Ministry of Finance required Public Sector Entities to confirm and agree inter-agency charges. Transactions that were not substantiated were written-off. The Audit Office will undoubtedly find that in auditing the 2014/15 financial year disagreements of inter-agency transactions are substantially reduced. This is another example of the progress being made.

Based on the findings of the Office of the Auditor General from the 2014/15 EPS Audit the Ministry of Finance will determine if it is necessary to implement the inter-agency module known as Advanced Global Inter-company System ("AGIS") in the Government's financial reporting system by 31 December 2016. The use of AGIS will reduce inter-agency transaction mismatches as these transactions will require agreement by both counterpart agencies prior to recognition in their respective ledgers.

The Ministry of Finance also continues to work on a Public Finance Manual, which is in accordance with best practices and GAAP. The Manual will be disseminated to all Public Sector Entities and will serve to improve the consistency in the application of GAAP. It is expected that the Manual will be completed by 30 June 2016.

Madam Speaker, these are the actions being taken at present to address the issue of an Adverse opinion on the EPS accounts, however, I am of the view that improving the audit opinion alone is not sufficient. Therefore, the Ministry of Finance is not only working towards improving the EPS audit opinion but work is also underway to improve reporting through the development of a more comprehensive Annual Report which will be specified in an Amendment to the PMFL during the 2016/17 financial period.

At present, the public is only provided with the financial statements of the Government and in many cases it would require an accounting degree to interpret these complex reports. The Ministry of Finance is therefore seeking to develop a reporting template that provides more insight into the operations of the Government and provides the public with more information, particularly related to the outcomes achieved for the year.

For this expanded report to be beneficial it is important that information is presented in a format which is easily interpreted by members of the public. A more comprehensive Annual Report will also provide the Public Service with a means by which to demonstrate the outcomes achieved with public funds. This is yet another progressive move being made by the Ministry of Finance.

## **2015/16 Financial Forecasts**

Madam Speaker, the current 2015/16 financial year which ends on 30 June, has been a notable one in terms of financial performance and is the base from which 2016/17 Budget is prepared. The 2015/16 Forecasts were last updated on 23 May 2016.

### **Forecast Operating Revenues**

The Government is forecasted to earn **\$696.1 million** in total revenue for 2015/16. This amount is **\$34.9 million** higher than the **\$661.2 million** shown in the original budget. The significant overage is mainly as a result of **\$16.0 million** higher revenues from stamp duties related to land transfers; **\$5.3 million** more from motor vehicle and other import duties; and **\$2.0 million** more from tourist accommodation taxes.

### **Forecast Operating Expenses**

The forecast operating and financing expenses for the Core Government are expected to be **\$567.8 million** for 2015/16. This amount is **\$13.5 million** higher than the original budget of **\$554.3 million**. The increases were mainly as a result of the following:

- **\$8.4 million** to fund an increased number of uninsured, underinsured and indigent persons requiring specialist tertiary level medical care outside of the Cayman Islands;
- **\$2.0 million** to fund services to respond to the higher than expected number of illegal migrants landing in the Cayman Islands; and
- **\$1.4 million** to fund additional mosquito control measures to mitigate the potential for outbreaks of mosquito borne diseases such as the ZIKA virus.

### Performance of Statutory Authorities and Government Companies

Statutory Authorities and Government Companies (also referred to in the Budget Documents as Public Authorities) are forecasted to have a net operating surplus of **\$12.4 million** for the fiscal year ending 30<sup>th</sup> June 2016. This amount is closely in line with the \$12.9 million forecasted in the original 2015/16 Budget.

Agencies forecasted to perform better than expected include the Civil Aviation Authority which is on track for a \$2.9 million higher surplus and Cayman Airways is forecasting a \$2.0 million higher surplus. These positive variances are offset by underperformance at the Cayman Islands Airports Authority and the Port Authority of the Cayman Islands with forecasted reductions in their budgeted surpluses by \$4.0 million and \$2.2 million, respectively.

### Forecast Surplus from Operating Activities

The 2015/16 fiscal year forecast operating surplus for the core government is \$128.3 million which is a \$21.4 million improvement on the \$106.9 million estimated in the 2015/16 approved budget.

### Forecast Cash Position

Madam Speaker, our Cash Balances are a key indicator of the Government's overall financial performance and a critical component for **Securing Cayman's Future**.

