

BUDGET 2007

TREASURY MINISTER'S SPEECH

20th March 2007

"Securing the Future"

Mr. President,

Today's Budget is my sixth, and the first budget of a new administration. It is unusual in so far as it takes place at the March sitting of Tynwald, and there has been only a short period of time since the general election for some of my ministerial colleagues to get to grips with their new portfolios. In presenting today's proposals, in the best traditions of the Isle of Man, I have sought to balance change with continuity, sought to maintain the confidence of investors, and sought to build upon the positive international reputation for economic success that have been a feature of my last five budgets.

At the same time, I have been determined to maintain and improve the levels of support given to those on low incomes, in order that this economic success benefits all members of society.

In considering how to begin then, I looked back at my first budget speech entitled "open for business". In many respects, the optimism present in 2002, with a large surplus and reduced rates of taxation, remains in place. Growth in the economy has averaged more than 6% per year in real terms over the last five years, and Government revenues have increased over the same period by over £100 million.

Of course in 2002 we had yet to embark upon what became known as the Modified Taxation Strategy. The creation of a zero-rate of corporate tax for the majority of companies, and the abolition of our Exempt Company regimes, was felt by some to be unaffordable. But, by ensuring strong growth, and by maintaining business confidence over the last five years, we were able to complete the taxation strategy in line with our international commitments, and without requiring large reductions in spending, or higher personal taxes.

When I look at the current problems in other jurisdictions in implementing what has become known as "zero/ten" it gives me great satisfaction to reflect on what we have achieved here.

But we cannot afford to rest on our laurels. There are a number of longer term opportunities and threats to our continued economic wellbeing. Reform of public service pensions, dealing with international pressures or developing new markets may not have

same impact of major changes in taxation or new spending plans; but they are the foundations upon which our future prosperity will be built.

I would first like to update members on our economic performance.

We are in our twenty second year of unbroken growth.

We approach this Budget with the economy performing as well as it has done at any time in the last five years — but with the significant challenge of sustaining such performance and the future health of our public finances.

The economy is estimated to be currently growing at around 8% in real terms, the fastest rate for six years, and higher than the 5.5% expected at the time of my last budget. This growth is widespread. It is being generated across all sectors of the economy. Banking deposits and funds under management are at record levels, and numbers of company formations are increasing.

The overall strength of the economy at the moment is best reflected in the labour market, where 2006 saw a fall in unemployment over the course of the year for the first time since 2000 to a current level of 616, a rate of 1.5%. We are also seeing record numbers of job vacancies being lodged with the DTI with 1,400 in the first two months of this year alone.

As the recently published Census Report showed, our population increased by 4.9% over the last five years. However, over this period the value of our national output of goods and services has gone up in real terms by some 33%. This took our national income per head from 3% behind that of the UK to more than 10% above. The Island's national income per head now stands at over 20% above the average for the 15 leading EU economies. Over the same period our workforce has risen by just 4.4%. This shows a significant and welcome improvement in productivity, a key target of the Economic Strategy as approved by Tynwald in October 2004.

This is a phenomenal achievement and one that reflects well on our Island workforce, our business managers and entrepreneurs, even, dare we say it, Government, which has striven to create an environment in which business can flourish.

Economic growth is the prerequisite to raising living standards. It sustains and creates jobs, one of the key means of providing household incomes that are so necessary for the benefits of growth to be felt across all of society. Further, it provides for the public revenues that are used to maintain and improve the physical infrastructure and the quality of core public services. And of course it provides for the public revenues that allow further for the redistribution of the wealth created, in the form of financial support to the less fortunate and those on lower incomes.

It is for this reason that the focus of this and future Budgets must be on securing the future through growth and development of the Island's economy.

In an environment where growth and productivity are vital, it is important not to put all our eggs into one basket. Ensuring the diversification of the economy is not only desirable from the point of employment opportunities and wider social and environmental benefits, it will also protect us from potential downturns or wider global trends in particular sectors.

It will also require employees to be flexible, in order to be able to take up the employment opportunities that will be available as the economy expands and evolves. Training and taking on new skills become crucial to the well-being of our own people, and the priority given to developing skills across a number of Government Departments is testament to our commitment to assist our workforce develop and reach their own potential.

Of course, we will never achieve our economic goals without some recruitment of employees from outside this Island, particularly where new skills and experience are required. Government must have a work permit system that facilitates such recruitment, and ensures we get the best people in key new posts which will, in itself, create further employment opportunities for local people.

Recent announcements in respect of BA Connect show as a practical example the volatile nature of employment and we must guard against complacency. In short, the challenge is to further raise productivity, so as to maintain and improve the competitiveness of our companies and particularly those who, directly or indirectly, are competing in the UK and in export markets further afield. Fail in this and our proud record of 22 years of unbroken growth and raised living standards will be under threat.

We will be helped in this if we can contain local inflation. On this front there has been good news in the last year with the annual inflation rate having come down from its peaks of over 6% to average 3% in 2006, as energy cost pressures subsided.

I should also comment on the average earnings figures, which showed a 9.6% increase for the year to June 2006. All economic data is subject to the vagaries of statistical sampling, and Members may recall that the figures for the year to June 2005 showed an increase of just 0.9%. I would therefore caution against reading too much into just one year's figures. Over the two years however, there has been a 10.6% increase. Some of the recent increase may be the result of our success in attracting high value jobs in areas such as E-Gaming and Financial Services. Of most interest though is the comparison between earnings in the Public Sector compared with the Private. The differential between private and public sector average pay was 9.2% in June 2004, and had risen to 19% by June 2006. Public Sector pay has considerably outperformed that of the Private Sector, and the gap between public and private sector salaries has widened dramatically in the last two years.

Levels of Public Sector Pay are now a cause for serious concern within Government and within Treasury. Over one third of Government spending now relates to direct employment costs, around £300 million a year. When you consider that public sector workers also have access to generous final salary pension schemes, and better job

security, then in my opinion the gap between public and private sector remuneration has grown too wide.

I say this not because we do not value the work done by those in the public sector, but because the generation of wealth, and the taxation receipts needed to invest in the public sector are made by those in the private sector, and we cannot afford to undermine this by making it difficult or expensive for the private sector to recruit staff, and thereby generate that wealth. We must also guard against committing government to unsustainable expenditure commitments into the future.

