

## A FAIR AND BALANCED VISION FOR THE FUTURE

### INTRODUCTION

Madam President,

I will start by saying that my budget today is based on four very important principles.

- It honours the promise of this Government to balance the books.
- It continues to focus on fairness.
- It maintains funding for vital services for the Island's community, and particularly those who are vulnerable.
- It starts us on the path of building systems, finances and services for the next generation and not just for the next general election.

Four years ago I laid out this Government's plan to rebalance our budget by 2015-16. This has been a challenging but necessary task. This budget demonstrates that Government will succeed in achieving that core objective.

The restructuring of Government Departments in 2014, combined with Departments' delivery of savings initiatives, including the shared service efficiencies, has resulted in a Government that is now leaner and better equipped to meet the needs of our people. The salary budget has been reduced by some £50 million in real terms, achieved through combining back office functions, outsourcing or even stopping some services, and through continuous improvement.

This budget is now more targeted to deliver our core services. Whilst maintaining funding levels for Government's priority services, it provides an additional £2 million funding for Health development initiatives through the Health Inspection Fund. The publication of the Ci65 report signalled that the review of the social security system has begun, and we are committed to encouraging more people to look for and to return to work, which will build a culture less reliant on state support. We are going back to the original principles of the Beveridge Report. The invaluable work of carers in our community is being recognised, with additional resources being made available in this area to reward their role in our society.

The capital programme is designed to protect, maintain and where appropriate enhance the Island's infrastructure assets, valued at £1.2 billion. We will continue with an ambitious construction programme the details of which I shall outline later in my speech. The future security of the capital programme is also protected as interest on loan charges is reinstated so Departments can once again make contributions back into the Capital Fund for its replenishment and to invest for the benefit of future generations.

Government has built the foundations for the future delivery of public services within a system of sound and balanced public finances. This has been recognised by our rating agency. It is now up to us to ensure that this can be done in an affordable and sustainable manner that continues to grow the economy, whilst also protecting the most vulnerable. To achieve a rebalanced current account budget was always going to be Phase 1 of the restructuring of Government finances. Phase 2 requires some major longer term changes which cannot be rushed. Keeping focused on our approach to healthcare, welfare and

pensions, we must bring Government's reserves and internal funds onto a more sustainable position in the longer term, for the benefit of our children and grandchildren. We owe it to them!

Looking ahead we need to focus on the rising cost of welfare, and contemplate wide ranging reforms to better target public funds towards the most vulnerable in our society. More fairness is necessary, and the change will be unpopular for some. We must develop a strategy for making the public sector pension schemes more affordable for the taxpayer, and secure the long term sustainability and security of the schemes for their members. We must also review the terms and conditions of Government employees to bring the cost of public sector employment more into line with the private sector, yet at the same time continue to offer market rates to be able to recruit, retain and motivate the workforce required for effective service delivery.

I am now looking for a fair transition to a new Financial Management Strategy. Through taxation and welfare reform, whilst at the same time suppressing Government spending levels and achieving less reliance upon reserves, we will achieve greater fairness in our society. Having achieved our short term budgetary aim, I believe we are now in a position to strike a fair balance between the need to grow the economy and to protect the truly vulnerable.

Madam President, I will now turn to our economic performance.

## **ECONOMIC PERFORMANCE AND OUTLOOK**

The global economy continues to struggle to rebound from the debts incurred in the banking crisis of 2008-9. In the Eurozone in particular it appears all we have to look forward to is a long period of low growth and high unemployment.

That said, in the United Kingdom and the United States growth prospects are better, and this is also true for many of the global markets that we now compete in.

On the Isle of Man we recorded our 30<sup>th</sup> year of consecutive growth in 2012-13. I expect growth to improve from the 3.2% recorded in that year to around 4% in each of the following three years namely 2013-14, 2014-15 and 2015-16.

We are seeing big falls in unemployment, which is down around 189 (or 16%) since the time of my last budget. The nature of employment is changing, with more job growth at lower pay levels. The result is that the fiscal benefits of this increasing employment in terms of income tax and National Insurance are not as great as we would have hoped.

This increasing employment at lower salary levels has also had an effect on existing workers. We have seen a drop in salaries in real terms (after inflation) of around 10% over the last five years, which is only now beginning to reverse itself.

It has done so due to salary growth increasing to around 2% at the same time as inflation has fallen to around 1%. I expect inflation to stay low, helped by the considerable drop in oil prices that has occurred in recent months. It is estimated that the recent fall in oil prices will on average reduce household bills by a very welcome £200 per annum.

So overall I believe that with low inflation and increasing earnings, families will start seeing real increases in their incomes, and this will support spending in the local economy and provide some boost to those in the retail or catering sectors who have found it particularly

difficult in recent years. The planned income tax changes for 2016/17, which I will announce later, will also undoubtedly help.

It is also clear that interest rates will stay low, for longer than previously imagined. This will continue to hurt savers whilst benefitting borrowers. Our housing market has gone through a period of adjustment, with price falls in recent years. I believe this is more to do with migratory patterns than any underlying lack of confidence. Other statistics indicate that, whilst still positive, net immigration is lower than has been the case in recent years. I expect this to revert to historic norms with a recovery in the domestic economy, and as a result house prices should stabilise and then grow slowly once again. The decreasing size of the average household will probably also create demand.

A number of significant pieces of work that assist in our understanding of our economy have been completed in the last year. The Household Income and Expenditure Survey showed the extent to which Isle of Man residents have higher disposable incomes, and in some cases higher costs, than seen elsewhere. It also highlighted the levels of spending being incurred away from the Island. This information has already been used by my colleague in DEFA to develop his food strategy, given it shows a considerable proportion of our population being willing to spend more for quality local produce.

This work also fed into the VAT negotiations alongside surveys of our business community which really assisted us in our understanding of the local economy. I would like to thank all those who helped us in this work.

When I look at the Manx economy today, what is most striking is the way that it has, in recent years re-invented itself once more. The reason why we have continued to grow, when others have been through recession, is primarily the growth of our e-gaming and ICT sectors. These now rival financial services as the main engine of growth in our economy.

