



MINISTRY OF FINANCE

Statement on the 2010/11 Budget

‘the need for hard budgetary measures’

To the Consultative Forum, April 21, 2010

**Madam, Chair
Members of the Consultative Forum
Permanent Secretaries and Heads of Department
Colleagues in the Ministry of Finance
Ladies and Gentlemen**

Greetings and acknowledgements

A pleasant good morning to one and all!

Madam, Chair, I am honoured to have the opportunity to make a statement on the 2010/11 Budget for the Turks and Caicos Islands.

Ladies and gentlemen, we are meeting here today in the midst of continuing economic uncertainty due to the affects of the global economic crisis and other local challenges. During the last financial year several measures were introduced in response to these crisis and challenges. These measures are credible and are consistent with measures being implemented in other countries facing similar challenges. We have an important opportunity to learn from the current crisis and to ensure that we take steps today which will build sustainable economic performance in the future. This will of necessity require hard decisions today to secure our future tomorrow.

In the first section of this statement I will discuss the effects of the current crisis on the TCI economy. A review of deliberate efforts to stabilize our economy and return it to a sustainable growth path will also be presented. I will discuss new expenditure challenges facing us in 2010/11 and their implications, including plans

to limit the size of deficit. The third section contains summary information on the 2010/11 Budget parameters, presents information on our fiscal objectives for the year and other planned reforms.

Before proceeding, I would like to acknowledge the generosity of Her Majesty's Government in providing a grant of \$7.5 million to assist us in our rebuilding exercise following Hurricane Ike. The assistance of other development partners such as the European Commission, Caribbean Regional Technical Assistance Center, Caribbean Development Bank and United Nations Development Programs is also noted.

I am profoundly indebted to my staff in the Ministry of Finance and also our advisers. I would like to acknowledge and thank them for their assistance during a very challenging year and during preparation of the new budget.

The support and cooperation of Permanent Secretaries and Heads of Department is acknowledged.

The advice and contribution of the Advisory Council and Consultative Forum in finalizing the Budget is also acknowledged.

I would like to acknowledge the inputs on members of the private sector who have participated and continue to participate in various studies undertaken by the Ministry of Finance.

Section One

1. Context

Madam, Chair, the reasons for the present, unprecedented financial crisis, including the large number of unpaid bills inherited from the previous Government and the global economic recession, have been explained in the 2009/10 Budget Statement, and need not be repeated here. Suffice it to say that the crisis has had a devastating impact on all walks of life in the Turks & Caicos Islands. The recovery is likely to take some time and will involve some difficult decisions.

During the last few years recurrent revenues have fallen significantly from \$207 million in 2007/08 to some \$130 million in 2009/10, resulting in a depletion of our reserves and successive budget deficits. That we have experienced difficulties in paying out creditors in a timely manner is well documented.

The TCI now confronts the classic problem of a small economy faced with much diminished revenues, mounting demands for public services notably in the social sectors and crime prevention and with almost no instruments to mitigate this problem other than that of radically cutting its public expenditures. Since TCI uses the US dollar as its currency, it cannot adjust its exchange rate or print money in order to reduce the pain of expenditure reduction. Nor as an Overseas Territory of the United Kingdom (UK), does it have access to the concessional medium term financing from the International Monetary Fund or World Bank that is available to other Caribbean jurisdictions. This means that the TCIG has limited means to provide an economic stimulus package as have been seen in other crisis stricken economies across the world.

Madam, Chair, it has been argued from different sides that Government does not have a plan for the recovery from the financial situation, and that it is not proposing solutions to the dire economic crisis that besets us. This is not true. Government does know what it takes to bring the public finances and the economy back on its feet, and has to that effect devised a comprehensive recovery and stabilization strategy - enshrined in the Turks & Caicos Public Fiscal Stabilisation Plan. This plan sets out a multiplicity of short term actions and measures, as well as medium term reforms, which combined will contribute to a restoration of a balanced and sustainable financial situation and provide much needed stimuli to the private sector.

The overriding problem is, however, that Government does not have the financial means to implement all the measures as expediently as it would like to, for example, pay off all debt to local and international creditors or inject significant financial support into the private sector to boost investment and consumer demand.

While the short term measures and the longer term reforms set out in the stabilisation plan are all imperative for the creation of a sustainable fiscal position of the TCIG, the current imbalance between revenues and expenditures and the uncertainty with respect to the pace and coverage of the global economic recovery, means that Government relies heavily on external financial support for the implementation of the reforms; to provide an economic stimulus and to fill the fiscal gap envisaged for the transitional period. Therefore the TCIG is currently in the process of soliciting funding from its traditional development partners – the UK Government, the European Commission and the Caribbean Development Bank – in order to secure funding for the effective implementation of the stabilisation plan.

Madam, Chair, I will refer to the stabilization plan, throughout this statement and what has been achieved to date , however, let me first provide you with a quick overview of the financial situation.

