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FALKLAND ISLANDS

REPORT OF A VISIT BY

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Summary of Conclusions

1. The wealth of the territory shows a steady downward trend.

2. This trend has been temporarily reversed by boom wool prices but in the long term can only be stopped by productive private investment in agriculture.

3. Every pressure and reasonable incentive must be made to encourage domestic reinvestment of company profits. The fiscal/exchange control situation should be kept under review.

4. Tax revenue should be increased (by over 20%) and most of the subsidies to consumers of public services phased out (a 50% revenue increase).

5. With one possible exception (grass seeding), available technical and economic information provides a solid basis for agricultural investment.

6. While agriculture will continue to dominate the economy and must receive priority attention, kelp (seaweed) harvesting and tourism could make a significant contribution to the national income within 5 years.

7. The majority of capital expenditure over the next decade must be financed from surpluses on the recurrent budget.

8. There seems to be a case for a 3-man/3-year grass trials programme, possibly financed by U.K. Technical Assistance.

1. INTRODUCTION AND BACKGROUND

1.1 The history and geography of the Falkland Islands is well described in a number of recent reports and I will not attempt to repeat this in any detail in this report. Suffice to say that the Falklands is a Crown Colony of 2,000 people 300 miles east of Southern Argentina, whose income is derived almost solely from the wool produced by 600,000 sheep extensively grazed over 4,700 square miles of semi-moorland. There is no poverty in the islands, but like many other monocultures the overall trend has been a fall in the international purchasing power of the export product. This situation, combined with static production levels increasingly threatens the standard of living to which the Islanders have become accustomed.

1.2 During the last 50 years a series of experts have commented and advised on the agricultural sector, but until very recently the 29 farms operated much as they had done in the 19th century. As the pressure on incomes built up during the late 1960's the pace of advice increased - more particularly an Economic Survey (Guillebaud, 1967), A Report of the Sheep and Cattle Industries (Davies, 1971) and a study of the Economics of Wool Production (Theophilus, 1972). Their principal advice was unanimous - namely that without heavy reinvestment of farm profits in the land (e.g. pastures, fencing, ditching, etc) the wealth of the Colony would decline.

1.3 Experts provided under U.K. Technical Assistance are currently reviewing the efficiency of the public sector (Mr H. Waller) and the fiscal situation (Mr J. Comben). My terms of reference are:

(i) to assist the Government in the planning of a 5-year capital budget plan;

(ii) a brief appraisal of the Colony's economic situation

and (iii) to co-ordinate any advice that I may give with that of Messrs Waller and Comben.

2. ECONOMIC SITUATION

2.1 Table 2.1 below gives a best estimate of National Income between 1959 and 1971.

Table 2.1 National Income 1959-71 (£s)

	Personal Incomes	Company Profits	Gov't Investment Income	Misc. Other	Total N.I.	N.I. Per Cap	London Av. Wool Price (Pence/kilo)
1959	532,026	284,999	24,000	17,536	858,560	400	43.95
1960	581,072	272,764	23,999	42,457	920,292	433	42.85
1961	n.a.	n.a.	26,842	30,242	n.a.	-	44.09
1962	n.a.	n.a.	31,141	21,590	n.a.	-	43.13
1963	583,285	464,413	35,948	22,029	1,106,215	514	51.53
1964	634,140	458,345	31,000	26,387	1,149,872	547	52.31
1965	718,078	255,025	31,000	42,781	1,046,934	503	44.05
1966	796,682	320,415	67,435	57,494	1,242,026	574	45.11
1967	815,764	134,000	108,621	66,395	1,124,786	530	37.43
1968	820,000	156,128	36,565	30,704	1,043,398	496	39.60
1969	829,059	195,607	37,521	45,788	1,106,975	528	41.99
1970	830,000	121,163	156,241	76,811	1,184,215	579	36.77
1971	832,895	30,613	170,467	32,778	1,066,753	528	31.95

2.2 The last column gives the annual average London Wool Price which has an immediate and direct correlation with company profits. As the average wool production costs have risen from about 30p per kilo in 1960 to 38p per kilo in 1971 the share of company/...

company profits in N.I. has fallen. The upward trend in personal money incomes is very largely a function of imported U.K. inflation. The size of the labour force has actually fallen slightly and this has been only partially compensated for by increases in productivity. Government Investment Income from various Colony funds invested overseas is related to movement on the London Stock Exchange and as such fluctuates widely from year to year. (It is of course only real Colony income to the extent that it more than covers inflation - or loss in purchasing power of the capital funds). The "Miscellaneous Other" column includes house and land rents, reimbursement from the Savings Bank, the contribution towards administrative costs from South Georgia, small amounts of U.K. grant aid, and for 1965 and 1966 a surplus made by the Falkland Islands Freezer Company.

2.3 For the decade 1962-1971 per capita income remained virtually static at just over £500 but during this period the purchasing power of the £ fell by 50 per cent.

2.4 Up until 1970 aggregate domestic expenditure has been only 60-70 per cent of aggregate national income. The difference is made up by the movement of both corporate profits and personal savings to the U.K. where the former is distributed as dividends and the latter invested. Most of the Company owners reside in the U.K. and even the assets of the Government Savings Bank through which most local personal saving is channelled are invested in the U.K. In this situation it is not surprising that the economy has been stagnating. In the last 70 years improved sheep breeding methods (higher wool yield per sheep) appear to have only just compensated for decline in the pasture (fewer sheep). With a few exceptions there has been no directly productive investment this century - such farm investment as has occurred has traditionally been in staff amenities. For example, the dominant Falkland Islands Company which owns half the land has invested virtually all its agricultural surplus in U.K. property.

2.5 Until the recent rise in wool prices (trebled in 18 months) it appeared that by 1974/5 many farms would be in severe financial difficulty and the administration would find itself unable to balance its budget. These abnormally high prices brought a reprieve, but one which is likely to be short-lived. All the indications are of a fall down to 50-60 p. per kilo by 1974, and this would bring the Falklands back into the borderline position where the farms have no surplus available for either investment or payment of corporate taxation. By 1976 only a return of boom wool prices would curtail a steady fall in living standards on a scale that higher levels of U.K. aid, even if forthcoming, could not effectively alleviate.

