

## 2010 Budget - A triumph of creative accounting, more 'spin' than substance

Written by Chris Blyth

Monday, 22 February 2010 23:52

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There is, of course, no “right answer” as regards economic policy and the making of a budget. There are any number of variations on the theme which can be valid, depending on one’s political stance, the exigencies of the situation, and the time-frame applicable. Mr Bell’s latest budget has apparently been greeted enthusiastically by many as “right for the times” now facing the Isle of Man.

The alternative view, however, is that Mr Bell’s budget is a major missed opportunity, and a very weak and indecisive response to the serious situation which we face. It has all the hallmarks of “spin” rather than substance, of a lack-lustre government unwilling to face its responsibilities, and of taking the face-saving “easy options” rather than the honest and perhaps more difficult decisions that are required for the long-term,

There is also a deep-seated suspicion that this is the precursor budget in the long run-up to a general election next year, and that it has accordingly been tailored to cause the least upset, and to be as “customer friendly” as it can be – and to aid the re-election of a dysfunctional government, headed by a Chief Minister, short on leadership, and lacking any vision for the sort of society to which we should be aspiring over the next 20/30 years, intent only on its own re-election.

There is a clear and explicit hope that the private sector will provide the “engine of growth” to put the economy back on track, and enable the public sector to escape relatively unscathed from the economic strictures resulting from the credit crunch, and the VAT revenue sharing difficulties. There is also an unstated hope (if not expectation) that an incoming government in UK in Summer 2010 will raise VAT to 20% (and automatically increase our tax revenue receipts) – and thus “rescue” the income side of the manx accounts.

The announcements by Mr Bell were therefore predictable – taking measures which meet the “balanced budget” target, but without the radical action and rigour that the economy really needs. Our performance in the current year (2009/10) is already disappointing – budgeted to produce a modest surplus of just £200,000 (on a budget approaching £600million), we are actually expected to end up with a deficit of more than £24 million. This outcome was (or should have been) predictable, given the reduction in the VAT rate from 17.5% to 15%, and the very weak state of the retail market throughout the year. However, our Treasury failed to read the situation, or to react to it (allowing public sector headcount to increase, and expenses to rise etc), and necessitating the shortfall to be made up from the reserves. So much for forecasting accuracy and Treasury rigour!!

### For the years ahead, the key events of the 2010 Budget include :

1. **Appropriations from the reserves** – worth £15million in the 2010/11 Financial Year, and a total appropriation of £114million over the next 5 years. Yes, the reserves are there as a contingency for a short-term “rainy day”. Our government, however, seems intent on using the reserves as a structural adjustment for the medium term –with a major reduction in the reserves by 2014 - which, it must be suggested, is NOT the appropriate answer for a “prudent” Treasury Minister.

2. **Raising the higher rate of income tax from 18% to 20%** - with small adjustments to personal allowances – is uncontroversial and was widely expected, given the economic circumstances we face. The relatively minor adjustment to the “tax cap”, from £100,000 to £115,000 is perhaps rather more contentious, and could have been significantly higher, without damaging the intent of attracting “higher net worth individuals”.

3. **Changing the “accounting rate” for capital projects** in the public sector (from 3.25% to 0%) – allegedly saving £19 million per year – is pure “creative accounting”, “smoke and mirrors” which appear to make a very significant impact on the savings necessary, but which impacts quite adversely on the funding of the capital budget for future years. It is to be noted this repeats the action taken in the 2008/9 Budget when the rate was reduced from 6.25% to the current 3.25%, which again allegedly saved another £17million per year. The same financial “three card trick” applies to the revised repayment period on some capital schemes – taking longer to pay, and thus reducing the annual charges applicable.

4. **The creation of a Dept of Economic Development** is clearly intended to encourage growth in the private sector, and provide the employment opportunities (and associated tax revenues) to generate growth in the economy generally, and thus allow continued funding for our public sector. However, this is a major gamble – there is great uncertainty and a very hesitant recovery in European economies, UK manufacturing has suffered a 10% cut in output in 2009, there are very serious difficulties facing the banking sector in the re-building of their balance sheets and in the provision of ongoing credit facilities to the private sector, there is the massive debt burden overhanging the UK (in particular), and the consensus forecast is that it will be 2014 before most European economies get back to 2008 activity levels. Is it worth the gamble? Probably – but the government should acknowledge that it is unlikely to produce the returns in the short to medium-term required to avoid the need to cut the public sector significantly more than the current projections appear to assume..... and the absence of any meaningful Budget measures (such as increased grants, subsidies and other assistance) is unlikely to provide the favourable environment necessary to encourage the private sector.