In light of the above, Treasury has considered whether it would be right to state publicly our expectations for the upcoming pay round. In doing this obvious problems emerge. One is that it may be seen by some as a benchmark for upward negotiation. Secondly it may limit individual employment groups negotiating efficiency or other improvements in return for higher salaries. Weighed against this is that the lack of such guidance does not encourage restraint, nor focus minds on the key issue that resources will always be limited, and the more that is spent on salaries, the less that is available elsewhere.

As I stated before, I have no desire to return to the days when pay in the public sector was the poor relation of that in the private sector. We need to pay fairly and with regard to the overall economy. On balance though I believe the time has now come to be clearer in our intentions. A 1% increase in salaries will cost Government around £3m per annum and so I am setting aside a figure of £7.5m to cover all pay increases for 2007-8.

In addition, I am pleased to report that overall staffing numbers will rise by just 12 in 2007-8, and that the only new approvals have been those associated with planned capital schemes. The priority for any further posts going forward has to be for those that develop the economy, and bring in new revenues.

In summary then the Isle of Man continues to offer a fast growing economy, with increasing per capita wealth, without high inflation, any Treasury Minister's ideal scenario.

Mr President, I now turn to matters relating to the External Environment.

Since 2000 we have maintained the coveted AAA credit rating from both Standard and Poor's and Moody's credit rating agencies, and once again I can confirm their retention. This is an international standard that provides would-be investors in the Island with the confidence that they are dealing with a blue chip jurisdiction with sound economic and financial management policies, and represents a clear competitive advantage for us over other locations.

The challenges that have faced the Isle of Man over the last five years or so have been unprecedented. I said last year that these challenges would be with us permanently, and the last twelve months has proved this to be the case.

Mr. President, all of us in this Court are aware of the amount and weight of the international pressure that has been put on the Isle of Man. We have reacted

responsibly and as a good international citizen within the increasingly connected global economy. Part of what we have done has involved reform in how we tax companies, reforms which will be finalised this April with the abolition of Exempt Companies. In addition, we have joined the debate on international tax cooperation and presented the position of a small but highly successful financial centre in the face of often ill-informed and unfair criticism. We have been negotiating actively with a number of countries on bilateral tax agreements, following Tynwald's ratification of the Tax Information and Exchange Agreement with the United States of America last April and then the tax agreements with the Netherlands the following month.

In my estimation the pressure on some countries that have finance centres is going to increase significantly in the near future. It may even be that not all finance centres can survive in the long term, and only the best will remain.

I am determined to ensure that our strategies and policies will firmly place the Isle of Man in that remaining group of financial service centres.

My job as Treasury Minister is to protect our economy. Much of the attraction of the Isle of Man as a location for corporate or individual investment derives from our reputation, and that reputation has been built up painstakingly over decades. Our economy and our reputation are enhanced each time we conclude an international tax agreement, and I wish to inform Honourable Members that this area of Treasury's work is being given an ever-increasing importance in view of what it can deliver.

As this Honourable Court has determined in the past, the Isle of Man should seek bilateral tax agreements with other countries based on international norms; namely double taxation agreements. Stand alone tax information exchange agreements are not appropriate unless they can be coupled with benefits for our economy. As the world changes, however, so must we; and I wish today to state simply that the preservation of our reputation and good standing may be a benefit in itself as we consider our stance on further taxation agreements.

Inevitably, part of what other countries seek is assistance with their own tax compliance activities. None of us in this Court, Mr. President, or the many businesses that comprise our economy or those companies and people that invest here for all the right reasons should fear our giving that assistance. It is the right and responsible way to act. The exchange of tax information is subject to rules, and the legitimate confidentiality of investors here is protected carefully.

There will be a further IMF inspection due in spring 2008, and we look forward once again to demonstrating that the Isle of Man is a world class regulated financial jurisdiction.

Maintaining a positive national reputation is the result of not only doing the right things, but also getting your message across. For this reason I have set a further £100,000 aside for future External relations activity, to support key personnel in their international discussions.

The Isle of Man remains an attractive place in which to do business. The new Manx Corporate Vehicle, resulting from the Companies Act 2006, has been a factor in the increase in company registrations. Over four hundred of the new type of companies were incorporated in the first three months of operation, and nearly 3,500 companies were incorporated in the whole of 2006, the highest number since 1999. It remains too soon to tell if this is the start of a longer term increase in company formation activity, but the initial signs are certainly encouraging. Once we have had time to assess the impact of the Companies Act 2006, we will need to review and update other company legislation and associated issues. These will be matters I will be discussing with the Financial Supervision Commission in the next few months.

The Fund Management Sector also continues to grow strongly. Funds under management rose from around £15 billion in 2005 to around £21 billion in 2006, a rise of almost 50%. Over 400 people now work in this area, generating significant taxation receipts. Treasury have recently received a report into the future growth of this Industry. The reports authors believe that with the Government's assistance the sector can achieve the objective of \$50 billion of funds under management, plus \$100 billion of funds under administration well before 2010.

Bank Deposits have also risen, with over £43 billion reported in September 2006. This is an increase of 15% on the equivalent figure a year ago, and reflects the inherent strength of our banking sector going forward.

The Insurance business has also performed well, with premium income rising by 43% in 2006, and a further £7 billion growth in funds under management, both record figures. There has also been a near doubling of the number of registered international pension schemes, which are attracting both business and high net worth individuals to a flexible, secure and well regulated environment.

The supporting industries to our economy are often overlooked in a budget speech, but I believe that they give us a key competitive advantage. The professionalism of our legal and accountancy services, the innovation and quality of our manufacturers and our dynamic construction industry amongst many other all contribute to the growing success and expansion of our economy and the generation of revenues to support our public services.

