

“MEETING THE CHALLENGE”

Introduction

Mr President,

I am sure that all Honourable Members, and indeed our community generally appreciate the wholly exceptional circumstances within which we have had to produce a balanced Budget today.

The downturn in the world economy and the consequent turmoil in the banking industry would have stretched us at any time, but the additional pressures created by the unilateral revision of the revenue sharing arrangement within the Customs and Excise Agreement and the need to respond in such a short time to the significant reduction in income resulting from that action, have all combined to create the most unprecedented challenge we have faced in living memory.

That challenge has been heightened in many ways because of the success the Island has enjoyed in recent times, with 26 years of unbroken economic growth, record levels of investment in our public services and infrastructure, a long period of low unemployment and a steady growth in Government's income.

So it is important to remember that my Budget today and the actions being taken reflect only the first steps towards the comprehensive rebalancing of Government finances and priorities which are needed to ensure stability and the protection of our key public services and competitive economic position in the medium to long term.

As Treasury Minister it gives me no pleasure in having to ask for Tynwald to give support to measures which may prove unpopular in the short term to achieve long term gain.

This Budget is the start of a necessary process to identify a sustainable structure and size of Government appropriate to our new financial environment, which will involve a rigorous focus on delivering real and ongoing efficiency improvements and cost reductions, alongside the development of new revenue streams.

The first steps in shaping that future have already been announced by the Chief Minister. Four key work streams, our primary focus, plus a further two related work streams have been established. These are:-

Economic development
Taxation
Budget rebalancing and
International relations

supported by work on communication and industrial relations.

Each work stream has a clear political and officer accountability, reporting to a sub-committee of the Council of Ministers, consisting of the Chief Minister, Minister for Trade and Industry, and myself.

Each work stream has, or is developing, the necessary objectives and action plans, further details of which will be forthcoming in the months ahead.

In respect of the budget rebalancing work stream, we have sought to understand the implications of the options before us in meeting the fiscal challenges in the years ahead. There have been a number of dimensions to this.

Firstly there has been the local economic dimension. Clearly we have sought to protect local jobs, local employment, and local spending, in preference to spending large sums elsewhere.

Secondly there has been the international dimension. The world is changing rapidly around us. That presents threats but also opportunities and we need to frame a budget that reflects this changing reality.

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Thirdly there has been the personal dimension. The aggregate impact of all the changes on different groups has had to be understood, as we have sought to maintain a fair system of taxation that protects the most vulnerable in society.

Finally we have been working to show a credible plan for making the transition to a lower level of indirect taxation receipts, both for internal and external audiences.

For 2010-11 our Indirect tax receipts will be £85 million lower. From 2011-12 onwards we have anticipated reduced income of around £140 million per year.

So how have we gone about this meeting these shortfalls ?

There were four options available.

Firstly we could reduce annual government spending.

Secondly we could raise taxes or charges.

Thirdly we could reduce our capital spending, and require less money to be provided for this from our annual revenue budget.

Finally we could use our reserves, at least in the short term.

We have chosen a combination of all these options and the Pink Book shows how this mix of measures will be implemented, year by year over the next 5 years.

In respect of Taxes and Charges we have balanced the need for more revenue with the need to remain competitive. We have also sought to raise the majority of the burden of increased taxation in the first year. Taxes and Charges will increase by £20 million in 2010-11 with a further £7 million required next year.

In respect of Capital Spending, we will transfer £24 million less into the Capital Fund in 2011-2012 and will reduce Capital Spending by around £11 million. By the end of the five year

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period, we will have found £59 million of the £140 million annual shortfall from lower transfers to the Capital Account, but we will still have a Capital Programme during this period that is, excluding the major off-island contracts, of a similar size to that achieved in the last five years.

Over the 5 year period, our use of reserves will cost in total around £114 million, one third of the value of the Reserve Fund, or 7% of total reserves. £15 million will be used in 2010-11, rising to a peak of £43 million in 2012-13. By the end of the five year period, we will not be using reserves to finance ongoing spending commitments.

Finally then there are Revenue savings. These will develop over the five year period as we implement a programme of savings. For next year, some £26 million has been saved, along with around 100 posts across Government. This has been achieved so far, without the need for redundancies. Of this £26 million however, only £16 million is sustainable in the long term, the rest relating to deferred replacement of equipment, or use of reserves for ongoing spending commitments.

By 2011-12 we will need to have found a further £24 million of savings, in order to achieve the next target of £40 million. By the end of Year five £49 million will be required. If we can reduce our staffing costs by 10% over this period then this will realise £30 million per annum, sixty per cent of the target. To do this will require significant restructuring including areas such as provision of shared services, one stop shops and better property management, and will require a period without annual pay rises. It will also require a critical and rigorous look at what services Government continues to provide, and how they are provided.

Work in all these areas has begun, and will intensify during 2010-11. As they develop our plans must be flexible enough to adapt to changing circumstances. Any number of external influences could cause them to be rewritten, and as indicated earlier, we must be aware that significant uncertainties remain, and are likely to persist, through much of the transitional period.

Which brings me to the **economic background** to today's Budget.

There are signs of recovery in the world's leading economies after a worldwide slowdown. The IMF is forecasting an increase in world trade and investment flows of 2% this year compared to a fall of 12% in 2009. Levels of household, corporate and government debt remain a concern

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that could limit the speed of recovery and future growth expectations. Sovereign debt levels in some European countries in particular are a growing cause for concern and uncertainty, making decisions surrounding the pace of monetary tightening even more difficult than they already are.

