REPORT ON A VISIT TO THE FALKLAND ISLANDS

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by

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1. Introduction

1.1 The terms of reference of this visit were to carry out a Manpower Review, jointly with Mrs C B Johnson of Latin America Department, and to prepare a Development Plan for the period 1978-83 to carry on from that for 1973-78. The Manpower Review report has been prepared separately; this report covers the Development Plan and other matters discussed during my visit.

1.2 In writing this report I have not attempted to provide background on the economic structure or other aspects of life in the Falkland Islands. The most comprehensive source of such information is of course the Shackleton Report.

1.3 I would like to thank all those in Government and outside who gave their time both in and out of normal working hours, whose cooperation and advice were essential and whose hospitality made my visit so enjoyable.

2. Current Economic Situation

2.1 The main features of the economy remain as described by Lord Shackleton. The population is continuing to fall slowly and is now below 1850, including temporary residents. The economy is stagnant, being wholly dependent on the level of wool prices and lacking private investment in the all-important sheep farming industry or in diversification. Leaving aside major developments in the oil industry and ocean-going fishing, which if based in Falklands would probably require such an inflow of personnel and capital as would completely change the Islands' way of life, there appear to be modest possibilities for diversification despite the lack of progress on what seemed at one time to be the most promising of them, namely alginates. However, the main future of the Islands still lies with sheep farming and in particular the GTU's long-term efforts to improve pasture. There will be a small surplus on the Government budget in 1977-78 but financial prospects are not encouraging unless and until the economy generally picks up. This is discussed in more detail below (section 4).

3. Development Plan

3.1 Although it was originally intended to produce a development plan to follow on from that for 1973-78(1) this proved to be impractical both because no preparatory work had been done to identify projects for such a plan and also because no estimates have been made of the level of either domestic or aid funds which are likely to be available over the next few years. So far as domestic funds are concerned, which for a country with as high a per capita income as the Falkland Islands might be expected to be the main source of finance, action to mobilise funds for development should form part of the package of measures which should follow the final report of the fiscal review (cf para 5.5). At the same time, since the 1973-78 loan of £300,000 will probably be fully committed by around the end of 1978, it will be necessary for ODM to consider of what size and on what terms the next tranche of aid should be. The time required to examine further the financing side of the plan should be used by FIG to consider more fully the possible calls on such funds over the next five years.

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(1) A note on the implementation of the 1973-78 Development Plan is attached as Annex A.

3.2 It is suggested that once progress has been made on these points there will need to be a further visit from ODM by an economist and a desk officer if the work done on the Plan is to be drawn together and administrative arrangements necessary for the next tranche of aid are to be made. This visit might be expected to be at around the end of 1978.

3.3 Although no Development Plan could be produced during the visit, discussions were held with various officials on possible projects for the period of the Plan. Apart from projects which are already in hand, ie the Stanley - Darwin Road, the YPF Jetty and the Stanley Senior School Hostel, the capital requirements which could be identified were quite modest. The projects which would fall within the 1978-83 period, excluding balances outstanding on existing projects are described in the following paragraphs. It must be emphasised strongly that some of these projects are at this stage no more than ideas at departmental level. Except where stated otherwise, it should not be assumed that these projects have been endorsed by FIG or, in the case of potential aid projects, by ODM.

Pasture Reseeding

3.4 The work of the GTU in attempting to find profitable and technically viable ways of improving pasture and hence productivity is of considerable interest. Indeed, the Falkland Islands Company have declared their intention of reseeding 2000 acres pa along lines similar to those being tested by GTU. In general, any investment in reseeding should be commercially viable without subsidies, though FIG should ensure as part of their Fiscal Review that the company tax system offers sufficient incentives for reinvestment. However, the leader of the GTU suggested that a small amount of money might be needed over the next year or two to subsidise reseeding taking place under the control of GTU. The rationale for this is that, by meeting part of the cost, the GTU will be able to control the reseeding and insist on appropriate recording and testing of results. A first draft of a scheme covering approximately 1800 acres spread over a number of different sites was provided by the head of GTU. As drafted, farmers would meet half the cost, FIG would provide 25% and ODM 25%. This proposal had apparently been drawn up since the visit of John Eadie (HFRO) and Bob Waddell (ODM Agricultural Adviser). Their views should be sought on the technical need and justification for the project and whether now is the right time to start such a programme. The cost of the project would be about £60,000 so that the amount to be included in the Development Plan would be £30,000. If the project is put forward by FIG and if it is supported within ODM on technical grounds, I consider it would be a justifiable use of aid funds at the order of costs quoted above. It should however be made clear to FIG that this would not be the start of a continuing capital programme but rather a one-off project to promote the GTU's work.

Sub-division of Land

3.5 The relative viability of small and large farms is a controversial active issue in Falklands. Those in favour of smaller farms argue they will help keep money in the Falklands and, by providing an opportunity for islanders to have a stake in the Islands, will reduce emigration. These arguments were supported in the Shackleton report. On the other hand, some argue that existing farms are of the most economic size and that the viability of the Islands' economy would be affected adversely by sub-division. The Falkland Islands Company have offered to sell one of their farms (Green Patch) to Government for the purpose of sub-division and a committee has been established to assess the technical and economic viability of such a scheme. It will be necessary to be sure both that the new units would be profitable for their owners or tenants and also that the Islands as a whole would benefit through more productive use of the land. Doubts have been expressed about the suitability of Green Patch; should these be well-founded it would be better to wait for the opportunity of obtaining a more appropriate piece of land than to embark on a project which, whatever the merits of sub-division, seemed a doubtful proposition.

