

IS CAYMAN COMMITTING ECONOMIC SUICIDE?

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In July of this year, Cayman Islands Premier McKeeva Bush sent a shockwave through not only Cayman but the international financial community when he proposed the first ever income tax in Cayman – which he called a “community enhancement fee.”

The proposed tax, since dropped, would have been a 10 per cent payroll tax on expatriates making more than \$36,000 per year. Cayman had never had a direct income tax, and officials have always previously insisted that Cayman would never have one. The lack of income taxes, along with an honest, efficient judiciary, strong protection of property rights, free movement of capital and limited and cost-effective regulation have made Cayman one of the world’s most successful offshore financial centres.

Cayman rose from a poor Caribbean backwater to an entity having a per capita income roughly on par with the US over the last four decades. There is little real poverty, relatively good infrastructure, low crime, and a well developed tourist industry, making Cayman a very attractive place to live and work. Cayman’s Achilles heel is that it is a functioning democracy where the civil servants have a disproportionate influence – like in Greece, and in many towns and cities in the US. Because

of the large number of expats living in Cayman, only about half of the resident adult population has the right to vote. The current population is about 55,000, yet only 12,360 people voted in the last election. There are about 3,600 civil servants, up 50 per cent from 2005 when there were about 2,400, a large proportion of which are local Caymanians with the right to vote. Expatriates are employed primarily in private business.

Most of those who vote have a family member or least a good friend who is a civil servant, and Caymanians, like others, tend to defend and support their family members and friends. Politicians, being politicians (in both of the two major parties), thus pander to the civil servants to get their votes and the votes of their family members and friends. The consequence is a bloated civil service with salaries and benefits growing far faster than the economy. Obviously this is not sustainable and has probably already passed the tipping point.

During the last five years, the Caymanian economy has been stagnant – no real increase in GDP – because of both the world-wide financial crisis, which has had a heavy impact on the large Cayman financial and tourist industries, and the negative effects on the economy of too much growth in government. As can be seen in the following chart, government spending in Cayman is growing very rapidly as is the debt burden.

There is no “tax increase” solution to this problem. Again, if government spending is growing faster than GDP, no amount of tax increase can stop the inevitable meltdown of the economy. The problem was recognised three years ago, at which time, the government engaged a group of internationally known economists and fiscal experts to assess the problem and make recommendations – which came to be known as the Miller Commission, after the chairman of the Commission.

CAYMAN BY THE NUMBERS			
	2006	2011	Per Cent Change
Population	52,000	55,000	5.8%
Total Gov't Revenue (in millions)	\$500.4	\$545.8	9.1%
Total Gov't Spending (in millions)	\$433.1	\$626.1	44.6%
Interest on Debt (in millions)	\$8.9	\$32.9	269.7%
Gov't Spending as % of GDP	17.7%	25.4%	43.5%