# The 2021-22 IoM Government Budget – An Opinion

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## 1 Budget Backdrop and High-Level Observations

The global backdrop to the 2021-22 Manx Budget has been one of great global turbulence and change - most of it brought about by the first year of the Covid-19 Pandemic. This Government, as is the case for most other governments around the world, is continuously grappling with the consequences of this global health and economic crisis. The IoM Government 2021-22 Financial Year (FY) Budget makes it clear that this Pandemic is having a significant ongoing impact on IoM Government finances.
Fortuitously, when the Pandemic arrived here in March 2020, the IoM Government’s finances were in relatively strong position. For example, the latest round of FERSA (VAT) discussions had been successfully concluded with the HRMC and the total market value of the Reserves was strong. This ‘strength’ means that the IoM Government’s finances will be able to withstand significant cashflow deficits for a number of years, unlike in the UK, where its Government will borrow £355b (17% of GDP) in the current financial year and even more in the next few years.

The IoM Treasury seems to be reacting to the Covid-19 Pandemic in a similar way that one might expect them to respond if the Island had been hit by a devastating storm or earthquake. I.e.: they appear to be treating this (Covid) situation as if it was a one-off crisis that had happened and would not keep happening. After the crisis was over, the Government would provide financial and other rebuilding support. But that is not the way things are with Covid. The Covid-19 Pandemic is not a limited one-off event, it is an evolving ongoing event. Even after the entire population of the Island has been vaccinated, Covid will not have been totally and permanently eliminated from the Island and we will still have to keep finding ways of coping with the consequences of inevitable ongoing infections.

It is evident from the 2021-22 Budget that the Covid-19 Pandemic has thrown the IoM Government 5-year plan meaningfully ‘off course’. However, the Budget makes very few references to what the Government expects the future impact of Covid-19 will be on Government finances in the next few years. This omission is probably the primary limitation of this Budget.

Rightly or wrongly, it seems that very little forward-looking (Covid-inclusive) econometric modelling was done in preparation of the Budget. Similarly, it seems that the Treasury does not appear to have a current and comprehensive ‘Strategic Plan’. Instead of the Budget being a set of ‘harmonized’ numbers, built around a comprehensive plan, almost all of the main figures appear to be either projections of past trends, or a reflection of the assumption that the IoM economy will shortly return to something approximating the ‘old normal’. It is therefore not unreasonable to conclude that the declared FY 2021-22 surplus of £219k, and indeed the Budget as a whole, may be little more than ‘optimistic’ goals.

2 IoM Treasury’s 2021-22 Manx Budget Headlines

The following graphic contains the Treasury’s view of their 2021-22 Budget’s Headlines.

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1 As far as we are aware, there is no legislative requirement for the IoM Government to budget for a surplus; budgeting for a surplus is merely a long-standing ‘mutually agreed’ convention.
3 Some General Issues

3.1 The Financial Impact of the Covid-19 Pandemic

As part of the 2021-22 Budget, the Treasury gave an update on the expected impact of the Pandemic on Government finances in FY 2020-21. The total impact is projected to be £208m:

- £74m reduction in Revenues (including a 10% impact on VAT)
- £53m draw from Contingency
- £71m draw from the NI Fund (Support Schemes)
- £10m draw from the Economic Recovery Fund

Presumably the bulk of these costs arose from the first two lockdowns (12 weeks then 3 weeks). However, the current (third) lockdown (assume 4 weeks in 2020-21) was not anticipated and was therefore not included in the Budget. Assuming that on ‘average’, a lockdown costs the IoM Government about £7m per week, then the actual total Covid-related costs in 2020-21 will be approximately £21m greater than the Budget forecast of £208m.

Furthermore, the Budget does not appear to make any specific allowances for any reductions in Revenue or any increases in costs due to Covid-lockdowns and border closures in FY 2021-22. Treasury seems to be assuming that there will be no Covid-19 lockdowns in 2021-22. By contrast, in early March 2021, the Department for Enterprise released a theoretical ‘exit strategy’ which it hopes will guide the Island out of the current Covid restrictions. Even though their strategy is imprecise, it does envisage that the current lockdown will be lifted sometime during April 2021, and also that the largely ‘closed borders’ policy will stay in place until about September 2021. On reflection, it seems that it would have been prudent to assume within the 2021-22 Budget, that at least one lockdown of a similar duration (3 to 6 weeks) would occur in 2021-22, and to estimate the costs of that.

