

# **BUDGET 2006**

## **TREASURY MINISTER'S SPEECH**

**21<sup>st</sup> February 2006**

### **"Springboard to the Future"**

Mr. President,

In the weeks that lead up to the presentation of the annual budget, I am always very conscious of the various moods and opinions that are expressed by a variety of audiences as to what position the Island has reached in terms of economic prosperity, quality of life, levels of public services and similar factors.

If one were to listen solely to some of the opinions expressed on the Island, one might be forgiven for believing that things are far from promising. However, when you listen to the views expressed by those from further afield, or those who are in regular contact with a wider audience, the message is one of admiration for the achievements made by the Isle of Man in the last decade.

In order to establish in my own mind our current status, there are three fundamental questions that I ask myself as the Treasury Minister. Firstly, where are we in terms of our financial and economic development? Secondly, "how have we reached this position?" If we know the answer to this question we can start to answer the third and final question: "where do we want to go from here and how will we get there?"

Taking each of these questions in turn, I believe that we have reached a significant milestone in our history as today we reach the culmination of what has become known as the modified taxation strategy.

In doing so, we are further establishing our Island as a jurisdiction that delivers on its promises - that has had the skills and the boldness to devise a strategy that has enhanced our reputation around the world, while protecting our economy in the process.

In terms of economic progress where are we today? Well, we are now in our 21<sup>st</sup> year of unbroken economic growth, such growth having averaged 7.4% over the past 10 years and per capita GDP is now 106% of the UK. Unemployment has been at or below 1.5% for the past 7 years, our economy continues to diversify and our externally managed funds are currently valued in excess of one billion pounds.

Significant investment in new infrastructure has been made during the past decade. We have committed over half a billion pounds in the last five years alone and can point to the new Noble's Hospital, the Energy from Waste Facility, the refurbished Villa Marina, new sewerage treatments works and infrastructure, improved schools and a new Water Treatment Works as further evidence of the investment in our society that our economic progress has made possible.

Prior to the 2002 Budget, housing had been identified as a key issue by Honourable Members and I can advise that some £200 million has been made available to DoLGE and the Local Housing Authorities to progress housing schemes over an 8 year period to 2010. Over this period, in excess of 1,000 new houses for the public sector will have been built which includes 600 houses that were not deemed practical to refurbish and which have had to be demolished. In addition, a further £85 million has been made available to undertake repairs and refurbishment of the public sector housing stock, ranging from total refurbishments to replacement windows, improved insulation and the installation of more cost-effective central heating systems.

For the six year period to March 2009, the Housing Reserve Fund will have provided £44 million in grants, loans and construction subsidies for over 800 designated properties for first time buyers.

Work is currently ongoing in respect of the second Water Treatment Works and the new prison, both of which are now in the course of construction. We also have a state of the art power station, with links to the adjacent islands for both gas and electricity.

As a result of our sound economic and financial management policies, we obtained the coveted AAA credit rating from both Standard and Poor's and Moody's credit rating agencies in the year 2000. Each year, I am able to report that this status has been maintained and the message may have lost some of its importance to a local audience. However, we should not lose sight of what an achievement it was to gain this rating and to have kept it at this level for the past five years. It is an international standard that provides would-be investors in our country with the confidence that they are dealing with a blue chip jurisdiction. Few countries around the world are able to attain this coveted credit rating level.

So to turn to my second question, how have we reached this position and what have been the reasons for the prosperity that we enjoy today?

As I commented earlier, we have had many years of economic growth which have stemmed from sensible and achievable financial targets. We are fortunate that our legislation does not permit a deficit budget. We must always budget for a surplus and never spend more than our estimated income. Therefore, we can never speculate on what might happen, we can only budget for what we believe will happen.

With the exception of the statutory boards, we do not borrow money to finance capital expenditure. All the capital expenditure incurred by Government Departments has been financed through internal loan schemes.

We are where we are today because the public and private sectors on the Island work well together. We consult on legislative reforms and on other issues where Government can assist in developing an environment in which businesses can flourish. Such consultations extend beyond this Honourable Court. We talk to Trades Unions representatives and the public. We listen to such views and act accordingly. At times it has been challenging work but it is necessary if we are to achieve the right balance and consensus as to the way ahead.

We have diversified our economy into areas such as films, space, marine administration, e-gaming and other e-commerce related activities. More companies are using the Island's reputation as a stable and well-regulated economy to apply for Alternative Investment Market listings on the London Stock Exchange.

These ideas have borne fruit because we have not been afraid to market our initiatives and to take them out into the world. We are an independently minded nation and nobody owes us a living. We have to earn our revenues by constantly reminding potential customers of what we can offer, by ensuring that our messages reach the right people and by maximizing every opportunity that presents itself. If we do not, our competitors will. The Isle of Man is competing on a world-wide stage and our standards of professionalism and commitment to generating new business must be sustained and enhanced if we are to go forward.

Tynwald has given its unwavering support for the measures that have been introduced in recent Budgets. This solidarity and sense of purpose has served the Island well in its pursuit of economic success and I look forward to that continuing. Its importance to the business community should not be underestimated.

While it is nice to look back at the past, especially when it has been so positive, the Annual Budget process is about setting the parameters for the future and for realizing a vision as to where it is we want to be in 5 or 10 years' time. This was my third question, namely what are our objectives and goals and how will we achieve them?

We need to further develop the economic and fiscal strategies that have stood us in such good stead in recent years and constantly review and refine these strategies to ensure they are still timely and relevant to our ongoing situation.

We are no longer in need of new business at any cost. Our economic strategy is based upon the need to attract high value businesses that employ highly skilled individuals. We do not have the numbers of people to supply labour to new companies that provide relatively low skilled employment to large numbers of people. Neither do we wish to create unnecessary burdens on our schools, housing, health services, roads and other elements of our infrastructure by unnecessarily increasing our population.

Therefore, we need to continue to invest in new technology, to train and to educate our indigenous workforce to ensure that they are best placed to share in the prosperity that our economy can provide. We will need to explore further options to diversify the economy.

The Isle of Man must continue to adhere to the principles of internationally accepted and applied regulatory standards, while remaining committed to the promotion of a level playing field.

We need to maintain our competitive edge and avoid complacency. Our recent Earnings Survey showed that average earnings have increased by 0.9% during the past year. My concern is that hidden in that figure is the fact that the average public sector wage is now 15% ahead of the private sector average.