As a result we are more diversified, and stronger in economic terms than we have been possibly at any time in our history. I expect the benefits of this economic growth to start being felt more widely in the years ahead, which will be good for all parts of our community.

## LOCAL ECONOMY

### Overall comments

The main highlights and indicators of our local economic performance show that:

**National income** has grown by an annual average of nearly 3.5% compared with the average of 1.6% across advanced economies and is on a par with the global average.

**Productivity** improved by 3.5% between 2011 and 2013, measured by GDP per hour worked. In the UK it increased by 1.5% over the same period.

**Employment** has been maintained. At 973, the total number of people registered unemployed at the end of January 2015 was the lowest January figure for 4 years, indicating that the Department of Economic Development's increased support for export-generating sectors is paying off.

**Average earnings** have fallen 2.4% in real terms, which is in line with trends across the developed world. Government has acted to assist, with an increase to the minimum wage

of 3.9% effective from 1<sup>st</sup> October 2014, which is above the rate of inflation. Over time we would encourage employers to move from the minimum wage to a living wage to share the benefits of a dynamic economy.

## **Vision2020**

Vision2020 which was launched in January 2014 set out a compelling vision for a successful economic future for the Isle of Man and we have been busy delivering the plan since then. For example Vision2020 forecast that our fast growing sector, e-Business, would represent 23% of the economy by 2020. The 2012/13 National Income statistics released by Economic Affairs showed that e-Business was already 20% of the economy due to a growth factor of over 40% in that year.

## **Financial and Professional Services**

Financial and professional services have faced an unprecedented level of regulatory reform including automatic exchange of information driven by the US FATCA legislation, the Independent Commission on Banking in the UK to separate retail and investment banking (the Vickers Report). To these are added European legislation such as Solvency II affecting insurance and the Alternative Investment Funds Management Directive affecting the fund management sector.

Increased marketing activity has focused on developing stronger ties with the UK regions and further developing relationships with China and the Middle East.

Ties with the North West Region were strengthened through our participation in the successful International Festival for Business in Liverpool last summer, in partnership with over 50 local businesses. We signed formal Memorandums of Understanding with Liverpool Vision and Northern Ireland's Department of Enterprise, Trade and Investment.

Banks are concerned about regulatory changes, but the Isle of Man's banking sector remains healthy, with deposits holding steady for a year at just over 40 billion pounds. The Life Assurance sector continues to show positive growth with good business levels resulting in local businesses taking on further staff.

The Captive Insurance sector has had a successful year. Feedback indicates a steady line of potential business opportunities and this will be bolstered with the launch of new products such as Index-Linked Securities later this year

Indications from the pension sector remain generally positive as does the outlook for the fiduciary sector.

The strategy of attracting High Net worth Individuals to the Isle of Man has been vital in creating jobs and generating Government income. There has been comment in some quarters that the number has fallen as a result of the changes which I announced last year, but I am of the opinion that those fears are not justified with currently more interest than we have seen for some time in our scheme. Only one person has left following the changes to the scheme and as far as we can tell there was no connection between the changes and the decision to relocate. These High Net Worth individuals make valuable contributions to our economy. For example, vital work for local construction firms has been created through the building of residential properties for such individuals.

## **Registries**

The world class service and value for money continuing to be offered by our Ship and Aircraft Registers is helping to support 600 jobs in the local maritime sector and 80 jobs in our aviation services sector.

The Ship register has maintained its Gross Registered Tonnage at around 16 million tonnes and the Aircraft registry continues to register around 100 high quality corporate jets per year, well ahead of its competitors.

## **Emerging Sectors - E-BUSINESS**

E-Business is the fastest growing part of the economy, generating 300 new jobs since 2011: and it now accounts for 20% of National Income.

To ensure its continued success, protect against market changes and develop new opportunities we are working closely with the gaming industry and related organisations on the Island, including the Manx e-Gaming Association, the Chamber of Commerce ICT Committee and the e-Gaming Strategic Advisory Board.

We have modernised our intellectual property laws to bring them in line with the latest international standards and to keep the Island competitive in this area.

IT and business skills remain a key constraint. Therefore Government has worked with the private sector on a wide range of actions, which will aid growth and offer exciting new job opportunities.

In November 2014 Tynwald voted in favour of selling the Nunnery site to the International Centre for Technology Ltd for the purposes of developing it as a major training centre for IT. We are pleased to see this project progressing and look forward to their success in developing the Centre for the future growth of the industry.

In June 2014, the Isle of Man announced plans for a regulatory framework for digital currencies. The Island hosted the inaugural Crypto Valley Summit in September 2014, attended by over 170 Bitcoin entrepreneurs, enthusiasts and government representatives, and at the close of the year we now have more than 25 crypto currency businesses based on the Island.

Our approach has created a clustering effect, attracting both industry participants and their supporting technical systems. This will further enhance the digital diversity of the Island, with businesses creating products and services and providing test-bed capabilities.

## **Emerging Sectors – ENERGY**

Offshore energy offers great potential for economic benefit. In autumn 2014 the Government announced preferred partners for the development of offshore wind and tidal projects which we anticipate will bring in more than £5 million of income by 2023 and generate around 50 onshore jobs.

We are also working with interested parties to undertake 3D seismic studies in the Isle of Man's territorial waters in order to provide further data on potential reserves of hydrocarbons,

predominantly natural gas. This is in advance of a hydrocarbon licence round which we will be conducting to allow oil & gas companies to prospect for hydrocarbon reserves.

### **Established Sectors – MANUFACTURING**

Manufacturing is important to the Isle of Man. Virtually everything we make here is exported off-Island which helps create further economic benefit. The 23 members of the Isle of Man Aerospace Cluster - now employ nearly 900 skilled engineers and support staff, which is 6% up on the figure of April 2013 and 38% more than in 2006 when the Cluster was created.

The Cluster is an integral part of the UK supply chain for the aerospace industry and supplies components for every major civilian and defence aerospace project in the world.