3.2 The Budgeted Surplus for FY 2021-22 is Optimistic

The budgeted 2021-22 surplus of £219k has been partially enabled by transfers of £84.046m from the Reserves. If these transfer amounts were excluded, then the declared surplus would have been a deficit of £83.827m.

The surplus was also enabled by a set of optimistic Revenue numbers. It seems that total Revenues are about £30 to £50m higher than a more conservative assessment of the likely Covid-suppressed economy would appear to justify (Refer to Section 4 below).

If a different approach had been taken to constructing this Budget, the net ‘bottom line’ could have been a deficit of circa £130m, and not the declared surplus of £219k.

3.3 A ‘Provisional’ Budget

The Budget Pink Book uses the term ‘Provisional Budget 2021-22’ on multiple occasions. This (easy to overlook) qualification could potentially indicate that the Treasury is itself uncertain about the financial outlook for 2021-22, and is thereby signalling that they intend to issue a ‘final’ Budget later in the financial year.

3.4 Inflation

None of the references to Inflation in the 2021-22 Budget are forward looking. All ‘Inflation’ linked increases are small and/or relate to historical rates and existing conventions.

Examples:
- The Budget assumes that pay rises will be capped at 1.0%
- Departmental ‘non-pay’ items are assumed to increase by 0.7%
- There are two provisions for increased benefit payments. The benefits linked to UK CPI will rise by 0.5%, and those linked to IOM CPI will rise by 0.0% (no change)
- The Manx State Pension and the Basic State Pension will be increased at the faster rate of 2.5% (the Triple Lock Agreement)

Should the expectations of Bank of England that UK (and by inference the IoM) CPI will rise during 2021 eventuate, then some of these Budget assumptions could become at ‘risk’.
- Public servants will likely ask for pay rises that are greater than the budgeted 1.0%
- The cost of ‘non-pay’ items to Government departments will be above the budgeted 0.7%
- The cost of providing public servant pensions and benefits could increase sharply, especially in later years

4 Revenues

Many of the key numbers, especially those on the Revenue side, appear to be what one could reasonably describe as optimistic numbers. The Treasury Minister said that this Budget included, “Strong income growth assumptions for taxation revenue post pandemic reflecting confidence in our economy”. What was missing from this statement is any justification for these strong assumptions. The Treasury’s (strong) expectations for Revenues are:

<table>
<thead>
<tr>
<th>ANALYSIS OF TREASURY INCOME</th>
<th>Budget 2021-22</th>
<th>Ind. Plan 2022-23</th>
<th>Ind. Plan 2023-24</th>
</tr>
</thead>
<tbody>
<tr>
<td>CUSTOMS &amp; EXCISE</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>V.A.T.</td>
<td>£324,099</td>
<td>£247,693</td>
<td>44</td>
</tr>
<tr>
<td>Duty</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Duty</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>INCOME TAX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Resident Income Tax</td>
<td>£193,062</td>
<td>£215,609</td>
<td>21</td>
</tr>
<tr>
<td>Company Tax</td>
<td>£14,800</td>
<td>£15,900</td>
<td>2</td>
</tr>
<tr>
<td>Non-Resident Tax</td>
<td>£26,000</td>
<td>£21,100</td>
<td>5</td>
</tr>
<tr>
<td>TOTAL INCOME TAX</td>
<td>£226,762</td>
<td>£232,609</td>
<td>26</td>
</tr>
<tr>
<td>NT OPERATING ACCOUNT</td>
<td>£277,236</td>
<td>£262,781</td>
<td>28</td>
</tr>
<tr>
<td>OTHER TREASURY INCOME</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fine</td>
<td>£750</td>
<td>£759</td>
<td>4</td>
</tr>
<tr>
<td>Interest on Investments</td>
<td>£5,270</td>
<td>£5,392</td>
<td>1</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>£3,649</td>
<td>£1,655</td>
<td>5</td>
</tr>
<tr>
<td>TOTAL OTHER TREASURY INCOME</td>
<td>£9,860</td>
<td>£7,209</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>£522,867</td>
<td>£970,281</td>
<td>1.00</td>
</tr>
</tbody>
</table>

The following are three examples of where the 2021-22 Budget figures appear to be quite optimistic.