We have given generous pay settlements to our public sector workers in recent years, but we must ensure that any future increases are earned and do not erode our position as a competitive jurisdiction. I have stated in previous years that we are no longer a low cost environment.

I have given much thought in the past to the need to maintain an inclusive society in which all are sharing from the increasing standards of living that can be provided. By definition, there will always be those who prosper to a greater extent than others.

However, everyone has a part to play and there will always be a range of occupations and skills required within our community. The issue of the less well off and the vulnerable groups within our society features prominently in my proposals today.

Fortunately, and to complete my answer to my final question, I believe we have a very good idea of how we will achieve our objectives in the forthcoming years. We will not achieve them by allowing complacency, waste, mismanagement and poor financial control to feature in our efforts. As our annual level of expenditure increases, we must ensure that every pound that we spend is wisely spent. Just because we have many more pounds to spend that we did a few years ago should not diminish our determination to maximize value for money.

We also need to be fully aware that our economy is now inextricably linked with the global economy. Should we encounter less prosperous times in the future; Government Departments will be obliged to budget for more modest increases. That will be a true test of political and officer skills. It is a test that we have not been faced with for many years and I hope that we will be up to the task if the time comes.

The challenges that have faced the Isle of Man over the last five years and more have been unprecedented. Not so much those challenges that are driven domestically — all past Governments have had to deal with things such as the need to generate economic growth, spread the benefit of that growth, meet ever-rising aspirations and expectations, and do all this within the statutory rules that decree the need for a budget surplus.

What is relatively new and extremely challenging are the effects of the heightened external interest in the Isle of Man, particularly that emanating from supranational bodies such as the OECD, the European Union and the IMF. We are all aware of the nature of these challenges, which relate to taxation and regulatory issues and which could have seriously damaged the economy. What we can justly be proud of is how we have responded to these challenges. The strength of Government, private industry and the general workforce has been shown once again, in particular through determining a consensus on the positioning and repositioning of the Island on key issues and practices.

By no means are these external challenges over – in fact, quite the contrary. They will be with us permanently. But let us just take stock of how, in facing them, we have performed and where we are currently positioned.

Internationally, we have become one of the leading voices of the smaller international finance centres through our constructive engagement with the OECD. This role was undoubtedly a factor in helping us secure the taxation agreements with the Dutch Government in October last year, the first of their type anywhere in the world. We

believe it will place us in a strong position in the evolution of the offshore finance world into the future.

All our direct tax changes meet our commitment to the EU and we have satisfied all of the bodies which have chosen to look at the probity and quality of our financial regulatory systems and associated legislation.

We have seen how these factors, coinciding with the global economic slowdown of recent years, have seriously affected the economic performance of neighbouring and competitor jurisdictions. But, while over the last five years annual growth in the UK has averaged only 3% and across the EU as a whole only 2½%, Isle of Man growth has averaged around 6%, with last year's real growth in GDP equating to 6.3%. Average earnings are now some 20% higher than in 2001. The unemployment rate over this period has remained below 1½%. Employment has increased such that there are now some 41,000 people in employment on the Island. This is some 2,000 more than in 2001. Government revenues have grown by almost one-third. And we have achieved this growth whilst generally containing local price pressures. Whilst fuel and energy prices did serve to push our annual rate of inflation to well above the norm in the winter of 2004-5, inflation is now at 3.3%, the lowest for two years.

One of the results of the efforts of both Government and the private sector has been the recent accolade from the highly respected publication, "the Banker", which has voted the Isle of Man its "European Finance Centre of the Future", with the Island coming second only to Singapore in the World Finance Centre category.

With inward migration and an expanding economic output it may appear odd that the picture coming from the Island's retailing sector is not a buoyant one. There is evidence to suggest that sales volumes are falling.

A number of reasons can be put forward to explain this. One is the low rate of increase in personal incomes as detected by the latest Earnings Survey. The Survey reported that despite pay rises afforded to the public sector, average earnings increased by only 0.9% between June 2004 and June 2005. There are also factors arising from the static population movements encountered a couple of years ago and the growing popularity of internet shopping. And of course there is always the matter of off-Island shopping generally.

The Earnings Survey results would appear to reflect the actions of private sector employers seeking to limit increases in their wage bills to compensate for increases in their energy bills. It is also likely that consumers will be doing similar by accommodating their significantly higher fuel bills through reducing their High Street spending.

Small increases in salaries, increased internet shopping, increased savings levels and reduced proportions of salaries available for spending on consumption goods all add up to a situation where the economic fundamentals of a sound and expanding economy are nevertheless failing to translate into improved sales for the Island's retailers. But there is no easy policy remedy for this. By continuing to seek to expand the economy and the population, raise visitor numbers, and minimize the tax take from personal wages and from retailers' revenues this Budget and attendant Government policies are already doing all that is possible for the sector.

However, I can announce that in order to establish what else might be possible, particularly in respect of improving the retailing environment for shoppers, a working group has now been established by the Economic Development Committee of the Council of Ministers. I for one recognize the benefits that a vibrant retailing industry can bring, not just to residents and the visitor industry but also as an attraction to prospective inward investment and entrepreneurs.

Looking forward, we believe we can sustain growth of at least 5% annually during the next 3 years. Moreover, the adoption by Tynwald of the Economic Strategy in October 2004 gives a focus on how we might attain this growth in output without a commensurate increase in labour requirements. As I have already stated, we will need to pay ever-increasing attention to these policies, in relation to marketing, training, labour participation, and commercial legislation if we are to attain the Holy Grail of economic growth without the downside of attendant increases in public service costs associated with increased population pressures.

I have in the past expressed my concern about the very substantial increase in staff numbers across Government and the high long term cost of sustaining over 8000 employees in Government service. I am pleased to say that this year we have contained this increase to a total of 36 new posts. When set alongside a reduction of 18 posts at the MEA and 2 new posts in the Clerk of Tynwald's Office, the net figure for the whole of Government this year will be 20, the lowest for many years, and in stark contrast to the 212 posts approved last year.

I turn now to issues relating to public expenditure and the Capital Programme.

I must begin by again expressing my disappointment and dismay at the lack of progress in many of the capital schemes that were scheduled for the current year.