One of the challenges facing the precision manufacturing sector is the availability of suitably skilled labour, and this is compounded by an ageing workforce. The Department of Education's £1 million investment into a new Advanced Manufacturing Training Centre in September 2014 will provide significant help to local industry in terms of overcoming this challenge. This initiative represents a tripling of the number of engineering apprentices.

### **Established Sectors – VISITOR ECONOMY**

The Visitor Economy is a vital sector for the Isle of Man as it supports a significant number of local jobs and provides the infrastructure for our tourism, hospitality, retail and leisure services. The current tourism strategy has focussed on encouraging development of high value niches and new markets, especially those that exploit the natural beauty of the IOM. A new strategy is currently being developed for launch in summer 2015 which will provide a clear way forward for the industry's efforts in promoting our Visitor Economy.

This support and greater focus is helping instil confidence among those seeking to invest in the sector and the total number of bed spaces in the Isle of Man has increased 14% over the past 3 years with 60% of bed spaces now of 4\* and 5\* quality in line with customer expectations.

A 2013 study by the Treasury revealed that almost 40,000 visitors attended the 2013 TT Races, a 27% increase on the 2010 figure. The total spending of TT visitors in 2013 had been £26.2 million compared with £19 million in 2010. The economic contribution of this figure generated an exchequer benefit of some £3.5 million. The new TV contract and media exposure brought the TT Races to a worldwide TV audience of 30 million.

Honourable Members will already have heard about the plans for a TT World Series at a briefing last month which could bring exciting opportunities for economic benefit and overall promotion of the Isle of Man.

### **Domestic Economy**

A new Retail Strategy was launched in December 2013 by the industry with Government support. The sector has faced very challenging times in recent years but the worst appears to be behind it and 14 months on from the launch of the strategy the feedback from industry has been encouraging.

Government has also provided structured support and training for independent retailers to help ensure excellence in service delivery. To date nearly 300 staff from independent

retailers have undertaken customer service skills training courses provided at no charge to the sector.

### **Work Permits**

The modernised Control of Employment Act has received Royal Assent and will ensure that our work permit system protects Isle of Man workers while ensuring that employers are able to attract the skilled workers they require in a timely manner. The provisional implementation date for the Bill and Regulations to come into force is 1<sup>st</sup> August 2015.

### **Assistance for the Unemployed**

As at the end of November 2014 it was clear that we have made great strides in this area with overall, unemployment having fallen by 25% since December 2013, Long-term unemployed having fallen for the eighth consecutive month by 50, and the number of under 25's claiming jobseekers' allowance has also fallen by 81 (or nearly 20%) since that date.

This shows that Government's policies to aid the unemployed – and particularly the two key groups of the Long Term Unemployed and young unemployed – are working, and working well. In the last 2 years Government has also invested an additional £500,000 to assist individuals who are unemployed to find suitable work: including additional work placements, training and other initiatives with the local private and third sector. It is estimated that over 200 individuals have been helped into employment as a result of this additional funding. This is a good example of Government policy which is helping us to grow the economy and protect the vulnerable and balance Government's budget through savings to benefits. It also offers significant health benefits for those returning to the workplace.

A Work Placement Programme now offers 12 weeks of paid experience with an employer. To date this programme has provided 260 opportunities to participate in a work placement with an average of 13 placements running each month. Of these 101 (39%) have entered employment as a direct result. The Programme has an impressive retention rate of 55%.

### **INTERNATIONAL OUTLOOK**

Madam President, as an international business centre, the Isle of Man must always keep a weather eye on developments in global standards and on discussions which might affect our trading environment in the future.

I said last year that the FATCA model of automatic exchange of tax information was to become the next international standard. There remains an enormous energy and enthusiasm in the G20 and other organisations to bear down on tax evasion in a variety of ways, and tax cooperation is still at the forefront. We are rapidly entering a phase where automatic exchange of information based on a common reporting standard will be the norm. Although this causes teething problems for business, and I will not hide away from the fact that they are burdensome; ultimately, I believe that a common approach will make compliance more straightforward, as single systems will only need to be implemented.

Even as these momentous changes are bedding in, new initiatives are appearing. One in particular is worth mentioning today, and this is a project known as BEPS – which in technical jargon is base erosion and profit shifting. In the words of the OECD:

“BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. BEPS is of major significance for developing countries due to their heavy reliance on corporate income tax, particularly from multinational enterprises.”

At the heart of this project is the same theme as I mentioned just now: harmonisation around multilateral, common rules and approaches. It aims to have a concrete plan signed off by the G20 this year, and already we are seeing moves in the EU to have a directive covering the same ground and more.

Honourable Members will also recall that Prime Minister Cameron was very energetic last year in pushing the international community to improve transparency in financial services, in particular information about the “beneficial ownership” of companies. He said that the best way to achieve this would be through having a public register of such information. The leader of the opposition also recently spoke in favour of a public register. However, as things stand now, public registers of beneficial ownership information cannot, by any measure, be called an international standard.

I must make clear that the Isle of Man has a legal regime which meets the international standard on beneficial ownership information: ensuring that the ownership of companies is known, verified and available to the authorities.

The Isle of Man is a forward-looking country, which takes careful notice of international best practice and has a long-established policy of complying with international standards. With this in mind, and in line with our G8 Action Plan, we conducted a consultation to gather views on our current regime and on whether the introduction of a centralised registry of beneficial ownership information would improve transparency. The responses to the consultation are being reviewed, and we are also considering additional information which has emerged from the EU and G20 since our consultation finished. I will give a further update when the picture is clearer.

Whilst we need to have Isle of Man policies in respect of the potential initiatives outlined earlier, we must ensure that our approach is not insular and takes account of the wider changes happening in the world today. We are used to adapting and reinventing ourselves, and I am sure that we will continue to do so. But it is important that Members of Tynwald Court are aware that our economy on this small island sits in a network of economies around the world, both small and large, and we can never be complacent. We must be constantly planning our next moves and adaptations.

