

**CHIEF MINISTER'S BUDGET SPEECH**  
**JUNE 2006**

Mr Speaker,

**1. INTRODUCTION & SUMMARY**

It is an honour to present my eleventh successive budget of Government revenue and expenditure to this House. And it is my pleasure to inform this House that both in terms of public finances, and in terms of the economy as a whole, Gibraltar's economic position has never been better.

In summary:

- (1) The Government's budget surplus in the year just ended was a record all time high of £22.3 million;
- (2) The Government's capital reserves stand at a record all time high of £93.6 million;
- (3) The number of jobs in our economy stands at a record all time high of 16,874, up 880 on the year;
- (4) The rate of taxation stands at a record, all time low; and
- (5) Government investment in public services and capital projects and amenities stands at an all time high.
- (6) The economy is bigger than ever before.

By any and every measure the economy is healthy, prosperous and growing.

The Government will continue to share the fruits of this economic success throughout the whole community by, once again this year, lowering taxes significantly. Indeed, later on in my address to the House, I will outline the most radical changes to our tax system and to our Social Insurance Contribution system, since taxation and social insurance were introduced in Gibraltar. These measures will benefit thousands of people.

The Government will also continue to share out the fruits of our economic success throughout the Community by investing, from our record capital reserves, in affordable housing, rental housing, public housing refurbishment, parking projects, new roads, sports and leisure amenities, heritage projects, street beautification projects and many more, which I will set out later in my address. Indeed, the Government has £140 million worth of capital investment projects in the pipeline for execution during the next 18 to 24 months or so.

Mr Speaker, luxury developments are important to Gibraltar economically. They provide economic activity, valuable assets and indeed revenue and capital to the Government, which Government is then able to invest in public services and capital projects. That said, it needs to be borne in mind that the overwhelming majority of buyers in these so-called luxury developments are Gibraltarians.

During the remainder of this address I will analyse in some detail, firstly, the public finances, Government's budgetary performance, the public sector and I will review the Government's capital projects programme; secondly, the state of the Economy as a whole; thirdly, I will comment on some of the economic issues that others in Gibraltar have raised publicly during the last year; and finally I will, of course, be announcing my budget measures for this financial year.

## **2. PUBLIC FINANCES**

As I said in my introductory remarks, public finances have never been in better shape.

### **(a) Budget surplus y/e 31<sup>st</sup> March 2006**

Every year I have explained how the Government uses the budget surpluses generated in the previous year. I have

explained that Government gives part of it away in tax cuts, uses another part of it to finance improvements and development of public services (like health, education, social services and sports and leisure services) and uses another part of it to invest in capital projects.

Our successful management of the economy has enabled us to do all three of these things in record amounts during each of the last 10 years, and last year's record Government budget surplus enables us to continue to do so this year.

Last year's overall budget surplus stood at the record level of £22.3 million including the Consolidated Fund, and Government Agencies and authorities. This is an all time record, and reflects mainly buoyant tax revenue. There are no budgetary deficits carried forward in any of the agencies, so the figure of £22.3 million is gross and net of deficits carried forward. The overall surplus of revenue over expenditure of £22.3m is struck as follows: -

	<u>Rev</u>	<u>Exp</u>
Consolidated Fund Recurrent	198.5m	131.3
Consolidated Fund Exceptional	-	.5
GHA	26.2	50.7
GEA	16.6	21.6
ECA	0.6	5.8
GDC	4.3	5.7
SSA	-	3.8
GSLA	-	0.9
SAF	-	3.6
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Total	£246.2m	£223.9m

The Consolidated Fund expenditure figure is net of contributions to the agencies and authorities. And the revenue of the agencies and authorities is net of contributions from the consolidated Fund. The result provides Government's overall revenue and expenditure position.

As far as concerns the Consolidated Fund only, the forecast outturn surplus reflected in the amended budget book tabled in the House shows a figure of £19.4 million, but final Treasury reconciled figures will show that the actual amount for the year was £20.3 million. This is also a record.

This Consolidated Fund surplus (that is the published figure of £19.4 million) was achieved following revenue of £197.6 million, and expenditure of £178.2 (including £0.6m of exceptional expenditure).

The actual Consolidated Fund surplus that will appear in the accounts for 2005/06 is £20.3 and not £19.4 m. This is because, Revenue is £0.9 million more that reflected in the Forecast Outturn.

Revenue (at £197.6m) was £16.4 million higher than was estimated at the year start. The House is aware that Government's estimating of revenue usually tends to the conservative side, in order to provide a buffer in the event of unexpected falls or volatility in revenue levels.

The main contributions to this higher than estimated revenue were Income Tax (£7 million), Company tax (£5 million), Exempt Company tax (£1.2 million), Rates (£0.75 m), Gibtel dividend (£1m) and Gaming Tax (£1.8m).

Consolidated Fund expenditure, on the other hand was £178.2, compared to the estimated figure of £181m, i.e. consolidated fund expenditure was £2.8 million less than estimated.

Comparing the year on year actual figure for 2004/5 with the forecast outturn for 2005/6, the position is as follows: -

	<u>Actual</u> <u>y/e 31.3.05</u>	<u>Forecast Outturn</u> <u>y/e 31.3.06</u>
Consolidated Fund Revenue	£181.0m	£197.6m = +£16.6m
Consolidated Fund Expenditure	£180.0m	£178.2m = - £1.8m

Mr Speaker, the fall of £1.8m in consolidated fund expenditure, does not mean that less money was spent on services last year. Indeed, more money was spent. But the comparison with the y/e March 05 shows a fall, because in the y/e March 05 there was expenditure on clearing prior year's deficits carried forward in certain authorities and agencies, and that was not expenditure in actually delivering services in that financial year.