2. Status on current financial situation

As you know 2009/10 was a very challenging year, financial management focused on maximizing revenue and controlling costs as part of the Fiscal Stabilization Plan. The government made great efforts to negotiate a consolidated loan of \$85 million. The loan is a key component of the Government's strategy to normalize its arrears and is discussed further below.

Due to the collapse of the most important revenue heads, such as import duties and stamp duty recurrent revenue declined by some 34% during 2009/10, from \$198 million in 2008/09 to \$131 million on March 31, 2010.

The Government has made extensive efforts to curb expenditure, ultimately achieving a reduction of over 30% compared with 2008/09. Expenditure outturn for 2009/10 was slightly under the budgeted amount (\$162.0 million compared with a budget of \$162.1 million). This is a major accomplishment. Very few countries have achieved cuts of this magnitude, in such a short time, during the current crisis. This has not gone unnoticed by our international development partners and should increase our prospects of securing development assistance, including potentially the early resumption of budget support from the European Commission, which was suspended at the end of 2008.

During the year strict expenditure commitment and control measures were introduced.

Expenditure cuts have been made in virtually all areas. As a result average monthly recurrent expenditure for 2009/10 was reduced to \$13 million compared with \$21.4 million during 2008/09.

Major expenditure cuts have been made in the following areas, with the substantial savings:

- Utilities; \$1.8 million, reflecting a 41% cost reduction.
- Communication expenses; from \$4.4 million to \$2.6 million, for a savings of \$1.5 million.

- Subventions; were reduce from \$17 million to \$8.7 million, for a savings of \$8.2 million.
- Medical referral costs; declined by 75%, with a reduction of some \$33.9 million.
- Scholarship costs; was reduced by \$5 million
- Central control of domestic and international travel; a 64% reduction, with a savings of \$1.2 million.
- Cancellation of public events like music and film festivals; resulted in savings of over \$3 million.

On the revenue side, various revenue streams were adjusted and several new ones added with partial effect in 2009/10. These included:

- Increase of accommodation tax from 10% to 11%;
- Introduction of 2.5% customs surcharge on development activities;
- Introduction of a money transfer levy;
- 5% increase of gaming machine tax from 30% to 35%.

Notwithstanding the new revenue measures total recurrent revenue outturn was only \$131.3 million, about \$26 million below the budgeted amount; reflecting a \$66.3 million drop in revenue since 2008/09.

The drop in recurrent revenue affected all revenue heads, with only accommodation tax showing some growth. The results for major revenue heads during 2009/10 were as follows:

- I. Import Duty was \$8.7 million below budget, with an outturn of \$50 million, compared with a budget of \$58.7 million. Reflecting the impact of the current crisis, it should be noted that the outturn for import duty was \$70.8 million in 2008/09.
- II. The outturn for Gaming Machine tax was \$2.7 million, compared with a budget of \$3.5 million.
- III. Accommodation tax was only \$2 million below budget, with an outturn of \$21 million, compared with a budget of \$23 million.
- IV. Business licence renewal fees were \$1.9 million, compared with a budget of \$2.1 million.

- V. Stamp Duty on land transactions was \$1.2 million below budget, \$11.7 million compared with a budget of \$13 million. It should be noted that the outturn for this revenue head was \$44 million in 2008/09.
- VI. Work Permits and residency fees, was only \$12.1 million, compared with a budget of \$15.9 million

Madam, Chair largely due to the collapse of recurrent revenue we ended the last financial year with a deficit of \$30.6 million; compared with a budgeted deficit of \$5 million for the year. This is in spite of our efforts to control expenditure.

3. Achievements to date and ongoing activities

As was noted previously the government's response to the current financial crisis is contained in the Stabilization Plan. I would now like to review some of the achievements made during 2009/10 and some of the activities currently being carried out. The efforts made to reduce and control expenditures and to enhance revenues have already been mentioned. In the following I would like to highlight a few other initiatives, which have a bearing on the proposed budget for next year.

3.1. Consolidated loan

A key strategy for 2009/10 was the arrangement of a loan to consolidate the amounts owed to our major commercial creditors, reduce our overdraft and reschedule several other long term debts. The delays associated with this loan are well documented and need not be repeated here; suffice it to say there have been no payments to creditors and as a result some debts have increased due to surcharge payments.

While the government had approval to borrow up to \$85 million, to date only \$79 million has been utilized. The net proceeds from the loan will be insufficient to pay off all creditors. This along with continued underperformance of recurrent revenue suggests the need for further action to resolve the outstanding short term debts. This could include seeking discounts on certain debts and the negotiation of repayment plans with the Government's largest creditors.

While I am confident that the Consolidated Loan will close shortly I must point out that it is not the solution to all of our problems. It will give us a limited breathing space to assess our options.