Madam President, I will close this section of my presentation by mentioning a profoundly important review which we will undergo next year. The assessment of our standards and effectiveness in the areas of countering money laundering and the financing of terrorism will be carried out next year by an organisation called MONEYVAL. Our last review, which was reported by the IMF in 2009, was a good one, and confirmed that investors and partner countries can rely on the quality of our business and regulatory environments.

In advance of the main review, the Government has commenced a national risk assessment exercise in conjunction with the World Bank, which will assist us in determining whether any changes are necessary to keep us in good standing internationally. Businesses are assisting us fully with this exercise, and I want to record my thanks that in addition to making money – which is always what a Treasury Minister wishes to see – and dealing with changes in our



regulatory and taxation regimes, so many of them are also prepared to assist the Government, and in so many ways, to prepare confidently for the future. It was greatly appreciated.

I will now turn to our financial performance.

## **FINANCIAL PERFORMANCE AND FORECAST**

We are broadly on target to achieve our budget as planned for the current year. We have had to reduce our income expectations by nearly £3 million, largely due to withdrawals from reserves and reductions in investment income, as well as the reduction in hydrocarbon oil duties. Expenditure levels are however, projected to be £2m less than budgeted, and so overall we are within £1 million of the original estimate, which will be absorbed within the operating balance of the revenue account. The required transfer from reserves remains at £11 million. Negotiations over the revenue sharing agreement with the UK are ongoing. Should negotiations be successful and previous years' provisional settlements provide any favourable adjustment in favour of the Island, then we would seek to top up internal reserves to support the new fiscal strategy going forward. Government remains on target to drive down the administrative cost of running our services by £10 million each year for the duration of the next phase of our rebalancing strategy. Government will continue to make savings through efficiency programmes and improved procurement practices, with a target of £16 million over the next three years.

Honourable Members will have seen in the Pink Book a reduction in the Department of Health and Social Care's budget of some £3.4 million. This reduction has resulted from utilising the structural surplus budget held over from the former Department of Social Care in respect of the local authorities' housing deficiency payments, which is no longer required at historical levels. This change has been achieved without any impact upon the routine spending requirements for health or social care services.

Health spending, therefore, has not been reduced, and I ask the Court to take note, that subject to the approval of this budget, a further £2 million cash injection into the Health Inspection Fund is to be made in the coming year. This will build on the £2.1 million already paid into this fund at the end of last year in order to finance improvement programmes at Nobles Hospital.

Another feature of the budget proposals is the creation of an £8 million Central Government Contingency in 2015/16. This will allow some flexibility for the financing of unbudgeted inflationary costs and other unforeseeable items, where the departments affected cannot contain these costs within their existing target. This move adds a measure of prudence to the budget, and will help sustain the reserves position going forward and support the new Financial Management Strategy.

The proposed budget for 2015-16 shows gross expenditure £945 million. The proposed net expenditure, at £545 million represents an increase of £1.6 million, which is just 0.3%. This, Honourable Members, allows not only for the creation of the new Central Government Contingency Fund, but also the reintroduction of capital loan interest payments by Departments. As part of the 2010 to 2015 rebalancing plan, temporary measures to reduce spending had included waiving interest on advances from the Consolidated Loans Fund. The proposed budget also sees the inclusion of a £1 million Storm Damage and Capital Programme Risk contingency, recognising the need for prudence in finance provision for

dealing with project variations and exceptional circumstances, such as the extreme snow experienced two years ago, and also the flood and storm damage experienced last winter.

The Manx Utilities Authority is already achieving synergies and cost savings and is ahead of its long term financial plan approved by Tynwald in January 2014. The blueprint provides for the £260 million bonds to be repaid in 2030 and 2034, and the Treasury grant for sewerage operations will be reduced to £nil by 2017-18, leaving just an annual contribution towards flood alleviation measures of £0.5 million per annum. Increases in electricity tariffs for the average consumer will be broadly in line with the January's inflation index, and contained, should natural gas prices remain at current levels. Taken together with an approximate 2.2% increase in the water rates, the lowest increase in over 16 years, which I hope Honourable Members will agree is welcome news for all.

On 10 November 2014 I announced that the Insurance and Pensions Authority and the Financial Supervision Commission are working towards a merger in 2015. However it seems appropriate for Tynwald to have first reviewed and approved the legislation transferring the existing functions to a new statutory board. It is therefore planned that draft legislation establishing the new, unified regulator will be submitted to Tynwald in March; with the actual date for the merger to be set a little later once the new body has been formally agreed and the recruitment of a new chief executive completed.

## **CAPITAL PROGRAMME**

We have reviewed and updated the Capital Programme for 2015-16. In particular we have again sought to focus the budget on construction activity, and I am able to announce a 6% rise in the overall value of construction and engineering activity next year, which is a rise of over £3 million to £60 million.

The largest scheme for next year will be the regional sewerage treatment programme, costing some £12 million. I am pleased to report that capital costs have fallen substantially below previous estimates of the development and modernisation of this programme, which will help to alleviate the burden on both ratepayers and taxpayers alike. In addition, Tynwald approved the new £9 million Henry Bloom Noble Primary School at its December 2014 sitting, with £6 million of this budgeted for 2015-16.

Investment in healthcare, housing and infrastructure all feature prominently in 2015-16, including proposals for new Adult Psychiatric in-patient facilities meeting one of the key aims of protecting the vulnerable.

I mentioned last year that it was essential to rebuild our capital fund. I am pleased to announce that with the introduction of interest on loan charges, at a rate of 1% in 2015/16; 1.5% in 2016/17; and, 2% in future years, the capital fund will grow steadily over the next five years: whilst continuing to fund a substantial investment and maintenance programme.

The Local Authority Housing programme will provide a mix of refurbishment and new build housing for general and elderly demand; the essential refurbishment of the Willaston estate alone accounts for an investment of more than £38 million over the next 10 years. Madam President, my budget today also proposes a £3 million transfer into the Town and Village Centre Regeneration Fund in order to provide finances for regeneration scheme expenditure commitments for projects across the Island, including in Castletown, Douglas, Laxey, Peel and Ramsey.