3.6 It is understood that the Green Patch Committee will report sometime in the middle of 1978. If and when any sub-division goes ahead the Government will need to raise money not only to purchase the land as it stands but also to finance necessary improvements and, perhaps, working capital. There might be a need for a subsidised rate of interest in the early years of such a scheme but the new farms will need to be commercially viable in the long term if they are to make a contribution to the development of the Islands.

Other Agricultural Development

3.7 It would be unwise for FIG to involve itself directly in commercial activities since this would put more pressure on an already stretched administration. However there may from time to time be small-scale private developments which require modest amounts of capital. This possible need should be borne in mind when considering the possible expansion of the Government's loan scheme (cf paras 5 - 5.6).

Stanley - Darwin Road

3.8 Shortly before my visit, and on the recommendation of the Internal Communications Study (ICS) of November 1977, ODM indicated a willingness to approve up to £710,000 for this project. It was also indicated that a further £50,000 would be made available for a separate project to purchase new plant for a plant funding scheme which was to be a condition of approving the road. Upon arrival it became apparent from discussions with ODM's Engineering Adviser, John Hodges, whose visit overlapped with my own, that the following additional sums will be required;

(i) £93,000 for the road itself

(ii) An amount very provisionally estimated at £50,000 for spares in order that existing road plant can be rehabilitated

(iii) £9,000 to prepare buildings as workshops for the plant.

3.9 Discussions with FIG indicated that not only will the above sums be required (see Hodge's report for details) but also that given the inexperience of PWD in building roads and Falkland's isolation from sources of parts for machinery, the inclusion of a 20% contingency allowance in the cost estimates was fully justified. Indeed, since any delays will increase costs through the effect of inflation it will be a considerable achievement if cost overruns can be avoided.

3.10 Unfortunately, there will not be any increases in benefits to offset the additional cost of the road, so that the already marginal economic case for the project is that much weaker. More seriously the determination of FIG to proceed with expansion of the air service, FIGAS, (see para 3.13 below) substantially undermines the economic case made for the project in the ICS report which relied for one-third of its benefits on the assumption that there would be no increase in FIGAS's capacity. Were the project being considered afresh, far more weight would have to be attached to social benefits and political considerations. Annex B sets out a revised calculation of the economic benefits and costs of the project.

Other Road Projects

3.11 The ICS report did not study the need for any roads other than the Stanley - Darwin road but said that further projects should be considered "in the longer term".

FIG will not have the capacity to undertake any further projects until the Stanley - Darwin road is completed at the end of 1980. There might therefore be further road projects in the second half of the Plan period. Subject to developments in the interim it seems more likely that any such construction would be of feeder roads linked to the Stanley - Darwin road than of further trunk routes. As pointed out by the ICS team it would be appropriate for such roads to be financed by landowners.

Purchase of a Britten-Norman Islander for FIGAS

3.12 The proposal to purchase an Islander for the Falkland Islands Government Air Service (FIGAS) was considered by the ICS team, who concluded that as long as the Stanley - Darwin road was built the economic and social benefits of an Islander would not be sufficient to justify the project. The additional costs of running the service were estimated in the report though no quantitative estimates of benefits were made except for the revenue which would be raised given the present number of passengers and existing tariffs.

3.13 Although the final report of the ICS study had only just arrived in Falklands at the time of my visit, its general conclusions were already known and it was clear that FIG did not accept the recommendation that FIGAS should not be expanded. Indeed it appeared that it had been decided that the project should be carried through at local expense if in the end ODM declined to finance it. As yet, however, no substantive reply to the points made in the report has been prepared.

3.14 It was not part of my job to go over again the ground covered by the ICS report, but since it seemed certain that FIG would wish to include it in any Development Plan and intended to resubmit it to ODM it was necessary to spend some time looking at the project.

3.15 One point which is immediately obvious is that the technical basis for the project is in dispute. The most obvious unresolved question is whether land planes would be more reliable, longer-lasting and more suited to Falklands conditions than float planes. In 1974 the CAA strongly favoured float planes; this is not accepted by FIG. A second issue is whether settlements will be able to construct and maintain adequate airfields. FIG clearly believe they can and are carrying out surveys of possible sites but CAA had doubts on this point in 1974 (see also Hodges report). The condition and remaining life of the existing Beaver aircraft also seem to be disputed. Since the aircraft were supplied only at the end of 1976 with zero hours on all moving parts they ought still to be in good condition. If they are not then, since half the cost was met from aid funds, efforts should be made to assess the reasons before investing in any other aircraft. In view of all these technical uncertainties I consider that it is essential that, if further consideration is to be given to this project by ODM, it should first be referred to the CAA.