Honourable Members may wish to note that in the current year, Departments had planned to spend £92 million on capital projects, but latest estimates are that only £54 million will be spent. Past performance suggests to me that this estimate may itself prove to be optimistic when we see the actual figure for the year.

On a more positive note, I am pleased to confirm that the construction of the New Prison is now on track and some £26 million will be spent on this project during 2006-7. In addition, improvements and extensions to secondary schools will cost over £6 million, whilst the Department of Transport has budgeted to expend over £16 million on projects including extensive improvements to Ronaldsway Airport and the Douglas Harbour facilities, further extension of the IRIS network, development of the Poortown Quarry and the replacement Animal Waste Processing Plant.

The Department of Tourism and Leisure is now pushing ahead with the Villa Marina Arcade refurbishment scheme with funding in place to allow the scheme to come to October Tynwald with a November start on site. This scheme completes Government's commitment to refurbish the Villa Marina complex since its acquisition from Douglas Corporation.

In addition to these sums, the Water Authority will expend over £25 million in 2006-7, principally upon the new Douglas Water Treatment Works and ancillary schemes, while the Local Authority Housing Programme is planned to expend £24.5 million to further alleviate problems in the local housing market.

In 2006-7 it is estimated that Departmental capital spending will total some £92 million with a further £1 million reserved for acting as a lender of last resort to Local Authorities and £7 million to fund essential capital works at the MEA.

Mr. President, these elements add up to a total outlay of approximately £150 million in 2006-7, which, with the exception of the Water Authority's expenditure, is financed without recourse to external borrowings. It is a figure that we should all reflect upon, as it is an enormous achievement for a small population.

In committing this level of funding, Government is again providing a huge stimulus to the local economy, especially to the local construction sector. I am concerned when I hear that Government is "not doing enough" to aid local businesses. We cannot always expect the public purse to be supplying the workflows to keep all businesses operating at their optimum levels. We will always do our utmost to support local organizations, but as in all economic cycles, there will be peaks and troughs and Government will not be immune to such movements.

However, I am very pleased today that I can now confirm that the Treasury has been advised that the 5% rate of VAT in respect of domestic property repairs will be extended for a further period until at least 2010, thereby providing ongoing savings to householders who are contemplating such works. I am sure the smaller building firms will be delighted to learn of this news, as will the householders themselves.

Turning now to the Revenue Account, I am able to report a probable surplus of **£11.8 million** for 2005-6, marginally above the original estimate and an estimated surplus of **£8.3 million** in 2006-7. Honourable Members will note that the current year probable surplus is in line with expectations despite spending increasing by £36.9 million over budget as a result of Supplementary Votes for pay and overspending during the year, principally at the MEA and the DHSS.

The anticipated surplus has been possible only as a result of a significant level of "one-off" receipts that may not be repeated in the future. We should not become over-reliant upon these exceptional receipts as to do so would leave a significant exposure should such monies fail to materialise.

In 2006-7, Government's net revenue expenditure, excluding Statutory Boards, will rise to **£522.1 million**, an increase of **£39.3 million** or **8.2%** in comparison to the current year's estimate. This follows from last year's increase of 7.7% and 7.3% the year before.

This will deliver a net increase in public expenditure over the 5 year life of Tynwald of £161 million.

Gross expenditure for 2006-7 is estimated to rise to £768.7 million, an increase of £49 million over the 2005-6 estimate of £719 million.

Mr. President, these increases are ahead of both the growth in the economy and more importantly, the growth in our income. Such increases are unsustainable in the long term. In 2006-7 we will need to generate an additional £25 million just to stand still. Unless there is a greater sense of financial discipline across Government, the ultimate outcome will inevitably be increased pressure on our ability to deliver the level of front line services to which we all aspire.

The DHSS will receive an 8.9% increase, amounting to almost £17 million of net additional funds for 2006-7. Its gross spending budget for 2006-7 will rise by over £25 million to an estimated £373.8 million. In other words, the DHSS will be responsible for spending over £1 million of taxpayers' funds every day of the year.

The total cost of Social Security benefits will increase by over 6%, almost twice the current rate of inflation, to a new figure of £185.4 million. This represents additional expenditure of £10.6 million.

From April 2006, the basic pension is to be increased by £2.20 per week to £84.25, with corresponding increases of £1.10 to the pension supplement, amounting to a new amount of £42.13 per week.

As a result of these increases, a pensioner married couple with the wife qualifying on her husband's contributions; will receive a basic pension plus supplements of £202.13 per week. This payment will amount to £67.38 more than the basic pensions of £134.75 payable in the United Kingdom.

I am acutely aware of the pressures being placed upon the DHSS to introduce new services. Therefore, and despite the current issues, extra funding has been made available to enable the Department to consider the introduction of new cancer screening services and the advancement of proposals with regard to services provided at Southlands.

From 2007/8, the Council of Ministers has endorsed the Department's recommendation that nursing care be provided free on the Island and that the commencement of a phased introduction will be considered as part of next year's budgetary process.

I remain seriously concerned about the quality of financial management within the Department, a concern which has been heightened by the recent announcement of an anticipated £8 million overspend and the consequent threat to services.

There is no doubt that public aspirations and technological and medical advances, together with changes in the U.K. funding arrangements, have placed huge extra pressures on the Department's budgets.

Indeed, in the U.K., the Government has appointed accountants to investigate poor financial performance in nearly one fifth of all NHS Trusts, which are collectively anticipating a one billion pound deficit this year.

I believe it is essential, if we are going to protect the quality of the health services we currently enjoy, that we initiate a debate as to how we fund the health services in the long term.

Following previous discussions between the Treasury and the DHSS, the Healthcare Commission Review into acute care services is already underway.

Furthermore, the Council of Ministers has now agreed to establish a working party, chaired by the Chief Minister, to investigate the financial management structures of the DHSS and to consider the various funding options which may be available in the future.

Details of this working party will be released in due course but I believe these reviews represent the minimum we should be doing to ensure we can develop and protect our health and social services into the future.

Financial support for the Tourism & Hospitality industry will continue for 2006-7 with the proposed extension of the Tourism Development Fund pending agreement on new schemes that will allow for much needed product development and marketing initiatives to take place. The visitor economy, both leisure and business, is worth around £112 million to the Island and underpins much of our high quality of life. This extension and proposed improvement to the financial support Government is able to offer will provide a catalyst for future change.