As an open, exporting economy the Isle of Man needs a thriving global economy. But the turmoil in the international financial markets over the last two years has yet to play out fully. With international corporations still assessing and addressing their business models and their structures, we can expect accelerated processes of reorganisation, rationalisation and consolidation amongst them. Therefore we will need to compete even harder to consolidate our own economic base, and to maintain the attractiveness of the Isle of Man to new and existing inward investment. The proposed new Department of Economic Development, if approved, will provide a strong platform to drive on with this essential work.

Clearly a key objective of this Budget is to try to minimise the impact of the new financial circumstances on the economy. It is not in our interest to take actions that depress local profits and incomes to the extent that it results in a slowing of the local economy.

I am pleased to report that the Island's economy has continued to grow, at an estimated 2.5% over the course of the year. We expect growth to increase to 4.5% in 2010-11. And whilst unemployment shot up at the start of last year, it quickly stabilised to finish the year at just below 1000: an unemployment rate of just 2.1%. The start of this year has also seen increases in unemployment with the January figure rising to 1,029 a rate of 2.4%. This is a normal pattern, even in the years when the economy is strong. But again, I expect numbers to stabilise as the year progresses. For comparison, during the last major slowdown in 1992-93, growth fell to under one percent, and unemployment rose to 1,900, a rate of 5.6%. Our strategy of diversifying the economy, has, to date, clearly protected us from such large increases in unemployment.

There is also a growing problem with young people who are not in education, employment or training, known colloquially as NIEETS. We need to ensure that no young person on the Island is left without access to one of these opportunities.

It has been our business community that has maintained their confidence in the economy and in levels of employment. Business can be assured that Government will be doing all in its power to help sustain the quality and attractiveness of the commercial environment and so in turn assist enterprise through these difficult times.

I would also like at this point to give particular thanks to our lending institutions. We have all heard and read about the difficulties being encountered in neighbouring countries by individuals and small companies looking to obtain credit and development funds at a time when institutions are tightening their terms and conditions to levels that are serving to depress economic recovery. I am happy to report that any such actions taken here have been much more judicious and that loans and credit facilities continue to be made available. Indeed 2009 saw bank lending to Isle of Man resident non-financial companies increase by an estimated 25% to around £1¼ billion, whilst financing to households also increased, by 14%.

Another area of uncertainty that is concerning many economic commentators is that of future price inflation. The fear here surrounds asset values, which are being pumped up as a consequence of government reflationary measures, particularly the massive borrowing of the G7 governments. There is the strong probability of this transmitting into the real economy and producing higher general inflation.

This is however, a longer term issue and should not be confused with what we are currently experiencing in our own inflation rate. Last year saw the Island's annual rate of inflation at below 1% throughout March to October. Indeed in late spring/early summer the rate was actually negative, for the first time since our records began in 1977. Key factors here were falling energy costs and a succession of reductions (from November 2008) in interest rates, and hence in borrowing and mortgage repayment costs. These benefits are now beginning to fall out of the twelve month period over which inflation calculations are made, and as a result the Island's rate has begun to rise, to currently stand at 4.5%. We will see further increases in the rate over the next few months for the same reasons but can reasonably expect inflation to fall thereafter.

Members will of course be aware of the range of challenges that we have had to face on the international front in the last twelve months, as the global financial crisis evolved. The liquidation of Kaupthing Singer and Friedlander (Isle of Man) Limited was formalised following the rejection of the scheme of arrangement last May, and Tynwald stepped in to ensure that all depositors received the sums due to them under the Depositors' Compensation Scheme.

We continue to receive more positive news from the liquidator in respect of eventual recovery, now estimated to be in excess of 90% of deposits, which is good news for the taxpayer and depositor alike. As a result I am able to revise down the projected loss to Government to around £5 million, and this sum will be provided from the reserve fund in line with accounting standards, as a cautious final estimate of the eventual cost.

Of course we still have around £100 million tied up in the liquidation which has been advanced from our cash balances, and remains a debt to Government, to be repaid from future liquidation proceeds. It will take many years for all this money to come back to us, but I remain convinced that by meeting our obligations to depositors under the Depositors' Compensation Scheme in full, and in a timely manner after the activation of the scheme, we have shown a caring and proactive response to the plight of the depositors, despite the minority who have yet to accept this outcome.

Problems in the banking system led to the commissioning by the United Kingdom of the Foot Report, which was published last October. The report showed that the Isle of Man was highly regarded in respect of its financial planning, regulation, governance, and international compliance. We welcomed the findings of the report and the acceptance within it of the important role which the Isle of Man plays in supporting the City of London with around 56 billion dollars of inward investment coming into the City from local financial institutions.

Finally in respect of the United Kingdom we have had the revision to the revenue sharing arrangements. This has presented our greatest and most recent challenge. There is no doubt that this, plus other events in the last year or so, have put our closest external relationship under severe strain. Our ability to deal with such challenges was illustrated when Standard and Poor's subsequently confirmed the "AAA" credit rating commenting that the government's "robust financial position will enable it to deal with the ongoing budgetary and economic pressures".

The renegotiation of the revenue sharing arrangements was unwelcome given the timing, and Honourable Members are aware that the arrangements had been updated and approved by the UK Treasury only two years before. It is reflective of a hardening of attitudes within the international community generally where resources are scarce and politics becomes more about power and less about principles.

This presents particular problems for small jurisdictions, such as ourselves, who have shown by their actions that they are willing and able to abide by international standards, only to find larger nations ignoring these when it suits. Not only that - but it becomes attractive for some to attack smaller nations to deflect from criticism at home.

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Our response to this changing global environment has been to reinforce the fact that we are responsible international partner, both to build trust and to challenge unfair criticism. We must continue to promote our case with strength and confidence wherever and whenever required. We must also be resolute in protecting our national interest.

