Ministry of Finance

Statement on the Economy

The world continues to go through a period of financial turmoil not seen since the 1930s. Following the collapse in global financial markets in 2008 many countries have seen their output and incomes fall or stagnate and both their private and public sectors have been counting the cost of rapidly expanding their spending and debts in the years before.

Today, even the government of the world's largest economy – the United States – is finding there are limits to how much more it can continue to spend and borrow. Indeed, many of the world's richest countries are having to make difficult decisions about what their governments can and can no longer afford. The more cautious the management of the public finances before the crisis and the greater the access to international finance, the better able countries have been to recover.

As we all know, the TCI was not well prepared on entering the crisis. As this, the first of two statements during July on the economy and public finances in TCI, will show, past administrations management of public finances was not cautious. Controls over the finances were weak, with wasteful spending that was at least tolerated. As a consequence there was little scope to borrow when a large source of government revenue evaporated.

Boom and bust

The Interim Government inherited a dire fiscal legacy. The economy doubled in real terms between 2002 and 2008, but that growth was neither balanced nor sustainable – it was a bubble that had to burst. It was fuelled by uncontrolled and rapid growth in construction and public administration over a short period of time, and the global financial meltdown and property crash in 2008 brought growth to an abrupt halt.

Instead of using strong tax revenues to build a cash reserve or invest in the future, previous administrations up to 2008 made new and expensive spending commitments, including rapidly expanding the civil service. Between 2002 and 2007 annual public sector spending increased more than threefold. Public revenues could not keep pace and the government budget fell into deficit, reaching almost $70 million in 2008. This was one-third higher than the income government was receiving. Spending has remained well above revenues ever since; the unaudited deficit for 2010/11 was more than $60 million.

The tax system cannot generate sufficient recurring revenues to cover such a high level of public spending. The tax base is too narrow, it is easily avoided by some, and it weighs too heavily on some groups and sectors of the economy, notably lower income taxpayers and the hospitality industry. In addition the tax base has been eroded by generous exemptions and concessions granted in the past, together with inadequate administration, collection and enforcement. The global recession and the collapse of construction meant that Government revenues almost halved, from a peak of $220 million in 2008/09 to around $120 million in 2010/11, reflecting the instability of the existing revenue system and its vulnerability to external shocks. The commitments made by the previous administration mean that we have only been able to cut government spending to around $170 million, of which more than 40 per cent is spent on staff.

The result of the policies of previous administrations has been an increasing deficit that will continue to grow without significant reforms. Expanding the TCI economy is vital, but this will not close the deficit fast enough to avoid defaulting on our debts without increasing revenues through the tax-raising and cost saving measures in the 2011/12 budget. Ducking these issues and hoping they go away is not an option. The Interim Administration, TCI businesses and everyone across the islands have a part to play.

Challenges for the economy

The Government’s revenue forecasts assume the economy will grow by around 4% each year, driven principally by continued growth in tourism. This is a healthy growth rate compared to many countries, but even at this rate it will not be sufficient to close the budget deficit and reduce public sector debt without reforms. If public spending and the tax system were left unchanged the budget would not be brought back into balance until around 2020 and by then public sector debt would be well over $1 billion.

Growth is of course difficult to predict, especially in the TCI economy in which the growth rate has fluctuated widely over time. Growth of 4% per year is not assured; independent forecasters including the World Bank and KPMG recognise that the region’s prospects are highly dependent on the pace of recovery in advanced economies. Regional economies, especially those dependent on construction and tourism, contracted sharply during 2008 and 2009, following the global financial crisis; and KPMG and other analysts in the region suggest that the funding prospects for real estate projects are less promising, given the amount of unsold and under-utilised inventory that already exists. Challenges to the local economy remain considerable.

Growing the economy

However, a rebound in tourism growth is expected. We have already seen an increase in international passengers coming to Providenciales. Our major new investment in an extended Providenciales International Airport is vital if TCI is to share in this regional growth. The airport has already attracted new flight operators, with the prospect of increased competition for airspace and lower fares. Similarly, the Government is optimistic that a number of developments will go ahead over the next year as property values become more affordable and tourist numbers continue to rise. Various housing developments are already underway, a revised Shore Club development is about to commence and talks continue with private equity investors interested in taking over a number of stalled developments or developing new branded hotels including entertainment and business conference facilities. Additionally, a number of existing resorts and other business have submitted expansion plans.

However, TCI must also seek to grow other sectors to provide alternative jobs and incomes, and the government has put measures in place to assist these and other areas of business. The budget contains some provision to stimulate the economy and we have already agreed measures to support agriculture, a deposit and return scheme for used bottles and cans at dedicated recycling centres, zero customs duties for renewable energy equipment, simplified business licensing procedures, new legislation to assist the development of the gaming sector for tourists, and to facilitate the fractional ownership of properties to help kick start renewed interest in vacation real estate.

We will continue to invest in stimulating the economy and in administrative and legal reforms to encourage growth and diversification, but these need to be accompanied by wide-ranging public sector reform to improve the openness and competitiveness of the business and economic environment. A bright future for TCI's economy is the goal we are all aiming to put on track. It will not happen immediately, it is not guaranteed and it will have to be achieved with a lower but better employed level of public expenditure. But is a goal everyone wants to see become a reality for the benefit of our families, our businesses and the international prestige of TCI.

Progress

With some tough decisions and support from the people of the TCI, the Interim Government is making progress. We are beginning to see the finances stabilize. Significant reform of revenues remains essential for this trend to be sustainable. In parallel the government is introducing a level of openness over the use of public funds that has not previously been seen in TCI. That is why the Ministry of Finance will shortly present its first quarterly report on the budget. It is only fair that hard-pushed working people should see what is happening with their money and how we are ensuring the economy improves as quickly as possible.

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