3.2. Revenue Management

A Review of Revenue Management was undertaken by the Revenue Control Unit. This identified significant arrears in excess of \$12 million for items such as water bills, conditional purchase leases, contributions to the scholarship fund and vehicle licenses. To address this problem a string of measures have been put in place to speed up recovery and to prevent arrears accumulating in the future. Measures include, among others, public awareness campaigns; court actions; negotiations and entering in formal payment agreements; publishing of names of offenders; a suggestion that offenders should not be allowed to serve on government boards; and new criteria for use of cheques.

3.3. New concession policy

A new concession policy as far as section 69 (the tariff code) and section 70 (the Minister's powers to grant tax exemptions) of the Customs Ordinance was adopted by the Advisory Council in December 2009.

The decision implies a much stricter use of the Minister's powers to grant exemptions; removal of certain categories of exemptions altogether or removal of exemptions to section 69 to ensure that exemptions are being granted as a statutory right.

A review of development agreements entered with developers in the Islands pursuant to the Encouragement of Development Ordinance, which deals with duty concessions in relation to Development Orders, is currently being undertaken. However, at the same time we are also taking cautious measures to support business and our community during the continuing difficult global economic environment. We aim to stimulate the economy where we can and reduce unnecessary burdens. To this end we have undertaken a comprehensive review of the current tariff system and, based on the recent revenue study, have revised the system and rates of stamp duty on property transactions. I will discuss these initiatives later on in this statement.

3.4. Revenue Study

Madam, Chair, the precipitous drop in recurrent revenue is symptomatic of the TCI's dependence on construction and real estate related income. Activity in these sectors remains at a low ebb as credit remains tight and the global economy

struggles to recover from a deep and prolonged recession. Recovery is likely to be slow and painful. However, to secure and reinforce that recovery and support the development of a more sustainable and equitable tax system in the TCI we have made significant changes to the system of stamp duty in the economy.

With immediate effect new stamp duty bands and rates are to be introduced, substantially reducing the regressive nature of the tax and the especially the burden on ordinary TCI residents seeking to buy homes or invest in small businesses. For example, properties less than \$500,000 will attract a charge of just 4% on Providenciales (2% on Grand Turk, Salt Cay and other less developed islands) rising to 10% for properties over \$3 million. In addition, purchasers will be able to choose to spread their stamp duty liability over 4 years or elect to pay in full on registration of their property with a discount of 10%.

These changes reflect the recommendations of the independent revenue study and should provide a much needed boost to the construction and real estate sectors in the TCI economy.

The Revenue Study was undertaken with the objective of making recommendations for reforms to ensure the TCI has a sustainable and competitive regime that is less susceptible to the vagaries of the business cycle. The Revenue Study has been completed and makes a number of recommendations to improve the efficiency of the tax system in the economy over the short and medium term-recommendations that we are acting on and will continue to review.

3.5. Tariff review

A comprehensive – participatory - tariff review is currently being undertaken, which seeks to:

One: Lessen the burden on those members of society who may be financially disadvantaged - by reducing the rates of duty on a large number of domestic items, including some processed foodstuffs that currently attract a duty rate of 27.5% (including the 10% surcharge).

Two: Greatly simplify the current tariff system by drastically cutting the number of duty rates. This will reduce the administrative burden on both the Customs Department and the business community, thereby improving efficiency and accuracy in the clearance of goods and collection of revenue.

Three: Improve social welfare by removing and reducing tariffs on essential items such as baby clothes and foods, medical and veterinary drugs and equipment, over-the counter pharmaceuticals, etc.

Four: Encourage the development of a 'greener' economy by removing tariffs on products such as low energy light bulbs and renewable energy equipment, whilst simultaneously increasing rates of duty on those items that are most damaging to the environment.

Five: Substantially reduce duty rates on materials and equipment required by key sectors of the economy including agriculture, construction, manufacturing and tourism in order to stimulate investment, growth and employment.

The new tariff structure will be finalized and announced shortly. It should be enacted by July 2010.

Section Two

Madam, Chair, Ladies and Gentlemen, I would now like to turn my attention to issues and challenges confronting us in the new Financial year.

4. Budgetary Challenges during 2010/11

To begin, I would like to point out that due to limited prospects of a full recovery of recurrent revenue during 2010/11; the Ministry of Finance took a strategic decision to freeze departmental expenditure for 2010/11 at the level of the 2009/10 outturn. The expenditure control measures introduced last year would also remain in place. Furthermore additional expenditure is only to be allowed in areas of high national importance or to meet contractual and statutory obligations. Budget consultations were therefore only held with major spending departments.

Consistent with the strategic decision underpinning preparation of the 2010/11 Budget, only the following increases in recurrent expenditure are included in the new budget:

One: The budget for the Royal Turks and Caicos Islands Police Force is being increased by \$4 million for a total of \$18 million to facilitate implementation of the review commissioned last year and other ongoing initiatives of the Force including; increases in recruitment and training of entry level staff and recruitment

of additional British police officers to increase capacity in community policing and crime detection.

