

Funding the Future

Cayman: the FCO letter that tells it ‘raise taxes...

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The full text of the UK Foreign and Commonwealth Office letter to the Cayman Islands turning down its loan application is a classic of its type. I can't rely on Cayman to continue to make it available, so here it is:

The Hon W McKeever 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.

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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