



CAYMAN ISLANDS
GOVERNMENT

*RESTORED PUBLIC FINANCES -
A BENEFIT OF DISCIPLINED GOVERNANCE*

**BUDGET
ADDRESS**



Delivered Friday, 15 May, 2015
Hon. Marco Archer, JP, MLA

2015/16

INTRODUCTION

Madam Speaker, it is with tremendous pride and great optimism that I stand today, before this Honourable House, to speak to The Appropriation (July 2015 to June 2016) Bill, 2015.

I will begin my Address today by giving thanks to the Lord, without whose guidance and direction I would be unable to stand before you to present my third budget since taking office in May 2013.

Two years ago, when I delivered my first ever budget Address as the newly appointed Minister of Finance and Economic Development, our country faced sizeable challenges: most notable among them was the deficient state of Government's finances; strained relations with the United Kingdom; and the uncertain direction of our economy. Whilst at times the road ahead seemed daunting, I remained confident that with faith, perseverance and prudence, not only would we achieve fiscal sustainability and repair our diplomatic ties; we would ultimately regain the trust of the people, and in so doing, enjoy sustained economic growth.

Whilst it is possible to continually improve the state of our public finances each year, I am pleased to report that our dedicated efforts are now bearing fruit, and we are finally on the cusp of **"Restored Public Finances – A Benefit of Disciplined Governance."**

Madam Speaker, the Government's first priority was to ensure that the public's finances were placed on a sound footing in order to make a positive difference in the lives of our people; a footing which will become the foundation upon which we build a stronger and more resilient Cayman Islands.

As I will outline today in this address, during the 2015/16 fiscal year, our cash balance will reach levels never before seen by the Government without having borrowed the money; we will once again deliver a surplus budget; our debt burden will continue to fall; and our Government will regain full compliance with all principles of responsible financial management as outlined in the Public Management and Finance Law (2013 Revision) (the PMFL).

When our fiscal plans come to fruition, the Government will be better able to serve our citizens and have greater flexibility in bringing much needed relief to our citizens through enhanced programs, better infrastructure, increased employment opportunities, and lower fees and taxes.

Madam Speaker, the 2015/16 Budget placed before you, represents a historic milestone for our country. It represents this Administration's unwavering commitment to maintain accountability in its financial affairs. It is the first Budget to achieve full compliance with all six Principles of Responsible Financial Management, as cited in the Framework for Fiscal Responsibility (the FFR) and reflected in the PMFL. This Government has therefore successfully positioned the country to meet all six of these principles by the established target date of 30 June, 2016. It should be noted Madam Speaker that the inclusion of the FFR into the PMFL significantly raised the bar on what were already very stringent goals with respect to the state of our Public Finances.

By way of example, before the FFR was added to the PMFL, the ratios for the Principles of Responsible Financial Management were assessed at 30 June each year. When the FFR was passed as an amendment to the PMFL, the assessment date for the 90-day Cash Reserve ratio was changed to 31 December each year, the date at which Government's unrestricted cash balances are at their lowest level. This meant that the significant cash inflows from financial services fees between January to March were of no assistance in meeting the December Cash Balance requirements. Therefore, the requirements of the FFR made it more difficult to meet the 90-day Cash Reserve ratio.

Madam Speaker, achieving these enhanced requirements have not been easy. This Government had to make many tough decisions along the way; and as a result, we have had to face our fair share of criticisms. However, I am confident that the decisions taken were the right decisions, and taken in the best interest of the people of the Cayman Islands.

COMPLIANCE WITH PRINCIPLES

Madam Speaker, I will now go into further details on the various principles under the PMFL and how the 2015/16 Budget forecasts achieve compliance with these principles:

1. **Net Operating Position:** For 2015/16, the requirement that Central Government revenues be greater than its expenses, **will be achieved**, as the Government is forecasting Revenues of \$661.2 million and Operating Expenditures of \$539.9 million, resulting in a \$121.3 million net operating surplus;
2. **Net Worth:** At the end of 2015/16, the requirement that Central Government assets less its liabilities be positive, **will be achieved**, as

the Government's assets are forecast to exceed its liabilities by approximately \$1.7 billion;

3. **Debt Service:** For 2015/16, the requirement that annual payments on all public sector debt not be more than 10 percent of Core Government Revenue, **will finally be achieved**, as the Government is forecasting a debt servicing ratio of 9.9 percent. A significant focus of this Government is to reduce the Public Sector debt burden as aggressively as possible while observing the PMFL requirement that all debt related payments should not exceed the 10 percent ratio in any fiscal year. As a risk mitigation strategy, and in the event of an unforeseen reduction in revenue which would threaten compliance with the debt servicing ratio, for the current 2014/15 fiscal year the Government has placed \$17.1 million into a debt service Sinking Fund which it will be able to draw upon to remain within the 10 percent limit. The total balance in the Sinking Fund now stands at \$18 million;
4. **Net Debt:** For 2015/16, the requirement that the total debt of Central Government plus the weighted average debt balance of Public Entities, less Central Government's liquid assets, be no more than 80 percent of Central Government Revenue, **will be achieved**, as the Government is forecasting a net debt ratio of 45.5 percent: this is well below the legally prescribed limit of 80 percent;
5. **Cash Reserves:** For 2015/16, the requirement that the unrestricted cash reserves of the Government at 31 December, 2015 be sufficient to cover 90 days of Operating Expenditures **will be achieved** as the Government is forecast to have sufficient cash reserves to cover approximately 94.7 days of Operating Expenditures at 31 December, 2015, the estimated lowest point during the fiscal year for unrestricted cash reserves; and lastly
6. **Financial Risks:** For 2015/16, the Government will continue to manage its risks prudently by maintaining sufficient insurance coverage on all Government property and major potential liabilities, and remain prepared in the event of a hurricane or other unforeseen adverse event.