Two: Debt service cost is budgeted at \$16 million, reflecting an increase of \$9 million, largely to meet the cost of debt service associated with the Consolidated Loan. Total debt service cost will be about 10% of recurrent revenue, which is well within normal international tolerances.

Three: An amount of \$7.5 million is included in the budget to meet cost of servicing the Special Investigation and Prosecution Team (SIPT); while \$2.5 million is budgeted to meet the cost of Civil Recovery. We envisage that these will be largely self financing with any recoveries will helping to offset these costs.

Four: The total budget for the Ministry of Health is estimated at \$43.9 million, reflecting an increase of about \$10 million. Madam, Chair, the breakdown of major costs for the Ministry of Health is as follows:

Transfer to NHIP – Treatment Abroad	- \$10,000,000
Unitary Payment for the hospitals	- \$18,000,000
Existing Hospital settlement expenditure	- \$ 500,000
Existing Treatment abroad	- \$ 1,000,000
Ambulatory Services	- \$ 500,000
New regulatory units	- \$ 80,000
Waste Management Services	- \$ 4,000,000

Ladies and gentlemen, I am obliged to point out that most of the increase in the Budget for the Ministry of Health is associated with the opening of the new hospitals where we have an obligation to ensure that the interfaces between primary care, emergency services and Interhealth Canada are fit for purpose and to mitigate the risk of increased expenditure downstream by appropriate early interventions. The project should eventually be expenditure neutral and will from the outset offer increased facilities in the Islands and in conjunction with the National Health Insurance Plan (NHIP) significantly reduce the percentage of cases treated overseas both in terms of cost and duration. Additionally, TCIG will have to allocate approximately \$1 million per month for the emergency treatment overseas program, which will be managed by the NHIP.

Madam, Chair, I want to give further assurances that the \$12 million allocated for treatment abroad is adequate, notwithstanding that a larger pool of persons would be eligible, because costs has already been substantially reduced; strict referral

protocols have been introduced and NHIP is exploring early introduction of reinsurance.

Five: An incremental amount of \$3 million is included in the Budget under the Ministry of Health to meet the cost of initial improvements to landfills on Providenciales and Grand Turk to address serious public health issues within these communities. This amount will be offset by substitution of some existing expenditure as well as the introduction of cost recovery measures. I will elaborate on possible options later on in this statement.

5. Proposed measures to reduce the recurrent budget deficit

Madam, Chair, I have just outlined a number areas where increased recurrent expenditure is justified during 2010/11. Our ability to afford these increases is made more difficult due to the collapse of recurrent revenue. It stands to reason that we will face the prospects of another deficit during this new financial year. As was already mentioned and I reiterate here, the expenditure control measures introduced last year will remain in place. This is key, as we have made gains in reversing the past trend of expenditure driving revenue, which has characterized financial management in the TCI for far too long and our efforts cannot be allowed to lapse. There is still more work to be done in this area. Additional effort would be made to enforce these efforts whereby the Ministry of Finance will strictly control new expenditure commitments and will not approve payments where the correct procedures are not followed. Furthermore, disciplinary action would be taken against irresponsible officers.

With that said, I would now like to elaborate on several new measures, affecting both expenditure reduction and revenue enhancement which has been factored into the new budget to limit the size of the deficit.

5.1. Personnel Costs

The Forum has already considered the government's decision to reduce personnel cost over the medium term so I will not go into the details of that again. As was already announced by the Chief Executive the Government has decided to postpone by one month (to 1 May) the introduction of the 10% cut as it affects salaries and wages. As was stated due to the underlying reality of our budgetary situation we will not be able to extend this postponement to other elements of the

pay bill such as allowances and overtime and that, hard as it is, we will have to find compensating savings elsewhere in the budget.

Overall, the savings we expect in unit costs over the financial year will be about \$4.1 million per year. Additionally, the work wages for non-established staff, which will also be reduced by 10%, would result in a further savings of \$916,666. Overtime will be strictly managed and will only be permitted where there is a category 1 situation, that is: a life threatening or other socially imperative circumstances. Estimated annual savings from this measure is \$1.25 million.

The employment freeze which was introduced last year will be strictly enforced whereby permission will have to be had from the Chief Executive and Permanent Secretary of Finance before recruitment can commence, and this will be restricted to only critical positions. Staff will be encouraged to take annual leave to lessen future liabilities.

5.2. Scholarship cost reduction

There are currently 276 students on scholarships. About 200 of these students should complete their studies by the end of 2010, with 100 due to complete by May. Therefore the scholarship budget has been reduced by \$3 million from last year. Even with this reduction, with enforcement of awards criteria and better monitoring of students' performance it will still be possible to allow students currently on scholarships to complete their courses of study and award about 20 new scholarships to high academic achievers. Savings of \$300,000 is also reflected in the Budget from a proposed 10% reduction in overseas students' subsistence which should be introduced at the start of the 2010/11 academic year.