The Core Government is forecasted to have bank account balances totalling \$414.4 million for this fiscal year ending 30<sup>th</sup> June 2016, some \$72.8 million more than the \$341.6 million shown in the 2015/16 Budget. The forecast closing cash position consists of an anticipated \$281.6 million in the operating bank account and \$132.8 million in restricted and reserve accounts. The improved cash position is primarily due to the higher than expected operating performance and improving economic conditions.

Based on the forecast cash results, the Government has recently taken the decision to transfer **\$18 million** to the Public Service Pensions Fund by 30 June 2016, to reduce the liability associated with the provision of pension benefits to retired civil servants and parliamentarians. This has been factored into the 2015/16 financial forecasts.

In addition, we will transfer **\$50 million** to the General Reserve Fund by 1 July 2016, bringing that Fund up to **\$95.9 million**. These transfers, help to reduce our long-term liabilities and secure our continued compliance with the Cash Reserve requirements. This is another clear demonstration of the Government's commitment to responsible financial management.

This is the first time since the 2004/5 fiscal year that funds have been transferred to the General Reserves.

Madam Speaker, one might ask the question: how is responsible financial management securing Cayman's future? Madam Speaker, the vastly improved operating and restricted bank account balances are necessary to fund current activities, remain compliant with the 90-day cash reserves requirement, and prepare for November 2019 when we will have to repay in one lump sum, the US\$312 million bullet bond.

Madam Speaker, there really is an important and productive purpose for this money. If it is squandered and not used productively, this and future generations will bear the burden for a very long time. If we are not careful, the country may become like Venezuela today where squandering of the country's wealth and resources has created an economic disaster and third world living conditions.

### **2015/16 Compliance with Principles of Responsible Financial Management**

Madam Speaker, overall the Government has practiced prudent financial management during 2015/16 and achieved compliance with the Principles of Responsible Financial Management and the Framework for Fiscal Responsibility. This has been confirmed in writing by the FCO in their letters of 18 February 2016 and 25 May 2016.

### **2016/17 Budget**

The 2016/17 Budget, Madam Speaker, covers an 18-month period (1 July 2016 – 31 December 2017). This is consistent with the provisions of the Public Management and Finance (Amendment) Law, 2015 which reflects Government's policy decision to transition the Government's financial year away from the current 1 July - 30 June period to the 1 January – 31 December period. This 18-month budget provides a transitional period in order to change the Government's fiscal year from the current 1 July - 30 June to a 1 January – 31 December period.

Therefore the 2016/17 financial forecasts are not directly comparable with those of a regular budget period of twelve months.



The two main reasons why the Government chose to change the financial year are:

1. Annually, the Government collects approximately 65% of its revenue during the January to June period with expenses generally spread evenly over the year. Aligning the start of the financial year with the high revenue earning period means that if the Government were to experience a significant reduction in revenue during January to June it would have enough time remaining in the financial year to take corrective actions to mitigate the impact of the reduced revenue. With the financial year starting in July, the January to June period occurs in the last half of the financial year and severely limits the ability of Government to mitigate the consequences of any significant revenue reduction.
2. With General Elections occurring in May, switching the financial year will allow an incoming Government six months to properly plan, prepare and pass their substantive budget. Under the current system, an incoming Government has to immediately deal with the preparation of an interim budget, followed by the full budget. This process places extreme stress on the Cabinet, Members of the Legislative Assembly, and the Public Servants and increases the risk of errors.

Madam Speaker, the change of the financial year is the first phase of reforms to the Government's Budgeting and Reporting systems.

The next phase will see the implementation of multi-year budgeting which will come into effect in January 2018 when the Budget and Appropriation Bill will articulate appropriations to cover two financial years spanning 24 months.

However, government agencies will be required to continue to produce annual audited accounts along with a performance report detailing their actual performance compared to their budget. There will also be an annual review process via the Finance Committee of the Legislative Assembly to allow an opportunity for Legislators to review the Government's budget.

## **Economic Outlook**

Madam Speaker, the preparation of the 2016/17 Budget takes into consideration global and domestic economic conditions. As a Government we have a responsibility to act prudently and support sustainable economic growth. Over the past three years we have done just that and today we see the benefits of those actions, a growing economy, falling unemployment and the absence of inflation.

