

**ADDRESS BY THE PREMIER OF THE CAYMAN  
ISLANDS, MINISTER OF FINANCE, TOURISM  
AND DEVELOPMENT  
ON THE MOTION TO RECOMMEND THE  
2012/13 STRATEGIC POLICY STATEMENT (SPS)  
OF THE CAYMAN ISLANDS GOVERNMENT TO  
THE LEGISLATIVE ASSEMBLY**

**Responsibility in times of Austerity**

## INTRODUCTION

Madam Speaker, this Motion seeks the approval by this Honourable Legislative Assembly for the Government's 2012/13 Strategic Policy Statement (or SPS) that I laid on the Table earlier today. The SPS is a high-level document whose primary purpose is to inform the public of the broad budgetary policies which will guide the Government's preparation of the 2012-2013 Budget. The SPS is by design, not as detailed as the annual Budget documents, because it is intended to be used as a guide to budget planning whereas the other annual budget documents are far more detailed and operational in nature.

This SPS has been prepared in full accordance with the Public Management and Finance Law, and reflects the key policy priorities of my administration for the next three financial years 2012/13; 2013/14 and 2014/15.

The SPS also provides the Government's financial forecasts for the same period, establishes the Operating and Capital expenditure limits that each Government Ministry/Portfolio must adhere to.

Madam Speaker, a responsible Government - which this Administration certainly is - must make decisions in a real-world real-time context. We live in a time when economic conditions the world-over are difficult:

- growth is sluggish;
- excessive reliance on borrowings in the past has created major difficulties in many European economies;
- and in the United States of America, approximately 40 cents in every dollar of its Government's expenditure is financed by borrowing;
- unemployment levels in many advanced countries are at, or near, record levels;
- and individuals and business entities that can invest are being very careful in their choices, and demanding in the returns they require for their investment.

Past Governments in the Cayman Islands have not fully accepted that this day would come. In particular, the immediate past administration failed to protect the future as they did not build-up sufficient cash reserves to allow the Government sound and sustainable options to combat economic difficulties, which were already starting to 'bite' under their watch.

My Administration inherited this situation, but we are determined to ensure that the Cayman Islands is able to improve its fiscal planning and overall financial management. This SPS bears out this intention and demonstrates our commitment to *Responsibility in Times of Austerity*.

Madam Speaker, the financial forecasts and Ministry/Portfolio targets set out in this SPS can be best described as "*Austere*" I say this because in order to achieve them, all public sector agencies will have to curtail any expenditure increases to a bare minimum over the next three years. Undoubtedly, this will require that some difficult decisions be made by the Cabinet and civil service managers. These decisions will have to be made within the context of the financial



and economic realities facing the Cayman Islands, balanced with the strong sense of responsibility we as legislators have to the people of these Islands.

Expenditure restraints will likely mean that there will be changes to services delivered by Government agencies. We can no longer afford to do business as usual. Here in Cayman the Government is often the sole provider of key healthcare and social services that many in our community depend on, but we must find a way to provide our key services in as cost effective a manner as possible, with minimum negative impact to service delivery.

The budgetary plans of any country and their accompanying narrative will at their best be inspirational and uplifting. I consider that this SPS and my contribution thereto do provide plans that are hopeful; but they would not be responsible if they were not grounded in reality.

I have structured my contribution to the Government Motion on the subject of the SPS, - by laying out the present realities and then presenting my vision for the future.

### **Framework for Fiscal Responsibility (FFR)**

Any approach to the present realities has to take into account the Framework for Fiscal Responsibility (the "FFR") which I signed with the United Kingdom Government on 23 November 2011.

The purpose of the FFR is: to curb excessive expenditure along with its consequential significant increase to public debt. I have had to sign this, and it was a bitter pill to swallow, because the past government like certain other countries engaged in over-expenditure and over-reliance on debt financing.

The United Kingdom Government is quite correct to be concerned about the twin-evils of over-expenditure and over-borrowing, not just in its own case but that concern extends to its Overseas Territories.

The requirements of the FFR mean that revenues, not borrowing, should be the first source of financing to be applied to fund Government's expenditures. This represents a change from the past when borrowing had become the norm.