5.3. Statutory body costs reduction

Statutory bodies which depend on government for subventions will be required to cut their expenditure by 10% to 15% to achieve minimum savings of \$1 million, which is also reflected in the new budget. We would expect these bodies to reduce personnel costs over a time and would carefully monitor implementation of this to ensure that there is a reasonable balance between emoluments and operational costs. Madam, Chair, efforts would be also made to ensure that statutory bodies which do not depend on the government for subventions take steps to control their costs, as this will in some instances increase net transfers to the government.

5.4. Other cost reduction areas

Rents will also be reviewed with a view to achieving savings of at least \$500,000. Funds would be allocated to refurbish government buildings on Grand Turk that were damaged during Hurricane Ike to serve as government offices; and the premises on Grand Turk and Providenciales vacated due to opening of the new hospitals would be remodeled for use as government offices to reduce rent costs.

While international travel costs has been effectively curtailed, potential savings remain regarding domestic travel cost which was about \$1.2 million for 2009/10. Accordingly, domestic travel costs will be curtailed under a new system whereby the Ministry of Finance will allocate each Ministry a set number of tickets each month. The aim is to reduce costs by 50% to achieve a saving of \$600,000.

Madam, Chair, I am satisfied that adequate effort has and will be made to control expenditure and that further cut backs would seriously undermine efficiency. It should be noted, however, that the measures I have outlined above have together reduced the budget deficit by over \$12 million. I would therefore like to now focus our attention on a few revenue measures that have been included in the new budget to enhance revenue collection as part of efforts to reduce the deficit.

5.5. Recurrent Revenue Growth during 2010/11

Madam, Chair, reports from the Caribbean Development Bank and the International Monetary Fund suggest that there should be some limited recovery in Caribbean economies during the year, although with a lag, depending on the magnitude of economic activity in the major economies. We are optimistic that there would be some recovery of our economy during 2010/11. As part of our efforts to reduce the budget deficit for 2010/11 we are projecting some modest growth in several major revenue heads as follows:

One: Import duty is estimated at \$52.5 million, reflecting a \$2.5 million increase over the 2009/10 outturn. We believe this outturn is achievable on account of the modest growth prospects and introduction of the new customs tariff regime including strict enforcement of concessions and introduction of a specific tariff on luxury items.

Two: Accommodation tax is estimated at \$24 million, reflecting a \$2.1 million increase over the 2009/10 outturn. We believe this is a prudent estimate as 2010/11 will be the first full year when the tax rate of 11% will be applied. We expect there to be modest growth in visitor arrivals along with less rate discounting. We also note the opening of new properties such as the Veranda Resort during the last financial year. It should be noted that a portion of the accommodation tax would be

devoted to funding a new Tourism Authority which was recommended by the Working Group on Tourism. The Tourism Authority would replace the Tourist Board, and allow more cost effective marketing and promotion of the TCI, which should result in increased visitor arrivals and therefore an increase in accommodation tax over a time period.

Three: Stamp Duty on Land Transaction is estimated at \$13 million, reflecting a modest increase of only \$1.3 million over 2010/11. We believe this total could be easily achieved and surpassed on account of the new stamp duty regime which is to be introduced. We also expect there to be some rebound in the real estate sector as well as introduction of fractional ownership arrangements which should increase transactions. We are also aware of plans for a few resort developments to come on stream.

Fourth: Telecommunications related taxes and fees are estimated at \$9 million.

Fifth: Work permit and residency fees are estimated at \$13 million, reflecting a \$2.9 million increase over 2009/10. We believe this outturn is achievable since there is currently a backlog of applications which the new Board, which will be in place for a full year, can clear up. Additionally, we have observed increased compliance with work permit requirements as persons endeavor to access NHIP benefits.

5.6. Revenue arrears collection measures

As was noted previously a revenue management review was undertaken during the year. This identified arrears totaling about \$12 million. Measures will be put in place to recover part of these arrears and are expected to yield \$3.0 million, which has been captured as part of the revenue estimates.

It should be noted that collection of revenue arrears is an important job evaluation criterion for Accounting Officers as it is simply not good enough to impose new taxes on the people of these Islands while millions go uncollected as revenue arrears. I would like to point out that the Ministry of Finance will demand and expect the cooperation of all Accounting Officers in collecting arrears and revenues as they fall due. I would like to put Accounting Officers on notice that where the required level of cooperation is not forthcoming I will be recommending that disciplinary action be undertaken against them.

5.7. New Revenue measures for 2010/11

Madam, Chair, consistent with the independent revenue study our efforts during 2010/11 would focus on implementing the short term recommendations of the report. In particular the review of fees and charges recommended in the report should result in some additional revenue for TCI provided they are implemented in a timely manner. It was noted that some fees and charges have not been changed for decades, in some instances, and yielded limited revenue and in fact are a nuisance. We will simplify the processes to make them less bureaucratic. Some fees and charges may be eliminated. A minimum net increase in revenue as a result of rationalization of business license fees and charges of \$100,000 is factored into the budget.