The economy of the Cayman Islands is an open, services-based one focused primarily on financial services and tourism, making it largely dependent on the free movement and flow of people and Capital. Our economy is directly influenced by global economic trends, particularly those occurring in the USA, which is our largest source market for tourists.

In addition, the Government's main sources of revenues (fees, charges) are directly linked to economic growth and the levels of consumption and transactions for goods and services.

These characteristics combined with our relatively small population and geographic size means that the Government has limited economic tools available to influence economic activity.

### **World Economy**

In its April 2016 World Economic Outlook, the International Monetary Fund reported that the global economic growth in 2015 was 3.1 percent, down from 3.4 percent in 2014. Global growth is forecasted to remain modest at 3.2 percent in 2016, with stronger growth in 2017 at 3.5 percent. The advanced economies are anticipated to expand by 1.9 percent and 2.0 percent in 2016 and 2017, respectively. Emerging markets and developing economies are projected to have a gradual recovery with average growth of 4.1 percent in 2016 and 4.6 percent in 2017.

### **The Cayman Islands' Economic Performance and Forecasts**

**Output (GDP) Growth** – In 2015, economic performance was estimated at 2.0 percent which is lower than the 2.4 percent recorded for 2014 but higher than the average of the previous four years of 1.6 percent.

The services sector which accounted for 94.7 percent of GDP in 2015, led the economic performance with a 1.9 percent growth rate, driven by greater economic activity in real estate, renting and business activities; other services; utilities; and financing and insurance services. The exception was hotels and restaurants which declined slightly due to a slowdown in the growth of stay-over arrivals primarily due to a lack of available room stock.

The real estate, renting and business activities sector was estimated to have increased by 2.9 percent with business services dominating the growth supported by higher registration of companies and partnerships for the second consecutive year. The real estate sector recovered during the year as the total value of property transfers grew by 8.8 percent to \$612.2 million, aided by the transfer of properties along the Seven Mile Beach corridor.

Other services, which included activities of households as employers, expanded by 3.4 percent in 2015 as work permits for “domestic workers” increased.

GDP generated by the utilities sector was higher by 2.1 percent as consumption of both electricity and water grew in 2015 with the increase in population. The growth in utilities was also due to lower cost, particularly fuel cost.

The financing and insurance services sector which accounted for approximately 41.0 percent of GDP was estimated to have expanded by 1.3 percent in 2015 from 1.0 percent in 2014. Insurance services grew as the increase in gross premiums outweighed net claims. Modest growth in financing services was due mainly to higher interest income in the local banking sector as domestic credit increased and the weighted average interest spread widened.

Indicators of construction sector activity such as the volume of imported building materials suggests that the sector expanded by 5.2 percent, which may be associated with several large on-going private and public sector projects. The wholesale and retail trade sector grew at an estimated 1.1 percent, bolstered by a 2.0 percent growth in non-oil merchandise imports.

Growth in the transportation, storage and communication sector was estimated at 0.7 percent. This sector benefitted from a higher number of cruise visitor arrivals coupled with the higher volume of cargo transportation. In the telecommunications sector, broadband connections grew by 16.7 percent; however, total domestic and international paid calls, measured in minutes, continued on a downward trajectory as the use of VOIP becomes more popular.

Government services expanded by 2.3 percent, this was due mainly to the combined effects of a marginally higher staff count and a 4.0 percent increase in salaries for core government employees in mid-2015.

**Inflation** – In 2015, the average consumer price index (CPI) declined by 2.3 percent compared to an average increase of 1.3 percent in 2014. The deflation occurred as downward pressure on prices for oil and oil-related goods and services and housing rentals outweighed upward pressure in housing rentals caused by an expansion in domestic demand from a higher population and increased economic activity.

The deflation in 2015 was directly related to the lower price indices for housing and utilities, transport, restaurants and hotels, and miscellaneous goods and services. The price index for housing and utilities fell by 6.9 percent. The cost of electricity, gas and other fuels, water supply and miscellaneous services also fell with the decline in oil prices. The latter also reduced the operation of the personal transport equipment component within the transport price index. The restaurants and hotels price index declined mainly due to slower growth in the numbers of stay-over visitors.