3.16 While in Falklands, I was not shown any figures which contradicted the estimates of cost made in the ICS report, though it was hoped that the capital costs of the hangar would be at the lower end of the range used in the report. However it seemed to be believed that an Islander/Beaver service would not be much more expensive to run than the existing service. Before resubmitting the project, it would be useful for FIG to go over the ICS estimates carefully and to produce revised estimates of costs and revenue if appropriate. Consideration should also be given to the financial target which FIG think would be appropriate for FIGAS. The ICS report suggested that the level of subsidy should be reduced from the present 50% to 25% (including depreciation). FIGAS at the moment does not even cover operating costs. The appropriate level of subsidy, if indeed there is a case for a subsidy at all, is obviously a political as well as an economic issue but FIG need to consider seriously the extent to which the budget can afford to finance losses on FIGAS.

Improved R/T Service

3.17 The existing R/T system is old and is getting increasingly difficult to maintain. A replacement system has been under discussion for some time and a preliminary application for aid funds was made in mid-1977, but progress has been delayed by uncertainty in Falklands about the most appropriate system. Trials have been carried out and are continuing on the most desirable system, with current thinking being that a mix of HF and VHF may be best. FIG are now purchasing a number of radios at a cost of about £17, 000 from their own funds but still intend to seek aid funds for the main system which may cost about £70-80, 000.

3.18 The R/T system is extremely important given the isolation of many of the communities in Falklands and it seems clear that a new system is required. However, current charges for the service are very low, not even covering operating expenses let alone providing funds for replacement. It appears that no consideration has yet been given to the level of charges which would be appropriate with the new system. Given this, there is an obvious risk that insufficient consideration will be given to economic issues in preparing the project. There seems little reason why most settlements should not pay a full economic rate for the service though in cases of hardship in small settlements a lower rate might be used. FIG will need to cover financial as well as technical aspects of the project in their eventual application.

Additional Generator for Stanley Power Station c £80, 000

3.19 This project was examined by the ODM Engineering Adviser, John Hodges, during his visit. His conclusion that an additional generator is not yet required but that the situation should be kept under review seems justified. It follows that an additional generator may be needed within the period covered by the Plan. At present, tariffs are sufficient to earn a surplus after transfers to a fund for repayment of the loan which financed 63% of the existing power station and also to a replacement fund. However contributions to the latter need to be reviewed in the light of inflation since the annual provision was fixed. If a project was eventually put to ODM it should be a condition that tariffs cover the full economic costs including a return on capital employed. There is no case for subsidising electricity supply in Stanley.

Slip Maintenance Facility

3.20 This proposal was suggested to John Hodges during his visit but is included here as a possible Development Plan project. The purpose would be to provide facilities to take the mv Forrest out of the water for maintenance and repair of the hull. The facilities might also be used by the mv Monsunen if the Falkland Islands Company were brought in on the scheme. The Forrest goes to the mainland every two years while the Monsunen goes annually.

From the economic point of view the case for such a project would depend on the savings in the recurrent costs of taking the vessels to the mainland being sufficient to earn a return on the capital employed. In estimating this, care would be needed to count only true savings; for example, if a vessel has to go to the mainland anyhow for other reasons, such as repairs which could not be done in Stanley, then savings could be very small.

Construction of such a facility would normally be expensive but it has been suggested that a floating dock may be available in South Georgia. If this proved to be true the project might be worth looking at in more detail, but otherwise it seems unlikely that it would be viable given the small number of vessels involved.

Stanley Senior School Hostel

3.21 The project to amalgamate the secondary schools at Stanley and Darwin, by building a hostel in Stanley and then closing Darwin school, is expected to start this year. Tenders are now being examined though as yet the cost is not known. The exact phasing of the project will depend on how soon one of the tenders can be accepted and which of the quarterly sailings to Falklands takes the required materials.

Additional Classrooms - Stanley Senior School

3.22 The former Darwin students can be accommodated fairly easily in Stanley Senior School because of the small size of existing classes. However, I was informed that there are one or two subjects where there would be difficulties and the Superintendent of Education also advised that there is a need for more rooms in order to be able to diversify the curriculum in such directions as rural studies, home economics and wood and metal work.

FIG have at their disposal some prefabricated "Coseley" buildings which have never been assembled and the suggestion has been made that these might be used to provide extra space for the Education Department. There is some doubt about the completeness and condition of the building kits (cf the report of a visit by the ODM Architectural Adviser, Mr Riley in September 1977) but if FIG decide that the additional classrooms are required then use of the Coseley units would if feasible be the most economical way to provide them. Unfortunately it seems that the adequacy of the units will not be known until assembly is started. This would make a "messy" and, in advance, uncostable project for aid finance and would appear to be much more suitable for local funds if available. Having said that, it might be possible to use the person who goes out to supervise the construction of the hostel to advise FIG on the assembly of the Coseley units and even to supervise the work. In view of possible ODM involvement, the proposals should be referred to the ODM Education Adviser to consider the educational justification for the extra space. It is unfortunate that the possible need for additional classrooms was not considered by FIG at an earlier stage of the hostel project.

3.23 Should the Coseley units prove to be unsuitable or unusable, the cost of providing the same space by other means would be very much more expensive and would require much fuller justification. It should perhaps be made clear to FIG that any technical or financial assistance provided for constructing the Coseley units would not imply a commitment to financing additional classrooms by other means. If completely new buildings were required it would first be essential on economic grounds to have a clearer picture of the longer term direction of education in Falklands than is now available.