The Conference market is one that the Isle of Man is now able to properly develop with the superb facilities on offer at the Villa Marina as well as significant improvements undertaken by a number of major hotels. £100,000 has been allocated for each of three years from the Marketing Initiatives Fund to allow the Department of Tourism to exploit the potential of this high spending market.

The TT continues to be a significant global event and will celebrate its Centenary year in 2007. Additional funds of £300,000 are being allocated to provide improved health and safety for riders and spectators and a further £500,000 has been included within the Capital Programme to improve the range of facilities, including hospitality units, to enable the TT to enhance its appeal to corporate sponsors and other guests.

With respect to other changes in net revenue expenditure, I can advise that there are a number of specific factors that have had an impact upon Departments' budgets for the forthcoming year.

The Department of Trade and Industry has transferred its training budget of almost £400,000 to Education, hence it appears to have a budget reduction, whilst Home Affairs again sees a sizeable increase as a result of expenditure relating to the New Prison.

Within the Department of Education's expenditure is provision for the payment of the controversial "top-up" fees, introduced in the UK at a level of £3,000 per annum. My colleague, the Minister for Education, has negotiated a reduction of this charge to £1,350 per student, and Government will meet this extra cost for all qualifying students, in addition to continuing to fund the university course fees on behalf of Manx students.

A new system of charging at the Airport to boost passenger numbers has resulted in a £3 million pound reduction in direct income to the Department of Transport. However, this has been as a result of extensive discussions involving the Department of Tourism and Leisure and the Treasury to optimize income to Government as a whole by

attracting more visitors to the Island. A range of tariffs will be offered which will reduce the average charge levied on airlines by 20%, while applying certain conditions relating to service levels, longer term commitment and fares.

At DoLGE, the costs to the taxpayer of waste management continue to increase, as reflected by the allocation of over £900,000 of additional funds for 2006-7.

For those who may be concerned by the apparent increase in Treasury funding, this is almost entirely due to elements of the rescue package agreed in July for the MEA, and which is estimated to cost the Treasury over £3.2 million pounds in 2006-7 in addition to other costs that I will detail later.

During the term of this administration I have consistently increased the level of our Overseas Aid budget by significant sums, year on year. In 2001, the budget was £275,000 and for 2005-06, a 54% increase was sanctioned, increasing the funds available to its current level of £1 million. For 2006-7, I propose a further increase of 40% or £400,000, in order to make available in the forthcoming year the sum of £1.4 million to fund assistance for those in foreign countries who are less well off than ourselves.

While on the subject of good causes, I would wish to take this opportunity to update Honourable Members on progress relating to the Isle of Man gaining a share of the good causes funding generated by sales of UK Lottery Tickets.

Previously, UK legislation did not permit such a distribution despite Lottery Tickets being sold on the Island since 1999. Therefore, the Isle of Man receives only the 12% duty levied on all ticket sales. However, as soon as the Treasury became aware of plans to introduce a new National Lottery Bill, representations were made to the Department of Culture, Media and Sport and to the Department of Constitutional Affairs to discuss the potential inclusion of the Isle of Man in the distribution of the good causes funds, which would have the effect of providing an additional share of the proceeds for distribution on the Isle of Man.

Following meetings between Treasury officers and their UK counterparts, such an agreement has been reached and if the National Lottery Bill, which received its second reading earlier this month, becomes law, it is likely that the Public Lottery Trust will oversee the distribution of this additional sum.

The precise manner in which the good causes funding may become available to the Isle of Man has yet to be agreed and will depend upon a variety of factors including sales of tickets and the needs of potential recipients relative to good causes in other areas.

However, I am advised that the amount involved may be as much as £800,000 per annum. Moreover, I believe a significant anomaly has been rectified by this course of action and I am hopeful that during the 2007-8 year, good causes on the Island will start to receive this additional funding.

Working with producers to assist with the management of change within the agricultural industry will be a major challenge for the Department of Agriculture, Fisheries and Forestry in the forthcoming years. The effective use of capital is a key issue and I have

increased funding for the Farm and Horticultural Improvement Scheme by £200,000 in 2006-7 to assist with dealing with responses for this initiative.

A key issue for our economy, and one that was highlighted in the Economic Strategy, is ensuring we maintain a highly skilled and productive workforce. To that end, I am delighted to report that the DTI used the additional funds provided at the last Budget to expand into key new areas of training, including manufacturing and team leader and management development. These efforts will continue in 2006-7.

The DTI is looking at all aspects of raising the number of residents in the workforce. As an example of its work in this area, the Department, working closely with the DHSS, has helped an additional 60 disabled people into employment during 2005-6, improving their quality of life and social inclusion while also helping employers and the economy. I look forward to further progress with this initiative in 2006-7.

I am delighted to inform Honourable Members that 2005-6 was not only the 10<sup>th</sup> anniversary of Isle of Man Film, but also its most successful, generating over £10 million of on-Island spending and 18,000 bed nights in local hotels. During the past decade, some 74 productions have been made on the Island, generating an estimated 170,000 bed nights for the tourist industry and a direct spend with local services and suppliers of approximately £60 million.

Indeed, Isle of Man Film is now a recognised brand and our film activities have helped considerably to raise the profile of the Island in export markets.

These achievements are now being made without any revenue contribution from the Department of Trade and Industry, but rather as a result of the re-investment of receipts generated by the Media Development Fund.

The shipping sector continues to generate major economic benefits for the Island in terms of income generation, tax revenues and employment opportunities, with more than 500 jobs currently filled within the shipping industry.

Of equal importance is the contribution made by Marine Administration to the international business reputation of the Island. In 2005, the Isle of Man Register was listed second in the world on the Paris MOU "White List" of quality flags, then later the same year it was voted joint first in an annual review of Flag States by key industry players.

It is hoped that the striking success of the shipping register can be repeated in the sector of civil aviation as the Island seeks to develop an aircraft register. A newly recruited Director of Civil Aviation will commence in post next month and I am sure this will further enhance the Island's reputation. Funding has been made available to the DTI to progress this project in the forthcoming year.

E-Business is also a key growth sector for the Island. Within E-Business, E-Gaming has enjoyed rapid growth in the past year. The Isle of Man is now positioned as one of the top jurisdictions for E-Gaming activities based on our reputation of being a well regulated, low tax environment, having a world class telecommunications infrastructure

and being increasingly responsive to the industry's needs. This has resulted in the relocation to the Isle of Man of companies from a range of different jurisdictions around the globe.