## RESERVES PERFORMANCE

Our reserves have increased by £7 million in spite of transfers out of the reserves in the same period of over £100 million: with key transfers relating to budget rebalancing (£31 million), Government pensions (£24 million) and social security payments (£12 million).

We are currently investigating how to support the growth of our economy better by providing financial support to new businesses in new or growing sectors. This review of the potential for some kind of National Investment Fund builds upon a proposal moved by the Honourable Member for Middle in this place.

I would like to thank my Treasury colleague and Council Member Mr Braidwood for his oversight of our Invested Funds.

## TAX AND NATIONAL INSURANCE

The Tax Strategy, unanimously approved by Tynwald in 2013, provides a clear set of principles from which the initiatives announced in this and my previous Budgets have been developed. This ensures that we have a stable tax regime which is essential to ensure continued economic growth by giving confidence to our business leaders who invest in their businesses creating jobs and opportunities for our young people. Our system of taxation must remain fair but competitive as well as being easy to comply with and efficient to administer. We must recognise the competitive pressures from our near neighbours and further afield. I do recognise that there has been comment from some quarters, recently, that taxation should be increased. This will not solve our problems and would merely put off the point at which we must better control our expenditure. In effect we would be dealing with the symptoms whilst ignoring with the underlying cause, and once again putting off difficult decisions.

However, now that Social Security has been a part of Treasury for almost a year, I believe there is another important principle – our taxation system must work in conjunction with our benefits system. We must remove cliff edges and improve incentives to work. Nobody should be better off on benefits than they would by engaging in full time employment.

One of my aims is to remove as many of the low paid as possible from income tax and to remove aspects of benefits from the tax system to better target resources for the most vulnerable. I believe that the way to do this is through the benefit system. In my opinion somebody working full time on the minimum wage should not pay income tax.

We also need to eliminate unnecessary bureaucracy by removing the requirement for as many individuals as possible to file an annual income tax return. These are ambitious but achievable aims and represent the biggest change in the Income Tax system for individuals in a decade or possibly much longer. Turning to my first aim, the boundary between tax and benefits is overly complicated and the two systems do not always work together to make it financially attractive to be in work. This must change and change it will.

From April **2016** I intend to abolish the 10% rate band for individuals and increase the personal allowance to over £14,000. We will therefore have a single tax rate of 20% after the personal allowance. I will announce the level of the personal allowance for 2016/17 in my Budget speech next year but my aim is to ensure that as a consequence of this change as many people as possible on low incomes benefit and I hope revenues will permit me to also ensure that nobody will be worse off. It will mean that over 10,000 low paid people will

no-longer have a tax liability. It will also significantly simplify the income tax system and reduce the instances where income tax acts as a disincentive to paid employment. This will also enable us to divert resources to ensure that those who *should* pay do pay.

As this is such a significant change to our system I am allowing a year for consultation and preparation. In the meantime, for this year, there will be no changes in the personal allowance, the rates of personal income tax or the 10% band.

Last year I indicated my desire to align the income tax allowances for all ages and therefore reduced the age allowance for those aged 65 or over. I remain convinced that this is the correct course of action and will remove the age allowance at the same time as the planned significant increase in the personal allowance in 2016/17. My second aim, to remove aspects of benefits from the tax system, such as personal allowance credits, is stated in the tax strategy. This cannot however be at the expense of the vulnerable. The Personal Allowance Credit or PAC, although refined in recent years, still acts as a potential disincentive to paid employment. It cannot be right that an individual working full time on the minimum wage does not qualify for a PAC but a working age individual with equivalent social security benefit income does.

The PAC was frozen last year at £500 for those with taxable income of £9,300 or less. For 2015/16 the PAC will be reduced to £400 and will only be paid to the elderly and disabled with taxable income of £9,500 or less. My ultimate aim remains that this will be one of the benefits eventually replaced in a new benefits system. All benefits need to be paid via the benefits system to ensure that we are making payments to those who really need the support. I will ask the Assessor of Income Tax to work with the Director of Social Security to put this in place for 2016/17 so that 2015/16 can be the last year of the PAC. For people who previously benefited from the PAC the Income Tax Division will endeavour to ensure that they claim any benefits to which they are entitled.

My final aim for personal taxation is to reduce bureaucracy for both the taxpayer and the Income Tax Division. Nobody likes filling in their tax return and today I am asking the Assessor to commence work on a system that dispenses with the need to file a tax return where the Division holds sufficient information to issue an assessment straight to an individual. It is estimated up to 20,000 individuals fall into this category. The individual tax regime has been with us for many years and is now becoming outdated. I hope that the Assessor can begin a consultation exercise on this subject shortly and that any new updated tax system for individuals will last as long as our current system.

I remain convinced that we need to maintain an attractive tax regime which includes a Tax Cap aimed at encouraging High Net Worth individuals to take up residence and support business development on the Island. We already have 59 five year Tax Cap elections - this equates to revenue of £35.4m over five years without factoring in any of the considerable direct and indirect economic benefits these individuals bring to the Island. For 2014/15 it is estimated that these 59 individuals have secured over 1,400 jobs on the Island resulting in £17.8m income tax and National Insurance receipts per annum. When you add in their personal income tax payments this makes a direct economic benefit of almost £25m per annum, or some £125m over the five years. The total economic benefit will be much greater in that additional jobs will be created and supported elsewhere in the wider economy. The construction industry is a good example of this, a number of high value private construction projects are under consideration generating the potential for significant construction demand.

This is a long way from when this cap was first introduced; at that point only 11 individuals and 3 jointly assessed couples would have had sufficient income to claim the cap.

I hope Honourable Members will feel that the five year election for the Tax Cap is serving its purpose and agree that it is appropriate to increase the annual Tax Cap amount by £5,000 to £125,000 per year. Finally on personal tax, the Homestay concession was introduced in April 1999 to assist with the accommodation for TT visitors. The monetary limit for the concession was last increased in April 2007 and I therefore propose increasing it by 20% to £1,800 for 2015/16.

I shall now turn to **National Insurance**.