The revenue study also pointed out that fees in the financial sector could be increased without undermining the competitiveness of the TCI in this industry. The Ministry of Finance will work along with the Financial Services Commission to ensure timely introduction on new sector fees. \$500,000 has been included in the budget to reflect the revision of sector fees.

As noted previously about \$3 million is included in the Budget for the Ministry of Health to introduce a sustainable solution to the solid waste management challenges we currently face. It is important that it is self-financing. Accordingly, cost recovery measures will be introduced. Madam, Chair, it is envisaged that the Forum would discuss cost recovery options in this area at a future session. These options might include introduction of a levy to be charged on the value of imports or a fixed fee to be added to utilities bills. Any new charge will require new legislation. However, it should be noted that net revenue of about \$2.0 million is included in the budget on this account.

Madam, Chair, better enforcement and introduction of new spectrum fees is being considered by the Ministry responsible for communications. Specific proposals will be brought to the Advisory Council and Consultative Forum at a later date. However it should be noted that \$2.2 million has been included in the revenue estimates on this account.

As part of arrangements for redevelopment of the Providenciales International Airport, the Airport Authority will acquire the shares of the private sector partner. Under the new arrangements there will no longer be the need to share dividends. As a result there should be a significant increase in excess revenue paid to the government. An amount of \$6 million has been included in revenue budget to this account.

Madam, Chair, in ending the discussion on the revenue measures being considered to reduce the size of the budget deficit I should point out that together these measures contribute about \$21.7 million in new revenues for the year.

Section Three

6. Fiscal Objectives for 2010/11

Madam, Chair, I would now like to turn my attention to the specifics of the 2010/11 Budget.

Our primary fiscal objective for the new financial year is to engender greater confidence in the government and reduce reputational risks. Consistent with this, the government will continue and consolidate the reforms that were begun in the last financial year to stabilize public finances. During the new financial year, expenditure will be prioritized and commitments controlled in line with available resources to ensure timely and predictable payments to creditors.

Our second objective is to provide economic stimulus and facilitate employment creation through a tariff review and a new stamp duty regime and implementation of capital projects.

Our third objective for year is to build confidence in the economy through economic diversification and facilitation of inward investment. The redevelopment of the Providenciales International Airport is consistent with this objective.

The government will have to increase short term borrowing to close revenue gaps, accordingly our fourth objective for the year is to introduce sustainable public debt management.

7. Budget 2010/11 Parameters

Madam, Chair, as noted already, continued efforts will be made to improve revenue collection and reduce arrears. I want to recall that the new revenue measures, including better collection of arrears, contribute about \$21 million towards the revenue estimates. As already discussed during 2010/11, TCIG will have to allocate more money to: ensure that the interfaces between the Ministry of Health and the new medical centers operate efficiently and effectively to reduce the costs of secondary case going forward; improve the management of solid waste

collection; debt service costs; and, the Special Prosecutions and Civil Recovery teams. These new areas of costs will add about \$25 million in new expenditure.

Taking into consideration these results, Recurrent Revenue for 2010/11 is estimated at \$155.1 million and recurrent expenditure is estimated at \$181.6 million. Average monthly revenue collection should be about \$13 million. Average monthly expenditure will thus increase from \$13 million to \$15.1 million per month, excluding costs for short term debt repayment.

Madam, Chair, the deficit for 2010/11 is estimated at about \$26.6 million. However as the US economy recovers and growth returns to TCI we anticipate a path towards recurrent surpluses in the coming years.

8. Financing the budget deficit and sustainable debt management.

Madam, Chair, consistent with our first fiscal objective for the year, the Government is investigating all possible sources of finance to fund the current deficit and repay short-term creditors at the earliest opportunity. Amongst the options being explored by Government are:

One: Whilst the UK Government has not so far provided direct funding to support the Government's budget deficit, the Government is in continuous dialogue with the Foreign and Commonwealth Office (FCO) and the Department for International Development (DFID) in London. A joint FCO/DFID team will be visiting the Islands in the coming weeks to prepare a report on the Government's finances.

Two: Grant funding is being sought from other donors. The Government has started programming for further assistance from the European Union, which is discussed further below.

Three: The potential for windfall income also exists. The Government is considering a scheme for the sale of sand to the Army Corps of Engineers. Such a scheme would need to be done in a manner that is sustainable and does not damage the environment. It is possible that the scheme could yield \$10m in the current financial year. The Government is also considering if there are other assets that could be disposed of without unduly affecting the quality of services provided on the Islands.

Four: Work has commenced and will continue toward agreeing a policy based loan with the Caribbean Development Bank. The policy based loan is a new instrument offered by the CDB to assist countries with additional finance to support them during a period of economic difficulty and fiscal reform. A sum of \$20 million would be sought and it is anticipated that disbursement would take place in 2010/11.