Indeed, comparing money spent on delivering public services during last year, with money spent delivering services during the previous year, the position is, an increase as follows: -

	04/05	05/06	
Consolidated Fund Recurrent	126.9	131.3	+4.4
Consolidated Fund Exceptional	2.2	0.6	- 1.6
Gibraltar Health Authority	46.6	50.7	+4.1
Elderly Care Agency	4.0	5.8	+1.8
Social Services Agency	3.5	3.8	+0.3
Gibraltar Electricity Authority	17.8	21.6	+3.8
Gibraltar Sports & Leisure Authority	-	0.9	+0.9
Gibraltar Development Corporation	6.4	5.7	- 0.7

Social Assistance Fund	3.4	3.6	+0.2
	<hr/>	<hr/>	<hr/>
Total	210.8	224.0	+13.2

Of this increase of £13.2, £4.4m was in the Consolidated Fund, and £8.8m in Authorities and Agencies.

The increases in expenditure that are accounted for in the Consolidated Fund are principally the following: -

- (1) £3m in Government Pensions
- (2) £1.7m in payroll costs

In the agencies and authorities the main increases in expenditure last year were on: -

- (1) Health Services - £4 million
- (2) Electricity - £3.8 million
- (3) Elderly Care - £1.8 million
- (4) Sports & Leisure - £ .9 million
- (5) Social Services - £ .3 million

(b) Budget 2006/07

Mr Speaker, looking forward to the current financial year, and in terms of overall revenue and expenditure, the government is estimating on the basis that it will receive revenue of a total of £250 million, and will spend a total of £232.7 million. These figures include the Consolidated Fund and agencies and

authorities. Accordingly we are estimating an overall surplus of £17.3 million.

The main estimated expenditure increases are as follows: -

(1) Consolidated Fund Recurrent :	£3.6m
(2) Health Services :	£1.7m
(3) Electricity :	£1.5m
(4) Social Services :	£0.3m
(5) ECA :	£0.3m
(6) GSLA :	£0.3m
(7) GDC :	£0.9m
(8) SAF :	£0.3m

All these figures are, again, real expenditure, i.e. net of contributions to and from the consolidated fund. This represents an estimated year on year increase in overall expenditure of £8.7m or 3.88% from £224m to £232.7 million.

Overall revenue is estimated on the basis of growth by £4 million, that is from £246 million to £250 million (or 1.63%), which is a conservative estimate.

In terms purely of the Consolidated Fund, the Government is estimating on the basis that revenue will grow by £4 million (2%), which is a conservative estimate; and that expenditure will rise from £178.2m to £185.9m, that is by £7.7m or 4.32% (these figures are obviously inclusive of contributions to agencies and authorities).

I should point out, Mr Speaker, that these figures for the estimates for the current year do not include the effect on estimated revenue figures of the budget measures that I will

announce today. Nor do they include, on the cost side, the impact of the increased services that I am announcing today.

(c) Public Revenue & Expenditure: increases since 1997

Mr Speaker, since 1<sup>st</sup> April 1997 (1997/98), (that is during the last 8 financial years) overall public revenue has grown from £138.4m to £246.2m p.a., that is £107m p.a. or 78%.

Overall public recurrent expenditure in the same period has grown from £126.9m p.a. to £223.4 p.a., that is £96.5m p.a. or 76%.

Mr Speaker these figures, being “recurrent” expenditure, exclude exceptional expenditure, of which there was £2.2 million in 2004/5, and £0.6m in 05/06. That would increase the overall expenditure figure by £2.8m to £226.2 million or a growth of 78% over these 8 years.

The public services which have increased most roughly speaking are

	97/98	2005/06
Health	£23m	£51m
Education	£13m	£20m
Social Services	£ 9m	£18m
Sport	£ 1/2m	£ 1m
Environment	£8 <sup>1</sup> / <sub>2</sub> m	£12 <sup>1</sup> / <sub>2</sub> m

These ballpark figures show the extent to which the Government has invested in expanding and/or improving health services, social services, education, sport and the environment of Gibraltar.



(d) Public Reserves

Mr Speaker, thanks to sustained budget surpluses in all but one year, the sale of ex-MoD properties received as part of the lands agreement, and premiums received from private developers for sale of land and development rights to them, the Government's cash reserves at 31.3.06 stood at the all-time high of £93.6 million, double the level of reserves in 1997.

The Government expects that substantial parts of this reserve will be spent during the current year on affordable housing and other major projects. But the Government will also receive more premiums on land sales and development rights, and will also generate a budget surplus during the year.

The level of reserves at the end of the current financial year will thus depend on a number of variables, mainly level of sales, extent of current year budget surplus, and extent and cost of progress on projects. The estimated figure quoted for 31 March 2007 of £82 million should therefore be treated in that light.

(e) Public Debt

In the meantime, and despite the government's ongoing, substantial capital investment programme, public debt remains at £93 million.

Since it remains static in absolute cash terms, while GDP and Government revenues have continued to grow very significantly, the level of public debt, as measured economically under OECD and EU principles, has continued to fall.

By OECD and EU measures Gibraltar's public debt is very low indeed, representing only 15.7% of GDP and the debt servicing cost represents only 3.6% of total Government revenue. This will fall to as low as 2% this year.

To place these figure in context, the benchmark is 40% of GDP, the UK figure is 33.7% and the EU target for all EU countries under the Maastricht Treaty criteria is 60%. Our debt stands at just 15.7% of GDP.

### 3. Public Sector

#### (a) Headcount

Mr Speaker, recently, one trade union official said that the Government's recruitment policy represented a threat to manning levels throughout the public sector. A few statistics will serve to prove the lie, and to show that, as part of its policy over the last 10 years, to upgrade and develop public services, the Government has very substantially increased the number of people employed in the public sector, and continues to do so.

Since 1999 Government related public sector employees have grown in number from 2857 to 3672 (excluding 52 GHA, Social Services and other temporary, supply staff), an increase of 815 or 28 ½ %! And the numbers continue to rise each year.