2.6 Short of an everlasting boom in wool prices, the only medium and long term solution is a serious policy switch by the landowners into large scale productive investment in their land. Time is not on their side, as such investment does not bring a quick return and, if there is a delay until they are faced with valueless assets, then they will find themselves unable to raise the capital. The prime culprit is the Falkland Islands Company, and the Colony should seriously consider whether the short term financial interests of a very small number of overseas shareholders should be allowed free rein over the destiny of the Islands. It is very unfortunate that, in the circumstances of the Colony, it would be difficult to use the media of taxation or exchange control to further encourage reinvestment of company profits (Guillebaud tried and failed). However the possibility of strong action (e.g. much higher company tax levels with cancellation of the U.K. double taxation agreement) should be kept under review and all possible pressures brought to bear to encourage investment, or sale by current owners to those interested in investment.

2.7 The field of land investment must, for the foreseeable future, remain the critical factor in determining the future wealth of the Islands. There are, however, two other broad areas of concern. Firstly the means by which small but fairly immediate gains can be obtained by increasing the efficiency of the existing operations of both public and private sectors. Secondly the possibilities of introducing significant new sources of income into the Islands.

3. THE PUBLIC SECTOR

3.1 The 165 members of the Colony Civil Service provide a wide range of services for the community. Apart from the normal administrative and social functions it operates the urban utilities (electricity, water, etc), services all the public infrastructure (roads, harbours etc), houses its officers and operates an internal air service. The diseconomies of the small scale involved are apparent but financially the Colony has as yet avoided the need for any recurrent subsidy from the U.K. Indeed, until 1970 U.K. capital and technical assistance was minimal. Since then the £100,000 loan for a power station and the £1.74 million grant for an airfield have altered the position somewhat.

3.2 Table 3.2 illustrates the budgetary position over the last 15 years.

Table 3.2

Recurrent Revenue, Expenditure and Reserves, 1958/59-1972/73

(£'000)

	Rec.Rev.	Rec.Exp.	Surplus/(Def.)	Value Reserves ‡
1958/59	288	262	26	232
1959/60	284	243	41	223
1960/61	237	248	(10)	214
1961/62	288	286	(26)	181
1962/63	293	317	(24)	162
1963/64	286	321	(35)	107
1964/65	385	328	57	132
1965/66	410	365	45	185
1966/67	380	392	(12)	193
1967/68	474	419	55	254
1968/69	407	465	(58)	167
1969/70	395	463	(68)	115
1970/71	520	498	22	144
1971/72	533	522	11	152
1972/73	413	509	(96)	50

‡ (Reserves = GRB + Reserve Fund: Changes in Reserves are dependent on both recurrent surplus or deficit and changes in the book value of the invested Fund: The figure given is at the last day of the financial year shown: Reserves does not here include the Development Fund which has an estimated current value of £0.1 million.

3.3 As a proportion of annual expenditure reserves have fallen virtually steadily since 1960 and so long as over half their normal revenue (direct taxation, and income from the Savings Bank) remains liable to violent fluctuation an average of anything less than 40 per cent (say £200,000) would appear inadequate. As there is an 18-month lag between a rise in wool receipts and any resultant increase in receipts of company income and profits tax, it is going to be difficult for/...

for the Government to survive the financial year 1973/74 without drawing down on the Development Fund for purposes of recurrent expenditure. In 1974/75 revenue from companies should more than double to £270,000 and even with a very low income from the Savings Bank this should allow a marginal positive balance. If, however, there is a decline on wool prices in 1974 to below 60p per kilo, the Government will be back in financial difficulties in 1976. If this level of wool continues for a number of years, and this seems likely, the Colony could not remain financially self-supporting without curtailment of public services or a very heavy increase in tax levels.

3.4 The table below gives a breakdown of local revenues by type for the last three years.

Table 3.4

Recurrent Revenues 1970/71 - 1972/73

(£s)

		Actual 1970/71		Actual 1971/72		Est. 1972/73 +	
	TAXATION						
1.	Direct Taxes	130,441		125,045		95,731	
2.	Indirect Taxes	45,493		48,514		47,860	
			175,934		173,557		143,591
3.	INVESTMENT INCOME		156,240		177,574		84,405
4.	PHILATELIC REVENUE (est)		40,000		14,500		16,000
	VARIOUS RECEIPTS						
5.	Fees & Fines	11,332		11,935		10,970	
6.	Reimbursements	15,498		14,998		17,081	
7.	Miscellaneous	5,754		6,606		5,790	
			32,584		33,539		33,841
	PAYMENT FOR SERVICES						
8.	Dependencies Contribution	–		9,000		4,500	
9.	Harbour Dues	9,108		11,225		9,550	
10.	House Rents	5,035		4,793		5,360	
11.	Electricity	42,838		50,224		53,350	
12.	Posts & Telecommunications	40,421		39,040		40,891	
13.	Aviation	17,528		19,111		21,500	
			114,930		133,992		135,151
	TOTAL		519,688		532,563		412,988

‡ Printed Estimates adjusted on information available January 1973

Items 1, 3 and 4 which normally make up over half the revenue are highly volatile but each for very different reasons. Direct tax revenue is linked to the price received for the wool clip two years previously, investment income to movement in the London Stock Market, and philatelic revenue to the number of new stamp issues.

3.5 In view of paras 3.2 - 3.4 above there is a very strong case for increasing general taxation receipts by a minimum of 10 per cent (or about £30,000 in an average year). Minor changes in direct taxation (see Income Tax, Profits Tax and Estate Duty in Mr Comben's Report) should increase their yield/...

yield by approximately £8,000 per annum. It is in some ways a pity that more cannot be done to either restrict the level of remittance to the U.K. or indeed to tax them at a higher rate but the constraints on doing this appear insurmountable. Now that the Falklands is outside the Sterling Area, exchange controls are a possibility but one that would have to be considered very carefully. I have doubts on the practicability of this in current circumstances. The simplest way of raising significant revenue seems to be an increase on the duty levels on spirits and cigarettes, a small duty on diesel fuel, and a small ad valorem duty on selected luxury manufactures. An amount of say £10,000 brought in by these increased duties on spirits and cigarettes would not make the respective retail prices in any way unreasonable by current international standards. A 5p. per gallon duty on diesel fuel (£5,000 per annum) is too small to significantly effect agricultural production costs and the 20 per cent ad valorem duty on manufactured luxuries (£6,000 per annum) should not discourage the vast majority of tourist purchases.