Madam Speaker, the Government's present fiscal year does not include an Appropriation for borrowing, and Government does not intend to borrow in the upcoming 2012/13 year nor any year in the intervening period to 30 June 2016 - the date by which the Government is required to become compliant with the limits specified for our Borrowing Ratios as per the FFR.

Madam Speaker, the scope of the FFR is not just restricted to central Government: Statutory Authorities and Government-Owned Companies – in other words, all Public Entities - are also encompassed within its provisions.

As an example, in the area of Debt Servicing Costs, the existing borrowings of other Public Entities must be added with those of central Government and must not exceed 10% of central Government's revenue.

Government is required to comply with the limits for the Borrowing Ratios specified in the FFR by 30 June 2016, so Public Entities are required to consult with central Government before embarking on any borrowing plans.

Madam Speaker, in presenting this SPS, my Government's course of action in presenting this SPS shall be putting the Cayman Islands on a sure path of financial security; we shall ensure that Cayman has the resources to respond to future financial and economic crises.

Madam Speaker, I also regard Government's 2012/13 fiscal year as the present because it starts on 1 July 2012 - only seven months away.

### **Economic Forecasts**

Madam Speaker, I have hinted at the pressing economic challenges facing the world; I will now take a few moments to provide some information regarding the global economic forecast.

As I said before, we operate in the real world, in real time

Our economic performance is closely bound up with what happens in the wider global economy.

### **Global Economy**

The global economy is still dealing with the effects of the Global Financial Crisis which started a few years ago; compounded by concerns of excessive sovereign debt burdens carried by countries across the world.

The macro-economic forecasts for the world economy have seen sharp changes since April 2011, reflecting the high degree of uncertainty among the 'advanced economies' the same economies that are traditionally considered the Cayman Islands' major source markets for financial services and tourism.

In April, global economic activity for 2011 was forecasted to grow 4.4 percent following a strong recovery of 5.1 percent in 2010. However, the forecast for 2011 has been revised downward to 4.0 percent in view of the actual performance in the first half of the year and the heightened downside risks foreseen in the second half emanating from the US and the European economies.

Growth in the US alone slowed from 3.0 percent in 2010 to 1.0 percent in the first six months of 2011 as a number of factors depressed household and business confidence. Low employment rates persisted while heightened uncertainty in the management of their fiscal deficit led to a downgrading of the US sovereign credit rating. External shocks from the tsunami in Japan and the sharp price increases in oil and other commodities also contributed to disruptions in economic output.



US GDP is now forecast to grow by 1.5 percent in 2011, a sharp decrease from the previous forecast of 2.8 percent.

Over the medium term, economic growth is forecast to improve to around 3.4 percent per annum by 2016.

In Canada, which is a growing source of demand for the Cayman Islands' stay-over tourism market, GDP growth in 2011 is forecast to be around 2.1 percent and 1.9 percent in 2012. Moderate growth of 2.2 percent per annum is expected by 2016.

The European economies are facing economic troubles too, this has been exemplified by the high profile sovereign debt crises of Greece, Italy and Spain which has been played out in the international press over the past several months. The 2011 GDP growth in the Euro area is expected to be only ¼ percent and forecast to be 1.1 percent in 2012. The medium term forecasts are cautious with growth being forecasted at 1.7 percent per annum in 2016.

In the United Kingdom (UK), GDP growth is forecast to be low but stable with 1.1 percent forecast for 2011 and 1.6 percent in 2012. Over the medium-term, some improvement is forecast and GDP growth is expected to reach 2.7 percent in 2016.

The stalled recovery of the advanced economies in the first half of 2011 has highlighted the high growth performance among emerging and developing economies. Overall output growth for this group is expected to be 6.4 percent in 2011 and 6.1 percent in 2012. Barring adjustments from overheating in some countries such as Brazil, and strong adverse impact from the low growth of the major economies, emerging and developing economies are expected to remain on the uptrend with output growth of 6.7 percent in 2016.

General price levels rose moderately among advanced economies in 2010 as consumption picked up on the one hand while prices of oil and non-fuel commodities rose sharply by 27.9 percent and 26.3 percent respectively.