These public sector employees breakdown as follows: -

	98/99	05/06
1. Government departments	2153	2170
2. Gibraltar Health Authority	617	808

3. Elderly Care Agency	-	243
4. Gibraltar Regulatory Authority	-	9
5. Social Services Agency	-	104
6. Gibraltar Electrical Authority	-	155
7. Gibraltar Sport & Leisure Authority	-	23
8. Gibraltar Development Corporation	<u>87</u>	<u>160</u>
	2857	3672

These figures do not include employees of wholly owned Government Companies, of whom there are 320.

In analysing these figures, a few points should be borne in mind, as follows: -

- The number of civil servants in Government departments have increased by much more than 17. This is because the 2153 figure for 98/99 includes Electricity Department and Sport Department employees (totalling about 169), but the 2005/06 figure of 2170 does not include those staff or departments because they had moved into Authorities. Overall increase is therefore about 186.
- GHA employees are, in the main, Government employees, even though they work in the Gibraltar Health Authority and not in a Government Department.
- The same is true of some Social Services Agency staff.

(b) Payroll Costs

The House may be interested in learning that last year, of the Government's overall total expenditure of £224 million, £122 million related to payroll costs (pay and pensions), that is nearly 55%.

(c) Public Sector not "too big"

Mr Speaker, much has been said recently, including by the outgoing President of the Chamber of Commerce about the Civil Service generally and the affordability of civil service pensions into the future in particular. Much of this comment is simply misinformed folklore.

Firstly, let me say that the Government makes no apology for rebuilding the civil service, and other parts of the public sector, and so significantly increasing staffing levels in them. The public sector is at the very heart of the delivery of all public services, including key services such as health, education and social services upon which this community is built, and it is not possible to modernise, expand and improve public services without an adequate number of staff.

Contrary to the myth propagated in some areas of the private sector, the vast, overwhelming majority of public servants are competent, hard working, committed and productive workers with little to envy, in this respect, their private sector colleagues. I know this from personal experience, having now worked both in the private and in the public sector. Of course, where there is inefficiency, lack of value for money or abuse of absenteeism, the Government should and will seek to remedy the situation. Similarly, and in co-operation with trade unions the Government will seek to modernise the way things are done, where this will improve the public service or value for money or route out inefficiency. Where the government does this in isolated parts of the public service, it is absurd for any trade union leader to try and pretend that this is an assault or a threat to the whole public sector.

The Government's superb record on recruitment, rebuilding staffing levels, promotion and training opportunities, as well as investment in improving public sector offices, depots and other work places speaks for itself.

Similarly, there is misinformed comment from time to time, in the private sector to the effect that the public sector is “getting too big”. Such remarks are misconceived. Whether you measure the public service in terms of its cost as a percentage of GDP, or its employees as a percentage of total jobs in the economy, the public sector is either staying the same size or getting smaller. It is economically speaking misinformed, to say that its getting bigger simply because the cost of running it increases each year in absolute terms.

Whatever indicator you choose to use, shows that, if anything the public sector is getting economically smaller not bigger.

In 1998 the Gibraltar Government and its public sector entities employed 22% of all jobs in the economy. As at 2005 that figure had fallen to 20%. In other words, measured by employment, the public sector is getting smaller relative to the size of the job market and the economy.

Finally, a comparison with the UK reveals that Government expenditure as a percentage of GDP continues to be much lower in Gibraltar than in the UK. In 2004/5 it stood at 30.3% in Gibraltar and at 38.2% in the UK.

#### (d) Public Sector Pensions

As with the cost and size of the civil service, so to with public sector pensions, it is not economically meaningful to speak of rising costs, or “becoming too expensive” or “being unaffordable in the future, without seeing those costs in the context of the economy of which it forms a part and rising Government revenues.

Perhaps I could illustrate that in the following way. In 1997/98 the bill for civil service pensions was £8.8 million. In 2005/06 it was £18.2

million. At first sight a huge increase. But in economic terms both figures are more or less the same percentage of total government revenue. 6% in 1997/98 and 7% in 2005/06 or, measured as a percentage of GDP, the pensions bill was 2.43% in 1997/1998 and 2.64% in 2003/4. The GDP for 2005 is not yet known, but if (which is unlikely), the economy grew by only 5% in 2005, the figure for 2004/5 would be 2.6% of GDP.

It is also said, therefore suggesting that it has not been done that the Government should tackle this issue by eliminating final salary pensions for new employees and replacing them with Contributory money purchase schemes.

Where have such commentators been these past few years? Are they not aware that hundreds of public sector workers in the GDC, the Social Services Agency, the Elderly Care Agency and others are indeed already on contributory money purchase schemes and that, as a result of setting up the Electricity Authority, and the Sports Authority future employees of those will be on such pensions as well. There has therefore been a huge amount of progress made in limiting the incidence and therefore the future cost of final salary pensions schemes on future generations of Gibraltar taxpayers.

#### **4. Government Capital Projects**

Mr Speaker, since 1997, the Government has invested £195 million in Capital Projects, which have transformed the physical appearance of Gibraltar and many of its public amenities. This sum excludes the New Hospital.

Earlier I referred to the Government's capital projects programme which would be funded from accumulated reserves and from the ongoing property sales programme.

The programme of Projects for execution during the next 12 to 24 months, falls mainly into 3 categories:

- (1) Housing projects;
- (2) Roads, Parking and Beautification Projects; and
- (3) Other Major Projects.

The following are the principal projects in each category which are either already under way, or which will be commenced during the current financial year.