Other Education Projects

3.24 Other possible needs for capital expenditure on education cannot be identified until the long-term structure of the system has been determined. This is now under active review but any changes will be spread over a number of years rather than occur overnight. In considering possible changes it will, in view of the likely budgetary situation, be essential to give full weight to relative cost as well as to educational improvement and FIG will need to weigh the claims of education against other sectors. It is certainly possible, however, that additional buildings will be required as part of educational improvement schemes in the early 1980s and the Development Plan should take account of this.

Purchase of an Ambulance c£7,500

3.25 A project will shortly be put to ODM for the purchase of a new ambulance. The existing ambulance is said to need replacement but in any event it only has 2-wheel drive whereas 4-wheel drive is said to be needed. Assuming both these points to be true, which the forthcoming application will need to show, this is still not wholly appropriate for aid finance both because of the replacement aspect and because it ought to be possible to finance such small items without looking for aid from ODM.

Hospital Theatre Equipment c £6,000

3.26 Again, this project will shortly be submitted for ODM finance and again it seems more appropriate for local finance. Although the project was not discussed in detail, it seems to derive more from a lack of finance for replacement over a period of time than from a new need.

Housing

3.27 Although it did not appear in the Development Plan for 1973-78, housing will have taken 24% of all capital expenditure (apart from construction of the airfield) during the period. This expenditure (£118,000) has been necessary in order for Government to meet its commitments, particularly for housing expatriate staff. In addition, of loans outstanding on 30 June 1977 under the Government loans scheme which had been granted since 1 July 1973, £19,200 (76%) were for purchase of housing. These funds had all been lent at 7% pa interest and the average amount lent was £2,400.

3.28 Housing is considered by FIG to be a major problem both for itself, in housing increasing numbers of expatriate staff, and more generally. The problem is in Stanley since, under the current system, farms provide housing for their staff until retirement when the old people have to make way for their replacements and generally have to come to live in Stanley. With very few houses having been built in Stanley in recent years, and those mostly acquired by Government, it is reported to be increasingly difficult to find housing and prices have naturally risen.

3.29 The first task for FIG would appear to be to estimate the size and nature of the problem. It should not be too difficult, given that Stanley has only 1000 people and Falklands as a whole only 1850, to carry out a survey to establish what housing is available and of what standard, the extent of any overcrowding and the likely increase in demand for housing (if any in a population which is gradually declining) over the next few years. Such a survey might be organised by the social worker or perhaps by a committee set up to examine the housing problem.

3.30 As noted above, Government already provides finance for housing, albeit on a limited scale. Means of increasing the funds available to Government for onlending to the private sector are under consideration (see section 5) and subject to giving priority to economically productive projects, eg agricultural or tourism development, some of any increased funds could be used for housing. The rate of interest charged however will need to be an economic one if the loan fund is to be able to keep going without constant replenishment. If subsidies are felt to be essential they should be limited to those least able to pay the full cost. Such funds should be available for house construction as well as for purchase since it is only by increasing the stock of houses that shortages can be overcome. Providing more funds without building additional houses will merely cause inflation.

3.31 The suggestion was put to me that FIG should, as a matter of high priority, build houses both to meet its own needs and also to ease the shortage of housing in the private sector. It was suggested that houses built for the private sector should be sold whenever those requiring housing could afford to repay and should be rented in other cases, at subsidised rents where necessary. Provision of housing for OSAS and TC staff is an FIG obligation which is unavoidable if expatriate staff are to be recruited; however, apart from staff now under recruitment there should be no increase in numbers over the next few years. More generally, it is impractical for FIG to take upon itself the responsibility to house all those who do not have the means to buy or rent a house. The budget is unlikely to be able in the near future to afford more subsidies on a substantial scale. Nor do I think it would be appropriate for aid funds to be used given ODM's policy on aid for housing. On the other hand, given the present employment system in Falklands, it might be appropriate for the farming companies to play a greater role in solving housing problems either by channelling funds through Government or by schemes to ensure that housing is available on retirement for those who have worked for many years on the farms.

4. Budgetary Situation

4.1 The 1977-78 estimates predict a surplus of revenue over expenditure of £54,000. Both revenue and expenditure are now expected to be higher than estimated but it is still hoped to achieve a surplus of £50,000. The achievement of this surplus despite the implementation of the salaries review at a cost of around £60,000 in this financial year, is primarily due to a large increase in income from stamps which is now expected to be £170,000 above the original estimate of £100,000.

4.2 Looking to future years, revenue will continue to be affected by variations in wool prices through their impact on profits. Company tax has varied by as much as £300,000 in recent years from £400,000 in 1975-76 to £96,000 in 1976-77. Income on Government investment abroad has also been a volatile item of revenue, again quite beyond the control of FIG. Because of these elements of instability, Government requires reserves which are effectively savings from good years which are held in order to avoid disruptive reductions in expenditure in bad years. While the level of the reserves to be held should be examined as part of the Fiscal Review, the present level of £440,000 does not prima facie seem unreasonable. In 1973, Armstrong recommended a level of £200,000, which would have amounted to 38% of recurrent expenditure at the time. The same proportion for 1977-78 would be £500,000. Such reserves should not be depleted for other purposes if the defence against variability of revenue is to be retained.

