



The Hon W McKeeva Bush OBE JP MLA
Leader of Government Business
Cayman Islands

Foreign &
Commonwealth
Office

London SW1A 2AH

From the Parliamentary Under Secretary of State

27 August 2009

Dear Mr Bush,

PUBLIC FINANCES IN THE CAYMAN ISLANDS

It was good to speak to you and Mr Jefferson on 25 August about the challenges your government faces. You were clearly concerned about the existing level of public debt. I myself was alarmed that an operating surplus recorded in 2007/08 could turn into such a large deficit the following year, especially when it was not budgeted for. Clearly a further large deficit cannot be repeated in 2009/10, so you will have to make some difficult decisions, which I hope will be understood and supported locally.

The global recession has put a large number of countries in a similar situation to yours – needing to consider economic stimulus against a background of weakening public finances. Most significant of these is your close neighbour, the United States. Yesterday the Federal Government reported that its budget deficit will reach almost US\$1.7 trillion this year, when the economy is expected to shrink by 2.8%. Cumulatively the deficit will be US\$9 trillion for 2010 to 2019.

Policy makers have to get the right balance between restoring confidence in the markets, by boosting economic activity, and ensuring that debt remains affordable. Unaffordable debt creates a debt spiral, which reduces governments' ability to address other needs. I am worried that the Cayman Islands are getting into that situation.

Those countries that can get the right balance will be those that can control expenditure, as well as having the widest and most predictable revenue bases. In the United Kingdom public debt has risen rapidly during the worldwide financial crisis and we have chosen to allow borrowing to grow during the worldwide recession so as to stimulate growth in the economy. At the same time we have made it clear that this can only be a temporary set of measures. Hence we have already announced that VAT will rise by 2.5% at the end of the year and we have outlined increases to the top levels of income tax.

As you know we in the UK have both indirect and direct taxes, including income tax, inheritance tax, business taxes, VAT and Council tax, ensuring a broad base for our revenues. A wide tax base automatically provides greater revenues to government as the economy starts to grow again, but even this does not guarantee that tax rates will not



have to be raised, or no new taxes introduced. We have therefore outlined a clear strategy to cut UK borrowing and debt over the coming years.

I cannot underline strongly enough that Parliament, being accountable to the UK public, will expect to see its Overseas Territories taking a similarly responsible approach to managing its finances. That means both ensuring a clear strategy for cutting borrowing and debt over the next three to five years and tackling expenditure.

I doubt that the Cayman Islands Government can afford to take on extra debt without both getting expenditure under control and widening the tax base. I therefore need to be absolutely convinced that there is a sustainable medium term plan for turning round the public finances and paying off the debt before being able to consider any extension of borrowing. Such a plan must be realistic about future business activity and therefore government revenues. It will need to target and prioritise both expenditure and revenue measures, and factor in risks in both areas. I suggest you consider, among other things, continuing uncertainties about the United States economy and other big markets, about the numbers of registered hedge funds and Cayman's other financial services, and about the possible outcomes of the next G20 summit and Michael Foot's report on the UK's offshore financial centres.

It would be unwise, I suspect, to rely too heavily on a rapid improvement in trust fund income or to expect that the Cayman Islands' prosperity can presume on an off-shore tax haven status.

To make public finances more resilient in the face of these uncertainties and to give me confidence that you will be able to service any new borrowing you will have to widen the tax base. I fear you will have no choice but to consider new taxes – perhaps payroll and property taxes such as those in BVI. I understand, of course, that in doing so you will want to consider carefully the implications for Cayman's economy, including the financial services industry, and the impact on less well off members of the community.

The budget also needs to get expenditure under tighter control. Clearly, operating expenditure has risen too quickly in recent years. This has reduced your scope to self-finance the capital projects that you have under way, putting additional pressure on borrowing. However, expenditure control needs to be permanent and sustainable, and needs to consider the effects it will have on delivery of policy. If any expenditure cuts would have to be made up in future years, in other words represented deferred expenditure, I would want to be reassured that your longer term plans enabled you to do this.

I understand you are addressing an audience of leading figures from both the public and private sectors this morning. I would be happy for you to share this message with them. I am sure that no individual present will want to see the public debt growing too fast in the current economic climate. But if I can be sure that your plans to manage the situation are realistic, and clear progress is being made, then I am prepared to consider further borrowing requests.

As we discussed, you intend to submit plans to me in the next few days. Hopefully these will reflect your discussions with the Caymanian public. I will be happy to consider them as soon as possible.



Please pass on my best wishes to people of the Cayman Islands.

A handwritten signature in black ink, appearing to read 'Chris Bryant', written in a cursive style.

CHRIS BRYANT