(1) Housing Projects

In addition to the Government's ongoing annual housing estate refurbishment and beautification and lift installation programme, which will continue this year, the Government's housing projects include:

- The Construction of Waterport Terraces;
- The Co-ownership scheme relating to Waterport terraces, Nelson's View, Cumberland Terraces and Bayview Terraces;
- Continuation of the £1.3m remedial works programme at Brympton Estate;
- Continuation of the £2.2 million project of remedial works to the Podium at Harbour Views;
- The refurbishment and sale, as affordable housing, of three old buildings in the Upper Rock.
- Building a new worker hostel at Devil's Tower Road;
- Providing a women's half-way hostel, the first ever in Gibraltar;
- Converting part of the old St Bernard's hospital site into a new sheltered residential home for the elderly;
- The rebuilding of sheds at Laguna Estate;

(2) Roads, Parking and Beautification Projects

Government has an extensive programme of such projects which are either under way already, or are expected to get under way during this financial year. They are as follows: -

- Four new roads will be built, all of them to decongest traffic and circulation. These are
  - A new road linking Castle Road and Willis' Road
  - A road linking Reclamation Road and Fish Market Road; and
  - A road linking Europort to Queensway at the Coaling Island Junction.
  - A new covered and protected Dudley Ward Tunnel access road.
  
- Four major projects to provide car parking facilities in residential areas: -
  - An underground car park at Sandpits. This project also provides three new tennis Courts and two new paddle tennis courts for the Sandpits' Tennis Club.
  - A multi-storey car park at Willis' Road;
  - A new car parking deck at New Harbours;
  - A car parking area between Old Naval Hospital Road and Vineyards.

Together, these 4 projects will provide well over 500 car parking spaces and lock-up garages for local residents.

- The Upper Town Renewal Scheme continues with a variety of street and building refurbishment and heritage projects;



- Recovery, refurbishment and beautification of Orange Bastion and Chatham Counterguard.
- The refurbishment and beautification of the Public Market and “La Plaza del Reloj”.

(3) Other Major Projects

The principal projects in this category include: -

- A major beautification and refurbishment of the cemetery, which is already under way;
- The replacement of the frontier fence, which is already under way;
- The building of a new prison at Lathbury Barracks;
- The completion of the new Bayside Sports Complex;
- The recovery and refurbishment of the King’s Bastion, and the building in it of a Leisure Centre;
- The refurbishment of the Guardhouse at John MacIntosh Square;
- The Conversion of the Retrenchment Block at Lathbury Barracks;
- A programme of refurbishment works to the Upper Rock;
- New premises for the RGP Marine Section and the Sea Scouts;
- The refurbishment of the Northern Defences and Tunnels.

All of these projects have a total value of about £140 million, of which around £63 million is expected to be incurred this financial year.

Other major projects will be announced during the course of the year, including the Government's further plans for rental housing.

As I have said Mr Speaker, this massive capital investment programme which will transform our streets and squares, retrieve much of our heritage, transform our housing, our sports and leisure facilities; build new roads and massively increase car parking facilities – in short a further major stage in the already extensive transformation of Gibraltar since 1996, possible, in part because of the Government's economic success, but also because of the Government's (sometimes criticised) policy of selling development land and rights to private developers, so that the proceeds can be invested for the benefit of the whole community.

Mr Speaker, some of the projects that I have just described are provided for in this year's Improvement & Development Fund's estimated expenditure of £38.5 million. This I&DF expenditure will be largely funded from sale of Government properties (£31 million) and contributions from reserves of (£5 million).

Last year we were able to spend £16.64 million against an estimate of £24.6 million, amounting to nearly 67%. This year, following the introduction of a new system for rolling out supervising and managing the execution of capital projects, we expect to be able to spend much more. Furthermore, there are more high value individual projects many of which are already under way or tenders already awarded. This also will facilitate a higher spend.

## 5. The Economy in the Private Sector.

Mr Speaker, the economy remains robust and buoyant, and continues to grow healthily.

(1) The size and growth of the Economy

As I told the House in December, during 2004 the economy grew by a gross 10.4% and an inflation – adjusted 8%. GDP in 2004 stood at £560 million. This increase or growth, has been brought about largely by an increase in total income from employment (+11.2%) as a result of the increased number of persons in employment (+8.1 %), and the increase in annual average earnings over that period (+3.9%).

The prediction (not an estimate) for GDP in 2005 is around £600 million, representing growth of 7%. The proper estimate figure will not be known until the Autumn.

Mr Speaker, the House may be interested in the following anecdotal information. If Gibraltar were an independent country (of which there are 185) our economy would be the 159<sup>th</sup> largest in the world, according to the World Bank list for 2004.

In terms of personal affluence, our GDP per capita is 10<sup>th</sup> in the world. Infact, it may be even higher because it is 10<sup>th</sup> comparing 2004 Gibraltar GDP to 2005 figures for other countries, i.e. were 10<sup>th</sup> ignoring our 2005 GDP growth!

(2) Inflation

Mr Speaker, inflation in Gibraltar during 2005 was running at 2.8%.

Given the openness of the Gibraltar economy, the rate of price inflation is determined to a large extent by factors which are outside local control, for example the rate of interest, oil prices, exchange rates, and inflation in countries from which we import our manufactured goods.

The Government predicts that the rate of inflation in Gibraltar is likely to continue within the 2% to 3% range throughout 2006.

(3) Employment

The number of jobs in the economy grew in 2005 by a huge 880 jobs or 5.5%. This is a very large increase in a single year and reflects the continued growth of most of the sectors of our economy.

There are now 3894 more jobs in the economy than in 1996, representing an increase of 30%! There are now 16,874 jobs in the economy, and we believe that this has continued to increase during 2006. Obviously, these 16,874 jobs represents an all time record high level of jobs in our economy, and is a further indicator of the economic success of which I spoke earlier.

782 of these new jobs were in the private sector, and 371 of those were in the Gambling Industry. As at October 2005 the Gambling Industry employed 1495 people, of which 120 were at the Casino, but the number of jobs in the online and telephone Gambling Industry alone has now risen further to 1634, showing that the Gambling Industry has become consolidated as a pillar of our economy.