A significant number of players in the space industry, including SES Global, the largest satellite operator in the world, have now established subsidiary companies on the Island. This is bringing a further welcome diversification to our economy and stimulating business across a range of professions. I was much heartened by the support of Honourable Members for resources to enable Government to pro-actively market the Island's capabilities in this sector. I am confident further successes will arise as a result of this stimulus.

The Treasury and all other concerned parties, including the Financial Supervision Commission, are actively working towards the introduction of a new type of company in the Isle of Man, often referred to as "The New Manx Vehicle". The drafting of this Bill is almost complete and I am confident that it will receive Royal Assent during this session. I would like to thank those representatives of the private sector who have so ably assisted us in developing this project.

The Treasury, in conjunction with the Chief Secretary's and the Chief Minister's offices, and supported by the Attorney General, will continue to progress the work and strengthen the contacts arising out of successful missions to Washington and Brussels during the past year. It is vital that these international contacts are maintained and further developed to ensure our robust participation in matters relevant to the protection and successful development of the Island. A further sum of £100,000 has been made available to enable this process to continue.

As I have previously stated, our dependence upon an ability to compete effectively in global markets cannot be overstated. To do so requires knowledge and expertise from an ever growing variety of sources around the world. I believe our investment in such resources will continue to reap the rewards that we have witnessed in recent times.

As is customary, I now turn to the transfers to Government's various reserve funds.

As Honourable Members will be aware, I frequently allude to the nature of Government receipts and in particular, the recurring and non-recurring elements of income streams. While we are able to accurately forecast income tax revenue, we are less well-placed to estimate indirect taxation receipts, due to the nature of the transactions that generate such income.

The amount of such one-off receipts is considerable and forms a significant element of Government's income each year. Therefore, it is sensible to ensure that a proportion of these receipts are matched against "one-off" expenditure, as opposed to annually recurring revenue expenses. These transfers should not be regarded as savings, as the money will get spent. It is an essential method of matching income and expenditure.

In previous years, including the current year, it has been my policy to retain the investment returns earned on the Reserve Fund within this account. This year, it is estimated that £10.4 million will be earned on the balances within the Reserve Fund and the Manx Currency Account. However, in 2006-7, the majority of investment income will

be used to pay the interest payment of £9.9 million due on the original £185 million MEA loan, as a result of the MEA's inability to meet its liability to the Treasury. In addition, I have transferred the balance of investment income generated by the Currency Account to the E-Commerce/ICT Fund, to assist with the development of the many new initiatives being progressed at the current time.

In the early part of this Administration world stock market declines created reductions in the values of some of our Funds, especially those with significant holdings of equities.

The establishment of the Investment Committee of the Treasury, originally under the chairmanship of Mr. Donald Gelling and latterly Mr. Adrian Earnshaw, has overseen a welcome return to positive territory for our major funds, as world markets have recovered. The Funds that hold significant equity investments, that is the Reserve Fund, the National Insurance Fund and the Public Sector Employees Pension Reserve have produced annual returns of in excess of 15% over the past three years, and over 20% in the past twelve months, offsetting the losses of the previous two years and generating a more than acceptable rate of return during the period of this administration.

As at the 31<sup>st</sup> January 2006, the value of our investments under external management exceeded one billion pounds for the first time in our history. However, I believe that we should continue to ensure the growing value of our reserves, many of which are pledged to meet the growing liabilities for state retirement pensions, public sector pensions and to provide some form of cover for the ever growing annual increases in expenditure that we incur.

In addition to the transfers that I announced in last year's Budget Speech for the current year I intend to transfer one million pounds to each of the following funds – the Public Sector Employees Pension Reserve, the Government Marketing Initiatives Fund, the E-Commerce Fund and the Housing Reserve Fund.

Members should not lose sight of the fact that, with the exception of the Pension Reserve, these funds are used to provide for expenditure of a one-off nature and are therefore not true reserves.

With regard to 2006-7, I propose a further transfer of one million pounds to the Pension Reserve and a further two million pounds to the E-Commerce Fund. I am aware of Government's ever increasing expenditure on a range of I.T. projects but we must not forget our objective to become a centre of e-excellence and the standards of I.T. that new businesses to our Island expect to find, both in terms of infrastructure and Government's ability to demonstrate its internal I.T. capabilities. It is a business in which we must be prepared to invest, both for the sake of our own efficiency but also to create the technological environment that we wish to demonstrate to a wider audience.

Treasury's Information Systems Division won a top international award in December for the Connect Mann project, beating strong competition from major private and public sector organisations in Europe, Middle East and Africa.

I had hoped to make further transfers to the reserve funds in keeping with the non-recurring income to which I have previously alluded. This has not been possible, although I hope it will be possible to review such matters at the next Budget.

In referring to the Public Sector Employees Pension Reserve, it is appropriate that I make reference to the significance of the requirement to provide for public sector pensions and the growing impact such payments are having on the Revenue Account.

In 2000-1 the actual costs of public sector pensions was approximately £20 million. In the current year the probable expenditure will be £30 million with an estimated figure of £33 million in 2006-7. This increase of 65% over just 6 years means that our payments are increasing at a rate higher than the very significant growth rates that we have achieved in our income.

The Treasury is acutely aware of the impact such levels of increase could have upon our Revenue Account in the medium to long-term and is assisting the Civil Service Commission in its deliberations with regards to the manner in which such liabilities may be mitigated.

I have set a target for the Public Sector Pension Reserve to attain a value equivalent to 40% of the current Government salary bill. The annual cost of Government salaries is now estimated to equate to some £270 million in 2006-7 and therefore, our immediate target is £108 million.

The estimated balance of the Pension Reserve at 31<sup>st</sup> March 2006 is £91.7 million to which will be added the £1 million transfer I have announced today in 2006-7.

Mr. President, I have always seen my highest priority as maintaining and growing this Island's competitive and vibrant economy in order to protect jobs and to increase Government revenues; part of which can be achieved through our taxation system.

Reductions in the burden of taxation have been delivered throughout my term of office. So far we have achieved a 10% standard rate of tax for individuals and a higher rate of 18%. I have increased personal allowances and raised the threshold at which the higher rate of taxation becomes payable. A simplified current year basis of assessment has been successfully introduced for individuals and Honourable Members will be aware of our generous system of tax reliefs which is currently the subject of consultation.