REVENUE SHARING ARRANGEMENT

The most significant external development in the last year has been the negotiation with the United Kingdom of a new Indirect Revenue sharing arrangement, within the Customs Agreement. Members will be aware that three quarters of our income now comes from Indirect Taxation and that on many occasions I have spoken of the volatile and unpredictable nature of many of these receipts. Creating a less volatile and more predictable revenue stream has been a key objective for Treasury in recent times, and I am pleased to announce that from April 2007 a new arrangement will be in place with the United Kingdom that will, in my opinion, bring us more security in planning our

future spending. The downside to this will be that there will be less in the way of one off "windfalls" that can be used for transfer to reserves.

The new arrangement will not necessitate the changing of the Customs and excise agreement with the United Kingdom, beyond the fact that the notice period to be given by either side increases from the current six months, to two years.

The new mechanism will allocate VAT and other revenues based on relative economic growth, that is the difference between growth here and in the United Kingdom. It is clear therefore that in developing the economy into the future, growth itself becomes the most important issue for all of us here in this Court, because, put simply, without economic growth we will not have the increases in revenues that can be used to maintain and improve upon our public services.

It is for this reason that I have put the creation of economic growth at the heart of today's budget.

I would like to turn now to the Revenue Estimates for the current year.

Government Revenues continue to be buoyant. Our income has risen from £537 million for the year ended 31st March 2006 to a probable amount of £584 million for the year ended 31st March 2007, an increase of £47 million.

With only a small number of supplementary votes for expenditure, I am able to report an estimated surplus of **£49.9 million** for 2006-7.

For 2007-8 Government revenues are estimated to be £575 million and Expenditure £538 million, giving a surplus before transfers to reserves of £37 million. These surpluses will reduce in 2008-9 and 2009-10, as income growth slows, and spending increases.

In recent years transfers have become an important part of the budget proposals. If we consider the Public sector Employees Pension reserve for example, then members will note that this reserve currently represents the only provision put aside by Government to meet its longer term pension liabilities. Government Departments are not, in the main, requested to meet the Employer's share of pension liabilities, and if they were, then the surplus for 2006-7 would be zero, not the £50 million surplus as reported above.

For this reason, I have instructed officers of the Treasury to explore the potential for better budgetary provision in Departmental estimates for pension costs from next year, with the intention of increasing the Public Sector Employees Pension Reserve. I have also set an objective for us to grow the percentage of pension liabilities covered by reserves year on year into the future. We will transfer £35 million out of surpluses in 2006-7 and 2007-8 into this reserve, in order to cover a larger proportion of these liabilities. As a result by 31st March 2008, the Public Sector Employees Pension Reserve will contain £145 million, or 12.0% of the total liabilities which are estimated to be around £1,200 million by this date. These liabilities represent the theoretical amount that would need to be put aside, to meet the pensions of all public sector employees, given

that such amounts would be invested until required on an individual basis. As such they are susceptible to assumptions over life expectancy, investment performance, and inflation, and in many cases pensions will not become payable for decades to come.

Despite this, it is important that we acknowledge the potential for future liabilities now. However managing public sector pensions does not rely simply on Government making more financial provision, but by dealing with the underlying cost of the schemes themselves. I welcome the proposal that, following changes to teachers and police schemes, a new Civil Service Scheme, based on average salary, will be introduced for new entrants from July 2007, with the closure of the existing final salary scheme, and we are aware of other developments that will result in changes to schemes for other employment groups.

In all our discussions over public sector pensions it is important to recognize the long term nature of the liabilities. Many of our schemes link to UK arrangements and one of the biggest challenges ahead is keeping abreast of the pace of change there. For this reason, I have agreed that the interest on the Public Sector Pensions reserve may be used, with Treasury consent, to the updating of various scheme rules, and to a more fundamental review of the cost effectiveness of managing and administering local schemes by way of linking to the United Kingdom.

The second largest transfer to reserves will be the £10 million transferred to the capital account. For the benefit of new Members I should explain that 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.

Significant investment in new infrastructure has been made during the past few years. 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, and soon a new Prison as tangible statements of the investment in our society that our economic well being has made possible. We have also invested over £100 million into Housing over the last five years, a record amount.

The nature of the Capital Programme is changing though. Although several large schemes remain, namely the Runway Extension, Bemahague School and completion of IRIS, Treasury have been keen to focus Departments on smaller scale maintenance programmes, which bring with them regular work to those in the construction industry, and an investment in our infrastructure that will postpone the need to consider such large scale one-off capital investments into the future.

Examples of this I would point to are the introduction of a Highways infrastructure Programme by the Department of Transport, the reintroduction of Minor Capital Works by the Department of Tourism and the ongoing programme of Housing Maintenance by the Department of Local Government and the Environment.

By progressing smaller works it is also expected that the delivery of the Capital Programme will improve. Delivery for 2006-7 will be higher, with around 70% of the

Programme Spent, up from 57% last year. This is lower than the figure contained in the Pink Book, as it would appear that, once again, Departments remain over optimistic in their assumptions. It is hoped that by progressing smaller schemes, a better flow can be maintained to the construction industry, minimizing the peaks and troughs, and the delays that sometimes emerge from large projects.

Housing remains a key issue for Government. I can advise members that some £145 million has been made available to DoLGE and the Local Housing Authorities to progress housing schemes over the next 5 years. By 2009 a further 440 first time buyer homes will have been completed, to add to the over three hundred new properties already sold to first time buyers. Over the last five years more than 400 public sector properties will have been refurbished or rebuilt. Over the next five, a further 620 are to be completed. That's over a thousand new or refurbished public sector properties in a decade, to add to the over seven hundred first time buyer properties. This investment, including the additional sums set aside for insulation, double glazing and central heating, will at last ensure that in the next few years, all those in public sector housing enjoy a decent environment that is fit for purpose, and that significant numbers of people get the opportunity to own their own home.

The Housing Reserve Fund has resulted in over £50 million of new investment into affordable housing since its inception in 2002. I will add £10 million into the Land and Property Acquisition Reserve, and £6 million into the Housing Reserve Fund in 2006-7 and 2007-8.

Finally I should refer to the transfers in respect of the E-Commerce/ICT Fund, and the Medical Indemnity Fund. The E-Commerce Fund continues to provide for investment in key government systems, and in 2007 business and individuals will be able to submit Income tax and VAT returns on line, providing a further streamlining of the administrative costs for business and government. An additional £5 million will be added to this reserve.