3.6 Updating of the various licences, fee levels and where possible crown land rentals, should bring in a further £2,000. The recent Crown Agents' report on Telecommunications (page 55) suggests that philatelic sales could be considerably increased. Certainly two or three commemorative issues every year now seems the normal pattern for small territories and if well organised this should bring in further windfall revenue of at least £5,000 over the current norm of about £15,000 per annum. Specialist advice should be readily available in London. Minting of special commemorative coins for sale to collectors can also be remunerative. Again advice should be called for.

3.7 What is described as Government investment income is available each year on the £1.3 million Government Savings Bank account after allowance has been made for the $2\frac{1}{2}$ per cent interest payable to depositors. Over the last two years this source has been unusually high and has accounted for fully one-third of total public revenues, and kept the accounts out of deficit. Projected receipts for this financial year are down to £84,000 and the Government cannot safely expect a higher level than this in future years. Indeed, despite the interest being tax free (thereby making the surplus to a small degree disguised income tax) in these days of high inflation I would recommend an increase in the interest rate payable to say $3\frac{1}{2}$ per cent per annum and this would reduce the surplus available to Government by about £13,000 per annum. Over the next decade the Government should make every attempt to phase out taxation on savings in favour of taxation on income and expenditure.

3.8 Regarding revenue earning services unless it is specifically accepted by the Government that there is a clear case for providing a subsidy the consumer should be charged for the full recurrent and capital costs of providing a given service. Indiscriminate and unquantified subsidies from general taxation and U.K. aid are highly wasteful, and can encourage severe distortion in patterns of consumption and investment. This is not commercialism but proper management. The services to which this applies in the Falklands are:

3.8.1 Administration of Dependencies
3.8.2 Stanley Harbour Services and m.v. Forrest
3.8.3 Provision of 53 houses, largely for civil servants
3.8.4 Urban utilities - Power, water and sewerage
3.8.5 Postal (excluding philatelic) and Telecommunications
3.8.6 The internal air service.

3.9/...

3.9 A very rough attempt is made below to estimate the element of subsidy for 1972/73 for those services that appear in public accounts.

(38)

Service	Rec. Revenue (A)	Est. Total Rec. Exp. (B)	Rec. Deficit (C)	Hidden Annual Capital Costs (D)	Est. Annual Subsidy (E)	Notes
Admin. of Depts.	4,500	6,500	2,000	-	2,000	Exp. taken approx 5% total Admin.
Marine	9,550	17,500	7,950	8,000	15,950	Exp = Harbour + Forrest + 7½% M.A.V.*
Housing	5,360	27,282	21,922	14,300	36,222	Rec. Exp = 30% pub Rec. + 15% M.A.V.
Electricity	53,350	39,867	(+13,493)	27,800	14,307	Rec. Exp = Vote less loan repayment + 30% M.A.V.
Posts & Tele-communications	40,891	61,696	20,805	23,000	43,805	Rec. Exp = Vote + 40% M.A.V.
Aviation	21,500	34,558	13,058	5,270	18,328	Rec. Exp. = Vote + 7½ M.A.V.
Misc. Public Utilities[x]	1,000	15,000	14,000	10,000	24,000	Approx. Taken from Govt. & Council Budgets
	136,451	202,403	66,242	88,370	154,612	

* M.A.V. = Miscellaneous Appropriate Votes = that share of Pensions, O/S Passages, Salary Review, P.D (excluding housing) and Miscellaneous Votes that can broadly be allocated to Revenue earning services = £39,334 for 1972/73 (see table 3.12)

x Miscellaneous Public Utilities = water, sewerage and garbage collection.

\+ Harbour and M.V. Forrest

The column of "Hidden Annual Capital Costs" is merely a best estimate on available information and the final column should be taken as no more than an order of magnitude. This exercise does, however, illustrate the large element of subsidy in all these services (54% - or (E) as % of (B) and (D)). Harbour dues should be adjusted upward to cover all appropriate capital and recurrent costs and the tariff charged by the m.v. Forrest to private users should be reviewed to ensure full charging. Public sector housing is a much more difficult area. Certainly where a house is rented or leased outside the Civil Service a full economic rent should be charged. Although an average of about £700 per annum of a Civil Servant's income is received in the form of a housing subsidy this form of disguised remuneration is also common in the private sector. It clearly discourages private investment in housing by all employees which would be a very desirable way of soaking up domestic savings. There is no possibility of moving into economic rents overnight but over the next decade Government should take every opportunity in, for example, salary reviews, to transfer real income out of subsidy into freely disposable remuneration.

3.10 I can see no reason why electricity consumption in Stanley should be subsidised. The sub-commercial U.K. capital that has been provided was not, I think, intended specifically for the benefit of heavy electricity consumers in Stanley, but as a means of helping the Falklands as a whole. The consumer should be charged for the use of the equivalent of commercial capital with the element of subsidy from the U.K. (i.e. surplus of revenue over expenditure) going into general Colony revenues. Regarding Posts and Telecommunications, I can see no reason for subsidising anything but internal telecommunications. Fully economic postal and external telecommunications charges should not be prohibitive to serious consumers. The internal air service is of such social and economic importance to the scattered population that I think charges should only be expected to cover recurrent costs. Urban public utilities such as water supply, sewerage and garbage collection have only recently been taken over from the now defunct Town Council. The level of rates appears little more than nominal and should be drastically revised to cover a substantial proportion of the costs of these services.

3.11 The surplus of ordinary revenue available after the cost of social and administrative services has been met plus the small amount of U.K. aid likely to be available will not alone be adequate to meet the future recurrent subsidy and capital requirements of the above services. There must be a substantial contribution from the consumers. If the suggestionsin para 3.10 above are followed and assuming little net contribution from rentals, revenues should be increased by approximately £75,000 to £210,000 within two years.

3.12 The table overleaf gives a breakdown of local recurrent expenditure into administrative, social and revenue earning services for the period 1970/71 to 1972/73.