Honourable Members are aware of the recommendations of our consultants, in the Ci65 report, to ensure that benefits are properly targeted and financed in a way that ensure the long-term viability of our benefits system. These recommendations need to be consulted on and discussed and I therefore propose only limited changes to National Insurance this year.

In 2012 I introduced the National Insurance Holiday Scheme to encourage the creation of new jobs on the Island. In the first year, there were 585 new jobs to which the holiday applied, from 272 different employers. This year the figures have been just as impressive with 448 new jobs from 225 different employers up to the end of January 2015. Overall since the introduction of the scheme, 666 employers have saved £2.2 million in National Insurance contributions and help create 1,685 new jobs.

The National Insurance Holiday Scheme has served the Island well. However, it is important that we help long-term unemployed people back to work. I am therefore introducing a new National Insurance Holiday for employers who employ a person who has been long-term unemployed or long-term sick. This new scheme will, at the request of the Minister for Home Affairs, also be extended to those recently released from prison to help them back into employment. This will provide additional support to our long-term unemployed and sick to help them get back into work, and also aid in the rehabilitation of those recently released from prison.

Ci65 recommended that those over state retirement age should continue to pay employees Class 1 National Insurance Contributions if they are still working, and this is something I completely agree with. I see no reason why anybody should effectively get a pay rise courtesy of the National Insurance Fund when they reach state retirement age. This is another significant change and therefore again this is a measure that will not be introduced immediately but will be considered over the next twelve months.

Madam President, the rates of Class 1 National Insurance Contributions in the Isle of Man for 2015/16 will remain at the current levels of 11% for employees and 12.8% for employers, and the employees' additional rate will remain at 1%; the rates in the UK are 1% higher in both cases. The Lower Earnings Limit will increase from £111 per week to £112 per week from April 2015 in line with the increase announced in the UK. This is the point at which an individual starts to build up rights to such benefits as Jobseekers Allowance and Basic State pension. The employee threshold will remain at £120 per week and the employer threshold will remain at £117 per week. The Upper Earnings Limit will remain at the current level of £784 per week.

I have long felt that the Class 2 contribution does not properly reflect the value of the benefits it provides; for example, an individual would only have to claim two weeks'

incapacity benefit to receive more than the annual Class 2 contribution. I am therefore proposing to double the weekly rate of Class 2 to £5.40 per week from 6<sup>th</sup> April 2015; however, the rates of Class 4 contributions charged on profits from self-employment will remain unchanged. Finally, the rate of Class 3 contributions will rise from £13.90 to £14.10 per week.

Madam President, I would now like to turn to **company taxation**.

The zero ten regime of taxation for companies is the corner stone of our economy and it is vital that it continues. The evidence is clear that our zero per cent company rate is a key factor in attracting new business to the Island and in assisting existing businesses to expand. We tinker with it at our peril!

The Island committed to the principle of fair tax competition when Tynwald agreed to abide by the European Union Code of Conduct for Business Taxation in 2000. I am sure Honourable Members will agree that as a reputable international business centre the Island must have a fair and transparent tax system for business taxation. We have seen in recent months the damage that can be done to the reputation of a country when allegations of secret deals are made. Fair tax competition means we cannot treat a company owned by a non-resident any more favourably than a company owned by a resident. We cannot simply increase the rate of company tax for locally owned companies or otherwise discriminate using our tax system.

The 10% rate on income from banking businesses reflects the importance of this sector to the Island's economy and the 10% rate for large retailers balances their importance as the providers of goods and employment against the inevitable consequences of such large enterprises trading on a small island and the demands on our infrastructure. This leaves the 10% rate on income from local land and property, where I have found no evidence that it has a wider economic benefit. In fact, the differential with the 20% rate for individuals makes tax planning rather tempting. I am therefore increasing the rate on income from local land and property for companies to 20%. Jersey and Guernsey already do this. This will raise approximately £3m per annum.

However, I would like to make it clear to our industry and any businesses looking to move to the Island that the zero rate for companies is here to stay. Madam President, I will now turn to our indirect taxation and provide an update on the VAT sharing mechanism with the UK.

### **VAT Sharing Mechanism (TBMM)**

In order to plan with certainty we need to conclude our discussions with the UK about the new revenue sharing arrangements under the Customs and Excise Agreement. By way of an update I can report that the data collection work, which covers both household and business surveys, is concluded and the preliminary results of the analysis have been shared with UK.

We are in discussions with the UK Government but it is not clear how long this will last, especially in view of the forthcoming UK General Election in May. We have, however, agreed a further provisional VAT and other duty share for the Isle of Man for 2015/16; which sees our share of the common duties rise by 3% to £286 million. I hope to have agreed the details of the new sharing arrangements by the time of my next budget. The range of Online VAT Services has continued to expand, as has their use. More than three out of every

five businesses are now enrolled to use this service which in turn has meant that almost three quarters of all VAT returns and European Sales List lines are now filed electronically.

### **Hydrocarbon Oil Duty**

Whilst the Island's Hydrocarbon Oil Duty rates for road fuel are to remain frozen for the second year, as in the UK, the reducing consumption of road fuel combined with last year's cut of one penny per litre means that revenue will continue to fall from £32.5 million in 2012/13 to £30 million in 2015/16. Whilst this freezing of the duty rate is good news for the Island's motorists it adds pressure to government's revenue and balancing the budget. As VAT is also levied on fuel for road use the falling price at the pumps will also reduce our indirect tax receipts.

### **Air Passenger Duty**

I am able to announce today that with effect from 1st May this year I am introducing an exemption from Air Passenger Duty for children younger than 12 years of age. I will be extending this exemption to children under 16 from 1 of March 2016. These measures will reduce the cost of air travel for families flying from the Island on larger commercial aircraft and are in line with equivalent exemptions being introduced in the UK. The estimated loss to revenue in 2015-16 is £150K; rising to £300K from 2016-17.

### **Gambling Duty**

An agreement reached with the UK new e-gaming licensing rules means that Isle of Man operators will not have to appoint a fiscal representative in the UK, thereby saving them substantial costs. We have responded to the new UK rules by allowing Isle of Man e-gaming operators to claim double duty relief up to a monetary maximum equivalent to the amount of gambling duty which would have been paid to the Isle of Man Treasury on the same activity. We recognise the burden that the new UK tax will place on our businesses and have responded.