Madam Speaker, full compliance is a significant milestone which should not be overlooked. We should remind ourselves of the underlying objective of the PMFL, which is to promote vigilance and transparency in the management of Government's finances. The PMFL, with the inclusion of the FFR, required the Government to improve accountability in all its public

sector operations, a task which this Administration has complied with and remains committed to.

However, before I delve further into the fundamentals of the Government's proposed budget for 2015/16, I will take a few minutes to reflect on the steps we have taken to this point, as it is worth evaluating the changes we have made to restore Government's finances.

2013/14 UNAUDITED ACTUALS

The 2013/14 fiscal year ended with a \$109.1 million operating surplus for the Entire Public Sector. This amount was \$8.9 million greater than the full-year original budget surplus of \$100.2 million. Public Entities reported a \$9.1 million surplus, while Central Government achieved a \$100 million surplus. This positive change in the operating performance was mainly due to higher than anticipated operating revenues, coupled with lower than expected operating expenses, and was achieved despite the 2.5 percent gratuitous payment of \$3.7 million to Civil Servants by the Government in June 2014.

Total revenues for 2013/14 were \$2.6 million more than the \$644.7 million projected in the approved Budget. Higher than expected revenues were largely due to increased activity in the economy, as well as improved efficiency in revenue collections. Specifically, revenue from increases in total merchandise imports and an uptick in the real estate market all contributed positively to the improved financial performance.

Total operating expenses of Core Government for the year ended 30 June, 2014 was \$547.3 million, or \$2.1 million less than the \$549.4 million originally budgeted in 2013/14. These savings can be attributed to the Government's concerted effort to manage its expenditures within the confines of the Government's four year Medium Term Fiscal Strategy agreed with the Foreign and Commonwealth Office.

Madam Speaker, the Government ended the 2013/14 fiscal year practically on budget for **Personnel Costs**, spending \$238.1 million. This is a testament to this Administration's commitment to manage the Civil Service headcount through restrained recruitment and attrition. Included in the amount for personnel costs was \$11.4 million paid into the Public Service Pensions Fund towards the Government's past service liability for Civil Service and parliamentary pension benefits.

Total **Supplies and Consumables**, were \$88.1 million. This was \$2.8 million less than the original 2013/14 budget anticipated. This was largely

due to underspends for items such as travel and professional consultation fees.

Total **Depreciation** expense for the year was \$25.9 million. This was \$2.1 million less than budgeted. The delayed acquisition of certain assets which were originally planned to be acquired earlier in the fiscal year created these savings.

For total debt overall, the Government saved \$0.9 million in **Finance Costs** during the 2013/14 fiscal year. This was due to our aggressive efforts to re-negotiate interest rates, reduce the balance of public debt, minimise the use of the overdraft facility and this Administration's stance on refraining from any new borrowings.

Madam Speaker, compared to fiscal year 2012/13, when the actual expense of \$0.8 million was incurred on bank overdraft interest only, this Administration reduced overdraft interest to \$0.1 million during its first year in office, 2013/14, and then completely eliminated overdraft interest charges during the current 2014/15 fiscal year. We only spend to the extent we can afford to, and we do not plan to enter into debt instruments to finance recurrent expenditure.

The Government spent \$102.2 million on **Outputs from Statutory Authorities and Government Owned Companies**, during the 2013/14 fiscal year. This amount was \$1.5 million over the budgeted amount, and was primarily a result of increased demand for medical services at the Health Services Authority, as well as an increase in output funding to the University College of the Cayman Islands.

Outputs from Non-Government Output Suppliers were \$1.3 million over budget during the 2013/14 fiscal year. This was mainly due to the unpredictable nature of certain expenditures such as Legal Aid Services under the Bill of Rights, Services for Refugees, and Overseas Medical Care.

The Government spent \$31.1 million in **Transfer Payments** for 2013/14, which was a savings of \$2.0 million from what was originally budgeted. Part of these savings stemmed from the Government's efforts to regularise the Young Nation Builders Scholarship Programme by properly aligning the terms and conditions of those scholarships with those of the Education Council to ensure equal treatment for all persons receiving scholarships from the Government.

Statutory Authorities and Government Owned Companies (SAGCs) recorded a combined net operating surplus of \$9.1 million. This was a

positive variance of \$4.1 million, when compared to the original budget. Improved performance was seen in various SAGCs. In particular, the Port Authority ended the 2013/14 year with a surplus, thanks to increased cargo volume. Additionally, the Civil Aviation Authority had a successful year in 2013/14, posting the highest net income ever realized by the Authority, mainly as a result of prudent management of the Authority's finances, as well as significant growth in the Cayman Islands Aircraft Registry. Other contributors to this positive variance were the Cayman Islands Monetary Authority, the Water Authority, CINICO, the Cayman Islands Airports Authority and the Maritime Authority.

Madam Speaker, I will speak briefly about our Public Entities which are usually not the area of focus during annual budget presentations. However, they are worthy of attention as collectively along with having first call on the country's revenue, they incur operating expenditures of approximately \$300 million annually, and account for approximately 40 percent of the total operating expenses of the entire public sector.