Table 3.12 Recurrent Expenditure 1970/71 - 1972/73 (£s)

Service	Actual 1970/71		Actual 1971/72		Est. 1972/73	
Admin Services						
Governor	9,959		8,695		7,374	
Agriculture	3,282		2,986		3,008	
Audit	1,902		828		2,307	
Customs	5,874		4,397		4,663	
Military	2,242		2,528		3,083	
Police and Court	11,493		10,726		11,952	
Secretariat etc	47,503		47,025		45,488	
		82,255		77,185		77,875
60% Miscellaneous	5,272		5,652		4,720	
40% Pensions etc	6,372		5,963		8,298	
30% P.W.D.	18,651		20,522		21,382	
O/S Passages	6,938		6,738		5,464	
Salary Review	-		-		7,455	
		37,233		38,875		47,319
Total Admin. Costs		119,488		116,060		125,194 (25%)
Social Services						
Education	61,126		60,431		64,489	
Medical	55,579		57,703		60,336	
Social Welfare	16,766		17,592		10,000	
Shipping Subsidy	46,502		61,060		-	
Meteorological	2,735		2,734		3,210	
		182,708		199,520		138,035
20% Miscellaneous	1,757		1,884		1,573	
30% Pensions etc	4,779		4,472		6,223	
20% P.W.D.	12,434		13,682		14,255	
O/S Passages	7,077		6,873		5,574	
Salary Review	-		-		9,472	
		26,047		26,911		37,097
Total S.S. Costs		208,755		226,431		178,132 (35%)
Rev. Earning Services.						
Aviation	29,518		28,635		31,598	
P & T	54,423		53,335		53,916	
Electricity	25,614		31,644		42,303	
Marine	12,422		14,134		12,755	
Housing (30% PWD)	18,652		20,523		21,381	
		140,629		148,271		161,953
20% Miscellaneous	1,757		1,884		1,573	
30% Pensions etc	4,779		4,472		6,223	
20% PWD	12,434		13,681		14,255	
O/S Passages	11,379		11,051		8,962	
Salary Review	-		-		8,357	
		30,349		31,088		39,370
Total R.E.S. Costs		169,987		179,359		201,323 (40%)
Total Rec. Exp.		49[illegible],230		521,850		504,649

Any such division of the budget into three sub-sections necessarily involves a large number of fairly arbitrary decisions about the allocation of funds. No doubt with much more attention it could be considerably refined. Nevertheless, it is adequate to illustrate/...

illustrate the following points. Firstly only about 25% of recurrent expenditure is allocated to the normal administrative functions of Government as such. It is the revenue earning services that take the largest share - namely 40%. (The total figure of £201,323 is not directly comparable with Table 3.9 because the latter involves the budget of Stanley Council and only two thirds of this are covered by revenues. (Table 3.4 - £135,151 for 1972/3). By 1973/4 almost all the saving resulting from the recent withdrawal of the shipping subsidy will be wiped out by the salary review plus general inflation on O'Cs.

3.13 It is indeed remarkable that a country so dependent on the fortunes of agriculture has no qualified Agricultural Officer. If an Agricultural Trials Unit is established (see below) the requirement can be delayed but if this, for any reason, is not forthcoming, then the recruitment of such an officer should be given high priority.

3.14 The organisation of the public service is currently being studied by Mr Waller, an establishments expert. The nature of the service is such that it is unlikely that acceptance of his recommendations will provide clear savings on administration costs in excess of £10,000 per annum.

3.15 The short term budgetary recommendations are summarised below taking the estimates for 1972/73 as a base.

Table 3.15 Summary of Public Sector Financial Recommendations

(£'000)

Recurrent Revenue		1972/73	Approx. Recommendations	
Taxation	:	144	+ 31	
Investment Income	:	84	- 13	
Philatelic Revenue	:	16	+ 5	
Various Receipts	:	34	+ 2	
Payments for Services #	:	136)	+ 75	
Rates	:	4)		
Total		418	+ 100	= 518
Recurrent Expenditure #		515	- 10	= 505
Balance available for transfer to capital				13

Central Government and Stanley Council

The financial year 1972/73 has had unusually low receipts in taxation. If investment income does not continue to fall and the current wool prices are reflected in very high taxation receipts in the 1973/75 (circa £300,000) then the surplus available for transfer to capital budget in that year could well be over £100,000. On average, and with a little luck, if the suggested measures are adopted then the Government could hope for an average recurrent surplus of about £70,000 over the remainder of this decade. The Colony should thereby be able to avoid increased dependence on external assistance in the medium term. In the long term only judicious private and public sector investments, particularly the former, will guarantee maintenance of the standard of living.

4. The Private Sector

4.1 The production of wool for export has dominated the economy of the Islands for a century and the fortunes of this industry will continue to determine the basic wealth of the islands for the foreseeable future. The apparent inability or unwillingness on the part of the landowners to invest in and develop their assets has/...

has been the subject of many reports and the paths to be followed in such matters as fencing and ditching are by and large as clearly defined as they ever will be. It is my opinion that unless active notice is taken of the extensive advice given in the recent Theophilus and Davis reports, the industry as a whole can do little but decline. There remains perhaps one serious gap which inhibits at least a proportion of the landowners from reinvestment, namely lack of knowledge on appropriate grasses for seeding open pasture. The carrying capacity of the land is constrained by an as yet unfilled nutritional gap in September - November when none of the local grasses grow. It is a possibility that technical assistance from the U.K. in the form of a three-man trials unit for three years could go a considerable way towards solving this problem.

4.2 Various attemps have been made in the past to export meat, the most notorious failure being the large C.D.C. freezer at Ajax Bay. Very recently an opportunity has opened for the export to Argentina of significant numbers of sheep on the hoof and, even at the expected f.o.b. price of £2 per head, this could become an important sideline for many farms.

4.3 The two areas open for diversification that one normally mentions are tourism and the collection and processing of seaweed. The latter concerns the plans of one U.K. firm, Alginate Industries Ltd., to invest about 2½ million pounds over the next 5 years in the harvesting and partial processing of kelp which is available in large quantity around the islands. They plan to be in full production by about 1976, employing about 80 persons and contributing directly and indirectly about £75,000 per annum to Government revenues. If the plans are implemented this will make a valuable contribution to the economy.