Mr President, all members of this Honourable Court are aware of developments in the EU which have provided challenges in the last twelve months.

Firstly, I should mention the Code of Conduct for Business Taxation and our “zero-ten” system. I will be issuing shortly a consultation document on business taxation, which provides a detailed analysis of the current situation. Our consultation will cover a number of areas, each of which is important if the Government is to reach a view on potential changes. As part of our work, we will hold further meetings with UK and EU officials to gain a better understanding of how zero-ten systems are viewed. We will review business tax regimes in the EU member states. In addition, we have engaged Deloitte, the business advisory organisation, to act as external consultants to support the Government. Deloitte has a wealth of experience and knowledge, which I feel will be invaluable as we embark on this important exercise.

Above all, this will be an open, public consultation and so any interested person will be invited to submit their views on the current Isle of Man business taxation system and on how it should adapt to fit better with developing international sentiments and standards.

We believe that in the case of the Isle of Man, the EU was content in 2003 that zero-ten was not a harmful system. If that position has changed, or may change, I owe it to Tynwald and to the businesses already in, or wishing to become part of, our economy to reach an understanding of the new circumstances and to determine what changes we might need to introduce. We will carry out the review carefully and will take the appropriate time to get the answers right, as my main responsibilities are to the Isle of Man and its economy.

However, an important aspect of our future stability and success is that the EU and the international community should be comfortable with our taxation system, because trade in goods and services between the Isle of Man and other countries should not be affected by concerns about our tax regime.

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This does not mean, Mr President, that we are willing to forego our autonomy in income tax matters: far from it. We have always been prepared to have a dialogue with the EU on tax co-operation, and if any member states have genuine concerns about our zero-ten regime, we are happy to discuss those concerns and to consider what is best for the long term future of the Island's economy. Such discussions must be based on mutual respect and agreed principles, and will be in line with the development of the Island's international personality.

Last summer I announced an early move to automatic exchange of information under the EU Savings Directive, as it was the right thing to do. The Isle of Man is a good international neighbour, and our track record in this regard is one of which I am proud.

A revised Savings Directive is still being finalised by the EU. A new directive will impact on our financial services sector and we will need to consider our position on it once the final version is agreed by the member states.

As part of the G20 summit in London on 2 April last year, the OECD published a report on compliance with international taxation standards. In view of our efforts over a number of years, and the number of tax information exchange agreements with other countries that we had signed, it was no surprise that we made the 'white list' immediately. We are continuing energetically to negotiate agreements with other countries, and our growing network of agreements can only be a good thing for our economy.

Mr President, a new feature of our tax co-operation work in 2009 was the signing of three comprehensive double taxation agreements with Estonia, Belgium and Malta. These agreements aim not only to put in place the standard on exchange of information, but also aim to foster economic growth. I expect that we will sign more double taxation agreements in the near future.

The International Monetary Fund published its report on the Isle of Man in September 2009 and praised our compliance in respect of international cooperation and the combating of money laundering. There is a high level of supervision and regulation within the financial sector on the island. This report was a testament to all those who work in the finance sector, and to the regulators themselves, and its praise results from the sustained efforts of many people over a long period to comply with the recommendations of previous reports.

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Enhancing the capacity of small jurisdictions to meet developing international standards was a key aspect of the creation of the Small Countries Financial Management Programme, which I launched at the World Bank in 2008. The inaugural programme was completed successfully last October. This showed once again the Island's leadership in the area of international cooperation, and our ability to utilise our experience for the benefit of developing countries.

I now want to review the performance of our **local businesses** over the last year.

In terms of the finance sector business in 2009-10 has clearly been difficult. The Island as a deposit taker has seen margins squeezed as interest rates have been held at very low historic levels. This will impact banking profitability for 2009-10, and corporate tax receipts in 2010-11. Bank deposits have seen little change, and although there has been a steady growth in new 2006 Act companies to the register, reducing numbers of 1931 companies have more than offset this. The funds industry has stabilised in recent quarters, but has similarly been affected by a general lack of confidence worldwide.

Whilst conditions are hard for many, Government's role is to promote and support our financial industries in winning new business. The Marketing Initiatives Fund will spend around £5 million doing that in the current year, and contains around £10 million for promotion in future years. Specifically, this has been used to support the promotion of AIM listing, in which we still hold a leading global position, with 15 of the AIM 100 top companies now being Isle of Man incorporated. We have also invested in a review of the captive insurance industry, with a near doubling of the funds under management in the insurance industry in the last six years, an indication that in many sectors outside of mainstream banking, local companies continue to grow and be successful.

Our continued economic success requires continual investment in marketing, not only in the finance sector, but to develop new markets and new jobs.

Government has helped to fund and conduct major promotional events in the UK, Europe, the Middle East and Asia, working closely with the Island's private sector. For example, the Monaco boat show was attended by a 50-strong joint public/private delegation, as was the global e-gaming exhibition in Copenhagen.

The information and communication technology sector – more commonly referred to as e-business – has continued to grow rapidly on the island throughout 2009, generating jobs and revenues for other local businesses. Government is playing a key role in this success. The DTI estimates that it will have paid over £2 million in financial assistance to e-businesses over the last 3 years which in turn has helped to secure over £20 million in local investment particularly in e-business infrastructure such as data centres. This will attract further e-business investment and jobs.

The e-gaming sector has continued to generate strong growth in 2009. There are now 21 e-gaming companies licensed in the Isle of Man with growth achieved also in non-licensable activities including another 7 companies expanding on the island in the areas of disaster recovery, affiliates and payment services. As a result the number of jobs supported by the sector is estimated to be over 550, an increase of around 100 from this time last year, and this rate of growth is forecast to continue in 2010. The jobs created are diverse in nature with skills often transferable from other sectors, not least financial services. The e-gaming sector is now contributing significantly to the Isle of Man economy in terms of quality of employment, tax receipts generated, local spend in the economy as well as important revenues for local banks, data centres, IT businesses and professional services firms.