The Medical Indemnity Fund relates to a period prior to 2005 when Government self insured against Medical negligence claims. Although many of the cases are complex, and take considerable time to resolve, it has been felt prudent to make additional provision for the potential settlement costs of these cases, based on the latest assessment of risk. A further £4 million will be added to this reserve.

I have referred previously to the need to generate economic wealth, in order to secure the future of our public services. Investment into the new Industries of tomorrow remains key if we are to continue to generate that growth. Success stories such as the finance sector, film, space and e-Commerce would not have happened without a flexible, responsive, pro-active and supportive Government. The Personal Tax Cap, a zero rate of Corporate Tax, modern company legislation, and investment incentives all make up an attractive package to potential investors. But it is foolish to think that these policies of themselves will bring in new business. We need to sell the benefits of coming to the Isle of Man, which is why, a year ago, I created the Marketing Initiatives Fund.

The fund has, over the last year, supported the development of the Space Industry, the Conference business, and the Branding project. Further applications are currently being considered in respect of the development of agriculture and tourism. In order to ensure there is adequate funding to be able to respond quickly and positively to new opportunities I intend to transfer a further £4 million into the Marketing Initiatives Fund this year, taking its total to over £6 million. One of the criticisms that Government sometimes faces is the speed that it moves when opportunities do present themselves. In order to be as nimble and flexible as possible I propose amending the rules governing the Marketing Initiatives Fund. At the moment any proposal exceeding £100,000 of spending has to be presented to Tynwald. This can mean delays in responding as quickly as may be necessary. Consequently, I propose amending this rule so that any spending request above £100,000 will in future be able to be approved by Council of Ministers. Clearly, I am sensitive to the accountability and transparency issues associated with this change and can assure Members that a comprehensive annual report on all spending out of the Fund will be made available.

Ensuring marketing opportunities are taken is important, but in order to secure the future, like Government, each sector of the economy needs to take a strategic view of the opportunities and threats it faces and define its vision and strategic direction. In 2002, in partnership with the funds industry I introduced initiatives to develop that sector and which were directly responsible for generating \$21 billion of the present assets under administration. In September last year, in response to the Fund Management Association's view of the opportunities for further growth in the Funds Industry and with the support of the Isle of Man Finance Steering Group, I agreed to the Isle of Man Funds Review Group being established. The Group's terms of reference included consideration of the legal, regulatory and fiscal framework for the establishment, domicile, management and administration of funds in the Isle of Man, together with the co-ordination and future structuring of the marketing and promotion of the Isle of Man's fund sector internationally.

I was particularly pleased when Mr. Paul Smith agreed to chair the Group. Mr. Smith was until recently Global Head of HSBC's Alternative Fund Services Division, one of the world's largest providers of Fund administration services. The Smith Report demonstrates the huge potential for growth that exists in the Isle of Man for this sector and makes a number of far reaching recommendations. I would like to pay tribute to Paul Smith and his Group for their hard work in developing this report as quickly as they have done. I will be issuing the Report on the budget website today for wider review and discussion and look forward to consulting and working with the FMA and the Review Group on the implementation of subsequently agreed recommendations, to help secure its vision of a having \$100 billion of funds under administration and \$50 billion of funds under management on the Island by 2010.

Under the auspices of the Isle of Man Steering Group, I have initiated two further strategic reviews in relation to the Banking and Captive Insurance Sectors and look forward to receiving them in due course.

Financial incentives for new businesses remain a key driver of improved economic performance, and I have a further change to make to assist in this area. Some members

will recall that the terms of the General Development Reserve, as set up in 1999; allow only the interest to be used for Economic Development. I have decided that this reserve has outlived its useful life and we will therefore replace it with an Economic Development Fund. The terms of this Fund will allow for all of the current £18 million balance to be used in the generation of economic growth, and will supplement and expand upon the support given by existing schemes. An additional £2m will be transferred into this reserve out of current surpluses, bringing the balance on the fund to £20 million. The key criterion to be applied to this new reserve is that of economic growth. Given this, it will have a direct impact on our revenues going forward, and will support those business opportunities that provide the best return in respect of growing our economy. To underpin this move the DTI will shortly be amending the Industry Act 1981 to broaden the definition of Industry, and DAFF similarly will be amending legislation to broaden the definition of agriculture to enable us to support and encourage emerging new sectors.

I am delighted to inform Honourable Members that 2006/7 was another successful year for Isle of Man Film. Two Isle of Man films grossed more than £6 million at the UK Box Office, namely Stormbreaker, and Miss Potter.

83 productions have now been made on the Island, generating an estimated 193,000 bed nights for the tourist industry and a direct spend with local services and suppliers of approximately £67 million.

Indeed, Isle of Man Film is now recognised internationally 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.

However, from 2007-8 a new model is required to enable the film sector to grow further. This will involve the external investment of the Media Development Fund into film projects, subject to the control of Treasury, and dependant on the individual submissions. Film finance is a complex area, but suffice it so say that Treasury, along with its advisors, will continue to seek the maximum return for the minimum risk, and seek to continue to use this Industry as a springboard for other Economic Development activities.

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. At the end of January 2007 there were a total of 448 merchant ships registered in the Island – a growth of 6% and the highest ever figure. This figure includes 48 commercial yachts, up from 29 a year ago, which is a prestigious and profitable market within which the Isle of Man has successfully established itself in a few short years. As Honourable Members may be aware, the Isle of Man Ship Registry was assessed to be the best ship register in the world for the second successive year by the global shipping industry. This is an excellent achievement and demonstrates that the Isle of Man can – and must – compete

with the best in the world in our chosen key sectors. In 2007-8 the Department of Trade and Industry will invest further into the Ship Registry's IT systems to help it remain among the best in the world.

It is hoped that the striking success of the ship register can be repeated in the sector of civil aviation as the Isle of Man seeks to launch an aircraft register in May of this year. This register will target private aircraft such as executive jets operated by companies and high net worth individuals. This is a logical extension of the Isle of Man's capabilities in financial and professional services. It is hoped that within 3 to 5 years of the aircraft register becoming operational, we will see economic benefits in terms of taxation receipts, management fees and new jobs.