4.3 There does not seem to be very much prospect of real increases in revenue under the existing fiscal system. Revenue from sales of stamps to philatelists has grown in recent years, as to a lesser extent has that from coins, but too much reliance on these sources could be dangerous if it leads to pressure to manage issues according to revenue needs rather than market possibilities.

4.4 More generally, increasing revenue depends, apart from on inflation which also affects expenditure, on either growth in the economy or the introduction of measures to raise more from existing sources or find new sources of revenue. While it is hoped that there will be growth of the Falklands economy in the reasonably near future, the lack of such growth in the past suggests that financial projections cannot afford to rely on it for at least the next few years. If additional expenditure is required FIG will need to be able to finance it from the existing economy.

4.5 On the expenditure side it seems likely that there will be additional commitments over the next few years. The airport will gradually absorb increasing funds, the most immediate requirement being maintenance of the airport road; the Stanley - Darwin road will need to be maintained; any expansion of the air service would, at present tariffs, require increased subsidies; maintenance of some assets is not currently being carried out, eg Stanley roads; and present votes for replacement do not seem in all cases to be sufficient.

4.6 Apart from recurrent expenditure, FIG also requires funds for capital development. Given Falklands level of per capita income, projects should generally be financed locally rather than from aid funds. Insofar as such expenditure is met from revenue rather than from loans, a subject requiring further consideration, FIG will need to aim for a surplus of revenue over recurrent expenditure.

4.7 Careful financial management will be required in order to meet recurrent and capital commitments and avoid deficits of other than a temporary kind. The work of the fiscal review should have as its main priority advising FIG on alternative ways of meeting its financial commitments. Falklands' record of financial independence is one to be proud of and it gives FIG a lot more financial freedom than is enjoyed by those UK dependencies which have been less fortunate or less efficient in their financial management and have had to rely on outside funds to balance their recurrent budget. With the right sort of advice and the will to do so, it should be possible to retain this record. It should however be made clear to FIG that dependence on budgetary aid involves far more than just estimating the deficit each year and applying for the balance. The rigorous scrutiny of estimates, the restrictions on any new expenditure and the regular reporting required considerably reduce the freedom of action of the recipient Government and take up a lot of time of both donor and recipient.

5. Fiscal Review

5.1 One of the subsidiary tasks of my visit was to discuss the interim report of the Fiscal Review on which no detailed comments had been received from FIG. It was explained to me that the report did not meet their requirements since it consisted of a series of ideas which, however interesting individually, did not constitute a coherent set of proposals. FIG therefore felt unable to respond in detail and wished to proceed with a second stage which would produce specific implementable proposals related to their requirements.

5.2 In view of the diffuse nature of the interim report I consider FIG's request to be reasonable. FIG do not have the necessary manpower to examine such a report and assess which of its proposals are worthwhile and feasible in Falklands. Moreover the interim report did not put its many ideas sufficiently into the context of the financial situation in Falklands. With no picture of likely budget trends over the next few years, it would be very difficult for FIG to decide what should be done.

5.3 I suggest that the first task of the next stage of the Review should be to examine the existing and expected budgetary situation so as to enable FIG to see what additional revenue will need to be raised in order to meet required levels of expenditure. The Review should result, after consultation with FIG, in a financial programme or plan which would provide a longer term framework into which annual budgets and day-to-day decisions should fit.

5.4 One aspect of the Fiscal Review's terms of reference which was not covered in the interim report was "reviewing tariffs on services provided by the Government and making recommendations on appropriate tariff levels". This is required whether or not any subsidies are considered to be necessary since it is highly desirable to know what level of subsidy is being provided, and to set financial objectives, if financial control is to be achieved.

5.5 Apart from advising on the recurrent budget, the Fiscal Review is also concerned with raising revenue for development, other than through general revenue, both for direct investment by Government and also for onlending to the private sector. My general impression was that although there is a lack of financial institutions to provide credit in Falklands, this has not been a substantial constraint on development; the problem has rather been the the lack of investment proposals. However, the possibility of raising development bonds to tap individual and company savings is worth following up. The possibility of investing a limited proportion of Savings Bank funds in Falklands should also be considered. It should not be thought however that such funds will be easy money; interest rates will need to be commercial if increasing subsidies from general revenue are to be avoided. The effect on the budget of repaying any such funds used for Government projects should be carefully considered.

5.6 Related to the above and again within the province of the Fiscal Review is the possible expansion of banking facilities. At the moment both FIG and the Falkland Islands Company offer limited services and both are considering broadening these activities. The provision of full current account facilities is a natural development and access to short-term commercial credit is also desirable. More generally, one of the main criteria which should be used in assessing banking proposals is whether they will lead to more or less funds being invested or income being received in Falklands and whether changes will add to or substitute for existing arrangements. It would be highly undesirable if changes merely improved facilities for lending funds abroad without even the merit of the present Savings Bank which pays its surpluses to Government's general revenue.