**Employment** – In 2015, the growth in GDP was accompanied by growth in the labour force by 3.6 percent to reach 39,138 persons. Total employment increased by 4.0 percent. The unemployment rate fell to 4.2 percent, with both Caymanian and non-Caymanian unemployment rates falling to 6.2 percent and 1.4 percent, respectively.

**Current Account** – In 2015, the balance of payments current account deficit was estimated to have narrowed by 23.1 percent due mainly to lower merchandise imports. Additionally, estimated visitors' expenditure was higher because of strong growth in cruise visitors and marginal improvement in air arrivals. Financial services continued to provide significant inflows of revenue as new company registrations and new partnership registrations continued to increase. On the other hand, the outflow of workers' remittances is estimated to have grown slightly as foreign employment increased.

## **Economic Stimulus Measures**

For the 2016/17 Budget period the Government will continue with the following economic stimulus measures which are designed to support economic growth and lower the cost of doing business and living here in the Cayman Islands:

- 1. reduced import duty on diesel fuel used by CUC to generate electricity;**
- 2. reduced import duty for licensed traders and**
- 3. reduced import duty on building materials;**
- 4. reduced trade and business licence fees for new licences; and**
- 5. Continuation of current incentives for Cayman Brac and Little Cayman.**

**1. Reduced Import Duty on Diesel** – Effective 1 January 2016, the Government further reduced the import duty charged on diesel imported by Caribbean Utilities Company Limited (CUC) for the generation of electricity from 50 cents per imperial gallon to 25 cents per imperial gallon.

This measure provides essential financial relief to all consumers of electricity in Grand Cayman, residential and commercial, freeing up “real cash” allowing for the opportunity to save that cash or spend it in other areas more beneficial to the wider economy.

**2. Reduced Import Duty Rates for Licensed Traders** – Effective 1 July 2014, for licensed traders only, the Government reduced import duty rates on items regularly charged at 22% down to a 20% rate. This reduction to 20% will remain in effect for licensed traders.

By reducing import duty rates, we are lowering the cost of doing business and expect that retailers and service providers will be able to pass these savings on to their customers, thereby lowering the cost of living and increasing aggregate output through demand for goods and services.

**3. Reduced Import Duty on Building Materials** –The Government will also continue to offer the import duty concession on building materials which are currently being charged import duty at the rate of 15% versus the normal range of 17% to 22%. This will continue to act as an incentive for the construction sector.



**4. Reduced Trade and Business Licence Fees** – As an incentive to support the development of small and micro business the Government will continue to offer the following discounts on Trade and Business Licence fees based on their location:

- George Town and West Bay – 50% discount;
- Bodden Town, North Side, East End, Cayman Brac and Little Cayman – 75% discount.

**5. Continuation of Current Incentives for the Cayman Brac and Little Cayman**

The Government will continue the following economic incentives for Cayman Brac and Little Cayman:

- A 100% import duty waiver on building materials imported to Cayman Brac and Little Cayman;
- A 100% import duty waiver on diesel fuel for Cayman Brac Power and Light;
- A 12.5 cents per gallon import duty rate (or a 83.3 per cent duty rate waiver) on the importation of motor gasoline to Cayman Brac; and
- A 100% waiver on stamp duty for the purchase of land in Cayman Brac.

Madam Speaker, when trying to stimulate our economy and especially with large projects by developers, we have to find the right balance between concessions and incentives, and the ability of Government to earn revenue that it can use to provide valuable public services and infrastructure while minimizing the burden on future generations.

The Government is currently developing a Concessions and Incentives policy framework and expects to complete this by 30 September 2016. It is intended that this policy will transition the country more toward deferring revenue to be paid at a future date rather than completely waiving the revenue to be paid. This approach will go hand-in-hand with truly incentivizing the projects most beneficial to the country financially, socially and economically.

## **The 2016/17 Financial Forecasts**

Madam Speaker, I will now turn to the details of the financial forecasts included in the 2016/17 Budget.

### **Forecast Operating Revenues**

Operating Revenues are forecast to be \$908.5 million. These forecasts are based on economic projections, specific market conditions, Government policies, and historical trends. In line with our commitment to keep the tax burden low, there will be no new revenue measures introduced in 2016/17.