I should also comment on E-Gaming. The Isle of Man has, due to our reputation of being a well regulated, low tax environment, not suffered as badly as some other jurisdictions from the position adopted by the United States on Internet Gaming. I do believe that considerable growth potential remains, particularly in the Far East, and that having a world class telecommunications infrastructure, and key players locally will assist us in winning this new business. A recent survey of the E-Gaming sector indicates that it is currently providing 230 jobs at an average salary of over £45,000 and several million pounds in tax receipts each year. Additionally, it is estimated that E-Gaming is making a valuable contribution to the wider economy by generating £60 million of local spend plus £750m in funds flowing through the local banking system. I acknowledge the concerns some raised in terms of our reputation when we first established an E-Gaming environment on the Isle of Man. We must acknowledge that all international business activity brings some jurisdictional risk. Government is consciously addressing this risk through a strategy of high-quality legislation and regulation and careful selection of licensed operators. This is consistent with our approach in banking, insurance and shipping among other sectors. I fully expect this Industry to come through its recent difficulties, and we remain committed to helping them do this.

Possibly the single most important issue for our economy is ensuring we maintain a highly skilled and productive workforce. To that end, I am delighted to report that the DTI has used the additional funds I was able to announce in previous Budgets to expand into key new areas of training. For example, in the last year over 100 Isle of Man workers have received financial support to secure management qualifications. Also, the DTI, working with the Department of Tourism and Leisure has trained over 800 people in the Retail and Hospitality sectors through the Manx Welcome Programme. Additionally, DTI is working closely with the Department of Education and the private sector through the Sector Skills Groups to forecast future skills needs and re-direct training efforts accordingly.

Two further Reserves give specific assistance to key sectors of the economy. The Tourism Development Fund will be expanded and replaced by the Visitor Amenity Development Fund, in order that it can support the development not only of Tourist Accommodation, but also the development of new visitor attractions. Some £6 million of funds will become available for more widespread support for this sector.

Secondly, I referred in my Speech last year to the considerable uncertainty within the agricultural industry arising from the likely loss of derogation in the meat sector. I am aware of the proposals for the de-coupling of support payments that could replace the production based schemes of the past.

I believe that there are few, if any, Honourable Members who would disagree that the quality of appearance of the Manx countryside is one of our major assets. It attracts visitors and new residents from many walks of life and provides an enviable environment in which our citizens can relax and enjoy a range of sporting and leisure pursuits.

However, farming is also an industry that can and should be given the freedom to flourish. We need to not only preserve the industry, but help it to combat the new threats that it faces from increased competition. We can all assist by purchasing local produce but in order to provide a more immediate measure of assistance, I propose to transfer the sum of £5 million to a new fund, the Agricultural Development Fund, to assist DAFF in implementing measures designed to re-shape and re-structure the agricultural industry so that it can better meet the challenges of the next few years with confidence.

Finally I should comment on the performance of our currently invested funds.

The Investment Committee of the Treasury, until November under the chairmanship of Mr Earnshaw, has overseen positive returns for all our major funds over the last 12 months. The Funds that hold significant equity investments and that represent approximately 90% of our externally invested funds are the Reserve Fund, the National Insurance Fund and the Public Sector Employees Pension Reserve. These three funds have produced annual returns of in excess of 13% over the past three years, a more than acceptable rate of return during the period.

When I presented my previous budget to this Honourable Court I was pleased to announce that the value of our investments under external management had exceeded one billion pounds for the first time in our history. I can confirm that this figure has increased during the year to the 31st December 2006 by approximately £70 million or around 6.9%, reflecting the positive returns seen by world stock markets over this period. The total value of invested reserves now stands at around £1.1 billion.

I turn now to issues relating to public expenditure and the Capital Programme in respect of future years.

As I noted before, delivery of the Capital Programme has improved significantly with an estimated 70% delivery in 2006-7, up from 57% last year.

Spending on the New Prison has been around £18m in 2006-7 compared to a £26m budget. This project will cost a further £12m to completion in 2007-8. In addition, the Runway Extension/End Safety Areas scheme will hopefully begin, along with the building of a new junior school for Ramsey.

The Department of Tourism and Leisure will spend £3m on the Villa Marina Arcade refurbishment scheme.

In addition to these sums, the Water Authority will expend over £8 million in 2007-8 completing the new Douglas Water Treatment Works, and £20 million in total. The Authority is now half way through its £100 million programme of major upgrading. The Local Authority Housing Programme is planned to expend £21 million to further improve the quality of the public housing stock.

In 2007-08 it is estimated that Departmental capital spending will total some £98 million with a further £5 million to fund essential capital works at the MEA.

Capital spending is then planned to reduce to a more sustainable level at around £70 million per annum. To those who say that Government does not support the construction industry I would point out that the proposed capital programme in Jersey for 2007 is £42 million, less than half the size of ours. The fact is that we continue to invest significant amounts in the upgrading of our infrastructure, and at the same time, provide employment opportunities for large numbers of local people.

In respect of Revenue spending, in planning for 2007-8 onwards, Treasury has, a statutory requirement not to budget for a deficit, in other words, we can never spend more than our estimated income. Therefore, we will always base spending plans on what we are relatively sure can be delivered, and not build ongoing spending on one-off, or volatile income sources.

This year, as we move into our new sharing arrangement within the Common Purse Agreement, I believe that it is wise to take a more cautious view as to our levels of indirect income in the short to medium term, and to restrain our spending commitments accordingly.

Gross Expenditure (that is, spending before recognition of Departmental receipts) will grow by nearly £41 million, to a total of £815 million, more than £10,000 for every man, woman and child, resident on the Island. With such significant sums being spent, it is clearly essential that all those in the public sector tasked with spending public money think and act in a financially responsible way. Only then will we see better prioritization, effectiveness and value for money from this huge financial investment into our public services.

Next year, net revenue expenditure will rise to **£538.4** million, an increase of **£16.3** million or **3.1%** in comparison to the current year's estimate. This follows from last year's increase of 8.2% and 7.7% in the previous years.