The manufacturing sector continues to play a vital role in our economy at a time when the economy generally is experiencing a downturn. It is the second largest primary sector after banking and employs over 3,000 people. Over the last five years, manufacturing has grown substantially, at 7.6% per annum, in real terms, 20% above the national average.

The Isle of Man aerospace cluster formed in July 2006. It has brought many of our manufacturing businesses much closer together and has encouraged a joined up approach in tackling issues facing the sector. The DTI continues to fund a formal relationship with the North West aerospace alliance which provides direct links to major industry leaders such as airbus and BAE systems and ensures the cluster is accepted as an important part of the UK supply chain. I am pleased to report that the Island's aerospace sector is forecasting it will double revenues over the next 5 years, generating over a hundred new jobs and generating millions of pounds more for our economy and in taxes.

The shipping sector continues to make a vital contribution to our economy, employing around 500 people locally. Worldwide the merchant shipping sector has declined due to falls in freight volumes, yet the Isle of Man has maintained its impressive fleet and related economic activity. For the ship registry, the outlook for 2010 is more positive than for several years as it expects substantial growth in new vessels from new clients, particularly in the Far East where targeted

marketing over the last two years is beginning to show results.

The Isle of Man aircraft register is now in its third year and has been an internationally recognised success. To date, around 200 high-quality corporate and private aircraft have been attracted to the Island's register. To put this in perspective, one of our major competitors, the Cayman Islands, has added 50 aircraft in the last 10 years. The growth of the Isle of Man aircraft register has generated millions of pounds of new revenues for local banks, advocates, CSPs and others. The future of the aircraft register looks extremely promising, with increasing numbers of new customers from Russia and the Middle East.

2009 saw a welcome return to a high profile for our film industry, with the launch of 'Me and Orson Welles' which has recently provided our first BAFTA nomination. This built on the success of 'A Bunch of Amateurs' which received a Royal Premiere last year. Market conditions remain difficult for film making, but the distribution model developed by CinemaNX, Government's investment managers, in conjunction with Isle of Man Film Limited has allowed us to stay at the forefront of the industry during difficult times, and will serve us well during the recovery period. Whilst we remain committed to diversifying the economy and promoting all sectors of the industry to contribute to our overall growth, such investment must always be prudent and generate a real return for Treasury.

The tourism industry remains an integral part of our diversified economy. There was a welcome increase in visitor numbers of 4.3% in 2009. Despite challenging conditions, our increased investment in promotion of the Island has clearly contributed to this increase, and assisted in building a positive national identity. We need to continue with this advertising in order to build upon these positive results in future years.

The Agricultural industry is clearly focussed on the ending of the meat derogation this year. The Agricultural Development Fund, created in 2007, will spend around £1 million in 2009-10 and £1.7 million in 2010-11 helping the industry adjust to this new set of circumstances.

I shall now turn back to our strategy for rebalancing the Budget in the medium term, and review each of the four areas, our Revenue Budgets, Capital spending, Reserves and Taxation.

Revenue Budgets

Our strategy in respect of revenue spending has been to reduce this as far as possible in the short term by removing items of spending that have been relatively easy to adjust, in order to allow for a longer term programme of savings to be set up and implemented. This was to avoid the need for immediate redundancies and the consequent impact on unemployment and the economy.

In many ways the decisions for 2010-11 represent the quick wins and relatively easy savings. They will need to be supplemented by longer term, more sustainable changes. Delivering such a programme of spending reductions will clearly be a key element of our strategic plan for the necessary rebalancing of the public finances.

2009-10

Like most nations, we have seen a downturn in receipts during the current year. In the main this has been as a result of lower VAT receipts in the pool of revenues that we share with the United Kingdom, mainly caused by the general economic downturn, not related to the change in the sharing mechanism.

This represents a fall of £28 million or 9.6% below estimates. Our banks have reported strong profits for 2008 and our resident tax, albeit lower than the year before, will still exceed the Budget estimate. It is expected that Direct Tax and other income will come in at around £11 million ahead of projections, leaving us with a net shortfall of £17 million or 3% of estimate and a probable income of £555 million for 2009/10.

On the spending side we have promoted restraint, in the light of the expected shortfall. Several Departments have come in below budget, but the DHSS, in spite of its efforts to contain expenditure, is projecting an overspend that will require a supplementary vote from Tynwald. Their forecast is for an £8.5 million overspend, of which £3 million relates to the implementation of a 3% pay award, the third year of a three-year pay deal.

That brings me on to our policy in respect of future pay awards. Projected salary commitments across Government for 2010/11 will be £316.4 million, an unsustainable level in the current economic climate. The Chief Minister has asked for Departments to try and reduce those costs by 10%. This will be a major challenge for everyone, especially as Government tries to avoid compulsory redundancies.

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The easiest way to achieve the balance we seek is through natural wastage and pay restraint as a 1% pay rise costs us £3.1 million per year.

So for 2010/11 I am announcing a freeze on salary budgets. I accept that this will be a challenge to achieve but I strongly believe it is more acceptable than a rush to compulsory redundancies which would be the alternative.

This will be in addition to further discipline in respect of vacancies, overtime and contract working. Already we have removed around 100 posts from the Government establishment, but this represents just over 1% of the current workforce. This was achieved by the release of vacant posts and by natural wastage, and as a result we have saved £3 million of salary costs, and a further £600,000 of annual pension liabilities.