Mr Speaker, the number of Gibraltarians economically active, that is participating in the labour market or self employed continues to rise and stands at an all time record high. The 2001 Census showed that 10,090 Gibraltarians were economically active. Despite a constant, if ageing population, this has risen as at October 1995 to 11,203. This represents an increase of 11% over the past 5 years. In 2001 the Gibraltarian population aged 15 and over totalled 18,500 of which 55% were economically active. This stood at 61% in October 2005. This is supported by the 2005 Employment Survey which shows that the number of jobs held by Gibraltarians increased from 9154 in October

2001 to 9870 in October 2005 - a rise of 7.8%. Thus employment within the economically active Gibraltarian population is estimated at 97%, almost full employment.

This makes it inevitable that the bulk of new jobs resulting from further economic growth will be taken by outsiders. Indeed, without importing labour, our economy simply cannot grow and could stagnate over time. The Government therefore rejects the economically misconceived, pseudo nationalistic and politically motivated remarks that one hears from time to time to the effect that there are “too many Spaniards employed in Gibraltar”. The Gibraltarian labour supply is effectively fully deployed already at around 9900. Gibraltarians reaching retirement age are replaced in the labour market by school leavers and returning graduates, but in net terms Gibraltarian labour supply is effectively fully deployed.

Indeed, Mr Speaker since 1996 the number of Gibraltarians in employment has risen from 9390 to 9870, an increase of 480, represented entirely by women.

If we go back to 1988 the number of Gibraltarians in employment has risen by 1034 or 11.7% comprising 945 women and 85 men.

#### Average earnings

Average earnings in respect of all employees increased in 2005 by 8.7% from £17,834 p.a. to £19,383 p.a.

Mr Speaker, in 2005 the average wage earner in Gibraltar was at least 30% better off in terms of net take home pay compared to the average wage earner in 1995, after pay rises and inflation. The principal reason for this 30% improvement in net take home pay is the impact of the Government's very significant tax cuts since 1996.

## The Sectors of the Economy

### (a) Tourism

Mr Speaker, the buoyancy of the economy is not just reflected in rising GDP, rising employment numbers, and rising tax yield from companies and individuals. It is visible also from these economic indicators that relate specifically to individual sectors of the economy.

In relation to the Tourism sector, the number of visitors to Gibraltar in 2005 reached a record high of 7.8 million. Arrivals by land and sea reached record levels, and arrivals by air were the highest since 1989.

Cruise ship passenger arrivals increased by 15.4% reaching the record level of 187,824, in 171 cruise ship calls.

Hotel occupancy rates crept up to another record of 68.6% even though a reduction in guest nights offered was reflected in a slight reduction in Guest nights sold and total arrivals. At 68.6% hotel occupancy rates compared to 43.3% in 1996.

The Government remains of the view that hotel business in Gibraltar will not improve further unless and until there is a substantial increase in the number of hotels and hotel rooms and beds available. This will give Gibraltar a capacity which will more interest tour operators. Arguably, Gibraltar is already short of hotels even for current demand. The 68.6% occupancy rate conceals the fact that there are times of the year during which tourists and businessmen alike simply cannot get a room in our hotels. This constrains economic growth. Government is thus embarked on a policy to encourage and attract new hotel investment and construction in Gibraltar.

### (b) Financial Services

Mr Speaker, the financial services sector, for which I have direct ministerial responsibility, also continued to both prosper and to reposition itself in higher value, sustainable activities, despite the continuing uncertainty in relation to tax.

The Government continues to work well with the industry to carve out new opportunities and to shore up existing ones. This is reflected in such things as the recent amendments to the Income Tax Ordinance, administrative tax rulings by the Commissioner of Income Tax, and the recent legislation for Experienced Investor Funds. The latter will, I think, be an exciting new growth area for our finance centre, which several operators are already successfully exploiting.

But our banks continue to develop and grow their investment and private banking operations and their assets under management, all despite the arrival of the Taxation Savings Directive, which has not had the impact that some of the more pessimistic observers had feared and predicted.

The reputation of Gibraltar in international finance circles remains high and this will be further bolstered by the positive assessment that we expect to receive from the IMF following their recent inspection visit.

Bank deposits and other liabilities increased by over £1 billion or 18.7%, following an 18.6% increase the previous year. Cash, loans and other assets also increased in aggregate by the same amount. 2005 saw 1 new banking licence issued.

Insurance related licences grew by 10 to 83 in 2005 (from 73 to 2004) and by a further 5 to 88 in 2006 so far. This sector has now grown from 29 licences in 1996 to 88 now.

Similarly investment firms continue to grow in number from 12 in 1996, to 22 in 2004, 24 in 2005 and 26 so far in 2006. During this year we

have agreed the establishment of investment services passporting into the UK. This should further bolster this sector.

Company & Trust management also continues to grow, albeit more slowly, from 77 in 1996 to 80 in 2004 and 82 now. This is creditable and encouraging given the turmoil represented by the end of our exempt status company product. Once again the versatility and skill of the sector, coupled with the close working relationship with the Government has cushioned the impact of this measure on business levels.

Employment levels in the Finance Centre in 2005 stood at 2320, up 5.6% or 123 from 2004. It is up 724 or 45% from 1996! The sector now accounts directly for 13.7% of the jobs in the economy. However, these figures exclude self employed professionals within the finance centre, and it is thus certain that the number of people active in this sector is higher, probably nearer 2700.

(c) The Gambling Industry

Mr Speaker, Gibraltar is now established as one of the world's foremost and pre eminent centres for on-line gambling activities. We are also among the world's pioneers in devising a legislative and regulatory framework for the on-line and telephone gambling industries.

Employment in the Gambling Industry currently stands at 1634, up from just 185 in 1996.

We are proud to host three listed and publicly traded Companies, in Partygaming, 888.com and 32 Red Bull. These companies which are fully established in Gibraltar enhance our business profile and promote our economy as a whole.



The financial sector, the hotel and restaurant sector, and the gambling sector now account for 28.7% of all jobs in the economy, virtually the same as the MOD represented back in 1981 (32.3%). This is a mark of the extent to which Gibraltar has successfully replaced the lost MOD activity with the financial sector, tourism, and now Gambling. Indeed the MOD now accounts for just 6% of jobs in the economy.