Madam Speaker, for several years following the introduction of Government's financial reform in 2004, the Government's budget featured a line item called "net deficit" of Statutory Authorities and Government Owned Companies. The people of these Islands expect that this Progressive-led administration will ensure that all Public Entities utilize their financial resources in a manner that benefits the country as a whole.

Madam Speaker we have instituted real management and guidance, challenging Public Entities to improve their overall financial performance and holding them accountable for delivery. As a result, we are no longer seeing collective net deficits; rather we are seeing growing surpluses as loss making Agencies reduce their losses, while profit making agencies increase their returns to Central Government. I have said it before and will always believe that since they operate with delegated authority from the Central Government, the relationship between Central Government and SAGCs should be like that of 'parent and subsidiary companies' as is common in the corporate world.

Our 26 Statutory Authorities and Government Companies are not an insignificant part of the entire public sector Madam Speaker, and I believe the results speak for themselves when the entire group contributes to lifting the country out of its previous economic and financial challenges.

Many of these institutions were created with the best of intentions to deliver critical services, regulate important industries, or promote various aspects of

our culture. However, somewhere along the way a few have gone off the rails.

Public institutions can either advance or hinder social and economic progress; and as the Minister with responsibility for Finance and Economic Development, it is my duty to ensure, with the support of my colleagues, at least from a fiscal management perspective, that these institutions do not hinder, but rather serve to advance progress in this country socially, financially and economically.

Madam Speaker, returning now to the results of operations for the fiscal year ended 30 June, 2014: total Assets of the Government were \$2.27 billion, of which Property, Plant, and Equipment was \$1.74 billion. Total Liabilities were \$855.6 million, and total Net Assets were \$1.42 billion. Government's Debt Balance stood at \$548.9 million at 30 June, 2014. This amount continues to decrease with scheduled payments.

Total overall closing bank account balances as at 30 June, 2014 was \$173.9 million; of which \$108.3 million was held in Reserve and Restricted bank accounts whilst the Operating bank account had a positive balance of \$65.6 million.

Madam Speaker, I would like to further highlight that the 2013/14 Annual Accounts were prepared and submitted in line with the statutory deadline of 31 October, 2014 – these accounts are expected to be audited before the end of this current fiscal year. This will result in the first set of audited entire public sector accounts since the PMFL came into effect in 2004.

Overall, the financial results for 2013/14 speak for themselves, and demonstrate that this Administration got off to a strong start in the management of the country's affairs during their first year in office.

With no borrowing during the 2013/14 fiscal year, Central Government's unaudited \$100 million Operating Surplus provided the funding for Capital Expenditures and Investments of \$41.2 million, as well as a means of repaying Government's debt principal obligations of \$25.5 million. The Operating Surplus also increased Government's Cash Reserves during the year – which was necessary in order for the Government to comply with its legal obligation to have sufficient cash balances to meet 90 days of Operating Expenditures.

The further consideration that will be examined is whether to make a transfer of some cash balances to General Reserves. Given that the Government deliberately chose to manage its finances without the use of an

overdraft facility, the operating bank account balance must always remain positive and always be sufficient to pay Government's expenses. Making a transfer of cash to General Reserves means that, in the event of a subsequent need to use the amount transferred, the approval of the Legislative Assembly is required and, the time required to obtain the approval may not allow for urgent use of the funds transferred to General Reserves. Hence, the amount of any transfer to General Reserves requires careful estimation but, such a transfer is noble because in layman's terms, it would represent the Government's achievement in "putting aside funds for a rainy day."

Madam Speaker, this is comparable to a business deciding whether to place more funds in a fixed deposit or to keep it in their chequing account to be utilised in meeting expenses. Nevertheless, the Government gives the country its assurance that whenever a transfer can be made to General Reserves, it will be made to the greatest extent possible.

2014/15 FINANCIAL FORECASTS

Madam Speaker, I will now focus briefly on the forecast financial results for the current 2014/15 fiscal year as they form the foundation for the 2015/16 Budget.

At 31 March, 2015, the forecast operating surplus for the financial year ending 30 June, 2015 was \$134.6 million; \$6.6 million more than the \$128.0 million originally anticipated in the 2014/15 budget.

The Government's Operating Revenues are forecast to be \$660.2 million. This amount is \$2.4 million more than the \$657.8 million originally budgeted. Increased activity in the domestic economy and the U.S. economy, as well as the growing demand for our tourism product, positively impacted various revenue streams, resulting in an increase in merchandise imports, and a significant upsurge in real estate sales.

The forecasted 2014/15 operating expenses of Core Government is \$538.7 million compared to \$536.8 million originally budgeted for the year. Once again, the Government remained steadfast in carefully managing its expenditures.

Personnel Costs for 2014/15 are forecast to come in below budget at \$232.3 million; or \$9.5 million less than originally budgeted. The Government has continued its efforts to gradually downsize the Civil Service,

and has placed special attention on improving employee efficiency in order to enhance the value and the provision of Government services.

Turning to **Financing Expenses**, the Government is forecast to come in on budget at \$28.5 million in Financing Expenses for the 2014/15 fiscal year. As a result of continued prudent fiscal management, the Government was able to operate throughout the 2014/15 fiscal year without the need for an overdraft facility.