I should make reference to pension reform. Long term, reviewing the funding of pensions is critical to the control of public finances. We need to take control of our own destiny in this area, as much to protect our staff from further uncertainty from UK changes as to manage the long term financial implications of our own employment.

Current pension expenditure is forecast to overspend the budget by £6m this year, which now has to be met by the taxpayer. Pension costs are expected to grow by around 10% per annum. With the financial challenges ahead, we must take action to bring future liabilities back under control. The new proposals from Hymans Robertson have been through considerable consultation, and will provide members with opportunity to deliver an affordable pension scheme. We expect the final proposals to come to Tynwald next month.

Finally, the investment income for the current year has been adversely impacted by low interest rates and the need to cash flow the Depositors' Compensation Scheme payments to the Kaupthing Singer & Friedlander depositors.

Taking both the revenue and expenditure forecasts together, I expect a deficit in 2009-10 of around £25 million.

I will not therefore be able to announce any new transfers to reserves.

Before turning to the revenue estimates for **2010-11** in detail, I need to put them into a wider context

This budget is part of a wider work in progress. It should be seen in the context of both the medium term Budget rebalancing strategy that I set out earlier, and the Chief Minister's restructuring of Government proposals. Both are intended to make Government leaner and fitter and more capable of providing services within a planned lower level of income. It is important that we knit these strands together, keeping focussed on delivery of outcomes, be they a co-ordinated approach to Business Development or a programme of cost reductions and efficiencies.

Along with the Chief Minister and my Council colleagues, I believe that Government's Strategic Plan remains the basis of our strategic direction, but this budget and the proposals for the restructuring of Government both give a greater priority to the stimulation of economic growth, due in part to a more difficult international environment. They also show that change must happen, in a planned and orderly manner, and that we must "grasp the nettle" to reposition ourselves, both economically, and in respect of the delivery of Government services.

In respect of future years then, we have had to plan our actions taking into account a number of uncertainties. Whilst it is important that we clearly indicate the direction in which we are heading, we must remember that we will also need to maintain flexibility, to adapt to changing circumstances. So our plans are based on our best estimates of revenues and economic conditions, but we are ready to adjust these if circumstances require us to do so.

For 2010-11 we have produced a balanced budget, but it has involved considerable restraint on spending, increasing some charges, and further use of reserves.

This has involved considerable detailed work on departmental budgets, seeking to determine the most appropriate areas to reduce. Some £26 million of cost has been removed, although some of this is temporary in nature.

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Particular areas such as replacement of vehicles or equipment have been impacted. We have looked at grants and support given to other organisations and in some cases have requested savings. For example the subvention to Manx Radio will reduce by 2% in 2010-11 rather than increasing by around 3%, and there have been reductions in the overall level of funding for the sports and arts councils. To minimise these we have looked again at the distribution of lottery duty, and are proposing a new formula that seeks to balance the requirements of the four grant aided bodies.

Overall we have begun to make the savings we need in Revenue budgets. On a like for like basis Departmental spending will reduce by 6.5%, or £37 million in cash terms.

We have reduced the rate of interest on our internal loan charges to 0%, and rescheduled repayments on several schemes. This has removed around £24m from Departmental budgets, at the expense of reduced provision for future capital developments. If we allow for the reduction in the rate of interest on loan charges, the figures show a 3.2% reduction, totalling £18.3 million.

We have achieved reductions across all Departments, with the Department of Transport losing 21.8%, and others varying smaller amounts.

As usual I have tried to protect Health and Education as best I can.

The Department of Health and Social Security shows a small increase of 0.1%, the only Department to receive an increase this year, and Education has the smallest percentage decrease of 1.9% or around £2 million.

This will leave the DHSS with an annual net budget of £247 million with Education the second largest spending Department with £102 million, both still very substantial amounts for a community of 80,000 people.

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We have been able to once again increase the state pension for 2010-11 by 2.5%. The basic state pension increases by £2.40 per week from £95.25 to £97.65 a week for single people and by £3.85 from £152.30 to £156.15 per week for married couples.

I will now move on to the **Capital Programme**.

The capital programme remains vital to the health of our construction sector, and to maintaining employment. The most significant unemployment increases in January were in the construction sector. Whilst we will have a smaller budget available for capital schemes in the years ahead, our strategy has been to look back at what has been delivered in the past, and set future budgets at around the same level, taking into account some of the large off-Island contracts that we have previously been able to afford. We have also used the balance in the Capital Fund, to ensure that the programme reduces to a sustainable level in stages, so as to minimise the wider economic impact. The onus is clearly upon Government to ensure that we deliver as close to 100% of these budgets in the future, rather than the traditional 60-70%.

There has also been an even greater focus on schemes using local companies rather than off-Island contractors, and on maintaining our current infrastructure rather than starting on new commitments. As an example of this we have ensured that for 2010-11, the budget for construction schemes provided by Government, Local Authorities and Statutory Boards is £66 million, 5% higher than the £63 million anticipated for 2009-10.

For the current year delivery will be 85%, a good benchmark of where we need to be. We have virtually completed the runway extension and have made good progress on the new secondary school.

Capital schemes need to assist employment locally, but cannot be used solely for that purpose. It is important that the industry responds to the Government's requirements in the next five years, and deliver schemes that contribute to the Government's strategic aims.

As an example of this, I can tell members that no housing schemes, including those managed by local authorities have been deferred by the Council of Ministers as a result of the reduced level of income.

So we have not stopped investing in the local infrastructure, or cut back on providing quality homes for our people. Including local authorities, some £37 million will be spent on our housing stock next year.