Honourable Members, I will now turn to the **Welfare Benefits System**.

## **SOCIAL SECURITY AND WELFARE REFORM**

The recent reviews of the Island's Social Security system have shown that we simply cannot afford our current arrangements in the long term. As regards state pensions, we must seriously consider a simple, flat-rate pension, paid at a reasonable rate, with entitlement accrued over a longer period, which is viable in the longer-term and which would not place unreasonable demands on workers and employers. People may need to be encouraged to build up supplementary provision through workplace or other private pension arrangements. The State Pension was never meant to be income replacement in retirement.

We will start a full consultation exercise on the future of our social security system next month. The Ci65 report – an assessment of the viability and future sustainability of our benefits and state pension system - was published on the Government web-site on 5th November, and we will follow this with briefings for Members of Tynwald, public meetings and a consultation document. The issues at hand are of the greatest national importance and it is vital that we hear what the public thinks. How to reform will be one of the most important decisions to be made since the introduction of the welfare state. I would however reassure Honourable Members that I will be guided by the founding principles.

## **Annual review of social security benefit rates – benefits paid from NI Fund**

Madam President, I turn now to the annual review of the rates of social security benefits and allowances payable in the Island. As Honourable Members are aware, these can be divided into two groups: those which are funded out of National Insurance contributions and those which are funded out of general revenue.

As regards those benefits which are funded from NI contributions, the rates of benefits and allowances will be increased from the week commencing 6<sup>th</sup> April 2015 by the same amounts as in the UK. In particular, this means that under the so-called triple lock guarantee, basic state pensions will rise by 2.5% - double the rate of inflation at the customary reference point in September- whilst the Additional State Pension, bereavement allowances and incapacity benefit will rise by 1.2%, in line with UK CPI at the September reference point.

I remind Honourable Members that the Manx CPI for January 2015 was minus 0.2% - the first time this inflation index has been negative since it was established in 2008 – and I am therefore confident that this increase is both fair and affordable.

The Retirement Pension Premium will increase by 1.2% - the same as for Additional State Pension, whilst the Nursing Care Contribution is to increase by 1.0%, in line with the Isle of Man CPI.

In the light of recent reports from both the UK Government Actuary and Mercers, and given that the Manx Pension Supplement already costs over £36 million a year, I believe it would be inappropriate to increase the rates of the Pension Supplement at this time. However, as I have just stated, pensioners will benefit from a 2.5% increase in basic state pensions as well as 1.2% more in Additional State Pension for those who qualify. I am sure that Honourable Members will agree that this is welcome news.

## **Special Increase in Carer's Allowance**

I have for some time now been deeply concerned that people who give up or have to refrain from work in order to provide full-time care to a severely disabled person are offered very little from our social security scheme. In fact, the current weekly rate of Carer's Allowance is just £61.35. Carers have an incredibly important role to play in our society and are often the difference between a person being able to live in their own home and having to go into care. Recognising the invaluable contribution they make, I am delighted to be able to announce that from 6<sup>th</sup> April 2015 Carer's Allowance is to be brought up to the same level as the Nursing Care contribution: that is to £112.10 per week - an increase of some 82.7%. This will be of enormous benefit to around 320 carers who currently receive Carer's Allowance. The additional expenditure of around £850,000 per annum is to be financed from savings through the reduction and more focussed targeting of the Personal Allowance Credit which I mentioned earlier.

## **Annual review of social security benefit rates – benefits paid from general revenue**

I turn now to those benefits which are funded out of general revenue. Again, these can be divided into two groups – universal and income-related. Honourable Members will recall that through the Welfare Reform and Wellbeing chapter of the *Agenda for Change* this



Honourable Court agreed to be realistic about what we can afford and to ensure scarce public resources are targeted to those most in need.

For many years it was the norm to automatically increase means-tested benefits in line with domestic inflation, though more recently increases have been linked to increases in earnings. However, the cost of our social security scheme is rising rapidly and we cannot afford to keep adding to those costs. Therefore, I have decided that the rates of child benefit, attendance allowance, disability living allowance – with one exception, which I shall explain in a moment - and each of the prescribed amounts for income support, income-based jobseeker's allowance and employed person's allowance will not be increased from this April.

The exception is the higher-rate mobility component of Disability Living Allowance. Entitlement to this component is a pre-requisite to leasing a vehicle through the Motability scheme. In order to ensure the continued availability of this scheme to disabled people in the Island, I shall be increasing the higher-rate mobility component by 1.3 per cent from April, so that the difference between UK and Isle of Man rates is maintained at its current level. However, simply freezing the rates of these revenue-funded benefits alone does not contribute enough to balancing the budget. We must significantly reduce the cost of our social security scheme going forward. To achieve this, I intend to take a number of measures which I shall now explain.

### **Child Benefit**

As Honourable Members are aware, from last April we started to means-test entitlement to child benefit. Currently, families whose incomes are less than £60,000 a year are eligible for the maximum amount of child benefit; families whose incomes are between £60,000 and £90,000 receive a reduced amount of child benefit and families with incomes above £90,000 a year are not entitled to any child benefit. I have to announce that from this April each of the income thresholds will be reduced by £10,000, in order to reduce expenditure by around £1 million annually. So, from 6<sup>th</sup> April 2015, families with annual incomes of less than £50,000 – a little under twice the amount of median earnings in the Island - will continue to be entitled to the full amount of child benefit; families with incomes of between £50,000 and £80,000 will receive reduced amounts of child benefit, whilst families with incomes above £80,000 will no longer be entitled to child benefit.