Inflation is expected to rise among advanced economies in 2011 to 2.6 percent as monetary policies are likely to continue supporting domestic growth. In addition, oil and nonfuel commodities prices are expected to surge further in 2011 by 30.6 percent and 21.2 percent respectively. However, a modest reversal of these commodity price trends is foreseen for 2012, reflecting the dampened growth prospects and rising financial instability among advanced economies. Inflation is forecasted to be more moderate, at 1.4 percent in 2012 among these economies.

### **Cayman Islands Economic Forecasts**

**Output (GDP) Growth.** Signs of recovery appeared in the first six months of 2011 as economic activity grew at an estimated 1.3 percent, following a 4.0 percent decline in 2010. The key sectors in the recovery trend were hotels and restaurants, financing and insurance, and wholesale and retail trade. However, other sectors continued to perform weakly led by construction and real estate, renting and business services.



Domestic recovery has been led so far by tourism services. In 2010, these services enjoyed an increase in external demand from the strong growth of air arrivals (6.0%) and cruise arrivals (5.1%). The strong upturn in the stay-over market continued in the first half of 2011 with air arrivals increasing by 8.0 percent, although cruise visitors decreased by 3.4 percent in that period.

In the first six months of 2011, activity in the domestic financing and insurance sector, which comprises approximately half of the country's GDP, saw an increase in their total foreign investment (29.5%) and loans to non-residents (10.1%), reversing the declines posted in 2010. Total domestic credit also rose in the first six months of 2011, although at a rate slower than in 2010, on the back of higher public sector borrowings.

Meanwhile, in 2010 global financial conditions continued to impact the local licensed institutions: banks and trusts decreased by 7.9%, stock exchange listings were down by 15.2%, mutual funds registrations by just under 1%, and insurance licenses decreased by 6%. However, new company registrations and new partnership registrations rebounded by 3.7 percent and 19.9 percent, respectively. For the first half of 2011, most of the financial indicators continued to fall, however, at lower rates compared to 2010 while strong growth was recorded for new company registrations.

The real estate, renting and business activities sector recorded another decline in 2010 at 2.4 percent, accounted for mainly by the real estate sub-sector which dipped further by 13.5 percent. In the first half of 2011, the latter was revived with a steep increase in the value of property transfers due to a few high-value properties. Nonetheless, the overall performance of the sector declined.

In construction, the severe curtailment of demand persisted with double-digit declines in total value of building permits and project approvals in 2010 and in the first half of 2011.

The actual overall performance of the economy in the first six months points to a modest recovery of GDP by 1.2 percent in 2011. Continued recovery is forecasted for 2012 with a 2.2 percent growth, bringing GDP growth for FY 2011/12 to 1.7 percent. This is hinged on a more broad-based recovery of the financial services industry, and stronger growth of tourism arrivals and construction.

**Inflation.** In 2010, the domestic economy experienced higher prices for transport goods and services (8.1%) and electricity (21.3%) induced by the sharp increase in global oil prices. However, the overall price increase was held back at 0.3 percent, reflecting the downtrend in housing rental prices which comprise a significant portion of household spending. Inflation was slightly higher at 0.5 percent in the first half of 2011 as average prices of food and non-alcoholic beverages, transport, and miscellaneous good and services picked up while housing-related prices remained subdued.

The inflation rate for 2011 is forecasted at 0.9 percent considering the quarterly trend as of the first half of the year. Upward adjustment in the average prices of transportation, restaurants and hotels and alcohol and tobacco are expected to be mitigated by low inflation in the housing



sector. The forecast inflation for FY 2011/12 is placed at 1.2 percent, conditional on the forecast downtrend in global prices of oil and non-oil commodities, and soft inflation forecast for the US.

**Employment.** The economic downturn had severe impact on labor supply and employment. The total labor force was shrunk by 0.7 percent in 2010 as work permits for expatriate labor fell by 13.1 percent due largely to the loss of work opportunities in construction, hotels and condominiums and financial services. Consequently, the unemployment rate went up to 6.7 percent in 2010.