I am not forgetting the Taxation Strategy commitment to reduce the higher rate of tax for individuals to 15%. Our estimate of the cost of moving to 15% using current data is £8.2 million pounds. I do not judge that we are in a position where this move would be prudent at present. The taxation of companies has also been reduced over the past five years by the introduction of a 0% rate of tax in some sectors and a maximum rate of 18%.

In recent years, the most difficult challenges have been to find the right responses to international pressure, to continue to stimulate a vibrant and diverse economy and thus to deliver excellent public services and look after those who are less fortunate.

On reflection, I believe that this balance has been achieved and I am sure, Mr. President, that this Honourable Court will see clearly that same balance in my announcements today.

Government and the Treasury have a range of responsibilities, one of which is that we

must provide for those in our community who are less well off. At the same time, we must ensure that those who are less well off are not disadvantaged by bureaucracy or rules that leave them poorer for no good reason. As a keynote of this Budget, I will announce today measures that are designed specifically to help those on low incomes.

Mr. President, I will deal with the routine changes within the tax system quickly so as to give more time to explain other measures in detail.

There will be no change this year to the annual rates of tax paid by individuals; they will remain at the standard rate of 10% and the higher rate of 18%.

For the 2006-07 tax year personal allowances will be increased to £8,670 for a resident individual and £17,340 for a married couple. The threshold at which the higher rate of Income Tax becomes payable will also be increased to £10,500 for a single person and £21,000 for a married couple who are jointly assessed.

I move now, Mr. President, to the changes that are designed to help those on low incomes. Members will recall that we introduced the Personal Allowance Credit with effect from the 2002-3 tax year.

The system ensures that those people who have insufficient income to use up their personal tax allowance receive a tangible benefit in the form of an annual cheque.

We have in place the Low Income Working Group comprising of officers from the Treasury and the DHSS that reviews policies affecting those less well off people in the Isle of Man and makes recommendations to the Treasury aimed at assisting them. The Group recommended this year that we should disregard non-taxable benefits, such as the attendance and disability allowances, when calculating the Personal Allowance Credit. That recommendation is being implemented.

The Group also recommended for retired people a further £10 per week disregard of pension for income support purposes, and that will also be implemented. I am minded to go beyond those recommendations and make further changes that will enhance what we provide to low income groups.

Mr. President, the maximum amount of Personal Allowance Credit payable will be increased by 40%, from £250 to £350 from 6th April 2006. Furthermore, to ensure that bureaucracy does not lead people qualifying for the credit to miss out on it, payment will be made automatically based on the income declared on a person's tax return. The Assessor of Income Tax will remove the section from tax return forms that requires people to make a specific claim for the Personal Allowance Credit.

I have consistently stated my belief that we should go further to support the less well off. A further example of what I believe to be an anomaly within the current system is that a number of people find themselves in a taxpaying position as a result of the receipt of benefits.

For example, where a single parent caring for children is not able to work, benefits may exceed the tax allowance and so create a tax liability. Some individuals may have a combination of low incomes and some benefits that totals an annual income in excess of their personal allowance, again leading to a tax bill.

Honourable Members will, I am sure, agree with me that it makes little sense for Government to give people benefits and then claw back some of them in the form of taxation. The Assessor has informed me that some Members of this Court have made representations on behalf of constituents who find themselves exactly in these situations.

Mr. President, I intend that we should make two further changes to the system. Firstly, in instances where a person's only income is in the form of taxable benefits and the total amount of those benefits would give rise to a tax liability, I propose not to tax those benefits.

Secondly, where a person has some income besides benefits but that other income would not in itself give rise to a tax liability, we will not treat the benefits as taxable. The exact benefits which are to be covered by these changes and the conditions which must be met will be published shortly.

In addition, later in our agenda there is a Motion to provide for the increase in the annual income support personal allowance of £52 and the increase in the level of Winter Payment Bonus from the planned level of £200 to the higher amount of £260, as announced in July 2005.

This was paid in January of this year and I can now announce a further increase of £40 to enable the payment due in January 2007 to further rise to £300.

These increases follow the announcement in April 2005 of the previous increase in income support personal allowance of £44 per annum to reflect the impact of the MEA standing charge, a charge that was of course effectively removed as part of the Treasury package approved by this Honourable Court in July 2005, enabling the most vulnerable members of our society to retain this additional funding.

At the other end of the income tax scale, a consultation exercise in respect of a cap on individuals' tax liabilities has been carried out. The underlying aim of having such a cap is to attract wealthy entrepreneurs to our Island and to encourage them to stay. By having such people as residents, we not only receive direct benefits in terms of income tax receipts, but indirect benefits that arise from new businesses that are set up and which create employment that drives forward our economy and funds the benefits to which I have just alluded.

The amount of comment generated by the consultation process was enormous, and strongly confirmed my original view that this policy would have an immediate and significant effect.

The Isle of Man can gain a clear competitive advantage by having a system that is public, simple to understand and available to all. Therefore, Mr. President, I propose that we should introduce a cap on personal tax liabilities at a level of £100,000 for a single person and £200,000 for a married couple who choose to be jointly assessed with effect from 6<sup>th</sup> April 2006.

One relatively minor change that I am also announcing today is that the rate of supplement on overpaid tax will be decreased from 3% to 2% from 6<sup>th</sup> April 2006. The new rate is more in alignment with what is seen elsewhere, although it retains the

element of compensating taxpayers where Government has held overpaid tax for whatever reason.

I have already mentioned the consultation that was started last month on the future of our personal tax relief system. Representations are still being made and so I am not in a position today to give a detailed response. What I do wish to state clearly to this Court is that I intend that we will make changes to the way that we give interest relief for property purchases.

I have no intention, Mr. President, that any such changes will disadvantage people buying their homes. Tax relief for Mortgage Interest paid on a person's primary home loan will remain unchanged. However, we ought not maintain a system that gives tax relief regardless of how many properties a person buys and I intend that as soon as is practical we will remove the relief for interest that relates to second and subsequent properties. Such a move will not be unfair and I do not feel that it will have a negative impact on the property or mortgage and loans sectors.

I am also aware of the current fragility of the retail sector and can state that I am not minded to remove the tax relief on personal loans for non-property assets as they play an important role in maintaining a strong retail market.

