



FALKLAND ISLANDS GOVERNMENT

GREEN PAPER ON THE BUDGET

NOVEMBER 2008

Green Paper on the Budget

Introduction

This 'Green Paper' sets out the Government's views on the overall position of public finances over the next five years. It does this in order to stimulate debate and raise the level of understanding of everyone about the financial issues and choices that face the Islands. Over the next two years, some major choices need to be made about the levels of public service and the levels and sources of government revenue. A range of green papers looking at financial issues and choices will be provided in order to encourage everyone to have a say before decisions are made.

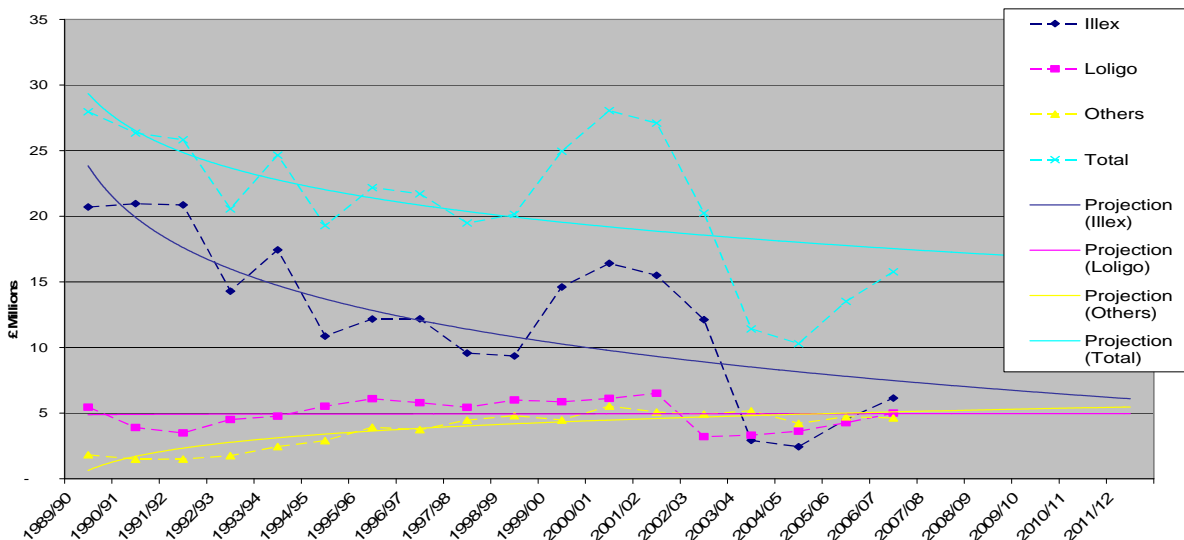
Background

Our Islands have enjoyed a long period of economic success and strong government finances. There have been times when money has been tight and government has had to cut back. But on the whole we have managed to expand public services and substantially develop the Islands

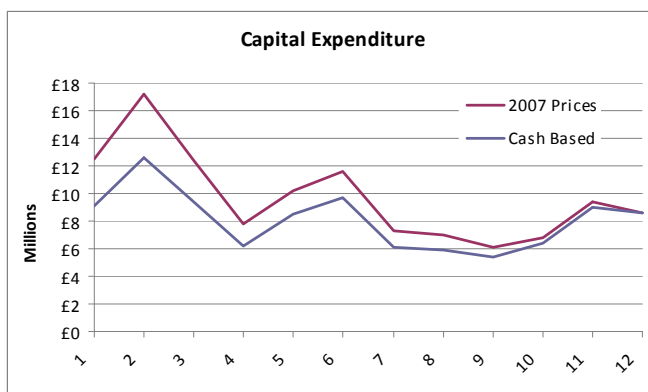
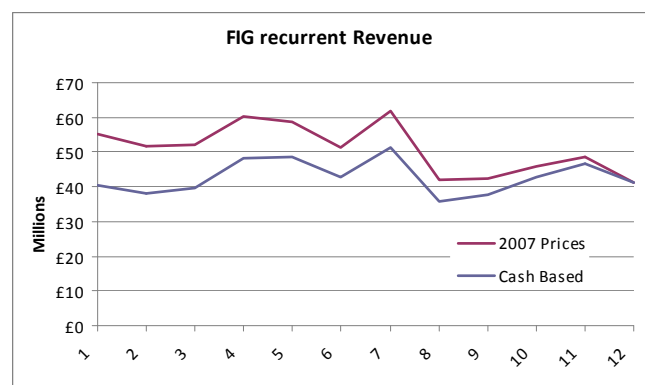
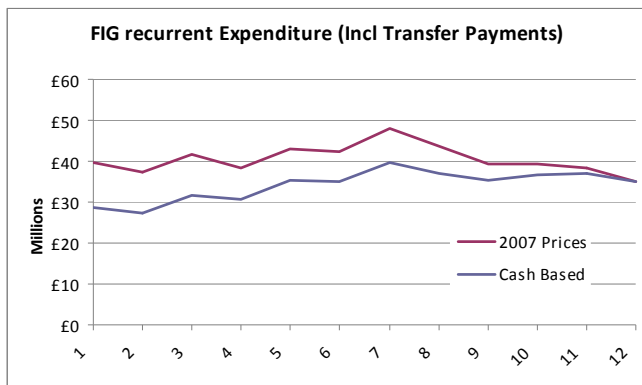
But now the strain on public finances is greater than at any time since the commencement of fisheries licensing in 1986. There are a number of reasons for this:

- We expect a lot from our public services. We know what is achieved overseas in the UK and elsewhere and quite rightly wish the same to be provided for us;
- Government is required to achieve ever increasing international and UK standards in what it does (for example in aviation and maritime services, medical services, planning policies) and this can be time consuming and expensive;
- We need to continue to invest in economic growth and infrastructure;
- But our services are relatively expensive due to our location and size;
- Over many years, strong revenues from the Fishery have allowed us to develop services, standards and investment with comparatively low taxes. Government has also been able to dispense with some charges (property rates, MSL) and provide many things at no or little charge which elsewhere would not be provided or would be charged at full cost;
- But revenues from the Illex Fishery have not been as good in recent years due to a number of factors;
- Government has been cutting back for several years and improving its efficiency, but we are now reaching the limits of what can be done by simple 'good housekeeping'

This graph shows the fall in Government revenues from Illex:



The effects on government finances are shown in the following charts:



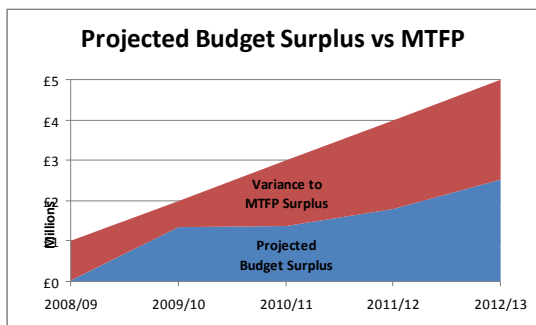
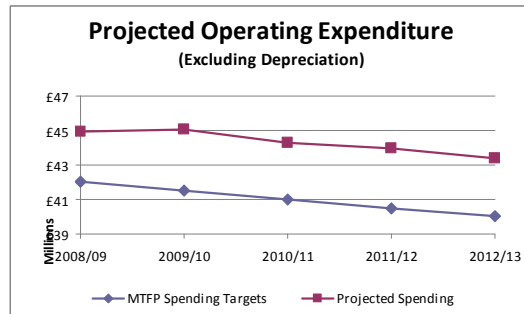
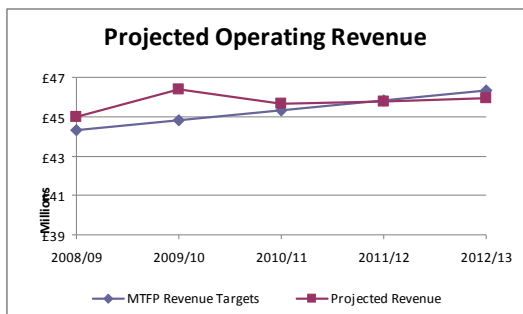
The charts show how Government expenditure and revenue increased in the years up to 2002/3, and then have consistently fallen back as expenditure reductions have kicked in. In real terms, Government raises less revenue and spends less than it did ten years ago in 1998/9.

Our current challenges

In order to tackle the situation, Government adopted in 2007 a Medium Term Financial Plan. This set targets for reducing spending by £0.5million each year to 2013, and for increasing revenue from ways other than Illex by £0.5m each year. The aims of the Plan are to:

- reduce the dependency on Illex revenue which has been reducing over time;
- ensure that sufficient budget surpluses are planned so that future unavoidable cost pressures can be met even if government revenues generally do not grow (in the current economic climate, it is unlikely that company and personal taxes will increase; but there will be cost increases such as fuel we cannot avoid)
- over and above this to hopefully free up resources for re-direction to new priorities in the Islands' Plan.

But so far it is proving very difficult to find ways of achieving sufficient revenue growth and expenditure reductions to achieve the targets in the Plan. Based on the budget set for 2008/9, we will fall far short of the Plan's targets:



If the Medium Term Financial Plan targets are not achieved, not only will we struggle to find any new money to improve services or invest in development but we will be very vulnerable to further reductions in Illex revenues and unavoidable cost increases.

Areas of cost increase which the Government is likely to face include general inflationary pressures on goods and services, fuel costs and things such as Medical Treatments Overseas which have been increasing substantially.

On the revenue side, Illex revenues can be expected to continue to fall. Taxes from companies and individuals are unlikely to increase in the current economic climate. And our income from Government investments is also likely to be limited in the global financial climate.