Work permits fell further by 7.5 percent in the first half of 2011 compared to the same period a year ago. The forecast unemployment rate is seen to decline marginally to 6.5 percent in 2011, mainly as a result of the reduction in expatriate labor force. Conditional on a modest GDP growth in 2012, the unemployment rate is forecast to ease down to 6.2 percent next year. The unemployment rate for FY 2011/12 is estimated at 6.4 percent as compared to 6.6 percent for FY 2010/11.

### **Financial Forecasts**

Madam Speaker, I will move on to highlight the financial forecasts which are contained within the SPS document.

### **Revenue Forecasts**

Madam Speaker, in times like these, “cash is King”, without it the Government cannot function and it is important that we maximize all opportunities to earn and preserve cash in order to give the country the resources to ward off any future economic crisis as well as continue to strive for proper national development.

I will now highlight the revenue forecasts contained in the SPS document. They are based on my Government’s commitment to responsible financial management and our determination to leave the financial affairs of this country in a much better condition than we inherited when we were elected in 2009.

As we all know the Cayman Islands Government earns revenue through a series of user fees and charges rather than the direct taxation method utilized by most countries. This model has been criticized by many but my Administration supports the current structure, while acknowledging that there is room for improvement. We are committed to improving our revenue collection systems and will continue to refine and develop them; we will enhance enforcement, compliance and improving the payment methodologies. The aim is to reduce volatility in actual cash collections.

The Government is not proposing to implement any major new revenue measures over the next three financial years, but will reserve the right to revisit this policy should our economy-and thus financial situation, not improve in line with current projections.

The SPS forecasts that the Government will earn approximately \$560.8 million in 2012/13; \$572.6 million in 2013/14 and \$587.4 million in 2014/15. This represents a healthy annual growth rate of 2.3 percent, and is in line with the projected economic growth as well as the implementation plans of some of the planned major economic developments for the Cayman



Islands such as the Cruise Port project; Cayman Enterprise City, Narayana Health University Project; and the ForCayman Investment Alliance.

### **Operating Expenditure**

Turning now to our Operating Expenditure forecasts, Madam Speaker, the Government is forecasting Operating Expense to be \$497.9 million in 2012/13; \$502.9 million in 2013/14; and \$508 million in 2014/15. This level of operating expenditure represents a modest 1 percent annual growth. It will present significant challenges for the Government to stay within these targets.

The challenges arise mainly from three areas of urgent need: improvements to education infrastructure; the need for improved policing and border security; and the implementation of the human rights provisions of the 2009 Constitution Order.

These are all very important matters for the Cayman Islands and each could easily justify a significant increase in operating expenditure for the government agencies charged with their implementation. The Government however, must keep its operating expenditure below its revenues, and cannot allow agencies free reign to determine their levels of expenditure.

As such we are establishing strict expenditure targets that each Government agency must adhere to and we are tasking them to look for cost efficient and innovative ways of delivering service improvements and meeting demands for service while minimizing the cost to the public purse.

Some of this work has already been started. Over the past 18 months the Deputy Governor has led various teams which have reviewed Government Agencies for possible savings. This important work must continue and we must implement effective recommendations and so realize the savings in the shortest possible time.

### **Operating Surplus**

If the Government and Public Entities are able to achieve the revenue and operating expenditure targets forecast in the SPS, it will report operating surpluses of \$23.5 million in 2012/13; \$31.5 million in 2013/14; and \$42.5 million in 2014/15.

Operating surpluses are a vital component of the Government's fiscal strategy as they are essential to build cash reserves and fund capital investment activity – this includes equity investments into Statutory Authorities and Government Owned Companies. If the Government cannot generate operating surpluses it will potentially hamstring the development of the country and put at risk important public services. That should tell anyone with ears to hear, how serious our fiscal discipline, and our management innovations, have to be.

### **Principles of Repsonsible Financial Management**

We have agreed with the intent of the Framework for Fiscal Responsibility, to return to the Principles of Responsible financial management set out in the Public Management and Finance Law, The SPS is accordingly forecasting the following levels of compliance with the key Principles over the forecast period:



Net Debt Ratio: The FFR requires that the Government not have a net debt ratio greater than 80% of Operating Revenues. The SPS is forecasting a Net Debt ratio of 88.2% in 2012/13; 80.8% in 2013/14; and 71% in 2014/15. This means that the Government would therefore achieve compliance with this ratio during the 2014/15 financial year.