5. **The announcement of a “pay freeze”** for the public sector has been long overdue – and the reaction from one union spokesperson (Mr Moffatt) expressing unhappiness with the announcement was pure grandstanding, since he must have been well aware of its near certainty. Now Mr Bell just needs the courage to extend the pay freeze to at least three years – but given that next year includes a general election, one suspects that this will not happen.....

though the Pink Book assumes no salary increases for the two years 2010 and 2011!

**6. The cut to date in government headcount of just 99 heads**, achieved through “natural wastage”, though laudable, is unimpressive and also just plain dishonest – these were unfilled vacancies or retirements. What is required is a clear and unambiguous statement of intent as regards our excessively large public sector headcount – and an explicit objective to reduce it substantially, from the 8200 currently to perhaps no more than 7000 over the next three years, thus making a very significant contribution to the savings necessary to balance the government’s books. The absence of specific plans to ensure the necessary headcount cuts is disingenuous – the workforce and the taxpaying public deserve better from this government.

### **The Budget was also notable for some significant omissions.**

1. The government missed a very obvious opportunity to address the **public sector pensions liability** – costing a total of £44 million this year (increasing to £52 million in 2010/11, but funded by employee contributions of only £12million – meaning the taxpayer is paying £32 million this year as the employer contribution and “top up” (and going up to £40 million next year). The Pensions Reserve Fund (now valued at £230 million at end 2009), but with a total liability for public sector pensions (estimated by Treasury at £1,380 million) leaves a major gap for the taxpayer to fund..... and one hopes (but doubts in this instance, given reduced interest rates and lower returns on investments) that the Treasury estimate is accurate! At the very least, the government should have announced the closure of the final salary scheme to any new entrants to the public sector – with minimal impact in the short term, given the “headcount restraint” programme now in place. A determined approach is now urgently required to resolve this growing problem – it cannot be allowed to drift.

2. **The Budget contained no consideration for the wider issues relating to our rapidly ageing population** – with ever more expensive expectations and requirements for health care and pensions – but nothing has been said or introduced which shows this government has given proper evaluation of just how to extract increased “value for money” from this issue. The splitting of the DHSS into the two new Departments (for Health, and for Social Security) is sensible, but both will struggle (and almost certainly fail) to live within their allocated budgets, given the growth in numbers of “senior citizens”, and their health needs, and given the sheer size and extent of our welfare benefit entitlements. Will we see the introduction of means testing and end of some benefits being on a “universal” basis – almost certainly, but not yet (cynically, probably waiting until after the general election)? Given the impending pensions and benefits crisis, Mr Bell might also have considered introducing some measures to encourage long-term savings plans, or private pension provision – to reduce the dependence culture rapidly overtaking the government’s ability to continue.

3. Our Chief Minister has made clear his (and his government’s) unwillingness to change **the status of our various “Statutory Boards”**

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– and again, this is just not acceptable in our current economic difficulties. For example, the buses and trains are losing £10 million per year, the airport is costing £6.5 million per year, whilst the Post Office contributes less than £2 million per year. A more commercial approach is urgently required, and a dismissal of the opportunity – aired in the Scope and Structure of Government Report but recently rejected by the Council of Ministers – is inflexible and unrealistic.

4. **Some “green measures”**, such as increased grants to encourage better home insulation, or the fitment of solar panels, aimed at reducing our carbon footprint and energy consumption, would also have been helpful, and at relatively modest cost.

So, overall, a very disappointing budget, loaded with “spin” rather than substance, some modest tax rises but a major raid on the reserves, aimed at minimum disruption to the “status quo”, and delaying the measures necessary to re-structure our public services – and thus maximizing the government’s re-electability. Also disappointing was the lack of serious questioning by members of Tynwald of the Budget, particularly given the imminent re-structuring of departments and our financial difficulties – but the [block vote system](#), whereby most MHK’s owe their income to the patronage of the Chief Minister, then ensures the necessary vote in Tynwald – and the ship of government moves on. Roll on the General Election !

Chris Blyth