### **Forecast Operating Expenditures**

The 2016/17 Budget forecasts total operating and financing expenses of **\$862.4 million** for core government. This represents a 3.7% annualised increase over the 2015/16 Budget and is driven by the following:

- **\$4.2 million** for enhancements to Public Education Services through the implementation of recommendations emanating from the recent independent review of the Cayman Islands Public Education System and also a series of baseline school inspection reports;
- **\$3.2 million** for improvements to the regulatory services provided by the Cayman Islands Monetary Authority for the financial services industry in order to keep pace with ever-evolving international regulatory requirements and to prepare for the upcoming IMF and FATF assessments in 2017;
- **\$2.1 million** for improved public health programmes and management and control of communicable diseases;
- **\$2.0 million** for the implementation of a remuneration strategy to address pay stagnation and pay competitiveness for Civil Servants;
- **\$1.4 million** for the May 2017 General Election;
- **\$1.1 million** for additional resources for the Needs Assessment Unit and the Department of Children and Family Services to enhance services to the most vulnerable and at risk persons in our society;
- **\$1.0 million** for increased support services to the Judiciary and Legal Aid;
- **\$0.4 million** for the implementation of various public sector reforms under the umbrella of Project Future;

- **\$0.5 million** for the implementation of a Conditional Release Programme to better enable prisoners to successfully reintegrate into society as productive citizens following release from incarceration; and
- **\$0.3 million** for the creation of an Office of Public Ombudsman.

The Government is very aware of the potential impact that increased operating expenses can have on the overall financial performance. Accordingly, we have limited increases to the above priority areas in order to achieve positive long term benefits that support economic growth, enhanced security, improved quality of life, and improved efficiency in the delivery of public services.

The major components of the 2016/17 forecast operating expenses, as shown in the financial statements are:

- **Personnel Costs** – are budgeted at **\$402.3 million** and include funding for additional staff to deliver the initiatives included in the budget that I just spoke to.
- **Supplies and Consumables** are budgeted to be **\$142.3 million** and include additional expenditure for the maintenance of public buildings and parks; and supplies for new programmes.
- **Outputs from Non-Governmental Output Suppliers** are budgeted at **\$34.4 million**, the major items being:
  - **\$17.2 million** for tertiary medical care at various overseas and local providers for uninsured, underinsured or indigent persons;
  - **\$4.0 million** for Legal Aid services;
  - **\$2.9 million** for rental accommodation for persons in need;
  - **\$2.3 million** for primary and secondary education by private schools; and
  - **\$2.1 million** for the care of the indigent, elderly and disabled persons.

- **Outputs from Statutory Authorities and Government Companies** are budgeted to be **\$152.6 million** during 2016/17 and will be used to purchase various services, the major ones being:
  - **\$44.6 million** from the Health Services Authority for the provision of various medical services to the community;
  - **\$42.9 million** from Cayman Islands National Insurance Company – health insurance for civil service retirees; seamen and veterans;
  - **\$24.7 million** from Cayman Airways Limited to provide airlift to the Cayman Islands from strategic tourism markets and between the Cayman Islands;
  - **\$20.8 million** to the Cayman Islands Monetary Authority for the regulation of the financial services sector of our economy;
- **Transfer Payments** are budgeted to be **\$48.9 million**. The major items in this category are:
  - **\$15.9 million** for Local and Overseas Scholarships;
  - **\$11.7 million** for Poor Relief Payments and Vouchers;
  - **\$9.0 million** for Ex-Gratia payments to Seamen and Veterans; and
  - **\$2.3 million** for Employment Initiatives.
- **Financing Expenses** are budgeted to be **\$38.9 million** and covers the interest payments associated with the portfolio of Core Government Debt which is scheduled to decline during 2016/17 by \$52.3 million, from \$503.4 million to \$451.1 million.
- **Depreciation** is budgeted to be **\$39.67 million**.

## **Capital Investments**

Turning now to Capital Investments, Madam Speaker, the Government is committed to making sound capital investments which will enhance the country's infrastructure and strengthen opportunities for long term economic growth. These investments are being made only after thorough analysis to determine their appropriateness, cost effectiveness and sustainability while also following all of the best practice procurement processes set out in the PMFL.

For 2016/17, the Government intends to make investments totalling **\$103.3 million**, without any new long-term borrowings. The planned Capital Investments will be entirely funded from existing resources – that is – cash generated from operating activities and surplus cash reserves.