One allowance that has probably outlived its initial purpose is the Tourist Business Incentive Allowance. I have therefore asked the Assessor to review the operation of this allowance. In the interim, from 6<sup>th</sup> April 2006, no new applications for this allowance will be accepted.

Mr. President, I turn now to reviewing further the Taxation Strategy and the steps that we need to take in order to bring it to completion.

The Isle of Man has been almost unique in having had a public taxation strategy for five years and in openly updating that strategy when circumstances dictated. We have now reached the culmination of a careful and orderly planning process; a process that has involved much consultation and that has produced something that I am convinced not only delivers stability and confidence for the various stakeholders in our economy, but far more importantly provides many opportunities for growth, both organically for businesses that are already based here and by attracting new businesses to our shores.

As a tangible example of the benefits arising from the consultative approach adopted by Government, I would refer to the tax changes provided for in the 2003 Budget in relation to the Isle of Man fund management industry. In 2005, funds under administration in the Isle of Man grew by 41.5% to stand at US\$25.9 billion. This has contributed new revenues to the Treasury and provided additional jobs in a global industry in which the Island is now a substantial player.

Some three weeks ago, the clauses of the 2005 Income Tax Amendment Bill were reviewed in another place. One of the new measures being introduced by that Bill is a Corporate Charge. This Charge, which will be payable by all Manx companies, but creditable against the tax bill of those that still pay tax, is designed to offset the loss of fee revenue from the tax exempt sector once it joins our mainstream corporate taxation system.

The 2006-7 financial year is one of transition for many companies. Tax exempt companies that exist as at 5<sup>th</sup> April 2006 may continue with their current status until 5<sup>th</sup> April 2007, or may move to the mainstream system during this transitional year.

As Honourable Members will be aware, the tax exempt companies pay annual fees. We must be careful that Government revenues are maintained during the 2006-7 transition year, and therefore I am announcing today that the Corporate Charge will apply during the forthcoming year and that it will be set at £250 per company. This will provide an estimated income of some £5.3 million.

Mr. President, the importance to our economy of the banking sector cannot be overstated. If we look at some of the statistics shown in the 2014 Report that was released last year, we can see that the banks generate one fifth of our gross domestic product and directly and indirectly give employment to one quarter of our workforce.

Since the revised taxation strategy was published in 2002, I have indicated that the banks would be taxed at 10%. The precise definition of what this entailed was not made public until detailed policy work had been carried out within the Treasury.

Mr. President, the general rate of corporate income tax is to be 0%. However, in order to ensure that Government can continue to generate revenue sufficient to provide the high quality of services that our population rightly expects, the banks will be taxed at 10% on their banking income. Where they have income that would otherwise be taxed at 0% if it were in a separate company, we will allow them to split their profits into a part taxable at 10% and a part taxable at 0%.

A Treasury working party that has including banking and accountancy representatives, has determined how different types of income will fall to be treated, and the Assessor will today publish further details in relation to this matter.

If economic conditions were sufficiently attractive, Honourable Members might wish that the Treasury should propose that all companies be taxed at a rate of 0%. That would certainly take some of the European Union pressure off us! Indeed, a globally applied corporate income tax rate of 0% would give complete clarity for all.

What I can say today, Mr. President, is that we can do something for the banks that will give them stability, confidence and opportunities for future growth – all in keeping with the approach to economic management that I outlined earlier.

The October 2005 consultation paper examined whether we could treat income arising from capital reserves that the banks are required by law to maintain and account for separately, from income earned from their customer bases. Such an approach is not unprecedented. The Belgian Government, and Belgium is of course a European Union Member state, is introducing a very similar measure.

Therefore, having studied alternative taxation strategies, our intention is to encourage the banks to have subsidiary companies in the Isle of Man rather than trading branches and to encourage their retention of capital within our economy.

To assist in this process I have decided to tax the income arising from capital reserves in

excess of the regulatory requirement, at the general rate of 0%. This move has a cost that can be met from the 25% of the total of the European Union Savings Directive Retention tax that we will retain.

As this policy will provide a significant stimulus to the banking sector, that cost is expected to be recouped in the short-term by additional taxation receipts from the existing banks on the Island, new entrant banks relocating as a result of the attractiveness of our taxation system and the additional employees that the banks will need in order to cope with the anticipated growth in their business.

It was indicated in consultation last autumn that company profits earned from land and property in the Isle of Man will be taxed at a rate of 10%. This approach recognises that the land of the Island is a precious national asset and that businesses in this sector should be subject to special rules.

The Treasury perspective is that land and property business profits should not be tax-free. Mr. President, so that my Honourable Colleagues are clear as to the types of businesses covered, I am referring to the letting of property, property development, trading in land and property and quarrying and similar activities, all of which are trading undertakings. I say this to make clear that the Treasury has no intention of introducing capital gains tax. Farming and related agricultural sector companies will continue to benefit from the 0% rate of tax as they did by concession last year.

The result of taxing these income sources at 10% is that we may have a number of companies with profits split between varying rates of tax. In order to encompass such situations, the 2005 Income Tax Amendment Bill provides the Treasury with the powers to impose varying rates of tax. These changes also mean that whilst our current group and loss relief rules will be maintained, their application will need to be amended to relieve profits taxed at the same rates.

I can also tell Honourable Members that Treasury considered whether utilities companies, such as gas, oil and petrol products and telecommunications should be taxed at 10% on their profits. Taking all factors into account, I feel that this is not an appropriate move at this time. However, I should like this Court to note, as I should like the utilities companies to note also, that the costs of these companies will be very much reduced by their moving into the 0% corporate income tax regime.

We want the Isle of Man to be a competitive place in which to do business, but we do not wish to see the Manx consumer disadvantaged. I would call on the businesses affected by the moves in April of this year to pass on some of their savings to their customers, and so stimulate the economy all round. I will maintain a careful watch on this situation to monitor their progress.

Mr. President, to conclude my offerings in respect of the taxation strategy, I would like to look to the future. For some time, it has proved very useful to the Isle of Man to have been able to show a public tax strategy to anyone who was interested. The implementation of the various changes in April of this year and in April of next year bring to a close a five year period in which we have been working towards the culmination of this strategy.

I am sure that Honourable Members will support me in proposing that we develop and publish a new taxation strategy looking forward from April 2006. Endorsed by Tynwald, such a strategy could generate further interest in our Island as a place to live and do business and further support our economic growth. I will ask the Assessor to lead a rapid review so that I may bring some proposals before you at the earliest opportunity.