4.4 The potential contribution of tourism is less clear. Restricted communications limit the present industry, if it can be called such, to the servicing of the passengers from about 10 to 15 cruise liners and scientific vessels a year - perhaps 10,000 persons. These one-day visitors to Stanley do seem to spend about £5 - 7 per head on tax-free luxury manufactures and the small amount of local handicrafts available for sale. The local income from this, largely received in the form of mark-ups on imports, must be somewhere in the region of £15,000 per annum. In 1976, after the proposed permanent airfield has been completed, the opportunity will arise to widen the industry to include numbers of residing tourists. I would think that the islands can expect to tap only a small part of the market, in particular the rich seeking the unusual (e.g. trout fishing) and the specialist whose primary interest would be the wildlife. It is of course very difficult to predict but over a five month season, November to March, when the weather is normally not upleasant, it would be very optimistic to expect more than 400. On the basis of an average stay of two weeks (5,600 bed/nights) and an occupancy rate of 70% (i.e. 8,000 bed/nights) in the season for a five month season (say, 150 nights) the accommodation requirement is 53 beds. The only Hotel in the Falklands, the Upland Goose in Stanley (22 beds) will not be adequate or appropriate for the type of tourist under consideration, except as a media for short-stay transit (i.e. between arrival and dispersal to other accommodation). Private enterprise should be encouraged to invest in a few small units of accommodation at those points around the Islands which would be best suited to the specialist traffic expected (e.g. next to nature reserves). A collective total of 35 - 40 beds outside Stanley should be aimed for by 1976. There does not seem to be a strong case for considering a large new Hotel in Stanley. However, this could change rapidly and potential overseas investors should be encouraged by Government to at least keep the situation in review. /...

review. It is possible that overseas interests may be generated in an immediate investment in a small new Stanley Hotel (e.g. L.A.D.E.) but I would consider this unlikely at the moment.

4.5 While the Falklands cannot afford to throw away the benefits (communications etc) that tourism might bring this will never be a large industry and as such should not receive a disproportionate share of public administrative and financial resources. A small amount of public capital seems to be required to get the industry off the ground, particularly for investment in accommodation and handicrafts. Such a temporary diversion of public funds seems reasonable in current circumstances but thereafter private investment capital should be left to bear the burden.

4.6 With reference to public services, it is particularly important that the tourist be fully charged for all of these that he consumes. The Government should not be in the position where it is subsidising tourism from general taxation of the local population. It may not be possible to avoid an element of subsidy in particular services (e.g. Air Service) but the Government should be concerned to avoid a situation of private gain at public expense after the industry has overcome its birth pangs.

4.7 Such banking services as exist in the Falklands are provided by the Government (Savings Bank) and the F.I.C. (miscellaneous services). The existing system is clearly not entirely adequate and some priority should be given to the establishment of a local branch of a U.K. clearing bank. On available information there does not seem to be a need for offering any special inducements. The effect of a commercial bank on Government revenue should be given due consideration when the situation arises.

4.8 There does seem to be a possibility, albeit a small one, of developing a fishing base in the Falklands. The Russians and Spanish are already operating in the waters around the islands using factory ships rather than a land base. Recently there has been some investigatory activity concerning hake resources by both an Argentine Company and by the U.N.D.P. (ref DP SF 310 ARG 10A) and the Government is trying to interest the Japanese firm Taiyo. I would advise that the O.D.A.'s Adviser on Fisheries, Dr Hall, should be informed of any developments.

4.9 Many other possibilities for diversification have been mentioned and the technical and commercial aspects of them should, where possible, be investigated (e.g. Montan wax from peat). In this context, however, it should not be forgotten that agriculture is and will remain the priority industry; and secondly that the dearth of surplus labour and the sheer physical isolation of the Falklands together will weigh heavily against many technical possibilities.

5. <u>Government Capital Budget</u>

5.1. Excluding receipts from E.S.R.O. and payments to Cable and Wireless which pass through the capital budget every year (see Estimates for 1972/73, pp 31 and 32) public sector capital expenditure is currently financed by withdrawals from the Development Fund (valued at £102,500 at 30th June, 1972) a small amount from local loan repayments and receipts of U.K. aid in the form of loan or grant. Recently the only large amount of U.K. aid received was for the purpose of expanding Stanley power supplies. Expenditure from the Colony Development Fund has been running at about £15,000 per annum on a variety of very small projects - very often just replacement of individual pieces of equipment (e.g. a float for one of the two locally based aircraft).

5.2/...

5.2 Future sources of capital revenue will consist of the existing Fund, the surplus available from the recurrent budget, local loan repayments and U.K. aid. I would recommend that the amount held in reserves for both recurrent and capital purposes be minimised. It would seem sensible to phase out the Development Fund in favour of one reserve fund held for both recurrent and capital purposes. The backbone of capital revenues should be the recurrent surplus but local recurrent revenues will almost certainly fluctuate to such a degree that in a bad year reserves will be needed to supplement both recurrent and capital budgets. Paragraph 3.15 above suggests that 1974/75 and thereafter the Government should plan for the surplus on recurrent available to average £70,000 per annum. To this could be added £5,000 per annum from repayment of local loans. Excluding the permanent airfield, for which a separate allocation will be made (£1.739 million) U.K. aid can be expected to be a maximum of £100,000 in the U.K. financial year 1973/74 and thereafter a maximum of £50,000 per annum. If and until notified otherwise this should all be in the form of grants - whatever the content or purpose of the aid may be. If a project involves lending to the private sector the local Government and not the U.K. would receive the loan repayments, i.e. the Falkland Islands Government would on-lend a U.K. grant. Normally the U.K. would wish to approve the terms of on-lending.

5.3 As for expenditure, clearly agriculture must be the priority. It is never simple to use public funds to aid private enterprise in order to encourage it to act in the public interest. For example, not only must the Government avoid direct substitution of public funds for private investment that would have in any event taken place (i.e. give an immediate boost to distributed profits) but the aid hopefully should act as a catalyst to the general level of investment in the sector concerned. Taking this and many other matters into consideration, including, of course, technical advice, I would recommend an allocation of £50,000 in your financial year 1973/74 to subsidise by 100% the cost of materials required for 200 miles of sub-division fencing. An aid project should be forwarded to the U.K. as quickly as possible including a request for a tied aid waiver (i.e. non-U.K. purchase) for the timber (circa £20,000) that will be required. By far the cheapest and most convenient source would seem to be Latin America. Grants of materials will, of course, cover only new fencing and farms should be asked to send in requests which cover details on miles, purposes (i.e. expected benefit) dates of implementation, associated investments etc. All farms should have proper investment plans covering at least 5 years - the production of such would certainly clarify their case for public subsidy. After 1973/74 I would provisionally suggest a subsidy allocation for about 50 miles per allocation, with the non-U.K. element (i.e. timber) purchased from local public funds.