Apart from the short-term programme for the next stage of the Fiscal Review, which is to be defined in revised terms of reference (FIG are to provide a draft), there is a need for FIG to have access to financial advice on a longer term basis. This might be done by paying the Fiscal Adviser appointed for the next stage of the Review a modest retainer and then fees on an agreed scale for specific tasks undertaken. This longer-term role seems justified given the professional isolation of the Financial Secretary and the fact that with wide-ranging responsibilities and a small staff he does not have the time to give the time to longer-term problems which is required. If requested by FIG, I would recommend that ODM meet the costs of this for a limited period and within overall limits agreed with FIG. After this period, the costs should be borne by FIG.

6. EEC Aid

6.1 I was asked in ODM to raise two matters concerning EEC aid with FIG during my visit; these were the use of Falkland's allocation from EDFIV and the position regarding any claim which might be made for 1977 under the STABEX scheme. On the former it had been suggested that the EDF money be used to part-finance (with ODM) some X-ray equipment but due to delays within the EEC in agreeing the terms of aid this will now be financed wholly by ODM. The only available project of an appropriate size was for more health equipment (see paras 3.25 - 26 above) but FIG said that in view of the likely delay in getting EEC approval they intended to submit the project to ODM. At the appropriate time it should not be difficult for FIG to identify a small project, particularly for health or education. It was put to me that the proposal to provide the 18,000 u.a. (c £11,000) involved on loan terms was unreasonable, not because of the direct cost of repayments but because the administrative costs involved would be high in relation to the size of the loan. I agreed to raise this point on my return and suggest that a case might be made that EDF programmes below a certain size should always be on grant terms for ease of administration regardless of the per capita income of the country involved.

6.2 On Stabex, it became apparent that Falklands could not make a return as requested by the Commission since value figures for its exports (almost entirely wool shipped to the UK) are normally not available until 12-15 months after the wool leaves Falklands. An approximate value for 1977 was worked out together with the reference level for 1973-76; these estimates indicated that it was very unlikely that any transfer would be due for 1977. The Commission will, however, need to consider how the Stabex system for future years should be administered in Falkland's case; I would argue that the returns required from FIG should be kept to the minimum in view of the very small size of the administrative machine.

Annex A

CAPITAL EXPENDITURE DURING THE PERIOD OF THE 1973-78 DEVELOPMENT PLAN

It is generally useful as part of the planning process to look back at the end of a Plan in order to see how far the Plan was implemented and foresaw the needs of the period. This note sets out what was planned and what actually happened. It does not attempt to compare planned and actual expenditure in detail but provides the material for this to be done at a later date if considered desirable.

The Data

Table I sets out the Plan as approved by the Falkland Islands Legislative Council in May 1973. It will be noted that it divided projects into those expected to be financed from UK aid and those for which local funds were to be found. Planned aid expenditure was £300, 000 which corresponded to an interest free, 25 year, loan of the same size which was offered at the time. Local funds were expected to meet £292, 250 expenditure, almost exactly half of the total Plan.

Table II sets out expenditure under aid funds during the period. Taking revised estimates figures for 1977-78 total expenditure is expected to have been £6. 02m, of which £5. 82m will have been for the airport which was not included in the Plan and was financed on grant terms.

Table III shows local expenditure, excluding £23, 220 for repayments and interest on a loan from the Savings Bank and £17, 000 for Telecommunations Equipment which passed through Government accounts but was not proper local capital expenditure. Total expenditure including revised estimates for 1977-78 is expected to have been £0. 29m.

Analysis

The construction cost of the airport overwhelms all other expenditure during the period of the Plan; its cost per head of population must be one of the highest of any project ever financed by ODM. Of the remaining aid expenditure, which is expected to have amounted to about two-thirds of the Plan figure, nearly three-quarters was spent on projects in the Plan, 5% on completing the Power Station project which preceded the Plan and a little over 20% on projects outside the Plan (of which three-quarters was for a very recently approved project for X-ray machines). These figures emphasise the importance of the Development Plan in identifying aid projects and conversely the low level of project identification for aid finance subsequently.

Examining local expenditure in a similar way, only 20% is expected to have been spent on projects identified in the Plan, a small part of which was to meet over-runs on aid projects. The remaining 80% is expected to have been for projects identified since the Plan was prepared.

Overall, the Plan budgeted 28% for natural resources, 48% for communications, 14% for education; 5% for tourism and 5% for other projects. In practice, disregarding the airport, only 11% will have been spent on natural resources development, 33% on communications, 2% on tourism and 1% on education. Housing is expected to have taken 24% and loans, in which housing is the main element, another 10%; other projects make up the balance of 19%.

Of projects in the Plan not included in the above figures, some have been deferred rather than abandoned. The provision for Major Roads is the largest example. The Plan envisaged £25, 000[1] of aid money and £62, 000 of local funds being spent on the Estancia road once equipment was available on completion of the airport. In fact, the road project has been delayed, has been changed to that from Stanley to Darwin, total costs are much higher and the balance between aid and local funds has been shifted so that most costs are met from aid. However, the concept of using ex-airport plant for road construction remains as planned. Another major project which has been deferred rather than cancelled is the Stanley Senior School Hostel, accounting for £72, 000 of the unimplemented aid programme after allowance for £8, 000 spent on an abortive scheme. A third project, the Grassland Trials Unit Capital Costs, £17, 000, was financed under TC. A further £67, 500 for seed and fertiliser subsidies was provisionally set aside to finance following-up the work of the GTU and has not been used. The Plan was over-optimistic about the speed with which the GTU would produce results but it is still hoped that such results will be produced. It is, however, uncertain whether funds will be needed for subsidies. Finally, the Plan included £115, 500 for telecommunications, assuming investment as a follow-up to the Lefevre report. Again, such investment has been delayed, due to technical uncertainties, rather than cancelled. Around £20, 000 will have been spent on telecommunications during the Plan; further expenditure is planned but FIG hope that this will be financed from aid funds rather than, as in the Plan, from local funds.