Five: Given the scale of the challenge facing the TCI, it is inevitable that some further commercial debt financing is required. The financing strategy therefore includes additional commercial borrowing of about \$25 to \$30 million in 2010/11 to repay outstanding bills, to finance the projected deficit and to finance capital projects. Ultimately the level of new borrowing will depend on the extent to which funds are forthcoming from other sources.

Madam, Chair, despite the recent Consolidated Loan and the expected additional borrowing in 2010/11, it should be noted that the Government's indebtedness is still relatively modest compared to other Caribbean islands. The total debt stock, including short term arrears and allowing for the consolidated loan, is currently \$159 million – equivalent to 31% of Gross Domestic Product (GDP). This is similar to indebtedness in other Overseas Territories and, whilst we would not advocate increasing the debt much further, can also be compared favorably to indebtedness in many other Caribbean islands, such as St. Lucia (70%), Antigua (93%) and St Kitts and Nevis (178%).

Similarly, debt service costs will increase as a result of the Consolidated Loan and any new borrowing. The Government will carefully monitor these costs to ensure they remain at a sustainable level and will consider refinancing its debts if necessary to achieve this. Over the longer term, the Government will seek to reduce debt service to below 8% of recurrent revenue.

In the short term, due to revenue seasonality effects, the Government will face a challenge in meeting its cash flow requirements during the summer months (May to September). Cash flow management arrangements including a short term loan or increase in the bank overdraft facility would be explored to better ensure timely payment of government obligations. Once the Government has secured the financing necessary to meet its short term commitments, our efforts can turn to managing tomorrow rather than yesterday!

9. Capital Expenditure programs

Madam, Chair I would now like to make some remarks on the Capital budget.

Capital expenditure programs have been limited to the amount of fuel tax revenue and have been severely curtailed as part of the stabilization plan. During the last financial year priority was focused on implementing projects with funding from the UK Government hurricane assistance grant. To date over 97 projects have been implemented in the Health, Education and water sectors on several Islands of the TCI. These projects provided some measure of economic stimulus and facilitated employment maintenance and creation on the affected Islands.

One indirect benefit of the UK intervention was the enhancement of the capacity of the Department of Economic Planning and Statistics in the area of project preparation and tendering. The mechanism for selecting the successful bidders was open and transparent as there was competitiveness throughout the entire process with value for money being realized and social cost and benefits to society also recognized.

Effort was also made to program grant assistance from the European Commission.

During 2010/11 effort would be made to expand capital expenditure program to further stimulate the economy and create more jobs. Preference would be given to labor intensive projects; and where contracts are awarded contractors would be required to demonstrate a commitment to employing TCIslanders. Madam, Chair, you would be pleased to know that we have already announced a small but much needed boost to the agricultural sector in the economy. The government farm on North Caicos will receive a capital injection of \$150,000 over the next 18 months to scale up production and provide equipment for collective use by the government farm and members of the Turks and Caicos Farm Association. It will also be complemented by a \$60,000 loan fund administered by TCInvest and number of other measures to secure land for long term agricultural use.

The capital budget for 2010/11 is estimated at \$29 million, reflecting an increase of some \$20 million over 2009/10. The capital budget will be financed as follows:

One: \$12.3 million in grant financing. The European Commission has already approved grants totaling €6.3 million (about \$8 million) to fund a post Hurricanes Ike and Hanna housing rehabilitation initiative; and technical assistance earmarked for legislative and revenue reviews. The UK Government provided grant assistance related to hurricane recovery and works financed by these funds will continue into 2010/11. Approved grant assistance from the Caribbean Development Bank to the

sum of \$1m from the BNTF 5th & 6th programs, will go towards projects in the health and educations sectors.

Two: \$5.9 million from local funding from the Infrastructure Development Fund. The budgeted amount reflects a \$0.25 increase in the fuel tax to \$0.50 which should result in additional revenue of \$2.5 million. It is noteworthy to mention that this increase will allow much needed infrastructural works to commence such as the following:

- Repairs to Police Barracks – Providenciales
- Renovation of Police Barracks - South Caicos
- Counterpart Contribution for BNTF 5th and BNTF 6th funding
- Counterpart funding for the EC Housing Initiative
- Salt Cay Break Water
- HJRHS New Administrative Block completion
- Construction of New Six Classroom Block at HJRHS
- Restoration of Sea Bed in Providenciales
- Transfer and equipping of the Attorney General's Chambers at new premises

Three: \$4.5 million from increase public sector borrowing. It should be noted that projects earmarked to be financed from loan proceeds will not be implemented if borrowing approvals are not obtained.

Madam, Chair, you would be pleased to know that an amount of \$200,000 is budgeted to undertake a House Income and Expenditure survey, which for the first time will enable us to produce our won consumer price index. This survey will allow us to update enumeration districts in advance of a national population census, which is expected to be undertaken as part of a regional census project. An amount of \$200,000 is also budgeted to start work on the census.

Additionally, work is ongoing to programme a further grant of about \$16 million from the European Commission under the 10th European Development Fund, which should be utilized between next year and the end of 2013.