**\$68.1 million** will be invested in Core Government assets, the major investments in this category being:

- **\$7.9 million** for the continued development of the new John Gray High School;
- **\$6.9 million** for the revitalization of central George Town project;
- **\$6.5 million** for improved solid waste handling facility;
- **\$6.0 million** for the purchase of lands for national environmental conservation purposes – this item will be funded by a withdrawal from the Environmental Protection Fund;
- **\$1.0 million** for enhanced cyber security for the Government's information technology infrastructure;
- **\$3.4 million** for upgrades to the road network;
- **\$2.5 million** for a residential mental health treatment facility;
- **\$1.5 million** for a Household Recycling Centre; and
- **\$0.5 million** for the ongoing development of the cruise berthing project.



A total of **\$35.2 million** will be invested in SAGCs to fund debt service obligations; operational losses and various capital projects. The major investments in this category are:

- **\$12.7 million** to the Cayman Turtle Farm (1983) Limited to fund debt servicing and operational losses;
- **\$7.7 million** to Cayman Airways Limited to fund debt servicing obligations;
- **\$7.5 million** to the Cayman Islands Airports Authority to fund the redevelopment and expansion of the passenger terminal at the Owen Roberts International Airport;
- **\$3.4 million** to the National Housing Development Trust to fund debt servicing obligations;
- **\$2.0 million** to the Cayman Islands Development Bank to fund debt servicing obligations; and
- **\$1.6 million** to the Health Services Authority to fund the purchase of various medical equipment and upgrades to facilities.

### **Cash and Debt Management**

In 2016/17 the Government will continue to focus on cash and debt management, while also proactively managing our long-term liabilities.

It is critical that we continue with this strategy, not just from the perspective of FFR compliance but because it is prudent and wise. We need to make certain that we build a firm foundation for truly sustainable long term financial stability, enabling the country to provide high quality public services to future generations of Caymanians. We have been handed a rich legacy by our forefathers and today as guardians we must act responsibly for future generations of Caymanians.

During 2016/17 there will be no new borrowings and the Entire Public Sector Debt balance will decline by **\$70.3 million** to **\$523.1 million** resulting in a Debt-to-GDP ratio of 17.8% for the EPS. This is a significant improvement over the 27.2% that existed in 2012/13.

### **Long Term Liability Management**

The Government has been a leader in the Cayman Islands in terms of being a responsible employer and offering its employees' pension and post-retirement healthcare benefits. These benefits come at a cost but they help to ensure that thousands of persons have valuable financial and healthcare benefits to sustain them in their twilight years.

The 2016/17 Budget provides clear information about these two significant liabilities and the plans and strategies in place to manage them over the long-term. The Government has always met its expenses associated with the provision of these benefits.

### Pensions

There are three established pension plans for the Government – the Public Service Pensions Plan, the Parliamentary Pension Plan, and the Judiciary Pension Plan – to provide pension benefits to its employees. The Government continues to make contributions to the pensions plans on a monthly basis.

The 2016/17 Budget includes approximately \$388.3 million of pension liability based on an actuarial accounting valuation report as at 30th June 2015 and estimated pension expenditure of \$49.2 million. The forecast also includes an additional cash contribution to the Public Service Pensions Fund of \$15.0 million in 2016/17, which directly reduces the pension liability. An accounting valuation is required by International Public Sector Accounting Standards (IPSAS) 25, Employee Benefits.

An accounting valuation report is only a snapshot of a Plan's estimated financial condition at a particular point in time; it does not predict the Plan's future financial condition or its ability to pay benefits in the future and does not provide any guarantee of future financial soundness of the Plan. The underlying principle of this requirement is to recognise the costs of providing employee benefits in the period which the benefit is earned by the employee, rather than when it is paid or payable.

### Post-Retirement Healthcare

The Cayman Islands Government (CIG) provides post-retirement healthcare benefits to current pensioners, seamen and veterans and future civil service retirees. Civil servants are required to complete a minimum of 10 years in service and also retire from the Civil Service in order to obtain such healthcare benefits in the future.

IPSAS 25 requires the accounting and disclosure by public entities for employee benefits inclusive of post-retirement healthcare benefits. IPSAS 25 does not require the Government to actually fund these benefits, but to report the future costs of benefits already earned by current and past employees and to assign a yearly budget expense to take account of the promised and actual benefits associated with each year's service. These amounts are to be reported in the Statements of Financial Position and Financial Performance. Each year's cost will then add to the healthcare obligation.