### **Free TV licences for over 75s**

Since the beginning of 2002, everyone aged 75 or over has been eligible to receive a free TV licence, irrespective of their means, under similar arrangements which exist in the UK. The cost of this provision is borne by the Manx taxpayer and currently amounts to around £700,000 a year. Madam President, as I alluded to earlier, this Honourable Court has resolved to be realistic about what we can afford going forward. Our much reduced revenue resources must be focussed on those who need them most. Free TV licences for the over 75s on a universal basis are no longer affordable and cannot be justified. Free TV licences for the over 75s are provided in UK regulations, which are being extended to the Island. Therefore, we shall shortly be asking the UK Government to amend the relevant regulations in order to exclude the Isle of Man from the earliest possible date.

However, pensioners on low incomes will be protected from this measure. There is already in place a scheme which enables pensioners who receive income support to receive a payment from Social Security for the full cost of their licence. For others, the BBC offers

direct debit options to spread the cost of a licence over periods of up to a year. Net of additional payments for those who receive income support, this measure is expected to save around £600,000 in a full year.

### **Jobseeker's Allowance**

The Isle of Man continues to enjoy economic growth, yet both long-term unemployment and youth unemployment remain stubbornly high. Just under 200 jobseekers - a fifth of the total unemployed register - have been registered as unemployed for over a year. This number has barely changed over the last two years, despite Government initiatives specifically targeted at reducing the number.

Over a third of the total number of unemployed people is under the age of 25, and a third of them have never worked. The rates of income-based jobseeker's allowance payable on the Island are significantly higher than in the UK and the amount of earnings from part-time work which can be ignored for jobseeker's allowance purposes here is also significantly greater than in the UK. It is a fundamental principle of the 1942 Beveridge Report that people must always be better off in work than on benefits. Yet, it may be that our relatively generous approach is dissuading some jobseekers from leaving benefit to take-up a job.

I believe there would be merit in reducing the current rates of allowance – either across the board, or on a targeted basis - and my officers will report to me before the end of March, on measures aimed at cutting expenditure by up to £400,000 a year.

### **Incapacity Benefits**

Approximately 2,000 people have been receiving incapacity benefits for over a year. The new Personal Capability Assessment piloted by the Department of Social Care in 2012-13 showed that a proportion of those claiming incapacity benefits are actually capable of performing some form of work. With the help of a new provider, over the next three years the majority of recipients of long-term incapacity benefits will have their work capability formally assessed. If people are capable of some form of work, even if it is not in the same role they previously occupied, they will be encouraged into the workplace. But this is not just about making cost savings - it is a genuine attempt to help people escape the benefits trap and realise their full potential.

We have a duty to ensure people are receiving the support that is right for their circumstances and that Government's resources are focused in the most appropriate manner. There is a body of evidence which demonstrates that people are better off in work than out of work, not only financially but in terms of their health and wellbeing, their self-esteem and the future prospects for themselves and their families. People who are long-term unemployed or who have never worked are up to three times more likely to be in poor health than those in work. We have inadvertently built up a dependency culture when medical and nursing evidence shows that work empowers, energises and makes someone feel worthwhile, useful and builds their confidence and self-esteem

### **Capping allowances in means-tested benefits for public sector rents**

When assessing entitlement to means-tested benefits, such as income support or employed person's allowance, allowances are made for certain housing costs which the claimant or their partner are liable to pay in respect of the property they occupy as their home. Under the current rules, people renting properties from the Department of Health and Social Care

or a local housing authority get allowance for the full amount of rent and rates for which they are liable in the assessment. However, for those renting in the private sector the amount that can be allowed is capped. The broad intention of the cap is to ensure that the taxpayer is not paying for accommodation which is of a greater size than the claimant and their family, if they have one, actually need. I believe that the same principle should apply to tenants of DHSC and local authority properties.

Therefore, subject to limited transition protection for the handful of cases who would otherwise be affected immediately, the same limits as already apply to claimants renting in the private sector will also apply to claimants renting in the public sector, from the beginning of April.

## **CONCLUSION**

Madam President,

So far so good! We have come a long way to arrive at a balanced budget. The journey has had its challenges, but I always had confidence that we would succeed. The budget for 2015-16 represents the culmination of these efforts over the last four years, and what is now presented is a balanced and more prudent budget. This is a budget that better targets those areas requiring additional support, in particular Health through the Health Inspection Fund. A vote in favour of this budget is therefore a vote for Health.

It also recognises the special importance to the community of those that care for others through the very substantial increase to the Carers Allowance. Reviews of the taxation and social security systems have begun. Consultation on changes to the personal allowance and 10% band will commence in the coming year with a view to further simplification and removal of a significant number of people from the tax net.

We are finding ways of using measures to grow the economy whilst at the same time reducing dependence upon the state where people can be better off through work. We are developing greater fairness and greater sustainability through the prioritisation of resources to those areas where needs are greatest. The transition will be challenging for some of those affected, but decisions have to be made which seek to protect the longer term sustainability of our resources for the benefit of our wider society and economy, whilst at the same time continuing to protect the truly vulnerable.

This is a budget that firmly puts in place the structures to help us achieve long term affordability and sustainability in the public finances. We must continue to support the economy and more effectively deliver our services at no extra cost. We need a smaller, smarter government which gives the taxpayer better value for money. We will seek reform to drive down our long term liabilities, not least in terms of pension and welfare costs. Only then can we claim to be truly living within our means. I am confident that given what we have achieved so far, with closer working together, we will succeed.

Before closing I would like to thank the Treasury Members – Mr Downie, Mr Braidwood and Mr Henderson - who have each in their own way with their different perspectives helped me with their advice and counsel in the production of this budget. Thanks also need to go to my colleagues in the Council of Ministers who have worked hard through some long budget sessions to arrive at this point.

I will repeat by saying that my budget today is based on the following four principles.

- It honours the promise of this Government to balance the books.
- It continues to focus on fairness.
- It maintains funding for vital services for the Island's community, and particularly those who are vulnerable.
- It starts us on the path of building systems, finances and services for the next generation and not just for the next general election.

With its prudent and focussed approach, this budget represents sound and balanced stewardship. It is a positive budget reflecting the positive achievements of this Government. I call on you to join me in working together for the future benefit of this Island, and I commend this budget to the Honourable Court.

**Hon W.E Teare MHK  
Minister for the Treasury**

**17<sup>th</sup> February 2015**