(d) The Port

The port continues to make an important and growing contribution to the economy, with number of ship visits and bunkers sold both standing at record highs, and cruising continuing to grow.

The Wholesale & Retail Trades.

Mr Speaker, the wholesale and retail trades is important to Gibraltar, economically and socially. It employs a total of 2692 people, of whom 1422 are Gibraltarians. And this is perhaps the sector of our economy that is most challenged by a combination of factors. These are fewer high spending Americans cruising in the Mediterranean; Spain's retail offering is now very competitive both as to price and range of goods; Gibraltar residents understandably seek the best options both as to price and choice, and so often shop in Spain. It is not realistic to expect people to forego the opportunity to buy goods more cheaply and thus make their disposable incomes go further.

The Government will seek to work closely with the new board of the Chamber of Commerce to see what Government can sensibly and realistically do to help these important sectors. But Government tinkering with peripheral costs is not usually an alternative to a sound product and business model. Our businessmen must do as they have always done, and that is to vary the offering and the shopping experience to carve out a commercial opportunity despite our lack of price competitiveness.

Main Street in particular must remain a distinct and unique shopping environment. I believe that if it becomes indistinguishable from a UK High Street, or a Spanish shopping precinct, by a proliferation of retail franchise outlets it will struggle to survive.

All that said, according to the Chamber's 2005 Report, 2005 was "another reasonably good year for the retail sector with most retailers reporting single digit growth on like for like sales".

I would especially urge large retailers to buy as much of their stock as possible from local agents and wholesalers. The employees of such wholesalers are the customers of the large retailers. It is therefore in their interests to sustain the jobs, and thus the purchasing power, of wholesaler employees.

Some of the measures that I will announce later in this address are intended to assist these businesses.

(f) Property Development

Mr Speaker the Property Development Sector continues to prosper and to provide very substantial economic activity and growth. This continuing boom in property development benefits the economy in many ways.

It provides employment, both during the construction phase and afterwards in relation to staffing, management, repairs and maintenance. It provides the Government with revenue and also capital from the sale of land and development rights. We have already seen how Government reinvests this capital in other projects which benefit the whole of Gibraltar. And of course, it reflects and projects the huge international investor confidence that now exists in Gibraltar, as a reputable and successful business and investment location.

There is a considerable pipeline of investments, that will boost, not only the supply of quality residential accommodation but also the supply of office and commercial premises which are now in short supply. These projects include the very impressive Ocean Village, which will additionally enhance Gibraltar's Marina and Leisure facilities; Tradewinds, the Anchorage; King's Wharf; the Midtown Development and of course the huge and transforming Eastside Development.

(g) Government support for business.

Mr Speaker, the outgoing Chairperson of the Gibraltar Federation of Small Business, (the one who said she was not going into politics) said, (more or less at the same time) that the Government lacked interest in and did not care about, small business.

The outgoing President of the Chamber of Commerce, was generous enough to recognise in his 2005 Annual Report that during his several years as President, Gibraltar had made "huge strides on both economic and political fronts" and applauded "the Government's record on economic growth". He went on to raise several issues upon which I think it is appropriate for me to comment .

Firstly, let me remind those who say that Government does not care about small business, of the unprecedented number measures that this Government has introduced to help small business: -

- (1) We have introduced a reduced tax rate of 20% for small businesses;
- (2) We have abolished tax on a company's investment income;
- (3) We have discontinued the practice of annual 10% increases in Social Insurance Security contributions, and, instead, have had only 2 increases in 10 years;
- (4) We have built three new industrial parks;

- (5) We have simplified the payment of Social Insurance contributions by abolishing stamps and cards;
- (6) We have put out all procurement contracts to open tender thereby establishing a level playing field and equality of opportunity;
- (7) We have exempted computers and commercial vehicles from import duty;
- (8) We have radically improved the postal service;
- (9) We have set up the Invest Gibraltar "one stop shop service" to advise small business.
- (10) We have provided extra tax relief for replacement of business facades;
- (11) We have taken over liability for Maternity allowance, which was previously payable by employers,
- (12) We have relieved students on holiday jobs from tax and social insurance contributions,
- (13) Self employed businessmen have seen a very substantial reduction in their tax rates;
- (14) We have introduced a 20% (later reduced to 10%) discount for early payment of rates.
- (15) We have introduced a "one stop shop service" for registration of new employees;
- (16) We have halved the rate of import duty on many goods, and reduced it to zero on many other;
- (17) We have relieved businesses on Main Street of the obligation to pay for half the cost of the Main Street beautification project;
- (18) We have extended the street beautification programme in manner that has benefited many small businesses;
- (19) We have introduced telecommunications liberalisation which has resulted in the significant reduction of telephone tariffs;
- (20) The growth in the finance centre, gambling industries and port activities has hugely benefited small businesses who supply and service their needs;

- (21) We have financed hotel refurbishment through the hotel assistance scheme.
- (22) We have financed a very substantial amount of training opportunities and course for the staff of private businesses.

Against all of these measures it is said that we have increased rates by 10% and more. We have not increased rates, we have reduced from 20% to 10% the early payment discount which we ourselves introduced.

It is said that we have increased the minimum wage by 12.5%. We make no apology for this. The economy of Gibraltar has generated substantial wealth and it is important that the benefits of this reaches the lowest paid. Government does this through substantial tax cuts, but employers need to contribute also through socially responsible minimum wages. £4.50 an hour for a 39-hour week represents a weekly wage of just £175 per week or £9126 p.a. No good employer should be paying less than that, and all should be paying more than that!

It is said that we increased social insurance contributions by 10%. With respect, the proper way to look at it, is that we have discontinued the previous annual 10% increases, and limited increases to only 2 in 10 years! That is to support business, not to ignore it or not care about it!