Debt Service Ratio: The FFR requires that the Government's debt service costs be brought down to not be greater than 10% of Operating Revenues. The SPS is forecasting a Debt Service Ratio of 10.4% in 2012/13; 10% in 2013/14; and 9.4% in 2014/15. These calculations are done on the basis of the existing definitions within the Public Management and Finance Law. The changes to the Borrowing Ratios first take effect in respect of the SPS for the 2013/2014 year – due to be presented in the Legislative Assembly by 1 December, 2012.

Cash Reserves: The FFR requires that the Government have liquid cash reserves of not less than 25% of forecast annual operating expenses. The SPS is forecasting cash reserves equivalent to 31% in 2012/13; 30% in 2013/14 and 32% in 2014/15. These comply with the requirements of the FFR.

### **Capital Expenditure**

As with Operating Expenditure, the Government had to make difficult decisions regarding capital expenditure. The choices here range from purchase and construction of assets by Ministries and Portfolios, to equity investments into Statutory Authorities and Government Companies.

The Government has committed to no additional borrowing over the next three financial years. The monies available for capital expenditure will be restricted to cash generated from operating surpluses – it will therefore be a fraction of that which was spent in previous years.

Over the SPS forecast period Capital Investments will be restricted to \$58.9 million in 2012/13; \$43.6 million in 2013/14; and \$43.6 million in 2014/15. These investments will be directed to support debt servicing obligations in Statutory Authorities and Government Companies and for the development of key pieces of infrastructure.

### **Vision for the Future**

Madam Speaker, I have dealt with the present and the near-term future.

I want to turn my vision now to the longer-term future.

I see a future for the Cayman Islands in which there is:

- zero Public Debt;
- significant financial reserves of the Government;
- Zero-tolerance to crime and near zero crime;
- full employment;
- holistically educated population;
- a stream-lined and nimble public sector, graced with strategic planning skills and inspired good governance capabilities,

•a generously enhanced ethos of corporate citizenship, and a well-established practice of social enterprise investment.

How are we going to achieve such a vision of the common good?

As soon as is realistic, the Government will start making annual Appropriations from Revenues to General Reserves;

We must in conjunction with the leaders within the business community, the churches, the schools and to the wider public, to build effective crime prevention and positive social development programmes. Crime is hurting our Islands and we need to immediately improve detection and enforcement, as well as increase the incentives for persons to provide evidence and information to law enforcement agencies;

We can help our unemployment state and move towards full-employment if the projects that Government signaled almost from our first day in office, are not unduly hampered - Projects such as the Cruise Port; Cayman Enterprise City, Narayana Health University; and the ForCayman Investment Alliance;

A holistically educated population should be our objective, combining the benefits of completion of the high schools, an ever-expanding UCCI course offering, the further development of vocational studies including the Hospitality School, and continued access to quality overseas tertiary training.

Let us bear in mind that the well-educated person not only develops their intellect and job skills, but nurtures their aesthetic appreciation, and their spiritual well-being.

Revitalisation of the public sector, and a renewed partnership with the private sector, are now compellingly necessary. Our ability in Cayman is proven. It is time now to apply it to a development model for the 21<sup>st</sup> Century.

### **Conclusion**

Accordingly, I ask that all Honourable Members of this Legislative Assembly to support Government Motion # 4 of 2011-12, to grant approval for a Strategic Policy Statement that charts a responsible course for financial management of the Cayman Islands through times of austerity.

Madam Speaker, I have provided the reality of the present austere times - times which require Government to apply strict fiscal discipline in presenting the SPS that has been Tabled.

I have also presented my vision for the future: one that is filled with hope and promise but one which clearly indicates that the Government, the wider Public Sector and the private sector need to act in an effective partnership to better our present economic and financial position we must take action and do it in a harmonized way, under the grace of Almighty God, to better our Islands' economy and to ensure that Cayman continues to be a most desirable place to live and move and have our being.

Thank you, Madam Speaker