Government capital spending is expected to be £106 million this year, including £27 million on the runway extension. Next year the programme will be £96 million, including £12 million for the start of the extension of the natural gas network, if it is approved by this Honourable Court. This promises to bring cheaper natural gas to a larger proportion of the Island, and will reduce our dependence on reducing supplies of LPG. For clarity I should point out that Manx Gas will pay for access to this Government-owned infrastructure. As such this investment will not only help secure supplies of gas for much of the Island, but will generate valuable revenues that will finance further capital development in the decades ahead.

There is also provision to continue with IRIS, and to redevelop the Bowl, if there is a final agreement with Douglas Corporation over its transfer.

I will now turn to considering changes in respect of **Reserves**.

Our strategy for Reserves has been to minimise the commitment of these for rebalancing the budget and to set a clear timetable for the ending of their use within 5 years. This will require £114 million of Reserves to be spent, around one third of value of the Reserve Fund, or 7% of total reserves.

We will seek to reduce these figures if we can. For 2010-11 a £15 million transfer from the Reserve Fund is being sought, in order to create a balanced budget.

Having already noted that expenditure will exceed income in the current year, I have no new transfers to reserves to announce. Having said this, to support the further development of the local economy, I have a number of changes between reserves to propose. There is also no doubt that we need to reprioritise and make better use of our internal funds, which will similarly come under pressure as we rebalance our revenue budgets. As an indication of this, the book value of our internal reserves is projected by the end of 2010-11 to be at its lowest level since I

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became Treasury Minister. This strongly reinforces the need for ongoing savings to be made in revenue budgets, in order that we can remove any reliance on internal reserves, be it for information technology, housing or acquisition of land.

Members will be aware that over the last few years considerable resources have had to be deployed in support of the Manx Electricity Authority. The Authority has under the chairmanship of several members in this Court made huge strides towards rebalancing its own budget, and with the new challenges facing all of us, the time is now right to go a step further.

So from 2010-11 the MEA will be meeting from its own resources the full cost of the bond interest, and providing for the standing charge rebate which together last year totalled £7.2 million. It will still borrow for capital schemes from Government, and will repay these in the normal manner. These changes will be implemented by increasing the tariff by two pence per unit, from September 2010 (but at the same time by reducing the fuel surcharge by 1 pence). This will result in a 7% increase in the average electricity bill. There will be offsetting relief for those on low incomes that I will come to later.

As a result of this change, I can close the standing charges rebate fund, which contains around £3.5 million. The remaining proceeds will be transferred to the legal cost reserve, which has come under pressure from a number of large costs in the last twelve months.

I should put on record my thanks for the constructive responses from all statutory boards in respect of the financial challenges ahead. Apart from the MEA, the Post Office has agreed to raise the proportion of their profit that is paid into Treasury from 45% to 50% and have also agreed to transfer £2.5 million from their reserves into the capital fund.

I will transfer £2 million from the Visitor facility improvement fund into the capital fund for next year. This will allow for the necessary refurbishment of the Snaefell railway track.

I will also create a Restructuring Fund with a transfer of £3 million from the Economic Development Fund. It is critical that as we look at our medium term efficiency programme we have the resources to enable us to deliver the programme of change required. I am conscious that the recent announcements of the restructuring of Government Departments might lead to some confusion in this area. The purpose of this Fund is to ensure there are sufficient funds

available to provide necessary external assistance in relation to economic development, the review of taxation and the spending reduction programme. It is not intended to meet costs flowing from the restructuring of Departments.

The areas we will look at will contribute to the Chief Minister's objective of saving 10% of salary costs, by introducing shared services and one stop shops. There will need to be a look at the Government estate, to rationalise and remove inconsistency in respect of office provision, and to consider what services should be provided by Government free, and what should be more commercially based. There is a huge amount of work to be done to identify and deliver on these savings over the next few years, but as indicated earlier there will be no panic or fire-sale of assets as we adjust.

Use of Information Technology can be an effective facilitator of change, but this must always be within a tightly controlled financial environment. Honourable Members will recall that at this time last year, I made a commitment that the Value for Money Committee, under the chairmanship of my colleague Mr Downie MLC, would review ICT spending to ensure effective use of these funds.

Acting on behalf of the Committee, the Chief Internal Auditor commissioned an independent review of the strategy and arrangements for the provision of ICT. Whilst the findings highlight that ISD and Departments need more focus on how service performance is measured and communicated, the review noted that there is compelling evidence that the ISD budget does provide value for money. The review also noted that ISD's core services such as data centre, network, server/application availability, desktop services and helpdesk are of a high quality.

As a practical example of the savings that can be achieved, the original Connect Mann contract delivered £1.4 million of annual revenue savings, and the renegotiation of it this year, has delivered a further £450,000 of annual savings, and an improved level of service.

Finally before moving on to taxation, I should update members on the overall performance of our invested funds. The market value of the invested reserves has risen by around £180 million since the 31st March 2009, to a figure at the end of December of £1.275 billion. Under the chairmanship of Mr Braidwood MHK, the investment committee of Treasury continues to monitor performance of investment managers to ensure we have the best position from which to draw down on reserves over the next few years.

Taxation

I will now turn to changes in taxation. Our strategy here has been to find around £20 million from increases in taxes and charges for 2010-11, with an additional £7 million next year. Beyond this, no further tax changes are currently required.

Back in November, the DHSS gained approval for an increase in National Insurance Contributions from April 2010. This will add 1% to all employee National Insurance Contributions, in line with the increase introduced in the United Kingdom in 2003, and will extend above the upper earnings limit as it currently does in the United Kingdom. This will result in around £7 million of additional income annually.