Outputs from Non-Government Output Suppliers are forecast to be \$6.9 million higher than the original budget. This is primarily due to over utilization of Overseas Medical Care, along with increased cost for the custody, care and repatriation of Cuban Refugees.

The Net Surplus of Statutory Authorities and Government Owned Companies is forecast to be \$13.1 million for the fiscal year ended 30 June, 2015. This amount is \$6.0 million more than the \$7.1 million included in the 2014/15 budget. The Cayman Islands Airports Authority, CINICO, and the Health Services Authority have all been performing better than expected. Cayman Airways has also been experiencing positive results, and this is due to increased air arrivals coupled with lower operating costs as a result of declining fuel prices. Increasing cruise visitor arrivals also positively impacted the Port Authority. As I noted earlier Madam Speaker, it is no longer business as usual, and the interventions of this Government in driving accountability are starting to bear fruit.

As a result of increased revenues and reduced operating expenditures, the Central Government is forecast to have closing bank account balances totalling \$269.6 million. This amount is \$13.5 million more than the \$256.1 million shown in the 2014/15 budget. The very important Operating Bank account balance is expected to be \$138.4 million at 30 June, 2015, and Restricted Cash Balances will make up the difference of \$131.2 million.

Madam Speaker, preliminary results for fiscal year 2014/15 show that we are on track, yet again, to outperform the initial budget expectations, and poised to fulfil our obligations towards achieving FFR compliance by 30 June, 2016.

ECONOMIC OUTLOOK 2015/16 to 2017/18

Output (GDP) Growth

The economic landscape over the medium-term looks favourable. Overall growth for our country, particularly as it relates to our tourism sector, is

foreseen to be on an upward trajectory. Although our domestic growth is contingent on growth in the advanced economies, recent projections for these economies suggest accelerated recovery; in particular, GDP growth for the United States is projected to jump from 2.4 percent in 2014 to 3.1 percent in 2015, despite its first quarter performance.

Domestic private consumption and investment will continue to support our growth, since Government's commitment to the FFR has significantly impacted its role as the major stimulator for the economy through increased expenditure. Notwithstanding the Government's limitations under the FFR, as with previous years, this year's economic stimulus package of \$20.1 million, is geared at reducing the cost of doing business through lowered import duties, is expected to positively impact disposable income and domestic demand.

Economic growth over the medium-term is also expected to be driven by the construction sector, stemming from a number of private sector investment projects. These include: the new Kimpton Hotel and Condominiums on Seven Mile Beach, and the redevelopment of the former Hyatt Beach Suites Hotel. Once completed, these projects are expected to directly boost our tourism offerings, while generating indirect economic benefits in areas such as wholesale and retail, transport, and the utility sectors.

In addition to the economic stimulus package implemented by Government, this Administration has identified five major projects which are expected to boost investment and economic growth. These are the George Town cruise berthing facility; the Owen Roberts International Airport Terminal upgrades; the revitalisation of George Town; the extension of the east-west arterial road; and a new solid waste management facility. In particular, a higher growth prospect for the tourism sector is anticipated over the long-term from the airport and cruise berthing projects.

External demand is also likely to be boosted by the Health City Cayman Islands Hospital, now that the hospital is JCI accredited and has received the Gold Seal of Approval from Joint Commission International.

Barring any major global events, whether man-made or natural, which could negatively impact the growth of our tourism and financial services, real GDP growth for the Cayman Islands is forecast at 2.1 percent in 2015/16. Thereafter, the growth rate is forecast to grow to 2.3 percent in 2016/17 and 2.6 percent in 2017/18.

Inflation

With the anticipated boost to domestic demand for goods and services resulting from the increase in tourism, along with the implementation of various infrastructure projects, slightly higher inflation rates are projected over the coming years. This is to be expected as inflation is a natural by-product of growth and development in any economy.

For fiscal year 2015/16, inflation is forecasted at 1.7 percent, up from 1.4 percent in 2014/15. This assumes global oil prices will remain sufficiently low enough to dampen the build-up in inflationary pressure due to higher domestic demand for goods and services related to tourism and construction. Thereafter, the inflation rate is forecast to increase to 2 percent in 2016/17 and then to 2.4 percent in 2017/18.

Employment

The unemployment rate is expected to be 4.7 percent in 2014/15 and remain at 4.7 percent in 2015/16 because of an expected increase in the Labour Force due to an increase in the retirement age from 60 to 65 and, the natural increase in the working age population amongst Caymanians. Thereafter, the unemployment rate will decline to 4.5 percent in 2016/17 and it is expected to remain at 4.5 percent for 2017/18. New employment opportunities are expected to be created directly and indirectly from the public and private construction projects and operation of the major tourism development projects, particularly the Kimpton Hotel, the redevelopment of the former Hyatt Beach Suites Hotel and the new cruise terminal.

Current Account

Madam Speaker, the growth in imports and remittances are expected to be outweighed by the growth in inflows from tourism and financial services, thereby narrowing the deficit for the current account in the balance of payments from 21.6 percent of GDP in 2014/15, to 21.1 percent in 2015/16.

While inflows from tourism services are expected to be higher in the succeeding years, outflow of payments to the rest of the world are expected to accelerate due to the volume of construction materials and consumable goods imported to facilitate the planned private and public sector projects. Therefore, the current account-to-GDP ratios are forecasted at 22.4 percent in 2016/17, and 23.2 percent in 2017/18.