5.4 Ditching/peat cutting machines are an area where public funds might be utilised (purchase for hire) but as an increasing number of farms are purchasing their own, I would suggest waiting for at least two years in order to measure the adequacy of this private initiative. One peat cutting machine (£750) would, however, be a useful labour saving asset for Stanley.

5.5 Para 4.1 above suggests the requirement for a Grassland Trials Unit. Most of the cost of this should be met from U.K. Technical Assistance Funds (i.e. not capital aid) but there will be certain associated capital requirements - housing, work buildings, research materials. Hopefully the local farming community will provide a proportion of the resources required (e.g. use of land and sheep). If such a trial proves reasonably successful it is likely that by 1976 there will be a case for a limited subsidy on fertilizer and/or grasses.

5.6 To enable the apparently required amount of tourist accommodation to be available within three years I would suggest an allocation of £40,000 spread over 1973/74 and 1974/75. This should be on loan to commercial operators after receipt and consideration of their plans. Appropriate terms for on-lending should approximate to repayment over 10 years after a three year grace period at a rate of interest of 7% p.a. Very small allocations are also required for tourist promotion (£500 p.a. for two years) and handicrafts development (£750). The latter I suggest be lent at 5% p.a. with a two year grace period and repayment over 10 years.

5.7 Major road developments, and I refer particularly to a project connecting Stanley with the interior of East Falkland, should await the completion of the permanent airfield in 1975/76. Prior to this there is a case for some expenditure on improving some of the very bad areas on existing Land Rover tracks. I suggest an allocation of £5,000 per annum from U.K. aid for the purchase of steel culverts and an allocation of £10,000 from local funds to cover the cost of a very small road development (not maintenance) gang.

5.8 The prison requires replacement and an allocation of £16,000 is made, 25% in 1973/74 and 75% in 1974/75. A specialist dustcart (£3,000) will be needed in 1974/75.

5.9 It has been proposed for some time to close the Darwin school and by building a new hostel in Stanley, centralise all major educational institutions. The hostel, which would provide accommodation for 80 pupils would cost £80,000 - £100,000. The justification is financial, educational and social, but on available figures the recurrent financial saving does not of itself give any strong case. The decision must rest on the other benefits suggested. Fortunately, an Educational Expert from the U.K. will shortly visit the Colony and he will be able to assess at least the educational benefits.

5.10 It is expected that by 1976 a third aircraft will be required for the internal air services. The existing aircraft will require replacement in or around 1977/78. Appropriate allocations of £35,000 per aircraft are suggested.

5.11 The recent Crown Agents report on telecommunications suggested an investment of over £325,000 over five years. In the circumstances of the Colony this seems unrealistic but as funds become available in 1974/75 and thereafter much of the existing internal telecommunications equipment which is almost 20 years old must certainly be replaced. There does seem to be a case for restricted V.H.F. development but I do not think major telephone developments, particularly in Stanley, can or should be afforded before the late 1970's. The report on the development of broadcasting services by the B.B.C. is a useful document and clearly some new equipment should be purchased by 1975/76. Most of this will have to be of U.S. manufacture and tied-aid waivers will be required if U.K. aid is used. For the telecommunications and broadcasting projects both local and U.K. will have to be used.

5.12/...

5.12 The table below summarises the proposed capital expenditure budget for the next five years.

Table 5.12.

Proposed Capital Expenditure Budget, 1973/74 - 1977/78 (£s)

		1973/74	1974/75	1975/76	1976/77	1977/78
U.K. Aid.						
1.	Sub-Division Fencing Subsidy	50,000	5,000	5,000	5,000	-
2.	Grass-seed subsidy	-	-	-	2,000	5,000
3.	Peat cutting machine	750	-	-	-	-
4.	Trials Unit - Cap. Costs	18,000	4,500	-	-	-
5.	Tourism - Loans	20,000	20,000	-	-	-
6.	Handicraft - Loan	750	-	-	-	-
7.	Tourist Promotion	500	500	-	-	-
8.	Minor Roads (Culverts)	5,000	5,000	-	-	-
9.	Major Road Projects (Equipment)	-	-	25,000	-	-
10.	Prison	4,000	12,000	-	-	-
11.	Dustcart	-	3,000	-	-	-
12.	Telecommunications (Equipment)	-	-	15,000	8,000	15,000
13.	Broadcasting (Equipment)	-	-	5,000	5,000	-
14.	Aircraft for I.A.S.	-	-		30,000 (1)	30,000 (1)
		100,000	50,000	50,000	50,000	50,000
(15.	New School Hostel)	(20,000)	(70,000)			
Local Capital Funds						
16.	Minor Roads (local costs)	10,000	10,000	-	-	-
17.	Major Roads (local costs)	5,000	-	15,000	20,000	20,000
18.	Trials Unit (local capital costs)	5,000	-	-	-	-
19.	Telecommunications	-	53,000	30,000	20,000	20,000
20.	Fencing (Timber)	-	7,000	7,000	7,000	-
21.	Fertilizer subsidy	-	-	12,000	23,000	30,000
		15,000	70,000	70,000	70,000	70,000

The above does not attempt to set out a rigid allocation of funds over five years. It is a pattern of expenditure which certainly after 1974/75 can be no more than indicative. For example, a positive decision on item 15, the hostel, will almost certainly require deletion of quite a few of the other items. Telecommunications expenditure does not exactly follow the Crown Agents five year plan; and the phasing in of a fertilizer subsidy in three or four years time will depend very much on the advice of the Trials Unit.

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6. Technical Assistance

6.1 During the last four years there has been an upsurge in the flow of technical assistance from the U.K. The possibilities for further short-term T.A. have been widened by the development of the air-link. In the very near future visits by education and trout fisheries experts are expected and later this year a B.A.S. scientist is due to make a study of the montan wax content of the local peat. 1973/74 should see a visit by a sheep shearing instructor and the start of a two year scientific study of the Upland Goose (which competes with the sheep for the good grass). The Colony also desires the services of a Wildlife expert for two years - although I would have thought this last item rather excessive.

6.2 There might, on a low priority basis, be a need for very brief visits by a physical planner and by a handicrafts expert (look into uses of sheep-skin etc). The airlink also offers the opportunity for brief visits by ODA advisors, many of whom already visit Latin America from time to time.