The increase in Net Revenue expenditure is lower predominately due to the movement of some £7.5 million of income from Income Tax to the Financial Supervision Commission, in respect of the Corporate Charge. Without this adjustment, the rise in expenditure would have been 4.6%, still the lowest for at least a decade.

Mr. President, this represents considerable restraint by my Ministerial colleagues. This is vital as we move forward into a new environment where three quarters of our income will be determined by a new revenue sharing arrangement.

There is no doubt that in areas such as Health and Social Services, financial resources are tight, which emphasises the need to make the best use of those resources. All those who work in this area have a part to play in getting the best value from the taxpayers funding, and I believe that there are some signs that this message is getting through.

The DHSS will receive a 4.5% increase, amounting to over £9 million of net additional funds for 2007-08. Its gross spending budget for 2007-08 will rise by 5.8% or £21.6 million to an estimated £395 million.

I remain concerned about the financial position of the Department, although the Minister for Health and Social Security has already made positive moves in addressing some of the problems. However, it would appear that the DHSS is heading for a further overspend in the current financial year, and that resources will remain scarce well into 2007-8. I wish to put on record my continued support for the Minister and officers of the Department who are working to achieve a balanced budget and Treasury will continue to assist them in their efforts.

There is no doubt that a number of issues are impacting on Health spending, such as medical advancement, but these have not been helped by changes to UK Funding arrangements, that have resulted in increased costs for the DHSS in supporting treatment elsewhere.

The working party into the longer term DHSS funding options has not yet reported. Despite this Treasury have, through the Capital Programme, made £5.5 million available to ensure that key equipment is replaced, and that the Community Care Support Services or Electronic Patients Record System can be implemented, subject to the approval of this Court. It is vital that these capital investments result in a more efficient health service, and that as a result, more resources are made available for patient care, not administration.

From April 2007, the basic pension is to be increased by £3.05 per week to £87.30, with corresponding increases of £1.52 to the pension supplement, amounting to £43.65 per week. This amounts to a £4.57 per week increase for those receiving both payments.

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 £209.40 per week. This payment will be nearly £70 more than the basic pension of £139.60 payable in the United Kingdom.

I have already touched upon the replacement for the Tourism Development Fund. But 2007 also marks the 100th Anniversary of the TT Races. Based upon figures from external sources, we can expect around 50,000 visitors this summer, up around 20,000 on previous years. It is important that the event, with such an international audience, is

deemed a success, and Treasury will continue to work with Departments to identify and make proper provision for the festival.

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 Home Affairs increase at 7.1% represents the cost of the Loan Charges associated with the new prison, which have risen by over £1 million per annum.

The Department of Education increase includes provision for an increase in Employers Superannuation costs of around £1.8m.

There are two specific areas in which I wish us to focus more effort. The Legislative Programme often contains within it hidden costs, and in the past Departments have not been as good as they can be at assessing these implications. I am therefore instigating a financial review of the legislative programme, to be conducted by Treasury alongside next year's budget round.

We can also improve in the use of Government Assets, especially land and buildings. I am therefore instructing officers to conduct a review of the land and buildings in Government ownership as part of the next budget round, to ensure that our portfolio of assets meets our short and long term requirements.

By any standards the Isle of Man is a wealthy country. During my time as Treasury Minister, I have increased the level of our Overseas Aid budget by significant sums year on year. Since 2002, the budget had risen from £300,000 to the current £1.4 million.

Under the Chairmanship of Mr Waft, the Overseas Aid Committee now supports over 90 projects around the world, and I would like to highlight a couple of examples of the work that has been made possible by recent increases. The Committee backed a Christian Aid campaign for clean drinking water in Ethiopia pound for pound, and in response the Manx people raised over £29,000, the highest per-head in the British Isles. As a result over 4,000 people now have access to clean drinking water. The Committee also provided support for education and a proper diet for some 4,000 street children in Kampala, Uganda. Of course there is always more that can be done. For this reason, I propose a further increase of £400,000, or 29%, in the overseas aid budget for 2007-8, to assist those less fortunate than ourselves.

While on the subject of good causes, I can 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.

From December 2006, Island Charities have been able to apply to the distributing bodies in the United Kingdom for lottery grants. Treasury have been negotiating with the Big Lottery Fund to enable a local distribution of their proportion of the good causes funds by the Isle of Man Public Lottery Trust and I remain hopeful of a positive announcement in this regard in the next few months.

The lighting of the MEA Fibre Optic Cable with our partner Boeing is expected to happen this year, as we now are close to being able to sign contracts. This will bring additional competition into the market for large volume broadband transmission, and will benefit business, and ultimately consumers with better or cheaper connectivity.

Whilst mentioning the MEA, I should put on record my appreciation for the work done by the Board and senior management of the organization in improving its financial performance in the last year. Whilst significant amounts of government funding, around £17m, will still be required in 2007-8, this represents a reduction of around £5 million on the budgeted figure for last year, and is well ahead of the projections contained within the plan approved by Tynwald in July 2005. This has been achieved while staying within the pricing policies laid down in that report, and in fact, whilst improving the overall financial situation, the MEA have recently announced the removal of the fuel cost adjustment, lowering prices for consumers by around 9%.

The Island's international profile continues to grow in both traditional and emerging space industries. We now have 4 out of the world's top ten satellite operators incorporated here, including SES, Inmarsat, Sea Launch and Loral. In December last year we saw the launch of the first "Manx Satellite" from Kourou in French Guiana and we have just been told that the International Space University has agreed to establish an International Institute of Space Commerce on the Island. This is further evidence of our growing profile and reputation amongst the space community, supported by our substantial investment in extensive marketing and promotional activity.

We aim to build upon this by introducing a space and telecommunications Bill into the branches which will facilitate the creation of a space register, similar to those previously created for shipping and aircraft.

Mr. President, I will now turn to taxation.

I intend to deal first with the routine changes that we tend to make each year. In saying that, this Court will of course realise that there can be no automatic assumption that tax allowances will rise every year, either in line with inflation or by any other amount.

The rates of tax paid by individuals will remain this year at the standard rate of 10% and the higher rate of 18%.

For the 2007-08 tax year personal allowances will be increased by 2.1% to £8,850 for a resident individual and £17,700 for a married couple. The threshold at which the higher rate of Income Tax becomes payable will remain this year at £10,500 for a single person and £21,000 for a married couple who are jointly assessed.