We could even find ourselves facing a budget deficit!

Some difficult choices

What this means is quite simply Government either has to cut back on spending, or we need to raise much more money through taxes or by other measures.

Many years of pruning departmental budgets have meant that any easy or obvious economies have already been made. Obviously, Government will continue to find economies through reduction in administration and management, new ways of working and overheads. Targets will be given to directors and other managers to achieve this.

This year whilst setting the budget, Government looked at many major cost cutting options, and also had all budget managers in the civil service suggest options within their own services. But this produced only limited results. This is partly because budget managers after several years of cutting back had run out of any obvious or easy options. It was also because the major cost cutting options (such as spending and

charging in the Health service and education) required considerable thinking through if reductions were to be achieved which minimised the effects on people, particularly those on lower incomes. This thinking through will now be achieved through developing proposals carefully in consultation with the public over the next 6 – 18 months.

But these are unlikely on their own to achieve the amounts required. That can only be done through cutting services or economic investment projects, or by raising more revenue. Neither is easy or popular.

For example, to bridge the currently predicted £3m gap in the Medium Term Financial Plan by 2012/13 we could:

- Raise £3m from personal tax – an average of £2,304 per year per person. This would hit the lower paid particularly hard
- Raise £3m from company tax – an average of £55,555 per company (for a typical company currently paying £86,295 on a pre tax income of £357,159 in 2006). This would discourage investment and reduce economic growth
- Reduce Health and Education spending by £1.5M each. This would mean ending Medical Treatments Overseas for all but desperately urgent cases and ending all support for students overseas in further and higher education
- Close the Falkland Islands Meat Company (Fimco) and/or cease the Ferry. This would mean large parts of the Government's strategy for providing a sustainable Camp would be removed, and money already spent would obviously have been wasted.

To avoid hard choices, some might be tempted to dip in to our Consolidated Fund. This currently is worth about £87m and has been built up over many years. But that would be irresponsible: like any other savings account, if we dip in to it rather than making difficult choices, it will gradually run out. And we need to use the Fund wisely to provide contingency against any sudden fall in revenues and to invest in future economic growth through major projects like a new port.

Equally, it is not automatic that reducing Government expenditure is a good thing. Individuals, particularly the vulnerable and those on low incomes will be affected. There will be less money in the economy, business sales would be affected and economic growth will suffer.

How we intend to approach things

If the choices facing us were easy and simple they would have been made by now. Reducing services, charging more for services or raising more money through taxes are all difficult. To do so in a way that minimises the negative effects on people, particularly those on lower incomes, and does not damage the economy, needs careful thought and planning.

So Government intends to devote real time and effort over the next few months to examining the options.

It is also vital that as much people as possible can take part in this process, to offer ideas and to help select those options which ultimately provide the best way of balancing the books.

This Green Paper gets the ball rolling. Government will be seeking as much discussion as practically possible on the situation it presents and suggested way forward.

There will be further Green Papers on key financial subjects such as Further and Higher Education Student Funding, Health Treatment and Finance, Government Revenues and Fiscal Policy and Wealth Related Payments (means testing).

Each Green Paper will clearly and simply set out the issues and early options for change. They will be published and arrangements made for public discussion and submission of ideas. Active participation in the process from those directly affected, the business community and the public generally will be sought.

After further examination of the options, working through of details and public discussion, White Papers will be published which set out in detail how Government intends to deal with the overall situation and with each of the major areas included in Green Papers. After further public discussion and opportunity for comments, the Government will finalise its decisions through budget setting (in 2009 and 2010 – some of the major areas will require more detailed consideration than is possible for 2009) and where required legislation.

Some key questions

Government wants to hear as many views as possible. Some of the questions which it particularly wishes to have views on are:

- 1. Has enough information been provided about the overall financial situation?*
- 2. Are the aims of the Medium Term Financial Plan to reduce spending and increase revenue the right ones? If not, what would a more appropriate financial strategy consist of?*
- 3. Are the targets set in the Medium Term Financial Plan (£0.5m spending reduction each year; £0.5m revenue increase each year) right? If not, what would be?*
- 4. Where should priority be placed in our situation – raising taxes, or reducing spending?*
- 5. If spending is to be substantially reduced, what are the options? For example, is it preferable to reduce further and higher education grants, or reduce medical treatments overseas, or reduce spending on economic development projects?*
- 6. If taxes are to be raised, where should the emphasis lie – corporation tax or personal tax? Should personal income tax be made more progressive (i.e. higher earners pay a greater percentage)?*
- 7. What about ‘means testing’? How would it be if charges were levied for some essential services such as health care, but with free services for the less well off?*

The public consultation period in relation to this Green Paper will close on 19th December. Please submit your views on these and related issues before that time: either at a public meeting, other meetings called to discuss the Green Paper or by e-mail councillors@sec.gov.fk or in writing to Legislative Councillors.