6.3 Many cadet farm managers recruited or educated in the U.K. would certainly benefit from a one or two year Agricultural Diploma course at a selected Agricultural College before beginning their career in the Falklands. The training of, say, five a year would make an invaluable long-term contribution to agriculture.

22. No soil preparation of any kind was carried out in either location and no fertilizers were supplied. It is highly probable that if mycorrhiza had been introduced the results would have been more satisfactory.

23. Though Sitka spruce has not been tried in sand here, it has a reputation for adaptability on such areas. It is possible, that as the plant moves with a good ball of earth, establishment may be assured though fencing, to prevent entry of stock, is imperative.

24. The factors which appear to limit the types of trees that have become established in previous attempts at afforestation may be summarized thus:-

(a) Raw acid peat soils often impervious to surface water.

(b) Water-logging of prepared holes in which trees are planted.

(c) High winds which become laden with salt after passing over hundreds of miles of ocean.

(d) Lack of mycorrhiza.

(e) Late frosts, and low summer temperatures.

25. However, if soil is prepared, it is possible that some trees that grow under somewhat similar and rigorous conditions might be worth trying in future experiments. Among these may be included the following selected from Sudbury's (1907) Forest Trees of the Pacific Slopes.

Abies lasiocarpa.	Betula alaskana.	Picea canadensis.
Acer glabrum.	Chamacyparis nootkatensis.	Pinus muricata.
Alnus tenuifolia.	Cupressus pygmea.	Populus balsamifera.
Alnus sitchensis.	Larix larinina.	Populus tremuloides.
Betula kenaica.	Picea mariana.	

26. In addition to these it is possible that trees which grow on the eastern coast of Newfoundland or Nova Scotia and are there subjected to heavy salt laden winds, may be found suitable in the Falklands. They would certainly be worth trying.

27. Skottsberg 1942: Recommends Pilgerodendron (Libocedrus) uviferum, Nothofagus antarctica, Drimys winteri, Maytenus magellanica in addition to pines and species of Betula and Sorbus.

(Signed) H. R. Evans

15th June, 1946.

Copied TB.

COMMENTS ON THE REPORT OF MR G.A. ARMSTRONG

(ECONOMIST F.C.O.)

The Falkland Islands Co. Ltd., has received with disappointment and regret the report by the Foreign and Commonwealth Office economist Mr G.A. Armstrong on his visit to the Falkland Islands. The Company is disappointed at the failure of Mr Armstrong to understand the problems of the Islanders and the sheepfarming industry and offended by the prejudice shown in the report's criticisms of its own role in the Colony.

The current report repeats some of the errors of the Guillebaud Report which was the subject of a detailed reply by the Company. It is assumed, therefore, that the reply was not made available to Mr Armstrong. It should be recorded that the Guillebaud fiscal recommendations, which were based on statistical information which the Company considered to be inaccurate, resulted in legislation which was doomed to failure and was in fact repealed.

We have the following comments to make on the report.

Summary of Conclusions

1. The wealth of the Colony shows a steady downward trend since 1967/68 because of falling wool prices and rising Government expenditure not all of which is necessary for the sheepfarming industry. The industry itself introduced economies to counter falling revenue but there is no evidence to suggest that reciprocal action was taken by Government.

   Until the early 1960's the Company paid the greater part of its taxation liability in the United Kingdom with a rate exceeding 60% on its peak profit made during the Korean War when wool soared in price. The rate in the Colony at that time was 17½%.

   It was not until 1961 that the Company was invited to submit proposals relating to fiscal policy, acceptance of which ended the loss of revenue to the Colony. If action had been taken earlier there would have been no financial crisis in the early 1970's.

2. The gloomy prognostications of the F.C.O. delegation on the wool market in the Falkland Islands in November 1972 are echoed by Mr Armstrong and the following figures

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must therefore be recorded:-

	Average Realised Price Per Kilo
	P
1971	32
1972	55
1973	73
1974	111

Productive private investment is exactly the policy this Company is pursuing.

It is to be hoped that the policies advocated by Mr Armstrong are not policies endorsed by H.M. Government. The Company has always discharged its great responsibilities to the Colony responsibly, fairly and honestly. Its policies have been directed toward the long term good of sheepfarming industry and the Colony in which it has a tremendous stake. The Company has always been a public Company and its shareholders have received a fair return from the risk capital involved.

5. This parragraph is totally erroneous. The only proven method of increasing farm production without proportionate increases in costs is pasture reseeding, as yet only of some types of camp. Various methods, appropriate to different types of camp, have been developed on various farms, some of them FIC farms, in spite of more discouragement than help from visiting experts. We are pursuing this form of development as fast as human resources permit.

Introduction and Background

1.2 This is true - butnone of the experts has stayed long enough to test the validity of his advice, given on the basis of experience in a totally different enviroment. Intelligent and dedicated managers have, unstinted of capital by their owners, and have found it wanting.

Economics Situation

2.1 The table of National Income is interesting but doubtfully complete although it is difficult to comment without further information. Presumably the figures for personal income include income from all sources shown on tax returns with the exclusion of dividends from sources within the Colony. Company profits presumably represent assessable profit within the Falklands after wear and tear allowances. It is interesting that F.I.C. contributed over 54% of the reported Company profits on this basis.

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2.2 Mr Armstrong presumably means farm labour when referring to a fall in the labour force. It would be helpful if the statistical information, upon which he bases his assertion that the fall has only partially been compensated by increased productivity, were made available.

2.3 The index of retail prices of the U.K. Department of Trade and Industry does indeed show the fall in the purchasing power of the £ given in the report. The local index would have been more relevant.

2.4 This paragraph is netiher clear not accurate. Is the reference to aggregate domestic expenditure up to 1970 for the decade or some other period? Where are the figures for domestic expenditure and from what sources have they been compiled? There were, in the Company's opinion - and it was never refuted - gross errors in the calculation of domestic expenditure which led to scepticism over his recommendations in Professor Guillebaud's report.

It is quite untrue to state that distribution as dividend follows the movement of corporate profits to the U.K. Without recourse to the Company's records it is difficult to see how the information which is necessary for true economic evaluation can be available. No request for statistical information has been received by the Company.

It is stated as a fact that F.I.C. has invested virtually all its agricultural surplus in U.K. property. This is untrue and in any event contradicts the earlier statement that profit is distributed following repatriation to U.K. The amount of agricultural profit of the F.I.C. cannot be known to Mr Armstrong but the Company's published balance sheet at 31st December 1970 would be.