It is said that we increased electricity and water tariffs by 12% and 17% respectively. Indeed we did! But the proper way to look at it, is that we absorbed years and years of fuel and other cost rises and didn't pass the costs on to business users as they do in every other country. In most of Europe the tariffs are going up by similar percentages every year due to the massive increases in oil prices – let alone once in 20 years! The Government is hugely subsidising electricity and water to

business. The recent increases do not even recover the cost of the most recent fuel price rises.

The reality is that tariffs have increased by much less than the rate of inflation over the last 20 years. Utilities prices are therefore hugely lower, in real terms, than they were in 1986!

It is said that Government does not consult about rises in taxes, fees and tariffs affecting business. No Government does so. What would be the point anyway? Is it likely that any business would ever support any such rise?

It is said that there is concern about Government's financial management because Government is not more effective in collecting arrears. Indeed the Chamber of Commerce's 2005 Annual Report says this, about it:-

"This apparently lax attitude does nothing to discourage unscrupulous traders, and others, from the continued practice of not meeting their liabilities on time. It just penalises these businesses that do play by the rules".

Mr Speaker, I entirely agree with those sentiments, but when Government got tough by introducing heavy fines for illegal labour, i.e. that is not registered and does not pay social insurance and PAYE, it was the Chamber who accused the Government of taking "draconian measures".

Mr Speaker, I look forward to meeting with the new board of the Chamber to work through this issue and establishing an effective, joint approach to remedying this issue upon which we now appear both to agree.

Mr Speaker, the Treasury is making, and will continue to make, substantial efforts to recover arrears. Companies and Directors (where possible) are being pursued. Companies are being placed into liquidation, and meaningful arrears agreements are being entered into, which as well as paying off arrears by realistic instalments, require a commitment to stay upto date with current obligations.

Mr Speaker, there has also been justified criticism of the facilities at the commercial gate and the Customs Entry Processing Unit, and indeed of other aspects of the way Customs Department works. The House will by now be aware that there is a thorough and comprehensive review of Customs currently under way, which has been welcomed by staff and business alike. We are confident that the outcome will address many of business' concern in this respect.

In the meantime Government is grateful to Customs Department staff from enduring the facilities at the EPU. These are pending imminent relocation, either to a new site or to a facility there or thereabouts, built in the context of any new, relocated Airport Terminal that may result from an Airport Agreement. We cannot, at present, invest substantially on the existing EPU building, in case the space is required for the new air terminal. We will consult fully with staff, customs agents and business in relation to its possible relocation to a new site.

## **Budget Measures**

And so, Mr Speaker, to this year's budget measures.

### 1. Income Tax

As I said earlier, it is the policy of this Government, which we have implemented every year since 1996, to use the Tax System as a means of sharing throughout the community the fruits of our economic success.

Since 1996 there has been very substantial reform of our tax system that has reduced effective tax rates by nearly 40%. Personal and other allowances have been hugely increased, actually nearly doubled. New allowances have been introduced.

In addition, the tax bands and rates have been widened and recast. For example, in 1996 tax started at 20% and reached 35% after just £7,000 of taxable income. Now, tax starts at 17% and does not reach 35% until £10,000 of taxable income (and that in addition to the effect of higher and new tax allowances). Also, the top rate has been reduced from 50% to 45%. And senior citizen's allowances are topped up to £10,000, thus ensuring that the first £10,000 of Senior Citizen's Income is tax-free. Finally, a low-income earners tax credit has been introduced to target tax cuts specifically at the low paid.

This year, as in all previous years we are continuing with our tax cutting agenda.



I am therefore announcing the following important tax cutting changes to the tax system, with effect from 1<sup>st</sup> July 2006: -

(1) Abolition of Income Tax on Occupational Pensions

Income Tax will no longer be payable on occupational retirement pension income received by any person aged 60 or over. Such pension income will therefore be tax-free. This exemption will also apply, at age 55, to ex-policemen and ex-firemen who retire at 55 by statutory compulsion. This measure will benefit around 6000 taxpayers.

(2) “Topping up” of Tax allowances

Every taxpayer’s “total tax allowances” will be “topped up” to £3,500, if they have less than that. Accordingly, and subject to the allowance apportionment rules, no taxpayer will pay tax on the first £3,500 p.a. of income. This measure will benefit around 6000 taxpayers.

(3) Restructure of Rates and Bands

- The 35% rate band is abolished, and £3,000 of it is transferred down to the 30% band, which thus increases from £6,000 to £9,000. This measure will benefit 3200 taxpayers.
- In addition, the top-rate of tax is further reduced from 45% to 42%. This measure will benefit 4500 taxpayers.

The new (much simplified since 1996) band structure is therefore as follows: -

£4,000 at 17%

£9,000 at 30%

Balance at 42%

(4) Low income earners tax credit, which is worth £230 p.a. to people with taxable earnings of less than £8,000 p.a., will increase by 20% to £275. This is equivalent to forgiving tax on the first £1,600 of taxable income. This will benefit around 8000 taxpayers.

(5) All other allowances will be increased by 3%. All taxpayers benefit from this.

(6) The Income Tax Ordinance contains many provisions that are discriminatory as between men and women. The Ordinance will be thoroughly reviewed during the next 12 months, with a view to the elimination of all provisions that discriminate between men and women. I am announcing one to-day. The “wife” allowance is available only to men in respect of their wives. In future, this will be known as the “spouse” allowance, and will therefore also be available to women in respect of their husbands.

(7) Annuities.

At present people that are not on final salary occupational schemes, have to buy an annuity with at least 75% of the capital sum derived from the pension (subject to certain exceptions). In addition any capital withdrawn in excess of 25% is taxed at 20%.

Annuities are difficult to obtain and rarely represent good value for money. Accordingly, the need to purchase an annuity is abolished. Pensioners may withdraw the whole of their capital, and, what is more, the 20% tax is abolished, so that they may withdraw 100% of the capital, tax-free.