10. Reform Agenda

Madam, Chair once we are able achieve our first fiscal objective of rebuilding the reputation of the government by being able to pay our bills in a timely manner we

would be in a better position to continue and increase the pace of the reform agenda. Therefore during the year several measures commenced under the Stabilization Plan shall be progressed.

One: Clearly the current proportion of revenues swallowed up by salary and wage costs is unacceptable at between 60% and 65% of revenue and this will have to be reduced. Work will continue on the civil service right sizing program to reduce the cost to 45% of available revenue by March 31, 2014. This will be done in a comprehensive manner. Ultimately, it is aimed at ensuring we have a more efficient, highly motivated and better paid civil service that is equipped to address the issues facing the Turks and Caicos Islands. In the short term, the overall effects of this program will be offset, at least in part, by the necessity to enhance skills levels in several crucial areas and the very high gratuity and leave costs involved in any redundancies. This program will build on efforts which have already commenced and will be done in accordance with a clear work plan, which would allow for consultation with civil servants and the private sector.

Two: Work has commenced on implementing the short term recommendation of the Revenue Study, prepared by Prof. Alan Roe. These will continue and will include building capacity in key revenue departments such as the Customs Department and the Revenue Control Unit. During the course of the year technical assistance would be deployed to lead further public consultations related to implementation of medium recommendations of the study including discussions on the possible introduction of conventional taxes such as Value Added Tax or a General Sales Tax or property tax

Three: A new public financial management ordinance should be formulated to allow better budget planning, forecasting, reporting and implementation within a medium term perspective while ensuring greater accountability and transparency.

Four: Efforts will be made to enhance the capacity of government departments in the areas of financial management and statistics to include greater emphasis on forecasting, budgeting and controlling expenditure. These efforts will be supplemented by the centralization of certain categories of financial transactions, for example all utility bills will be sent direct to the Treasury and management information relayed to Ministries and Departments. This change, along with similar changes, will help remove the uncertainty surrounding the accuracy and completeness of financial data on the SmartStream system – a situation that has

plagued us for far too long. I shall also be reminding all Accounting Officers of the critical importance of entering purchase orders and invoices onto the system at the earliest opportunity – in days rather than weeks – failure to adhere to the timelines will lead to the surcharging of persistent offenders.

Five: During the year a review of the scholarship program should be undertaken to determine a sustainable funding level and reassess awards criteria. Other matters that can be considered as part of the review should include means testing and the possible creation of a revolving loan fund.

Six: As part our reform agenda social safety net programs would be assessed to improve their effectiveness and to better target assistance towards those most in need. As part of the Policy Based Loan with CDB we plan to undertake a new poverty assessment and develop a poverty reduction action plan to more strategically focus our social safety net programs and build capacity in this area.

Madam, Chair, technical and financial assistance would be sourced from our development partners such as the Caribbean Development Bank (CDB), European Commission (EC), Caribbean Regional Technical Assistance Center (CARTAC) and the UK government to address capacity gaps and development challenges facing the TCI.

Conclusion

In concluding, Madam, Chair, I wish to recall the Financial Year 2009/10 was not a dance on roses, and prospects for 2010/11 as I have outlined today are not much brighter. However, it is my sincere belief that the stabilization plan, alongside external funding, will make a huge change for the better. However, the process of recovery takes a concerted effort, which means that Government, the Advisory Council, the Consultative Forum, the business community and not least the public at large must show an understanding of the problems facing us and appreciate the fact that the recovery necessarily entails hard budgetary measures and sacrifices across the board.

However, I must hasten to add that while tough short-term measures are imperative to restore a stable financial position, Government recognizes that continued expenditure cuts will have serious negative socio-economic consequences in the long run. Already now, it is clear that the tight commitment and expenditure control and expenditure cuts have had an adverse impact on social welfare services

and maintenance of government assets and infrastructure. This is an undesirable situation, which should be avoided.

As outlined in this budget statement, within its resource constraints the government is committed to providing some measure of economic stimulus and facilitation of private sector development and employment creation.

The government is committed to fundamental financial reforms including sustainable debt management to promote future economic certainty that will ensure more predictable, stable and sustainable revenues. This will increase prospects for rebuilding our reserves over the medium to long term.

Many of the challenges facing us today are deep-seated and have been affecting us for too long. We have discussed solutions to these issues in past budgets, with limited results. Now is not the time to apportion blame and extract your pound of flesh. Instead we have to lock hands together and seize the opportunity provided by our challenges to make a difference. We cannot waste the current crisis. We have to use this as an opportunity to put our financial house in order.

Finally, I would like to commend the 2010/11 Budget of \$181,929,561 for recurrent expenditure and \$29,780,486 for capital expenditure to the Consultative Forum for consideration.

Madam, Chair, Ladies and Gentlemen, I thank you for the courtesy of your attention and may God bless our deliberations and these Turks and Caicos Islands.