However, Mr. President, there is one further concept that I would like to mention today. The consultation last year in respect of the tax cap on individual tax liabilities led to enormous interest internationally and has led to suggestions in some quarters that we ought also to consider the feasibility of a cap on corporate tax liabilities. I feel that this suggestion has significant merit as it is perfectly consistent with the Economic Strategy objective of seeking to attract high profit, low labour intensive activity. Subject to consultation as with previous proposals, my current view is that it ought to be a part of our future taxation strategy.

In view of the existing measures that we are already committed to introducing for companies, I do not consider it prudent that such a measure should have any adverse impact upon our existing tax receipts. Therefore, if it were considered a good move, my initial view is that a corporate tax cap would be set at a level above the maximum amount of tax currently paid by any company in the Isle of Man.

Despite this caveat, it is my view that a cap of this kind would be well received and that it is not out of keeping with the overall shift that we have towards a 0% rate of tax across the board for companies.

Mr. President, when you look back over the past decade, the economic performance of the Isle of Man is a success story that we should all be proud of. During the past five years we have maintained our strong record of growth and on the back of our taxation and economic policies we continue to stimulate huge interest around the world.

It is entirely proper that everybody on the Island should share in the success that has been achieved. That is why public expenditure has increased so dramatically, why personal taxation has been reduced, not only by reductions in headline rates but also by the type of changes that I have announced today and in previous budgets that deliver real benefits to those on low incomes.

It is why social benefits have increased year on year at rates that are in excess of cost of living increases. It is why this Government has committed huge amounts of funds to mitigating the impact of rising electricity charges and invested hundreds of millions of pounds in infrastructure assets.

However, and I fully acknowledge that I have already made this point on many previous occasions, we cannot anticipate that our revenues will always grow at the rate that is now funding the higher costs of the public services that we increase, year on year.

We must ensure that we continue to increase reserves, to match one off income with one off expenditure and to recognize the volatility within the estimates of our future income streams. Not to do so would be irresponsible but I am concerned that it will require a commonality of purpose if any meaningful reduction in the rate of growth of expenditure is to be achieved.

In order that we can maintain our economic progress, the Budget today provides further opportunities to those who create the wealth that in turn provides Government with its income to spend.

The personal tax cap is already attracting considerable interest and I am confident this will add to our overall tax receipts in the forthcoming year. Furthermore, the additional benefits that such individuals will bring in terms of local spend and entrepreneurial activities can create further opportunities for growth.

Last year, an article in the Jersey Evening Post commented on the reasons why the views being expressed in the 2005 Budget exuded far more optimism than that of the Jersey offering. I quote a small extract from this article as follows:

“The Manxman is more confident because he can see the taxman taking less from his pay packet. The Jerseyman is less confident because he can see the taxman taking more from his pay packet.”

This year, the changes I am proposing will benefit those on low incomes by removing a number of non-taxable benefits from the Personal Allowance Credit computation. Increased personal allowances and increases in the scope and quantum of the Personal Allowance Credit will provide further assistance to the less well off and take a significant number out of the tax net and into the scope of the Personal Allowance Credit.

In addition, the increases to funding for the DHSS that is specifically targeted at low income groups will provide a further sum of almost half a million pounds. All in all, these measures combine to provide a total of approximately £3.5 million, representing the biggest support package ever provided to those who need it most.

In presenting this Budget today, I have refrained from referring in too great a detail to the financial affairs of the MEA. I do so now simply to remind Honourable Members of the scale and complexity of issues that have faced the Treasury since the additional loans were discovered some fifteen months ago.

I will not dwell upon the amount of work that was required to create a package of measures that would shield the public from the consequences of the expenditure sanctioned by the previous Board. Suffice to say that the measures approved in this Honourable Court last July represented the culmination of months of effort to establish the true financial picture at the MEA and the potential consequences for the electricity consumer.

I would pay tribute to the members of the new Board at the MEA, who stepped into the breach at very short notice. In particular, I would commend the efforts of the new Chairman, Mr. Eddie Teare and the Member of Council, Mr. Eddie Lowey. I believe this Honourable Court owes all the new members of the Board a debt of gratitude for taking on these positions in such difficult circumstances.

Had it not been for the MEA we would have retained reserves of almost £20 million which we have used to fund the Standing Charge Reserve and pay this year's interest on the original bond monies. We would not have incurred additional revenue expenditure of £3 million on other interest charges.

For the next decade, we are committed to subsidize household and business electricity bills to the tune of some £14.7 million per annum. This represents the interest charges on £240 million of borrowings and the £1.6 million cost of providing the credit in respect of the standing charge. This has removed some of the options that I might have otherwise have considered as part of this year's Budget.

However, we are where we are and as I remarked last year, the strength of any nation and its economy lies in its ability to withstand challenges. The fact that we have been able to resolve this issue and still deliver such a positive Budget despite this untimely commitment is a testament to the strength of our financial policies.

The 2006 Budget marks the delivery of our promises to the international community and demonstrates the Isle of Man's ongoing commitment to innovation. It provides for significant increases in public expenditure and the provision of further assistance to those in our society who need it most, both at home and overseas. It is also a Budget for business, inviting the enterprising and the ambitious to come to our Island to work with us.

We have stayed resolute in the pursuit of our goals throughout this administration. We have delivered on our pledges in terms of both taxation and social strategies. However, this does not in any way mean that we have reached the end of the road. Already, Mr. President, our thoughts are turning to the further enhancement of our initiatives and the need to remain competitive in an ever changing world.

So it is not the end of our journey, neither is it even the beginning of the end. However, we may look back at 2006 and consider it to be the end of the beginning. What I believe we are doing today is putting in place further measures that will create new opportunities in our never ending quest for economic progress and provide a springboard to the future.

A future in which all our citizens will benefit from the creation of additional prosperity for the Island.

Honourable Members, I will conclude my remarks by thanking my political colleagues in the Treasury, Mr. George Waft MLC, Mr. Adrian Earnshaw MHK and Mr. Eddie Teare MHK for their help and support during the year and to my colleagues in the Council of Ministers who share in the difficult decisions in relation to allocations of resources.

I commend the 2006 Budget to Honourable Members.

**Hon. A. R. Bell, M.H.K.,  
Minister for the Treasury  
21st February 2006**