(8) Charity Giving

Until now we have had a covenant system, which is no longer working well. This will be replaced by a Gift Aid Scheme, under which taxpayers will be able to gift up to £1000 from taxed income. The Government will gross up the amount and refund to the approved charity the tax paid at the standard rate.

(9) Mr Speaker,

The present tax system is harsh on people without certain allowances to claim such as mortgage, pensions/life insurances etc. with effect from 1<sup>st</sup> July 2007 we will introduce a dual system whereby taxpayers will be able to pay tax in accordance with whichever of the two following systems produces the lowest tax bill for them;

- (1) the present system of tax allowances, tax band and tax rates; or
- (2) a new flat lower rates, and capped system which will be announced during the course of the year.

## 2. Social Insurance Contributions

The reform of this scheme has been pending and under consideration for some time. There are two aspects to the reform: the method of payment and the rate of payment.

### 2.1 The Method of Payment.

The Government has already changed the system of payment of Social Insurance Contribution by abolishing the old card and stamps. We are now going one step further by merging the systems of Social Insurance and Income Tax collection into one. With effect from 1 January 2007 Social Insurance Contributions will be paid and collected through the PAYE tax system. Further detailed technical, administrative and explanatory statements will be made during the next few months.

## 2.2 The rates of payment.

With effect from 1 January 2007 the current system of Social Insurance will be changed. The present system has only two principal rates. One for those who work less than 15 hours per week, and another for those who work longer. The present system has two consequences which Government wishes to address. Firstly, it results in people who work just over 15 hours paying much more than people who work perhaps just a couple of hours less a week. Government wishes to introduce a system that enables contributions to be smoothed out between the reduced rate and full of contribution. Secondly, the present system operates as a disincentive to part-time work, especially for the low paid.

The new system, about which the Government will consult with employer organisations and trade unions, will be earnings related subject to a cap in contributions rates at the current level, with a mechanism built in to safeguard low paid workers.

## 2.3 Abolition of Social Insurance Contributions for over 60s

With effect from 1 July 2006, Social Insurance Contributions will cease to be payable when a contributor reaches the age of 60. However, for those contributors whose statutory occupational retirement age is before 60 – firemen and police officers – Social Insurance Contributions will cease to be payable when the contributor reaches the compulsory retirement age. The DSS will award credits to all such contributors from the period of cessation of payment of contributions, upto the date of state retirement age. This will apply only to employees contributions. Employers will continue to contribute. This measure will regularise the current position where credits are only awarded to unemployed persons over the age of 60, whereas employed persons are required to continue making contributions. This penalises those who choose to work.

## 3. Rates

- 3.1. The early payment discount currently available for commercial rates, will be extended to rate payers of domestic premises with effect from 1<sup>st</sup> October 2006.

This will apply to ratepayers who are upto date with the payment of their current bills, and have no historical arrears or are upto date with their repayment agreement relating to any existing historical arrears.

- 3.2. With effect from 1<sup>st</sup> January 2007, rates on commercial premises used for retailing or wholesaling of goods will be reduced by 15%. This scheme will thereafter be extended to other small business categories.

- 3.3. Rates are abolished on individual, privately owned garages and parking spaces.

#### 4. TV Licences

T V licence fees are abolished.

#### 5. Bus Travel & Road Tax for over 70s

- Persons over the age of 70 will be entitled to a free pass to travel on Government owned bus services, i.e. The Gibraltar Bus Company Ltd. Initially, this concession will not apply to Route No 9.
- Road Tax is abolished with effect from the expiration of current discs, for any vehicle registered solely in the name of a person over 70 years of age, and driven principally by that person.

#### 6. Import Duty

As an aid to business, import duty on goods vehicles, for exclusively business use will be exempt from import duty.

7. Disability Allowance.

During the last 8 years, the Disability Allowance which had remained frozen prior to 1996, have been increased by 70% to £25.80 (weekly child rate) and £36 (weekly child rate). These rates will now again be increased by 20% to £31 p.w and £43 p w respectively.

8. Maternity Grant.

This is currently payable at £350, and is means tested. It is not payable if joint income exceed £35,000 per annum. It will now be payable at £400 and the means testing is abolished.

9. Elderly Persons Minimum Income Guarantee.

This financial safety net for the elderly introduced by this Government, continues to benefit a significant number of elderly persons. The rates of payment presently stand at £98.20 p.w. for a single person and £131 p.w. for a married couple. These rates will be increased by 5% to £103 p.w. and £137.50 respectively.

10. Environmental Measures.

The Government proposes in future to use the tax system, especially the indirect tax system, to aid and encourage environmentally friendly practices. As a start, during the next 12 months, Government will review the import duty regime applicable to such things as bio fuels (when importation of it is available), solar heating systems, energy saving lighting and electrical equipment, and vehicles, and the road tax scheme, with a view to measures that aid the environment.

## 11. School Computers.

The Government will, this year, invest £250,000 in upgrading the quality and quantity of computers in all our schools, and in equipping them with interactive whiteboards, digital Projectors, and lap top computers, and other peripheral equipment.

## 12. More Policemen on our Streets.

The demand on our police force is constantly increasing as a result of the expansion of Gibraltar, physically and economically. Furthermore, society much values the presence of policemen and women on our streets.

Accordingly, this year, the Government will provide funding to enable the RGP to increase the number of policemen and policewomen available for street policing duties by 23. This amounts to an increase of over 13% in the number of constables and policewomen available for street policing duties. This will be achieved through a combination of recruiting more policemen and policewomen and recruiting new clerical and administrative staff to do work presently being done in the station by police officers, that can easily be done by civilians, thus freeing up these officers for policies duties. This is called civilianisation of posts.

Mr Speaker, these measures demonstrate once again that the Government's economic policies and our management of Gibraltar's affairs are delivering real benefits to the whole community. More jobs, higher incomes, more and better public services, better public amenities and environment – and an unprecedented 10 years of continuously falling tax rates.

I commend the Bill to the House.