2015/16 FINANCIAL FORECASTS

Madam Speaker, I would now like to focus the attention of Honourable Members to the financial forecasts included in the 2015/16 Budget. Total Operating Revenues are forecast to be \$661.2 million; Operating

Expenditures are forecast to be \$525.2 million; and Financing Expenses are forecast at \$27.6 million. This results in a Core Government net Operating Surplus of \$108.4 million. After factoring in the forecast net Operating Surplus of the Statutory Authorities and Government Owned Companies of \$12.9 million, the Entire Public Sector is forecast to record a net Operating Surplus of \$121.3 million.

The 2015/16 Net Operating Cash Flows are forecast to be \$139.6 million. This will be used to fund Capital Expenditure and Equity Investments of \$50.3 million; make principal debt repayments of \$20.0 million; other cash inflows expected during the year amount to \$2.7 million; and the remaining balance of \$72 million will be used to further improve the Government's operating cash balances.

As you can see, Madam Speaker, the financial results for 2015/16 are well aligned with the requirements of the FFR and the compliance date of 30 June, 2016.

Revenues

Madam Speaker, this Government said from the outset that it would not introduce any new revenue measures. That is a commitment we've kept, and, all things being equal, one that we intend to keep for the duration of our term. Madam speaker, the revenue that the Government collects is an absolute necessity as it enables the Government to improve our infrastructure, provide educational opportunities for our children, healthcare and security for our citizens, and provide for the less fortunate among us.

The 2015/16 forecast operating revenue of \$661.2 million includes no new revenue measures, and represents a very conservative 1 percent growth rate over what was budgeted for 2014/15. This is possible because of the growth in the domestic economy.

This Government has recognized the challenges faced by many Caymanians on a daily basis in trying to make ends meet. The Government therefore took steps to provide relief to the average citizen through the reduction in rates for certain revenue items which will continue to have maximum impact on disposable income and the economy over the coming year.

Madam Speaker, as you know, there are few tangible goods produced in the Cayman Islands and much of what we consume is imported from elsewhere. The reduction of two percentage points on the majority of dutiable items was one measure that the Government implemented in 2014/15 which will continue for the 2015/16 fiscal year.

Madam Speaker, everyone knows that the cost of electricity in these Islands accounts for a major part of private household spending as well as the cost of doing business. In 2014/15 the Government began to provide some relief by reducing the import duty placed on diesel fuel consumed by CUC by 25 cents per gallon which took effect in January 2015. The value of the revenue forgone from January to June 2015 is estimated to be \$4.2 million. For 2015/16, the 25 cents duty reduction equates to additional disposable income of \$4.2 million between July to December 2015 and a further \$4.2 million boost between January to June 2016.

In addition to what has been detailed above, Madam Speaker, the Government will again reduce the import duty placed on diesel fuel consumed by CUC by an additional 25 cents per gallon starting on 1 January, 2016. This means that Government will forsake a further \$4.2 million during the last six months of the 2015/16 fiscal year.

Therefore, the total diesel duty reduction from January 2015 to June 2016 is \$16.8 million when considering each 25 cents reduction in January 2015 and January 2016. This reduction will provide further relief to the cost of electricity as well as generate increased disposable income to be spent in the local economy.

Once again, it is expected that additional disposable income will result in a greater level of spending in the economy – which will provide increased activity for business entities, greater opportunities for employment and enhanced quality of life for individuals.

Madam Speaker, the total stimulus package in the 2015/16 Budget is \$20.1 million: \$12.6 million in diesel duty reduction and \$7.5 million in a cost of living adjustment to the Civil Service. This represents a direct increase to disposable income, to be spent within the local economy.

Operating Expenditures

Madam Speaker, the 2015/16 forecast for Core Government Operating Expenses is \$552.8 million, inclusive of Financing Costs. This represents a \$16.0 million increase from the 2014/15 budgeted expenditure level. This increase includes, among others, the Government's planned award of a 4 percent cost of living adjustment which is expected to cost the Government \$7.5 million; \$3.8 million to purchase outputs from CIMA; \$1.8 million to CINICO with respect to health insurance benefits for pensioners; \$0.9 million to fund additional recipients under the Seamen's *ex-gratia* regime; \$0.7 million of additional funding with respect to the e-Government initiative; and \$0.5 million for salary re-grades during the fiscal year.

Madam Speaker, this Government will not allow fiscal constraints and the challenges of our present circumstances to prevent us from capitalizing on key opportunities and making short term sacrifices to realize long term benefits. Therefore, Madam Speaker, whilst the 2015/16 budget shows a 3.0 percent increase in the Government's planned operating expenses, the reality is that we are also making investments into innovative methods of delivering enhanced services to our citizens which will make the Government more efficient and save the country money in the medium to long term.

Madam Speaker, we are aware that we must do more with less. However, it is equally important that we identify those priority areas that will place the country and our people in the best possible position for this and future generations to grow and develop economically and socially. Yes, we are going to do more with less, as we have been doing, but more importantly, we are going to do things right. That means, we are focusing on investments in education for our people, for their upward mobility, social advancement, and to reach the levels of economic prosperity that is the potential of every Caymanian; we will invest in necessary infrastructure to facilitate growth and diversification and support the key pillars of our economy; we will invest in modern technology; and we will improve Government services at all levels, **but** we are **not** going to increase the tax burden in order to do so. The Government has a firm grasp on the situation.