In deciding how much we needed to increase tax receipts, relative to the savings in spending and reductions in capital transfers, I had to bear this increase in National Insurance in mind.

Other Departmental charges will rise by approximately £3 million, with the major increases being a rise of around 10% in Vehicle Excise Duty, the increasing of Waste charges from £10 to £29 per tonne, and a rise in Company Fees. These increases alone will raise around £2 million and result is that I need to raise in the region of £10 million more from income taxes.

We are in very difficult circumstances, and the changes that I announce today must be seen as the start of a process of moving toward a different approach to taxation. Going forward, we may need to review further the range of tax allowances and reliefs that are currently in place.

This government will do all that it can to protect the less well off in our community, and I have kept this principle at the front of my mind in preparing my budget.

Mr President, A stable, competitive tax regime has given confidence to investors and residents alike and has contributed to the strong economic growth the Island has enjoyed for many years.

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I continue to strongly support this strategy.

However, after exploring my options to achieve a balanced budget, reluctantly I have had to make the decision to raise the higher rate of personal income tax from 18% to 20%. This measure alone will generate £9.4 million in additional revenue.

I am holding the basic rate of income tax at 10%, and the band of income taxable at 10% will be held at £10,500 for a single person and £21,000 for a married couple.

Questions have been asked in this Honourable Court and in another place about my intentions regarding the individual tax cap policy, which was introduced in 2006. I repeat, Mr President that this is a key policy aimed at encouraging entrepreneurialism, wealth creation and wealth management and at attracting new residents to the island, and we should not abandon it. However, we have not raised the £100,000 cap limit since it was introduced. During that period, inflation in the Isle of Man has run at an annual rate in the region of 3% to 4%, before rising to over 6% for a short time in 2008 and then falling to very low levels for most of 2009. Taking this into account, I think it right that the limit should rise this year to £115,000. This move, which is equitable and yet which preserves a highly competitive policy for the Island, will raise an additional £1.2 million per year.

The tax allowance for non-resident individuals, which currently stands at £2,120, will be abolished from 6 April 2010. This change will raise £400,000 per year in additional revenue.

Mr President, tax relief for interest payments is currently subject to a cap of £15,000 per year. I introduced that limitation in 2008, and did not change it in last year's budget. While interest relief has been part of our system for many years, its cost is high; being approximately £13 million each year. As Honourable Members are aware, interest rates are at historically low levels, and are expected to remain so for a considerable time. The time is right to reduce the limit from 6 April to £10,000 per year. This move, Mr President, will generate an additional £400,000 in tax revenue, and will affect approximately 450 households. Even with this change, I estimate that a single person will still be able to claim tax relief in relation to the interest on a £200,000 loan or mortgage, and for married couples this tax relief will cover the interest on a £400,000 loan or mortgage.

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In relation to interest relief, I am also asking the Assessor to review our policy overall, and to advise me of any further changes that are necessary in order to achieve the following two aims. Government's long-term policy has been that we should encourage home ownership through the tax system, but I believe that this encouragement should be carefully focused and easy to understand. The two aims, therefore, are that we should provide interest relief only in respect of the mortgage on one main home and that the level of relief should be set at a level consistent with that required to buy a first time buyer's property under the Government's House purchase assistance scheme: currently £150,000. This strikes me as a clear and fair approach, and I hope that Honourable Members will agree with me.

Mr President, despite increasing the amount of income tax that many people will have to pay in 2010/2011 and in the future, I did indicate a few minutes ago that I wished to protect those who are less well off. We did not increase the level of the personal allowance last year, and it is appropriate to do so this year. I am therefore increasing the personal allowance by 1% to a level of £9,300 for a single person and £18,600 for a married couple. Related allowances will also be increased: with the single parent additional allowance rising to £6,400; the blind or disabled person's allowance rising to £2,900; and the allowance for people over the age of 65 rising to 2,020. The increase in the personal allowance will take 235 people out of the income tax net completely. The cost of these increases will be £660,000.

I am proud of the help that the personal allowance credit system has given to the less well off in our society since I introduced it in 2002. Almost 11,000 people are expected to benefit from payments of £550 this year, and the cost of the system will be almost £6 million. We ought to hold fast to our policy of supporting those on low incomes, and at the same time ensure that such support goes, as far as is possible, to those in genuine need.

Mr President, I am announcing today that the personal allowance credit will be increased by 18%, to £650. This measure targets another £1 million of support to the less well off. At the same time, I will introduce changes which remove students in full time education, the spouses of tax capped individuals and people sentenced to terms in prison of a full tax year or more from the personal allowance credit system so as to ensure better targeting of this value support. £100 is a significant increase, and is a deliberate measure intended to assist the most vulnerable in society with increased costs, including the increase in electricity charges referred to earlier.

Mr President, I would now like to cover a small number of final points in relation to income tax.

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I am issuing new income tax instalment payment rules which will apply from 6 April this year. They are designed simply to let employers know what their obligations are within the system. A number of employers deliver tax, National Insurance and returns late, and I wish to tighten up the system to make it both more efficient and to improve government cash-flow. This improvement is expected to bring £600,000 forward into the coming year, although I should stress to all Honourable Members that this is not new tax. I simply wish to see the tax that is due paid on time.

The Assessor carries out investigation work in relation to those people and businesses who are either failing to declare income or who are underdeclaring it. In the last tax year, the Income Tax Division produced £2.7 million from its compliance work. I have said in previous budget speeches that it is important that everyone on the Island pays the right amount of tax at the right time, and yet I feel that we continue to have a situation where a small number of people either ignore or try to work around their obligations as taxpayers.