To summarise the figures in the previous paragraph, around £325, 000 (54%) of expenditure envisaged in the Plan has been delayed rather than abandoned, though it is not clear whether that for seed and fertilizer subsidies will be required, and a further £17, 000 has been spent but not through the capital expenditure accounts. It appears that the balance of funding of these projects will be different from what was expected in 1973, with aid funds taking a much larger share. This relief for the local budget has been used by FIG primarily to finance purchase of houses which was not included in the Plan at all.

Conclusions

Although over half of planned expenditure has been delayed beyond the period of the Plan, the programme will eventually largely have been carried out. Over the period of the Plan, aid expenditure will have followed the Plan much more closely than local expenditure will have done. This perhaps reflects the fact that the Plan was prepared by ODM rather than FIG, which is unavoidable given the small size of the local administration.

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[1] In fact, since the aid funds appear to have been for purchase of plant, it can be argued that the money was spent as part of the airport project since JCL handed over the equipment as part of the final contract settlement.

Table I

CAPITAL EXPENDITURE BUDGET 1973 - 1978

		1973/74 £	1974/75 £	1975/76 £	1976/77 £	1977/78 £
UK Aid						
1.	Fencing Subsidy	50,000	-	5,000	5,000	-
2.	Grassland Trials Unit Capital costs	17,000	-	-	-	-
3.	Peat cutting machine	2,750	-	-	-	-
4.	Grass seed subsidy	-	-	-	2,000	5,000
5.	Tourism loans	10,000	-	10,000	-	10,000
6.	Handicrafts - Loan	750	-	-	-	-
7.	Tourist promotion	500	-	-	-	-
8.	Minor Roads - Culverts	5,000	-	-	-	-
9.	Major Roads - Equipment	-	-	10,000	10,000	5,000
10.	Dustcart and Incinerator	4,000	-	-	-	-
11.	Broadcasting Equipment	-	-	5,000	3,000	-
12.	New Aircraft	-	-	-	30,000	30,000
13.	School Hostel	10,000	50,000	20,000	-	-
		100,000	50,000	50,000	50,000	50,000
Local Development Fund						
1.	Prison	4,000	12,000	-	-	-
2.	Minor Roads (Local costs)		10,000	-	-	-
3.	Major Roads (Local costs)	-	-	15,000	27,000	20,000
4.	Trials unit (Local costs)	-	5,000	-	-	-
5.	Telecommunications	-	35,500	40,000	20,000	20,000
6.	Fencing (Timber)	-	7,000	7,000	-	-
7.	Fertiliser subsidy	-	-	7,500	23,000	30,000
8.	Water Meters	8,000	-	-	-	-
9.	Tourist Promotion	250	500	500	-	-
		12,250	70,000	70,000	70,000	70,000

Table II

CAPITAL EXPENDITURE FROM AID FUNDS 1973/74 - 1977/78 (£)[1]

	1973/74	1974/75	1975/76	1976/77	Revised Estimates 1977/78
Natural Resources					
Fencing Subsidy	48,625	-	3,313	1,106	-
Improvement of Poultry Stock	-	116	-	170	-
Communications					
Minor Roads - Culverts	1,643	2,656	-	-	-
Permanent Airfield	50,969	1,562,788	1,313,789	1,137,131	1,753,147
Oil Supply Jetty	-	-	-	2,580	-
Beaver Aircraft & Floats	-	-	-	57,122	-
Tourism					
Tourism Loans	5,747	-	-	-	-
Tourism Promotion	309	-	-	-	-
Education					
School Hostel	8,000	-	-	-	-
Other Projects					
Stanley Power Station	8,541	520	-	-	-
Peat Cutting Machine	3,125	-	-	3,500	-
Handicraft Loans	750	-	-	-	-
Dustcart & Incinerator	1,265	5,732	-	-	-
Updating Falkland Islands Exhibition	3,000	-	-	-	-
Hospital Equipment	99	7,632	1,729	-	-
X-Ray Equipment	-	-	-	-	30,000
	132,073	1,579,444	1,318,831	1,201,609	1,783,147
Deduct Permanent Airfield	50,969	1,562,788	1,313,789	1,137,131	1,753,147
	81,104	16,656	5,042	64,478	30,000

[1] Taken from FIG accounts and therefore for FIG financial years, ie 1 July - 30 June.