4.1 VAT

The projected VAT figure for 2020-21 is £272m, which is £25m below the Original Budget (£297m). The projected VAT figure for 2021-22 is £324m, which is £52m (19%) higher than the projected figure of £272m for 2020-21.

If the IoM external borders remain largely closed until, as expected, September 2021, then the IoM economy is likely to perform in 2021-22 similarly to how it did in 2020-21, not a ‘normal’ year by any stretch of imagination. Therefore, it seems that the actual VAT results for FY 2021-22 will more likely be closer to the 2020-21 figure (£272m), than they are to the FY 2021-22 budgeted figure of £324m.
4.2 Air Passenger Duty

In 2020-21 the Revenue Income from Air Passenger Duty collapsed from £5.5m to £450k. The Budget assumes that it will jump back to £5.5m in 2021-22. Because a return in FY 2021-22 to the full former flight schedules seems unrealistic, the budgeted figure of £5.5m seems equally unrealistic.

4.3 Miscellaneous Income

The Budget has an expectation of £3.84m Miscellaneous Income in FY 2021-22. As no details have been provided to support this figure, it may be too optimistic.

5 Selected Expenditure Items

The following table sets out the Budget’s figures for two important expenditure items.

<table>
<thead>
<tr>
<th></th>
<th>Actual 2019-20</th>
<th>Budget 2020-21</th>
<th>Probable 2020-21</th>
<th>Provisional Budget 2021-22</th>
</tr>
</thead>
<tbody>
<tr>
<td>NI Funded Payments</td>
<td>251,251</td>
<td>257,139</td>
<td>323,156</td>
<td>263,034</td>
</tr>
<tr>
<td>Transfer from the PSEPR</td>
<td>(32,014)</td>
<td>(36,336)</td>
<td>(38,468)</td>
<td>(36,348)</td>
</tr>
</tbody>
</table>

5.1 NI Funded Payments

This Budget includes an estimate that in 2020-21 the probable NI Funded Payments will be £323m, £66m higher than the Original Budget of £257m. This ‘overspend’ approximates the amount (£71m) that will be taken from the NI Investment Fund during FY 2020-21 to pay for salary/ income support programs, which were necessitated by the Pandemic. The budgeted NI Funded Payments figure for FY 2021-22 is £263m, £60m less than the probable 2020-21 figure. However, if the current lockdown continues into FY 2021-22 (something that looks highly likely), and if there are no more Covid lockdowns in that financial year, then the 2021-22 NI Funded Payments figure could become higher than the budgeted £263m. Any additional lockdowns will, of course, result in the 2021-22 NI Funded Payments figure being even higher, provided the Treasury continues with their salary/ income support programs.

5.2 PSEP Reserve Annual Deficits

The PSEP Reserve Account is forecast to be fully depleted sometime during 2022-23. There are currently no special plans to fund the annual PSEP deficits after that date. The only conclusion one can reasonably come to is that the Treasury is anticipating that, post FY 2022-23, these annual deficits will be paid for out of higher Revenues, and failing that, by withdrawing money from the General Reserve Account. It seems that, unless there is a significant recovery in the IoM economy between now and then, the funding of all future PSEP deficits will, one way or another, put pressure on all other Government spending.
6 Other Issues

6.1 The Economic Recovery Fund/ Economic Recovery Group

Over and above the costs associated with the support programs that help manage the ongoing impacts of Covid-19 on the IoM economy, the Government has established an Economic Recovery Fund and also the Economic Recovery Group. Both of these are off to a very slow start. Of the total £100m that the Government set aside to ‘recover’ the Island’s economy, only £10m was budgeted to be transferred to the Economic Recovery Fund in 2020-21, and it appears that just £3m will be spent. None of the initiatives announced so far are what one might describe as large or strategic.