The initiatives that the Government is working on and are funded in the 2015/16 Budget are:

1. Preparing the management framework to facilitate implementation of approved recommendations from the Ernst and Young Report in regards to 'Project Future;'
2. Investing in e-Government initiatives to improve access, service levels and efficiency across the Public Sector;
3. Establishing the Central Procurement Office, which will bring efficiencies to the Government by leveraging our significant buying power; and
4. Establishing a Major Projects Office which will manage the Government's major project initiatives such as the Airport redevelopment, the Cruise Berthing facility, and the Integrated Solid Waste Management System.

Madam Speaker, the major components of the operating expenses in the Appropriation Bill are as follows:

Personnel Costs are budgeted at \$252.4 million, which includes a provision of \$11.4 million to be paid into the Public Service Pensions Fund towards the Government's past service liability for Civil Service pension benefits. Personnel Costs are by far the largest component of the Government's budget. Also included in the Government's fiscal plan is a cost of living adjustment of 4 percent for Civil Servants. As the Government noted in the presentation of the Strategic Policy Statement last November, the 4 percent is significantly less than the cumulative growth of inflation since the last cost of living adjustments which took into account inflation rates to 2007.

Whilst the Government would like to do more and catch up with the rate of inflation, we have to be cognizant of our continued fiscal constraints and the need for ongoing sacrifices for the benefit of the entire country. Madam Speaker, any government should recognise that they do not govern for the sole benefit of the Public Service; they govern for the benefit of the entire country with the assistance of the Public Service.

There are other important points that need to be made with respect to the award of the 4 percent cost of living adjustment:

- the award is not funded by any new taxes being implemented – the award is funded by operational savings and existing revenues and there will not be any increases to existing taxes, fees and charges; and
- the cost of living adjustment should not be inflationary since there is no added cost to taxpayers and businesses by way of increased taxes.

Madam Speaker, I wish to take a few minutes to speak about a matter concerning Civil Service personnel costs; a matter which successive Governments have neglected. Madam Speaker, I am proud to be a part of a Progressives-led Government that has the will and fortitude to deal with some of the more difficult issues to which previous administrations have taken the Ostrich approach. One of those issues, Madam Speaker, is the Government's current post-retirement healthcare benefit plans.

Madam Speaker, the Mercer Report shows that if this country continues with the present regime, we will be facing a healthcare liability of approximately \$1.18 billion dollars. The estimated operating cost in relation to post-retirement healthcare benefits was \$135 million with respect to the 2014/15 year. Madam Speaker, that analysis suggests that without taking the necessary steps, it is the country that will suffer.

Madam Speaker, this Honorable House enacted legislation which requires the Government to ensure that its fiscal plans do not entail annual operating costs which are greater than the expected revenues for the same fiscal year.

In other words, when it comes to the current post-retirement healthcare benefit regime, we have to accept that it is simply unaffordable and something must be done in the best long term interest of the country.

If left unresolved, in three years, the current post-retirement healthcare regime will cost the Government approximately \$161.8 million for the 2017/18 fiscal year.

Such a situation would limit the Government's ability to provide future relief in terms of reduced fees and taxes to the country as we would need to keep the Government's revenue sufficiently high enough to absorb such significant costs. And may even impinge upon the provision of essential services.

As I said in my address to the 2015/16 Strategic Policy Statement, the Government intends to own this problem and to do something about it. Now that we have the Mercer Report Madam Speaker, we are in the process of negotiating appropriate measures which we hope will be sustainable for the country. Working with our actuaries and the Civil Service, the Government will be considering the feasibility of the following measures:

1. We will raise the retirement age from 60 to 65 years. Madam Speaker, present life expectancy in the Cayman Islands is approximately 82 years. Therefore, by increasing the retirement age by 5 years, the period of time that employees will be drawing post-retirement benefits could be reduced by as much as 25 percent. However, this does not only benefit the country, it also allows **willing and able** Civil Servants to earn a higher salary as compared to a pension; negotiate lower mortgage payments with more years to repay their mortgages; and the associated mental and physical health benefits of working and remaining active;
2. Capping the lifetime limit on claims. Madam Speaker, presently, every Civil Servant enjoys a lifetime maximum on health insurance claims of \$5 million. Very few actually reach that limit, but the fact that it exists results in a potential liability that is quite high. The Government will therefore propose to lower that limit to a more realistic figure which will also limit government's potential future liability. For the sake of comparison, private sector employees usually have a lifetime

maximum of \$2 million, and that is for the very senior employees and partners in professional firms; and

3. The Government plans to introduce a graduated post-retirement benefit scheme. It is unreasonable, Madam Speaker, nor can this country afford, for someone to spend 30-plus years of their working career in the private sector, join the Government at age 50, then retire in 10 years with the same full coverage of lifetime free medical as someone who has worked their entire career in the Civil Service. But that is the present regime and it is simply unsustainable.

Madam Speaker, while the aforementioned measures will begin to address the healthcare liability we must do more. Madam Speaker, the EY Report recommended and I quote, "That we should introduce co-pay and deductibles for all CINICO customers".

Given that the majority of CINICO customers are Civil Servants and healthcare benefits are part of their contractual terms and conditions of service, we will request the Deputy Governor and Head of the Civil Service to present a business case to Cabinet on the feasibility of this recommendation and potential impacts on the Civil Service, Civil Servants, CINICO and the Health Services Authority.

What is clear is that we cannot ignore the problem; but we must fully understand the complexity of the issue and develop a solution that is both effective and sustainable. We aim to have a modernized benefits strategy in place by 2018.