The results of an IPSAS 25 healthcare liability actuarial valuation completed in September 2014 by actuaries, estimated the post-retirement healthcare obligation as at 30 June 2014 to be \$1.2 billion with the post-retirement medical expense totalling \$117 million for the year ended 30 June 2014. The Government currently operates on a “pay as you go” basis in which healthcare costs for retirees are included as operating expenditure each budget. This method of managing post-retirement healthcare liability is similar to that practiced by many other jurisdictions around the world.

The 2016/17 Budget includes \$42.9 million of expenditure for providing healthcare benefits to current pensioners, seamen and veterans; this amount represents 4.9% of the Government’s overall operating expenditure budget. While the healthcare liability over the long term appears to be significant, the actual cost of covering the healthcare on an annual basis, despite continually increasing, has proven to be manageable and should not be compared to a bullet bond that is due and payable all at once.

Nevertheless, the Government is committed to reducing the cost of healthcare which is anticipated to substantially reduce this growing liability. Additionally, legislative changes have been made recently to increase the retirement age from 60 to 65. This increase in retirement age will impact the healthcare liability calculation. A new actuarial valuation will be commissioned in the near future which will take these changes into consideration.

The 2016/17 Budget Plan and Estimates document includes the details of the 30th June 2014 valuation on post-retirement healthcare in the Notes to the Financial Statements providing transparency with respect to the information currently available.

## **Compliance with FFR Targets**

With respect to compliance with the Principles of Responsible Financial Management set out in the Public Management and Finance Law and the Framework For Fiscal Responsibility, the 2016/17 Budget forecasts the following levels of compliance with the principles:

1. **Net Operating Position: should be positive** – Core Government's Revenues should be greater than its expenses. For 2016/17 compliance is achieved as the Government forecasted revenue of \$908.5 million is \$46.1 million greater than its forecast operating expenses of \$862.4 million;
2. **Net Worth: should be positive** – Core Government's assets less its liabilities should be positive: at the end of the 2016/17, the Government's assets are forecasted to exceed its liabilities by approximately \$1.2 billion;
3. **Debt Service: that is, the annual payments of interest and principal related to all public sector borrowing commitments should be no more than 10% of core Government Revenue** – the Government is forecasting a debt servicing ratio of 9.8% for 2016/17;
4. **Net Debt: The total debt of Core Government, plus the weighted average debt balance of Public Authorities less Core Government's liquid assets, should be no more than 80% of Core Government's revenue for the fiscal year** – for 2016/17, the Net Debt ratio is forecast to be 34.3%;
5. **Cash Reserves: The unrestricted cash reserves (Operating Bank Account + General Reserve Fund) of the Core Government – measured at the lowest point in the fiscal period – should be sufficient to cover 90 days of Core Government's estimated operating expenditures** – for 2016/17, the Government is forecasted to have sufficient cash reserves to cover approximately 154.3 days of operating expenditures at the lowest point during the fiscal period.

Madam Speaker, in the coming months, the Government intends to hold discussions with the United Kingdom with a view of clarifying the interpretation of some of the FFR ratio requirements. For example, as it is written currently, any repayment of debt during a year increases the debt service ratio thereby effectively penalizing us for acting prudently and paying down debt. We do not believe that one-off debt repayments should count against compliance with the FFR.

## **Conclusion**

The preparation of the Government's Budget is an enormous undertaking and this year would not have been possible without the hard work and commitment of many and I wish to thank the Honourable Minister for Overseas Territories, Mr. James Duddridge of the United Kingdom's Foreign and Commonwealth Office and his team for their swift approval of the 2016/17 Budget. We formally submitted the Budget to the FCO on the 18 May 2016 and received approval on the 25 May 2016.

I also wish to thank Her Excellency the Governor; the Honourable Premier; Cabinet Ministers; Official Members of Cabinet; Councillors; Chief Officers and their staff. I especially wish to thank the team within the Ministry of Finance for their excellent work and commitment to **Secure Cayman's Future.**

It has been both an honour and a privilege to present this Budget today. I now humbly commend the **Appropriation (July 2016 to December 2017) Bill, 2016** to this Honourable House and ask all Members for their support of the Bill.

Thank you, Madam Speaker.