I am increasing the maximum relief available to individuals in respect of charitable giving by £500 to £6,000 per year.

For companies, the standard rate of 0% and the higher rate of 10% for banking income and income from land and property will remain unchanged. We remain ahead of our counterparts in this regard, and continue to offer one of the most competitive business taxation locations in the world.

The Personal Allowance Credit 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.

Last year, Mr. President, I introduced changes designed to simplify the Personal Allowance Credit system, to make it more widely available and to increase the amount of credit that those people who qualify for it receive. Those changes had a dramatic effect, with the number of Personal Allowance Credit payments rising from 2,800 in December 2005 to 6,600 in December 2006; which represented £1.3 million extra for those people on low incomes.

Honourable Members will be pleased to hear that this year I will commit a further £600,000 to supporting those who are less well off. The Personal Allowance credit maximum will be increased by 20%, or £70, to £420 for a single person and £840 for a jointly assessed married couple. The lower income limit below which a full credit is payable will increase to £6,170 and the upper limit will also rise to £8,670. I am keeping in place the fuel supplement element of the Personal Allowance Credit system, which amounts to £100 of the above figure.

There are also changes to benefits, such as the increase to the Pensioner Premiums in Income Support that will directly assist those on low incomes, and the continuation of the programme of insulation of public sector properties, instigated by the Low Income Group, that was announced last October, at a cost of £600,000 per year. The first 209 properties to receive improved insulation under this initiative have been identified and work is underway that will cut these families fuel bills by up to £200 per annum. Fuel costs have actually reduced recently, with annual fuel cost inflation now running at just over 1%. Recent reductions in MEA charges will assist further, and gas prices will be reduced by 8% with effect from the 1st April.

Whilst we need to keep fuel costs under close scrutiny, the indications are that they are now reducing, albeit not back to the levels seen a few years ago. It is for this reason that we still consider fuel efficiency as the most effective long term solution to reducing household fuel bills.

I have one further announcement to make in respect of Low Incomes. Some members have raised with me the plight of those just outside the benefit system, commonly known as those in the grey area. The Low Incomes Group has been investigating this, and is working on proposals for a variable rate of winter bonus, to be paid to those whose income means that they just miss out on existing support. We anticipate this payment to be in place before next winter, subject to Members' approval.

Climate change is becoming more of a concern with time, and certain features of our taxation system can be framed in ways that encourage "green" behaviour. Company cars are provided as benefits to employees in a number of circumstances, and this benefit is taxed as if it were income on the basis of figures provided by statutory tables. The company car and its fuel are looked at separately for tax purposes. Car benefit rates have not been increased since 1994, and car fuel benefits were last increased in my 2005 Budget.

Mr. President, I am asking the Assessor to review the taxation of company cars and fuel provided for them with a view to shifting the system to one based on environmental impact. This review will be published in due course, and the changes resulting from it will be introduced from 6 April 2008.

There is one measure that I can introduce today though, and that is to exempt Electric Cars provided to employees from all benefit in kind charges.

In addition I am announcing that there will be a supplementary rebate of 2.2 pence per litre in the rate of duty applicable to Bio-Diesel, used in the Isle of Man, the maximum permissible under the Customs agreement.

Finally, we need to encourage more use of public or shared transport. I have therefore asked the Assessor to progress the introduction of a scheme whereby no taxable benefit in kind is levied on employees who are provided by their employer with free bus or coach transport to and from a regular place of work. It is hoped that employers will take part in such an initiative, and that, as a result, more people will use public transport to get to and from work, reducing traffic flows and helping the environment.

We cannot neglect our wider responsibilities to all members of society, and the environment, and the changes that I have announced reflect those responsibilities.

Mr. President I stated to this Court in my 2006 Budget that I intended to change the way that we give tax interest relief for property purchases.

There is no simple way to treat separately mortgage interest from other interest, and so the two relief's need to be considered as one. It has also been important to ensure that any changes do not disadvantage ordinary people buying their homes, and do not have a negative impact on the property or mortgage and loans sectors. I do not intend to move away in this Budget from the wider principle of giving tax relief for interest paid on personal loans for non-property assets as it plays an important role in maintaining a strong retail market. Similarly, what I am about to say has no bearing on how business people claim interest as a business expense: that system will be unchanged.

Honourable Members will wish me to introduce any changes on the basis of fairness and simplicity, but also with some time delay to enable any people affected by them to prepare. Accordingly, from 6 April 2008 I will introduce a general limit on the amount of interest that can be deducted from a person's income for tax purposes. That limit will be £15,000 of interest for a single person and £30,000 for a jointly assessed married

couple. At a rate of 6%, this would equate to total debt of around £250,000 for a single person, and £500,000 for a couple, well above levels that I hope Honourable Members would accept as affordable for the vast majority of taxpayers.

Mr. President, in my 2006 Budget I reviewed how powerful the publication of our updated taxation strategy in 2002 had been. That strategy showed our forward planning, commitment to Manx business and international bodies and our skill in managing the national budget. I also indicated last year that we ought to strive to have some key forward-looking aspects of a new taxation strategy agreed by this Court after the election.

The main part of the 2002 strategy focused on company taxation. It was all delivered on time and very professionally and has given stability to our economy and those businesses within it at the same time as creating a dynamic environment for future growth.

There is not a lot more that I can do for companies after taking most of them out of the tax system!

We need now to look at individual taxation, and a key element that I want to move forward with is pensions. I am releasing publicly today Treasury's response to the consultation on pensions that was carried out last year.

The Isle of Man has historically been a thrifty nation, with both the Government and the people being averse to debt and keen on saving. Honourable Members also know that we have a well-regulated financial system here that gives enormous protection and confidence to investors of any type. Taking all of these factors into consideration, I feel that we ought to liberalise how we tax the money and assets that people are able to put aside for retirement or ill health.

Mr. President, our current system allows people tax relief on pension contributions, tax free growth of their pension funds, a tax free lump sum once the pension starts and taxation of the pension thereafter. The system is, however, hedged around with all sorts of limitations and it is these limitations that I am convinced have now become over-restrictive and long overdue for an overhaul.