Therefore, Madam Speaker, in the interest of transparency and full disclosure, the Government has acknowledged the cost of this issue in the notes to the 2015/16 Financial Statements.

We intend to work assiduously with all stakeholders to arrive at a solution that is equitable, fair and most importantly, one that this country can afford.

Continuing with the 2015/16 forecast operating expenditures:

- **Supplies and Consumables** are budgeted at \$89.5 million; this reflects a marginal decrease when compared to the estimated expenditure of \$90.7 million for 2014/15. Notwithstanding, the Government has included provisions for important investments in e-government, support for school facilities and various other ancillary costs to support ongoing service delivery.

- **Outputs from Statutory Authorities and Government Companies** are budgeted to be \$98.7 million for 2015/16. This amount is \$4.6 million more than the forecasted \$94.1 million for 2014/15.
- Madam Speaker, the importance of CIMA to our crucial financial services industry cannot be over emphasized.
- Therefore, when CIMA reported to the Government that it may not yield the previously expected level of revenue from the Hedge Fund Directorship fees; the Government took swift action in providing an additional output funding of \$3.8 million to ensure there would be no interruption to the operations of that Agency.
- Madam Speaker, earlier I spoke about the growing concern of increased costs associated with the current post-retirement healthcare benefit regime. In 2015/16, the Government will have to pay an additional \$1.8 million to CINICO for the healthcare coverage of Civil Service Pensioners.
- That will bring the total provision paid to CINICO for this coverage to \$21.4 million for 2015/16. That figure, Madam Speaker, is twice the amount the Government will provide to CIMA to regulate our entire financial services industry for 2015/16; it serves as yet another reminder, that something must be done and soon.
- **Outputs from Non-Governmental Output Suppliers** are budgeted to be \$22.8 million for 2015/16. The major items in this category are: \$11.4 million for the provision of overseas medical care for Indigents; \$2.7 million to provide Legal Aid services to qualified persons; \$1.6 million to provide Rental Assistance to persons in need; and \$1.5 million for primary and secondary education by private schools.
- **Transfer Payments**
Madam Speaker, the provision of Transfer Payments is largely used to support the most vulnerable in our society. It includes programs which provide assistance to our Seamen and Veterans, provide scholarships to our children, and relief for the poor. For 2015/16, the Government has made provisions of \$7.6 million for poor relief payments and vouchers; \$7.1 million in benefit payments to Seamen and ex-Servicemen; \$11.6 million in Scholarships; and \$0.7 million in Housing Assistance.

- Total Transfer Payments for 2015/16 is budgeted at \$32.6 million; this amount is \$1.3 million higher than the \$31.3 million forecasted for the current 2014/15 fiscal year.
- Worthy of noting is the Government's intent to provide an additional \$0.3 million for Needs Assessment Support, and \$0.9 million to fund additional recipients under the Seamen's *ex-gratia* regime.

Madam Speaker, this country should never forget nor seek to diminish the contributions made by those who came before us, especially our seamen and veterans, without whose efforts we would be unable to enjoy the economy and the freedoms we now have. Therefore, when it came to achieving the results required for legal compliance with the FFR, the Government was adamant that the budget targets would not be achieved by merely pulling resources away from the most vulnerable within our society; rather, sacrifices would have to be made in other areas to ensure that we could continue to provide critical support where it is needed.

- **Financing Expenses** are budgeted to be \$27.6 million for 2015/16; this represents a \$0.9 million decrease from the 2014/15 forecast amount of \$28.5 million. Financing costs will continue on a declining trajectory, as the Government continues to work hard to reduce public sector debt levels. I am also happy to report Madam Speaker, that no ancillary borrowing costs will be incurred for 2015/16 as the Government does not plan to undertake any new long term borrowings, nor will it require the use of any overdraft facilities.
- **Depreciation and Amortisation** are budgeted to be \$27.3 million for 2015/16. This reflects the annual wear and tear on various Government assets in the provision of goods and services. Whilst no cash is actually expended for depreciation, under accrual accounting the Government is required to recognize this cost as it improves transparency and better reflects the true cost of operations.

Capital Investments

For the 2015/16 fiscal year, Capital Expenditures and Equity Investments in Public Entities are forecast to be approximately \$50.3 million.

The 2015/16 Budget allocates \$31.3 million to be invested in assets of the core Government such as:

- \$10.5 million for the Ministry of Planning, Lands, Agriculture, Housing and Infrastructure for various capital projects, including: \$5.3 million

relating to the revitalization of Central George Town and \$3 million to cover gazetted land claims and road surface upgrades;

- \$8.0 million to the Ministry of District Administration, Tourism and Transport for various capital projects, including: \$4.2 million towards the Cruise Berthing facility and \$3.5 million for various capital projects on Cayman Brac;
- \$5.0 million for the Ministry of Education, Employment & Gender Affairs towards the phased construction of the John Gray High School;
- \$2.2 million for the Ministry of Health and Culture for various capital projects including solid waste management;
- \$2.0 million for the Ministry of Home Affairs for capital projects relating to National Security; and
- \$1.5 million to the Ministry of Community Affairs, Youth & Sports for upgrades to the Haig Bodden Play Field and to develop a Walking Track at the Bodden Town Primary School.