This showed U.K. property of £65,906 presuming that the reference is to real property. Over what period is this deemed to be our agricultural surplus? The same balance sheet shows the Company's interest in David Smith & Co. Limited, at £259,000 of which £171,000 was finance for the purchase of the Colony's wool. There is not one reference in the report to the Company's support for wool marketing and wool purchasing. The significance of this support can be gauged by the fact that 90% of the

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Colony's wool for 1974 has been purchased by David Smith & Co. Ltd., in strict competition and for ever expanding markets.

The trend of Falkland wool production over the last 80 years has been much more encouraging than Mr Armstrong's and previous reports make out. Sheep numbers are not directly relevant and the peak numbers reported in the 1890's are believed to have been exaggerated. Average total annual production of wool in the decade 1961-70 was higher than in any previous decade since 1891-1900 the first for which figures are available. And the average quality of the wool in this last decade was finer than ever before, due to change in breeding policy caused by an increased price differential in favour of finer wool. And, as any sheep-farmer knows, other things being equal the finer the wool the lighter the fleece.

There have always been progressive owners and managers of Falkland farms in constant search for means of increasing production without proportionate increase in costs. The facts are that large scale use of lime and fertilisers has been tried and found totally uneconomic; so too have increased subdivision and rotational grazing been found by themselves ineffective; it was not till the 1950's that suitable machinery became available for large scale cultivation and reseeding, which is proving effective, though slow in action.

2.5 "All the indications are of a fall to 50-60p per kilo by 1974". This is quite contrary to opinions expressed to us by experts in the wool trade. In fact the 1973/4 Falkland clip has been sold forward at an average price of about 111 ppk.

2.6 See remarks under Summary & Conclusions para. 5. It is quite untrue to say that the Falkland Islands Company has been reluctant to reinvest in the Colony and has considered only the short term financial interests of its shareholders. Appart from large investment in shipping, warehousing retailing and other services in Stanley, which never were not could be strictly commercial propositions in their own right, but which were necessary to the sheepfarming industry as a whole and to the contentment of the Colony's people, this Company has pioneered on a large scale two methods of ditching and two of pasture

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reseeding, and has spent a great deal of money on machinery for those purposes - certainly more in recent years even in proportion to size than any other farm owner.

Total capital investment of F.I.C. in the Colony since 1946 exceeds £1,400,000.

F.I.C. rejects utterly the assertions in this and other reports that what has been lacking in the Falklands is investment in the land. Money is and always has been available for projects which show commensurate yields as evaluated on normal commercial principles. It is the commercial approach to expenditure which is noticeably lacking in reports on the Falklands. Given this approach the wasteful expenditure on the freezer project by C.D.C. woul not have occurred. Unproductive capital investment is of benefit to no one.

3.1 Not only has the Colony avoided the need for any subsidy from the U.K. Government but also it has contributed substantial sums to the U.K. exchequer. The £1.74m. airfield grant is only returning to the Falkland what has previously been taken out.

3.2 (Table)

The net revenue deficit between the years 1958/59 and 1972/73 amounts to £72,000 whereas reserves have fallen by £182,000. Is the difference wholly attributable to capital losses on investments and if so has Mr Armstrong not any comment to make on investment policy which can bring about such a result? - particularly in view of the fall in purchasing power of the £ to which he refers in paragraph 2.3.

3.5 Consumption of diesel fuel on farms tends to be proportionate to the amount of development work being done. It is a large element in the cost of reseeding. If development is to be encouraged it would be more appropriate to subsidise than to tax it.

3.7 Given that a substantial part of the remittances to the U.K. take the form of personal savings the recommendation in this paragraph that the Government should phase out taxation on savings seems at variance with paragraph 3.5 where it is suggested that remittances to the U.K. should be taxed at a higher rate. It would be interesting to have the reaction of Parliament to such discriminatory legislation as this for a British Colony populated by British people.

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3.9 M.V. Forrest is no longer necessary for the Colony.

3.14 It is not the view of industry that administrative savings of £10,000 only could be achieved.

The Private Sector

4.1 "There remains perhaps one gap ...". This is total nonsense.

4.3 We understand that Alginate Industries expect to employ many more than 80 men.

4.4 The F.I.C. has stated that it will support tourism financially if it should become a viable prospect. The Falkland Islands does not need outside capital particularly from L.A.D.E. which is an Argentine Government subsidiary.

4.7 There is no banking service which is not provided or offered by F.I.C. The Company acts as agent in the Colony for all the major U.K. banks none of whom has ever been interested as far as we are aware in establishing a branch there. Recent legislation will enable F.I.C. to place its services on a more rational basis and an application for a licence for a new subsidiary "The Bank of the Falkland Islands Ltd" has been submitted.

4.8 F.I.C. is interested in developing a fishing industry for the Colony and is having talks with Chr Salvesen of Leith to this end.

Government Capital Budget

5.3, 5.4, 5.5 Farm owners and managers have acted sensibly in not following the advice of some visiting experts to subdivide adnauseam. There is no easier way to throw money away and increase recurrent costs with little or no increase in production. To some extent the Davis Team's report recognised this. The experts who have recommended investment in ditching machinery have ignored the fact that F.I.C. has pioneered large scale use of two types of such machinery, and that while these were successful in producing some improvement, expenditure was out of all proportion to return.

5.9 Whatever Educational Advisers may say good men would be lost from farms if their children were deprived of education until old enough to goto a boarding school in Stanley. The most satisfactory answer has been proved

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to be primary teaching in farm settlements by farm employees with other duties in connection with store and/or book-keeping, approved, given some training and supervised as teachers by the Superintendent of Education, and subsidised by Government on a per pupil basis.

The sheepfarming industry will only remain viable if it retains employees adequate in numbers and quality. It will not be able to do so if standard of childrens' education and of medical care are not maintained and improved.

5.12 This capital expenditure budget is useless as a guide to effective deployment of funds for farm development, which needs careful consideration by a local comittee of experienced farm managers. A major priority aim should be elimination of the sheep ked from the Islands by use of stick as well as carrot.

Technical Assistance

6.3 We have learned from experience that it is unwise to recruit cadet farm managers as such in the U.K. It is far better to promote men who have started at the bottom of the farm ladder, whether locally born or immigrated. What is needed is the means of providing promising young men, who have practical experience, with the technical education which will raise their promotional ceiling.