A further £30m is to be transferred to the Economic Recovery Fund in the FY 2021-22. The slowness of implementation and lack of substance to date suggest that the Economic Recovery Fund/ Economic Recovery Group will not have much impact on the IoM economy any time soon.

6.2 Skilled Labour Shortages

In the Budget there is no mention about the current skilled labour shortages and the additional costs that are likely to flow from this. One of the background reasons for this shortage of skilled labour is that ‘non-British’ skilled workers are being prevented from entering the UK due to a combination of Brexit and Covid-19 restrictions.

Anecdotally, it appears that skilled labour shortages are occurring across economy; especially in the construction industry and the medical sector. Two examples of how current labour shortages are impacting the IoM economy:

- Dandara has recently returned deposits to some of its customers who wanted to purchase new properties in phases 2 and 3 of the Ballasalla Estate project. They announced that they have done this because of the additional costs of materials and difficulty to hire sufficient numbers of workers. It seems that, although Dandara have cancelled the contracts which they had with customers, they will continue to build phase 2 of this project, as resources permit, and will at a later time re-offer these properties for sale. Presumably, if property prices continue to rise as they have been recently, Dandara will be able to re-offer these same properties at higher prices than in the original contracts. This remains to be seen.

- The GP partners (Snaefell Surgery in Anagh Coar, South Douglas) are in the process of renegotiating (perhaps even terminating) their contract with the Government, citing ‘wholly insufficient’ funding. This is the second GP surgery in just 12 months that has announced its closure. The issue seems to have arisen from a combination of ‘DHSC Funding’ and also the inability to recruit suitable medical staff from abroad.

Both of these examples imply that higher Inflation is already here in certain parts of the IoM economy, and therefore is impacting upon ‘budgets’ in both the private and public sectors.

6.3 Possible Black Listing by the EU

There was no direct mention in either the Budget Pink Book or in the Treasury Minister’s speech of how the possible EU ‘Black listing’ of the Island, should this happen, would impact Government finances. It seems that if the Island is to avoid blacklisting, it will need to increase the corporate tax rate to a minimum of 10%. The Treasury Minister may have
indicated how he personally feels about this issue when he said in his speech, “Now is not the time to put up taxes.”

6.4 Capital Programs

This Budget allows for a £182m to be spent on capital programs in 2021-22, but only £82.1m of which is expected to be actually spent in that financial year. However, the apparent shortage of suitably skilled workers on the Island, together with higher input costs, will make it difficult for the Government to deliver even those already scheduled projects.

6.5 Issuance of an IoM Government Bond

The Budget states that Government has taken measures to the “Investigation of options available to raise funds through a sovereign bond issue.” If Government finances are going to have a cashflow deficit in each of the next few years, it might be opportune for the Government to issue an IoM Government Bond soon, especially as it seems that globally the interest rates on other Governments’ Bonds are beginning to rise.

7 Conclusions

1. The Covid-19 crisis is having and will continue to have a significant ongoing negative impact on IoM Government finances;
2. Right now, IoM Government finances are in a good place, especially when compared to the situation facing the UK Government;
3. The 2021-22 Budget did not anticipate the current lockdown and does not include any specific estimates for the impact of Covid-19 on FY 2021-22 Revenues and Expenditures. Therefore, some of the budgeted Revenue figures for FY 2021-22 appear to be too optimistic;
4. The impact of rising Inflation on Government finances is likely to be greater than budgeted for;
5. The 2021-22 Budget is a provisional Budget, a holding Budget, which will likely be ‘adjusted’ by the next Administration later in 2021;
6. The Economic Recovery Fund will not have much impact on the IoM economy any time soon;
7. Other issues like a shortage of skilled workers may present ongoing challenges to the IoM economy;
8. Now might be an ideal time for the IoM Government to issue a Sovereign Bond.
‘If you wear it like this you can’t see any’