Additionally, a sum of \$19 million will be invested in Statutory Authorities and Government Companies, primarily to fund the debt service obligations of these entities. The major investments in this category are:

- \$9.0 million to the Cayman Turtle Farm (1983) Limited to fund debt servicing and operational losses;
- \$5.1 million to Cayman Airways Limited to fund debt servicing and capital expenditures;
- \$2.4 million to the National Housing Development Trust to fund debt servicing obligations; and
- \$1.5 million to the Cayman Islands Development Bank as part of the re-capitalization of that Entity.

Cash and Debt Management

During 2015/16, total cash balances are expected to grow by \$72 million, reaching \$341.6 million by the 30 June, 2016. When this is achieved, it will be unprecedented for a year in which the Government undertook no new borrowings.

At 1 July, 2015, the Core Government Debt is expected to be \$523.4 million. Over the 2015/16 fiscal year, the Government will make principal payments of \$20 million, thereby reducing the outstanding debt to \$503.4 million by June 2016.

Madam Speaker, I would also like to share with my legislative colleagues that the Cayman Islands Development Bank (CIDB) will make an early repayment of a US\$5 million Bond, before the end of this current fiscal year, 30 June, 2015, using its own reserves.

This particular Bond, Madam Speaker, is not legally due for payment until the 2015/16 financial year. However, early repayment will save the country on interest cost, strengthen the balance sheet of CIDB and place the organization on a more sustainable footing going forward. This action is consistent with our prudent fiscal management policies and our unwavering resolve to reduce the Public Sector debt burden. Before 30 June, 2015, CIDB will re-finance US\$36.8 million of bullet bonds utilising amortising structures that allow the repayment of debt principal over time and, other factors being equal, will result in less interest being paid when compared to the currently held bullet bonds.

In addition to the early Bond settlement, which strengthens the Public Sector's debt position, in 2014/15 Government has contributed \$17.1 million to a dedicated debt service Sinking Fund. The total balance in the Sinking Fund now stands at \$18 million. This Fund will serve the Government well in future years as other Bonds mature and facilities that were executed with deferred principal payments, fall due for payment.

Therefore, Madam Speaker, the Government's overarching fiscal policy for the 2015/16 Budget will continue to centre on:

1. Controlling operating expenditures;
2. Limiting Capital Investments;
3. Decreasing Public Debt; and
4. No new long term borrowings.

CONCLUSION

As Colin Powell once said, "A dream does not become reality through magic; it takes sweat, determination and hard work." And I would add to that, Madam Speaker, courage!

The people of these Islands were called upon to make sacrifices during the difficult period of the recent global recession. As Minister with responsibility for Finance, it is my duty and honour, along with my colleagues, to ensure that those sacrifices are not in vain, and to do my part in making sure that every dollar counts.

Madam Speaker, it is crystal clear to this Government, that our privilege to lead and our ability to make the necessary interventions to achieve the required broad outcomes for our society, is only possible with the support of those we govern.

The Budget before you not only represents a significant accomplishment for Government's finances; it represents that success can be achieved through sacrifice; the 2015/16 Budget is a result of many sacrifices.

This Administration remained committed to returning our public finances to a sustainable position. And although having to make the responsible decisions was oftentimes difficult, it was absolutely necessary. Yet given our tight fiscal constraints, the very fact that we have been able to maintain business as usual is an achievement in itself. Because, even though the Government's policy objectives were limited to the specifications of the PMFL, our approach to policy was limitless!

And now, thanks to our innovative efforts and dedicated strategies, we are poised to achieve full compliance with all six Principles of Responsible Financial Management in the PMFL by the stipulated deadline of 30 June, 2016.

Madam Speaker, achieving compliance with Principles means that Government will not have to seek prior approval of the FCO to present an annual Budget to the Legislative Assembly. However, it is important for the public to understand that such compliance does not mean Government can take on significant borrowing in the future, if the effect of such new borrowing would breach the ratios in the Principles of Responsible Financial Management. The Principles and their associated ratios have to be satisfied in all future fiscal years.

It is also very important for it to be clearly understood that, unless there are extenuating circumstances, in order to ensure that borrowing does not occur to balance future budgets, it is necessary that Government's future expenditures do not grow at a faster rate than the country's economic growth. Such restraint on future expenditures will avoid the need for unreasonable or unnecessary increased taxes, fees, rates and charges. I made this critical point in my 2014/15 Budget Address by stating: "However, our goal ought to be that we control Government expenditure so that it grows at a slower rate than the overall economy for any given period. This is the only way of avoiding the risk of increased taxation or deficit spending financed by borrowing." It is worthy of repetition in this Address.

Madam Speaker, I therefore reiterate that I am proud of the accomplishments this Government has achieved to date. We sacrificed our desires, we adjusted to our realities and we transformed our challenges into opportunities.

According to David McCullough, two-time Pulitzer Prize winner, "Little of consequence is ever accomplished alone."

Therefore, I would like to acknowledge that the preparation of the Government's Budget is an enormous undertaking, requiring the cooperation and commitment of many. I therefore wish to thank Her Excellency the Governor; the Honourable Premier; Cabinet Ministers; Official Members of Cabinet; Councillors; Chief Officers and their staff.

I would also like to extend my profound gratitude to all staff in the Ministry of Finance and Economic Development that assisted in the preparation of the 2015/16 Budget documentation.

Madam Speaker, it has been a privilege for me to stand before this Honourable House today. I thank you for your attention and to God be the glory for great things He has done.

I now humbly commend the **Appropriation (July 2015 to June 2016) Bill, 2015** to this Honourable House, and ask all Members for their support of the Bill.

Thank you, Madam Speaker.