Table III

CAPITAL EXPENDITURE FROM FIG FUNDS 1973/74 - 1977/78 (£)

	1973/74	1974/75	1975/76	1976/77	Revised Estimates 1977/78
Natural Resources					
Fencing Subsidy	-	-	-	2,581	-
Communications					
Assistance - Temporary Airfield	216	588	-	-	-
Assistance to YPF Construction Team	-	3,900	1,631	-	-
Telecommunications	-	-	3,152	132	17,000
Beaver Aircraft & Floats	-	-	-	57,122	-
Stanley Roads	-	-	-	-	12,500
Tourism					
Tourism Promotion	-	-	-	-	700
Other Projects					
Loans	2,640	5,100	6,050	8,500	25,000
Water Meters	2,086	-	-	-	-
Purchase of Houses	-	26,400	21,200	15,400	55,000
Hospital Equipment	-	-	1,338	-	700
Local Expenses relating to Technical Assistance	-	-	-	5,032	13,630
Peat Cutting Machine	-	-	-	2,531	-
	4,942	35,988	33,371	91,298	124,530

Annex B

REVISION TO THE ECONOMIC ANALYSIS OF THE STANLEY - DARWIN ROAD

Introduction

Following further examination of this project in Falklands by John Hodges, ODM Engineering Adviser, and myself and in the light of events since the Internal Communications Study (ICS), certain changes to the economic appraisal of the project are required. As far as possible the revised analysis follows those in the ICS report.

Revision to Costs and Benefits

The amendments to the analysis and the reasons for them are as follows:-

(i) Additional costs of £93,400 have been identified (cf Hodges report, para 18). Since the money is for actual expenses (mainly camping allowances) rather than salary payments no adjustment is required (cf ICS report, Annex H para 3) to arrive at economic costs from financial costs except to exclude inflation. Although the cost of rehabilitating the JCL plant has been increased, by a provisional estimate of £50,000 for spares, no change is made to the cost of the road because assumed hire rates were not based on actual plant values and expected costs. It must, however, be recognised that plant hire rates may vary depending on the findings of the RE's and the financial viability of the funding scheme.

(ii) The ICS report argued that the full 20% contingency included in financial costs should only be included as an economic cost if it was "fully expected" that it would be used. It went on to include only 10% contingencies. It is my view that given Falklands lack of experience with road construction, the problems of implementing such a project in a small isolated country, and the fact that detailed design will only be done as the road proceeds, the inclusion of a 20% contingency is fully justified and this has been done in the revised analysis.

(iii) The ICS report recommended that there should be no increase in the capacity of FIGAS and assessment of the benefits of the Stanley - Darwin road assumed acceptance of this. It is now understood that, despite the ICS report, FIG are determined to go ahead with the purchase of a Britten-Norman Islander, to the extent that if ODM reject the project they intend to finance it from local funds. This necessitates re-estimation of the benefits assumed to follow from the diversion of traffic from FIGAS to the road.

Following the methodology of the ICS report (Annex H, paras 11-15), which appears to result in a generous estimate of benefits, an expansion of FIGAS is important because it makes it unlikely that the spare capacity created by the transfer of traffic from air to road will be taken up. Given that it must now be assumed that an Islander will be purchased then it is necessary to take the minimum ICS estimate of benefits throughout the analysis. This estimate is based on the assumption that the operating costs of the trips which would have carried Stanley - Darwin traffic without the road could be saved. However, given the way in which FIGAS operates, with multi-stop flights, and given the central position of Darwin it seems likely that the transfer of traffic would lead more to lower load factors than to fewer trips so that even variable costs would not be saved to a very great extent. Rather than use the ICS minimum of £15,000 pa for benefits from diverted traffic from FIGAS, I have included £10,000 as a minimum and £15,000 as a maximum, allowing in these figures as implied in the ICS report that a small part of the released capacity might be taken up.

Revised Cost Benefit Analysis

The January 1978 prices equivalent of £93,400 in cash prices is £81,500. The additional costs will be concentrated in the last 20 months of the 26 months construction period so that, assuming a start in September 1978, £40,750 needs to be added to 1979 costs and £40,750 to 1980 costs. In addition, all capital costs in Table 5 of Annex H of the ICS report need to be increased to allow for 20% contingencies rather than 10%.

The estimates of benefits need to be adjusted by the reduction of the minimum estimate from £42,160 pa to £37,160 pa and of the maximum estimate from £92,320 pa to £77,320 pa.

Table 5 in Annex H of the ICS report is therefore replaced by Table I below.

Table I

STANLEY - DARWIN ROAD

DISCOUNTED CASH FLOW CALCULATIONS (£)

	1978	1979	1980	1981-2028
Costs				
(a) Capital	114,927	398,546	278,437	-
(b) Maintenance			8,000	15,500
NPV @ 8% = £879,467				
Benefits				
(a) Maximum	-	-	31,000	77,320
NPV of Maximum Benefits £774,875				
(b) Minimum	-	-	15,000	37,160
NPV of Minimum Benefits £372,492				
(c) Mean	-	-	23,000	57,240
NPV of Mean Benefits £573,683				

ie With Maximum Benefits NPV of Road at 8% = - £104,592
" Minimum Benefits " " " " " = - £506,975
" Mean Benefits " " " " " = - £305,784

and Internal Rates of Return are:-

With Maximum Benefits 7%
With Minimum Benefits 1%
With Mean Benefits 4%