The pensions consultation produced a large number of sensible and well-argued proposals, many of which I agree with. We need to provide Manx residents with the opportunity to put aside small and large amounts for their retirement in a tax-efficient way. We need to be flexible about what can be given this tax-efficient treatment. We should not force people to acquire annuities when a pension kicks in if that type of product is at historically low yields. Moreover, we should allow the funds that people build up to pass on to their loved ones if they die before drawing the full benefits.

Rather than go into drawn-out technical detail today, Mr. President, which I am sure that this Court would not thank me for, I will give an assurance that a pension taxation bill will be introduced in the Keys shortly. That bill will be designed explicitly to bring our

system for the taxation of savings for retirement and ill health into the twenty-first century, and its provisions will be open to wide consultation in order to ensure that the new modern system is as good as it can be. I believe that the best way to ensure a future for local private pension provision, following the decision of Norwich Union to pull out of pension provision in the Crown Dependencies, is to create a business climate where the taxation of pensions is flexible and competitive. This will reduce the regulatory burden that I understand was a contributory factor in this decision.

Mr. President, whilst discussing taxation matters, I would like to update this Court on the personal tax cap that was introduced last year. There has been a lot of interest in this simple, innovative and competitive policy that was designed to attract wealthy entrepreneurs to the Island. For reasons of taxpayer confidentiality, I am not at liberty to go into detail, but I can report that people have already moved to the Isle of Man as a result of the tax cap, that more people have signalled their intention to move here and that the policy has therefore proved itself a useful addition to the range of attractive features that the Isle of Man offers to potential residents that will develop our economy.

I do not intend to change the level of the tax cap this year, and so it will remain at £100,000 for individuals and £200,000 for married couples.

Mr. President, in my Budget last year I discussed the concept of a corporate tax cap. Some might ask why we are proposing special treatment for our banks. The answer is simple, that they represent our principal corporate tax payers, and as such their success will generate additional revenues for Government.

There is no doubt that a cap on company tax liabilities would be as attractive and competitive as the personal tax cap. I do not doubt that it would attract more business to the Island. However, there may be other ways to assist our banking sector and therefore I have asked the Assessor of Income Tax to liaise with the Association of Licensed Banks and to incorporate any agreed recommendations into a revised Taxation Strategy, with the intention of bringing such a Strategy to this Honourable Court by October of 2007. This will include a review of the whole of the implementation to date of current Taxation Strategy, to ascertain the extent to which it met its original objectives and to make recommendations for future changes if it felt appropriate.

Before concluding I have two further matters to cover.

I have asked the Assessor to review the operation of the Distributable Profits Charge. Honourable Members will recall that this measure was designed to limit the potential for people living in the Isle of Man to defer the payment of tax on their income by lodging it in a company taxed at the zero rate of tax. After consultation, Treasury decided that in cases where the charge was triggered, it would be settled by the company rather than the shareholders. Although I am content that the Distributable Profits Charge system is appropriate and fair, I am aware of concerns expressed about it. As such, it is only right that we take a careful look again at the Distributable Profits Charge and deal with any resulting issues.

The second matter relates to the Corporate Charge. Following comments from the Corporate Service Providers industry, that it would be more convenient and cost-effective for them and their clients if companies could pay the Corporate Charge at the same time as filing their Annual Return under the Companies Acts, Treasury reviewed the situation. The review concluded that such a change would simplify administration not only for the companies concerned, but also for Government, the only impact being that the charge would need to be collected by the FSC, and not by the Income Tax Division. It has therefore been decided that the Corporate Charge in its current form will be abolished, and replaced by a new Annual Return filing fee of £320, made up of the current filing fee of £70, and the current Corporate Charge of £250. There will be no increase in the overall amount charged.

Mr. President,

This Budget marks a watershed in the development of the economy of the Isle of Man.

The last five years have been a period of real achievement.

We have achieved success in creating one of the fastest growing economies in Europe; success in resolving the immediate threats from the E.U. and the OECD which could have seriously damaged the Island. And success in growing our revenues to ensure the continued provision of high quality public services for our people.

However, now more than ever we must guard against complacency. As we look forward there are fresh challenges waiting to confront the Island every bit as testing as those we have so recently combated.

The theme of this year's Budget is securing the future.

The renegotiation of the Customs Sharing Agreement is a vital first step towards that goal. This will give us a more secure Agreement and a more predictable flow of future tax revenues. In removing revenue volatility, our future success will depend on economic growth and I have established over £30million in various funds to stimulate future expansion.

The challenge now is for our business community to wake up from any collective complacency and rise to the opportunities we have created.

I am very confident of the Island maintaining its outstanding success in the time ahead. Nevertheless I also believe that we need to display a more cautious approach to our spending commitments during the transitional period to avoid overstretching ourselves.

This will challenge both Tynwald and in particular the Civil Service and its culture, to streamline Government services to ensure that the taxpayer gets the very best value for money from all of our investments. Improving efficiency here will release existing money to be redirected into essential front line services.

Above all whilst confronting these new challenges and opportunities which lie ahead we must reassure those more vulnerable members of our society that they are not forgotten and maintain and expand our support for them.

Mr President, I will conclude my remarks by thanking my current and former colleagues in the Treasury, Mr George Waft MLC, Mr Adrian Earnshaw MHK, and Mr Eddie Teare MHK, and more recently Mr Alex Downie MLC and Mr Phil Braidwood MHK for their help and support throughout this challenging year. I would also like to thank my colleagues in the Council of Ministers and indeed Members of Departments for their cooperation and understanding in constructing this Budget.

In particular I would like to thank my key Treasury officers, the Chief Secretary and the Attorney General for the huge amount of work which has been put in to secure our new Agreement without which we may well have been considering a very different Budget this year.

Today's Budget is a first step along this new road towards securing the future. I hope Honourable Members will recognise the need this year to take a longer term view of the way ahead and join me on this journey, build on our success and give their support to the Budget today.

Mr. President, I commend the 2007 Budget to Honourable Members.

**Hon. A. R. Bell, M.H.K.,
Minister for the Treasury
20th March 2007**