Mr President, I want to inform this court of three tax compliance initiatives today. Firstly, we are discussing with counterparts in Guernsey and Jersey what sort of agreements need to be put in place to allow the Assessor more easily to obtain information from those countries which will assist in carrying out investigation work. I will inform Honourable Members of progress in due course.

Secondly, in order to encourage those people who have not declared all of their income to do so, of whom many are afraid of being found out by the Assessor, I intend to by concession waive the imposition of penalties in respect of any voluntary disclosures made by taxpayers during a three month period during 2010/2011. The Assessor will announce the exact dates in due course. Tax and interest will be charged on this income as normal. A similar scheme was run between April and October 2003, which resulted in additional tax of £3.1 million. I cannot accurately predict how much revenue this exercise will produce, but I feel it fair to give taxpayers a chance to bring their affairs up to date. Once this period has been completed, I will ask the Assessor to pursue non-compliance assertively.

We have also looked at introducing ways that people and businesses can interact with us through the internet, and the income tax division has been very much involved in that development, as I indicated earlier. Ultimately, I would like us to get to a position where the online submission of a tax return is the norm. We should consider making it beneficial in some way for people and businesses to use the internet for their taxation affairs. We should look to build on every available opportunity to ensure that our departments work more efficiently and provide a better customer service whilst seeking to reduce our overall costs. The further

development of on-line services can contribute to achieving these goals.

Before we can get to that point, we need to have a far simpler system in place. Our need to raise additional revenue may give us the spur to move in an orderly fashion to a simple taxation system, and I expect to make further announcements in this area next year.

The Income Tax Division has been very much involved in the development of online services and I am pleased to announce that all individual taxpayers will be able to submit their tax return online from 6 April 2010. I have asked the Assessor to develop the system further so that taxpayers can be provided with online assessments and other correspondence.

There have recently been further additions to online tax services for employers which provide wider suite of options.

The tax measures which I have just announced, Mr President – and not taking account of the uncertain level of revenue from the “amnesty” – will generate approximately £10.3 million in income tax. The higher burden falls on the better off residents of the Island, and while it gives me no pleasure to have to put that burden on them, I trust that Honourable Members will see it as an appropriate strategy. At the same time I have protected the less wealthy, and in many cases I have improved their position.

These tax measures are balanced, fair and appropriate to the needs of the Isle of Man. There is more work to do, and further changes are likely.

Conclusion

Mr President

To achieve a balanced budget today has demanded a tremendous amount of hard work. I would like to sincerely thank Members of Tynwald in their Departmental capacities, officers across Government, my colleagues on the Council of Ministers and Mr Braidwood and Mr Downie in Treasury.

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But I would especially like to thank my Treasury officers for delivering this Budget on top of what has been a year of relentless challenges confronting the Island.

Without doubt the combination of challenges which the Island has faced in recent times and will continue to face in the time ahead are almost without precedent.

The near melt-down of the world economic system and the sustained pressure on small countries, such as our own, have stretched our resources to the limit and the arbitrary rebalancing of the VAT sharing mechanism by the UK Government will now force us to rethink the size and scope of our public services with a new urgency and a new sense of priority.

So far the Island has succeeded in avoiding the level of economic downturn experience elsewhere and has punched above its weight in defending the Isle of Man in the international arena.

But there is one simple message which has evolved from the turmoil of the last few years which we ignore at our peril:

THE WORLD HAS CHANGED!

We cannot and must not assume that both politically and economically things will settle down and life will continue much as before.

Government has to begin to lay the foundations of a new strategy, both economic and social, to take us through the next decade and beyond. A reaffirmation of our commitment to maintain a prosperous and caring society, our guiding strategy for the last twenty years, but adapted to reflect the new era which is opening up before us.

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I am a passionate believer that prosperity and caring have to be inseparable aspirations for our Island and never more so than at the present time.

It is with that background that I have tried to construct this Budget, undoubtedly the most difficult for a great many years and one which has to be viewed as work in progress as it will take several Budgets to fully rebalance our finances and reprioritise Government expenditure.

There is no quick fix in this exercise and I have had to use a mixture of spending reductions totalling £26 million, reserves of £15 million, increased charges of £3 million and tax rises of £17 million to achieve the required balance for next year. In addition we will reduce the transfer to the capital fund by £24 million which in total produces the £85 million required.

In good times these are decisions none of us would want to take and they have caused me a great deal of anguish personally in identifying a balanced approach to this challenge.

I have had to ask most people to accept a degree of short term pain to ensure long term gain and stability.

I have had to ask Government Departments to radically review their aspirations and priorities to ensure the protection of key front line services.

And I have done my best with limited resources to try and protect those on low incomes and pensioners from the worst of these pressures.

But I still remain confident and optimistic.

Our economy has avoided recession and is still growing. Unemployment is low and we have benefited from building our reserves in recent years. We have rebuilt most of our infrastructure and diversified our economy and established a quality of life which is still the envy of many.

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We are fortunate to have a high quality, hard working Government work force, though I acknowledge that we are having to increase the financial and work pressures on many at this time.

Additionally the long-standing partnership between Government and our business community remains strong. The strength of that partnership has formed the bedrock of our economic growth over the past twenty years and must continue to do so into the future.

Today marks the first step on a journey we all have to take. There will be challenging times and many more difficult decisions ahead of us.

However the Isle of Man has always proven to be resilient at such moments. The key to success will be our ability to adapt even though we often underestimate our capacity for change.

I believe if Tynwald, employers, employees and the wider community work together to confront these challenges, then we will emerge stronger and more secure in the future and send a very clear message to the outside world:

'WHICHEVER WAY YOU THROW US, WE'LL STAND!'

I beg to move

**Hon Allan Bell MHK, Minister for Treasury
16th February 2010.**